PREM 19/851

SECRET

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PART 7

Confidential Filing

Policy towards the nationalised industries

Financial control

NATIONALISED INDUSTRIES

Part 1: May 1979

Part 7: July 1982

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
(new covers) 31-12-82 — ends —							

PREM 19/851

PART 7 ends:-

31-12-82 (HMT-En)

PART 8 begins:-

DOT to HMT 5/1/83

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E (82) 55	1. 7. 82
E (82) 18th Mtg, Min 1	14. 7. 82
E (NI) (82) 6th Mtg Min 2	26. 7. 82
E (NI) (82) 24	30. 7. 82
E (NI) (82) 25	1. 9. 82
E (NI) (82) 26	3. 9. 82
E (NI) (82) 27	3. 9. 82
E (NI) (82) 7th Mtg Min 2	8. 9. 82
E (NI) (82) 7th Mtg Min 3	8. 9. 82
L (82) 67	13. 10. 82
E (NI) (82) 30	29. 11. 82
E (NI) (82) 9th Mtg Min 2	7. 12. 82
E (NI) (82) 32	8. 12. 82
E (NI) (82) 35	17. 12. 82
E (NI) (82) 10th Mtg, Min 1	22. 12. 82
E (NI) (82) 10th Mtg, Min 4	22. 12. 82

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed R. Porman Date 25 Oct. 2012

PREM Records Team

Nat Industries c/c SV

NBPM

MO 5/1

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

J D West Esq
Principal Private Secretary to
The Secretary of State for Energy

31 December 1982

Dear Julian,

PROGRAMME FOR DISCUSSION OF CORPORATE PLANS: 1983

I have shown the Chancellor of the Exchequer your letter to John Kerr of 21 December in which you give warning that March, rather than February, is a more realistic time for discussing the Corporate Planning document for the electricity supply industry (England and Wales).

The Chancellor is quite content with this. He also hopes that the Committee can consider at the same meeting a paper by the Secretary of State for Scotland on the two Scottish Electricity Boards. He understands that the Scottish Office are well advanced in drafting a performance review, which could provide the basis for a review of prospects of those two Boards. I should be grateful if Muir Russell could note this.

The Chancellor has also seen that your Department will seek to ensure that the June/July deadline is met for the discussion of BGC's net Corporate Plan. He thinks it important that the discussion does not slip beyond July. If it were delayed, it would take place after Ministers began to consider the Corporation's IFR position. This would be a pity.

I am copying this letter to the Private Secretaries to other members of E(NI), to Richard Hatfield and to Gerry Spence.

Yours sincerely

Margaret O'Mara

MISS M O'MARA
Private Secretary

Nat Ind

Policy

Prime Minister

29/12

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Patrick Jenkin MP
Secretary of State
Department of Industry
Ashdown House
123 Victoria Street
London SW1E 6RB

23 December 1982

Dear Patrick,

NATIONALISED INDUSTRY INVESTMENT APPROVALS

We need to give nationalised industries' formal approval for their level of investment in each of the next three years.

I enclose a table which sets out industries' expected level of expenditure on fixed assets in the UK in 1983-84 to 1985-86 (industries whose figures are not yet settled have been excluded). Figures have been taken from the returns that your Department has submitted and will be included in the forthcoming Public Expenditure White Paper (except for those not publicly announced). As is customary, I am content that you should, as appropriate and as soon as possible, give your industries' formal approval to spend up to 100 per cent of the sums listed for 1983-84, 85 per cent for 1984-85 and 70 per cent for 1985-86. The table shows approved levels of investment calculated on this basis. The figures are consistent with EFLs for 1983-84 and external finance requirements for later years that we agreed in this year's IFR. Officials will shortly circulate detailed baseline figures for individual industries over the next three years in order to help industries' future planning. If industries fulfill their plans, investment in 1983-84 will increase by about 12 per cent over this year's estimated outturn (excluding BNOC).

I hope that when you give your industries their approvals you impress upon them the need to make full and proper use of their investment funds. We have all been embarrassed by industries' underspending on investment this year and last year, and we should do all we can to prevent a repetition of this in 1983-84. In this context, I am aware that a problem has already arisen in the case of the British Airports Authority where the Board have decided to cut investment for 1983-84 to a level some £22 million less than provided for in the White Paper. I hope Arthur Cockfield will let me have his views on this as soon as possible.

I am copying this to other Ministers with nationalised industry sponsorship responsibilities, Sir Robert Armstrong and Robin Butler.

Yours

Leon

LEON BRITTAN

NATIONALISED INDUSTRY FINANCING

Expenditure on Fixed Assets in the UK

Investment Approvals 1983-4 to 1985-6

	1983-84	1984-85		1985-86	
	Approved expenditure	Estimated expenditure (a)	Approved expenditure (85% of (a))	Estimated expenditure (b)	Approved expenditure (70% of (b))
ELECTRICITY (ENGLAND AND WALES)	1395.0	1475	1254	1534	1074
NORTH OF SCOTLAND HYDRO-ELECTRIC BOARD	43.1	44	37	51	36
SOUTH OF SCOTLAND ELECTRICITY BOARD	431.7	335	285	290	203
BRITISH GAS CORPORATION	885.0	876	745	791	554
BRITISH TELECOM	1997.0	2230	1896	2259	1581
POST OFFICE	130.0	140	119	150	105
NATIONAL GIROBANK	9.0	7	6	8	6
BRITISH AIRWAYS BOARD	229.0	198	168	200	140
BRITISH AIRPORTS AUTHORITY	152.0	156	133	185	130
BRITISH RAILWAYS BOARD	337.0	387	329	482	337
BRITISH WATERWAYS BOARD	3.5	4	3	4	3
NATIONAL BUS COMPANY	59.0	72	61	88	61
SCOTTISH TRANSPORT GROUP	18.8	17	14	19	13
CIVIL AVIATION AUTHORITY	26.1	30	26	34	24

Notes

(1) 1984-85 and 1985-86 figures rounded to nearest £million
(2) NCB, BSC, and BS figures still to be settled (NCB expenditure approved at £800 million for 1983-84)

Nat Ind : Policy Pt 7.

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Nat Ind Policy Pt 7

File

10 DOWNING STREET

From the Private Secretary

MR. HATFIELD
CABINET OFFICE

STATE MONOPOLIES REPORT

The Prime Minister has agreed that there should be a discussion under her chairmanship at E(NI) of the CPRS State Monopolies Report.

The Prime Minister has also agreed that the paper attached to this note should form the basis for the discussion.

In circulating this note, you will no doubt bear in mind the need to remind recipients of the sensitive nature of the material and the need to restrict its circulation to the minimum.

I am sending a copy of this minute to John Sparrow (CPRS).

M. C. SCHOLAR

23 December 1982

N.B. Copies of CPRS report 27 – 35 to R.T.A's office 24/12/82

CONFIDENTIAL

NBPM

Mws 23/12

cc

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

JF2293
Secretary of State for Industry

23 December 1982

The Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Dear Geoffrey,

PROGRAMME FOR DISCUSSION OF CORPORATE PLANS : 1983

Thank you for your letter of 13 December, which enclosed the above Programme. I confirm that these arrangements are acceptable to me.

2 I am copying this letter to our E(NI) colleagues, to Sir Robert Armstrong and to John Sparrow.

Yours

Patrick

Nat Ind
Policy

CABINET OFFICE

Central Policy Review Staff

With the compliments of
John Sparrow

70 Whitehall, London SW1A 2AS
Telephone 01-233 7765

CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765
From: John Sparrow

Qa 06196 **RESTRICTED**

21 December 1982

Dr Gerard Vaughan MP
Minister of State for Consumer Affairs
Department of Trade
1 Victoria Street
LONDON S W 1

Dear Dr. Vaughan,

Nationalised Industry Consumer Councils

with MCS.

I have seen your letter of 14 December to the Chancellor of the Exchequer and his reply of 17 December.

I, too, am content with the paper, subject to the points the Chancellor makes about the overlap with the role of the Comptroller and Auditor General.

I am sending copies of this letter to the recipients of yours.

Yours sincerely,

John Sparrow.

John Sparrow

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK, LONDON SW1P 4QJ

01-211 6402

John Kerr Esq
Private Secretary to the
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London
SW1P 3AG

21 December 1982

Dear John,

PROGRAMME FOR DISCUSSION OF CORPORATE PLANS: 1983

The programme of E(NI) discussions attached to the Chancellor's letter of 13 December included February-March for Electricity (England and Wales). The electricity industry is having to alter its planning cycle in order to produce a corporate planning document early in 1983, and we believe March to be a more realistic prospect than February.

Following E(NI) on 7 December, the Department is committed to improving the quality of BGC's next corporate plan. This will entail a good deal of extra work, but we shall seek to ensure that the July deadline is met.

I am copying this letter to the private secretaries to members of E(NI), to Richard Hatfield and to Gerry Spence.

Yours ever,

J D WEST
Private Secretary

nat Ind, Policy, Pt 7

22 DEC 1982

Nat- Ind ~~g/c~~ JV

SECRETARY OF STATE FOR TRANSPORT

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

NBPM

MLS 21/12

Dr Gerard Vaughan MP
Minister of State for Consumer Affairs
Department of Trade
1 Victoria Street
LONDON SW1H OET

21 December 1982

Dear Gerry

Thank you for sending me a copy of your letter of 14 December to Geoffrey Howe, enclosing a copy of the paper which you propose to publish on the Nationalised Industry Consumer Councils.

I am content with the paper, and with your proposals for early publication.

Copies of this letter go to Geoffrey Howe and to the other recipients of yours.

Ever

David

DAVID HOWELL

Nat Ind

Policy

Prime Minister ①

I understand that you agreed, during your meeting with Mr Sparrow on 30 November, that this could now be circulated and discussed.

We will need all the Ministers at X.

E(NI), in fact, comprises these and no-one else. So it makes sense to take this at E(NI) under your chairmanship.

Agree?

MCS 22/12

CONFIDENTIAL

Qa 06192

To: MR SCHOLAR

From: JOHN SPARROW

20 December 1982

State Monopolies Report

1. As requested in Mr Butler's record of my meeting with the Prime Minister on 30 November, I attach a covering note for the CPRS State Monopolies Report to form the basis for discussion in a small group of Ministers.

2. I suggest the Prime Minister invites to the meeting the Chancellor of the Exchequer, the Secretaries of State for the Environment, Scotland, Industry, Transport, Energy, Employment and Trade, and the Chief Secretary. I am therefore sending to you under separate cover sufficient copies of the Report and covering note for circulation to these Ministers.

x Yes MT

3. In your note setting up the meeting you may consider it prudent to remind recipients of the sensitive nature of this material and hence the need to restrict its circulation to a minimum.

4. I am sending a copy of this minute and the attachment to Sir Robert Armstrong.

JS.

Att

CONFIDENTIAL

CPRS Report on State Monopolies

1. Earlier this year the Prime Minister asked the CPRS to examine how to reduce the power of the state monopolies, introducing increased competition where possible, and to study systems of regulatory agencies.

2. The report is attached. The conclusions and recommendations are set out briefly in Section IV (paragraphs 80 - 89) which is attached separately for ease of reference.

3. The report identifies a number of problems associated with state monopolies; problems which arise partly because the industries are monopolies and partly because they are state owned. The report describes possible ways of reducing the power of the monopolies and thus the power of the associated unions.

4. The report puts forward various options for change. There is no single preferred solution. Not all of the options will be applicable to each monopoly.

5. The CPRS now recommends that Ministers consider the report's conclusions and the options it proposes, with a view to:

(i) deciding whether they agree with the general analysis of the report;

(ii) setting in hand, for each of the industries concerned, specific studies of how to reduce the monopoly power of that industry and its unions;

(iii) considering further the proposals in the report for removing Government guarantees against bankruptcy of state monopolies and for encouraging joint ventures between public and private enterprise.

6. Only Sponsor Departments and the Treasury have the knowledge and resources to carry out this work in appropriate detail but the CPRS would wish to be kept in contact with the studies as they progress.

7. The CPRS report also provides a wider context for the current studies on privatisation and contracting out. Ministers may wish to ensure that future consideration of progress in all these areas is co-ordinated.

8. Finally, Ministers are invited to agree that the studies proposed in Paragraph 5 should be completed within six months for consideration by E(NI).

20 December 1982

IV - CONCLUSIONS AND RECOMMENDATIONS

80. We have examined in our study the development of state monopolies and shown that in many instances monopoly has been created and is not inevitable. The core of natural monopolies, where a second supplier would necessarily face prohibitively high costs, is narrower than is generally perceived. We have also examined the evidence available on the performance of the state monopolies, and have listed the adverse features which arise partly because they are monopolies and partly because they are in public ownership. The power of the unions stems mainly from the indispensable and monopoly nature of the products and services provided.

81. We suggest that the scope for change should be examined in detail for each industry. For various reasons the climate for change is right. The options discussed are not mutually exclusive; in many cases they are complementary. Not all are applicable to each industry. The overriding need is to break up the existing national monopolies.

A. Increase competition

82. The first objective should be to increase competition wherever possible. This means removing obstacles, and creating the right conditions for competition to develop -

a. remove the statutory bar on entry - necessary, but often not enough by itself;

b. regulate to ensure fair competition - we consider that an independent regulatory agency will provide the best assurance to potential competitors, against unreasonable pricing or regulatory actions by the state monopoly;

c. require industries to sell off parts where competition is possible - a quicker way to promote development of effective competition than waiting for new private sector entrants to appear;

d. as a step to privatisation under c, split industries into separate state companies, either by function (eg Sealink) or by region (eg regional electricity generating companies);

e. presumption against allowing state monopolies to expand - moving into new areas may sometimes increase efficiency or reduce dependence on another monopoly, and may increase competition short-term, but it increases market (and union) power.

B. Restructure and regulate

83. The process of stimulating effective competition will take time, and there will still be a core of natural monopolies. For the remaining monopolies, ways must be found to improve their performance. Last year's CPRS report made proposals within the existing framework of government/industry relations. This report reviews more radical options -

a. Privatise - this will remove the adverse features of state control, but not those of monopoly power (and union power); hence regulation and/or regionalisation should generally come first;

b. set up an <u>independent regulatory agency</u> - this should be an effective means of preventing monopoly abuse, but depends on Government willingness to hand over some of its powers to the agency (otherwise it merely adds another layer of supervision); hence we recommend that the experience of regulating British Telecom should be taken into account before regulatory agencies are established for other industries;

c. split the industry into <u>regional corporations</u> - in a natural monopoly these will not compete directly, but will enable management performance to be compared, so that a regulatory agency can be more effective; this will be strengthened if regional corporations borrow on their own credit without guarantee against bankruptcy, and if the possibility exists of a monopoly licence being withdrawn and the licence transferred ("competition for the field" as opposed to "competition in the field").

d. extend <u>franchising and contracting out</u> - much wider opportunities exist than have been considered so far, and should be pursued, even within the present framework, to promote efficiency by introducing private sector management and to reduce union power.

C. <u>Reduce union power</u>
84. There is a need to redress the imbalance of union power that currently exists. We believe that the options described above should all help to reduce monopoly power and therefore union power. Proposals for further general legislation on unions will be considered following a consultative period. The proposal for statutory cooling off periods may be useful in the state monopoly context. However we consider that other action might also be taken -

a. further studies should be undertaken where necessary to see how best to stand up to the ransom threat, for example by stockpiling;

b. union attitudes need to be changed; this should be tackled through management action;

c. where an industry is already structured on regional lines there may be advantages in developing decentralised wage bargaining;

d. linking wages more to performance will help to develop a relationship between effort and reward and hence lead to more responsible action.

D. <u>Change the statutory and financial context</u>
85. Other changes might also be made in order to change the context in which the state monopolies operate -

a. encourage private finance and joint ventures;

b. remove Government's guarantee against bankruptcy;

c. remove the statutory duty to supply;

d. make cross-subsidisation of classes of business including uneconomic social services more explicit.

Conclusions

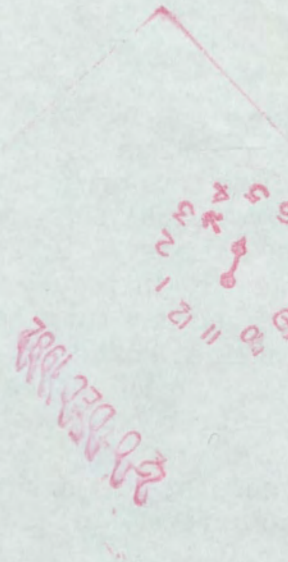
86. The problems of monopoly power, and alternatives to state ownership, have baffled numbers of people for many years. We do not claim to have found any simple solution, for example in the model of a regionalised and regulated industry. In some industries or parts of industries where it proves impossible to introduce competition, the costs of splitting into regional organisations may turn out to be greater than the benefits, and Ministers may decide against handing over their powers to an independent regulatory agency. In such cases there may be no better course than the present system, with better business management along the lines proposed in last year's CPRS report. But we believe that the more radical options in this report need to be seriously and imaginatively examined in relation to the particular circumstances of each industry.

Recommendations

87. In order to effect changes wherever possible, we recommend that Sponsor Ministers should be invited to review the industries for which they are responsible and make detailed proposals, based on the general conclusions reached in this report and options put forward for change. Departments are already considering opportunities for privatisation and a separate exercise is being carried out to ascertain if nationalised industries could contract out more of their activities. A certain amount of ground will therefore already have been covered. We recommend that these efforts should now be extended to consider those more fundamental changes which might be made to break up the state monopolies and reduce their power.

88. We recommend that Treasury Ministers should be invited to consider the proposals for removing guarantees against bankruptcy and for encouraging joint ventures.

89. We further recommend that Sponsor Ministers should be invited to consider the proposals aimed at reducing the power of the unions in their industries.



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21 October 1982

A STUDY OF THE STATE MONOPOLIES

Introduction

1. At the request of the Prime Minister, the CPRS has carried out a study of the nationalised industry monopolies, with a view to identifying ways in which their power could be reduced.

2. It was agreed that the study should examine how monopoly power has in practice been exploited, and how it could be curtailed through improved competition, privatisation, structural changes and regulatory pressure. It was further agreed that consideration should be given to ways of constraining union power in these key industries.

3. The CPRS began this study by carrying out brief reviews of the coal, electricity, water and telecommunications industries. These were based on discussions with officials in the Sponsor Departments and others, and a review of the published material and of the manner in which these industries are organised in other countries, notably the USA and Germany.

4. Last year the CPRS carried out a study of the relationship between Government and the nationalised industries, to review how they might be better controlled within the existing governmental framework. We have not sought in this study to duplicate any of this earlier work. Instead we have examined those more fundamental changes which might reduce the power of the state monopolies. We would like to re-emphasise however that the successful operation of any organisation depends on the quality of its management and we recommend that incentives should be improved to attract the best people to run these large corporations.

5. This report does not contain a blueprint for action in respect of the industries chosen for study, but rather general themes and principles which might be considered for application to each of the state monopolies. The CPRS recommends that as a next stage Sponsor Ministers should undertake a review of the industries for which they are responsible and make detailed proposals, based on the general conclusions reached in this report and options put forward for change.

6. We have structured this report as follows -

Findings following our review of regulatory agencies in the United States and also in the United Kingdom are set out in the annex.

I - The Nature of State Monopolies

Monopoly - Natural or Created?

7. Monopoly exists where there is a single supplier of a commodity or service. The extent of monopoly power depends on whether the entry of competitors into the market is restricted, either by economies of scale or by legislation, and whether there is any close substitute for the commodity.

8. In the United Kingdom many of the state monopolies supply products and services which are not strictly "natural monopoly" products, defined as those where a second supplier would face prohibitively high costs (including costs of entry), because of the nature of the market and technical economies of scale. Corporations have typically been established by statute as sole suppliers of certain products, and their monopoly position has thus been created. Examples of activities where competition has been prevented and monopoly situations created include -

a. electricity generation;

b. telecommunications services;

c. coal production;

d. local bus transport;

e. collection of water;

f. sewage treatment and disposal;

g. postal services.

9. On the other hand nationalised industries also provide some services which it is less easy to envisage being duplicated by other suppliers. These natural monopoly activities include -

a. transmission and distribution of water, gas and electricity;

b. sewerage;

c. possibly the provision and maintenance of railway tracks.

Thus the list of genuine "natural monopoly" activities is not a long one and it is shrinking. Services which were at one time thought to be necessarily provided by only one supplier are now being opened up to competition - for example long distance telecommunications services, electricity generation, gas supply and bus transport. This shows that the boundary is not absolute, and competition may become possible as perceptions change, technology develops and costs of entry decrease. Common carrier infrastructures are possibly the only operations of a strictly natural monopoly nature.

10. During the first half of this century, in many developed countries, monopolies were tolerated and even encouraged for certain activities. In such industries as electricity, water, gas, telecommunications, air and surface transportation, it was often considered that the "public interest" was best served by having a monopoly supplier. Competition was typically considered wasteful and monopoly rights were granted in return for a statutory duty to supply, sometimes in uneconomic circumstances.

Regulation of power

11. However the creation of a monopoly implies a concentration of power, particularly over pricing (and profits) and over the service provided. Governments appreciated the need to control this power and either set up a regulatory system where the industries remained in private hands, or alternatively brought them into public ownership.

Rationale for state ownership

12. In addition to the need to regulate monopoly industries, certain utilities were nationalised because -

a. the provision of the product or service to the whole population was considered to be of vital importance to society;

b. the industry was of special significance to the economy and to employment;

c. public funds could more easily be provided to guarantee provision of services;

d. the industry needed controlling for technical reasons, for example to control the hydrological cycle or to create a national grid for gas or electricity;

e. the industry had not fared well under private ownership, for example the coal industry or the railways, and needed reorganising "in the public interest".

II - THE PROBLEM AND THE RATIONALE FOR CHANGE

The consequences of creating monopolies

13. There have been many benefits from the creation of monopolies. Duplication of facilities, for example the pipework, grid or common carrier infrastructure has been avoided and economies of scale have resulted. But there have also been disadvantages. Some of these arise from the creation of monopoly itself. Others arise through state ownership.

Adverse features of monopoly

14. Although some of the following features might apply to British industry generally, it appears to us that they are worse in those industries which are monopolies -

a. failure to innovate, to respond to market signals, and to take account of consumer and local interests. Because monopolies do not face competition, they are less market-oriented;

b. inefficiency of operations, deficiencies in management practices and inward-looking management. Monopolies have no incentive to remove inefficiencies because their additional costs can be passed on to the consumer in increased prices;

c. cross-subsidisation of uncompetitive and loss-making operations. Monopolies often subsidise peripheral activities where they face direct competition or main activities where they are under threat from close substitutes (this may be necessary for a time, to shield new products, but is distorting and inefficient if it continues indefinitely);

d. greater union power through threat of industrial action and disruption of monopoly (and often essential) supply. This power has long been latent, but since the early seventies unions have shown a greater willingness to use it. In the last few years there has been resistance to demanning in certain industries, and lack of flexibility in the use of labour to meet changing economic and technical conditions;

e. a failure to encourage innovation and competitiveness in suppliers. As monopsony buyers, the industries have been inflexible in their requirements and have often overspecified the product in the interests of greater security of supply.

Adverse features of state ownership

15. The original Morrisonian concept was to appoint a board of directors who would ensure that the industry was being properly run in the nation's interest. However this concept of an arm's length relationship between Government and the nationalised industries has been difficult to maintain and Ministers have been drawn into intervening in industries' affairs. There are several reasons for this -

a. Parliament has considered Ministers accountable for the well-being of these industries and their actions;

b. it may appear to Ministers that national economic objectives can be achieved by influencing nationalised industries' behaviour;

c. the threat of labour disputes and union demands has led to intervention, in the short term interests of the public;

d. some industries have needed heavy external (state-guaranteed) borrowing for investment, and others have been judged to need Exchequer subsidies to maintain output and employment.

16. State ownership has had a number of adverse features -

a. prices have been artificially constrained, for example in the early seventies, resulting in inefficient pricing policies, customers receiving incorrect pricing signals, and incorrect forecasting and investment decisions;

b. investment has been artificially constrained at times as a means of deflating the economy;

c. there has been a failure to establish objectives and monitor the performance of the industries properly;

d. there has been a failure to deal with structural decline in certain industries, in particular the railways and (recently) the coal industry;

e. Government financial backing and the absence of the threat of bankruptcy has led to complacency and inefficiency as the industries have been protected from market disciplines;

f. hidden cross-subsidisation of services has been encouraged. This has exacerbated the supply-oriented approach of the industries by shielding them further from market forces. Hidden cross-subsidisation has made it difficult to identify those services the Government would wish to see continued and to determine whether it has been getting value for money.

17. A major problem has been the inevitable conflict which Government has faced in trying to reconcile the following responsibilities -

a. manager of the economy;
b. owner of the business;
c. banker to the business;
d. regulator of monopoly, including protector of the consumer;
e. provider/subsidiser of social services (rural telephone kiosks, railway lines etc)

18. State ownership has also sometimes enhanced union power, because the industries are interdependent (eg coal and electricity) and the Government as owner has presented a common target to union negotiators in the various industries.

<u>Rationale for change</u>

19. The existence of past and potential abuses of monopoly power and of state ownership, together with the real threat of union power, present cogent reasons for seeking to change the status quo. The climate for change is right: the traditional arguments in favour of large monopoly utilities and public ownership are being questioned; there is increasing criticism of the

industries by consumers; what would have been considered unthinkable a few years ago is now happening, for example there are private sector refuse collectors and a rival telecommunications company is starting to develop. Above all there is a political will to change.

20. In the remainder of this report we consider options for change. These options are not mutually exclusive, and could be complementary. Not all of the options will be applicable to each industry.

III - A REVIEW OF POSSIBLE REMEDIES

21. The distinction between "created" and natural monopolies, though not absolute, is useful in considering remedies. For those industries or parts of industries where cost structures are such that alternative suppliers could compete, the problem is to remove obstacles in their path. But for natural monopolies, other means have to be found to restrain and control monopoly power. In this section we first consider the manner in which competition can be encouraged in those industries where monopoly has been created; where natural monopolies will remain, we consider ways of restructuring and regulating these so that abuses are diminished. Finally we review ways of reducing union power and other steps to change the context in which state monopolies operate.

Increase Competition

Remove the statutory bar on entry

22. For those industries where monopoly has been created, it is necessary to provide a suitable environment for competitive and innovative enterprise. The first essential is the removal of the statutory bar on entry and this may be enough in some instances to allow competition to develop. Legislation has been introduced to encourage competition in the long distance bus transport, industrial gas and trunk telecommunications markets. Further legislative steps are to be taken to facilitate the private generation of electricity as a main business and its supply using the national grid as a common carrier. Only a few years ago competition in most of these industries would have been regarded as unthinkable.

23. However the practical difficulties facing potential new competitors are significant and there must be doubts about the willingness of the private sector to invest in industries where the costs of entry are likely to remain high. The decision to enter the market is bound to be a risky one, not least because of the political risk that the statutory role of the state industry as sole supplier might be reimposed. And any new competitor, facing the state monopoly's dominant position over a wide range of products, must be vulnerable at least for a time to cross-subsidisation and "predatory pricing" in his chosen markets. There may also be regulatory problems, for example over interconnect arrangements and equipment compatibility as in the BT case. Union pressure may prevent competition. The removal of the statutory bar on entry may not be enough on its own to achieve the objective of greater competition. At least protection, and perhaps even some forms of positive discrimination, may also be needed until new competitors are established.

Regulate the terms of competition

24. Regulation is primarily thought of as a way of controlling monopoly and this is comprehensively dealt with in paragraphs 49-56 below. However regulation is also necessary to protect emergent competition. The Government needs to provide some assurance to potential competitors that the competition will not be unfair. This means taking away the power of the state monopoly to impose unreasonable pricing or regulatory burdens. In principle the Sponsor Department may be in a good position to back Government assurances by detailed supervision of the state industry's behaviour. But in practice we consider that Sponsor Departments are likely to be less effective in this role than an independent regulatory agency.

Prevent the expansion of state monopolies

25. Any expansion of a state monopoly into a new area is bound to increase its market power. If successful, it will increase the scope for cross-subsidisation of other less profitable activities. We have also noted in our study that nationalised industries abuse their monopoly power when they become involved in activities that are not truly monopolistic. Inefficiencies and other malpractices are carried over into the non-monopolistic activities. Unprofitable and inefficient operations are typically subsidised by the monopoly activities and the industries compete unfairly. We are sceptical about the effectiveness of regulatory mechanisms to neutralise this power. In addition the extent of union power will be increased if the industry is permitted to expand its activities; this will be further enhanced if cross subsidisation occurs and there is a lack of any threat of bankruptcy. It is arguable for example that the National Union of Seamen would have taken a less militant stance in the recent Sealink dispute if that company had not been owned by British Rail.

