ECONOMIC RECONSTRUCTION GROUP

The next meeting will be held on Friday 8th July 1977 at 11.00 a.m. in the new Westminister Hall Interview Rooms at the House of Commons, Room W.1.

AGENDA

To discuss the Final Report of the Nationalised Industry Policy Group chaired by the Hon. Nicholas Ridley.

Paper enclosed: Nationalised Industries Policy Group Report (PG/10/77/38).

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AB/LSA

30th June 1977

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CONFIDENTIAL

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ECONOMIC RECONSTRUCTION GROUP

8TH JULY, 1977

Final Report of the Nationalised Industries Policy Group

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FINAL REPORT OF THE POLICY GROUP ON THE NATIONALISED INDUSTRIES

PART 1 - Running Nationalised Industries

A. MOTIVATION

1. There are fundamental differences between the private and the public sector. In the private sector there is the fear of bankruptcy and redundancy - "the stick"; there is also the hope of reward in the form of higher dividends, salaries or wages, as the results of success - the "carrot".

2. These "sticks" and "carrots" are weaker in the nationalised industries. The sanction of bankruptcy does not, and cannot apply although that of redundancy can and does. The incentive of working for higher reward applies in relation to piece-work or payment-by-result schemes - in no cases does it apply to management, let alone to the providers of investment capital. People are rarely dismissed for inefficiency.

3. There is a need to provide sticks, and carrots, in the public sector. They are bound to be infinitely less effective than those in the private sector - because of the very nature of the public sector and its immunity from bankruptcy. But some sanction is necessary when there is a serious failure - and some reward is necessary when performance is good.

4. One element of our policy for the public sector should be to provide greater rewards for success and penalties for failure - particularly for managers - but as far as is practical for all concerned.

5. More and more the nationalised industries are run for the benefit of those who work in them. The pressures are for more jobs for the boys, and more money for each boy. The need to satisfy the customer is less and less apparent: mainly because they tend to be monopolistic concerns.

6. Another element of our policy should be to break up the monopolies, and to make each unit of public industry survive, and prosper, by means of providing a better service to the public than its competitor. There are sections later in this paper describing how we should do this.

B. MANAGEMENT INFORMATION

1. Unit costs are vital information in relation to measuring efficiency. Any attempt to improve efficiency must start from considering unit costs. In the nationalised industries the output is measurable and unit costs can be obtained.

2. The strange thing is that this information about unit costs is not made available publicly, although it is probably available to managers in the nationalised industries. This information would be of the greatest value in monitoring efficiency. Parliamentary Questions asking for information about the unit costs of nationalised industries and the comparable costs in other industrialised countries are answered by Ministers by saying that the information is not available. It is clear from answers that the civil service either does not know or will not release such information.

3. The truth is that the Government's attitude to the public sector is not commercially orientated. The cost of producing steel, or electricity, or coal, or air travel is determined by a mixture of the political pressures and the union pressures. The income that may be obtained depends upon what the customers will pay, and the political pressures at work. The resulting return on capital varies between zero in the Steel Industry, to a 120% return on capital in the duty free shops at London Airport, but it is usually much less than the cost to the State of providing the capital.

4. The cost and the income are not related in the bureaucratic mind. It follows that the loss is a residual representing the political price that must be paid. Striving after efficiency has thus tended to be fruitless - because both the financial inputs and the financial outputs are the result of political determination. Publishing unit costs would at least highlight the extent of the inefficiency.

5. The nationalised industries should be required to keep and to publish detailed unit costs, in the interests of public accountability.

C. COMPETITION

1. The public sector is very seldom found in successful direct competition with private producers. There are exceptions - buses, some ports, special steels, Giro, parts of the National Freight Corporation and a few others. Such competition nearly always results

in heavy public sector losses, rather than in an attempt being made by the public sector enterprise to improve its performance. The usual reaction is to seek ways of disguising the loss, and/or of disadvantaging the private sector competitor, or better still obliterating it. For instance the National Bus Company sought to dress up its 1975 loss of £19m as a profit of £1m in its accounts - the Giro behaved similarly. The B.T.D.B.'s answer to Felixstowe's success was to try to buy it out; the BSC's reaction to competition in special steels was to put up the price of crude steel to its competitors discriminatingly. None of them sought to increase efficiency in order to meet the competition.

2. The sanction of competition for the public sector therefore, although in theory desirable, is not really effective so long as no penalty attends upon losing in that competition. Losses have always been made up in the past. Special pleading as to how they arose has always been accepted. No disciplinary action has ever resulted.

3. There is another respect in which such competition is unfair. Private companies have to raise capital in the market at commercial rates, whereas the Nationalised Industries can borrow from the Exchequer easily and relatively cheaply.

