



FCS/84/243

SECRETARY OF STATE FOR TRANSPORT

1. In view of my absence in Dublin on 11 September, I shall not, unfortunately, be able to attend the Ministerial discussions of the draft Cabinet paper on the CAA Review. I am therefore writing with my comments on those aspects of the paper which have an international dimension.

2. The effectiveness of the proposals dealing with the international routes is, of course, bound to be influenced by the reactions of the other countries involved. We shall need to take the following considerations into account when deciding what action to take on the Review's recommendations:

(a) in the course of the public debate on the CAA Review, it has frequently been argued, particularly by BA, that the best way of advancing competition would be to promote dual designation rather than transfer routes, since the latter merely replaces one UK carrier by another without introducing direct competition between them. This argument ignores the fact that very few countries are prepared to accept dual designation. For instance, strong resistance by the Saudis to dual designation has prevented BCal from operating on the Riyadh route while BA is still operating into Jeddah.

(b) Even where a straight substitution takes place, it is likely that the other government will seek to improve the position of its own airline at the expense of the newcomer. Zimbabwe for example, has indicated that it would not accord BCal the privileged position now enjoyed by BA.

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- (c) Some countries may also react adversely to being allocated the second airline as opposed to the national flag carrier.
- (d) A change could also reinforce the competitiveness of the other country's national airline if it had access to Heathrow, while the British carrier operated from Gatwick with its poorer network on onward connections. And any suggestion that those flying into Heathrow should change to Gatwick would be firmly resisted.

3. Even so, we must be careful not to allow these tactical arguments to blind us to more important strategic analysis. British Caledonian are currently suffering from a route network heavily dependent on debt-ridden developing countries in South America and Africa. If they are to provide effective competition to British Airways in Europe or, eventually, on the Australian route, they will need a stronger base than their present routes provide. This is at the heart of the CAA case - which is really our own - for an airline industry with some chance of real competition, diversity and choice between operators that are all in private ownership and strong enough to stand on their own feet. I have found it very helpful to read the restatement of that case by John Dent at last month's Financial Times conference.

4. It is on this basis that I approach the conclusions in your paper. I have no difficulty with any of them in principle, but I think we shall have to look carefully at the practical consequences of the various options for route transfers:

- (a) to give BCal all the Saudi routes would be a bold move. It would certainly vastly improve BCal's position. But it would, as our Embassy in Jeddah have already reported, put severe strain on our relations with the Saudis, both government and private companies, and probably lead to a transfer of business to the other airlines which

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would affect British earnings on these routes and onward to New York;

- (b) the Zimbabweans will seek to exploit any change to BCal to alter the balance of the Air Services Agreement established at independence, which they believe unduly favoured BA;
- (c) the Caribbean is an area in which we have a number of on-going air service problems resulting from rivalries between the small states involved and their suspicion of the old colonial power.

And in all cases there is the penalty to be paid in the lost revenue from the substitution of Gatwick for Heathrow as the British airline's terminal point.

5. I would have no objection to agreeing now to the transfer of the Harare and Caribbean routes; but if the Saudi routes are also proposed for transfer I think we should first consider very carefully the consequences both for our relations with Saudi Arabia and for privatisation of BA.

6. Of course, as your paper points out, privatisation may in any case be delayed by the Laker dispute. And it is attractive to agree that in that case we can afford to delay our response to the CAA Review, which was after all prompted by the need to consider the effect of an unreconstructed BA on the civil aviation market after privatisation. But the Saudi problem is, as you know, with us anyway. The Riyadh route has only recently been opened to international traffic and the CAA have awarded the route to BCal. You have dismissed BA's appeal against this decision. The Saudis, however, remain adamantly opposed to dual designation ie they will not let BCal on to the Riyadh route while BA retain the Jeddah and Dhahran routes. There is little we can do to budge them. If we cannot





use dual designation, and are not ready to agree that BCal have all the Saudi routes, are we really content that no British airline should, for the present at least, serve the particularly lucrative Riyadh route?

7. The difficulties argue themselves, as you know far better than I. But I am sure you are right not to let them stand in the way of your overall strategy.

8. I am sending copies of this minute to ~~our~~ Cabinet colleagues and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

GEOFFREY HOWE

Foreign and Commonwealth Office

10 September 1984