PRIVATE AND CONFIDENTIAL

Copy 1

NATIONALISED INDUSTRIES POLICY GROUP

REPORT

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SUMMARY

To date, the performance of nationalised industries has been very poor (1.1-1.3). The Party and the country understand that there is a pressing need to improve the efficiency of the nationalised industries. A good start has been made in reversing the socialist ratchet and returning public sector businesses to private ownership. The next Government will want to build on this foundation, and to take measures to improve the performance of those businesses remaining in the public sector, particularly by opening them up to increased competition (1.7-1.11).

The Group advocate the need for a strengthened competition policy which will allow new competitors to emerge in many of the areas which have become, but which are not necessarily, the preserve of State-owned business (2.3-2.9). Where new entrants are unlikely, private sector involvement can be increased through pressure on nationalised industries to contract out parts of their operations (2.5). Splitting up the massive State-owned businesses brings a number of advantages which include the fact that the component parts can then compete with each other. Regionalisation of monopolies will at least allow their performances to be compared(2.7). The Group is convinced that increased competition is the key to improved performance and improved customer service from the nationalised industries. It brings new minds to bear on business problems, and leads to new jobs, new services and new products through innovation.

Where local or national monopolies remain, there will be a need for regulation, whether they are publicly or privately owned. This should be a last resort, and in many cases, regulation will only be needed in an interim period while competition takes root (2.7). The ideas proposed by Professor Littlechild for BT are developed to cover cases where competition will remain weak (2.15). Automatic quinquennial reviews of the nationalised industry monopolies should be carried out by the MMC (2.6).

A major achievement of this Government has been to change perceptions about the inevitability of State ownership. In the next Government, the onus should be on sponsoring departments to show why their nationalised industries cannot be privatised. Even where this is impossible or premature, peripheral businesses and profitable parts of the main businesses should be returned to private ownership. It seems inevitable, however, that some businesses, including those which ought to operate as normal commercial companies but which have major commercial problems, will remain in public ownership for some time.

The next Government will want to improve the management of the remaining businesses, and develop more effective surrogates for market forces. Many of the businesses should be restructured and decentralised. These smaller units will be more easily managed (2.22). The recruitment of first class chief executives is crucial, and Government must not be afraid to pay market salaries (2.17). Non-executive directors, properly remunerated, should be in a majority on the board (2.20).

A better relationship between Government and the nationalised industries will result if broad strategic objectives are agreed

with incoming chairmen (2.22). Clear and realistic financial and performance targets should be agreed with the boards to stimulate efficiency in the absence of exposure to the full rigours of market forces. These should be set on a three year rolling basis (2.23) and published wherever possible (2.24). The EFL remains a key control and should be adhered to except in the most exceptional circumstances (2.36). In addition, the industries should be subjected to regular value for money audits by their commercial auditors (2.26).

If nationalised industries are to behave more like commercial companies, they should be structured more appropriately. Their relations with Government should be handled by small teams in the sponsoring department staffed in part by people from the private sector (2.25). The industries should be structured as Companies Act companies. To facilitate this, the balance sheets will need to be restructured. Dividends should be expected on public dividend capital and gearing levels should be prudent (2.32). As an interim step, the process of seeking capital reconstruction prior to transformation should be subject to extensive departmental and Parliamentary scrutiny (2.33). Nationalised industries should normally be allowed to borrow only from the National Loans Fund, but on terms which they could achieve from a commercial bank (2.37).

Improvements in the performance of the State-owned industries should, in most cases, lead to their return to private ownership. Ownership should be spread as far as possible, with special provision for customers to buy shares where possible. The Government should not be deterred by criticism about the sale price (2.41-2.44).

The recommendations in Chapter 3 for the individual nationalised industries are summarised on the attached table. Priority is indicated in terms of the year after the election in which action would be appropriate. The Group also recommends further moves to dispose of the Government's unwieldy portfolio of minority shareholdings (3.79-3.81).

TABLE 1 Summary of Specific Industry proposals

	Ownership	Peripheral businesses	Monopoly	Regulation	Priority
RR	Sell as soon as possible.	n/a	Competitive.	No need.	1
BA	Sell as soon as possible.	Sell these first.	Competitive.	No need.	1
ROF	Sell off as many factories as possible.	n/a	Most compete.	No need.	1-3
NBC	Sell off as many component parts as possible.		Local authorities to be responsible for providing routes through tenders.	Local Authority administered.	1-2
BAA	Abolish. Each major airport to have its own authority, privately owned.	-	-	Landing charges at Heathrow to be regulated.	
BT	Sell 51 per cent as pledged.	-	More aggressive competition policy essential.	Interim regulation until competition is established.	1
BGC	High pressure network sold as a common carrier. Local boards sold as distribution companies.	Oil interests to be disposed of. Showrooms sold individually.	Gas suppliers will compete with each other, having equal access to common carriers.	Regulation of the monopoly common carrier, and local distribution monopolies needed.	1-3
ESI	National grid sold as a common carrier. Area Boards sold as local distributors. 5 Generating Boards sold separately.	Showrooms sold individually. Electricity Council abolished.	Suppliers would compete, with equal access to the common carrier. Area Boards free to generate.	Generation unregulated. Distribution and transmission monopolies regulated.	1
BR	The basic tracking and signalling, at least, seems destined to remain remain publicly owned.	Accelerate property disposals.	Franchise out catering, station management, possibly passenger services.	Monopoly prices to be	1 for franchising as much as possible.

	Ownership	Peripheral businesses	Monopoly	Regulation	Priority
BL	Split into component parts. Sell as many as possible. Volume cars likely to remain in public ownership for some time.	Continue divestment as matter of urgency.	Competitive.	No need.	1-3
BSC	Sell or close down the downstream businesses. Split upstream businesses into its components. These likely to remain publicly owned for some time.	Sell peripherals.	Downstream divestment will end unfair competition. Aggressive competition policy needed. Upstream businesses to compete with each other.	No need.	1-3
BS	Sell warship yards, sell or close offshore yards. Sell Falmouth shiprepair. Merchant ship-building likely to remain in public ownership for some time, split though into component parts.	-	Merchant yards to compete with each other.	No need.	3
PO/Giro	Retain in public ownership.	Crown offices sold or put out to tender.	Threat of suspension of monopoly gives competitive spur. Encourage competition from new post technologies.		
Water	Retain in public ownership.	-	Pressure to contract out services.	Regulation needed.	

The Manifesto should contain a summary of the Government's achievements in reducing the extent of State ownership in industry and opening up the nationalised industries to competition. It should emphasise the dangers and abuses of monopoly power. The electorate must be reminded of the benefits which competition brings - more choice, better service, lower prices. Businesses returned by the Government to private ownership have, despite initial misgivings, thrived on the change. Freedom from Government, access to capital from the private sector and the need to compete on equal terms have given rise to a new sense of purpose. Employees have often become shareholders, and where new firms have moved to compete with nationalised industries, employees have had their choice of possible employer increased.

The major peldge should involve the sale of 51 per cent of the shares in BT. It should stress the benefits which this measure, along with increased competition in telecommunications, will bring to the consumer, and in particular, highlight the formula to be used to restrain the price of local calls.

