

PART 4

235
Confidential Filing

of Public Sector Assets

tion of transfer of Government
Establishments to the private sector

ion of British Railway Board
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of BGC Oil Assets

ECONOMIC
POLICY

Part 1: June 1979

Part 4: October 1980

Date	Referred to	Date	Referred to	Date	Referred to	Date
	5.6.81					
	16.6.81					
	17.6.81					
	18.6.81					
	7.7.81					
	13.7.81					
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	10.8.81					
	30.9.81					
	6.10.81					
	9.10.81					
	14.10.81					
	21.10.81					
	Phobos					

PREM 19/444

PART 4 ends:-

S/S Trade to FST 21.10.81

PART 5 begins:-

S/S Transport to Ch/Ex 3.11.81

Cabinet / Cabinet Committee Documents

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

Date 31 March 2011

PREM Records Team



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MUS 21/10

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CONFIDENTIAL*From the Secretary of State*

The Hon Nicholas Ridley MP
Financial Secretary
HM Treasury
Treasury Chambers
Parliament Street
London, SW1P 3AG

21 October 1981

Dear Nick,

ms

BRITISH AIRWAYS: PRIVATISATION

Thank you for your letter of 8 October.

The Department considered a year ago with Hill Samuel, our merchant bank advisers, what scope there was for early privatisation of BA in the light of its deteriorating financial position. It was Hill Samuel's own advice which led us to the conclusion that privatisation was unlikely to be feasible until BA once again had some profitable performance behind it. They considered in particular the idea of accepting a low price in order to obtain an early privatisation despite BA's losses, but there appeared to be a number of difficulties in that course. The main one was the difficulty of finding a buyer prepared to take BA on as a going concern in its present condition. Certainly a privatised BA would have considerable difficulties in raising finance to fund the airline's substantial and largely committed capital investment programme, once the Treasury guarantee was no longer available.

Our impression, too, is that BA's debt-equity ratio is now so unsatisfactory that privatisation is likely to be impossible without a large injection of public dividend capital: this will add considerably to the short-term costs of privatisation.

CONFIDENTIAL



From the Secretary of State

CONFIDENTIAL

However, I am as keen as anyone to privatise British Airways just as soon as I can, and I agree it is time to have a fresh look at the prospects. Sir John King, I know, remains anxious to privatise the airline and is himself considering what is the best way forward. I propose therefore to ask my officials to get a fresh assessment from Hill Samuel, covering in particular the points you raise. When I have the results of this, and of Sir John King's current exercise, I will write to you again.

I am copying this letter to the Prime Minister and Sir Robert Armstrong.

John Biffen

JOHN BIFFEN

CONFIDENTIAL

CONFIDENTIAL

Econ Pol

10 October, 1981

National Freight Company Limited

The Prime Minister has seen and noted your Secretary of State's minute of 16 October about the sale of this company to the consortium of senior managers and employees.

I am sending copies of this letter to the Private Secretaries to the Members of the Cabinet, the Financial Secretary and David Wright.

MICHAEL SCHOLAR

A Mayer, Esq
Department of Transport

CONFIDENTIAL

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CONFIDENTIAL

cc A. Dwyer

(2)

Prime Minister

PRIME MINISTER

MUS 16/10

W

NATIONAL FREIGHT COMPANY LIMITED

You will be glad to know that I have now reached agreement for the sale of this Company to a consortium of senior managers and employees. This follows several months of detailed financial and legal negotiations since Norman Fowler announced in June that he was considering an offer from the consortium, worth in excess of £50m. The finally agreed price is £53.5m. The agreement is conditional on the members of the consortium raising between them some £4m to £5m: a syndicate of banks is providing the rest of the purchase price.

The financial negotiations have been handled by Schroders who firmly recommend acceptance at this price. The Financial Secretary agrees.

The agreement provides for £46m to £47m to be devoted to making up deficiencies in the pension fund as provided for in last year's Transport Act. The net proceeds will therefore be around £6.5m. The sale should be completed in mid-January.

No interest has been shown by other purchasers, except for one indication of a possible bid which Schroders have advised in the circumstances should not be pursued. In that case a complete consortium had not been formed.

I propose to announce this piece of good news to the House in a written answer on Monday. It will be well received by our supporters and criticism from the Opposition will be muted by the

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CONFIDENTIAL

fact that employees at all levels are being invited, and are expected, to participate. There could be criticism to the effect that we are "giving away" valuable "public" assets, but we are in a strong position to refute this by reference to Schroders' independent advice that the price is fair and reasonable.

I am sending copies of this to our Cabinet colleagues, to the Financial Secretary and to Sir Robert Armstrong.

DA.
2

DAVID HOWELL

16 October 1981

CONFIDENTIAL

Prime Minister *Sam PD.* (2)

ML 9/10
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

9 October 1981

The Rt Hon Francis Pym MP
Lord President of the Council
Privy Council Office
Whitehall
London SW1A 2AT

Dear Francis,

CABLE & WIRELESS FLOTATION

We are now about a fortnight away from the planned date for the public offer of Cable & Wireless shares. In the run up to the flotation and during the two week period of the offer there is a danger that Ministers might make comments about Cable & Wireless which, while innocuous in any other circumstances, might be taken by prospective purchasers as relevant to the flotation and which could in the extreme result in the withdrawal of the Prospectus or render the Government liable to legal proceedings for misrepresentation.

2 I attach a note, prepared by this Department's Solicitor and by City legal advisers, setting out the legal position. I should be grateful if you, and all colleagues to whom I am copying this letter, could consider it carefully and exercise particular care in making comments or statements in respect of Cable & Wireless in the period until the flotation is complete. This applies both to statements in the House and those made elsewhere. Special care should of course be taken at the Party Conference next week which will be widely publicised.

3 There is a further and wider dimension to be considered. The success of the flotation will be best pursued if it is presented to the investing world in very much the same way as any other large issue and through concentration on the financial merits of Cable & Wireless rather than on the political controversy associated with privatisation. I therefore strongly counsel that we should avoid any statement in respect of Cable & Wireless likely to awaken the political controversy that is never far from the sale of public sector assets. Until the flotation is completed, I hope that the Government as a whole will take a low profile.

CONFIDENTIAL



4 The Cable & Wireless application for a licence to build an alternative telecommunications network ("Mercury") is still an extremely sensitive subject in view of its implications for BT. References to "Mercury" in the Prospectus are having to be drafted with particular care so it is especially important that as little as possible should be said by the Government about this project. If any reference in public is at all necessary I strongly advise colleagues to study the most recent Ministerial statement on Mercury, which was made by Kenneth Baker on 24 September, and to be very careful to adhere to the terms of that speech. A copy of the relevant extract of the speech is also attached to this letter. As a further precaution may I ask colleagues to ensure that any proposed references to Mercury are cleared in advance by my Department.

5 I am addressing this letter to you in the light of your responsibilities for Government information. I am copying it, with the attached note, to the Prime Minister, to other members of Cabinet, to the Chief Whip, to the Paymaster General and to Sir Robert Armstrong.

Your ever
Patric

CONFIDENTIAL

LIABILITY OF THE GOVERNMENT FOR STATEMENTS MADE OTHER THAN IN THE PROSPECTUS

A purchaser of shares may be able to claim some form of relief on the grounds that he was induced to enter into the contract to purchase by a misleading statement. The liability may arise whether the misrepresentation was made fraudently, negligently or even wholly innocently.

The misrepresentation must be material ie it must be one that would affect the judgment of a reasonable man in deciding whether or not to enter into the contract, and the representee must show that he relied upon the misrepresentation in deciding whether to enter into the contract. (In practice, however, it is difficult to maintain a defence that the misrepresentation was immaterial or that the representee did not rely on it). It is sufficient if the misrepresentation was only one of several inducements to enter into the contract. Despite the fact, therefore, that the Prospectus, which will be carefully vetted, may be read by prospective purchasers they may also have relied upon mis-statements made other than in the Prospectus, for instance by Ministers in Parliament or outside. The closer to the issue that statements are made the more likely it is that a purchaser will be able to show that he relied upon such statements. It also seems likely that the risk of purchasers relying on such statements would be magnified in the case of employees who, it is thought, would be more likely to decide to buy shares because of the statements of Ministers than because of a careful study of the Prospectus.

The general rule is that the liability will arise only where the misrepresentation involves a mis-statement of existing fact. There

may be no liability, therefore, if the statement falls into one of the following categories:

(i) Mere Puffs

ie sales patter, eg C&W provides excellent telecommunications services.

(ii) Statements of Opinion

Some statements of opinion give no rise to liability either because they are mere puffs or because the maker of the statement had, as the other party knew, no personal knowledge of the facts on which he based his opinion, and it is understood that he could only state his belief. Eg if a Minister stated that in his opinion C&W would be even more successful in private ownership it would be understood that this was his belief and he could have no knowledge of whether it would in fact be more successful.

However, where the opinion is or appears to be based on facts particularly within the knowledge of the maker there may be a misrepresentation because the maker has implied that he has reasonable grounds on which to base his opinion. Eg if a Minister states that it is his belief that C&W will gain many new and profitable contracts as a private sector company he may be taken to have represented that he knows as a fact that new contracts are ready to be concluded with the new company. If this is not so there may well be a liability for a misrepresentation.

It should be stressed that in the case of Ministers giving opinions on the new company there is a particular risk that they will be believed to have a knowledge of facts on which the opinion is based. The very fact that it is a Minister speaking will lend a certain authority to the statement. What may genuinely be merely a belief of a Minister, therefore, may not be recognised as such and he may be believed to have based his opinion on facts which are not in his possession.

(iii) Statements as to the Government's Future Conduct

A promise to do something in the future may be nothing more than a statement as to the present intention of the maker's future conduct. If so, the maker of the statement does not misrepresent a fact merely because he fails to fulfil the promise. It will however be a misrepresentation if the maker does not in fact have the intention of fulfilling the promise at the time he makes the statement. It must be stressed that a statement of intent as to future conduct if carelessly made may lead to serious consequences and there may be some difficulty in showing that a Minister actually had the intention when he made the statement.

(iv) Statements of Law

Statements which contain an error purely of law (such as an incorrect interpretation of a statute) will not give rise to legal liability on that account alone. However, a statement that a statute applies to a certain set of facts which are themselves incorrect may amount

to a misrepresentation of fact giving rise to liability on the principles stated above.

Conclusion

In every case it will be a question of fact to be judged by the Court whether the grounds stated above are satisfied in order to give rise to a liability for a misleading statement. There is frequently a fine distinction to be drawn in deciding whether a misrepresentation was in fact material. Likewise it is often difficult to conclude whether the statement was a mere puff or in fact a misrepresentation of existing fact; whether the maker of an opinion was understood only to have been stating his belief or to have based his opinion on facts within his knowledge; or whether at the time he made a statement as to his future he did have the intention of fulfilling his promise.

The best advice to Ministers is that they should confine their remarks to:

- (a) statements of published facts eg C&W's past profits;
- (b) statements on matters within the Government's control eg that it will stand by its commitments in relation to the liberalisation of BT's networks; or
- (c) statements which are clearly expressions of opinion or belief, rather than factual forecasts eg that C&W's chances of success are better in the private sector than as a nationalised industry.

Ministers should avoid statements which are of opinion or belief but which may appear to have some factual basis eg predictions about

the successor company's level of profits or dividend performance in future years. Again, it must be remembered that statements of belief by Ministers may be relied upon because they may be believed to have firm facts on which to base their opinions.

Ministers should also avoid statements which only partially disclose facts. As a general rule there is no duty to disclose material facts. However, to reveal some facts, all of which are true, but to fail to reveal other facts which affect the weight of those stated and make the statement misleading may be a misrepresentation.

Finally, it should be pointed out that statements true at the time they are made may cease to be true later. If the statement is not corrected it may be a misrepresentation. Ministers should, therefore disclose any facts which falsify statements previously made by them.

EXTRACT FROM MR KENNETH BAKER'S SPEECH AT THE BUSINESS
COMMUNICATIONS CONFERENCE IN LONDON ON 24 SEPTEMBER 1981

PROJECT MERCURY

As well as the measures to liberalise the market for equipment attachments and to promote a diversity of value added services, we have also examined the possibility of permitting a measure of direct competition in telecommunications transmission. We have received detailed proposals from the "Mercury" Consortium of C&W BP and Barclays Merchant Bank for a national digital network for voice and data, based extensively on fibre optics. The stated objective of Mercury is to provide an advanced communications infrastructure, including wide band digital services, which would help to stimulate other new services including value-added enhancement and developments in local area networking.

It is essential that the special needs of industry and commerce should be met promptly and efficiently and many users have stressed the need for an alternative transmission option. I announced in the House of Commons in July that the Government had decided that there were major advantages in having Mercury as the second network provider to help meet these needs alongside BT. There were various technical issues still to be resolved and I am pleased to say that excellent progress has been made on these matters.

Meanwhile the Mercury consortium has pressed on further with its planning. There remain a number of points of detail to be settled in discussion between the Consortium, BT and my Department and I am ensuring that these are dealt with as a matter of urgency. Consequently the Secretary of State hopes to issue a licence shortly to Cable & Wireless on behalf of the Consortium to provide a

communications system for business users which will become the second network carrier in the UK.

Project Mercury will be aimed at opening out a new market. BT will itself be competing for a share in this new market, and the Government will seek to make sure that Project Mercury's development is not a mere duplication of existing facilities. For the foreseeable future, therefore, Project Mercury will be the only alternative system to BT and I therefore welcome the judgement of the POEU that it will be possible for BT to live with it. The Government welcomes this exciting development which marks an important advance for telecommunications in this country and which will help provide the customer with a wider choice with all the benefits that brings. I am sure that the Consortium will now press ahead to make the project a reality.



Prime Minister

(2)

To note. Mr Ridley is
pushing hard for bringing forward
floating off British Airways.

Treasury Chambers, Parliament Street, SW1P 3AG

PLS 8/10

ms.

The Rt Hon John Biffen MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
London
SW1

8 October 1981

Dear John

BRITISH AIRWAYS : PRIVATISATION

I wonder if we should not be taking another look at ways of privatising British Airways as a whole in the lifetime of this Parliament.

BA's move into the red, and the prospect of some years of losses before a very modest current cost profit is forecast for 1984-85, have of course cast a shadow over the privatisation plans which we brought with us when we came to office. At the same time I know that you have not finally ruled out full privatisation within the life of this Parliament. As I understand it, you are not necessarily wedded to the idea of selling BA at the maximum price; your objective, I believe, is privatisation as soon as possible, on the basis that you wish to sell BA as a going concern, to avoid asset stripping, and to get a reasonable price. But you doubt if a buyer who is prepared to pay a reasonable price is likely to turn up until BA has some profitable performance behind it. Even on the most optimistic turn of events, that could scarcely mean a flotation before the end of 1983, and I think it fair to say that the chance of that is pretty slender.

Would it not be possible to adopt a rather different approach? Presumably, even in BA's present circumstances, there is some price at which a buyer could be found, even if that meant that we were selling it rather cheap. What we lost by way of sale proceeds would need to be weighed in the balance against a very considerable PSBR saving over a period of years, in respect of BA's external borrowing requirement and possibly, losses, as

compared to a situation where we floated off the company only when it was profitable or about to become so. And, of course, we would have fulfilled the political commitment with which we came to office, and which John Nott confirmed to Parliament as Government policy.

What I am suggesting is that it might be worth getting an up-to-date assessment of the sort of price which we might hope to achieve through a sale in, say, early 1982-83, or at all events in the course of that year. With the benefit of that information, we could then assess the desirability or otherwise of proceeding down that road.

I wonder therefore if you would think it worth getting a merchant bank to give us such an assessment of the company's present worth and sale prospects?

I am sending a copy of this letter to the Prime Minister.

John
Nicholas

NICHOLAS RIDLEY

CONFIDENTIAL



2PPS

NBPM

MUS

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

6 October 1981

J.R. Ibbs, Esq.,
Central Policy Review Staff,
Cabinet Office

Dear Robin

CONTRACTING OUT PUBLIC SECTOR FUNCTIONS

I am most grateful to you for your letter of 13 July and the progress report on contracting out. I have also seen Barney Hayhoe's letter of 10 August, and Michael Heseltine's of 16 September.

underneath
I fully support the CPRS recommendations. It is of the highest importance that colleagues should take a close personal interest in the extension of contracting out in the areas for which they are responsible; and that they should review progress - and look for new opportunities - regularly. As your report made clear, there has been a substantial increase in the number of departmental functions judged to offer scope for further contracting out. It is important now to get ahead as quickly as possible. I am grateful to Barney Hayhoe for his offer of CSD assistance to departments who face difficulties.

I think it is right that action should be taken forward on a departmental basis but it may be appropriate at a later stage for the CPRS to bring the threads together again, so that my colleagues and I can reassess the position.

You will have seen Treasury DAO letter 11/91 which gives advice to departments on how to deal with VAT following the move to cash planning.

I am sending copies of this letter to the Prime Minister and other members of the Cabinet; and also to Sir Robert Armstrong and John Hoskyns.

[Handwritten signature]

GEOFFREY HOWE

CONFIDENTIAL

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File No. 10 DOWNING STREET OUTWARD
 Department
 Drafted by WILLIAM RICKETT TELEGRAM
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 Tel. Extn.

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[TEXT]

FOLLOWING CONFIDENTIAL MESSAGE FOR WHITMORE,
 PRIME MINISTER'S PARTY, FROM RICKETT, 10 DOWNING STREET

Message begins:

The Industry Secretary seeks the Prime Minister's approval to the appointment of Government directors to the Board of Cable and Wireless by 7 October.

The flotation of shares in Cable and Wireless takes place next month. The Government intend to retain the right to appoint two directors after the flotation. Kleinwort Benson, who are advising on the flotation, recommend that the prospectus must say who are to be the two Government directors. They also advise that the composition of the Board should not be changed before flotation. The Industry Secretary

/ accepts

CONFIDENTIAL

Copies to:-

No 10.

GgSntz
 2/10/81

NO DISTRIBUTION

CONFIDENTIAL

- 2 -

accepts this advice, and is therefore confined to choosing the two Government directors from the existing non-executive members of the Board.

The Industry Secretary, after consultation with the CSD and Treasury, has decided that HMG should in fact appoint only one director before the flotation from the existing members of the Board, and should leave one slot vacant to be filled later in the year. Mr. Jenkin recommends that, of the existing Board members, Mr. Alan Wheatley, a senior partner in Price Waterhouse and aged 43, should be appointed the Government director. If the Prime Minister agrees, the prospectus will announce this appointment, and will make clear that the second Government appointment will only be filled later in the year. This announcement will make no difference to the existing composition of the Board, but leaves HMG some room for manoeuvre in the future.

Although the leaving of a vacancy creates some uncertainty about the future composition of the Board, Kleinwort Benson and DOI feel the market will be able to accept this, provided that the name of the other Government director is announced.

Message ends.

WPSN

CONFIDENTIAL

NOTHING TO BE WRITTEN IN THIS MARGIN



10 DOWNING STREET

Mr Dufrenoy
Mr Wolfson

I would be grateful for any
comments you may have on
the attached by 3 pm tomorrow

WFSN

4/10

Mr Rickert

No virus. I think
Robin Hoo should be
consulted, in case he
has. They (CPRS) have
been closely involved in
aspects of BT, C+W,
including the Mercury
project. DD 2/10



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

30 September 1981

Michael Scholar Esq
10 Downing Street
London SW1

Dear Michael

CABLE AND WIRELESS: GOVERNMENT DIRECTORS

We have been discussing with the Treasury and the Civil Service Department, the appointment of Government directors to the board of Cable and Wireless, following the expected flotation of shares next month.

2 Ministers agreed in July (E(DL)3rd Mtg) that the Government should retain the right to appoint two directors, in order to ensure that the Board continued to have a strong non-executive element and so to give some protection to the Government's continuing interests as a substantial shareholder. The company's Articles of Association will contain the necessary provision.

3 Our advisers on the flotation (Kleinwort Benson) have strongly recommended that it would be undesirable to alter the composition of the Board immediately before flotation so if we are to decide now who are to be our two nominees our choice has to be confined to the four existing non-executives. This creates some difficulty, as Sir Patrick Meaney (Managing Director of Thomas Tilling) has already indicated that he may wish to leave the Board soon after flotation because of the pressure of his other commitments, while Mr Gordon Brunton (Chief Executive of the Thomson Organisation) has only recently joined the Board and is not yet able to give much of his time to C&W's affairs. Of the remaining two possibilities, the Treasury and the CSD agreed with us that Mr Alan Wheatley, a senior partner in Price Waterhouse, is well qualified to be a Government Director. Mr Wheatley is 43 and since joining the Board earlier this year he has given his Chairman (Mr Eric Sharp) strong support in his efforts to overcome past weaknesses in the Company's financial control systems. It is unusual for Price Waterhouse to allow partners to accept appointments on the boards of private sector companies, but we understand that they would be content to allow Mr Wheatley to continue, as a Government director, with C&W.



4 This leaves Mr David Berriman, Managing Director of Guinness Mahon, who has been on the C & W Board since 1975. We believe that during this time he has done his best to secure action to remove deficiencies in the company's management, but until Mr Sharp's arrival a year ago he appears to have received little support from his Chairman and fellow directors. My Secretary of State considers that Mr Berriman will continue to be a valuable member of the Board, but has decided on balance not to invite him to serve as a Government Director.

5 He therefore proposes to announce in the prospectus, the intended appointment of Mr Wheatley and to leave the second place vacant until later in the year. This will enable us to appoint another non-executive with a strong commercial background, which will be particularly desirable if Sir Patrick Meaney confirms his wish to leave the Board.

6 I should be grateful to know whether this proposal has the Prime Minister's approval. I regret that the timetable for the flotation means that we need to finalise the prospectus on this and all other points no later than 7 October.

7 I am sending copies of this letter to the private secretaries to the Chancellor of the Exchequer and the Lord Privy Seal.

Yours ever

RICHARD RILEY
Private Secretary



file - ~~Blackley~~ 29
Mrs. McDonald

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/16245/81

Your ref:

16 SEP 81

NBPM

MUS

Lee Belfry

I was particularly pleased to see a copy of the CPRS Report of 13 July 1981 on Contracting Out Public Sector Functions as it shows clearly both the considerable progress which has been made and the benefits gained from contracting out.

In my own Department I have been pressing ahead on several fronts and have recently agreed proposals to close 4 of the 7 existing PSA vehicle fleet maintenance workshops (Annex A to the Report item 14a) and put their work to the trade which should achieve an overall saving of some 80 staff. I have also agreed that the PSA London Furniture workshop services can be provided by private contractors, retaining only a small team to service the Palace of Westminster. This would achieve a further reduction of some 190 staff.

Within DOE (Central) progress has also been made on the transfer of the Hydraulics Research Station to the private sector (Annex item 10c). I have set up a Shadow Board under the chairmanship of Sir Alan Harris to act on behalf of the prospective company. I believe that the Station's commercial prospects are good, that it will benefit from the discipline of the private sector, and that within a few years it will become self-supporting.

Pending the outcome of the studies on the long term future of the Ordnance Survey (Annex A item 15) I am, as you know, proposing to set up a trading fund for the Survey with a published trading account and further progress is being made on proposals for a new statutory body whose staff would no longer be civil servants, to be responsible for the audit of local authorities in England and Wales.

As recommended by the CPRS, I propose to maintain my own close personal interest in contracting out and to conduct an internal review of progress in the Spring of next year.

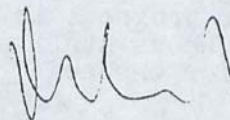
I will also be taking steps to ensure that the relevant officials are aware of the CPRS recommendation that departments who are having difficulty in contracting out because of union resistance should approach CSD for advice and help as appropriate.

In addition I have noted the final CPRS recommendation relating to the wider dissemination of the results of the DOE (PSA) Rayner Scrutiny Programme on PSA Custody Services. I have recently received the final Report of this scrutiny and official level consultations with CSD, another user Department and the Security Service on the implementation of its recommendations are about to begin.

Turning to Part II of the report, contracting out by local authorities is, of course, a matter on which individual authorities must reach their own decisions, but I am, as the report points out, taking a number of steps to promote positive consideration of its potential scope and benefits. The new legislation on direct labour organisations which we brought into operation last April requires local authorities to invite tenders for a substantial proportion of their construction and maintenance work. The accounting disciplines it imposes will also make them increasingly conscious of the relative costs of using direct labour and private sector contractors, and will enable properly costed choices to be made. My department will encourage and accelerate this process by appropriate guidance. More generally, I am expecting to receive shortly the final report of the study which my Department has commissioned on pricing and methods of service delivery in the local environmental services. It will, I hope, provide more information about recent experience of contracting out provision of local services and I shall be considering how best to take the CPRS recommendations forward in this light.

I am copying this letter to the Prime Minister and other members of the Cabinet. Copies also go to Sir Robert Armstrong and John Hoskyns and Robin Ibbs.

Yours ever



MICHAEL HESELTINE



1981 130 9



Minister of State

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

Econ
P51
Civil Service Department
Whitehall London SW1A 2AZ
Telephone 01-273 3000

10th August 1981

Dear Geoffrey,

R 11/8

CONTRACTING OUT PUBLIC SECTOR FUNCTIONS

I have seen a copy of Robin Ibbs' letter to you of 13 July, enclosing a copy of the second progress report by the CPRS on contracting out public sector functions.

I agree with the recommendations of the report. In particular, I agree that Ministers must take a close and continuing interest in ensuring that progress on contracting out is maintained both in their own departments and in related areas. CSD will continue to remind departments, where appropriate, of the need to look carefully for areas in which further contracting out might be achieved, and will be happy to try to help any departments that run into difficulties with contracting out.

I am sending a copy of this letter to the Prime Minister and other members of the Cabinet. A copy also goes to Sir Robert Armstrong, Robin Ibbs and John Hoskyns.

Barney Hayhoe
Barney

BARNEY HAYHOE



CABINET OFFICE
Central Policy Review Staff

From: J. R. Ibbs

70 Whitehall, London SW1A 2AS

Telephone 01-233 7765



hivie
PA 14/7
ECON
To Sir. PJT

CABINET OFFICE
Central Policy Review Staff

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

From: J. R. Ibbs

CONFIDENTIAL

Qa 05619

13 July 1981

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Dear Chancellor,

Contracting Out Public Sector Functions

You may recall that on 12 August 1980 you wrote to other members of MISC 14 with a copy of the Central Policy Review Staff's first progress report on contracting out public sector functions. MISC 14 asked for a second progress report this year. I now enclose a copy of this. Part 1 deals with contracting out public sector functions (excluding functions of local authorities and nationalised industries). Part 2 is about local authority contracting out.

I very much hope that Ministers will continue to take a close personal interest in work on this issue. In particular, I hope they will consider carefully whether it might be possible to make faster progress on particular fronts, and whether there are any further opportunities for contracting out within their Departments. This can contribute usefully towards manpower targets.

In order to help Departments pick up possibilities for contracting out which they may not have considered earlier, Annex B in Part 1 of the report summarises new or previously unallocated functions that have been identified from reports submitted to the CPRS.

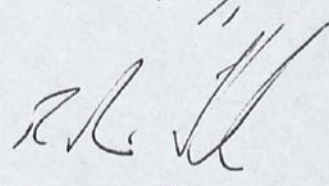
The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
H M Treasury
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You will also see from this Annex that work is in hand on a number of studies of the scope for contracting out specific functions, and we have therefore recommended that Ministers conduct their own internal review of progress every six or nine months.

Our other recommendations on the main report will be found at paragraph 25 in Part 1, and those on local authority contracting out at paragraph 15 in Part 2. These recommendations have been discussed with the main departments concerned, and I hope that Ministers will endeavour to implement them at the earliest opportunity.

I am sending a copy of this letter and enclosures to the Prime Minister and other members of the Cabinet. A copy also goes to Sir Robert Armstrong and to John Hoskyns.

yours sincerely,


J R Ibbs

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CONTRACTING OUT PUBLIC SECTOR FUNCTIONS

(excluding functions of local authorities and
nationalised industries)

A progress report by the Central Policy Review Staff (CPRS)

This is a second report by the CPRS reviewing progress on contracting out public sector functions (excluding functions of local authorities and nationalised industries). It sets out the background to the work, action taken following the first report, and subsequent progress; and makes certain recommendations (paragraph 25).

Background

2. At the beginning of 1980 the CPRS submitted a report (MISC 14(80)2) to the Ministerial Steering Group on Government Strategy on the scope for contracting out public sector functions to the private sector (other than functions of local authorities and nationalised industries). The CPRS itself was not able to carry out a detailed investigation of the opportunities in each Department. It had to rely necessarily on department's own assessment. Then on the basis of the short notes provided by departments, the various functions were grouped by CPRS into one of three categories:

- A - scope for further contracting out;
- B - existing balance about right;
- C - no scope for contracting out.

3. The allocation of functions to each category is summarised in Annexes A and B. On a crude count 30 [1980:18] functions are in Category A, 18 [1980:14] in Category B, 10 [1980:10] in Category C and 24 are still under investigation.

4. The CPRS recommended that in order to maintain the impetus departments should be asked to submit progress reports later in the year, and that Departmental Ministers should be asked to take note of the results of the study so far, to satisfy themselves that opportunities for more contracting out were not being overlooked, and to take a personal interest in continuing work within their own departments and in the progress reports.

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The First Progress Report

5. The first progress report was considered by Ministers in August 1980 (MISC 14(80)5th Meeting) when four recommendations were made. Each recommendation is listed below together with the action taken upon it:

i. Ministers should ask for a further progress report in about 9 months' time;

Action: This report fulfils the remit;

ii. the Chancellor of the Exchequer should write to colleagues with a copy of the CPRS progress report, and should ask for their close personal interest in further developments in their own departments;

Action: The Chancellor wrote to colleagues in these terms, attaching a copy of the CPRS report, on 12 August 1980;

iii. departments should ensure that the Treasury's advice concerning VAT is known at all relevant levels and that their internal budgets are constructed in such a way that any additions to cover higher VAT payments are returned to the relevant division;

Action: It is clear from the replies received from Departments that this has been done;

iv. the CPRS should prepare a note for the Group summarising the work in hand or proposed on Government sponsored research and development.

Action: A report by ^{the} CPRS on techniques in Departments for monitoring research and development is to be considered separately by the Group.

The Second Progress Report

6. In March 1981 the CPRS wrote to Departments asking for details of progress in contracting out each of the departmental functions mentioned in the previous reports, together with any other functions not previously mentioned which had since been included. Departments were not asked to report again on functions which they had earlier placed in Category C (i.e. no scope for contracting out) unless, of course, they had changed their view. They were, however, asked to comment on those functions which other departments were contracting out but for which they had not yet submitted details. These functions are more usually the "common functions" - as defined in the first report - and the Civil Service Department (CSD) agreed to add its own comments to those of departments.

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7. This report and its three Appendices are based on these progress reports and the CSD submission. The key points from departments' replies are summarised in Annex A which shows the previous categorisation of each function and any change. It also includes entries from departments which were not previously included but are appropriate to an existing identifiable function - these are asterisked. The categorisation is as before i.e. categories A, B and C as in paragraph 2 above, except that a question mark indicates that an investigation is proceeding to see whether further contracting out will be possible. New or previously unreported functions are listed in Annex B, and are categorised in the same way.

8. It will be seen from the following extract from Annex A that 7 functions have changed category since the last report:

Functions	Previous Category	New Category
10(a) Architectural R & D Work (DES)	B	C
13(a)(iii) Transport Services (PSA) : IDS	C	?
13(b) Transport Services (MOD)	C	A
14(b) Vehicle Fleet Maintenance (MOD)	C	A
21(b)(ii) NHS Functions: Laundry Services - Northern Ireland	?	C
21(c) NHS Functions: Manufacture of Blood Products.	A	C
22 Office of Population Censuses and Surveys.	B	?

9. Full details of progress, as reported by Departments, are given under functional heads at Annex C.

10. Departments' response to this call for a second progress report has been varied. Some departments conducted a wide-scale review at the time of the original exercise, and have had little to add. Others have used the earlier CPRS report, and the first progress report, as the basis for a further

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reconsideration of the options e.g. Northern Ireland Office. Some departments have concluded in all rounds that there is little scope for contracting out the functions under their control. Once again there is evidence of close Ministerial interest in some, but not all, cases.

The VAT Problem

11. Ministers may remember that in the first CPRS report we pointed out that we had found that cost comparisons between in-house and contracted out work can be distorted by the incidence of Value Added Tax (VAT). As a result of our report the Treasury issued a letter to Departmental Accounting Officers (DAO2/80). This demonstrated that comparisons should properly be made excluding VAT. Departments which contracted out might, as a result, have to pay more VAT, but since changes in VAT liability represent price rather than volume changes any increase should be met in the revaluation of volume figures to cash terms during each public expenditure survey. An adjustment on these lines cannot be made once the cash limits for the next year have been set, but, since it should normally be possible to foresee any substantial switching to contracting-out before the cash limits are set, this should not be much of a problem in practice. However, despite that letter there was still reference to the 'VAT problem' at the time of the last progress report e.g. MOD dealing with cleaning, and the DHSS report on the NHS, so we recommended that departments ensured that the Treasury's advice was known to all those who may have been in a position to make those decisions.

12. DHSS have expressed concern that health authorities will be hit by the move to cash planning for Survey purposes. Paragraph 4 of the DAO letter describes the impact of the previous Survey rules, and it will have to be revised in due course. Under the new system, departments will be advised that the Treasury cannot undertake automatically to adjust their PES provision to reflect any additional VAT payments resulting from contracting out, but it will be open to departments to include a bid to cover the additional VAT costs. It will then be for Ministers to determine how the bid should be treated in the light of their objectives and priorities.

13. DHSS maintains that since they are now unable to guarantee to health authorities that they will automatically have increased VAT costs reflected in their cash limits, DHSS cannot at present advise health authorities to ignore the effects of VAT in any comparison of costs between undertaking

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activities in-house or contracting them out. DHSS intend to await clarification on how the advice in DAO2/80 is to be applied following the change in the control and planning of public expenditure from volume to cash outlined in the Chancellor's Budget Statement of March 1981 before issuing advice on this subject to health authorities.

14. In view of this particular difficulty we understand that the Treasury is reviewing its advice to departments in DAO2/80 on how to deal with VAT following the move to cash planning for Survey purposes.

What progress?

15. As one would expect, progress in contracting out public sector functions has varied from function to function. Some areas like contract cleaning, vehicle fleet maintenance and the regional car service have made good progress. Submissions to Ministers to contract out complete functions have been, or are about to be, made for other functions e.g. testing of heavy goods vehicles and passenger vehicles; road haulage.

16. Some functions are held to have arrived at the right balance between contracting out and in-house services e.g. training, and little further progress can be expected.

17. However, there are other areas where progress seems unnecessarily slow bearing in mind that departments have had over a year and a half to reach this stage. Some examples - not exhaustive - are:

MOD: Agency staff: Only now about to produce pilot area contract specifications prior to tendering.

Reprographic services: currently assessing cost implications. The next stage will be to issue tenders.

Scottish Office:

Contract Cleaning: The option for contracting out all cleaning is only now to be fully examined with first steps to making the change expected in 1981-82.

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DHSS: Contract Cleaning: Ministers had still to write to Authorities about the outcome of talks with cleaning industry. Authorities do not appear to be giving the matter high priority.

18. DHSS, in their response, have restricted their information solely to the effect on the National Health Service. It would be useful to know what progress has been made in contracting out common service functions within DHSS itself.

19. The CPRS think that Ministers should be encouraged, once more, to take a close and continuing interest in the progress of their departments towards the contracting out of functions. This is, of course, relevant to the achievement of departments' manpower targets.

20. Ministers may also like to be aware of the following general points which came out of departments' replies:

- i. there are still a number of mentions of resistance by the unions;
- ii. some departments mentioned security problems - particularly important in Northern Ireland;
- iii. there was mention of the lack of capacity in the private sector to cope economically with certain areas of work suitable for contracting out e.g. NHS catering in Northern Ireland; building maintenance in Scotland;
- iv. agency staff e.g. telephonists, typists, are used only in the last resort because of high costs;
- v. high charges for management consultants tend to discourage departments from using them (but see 21.iii.) and the cut-backs in Government expenditure have restricted the budgetary provision for them.

