PO-CH/NC/0295
PART A

Part. A.

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Begins: 17/6/87.
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PO -CH /NL/0295
PART A

PO -CH /NL/0295
PART A

Chancellor's (Lawson) Papers:

PRIVATISATION PROCEEDS

Disposal Directions: 25 Years

20/10/95.

293/040

CONFIDENTIAL

FROM: F CASSELL

DATE: 17 JUNE 1987

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Sir Peter Middleton
Mr F E R Butler
Mr Monck
Mr Moore
Mr Peretz
Mr Scholar
Mr Turnbull
Mr Odling-Smee
Mr Sedgwick
Mrs M E Brown
Mr Colman
Mr Bent
Ms Leahy

PRIVATISATION PROCEEDS 1987-88

The figuring in Mr Moore's Submission of 17 June below needs to be seen against a background in which the latest figures suggest a substantial undershoot on the PSBR forecast for this year. The margins of error are, of course, enormous. But they mean that we cannot rule out - even with privatisation proceeds no higher than the £5 billion assumed at Budget time - that the public sector will actually be in surplus this year.

2. So even though additional asset sales may have little significant real effects on the economy they would add to what could be a difficult presentational problem.

3. Paragraph 11 of Mr Moore's Submission raises the possibility of selling less than the full holding of BP shares this year, and concludes that to retreat now could be damagingly interpreted by the market as a lack of confidence in the success of the sale. I wonder. The market knows the price has risen since the intention to sell was announced, and would recognise that we had in mind a broad sum to be raised from BP as a contribution to the £5 billion total. It is at least arguable that the market would feel that in holding back part of the shares we were expecting to sell them at a higher price in the future.

4. I think we should strive to keep privatisation proceeds this year as close as possible to the announced total of £5 billion, and that our chances of achieving this will be increased if we do not close off at this stage the option of selling less than the full amount of our holding in BP.

F CASSELL

3687/016

CONFIDENTIAL

FROM: D J L MOORE
DATE: 17 JUNE 1987

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Sir Peter Middleton
Mr F E R Butler
Mr Monck
Mr Cassell
Mr Peretz
Mr Scholar
Mr Turnbull
Mr Odling-Smee
Mr Sedgwick
Mrs M E Brown
Mr Colman
Mr Bent
Ms Leahy

PRIVATISATION PROCEEDS 1987-88

This note advises you of BT's latest ideas on the redemption of their £500 million preference shares and on our latest assessment of the total outcome for the year.

BT Preference Shares

2. The BT Board has agreed in principle that they should give us the required 3 months' notice of their intention to redeem £250 million. When that tranche has been refinanced they would then redeem the remaining £250 million once it was clear that this could be done on suitable terms. Since the preference shares are at 11.95% it is not surprising that they wish to redeem - indeed they have been slow to move - and it must be likely that they can refinance the full £500 million on suitable terms in this financial year.

3. We must therefore assume that we have additional proceeds this year of £250 million certainly and £500 million very probably. BT will be open to suggestions on the precise timing. But the only way to stop the redemptions would be to propose negotiation of a revised dividend in line with comparable current rates. But this would still leave

us vulnerable to BT taking the initiative to redeem if interest rates fell further and would therefore add to the uncertainties of planning for later years. To negotiate away the right to that initiative could require further concessions. Any such renegotiations could be difficult to defend. I recommend that we take the proceeds this year.

1987-88 Total Proceeds

4. In round figures and £ million the outcome could then be:

3400	firm
500	BT preference shares
550	BAA first instalment
800	BP first instalment
5250	

If gas loan no BP, Then £4.7 bn

5. The £3.4 billion is mainly Rolls Royce, ROFs, BA(II) and Gas(II). I have assumed that the £250 million for Gas debt due in 1988 will be taken in 1988-89, though you do not have to decide on that until January.

6. The BT preference shares could, as explained above, be only £250 million, and if necessary we could substitute the further £250 million with the Gas debt. But £500 million from BT seems much more likely.

7. The BAA first instalment of £550 million is 50% of an estimated £1,200 million less an allowance for costs. However, we have asked Transport and the advisers to consider about 40%, in which case we would be down to, say, £450 million or £5.15 billion in total.

8. The BP first instalment is still uncertain. My separate note on the BP sale explains why on present

assumptions we could receive a gross £1 billion at a price of £3.50. £800 million allows for discounting of some of our shares in the fixed price offer and for costs of sale. The first year costs could be further reduced to, say, £700 million if you decide to retain some shares for giving as loyalty bonuses.

9. On the other hand BP receipts will obviously be higher (or lower) if the share price changes between now and October. Additionally, or alternatively, they could rise by up to £500 million if we took up to 40% as the first instalment rather than the 33% assumed above. We will of course aim to avoid this but we must take account of advice on whether 33% is a prudent minimum for a first instalment of a stock which could fall heavily before we come to collect the second instalment.

10. In the meantime while we could end up with more (or less), around £5.25 billion looks a possible outcome and I hope that you would agree that something like this would be acceptably near to the £5 billion target (it could be regarded as offsetting the 1986-87 shortfall of £356 million). An outcome somewhat over £5 billion is of course not surprising given that proceeds are benefiting from a bull market; that BT are redeeming their preference shares in response to falling interest rates; and that, contrary to our earlier worries, no sales have been deferred to next year as a result of Election timing.

11. If nevertheless you did want us to aim for lower proceeds, the only further measure, in addition to trimming the BAA instalment and renegotiating the terms of the BT preference shares, would be to sell less BP shares. However this would be contrary to your decision, reflected in the announcement, to sell all the remaining shares. The provision that this was subject to market conditions has been (rightly) interpreted as meaning adverse, rather than highly favourable, conditions. To retreat now could be

damagingly interpreted by the market as a lack of confidence in the success of the sale.

1988-89 to 1991-92

12. I am preparing a separate note on the later years. This will point out that average proceeds over the next 4 years seem bound to be more than £5 billion a year because of the size of instalments from earlier years plus likely proceeds from Steel, Water and Electricity as well as a further sale of, say, a third of our BT shares. Provisionally, an average of £6 billion or so a year looks more plausible for this period of major sales. While we can aim for a smoothish path of proceeds the outturn could be lumpier because the timing of sales is uncertain and you may wish it to be driven primarily by a need to complete sales as soon as practicable, particularly in the two years preceding the next Election. But I will discuss these issues and the options in more detail in my note on these later years.

Ch
Seems v diff, but wait for submission
AA

Conclusions

13. In the meantime for 1987-88 I invite you:

(i) to agree that I should tell BT that - as we must if we do not offer to renegotiate the terms - we will take receipt of their notice to redeem £250 million initially and probably £250 million more, subject to agreement on a precise time in the Autumn which suits us;

(ii) to note that the 1987-88 outturn could be in the order of £5.25 billion but that there are uncertainties either way.

DJLM.

D J L MOORE

CONFIDENTIAL

Privatisation Proceeds 1988-89 to 1991-92

£ million

	1988-89	1989-90	1990-91	1991-92
1. Gas debt	250	400	400	350
2. Gas (III)	1600	-	-	-
3. BAA (II)	650	-	-	-
4. Miscellaneous*	100	200	100	100
5. BP (II),(III)	2400	2400	-	-
6. BT (I),(II),(III)	1000	2250	-	-
7. BSC	-	750	750	-
subtotal	6000	6000	1250	450
Water/Electricity	-	-	[4750]	[5550]
TOTAL:	6000	6000	[6000]	[6000]

*mainly redemption of BT loan stock, plus an allowance for the sale of the residual holding of Wytch Farm in 1989-90.

1. This table sets out a possible pattern of proceeds on the assumption that, contrary to our wishes, the main Water legislation is in the second Session and sales cannot start until 1990-91 when Electricity sales should also be ready to roll.

MR 2/22

PRIVATISATION PROCEEDS

[Front page headline in today's FT: "Government likely to overshoot target for privatisation receipts"]

LINE TO TAKE

Not practice to speculate about proceeds of privatisations. Privatisation of BAA and sale of residual BP shareholding not yet taken place.

BACKGROUND

The front page article in today's Financial Times suggests an overshoot on the £5 billion privatisation target for 1987-88 of up to £1¾ billion.

2. We cannot refute the FT arithmetic, which is entirely logical on the assumptions known to them. Nor can we muddy the water. It is simply a matter of taking the proceeds already received, adding an estimate for BAA for which a sale price is announced tomorrow, and assuming a one-third sale of BP at £2 billion plus later this year. There are no other uncertainties.

3. [Market sensitive: not for use] What the FT do not know is
x that the structure of the BP sale ~~will~~ is likely to reduce the proceeds to HMG in
may x 1987-88. (BP ~~will~~ be raising £1½ billion of new capital
would x themselves, in conjunction with the Government sale, and ~~will~~ take this all in the first instalment of the combined sale, depressing HMG's take this year. But the BP Board have not yet formally taken a decision to raise this new capital, and when they do they are required to make an immediate announcement to the Stock Exchange. At this stage, therefore, we should not even hint at the possibility.)

Tuesday July 7 1987

Government likely to overshoot target for privatisation receipts

BY PHILIP STEPHENS, ECONOMICS CORRESPONDENT

THE GOVERNMENT looks set to overshoot its £5bn target for receipts from its privatisation programme in the current 1987-88 financial year by up to £1½bn.

The likelihood of a large overshoot was acknowledged in Whitehall yesterday as Mr Norman Lamont, the financial secretary to the Treasury, hinted that future privatisation proceeds would be boosted by the sale of the Government's remaining shareholding in British Telecom.

Mr Lamont, speaking at a conference in London, said that the Government had not decided on the timing of a disposal of its £8.8bn holding in BT, but noted that it would be free to sell it from next April.

The rise in stock market values behind the prospective overshoot in receipts this year is welcome news for the Government and for taxpayers but it comes at an awkward time for the Treasury.

It has strengthened expectations that the official target for the public sector borrowing requirement will be undershot in 1987-88 for the second consecutive year.

The target was lowered from £7bn to £4bn in last March's Budget, but the overall buoyancy of the economy and further strong increases in tax revenues suggest even the lower figure may turn out to be an overestimate. It is still too early for the Treasury to make an accurate forecast of the PSBR outturn, but its latest, unpublished, projections of the economic outlook are thought to point to an undershoot.

The problem for the Treasury is that the favourable financial outlook is likely to encourage spending ministers to redouble their efforts to secure extra financial resources in the current round of public spending negotiations.

Mr John Major, the newly-appointed Chief Secretary to the Treasury, has indicated that he will defend the £154.2bn spending target for 1988-89 set in the January White Paper. Because of higher-than-expected inflation, however, that total represents a slight fall in the volume of spending.

Within the overall figure, the plans suggest a significant fall in spending on defence, an effective freeze for health and social services, a fractional cut in social security spending, and increase of less than 0.5 per cent for education. They also make no allowance for a range of commitments made in the run-up to the election, nor for a likely rise in contributions to the European Community.

Government departments are believed to have submitted extra bids totalling several billion pounds. Some of these demands will be whittled down and others will be met from a £5bn reserve but there is strong speculation in Whitehall that the overall target will have to be raised.

Spending ministers are expected to argue that the healthy financial position makes it possible—as with last year—to have increases in public spending and tax cuts. Against that, however, the Treasury would like to keep open the option of another reduction in the PSBR to offset the impact of additional privatisation proceeds.

Continued on Back Page

Privatisation receipts Continued from Page 1

The exact size of the overshoot in those proceeds will depend on what proportion the Government takes this year of the £6.5bn expected from the sale of its BP shares. It will also be affected by whether British Telecom repays around £500m of loan stock it owes the Treasury.

