Chex Lawson

PART D

CONFIDENTIAL

(Circulate under cover and notify REGISTRY of movement)

MANAGEMENT-IN-CONFIDENCE

PO -CH /NL/0221

PART D

CHANCELLOR'S PAPERS ON NEXT STEPS AGENCIES

PO -CH /NL/0221

PART D

Begins: 20/5/88

Ends: 26/7/88

DD: 25 years

13/9/95

ps2/77M

UNCLASSIFIED

FROM: MISS M P WALLACE
DATE: 20 May 1988

MR L J HARRIS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Dame Anne Mueller
Mr Anson
Mr Phillips
Mr Turnbull
Mr Luce
Mr C D Butler
Mr Kelly
Mr Odling-Smee
Ms C Evans
Dr Freeman
Mr Welsh
Mr Battishill - IR
Mr Unwin - C&E
Mr Dole - HMSO
Mr Patterson - DNS
Mr Taylor - COI

TCSC NEXT STEPS ENQUIRY

The Chancellor was grateful for your minute of 17 May. He is content for you to lead for the Treasury, with the back-up team you propose.

MPW.

MOIRA WALLACE

dti

the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon John Major MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard 01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

CHIEF SECRETARY
REC. 26 MAY 1988
ACTION Mr Burgner
COPIES TO Cx, Sir P. Middleton
Mr Anson, Sir ? Wilson, Mr Monck
Mrs Case, Mr Turnbull, Mr Robson,
Mr Waller, Mr Mason, Mr Jameson
Mr Bradley Mr Elias
Mr Call

Direct line 215 5422
Our ref DW3AIE
Your ref
Date 26 May 1988

Dear John,

REVIEW OF DTI'S RESEARCH ESTABLISHMENTS

Thank you for your letter of 13 May in response to mine of 9 May.

I visited NEL on 16 May. While I was impressed by the work, I see no reason for the bulk of it to be carried out within DTI. I have therefore decided to encourage the development of NEL within the private sector. This completes my review of the recommendations made by officials, a copy of which I sent to you and colleagues with my earlier letter. I intend to make an announcement of my decisions on the REs by Written Answer on 9 June. The attached draft meets requests by Malcolm Rifkind and you that there should be no irrevocable commitment to privatisation of NEL until any proposals are thoroughly examined. The draft also makes clear the need for further work to establish agencies for the remaining REs as well as for the National Weights and Measures Laboratory.

I should be obliged to have any comments on the draft statement by 6 June.

I am sending copies of this letter to Malcolm Rifkind, Nicholas Ridley, Paul Channon, and Cecil Parkinson and to Sir Robin Butler.

Yours

David

CONFIDENTIAL & MANAGEMENT IN CONFIDENCE

(Until public announcement)

DRAFT ANNOUNCEMENT ON THE REVIEW OF THE RESEARCH ESTABLISHMENTS

1. In the White Paper, "DTI - the department for Enterprise", I announced my intention to review DTI's four Research Establishments (the National Physical Laboratory, the National Engineering Laboratory, the Laboratory of the Government Chemist and Warren Spring Laboratory). The review has now been completed.

2. I have decided that in future the REs should concentrate on research that is required by Government, whether for statutory, regulatory or policy reasons. I wish to encourage technology transfer and non-research activities arising from this work so that the widest possible benefit can be drawn from it. Consistent with the focus on work for Government as customer, industrially relevant R&D and repayment work for industrial customers will each be limited in future to approximately 10% of the full cost of each RE. Additionally, each RE will be able, as at present, to spend on strategic research up to 10% of the full economic cost of such work carried out for DTI. Programmes of industrially relevant R&D will, in general, receive up to 50% support and will be carried out for groups of companies who have agreed to collaborate to share the benefits and the remaining cost of the work. These criteria are consistent with those announced in the White Paper for the support of extramural R&D.

3. WSL will in future concentrate more heavily on environmental engineering, largely for public sector customers, with a reduction in industrially relevant R&D.

4. To give greater flexibility and responsibility to the laboratories, I plan to establish NPL, LGC and WSL as separate agencies, within the public sector, in line with the policy described in "Improving Management in Government: The Next Steps". This is an appropriate structure for laboratories whose main task is to undertake research for public sector customers.

5. NPL, LGC and WSL would thus retain their identities, but the benefits of common services would be fully exploited within the new structure. Work will now be put in hand to develop the agency framework for these laboratories together with that for a fourth agency for the National Weights and Measures Laboratory, and I hope that it will be possible to have them operational by April 1989.

6. Roughly three quarters of the work at NEL currently falls into the category of industrially relevant R&D. Generic industrial research is important for the long term prosperity of manufacturing industry. I want it to continue but would greatly prefer that research of this nature is carried out in the private sector rather than within DTI. The principal beneficiary is industry, not Government, and strong signals from industry are needed in guiding the development and

direction of the work. This "market pull" is more easily provided and understood when the R&D is carried out in an organisation whose progress depends directly on its success in providing services to industry.

7. I therefore invite organisations which have experience of carrying out contract R&D for external customers, and of disseminating the results of their work widely by effective technology transfer, to make proposals to DTI by 22 July to develop NEL within the private sector. I would be happy to receive proposals from NEL staff as well as from external bodies.

8. I would wish either to make suitable arrangements with the new owner for the continuation of the work that NEL does for Government on flow measurement, or to retain that work within DTI, as part of an agency. There will also need to be proper arrangements for the ownership of the assets of NEL. Finally, DTI would be prepared to continue to support industrially relevant R&D carried out at NEL by the new owner, subject to the normal criteria applied to extramural R&D.

9. I have taken steps to inform the staff of the REs and their trade union representatives in parallel with my announcement. There will be full consultations with the Trade Union Side on the implications for staff.

dti

the department for Enterprise

MANAGEMENT IN CONFIDENCE & CONFIDENTIAL

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

John W Fairclough Esq F Eng
Chief Scientific Adviser
Cabinet Office
70 Whitehall
London
SW1

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard 01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

CHIEF SECRETARY
REC. 26 MAY 1988
ACTION Mr Burgner
COPIES TO C, Sir P Middleton, Mr Anson, Sir A Wilson, Mr Monck, Mrs Case, Mr Turnbull, Mr Robson, Mr Waller, Mr Mason, Mr Jameson, Mr Bradley, Mr Ellis, Mr Call

Direct line 215 5422
Our ref DW3AHE
Your ref
Date 26 May 1988

Dear John,

CIVIL RESEARCH ESTABLISHMENTS: NEXT STEPS REVIEW

Thank you for your letter of 17 May about arrangements for taking forward consideration of civil research establishments and laboratories as executive agencies. I am very happy with the approach outlined in paragraph 3 of your letter and work is well-advanced on the points which you have highlighted.

We are already in touch with your people about taking forward consideration of the DTI REs as Next Steps candidates and will keep them posted on progress. My hope is that we will have proposals to put to you and Peter Kemp by September at the latest.

Against this background I am made slightly uneasy by your proposal that there should be common elements in the terms of reference and timetables for different agency reviews. We must ensure that all the important points are covered but I hope we can avoid giving the impression of prescription from the centre, and keep up the informal consultation at official level that has already begun.

I am copying this letter to the recipients of yours.

Yours,
David

the Enterprise

ps2/7M

CONFIDENTIAL

FROM: MISS M P WALLACE

DATE: 26 May 1988

PS/CHIEF SECRETARY

cc Sir P Middleton
Mr Anson
Mr Phillips
Mrs Case
Mr L Harris
Mr Luce
Mr Turnbull
Mr Revolta
Mr K S Wright

LAND REGISTRY

The Chancellor has seen Mr Wright's minute of 18 May about the Land Registry's Summer Supplementary. He has asked whether there is a case for turning the Land Registry into an agency.

MPW.

MOIRA WALLACE

pps pl.

Pg.

FROM: MISS C EVANS
DATE: 26 MAY 1988

SIR PETER MIDDLETON

PBM may like a word. Who would want a row with the TCSC on this?

passed to PS/PBM

cc Chancellor of the Exchequer 12/2
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Anson
Dame Anne Mueller
Mr Phillips Mr Monck
Mr Odling-Smee
Mr L Harris
Mr Turnbull
Mr Luce
Mr Kelly
Mrs Burnhams
Mr Wynn Owen

TCSC NEXT STEPS ENQUIRY 6 JULY, 11am

I put to the Clerk to the sub-committee our proposal that the team to appear befor the sub-committee should be Messrs Harris, Turnbull, Luce, and Kelly, as approved by the Chancellor. The Clerk has now telephoned to say that the Chairman, Mr Radice, would prefer if you could head the team. The reason is that the sub-committee regard this as a very important, high profile, enquiry and would like this (final) session, to take an overview of the broad general picture and the significance of the Next Steps changes. They feel that you would be best able to provide this perspective. You would be following sessions with Peter Kemp, Sir Robin Butler and Richard Luce.

2. In offering the team of Under Secretaries, I had already pointed out to the Clerk that this representation would provide the sub Committee with expertise across the range of issues raised by the Next Steps changes, but the proposal to invite you reflects the sub-committee's wish for a higher profile session. Would you be willing to attend the hearing on 6 July (or at another date if this is not convenient)? there is a meeting of NEDC that morning.

CE

MISS C EVANS

iae2.sc/Rob/REs

MANAGEMENT IN CONFIDENCE

BF 1/6

FROM: H M ROBERTS

DATE: 27 May 1988

1. MR BURGNER (not seen)

2. CHIEF SECRETARY

cc. Chancellor
Mr Anson
Sir A Wilson
Mr Monck
Mrs Case
Mr L J Harris
Mr Turnbull
Mr Waller
Mr Mason
Mr Jameson
Mr Bradley
Mr Elias
Mr Call

REVIEW OF DTI RESEARCH ESTABLISHMENTS (REs)

Background

1. You will recall that Lord Young wrote to you on 9 May outlining his broad conclusions on the recommendations of DTI's review of its research establishments. His conclusions were that the National Physical Laboratory (NPL), the Laboratory of the Government Chemist (LGC) and Warren Springs Laboratory (WSL) should be converted to agencies and that he would reach a decision on the review's recommendation to privatise the National Engineering Laboratory (NEL) following a visit to NEL.

2. You responded to Lord Young welcoming his conclusions, noting the considerable amount of detailed work required successfully to establish "next steps" agencies and pressing him not to make an irrevocable commitment to privatising NPL irrespective of cost implications.

MANAGEMENT IN CONFIDENCE

Issue

3. Lord Young's letter of 26 May (attached) confirms his decision to encourage NEL privatisation and attaches a draft Statement for announcement to the House on 9 June, inviting comments by 6 June.

4. The terms of the draft statement seem broadly acceptable. They include discussion of the rationale for the decision (paragraph 2) and indicate the objective of agency status for NPL, LGC and WSL with an operational target of April 1989 (paragraph 5). However paragraph 4 of the draft assumes that the establishment of REs as agencies is automatic; "next steps" procedures allow them only to be candidates for agency status at this stage.

5. On NEL, Lord Young is inviting research and technology organisations to make proposals for continuing the development of NEL in the private sector by 22 July, 6 weeks after the statement. We have discussed with DTI the mechanics of this procedure and shall be kept abreast of developments.

Conclusion

6. We recommend you write to Lord Young agreeing to the terms of his draft statement but suggesting an amendment in line with paragraph 4 above, and reiterating our concern that Treasury officials should be kept informed of developments on setting up RE agencies, and that appraisal of options for privatising NEL should take account of all the relevant costs. In view of Lord Young's 6 June deadline, it would be helpful to write early next week.

HMR

MS H M ROBERTS

iae2.sc/Rob/REs

MANAGEMENT IN CONFIDENCE

DRAFT LETTER TO LORD YOUNG ON REVIEW OF DTI'S RESEARCH ESTABLISHMENTS

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1

May 1988

REVIEW OF DTI RESEARCH ESTABLISHMENTS (REs)

1. Thank you for your letter of 26 May attaching a draft statement announcing the conclusions of the review of DTI research establishments and inviting comments.

2. I am content with your draft statement and welcome your decision to invite proposals for privatisation of NEL; any final decisions on NEL will need to take full account of the balance of all relevant costs and benefits.

3. The establishment of the remaining REs as "next steps" agencies cannot be assumed under the agreed procedure and I suggest you amend paragraph 4 of your draft statement as follows:

> "I plan to consider establishing NPL.... This seems an appropriate....."

Setting up agencies will involve much detailed work and as my letter of 9 May indicated I should be grateful if my officials can be kept fully informed.

4. I am copying this to Malcolm Rifkind, Nicholas Ridley, Paul Channon, and Cecil Parkinson and to Sir Robin Butler.

J.M.

577b.

Mr Andren 63A/11
We spoke. Grateful for comments to assays
27/5

dti
the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon John Major MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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Telex 8811074/5 DTHQ G
Fax 01-222 2629

CHIEF SECRETARY
REC. 26 MAY 1988
ACTION Mr Burgner
COPIES TO Cx, Sir P. Middleton, Mr Anson, Sir A Wilson, Mr Monck, Miss Case, Mr Turnbull, Mr Robson, Mr Waller, Mr Mason, Mr Jameson, Mr Bradley, Mr Elias, Mr Call

Direct line 215 5422
Our ref DW3AIE
Your ref
Date 26 May 1988

Dear John,

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I should be obliged to have any comments on the draft statement by 6 June.

I am sending copies of this letter to Malcolm Rifkind, Nicholas Ridley, Paul Channon, and Cecil Parkinson and to Sir Robin Butler.

Yours
David

the Enterprise initiative

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4. To give greater flexibility and responsibility to the laboratories, I plan to consider establishing NPL, LGC and WSL as separate agencies, within the public sector, in line with the policy described in "Improving Management in Government: The Next Steps". This ~~is~~ seems an appropriate structure for laboratories whose main task is to undertake research for public sector customers.

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direction of the work. This "market pull" is more easily provided and understood when the R&D is carried out in an organisation whose progress depends directly on its success in providing services to industry.

7. I therefore invite organisations which have experience of carrying out contract R&D for external customers, and of disseminating the results of their work widely by effective technology transfer, to make proposals to DTI by 22 July to develop NEL within the private sector. I would be happy to receive proposals from NEL staff as well as from external bodies.

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9. I have taken steps to inform the staff of the REs and their trade union representatives in parallel with my announcement. There will be full consultations with the Trade Union Side on the implications for staff.

CABINET OFFICE
OFFICE of the MINISTER for the CIVIL SERVICE

Horse Guards Road
London SW1P 3AL

Telephone: 01-270 6450

E P Kemp CB
Second Permanent Secretary

CH/EXCHEQUER
REC. 01 JUN 1988
ACTION CST
COPIES TO

1/6

J W Fairclough Esq
Chief Scientific Adviser
70 Whitehall
London SW1A 2AS

27 May 1988

Dear John

FUTURE OF RESEARCH ESTABLISHMENTS - IBBS AGENCIES

Thank you for sending me a copy of your letter of 17 May to the Secretary of State for the Environment about the task you were given by E(ST) on 9 May to co-ordinate reviews of Civil Research Establishments as agencies. We met to discuss this.

You said that your purpose in recommending these reviews was to improve efficiency by putting Government civil research on to a more clearly defined "customer-contractor" basis. This is something which has been sought for some years. It is very much in line with the "Next Steps" agency concept of focussing more sharply on results and defining more clearly the tasks to be done and distinguishing between those who commission the work and pay for it from those who carry it out. You were also concerned to look at the relationship between establishments serving different Departments. This was the other aspect of the task which E(ST) had asked you to undertake. Your proposals were designed to address the issue by encouraging competition between establishments for Government work through competitive tendering.

So far as the establishment of agencies go, the policy and resources framework document is the vital element which will define the relationships that are involved. We have prepared and issued to Departments a note about what these documents should cover so far as the generality of agencies go. What I would like to suggest is that we look at this guidance to see what sort of additional material might have to be included to make it particularly relevant to the Research Establishments and the arrangements for competition which you have in mind. When we have settled this together, we would let the Departments involved have it as a basis on which they might take forward the creation of their agencies as appropriate. As it happens, and not surpringly, a number of the establishments listed in the Annex to your letter are already on the lists that various Departments have provided as possible agency candidates.

We envisage that generally speaking each Research Establishment would constitute a separate agency, though individual Departments may want to group some for convenience. However, as I explained to you, there is one particular concern which we have, which I understand is reflected in Departments, which is the extent to which there must necessarily be commonality of terms and conditions as between one research agency and another, and the extent to which it is necessary to look for a common timetable for the various reviews and the establishment of the various agencies. We agreed to identify in the note about the policy and resources framework document for Research Establishments any points which were thought appropriate to apply across the board. You would be content to talk through any doubts about these points with Departments. It was not your intention to suggest any kind of straitjacket - and from my point of view that would indeed be quite contrary to the whole agency concept, which is essentially based on the argument that Government activities all differ one from the other - nor were you necessarily looking for a single timetable, though the requirement on you from E(ST) to report back on the co-ordination of these reviews meant that it was necessary to establish an end date for their completion. You would pursue with Departments whether the date you had suggested of end September was achievable.