26. We start therefore with a strong presumption against allowing state monopolies to integrate vertically or to expand into other areas of business, except where this is to reduce their dependence on other monopolies. We recognise that in some instances it may be beneficial to a state (or private) monopoly to expand its operations but consider that the onus of proof must be on the industry itself. Thus we have a presumption against allowing British Telecom to manufacture its own products and to enter new markets involving cable systems and information technology, unless it can be demonstrated that these are essential to the efficient supply of a telecommunications service or to the preservation of competition. It could be argued that if an alternative telecommunications company could be found to enter the interactive cables market, this would create competition for British Telecom.

Require the industries to sell off parts where competition is possible

27. Reliance on new competitors entering the field in the case of many of the state monopolies will be a slow method of introducing competition. A faster method will be to break up the monopolies by selling off parts where competition is possible. The present Government has already taken some steps in this direction, but these have mainly been confined to peripheral activities. Over time this could be taken a good deal further, and extended to the main businesses, for example electricity generation, to reduce industries down to the core of natural monopoly activities. This will require clear political will, with a high priority for privatisation above other industrial objectives such as the preservation of particular jobs and activities. It will also require expertise to translate the objective into practical proposals for individual industries and parts of industries.

28. Confining the industries to their natural monopoly activities might result, for example, in -

a. electricity generation being first regionalised and then sold, electricity showrooms being sold (or closed), and area boards transmitting and supplying electricity as monopoly suppliers. Consideration might also be given, as a second stage, to confining the state industry to a common carrier role;

b. British Gas Corporation being reduced to a pipeline carrier only. Its exploration and production activity, together with its consumer services, would be hived off;

c. splitting up British Telecom into area monopolies, a trunk telecommunications company and an international telecommunications company. BT Enterprises and Martlesham would be sold separately.

29. In cases where immediate privatisation is not possible, it may be worth considering the establishment of a separate state corporation (eg Sealink separate from British Rail) with its own separately accountable management, as a half-way house. Or regional corporations might be set up and allowed to compete. This is considered further in paragraph 43 below.

Restructure and regulate to improve efficiency

Privatise state monopolies

30. Efforts have been made by the present Government to return industries from the state to the private sector. To date no state monopoly has been privatised although plans have been announced to sell shares in British Telecom in the next Parliament.

31. The main advantage of privatisation appears to us to be the likelihood of removal of many of the adverse features of state ownership described in paragraph 16 above. We have sought to examine the evidence available on the relative performance of monopoly industries in private and state ownership. Many of the inefficiences which occur in the water industry apply as much to the private water companies as to the water authorities; however the mechanism in this industry for regulating the companies is deficient and provides no incentive to efficiency. Some of the research in the United States and Australia indicates that monopolies in the private sector operate more commercially and efficiently than comparable state owned monopolies. In our view there is a general presumption that private ownership will lead to better results than state ownership.

32. Privatisation of state monopolies in their entirety will not however resolve the difficulties (referred to in paragraphs 15-18 above) which are inherent in any monopoly whether state or private. We consider that apart from selling off operations where competition is possible privatisation is likely to be more beneficial if the industry is fragmented into regional companies which are subjected to independent regulation, and later privatised.

33. It is difficult to privatise loss-making operations. However with few exceptions it should be possible for each of the state monopolies to be made profitable. It is likely that those parts of the rail system which are judged socially desirable will always require public financial support and remain in public ownership. The other large loss-maker, the National Coal Board, should be capable of being made profitable in the longer term, regionalised and then privatised.

Expand franchising and contracting out

34. Franchising and contracting out introduce "competition for the field" as opposed to "competition in the field". If parts of the industry's operations are franchised or contracted out, this will reduce the size of the state monopoly and thus its power; in particular union power will be fragmented. It

should also introduce benefits of private sector involvement. At one extreme a franchise could be granted for supply of the monopoly service. At the other there could merely be an extension of the present practice of contracting out. Thus where privatisation of activities is ruled out for any reason, franchising and contracting out may be adopted as "second best" solutions. An example of franchising is television where independent television companies are granted licences to broadcast for eight years; examples of contracting out include refuse collection and bureau computer services.

35. One of the criticisms of state monopolies is that the technical specifications for construction of plant and the supply of services are too high. In the case of franchising and contracting out, responsibility for ensuring that the services are provided to a given standard rests with the franchisor. However the franchisee is actually responsible for the service. Franchising activities to the private sector will create an incentive to reduce technical specifications to the extent that this is consistent with the standard of service required.

36. Franchising and contracting out are likely to be easier to introduce in labour intensive situations, where the initial investment is not high. However franchising in capital intensive industries should not be ruled out. Normally in order to make it attractive to a potential investor the length of the franchise would need to be sufficently long for him to recover his investment. However if the franchise is too long, this could result in the franchisee developing all the adverse features of the monopoly industry in which he is operating. This could be avoided if franchising was widespread in an industry since there might be frequent competition for franchises which would provide an incentive to efficiency. Alternatively the management of operations only could be franchised for shorter periods with the assets continuing to be owned by the franchisor.

37. Franchises should be arranged to place the financial risk on the franchisee. It will also be necessary to provide safeguards when the activity remains a monopoly supply and the franchisee fails to perform adequately. The right to appoint an alternative franchisee or to acquire the assets and take over the operation should be retained in exceptional circumstances, which will need to be clearly spelled out in advance so as to avoid termination subject to political whim.

38. If industries are acting efficiently, they should be continually reviewing the relative costs of providing services themselves and of contracting them out. However there are pressures against this practice, for example from unions who see an erosion of their membership and power base, and from management because of the loss of status in a smaller organisation, and because of entrenched attitudes. Indeed over the years the industries have tended to take on themselves functions previously performed by others. This probably reflects a general tendency among large organisations in the UK, as opposed to Japan where contracting out is seen as a useful way of preserving flexibility and avoiding long-term commitments to employees. Where contracting out has been introduced it has mainly been confined to peripheral activities such as maintenance of vehicle fleets and catering. However we consider that the state monopolies should consider this more imaginatively and investigate the contracting out of mainline activities such as power station maintenance, the provision of postal services and meter reading - possibly jointly with other nationalised industries.

Regionalise state monopolies

39. By regionalisation, we mean the fragmentation of state monopolies into discrete independent companies based on geographic rather than functional lines. This is different from decentralisation, which is the devolution of decision-making and responsibility to subsidiary regional organisations, under central ownership and control.

40. Where it proves difficult to encourage new competitors to enter an industry and where an industry cannot easily be confined to a common carrier role, regionalisation may help. Apart from breaking up large national monopolies, regionalisation may also be a prelude to and facilitate privatisation.

41. Regionalisation of state monopolies appears to us to have the following advantages -

a. it brings the supplier closer to the customer and should result in greater attention to consumers' interests and complaints;

b. it facilitates comparison between monopolies and should therefore encourage competition between managers and greater consumer pressure for change;

c. it is more likely to lead to innovation in the industry because of the absence of centralised control and single culture, which are typical of national organisations;

d. it will facilitate regulation by a regulatory agency because of the comparisons available and reduced likelihood of "agency capture", referred to further below;

e. it will facilitate regional wage bargaining and local productivity schemes, referred to in more detail below;

f. it may reduce the likelihood of national disruption and therefore the bargaining power of the unions;

g. it may facilitate privatisation since it may be easier to sell smaller regional units;

h. it is less likely to lead to monopsony purchasing and uncompetitive suppliers;

i. smaller organisations are easier to manage.

42. Decentralisation on the other hand is unlikely in our view to result in the same benefits. Inevitably a large measure of control will remain with the central organisation and regional freedom of action will not be present to the same extent. We do not believe for example that decentralisation will result in the benefits identified under items c to h above being achieved.

43. Regionalisation of those industries where the monopoly position has been created could be used to facilitate competition. Examples of this are electricity generation and coal. However in the case of the coal industry any major change is difficult at the present time because of the strong militant union. In this industry we consider that decentralisation now may represent a step towards regionalisation at a later date when individual prosperity appears more relevant to miners than NUM unity.

44. Although the gas and electricity industries are decentralised in varying degrees, they are not structured into independent regional organisations. In addition it is generally accepted that the current structure of the electricity industry is unsatisfactory. The separation of a centralised generation authority from regional distribution and supply boards does distance the consumer from the dominant sector of the industry, the CEGB. In consequence, the potential for both inefficient and non-market oriented behaviour is inherent in the current organisation.

45. Our discussions in Germany have indicated that a regionalised electricity system, largely made up of separate power-boards, appears to allow a greater degree of market response and the potential for limited competition. There is evidence that the different approaches of the various authorities in Germany encourage more innovation and allow individual authorities to learn from others. This combination of innovation and imitation is more likely to lead to an efficient and responsive system than the approach of a single centralised organisation. We recommend that this model should be considered alongside proposals mentioned earlier for reducing the electricity monopoly to a common carrier role.

46. In the case of British Telecom, the lack of separate internal commercial relationships and adequate financial information makes regionalisation difficult at present. However we consider that the monopoly power of this corporation is more likely to be reduced by fragmentation into regional areas (with privatisation later) and by the separate sale of trunk, international and other activities rather than by privatisation as a whole.

47. One of the industries we studied, namely water, is already organised on a regional basis. However this has not produced the benefits we believe possible for several reasons. These include -

a. the regulatory function has traditionally not been adequately performed;

b. until recently the political will has not existed to remove inefficiencies in the structure of the industry.

48. We formed the view particularly following our visit to Germany that more could be done to stimulate competition between the management of different regions by means of inter-regional comparisons of price and performance. These comparisons could be made by a more effective form of regulation at national level.

Improve regulation

49. Whether monopolies remain in the public sector or become privately owned there is a need to regulate them to prevent monopoly abuse. In particular there is a need to ensure that -

a. they do not charge unreasonable prices and so make monopoly profits;

b. they act as efficiently as possible, in the absence of competition;

c. they do not concede excessive wage increases, with a knock-on effect throughout the economy, and finance them by inflationary price increases;

d. the consumer is protected, complaints are dealt with satisfactorily and the product or service is of a reasonable quality;

e. they do not engage in anti-competitive practices;

f. where they are dominant purchasers of other industries' products they encourage healthy competitive suppliers in the interest of the economy as a whole.

50. In addition to controlling monopolies better, there is also a need for regulation where competition is being introduced, in order to protect smaller operators from the dominant suppliers and ensure that competition is fair.

51. At one time it was believed that a board appointed by the Secretary of State could be relied on to see that state owned monopolies were properly run "in the public interest". Thus they were expected to ensure that the above adverse features would not occur. Last year's CPRS report recommended a key role for non-executive directors. However this will not be enough on its own, since -

a. the industries cannot be properly directed and managed in the absence of strong boards with executive as well as non-executive directors;

b. these directors have to resolve conflicts of interest between what is best for the corporation and what is judged to be in the public interest;

c. it is difficult for non-executive directors alone, being part-time and reliant as they are on the organisation for information, to ensure the efficient running of the industry.

52. Other mechanisms have been introduced. The Sponsor Departments have increased the extent of their monitoring of the industries. Nationalised Industry Consumer Councils (NICCs) have been established to represent the consumer and advise on consumer policy. The Monopolies and Mergers Commission (MMC)is being used on a periodic basis to investigate instances of inefficiency, monopoly abuse and anti-competitive practices. However in our view these organisations in their present form are unlikely to fulfil the regulatory function defined above for the following reasons -

a. Sponsor Departments will continue to have to attempt to resolve the conflict of interest described in paragraph 17 above. They are likely to go on giving low priority to regulatory responsibilities where these cut across political concerns and relations with the industries. In addition despite agreement to improve monitoring following the CPRS report on relationships with nationalised industries last year, it will be difficult for them to attract appropriate staff with business expertise to perform these tasks;

b. the NICCs rely heavily on voluntary support. They are often ignored by their industries. Without considerable expansion in their resources, rights and powers, their regulatory role will be limited. We consider that additional resources would be better employed elsewhere;

c. while the MMC is able to investigate subjects in depth, it remains an ad hoc review body visiting industries on a four to five year cycle. Sponsor Departments may not follow up recommendations with sufficient vigour for the reasons given above.

53. We have reviewed the experience of regulatory agencies in the United States and here. Our detailed findings are set out in the attached annex. Although these agencies have some adverse features, we are attracted by the benefits that could result from independent regulation of state monopolies. There is a need for continuous regulation of monopoly activities which we do not believe the present framework is capable of providing. A separate regulatory agency is likely to be more effective if -

a. the industry is first fragmented into regional operations. This will facilitate comparison, for example of prices and performance, and is less likely to lead to agency capture;

b. the agency is given wide powers of access to information and powers to ensure implementation;

c. it has a maximum degree of independence from Government thus making political decisions and actions affecting the industry more transparent;

d. there is complete or partial privatisation and there is provision for removal of monopoly rights. Where the regulatory agency has the ultimate sanction of withdrawing the monopoly licence, or at least recommending its withdrawal, there will be greater incentive for both public and private sector operations to refrain from monopoly abuses.

54. The appropriate mechanism for regulation will depend on the nature of each industry, and there are a number of issues needing to be examined, including -

a. the precise definition, in statutes or more informally, of the responsibilities of the agency, the Sponsor Minister and the Board of the industry itself;

b. the nature and funding of the agency;

c. which Secretary of State should be responsible for it;

d. whether there should be one agency for all the industries or one for each;

e. the relationship with MMC and the OFT.

55. We consider, in particular following our study of the German regulatory arrangements, that the scale of activities and degree of intervention should be less where there is competition for the field or an effective base for

regional comparison. We appreciate that the establishment of regulatory agencies will lead to additional expenditure although this could be offset to some extent by the abolition of the NICCs whose duties might be assumed by the agencies. However we consider that if the monopolies cannot be broken up by competition as advocated earlier in this report, then their power should be constrained by better regulation. It is arguable that this will produce expenditure savings which will more than offset the additional costs involved.

56. Accordingly we recommend that regulatory agencies should be established where the industry can be fragmented into independent regional organisations. Where regionalisation is not the best course, for example in the case of a common carrier role, and the monopoly remains in the public sector, then we recommend that rather than create an agency, regulation through Sponsor Departments should be improved. In order to achieve this, we consider that the recommendations in the 1981 CPRS report on the relationship between Government and the nationalised industries should be implemented. Where a monopoly is to be privatised, then we recommend that a regulatory agency is established to ensure regulation independent of Government and therefore as far removed from political pressures as possible.

57. The creation of regulatory agencies will involve a fundamental change in the relationship between Government and the state monopolies. Such a change is presently in hand in the case of British Telecom. We consider that the establishment and experience of the Office of Telecommunicatons will provide valuable lessons for regulation in other industries. A suitable candidate for early regulation would be the water industry.

Reduce union power

58. Union power in a monopoly industry stems from the following conditions -

a. the service is indispensable;

b. there is no close substitute;

c. there is no possibility of the service being provided in some other way.

The trade unions are more conscious than they were of their power to demand excessive pay increases and job protection at the expense of their industries, the Government and the consumer. During the seventies the balance of power in the nationalised industries swung towards trade unions and away from management. In recent years wages in state monopolies have increased faster than average industrial wages, restrictive working practices have remained, no-redundancy agreements have spread, and in some cases union power has become more centralised and more co-ordinated. There has also been some evidence of increased militancy. If wages are too low and out of line with other industries, as had happened in the coal industry by the early seventies, this can cause problems.

59. We consider that union power can be reduced in a number of ways -

a. by privatising potentially competitive activities. Privatisation directly introduces the threat of bankruptcy into those parts concerned, and at the same time reduces the size of the remaining organisation and therefore the power base;

b. by introducing competition wherever possible. The existence of competition coupled with the possibility of bankruptcy and therefore loss of employment is likely to result in a more commercial environment;

c. by expanding franchising and contracting out;

d. by regionalising the organisation.

These options have been examined in the earlier part of this report.

60. Both the 1980 Employment Act and 1982 Employment Bill have sought to reduce union power by reducing unions' and individuals' immunities for unlawful acts. Further proposals for changing the legislative environment are being pursued by the Secretary of State for Employment following consideration in E Committee; we have not sought to duplicate this work by putting forward detailed proposals in this report. However, two legislative measures, the provision of statutory 'cooling off' periods and powers to make strikes unlawful, are particularly relevant to the reduction of union power in state monopolies. These measures were discussed in detail in the 1981 Green Paper "Trade Union Immunities" (Cmnd 8128). We believe that making strikes unlawful would be ineffective because of the difficulty of taking sanctions against strikers, but that the introduction of 'cooling off' periods may be a useful move at an appropriate time.

Standing up to union power

61. There is a growing realisation that it is possible to stand up to union power, at least in the short term. During postal strikes alternative methods of postal delivery develop. Even in telecommunications, where the chances of action are higher than in the past, it is likely to involve selective withdrawal of staff rather than an all-out strike and this would probably lead to a progressive deterioration of service in areas affected. Stockpiles of coal at power stations may be used to weaken the resolve of miners to strike. We consider that where studies have not already been carried out consideration should be given to ways in which union power can be reduced through self-sufficiency, including -

a. reducing consumers' dependence on the state monopolies, for example by removing barriers to collection of water by private industry, generation of electricity and telecommunications;

b. reducing the interdependence of state monopolies, for example by allowing the CEGB to develop its own water sources and by encouraging water authorities to develop stand-by generation of electricity;

c. stockpiling and building in redundant capacity.

Above all, management needs to be persuaded to take a resolute line when dealing with unreasonable union demands.

Changing union attitudes

62. In many cases the unions are single industry unions so that union officials, as well as management, have been sheltered from external market forces. Trade union negotiators are often more militant than the members they represent. A strategy to increase the influence of moderate elements should be pursued, for example by better and more consistent management

communications both to union leaders and directly to members, and by introducing private sector management through joint ventures, competition and privatisation. This is likely to create new loyalties and break down existing prejudices.

Decentralising wage bargaining

63. It is claimed that decentralised bargaining exposes weak local management to militant union power. In addition one area can be played off against another by a strong cohesive union, with a consequent risk of wage settlements leapfrogging each other. While we recognise these risks, we consider that where an industry is regionalised then decentralisation of bargaining may be advantageous since -

a. it should bring bargaining closer to local realities;

b. it should lead to regional pay differentiations reflecting local conditions;

c. it could reduce the power of the unions who will be stretched and less likely to be cohesive as a national group;

d. it should lead to an increase in local productivity agreements.

Linking wages to performance

64. We consider that wages and salaries should be linked more closely to productivity and performance since this is more likely to lead to employees being less inclined to threaten disruptive action and sanction restrictive practices. Their livelihood and prosperity become more closely allied to the success of the organisation for which they work. Accordingly we recommend that efforts should be made to introduce more well-designed productivity and incentive arrangements where appropriate.

Change the financial and statutory environment

65. We have outlined above methods of reducing the respective powers of the state, the monopolies and the unions in trying to resolve the problems identified in Section II. All these involve significant changes to the operating environment. There are other changes which might be made which would help to create a new climate. These are described in the remainder of this section.

Encourage private finance and joint ventures

66. Private finance can make a contribution to the problem if it brings with it new pressures for greater efficiency. It is clearly irrelevant if private money is protected from loss. A recent development was the BT Bond, though this has been overtaken by plans for privatisation. The principle behind the proposed BT Bond was that its return was related to BT's performance: essentially it was a form of equity. The intention was that this form of financing would bring about pressure for improved performance, because the borrower would wish or need to raise further finance on a similar basis.

67. However the effectiveness of this option should not be exaggerated. Investors have no sanction against the Board if performance is inadequate and if the Board has other sources of future finance. Thus the holders of the London Transport Passenger Board's C Stock in the 1930s became defenceless victims of that Board's inadequate return.

68. Alternatively the private sector can play a role in a particular activity within a corporation. This may either be simply a financial involvement, or it may be a joint venture. We believe that such joint financial frameworks introduce private commercial practices and disciplines, and that, provided they are reasonably free-standing, they should be encouraged, even in cases where it is hard to demonstrate immediate and tangible benefits. We consider that, even where the public stake exceeds 50 per cent, Government should make it clear that it accepts no implied commitment to guarantee the finance.

Remove the guarantee against bankruptcy

69. It is at present considered unthinkable that a utility monopoly should be permitted to become insolvent. Even where private monopolies exist, for example in the water industry, there is no ultimate sanction against inefficient management and unions contemplating extremist action. This has created the cosy and complacent thinking that currently exists in these industries. There is an absence of commercial disciplines.

70. Morrison's original conception for nationalised industries was that they should stand on their own without a guarantee of Government funding. However, Ministers would find it difficult not to support state industries and the legislation has often been interpreted accordingly.

71. We regard the guarantee against bankruptcy as part of the framework which encourages the abuse of monopoly power and inhibits the pursuit of efficiency. We therefore consider that removing the guarantee against bankruptcy may have benefits, in changing attitudes within monopolies and also in eliminating loss-making activities where restructuring has proved difficult by other means. This would be best achieved by creating Companies Act companies, to emphasise that the Government sees them as businesses specifically with limited liability and not as distinct public corporations. It might for example be easier to close down excess capacity or to introduce new manning practices by taking the drastic step of appointing a receiver rather than operating through the existing or even a reconstituted board. The receiver would restructure the business and dispose of those parts which are viable or for which the state is prepared to make explicit subsidies. At some stage in the future restructuring of the coal industry involving closure of uneconomic mines might be capable of being carried out more easily through the appointment of a receiver.

72. It is less easy to envisage decisive advantages from removing the guarantee of bankruptcy in the case of activities where the business is a national natural monopoly, since insolvency could be avoided by price increases unless a regulatory authority or Government prevented this. Within a regional framework insolvency could lead to another regional company taking over the operation.

73. We recognise that without Government backing, external loans to nationalised industries would cost more. In addition we accept that the first large public bankruptcy may have adverse knock-on effects on future trading arrangements by the monopolies and on the financial markets. However the decision to appoint a receiver for one of the state monopolies would not be taken lightly and would not happen often. We consider that when it did occur it would have major implications in "encouraging the others" to maintain commercial disciplines despite the monopoly power. As a result, we see net advantages in removing the guarantee of Government funding.

Remove the statutory duty to supply

74. We have referred to the supply-oriented approach of most of the nationalised industries. Employees in the state monopolies typically consider themselves as providing a public service rather than carrying on a business and selling a product. To some extent this attitude has acted as a brake on abuse of union power. The threat of termination of a public service was until recently unacceptable to many employees. However in the last decade, as employees have become more conscious of their ability to achieve objectives by holding the public to ransom, the beneficial effects of the "public service" attitude have diminished.

75. The dominant consideration has been to supply, not necessarily at least cost, rather than to ascertain what the customer wants. This has typically been used as an excuse, for example in the electricity industry, for excessive planning margins.

76. Now that the bulk of the population is connected to essential public services, we consider that the statutory duty to supply may be an anachronism and also irrelevant. It has diminished the importance of consumer choice and led to surplus capacity. Its removal could encourage a change in attitude.

Make cross-subsidisation explicit

77. Many of the state monopolies have a statutory duty not to discriminate between customers. Initially this was designed to prevent monopoly profit and result in "fair" pricing. However the industries have taken this to mean standard pricing for consumers regardless of cost. Thus many services are provided at uneconomic prices and subsidised by more profitable activities. Typically rural consumers are subsidised by urban consumers.

78. Hidden cross-subsidisation of this nature may achieve social objectives, as well as being politically convenient, but it has many adverse features -

a. it increases the ability of the monopoly to hide inefficiency;

b. it makes the prices of profitable services higher, thus restricting demand, and confusing market signals;

c. it results in the funding of loss-making services being questioned only on an irregular basis, if at all.

79. We recommend that the monopoly industries should be required to cost separately their services and products so that cross-subsidisation is not hidden but either explicit between consumers or eliminated by separate subsidy of social loss-making activities. The latter course would add to public expenditure, but it is the only way of avoiding economic distortions while meeting social objectives.

IV - CONCLUSIONS AND RECOMMENDATIONS

80. We have examined in our study the development of state monopolies and shown that in many instances monopoly has been created and is not inevitable. The core of natural monopolies, where a second supplier would necessarily face prohibitively high costs, is narrower than is generally perceived. We have also examined the evidence available on the performance of the state monopolies, and have listed the adverse features which arise partly because they are monopolies and partly because they are in public ownership. The power of the unions stems mainly from the indispensable and monopoly nature of the products and services provided.

81. We suggest that the scope for change should be examined in detail for each industry. For various reasons the climate for change is right. The options discussed are not mutually exclusive; in many cases they are complementary. Not all are applicable to each industry. The overriding need is to break up the existing national monopolies.

A. Increase competition

82. The first objective should be to increase competition wherever possible. This means removing obstacles, and creating the right conditions for competition to develop -

a. remove the statutory bar on entry - necessary, but often not enough by itself;

b. regulate to ensure fair competition - we consider that an independent regulatory agency will provide the best assurance to potential competitors, against unreasonable pricing or regulatory actions by the state monopoly;

c. require industries to sell off parts where competition is possible - a quicker way to promote development of effective competition than waiting for new private sector entrants to appear;

d. as a step to privatisation under c, split industries into separate state companies, either by function (eg Sealink) or by region (eg regional electricity generating companies);

e. presumption against allowing state monopolies to expand - moving into new areas may sometimes increase efficiency or reduce dependence on another monopoly, and may increase competition short-term, but it increases market (and union) power.

B. Restructure and regulate

83. The process of stimulating effective competition will take time, and there will still be a core of natural monopolies. For the remaining monopolies, ways must be found to improve their performance. Last year's CPRS report made proposals within the existing framework of government/industry relations. This report reviews more radical options -

a. Privatise - this will remove the adverse features of state control, but not those of monopoly power (and union power); hence regulation and/or regionalisation should generally come first;

b. set up an <u>independent regulatory agency</u> - this should be an effective means of preventing monopoly abuse, but depends on Government willingness to hand over some of its powers to the agency (otherwise it merely adds another layer of supervision); hence we recommend that the experience of regulating British Telecom should be taken into account before regulatory agencies are established for other industries;

c. split the industry into <u>regional corporations</u> - in a natural monopoly these will not compete directly, but will enable management performance to be compared, so that a regulatory agency can be more effective; this will be strengthened if regional corporations borrow on their own credit without guarantee against bankruptcy, and if the possibility exists of a monopoly licence being withdrawn and the licence transferred ("competition for the field" as opposed to "competition in the field").

d. extend <u>franchising and contracting out</u> - much wider opportunities exist than have been considered so far, and should be pursued, even within the present framework, to promote efficiency by introducing private sector management and to reduce union power.

C. <u>Reduce union power</u>
84. There is a need to redress the imbalance of union power that currently exists. We believe that the options described above should all help to reduce monopoly power and therefore union power. Proposals for further general legislation on unions will be considered following a consultative period. The proposal for statutory cooling off periods may be useful in the state monopoly context. However we consider that other action might also be taken -

a. further studies should be undertaken where necessary to see how best to stand up to the ransom threat, for example by stockpiling;

b. union attitudes need to be changed; this should be tackled through management action;

c. where an industry is already structured on regional lines there may be advantages in developing decentralised wage bargaining;

d. linking wages more to performance will help to develop a relationship between effort and reward and hence lead to more responsible action.

D. <u>Change the statutory and financial context</u>
85. Other changes might also be made in order to change the context in which the state monopolies operate -

a. encourage private finance and joint ventures;

b. remove Government's guarantee against bankruptcy;

c. remove the statutory duty to supply;

d. make cross-subsidisation of classes of business including uneconomic social services more explicit.

Conclusions

86. The problems of monopoly power, and alternatives to state ownership, have baffled numbers of people for many years. We do not claim to have found any simple solution, for example in the model of a regionalised and regulated industry. In some industries or parts of industries where it proves impossible to introduce competition, the costs of splitting into regional organisations may turn out to be greater than the benefits, and Ministers may decide against handing over their powers to an independent regulatory agency. In such cases there may be no better course than the present system, with better business management along the lines proposed in last year's CPRS report. But we believe that the more radical options in this report need to be seriously and imaginatively examined in relation to the particular circumstances of each industry.

