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PREM 19/988

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CONFIDENTIAL

Policy Towards!
Privatisation

Disposal of Public Sector Assets

Contracting out of Public Sector

Functions

ECONOMIC POUCY

Part 1 June 979

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Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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•PART 6 ends:-

SAS Energy to Ch/Ex 18: 1.83

PART begins:-

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date		
E(NI)(82) 7 th Meeting, Minute 2	08.09.82		
E (DL)(82) 8	18.10.82		
E (DL)(82) 9	28.10.82		
E (DL)(82) 4 th Meeting, Minutes	02.11.82		
E (DL)(82) 10	11.11.82		
C (82) 41	10.12.82		
CC (82) 53 rd Conclusions, Minute 7	16.12.82		
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The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed Oswayland

Date 15 March 2013

PREM Records Team

MBPM Ms 18/1 01-211-6402 CONFIDENTIAL The Rt Hon Sir Geoffrey Howe QC MP Chancellor of the Exchequer Treasury Parliament Street London January 1983 SW1P 3AG CONTRACTING OUT IN THE NATIONALISED INDUSTRIES In your letter of 11 August to Willie Whitelaw you asked for details of nationalised industries' progress with contracting out. I have set out the details for the energy industries in an Annex to this letter. Contracting out is already practised on a substantial scale, but I shall continue to encourage them to explore opportunities which they may previously have overlooked. Copies of this letter go to the Prime Minister, members of the Cabinet, Michael Havers, James Mackay, Sir Robert Armstrong and John Sparrow. NIGEL LAWSON

CONFIDENTIAL

CONTRACTING OUT IN THE NATIONALISED ENERGY INDUSTRIES

British Gas Corporation

In 1981/82 for every two people employed directly on distribution and other engineering work the Corporation employed one contract worker. Works contracted out include pipeline construction for the national and regional gas transmission systems and the local distribution network; large capital projects; and most central heating installation work.

British Nuclear Fuels Limited

In 1981/82 88% of BNFL's investment of £740 million was with outside contractors. Work included the building of major chemical plant.

Electricity Supply Industry

In 1981/82 75% of the £830 m CEGB, expenditure on engineering projects was with outside contractors. Work contracted out included power station and transmission line construction; repair and maintenance of generating plant, cables and property; cable-laying and overhead line erection; cleaning, catering and security services; tree-felling and gardening; pole inspection; computer, office machinery, television and audio appliance maintenance; cavity wall insulation; and conversion of timeswitches.

National Coal Board

In 1981/82 83% of mining capital expenditure was with outside contractors, £600 million out of £720 million. Work contracted out included all opencast coal getting; civil, mechanical, electrical and mining engineering works; and the purchase of equipment and machinery.

UK Atomic Energy Authority

In 1981/82 15% of the Authority's gross cash expenditure was on extra-mural work. This included the design, development and manufacture of replacement tube bundles for the prototype fast reactor heat exchangers; and a contract placed on behalf of the Department of Energy with National Nuclear Corporation for the design and development of components for a commercial fast reactor power station.

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Public

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DEPARTMENT OF TRANSPORT 2 MARSHAM STREET LONDON SWIP 3EB

Prime Minister

The Rt Hon John Biffen MP Lord President of the Council and Leader of the House of Commons Privy Council Office 68 Whitehall LONDON SW1A 2AT

Ms 18 1

17 January 1983

Dea John

m

OFFER FOR SALE OF SHARES IN ASSOCIATED BRITISH PORTS HOLDINGS PLC

On 31 December the British Transport Docks Board was reconstituted as Associated British Ports (ABP) and Associated British Ports Holdings PLC (ABPH) was designated as its parent company. This was in preparation for the offer for sale of shares in the holding company and we are now about a fortnight away from the planned date for the offer.

In the run up to the flotation and during the period of the offer (about 10 days) there is a danger that Ministers may make comments about ABP or about the British ports industry in general which, while innocuous in any other circumstances, might be taken by prospective purchasers as relevant to the flotation and which could, in the extreme, result in the withdrawal of the prospectus or render the Government liable to legal proceedings for misrepresentation.

I should therefore be grateful if you and our colleagues could exercise particular care in making comments or statements in respect of ABP or ports in the period until the flotation is complete. This applies both to statements in the House and those made elsewhere.

CONFIDENTIAL

The success of the flotation will be best pursued if it is presented to the investing world in very much the same way as any other issue and through concentration on the financial position of ABPH rather than on the political controversy associated with privatisation. I therefore strongly advise that we should avoid any statement in respect of ABPH that is likely to stir up the political feelings that are never far from the sale of public sector assets. Until the flotation is completed, I hope that the Government as a whole will take a low profile on the sale.

I am addressing this letter to you in view of your responsibilities for Government information. I am copying it to the Prime Minister, other members of Cabinet, the Chief Whip and Sir Robert Armstrong.

Tan co

DAVID HOWELL



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FROM THE MINISTER OF STATE FOR INDUSTRY AND INFORMATION TECHNOLOGY

Kenneth Baker's Office

Tim Flesher Esq Private Secretary to The Prime Minister 10 Downing Street Prime Minister 2

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 SWITCHBOARD 01-212 7676 6401

17 January 1983

Dear Trin

CABLE AND WIRELESS PLC: INTERIM RESULTS

Eric Sharp, Chairman and Chief Executive of Cable & Wireless plc, has asked us to send you the enclosed copy of his company's interim results which show that profits are up 47%. These and the accompanying statement are an example of successful privatisation — indeed probably the most successful of our privatisations and in a recent article in the FT C & W ranked 47 in the list of the 500 European companies which have the highest market valuation. This is good news and Mr Baker has congratulated Eric Sharp on these achievements.

N M MCMILLAN

PRIVATE SECRETARY

Your sweet

M74/M74AAM

CABLE & WIRELESS PLC

INTERIM REPORT

The unaudited results for the six months ended 30th September 1982 are:-

	6 months to 30th Sept 1982	6 months to 30th Sept 1981	Year to 31st March 1982
	<u>£M</u>	EM 6 months	<u>£M</u>
Historic Cost Results		30 Sept 1980	
Turnover	193	178 127	354
Trading Profit	54	41 27	78
Investment and Leasing	13	4 -	19
Profit before taxation	67	45 27	97
Tax	24	20 11	37
Minority interests	6	1 -	7
Profit attributable to Shareholders	37	24 16	53
Earnings per share	13.8p	8.9p	20.2p

NOTES

- 1. Changes which affect comparative figures are:
 - a) Bahrain was a branch until 1st July 1981, when it became an associated company;
 - b) Hong Kong was a branch until 30th September 1981, when it became an 80%-owned subsidiary.
- 2. The estimated tax liability of £24m consists of UK tax £16m (£9m 1981), overseas tax £7m (£10m 1981) and associated companies £1m (£1m 1981).
- 3. Exchange differences arising from the translation of foreign currency assets and liabilities into sterling at 30th September have been excluded.
- 4. Trading profits include £8m (£4m 1981) from profits of the associated companies managed by the Group.
- 5. Earnings per share for each six-monthly period have been calculated on the 270 million shares currently in issue. During the six months to 30th September 1981 the share capital was 100 million £1 shares. It was subdivided and increased during October 1981.

COMMENTS ON RESULTS

The pre-tax profit of £67m is an improvement of 47% over the £45m for the comparable period of last year. Trading profits and turnover increased by 27% and 17% respectively after adjustments for Bahrain to an associated company from 1st July 1981.

Results expressed in sterling for a Group which has most of its activities overseas have been helped by current sterling exchange rates. The trading profit has increased over the comparable period of last year by some £5m currency gain.

The trading results have continued to show improvements, particularly from continued progress in achieving improved margins. The telecommunications business in the United States is producing improved profits significantly above the level of the comparative period last year. The volume of business handled by the Group continues to increase, but at a slower rate, reflecting current economic conditions.

The increased attention given to the management of cash is benefiting results and as investment is made in new business opportunities, interest income will be replaced progressively by trading profits.

Future investment income will reduce by some £3.5m annually, following an exceptional tax payment on 1st January 1983 resulting from the net extraordinary gain and balancing charges which appeared in the accounts in March 1982 and 1981 respectively.

Interim Dividend

The board has declared an interim dividend of 3.2p per ordinary share (1981 - 2.6p) payable on 1st April 1983 to shareholders on the register on 1st March 1983. The cost of the interim dividend is £8,640K (1981 - £7,020K).

Issued by: Corporate Affairs Department,
Cable & Wireless PLC,
Mercury House,
Theobalds Road,
Holborn,
London,
WC1X 8RX.

Tel: 01 - 242 4433 Ext.4490

Ref: A082/0524 CONFIDENTIAL PRIME MINISTER Using Private Enterprise in Government (C(82) 41)BACKGROUND On 10th August this year the Chancellor of the Exchequer sent you a minute on contracting out public sector functions. This suggested that more could and should be done to encourage contracting out, and proposed that you should send a personal minute to all Departmental Ministers asking them to review progress and to identify new opportunities. The Secretaries of State for Social Services and for the Environment would be invited to conduct similar reviews of the National Health Service (NHS) and local government respectively. 2. You decided that the exercise should be put in hand by the hAG A Chancellor rather than yourself. He therefore wrote on 11th August to all members of the Cabinet. He asked his colleagues to reply by the end of October, setting out a detailed programme of the further measures that might be taken during the remainder of the Government's term of office and summarising the main prospects in the longer term. 3. We understand that the Chancellor has been disappointed by the replies he has received. His present memorandum (C(82)41) FLAG B contains no specific proposals for new measures of contracting out. Instead, it proposes a 'major and co-ordinated drive to secure further contracting out in the public sector', and makes procedural suggestions for the various parts of the public sector (Civil Service; NHS; local government; nationalised industries). The Chancellor, together with the Ministers concerned with the NHS, local authorities and nationalised industries, would report progress to the Cabinet in May 1983, when the Chief Secretary, Treasury, also proposes to report on Civil Service numbers. -1-CONFIDENTIAL

CONFIDENTIAL

4. The Chancellor of the Exchequer also refers to his intention to correct an anomaly involving value added tax (which is thought to inhibit contracting out), and to the work commissioned by the Cabinet on 25th November in connection with the Civil Service and Related Bodies (Redundancy Compensation) Bill (CC(82)50th Conclusions, Minute 1, Conclusion 3).

MAIN ISSUES

- 5. There is unlikely to be dissent from the objective of contracting out to the maximum possible extent or from the procedural suggestions in the Chancellor's paper. The main purpose of the discussion should threfore be to give the contracting out exercise new impetus by putting the collective political will of the Cabinet behind it.
- 6. It may be worth enquiring why the results of the exercise launched in August are relatively slight. The Chancellor refers to some general inhibitions, for example industrial relations and managerial obstruction. The solution in both these cases is largely a matter of determination, and skill in presenting and explaining the issues. There may, however, be other obstacles which require closer analysis, if they are to be effectively dealt with.
- 7. There may be areas in which Departments find it difficult to act in isolation and need an initiative from the central Departments. It is, for example, sometimes suggested that Departmental accounts and internal audit could be contracted out; but that individual Departments cannot take a decision in this sense, partly because of likely problems with departmental staff sides, partly because of the potential difficulty in justifying to Parliament differences of standards between Departments. It is therefore said that what is needed in such areas is a policy for the whole Civil Service; or, at least, that it should be accepted by a significant number of Departments as an available option.

CONFIDENTIAL 8. It is also possible that procedural changes might help. For example, there might be merit in establishing a Ministerial committee on contracting out to parallel the Ministerial Subcommittee on the Disposal of Public Sector Assets (E(DL)). But until there is a better idea of what the obstacles are to greater contracting out, it will not be possible to decide how to make progress. HANDLING 9. I therefore suggest that you might first ask the Chancellor of the Exchequer to introduce his memorandum; depending on the time you wish to devote to this item you might then ask other members of the Cabinet for constructive suggestions as to how faster progress might be made. CONCLUSIONS 10. You will wish the Cabinet to reach conclusions on the proposals in paragraph 8 of C(82) 41. Depending on the course of discussion you may wish to direct attention to particular obstacles in the way of contracting out and how they might be overcome. Should it appear from the discussion that new Ministerial or official machinery might be useful, I will submit further advice. Robert Armstrong 14th December 1982 -3-CONFIDENTIAL

Eccon Pol Privatisation



CABINET OFFICE

Central Policy Review Staff

With the compliments of John Sparrow



70 Whitehall, London SW1A 2AS Telephone 01-233 7765 22 30

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CABINET OFFICE

Central Policy Review Staff

70 Whitehall, London swia 2As Telephone 01-233 7765

Qa 06189

From: John Sparrow CONFIDENTIAL

14 December 1982

The Rt Hon Sir Geoffrey Howe QC MP HM TREASURY S W 1

Dear Geoffrey,

Contracting Out: C(82)41

I offer some thoughts on your 3 December minute to the Prime Minister.

I agree that it will be useful to link the drive for more contracting out with the next Civil Service Manpower Exercise. It would be helpful to set manpower targets at levels which take account of the need to make contracting out attractive to Departments; and they should of course be allowed to score reductions in staff flowing from contracting out towards their manpower targets.

In the nationalised industries, good management will already be pursuing contracting out as one of its commercial objectives - wherever it makes commercial sense. There are dangers in getting sponsor Departments too much involved in this as in other detailed areas of management.

You may recall that in our report on unemployment, we suggested that contracting out might include a public sector equivalent of 'management buy-outs'. The idea was that there might be an open invitation to public service employees engaged in self-contained areas of work, to volunteer (individually or in groups) to become sub-contractors for their existing work. This could be a way of helping overcome the 'chicken and egg' problem that because a function is now carried out within the public sector there is often no alternative private capacity. Moreover, it

CONFIDENTIAL

would create a core of business for new small enterprises; and might throw up opportunities for contracting out which would not occur in main line management.

I am sending a copy of this letter to the Prime Minister.

Your sincerely,

John Sparrow

380 230 PF PR 23

PRIME MINISTER

Prime Munitar 13 December 1982

Mes 13/12

USING PRIVATE ENTERPRISE IN GOVERNMENT: CABINET

The recommendations for action in Geoffrey Howe's revised paper are quite satisfactory, but the argument for contracting-out is presented in a rather desultory way.

I understand that Norman Fowler and Michael Heseltine have reservations about going too explicitly into what could be done, on the grounds that unfavourable publicity might damage the farreaching plans which they have in mind.

But without recommending specific areas as suitable, I do think that the paper ought to lay down some clear and systematic criteria for contracting-out. We need to concentrate the minds of future Ministers as well as present ones.

I suggest that to the Why Contract Out? section, we should add something like:

"Contracting-out should be considered when:

- (a) there is no compelling reason why the function should not be carried out by the private sector without the day-to-day involvement of governmental authority;
- (b) full privatisation is either impossible or undesirable;
- the function can be carried out at least as cheaply and (c) efficiently by the private sector, after due apportionment of overheads."

The Chancellor proposes to report progress in May. Isn't that In the in the is. rather leisurely?

FIVE SU CONFIDENTIAL 10 DOWNING STREET From the Private Secretary 10 December, 1982 Using Private Enterprise in Government Thank you for your letter of 9 December, which which you enclose a further draft of the Cabinet paper on contracting out. The Prime Minister is content for this paper to be circulated for discussion at Cabinet next Thursday. I am sending a copy of this letter to Richard Hatfield (Cabinet Office). M. C. SCHOLAR Miss M. O'Mara, H.M. Treasury CONFIDENTIAL



10 DOWNING STREET

Prime Minister Long

Cabinet Paper on Contracting ont"

-i.e an using private enterprise in

government

The Treasing have pepped in this

peper a bit (not very much).

I am told privately that both

Mr Heseltine and Mr Finler have

much more radical plans - but do

not mant them circulated because

of the risk of "destroying 10,000

pishic sector jubs" leaks. P. TO

Mr Ridley and the chancellor

Minh the paper should go normal

and the conclusions agreed as

I't will keep up the momentum

of this initiative!

Agre to circulation?

Mus 1/12

CONFIDENTIAL Treasury Chambers, Parliament Street, SWIP 3AG 01-233 3000 9 December 1982 Michael Scholar, Esq., No.10 Downing Street Dear Michael USING PRIVATE ENTERPRISE IN GOVERNMENT As promised, I am enclosing a further draft of the Cabinet paper on contracting-out, which the Chancellor discussed with the Prime Minister yesterday evening. This has been produced by officials and the Chancellor has not yet had an opportunity to see the new text but we shall be showing it to him on his return from Germany tomorrow lunchtime. your derived, Margaret o'has MISS M. O'MARA

DRAFT

USING PRIVATE ENTERPRISE IN GOVERNMENT

MEMORANDUM BY THE CHANCELLOR OF THE EXCHEQUER

We are committed to reducing the size of the public sector. One way of doing this is by 'privatising' public sector operations completely: we have made good progress in this, and more is planned. Other tasks must remain in the public sector, but there is no reason why they need be done by public servants. It is often more efficient to 'contract out' such tasks to private enterprise. The time has come for another major push in this direction. I wrote to Cabinet colleagues in the summer asking for their further suggestions. I have received several interesting proposals, but the results are still patchy. I now want to make a further search for suitable candidates and enlist the support of all my Cabinet colleagues.

Why Contract Out?

Experience both in this country and in the United States suggests that the private sector, with the stimulus of the profit motive, can very often undertake operations on behalf of Government more cheaply than the Government itself can perform them. This in turn establishes private businesses with a potential for expansion including expansion overseas. It is true at national and at local level, in the Health Service and probably also in nationalised industries. There are serious obstacles. The present system was not designed to encourage contracting-out, and it needs a major push to achieve this. I am not, however, urging wholesale contracting-out at any price: only in those cases (a very large number, I should judge) where it will show a clear economic advantage.

The Target Areas

The motive is the same throughout the public sector, but the circumstances are different. We need a four-pronged approach, but in order to maintain momentum, I think Cabinet should review progress by the middle of next year. There are a few general issues on which some central co-ordination by the Treasury will be needed.

Central Government

Under the stimulus of tight manpower targets, several functions have already been contracted out. There are a number of common services where the onus should be on departments to show why they should not be contracted out. It is within our own power to

deal with any problems which may arise. In a parallel paper C82 .., the Chief Secretary has made proposals for the control of Civil Service numbers after 1984. He suggests a major interdepartmental exercise in the New Year to identify the scope for further reductions. I propose that in the course of that operation we identify the scope for further contracting-out of central government functions, and decide how to follow it up. The results are to be reported back to Cabinet in May 1983. This will also be a convenient opportunity to take stock on contracting-out generally.

Local Authorities

There has already been legislation in this Parliament to ensure that Direct Labour Organisations compete on equal terms with private sector contractors. There is scope for extending this principle, but we must expect considerable opposition from local authorities, with some refusing to co-operate. I have discussed this with the Secretary of State for the Environment and we consider that for the immediate future we should confine ourselves to urging all local authorities, wherever we have an opportunity, to follow the example of those who are already finding that contracting-out pays handsomely. We need to ensure that the successful examples are well publicised and that any apparent shortcomings are dealt with properly.

National Health Service

The Secretary of State for Social Services has already started a contracting-out campaign, beginning with a series of pilot experiments in each regional health authority, to demonstrate the scope for contracting-out initially of catering and cleaning, but extending further in due course. One obstacle until now has been the VAT paid on bought-in services but not on in-house operations. I propose to remove this difficulty (see below).

Nationalised Industries

The industries already have every economic incentive to contract-out operations where this is the most efficient solution. I recognise that there will sometimes be operational or industrial relations objections. There may also be an element of empire building. These issues should be pursued during 1983, industry by industry, probably in the course of the annual corporate planning discussions. I propose that Treasury and departmental officials collaborate in identifying the areas where the industries might be pressed to contract out more of their operations, bearing in mind the industries' responsibility for day-to-day management decisions.

General

a. The VAT anomaly applies only to the National Health service and central government departments. Local authorities already have VAT refunded to them.

CONFIDENTIAL

Nationalised industries recover it through their prices. I intend to legislate in the next Finance Bill to allow the Treasury to make an order refunding VAT to government departments and the National Health Services, where specific operations or groups of operations are contracted out. This will remove the present disincentive to such action.

- b. <u>Industrial relations</u>. There is no doubt that the unions, particularly in the NHS and the Civil Service, will resist any major extension of contracting-out. We already expect trouble in one or two government departments. Obviously the NHS exercise cannot be launched until the present pay dispute is resolved; but in general, I think we must face up to these difficulties as they arise.
- c. Managerial obstruction. There is understandable reluctance on the part of managers to give up any part of their functions. We must take every opportunity to counter this by pointing to the efficiency gains which have already been secured in some areas by greater use of the private sector. Some of these issues affect all four sectors, and the Departments concerned will need to remain in close touch and exchange experience as the operation proceeds. The Treasury can make suitable arrangements.
- (d) <u>Civil Service and Related Bodies (Redundancy Compensation)</u> Bill: Some of the work Cabinet commissioned on 25 November raises issues of importance in this context particularly on the NHS and industrial relations. The Treasury will co-ordinate the two exercises.

Conclusion

I invite the Cabinet to agree:

- a. that there should be a major and co-ordinated drive to secure further contracting-out in the public sector;
- b. that the possibilities in the Civil Service should be pursued vigorously as part of the review of Civil Service manpower after 1984;
- c. that the Health Service Ministers should implement the proposed pilot studies in regional health authorities;
- d. that we should continue to urge local authorities to contract out operations wherever possible,
- e. that opportunities for contracting-out in the nationalised industries should be pursued, either as part of the examination of the 1983 corporate plans for each industry, or separately.

CONFIDENTIAL

f. that I should, together with the Ministers concerned with the Health Service, local authorities and nationalised industries, report progress to Cabinet in May, at the same time that the Cabinet considers the outcome of the Civil Service manpower exercise.

and to note:

- g, that I shall include a provision in the next Financial Bill to allow the Treasury to make an order refunding VAT to government departments and the National Health Service and
- h. that the work on the issues concerning contracting out raised by the Civil Service Etc Bill will be co-ordinated with this exercise by the Treasury.

CONFIDENTIAL Prime Minister 2 A lopic for your Treasury Chambers, Parliament Street, SWIP 3AG (Wednesday) 01-233 3000 weekly meeting with The chanceller. PRIME MINISTER Mus 6/12 CONTRACTING OUT We have on several occasions discussed the need to reduce the size of the public sector by contracting out as many functions as possible from central and local

government and the Health Service. You will recall that MISC 14, in the summer, gave me a remit to pursue this further.

- 2. I discussed progress informally last week with Norman Fowler and Michael Heseltine (Leon Brittan and Nicholas Ridley were also present), and we reached a considerable measure of agreement on the next steps. These are set out in the attached note, which is cast in the form of a draft paper to Cabinet. Perhaps you could find time to discuss this with me, if necessary. Subject to your agreement, I should like to circulate it for Cabinet on 16 December, when I understand we shall also be taking Leon Brittan's paper on Civil Service manpower after 1984. As you will see, the two topics are closely connected.
- 3. I am sending a copy of this minute to Sir Robert Armstrong.

G.H

3 December 1982

E O DEC AS

DRAFT CABINET PAPER ON CONTRACTING OUT

We need to intensify our campaign to encourage the contracting-out of activities in the public sector. I have an outstanding remit from MISC 14 (the Ministerial group on industrial policy) to consider this issue. I wrote to Cabinet colleagues in the summer asking for their further suggestions. I have received several interesting proposals, but the results are still patchy. I now want to make a further search for suitable candidates and enlist the support of all my Cabinet colleagues.

Why Contract Out?

Experience both in this country and in the United States suggests that the private sector, with the stimulus of the profit motive, can very often undertake operations on behalf of Government more cheaply than the Government itself can perform them. This in turn establishes private businesses with a potential for expansion including expansion overseas. It is true at national and at local level, in the Health Service and probably also in nationalised industries. There are serious obstacles. The present system was not designed to encourage contracting-out, and it needs a major push to achieve this. I am not, however, urging wholesale contracting-out at any price: only in those cases (a very large number, I should judge) where it will show a clear economic advantage.

The Target Areas

The motive is the same throughout the public sector, but the circumstances are different. We need a four-pronged approach, but in order to maintain momentum, I think Cabinet should review progress by the middle of next year. There are a few general issues on which some central co-ordination by the Treasury will be needed.