It seems to me that from my point of view as Project Manager for the Next Steps initiative this is a worthwhile and sensible way forward. We stand ready to give further help if this would be useful.

I am copying this letter to the Private Secretaries of those who had copies of your letter.

Yours ever
Peter

E P KEMP

012/2986

MANAGEMENT IN CONFIDENCE

CHIEF SECRETARY TO THE TREASURY

cc:
Chancellor
Mr Anson
Sir A Wilson
Mr Monck
Mrs Case
Mr L J Harris
Mr Turnbull
Mr Burgner
Mr Waller
Mr H M Roberts
Mr Mason
Mr Jameson
Mr Bradley
Mr Elias
Mr Call

Treasury Chambers, Parliament Stre

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1H OET

2nd June 1988

Dear Secretary of State,

REVIEW OF DTI RESEARCH ESTABLISHMENTS (REs)

Thank you for your letter of 26 May attaching a draft statement announcing the conclusions of the review of DTI research establishments and inviting comments.

I am content with your draft statement and welcome your decision to invite proposals for privatisation of NEL; any final decisions on NEL will need to take full account of the balance of all relevant costs and benefits.

The establishment of the remaining REs as "next steps" agencies cannot be assumed under the agreed procedure and I suggest you amend paragraph 4 of your draft statement as follows:

"I plan to consider establishing NPL .... This seems an appropriate ....."

Setting up agencies will involve much detailed work and as my letter of 9 May indicated I should be grateful if my officials can be kept fully informed.

I am copying this to Malcolm Rifkind, Nicholas Ridley, Paul Channon and Cecil Parkinson and to Sir Robin Butler.

Yours sincerely,

Joe Elliott

for JOHN MAJOR

(Approved by the Chief Secretary and signed in his absence) pp spr (reecs kpp

~~pnp~~

[weeded]

MANAGEMENT IN CONFIDENCE

FROM: L J HARRIS
DATE: 6 JUNE 1988

Ch/ also ~~As you will see, work is in progress on Land Registry as possible agency. (Your question behind)~~

cc Mr Anson
Mr Phillips

MISS WALLACE — 12/

mpw 8/6.

AGENCIES

You asked me about the general procedure for establishing agencies, and for a note on progress so far.

Under the guidance notes approved by the Cabinet, the preliminary identification of potential agencies is a matter for their parent departments or the Treasury expenditure divisions concerned, though in practice the Project Manager in OMCS also has a large part to play in encouraging departments to bring forward suitable candidates. Once a candidate has been identified, the parent department is required to review the alternatives to agency status, including privatisation, and, if satisfied that the agency approach is right in principle, to analyse the proposal in more detail. If, on the basis of that analysis, the departmental Minister is willing to approve the proposal in outline, the department next discusses it with the Project Manager, and then submits it to the official Treasury. Once the Treasury is satisfied that there is a prima facie case, the department draws up the draft policy and resources framework. After agreement with the Treasury and the OMCS, the framework is submitted for approval first to the departmental Minister and then to the Chancellor, the Minister of State, Privy Council Office, and, in the more important cases, the Prime Minister. The way is then clear to set up the agency, appoint the Chief Executive, and prepare the annual and corporate plans.

The Prime Minister, in her statement on 18 February, announced that 12 executive functions were being considered as possible agency candidates. These are still being processed, with the likelihood that the first to reach the agreed framework stage will be the Vehicles Inspectorate, with a target date of 15 July. Some others, such as the Companies Registration Office, are close behind it, while the more complicated proposals for such agencies as the Non-nuclear Defence Research Agency are taking a good deal longer to evaluate. If all twelve initial candidates come to fruition, the resultant agencies will cover some 71,500 people.

In preparation for his progress report to the Prime Minister later in the summer, the Project Manager has been looking at the scope for adding other candidates to the list. A further 15 have been identified as "firm", in the sense of having been announced publicly (such as the Occupational Health Service in OMCS) or notified to OMCS as probable future candidates by departments (such as the Ordnance Survey and the Land Registry). If eventually established, these 15 agencies would contain a further 21,700 people.

Later possibilities mentioned more tentatively by departments would add a further 46 agencies and 67,400 people to the list. A fourth, and highly speculative, tranche noted by the Project Manager would yield 114 agencies containing 278,200 people; it would cover some of the very largest executive functions of central government, including tax collection and the payment of benefits.

The total for all four categories comes to 187 agencies covering 438,800 people. This seems to be the figure the Project Manager had in mind when, in his recent oral evidence to the Treasury and Civil Service Sub-Committee on Next Steps, he estimated that 75% of the Civil Service might be organised as agencies within ten years.

Some of these figures have been obtained in confidence from OMCS, and are not for public use at this stage. The Project Manager's team have recently written to all departments inviting them to identify potential agencies under various headings, and, in addition, to list those activities which are unlikely ever to be suitable for the agency approach. Their replies will form the basis of the next report to the Prime Minister.

Leonard Harris

L J HARRIS

FROM: L J HARRIS
DATE: 10 June 1988 p.p.

CHANCELLOR

cc Paymaster General
Sir Peter Middleton
Mr Anson
Mr Phillips
Mr Welsh
Ms Evans
Mr D B Rogers - IR
Mrs V P M Strachan - C&E

cc Mr Grieve & return

NEXT STEPS: TRADE UNION SIDE EVIDENCE TO TCSSC

We understand from the Inland Revenue that the First Division Association and the Association of Inspectors of Taxes have been invited to give oral evidence to the Treasury and Civil Service Sub-Committee on Next Steps next Wednesday, 15 June. The team will be led by John Ward, the professional General Secretary of the FDA, but the AIT officials will both be serving members of the Tax Inspectorate, though one of them is at present entitled to 100% facility time for union duties. They apparently intend to submit written evidence which, among other things, will be critical of the Financial Management Initiative, and will express some scepticism about the ability of Ministers in practice to avoid intervention in the day-to-day affairs of executive agencies. This is likely to be a source of some embarrassment to the Council of Civil Service Unions, who have so far attempted to preserve a broadly neutral approach to the Next Steps proposals.

The Sub-Committee is, of course, empowered to call whatever witnesses it likes. It should be clear that the AIT members are giving their opinions in their capacity as union representatives, and not as Inland Revenue officials, but there is always a chance that the few members of the Press who have been following the Next Steps hearings closely will choose to ignore the distinction and cite the AIT's views as evidence of divided councils within Whitehall on the Government's response to the Next Steps Report.

L J HARRIS

Dictated by Mr Harris
but signed in his
absence

Harsh: this is a TU view.

64

From: S D H SARGENT

Date: 1 July 1988

PRINCIPAL PRIVATE SECRETARY

cc Mr Anson
Dame A Mueller
Mr Phillips
Mr C W Kelly
Mr L Harris
Mr Luce
Mr Turnbull
Mr C Welsh
Miss C Evans

Ch/
OK?
AF 1/7

TCSC INQUIRY ON NEXT STEPS: 6 JULY

... I attach a copy of the opening statement which Sir Peter Middleton proposes to make to the TCSC at the session next Wednesday morning. Sir Peter would be glad to know whether the Chancellor is content with this.

OK – tho' on balance
I wd be inclined to omit
para 1 (in wh case there is
a conspicuous automatic
[illegible] must on para 2).
N.

S D H SARGENT
Private Secretary

OPENING STATEMENT OF THE TREASURY'S POSITION

The objective of the Government's economic policy is to defeat inflation and to maintain a vigorous, enterprising economy. Since 1980 the framework for macro-economic policy has been provided by the Medium Term Financial Strategy. This is intended to bring down inflation over a period of years and ultimately to achieve price stability. Economic policy is therefore set in a nominal framework with monetary and fiscal policy designed to keep money GDP on a path consistent with the Government's objectives.

2. Public expenditure, [in line with this overarching objective,] must be controlled in cash terms otherwise it cannot be properly integrated with economic policy more generally. The system has to be directed to controlling inputs. If you lose control over cash inputs you lose control over public expenditure.

3. But the Government is also committed to encouraging enterprise, initiative and flexibility. This is designed to improve the supply performance of the economy and increase the non-inflationary growth of output. It involves reducing the scope and role of the state to the maximum practicable extent and changing the balance between the public and private sectors. It also means that it is every bit as important to improve productivity in those activities which remain in the public sector as it is in the private sector. We need to get the most out of what is put in by improving outputs, effectiveness and efficiency and value for money generally. And we need incentives to reduce costs.

4. So we need to find a system which maximises value for money and at the same time does not add to the pressures for increased public expenditure and the difficulties of control.

5. The chosen route for this has been the Financial Management Initiative and related developments. This, in essence, has involved more devolution of responsibility from the centre to departments, and within departments, as their financial systems have developed, and as the Treasury felt they were able to manage effectively within the cash totals allocated to them in the public expenditure planning process. It has also required the development of more and better measures of performance and output against which to judge progress and as a basis for setting tough targets. In return, senior management in departments and the Treasury would be provided with much better information from departmental systems with which to carry out their role of monitoring and control. As the Public Accounts Committee said in its report on progress on the FMI last year, "We emphasise the importance we place on providing managers <u>at all levels</u> with information enabling them to measure outputs and consider value for money aspects of their operations". I regard the Treasury as being part of the spectrum of control for these purposes.

6. Next Steps carries this process a stage further. It involves the creation of agencies to carry out executive functions within resource and policy frameworks set by departmental Ministers in agreement with the Treasury. This will give managers greater responsibility. If it is to enhance expenditure control, as it should, it will involve a high degree of reliance on departmental budgeting systems. And it must involve penalties as well as rewards if expenditure and running cost objectives are exceeded.

7. The Treasury is also the department responsible for Civil Service recruitment policy, pay and superannuation. Pay and superannuation expenditure account for some 65 per cent of running costs. Pay is also important because it affects what the private sector does. So long as agencies remain within the Civil Service their basic pay structures will be within the ambit of the central negotiations between the Treasury and Civil Service unions, or perhaps negotiated by the agency within a framework set by the Treasury. As

a matter of policy, we have been building flexibilities into the central system to enable departments to respond to particular circumstances. But there are close and well established links between pay groups across the public sector and it will be essential to avoid repercussive leapfrogging within the public sector as agencies develop.

53/3650

MANAGEMENT IN CONFIDENCE

From: SIR PETER MIDDLETON
Date: 1 July 1988

CHANCELLOR

Ch,
Content with
PEM's recommendations?
AP 1/7

Content

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Anson
Mr Phillips
Mr Luce
Mr Turnbull
Mr C W Kelly
Mr C D Butler
Miss Peirson
Mrs Lomax
Mr Peretz
Mr L Watts
Mr C Welsh
Mr L Harris

NEXT STEPS CANDIDATES: CHANCELLOR'S DEPARTMENTS

We have been looking at the scope for putting forward some of the departments and other units reporting to Treasury Ministers as future agency candidates. The attached note by Mr Harris, with which I agree, sets out the position reached, and I now seek your approval to its recommendations.

2. We do not think that either CCTA or the Rating of Government Property Department should be further considered as potential agencies at this stage. The interaction between policy and operational work in CCTA would make it difficult to split off its purely executive functions in the way envisaged in the Next Steps report, while the future of the RGPD is being separately reviewed in the light of the introduction of the community charge.

3. The Chairmen of the two Revenue Departments have already minuted you separately about their special position in relation to Next Steps, and you have agreed that they should be identified as bodies which already have many of the characteristics of

agencies, and therefore do not need major structural reform to fit in with the Next Steps approach, although they will not necessarily be formally identified as agencies.

4. HMSO was one of the twelve initial agency candidates mentioned in the Prime Minister's statement on 18 February. A firm decision on this will have to await the outcome of the current privatisation review, but if it is decided that HMSO should remain with the Civil Service for the time being it should be possible to move to agency status quite quickly.

5. All the remaining units mentioned in Mr Harris' note are with varying degrees of enthusiasm and with differing timescales willing in principle to be considered as candidate agencies, on the understanding that they will retain control over how and when decisions should be publicly announced. Three of them - the Royal Mint, the National Investment and Loans Office and the Paymaster General's Office - are firm candidates in the sense that we believe them to be prima facie suitable for agency status, subject to the further detailed analysis required by the Guidance Notes agreed by Cabinet. Of these, the Royal Mint is the strongest candidate for early conversion though, if you agree, I shall need to have a word with the Deputy Master to reassure him that no radical change in his trading status is contemplated. Another five - the Department for National Savings, the Central Office of Information, the Government Actuary's Department, the Chessington Computer Centre and the Civil Service Catering Organisation - are strong possibilities which we propose to put into the "currently being examined" category. Finally, the Registry of Friendly Societies is a slightly more remote possibility, and one which we propose to classify as a "possible future idea".

6. If you are content with this way of proceeding - which does not finally commit us to any or all of these bodies becoming agencies - we will arrange to let the Project Manager know so that the numbers involved can be reflected in his forthcoming summer report to Ministers on progress. This will not, of course, identify individual agency candidates other than those already announced.

P E MIDDLETON

MANAGEMENT-IN-CONFIDENCE

FROM: L J HARRIS
DATE: 30 June 1988

SIR PETER MIDDLETON

cc Mr Anson
Mr Phillips
Mr Luce
Mr Turnbull
Mr Kelly
Mr C D Butler
Miss Peirson
Mr R I G Allen
Mr Culpin
Mrs Lomax
Mr Peretz
Mr Watts
Mr Welsh

NEXT STEPS CANDIDATES: CHANCELLOR'S DEPARTMENTS

We agreed at your meeting on 19 April that, in conjunction with the Expenditure Groups concerned, I should discuss with the head of five departments reporting to Treasury Ministers the possibility of their being put forward as firm candidates for agency status. The five - which I shall refer to as Chancellor's departments, though that is not strictly accurate in some cases - were the Department for National Savings, the Royal Mint, the National Investment and Loans Office, the Paymaster General's Office, and the Chessington Computer Centre. I have now completed my round of consultations with these bodies, and the relevant parts of this report have been agreed with each of them and with the expenditure division concerned.

At the beginning of June, the Project Manager's team wrote to all departments asking them to analyse their activities under the broad headings of the initial 12 agency candidates announced by the Prime Minister on 18 February; other firm candidates (even if only identified internally); other agency candidates currently being examined; possible further ideas; and activities unlikely ever to become an agency. OMCS asked for each category to be broken down to show its name, function, staff numbers involved, and target dates for decisions in principle on agency status and, where appropriate, for implementation. This information is needed as background to Mr Kemp's first progress report to the Prime Minister, though he has promised not to make use of it publicly without the originating departments' agreement. Our response will need to cover the five candidates mentioned above, plus COI, CCTA, CISCO, GAD, RGPD, and the Registry of Friendly Societies, together with a brief note on why other parts of the departmental Treasury are unlilkcly ever to be suitable for agency treatment. The Revenue Departments will be putting in their own response, along the lines of the recent submissions by their Chairmen to the Chancellor.

The general reaction of the five Chancellor's Departments to whom I have spoken is that all of them are willing to be converted into agencies, though most of them are not convinced that it will make much difference to them in practice, but that, with the exception of Royal Mint, they would, for varying reasons, like to postpone implemention for a year or two.

The Deputy Master of the Royal Mint is not very enthusiastic about the prospect of becoming an agency, principally because he finds difficulty in seeing any real benefits for his department in that approach. He accepts, however, that the Mint already has all the characteristics and most of the administrative machinery identified in the Next Steos report and the Guidance Notes. He is willing to be put forward as a candidate, provided that that does not lead to the Mint being given a higher public profile than it has at the moment; he takes the view that the Mint is a highly successful commercial and industrial undertaking, and that its operations could only be adversely affected if it were to become the object of political controversy. He would not want the Mint's corporate plan to be made available for discussion, much less approval, by the TCSC or any other Parliamentary body, and he would need an assurance, which I have already given informally, that the Mint's operations would not be subject to monitoring by the OMCS project team. He thinks that there might well be a case for giving the Mint public corporation status or converting it into a wholly owned plc; but he would in any case want the policy and resources framework to give him the maximum possible freedom to develop and expand within sound commercial principles. He is broadly content with the existing pay regime for the general service support grades, but would want discretion to offer competitive rates of pay within his agreed pay bill to specialist craft, IT and marketing staff.

There will clearly be a need for a good deal of detailed discussion about the precise status of the Mint as an executive agency and about the managerial freedoms to be built into the framework, but I think that the organisation is already close enough to the agency concept for you to recommend the Mint to the Chancellor as a firm candidate for the second tranche, with a target date for implementation of April 1990 at the latest. But in view of Mr Garrett's reservations, Mrs Lomax has suggested, and I agree, that it would be as well for you to have a personal word with him about the proposal before any firm decisions are taken.

The National Investment and Loans Office is already, in the non-technical sense, an executive agency of government, with its own Accounting Officer and no responsibility for policy advice to Ministers. Its Director, Mr Peattie, is happy for the Office to be put forward as a candidate agency, but would like a year to 18 months to work up a more detailed management system with clearly identified long term aims and objectives as a basis for a framework to be approved by the Economic Secretary. Two areas which will require attention are staffing, where the small complement of 49 staff makes it essential to co-operate with other departments (and, in future, with other agencies) in recruitment and career management, and the difficulty of drawing up a corporate plan for an organisation whose operations are so closely dependent on future monetary policies.