Recommendations

87. In order to effect changes wherever possible, we recommend that Sponsor Ministers should be invited to review the industries for which they are responsible and make detailed proposals, based on the general conclusions reached in this report and options put forward for change. Departments are already considering opportunities for privatisation and a separate exercise is being carried out to ascertain if nationalised industries could contract out more of their activities. A certain amount of ground will therefore already have been covered. We recommend that these efforts should now be extended to consider those more fundamental changes which might be made to break up the state monopolies and reduce their power.

88. We recommend that Treasury Ministers should be invited to consider the proposals for removing guarantees against bankruptcy and for encouraging joint ventures.

89. We further recommend that Sponsor Ministers should be invited to consider the proposals aimed at reducing the power of the unions in their industries.

ANNEX

A REVIEW OF REGULATORY AGENCIES

1. As part of our study we have considered the experience of regulatory agencies in the United States where there is a long history of private sector ownership of monopoly industries and also of regulation. We have also examined regulation in the United Kingdom of broadcasting, air transport, local stage carriage bus services, private water companies and pharmaceutical companies. Where a monopoly exists, there is a need to regulate its activities in the interests of consumers, primarily in order to prevent excessive prices and therefore monopoly profits or excessive costs.

2. However in the United States in particular in the past it is competition as much as monopoly that has been restricted and regulated. In certain industries, mainly transport, monopolies and limited competition have been tolerated on the grounds that this best serves the public interest. A period of de-regulation of potentially competitive industries began under the Ford administration with some resistance from the operators who had previously been protected from competitive forces and effectively guaranteed a steady stream of profits. Experience has shown that regulation has had many unsatisfactory features, referred to further below, and we therefore recommend that regulatory agencies are only established where necessary. We consider that regulation is essential -

a. where, despite the introduction of competition, a created monopoly will exist for some time and there is a need to ensure that the monopolist competes fairly with new entrants to the market;

b. where natural monopoly cannot be avoided.

3. Regulation in the United States dates from the last quarter of the 19th Century where it was thought necessary in order to protect customers from exploitation by private monopolists. Regulators have been mainly concerned with ensuring a secure supply, at a fair price, and partly as a result of these and other considerations, mentioned below, regulatory agencies have suffered from the following defects -

a. they are too bureaucratic and legalistic. This is partly a reflection of the relative dominance of lawyers in United States commercial life and also of the difficulty the regulators and regulated have experienced in agreeing a "fair price" and "fair rate of return";

b. hearings are too formal and applications for price increases too burdensome;

c. the commissions have been too slow to respond. There have been delays in granting price increases, in periods of inflation. Such delays are referred to as the "regulatory lag";

d. many agencies have developed a cosy relationship with their industries and have failed to be sufficiently questioning and investigative in their approach. This is referred to as "agency capture".

e. economic efficiency has not been encouraged. Agencies have been more concerned with ensuring that a rate increase is reasonable;

f. they have responded too much to local political pressures and have tended to favour short term interests, and present rather than future consumers;

g. some commissions are underfunded and understaffed and lack good quality staff;

h. in order to increase their return, utilities have artificially expanded their "rate base" or capital employed;

i. agencies have condoned and even fostered unimaginative tariff structures and pricing policies.

Perhaps the most damaging effect has been the regulatory lag which, coupled with adherence to historic cost accounting, has resulted in low rates of return. This has affected bond and credit ratings. As a result regulated industries have had difficulty in expanding their funding at economic rates and have been loath to make new investments.

4. Despite these defects, the clamour for de-regulation has not extended to the monopoly industries such as telecommunications and electricity. Indeed in the former, the United States can claim, under the regulation of the Federal Communications Commission (FCC), to have developed one of the world's better telephone systems. The FCC has to some extent stimulated competition to AT and T and required that company to make interconnection facilities available. More recently it has been agreed with AT and T that it should divest itself of its local regional telephone operations in return for permitting it to retain its interests intelephone equipment.

5. Experience in the United Kingdom of regulation of private sector monopolies has not been encouraging. However as in the United States, this has mainly been the result of the methods of regulation used. Thus -

a. it is claimed that the Independent Broadcasting Authority (IBA) has failed to make the independent television companies operate more efficiently and economically. However the IBA has no direct responsibility for efficiency and the companies have little incentive to reduce costs, because monopoly profits are constrained by a levy which results in a marginal tax rate of 82 per cent above a certain level;

b. private water companies have had no incentive to improve their performance, other than from the threat of nationalisation, because profits earned in excess of a maximum rate of dividend must be ploughed back into the business or returned to water ratepayers.

6. Regulatory agencies can however claim certain advantages -

a. they act as a surrogate for market forces and aim to prevent abuse of monopoly power;

b. they are a better method of regulation than a Government Sponsor Department since they will not have the other conflicting responsibilities of manager of the economy, owner of the business, banker and subsidiser of social services;

c. they are likely to be more professional and can present a better method of highlighting inefficiency and promoting efficiency. Staffing is less likely to be constrained by Civil Service terms of employment and remuneration - they can more easily employ staff with expertise and knowledge of the industry concerned, accountants and economists;

d. there is greater transparency of decision making. The pricing mechanism will be divorced from Government and subsidies for loss-making and "social" activities are likely to become more explicit;

e. there is increased public accountability on the part of the industry being regulated;

f. they are essential if the monopoly is to be privatised, in order to reduce uncertainty and potential interference which would exist under Government regulation;

g. they will be able to assume the responsibility of the NICCs whose duties they will be able to carry out more effectively;

h. they offer the prospect of continuous regulation of monopoly.

7. We consider that regulatory agencies can be an effective method of reducing monopoly power and are essential if state monopolies are to be privatised and remain monopolies. They are likely to be most effective if accompanied by regionalisation, since this will facilitate comparison and is less likely to lead to agency capture. The deficiencies noted above are less likely to arise if the following conditions exist -

a. the agency should be divorced from Government in order to reduce the possibility of political intervention;

b. the agency should be managed by a small number of members who are full-time appointees of the Government. Terms of office should be at least 5 years, with cyclical rotation in order to minimise political interference. The members should be properly remunerated;

c. the agency should have statutory investigative and judicial powers. These will include rights of access to information and premises, to subpoena directors and staff, to conduct audits and reviews and to request the MMC to investigate the monopoly;

d. care should be taken to ensure that appellate arrangements will not result in political interference; we consider that the MMC should be able to fulfill this appellate function, with its experience of examining "public interest" questions;

e. uncertainties are created in the US system of regulation because agencies attempt to determine each year when approving price increases a fair rate of return based on the monopoly's relative efficiency. Major reviews of rates of return and of efficiency should only take place periodically, for example every 4 or 5 years. The results of efficiency reviews should represent a major input to the determination of permitted maximum rates of return, so that past effort and achievement are rewarded. However some flexibility should also be permitted to the agency in the intervening period as an added stimulus to efficiency;

f. permitted rates of return should be established by the agency (or the MMC as the appellate) rather than by Ministers, in order to reduce the possibility of political interference;

g. the agency should have powers to ensure that the monopoly is constrained and abuses are remedied. In the longer term the permitted maximum rate of return can be varied to meet this need. In the short term, price restraint could be used where maximum rates of return are likely to be exceeded;

h. the agency should be adequately funded and should be permitted to recruit those staff appropriate for the task, from outside the Civil Service where appropriate, at market rates of remuneration;

i. the agency should be permitted to examine all aspects of the business, including profits, efficiency, pricing, extent of market and services provided, standards of service, consumer protection, investment and possible abuses of monopoly power such as cross-subsidisation to keep out competitors and pressure on suppliers;

j. current cost accounts should be used primarily as the financial basis for regulation. However we would point out that for many industries there is a high degree of subjectivity involved in the preparation of CCA accounts. As a result we consider that for the time being at least it will be necessary for agencies to have regard to and even regulate by reference to historic cost accounts, as well as CCA accounts.

c/c JU

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

(2)

CONFIDENTIAL

Prime Minister

Legal qualms about BAA's objectives.

MCS 17/12

From the Secretary of State

The Rt Hon Leon Brittan QC MP
Chief Secretary
HM Treasury
Parliament Street
London
SW1

17 December 1982

Dear Leon,

As you know, we have had some difficulty in handling the CPRS recommendations over agreed corporate objectives for the British Airports Authority largely because the current litigation with the airlines has made the Authority acutely sensitive to the statutory basis of their relationship with me.

You will recall that objectives were agreed with E(NI) earlier this year and were sent to the Chairman of the BAA by my predecessor. We were subsequently informed that Counsel had prepared an opinion which advised the BAA that what was proposed was almost certainly unlawful in principle and certainly unlawful in detail. Mr Peter Scott QC (who is acting for the BAA in the legal action) suggested that the Government was seeking to bind the Authority to a series of objectives which, however desirable they might be, were not the objectives presented by the statute and to do so in a manner which left it unclear whether these objectives would be changed if the BAA in exercising the statutory judgement which it was required to exercise, considered it necessary or desirable to do so. He advised that it was one thing for a statutory authority to have objectives arrived at in the exercise of its own judgement, and which it reviews from time to time. This was legitimate providing the Authority was prepared to reconsider such objectives in the light of representations made by those whom it is bound to consult. It was another to bind itself to an agreement with the Government to follow a pre-determined course which fettered its statutory discretion.

My officials and lawyers have had quite lengthy discussions with the BAA about the implications of this Opinion. In many respects we believe it goes too far and fails to reflect sufficiently the special position of the Government in relation to the

CONFIDENTIAL

From the Secretary of State

nationalised industries. Nevertheless it has necessitated more careful handling of the matter than we had anticipated. The outcome is that in responding to our proposals, the Board has formulated and adopted a revised set of objectives (copy attached) which will form the basis of their next Corporate Plan. These take into account our proposals and the CPRS recommendations but the Board have not explicitly sought either my comments on the objectives or my agreement to them.

In fact, other than in style and general approach, they embody all but three of the objectives approved by E(NI) in March. Those omitted pose no serious difficulties since the subjects involved can be, and indeed are, covered by other statutory arrangements. More importantly the Board's objectives now recognise the need to meet financial and performance aims, and indeed any other targets which are agreed with Government from time to time: this is objective (e) on the Board's list. As you know in the litigation the plaintiffs allege that we were acting ultra vires in setting a financial target for the BAA: my defence is that the target was agreed with the Authority but it is nonetheless a sensitive issue and the Board's adoption of this objective is helpful.

In sending me the new objectives the BAA's Chairman has said that the Board are now working on a wide range of quantified performance aims, including a financial target, and that he would welcome discussions in the New Year on the financial and performance aims for the next and subsequent financial years which will have to replace the present targets when they expire on 31 March 1983. I attach great importance to such quantified indicators of overall performance.

Now that the Board has adopted objectives which are broadly acceptable we can therefore move on to the next, and more important stage, of determining specific quantified objectives in time for these to be taken into account in the Board's next Corporate Plan. I hope therefore that you are content for me to proceed on this basis.

I am copying this letter to other members of E(NI) and to Robert Armstrong.

Yours,

Arthur

LORD COCKFIELD

CORPORATE PLAN 1983 - OBJECTIVES OF THE BAA

The BAA's primary objective is to respond to the present and future needs of air transport in an efficient and profitable way by operating, planning and developing its airports so that air travellers and cargo may pass through safely, swiftly and as conveniently as possible.

In support of this general objective the essential policies are:

(a) To maintain, using the regulatory framework, high standards of safety for aircraft, passengers and airport staff, and to ensure that these standards match development in the air transport industry.

(b) To ensure, within the limits of the Authority's powers, high standards against terrorism and crime in its airports.

(c) To improve, as far as its powers permit, the range and quality not only of services offered to its customers but also those provided by other organisations and to have regard to the best practice of other airport authorities in the U.K. and abroad.

(d) To maintain, as a public enterprise, a competitive and commercial approach to its operations, and to improve operating efficiency.

(e) To ensure, as far as possible, that it meets the financial and performance aims, external financing limits and other targets agreed with the Government from time to time.

(f) To provide facilities at the airports such as are necessary to enable them to meet the needs of air transport in a safe and cost effective manner.

(g) To ensure, as a good employer, fair pay and conditions of service for employees and to encourage a working partnership leading to higher productivity and higher standards of service to the public through proper arrangements for participation, consultation and negotiation.

(h) To operate in harmony with the communities adjoining its airports and to seek to maintain a balance of interest between those communities and the needs of air transport.

(i) To market its skills and experience in its own specialist field both in its own right and in support of the efforts of other British consultants, contractors and suppliers in the service of the air transport industry.

17 DEC 1982

O/C

Nat. Ind.

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
Telephone Direct Line 01-212 3301
Switchboard 01-212 7676

Secretary of State for Industry

14 December 1982

JU508

NBPM

MWS 20/12

The Rt Hon Dr Gerard Vaughan MP
Minister of State for Consumer Affairs
Department of Trade
1 Victoria Street
London SW1

Dear Gerry,

I have seen your letter to Sir Geoffrey Howe of 14 December, attached. about the future of the Nationalised Industry Consumer Councils.

2 Apart from two slight factual alterations to paragraph 33 i.e delete "British" in line one, and replace "BT" with "telecommunications" in line 9, I have no comments on the paper attached to your letter.

3 I am copying this letter to the recipients of yours.

Yours ever

Patrick

20 DEC 1982

Not Fwd
Pollas

Informed Vaughans Office 17/12

Logie

Yes please say no objection from here.
M

10 DOWNING STREET

Michael

Dr. Vaughan's office are asking if we having any comments on his letter to the Chancellor of 14/12.

Do you wish me to relay the PM's agreement to publish?

Logie

17/12

RESTRICTED

2pps

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

17 December 1982

Dr Gerard Vaughan MP
Minister of State for Consumer Affairs
Department of Trade
1 Victoria Street
LONDON SW1H 0ET

Dear Minister,

In your letter of 14 December you sought approval to publish a paper on 'Nationalised Industry Consumer Councils - A Strategy for Reform'.

I am in general content with the paper. I agree that the NICCs require clear advice on their role, and guidance as to how it fits with other initiatives to make nationalised industries more efficient and accountable.

However, a possible expanded role for the Comptroller and Auditor General in relation to the nationalised industries is at present under consideration in the light of the St John Stevas Bill. The outcome is uncertain, but it could involve changes affecting investigations by the Monopolies and Mergers Commission under Section 11 of the Competition Act 1980. This would conflict with the references to this aspect of nationalised industry accountability in your paper.

There is therefore a case for delaying publication of your paper until the position is resolved. An alternative might be to amend it. If you prefer the latter course, perhaps your officials would be in touch with mine, and Patrick Jenkin's, about appropriate changes.

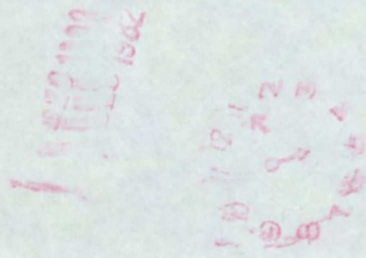
Copies of this letter go to the recipients of yours.

Yours sincerely,

Margaret O'Mara

GEOFFREY HOWE

(approved by the Chancellor
and signed in his absence)



cc JV

DEPARTMENT OF ENERGY
THAMES HOUSE SOUTH
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PARLIAMENTARY UNDER
SECRETARY OF STATE

The Rt Hon Gerard Vaughan MP
Minister of State for Consumer Affairs
Department of Trade
1 Victoria Street
LONDON
SW1H OET

17 December 1982

Dear Gerry,

NATIONALISED INDUSTRY CONSUMER COUNCILS

I have seen your letter of 14 December to Geoffrey Howe.

I am content that you should publish your paper, subject to deleting the final sentence of paragraph 26. I am still considering whether to use the Energy Bill to give statutory status to the Electricity Consumers' Council and I will write to you separately on this point.

I am copying this letter to the recipients of yours.

Yours ever,
David

DAVID MELLOR

O.L.D.   ~~C~~ JV.

DEPARTMENT OF TRADE
1 VICTORIA STREET
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01 215 5662
SWITCHBOARD 01 215 7877

From the
Minister of State
for Consumer Affairs

1

Prime Minister

Agree to publication on Friday, subject to colleagues?

Yes MT

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury

14th December 1982   MCS 14/12

Dear Geoffrey

We are under increasing pressure to announce our intentions on the future of the Nationalised Industry Consumer Councils (the NICCs).

The NICCs do an important job - indeed I believe that at present they are needed more than ever before. But their role, and the context in which they operate, are changing and will change further as we develop our wider nationalised industry policies.

For this reason - and because I see no prospect of legislation on the NICCs in the present Parliament - it would be premature to take final decisions now on the long term shape of arrangements to represent consumer interests in the public sector. The immediate task as I see it is more modest to give the NICCs as they stand a clearer lead on how to tackle their job ; to strengthen their working relationship with the industries (and with Government); and to make a start on rationalising and tidying up the present structure.

A strategy for reform on these lines is outlined in the enclosed paper, which I hope to publish shortly as a follow-up to the Departmental consultative document issued a year ago. It recognises that a Bill would be desirable when Parliamentary time permits, to put the NICCs on a more up-to-date and more uniform statutory footing. But it places the immediate emphasis on reform within the existing statutory framework, in particular through the preparation of guidelines for NICC operations.

Failure to bring the review to an early conclusion would expose us to considerable criticism. We announced it in 1979. Continuing uncertainty about our intentions would have serious implications for morale in the NICC system - notably among the 1,000 or so (mostly unpaid) Council members on whom the structure depends.

I would be glad to know if possible by Friday 17 December, if you and our other colleagues are content with what I propose. I am copying this letter with enclosure to the Prime Minister, members of E(NI), Lady Young, John Biffen and Sir Robert Armstrong.

Yours

Gerard Vaughan

MP

THE NATIONALISED INDUSTRY CONSUMER COUNCILS

A STRATEGY FOR REFORM

Foreword by the Minister for Consumer Affairs

We are all customers of one or more of the nationalised industries - electricity, gas, coal, water, the railways, the Post Office, and so on. The prices they charge us are a crucial part of our family budget; they are major items of cost in every business, large or small; and their financial requirements are a demanding factor in terms of "public expenditure" and thus in the whole national budget.

As customers our most direct concern is with the service they give us. Is it what we want and need? Is it a good service? Is it the best available? Could it be done differently?

In the context of an "open market" situation customers can give weight to their views on these questions by taking their business elsewhere, or by threatening to do so.

But, with a nationalised industry choice of that kind does not exist. So, how do we, the customers, make our voices heard? What does the Government do to help? What should it do?

As Minister for Consumer Affairs, the voice of the consumer in Government, if I may put it like that, I attach special importance to two moves in this connection. One is the working of the Competition Act 1980, under which the Monopolies Commission can look at the efficiency and value for money aspects of the nationalised industries; the other is the working of the Nationalised Industry Consumer Councils. Competition Act reports are already proving a fulcrum for change and improvement and there are more to come. This paper is about the NICCs.

I am convinced that the NICCs are needed now more than ever before. But in recent years their role, and the context of their consumer work, has changed and will change further.

In these circumstances, I do not pretend that we have found suddenly a magic formula that will enable consumers to achieve total success in persuading these enormous (and immensely influential) industries to do a more effective and economical job. But I do hope that the proposals set out in the following pages will each be seen as a step in the right direction, and that, collectively, they will help the management of these industries to become more responsive to the needs and wishes of their customers - you and me.

GERARD VAUGHAN

I THE NEED FOR NICCS

Background

1. In May 1979 the Government announced their intention of reviewing the Nationalised Industry Consultative and Consumer Councils and Committees (NICÇs) in Great Britain. The review has taken place against the background of the Government's general objective, announced by the Prime Minister on 16 January, 1980 to "encourage the good management of public bodies which continue to serve the country, while dispensing with those for which there is no further need".

2. In December 1981 the Department of Trade published a consultative document - "Consumers' Interests and the Nationalised Industries" - on the scope for reform. Some 300 organisations and individuals responded. The overwhelming conclusion was that the NICCs are valuable and still required; but that the present machinery should be made more effective.

The Nationalised Industries and their customers

3. Practically everyone has a major interest in the nationalised industries. Most of the industries subject to NICC scrutiny are monopoly, or near-monopoly, suppliers of essential goods and services. Their output accounts for nearly 8% of GNP; their bills cost the consumer almost 11% of his expenditure. But many of their customers are dissatisfied with their performance; for

example, recent surveys by the National Consumer Council show this to be a major area of consumer concern.

4. The main thrust of the Government's policy is to improve nationalised industry performance by subjecting them more effectively to market forces. Statutory monopolies in the supply of gas and electricity, and in postal and telecommunications services, are being relaxed. British Telecommunications and other nationalised industries are to be transferred to private ownership

5. But most nationalised industries will remain monopolies, or near monopolies. In such cases disciplines on them are being further developed as a substitute for the market. The Government's aims - in the achievement of which the industries' "sponsor" Departments have a central role to play - are to improve the industries' efficiency by ensuring that they make the most productive use of their resources within the framework set by their financial targets; and to improve their performance both by the various objectives specified for them and in responding to customer needs.

6. This involves action to improve, where appropriate, the management effectiveness of the industries' boards; to establish clear objectives (including financial and performance targets) for each industry; and to strengthen the arrangements outside as well as inside Government for monitoring industry performance.

Role of the NICCs

7. The NICCs have an essential role in this monitoring process in relation to standards and quality of service. An informed contribution from them at local, regional and national level will help consumers directly; and indirectly may also stimulate improvements in efficiency in the industries concerned.

8. All NICC members, other than the 44 Chairmen, are unpaid volunteers - some 3,000 all told. The Government's starting point is that the reforms needed in the NICC machinery should seek to reinforce the voluntary nature of the existing system and its roots among individual customers. The NICCs should be a mouthpiece for the ordinary consumer; so it is essential for the channels upward from the local level to the national level in the NICC structure to work efficiently.

II THE NICCs' JOB

Improving Quality of Service

9. The NICCs' central functions are to monitor the industries' standards of service and to press for improvements in their "customer performance". These functions can be performed most effectively where clear yardsticks exist against which performance can be measured.

10. Such yardsticks may be quantitative performance indicators or "customer performance targets" - for example, the proportion of first class letters delivered within 24 hours or the number of trains running to time - or more qualitative criteria for staff courtesy and responsiveness, where straightforward quantified targets are not possible; and there are also Codes of Industry Practice, such as those adopted by the gas and electricity industries. Performance indicators and targets can thus provide an objective basis for assessing an industry's success in meeting consumer needs. Qualitative criteria and codes of practice can give the consumer a clear idea of the quality of service which the industry aims to provide, and of the remedies available to him if it fails to meet the promised standards.

11. Much has already been done in all these areas. But the NICCs can and need to do more, reinforcing action by Government itself to encourage the industries to develop and publicise performance yardsticks, and to publicise the results achieved by the

industries in relation to them. The objective should be to establish clearly the standards of service which customers should expect; and to develop a climate in which all concerned in the industry see the attainment of these standards as an important part of their job.

Nationalised Industry Prices

12. The NICCs should be consulted about and comment on industry policies and plans. In particular they must ensure that the consumers' view is clearly heard in decisions on costs and prices.

13. Tariff structures are an area in which most NICCs have long been active. The general levels of tariffs (as determined by the need to raise an economic level of revenue), like the industries' financial targets, reflect the broader economic circumstances of each industry including its costs and market position, which are assessed in consultation with sponsor Departments. The NICCs' influence in this area cannot be decisive. The NICCs do, however, have an important role to play, along-side the Government itself, in encouraging the industries to contain costs (and hence prices); they can thereby make an informed contribution to the improvement of industry efficiency.

14. In this connection the NICCs may from time to time be able to point to a need for investigations by the Monopolies and Mergers

Commission under section 11 of the Competition Act 1980; and to contribute evidence to such investigations.

Complaint procedures and redress for the customer

15. The NICCs' third main area of operation relates to redress for individual customers when things go wrong.

16. Responsibility for taking swift and effective action to resolve complaints lies above all with the industries themselves and should be a priority for them. The NICCs' role in this is to evaluate the industries' arrangements for complaint handling and seek to improve them. This includes the establishment (eg in Codes of Practice) of adequate complaint handling procedures and of arrangements for recording, monitoring and drawing policy conclusions from the general pattern of complaints. NICC appraisal of management performance on complaints should be integrated with the wider work already mentioned on "customer performance" generally.

17. The NICCs must also continue to provide a channel for consumers to pursue complaints which have not been satisfactorily resolved by the industries themselves. If the latter do their jobs properly, they should themselves be capable of handling all routine cases to the satisfaction of the customers concerned. Of the more difficult cases taken up with the NICCs, the majority will continue to be dealt with by NICC staffs (and where it exists, the local or district tier of the NICC structure).

18. But there are some general matters requiring examination by the Councils themselves. These include the scope for improving and rationalising the NICCs' working relationships with other advice services, in particular the Citizens' Advice Bureaux; for significantly improving customer awareness of and access to NICC assistance; and for establishing, in conjunction with the industries, arrangements for recourse to independent arbitration to settle disputes which the normal complaint and conciliation machinery has failed to resolve.

Practical guidelines are needed

19. To be effective in practice the principles already outlined will have to be expanded into guidelines for each NICC. These will need to reflect the character of the industry concerned and the levels (national, regional and local) at which the NICC operates. As a major element in its strategy for reform the Government will invite each national Council to prepare proposals for guidelines, in consultation with the regional Councils and (where appropriate) district committees, and with the industries themselves.

20. It would be inappropriate to make such guidelines legally binding. Ideally however the Government would like to give them a measure of Parliamentary authority and will do so in primary legislation when Parliamentary time allows. Thus the national Council in each industry will have to submit proposals, for

approval by the Secretary of State (and, possibly, presentation to Parliament) on its organisation, functions and priorities. The aim will be to establish, in consultation with the industries themselves, broad agreement on what the NICCs will undertake in the three key areas identified above, and on how it will be carried out.

III THE LEGAL POSITION

21. At present the NICCs' legal rights and obligations are based on six statutes, the oldest of which dates from 1946. Most NICCs are required to consider matters affecting the consumer interest in their industries (including matters referred to them by consumers and, in some cases, by Ministers, as well as matters which they themselves consider important); and to report thereon to the industries and/or to Government. Most of the industries are equally required to consult the NICCs on matters of importance to their customers. But the NICCs' precise obligations, and the industries' corresponding duties, vary (often illogically) from one industry to another.

22. The balance of opinion in our consultations was firmly in favour of reforming and strengthening these statutory arrangements. A number of NICCs urged that their statutory rights to information from the industries should be strengthened. They argued - with reason - that access to information is crucial to the effective performance of their functions. They gave telling examples of cases in which the industries had failed to provide the data they believed necessary.

23. The Government agree that the industries must co-operate in providing information - even at additional cost in time and trouble to themselves - if the NICCs are to do their jobs effectively. But the NICCs do not need new wide-ranging statutory rights of access to information. That could impose costs and

burdens on the industries out of all proportion to any practical benefit for consumers. In any case any attempt to set out in detail what information the NICCs do need is unlikely to be productive.

24. Ultimately the NICCs and the industries have to agree, as a practical matter, what can and cannot reasonably be supplied. But a statutory framework, laying down the basic rights and obligations of both parties, is essential if satisfactory working relationships are to be achieved. And it is clear that the existing statutory arrangements should be rationalised and updated.

25. The Government therefore intend to bring in new legislation to establish a more uniform legal basis for NICC operations by consolidating the best features of existing legislation. The general framework will need to be modified in its application to particular industries; but the Government's broad intention is to provide that:-

i The NICCs will be obliged to consider any matter relating to the services provided by their industries which is raised with them by consumers in the industry concerned (and by the Government in the case of the national Councils, or by the national Councils in the case of the regional Councils), together with any other such matter which appears to them to require consideration; and to report as appropriate to the industry and/or to Government.

The consultative document of December 1981 concluded that there was no case for including scrutiny of rail fares within the statutory remit of this Central Transport Consultative Committee (CTCC) and the Transport Users' Consultative Committees (TUCCs). The Government will take a final decision on this in the context of its decisions on railway finances, following the report of the Review Committee chaired by Sir David Serpell.

ii The industries will be obliged to inform the NICCs of their "general plans and arrangements"; to provide such supporting information as is necessary for the discharge of the functions of the NICCs; and - following, generally, the precedent established by the Post Office Act 1969 - to consult the NICCs before putting into effect any proposals with significant implications for their customers. There will be provisions in the unlikely event of a dispute about the interpretation of these obligations for it to be resolved in the last resort by an appropriate Minister.

[26. The Electricity Consumers' Council (ECC) for England and Wales is the only NICC which at present has no statutory basis. The Council was constituted in 1977 by Ministerial minute. The Government have accepted that its relationship with the electricity supply industry and indeed with the regional Electricity Consultative Councils is likely to be strengthened if it is established as a statutory body. The Energy Bill now before Parliament will provide accordindly]*.