Central Government

Under the stimulus of tight manpower targets, several functions have already been contracted-out. There are a number of common services where the onus should be on departments to show why they should not be contracted out. It is within our own power to deal with any problems which may arise. In a parallel paper C82 .., the Chief Secretary has made proposals for the control of Civil Service numbers after 1984. He suggests a major interdepartmental exercise in the New Year to identify the scope for further reductions. I propose that in the course of that operation we identify the scope for further contracting-out of central government functions, and decide how to follow it up. The results are to be reported back to Cabinet in May 1983. This will also be a convenient opportunity to take stock on contracting-out generally.

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Nationalised Industries

The industries already have every economic incentive to contract-out operations where this is the most efficient solution. I recognise that there will sometimes be operational or industrial relations objections. There may also be an element of empire building. These issues should be pursued during 1983, industry by industry, probably in the course of the annual corporate planning discussions. I propose that Treasury and departmental officials collaborate in identifying the areas where the industries might be pressed to contract—out more of their operations, bearing in mind the industries' responsibility for day-to-day management decisions.

General

- a. The VAT anomaly applies only to the National Health service and central government departments. Local authorities already have VAT refunded to them. Nationalised industries recover it through their prices. I intend to legislate in the next Finance Bill to allow the Treasury to make an order refunding VAT to government departments and the National Health Service: , where specific operations or groups of operations are contracted-out. This will remove the present disincentive to such action.
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CONFIDENTIAL

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- (d) <u>Civil Service and Related Bodies (Redundancy Compensation) Bill:</u> Some of the work Cabinet commissioned on 25 November raises issues of importance in this context particularly on the NHS and industrial relations. The Treasury will co-ordinate the two exercises.

Conclusion

I invite the Cabinet to agree:

- a. that there should be a major and co-ordinated drive to secure further contracting-out in the public sector;
- that the possibilities in the Civil Service should be pursued as part of the review of Civil Service manpower after 1984;
- c. that the Health Service Ministers should carry out the proposed pilot studies in regional health authorities;
- d. that we should continue to encourage contracting-out wherever possible in the local authority area,
- e. that opportunities for contracting-out in the nationalised industries should be pursued, either as part of the examination of the 1983 corporate plans for each industry, or separately.
- f. that I should, together with the Ministers concerned with the Health Service, local authorities and nationalised industries, report progress to Cabinet in May, at the same time that the Cabinet considers the outcome of the Civil Service manpower exercise.

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Even Pol, Privatiscition, Pto

CONFIDENTIAL Gon Pol for DEPARTMENT OF TRANSPORT 2 MARSHAM STREET LONDON SW1P 3EB 01-212 3434 Prime Minister (4) The Rt Hon Sir Geoffrey Howe, QC, MP Chancellor of the Exchequer HM Treasury Treasury Chambers Parliament Street 3 November 1982 SW1P 3AG)ee Pun PUBLICITY FOR MONOPOLIES AND MERGERS COMMISSION REPORTS Thank you for copying to me your letter of 1 October to Arthur Cockfield on this subject.

I firmly believe that we must gain as much favourable publicity for the action we are taking to implement MMC reports on nationalised industries. Like Arthur, I am therefore attracted to your idea of publishing progress reports, and would be happy for my officials to take in an exercise to work up the proposition. I would suggest however that we ask officials, in doing so, to consider carefully how best to tie in these arrangements with the existing procedures for reporting progress on individual MMC reports to Parliament.

I am copying this letter to members of E(NI) and to Sir Robert Armstrong.

DAVID HOWELL

CONFIDENTIAL

23 NOV 1882

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SWIH 0ET Telephone 01-215 7877

CONFIDENTIAL

From the Secretary of State

Mus 23/11

The Rt Hon Sir Geoffrey Howe QC MP Chancellor of the Exchequer Treasury Chambers Parliament Street London SWIP 3AG

November 1982

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CONTRACTING OUT PUBLIC SECTOR FUNCTIONS

In your letter of 11 August to Willie Whitelaw, you asked for a fresh survey of potential candidates for contracting out. You also asked, through your Private Secretary's letter of 26 August, that this exercise should extend to the nationalised industries.

We are currently actively pursuing two modest contracting out measures:-

- (a) several private sector bodies have expressed interest in running the proposed new registry for yachts and other small vessels.
- (b) discussions are in train with a view to a private sector body taking over the British Overseas Trade Board's Market Entry Guarantee Scheme (although the government may have to retain responsibility for the "guarantee" element).

I have identified seven other areas which seem to offer some possibility of similarly modest moves towards contracting out, and which merit exploring futher:-

- (a) some of the work of the Civil Aviation Authority's 'in-house' research facility, the Directorate of Operational Research and Analysis;
- (b) Some expert advice and research on consumer safety matters;



From the Secretary of State

- a drive to identify alternative private sector sources where work is currently contracted out to public sector bodies;
- (d) some of the technical services connected with the British Overseas Trade Board's Joint Venture scheme;
- (e) some aspects of the dissemination of overseas tariff information;
- (f) some aspects of the dissemination of export intelligence;
- (g) the Export Credit Guarantee Department's legal services. (Patrick Jenkin's letter of 11 November reported on the scope for contracting out some of the common services of the Departments of Trade and Industry).

Progress in these areas will not lead to substantial savings in staff or expenditure, but, with my proposals on privatisation, would represent a useful slimming down of the scope of my Department's activities.

Turning to the nationalised industries, my primary objective is, of course, to privatise British Airways as a whole as soon as practicable, rather than engage in piecemeal contracting out. The British Airports Authority's philosophy is to contract out as many functions and services as possible – they directly employ less than 3,500 of the nearly 50,000 people who work at Heathrow, which leaves little scope for further action. And again my primary objective is privatisation, albeit on a slightly longer timescale.



From the Secretary of State

I am sending a copy of this letter to the Prime Minister, to other Members of the Cabinet, to the Attorney General and the Lord Advocate, and to Sir Robert Armstrong and John Sparrow.

LORD COCKFIELD

23 NOV 1982

CONFIDENTIAL MANAGEMENT IN CONFIDENCE



2pps.

Prime Minister

Mus 23/11

MINISTRY OF DEFENCE WHITEHALL LONDON SWIA 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 211/3

MO 21/8/5

19th November 1982

Dear Geoffrey

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In your letter of 11th August to Willie Whitelaw, you asked for a report on progress in contracting out public sector functions. I have already given you a progress report on the closely related subject of privatisation. I attach at Annex summaries of our contracting-out activities as requested by your Private Secretary in her letter of 18th October to the Private Secretary to the Secretary of State for the Home Office.

The largest contracting-out exercise under way in my Department is accommodation cleaning. This has been outstandingly successful. When it began, we identified about 7,300 (full-time equivalent) complemented cleaning posts, although this number was subsequently reduced by closures and complement reductions. far, about 4,800 posts have been saved through bringing in private sector cleaning contractors. On the basis of our standard cost comparison, the estimated financial savings are about £72 million a year, or around one-third of the total. The exercise concentrated initially on the larger defence establishments, almost all of which have now changed to contract cleaning. The very small establishments now being considered are expected to yield up to 1,000 further posts. Only 2-300 posts were exempted from the exercise on nonfinancial grounds (some for security reasons or because the establishment is due to close). Provided that contract cleaning continues to prove cheaper, there should be very few directlyemployed cleaners on our books by April 1984.

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The Rt Hon Sir Geoffrey Howe QC MP

CONFIDENTIAL MANAGEMENT IN CONFIDENCE



Contract catering has also been examined, mainly at Service bases, but here the cost comparisons have been less favourable to contract. The Army Department is nevertheless running a pilot study of contract catering at three locations, and we hope to be successful in identifying a few further possibilities including RNC Greenwich.

As part of a general study of the Services' training organisation under the leadership of Jerry Wiggin consideration is being given to the scope for contracting out more training to the private sector. Possibilities being looked at are Service basic MT driver training, ADP training and language training. No decisions have been reached on the extent of any contracting-out; much will depend upon whether potential savings can be reliably identified.

The repair of defence accommodation stores (DAS) - furniture for example - formerly carried out at a number of Navy and Army Department depots has ceased with a view to contracting out in due course. No cost comparison between in-house and contract repair can be provided since very little of the work undertaken by the 66 posts involved has yet been put to contract. In my report on privatisation I mentioned the extended use of contractors in this area at the RAF Maintenance Unit at Quedgeley, which has now been agreed in principle, and where there is a potential saving of some 400 civilian posts.

We are actively exploring a number of other areas where we may be able to make use of the private sector. It is expected that invitations to tender will be issued in November which will enable the Air Force Department to assess the cost effectiveness of contracting out compressed gas production and cylinder servicing. There is a potential saving of about 180 civilian posts if this can be done.

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MANAGEMENT IN CONFIDENCE

Initial studies have established the feasibility of contracting out some of the tasks currently undertaken at the Air Publications and Forms Store, Woolwich. If the work is eventually placed with contractors, up to 150 civilian posts would be saved.

At a very minor level, we have contracted out the production of our daily press cuttings service, and we intend also to use a private firm to produce cuttings from Hansard.

In the Procurement Executive, there has been a steady devolution to industry of work undertaken by the Sea, Land and Air Systems Controllerates, including the Quality Assurance establishments under their control. So far as quality assurance is concerned, greater responsibility for monitoring has been steadily transferred to approved firms over the past few years. Some of the functions hitherto undertaken by Project Management teams . within the department are being devolved to contractors. These include project planning, cost control and production of development cost plans for military equipment such as armoured fighting vehicles and air defence systems, and also the monitoring of the reliability of in-service equipment. In the three Controllerates, contracts to the value of around £4.5 million are expected to be placed in 1982/83, rising to around £6.3 million by 1985/86. It should be noted however, that it has sometimes been necessary to contract out such work simply in order to manage the rising equipment programme; necessary tasks can no longer be undertaken by MOD staff because of reducing manpower provision. In some cases, in-house staff with the required expertise are not available. There are other cases where the requirement for staff is temporary or variable. Experience to date suggests that contracting out such work can prove 11 times as expensive as employing in-house staff. Treasury approval for all contracts in this area of work in excess of £100K is required.



In the Procurement Executive the major proposals for contracting out concern research and development work currently undertaken in the R & D Establishments. Following the Strathcona Report more responsibility for the provision of Post Design Services (i.e. the continuing support for in-service equipment) has been placed on industry. Much of this contracting-out has already been implemented, including work undertaken by the Royal Signals and Radar Establishment and the Royal Aircraft Establishment (RAE).

The contractorisation of support services at the RAE Range at West Freugh has been implemented, with the saving in July 1982 of 30 non-industrial and 116 industrial civil servants and a financial saving of around £250K a year. Proposals to contract out support services at MVEE Kirkcudbright, where the potential saving is 67 civilian (5 non-industrial and 62 industrial) and 18 Service posts have been approved and will be implemented next May at a saving of £146K per annum. Tenders have been issued for the provision of technical support services at A & AEE Boscombe Down, where 55 posts could be affected.

From what I have listed above you will see that the drive to use private contractors for public sector functions has been pursued at all levels and in all parts of the MOD. All concerned are fully seized of the need to keep up the pressure and to convert potential savings of cash and staff into reality.

Copies of this letter go to the Prime Minister, other members of the Cabinet, the Attorney General, the Lord Advocate, Sir Robert Armstrong and John Sparrow.

Hours ever

John Nott

CONTRACTING OUT PUBLIC SECTOR FUNCTIONS CONTRACTING OUT SINCE 1979

Services	Expenditure Prior to Contracting Out	Saving	Date
Accommodation Cleaning	£22m approx	£8.8m	1980-82 cont
Catering	£1.7m approx	£0.15m Ø£45k from pilot studies	1981-82 cont
Press Cuttings	£39,000	£24,000	1981
R & D Work	*	*	
Quality Assurance etc	*	*	
Project Management Functions	*	*	
PDS Work	*	*	
Range Support Services (West Freugh)	*	£250k	1982
Insurance Cover	£16m approx +	£11m (total)	being introduced progressively 1982-92

^{*} Figures not available or difficult to quantify

^{+ 1981} prices; includes areas not being contracted out

CONTRACTING OUT - FUTURE PLANS 1982/83 & 1983/84

Services	Expenditure Prior to Contracting Out	Saving	Date
Accommodation stores holding and maintenance (Quedgeley)		o greater han £800k	1984
Accommodation Cleaning	£5.5m approx	*	1982-84
Catering	£5m approx	*	1982-84
Hansard Cuttings	£24,270 +	£16,000	+ 1982-83
R & D Work	*	*)	
Quality Assurance etc	*	* \	continuing
Project Management Functions	*	*	
PDS Work	*	*)	
Compressed Gas production and cylinder servicing (RA	£812k	*	1983-84
Repair of Accommodation Sto	eres £400,000	*	1983-84

^{*} Figures not available or difficult to quantify

Ø 1980/81 prices

^{+ 1982} prices

CONTRACTING OUT - POSSIBLE FUTURE CANDIDATES

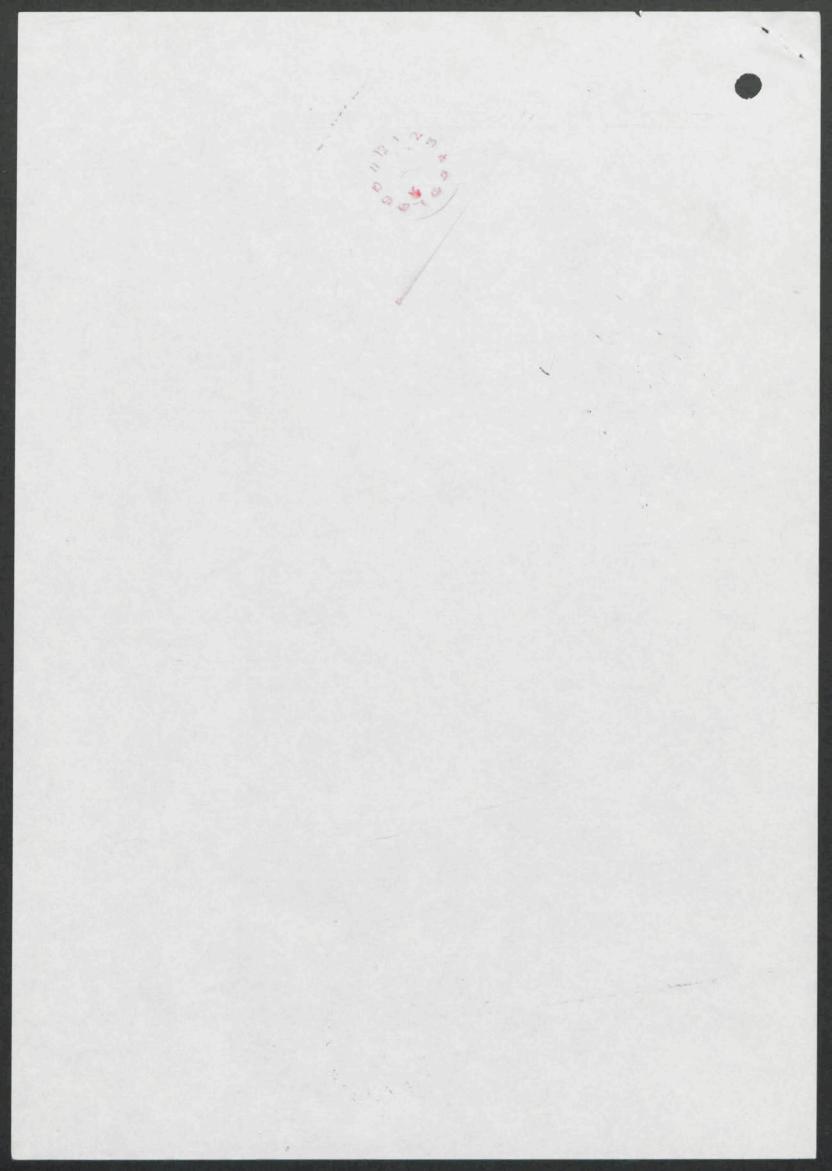
Military Bridging and Field Engineering

Basic MT Driver Training

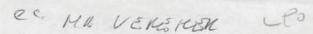
ADP Training

Language Training

Air Publications and Forms Store (RAF)



CONFIDENTIAL





10 DOWNING STREET

From the Private Secretary

15 November 1982

Dear Mayoret,

PRIVATISATION

The Prime Minister was grateful for the Chancellor's minute of 9 November, in which he reported on the proposals put forward by Departments as regards potential candidates for privatisation in this and the next Parliament.

Mrs. Thatcher notes the conclusion of E(DL) that these proposals constitute a useful first step towards keeping up the momentum of the Government's privatisation efforts; she endorses the Chancellor's determination to avoid a situation, after the election, in which no further progress on privatisation can be achieved because insufficient work has been done at an early stage; and she has commented that she does not consider the list put forward as necessarily excluding possible further candidates.

I am copying this letter to the Private Secretaries to all members of the Cabinet, the Financial Secretary (H.M. Treasury) and Richard Hatfield (Cabinet Office).

Your sinevely,

Michael Scholan

Miss Margaret O'Mara, H.M. Treasury.

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CONFIDENTIAL Prime Minister

Please see The

Chamellori minute (attached),

Agree X? MR SCHOLAR Mr Mount Mr Walters PRIVATISATION Mus 12/11 The Chancellor's note to the Prime Minister of 9 November reports the conclusions of E(DL), and summarises in the annex the current proposals for privatisation, in both this Parliament and the next. We are as you know constantly reviewing the privatisation programme, and indeed Chris Monckton is making it a particular concern of his. We may be able to reach our own judgements shortly about possible further candidates for privatisation, other than those already identified by departments. As I have mentioned to you, one possibility is the Civil Service College. For the moment I think the right course is, if the Prime Minister agrees, for you to reply to the Chancellor's office making two points: We strongly endorse the Chancellor's determination to avoid finding ourselves in a situation where we cannot make further progress, because insufficient work has been done at an earlier stage; and While noting the present plans of departments, as (ii) summarised in the annex to the Chancellor's minute, we do not regard these plans as necessarily excluding possible further candidates, because the search for functions or organisations which could be better carried out in the private sector is a never ending one. 12 November 1982 CONFIDENTIAL

JH 222 DEPARTMENT OF INDUSTRY ASHDOWN HOUSE 123 VICTORIA STREET LONDON SWIE 6RB TELEPHONE DIRECT LINE 01-212 3301 SWITCHBOARD 01-212 7676 Secretary of State for Industry // November 1982 Rt Hon Sir Geoffrey Howe QC MP Prime Minister Chancellor of the Exchequer Treasury Chambers London SW1 gan Ged vey, CONTRACTING OUT OF PUBLIC SECTOR FUNCTIONS: PROGRESS REPORT Your letter of 11 August to Willie Whitelaw asked for progress reports on contracting out. Mine is attached. 2 It does not cover the nationalised industries which this Department sponsors. I shall write separately to you on these. Since the Department exists to help industry and to ensure that industry's voice is heard within Government most of our expenditure is in the form of financial assistance to industry. Such executive functions as we have tend to be run on our behalf by those closer to the coal face or in partnership with them where this is possible. It follows that there is no scope for

- Since the Department exists to help industry and to ensure that industry's voice is heard within Government most of our expenditure is in the form of financial assistance to industry. Such executive functions as we have tend to be run on our behalf by those closer to the coal face or in partnership with them where this is possible. It follows that there is no scope for large scale contracting out. Nevertheless as my report shows there are opportunities and these are being pursued. In addition we are examining ways in which we can increase the use of private organisations such as banks, Chambers of Commerce and Regional branches of the CBI to publicise and help with our schemes of assistance. Whilst this will not have a direct impact on public expenditure as such, it is in line with our philosophy of using the private sector wherever possible.
- It has not proved possible to provide in any coherent way information on staff savings and the impact on public expenditure which was requested in your Private Secretary's letter of 18 October. However, we have provided what we can.
- 5 I am sending copies to the recipients of yours.

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CONTRACTING OUT: PROGRESS AND PROSPECTS

REPORT BY SECRETARY OF STATE FOR INDUSTRY

OFFICE SERVICES PROVIDED TO THE DEPARTMENTS OF INDUSTRY AND TRADE

As a contribution to meeting the manpower targets of the Department of Industry, officials are carrying out a programme of studies on the feasibility and costs of contracting out some of the common services of the Departments of Industry and Trade. The studies should be largely completed early in 1983.

- 2 The options being considered are as follows:
 - i) The replacement of directly employed security officers by employees of private security organisations. This might save up to 33 posts.
 - ii) Putting out to private contract major elements of reprographics work. This might save up to 40 posts.
 - iii) In the longer term and less certain, the privatisation of the typing pool at Eastcote. If successful it would save up to 72 posts.
 - iv) The abolition of the Department's photographic unit and drawing office, with commissioning of work from private organisations. This would save 13 posts.
 - v) On computer services, employing contractors to prepare data, to do system analysis and programming, and to operate the Eastcote Computer Centre. External use is already made of consultants for specialised tasks and some old style data capture (ie on to paper tape) is already contracted out. It is not possible to estimate likely staff savings.



- 3 Virtually all general office cleaning is already contracted out. The small element still undertaken by direct labour is kept under review and progress continues to be made in its reduction.
- The printing, physical distribution and advertisement selling operations on 'British Business', a magazine of the Departments of Industry and Trade, are already in the hands of private sector contractors, as are the printing and where applicable advertisement selling of the staff newspapers 'Ti-Line' and 'Coastguard'. I have just agreed in principle to the contracting out of the business section of "British Business" which will save 2 posts. Officials are looking at further options: I am hopeful of saving up to 3 further posts on 'Ti-Line' and 'Coastguard'.

COLLECTION OF LEVIES

- The number of levies operated under the Industrial Organisation and Development Act 1947 has greatly diminished in recent years. Of these, textile levies are already collected on a contract basis by an outside company and this has proved cost effective. The estimated cost of the contract in its first year (1981/82) was £7,000 and in 1982/83 is £4,000 plus £150 a year for the printing of forms. It is not possible to compute the extent of any net savings in public expenditure. One post has been cut, partly because of the contracting out, and there has been a reduction in the clerical workload which might conceivably lead to the loss of a second post.
- 6 When the furniture levy is abolished at the end of the year the large amount of chasing up of defaulters that will probably be necessary will be undertaken by the solicitors of the industry research association and not by ourselves. This will not save any public expenditure since the winding up expenses are to be paid out of the proceeds of the levy. There may, however, be some small saving in official time.



- 7 The collection of the small cutlery levy and the iron casting industry research levywill remain with the Department. In both cases collection forms an integral part of a larger block of work, and no staff would be saved by contracting it out.
- 8 No other levies of any significance are now collected by the Department.

MONITORING OF DEPARTMENT'S ASSISTANCE TO INDUSTRY

9 We are considering a suggestion of Jeffrey Sterling on whether it is feasible to involve the banks in the monitoring of companies which have received financial assistance from us.

RESEARCH ESTABLISHMENTS

- 10 The National Maritime Institute was privatised on 1 October 1982 and plans are well ahead to privatise the Computer Aided Design Centre in April 1983. Our policy is wherever possible to transfer work from the Department's research establishments to the private sector and the Chief Engineer and Scientist is to report to me by the end of the year on the scope for further movement in this direction.
- Il As recommended by the recent Rayner Review of Support Services at R&D and Allied Scientific Establishments, estimates are being sought from private sector contractors for cleaning and security services where these are presently done in-house.

 Maximum potential savings are 54 and 38 posts respectively. But the extent of these, and cost savings if any, cannot be determined before the conclusion of negotiations, expected around the turn of the year.
- 12 The work done by the Department's Technology Reports Centre was transferred in December 1981 to the British Library. This

saved £400,000 per year (at 1981 prices) and will have saved 37 posts when the closure is completed this month. STAFF NUMBERS AND PUBLIC EXPENDITURE 13 I cannot give any sensible estimate of the impact on public expenditure of the possible measures described in this paper, nor of the timing of any changes. A maximum of almost 300 posts might be saved if everything is able to be carried through. Department of Industry November 1982

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Treasury Chambers, Parliament Street, SWIP 3AG 01-233 3000

PRIME MINISTER

In your minute of 28 July you asked colleagues to put in hand surveys of potential candidates for privatisation in this and the next Parliament; and invited me, as Chairman of the Sub-Committee on the Disposal of Public Sector Assets (E(DL)) to report on the proposals put forward.