The Manifesto should also promise to privatise Rolls-Royce (citing the BAe precedent) and British Airways. Progress towards viability in BL, BS and BSC should be outlined. Those businesses have all been supported through a very difficult time. Strong management has, in each case, taken hard decisions to save as many jobs as possible. For the future the Manifesto should promise to ensure the future of these businesses by splitting them into smaller, more manageable businesses. Those parts which are able to benefit from private sector operation will be allowed to do so, while the public sector managements will be left free to concentrate their efforts on the major problem areas. There needs to be a specific promise to reduce the demands which these businesses make on the taxpayer.

The BT commitment shows what can be done to open up the national utilities to competition. The Manifesto should point out the moves made to introduce competition on the margin in gas and electricity supply, and promise further moves to increase competition and greater customer sensitivity in the supply of energy and water. It should admit that the central problem of inefficiency in the national railway remains, and promise radical remedial action to produce better, cheaper services and value for money for the taxpayer. It should also promise to move towards more customer-sensitive bus services in rural areas, and to achieve full disclosure of subsidies for social purposes in both rail and road transport.

CHAPTER I

Introduction

1.1 Very few people would argue that the nationalised industries have proved to be an asset to Britain. In today's money, capital written off since nationalisation has totalled around £40 billion. In 1980, the real rate of return on the £90 billion employed in the industries, including subsidies, was minus 1 per cent, and since 1972 has averaged around zero.

1.2 These industries account for 7 per cent of employment, over 9 per cent of GDP and 13¼ per cent of investment in Britain. Their performance is thus of very great importance, and has been noticeably worse than the private sector. Control over labour costs has been poor, particularly in gas, coal, electricity and telecommunications. In 1970, public sector pay was roughly in line with the national average. By 1981, it had risen to 15 per cent above for manual workers and 8 per cent above for non-manuals. Productivity performance has also been poor, except in the capital-intensive businesses. It has increased particularly slowly in the ports, in coal and on the railways.

1.3 Recently, prices charged by nationalised industries have risen rapidly. This was in part due to the unwinding of subsidies, but also to the failure of these businesses adequately to control costs and improve efficiency (see Annex B). They have made substantial demands on public spending and borrowing (Annex C). At a time when so many factors make it difficult to achieve the cuts in public expenditure which are central to the Government's economic policy, a reduction in the burden imposed by the nationalised industries is vital.

1.4 Surveys indicate that, in general, nationalised industries are regarded by the public as inefficient and uncaring. The time is therefore ripe to build on the achievements to date in reducing and controlling the nationalised industry sector.

The Political Background

1.5 Nationalisation began in 1945, and continued inexorably until 1979. The Labour Party's arguments for nationalisation can be summarised as follows:

(a) The State should control the commanding heights of the economy.

(b) Industrial relations would improve.

(c) Full employment would be maintained by expanding the state sector.

(d) Increased productivity would result from new management and new attitudes.

(e) Regulation of monopolies was best achieved through state ownership of the monopoly.

(f) National and social priorities would not be undermined by the search for short-term private sector profits.

(g) Ownership of key industries should be in the hands of the State on behalf of the people.

1.6 The absurdity of these propositions is self-evident when judged against the performance of the industries. A former advocate of nationalisation, Mr. Richard Pryke of Liverpool University, summed up the economic arguments as follows:

"The most likely explanation for the poor performance of public enterprises is that they are in public ownership. What public ownership does is to eliminate the threat of a takeover and ultimately of bankruptcy and the need, which all private undertakings have from time to time, to raise money from the market."*

The problems inherent in State ownership have been compounded by the Morrisonian constitution adopted for the industries. This has allowed them to be virtually unaccountable, and has led inevitably to an unsatisfactory relationship with Governments of both parties over the last 35 years.

Introduction of Private Sector Disciplines into the Public Sector

1.7 The present Government has made a useful start in tackling the nationalised industries (see Annex D), but much remains to be done. The challenge facing the next Government will be to build on the foundations already laid in a logical and politically popular way. In the next Government there should be a strong presumption that nationalised industries should be returned to the private sector unless the sponsoring Minister is able to argue conclusively that they should remain in public ownership.

1.8 There are three broad aims which the Government should pursue and which we discuss below:

(A) More competition in every area of the nationalised industries' activities.

(B) Privatisation where possible.

(C) Increased efficiency in the remaining monopolies.

1.9 A. Introducing Competition. The introduction of new competition to existing monopoly or near monopoly business is designed to;

(i) lower prices through improved efficiency;
(ii) improve quality and type of services;
(iii) speed changes in the type and range of service offered;
(iv) create new jobs and new businesses on the fringes of the public sector supplier, and provide more job choice for employees;
(v) reduce the power of monopoly unions, and remove Government from pay negotiations;
(vi) avoid single stream decision taking.

Examples

Following inter city coach deregulation, fares halved in first year

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* The Review of the Institute for Fiscal Studies, July 1982.

of operation; the number of passengers carried increased substantially; several new coach businesses built up; and more luxury long distance services came into operation. In telecommunications, the threat of Mercury competition of certain trunk routes has led to a $\frac{1}{3}$ tariff reduction by BT on these routes. Other competitive pressures have reduced waiting lists for telephones and other equipment. A host of new products/companies in peripherals for the telephone system are springing up.

1.10 B. Privatisation. In addition to the advantages summarised in 1.9 above privatisation enables the Government to realise assets so that the funds raised can be reinvested for other purposes. There are a number of different routes to privatisation which can be summarised below.

(1) Sale of whole businesses

The purposes of such policies are:

(i) to reduce the amount of commercial risk the taxpayer runs. Most public industries go into loss at some stage and these need taxpayer funding;

(ii) to release management from government and Treasury controls and instil a more commercial attitude in the business;

(iii) to break the magpie mentality over ownership of assets common in public businesses;

(iv) to reduce monitoring costs in Departments of State;

(v) to avoid the complacency which arises when the Treasury is felt to be present as a 'back stop';

(vi) to get the Government out of wage bargaining;

(vii) to raise money for the Government.

Examples

To date NFC, Britoil, Associated British Ports, Cable and Wireless and British Aerospace are among the businesses which have been sold. The sale of Britoil has protected the taxpayer against some of the current pressures on oil markets (Britoil shares down substantially since issue). The Britoil board are contemplating overseas diversifiaction which is commercially sensible but would have been difficult under Treasury controls. The sale of the docks may lead to a better use of their major property assets. NFC has improved its results since sale, and this business is now owned by a consortium of its own management and workforce.

(2) Sales of subsidiaries or assets outside the mainstream business

The purpose of this is to:

(i) reduce the complexity of the management problem in what are large and complex businesses, and remove Treasury control;

(ii) concentrate management attention more clearly on the main business;

(iii) facilitate the introduction of new capital and management initiative into subsidiary businesses that have often been starved of both by the demands of the main business;

(iv) raise money for the Government.

Examples

Sales to date include RDL from British Steel, Alvis and Prestcold from BL, several investments from the NEB (BTG), hotels and property from British Rial. In a case like Alvis the marriage with the aggressive sales team of USH has swelled the order books and improved the prospects for the business, whilst the BR hotels will obtain much needed new capital.

(3) Sale of shares in businesses already substantially in the private sector

The purpose of this is to:

(i) raise cash;

(ii) reduce monitoring responsibilities, and risks of the Government.

Examples

Sales to date include more shares in BP and British Sugar.

1.11 C. Increasing Measures for Efficiency in remaining Monopolies. There are a number of ways in which pressures can be increased.