* subject to decisions on the Energy Bill

IV ORGANISATION OF THE NICCs

27. There are at present 44 NICCs covering the gas, electricity, coal, rail, post and telecommunications industries. They require nearly 1000 Ministerial appointments (and around 2000 appointments are made at local level by the gas and electricity Councils). Together they cost around £4 million a year to run.

28. This Chapter reviews the structure, scope, financing, and staffing of the NICC system in the light of the Government's general policy that non-Departmental public bodies must be - in the words of the MPO Guide on Non-Departmental Public Bodies - "effective, efficient and economical in the conduct of their affairs, so that the taxpayer gets good value for money".

29. One suggestion in the consultative document was to amalgamate the NICCs into three broad sectoral organisations dealing respectively with energy/utilities, transport and communications. It was suggested that this might create a more streamlined and authoritative structure than at present. Opinion in the consultations however was decisively against it. The Government have accepted that its disadvantages - in terms of the risk of increased remoteness of the NICC structure both from consumers and from industry management - would outweigh the possible advantages. The Government intend therefore to retain the essentials of the

present "one-to-one" NICC/Industry structure. But closer working relations within that structure need to be developed between NICCs in the same and different industries.

30. Retaining a "one-to-one" arrangement generally does not mean however that some simplification of the present structure is ruled out at regional and district levels. Emphasis has been placed earlier in this paper on maintaining close contact with consumers at the grass roots. But it is clear that the arrangements for doing so can be varied and more flexible - and less costly - than those presently to be found. Quite apart from the nature and number of the regional and local bodies, further work is needed on an industry-by-industry basis on the relationship between the national, regional and local tiers of the system. In some industries it may be desirable to strengthen the authority of the national Council vis-a-vis the regional machinery. At all events, a closer relationship should be forged between the regions and the centre - while maintaining, of course, the separate identity of the Councils in Scotland and Wales.

Gas and Electricity

31. Accordingly the national Gas and Electricity Councils will be invited to review the existing pattern for consumer representation in their industries at local level through district committees; and to suggest options, after consultation with the regional Councils which at present appoint and service these committees, for simpler, less costly and more flexible arrangements.

Decisions on the shape of the "third tier" in gas and electricity - and on any changes needed in its present statutory basis - will be taken in the light of the Councils' proposals.

Posts and Telecommunications

32. With the transfer of British Telecommunications (BT) to private ownership, the functions of the Post Office Users' National Council (POUNC) and the Post Office Users' Councils (POUCs) for Scotland, Wales and Northern Ireland in respect of BT will be transferred to the new Director General of Telecommunication who will oversee the entire telecommunications industry. POUNC and the POUCs will continue to deal with postal services.

33. The British Telecommunications Bill at present before Parliament provides for the establishment of consumer advisory bodies to assist the Director General of Telecommunications, including separate bodies in Scotland, Wales and Northern Ireland. It will also be desirable for the Post Office Advisory Commmittees, which are not formally part of the NICC structure, to continue to link BT management and customers at local level. Provision is made in the Bill for continuing financial support on the modest scale required to keep the POACs involved with BT as well as Post Office affairs.

Nationalised buses

34. The nationalised part of the bus industry (the National Bus Company and the Scottish Bus Group) provides less than half of all bus services in Great Britain. They offer express, contract and private hire services, and tours, in competition with other modes of transport and with the many independent bus and coach operators. The Government sees no case for extending NICC scrutiny to these commercial services.

35. On the other hand, NBC and SBG subsidiaries still dominate the market for local "stage carriage" bus services in many areas. But these local services are run under licence from the Traffic Commissioners; and many are supported financially by local authorities. It is an important function of both to reflect consumer interests and to pursue individual customers complaints. In these circumstances the Government accept the conclusion of the Monopolies and Mergers Commission in their recent report on certain bus undertakings [HC442] that there is no need to supplement the Traffic Commissioner/local authority arrangements by creating additional consumer machinery in the bus sector.

London public transport

36. It is generally agreed that the existing arrangements for representing consumer interests in public transport services in London are unsatisfactory. British Rail services in London fall within the ambit of the London TUCC as does the closure of London

Transport Underground lines and stations. All other questions concerning LT services, such as the running of Underground services, fall to the London Transport Passengers Committee (LTPC) which is a statutory body but not a NICC financed by the Government. A further complication is the LTPC's jurisdiction over LT services running outside the GLC area.

37. The House of Commons Transport Committee have recommended, in their recent report on London, that a single Public Transport Users' Committee for London should be established to replace the LTPC and the TUCC for London. The Committee has also made wider structural recommendations, most notably that there should be a Metropolitan Transport Authority for London. The Government's decisions in the light of their recommendations will be announced separately as soon as possible.

Appointment procedures

38. The existing statutory arrangements governing appointments to the NICCs will be simplified when new legislation is brought forward. The Councils will be slimmed down to a maximum membership of 15-20. The present statutory requirement that regional Councils for gas and electricity must have a certain proportion of members nominated by local authorities will be abolished.

Financing and personnel management

39. The Government are satisfied that the current level of funding of the NICCs is adequate to enable them to operate effectively on the basis outlined on this paper. Expenditure on them is at present controlled on the same basis as other administrative expenditure borne on the Department of Trade Vote.

40. Funding by grant-in-aid (which would in due course require the national Councils for gas, electricity as well as rail transport to play a role in administering and accounting for all NICC expenditure in their industries) would more appropriately reflect the NICCs' status as independent bodies. Detailed proposals to this end will be brought forward as soon as possible, together with proposals for a more open system of recruitment for NICC staffs, more uniform terms and conditions of service, and greater opportunities for staff movement between jobs in the NICC structure.

41. These changes in the present arrangements for financing and staffing the NICCs will be fully discussed with all concerned with a view to full implementation following passage of the new legislation.

V MAKING THE SYSTEM WORK FOR THE CONSUMER

Relations with Government

42. In itself NICC scrutiny, however sophisticated, will do nothing to improve the quality and value-for-money of the services which the nationalised industries provide unless the industries themselves - and their sponsor Departments - respect and act on NICC suggestions. That requires a constructive, co-operative working relationship between all three. It is this above all that the Government's strategy for reform is designed to promote.

43. Without losing (or, equally important, giving the appearance of losing) their independence, the NICCs need close and direct contact - especially through their Chairmen - with industry management. Equally important, they must develop closer and more effective relations at national level with the sponsor Departments which are central to the whole system of control.

Following up NICC reports

44. The NICCs must equally continue to speak out forcefully through annual and ad hoc reports. The Government believe that all reports should normally be addressed jointly to the Minister with general responsibility for consumer affairs; to the Minister with direct responsibility for the relevant industry; and, by NICCs in Scotland and Wales, to the Secretary of State for the country concerned.

45. It is important that NICC recommendations should be properly followed up. This must be primarily a matter for the industries themselves. The type of follow-up required will vary from case to case and should not be rigidly prescribed. The Government intend however to explore with the industries the scope for more systematic arrangements for examining and, where appropriate, responding publicly to NICC reports.

46. The Government will not lay down in detail how and on what the NICCs should report. But their annual reports - perhaps a single report covering each industry rather than a series of regional reports and a national report - should be shaped by the operating principles outlined in Chapter II above; and in particular should contain regular assessments of industry progress in the area of customer performance and standards of service.

Cooperation between the Consumer Bodies

47. As noted above (para 29), the Government seek more interchange between the NICCs themselves and with other agencies. The Government propose to invite the National Consumer Council (NCC) to consider, in consultation with the national NICC Chairmen, ways of strengthening the present arrangements for informal liaison between the NICCs, and between the NICCs collectively and the NCC (perhaps, for example, through the institution of a national NICC

"Chairmen's Group" under NCC auspices, reporting as necessary to the Minister for Consumer Affairs). The possibility of closer co-operation with other bodies will also be explored and encouraged (eg with the Citizens' Advice Bureaux service, the Air Transport Users Committee).

VI LEGISLATIVE STEPS AND ACTION NOW

48. Implementation of some of the changes, outlined in this paper will require legislation, which will be introduced as soon as Parliamentary time permits; this will provide, for example, for a statutory basis for the NICCs' detailed operating guidelines (para 20); for the improvement and rationalisation of the NICCs' legal rights and obligations (para 25); and for the reform of the structure and organisation of the present system.

49. Pending legislation, a start will be made at once on:-

(a) preparing guidelines for NICC operations on an industry-by-industry basis, in the light of proposals from the NICCs themselves [para 19];

(b) improving the arrangements for:-

i liaison and co-ordination between the national, regional and local tiers of the NICC system (para 30), and between the the NICCs and the National Consumer Council (para 47);

ii consumer representation at district level in the gas and electricity industries (para 31);

iii NICC financing and staffing (para 39-41);

iv NICC reporting (paras 44-46).

Prime Minister

MCS 14/12

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

13 December 1982

The Rt Hon Patrick Jenkin MP
Secretary of State for Industry
Ashdown House
123 Victoria Street
LONDON SW1

MT

Dear Patrick

PROGRAMME FOR DISCUSSION OF CORPORATE PLANS: 1983

We have agreed in the past that it is desirable that E(NI) should consider the corporate plans of all the major nationalised industries. But since the number of E(NI) meetings must inevitably be limited, and as we have to consider the plans over a relatively short period, it is necessary to arrange and adhere to a strict timetable for consideration of individual industries' plans. My officials have prepared the enclosed programme in conjunction with the Cabinet Office and it has been agreed among officials at NIP. Those nationalised industries which do not appear in the programme are expected either to be the subject of separate collective Ministerial discussion; or to have plans which can be cleared in correspondence. I should be grateful if all members of E(NI) could confirm that these arrangements are acceptable to them.

I am copying this letter to our E(NI) colleagues, to Sir Robert Armstrong, and to John Sparrow.

GEOFFREY HOWE

E(NI) 1983: PROGRAMME FOR CONSIDERATION OF NATIONALISED INDUSTRIES CORPORATE PLANS

INDUSTRY	E(NI) DISCUSSION
Electricity (England and Wales)	Feb-March
Electricity (Scotland)	Feb-March
British Waterways Board	March-April
Post Office	May
British Telecom	June
NBC)	June
STG)	
BGC	July
British Shipbuilders	July
Water Authorities	Sept-October

NOTE:

NCB, BSC, BA and BR are expected to be subject of separate collective Ministerial discussion not necessarily linked to the planning cycle. Other industries can be dealt with in correspondence.

Nat Ind Pol

Cf PPS?

(2)

CHIEF SECRETARY TO THE TREASURY

Prime Minister

To note that the Chief Secretary suggests that he replies to Mr Payne's reply to your letter.

MCS 2/12

Treasury Chambers, Parliament Street, SW1P 3AG

William Rickett Esq
10 Downing Street
London SW1A 2AL

2 December 1982

Dear Willie

You asked for comments on the letter dated 19 November from Mr Payne, the Chairman of the Nationalised Industries' Chairman's Group about capital underspending by the nationalised industries.

Mr Payne has responded favourably to the Prime Minister's initiative in drawing attention to the importance of maintaining investment programmes, and a further letter from the Prime Minister is not required. He has however made one or two debating points which the Chief Secretary proposes to take up with him as in the attached draft.

Yours sincerely

Jol. Gieve

JOHN GIEVE
Private Secretary

THE
DRAFT LETTER FROM/CHIEF SECRETARY TO:

Norman Payne Esq
Nationalised Industries' Chairmen's Group
Hobart House, Grosvenor Place, LONDON SW1X 7AE

I was glad to see from your response to the Prime Minister's letter of 2 November that the Chairmen of the Nationalised Industries are taking all possible steps to achieve the agreed levels of capital expenditure.

2. We fully appreciate that there are factors affecting the level of investment outside your direct control; indeed the Prime Minister recognised this in her letter to you. Nonetheless we hope that the industries will so far as possible make full and proper use of the provisions we have made for capital investment within their external financing limits. I recognise that the time available within the current financial year is limited but following the recent Investment & Financing Review the industries' external financing limits for 1983-84 have been announced. They should therefore be in a position now to put forward their proposals for future capital expenditure. Once these have been approved the industries will be able to plan ahead with confidence on the basis of the agreed programmes of investment.

3. I note what you say about the level of wage increases in the last pay round but the fact remains that the overall increase in average earnings in the nationalised industries was markedly ahead of that for the public services generally. We have clearly indicated that in the coming year pay increases in the public services where the Government is the employer must be accommodated within an increased cash provision for 1983-84 of 3½ per cent over the previous financial year. Nationalised industry employers need to adopt an equally firm stance. Failure to do this would imply higher prices or less investment. The public are already critical of the level of nationalised industry prices and would react strongly to increases which could be attributed directly to excessive pay

settlements. And it would of course be damaging for the industries themselves if the investment we agree to be necessary had to be held back because of unjustified pay increases for their employees.

[L.B.]

NATIONALISED IND: POLICY PT7

qc JV

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Prime Minister 2

MCS 3/12

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

30 November 1982

Dear Geoffrey,

NATIONALISED INDUSTRIES: PROGRESS SINCE THE CPRS REPORT
SCOTTISH ELECTRICITY BOARDS

At the meeting of E(NI) on 8 September it was agreed that I should report by the end of November on the progress made in implementing the CPRS recommendations so far as the three Scottish nationalised industries are concerned. I wrote to you on 23 September about the Scottish Transport Group (STG) and am now writing to report progress with the two Scottish Electricity Boards (SSEB and NSHEB).

My letter of 26 February set out a number of objectives for the Boards on which I received comments from Leon Brittan and Mr Sparrow. Since then I have seen the correspondence from Nigel Lawson on objectives for the CEGB. I regret that I am not yet able to circulate revised objectives for the Scottish Boards but I hope to be able to do so in the next few weeks. I have, however, had discussions about possible objectives with the new Chairman of SSEB and the Chairman designate of NSHEB before their appointments. I took the opportunity to stress the importance which the Government attaches to increased efficiency in the nationalised industries and the need to deal with the excess generating capacity which exists in Scotland. I intend to follow up both these points in setting objectives for the two Boards.

In order to improve our own business understanding I intend to appoint an accountant from the private sector with appropriate business experience for an extended secondment to the Scottish Office. He will assist my officials in dealing with the Scottish Electricity Boards and the STG. Already we have had a favourable response from some of the major firms who were approached and I hope to make an appointment soon.

Discussions have been underway with officials from the two Boards to devise improved monitoring returns which will enable us to build on the information currently available within the Boards and improve our understanding of their performance. I would hope these new arrangements can be in place for the start of the next financial year. Board officials have also accepted the need to produce study documents dealing with strategic options open to the Boards for consideration by Ministers. We will be pursuing this point in discussions with the Boards in the context of their existing corporate plans, which do not meet the criteria for such plans as envisaged by the CPRS. A draft performance review has also been prepared and has recently been circulated at official level.

In the area of better self regulation, you will be aware of the recent efficiency audit of SSEB by Coopers and Lybrand which found that the Board's performance compared favourably with other organisations of similar size and type. The consultants also commented favourably on SSEB's methods of investment appraisal. I have emphasised to the Chairman of SSEB the need to pursue vigorously the recommendations which emerged from the study. I made this same point to the Chairman designate of NSHEB which is also currently the subject of an efficiency study by management consultants.

As I said in my letter of 23 September, I met the Chairman of the three Scottish nationalised industries as a group for an initial discussion on this exercise, and have held individual discussions with the Chairman of SSEB and the Chairman designate of NSHEB who is due to take up his appointment on 1 January 1983. In addition senior officials recently met the Board of SSEB and as you know Alex Fletcher and I occasionally meet informally with the Chairman and Board members. However, I agree that a more formal arrangement for meeting annually with the three Boards will be very helpful.

As far as the constitution of the Boards is concerned, they already meet the criteria recommended by the CPRS. They both have fewer than twelve members, of whom the majority are non-executive with good private sector representation. I do, however, intend to strengthen the SSEB's Board financial, business and economic membership in the longer term.

Although other preoccupations within the Scottish Economic Planning Department have delayed our consideration of the application of the CPRS recommendations to the Scottish Electricity Boards I am confident that we are now making good progress. As I noted earlier, I intend to circulate very soon my proposals for the objectives for the Boards.

I am copying this to other members of E(NI).

Yours ever,

George

Nat Ind

Policy

c.c. Mr. Scholar
- Press

Nat. Ind

10 DOWNING STREET

From the Private Secretary

19 November, 1982.

I enclose the response from the Chairman of the Nationalised Industries' Chairmen's Group to the Prime Minister's letter of 2 November in which she drew attention to the importance of maintaining investment programmes wherever possible.

I should be grateful for your comments on Mr. Payne's remarks, and for a draft reply for the Prime Minister to send to Mr. Payne by 3 December, if you judge that a reply is necessary.

W. F. S. RICKETT

Miss Jill Rutter,
HM Treasury.

10 DOWNING STREET

From the Private Secretary 19 November, 1982.

I am writing on behalf of the Prime Minister to thank you for your letter of 19 November. I will place this before her as soon as possible.

W. F. S. RICKETT

N.J. Payne, Esq., C.B.E.

Prime Minister 2
We will let you have a draft reply.
Duty Clerk
Mr W. Rickett
19/11

Nationalised Industries' Chairmen's Group

Chairman
Norman J. Payne CBE

Hobart House
Grosvenor Place
London SW1X 7AE
01-235 2020

19th November 1982

The Rt. Hon. Margaret Thatcher, MP,
The Prime Minister,
10, Downing Street,
London S.W.1.

MG

Dear Prime Minister

I have now had an opportunity to consult my colleagues about your letter of 2nd November.

The Chairmen share your wish to see the Corporations' capital spending reach the level authorised for 1982-83. None of us have any desire to defer profitable projects, and we are taking every prudent and commercially sensible step to maintain our planned investment programmes, wherever possible.

There are, however, factors outside our control which operate against that objective in many cases, - though the Corporations' situations differ widely. Some are economic: e.g. with current market conditions being what they are, and less optimism now being expressed about the timing of the upturn, the Corporations, as profit-oriented businesses, are bound to re-examine critically investment programmes originally proposed some 18 months ago. Some are organisational: e.g. the way in which Departments treat investment authorisations and EFLs as maxima rather than mid-point estimates forces a constant depressive effect on the planning of expenditure. Also, the welcome fact that we are now building planned facilities cheaper, helped by keener quotations from suppliers and contractors, appears as an underspend in the statistics. For our part, we shall continue to do whatever we can to overcome such obstacles; though with only a third of the year remaining, time is not on our side.

I must add that my colleagues and I regretted some of the points which you made to the Commons on 3rd November, which ranged wider than the specific issue raised in your letter. In particular:-

(a) The Chairmen have been pressing for nearly three years for more investment in the public sector industries, both on commercial projects which satisfy the profitability criteria and on socially-desirable infrastructure schemes. Throughout all that period, our arguments met with vehement opposition in Whitehall. Capital spending by major businesses with long "lead times" cannot be increased suddenly.

(b) Neither can it prudently be increased without some assurance that a higher level of investment will be maintained in the future. The Autumn Statement said nothing about our investment levels after March next; and in aggregate, our access to external finance is to be cut in real terms next year.

(c) Any suggestion that Corporations maintained their external borrowings but cut back on investment in order to finance excessive wage increases needs to be set alongside both the CBI's figures and those of the Department of Employment. These show clearly that the public sector of industry did just about as well as the private sector in restraining wage increases in the last Pay Round.

Yours sincerely

Lord J. Payne

Nat Ind, Policy, Pt 7

Nat Ind

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

cc JL

Prime Minister (2)

MCS 4/11

From the Secretary of State

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

4 November 1982

Dear Geoffrey,

PUBLICITY FOR MONOPOLIES AND MERGERS COMMISSION REPORTS

Thank you for your letter of 1 October.

The annual report of the Director General of Fair Trading does of course contain some details of follow-up to Commission reports on monopolies, mergers, general references and investigation into anti-competitive practices. But for references of nationalised industries made under the 1980 Competition Act these go no further than statements made on publication of the Commission's individual reports.

I therefore welcome your suggestion that we should consider the possibility of Government giving publicity to progress on the implementation of reports on the nationalised industries and, subject to the views of our colleagues in E(NI), would be happy for our officials to work up a proposition as you suggest.

I am copying this letter to members of E(NI).

Yours,
Arthur

LORD COCKFIELD

Nat Ind, Policy, Pt7

-1 NOV 1982

11 12 1 2 3 4 5 6 7 8 9 10

cc Nationalised industries

Policy : Pt 7

JR

file

cc dhe — CS, HM

Press

10 DOWNING STREET

THE PRIME MINISTER

2 November 1982

Dear Mr. Payne,

I recently met the Group of Eight, the body which represents all sides and parts of the construction industry. They expressed concern about shortfall on nationalised industries' planned capital expenditure, and I suggested they should approach nationalised industries direct to persuade them of the need to spend their capital allocations. I also told the Group that I would write to nationalised industry Chairmen, setting out the Government's views.

As you will know, the investment plans put forward by the nationalised industries for 1982/83 and approved, were 26 per cent higher in cash terms than the estimated outturn achieved in 1981/82. This large increase has received a great deal of public attention. I recognise that events outside industries' direct control might cause investment plans to be revised downwards during the course of the year but I hope that every step is taken to ensure that this only happens after careful consideration. Where reductions in expenditure are needed to ensure that an industry stays within its External Financing Limit, I would hope that profitable investment is only reduced as a last resort.

The importance of maintaining investment programmes wherever possible has been brought to sponsor Ministers' attention. I would be grateful if you would let your fellow Chairmen know my views.

Yours sincerely

Margaret Thatcher

Norman Payne, Esq.

Mr Kemp
Mr Mountfield
Mr Chivers
Mr Culpin
Mr Grimstone
Mr Hall
Mr Hart
Mr Houston
Mr Morgan
Mr Pirie
Mr N Wicks

Mr R Wilson
Mr Norgrove
Mr Rayner

cc Chancellor
Economic Secretary
Financial Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Quinlan
Mr Burgner

Treasury Chambers, Parliament Street, SW1P 3AG

(2)

Prime Minister

To note MCS 25/10

Rt Hon Lord Cockfield
Secretary of State
Department of Trade
1 Victoria Street
London SW1H OET

22 October 1982

Dear Arthur,

EFLs FOR 1983-84

We expect to announce nationalised industry EFLs for 1983-84 very quickly after the Cabinet reaches conclusions on this year's Public Expenditure Survey. I am grateful for the assistance I have had from you and other colleagues during the IFR and I attach an annexe setting out the EFLs you and I have provisionally agreed for the industries that you sponsor. I do not intend to re-open at Cabinet the agreement that we have provisionally reached.

I imagine you will want to let your Chairman know in confidence their likely EFLs before announcement both as a courtesy and to minimise any risk that they will publicly "disown" or criticise the figures when they are announced. The final outcome will of course have to be confirmed at Cabinet but I am content that, provisionally, you should proceed on the basis of the figures attached to this letter. I will then assume that once Cabinet confirms these figures you are content they should be published.

I am sending copies of this letter to other sponsor Ministers with the figures of their industries. I am also sending copies to the Prime Minister, and Sir Robert Armstrong.

Yours ever,
Leon

LEON BRITTAN

DEPARTMENT OF TRANSPORT

EFLs 1983-84

	£m cash
British Railways Board	973
National Bus Company	69

DEPARTMENT OF INDUSTRY

EFLs 1983-84

	£m cash
British Steel Corporation	200
British Telecom	120
Post Office	-20
National Girobank	0
British Shipbuilders[1]	150

Notes

1. BS EFL provisional pending decisions on Corporate Plan.

DEPARTMENT OF TRADE

EFLs 1983-84

	£m cash
British Airways Board	8
British Airports Authority	33.5
Civil Aviation Authority(1)	16.5

Notes

1. CAA EFL will not be included in published list of nationalised industry EFLs until discussion about position of C&AG concluded.

DEPARTMENT OF THE ENVIRONMENT

EFLs 1983-84

	£m cash
British Waterways Board (1)	42

Notes

1. BWB EFL of £41.9m rounded to £42m for publication.

2. Regional Water Authorities EFL (£345m) will not be included in published list of nationalised industries' EFLs.

DEPARTMENT OF ENERGY

EFLs 1983-84

	£m cash
National Coal Board	1130
Electricity (England and Wales)[1]	-362
British Gas Corporation	0

Notes

1. Electricity EFL assumes neutral pricing assumptions.

SCOTTISH OFFICE

EFLs 1983-84

	£m cash
North of Scotland Hydro-Electricity Board	0
South of Scotland Electricity Board	256
Scottish Transport Group (1)	19.5

Notes

1. STG EFL of £19.6m rounded to £19.5m for publication.

M

Nat Ind Policy

FILE

MFJ

cc: CO
D/Emp
D/Energy
HMT
Trans
D/T
DOE
D/Ind

10 DOWNING STREET

From the Private Secretary

15 October 1982

Dear Muir,

Scottish Electricity Boards' Borrowing Powers

The Prime Minister was grateful to your Secretary of State for his minute of 4 October about the borrowing powers of the Scottish Electricity Boards. She has also seen the subsequent correspondence between your Secretary of State and the Chief Secretary.

The Prime Minister agrees with your Secretary of State's conclusions as set out in his letter of 12 October i.e. to a borrowing limit of £2,700m., with an interim limit of £2,300m.

I am sending copies of this letter to the private secretaries to the other members of E(NI).

Yours sincerely,

Michael Scholar

Muir Russell Esq
Scottish Office.

RW

1. Mr Flesher
2 PA

10 DOWNING STREET

1

Prime Minister

Nigel Lawson wishes to announce Philip Jones' appointment to the Electricity Council next week before his objectives letter has been cleared with E(NI). It has to be consistent with Walter Marshall's, and Mr Jones has agreed to accept an objectives commitment on these lines.

Agree?

Yes

TOLD MR WEST MCS

MCS 15/10

ccpr

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Leon Brittan QC MP
Chief Secretary
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

12 October 1982

Dear Chief Secretary,

In your letter of 6 October with mcs you suggested that the proposed Bill to increase the borrowing powers of the Scottish Electricity Boards should be delayed until the 1983-84 session in view of our recent discussions about the Boards' external financing requirements for 1983-84.

I have given your suggestion careful consideration, but I do not think we should follow this line. It seems to me that little would be gained by delaying the Bill, but there is great potential for embarrassment to be caused should the borrowing limits be reached earlier than expected. I would therefore prefer to stick to the existing timetable and introduce the Bill next Session. I do, however, take your point about the level of the borrowing limits and am prepared to reduce them to £2,300m and £2,700m as you suggest.

I am copying this letter to the Prime Minister and other members of E(NI).

Yours sincerely

[signature]

Approved by the Secretary of State
and signed in his absence

Nat Ind, Policy, Pt 7

cc JL
NBPM Nat. Inc)

MCS 7/10

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon George Younger TD MP
Secretary of State
Scottish Office
Dover House
Whitehall
London SW1A 2AU

6 October 1982

Dear Secretary of State

I have seen your minute to the Prime Minister of 4 October suggesting the limits on the statutory borrowing of the Scottish Electricity Boards to be included in a Bill next Session.

We met last week to discuss the external funding limits for the Boards up to 1985-86 and settled on figures somewhat lower than the Boards had originally proposed. I am also sure that it is right to exclude any provision for a new nuclear power station after Torness at this stage. These factors, together with inflation assumptions more in line with the progress we have been making recently, suggest cumulative borrowing requirements significantly lower than forecast by the Boards. Indeed, I wonder whether the Bill could not be put off until the 1983-84 Session. You might wish to consider this, although I should understand if you felt it would be cutting the timescale for Parliamentary approval too fine.

It seems entirely sensible to include two limits in the Bill, the higher to come into effect by Affirmative Resolution later. You suggested intervals of about 3 years between Parliamentary scrutiny and I would certainly not want to plan on the intervals being any longer. On the basis of the forecast borrowing requirements now anticipated, I think it would be prudent to set them a little lower than you propose, at £2,300 million for the first limit and £2,700 million for the second.

A copy of this goes to the Prime Minister and other members of E(NI).

Yours sincerely
JSI. Grieve

LEON BRITTAN
[Approved by the Chief Secretary
and signed in his absence]

Nat Indx, Policy, A7

①

~~cc~~ J.V.

Prime Minister

Agree this proposal, as modified in the exchange of letters with the Chief Secretary (attached) i.e. for a borrowing limit of first £2,300m then £2,700m?

