Policy Recommendations of the Smaller Business' Group
and the Nationalised Industries Group

Covering Note by Michael Heseltine.

The Policy Documents by the Smaller Businesses Policy Group and the Nationalised Industries Policy Group are attached for consideration by colleagues.

These papers will be presented by Mr. David Mitchell MP, and the Hon Nicholas Ridley, Chairmen of the Smaller Businesses and Nationalised Industry Groups respectively.

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NATIONALISED INDUSTRIES

(A paper by Michael Heseltine)

A group was established to consider policy towards the Nationalised Industries under the chairmanship of Nicholas Ridley, M.P. It began its work in March and has presented the annexed report. Its recommendations fall into three areas:

(i) Denationalisation;

(ii) Financial Control;

(iii) Relationship with Government.

1. Denationalisation (Pages 1-4 of Annex)

The policy group has not yet been able to meet with members of the other policy groups covering the nationalised industries, and does not therefore advance firm conclusions. It does, however, suggest that the following principles should be applied in any policy towards nationalised industries:

(a) Ultimately the only solution which could surmount the manifold problems of the nationalised industries would be their return to the private sector. Various factors prevent this being achieved in every industry. I recommend, however, that as an earnest of our intentions we should pledge ourselves to denationalise at least one industry at an earliest date, probably the National Bus Company.

(b) Overall, I recommend that we should construct policies designed to lead to the slow erosion of the public sector of industry. This would involve:

(i) the removal of statutory monopolies;

(ii) the fragmentation of state industries into smaller units, coupled with a policy of selling off those units wherever possible;

(iii) where practicable, the issuing by nationalised industries of of various types of shares as a means to denationalisation, including the issue of equity shares to workers (the options are outlined in paragraph 10, page 2 of the annexed policy group report).

Effective denationalisation through the issue of shares and the sale of small units should appeal to work forces who should see consequent increases in productivity and earnings. We should, however, be cautious of applying these policies at an early stage in very sensitive industries.

2. Financial Control (Pages 4-5 of Annex)

The following proposals apply for the management of public sector finances under a Conservative Government.

/... (a)

(a) each industry should be set a financial target expressed as a rate of return on capital employed (see paragraph 2, page 4 of Annex);

(b) price control should be avoided. Prices will be determined by target rates of return set. Wherever there is evidence of exploitation of a monopoly, the Government should refer it to the Director General of Fair Trading;

(c) there should be improvements in the industries' accounts, which should be published half yearly and should show clearly results on each of their activities including losses on uneconomic ones. Wherever an industry is asked to undertake uneconomic activities it should be able to apply to Government for a specific subsidy in order to continue it under terms outlined in paragraph 4, page 4 of the Annex;

(d) nationalised industries should not be permitted to diversify into new activities in competition with the private sector;

(e) investment control on the industries should be maintained, as outlined in paragraphs 5 and 6 of page 5.

3. Relationship with Government

These proposals have certain implications for the machinery of government which are set out in Part III of the Annex. Part III also contains suggestions on changes in the methods of appointing the top management of nationalised industries in paragraphs 5 and 6.

I recommend that we should place emphasis in speeches on the potential usefulness of the parliamentary select committee as a check on nationalised industry activities.

Few of these recommendations would find inclusion in a manifesto, although I should wish to include as a demonstration of our intentions the denationalisation of the National Bus Company or another small industry.

4. Legislation

The proposals involve very little legislation. An enabling Bill may be necessary to end the monopolies and to take the power to dispose of assets.

5. Financial Implications

This will depend on the extent of denationalisation. It is certain that public expenditure must be reduced through the gradual elimination of subsidy and the movement towards commercial pricing. Nationalised industry prices will be increased by the proposals but reductions in public expenditure will produce complementary benefits. Amounts saved may eventually be quite substantial.

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INTERIM REPORT OF POLICY GROUP ON NATIONALISED INDUSTRIES

Terms of Reference:

To consider what the relationship should be between a Conservative Government and the nationalised industries, and to make recommendations.

Membership:

Hon. Nicholas Ridley, M.P. (Chairman)
Rt. Hon. Maurice Macmillan, M.P.
Mr. Michael Heseltine, M.P.
Rt. Hon. Sir John Eden, M.P.
Mr. Paul Channon, M.P.
Mr. Peter Tapsell, M.P.
Sir George Young, M.P.
Mr. Peter Rees, M.P.
Mr. David Alexander
Mr. John Wood
Mr. Nicholas True (Secretary)

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PART I DENATIONALISATION

1. Our discussions have brought us to the conclusion that there are inherent defects in Nationalised Industries which exist because they are nationalised and which cannot be overcome. These difficulties relate mainly to financial control, to control of wages, to investment control and to efficiency. We set out later in this paper the best control system that we have been able to devise, but we want to make it clear that it is unlikely greatly to change the performance of industry in public ownership.