I recommend that NILO should be identified as a firm candidate with an implementation date of January 1990.

The Paymaster General's Office operates a wholly executive banking and payment service, and the Assistant Paymaster General, Mr Andrews, agrees that eventual conversion to agency status could be appropriate. There are, however, three reasons why he considers that the change should be postponed for about 3 years. First, PGO will soon be embarking on a major relocation study which is likely to tie up for at least a year the very limited management services resources on which Mr Andrews would have to rely for setting up the framework. Second, the top three managers in PGO, including Mr Andrews himself, are all due to retire in the course of the next 2½ years. Mr Andrews, I think rightly, feels that launching the Office on the agency course should be the responsibility of the new management team, though he agrees that he should aim to have the whole package ready for implementation as soon after the handover as possible. Third, the PGO are considering moving to a repayment basis for their services. If that happens, they would want to have the new system up and running before they took on any structural changes.

The main problem to be addressed in the framework would be the PGO's acute staffing difficulties, caused by the twin pressures of the business expansion taking place in Crawley and the attractive job opportunities offered by Gatwick Airport, but the chance would also be taken to iron out with the Treasury and the Bank of England other administrative obstacles to improved efficiency.

I recommend that PGO should be identified internally as a firm candidate now, with the reservation that planning for the change cannot begin before the end of next year, leading to possible implementation during 1991, the precise timing depending on the outcome of the other reviews mentioned earlier.

Very few members of DNS are involved in policy advice. But the policy involvement of the Director and a few others is in highly sensitive areas - funding policy and interest rates - and moves in this constantly changing area can have big and sudden consequences for workload and service delivery.

The majority of DNS staff are located in areas where problems of recruitment and retention are minimal, and the Director accepts that in principle DNS meets the main criteria for agency status. He does not think that the change would yield any major benefits in terms of the more efficient delivery of services. He is sure that there will be scope for improving corporate planning for National Savings now that the funding policy prospects are becoming rather clearer, but this is not necessarily linked with agency status. Mr Patterson would, however, be extremely reluctant to go public on any decision to turn DNS into an agency this year. The disappearance of the PSBR has led to renewed apprehensions among the staff of DNS about the Department's future role, there is a risk that some members of the Trade Union Side would exploit fears of privatisation, job losses, and lower rates of regional pay despite Ministers' assurances to Parliament that the Government has no such plans. An early announcement of the intention to move to agency status would be seized on by the activists as evidence that much more radical changes were in the offing, and Mr Patterson's strong preference would be to let the new situation in which DNS finds itself settle down until after the next Budget and the next review of the Department's corporate plan. By that time, some of the early agencies will be in operation, and it should be evident that some of the wilder allegations of the mischief-makers about the Government's true intentions are without foundation. He and the Treasury would also like to get some decisions about the Ordinary Account out of the way first (late in 1988) so that these could not be blamed on agency status.

In these circumstances, I recommend that DNS should be put into the OMCS category of candidates currently being examined, with a target decision date of June 1989 and a change to agency status, if agreed, in April 1990. I should add that Mr Patterson sees no scope for setting up agencies within DNS.

The Director of the Chessington Computer Centre agrees that the Centre could be converted into an agency with minimal changes to the existing arrangements. However, he takes the view that this would do nothing in itself to improve the efficiency of his organisation; indeed, the introduction of formal corporate planning and the duplication of some of the services now provided by EOG could well increase its workload to no obviously good purpose. In order to achieve the release of managerial energies postulated by the Next Steps report, he would argue for more fundamental changes to be incorporated in the framework. These would include freedom to hire, fire and pay staff the local rate for the job, going beyond the flexibilities now being introduced, including inducements for some high fliers to join the Centre. He would be looking for exemption from the gross running cost control regime, coupled with putting all the Centre's customers on a full repayment basis, and some further relaxation of the annuality rules. It might make sense to give the Centre its own administration vote, or even to consider establishing it as a trading fund. Mr Edwards will be developing these and related ideas in a "shopping list" paper which he will be submitting to you through Mr Butler. In the meantime, he would prefer not to commit the Centre to being a firm agency candidate and would in any case want to avoid implementation coinciding with the throes of the current computer replacement which will not be completed until the early part of next year.

Chessington are already on a development path which will take in most of the questions that need to be considered before making the decision on Agency status. The Business Plan required for the current study into computer replacement followed by the Autumn Review into Fees and Charges will create some of the basic building blocks for a corporate plan. These together with reviews of performance measures, organisation, management and financial systems, and net running costs would enable Chessington management to make a recommendation.

Given these reservations, I think that the Centre should go into the "being currently examined" category, with a target decision date in Spring 1989. Timing of the change would have to await the completion of the fuller review.

That leaves the other Chancellor's departments listed in paragraph 2 above. The Revenue Departments are a special case because of their size and their statutory position, and as noted above both Chairmen have already put their own submissions to the Chancellor suggesting that the two departments should be listed in a separate category as already having most of the agency characteristics, but with no commitment to formal conversion to agency status.

On the basis of the response of the Chancellor's remaining departments to the OMCS enquiry, I suggest that they should be categorised as follows:

Currently being examined:

Central Office of Information
Government Actuary's Department
Chessington Computer Centre
Civil Service Catering Organisation

Possible future idea

Registry of Friendly Societies

Unlikely to be suitable:

Rating of Government Property Department

Central Computer and Telecommunications Agency.

PP L J HARRIS

Dictated and seen by
Mr Harris but signed in
his absence

NH8/28Jo

UNCLASSIFIED

Ch/

PMP

PEM is rather keen to retain this first para, and has asked why you would prefer it dropped. I said I thought it would tend, if anything, to lead the Committee to ask questions/make points about general economic policy, which would not be helpful. But I would ask you again.

JT 5/7

FROM: J M G TAYLOR

DATE: 4 July 1988

PS/SIR PETER MIDDLETON

cc Mr Anson
Dame A Mueller
Mr Phillips
Mr C W Kelly
Mr L Harris
Mr Luce
Mr Turnbull
Mr C Welsh
Miss C Evans

TCSC INQUIRY ON NEXT STEPS: 6 JULY

The Chancellor has seen your minute of 1 July.

2. He is content with the opening statement which Sir Peter proposes to make - though on balance he would be inclined to omit paragraph 1 (and, consequently, the phrase "in line with this over arching objective" in paragraph 2).

Passed on to PS/PEM

JT 6/7

JT

J M G TAYLOR

Right. It will/may lead them to ask questions about the current trend of inflation & money GDP, wh. we cd do without, not least in the wake of the PX Cabinet.

Rt X!
PEM [illegible]

MANAGEMENT IN CONFIDENCE

pp

FROM: E P KEMP
DATE: 14 July 1988

Ch/ Just arrived.
We will circulate as necessary on Monday

1. SIR ROBIN BUTLER

2. MR WICKS

NEXT STEPS

I attach my first report as Project Manager.

2. Since my appointment in February I and my team in OMCS have made good progress in implementing this policy. I can now report that so far:-

- the first Executive Agency (the Vehicle Inspectorate of the Department of Transport) will be established on 1 August 1988. There are 28 further publicly named candidates covering (with VI) about 170,000 staff. The biggest is the Social Security operation. I expect 4 Agencies to have been set up this year.

- I have made a detailed examination with Departments of further possibilities, and about 37 more activities, covering about 50,000 staff are being considered, with more to come;

- there is agreement in principle to greater financial flexibilities for individual Executive Agencies, and discussions are continuing over pay (including performance pay) developments, and more devolvement and improved delegations to managers. All these are fundamental to improving performance and getting the right results.

- an action plan has been established to reorient training and career management in the direction indicated by Next Steps.

3. This work confirms my preliminary personal view given to the TCSC in May that it is practicable to envisage that over the next 10 years

some three quarters of the Civil Service will be organised in Executive Agencies, and that improved value for money and increased efficiency, for the benefit of the public, taxpayer and staff, are in prospect as a result.

4. My programme for the next six months includes the following :

- setting up those Executive Agencies due to be established before the end of the year and putting target dates on the further firm possibilities that have been identified;

- scrutinising the remaining Departments or parts of Departments in conjunction with Departmental management to identify the full range of possibilities and to establish timetables. Particular attention will be given to Ministry of Defence, and to the Inland Revenue and Customs and Excise, which in their different ways present special issues;

- refining and putting into practice the financial flexibilities which have been agreed in principle with the Treasury, and pursuing pay and personnel flexibilities, including appropriate performance pay schemes;

- implementing the action plan on training which has been agreed with Departments, including a review by Departments of their current training programmes;

- setting up ways of evaluating the benefits of the initiative, both overall and at individual level.

5. I shall make another progress report at the end of this year which will also set out my programme for the first six months of 1989.

6. Looking ahead, I hope that by this time next year more than a dozen Agencies will have been set up and that work on many others will be

2.

well advanced. Departments will have reviewed all of their remaining activities and set a firm timetable for establishing other Agencies where it is practicable to do so. The main across-the-board issues will have been settled. An improved training programme will be well under way. We should have an initial evaluation of the results being achieved by the early Executive Agencies.

7. It is proposed that the Minister of State Privy Council Office will before the Recess lay before Parliament a progress report on the lines of the draft written Answer below.

8. I am copying this minute and the attachments to the Private Secretaries of Members of the Cabinet, the Attorney General, the Minister of State Privy Council Office, the Minister for Overseas Development and Sir Robin Ibbs.

E.P.K.

E P KEMP

DRAFT QUESTION: To ask the Minister for the Civil Service, what progress is being made with the Next Steps initiative, and if he will make a statement.

DRAFT REPLY: Following the Prime Minister's announcement of 18 February, the Project Manager and his team have been working on the implementation of this initiative.

2. The purpose of Next Steps is to improve management in the Civil Service. The main element is the establishment of individual Executive Agencies to carry out executive functions. 12 initial candidates were listed in February and a further 17 candidates have since been announced, including the DHSS Social Security operations. In total these 29 activities cover over 170,000 people.

3. My rt hon Friend the Secretary of State for Transport is today announcing that he is establishing the Vehicle Inspectorate within his Department as the first Executive Agency, with effect from 1 August 1988. We expect that the next will be the Companies Registration Office, DHSSs Resettlement Units, and the Employment Service. Work on the other candidates is progressing well and at the same time Departments are considering with the Project Manager the rest of their operations in line with the Government's acceptance of the recommendation that to the greatest extent practicable the executive functions of Government should be carried out by Agencies.

4. Establishing Agencies is only part of the task. The Project Manager has drawn up an action plan in conjunction with Departments aimed at reorienting training and career management, so that staff are properly trained and experienced in the management of the delivery of services. At the same time attention is being paid to the scope for giving greater personal responsibility to managers throughout the Service, including the scope for increased financial flexibilities and devolvement in pay and personnel matters.

5. I shall make a further report to the House before the end of this calendar year.

pay2.rs/KC/62

CONFIDENTIAL

PMP

FROM: C J A CHIVERS
DATE: 15 JULY 1988

1. MR KELLY cwk 15.7.

2. PAYMASTER GENERAL

I endorse these recommendations. In our view the HMSO proposals make considerable sense whether or not they are privatised. A decision about privatisation is, however, probably necessary before the report is published, since that could affect the way it is handled. A separate submission on this is coming forward through Sir Peter Middleton early next week.

cc PS/Chancellor
PS/Chief Secretary
Sir Peter Middleton
Mr Anson
Dame Anne Mueller
Mr Phillips
Mr Harris
Mr A J C Edwards
Dr Freeman (personal)
Mr G Jordan
Ms Seammen
Mr Strachan
Mr Wood
Mr A S Jordan
Mr Partridge

Mr Kemp (OMCS)

Mr Dole) HMSO
Mr Lynn)

HMSO RESTRUCTURING PROJECT : PAY AND GRADING PROPOSALS

As you know, work is in hand on the possibility of privatising HMSO, and advice will be coming forward on that shortly. Meanwhile HMSO have been considering, with the help of consultants, how they might re-cast their pay and grading structure in order to become more efficient. You discussed their ideas with HMSO management and with the consultants (MCP) in May. These are changes which HMSO would want to make whether or not they remained in the public sector: they are seen as essential to HMSO's long-term survival as a competitive business.

2. HMSO will be submitting their report to you, and releasing it to their unions, before the end of this month. Its proposals will be of some importance:

(a) because they are radical and far reaching, and raise potential difficulties on the industrial relations front; and

(b) because they may to some extent set a pattern for other Ibbs agencies of a trading character.

3. The Treasury (LG Division) has been represented on the steering group overseeing this review, and latterly we have had some more formal exchanges with HMSO about the pay and grading proposals. Nevertheless they will be published on HMSO's authority, and the Treasury will not be committed to them.

The proposals

4. The central proposal is that all the non-industrial grades below the Controller should be transferred to a pay spine (somewhat like the IPCS spine). Existing grades would be abolished, jobs re-defined and each job positioned afresh on the pay spine by reference to its job weight. All the re-defined jobs would be advertised, and existing HMSO employees would have to apply for them. This procedure would be carried out progressively division by division throughout the organisation, with the aim that at the end of it - in about 3 years' time - after a period of voluntary staff rundown there should be a manageable number of eventual redundancies.

5. The pay scales to which staff would be assigned on the new spine would vary in length, ranging from only three full increments at the bottom to seven increments at the top. **All progression up these scales would be performance-related.** HMSO management would want to use the pay spine flexibly to respond to skills shortages and to reward certain staff for acquiring qualifications. They would also want to be able to pay performance bonuses to staff at all levels.

Purpose of the change

6. HMSO say that they find the present structure of civil service grades too restricting. There are too many management levels, and there are rigidities which prevent them from organising their work as efficiently as they could. They would

like to be able to offer incentives, for example, to people at EO level short of promoting them to HEO. They believe that there are substantial savings to be achieved from a more streamlined structure, in which fewer people are paid rather more and are more fully stretched to maximise performance. It remains to be seen, of course, how successfully the projected savings can be achieved in actual negotiations; and the scheme will have to be abandoned if the balance of advantage turns against them.

<u>Negotiability</u>

7. HMSO want to proceed by consent with the unions. They say that their local unions, who have been kept in touch with the review in general terms, are sympathetic because they realise that some such reform is essential to HMSO's longer-term survival. Although there will be some job losses, the plan offers the prospect of increased pay for those who remain and who undertake increased responsibilities and achieve greater efficiency. HMSO say that they will not make the changes, section by section, unless it can be shown in each case that there will be a financial saving as a result. The overall target is a saving of £1 million a year to start with, with further gains coming through later.

8. If the local unions are prepared to go along with these changes it will put the national unions (with whom negotiations will have to be conducted, at least initially, by the Treasury) in a very difficult position. If one of them, say the NUCPS, were to hold out against the changes on doctrinaire grounds it would run the risk of losing its members to the others (most probably the IPCS, which we imagine would be glad to take over the management of the whole agreement). If, on the other hand, <u>all</u> the unions concerned at national level were to be opposed, it is conceivable that the local trade union side might wish to go its own way. It is impossible to be certain, but our guess would be that while the initiative will cause the national unions some distress in the end they may choose to let the matter go, consoling themselves with the thought that HMSO is only a small organisation - 3000 non-industrials - and not central to the civil service.

Control of the paybill

9. We have been particularly concerned that a departure from normal civil service pay and grading arrangements should not lead to a loss of control over the paybill. We have an outline agreement with HMSO about that, but the details of the control procedures need further working out.

10. Our intention is that each year, in the context of HMSO's corporate plan, we should determine their total paybill for the coming year as a control figure within which they would have to operate. The increase in the total paybill allowed would provide for pay rates to be increased, within what HMSO can afford, on average in line with what was happening elsewhere in the civil service, modified as necessary to take account of HMSO's specific recruitment and retention position. But within the total approved HMSO would be able, subject to certain rules and guidelines, to give larger or smaller increases to certain groups and to allocate a proportion (which could be linked to their corporate results) to performance bonuses.

11. If HMSO is to be privatised in due course these problems will disappear and the arrangements which we are devising at the moment can be seen as merely transitional.

Mobility

12. We have also been concerned that if HMSO draws away from the rest of the civil service in pay and grading it will inhibit transfers to and from other Departments. But on closer examination there does not seem to be much of a problem here. Movements are in practice very limited; and so long as HMSO are applying common grading standards the occasional transfer can be arranged without too much difficulty even if the grades are different.

Conclusion

13. We believe that HMSO's proposals have much to commend them:

i. it would be a "flexible pay" system, with a strong emphasis on performance pay;

ii. HMSO managers have a very clear desire to make these changes in the interest of the business, not because they see it as a way of increasing pay rates for their staff;

iii. the local trade unions seem likely to be favourably disposed, understanding that these changes are essential for the survival of HMSO;

iv. HMSO is a relatively small and specialised organisation which is in a sense on the periphery of the civil service, so that we do not have to be too worried about pay repercussions; and

v. we shall be aiming to establish a framework of overall paybill control, but with flexibility as to the distribution of pay increases within that overall total, which could be a useful model for other candidate agencies of a trading nature in due course.