Yes and

MES 14/10

NEW ST. ANDREWS HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

PRIME MINISTER

SCOTTISH ELECTRICITY BOARDS' BORROWING POWERS

The aggregate outstanding borrowing of the Scottish Electricity Boards is limited to £1,950 million by Section 29 of the Electricity (Scotland) Act 1979. The Boards expect to reach this limit some time during the financial year 1983-84 and we must therefore have new legislation increasing the limit on the Statute Book by next Summer Recess at the latest. A place has been booked in the Scottish Legislative Programme next session for an Electricity (Financial Provisions) (Scotland) Bill to increase the Boards' statutory borrowing limit. The Bill's proposals are in line with previous practice. Past experience suggests that they are unlikely to be seriously challenged although there is likely to be some discussion about electricity prices, Torness and the Invergordon smelter closure.

Past practice has been to fix an overall limit of the amount expected to be required to cover the Boards' borrowings for 6-7 years ahead with an interim limit to be reached after about three years. This interim limit can only be exceeded by Order requiring an affirmative resolution of the House of Commons.

I propose therefore that the borrowing powers conferred by the Bill should be related to a maximum of £2,800 million with an interim limit of £2,400 million. These limits are lower than the estimates provided by the Boards and in my opinion reflect the position more accurately. I would be grateful for your agreement to proceed with this legislation.

I am copying this minute to other members of E(NI).

G.Y.

G Y

4 OCTOBER 1982

CONFIDENTIAL NATIONALISED INDUSTRIES

cc J.V.

Prime Minister (2)

MCS 1/10

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

1 October 1982

The Rt. Hon. Lord Cockfield,
Secretary of State for Trade

Dear Arthur

PUBLICITY FOR MONOPOLIES AND MERGERS COMMISSION (MMC) REPORTS

There have been various exchanges recently, starting with Gerald Vaughan's letter of 27 July, about the need to do everything possible to capitalise on MMC Reports. This is a worthwhile aim in itself. It is also something we have been thinking about in the context of the discussions we are having with senior backbench MPs about the future role of the C&AG.

The position of the nationalised industries is central to these discussions. An important element of the Government's position has been to encourage the PAC (or other Select Committees) to follow up MMC Reports as a counter to the argument that the C&AG should have access to, and report on, the nationalised industries. Anything which can be done to emphasise the importance we attach to MMC reports will be helpful in this context. One possibility that has been suggested is that the Government could usefully publish either annually or as a one-off exercise a report drawing together progress in implementing past MMC Reports. This would provide a focus for attention in addition to the specific Parliamentary statements which ought to be made on individual reports.

If we were to take this idea forward, we should need to do so with some care in the light of progress we make in the discussion about the role of the C&AG. But at first sight it seems to me to be an idea worth pursuing. If you agree, it would be helpful if our officials could work up a proposition in more detail.

I am copying this letter to members of E(NI).

GEOFFREY HOWE

CONFIDENTIAL

c/c JV

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon George Younger TD MP
Secretary of State
Scottish Office
Dover House
Whitehall
London SW1A 2AU

JA 28/9

27 September 1982

Dear Secretary of State,

OBJECTIVES FOR THE SCOTTISH TRANSPORT GROUP (STG)

You wrote to Geoffrey Howe on 9 September setting out revised draft objectives for the Scottish Transport Group.

I am broadly content with the objectives proposed which, as you say, have been discussed between our officials. An important ommission is of course any reference to privatisation. The possibility now being studied of privatising the Group as a whole would have important implications for future operation and I think it important that the objectives contain an unambiguous statement of our intentions in this respect. When the merchant bank studies now underway are completed I hope you will be able to bring forward quickly to E(DL) a paper setting out your proposals on privatisation which will allow us to reach a collective view on what objectives should be given to the group in this respect. In the mean time, the objectives will have to be held back from STG. While this delay is regrettable I believe it is worthwhile because it enables us to clarify those important questions.

I am copying this letter to members of E(NI), to Sir Robert Armstrong and to Mr Sparrow.

yours sincerely

for LEON BRITTAN
/Approved by the Chief Secretary
and signed in his absence/

Nat Ind

Policy

Pt 7

Prime Minister (2)

MES 24/9

cc

NEW ST. ANDREWS HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

MS

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

23 September 1982

NATIONALISED INDUSTRIES: PROGRESS SINCE THE CPRS REPORT
SCOTTISH TRANSPORT GROUP

I am writing to report on the progress so far in implementing the CPRS recommendations so far as the Scottish Transport Group (STG) is concerned. For convenience this report follows the sequence of recommendations as they were presented to NICG.

P+6

I minuted on 26 February about objectives for STG's two main operating subsidiaries, Caledonian MacBrayne and the Scottish Bus Group. There was as you know some delay in E(NI) in settling the manner in which the exercise should be handled but we have made further progress over the summer, and revised proposals went to you on 9 September. We now have a study underway on potential for privatisation of STG, and our conclusions on that will need to be fed into the objectives in due course. Obviously, we have not yet discussed objectives with STG.

To assist our own business understanding we have had an accountant on secondment to the sponsoring division for STG for the last year. We are now trying to recruit a further accountant from one of the major firms, and with appropriate business experience, for an extended secondment. He will assist my officials in dealing with STG and with the two Scottish Electricity Boards.

Discussions have been underway with the Group throughout the summer on proposals for improved monitoring. These can most appropriately be pursued now in the context of discussions of the Group's corporate plan review.

As to better self regulation of the Group, we have already encouraged the Chairman to review the senior management of Caledonian MacBrayne, which has given us particular cause for concern; and I hope that some changes will be made soon which should improve that Company's public image and capacity for policy planning. As you know, in the general pursuit of greater efficiency, we have referred Caledonian MacBrayne to the Monopolies and Mergers Commission for a section 11 inquiry. This is now underway.

I have met the Chairman of the three Scottish nationalised industries for an initial discussion on this exercise, and since then Allan Stewart has met the whole STG Board, and the head of the sponsoring Division has attended a Board meeting. In addition Allan, Alex Fletcher and I meet the Chairmen and Board members from time to time on an informal basis; and we attach great value to keeping in touch in this way. We agree, however, that a more formal meeting with the STG Board annually will be a useful supplement.

As to membership the Board currently stands at 10 - a full-time Managing Director who is Deputy Chairman, a part-time Chairman, and 8 other part-time members. There is one vacancy caused by a recent death, and two other vacancies occur at the end of the year. Because of the mix of abilities currently on the Board and our wish to strengthen business expertise, we propose to fill all these vacancies. However a larger number of vacancies arise at the end of 1984, and it will be appropriate then to consider whether the overall size of the Board should be reduced.

Thus we are making good progress, within the constraints of staff resources, with implementation of the CPRS recommendations.

The important thing, however, is to achieve the broad objectives which the CPRS identified - that is, basically, a more satisfactory understanding and relationship between Government and the nationalised industries. As time passes and the report itself recedes in our memories we shall need to guard against the temptation to have an officious regard for the form rather than the substance of the CPRS recommendations

I am copying this to other members of E(NI).

GEORGE YOUNGER

Nat Ind o/c JV

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Rt Hon Leon Brittan QC, MP
Chief Secretary to the Treasury
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1

NBM
MS 23/9

22 September 1982

Dear Leon

I have seen a copy of your letter of 3 September to Reg Eyre about the NBC performance and corporate plan review.

I think I should make clear before we meet on Thursday that I cannot entirely accept what you say either about NBC's record in controlling unit costs, or about investment.

It is certainly true that unit costs rose substantially in 1980 as a result of a large real wage increase conceded by NBC, along with the rest of the bus industry. But in 1981 the company achieved a quite remarkable reduction in unit costs of 4.4% in real terms (against our performance aim of a 3% reduction); and I think we should give them credit for this.

Nor do I believe that we have any evidence for regarding NBC's investment plans as ambitious. On the contrary, in the light of what the company say in their Corporate Plan about vehicle lives exceeding depreciation lives, it may well be that their plans are too low for the long term health of the business. We should in my view reserve our judgement on this until the discussions between our officials and the company are complete.

Yours ever

David

DAVID HOWELL

Nat Ind

Policy

Pt 7

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CONFIDENTIAL

qc JV

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

20 September 1982

John Sparrow Esq
Central Policy Review Staff
70 Whitehall
London
SW1A 2AS

NBPM

MS 22/9

Dear Mr Sparrow,

NATIONALISED INDUSTRY OBJECTIVES: THE POST OFFICE

Thank you for your letter of 8 September to David Saunders.

We accept that there has been useful discussion on Post Office objectives since last December, but I think our discussions have shown how difficult it is to set clear cut objectives for a body which under statute has a number of different obligations.

2 So far as the review of long term strategy for the Post Office is concerned, the Secretary of State, as he said at his meeting with you on 12 July, is anxious that the Post Office should not be burdened with a full scale review and he would like to concentrate the study on the impact of new technology in the Post Office. I understand that preliminary talks have already been held between the Post Office, the CPRS and officials of this Department, and the Secretary of State will look forward to hearing about the outcome of the study in due course.

3 I am sending a copy of this letter to the Private Secretaries to the Prime Minister, other members of E(NI) and to Sir Robert Armstrong.

Yours sincerely

Caroline Varley

CAROLINE VARLEY
Private Secretary

Wat Ind

Policy

Pt 7

22 SEP 1982

NEW ST. ANDREWS HOUSE Natlnd
ST. JAMES CENTRE
EDINBURGH EH1 3SX

MBPM

MLS 13/9

CONFIDENTIAL

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1

9 September 1982

Dear Geoffrey,

OBJECTIVES FOR THE SCOTTISH TRANSPORT GROUP (STG)

I now attach revised draft objectives for the Scottish Transport Group, which have been re-formulated in the light of our discussions in the Spring in E(NI). I was grateful for comments on my earlier proposals from Mr Sparrow. I have also seen the subsequent exchanges between Leon Brittan and David Howell about NBC objectives, and there have been useful discussions between our officials.

As you will see I have as before proposed separate sets of objectives for the Scottish Bus Group and for Caledonian MacBrayne. These are the two main operating arms of the Scottish Transport Group and their respective businesses are, obviously, very different. To have set objectives for STG as a whole would have been a pointless and anodyne exercise; and I see no benefit in setting objectives for STG's other very minor activities which are in general little more than providers of management or other related services for the Group itself. (The exception is MacBrayne Haulage, but it may anyway be a candidate for privatisation - see below).

I have not included privatisation objectives for the bus group or for Caledonian MacBrayne simply because that is premature. But you will know that a merchant bank is now looking at STG as a whole, with a view to possible privatisation. I will report on the outcome as soon as possible. We shall thereafter know how privatisation should be carried forward in relation to STG, and what if any reference needs to be made to it in Group objectives.

I am copying this letter to members of E(NI), to Sir Robert Armstrong and to Mr Sparrow.

Yours ever,

George.

SCOTTISH BUS GROUP

(i) It shall be the objective of the Company, acting within the statutory and financial framework, to provide road passenger transport services in and to and from Scotland, in accordance with commercial principles.

(ii) The Secretary of State will from time to time set medium-term targets for the Company and these may reflect social as well as economic considerations. It shall be the objective of the Company to meet the financial target, and the associated borrowing and financing limits, and in so doing provide as substantial as possible a network of stage carriage services to meet demand, especially in rural areas, having regard to

(a) the willingness of passengers to pay

(b) the ability to cross-subsidise services on a regional basis, and

(c) the willingness of local authorities to provide financial support where necessary.

(iii) Subject to objective (ii) to improve efficiency by reducing unit costs and use assets in the most efficient and economical way; and, in particular, to achieve the performance aims determined by the Secretary of State from time to time.

(iv) To liaise fully with local authorities over the provision and standards of bus services within their areas and to keep these matters under review.

(v) In carrying out its programme of investment to use techniques of appraisal agreed with the Scottish Development Department, and to aim to keep whole life vehicle costs to the minimum.

(vi) To keep in touch with developing thinking on new ways of providing passenger transport services by road, particularly in rural areas.

CALEDONIAN MACBRAYNE

(i) Having regard to the financial target determined by the Secretary of State from time to time and to the needs of the local communities served, to provide efficient shipping transport services to the Western Isles and on the Clyde estuary.

(ii) To keep under review their ferry network's timetables and routes so as to ensure the best matching of services and local needs.

(iii) To consult local interests fully in the pursuit of (ii).

(iv) To use existing assets in the most economical way and to achieve such performance aims as the Government may determine from time to time.

(v) To contain external financing requirements within the limits set by the Secretary of State.

(vi) To use techniques of appraisal agreed with the Department in carrying out its programme of investment, and in doing so to take into account technical innovation, likely changes in patterns of need over the lifetime of the proposed investment, and also of the need for optimal flexibility in the future use of ships.

(vii) To have particular regard in the provision of its services to providing the maximum benefit to island economies, particularly by encouraging indigenous economic activity and job creation.

Prime Minister (2)

The Treasury seem to be injecting some momentum into this necessarily large and unweildy process.

To note.

MCS 9/9

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Michael Scholar Esq
No. 10
LONDON
SW1

9 September 1982

Dear Michael,

ACTION ON NATIONALISED INDUSTRIES

The Chancellor recently had prepared within the Treasury a summary note bringing together the various strands of action which the Government has in hand on the nationalised industries. By definition, there is nothing new in this - it simply sets out in an organised framework matters which Ministers have in general already considered and agreed. The Chancellor thought however that the Prime Minister might find it useful for backbround reference, and I attach a copy accordingly.

I am sending a copy also to Richard Hatfield and Gerry Spence.

Yours ever,

Peter

P S JENKINS
Private Secretary

CONFIDENTIAL

NATIONALISED INDUSTRIES : ACTION CHECKLIST

The following action checklist has been prepared following a review within the Treasury of action to implement the general directions of present Government policy towards the nationalised industries. These directions relate to the need to secure greater efficiency, first, by maximising competition and exposure to market forces, which would take the form of privatisation wherever this was achievable; second, by sustained and determined use of the existing framework for controlling those industries (largely monopoly providers of essential services) when market forces could not be introduced either through privatisation and/or competition.

2. Action towards these objectives can be conveniently grouped under 3 headings:

(i) privatisation and competition;

(ii) strengthening the framework of control; and

(iii) improving the quality of Chairmen and Board Members.

The checklist summarises work already in hand and indicates the areas where the case for greater effort or new initiatives is recognised.

(i) Privatisation and Competition

(a) Pursue existing privatisation programme energetically.

BNOC (November/December 1982, subject to favourable market conditions); BTBD (January 1983, subject to resolving dispute over Port Talbot and BSC); BFC - Wytch Farm (early 1983); BGC - North Sea oil assets (possibly summer 1983); BA (possibly autumn 1983); BT (legislation in 1982-83 session, initial asset sales immediately following a General Election).

Action: To ensure that all the legislative and administrative steps are taken to time (Sponsor Departments and Treasury).

(b) Ensuring continued pipeline of privatisation cases.

Action: Need to follow up Prime Minister's recent minute to E(DL) (now circulated to other Cabinet members) asking for candidates by September. These need to cover both the smaller cases where privatisation action might be taken in this Parliament and also ideas for a programme for the next Parliament. The latter should include plans involving the major monopoly utilities. (Sponsor Departments and Treasury).

(c) Action on major monopolies.

Action: Partly covered by (b). In addition CPRS on-going study for reducing monopolies. Major section on privatisation. Report by autumn. (CPRS, in discussion with the Treasury and Sponsor Departments.)

(d) Increasing competition, strengthening market pressures, role of private finance.

Action: To encourage Departments and industries to suggest ways of introducing greater competition and market discipline into industries particularly monopolies; including viable proposals for private capital (e.g. bond-type finance, project finance, joint ventures, franchising, contracting out, etc.).

Action: Sponsor Departments and Treasury. Treasury participation in Working Parties for BR, BAA. Action under (b) and (c) also relevant.

(ii) Strengthening the Framework of Control

(a) Setting strategic objectives.

Programme in hand for all industries; need to be explicit about business and social objectives.

Action: Sponsor Departments, CPRS and Treasury.

(b) Setting tight EFLs.

Annual programme through the IFR culminating in EFL-setting in the autumn. Effective monitoring throughout the year.

Action: Sponsor Departments and Treasury.

(c) Financial targets.

In operation for virtually all industries. Need to re-set when they expire and to monitor throughout. Should be explicitly related to strategic objectives.

Action: Sponsor Departments and Treasury.

(d) Performance aims.

In place for little more than half the industries. Further push needed to get them accepted for all industries.

Action: Treasury and Sponsor Departments

(e) Improved monitoring.

To achieve better understanding of the industries as businesses and early warning of likely problems.

Action: Sponsor Department to agree and implement improved arrangements with the industries.

(f) Efficiency

External (MMC and management consultants): Need to ensure that the enhanced programme rolls forward with adequate references in number and quality, and with effective follow-up.

Action: Department of Trade, Treasury, Sponsor Departments.

Internal: Encourage the industries to improve their own arrangements for monitoring efficiency, e.g. by internal Efficiency Audit Committees or moving towards VFM auditing.

Action: Sponsor Departments, Treasury, CPRS.

(g) Annual Corporate Plan appraisal and performance review.

Need to consolidate and build on the new system after initial trial year (1982), so that proper business strategies are developed.

Action: Treasury and Sponsor Departments.

(h) Determination of levels of investment.

Ensure better appraisal of investment programmes and projects with sound methods and standards of appraisal by all industries.

Action: Sponsor Departments, Treasury.

(iii) Improving the Quality of Chairmen and Board Members

(a) Selection procedures.

Need for early and effective action by Sponsor Departments to ensure that vacancies are filled in a timely manner. Greater role for PAU both as a clearing house for approaching candidates and for a more active input into departmental selection and appointment processes.

Action: Treasury has initiated consultation with PAU/MPO. Sponsor Departments and NICG will need to be involved later.

(b) Need for better Board structures.

e.g. Smaller Boards, majority of non-Executive Directors, on lines of CPRS report.

Action: Sponsor Departments, reporting centrally with timetable for action.

(c) Contracts of service, compensation, etc. for Chairmen and Board Members.

Action: Treasury/MPO to consider what improvements are possible and worth pursuing. Subsequent discussions with NICG.

(d) Board Members' pay.

Sponsor Departments to put proposals for 1982 to Treasury for individual industries.

Action: Sponsor Departments.

Treasury and NICG Working Party on performance-related pay for 1983 and following years.

Action: Treasury.

HM TREASURY
7 September 1982

NBPM
PUS 8/9
2 ... S

CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765

Qa 06061

From: John Sparrow
CONFIDENTIAL

8 September 1982

David Saunders Esq
Private Secretary to the
Secretary of State for Industry
ASHDOWN HOUSE
S W 1

Dear David,

Nationalised Industry Objectives: The Post Office

I have seen a copy of your letter of 31 August to John Kerr.

I think I should make it clear that the CPRS criticism from which you quote read in full: "Statutory objectives, I am sure you will agree, are hopelessly vague. I think you need to bring them to Ministers' attention but they are not germane to business objectives."

This reflects the CPRS view that the present objectives exercise should go beyond statutory obligations and should seek to clarify what the Government really wants from nationalised industries - the point which the Chancellor makes in his 5 August letter on 'the overall character of Government policy for the particular industry'.

It would be unfortunate if recipients of your letter were left with the impression that there has been no further constructive discussion or progress on Post Office objectives since that December letter. In fact, the CPRS's 7 April note to Ministers (E(NI)(82)11) sets out various questions on the longer term development of the Post Office which it suggests Ministers need to answer before clear objectives can be defined. The CPRS therefore proposed that there should be a review of the long term strategy for the Post Office. The Post Office, the Department of Industry and the CPRS have agreed to work together on that review and will be starting on it in the next few weeks.

I am sending a copy of this letter to the Private Secretaries to the other members of E(NI), and to Sir Robert Armstrong.

Yours sincerely,

John.

John Sparrow

08 SEP 1982

CONFIDENTIAL

P.0845

PRIME MINISTER

Progress in implementing CPRS Report on Relationship between Government and Nationalised Industries:
E(NI)(82)25 and 27

These notes by the Central Policy Review Staff and the Chief Secretary, Treasury, are summary reports on the current situation regarding:

(i) Progress on objectives, monitoring and Board structures (E(NI)(82)25; and

FLAG A

(ii) the system of performance review and corporate plan appraisal (E(NI)(82)27.

FLAG B

FLAG C

You will recall that you have recently received a report from the Secretary of State for Energy (minute of 26 August) on progress in the energy industries; Mr Rickett's letter of 31 August to the Department of Energy conveyed your strong approval.

2. Both notes show that progress has been made, but that there is more to be done. The details differ quite significantly from industry to industry; and I suggest that little is to be gained at this stage from an extended discussion. If the proposals in E(NI)(82)25 are endorsed, there will be appropriate opportunity for the Sub-Committee to consider individual industries.

3. I therefore suggest that you should invite Mr Sparrow and the Chief Secretary, Treasury to introduce their notes, concentrating on the points which they consider to need Ministerial attention. You might then ask the Secretaries of State for Industry, Energy, Scotland and the Environment whether they see any difficulties in the recommendations at paragraph 2(b) to (g) of E(NI)(82)25. (Paragraph 2(a) of that paper, and E(NI)(82)27 are simply recommendations to 'take note'.)

CONCLUSIONS

4. You will wish the Sub-Committee to endorse the programme outlined in E(NI)(82)25, subject to any points that may be made in discussion.

PLG

P L GREGSON
Cabinet Office
7 September 1982

cc JU

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

NBPM
MCS 8/9

The Rt Hon Sir Geoffrey Howe, QC, MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

7 September 1982

Dear Geoffrey

END-YEAR FLEXIBILITY FOR NATIONALISED INDUSTRIES

I have just seen the July correspondence between Nigel Lawson, Patrick Jenkin, John Sparrow and yourself about end-year flexibility for capital spending by nationalised industries.

I need hardly say that I am in favour of any steps we can take to ease artificial restrictions on worthwhile investment. I would myself attach the highest priority to helping central Government programmes in this way. It is in that area that the criticism from Members of Parliament and interests such as the construction industry has been strongest, and the loss of productive work caused by rigid annual cash limits is hardest to defend.

I can also see a case for allowing nationalised industries rather more flexibility for capital spending within the EFL system if suitable means can be devised. But Nigel Lawson's formula might I think be open to manipulation by the industries. It could also lead to difficulty where, as can sometimes happen, the provision taken into account in settling the EFL differs from the industry's investment ceiling.

It might be helpful if officials could do some work on the technicalities, therefore, before we return to the subject in the autumn.

Copies of this letter go to those who received Nigel Lawson's letter of 13 July.

Yours ever

David

DAVID HOWELL

P.0844

PRIME MINISTER

Quarterly Monitoring Report (June 1982):
E(NI)(82)26

BACKGROUND

Flag A
Flag B
Flag C

This memorandum by the Chief Secretary, Treasury, with its associated note by Treasury officials, continues the regular series of quarterly monitoring reports on the nationalised industries. The previous report, for the quarter ending March, 1982, was circulated as E(NI)(82)14 and discussed at E(NI)5th Meeting, Item 2. That meeting, among other things, invited the Chief Secretary to consider whether the deadline for the submission of monitoring returns from the nationalised industries should be extended from the present four weeks after the end of the relevant quarter to six weeks. E(NI)(82)26 also discusses this question.

MAIN ISSUES

2. The issues can be divided into two categories:

(i) The information revealed by the latest monitoring returns on external financing limits (EFLs) and investment in fixed assets; and

(ii) possible changes in procedure to improve the present monitoring system.

External Financing Limits

93

3. The only industry to forecast a significant overshoot beyond its EFL is British Rail. The forecast overshoot is £167 million, of which £90 to £130 million is attributed to industrial action. British Rail has corrective action in hand. You will no doubt wish to ask whether it is sufficiently vigorous, and whether extra finance could be raised by additional sales of assets.

4. The report also suggests that British Airways may be at risk of breaching its EFL, largely because of higher redundancy costs (which may be offset at least in part by higher proceeds from the disposal of assets). You may wish to ask for an up to date assessment from the Secretary of State for Trade.

5. Finally, the National Coal Board is also suggested as a potential cause for concern; but it is hard to assess the prospects until the outlook on the wages front is clearer.

Fixed Assets

6. A number of industries are forecasting lower investment in fixed assets than allowed in the FSBR* forecast. However, the report by officials gives what appeared to be satisfactory explanations for most cases. The main possible exception is British Telecom: the factors given in the report seem to be things that might reasonably have been allowed for in the original forecasts. You may wish to ask the Secretary of State for Industry whether he is satisfied with British Telecom's forecasting methods.

£315m

7. A general point made by the Chief Secretary is that it is undesirable that industries should reduce investment in fixed assets rather than current costs in order to stay within their EFL: he asks the Sub-Committee 'to ensure that cuts in capital spending only take place as part of an agreed strategy to reduce costs'. Clearly the general sentiment is right; but it is not possible to ensure that the result desired by the Chief Secretary will be achieved. Ministers do not have the necessary powers; and there is the danger that if they discourage their industries from reducing investment they will be blamed for any resulting overshoot of the EFL. You may therefore think it right that any conclusion of the Sub-Committee should be expressed in more guarded terms.

Procedures

8. The Chief Secretary was invited at E(NI)5th Meeting to consider extending the deadline for the submission of returns from four to six weeks after the end of the relevant quarter. The main reason for this was that many industries refuse to submit returns until they have been approved

6 weeks

* Financial Statement and Budget Report

by the Board; and the timetable for board meetings does not necessarily fit the timetable for the submission of monitoring returns. It was suggested that a deadline of six weeks would be more likely to be respected.

9. The Chief Secretary, however, argues that an extension would reduce the chances of being able to take timely corrective action; and that the existing deadline should therefore be maintained. He suggests that existing procedures should be tightened as follows:

(a) all quarterly monitoring information sent by the industries to sponsor departments should be copied simultaneously to the Treasury; and

(b) industries should similarly send copies of all monthly funds flow statements to the Treasury by the end of the calendar month following the period to which they relate.

These suggestions appear to mean no more than that the industries should send copies of all monitoring material to the Treasury as well as to the sponsoring department. Some departments and industries may see objection to this on the grounds that it may confuse responsibility; but it should be possible to work out arrangements at official level that will avoid such a risk.

10. Finally, the Chief Secretary suggests that since many industries have been unwilling to provide quarterly forecasts of capital requirements, internal resources, and external financing requirements, officials of sponsoring departments should be instructed to fill the gap. This would be very much a second-best solution: industries will feel no responsibility for forecasts prepared by sponsoring departments, and are very unlikely to answer questions based on comparisons between departmental forecasts and their own outturns. Similarly, departments will always have the excuse of 'special factors', of which only the industries could be expected to be aware. The desirability of having quarterly forecasts against which to

monitor outturn was accepted by Ministers in principle in September 1981 (E(NF)(81)2nd Meeting) as part of the CPRS monitoring proposals. Clearly it is most important to have budgets against which to monitor outturn; and you may think it better to ask sponsoring Ministers to take the question up personally with their Chairmen before concluding that the attempt to secure quarterly budgets from the industries themselves must be abandoned.

HANDLING

11. It will be convenient to divide this item up into two parts:

(i) information in the current monitoring report and the prospects for individual industries;

(ii) possible improvements in monitoring procedures.

You will wish to ask the Chief Secretary, Treasury to introduce the first part of the discussion. The Secretaries of State for Transport, Trade and Energy might then be asked to comment on the prospects for British Rail, British Airways, and the National Coal Board respectively, and the Secretary of State for Industry on the adequacy of British Telecom's procedures for forecasting investment in fixed assets.

12. The Chief Secretary, Treasury could also be asked to introduce the second part of the discussion. All sponsoring Ministers are likely to have views. Mr Sparrow will wish to comment from the standpoint of the CPRS work on monitoring arrangements.

CONCLUSIONS

13. You will wish to Sub-Committee to reach conclusions on the following:

(i) Any further information or corrective action required in respect of particular industries because of the prospects for EFLs and expenditure on fixed assets shown in E(NI)(82)26.

(ii) Whether the industries are to be given any guidance on reductions in expenditure on fixed assets in order to stay within their external financing limits.

(iii) Possible changes in monitoring arrangements, especially -

(a) the deadline for the submission of monitoring returns;

(b) sending information to the Treasury direct as well as to sponsoring departments;

(c) whether officials should now be instructed to draw up quarterly budgets of capital requirements, internal resources and external financing requirements if industries are unwilling to provide such budgets themselves.