Before those two items are counted, receipts from the sales of British Gas, British Airways, the British Airports Authority, Rolls-Royce, Royal Ordnance, and National Bus, are expected to total about £4.2bn. If the BT loan was repaid and the Treasury took one-third of the BP proceeds this year, total receipts would reach £6¾bn.

Those figures make it clear that there will be no immediate financial pressure on the Government to sell its remaining BT stake. It could, however, be used to plug an expected gap in the privatisation programme in perhaps 18 months to two years' time if the sale of the water authorities is further delayed.

C5/033

CONFIDENTIAL

FROM: A W KUCZYS
DATE: 26 June 1987

MR D J L MOORE

cc: PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Cassell
Mr Peretz
Mr Scholar
Mr Turnbull
Mr Odling-Smee
Mr Sedgwick
Mrs M E Brown
Mr Culpin
Mr Bent
Mr Tyrie

PRIVATISATION PROCEEDS 1987-88

The Chancellor and Financial Secretary discussed your and Mr Cassell's minutes of 17 June with you and others on Friday 19 June. The Chancellor noted that on current assumptions, the proceeds outturn for 1987-88 was likely to be a little one side or the other of the £5bn target. If the BP sale went ahead in full, the likely figure was £5¼bn. If it did not, and the Gas debt was subsituted, then the outturn would be of the order of £4¾bn. It was agreed that the BP sale should proceed, but that we might try and persuade BT only to redeem £¼bn, rather than the full £½bn, of their preference shares.

1987-88 PSBR

2. Mr Cassell said that the PSBR this year was much more likely to undershoot than to overshoot. There was a case for trying to avoid overshooting on privatisation proceeds, which would exacerbate the position. In discussion, however, it was agreed that there was a danger of the tail wagging the dog here. Whether the privatisation proceeds totalled £5¼bn or £5bn was neither here nor there in relation to the likely scale of the PSBR undershoot. It would be wrong to retreat now from a full sale

of the remaining BP shares. There were, however, ways in which the 1987-88 proceeds might be trimmed slightly: a loyalty bonus for BP would have this effect, as would rounding down the price of the first instalment of BAA shares. The Chancellor would, at a later stage, want to discuss the question of the PSBR undershoot, in the light of the summer forecast.

Privatisation Proceeds in later years

3. In your minute, you had proposed raising the target in later years from £5bn to £6bn. The Chancellor said he would be prepared to consider this, but would want to be confident that we could maintain proceeds at that level over a number of years. It was very important that the proceeds path should be smooth. You said that that could be difficult to deliver in practice, and the Chancellor agreed that he would not hold up a genuine privatisation (as apposed to a secondary sale) merely for the sake of smoothness. However, the sale of residual holdings gave us some flexibility.

4. More specifically, the Chancellor was dubious about the projected total of £4750m from Water and Electricity in 1990-91. This assumed a batch of three water authorities being sold in that year. The Chancellor's view was that, in order to get the programme of water privatisations off to a successful start, it might be better to go first with one Authority whose management were fully committed and enthusiastic. Severn Trent was the obvious example.

5. If the total from Water and Electricity were therefore substantially lower in 1990-91, and if the third tranche of BT were postponed from 1989-90 to 1990-91, then the total proceeds would remain at around £5bn a year. (It might be best to defer the further tranches of BT in any case, until we had a better idea of how the proceeds from Water and Electricity were likely to build up.) You would provide a further note on proceeds in later years.

Conclusions

6. It was agreed that the BP sale should go ahead this Autumn as planned. You would provide a further note on privatisation

proceeds in future years. And the Chancellor would want to discuss the question of an undershoot in the PSBR on the basis of the Summer forecast.

A W KUCZYS

3678/018

CONFIDENTIAL

FROM: D J L MOORE
DATE: 1 JULY 1987

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Monck
Mr Cassell
Mr Peretz
Mr Scholar
Mr Turnbull
Mr Odling-Smee
Mr Sedgwick
Mr Culpin
Mrs M E Brown
Mr Colman
Mr Bent
Ms Leahy
Mr Tyrie

~~Ch/ See also minute from Andrew Turnbull below~~ AWK 1/7

PRIVATISATION PROCEEDS
1988-89 to 1991-92

You have discussed with us my note of 17 June on 1987-88. You agreed that we should continue to assume sale of all our remaining BP shares. Looking forward to the later years, you said that you would be willing to move up to an annual target of £6 billion provided you were confident that proceeds at that level could be maintained over a number of years; and that, while the aim should be to achieve a smooth proceeds path, you would accept overshooting the target in any year rather than hold back a privatisation.

Ch/ This is true, but you made it clear your thought the case for moving to £6 billion had not been made out AWK 1/7

2. I now attach a paper which discusses the programme for these later years. The conclusion is that because of the size of the candidates in the pipeline we ought to raise the annual totals from £5 billion to at least £6 billion, though the totals for 1990-91 and 1991-92 are particularly uncertain while so much remains to be settled on the shape and timing of Water and Electricity sales.

3. The paper shows how the totals in the first two years might be kept down to £5 billion if you so wished, principally by exercising options on the scale and timing of the BT sale. Even if these two years were kept down

to around £5 billion it would be very difficult to keep down the two following years to that level other than by deliberately holding back Water and/or Electricity sales which you do not want to do. On the other hand, if Water and Electricity sales went much more slowly than assumed here and provided insufficient proceeds to make up the £6 billion target, there could be scope for topping-up from further BT sales - either conventional sales or, if you were willing, bought deals with institutions, either UK or overseas.

4. But whatever the level of the published totals there are undoubtedly problems in keeping close to them in practice, as we are finding this year in a bull market and with everything going better than expected in terms of proceeds (e.g. our figures assume a price of £3.50p for BP but it was at £3.89p on 29 June and 1p = £17.3 million on HMG's holding). And there comes a point when manipulation of the size and timing of instalments is not practicable or defensible in either marketing or value for money terms.

(= an extra £2/3 billion)

5. Given these problems over levels and smoothness, you will want to read this paper alongside the paper of 1 July* by Mr Turnbull which examines the case for changes in the presentation of privatisation proceeds in relation to public expenditure and to borrowing.

*immediately below

DJM.

D J L MOORE

Enc:

CONFIDENTIAL

Privatisation Proceeds 1988-89 to 1991-92

£ million

		1988-89	1989-90	1990-91	1991-92
1.	Gas debt	250	400	400	350
2.	Gas (III)	1600	-	-	-
3.	BAA (II)	~~625~~ 725	-	-	-
4.	Miscellaneous*	100	200	100	100
5.	BP (II),(III)	2400/2700	2400/2700	-	-
6.	BT (I),(II),(III)**	1000	2250	-	-
7.	BSC	-	750	750	-
	sub-total	6000	6000	1250	450
	Water/Electricity	-	-	[4750]	[5550]
	TOTAL:	6000	6000	[6000]	[6000]

*mainly redemption of BT loan stock, plus an allowance for the receipt of the second tranche of receipts from the Wytch Farm sale in 1989-90.

**the table assumes that the 2nd & 3rd BT instalments both fall in 1989-90, though an option would be to have the 3rd in the following year.

1. This table sets out a possible pattern of proceeds on the assumption that, contrary to our wishes, the main Water legislation is in the second Session and sales cannot start until 1990-91 when Electricity sales should also be ready to roll.

2. It shows how proceeds might total £6 billion in each of the first two years on a basis which I explain below. The paper discusses how these plans might be altered if it were possible to have some Water sales in 1989-90 and also what would be necessary if you wanted no more than £5 billion in each year.

3. In 1990-91 and 1991-92 I have simply assumed that as many Water and Electricity sales as possible would be packed in before the next Election and that proceeds would be sufficient to bring the totals up to at least £6 billion a year and possibly more. This approach sidesteps questions, which are impossible to answer yet, of how Electricity might be privatised, of the order in which the Water Authorities might be sold, and of what priority might then be given to Water and Electricity sales respectively.

4. Items 1-7 in the table total about £13.75 billion over the 4 years, (the BT component is put at £3.25 billion but it could be anything from nil to £9 billion). Water is probably worth around £7 billion and so we could be heading for £20 billion in the 4 years without taking account of any Electricity proceeds. This points to an average of at least £6 billion a year, allowing for Electricity. Even so the implication of these figures and of the timetable is that not all the Water Authorities will necessarily be sold in this period and that not all instalments would have been received; this should be made clear to DOE Ministers. Even more so, the message is that probably most of the Electricity proceeds will be post 1991-92 even if sales were before then.

5. The totals in the table are seductively smooth but the outturns could well vary for the first two years (e.g. if there were no Steel sale in 1989) and for the two later years they are so uncertain that I have square bracketed them. Any shortfall on the £6 billion in 1990-91 and later could probably be made up from further BT sales. But if all goes reasonably well it is much more likely that we could be looking at more than £6 billion in these later years.

1988-89 and 1989-90

6. There is some scope for switching Gas debt redemptions between financial years. The third Gas equity instalment in 1988-89 is fixed, and in July we will have a firm figure for the second BAA instalment. The miscellaneous row will not change much. The BP second and third instalments are based on a price of about £3.50p and could change significantly (1p on the price equals £17.3 million on the gross value of our holding). But any changes in the BP outturn for these years could be offset by changes in the BT figures.

7. By the end of October and the conclusion of the BP sale we will have pretty firm figures for items 1-5 in the table and we can focus on the options for a BT sale.

British Telecom

8. After April 1988 you are free to sell the 49% BT holding - currently worth about £9 billion - and there is a good case for selling some of it in summer or autumn 1988.

9. Otherwise there would be no sales in 1988. And it could be difficult to sell BT shares in 1989 because the valuation, and the writing of the prospectus, would be affected by some major decisions due around then - DG/OFTEL's revision of the RPI-3 formula after July 1989 and of certain licensing arrangements; and review by DTI of the BT/Mercury duopoly which runs to 1990.

10. For the purposes of the table I have assumed a £3¼ billion BT sale, with a 30% or so first instalment in 1988-89 and the second and third instalments both in 1989-90 (their timing would need careful thought as we will have the large final BP instalment in April 1989 plus BSC and/or Water sales later in 1989).

11. These figures and the pattern could be varied up or down after October when we know the likely outturn for sales 1-5. If necessary the third instalment could be in 1990-91. If there is to be a BT summer 1988 sale it should be announced no later than January 1988 so that we can get on with organising it; though if the November 1987 Autumn Statement puts 1988-89 proceeds up to £6 billion it should then be obvious to any numerate commentator that a BT sale is planned for that year. In announcing the sale you could also indicate that there would be further sales in later years, so underwriting the annual totals of £6 billion.

BSC

not attached

12. As explained in Mr Colman's minute of 12 June, Steel could be ready for sale in summer 1989 provided the European steel market remains reasonably orderly and some tough decisions are taken to reduce BSC's capacity and costs.

13. In the table I have guessed at total proceeds of £1.5 billion in two equal instalments in 1989-90 and 1990-91. This assumption is a good illustration of the great uncertainty over the totals. We do not have anything near a firm idea of total BSC proceeds. We do not know whether a 100% sale will be sensible. And we do not know whether any sale will be practicable in 1989. If it were not, and if this were not certain until after a BT sale in 1988, there could be a shortfall of £350 million (after bringing forward £400 million of Gas debt) on the £6 billion shown in the table.

Variations

14. In recognition of the size of the candidates in the pipeline I think we should move up to an assumption of £6 billion a year.

15. However, if you wanted only £5 billion in each of the first two years we could postpone the BT sale until 1989 provided we could cope with the problems described in paragraph 9. There could then be a sale of, say, £1¼ billion in 1988-89 and if necessary no further BT instalments in the later years. Alternatively, if BSC does go ahead in 1989 we could take both BSC instalments in 1989-90 and balance up with Gas debt, i.e. no BT sale.