(i) Tight EFL and clear and realistic performance targets.

(ii) Value for money audits.

(iii) Reduction in size of business units.

(iv) Change in corporate and financial structures.

(v) Anti-monopoly regulation.

(vi) Insistence on contracting out for ancillary services.

(vii) Fair remuneration and incentives for management.

These and other approaches are discussed in Chapter II below.

CHAPTER II

RELATIONSHIP BETWEEN GOVERNMENT AND THE NATIONALISED INDUSTRIES

2.1 In this Chapter we make proposals on the relationship between Government and the nationalised industries in general. These apply whatever the future structure we advocate in Chapter III for particular industries. Our proposals cover the co-ordination of Government policy towards the nationalised industries (2.2), the role for competition policy and regulation (2.3 - 2.15), and improved methods of control of remaining publicly owned companies (2.16 - 2.44).

Co-ordination of Policy

2.2 There are many themes which are common to different nationalised industries. Six different departments span the industries covered by our Report. It is important that the momentum towards privatisation is maintained; that a coherent approach to the whole sector is developed; and that proper cross-fertilisation of lessons and ideas is ensured. While action on a particular industry should be the primary responsibility of the sponsoring Minister, we believe that a Minister of State at the Treasury should take responsibility for co-ordinating Government policy towards nationalised industries. This role would be supportive to the sponsoring Ministers and not in any way prescriptive.

Competition Policy and Regulation

2.3 The introduction of competition, the freeing of controls and markets and the licensing of new entrants will be the most effective method of stimulating improvement in the efficiency of the nationalised or denationalised monopolies and must be encouraged wherever possible. Where an element of monopoly remains, every possible opportunity must be taken to introduce competition at the edges of the main business. Any formal or informal powers remaining with the nationalised industries to license their own competitors or to advise Government on their competitors must be removed as soon as possible.

2.4 Competitors to many aspects of the nationalised industries businesses will emerge on their own provided that the climate and framework is right. Competition, of itself, will increase efficiencies within the nationalised industries. Where new entrants are unlikely, every encouragement should be given to management of monopolies to contract out services to the private sector.

2.5 The right climate needs to be supported by strong competition policy which must be independent of Ministers. That means that businesses which feel themselves to be subjected to unfair competition or unfairly excluded from markets must be encouraged to complain directly to the Office of Fair Trading without needing to consider the attitude of any Government Department. The OFT needs a strong Board, not just a Director General plus officials, and should be required to refer such cases to the MMC where a prima facie case exits. The OFT must be independent, and allowed to take action on its own initiative as well as on Ministerial references. The MMC report should be published, although Ministers would not be bound by it.

2.6 This tough competition regime should apply to all private and public sector monopolies. Every five years the MMC should be statutorily required, without ministerial direction, to examine the monopoly position of each remaining nationalised industry and prepare a report on the way in which their monopoly position should be reduced. This report should pinpoint the precise effects of monopoly (e.g. higher wages, lax management) and recommend specific actions (e.g. decentralised pay bargaining; pressure to franchise out services, etc.).

2.7 Where there are a number of similar regional monopoly industries (e.g. water boards) left in the public sector then accounting sytems should be standardised to permit comparisons to be made between them. Internal accounting systems must also be fair and standardised so that proper comparisons can be made between external contractors' quotes and internal costs.

2.8 It is recognised that, despite the Government's strong commitment to competition some industries will remain private or public sector monopolies, with little prospect of a significant degree of competition within the near future. For these regulation may have to be a way of life for the forseeable future. For others, notably Telecom, increasing competition should make regulation increasingly less necessary. Regulation will only be needed until the fledgling competition is established. In the words of the Littlechild Report 'Regulation is essentially a means of preventing the worst excesses of Monopoly; it is not a substitute for competition'. Regulation has also to take place in conjunction with, rather than as substitution for, EFL control. EFLs impose a different but necessary pressure.

2.9 In considering the development of regulation in the UK, the following principles are important:

(a) The control of monopoly pricing and prevention of the use of monopoly power to restrict competition are the central purposes of regulation. It is in these two areas that regulatory responsibilities need to be most clearly and carefully defined.

(b) The role of the regulatory authorities in encouraging efficiency and innovation, and in providing general protection to the consumer, while valuable in circumstances where the market acts inadequately, is secondary.

(c) Cross-subsidisation is used by monopolies to disguise their true costs and to prevent fair competition. Wherever possible separate accounting systems should be used. Where Government subsidies are awarded in respect of social considerations (e.g. rural services), these should be transparent and specific.

Government Approach to Regulation of British Telecom

2.10 The existing responsibilities for regulating nationalised industries and the policy options available can be demonstrated by considering the position of British Telecom once 51 per cent has been sold.

2.11 In common with other monopolies, BT will continue to be subject to the scrutiny of the Monopolies and Mergers Commission and the Office of Fair Trading.

2.12 Unlike other monopolies BT will, in addition come under the scrutiny of OFTEL - a licensing and consumer protection organisation with limited and indirect power over prices, exercisable principally through referrals to the MMC and subject to the overriding powers of the Secretary of State, and, in the case of license variations, the Courts.

2.13 BT's prices will be controlled by a Local Tariff Reduction scheme, which will restrict future growth in rentals and prices of local calls through a formula, RPI-X, for five years. (X is to be fixed by the Secretary of State in negotiation with the British Telecom.) The purpose of this regime is to protect the consumer from monopoly pricing until competition ends the monopoly.

<u>Assessment of Government Approach</u>

2.14 (a) Compared with the other alternatives analysed in the Littlechild Report (No Explicit Constraints, Maximum Rate of Return, Output-Related Profit Levy, Profit Ceiling), the LTR system has a number of significant advantages. It is simple and readily understandable and the political advantages of price rises on voters' local phone bills below the rate of inflation are obvious. It should also produce near-maximum proceeds for the sale of BT.

(b) However, the LTR system has a major weakness - it is crucially dependent on the setting of 'x'. 'x' has to be set based on present levels of efficiency and cost structures. If the Secretary of State fixes 'x' at too large a percentage, it will discourage competition in local call markets, restrict BT's future cash flow and limit the proceeds of the sale. If 'x' is too small, too little of the expected decline, in real terms, of telecommunications equipment and technology costs (or improvements in efficiency) will be passed on to the consumer.

(c) Professor Littlechild sees no great difficulty in this area because he expects competition to take over fairly quickly from regulation. This may be optimistic if competition on trunk routes is restricted to Mercury. A more careful approach to the formula is needed in other industries where competition is weak.

(d) Future licensing of competition lies effectively with the Secretary of State, not an impartial body.

(e) OFTEL plays no obvious role which could <u>not</u> be played by OFT.

Proposals on Regulation

2.15 The regulatory approach suggested in the Littlechild Report should be adopted in relation to denationalised monopolies and nationalised industries with significant monopoly powers in all or part of their businesses. However, the following modifications should be introduced wherever possible

- The Formula should be based not on the Retail Price Index but on an index of appropriate input costs, including labour - the Special Index approach recommended by the MMC in 1982. Such a formula will be more realistic and therefore more credible, and ensure that cost reductions specific to the particular industry are not extracted as a monopoly rent.