- 2. The Annex to this minute lists those organisations and activities which, in response to your minute, colleagues have suggested might be disposed of before the General Election or in the new Parliament. E(DL) discussed these proposals on 2 November.
- 3. The Sub-Committee concluded that the proposals constituted a useful first step towards keeping up the momentum of our privatisation efforts, but that further action was necessary in two areas. First, our past experience has shown that developing privatisation proposals into a workable form is a time-consuming and painstaking business. It is therefore of the utmost importance that all Ministers concerned should now put in hand work to permit their proposals for privatisation to be put into effect at the earliest possible date. We must avoid finding ourselves, after the Election, in a situation where we are unable to make rapid progress with privatisation because insufficient work has been done meanwhile on the many policy and technical issues that arise in any particular case, especially for privatisation proposals affecting major nationalised industries.
- 4. Secondly, the Sub-Committee agreed that there was a continuing need for Ministers to take as wide-ranging and imaginative an approach as possible in trying to identify candidates for privatisation. Otherwise, there is a risk that the programme will run out of steam. Overall, special sales of assets should raise about £570 million in 1982-83 and, on present prospects, about £750 million in 1983-84 and £1500 million in 1984-85. Thereafter however the picture is much less satisfactory. At the moment, possible proceeds of less than £100 million in 1985-86 have been identified.



- 5. The Sub-Committee also agreed that where a monopoly is privatised, efforts should be made, whenever appropriate, to reduce its power either by introducing competition into the market concerned or by splitting the monopoly into regional companies; although in some cases such action may not be practical or may cause unacceptable delay in privatisation.
- 6. Every six months E(DL) will reconsider progress on and prospects for privatisation, on the basis of reports which the Financial Secretary will prepare.
- 7. I am copying this minute to all members of the Cabinet, the Financial Secretary, Treasury and Sir Robert Armstrong.

(G.H.)

9 November 1982

	Privatisation in this Parliament			
	/ Firm	Possible		
MINISTRY OF AGRICULTURE FISHERIES AND FOOD				
Covent Garden Market Authority		Report on prospects for sale of Market Towers office block being considered		
Land Settlement Association		Set up co-operative marketing structure, and dispose of surplus land and property		
Livestock	Privatisation of \$\frac{2}{3}\$ of artificial insemination service March 1983	Quality control may be privatised by end of 1982 as a result of advisory body report		
Forestry (see SCOTLAND Annex)				
	<i>></i>			
		SECRET		

Privatisation in the next Parliament

Comments

Has been on the market since Autumn 1980 (value +£20m). Lower price being considered. Intention is to end MAFF responsibility for financing tenants

	Privatisation in Firm	this Parliament Possible	Privatisation in the next Parliament	Comments
CHANCELLOR OF THE EXCHEQUER'S DEPARTMENTS				
Inland Revenue			Non-rating work of the valuation office.	Committee due to report in early 1983 on possibility of work being done in the private sector.
Civil Service Catering Organisation				Ministerial discussion of possibilities for contracting out/privatisation by end 1982, following recently completed Rayner Report on CISCO.
HMSO	Reprographic services			450 posts already saved: further reduction of 150 in next 18 months.
	Bindaries			400 posts saved.
	Printing presses (except London)			150 posts saved.
Treasury				Possibility for selling further BP shares to be kept under review.
		SECRET		

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	Privatisation in th	nis Parliament	Privatisation in the next Parliament	Comments
MINISTRY OF DEFENCE	<u>Firm</u>	Possible		
Royal Ordnance Factories				Privatisation expected subsequent to 1986. Place in legislation
Rocket Motor Organisation			Negotiations pro- ceeding with IMI Ltd	programme awaited for Legislation to convert ROFs to Companies Act Company.
Military Vehicles and Engineering Establishment			Negotiations proceeding for part sale to Fairey	
Defence Accommodation Stores		April 1984		400 posts
Miscellaneous Staff hostels)				
Procurement of medical stores				Considering privatisation
Military schools)				
		SECRET		

Privatisation in Privatisation in this Parliament the next Parliament Possible Firm Health Authorities being advised that products should only be manufactured in certain defined circumstances

SECRET

DEPARTMENT OF HEALTH AND

National Health Service

SOCIAL SECURITY

Miscellaneous

Comments

Cooperation

Review of possibilities for disposing of surplus NHS

land and

advanced

between NHS and public health care sector being reveiwed

properties well

Possible use of private sector in storing and distributing NHS supplies being reveiwed

DHSS in-house

NHS supplies testing and evaluation work being reviewed

	Privatisation in th	is Parliament	Privatisation in the next Parliament	
	<u>Firm</u>	Possible	. Fartrament	
DEPARTMENT OF EMPLOYMENT				
MSC				
Professional and Executive	Wholly commercial basis by April 1983		Full privatisation) possible	In
Skillcentres	Trading Fund status by April 1983		Full privatisation possible	ca ar re
Miscellaneous			\ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \	li
Health and Safety Executive unit for approving electrical equipment for use in flammable atmospheres			Privatisation { possibilities to be } reviewed in 1985 }	
	2			
-				
		SECRET		

Comments

In all three cases decision are subject to review in the light of re-organisation

	Privatisation in	this Parliament	Privatisation in the next Parliament	Comments
DEPARTMENT OF ENERGY Nationalised Industries	Firm	Possible	- Idramono	
National Coal Board Electricity Council and	Legislation in 1983-84 session	Sale of non-mining subsidiaries and overseas interests	Opencast and other mainstream activities to be reviewed mid 1983 in the light of political feasibility (i)Electricity showrooms -	
Boards	allowing private supply of electricity as main business - open up to competition		ensuring competition on a fairer basis. (ii)Paper on future of electricity supply industry to E(NI) by end year dealing with privat- isation.	
British Gas Corporation	BGC offshore oil asset	 (i) Sale of BGC 50% interest in Wytch Farm January 1983. (i) Gas showrooms - enlarging private sector stake in sale of appliances. 	Undeveloped acreage Prospects for disposing of BGC's mainstream activities to be reveiwed	In midst of an assessment of undeveloped acreages, with a view to disposal
Britoil	Disposal of 51% of the shares November 1982		Further share sales may be possible	Estimated revenue £600 million (?)
Other industries				
British Nuclear Fuels Limited	3		Introduction of private capital	Advice on preparations required for partial privatisation to be received from Schroder Wa November 1982
Miscellaneous	Sales from oil stockpile (£35 million in 1982-83)	CECDET	Oil pipeline and storage system	Consultants to report by spring 1983 on possibil- ity for privatis ation of oil pipe

AND DIVIDOUS OF MAIN PARTITIONS	Privatisation in th	is Parliament	Privatisation in the next Parliament	Commen
DEPARTMENT OF THE ENVIRONMENT	Firm :	Possible		
Local Government				
Council house sales.	(i) Increase rate of sale of vacant local authority houses.			
	(ii) Maintain sales programme to ten ants			
Professional building services.		Some authorities (eg Birmingham) considering scope for privatisation.		
Countryside functions and allotments.		Possible scope for privatisation.		
Non-departmental public bodies				
Water Authorities.				Explore scope for privatisative with Water Authorities and private firms - initial assess- ment of viability April 1983.
British Waterways Board		(i) Disposal of BWB freight interests and non-operational estates.		
		(ii) Increase private investment in amerity developments.		
		SECRET		

	Privatisation in thi	is Parliament	next Parliament	Commen
New Towns	Firm Continuation of substantial disposals of industrial and commercial assets and housing.		HONO TOLITAGE	
Nature Conservancy Council Miscellaneous				Rayner Review due by April 1983 to indicate scope for privatis— ation.
Ordnance Survey	Trading Fund to be set up from April 1983.		Full privatisation.	Dependent on performance as a Trading Fund
Building Research Establishment Cartographic service				Board of Management to be appointed which will examine potential for establishing private compan or operating a trading fund.
Cartographic service		SECRET		Subjects of Rayner Scruting due to report November 1982. Decision by April 1983.

	Privatisation in	this Parliament	Privatisation in the next Parliament	Comment
	<u>Firm</u>	Possible	next Parliament	
HOME OFFICE				
Telecommunications for police, fire, prison and civil defence services			Full privatisation possible	Cannot guarante privatisation since local
	•			police/fire authorities could choose to do it for
				themselves. No feasible to change until
				completion of conversion programme in 1989.
Radio regulation			Privatisation of parts	
		SECRET		

	Privatisation in t	chis Parliament	next Parliament	Comments
EPARTMENT OF INDUSTRY	Firm	Possible		
ationalised Industries				
British Telecom			Sale of 51% of company to private sector with first tranche offered after the election	
ritish Steel Corporation		(i) Further joint ventures with private sector (ii) Peripheral activities, land and property	Tubes Division and other major operating divisions as they can be brought to continuing viability	Lack of profitab- ility prevents sale of major operations but possibilities will be kept under review
British Shipbuilders			Vickers, Yarrow and Vosper warship builders	Dependent on cutting down capacity in line with likely demand from MOD and from exports
			Vosper & Tyne ship repair activities	Currently loss makers. Present action on demanning may assist saleabilit
Post Office and National Girobank				Special problems eg social obligations need careful study before privatisatio proposals are put forward
Other industries				
	Complete sale of shareholdings in private companies (eg United Medical Enterprises, 1983)			Further hiving off being considered in a separate review by Secretary of State. Possibility of self-financing.
	*****	SECRET		

Privatisation in the next Parliament
Sale to private sec

Comments

Sale to private sector by 1990

Corporate plan becomes availabe in Autumn, when more precise timetable can be formulated

Privatisation by 1990

BAe prospects
dependent on
other Government
decisions Review
possibility of
further share
sales in
February.
Prospects not
good at present.

Present undertaking and views of foreign governments need to be taken into account

Review of possibility of privatising other research establishments and functions to be completed by end of 1982

(October 1982) English Industrial

English Industrial Estates Corporation (sale of leases)

Computer aided design centre April 1983

SECDET

		SECRET		
	Privatisatio	n in this Parliament	Privatisation in the next Parliament	Co
	· Firm	Possible	1000 10	
LORD CHANCELLOR'S DEPARTMENT		Management of Investment Funds		Re , ou
		Part of Official Solicitor's work		Re
	2			
	X Annual Control of the Control of t			

Comments

Review to be carried out: timing uncertain

Review to be carried out

Privatisation in the next Parliament

Possible

Comments

Discussion with various interests with a view to full privatisation

Various minor fields being examined (eg poultry testing, milk recording, meat classification)

Maintaining contact with Great Britain studies of private finance for railways, airports and roads

SECRET

	Privatisation in th	nis Parliament	Privatisation in the next Parliament	Comments
	<u>Firm</u>	Possible	HEXC TAITIAMENTO	
SCOTTISH OFFICE				
Scottish Transport Group				Assessment of prospects for privatisation to be completed by merchant bank for report to E(DL) in November
Scottish Electricity Boards	Legislation enabling private stake in generation of electricity		Increased private involvement in electricity generation	D(DD) IN NOVEMBER
Forestry Commission			Further increase in annual sales programme under discussion	Part of Forestry Commission falls to Welsh Office and Ministry of Agriculture
		SECRET		

	Privatisation in	this Parliament		Privatisation in the next Parliament	Comment
DEPARTMENT OF TRADE	Firm	Possible			
British Airways		Sale of 51% of shares in late 1983			
British Airport Authority		1,50	,	Introduce part private finance, with possibility of full privatisation	
Civil Aviation Authority		Part disposal aerodromes in Highlands and Islands of Scotland	of		
ECGD					Review of ECGD's organisation and functions to be undertaken including scope for privatisation
Tourist Authorities and) Boards					Possibilities to
Merchant Navy Welfare Bard)					be considered
	3				
		SECRET	-		

	Privatisation in th	is Parliament	rrivatisation in the next Parliament	Comments
EPARTMENT OF TRANSPORT ationalised Industries	<u>Firm</u> .	Possible		
ritish Transport Docks Board	Flotation January 1983			
ritish Rail	(i) Complete sale of remaining hotels in 1982-83	(i) Sale of Sealink	(i) Victoria Gatwick line and other private capital schemes - preliminary exploration of possibilities	British Rail Engineering Ltd. Possibility of privatisation could be considers further in the light of Serpell Review due Autumn 1982
	(ii) Increase pace of property disposals	(ii) Privatisation of train catering		
	(iii) Private tenders for supply of rolling stock encouraged			
ational Bus Company	Separate accounts established for National Express and National Holidays by Jan 1983 for later privatisation			Possibility of opening up stage carriage operations to private capital being considered
iscellaneous				
eavy Goods Vehicle testing	Transfer of responsibility to Lloyds register			
rivate finance for road building		Invite tenders for an experimental scheme in 1983		
ptorway service areas	Sale to be completed 1983-84	a CORFT		
		SECRET		

Comments

Firm

0

Possible

DEPARTMENT OF EDUCATION AND SCIENCE)
FOREIGN AND COMMONWEALTH OFFICE
MPO
PAYMASTER GENERAL
WELSH OFFICE

TOTAL OFFICE

**TOTAL OFFICE*

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Proposals dealt with in other Departmental annexes.

CECRET

Nil return on privatisation

Debate on the Address - 5th Day. Tuesday 9th November

Labour's resolution on "The Attack on Public Enterprise and its Effect on Unemployment".

helist

This brief deals with the <u>nationalised industries and privatisation</u>. Another, on unemployment, has also been circulated for the debates on the Address.

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The Performance of the Nationalised Industries

Nationalised industries represent around 10% of GDP and employ 8% of the UK workforce. They dominate strategic sectors of the economy - energy, transport, steel etc. - and represent the major suppliers and customers of many firms in the private sector. Their efficiency and viability are crucial to the nation's economic performance. Few people would argue that their record is good:

- * In the thirty year period after 1954, accumulated government subsidies, capital write-offs and other payments amounted to nearly £8 billion. (Hansard, WA 31st July 1975, col 630).
- * Since the system of EFLs was introduced by Labour in 1976-7, the burden on the Exchequer has averaged nearly £2½ billion per year.
- * Pre-tax returns on investment have lagged consistently behind those of the private sector. Since 1972, the average rate of return on nationalised industries has never been significantly above zero.
- * The pre-tax real rate of return on the capital stock of £94 billion in 1980, including subsidies, was minus 1%. (Hansard, WA 28th June 1982, col 277).
- * Productivity performance in ports, steel, coal and rail has been notably below average.
- * Control on labour costs has been poor in most nationalised industries and notably so in gas, coal, electricity and telecommunications.
- * Over the public sector as a whole, pay was roughly in line with that in the private sector in 1970, but by 1981 had risen to 15% above for manual workers and 8% above for non-manuals.
- * In response to the recession, the private sector as a whole reduced its financial deficit by £1.6 billion in 1980-1, while the nationalised industries in aggregate increased theirs by about £700 million.
- * In 1981-2, the five biggest loss-makers among the nationalised industries produced a total loss of £1.5 billion.
- * Seven out of ten days lost because of strikes in 1980 and 1981 were within the public sector.
- * Prices charged by the nationalised industries have risen more rapidly than prices as a whole:

- 2 -

% increase in Year to	RPI	Goods and services produced mainly by nationalised industries
Jan 1979	9%	7%
Jan 1980	18%	17%
Jan 1981	13%	2.7%
Jan 1982	12%	11%
Sept 1982	7%	1 4%
Jan 1979- Sept 1982	55.8%	82.9%

Some of this increase was due to the unwinding of subsidies used by Labour to massage prices down in time for the election. These were costing £1 billion per year when the Government took office. However, as Nicholas Ridley, Financial Secretary to the Treasury, has said: "Another part of this rise in prices was certainly due to their failure to contain costs and improve efficiency". (Gloucester, 12th February 1982).

Reasons for poor performance

- * Nationalised industries, unlike private sector companies, are shielded from daily accountability to shareholders and bankers. The Chancellor has said: "The Morrisonian constitution grants our nationalised corporations a degree of autonomy which is probably unique in the Western world. In the strict sense of the word, they are constitutionally 'irresponsible'". (London, 1st May 1981).
- * They often have a monopoly position in the market. This removes them from the discipline inherent when customers can choose between competing suppliers.
- * They are frequently subsidised. The Chancellor has pointed out: "In the past, we have tended to subsidise production of those goods the public least wants, produced by processes which are least efficient, manned by employees who are most highly paid relative to their productivity". (ibid). The attitudes which this situation has engendered are very difficult to eradicate.
- * Often, their managers have been unable to resist irresponsible pressure from trade unions, whose bargaining position is frequently bolstered by closed shop agreements.
- * Without the ultimate threat of bankruptcy, there is little pressure to adapt and innovate.

Successive governments have grappled with the need to engineer constraints on the nationalised industries which will make them respond to their customers, 'bankers' and 'shareholders' in the way in which private sector companies do. It is very difficult to simulate the pressures of the market place, although these efforts continue. However, where it is appropriate, a much better solution is to return the industries to the private sector.

Public perceptions

Since 1950, a growing majority of the electorate has declared itself opposed to nationalisation. Recent surveys confirm the trend. The following tables are from an NOP survey in August 1982, commissioned by Aims.

1	The Labour Party proposes to nationalize several more companies when it is next in Government. Do you think more companies should be nationalized or not? Yes, more should be nationalized	16 63	Labour % 38 35 7	Conservative 70 5 85 2	41liance
	It depends which companies Don't know	16	19	8	14
2	Do you think more nationalization would make living standards in Britain go up or down, or would it make no difference?				
	Living standards would go up Living standards would go down It would make no difference Don't know	15 41 28 17	26 17 39 19	7 63 20 11	12 38 33 16
3	Overall, would you say nationalized industries are more efficient or less efficient than free enterprise industries?				
	More efficient Less efficient It varies No difference Don't know	12 62 6 4 16	25 38 9 6 21	5 82 3 2 8	10° 66 7 3

Benefits of privatisation

- * The business is removed from the unreal world in which continued operation is guaranteed by the State. The ultimate threat of bankruptcy, and more usually, the need to persuade investors to invest in the business, impose essential pressures for improved efficiency.
- * Managers the people who know most about the business are liberated from political considerations. They can raise money in fair competition with other borrowers, and expand or contract the business and set prices as the market dictates.
- * The allocation of scarce capital is made more efficient when investment projects compete. This is good for the whole economy.
- * Employees are able to identify more closely with the commercial realities facing their industries. They can take a stake in them: 90,000 of them already have, under preferential arrangements. The National Freight Company is now owned by a consortium of its managers and workforce.

- 4 -Consumers benefit from the effect which competition has on the efficiency and pricing policy of companies. Small investors are often given preferential access to shares and the opportunity arises to interest people in direct involvement in the purchase of shares. Ownership by individuals (or by the institutions who look after the pension and insurance provision for individuals) constitutes real ownership by the people. Progress on privatisation/liberalisation The Government has made substantial progress in reversing the "Socialist ratchet". For the first time since the war, the size of the publicly owned sector of industry is being significantly reduced. Communications Industry British Telecom has operated separately from the Post Office since October 1982. Nearly half the Government's shares in Cable and Wireless were sold in Autumn 1981, to form a private sector company. Mercury was given a 25 year licence in February 1982 to run an independent telecommunication network in competition with BT. The first service is expected in early 1983. Value added services, offered by private firms using BT's network, are now being licensed. The supply and maintenance of telecommunications apparatus has been opened up to competition. One result is that private subscribers will no longer have to rent telephones other than the first from BT. Legislation in place contains powers to require BT to form wholly owned subsidiaries and dispose of them. Legislation outlined in the Queen's Speech will put BT into Companies Act form and enable the sale of shares. This will be a major extension of real public ownership. Legislation in place allows the Post Office monopoly to be suspended. Private operators have been licensed to provide mail services and document exchanges. Transport Industries Legislation in place permits the denationalisation of British Airways. The National Freight Corporation (now Company) has been bought by a consortium of management and workers. The traffic licensing regime has been relaxed, particularly in relation to express coash services. Legislation in place allows private capital in the National

- 5 -Bus Company. British Rail's hovercraft subsidiary has been merged with Hoverlloyd, to form a new private sector company, Hoverspeed. Six BR hotels have been sold, together with a significant portfolio of property. Legislation in place allows the sale of Sealink, BR's ferry service. The British Transport Docks Board, which owns 19 ports, is to be denationalised shortly. The testing of heavy goods vehicles is being transferred to the private sector. Energy Industries Legislation in place permits the sale of shares in Britoil (formed from the oil exploration/production arm of BNOC), and BGC's oilproducing interests in the North Sea. It is intended that Britoil will become a private sector company, although the Government will retain special rights to prevent unacceptable changes in future control. BGC's statutory privileges in buying gas, and its monopoly position in supplying large gas consumers, have been removed. Legislation in place permits the sale of BGC's showrooms, subject to further legislation on safety. BGC's half share in the Wytch Farm onshore oilfield is in the process of being sold. Legislation outlined in the Queen's Speech will permit the private generation of electricity as a main business. Other Industries British Aerospace and Amersham International have been transferred to the private sector. Legislation outlined in the Queen's Speech will permit privatisation

of British Shipbuilders.

BL has disposed of its interests in Prestcold, Coventry Climax and Alvis.

Significant progress has been made with the rationalisation of the British Steel industry, both within BSC and in those sectors of the market where BSC and the private sector operate.

Part of the operations of BSC have been returned to the private sector in the form of a separate company, Allied Steel and Wire Ltd., now one of the largest wire companies in Europe. The Corporation has been reorganised so that the saleable parts, which are not part of the mainstream steel business, are formed into Companies Act companies. BSC's major construction subsidiary, Redpath Dorman Long Ltd., has been sold. Sheffield Forge masters is being established as a unique combination of publicly owned

- 6 -(BSC) and privately owned (Johnson Firth Brown) industrial interests. The NEB holdings in 21 companies have, to date, been sold back to the private sector. Prominent among these were holdings in ICL, Ferranti Ltd., and Fairey Holdings Ltd. The NEB's role as an agent of "back door nationalisation" has been ended. In the longer term, the Government has made it clear that it does not accept that state ownership is the only solution for the so-called natural monopolies. Privatisation of British Telecom The Government's plans are outlined in the White Paper on the future of telecommunications, Cmnd. 8610, published in July 1982. The Queen's speech outlined the intention to introduce a Bill which will convert BT into a public limited company with its shares owned by the Government. The Bill will also contain powers for the disposal of up to 51% of the shares although the intention is that the sale will take place after the next election. The new company will operate under licence, in the way that the telephone service of Kingston upon Hull and the new Project Mercury do. Terms of the licence will ensure that BT: continues to provide access to telephone services to everyone who currently has such access. provides services throughout the British Islands, including rural areas and remote locations. provides essential services like 999 and telephone kiosks. The licence will be enforced by a new Office of Telecommunications, which will also ensure fair competition and fair prices, and prevent exploitation by BT plc of its dominant position. The Bill will also provide for the reform of the Telegraph Acts which set out the code under which telecommunications undertakings place their plant. The Bill will include measures to strengthen the provisions of the Wireless Telegraphy Acts which are administered by the Home Office and which are not to be confused with the Telegraph Acts. The measures will tighten controls on the availability and use of illicit wireless telegraphy apparatus. Points to Note No person who has access to telephone services at the moment will be denied access to them in the future, whether they rely on telephone kiosks or live in rural areas. Privatisation will bring to BT all the advantages which other companies enjoy associated with the ability to supplement finance from revenue and loans by finance from equity.

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- BT will be able to plan its investment programme in relation to its own commercial judgement.
- The legislation will safeguard existing employee pension rights, and will in no way disadvantage employees or weaken their pension position. The Government cannot guarantee how pension arrangements will evolve in the future even in the nationalised industries.
- Employees will be able to buy shares in the firm for which they work.
- The US, where the telephone companies are privately owned, has seen a huge expansion in telephone networks and the numbers employed by telephone companies. BT too will have the opportunity to expand.
- Increased finance from borrowing will mean less finance from revenue. Today's customers will no longer have to pay higher bills to cover tomorrow's investment.
- Customers will, for the first time, have contracts which give them rights against BT. Consumer protection will be enhanced by the Office of Telecommunications.
- Labour ought not to accuse the Government of neglecting BT. Investment in telecommunications has been:

Outturn					97	Planned
£ millio	on					
1976-7	1977-8	1978-9	1979-80	1980-1	1981-2	1982-3
816	844	993	1,215	1,545	1,898	2,380

Share price

It is of course against the Government's interest to see shares underpriced. There are however risks in pitching the price too high. Not only Government faces this problem - the recent share issue by STC was substantially oversubscribed. However, the Government will make every effort to ensure that the purchaser of shares and the taxpayer get a good deal.

BT results

Year ending March:	1979	1980	1981	1982
Profit f million (on new accounting basis post-1980)		129.1	180.7 123.9	457.8
Real return on new assets revalued at replacement cost %	6.9	4.6	4.4	6.5
Turnover f billion	3.2	3.6	4.6	5.7

- 8 -

Privatisation of British Shipbuilders

Legislation will be introduced which will remove present statutory obstacles to the introduction of private capital and also provide enabling powers for the Secretary of State for Industry to direct British Shipbuilders to dispose of particular assets or subsidiaries. This measure will allow the Government to fulfil its commitment to promote private ownership in the nationalised shipbuilding industry.