16. If Water sales were possible in 1989-90, and if you wanted proceeds of no more than £5 billion, the BT sale could be scrapped entirely if it were likely that a BSC sale was on.

17. Alternatively if Water sales could start in 1989-90 and if around £6 billion a year were acceptable the BT sale could be confined to £1 billion in 1988-89 and Water sales in 1989 substituted for the BT receipts of £2¼ billion shown in the table for 1989-90.

18. In short the BT sale is a key to flexibility. How we can use it most effectively can be decided when we have a better idea of when Water sales will start and as good an idea as possible of whether and when the BSC sale is a runner (though there will be some uncertainty on this until near the time of the sale).

<u>1990-91 and 1991-92</u>

19. The basis for the figures in the table for these years is explained in paragraph 3.

20. Our current understanding is that if the Water Bill is not enacted until summer 1989 sales cannot start until summer 1990. This is because after Royal Assent it will be necessary to split functions between the new public sector Rivers Authority and the revamped Water Authorities which would be vested as plcs. DOE claim this would take until April 1990.

21. The first batch of Water Authorities could be sold in summer 1990. But the rest would have to compete with Electricity sales in autumn 1990 and summer and autumn 1991. With the next Election no later than June 1992 there is likely to be a pile-up. That is why we want Water sales to start in 1989 if possible.

CONCLUSIONS

22. Given the size of the coming privatisation programme there is a strong case for moving up to annual totals of £6 rather than £5 billion; and it is possible that more might be necessary from 1990-91. But whatever the targets it would be realistic to allow for flexibility around them because of in-year uncertainties. It would be easier to be tolerant of such variations in the path if privatisation proceeds were not included in the aggregates for which macro-economic objectives are set and so did not enter into the judgment about whether expenditure or borrowing plans were being hit. The options are discussed in Mr Turnbull's paper of 1 July on the treatment of privatisation proceeds. \below

DJLM.

D J L MOORE

2136/26

CONFIDENTIAL

FROM: A TURNBULL
DATE: 1 JULY 1987

CHANCELLOR

cc CST
FST
EST
Sir P Middleton
Sir G Littler
Sir T Burns
Mr F E R Butler
Mr Wilson
Mr Anson
Mr Cassell
Mr Monck
Mr Scholar
Mr Moore
Mr Odling-Smee
Mr Peretz
Miss Peirson
Mr Sedgwick
Mrs R Butler
Mrs M E Brown
Mr Gieve
Mr Mowl
Mr Pratt
Mr Watts
Mr Deaton
Mr Bent
Mr Tyrie

TREATMENT OF PRIVATISATION PROCEEDS

The treatment of privatisation proceeds as reducing expenditure and the deficit has come into question in three contexts. First, the paper on the public expenditure treatment of local authority expenditure suggests a new planning total which places local authorities' self-financed expenditure below the planning total but within general government expenditure, as debt interest is treated now. One possibility would be to treat privatisation in the same way.

2. Second, the report to the previous Chief Secretary on the conference Mr F E R Butler and I attended in Ottawa in April noted that both France and Japan deliberately avoided treating privatisation proceeds as either negative expenditure or revenue but rather as financing the deficit. They felt it unwise to improve the appearance of the deficit as this would make it more difficult for the Ministry of Finance to keep up the pressure on spending departments. Both countries devoted most of the proceeds to the reduction of debt, channelling them through special funds. The then Chief Secretary asked whether a similar treatment might be considered in the UK.

3. Third, as Mr Moore's submission of 1 July below points out, it is possible to **plan** for a smooth run of total privatisation proceeds over a period of years but there is no certainty of being able to deliver it - eg it might be necessary to go over the target in one year to allow for a particular privatisation if this turned out to be possible earlier than previous assumed;

a planned sale could fall through when it was too late to replace it; within a year, proceeds can vary significantly from estimates if markets are strong (as this year) or weak. The presentation of the privatisation totals should recognise these uncertainties.

4. Consideration of the treatment of privatisation proceeds in the expenditure aggregates leads on to the treatment in the measure of the fiscal deficit. At the same time, any change in the way sales and purchases of financial assets are dealt with raises questions about sales and purchases of existing physical assets, especially land and buildings. Inevitably one is dealing with a spectrum of transactions and changes in definitions need judgements about whether any new borderline is more defensible.

5. The attached paper sets out the present treatment of privatisation proceeds, identifies a number of options for change, and considers what would be involved in each. Briefly the options are:

a. maintain present definitions but increase emphasis on the expenditure aggregates and PSBR excluding privatisation proceeds;

b. take privatisation proceeds out of the planning total but leave them in GGE and the PSBR;

c. redefine both the expenditure aggregates but leave the PSBR unchanged;

d. redefine the planning total, general government expenditure and the PSBR.

For each of these options there is the possibility of extending the redefinition to the other Odling-Smee/Riley adjustments, eg physical assets and net lending on commercial terms.

6. At a meeting held by Sir P Middleton, a variety of views were expressed. Some saw merit in taking privatisation proceeds (or the related national accounts concept "net cash expenditure on company securities") out of measures of expenditure and deficit, though it would be more difficult to present such a change now

than it would have been in the early stages of the privatisation programme. Others felt that a deficit defined in this way, though perhaps a better measure of fiscal stance or of the public sector's claim on capital markets, was not sufficiently robust to justify surplanting the PSBR which had remained largely unchanged for nearly 20 years. Other, equally troublesome, borderline issues would remain.

7. The meeting then considered whether there was a case for adjusting the planning total and GGE while leaving the PSBR unchanged, either by adding privatisation proceeds back as an adjustment line, or by including them in general government receipts. Though this had some support, most present felt that reluctance to deploy the argument that privatisation proceeds were more akin to financing transactions, and should be taken below the deficit, weakened the case for adjusting expenditure.

Agree.

8. The course which commanded most support at the meeting was, therefore, that we should leave the definitions of both GGE and the PSBR unchanged, while continuing to emphasise the figures for both excluding privatisation proceeds. This would answer criticisms that the Government was ignoring the different impact of privatisation proceeds, but without raising questions of what was <u>the</u> best measure of expenditure or the deficit. Emphasising the figures excluding privatisation proceeds would also help accommodate variations in the privatisation programme of the kind indicated in paragraph 3.

9. The final possibility was to take privatisation proceeds out below the planning total, but leave them within GGE. This would help ease the problem of managing the privatisation programme as variations from planned sales would not enter the calculation of whether or not the planning total was hit. But to make such a change in isolation would raise the question of why the same change was not being made for GGE without producing a satisfactory answer. Some saw merit, however, in making this change less conspicuously if it were decided to undertake a major reconstruction of the planning total as part of a revised treatment of local authority expenditure.

AT

A TURNBULL

cc Mr Wells)
Mr Mansell) CSO

2/2995

CONFIDENTIAL

TREATMENT OF PRIVATISATION PROCEEDS

This paper considers the treatment of privatisation proceeds within the public expenditure aggregates and the PSBR and the options for change. It looks also at the implications for other transactions such as purchases and sales of land and buildings or net lending on commercial terms, which have also been considered as adjustments to the fiscal deficit.

Current Position

2. The term "privatisation" covers a wide spectrum of transfers of activity to the private sector from a hospital contracting out its cleaning to the sale of British Gas. The main concern here is the Government's **central** privatisation programme which comprises mainly the sales of company securities for cash but in the past has also included sales of Forestry Commission land, motorway service areas, and commodity stockpiles. It does not include sales of council houses and most other sales of land and buildings. At present, proceeds of this central privatisation programme reduce the public expenditure planning total (PEPT) and are shown separately from departmental programmes.

3. General government expenditure (GGE) is built up from national accounts catgories and differs in a number of respects from the public expenditure planning total which is defined for the purpose of expenditure control. GGE does not recognise privatisation proceeds as a distinct category but there is a considerable overlap between privatisation proceeds and the national accounts category of "net cash expenditure on company securities", the latter including other transactions in company securities such as the purchase of shares in Rover. The relationship between adjustments to the PEPT and adjustments to GGE is considered in more detail in the Annex.

4. The expenses incurred in selling shares are within the planning total, being netted off as part of the central privatisation programme. GGE also includes these expenses but as current expenditure rather than under the category of cash expenditure on company securities.

5. The PSBR is the difference between GGE and general government revenue plus the market and overseas borrowing of public corporations. At present all privatisation proceeds reduce the PSBR through one of these components.

Objectives

6. In seeking the best treatment for privatisation proceeds one needs to bear in mind the following objectives:

a. the treatment should be conducive to robust control of public expenditure;

b. it should provide for the efficient management of the privatisation programme;

c. the measure of fiscal deficit should provide a good indication of the stance of fiscal policy;

d. given that the company securities which the Government sells on privatisation are fairly close substitutes for gilts or national savings, it makes sense to consider the Government's various demands on financial markets together.

The new treatment should meet with general acceptance so that there is little pressure to change it again and it is important that one can justify what is included and excluded (eg council house sales).

Possibilities for change

7. There is no suggestion of altering the underlying framework of national accounts. The following options are concerned with changes to policy aggregates:

a. Retain the present treatment whereby privatisation proceeds reduce the PEPT, GGE and PSBR, but when publishing figures for them (eg in PEWP and FSBR) to emphasise the paths adjusted for privatisation proceeds to an even greater extent than at present.

b. Enter privatisation proceeds below the planning total but still within GGE, though as in (a) it would be the excluding measure for GGE that would be emphasised. This could be as part of a restructured planning toal to provide a different treatment of local authority expenditure.

c. Remove privatisation proceeds from the planning total and net cash expenditure on company securities from GGE (ie no longer netting them off) leaving the definition of the PSBR unchanged but presenting it with and without privatisation proceeds though with more emphasis on the latter. (The precise changes to GGE and PEPT under this option are considered in the Annex.)

d. Change PEPT and GGE as in option (c) but carry through the changes to GGE into PSBR, so that transactions in company securities including privatisation proceeds would be part of the financing of the PSBR.

8. At present, privatisation proceeds are shown net of the expenses incurred in selling shares. This treatment allows us to avoid making any public forecast of sale expenses, by taking token Estimate provision for sale expenses and then, subsequent to the sale, taking a Supplementary which takes provision for the gross sale expenses and Appropriates in Aid sufficient of the proceeds to match those expenses. There is no direct net claim on the Reserve, nor is there any increase in cash limits.

9. If gross privatisation proceeds are removed from public expenditure, it would be difficult to justify removing sales expenses as well. They clearly represent public expenditure within the Government's control and would be so treated in the national accounts. The normal treatment would be to show these expenses in the PEWP and as cash limited Estimates, with any increases being a claim on the Reserve, but this would mean disclosing forecasts of sale expenses into the Estimates and this could be market sensitive. It would be relatively straightforward to avoid disclosure in Estimates by taking token provision as we do now. But to avoid disclosure, it would also be necessary to keep sales expenses out of departmental programmes in the White Paper. This,

in turn, implies accepting sales expenses as a claim on the Reserve, there being no prospect of getting departments (including the Treasury in the case of BT and BP) to absorb these costs.

Considerations

10. From the point of view of **public expenditure control**, we were able, for a number of years, to benefit presentationally from the inclusion of privatisation proceeds in the planning total and GGE. Increases in programme expenditure were offset by increases in privatisation proceeds allowing us to show planning totals as being held, to quote lower rates of increase in public expenditure and lower ratios in relation to GDP. In the Autumn Statements and White Papers of the last two years we have drawn attention to the aggregates both including and excluding privatisation proceeds. However, this still afforded a degree of flexibility; for example, when discussing the real rate of growth of expenditure we excluded privatisation proceeds but we included them when focussing on the ratio to GDP.

