

CONFIDENTIAL

289



Chancellor of the Duchy of Lancaster

CABINET OFFICE,  
WHITEHALL, LONDON SW1A 2AS

Tel No: 233 3299  
7471

6 January 1986

The Rt Hon Kenneth Baker MP  
Secretary of State for the Environment  
Department of the Environment  
2 Marsham Street  
LONDON  
SW1

NBPN

D Ken H.

WATER PRIVATISATION - WHITE PAPER

attached

Thank you for the copy of your minute of 23 December to the Prime Minister, enclosing a draft of the White Paper.

The draft makes a good case for privatisation of the industry on the basis of integrated river management, and sets out well the ways in which the interests of the customer and the environment are to be safeguarded.

There are three points, however, where the draft needs particularly to be presented convincingly. The first is the point (para 2.26) at which the argument is made that privatisation is now the best means of continuing and enhancing a process of improved efficiency and service generated since 1979. We must make clear that providers of private capital are both more flexible, and inclined to the enterprising and innovative approach, than public providers of capital. They will give the now-improved management and staff the impetus they need for greater efficiency. And, in practical terms, state ownership imposes constraints which the authorities' managements wish themselves to be free of.

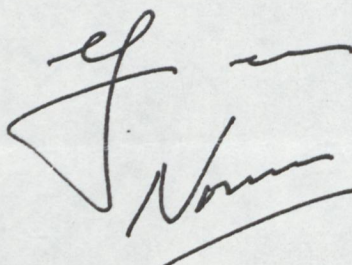
The second, and related, point concerns water metering. The draft should be more positive in its approach. Charging by reference to rateable values will increasingly be anachronistic; and charging by reference to consumption is much preferable for a private sector company engaged in selling a service to its customers.

The third point concerns price controls. A price control set by reference to changes in average performance on costs provides safeguards for customers in higher-cost areas, but does not guarantee to customers in lower-cost areas that their charges adequately reflect the above-average performance achieved in their

Jan

area. Some provision should be made for this. We might also stress that the price of a commodity should be expected to reflect the change in performance of producers in the industry and the average cost of its inputs. One safeguard, however, should be not necessarily to allow companies to pass on directly in full changes in costs which are within their control, eg some pay increases, nor entirely to be able to pass on changes in the cost of capital, which must be reflected, in part, on the rate of return to equityholders.

I am copying this letter to the Prime Minister, Members of Cabinet, John Wakeham, Bertie Denham, Sir Robert Armstrong and Brian Griffiths.

A handwritten signature in black ink, appearing to read 'Norman Tebbit', with a large, stylized initial 'N' and a horizontal line extending to the right.

NORMAN TEBBIT

LOCAL GOVT PCB

WATER INDUSTRY



CONFIDENTIAL

cebg



PRIME MINISTER

WATER PRIVATISATION - WHITE PAPER

Following consideration in E(A) on 19 November of the memorandum on Water Authority Privatisation submitted jointly by Nicholas Edwards, Michael Jopling and myself, we now submit a draft White Paper for colleagues' approval. This has been drafted to provide a clear statement of our policy and to meet the various points raised during the E(A) discussion.

In developing and clarifying our views on the form of regulation, John Patten and I have had the benefit of a report from Professor Littlechild which it is my intention should be published at about the same time as the White Paper. Section 4 of the draft White Paper follows his lead in proposing a system of regulating prices and service levels together; and the management would be motivated to make profits by achieving both as efficiently as possible. Our proposals also take full advantage of the potential for competition between the ten authorities in the stock market and in all other possible ways.

Flood prevention and land drainage cannot be dealt with in this White Paper though paragraph 3.10 states the new context in which the administration and financing of these functions must now be reviewed. On pensions we cannot go beyond the statement on para 7 of Section 1 until we have had discussions with the water authorities and the Treasury; the statutory water companies' employees are in the same pension arrangements as the authorities' and careful negotiation will be needed when the broad shape of our proposals has been disclosed. Tax issues too cannot be resolved unambiguously before water authority asset registers have been reviewed, but we shall not be under immediate pressure to show our hands on taxation. The proposals in Section 5 should allay the inevitable misgivings of the environmental interests, with careful presentation. The investors will have to accept them if water authorities are to be privatised at all.

CONFIDENTIAL

CONFIDENTIAL



On water metering, the White Paper does I hope reflect your views as expressed in your Private Secretary's minute of 9 December. In particular it makes clear our support for the extension of metering, the advantages of economies of scale in installation and the need for large scale trials.

In conclusion I would just like to mention the statutory water companies. They are already in the private sector, so they are not the main focus of our policy. However, we do see advantage in their agreeing to convert themselves into PLCs and to come within the same regulatory framework as that to be established for the WSPLCs; our bill will provide for this voluntary transition. I am pleased to report that the initial response to this suggestion from the Water Companies Association has been quite encouraging.

As our policy paper E(A)(85)64 made clear, our aim is to legislate for water authority privatisation in the 1986/87 session, to incorporate all water authorities as WSPLCs as soon as possible after Royal Assent, and to be ready during 1987 to begin a sequenced flotation of all the authorities. This is a very tight timetable, and to hold to it is essential for the White Paper to be published very early in the New Year. I would therefore ask all colleagues to let me have any comments on the draft White Paper by Monday 13 January at the latest.

I am copying this minute to all Cabinet Colleagues and to John Wakeham, Bertie Denham, Sir Robert Armstrong and Brian Griffiths.

*SWenderson*

*for*

K B

*Approved by the Secretary of State and  
signed in his absence*  
23 December 1985

CONFIDENTIAL