Background

In 1950, 42% of the world's new ships were built in British yards; by 1978 the figure had fallen to $4\frac{1}{2}$ %.

While output per person employed in manufacturing rose by 1.7% between 1976 and 1978, output per person employed in shipbuilding fell by 9%.

Falling productivity has meant falling market share, at a time when the total size of the market has also been falling.

Labour's nationalisation of Shipbuilding in 1977 was seen as: "The only way to ensure secure, long-term employment" (James Callaghan, "British Business", 8th July 1977).

At the same time, Labour introduced the Shipbuilding Redundancy Payments Scheme, indicatng that they saw the need to reduce over-capacity and over-manning.

On April 4th 1979, Labour announced that losses of £100 million in 1979-80 would be tolerated, in order to retain $3\frac{1}{4}\%$ of world merchant shipbuilding output.

Lack of commitment to rationalise capacity and end wasteful subsidies damaged the industry. The present Government remains determined that support will be temporary and diminishing, and that viability will be regained.

Government assistance to BS has totalled over £600 million since the government took office. It comes in a number of forms:

1. Through the external financing limit (${\sf EFL}$) which covers losses and capital spending:

Year 1979-80 1980-1 1981-2 1982-3 EFL £236 million £176 million £150 million £123 million (announced)

2. Through the Intervention Fund (IF) which defrays up to 25% of the cost of building ships.

Year to July: 1980 1981 1982
IF assistance £65 million £55 million £45 million offered :

3. Shipbuilding Redundancy Scheme. This has cost the Exchequer over £55 million to date, and has helped the industry shed 19,00 employees.

Recent BS results have been encouraging:

	1979-80	1980-1	1981-2
Loss before IF assistanc	e £174 mn	£85mn	
Loss after IF assistance	£110 mn	£41mn	£19.7m

The trading loss limit (after IF assistance) is £10 million for 1982-3. The Corporate Plan envisages break-even by 1983-4.

There has been welcome diversification. Cammell Laird and Scott Lithgow have moved into offshore work, and Cammell Laird and Swan Hunter have moved into warship work.

Productivity has yet to regain the level before nationalisation. 1979 was actually worse than 1978, although there have been improvements since.

In 1981-2, BS increased its market share to 2.5%, the best result in any year since vesting day. BS has made this considerable progress against the background of severe recession. Only South Korea, the UK and W. Germany among the leading shipbuilding nations managed a higher order book in the second quarter of 1982 compared with the first, and the total world order book fell by over 1 million gross tonnes to 32.7 mgt. The UK share increased by 10,8000g tons to 1.07 million g tons.

Results for the various divisions in 1982-3 were:

1982	Turnover £000	Trading profit £000	Average number employed
Merchant Shipping Division	395,759	(36,177)	24,264
Warship Building Division	428,387	38,582	24,888
Engineering Division	71,372	(2,191)	4,123
Shiprepair Division	53,189	(9,493)	4,070
Offshore Division	134,769	(13,678)	8,645
1981			
Merchant Shipping Division	368,853	(36,713)	25,763
Warship Building Division	408,418	32,177	25,396
Engineering Division	61,596	(12,271)	4,625
Shiprepair Division	57,100	(7,275)	4,611
Offshore Division	101,065	(20,024)	9,091

Figures in brackets denote losses.

Electricity and Nuclear Installations Bill

Legislation will be introduced which will fulfil the Government's commitment to allow the private supply of electricity as a main business. Mr Nigel Lawson, Secretary of State for Energy, announced on June 28 (OR Volume 26, Col. 228) that he proposed to remove the statutory bar on the private supply of electricity as a main business and had consulted interested organisations for their views. Equally important, the legislation will also encourage private generation, including industrial combined heat and power schemes, by enabling surplus electricity to be sold to Electricity Boards at a fair price and by allowing the existing transmission and distribution system to be used by private generators and suppliers on fair terms.

Another part of the legislation will amend the Nuclear Installations Act 1965 concerning the liability of nuclear operators for damage caused by nuclear incidents. The principal amendments will raise the statutory limits on the amount of compensation payable, to take account of past inflation.

Nation	alised	Industrie	s' Finance
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(£m - cash)

				(2.11)		
				Contribution to capital spending from total internal resources	Total External Finance	
Α.	1980-81 March 1980 Outturn	Budget	Forecast	4043 2626	2196 2900	
В.	1981-82 March 1981 Outturn	Budget	Forecast	4694 3593	2390 2960	
C.	1982-83 March 1982 Outturn	Budget	Forecast	5002 ?	2739 ?	

(Source - Public Expenditure White Paper Cmnd 8494-11 pp. 74-8)

Industry

1982-83 Externa Financing Limit £ million

				7
National Coal Board			962	
Electricity (England & Wales)			-243	
North of Scotland Hydro-Electric Board			9	
South of Scotland Electricity Board			211	
British Gas Corporation			-83	
British National Oil Corporation			-85*	
British Steel Corporation			350	
British Telecom			320	
Post Office and Girobank			-38	
British Airways Board			-8	
British Airports Authority			47	
British Railways Board		1	897	
British Transport Docks Board			-7	
British Waterways Board	1		-39	
National Bus Company			69	1
Scottish Transport Group			20	
British Shipbuilders			123	

^{*} The British National Oil Corporation figure is an external financing requirement, and does not represent a formal limit. (Hansard, 7th April 1982, WA Col 379)

Labour policy on nationalisation

Labour's Programme 1982 states: "We have to demonstrate the practical benefits of common ownership, showing how public enterprises can be a spearhead for innovation and new investment, making clear the benefits to both workers and consumers, and exploring the best forms of organisation and different forms of common ownership". At least they concede that the practical benefits have not been demonstrated yet, despite over 30 years since Labour's nationalisation programme first got underway.

The programme also promises "a radical improvement in the service which these industries provide to the people who own them". Again, at least the present shortcomings are appreciated. Nevertheless, Labour plans to renationalise the businesses which the present Government has returned to the private sector, to undo everything which has been achieved in liberalising the state monopolies and to extend nationalisation into each important sector of industry.

The terms upon which renationalisation would proceed have been the subject of dispute within the Labour Party. Mr Benn told the House of Commons: "Both at the TUC Congress last year and the Labour Party Conference last year, we called...for the reacquisition of public assets without compensation". (Hansard, 10th November 1981, col. 499). However, the Right of the party appears to have succeeded in moderating this. Labour's Programme 1982 states that "shareholders should be repaid precisely the amounts which were paid for the assets at the time they were denationalised".

A still different form of words emerged from the last Labour Conference. The motion passed said that compensation would only be given: "on proven need and at a level which ensures that the recipients do not gain from their investment".

Labour will extend state ownership into the electronics industry. The Programme states: "GEC, which occupies a pivotal position in the British electronics and electrical engineering industries, will form an integral part of our public ownership programme." It also promises more state ownership in construction and building materials, pharmaceuticals, road haulage, major ports, and timber products. It states that existing nationalised industries will be allowed to diversify; and that "We are committed to take a majority stake in all existing and future North Sea oil fields". Mr Benn has warned: "It is long-term policy of the Labour Party to bring all oil into public ownership, including BP". (Hansard, 10th November 1981, col. 499). The 1982 Conference approved a motion which included a call for the nationalisation of 20 to 25 large companies.

At the Labour Party Conference in 1976, Mr Callaghan said that the NEC's proposal to nationalise the banks would be "an electoral albatross", (Blackpool, 24th September 1976). However, among proposals listed for consideration in Labour's Programme are: *A public stake in the banking system established by taking one or more major clearing banks into public ownership", and "An extension of public ownership into other parts of the financial system". The 1982 Conference threw out a motion to nationalise the banks, but only on a margin of 3.4 million votes for, 3.1 million against.

On the subject of the price to be paid for assets confiscated by the State. Labour's programme warns: "We have learned the lessons of past mistakes and will not overcompensate." It is suggested that shareholders could be compensated by government bonds which would have staggered periods of redemption.

Labour's plans for confiscation extend beyond their nationalisation proposals. They promise to: "provide a statutory right and mechanism for workers in private firms - subject to government consent - to convert their enterprise into a workers' co-operative by acquiring the assets of the firm". There is no discussion of the need for consent from the owners of the enterprise, nor of the terms of compensation.

Alliance policy on nationalised industries

The SDP Green Paper No. 2 states: "If a (nationalised) industry is operating in a competitive environment and can viably be operated as a commercial concern, there is no overriding case for subjecting it to the sort of system of Government control which exists at present.... We propose therefore that the competitive industries should be set up as Companies Act companies and given an equity structure Even if the Government continued to hold the initial equity, there would be no objections to issuing further equity to private shareholders Ownership would gradually pass from public to private hands".

This is very similar except perhaps in its stress on gradualism, to the Government's policy. So is the SDP's policy, set out in the Green Paper, of increasing the pressure on the nationalised industries to be efficient, although it is unclear how this would be reconciled to their plans to introduce subsidies. The SDP agree with the Government that the State monopolies need to be kept under tight control.

However, the SDP and the Liberals voted with Labour during last year's debate on the address on a motion "regretting that the Gracious Speech contains proposals which, in putting private profit before public interest, strip the nation's North Sea oil and gas assets"

They voted against the Oil and Gas (Enterprise) Bill second reading and (with the exception of Christopher Brocklebark Fowler, who was then a Conservative and the Liberal Stephen Ross), against the British Telecommunication Bill second reading. The SDP did not exist on the latter occasion, but many SDP MPs voted as Labour MPs on this occasion.

It is therefore very difficult to ascertain whether the theory of the Green Paper commends itself to the Party in Parliament, and how it would be applied in practice.

Conservative Research Dept 32 Smith Square LONDON SW1 LMR/CR 8.11.82

Mus 5/11 House of Lords, SW1A OPW 5 November 1982 Confidential Door Margaret, THE CONTRACTING-OUT OF PUBLIC SECTOR FUNCTIONS In your letter of 18 October, you asked departments for more detailed information about contracting-out public sector functions. The Lord Chancellor's letter of 11 October to the Chancellor of the Exchequer explained that although it was not appropriate to consider his principal function as being suitable for privatisation (nor, presumably, for contracting-out), there were three areas which would be investigated. At this stage it is simply not possible to give more than a very broad indication of the likely timing of any action which would result from these studies or of the savings which might be expected Investment activity There is to be a review, probably in the form of a Rayner Scrutiny, of the arrangements governing the investment of privately owned funds by the various courts and offices under the Lord Chancellor's control. The scrutiny will also consider the possibility of transferring to a private sector agency the management of some or all of the investment portfolios currently managed by the Department. The scrutiny will take place during 1983; implementation of any recommendations is expected during 1984/85. Savings in cost terms cannot be anticipated because much of the present operation is self-financing. Nevertheless, staff savings of the order of 15 posts are indicated in the Public Trustee Office. There could also be consequential savings elsewhere, for example in the Court Funds Office. .../2 Miss O'Mara Private Secretary to the Chancellor of the Exchequer

Official Solicitor's Department The receivership work of the Official Solicitor's Department is currently being reorganised. This provides an opportunity to consider whether some of the other functions of the Department, particularly conveyancing on sales of estates of Mental Health Act patients, could be carried out more effectively by local solicitors. Solicitors would be invited to compete for contracts on an agency basis which might produc public expenditure savings. (The current cost of conveyancing is £115,000 per annum.) It is hoped to conduct the review early in the New Year and to implement any recommendations as soon as practicable thereafter, probably during 1983/84. Suitors' funds in county courts At present, suitors' funds in county courts are handled by the Paymaster General. If the clearing banks were able to provide a more economical and more efficient service, this Department would undoubtedly benefit by way of lower bank charges and better administrative arrangements. The main staff savings would fall to the Paymaster General's Office. However, the financial disadvantages might outweigh the manpower benefits; the overnight balance is currently estimated to be about £20m. I understand that the Accounts and Purchasing Division of the Treasury intend to include the banking of suitors' funds in their service-wide review of banking arrangements. I am therefore not in a position to provide details of the timing and possible savings. Enforcement of debts Your letter also asked for details about those functions which have been contracted out since the Government took office. We have none to report. But steps have been taken to enable the enforcement of certain judgments to be contracted-out during the course of 1983/84. The Administration of Justice Bill provides for county court judgment debts of between £2,000 and £5,000 to be enforced, if the creditor so chooses, by the Under-Sheriff's Office (private sector) instead of the county court bailiffs (public sector) as the law presently requires. After the Bill has completed its passage, further work on subordinate legislation and administrative arrangements will be necessary to give effect to this change. Savings will depend upon the extent to which judgment creditors avail themselves of the new arrangements. These cannot be predicted, but are unlikly to be significant. However, ../3

the Lord Chancellor will hold the matter under review in order to decide, whether in the light of experience, it is in the public interest further to broaden the area of choice.

Yours sincerely,

D.E. Stoff

D E STAFF Private Secretary

P.S. I am sending a copy of this letter to the recipients of yours.

CONFIDENTIAL SETV



DEPARTMENT OF TRANSPORT 2 MARSHAM STREET LONDON SWIP 3EB

01-212 3434

5 November 1982

The Rt Hon Patrick Jenkin MP Secretary of State for Industry Department of Industry Ashdown House 123 Victoria Street LONDON SW1

DISPUTE BETWEEN THE BRITISH STEEL CORPORATION AND THE BRITISH TRANSPORT DOCKS BOARD

As we agreed when we discussed this matter on 1 November I have again been over the issues with the Chairman of BTDB to see whether there was any further ground which might be given by BTDB as a basis for a quick settlement out of court. But there clearly is not - at least as far as the Docks Board and their City advisers are concerned. And the City advisers, Kleinwort Benson and Cazenove, are unequivocal in their view that there can be no successful flotation until the issue is settled.

The Board are also quite clear that, in their present offer, they have already gone as far as they responsibly can. It has meant offering concessions on a long-standing contract (based on Treasury requirements for capital investment at the time) which will significantly reduce the value of the Board's business and hence its sale price. They defend having moved this far on the grounds that the changes involve a re-scheduling rather than a re-negotiation of the contract. But they feel, quite rightly in my view, that they have now stretched to the limit the bounds of both financial propriety and business prudence; and they have gone this far only to assist the Government in achieving its political objective of an early privatisation, not in response to the special pleading of BSC. To give way to BSC on this contract would have serious "knock-on" consequences for the Board's many other similar long-term contract: Our independent advice is that these would cast a shadow of uncertainty over future revenues from contract-based operations which would effectively prevent a successful flotation.

CONFIDENTIAL

Of course I fully recognise that BSC's single-minded aim in all this is to reduce their costs. That is wholly commendable. It is their approach that is worrying. To withhold substantial payments under a long-standing contract as a means of bringing pressure to bear on the much smaller BTDB to re-negotiate the contract is not the right way to do business. To condone that approach would be to undermine business confidence in contractual relationships with the nationalised industries which are in difficulties.

From the Government's point of view the question is one of political priorities. If we agree, as surely we must, that the privatisation of BTDB is the immediate political priority in this case, then Ian MacGregor must be persuaded to accept the existing contract as a business reality, however unpalatable, and settle on the basis of BTDB's concessionary offer. If he is not - and, as you know, the Government has no powers to intervene - then BTDB will withdraw their present offer, which has been put forward explicitly "without prejudice", and the matter will go before the court at the earliest on 12 January. The Board are confident of the strength of their case, and BSC will have to face the prospect of an adverse decision on the basis of the contract without the concessions at present on the table. It is difficult to see how the game can be worth the candle from their point of view other than as a convenient delaying device.

It goes without saying that it should be quite unnecessary for two state Corporations to go to such lengths over an issue of this kind. But it would be really intolerable if what must be a relatively small matter for BSC were to be allowed to frustrate our privatisation policy in this case by recourse to tactical delaying devices of this kind. I hope you can now persuade Ian MacGregor to accept the concessions BSC have already obtained and settle this business quickly so that this sale can go ahead in January as we want. A settlement on these terms would be an improvement from BSC's point of view

CONFIDENTIAL

and of course there will be nothing to prevent BSC from pursuing their cost-reducing objectives with a privatised BTDB in the normal course of business.

Unless you can get Ian MacGregor's agreement to settle within the next few days I see no alternative but to tell our merchant bank that a January sale is off. We cannot have them stimulating interest in the City only to cancel the sale at the last moment. Before taking this step I would of course want to discuss the situation with our colleagues.

I am copying this to the Prime Minister, Geoffrey Howe, Nicholas Edwards, Nicholas Ridley, Norman Lamont and to Sir Robert Armstrong.

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DAVID HOWELL

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Management and Personnel Office Whitehall London SW1A 2AZ Telephone 01-273 4400 GTN 273 4400

4 November 1982

The Rt Hon Sir Geoffrey Howe, QC, MP Chancellor of the Exchequer HM Treasury Parliament Street LONDON SW1P 3AG

Prime Minister 2

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PRIVATISATION AND CONTRACTING OUT

I have considered the scope for privatisation and contracting out in MPO.

The nature of MPO's functions provides very little scope for contracting out to the private sector. Recruitment, Civil Service training and MPO central policy responsibilities do need to be led, managed and primarily staffed by civil servants. However we have for many years made use of outside people for training and recruitment purposes and I am anxious that we should extend this practice when it makes sense to do so.

The Civil Service College uses many outside lecturers and is likely to do so more widely as College staff numbers are cut to meet the 1 April 1984 target. The College is also alert to the possibility of "farming out" courses to other bodies when good courses are available at acceptable cost. More generally, the department is in touch with other departments about the scope for contracting out their training work when the key considerations of quality, relevance and cost point that way. Some 20% of all Civil Service training was bought outside last year and this does not include the considerable outside input to departmentally run courses.

The Civil Service Commission has also for many years used outsiders on its selection boards as the most economical way of providing Chairmen and because the use of outside "experts" as members of boards ensures that successful candidates measure up to outside standards in the professional field. The Commission also uses outside people in examination work.

The Medical Advisory Service uses doctors on a fee paid basis to help in its responsibility for monitoring and maintaining the health standards of civil servants. It is in the process of establishing a network of Assistant Divisional Medical Officers paid on a sessional basis as a more efficient and effective way of coping with this task.

We also have a number of consultancy assignments to supplement the work of staff in the central policy area of the department - for example in connection with the Financial Management Initiative (2 full-time and 2 part-time consultants in the joint MPO/Treasury Financial Management Unit) and the forms review (a 3 year contract with Reading University and a 2 year contract with the Plain English Campaign).

Total expenditure on the use of outside people and consultancy assignments is currently about $7\frac{1}{2}\%$ of the MPO's total budget. This expenditure will rise to nearly $8\frac{1}{2}\%$ on a comparable basis by 1985-86.

On the domestic front the major expense of cleaning was contracted out in the early days of CSD. Earlier this year we stopped using PSA's car service for official visits by our senior staff (except, for practical reasons, for myself and the Second Permanent Secretary) and contracted out the work to a private hire service. The outlay and therefore savings are small but the arrangement has met MPO's needs more effectively.

For the future, next'year after MPO's move to GOGGS has been completed, we shall review our departmental van services (provided in fact by PSA) on need and cost grounds following the move to repayment from 1 April 1983. There may be scope for contracting out but it is too early to say one way or the other.

After the move to GOGGS the need for security guards will reduce; but it is intended to review the patrol arrangements at the Civil Service College, Sunningdale. The catering arrangements there will also be looked at in the light of a current comparative study of outside practice.

In summary you will have gathered that MPO's contribution to future privatisation or contracting out must of necessity be fairly small - partly because so much work is already handled on a contract basis. Our domestic plans are still tentative and therefore expenditure and savings in 1982/83 and 1983/84 cannot be firmly stated. In any event however the amounts involved would be small.

I am copying this letter to the Prime Minister, Cabinet colleagues and Sir Robert Armstrong.

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Northern Ireland Office
Stormont Castle
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The Rt Hon Sir Geoffrey Howe QC MP Chancellor of the Exchequer Treasury Chambers Parliament Street LONDON SWIP 3AG

1 Garage

3 November 1982

CONTRACTING OUT

I am writing in response to your letter of IL August to Willie Whitelaw as the second part of the exercise initiated by the Prime Minister in July. I wrote to you on 23 September about Privatisation.

My Departments have now reported to me on progress made and possible new initiatives for contracting out. As the Report enclosed with this letter indicates, progress is continuing and further likely candidates have emerged.

We regard progress in this area as being particularly important in Northern Ireland where the public sector occupies an even more dominant position than in the rest of the UK. There are some distinctive factors constraining contracting out in Northern Ireland, including some lack of capacity, expertise and competition in the local private sector and security considerations, but our different arrangements for many traditional local authority functions can to a limited extent increase the opportunities where these functions are directly carried out by Northern Ireland Departments.

As the Report shows we will be continuing to seek to promote the involvement of the private sector whenever it is helpful to do so including in such areas as the Health Service and Departments will continue to monitor all the initiatives in Great Britain for possible



application here.

I am copying this letter and the Report to the Prime Minister, members of E Committee and to Sir Robert Armstrong.

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AGRICULTURE

Present Position

Three targets have been achieved:

- Over 90% of routine tuberculosis testing is now undertaken by private practitioners;
- 80% of minor watercourse maintenance is contracted out;
- Virtually all urban main drainage is done by contractors.

 Additionally, appropriate work on other arterial drainage schemes is contracted out from time to time.

Further Development

Certain functions which had previously been considered for privatisation, eg milk recording, pig classification, artificial insemination and quarantine may provide suitable candidates for contracting out if privatisation is not successful.

INDUSTRY AND EMPLOYMENT

Present Position

Custodial services at <u>Enterprise Ulster</u> (a Government sponsored direct labour organisation) have been transferred to outside contractors with estimated savings of £75,000 in a full year.

A review of the Northern Ireland Electricity Service has revealed a potential for contracting out electrical applicance work. Much such work

is already contracted out but changes of policy have been introduced which now present further opportunities. Tender documents have been prepared for . contracting out canteen services at Government Training Centres.

Further Development

Contracting out and privatisation are of considerable interest to the new

Industrial Development Board established in September this year. The IDB

already uses private agencies in certain fields such as direct mailing, advertising and promotional activities, but wishes to consider the matter further as it develops its work.

ROADS, WATER AND TRANSPORT

Present Position

The Department of the Environment (NI) is the Roads and Water Authority for NI, and the scope for contracting out design and construction work has been examined. Consultants are employed for certain categories of work. At present some 60-70% of water and sewage design work is done outside and operational work is shared between water service staff and contractors. In the Roads Service all major new works are contracted out but on maintenance and minor works the private sector has been shown to be not necessarily more efficient than in-house operation.

The Department will continue to monitor the balance between in-house and contract work and adjust accordingly. A major review of the arrangements for the maintenance of the plant and vehicle fleet, principally used by the Roads and Water Service, is in progress with the possible outcome that at least some of the work could be contracted out.

The DOE(NI) is the recipient of a large number of <u>public liability</u> claims. Arrangements are in hand to review the handling of these claims and to consider the possibility of using insurance brokers for their processing.

All vehicle testing in NI takes place at Government centres. The activity had previously been considered

as a candidate for contracting out but rejected on security grounds. At the request of Ministers, the position is being reviewed again and a report is expected from the RUC/NIO shortly.

HOUSING

Present Position

Considerable privatisation has taken place - sale of houses, provision of mortgages by building societies and development of the Co-ownership Housing Association. Extensive use has been made of private solicitors in the implementation of the <u>Housing Executive house sales programme</u> and in certain cases private estate agents have also been employed.

Further Development

The prime candidate is the <u>landscape</u> and <u>grounds maintenance</u> function of the NI Housing Executive.

ENVIRONMENTAL SERVICES

Present Position

Collection and disposal of refuse has been discussed with the local authorities

and the Department is keeping in touch with action in GB. As this service, is one of the major functions of NI District Councils they are rather more reductant to transfer it than some of their GB counterparts.

Further Development

The DOR(NI) Lands Service which has been mentioned in a previous report on privatisation has been the subject of a recently completed Rayner Study. Future action in this area awaits the outcome of that exercise.

DCE(NI) are presently examining means of comparing the cost of in-house Graphic Services with the cost of obtaining a similar service from a private firm.

EDUCATION

Present Position

Most school building, sport and recreation capital work is already contracted out. In addition to the actual construction work, a considerable proportion of the planning work involved is also contracted out by Education and Library Boards, voluntary authorities and District Councils. The Department and the Boards employ some professional staff to ensure that correct building standards are maintained.