- The level of 'x' should be established after a full and detailed examination of costs and cost trends in the industries concerned. The examination should be carried out by or on behalf of the Department. It should be limited in duration - probably a maximum of six months. It is recognised that the outcome will not be perfect; but such an examination is essential if both the consumer and the Industry are to have faith in the formula. Once fixed 'x' should not be changed for at least five years; if it is felt after that period that insufficient competition has been introduced another examination should take place to fix 'x' for another period.

- Competition through Licensing should be rigorously encouraged wherever possible. (For example, the obvious dangers of Mercury and BT forming a de facto cartel on trunk line prices should be avoided by allowing additional competitors in that sector of the market at the unfettered discretion of the DGT).

- Responsibility for Regulation should not be assigned to further offices on the OFTEL model but to be located within the OFT. Specific bodies such as OFTEL should not be established in future. The sponsoring department should establish the price formula, the OFT ensure its observance. This will reduce duplication and confusion of responsibilities, lead to more effective use of manpower, and reduce the risk of the regulatory machine being "captured" by the industry it should control.

- Targets and EFLs. Regulation, in the case of industries continuing in public ownership, needs to be combined with the setting of realistic targets and tight control of EFLs.

The Control of Publicly owned companies

2.16 It seems inevitable that some businesses will remain in public ownership. It is very important that the management of these businesses should be improved. Our proposals here relate to the quality of management (2.17 - 2.20), the nature of the management task (2.21), and the criteria against which performance is judged (2.22 - 2.24).

Quality of Senior Management

2.17 Experience in private sector and public sector industries over the past few years has highlighted the overriding importance of appointing and motivating a first class chief executive. We believe that the political argument for proper remuneration of key individuals in senior positions has been accepted. However it is essential that practice in this area should catch up with principle. Government should be willing to take the inevitable short term political criticism in order to get the right man for the job. Government must be prepared to take risks with appointments of younger managers. Generally a five year contract is appropriate for Chairmen; shorter contracts may be suitable in particular circumstances.

2.18 We recommend that, wherever possible, consultation should take place between the Secretary of State and board members before new board executive appointments are made. It is desirable that new appointees should start off with the general support of the board.

2.19 It is impossible to make a general recommendation as to whether the Chairman and chief executive post should be combined. This depends on the type of business, the likely action required and the individuals available. When the business is in a period of significant change there is much to be said for combining the posts of chairman and chief executive.

2.20 The Group attached great importance to the role of non-executive directors. These directors must be independent, properly remunerated and of a high calibre. As a general rule the non-executive directors should be in the majority on the board. The executive directors will then always be aware that policies can be rigorously assessed in the board room. Non-executive directors should be appointed for three years with a third coming up for reappointment every year. It is important that there are no financial penalties attached to employees becoming board members. Ministers' power over the board will not undermine the NI board's independence provided that they are working to clearly defined targets as explained below. We stress that our general recommendations in this paragraph may well not be suitable to every industry.

Structure of the Nationalised Industries

2.21 High calibre, well motivated managers are clearly important for the nationalised industries. The Group also believes that their performance can be improved by forming smaller management units where possible. The bureaucracies created to cope with a number of the larger industries mean that real decision making is often at fairly junior levels in the organisation; and business initiative is stifled by the need for major decisions to be passed up the line. Smaller units will be more manageable, as well as paving the way for privatisation of the separate parts.

The Setting of Objectives, Targets and Performance Criteria

2.22 Strategic objectives - covering, for example, privatisation of all or part of the business - should be agreed with the incoming Chairman before he is appointed and made public wherever possible. His performance and remuneration should be judged against the achievement of these objectives. More detailed financial and (for monopolies) service targets should be negotiated and agreed with management. Exceptionally it may be appropriate for Departments to impose targets. Once set targets must not be changed except in the most extreme circumstances.

2.23 The targets should be financial and customer service orientated and should be set on, at minimum, a forward rolling three year basis. They must be readily understandable to the workforce and consumers. The financial targets should be based on the <u>cost</u> of providing the service and not related to profitability. It is too easy to manipulate capital related targets; and profit targets are influenced by the monopoly position of the industry. Non-financial targets could cover such matters as employees per unit of service delivered (e.g. per megawatt of electricity generated) or quality of service provided (e.g. per cent trains running to schedule). The management must expect to be judged on achievement of the targets.

2.24 Wherever possible objectives and targets should be published. It is recognised that in some industries it will be desirable to keep confidential particular targets which may be politically or in other ways, contentious.

Monitoring of Nationalised Industries

2.25 Improved monitoring of the industry's performance is essential. The present convention about Ministerial non-involvement in day to day matters must be preserved. However, the industries must be accountable. A small special unit should be established in each sponsoring department charged with monitoring the performance of the industries. It should be staffed in part by people seconded or recruited from the private sector with appropriate managerial and accounting skills. The unit should agree with the industry the information which should be provided to it on a regular basis. The information required from each industry will be different but should enable the unit to check, at the least, whether targets are likely to be attained. The annual review of performance and forward projections should be far more rigid than is currently the case.

2.26 It is important that value for money audits should become a regular feature of nationalised industries internal and external controls. The annual VFM audit should comprise both a confidential management letter and a public report on the efficiency, effectiveness and economy of the business. Action on the letter would be expected within a reasonable time frame. The industry would be expected to agree to all reasonable audit requests. Its external auditors should normally carry out the value for money audit. They should be seen to owe their appointment to the Secretary of State, to avoid any appearance of possibility of being 'captures' by the industry.

2.27 The Group feels that the MMC powers of investigation, and of carrying out VFM audits should be retained, for occasional in-depth studies. The advantages of investigation by an outside body with cannot be 'captured' by the industry lobby are considerable. The temptation for Ministers of passing on the more politically contentious issues to the MMC (presumably in the hope that they will go away) must be resisted. The possibility of amending the 1980 Competition Act so that the MMC can comment on ministerial decisions relating to the funding of the nationalised industries should be investigated.

2.28 The Group is opposed to an extension of Parliament's powers of scrutiny over the nationalised industries. The current powers of investigation by Select Committees are adequate and should be used more often.

Consumers and Nationalised Industries

2.29 The consumer interest must be adequately protected. This is particularly important to reassure the public at a time of change in the status and ownership of the industries. There are two appropriate levels of consumer representation for monopoly industries:

(a) The local/regional consumer council for each utility, designed to deal largely with consumer complaints, should be based on the formula of the Regional Electricity Consumers' Councils. There is a case for strengthening their powers to follow through a consumer complaint. Their status will be enhanced if the recommendations below to move to regional utilities are accepted. There would be little change in the number of consumer bodies.

(b) There should definitely be two national consumer bodies to cover the effective monopolies, one for the Transport Industry and one for the Energy Industry. The need for national bodies in other areas - post, water, telecommunications - must be considered. The national bodies would have an advisory role and could consist of individuals of considerable standing and expertise. They would be closely involved in setting the service targets and would review, together with the industry boards, the performance of the industry against the targets. They would be encouraged to use their power to refer matters to the OFT and to discuss with the sponsoring department's unit value,for money audits which they might wish to see carried out.

2.30 There is resistance from the consumer bodies to central bodies of this kind since it is argued that they get out of touch. However it is important that the consumer interest be represented strongly at national level at a time when more power and importance is being passed to the regional companies.

Status of Nationalised Industries

2.31 Most of the nationalised industries are statutory corporations. This is based on the original Morrisonian concept and was devised to give the Industries independence from Ministers. Interference by Government has been the rule rather than the exception. Yet it is only during this Government that Chairmen have publicly referred to their statutory position.