21. The following particular points are of interest:

- i. MAFF have replaced 7 departmental telephonists with 8 British Telecommunications staff at greater cost. This seems to go against one of the original criteria for contracting out i.e. that it cost no more than the present service;

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- ii. D/Energy have decided to reduce the amount of contracting out in order to save money e.g. less use of computer bureaux services; reprographic services being brought in-house;
- iii. DOE have increased dramatically the use of management consultants and computing services;
- iv. MOD report that there has been increasing pressure from industrial and non-industrial trade union sides to include in the cost comparisons other costs of adopting contracts falling outside departmental votes, such as redundancy compensation payments, costs of unemployment benefit and the like. It has been agreed that the lump sum payment should be expressed as an equivalent annual amount, discounting at the Treasury's test discount rate, currently 5 per cent, when comparing the cost of in-house and contract services. This was agreed in principle in correspondence between the Civil Service Department and the Council of Civil Service Unions, and endorsed by the Treasury. A claim for inclusion of VAT was rejected.

It is appropriate at this point to remind departments of the detailed guidance on privatisation and hiving off which was issued by CSD in March 1981. The guidance includes a note drawing attention to the costs of redundancy compensation and discussing how these might be minimised, together with notes on comparing costs of work carried out by departmental staff and facilities, and that done by other means, transitional superannuation and redundancy costs and machinery of government aspects. The guidance is intended to help departments reach decisions on contracting out which are commensurate with sound management and good value for money to the taxpayer.

- v. HMSO have posed the question of the need for custodial services during 'silent hours'.

22. The last item is very relevant in as much as the DOE (PSA) have recently submitted for Ministerial consideration a Rayner Scrutiny Programme on the PSA Custody Service. Its recommendations have yet to be approved by Ministers but the report states there is some evidence to suggest there are cheaper alternatives to security cover. The alternatives could obviously include:

- i. no cover at all;
- ii. contracting out to private security firms;

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iii. greater use of intruder detection systems.

23. These would of course be subject to the relevant references to the need for security guard cover contained in the manuals of guidance issued by the CSD and the Security Service.

24. The CPRS recommends that on publication of the Rayner Scrutiny Programme on PSA Custody Service all departments should be made aware of its recommendations and take steps to implement them as quickly as possible.

Recommendations

25. The CPRS recommends that:

i. Ministers should take a close and continuing personal interest in further developments in their own departments and areas in which they have a responsibility e.g. DHSS for the NHS, and should consider the desirability of conducting their own internal review of progress, say, every six or nine months;

ii. CSD, when reviewing progress towards manpower targets, should take the opportunity to remind departments of the continuing need to look for ways of contracting out functions;

iii. the Treasury should complete urgently their review of advice to departments in DAO 2/80 on how to deal with VAT following the move to cash planning for survey purposes;

iv. departments who are having difficulty in contracting out because of union resistance should approach CSD for advice and help, as appropriate;

v. on publication of the DOE (PSA) Rayner Scrutiny Programme on PSA Custody Service all departments should be made aware of its recommendations and take steps to implement them.

Central Policy Review Staff
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13 July 1981

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Annex A: Summary of Progress

FUNCTION	PREVIOUS CATEGORY	CHANGE IN CATEGORY (WHERE APPROPRIATE)	COMMENTS
1. CONTRACT CLEANING	A		Progress continues to be made. A number of Departments are wholly cleaned by contract. Security considerations prevent this in others eg FC0, NIO. DHSS making very slow progress with NHS Authorities. Scottish Office only just considering options, with first steps to changes expected in 1981-82.
2. MANAGEMENT CONSULTANTS	B		Customs and Excise, MOD, Energy, HMSO use them on a relatively small scale in appropriate circumstances eg no in-house expertise available. DOE/Transport report dramatic increase in use. Expenditure on OM assignments up from £3,000 in 79/80 to £180,000 in 80/81. Industry/Trade suggest there may be longer term advantages in use of outside experts. Rayner study in MOD advocated wider use.
3. AGENCY STAFF (eg typists, etc)	B		Six Departments reported use of agency staff. Usually employed as last resort because of greater expense. MAFF replaced 7 Government telephonists in HQ with 8 British Telecommunications staff at higher rates of pay.
4. COMPUTING SERVICES AND STAFF	B		Continued progress. DOE/Transport make great use of outside agencies to provide computer services, employing 30 commercial computer bureaux at a cost of £2.2 million in 80/81. DHSS only at discussion stage with Regional Health Authority Chairman.
5. TRAINING	B		Some progress despite Category B status. DOE/Transport using private consultants for short courses in accounting. FC0 contract out all language training except where full time teachers can be justified.

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FUNCTION	PREVIOUS CATEGORY	CHANGE IN CATEGORY (WHERE APPROPRIATE)	COMMENTS
6. SECURITY STAFF	B		Continued progress. Rayner study in progress at DOE/Transport which may have service-wide implications, particularly for custodial services during 'silent hours'. Northern Ireland Office inhibited by security problems from employing any contractors. HMSO question why 'silent hours' staff are used at all.
7. a. CATERING (CISCO)	C		Treasury carrying out comparative study to see if private contractor is cheaper.
7. b. CATERING (NHS)	A		NIO report no real scope for contracting out because of lack of capacity in the private sector and security risks.
7. c. CATERING (HOME OFFICE RESIDENTIAL TRAINING ESTABLISHMENTS)		?	Pilot studies being undertaken at 3 establishments. If contracts are let this will not start before April 1982.
7. d. CATERING (MOD)		?	Very slow progress. Detailed evaluation of tenders is proceeding.
8. REPROGRAPHIC SERVICES	B		HMSO review of reprographic services is continuing. Energy doing more in-house. DOE/Transport are untying from HMSO for some goods and services and will deal direct with the trade.
9. a. ARCHITECTURAL AND BUILDING DESIGN WORK (PSA)	A		37% of major design work contracted out compared with 35% in 79/80 and 25% in 78/79. Further work to private sector as staff reductions take effect.

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FUNCTION	PREVIOUS CATEGORY	CHANGE IN CATEGORY (WHERE APPROPRIATE)	COMMENTS
9. b. ARCHITECTUAL AND BUILDING DESIGN WORK (HOME OFFICE)	B		-
9. c. ARCHITECTUAL AND BUILDING DESIGN WORK (NHS)	A		-
9. d.* ARCHITECTUAL AND BUILDING DESIGN WORK (NORTHERN IRELAND OFFICE)		?	Dept of Finance examining the possibility of increasing present 25% allocation to private sector to 50%. Dept of Health and Social Services contract out 85%-90% against agreed norm of 65%-70%. Dept of Commerce contract out all work in connection with factory building programme.
10. a. ARCHITECTUAL R & D WORK (DES)	B	C	No scope for further contracting out.
10. b. ARCHITECTUAL R & D WORK (NHS)	B		-
10. c. ARCHITECTUAL R & D WORK (DOE)	B		Study in progress to investigate scope for transferring to private sector. Agreement in principle to transfer Hydraulics Research Station to private sector.

Not previously included

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FUNCTION	PREVIOUS CATEGORY	CHANGE IN CATEGORY (WHERE APPROPRIATE)	COMMENTS
11. a. OTHER R & D (BUILDING RESEARCH ESTABLISHMENT)	A		DOE Review just completed to explore options for changing the status of the Building Research Establishment.
11. b. OTHER R & D (ENERGY)	B		30 staff from Marine Technology Support Unit at Harwell hope to be brought into the Dept.
11. c. OTHER R & D (AGRICULTURE)	B		Possibility of further contracting out being discussed.
11. d. OTHER R & D (INDUSTRY)	B		
11. e.* OTHER R & D (MOD)	-		Policy is to extend R & D work to private sector.
11. f.* OTHER R & D (HMSO)	-		Some activities in Technical Services Division could be contracted out.
11. g.* OTHER R & D (INDUSTRY AND TRADE)	-		Awaiting report of possibilities of contracting out research work.

* Not previously included

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FUNCTION	PREVIOUS CATEGORY	CHANGE IN CATEGORY (WHERE APPROPRIATE)	COMMENTS
12. a. BUILDING MAINTENANCE (PSA)	A		75% of work now contracted out. Directly employed labour reduced by 17%. Reduction of 40% by 1984 planned.
12. b. BUILDING MAINTENANCE (HOME OFFICE - PRISONS AND QUARTERS)	B		
12. c. BUILDING MAINTENANCE (NHS)	A		NIO currently preparing a paper revising the use of Directly Employed Labour to produce most cost effective methods of operations.
12. d. BUILDING MAINTENANCE (ANCIENT MONUMENTS)	A		Progress continuing. DOE have scheduled 40% of work for contracting out in 81/82. SO restrained by lack of suitable firms for contracting out.
12. e. BUILDING MAINTENANCE (SCOTLAND)	-		Virtually all work at Police College and Fire Service Training School now done by private contractors.
12. f.* BUILDING MAINTENANCE (NORTHERN IRELAND OFFICE)	-		Dept of Finance No scope for contracting out. Dept of Health and Social Services (NHS). Use of labour under critical review but industrial relations difficulties limit scope for further contracting out. Dept of Commerce contracts out all work in connection with factories programme.

* Not previously included

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FUNCTION	PREVIOUS CATEGORY	CHANGE IN CATEGORY (WHERE APPROPRIATE)	COMMENTS
13. a. TRANSPORT SERVICES (PSA) i. <u>Regional Car Service</u> ii. <u>Road Haulage</u> iii. <u>IDS</u>	A A C	?	Vehicles and staff still being reduced and scope for further reduction. A submission has been made to Ministers recommending total contracting out. A review of the London based Interdepartmental Despatch Service is in progress.
13. b. TRANSPORT SERVICES (MOD)	C	A	MOD looking at all forms of transport for ways of contracting out.
13. c. TRANSPORT SERVICES (NHS)	C		
13. d. TRANSPORT SERVICES (CSD) i. Service Vehicles ii. Function Vehicles	A C		MAFF continues to run own fleet, hiring vehicles when financially advantageous. ODA hire as an alternative to purchase under investigation by Transport Economy Unit (CSD) HMSO Office Machine Technical Services vehicles indispensable.
14. a. VEHICLE FLEET MAINTENANCE (PSA)	A		Under consideration by Ministers. Staff numbers cut by nearly 30% overall.
14. b. VEHICLE FLEET MAINTENANCE (MOD)	C	A	Pilot study in hand to cease in-house support of certain commercial vehicles and their spares.

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FUNCTION	PREVIOUS CATEGORY	CHANGE IN CATEGORY (WHERE APPROPRIATE)	COMMENTS
14. c. VEHICLE FLEET MAINTENANCE (NHS)	B		Pilot management service study just completed. Results to be made available to NHS in due course.
14. d. VEHICLE FLEET MAINTENANCE (CSD)	A		Progress continuing. Most work now done by private garages except in London where PSA used. <u>MSC</u> fleet serviced by Skillcentres.
15. CARTOGRAPHIC SERVICES	A		<u>Energy</u> have cut back on use of outside contractors. <u>DOE</u> contract out nearly all printing and over half of photographic processing of artwork. Ordnance Survey Review in progress. <u>ODA</u> report completion of Rayner scrutiny on Directorate of Overseas Surveys for submission to Ministers.
16. LEGAL SERVICES	C		Rayner report by <u>Employment/DHSS</u> recommends greater use of local and regional office staff to represent Departments. Trade undertaking Rayner scrutiny. Trend is away from use of agent solicitors.
17. OTHER SPECIALISTS	C		
18. INLAND REVENUE VALUATION OFFICE	B		Review approaching completion.
19. DESIGN AND SUPERVISION OF MAJOR ROAD SCHEMES (ENGLAND)	A		Transport About £754 m of work, one third of the total, goes to outside consultants. Further proposals being considered. <u>[NO bulk of design work undertaken by private consultants.]</u>

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FUNCTION	PREVIOUS CATEGORY	CHANGE IN CATEGORY (WHERE APPROPRIATE)	COMMENTS
20. TESTING OF HEAVY GOODS VEHICLES AND PASSENGER VEHICLES	A		Transport Legislation planned for 81/82 session. <u>NIO</u> detailed examination carried out which requires further consideration.
21. a. NHS FUNCTIONS: USE OF OUTSIDE HEALTH CONTRACTORS	A		<u>DHSS</u> circular issued January 1981 to Authorities. Centrally-funded pilot project being considered. <u>SO</u> about to issue a circular.
21. b. NHS FUNCTIONS: LAUNDRY SERVICES i. Great Britain ii. Northern Ireland	A -	C	<u>DHSS</u> British Laundry Associations interested in potential for capital investment. Discussions in progress. <u>NIO</u> lack of capacity in private sector and higher cost of commercial service preclude <u>NIO</u> from contracting out.
21. c. NHS FUNCTIONS: MANUFACTURE OF BLOOD PRODUCTS	A	C	<u>DHSS</u> Ministers decided no satisfactory basis for commercial involvement without serious risk to voluntary blood donor programme.
22. OFFICE OF POPULATION CENSUSES AND SURVEYS	B	?	Rayner report on Govt statistics completed. Recommended that all ad hoc social surveys should be contracted out if they cost less.
23. FCO FOREIGN TRAVEL AND ALLOWANCES	?		<u>FCO</u> Continued progress. Travel booking and freight services contracted out, as well as unclassified bag service. Study in progress on Foreign Services Allowance system. <u>ODA</u> Possibility of contracting out this service still to be considered by management.

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FUNCTION	PREVIOUS CATEGORY	CHANGE IN CATEGORY (WHERE APPROPRIATE)	COMMENTS
24. PUBLISHING	?		Progressing. Study at HMSO continuing. MAFF offered some titles to private sector.
25. BUSINESS STATISTICS OFFICE	?		Industry/Trade Continuing improvement in unit output but Departments inhibited from contracting out more than one third of the work because of commercial confidentiality.
26. ADVANCE FACTORY PROGRAMME	B		
27. DEPT OF INDUSTRY ADVISORY SERVICE	B		

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Annex B: Summary of progress on new or previously unallocated functions identified by Departments

	FUNCTION	CATEGORY ALLOCATED	COMMENTS
28.	Restoration of Opencast Sites	?	<u>MAFF</u> , in consultation with National Coal Board, is looking at possibility of contracting out.
29.	Brucellosis Testing	?	<u>MAFF</u> Possibility of contracting out being looked at.
30.	Tuberculin Production	?	<u>MAFF</u> " " " " " "
31.	Laboratory work for the Intervention Board for Agricultural Produce	?	<u>MAFF</u> " " " " " "
32.	Land Management	?	<u>MAFF</u> " " " " " "
33.	Operation and Maintenance of MOD facilities	A	<u>MOD</u> includes fuel depots and pipelines, accommodation, stores movement and repair, airfield equipment, forms and publications storage.
34.	Press Cuttings Service	A	<u>MOD</u> Provincial press cutting service now to be extended by trial of service covering national press.
35.	Equipment Codification	A	<u>MOD</u> examining possibilities for further production and printing of illustrated parts catalogues.
36.	Equipment, maintenance and repair	A	<u>MOD</u> studies in hand covering a wide range of Defence equipment.

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Annex B: Summary of progress on new or previously unallocated functions identified by Departments

	FUNCTION	CATEGORY ALLOCATED	COMMENTS
37.	Claims Commission services	?	MOD Following Rayner study recommendation, examination of scope for using commercial brokers. Tenders now being sought with the aim of covering motor accident and employer's liability work through conventional insurance or a claims handling agency.
38.	Ground maintenance	?	MOD Initial consideration of feasibility of putting various small packages of ground maintenance work out to private contractors.
39.	Pharmaceutical manufacturing	?	DHSS Work is going on to improve NHS costing information generally. NHS Treasurers have been asked to co-operate in devising a standard method of costing NHS pharmaceutical operations, as a basis for comparing the costs of in-house and commercial products.
40.	Agricultural Loans Scheme	C	NI0, Department of Agriculture The Agricultural Loans Scheme was closed to the receipt of new applications as from 30.11.79 and loans for fishermen and fish farmers were terminated as from 7.11.80. Future loans will, therefore, have to be obtained from outside sources.
41.	Maintenance of Minor Waterways	A	NI0, Department of Agriculture Scheduled work put out to contract has increased from 300 kilometres prior to 1980 to about 1,700 kilometres.
42.	Quarantine Services	C	NI0, Department of Agriculture because of diverse way in which animal imports operate considered no scope for contracting out.

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Annex B: Summary of progress on new or previously unallocated functions identified by Departments

	FUNCTION	CATEGORY ALLOCATED	COMMENTS
43.	Hospital Services	C	NIO, Department of Health and Social Services Lack of demand and few private hospitals - who depend on NI health services for blood products, laboratory tests, etc - remove scope for contracting out.
44.	Specialist Advisory and Testing Services	A	PSA Action is being taken to increase substantially the amount of work put to the private sector from its current level of 13 per cent.
45.	Central Engineering Workshop Burtonwood	A	PSA A submission has been made to Ministers which recommends the discontinuation of heavy mechanical engineering activities, except for certain special services.
46.	Transport and Road Research Laboratory	?	Transport Following an ACARD recommendation the Department is considering the scope for contracting out.
47.	Insulation Grants Appeal	A	Welsh Office report some progress has been made in contracting out the work on appeals into Departmental decisions on insulation grants in respect of properties affected by road schemes. The value of work undertaken in 80/81 was £53,000 and £30,000 worth of contracts are expected to be let this year.

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Annex B: Summary of progress on new or previously unallocated functions identified by Departments

	FUNCTION	CATEGORY ALLOCATED	COMMENTS
48.	Central Film Library	A	Central Office of Information (COI) have negotiated an agreement from 1.8.81 to include computerisation of the library function. Saving of 38 staff.
49.	Film Directing and Editing	A	COI intend to perform this work using freelance personnel and hiring commercial facilities saving 26 staff by March 1982.
50.	Distribution and Shipping	?	COI starting an investigation and hope to contract out parts of it. About 10 posts may be saved.
51.	Maintenance Work at Training Schools (Northern Ireland)	?	Investigations not complete, but indications are that there may be scope for contracting out.

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ANNEX C

Departmental Comments on functions (including CSD comments on "common functions" where appropriate).

1. The numbering of functions 1-27 in this Annex follows that in Annex A of the CPRS report "Contracting out public sector functions" (MISC 14(80)2) with new or previously unallocated functions contained at 28-51.

1. CONTRACT CLEANING - category A

2. CSD Summary of Departmental Comments

In the F & CO, D/Energy and the London HQ buildings of DoE/DTp, contract cleaners are now used except where security considerations prevail. Nearly half of all DE's offices are already cleaned by contractors and a review of the remainder is in hand. In MAFF, all Central London buildings will shortly be contract cleaned and in the Regions and Laboratories, considerable efforts are being made to switch from direct to contract cleaning involving some 150 posts. In the course of planning staff reductions, Scottish Office are considering the contracting out of all cleaning; and meetings are now being held with CSU. In addition, C & E are considering the introduction of contract cleaning for a number of their buildings. MoD are meeting trade union resistance in their efforts to replace direct staff with contract cleaners, which is leading to difficulty and delay. They estimate potential savings to be £2M and 1,500 posts. In HMSO, little scope is seen, however, for extension of contract cleaning since this would be met by strong union opposition.

3. CSD report that since the last report there has been a great deal of progress made in this area.

4. On the problem of allowing for VAT in comparisons of the cost of contracting out, the CSD circulated a letter to Establishment Officers on 9 December 1980, after consultation with the CSU, advising departments that VAT should in future be excluded from cost comparisons. The CSU have

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argued that, by analogy with the exclusion of VAT from cost comparisons, National Insurance contributions should be excluded on the grounds that it entails no Exchequer cost. We have not accepted their argument because National Insurance contributions are not self-balancing in the same way as VAT. An allowance is to be made for redundancy payments.

5. The following comments were received from Departments:

i. MAFF

In central London it is proposed to switch to contract cleaning for all but 2 floors of 3 Whitehall Place. All Ministry buildings in Central London will then be contract cleaned. Considerable efforts are being made in the regions and at Laboratories to switch to contract cleaning. Estimated cumulative posts involved are: 1981/82 71; 1982/83 144 $\frac{1}{2}$; 1983/4 146 $\frac{1}{2}$.

ii. HM Customs & Excise

Although many buildings are already cleaned under contract the introduction of contract cleaning in more of the Departments' buildings is under consideration.

iii. MoD

Continued progress. Decisions to change to contract now taken for some 44 establishments: potential savings to date over £2m and 1,500 posts.

iv. Employment

Over half of all DE offices are already cleaned by contractors and a review of the remainder is in hand. It is intended to change to contract cleaning if it will save money. Union opposition to contract cleaning has slowed the changeover.

v. Energy

Only 2 cleaners employed for special purposes where it is not feasible to contract out.

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vi. DoE/Transport

Cleaning arrangements in 3 remaining London HQ buildings served by directly employed cleaners were changed to contract cleaning from 1 March 1981.

vii. FCO

Contract cleaners used except where security considerations prevail (in Main Building and at Hanslope Park). All window cleaning has been contracted out.

viii. DHSS

Ministers have decided not to issue any further formal guidance to Health Authorities but to write personally to Authority Chairman. This decision follows the issue of a circulation in January 1981 encouraging and facilitating the extension of contractual arrangements and other forms of cooperation between the NHS and the independent medical sector, and the publication in February 1981 of 'Care in Action', a handbook of policies and priorities for the health and personal social services in England containing an Appendix on efficiency in the NHS which commends to the Authorities a number of examples of approaches and ideas which have already worked well in particular places.

Ministers have had discussions with the cleaning industry, the outcome of which will be conveyed to Authorities in the forthcoming letter. However, because the letter is bound to become known to staff and could be regarded as provocative at the present stage of the pay round, its issue is being delayed until a more opportune moment.

No reliable account of progress can be given until replies to the Ministerial letter have been received. However, few authorities appear to be giving this matter high priority - partly because they are preoccupied with NHS restructuring. There have been a few reports of Authorities reverting from contract to direct cleaning. These are being followed up with the Authorities concerned.

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During discussions with Ministers the cleaning industry have been encouraged to market their services more forcefully with Authorities. This they have done but with little reported success so far. One firm has offered a free consultancy on an experimental basis. An experiment is being mounted with a willing Area Health Authority.

A standard contract has been drawn up for pest control and will be ready for issue shortly.

ix. HMSO

A lot done by contractors but some office areas (3 of the Regional Offices, Gateshead Press) and most 'industrial' areas are still covered by direct labour. In most instances, the chief obstacle to change would be custom of the house. All window cleaning is done by contract.

x. Northern Ireland Office (NIO)

a. Civil Service

Thus far only limited progress has been made on contract cleaning. The previous report had anticipated that progress would be slow due to the limited capacity of the private sector and to the potential security risks involved. Early indications suggest that contract arrangements on a departmental basis may well be on too small a scale to achieve the greatest cost effectiveness, or to encourage expansion in the private sector, and that central arrangements may have to be considered in the longer term. A review of cleaning services in the NIOS is indicating that substantial savings in cost and manpower should be achievable and until improvements have been made, there is no reliable base on which to judge the true cost effectiveness of contracting out. Nevertheless the Department of the Environment (NI) have already contracted out cleaning services in some office buildings which have been newly occupied and have taken steps to employ private cleaning firms at Vehicle Inspection and Driving Test Centres.

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b. Department of Health and Social Services (NHS)

Further examination with the NI health services suggests that there is no significant scope for contracting out, mainly because of lack of capacity and expertise in the private sector and of the difficulty for that sector of coping economically with the flexibility inherent in hospital cleaning arrangements. There are also security considerations with understandable reluctance to give outsiders ready access to wards where there are patients regarded as security risks.

xi. Overseas Development Administration (ODA)

Since July 1980 a further cleaning contract - for the new premises in East Kilbride to which parts of ODA are to be dispersed - has been let.

In the past, arrangements for cleaning the windows of Government Offices in London have been made by the Property Services Agency (PSA). This responsibility has now been passed to occupying Departments. PSA used to contract out window cleaning of both Eland House and 29 Bressenden Place. ODA has adopted this practice and let contracts for both premises.

Formerly, the Ministry of Agriculture, Fisheries and Food offered a pest control service for Government occupied buildings. In 1978 this service was withdrawn and ODA let an outside contract for pest control in both Headquarters' buildings.

xii. Scottish Office

In the course of considering further staff reductions we have considered contracting out all Scottish Office cleaning. The Secretary of State has agreed that this option should be fully examined and we have had meetings with the Civil Service Union about comparative costs. The first steps towards making the change are expected in 1981-82.

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xiii. Treasury

Contract out all domestic office cleaning.

xiv. Welsh Office

All domestic office cleaning and window cleaning is contracted out.

2. MANAGEMENT CONSULTANTS - category B

6. CSD Summary of Departmental comments

CSD and MAFF have contracted out only one assignment each since 1 July 1980. There has been a large increase in the use of consultants in DOE/DTp since July 1980 where 13 assignments have been contracted out. Proposals for introducing private sector practices into departmental or related functions have led to greater use of consultants. In the DOI & T, 19 assignments were commissioned and the increasing sophistication of technological environment is likely to lead to greater use of consultants.

7. CSD report contracting out of management consultancy is necessarily considered on an ad hoc basis, project by project, which means that progress made one year can quickly be lost if the will to contract out is not maintained. In practice, the high charges for management consultants tend to discourage departments from using them and the cut-backs in Government expenditure have restricted the budgetary provision for them.

8. The following comments were received from Departments:

i. Customs & Excise

Computer and management consultants employed as and when necessary.

ii. MOD

Used on a relatively small scale but a recent Rayner Study of Inspection and Audit methods advocated wider use.

iii. Energy

No management services capacity and rely on CSD to meet needs. Consultants are used when expert technical/scientific/commercial advice not available in-service.

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iv. DOE/Transport

Use of private sector management consultants has increased dramatically in the last year. Estimated expenditure on OM assignments has risen from just over £3,000 in 1979/80 to nearly £180,000 in 1980/81. In the period July 1980 to February 1981 13 projects were given to consultants compared with one and a part of another undertaken in-house. [Note. If use of consultants (and accountants) is interpreted more broadly (ie other than OM type assignments) there is again a rising trend. The cash provision for this purpose in 1981/82 is nearly £4.8m compared with £2.6m for 1980/81.]

v. HMSO

Management consultants employed readily enough when appropriate. The only activities undertaken with domestic staff, but which might be brought in, are Work Study (1 SEO, 3 HEO and 2 EO) and O & M (1 SEO, 1 HEO). There would be financial and other disadvantages in switching to outside consultants in each of these areas.

vi. Industry & Trade

The situation has not changed in such a way as to cause us to modify our previous comments. However, we would add that against a background of diminishing Civil Service staff resources, and the need for economy in both salary and superannuation costs, the use of outside experts may be of longer term financial advantage. During 1980 the two Departments commissioned some 19 management consultancy assignments, amounting to over £500,000.

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3. AGENCY STAFF - category B

9. CSD

Most Departments have reported that they only employ agency staff (mainly secretaries and telephonists) where absolutely necessary, since it is very expensive to do so.

We reported last year that there was "often little to choose" on cost grounds between Post Office telephonists and directly employed staff. Although this was true of the past, the Post Office have recently made large increases in their charges, which means that it is now demonstrably cheaper to employ staff direct.

10. The following comments were received from Departments:

i. MAFF

Replacing 7 Government telephonists in HQ with 8 British Telecommunications (BT) operators. Consideration is being given to making similar changes in the regions and at the major laboratories. [CPRS note: BT have higher manning standards than the Government service as well as higher rates of pay].

ii. Customs & Excise

Agency typists and telephonists used as and when necessary, but with reluctance because they are usually more expensive than our own staff.

iii. MOD

About to produce pilot area contract specifications prior to tendering.

iv. Employment

Use agency staff - mainly secretarial staff - but only for short term needs because they are expensive.

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v. HMSO

Currently employ agency programmers on the main Distribution Centre project but only reluctantly as a substitute for much cheaper domestic staff who are difficult to recruit.

Agency typists have employed (in London) in the past and could conceivably be so again if recruitment drives failed, but Trade Union Side antipathy would need to be overcome. Again, thought, agency typists must be regarded as expensive and not altogether satisfactory substitutes for departmental staff. HMSO would not go for them, or telephonists or teleprinter operators, out of choice.

vi. Treasury

The Treasury make use of agency typing staff to fill an essential operational need by filling the gap in our typing force but this is an expensive option and we endeavour to keep the numbers employed and the costs to an absolute minimum.

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4. COMPUTING SERVICES AND STAFF - Category B

11. CSD summary of Departmental comments

DOE/DTP make substantial use of outside agencies to provide services. They currently employ 30 commercial computer bureaux at a cost of £2.2M in 1980/81 and an estimated £2.7M in 1981/2, compared with £1.7M in 1978/9 and £1.9M in 1979/80 (- figures exclusive of CCTA's charges for departmental expenses and VAT). ODA have introduced an Accounting Information System with the help of commercial programmers. A commercial bureau is used for statistical work in connection with the Aid Programme and is currently being used to introduce a micro FIS for pensions work for staff who have worked overseas in HMG service. Ad hoc requests in ODA are also put out to contract.

12. CSD report it remains the case that there is very limited scope for increasing the use of the computing services industry, particularly since it is more expensive than using in-house staff. The fact that fee rates for computer consultants have been rising regularly and significantly has tended to increase the disparity.

13. Figures for the years previously quoted and for the current year, excluding VAT, are -

78/79:	Computer bureaux	£4.5M;	Computer consultants	£3.5M
79/80:	"	"	£7.5M; Computer	" £2.7M
80/81:	"	"	£7.0M; "	" £3.5M

14. These figures relate to the use of the computing services industry by central government departments and are mostly concerned with administrative functions. They include the work of FCO, Department of Energy, ODA and DI, mentioned separately in the last CPRS progress report, but do not include work done for R & D Establishments, for MOD weaponry applications nor for the NHS.

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15. However, the volume of work contracted out during the current year has not shown any significant increase or decrease recognisable as a trend.

16. The following comments were received from Departments:

i. Energy

Second mini-computer now installed and bureaux services costs hoped to be halved in next 2 years.

ii. DOE/Transport

make much greater use of outside agencies to provide computer services than do other Departments. DOE/DTP currently employ some 30 commercial computer bureaux at a cost of £2.2M in 1980/81 and an estimated £2.7M in 1981/82, compared with £1.7M in 1978/79 and £1.9M in 1979/80 (figures exclusive of CCTA's charges for departmental expenses and VAT).

iii. FCO

While FCO staff plan and undertake preliminary studies of computer projects, the systems analysis, design, programming and implementation are contracted out to consultants. A comprehensive strategic study of the FCO's long term computer needs will be made this year by consultants.

For the second stage of the Passport Office computerisation project we employed the same consultants who carried out the feasibility study.

iv. DHSS

A policy paper about NHS computing discussed with Regional Health Authority Chairman in March 1981, drew attention to the desirability of using commercial services to develop new hospital systems which could not readily be provided internally.

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v. HMSO

buy in both computing services (software, packages, processing time) and staff when appropriate, particularly in connection with the development of the new peripheral systems (Main Distribution Centre, Supply Stock Control) but for the most part we rely on Computer Centre, Norwich.

Departmental policy aims at more use of domestic resources, not buying-in, once Computer Centre, Norwich processing for HMSO is transferred to this Department in 1983.

vi. Overseas Development Administration (ODA)

Arising out of an earlier report an Accounting Information System has been introduced into ODA with the help of commercial programmes. A Commercial bureau is used for statistical work in connection with the Aid Programme and is currently being used to introduce a micro FIS for pensions work for staff who have worked overseas in EMG Service. Ad hoc requests for Departments in ODA are also put out to contract.

5. TRAINING - Category B

17. CSD Summary of Departmental Comments

The latest departmental responses show the following expansion in the use of outsiders in training:

- i. DOE/DTP have started to use private consultants to present short courses on accounting and continue to look for further scope for contracting out.
- ii. ODA have employed a consultant to assist with the task of producing manuals for new staff they will have to train as a result of the dispersal to Scotland.
- iii. FCO contract out all language training, except where demand is sufficiently large to justify employing full time teachers. On the non-language side, various courses are contracted out, and outside experience "bought-in" for in-house courses.

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18. CSD state the position remains unchanged from that given in the 1980 report which concluded that the present use of outside contractors in training is just about right. There might be scope for gradual expansion in some areas subject to considerations of quality, relevance and cost: departments are alert to this possibility.

19. The following comments were recieved from Departments:

i. DOE/Transport Although training remains a category B item, the Departments continue to look for further scope for contracting out. Some limited opportunities have been found including the use of private consultants to present short courses on accounting.

ii. FCO contract out all language training except that for, which the demand is sufficiently large to justify employing fulltime teachers. On the non-language side we contract out course in introductory and international economics, international affairs and international law, and, 'buy-in' outside expertise for in-house courses.

iii. HMSO generally rely on in-house facilities but "buy-in" tutors to cover particular topics on domestic courses whenever appropriate. No basic changes in these arrangements is contemplated.

iv. Overseas Development Administration (ODA)

Because of ODA dispersal it was necessary to prepare quickly detailed manuals for the guidance of the large numbers of new staff. A consultant was engaged to assist with the task.

6. SECURITY STAFF - Category B

20. CSD report, as in 1980, that they believe the present extent of contracting out is about right, and that the use of contract staff is generally more expensive.

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21. The following comments were recieved from Departments:

i. MAFF Two security staff at Guildford being replaced by contract arrangements and further consideration being given to replacing fulltime night security staff in Northern Regions by other methods of surveillance.

ii. MOD Pilot studies in hand. Limited area offer possibilities but difficulties of security aspects in other areas.

iii. DOE/Transport Contract security staff are used at the South Ruislip stores depot and are being considered for the Cardington training centre if and when MOD (RAF) cease to use their personnel for security duties. Elsewhere access control to buildings is covered by messengers. If the present Rayner study concludes that 'silent hours' custodial services should be put out to contract, we would want to consider including our access control duties so that there would be a 24 hour contract security service.

iv. FCO As reported before, there is already a certain amount of contracting out of security work. We may also have to extend the use to the Belfast Passport Agency which is due to move into new premises (and so lose its current use of common services staff) some time in 1982.

v. HMSO buy-in contract security staff to cover the silent hours for practically all the buildings calling for it, but at Atlantic House and Cornwall House we rely on PSA night custodians and at Manor farm and Harrow Presses we use HMSO employees. For some of these addresses the real question is why we employ anyone at all, not whether we should switch to contract services.

vi. Industry and Trade

Further consideration now indicates that the question requires more detailed examination before any firm conclusions can be reached. We think because of the wider implications this should be undertaken on behalf of all Departments.

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vii. Northern Ireland Office

Because of the particular security situation in Northern Ireland any movement towards contracting out has to be handled with utmost caution. To date no contracting out has taken place. Department of the Civil Service (DOCS) which has the responsibility for the Stormont Estate containing the main Government offices, is constrained from contracting out because of security considerations which apply in particular to that Estate. Other Departments acting on advice from DOCS as necessary will continue to seek opportunity for contracting out at individual locations. This will be done within the constraints imposed by the need for security clearance of staff employed by outside firms, and the need to consult Staff Side.

Following a full scale review of the Civilian Search Unit it has been decided because of operational and legal difficulties that the Civilian Search Unit function could not be contracted out.

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7a. CATERING (CISCO) - Category C

22. CSD summary of Departmental comments

At a small number of MOD establishments detailed evaluation of tenders is proceeding for contract catering, which may offer some savings. In HMT a comparative study is currently being carried out to look at the alternative of using private catering for the Snack Bar. Of the 35 restaurants in DOE, only 9 are run by CISCO. The others are committee managed, 3 of whom employ outside contractors. The Committees do however benefit from the advisory service (for which the department has to pay) provided by CISCO.

23. CSD report it remains the case that substantial contracting out of catering could only be achieved at additional cost. The decision to use outside caterers in any particular establishment is taken on the merits of the individual case and, at the margin, some contracting out may prove feasible.

24. The following comments were received from Departments:

i. DOE/Transport

Of 35 staff restaurants only 7 are operated by CISCO. The rest are run by management committees of Official and TU side representatives who employ catering staff direct (ie non-civil servants), or, in 3 cases, employ outside contractors to run the restaurants on their behalf.

ii. HMSO

All in effect contracted out. Canteens are staffed by contractors' employees or are employed by canteen committees.

iii. Treasury

At present CISCO provides a Snack Bar Facility (which costs Treasury around £17,000 in 1980/81). We are carrying out a comparative study by looking at the alternative of using a private catering organisation to provide this service to see whether it can be supplied more cheaply.