14. On balance we believe that this is an initiative worth taking and that the risks are manageable. We recommend you to agree that HMSO should go ahead and publish their report. The intention is that it should be submitted to you and released to the unions, both locally and nationally, on the same day. We - or HMSO - will advise you of the date of publication, and we shall cooperate in preparing briefing for the occasion.

KIT CHIVERS

pup

HMSO - OUTLINE CONSIDERATIONS OF PRIVATISATION FEASIBILITY

INTRODUCTION

1. The object of this paper is to consider the feasibility, costs and benefits of privatisating some or all of the operations of HMSO and to identify some of the principal issues to be determined in this context. It is prepared in the context of HMSO's plans for moving to Agency status under the "Next Steps" developments which were announced in February 1988 when HMSO was identified as a candidate.

2. The paper does not address the means of privatisation, nor does it attempt to put a firm value on the business. These are both matters which will obviously need to be addressed if a decision in principle is taken to explore further the possibility of privatisation. It is likely that privatisation is not an immediate prospect and that a period of several years is needed to enable HMSO to take action to maximise potential sales proceeds and to influence the most appropriate means of privatisation.

3. The scope of this review has been extremely limited, both because of limitations as to available time and because of the need to preserve confidentiality.

4. The remainder of this paper is arranged as follows:

Main report - Consideration of the main features of the business in outline and discussion of the privatisation issues

Appendices

1. Summary profit and loss accounts and balance sheets
2. HMSO
3. Supply division
4. Print procurement division
5. Production division
6. Publications division

Potential for privatisation

1.1 There are 2 principal tests to be considered in determining whether or not a body is capable of privatisation:

i. Commercial viability - The body must be capable of operating profitably in the private sector when freed of both the restrictions and protection offered by its public sector role.

ii. Public interest - a) There are certain activities (generally with security implications) where the close control of government is essential to the integrity of the operation.

b) There are other areas where although there are not the same considerations as (a) above, the public interest is not best served because of the effect on the public sector of privatisation.

1.2 The 4 operating divisions of HMSO have been separately assessed against these 2 criteria (see appendices 3-6) and the position may be summarised:

1. Commercial viability -

Capable of privatisation - 1. Supply division
2. Print procurement division
3. Publications division (only after restructuring relationship with customers)

Marginal - Production division - currently unprofitable and even after a return to profitability likely to be of relatively low value.

2. Public interest

Capable of privatisation - 1. Supply division; 2. Print procurement — Only if selling prices are raised to commercial levels prior to privatisation to ensure that profitability and thus proceeds are maximised

3. Publications division - Publishing
- Bookshops

4. Production division - Edinburgh Press

Uncertain - Production division - Hansard Press
Parliamentary Press
Manchester Press

Doubtful - Production division - Macaulay Press

Publications division - Crown Copyright

Although the above analysis suggests that a substantial proportion of HMSO is capable of privatisation there are a number of detailed considerations and action required before such prospects can become a reality. These are summarised below:

Customer reaction

1.3 HMSO is dependent on a very small customer base and, while action can be taken to extend this, it is likely to continue to be so dependent, at least initially, on privatisation. The reactions of those customers to a privatised HMSO is therefore critical to the prospects for a successful privatisation. The majority of HMSO's customers are not currently obliged to purchase from HMSO and some have carried out investigations into whether HMSO provides best value for money. These investigations have generally resulted in HMSO retaining the business. In theory, therefore, if a privatised HMSO can maintain or improve quality of service and continue to keep prices below those of the competition, it should be able to retain the majority of its existing customer base. It is possible however that on privatisation government departments will not be able to continue delegating responsibility for observing public procurement regulations. The Treasury has written to the European Commission on this point in connection with the privatisation of The Crown Suppliers. No response has yet been received. It seems reasonable to assume that the ruling for The Crown Suppliers is likely to be applicable to HMSO. It is impossible to predict what effect this, together with the change in perception of departmental purchasing officers towards a privatised HMSO, will have. It is, however, likely that departments' current ability to rely on HMSO to fulfil all public procurement obligations on their behalf is a significant factor in many customers decisions to rely on HMSO. In the extreme case, government departments might decide to centralise public purchasing in this area and, in effect, create a "son of HMSO". A purchaser may well look for assurances that this will not happen. Consideration is also required as to whether government purchasing rules will allow departments to obtain the majority of their requirements in the areas of HMSO's business from a single private sector source.

Supply division

Background

1.4 Turnover of the supply division over the last 4 years has been:

	£m External	£m Internal	£m Total
1984-85	127	23	150
1985-86	151	22	173
1986-87	163	24	187
1987-88 (unaudited)	165	26	191

1.5 The principal activity of the Supply division is the supply of paper, paper products, stationery, office machinery, typewriters, photocopiers and microcomputers. The division is in the middle of the spectrum of supply to government between 3 agencies, the other 2 being The Crown Suppliers for furnishing and CCTA for systems.

Assessment

1.6 i. The division currently supplies stationery to its major customers at prices averaging around 12-15% lower than they would otherwise be able to obtain. On privatisation the division will set its prices at the highest possible level commensurate with not losing its major customers. It is not possible to predict what this price might be but it is likely to be less than 12-15% lower than the competition. Public sector customers are likely to have to pay higher prices. This can only be justified if the potential of the division to increase profitability is fully reflected in the price achieved on privatisation.

ii. The possibility of a Monopolies and Mergers Commission reference cannot be ruled out.

Print procurement division

Background

1.7 Turnover of the print procurement division over the last 4 years has been:

	£m External	£m Internal	£m Total
1984-85	94	29	123
1985-86	93	30	123
1986-87	113	30	143
1987-88 (unaudited)	116	30	146

The principal activity of the Print Procurement division is the purchase of printing, binding and related products for its customers. The printing industry is extremely fragmented: it is estimated that some 75% of all firms in the industry have fewer than 100 employees. The division considers that its expertise (print buyers are recruited on the strength of their experience of the printing industry) and knowledge of some 3000 printing firms enables it to obtain far better terms for its customers than they could for themselves in an industry where the difference between the highest and lowest quotations for a job can be several hundred percent.

Assessment

1.8 i. As 1.6(i) above. It is even harder to analyse the effect on both the profitability of the division and the additional costs to the public sector of privatising the Print Procurement division. The activities of the division are virtually unique and it is therefore extremely difficult to establish market prices for its services. If privatisation proceeds are to be maximised it is even more important for this division to have established its ability to operate within the private sector.

Production division

Background

1.9 Turnover of the Production division over the last 4 years has been:

	£m External	£m Internal	£m Total
1984-85	5	24	30
1985-86	5	23	28
1986-87	4	24	28
1987-88 (unaudited)	4	25	29

External turnover is in respect of reprographic services provided to departments which make a modest contribution to operating surplus. The majority of the division's business is internal for the Publications division.

1.10 The division operates 5 presses, of which 4 are specialised:

i. Hansard Press (prints House of Commons Hansard to very tight deadlines)

ii. Parliamentary Press (prints other Parliamentary material such as Order papers, Bills etc)

iii. Macaulay Press (classified work - principally the Budget and also work for MOD and FCO)

iv. Manchester Press (security printing of items of potential monetary value such as passports, giro cheques and pension books)

v. Edinburgh Press (database and general printers)

With the exception of the Edinburgh Press, all are relatively new, purpose built presses. Prices are agreed on the basis of comparable trade prices.

Assessment

1.11 i. The division is almost wholly dependent on the Publications division for its business. Although this does not necessarily eliminate the privatisation option, it does severely limit the potential proceeds. One possible benefit of privatisation would be to enable the Presses to tender for private sector work at times when the presses would otherwise be idle (for example, the Hansard Press during the day and during Parliamentary recess).

ii. The division is currently loss making but is forecast to move into profit by 1989.

iii. Much of the division's activities are of a nature where public interest considerations are relevant. In particular, the Macaulay Press handles classified data and its staff require positive vetting. There do not appear to be any reasons why privatisation could not be considered on a Press by Press basis.

Publications division

Background

1.12 Turnover of the Publications division over the last 4 years has been:

	£m External	£m Grant	£m Total
1984-85	39	6	45
1985-86	43	4	47
1986-87	43	4	47
1987-88 (unaudited)	43	4	47

Government grants are made to subsidise two commercially uneconomic activities:

a. Production and sale of Hansard at substantially less than full cost; and

b. Sale of HMSO publications to public libraries at half the published price

1.13 The Publications division provides a service to departments which wish to publish information to the general public. It differs from a commercial publisher in that, although it takes the commercial risks, it does not have editorial control over contents and cannot always reject material for publication if it considers publication to be uneconomic. HMSO is obliged to publish any matter which is in pursuance of a statutory requirement but does have more discretion with other material. Unlike commercial publishers HMSO does not generally commission work, although if market opportunities are identified these will be pointed out to the relevant bodies.

1.14 Publications are priced to achieve the objective of breaking even over certain groups of publications, some of which (especially Parliamentary items) are priced at scale rates. This results in a substantial cross subsidy between publications.

1.15 The division is involved in 2 other activities:

i. Retailing

ii. Crown copyright

Retailing activities are carried out through 6 dedicated bookshops in major UK Cities. The shops sell only HMSO publications and a few publications of other "public bodies". They are currently profitable, although they receive greater discounts than the trade as it is considered that they provide a more comprehensive service to the customer (for example stocking a far wider range of titles).

1.16 Crown copyright is vested in the Controller personally. The copyright covers any work originated by a Crown Servant or commissioned by the Crown. Copyright fees are generally charged on a flat fee basis but sometimes on the more common royalty basis, generating income of £0.5m per annum in total.

Assessment

1.17 i. The existing relationship between government customers and the Publications division would have to change so that departments take the commercial risk and costs of the majority of its publications. The publisher would then act as agent for the department charging a percentage of selling price as remuneration for the service. The Publications division would be required to compete for such work with the private sector.

ii. The position of the grant-subsidised activities needs to be considered. It would be possible to continue making grants to the division after privatisation, but it may be preferable to make them, if necessary, to the ultimate purchasers (the majority of whom are in the public sector).

iii. It is probably not appropriate that Crown Copyright should be privatised. The relationship between HMSO and Crown Copyright will probably require greater formalisation, but there is no reason why a publicly-owned Crown Copyright should prevent privatisation of the remainder of the division. The Crown Copyright is itself an extremely valuable asset. For example, by agreement between HMSO and Ordnance Survey, the latter is allowed to retain income of £8-9 million per annum in respect of the Crown Copyright.

Methods of privatisation

1.18 There are generally 3 potential methods of privatisation:

i. public flotation

ii. management buyout

iii. private trade sale

In addition it will be necessary to decide whether the business should be sold as a whole or whether the constituent parts should be sold separately.

1.19 For public flotation to be a realistic option the elements to be privatised must be able to demonstrate a 5 year trading record (or 3 for the Unlisted Securities Market) and be prepared to incur considerable professional and marketing costs in the process. In the short term therefore this is clearly not a viable option. In the longer term however it might be feasible. HMSO is an established name and if the commercial potential of the business can be translated into bottom line profit then the overall value of the business may be adequate to justify the costs. If flotation is the chosen option it will probably be preferable to sell the business as a whole.

1.20 A leveraged management buyout generally requires 3 conditions:

i. strong management

ii. positive cash flow to service substantial debt costs; and

iii. asset backing to provide security for loans.

The option for a management buyout should not be discounted but it would probably be difficult for management to put together a package for the business as a whole. Some individual elements, such as the Presses or the bookshops where there is asset backing might be amenable to such action.

1.21 By far the most likely option in both the short and longer term is a private trade sale. This should probably be by tender to ensure the best price is obtained. It may not be necessary to prejudge whether the business should be sold as a whole or in its constituent divisions (or parts thereof). Tenderers may be allowed to bid for any or all of the divisions and the final decision can be taken on the basis of such bids. The Supply and Print Procurement divisions may well be attractive as a combination since they generally serve the same customer base and the publications and production divisions also have a measure of "fit" which may be attractive to purchasers. Some larger companies may be interested in the whole since it will give them a very strong entree to the public sector and allow them the possibility of adding to the range of services offered.

1.22 The question of whether HMSO can be privatised without enabling legislation has not yet been considered in detail. Again, it seems reasonable to assume that, since HMSO has the same legal status as The Crown Suppliers as a trading fund, the same considerations are likely to apply. This would suggest that legislation will be required in order to avoid high transfer costs.

Pre-privatisation steps

1.23 If a decision in principle were taken that the privatisation option should be pursued seriously, it is still likely to be several years before sale can be effected. There is much that can be done during that period to increase the chances of successful privatisation and maximise the proceeds. The objective of such action should be to restructure HMSO as far as possible along the lines on which it would operate in the private sector. These steps include:

1. Organisational restructuring

2. Refocussing targets

3. Changing the financial relationship with departments sponsoring Government publications

1.24 HMSO is already organised on a largely free-standing divisional basis, although it would assist the sale process if financial accounts were prepared on a fully divisional basis so that a potential purchaser of a division could identify more easily the working capital requirements of the division. Within divisions, however, the objectives of HMSO have led to significant cross subsidisation between different products and services, for example small order quantities have been subsidised by larger quantities and the more popular Parliamentary publications subsidise the less popular. A private sector company would consider each product or service separately and, where they were not profitable, either take action to take them into profit or cease to supply the product or service. It may not be possible completely to rationalise such activities while HMSO remains in the public sector, but it is vital that they are identified for two reasons, first so that the true value of the profitable activities can be realised on sale and second, so that the products and services that are unlikely to be available from a privatised HMSO can be identified and consideration given as to whether and how such products and services should be supplied in future.

1.25 The business targets of HMSO have differed from those that would apply in the private sector. As a consequence, the reported results of the business, particularly the Supply and Print Procurement divisions, reflect the fact that a substantial part of the benefit of bulk purchasing and HMSO's expertise is passed on to the customer, which would not continue after privatisation. It is vital that these businesses are not sold at the substantial undervaluation suggested by the published results to date. Refocussing business targets towards profit maximisation (which could probably be done by raising the targets set by the Treasury) would ensure that this potential was fully reflected in the trading results and thus in the sale proceeds. HMSO should, if possible, be allowed to compete in the private sector prior to privatisation to establish the extent to which it can penetrate or establish markets there. The greater the evidence available to a potential purchaser that there is a market in the private sector, the greater will be the privatisation proceeds.

Potential proceeds on privatisation

1.26 The major determinants of the value of any trading company are its level of maintainable earnings and their quality. Asset values, while of relevance, are rarely a major factor. Maintainable earnings is the level of earnings which it is reasonable to assume an organisation will generate on its continuing business. It does not include any one off or exceptional items since these are not items which a purchaser could expect to recur. Quality of earnings is generally a function of a company's business activities and represents perception as to the maintainability and potential volatility of earnings. For example, quality of earnings from food retailing will generally be considered better than for commodity trading since the latter is subject to a far greater degree of volatility.

1.27 The reported surplus on ordinary activities before interest paid on long term debt in 1986-87 was £8.5m, the unaudited figure for 1987-88 is £8.0m. It is assumed for these purposes that the NLF debt will effectively be repaid from the proceeds of sale and that the business will be debt free on privatisation. Corporation tax has not been payable in the past but in assessing the value of the business it must be assumed that it will be payable in future. The current average price/earnings ratio in the printing and publishing sector is 15 and the industrial group as a whole 13. Taking the whole business, a purchaser is likely to look for a discount against quoted ratios to allow for the reliance of the business on a very small customer base and the uncertainty over the reaction of those customers to the privatisation of HMSO. If therefore maintainable earnings of £8m (which implies post tax earnings of £5-5.5m) are assumed and a P/E ratio of 10 considered appropriate, a value in the range £50-55m is suggested for the whole business, out of which the amounts due to the NLF would have to be repaid. The amount of the premium on prepayment would be determined by actuarial valuation of the indebtedness at the time of the prepayment. This in turn would depend on the difference between the rate of interest charged on this indebtedness (principally in the range 14-16%) and market rates at that time. At current interest rates the amount of the premium would be substantial.

1.28 However, HMSO has not had profitability as an objective in the past. Considerations of the Supply and Print Procurement divisions in particular suggest that there may be substantial additional potential for profit not currently realised. For example if the Supply Division were able to reduce the amount by which it undercuts its competitors from around 12-15% to around 5% without losing business it would be able to increase its operating surplus by £10m. On the same assumptions as above this would add another £60-70m to the value of the business. Even if the margin by which the division undercuts the competition could only be reduced to 10%, it would still imply an increase in profitability in the range £3-6 million. The current review of staff structures may also identify areas where substantial cost savings can be made without impairing the ability of the business to service its customers. This will also add considerably to the potential value of the business.