4. It follows that competition between private and public sector companies should be avoided until there is designed for the public sector a financial discipline which really works, and there is equality in the cost of capital raising.

D. FINANCIAL CONTROL

1. It is clear that the next Tory Government will have to manage a sizeable public sector, even if in the long run it can be reduced. The proposals later on in this paper might result in a much larger number of units (albeit a smaller total volume) in the public sector. Further proposals are therefore put forward for managing those concerns with which our government will find itself burdened.

2. The principal instrument of control should be to set each concern a financial obligation to achieve. This obligation should be expressed as a required 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 has updated the value of its assets to cope with inflation. Government should therefore set arbitrary capital employed figures for each concern, upon which each would be required to pay the prescribed rate of return. (The "capital employed" could be increased (or

decreased) annually in the light of any changes in the value of its existing assets. The rate of return should be the same for all industries.)

3. New advances of capital for the industries should be made at a price a little above the cost of capital to the Exchequer, at the time they are drawn, in order, as nearly as possible, to lend to the industries at the same interest rate at which the private sector borrows.

4. This control mechanism is analagous to cash limits. It could be used to squeeze public industry a little over the years - but it must not be used to squeeze too hard or it would break down.

5. It would be important to establish that the required rate of return was totally inflexible. It must eventually be taken for granted that in order to meet the obligation plants must be closed and people must be sacked. It would therefore be trebly important for the obligation to be worked out realistically - first in relation to the likely rate of inflation, secondly, in relation to the likely relative movement of wages between different groups, and thirdly in relation to the possibility of improving productivity.

6. If the nationalised industries were eventually to be broken up into smaller units, the return on capital obligation could be applied to each unit, just as a holding company with a number of subsidiaries does.

7. The importance of such a policy should be stressed. If the required rate of return on capital was not achieved, either management must demonstrate that it was taking effective action to rectify the omission, or it must be replaced. Effective action might mean that men would be laid off, or uneconomic plants would be closed down, or whole businesses sold off or liquidated. The National Freight Corporation, B.S.C., the Giro, Govan shipbuilders would be on the list, among many others, for drastic treatment if this policy were followed.

8. It should be asked whether we have the political willpower for such a policy. If there were to be weakness in one case - doubtless a politically embarrassing one - the whole policy would be lost. There is no other way to restore financial responsibility in the public sector of industry. Something like this has to be done if the country's economy is to be brought under control. Nevertheless there is no point in undertaking it if we are not prepared to go through with it.

E. PRICE CONTROL

1. Price control must be avoided at all costs. If there is evidence of exploitation by a State monopoly, either in the form of excessively high margins, or of discriminatory or cross-subsidised pricing, 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 required rate of return on capital employed. This would result in some pressure for higher productivity and efficiency, as well as transferring some of the odium for price rises from government to the industries. It must, however, be recognised that prices calculated to produce a commercial rate of return to nationalised industries would result in the government incurring a degree of unpopularity.

F. UNECONOMIC ACTIVITIES

1. Whenever an industry considered it was being asked to undertake uneconomic activities (rural telephone kiosks, branch or commuter railway services, uneconomic pits, or steel mills, etc.), it would be open to it to apply for a specific subsidy from government, if government wanted it continued. If Government refused, the activity must either be fully charged for or be discontinued. The industries should be required to keep proper accounts and show the results on each of their activities, including the losses on uneconomic ones. This policy could lead to undesirable bargaining situations, but the advantages of identifying and quantifying the loss-making activities would 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.

2. The cost of subsidies to continue uneconomic activities should be borne on the vote of the Department which wanted them carried on. It would be necessary for the Department to be precise and specific about those uneconomic activities it wished to buy: e.g. 3 million tons of extra coal; or a commuter service from Reigate to London of a certain frequency; or 1,000 extra rural telephone kiosks, etc. If the requests are specific, to do this is practical, and would not involve a lot of extra paper work.

3. It is by these means that provision can be made for major social problems resulting from making the Nationalised Industries more efficient. There are whole towns dependent on steel works, coal mines and ports, which might be severely deprived if full efficiency policies are carried out. The responsibility for dealing with these

problems is that of Government rather than the Industry. The Government can either refund the industry for the continuation of uneconomic plants for social reasons, or it can use its financial strength to bring in new industries; or it can compensate financially the victims of industrial change.

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

5. It is worth noting that this policy would make infinitely more difficult such concepts as "energy policy" or "transport policy". Any Minister seeking to promote such policies would have to pay for the uneconomic costs he imposed on any industry with money from his own vote. It would also mean ending social concessions - such as the government contribution to the Redundant Mineworkers Pension, and half fares for students and pensioners on public transport, unless the relevant sponsoring Ministers were prepared to pay the cost of them out of their votes.