11. However, the benefit of treating privatisation proceeds as negative expenditure within the planning total has been a depreciating asset. We no longer see much advantage in using higher privatisation proceeds to disguise higher programme spending - the effect is merely to stimulate accusations of unsound finance. It is doubtful whether there are now significant benefits in terms of control to be secured. The privatisation programme has a rationale of its own and has no real links with other expenditure programmes. In contrast to the case of local authority sales of houses, departments are not allowed to increase their expenditure where the privatisation programme is exceeding its planned level, nor is there, in practice, any general expectation that they will find offsetting savings if proceeds prove to be below the plan. Increasing the emphasis on the measures excluding privatisation proceeds as in options (a) and (b) would improve presentation without loss of control. But it could be argued that keeping the proceeds within the planning total and GGE but then presenting the aggregates after taking them out effectively concedes the case that they do not really belong there, without entirely removing the underlying suspicion of unsound finance. This leads to consideration of options (c) and (d).

12. In macro-economic terms, the impact of privatisation proceeds on aggregate nominal demand is not significantly different from the sale of gilts (though the supply side effects are quite different). Both of them may alter relative yields on different financial assets, but they are unlikely to affect the overall level of interest rates or financial conditions more generally. By contrast a reduction in the PSBR resulting from reduced expenditure on goods and services would tighten financial conditions and reduce money GDP. A measure of the fiscal stance that was intended to represent the impact of fiscal policy on money GDP should therefore exclude privatisation proceeds.

13. However, a similar argument could be made about all transfers of existing assets between the public and private sectors (eg including council house sales) and that part of net lending which is done on commercial terms and hence would otherwise be done by the private sector. It would not be easy to justify excluding privatisation proceeds but not all the other items from the PSBR.

14. Although removing central privatisation proceeds alone from the PSBR (as in option (d)) would represent an improvement on the present definition, dispute would still remain about the treatment of other asset sales and we might have difficulty in persuading people that the change would be permanent. Adoption of a new definition might also make it more difficult to defend the existing position that no single measure of fiscal stance was appropriate in all contexts.

15. There are also macro-economic arguments for removing privatisation proceeds and related items from GGE. These are similar to those for removing them from the PSBR. The underlying reason for reducing the GGE/GDP ratio is to create room for reductions in the tax burden. Changes in privatisation proceeds can be reflected in changes in either the tax burden or borrowing,

assuming that other expenditure is unchanged. Their exclusion from the PSBR implies that they would normally be offset by changes in borrowing rather than taxation. In such circumstances it would be misleading if GGE were to change when privatisation proceeds changed, since it would signal a change in the tax burden which would not normally occur. As with the PSBR, there is no macro-economic reason in the GGE case for distinguishing between privatisation proceeds and the other related items, including council house sales.

16. There are, however, dangers in having definitions for the planning total and GGE which are too far apart. The Government's medium term expenditure objectives have been framed in terms of GGE. The planning total provides an intermediate target which, if achieved, will (after taking account of the forecast for debt interest) secure the expenditure objectives. On control grounds, therefore, changes in the planning total and GGE should as far as possible be consistent with one another. For example, to exclude all purchases and sales of existing assets from GGE might signal that such transactions were in some sense of less concern and make it difficult to continue to retain them in the planning total.

17. As explained in Mr Moore's paper of 1 July, the present treatment does not provide for the most **efficient management of** the privatisation programme. If the government performance against the target was no longer as crucial (which it is by being included in the planning total) greater weight could be given to the state of the market when considering the appropriate timing of sales and of part payment. We should try to avoid a situation where, for example, the amounts and timing of instalment payments might have to be manipulated in order to get nearer to targets even if this were not in the interests of maximising proceeds from the sale. All the options would represent some easement of the difficulties.

18. Removing privatisation proceeds from the PSBR as in option (d) would allow what many see as two ways of **financing** the Government deficit - sales of gilts and equities - to be better integrated or at least make the existing degree of integration more apparent. It would, for example, make it easier to take account of the pattern

of gilt redemptions in future years in deciding the timing of calls on privatisation issues.

Presentation

19. Any change to PEPT, GGE and PSBR would have to be carefully handled and presented. Superficially it would suggest higher public expenditure and a higher PSBR:

£ billion

	1985-86	1986-87	1987-88	1988-89	1989-90
PEPT (present)	134	140	149	154	162
PEPT (without pp)	137	145	154	159	167
GGE (present)	159	165	174	180	188
GGE (without cecs)	162	169	179	185	193
PSBR (% GDP) (present)	1.6	1	1	1	1
PSBR (% GDP) (without cecs)	2.3	2	2	2	2

[Source: compiled from FSBR 1987-88]

20. If privatisation proceeds were excluded from the PSBR, we would need to present the illustrative path for the fiscal deficit in the MTFS in terms of the new aggregate. On current figures this would be 2 per cent of GDP a year from 1986-87 to 1990-91. There are two presentational differences about this. First, it is above the 1 per cent which is the long term aim - but this may not be serious drawback because financial markets already understand the point. Secondly, there would be only a very small decline, if any, in the figure over the medium term. It would probably be necessary to introduce a gradual decline, for example by holding the figure constant in nominal terms instead of rising (from about £9 billion in 1987-88 and 1988-89 to about £10 billion in 1989-90 and 1990-91) as it does in the current MTFS.

21. Since the current presentation does not conceal the fact that privatisation proceeds are netted off public expenditure

and PSBR, and given that past figures would be revised to show the new aggregates on a consistent basis, no-one should be misled by the change. However, to help avoid any confusion and misleading interpretations any redefined aggregates could be given new names.

20. Even though the Treasury has given emphasis to the aggregates excluding privatisation proceeds, options (c) or (d) would still represent a major break with the past and would need to be justified. When the privatisation programme was started, the accounting treatment adopted was simply that which was in force at the time. However, as the privatisation programme has grown from £405 million in 1980-81 to around £5 billion now - a reconsideration is called for. It has always been recognised that these transactions are different in kind from most expenditure and given the increase in the size of the programme it becomes more important to separate out privatisation proceeds from the trends for the rest of expenditure and, in option (d), for borrowing. It would, moreover, be a change which many commentators have called for and is more likely to be welcomed than criticised.

23. In the past we have justified the present treatment of expenditure and the deficit with reference to international conventions. However, there is no single internationally recognised convention. IMF, UN, OECD and the EC each have their own manuals and even the IMF interpret their own guidelines differently from the approach we have taken. The main consistency in international conventions is in terms of treating financial transactions on a net basis and this would be retained by all the options. None of the options would affect the underlying framework of national accounts.

24. Several other changes have been suggested to the planning total and PSBR such as the revised treatment of local authority expenditure. There would clearly be advantages in introducing all such changes at the same time, thereby easing the problem of presentation.

A Special Fund

25. If privatisation proceeds were excluded from the PSBR, any discipline that a fund would impose on the uses of the proceeds

would be unnecessary, since they would essentially be assigned to reducing debt. There would, however, be more of a case for a special fund if privatisation proceeds were not excluded from the PSBR. The purpose in this case would be to put a ring fence round them and indicate that they were not available for additional public expenditure. However, hypothecation of revenues is avoided for generally good reasons. And a publicly visible fund, like that canvassed for North Sea oil revenues, could be counter-productive if it stimulated claims for additional expenditure. On balance we would recommend against setting up a special fund.

GEP Group
July 1987

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ANNEX

PRIVATISATION PROCEEDS, PLANNING TOTAL AND GGE

This annex outlines in more detail the relationships between privatisation proceeds and the expenditure aggregates, PEPT and GGE. It goes on to consider how precisely the aggregates would be changed in a revised treatment of privatisation proceeds.

The Expenditure Aggregates

2. The Government's central privatisation programme comprises mainly but not exclusively the sales of company securities for cash. At present the proceeds of this programme reduce the public expenditure planning total (PEPT) and are shown separately from departmental programmes.

3. The national accounts framework does not recognise privatisation proceeds as a distinct category, nor does it employ the PEPT as a concept. National accounts derive a financial surplus/deficit from the expenditure and receipts on current and capital accounts. In this framework both cash expenditure on company securities and net lending to the private sector are treated as financial transactions (ie financing the deficit on current and capital accounts).

4. General government expenditure (GGE) and the PSBR are hybrid concepts in that they are not themselves part of the national accounts framework but are built up from national account categories. GGE is the sum of current and capital expenditure (as defined in national accounts), net lending to other sectors and cash expenditure on company securities. The latter is a net concept and thus includes the major part of privatisation proceeds but also any purchases of company securities. General government expenditure differs from PEPT in a number of respects where Ministers have decided to adopt a different coverage for reasons of expenditure control. The PSBR is the difference between GGE and general government receipts plus the market and overseas borrowing of public corporations.

Privatisation Proceeds and Cash Expenditure on Company Securities

5. There is a substantial overlap between the privatisation programme and the national accounts category of "cash expenditure

on company securities" in that both include the proceeds from the sales of shares in nationalised industries. The overlap between these two categories is shown as Area B of Figure 1. However, the privatisation programme also includes a number of items apart from the sale of company securities such as the sales of certain physical/fixed assets (eg land and buildings) which are not credited to departmental programmes, some sales of stocks, a small amount of net lending, and the expenses incurred in selling shares (Area A). A full list of the national accounts categories of the privatisation programme is shown in Table 1. Most of these items are within GGE either because they fall in the category of "cash expenditure on company securities" or some other expenditure category such as fixed investment, net lending or final consumption. However, North Sea oil licence premia are within the privatisation programme but are treated in national accounts as central government revenue while other proceeds fall within the public corporation sector rather than within general government. Because the PSBR is the difference between GGE and general government revenue plus the market and overseas borrowing of public corporations, all these privatisation proceeds are within the definition of the PSBR so that the proceeds reduce the PSBR rather than forming part of its financing.

6. As Figure 1 shows the national accounts category "net cash expenditure on company securities" includes not only the sale of shares in former nationalised industries but also the purchase of shares (Area C). It thus includes the injection of funds into Rover for restructuring since this took the form of purchases of equity and a small amount of Northern Ireland industrial support (see Table 2). This category would, in addition, include the cost of any nationalisation which took the form of purchases of share for cash but not one which took the form of a swap of shares for gilts.

Changes to the Expenditure Aggregates

7. The arguments for taking privatisation proceeds out of the planning total relate largely to the sale of shares in nationalised industries - Area B in the diagram. Under option (b) in the main paper, these would be removed from PEPT and under options (c)

and (d) from both PEPT and GGE. One needs to consider, however, how to treat the two non-overlapping areas of Figure 1.

8. In order to maintain the national accounts basis of GGE it is desirable that GGE be defined as the sum of national accounts categories. This suggests removing "cash expenditure on company securities" from GGE in options (c) and (d). This, however, would also have the effect of removing purchases of company shares - Area C - from GGE but not from the planning total.

9. For the minor items in Area A it is proposed that under options (b), (c) and (d):-

i. the proceeds from the sales of land and buildings and the stockpiles (and other items still within GGE) which at present are treated as privatisation proceeds should score as negative expenditure on the relevant departmental programmes with corresponding reductions in future PES provision;

ii. the administrative expenses incurred in selling shares (including vouchers given to purchasers) score as expenditure on the relevant departmental programme;

iii. the revenue from North Sea oil licences and Crown Agents receipts be treated as government revenue, thereby removing a nationalised accounts adjustment between GGE and PEPT;

iv. the public corporations receipts and expenditure currently classed as privatisation proceeds be taken into account in setting their EFLs.