2.32 The next Government should change all the industries to Company Act company status. Ideally this should be done through one Bill although this may well be politically and technically impossible. In practice we do not expect that a change in status will reduce the independence of the chairman and board.

2.33 As an interim step (before Companies Act status has been imposed) statutory corporations seeking capital reconstruction should be subjected to much greater departmental and parliamentary scrutiny. In particular select committees should be encouraged to carry out a major investigation cross examining management, and the sponsoring department should be required to prepare a full report. Government should indicate that they would be prepared to grant time for a debate. It is important that such a reconstruction should be a traumatic experience for management and employees.

Financing the Nationalised Industries

2.34 The present structure of the industries means that, apart from tight EFLs, poor performance as against targets causes little inconvenience to management. Parliament is merely asked to extend borrowing limits by an appropriate amount when necessary. The same nationalised industry under Companies Act status would still have the support of the state but would have a number of hurdles to jump. The change to Companies Act status and the wish to create private sector discipline necessitates a move to ensuring that the balance sheet and financing methods remain as closely as possible comparable with private sector companies.

2.35 With this structure, poor performance would result progressively in passing the dividend, breaking financial undertakings, and becoming bankrupt (assuming that the government was prepared to let this happen). At each stage the deteriorating position would increase the chance that radical steps would be taken. These pressures will assist.

2.36 The major cash control system should continue to be the External Financing Limit. This is a useful but blunt instrument which has been taken seriously by the nationalised industries, although it sometimes results in year end window-dressing. The broad cash control discipline exerted by the EFL is similar to that exerted by large private sector companies' bankers. The main criticism of the EFL system is that the Government has been too willing to increase the EFL under pressure. For so long as the Government remains as 100 per cent owners it is appropriate for the EFL to be retained, although shortfalls should be able to be carried over into the next financial year. In the setting of the EFL, attention must be paid to the balance sheet structure of the industry. The assumptions underlying the EFLs should be spelt out, if these change dramatically then changes should be made.

2.37 Nationalised industries should, prima facie, be restricted to borrowing from the National Loans Fund; but they must have the same flexibility as they could achieve from the private banking sector. A general rule would be that any laons which an industry could acquire from private sector banks with a government guarantee should be available to it from the National Loans Fund on similar terms and conditions. It would be up to the government to decide whether the National Loans Fund should provide the finance itself or whether the industry would borrow with a guarantee from the markets.

2.38 The Group believes that more could be done to introduce private sector financing of particular nationalised industry projects. The initiative must come from the industries and the projects concerned should not benefit from implicit or explicit Government guarantees, undertakings or assurances in any way. Treasury support should be given to those initiatives.

2.39 It is essential that the move towards a Companies Act company is accompanied by a restructuring of the balance sheet. The debt: equity ratio should never exceed 1:1 and preferably should not be greater than 1:2. The Government should expect to receive a dividend on public dividend capital. Assets should be valued on a realistic basis. Any social payments or grants from the Government should be clearly identified as such.

2.40 Government should interefere only in the most exceptional circumstances in the pricing of the Nationalised Industries' goods and services. Realistic setting of EFLs, financial targets and a sound balance sheet, coupled with MMC, Departmental and Select Committee investigations should create sufficient pressure to make additional intervention unnecessary. Intervention should therefore be regarded not only as a failure of management but a failure by Government to set the right objectives and targets.

<u>Methods of Privatisation</u>

2.41 Ancillary businesses of whatever size should be offered first to management and workforce; but they should not be offered at an unreasonable discount from the 'market price'. If the Government is advised that there is no 'market price' then the business should be sold for whatever management and workforce will pay.

2.42 Sales of whole businesses to private sector companies should be considered. Preference should be given to UK company purchasers for political and nationalistic reasons. Rather than not take any action it would be better to accept the adverse political reaction of sale to a non-UK parent company (if a flotation is unlikely to succeed) than add to the monopoly power of an existing UK private sector producer.

2.43 The Group has no preferred method for a public offer for sale. It must depend on the circumstances of the company and on the prevailing market conditions. The Government should not be deterred by the difficulty of setting the 'right price' for a public flotation. The difference between massive under and over subscription is tiny. The important and overriding objective must be to dispose of the asset. Preferential treatment in share allocation should be given to both employees and private customers. Arrangements should be made by management (as in the NFC buy-out) for share purchase loan facilities to be available for employees, repayments to be made through the pay packet.

2.44 Customers should be encouraged to subscribe for shares and be able to pay for them through the quarterly account with appropriate rates of interest being paid for credit extended. There are a number of technical problems associated with such schemes. The City will argue strongly against them. They can and should be carried through. On pure financial grounds the political security against re-nationalisation which very widespread personal ownership would give is likely to reduce the market's perceived risk and therefore increase the striking price.

CHAPTER III

INDIVIDUAL INDUSTRIES

3.1 The industries considered fall into four general categories.

3.2 Some businesses are ripe for rapid privatisation: Rolls-Royce; British Airways; and some of the component businesses in the Royal Ordnance Factories and the National Bus Company.

3.3 Some have to be considered as utilities. Of these, BT, BGC and the ESI could be privatised while the water industry is likely to remain publicly owned. Whether privately or publicly owned, these utilities would need to be regulated, although regulation is not essential to BT once the latter faces real competition.

3.4 Some businesses, (BL, BS, BSC) are in the public sector because they are not commercially viable. The recommendations for these three businesses are very similar. The saleable parts should be sold before they in turn become unprofitable and are starved of new investment. A rump business may remain in public ownership in each case. Sale of businesses that subsequently encounter difficulties is still a sensible course. It proved easier to rescue ICL in its most recent period of difficulty because it was no longer in government ownership. Its status as a private sector company enabled the negotiation of tough terms and reorganisation and rejuvenation without direct recourse to public funds.

3.5 Finally, the water industry (mentioned above as a utility) and the Post Office and Giro Bank, are likely to remain in public ownership.

3.6 The general principles of utility regulation have been discussed in paragraphs (2.8-2.15). The principles of managing and monitoring the businesses left in public ownership (or awaiting privatisation) are discussed in paragraphs (2.16-2.44). For the publicly owned 'rump' businesses of BL, BS and BSC, the prime management ovjective should be to get them into a state from which they can return to normal commercial operation.

Rolls-Royce

3.7 The danger in keeping Rolls-Royce in the public sector is that both management and workforce are growing increasingly used to the idea that Government will always pay the bills. Major capital investment will be needed in future projects, and the Group believes that real commercial pressures would lead to beneficial international collaboration. Certainly, full exposure to competition without the protection of Government would bring great pressure to control costs.

3.8 There are strong parallels between BAe and Rolls-Royce. Despite strategic considerations, privatisation is perfectly possible and desirable. Some form of dowry would probably be needed, possibly in the form of development contracts. It is likely that either the Derby or Bristol works would need to be run down before privatisation.

3.9 There is always the risk that financial pressure on the company will become serious at some future time. However, operation in the private sector will minimise the risks because of the improvements in performance which should result.

3.10 Priority: Year 1. Sale should be by public flotation.

British Airways

3.11 This business should be privatised as soon as possible - the airline business is so cyclical that the government should not await "good market conditions" for too long. The peripheral businesses should should be sold first, including British Airtours and BA Helicopters.