2. The only solution which would have dramatic effect would be to return the industries to the private sector. We are aware of the difficulties of doing this: the shortage of buyers, particularly under a threat of "renationalisation", the difficulty of legislating, and the possibility of bitter industrial action to frustrate us. We do not therefore favour a policy of wholesale denationalisation by legislation of the old fashioned variety.

3. Nonetheless it might be right to make clear our dislike of the size of the public sector, by announcing our intention to denationalise at least one industry. The National Bus Company seems the obvious one. It would not be too difficult to sell the buses, and it could be coupled with the repeal of bus licensing. To do this would be a demonstration of the sincerity of our intentions.

4. Our main policy, however, should be the pursuit of plans for a more organic and automatic erosion of the public sector of industry. How far we can go will depend upon the political climate at the time, but we should make such preparations as we can so that we are at least ready to take advantage of a favourable mood if there is one.

5. We believe that wherever possible we should remove statutory monopolies. In some cases – e.g. gas, electricity, post, telephones /which incidentally should be separated/ – it is necessary to allow the main trunk network to remain a monopoly, but at least that monopoly should end at the subscriber's front door. In most cases we believe the monopoly can and should be broken. Teh industry, itself, should never, as now in the case of coal or gas, have the statutory power to license rivals.

6. We would also like to see state industries broken up into small units to the maximum extent possible. This can be done mainly by administrative action. Each unit should become a separate profit centre publishing its own profit and loss account, and where applicable a balance sheet.

7. We would then be in a position to sell or give such units to private sector companies, or to private shareholders, or to the workers themselves. We should sell units cheaply – in many cases give them away free – partly because they will often be of little value, and partly because it will help to break up the public sector.

8. The scope for such a policy is not enormous. We doubt if it can apply to the great utilities like posts, gas, electricity, and the railways – at any rate in the first instance. But it might succeed in those industries where there is room for greater efficiency – because earnings could be higher after denationalisation. This would be a genuine experiment in co-ownership or worker control. It would be difficult for the Labour party to attack. Indeed

/... if it succeeded

if it succeeded it would be irreversible by a future Labour Government. There might be demands for its extension by workers in other nationalised industries.

9. There is probably room for up to a three-fold increase in productivity (and therefore of earnings) in large parts of the public sector of industry. Our plan is to tap this potential by demonstrating the scope for higher earnings (as well as a share of the assets) which could follow denationalisation of small packages. The problem is to find sufficient areas where the plan is practical.

10. There is a further method by which we could denationalise. There are many schemes being suggested to make nationalised industries issue their own equity shares, convertible shares, or loan stock to the public. Our view about these schemes is as follows:

(a) There is no point in nationalised industries issuing loan stock guaranteed by the Treasury; it is cheaper for the Treasury to borrow direct. If it is not guaranteed no one will lend to them, unless at much higher cost.

(b) The issue of equity capital is only meaningful as a means of denationalisation, since equity means ownership. It might be a way that could be employed to denationalise a specific industry at some stage.

(c) Convertible shares are another possibility: they constitute a sort of delayed action method of denationalisation.

(d) There is also a scheme for partially guaranteed equity shares being pushed at present. This is also a sort of delayed action method of denationalisation.

(e) It is possible to give or sell at a discount equity shares to the workers, perhaps in the ratio of their years of service. This is probably the best way of giving an industry to the workers. It was done in the case of Voltswagen, but the shares reverted to the typical ownership pattern very quickly.

11. We indicate in the table which follows the possible scope for applying any of these methods of denationalisation to the existing nationalised industries.