G. INVESTMENT CONTROL

1. Investment control by government must alas continue. Admittedly it is this control which gives the Civil Service its opportunity for detailed, fussy supervision of the industries. But it should be possible to insist on overall control only - and prevent the bureaucracy checking each item of investment. The control is necessary both for purposes of public expenditure control as part of macro-economic policy, and also for preventing the industries extending their empires too much, or into undesirable fields. For the latter purpose Ministers must have enough information to say no, if they want to. For both purposes, having to earn the required rate of return will be a steadying influence, but the Chancellor must retain the power to make arbitrary cuts.

2. Investment control should be carried out by means of the preparation and negotiation of five-year rolling corporate plans, agreed between each industry and its sponsoring Department and published. There should be a commitment by government to the investment intentions in such a plan as follows:

Year 1	100%	of	total
Year 2	90%	of	total
Year 3	75%	of	total
Year 4	50%	of	total

H. ACCOUNTS

1. Government should insist on an improvement in the industries' accounts. They should be published half-yearly and follow a standard laid down pattern. In addition to the usual information the accounts should show the cost per unit of output, plus the comparable figures for previous years, and those of rival concerns in other similar countries. This might be an added spur to greater efficiency. They should also show audited profit and loss accounts and balance sheets for all subsidiaries.

2. It is for the Public Accounts Committee to consider whether it would like to get the Comptroller and Auditor General to audit the accounts of Nationalised Industries, and to report upon them to it.

I. GENERAL

1. It is recognised that there are defects in this overall system of control. Doubts must 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, would seem to have the greatest authority, and also to have the merit of increasing public knowledge of what each activity really costs. If later some industries are broken down into a larger number of "profit centres", this is probably the only practical control system which could have general application right across the board.

2. Until such times as we can make the financial disciplines real (if we ever can) it is not wise to consider nationalised industries as commercial undertakings, and to give them full freedom to expand into any activity which catches their fancy. They are at present almost certain to undercut, and to make losses, in the belief that they can recoup from the taxpayer. In the process they damage private sector competitors. Investment control should therefore be used to restrict the industries strictly to their main-line activity.

3. Where they are already engaged in such extra-mural activities it is probably not worth a major 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 arose it should certainly be taken. But a major political battle for a very small piece of industrial ground is not to be recommended.

J. MINISTERIAL RESPONSIBILITY

1. It follows from the policy for financial control proposed above that there should be only one Minister responsible for setting rates of return on capital, monitoring performance, and acting as banker to each industry. To have each of the sponsoring Ministers doing this might lead to different industries being treated differently. Some Ministers might be tempted to be more lenient than others, in return for an industry doing what he wanted. It is essential to concentrate responsibility for financial control in one pair of hands, if "arm twisting", and Ministerial interference in the running of the industries, is to be avoided.

2. The Minister with the overall responsibility for the financial performance of the industries should undoubtedly be a Treasury Minister. He should be the Chief Secretary, or if he is overloaded, any other Treasury Minister could take the work on.

3. "Sponsoring" Ministers would of course negotiate for and provide subsidies for uneconomic activities on their votes.

4. The major remaining function of government in relation to the nationalised industries is control of investment, and on balance it would seem reasonable to leave this initially to the sponsoring Minister, with ultimate Treasury control, as at present.

K. WAGES POLICY

1. Even if an incomes policy of a sort is thought to be necessary for the public service, there is a strong case against having one for the Nationalised Industries. A firm control, and a much more flexible one, can be exercised through the required rate of return on capital.

2. One reason why an incomes policy for the Nationalised Industries is inferior to a required rate of return is that it is neither desirable nor necessary to have identical levels of wage increases throughout the public sector. Some workers are in much shorter supply than others. Some work in industries much more vulnerable to strike action than others. It is wrong that, say, a 25% pay increase for miners should necessarily result in a similar one for typists. "Across the board" negotiation of wages and salaries should be discouraged wherever possible. By having a financial obligation, managers can be given the freedom to increase pay where shortages exist or where productivity is increased within the overall limit of financial control.

3. We can exercise some control of wage increases in the nationalised industries by requiring our specified financial result of the year's trading. There would be complete freedom for the industries to increase their prices. The sanction for conceding an excessive wage claim, or tolerating a high degree of overmanning, would be that prices have to be increased to pay for it, in order to meet the financial obligation. This would lead both to unpopularity for unions that obtained excessive wage claims, and more important, to resulting high prices which would in some cases lead to falling demand resulting in closures and redundancy. Firmness would be necessary in insisting that there would be no extra financial help to meet higher wage costs.