Roughly one-third of school transport is provided by the Education and Library Boards where the public transport authorities are unable to make satisfactory arrangements. There is a lack of suitable private sector operators. However, before putting buses on new routes Boards advertise school transport contracts and both public transport companies and private operators are invited to tender.



The contracting out of school meals was considered by a working party in 1979. It concluded that caterers were only interested in large schools where substantial profits might be made and would be unwilling to provide a general service which would incorporate small rural schools. However, one of the five Education and Library Boards has agreed to institute more detailed studies to determine the precise costings of contracting out and consequent effects on public expenditure.

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The Department is also examining the possibility of contracting out the <u>running of leisure centres</u> or individual services within existing sports complexes such as cleaning, cafeteria, caretaking etc. These facilities are managed by the District Councils.

HEALTH SERVICES

Present Postion

Previous investigations on contracting out had indicated that cleaning,
laundry and catering services could be considered as suitable canditates
but the apparent lack of capacity in the private sector in Northern Ireland
was a major drawback. The Department has been following closely developments
in contracting out these services in the NHS in England where Regional Health
Authorities have been requested to test the commercial market in a positive
way during 1983. This approach may not prove very productive in NI where the
market is smaller and few, if any, outside firms may be interested. However,
DHSS(NI) have asked DHSS(L) for an approved list of catering and domestic
cleaning firms in England and will be contacting them, and also the Association
of British Launderers and Cleaners, about possible interest in work in NI.

Given a reasonably favourable response the Department proposes to suggest that the NI Health and Social Services Boards should test the market in the rest of the UK as well as in NI.

Additionally, it is now Department policy to ask Boards to consider the merits of contracting out <u>laundry services</u> in situations where new investment is being contemplated. DHSS(NI) has asked one of its HPSS Boards to consider contracting out laundry services rather than to proceed with substantial capital investments. A full investment appraisal will be required before any proposal for capital investment will be approved.

DHSS(NI) currently undertake in the region of 10-15% of architectural and building design services in-house and this is considered to be the minimum necessary to retain professional staff and specialist knowledge.

Further Development

A discussion document prepared by DHSS(L) relating to potential areas for the use of outside contractors in the context of building maintenance is awaited. A report (following a local review) suggested more extended use of outside contractors on estate management. This report is presently the subject of consideration by the Health Boards in consultation with Departments.

DHSS(NI) also propose to draw the new Industrial Development Board into the debate about what can be done to <u>stimulate commercial interest</u> in the delivery of health support services.

LAW, ORDER AND POLICE SERVICES

Present Position

All catering in the Police Authority to the value of £2.25m in the current financial year is now contracted out as is virtually all building and maintenance work to a value of around £10m in this financial year. Some 30% of design and planning work is undertaken by consultants while an estimated £1.2m will be spent in this financial year on maintenance work undertaken by private garages on police vehicles as against £2.1m in the Police Authority's own workshops. The cleaning of the Visitors Centre at HMP Maze formerly undertaken by Prison Officer Staff, has now been contracted out and a contract has been let to a private security firm to carry cash to two of our prison establishments. We are currently examining the extension of the service to other prisons.

Some work on the telecommunications side, eg CCTV and Public Address/Bomb Alarms Installations has been contracted out but experience here has not been satisfactory. The systems require excessive maintenance and the NIO has concluded that the scope for contracting out is limited.

Further Developments

Subject to the overriding security constraints the NIO is considering contracting out <u>cleaning services</u> for the Police Authority. This work costs around £1m per annum and there should be a possibility of using outside staff in at least some areas

OTHER PUBLIC SERVICES

Present Position

Northern Ireland Departments, in general, still use in-house cleaning services but where possible do employ contract cleaners. A major exercise to improve the efficiency and effectiveness of the cleaning services is well under may and when this is completed we propose to further examine the cost and effectiveness of our cleaning services against those of outside contractors. We estimate potential savings of £1.3m in in-house services by means of this exercise. NI Departments are alert to the possibility of using private security firms where appropriate and do so in many instances. Considerable savings are being effected by the installation of intruder detection systems as an alternative to security guards.

Further Development

An increase in contracting out computer services is envisaged. A balance will need to be struck between essential Government requirements, probable increase in cost and the need to develop the use of the new and advanced technologies so as to improve the performance and efficiency of the Government service. The most profitable areas are likely to be accounting, engineering and agriculture.

Prime Ministry & Mrs 4/11 SWYDDFA GYMREIG WELSH OFFICE **GWYDYR HOUSE GWYDYR** HOUSE WHITEHALL LONDON SWIA 2ER WHITEHALL LONDON SWIA 2ER Tel. 01-233 3000 (Switsfwrdd) Tel. 01-233 3000 (Switchboard) 01-2336106 (Llinell Union) 01-233 610@irect Line) Oddi wrth Ysgrifennydd Gwladci Cymru The Rt Hon Nicholas Edwards MP From The Secretary of State for Wales November 1982 CONFIDENTIAL Gen. THE CONTRACTING OUT OF PUBLIC SECTOR FUNCTIONS I have now completed my review of all my Department's activities on contracting out. I attach a report dealing with the specific issues raised in your letter of 11 August to Willie Whitelaw and in the more recent letter of 18 October. As to the scope for contracting out, my responsibilities broadly fall into two categories: those activities directly carried out by the Welsh Office and more indirectly areas such as local government, the Welsh Development Agency (which has already contracted out its construction and maintenance work) Pistrict Health Authorities and the Welsh Water Authority where I can influence but not directly control future planning. I have encouraged the extension of contracting out in these areas and this has already borne some fruit - particularly, as my report shows, with the District Health Authorities and I believe there will be further progress including assessments of financial consequences to report. On the more direct Departmental activities contracting out has been used wherever possible for a number of years. For example my Transport and Highways Group has never employed a Road Construction Unit and the bulk of design work on trunk roads and motorway schemes in Wales has been, and continues to be, undertaken by private consultants. I am sending copies of this letter to all members of the Cabinet, the Attorney General, the Lord Advocate, Sir Robert Armstrong and to John Sparrow. Non The Rt Hon Sir Geoffrey Howe QC MP Chancellor of the Exchequer HM Treasury Parliament Street LONDON



WELSH OFFICE PROGRESS REPORT ON THE CONTRACTING OUT OF PUBLIC SECTOR FUNCTIONS

PART I - DEPARTMENTAL FUNCTIONS

(Numbering of functions and categorisation as in CPRS report of July 1981)

1. Contract Cleaning: Category A (Departments generally); A(W.O.)

- 1. All main Welsh Office domestic office cleaning and window cleaning is contracted out. (See Item 1.xiv. on page C6 of CPRS report.) This is the case also in WOAD as far as window cleaning is concerned but there are some 21½ [cleaners directly employed in various offices, a number of which are in small out stations unlikely to attract a contractor. But further contracting out needs to be considered.
- 2. Caerphilly Castle, Castell Coch and Tintern Abbey are already cleaned by contractors. Caermarfon Castle is a possibility, which might reduce the direct labour force by one. The remaining ancient monuments will be looked at but scope for further contracting out is not anticipated.
- 3. [Contract cleaning could produce savings in the Health Service. The industry is ready to meet the specialised needs of the DHSS and has sought a meeting with the Department. AHA Chairmen are to be invited to consider the potential advantages.

2. Management Consultants: Category B (Departments generally); A? (W.O.)

- 4. The Welsh Office has little direct experience of the use of management consultants. The possibility is being explored of contracting out the management of the oil depot at Llanreath, Pembroke Dock, which the Department holds for use in the event of a major oil tanker disaster off the west coast of Wales.
- 5. The scope for the use of management consultants by the NHS in Wales is regarded as limited, because AHAs have their own management services teams with the kind of specialised knowledge of the Health Service which outsiders lack. Moreover, since consultants of repute are expensive to employ, the Department would advise AHAs to consider each case carefully before committing funds for this purpose.

3. Agency Staff: Category B (Departments generally); C (W.O.)

- 6. The Welsh Office shares the generally held view (See item 3.9 on page C8 of the CPRS report) that agency staff would be employed only if absolutely necessary, since it is very expensive to do so.
- 4. Computing Services and Staff: Category B (Departments generally); B/A (W.O.)
 - 7. The Welsh Office is considering the introduction of mini and micro computers in order to save money spent on bureaux services (of the order of £100,000 per year) and improve departmental control. This is the approach also of the Department of Energy, which has decided to reduce the amount of contracting out to computer bureaux for the same reason (Para. 21(ii) on page 7 of Part I of the CPRS report.)
 - 8. In England, RHA Chairmen have agreed proposals by the DHSS which is now preparing specific advice on the use of commercial computing services where computing package development would otherwise have to be undertaken by the NHS. Against this background, the Welsh Office is looking into policy on NHS computing in Wales.

Training: Category B (Departments generally); C (W.O.)

9. The Welsh Office relies in the main on internal training facilities, the Civil Service College and other specialist facilities within Government Departments. The Department is alert to the possibility of using outside contractors if a need were perceived in specific areas and subject to considerations of quality, relevance and cost (Para. 18 on page C13 of Part I of the CPRS report.) An example of such usage is for aerial photography (see para. 23 below.).

6. Security Staff: Category B (Departments generally); B/C (W.O.)

10. The CSD's continuing view is that the present extent of contracting out is about right and that the use of contract staff is generally more expensive. (Para. 20 on page C13 of Part I of CPRS report). The present position in the Welsh Office is that private contractors provide security cover in both Cathays Park buildings throughout the day and night: This is the cheaper arrangement but, following the industrial action in 1980, recruitment of Welsh Office staff to provide daytime cover has been agreed by the Secretary of State.

7(a). Catering (CISCO): Category C (Departments generally); C (W.O.)

11. CSD contend that substantial contracting out could only be achieved at additional cost but that individual cases should be decided on their merits since, at the margin, some contracting out may be feasible. The Welsh Office is watching the progress of a comparative study of CISCO and private catering for the snack bar in the Treasury, with a view, possibly, to 'read across' of the results.

7(b). Catering (NHS): Category A (DHSS(NI)); C (DHSS); C (W.O.)

12. The Welsh Office agrees with DHSS that contracting out is inhibited by private caterers' lack of expertise in the specialised field of hospital catering, lower cost and higher efficiency of directly provided services, and union and staff opposition. But there may be some limited scope in future for using contractors for specific local problems which cannot be solved within the NHS.

9(a). Architectural and Building Design Work (Arcient Monuments): Category A (PSA generally); B (W.O.)

13. Preservation work on monuments requires staff experienced in the needs of this kind of work and the Welsh Office Ancient Monuments Branch will, therefore, always need to employ its own architects. There is scope for the employment of outside architects in the design of such structures as ticket offices, toilets and display centres where the work, although archaeologically and aesthetically or lighting installations. Use has already been made of consultants for these purposes and will continue to be made in the future, but work of this kind does not form a large part of the architects' workload and is unlikely, on its own, to give scope for a staff reduction. Engineering consultants are being used this year at a cost of £10,000.

9(c). Architectural and Building Design Work (NHS): Category ? (Departments generally); B (W.O.)

14. The principle of using outside contractors is already accepted. Around 70% of the work is already contracted out by WHTSO and AHAs in Wales. No further scope is foreseen but the situation will continue to be monitored.

- 11. Research and Development: Category ? (Departments generally); ? (W.O.)
 - 15. The greater part of the R&D sponsored by the Welsh Office is carried out by public sector institutions. There would seem to be little scope for further privatisation. An inter-departmental committee is looking at the possibilities in the industrial field.
 - 16. If the recent (and still Confidential) decision to close the National Building Agency is confirmed, there will be a need to consider continuing the kind of work done by it in Wales by contracting out to other research organisations. The current cost of housing research carried out in Wales through the Agency is about £70,000 in 1981/82.
- a.51(12(d)Building Maintenance and New Works (Ancient Monuments):

 Category A (Departments generally); B (W.O.)
 - 17. Special skills, e.g. in consolidation of old stonework to match the style of the original, have been built up by the Department's direct labour force over many years and are not to be found in the general building trade. A archaeological work which would lead to difficulty in timing if contractors were painted woodwork and for special stonework preservation (£7,000 in 1981/82).
 - 18. There is scope for use of outside contractors for construction and maintenance of ancillary structures. In 1981/82 it is estimated that out of a total £37,854 will be expended through contractors. Comparable figures for ancillary maintenance are £52,615 and £44,115.
 - 13(c). Transport Services (NHS): Category C (Departments generally); B/? (W.O.) 14(c). Vehicle Maintenance (NHS): Category B (Departments generally); B/? (W.O.)
 - 19. The results of the DHSS Central Management Services Study on the relative merits of different maintenance arrangements for NHS vehicles will be made available to the Welsh Office and action in Wales then considered. Already, cover 40% of the maintenance undertaken on ambulance transport in Wales is be invited again to consider the potential advantages of contracting out.
 - 15. Cartographic Services: Category A (Departments generally); B (W.O.)
 - 20. All printing work is contracted out through HMSO, which determines which agency (including HMSO itself) should do the work. The Welsh Office is charged by HMSO for handling the work. Were the Department able to negotiate directly with the printer, the procedure would often be more efficient and the handling charge (up to 15% of the total) would be saved.
 - 21. Less than half of photographic processing is contracted out, but the proportion is falling now that there are improved facilities for in-house work in the new building. The major constraint now is the size that can be photographed with the camera available. Work in-house saves time and cost. For example, production of proof maps from the Special Community Review artwork, essential for accurate checking pruposes, would cost at least £44,000 in the private sector compared with £14,000 in-house. Time is saved because work can go directly from the drawing board to the darkroom and back.

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- 22. Artwork is all done in-house. Work is taken on only if it is specifically related to the functions of Welsh Office Divisions and considered by them to be essential; extraneous work and work not relevant to a cartographic function has now been dropped.
- 23. Outside consultants (the National College of Agricultural Engineering) were used for a training course in aerial photography.
- 24. All the Ancient Monuments Branch's photography is already done by contract Estimated expenditure for 1981/82 is £25,000.
- 25. Cost, security and convenience are the factors inhibiting contracting out. Even where work could be contracted out at a competitive rate, difficulties would arise since much of the work requires access to Departmental records and since there are no firms in Wales which could offer work of the necessary quality. Using firms in South East England would increase communications costs There are also specific reasons for maintaining an in-house capability: the need for recording work such as the Land Use Records and River Variation Orders and the need for a secure and priority service.
- 26. It is considered that the Welsh Office contracts out all that it is possible or effective to put out. External costs are monitored regularly as a check. It would be possible to contract out more Drawing Office work but only at a substantially greater cost than in-house work. 'Read across' of DOE experience is not applicable since the Welsh Office's cartographic services reflect those of many of the major functional Departments in Whitehall.
- 16. Legal Services: Category C (Departments generally); A (W.O.)
 - 27. The Welsh Office has considered carefully the arguments for and against contracting out NHS litigation and conveyancing work currently done by the Legal Division. The Secretary of State endorsed recently a recommendation to retain litigation work, the privatisation of which was considered contrary to the public interest since there could be no confidence in the maintenance of the quality, promptness and consistency of advice to the NHS.
 - 28. The advantage of having one central source of professional expertise applied in the case of conveyancing also, but the increasing backlog of casework was a complicating factor. The Secretary of State therefore decided in favour of keeping the backlog under control by limiting the number of cases on hand to those which can be dealt with by the existing staff and putting the significant number of remaining cases out to private solicitors. There will be a review after 12 months to judge how the private solicitors are coping with a view to considering further moves in the same direction.
- 29. The possibility of 'reading across' from the Department of Trade's Rayner Scrutiny, which includes the option of utilising outside lawyers for prosecution work, will be examined. It has been hinted that there might be recommendation for setting up of a network of solicitors to act for Departments and for a greater use of agent solicitors, subject to certain provisions (Para 60 on pag C29 of the CPRS report.). The second secon

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- 19. Design and Supervision of Major Road Schemes: Category A (DTp); B (W.O.)
 - 30. The communications and signalling system for the M4 Motorway in South Wales, which has been substantially completed since the early 70's, and for many other of the Welsh Office's trunk road improvement schemes, has been designed by Consulting Engineers rather than by Welsh Office staff. During this period the number of the Department's Electrical Engineers has been reduced from 4 to 2. It will be the policy to employ Consultants to the maximum extent possible in the design of the communications and signalling systems needed for the planned trunk road improvement schemes, although no further reduction in the number of Welsh Office Electrical Engineers can now be expected.
 - 31. Reference is made in the CPRS report (para. 63ii on page C31) to the fact that the RCU Organisation has never applied in Wales and that Consulting Engineers (rather than local authorities acting as Agents) are responsible for preparation and design work on most of Welsh trunk road improvement schemes. This applies not only to the major schemes (over £1m) but to the smaller improvement schemes as well. For example, the Department has used Consulting Engineers to design and supervise a number of trunk road bridge reconstruction schemes of under £1m value and also culvert replacement schemes. In all the Department is using some 21 firms of Consulting Engineers for its road improvement schemes and also 8 firms of architects.
- 21(a).NHS Functions: Use of Outside Health Contractors: Category A (Departments generally); A (W.O.)
 - 32. A circular similar to that issued in England (para. 65i on page C33 of the CPRS report) has been issued in Wales, encouraging the extension of co-operation between the NHS and the independent medical sector.
- 21(b). NHS Functions: Laundry Services: Category A (Departments generally); A (W.O.)
 - 33. As in England, experience in Wales has shown that commercial laundries cannot offer as comprehensive a service at a comparable cost. There is also resistance to taking foul wash so that the NHS would still be involved in part of the laundering function by having to service foul wash before passing it on. However, AHAs will be asked to consider the use of private contractors when new capital schemes are designed.

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- 21(c).NHS Functions: Manufacture of Blood Products: Category C (IHSS): C (W.O.)
 - 34. Wales does not have a Blood Products Laboratory. Blood products are prepared for England and Wales, mainly at a central laboratory, from raw materials supplied by Regional Transfussion Centres. DHSS Ministers have decided that there is no satisfactory basis for commercial involvement without serious risk to the voluntary blood donor programme (para. 67 on page C34 of CPRS report.
- 24. Publishing: Category ? (Departments generally); B (W.O.)
 - 35. A major recommendation of the Rayner report on the Statistical Services of the Welsh Office was that use of HMSO services for publications should cease. It was agreed subsequently to implement the recommendation by purchasing word processors and going to private printers for the statistical publications with which the word processors could not cope. Use of word processors retains the work in-house and going to a private printer with one or two publications will result only in contracting out by the WO rather than by HMSO.

Restoration of Opencast Sites

Brucellous Testing

30. Tuberculin Production

Category ? (MAFF) 31. Laboratory Work for the Intervention Board for Agricultural Produce

36. Functions 28-30 primarily relate to ADAS, which is still operating on an England and Wales basis, and the Welsh Office will be kept informed of progress. Function 31 is the responsibility of MAFF alone.

Land and Estate Management: Category? (MAFF); C/B (W.O.)

- 37. The Welsh Office is seeking to dispose of its land holdings. It would therefore be impracticable to consider contracting out at this stage.
- 38. In-house estate surveyors carry out letting of property and assessment of rents. They use the Inland Revenue valuation service as agents for purchases of monuments and claims for compensation (some 5 cases per annum). The possibility of contracting out any of this work has not been considered but any saving in staff would be marginal.
- 39. Land surveys are an essential part of the restoration and recording work of the Ancient Monuments Branch. Large land surveys are contracted out (at an estimated cost of £13,600 in 1981/82) whereas small surveys are carried out in-house by a staff of 2 who fit them in with other work. Further contracting out is unlikely to lead to staff savings.
- 40. Custodians and sales staff man 24 monuments. The possibility of contracting out is being considered by the DOE and the Welsh Office will explore the feasibility of 'reading across' to Wales.
- 41. The bulk of archaeological work is carried out by agents (4 archaeological Trusts, the University of Wales and the National Museum) or by casual appointment of specialists.

38. Ground Maintenance: Category ? (MoD); B (W.O.)

- 42. The largest item, grass cutting, is done by contractor at the 24 monuments in Anglesey and at Caerleon, Caerphilly Castle, Monmouth Great House and Tintern Abbey at an estimated cost of £31,000 in 1981/82). Custodians, key keepers or directly employed labour do the work at 80 other monuments. There would be no staff reduction of custodians or key keepers if the work were contracted out but there could theoretically be a saving of 2 or 22 on directly employed labour. But there are practical disadvantages, since the employees do other work, such as checks and small repairs, and the use of contractors, even if they were attracted to working at the sites, would involve visits by supervisors. A grounds maintenance consultant is already employed at £6,000 per annum.
- 39. Pharmaceutical Manufacturing: Category ? (DHSS); ? (W.O.)
 - 43. Comparisons between what it costs to manufacture pharmaceuticals in-house as opposed to obtaining them from commercial companies are being made in England. The Welsh Office intends to ask AHA Treasurers to co-operate in devising a standard method of costing NHS pharmaceutical operations on the lines of the English exercise (page B2 of CPRS report.).

47. Housing: Insulation Grants Appeal: Category A (W.O.)

44. As reported in the CPRS report (page B3) some progress has been made in contracting out the work on appeals into Departmental decisions on insulation grants in respect of properties affected by road schemes. The value of work undertaken in 1980/81 was £53,000 and £30,000 worth of contracts are expected to be let this year. The use of firms of architects to supervise the installation of noise insulation is likely to increase at the expense of the National Building Agency, if it closes, and the local authorities.

Functions not listed in the CPRS report

Family Practitioner Services: Category C (W.O.)

- 45. These services have been considered anew. The vast majority of such services are, of course already fully contracted out in that medical and dental general practitioners, chemist contractors and opticians have the status of independent contractors, their contract with the Department being a contract to provide services, not a contract of service. There is obviously no scope for further contracting out in such circumstances.
- 46. The exception is the Welsh Pricing Bureau, a service provided by WHTSO, which is responsible for analysing and costing prescriptions. There is a proposal that the work of the Bureau should be computerised and it could be said that the computerisation process is a candidate for contracting out: against this however is the fact that the corresponding Prescription Pricing Authority in England is already in process of being computerised and that it would be absurd for the corresponding function in Wales to be carried out differently. The only logical answer is for the Welsh Pricing Bureau to take advantage of the development work which has already been done and to adopt a similar, and fully compatible system. The service should not be contracted out.

Aerial Surveillance of Inshore Waters: Category A (MAFF, DANI, W.O.)

47. Following the disbandment of the RAF Squadron which, until earlier this year, covered UK inshore waters for purposes of aerial surveillance, Fisheries Departments (other than DAFS, who operate independently) have considered the employment of civilian aircraft. Initial estimates of the cost were less than half the £570,000 per annum cost of an MoD Sea Heron Service. A trial with a civilian aircraft is in progress with a view to proceeding to a long-term contract. Inter-Departmental financial arrangements are under consideration.

PART 2. LOCAL AUTHORITY FUNCTIONS

- 48. In the fields of activity within the jurisdiction of LG Division action awaits publication of the outcome of DOE's research project aimed at identifying useful examples of current contracting out practice in local environmental services. Limited scope is anticipated but the mounting of a propaganda exercise with Welsh local authorities is supported.
- 49. It is thought possible that private sector planning consultants might be used for the structure and local plans work of local planning authorities. Whether this possibility will be broached by DOE is not known.
- 50. No reference to DHSS is made in this Part of the CPRS report, which must reflect the inherent difficulties in the way of hiving off any significant parts of the functions of the social services authorities. One cannot envisage, for

7

example, the private sector being entrusted with the child care functions of such an authority. Minor segments of the social services function might be a different matter. Some services are already partly privatised eg boarding houses etc for mentally handicapped and other groups in care. In addition local authorities might be encouraged to entrust home help responsibilities to contractors, and the same could conceivably apply to cooking and cleaning functions in residential homes. However, repercussions on the part of the relevant trades unions could be expected and it would be unrealistic to believe that the Welsh Office could make any significant progress on these lines in the absence of a DHSS lead.

PSD 30 September 1981

12(c) Building Maintenance (NHS): Category A (DHSS(NI);? (Departments generally); B (W.O.)

51. AHAs in Wales do make use of outside contractors, especially for maintenance of specialist equipment and work which by its intermittent nature does not justify the employment of full-time staff. Routine building maintenance is carried out by direct labour, which has the advantage of giving emergency cover and flexibility. But AHA Chairmen will be invited again to consider the potential advantages of contracting out.

CONFIDENTIAL



Prime Minister &

ECURITY FUS 29/10

DEPARTMENT OF HEALTH & SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SEI 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

The Rt Hon Sir Geoffrey Howe QC MP Chancellor of the Exchequer Treasury Chambers Great George Street LONDON SW1

29 October 1982

Dear Shandlos

In her minute of 28 July, the Prime Minister asked Departmental Ministers to report to you on their plans for further measures of privatisation.

