

PRIME MINISTER10 July 1984

c Mr Redwood

CIVIL AVIATION POLICY REVIEW

1. Whether we like it or not, as we run up to the sale of British Airways, the world at large will see our response to the CAA review as symbolic of our real intentions towards privatisation. Are we genuinely concerned to bring about competition, or just auctioning BA off for the highest short-run proceeds?

2. There may be a case for Government to accept the CAA's findings whole, because the Authority was asked to act as Government's independent expert adviser. The CAA will be seen as pro-competitive, and the Government would be given a reasonable ride if it agreed. Yet, if Mr Ridley is correctly forecasting what the CAA is going to say, the recommendations seem to us flawed in parts.

We fully support the Authority's wish to ease entry to the domestic route market (paragraph a) and to deregulate domestic fares (paragraph b). Allowing BA to stay in the charter market (paragraph c) also looks sensible, although it may provoke surprise among the independents.

3. Where we find fault with the CAA's logic is in the enforced transfer of domestic routes from BA to others (paragraph d) and of international routes from BA to BCal (paragraph e). We see the following points as fundamental:

- i. What does route stripping do for competition? There is no greater freedom of choice for the traveller if BCal is designated the single British carrier on a given route. If BA and BCal share the UK's 50% portion of a pooled route, that seems to us to weaken the prospects of both British carriers against foreign competitors.
- ii. Chipping pieces off BA is bound to delay privatisation. It will generate redundancies at BA; will require asset valuation, negotiation and sale; will involve the independents in large-scale recruitment of people and the funding of new assets; will require the re-negotiation of Government to Government treaties overseas; and will make BA's prospectus harder to write. It will delay exposing BA to the rigours of the market. It will make Government look hesitant when it need not and should not. The costs seem to us large and open-ended, the benefits small and uncertain.

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iii. At the end of April, the CAA saw no "competitive balance" argument in favour of stripping BA of some of its route rights. The Authority is now shifting its ground to concern about BCal's survival. The CAA cannot underwrite BCal's survival, and should not even attempt it. If an initial allocation of routes to BCal did not work, what next? More routes? Given their weak balance sheet, what will BCal use for money if surplus BA assets are to be sold to them at fair prices? Why indeed confine the help to BCal? Aid to the independent airlines, however disguised, seems to us a very slippery slope for Government.

4. Either solution presents a political problem. Back the CAA and you lose some of Lord King's achievement and enthusiasm, BA will mount anti-Government publicity, and you will have delay. You may do better on competition grounds. Back BA and you will then have the BCal backbench lobby against you, and the press will construe the decision as anti-competitive.

We recommend that the best bet is to go confidently for an early sale, (this is also the Treasury view) and to try to deflate the anti-competitive argument by:

- i. reaffirming Nicholas Ridley's desire for national and international deregulation of routes;
- ii. explaining that, at bottom, BCal want extra monopoly routes, not more competition;
- iii. emphasising that 'giving' routes to BCal leaves open the rights and ambitions of other smaller but equally worthy airlines.

5. Economically, all the arguments are on BA's side. If there is any case for making a non-economic gesture, in order to head off opinion which champions BCal as David taking on BA's Goliath, it should be a small gesture on domestic routes only. David did not win by making out a case for having Goliath's sword.

  
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