

PRIME MINISTER

8 July 1986

UK/US AIR SERVICES AND BA PRIVATISATION

Our goal is a satisfactory renegotiation of the capacity control annex of the Air Services Agreement covering scheduled North Atlantic traffic and, early in 1987, the successful flotation of BA. BA's remaining anti-trust liabilities are no longer a serious obstacle in this regard.

However, the Bermuda 2 negotiations will not be easy and the Government is likely to face some tough decisions. At this stage, we need consider only the most immediate - the UK team's remit for the forthcoming Bermuda 2 capacity control negotiations.

The Department of Transport make a strong case for not budging from the existing basic safeguards for British airlines operating scheduled services across the North Atlantic. Whereas the UK airline industry is dominantly international (95%), the huge US airline industry is dominantly domestic (80%). From this strong domestic base, characterised by a handful of giant airlines controlling hub and spoke systems centred on major airports, the US Government would like unfettered freedom to compete for North Atlantic business. Yet the supposed champions of deregulated competition are not prepared to give foreign competitors access to US business beyond the major gateway airports, or

access to the computer reservation systems through which the great majority of US airline bookings are made.

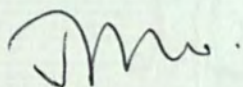
It might seem that the basic issue is one of priorities, between:

- the liberalisation of air services to benefit consumers - and the most efficient and competitive airlines;
- upholding the interests of our successful and growing commercial airline industry (which is diverse, well managed, enterprising and has little to fear from liberalisation based on fair and equal competition);
- early in 1987, successfully privatising BA (which can expect to prosper in fair competition with its peers).

But there are no real conflicts of priority. None of these objectives will be served by conceding ground to the US Government over the basic safeguards of the Bermuda 2 capacity control annex. If privatising BA early in 1987 was our overriding objective, there would indeed be a case to take a more conciliatory line in the Bermuda 2 negotiations. But if that were so, the diminished commercial prospects for BA would be evident and the privatisation could easily flop. BA's £80 million loss of North Atlantic revenue since Libya/Chernobyl has reminded investors of the importance of this market.

Recommendations

There seems to be little need for a meeting of MISC 112 at this point. John Moore's remit for his negotiating team on basic safeguards is sound; likewise, the conciliatory aspects. Giving US airlines increased access to UK regional airports - presumably in the North and Scotland - should provide a much needed boost to business activity in these areas. In the case of charter and cargo services, there are fewer obstacles to fair competition and our airlines have nothing to fear from a more liberal régime.



JOHN WYBREW