Health Services

The private health sector is a mixture of voluntary, charitable and commercial enterprises, ranging from small nursing homes to modern hospitals, capable of undertaking major surgery. A number of the hospitals and nursing homes are run by religious foundations. Health Authorities use some of the facilities on a contractual basis. Many beds in longstay private nursing homes are for example occupied by patients paid for by the National Health Service. Substantial numbers of doctors work in both the National Health Service and private hospitals.

The size of the independent sector is comparatively small, but the benefits to the National Health Service of there being a partnership between the State and the private sector are out of all proportion. The development of private facilities draws on other sources of finance and increases total health care provision in the country and, therefore, helps to bridge the gap between the supply of health care and demand. The private sector can relieve pressure on hard-pressed NHS services either directly or by allowing the NHS to direct resources to other areas.

Our strategy therefore is to build a proper partnership between the public sector and private and voluntary services. I am aiming to break down artificial barriers to co-operation between different agencies and to use the contribution of private health care to best effect.

E.R.

To this end I have asked Arnold Elton to chair a small Party working group to look at co-operation between the NHS and the private health care sector.

Contracting Out

I shall be sending you very shortly a fuller account of progress and prospects for contracting out in response to your letter of 11 August to Willie Whitelaw.

I shall shortly require authorities to seek tenders for all maintenance contracts in excess of £15,000 (which should lead to an increase in private work - already substantial) and the amount of in-house building and engineering design is now on average less than 40 per cent. Another area is the use of independent accountants to audit the accounts of health authorities; I have decided on a trial to test their value.

Land

A review of possibilities for disposing of surplus NHS land and property is well advanced.

Manufacture of products by the NHS

Many health authorities make products for use in hospitals. I shall shortly be advising authorities that they should manufacture products only when it is clearly more economical to do so than to buy them, or when no suitable product is otherwise available. The new policy will in general apply to medical equipment and supplies for diagnostic, therapeutic and rehabilitation purposes and to most pharmaceutical products for medical use.

NHS Supplies

Following a Rayner scrutiny last year, we have already transferred most of the health care industry export promotion work previously undertaken by the Department to the independent British Health Care Export Council and are discussing with industry how far the rest of the work can be transferred to the private sector.

Responsibility for NHS supplies is vested in the Supplies Council, a statutorily independent health authority. The Council is reviewing, with the help of consultants, the possibility of making more use of the private sector in storing and distributing NHS supplies. My officials are in touch with this work, though results are not expected until next year.

The Department undertakes important and necessary work in evaluating NHS equipment and testing prostheses. We shall be considering whether some of this work can be undertaken by independent test houses such as that run by the British Standards Institute. We shall also review the possibility of manufacturers being assessed against our guide to good manufacturing practice by an independent body. Those aspects will, however, need to be discussed with industry (who may well resist), the Supply Council and other bodies concerned. I would not expect results before next year.

E.R.

Personal Social Services

Most of the services provided by local authority social services departments are aimed at needs which in the bulk of cases are already met privately - by families, by friends and neighbours, and by formally organised voluntary effort. The social services exist as a safety net for those with no other source of care and I do not think it would be possible to redefine local authorities' responsibilities by leaving some of them entirely to private agencies. Local authorities can, however, be encouraged to discharge their responsibilities by purchasing private and voluntary services on behalf of clients.

I am copying this letter to other Cabinet colleagues and to Sir Robert Armstrong.

your sineway,

David blash

. NORMAN FOWLER

(Approved by the Secretary of State and signed in his absence)

CONFIDENTIAL

Prime Minster D Mrs 28/10

QUEEN ANNE'S GATE LONDON SWIH 9AT

7 October 1982

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Deargethy

THE CONTRACTING OUT OF PUBLIC SECTOR FUNCTIONS

You asked in your letter of 11 August for a report by the end of October on progress to date with contracting out and the further measures that might be taken. The information that follows was assembled on the basis of your original request and does not, therefore, cover all the ground suggested in your Private Secretary's letter of 18 October. I have asked for such additional material as is readily available to be assembled quickly and I shall send that to you as soon as I can. In the meantime I hope you will find the following helpful.

As you know, our principal efforts in this area have been directed towards the privatisation of domestic services at the thirteen residential training establishments for which the Home Office is responsible. The exercise is being conducted in three phases and is planned to be completed by September 1983. It has to date been found feasible and profitable, to contract out catering, housekeeping and security services, but the privatisation of other services such as transport and gardening has so far proved to be impracticable on either financial or management grounds.

In the first phase contracts were awarded for the provision of services at three establishments - the Police Training Centres at Bruche and Chantmarle and the Prison Service College, Wakefield (Love Lane). The contracts, each for three years have been in operation since 1 April 1982, and performance so far has been satisfactory. The three contracts should cost about £986,000 in 1982/83. This represents an estimated financial saving of over £300,000 and a staff saving of over 160.

In the second phase contracts have been awarded for catering, housekeeping and security services at four establishments - Ryton Police Training Centre, the Police Staff College, Bramshill, the Central Planning Unit, Pannal Ash, and the Prison Officers Training School at Leyhill. In addition contracts have been let for catering and housekeeping services at Ashford Police Training Centre where the company to which the contract was originally given withdrew. The contracts will operate from January 1983 and discussions with successful contractors are in progress about arrangements for handover and recruitment of staff. The annual cost of the contracts at the five establishments is estimated at £1,590,000 and financial savings at about £650,000. There is a probably saving of about 250 staff.

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We are now embarked upon the third phase. Privatisation studies are already in progress at the Fire Service College, Moreton; the Police Training Centres at Dishforth and Cwmbran, the Prison Service College, Wakefield (Aberford Road) and the Home Defence College, Easingwold. The aim is to invite tenders in November and to take decisions in February/March 1983 for the introduction of the contracts in September 1983. We would hope to achieve annual financial savings on these contracts in excess of £650,000 and there are potential staff savings of about 290.

Contracts have been awarded to Grandmet Catering Services Ltd. for services at Bruche, Chantmarle and Ryton Police Training Centres, the Prison Service College (Love Lane) and the Prison Officers Training School, Leyhill. The Sutcliffe Catering Company (North) has obtained the contract for Pannal Ash and ARA Food Services Ltd., from Bramshill. At Ashford the contracts are being let to Pennine Catering Services for catering and County Cleaning Contractors for housekeeping.

The cost of redundancy compensation (and payments in lieu of notice) is estimated as:

First phase	(actual)	£300,000	
Second phase	(estimated)	£450,000	
Third phase	(estimated)	£500,000	
		£1,250,000	

The cost of redundancy payments in the first phase at each establishment has been more than covered by savings in the first year.

The trade unions - industrial and non-industrial - have been consulted and kept informed at all stages. They have stated their objection to the principle of privatisation but have so far taken no action to impede progress. All other interested parties have been kept fully informed. Most now seem reluctantly to accept the financial case for privatisation, but there is still strong opposition from the Association of Metropolitan Authorities and particularly from some AMA-dominated local authorities' committees for the Police Training Centres.

The staff savings achieved and in prospect are, of course, essential to offset demand-led growth in Home Office central and administrative services, particularly in the immigration, police support and radio regulatory areas.

Aside from the residential training establishments, there is extensive contracting out of work on prison design, construction and maintenance. Over 90% of the new design work is undertaken by professional nominated firms and expenditure on professional fees in 1981-82 amounted to some £7 million. Prison building is mainly undertaken by contractors, although to a limited extent direct labour (prison works staff supervising inmates) is employed. An increasing proportion of work on the maintenance of staff quarters is also being done by outside term contracts and 100 prison establishments have planned maintenance schemes for mechanical and

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engineering installations, the documentation for which is provided by private firms. Sales of property are also handled by appointed agents.

In the field of transfer services we are at present operating 228 contracts for the conveyance of prisoners and escorts by taxi, mini-bus and coach and the number of contracts placed is likely to remain around this figure in future years. The annual value is around £3.5 million. Freight transport is also widely contracted out to a value of around £1.2 milllion a year; the bulk of this relates to the activities of prison industries and farms and gardens. We are currently engaged on a detailed examination of the transport arrangements for the main distribution networks for prison farm produce with a view to contracting out all the delivery work if there is a cost advantage.

As for fleet maintenance, the 1,040 vehicles in the Home Office fleet are operated from 200 different locations spread around England and Wales. Almost all local units already use commercial garages for the maintenance and repair of their vehicles. The exceptions are those major repairs, usually to heavy vehicles, for which there is a cost advantage in putting the work to our vehicle repair depot at Swindon, having regard to such considerations as urgency and the distance involved. The role and effectiveness of the Swindon Depot are, however, under review.

Our Directorate of Telecommunications has for some time used contractors for the installation of large control systems and radio link assemblies. We expect to spend about £0.3 million on contract labour this year and about £1 million in 1983/84. This increased use of private contractors stems from decisions at the World Administrative Radio Conference 1979, which require all police and fire VHF systems to be converted to new frequencies. On present plans we shall be using contractors for radio surveys; the technical evaluation of some new equipment; the provision of foundations for temporary masts; and the erection, dismantling and transportation of temporary equipment cabins and masts at hill-top sites.

Contract cleaning now operates in all our London headquarters buildings with the exception of the Ministerial suite on the 6th and 7th floors at Queen Anne's Gate which, for security reasons, must continue to be serviced by directly employed cleaners. 68 contracts, three apportioned costs and sixteen agreements covering office and window cleaning plus an additional agreement for pest control have been negotiated.

I hope this information goes some way to meeting your propose. I shall, as I say, let you have the additional factual information requested by your Private Secretary as soon as I can.

CONFIDENTIAL Prime Minish 2 3 Mcs 28/10 gd. Jv. DEPARTMENT OF EDUCATION AND SCIENCE ELIZABETH HOUSE, YORK ROAD, LONDON SEI 7PH TELEPHONE 01-928 9222 FROM THE SECRETARY OF STATE The Rt Hon Sir Geoffrey Howe QC MP Chancellor of the Exchequer Treasury Parliament Street London SWIP 3AG **27** October 1982 I can Gotfrey. THE CONTRACTING OUT OF PUBLIC SECTOR FUNCTIONS Thank you for sending me a copy of your letter of 11 August to Willie Whitelaw on the scope for further contracting out of public sector functions. I do not think that we can realistically expect to see contracting out on a major scale or at an early date for the provision of school education. Our aim is to look towards greater opportunities for parents and students alike to opt, if they wish, for the independent sector. We have already introduced the assisted places scheme to enable pupils who might otherwise not be able to do so to be educated at independent schools. Even with the present limited intake, the cost will eventually build up to £30m a year, with little by way of identifiable offsetting savings to local authorities. As you know from my speech to the Party Conference, I am also considering the role of vouchers and "open enrolment" in increasing the choice to parents between the maintained and independent sectors and willing The maintained scctor This is not to say that I rule out the contracting out of particular functions in schools. But experience so far suggests that this is unlikely to lead to a more effective use of resources in many areas. A number of local education authorities have looked at the scope for contracting out the school meals service; but this is not an attractive commercial proposition because there is an upper limit to demand confined to a small part of the day on only about half the days in the year. The unattractiveness to commercial operators is underlined by the one experiment that has gone ahead so far: an experimental one year contract has been awarded in Essex to a Colchester firm to operate the catering at Clacton County High School from this September. The tender was slightly above the Authority's estimate for their own service at the time and, in the case of a similar tender for catering at a primary school (which is not to go ahead), the lowest tender received was double the costs of the Authority's school meals service. Neville Bosworth's experience in Birmingham is similar. CONFIDENTIAL

We have no evidence either of local education authorities being able to gain significantly from contracting out their cleaning for schools. Croydon experimented with this but had to terminate the initial contract involving two schools because of problems with the unions. However, the experience of the experiment and a review of the possibility of contracting out all its school cleaning has enabled Croydon to bring about savings of about one-sixth (£0.3m) in its direct labour cleaning budget. This demonstrates the greater willingness of unions to change previous conditions of service and practices when faced with the alternative of contracting out. I believe that there is some scope for cutting costs and manpower and improving the quality of the school cleaning service.

I shall consider what more I can do to encourage contracting out in the local authority education service in the light of Michael Heseltine's response of 19 October to your specific request for a report on local government generally. In the process I will pay particular attention to school cleaning: the decision must be for individual authorities, but they need to be aware of the scope for savings.

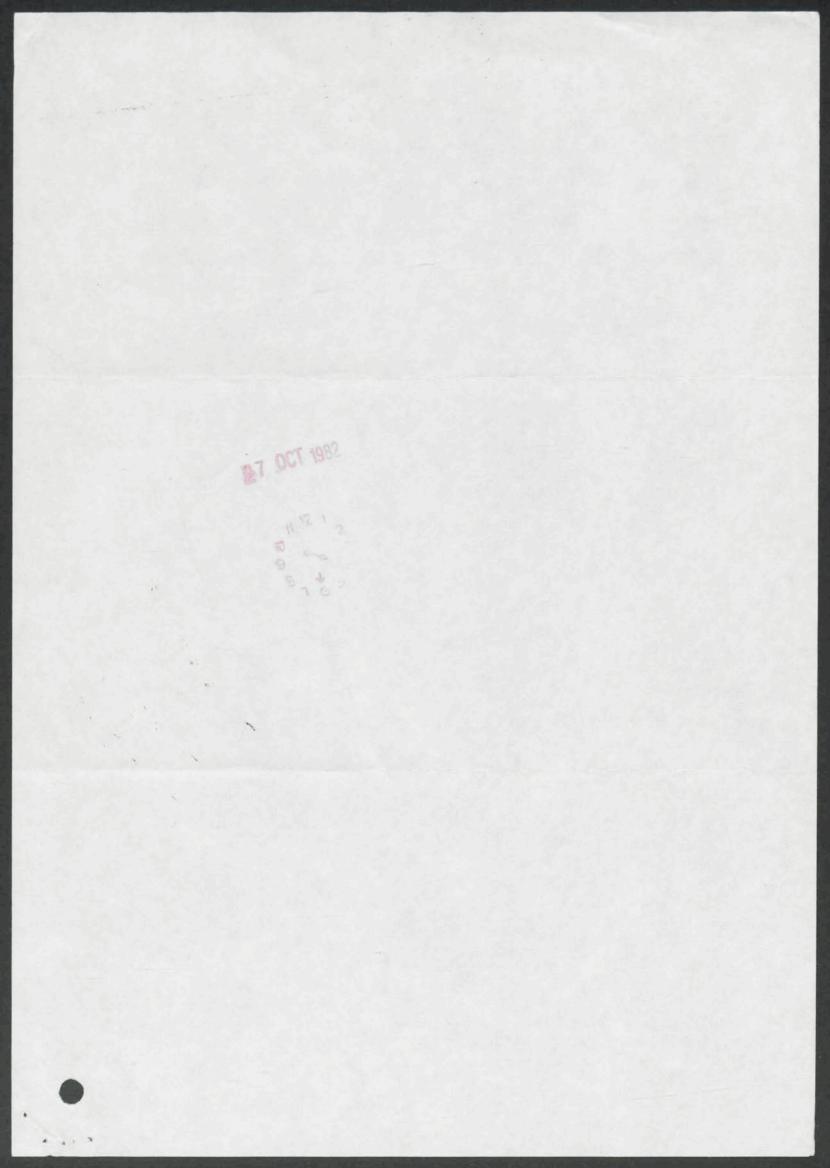
The universities are already private institutions. As you know, my aim is to see these become less dependent upon the tax-payer. My officials are in touch with yours about the part which the tax system might play in this and I also await some further views from those I have approached within the universities. I hope also to put some firm proposals to you soon about loans for student maintenance - again, I fear, with associated extra short-term costs as a condition of much larger long term savings. Again, I think it is right that we should expect higher education institutions to exploit their resources to the full and to undertake consultancies for the private sector so as to increase their income. Cranfield Institute of Technology is the pace-setter here; but it is a specialised institution and does not face what is a major barrier for polytechnics and other maintained colleges, namely the legislation which restricts the trading activities of local authorities. I am looking further into-this.

Finally, there are my Department's own activities. The executive tasks (such as pensions administration, preparation of statistics and the administration of postgraduate awards) have been the subject of recent Rayner scrutinies and there is little scope for contracting out except perhaps in the case of the administration of some postgraduate awards, which I am pursuing. Otherwise the Department makes use of private contractors for particular services (including office cleaning) and research and that will continue.

To sum up - and here I refer specifically to your Private Secretary's letter of 18 October - there has been no contracting out of education services since we took office and there are no plans for this year or next. Looking ahead over a much longer period, I believe that there is scope, by the different routes to which I have referred, for a substantial reduction in the extent to which the cost of education is met from public funds. The price will be some smaller short term additions. I cannot be more precise at this stage.

I am copying this letter to the Prime Minister, other members of the Cabinet, the Attorney General, the Lord Advocate, Sir Robert Armstrong and John Sparrow.

Lun.



CONFIDENTIAL



DEPARTMENT OF TRANSPORT 2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

Prime think (2)

Ms 22/10

20 October 1982

Dea Petrice

The Rt Hon Patrick Jenkin MP Secretary of State for Industry

Department of Industry

123 Victoria Street

Ashdown House

LONDON SW1

DISPUTE BETWEEN THE BRITISH STEEL CORPORATION AND THE BRITISH TRANSPORT DOCKS BOARD

I wrote to you about this on 4 June, and there have since been discussions between our officials. BTDB have been attempting to resolve the deadlock with the BSC, but so far with a total lack of success. In addition, as your people know, the BTDB commissioned a report from Price Waterhouse, jointly with my Department, to examine the figures and assess their implications for the successful flotation of BTDB, and your people have had a summary of the conclusions of that report. This has also gone to Treasury officials.

I recognise that BSC have many more difficult and apparently pressing issues to deal with, and that this is making great demands on your time. But it has now become extremely urgent to settle the dispute if flotation is to be practicable in January next as we, plan. The purpose of this letter is to suggest that, despite all the other difficulties, we really must have an early talk, and then quickly see Ian MacGregor thereafter.

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BTDB are convinced that they have right on their side. They take the view that there is a legal agreement on which they are entitled to rely. But in an attempt to get a solution they have already made an offer of substantial concessions to BSC which would, as I am advised, reduce the likely value of the BTDB business, overall, by at least £5m. Price Waterhouse have confirmed that the concessions which BTDB have offered are substantial. However, BSC are pressing for a radically different agreement which would, in the view of the merchant bank advising me on the flotation, reduce the total value of the business to an extent that would put the possibility of any flotation at all at risk.

Put simply, Kleinworts advise me that we cannot hope to proceed with a successful flotation until this dispute has been resolved. Furthermore, flotation will be endangered if BTDB are forced to make concessions going beyond the offer they have already made. The amount at issue for the BSC may seem small in their terms, but the results are crucial if we are to float half the shares in BTDB, which is of course a very much smaller commercial undertaking.

In my view, and despite all the other graver issues facing the BSC, it has now become a political priority that Ian MacGregor should be persuaded to settle this matter, more or less on the basis already offered by BTDB. If the matter goes to the Courts, BTDB are confident that they will win. But the delay involved will make flotation impossible in January, and it is far from clear that flotation will be practicable this Parliament. That seems to me an intolerable prospect.

I am sending copies of this letter to the Prime Minister, Geoffrey Howe, Nicholas Edwards, Nicholas Ridley and Norman : Lamont.

1) and

DAVID HOWELL

CUNFIDENTIAL



Rime Minister 2

2 MARSHAM STREET LONDON SWIP 3EB

ms 22/10

My ref:

01-212 3434

Your ref:

Coctober 1982

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PRIVATISATION AND CONTRACTING OUT

The Prime Minister's minute of 29 July asked us to report to you on further opportunities for privatisation. In your minute of 11 August you then asked for a further report on contracting out, making specific reference to local government and to the NHS.

I had already put in hand work covering the whole range of opportunities from full privatisation to contracting out following receipt of the Prime Minister's original request and our discussions and MISC 14 on 29 July (MISC 14(82)3rd). On receiving your request I decided that, rather than draw too rigid a distinction between privatisation and contracting out, it would be preferable to allow the work to continue and present a full report on both as soon as possible. This means that we have advanced slightly the appraisal of local government services ahead of your October deadline.

// I am therefore enlosing 2 papers. The first deals with the DOE, Ordnance Survey and related public bodies (excluding local authorities). The second deals with local government.

I should appreciate an early discussion with you on how best to take forward the discussion with colleagues.

I am copying this to the Prime Minister, to members of $\boldsymbol{\Xi}$ and to Sir Robert Armstrong.

MICHAEL HESELTINE

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PRIVATISATION AND CONTRACTING OUT IN LOCAL GOVERNMENT TE BY THE SECRETARY OF STATE FOR THE ENVIRONMENT

- 1. This paper reports the progress we have made since we took office in both privatisation and contracting-out in local government. In the services for which I have Departmental responsibility we have so far:
 - i. dramatically increased the sale of council houses. By April 1984 up to two-thirds of a million houses (out of perhaps 1.5m potentially in the market in Great Britain) will have been sold to sitting tenants under Right to Buy;
 - ii. forced local authority direct labour organisations (DLOs) to compete with the private sector for construction and maintenance work; and
 - iii. seen the beginnings of a transfer of refuse collection and street cleaning services to private firms (Southend and Wandsworth are the leading examples).
- 2. In each of these areas there is more do do. In housing I want to achieve a still higher rate of sales of vacant local authority dwellings by changes in the subsidy rules and by some legislative changes. The contracting-out of housing management is a major new area of local government activity for privatisation in which I intend to exert what influence I can on authorities to set an example. I also want to see more building professional services being provided for local authorities by the private sector rather than be carried out by local authorities in-house staff. An important step forward in this area will be the introduction of the option of private sector building control certification in next Session's Housing Bill.
- 3. For <u>DLOs</u> I want to see further reductions in the amount of new work and maintenance work that can be done without competition below

he £50,000 and £10,000 thresholds respectively as from 1 April 1983, and to allow tenants to do more minor repairs themselves.

- 4. In refuse collection and street cleaning my colleagues and I will increase, over the coming months, the work of persuasion to which we have already devoted much effort and which is now beginning to show the first results. I have accepted an invitation to address a conference in November organised jointly by the CBI and the Local Government Chronicle at which representatives of local authorities and of contractors will discuss the lessons not only of recent experience in such places as Southend and Wandsworth but also of contracting-out other services.
- 5. There are varying degrees of scope for increasing contracting-out in the other DOE local government services land use planning, sport and recreation, countryside functions and minor environmental services.
- 6. Further details for all these services are set out in the annex.
- 7. For all the services for which I am responsible I have asked my officials to examine in detail the scope for further development in the involvement of the private sector and the means by which is can be secured. In particular I have in mind the production, for each service, of a short handbook which would help local authorities to deal with the practical problems involved in the contracting-out of services.
- 8. I believe that a similar approach would yield valuable results in local government services for which other Departments are responsible.

MH 19 October 1982



HOUSING

Ownership

By April 1984 up to two thirds of a million council houses in GB (out of perhaps 1.5m potentially in the market) will have been sold to sitting tenants under Right to Buy. In addition, there is government encouragement for the improvement for sale, homesteading and the sale of vacant properties. Legislation is being prepared for the next Session to extend RTB.

Management and Maintenance

Repairs and maintenance work is subject to the compulsory competitive tendering provisions of the Local Government and Planning Act 1980. Ministers are considering the scope for increasing the amount of work to be subject to the provisions. Day-to-day repairs are contracted out wholly or partially by some authorities but not others. Guidance will shortly be issued to all local authorities on the substantial scope which exists under present legislation for more small housing maintenance work to be carried out by the tenants themselves. Some 150 authorities use Giro for rent collection. On housing management generally we propose to explore with selected authorities the scope for contracting out the entire management of council estates, subject to appropriate reservations or safeguards for the exercise of LA democratic functions (eg rent fixing, clearance and improvement), statutory duties (eg homelessness) letting policies, tenants' rights and social welfare matters.