These adjustments would mean that under options (c) and (d) the changes to GGE and PEPT were fairly similar, removing the national accounts adjustment for North Sea oil but introducing one for the purchases of company securities. Under option (b) the national accounts adjustment for North Sea oil would be removed but one would be introduced for the proceeds from the sales of nationalised industry shares.

10. Although the proposed changes to GGE would not affect the underlying framework of national accounts, the dividing line between

cash expenditure on company securities and net lending is sometimes a difficult one to draw and hence there are arguments for treating these two categories in the same way when defining GGE. However, it is probably more important that any changes to GGE and PEPT are as similar as possible. It is therefore proposed that net lending remains within GGE.

Changes to PSBR

11. Under option (d) the change in GGE would be reflected in PSBR which was still the difference between GGE and general government receipts plus the market and overseas borrowing of public corporations.

12. Under option (c) the definition of the PSBR would remain unchanged . The following tabulations show the relationship between aggregates under the present treatment and one possible way of presenting option (c). However, there are other possibilities such as bringing "cash expenditure on company securities" into the calculation of general government receipts and thereby maintaining the present definition of the general government borrowing requirement.

Present Treatment	Option (c)
Departmental programmes + Reserve + Privatisation proceeds(4)	Departmental programmes(1) + Reserve
Planning Total + Debt Interest - PC Market and Overseas Borrowing + Other n/a adjustments	New Planning Total + Debt Interest - PC Market and Overseas Borrowing - Cash expenditure on company securities excluded from privatisation programme(2) + Other n/a adjustments(3)
General Government Expenditure - General Government Receipts	"New" General Government Expenditure - General Government Receipts
GG Borrowing Requirement + PC Market and Overseas Borrowing	"New" GG Borrowing Requirement + PC Market and Overseas Borrowing + Cash expenditure on company securities(4)
PSBR	PSBR - privatisation proceeds(2)(4)
	Adjusted PSBR

<u>Notes</u>

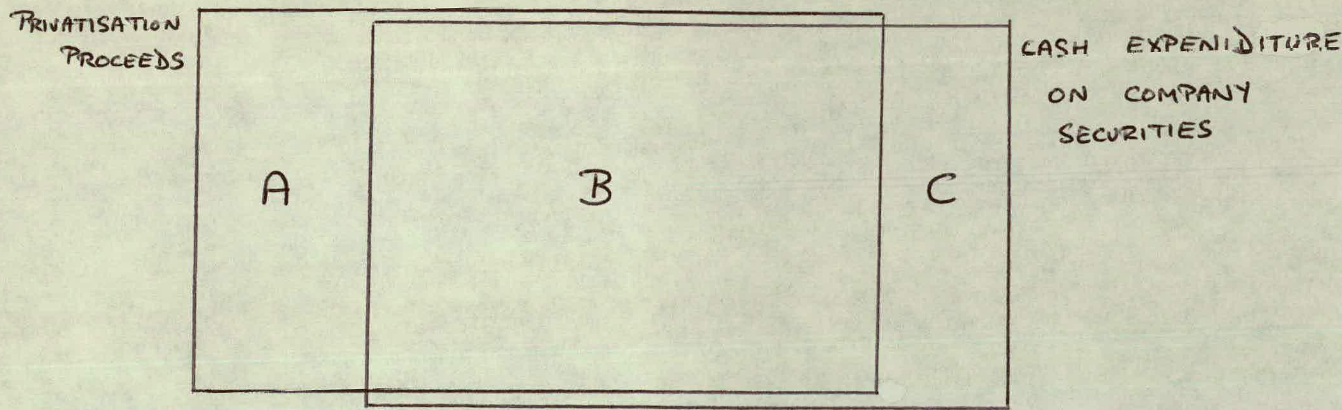
(1) Adjusted for items (i), (ii) and (iv) of paragraph 9

(2) Adjusted for items (i)-(iv) of paragraph 9

(3) Adjusted for item (iii) of paragraph 9

(4) Privatisation proceeds are a negative expenditure item and net cash expenditure on company securities is a negative amount since they are mainly sales

Figure 1



		Expenditure (+) Receipts (-)	Items in Table 1
A :	Sales of land etc. and stocks	(−)	(f + g + k)
	Administrative Expenses	(+)	(c + e)
	Revenue in National Accounts	(−)	(a + b)
	Net lending	(−)	(i)
	Others	(+)	(d + j)
B :	Sales of Nationalised Industries	(−)	(h + l)
C :	Other cash expenditure on company securities (eg Rover restructuring and some Northern Ireland industrial support)	(+)	

Table 1

CENTRAL PRIVATISATION PROCEEDS

£ million

Economic category / Transactions	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86
Central government receipts						
Rent and royalties etc						
North Sea Oil Licences premium (a)	210		33		121	
Capital receipts						
Crown Agents and CAHRB - sale of property (b)		7	16	2		
Central government expenditure						
Final consumption						
Administrative expenses incurred in selling shares (c)	-5	-13	-14	-35	-157	-73
Current grants to persons						
Pension payments to National Freight Company Ltd (d)		-49				
BT rental voucher costs (e)						-16
Gross domestic fixed capital formation (net sales).						
Forestry Commission - sale of land (f)		7	14	23	21	17
Land Settlement Association - sale of land (f)				2	13	5
Property Services Agency - sale of land etc (f)	4	1				
Motorway Service Areas - sale of land etc (f)	28	19	4	1		
Increase in book value of stocks and work in progress						
Commodity stocks (g)		19	7	4	5	
Oil stockpiles (g)		63	33	11	1	-
Cash expenditure on company securities						
Sale of shares :						
Amersham International (h)		67				
Associated British Ports (h)			48		52	
British Aerospace (h)	49					363
British Petroleum (h)		9		566		
British Sugar Corporation (h)		44				
British Telecommunications (h)					1497	1272
British Telecom debentures (h)					44	6[illegible]
Britoil (h)			255	293		450
Cable and Wireless (h)		190		275		593
Enterprise Oil (h)					393	
National Freight Company		54				
Net lending to public corporations (i)						
Britoil (reduction in net lending)			91			
Public corporations receipts						
Gross trading surplus						
North Sea Oil licences premium (BNOC) (j)	-15					
Public corporations expenditure						
Gross domestic fixed capital formation						
NTDC and NTC - sales of land etc (k)	52	73	1			
RWA's - sales of land (k)						
Cash expenditure on company securities						
NEB/Brit Tech Group sale of shares (l)	83	2			142	30
Total Central Privatisation Proceeds	405	493	488	1,142	2,132	2,702
Memorandum items						
Excludes the following:						
CG Other identified financial liabilities						
Advance payments from BNOC	-49	-573				
Retained by industry concerned and taken into account in the settling of external financing limits						
British Rail Hotels			30	15		
International Aeradio Ltd (Brit Airways)			60			
Jaguar Cars					297	
Wych Farm (Brit Gas)					82	
Sealink					40	26
BS Warship Yards						75

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TABLE 2: NET CASH EXPENDITURE ON COMPANY SECURITIES NOT INCLUDED WITHIN PRIVATISATION PROCEEDS

£ million

	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
			Outturn				Plans		
Finance for BL	370	150	-	0	680	0	0	0	0
Northern Ireland Industrial Support	1	-	2	2	2	2	2	2	2
Total	371	150	1	2	682	2	2	2	2

MR 2/18

CONFIDENTIAL

FROM: A W KUCZYS
DATE: 6 July 1987

MR D J L MOORE

cc: PS/CST
PS/FST
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Monck
Mr Cassell
Mr Peretz
Mr Scholar
Mr Turnbull
Mr Odling-Smee
Mr Sedgwick
Mrs M E Brown
Mr Tyrie

PRIVATISATION PROCEEDS
1988-89 to 1991-92

The Chancellor was grateful for your minute of 1 July. He would like a brief meeting with you (and the Financial Secretary) to discuss 1990-91 and 1991-92 in particular. We will be in touch to arrange this.

AWK

A W KUCZYS

ps3/6K

CONFIDENTIAL

RP

FROM: A W KUCZYS
DATE: 14 July 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Monck
Mr Cassell
Mr Peretz
Mr Scholar
Mr D J L Moore
Mr Turnbull
Mr Odling Smee
Mr Sedgwick
Mrs M E Brown
Mr Tyrie

PRIVATISATION PROCEEDS: 1988-89 TO 1991-92

The Chancellor yesterday discussed Mr Moore's submission of 1 July with the Financial Secretary, Mr Monck and Mr Moore. Since the previous discussion of proceeds, we now knew for certain that the Water legislation would be in the second Session. Electricity proceeds remained extremely uncertain. The Chancellor did not want to agree to increasing the proceeds target to £6 billion unless he was confident that it could be sustained at this level. The problem was that, in the table in Mr Moore's submission, the proceeds for 1990-91 and 1991-92 came almost totally from water and electricity.

2. Mr Moore pointed out that we were probably up to about £5.4 billion in 1988-89 anyway, even without anything from BT, made up as follows:

	£m
Gas debt	250
Gas (III)	1,600
BAA (II)	725*
Miscellaneous	100
BP (II), (III)	2,700*

*Figures revised upwards since Mr Moore's submission of 1 July.

There was a difficulty in postponing the BT sale until 1989-90, in that Professor Carsberg would be revising the RPI -x formula in late summer 1989, and the review of the current duopoly started then. All this could make marketing and drafting the prospectus more difficult. Nonetheless, the Chancellor asked that the option of selling BT in late 1989 be kept open.

3. As far as water authorities were concerned, the Chancellor questioned whether it was sensible to sell them in batches of three or four. The Financial Secretary explained that the advisers supported this. Otherwise, there would be a steady stream of sales taking up all available slots for some time. It would also make it possible to mix the more saleable authorities with the less attractive. Nonetheless, investors would not have to buy into more than one authority if they did not wish to do so, and it was agreed that it would be desirable to have a single "flag-ship" sale to start things off.

4. Finally, the Chancellor noted that there was a considerable residue of BT to be sold even after the one-third tranche Mr Moore had earmarked. That would provide considerable flexibility, although it was essential to avoid any over-restrictive undertaking which would prevent an early further sale. Given that, the Chancellor agreed that the target for future years should be raised to £6 billion. Mr Monck was inclined to avoid announcing this in the Autumn Statement, given that the Chief Secretary would at that stage have just completed the process of scaling spending bids down to save rather smaller amounts than £1 billion. On the other hand, it would be undesirable to put a figure in the Autumn Statement which looked phoney. It was agreed that the revised target should be announced in the Autumn Statement (and revealed to colleagues at the final Cabinet before that). In addition, we should seek advice on the possibility of selling the residual holding in BT as an

annual series of small retail sales. This would increase flexibility still further, possibly at the cost of reducing the overall proceeds.

A W KUCZYS

3694/001

Pps. p1

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FROM: D J L MOORE
DATE: 30 SEPTEMBER 1987

CHANCELLOR

cc: PS/Chief Secretary
PS/Financial Secretary
Sir Peter Middleton
Mr F E R Butler
Sir Terence Burns
Mr Cassell
Mr Monck
Mr Peretz
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mrs M E Brown
Mr Bent

Thanks. I note x:

PRIVATISATION PROCEEDS 1987-88

In June I advised that the 1987-88 outturn would be in the order of £5¼ billion though with uncertainties either way. £5¼ billion remains a reasonable estimate, though some of the underlying assumptions have changed and the outcome turns on the outcome of the BP sale.

2. In June I reported that BT had decided to redeem £250 million preference shares and that it was very likely that they would also want to redeem the £250 million which would then remain. The first £250 million will be redeemed in December. But, as you wished, I have persuaded them to defer the second £250 million redemption to April 1988. You have already agreed that the next Gas debt repayment of £250 million should also be deferred to 1988-89 (though we do not have to go firm on that until January).