1.29 The net asset value of £68m at 31 March 1987 appears, so far as can be determined, to be a fair assessment of the trading value of the assets at that date. This value certainly serves to underpin the earnings basis valuation. That it is higher than the earnings valuation suggests that the return on assets is low and indeed this does appear to be the case since the target is only to achieve a return of 5% on capital employed (in this case there is little difference between historic and current cost capital employed) which is low by private sector standards.

1.30 The analysis suggests a minimum value of £50m for the business as a whole before repayment of NLF debt with a potential value of several times that figure if the profit potential can be unlocked and demonstrated to a purchaser. Several factors must, however, be weighed against this:

i. government customers will have to pay higher prices for supplies in future.

ii. there are likely to be substantial costs in funding a pension fund on transfer to the private sector [very tentative estimate derived from Coopers & Lybrand's report on The Crown Suppliers in the range £85-95m]. This of course would be balanced out by the reduction in the future obligations to pay pensions to the individuals concerned.

Conclusion

1.31 There do not appear to be any insuperable obstacles to the privatisation of much of the business of HMSO in the longer-term. However, if privatisation were attempted in the short term, it is likely that the sale proceeds would be outweighed by pension funding costs (although the latter would be matched by a reduction in liability to pay pensions in future), government departments would have to pay more for stationery and printing supplies; and the Government's objectives in making official information available to the general public would be put at risk. This does not therefore seem an attractive proposition at present.

1.32 Although in the longer term privatisation of much of HMSO's business should be technically feasible, it is a much more open question as to whether privatisation is desirable. In favour of privatisation a number of potential benefits can be cited:

i. Prices charged to customers for supplies would be at commercial market rates. Public sector customers would thus be obliged to consider the most efficient and effective ways of obtaining these supplies and would suffer a greater impact from the consequences of their own inefficient purchasing and stock control procedures;

ii. There would be no risk of the public sector subsidising any private sector customers of HMSO with the benefit of lower than market prices. HMSO has at present very little in the way of private sector custom (principally formerly nationalised industries) but as the privatisation programme proceeds this proportion may increase.

iii. The relationship between the Publications division and its customers would have to be changed so that customers bore more of the commercial risks of publication. This would require that departments become fully aware of the financial consequences of their publications and thus promote greater efficiency.

iv. The Production division would be able to tender for private sector work to utilise spare capacity on some of its specialised presses.

v. HMSO is already examining the ways in which services are cross subsidised within divisions. Privatisation would accelerate this process, ensuring first that all services could justify themselves on a commercial basis and second, that customers were aware of the full costs of the services they purchased.

1.33 As against this, a number of potential disadvantages need to be considered:

i. To enable privatisation proceeds to be maximised, HMSO needs to raise prices to commercial levels prior to privatisation. The traditional concept of a Trading Fund is that it should set its prices at a level sufficient to achieve its financial targets and pass any further benefits on to its customers. Thus in the run up to privatisation HMSO's traditional relationship with its customers will have to be changed and the overall cost of HMSO's services to Government increased. Quite apart from the implications for individual departmental budgets, this might give rise to political controversy.

ii. As a further factor in maximisation of proceeds, HMSO needs to demonstrate at least the potential to operate successfully in the private sector. The operations of HMSO under the HMSO Trading Fund Order 1980 are the supply of its various goods and services to public sector customers and "operations ancillary" thereto. It is a moot point as to whether HMSO can develop significant private sector business while staying within its remit under the Order.

iii. Whilst much of HMSO's business is involved in purely commercial activities, there is an extent to which it acts as a central purchasing agency for its public sector customers, assisting these customers in obtaining best value for money. A privatised HMSO will have as its principal objective profit maximisation and will thus be unlikely to offer impartial advice and, possibly, some of the services (such as equipment testing) currently offered. If such agency functions cannot be retained in the public sector, it is likely that, to maintain efficiency in public purchasing in this area, some form of replacement will have to be established. To some extent the privatisation of The Crown Suppliers will compel departments to face up to this in a similar area of procurement.

1.34 Although privatisation does not appear to be a practical proposition in the short term, action to be taken by HMSO in the next few years will influence the prospects for a successful privatisation in the longer term. If the privatisation option is to be kept open, then action needs to be taken to improve profitability and to restructure relationships with government departments on even more commercial lines. Whether or not the option is to remain open, there is still a great deal that HMSO can do as an executive agency to sharpen up its performance and its relationship with its customers. Work is already underway.

APPENDIX 1A

HMSO - OPERATING STATEMENTS

	1984-85 £m	1985-86 £m	1986-87 £m	1987-88 Unaudited £m
Turnover	263.4	292.3	321.9	330.3
Change in stocks	1.1	1.6	1.1	(2.6)
Government Grants	6.5	4.3	4.0	4.3
Other income	0.6	0.5	0.6	0.6
External income	271.6	298.7	327.6	332.6
Raw materials	36.0	36.8	37.2	39.4
External charges	156.5	183.3	209.9	210.3
Cost of goods and services	192.5	220.1	247.1	249.7
Resource costs				
Staff costs	42.4	41.6	44.6	46.7
Depreciation	2.5	2.6	2.4	3.7
Other charges	22.7	25.1	26.0	24.8
Total expenses	260.1	289.4	320.1	324.9
Operating surplus	11.5	9.3	7.5	7.7
Interest receivable	2.3	2.3	1.0	0.3
Surplus on ordinary activities	13.8	11.6	8.5	8.0
Interest payable	8.9	7.9	7.0	5.9
Net surplus	4.9	3.7	1.5	2.1

APPENDIX 1B

HMSO - HISTORIC COST BALANCE SHEET AT 31 MARCH 1988

	£'000	£'000
Fixed assets		
Intangible assets	420	
Tangible assets	42951	
		43371
Current assets		
Stocks	27214	
Debtors	45380	
Cash at bank and in hand	28563	
	101,157	
Creditors: amounts falling due within one year	(77434)	
		23723
Total assets less current liabilities		67094
Financed by:		
Provision for insurance		6000
Capital and reserves		
National Loans Fund	27682	
Revaluation reserve	3823	
Retained surplus	29589	
		61094
		67094

APPENDIX 2

HMSO

Current activities

2.1 HMSO has 4 business activities:

1. Supply

2. Print procurement

3. Production

4. Publications

All are distinct operations, although there is a significant amount of interdivisional trading between them. Such trading is generally carried out on terms similar to those applying to external sales. The business activities of each division are considered in more detail in sections 3-6, since different considerations apply to the potential for privatisation of each.

2.2 HMSO has 2 external financial objectives as a trading fund:

i. to break even on revenue account after covering all costs, including long-term interest; and

ii. to achieve a return of 5% on average net assets in current cost terms, excluding long-term interest.

In practice it has comfortably achieved these targets and, indeed, has been obliged to do so by the very high average rate of interest (15.25%) on originating debt from the NLF. Any potential profits available to HMSO in excess of amounts required to meet its targets have tended to be returned to its customers in the form of lower prices. In support of this statement it should be noted that indices covering various aspects of HMSO's activities show that relative price changes of HMSO's products are very much lower than those of the commercial sector for similar products.

2.3 External turnover of HMSO over the last 4 years has been:

	£m
1984-85	263
1985-86	292
1986-87	322
1987-88/unaudited	332

Reported operating surpluses have been declining. These surpluses are not, however, analagous to profit in the commercial sense, since HMSO's objectives do not include profit maximisation. Accordingly the current level of operating surplus is of little relevance in considering either feasibility for privatisation or potential proceeds. Summarised operating statements for the last 4 years are attached at Appendix 1A.

2.4 HMSO's customer base is almost exclusively public sector (as defined in the HMSO Trading Fund Order 1980) and predominantly central government departments (approximately 75% of turnover for the supply division and 90% for print procurement) with the remaining customers including local government, health authorities and current and former nationalised industries. The 10 principal customers account for some 68% of total sales of which half is attributable to just two customers (MOD - 20% and DHSS - 14%) The major customers of HMSO as a whole are generally also major customers of each division.

2.5 Although not seeking to maximise profits, HMSO is to some extent in commercial competition. With the exception of Parliament (turnover £13m per annum) no customers are obliged to purchase through HMSO and, indeed, a number of departments have reviewed their arrangements with HMSO in comparison with alternative sources of supply (private sector or own procurement). These reviews have generally concluded that HMSO should remain the supplier, although they have also resulted on occasion in renegotiation of terms. HMSO considers that it can usually procure the best prices for its customers, although on occasion it has not been able to match performance standards of private sector suppliers.

These difficulties have been and are being addressed by investment in the latest technology. Since government departments were "untied" from HMSO in 1982 there has been only a small loss of custom, mainly in areas where the customer itself has been loosening ties with central government (eg MSC, Royal Mint, Patent Office).

Income

2.6 HMSO income is considered on a divisional basis in sections 3-6 below.

Expenditure

2.7 Direct expenditure is charged to relevant divisions. Central corporate services also incurred some £15.4m of expenditure in 1987-88 which was reallocated to the divisions In weighing up the respective merits of privatisation of the whole or privatisation of the constituent parts, it will be necessary to consider the extent to which the central corporate costs can in practice be split between activities.

Assets

2.8 The balance sheet at 31 March 1987 is attached at appendix 1B. The position shown at 31 March is not wholly representative of the general position. Since the majority of its customers operate on the annual cash vote system there tends to be a surge in spending by those customers in the last month or two of the financial year, resulting in a stronger balance sheet at 31 March than is more generally the case.

2.9 Most assets appear to be stated at their trading value. HMSO's land and buildings (net book value £27.9m) are revalued on a rotating basis and the directors consider that there is no significant difference between market value and book value. The intangible asset of £420,000 represents the set up costs of the new Parliamentary Press prior to its opening. These are being written off over 5 years and there have been no additional costs capitalised since 31 March 1987.

2.10 The NLF debt of £34.7m can only be repaid early at a premium reflecting the high interest rate. The real net asset position is thus less than the stated amount of £67.1m by the amount of the premium.

Taxation

2.11 HMSO is not currently liable to corporation tax. On privatisation it would be subject to corporation tax at 35%. On sale to the private sector it would be necessary to establish transfer values for fixed assets for the purposes of capital allowances. The higher these values are, the greater the attraction of HMSO to the private sector since the availability of capital allowances will reduce corporation tax payable on future profits. From the point of view of public revenue this is very much a double edged sword - high agreed transfer values will tend to enhance the price because tax reliefs will be available to a purchaser but will also reduce future tax revenue.

Staff and Pensions

2.12 A consultant's review of HMSO's staff and salary structure is currently in progress and a report is due by June. It is not possible at this stage to estimate what effect such restructuring might have on the profitability and therefore value of the business, but significant improvements in efficiency are forecast.

2.13 HMSO had some 3300 employees at 31 March 1988. The vast majority of these are members of the Principal Civil Service Pension Scheme (PCSPS) which provides benefits which are greater than those generally available in private sector schemes. The PCSPS is not a funded scheme and, if accrued pension benefits of HMSO employees are to be transferred to a private sector scheme, it will be necessary to make a substantial payment to fund such a scheme.

2.14 The following calculations are based on the assumption (which may or may not be reasonable) that the profile of HMSO employees is similar to the sales and marketing division of The Crown Suppliers (TCS) and that it is therefore reasonable to seek an analogy with the calculations made by Coopers & Lybrand of the likely costs in the TCS case. It must be **EMPHASISED** that this estimate is extremely rough and ready and may be significantly different when examined by a qualified actuary. On the assumption that pensionable salary costs of HMSO staff are £38m per annum and tht the profile of employees and other assumptions made in C&L's calculations are valid, this would suggest a funding cost in the order of £85-95m. This would be a one off payment which would be balanced out over time by the reduction in pensions payable by the PCSPS to HMSO employees in future.

SUPPLY DIVISION

Current activities

3.1 Turnover of the supply division over the last 4 years has been:

	£m External	£m Internal	£m Total
1984-85	127	23	150
1985-86	151	22	173
1986-87	163	24	187
1987-88 (unaudited)	165	26	191

The rate of increase has slowed in 1987-88 as the major customers have themselves been cash restricted and the opportunities for obtaining new customers are limited.

3.2 The principal activity of the Supply division is the supply of paper, paper products, stationery, office machinery, typewriters, photocopiers and microcomputers. The division is in the middle of the spectrum of supply to government between 3 agencies, the other 2 being The Crown Suppliers for furnishing and CCTA for systems.

3.3 There are 3 other small but important areas of activity:

i. Laboratory (testing of stationery products to ensure compliance with safety standards and to assess value for money between competing products)

ii. Office machinery testing (similar activities to laboratory for office machinery)

iii. Office machinery servicing (provision of servicing either by third parties or by HMSO own staff in major conurbations).

Of these, (i) and (ii) are treated as overheads (estimated overhead cost £800-900k per annum) and not charged as separate services. The office machinery servicing is run as a recharged service although the third party servicing does run at a loss (unlike the own staff servicing which is profitable).

3.4 Supplies are procured from a wide source of suppliers (of which Rank Xerox with approximately £20m per annum is some 3 or 4 times larger than any others). Although HMSO has no great dependency on any one source of supply, for many suppliers HMSO is the major customer. HMSO is thus able to obtain good levels of discount on standard items which benefits are largely passed on to customers.

3.5 HMSO also ensures compliance with various regulatory requirements for public purchasing:

i. EC/GATT procurement requirements

ii. health and safety standards

iii. the public purchasing initiative

iv. development area status.

v. priority suppliers

vi. small firms policy

3.6 Sales quantities vary significantly, depending on the overall requirements of the customer and ordering frequency. In the past, large orders have tended to subsidise small orders which carry a much higher proportionate cost. HMSO is moving towards a system of charging small order supplements in an attempt to reduce the proportion of small orders (approximately 15% of current orders are for less than £20).

Competition

3.7 Potential competition for the Supply division comes from 4 sources:

i. private sector suppliers;

ii. customers;

iii. manufacturers.

iv. a privatised TCS (see 3.18).

There are relatively few private sector companies which operate in this field as "middlemen" in the same way as HMSO. Those that do (which include Cartwright Brice and Chapmans) are principally sales based organisations and provide few, if any, other services. Relative to HMSO, the scale of activities of these companies is minor. The principal "competition" is reckoned to be the scope for customers to purchase direct from manufacturers and for manufacturers to sell direct to customers.

Strengths and weaknesses of current operations

3.8 The principal strength of the Supply division at present is its purchasing power which enables it to sell products to its larger customers at an average of 12-15% below the prices they could obtain elsewhere. Prices to smaller customers which would not have the same ability to negotiate discounts with commercial suppliers may be further below market prices. Other advantages include the testing facilities which provide quality assurance and enable identification of vfm and compliance with public purchasing regulations. In the past poor response times have lost some work for the division. A "Just in time service" is being set up and it is hoped that this, combined with the recent reorganisation of the main warehouse in Bristol, will enable the division to compete more effectively for work where performance standards rather than price are the major factors.

Expansion possibilities

3.9 The division has identified 2 internal factors which could limit expansion:

i. Bristol warehouse

ii. Billing system.

The main warehouse in Bristol has now been reorganised and should therefore be capable of servicing a larger customer base. The billing system has been the subject of criticism and would not at present be able to handle a significant increase in volume of activity. Work is however being done to improve the position and this, combined with the attempts to discourage the proliferation of small orders, should lead the division to a position where it could cope with a significant increase in the level of turnover in a few years' time.

3.10 Externally there are 3 different sectors which a privatised Supply division could consider:

i. Central government;

ii. other public sector;

iii. private sector.

The division already has a substantial penetration in central government and it must be doubtful if any significant additional opportunities are available. The division has a very much smaller proportion of business in the rest of the public sector. Limited marketing activity has been undertaken here with a moderate degree of success. Opportunities certainly exist, but new customers in this area are unlikely to be as desirable as the larger central government customers since requirement levels are likely to be much lower. The bulk of the private sector buys direct from manufacturers and there may be opportunities for the division to bring its bulk buying capacity to bear, provided its marketing can be properly focussed to persuade the private sector of these opportunities. This potential is, as yet, untested.

Privatisation considerations

3.11 There are a number of factors to be considered in assessing the feasibility of privatising the Supply division:

i. Effect on customer base

ii. Monopoly position

iii. Public procurement requirements

iv. Other activities of the Supply division

v. Interaction with other divisions of HMSO

vi. TCS

3.12 As noted above, HMSO estimates that its prices to its larger customers average around 12-15% below the rates at which those customers could otherwise obtain the supplies. A privatised Supply division would have as its principal objective maximisation of profit rather than the wider considerations of obtaining the best prices commensurate with the appropriate quality standards and passing the benefits to customers. It would be extremely difficult, if not impossible, to devise a mechanism whereby the division could be privatised while retaining the benefits of lower prices for customers. A privatised division will seek to set its prices at the highest level it can while still retaining its principal customers. It is not possible to say what this level will be and, indeed, it is likely to vary for different customers. The effect of this on the value of the division is quite dramatic. If, for example, a privatised division considered that price levels some 5% lower than the competition were sufficient to retain customers, it would imply an increase in external turnover from £165m to around £175-180m. Although in turnover terms this is not significant, at the profit level it is critical since the additional turnover is all profit. It would, for example, have increased the 1987-88 surplus before interest from £1.4m to a range of £12m-17m which would massively increase the value of the division.