PLG

P L GREGSON
Cabinet Office
6 September 1982

RESTRICTED

Prime Minister (4)

CC JV

MCS 6/9

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Reginald Eyre Esq MP
Parliamentary Under Secretary
of State for Transport
Department of Transport
2 Marsham Street
London SW1P 3EB

3 September 1982

NATIONAL BUS COMPANY (NBC): PERFORMANCE AND CORPORATE PLAN REVIEW

Thank you for your letter of 20 August enclosing a review of NBC's performance and corporate plan.

I welcome the progress the NBC has made, particularly in the last two years. But their poor record in controlling unit costs is cause for concern together, as you say, with the continuing losses made by the non-stage businesses. Our aim must be to reverse these trends in the future and I shall be looking for consequent improvements in NBC's financing projections. I think it is also worth recording now that NBC's investment aspirations, while starting from a very low base, in total struck me as ambitious. The very limited room for manoeuvre we have on the financing side means that the justification for plans on this scale will need to be gone into in considerable detail.

Overall, I agree that the Review identifies the right issues and forms a useful basis on which to tackle NBC about them. The timetable is obviously tight. We will need to take a preliminary view on some of the issues towards the end of September in the course of our bilateral discussions of the IFR projections. I hope, therefore, the discussions at NBC can get under way and be completed as quickly as possible.

I am copying this letter to the Prime Minister, Members of E(NI), to George Younger and to John Sparrow and Sir Robert Armstrong.

LEON BRITTAN

RESTRICTED

MBPM MCS 1/9 JV

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Nat Ind

JU665

Secretary of State for Industry

31 August 1982

John Kerr Esq
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Dear John

NATIONALISED INDUSTRY OBJECTIVES

I am writing to let you have this Department's comments in reply to those contained in the Chancellor's letter of 5 August to my Secretary of State. We were a little suprised to receive further comments of a drafting nature at this stage, since the drafts which were sent to the Chancellor had already been agreed at official level with both Treasury and CPRS. I set out below the Department's reactions to the suggestions made.

The Post Office

The revised main objective now proposed in fact summarises part of the existing statutory duty of the Post Office. A clause on these lines was included in the original draft sent to the Treasury last December but it was criticised by CPRS as "hopelessly vague" and "not germane to business objectives", and was therefore withdrawn. However, we do not wish to resist the Chancellor's suggestion, as in our view objectives for the Post Office cannot be as clear-cut as the CPRS and Mr Hoskyns would wish.

National Giro

We are content to accept what the Chancellor proposes.

British Shipbuilders

BS are under a statutory duty to prepare a Corporate Plan annually. We have in the past avoided saying that we "agreed" the Corporate Plan since this carries the implication that we are committed to maintaining a particular configuration of yards. What we have done is "agree" the financial limits. The reference to the Corporate Plan therefore fits better in objective 2 than objective 1. On this basis objectives 1 and 2 would be as follows:

1. Operation as a commercial enterprise and

(a) to reach, as quickly as practicable, a state of enduring profitability;
(b) to earn an appropriate real rate of return on its assets;
(c) progressively to reduce its requirements for Government finance; and
(d) to pay dividends on its capital.

2. Meet the financial targets which will be set by the Secretary of State after consideration of BS's annual Corporate Plan and which will reflect the Government's policy of reducing financial support for BS."

This re-formulation has been agreed with Treasury officials.

British Steel Corporation

In this case also, we do not formally agree the Corporate Plan. We see difficulties about adopting the wording suggested, and will discuss the matter with you at official level.

We can agree the suggested amendment to the last two lines of objective 1.

British Telecommunications

My Secretary of State gave the draft objectives to Sir George Jefferson on 2 August, with a view to discussion and eventual agreement, following agreement of these objectives by E(NI). We agree with the Chancellor's point about the performance objective, which has yet to be drafted, but should prefer not to make any other alterations until we have received comments from BT. We will bear in mind the other suggestion if a suitable opportunity arises during discussion to put it forward.

I am copying this letter to the Private Secretaries to other members of E(NI) and to Sir Robert Armstrong.

Yours sincerely
David Saunders

DAVID SAUNDERS
Private Secretary

FILE

da

Nat Ind

10 DOWNING STREET

From the Private Secretary 31 August 1982

The Prime Minister has seen your Secretary of State's minute of 26 August, in which he reports to E(NI) on the progress of bilateral discussions with the nationalised energy industries in implementing the proposals in the note sent to the NICG, and on the composition of the Boards of the industries. The Prime Minister has asked me to say that she considers the arrangements that your Secretary of State has made to be quite excellent.

I am sending a copy of this letter to Richard Hatfield (Cabinet Office).

W.F.S. RICKETT

Julian West, Esq.,
Department of Energy.

2PPS 2

Prime Minister

cc

Thank you. Excellent arrangements.
MT

PRIME MINISTER

see Pt 6

At meetings of E(NI) earlier this year we agreed that sponsor Ministers should report to the Committee:

i. on the progress of bilateral discussions with the industries in implementing the proposals in the note sent to NICG;

ii. on what adjustments to the Boards of the industries are desirable in order to improve their effectiveness.

Bilateral Discussions

On objectives, the substance of our objectives for the NCB has been fully accepted by the new Coal Board Chairman, Norman Siddall. I have written to colleagues with the final version of the CEGB objectives: I believe these will be generally acceptable to the new CEGB Chairman, Sir Walter Marshall. Once these are settled, we will be able to establish objectives for the electricity supply industry as a whole. The draft BGC objectives are currently being discussed at official level with the Treasury and CPRS. I hope to be able to put them to colleagues soon.

I have written to the chairmen of the industries to open discussions on other items in the NICG note. Officials, with the co-operation of the Treasury and CPRS, are working with the industries to develop our technique of monitoring and producing performance reviews as background to consideration of the corporate plans. Both BGC and the CEGB have already formed efficiency audit committees drawn from their non-executive directors.

Nationalised Industry Boards

As we agreed when we discussed this on 11 May, more important than any abstract recipe for the size or structure of the Boards is the quality and mixture of abilities of the individuals who comprise them. I have already taken a number of steps and will be taking more over the next year to improve the performance of the Boards for which I am responsible.

In the case of the NCB, the last few months have been dominated by the appointment of a new chairman and two new deputy chairmen. I have taken steps to improve the efficiency of the Board's workings by regrouping all the main activities of the Board under the deputy chairmen, the senior of whom has been given specific responsibility for improving co-ordination in areas where it has been weak in the past. I plan to strengthen the Board further over the coming year.

As for BGC, I have substantially strengthened the Board by the appointment of 3 new top-flight part-time members from the private sector, one (Martin Jacomb) from the City and two (Derek Birkin and Sir Leslie Smith) from industry. The number of full-time executive members has been reduced from 7 to 5. Two BGC Regional Chairmen are also part-time members, though one resigns in August and will not be replaced. The current deputy chairman also retires next June and I am using this opportunity to reconsider the role of that position on the Board. I am satisfied that the appointment of the 3 new high-calibre part-time members has already improved the overall quality of the Board and do not propose, at present, replacing any members before their appointments expire.

The current structure of the Electricity Council, numerically dominated by the Area Board chairmen, is governed by statute and changes can be considered only in the context of changes in the structure of the industry as a whole. What matters most on electricity, however, is the CEGB Board. This currently consists of 5 executive and 5 non-executive Members. It has been greatly strengthened not only by the appointment of Sir Walter Marshall as Chairman, but also of Eric Sharp and Richard Giordano as non-executive members. I will wish to discuss further changes with Walter Marshall as he settles in. The Area Electricity Boards currently have 9 members each, of which two, the chairman and deputy-chairman, are full-time executives. There is a constant flow of appointments to these Boards, and in making them I am continuing the policy of strengthening their industrial/business experience.

I am copying this minute to colleagues in E(NI)

NL.

NIGEL LAWSON

26 August 1982

In the case of the NCB, the last few months have been dominated by the appointment of a new chairman and two new deputy chairmen. I have taken steps to remove the difficulties of the Board's working by regrouping all the main activities of the Board under the deputy chairmen, the senior of whom has been given specific responsibility for improving co-ordination in areas where it has been weak in the past. I wish to strengthen the Board further over the coming year.

As for BSC, I have substantially strengthened the Board by the appointment of 3 new top-flight part-time members from the private sector, one ([illegible]) from the City and two (Derek Birkin and Sir Leslie Smith) from industry. The number of full-time executive members has been reduced from 7 to 5. The BSC Regional Chairmen are also part-time members, though one resigns in August and will not be replaced. The current deputy chairman also retires next year and I am using this opportunity to reconsider the role of that position on the Board. I am satisfied that the appointment of the 3 new high-calibre part-time members has already improved the overall quality of the Board and do not propose, at present, to make further changes before their appointments expire.

The current structure of the Electricity Council, historically originated by the Area Board chairmen, is governed by statute and changes can be considered only in the context of changes in the structure of the industry as a whole. What matters most on electricity, however, is the CEGB Board. This currently consists of 5 executive and 5 non-executive members. It has been greatly strengthened not only by the appointment of Sir Walter Marshall as Chairman, but also of [illegible] and Richard Giordano as non-executive members. I will wish to discuss further changes with Walter Marshall as he settles in. The Area Electricity Boards currently have 9 members each, of which two, the chairman and deputy-chairman, are full-time executives. There is a constant flow of appointments to these Boards, and in making them I am continuing the policy of strengthening their industrial and business experience.

I am copying this minute to colleagues in E(NI).

[illegible]

WM 20/8

~~CC~~ J.V.

Nat Ind

01 211 6402

The Rt Hon Sir Geoffrey Howe QC MP
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

26th August 1982

Dear Geoffrey

END YEAR FLEXIBILITY FOR NATIONALISED INDUSTRIES

Thank you for your letter of 28 July. I have also seen John Sparrow's of 22 July and Patrick Jenkin's of 23 July.

I must confess I am not convinced by the arguments you put forward, at least on the question of capital underspending. Rather than continue the discussion now, I agree that we should return to this and related questions in the autumn.

I am copying this letter to the Prime Minister, other members of E Committee, George Younger and Sir Robert Armstrong.

Yours ever
Nigel

NIGEL LAWSON

SC

Nat Ind

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB
01-212 3434

My ref: H/PSO/26382/82

Your ref:

The Rt Hon Leon Brittan QC MP
Chief Secretary to
The Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

20 AUG 1982

Prime Minister

Dear Leon,

NATIONAL BUS COMPANY OBJECTIVES

Thank you for your letter of 28 July to David Howell, who is abroad at present.

I can accept the compromise you propose. I am sending the agreed objectives to Lord Shepherd today, with a covering letter making clear that we expect the Company to put forward firm proposals by the end of this year for the privatisation of property and by September 1983 for the privatisation of National Express and National Holidays. I shall also say that we intend to publish the objectives themselves, in the autumn. We shall aim at joint publication as suggested by John Sparrow in his minute of 2 August to the Prime Minister.

Ref-1

I am sending copies of this letter to the recipients of the earlier correspondence.

Yours ever

Reg

REGINALD EYRE

cc JU

RESTRICTED

PARLIAMENTARY UNDER SECRETARY OF STATE

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref:

Your ref:

20 August 1982

Prime Minister 2

The Rt Hon Leon Brittan QC MP
Chief Secretary of the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

MS

Dear Leon,

NBC PERFORMANCE AND CORPORATE PLAN REVIEW

E (NI) Committee decided earlier in the year that Performance and Corporate Plan Reviews for the smaller industries should be cleared in correspondence.

I enclose on David Howell's behalf a Review of the National Bus Company, which takes account of discussions with your officials. The main points of the review of past performance are summarised in Annex A to this letter. I believe that the NBC management emerge with considerable credit, though we must obviously be concerned about rising costs and about the disappointing performance of the non-stage businesses.

At Annex B, I attach a summary of the main points which officials have identified for action between now and the time when final decisions on the Investment and Financing Review are taken in the Autumn. All these recommendations are important, but that requiring a review of the medium term financial target will pose particular difficulties, given the problems with NBC can expect to meet in the future as our policies for the control of local authority transport subsidies put more pressure on local authorities, and make it more likely that they will decide to cut rather than increase current levels of revenue support.

I suggest that our officials should now get on with discussing the action points with the Company, and report back by the end of October.

I am sending copies of this letter to the Prime Minister and other members of E (NI), to George Younger and to John Sparrow and Sir Robert Armstrong.

Yours ever
Reg.

REGINALD EYRE

ANNEX A

NATIONAL BUS COMPANY

Performance Review - Summary and Conclusion

Stage Services

1979-81 saw a rapid decline in demand for stage carriage services. Over the period as a whole, NBC succeeded in improving productivity while reducing the size of the business. The company remained within the EFLs set for it and bettered its performance aim.

Costs increased in real terms over this period. Unit costs increased particularly rapidly in 1980 when demand declined by 8%. Services were reduced by only 2%, but fares had to be increased by 11% in real terms and NBC still incurred a net loss of £32.9m.

In 1981, management action secured unit cost reductions and improved productivity. Fares were increased by only 2%;but services were reduced by 8%, broadly in line with the fall in demand in that year. Financial results improved, the c.c.a net loss being reduced from £32.9m to £18.2m.

Investment

Very substantial reductions were made in investment over the period. Further reductions have been made in 1982. The current low level of vehicle purchases is a product of several special factors, and a somewhat higher level may be necessary in the longer term.

Non-stage businesses

The position of the non-stage businesses is disquieting. All incurred losses on a fully allocated cost basis over the period. Although the contribution accounts show a more favourable picture much depends on NBC's definition of "long run unavoidable costs".

NATIONAL BUS COMPANY

Corporate Plan Review - Recommendations for action

In responding to NBC's 1982 Corporate Plan, the Government should give priority to the following proposals:

i. Reviewing NBC's business strategy, especially in relation to the fares/services trade off and variations in the forecast level of revenue support;

ii. Reviewing theGroup medium term financial target, with a view to establishing its relationship to a commercial return on assets;

iii. Setting a medium term performance aim to control costs, including maintenance costs;

iv. Seeking a firmer justification for the investment proposals, and an analysis of their consequences for whole-life costs;

v. Setting a new financial target for National Express and National Holidays;

vi. Pressing for an improvement in the financial performance of local coaching;

vii. Improving the contents of the 1983 Corporate Plan.

hm 23/8 cc JV

PARLIAMENTARY UNDER SECRETARY OF STATE

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB
01-212 3434

My ref: H/PSO/26263/82

Your ref:

Dr G Vaughan
Minister of State for Consumer
Affairs
Department of Trade
1 Victoria Street
LONDON SW1H OET

20 AUG 1982

Dear Gerry,

Ref-2 You wrote to David Howell on 27 July about the present procedure for handling the various stages of Monopolies and Mergers Commission reports on nationalised industries. David is still away on holiday, so I am replying on his behalf.

It is very important that we get the procedures right, and I am most anxious that we should not make too little of any substantive competition issues which arise from these reports. It would however be a mistake to under-estimate the stimulating effect which the mere announcement of an investigation seems to have on the industries concerned. I think that it puts them under very useful immediate pressure to try to put their house in order so as to avoid criticism. I think that the Department of Trade can attract a good deal of media attention when an investigation is announced.

Following that stage I can see no way, however, of deciding the handling of publicity in general - we need to look at each report on its merits. Indeed Nigel Lawson has already made this point in his letter to you of 5 August.

The real problem as I see it is how to ensure adequate publicity at the time that the report is published. The difficulty of course is that we do not want to be premature in our judgments, and we can never be certain that we shall be able to welcome all the findings in a report. It is, however, a fact that this is the point where the Press are likely to take the maximum interest, and I would not normally expect to get so much interest at the time of the three months stocktaking and the one-year follow-up. I think that unless the Commission specifically recommend action under competition law, publicity at the time of publication of the report must be primarily the responsibility of the sponsor Ministers, since the detail of statements at this stage must be tied in with the policy the sponsor Ministers are pursuing in relation to the industry. But I am sure that we should keep in very close touch with you about what it would be right to say about any general competition aspects in the report. It would also seem right to me to emphasise the place of any particular report in the coherent rolling programme for which the Department of Trade are responsible.

We might also be able to stress the importance of the programme in relation to nationalised industries generally in some at least of the reports to Parliament which will be appropriate at later stages.

I am sending copies of this to members of E(NI).

Yours ever
Reg.

REGINALD EYRE

cc JU

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

Prime Minister 2

13/8

CONFIDENTIAL

From the Secretary of State

Michael Scholar Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SWI

12 August 1982

Dear Michael,

FOLLOW-UP TO CPRS REPORT ON NATIONALISED INDUSTRIES

E(NI) on 8 March invited sponsor Ministers to report by the end of July on progress made with discussions with the chairmen of the nationalised industries they sponsored on the implementation of the CPRS report on nationalised industries; on 11 May, the Committee asked Ministers to include in their report how they proposed to apply the CPRS recommendations on board size and composition.

Nat Ind, Policy, Pt 6

I summarise below progress to date on the main CPRS proposals in relation to British Airways and the British Airports Authority.

A Objectives

For British Airways these were agreed in discussion between my Secretary of State and Sir John King on the basis set out in the Secretary of State's minute of 3 March to the Prime Minister, with the addition of an overriding objective, which Lord Cockfield believes encapsulates the detailed objectives, that British Airways should be "floated off as a prosperous, efficient private sector company standing in high repute with its customers, its staff and its shareholders". In view of the current litigation, the British Airports Authority are understandably and acutely sensitive to the statutory basis of their relationship with the Secretary of State. They are therefore concerned that any changes we propose in our relationship should not lay them open to further challenges in the courts. They have not therefore formally responded yet to the draft objectives agreed by E(NI). Following recent contacts, we believe that progress can be made on the draft objectives agreed by E(NI) but perhaps more slowly than with some other less exposed nationalised industries.

B Corporate plan and performance reviews

The CPRS's main proposals have been agreed with both BA and the BAA.

CONFIDENTIAL

CONFIDENTIAL

From the Secretary of State

C Monitoring

British Airways have agreed in principle to let us have on a regular basis broadly the same information that now goes to the Board. Price Waterhouse have been advising BA on how to improve the information going to the Board and their proposals were rather similar to those of the CPRS. The newly appointed Chief Financial Officer will also have views on what the Board needs. We have not yet started receiving this more detailed information from BA, but we are pressing them to introduce the new arrangements as soon as possible. BA have provided us with a phased budget, as they had already done last year. Agreement has been reached with the BAA on improved monitoring arrangements and the provision of a phased budget; these arrangements have now been implemented.

D Board size and composition - self-regulation

Sir John King's major preoccupation in this area has been the structure of British Airways' Board and he has recently proposed some changes. He has not yet responded on other aspects of the CPRS's proposals. He is giving further consideration to the question of establishing an enhanced committee structure on the Board, including the possibility of an internal audit committee. The BAA have received a report from Professor J Hunt of the London Business School on their internal management structure and implemented almost all its findings, including the creation of a new corporate planning section, the strengthening of the internal resources devoted to audit of performance, and a re-structuring of senior management responsibilities. (As an interesting innovation for a nationalised industry, the BAA has this year, for the first time, published its own performance review as an adjunct to its annual report and accounts). The BAA Board already accords with the CPRS recommendations on size, and it has a majority of non-executive directors. It established an internal audit committee some years ago; though its composition includes executive members of the Board. It has been agreed that the Chairman and other full-time members of the Board may seek part-time directorships to widen their experience (we had previously agreed this in principle in the case of BA). Both the BAA and BA have increased financial responsibility for individual senior managers (in the case of BA through a new divisionalised structure.

I am copying this letter to the Private Secretaries of members of E(NI) and of Sir Robert Armstrong and Mr Sparrow.

Yours sincerely,

JOHN RHODES
Private Secretary

FROM THE MINISTER FOR INDUSTRY AND EDUCATION

SCOTTISH OFFICE
NEW ST. ANDREW'S HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

Dr Gerald Vaughan MP
Minister of State for Consumer Affairs
Department of Trade
1 Victoria Street
LONDON
SW1H OET

10 August 1982

12/8

MONOPOLIES AND MERGERS COMMISSION (MMC): FOLLOWING UP REPORTS

I have seen your letter of 27 July attached to David Howell.

I do agree that we should take full credit for the programme of Section 11 references. In Scotland at least there should be no problems; the Report of the current investigation into Caledonian MacBrayne will generate considerable press interest when it is published, regardless of what Ministers say at the time. We will certainly emphasise again, as we did when the investigation was announced, that this is part of a rolling programme of references under Section 11 of the Competition Act. We need to do this to assure the industry concerned that it is not being singled out and that the reference is not the result of any particular disapprobation. We can take care also to emphasise the positive aspects of the rolling programme of references.

I think we should be careful about going any further. Such reports as we have seen so far following Section 11 investigations have been substantial documents which do not admit of instant responses. Such responses might be difficult to avoid if we were to hold press conferences such as you suggest. They would be particularly unfortunate in the present delicate state of our relations with nationalised industries; and would not necessarily help us in reaching sensible conclusions with them on implementation.

I am copying this letter to Members of E(NI).

ALEX FLETCHER

FILE

bc JV
cc CPRS D/Ind
CO SO
WO DOE
D/M HMT
D/Trans
CSO
DOT

da

3

10 DOWNING STREET

Nat Ind

From the Private Secretary

9 August 1982

Dear Julian

Nationalised Industry Objectives - Policy Letters

The Prime Minister has seen your Secretary of State's minute of 27 July, and the subsequent minutes from Mr. Sparrow of 2 August and from the Chancellor of the Exchequer of 5 August. She is content with your Secretary of State's essentially three-tiered procedure for the publishing of statements of objectives for the nationalised industries, subject to the qualifications expressed by the CPRS and the Chancellor of the Exchequer.

I am copying this to the Private Secretaries to other members of E(NI), to Adam Peat (Welsh Office), Richard Hatfield (Cabinet Office) and to Gerry Spence (CPRS)

Yours ever

Willie Rickett

Julian West, Esq.,
Department of Energy.

SECRET

CONFIDENTIAL

CC JV

Prime Minister 2

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

5 August 1982

The Rt. Hon. Patrick Jenkin MP
Secretary of State for Industry

Dear Patrick

NATIONALISED INDUSTRY OBJECTIVES

I am replying to your letter of 30 June attaching the latest drafts of objectives for the nationalised industries sponsored by you and for BL and Rolls-Royce. These represent a useful step forward towards clarifying the objectives of the industries but I still have a number of comments. These are of two kinds. I have a number of detailed suggestions to make on the content of some of the drafts but I am also concerned about the lack of consistency both in structure and presentation between the proposed drafts for the different industries.

I shall leave aside the objectives for Rolls-Royce which you say are being reconsidered and BL, with which I am content. Indeed John Sparrow's draft of BL's objectives is commendable for its simplicity and clarity.

I recognise that the diversity of the remaining industries, and of the conditions in which they operate, make it impracticable to adopt an identical format for their objectives. It would not be appropriate to elaborate for BS or BSC the same sort of detailed complex of objectives as has been done for BT and the Post Office. Nevertheless in my view there remains scope for greater consistency in the shape and general methodology of the objectives.

Nearly all the drafts have as their first objective a statement setting the overall character of Government policy for the particular industry. This general approach was lucidly argued by John Hoskyns in his minute of 30 April and it seems to me right. For the Post Office, however, there is no clearly defined central principal to which the Hoskyns' hierarchy of objectives and sub-objectives could relate. Instead the fundamental aim of the Post Office is diffused through Objectives 4 and 11. These need to be brought together, preferably as the first objective. On a more detailed point Objective 4 which refers to maintaining an effective postal service consistent with "the highest

/quality of

quality of service demanded by the customer" goes well beyond the statutory requirements of Objective 11 and, if interpreted literally, could prove very expensive. To meet both points I would suggest for a first objective something along the following lines (supplanting existing Objectives 4 & 11):

> "[The prime objective of the Post Office is] to provide as far as practicable (and to the extent that no other person offers a service) such services throughout the UK for the conveyance of letters as satisfy all reasonable demands. In providing such services to operate commercially and to have regard to the social, industrial and commercial needs of the UK."

In other respects the objectives for the Post Office seem broadly acceptable.

Having established the overriding objective of the industry, the drafts in the main set out the subsidiary aims necessary for the achievement of the first. There is some difference here in the treatment of Government targets such as EFLs and financial targets. In the BS and BSC drafts they are subsumed into the first objective while for Giro they are left to the last; and for the Post Office and BT they are in between. Given the importance we attach to the control of the financing of BS and BSC the prominence given to these targets is appropriate. However it is not so clear why Giro should differ from the Post Office and BT in this respect. For Giro Government targets, currently 3(iii), (iv) & (v), could be given more prominence by bringing them into Objective 2 where they would be shown as (iv), (v) & (vi). The preamble to Objective 2 would need to be amended to read:

> "To meet the above objective, in a manner consistent with Government policy, Giro should:".

This would also tidy up the last section of the Giro objectives which at present equates Giro's policy on industrial relations and technological innovation with its obligations to Government.

I am not entirely content with the British Shipbuilders' objectives: Objective 1 in particular seems rather obscure. Moreover a reference to the annual Corporate Plan needs to be included to provide a logical basis for speaking later, in Objective 3, about "corrective action". To meet these points I suggest that Objective 1 should be redrafted as follows:

> "1. Operate as a commercial enterprise in accordance with an annual Corporate Plan, agreed with the Government, and:
>
> > a) to reach, as quickly as is practicable, a state of enduring profitability;

b)

b) to earn an appropriate real rate of return on its assets;

c) progressively to reduce its requirement for Government finance; and

d) to pay dividends on its capital."

The following paragraph, which is in the nature of a comment on Objective 1, should be deleted since it detracts from the clarity of the objective.

The objectives for BSC are generally acceptable except for two points. First, it would make sense (as in British Shipbuilders) to bring up into Objective 1 the reference to the Corporate Plan currently in Objective 3. Second, the last two lines (following the semi-colon) of the first objective would be better in the following form:

> "... and progressively reduce the need for financing by the Exchequer with the aim of generating sufficient profits by 1985-86 to cover its capital investment needs without recourse to the Government."

This change avoids an explicit reference to "self-financing", which would be inconsistent with CMND 7131 and Government evidence to the Treasury & Civil Service Committee.

Finally, if it is not too late, I would like to make two points on BT's objectives. 5(c) on improving labour practices might sensibly be separated as an objective in its own right to follow 4 - so the need to attach monopoly labour practices is as clearly recognised as the need to develop good business practices in what has until recently been a State monopoly supplier. Second, the as yet undrafted performance objective should be at least as testing as that proposed in your paper E(NI)(82)22.

I am copying this letter to other Members of E(NI) and to Sir Robert Armstrong.

GEOFFREY HOWE

-5 AUG 1982

S E C R E T

Prime Minister 2

Both the Chancellor and the CPRS (minute attached below) agree in general with Mr Lawson's approach to publishing statements of nationalised industry objectives. They add only minor qualifications.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

NATIONALISED INDUSTRY OBJECTIVES - POLICY LETTERS

with PM

Nigel Lawson sent me a copy of his minute of 27 July on the publication of policy letters agreed for the nationalised industries.

2. I agree with Nigel that we are clearly committed to publishing some statement of objectives for each of these industries; that what is said would depend on the circumstances of the particular industry; that publication should be at a time of the Government's choosing; and that the form of publication should be at the discretion of the sponsor Minister. I also agree with his proposals for handling the more sensitive material excluded from what is published.

3. I would make two qualifying points. First, given the public interest in the objectives, the normal presumption ought to be in favour of fairly full publication, although I recognise that this must stop short of revealing objectives which are at all sensitive. Second, the timing and form of publication should be decided in consultation with the Chairman concerned. As Nigel points out, the objectives will have been agreed with the Chairmen and Boards. We want the industries to feel fully committed to the objectives and their publication will be an event of some importance for them. It therefore needs to be handled sensitively.

4. As far as the NCB is concerned, Nigel's proposals for publication involve a fairly drastic pruning of the policy letter to the Chairman. However the NCB is a particularly sensitive case; and much of the letter was concerned with

tactics which would in any case be unsuitable for publication. While I can therefore go along with what is proposed we may well want to somewhat fuller publication in other cases.

5. Finally, I note that Nigel proposes some modification of the particular paragraphs for the purpose of publication. The letter was of course collectively agreed; if the modifications are at all substantial, therefore, I should be glad if we could be consulted at official level.

6. I am copying this minute to other Members of E(NI), the Secretary of State for Wales, Sir Robert Armstrong and Mr Sparrow.