3. This means that, BP apart, we have certain receipts of £4160 million - see Annex for details. Our present best estimate of BP receipts this year is around £1100 million. If this is right, we then have a total of about £5¼ billion.

4. The 1987-88 BP proceeds look likely to be more than I had assumed in June, so offsetting the "saving" on the BT preference shares. This is mainly because we have now

taken into account the fact that the benefit of the expected excess of the International Offer price over the UK fixed price will all come through in the first year, so that the second and third instalments can be the same for all the partly-paid shares. The International Offer price will be announced on 30 October, in the light of the bids made on 28 October; in the meantime we are assuming that it will be at a small premium to the market price.

5. We will also know on 30 October how many shares we have to hold back to operate the share bonus scheme, though our present estimate already makes an assumption.

6. By no later than 14 October we have to decide the first instalment payment in the UK fixed price offer. If it were 10p less than our present working assumption, 1987-88 proceeds could be about £200 million less. However, Rothschilds strongly advise against going below one-third of the offer for sale price: otherwise we increase the risk that, if there were to be a substantial fall in the share price by August 1988, people would not pay up for the second instalment.

7. To sum up, subject to these continuing uncertainties, our current best estimate is net BP proceeds of around £1.1 billion in 1987-88. By 14 October we can make a firmer estimate. On the afternoon of Friday 30 October we will have a very near final figure (subject only to relatively marginal uncertainties over first year costs). Therefore by the time of your Autumn Statement there will be no good reason for not giving an up-to-date estimate of total proceeds for 1987-88.

X 8. I will put up another submission next week on the proceeds outlook for 1988-89 and onwards.

DJLM.

D J L MOORE

Enc:

3693/021

ANNEXE

CONFIDENTIAL

£ million

Privatisation Proceeds 1987-88

Gas II	1700
debt II	-
ROFs	190
BA II	403
RR II	1049
BAA I	495
BT loan	23
preference shares	250
Miscellaneous	50
	4160

ps3/5T

CONFIDENTIAL

67. 13/10

FROM: J M G TAYLOR
DATE: 2 October 1987

MR D J L MOORE

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Peretz
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mrs M E Brown
Mr Bent

PRIVATISATION PROCEEDS 1987-88

The Chancellor was grateful for your minute of 30 September, and looks forward to your further submission on the outlook for 1988-89 and onwards.

JT

J M G TAYLOR

V3700.02

SECRET

FROM: D J L MOORE
DATE: 8 October 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir Peter Middleton
Sir Terence Burns
Mr FER Butler
Mr Monck
Mr Cassell
Mr Peretz
Mr Scholar
Mr Turnbull
Mr Olding-Smee
Mr Sedgwick
Mr Culpin
Mrs ME Brown
Mr Colman
Mr ML Williams
Mr Bent
Mr Call

A mtg with thing ordered in red, pl. N.

Ch/

Some complicated issues here.
(1) Would you like a meeting to tease these out? If so, perhaps CST, FST, PEM, FERB, Monck, Scholar, Turnbull, Moore?
Or (2) shall I, at this stage, ask for CST + FSTs views only?
Or (3) Are you ready to decide on the basis of this note alone? If so, £6 billion or £5½ billion (with the understanding at 'X' in Para 28) AS 8/10

PRIVATISATION PROCEEDS 1988-89 to 1991-92

Pps below

Before the summer holidays you provisionally decided, on the basis of my minute of 1 July, that the proceeds target for 1988-89 and onwards should be raised to £6 billion a year, and that this would be announced in the Autumn Statement. You wanted to be sure that proceeds could be sustained at the £6 billion level, and you saw the flexibility offered by the BT holding as the key to this.

2. I have now reviewed the assessment to take account of options and uncertainties which have emerged since the summer, particularly over BT. Provided there is one major sale in 1988 we can be confident of getting around £6 billion for 1988-89; otherwise we could get at least £5.6 billion. It remains possible that we can continue to get £6 billion in each of the following years, but there are so many imponderables that we cannot be fully confident of delivering. If you want a flat projection, it looks as though the choice is between £5½ and £6 billion a year.

below

3. I have reported in my note of 30 September that, subject to the outturn on BP, we should get total proceeds of around £5¼ billion in 1987-88. There are three main stages in the assessment for the three following years: the proceeds from instalments from earlier sales and from BP; the options for BSC and BT which mainly affect 1988-89 and 1989-90; and our rough assumptions for Water and Electricity which could have some impact on 1989-90 (Water) but mainly affect 1990-91 onwards.

4. Proceeds from instalments from earlier sales with estimates for the BP second and third instalments and smaller, miscellaneous sales, are shown in the top half of the table in Annex A. They total:

		£ million	
1988-89	**1989-90**	**1990-91**	**1991-92**
5200	2950	500	450

5. The first instalment of either a BT or a BSC sale would take us to about £6 billion in 1988-89. Even with no sale we could increase the £5.2 billion to up to £5.6 billion by bringing forward up to £400 million of gas debt (and similar tunes can be played in later years). Energy also have around £100 million of Gas shares which are no longer needed for bonus payments and which I have not allocated in the tables.

BT and BSC

6. In July we assumed a sale of part of the BT equity (then worth £9 billion but now about £8 billion) with one instalment in 1988-89 and two in 1989-90; and a BSC sale with two instalments in 1989-90 and 1990-91. That combination could give the numbers in row A+B in the table - ie about £6 billion in each of the first two years.

7. But it no longer looks a sensible proposition. BT's current reputation, together with the possibility of an MMC review, make it a poor prospect for Summer 1988, and I doubt if BT are any longer expecting a sale then. Moreover, following the big upturn in their profits, privatisation of BSC at the end of 1988, rather than Summer 1989, is now being seriously considered (copy recipients should note that the possibility has not yet been canvassed outside the Treasury and DTI). We will brief separately on this. But if it were practicable, you have said that you would welcome it.

8. If there were a BSC sale in 1988-89 we might have the total proceeds shown in A+C. (BSC proceeds are still uncertain, but I have assumed a 100% sale on the grounds that it is better to

sell the lot in a period when there is relative confidence over BSC's performance). You will see that there is no problem in getting to about £6 billion in 1988-89.

9. But to get to £6 billion in 1989-90 it would be essential to have a major BT sale in 1989. This should be practicable - though see paragraph 2 of Annex B which discusses BT in more detail. The BT sale would have to give around £2 billion, from two instalments in 1989-90; or less to the extent that a Water sale could be ready in late Autumn 1989. (**NB:** This is no more than a possibility at this stage).

10. If, however, neither BSC nor BT could be done until 1989, it would be more complicated. We could have BSC in Summer 1989 and BT in the Autumn. But if a Water privatisation were ready for the Autumn, and you wanted to give precedence to it over BT, we would then need to take both BSC instalments in 1989-90 and to get around £800 million from Water to reach as much as £5½ billion in the year. (There could then be difficulty in finding a slot for BT before the next Election, and therefore problems for proceeds in 1990-91 and 1991-92). These possible complications reinforce the message that a BSC privatisation in 1988, allowing for BT and a Water sale (if ready) in 1989, is highly attractive to the management of the programme.

11. I have summarised in Annex B the pros and cons of a BT sale in each of the next four years. A further option would be to sell up to, say, £500 million shares by way of a bought deal in any year in which we were short on the target. This has not appealed to you in earlier discussions. But I suggest that it could be kept on the shelf as a possibility for deployment in any year in which we found ourselves short on receipts - eg it could help in the situation described in the last paragraph. In the absence of a major BT sale, it would be a means of reducing the holding from 49%. Given a total holding of £8 billion or so, there would still be ample opportunity for wider share-ownership sales later on.

Water and Electricity

12. In July we assumed that there could be no Water and Electricity sales before 1990-91 but that there would then be sufficient to top up to £6 billion in that year and in 1990-91. The insurance was to be BT.

13. As noted above, although DOE Ministers are not yet committed to it, there is now a chance of one or even two Water Authority sales in Autumn 1989. If these were possible there would be a strong case for going for them in order to reduce the possibility of a log-jam of Water and Electricity sales in 1990 and 1991. But to do so at the expense of a BT sale could cause proceeds target problems in the circumstances described in paragraph 10.

14. Setting aside the possibility of some Water proceeds in 1989-90, the question is how much could we get in from Water and Electricity in 1990-91 and 1991-92. On the options in the tables, we need at least £4,500 million and £5,500 million respectively to get to totals of £6 billion; though in 1991-92 there would be a chance of topping up from BT <u>if</u> the review of the BT/Mercury duopoly were over.

15. Total proceeds from Water Authorities could be £8-£10 billion; from Scottish Electricity £3 billion; from Area Boards up to £4 billion; and from generation £10 billion plus, but perhaps less if there were a break-up. We have no considered advice yet on these electricity receipts.

16. This gives a total of roughly £25 billion. But:

(i) some of the Electricity proceeds will come from debt sales or repayments which could spread over several years;

(ii) the generating side could probably not be sold before the next Election if it were split up;

(iii) you have said that you would go for 51% rather than 100% Electricity sales.

Taking these points together, and assuming 100% sale of the ten Water Authorities, we could have the necessary £10 billion coming in from these industries before the next Election, provided sufficient instalments were paid in time.

17. If we could have three major sales between May and December 1990 (as we have done this year) we could get to £5½-£6 billion in 1990-91 depending on the timing of instalments; obviously we could be more confident of the outcome if generation were sold in 1990. 1991-92 would depend on instalments from 1990-91 sales and on whether another major sale could be got in before the next Election. If we were short, another BT sale <u>might</u> be a possibility for 1991.

18. I am aware that this is all very complicated and uncertain. But until we are clearer on what we are privatising, and when, it is difficult to be any firmer.

([illegible] discharge problems get the [illegible])

Conclusions

19. A BT sale in 1988 now looks a very poor starter. If BSC privatisation is practicable at the end of 1988 we should go for it. But if there is not to be a dip in proceeds in 1989-90 we must then have a major BT sale in Summer 1989.

20. If it is possible to get one or more Water Authorities sold in Autumn 1989 it would ease the potential Water/Electricity log-jam in 1990 and 1991. We would reduce 1989-90 BT proceeds accordingly.

21. Provided there is a sale of BSC (or BT) in 1988, there will be no problem in getting to £6 billion in **1988-89**; indeed it would be unavoidable. Without any sale we could get at least £5.6 billion by bringing Gas debt repayments forward.

22. Annex A shows how £6 billion could be achieved for **1989-90**. It would be depend on getting major BT receipts in the year. But there would be difficulties for the proceeds target if BSC could not be until 1989 and if we could not have a BT sale also in that year because we wanted to give precedence to a Water sale.

23. **1990-91** is uncertain. But it should be the first major year of Water and Electricity sales and, depending on the combination of sales and the timing of instalments, they could be sufficient to get to a total of £5½-£6 billion.

24. **1991-92** is even more uncertain - though we will not be publishing a figure for it this year. If a pre-Election dip looked likely, another BT sale might be a possibility to top up Water and Electricity proceeds.

25. You will wish to review the proceeds total to be published in the Autumn Statement in the light of this assessment.

26. The safest option would be to publish either £5½ billion or £6 billion for 1988-89 but to leave the later years at £5 billion with the expectation that they would be increased in due course when there was more certainty over the prospects.

27. But I gather from GE colleagues that a lower projection of proceeds in the Survey years after 1988-89 would be inconvenient for the growth pattern of the public expenditure plans. And it has been your practice in recent years to give a flat projection over the Survey period.

28. These considerations point to a choice between £6 billion and £5½ billion in each of the three years. As I have explained above, £6 billion a year is a reasonable possibility though not certain of delivery in each year. If you preferred a more cautious £5½ billion, I trust that this would be on the understanding that if there were a sale in 1988 - of either BSC or BT - an outturn of around £6 billion in 1988-89 would be acceptable.

