21 October 1983

Policy Unit

PRIME MINISTER

COMPETITION AND PRIVATISATION

The Chancellor's July initiative is in danger of losing its way. We will certainly fail to meet our objectives on privatisation and competition during this Parliament if we accept the disappointing replies from Departments.

The Treasury's paper for E(A) does introduce a sense of urgency. It is now essential for you to put your full authority behind the privatisation programme.

We suggest that at the E(A) meeting, you:

1. Endorse Nigel's paper calling for a co-ordinated timetable for action for this Parliament.

2. Announce your intention of chairing regular progress meetings to ensure that the momentum is maintained.

3. Request Sponsor Ministers who have not yet reached final decisions to produce timetable options for their industries.

This will give John Moore sufficient backing to ensure that Sponsor Ministers expose their thinking and, equally importantly, provide the political commitment which appears to be required before Sponsor Departments carry out the detailed work which this programme requires.

It is not as if the Chancellor's July letter began this exercise. Departments should have been thinking about privatisation and competitition since 1979. By December, we shall be 6 months into our second term.

We cannot allow Peter Walker and others to opt out of this exercise. Preferred solutions for gas and electricity are still being developed, but Peter could at least produce alternatives which can be modified later on. We cannot agree a co-ordinated programme which omits the energy industries. Peter may argue that these issues have to be handled with great secrecy, but there is no secret about our Manifesto commitment to introduce private capital into the gas and electricity industries.

To give you some idea of the lack of commitment in Departments, I attach a copy of John Redwood's report on the British Leyland submission.

The replies from Departments have also failed to take proper account of the points mentioned in Nigel's paragraph 5, such as the introduction of competition and the treatment of the loss-making industries. Some of these were explored at the Chequers seminar and in earlier reports, eg from the CPRS. But they still do not seem to have sunk in. We attach a summary of these points which might help John Moore to extract proper responses on the second round.

Would it be useful to circulate these to colleagues?

FM

FERDINAND MOUNT

COMPETITION AND PRIVATISATION

In the light of the responses to the Chancellor's letter of 25 July, it may be helpful to re-emphasise certain points which have been made in previous debate. It is hoped that these points will assist in the forthcoming discussions between the Financial Secretary and departments concerned with privatisation.

1. Our objective is to displace state ownership and control both by private ownership and, wherever possible, by the discipline and pressures of the marketplace. The introduction of competition is therefore an essential element of our policy and one which is more relevant for the public utilities and so-called "natural monopolies" than for manufacturing industries where a competitive environment already exists. We must ensure that all barriers to competition, including legislative barriers, are removed and that structural changes are considered which encourage competition.

Using Existing Legislation

2. To avoid crowding the Parliamentary timetable, we must use to the maximum the powers under existing legislation to sell off parts of the nationalised industries, particularly those areas which can operate in a competitive environment.

Splitting up Conglomerates

3. The claimed benefits for vertical integration in many state industries should be critically examined. Large, unsuccessful conglomerates should not be held together in the belief that in due course they will become more successful and profitable overall, enabling sale of the whole. Experience shows that it is usually better to split them up and gain the benefits from management diversity and access to private capital for the separate bits.

Reducing the Natural Monopoly

4. It is often possible to separate the parts of a nationalised industry which could operate in competitive markets from those which are natural monopolies. In most cases, the extent of natural monopoly is small and confined to the common-carrier infrastructure. The natural-monopoly elements can be left in the public sector, or privatised and regulated. Whichever route is preferred, we should do everything possible to provide a competitive environment for those who buy from or sell to a natural monopoly.

Long-Term Contracts and Franchising

5. Long-term contracts for the use of the services of a common carrier, in effect leasing part of the network, can be an effective way of increasing market pressures. Similarly, franchising does allow for periodic competition and gives scope for the entry of new producers within a network industry.

Regionalisation

6. Although regionalisation would produce local monopolies in those industries where effective competition is not possible, there is scope for stimulating competition between the management of different regions by means of inter-regional comparisons of price and performance. The opportunity for innovation and emulation amongst regional companies does offer a better chance for a more dynamic and efficient industry than a centralised organisation. Economies of scale are unlikely to be prejudiced by a regionalised industry. The problems of economic and union monopoly power are more likely to be tackled by a regionalised system of independent, privatised companies.

Regulation

7. There is a need to keep the requirements for regulation to a minimum. There may be a need to provide protection for developing competition until it is able to compete on fair terms in the market-place. In general, however, a system of regulation by exception which is independent of Government is to be preferred. This reduces the bureaucratic and administrative activities of the regulatory agency, and enables it to concentrate on those cases where abuse of power is in question. Although local monopolies will still require some degree of regulation, a simpler system is more likely if the performances of a range of private companies can be compared.

Loss-Making Industries

8. We should not be mesmerised by the idea of making the business profitable before selling it. Experience has shown that on many occasions, losses grow worse with time, making disposal more difficult, whilst we believe that private ownership is more likely to achieve the business's recovery more rapidly. If the business is never likely to be profitable, then the City are the best judge of the real worth of the assets.

Waiting for Better Figures

9. In particular, sales should not be held up on the grounds that the following year's profits are likely to be better, thus leading to a higher sale price. Markets are quite able to discount ahead if profits forecasts can be proposed in a credible way. Similarly, we should not pump in subsidy in order to achieve a sell-off price that looks good in the House of Commons.

Transparency of Subsidy

10. We do need to appreciate, however, the likely consequences of privatisation in such cases where we are making an implicit decision about potential closures. The desired balance between commercial criteria and social objectives must be made explicit. This will usually require a greater degree of transparency on cross-subsidisation, in order that we can identify and decide the level of support which an uneconomic social service should receive.

Writing off Debt

11. Privatisation should not be held up through alleged difficulties with the level of debt. In many cases, the money has already been lost and it makes sense to write off a substantial proportion of the debt in order to give the new business a better balance sheet if it is then being sold to new owners.