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7b. CATERING (NHS) - Category A

25. The following contribution was received:

Northern Ireland Office

Department of Health and Social Services

The main area with large scale catering is the Health Service. Further examination has indicated that there is no real scope at present for contracting out because of lack of capacity in the private sector, in particular, to provide the kind of diverse service that it needed for nutritional and dietary purposes. In addition contracting out would mean that the considerable economic advantage in bulk purchasing on the national and regional contracts of DHSS (GB) which is available to Northern Ireland would be lost. There is also the potential security risk involved to be taken into account, as with contract cleaning.

7c. CATERING (Home Office Residential Training Establishments) - Category ?

26. The Home Office is engaged on pilot studies at three establishments (Bruche and Chantmarle police training centres and the Prison Service College at Wakefield) with the aim of drawing up specifications and inviting tenders from private contractors for the provision of an appropriate range of services. The prices quoted by contractors will be included in a comparisons of costs on the basis of which decisions will be taken on which, if any, services to contract out to the private sector. If contracts are let as a result of this exercise it is not expected they will start to run before April 1982. The positions of domestic services in the remaining residential training establishments will be considered in the light of these pilot studies.

7d. CATERING (MOD) - Category ?

27. At a small number of establishments contract catering would appear to offer the possibility of savings. Detailed evaluation of tenders is proceeding.

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8. REPROGRAPHIC SERVICES - Category B

28. The following comments were received from Departments:

i. MOD Currently assessing cost implications. The next stage will be to issue tenders.

ii. Energy To reduce costs and improve efficiency Department is attempting to bring in-house much that is now contracted out but without any increase in staffing levels. This gives the right balance between efficient use of resources and contracting out.

iii. DOE/Transport

Reprographic work not done in-house has been arranged through HMSO. However from April 1981 we shall be untying from HMSO for certain goods and services, including reprographic services, and we shall consider placing orders direct with the trade.

iv. HMSO The review of HMSI reprographic services is continuing.

HMSO's domestic facilities, mainly used by other Government Departments are being progressively run down but, at the very least, some resource will be needed to be preserved for domestic purposes; bought-in services would not be wholly effective.

9.(a) ARCHITECTURAL AND BUILDING DESIGN WORK (PSA) - Category A

29. 37 per cent of major design work is now contracted out. The proportion would be higher but for reductions in new works programmes. Further work will be put to the private sector as staff reductions take effect.

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9.(d) ARCHITECTUAL AND BUILDING DESIGN WORK (NORTHERN IRELAND OFFICE) - Category ?

30. Northern Ireland Office

a. Department of Finance

Normally 20 per cent of the Architectual and Civil Engineering Design goes to the private sector. The Department of Finance is currently examining the possibility of increasing this percentage to a target of 50 per cent although the indicators are that substantial extra costs to the public purse are likely to be involved. A submission to Ministers for a policy decision is expected in the near future.

b. Department of Health and Social Services

The Department on its capital programme currently undertakes 10-15 per cent of these services in-house against an agreed norm of 30-35 per cent and the DESS(L) figure of 35-40 per cent. A much higher proportion of this work is therefore contracted out in NI as compared with GB. It is considered that the present in-house proportion is lower than would be desirable and should be maintained at least in order that staff can retain and develop the specialist knowledge in hospital design and building.

c. Department of Commerce

This work, which is in connection with the factory building programme, has all been contracted out.

10.(a) ARCHITECTUAL R & D WORK (DES) - Category B

31. No scope for further contracting out. Change category to C.

10.(c) ARCHITECTUAL R & D WORK (DOE) - Category B

32. R & D expenditure is being transferred to private sector contractors wherever appropriate, and a study is in hand to investigate the scope for this. Officials have been instructed to work towards a goal of 50 per cent compared with only 13 per cent of expenditure placed with the private sector in 1980. Opportunities vary

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between subject areas; in housing social research, for example, contractors are already used for more than 90 per cent of projects, the exceptions being particularly substantive or urgent items.

33. Agreement in principle has now been reached with the Treasury and CSD to the transfer of the Hydrolics Research Station to the private sector. Arrangements are in hand to establish a shadow board from September 1981 which will negotiate the final privatisation arrangements. The change will save some 250 civil service posts.

34. DOE/Transport (Common Services)

There has been little new activity since our last report. No new projects have been undertaken in-house and only two extra-mural contracts have been let - one to the National Building Agency and the other to a private contractor.

11.(a) OTHER R & D (BUILDING RESEARCH ESTABLISHMENTS) - Category A

35. DOE A review has just been completed to explore the options for changing the status of the Building Research Establishment. Five options have been identified for consideration by Ministers, ranging from full privatisation to remaining in the Civil Service but with an increased commercial role.

11.(b) OTHER R & D (ENERGY) - Category B

36. Non nuclear R & D continues to be undertaken by contractors outside the Department. However, 30 staff from the Marine Technology Support Unit at Harwell hope to be brought into the Department.

11.(c) OTHER R & D (AGRICULTURE) - Category B

37. Following the initial work carried out by CPRS, MAFF has contributed to a data base compiled at the suggestion of the PUSS, Department of Industry, who is conducting a study across Departments. Possibility of further contracting out being discussed.

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11.(e) OTHER R & D (MOD) - Category ?

38. Current policy is to extend the already substantial reliance on R & D of military equipment by contract.

39. Many areas of R & D Support functions under consideration including transport, printing, workshops, test facilities, aircraft servicing, design and development work, project support and computer software.

11.(f) OTHER R & D (HMSO) - Category ?

40. Some activities in Technical Services Division might come within the scope of this heading but arguments could be adduced for keeping them in-house.

11.(g) OTHER R & D (INDUSTRY AND TRADE) - Category ?

41. MISC 14 have asked E(DL) to investigate the possibilities of contracting out research work. Nothing further can be done until E(DL) has reported.

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12a. BUILDING MAINTENANCE (PSA) - category A

42. Three-quarters of this work is now undertaken by private firms, the remainder by Works Directly Employed Labour (DEL) force. DEL manpower has fallen from 18,000 at 1 April 1979 to 16,000 at 1 April 1980 and a forecast 15,000 by 1 April 1981. This represents a 17 percent reduction over the 2 year period. A 40 percent reduction by 1984 is planned, with further reductions to 50 percent or more.

12c. BUILDING MAINTENANCE (NHS) - category A

43. The following comment was received:

Northern Ireland Office

Department of Health and Social Services (NHS)

The position in Northern Ireland does not materially differ from that in Great Britain in that for operational reasons (e.g., emergency cover, flexibility in use of labour) some maintenance is best undertaken by direct labour. The DHSS is keeping the utilisation of labour under constant and critical review. The Department is endeavouring to achieve general application of a nationally agreed productivity scheme as for the NHS in Great Britain. In the light of experience in Great Britain industrial relations difficulties are thought likely to limit the rate of progress in contracting out further work.

The Department of Health and Social Security is currently preparing a paper revising the use of Directly Employed Labour (DEL) so that the most cost effective method of carrying out maintenance is adopted taking into consideration the constraints involved in using outside contractors. Because of the similarity of the problems involved, DHSS will liaise with the Department of Health and Social Security to determine further action.

12d. BUILDING MAINTENANCE (ANCIENT MONUMENTS) - category A

44. The following comments have been received from Departments:

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i. DOE

In-house work on design and execution of maintenance schemes is being run down in favour of contracting out. Some 40 percent of the maintenance programme in 1981/82 is scheduled for contract action. Some in-house capacity has to be retained e.g. for design at royal residences and for works at mediaeval ruins. Consideration is also being given to contracting out some staffing functions such as warding and custody.

ii. Scottish Office

report that SDD arrange contracting out where this is practicable, though there are restraints caused by the need for very specialised expertise for much of the work and more generally by the lack of suitable firms in the areas concerned. The Department is in touch with the Department of the Environment about developments in England.

12e. BUILDING MAINTENANCE (SCOTLAND) - category ?

45. Virtually all building maintenance work at the Scottish Police College and the Scottish Fire Service Training School is done by private contractors.

12f. BUILDING MAINTENANCE (NORTHERN IRELAND OFFICE) - category ?

46. Northern Ireland Office

a. Department of finance

The workload is very fragmented both in size of job and geographical location: over 20,000 separately identifiable units of work are carried out annually all over the country in 2,000 buildings occupied by eleven separate client bodies. The work consists largely of day-to-day repairs and adaptations costing only hundreds of pounds, all carried out to an estate which is usually "in occupation". Contracting out of this would introduce serious problems in co-ordinating and maintaining essential estate management records which require in-house liaison. In addition, because of its unattractive nature to the private Consultant, it would be extremely expensive in fee-cost compared with in-house working. It is not therefore considered that there is any scope for contracting out in this sector.

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b. Department of Health and Social Services (NHS)

The position in Northern Ireland does not materially differ from that in Great Britain in that for operational reasons (e.g. emergency cover, flexibility in use of labour) some maintenance is best undertaken by direct labour. The DHSS is keeping the utilisation of labour under constant and critical review. The Department is endeavouring to achieve general application of a nationally agreed productivity scheme as for the NHS in Great Britain. In the light of experience in Great Britain industrial relations difficulties are thought likely to limit the rate of progress in contracting out further work. The Department of Health and Social Security is currently preparing a paper revising the use of Directly Employed Labour (DEL) so that the most cost effective method of carrying out maintenance is adopted taking into consideration the constraints involved in using outside contractors. Because of the similarity of the problems involved, the Department of Health and Social Services will liaise with the Department of Health and Social Security to determine further action.

c. Department of Commerce

The Department, in connection with its factories programme, has contracted out all building maintenance work.

13a. TRANSPORT SERVICES (PSA) - categories A and C

47. Regional Car Service - category A

The fleet was reduced to a total of 33 vehicles by the end of 1980 and there is some scope for further reduction. From 1979 to 1981 staff has reduced from 10 to 8 non-industrial and from 83 to 31 industrial.

48. Road Haulage - category A

A submission has been made to Ministers recommending the total contracting out of this activity.

49. Interdepartmental Despatch Service - category C

A review of the London based service is in progress.

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13b. TRANSPORT SERVICES (MOD) - category A

50. Following the Strathcone report Department now looking at all forms of transport in support services for ways of contracting out. Category changed from C to A.

13d. TRANSPORT SERVICES (CSD) - categories A and C

51. CSD summary of departmental comments

A large number of departments already make regular use of private contractors to transport items such as computer tapes between headquarters and regional centres, where it is economical to do so. HQ, for example, who already spend over £4m per annum on hired vehicles to convey inmates and to carry freight are currently engaged on a comparative study of the cost of official and hired/contract transport to deliver stores to prisons. Ordnance Survey are mounting a similar exercise to determine the cheapest means of transporting stores and exhibition material. Some departments, such as C & E and MoD have little scope for contracting out because of security considerations, and in other cases it is more economic to continue to make use of official vehicles.

52. Service Vehicles - category A

The following comments have been received from Departments:

i. MAFF

Concluded that they should continue to operate its own fleet of vehicles; hiring will be used where circumstances make it financially advantageous and operationally acceptable.

ii. Overseas Development Administration (ODA)

Vehicle hire as an alternative to purchase is being investigated by the Transport Economy Unit of CSD. In the most recent case purchase was approved by CSD.

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53. Function Vehicles - category C

HMSO

In-house services mainly in London and with Office Machines Technical Services (OMTS). Department suggest that OMTS vans seem indispensable to its outside activities. The value of the main van services may be said to depend on comparative costs but there would probably be other difficulties also in going over to contractual services.

14a. VEHICLE FLEET MAINTENANCE (PSA) - category A

54. The future of the Vehicle workshops is under consideration by Ministers. From 1979 to 1981 staff has reduced from 64 to 50 non-industrial and 312 to 215 industrial.

14b. VEHICLE FLEET MAINTENANCE (MoD) - category A

55. Pilot studies in hand to cease in-house support of certain commercial vehicles and their spares. Category changed from C to A.

14c. VEHICLE FLEET MAINTENANCE (NHS)

56. DHSS

A pilot management service study has just been completed on the relative merits of different maintenance arrangements for NHS vehicles. The results of the full study will be made available to the NHS in due course.

14d. VEHICLE FLEET MAINTENANCE (CSD) - category A

57. CSD Summary of Departmental comments

Departments make extensive use of commercial garages for vehicle maintenance and repair. DEm will shortly be using the servicing facilities of National Carriers Ltd for an experimental period in order to assess that company's viability as a maintenance outlet, while Ordnance Survey are considering the use of a local garage to service their headquarters fleet as an alternative to their present use of directly-employed labour.

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58. The following comments were received from Departments:

i. MAFF

Repairs and maintenance continue to be carried out by commercial garages except where PSA workshop can be used with advantage.

ii. Customs & Excise

Most of work done in private garages.

iii. Employment

Vehicles serviced by local garages except in London where PSA is used. MSC fleet serviced by Skillcentres. Negotiations are in hand to change the London arrangements to produce further savings.

iv. FCO

Transport is already maintained at outside garages where it is economical to do so and there are no security considerations preventing the use of local garages. At posts overseas, mechanics are only employed directly where there are compelling reasons for so doing.

v. HMSO

Have domestic facilities in London, also used for some HMSO vehicles kept outside London. The value of this service depends on comparative costs but there would probably be other difficulties also in going over to contractual services.

vi. Industry and Trade

Some limited use is already being made of the private sector for vehicle maintenance, and approval has been obtained from the CSD Transport Economy Unit to pursue the proposal to transfer further work from PSA.

vii. Overseas Development Administration

A local garage is now being used to service the COPR vehicles and the service is satisfactory.

15. CARTOGRAPHIC SERVICES - category A

59. The following comments have been received from Departments:

i. Energy

Have cut back on the amount of work and services undertaken by outside contractors in order to reduce costs.

ii. DoE

Much of DoE cartographic work is not appropriate for contracting out, being mostly short tasks requiring a quick response and close working with customers (80 percent of jobs are completed in under 2 days). Nonetheless, work is contracted out where possible. Nearly all printing and half of the photographic processing of artwork is done by commercial firms. Mapping of national boundaries for computerisation is being done by a private firm, and a system for automated digitising developed by DoE is being exploited commercially. Decisions on whether certain other services might be privatised or contracted out will be taken in the light of the Ordnance Survey Review.

iii. Overseas Development Administration

The Rayner Scrutiny of the Directorate of Overseas Surveys has been completed and is currently being considered by the Staff Side: recommendations will shortly be submitted to Ministers.

iv. Property Services Agency

Progress on this item depends partly on decisions yet to be taken on the Report of the Ordnance Survey Review Committee. Nevertheless, PSA has been examining the possibilities and whilst there is some evidence that contracted-out work of this kind is more expensive and requires a good deal of in-house supervision, it is proposed to carry out one or more trials at typical Estates Area Offices in order to assess costs and quality of service. Much of the PSA's cartographic work, however, is directly related to Ministry of Defence property records where, on ground of security, contracting out is not practicable.

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v. Scottish Office

SDD have examined carefully the scope for further contracting out and conclude that there is no suitable body of work which would enable contracting out on any scale to be feasible. There are, however, to be reductions in the number of staff in this area.

16. LEGAL SERVICES - category C

60. Rayner report by D/Employment and DHSS commented on the cost of agents' fees and associated costs and recommended that local office and regional office fraud staff represent the Departments in fraud prosecutions on social security legislation and that greater use is made of Departmental solicitors in other cases. Trade undertaking a Rayner scrutiny which includes the option of using outside lawyers for prosecutions work. Provisional recommendations likely to include the setting up of a network of solicitors to act for Departments and a greater use of agent solicitors, subject to certain provisions. Final report due for submission in mid-July 1981.

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18. INLAND REVENUE VALUATION OFFICE - category B

61. The review of the structure of the Valuation Office (in which CSD is involved) is approaching completion. In the meantime there has been no change in our view that our present recoverable service work arrangements are in principle about right. They enable, but do not require, the kinds of government-sponsored authorities for which work is done on recoverable service terms to look to District Valuers for valuation advice and to the extent that those authorities are not satisfied for any reason (quality, efficiency, cheapness, timeliness, absence of direct control, or whatever) with the service they get they are free to turn to private sector or to in-house advisers. So far as details of the arrangements are concerned we are, alongside the Valuation Office Review, seeking to improve the measurement of resource-user and cost-attribution because of shortcomings of which we are aware.

62. The Valuation Office Review will be looking at the wider question of the work done on allied service terms. Much may depend in respect of this work, on whether it is decided to switch from an allied service to a charging basis, and the extent to which Departments remain 'tied' to the Valuation Office. It would be for other Departments (and not the Valuation Office), if they were not 'tied', to decide whether to 'employ' the District Valuer and the extent of any savings would therefore ultimately depend on how much client departments themselves switched to the private sector.

19. DESIGN AND SUPERVISION OF MAJOR ROAD SCHEMES (ENGLAND) - category A

63. The following comments have been received from Departments:

i. Transport

The Secretary of State for Transport's proposals for transferring most of the work of the RCU Sub-Units to private consultants were announced last October. After consulting local authorities and

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the staff involved, his final decisions on which work should go to consultants were announced in December. Since then the Department and a "Clearing House" (set up to look after the interests of the 1600 or so staff involved) have been considering proposals submitted by consultants.

On 12 March 1981 the Secretary of State announced the names of the first consultants to whom he would be offering work. This involved the road schemes previously undertaken by the Buckinghamshire, Hertfordshire, Bedfordshire and Essex Sub-Units of the Eastern area and by the Durham Sub-Unit in the North-East. The value of the work offered is estimated to cost £734 million and represents about one third of all the work which is to be transferred to consultants.

Consultants' proposals for the work of the remaining 9 Sub-Units are being considered progressively and it is hoped that all the work going to the private sector will be offered to firms by the end of the summer.

[ii. Welsh Office do not have Road Construction Units and the result is that the bulk of design work on trunk road and motorway schemes is undertaken by private consultants.]

20. TESTING OF HEAVY GOODS VEHICLES AND PASSENGER VEHICLES - category A

64. The following comments have been received from Departments:

i. Transport

Legislation is planned for the 1981/2 Session. The proposals were dropped from the 1980/81 Transport Bill, following the Leader of the House's request to colleagues to reduce pressure on the legislative programme.

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The Secretary of State published a policy paper in August 1980 announcing his intention to divide the present network of 91 testing centres between a small number of private sector companies, each running a chain of centres. The companies would make their money from test fees paid by vehicle operators.

These proposals have attracted a good deal of opposition, and the additional time made available by the postponement of legislation is being used to consult further with the industry on the organisation of the new system. The underlying concern is that the existing impartial standards should not deteriorate, in the interests of road safety. The Secretary of State believes that this concern can be met if there are thorough arrangements for supervision and monitoring and is looking at the proposals of involving industry representatives in these arrangements.

Transfer to the private sector will reduce Civil Service manpower and introduce an element of competition, in terms of services offered to operators, which should promote efficiency. In Government accounting terms the testing system already covers its costs, but there may be benefits to the PSBR from disposal of the assets of the system. The size of any such benefits will depend on market response, and on the scale of payments which have to be made for pensions and redundancy compensation.

The proposals will continue to be controversial; even if agreement can be reached with the operators organisations, the unions will maintain their opposition.

ii. Northern Ireland Office

Department of the Environment

A detailed examination has been carried out by DOE (NI). Transport is organised differently in Northern Ireland and this examination has brought to light significant difficulties, particularly in terms of cost and security which will require further close consideration.

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21.a. NHS FUNCTIONS: USE OF OUTSIDE HEALTH CONTRACTORS - category A

65. The following comments have been received from Departments:

i. DHSS

In January 1981 DHSS issued a circular to encourage and facilitate the extension of contractual arrangements between the NHS and independent hospitals and nursing homes and other forms of co-operation between the NHS and the independent medical sector. It is too soon to say what practical effect this will have since Authorities must consider the resource implications of such arrangements within their overall cash limits.

In addition the Department is considering the possibility of a centrally-funded pilot project in a selected Health District. Discussions are however still at an early stage.

ii. Scottish Office

SHHD are about to issue a circular to Scottish Health Boards providing guidance on contractual arrangements for the treatment of NHS patients in private hospitals and nursing homes and encouraging co-operation between the NHS and the independent medical sector. The Department is closely in touch with DHSS about the scope for changes in other areas of the NHS that have been identified as suitable for contracting out, but current industrial relations problems and the opposition of the NHS trade unions are likely to impede progress.

21.b. NHS FUNCTIONS: LAUNDRY SERVICES - category A

66. The following comments have been received from Departments:

i. DHSS

Discussions between the Department and the British Launderers Association culminated in the latter deciding that they would not usually be able to offer a cheaper alternative to the existing NHS laundering. They are, however, interested in the potential for

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capital investment and the Department proposes to advise Authorities to consult the industry before embarking on any substantial capital programme.

Discussions are already under way about the possibility of meeting commercially the laundry needs of two Area Health Authorities.

ii. Northern Ireland Office

Laundry Services in NHS, identified in the last CPRS report as having been moved from category C to category A, have been specially considered. A detailed reappraisal of these services in Northern Ireland has been carried out and has confirmed that there is a severe lack of capacity in the private sector to cope with all types of laundry items and standards in the health services. In view of this fact and of substantially higher costs in the commercial field, the conclusion is that this subject should remain in category C in Northern Ireland - no scope for contracting out.

21c. NHS FUNCTIONS: MANUFACTURE OF BLOOD PRODUCTS - category C

67. Following preliminary discussions between the Department and the pharmaceutical industry, and broad agreement with one firm on the basis on which they would be prepared to manage the Blood Products Laboratory, Ministers decided that there was no satisfactory basis for commercial involvement without serious risk to the voluntary blood donor programme. This item should therefore be transferred from category A to category C.

22. OFFICE OF POPULATION CENSUSES AND SURVEYS - category ?

The Rayner Report on Government Statistics has been completed. One of the recommendations is that all ad hoc social surveys should be contracted out where private sector costs are less than those of OPCS. If this recommendation is accepted by the commissioning departments then this will lead to a greater share of ad hoc household survey work going to the private sector. However, other aspects of the recommendations, if accepted in full, would lead to a reduction in the level of ad hoc survey activity anyway.

23. FCO FOREIGN TRAVEL AND ALLOWANCES - category ?

69. The following comments have been received from Departments:

i. Foreign and Commonwealth Office (FCO)

In addition to travel bookings and freight services for Diplomatic Service (DS) personnel, DS official freight and unclassified bag services are contracted out to a freight forwarding Agency Pandair, who maintain a small unit in the FCO.

The FCO and CSD are considering whether Employment Conditions Abroad Limited, who specialise in setting rates of payment for staff of private companies abroad could meet satisfactorily the demands of the Foreign Services Allowance system. ECA are currently conducting a study for a selection of countries.

ii. Overseas Development Administration

This is a possible area for contracting out but has not yet been fully considered by the Department. The possibility has been mentioned in an internal report about office services generally but it has still to be considered by management.

24. PUBLISHING - category ?

70. The following comments have been received from Departments:

i. MAFF

In December 1980 granted discretion by CSD to offer a limited number of MAFF titles to publishers in the private sector.

ii. MoD

Publishing/Printing/Editing: General field being considered; also arrangements if HMSO tying ceases.

iii. HMSO

The study which arose from the consideration of tying arrangements is still in progress. So far as we are aware there has been no significant use of private sector publishers as yet.

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iv. Industry and Trade

It is still the intention to transfer from HMSO responsibility for the remaining publishing functions, but the scope for doing so is subject to staffing constraints. It is likely that HMSO will continue to be used for print procurement (on a repayment basis) since there is no in-house capacity for monitoring printers' bills.

25. BUSINESS STATISTICS OFFICE - category ?

71. Industry and Trade

There has been a continuing improvement in the unit output of Business Statistics Office (BSO) data preparation work. CSD have accepted responsibility for looking at the further development of proficiency allowances designed to improve productivity. However, only about a third of the total data preparation work at BSO could be contracted out, because the remaining part of the work is covered by BSO's legal obligation to protect commercial confidentiality. The work that could be contracted out is that carried out for the Companies Registration Office; were this to happen, the difficulty of managing the peaks and troughs associated with other work would become more pronounced and would conflict with the objective of minimising costs. The question of computing costs in general and data preparation costs in particular have been brought to the forefront by the various Rayner reviews, and are being considered fully under the responses made to them.

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41. MAINTENANCE OF MINOR WATERCOURSES - category A

72. Northern Ireland Office
Department of Agriculture

During 1980 the Department of Agriculture used the services of contractors for maintenance work on an increased number of minor water-courses. Prior to 1980 some 300 kilometres were scheduled for maintenance by contractors but contract maintenance has now been extended to approximately 1700 kilometres. To date 360 individual contracts have been awarded and the Department of Agriculture is keeping firmly in mind the possibilities of extending contract work beyond the present level. The Department is satisfied with the contractors work so far and no major difficulties have been experienced. The Ulster Farmers Union has also indicated that farmers are pleased with the speed and standard of the contractors' work.

42. QUARANTINE SERVICES - category C

73. Northern Ireland Office
Department of Agriculture

There are serious practical difficulties in contracting out in this area because of the diverse way in which animal imports operate in Northern Ireland. Animals and poultry are imported by individual farmers and poultry companies through DANI quarantine rather than through quarantine run by commercial importing agencies under MAFF supervision in GB. There would be difficulties in operating a closely knit private quarantine service here on Great Britain lines. The present tight centralised control has contributed to the excellent health record and reputation enjoyed by the Northern Ireland livestock industry.

74. The possibility of contracting out has been pursued and some information on costings of the equivalent Great Britain services has been obtained but due to the private nature of these services it has not yet been possible to obtain sufficient data to make a meaningful comparison in the matter. In all the circumstances it is considered that Quarantine Services in Northern Ireland should be treated as belonging in Category C.

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43. HOSPITAL SERVICES - category C

75. Northern Ireland Office

Department of Health and Social Services

The scope for privatisation is extremely limited in Northern Ireland for two main reasons. First, there is no evidence of any public demand for such services beyond what is already available. Second, there are very few private hospitals and these provide limited services. The major facility of this type is in Belfast, has only some 40 beds, and has to depend upon the NI health services for such support as blood products, laboratory tests, etc. It is considered therefore that hospital services in Northern Ireland should be in Category C.

46. TRANSPORT AND ROAD RESEARCH LABORATORY - category ?

76. Transport

The Transport and Road Research Laboratory (TRRL) is currently funded entirely by Government. It undertakes research on behalf of the Department of Transport on, amongst other things, highway construction, road safety, traffic engineering and public transport. The Laboratory's overseas unit also undertakes work, funded by the Overseas Development Administration, on behalf of foreign governments. TRRL employs in total some 620 staff.

77. The Advisory Committee on Applied Research and Development (ACARD) recommended, in its report on public purchasing in the research and development field, that the Government should consider how the expertise of public sector R & D establishments might be effectively marketed abroad. The Department is therefore considering the scope for contracting out exploitation of research work, though no decisions have been taken about the form and extent of these arrangements.

48. CENTRAL FILM LIBRARY - category A

78. Central Office of Information

This activity had been examined on a number of occasions over the last ten years with a view to contracting to a commercial film library.

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When tenders have been received it has always been found less expensive to continue to carry out the work in house. However we have now negotiated an agreement with the Services Kinema Corporation which will include computerisation of the library function and enable the work to be carried on at no greater cost. This agreement takes effect on 1 August 1981 from which date the SKC will take over the running of the Central Film Library and the staff saving of 38 posts will follow shortly after.

49. FILM DIRECTING AND EDITING - category A

79. Central Office of Information

Following a reduction in work load, it has been found that the film directing and editing functions carried out by COI staff could more economically be performed by the use of freelance personnel and the hiring of commercial facilities. We are at the beginning of difficult negotiations with the film trade unions over this but it is planned to take effect by the end of this financial year, with a saving of 26 posts.

50. DISTRIBUTION AND SHIPPING - category ?

80. Central Office of Information

We are about to start an investigation into this operation with a view to contracting out some parts of it. We have yet to compare costs but it is possible that about ten posts might be saved.

51. MAINTENANCE WORK AT TRAINING SCHOOLS (NORTHERN IRELAND) - category ?

81. Detailed investigation of maintenance work at Training Schools is still not complete but the work done so far suggests that there may be scope for some contracting out of this function.

RESTRICTEDLOCAL AUTHORITY CONTRACTING OUTA Progress Report by the Central Policy Review Staff (CPRS)Introduction

1. The Ministerial Steering Group on Government Strategy asked for a CPRS progress report on contracting out public section functions (excluding functions of local authorities and nationalised industries). Since the original report on local authority contracting out complemented the main study, the CPRS thought it would be useful for the Group to have a progress report on the local authority aspect, too, although one was not specifically called for.

Background

2. At the meeting on 28 January 1980 (MISC 14(80)1st Meeting, Item 2) the Group instructed the CPRS to conduct a review of the scope for contracting out local authority services to the private sector.

3. The CPRS report (MISC 14(80)10) was considered by the Group at its meeting on 22 April 1980 (MISC 14(80)3rd Meeting, Item 1). The main points arising out of the report were that:

a. The CPRS believed that the principal yardstick for deciding whether a service should be contracted out should be the cost of that service, when properly analysed.

b. There was insufficient evidence to support general conclusions that particular local authority services could be carried out more cheaply by the private sector. Legislation to enforce contracting out would thus be premature.

c. Since the local authority financial system did not appear to create an in-built bias against contracting out, no specific financial incentives seemed necessary.

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d. The CPRS, therefore, recommended that the principal scope for progress lay in improving the information available to local authorities about the possibilities of cost saving by contracting out.

4. The CPRS report made a number of recommendations which were endorsed by the Group. Full details of these are given at Annex A.

Present Position

5. In the past year the Department of the Environment (DOE) has concentrated on ways of meeting the general recommendation in the CPRS report about improved information at d. above. Possible sources of information, such as the District Audit Service and LAMSAC, as suggested by the CPRS, have been explored, but there has been found to be an overall lack of consistently produced information available centrally on local authorities who have either adopted contracting out or who have undertaken feasibility studies and cost comparisons.

6. To help remedy this information gap, DOE has commissioned a research project with the aim of identifying interesting examples of current contracting out practice in the local environmental services sector of local authority activity. The study will explore the rationale of present practice in relation to local authorities' general policies and budgetary and accounting practices, and the scope for alternatives to existing practice. The report of the study will be published in the summer and should provide useful information for local authorities on the areas where private contractors have been used successfully and the factors which need to be considered. It will be followed up by more detailed studies of particularly interesting cases.

7. Significant additional information relating to contracting out will also soon be available to individual local authorities in the field of construction and building maintenance. Under Part III of the Local Government Planning and Land Act 1980 which came into effect on 1 April this year, their direct labour organisations will be required to bid for a substantial proportion of their work in competition with the private sector. They will have to keep full trading accounts and local authorities will, for the first time, have all the

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information they need to weigh the costs and benefits of carrying out work themselves against those of using outside contractors.

8. Additionally, information about overseas experience of contracting out is being made available to local authorities. Ministers are continuing to stress in speeches, articles and the like that it is important for local authorities to consider how contracting out can produce useful economies in the provision of services, and will be drawing attention to the results of the current research when the report is available.

9. DOE report that the following further steps are being taken in pursuit of the recommendations in the CPRS paper:

a. CSD have, with DOE, held discussions with LAMSAC to explore the areas where central government experience of contracting out, and cost-saving generally, might usefully be shared with local authorities. Relevant CSD work identified so far has concerned studies of a general nature in pursuit of efficiency in central government. Contact with LAMSAC is, however, continuing, and they will be kept informed of any relevant studies of contracting out in central government;

b. the Chief Inspector of Audit has made arrangements to be notified by auditors of instances of contracting out. The circulation of this information, and the results of DOE's current research project, should help auditors to assess the financial effects of contracting out and thus put them in a better position to draw local authorities' attention to this approach where they consider there are savings to be made;

c. consideration is being given to ways of providing more information to local authorities about the ability of the private sector to provide public services. The possibility of approaching some of the main trade associations for assistance is being explored, and in the refuse collection field, Lord Bellwin is meeting a number of leading refuse and cleaning companies with a view to discussing what they might do to make local authorities more aware of the services they can provide.

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10. The Scottish Office and the Welsh Office are both awaiting the results of the DOE study before taking action.

11. In Northern Ireland, following the reorganisation of Local Government in 1973, the functions, which in Great Britain (GB) are carried out by local authorities, are operated mainly within central Government e.g. Housing, Roads, or by 100 percent centrally funded statutory bodies e.g. education and health, and only minor services are left with local authorities e.g. cleansing, refuse collection services, and some sport and recreation services. A separate examination of the local authority services in Northern Ireland has not, therefore, been undertaken, but it is intended to review the position when more is known about actual progress in GB. The most likely interest for Northern Ireland District Councils is in refuse collection, and close contact is being maintained with any progress in this field in GB.

Conclusion

12. Progress has been very slow. The Scottish Office, Welsh Office and Northern Ireland Office have taken no action pending the outcome of developments within DOE; in the case of Northern Ireland the scope for contracting out local authority services is limited.

13. DOE have had difficulties because of the lack of consistently produced information available centrally on local authorities who are contracting out or making cost comparisons.

14. However, given the work in hand by DOE, the implementation of Part III of the Local Government Planning and Land Act 1980, and the continuing dissemination of information by Ministers of the economies to be gained by contracting out, there should be substantial progress over the next few months.

Recommendations

15. The CPRS make the following recommendations:

- a. following publication of the results of the research project on current contracting out practice in the local environmental services activity:

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- i. DOE should take steps to make the information widely available to local authorities as quickly as possible, with recommendations as appropriate;
- ii. DOE should consider urgently which cases warrant a follow-up and arrange for detailed studies to be put in hand;
- iii. Scottish Office, Welsh Office and Northern Ireland should convey the outcome of the research project quickly to their own local authorities, with any guidance thought necessary for implementing its proposals;
- iv. DOE should consider producing a background note or speaking note for Ministers, perhaps for distribution through the Office of the Chancellor of the Duchy of Lancaster and Paymaster General, in order that all Ministers, in their speeches, etc, can continue to stress how important it is for local authorities to consider how contracting out can produce useful economies;
- b. DOE should encourage authorities to make use of the information on comparative costs and benefits of directly employed labour and outside contractors in the field of construction that will become available as a result of the implementation of Part III of the Local Government Planning and Land Act 1980.
- c. CSD and DOE should continue their discussions with LAMSAC and keep them informed of any relevant studies of contracting out in central government;
- d. in addition to c. DOE should consider whether this exchange of information with LAMSAC is adequate for getting through to authorities themselves, and what the alternatives are;
- e. DOE should arrange for instances of contracting out notified by auditors to be made widely available;
- f. DOE should consider inviting the Chief Inspector of Audit to feature some interesting aspects of contracting out in his annual report;

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g. DOE should prepare a further progress report in about 9 months time for submission to Ministers.

16. There are two riders to these recommendations:

a. the dissemination of information by DOE in a number of these recommendations - but especially a.i. - will need to be handled very diplomatically. It is not envisaged that information would merely be issued with instructions to implement the various recommendations. DOE should, therefore, give careful thought to the best way to handle the proposals taking into account the circumstances of each individual authority;

b. we should note that, while the above recommendations have been framed - in general - in terms of action by DOE, we envisage similar action being taken by the Scottish Development Department and the Welsh Office as appropriate, in consultation with DOE.

Central Policy Review Staff
70 Whitehall
London SW1

July 1981

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Recommendations

18. Our detailed recommendations are as follows:

- a. The CSD and possibly other Departments with relevant experience (eg the CCTA and the PSA) should issue a series of short working papers giving details of the calculations they have done to show the comparative costs of in-house provision and contracting out in areas which are of interest to local as well as central government.
- b. DOE should consider the possibility of arranging for the publication, by whatever means may be appropriate, of notes of cost comparisons made by District Audit in the course of their regular work. These comparisons are publicly available within the relevant authorities, but are not at the moment otherwise published. It should be possible to publish examples without divulging the authorities' names.
- c. DOE should ask LAMSAC to consider whether they could make the results of relevant consultancy studies more widely available - again it should be possible, if necessary, to disguise the authorities in question.
- d. DOE, with the help of District Audit, should identify those authorities which are at present making most obvious headway in key areas, and should then try both to obtain details of the progress of these schemes, and to encourage CIPFA or the authorities themselves to publish the results of their experience. These cases could then to some extent at least be seen as experiments. (We think this approach is to be preferred to experiments artificially promoted by central government or to a theoretical study of comparative costs by consultants.)
- e. DOE should consider how effectively to disseminate material made public as a result of recommendations a. to d. above. It will be important that the local authority associations, and through them their members, should have their attention specifically directed towards relevant information becoming available. But there may also be scope for a wider based information campaign aimed at the Press and so at ratepayers and electors.

f. DOE should invite the Chief Inspector of Audit to consider bringing to district auditors' attention the importance of contracting out as an option in the context of cost savings. The objective of this would be that, on the basis of information already in their hands, (and additional information as it becomes available), district auditors should in appropriate cases draw the attention of individual authorities to options for contracting out which would give rise to cost savings. (Where such options are insufficiently followed up by the authority concerned the auditor would be able at his discretion to draw attention to this in his report.

g. DOE should consider encouraging the CBI (and possibly other employer organisations) themselves to review the current range of local government services and the extent to which the private sector does, or could, contribute and, on the basis of this, to encourage their members to consider submitting proposals in the more promising areas to appropriate local authorities.