X

DJLM.

D J L MOORE

SECRET

ANNEX A

Privatisation Proceeds (without Water and Electricity)

£ million

		1988-89	1989-90	1990-91	1991-92
	Gas debt	250	400	400	350
	Gas III	1600	-	-	-
	BT preference shares	250	-	-	-
	BAA	690	-	-	-
	*Miscellaneous	110	250	100	100
	*BP II & III	2300	2300	-	-
A		**5200**	**2950**	**500**	**450**

*estimates.

		1988-89	1989-90	1990-91	1991-92
EITHER	BSC	-	800	900	-
	BT	800	2000	-	-
	Gas debt (brought forward)	-	250	-	-
B		**800**	**3050**	**900**	-
A+B		6000	6000	1400**	450**
OR	BSC	800	900	-	-
	BT	-	2000	1000	-
	Gas debt (brought forward)	-	150	-	-
C		**800**	**3050**	**1000**	-
A+C		**6000**	**6000**	**1500****	**450****

** These totals would be brought up to the target by combinations of proceeds from Water and Electricity sales, and possibly by another BT sale.

V3700.03

SECRET

ANNEX B

? or Autumn
'or winter
or Spring 1989

Options for the Timing of BT Sales

1988-89

1. OFTEL are due to examine the RPI-3% price formula to apply from 1989. They will review it in 1988 and there is a wide expectation that they will make a reference in, say, April 1988 to the MMC who could then take six months. It would not be impossible to have a Summer 1988 sale, because the outcome of the review would not affect 1988-89 profits. But the reference, together with BT's poor reputation with the public, could be a depressing setting for the staging of a sale.

1989-90

2. The price formula review would be over and BT would have had more time to repair their reputation. But unless they choose to cover it in the 1988 review, OFTEL will be reviewing the "resale" arrangements which run to July 1989 and allow BT to benefit from prohibitions on the leasing of their lines. Changes in the regime from 1989 could enable firms with lines leased from BT and Mercury to sell use of their leased lines to others. However, BT are prepared for this possibility and do not think it would impinge significantly on their 1988-89 profits. If this is right, a major BT sale in 1989 could be on and it would be possible to get the full £6 billion shown in row A+C.

1990-91

3. BT should then be in the clear from OFTEL reviews. But after November 1990 DTI will review the BT/Mercury duopoly and consider whether there should be new entrants into the industry. They are pledged not to start this work formally before November 1990, though in practice they would probably be making informal preparations earlier. Thus any sale in 1990 (which would be necessary only if Water and Electricity do not come up to expectations) would have to be before the DTI review if we were worried over disclosure problems. But we could not have a major BT sale in this year if we had already had one in 1989.

1991-92

4. If the DTI duopoly review were over, and any previous BT sale were no later than 1989, it might be possible to have a sale in, say, Autumn 1991, if there were difficulties over Water and Electricity sales in the run-up to the next Election.

Cl/10/mjd

SECRET

BP

FROM: J M G TAYLOR
DATE: 9 November 1987

MR D J L MOORE

cc Mr Monck

PRIVATISATION RECEIPTS

The Chancellor has noted that, should the Bank have to buy back a significant number of BP shares, this will have an impact on our schedule for privatisation receipts. He thinks it would be sensible, therefore, to set in hand some contingency planning covering what we might do to ensure a smooth flow. He has in mind that we might need to alter the timetable for other privatisations.

2. I should be grateful if you could take this forward.

JT

J M G TAYLOR

3698/16/sh

SECRET

FROM: D J L MOORE

DATE: 26 NOVEMBER 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir Peter Middleton
Mr Anson
Mr Cassell
Mr Monck
Mr Peretz
Mrs Lomax
Mrs Brown
Mr Bent
Mr Call

PRIVATISATION RECEIPTS: BP, BT AND BSC

You asked what might be done to ensure a smooth flow of privatisation receipts if the Bank had to buy back a significant number of BP shares, and whether this would alter the timetable for other privatisations.

2. If they were to buy back some shares in the Financial year 1987-88 and if those shares were resold, at a profit to 70p, in 1988-89 there are two immediate possibilities for evening out proceeds between the two years. (NB If no BP shares come into the Bank we should end up very close to the £5 billion target for 1987-88).

3. First, we could take in £250 million Gas debt in March rather than, as currently planned, in April 1988. We need to notify British Gas of our decision by no later than Friday 8 January. (It is possible that they would agree to waive the formal requirements on us and give us more time; but they refused to do so a year ago.)

4. Second, we could suggest to BT that their remaining £250 million preference shares should be repaid in March rather than April 1988. They are required to give us three months notice of redemption and anything shorter carries some cost to us as we are getting 11.95% on the prefs. But, subject to any Accounting

Officer points, this could be justified if the case for smoothing proceeds were judged to be overriding.

5. In 1988-89, on the assumption of no BT sale and the first instalment of a BSC sale, we had estimated nearly £6 billion proceeds (my minute of 8 October). We should remain between £5 and £6 billion if we brought forward £500 million to 1987-88, as above, and offset it with Bank sales of BP shares.

6. But if things were so bad that Bank BP shares could not be sold in 1988-89 and the Bank were, therefore, paying us the second instalments on those shares, we could then be in trouble. And, in this situation, unless the root of the problem was BP in particular rather than the market in general, the possibility of a BSC sale could be looking sick.

7. Setting aside possible BP complications in 1988-89, I think we should assume that a BT sale in 1988 is improbable but that a sale in 1989-90 should be possible.

8. Although DTI are unable to give us any more guidance, our understanding remains that in January OFTEL will discuss with BT the revision of the RPI-3 formula to take effect in 1989. The probability is that OFTEL will elect to ask the MMC for a review and, if they did not do so, Lord Young could require it. The MMC would probably not report until the Autumn and then OFTEL would need to consider further before finalising the new regime. In the meantime the BT top management would be heavily preoccupied by the MMC review. If these assumptions are right a sale in summer or autumn 1988 would not be on. But, if, contrary to what we suspect, there is no MMC review and if OFTEL and BT settle on the new formula by Spring 1988, there could be an Autumn 1988 sale if that were wanted.

9. Either way the new pricing formula should be finalised by early 1989 and the options are open for a BT sale in Spring, Summer or Autumn 1989. Assuming a BSC sale in the period November 1988-January 1989, and the first Water sales possibly starting in November 1989, the best bet for BT looks to be in

the period April to July 1989. The amount to be sold, and the number and timing of instalments, could be tailored to meet our requirements for total privatisation proceeds.

10. Assuming there is a BSC sale around the end of 1988 we should have flexibility to choose whether all the proceeds are taken in 1988-89 and, if not, how much should fall in 1989-90. But the assumption of a major BT sale in summer 1989, and the hope that Water Authority sales might start in November 1989, reinforce the case for selling BSC by no later than January 1989. Otherwise, there could be a log jam.

11. We are looking further at the options for later years and for programming a series of Water and Electricity sales.

DJL.

D J L MOORE

BP

SECRET

FROM: J. ANSON
27th November, 1987.

CHANCELLOR

c.c. Chief Secretary
Financial Secretary
Sir Peter Middleton
Mr. Cassell
Mr. Monck
Mr. Peretz
Mrs. Lomac
Mr. Turnbull
Mrs. Brown
Mr. Richardson
Mr. Bent
Mr. Call

This completely misses the point. My concern was not with 1987-88, but with 1988-89: PSBR on the basis of ...

PPS. To save you the trouble, I have now drafted the minute to the Bank of this nature. N.

PRIVATISATION RECEIPTS: BP, BT AND BSC

Mr. Moore has submitted advice in answer to your question what might be done to smooth privatisation receipts if the Bank had to buy back a significant number of BP shares. He has suggested a number of steps which would enable receipts now planned for 1988-89 to be brought in during 1987-88.

2. I would advise strongly against bringing back receipts in this way. At present, we face a likely shortfall in the public expenditure planning total this year, but a very tight situation in 1988-89.

3. As far as 1987-88 is concerned, our latest estimate is that expenditure will fall short of the planning total by £1.5 billion. We would have to be very unlucky now for this to turn into an overspend. As Mr. Turnbull's note below shows, if <u>all</u> the BP shares were bought and none sold, the central forecast now would be zero.

4. For 1988-89, we have always recognised that a Reserve of £3.5 billion involved considerable risks in relation to known potential claims, eg on local authority current

expenditure and social security. One of the reasons which weighed in the decision to make the Reserve £3.5 billion rather than £4 billion was that privatisation proceeds in 1988-89 might exceed the plan. It would add to the risks to shift known receipts from that year to this.

J. ANSON

The Chancellor was most surprised to receive Mr Anson's note of 27/11, covering submissions from Mr Moore of 26/11 and Mr Turnbull of 27/11. The Chancellor is well aware of the overall state of play, and his concern was manifestly not about privatisation proceeds in 1987-88 but about privatisation proceeds in 1988-89, when the contingency plan clearly needs to be a BT sale in that year. He would therefore be grateful if the submissions by Mr Moore could be withdrawn, so that Mr Moore can provide a new submission which answers the question the Chancellor originally asked.

2130/4

FROM: A TURNBULL
DATE: 27 NOVEMBER 1987

MR ANSON

cc Mr Richardson

PROFILE OF PRIVATISATION RECEIPTS

You asked for comments on Mr Moore's submission.

2. First, on the level of GGE and the ratios to GDP, we are indifferent about the privatisation profile as we have, wisely, specified our objectives excluding privatistion proceeds.

3. There are, however, implications for the way the Government's performance in delivering the planning total is assessed. If no BP shares are bought, our latest assessment is that the planning total would be undershot by about £1.5 billion. If all of them are bought we would end up with an outturn at almost exactly the planning total. (I am assuming that the market circumstances which caused this to happen would prevent any resale in 1987-88.) If the £500 million of BGC or BT debt is shifted we could come out £500 million under even if we bought all the BP shares. Thus our range of outcomes for the planning total in 1987-88 is -£1.5 billion to zero, but this is before allowing for any error in the underlying forecast. It is not impossible that we could emerge with an overshoot.

3. For 1988-89 the range of possibilities is enormous. The worst case would be that the BP shares are bought, that they are not sold so we forego the second instalment, that we had moved the BGC/BT debt and that we achieved a sale of neither BSC nor BT. Although one is combining a number of probabilities, the combination is by no means impossible. The result would be proceeds of £2.4 billion, ie BGC + BAA + miscellaneous - see attached table from Mr Moore's 8 October submission.

4. The highest outcome for 1988-89 would occur if no change were made to the BGC/BT debt, BP were bought and sold (one part paid before August or two parts paid after August) at say a one part paid price of £1.00. This would produce an extra £2 billion. The outcome would be proceeds of about £7.2 billion (I assume that if this happened BSC would be postponed). Thus we have a range of outcomes between £2.4 billion and £7.2 billion.

5. Once we are past the White Paper, interest in 1987-88 outturn wanes rapidly and the focus shifts to the delivery of the 1988-89 planning total and we should therefore ask what gives us the best chance of hitting it. We should bear in mind that GEP put forward a strong case for a Reserve of £4 billion in 1988-89 on the basis of the claims we could identify (Mr Gieve's submission of 22 October). We were persuaded to accept £3.5 billion on the argument that known commitments alone would deliver the privatisation proceeds in full and that something extra was likely which would represent a second tranche to the Reserve. Thus from GEP's point of view we should judge the privatisation proceeds against a par of £5½ billion. The range of outcomes is distributed asymmetrically about that point, with more downside than upside. In these circumstances I would not take action which increases the downside risk when the improvement is to the past year about which we are less concerned.