4. There is no doubt that this new regime and, through it, the government would be challenged sooner or later. A number of different unions might try to be the first to breach it, so that all might pour through the breach. It would be cardinal for the government to hold firm; even if high wage claims had to be conceded in one industry or another, the policy must remain intact. It would be essential that, as a consequence, prices in that industry were raised enough to pay for the cost of settlement, or surplus land or assets be sold off, or uneconomic activities closed down.

5. It is essential to get away from the concept of wage comparability and to substitute that of public vulnerability. Just because one industry pays 25% more, there is no need for another industry to pay more. The things that should really determine wage settlements are:

i) The shortage or surplus of manpower in the industry concerned.

ii) The vulnerability of the nation to a strike.

Either or both of these two should always be the determining factor.

6. It is perhaps worth trying to set down a table of public "vulnerabilities". This can be no more than a rough guide to illustrate the principle above.

	Industry	Weeks of strike the nation can survive
Category I	Sewerage and water	zero
	Electricity	zero
	N.H.S.	zero
	Gas	zero
Category II	Railways	four
	Coal	six
	Docks	eight
	Dustmen	ten
Category III	Buses and Tubes	A long time
	Posts and Telephones	"
	Education	"
	Civil Service and Tax	"
	Air Transport	"
	Steel	"

7. It is interesting that these fall neatly into three categories - those where a strike is virtually unacceptable, those where survival can be only for a month or so, and those where strikes have little effect. For the first, and possibly second category it is worthwhile to consider a policy of making strikes illegal.

8. The following table gives the present position in the major industrialised countries about the legality of strikes, in various public sector industries and occupations.

Country	Industry	Restrictions on striking
United Kingdom	Police	Illegal to organise a strike
	Armed Services	Illegal
	Gas and Electricity	Could be illegal under certain circumstances
	Post Office	Could be illegal under certain circumstances
U.S.A.	Federal employees	Illegal
	State employees	Varies, but generally legal
France)		
	State employees	Strikes are illegal
Germany)		
Japan	State employees	Striking is illegal, and remains so despite a strike to make public sector striking legal which failed quite recently.

9. It is the case in these countries generally that public sector strikes are illegal, although the trend is towards liberalising the position. In Britain, the law would have to be extended to making strikes illegal, or restricting their legality, to sewerage, water, coal, railways and docks, if there were to be any legal defences against strikes in our most vulnerable industries. One can imagine the zest with which such legislation would be opposed; legislation of this sort would cause the maximum political "aggro" with very little worthwhile result.

10. Legislation to deal with tax refunds and unemployment pay for strikes would be far more likely to succeed than making strikes illegal in certain sensitive industries.

11. Equally, the idea must be rejected of a strikebreaking corps of trained volunteers standing by to run the mines, the trains, or the power stations.

12. There seems no alternative in the short run to paying the price of having state monopoly industrial unions. Since they have the nation by the jugular vein, the only feasible option is to pay up. This should not mean that the increase becomes available to the whole of the public sector automatically; nor should it result in the whole policy being in ruins. Government must make it clear that increased wages will have to be found from either:

increased prices,
or increased productivity,
or cutting our inefficient units.

In setting required rates of return on capital, government should seek to anticipate these situations.

13. As a long term policy government should seek to manoeuvre the nation out of the position where it is vulnerable to monopoly unions in vital industries. This is dealt with in Part II of the paper.

L. MANAGEMENT

1. Management in the nationalised industries has been given a hopeless task hitherto. It has been under statutory obligations to break even or make a certain profit, but in practice they have been constantly overlaid by political requests from Ministers which vary from keeping rural telephone kiosks going to not putting up prices when they should. The objective is thus lost.

2. It is hoped that a policy of rewarding nationalised industries for uneconomic activities separately would improve this situation. Managers should be given the clear and simple objective of earning their required rate of return. Later proposals in this paper suggest ways of insulating the managers from political direction, whether by Ministers or by Civil Servants.

3. Salary scales, particularly in the last two years of incomes policy, have become hopelessly compressed, making promotion often unwelcome and making it increasingly difficult to attract good managers. There must be far higher rewards at the top in future, including if possible some sort of extra payment for success.

4. There has been a tendency for nationalised industry boards to seek to centralise, unify and concentrate power. The opposite is needed - diversity, smallness and independence.

5. Better management of the public sector is fundamental to success. This is not only a question of selecting better people, but rather one of putting managers into a position where their objectives as managers are clear and where they are allowed to get on with achieving them. There must also be clear political objectives and this is harder still to achieve.

6. One political objective must be to fragment the public sector of industry into a number of independent units, which could eventually be denationalised.

7. The financial discipline outlined above - return-on-capital obligations for nationalised industries - would make it quite easy to devolve financial control. If, for instance, the Chairman of the N.C.B. had to make £10m return on his capital, he could allocate that target in a series of different targets for each pit. Indeed it should be the reaction of a hardpressed manager to pass on his responsibilities down the line - otherwise he has no one else to blame but himself if things go wrong.