3.13 The difficulty is that while the statement that HMSO prices average around 12-15% lower than those available elsewhere can be tested (and indeed should be by any external consultants appointed) without changing the current basis of doing business, it will be almost impossible to test the level to which a privatised HMSO could raise prices without actually doing so in advance of privatisation.

3.14 There is at present very little competition for HMSO Supply division from similar organisations. A privatised division would dominate the market and it would be advisable to ensure that there were no danger of a Monopolies and Mergers Commission reference. The strongest defence against such a reference is that all customers have the freedom to buy direct from the manufacturers if they so wish.

3.15 One advantage to most of its customers of using HMSO at present is that HMSO undertakes to abide by public purchasing requirements thus absolving departments from the need to set up their own monitoring mechanisms. In the analogous case of TCS, Treasury is exploring with the Commission whether the observance of EC/GATT rules can be delegated to a private sector company, although no response has yet been received from the Commission. It seems reasonable to assume that the ruling in the case of TCS is likely to apply also to HMSO. It is probably impossible to quantify the value of this service to departments at present and thus the likely effect on customers' attitudes to HMSO if this service can no longer be provided.

3.16 The major business activity of the division is the supply of product to its customers. There are 2 ancillary activities whose role could be examined prior to privatisation: laboratory and office machinery testing facilities, and servicing. The former is thought to be unique and, properly marketed, there seems no reason why it should not become a profit centre in its own right selling the results of its investigations to its clients (who will include HMSO). The position of the servicing needs to be considered. The current objective of servicing is to break even overall. Within this objective HMSO's own servicing staff, who operate in the major centres, are profitable, while customers based in more remote locations are serviced by third parties arranged by HMSO at a loss. The basis of charging for this latter service could be re-examined with a view to establishing at least a break even position.

3.17 Some 13% of estimated 1987-88 turnover is with other divisions of HMSO. If the Supply division were privatised separately from the remainder of the activities some of this turnover might be lost since the other divisions would be freer to obtain supplies from elsewhere. That said, the Supply division's superior purchasing power should mean that it has the competitive edge to retain much of the other divisions' business. In any event although loss of this business would affect the value of the division it is not so critical as to jeopardise the viability of the business.

3.18 Although there is currently no single major competitor to the Supply division, it is possible that the privatisation of TCS could create a very major competitor. Both TCS and the Supply division share the same customer base although, by agreement, they do not compete at present. It is quite possible that a privatised TCS could seek to expand by widening the range of products it sells to its existing customer base - one obvious direction for expansion of its range would be the products currently offered by HMSO. On the other hand, of course, one option for HMSO, privatised or not, would be to expand the product range it offered to its existing customer base by including products currently sold by TCS.

Summary

3.19 Of the two tests of suitability for privatisation, commercial viability and public interest, the Supply division clearly passes the first. The position with regard to the public interest is less certain. There appears little doubt that privatisation is likely to increase the cost to government of the supplies it obtains from HMSO; this can only be justified if the price obtained on privatisation fully reflects this potential.

PRINT PROCUREMENT DIVISION

4.1 Many of the considerations as to the suitability of the Print Procurement division for privatisation are similar to those for the Supply division. This section therefore concentrates on the differences between the divisions.

Current activities

4.2 Turnover of the print procurement division over the last 4 years has been:

	£m External	£m Internal	£m Total
1984-85	94	29	123
1985-86	93	30	123
1986-87	113	30	143
1987-88 (unaudited)	116	30	146

The principal activity of the Print Procurement division is the purchase of printing, binding and related products for its customers. The printing industry is extremely fragmented: it is estimated that some 75% of all firms in the industry have fewer than 100 employees. The division considers that its expertise (print buyers are recruited on the strength of their experience of the printing industry) and knowledge of some 3000 printing firms enables it to obtain far better terms for its customers than they could for themselves in an industry where the difference between the highest and lowest quotations for a job can be several hundred percent.

4.3 The division estimates that it has some 90% of all central government printing business but has very little penetration in the public sector outside central government (over 90% of external turnover is to central government). The majority of assignments are priced at "cost plus" although there is an increasing trend by government departments to seek firm pricing. Provided the division can operate efficiently, this latter is likely to lead to greater profitability commensurate with the greater risk assumed. The amount of mark up charged varies with the nature and size of the job, the range currently being 4-15%.

4.4 In addition to its print procurement activities, the division's knowledge enables it to provide specialist advice to customers and the Technical Services division is involved in research in printing development. These services are treated as cost centres and are not charged out separately. Indeed, to the extent that these services reduce costs to customers, they reduce the surplus, since the majority of assignments are priced on a "cost plus" basis. The division also has a "Forms Centre" which stores government forms in bulk, issuing them as required. Turnover is some £5m and it makes a small contribution to operating surplus.

Competition

4.5 There are virtually no similar organisations in either the public or private sectors, although customers are always able to go direct to printers.

Strengths and weaknesses of current operations

4.6 The division has knowledge of the printing industry without parallel. This usually enables it to obtain far better prices than its customers could obtain for themselves. Whilst the division can normally demonstrate substantial price advantages available through using its services, its ability to increase its business is dependent on customers' perception of the benefit of such services. The relatively low level of penetration outside central government might indicate that customers' perceptions are not easy to influence. The current pricing basis of "cost plus", whilst beneficial to the public interest as a whole, can actually act to the disadvantage of the division itself, since efficiency in print procurement results in a reduction of the operating surplus.

Expansion possibilities

4.7 The principal constraint on expansion of activities is the limited number of print buyers available with adequate experience of the industry. The change in the nature of the printing industry over the last 10 years and, in particular, the reduction in the numbers serving printing apprenticeships means that this relative scarcity is unlikely to be relieved in the short term. Greater flexibility in the ability to offer competitive salaries would to some extent offset this difficulty. It is estimated that recent improvements in computer systems would allow an increase of some 25-50% in the current level of business.

4.8 There appears to be little scope for significant further penetration into central government. The potential in the rest of the public sector and in the private sector could be substantial if potential customers can be persuaded of the benefits to be obtained by using HMSO services. To obtain a significant amount of work from these sources will require an aggressive marketing policy.

Privatisation considerations

4.9 Many of the privatisation considerations are similar to those facing the Supply division:

i. Effect on customer base

ii. Monopoly position

iii. Public procurement requirements

iv. Interaction with other divisions of HMSO

The effect on the customer base of privatisation is even harder to quantify than in the case of the Supply division. The division is only able to obtain better prices because of its knowledge of where to look for the best prices and not by aggregation of demand. If a customer by chance goes to the cheapest source then it is unlikely that the division can obtain a significantly better price. The benefits to customers are predicated on the assumption that in the majority of cases they will not obtain the best prices and quality because they don't know where to look while HMSO does. It is extremely difficult therefore to know how a privatised division would price its services. It could presumably compete with any printers its customers choose to invite to tender - but it is impossible to say what effect this would have on profitability although it could be substantial.

4.10 Since, unlike the supply division, most of the division's activities are in the nature of one off assignments which themselves require the obtaining of quotations from the printing industry, it would be theoretically possible to require a privatised division to continue to render its services on a cost plus basis. This would at least reduce the potential for increase in public sector costs in this area, but would still have disadvantages:

i. if the division obtained private sector work on terms that were more profitable to it than public sector work, it may be inclined to neglect the latter to benefit the former;

ii. there would be no incentive to do more than undercut the competition by sufficient to obtain the contract. There is no reason why the division should continue to give advice to reduce costs substantially (sometimes by up to 50%) as it does currently.

<u>Summary</u>

4.11 The position with regard to the Print Procurement division is similar to that facing the Supply division - it is probably commercially viable but it is less clear that the public interest will be best served by privatisation. It will be even harder than in the case of the Supply division to ensure that proceeds are maximised to offset likely increases in departmental expenditure. To maximise proceeds on sale it would probably be necessary to allow the division to compete in the private sector prior to sale for two reasons, first, to show that a private sector market does exist and second, to establish market prices for its

PRODUCTION DIVISION

Current activities

5.1 Turnover of the Production division over the last 4 years has been:

	£m External	£m Internal	£m Total
1984-85	5	24	30
1985-86	5	23	28
1986-87	4	24	28
1987-88 (unaudited)	4	25	29

External turnover is in respect of reprographic services provided to departments which make a modest contribution to operating surplus. The level of turnover has been in decline for many years as new technology has enabled departments increasingly to undertake the work in house. This declining trend is unlikely to be reversed. The majority of the division's business is internal for the Publications division.

5.2 The printing industry has been suffering from overcapacity for some years. As a result the Print Procurement division is often able to buy at less than full cost from printers who are prepared to accept work on almost any terms. If, therefore, the Print Procurement division is to fulfil its brief to provide the cheapest source commensurate with the required quality it is unlikely to be able to give many profitable opportunities to the production division. The division has thus concentrated in the main on specialist work for the Publications division in areas where there is little or no private sector competition.

5.3 The division operates 5 presses, of which 4 are specialised:

i. Hansard Press (prints House of Commons Hansard to very tight deadlines)

ii. Parliamentary Press (prints other Parliamentary material such as Order papers, Bills etc)

iii. Macaulay Press (classified work - principally the Budget and also work for MOD and FCO)

iv. Manchester Press (security printing of items of potential monetary value such as passports, giro cheques and pension books)

v. Edinburgh Press (database and general printers)

With the exception of the Edinburgh Press, all are relatively new, purpose built presses. Prices are agreed on the basis of comparable trade prices, and under the terms of current arrangements the individual presses results are likely to be:

Hansard	-	small profits
Macaulay	-	break-even
Parliamentary	-	very new and currently loss making but should be profitable in time
Manchester	-	very profitable
Edinburgh	-	break even

Competition

5.4 The printing industry as a whole is extremely competitive. Those companies which have been successful have identified market niches and invested in technology to enable them to compete effectively in their chosen markets. This is the route adopted by HMSO for its specialist presses. If privatised, these presses would have to compete for the work they currently undertake - but provided investment levels are maintained there is no reason why the presses should not maintain much of their existing work.

Strengths and weaknesses of current operations

5.5 4 of the 5 presses are modern and have been specifically designed for their current work. This should enable them to maintain a competitive edge over their rivals. This specialisation while the major strength could also be the major weakness - if a competitor were to obtain the contracts for work currently undertaken by one of the specialised presses, it might be extremely difficult for that press to find adequate work as a substitute. The Edinburgh Press as a general printer is having to operate in a highly competitive area with no marketing edge - it is likely to continue to struggle as long as there is general overcapacity in the industry.

Expansion possibilities

5.6 These are extremely limited. The presses are already close to capacity and unless a further market niche can be identified it would be hard to justify the substantial investment needed for expansion. Privatisation would allow the Hansard and Parliamentary Presses to compete in the private sector for work during periods of Parliamentary recess.

Privatisation considerations

5.7 There are a number of factors to be considered in assessing the feasibility of privatising the production division:

1. Relationship with other divisions

2. Commercial viability

3. Public interest

4. Privatisation methods

5.8 Although classified as a separate division, the Production division is in substance a sub-division of the Publications division for which it undertakes the majority of its work. This would not necessarily rule out privatisation of the division separately from the Publications division. To maximise privatisation proceeds it would be necessary to ensure that the division had contracts for its main activities which had some period (say 2-3 years) still to run. Privatisation would then be possible, although proceeds would not be high since a purchaser would be gambling on winning renewals of printing contracts after the primary period.

5.9 The division incurred a deficit of £1.7m after allocated interest in 1986-87 and a loss of £2.2m (unaudited) for 1987-88. The 5 year plan shows a further small loss in the 9 months to 31 December 1988. Thereafter it is anticipated that the division will move into surplus. Assuming that prices obtained are commercial ones, the forecasts show that the division is commercially viable in the longer-term. Maximisation of proceeds will be easier to achieve after a sustained return to surplus.

5.10 It is a matter of policy as to whether it is desirable for the division's activities to be carried out in the private sector. The Parliamentary and, particularly, the Hansard Presses are geared to very fast production of substantial amounts of material. There is nothing particularly confidential about such information and it is the high performance standards required that have led to the use of these HMSO presses. There is no intrinsic reason why such performance standards cannot be provided by the private sector although this is an area of considerable Parliamentary interest, and therefore political sensitivity. Staff at the Macaulay Press are all positively vetted and in view of the classified nature of much of that Press's output, it may be thought that the confidentiality is best protected by retaining it in the public sector. Security printing of items such as banknotes is already carried out in the private sector and there thus appears to be no reason why the Manchester Press cannot also operate in that sector. There appear to be no public interest considerations to prevent the Edinburgh Press being privatised.

Summary

5.11 The division is forecast to be operating in surplus by 1989. It is therefore potentially capable of privatisation on the viability test. However its dependence on a single customer is likely to reduce substantially the potential proceeds since the quality of earnings will be viewed as poor by a potential purchaser. On public interest grounds there is a strong case for maintaining the Macaulay Press within the public sector. There do not appear to be any significant reasons, apart from the political sensitivity, for not privatising the other elements of the division.

PUBLICATIONS DIVISION

Current activities

6.1 Turnover of the Publications division over the last 4 years has been:

	£m External	£m Grant	£m Total
1984-85	39	6	45
1985-86	43	4	47
1986-87	43	4	47
1987-88 (unaudited)	43	4	47

Government grants are made to subsidise two commercially uneconomic activities:

a. Production and sale of Hansard at substantially less than full cost; and

b. Sale of HMSO publications to public libraries at half the published price

6.2 The Publications division provides a service to departments which wish to publish information to the general public. It differs from a commercial publisher in that, although it takes the commercial risks, it does not have editorial control over contents and cannot always reject material for publication if it considers publication to be uneconomic. HMSO is obliged to publish any matter which is in pursuance of a statutory requirement but does have more discretion with other material. Unlike commercial publishers HMSO does not generally commission work, although if market opportunities are identified these will be pointed out to the relevant bodies.

6.3 Publications are priced to achieve the objective of breaking even over certain groups of publications, some of which (especially Parliamentary items) are priced at scale rates. This results in a substantial cross subsidy between publications.

6.4 The division is involved in 2 other activities:

i. Retailing

ii. Crown copyright

Retailing activities are carried out through 6 dedicated bookshops in major UK Cities. The shops sell only HMSO publications and a few publications of other "public bodies". They are currently profitable, although they receive greater discounts than the trade as it is considered that they provide a more comprehensive service to the customer (for example stocking a far wider range of titles). Crown copyright is vested in the Controller personally. The copyright covers any work originated by a Crown Servant or commissioned by the Crown. Copyright fees are generally charged on a flat fee basis but sometimes on the more common royalty basis, generating income of £0.5m per annum in total.

Competition

6.5 The Publications division of HMSO is not really in competition with the private sector since it operates in a rather different way to commercial publishers.

Strengths and weaknesses of current operations

6.6 The division is the generally accepted authority on central government publishing and is thus well placed to continue to attract such work after privatisation. It has however virtually no experience in the commercial sector editorial side of the business, which would be a major competitive disadvantage to attracting work from the private sector. A purchaser who could provide this editorial capacity might find the sales and distribution network attractive.

Privatisation considerations

6.7 There are a number of factors to be considered in assessing the feasibility of privatising the Publications division:

i. Commercial viability and relationship with departments

ii. Grant aided activities

iii. Ancillary activities

6.8 It would be difficult for the Publications division to continue to operate in the same manner outside the public sector. Where profit maximisation is the key objective, the viability of each publication would be considered separately and it is likely that the nature of many publications means that they cannot be profitable. A private sector company would not accept such material for publication without subsidy. This need not, however, act as a bar on privatisation if the relationship between HMSO and its customers were altered. Currently HMSO takes the commercial risk on all publications for departments but has little editorial influence. If departments were prepared to take the commercial risk by paying the publication cost, at least for the non profitable items, it should be possible to obtain a publisher (either HMSO or a private sector publisher) to undertake publication. Such action would have the effect of requiring HMSO to compete in the market place with other publishers for almost all of the work it currently receives as a matter of course. HMSO's lack of commercial editorial experience may prove to be a disadvantage in this area - although one available option would be to buy in such skills.

6.9 The effect of this on departments would be to increase the costs to them of many of their publications, while producing income from some of the more popular items. This would have the advantage of obliging departments to consider more closely the costs of their publications.

6.10 It would always be possible to continue the grant system to the uneconomic activities after privatisation. At least in the case of the grant for Hansard, this would not be particularly satisfactory, since the grant is to subsidise production cost. There is always scope for abuse and disagreement in determining what are allowable costs for grant purposes. There are 2 more satisfactory possibilities:

i. the grant should be discontinued and purchasers, the vast majority of whom will be in the public sector, obliged to pay the full cost

ii. if a decision were taken to privatise the Publications division but not the Hansard Press, to pay the grant to the Hansard Press to subsidise the production costs.

6.11 It would be easier to continue the subsidy on sales of HMSO material to public libraries, since the levels of such sales are easier to verify. It may, however, be presentationally more acceptable to make the grants to the libraries rather than the publisher after the latter has been privatised.