13 JUL 1981





From the Secretary of State

The Rt Hon Norman Fowler MP
Secretary of State for Transport
Department of Transport
2 Marsham Street
London, SW1P 3EB

7 July 1981

Dear Norman

I have seen copies of Michael Marshall's letter to you of 10 June and of Geoffrey Howe's to you of 12 June about the privatisation of testing of heavy goods and passenger service vehicles.

This is to say that I entirely agree with all the points made by Michael Marshall. A sale to a single bidder, thereby establishing a monopoly company backed by statutory provision, would be inconsistent with our competition policy generally. It would sit most oddly with past and future references to the Monopolies and Mergers Commission of mergers potentially damaging to competition, and indeed might well in itself create a merger situation which I should need to consider for possible reference to the Commission under the Fair Trading Act. It would also sit strangely with our efforts to cut back other public sector monopolies, for example, the British Gas Corporation's monopoly in the retailing of gas appliances. Charging excessive vehicle testing fees is not the only way such a company could take advantage of its captive market, and I am not convinced that the controls and safeguards proposed would prove effective in practice.

I therefore hope we would think very carefully before following a course which precluded scope for competition.

I am copying this to the recipients of yours.

Wm S John Biffen

JOHN BIFFEN

*Econ Pol**From the Secretary of State*

The Rt Hon Norman Fowler MP
Department of Transport
2 Marsham Street
London SW1P 3EB

18 June 1981

*12 18/6**Dear Norman*

Thank you for copying to me your letter of 12 June to Sir Keith Joseph about the proposal by the managers of the National Freight Corporation to take over the company themselves.

On the basis that the proposal creates no merger situation requiring a decision from me on possible reference to the Monopolies and Mergers Commission I am content that you should proceed as you suggest. I understand that your officials have satisfied the Office of Fair Trading (whose Director General has a duty under the Fair Trading Act 1973 to advise me on mergers) that on the information available no such merger situation would be created.

If this subsequently turned out not to be the case the Director General would of course have to consider and advise me on the implications of any merger situation created by the proposal, as indeed he would if a merger situation arose through a disposal of their shares by a group of NFC managers in the future.

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

JOHN BIFFEN

THURSDAY 18 JUNE 1981

TREASURY

C - Lincoln

No 151

MR KENNETH CARLISLE: To ask Mr Chancellor of the Exchequer, if he will make a statement about expected proceeds from the sale of public sector assets.

MR NIGEL LAWSON

The British Petroleum Company Ltd has announced today a rights issue to raise £624 million. It would have cost the Government and the Bank of England together some £280 million to subscribe for the rights in respect of their shareholdings in the Company. This expenditure could not have been justified at a time when the Government is giving priority to containing public expenditure and the public sector borrowing requirement. The Government and the Bank are therefore not taking up their rights.

In order to provide for the disposal of the Government and the Bank's rights in an orderly manner, shares which would otherwise have been offered to the Government and the Bank will, subject to an additional payment of 15p per share, be offered to the Company's other shareholders and the participants in their Group share schemes for employees.

This offer has been underwritten and the additional payment will produce net proceeds of some £14 million, which will be collected by the Company on behalf of the Government and the Bank.

The Company's offering circular for the rights issue records that, while HMG's policy of selling publicly-owned assets to the private sector is regularly reviewed, HMG has no plans at this stage to sell any more of its present holding in the Company, and will not do so in the financial year ending 31 March 1982, nor does the Bank of England have any plans to sell, other than to HMG, any of the shares in BP representing the holding acquired by the Bank in 1975 from Burmah, which acquisition is currently the subject of litigation. The offering circular also records the Government's re-affirmation of its intention to maintain its relationship with BP in a way which does not breach the traditional practice of non-intervention in the administration of BP as a commercial concern.

An Estimate for a token amount will be presented to the House in due course to provide for the Government's expenses of the sale. The net receipts from the additional payments will be credited to the public sector asset disposals programme. The Government stated in the Public Expenditure White Paper (Cmnd 8175) that sales planned for 1981-82 were expected to yield some £500 million in outturn prices.



2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/15379/81

Your ref:

17 June 1981

Dear Secretary of State

I have seen Norman Fowler's letter of 12 June about the scheme for the sale of National Freight Company to its managers.

I would simply like to register my strong support for what he proposes.

I am sending copies of this letter to the recipients of Norman's letter.

*Yours sincerely
J. Heseltine*

MICHAEL HESELTINE

Approved by the Secretary of State and signed in his absence

Rt Hon Sir Keith Joseph MP



DEPARTMENT OF INDUSTRY
Ashdown House
123 Victoria Street
London SW1E 6RB

Telephone Direct Line: 01-212
Switchboard: 01-212 7676

With the Compliments of the
Parliamentary Under Secretary of State



From the
Parliamentary Under Secretary of State

The Rt Hon Norman Fowler MP
Secretary of State for
Transport
Department of Transport
2 Marsham Street
LONDON

SW1

Elon PC

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 5902
SWITCHBOARD 01-212 7676

// June 1981

R. 14/1

Dear Norman,

THE NATIONAL FREIGHT COMPANY LIMITED

TL + MAP

I have seen your letter of 12 June to Sir Keith Joseph on the offer from a consortium of senior management and staff to buy out the National Freight Company.

Subject to the offer making financial sense, I agree that the consortium should be given every encouragement. I particularly welcome your assurance that the consortium intend to encourage all employees to buy shares in the company. As you know, the need for greater employee participation is something we are currently trying to impress upon industry.

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

Yours sincerely

Michael Marshall

MICHAEL MARSHALL



10 DOWNING STREET

Did not see.

na

MAD

PRIME MINISTER

I mentioned during Questions briefing that Norman Fowler intends to make an Oral Statement on Thursday, foreshadowing the takeover of the National Freight Company by a group of its senior managers.

He explains the proposal in the attached letter. The draft Statement is at Flag A. Content that he should go ahead as proposed?

*There are cautionary
notes from Mr
Lawson at Flag B,
but he does not object to the
statement.*

16 June 1981



B
2 pps

Mike

Treasury Chambers, Parliament Street, SW1P 3AG

Did the PM

see the statement?

The Rt Hon Norman Fowler MP
Secretary of State for Transport
2 Marsham Street
LONDON
SW1

16 June 1981 *lf so, p.a.*

Norman

with TC or HAT

TL

16/6

Your letter of 12 June to Keith Joseph invites colleagues to agree that we should go ahead with the sale of the National Freight Company Limited on the basis of the Management Consortium offer.

I entirely agree that this offer is a welcome and attractive one. It should enable privatisation to take place immediately and certainly, rather than waiting until flotation proves possible, say in 1982 or 1983. It would provide adequate proceeds to fund the large deficiencies in the pension scheme without any continuing liability for HMG. It would also hand over control to the present management and employees, which would further our policy of encouraging employee share ownership in privatisation cases. For all these reasons I am sure we should follow up the offer vigorously and I would be quite happy for you to make the statement you propose.

At the same time, we have to bear in mind the need to be able to defend a decision to sell and the price obtained, possibly before the PAC, as in the best interests of the Exchequer and the taxpayer. As you recognise, the normal course in selling a public sector asset would be to invite competitive bids. It is for that reason that we normally favour flotation in privatisation cases. That is not an option in this case but I think that, in considering the offer with your merchant bank advisers, you should satisfy yourself that no better offer is available. If it is, we would have to consider it together with the Management Consortium offer. If there are no alternative bids, which seems the most likely situation, again you will need advice from the merchant bank about the reasonableness of the management's offer so that we can satisfy ourselves on that score. But none of this need hold up your statement or deter the Consortium from pressing ahead.

I am sending copies of this letter to the Prime Minister, Francis Pym, Michael Jopling, Keith Joseph, the other members of E(DL) and Sir Robert Armstrong.

Nigel Lawson

NIGEL LAWSON

070
COMMERCIAL: IN CONFIDENCE



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

A

The Rt Hon Sir Keith Joseph Bt MP
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
LONDON
SW1

12 June 1981

Joe Keith.

I mentioned at the meeting of E(DL) on 10 June the proposed scheme for a take-over of the National Freight Company by the managers themselves. With Barclays Bank now firmly behind the scheme events have been moving faster than expected. Following enthusiastic support from the top 120 managers at a Conference earlier this week a formal offer for the Company has now been made to me. The deal would be worth £51m to £53m gross, depending on the precise figure for the pension deficiencies. We have already agreed that the pension deficiencies would have to be funded from sale proceeds. Thus, the net proceeds to the Government of £5m from this offer for the issued shares would be of the order we have always envisaged. A copy of the letter of offer is attached.

In my view this is an extremely attractive proposition which opens up the possibility of achieving our denationalisation objective a good deal sooner than by flotation, and in a way which would be difficult to challenge seriously. Because of the recession and the problems of the parcels businesses, the Company is not a particularly attractive market proposition at present. Yet here we have the clearest possible vote of confidence in the Company's future from those best placed to make a judgement, and who are moreover prepared to put their own money at risk in backing

COMMERCIAL: IN CONFIDENCE

their judgement. I can think of no better way of motivating management and employees all down the line when it comes to the Company meeting the challenges that lie ahead. And in this context I should perhaps make clear that the intention is to encourage all employees, not just those in the management grades, to buy shares, including purchase by deduction from salary.

The amount of the offer falls within the bracket of £50-60m which Schroders, the merchant bank who have been advising me on this matter, advised some months ago might be achieved from flotation in 1982 or 1983; and since then market conditions have deteriorated. We shall, of course, need to ensure that Schroders are given adequate time to consider afresh whether the price is a fair one now. We have been plainly advised by them that flotation would not be possible until the middle of next year at the earliest. That course does not therefore provide an alternative to accepting the management's offer as a means of achieving our policy objective quickly. The only realistic alternative would be to invite competitive bids from single purchasers. To do so could conceivably produce a marginally better return to the Exchequer. But there would be serious risks in that course. In particular, we might lose this bid and impair the commitment and morale of the management in the consequent delay and confusion; or, if no bid were forthcoming, we might have eroded the basis on which as much as £51-53m has been offered.

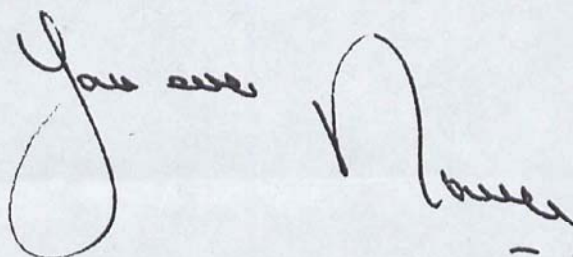
If this management proposal is to have any chance of success it will be important to keep up the momentum gained at the recent Management Conference. In practice, this means an announcement within the next few days indicating the Government's position and giving the consortium the opportunity to go ahead in transforming their offer in principle to one of substance.

COMMERCIAL IN CONFIDENCE

In all the circumstances I have no hesitation in recommending to colleagues that we should go ahead on the basis of this offer from the management consortium.

I should be grateful to know by Tuesday lunchtime if my colleagues agree with me, in time to be able to tell the Chairman not later than Wednesday, 17 June, and to make an oral statement the following day, on the lines of the attached draft.

I am sending copies of this to the Prime Minister, Francis Pym, Michael Jopling, the other members of E(DL) and Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Norman Fowler', with a large, stylized initial 'N'.

NORMAN FOWLER

COMMERCIAL IN CONFIDENCE

COMMERCIAL CONFIDENTIAL

DRAFT OF A STATEMENT BY THE SECRETARY OF STATE

THE NATIONAL FREIGHT COMPANY LIMITED

The House will know that under the provisions of the Transport Act 1980, the National Freight Corporation was wound up and the assets transferred to the National Freight Company Limited, with the intention of selling the shares to private investors as soon as possible. The Act made special provisions to allow me to fund the deficiency in their pension scheme from the proceeds of sale.

Flotation has not so far proved practicable. But I can now tell the House that I have, within the last few days, received an offer from a group of senior managers, who have told me that they are confident that they can put together a widely based consortium of managers and employees to purchase the shares and to take over the control of the Company.

This is an imaginative and exciting proposal which, if achieved, will transfer the ownership of the Company to its employees. They have in particular given me an assurance that they intend that the Articles of Association of the new Company will contain provisions designed to secure that for the first five years of its existence the Company will remain in its present form. It will not be their intention to seek a Stock Exchange quotation during that time.

I have told the group of managers concerned that I shall need to consider this offer with my merchant bank advisers. This will take a few weeks; in the meantime I have encouraged them to press ahead with their plans as rapidly as possible.

The Merton Centre,
45 St. Peters Street,
Bedford, MK40 2UB.

The Rt. Hon. Norman Fowler, MP.,
Secretary of State for Transport,
Department of Transport,
2 Marsham Street,
London, SW1P 3EB.

11th June, 1981.

Dear Secretary of State,

I am writing on behalf of a consortium of senior managers and staff of the National Freight Company Limited with the backing and participation of Barclays Merchant Bank, to say that we are in principle and subject to contract prepared to make you an offer to acquire the National Freight Company.

The outline terms are as set out on the attached sheet. We are offering to purchase the ordinary share capital at par and to arrange to discharge the outstanding 'road-based' pensions obligations which would otherwise fall to be covered out of the proceeds of sale. These together amount to a total of between £51 and £53 million.

We would hope that you will be able to give an early indication that this offer is acceptable to you. In turn, we would expect to be able to provide the necessary finance by the 30th September, with the acquisition becoming effective on the 1st October 1981.

Yours sincerely,



P.A. THOMPSON


Encl:

SUBJECT TO CONTRACT

ABC Company Limited (consisting of a consortium of management and employees of the National Freight Company Limited together with Barclays Merchant Bank Ltd.) hereby offers to purchase from the Secretary of State the entire issued share capital of the National Freight Company Limited on the following terms:-

1. On 1st October 1981 ABC Company Limited will pay the Secretary of State the sum of £5 Million for the issued share capital of National Freight Company Limited.
2. Within one day of that date, ABC Company will procure that the pension deficiencies of National Freight Company Limited referred to in Part II of the Transport Act 1980 (estimated to amount to £46-£48 Million on that date) will be funded to the reasonable satisfaction of the Trustees of the Fund and of the Secretary of State.
3. ABC Company requires no warranties or indemnities as regards the past, present or future trading or financial position of the National Freight Company.
4. Although ABC Company requires no warranties as to title to any of the properties of the National Freight Company and its subsidiaries, it requires the Secretary of State's assurance that he will use his best endeavours to procure that the British Railways Board and other statutory transport undertakings continue to co-operate fully with the National Freight Company in matters relating to the disposal and acquisition of property.
5. The Articles of Association of ABC Company will contain provisions designed to secure that for the first five years of its existence it will remain in its present form. In particular, it will not be the intention to seek a Stock Exchange quotation during that time.

11.6.1981.



010
Mr. Duguid

10-6-81

Prime Minister

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COMMERCIAL-IN-CONFIDENCE

In C.F.C. would
probably help under
one of their schemes
not

PRIME MINISTER

NATIONAL FREIGHT COMPANY LIMITED

There is a potentially exciting new development concerning our efforts to put the NFC into the private sector.

Schroder Wagg, who have been advising us on selling this Company, told me a little time ago that flotation would not be practicable until Summer next year at the earliest. This is too late, and I invited them to consider possible alternatives. Quite independently, the top management of the Company told me a few weeks ago that they intended to promote a take-over bid for the Company by the managers themselves. Barclays Bank have agreed to back their scheme financially. They are requiring the management to raise a minimum of £2½m themselves. There are some 2,500 management, and I have just been informed that a conference of the top 120 managers today greeted the idea enthusiastically, and committed themselves to trying to raise the money. The proposal will be put as soon as possible to the management more widely, and will later be put to all the staff. The Chairman and his immediate colleagues will be coming to report to me personally tomorrow.

I shall of course need to consider these proposals with colleagues in E(DL), and I shall circulate a paper as soon as I have had my talk with the Chairman. We shall also need an independent valuation by the Merchant Bank to ensure that we

COMMERCIAL-IN-CONFIDENCE



COMMERCIAL-IN-CONFIDENCE

get a fair price. I hope we can reach agreement on these matters within a few weeks, and in the meantime the Company will try to avoid any premature publicity. But that cannot be guaranteed, which is why I thought I had better send you this interim report immediately.

It is of course too early to be confident of success but the prospects are definitely encouraging.

I am copying this to the Chancellor of the Exchequer, the Secretary of State for Industry and Sir Robert Armstrong.

~~NORMAN FOWLER~~

10 June 1981

COMMERCIAL-IN-CONFIDENCE

~~SUBJECT~~
CF L. hie?
C. F. M. hie?
2 cps.



PRIME MINISTER'S

10 DOWNING STREET
PERSONAL MESSAGE

THE PRIME MINISTER

SERIAL No. 177/81

18 May 1981

DSG
ce DO I
NMT (F.S.)
fu.

Dear Prime Minister,

Thank you for your letter of 21 April about Cable and Wireless Limited.

You are correct that the Government proposes to sell some of its shares in the Cable and Wireless Group. Our intention is to retain just over half of the shares so that the company will become jointly owned by the public and private sectors. This arrangement would seem to be similar to your partnership with Cable and Wireless (West Indies) Limited in the Trinidad and Tobago External Telecommunications Company. It reflects the view of many overseas governments, on whose behalf Cable and Wireless owns and operates telecommunications facilities, that the British Government should continue to have a shareholding in the parent company.

I can assure you that the proposed sale of shares does not involve any offer for sale of shares in Cable and Wireless (West Indies) Limited. Only shares in the parent company are to be

sold and your Government will be free to apply for shares like any other investor. The sale of shares will not affect the parent company's commercial contracts with clients and partners or the contracts of its subsidiaries. Cable and Wireless remains committed to its Trinidad and Tobago operations and I hope that there will continue to be a successful partnership with your Government.

Yours sincerely

Nargant Richter

The Honourable George N. Chambers.



16/1/81 Answer
Dean Pot

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

PS/ Secretary of State for Industry

15 May 1981

Michael Alexander Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Type for PM's signature.
15/5
Mun

Dear Michael

Thank you for your letter of 29 April enclosing one to the Prime Minister from the Prime Minister of Trinidad and Tobago about Cable and Wireless (C & W). I am sorry about our delay in replying.

2 The Trinidad and Tobago Government appear to suppose that the sale of British Government shares in C & W will involve the sale of shares in its subsidiary company, C & W (West Indies) Limited. This is a wrong impression; the privatisation plans announced on 9 March affect only the Government's shareholding in the C & W parent company and not the parent company's subsidiary interests.

3 It is possible, however, that the letter may reflect a desire by the new Government of Trinidad and Tobago to take advantage of the British Government's privatisation of C & W to increase its 50% stake in the Trinidad and Tobago External Telecommunications Company Limited. If so, C & W would wish to discourage this development although they realise that it is always open to a foreign government to increase its control over the company's local operations.

... 4 The attached draft reply has been agreed with the FCO. It seeks to reassure the Trinidad and Tobago Government that privatisation of C & W will not affect the company's existing contractual commitments.

5 I am sending copies of this letter and the draft reply to Roderic Lyne (FCO) and Stephen Locke (Treasury).

Yours ever
Ian

I K C ELLISON
Private Secretary



DRAFT REPLY FOR THE PRIME MINISTER TO SEND TO THE PRIME MINISTER
OF TRINIDAD AND TOBAGO

Thank you for your letter of 21 April about Cable and Wireless Limited.

You are correct that the Government proposes to sell some of its shares in the Cable and Wireless Group. Our intention is to retain just over half of the shares so that the company will become jointly owned by the public and private sectors. This arrangement would seem to be similar to your partnership with Cable and Wireless (West Indies) Limited in the Trinidad and Tobago External Telecommunications Company. It reflects the view of many overseas governments, on whose behalf Cable and Wireless owns and operates telecommunications facilities, that the British Government should continue to have a shareholding in the parent company.


I can assure you that the proposed sale of shares does not involve any offer for sale of shares in Cable and Wireless (West Indies) Limited. Only shares in the parent company are to be sold and your Government will be free to apply for shares like any other investor. The sale of shares will not affect the parent company's commercial contracts with clients and partners or the contracts



of its subsidiaries. Cable and Wireless remains committed to its Trinidad and Tobago operations and I hope that there will continue to be a successful partnership with your Government.

Ecan Pol

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After much foot-dragging by BGC and the Department of Energy, we finally decided on this course last October. Lazard's was then asked to advise on how BGC could sell voluntarily via a newly formed subsidiary company. This was a complex exercise and hence took several months to complete. BGC have now turned down the Lazard's approach, and Mr. Howell is consequently going ahead with a direction to sell Wytch Farm. We are still on schedule for getting the money in in 1981/82, which is what the Treasury were planning for.

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PRIME MINISTER

BGC: DISPOSAL OF OIL ASSETS

The Chancellor has asked me to comment on David Howell's minute to you of 27 April about the disposal of BGC's oil assets.

I am sure that David is right in proceeding with the necessary consultations with BGC for a direction for the sale of their interests in the Wytch Farm oil field, as was agreed at E(80)30th meeting. I assume that subject to the outcome of the consultations and the legal advice, he then intends to ensure that the sale is made as quickly as possible so that we can be certain of securing the proceeds in 1981-82. As I commented in my minute to you of 16 October, arrangements need to be made to remit the proceeds of the sale to the Exchequer and not to leave them with BGC. I hope that the Department will keep the Treasury in touch with progress.

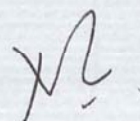
I also agree with David that once BGC's interest in Wytch Farm is sold, it would be desirable to establish a new North Sea oil company based on BGC's existing interests. Not only would this be an attractive new British private sector concern, but the proceeds of the sale of shares would help reduce the PSBR.

BGC will clearly not co-operate in such a venture and the existing powers in the Gas Act may not be sufficient to compel the Corporation to sell their offshore interests. New powers could well need to be taken and they could be included in the Bill to abolish BGC's gas purchase monopsony if, despite QL's conclusion, room was to be found for that Bill in next sessions programme. The Bill might also include any powers necessary to restrict BGC's retailing activities if, as I hope, it is agreed to implement something like the radical option put forward in the recent Monopolies and Mergers Commission Report to reduce BGC's dominance in the retailing of gas appliances.

CONFIDENTIAL

Such a bill, dealing with the injection of private capital into the Corporation's offshore activities, the abolition of the monopsony and the encouragement of competition in their retailing activities, could be politically attractive and could be presented as an important step in our privatisation programme.

I am sending a copy of this minute to the Members of E, Nicholas Edwards, George Younger, the Attorney General and Sir Robert Armstrong.



NIGEL LAWSON

6 May 1981



10 DOWNING STREET

From the Private Secretary

29 April 1981

b F 13-5-81

I enclose a copy of a letter which the Prime Minister has received from the Prime Minister of Trinidad and Tobago about Cable and Wireless. I should be grateful if you could let me have a draft reply which the Prime Minister might send to Mr. Chambers. It would be helpful if this could reach me by Wednesday 13 May.

I am sending copies of this letter and its enclosure to Roderic Lyne (Foreign and Commonwealth Office) and Stephen Locke (HM Treasury).

M. O'D. B. ALEXANDER

I.K.C. Ellison Esq
Department of Industry

SC

MFJ

29 April 1981

Thank you for your letter of
27 April. I have brought your
Prime Minister's letter to
Mrs. Thatcher's immediate attention.

MODBA

His Excellency Mr. Eustace Seignoret

AD.

CONFIDENTIAL

Prime Minister

2

PRIME MINISTER

BGC: DISPOSAL OF OIL ASSETS

You will recall that I minuted you on 8 October that the British Gas Corporation had commissioned Lazards to advise on the disposal of a majority holding in their oil interests in a way consistent with their statutory obligations.

The Board of the Corporation have now considered Lazards' report and have concluded that they could not voluntarily sell those assets by means of a sale of shares in a subsidiary company taking in their oil interests. The Board of the Corporation have been advised that they are obliged to act in good faith in the interests of the Corporation as such and that a distinction may be made between the powers, duties and objectives of the Board, on the one hand, and the wider concerns of the Government, on the other. The Board consider that the sale of assets proposed would not be something that they would choose to do voluntarily nor would the objective be to provide funds for the Corporation.

The Corporation's rejection of the Lazards proposal as inconsistent with their statutory obligations is disappointing. I remain of the view that it would be desirable to establish a new North Sea oil company based on BGC's existing interests, and that this would be an attractive new British private sector concern. I shall be considering the possibilities further.

In the meantime I am proceeding with the necessary consultations with the Corporation for issuing a direction under section 7(2) of the Gas Act 1972 for disposal of their interests in the Wytch Farm oil field, as we agreed at E(80)30th Meeting. I expect that this will be resisted by British Gas and I will have to satisfy myself that the disposal will not impede or prevent the proper discharge of the Corporation's duties. If it appears safe to issue a direction (and

BGC still seem to be dragging their feet over the sale of oil assets. So Mr Howell is now going to issue a direction to force them to sell Wytch Farm. The

Trang (Flag A) are content, and suggest that legislation may be needed if, as Mr Howell still proposes, there is to be a N. Sea oil co. based on BGC's

other oil interests.

12

7/5

I will consult the Attorney General at that stage before proceeding) it will have to be laid before Parliament for a period of 40 days after which the statutory instrument may be made. British Petroleum, BGC's partners in the field, have the right to match any bid which in itself may deter potential outside buyers. I doubt whether in any event we could expect to bring in more in 1981/82 than about £100 million that the sale of BGC's interest in Wyth Farm might realise.

I am sending a copy of this letter to the members of E, Nicholas Edwards and George Younger, the Attorney General and Sir Robert Armstrong.

Secretary of State for Energy

27 April 1981

DL
7



TRINIDAD AND TOBAGO
HIGH COMMISSION
LONDON

01-245 9351

27th April, 1981.

The Private Secretary to
The Prime Minister,
No.10 Downing Street,
London, SW1

Dear Private Secretary,

I enclose a letter from the Prime Minister of Trinidad & Tobago, the Hon. George Chambers, M.P., to the Rt. Hon. Margaret Thatcher, M.P., Prime Minister of the United Kingdom, and shall be glad if you will arrange for its transmission.

yours sincerely
Eustace Leignart

High Commissioner

SUBJECT



PRIME MINISTER

PRIME MINISTER'S
PERSONAL MESSAGE
T66A/81
SERIAL NO: 1

21 April, 1981

The Rt. Hon. Margaret Thatcher, M.P.
Prime Minister of the United Kingdom
No. 10 Downing Street
London S.W.1
ENGLAND

Dear Prime Minister,

I have the honour to refer to information which suggests that your Government proposes to divest itself of approximately one-half of its substantial shareholdings in the Cable and Wireless International Telecommunications Group of which Cable and Wireless (West Indies Ltd.) is a member.

You will recall, Prime Minister, that in September 1969 the Government of Trinidad and Tobago entered into a joint venture agreement with Cable and Wireless (West Indies Ltd.) to form an external telecommunications company - Trinidad and Tobago External Telecommunications Company Ltd. (Textel). The Government of Trinidad and Tobago holds 51 per cent and Cable and Wireless (West Indies Ltd.) holds 49 per cent of the shares.

My Government wishes to ascertain whether the information accurately reflects the intentions of your Government. In the event that it does, my Government would wish to have the assurance that early negotiations may be possible so as to give the Trinidad and Tobago Government first option to purchase the shares of Cable and Wireless (West Indies Ltd.)

I should be most grateful for an early reply to this matter.

Please accept, Prime Minister, the assurances of my highest consideration.


George M. Chambers



CONFIDENTIAL

Econ Pol
DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

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

1st April 1981

Leon

BRITISH TRANSPORT DOCKS BOARD: 1980/81 EFL

Thank you for your letter of 5 March.

I agree with your conclusion that it would be presentationally damaging to revise the EFL to a new figure late in the year which might in the event be unattainable.

I can however see little advantage in pressing the Board to strive for additional savings in the last few days of this year unless we can point to very specific ways of achieving them. As you say, there have already been significant cuts in investment and costs and it seems to me potentially counter-productive in terms of our own credibility to ask the Board for further savings which could only be marginal, since capital investment expenditure will be irrevocably committed and asset sales do take time to arrange - if any additions are in fact possible.

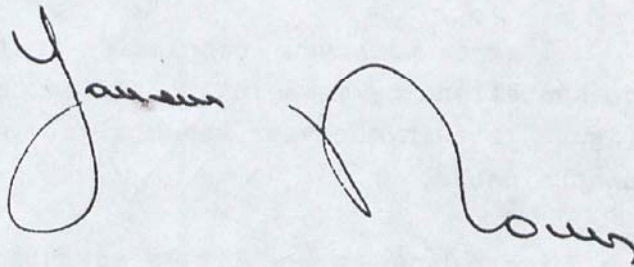
I can appreciate your desire to penalise the Board for their failure to meet their EFL, but I cannot accept your suggestion that their 1981/82 EFL might be adjusted except for the £2.4m due from BSC should this not be paid in the current financial year. As I told John Biffen at the time the

CONFIDENTIAL

CONFIDENTIAL

1981/82 EFL was set, we have set BTDB a very stiff target in the face of the recession, and they will have great difficulty in meeting it. Setting an even tougher target could well precipitate either yet another breach or cutbacks in investment which could impair the operation of their ports and affect the prospects for BTDB's privatisation. I certainly think we should look very carefully at the revised investment and financing outlook which will be contained in the Board's 1981 Investment and Financing Review before committing ourselves to any action on next year's EFL.

I am copying this letter to the recipients of yours.



NORMAN FOWLER



10 DOWNING STREET

From the Private Secretary

9 March 1981

Cable and Wireless

The Prime Minister read the draft statement enclosed with your letter of 6 March over the weekend, and as I told you, she was not entirely happy with it. In particular, she took the view that the penultimate paragraph of the draft would be likely to restrict the Government's future course of action in selling off further shares in the company.

We have subsequently agreed that, in order to take care of the Prime Minister's point, the penultimate paragraph should be deleted, and that the last sentence of the paragraph preceding it should read:

"The part ownership formula we have decided on will follow the precedent set up by BP, leaving the Government with a major shareholding capable of safeguarding overseas governments' interests as necessary."

We also agreed that the words "both stability and" should be deleted from the final sentence of the draft.

I understand that the FCO are content with these changes.

I am sending copies of this letter to Michael Arthur (FCO), Steven Locke (Treasury), Murdo Maclean (Chief Whip's Office), Nicholas Huxtable (Chancellor of the Duchy of Lancaster's Office), David Wright (Cabinet Office) and Bernard Ingham.

T. P. LANKESTER

J.C. Hudson, Esq.,
Department of Industry.

Rtd

PRIME MINISTER

Statement on Cable and Wireless

Mr. Baker had a rather mixed reception in the House this afternoon. The Opposition varied between telling him he was doctrinaire and that there was no point in selling shares in Cable and Wireless, since it was already a perfectly successful limited company.

The only reply which might be quoted back at you is Mr. Baker's assertion that the sale of shares would enable the company to "escape from the dead hand of the British Treasury".

Ray Whitney asked why more shares were not being sold. Mr. Baker said that this was a matter of fine judgement. The Government had calculated that it was right at this stage to go down the BP route. That did not preclude the sale of further shares in future years. They did however want to assure foreign governments that there was a continuing basis of stability and responsibility underlying Cable and Wireless.

He also said at one stage that the Government hoped to receive something over £100 million as a result of the sale.

9 March 1981



STATEMENT ON CABLE AND WIRELESS

On 2 December my Rt Hon Friend the Secretary of State for Industry told the House that in the British Telecommunications Bill the Government had included a clause broadening its power to dispose of shares in Cable and Wireless.

Since then we have been considering, in close consultation with the company whether and how shares might be sold. Before reaching a final conclusion we consulted, through the Foreign and Commonwealth Office, all the Governments of the 30 or so countries in which Cable and Wireless operates telecommunications services under a Government concession. No objections have been raised to the Government's proposals.

The Government has now decided to make a public offer for sale of just less than 50% of its shares, subject to obtaining the necessary powers in the British Telecommunications Bill. We and the Company are agreed that when shares are offered for sale special arrangements will be made for employees to acquire shares.

Cable and Wireless already enjoys a large degree of commercial freedom. The Government intend to refrain from using their rights as a shareholder to intervene in the Company's commercial decisions. Cable and Wireless will be



freed from the close relationship which exists between the Government and public corporations which must on occasion constrain the company from being wholly responsive to market forces. The part ownership formula we have decided on will follow broadly the precedent set in the case of BP, leaving the Government with a major shareholding capable of safeguarding overseas governments' interests as necessary.

The Chairman and Court of Directors of Cable and Wireless are in agreement with this line of action. Cable and Wireless has had a long record of achievement both in private hands and since 1946 as a public sector company. The proposed sale of shares will create a partnership between the public and private sectors. This new arrangement will provide the commercial flexibility and access to the financial markets necessary to exploit the growth and opportunities in the rapidly expanding telecommunications sector.

This is not in accordance with our decision to leave open the possibility of further discussion.

Nick Sanders Esq



FROM THE
MINISTER OF STATE
FOR INDUSTRY AND
INFORMATION TECHNOLOGY
Kenneth Baker's office

CONFIDENTIAL
DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 6401
SWITCHBOARD 01-212 7676

Nicholas Huxtable Esq
Private Secretary to
The Chancellor of
the Duchy of Lancaster
Privy Council Office
Whitehall
London SW1

6 March 1981

Dear Nicholas,

CABLE AND WIRELESS

I enclose the revised text of the statement
which Mr Baker will make on 9 March.

I am copying this to Nick Sanders (No 10),
Michael Arthur (FCO), Steven Locke (Treasury),
Murdo Maclean, Bernard Ingham and David Wright.

Yours sincerely,

Jonathan Hudson

JONATHAN HUDSON
Private Secretary

1
PRIME MINISTER

Contact with
this C+W

statement

for Monday?

MS

6/3



CONFIDENTIAL

STATEMENT ON CABLE AND WIRELESS

On 2 December my Rt Hon Friend the Secretary of State for Industry told the House that in the British Telecommunications Bill the Government had included a clause broadening its power to dispose of shares in Cable and Wireless.

Since then we have been considering, in close consultation with the company whether and how shares might be sold. Before reaching a final conclusion we consulted, through the Foreign and Commonwealth Office, all the Governments of the 30 or so countries in which Cable and Wireless operates telecommunications services under a Government concession. No objections have been raised to the Government's proposals.

The Government has now decided to make a public offer for sale of just less than 50% of its shares, subject to obtaining the necessary powers in the British Telecommunications Bill. We and the Company are agreed that when shares are offered for sale special arrangements will be made for employees to acquire shares.

Cable and Wireless already enjoys a large degree of commercial freedom. The Government intend to refrain from using their rights as a shareholder to intervene in the Company's commercial decisions. Cable and Wireless will be



Capable of Subordination

own interests
highly in

necessary.

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freed from the close relationship which exists between the Government and public corporations which must on occasion constrain the company from being wholly responsive to market forces. The part ownership formula we have decided on will follow the precedent set up by BP, leaving the government with a major shareholding.

The Government will be able if necessary to use its position as the major shareholder to ensure that the Company properly fulfills its obligations to overseas Governments under its concessions and under the auspices of the Commonwealth Telecommunications Organisation.

The Chairman and Court of Directors of Cable and Wireless are in agreement with this line of action. Cable and Wireless has had a long record of achievement both in private hands and since 1946 as a public sector public company. The proposed sale of shares will create a partnership between the public and private sectors. This new arrangement will provide both stability and the commercial flexibility and access to the financial markets necessary to exploit the growth and opportunities in the rapidly expanding telecommunications sector.