8. This has not happened hitherto. There has been a tendency in public industry to centralise all decision-making and financial responsibility at the centre. Subsidiary units, controlled by close monitoring of their performance as in the private sector, are very rare. It is probable that part of the reason for this has been the demand for total, instant information about nationalised industries by the civil service, making decentralisation difficult. Part of the reason may lie in the motivation of their managers; empire-building is the only human ambition not denied to them. Part of it is an ugly modern fashion for uniformity.

9. To alter this situation Ministers would have to show more self-discipline. They would have to refuse to answer PQs and MPs' letters dealing with the day-to-day affairs of the nationalised industries, in accordance with the statutory position. They would have to eschew trying themselves to manage the industries and concentrate solely upon obtaining the required return on capital. More difficult, they would have to prevent the civil service from crawling all over the industries they sponsor. The following suggestion is designed to achieve just that, as well as to facilitate the better management of the industries.

10. The boards of the nationalised industries should become "supervisory" boards. The Chairman, and Deputy-Chairman might even become part-time, and all the other members should certainly be part-time. Their functions would be:

a) to protect the management against ministerial and bureaucratic pressures and interference, and to deal with MPs and the public;
b) to hire, fire and reward the management;
c) to ensure that the required return on capital was met;
d) to reorganise the industry into smaller accountable units as best they could;
e) not to attempt to manage the industries themselves. They would in effect become holding company boards; management would be left to subsidiary management boards.

11. The advantages of this idea are that it would not require legislation; that it would provide the opportunity of getting the right people into the right jobs; and that it would provide a way of accommodating a certain amount of worker participation if that is soon to be imposed by law. It would also be, superficially, not very far away from the recent NEDO Report, which might make it slightly more acceptable to the establishment. These points are expanded in the next three paragraphs.

12. There is a strong case for avoiding legislation in the field of public industry as far as possible. Not only is legislative time scarce but it would stir up an unnecessary hornet's nest. The only necessary Bill would be one to end the public sector monopolies. Ministers already have power to make all board appointments to nationalised industries.

13. Government could appoint competent people to run the holding boards (who had not necessarily made their careers in the industry) and who were sympathetic to the objectives set out above. Capable managers who are at present on the main boards could be given executive responsibility on the subsidiary management boards. Most would be happy to accept this because the pay and conditions of service of senior managers are much better than those of board members. But compensation to induce such moves might be necessary. Thereafter the hiring and firing of members of management boards would be for the holding board, as well as the determination of senior managers' pay and conditions.

14. If there was a statutory obligation (or it was thought prudent in relation to the circumstances) to have some worker or trade union directors on nationalised industry boards, they could be appointed to the holding board. Provided they were in a distinct minority, they could do little harm.

15. Commercially-minded bankers and holding company chairmen are the sort of people government would need to recruit, and thought should be given immediately to potential candidates. They should not be appointed for a fixed period of years, in order both to give them continuity if they were successful and to facilitate their dismissal if they were not. In addition to decent salaries, success should be rewarded with a public honour. They should be thoroughly committed to the policy of fragmentation and strict financial control outlined above before they were appointed.

16. Holding board chairmen and deputy-chairmen should be extremely well-paid in order to allow room for a pecking order all the way down the line. Other holding board members could presumably be non-executive and could be paid as such.

17. The holding board should be able to devise bonus and incentive schemes for managers. As the management board members would not be board members within the meaning of the Acts, this would be legal. They should be encouraged to devise "carrots".

18. Considerable unpopularity would attach to board chairmen if they used the system of financial control purposefully. It would result in sackings, redundancies and closures. It would be the main method to achieve higher productivity but would not be popular. However, it is more desirable that the commercial buck should stop with them than with Ministers. This is another reason why Ministers should eschew responsibility for all but the rate of return on capital. It is also another reason why successful board chairmen should be awarded with public honours.

PART II

DENATIONALISATION

M. GENERAL

1. The process of returning nationalised industries to the private sector is more difficult than ever. Not only are the industries firmly institutionalised as part of our way of economic life, but there is a very large union and political lobby wanting to keep them so. A frontal attack upon this situation is not recommended. Instead the group suggest a policy of preparing the industries for partial return to the private sector, more or less by stealth. First we should destroy the statutory monopolies; second we should break them up into smaller units; and third, we should apply a whole series of different techniques to try and edge them back into the private sector.

N. ENDING MONOPOLIES

1. The first problem to deal with is to end statutory monopolies in the public sector. It is no good selling pits, or steel mills, etc; if it is illegal to operate them. Moreover the monopolies are in themselves damaging and restrictive of innovation and efficiency.