(G.H.)
5 August 1982

5 August 1982

MR RICKETT

Nat. Ind

STRUCTURE AND MEMBERSHIP OF NATIONALISED INDUSTRY BOARDS: BRITISH RAIL

In his note of 4 August, Mr Howell proposes that we leave the size and structure of the British Railways Board unchanged until the Government has taken decisions on the basis of the Serpell report, which is due in early November.

There are two points here to which I should like to draw the Prime Minister's attention. First, it would be at least as logical to make the changes before decisions have to be taken about the long-term future of the railways, to ensure that we are dealing with as sympathetic a Board as possible. Second, the Prime Minister will recall her wish, which she expressed openly a few weeks ago, that one of the vacancies be filled by Sir John Hoskyns.

JOHN VEREKER

Nat Ind
IV

WM
8/8

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

Dr Gerard Vaughan MP
Minister of State for Consumer Affairs
Department of Trade
1 Victoria Street
LONDON SW1

5th August 1982

Thank you for sending me a copy of your letter of 27 July to David Howell about the publicity attending the publication of MMC reports on the nationalised industries.

I have no view on the handling of the particular report on bus undertakings which has just been published. However I do think that the publicity for each report should be considered on its merits. In particular, I would not wish to encourage expectations of a press conference on the report on the NCB until I know what it says and have assessed its impact in the circumstances surrounding its publication.

However, I see the need for coherence in Government responses and therefore attach great importance to adequate interdepartmental consultation in cases where there are to be separate press statements.

I am copying this letter to recipients of yours.

NIGEL LAWSON

Prime Minister 2

cf JV

WR 4/8

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Nigel Lawson MP
Secretary of State
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

4 August 1982

MS

Dear Nigel,

Thank you for your letter of 30 July enclosing a revised draft of an open policy letter to the new Chairman of the CEGB. It does seem sensible to be able to make this policy guidance public wherever we can.

I quite understand why you would prefer to deal with the points I raised in my letter of 22 June in your confidential rather than public, guidance to the Chairman. That will meet my concern over the need for an early report on possibilities for injecting private risk capital into the industry and for the development of a more effective private nuclear industry. On purchasing, there is still a risk that even confidential guidance given by the Government could leak, causing embarrassment with the European Commission. I suggest that our officials try to devise a "safe" formulation, but if this proves impossible we may regrettably have to leave it out altogether.

I also appreciate why you have removed from the public document the objectives concerning a review of the role and structure of the CEGB and the maintenance of secure supplies of fuel. There seems to me a risk, however, that by not referring to the latter at all (at a time when the Government is widely reported to have directed that stocks should be built up), we may stimulate speculation that confidential directives have been issued on the point. This may be unavoidable, but the policy letter might usefully re-iterate the general duty of the Board to ensure security of supply so that we have something on record to point to if challenged. As well as the reference in objective (3) you might therefore consider rephrasing the last part of the first paragraph to read:

> "...economic system for the secure supply of electricity in bulk".

Finally, I take it that we shall be able to say that Sir Walter Marshall agrees with the policy objectives set out in the letter.

A copy goes to the Prime Minister, other colleagues on E(NI), Sir Robert Armstrong and Mr Sparrow.

LEON BRITTAN

CONFIDENTIAL

~~cc~~ JV

Prime Minister 2

LM 4/8

PRIME MINISTER

MS

STRUCTURE AND MEMBERSHIP OF BOARDS OF NATIONALISED INDUSTRIES

At E(NI)'s meeting of 11 May, it was agreed that Ministers would report back to the Committee on the scope for reduction in the size of Boards of Nationalised Industries and on steps which could be taken to increase the proportion of non-executive part-time members, with particular emphasis on their role in increasing the efficiency of the industries in which they serve. Here is the position on the Transport Nationalized Industries.

I am no longer concerned with the Board of the National Freight Company and I do not propose to suggest any changes on the British Transport Docks Board because I believe that the less disturbance there is in the months running up to flotation, which I am now expecting in January, the better.

As to the British Railways Board, I am sure that we must leave the size and structure of the Board until we have cleared our minds on the fundamental questions of future railway policy which we shall have to address when we have Sir David Serpell's Report. It would also be desirable to discuss our ideas with whoever is to succeed Sir Peter Parker in September of next year. Meanwhile, I shall look very carefully at the individual performance of members whose appointments come up for review. There are already two vacant places on the Board and the future of a third one is also before me now - the one which has been held for the past three years by Simon Jenkins. In one way or another I am sure that I must reinforce the Board in controlling the engineering side of British Rail.

CONFIDENTIAL

There is no Serpell Review to wait for in the case of the National Bus Company and so I can report exactly how I see this one developing. The Board has thinned out the top executive ranks below Board level and made a saving of around £150,000 a year by doing so. They run with a very small headquarters office which depends heavily on three full time members, Mr Robert Brook the Deputy Chairman and Chief Executive and two former managers from the field, Mr Rawlinson and Mr Dalton. There is at present another full time member, Mr Carruthers who is due to retire at the end of this year. I have already agreed with the Chairman, Lord Shepherd, that Mr Carruthers will not be replaced by a full time executive but by Sir Robert Lawrence on a part-time term not exceeding two years to get moving with the introduction of private capital into developing NBC property. This will give us a part-time Chairman, three full time executives and seven part-time non-executives. I have considered whether I could cut down the non-executives further, but since the Chairman, very sensibly in my opinion, makes the non-executives share out between them membership of the Boards of the 39 subsidiary companies I think that it would not really make sense to cut their number down.

Among them there are two very good young members whom I intend to reappoint at the end of this year - Geoffrey Parker from European Ferries (aged 44) and Kate Mortimer of Rothchilds (aged 34). The appointments of three of the other four are due to expire at the end of 1983, and on grounds of age or effectiveness I expect to be looking for new names. There will also have to be a replacement for Mr Rawlinson as a full time executive at the end of 1983. I shall need to be careful not to

CONFIDENTIAL

cut too deeply into the continuity of a Board which in recent times has been performing well, to testing financial targets in conditions of depressed trading.

I am sending copies of this minute to the Members of E(NI).

DH.

DAVID HOWELL

4 August 1982

CONFIDENTIAL

CABINET OFFICE

Central Policy Review Staff

With the compliments of

John Sparrow

70 Whitehall, London SW1A 2AS

Telephone 01-233 7765

Nat Ind. Pt JV

5 Mn's

WM 3/8

CABINET OFFICE
Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: John Sparrow

CONFIDENTIAL

Qa 06012 3 August 1982

The Rt Hon Nigel Lawson MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
SW1

Dear Nigel,

Policy Letter for the New Chairman of the Central Electricity Generating Board

I have seen your letter of 30 July 1982 to the Chief Secretary to the Treasury enclosing an amended version of the policy letter for Sir Walter Marshall.

I support your proposals and hope that it will be possible to include in the confidential guidance to the new Chairman the procurement objective as originally drafted, subject to any necessary qualification about international obligations.

I am sending copies of this letter to the Prime Minister, other members of E(NI) and to Sir Robert Armstrong.

Yours sincerely,

John

John Sparrow

CONFIDENTIAL

fc JV

CONFIDENTIAL

Qa 06008

To: PRIME MINISTER

2 August 1982

From: JOHN SPARROW

NI Objectives - Policy Letters

- TPM

1. I have seen the Secretary of State for Energy's minute of 27 July about the publication of policy letters.

2. In the CPRS report, the intention was that, once they had been agreed by Ministers collectively, clear objectives would form the framework for the relationship between the sponsor Minister and the Chairman. Whether such objectives were to be made public or not would be at the discretion of the Secretary of State. E(NI) took the view that some might even be too sensitive to be written down and circulated within Government, and might have to be agreed orally.

3. Nevertheless the direction in which a major nationalised industry should move is a matter of legitimate public interest, and Ministers have recognised all along that some version of the objectives would be likely to become public knowledge. Indeed, as a result of the Secretary of State for Industry's March 15 announcement of the changes the Government propose to make in their relationship with nationalised industries, objectives will inevitably be a matter of interest and public debate.

4. In my view it should be the objectives that are considered for publication. The objectives represent a clear and concise statement of the strategy approved by the Government for each industry at any time, and if anything is to be published it should in general be a suitably edited version of those objectives. Policy letters, on the other hand, have so far only been written for the NCB and CEGB, and this was mainly because in each case the appointment of the Chairmen was so pressing that there was no time to prepare objectives as such. I would therefore agree that in these two cases the policy letter should be published, whilst expecting that the normal course would be to publish the objectives alone.

5. I also support the three-tier approach put forward by the Secretary of State, distinguishing between objectives that are to be conveyed orally, confidentially in writing and those that are to be published.

6. I suggest that, once the Chairman and Board have agreed to a version for publication, this might be published jointly by the Secretary of State and Chairman. This would have the advantage of securing the Chairman and Board's public commitment, and reduce the risk that any debate on difficult points could be reopened in public.

7. Once the objectives for NCB and CEGB have been published, there will no doubt be pressure for objectives for all the other industries to be published as well. As a matter of handling, I would not recommend that the remaining sets of objectives should be published as a group; indeed, it would be advantageous if the publication could be kept fairly low key. While the setting of objectives is an important development, the publishable versions are likely to omit or play down the more contentious points, and the Government could be criticised for avoiding key issues. The justification for publishing objectives for NCB and CEGB first is that they have been agreed as part of the process of appointing a new Chairman. Objectives for other industries will be agreed in due course, and in appropriate cases Ministers may wish to link their publication with the appointment of new Chairmen.

8. I am sending copies of this minute to other members of E(NI), the Secretary of State for Wales, and to Sir Robert Armstrong.

JB.

JF1317 RESTRICTED

Nat Ind

Nat Ind Policy

Prime Minister 2

PRIME MINISTER

PROGRESS IN IMPLEMENTATION OF CPRS REPORT ON RELATIONS BETWEEN GOVERNMENT AND NATIONALISED INDUSTRIES

It was decided at E(NI)(82)4th Meeting that sponsoring Ministers should report as at the end of July on progress in implementation of the major recommendations (other than those concerned with increasing expertise in Departments).

2 Below I give an account of the position in relation to each of the industries sponsored by my Department.

THE POST OFFICE

3 I have discussed with the Chairman the points set out in the paper circulated by the Chancellor to members of the NICG.

4 Mr Dearing was in agreement with the broad thrust of the paper, but made the following points:-

there would need to be effective recognition of the diversity of nationalised industries;

the allocation of special roles to non-executive directors should not be allowed to destroy the unity of the Board;

there were an excessive number of bodies and organisations probing and asking for information; he preferred to deal only with the sponsor Department;

there was no objection to monitoring performance and setting objectives, but a detailed analysis of methods and systems was inappropriate.

5 I have some sympathy with all these points, particularly in the context of an industry which is operating profitably and is not a continual drain on the tax payers' money. At the same time the Post Office has invested in it a considerable amount of Government money and some oversight is essential. It is a question of finding the right balance.

6 On Board size and composition, the statute allows for 12 Board members, although at present there are only 11. The Chairman does not wish to increase the size of the Board though should he choose to do so I would expect him to propose to fill the vacancy with a part-time member. From the end of August, taking into account our wishes, the Board will be composed of a full-time Chairman, 5 full-time executives and 5 part-time Board members. In addition steps are in hand which should result in the appointment of two of the executive members as non-executive directors in the private sector. Consideration is also being given to devising a system whereby both the Chairman and Board members might be paid by results.

7 I do not think that it would be productive to attempt to press the Chairman to make further changes. The Post Office Board was, as you know, reconstituted less than a year ago, following the split of the old Post Office and British Telecom. Its structure was designed partly with the streamlining of senior management in mind and this will have enabled the chairman to cut out by September of this year the two most senior management levels on the postal side and to reduce the next level down by at least 3 posts.

8 Bearing in mind that the next expiry of a full-time Board appointment will be on 31 December 1983, I think that the Board structure from August this year can be regarded as a sufficient recognition of our wishes.

BRITISH TELECOM

9 My proposed objectives for the industry in the period before privatisation were taken by E(NI) on 26 July. I will now put the objectives to Sir George Jefferson. I met the full BT Board on their Corporate Plan, and put my Corporate Plan review to E(NI) also on 26 July. There are a number of matters arising from that review that I will be taking up with the Corporation.

10 Separately, my officials are seeking to improve the quality of information that we receive from British Telecom, specifically in the area of receiving a calenderised funds flow statement.

11 I have not pursued with British Telecom the question of Board size and composition. This is because the British Telecom Board is effectively set now for some time, since it was appointed only last October when the Corporation was formed. With our privatisation proposals, BT should now become a Companies Act Company before we would have the opportunity for any substantial alteration to the structure of the Board - which any way is not too far from reflecting the CPRS's proposals. We may, as sole shareholders before a sale, wish to consider the implications of Board Structure and membership for this, but this is a separate question.

BRITISH STEEL CORPORATION

12 We have, as you know, carried out a review of their past performance and of their Corporate Plan 1982/85; this review was considered by E(NI) in June when the EFL for BSC for 1982/83 was decided. We have continued to monitor BSC's performance in detail on a monthly basis. I have not yet held a discussion with Mr MacGregor on the future size and composition of the BSC Board: my main consideration here is first to ensure that there will be an effective top management team at BSC after the expiry of Mr MacGregor's term of office in June 1983.

BRITISH SHIPBUILDERS

13 Some of the points in the paper to the NICG eg strategic objectives have already been broached with the BS Chairman and action is in hand on some others, eg the Corporate Plan and performance monitoring, while BS has already created individual profit centres in moving to a divisional structure. However there has not as yet been a suitable opportunity to discuss the paper as a whole with Mr Atkinson.

BL AND ROLLS-ROYCE

14 These are not, of course, Nationalis~~t~~ed Industries nor are their Chairmen members of the NICG. However, they were included in the scope of the CPRS Report, and I have communicated the main proposals to Michael Edwardes and Frank McFadzean.

15 I have not felt it necessary to meet Michael Edwardes to discuss the paper given to NICG since his company's few comments on our proposals, which he wrote to me about, were not contentious. The BL Board is already of the size and composition suggested by the CPRS - small and with a majority of non-executive Board members.

16 I have discussed Board size and composition and the role of non-executive directors with Frank McFadzean whose reaction was

pretty negative. Rolls are of course operating in a highly competitive environment and the discipline of the market place requires that they pay close attention to efficiency. I believe that Rolls is as much disciplined by the market place as by Government control and direction and to a large extent therefore the recommendations would not be appropriate in their case. Our existing monitoring arrangements are close to the CPRS model. The Government's main concerns are in relation to financial performance and I am generally content with the present arrangements on financial monitoring of Rolls.

17 We are considering revised objectives for Rolls-Royce in connection with the appointment of a new Chairman.

18 I am sending copies of this minute to the members of E(NI), Sir Robert Armstrong and John Sparrow

PJ

PJ

2 August 1982

Department of Industry
Ashdown House
123 Victoria Street

cc ~~JV~~

Prime Minister (2)

To note

MLS 30/7

01 211 6402

The Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Parliament Street
London
SW1

30 July 1982

Dear Chief Secretary,

POLICY LETTER FOR THE NEW CHAIRMAN OF THE CENTRAL ELECTRICITY GENERATING BOARD

My minute of 27 July to the Prime Minister discussed the general issue of publishing policy letters to nationalised industry chairmen. If colleagues accept my proposals, I intend to send a letter on the lines of the attached draft to Sir Walter Marshall on the clear understanding that it will become public. I shall give him further confidential guidance on the points omitted from the version annexed to E(NI)(82)17.

Against this background, some of the changes to the draft with E(NI)(82)17 will be self-explanatory. I should however like to answer the particular points raised by you and other colleagues on that draft.

I recognise the potential problems with the Commission to which the original objective 1d (on purchasing) might have given rise and it has therefore been omitted. I should however like to include it in the confidential guidance, with a suitable proviso about our international obligations, and I note Patrick Jenkin's support for an objective of this kind. If you feel that there might still be difficulties, perhaps our officials could work out a satisfactory form of words.

You suggested that on competition and private risk capital, the Chairman should be asked to submit an interim report on the possibilities by the end of the year. I think you will agree that to include a particular deadline in a published letter could attract undue attention, but I will certainly make clear to Sir Walter Marshall that I should like his advice on these questions at the earliest practicable date.

As you will see, the objective relating to nuclear power has been much shortened and revised with an eye to publication, bearing in mind also the Government's position with regard to the Sizewell Inquiry - a point which Michael Heseltine raised. I shall aim to cover your point about the nuclear industry in the additional confidential guidance.

Michael also suggested the insertion of a new objective dealing with environmental standards. This point arose earlier in connection with the policy letter to the new chairman of the NCB, and my view is the same in relation to the CEGB; that compliance with environment standards is not an objective in its own right but a constraint within which the industry must operate. I hope therefore that Michael will agree, as he has in the case of the NCB, that there should not be a separate objective on this subject for the CEGB.

In answer to Mr Bailey (CPRS), I can confirm that we are discussing various aspects of corporate planning with the industry and my officials will keep the CPRS in touch on this.

Subject to colleagues agreement to my proposals on the general question of publication, I would aim to hand over a letter on the lines attached to Sir Walter Marshall as soon as possible.

I am copying this letter to the Prime Minister, other colleagues on E(NI), Sir Robert Armstrong and Mr Sparrow.

Yours sincerely

J.P. Ward

NIGEL LAWSON
(Approved by the Secretary of State
and signed in his absence)

POLICY LETTER FOR CEGB CHAIRMAN

This letter sets out the objectives which the Government wish you to pursue as Chairman of the CEGB. The objectives elaborate on the responsibilities and obligations placed by Statute on the Board as a whole, and in particular the duty to develop and maintain an efficient, co-ordinated and economic system of supply of electricity in bulk.

(1) Your prime objective must be to run the Board with maximum efficiency, ensuring that sustained and detailed attention to cost control extends through all aspects of the Board's activities. In this context:

(a) challenging cost control targets should be set wherever practicable, and carefully monitored;

(b) the Board should achieve its part of industry-wide performance targets which are set by Government;

(c) every effort should be made to ensure that power stations are built to time and cost.

(2) It must also be your objective to increase the scope for competition in electricity supply. You should review the prospects for the injection of private risk capital into areas of the Board's operations, and make positive recommendations to me wherever possible. In co-operation with Area Boards when appropriate you should seek to develop co-operation with private generators, ensuring that effective commercial and technical arrangements exist to take full economic advantage of their potential contribution to supply.

(3) In developing proposals for capital investment, your objective should be the production and distribution of electricity at the lowest possible cost consistent with maintaining adequate standards eg of security of supply. Capital investment proposals should be set out comprehensively for my approval, giving an account of the

strategic framework against which they have been developed. The Board should continue to pay close attention to the methodology used in capital investment appraisal.

(4) You should ensure that the Board does all possible to explore and exploit the full potential of nuclear power to contribute to the cheap; effective and safe production of electricity.

(5) The Board's plans for efficient operation, and cost-reducing investment, should be developed within the framework of a corporate plan for the industry, which will be reviewed annually with Government. They should take full account of the financial targets agreed with Government and of the industry's External Financing Limits. The Board should ensure regular and effective information flows to assist the Government and the Electricity Council to monitor performance in relation to those targets and limits.

(6) The Board should set its prices so as to reflect the costs at the margin of meeting demands on a continuing basis. It should pay careful attention to the impact of the bulk supply tariff on different categories of the electricity supply industry's consumers. In appropriate cases, the Board should be ready, subject to the provisions of Section 2(6) of the 1957 Electricity Act, to discuss with bulk industrial users and the Area Boards the possibilities of direct supply by the CEGB.

(7) You should work closely with the Chairman of the Electricity Council on all major issues affecting the industry. I shall be sending him a copy of this letter for his personal information. The need for close working relationships within the industry as a whole was stressed in David Howell's statement of July 1980, which I attach.

Finally, I should make clear that the Government may wish to give further guidance to you at a later date or to impose constraints from time to time, for wider reasons, on your ability to achieve one or other of these objectives.

Nat Ind Policy

CW ~~3/~~ 2/8

Treasury Chambers, Parliament Street, SW1P 3AG

Dr Gerald Vaughan MP
Minister of State for
Consumer Affairs
Department of Trade
1 Victoria Street
London SW1H OET

30 July 1982

Dear Minister,

MONOPOLIES AND MERGERS COMMISSION (MMC): FOLLOWING UP REPORTS

will request is required

Thank you for copying to me your letter of 27 July to David Howell. I agree entirely that we should do everything we can to capitalise on MMC reports and I am sure you are right to suggest that where reports throw up substantive competition issues these should be reflected in the statements subsequently made by the Government.

More generally, your letter prompts me to emphasise the need to keep to the original timetable for statements 3 and 12 months after publication of a report. There have been one or two cases recently where this timetable has showed signs of slipping. The aim of these statements, particularly the report after 12 months on what has actually been done, is to ensure that the industries concerned cannot put reports to one side however much they might wish to do so. It is crucial, for this discipline to be maintained, that the timetable is kept to in all cases except in the most exceptional circumstances. I hope that colleagues responsible for following up individual reports will give priority to achieving this aim.

I am copying this letter to members of E(NI).

Yours sincerely

T. Mattews

for LEON BRITTAN

[Approved by the Chief Secretary
and signed in his absence]

CONFIDENTIAL

Prime Minister (2)

The Treasury fending off extra spending again.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

The Rt Hon Nigel Lawson MP
The Secretary of State for Energy

28 July 1982 MCS 30/7

Dear Nigel

END-YEAR FLEXIBILITY FOR NATIONALISED INDUSTRIES

Thank you for your letter of 13 July putting forward ideas for increasing end-year flexibility for the nationalised industries, in particular in respect of their capital spending. John Sparrow in his letter of 22 July has written in support of the latter.

As you know, discussions of the note by officials circulated under C(82)29 have been postponed until the autumn. In view of the close relationship between this paper and the various ideas put forward in your letter it would seem sensible to hold over substantive discussion of your proposal also. However I have to say that I see quite considerable disadvantages in even your more limited proposals concerning capital expenditure. The main objection is that the reasons for shortfall in capital expenditure may not be ones which would justify a carry-over. They may result not from the slowing down of project expenditure but for some other reasons, such as inflation slower than forecast or revised market prospects, for which lower capital expenditure may be the proper commercial response. It would seem wrong to allow any underspending in such circumstances to lead to an additional allocation in the next financial year. I would also expect a scheme such as yours to lead to a marked increase in detailed monitoring of capital and other spending by the industries. In addition to this there is the familiar problem that any scheme of flexibility will lead to increased expenditure overall.

These objections apply a fortiori to the wider scheme encompassing current costs. Indeed it would seem to me illogical to reward economy on current costs by a bonus in the following year which might well erode the impulse to greater efficiency.

However I am quite willing to look at these ideas again when we return to the subject more generally in the autumn.

I am copying this letter to the recipients of yours.

GEOFFREY HOWE

c/c JV

Prime Minister (2)

MCS 28/7

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon David Howell MP
Secretary of State
Department of Transport
2 Marsham Street
London SW1P 3EB

28 July 1982

MS

Dear David,

NATIONAL BUS COMPANY (NBC) OBJECTIVES

Thank you for your letter of ~~23~~ TPM July. I am glad that you have felt able largely to accept my suggestions.

I would however like to return to the point about setting a timetable for privatisation of NBC's coaching and property subsidiaries. I accept that the uncertainties surrounding the prospects of privatising these companies make it difficult to set a target date for privatisation itself. I do however feel that we need to give some indication of the priority we attach to the privatisation objective which we wish the Company to pursue once the first step of producing separate accounts for the coaching businesses is complete. This could be done by including a target date for the Company to bring forward proposals for privatisation. This would leave the Company in no doubt about what we expected of it and the approach would also be more in line with the objectives we are agreeing for other industries where timetables are being attached to privatisation. Implementation of the proposals would of course be determined by the market.

I should be grateful if you could reconsider this point. I would be prepared to see it made in a letter to the Chairman accompanying the objectives rather than the objectives themselves if you felt that that was preferable to avoid offering up public hostages to fortune.

On the question of publication, you will I imagine want to give some thought to how and in what form the final objectives might be publicised. For my part I see no objection in the case to publishing the objectives themselves as they stand.

I am copying this letter to recipients of yours.

Ever
Leon

LEON BRITTAN

DEPARTMENT OF TRADE
1 VICTORIA STREET
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01-215 [illegible]
SWITCHBOARD 01-215 [illegible]

From the
Minister of State
for Consumer Affairs

The Rt Hon David Howell MP
Secretary of State for Transport

27th July 1982

I wonder if I could have your thoughts on the present procedure for presenting Monopolies and Mergers Commission Reports on Nationalized Industries under the Competition Act 1980 and whether or not we can make more out of them. As you will know the Report on four bus undertakings is to be published tomorrow. It has some important comments not only on efficiency but on the use made of financial muscle which has implications for private businesses, and is thus of particular interest.

As I understand it, the present procedure is for this Department on publication simply to announce that fact and that there will be discussions with the industry concerned. The sponsoring Department then discusses the report with the industry and makes a further statement usually several months later on any action to be taken.

This can mean that we undersell the value of the Nationalized Industry reference programme which is an important part of our strategy towards the control of state monopolies.

It is obviously too late to change the arrangements for tomorrow on which I have already written to Reg Eyre. But if we do not comment on the substance at the time publication I think we should certainly create more impact at the time of the further statement.

One way of doing this would be for this Department to make the statement emphasizing the competition aspects, but that would expose us to follow up questions on the detail which I do not think would be satisfactory. I can also see that the particular industry might feel concerned if their sponsoring Department were not involved.

I wonder, therefore, if we might consider having a joint presentation with the possibility of a joint Press Conference so that we could not only cover the immediate action in the industry but also create a stronger impression of a coherent rolling programme which in most cases will have positive results. We might also issue Press Statements, commenting on our individual interests.

Perhaps you and other recipients would let me have your views. The subsequent announcement on buses could be an opportunity for us to try something different.

I am sending copies of this letter to members of E(NI).

Gerard Vaughan

JV

Prime Minister (1)

1

PRIME MINISTER

Agree this 3-tiered approach?

MCS 28/7

Yes

NI OBJECTIVES - POLICY LETTERS

We have agreed on the content of the policy letters which might be sent to the Chairmen of the NCB and CEGB, incorporating our objectives for these bodies. The new Chairman of the NCB has accepted the objectives for his industry and will endeavour to persuade his Board to be guided by them.

However, we have not yet decided how we propose to deal with requests to see policy letters from, for example, Select Committees, the MMC, the trade unions and the press. (The Daily Telegraph reported on 17 June that we were working on a policy letter for the NCB.) We must clearly do so before I send any policy letters out.

We have always recognised the risk that they would leak and we have acknowledged that some of our objectives might be too sensitive to communicate in writing to the industries, let alone published. At the same time the objectives set out in the policy letters will be mostly of a kind which we will want the Chairmen to communicate fairly widely within their industries. There are obvious advantages in a common approach to handling this problem. I am writing now to let you know what I propose.

For every industry there should be some statement of objectives which should be published. Since we announced in the House on 15 March that we intended to agree such objectives with the industries, this is unavoidable. Moreover, in the note we sent to the NICG we spoke of objectives being agreed "with chairmen and boards". It would be best if we took the initiative in publishing the letters at a time of our own choosing. I therefore suggest that as a matter, of course our communications to the Chairmen should be published, probably by means of a Written Answer, though this would be a matter for each Minister's discretion.

I doubt whether all the policy letters could take a common form. What we say in each published policy letter will have to take account of the particular circumstances of each industry. In some cases the objectives we publish may be no more than a simple statement of the few strategic points which we recognised as the ideal at E(NI)'s third meeting this year. In other cases there may be no problem about publishing a policy letter giving a more extensive exposition of our objectives. Where the published letter is confined to only a few strategic points, it will be necessary to decide how best to convey our more sensitive objectives. The most sensitive of these should, I suggest be conveyed orally to the Chairmen on a personal basis and a record of the points made (and of the Chairman's agreement) could be kept in the Ministers' Private Offices for reference as necessary. Other material which, although less highly sensitive, is nevertheless unsuitable for publication, could be conveyed in writing in the form of a separate letter forming part of our normal confidential correspondence with the Chairmen on current policy issues. Such a letter would of course be circulated by the Chairman to Board Members. Responsible Ministers could discuss with individual Chairman how best to proceed.

With these considerations in mind, I have looked again at the draft policy letters for the NCB and the CEGB and have taken into account the comments of Norman Siddall and Walter Marshall. Siddall has accepted all the points in the text enclosed with my letter of 18 June to the Chief Secretary. But to publish a letter on these lines would play into the hands of Arthur Scargill. I therefore propose to send Siddall a letter which I would subsequently publish containing a slightly modified version of paragraphs 1 - 3 and paragraph 16 of that text. I would deal separately, in one or other of the ways I have proposed in the preceding paragraph, with the points in paragraphs 4 - 13. I have recorded separately that Siddall has already accepted paragraph 14.