Direct Labour Organisations:

- 1. Part III of the Local Government Planning and Land Act 1980 introduced legislative controls over all construction and maintenance work undertaken by directly employed local authority staff (DLCs)
- 2. In essence the controls oblige DLOs to operate on a trading fund basis and to compete with private sector construction firms for a substantial proportion of their work. The main features are:
 - (i) All income and expenditure must be properly accounted for in separate DIO accounts.
 - (ii) DLOs must operate so as to cover all their costs and in addition make a positive rate of return (currently 5% in CCA terms) on capital employed.
 - (iii) DLOs must compete with contractors for
 - (a) Highways and Sewerage work:
 - all jobs of new construction or maintenance individually valued at over £50,000.
 - (b) All other building work:
 - all jobs of new work individually valued at over £50,000, and one third (by total value) of jobs below this threshold;
 - all jobs of maintenance individually valued at over £10,000, and 30% (by total value) of jobs below this threshold.
 - (iv) DLOs must prepare prior written estimates for all jobs undertaken, and may not credit more than these amounts as their income.
 - (v) DLOs must publish balance sheets, revenue accounts, and statements of rate of return achieved giving a true and fair view of their activities; and, in addition, an annual report on their DLO activities.
 - (vi) The Secretary of State has powers to call for special reports from individual DLOs which fail to perform satisfactorily, and may thereafter impose special conditions on them or close them down.
 - 3. Consideration is being given to further reductions as from 1 April 1983, of the amount of new work and maintenance work that can be done without competition below the £50,000 and £10,000 thresholds ((iii) above). (The thresholds are set by Order).

3) CAL GOVERNMENT BUILDING PROFESSIONAL SERVICES (ARCHITECTURAL, SURVEYING AND ENGINEERING)

Contracting Out

Most local authorities already contract out varying amounts of their building professional mainstream services. Private practice is extensively used to supplement an authority's own in-house capacity or to obtain a particularly specialised professional expertise. We are discussing with local authorities the implementation of the Monopolies and Merger Commission ruling on competition on professional fees. This should lead local authorities to compare the costs of their in-house service with competitive bids from private consultants.

Privatisation

One London borough has privatised its architectural services using a private practice set up by professional staff previously employed by the authority. A number of authorities, particularly the small district councils which have no consistent demand for quantity surveying and (to a lesser extent) architectural services, maintain no inhouse capacity and use private practice as the need arises. A few others, (eg Birmingham) are now exploring the possibility of privatising professional building services as part of their wider consideration of the scope for privatising or contracting out a range of services.

The responsibility of professional staff in this area may in include financial appraisal of local authority capital investments, the supervision of commissions and preparation of design briefs.



(4) REFUSE COLLECTION, CLEANSING AND WASTE DISPOSAL

Activity

Refuse Collection

Power to collect household waste without change and trade and other refuse at a reasonable change (Sections 72 and 73 Public Health Act 1936).

Present Position

Majority of household waste collected by District Councils, with some collected under contract e.g. Southend, Wandsworth etc Collection of industrial waste almost entirely in private sector hands.

Scope for Further Development

Extension of Contracting out could be achieved by developing performance controls akin to those supplied to DLOs by L.G.P.I Act 1980. Details would need further study but might include enforcing acceptance of lowest tender and mandatory code of practice on tendering procedures.

Street Cleansing

Duty Polocal authorities to cleanse highways for purposes of public health/road safety. Standard of discretion of local authority/ courts (Section 22, Control of Pollution Act 1974)

- Majority District Councils with recent examples of contracting out e.g. Wandsworth, Southend etc

Ditto

Waste Disposal

Power to enable local authority to provide places for deposit of refuse and plant or apparatus for treating/disposing of waste. (Section 76 Public Health Act 1936. Duty to make adequate arrangements under Section 1 Control of Pollution Act 1974 not yet implemented) Control and monitoring duty (imposed by licensing provisions of Control of Pollution Act 1974)

Disposal of industrial waste already in private sector hands. County Councils provide majority of disposal outlets for household waste although a proportion of transport routes and disposal sites in private sector hands (e.g. London)

Decrease private sector provision of disposal facilities, by contracting out, through extension of performance controls on local authority operations. Feasibility needs further study. Also possible scope for contracting out technical element of local authority monitoring function

(5) PLANNING

Activity

Preparation of structure and other plans under Town and Country Planning Acts and carrying out of related studies.

Present Position

Function of county and district councils. Some use already made of consultants to carry out studies.

Scope for Further Development

Possible further scope for contract-ing-out planning studies, but authorities should not be encouraged to commission elaborate and expensive surveys.

(6) SPORT AND RECREATION SERVICES

Activity

Provision and management of facilities (swimming pools, sports centres, golf courses etc)

Present Position

Some contracting-out of management

Scope for Further Development

Increased contractingout of management of facilities, including involvement of voluntary sector.



(7)

COUNTRYSILE AND RURAL AFFAIRS

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PRESENT POSITION

SCOPE FOR FURTHER DEVELOPMENT

'Countryside' functions

Local authorities provide various facilities, eg country parks, picnic sites, caravan sites, car parks and study centres. Some existing private sector

Possible scope for more privatisation, and contracting of ancillary services and maintenance. But some facilities (eg country parks) hare to make self-supporting and charges would detract from

provision.

role in diverting demand from areas subject to heavy recreational pressures.

Allotments

80% of allotments provided by local authorities; less than 20% by private associations.

May be some scope for increased private (including voluntary) activity. Likely to be highly controversial.

Paths, Bridleways tree preservation

Probably some contracting out of maintenance.

Could be scope for further contracting out of, mainly, maintenance functions and possibly of some administrative tasks.



(8) MISCELLANEOUS ENVIRONMENTAL SERVICES

ACTIVITY

PRESENT POSITION

SCOPE FOR FURTHER DEVELOPMENT

Public Conveniences

A small number of authorities are known to have contracted out maintenance and staffing of conveniences.

Considerable for contracting out. But with prevalent levels of vandalism, a new regime would be likely to involve a new approach to the level of charges for use.

Public Laundries and non-swimming baths

The public provision of these services is in decline with the availability of laundrettes and private facilities.

Little further scope: privatisation already very substantial.

Markets

Some authorities have already handed over the operation of their markets to private firms. These are presumed to be markets operated under charter or presumed charter. The position of markets acquired or established under public general Act powers or acquired or established under local Acts is less certain.

Markets established under public general Act powers cannot at present be leased.

Considerable in principle, but would be controversial.

NOTE BY THE SECRETARY OF STATE FOR THE ENVIRONMENT

PRIVATISATION AND CONTRACTING OUT OF SERVICES IN DOE(C), PSA, ORDNANCE SURVEY AND RELATED PUBLIC BODIES (EXCLUDING LOCAL GOVERNMENT)

Introduction

Much has already been done to reduce the involvement of the Government in particular, and the public sector in general, in the services for which my Department is directly or indirectly responsible. This has been achieved mainly through the contracting out of services but also by the hiving off of functions to independent bodies or to private companies. A summary of the present position is given in the attached schedule.

Definitions

For the purposes of this paper the definition of 'privatisation' has been drawn widely to include not only the transfer of responsibility for particular services to the private sector, but also transfers from the Department to new independent bodies. 'Contracting out' indicates the transfer of service delivery to private agencies and also covers new joint ventures involving public and private finance. These terms have been employed in the attached schedule, which also distinguishes between achievements to date (at 1.9.82) and proposals in hand or under investigation, noting in particular what will have been achieved by the end of this financial year.

The functions listed are those of DOE(C)(including common services also provided to DTp), the Property Services Agency, the Ordnance Survey and related public bodies - but exclude the work of local government (which is the subject of a separate paper).

Privatisation

The main privatisation initiative, in the first sense, has been the setting up of a private company to take over the activities of the Hydraulics Research Station (at present 250 staff are still on secondment from the Department). The Countryside Commission became an independent body on 1 April and the decision to set up a new public sector agency to bring together a number of existing bodies dealing with ancient monuments and historic buildings, which I announced on 16 June, will, subject to the successful passage of legislation, lead to a reduction in Civil Service posts of 1,000 or more. It will also provide a great opportunity to improve the standard of care of the Nation's heritage and incidentally to reduce by at least one the number of public sector bodies in this field.

Officials have been instructed to take a further hard look at the scope for privatisation in the water industry. We are holding open the possibility of a major privatisation project in the Mersey area. We have also had initial contacts with Thames WA about possibilities in their area and shall shortly be approaching other authorities. We have compiled a list of private firms with the known expertise to construct and run major installations and are starting to explore with them in general terms the problems that are likely to arise with privatisation. The water authority objectives recently agreed by colleagues have now been sent to Chairmen and the opportunity of a recent meeting with Chief Executives was used to draw their attention to the importance which Ministers attach to the extension of suitable opportunities for private sector participation. We intend to study French practice, where private companies play a major part in the provision of water services, to see what lessons it holds for us.

Contracting out

PSA's work is already very substantially contracted-out, including all new construction work, 80% of maintenance, 40% of design work, and all property margeting. In all £1,950m of 1982/3 forecast spend of £2,150M (ie 90%) will go to private contractors, consultants

and suppliers. This reflects policies we have implemented since 1979. Further progress including out-house design work rising to 60% is planned, as summarised in Section II of the table.

I expect water authorities to contract out as much as possible of their functions: 90% of capital works and 30% of design and supervision work are already contracted out. Possibilities for the future include leasing recreational facilities and fishing rights, and contracting out operations such as sludge disposal, plant maintenance, emergency repairs and the design, construction and operation of major new works. The water authorities are already doing some of these things but I am setting in hand further work on the extent to which contracting out already takes place in the water industry and to ensure through the exchange of information that all water authorities do so where the benefits are clearly established — I have specifically asked for DLO work to be included in this review.

Other examples are the development work of the Ordnance Survey (section III of the table) and, in a somewhat different context, the arrangements that I have put in hand for the greater use of private consultants in the planning inspectorate. There is scope for further developments of this kind, especially in the PSA.

The involvement of private finance in joint ventures has been achieved by the Ordnance Survey and is a feature of our inner city initiatives. Elsewhere I have backed an experimental environmental improvement scheme mounted by the Countryside Commission to involve private interests in the rehabilitation of derelict land on the fringe of towns.

MINIS

I have been able to use MINIS as a means of prompting and monitoring progress in these fields but in the next round, which is about to begin, there will be a specific instruction for each directorate to consider the scope for further privatisation and contracting out.

Next Steps

Meanwhile there is much further work to be done on the development of initiatives already identified, and if colleagues are content with the proposals illustrated in this paper and its annex officials will continue as indicated.

MH Department of the Environment October 1982

PRIVATISATION AND CONTRACTING OUT: DOE(C), PSA, ORDNANCE SURVEY AND RELATED PUBLIC BODIES



I DOE(C)

1 FUNCTIONS	2 ACTION TO I	DATE (1.9.82)	(and Progress ex	OR FURTHER ACTION (pected by April 83)
	i)PRIVATISATION	contracting out	i) PRIVATISATION	CONTRACTING OUT
1. Establishments* a) Cleaning Services		Cleaning services have been put out to contract in all major buildings for which DOE(C)/DTp are responsible, except the northern Regional Office, the Metropolitan and Northern Traffic Area Offices (DTp), the Building Research Establishment and the Residential Training Centre at Cardington. Negotiations with the Civil Service Union and private contractors are in train to switch to contract cleaning at these five remaining locations.		Complete the negotiations to switch to contract cleaning at the five locations mentioned, saving 49 full-time and 157 part-time posts by April 83.

1 FUNCTIONS	ACTION TO 1	DATE (1.9.82)	POSSIBILITIES FO	OR FURTHER ACTION pected by April 83)
	PRIVATISATION	CONTRACTING OUT	1) PRIVATISATION	CONTRACTING OUT
b) Training		Whenever training requirements arise, we consider whether they can be met by outside bodies. Even where the training takes place at our own Training Centre, a fair proportion of the lecturing is contracted out to consultants.		A study is being conducted of the scope for further contracting out of the training provision to the private sector. It will be completed by the end of 1982.
*Note:	Establishments is a Departments.	common service to DOE	(C) and DTp: the retu	rns cover both
				editablishment plant pla
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FUNCTIONS	ACTION TO I)ATE (1.9.82)	POSSIBILITIES FO	OR FURTHER ACTION pected by April 83)
	PRIVATISATION	CONTRACTING OUT	PRIVATISATION	CONTRACTING OUT
2. Historic Buildings and Ancient Monuments.	Legislation is being prepared for the 1982/83 Session to set up a non-Government public sector agency to carry out certain of the Secretary of State's functions in the ancient monuments and historic buildings field. The proposal will result in a reduction in Civil Service manpower of about 1,000. b) It is hoped in the same legislation to convert the Armouries at HM Tower of London to Trustee status. 66 staff involved.	to contract out certain non- horticultural activities in the Royal Parks (toilet attendants, some litter collection) with a potential saving of some 45 Civil Service posts. b. 40 private contract Inspectors and 40 employed by		Examination in hand of the scope for contracting out further activities in the Royal Parks. It will be well advanced by April and could be complete by July 83.

FUNCTIONS	ACTION TO DATE (1.9.82)		POSSIBILITIES FOR FURTHER ACTION (and Progress expected by April 83)	
	i) PRIVATISATION	CONTRACTING OUT	PRIVATISATION CONTRACTING OUT	
		e. Some 50% of design work for projects at ancient monuments is now put out to private sector.		
3. Planning a) Cartographers b) Planning Inspectorate		The Inspectorate's present part-time force of about 50 includes 12 consultants in private practice. On the Secretary of State's instructions the total part-time reserve is being increased to 100 by taking on more private consultants. Phased recruitment of the extra consultants is now under way		

1 FUNCTIONS	ACTION TO D	ATE (1.9.82)	POSSIBILITIES FO	OR FURTHER ACTION pected by April 83)
	PRIVATISATION	CONTRACTING OUT	PRIVATISATION	CONTRACTING OUT
4. Research a) HRS	HRS Limited began trading on the 1 April 82 under a Board of Directors appointed by the Secretary of State. 245 staff were seconded to work for the company from that date. The Board have obtained a number of organisations as guarantors of the company and plan to hold their first AGM in October.			
b) BRE	The Government have already announced that a Board of Management is to be appointed, one task of which will be to examine ways of increasing cost recovery either by operating a trading fund or establishing a private company.			The recent Rayner Review of Support Services has identified scope for contracting out in workshops and site security for which arrangements will be in hand by April 83. The further follow up work may identify other opportunities.
0				



I DOE(C) - Continued

1 FUNCTIONS	2 ACTION TO DATE (1.9.82)		3 POSSIBILITIES FOR FURTHER ACTION (and Progress expected by April 83)	
	i) _{PRIVATISATION}	CONTRACTING OUT	i) PRIVATISATION	CONTRACTING OUT
c) Departmental Research		The policy of increasing the proportion of extramural research commissioned in the private sector has been temporarily reversed in 1981/82 by virtue of the large expenditure on radioactive waste research. At the present time only public sector contractors have the necessary facilities and expertise to execut this programme.		The Department will continue to aim for the target of 50% of our extra-mural research being contracted to the private sector by 1983/84. Effort will be concentrated on finding suitable contractors in the environmental protection and radioactive waste areas which in 82/83 employ public sector bodies for the majority of their research work.

II PROPERTY SERVICES AGENCY (PSA)

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FUNCTION	ACTION TO DATE (1.9.82)		POSSIBILITIES FOR FURTHER ACTION (and Progress expected by April 83)	
	i) PRIVATISATION	CONTRACTING OUT	PRIVATISATION	CONTRACTING OUT
a) Property Maintenance b)Design of major (£100k+) projects		Directly employed labour force (DEL) cut from 18,200 in April 1979, to 13,000. 80% of work now contracted out. In-house staff cut from 2500 in 1979 to 2000. Private consultants' share of design work raised from 26%		Policy decision alread to work which cannot be contracted out (eg running of high-security defence installations). This process is in hand and will continue as appropriate. Action in hand to cut in-house staff to 1600 by April 1984. This will raise consultants share to 60%+, on current
c) Estate Work		Increased use of private agency for: - Rent reviews - Property Marketing - Property Search - Building Measure- ment. Total fees 1982/83 (forecast) £2.5m. (1979/80, £238,000).		forecast of workload. Further experimental commissions in these and other estate fields to test costs and performance.

1	FUNCTIONS	ACTION TO I	DATE (1.9.82)	(and Progress exp	OR FURTHER ACTION pected by April 83)
		PRIVATISATION	CONTRACTING OUT	i) PRIVATISATION	CONTRACTING OUT
a)	Technical Services	"Construction" magazine, PSA,5 technical journal, sold as going concern to private publisher.			
f)	Custody Guard Service for Government Departments. PSA Supplies		Delivery of goods, packing for overseas freighting, and furniture repair* entirely contracted out. Increased use of private vehicle repair firms. *Except for a small workshop serving		PSA reviewing user Departments' require- ments in consultation with MPO Security Branch. Review will cover scope for greater use of private contractors. Completion end October 1982.
0			Palace of West- minster		

1	FUNCTIONS	ACTION TO D	ATE (1.9.82)		R FURTHER ACTION ected by April 83)
		PRIVATISATION	CONTRACTING OUT	i) PRIVATISATION	CONTRACTING OUT
	General	A Trading Fund is proposed to be set up from 1 April 1983, subject to an Order requiring Affirmative Resolution (This will permit a more commercial approach but not true privatisation)		Experience with Trading Fund may reveal scope for some true privatisa- tion, but not in this Parliament's lifetime.	
-	Establishments		Goods vehicle deliveries to field offices £49k. Office cleaning £149k.		
	Finance		General ledger Accounting system £41k.		
The state of the s	0				*

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	FUNCTIONS	ACTION TO DATE (1.9.82)		POSSIBILITIES FOR FURTHER ACTION (and Progress expected by April 83)	
		i) PRIVATISATION	11) CONTRACTING OUT	i) PRIVATISATION	CONTRACTING OUT
d)	Mapping		Digital Mapping Software Develop- ment £29k.		
			1:1250 mapping (pilot contract) £52k.		Dependent on results of pilot contracts and on resources which can be devoted
			1:2500 map revision (pilot contract) £38k.		to revision of survey (but not before April 83).
e)	Aerial Photography	ť	100% normally sub- contracted (£124k. placed since 1 April 1982).		
f)	Joint Ventures with Private Sector in Printing and Cartography		£371k. placed since 1 April 1982		Seven new ventures under examination, if commercially viable some will have been
g)	Building Maintenance			See PSA Sheet	implemented by April 83.
	0				

FUNCTIONS	ACTION TO D	ATE (1.9.82)	POSSIBILITIES FO	R FURTHER ACTION Dected by April 83)
	i) PRIVATISATION	ii) CONTRACTING OUT	PRIVATISATION	ii) CONTRACTING OUT
1. Water Authorities	Private finance route for Mersey Scheme explored; preliminary exchanges with Thames WA on possible schemes; list of private	supervision work contracted out; other functions	Continue to explore scope for privatisa-tion with TWA, NWWA other WAs and private firms and complete initial assessment of	of contracting out (including DLO work); ensure all RWAs do so where benefits have been clearly
	firms with known expertise prepared; further discussions to be arranged.	contracted out to a lesser extent.	viability by April 83; study French practice.	established. TWA pilot scheme for major project will have been formulated by April 83.
2. British Waterways Board			Proposals will be prepared before the end of 82 for further consultation with BWB and interested Departments regarding disposal of diverse BWB freight interests and non-operational estates.	
			BWB will also be encouraged to increas private investment in amentiv developments wherever possible on lines identified in a recent consultants report.	e

FUNCTIONS	ACTION TO DATE (1.9.82)		POSSIBILITIES FOR FURTHER ACTION (and Progress expected by April 83)	
	PRIVATISATION	CONTRACTING OUT	i) PRIVATISATION	CONTRACTING OUT
3. New Towns	The disposals programme is gradually transferring the new towns' property management function to the private sector. Since 1979 £280M worth of commercial and industrial property and 17% of the housing stock have been sold. Their development function now relies substantially on partnerships with the private sector.	Corporations has been applied: the total of staff employed has fallen by nearly 20% since 1979. The contracting out of maintenance work, already widespread, has been extended. New professional	disposals programme.	Continued use of consultants for new work and to replace where necessary staff who leave voluntarily Continued pressure to reduce staff numbers.
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FUNCTIONS	ACTION TO D	ACTION TO DATE (1.9.82)		POSSIBILITIES FOR FURTHER ACTION (and Progress expected by April 83)	
	i) PRIVATISATION	CONTRACTING OUT	PRIVATISATION	CONTRACTING OUT	
4. Countryside Commission	On 1.4.82 became non-Departmental body no longer agent of the Crown. 101 Civil Service posts will be saved. (Commission have now sought public comments on a Prospectus for their style of working under new status which aims at giving greater support to the voluntary bodies and private sector. Operation Ground-work in St Helens is major initial example of conservation in conjunction with private sector).		scope for contracti	ng their public espectus (which is ald possible examine ang our some research anformation services	
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FUNCTIONS	ACTION TO DATE (1.9.82)		POSSIBILITIES FOR FURTHER ACTION (and Progress expected by April 83)	
	PRIVATISATION	ii) CONTRACTING OUT	i) PRIVATISATION	11) CONTRACTING OUT
5. Nature Conservancy Council	Land purchase as nature reserves NCC encourages voluntary organisations (and industry) to purchase sites requiring protection. NCC will grant aid such purchases as an alternative to purchasing the land themselves.	NCC seeks cheapest solutions eg last annual report printed privately rather than by HMSO.	NCC is non-Department non-civil servants. Review (due for compapril 83) should in material scope for examine scope for coresearch.	icate whether privatisation. Could
6. Audit Commission	Legislation enacted to establish Commission (to be fully operational by April 83)			This will increase scope for auditing to be done by private sector (but not before April 83).
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Prime Minister 2

Treasury Chambers, Parliament Street, SWIP 3AG 01-233-3000

18 October 1982

C J Walters Esq Private Secretary to the Secretary of State for the Home Office 50 Queen Anne's Gate SW1H 9AT

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Dear Colin

THE CONTRACTING OUT OF PUBLIC SECTOR FUNCTIONS

The Chancellor wrote to the Home Secretary (copied to all members of the Cabinet) on 11 August asking colleagues to review progress on contracting out and to identify where new opportunities existed. Replies were sought by the end of October,

The first replies have now been received. We are concerned that, judging by these, not enough hard information is being provided about the scale of measures taken or planned and about the proposed timing of further action. We appreciate that it may be difficult to be precise, particularly about future plans. But, so far as possible, the replies should identify the specific services which have been contracted out in each year since the Government took office; the amount of public expenditure spent on provision prior to contracting out; and — perhaps most difficult but most interesting — the net savings in expenditure achieved or expected. As to future plans, the replies should describe any contracting out measures firmly planned in each of the financial years 1982-83 and 1983-84, again noting the amount of public expenditure involved and if possible any savings expected. Separately, possible future candidates, no matter how preliminary the plans, should be identified; some broad indication of both timing and the amount of expenditure involved would be useful.

We realise that getting this information may involved considerable work for some departments. But it is necessary if we are to prepare a paper which sets out a detailed programme of action during the remainder of the Government's term of office and summarises the main prospects in the longer term.

t replies should h?

tter to the Print Attorney General and John Sparr

Can I remind you that replies should reach the Treasury by the end of this month?

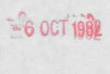
I am copying this letter to the Private Offices of all members of the Cabinet, the Attorney General, the Lord Advocate, Sir Robert Armstrong and John Sparrow.

your siceres, Morganer O'Mora

MISS M O'MARA Private Secretary

2 pps c/ IV PRIVY COUNCIL OFFICE WHITEHALL LONDON SWIA 2AT Chancellor of the Duchy of Lancaster and W 6 October 1982 Paymaster General Dear Purabe Secretary PRIVATISATION: SUSTAINING THE MOMENTUM - attacked Your letter of 23 September to Julian West asked for a report on potential candidates for privatisation. We have looked at the banking function of the Paymaster General's Office, and a copy of a note prepared by the Treasury was sent to you in July 1981. The note doubted whether privatisation was worthwhile, mainly because of the loss of very large amounts of interest-free overnight money which would result. The other major function of the office is the payment of public service pensions. It seems unlikely that the cost of an in-depth investigation of this area would be repaid, but we hope that recent Rayner studies (which included an examination of the present arrangements under which PGO pays teachers' and service pensions) will throw some light on this. One area of PGO activities which has recently been privatised is the provision of night security for the office at Crawley. Since 1 February 1982 this function has been contracted to Security Guards Limited. I am copying this letter to Private Secretaries of Cabinet Ministers and to Richard Hatfield (Cabinet Office). for smarely alex andreway A K GALLOWAY Private Secretary Miss M O'Mara Private Secretary to the Chancellor of the Exchequer

Treasury Chambers Parliament Street London SWIP 3AG







Secretary of State for Industry

The Rt Hon Geoffrey Howe QC MP Chancellor of the Exchequer HM Treasury Parliament Street London SW1 Prine Minister @ Se Ever PM

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET

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TELEPHONE DIRECT LINE 01-212 3301

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30 September 1982

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PRIVATISATION: DEPARTMENTAL RESEARCH LABORATORIES

Today I attended the launch of the National Maritime Laboratory Ltd (NMI) as a private company. We have therefore successfully completed the first of the privatisations of our laboratories which I mentioned in the Report I sent you on 16 September. We remain committed to the privatisation of the Computer Aided Design Centre (CADC) with 1 April 1983 as the target date.