3.12 Priority: 1. Sale by public flotation.

Royal Ordnance Factories

3.13 These factories are not as efficient as they might be. They are bureaucratic and concealing their true costs. They should be sold, factory by factory, as soon as possible. The articles of association of those in strategically important areas will need to prohibit overseas sale. Where an acceptable price cannot be achieved, because of a lack of really interested buyers, public ownership should be retained.

3.14 MoD would be a monopoly customer for some of the factories. This has to be accepted and current defence sales criteria retained.

3.15 Priority: Year 1-3, sale on a factory basis.

National Bus Company

3.16 NBC should be split into its component parts, and any parts which can be sold should be (e.g. National Express, National Holidays). If there are no purchasers of the component parts then assets should be disposed of piecemeal.

3.17 Local Authorities should be required to put routes out to tender, either singly or in a group to ensure that minimum service is preserved. The authority should specify fares and service levels and accept positive or negative tenders as appropriate.

3.18 Priority: Year 1-2; tender on a regional basis.

British Airports Authority

3.19 There is no need for a single authority running Britain's major airports. Each airport should be run by its own authority, and these should be privately owned. Local authorities should be required to divest themselves of airports. Each authority should franchise as many of its services as possible.

3.20 Because Heathrow is so much more attractive to airlines than any other airport, it can push up its landing charges without too much fear of losing business. Price regulation would be needed. A reasonable level of charges should be established and then increases regulated by a formula like the one proposed by Professor Littlechild.

3.21 The activities of the CAA could be extended to the allocation of airport space to airlines requesting it.

3.22 Ideally the airlines themselves should be responsible for as much as possible of the service which their passengers receive at the airport. With privately-owned airports, the airlines would be able to negotiate on purely commercial grounds to lease check-in facilities, catering facilities, baggade handling etc. and operate these services themselves.

3.23 Priority:

British Telecom

3.24 The Government has already promised that 51 per cent of the shares in BT will be sold early in the life of the next government. The Group considered splitting the international business from the rest, but decided that the present privatisation plans had gone too far to permit this. A major advantage of privatisation for British Telecom is that the ability to raise finance from shareholders and raise loans in the market will mean that investment is no longer financed disproportionately from revenue.

3.25 Since October 1981, BT has been opened up increasingly to competition (e.g. Mercury, attachment etc.). However, significant parts of the business remain effective monopolies. Every opportunity to introduce competition should be taken. The Group regrets the limitation of competition to Mercury, and believes other trunk carriers should be licensed.

3.26 When privatised, BT will be the first important private sector monopoly in Britain. The provisions for regulation are therefore vital (see 2.8 - 2.15). Unless competition is extended beyond the entry of Mercury, regulation of the temporary nature proposed by the Littlechild Report will be inadequate. Modifications, such as those developed in para. 2.15, will be needed.

3.27 Priority: Year 1 - Privatisation should include sale of shares to customers.

British Gas

3.28 British Gas controls both the demand for and supply of gas. Its immense power has led to a serious distortion of the gas and energy markets.

3.29 Ownership should be transferred to the private sector within the lifetime of the next Government. The industry should be restructured to this end:

(a) The national high pressure grid has, following the Oil and Gas Enterprise Act, become a common carrier. It should be operated by a regulated Companies Act company with 100 per cent of its shares sold to the public. The carrier would be obliged to take any gas meeting specifications, provided it has capacity. Any company would have the right to build and operate competing high pressure lines.

(b) Regional distribution companies would be formed, privatised with shares as widely owned as possible. These companies would be responsible for purchasing their own supply of gas. These could, in principle, compete with each other, and could be forced by OFT to lease unused capacity to others wishing to use it.

3.30 The common carrier would be permitted to increase prices on an industry basket formula after a rigid cost examination (see para. 2.15). Prices of contracted gas to each regional board would initially allow them to meet historic demand at the presently prevailing price. The Regulatory Agency would produce comparative statistics on performance of the regional boards on an interim basis.

3.31 BGC's interests in both onshore and offshore oil should be disposed of as soon as possible. The Government has taken powers to direct the latter. Before the industry is restructured as above, the retail outlets should be sold off individually to the highest bidder.

3.32 Priority: Year 2. Sale of local distribution businesses by public flotation. Year 1, sale of oil interests and showrooms, year 3, sale of high pressure grid, public flotation.

The Electricity Supply Industry

3.33 Single stream decision taking and political interference has led to unreasonably high operating costs. Efficiency has to be improved.

3.34 The twelve Area Boards should be sold as independent (regulated) businesses, buying electricity from the national grid or generating their own. They would compete for business outside their boundaries, and be forced to distribute at regulated tariffs where customers in their region contracted with other suppliers. Relationships between Area Boards and private generators have been established by the Energy Act. The Regulatory Agency would be able to make comparative assessments of efficiency and exercise power through having to approve tariffs.

3.35 The national grid in England and Wales would operate as a regulated monopoly, with its shares sold to the public. It would transfer power from any of the five generating boards (see below) or other generators. The principle of common carriers transactions has been established in the Energy Act. The transmission company might well act as agent for some or all of the Area Boards in purchasing electricity on a merit-order basis.

3.36 The five CEGB regions would each become a separate generating company. These would again have shares sold to the public. They would compete with each other to supply the grid, and would therefore not need to be regulated.

3.37 The common carrier should be permitted to charge on cost related basis (see 2.15 above), and required to show no undue preference to particular Area Boards. The Area Boards should have prices controlled on an industry basket formula so that higher efficiency would be needed to earn higher profits. Generating companies should be unregulated and free from Government interference (except on safety, etc.). The MMC would ensure that they did not form cartel arrangements.

3.38 Electricity showrooms should be sold to the highest bidder. The Electricity Council should be abolished. The SSEB should be left as an integrated power board at least until the restructuring of the industry in England and Wales is complete. It may then be appropriate to introduce a separate grid in Scotland.

3.39 Priority: Year 1. Flotation of Area Boards and sale of showrooms to take first priority.

British Rail

3.40 The hotels, Sealink and Hoverspeed are currently being sold off. British Rail should be pressurised to accelerate other peripheral disposals, particularly property.

3.41 35,000 of British Rail's 203,000 staff are employed at British Rail Engineering Ltd. This organisation has very low efficiency (turnover per employee in 1982 was £13,300, less than half that of a comparable engineering business). The facilities at BREL would be attractive to any enterprise interested in supplying or repairing rolling stock for the UK or overseas market. This business should be privatised. The present situation in which it is BR's sole supplier should end.

3.42 Of the remaining 170,000 staff, no fewer than 50,000 are salaried, involved mainly in clerical work and administration. In 1982, BR received passenger and freight grants totalling £928 million and lost £173 million. BR has found it extremely difficult to push through the productivity package necessary for its operational efficiency.

3.43 BR's problems are not going to be solved easily. Some of its services to passengers (station management, catering) could be provided more cost-effectively if they were franchised out. Its financial problems could be eased by more main site development from within its large property portfolio. Nonetheless, some of the problems caused by strong unions and lack of dynamism in the train business would remain.

3.44 The possibility of private sector franchising of train services has been canvassed. Indeed, the Victoria-Venice service is now being run by private operators for the luxury market. The group were attracted by a structure in which train services in each region would be franchised out, with BR left to operate the track and signalling. This would be the logical extension of proposals we have made for other utilities, and could be built up as quickly or slowly as policy makers wish.