My policy letters to the Chairmen of other energy nationalised industries will reflect the procedure I have suggested. I hope that you and other colleagues in E(NI) agree that we should follow this essentially three-tiered approach generally and that you are content for me now to proceed on the lines I have proposed.

I am copying this minute to other members of E(NI), the Secretary of State for Wales, Sir Robert Armstrong and Mr Sparrow.

NL.

Secretary of State for Energy
27th July 1982

Nat Ind Policy

CONFIDENTIAL

Qa 05993

To: PRIME MINISTER

23 July 1982

From: JOHN SPARROW

MMC - Efficiency References in 1983

1. E(NI) will be considering a paper (E(NI)(82)18) by the Chief Secretary on 20 July. The main point at issue is whether British Telecom (BT) should be referred to the MMC for a study in 1983.

2. The CPRS believes that there are sound reasons for doing this -

(a) the detailed knowledge of BT, its pricing and cost structure, in the Department of Industry is weak. BT has traditionally been secretive about its financial information and operating practices. If the proposed regulatory body is to do its job properly, it needs information about the business and a wide-ranging MMC enquiry should help provide this;

(b) BT is known to be abusing its monopoly powers. It has been cross-subsidising its services for many years. There may be other areas of abuse which have not come to the Department's attention. The MMC has been established to consider possible abuse of monopoly power;

(c) BT is known to be inefficient. Absolute wage levels in BT remain very high and bad working practices abound. The MMC has also been established to highlight instances of inefficiency in public bodies and should therefore be asked to investigate BT.

3. The reasons put forward by the Department of Industry for delaying a reference are not sufficient, since -

(a) even after the current liberalisation process and possible privatisation, BT will still be a monopoly for the bulk of its activities;

(b) a reference should not prejudice (and could, by clearing the air, assist) a successful flotation. The MMC would complete their work in 1983 while the earliest realistic date for flotation would be Autumn 1984;

(c) while MMC enquiries do impose a burden on the industries being investigated, for the reasons in (b) above, this should not clash too onerously with the additional work required for privatisation. BT should be able to deal with this;

(d) if a reference is delayed, it would be impractical to have an investigation in the year of a flotation and unreasonable to refer BT in the two years subsequent to privatisation. This would defer the enquiry until late 1986 at the earliest, which would be undesirably late.

4. I am sending a copy of this minute to Sir Robert Armstrong.

PJ.

JH 840

Prime Minister (2)

MCS 26/7

Nat Ind Policy

SCJV

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

23 July 1982

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Dear Geoffrey,

END YEAR FLEXIBILITY FOR NATIONALISED INDUSTRIES

I am writing to comment on Nigel Lawson's letter to you of 13 July.

2 I support the idea that there should be a complementary range of flexibility in relation to capital expenditure when an industry does not use the whole of its EFL in any particular year, and I would support a figure of 5%.

3 In the existing area of flexibility we already recognise that phasing of capital expenditure cannot be judged so nicely as to comply exactly with a pre-set EFL, and it would seem logical to apply the same principle when there is an underspend.

4 I am less convinced about the idea of using this mechanism to "reward" industries which have made current cost savings. I feel the motivational effect would be slight and that our attitude should be that current cost savings are essential and that management should not receive special rewards for making them.

5 I am copying this letter to the Prime Minister, other members of E Committee, George Younger and Sir Robert Armstrong.

Yours ever

Patrick

Nationalised Industries Policy

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

Prime Minister (2)

MCS 26/7

The Rt Hon Leon Brittan QC, MP
Chief Secretary to the Treasury
HM Treasury
Treasury Chambers
Parliament Street
SW1P 3AG

23 July 1982

Dear Leon

NBC OBJECTIVES

Thank you for your letter of 6 July. I have also seen George Younger's letter to you of 15 July.

I am in general content with the reformulation you have suggested, although I think it would help if the words "subject to paragraph 2 below" could be inserted in the first paragraph. This would make it clear that commercial objectives might be over-ridden by social ones if the Government so directed.

On your objective 2(a) our discussions with the Company have related specifically to their National Express and National Holidays operations, where I have made it clear that separation of accounts should be achieved by the end of this year. I would propose, therefore, to refer to those businesses and give the date of 1 January 1983. I am, however, doubtful about the wisdom of attaching a timetable to privatisation itself, as suggested in your 3(d), since any date could turn out to be something of a hostage to fortune given the uncertainties of the market.

My original objective (f) in fact omitted any reference to property, and I would therefore propose to replace the words "their coaching, holiday and express operations" by "National Express, National Holidays and property development".

Subject to these points I now propose to send the objectives to Lord Shepherd. I am copying this letter to the recipients of yours.

Yours ever

David

DAVID HOWELL

Nat Fund Policy

CABINET OFFICE

Central Policy Review Staff

With the compliments of
John Sparrow

70 Whitehall, London SW1A 2AS
Telephone 01-233 7765

cc JV

Prime Minister (2)

MCS 23/7

CABINET OFFICE
Central Policy Review Staff
70 Whitehall, London SW1A 2AS Telephone 01-233 7765

Qa 05992

From: John Sparrow
CONFIDENTIAL

22 July 1982

The Rt Hon Sir Geoffrey Howe QC MP
HM Treasury
S W 1

Dear Geoffrey,

End Year Flexibility for Nationalised Industries

I have seen Nigel Lawson's letter to you of 13 July and support the proposal to introduce more flexibility where there has been an underspend of capital expenditure cash allocation in any one year. At present when such an underspend is in prospect, nationalised industries are tempted to utilise the full extent of their EFL by inefficient devices such as early payment of suppliers' invoices for current operating costs. If an industry is allocated funds for approved capital expenditure, it is not in anyone's interests to remove the allocation if it is not possible, for whatever reason, to pay for that expenditure in the year in question.

I concur with the suggestion that industries should be permitted to carry forward to the following year some portion, say 5 per cent, of their EFL allocation for capital expenditure. This amount would be added to the following year's EFL; it should be clear that there will be a deduction of the same amount from the current year's EFL.

Nigel Lawson also raises the question of undershoot arising from savings in current costs. Here I believe that the net effect of carry forward would be disincentive, and I do not therefore support that part of his letter.

I am sending a copy of this letter to the Prime Minister, other members of E Committee, the Secretary of State for Scotland, and to Sir Robert Armstrong.

Yours sincerely,

John

John Sparrow

Nat Ind Policy

P. 0817

PRIME MINISTER

Monopolies and Mergers Commission (MMC) Efficiency Investigations:
Programme for 1983
(E(NI)(82)18)

BACKGROUND

E(NI) agreed in late 1981 that, as part of the Government's efforts to improve nationalised industry efficiency, up to six nationalised industries should be referred each year to the MMC. In February the Sub-Committee agreed on a programme of references for 1982.

2. The Chief Secretary's memorandum proposes that the Government should now announce that in the first half of 1983 there will be references of British Telecommunications (BT), British Shipbuilders and a bus operator; and that the provisional but not to be announced programme of references for the second half of next year should cover an aspect of the water industry, British Airways and area electricity boards.

MAIN ISSUES

3. The only issue for discussion at this stage is whether BT should be referred to the MMC in the first half of next year. Such questions as are still unsettled on the other proposed reference (for example the precise terms of the British Shipbuilders reference and which bus operator should be examined by the MMC) can be left to be settled later.

4. Some of the arguments for and against a BT reference are set out in the note by the Chairman of the Official Committee on Nationalised Industry Policy (NIP) attached to E(NI)(82)18. The arguments for referring BT appear to be:

(i) BT will dominate the telecommunications market, even when privatised for some time; it is important that there should be an early investigation of its efficiency.

(ii) E(TP) has agreed that the MMC should continue to have a role in monitoring BT's efficiency, perhaps every five years, after privatisation: it would be desirable to establish as soon as possible a benchmark against which further progress can be gauged.

5. The arguments against referring BT adduced in the NIP report are:

(a) a reference might in some way frustrate the privatisation programme, either by prejudicing a successful flotation or by putting an undue burden on BT's management;

(b) liberalisation and privatisation will themselves provide a stimulus to greater efficiency;

(c) there is anyway a possibility of the OFT referring BT to the MMC for the investigation of alleged anti-competitive practices in BT's radiopaging services.

6. You will want E(NI) to evaluate the strength of these arguments. On the face of it privatisation of BT and the Government's liberalisation programme for telecommunications do not expose the corporation to sufficient competition to remove any justification for an efficiency audit by the MMC. As the Secretary of State for Industry accepted in discussion in E(TP), BT will dominate telecommunications for many years to come. On the other hand a general MMC investigation of BT which lasted for much of 1983 might absorb some management time which would otherwise be spent on privatisation and liberalisation. The balance of argument may turn on what sort of investigation the MMC might undertake and how long it would last. One possibility appears to be an examination of BT's investment appraisal procedures - which could be limited in both scope and time and could be of value in helping to prepare BT for the more competitive environment in which it will have now to operate.

7. If a reference of BT is ruled out, the options are:

(a) to refer the Post Office; the NIP report suggests this as a fallback;

(b) to bring forward one of the references tentatively planned for the second half of 1983: a water reference might be the easiest to agree on now;

(c) to have only two references in the first half of 1983 - British Shipbuilders and a substantial bus reference (LT or a passenger transport executive) would seem to be a respectable six months' work.

HANDLING

8. The Chief Secretary, Treasury is likely to be unable to attend the meeting; if so, the Chancellor of the Exchequer will introduce the paper. The Secretaries of State for Industry and Trade will want to comment, as may other members of the Sub-Committee, and Mr Sparrow.

CONCLUSIONS

9. You will want to reach conclusions on the following questions:

(i) Can the Sub-Committee endorse the Chief Secretary, Treasury's proposals apart from the proposed reference of British Telecommunications?

(ii) Should British Telecommunications be referred to the MMC in the first half of 1983?

(iii) If not, should the Post Office be referred; should one of the references suggested for the second half of the year be brought forward; or should there be only two references in the first six months of 1983?

PLG

P L GREGSON

22 July 1982

Scott
Not ind

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

NBPM MS 16/7

The Rt Hon Leon Brittan QC MP
Chief Secretary
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

15 July 1982

Dear Leon,

NCB OBJECTIVES

Thank you for sending me a copy of your letter of 6 July.

So far as the Scottish Bus Group is concerned the position on social and commercial objectives is very much as David Howell has described. We set a financial target for the Group, and having made their dispositions to satisfy the target we expect them to provide as substantial a network of local bus services as they can. Maintenance of the network, which is desirable for social reasons, depends substantially on cross-subsidy. Local authority subsidy allows for the maintenance of a larger network than could be provided by internal cross-subsidy alone. We have the opportunity to influence the level of cross-subsidy by the financial target we fix.

SBG is on target to meet its medium-term financial target. The Select Committee on Scottish Affairs, in its most recent report, have repeated the customary criticisms of imposing a financial target on what they regard as being essentially social services: and we have to face up to the prospect in coming years of a deteriorating financial situation for bus services, as for example New Bus Grant is withdrawn and the opportunities for operating economies are exhausted.

However in the meantime I see no conflict between what is being proposed for the NBC, and my own approach for SBG. Our officials are in touch about SBG's draft objectives, about which I shall hope to write again formally, shortly.

I am copying this letter to David Howell, other members of E(NI) and to Mr Sparrow and Sir Robert Armstrong.

Yours ever,

George.

Prime Minister (2)

c/c JV

MCS 13/7

01 211 6402

MT

RESTRICTED

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1

13th July 1982

Dear Geoffrey

END YEAR FLEXIBILITY FOR NATIONALISED INDUSTRIES

Amongst the changes in the system of financial control of the nationalised industries which you announced in August 1980 was the arrangement under which industries could exceed the current year's EFL within a maximum of 1% of forecast turnover and fixed investment expenditure on condition that the amount of the excess was deducted from the following year's EFL.

Leon Brittan has now circulated a note by officials (under C(82)29) on end-year flexibility for public expenditure programmes, with details of a possible scheme for carrying forward to the following year underspends on capital expenditure.

The reasons for considering this again sympathetically (for example the difficulty of accommodating project expenditure to precise cash limits) are equally valid for expenditure of the same kind by the nationalised industries. I would like to propose that an industry should be allowed to carry forward to the following year an underspend on its capital expenditure allocation to the extent that such underspending is reflected in an EFL undershoot and subject to some suitable maximum, say 5% of the allocation. There would need to be a corresponding increase in the following year's EFL.

While this would not wholly meet the remaining concern of the industries about the incompatability of rigid EFLs with commercial operations, it would be a useful move which would enable them to plan and manage their capital spending on a more efficient basis.

It is also at least worth considering whether the nationalised industries might not be allowed to carry forward some proportion of any EFL undershoot resulting from savings in current costs, as an additional incentive to them to make such savings.

I am copying this letter to the Prime Minister, other members of E Committee, George Younger and Sir Robert Armstrong.

Yours ever
Nigel

NIGEL LAWSON

Nat Ind

CONFIDENTIAL

P.0805

PRIME MINISTER

Nationalised Industries: 1982 Investment and Financing Review.

E(82)55

BACKGROUND

This memorandum by the Chief Secretary, Treasury, with the accompanying note by officials, is the first stage in consideration by Ministers of the investment programmes and financing requirements of the nationalised industries as part of the public expenditure survey. This year the review covers, for the first time, the Regional Water Authorities (RWAs) and the Civil Aviation Authority (CAA); but it excludes the British National Oil Corporation and the British Transport Docks Board, since they are due to be transferred to the private sector.

2. The main figures behind the review are set out in the table below:

Financing requirements of the Nationalised Industries
1983-84 to 1985-86

£ million cash

	1983-84			1984-85			1985-86		
	Baseline	Bid	Total	Baseline	Bid	Total	Baseline	Bid	Total
Capital requirements	8542	502	9044	9179	399	9578	9546	468	10014
Internal resources	5460	-634	4826	6644	-731	5913	6925	+178	7103
External Finance	3082	1136	4218	2535	1130	3665	2621	291	2912

Individual items may not sum to totals because of rounding.

They are made up of figures for the individual industries which are of variable quality, since not all are based on full discussion of an up-to-date corporate plan. However, it is already clear that in aggregate the industries are asking for substantial additional resources: £1.1 billion above the baseline for 1983-84; another £1.1 billion in 1984-85; and £0.3 billion in 1985-86. These figures could well be increased by reductions in electricity tariffs (leading to a higher financing requirement) if the financial target for that industry is reduced; and by such things as the consequences of the current rail dispute.

3. The additional bids are accounted for by a relatively small number of industries (see table 3 to the report by officials) and are mostly due to a combination of lower internal resources and increased capital requirements, eg:

	External Finance Additional Bid £		
	1983-84	1984-85	1985-86
National Coal Board	431	357	257
Electricity supply in England and Wales and Scotland	269	138	-168
British Gas Corporation	59	210	-123
British Telecom	237	278	171
Post Office	104	82	45

4. The Chief Secretary regards the overall situation as unacceptable and proposes that Ministers should aim at reductions below the baseline of £0.5 billion in each of the three years (ie a reduction on the current bids of £1.6 billion in each of 1983-84 and 1984-85, and a reduction of £0.8 billion in 1985-86).

5. To achieve this, it is proposed that no industry should be allowed more than its baseline figure in the White Paper on the Government's Expenditure Plans 1982-83 to 1984-85 (Cmnd 8494), and reductions should be made wherever possible. Officials should hold discussions on this basis with individual industries and report back with proposals for achieving the target; Ministers would consider the results by the end of September. The Chief Secretary suggests that the best ways of reducing the financial requirements of the industries will be reductions in current costs; reductions in requirements for working capital; ensuring that forecasts are realistic (particularly regarding pay increases and the volume of investment); and cutting

out investment which yields an inadequate return. He is not in favour of reducing borrowing by tariff increases.

MAIN ISSUES

6. It is unlikely that the Committee will disagree with the Chief Secretary's view that a substantial reduction in the financial requirements of the nationalised industries is desirable. This view will be reinforced by the Chief Secretary's paper for Thursday's Cabinet on the 1982 Public Expenditure Survey, showing excess bids of £6.2 billion for 1983/84 and £8.0 billion for 1984/85. They will also have in mind the recognition by E Committee on 1 July (E(82)17th meeting, item 2) that the EFLs for nationalised industries should be set at levels which required them to strive for moderate pay settlements.

7. The main issues are therefore:

i. is the overall level of reduction being sought about right?

ii. how will pay be handled in the EFL discussions?

iii. are there any points affecting individual industries which need to be discussed generally at this stage?

iv. are the proposed next steps acceptable?

Overall level of reduction

8. Although the public expenditure and pay arguments point clearly towards reducing the nationalised industries' EFLs, realistic targets must be set. A substantial proportion of the additional bid is accounted for by a shortfall in internal resources (£642m out of £1,119m in 1983-84 and £770m out of £1094m in 1984-85). This is based on the industries' views of economic prospects which appear to be generally consistent with the range of outside forecasts. There is everything to be said for putting pressure on the industries to cope with worsening trading prospects by more rigorous cost reductions. If however the EFLs are set unrealistically low, and later have to be increased substantially

either in the course of discussions on the Survey (there were substantial increases over the baseline in the 1981 IFR) or subsequently after EFLs have been set (as in 1981-82), this is an unsatisfactory way of proceeding - both in relation to the nationalised industries themselves and as a basis for taking decisions about the other elements in the Public Expenditure Survey.

9. The conclusion may be that, at this stage in the exercise, the overall level of reduction being sought by the Chief Secretary is about right. It would however be prudent to assume that the reduction which will emerge from the bilaterals will be considerably less and that the out-turn will be still less favourable. This will need to be kept in mind in the discussions about the rest of the Public Expenditure Survey.

Pay

10. In line with the discussion in E Committee on 1 July (E(82)17th meeting, item 2) the Chief Secretary proposes (in para 5 of his paper):

> "While we do not want to impose specific figures for either inflation or pay on the industries, we must ensure that they are not seeking an easy life by building undue pessimism into their forecasts. The assumptions about pay particularly need to be scrutinised carefully, given the importance of this sector in setting the tone for the pay round as a whole."

11. The report by officials attached to the Chief Secretary's paper (in particular paragraph 20 and Table 7) does not suggest that there is much scope for reducing EFLs merely by changing the pay assumptions. The industries mostly assume fairly steady inflation in the 9-10 per cent range, in line with outside forecasts but more pessimistic than the Treasury's. The assumed nominal pay increases are broadly similar to those assumed by the Treasury, but when allowance is made for the industries' more pessimistic view of inflation, the industries generally assume increases in real terms of between nil and 1 per cent in real terms in each year. Some industries at the top of the range (eg the Post Office assuming a real increase of nearly 4 per cent in 1983-84 and the National Girobank of nearly 5 per cent in 1984-85) will need to be probed carefully on their pay assumptions. In general however a tougher message on pay to the industries must mean telling them to plan for a reduction in real earnings rather than the nil or marginal increase which most of them have assumed. It is desirable that the Committee should be fully aware of this.

Individual industries

12. You will probably not wish to get into detailed discussion at this stage of individual industries, unless a sponsoring Minister has an important point to raise. You may however wish to note that in several industries the increased capital requirements, either for expenditure on fixed assets or for working capital, are hard to reconcile with the assumptions about poor market prospects and the shortfall in internal resources. This is noticeable particularly in the case of the National Coal Board (where however the figures are provisional pending the new Corporate Plan in October), British Telecom (where there has been a shortfall in planned investment in fixed assets in the past) and the Post Office.

13. Some Ministers may argue that it is unrealistic to set a minimum target for each industry of no increase over the existing baseline. If so, you may wish to invite the sponsoring Minister to discuss with the Chief Secretary what would be an acceptable alternative overall for the group of industries for which he is responsible.

Next steps

14. It is unlikely that there will be disagreement with the Chief Secretary's proposals on how the exercise is to be carried forward, ie discussions by officials with the industries over the summer within guidelines concentrating attention on reduction of current costs, on the scrutiny of planned investment for adequacy of return and realism, and on avoiding increased tariffs.

HANDLING

15. You will wish the Chief Secretary, Treasury to introduce his memorandum. You might then invite Ministers with sponsoring responsibilities - the Secretaries of State for Industry, Energy, Transport, Trade, Scotland and the Environment (for RWAs) - to comment, both generally and from the standpoint of the industries for which they are each responsible. The Secretary of State for Employment may wish to comment, particularly on the pay assumptions. Mr Sparrow may have general comments.

N.I

CONCLUSIONS

16. You will wish the Committee to reach conclusions on the following:

i. What should be the target increase or reduction for the nationalised industries, compared with the baseline, in 1983-84, 1984-85 and 1985-86?

ii. Does the Committee agree that the target for individual industries should be, as a minimum, no increase on the existing baseline and preferably a reduction? If there are any exceptions, how should they be dealt with?

iii. Are there any other points which should be noted at this stage about individual industries?

iv. Does the Committee have any views about the handling of pay in the discussions with the industries?

v. Are the proposed next steps acceptable, including the guidelines about preferred ways of achieving EFL reductions?

PLG

P L GREGSON

12 July 1982

CONFIDENTIAL

Nat- Ind c/c JV

Prime Minister (4)

MCS 8/7

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon David Howell MP
Secretary of State
Department of Transport
2 Marsham Street
London SW1P 3EB

6 July 1982

Dear Secretary of State,

NATIONAL BUS COMPANY: OBJECTIVES

I have seen a copy of your letter of 10 June explaining how your proposed objectives for NBC are intended to embrace social as well as commercial objectives.

I can accept the principle of what you propose and therefore the need to formulate objectives in such a way that in moving towards a fully commercial remit we have freedom to take into account the wider consequences of a decline in bus services. I am concerned however that NBC's management should be left in no doubt that the presumption is that they should operate in accordance with commercial principles unless asked to do otherwise. Objectives are intended to give unambiguous guidance to management in the running of their business and I think it is important that the objectives for NBC are explicit on this point. The attached redraft is intended to reflect this point without altering the substance of what you propose. I hope you will find it acceptable.

If we are to proceed on the basis of allowing social considerations to be taken into account in setting NBC's financial targets, we shall need also to ensure that a compatible approach is adopted in Scotland in respect of the Scottish Transport Group. I would welcome George Younger's comments on this aspect. Given that the objectives provide only a framework within which it is possible to take social considerations into account I do not myself see why in principle there should be difficulty in reconciling objectives for the two bus groups, particularly with the redraft I have proposed which makes explicit the underlying presumption of commercial operation.

On a point of detail, I think it would be helpful, and in keeping with the approach we are adopting to objectives generally, if a timetable could be attached to objectives (c) - separating the accounts of the coach business from the main business - and (f) - privatisation of the subsidiaries. Perhaps you could consider what might be possible.

I am copying this letter to members of E(NI), to George Younger and to Sir Robert Armstrong.

yours sincerely

for LEON BRITTAN
(approved by the Chief Secretary & signed in his absence)

PF

OBJECTIVES FOR THE NATIONAL BUS COMPANY

It shall be the objective of the Company, acting within the statutory and financial framework to operate all its activities in accordance with commercial principles.

2. The Secretary of State will from time to time set medium term financial targets for the Company . Where it appears desirable to the Secretary of State on wider social grounds, the financial target may allow for a less than commercial return on capital invested in stage carriage services. It shall be the objective of a company to meet the financial target, and the associated borrowing and financing limits, and in so doing provide as substantial as possible a network of stage carriage services to meet the demand expressed by:

a. the willingness of passengers to pay;

b. the willingness of the relevant local authorities to make adequate subsidies available for the support of bus services in their area to the extent to which they cannot be financed from passenger revenue; and for the support of concessionary fare schemes.

3. It shall also be the Company's objectives:

a. to reflect the performance of its non-stage trading activities in separate accounts [by];

b. to continue to improve efficiency by reducing unit costs and by providing a pattern of services and facilities which makes the most effective use of resources, in particular by meeting any specific targets including performance aims agreed with the Secretary of State;

c. to have regard to the guidelines set by government for the planning and appraisal of investment and the criteria to be applied to it, and in procurement policies to aim to keep whole life vehicle costs to the minimum;

d. to introduce private capital into their coaching, holiday and express operations [by   ]; and to review their investment in BM(H);

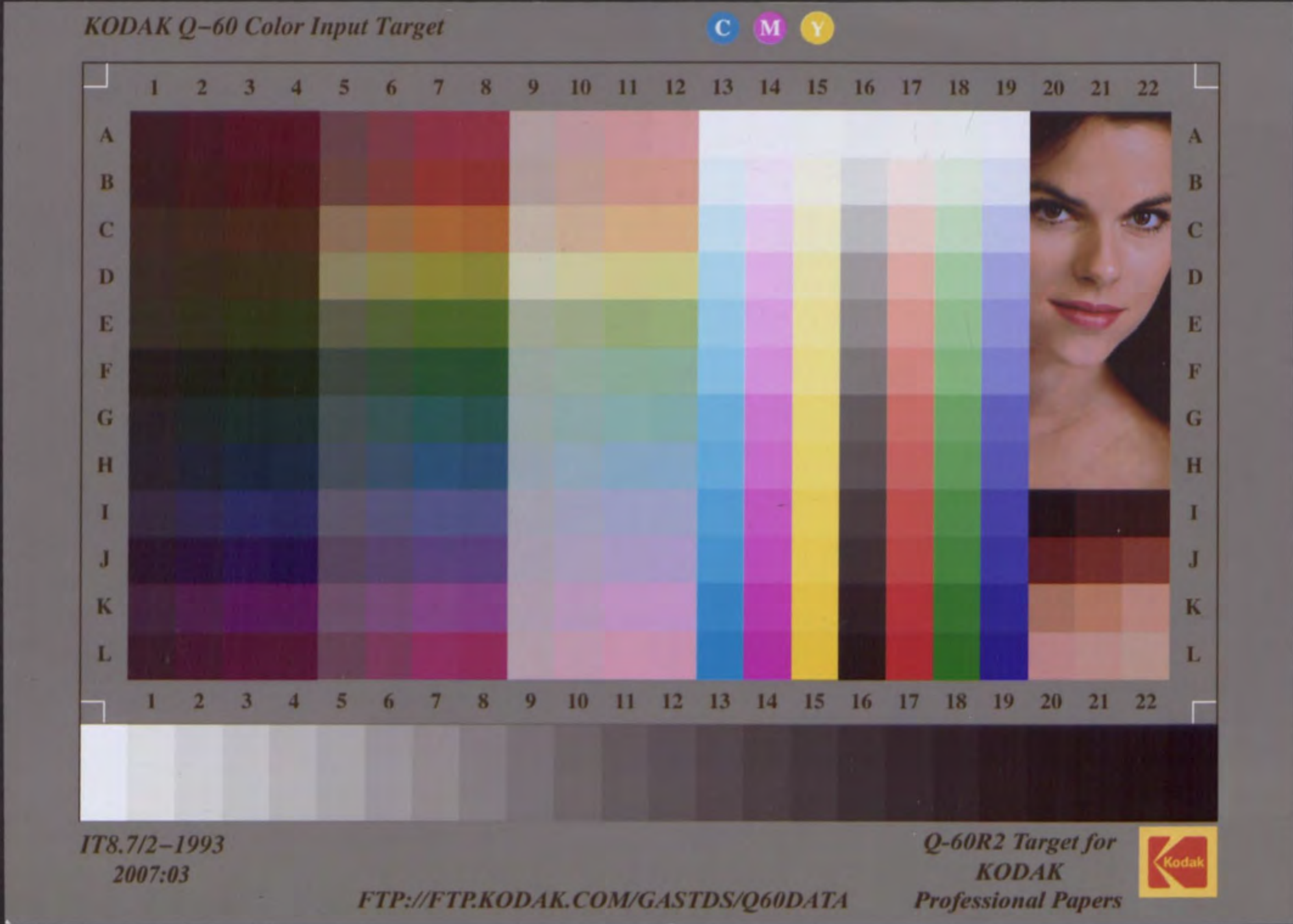
e. whilst competing with other operators on normal commercial terms, to avoid unreasonable competitive behavier such as uneconomic pricing of particular services or unreasonable denial to other operators of access to facilities serving the public as a whole.

PART Pt 6 ends:-

Incl to HMT 30.6.82

PART 7 begins:-

E(82) 55 1.7.82


KODAK Q-60 Color Input Target
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A B C D E F G H I J K L
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