/... TABLE I

TABLE I

Possible treatment of each Nationalised Industry

Industry	Is it a Monopoly?	Can monopoly be broken?	Can industry be split up?	Potential for Denationalisation: By selling units	By selling shares	By selling worker shares
Telecommunications Electricity Gas	Yes	Yes, but only inside customes front door	No	No	No	No
Posts	Yes	Yes, but only for delivery from town centre etc.	No	No	No	No
British Rail	Yes	No	Catering, Hotels, Ships, etc. can be sold off			
London Transport	Yes	No	No	No	No	No
British Airways	No	–	Possibly?	No	Possibly	Possibly
British Airports Authority	No	–	Yes	No	No	No
British Aerospace	Semi	Yes	Yes	–	Possibly	–
British Shipbuilders	Yes	Yes	Yes	Yes	Yes	Yes
N.F.C.	No	–	Yes	Yes	Yes	Yes
National Bus Company	No	–	Yes	Yes	Yes	–
B.T.D.B.	Semi	Yes	Yes, into separate ports	Yes	Yes	Yes
Rolls Royce	No	–	Yes	Yes	Yes	Yes
B.L.M.C.	No	–	Yes	Yes	Yes	Yes
N.C.B.	Yes	Yes	Yes	Yes	Yes	Yes
B.S.C.	Yes	Yes, but not for crude steel	Yes	Yes	Yes	Yes
Forestry Commission	No	–	Yes	Yes	–	–
British Waterways	Semi	No	Yes	No	No	No
Cable and Wireless	Semi	No	No	No	No	No

/... 12.

12. This table is no more than a guide to the potential. It is our intention to pursue with the policy group discussing each industry the extent to which the potential can and should be realised. We would like to report further on this later.

PART II FINANCIAL CONTROL

1. It is clear that we will have to manage a sizeable public sector, even if in the long run we are able to reduce it by these means. Indeed our proposals might result in a much larger number of units (albeit smaller in total) in the public sector. We therefore put forward the following proposals for managing those concerns with which we are left at any time.

2. The principal instrument of control should be to set each concern a financial target to achieve. This target should be expressed as a rate of return on capital employed. The amount of capital employed in each undertaking is, of course, arbitrary. Many industries have had capital written off, and none have updated the value of their assets to cope with inflation. Government should therefore set out arbitrary capital figures for each concern, upon which each would be required to pay the prescribed rate of return. The "capital employed" would be adjusted annually in the light of further capital advanced and of changes in the value of existing assets. The rate of return should be the same for all industries. This system is analagous to Cash Limit controls, and can be used to put pressure on the industries.

3. We should not exercise price control. If there is evidence of exploitation of a monopoly, either in the form of excessively high margins, or of discriminatory or cross subsidised pricing, the Government should refer the matter to the Director General of Fair Trading. (Powers already exist.) The general level of prices would in fact be determined by the target rate of return set on capital employed. We believe in addition that this control would result in some pressure for higher productivity and efficiency, as well as transferring the odium for price rises from the Government to the industries. It is, however, recognised that prices calculated to produce a commercial rate of return to nationalised industries will result in Government's incurring a degree of unpopularity.

4. Whenever an industry considered it was being asked to undertake uneconomic activities (rural telephone kiosks, branch or commuter railway services, uneconomic pits and steel mills in Scotland etc.), it would be open to it to apply for a specific subsidy from Government in order to continue it. If Government refused, the activity must either be fully charged for, or discontinued. The industries should be required to keep proper accounts and show their results on each of their activities including the losses on uneconomic ones. We recognise that this can lead to undesirable bargaining situations. But the advantages of identifying and quantifying the loss-making activities seem to us to outweigh this disadvantage. If it could be seen publicly how much we were paying for what, there would be more informed public debate about whether we were getting value for money.

It will be necessary for the Government to be precise and specific about those uneconomic activities it wishes to buy: e.g. 3 million tons of extra

/... coal burn;

coal burn; or a commuter service from Reigate to London of a certain frequency; or 1,000 extra rural telephone kiosks, etc. We believe that this would be practical, would not involve a lot of extra paper work.

Such direct subsidies for uneconomic activities should be the only additional source of Exchequer revenue available to an industry to meet its target rate of return.

5. We believe that investment control by the Government must continue. We recognise that it is this control which gives the Civil Service its opportunity for detailed, fussy supervision of the industries. We hope it would be possible to insist on overall control only - and prevent the bureaucracy checking each item of investment. But we recognise that the control is necessary both for purposes of public expenditure control and macro-economic policy and for preventing the industries extending their empires into undesirable fields. For the latter purpose Ministers must have enough information to say no, if they want to: for the former having to earn the target rate of return will be a steadying influence, but the Chancellor must retain the power to make arbitrary cuts.

