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17 March 1986

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NBM

John

NATIONALISED INDUSTRIES AND ACCOUNTING FOR ECONOMIC COSTS AND CHANGING PRICES

Thank you for your letter of 7 February about the proposed publication of the Byatt Report. I am content that the Report should be published in late March as you suggest.

I must say, however, that I would only support a low key publication with a disclaimer of endorsement of the principles of the report. As you know the proposals involve considerable departure from accounting practice in the Private Sector, where the Statement of Standard Accounting Practice for Current Cost Accounting has recently been suspended. It would therefore seem sensible to see reactions to the report before in any way accepting its conclusions. Other pointers to caution are:

- i The fact that the privatisation programme is taking place on the basis of historic cost accounts. I would not wish to see any steps which made our objectives here more difficult to achieve.
- ii The relative unimportance of current cost accounting to loss-making nationalised industries operating in competitive markets (such as BS) where targets relate crucially to the limitation of cash outflow rather than a rate of return on net assets.
- iii Possible European Community implications of publishing an apparently larger loss for such industries.

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BOARD OF TRADE
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For much of the same reasons I would not wish the publication of the report to be accompanied by a statement by HMG "explaining why it applies particularly to nationalised industries", a point which is made very well in the Byatt Report itself. I need not stress the sensitivity both for industry and generally of any aspects of the report which might be taken to imply increases in prices charged by nationalised industries.

You also seek agreement to a statement in support of the principle of accounting for changing prices. I know that Leon Brittan agreed to consider such a statement when the Byatt Report was published. However, as you will recall, he was unable to agree to a request for such a statement in January because Michael Howard in December had just advised the Chairman of the Accounting Standards Committee of our unwillingness to legislate on this matter, whilst reassuring him at the same time of Government long standing support for the principle of accounting for changing prices. Memories of our stance on legislation would have been sufficiently fresh for an endorsement of the principle of accounting for changing prices to rankle. I believe this is still the case and I do not therefore see the need to do more than make the report available for further debate.

I should be interested to see the reaction by the Nationalised Industries Chairmen's Group to your letter to Bob Haslam of 7 February. Their views will be needed before any decision on publication. I also look forward to seeing the text of any release to accompany publication of the report.

Copies of this letter go to the Prime Minister and other E(NI) members and to Sir Robert Armstrong.


PAUL CHANNON 

Nat Ind: Policy Pt 10.





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24 February 1986

NBRN

Dear John

NATIONALISED INDUSTRIES: ACCOUNTING FOR ECONOMIC
COSTS AND CHANGING PRICES

Thank you for your letter of 7 February covering a copy of the report of the advisory group chaired by Ian Byatt. ^{at trap}

I am content for the report to be published, as you propose, and with the general way in which you intend to handle this. I know that you will be consulting colleagues about the terms of any public statement associated with publication, so I shall reserve detailed comment until I see a draft of what you propose to say. But I should like to make the general point that the Byatt Report recommendations are not universally applicable to all nationalised industries (there are, as you will appreciate, particular difficulties with grant-aided industries like BR and LRT), and I hope that any statement will keep this point in view. I am aware that my officials have expressed these reservations during earlier discussions of the report.

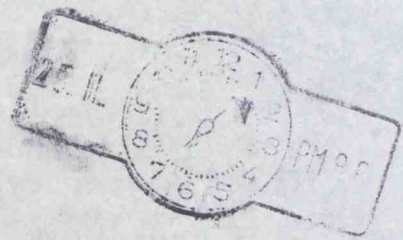
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Nicholas Ridley

NICHOLAS RIDLEY

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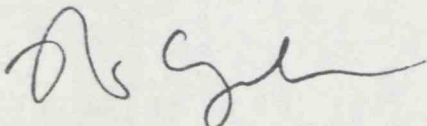
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24 February 1986



NATIONALISED INDUSTRIES: ACCOUNTING FOR ECONOMIC COSTS AND CHANGING PRICES

Your letter of 7 February to Paul Channon expressed your intention to publish in late March the report of the Treasury Advisory Group chaired by Mr Byatt and asked whether colleagues saw any difficulties.

In present circumstances, I am very nervous about publication of this report under Government aegis because it may have adverse implications for our privatisation programme. My officials have raised this point with yours on various occasions in recent months.

The Report not only strongly advocates CCA accounting procedures, but also recommends their further development and elaboration in the public sector and indeed elsewhere in the economy. I shall want to seek a full assessment of the implications of publication from my professional advisers on the BGC privatisation. Publication might well affect the sale proceeds.

It is already clear that the Report's general thrust is being used against us by BGC, from their inside knowledge of the Report, in our negotiations over their capital structure for privatisation. It also encourages BGC's resistance to our policy - agreed with John Moore - of structuring the privatisation Prospectus around Historic Cost Accounts. Our merchant banking advisers tell us this is essential for the flotation.

The Report also still displays particular insensitivities in paragraph 119. It asserts that economic rents should be capitalised in balance sheets as tradeable, intangible, assets; with the inference from the whole report that a full return should then be earned on them. The obvious case of economic rents, that of BGC's North Sea gas contracts, will be well known to all readers of the Report. It will be equally known that the Report's recommended treatment of economic rent could simply drive up prices to gas consumers and is certainly at variance with what Government intends for the treatment of BGC's post-Gas Levy economic rent. Here again, do we really wish to fuel public debate at this stage?



Were it not for the privatisation implications I might have agreed to publication of the Report in low-key as a "technical document for discussion". Even then, however, I would have thought it necessary to make an explicit disclaimer that the Government was in any way committed to its ideas. Although you say that sponsor Department officials broadly accept the Group's conclusions, my officials have always explicitly reserved their and my position on the Report's policy implications. We should certainly consider the implications of continuing to apply CCA in its present or even more elaborate form to industries, when it looks to be on the way out in the economy at large. The current views of NICG Chairmen on this should be considered before we take any decision about publication.

All in all, I conclude that there is no point, and much risk, in early publication of a Report which points out, in its own words, that it has not solved all the problems "particularly of implementation". I am aware that there have already been a few leaks to the Press about its existence. But I suggest that we could if necessary reasonably resist any pressures for general publication under Government aegis at the present time on the simple ground that the work has not yet been completed. There is little value in propagating ideas which, whether judged desirable or not, have not in any way been tested for their feasibility and practical advantages. The Group could be asked to examine this aspect with the industries and complete the job before we decide about publication.

I am copying this letter to the Prime Minister and other E(NI) members, and to Sir Robert Armstrong.

PETER WALKER

NAT IND

POLICY

PT 10