6.12 The bookshops, which are all thought to be in prime locations in major cities, are quite clearly saleable in their own right. It might be difficult to ensure that they stocked as wide a range of HMSO publications as they do at present, since the new owners are likely to wish to widen the range of stock. It might be possible to achieve a reasonable range of HMSO stock by allowing higher discounts if a large range of HMSO products is maintained.

6.13 It is probably not desirable to have Crown Copyright vested in the private sector. On privatisation of the remainder of the division therefore it would probably be appropriate to retain the copyright department in the public sector and to vest copyright in some other public servant. There is then the option of treating the copyright as an asset and allowing use of the copyright to the highest bidder (who may or may not be HMSO). This would provide a more competitive market and would ensure a continuing income stream to government, but the lack of exclusivity for HMSO would tend to reduce its privatisation value. The Crown Copyright is potentially an extremely valuable asset, for example by agreement between HMSO and Ordnance Survey the latter is permitted to retain £8-9 million of copyright income per annum and there are a number of other publications (such as The Highway Code) which sell in substantial numbers and which would give rise to substantial royalties charged on a commercial basis. It will be important to ensure that the relationship of copyright to existing publications is formalised prior to privatisation and that, if HMSO is to retain the right to exploit such copyrights, the full value of such rights is recognised on sale.

Summary

6.14 As currently constituted it would be difficult to privatise the Publications division while continuing to provide a means by which government departments can have their material published. The prime objective of the division is to meet the needs of Parliament and Government in a democracy to make information about offical activities available to the man in the street. It may however be possible to adjust the relationship so that departments take the commercial risk and HMSO (or indeed a competitor) acts as a publishing manager. If this change could be brought about there would then be no public interest reason why the main publishing business and the bookshops should not be privatised. It is probably not in the public interest to allow Crown Copyright to be transferred to the private sector but it should be possible to arrange matters so that it remains in the public sector without affecting privatisation of the remainder of the division.

3457/005

MANAGEMENT IN CONFIDENCE

FROM: A J C EDWARDS
DATE: 18 July 1988

1. SIR PETER MIDDLETON
2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Anson
Dame A Mueller
Sir A Wilson
Mr Phillips
Mr C D Butler
Mr Harris
Mr Kelly
Mr Luce
Mr Moore
Mr Turnbull
Mr Chivers
Mr Welsh
Mr Willacy
Mr S N Wood
Mrs Brown
Mr Dixon
Mr Bent
Mr Lyne
Mr Inglis
Mr Nicol
Mr Partridge
Mr Deaton
Mr Call

HMSO : POSSIBLE PRIVATISATION AND AGENCY STATUS

You asked us in February to examine the possibility of privatising HMSO. You noted in doing so that this was a necessary part of the process of considering HMSO for agency status.

2. In response to this remit, Mr Inglis of CA Division has produced the attached in-house report on posible privatisation with the help of HMSO and with the benefit of comments from Treasury divisions: it is not, of course, a full-dress feasibility study. We have discussed Mr Inglis' report with many of those on the copy list and at a meeting taken by Sir Peter Middleton.

3. HMSO themselves have in the meantime produced a paper on agency status, together with plans for a major reform of their staff structure involving the replacement of civil service grades by a new system under which staff would be paid according to the assessed quality of the job they did, with pay above basic level for each job to be dependent on performance. The full report is attached. HMSO's proposals, which raise important issues not least as regards overall changes in HMSO's pay bill and the likely repercussions for all Next Step agencies, were the subject of Mr Chivers's submission of 15 July to the Paymaster General.

4. The present submission discusses both privatisation and agency status. It suggests that HMSO, though not yet ripe for successful privatisation, should be given agency status in the Autumn and encouraged to develop along commercial lines in a way which would make privatisation an attractive option in 3 or 4 years time if Ministers so decide.

5. We would see considerable advantage in early decisions, covering both privatisation and agency status, for announcement before the Summer Recess. This seems to us desirable not only in itself but also in the context of finding a successor for the present Controller, Mr Dole. If you agree with the suggested approach, therefore, we recommend that you should minute the Prime Minister, Mr Luce and the other Ministers concerned with a view to an announcement through an arranged written Parliamentary Answer on Thursday or Friday of next week.

Nature of HMSO's business

6. The main section of Mr Inglis' report summarises and considers the position with respect to each of HMSO's four divisions, which are discussed in more detail in the annexes. These are:

(i) supply division, which procures stationery and office supplies, up to photocopiers and microcomputers, for public sector organisations. Annual turnover: some £190 million.

(ii) print procurement division, which places public sector printing requirements with printers who offer best value for money. Annual turnover: some £145 million.

(iii) production division, which prints Hansard, market-sensitive Government publications such as the FSBR, and documents of value such as passports. Annual turnover: some £30 million.

(iv) publications division, which exercises Crown copyright on behalf of the Controller and publishes Government documents, including a high proportion of unremunerative documents required by statute. It owns six bookshops in major city centres. Annual turnover: some £45 million.

Feasibility of privatisation

7. Mr Inglis' report considers the possibility of privatising each of HMSO's divisions against the criteria of their actual (or potential) commercial viability and the effect on the public interest. The conclusions on feasibility, summarised in paragraphs 1.1 to 1.3, are:

- with the probable exception of parts of the production division, all of HMSO could in time be made sufficiently profitable for privatisation;

- security considerations probably rule out sale of the Macaulay Press which prints the FSBR etc, and other parts of the production division also pose difficulties. Crown copyright, in the publications division, is also not a natural candidate;

- there is a difficult issue over EEC/GATT requirements for public purchasing, which HMSO currently manages on behalf of public sector clients. The Commission are being asked whether, in the TCS case, they would accept that a private sector purveyor could carry out these functions: their preliminary response has been favourable. If not, a public sector agency would need to retain this function or departments would have to undertake it themselves and incur additional costs.

8. Subject to resolution of these points, privatisation seems likely to be feasible in due course for most of HMSO's business. The more cogent questions are whether privatisation would be desirable and if so when and how far it should extend.

9. It is worth noting at this point that if the whole of HMSO were to be sold, the Treasury would be the vendor. This would mean creating a small team for the sale within the Treasury who might or might not be fully occupied on that work. If only parts were sold, HMSO could be the vendors, with a more usual role for the Treasury. The sale would probably take the form of a private trade sale rather than flotation or leveraged management buyout: there is likely anyway to be something of a logjam of flotations over the next few years.

Desirability of privatisation

10. The case for privatising HMSO seems to us to rest, not so much on the particular considerations in paragraph 1.32 of Mr Inglis' note, as on the familiar and general arguments for privatising quasi-commercial operations. Privatisation would further sharpen the incentives to HMSO to be competitive and efficient (though with untying HMSO already has to operate in a competitive environment). It would make it easier for HMSO to compete for private business, for example for the presses. It could encourage a further transformation of attitudes within the enterprise. Privatisation would moreover be in keeping with the Government's philosophy that the public sector should not do what the private sector can do equally well or better.

11. There are however two considerations which argue persuasively against early privatisation.

12. First, privatisation in the near future would be likely to be a <u>bad financial deal</u> from the Government's point of view. Although HMSO has consistently met its financial targets as a Trading Fund, these targets have not been particularly exacting. Mr Inglis's anlaysis suggests that HMSO's profits to date would not justify a price in excess of £50-60 million, well below the estimated net asset value of some £67 million at 31 March 1988.

13. A price of this order would suffice to cover repayment of the £34 million or thereabouts of HMSO's NLF borrowing <u>plus</u> a premium reflecting the high rates of interest on the outstanding debt. It would not suffice to cover the cost (not actuarially assessed at this stage, but possibly of the order of £85-95 million) of funding the pension liabilities of HMSO's employees. Although the public sector would of course be relieved of future pension liabilities with a similar net present value, the short term impact of privatisation would on these figures be to <u>increase</u> the public sector borrowing requirement by £30-40 million. GEP's view is that the pension funding payment, although it would require an Estimate, would not score as public expenditure but rather as a financial transaction. This somewhat counter-intuitive treatment follows from the convention whereby, for national accounts and public expenditure purposes, PCSPS pensions payments are treated as proxies for the contributions which would be paid if the scheme were funded. Although it could be argued that the funding payment was in effect a commutation of future pension payments and hence public expenditure, the existing convention, discussed with the TCSC in 1985, sees funding payments as transfers of contributions which have already been scored as public expenditure, so that scoring them again would be double counting.

14. More important than the above is the comparison between the price likely to be obtainable now and that likely to be obtainable in (say) 3 or 4 years time, if HMSO develops its business along more commercial lines and can show a more impressive record of annual profits. Mr Inglis's analysis suggests (paragraph 1.30) that HMSO's potential value in a few year's time could be <u>several times</u> the existing figure. If the Treasury were a

private sector holding company we would not, I suspect, consider selling at this point. We would, on the other hand, be terrified that some external predator would take HMSO over at a price which would be greatly to his advantage and our disadvantage.

15. The second consideration which argues against a hasty decision to privatise HMSO is that there are arguably considerable benefits to the public sector in terms of finance, security and reliability in having its own, in-house publications, print and supplies procurement, and even production capability - benefits which should not lightly be forgone. In addition to the points on Crown copyright, security printing and compliance with international public purchasing obligations discussed in paragraph 4 above, these benefits arguably include:-

(i) an assured ability to publish official information;

(ii) a discount, currently estimated at 12-15%, on stationery and other supplies to Government departments, compared with the most competitive private sector suppliers;

(iii) access to expertise and market power in the purchase of printing services which probably yields price and timing dividends to departments and which it would be neither possible or economic for individual departments to replicate.

16. These possible benefits should not be overstated. Any weakening of the Government's assured ability to publish official information might arguably be fairly small. Similarly, the discount which Government departments enjoy on HMSO supplies could in principle be offset by the capital sum on disposal provided that favourable disposal terms could be obtained. The issue would then be whether it is worthwhile to exchange the discounts for a capital sum. If HMSO is to develop on a more fully commercial basis, moreover, the discount will probably need to be reduced anyway.

17. It is clear nevertheless that there are certain benefits in the existing arrangements which should not be lightly abandoned as part of a hasty privatisation programme. It will therefore be important to consider carefully to what extent they could be preserved if HMSO were privatised and, in particular, which of HMSO's functions would best be retained in the public sector in the event of privatisation. This applies particularly to the point at (iii) above about purchasing expertise and market power. In HMSO as in The Crown Suppliers (TCS) and CCTA there are certain basic purchasing skills and functions which should probably be retained in the public sector, perhaps amalgamated in some central purchasing consultative agency. Mr Willacy is developing some more considered thoughts on this subject. It would seem desirable, in the light of that work, to study further whether there might be advantage in some restructuring of HMSO which would separate functions that the public sector would preferably retain from functions which could be privatised or contracted out. This would pave the way for later privatisation if Ministers so wished.

18. DOE decided in February this year to privatise TCS, which fulfils a similar purchasing role in relation to office furniture and fuel and where some similar problems arise. We do not, however, see that somewhat hasty decision to privatise as being in any sense a compelling precedent for HMSO. Other things equal, it would have been better to sort out most of the problems we are now having to tackle with TCS <u>before</u> privatisation was announced. The key consideration in the case of TCS was that, in the light of the consultants' reports and TCS's reaction to them, it was felt that the business was not efficiently run and that the only way to overcome management resistance to change was to go for privatisation. HMSO, on the other hand, has a much better record, a greater ability to adapt within the public sector and greater potential.

<u>Points for next 3-4 years</u>

19. If HMSO stays within the public sector for the foreseeable future, there are several areas where it will need and wish to

make progress anyway and where progress would be perfectly consistent with (while in no way necessitating) a later privatisation. These include agency status (see further below). They also include:-

(a) possible restructuring into hard-core public sector functions, which might eventually become part of a central purchasing consultative agency, and other more executive/commercial functions, as discussed above;

(b) continuing to put HMSO's activities on a more commercial footing, probably including higher target returns on capital and a move towards market prices;

(c) examination of the possibilities for broadening the client group to include more customers in the rest of the public sector and even the private sector;

(d) possible amendment of HMSO's Trading Funds Order to permit a freer development of HMSO's commercial activities;

(e) decisions on the staff pay and grading restructuring now being considered, where the overriding objective should be to facilitate the achievement of an exacting target for enhancing productivity and profitability without losing control of the pay bill or creating unacceptable repurcussions elsewhere;

(f) the possibilities for a more efficient use of the printing presses which are currently underutilised at certain times.

Agency Status

20. We see a clear presumption in favour of giving HMSO agency status in the Autumn, unless Ministers wish to go for immediate privatisation (in which case the agency status would be a complication rather than a help).

21. The main considerations which point to such a conclusion are as follows. First, HMSO already fulfils virtually all the criteria for "next steps" executive agency status. It has extensive commercial or quasi-commercial operations, a Chief Executive, a corporate plan which includes financial targets, and commercial accounts. That is why the Treasury identified HMSO in July 1987 as an agency candidate, as did the list of initial candidates for agency status which was placed in the library of the Houses of Parliament simultaneously with the Prime Minister's 18 February announcement on executive agencies.

22. A second consideration is that HMSO's staff restructuring plans, which are conditionally endorsed in the submissions of 15 July from Mr Kelly and Mr Chivers, would sit more confortably in an agency than in any other form of public body.

23. In accordance with the established rules for executive agencies, formal declaration of agency status should be preceded by preparation of a policy and resources framework document. In HMSO's case, this document could be quite short: a first draft forms part of HMSO's accompanying submission. It draws on existing structures and procedures and defines the financial relationship between the Government and HMSO, including delegated authorities.

24. If Ministers agree with the general approach, we suggest that the aim should be to announce a decision in principle on agency status before the Summer Recess and then formally to declare HMSO an agency, together with publication of the framework document, in the Autumn. OMCS agree with this approach.

Possible conclusions on privatisation and agency status

25. In the light of the above analysis, the three prime options would appear to be:-

(i) to proceed immediately to privatisation;

(ii) to decide firmly on privatisation in 3-4 years' time, while adopting agency status for the time being and taking the opportunity progressively to put the business on a more commercial footing (as in paragraph 19 above); and

(iii) to decide now not to privatise HMSO immediately but to adopt agency status and develop HMSO's activities on a more commercial footing (as in paragraph 19 above) so as to bring HMSO to the point where successful privatisation would be possible, on attractive financial terms, in 3-4 years' time, if that should then seem desirable.

26. The analysis in Mr Inglis' report and this minute seem to argue powerfully against option (i). Option (ii) would make better sense in terms of Mr Inglis's analysis and would have the merit of setting clear goals for HMSO's development over the next few years. There is much to be said, however, for not taking decisions in this way long before they are needed: long interregnum periods tend to be bad for staff morale and business relationships, and circumstances can easily change. That being so, option (iii) looks to us to be the most attractive option. In the medium term, after a period of further development in HMSO, privatisation in whole or in part could well be beneficial as well as practicable. It would however arguably be premature, and indeed harmful, to prejudge the issue now. There seems much to be said for a policy of pursuing the restructuring, efficiency and other improvements discussed earlier in this minute without prejudice to later decisions to privatise or not to privatise but in the knowledge (and with the intention) that such improvements should be helpful in the context of possible future privatisation.

27. This approach would closely resemble that favoured by the Controller of HMSO, Mr Dole. Mr Dole's own conclusion is:

"It seems both undesirable and unnecessary to make any decision or announcement at the present time about the possible future privatisation of HMSO: undesirable because the experience of TCS suggests that a public announcement too far in advance can have serious adverse effects both on staff morale and on business relationships; unnecessary because the first steps towards privatisation would in any event have to be the very same restructuring and efficiency improvement measures which HMSO is planning to undertake as a Next Steps agency."

28. If, contrary to the above, Ministers were minded to embark on privatisation as soon as possible, we would need to establish a privatisation unit within Treasury or HMSO, depending on whether Ministers wished to sell off the whole or parts. We would also need to commission a merchant bank to make a full-dress feasibility study in preparation for privatisation, which would almost certainly need to take the form of a private sale.

Next action

29. If you wish to go for privatisation at the earliest opportunity, there will be a certain awkwardness over timing of announcement. An announcement before the summer recess would have advantages, not least in relation to advertising for Mr Dole's successor. However, Mr Luce is planning, as part of his announcement next Monday about the state of play on Agencies generally, to recapitulate the list of Agency candidates. It would clearly be somewhat embarrassing to include HMSO in such a list on Monday and then announce privatisation on Thursday or Friday. Ministers would have therefore to choose between dropping HMSO from Mr Luce's list (which would probably be noticed), announcement on Monday of next week (which would allow very little time for clearance with other Ministers) and delaying announcement until the autumn, by which time a decent interval would have elapsed since Mr Luce's statement.