6. Investment control should be done by means of the preparation and negotiation of five year rolling corporate plans, agreed between each industry and the Government and published. There should be commitment by the Government to the investment intentions in such a plan as follows:

Year 1	100%
Year 2	90%
Year 3	75%
Year 4	50%
Year 5	-

7. We would insist on an improvement in the industries' accounts, which should be published half yearly and follow a standard pattern. The accounts should also show the cost per unit of output, plus the comparable figure for previous years, and for rival concerns in other similar countries. We believe this might be an added spur to greater efficiency. It would also be desirable to encourage nationalised industries to enter into partnership with foreign private sector companies in overseas investments. This would have the effect of imposing upon them a vicarious equity discipline.

8. We recognise that there are defects in this system of control. They basically arise because there never has been, and never can be, any real financial discipline where the possibility of bankruptcy does not exist. Any system of financial control lacks an ultimate sanction. Nevertheless this system, which is neither novel nor impractical, seems to us to have the greatest authority, and also to have the merit of increasing public knowledge of what each activity really costs. If we break some industries down into a larger number of "profit centres", it is probably the only practical system which could have general application right across the board.

9. It does not appear to us possible to consider nationalised industries as commercial undertakings, and to give them full freedom to expand into any activity which catches their fancy. They are bound to undercut, and to make losses, in the certain knowledge that they can recoup from the taxpayer. In the process they damage private sector competitors. We therefore think investment control should be used to restrict the industries strictly to their main line activity.

10. Where they are already engaged in such activities, it is probably not worth a mjaor fight to get them to divest. Electricity and gas showrooms are cases in point – and so is the NCB's landscape gardening and ironmongering activities. If an easy opening to sell off such peripheral activities arises, we should certainly take it: but we are against a major political battle for a very small piece of industrial ground.

PART III RELATIONSHIP WITH GOVERNMENT

1. It remains to consider how the Government should organise itself to control public industry. It must retain a firm control, for reasons given already, and yet detailed interference must be avoided. The present degree of Civil Service control is too great.

2. The suggestion we make which, we believe, will more nearly give us the right balance is as follows. A Treasury Minister – say the Chief Secretary – should be responsible for exercising financial control over the industries. He should set the target rate of return on capital. This is very similar to the Treasury's role in setting cash limits on blocks of Central Government expenditure. We do recognise the heavy workload of the Chief Secretary but believe that it would not be impossible for him to undertake the new responsibility.

3. The Departmental Minister would then supervise the Industries' progress towards achieving the specified rate of return. He might wish for quarterly or monthly returns from the industry. He would keep the Treasury posted as to whether the industries were on target or not.

4. The Departmental sponsoring Ministers would also decide whether to pay fo[r] any uneconomic activities, and also for setting the industry's plans into any wider framework – like energy policy or transport policy. The cash for any deviations from the path of commercial rectitude would fall upon that Department's vote. By these means we would hope to reduce interference, and to exert a more direct financial discipline.

5. Of crucial importance is the top management of the industries. It is essential to obtain good, independent managers. First of all we must pay them properly – at levels likely to be competitive with those paid in large private sector concerns. Secondly, we must find better ways of recruiting them. We should perhaps go to private "head hunter" firms for this task. Thirdly, we should end the system of five year contracts. It makes it difficult to sack a bad appointment early. It leads to insecurity for all Board members at the end of each five year period. It gives them less rights to claim compensation if they are sacked than senior staff members not on the Board. We should appoint them solely on the basis of 12 months' notice.

6. Wherever possible we should let the concern itself select a manager. This will be particularly important if we succeed in getting a large number of smaller concerns. But the job is bound to remain one for Minisiters to discharge in relation to the large public utilities which we are likely to have for some time to come.

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7. Nationalised industries should be subjected to tighter scrutiny by the parliamentary select committee. With expert outside advice, the select committee would produce regular public reports on nationalised industry activities, which should act as a further and authoritative source of control. The Select Committees would also monitor closely levels of nationalised industry spending.

PART IV CONCLUSION

1. These proposals are outline ones only. We only started work in March - and will need more time to work the proposals up with the other policy groups concerned, if the broad outlines are acceptable to the Shadow Cabinet.

2. The proposals involve the minimum of legislation. Perhaps one enabling Bill might be necessary to end the monopolies and to take power to dispose of assets. But even this could perhaps be done administratively.

3. These proposals may result in the prices of some nationalised industry products being higher, but as they will result in less public expenditure, the general level of prices may tend to be lower relatively. Higher prices will produce a return to the Treasury, an end to price subsidies, and less demand for investment money. It is impossible to quantify the amounts involved, but they might be quite substantial.

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