3.45 We have not been able to evaluate the practical implications of a move to franchised train services. If the practical difficulties are not insuperable, action should be taken along these lines. In any case steps will have to be taken to make BR's operations more cost-effective. The incoming chairman should be left in no doubt that this should be his overriding objective for the train business.

3.46 As a monopoly, BR's prices ought to be regulated, using a regime like that developed in paragraphs 2. 15).

3.47 Subsidies for social routes should be made more transparent.

3.48 Priority: 1 strengthened management; sale of peripheral businesses; franchising out of as much of the business as possible. Over a larger timescale, the franchising out of train services should be implemented if at all possible.

British Leyland

3.49 The objective of denationalising BL will be achieved only through selling the individual businesses separately. This will require a clear instruction from the Government to the Board of BL.

3.50 The sale of the whole of BL may never be possible. However, the parts of BL are stronger than the whole, and indeed the original merger is one of the major causes of BL's present problem. If BL is sold as a whole, the chance of the Government getting it back during the next downturn in the world market for volume cars is considerably increased.

3.51 The business should therefore be separated, in accounting as well as in managerial and operational terms, into its component parts, with the objective of selling each part as soon as is practical. Breakdown into only four groups (cars, uniparts, Land Rover and Leyland) is insufficient for this purpose. BL should be re-organised into smaller groups in order to achieve this objective.

3.52 Jaguar and Land Rover can be sold immediately. Cars and Leyland may only be capable of being denationalised through co-operation with a foreign manufacturer. This co-operation (through outright sale or the setting up of a joint company) should be actively pursued.

3.53 The best protection for UK suppliers to any part of BL lies in supplying components that are internationally competitive in terms of price and quality. The drive to improve suppliers' performance has already begun in BL. Given the large proportion of bought-in components, this is essential if BL's competitive position is to be strengthened.

3.54 In the long term the health of BL is the only way of guaranteeing the health of its UK component suppliers. Denationalisation has no impact on these basic facts of economic life for component suppliers - except to underline the importance of recognising and reacting to them. Even in public ownership, BL is stepping up its use of imported components.

3.55 Priority: Years 1, 2, 3. Sales and/or public flotations whenever possible.

British Steel Corporation

3.56 Considerable progress has been made in cutting costs at BSC. The corporation remains a monolith which is determined to pursue its vertical integration policy. The dangers of single stream decision making are clear. The incoming Chairman should be given defined terms of reference. BSC must continue progress towards the sale of its peripheral businesses. Obvious future candidates include BS Chemicals, Pipeworth Engineering Ltd., Stanton and Stavely Ltd., among others.

3.57 BSC should also be directed to withdraw from downstream activities. Phoenix I involved nationalisation. Further developments of this kind should be avoided. Rather, BSC should be instructed to sell off those downstream businesses which compete with private sector firms, and close any which are unsaleable. The luxury of vertical integration for BSC has proved very damaging for the private sector, because BSC can always underbid them using taxpayers' money.

3.58 Upstream, BSC's businesses should be split into their component parts. The benefits of autonomous management would outweigh the loss of limited operating scale economies. The benefits of joint purchasing could be achieved - as they were before nationalisation - by a common agency. These smaller publicly owned companies should compete as Companies Act companies with finite resources, and Government should be willing to accept the consequences if the least efficient were driven out of business by continuing overcapacity. The decision as to size of cash resources will reflect practical judgements. Over time it is hoped that the surviving companies will be returned to the private sector. Diversity in decision making will prove beneficial to the industry.

3.59 Priority: Years 1 - 3. Restructuring to commence immediately. Sales whenever possible.

British Shipbuilders

3.60 State ownership means that many difficult decisions have been shelved (rationalisation of engineering) and marketing thrust has been limited (warships). The Party pledged privatisation of shipbuilding in its last Manifesto. Powers to direct disposals are now being taken.

3.61 The Group believes that the warship builders should be sold, not necessarily as a single entity. All three main yards are profitable, although, under BS management, success in overseas markets has been reduced almost to zero. The Group did not believe that warship building was of any greater strategic significance than many other activities already in the private sector. The sensitive technology has in the on-board radar and weapon systems manufactured by private companies.

3.62 Within the offshore division, Cammel Laird and VO Offshore should be sold, and Scott Lithgow run down. The Falmouth ship repair yard should be sold, and the remaining ship repair facilities within BS should be put under increased pressure to perform profitably. The engineering division should be split up into parts for sale, parts for closure, and parts which are a necessary adjunct to merchant shipbuilding.

3.63 This would leave BS as a merchant shipbuilder, with access to IF assistance, but with a heavy burden of debt which should be restructured to leave the company as separate Companies Act companies.

3.64 Priority: Year 3. Sales of Warship yards should take place as soon as possible.

Post Office

3.65 Some progress has been made in improving the efficiency of the Post Office. More can be done, by setting well thought out targets and occasional threats of removing the letter monopoly.

3.66 The Group has agreed that the Post Office ought to remain in public ownership. There is no other way of ensuring a universal service, with inland postage rates independent of the distance involved. The political consequences of removal of the monopoly would be most serious in the rural areas.

3.67 The Group considered that the operation of Crown Offices should be put out to tender or sold outright (but with an obligation to provide a service) depending on local circumstances. Priority should be given to increasing services provided through sub-offices; action on gas and electricity showrooms should lead to more business in connection with the payment of bills.

3.68 Parcel post has always been open to competition. In October 1981, courier services and premium (high speed) services were liberalised. This, and the potential threat to the letter post monopoly, are important in spurring increased efficiency and curbing the power of the monopoly trade union.

3.69 The Post Office has a financial target of a 5 per cent reduction in real unit costs over 3 years. The annual report also contains indicators of the quality of 1st and 2nd class postal services. These targets should be examined at the beginning of the new Parliament.

3.70 Priority: -

Girobank

3.71 Should remain with the Post Office. Giro offers useful competition to the large clearing banks, brings business to small Post Offices, and will be increasingly important as the economy moves in the direction of cashless pay. There may be a case for re-examining whether Girobank should be privatised in the context of a change in law relating to Building Societies.

3.72 Girobank must operate in the future in free and fair competition with the clearing banks. It should be closely monitored and given demanding financial targets.

3.73 Priority: -

Water Authorities

3.74 The water strike has shown the danger of over-centralisation and single wage negotiation units. The business seems destined to remain publicly owned. The National Water Council is being abolished. Vigilance will be needed to prevent its reinvention by the Water Authorities.

3.75 The supply of water and treatment of sewerage is a natural regional monopoly. Pressure is needed to effect more contracting out of work to the private sector. This can be done by a strict EFL and the regulatory framework described above (para. 2.8-2.15).

3.76 The business should be required to provide 5 year plans setting out the rate of renewal, repair and extension of assets. This would allow rational discussion of investment needs, and pricing policy. Requirement for cash should be the focus of monitoring. Detailed targets need to be set. The separate businesses should be encouraged to negotiate wage increases locally.

3.77 Better information needs to be made available to consumer bodies to allow better regulation. The ultimate sanction is reference to the MMC. Prices would need to be regulated as for other utilities.

