

Av. changes  
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P.0843

PRIME MINISTER

British Airports Authority: E(NI)(82)19

BACKGROUND

FLAG A  
FLAG B  
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This note by the Secretary of State for Trade discusses the performance and current position of the British Airports Authority (BAA). In his minute to you of 23 July the Secretary of State suggested that the note could be cleared in correspondence. Mr Scholar's letter of 26 July raised a number of questions. In response, further information was supplied in a letter of 5 August from the Department of Trade; but Mr Rickett's letter of 9 August recorded that you still had misgivings. The Secretary of State for the Environment (letter of 16 August) has also raised doubts, to which the Secretary of State for Trade has replied in his letter of 27 August.

FLAG G

2. The papers are all concerned with BAA's current and prospective performance. As recorded in the Annex to the note by the CPRS (E(NI)(82)25), which is for separate discussion at the same meeting, consideration of the BAA's objectives must await the outcome of the litigation brought by a number of airlines challenging the BAA's charging policy and the Government's rights with regard to that policy. The Annex also implies that no further action is required regarding monitoring arrangements, or Board structure and membership.

3. The BAA is a fairly small organisation by nationalised industry standards. It employs little more than 5,000 people (excluding security staff); and its turnover in 1981-82 was under £300 million. Nevertheless, it has quite an important investment programme in prospect (around £675 million cash over the period to 1985-86); and the Secretary of State for the Environment has argued, in effect, that it is a potential model for dealings between the Government and a public sector monopoly.

MAIN ISSUES

FLAG H

4. E(NI)(82)19 asks the Sub-Committee to note that the Secretary of State for Trade intends:



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(a) to agree the general direction proposed in the BAA's corporate plan;

(b) to endorse the BAA's investment programme, subject to detailed approval of annual totals;

(c) to underline the importance of containing current costs and of moving more swiftly towards economic pricing levels;

(d) to ask for improved performance, keeping external financing within the levels in the 1982 Public Expenditure White Paper.

The main doubts raised in the correspondence are:-

(i) Are the BAA's control of, and objectives for, current costs sufficiently rigorous?

(ii) Is their investment planning satisfactory?

It may also be desirable to discuss:

(iii) Is the BAA's pricing policy acceptable?

Current Costs

5. The BAA has two performance aims for the period 1980-81 to 1982-83: to achieve an average annual increase of at least 3 per cent in the number of passengers handled per employee; and to achieve an average annual reduction of at least 2½ per cent in operating costs per passenger. The Secretary of State for Trade suggests that the first will be obtained (in fact, exceeded, according to Section 3 of the background note circulated with the DoT letter of 5 August), but not the second. At first sight, this is surprising. According to information on pay settlements in the DoT note, average earnings will have increased by about 32 per cent in the three years 1980, 1981 and 1982, compared with an increase in the RPI of 56 per cent - a fall in average real earnings of some 15 per cent. ? Since the number of passengers handled per employee has been rising, other costs must have increased quite considerably. The DoT letter of 5 August mentions





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depreciation, rates and energy costs, and suggests that little can be done about them. That may be true of depreciation. But some economies should be possible in the use of energy; and it may be that BAA could reduce their rate bill, for example by using less, or less expensive, office space (clearly, little can be done about the airport installations themselves, at least in the short run).

6. There is also little in the papers about the BAA's future aims for productivity. As the Secretary of State for the Environment has pointed out, it is suggested (paragraph 10 of E(NI)(82)19) that the need to open and staff new terminals will reduce productivity (or its rate of increase). Is this so? If it is, what are the likely effects on profitability; and are they acceptable?

7. You will no doubt wish to explore these aspects.

#### Investment programme

8. The letter of 16 August from the Secretary of State for the Environment suggests that the investment programme in the BAA's corporate plan will generate substantial over-capacity, even by comparison with fairly optimistic traffic forecasts. However, the level of investment indicated in E(NI)(82)19, at £675 million, is well below that proposed in the corporate plan (£822 million), so that this point, at least in part, has already been allowed for. The Secretary of State for Trade's letter of 27 August also says that the estimates of over-capacity made by Mr Heseltine are overstated, and points out that it is impossible, because of the "lumpiness" of investment, always to match investment and capacity.

9. The Secretary of State for the Environment also suggests that the productivity of existing facilities might be improved as an alternative to increasing capacity. However, Heathrow is much more intensively used than the busiest European airports, as the Secretary of State for Trade points out in his letter of 27 August.

10. If, following the correspondence and discussion, concern remains about the BAA's investment programme this can be further pursued between the Treasury and the Department of Trade in the context of the nationalised industry investment and financing review.

#### Pricing policy

11. Both you and the Secretary of State for the Environment have drawn attention to the substantial increase that has taken place over recent years in the BAA's charges to airlines. To the extent that the increase results from a failure to control costs,



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it is obviously undesirable. However, it is only fair to recognise that it also stems from the Government's policy of setting the BAA more stringent financial targets, and restricting its access to external finance to a greater extent, than is the practice in many overseas countries. It is, in fact, these latter aspects which are the main points of contention in the impending litigation, as the Secretary of State for Trade points out in his letter of 27 August.

12. Indeed, the Secretary of State for Trade proposes to continue with the policy, despite some resistance from the BAA. In response to the litigation, the BAA has decided to hold its charges in 1982-83 at the level of May 1981. The Secretary of State intends to press the Board to progress 'more swiftly towards economic pricing levels'. Provided that costs are properly controlled, this seems consistent with the Government's general policy towards the nationalised industries, though the litigation is a complication. (To press ahead with the policy could be regarded as provocative; on the other hand, to fail to do so could be taken as an admission that the policy is wrong).

13. A related aspect is profitability. The BAA's current financial target is to achieve a 6 per cent rate of return on assets in current cost accounting (CCA) over the period 1980-81 to 1982-83. Paragraph 7 of Part II of the note attached to E(NI)(82)19 speaks of a 3 per cent CCA return over the period to 1986-87. Presumably some decline in the rate of return is inevitable as a result of the need to instal new capacity, which will not at first be fully used. But it is not clear whether the Secretary of State for Trade regards 3 per cent as adequate; or whether he expects it to be increased, by deferring investment, increasing charges, or other means.

HANDLING

14. You will wish to ask the Secretary of State for Trade to open the discussion by reference to his note and the correspondence. You might then invite the Secretary of State for the Environment to enlarge on the points made in his letter of 16 August. Any member of the Sub Committee may wish to comment; the Chief Secretary, Treasury, in particular, is likely to have comments, both on the figures in the context of the investment and financing review and because of possible implications for nationalised industry policy; the Scottish representative (the Secretary of State for Scotland is unlikely to be able to attend himself) may have departmental points to raise. You yourself will wish to be satisfied that the points raised in your Private Secretaries' letters are fully dealt with.



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15. In general, however, I suggest that you will not wish to be drawn too much into details. The Sub Committee's views can be taken into account in the investment and financing review discussions which are currently in train. They are due to be concluded this month; and the Chief Secretary, Treasury will report the conclusions to E Committee for consideration.

CONCLUSIONS

16. You will wish the Sub Committee to reach conclusions on the extent to which the recommendations in paragraph 13 of E(NI)(82)19 should be:

- (a) endorsed as they stand;
- (b) endorsed, subject to points of emphasis or detail; or
- (c) remitted for further discussion, at least in the first instance, between the Secretary of State for Trade and the Chief Secretary, Treasury as part of the current investment and financing review discussions.

*PLG*  
P L GREGSON

Cabinet Office

6 September 1982