This follows
future
action
we must
not do
that



Ela R

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Norman Fowler MP
Secretary of State
Department of Transport
2 Marsham Street
London SW1

5 March 1981

2 Norman

R 12/13

BRITISH TRANSPORT DOCKS BOARD: 1980-81 EFL

Following my letter of 9 February, our officials have discussed with each other and the Board the prospects for the BTDB meeting their 1980-81 EFL of -£10m. I understand the Board are now forecasting an external finance requirement of -£3.5m and that there is some doubt about this figure because of uncertainty surrounding the timing of a payment of £2.4m to the Board.

The uncertainty surrounding the forecast outturn for 1980-81 brings with it the strong possibility that a revision of the EFL would be followed shortly afterwards by its breach. This would be damaging presentationally and I feel, therefore, that the best course would be to leave the existing EFL unchanged but to press the Board to take whatever steps they can in the remaining weeks of the year to improve upon their present forecast for external finance. In asking you to press the Board to seek offsetting savings, I am mindful that they have already cut investment and reduced costs by significant amounts. It is likely, however, that scope still exists for savings in capital and current costs and for increasing asset sales even if the savings achieved will be marginal. A statement to the House about the Board's failure to meet their EFL can be made when the final size of the breach is known.

We will need to consider further the case for adjusting the 1981-82 EFL when the outturn for the current year is known. While these considerations will need to take into account factors such as the actual timing of the £2.4m payment to the Board from the British Steel Corporation and the prospects for next year, I am particularly conscious that this will be the second year in succession that the Board have failed to meet their EFL. For this reason alone, I believe there is a strong presumption in favour of some reduction in next year's EFL.

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

Leon

LEON BRITTAN

CONFIDENTIAL

PRIME MINISTER

Cable and Wireless
(E(81) 27 and E(DL)(81) 1)

BACKGROUND

The Secretary of State for Industry's memorandum (E(81) 27) is in response to your wish that the Committee should discuss whether the Government should sell just under 50 per cent of its shares in Cable and Wireless (C and W) - as agreed by the sub-committee on Disposal of Public Sector Assets on the basis of E(DL)(81) 1 - or more.

2. The present aim is to sell the shares on 21st October. The highly provisional estimate is that the yield might be in the order of £150 million; this would be a major contribution to the target of £500 million total cash disposals in 1981-82, which will be published in the Public Expenditure White Paper, and to the confidential target endorsed by E(DL) of £600 million plus.

3. 99 per cent of C and W's revenue comes from abroad, and about 66 per cent is from business subject to periodic "concessions" from overseas governments, with business in Hong Kong and Bahrain currently providing about 80 per cent of the company's profit. It is essential both to the proposed sale, and to the future of the company, that these concessions should not be broken off prematurely, and that the chances of negotiating their extension and maintaining other overseas business should not be prejudiced. The formula of 50 per cent less one share was based on E(DL)'s judgment that this was necessary to satisfy overseas governments that there would be a continuing close relationship between the Government and C and W, backed up by a degree of control which, in those governments' eyes, would be sufficient to protect their local interests. Approximately 30 governments have now been consulted on the formula, and the Commonwealth Telecommunications Organisation and its members have been informed. The Secretary of State for Industry is firmly of the view that the decision of E(DL) should stand. He accepts privately, however, that there might be a further sale of shares at some later date, if this can be done without jeopardising the company's overseas operations.

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4. The E(DL) decision is open to the criticism that since the Government is explicitly giving up commercial control of the company - to ensure that it will score henceforth as part of the private sector - there could be a case of retaining only 25 per cent of the shares, that is sufficient to block changes in the Articles of Association. This could perhaps yield up to £75 million more to the disposals target in 1981-82.

5. On the other hand it is common ground that, if the possibilities of selling a higher proportion of shares were to be explored, the Government would have to consult overseas governments again. The objections to following this course are set out in paragraphs 4 - 10 of E(DL)(81) 27. They are:-

- (i) the reactions of overseas governments are likely to "become more negative, the more our residual shareholding is diminished"; and in particular they would be sensitive about the possibility of substantial foreign shareholdings in C and W (paragraphs 5 and 6);
- (ii) the attempt could wreck the crucial current negotiations with the Hong Kong government on their concession which expires in 1987, and with the Bahrain government over their concession expiring in July 1982 - see paragraph 7, and for Hong Kong in particular the letter of 2nd March from Mr. David Young to Mr. Lankester annexed to E(DL)(81) 27; *Flag C*
- (iii) the strongly held view of Mr. Eric Sharp, the Chairman of C and W (and formerly Chairman of Monsanto UK) and his Court of Directors is that in the first instance the Government should not sell more than half of its shares - see paragraph 8;
- (iv) the fear that the world-wide extension of C and W's new high speed digital network could be prejudiced - paragraph 9;
- (v) Kleinwort's advice that any blocking provisions in the Articles of Association, to provide for Government veto of decisions taken by the Court of C and W, would depress the value of the shares - paragraph 10;

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- (vi) Concern that if further consultations went badly wrong this could not only stop a sale this year but also depress the company's long term business prospects.

HANDLING

6. After the Secretary of State for Industry has introduced his paper, you will wish to hear, in particular, the views of the Foreign and Commonwealth Secretary on the likely consequences of further consultations with overseas governments and of the Chancellor of the Exchequer on the financial balance of advantage in going immediately for the sale of a higher proportion of shares. The Secretary of State for Defence also has a strong interest in the future of C and W, because they provide for transmission of military and classified traffic to Hong Kong and beyond, and because of their involvement in a contract for a communications system for the Saudi National Guard.

7. Granted that any change in the objective now would require further consultations with other governments, the main questions seem to be:-

- (i) How real is the risk that further consultations, which would not necessarily lead to the sale of a higher proportion of shares, would spark off reactions by overseas governments (and by Hong Kong and Bahrain in particular) damaging to the commercial prospects of the company and to the prospects of the sale?
- (ii) If it were accepted that consultations should be undertaken:
- (a) could the sale still be concluded in time for the proceeds to contribute to the disposals target for 1981-82?
 - (b) should the aim be to retain only 25 per cent of the shares, or should the Secretary of State have flexibility on this?
 - (c) to what extent might the prospective yield be abated by any delay and by the inclusion of blocking provisions in the Articles of Association?

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CONCLUSIONS

8. In the light of the discussion you will wish to record conclusions:-

Either inviting the Secretary of State for Industry to arrange for further consultations with overseas governments with a view to selling a higher proportion of shares - stipulating whether the aim should be a sale of 75 per cent of the shares or giving him flexibility between 50 and 75 per cent in the light of his consultations;

Or reaffirming the E(DL) decisions in favour of a sale of 50 per cent minus one share this autumn, on the understanding that steps to sell additional shares will be taken as soon as this can be arranged consistently with securing the future of C and W's overseas operations; and authorising the Minister of State, Department of Industry to make a statement, at a time to be agreed by the business managers, on the lines of the draft annexed to his Private Secretary's letter of 19th February to the Private Secretary to the Chancellor of the Duchy of Lancaster.

RA

(Robert Armstrong)

4th March 1981

CONFIDENTIAL

Qa 05267

To: MR LANKESTER
From: J R IBBS

Cable and Wireless

1. The CPRS has for some time believed that retention by the Government of majority control, at least for a period, would be essential for successful flotation of Cable and Wireless because such control is needed if foreign governments, notably Hong Kong and Bahrain, are to continue to grant the concessions on which the cash flow and business strength of the company are based. This belief has recently been confirmed by David Young's first hand experience in Hong Kong.
2. The work which the CPRS has done on space policy and information technology has shown that Cable and Wireless has an important role to play in the international development of UK interests in these subjects. If Cable and Wireless were severely diminished through loss of the Hong Kong and Bahrain concessions, it would be unable to fulfil this role and there is no suitable alternative agency in existence.
3. We consider that these are strong arguments in favour of aiming for a sale of just less than 50 per cent of the shares as proposed by the Secretary of State for Industry.
4. I am sending a copy of this minute to Sir Robert Armstrong.

[Handwritten signature]

H.K. - Bahrain

4 March 1981

CONFIDENTIAL



David Young
Special Adviser

✓ Cabinet Office

Department of Industry
Ashdown House
123 Victoria Street
London SW1E 6RB

Telephone: Direct Line 01-212 0440
Switchboard 01-212 7676

*For E Folder
Thursday*

2nd March, 1981

T. P. Lankester, Esq.,
Private Secretary,
10 Downing Street,
London, S.W.1.

1/1 les Tim

CABLE & WIRELESS PRIVATISATION

I have seen the recent correspondence and as I have only today returned from Hong Kong I thought that I should write to let you know some of the commercial reasons which require HMG to retain just over 50% on the initial flotation.

1. About two-thirds of C & W's profits originate out of Hong Kong where we have a concession which expires in 1987 at which time the Hong Kong Government (HKG) would be entitled to buy the assets at written down book value (this could be less than six months' profits). We have now successfully negotiated a new long term concession in a joint company in which HKG will have a 20% interest and is still subject to the payment of a new royalty which is being negotiated. HKG was very resistant to the idea that we would either relinquish control of C & W or even float off a local subsidiary. It was only when I told the Governor that the position would be "analagous to BP", and that is that we would relinquish commercial control but retain strategic control, that the negotiations prospered. Without this new concession there could be no flotation of C & W and even now we are very dependent upon the goodwill of HKG in order to help us with a number of very real local difficulties. Indeed there was a time last week when I thought that we might even have to cancel the flotation but with considerable help from HKG these difficulties have been largely overcome.

2. In Bahrain our concession expires next year and we have only now been able to agree in principle the renewal which will involve giving a 60% share to local interests. Once again, the Ruler expressed concern at our privatisation proposals and it was only our assurance that we would maintain strategic control that won the day.

...../Cont.



- 2 -

C & W acts on a government to government basis in over 30 areas and since 1947 has been regarded as an arm of HMG. I believe that after a year or two of experience as an independent commercial concern, we will be able to place further shares on the market and substantially reduce our holding. To do so at this time would undermine the commercial basis of the flotation since there would then be pressure from local commercial interests to take either an increased share or control of the existing C & W local operation. This I know for a fact as I have just fought a hard battle with the HK Telephone Company who had plans to buy up a substantial stake in C & W in order to obtain a measure of control to improve their own position. David Newbigging of Jardines and Sir Sydney Gordon of China Light & Power are amongst the HK Telephone Company's directors and it was only when I told them that we were retaining strategic control that they modified their ambitions. We will still have to face this problem if and when we dispose of further shares.

Yours ever

Wain

CONFIDENTIAL



CC HAT
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CJO
FBO

LPSO
MST
CO
CWO

24

Alan P. J.

10 DOWNING STREET

From the Private Secretary

2 March 1981

Cable and Wireless

The Prime Minister has read your letter of 27 February, and the letters of the same date from the Treasury and the FCO.

She is still not convinced that it would be right to sell off less than 50 per cent of the Government's shares in Cable and Wireless, and she would like the matter to be discussed in E Committee on Thursday 5 March.

The objections to a larger than 50 per cent sale rest mainly on the understandings that have been reached with various overseas Governments. The Prime Minister has asked in particular what is the precise nature of these understandings.

I should be grateful if you could arrange for a paper to be circulated to E Committee and that it should cover this point.

I am sending a copy of this letter to the Private Secretaries to members of E(DL), Michael Arthur (Lord Privy Seal's Office), Jonathan Dawson (Ministry of Defence), Murdo Maclean (Chief Whip's Office) and David Wright (Cabinet Office).

TL

Mrs Liz Riley,
Department of Industry

CONFIDENTIAL

SK



10 DOWNING STREET

TLM

I told DoI that the PM wasnt happy,
ad that I thought that it wd need
collective discussion.

I told DWright the same.

Can you confirm formally with
everyone that it is to go to E?

MS
2/3



Treasury Chambers, Parliament Street, SW1P 3AG

27 February 1981

J C Hudson Esq
Private Secretary to Minister of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
LONDON
SW1

Dear Jonathan,

CABLE AND WIRELESS

The Financial Secretary has seen the Prime Minister's comment on your letter of 19 February.

The Financial Secretary agrees with the Prime Minister that we should consider carefully whether we cannot sell more than 50% of our shareholding in Cable and Wireless, perhaps even in the first instance. He is well aware of the concern of the Chairman, Eric Sharp, that we should not upset overseas concessionaire governments, who attach importance to some continuing link between the company and HMG. But given that we are agreed that the initial sale must be the occasion for giving up effective control - to ensure that C & W henceforth scores as part of the private sector - it must be very much a matter of judgement where we should stop, and it is not entirely clear that the Governor of Hong Kong's preference for 50% must be allowed the final say.

The Financial Secretary recalls that, when he met your Minister and the Chairman recently, he pointed out that we had not stopped at 50% in the case of BP; and that you had agreed to explore the possibility of an eventual smaller C & W shareholding, to which Eric Sharp for his part did not seem necessarily opposed. Could we not reconsider the case for going further, perhaps as far as 33%, now, even if that means delaying an announcement while we consult overseas governments? There are so many imponderables in reaching our disposals target for 1981-82 - an objective doubly important since we failed in 1980-81 - that an extra contribution from C & W would be a welcome bonus.

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I am sending copies of this letter to Nick Sanders and to other recipients of yours.

Yours ever,
Stephen

S A J LOCKE
Private Secretary

CONFIDENTIAL



From the
Minister of State

Kenneth Baker's Office

Nick Sanders Esq
Private Secretary to
The Prime Minister
10 Downing Street
London SW1

Dear Nick

CABLE AND WIRELESS

Thank you for your letter of 23 February.

The question of what proportion of the Government's shareholding in Cable and Wireless should be sold was considered very carefully before E(DL) reached its decision. After consulting the FCO, the company and the Governor of Hong Kong, where C & W have by far their most important concession, and after taking preliminary soundings of other overseas governments, Mr Baker reached the view that HMG should, at least initially, retain a clear majority of shares in order to safeguard the company's position in the countries where it provides services under a concession. These concessions account for two-thirds of the company's income. We found that HMG's ownership of Cable and Wireless is a reassurance for many of these countries, principally in the Commonwealth that their vital international communications are in safe hands. It is open for these governments to make other arrangements at will particularly as several of them in the Caribbean, have close political ties. Our fear was that if one or two countries decided to use the pretext of disposal by HMG to nationalise the local C & W operation others would follow suit. A widespread domino effect of this sort could have upset the basis of the company's business and spoiled the prospects for any sale of shares. The 50/50 formula was in this sense judged to be consistent with our central objective of maximising the proceeds from disposal. We have now formally consulted all overseas governments about disposal on this basis and have so far received the endorsement of nearly all of them. If it were decided to sell more shares, either now or at a later date, we would need to consult these governments again.

DEPARTMENT OF INDUSTRY

ASHDOWN HOUSE

123 VICTORIA STREET

LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 6401

SWITCHBOARD 01-212 7676

What was the main
nature of the
understanding with
the Commonwealth?

at the Hong Kong
1 still think

US 2 1/2 100 Pmin Antish

like.

not.

You suggested that we sell off, say,
67% of Cable and Wireless return from 50%.
The difference would be worth about £50m.
The Treasury ^(Fig 1) are keen to get this extra
money, but ^(Fig 2) 27 February 1981
DoI and FCO ^(Fig 3) argue that anything less than
a 50% stake would jeopardise C&W's
overseas operations; they say that overseas
governments where C&W operate have been
convinced and have urged that HMG should
retain a majority stake.

(I think this will need to be
revised in E next week.
Agree?

DL

27/2



CONFIDENTIAL

The Prime Minister is of course right in assuming that about 30% of the shares would generally be taken as a controlling interest. We intend that HMG should relinquish effective control of C & W after flotation so that the company will fall outside the scope of the PSBR and it has been generally agreed with the Treasury that where the Government specifically eschews control, a private sector classification may be obtained even with a Government holding of just over 50%. We are keeping open the option of a further sale of shares at some time in the future.

I hope that this explanation makes clear why it was decided to sell no more than around half of the shares in the first instance and that the Prime Minister will be able to agree the main points of the draft statement. Mr Baker has in any event had to reconsider the timing of the statement and decided to postpone it until he has had an opportunity to consider with the Chairman of the company some important developments in crucial discussions which the Chairman is having in Hong Kong this week. Instead of the 4 March, Mr Baker hopes to be in a position to make the statement a week later.

I am copying this letter to the recipients of yours.

Yours sincerely
L. Riley

LIZ RILEY
Private Secretary

CONFIDENTIAL



Foreign and Commonwealth Office

London SW1A 2AH

27 February 1981

Dear Nick,

CABLE AND WIRELESS

Thank you for copying to me your letter of 23 February to Jonathan Hudson.

Our earlier soundings of the Governments of places where Cable and Wireless operate showed that they attached considerable importance to HMG retaining a dominant influence in the company even after some of its share had been disposed of to private holders. The views of the Bahrain Government were clearly stated to this effect. This is important because Bahrain, which the Prime Minister will be visiting in the Autumn, is Cable and Wireless's second largest profit centre. In Ministerial correspondence earlier this year (resting with Sir Ian Gilmour's letter of 30 January to the Minister of State in the Department of Energy) it was agreed that to reassure those Governments HMG would need to retain more than 50% of the shares.

Even if a 33% holding would in fact give HMG effective control, we believe that we would still have to go back to foreign governments to explain our new position. This would take time, and could lose goodwill and arouse suspicions, in turn putting at risk the continued smooth operation of Cable and Wireless in the countries and Territories concerned.

For these reasons we would prefer the disposal of Cable and Wireless shares to go forward on the basis previously discussed between Ministers.

I am copying this letter to the recipients of yours.

Yours sincerely

Michael Arthur

M A Arthur
Private Secretary to the
Lord Privy Seal

N Sanders Esq
10 Downing Street

CONFIDENTIAL

910



SIR PETER CAREY

Bae FLOTATION

The flotation of British Aerospace has clearly been a success. I hope to thank those who contributed to this success at the small party I am holding on 9 March. But I want you and the Department to know that my colleagues and I very much indeed appreciate the resolute and effective work which has been put in by all concerned in Air Division. There have been immense obstacles and the whole enterprise could have fallen at any one of them. The flotation represents a memorable achievement by all concerned. I hope that the Department obtains the same satisfaction as I do on the day that the shares in British Aerospace Public Limited Company are traded on the Stock Exchange for the first time.

I am copying this minute to the Prime Minister.

Ken Rd 2

PRIME MINISTER

A nice gesture

mt

MS
23/2

KJ.

K J
20 February 1981



DEPARTMENT OF INDUSTRY

ASHDOWN HOUSE

123 VICTORIA STREET

LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 6401

SWITCHBOARD 01-212 7675

From the
Minister of State's Office
Kenneth Baker MP

*Why less than
50% - 37 1/2%
could be
sufficient to return
effective control.*

Nicholas Huxtable Esq
Private Secretary to
The Chancellor of the Duchy of
Lancaster
House of Commons
London
SW1

19 February 1981

PRIME MINISTER

*Mr Baker wants to make an oral
statement on the privatisation of Cable
and Wireless, on Wednesday 4 March.*

Dear Nicholas,

*Content, subject to any change in timing
necessitated by other events?*

CABLE AND WIRELESS

Following my Minister's letter of 27 January to the Financial
Secretary E(DL) colleagues agreed in correspondence to
Mr Baker's proposals for the privatisation of Cable and
Wireless.

I now attach the text of a statement which Mr Baker proposes
to make to the House on 4 March. I would be grateful if you could
seek the Leader of the House's permission for this.

I am copying this to Nick Sanders (No. 10) private secretaries
to members of E(DL), Michael Arthur (FCO), Jonathan Dawson
(MoD), Murdo Maclean (Whips), David Wright and Bernard
Ingham (No. 10).

*Yours sincerely,
Jonathan Hudson*

Jonathan Hudson
Private Secretary



STATEMENT

On 2 December my Rt Hon Friend the Secretary of State for Industry told the House that in the British Telecommunications Bill the Government had included a clause broadening its power to dispose of shares in Cable and Wireless.

Since then we have been considering, in close consultation with the company whether and how shares might be sold. Before reaching a final conclusion we consulted, through the Foreign and Commonwealth Office, all the Governments of the 30 or so countries in which Cable and Wireless operates telecommunications services under a Government concession. We have informed the Commonwealth Telecommunications Organisation and its member Governments.

The Government has now decided to make a public offer for sale of just less than 50 per cent of its shares, subject to obtaining the necessary powers in the BT Bill. We and the Company are agreed that when shares are offered for sale special arrangements will be made for employees to acquire shares.

Cable and Wireless already enjoys a large degree of commercial freedom. The Government does not intend to use its rights as a shareholder to intervene in the Company's commercial decisions. Cable and Wireless will thus be free from any of the regulations which constrain Government owned corporations in the UK and this will help it to be more responsive to market forces. and would follow the precedent of BP.



The Government will be prepared if necessary to use its position as the major shareholder to protect the interests of overseas Governments in relation to the Company's responsibilities both under their concessions and under the auspices of the Commonwealth Telecommunications Organisation. The overseas Governments consulted have accepted this assurance.

The Chairman and Court of Directors of Cable and Wireless are in full agreement with this line of action. Cable and Wireless has had a long record of achievement both in private hands and since 1946 as a public sector public company. The proposed sale of shares will create a partnership between the public and private sector. This enterprise will be stable but it will also have a commercial flexibility and it will have access to the market which is essential for a fast growing telecommunications business.

*Mr Walter
Mr Inghid*



Recd Post

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Norman Fowler MP
Secretary of State
Department of Transport
2 Marsham Street
London SW1P 3EB

9 February 1981

2 Mon

*not copied to
me?*

*17-
2.*

BRITISH TRANSPORT DOCKS BOARD: 1980-81 EFL

You wrote to me on 2 February seeking my agreement to an increase of £5m in the British Transport Docks Board's 1980-81 EFL.

I understand that my officials have not had an opportunity to discuss the forecasts on which your request is based. They have told your own officials that there are a number of areas needing examination, and I think it would be best to defer a decision until this has been done.

When these discussions have taken place, we will need to consider any bid for an increase in the Board's EFL in the light of the standing of the central reserve and other potential claims, including that of British Rail, and also whether it would be appropriate to adjust the Board's 1981-82 EFL should an increase in that for the current year prove necessary.

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

Leon

LEON BRITTAN



Econ P.A.

CONFIDENTIAL TILL 12 NOON ON
THURSDAY 5 FEBRUARY

BRITISH AEROSPACE FLOTATION

BRIEFING FOR PRIME MINISTER'S QUESTIONS

Questions about British Aerospace's business or the financial terms of the Offer for Sale.

I must ask Hon Members to study the prospectus which will be laid before the House on Monday. Nothing I could say could add to or detract from the contents of that document.

What is the Government trying to achieve?

The Government believes that an organisation competing in international markets such as aerospace best lies in the private sector, so as to ensure that it responds to competition rather than to Government and political pressures. The move to the private sector will mean that the Company will be free to concentrate on its commercial objectives, and that it will no longer have to look to the Government for its external finance.

Why privatise an industry which is making profits in the public sector?

I entirely agree that British Aerospace has been a successful and profitable concern while a nationalised industry, and I congratulate its management and employees on this achievement. But it does not follow that the public sector is the best place for the industry. The Government believes that British Aerospace will be best able to build on its present strength as a private sector company.



CONFIDENTIAL TILL 12 NOON ON
THURSDAY 5 FEBRUARY

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What does the Government gain financially?

The most important gain is that the future funding requirements of BAe will no longer be a charge against the PSBR. In addition, there is the immediate benefit of the receipts from the sale.

What will be the Government's receipts from the issue?

The total value of the shares sold will be close to £150 million. Of this £100 million will be money raised for British Aerospace PLC to strengthen the business. The Government's receipts will therefore be close to £50 million. In addition the Government will retain a shareholding in the Company worth close to £150 million at the offer price. (The exact amounts will depend on how many shares are taken up by employees.)

Does this not compare badly with compensation?

This is not comparing like with like. The compensation was £158.75 million for the various predecessor companies, and was intended to reflect notional market values in a six-month period in 1973-74. The market capitalisation of British Aerospace is £300 million.

Is the Government selling half the Company for less than £50 million?

The Government's receipts will be close to £50 million. But that is after new money has been raised for the Company and special arrangements have been made for employees to acquire shares. A better indication is the market capitalisation of the Company of £300 million - of which the Government will retain nearly half.

What will be the expenses of the issue?

Between £4 and 5 million, of which the major component is the commission for underwriters and sub-underwriters.



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THURSDAY 5 FEBRUARY

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What percentage shareholding will the Government have after the offer?

Between 48 and 50%. The Government shareholding will be equal to the number of shares sold under the offer for sale, the balance being held by the employees.

Does the share price of £1.50 not compare badly with the net assets per share of nearly double that?

There are many companies where the market capitalisation falls far short of the net assets: Vickers, for example, has a market capitalisation about half its net assets; for Hawker Siddeley the figure is about two-thirds.

Will the Government use its shareholding to exercise control over the Company?

No. As we explained repeatedly during the debates on the British Aerospace Bill, the Government does not intend to use its rights as a shareholder to intervene in the Company's commercial decisions.

Will the Government provide finance for the Company?

The Company will obtain its external finance from commercial sources. British Aerospace will have no special access to Government funds - it will have the same eligibility for Government finance as other companies in the private sector.

How will United Kingdom control be ensured?

This was explained fully during the passage of the British Aerospace Bill. The Articles of Association restrict foreign ownership to 15% of the voting shares.



CONFIDENTIAL TILL 12 NOON ON
THURSDAY 5 FEBRUARY

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What are the arrangements for employees to acquire shares?

As has previously been announced, each eligible employee will be offered approximately £50 worth of shares free, to be held on his behalf by the Trustees of the British Aerospace Employee Share Ownership Scheme. In addition, subject to financial limits to be set out in the prospectus, employees who purchase shares under the offer and vest them in the Trustees will be allocated an equal number of shares free.

Will the Government urge people to buy shares?

I certainly hope the issue will be a success. But every prospective investor must make up his own mind on the basis of the prospectus.

NOTE: The attached written reply will have been given, in answer to a question from Mr Michael Grylls (North-West Surrey), at around midday on Thursday 5 February.

AIR5/DOI
4.2.81

File ref

Department of Industry

P.O. No.

.....
WED 4/2/81.....

340.....

- 44 Mr Michael Grylls (North West Surrey): To ask the Secretary of State for Industry.
W if he expects to make any further progress in privatising state controlled assets during the current year.

Norman Tebbit

Arrangements are in hand for the offer for sale by Kleinwort, Benson Limited on behalf of my right hon Friend the Secretary of State for Industry of about half of the issued Ordinary Shares of British Aerospace Public Limited Company. The Government will retain between 48.37% and 50% of the issued shares, the percentage being dependent upon the number of shares taken up under special arrangements for the employees. Pursuant to this reply I expect to give further details of the offer for sale tomorrow.

ANSWER (Thursday)

Further to the answer I gave on Wednesday 4 February 1981, arrangements have been completed for the offer for sale by Kleinwort, Benson Limited on behalf of my right hon Friend the Secretary of State for Industry of up to 100 million Ordinary Shares of 50p each of British Aerospace Public Limited Company at 150p per share, payable in full on application. The offer for sale has been underwritten by Kleinwort, Benson Limited, Hill Samuel & Co Limited, Morgan Grenfell & Co Limited and J Henry Schroder Wagg & Co Limited.

The prospectus will be advertised in the newspapers on Monday 9 February 1981, and will be laid before the House on that day. Application lists will open at 10.00am on Friday 13 February 1981.

Of the Ordinary Shares being offered for sale 66,666,667 are new Ordinary Shares which my right hon Friend the Secretary of State for Industry has agreed to subscribe at the offer price and which will be paid for out of the proceeds of this offer for sale, thus raising £100 million of new equity capital for British Aerospace PLC.

The Government has made arrangements for each employee of British Aerospace PLC who is eligible under the terms of the British Aerospace Employee Share Ownership Scheme to be offered, free of cost and at the Government's expense, 33 Ordinary Shares (worth approximately £50) to be held on his behalf by the Trustees of the Scheme. In addition, the Government has arranged for up to 2,178,990 Ordinary Shares to be available to eligible employees for purchase at the offer price (subject to a limit of 600 Ordinary Shares per employee and to scaling-down in the event of over-application by such employees); each employee who purchases shares under this arrangement and vests them in the Trustees will then have appropriated to him, free of cost and at the Government's expense, an equal number of Ordinary Shares to be held on his behalf by the Trustees. In addition, preferential consideration will be given to applications received from all employees at the offer price; and so far as possible, the Government's intention of promoting the widest possible ownership of shares will be taken into account when making allocations in the event of over-subscription.

Immediately after the offer for sale, the Government will hold the same number of shares as are sold under the offer for sale (ie between 48.37 per cent and 50 per cent of the issued share capital of the Company), the balance of the issued share capital being those shares acquired by or on behalf of the eligible employees under the special arrangements which I have described.

In order that British Aerospace PLC should remain under the control of citizens of the United Kingdom and Colonies, the Articles of Association of the Company restrict the number of foreign-held shares at any one time to 15 per cent of all voting shares in issue.

It is intended to meet the costs of the sale from the receipts. A supplementary estimate will be submitted to seek Parliamentary authority for this.

The following is the text of a letter which has been written by the Secretary of State for Industry to the Chairman of British Aerospace PLC concerning the future relationship between HM Government and the Company.



Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

3 February 1981

Sir Austin Pearce CBE
British Aerospace
Brooklands Road
Weybridge
Surrey KT13 OSJ

HM Government as customer

There will be no change in the relationship between the Ministry of Defence as customer and the Company as contractor consequent upon the Offer for Sale. British Aerospace is, and will continue to be, treated by the Ministry of Defence in accordance with the same criteria as other United Kingdom defence contractors with contracts awarded to meet United Kingdom defence requirements either by tender or, in the case of non-competitive contracts, subject to the profit formulae and post-costing arrangements agreed by HM Government and the Confederation of British Industry.

HM Government as shareholder

Following the Offer for Sale HM Government will have a shareholding of between 48.37 per cent. and 50 per cent. of the issued share capital of the Company, depending on the number of shares acquired by or for the benefit of the employees of British Aerospace under the special arrangements relating thereto. HM Government is prohibited by section 7 of the British Aerospace Act 1980 from using its powers under that Act to increase the proportion of Ordinary Shares it holds following the Offer for Sale. The only other relevant provisions under which HM Government might acquire shares in the Company are contained in Part II of the Industry Act 1972 as amended by the Industry Acts 1975 and 1980. Any acquisition made under those provisions would not be subject to the limit imposed by section 7 of the British Aerospace Act 1980 on the proportion of Ordinary Shares which may be held by HM Government. However, HM Government could only acquire shares under those provisions if the Company itself sought financial assistance and if the Secretary of State was satisfied that such assistance could not, or could not appropriately, be provided otherwise than by him.

/Following ...



Following the Offer for Sale HM Government does not intend to sell any more of its shareholding in the Company for the foreseeable future. HM Government has also made it clear that, in any event, it intends to retain a shareholding conferring more than 25 per cent. of the voting rights ordinarily exercisable in general meetings.

HM Government does not intend to use its rights as a shareholder to intervene in the Company's commercial decisions. It would be prepared to use its voting rights in cases where it wished to prevent an alteration to the provisions of the Company's Articles of Association relating to United Kingdom control, to the nationality of the Directors or to Government Directors. It might also wish to vote its shares in opposition to a resolution proposing the election of a Director believed to represent foreign interests. It does not expect to vote its shareholding in opposition to a resolution supported by a majority of the Board in other circumstances, although it retains the power to do so.

Under the Company's Articles of Association HM Government has the right to appoint two non-executive Directors to the Board and HM Government has now appointed Mr K.M. Bevens and Mr K. Durham as Government Directors. The Government Directors have no special powers and their duties, like those of all directors, are to the Company as a whole. The Government Directors are generally not entitled to vote at any Board meeting on any issue relating to a contract or proposed contract with the Company to which the Crown (or a person acting on behalf of the Crown or a company of which the share capital is wholly-owned by or on behalf of the Crown) is a party.

Sales support

The support of HM Government in relation to overseas sales will continue to be available to British Aerospace on the same basis as to other United Kingdom companies. Where there are in existence Memoranda of Understanding between HM Government and overseas governments relating to contracts entered into by British Aerospace, HM Government's undertakings under these Memoranda of Understanding will continue to be honoured. The Offer for Sale will not cause HM Government to change its criteria for entering into new Memoranda of Understanding. Existing facilities provided by the Export Credits Guarantee Department will be unaffected by the Offer for Sale. The Export Credits Guarantee Department will be prepared to consider applications from the Company for further facilities in exactly the same way as it would consider applications from any other company.

Airbus Industrie

HM Government reached an understanding, embodied in Principles of Co-operation established in 1978, with the governments of France and Germany to support the Corporation's participation as a full member of Airbus Industrie from 1st January, 1979 and to stand behind

/the ...



the Corporation in the discharge of its financial obligations to Airbus Industrie. These Principles now apply equally to the Company. HM Government has informed the French and German governments that the change in legal constitution and ownership of British Aerospace brought about by the British Aerospace Act 1980 and the Offer for Sale will in no way weaken the support of HM Government for participation by British Aerospace in the Airbus programme.

HM Government finance

The Company will have the same eligibility for government finance as other companies in the private sector, and as the Corporation's predecessor companies had prior to nationalisation. The principal statutes likely to be relevant are the Civil Aviation Act 1949, under which HM Government may give assistance for the design, development and production of civil aircraft, and the Industry Act 1972 (as amended), under which HM Government may give assistance to provide employment in the assisted areas or in the national interest. Any application for such government finance will be treated on its merits, and will be subject to the general guidelines and financial limits that may apply at any time in relation to the relevant statute.

Creditors

Persons who were creditors of the Corporation and its wholly-owned subsidiaries immediately before 1st January, 1981, the date on which the undertaking of the Corporation vested in the Company, are protected by section 9 of the British Aerospace Act 1980. This section provides that outstanding liabilities of the Corporation, which at the date of vesting became liabilities of the Company, or which may become liabilities of the Company under section 8 of the Act, will be discharged by the Secretary of State in the event of the Company being wound up except merely on a reconstruction or amalgamation. Under section 8 of the Act, the Company is liable for the judgment debts of companies which became its wholly-owned subsidiaries on the day of vesting where the cause of action arose before that day.

These provisions do not apply to obligations entered into by the Company or its wholly-owned subsidiaries after the date of vesting. Except as provided in section 9 of the Act, HM Government will have no commitment to meet the debts of the Company or its subsidiaries after the Offer for Sale.

Yours sincerely,

Kern Joseph



W. H. Lyham

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
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✓MS

Secretary of State for Industry

The Rt Hon Francis Pym MP
Chancellor of the Duchy of Lancaster
and Paymaster General
Privy Council Office
Whitehall
London SW1A 2AT

27 January 1981

Ami Lyham

*This came in after
questions today. But what
you said about B.Ae. was,
I think, OK.*

Mr Francis

BRITISH AEROSPACE FLOTATION

We are now less than a fortnight away from the planned date for the flotation of British Aerospace. In the run up to the flotation there is a danger that Ministers might make comments about British Aerospace which, while innocuous in any other circumstances, might be taken by prospective purchasers as relevant to the flotation and which could in the extreme render the Government liable to prosecution for misrepresentation. I attach a note, prepared by this Department's and by City legal advisers, setting out the legal position. I should be grateful if you, and all colleagues to whom I am copying this letter, could consider it carefully, and exercise particular care in making comments or statements in respect of British Aerospace in the period until the flotation has occurred. This applies both to statements in the House and those made elsewhere.

2 There is a further and wider dimension to be considered. Quite simply, the success of the flotation will be best pursued through its being presented to the investing world in very much the same way as any other large issue and through concentration on the financial merits of British Aerospace rather than on the political controversy associated with privatisation. I therefore strongly counsel that we should avoid any statement in respect of British Aerospace likely to awaken the political controversy that is never far from the organisation. Until the flotation is completed, I hope that the Government as a whole will take a low profile.

3 I am addressing this letter to you in the light of your responsibilities for Government information. I am copying it, with the attached note, to the Prime Minister, other members of Cabinet and to Robert Armstrong.

Yours ever.

Kear

LIABILITY OF THE GOVERNMENT FOR STATEMENTS
MADE OTHER THAN IN THE PROSPECTUS

A purchaser of shares may be able to claim some form of relief on the grounds that he was induced to enter into the contract to purchase by a misleading statement. The liability may arise whether the misrepresentation was made fraudently, negligently or even wholly innocently.