2. To do this will require legislation, but this nasty little Bill is the only legislation called for in this paper. It has some psychological importance - it sets the keynote for our attitude to competition. However it will attract considerable opposition.

3. The Bill would need to do the following things:-

Coal
a) Transfer the licensing of private mines from the N.C.B. to the Minister and restrict the conditions of licence to safety considerations only.
b) Transfer coal royalties from the N.C.B. to the State.

Electricity
Permit private generators of electricity to sell to the Grid, as of right.

Post Office
a) Split the letter post from Telecommunications. (The present P.O. is all in favour of this).
b) End the telephone monopoly at the Subscribers' "front door". (The P.O. oppose this, unconvincingly).
c) End the Post Office monopoly on the delivery (not the collection) of letters. (The P.O. oppose this and the idea requires more study).

Steel - Remove the Ministers power to approve private sector investment in Steel plant.

Buses - End the system of licencing (this might come better in a Transport Bill).

4. There may be other matters which should be included in this Bill. It might be necessary to take powers to dispose of assets in accordance with Part II of this paper. It seems sensible to seek blanket powers in this respect if advice shows it to be necessary.

O. THE LONG TERM POLICY OF FRAGMENTATION

1. The next phase should be to break up the industries into smaller units. The reasons for doing this are:-

i) To break up the power of monopolicy public sector unions;
ii) To root out inefficient units and cross-subsidisation;
iii) To spread responsibility and power wider in management;
iv) To make it easier for the worker to link his reward with his own effort.
v) To facilitate denationalisation.

2. The scope for fragmenting the industries varies from industry to industry. It is greatest in:

Group A	Coal	Motor Car Manufacture
	Shipbuilding	Buses
	Docks	Freight
	Airports	

.....

Group B It is in-between in:

Airways
Steel
Aircraft
Nuclear fuel
Cable and Wireless

.....

Group C It is minimal in: (these are the true utilities)

Gas	Posts
Electricity	Telephones
Railways (less ships and hotels)	Underground Railways
Water	

3. It is interesting that the "true utilities" (Group C) are mostly industries where the right to strike is denied by law; and also industries where the "public vulnerability" to a strike is high. There really is very little Government can do about these industries other than get them to price their wares correctly through a rate of return on capital policy.

4. The industries in Group B are industries where there is room for some fragmentation, although often economies of scale considerations will make it difficult to go far. Nevertheless government could and should take immediate steps to divide them up at least a little. Subsidiary and peripheral activities can certainly be made into separate profit centres - e.g. B.S.C.'s construction company, gas and electricity showrooms, B.A.'s domestic services.

5. The real opportunity lies in Group A. All of these industries could be broken down into the basic industrial unit - the pit, the yard, the port, the airport, etc. It should be a central part of our policy to seek to do this as quickly and as tactfully as possible. As a first step we could try to have bonus schemes based on productivity at each unit - leading perhaps to a demand for greater independence.

6. The difficulties of doing it are substantial but at least it would not need legislation. There would be trade union objection and opposition. It would need dedicated top management to carry it through. The civil service would resist it. The motivation of all concerned - from worker to board chairman to Permanent Secretary - is to do the opposite. The key to doing it lies in top management. This has been discussed earlier.

7. It will be very much easier to attempt a permanent form of denationalisation after we have achieved a certain degree of fragmentation, for most of the industries, rather than to try and denationalise whole corporations.

8. The scope for such a policy would not be enormous. It could not apply to the utilities like posts, gas, electricity, and the railways - at any rate in the first instance. But it might succeed in those industries where there was 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 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. This potential could be tapped 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 would be practical.

P. WAYS OF DENATIONALISING

1. Were we to decide to denationalise any industry, or unit of an industry, there are a number of ways in which it can be done:-

a) We could give one share to each person whose name is on the Electoral Roll (an idea advocated by Friedman).
b) Give (or sell) the shares to the workers, in proportion to their years of work. (This was done at Volkswagen).
c) Sell the shares on the open market.

There are many schemes being suggested to make nationalised industries issue their own equity shares, convertible shares, or loan stock to the public. They can be summarised as "BP solution" schemes. The following points about these schemes should be noted.

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

ii) The issue of equity capital would only be meaningful as a means of denationalisation, since equity means ownership. It is a way that could be employed to denationalise a specific industry at some stage. Witness the recent sale of BP shares!

iii) Issuing convertible shares is another possibility: they constitute a sort of delayed-action method of denationalisation.

iv) There is also a scheme for partially guaranteed equity shares being advanced at present. This would also be a sort of delayed-action method of denationalisation.

v) There seems no point in these schemes unless we issue more than 50% of the equity to the private sector, by whatever means. Otherwise control remains with the Government, with all the evils of State-run industry remaining. Their point is as a means of denationalisation, rather than as a means of getting more money for the State from the public.

d) Sell whole units to private buyers direct.