6. Another way of looking at the problem is to consider the picture in the first week of January. Suppose by then we have bought in the BP shares. Our guaranteed proceeds for 1988-89 are then £2.9 billion. I think it would be rash at that point to take a step which deliberately lowered our fallback to £2.4 billion.

AT

A TURNBULL

3700.01

SECRET

ANNEX A

Privatisation Proceeds (without Water and Electricity)

£ million

		1988-89	1989-90	1990-91	1991-92
	Gas debt	250	400	400	350
	Gas III	1600	-	-	-
	BT preference shares	250	-	-	-
	BAA	690	-	-	-
	*Miscellaneous	110	250	100	100
	*BP II & III	2300 Aug	2300 Apr	-	-
A		**5200**	**2950**	**500**	**450**
	*estimates.				
EITHER	BSC	-	800	900	-
	BT	800	2000	-	-
	Gas debt (brought forward)	-	250	-	-
B		**800**	**3050**	**900**	**-**
A+B		6000	6000	1400**	450**
OR	BSC	800	900	-	-
	BT	-	2000	1000	-
	Gas debt (brought forward)	-	150	-	-
C		**800**	**3050**	**1000**	**-**
A+C		**6000**	**6000**	**1500****	**450****

** These totals would be brought up to the target by combinations of proceeds from Water and Electricity sales, and possibly by another BT sale.

4405/16

SECRET

Sterry, F

MR ANSON

FROM: J GIEVE
DATE: 22 OCTOBER 1987

cc Mr F E R Butler
Mr Monck
Mr Turnbull
Miss Walker

RESERVE FOR 1988-89

You asked for a table setting out the bids we now foresee on next year's Reserve in order to substantiate the claim in paragraph 21 of my minute on balancing the books that we can foresee claims of £4 billion. Our latest figures are as follows.

	£ million
Local authority relevant	1900
Social security	500-1000
Defence - end year flexibility	400-500
- nuclear waste treatment	80
EC contributions	250-400
NHS pay	250-350
British Coal	100
FPS	50-100
Running costs	50
Hunterston B	15
Chancellor's debt initiative	10
BBC capital	5
	3610-4510

The figure for local authority relevant is the difference between provision and the October Forecast. The social security figure is taken from ST and is hedged around with qualifications. Miss Peirson thinks that the increase is likely to be at the top of the range or possibly even higher. The October Forecast pointed to an overspend of £1.2 billion. The others are also beset by qualifications. EC division expect the increase to be towards the higher end of their range, and ST say the same on NHS pay (especially if we do not nail down DHSS on the use of efficiency savings). The figure for British Coal assumes some cost to their EFL from a renegotiation of their contract with the CEGB and, probably, some costs in extra redundancy pay.

J.St. Gieve

J GIEVE

3977/28

PERSONAL AND CONFIDENTIAL

FROM: P J CROPPER
DATE: 27 November 1987

Noted. Perfectly reasonable for NF to do this, but he will clearly have it cleared by us. L

CHANCELLOR

cc Financial Secretary
Mr Tyrie
Mr Call

David Knapp, CPC, thought I (we) would like to know that Norman Fowler is writing a pamphlet for CPC on Privatisation. David asks me (us) if I (we) will cast an eye over it when he gets it.

2. Norman is current President of CPC so David was in no position to say that others had written pamphlets on Privatisation within the recent past.

PJC

P J CROPPER

PH1/203

SECRET

1 Jorgkt
2 pp

FROM: A C S ALLAN

DATE: 30 NOVEMBER 1987

MR ANSON

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Monck
Mr Peretz
Mrs Lomax
Mr D J L Moore
Mr Turnbull
Mrs Brown
Mr Richardson
Mr Bent
Mr Call

PRIVATISATION RECEIPTS: BP, BT AND BSC

The Chancellor has seen your note of 27 November, Mr Turnbull's note of the same date, and Mr Moore's note of 26 November.

2. The Chancellor's concern is not about privatisation proceeds in 1987-88 but about privatisation proceeds in 1988-89, when the contingency plan clearly needs to be a BT sale in that year. He would be grateful if Mr Moore could rework his submission so that it is directed toward the 1988-89 problem.

ACSA

A C S ALLAN

3698/34/sh

SECRET

FROM: D J L MOORE

DATE: 8 DECEMBER 1987

CHANCELLOR

cc PS/Chief Secretary
PS/FST
Sir Peter Middleton
Mr Anson
Mr Cassell
Mr Monck
Mrs Lomax
Mr Peretz
Mr Turnbull
Mr Sedgwick
Mr Odling Smee
Mrs Brown
Mr Bent
Mr Call

Thanks. Re para 7, the note fails to grasp that there will be a slight market on BP shares long after other conditions have improved for share sales. Thus we may well need to prepare, on a contingency basis, for a BT share sale in Dec 1988/Jan 1989. (A BT bought deal is unacceptable). I will hold a mtg in the new year when we know how much of BP we have taken back. NL

PRIVATISATION PROCEEDS 1988-89

You asked for a further note on the options for 1988-89; in particular on how we would cope with a shortfall in expected BP receipts and the scope for a BT sale should it be necessary.

2. On present plans, and if the pattern of BP receipts is not disturbed, we would be guaranteed to go slightly over the published target of £5 billion:

Gas debt	250
Gas III	1600
BT prefs	250
BAA III	690
BP II	2200
Miscellaneous	110
	5100

3. In setting the Reserve for 1988-89 at £3½ billion, rather than £4 billion as GEP had argued for, you took account of the fact that privatisation proceeds could well be rather higher - at least £5½ billion - than the £5 billion in the plans, and so provide a supplement to the Reserve. On present plans this objective will be met by the BSC privatisation. The first instalment from BSC could take the total to, say, £5900 million. This assumes two equal BSC instalments, from a (very provisional) £1700 million sale with netting off for costs in the first year.

4. This total will be higher to the extent that any BP shares bought by the Bank in 1987-88 are resold in 1988-89 with the proceeds coming as an addition to the BP second instalment. It is impossible to put a useful figure on this before the Bank scheme closes but it could be considerable.

5. The real problem hits us if a large number of BP shares come back to the Bank now, some or even all of them cannot be sold in 1988-89, and there is a shortfall on the second instalment (because the Bank has to pay it on their shares and/or other holders chose to forfeit their shares rather than pay more). At worse we could lose the whole £2200 million second instalment though, assuming some medium term holders, something nearer £1000 million might be more plausible.

6. If in this situation we had to look for further proceeds there are two possibilities before turning to BT:

i. we could bring forward to 1988-89 the £400 million Gas debt due for repayment in March or April 1989 (the resulting hole in 1989-90 could be filled if necessary in exactly the same way)

ii. we could try to take all the BSC proceeds in 1988-89 (either in one go or, with a November sale, taking the second instalment in March)

7. The reservation on (ii) is that if we are in difficulties on the BP front because of general market conditions - rather than oil or BP in particular - BSC proceeds will be down; and we might feel that we should only go ahead with a 51% BSC sale at that stage or, at worst, that the sale should be postponed. This reservation on the implications of generally bad market conditions also applies to any possibilities for a BT sale.

BT

8. If nevertheless we did have to consider BT for 1988-89 the options depend largely on whether there is an MMC review in 1988. We expect that, as a first step, OFTEL will start discussions in January with BT on the revision of the RPI-3 formula to take effect

in 1989, and possibly on other matters too. There are then two possible routes.

9. First, OFTEL could ask the MMC to review or, if they did not, Lord Young could require it. The MMC would be unlikely to report before the Autumn (and even that would be a speeding up of their present reporting rate) and then OFTEL would need to consider further before finalising the new regime. In these circumstances one option might be a BT sale in summer 1988 in advance of the critical stage when the MMC were coming to their conclusions. We do not have any City advice on whether this would be a sensible runner. But it does not look attractive to us. The BT top management would be heavily preoccupied with the review and could not easily cope with a major sale; the sale and the likely proceeds could be overhung by uncertainties over the outcome of the MMC review and by ongoing lack of confidence in BTs management; and unless we were confident by the spring that we were in trouble with BP or BSC proceeds it would be too soon to move to the BT option.

10. For these reasons, if there is an MMC review it seems to me that the most likely possibility for a BT sale would be very late in December 1988 or January 1989. But this would be practicable only if the BSC sale had to be postponed, say to summer 1989, and we knew that in sufficient time to get a BT sale launched.

11. Secondly, though it is unlikely, OFTEL and BT could reach an acceptable agreement by, say, Spring 1988 and the MMC would not be asked for a review. Even if this outcome were announced forthwith (and we are not certain whether it would be) it would be too late to have a summer sale. We could have an early October sale but this would have to be launched no later than April/May when, as noted above, it would almost certainly be too early to judge whether we were in difficulties with proceeds for either BP or BSC reasons. But if BSC ran into difficulties before the summer holidays a BT sale might be a possibility, in place of BSC, in December 1988 or January 1989.

12. An alternative approach would be to have a bought deal of, say, up to £500 million. I know that this has not attracted you

in the past. But it could be a means of topping up proceeds and could probably be mounted relatively quickly, so avoiding the problems of the much longer critical path necessary for a major offer for sale. Even at today's price our BT holding is worth over £6 billion and so there would still be ample scope for a wider shareownership sale later.

13. You should know that this is our own assessment without the benefit of any recent advice from DTI. They have recently become concerned that if they pass advice to us about their own and OFTELs plans, and this advice is not in the public domain, they could be committing an offence under the Companies Securities (Insider Dealing) Act 1985. As their Ministers know, they are taking Counsel's advice on this and in the meantime there is an embargo on passing information to us. I hope that this very tiresome situation will be quickly sorted out (and I understand that Lord Young is chasing his officials). If necessary, they will have to consider amending the legislation or we could be in all sorts of difficulty in handling this and other sales.

<u>**Conclusion**</u>

14. If the BP second instalment is safe we can get at least £5½ billion in 1988-89 by topping up the guaranteed £5100 million with Gas debt. If the BSC sale goes ahead as planned we should get £5½ - 6 billion without bringing forward Gas debt. And we would get more if we sold any BP Bank shares in 1988-89.

15. If we run into trouble with proceeds, the two first options are £400 million Gas debt and taking more from BSC in 1988-89.

16. If the BSC sale had to be deferred, and if we knew in time, a BT offer for sale might be possible in late 1988 or January 1989. But a BT sale before then looks very difficult because of the likely MMC review; and, in any event, we probably would not know before August that we were definitely in big trouble with BP and with the BSC sale and that we therefore needed a BT sale to top up.

17. An easier and quicker option might be a BT bought deal.

18. Provisionally the best time for a BT sale looks like summer 1989 but we will need to look at the timing and the amounts again when we are clearer on the water and electricity possibilities, if any, for Autumn 1989 and January 1990.

D J L MOORE

mjd 2/27Jn

SECRET

FROM: J M G TAYLOR

DATE: 9 December 1987

MR D J L MOORE

cc PS/Chief Secretary
PS/FST
Sir P Middleton
Mr Anson
Mr cassell
Mr Monck
Mrs Lomax
Mr Peretz
Mr Turnbull
Mr Sedgwick
Mr Odling-Smee
Mrs Brown
Mr Bent
Mr Call

PRIVATISATION PROCEEDS 1988-89

The Chancellor was grateful for your note of 8 December.

2. He has commented that there will be a blight on BP shares long after market conditions have improved for other share sales. Thus we may well need to prepare, on a contingent basis, for a BT share sale in December 1988/January 1989 (a BT bought deal is unacceptable).

3. He will hold a meeting in the New Year, when we know how much of BP we have had to buy back.

JT

J M G TAYLOR