The misrepresentation must be material ie it must be one that would affect the judgment of a reasonable man in deciding whether or not to enter into the contract, and the representee must show that he relied upon the misrepresentation in deciding whether to enter into the contract. (In practice, however, it is difficult to maintain a defence that the misrepresentation was immaterial or that the representee did not rely on it.) It is sufficient if the misrepresentation was only one of several inducements to enter into the contract. Despite the fact, therefore, that the prospectus, which will be carefully vetted, may be read by prospective purchasers they may also have relied upon mis-statements made other than in the prospectus, for instance by Ministers in Parliament or outside. The closer to the issue that statements are made the more likely it is that a purchaser will be able to show that he relied upon such statements. It also seems likely that the risk of purchasers relying on such statements would be magnified in the case of employees who, it is thought, would be more likely to decide to buy shares because of the statements of Ministers than because of a careful study of the prospectus.

The general rule is that the liability will arise only where the misrepresentation involves a mis-statement of existing fact. There

may be no liability, therefore, if the statement falls into one of the following categories:

(i) Mere Puffs

ie sales patter, eg BAe makes wonderful aeroplanes.

(ii) Statements of Opinion

Some statements of opinion give no rise to liability either because they are mere puffs or because the maker of the statement had, as the other party knew, no personal knowledge of the facts on which he based his opinion, and it is understood that he could only state his belief.

Eg. if a Minister stated that in his opinion BAe would be even more successful in private ownership it would be understood that this was his belief and he could have no knowledge of whether it would in fact be more successful.

However, where the opinion is or appears to be based on facts particularly within the knowledge of the maker there may be a misrepresentation because the maker has implied that he has reasonable grounds on which to base his opinion. Eg. if a Minister states that it is his belief that BAe will gain many new and profitable contracts as a private sector company he may be taken to have represented that he knows as a fact that new contracts are ready to be concluded with the new Company. If this is not so there may well be a liability for a misrepresentation.

It should be stressed that in the case of Ministers giving opinions on the new Company there is a particular risk that they will be believed to have a knowledge of facts on which the opinion is based. The very fact that it is

a Minister speaking will lend a certain authority to the statement. What may genuinely be merely a belief of a Minister, therefore, may not be recognised as such and he may be believed to have based his opinion on facts which are not in his possession.

(iii) Statements as to the Government's Future Conduct

A promise to do something in the future may be nothing more than a statement as to the present intention of the maker's future conduct. If so, the maker of the statement does not misrepresent a fact merely because he fails to fulfil the promise. It will however be a misrepresentation if the maker does not in fact have the intention of fulfilling the promise at the time he makes the statement: eg. if a Minister stated that the Government would continue to underwrite the Airbus project in the future and the Government subsequently withdrew there would be a misrepresentation only if the Government did not have the intention of continuing to back the project at the time the promise was made. On this example this would not of course be the case. It must be stressed, however, that a statement of intent as to future conduct if carelessly made may lead to serious consequences and there may be some difficulty in showing that a Minister actually had the intention when he made the statement.

(iv) Statements of Law

Misrepresentations as to the interpretation of a statute do not give rise to a liability but a statement that a statute applies to a certain set of facts which are incorrect may well be a misrepresentation giving rise to a liability. Eg. if a Minister states that launch aid may in law be provided under section 1 of the Civil Aviation Act 1949 for military aircraft this would be a

misrepresentation of law and would give no rise to liability. If, however, a Minister only said that launch aid could be provided for the promotion of the Jaguar aircraft this would probably be a misrepresentation of fact, to wit, that the Jaguar is a civil and not military aircraft and the misrepresentation might give rise to a liability. If a Minister states that launch aid will in fact be provided for a civil project the criteria for determining whether the statement could be a misrepresentation falls under (iii) above.

Conclusion

In every case it will be a question of fact to be judged by the Court whether the grounds stated above are satisfied in order to give rise to a liability for a misleading statement. There is frequently a fine distinction to be drawn in deciding whether a misrepresentation was in fact material. Likewise it is often difficult to conclude whether the statement was a mere puff or in fact a misrepresentation of existing fact; whether the maker of an opinion was understood only to have been stating his belief or to have based his opinion on facts within his knowledge; or whether at the time he made a statement as to his future he did have the intention of fulfilling his promise.

The best advice to Ministers is that they should confine their remarks to:

- (a) statements of published facts eg BAe's past profits or published financial target; or
- (b) statements on matters within the Government's control eg. that it will stand by its commitment in relation to BAe's membership of Airbus Industrie; or

- (c) statements which are clearly expressions of opinion or belief, rather than factual forecasts eg. that BAE's chances of success are better in the private sector than as a nationalised industry.

Ministers should avoid statements which are of opinion or belief, but which may appear to have some factual basis eg. predictions about the successor Company's level of profits or dividend performance in future years. Again, it must be remembered that statements of belief by Ministers may be relied upon because they may be believed to have firm facts on which to base their opinions.

Ministers should also avoid statements which only partially disclose facts. As a general rule there is no duty to disclose material facts. However, to reveal some facts, all of which are true, but to fail to reveal other facts which affect the weight of those stated and make the statement misleading, may be a misrepresentation.

Finally, it should be pointed out that statements true at the time they are made may cease to be true later. If the statement is not corrected it may be a misrepresentation. Ministers should, therefore, disclose any facts which falsify statements previously made by them.

27 JAN 1981



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re MFS
ECON POL

10 DOWNING STREET

From the Principal Private Secretary

19 January 1981

Subject filed as:
Defence: Part 4: Defence Budget.

CS

Dear Baron,

Defence Expenditure and BAe Flotation

The Prime Minister held a meeting this afternoon with your Secretary of State, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Industry and the Attorney General to consider both the proposal made by Mr. Nott in his minute of 16 January 1981 that he should make a statement tomorrow about cuts in defence expenditure in 1981/82 and the question of the flotation of British Aerospace on which recent Ministerial correspondence rested with Sir Keith Joseph's minute of 19 January. Sir Robert Armstrong was also present.

The Defence Secretary said that he was seeking cuts which in all would total £850m. in 1981/82. Of this figure £200m. was the saving agreed by Cabinet in November; the remaining £650m., which would not be mentioned in any Parliamentary statement, was the reduction necessary to bring the programme back into line with the original PESC provision for next year. He had reviewed the measures which his predecessor had been considering and as he had explained in his minute, he had concluded that he could find only £160m. of the £200m. cut agreed by Cabinet. The changes in the programme which this reduction required reflected the Chiefs of Staff priorities. He was not happy about the merger of No. 41 RM Commando with other Commandos, but Mr. Peter Rees was ready to go along with the amalgamation, provided the RM Music School remained at Deal. He did not see how he could find the remaining saving of £40m. without adopting measures which would have a very damaging effect on the defence industries.

Mr. Nott continued that he would like to make his statement the following day. He saw every reason politically for getting the announcement about defence expenditure next year out of the way as quickly as possible. It would be no easier to make it in a month's time. Indeed if it were delayed until just before or just after the Prime Minister's visit to Washington, this would be more embarrassing than doing it now. Moreover, once decisions about next year were announced he could get down to the much greater problem of the defence programme in the medium term. He should not conceal from his colleagues, however, the fact that he would

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have to reveal in answer to supplementary questions that a considerable number of jobs would be lost as a result of the present cuts in the defence programme. Yarrows, Vosper Thornycroft and Scott Lithgow would survive, but he expected Cammell Laird to close. About 6-7,000 job opportunities would be lost in the shipbuilding industry.

The Foreign and Commonwealth Secretary said that he did not believe that it would matter much if Mr. Nott made his statement on the day President Reagan was inaugurated; and in further discussion it was agreed that the Defence Secretary should go ahead as he proposed tomorrow.

The meeting then considered the draft statement in the light of the proposal to float British Aerospace in February. The Attorney General said that it was essential that the Defence Secretary's statement and the flotation prospectus should provide a proper understanding of our intentions in the defence field as they affected BAe. The Secretary of State for Industry said that with this general requirement in mind, he would like to see the draft statement amended in the way he had proposed in the minute which he had circulated today. First, he thought that the position on Sea Eagle should be explained more candidly than was done in paragraph 4 of the draft statement. Second, he did not think the second sentence of paragraph 8 explained explicitly enough for flotation purposes the decisions taken by Cabinet about defence expenditure in 1982/82 and 1983/84. Lastly, the fourth sentence of paragraph 8 suggested a much less radical review of the defence programme than the Defence Secretary's minute implied. In discussion it was agreed that:-

(a) The sentence about Sea Eagle in paragraph 4 of the draft statement should be amended to read:- "The Sea Eagle anti-ship missile will continue although further consideration will be needed before its place in the programme can be confirmed".

(b) The second sentence of paragraph 8 should be amended to make it clear that the reduction of £200m. in 1981/82 was carried through into the two following years, and in any case the words "defence expenditure" should be substituted for "resources". It was also desirable not to give unnecessary emphasis to the NATO commitment of 3% annual growth in real terms, now that General Haig and Mr. Weinberger were showing signs of playing down the significance of the commitment. If the Defence Secretary was asked in supplementaries whether the Government remained committed to annual increases of 3%, he should reply on the lines that the NATO commitment was clear and the Government had made plain that it abided by it.

(c) The fourth sentence of paragraph 8 should read "...is wide of the mark; but we must, over the next year, look realistically at our programmes to match them to the resources likely to be available".

/In subsequent

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In subsequent consideration of the draft statement it was agreed that the opening three or four sentences of paragraph 5 should be re-ordered and redrafted to bring out the fact that the quicker completion of defence orders had not only led to higher defence expenditure than planned but had also resulted in the Services getting new equipment more rapidly than expected. We should bring out the benefits as well as the disadvantages of the acceleration in the defence programme. On the other hand, the second sentence of paragraph 7 seemed to understate the effect of the changes in the shipbuilding programme on the warship construction programme, and the Defence Secretary agreed that he would revise this sentence to make it clearer.

Mr. Nott said that paragraph 2(b) of the Chancellor of the Exchequer's minute of 19 January about the BAe flotation assumed that any overspend on the 1980/81 cash limit for the defence budget would be offset by a compensating reduction in the 1981/82 cash limit. He did not challenge this as a reflection of general cash limit doctrine, but in the case of the MOD Cabinet had agreed in November that there should be a review of the cash limit in the summer of 1981. The fact was that if the cash overspend in the present year was clawed back in full, the defence programme would be brought to a halt. As he had explained in his minute of 16 January, to find a further saving of £40m. next year would lead to the closure of four shipyards. If he had to go substantially further than this, as he would if he had to claw back the whole of the overspend in 1980/81, the effects on defence industry would be disastrous. None the less, he would do what he could at the time of the cash limit review to offset the cash overspend in the present year.

The Chancellor of the Exchequer said that he understood the Defence Secretary's difficulties. He was ready in the mid-year review of the cash limit to take account of any exceptional movement in defence prices; the effect of Ministers' decisions on the AFPRB's recommendations; and the need, in principle, to offset in 1981/82 the overspend in 1980/81.

Mr. Nott then raised the suggestion set out in his minute of 19 January that the Youth Opportunities Programme should be expanded to allow young men and women to serve in the army. They would receive £23.50 a week and would join the army for between six and twelve months. The defence budget would meet the costs of their food, clothing and equipment, and in order to absorb them within the existing army organisation without creating new facilities for them, their number would have to be limited to something like 3,500. It was not, however, clear whether the Manpower Services Commission would be prepared to find their pay and allowance.

/In discussion

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In discussion there was general agreement on the political attractions of the proposed scheme, but it was argued that it would be unwise to take a decision on such a new departure in a rush and it would therefore not be sensible for Mr. Nott to mention the idea in his statement tomorrow.

The Prime Minister, summing up the discussion, said that the meeting agreed that Mr. Nott should make his statement on defence expenditure in 1981/82 tomorrow. He should amend the text attached to his minute of 16 January on the lines agreed in discussion and it should omit any reference to the proposal that young people participating in the Youth Opportunities Programme might serve in the army. The Defence Secretary should circulate a revised draft to all members of OD and the Attorney General by close of play today. The meeting also agreed that the Secretary of State for Industry should go ahead with the flotation of British Aerospace in February.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office), John Wiggins (HM Treasury), Ian Ellison (Department of Industry), Jim Nursaw (Law Officers' Department), and David Wright (Cabinet Office).

Yours sincerely,

Alfred Whittam

B.M. Norbury, Esq.,
Ministry of Defence.

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Original on
Defence Budget

Ref. A04026

Pt 4

PRIME MINISTER

Defence Estimates 1981-82
Flotation of British Aerospace

The Secretary of State for Defence sent you a minute and proposed Parliamentary statement on this subject on 16th January, which you will be considering at a meeting this afternoon. The Secretary of State for Industry has sent you a minute today on the relevance of this statement to the flotation of British Aerospace in February - see paragraphs 5-7 below.

2. The positive tone of the proposed statement is clearly the best way to tackle a difficult task. The big question about this particular approach is how it will affect our allies, particularly the United States. You will wish to take careful account of the views of the Foreign and Commonwealth Secretary on this crucial point. It is obviously to our advantage to get this statement out as long as possible before your visit to Washington in February. I can see why Mr. Nott wants to make the statement tomorrow. But you will want to consider with the Foreign and Commonwealth Secretary and the Secretary of State for Defence whether the timing is right vis-a-vis the Americans. Mr. Reagan will be concentrating on his inauguration tomorrow, and is unlikely to think about the statement at once. But its implications will undoubtedly be drawn to his attention: is there a danger that he may think that we timed the statement for Inauguration Day in the hope that he would be too busy to notice it?

3. On the substance of the statement itself, there are two general points of a positive nature which you may like to suggest should receive greater emphasis:

- (1) As one of the problems confronting the defence programme this year has been the accelerated level of deliveries from industry, there is an opportunity to deal with this phenomenon in more constructive terms than those used in paragraph 5 of the draft. Could the Secretary of State for Defence pay British industry the compliment of suggesting that part of his immediate cash flow problem stems from the over-prompt deliveries which he has been receiving from industry - which is a pleasant contrast to the accusations of late deliveries which are so often levelled at British companies?

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(2) The other positive point to which he might give greater emphasis is the fact that the proposed reductions will have little impact on the manning and equipment of the British Army of the Rhine, which is the British contribution to NATO to which our allies including the United States attach most importance. This point could be injected into paragraph 4 of the draft statement, which mentions a number of improvements which have been made in the defence programme in more general terms.

4. There is also one point of detail which you may care to suggest. I understand that No. 41 Commando is at present seriously undermanned. It might be worth mentioning this fact, if the Secretary of State for Defence can confirm its accuracy, to underline the statement that its merger with the other Commandos will not reduce the effective overall strength of the Royal Marines.

British Aerospace

5. The problem of dealing in the sales prospectus with the implications of the defence programme for British Aerospace is discussed in the minute of 7th January from the Minister of State, Department of Industry, to you and in the Secretary of State for Defence's minute to you of 16th January. There are two points in particular in the present draft statement which worry the Secretary of State for Industry:-

- (i) Paragraph 4 states that "Contrary to some reports, development work on the Sea-Eagle anti-ship missile will continue" - misleading because the possibility of cancellation is not ruled out (see paragraph 4 of the Secretary of State for Defence's minute to you).
- (ii) Paragraph 8 states "We must, over the next year or so, look realistically at our programmes to see what needs to be done" - satisfactory if it refers to the normal, ongoing process of review but difficult if it implies some more radical exercise.

The Secretary of State for Industry will, I understand, suggest drafting changes which could meet these points. He will copy his minute to the Attorney General and probably suggest that he should come to the meeting to advise on these questions.

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6. If the Secretary of State for Industry's points cannot be readily met, that adds to the case for deferring the statement until the issues can properly be thrashed out.

7. If, on the other hand, amendments can be made and it is accepted that there are no further defence problems for the British Aerospace prospectus, the way is clear for flotation subject to two points:-

(i) The Chancellor of the Exchequer accepting that February flotation should not be held up to enable a review of the BAe 146 aircraft to go ahead - the Financial Secretary appears to have accepted this in his letter of 12th January to Mr. Tebbit.

(ii) Your being satisfied that the sale of half the shares should go ahead for a net return to the Government estimated to be in the range of £15-£30 million - this is discussed in more detail in paragraphs 3 and 4 of the minute of 12th December to you from the Secretary of State for Industry in which he reported the recommendation of E(DL) that the Government should continue to aim for flotation as soon as possible in spite of the relatively low return.

ReA

ROBERT ARMSTRONG

19th January, 1981

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Forestry Bill

It is hoped that this brief will be of some help to Members during the passage of the above Bill through the House in the coming months.

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FORESTRY BILL1. Introduction(a) The Forestry Commission

Since the General Election in May 1979, the Government has been looking at the Forestry Commission with a view to rationalising its operations and in particular its annual cost to the Exchequer. This is particularly appropriate, as it is 60 years since the Commission was established on 29th November 1919.

"The remit given to the Commission's first Chairman, the 16th Lord Lovat, and his colleagues was to establish by the end of the Century a state forest resource of 715,000 hectares, and to encourage private owners to repair the wartime ravages and then maintain in a productive state some 1.2 million hectares of their own woodlands, so that neither war nor national emergency should ever again inflict the desperate timber shortages of the First World War" (Forestry Commission Annual Report 1979-80).

Today, the total land owned by the Commission has reached 1,263,400 hectares, or 3,121,860 acres (at 31st March 1980) (see Table 4).

The Forestry Commission is divided into two parts, namely the Forestry Enterprise and the Forestry Authority. Obviously, there is considerable interlinkage in their operations, but basically the Forestry Enterprise owns and manages the FC's forests throughout Great Britain, and the Forestry Authority handles research and development, grant aid to the private sector, disease control, legislation, education, etc. The Commission is funded by 'Grant in Aid', voted by Parliament on an annual basis. For more information on the Forestry Commission, see the 60th Annual Report and Accounts, which was presented to Parliament and printed on 15th December, 1980.

(b) The Bill

There are three main objectives of the Forestry Bill to be debated in the House, namely to give Forestry Ministers greater freedom to dispose of assets managed by the Forestry Commission, to allow the transfer from the Forestry Fund into the Consolidated Fund, receipts obtained from the Sales of Assets in the Forestry Enterprise and lastly, to increase the maximum number of Commissioners, other than the Chairman, from 9 to 10.

The Forestry Ministers are: the Minister of Agriculture, Fisheries and Food, the Secretary of State for Scotland and the Secretary of State for Wales. The Bill does not involve Northern Ireland. Increased manpower or public expenditure are not envisaged with the introduction of this legislation.

There are three existing Acts of Parliament involved in this Bill which will be amended accordingly:-

The Forestry Act 1967
The Countryside (Scotland) Act 1967
The Countryside Act 1968

There is likely to be some controversy over this Bill. It is dealt with on pages 3 and 4.

The Bill is NOT involved in matters such as Grant Aid, or the administration of Felling control. These are covered in the Forestry Commission's Consultative Paper on Private Forestry, published in December, 1980, which is available to Members in the Vote Office.

2. Powers to Dispose of Land Acquired for Forestry - Clause I

This clause gives unrestricted powers to the Forestry Ministers to dispose of land acquired for forestry, recreation, or amenity purposes and managed by the Forestry Commission (See page 8, Table 4. This is achieved through replacing the existing limited powers of disposal, contained in Section 39(2) of the Forestry Act 1967, as amended by Section 59 of the Countryside (Scotland) Act 1967 and Section 23(3) and 24(4) of the Countryside Act 1968.

The main objectives of this clause are to make more active use of the assets of the Forestry Enterprise, and to reduce its dependence on Public Funds. To achieve this, it requires the sale of assets that have been built up over many years and in some cases, to protect the viability of the wood processing industry who have shown concern about this proposal. It may be advisable for there to be lease back arrangements. This would allow the Commission to continue to gain practical experience in the management of forestry, which is essential for an effective advisory service to be given to the private sector. It also gives continuity of employment and amenity, particularly in those forests where recreational facilities have been developed for the public.

It is also proposed that up to a third of the Commission's reserves of land awaiting afforestation should be sold. However, it would not include land which is essential to the management of existing forests or that where planting would help maintain rural employment.

It is not possible to forecast accurately the uptake by the private sector of offers, but it is confidentially expected that 1982-83 will see the start of sales on a reasonable scale (see page 5).

3. Powers to Transfer Sums out of the Forestry Fund into the Consolidated Fund - Clause II

This clause adds a paragraph to Section 41 of the Forestry Act 1967 of sub-section 4(A) and removes Section 41(7) of the same Act, which conferred limited investment powers on the Forestry Commissioners.

The present system of financing the Commission was set up (i.e. the Forestry Fund) under Section 8 of the Forestry Act 1919 and continued under Section 41(1) of the Forestry Act 1967. The Grant-in-Aid voted by Parliament (see page 5, Table 1) is credited to the Forestry Commission Vote Account and sums required to meet the net expenditure of the Commissioners are transferred from there to the Forestry Fund each year. As far as income is concerned, all sums received by the Forestry Commission

from sales of timber, or from other sources, such as rents and the provision of recreational facilities, and capital sums received from the disposal of land and other assets, are paid into the Forestry Fund. The Forestry Commissioners have no powers to borrow money.

However, the annual Grant-in-Aid is in fact in two parts, namely moneys required for the Forestry Enterprise and the money required to carry out the functions as the Forestry Authority for Great Britain i.e. grants to private woodland owners, research and development, education, information and fiscal and regulatory duties. Once the Forestry Bill becomes law, the financial independence of the Forestry Authority is to be maintained.

At the moment, any credit balance in the Forestry Fund at the end of the financial year is, by Treasury agreement, carried forward to the next year. However, the Forestry Commissioners are expected to so arrange their drawing on the Vote as to ensure that the credit balance does not exceed a reasonable level. This clause enables the Forestry Ministers to surrender to the consolidated Fund any sums received into the Forestry Fund from the sale of assets. But it does not force them to do so and transfers must have Treasury agreement.

4. Power to Increase the Number of Forestry Commissioners - Clause 3

The 1967 Forestry Act provides for the number of Commissioners that can be appointed to the Forestry Commission and what qualifications they should have (Section 2(1) and 2(2)). This clause enables the Forestry Ministers to appoint an additional Commissioner to increase the number to ten and a Chairman. It is expected that the extra Commissioner will have business and commercial experience outside forestry and the wood-using industries, so that he will be able to advise on the disposal programme envisaged in the previous clauses.

5. Politics

The Government's Policy for the future of British Forestry, both Private and the Forestry Commission, was announced in a statement by George Younger, Secretary of State for Scotland, in the House on December 10th 1980. It included the proposal to make the grant-aid and felling licensing less complex and less costly to administer by introducing a single new scheme at the start of the next forest year (on October 1st, 1981). This, however, is not included in this Bill.

"There should be scope for new planting to continue in the immediate future at broadly the rate of the past 25 years. We see a greater place for participation by the private sector in new planting, but the Forestry Commission will also continue to have a programme of new planting, in particular where it will contribute to the rational management of their existing plantations, and also in the more remote and less fertile areas where afforestation will help maintain rural employment.

"The main basis of policy for the future must remain the successful and harmonious partnership between the private sector and the Forestry Commission. In accordance, however, with the Government's support for private enterprise and our policy of reducing public

expenditure, a determined effort will be made, by making better use of the capital invested in their existing assets, to reduce that part of the Commission's grant-in-aid which finances the Forestry Enterprise. We therefore propose to provide opportunities for private investment in these assets, including the sale of a proportion of the Commission's woodlands and land awaiting planting, with lease-back arrangements, where it is important to maintain continuity of management to meet wood supply requirements, or for other reasons. In planning its broad implementation of this policy, the Forestry Commission will take account of the views of the organisations concerned.

(Hansard, 10th December 1980, Col. 1405-6).

A clear indication of the stand to be taken by the Opposition was given by Gavin Strang at the end of the debate:

"Is it not a measure of the extent to which the Government are motivated by extreme Right-wing ideology that they should decide to dismember a State commission that has served the nation well under successive Governments for 60 years? Will the Rt. Hon. Gentleman admit that the British Paper and Board Industry Federation, which represents the Reeds and Bowaters of this country, is opposed to the hiving off of State assets? Will he end the nonsense about the Commission's having freedom to buy other land and admit that this is a policy of selling State assets, and that there are no forestry arguments in favour of it?"

(Hansard, 10th December 1980, Col. 1417).

The Private sector, namely the Economic Forestry Group and the Timber Growers Organisation, have indicated their approval of these measures, but believe that it will be some time before many forests belonging to the Commission actually come on the open market. They are not at the moment clear as to how the sales will be handled, in particular as to whether previous owners of the land will be allowed to have the first chance to buy back.

The Economic Forestry Group have also pointed out that there is a danger of 'swamping' the private sector if the sales are not strictly controlled. However, it is their view that annual sales of Commission assets could reach £20-25 million per annum in a couple of years' time.

Finally, it is unlikely that the uptake of the offer for sale of Commission's forests will be great in the first few years. It is not the intention of the Government to sell all the Commission's forests, or to sell only the better forests, leaving the uneconomical and far flung to be managed by the Commission. As it is, the total forest land owned by the Commission (see Table 4) is 247,000 hectares more than that envisaged when the Commission was established in 1919 (see Page 1).

Table 1

STATEMENT OF FORESTRY FUND RECEIPTS AND PAYMENTS
in the year ended 31 March 1980

Previous Year £000		Receipts	
29,310	Grant-in-Aid		£000
27,270	Sales of timber		43,250
1,713	Disposals of surplus assets		37,216
7,796	Miscellaneous		2,785
			9,648
66,089			
(498)	Decrease in working balance		92,899
			478
65,591			
			93,377

		Payments	
35,941	Salaries, wages and related expenses		42,832
4,772	Pensions and gratuities to retired staff		6,285
14,574	Materials, contract services and general expenses		25,834
	Acquisition of land, buildings and plantations and construction of		
2,969	buildings		5,025
4,271	Machinery and equipment		9,044
	Grants to private woodland owners (£2,584,000), universities,		
2,157	institutions, etc.		2,682
907	Remittances of VAT to Customs and Excise		1,675
65,591			
			93,377

NOTES ON TABLE**General**

1. Expenditure incurred by the Forestry Commissioners in the exercise of their powers in the performance of their duties is financed from the Forestry Fund which was constituted under Section 8 of the Forestry Act 1919. All sums received by the Commissioners are paid into this Fund.

2. Receipts and payments are shown inclusive of VAT where applicable.

Receipts

3. The Grant-in-Aid of the Forestry Fund voted by Parliament for 1979-80 was £43,480,000 of which £43,250,000 was drawn into the Forestry Fund. The remaining balance of £230,000 will be surrendered to the Consolidated Fund. Additionally the sum of £110,076 was received from the EEC Regional Development Fund in respect of roadwork and construction carried out by the Forestry Commission and remitted directly to the Exchequer.

4. Receipts from sale of timber rose by £9,946,000 as a result of higher prices and increased demand.

5. There was an increase of £1,072,000 in receipts from the disposal of surplus assets due to increased sales and higher prices.

6. Miscellaneous receipts rose by £1,852,000 due to increased charges for campsites and forest cabins and sporting lets (£470,000), increased estate income from mineral royalties and increased rents (£1,230,000) and other income from pension contributions, salaries of seconded staff, research work, repayment of private woodland grants, etc., increased due to higher prices and greater activity (£152,000).

Payments

7. Payments of salaries, wages and related expenses rose by over 18 per cent due to increased rates of pay and allowances and the inclusion of arrears of pay from 1978-79 (£420,000).

8. Payment of pensions and gratuities to retired staff and their dependants rose by £1,513,000 due to the award of higher superannuation benefits and an increase in the number of pensioners.

9. The cost of materials, contract services and general expenses rose by £11,260,000. But last year's figure was reduced and this year's correspondingly increased by a carry-over of unpaid bills from the previous financial year due to industrial action at the Scottish Office Computer Centre (£3,000,000). The real increase of £5,260,000 over the previous year is attributable to VAT (£860,000), increases in harvesting and road programmes (£1,800,000) and price increases (£2,600,000).

10. Expenditure on acquisitions and construction of buildings rose by £2,056,000. The carry-over of unpaid bills from the previous financial year due to industrial action was £400,000 and the actual increase of £1,256,000 arose from increased prices and programme. The area of plantable land acquired increased to 7,565 hectares compared with 5,675 hectares in the previous year and the average price paid per hectare increased to £357 per hectare compared with £295 per hectare in 1978-79.

11. Expenditure on machinery and equipment rose by £4,773,000. The carry-over of unpaid bills due to industrial action was £1,300,000 and the actual increase of £2,173,000 was due to higher prices (£700,000), higher VAT rates (£573,000), an increase in the purchasing programme and accelerated deliveries against orders (£900,000).

12. Remittances of net VAT to Customs and Excise increased by £768,000 due to greater sales resulting in a higher level of output tax from the increased receipts; this more than offset the rise in recoverable input tax from higher costs and the carry-over of bills from 1978-79.

(Forestry Commission Annual Report 1979-80)

Table 2

FORESTRY COMMISSION
ACCOUNTS OF THE FORESTRY ENTERPRISE FOR THE YEAR
ENDED 31 MARCH 1980
BALANCE SHEET AS AT 31 MARCH 1980

As at 31 March 1979 £000		£000	£000
	Source of Funds		
	CAPITAL AND RESERVES		
463,534	Capital	496,432	
(3,050)	Trading and Variance Account balances	(18,024)	
129,084	Current Cost Reserve	248,411	
<u>589,568</u>			726,819
93,959	NOTIONAL SUPERANNUATION FUND ..		107,583
<u>683,527</u>			<u>834,402</u>
	Employment of Funds		
117,717	FIXED ASSETS		144,935
	NET CURRENT ASSETS		
7,539	Stocks and work in progress	9,087	
7,603	Debtors and sundry debit balances ..	10,539	
1,990	Cash at bank and in hand	1,417	
<u>17,132</u>		21,043	
9,435	Creditors and accrued expenses ..	7,168	
<u>7,697</u>			13,875
558,113	PLANTATIONS at standard cost		675,592
<u>683,527</u>			<u>834,402</u>

(Forestry Commission Annual Report 1979-80)

Table 3

FORESTRY COMMISSION			
PLANTATIONS ACCOUNT FOR THE YEAR ENDED 31 MARCH 1980			
Previous Year £000		£000	£000
	At 1 April 1979: 875,240 hectares valued at		
482,685	standard (1978-79) cost		558,113
43,442	Revaluation adjustment		83,717
526,127			641,830
	EXPENDITURE		
43	Plantations acquired	139	
3,811	Land planted	6,201	
3,071	Formation	3,791	
2,697	Protection	3,053	
1,996	Crop improvement	2,333	
485	Lease rents, supplies and miscellaneous ..	645	
2,587	Road construction	3,368	
1,413	Road maintenance	1,450	
1,826	Research and development	2,241	
6,770	Labour oncost	7,823	
8,005	Overhead expenses	8,518	
16,953	Interest	20,149	
49,659			59,711
575,786			701,541
	INCOME		
159	Disposal of plantations	365	
63	Surplus on sale of Forest Estate properties	102	
479	Sundry income	550	
701			1,017
575,085	NET EXPENDITURE		700,524
	SUBSIDIES AND TRANSFERS		
5,260	Planting and restocking subsidies	8,406	
9,533	Transfer charge to Harvesting Trading Account for thinnings and fellings removed	13,796	
14,793			22,202
560,292	NET TOTAL		678,322
	At 31 March 1980: 890,939 hectares valued at		
558,113	standard (1979-80) cost		675,592
(2,179)	Variance from standard		(2,730)
501	Variance from previous year		(1,678)
(1,678)	Variance to date		(4,408)

(Forestry Commission Annual Report 1979-80)

Forestry Enterprise

Table 4

LAND USE
AT 31 MARCH 1980

	Thousands of hectares			
	England	Wales	Scotland	Great Britain
Forest Land				
Under plantations	250.4	135.9	497.7	884.0
Retained scrub	1.7	1.7	3.5	6.9
To be planted	6.8	3.4	61.3	71.5
Total	258.9	141.0	562.5	962.4
Other Land				
Agricultural and grazing	12.5	11.0	104.2	127.7
Forest workers' holdings	0.6	0.7	4.9	6.2
Unplantable and miscellaneous (includes nursery land)	31.0	8.0	128.1	167.1
Total	44.1	19.7	237.2	301.0
Total area	303.0	160.7	799.7	1,263.4

NET AREA OF FOREST LAND ACQUIRED/DISPOSED OF DURING THE YEAR ENDED 31 MARCH 1980

	Thousands of hectares			
	England	Wales	Scotland	Great Britain
Plantations acquired	—	—	0.2	0.2
Plantations disposed of	0.3	—	0.1	0.4
Planting land acquired	0.1	0.2	7.0	7.3
Planting land disposed of	—	—	0.2	0.2
Net area of forest land acquired/disposed of	(0.2)	0.2	6.9	6.9

PLANTING IN THE YEAR ENDED 31 MARCH 1980

	Hectares		
	New Planting	Re-stocking	Total
England			
Conifer	855	2,027	2,882
Broadleaved	43	141	184
Total	898	2,168	3,066
Wales			
Conifer	770	1,224	1,994
Broadleaved	27	17	44
Total	797	1,241	2,038
Scotland			
Conifer	14,052	2,253	16,305
Broadleaved	83	7	90
Total	14,135	2,260	16,395
Great Britain			
Conifer	15,677	5,504	21,181
Broadleaved	153	165	318
Total	15,830	5,669	21,499

(Forestry Commission Annual Report 1979-80)

Table 5

AREA PLANTED ANNUALLY BY THE COMMISSION IN THE 10-YEAR PERIOD 1 APRIL 1970 TO 31 MARCH 1980

Hectares

Year ended 31 March	England			Wales			Scotland			Great Britain		
	New Planting	Re-stocking	Total	New Planting	Re-stocking	Total	New Planting	Re-stocking	Total	New Planting	Re-stocking	Total
1971 ..	3,040	2,387	5,427	2,491	857	3,348	17,427	2,324	19,751	22,958	5,568	28,526
1972 ..	2,251	1,923	4,174	1,821	598	2,419	17,686	1,956	19,642	21,758	4,477	26,235
1973 ..	1,735	1,419	3,154	1,469	771	2,240	16,174	1,590	17,764	19,378	3,780	23,158
1974 ..	1,552	1,348	2,900	1,417	762	2,179	15,433	1,211	16,644	18,402	3,321	21,723
1975 ..	1,239	1,384	2,623	1,412	649	2,061	17,010	1,461	18,471	19,661	3,494	23,155
1976 ..	1,487	1,043	2,530	1,131	476	1,607	14,651	1,723	16,374	17,269	3,242	20,511
1977 ..	1,302	1,170	2,472	1,096	793	1,889	13,148	1,194	14,342	15,546	3,157	18,703
1978 ..	1,148	1,164	2,312	769	937	1,706	12,206	968	13,174	14,123	3,069	17,192
1979 ..	686	1,424	2,110	572	884	1,456	10,584	1,259	11,843	11,842	3,567	15,409
1980 ..	898	2,168	3,066	797	1,241	2,038	14,135	2,260	16,395	15,830	5,669	21,499

(Forestry Commission Annual Report 1979-80)

Table 6

AREAS OF PLANTATIONS AND VOLUMES OF TIMBER THINNED
AND FELLED IN THE YEAR ENDED 31 MARCH 1980

Area in hectares;
Volume in thousands of cubic metres

	Felled		Thinned		Total Volume Felled and Thinned
	Area	Volume	Area	Volume	
England					
Conservancy:					
North-West ..	348	80	2,302	110	190
North-East ..	392	114	1,447	84	198
East ..	500	119	4,100	142	261
New Forest and South-East ..	127	29	2,013	73	102
South-West and Dean ..	376	102	1,968	97	199
Total ..	1,743	444	11,830	506	950
Wales					
Conservancy:					
North ..	337	84	2,904	152	236
South ..	557	141	2,117	103	244
Total ..	894	225	5,021	255	480
Scotland					
Conservancy:					
North ..	424	152	1,356	75	227
East ..	337	88	2,394	118	206
South ..	312	86	3,130	155	241
West ..	498	136	1,586	86	222
Total ..	1,571	462	8,466	434	896
Great Britain ..	4,208	1,131	25,317	1,195	2,326

SALES OF TIMBER IN THE YEAR ENDED 31 MARCH 1980

Thousand cubic metres

Description	England	Wales	Scotland	Great Britain
Trees sold standing ..	268.6	206.5	286.9	762.0
Converted*				
Round timber and saw logs ..	296.9	109.2	247.7	653.8
Telegraph and other selected poles ..	7.0	1.1	6.9	15.0
Mining timber ..	39.1	17.7	0.1	56.9
Posts and stakes ..	15.0	9.4	2.2	26.6
Pulpwood and boardmill material ..	199.8	97.8	291.7	589.3
Firewood ..	17.7	2.4	2.7	22.8
Miscellaneous ..	26.4	0.6	—	27.0
Poles sold in length (other than selected) ..	1.5	0.7	2.5	4.7
Total ..	603.4	238.9	553.8	1,396.1