2. Different schemes are appropriate for different industries. It is perhaps easiest to consider each industry in turn, starting with the least hopeful.

3. The utilities are clearly the least likely candidates - partly because they are big and unlikely to be saleable, and partly because they might need "regulating" if they were sold back. In any case it is suggested they are in a lower category. They are:-

Gas, Electricity, Railways, Water, the Telephone network letter post (apart from delivery).

4. Next there is a group of industries, all, or parts of which, could be sold, either direct to private buyers, or by floating shares on the market (or by more complicated market operations). These are:-

National Bus Company	- sell companies as appropriate
National Freight Corp.	- " " " "
B.L.M.C.	- " " " "
British Shipbuilders split into A) Civil	- " " " "
B) Warships	- " " " "
British Aerospace	- " " " "
Alfred Herbert	- sell if at all practical
Rolls Royce	- " " " "

5. Next there are some industries which can, and should be broken down into basic units, and for these giving (or selling) the shares to the workers is recommended:-

N.C.B. break down into pits, and seek to form worker co-operatives wherever possible.

Ports - make all state-owned ports into separate profit centres, and seek to sell them or make them into worker co-operatives.

Airports - make each airport independent, and seek to sell them, or get the Local Authority to take them on.

6. The rest of the industries seem to be special cases.

A) British Steel Corporation should be divided into autonomous companies, mainly, but not entirely, on a regional basis. Each company will differ in profitability. The more profitable ones could seek capital from the market (without Treasury guarantee). They could thus be "eased" into the private sector over a period of time.

B) British Airways is another case where it seems practical imply the "BP solution". B.A. could be made to raise new capital by the issue of equity, or convertible, shares, again without Treasury guarantee.

C) British Aerospace - these companies, or parts of them, could either be sold direct, or encouraged to issue equity or convertible shares as above.

D) Cable and Wireless could be sold as a going concern - there may be security reasons why it should not be.

E) B.N.O.C. should be denationalised. There may be a regulatory function for it to discharge. A separate company could be formed to deal with this, while its assets could either be sold to other oil companies, or sold or given to the public at large.
Here is the greatest possibility of a "coup de theatre". It is not appropriate to give the shares to the workers - it is too capital heavy. It might be politically unwise to sell the assets to other oil companies - particularly American ones. The assets of B.N.O.C. are worth approximately £1000 m. We could offer them at at price, say, of half their value to the public at large, with a maximum holding permissible of, say, £ for each individual. They could be marketed through banks, post offices, or direct. This would be a positive act of giving public assets to the public, as well as making every man a capitalist.

PART III

SUMMARY OF PROPOSALS

PART I - RUNNING NATIONALISED INDUSTRIES

1. We should seek to provide greater rewards for success, and penalties for failure, in public industry.

2. We should avoid competition between the public and private sector until we have a workable system of financial discipline for the public sector, including capital raising.

3. We should set a required rate of return on capital for all Nationalised Industries. The rate should be constant, but the valuation of the capital should take into account realistically a number of other factors.

New advances of capital should reflect the cost of borrowing to the Government.

The required rate of return should be adhered to as a major political objective.

4. There should be no price control.

5. Uneconomic activities should be costed and separately rewarded by the Minister thinking them desirable. This is the way to deal with the difficult problem of mass redundancy caused by closing uneconomic plants, etc.

6. Investment control by the Government must continue.

7. Better, more frequent and fuller accounts should be required.

8. We should prevent, for the time being, nationalised industries extending their activities into new fields, by means of investment control.

9. A Treasury Minister should be responsible for administering financial control of the industries. Sponsoring Ministers would have much less to do with the industries, and there should be much less Ministerial interference.

10. We should exercise such control over wages as is possible, by means of the required rate of return on capital we set.

High wage settlements would cause the industry to have to slim down, and/or sell assets, and/or put its prices up, if it were to meet its rate of return.

We should build into our rate of return figures an allowance to meet a politically organised wage claim, in an industry where we are vulnerable, or where labour is in short supply.

We should not seek to extend the illegality of strikes in the public sector - strikers social security benefits are a more fruitful field.

11. Managers should be given clear objectives.

They should be much better paid than at present.

Nationalised Industry Boards should be made into Holding Boards, with most members part time. Management should be pushed down the line into subsidiary companies.

We should start now to recruit chairmen who will be sympathetic to our objectives.

PART II - DENATIONALISATION

12. Denationalisation should not be attempted by frontal attack, but by a policy of preparation for preparation for return to the private sector by stealth.