3.78 Priority: -

Minority Stakes

3.79 The significant minority stakes in Companies Act companies owned by the Government are held as a result of past flotation of the majority shareholding. They are

	Percentage of Shares held by the Government
Britoil	49.00
British Aerospace	48.43
British Petroleum	39.00
Mersey Docks and Harbour Company	20.00
British Telecommunications Corporation	49.00
Associated British Ports	48.5
Cable and Wireless	51

3.80 Unless there is a clear strategic reason for retention of the minority shareholding (as distinct from the desire to retain UK ownership, which where desirable can be achieved through the articles of the company) these minority shareholdings should be disposed of in the light of

- the Government's cash requirements
- the state of the Stock Market

during the life of the next Government.

3.81 These minority stakes are an unwieldy and unbalanced portfolio, serve no useful purpose in Government hands, and their sale would remove from the Government a responsibility for oversight that is hard to define and even harder to discharge.

ANNEX A

Terms of Reference and Group Members

The Group was appointed by the Chancellor of the Exchequer in November 1982 with the following terms of reference:

> 'To review progress made in reducing the role of the State and to restoring State industries and related activities to the competitive disciplines of the market sector by private ownership, reduction of monopoly powers and other means; and to consider the proper relationship between Parliament, Government and the Nationalised Industries with special reference to pricing and the flow of new investment funds.'

The Group had 16 meetings; the members of the Group were as follows:

Mr. Tim Eggar MP (Chairman)
Sir William Barlow
Dr. Norman Blackwell
Mr. Christopher Bland
Mr. Kenneth Carlisle MP
The Hon. John Eccles
Mr. Michael Grylls MP
Mr. John Redwood
Mr. John Watson MP

During the Group's deliberations, meetings were held with the Hon. Nicholas Ridley, MP and Professor Littlechild. In addition members of the Group had informal discussions with Ministers and others. The Group decided that, due to the time constraints, it would not request oral or written evidence from interested bodies and individuals.

The Group is very grateful for the first class assistance and support provided by the Group's Secretary, Dr. Lynda Rouse and by Miss Catriona Ritchie and Miss Joanna Smith who did the typing.

The Group decided that it was not competent to comment on the Nationalised Industries operating exclusively in Northern Ireland and Scotland (although reference is made in para. 3.38 to the SSEB).

ANNEX B

The Record 1979 - 1983

The 1979 MANIFESTO promised to:

Scrap Socialist programmes such as nationalisation of building land (p.9).

Offer to sell back to private ownership aerospace and shipbuilding (p. 15).

Sell shares of the NFC to general public (p. 15).

Encourage private bus operations through relaxation of licensing regulations (p. 15).

Interfere less in running of nationalised industries, and set a clearer financial discipline (p. 15).

Complete review of BNOC as soon as in office (p. 16).

Progress to date has significantly exceeded these initial expectations:

COMMUNICATIONS INDUSTRY

British Telecom has operated separately from the Post Office since October 1981.

Nearly half the Government's shares in Cable and Wireless sold in Autumn 1981, to form a private sector company.

Mercury given a 25 year licence in February 1982 to run an independent telecommunication network in competition with BT. The first service expected in early 1983.

Value added services, offered by private firms using BT's network, are now being licenced.

Supply and maintenance of telecommunications apparatus opened up to competition. One result is that private subscribers will no longer have to rent telephones other than the first from BT.

Legislation in place contains powers to require BT to form wholly owned subsidiaries and dispose of them.

Legislation before the election will put BT into Companies Act form and enable the sale of shares.

Legislation in place allows the Post Office monopoly to be suspended.

Private operators have been licensed to provide express mail services and document exchanges.

TRANSPORT INDUSTRIES

Legislation in place to permit the denationalisation of British Airways.

National Freight Corporation (now Company) bought by a consortium of management and workers.

Traffic licensing regime relaxed, particularly in relation to express coach services.

Legislation in place to allow private capital in the National Bus Company.

British Rail's hovercraft subsidiary has been merged with Hoverlloyd, to form a new private sector company, Hoverspeed.

Most BR hotels have been sold, together with a significant portfolio of property.

Legislation in place allows the sale of Sealink, BR's ferry service.

British Transport Docks Board (now Associated British Ports) has been privatised.

Testing of heavy goods vehicles being transferred to the private sector.

ENERGY INDUSTRIES

Britoil privatised.

Legislation in place permits the sale of BGC's oil-producing interests in the North Sea.

BGC's statutory privileges in buying gas, and its monopoly position in supplying large gas consumers, have been removed.

Legislation in place permits the sale of BGC's showrooms, subject to legislative measures on safety.

BGC's half share in the Wytch Farm onshore oilfield is in the process of being sold.

Private generation of electricity now allowed as a main business, and generators have access on fair terms to the grid as a common carrier.

OTHER INDUSTRIES

British Aerospace and Amersham International have been transferred to the private sector.

Legislation in place permits privatisation of British Shipbuilders.

BL has disposed of its interests in Prestcold, Coventry Climax and Alvis.

BSC has been involved in joint ventures with the private sector. Allied Steel and Wire Ltd. is a new private sector company set up by BSC and GKN. BSC's construction subsidiary, Redpath Dorman Long Ltd., has been sold.

The NEB holdings in 21 companies have, to date, been sold back to the private sector. Prominent among these were holdings in ICL, Ferranti Ltd., and Fairey Holdings Ltd. The NEB's role as an agent of "back door nationalisation" has been ended.

NATIONALISED INDUSTRY PRICES

	Latest Annual Change November 1982 on November 1981	Average Annual Change November 1982 on July 1979
PUBLIC SECTOR		
Nationalised Industries		
RPI components as follows:		
Fuel and light	15.0	19.7
Rail fares	27.3	17.5
Road fares	24.8	17.4
Postage	8.7	19.4
Telephones	0.1	18.7
	14.1	18.7
PRIVATE SECTOR		
RPI components as follows:		
Food	4.7	8.0
Transport/Petrol*	3.1	9.1
Services*	8.9	12.6
Repairs/maintenance of housing	8.6	11.6
Durables	2.4	5.5
Clothing & Footwear	1.3	3.2
Meals outside home	7.8	11.3
Miscellaneous	9.0	10.1
	4.9	8.3

*Other than those elements itemised separately under Public Sector (i.e. Rail and Road Fares, Motor Licenses, Postage and Telephones).

Source: Journal of Economic Affairs, January 1983.

	Grants and government net lending to nationalised industries					Public sector borrowing requirement	
	Nationalised industries sector as defined at time of forecast		Nationalised industries sector as currently defined			Budget forecast	Outturn
	Budget forecast (£m)	Outturn (£m)	£m cash	as % of planning total	as % of GDP at mkt prices	(£m)	(£m)
1979/80	2,255	2,944	3,052	4.0	1.5	6,881	9,919
1980/81	2,432	3,366	3,347	3.6	1.4	8,536	13,189
1981/82	3,045	2,848	2,848	2.7	1.1	10,566	8,685
1982/83	3,118	3,192(a)	3,192(a)	2.8(a)	1.2(b)	9,533	n.a.

Notes: (a) Estimated outturn

(b) Estimate

Sources: "Government's Expenditure Plans 1983/4 to 1985/6" Cmnd.8789 - II section 3 and earlier editions

"Financial Statement and Budget Report" 1982/3 HC 237 of 1981/2 table 20 and earlier editi

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"Financial Statistics" February 1983 table 2.5