*In addition the following volumes were converted and used internally for forest and estate purposes:

England ..	2.0
Wales ..	1.6
Scotland ..	4.3
Great Britain ..	7.9

(Forestry Commission Annual Report 1979-80)

FORESTRY COMMISSION FOREST AREA, PRODUCTION AND
STAFF NUMBERS FROM 1950 to 1980

Table 7

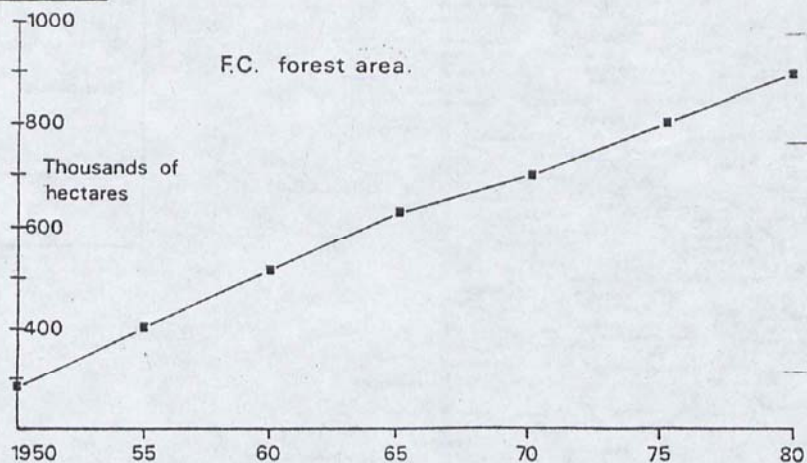


Table 8

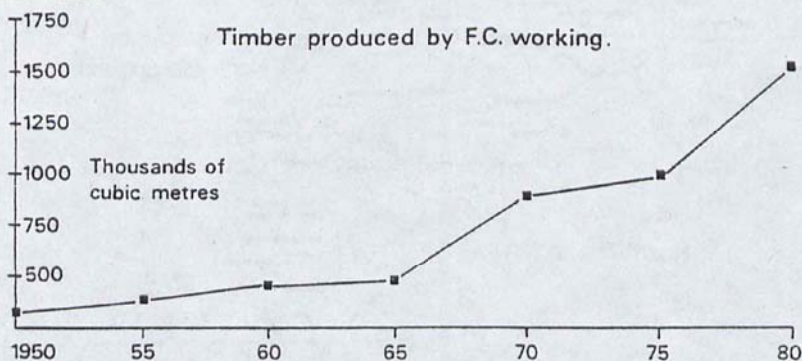
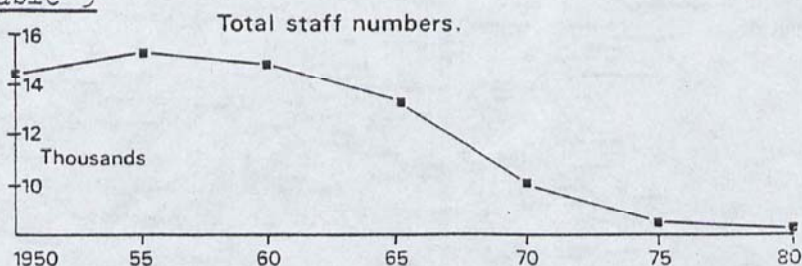
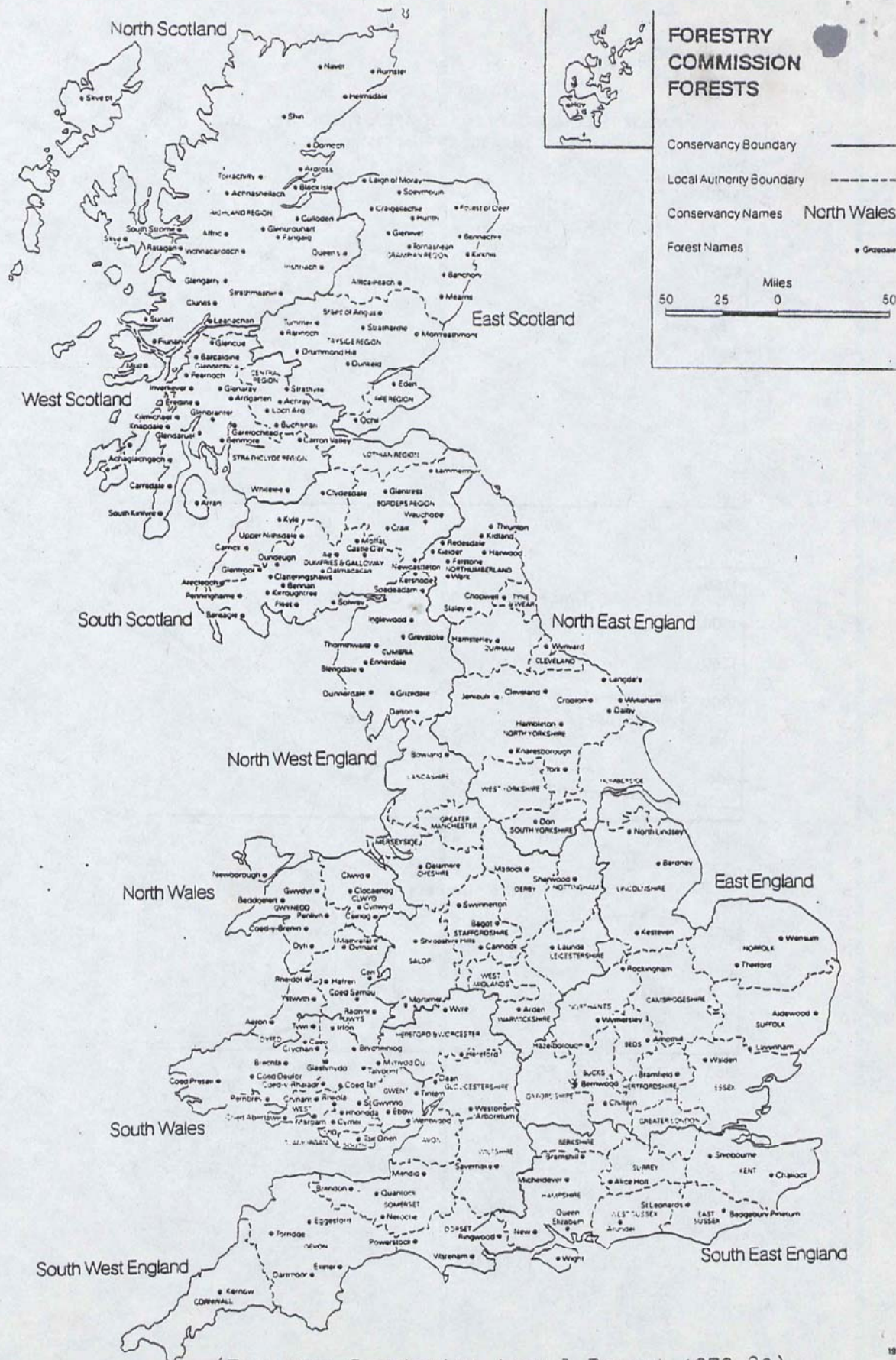


Table 9



(Forestry Commission Annual Report 1979-80)

Table 8



cc Defence Budget. CONFIDENTIAL



PRIME MINISTER

BAe FLOTATION

1 I have seen John Nott's minute to you of 16 January on the BAe flotation and on the defence estimates. I think it important, when we discuss this subject this afternoon, that the interactions between the two are fully understood. In essentials I believe that the draft statement which he proposes to make would solve most of the problems which we were concerned might frustrate a flotation. There are, however, three points on which I think that the statement would need to be more precise, so that a member of the public considering an investment in BAe shares would, by reading the statement and the prospectus, have a proper understanding of our intentions in the defence field as they apply to BAe.

2 The first is the question of disclosing the decision taken by Cabinet to reduce the defence budget by £200 million in each of the two later survey years. John proposes to deal with this by a statement that "The 3 per cent growth in resources will continue from the revised 1981/82 baseline". I am afraid that this is not quite explicit enough for flotation purposes. I think it would need to be expanded a little, so as to read "The 3 percent growth in defence expenditure in real terms will now be based on the reduced [or revised] 1981/82 baseline".

/3 ...

CONFIDENTIAL



3 The second is his reference to Sea Eagle. His proposed statement says simply that "contrary to some reports, development work on the Sea Eagle anti-ship missile will continue". The fuller statement of the position in his minute particularly addressed to the flotation makes clear that he has not at present gone beyond a strictly temporary reprieve. This question is so material to the flotation that it is necessary that our public statements should give a complete understanding of the position. I revert to this below.

4 The third point is that the references in the statement to the need to "look realistically at our programmes over the next year or two" give me a less severe impression than his minute which talks of a need for "a fundamental look at defence commitments, roles and capabilities". As I set out in the first paragraph we must ensure that the potential investor has a proper understanding of what we intend. This statement so soon before the flotation will be the basis on which investors will be forming their views of the market prospects for defence contractors in general and BAe in particular. I would expect the prospectus to refer to it specifically. In the light of the minute I confess to doubt whether the present draft of the statement meets that test. In the last resort it is John Nott who will have to satisfy himself that his statement does meet this onerous criterion, and can be regarded as definitive. We also need to be

/clear ...



clear whether the statement supersedes any of the assurances given last week by his Permanent Secretary; if it does we would need a satisfactory restatement of the position.

5 I have referred above to the need for complete candour in the Sea Eagle position. Of the decisions which John has reached this is the only one which causes difficulty for the flotation. Because of the importance of this project as a means of developing BAe's air-launched missile technology so as to keep it competitive for further major programmes, our merchant bank advisers feel that a great degree of assurance is essential. If it were at all possible much the best course, both for the flotation and for BAe, would be to reach a firm decision now that this project could be regarded as a firm part of the programme on the basis of the proposals which BAe have made to limit and defer the costs falling on the defence budget. I do hope that John Nott could on reflection reach this view (in which case the statement could be strengthened). If, however, he cannot, and I do understand his wish to preserve options, it would be a necessary condition for flotation for the Ministry of Defence to be able to say that the present intention was that the programme should be maintained throughout 1981/2, and that their expectation was that in the event of a decision to cancel it they would take alternative steps to secure the necessary technological capability in BAe. If that were the underlying position the draft statement would need to be expanded by including the phrase "... although further decisions will be needed to confirm its place in the programme ...".



6 I have set out in full detail what is needed to enable flotation to proceed. As Norman Tebbit indicated in his minute of 7 January preparations are now far advanced for an offer on 4 February; four underwriters and three brokers are involved, and there is widespread knowledge and public comment on our plans. Kleinworts have confirmed that the defence decisions of which they were aware until Friday could be accommodated subject to the point on Sea Eagle which I have already explained, within the market capitalisation earlier foreseen (£275-300 million), not necessarily at the bottom end, and that no more than £100 million of new money will need to be raised. Thus the net proceeds seem likely to be above the bottom of the range we have contemplated. If we do not go through with it, it will be very widely known that we have pulled back at the last moment. Much worse, however, is that I must warn that in reality I see virtually no chance of a further opportunity to privatise BAe, in the life of this Parliament. The next theoretical opportunity would arise in May or June; but Kleinworts and BAe have both made clear that they do not consider the prospects nearly as good as they are now - and, in any case, there is every probability that we should be in the midst of the defence review of which John Nott has told you. I want us all to be clear therefore that to pass up our present opportunity is no mere temporary hitch, but may well be the end of a major plank of our programme, and of a Manifesto commitment.

/7 ...



7 There is a further aspect to consider. If we do not go ahead with the issue, it is inevitable that many will surmise that this is because of defence uncertainties. This will enter the public domain, and might well cast doubt upon the credibility of any statement of the sort John Nott has in mind. There are therefore defence purposes, as well as our economic and political aims, to be served by proceeding with the flotation.

8 I am copying this to John Nott, the recipients of his minute of 16 January, the Attorney General with the previous papers (because of the legal responsibilities of disclosure required of the promoter of an issue), and to Sir Robert Armstrong.

Catherine Bell

PP KEITH JOSEPH
(approved by the Secretary
of State and signed in his
absence)

January 1981

Department of Industry
Ashdown House
123 Victoria Street

719/1

CONFIDENTIAL

Defence Budget.

3 PPs



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

PRIME MINISTER

BAE FLOTATION

I have seen Norman Tebbit's minute of 7 January to you.

2. On the three specific issues he raises:-

(a) Nigel Lawson has set out the Treasury view on the 146 review (his letter of 8 January);

(b) John Nott will wish to comment on the requirement for further Defence Budget announcements, but I should record that there is no Treasury objection to his pre-empting the Public Expenditure White Paper to the extent of revealing the agreed £200 million reductions for 1982-83 and 1983-84; the similar reduction for 1981-82 and the decision that any overspend on the 1980-81 cash limit would require a compensating deduction from the 1981-82 limit have of course already been announced;

(c) on the crucial question of the advisability of a sale in February given the level of expected receipts, my views were set out in my Private Secretary's letter of 15 December. There are financial (eg PSBR) arguments for selling as soon as possible, though I am still not satisfied that we would not do better first to bring about the cancellation of the 146. But the question is primarily political.

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3. If of course there were no real prospect of our agreeing on, and imposing, the cancellation of the 146, I would be much less uneasy about Norman Tebbit's recommendation for a February sale. Since on that scenario delay would only further reduce the likely net proceeds, there would be much to be said for going full ahead now despite the likely controversy.

4. Copies of this minute go to the other recipients of Norman Tebbit.

G. H.

(G.H.)

19 January 1981

CONFIDENTIAL

Defence Budget.

CONFIDENTIAL

Anti-Trust

2

MO 26/8/1

*in the letter
to the Secretary
the Secretary
the Secretary*



PRIME MINISTER

BAe FLOTATION

You can discuss this at the meeting with Mr. Mott on Monday, which the Chancellor and Sir Keith are also attending. The two outstanding issues seem to be x and y below. I am glad that the Chancellor is now prepared to go along with flotation.

Play A

I have now had a chance to study the issues which arise from Norman Tebbit's minute to you of 7th January.

x || 2. The first question is whether we can make public in time the £200M reductions in previously planned defence expenditure for 82/83 and 83/84 which are not at present due to be disclosed until the publication of the Public Expenditure White Paper in early March. As you know I shall be discussing with you on Monday an early general statement about next year's defence programme. This might be drafted in terms which meet this point.

*12
16/1*

3. More difficult are the problems related to the defence workload for British Aerospace. We are able, of course, to point to our clear indication to resume 3% real growth in defence spending after next year; and we can point to a clear and distinct share of the defence budget which British Aerospace have secured in the past. But I cannot be specific now about exactly how much money they will get from us over the next few years nor about which projects they will have - nor, of course, could I for any other firm.

y || 4. I recognise the great political importance of flotation for our objectives as a Government, and its importance for a thriving aerospace sector. I am concerned, however, that the conditions for a flotation now could create difficulties for me in conducting the sort of fundamental look at defence commitments, roles, and capabilities which even a few days in office has convinced me is necessary.



5. I have been able to reprieve for the present the Sea Eagle project - a key programme I am advised for proceeding with flotation - and research and development on this will continue for the time being. I am going to negotiate with British Aerospace on the basis of a plan we have developed with them for containing future levels of expenditure in any one year, and their initiating now a review of the structure of the Dynamics Group (involving the closure of a major site) to be effected in about 5 years time. Even so, I cannot exclude the possibility that, when I come to my review of the forward programme, cancellations and adjustments affecting British Aerospace, not, excluding Sea Eagle, may be necessary. If flotation proceeds, therefore, it must be on the understanding that my freedom to act is not constrained. Whether flotation can legitimately proceed on that understanding must be open to some doubt.

6. I do not know whether flotation in May would be any easier than flotation now. But given what I have said above, which must be disclosed to Kleinworts and British Aerospace, the prospectus will need to be drawn up in terms consistent with the wider objectives I have described.

7. I am copying this minute to the other members of E and to Sir Robert Armstrong.

50

16th January 1981
Ministry of Defence

CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG

Norman Tebbit Esq
Minister of State
Department of Industry
Ashdown House
123 Victoria Street
LONDON
SW1

8 January 1981

Dear Minister,

THE BAE 146 PROJECT

I should be most grateful if you could take a look at the correspondence on the 146 project which concludes with John Biffen's letter of 18 December to Keith Joseph, and Adam Butler's reply of 2 January.

Briefly, the position is as follows. The existence of the project substantially depresses the market value of BAe Ltd: in Kleinwort Benson's view the effect amounts to rather more than £150 million. The expected net receipts to Government from a sale of 50% of the shares are thereby reduced (both directly, and because the existence of the project is a major factor in determining the scale of the capital injection which the Government would have to make before a flotation) to a level which is likely to cause controversy. The Chancellor has accordingly argued - his Private Secretary's letter of 15 December - that E Committee should consider the possibility of cancelling the 146, and the Prime Minister agreed - her Private Office's letter of 16 December - that there was a need for early reconsideration of the project in E. Clearly such a review could only take place on the basis of a paper from the sponsoring Department, but John Biffen's letter of 18 December set out the issues which ought in the Treasury's view to be covered in any such paper.

Adam Butler's reply was however silent on many of the issues which John Biffen raised, and in particular contained no assessment of the viability of the 146 project. That was because he argued - and I agree - that cancellation would entail a postponement of the flotation; maintained that the aim of a flotation in February should have an overriding priority; and did not regard it feasible to conduct a full review of the 146 before final decisions for or against February would have to be taken.

I confess that I find this a little unsatisfactory. Without the review which Geoffrey Howe sought, a key factor relevant to the decision whether to sell in February will remain uncertain when that decision has to be taken. But since I understand that that will be in the next few days, the questions which John Biffen asked will I suppose now have to remain unanswered at that stage. However, if for any reason the Government were to conclude that it would be either impossible or unwise to sell the shares in February, I hope that you would then agree that your officials should start work forthwith on the paper for E which was envisaged last month.

Copies of this letter go to member of E, and to John Nott and Sir Robert Armstrong.

Yours sincerely,
Stephen Lohé (Private
Secretary)

pp NIGEL LAWSON

(approved by the Financial
Secretary, and signed in
his absence)

*cc Mr Ingham**2**PRIME MINISTER**From the Secretary of State**To see**MS 9/1*

Mike Pattison Esq
Private Secretary
10 Downing Street
London, SW1

*MS**8* January 1981

Dear Mike,

BRITISH AIRWAYS: EXTERNAL FINANCING LIMIT 1980/81

My Secretary of State, in his previous incarnation as Chief Secretary, agreed that British Airways should be allowed to overrun their external financing limit by £85m in this financial year. He proposed then that this decision should be announced by means of an inspired Parliamentary Question.

My Secretary of State intends that this Question should be tabled for answer on Monday 12 January prior to the mass meeting called by the BA unions next Tuesday to complain about the offer made to them on pay. I attach for your information a copy of the proposed Question and Answer, the text of which has already been cleared with Treasury officials.

I am copying this letter and attachment to the Private Secretaries of the Leader of the House, the Chief Secretary, the Chief Whip and Sir Robert Armstrong.

Yours ever,

Nicholas McInnes

N McInnes
Private Secretary

DRAFT

TO ASK THE SECRETARY OF STATE FOR TRADE IF HE WILL
MAKE A STATEMENT ON BRITISH AIRWAYS' EXTERNAL
FINANCING LIMIT FOR 1980/81

British Airways' external financing limit for 1980/81 was originally set at £230m but subsequently reduced to £219m to reflect payment during the year of a lower dividend on public dividend capital than had originally been assumed.

The volume of worldwide airline traffic in 1980/81 has been adversely affected by the general economic recession and even the modest element of market growth forecast by most operators has failed to materialise. For British Airways this factor, combined with the pressures of international competition and the strength of sterling, will result in a revenue shortfall for the whole year estimated at some £400m below the figure for which the airline originally budgeted. The Board has therefore taken steps to reduce capital expenditure and operating costs and to raise additional funds by disposing of assets including aircraft. However, in total these measures are still insufficient to meet the whole of this year's revenue shortfall. With the consent of the Treasury I have therefore agreed that British Airways' external financing limit for 1980/81 may be increased by £85m from £219m to £304m.



From the
Minister of State
PS/Mr Tebbit

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 7691
SWITCHBOARD 01-212 7676

Tim Lankester Esq
Private Secretary to
the Prime Minister
10 Downing Street
London SW1

8 January 1981

BAe FLOTATION

I regret that in my Minister's minute on BAe Flotation circulated last night, there was a typing error which resulted in the repetition of a considerable phrase in the third paragraph. While the meaning is, I think, not impaired, I am circulating, for the record, a re-typed version of the first page of that minute. *Amended*

Copies go to the private secretaries of all the recipients of my Minister's minute of 7 January.

Yours sincerely

Peter Mason

PETER MASON
Private Secretary



PRIME MINISTER

BAe FLOTATION

I am concerned about the extremely tight time schedule that must be met if we are not to lose the opportunity to float British Aerospace in February, especially in view of Kleinworts' advice that this would be the best and possibly the only opportunity open to us.

In Keith Joseph's absence abroad I am therefore writing in order to ensure that provided we can clear the difficulties caused by the defence review (which I am hopeful can be resolved in time) no other obstacles will remain in our way.

In Keith Joseph's minute to you of 12 December he reported the decisions of E(DL) that uncertainties about future defence programmes seemed likely to preclude flotation of British Aerospace in February, but that we should continue nevertheless to aim for flotation as soon as possible. With your agreement vesting of the business in a company, British Aerospace PLC, took place on 1 January. Simultaneously work has taken place to try to resolve the defence problems. While a solution has not yet been achieved encouraging progress has been made. There appears to be a fair prospect that such assurances as the Ministry of Defence are able to contemplate giving about their future purchases from Bae may be adequate to enable Kleinworts to proceed with a prospectus. In order to keep the February date open we are proceeding with preparations which will become increasingly public day by day. While, therefore, nothing will be wholly irrevocable until the first days of February the damage caused by a decision not to float in February is also increasing day by day, and it would be much better to call off now if we do not expect to achieve the February date.

My own very strong advice is that we should take our chances while they are available. That is in line with the conclusion of E(DL) that flotation should proceed if at all possible. Thus I recommend that we should confirm that we wish to go ahead in February, subject only to:-

a resolution of the defence problems on a basis satisfactory to the Secretary of State for Defence, Kleinworts and our legal advisers;

and b confirmation by Kleinworts that the proceeds will not be less than those recorded in Keith Joseph's minute of 12 December.



To reach that decision we would need to accept the points set out in the following paragraphs.

BAe 146: The Chancellor of the Exchequer considered that E Committee should review the possibility of cancellation of this project now. Adam Butler's letter of 2 January 1981 explained that this would not be compatible with flotation in February. If February in the end proves impossible we may need to revert to this question, but I suggest that we should not prejudice the February date on this account.

Announcement of Defence Budget Decisions

Although Cabinet has decided to reduce defence expenditure in each of the three survey years, the only public announcement of this has been in respect of 1981-82 and, in the normal course of events, there would be no announcement in respect of 1982-83 and 1983-84 until the Budget. I have firm legal advice, in line with that confirmed by the Attorney on our general duty as a promoter to disclose facts relevant to the issue, that we should be failing to discharge our responsibilities if we were not to disclose our overall defence decisions, since these are a relevant consideration affecting prospective investors' attitude towards a defence contractor. It is therefore necessary, if we are to bring off the flotation in which we have invested so much, for us to make an announcement, in the next fortnight, of the overall position on defence expenditure by indicating that the decision taken and announced for 1981-82 will be carried through to 1982-83 and 1983-84.

Proceeds: The conclusion of E(DL) that flotation should proceed if at all possible was reached after full consideration of the likely proceeds and the likelihood of criticism on that count. The Chancellor of the Exchequer subsequently warned again that sharp criticism was likely. There is, however, little prospect that deferral of flotation to later in this Parliament would increase the net proceeds. To be deterred by the prospective price, therefore, would be to abandon the objective of flotation in this Parliament. I therefore consider that E(DL)'s conclusion was correct.

I should be glad to know by the end of this week whether you and other colleagues agree to our proceeding on the basis I have described.

I am sending copies of this minute to the members of E and E(DL), to the Secretary of State for Defence and the Attorney General, and to Sir Robert Armstrong.

NT

7 January 1980

CONFIDENTIAL



From the
Minister of State

Scan
DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212-6401
SWITCHBOARD 01-212 7676

The Hon. Adam Butler MP

The Rt Hon John Biffen MP
Chief Secretary
HM Treasury
Parliament Street
SW1

2/1
2 January 1981

Dear Chief Secretary

THE BAe 146 PROJECT

In Keith Joseph's absence, I am replying to your letter of 18 December.

Before I deal with the substance of your proposal, I should like to put in perspective your comments about the previous consideration of the project by this administration. The consideration by MISC 11 was indeed brief; no papers were circulated and no review carried out. In the light of further consideration during which Keith explained that for the Government to impose a cancellation of the project would be incompatible with our policy of flotation, based as it was and is, on the view that decisions on the policies to be followed by BAe are best taken by its own Board against the discipline of raising finance from external sources, you accepted that cancellation of the 146 should not be pursued. Those arguments seem to me to be increasingly strong as we get nearer to the moment of flotation.

The Board of BAe have regularly reviewed the project and have consistently agreed that it should go ahead, and they have taken this view in the expectation that BAe was to become a private sector company relying on commercial sources for its funds. The Board have always believed that the 146 project is of strategic importance to their business, because it maintains BAe's ability to lead the design and development of a civil aircraft project, and thus, arguably increases its worth.

The Board have, naturally, taken fully into account the latest financial appraisal to which you refer, and which suggests that on certain assumptions the return on the project could be

/negative.....



negative. However, it suggests that there is almost an equally good chance of the project producing a positive return on future investment, and this, combined with the strategic considerations and the cost of cancellation, has confirmed the Board in the view that the project should proceed. The Chairman has assured me that regular reviews will continue, and if the arguments for cancellation were to become dominant he would respond to them as a matter of commercial judgement.

However, and as my second point, I do not think that your letter gives full weight to the effect cancellation would of itself have on the prospects for flotation.

Starting with the industrial consequences: direct employment on the 146 is now something under 2000, but is scheduled to rise to over 6000 in 1983, around 9% of the company's total UK workforce. It is likely that the Hatfield and Scottish facilities would close. That needs to be seen alongside the Board's view of the importance of the 146 to their standing as a civil aircraft manufacturer. It also needs to be seen alongside other prospective redundancies which could arise from the reductions in the Ministry of Defence's forward programme. Inevitably, a major reorganisation and closure decision would be liable to prejudice industrial relations, the more so if it were the result of decisions imposed on the company by Government. This, I think, makes clear that industrial considerations alone would mean a fairly lengthy postponement of flotation, assessed at two to three years by the Chairman.

A further important factor in assessing how long a cancellation of the 146 would postpone flotation would be the attitude of the Board. If cancellation was imposed by Government against the view of the Board, the consequences would, I am sure, be fatal to the chances of flotation in this parliament. First there would probably be resignations. The Chairman thinks that Sir Freddie Page, Chairman of the Aircraft Group, at least would go. More important, however, it would clearly be a massive vote of no-confidence/in the commercial judgement of the Board and its staff. I do not see how the Government could justify a policy of sale of the company, leaving it to the stewardship of a Board whose judgement on a major project the Government had repudiated. Thus even if there were not resignations, I would find it difficult to envisage flotation until there had been Board changes, and a new team could be presented in a prospectus as being suitably experienced. Clearly, if the Board took the decision voluntarily this would ease matters, but this could not realistically occur in under a year.

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/by the
Govt



I have so far assumed that cancellation of the 146 project is something which the Government could itself bring about. It is not, however, easy to see how this could automatically be achieved, since the continuation of the project is not something which requires Government approval. Government could cut back on the company's external financing limits; but the Board might choose, for a period at least, to try to continue the 146 by cutting expenditure on other projects with Airbus a possible candidate. You will be aware that HMG has undertaken to stand behind BAE in the discharge of its financial obligations to Airbus Industrie, and there would be some risk of the Board seeking to exploit that if we tried to coerce them by purely financial pressure. I do not want to exaggerate the point; but to reemphasise that privatisation depends in practice on the active support of the Board.

Finally, I should like to turn to the financial consequences of cancellation on the idealised assumption that it could be brought about immediately without causing other additional costs beyond those of the cancellation itself. Our present view is that BAE will require some £345 million from external sources in the years 1981-4. We do not have detailed figures for the 146, since we do not, of course, monitor the project as such. However, at an estimate, some £285 million of this requirement may be due to the 146. Cancellation costs at end-1980 are estimated at about £85 million (though this might be reduced by sale of assets etc), leaving a potential apparent net saving of £200 million, and a residual external requirement of around £145 million. This would, of course, be a charge against the PSBR compared with the small immediate credit and longer term benefits which would result from flotation in February. This calculation, however, is based on the unreal assumption that if the 146 were cancelled, no new project would emerge to take its place. The reality, I am sure, is that if the 146 were cancelled, BAE would be hungry for a new project. A large scale involvement in a new European single-aisle aircraft would, I suspect, be the most likely candidate. The launch costs of this would, of course, affect the apparent savings from cancellation of the 146, would increase the prospective charge to the PSBR and the prospect of this further investment to be financed would probably also require some capital injection to strengthen the financial base of the company. The financial implications of trying to cancel the 146 do not therefore seem to me to be all one way.

I have tried in this letter to assess the consequences of cancellation of the 146 for the prospects of flotation. In assessing the impact of delay, I feel sure that we should not be more optimistic than Kleinwort Benson, who advise that flotation will not be feasible within 18 months of the likely date of a general election, say, in autumn 1983. On that basis, if we

/cannot.....

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cannot float by spring 1982, we shall not do so this parliament. Thus any delay of much more than 15 months is likely to be fatal; and there seems to be no scenario which can accomodate the cancellation of the 146 in that time-scale.

In your letter you raised a number of detailed questions about the 146 project, which I am conscious that I have not attempted to answer in this letter. I have deliberately concentrated on the impact on flotation of action to bring the 146 project to an end. My first objective is to ensure that the possibility of flotation in February does not go by default through embarking on a detailed review. As you know, Kleinworts have strongly advised that that date gives us our best chance of success. I am, therefore, devoting every effort to seeing whether it is possible to get round the problems faced by events on the defence side. I do not regard it as feasible to conduct a full review of the 146 within the very short period before we have to take decisions for or against February. As I have said, we do not monitor the project, since it does not receive launch aid. Much information would, therefore, have to come from BAe. If we cannot float in February, I certainly recognise that you may wish to pursue further your more detailed points. For the purposes of reaching decisions about February, however, I hope that this letter will provide adequate background for any discussions which you consider necessary. On the defence front, we are working with the Ministry of Defence to resolve in the course of next week whether we can meet the essential requirements for a February flotation. If, therefore, you consider that a discussion of the 146 project is necessary it should be held in the course of that week.

I am sending copies of this letter to the members of E Committee, to Francis Pym, Nigel Lawson and Sir Robert Armstrong.

Your sincerely
Adam Butler

ADAM BUTLER (approved by the Minister
and signed in his absence)





Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Sir Keith Joseph Bt MP
Secretary of State
Department of Industry
Ashdown House
123 Victoria Street
London SW1

18 December 1980

Dear Keith,

R
19/12

THE BAe 146 PROJECT

You will have seen that the Prime Minister has agreed that there should be an early reconsideration in E Committee of the future of the BAe 146 project, as Nigel Lawson and I suggested in E(DL) on 11 December.

The project, first launched in 1973 but put on ice between 1974 and 1978, has so far under this administration been the subject of collective Ministerial discussion only rather briefly in July 1979, when its cancellation was agreed in MISC 11 on 16 July during the Public Expenditure Survey discussions. It was then left to you to determine how to implement the decision: you thought that it might not be necessary for the Government to take any initiative, since BAe might themselves be about to cancel. When Cabinet on 23 July endorsed the MISC 11 decisions, you entered a caveat that you might want to find the annual savings of £40 million attributed to the project's cancellation by cuts elsewhere on DOI Votes, but you subsequently explained to me that neither route seemed feasible, and that you thought that to force cancellation on BAe would involve a row with them which would in your judgement prejudice the disposal operation. You may think that this argument still applies; but I am sure you would agree that it needs testing against the advice from Kleinwort Bensons that the market value of BAe would be rather more than £150 million more without the 146 than with it. Kleinworts' advice will clearly have to be covered in such a review: this letter suggests other relevant issues.

Project Appraisal

My understanding is that BAe believe that, ignoring all expenditure up to the end of 1979 (some £50 million), the project, discounted at 2% in real terms, has a substantial negative net present value,

on their assumptions as to sales (450 copies) and the \$/£ exchange rate (declining from an average of \$2.30 this year). I gather that, also excluding all 1980 expenditure (some £80 million more), but on the same assumptions, and using the same discount rate, they see the NPV as positive. I think we need to know whether you agree with them, what view you take of their assumptions, whether I am right to assume that use of a 5% discount rate - or a higher rate appropriate to a risk project - would again produce a negative NPV even on their calculations, and what conclusions you draw about the project. While I recognise that the 146 is designed for use by small airlines who are unlikely to place substantial firm orders far in advance, and that significant sales are therefore unlikely before first flight (next May), how confident are you of sales of at least 450 copies, given that firm orders for only 5 have so far been secured?

Substitution

E Committee will wish to consider the employment aspect of the question. Could capacity now earmarked for the 146 be used for work offering a greater prospect of positive returns, eg increasing the rate of 748 production, or developing an improved 125? Or could BAe expect more work on Airbus, or more profitable subcontracting work?

Public Expenditure and PSBR Aspects

If BAe is not floated, continuing with the 146 presumably now means additional public expenditure of some £250 million over the next three years. Once and for all cancellation costs could amount to a maximum of some £80/90 million, most of which would presumably be additional public expenditure, but the figure might be substantially reduced if surplus capacity could be used profitably on other projects. If BAe is floated, the principal benefit from cancellation would be the very much higher net receipts to Government from the disposal operation. It would be helpful if you could provide some analysis.

Attitude of the BAe Board

If my understanding of their own investment appraisal is correct, it is not clear to me why BAe have not themselves cancelled the 146. If cancellation were to follow rather than precede a flotation, HMG would be open to criticism for having sold the shares at a time when the project's existence reduced the company's market value: those who had bought shares might appear to benefit at the taxpayer's expense. (Which could of course have wider repercussions on the disposals programme). I think we therefore need your assessment of why the BAe Board have so far resisted cancellation, and what it would take to overcome their resistance, under pressure either from us, pre-flotation, or harsh economic facts, post-flotation.

Other aspects of the question will no doubt occur to you, and I know that your officials have been monitoring the project closely.

CONFIDENTIAL

But it would I think assist E Committee if you could provide a paper covering at least the issues mentioned above.

Copies of this letter go to our colleagues in E, to Francis Pym and Nigel Lawson, and to Sir Robert Armstrong.

7-1
John Biffen

JOHN BIFFEN

CONFIDENTIAL



From the
Minister of State

The Hon Adam Butler MP

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 6401
SWITCHBOARD 01-212 7676

cc Mr Ingham

16 December 1980

Nigel Lawson Esq MP
Financial Secretary to the Treasury
H M Treasury
Parliament Street
London
SW1

Pin Mitchell

*You have already
approved this in
principle. Here is the
draft written answer.*

Dear Nigel,

ms

12/12

BRITISH AEROSPACE - VESTING ANNOUNCEMENT

... I attach a draft of the announcement I propose to make on Wednesday 17 December by means of a written answer.

The draft has been discussed with your officials, and in the light of their comments there are two points I should draw particularly to your attention. First, I have included in square brackets in the third paragraph a passage on the extent to which the Government will stand behind British Aerospace PLC while it remains wholly Government-owned. I would much prefer to include these words, because I think it is important that people who deal with BAe should be in no doubt about the position; but that they should also be fully aware of the way the Government's guarantee to the company during this period is limited, since it does not extend beyond the beginning of the offer for sale. I understand that officials at the Treasury were opposed to the idea of volunteering a statement that the Government stood behind the company, even though the principal purpose of the statement was to make clear the limited nature of the backing. I hope the present draft will be more acceptable, but if you feel strongly about it I would be prepared, reluctantly, to leave it out provided it was understood that the memorandum of understanding, which contains a full statement of the position, could be made available by BAe to anyone who sought clarification.

