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P.01343

PRIME MINISTER

Civil Aviation Authority Review

(E(A)(84)44)

BACKGROUND

The Civil Aviation Authority (CAA) published on 16 July a review of the implications of the privatisation of British Airways (BA) for competition and the sound development of the British airline industry. This review concluded with, among other things, recommendations for the transfer of certain routes now operated by BA to British competitor airlines.

2. At a meeting under your chairmanship on 11 July it was agreed that it would be desirable for the Government's response to the review to be made known before the Recess. The Secretary of State for Transport was asked to prepare a paper suggesting that the Government should be prepared to accept a number of recommendations which would increase competition, but not to accept major route transfers.

FLAG A 3. In his note E(A)(84)44 the Secretary of State for Transport summarises the CAA's recommendations. They are as follows.

(i) Transfer to other British airlines of all BA's international scheduled services out of Gatwick, Birmingham, Manchester and Glasgow, and those out of Heathrow to Harare and Saudi Arabia (paragraph 2(a)).

(ii) Measures to increase competition through the provision of new services by British airlines (especially British Caledonian (B.Cal)); more competition out of

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Heathrow; no debarring of BA from the charter market, but improved safeguards against predatory pricing; and a strengthening of the CAA's powers (paragraph 2(b) to (e)).

(iii) Relief of capacity constraints at Heathrow and Gatwick (paragraph 2(f)).

4. Mr Ridley proposes that the recommendations summarised at paragraph 3(i) above should be rejected; that those summarised at 3(ii) should be accepted, subject to further exploration with the CAA of the suggestion that the Authority should be given new statutory powers. Capacity constraints at Heathrow were the subject of Ministerial discussion earlier this year, in connection with the privatisation of airports, in the Ministerial Sub-Committee on Disposal of Public Sector Assets (E(DL)(84)1st Meeting, Item 1). At that discussion it was agreed that Mr Ridley should issue a consultative document. This is at an advanced stage of preparation. It will not advocate raising the ceiling on air traffic movements at Heathrow, since this would provoke powerful opposition from local residents and risk reopening the Stansted Inquiry. Mr Ridley proposes to stand firm on this.

FLAG-B

MAIN ISSUES

5. The main issues before the Sub-Committee are as follows.

- (i) What should be the Government's response to the CAA's recommendations on route transfers?
- (ii) What should be the Government's response to the CAA's other recommendations?
- (iii) When should the Government's decisions be announced?

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Route transfers

6. The argument is often advanced - and it has now been effectively accepted by the CAA - that BA has an over-dominant position among UK airlines, and that there should be a better balance. B.Cal. has mounted a considerable press campaign based on this argument and can be expected to claim that the CAA has vindicated it. It is likely to attract a good deal of support among the Government's supporters.

7. Route transfers on the scale proposed by the CAA would defer the privatisation of BA, both because the necessary legislation would be controversial and because it would be harder for investors to assess BA's past profits and future prospects. This argument weighed heavily with the Ministers present at the meeting on 11 July. However, it may not be easy to put across in public: the reply might be either that fostering competition is more important than privatisation or that the Government's privatisation programme should not take priority over doing justice to BA's competitors.

8. The Sub-Committee may therefore wish to consider whether the following additional arguments would be sufficient to carry the Government's case in public.

(a) Competition is mainly between British and overseas airlines, not between different British airlines.

(b) BA has shown that it can be made more efficient in response to that competition. Privatisation will take the process further.

(c) The effect of transferring routes from BA could be to create two weak British airlines rather than one strong one against overseas competition. (The Secretary of State for Trade and Industry attaches much importance to this point).


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Other recommendations

9. The Sub-Committee seem likely in general to endorse the other recommendations of the CAA (apart from those relating to air traffic movements at Heathrow and Gatwick, on which E(DL) has already reached conclusions). But they may wish to consider the following.

a. The Authority already has power to take a route away from one operator and give it to another but cannot use these powers solely to modify the competitive structure of the industry. If the CAA's powers were to be extended in this way difficult issues would arise, particularly when, following the privatisation of BA, all UK airlines will be in the private sector. Valuable rights would pass from one private sector company to another by administrative action based on the CAA's view of what the right competitive structure of the industry should be. The Secretary of State for Transport might be asked how he thinks such difficulties might be overcome and to raise these issues in the exploratory discussion which he already envisages with the CAA (paragraph 4(e) of E(A)(84)44).

b. It is not clear from the memorandum whether Mr Ridley intends to accept the suggestion in CAA recommendation 8 (Annex to E(A)(84)44) that the frequency of BA services at Heathrow might be reduced. We understand from his

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officials that Mr Ridley does not intend to reach any decision on this matter until he has seen the response to the consultative document on air traffic movements at Heathrow which he hopes to issue shortly.

Announcements

10. The Sub-Committee are likely to agree that the Government's decisions should be announced quickly. You will probably wish to invite the Secretary of State for Transport to circulate a draft of the announcement to the Sub-Committee. The discussion on the substance will probably have provided guidance on how the Government's decisions, in particular on proposals for route transfers, should be presented.

HANDLING

11. You will wish to invite the Secretary of State for Transport to open the discussion. The Chancellor of the Exchequer will wish to comment from the standpoint of the privatisation and competition programme. The Secretary of State for Trade and Industry will also wish to comment from the standpoint of competition policy as well as from his experience of the airline business. The Lord Privy Seal will have views on the implications for the legislative timetable of any suggestion that the CAA should be given power to transfer routes between airlines.

CONCLUSIONS

12. You will wish the Sub-Committee to reach conclusions on the following.

(i) The Government's response to the recommendations in the CAA review regarding:

(a) route transfers between British Airways and other airlines;

(b) capacity at Heathrow and Gatwick;



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(c) other matters.

(ii) How the Government's decisions should be announced.

PLG

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Cabinet Office
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16 July 1984

Dear Mr Hatfield

CAA REVIEW: AIRLINE COMPETITION POLICY

My Secretary of State's paper E(A)(84)44, due to be discussed at the meeting of E(A) on the morning of Wednesday 18 July, sets out the recommendations contained in the Civil Aviation Authority Review.

I enclose for your information, and the information of members of E(A), a copy of the CAA report published today.

Yours sincerely

Andrew Whittham

for

H C S DERWENT
Private Secretary