30. If on the other hand you agree with the approach suggested above, we would recommend a short announcement before the Summer Recess - that is, on Thursday or Friday of next week - by means of an arranged Written Parliamentary Question and Answer. We suggest that this announcement, while ruling out immediate

privatisation, should leave no doubt that privatisation remains a possibility for the future. The job-advertisement for Mr Dole's successor could then reflect this. It would be possible for the announcement to state explicitly that the question of privatisation will be reviewed in 3-4 years' time. You will wish to consider this. In HMSO's judgement, being explicit about this would make agreement with staff and unions on the staff restructuring package more difficult. This is a point to which Mr Dole attaches particular importance. It could also tend to hinder rather than help HMSO's partnership with Departments. The contrary view is that, if the Government does have it in mind to review the position in 3-4 years' time, it would be better to say so from the outset and to make the point that this is completely in keeping with the Government's established and well known policy on privatisation.

31. A draft Written Parliamentary Question and Answer in the above sense are attached. If you are content with these, and with the broad approach outlined in this submission, you will wish to consult the Prime Minister, Mr Luce and the other Ministers mainly concerned, and we stand ready to provide rapidly a draft minute for this purpose.

AJCE

A J C EDWARDS

3457/004

DRAFT ARRANGED PQ AND WRITTEN ANSWER

Mr ..... To ask the Chancellor of the Exchequer what plans he has for the future of Her Majesty's Stationery Office.

<u>MR NIGEL LAWSON</u>

My rt hon Friend the Paymaster General said in a Written Answer in July last **(OR 21 JULY 1987 Col 112)** that the Government has no present plans to privatise Her Majesty's Stationery Office. That remains the position. [In accordance with the Government's wider policies on privatisation, the Government will review this matter in 3 or 4 years' time. In the meantime], OR [However,] the Government sees every advantage in removing unnecessary constraints and encouraging the management of the Office to continue to develop the business on commercial lines. It has therefore been decided to establish HMSO in the autumn as one of the new style executive Agencies as foreseen by the Prime Minister in her February announcement about the future management of the Civil Service **(OR 18 February 1988 Col 1149 et seq.)**. HMSO will remain a Trading Fund within central Government accountable direct to Treasury Ministers but the Controller and Chief Executive will have greater freedom, within parameters agreed by Ministers, to manage the day to day affairs of the Agency and in particular to introduce an organisational and pay structure better suited to the most efficient achievement of the Agency's aims and objectives. Details of the new structure will be worked out with the Treasury during the next few months. The proposed changes will be the subject of full consultation with the Trade Unions.

960

SENIOR STAFF IN CONFIDENCE

[NB papers on Crown Suppliers in sep blue folder behind make interesting comparison]

From: SIR PETER MIDDLETON

Date: 20 July 1988

CHANCELLOR

Ch/ The timing is indeed urgent - and v. awkward too if you are interested in early privatisation [see para 29 of AJCE's note] MPW 20/7

Quite views of PMG v PSR.

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Anson
Dame A Mueller
Mr A Edwards

HMSO: POSSIBLE PRIVATISATION AND AGENCY STATUS

This is urgent because of Mr Dole's proposed early retirement which is not widely known and not known in HMSO. I have held up advertising for a successor pending this submission.

2. The course recommended is the safe one, though we should have to be quite explicit that agency status for HMSO did not preclude privatisation later. My own early preference was for option (ii) in paragraph 25 on the grounds that it would give the new Chief Executive a very clear remit - to prepare for privatisation in 3 or 4 years time. But I think one has to give weight to Mr Dole's views about staff morale in what has been a very successful organisation which is still in the process of change.

3. I hope that all proposals for agency status will contain an analysis of privatisation options of this quality.

P E MIDDLETON

SENIOR STAFF IN CONFIDENCE

PAYMASTER GENERAL

FROM: MS K ELLIMAN

DATE: 21 JULY 1988

APS/CHANCELLOR

cc: Chief Secretary
Financial Secretary
Economic Secretary
Sir Peter Middleton
Mr Anson
Dame A Mueller
Sir A Wilson
Mr Phillips
Mr Edwards
Mr C D Butler
Mr Harris
Mr Kelly
Mr Luce
Mr Moore
Mr Turnbull
Mr Chivers
Mr Welsh
Mr Willacy
Mr S N Wood
Mrs Brown
Mr Dixon
Mr Bent
Mr Lyne
Mr Inglis
Mr Nicol
Mr Partridge
Mr Deaton
Mr Call

Pse proceed as recommended by Paym.?

HMSO: POSSIBLE PRIVATISATION AND AGENCY STATUS

The Paymaster General has commented on Mr Edwards' minute of 18 July. He has said he is clear that paragraph 25(iii) is the correct option. What is less clear is the nature of next week's announcement. He would not be explicit in the PQ about reconsideration in 3-4 years' time, though he would be explicit to a candidate for the Controllership and, if the staff or unions asked, he would say that it clearly could not be ruled out, without specifying a time frame. The Paymaster would want the restructuring and development of HMSO to occur in a manner which allowed privatisation to remain in every sense a runner, and would want a management buy out to be further examined in the next 3-4 years.

Kim Elliman

KIM ELLIMAN
Private Secretary

mjd 3/37m

SENIOR STAFF AND MANAGEMENT IN CONFIDENCE

FROM: MISS M P WALLACE
DATE: 21 July 1988

SIR P MIDDLETON

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Dame A Mueller
Sir A Wilson
Mr Phillips
Mr Edwards
Mr C D Butler
Mr Harris
Mr Kelly
Mr Luce
Mr Moore
Mr Turnbull
Mr Chivers
Mr Welsh
Mr Willacy
Mr S N Wood
Mrs Brown
Mr Dixon
Mr Bent
Mr Lyne
Mr Inglis - CA
Mr Nicol
Mr Partridge
Mr Deaton
Mr Call

HMSO: POSSIBLE PRIVATISATION AND AGENCY STATUS

The Chancellor was most grateful for your minute of 20 July, covering Mr Edwards' submission of 18 July. He has also seen Ms Elliman's minute of 21 July. He too has concluded in favour of option (iii) - adopting agency status, and working towards the point where privatisation would be attractive in three or four years time, if it then seemed desirable. He also agrees with the Paymaster's detailed recommendations, about the form of the PQ, the line to be taken with a candidate for the Controllership etc.

woops: terms!

MPW

MOIRA WALLACE

lg.cj/ajce/minutes/10

MANAGEMENT IN CONFIDENCE

FROM: A J C EDWARDS
DATE: 22 JULY 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Dame A Mueller
Sir A Wilson
Mr Phillips
Mr C D Butler
Mr Harris
Mr Kelly
Mr Luce
Mr Moore
Mr Turnbull
Mr Chivers
Mr Welsh
Mr Willacy
Mr S N Wood
Mrs Brown
Mr Dixon
Mr B O Dyer
Mr Bent
Mr Lyne
Mr Inglis
Mr Nicol
Mr Partridge
Mr Deaton
Mr Call

Ch/ Content to minute PM as drafted?
MPW 22/7

OK

HMSO: AGENCY STATUS

In accordance with your and the Paymaster General's reactions to the submissions of 20 July from Sir Peter Middleton and myself, I attach a draft letter from you to Mr Luce with copies to the Prime Minister, Cabinet Ministers and other Ministers in charge of departments.

2. The draft letter prepares the way for an announcement on Thursday or Friday of next week, by means of an arranged written question and answer, that HMSO will receive Agency Status in the Autumn. The draft makes clear that the possibility of privatisation at a later stage remains open.

3. Perhaps Mr Dyer would be good enough to arrange for the Question to be put down on Wednesday of next week, subject to any reactions from Mr Luce.

4. I have kept in close touch with Mr Kemp about this dossier, and I imagine that Mr Luce, like Mr Kemp, will welcome your proposal. Mr Kemp would have preferred in a spirit of glasnost to declare the intention to review the privatisation issue again in three to four years' time. I do not imagine, however, that Mr Luce will press this point strongly if indeed he mentions it at all.

AJCE

A J C EDWARDS

Pse type final

DRAFT LETTER FROM THE CHANCELLOR TO

Rt Hon Richard Luce MP
Minister of State
Privy Council Office

HMSO: AGENCY STATUS

I propose, if you agree, to announce before the recess, by means of an arranged written question and answer on Thursday or Friday of next week, that the Government has now firmly decided to establish HMSO in the autumn as a Next Steps Agency.

As you will recall the Government announced earlier this year, in the candidates list released with the Prime Minister's 18 February statement, that HMSO was a candidate for Agency Status. You are due to confirm this in your statement on Monday.

Before reaching a final view on Agency status, I thought it right to ask Treasury officials to examine carefully the possibility of privatising HMSO. That examination has concluded that HMSO is not ready at this stage for successful privatisation - the financial terms would not be attractive - but should be encouraged to develop along commercial lines in a way which will make privatisation an attractive option in three or four years' time if Ministers so decide. I endorse this conclusion and propose that we should plan firmly for HMSO to develop in this way.

In the meantime, without in any way prejudging the decision on privatisation in three to four years' time, I see nothing but advantage in giving HMSO Agency status. Your officials and mine are agreed that HMSO fulfils all the relevant criteria: it has extensive commercial or quasi-commercial operations, a Chief Executive, a corporate plan which includes financial targets, and commercial accounts. That being so, I think that the way is open to announce a firm decision on Agency status. A draft arranged written Question and Answer for this purpose is attached. As you will see, the draft Answer leaves open the possibility of privatisation at a later stage.

I should like to make this announcement on Thursday or Friday of next week, before the recess. Early clarification of HMSO's position can only, I think, be helpful for the staff and the business. It will also enable early progress to be made on the important plans for staff restructuring mentioned in the draft Answer and on senior staff appointments which are urgently needed.

I would much appreciate having your reactions by Tuesday evening so that a Question may be arranged on Wednesday for answer on Thursday or Friday.

I am copying this letter to the Prime Minister, Cabinet Ministers and other Ministers in charge of departments, and to Sir Robin Butler.

3457/004

DRAFT ARRANGED PQ AND WRITTEN ANSWER

Mr ..... To ask the Chancellor of the Exchequer what plans he has for the future of Her Majesty's Stationery Office.

MR NIGEL LAWSON

My rt hon Friend the Paymaster General said in a Written Answer in July last **(OR 21 JULY 1987 Col 112)** that the Government has no present plans to privatise Her Majesty's Stationery Office. That remains the present position. However, the Government sees every advantage in removing unnecessary constraints and encouraging the management of the Office to continue to develop the business on commercial lines. It has therefore been decided to establish HMSO in the autumn as one of the new style executive Agencies as foreseen by the Prime Minister in her February announcement about the future management of the Civil Service (**OR 18 February 1988 Col 1149 et seq.)**. HMSO will remain a Trading Fund within central Government accountable direct to Treasury Ministers but the Controller and Chief Executive will have greater freedom, within parameters agreed by Ministers, to manage the day to day affairs of the Agency and in particular to introduce an organisational and pay structure better suited to the most efficient achievement of the Agency's aims and objectives. Details of the new structure will be worked out with the Treasury during the next few months. The proposed changes will be the subject of full consultation with the Trade Unions.

ps3/20T

MANAGEMENT IN CONFIDENCE

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Dame A Mueller
Sir A Wilson
Mr Phillips
Mr C D Butler
Mr Harris
Mr Kelly
Mr Luce
Mr Moore
Mr Turnbull
Mr Chivers
Mr Welsh
Mr Willacy
Mr S N Wood
Mrs Brown
Mr Dixon
Mr B O Dyer
Mr Bent
Mr Lyne
Mr Inglis
Mr Nichol
Mr Partridge
Mr Deaton
Mr Call

PWP

Treasury Chambers, Parliament Street, SW1P 3
01-270 3000

25 July 198

The Rt Hon Richard Luce MP
Minister of State
Privy Council Office
Whitehall
LONDON
SW1A 2AT

Dear Minister

HMSO: AGENCY STATUS

I propose, if you agree, to announce before the Recess, by means of an arranged Written Question and Answer on Thursday or Friday of this week, that the Government has now firmly decided to establish HMSO in the Autumn as a Next Steps Agency.

As you will recall the Government announced earlier this year, in the candidates list released with the Prime Minister's 18 February statement, that HMSO was a candidate for Agency status. You are due to confirm this in your statement today.

Before reaching a final view on Agency status, I thought it right to ask Treasury officials to examine carefully the possibility of privatising HMSO. That examination has concluded that HMSO is not ready at this stage for successful privatisation - the financial terms would not be attractive - but should be encouraged to develop along commercial lines in a way which will make privatisation an attractive option in three or four years time if Ministers so decide. I endorse this conclusion and propose that we should plan firmly for HMSO to develop in this way.

In the meantime, without in any way prejudging the decision on privatisation in three to four years' time, I see nothing but advantage in giving HMSO Agency status. Your officials and mine are agreed that HMSO fulfils all the relevant criteria: it has extensive commercial or quasi-commercial operations, a Chief Executive, a corporate plan which includes financial targets, and commercial accounts. That being so, I think that the way is open to announce a firm decision on Agency status. A draft

... arranged Written Question and Answer for this purpose is attached. As you will see, the draft Answer leaves open the possibility of privatisation at a later stage.

I should like to make this announcement on Thursday or Friday of this week, before the Recess. Early clarification of HMSO's position can only, I think, be helpful for the staff and the business. It will also enable early progress to be made on the important plans for staff restructuring mentioned in the draft Answer and on senior staff appointments which are urgently needed.

I would much appreciate having your reactions by tomorrow evening so that a Question may be arranged on Wednesday for answer on Thursday or Friday.

I am copying this letter to the Prime Minister, Cabinet Ministers and other Ministers in charge of Departments, and to Sir Robin Butler.

Yours sincerely

pp. **NIGEL LAWSON**

[Approved by the Chancellor and signed in his absence]

DRAFT ARRANGED PQ AND WRITTEN ANSWER

Mr ...... **To ask the Chancellor of the Exchequer what plans he has for the future of Her Majesty's Stationery Office.**

MR NIGEL LAWSON

My rt hon Friend the Paymaster General said in a Written Answer in July last (**OR 21 JULY 1987 Col 112**) that the Government has no present plans to privatise Her Majesty's Stationery Office. That remans the present position. However, the Government sees every advantage in removing unnecessary constraints and encouraging the management of the Office to continue to develop the business on commercial lines. It has therefore been decided to establish HMSO in the Autumn as one of the new style executive Agencies as foreseen by the Prime Minister in her February announcement about the future management of the Civil Service (**OR 18 February 1988 Col 1149 et seq.**). HMSO will remain a Trading Fund within central Government accountable direct to Treasury Ministers but the Controller and Chief Executive will have greater freedom, within parameters agreed by Ministers, to manage the day to day affairs of the Agency and in particular to introduce an organisational and pay structure better suited to the most efficient achievement of the Agency's aims and objectives. Details of the new structure will be worked out with the Treasury during the next few months. The proposed changes will be the subject of full consultation with the Trade Unions.

CABINET OFFICE
OFFICE of the MINISTER
for the CIVIL SERVICE

The Minister of State
Privy Council Office
The Rt. Hon. Richard Luce MP

Horse Guards Road
London SW1P 3AL

Telephone: 01-270 5929

Pup

CH/EXCHEQUER
REC. 26 JUL 1988 27/7
ACTION Mr. A.J.C. Edwards
COPIES TO CST, FST, PMG, EST
Sir P Middleton
Mr Anson Dame A Mueller
Sir A Wilson Mr Phillips
Mr C D Butler, Mr Harris
Mr Kelly Mr Luce
Mr Moore, Mr Turnbull
Mr Chivers Mr Welsh Mr Willacy
Mr S.N. Wood, Mrs Brown Mr Dixon
Mr B.O. Dyer. Mr Bent. Mr Lyne
Mr Inglis Mr Nicol Mr Partridge
Mr Deaton Mr Call

C88/3841

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1

26 July 1988

Dear Nigel,

HMSO - AGENCY STATUS

Thank you for your letter of 25 July. I welcome your decision that HMSO should be established as an Agency.

As you know, your officials have been in touch with mine and with the Project Manager. I am entirely content with what you propose. The only point I would make is on timing. Our latest understanding is that the TCSC report on Next Steps will be published at midday on Thursday, and for that reason it would be preferable, if possible, for you to make your announcement on that day rather than on the Friday. By the same token, and perhaps also in order to avoid unnecessary worry, I wonder whether you should add to the end of the proposed question words on the lines

This is being done.

> ".... for the future of Her Majesty's Stationery Office in the light of the Government's decisions on Next Steps".

Still on timing, I presume the details of the proposals to introduce new organisational and pay structure will be announced simultaneously with your proposals to establish HMSO as an Agency; they must be seen as all part of the same parcel.

Your announcement of course follows on from the announcements which Paul Channon and myself made yesterday morning, and for this reason and generally the handling of press enquiries will have to be looked at on an overall basis, to ensure that we are all seen to be pulling in the same direction. I am sure your people will continue to liaise with mine over this. The handling of questions relating to possible future privatisation will in particular need joint thought.

The Project Manager and his people stand ready now to work with yours and with HMSOs to complete the necessary steps, including filling out and agreeing the framework document, so that the way is clear to set the Agency up formally in the Autumn.

I am copying this to the Prime Minister, Cabinet Ministers and other Ministers in charge of departments, and to Sir Robin Butler.

Richard

RICHARD LUCE