Second, the last paragraph deals with the special arrangements to be made for employees at the time of the offer for sale. It is intended to circulate an explanatory booklet about the scheme to BAe employees before mid-January, in order to give them a few weeks to consider it ahead of flotation; and Parliament ought to be told

/ ... about the



about the free offer of £50 of shares before then. Distribution of this booklet would only be halted if a February flotation had by then been called off: in fact, I consider it unlikely that matters will have clarified to that extent by then. Accordingly we may have to go ahead with the publicity for the employee share scheme, and I therefore think it best to tie in the Parliamentary announcement with the statement about vesting.

I am afraid that I must ask for comments by 10.00 am on Wednesday 17 December. I am sending copies of this letter to the Prime Minister, to the Chancellor of the Duchy of Lancaster, the Chief Whip, to the other members of E(DL), and to Sir Robert Armstrong.

Yours in
Adam.

ADAM BUTLER

D R A F T

- Q TO ASK THE SECRETARY OF STATE FOR INDUSTRY IF HE HAS DECIDED WHEN THE BUSINESS OF BRITISH AEROSPACE WILL VEST IN THE SUCCESSOR COMPANY UNDER THE BRITISH AEROSPACE ACT 1980; AND IF HE WILL MAKE A STATEMENT
- A After consulting British Aerospace I have made an order under section 1(2) of the British Aerospace Act 1980 nominating British Aerospace Limited as the successor company for the purposes of section 1 of that Act; and after consulting British Aerospace and the Treasury I have made an order under section 14(1) of the British Aerospace Act which provides that 1 January 1981 is to be the appointed day for the purposes of that Act. On 1 January 1981 therefore all the property, rights, liabilities and obligations of British Aerospace will vest in British Aerospace Limited in accordance with the British Aerospace Act. Immediately thereafter the Company will apply to be re-registered as a public company under the Companies Act 1980 and its name will be changed to British Aerospace Public Limited Company.

The Government intends to offer for sale at the earliest appropriate opportunity about half the shares in the Company.

All the existing members of British Aerospace have been appointed as directors of British Aerospace Limited. Immediately before the offer for sale I intend to appoint two of the present non-executive directors, Mr K M Bevins and Mr K Durham, as Government directors of the company. While the Company remains wholly owned by Government the Secretary of State will continue to exercise the same measure of control over investment and borrowing as has been applicable to the Corporation. A memorandum

of understanding which provides the basis on which such controls will be operated will be agreed between British Aerospace Ltd and its directors and the Secretary of State before vesting and will be laid before the House. [The Government will stand behind the Company only while the Company remains wholly owned by Government. It will have no commitment to meet obligations of the Company after the beginning of the offer for sale, except as provided by section 9 of the British Aerospace Act 1980.]

I have made the following arrangements concerning the future capital and reserves of the Company. I have With the consent of the Treasury given a direction under section 3 of the British Aerospace Act that the Company shall, as a consequence of the vesting, issue shares to the Secretary of State to bring its total issued share capital to £40 million in nominal value. Further shares will be issued before or at the time of the offer for sale. Under section 15 of the Aircraft and Shipbuilding Industries Act 1977 I have, with the approval of the Treasury, determined the amount of the Corporation's commencing capital as £158.75m, which is equal to the amount of the compensation paid to the former owners of the companies which vested in British Aerospace under the 1977 Act. Under section 2 of the British Aerospace Act the Corporation's liability in respect of its commencing capital, and in respect of its public dividend capital of £110m, will be extinguished immediately before the appointed day. I have with the approval of the Treasury, determined that £ . m of commencing capital should be treated as public dividend capital, on which no dividend is payable in respect of past years. Interest will be payable on the debt element of the commencing capital from . 197. ^{at} . per cent per annum, resulting in a total payment for the period to 31 December 1980 of £10m. To have sought greater remuneration of commencing capital would have weakened the Company, ^{financially} and I am satisfied that the course I have adopted will produce the best financial outcome overall for both the Government and British Aerospace Ltd.

When shares are offered for sale the following special arrangements will be made for employees to acquire shares. All eligible employees, including all United Kingdom employees with one year's service, will be offered, free of cost and at the Government's expense, shares of approximately £50 in value at the offer price, provided they agree to vest them in Trustees for at least two years. In addition there will be a matching offer of a limited number of shares under which all eligible employees who purchase shares and vest them in Trustees will receive an equal number of shares free. All the free shares will attract the tax benefits laid down by the Finance Act 1978, as amended by the Finance Act 1980, if they remain vested in the Trustees for longer than four years. Details will be circulated to employees. These special arrangements will be in addition to the usual preferential consideration that will be given to applications received from all employees to purchase shares at the offer price.

CONFIDENTIAL



10 DOWNING STREET

From the Private Secretary

CC HO MOD HS
FCO D/TRANS
HMT FSO
LPO CWO
D/EMP
MAFF
D/T bcc Ingham
D/N
CSO
CO

Scan Pol.

16 December 1980

British Aerospace

The Prime Minister has now considered your Secretary of State's minute of 12 December, and also Peter Jenkin's letter of 15 December setting out the Chancellor of the Exchequer's views. She is content with your Secretary of State's proposals subject to the Chancellor's riders - in particular the need for an early reconsideration by E of the HS 146 project and the need for new funding arrangements if flotation has to be delayed by more than about six months after vesting.

I am sending copies of this letter to the Private Secretaries to the members of E, Brian Norbury (Ministry of Defence), Tony Mayer (Department of Transport), Stephen Locke (Financial Secretary's Office, H.M. Treasury), David Wright (Cabinet Office) and to Murdo Maclean (Chief Whip's Office) since you are planning to make a statement by Written Answer later this week on this matter.

TIM LANKESTER

Richard Riley, Esq.,
Department of Industry.

CONFIDENTIAL

KG

CONFIDENTIAL
confidential



Treasury Chambers, Parliament Street, SW1P 3AG

16 December 1980

The Rt Hon Sir Keith Joseph MP
Secretary of State for Industry
Department of Industry
123 Victoria Street
LONDON
SW1

R.

Dear Secretary of State,

16/12

BRITISH AEROSPACE - VESTING ANNOUNCEMENT

Thank you for your letter of 16 December enclosing a draft of the announcement you wish to make tomorrow.

I understand that Treasury and DOI officials have agreed some further minor amendments to the text. Of the points mentioned in your letter, on the first I am content with the present formulation of the passage on the limited extent to which the Government stands behind the Company. I note that you now propose to lay the Memorandum of Understanding before the House: I am sure that is right. On the second point the Treasury concern is that the final paragraph of the statement might cause some to conclude that flotation is imminent. As the E(DL) discussion showed, this is doubtful. But it is for you to judge whether inclusion of the paragraph could subsequently cause you any embarrassment, and I am content to accept your judgement.

I am copying this letter to the Prime Minister, to other Members of E(DL), and to Sir Robert Armstrong.

Yours sincerely,
Stephen Loshie
(Private Secretary)

pp NIGEL LAWSON

(approved by the Financial Secretary and signed in his absence)

Mr Dwyer



Prime Minister

The Chancellor is, after all, prepared to go along with vesting on 1 Jan. But if flotation is delayed by more than 6 months, he considers that new funding arrangements should be devised (see on

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

15 December 1980

wants the Hs 146 to be re-considered in

E - since cancellation would mean a bigger net return from flotation.

A decision is needed by tomorrow when the BAE Board are meeting.

to vesting
Shall we say "yes" / subject to the Chancellor's riders?

T Lankester Esq
Private Secretary
Prime Minister's Office
No.10 Downing Street
LONDON SW1

Dear Tim,

BRITISH AEROSPACE

You told me that the Prime Minister had asked for the Chancellor's comments on the Secretary of State for Industry's minute of 12 December reporting on the discussion in E(DL) on 11 December, and the majority view that it would be right to vest the BAE assets in the successor Companies Act company on 1 January. The Prime Minister was particularly concerned about the apparent need for a capital injection of £100 million to strengthen the Company before a subsequent flotation.

The Chancellor, who is now in Brussels, saw Sir Keith Joseph's minute over the weekend. I know that he is worried that the prospects of a successful flotation now look slim. It seems clear from what the Defence Secretary said in E(DL) that uncertainties about future Defence orders for BAE will probably preclude a flotation before the Spring or Summer. Net receipts then may be still lower than they would have been in February, and the Chancellor and the Chief Secretary both felt that to sell in February 50 per cent of BAE Ltd for only some £15 million net would evoke sharp criticism; and that there would be a risk of discrediting the manifesto commitment to privatisation if it were fulfilled in such an unsatisfactory way.

The Chancellor understands that the requirement for a capital injection of some £100 million springs from advice from the merchant bank involved, Kleinwort Bensons, about the need to establish the company on a basis which would enable it to survive the failure of the 146 project in 1983. The Bank of England, who are not now directly involved

/in planning



in planning for the flotation, endorsed in the early Summer the need for a substantial capital injection prior to flotation. Without it, and assuming that the 146 has not previously been cancelled, officials do not believe that a flotation would be possible in this Parliament.

For this reason, the Chancellor does not entirely share Sir Keith Joseph's view that the 146 project is a separate issue which is not immediate. He believes that if the 146 were cancelled now there would be a prospect of floating the Company for a very much larger net sum. As a minimum, therefore, he thinks that E Committee should consider the possibility of cancellation now.

With flotation in serious doubt, the Chancellor has considered whether it would be right to vest on 1 January. He agrees with the Secretary of State for Industry that the political arguments do not all go one way: vesting without an early subsequent flotation seems a rather empty gesture, since BAe would remain in the public sector and under full Government control. But he recognises the force of the argument that vesting is what BAe want, and that the Government will be expected to make use before long of some of the powers taken in the British Aerospace Act. Moreover, he is inclined in principle to favour moves away from the traditional Morrisonian structure and in the direction of market-place structures.

Treasury officials have drawn his attention to two problems which would arise in the case of BAe if, contrary to what was intended when the Act was drafted, the gap between vesting and flotation were protracted. First, there might be criticism of the virtually complete waiver of remuneration on the corporation's commencing capital - which has to be extinguished before vesting - if the balancing financial advantage to Government - which would accrue only on flotation - were long deferred. Secondly, the Act makes no provision for interim financing. The terms of the bank loans which BAe have negotiated, and on which they would have to rely, though appropriate to a private sector Companies Act company, are inappropriately onerous for a public sector company. Knowledge of them would bring criticism at home eg from the PAC, and would damage the Government's credit standing abroad.

/The Chancellor



X // The Chancellor has noted these difficulties, but does not regard them as over-riding, and would not wish to dissuade the Prime Minister if she were disposed to go along with the E(DL) recommendation on vesting. He has however asked me to mention that officials here believe that it would probably then be essential that the Department of Industry should accept that, if flotation has not in fact taken place within about six months after vesting, more satisfactory long-term arrangements would have to be devised. One solution would be to take new powers to guarantee borrowing by BAe Ltd, though we would also have to ensure that the terms of BAe's existing loans could at that point be renegotiated to reflect such a guarantee. This would reduce the risk of damage to the Government's own credit standing, which would otherwise grow as the period between vesting and flotation lengthened.

Copies of this letter go to the Private Secretaries of members of E, of the Secretary of State for Defence, the Minister of Transport and the Financial Secretary; and to Sir Robert Armstrong.

Yours ever

Peter.

P S JENKINS
Private Secretary

CONFIDENTIAL



PRIME MINISTER

BRITISH AEROSPACE

I do not see why
flotation should be
injected. However
it is a suspiciously
round sum. not

1 You will recall that the next step in the process of privatisation of British Aerospace (BAe) would be the vesting of BAe as a Companies Act company, in 100 per cent Government ownership, in preparation for a subsequent flotation of the shares. When this was last discussed during October, it was reluctantly concluded that the inevitable uncertainties then prevailing about future defence expenditure ruled out the possibility of a flotation before the end of the year. The issue of vesting was therefore also deferred.

2 E(DL) Sub-Committee returned to these issues earlier today, and this minute informs you of their conclusions. Kleinworts, who are advising on the flotation of BAe, recommended that flotation should be in February. The feasibility of this still depends however on the degree of assurance that could be given in the sales prospectus about future defence procurement. The Secretary of State for Defence made it clear to the Sub-Committee that, while decisions would have been taken by early January about the defence Estimates for 1981-82, the consequences of the public expenditure reductions in later financial years could not become clear until later in the Spring. In the meantime he could not guarantee that projects key to the future of BAe would necessarily continue. The Sub Committee entirely accepted that decisions on the industrial implications of the defence cuts must be made in due time, and for defence reasons, and should not be dictated by the desirability of this flotation.

Don't think so at all!

The Chancellor is very unhappy about this. Apparently, the Chief Secretary failed to agree the case but he has explicitly approved. I think we should give him a chance to comment on Monday before finally deciding.

*12**14/12*

CONFIDENTIAL

/We ...



We therefore concluded that a February flotation was unlikely but even so it may just be possible that the decisions which the Secretary of State for Defence is able to take would enable Kleinwort's to advise that such a flotation was feasible. We also thought that a more realistic aim might be for flotation in Spring or Summer although we were aware that Kleinworts regard a flotation as a dwindling possibility once the February 'window' has been lost.

3 We also examined the likely proceeds of privatisation. It has always been recognised that the Company would require a substantial capital injection before flotation, since it would need sufficient resources if it is to be favourably received by the market to withstand the collapse of one of the major projects on which it is engaged. Kleinworts advise that a further £100 million of capital would need to be put in, which would offset the proceeds of sale to Government. Allowing for this, the net return to Government from a sale of half of the shares is now estimated to lie in the range of £15-30 million. This is appreciably lower than we had hoped earlier in the year. Although we would do our best to present the sale so that the £100 million capital injection to strengthen the company was clearly exposed, we would inevitably face strong criticism from our political opponents, and perhaps in the Press, for disposing of the company at a time when its market value is apparently depressed. The compensation paid on nationalisation. (£159 million), and the imputed interest on that sum amount to £215 million. In addition there has been new public investment of £110 million (equivalent to £140 million at current values). With the injection of the further
/£100 million ...



£100 million immediately prior to flotation, the total public input could be presented as being as high as £450 million, against an estimated total market value of the company of £250 - 275 million. Nevertheless the Sub-Committee were conscious that the market value was unlikely to improve in the next year or two, because the company is engaged on major projects whose prospects are for the longer term. Thus if we are to make progress with our strong political commitment towards privatisation, we shall have to face fairly low sale proceeds. Treasury Ministers argued that the company's prospects were being depressed by the BAe 146 project, and that the cancellation of that project should be reconsidered. We agreed that this was not an immediate issue, and that if the Chief Secretary so wished should raise that question separately with colleagues, with a view to subsequent consideration in E Committee.

4 On balance the Sub-Committee concluded that, in view of the strength of our political commitment to privatisation of BAe, and other nationalised bodies, and the likelihood that there would be no immediate change in the market, we should continue to aim for a flotation of BAe as soon as possible in spite of the relatively low net return. We shall therefore wish to return to the question of the practicability and timing of the flotation as soon as the position on Defence orders has been clarified.

5 In the meantime the immediate question is whether, in spite of this delay to flotation, we should take the step of vesting the company from the 1st January. The political arguments on

/this ...



this point both ways. If, for reasons beyond our control, we are unable to float, we might be left with the potential embarrassment of a Companies Act company, wholly in Government ownership, for an indefinite period. The Treasury would prefer to avoid a long period between vesting and flotation. The Act did not envisage such a period, and there is no provision for giving loans to the company. They would need to borrow on the commercial market, at rates slightly higher than other Government borrowings, and this could cast some doubt on the Government's credit-worthiness for overseas borrowing. There is also a problem on the commencing capital debt of the company, which under the Act is extinguished on vesting. In the interests of a good return on flotation the remuneration of this debt should be restricted. But, if flotation is long deferred, this restriction could well attract criticism. On the other hand vesting confirms our commitment to privatisation, and makes progress along that road. The Board of BAe moreover feel strongly that we should go ahead with vesting now; and we need to secure their continuing co-operation.

6 On balance, the Sub Committee considered that it would be right to vest the new company from 1 January, and that we should maintain a clear determination to float the company as soon as possible thereafter. If you accept that view, we would suggest that an announcement of the vesting should be made by way of Written Answer as early as possible next week. The terms of that Answer would of course be cleared with you and other colleagues.

/7 ...

CONFIDENTIAL



5

7 I am sending copies of this minute to members of E and E(DL), to the Secretary of State for Defence and to Sir Robert Armstrong.



(approved by the Secretary
of State and signed in his
absence)

12.12.80

Department of Industry
Ashdown House
123 Victoria Street



Leon Bl.

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

8 December 1980

The Rt. Hon. George Younger, MP
Secretary of State for Scotland,
Scottish Office,
Dover House,
Whitehall,
LONDON. SW1A 2AU

✓ us

Leon Bl.

REVIEW OF FORESTRY POLICY : MINISTERIAL STATEMENT

I have seen a copy of your minute of 4 December to the Prime Minister and can confirm that I am content with the draft statement attached to it.

I am copying this letter to the Prime Minister and to the other recipients of your minute.

2 —

GEOFFREY HOWE

Howe

CONFIDENTIAL

MFJ

cc Press Off. cc
+ 50 letter

CO
Member of E
Sec of State for
Wales
N. Ireland
Paymaster Gen
CDLO
CWO (Commons)
" (Lords)

5 December 1980

Forestry Policy: Ministerial
Statement

The Prime Minister has seen your Secretary of State's minute of 4 December. Subject to the views of colleagues, she is content with the proposals set out in that minute and with the draft statement.

I am copying this letter to the recipients of your Secretary of State's minute.

NJS

Godfrey Robson Esq
Scottish Office.

CONFIDENTIAL



cc Press Office

1
PRIME MINISTER

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Contact,

subject to
colleagues' views?

CONFIDENTIAL

Yes

not

MS

4/10

PRIME MINISTER

REVIEW OF FORESTRY POLICY: MINISTERIAL STATEMENT

In my minute of 18 July, I sought, on behalf of the Forestry Ministers, the approval by E Committee of a paper on forestry policy, which envisaged a statement to Parliament before the Summer Recess. This then had to be delayed because of the uncertainty which had arisen on the future of the Bowater Mill at Ellesmere Port.

2. The Minister of Agriculture, the Secretary of State for Wales and I have now agreed a statement (copy enclosed) which has been revised to take account of the difficulties in the paper and board industry, on lines agreed at official level by the Departments concerned, including the Treasury and the Department of Industry. It deals also with our main conclusions and refers to the simultaneous publication of a supporting consultative paper (also agreed with the appropriate Departments) on the Forestry Commission's proposals to simplify the administration of grant-aid to private woodland owners and of felling licensing, on the lines of the report prepared under the auspices of Sir Derek Rayner. It also takes account of the conclusions which the Chancellor of the Exchequer will announce about the recent report by the Public Accounts Committee on forestry taxation.

3. The Forestry Bill, which will enable the sale of a proportion of Forestry Commission assets to proceed, is now ready for introduction, and its Second Reading will clearly be the occasion for a debate on forestry policy. It would be desirable to secure a Second Reading as soon as possible so that the Bill can be enacted in time for the Commission to start work early next financial year on the sales of assets. We therefore propose to make the policy statement on Wednesday, 10 December as background for a forthcoming Second Reading Debate. An added reason for an announcement no later than 10 December is that the report of the Forestry Sub-Committee of the House of Lords Select Committee on Science and Technology is being published on that date and we should get our statement out of the way before that.

The timing
is OK as far
as business is
concerned
MS

4. It has been the custom in the past to make forestry policy statements by means of Written Answers but because of the recent difficulties over announcements by Written Answer, and the sale of assets arising in this case, we feel that it would be desirable to make an oral statement in both Houses.

5. We therefore seek approval:

- (a) to the terms of the statement;
- (b) to the statement being made orally in both Houses on 10 December;

- (c) for the Minister of Agriculture to discuss with the Leader of the House a date for introducing the Forestry Bill.

6. I am copying this minute and the draft statement to Members of E Committee, the Secretaries of State for Wales and Northern Ireland, the Paymaster General, the Chancellor of the Duchy of Lancaster, the Chief Whips in the House of Commons and House of Lords and Sir Robert Armstrong.

J.S. Wilson

(Approved by the Secretary of State and signed in his absence.)

4 December 1980

REVIEW OF FORESTRY POLICY: DRAFT PARLIAMENTARY STATEMENT

The Government have now completed their review of forestry policy and with your permission, Mr Speaker, I should like to make a statement.

With the projected rise in demand for timber into the next century and with the world's forests likely to come under increasing pressure, the Government believe that long-term confidence in both forestry and wood processing industries in this country is fully justified. We look for a steadily increasing proportion of our requirements of timber to come from our own resources. A continuing expansion of forestry is in the national interest, both to reduce our dependence on imported wood in the long term and to provide continued employment in forestry and associated industries.

Recent difficulties in the pulp and paper sector, which represents only an eighth of the market for wood grown in this country, do not change that conclusion. Forest owners have adjusted to the changed markets. Export opportunities in Europe for small roundwood are being successfully exploited. Looking further ahead, our industries, with the more advanced processes being developed in this country, are expected to be capable of absorbing the rising production from our existing forests, and of enlarging their present 9% share of the home market.

There should be scope for new planting to continue in the immediate future at broadly the rate of the past 25 years. We see a greater place for participation by the private sector in new planting, but the Forestry Commission will also continue to have a programme of new planting, in particular where it will contribute to the rational management of their existing plantations, and also in the more remote and less fertile areas where afforestation will help maintain rural employment.

The main basis of policy for the future must remain the successful and harmonious partnership between the private sector and the Forestry Commission. In accordance however with the Government's support for private enterprise and our policy of reducing public

expenditure, a determined effort will be made, by making better use of the capital invested in their existing assets, to reduce that part of the Commission's grant-in-aid which finances the Forestry Enterprise. We therefore propose to provide opportunities for private investment in these assets, including the sale of a proportion of the Commission's woodlands and land awaiting planting, with lease-back arrangements where it is important to maintain continuity of management to meet wood supply requirements or for other reasons. In planning its broad implementation of this policy, the Forestry Commission will take account of the views of the organisations concerned. We will seek an early opportunity to take the necessary powers for private investment in Commission assets on these lines.

Following a review of the administration of grant-aid and felling licensing, carried out under the auspices of Sir Derek Rayner, we propose to make these less complex and less costly to administer. A single new scheme will be introduced at the start of the next forest year on 1 October 1981, of which the main features will be planting grants, a simplified plan of operations and a minimum of legal formalities. The Basis III Dedication Scheme and the Small Woods Scheme will accordingly be closed as from 1 July 1981. Existing Dedication Schemes will continue for present participants, although some procedures will be simplified and individual dedication agreements will not be renewed on a change of ownership. The felling licensing system will be simplified to recognise the change in circumstances since this was introduced. Copies of a consultative paper, on which the various interested parties are being invited to comment, have been placed in the Library.

and learned
As my right hon/Friend, the Chancellor of the Exchequer, has already informed the House, the Government intend to continue the current income tax arrangements for forestry in order to maintain confidence in the private sector.

CONFIDENTIAL



Ecan Pol

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALING 01-218 2111/3

MO 26/8/1

24th November 1980

Dear Keith,

R 27/11

BAe FLOTATION

Thank you for your letter of 7th November. Our officials are in touch and you can certainly count on us to be as helpful as we can in the circumstances.

We have in recent weeks been preparing Sketch Estimates for next year, based on the survey levels for the defence budget agreed in the spring. The Cabinet has now agreed a substantial reduction on those levels. Moreover, we are still forecasting an overspend in the current year which will have a bearing on the programme we can afford to keep in being, and this will add further uncertainty for some time. We are now urgently addressing these matters but inevitably our attention will be on 1981/82 as first priority. It will take more time to complete work on the long term costings and I would not expect possible options for 1982/3 and later years to be identified in the new circumstances before the New Year. Thus it would be difficult to follow Kleinworts proposal that an upper limit of the effect on BAe be established now.

This suggests to me that we need to take a broader approach than that suggested by Kleinworts, on the following lines. As soon as we have decided which BAe projects will be at risk in finalisation of our programme for 1981/82 we will bring BAe into our confidence, and they can then revise their forecast figures for inclusion in the prospectus. I fear, however, that this may be nearer to Christmas than to the end of November, and even then we shall not have a clear view of the size of the adjustment

The Rt Hon Sir Keith Joseph Bt MP

CONFIDENTIAL



necessary for the overspend. The prospects thereafter would remain uncertain and any reference necessary in the prospectus to future defence spending would have to be based on the real increases agreed in our recent round of Cabinet discussions.

We must remember that we pay more money to BAe than to any other company, with very large outstanding liabilities on our part, eg over £1000m in August this year; that in each of the last 4 years we have paid them over £500m (September 1979 prices), with over £550m in each of the last 2 years; and in the first half of 1980 we paid them some £340m. All of this seems to me to provide very valuable collateral about the place and fortunes of the organisation in the defence field which is recognised, I believe, by all informed opinion to be an area where risks must be taken.

I am sending a copy of this letter to the Prime Minister, and to Geoffrey Howe and John Biffen, and to Sir Robert Armstrong.

Mr. Pym

Francis

Francis Pym



Treasury Chambers, Parliament
Street, SW1P 3AG

Enclosures from the
Financial Secretary



Econ BL

Treasury Chambers, Parliament Street, SW1P 3AG

24 November 1980

The Rt Hon Norman Fowler MP
Minister of Transport
2 Marsham Street
LONDON
SW1

R

PRIVATISATION OF THE BRITISH TRANSPORT DOCKS BOARD

I have seen your letter of 7 November to Keith Joseph and in the light of the unusual circumstances of the British Transport Docks Board I have no objection to the change you propose. I also read, with interest, Adam Butler's view recorded in his Private Secretary's letter of 18 November that the creation of statutory corporations might have a wider application in other areas of privatisation involving continuing statutory responsibilities. It seems to me that the BTDB is an exceptional case and I am doubtful that the approach we have adopted here has a much wider application. But as he suggests this is something which officials might discuss.

I am copying this letter to the Prime Minister, members of E(DL), and Sir Robert Armstrong.

Roy Westwater

PP NIGEL LAWSON



From the
Minister of State 's Office

The Hon Adam Butler MP

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 6401
SWITCHBOARD 01-212 7676

Anthony Mayer Esq
Private Secretary to the
Minister of Transport
Department of Transport
2 Marsham Street
London
SW1

18 November 1980

Dear Anthony,

PRIVATISATION OF THE BRITISH TRANSPORT DOCKS BOARD

Mr Butler has seen your Minister's letter of 7 November proposing a change to the way in which private capital might be introduced into the British Transport Docks Board (BTDB). He has no objection to what is proposed, but considers that the arguments that have led you to make the change might be applicable in other proposed areas for privatisation which involve continuing statutory responsibilities. He believes it would be useful, therefore, for there to be some discussion among officials of the reasons that have led Mr Fowler to suggest this change, so that the lessons learnt in relation to BTDB are applied as appropriate elsewhere. He therefore hopes it will be possible for there to be some discussion in the official Committee on Nationalised Industry Policy and, if necessary, a report from that Committee to E(DL).

I am copying this letter to Nick Sanders, the private secretaries to members of E(DL) and David Wright.

Yours sincerely,
Jonathan Hudson

Jonathan Hudson
Private Secretary

Extract

CONFIDENTIAL Ecom 101
Meeting record PM/Ian MacGregor, Sir K. Joseph
- 2 - & David Young.
Cheques ~~Sat 20 Dec~~ Sat. 15 November

iv) Trade Unions. Mr. MacGregor said that the privileges of our trade unions were without parallel in the industrialised world. He hoped the government would take further action^{to}/rein them back.

v) Management Education. Mr. MacGregor said that the quality of management education in this country was abysmal, and most of the management schools were run by people who did not believe in private enterprise. That was partly why management in the UK was of a generally low standard. But another major problem was that there were not enough people with a scientific or engineering background on company boards: they tended to be full of people with accountancy and legal backgrounds, who were unable to form a judgement on production problems.

vi) Micro-electronics. Mr. MacGregor said that micro-electronics was the critical technology of the future. It was essential to maintain a high level of research in solid state physics if we were to maintain our position as an industrial power, and we needed more people in industry with a solid state physics background.

vii) Money Supply. Mr. MacGregor said he could not understand why the authorities here had such difficulty in controlling bank lending. Even taking into account the openness of our financial markets and companies' access to Euro sterling, he felt sure we could control lending if we had a proper definition of reserve assets; he also did not see why the Bank could not enforce reserve requirements of overseas subsidiaries of UK banks. He thought Mr. Volcker would have a lot to teach us, and offered to ask him to come over to talk with the Prime Minister.

After Mr. MacGregor and Sir Keith had left, Mr. Young stayed behind to discuss the new towns disposal programme and also certain ideas he had in respect of the PSA. He left the attached note on the disposals programme, and promised to let us have a further note on this and also one on the PSA to provide the basis for a discussion between the Prime Minister and Mr. Heseltine. Pending this meeting, the Prime Minister said that she did not wish the PSA Advisory Board

/ to be

Originals Nat. Inds. Steel
Pt 7.

CONFIDENTIAL

to be set up as had been proposed. (In fact, we had already told the Department of the Environment that the Prime Minister did not wish this to be set up for the time being).

12

25 November 1980

CONFIDENTIAL



Paper from Mtg Folder
PM / David Yang at

Cheques 15.11.80.

(Main record on Nat. Inds, Steel Pt 7.)

Cum byr. -

NEW TOWNS DISPOSALS PROGRAMME

	<u>Target</u>	<u>Result</u>	<u>Shortfall</u>
		£m	
1979/80	125	40	85
1980/81	260	130	130
1981/82	350		

1981/82 target has to be increased by 1980/81 shortfall and outturn prices adjustment. Could be in excess of £500 million.

Present Arrangements

Healey & Baker (Mr. Paul Orchard-Lisle) have been appointed Consultants to the Secretary of State and two firms, Jones Lang Wootton and Hillier Parker, have been appointed as selling agents.

Suggested Method

- A. One firm to be appointed for each New Town on an annual basis.
- B. A target to be set for each New Town.
- C. Re-appointment each year would not be automatic but would depend (inter alia) on the attainment of the target.
- D. Other methods to be considered for disposals:
 - (1) Property Company
and thus appeal to a different section of the Investment Market
 - (2) Property Unit Trust
and thus appeal to smaller Pension Funds
 - (3) Property Bond
which could be of interest to the private investor.



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

The Rt Hon Sir Keith Joseph MP
Secretary of State
Department of Industry
Ashdown House
123 Victoria Street
LONDON SW1

R
14/11
12/11
7 November 1980

For Keith.

PRIVATISATION OF THE BRITISH TRANSPORT DOCKS BOARD

Part 3
You will recall that my proposals for introducing private capital into the British Transport Docks Board following advice from my merchant bankers were agreed by E(DL)(80) 4th meeting on 8 July 1980 (memorandum E(DL)(80)9). The proposals involved replacing the existing BTDB with a two-tier organisation consisting of:-

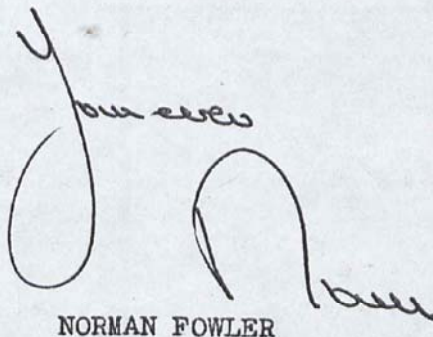
- i. a statutory company, and
- ii. a holding company registered under the Companies Acts which would hold the statutory company as a wholly-owned subsidiary.

Subsequent work on the proposal, and particularly advice from the lawyers, has shown that there are substantial advantages in making the lower body in the two-tier organisation a statutory corporation rather than a statutory company. The change will not only make the privatisation legislation simpler but will avoid a continuing commitment to amend the legislation of the body in accordance with future developments in UK and Community company law. (It is possible that some of the future Community legislation might even undermine the objectives of the present privatisation legislation.) I therefore intend to modify my proposals and replace

the BTDB with a two-tier organisation consisting of a statutory corporation and a holding company registered under the Companies Acts, which will hold the statutory corporation as if it were a wholly-owned subsidiary.

The change is a relatively small technical one which I think is a clear improvement on the previous proposal. It has the agreement of the merchant bankers who do not think the change will affect the price the Government will receive from the sale of shares in the holding company. However, it is a change from my previously agreed policy of which I would wish my colleagues to be aware.

I am copying this to the Prime Minister, other members of E(DL) and Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Norman Fowler', with a large, stylized initial 'N' and 'F'.

NORMAN FOWLER



Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
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The Rt Hon Francis Pym MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
London SW1A 2HB

7 November 1980
(received 12/11)

Am. Smith

Am Francis

7/11/80

BRITISH AEROSPACE FLOTATION

A3

Thank you for your letter of 20 October, in which you say that you regard the sort of changes in defence expenditure that have been discussed as wholly unrealistic, and argue for our pressing ahead with a November flotation.

2 I must make clear that, in the discussions that have taken place in strict confidence with the Department of Industry's financial advisers, Kleinworts, there was no assumption as to the scale of cuts in the defence budget that might eventually be decided by Cabinet. On the contrary, it was repeatedly stressed that no proposals had yet been put to Cabinet, and that there was therefore no question of decisions having been taken. What was made clear is that there would be proposals under discussion in the first half of November that, to the extent, if any, that they were to be accepted, would result in possible reductions in the defence budget and that there could be no guarantee that these proposals would not be accepted at least in part. I have sounded Geoffrey Howe on whether he believed it would be possible to exempt the defence budget from the current round of public expenditure cuts and he has emphasised that he does not believe this can be done. I consider, therefore, that the position that has been explained to Kleinworts is realistic: it is above all one of uncertainty.

3 Kleinworts have given firm advice that we could proceed with a flotation in November only if we foresaw no changes to the defence budget which might have material effect on British Aerospace. This is, in all the circumstances, impossible to guarantee, will not be known until early November at the earliest, and - at least in the eyes of our Treasury colleagues - is unlikely. At E(DL) there was agreement to an early vesting only if we could see a way through the defence problem. What has become clearer since our meeting is the scale, rather than the solution, of that problem. It was for that reason that

/I ...



I have regretfully concluded that a November issue is impossible.

4 I am determined, however, that we should do all we can to promote a January/February flotation. As I explained in my minute of 23 October to the Prime Minister, this is probably the last chance this Parliament and we must grasp it. The only means of doing so I have identified are those outlined in my minute: basically, to establish a limit to the damage likely to be caused British Aerospace by any cuts in the defence budget. This limit could be wide, provided we are prepared to accept the consequences on the share price. Kleinworts have suggested, by the way of illustration, a maximum effect on profits of £6-8 million, equivalent to an effect on the sales by BAe to the Ministry of Defence of about ten times this amount. (The effect of this on HMG's receipts might be about £20 million.) This is an extension and qualification of your own approach, of expressing confidence in British Aerospace's ability to secure a sizeable share of the defence business and is close to a helpful approach previously suggested by Ministry of Defence officials.

5 I know that it will not be easy to obtain the necessary information in time: for a flotation in January/February, we shall need the Ministry of Defence to have established by the end of November the maximum overall effect on British Aerospace of whatever revised defence budget may be decided. I hope that a start can be made on the preparatory work at once. I should like discussions to start as soon as possible comparing British Aerospace's assumptions of future sales to the Ministry of Defence with those of the Ministry about their future purchases from British Aerospace, so as to ensure that any views about the impact of future changes start from a comparable base, and also to establish, as far as possible, the size of the future base load of business which could be regarded as secure, even given the discussions about public expenditure we shall shortly have. I recognise that, even if this is done, there will be a need for rapid work once our public expenditure decisions are reached. The only alternative, however, is to accept defeat. That is something none of us could countenance unless compelled to do so. I am, therefore, grateful to you for your help in meeting this political priority.

6 I am copying this letter to the Prime Minister, the Chancellor of the Exchequer, the Chief Secretary and to Sir Robert Armstrong.

Cram-Kwiz



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Duty Clerk

With apologies -
due to an error this
was not copied to you.

With the Compliments of the
Private Secretary to the
Secretary of State for
Industry

M. Kenney.
12/11

* Public Sector Assets pts 3

CS 248 + 4 with Tim

PART 3 ends:-

TPH to Fuel 29.10.80

PART 4 begins:-

L (80) 57 31.10.80