13. We should first pass legislation to destroy the public sector monopolies. We might also need to take power to sell assets.

14. Secondly, we should fragment the industries as far as possible; and set up the units as separate profit centres. We discuss the scope for doing this, which varies greatly from industry to industry.

15. There a number of ways by which the denationalisation, either of whole industries or of fragmented units, could be achieved.

The utilities are low in the list of priorities.

There are a number of industries which should be broken up into separate companies, as many of which as possible should be sold to private buyers.

There are some industries - coal, ports, and airports - where we should seek to sell, or form workers' co-operatives of each pit, port or airport.

There are a number of special cases:-

B.S.C. should be fragmented regionally.

B.A. should be "BP-ized".

B.N.O.C. could form the subject of a special political initiative whereby the shares are sold at half price to everyone who wants to buy them.

CONFIDENTIAL ANNEX

COUNTERING THE POLITICAL THREAT

There is no doubt that at some time the enemies of the next Tory Government will try and destroy this policy. It is easier to predict the timing of this challenge than the exact area in which it will come. It is unlikely to be in the first six months after the Election - there is a sort of close season of goodwill, usually. But our enemies will not be able to let the policy get too well established, or it will be harder for them to break it. It seems likely that we will face the challenge between 6 months and 18 months after the Election.

The "casus belli" could be one of the following:-

(a) an unreasonable wage claim
(b) redundancies or closures
(c) our policy for the nationalised industries
(d) some other political issue

It seems infinitely more likely that the challenge will come either over a wage claim or over redundancies. Political strikes do not get the same support from the membership as strikes over issues which affect their pockets. Some issue of discontent will be found, where feeling is strong, and the full force of the communist disruptors will be used to exploit that discontent.

Doubtless it will occur in a "vulnerable" industry - coal, electricity, or docks for instance.

The strategy for countering this threat should be as follows:-

First, we should design our return on capital figures to allow some scope, in the vulnerable industries, for paying a higher wage claim than the going rate. This will not be easily apparent to the Unions but if the policy can survive intact by paying a higher than average wage claim it would be a victory.

Secondly, we might try and provoke a battle in a non-vulnerable industry, where we can win. This is what happened when we won against the postal workers in 1971. We could win in industries like the Railways, B.L.M.C., the Civil Service and Steel. A victory on ground of our choosing would discourage an attack on more vulnerable ground.

Third, we must be prepared for these strategems to fail, however; and we must take every precaution possible to strengthen our defences against all out attack in a highly vulnerable industry. If the attack comes in Electricity (or gas) there are really very few defences - we should be especially careful to avoid provoking the workforce in these industries. Luckily there is no great need to create redundancies in these industries.

The most likely area is coal. Here we should seek to operate with the maximum quantity of stocks possible, particularly at the power stations. We should perhaps make such contingent plans as we can to import coal at short notice. We might be able to arrange for certain haulage companies to recruit in advance a core of non-union lorry drivers to help us move coal where necessary. We should also instal, dual coal/oil firing in all power stations, where practicable as quickly as possible.

The chosen battle ground could be the Docks. Here again the best policy is keep stocks as high as possible, and to try and keep some ports open (e.g. Felixstowe and Shoreham?) for essential supplies and exports. A dock strike is not as crippling as an electricity stoppage.

Road Transport is another industry which is vulnerable, but the diversity of firms and ownership and the weak nature of the Unions, makes it less likely that action could succeed here.

Fourth, by far the greatest deterrent to any strike, whether in the public or the private sector, is clearly to cut off the supply of money to the strikers, and make the Union finance them. This is a policy question going beyond the Nationalised Industries, although as employer in these Industries the Government could be said to have some right to treat strikers differently in relation to Supplementary benefit and tax refunds. This seems too partial, however, and is not recommended. It is clearly vital in order to defeat the attack which assuredly will come in one public industry or another that our policy on state funds for strikers be put into effect quickly and that it be sufficiently tough to act as a major deterrent.

Fifth, we must be prepared to deal with the problem of violent picketing. This again is a matter going beyond policy for nationalised industries. But it is also vital to our policy that on a future occasion we defeat violence in breach of the law on picketing. The only way to do this is to have a large, mobile squad of police who are equipped and prepared to uphold the law against the likes of the Saltley Coke-works mob.

It also seems a wise precaution to try and get some haulage companies to recruit some good non-union drivers who will be prepared to cross picket lines, with police protection. They could always be used in the crunch situation which usually determines the result of any such contest.

Conclusion. These five policies seem all that is available and if integrated and used wisely they provide a pretty strong defence - particularly when there is no Incomes Policy against which to strike. They should enable us to hold the fort until the long term strategy of fragmentation can begin to work.