- In sending over my Report I undertook to let you have my further conclusions on the Department's Research Laboratories. Apart from the privatisation of NMI and CADC we have already set up through the National Physical Laboratory (NPL) the British Calibration Service (BCS) and the National Testing Laboratory Accreditation Scheme (NATLAS). I regard the way in which these involve the private sector as wholly successful: NPL has been enabled by their existence to make its services more effective and to play an expanding role in supporting industry, without increasing Civil Service staff numbers.
- I said in my Report that discussions are being held with the customer Departments of the Laboratory of the Government Chemist (LGC) to determine what, if any, of the work they contract to the Laboratory could be done by the private sector instead. I believe that there is scope for some of this work to be transferred, and we will continue in the interim to move towards this. I must, however, continue to be assured that the Government Chemist himself remains fully able to discharge properly analytical responsibilities (some laid upon him by Acts of Parliament) which it is difficult to see being performed outside the public sector.



4 Our other laboratories (NPL, National Engineering Laboratory (NEL), and Warren Spring Laboratory (WSL)) like LGC all carry out a wide variety of work which underpins the activities of Government and industry. Wherever possible (as with BCS and NATLAS) our policy is to transfer work to the private sector and programmes of work are reviewed with this in mind. However, in view of the Prime Minister's minute, I have asked my Chief Engineer and Scientist to carry out a special review and to report back to me by the end of the year. In particular I understand that he will be looking at procedures in other countries, particularly in the USA and the Federal Republic of Germany.

5 I am sending copies of this letter to the Prime Minister and to the other member of E(DL).

Yar eve

To Ing

Econ Pol Public Sector assets



Mr Burgner

Mr Hansford Mr Mountfield

Mr R Wilson Mr Grimstone

Mr Morgan

Mr Wicks

Mr Lovell Mr Monck Mr Carey Mr Monger Mr Kitcatt Miss Kelley

CC



Treasury Chambers, Parliament Street, SWIP 3AG 01-233 3000

23 September 1982

MB PM mes 7/10

J D West Esq. Private Secretary Department of Energy

Dear Julai

PRIVATISATION: SUSTAINING THE MOMENTUM

The Prime Minister wrote to the Chancellor of the Exchequer on 28 July (personal minute M6/82) asking all members of E(DL) to initiate fresh surveys of potential candidates for privatisation. This minute was subsequently circulated to all Cabinet Ministers not on E(DL), asking them to carry out similar surveys.

The Prime Minister asked Departmental Ministers to report to the Chancellor by mid September in order that a comprehensive report could be completed by the end of the recess. The Chancellor is concerned that this timetable should not slip and would be grateful if Departmental Ministers who have not yet responded could do so as soon as possible.

I am copying this letter to Private Secretaries of all Departmental Ministers who have not yet provided a full response.

Margarer O'hara

your sinceres,

MISS M. O'MARA Private Secretary



CONFIDENTIAL

From the Secretary of State

John Kerr Esq Private Secretary to the Chancellor of the Exchequer H M Treasury Treasury Chambers Parliament Street London SWI

22 September 1982

Dear Jun,

PRIVATISATION

The Prime Minister's Personal Minute of 28 July asked that progress reports on privatisation measures already set in hand should be sent to the Chancellor by mid-September.

Thus far, as with other Departments, our privatisation measures have focused largely on the public trading sector, which offers the most obvious scope for such initiatives. On this occasion, however, we decided that we would take a particularly close look at what might be possible in the less obvious areas of our Departmental responsibilities such as some of our regulatory activities and some services to exporters. As you will know, my Secretary of State is abroad at the moment, but we hope he will be in a position to write to the Chancellor with some new possibilities in the early part of next month.

In the meantime, it may be useful for me to set out the present position on the two public sector trading bodies for which this Department is responsible.

British Airways

The enabling legislation has already been enacted (the Civil Aviation Act 1980), but progress depends on improving BA's very bad trading results. We are currently working to a target of a flotation in late 1983.

British Airports Authority

E(DL) has agreed that the possibilities of privatising BAA in the short term are ruled out by the uncertainties arising from current litigation by the airlines and, to a lesser extent, the public enquiries into the expansion of the South East airports. Nevertheless,



CONFIDENTIAL

From the Secretary of State

it seems a possible candidate for privatisation in the next Parliament, and work on this has already been set in hand. Ministers have also agreed to pursue the possibility of introducing private sector finance into BAA's investment programme during the interim period while it remains in the public sector, with a view to reducing its call on the PSBR, and work on this too has started.

I am sending a copy of this letter to Michael Scholar (No 10), the Private Secretaries to all members of E(DL), and to Richard Hatfield (Cabinet Office).

Jours sinceroly Jours Muttern

JOHN WHITLOCK Private Secretary

CONFIDENTIAL

Prim Ministra @ gf IV



MCS 21/9 OUEEN ANNE'S GATE LONDON SWIH 9AT

September 1982

PRIVATISATION

The Prime Minister minuted you on 28 July on the need to sustain the momentum of the privatisation programme and Ministers were asked to report to you by mid-September on the action being

This would rule out any early change. As a

taken within their Departments. The scope for transferring Home Office functions entirely to the private sector is inevitably limited. Over 90% of Home Office staff are employed in the Prison, Police and Immigration and Nationality Departments, where most of the tasks are by their nature appropriate to central government and the scope for privatisation is very limited. One function that might be considered for privatisation in the longer term is the provision by the Home Office Directorate of Telecommunications of telecommunications for the police, fire, prison and civil defence services. But we could not guarantee that work given up by the Directorate would go to the private sector: it might be taken up in large part by local police and fire authorities whose duty it is by statute to see that their forces and brigades are properly equipped. And it would be vital to ensure that the communications of these emergency services were

result of international agreements, the Directorate are now engaged on a nationwide programme of conversion of police and fire mobile VHF systems. It would not be feasible, save at very great risk, to contemplate any radical change in present responsibilities until

In recent months officials have looked with yours at whether the work carried out by the National TV Licence Records Office could be privatised; the conclusion was that it could not. We are also examining some further possibilities for privatisation in the area of radio regulation.

It is perhaps more realistic to think in terms of considering what further scope exists for contracting out. Our principal efforts here have been directed at the contracting out of domestic services at our residential training establishments. We plan to complete this exercise in September 1983. There are also other areas where we already do a significant amount of contracting out, such as architectural design for prisons. We are looking again at the possibilities and I shall report separately on this in October in response to your letter of 11 August.

I am copying this to the Prime Minister, to members of E(DL)

and to Sir Robert Armstrong.

not put in jeopardy.

completion of that programme in 1989.

20 SEP TOPS

MANAGEMENT IN CONFIDENCE * JH 921 DEPARTMENT OF INDUSTRY ASHDOWN HOUSE 123 VICTORIA STREET LONDON SWIE 6RB TELEPHONE DIRECT LINE 01-212 3301 SWITCHBOARD 01-212 7676 Secretary of State for Industry 6 September 1982 Sir Geoffrey Howe QC MP Chancellor of the Exchequer Prine Minister HM Treasury Parliament Street London SW1 Dear Geoffrey, PRIVATISATION In her personal minute to you of 28 July the Prime Minister asked Departmental Ministers to report to you on the prospects for privatisation: I attach my report. Two of the main enterprises sponsored by this Department, namely British Aerospace and Cable and Wireless, have been

- 2 Two of the main enterprises sponsored by this Department, namely British Aerospace and Cable and Wireless, have been privatised and British Telecommunications, which we have announced we intend to float after the next Election, will be the third. For the less profitable industries the British Steel Corporation, British Shipbuilders, BL and Rolls Royce progress is inevitably slower but, as you will see from the report, the framework is being laid for the next Parliament and, where possible, disposals are being made on the way. The Post Office presents special difficulties but in view of the Prime Minister's request I am looking afresh at the possibilities.
- One question which might be covered in your eventual report to the Prime Minister is how far we should urge Chairmen to dispose of loss making activities at a very low, or negative. price perhaps significantly below the book value of the assets concerned, or ourselves be prepared to provide a substantial 'dowry' in order to secure the advantages of privatisation. A disposal on such terms may still be a good deal for the taxpayer if it avoids any future call on public finance by the activity concerned. The answer can greatly influence the extent and speed of progress; the point is relevant, for example to parts of the British Steel Corporation.
- 4 'I am not yet able to give you my final conclusions on this Department's research establishments; I shall write to you shortly on this. I shall also bear in mind the question of

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privatisation and disposals in my current review of the role of the British Technology Group.

5 I am sending copies of this minute and of the attachment to the Prime Minister and to the other members of E(DL).

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PRIVATISATION PRESENT SITUATION AND PROSPECTS

REPORT BY THE SECRETARY OF STATE FOR INDUSTRY

British Telecommunications

- announced in June the intention to establish British Telecommunications as a public limited company, and to float 51% of the shares after the Election. While an earlier sale of shares might be possible it would mean changing the recently announced decision and would set a very tight time-table which could seriously prejudice a successful flotation. However, it may be worth exploring the feasibility of selling shares to users and employees earlier than we have planned. Any such work would ensure that we are in a position to make a flotation, possibly in one tranche, as soon as possible in 1984 after the Election.
- 2. Selling <u>more</u> than 51% of the shares in the first instance might jeopardise the launch, as the stock market will find it difficult to digest the 51%; and any flotation would probably have to be accompanied by a pledge not to sell further shares for the foreseeable future (which in practice means 18 months or two years). However the position could be reviewed after such a period.

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3 It makes little sense in the meantime to sell off parts of BT. In the first place any profitable parts sold would diminish the overall value of the company. Secondly, any closure of loss-making parts, which are unlikely to find a private purchaser, would be disruptive to BT in the interim period.

British Steel Corporation

- The major integrated steel making plants of BSC can only be privatised after there is a real prospect of profitability and viability. This remains our aim. In the meantime, parts of BSC's business, peripheral and central, are being privatised or closed down in addition to sales of surplus land, property and other assets. Two major joint companies, free-standing from BSC, have been formed with private interests: Allied Steel and Wire (with GKN), turnover £314 million; and Sheffield Forgemasters, (with JFB), turnover £140 million. Both these companies are now in the private sector. Further, though smaller, ventures of this type may emerge.

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Because prospects for steel generally are poor in the short term, quicker progress on BSC disposals would be made if we were to tell Mr MacGregor that it was less important to obtain the best price for a business than to proceed with disposals as soon as possible. The BSC Chairman feels himself under an obligation to get a good price for BSC assets (having regard to book value), and this has caused difficulties with some potential sales. Other proposed joint ventures could also be helped by Government offers of assistance, (eg under the Private Sector Steel Scheme), as in the recent case of Sheffield Forgemasters.

British Shipbuilders

or its loss-making merchant shipbuilding and marine engine facilities while future prospects are poor. As regards BS's profitable warshipbuilding activities, Rothschild's advice is that Yarrow and Vosper (the BS specialist surface warshipbuilders) cannot be floated at present while their joint capacity appears in excess of MOD's long term requirements for surface warships and export performance is disappointing. Orders to replace Falkland losses coupled with a breakthrough on exports could alter the picture or it may be possible to interest again the previous owners, who are to be approached shortly on this matter. As regards Vickers, Rothschilds had advised that, subject to certain conditions, and in particular that the capital needed to finance their substantial modernisation programme (costing about £200 million) can be assured, a flotation after

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the election might be possible. In addition, Mr Plastow of Vickers Ltd (the private sector company) has expressed some interest in buying the Vickers subsidiary of BS and this is being explored further.

- BS can be expected to oppose strongly the sale of warshipbuilders since this will leave them only with loss-makers. However, a Bill will be introduced in the next session to take powers to direct BS to sell assets. These powers, which do not exist at present, would enable preparatory work to be done for the sale of at least Vickers and possibly the other warshipbuilders after the election.
- 9 BS have however been willing to sell off their small peripheral engineering activities such as Sunderland Forge and Wolsingham Steel, but they have failed to find a buyer.

 Wolsingham presents particular difficulties because of the general over-capacity in steel.
- 10 On shiprepair, BS are in response to Ministerial pressure taking action to eliminate losses at Vosper Shiprepairers and Tyne Shiprepair. Up to 1,400 jobs will be lost in the reorganisation which could bring these companies to a state where they might possibly be sold. There may also be other candidates for privatisation in shiprepair.



Post Office

11. When this was last looked at I saw considerable difficulties that in privatisating the Post Office as a whole and replacing a public monopoly by a private one. However in the light of the Prime Minister's minute the Department is considering afresh the possibility of privatisation of either all or part of the Post Office, or of joint ventures with the private sector.

British Technology Group

- currently reviewing the role of the BTG. However, whatever arises from this review it seems clear that there is a requirement for some public body dealing with some or all of the areas covered at present by the Group, which include technology transfer, support for new technologies and small firms.
- 13. The BTG is charged under the NEB's guidelines with disposing of the assets it already holds or assumes as soon as commercially practicable. The major shareholdings have all but gone (BL in which the Department now holds the shares is discussed below), and those that remain with the BTG, including Inmos, are unlikely to be saleable until the companies have established a good track record. The BTG is determined to maintain the momentum.

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BL

14. Our main objective, and that of the BL Board, remains the return of the whole of BL, probably by instalments, to the private sector as soon as practicable, and certainly by the late 1980s; and to show early and visible progress to this end. The BL Board are preparing, for presentation in their 1983 Corporate Plan, a strategy for privatisation that will involve, in the next two years, the sale of minority stakes in BL's more profitable businesses (ie Unipart and Land Rover), the continuation of existing collaborative links, and the search for new ones. This is the outcome of prolonged discussion with BL, and has been agreed following correspondence between Ministers. We shall have the opportunity to discuss the detailed programme when we consider BL's Corporate Plan in the Autumn. BL continues to dispose of its non-mainstream assets whenever buyers can be found.

Rolls Royce

15. It remains the Government's aim to return Rolls-Royce to the private sector as soon as practicable and the appointment of a new Chairman this autumn should provide a fresh impetus. Objectives for the company approved by Ministers and accepted by the chairman-designate require that the company should be managed in such a way that it can be returned to the private sector during the course of the next Parliament and no later than 1988. As an incentive the chairman-designate has been offered an option to purchase shares in the company as part of a performance-related remuneration package.

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1988 is the earliest target date which Chairman-Designate would accept before he has got his feet under table and is able to properly assess the Company's problems.

16. In the meanwhile, the Department will explore with the new chairman the possibility of hiving off the non-aero elements of Rolls Royce although they do not account for a very significant part of the company's business. It remains to be seen whether he will argue, as did the present chairman, that Rolls should retain its industrial engine side on the grounds that it is inextricably tied in with the aero-engine business. However there would undoubtedly be problems if an attempt were made to detach the nuclear work which Rolls carries out for the Ministry of Defence. The MOD would also need to be consulted about any suggestion that the marine side of Rolls business should be sold off.

17. POSSIBLE FURTHER DISPOSALS OF SHARES

(a) British Aerospace

The Government sold 51% of the shareholding of BAe on the basis of undertakings that it would not sell more in the 'forseeable future' (we have told Kleinworts that this means at the earliest not before February 1983), and that it intended, in any event, to hold more than 25% (in order to block any substantial foreign shareholding).

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Thus, in theory, it would be possible to sell a further 23% after February 1983. However, it is not clear how the market would receive a further tranche since Bae's future prospects are more than usually bound up with various Government decisions (eg launch aid for the A320) which will be taken over the next two or three years. And the management is unlikely to welcome a further major shift in the ownership. Nevertheless the possibility of a further flotation could be reviewed next February.

(b) Cable and Wireless

Following the offer for sale of Cable and Wireless (October 1981), and after deducting the shares committed to the Employee Share Schemes, the Government still retain 50% of the issued share capital of the company plus one Ordinary Share. The Government stated at the time of the sale that it intended to retain a majority shareholding in Cable and Wireless for the foreseeable future. This can reasonably be interpreted as meaning a period of not less than eighteen months (there is no commitment in this case to no further sales for at least 2 years as in the case of BAe). It would therefore be open to the Government to sell a further tranche of shares in Cable and Wireless in mid-1983. However this would be much too early given our commitments to overseas Governments and Cable and Wireless' review of their commercial strategy in the light of privatisation.

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English Industrial Estates Corporation

- 18. It is unlikely that the Government's policy on future industrial building in the Assisted Areas could be implemented solely by private enterprise. Since initial returns and long term yields there are unattractive the Government could persuade them to invest only by guaranteeing a minimum return which would result in the Government bearing the losses but taking none of the profits, hence increasing net public expenditure. Moreover the private sector might never be attracted to the worst (and therefore most needy) areas.
- 19. However following a review of the EIEC involving Mr David Young
 - the EIEC employ private sector contact management and labour for all their projects;
 - substantial private sector funds have been secured for a number of developments, and will continue to be sought;
 - the EIEC's historical assets (Government leases) which were unsaleable are being converted, by renegotiation, to saleable leases as opportunities arise. This is a slow process, but a substantial improvement in the rate of disposals, from around £2.7m in 1978 /79 to around £10m in 1982/83, has been achieved.

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Departmental Research Establishments

20. The intention is to set up the National Maritime Institute as a private company on 1 October 1982, and (although this is a very tight timescale) to transfer the Computer Aided Design Centre to the private sector by 1 April 1983. Discussions are being held with the customer Departments of the Laboratory of the Government Chemist to determine what, if any, of the work they contract to the Laboratory could be done by the private sector instead.

I am considering if there is further scope

I am considering if there is further scope for privatisation in this Laboratory or in the Department's three other remaining research establishments.

Other Departmental activities

21. None of the Department's own activities lend themselves to true privatisation (as opposed to contracting out which is being covered in the separate exercise conducted by the Chancellor of the Exchequer). The Department could withdraw from the Cotton Industry War Memorial Trust but this would require disproportionate effort, including legislation, to save only 2-3 hours of work per year.

22. The Design Council's role as the Government's principal vehicle for promoting good design could not be wholly financed by the private sector. Our power of appointment of members and the

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provision of most of its finance though a grant in aid ensures that the body does what we want it to do. A loosening of control would be detrimental in this respect.

ICB1

13 September 1982



Prime Minister 9

CONFIDENTIAL

John Sparrow Esq Head of Central Policy Review Staff Cabinet Office 70 Whitehall London SW1A 2AS

September 1982

Dem Mr Spannon,

Thank you for your letter of 31 August suggesting that it would be useful to do further work on international comparisons of the BAA's performance. I have also seen George Younger's letter of 6 September endorsing your proposal. Although this has been overtaken by the discussion at E(NI) on Wednesday 8 September, you may find it useful to have this record of our position in the matter.

I agree that international comparisons can be a useful indicator of relative efficiency and my officials have been working on this with the BAA for some time in response to a similar recommendation made by the Public Accounts Committee. As you recognise, the task is fraught with difficulties because of the wide disparity in the way airports are operated and financed. Few other airport authorities (even in the United States of America) publish anything like the amount of disaggregated financial and performance material provided by the BAA and there are at present no international arrangements for the exchange of such information of the kind that we have in ICAO for airlines.

Last year, my Department commissioned Professor Doganis, Professor of Transport Studies at the Polytechnic of Central London, a recognised expert who had already done some work in this field, to carry out a feasibility study. The result, owing to the lack of disaggregated and published information, was disappointing and we concluded that it was unlikely that outside experts would be able to obtain the necessary information for worthwhile results.



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This approach having failed we then asked the BAA to pursue the matter using its close contacts with other European airport authorities to obtain unpublished, and, in some cases, sensitive information. This work was given added urgency by the need to prepare for the forthcoming litigation.

This "in house" study is now virtually complete. I have seen some of the initial results and these suggest that the BAA compares well with other major European airports on most measures of financial performance and efficiency. However, the study is still being finalised and will not be made publicly available until the exchange of expert evidence in the litigation in November. Until then its very existence must remain confidential both to protect our position with the plaintiffs and the position of those airport authorities overseas who have co-operated with the BAA in helping with this part of the legal defence.

I think for the moment that it is best to allow the BAA to complete this work. If, when it is made available in November, it does not produce sufficient information of the sort that we want we can consider whether any further work should be commissioned but I shall need to consider the impact of our instituting such an examination on our handling of the litigation.

So far as international comparisons of charges are concerned, I am afraid that this is also more complex than might at first appear. Few other countries have reached the stage where their airport facilities are totally unsubsidised and the very different methods of financing mean that comparing like with like can be extremely difficult. Again, a good deal of research is already in hand as part of the preparations for the litigation (including work by outside consultants in the United States of America) and I do not think it would be helpful to our defence to duplicate such work at this stage. Again, the existence of these studies must be confidential at this stage.

I expect to refer the BAA to the MMC in due course, but this could not be until after the present litigation is resolved. I am advised that it would be inappropriate to establish a competing forum for considering the costs and efficiency of the Authority



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while the matter is before the High Court, and that it would be unhelpful to our defence, while the litigation is in progress, for me to take action which implied that I regarded the BAA's activities as meriting investigation on monopoly grounds. Nor do I think it would be helpful to our defence to institute other outside examinations of them in parallel with the litigation.

I am sending a copy of this letter to the Prime Minister and other members of E(NI).

Jours sincerery Journ weither

for LORD COCKFIELD

(Approved by The Servering of State and signed in his absence)

1 U SEP 1982



CONFIDENTIAL Prime Minister Tres 7/9 Caxton House Tothill Street London SW1H 9NXF Telephone Direct Line 01-213......6400 Switchboard 01-213 3000 The Rt Hon The Lord Cockfield Secretary of State Department of Trade 1 Victoria Street September 1982 LONDON SW1 De An than. BRITISH AIRPORTS AUTHORITY I have seen the recent correspondence in which doubts have been expressed about the operating efficiency of the British Airports Authority (BAA). I am of course in favour of setting tough targets for nationalised industries and I am all for exerting maximum pressure on BAA to reduce operating costs. I have no doubt that there is scope for substantial further improvements, particularly through more efficient use of space. There is, however, one important point that needs to be made in BAA's defence on the question of planning for new capacity. In his letter to you of 16 August Michael Heseltine called for a more critical review of BAA's investment programme because it seemed liable to produce "massive over-capacity" among the south east airports. In your reply you contended that there was bound to be some excess capacity for a time when a major new terminal is completed. You could have added that provision of some margin of estimated spare capacity is prudent practice given the fluctuations in the number of passengers and the very long lead times for new construction. Lack of such a margin combined with the long gestation period of Terminal Four have led to the situation you describe at Heathrow, where traffic is expected to exceed capacity before the new terminal is completed. All this seems to me to highlight the problems caused by our excessively long planning process. In order to allow sufficient time for public enquiries, Ministerial consideration and everything else that is involved, BAA need to set planning in - 1 - .

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hand at a very early stage, long before they can be reasonably expected to predict the timing of growth in demand. If they could expect planning decisions within 12 months, they would no doubt be able to plan new capacity rather more precisely.

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

J

Nos. No stell P.0843 PRIME MINISTER British Airports Authority: E(NI)(82)19 BACKGROUND This note by the Secretary of State for Trade discusses the performance and current position of the British Airports Authority (BAA). In his HAGA minute to you of 23 July the Secretary of State suggested that the note FAG B could be cleared in correspondence. Mr Scholar's letter of 26 July raised a number of questions. In response, further information was FIAGC supplied in a letter of 5 August from the Department of Trade; but Mr Rickett's letter of 9 August recorded that you still had misgivings. FLAG E The Secretary of State for the Environment (letter of 16 August) has also raised doubts, to which the Secretary of State for Trade has replied in his letter of 27 August. The papers are all concerned with BAA's current and prospective performance. As recorded in the Annex to the note by the CPRS (E(NI)(82)25), which is for separate discussion at the same meeting, consideration of the BAA's objectives must await the outcome of the litigation brought by a number of airlines challenging the BAA's charging policy and the Government's rights with regard to that policy. The Annex also implies that no further action is required regarding monitoring arrangements, or Board structure and membership. The BAA is a fairly small organisation by nationalised industry standards. It employs little more than 5,000 people (excluding security staff); and its turnover in 1981-82 was under £300 million. Nevertheless, it has quite an important investment programme in prospect (around £675 million cash over the period to 1985-86); and the Secretary of State for the Environment has argued, in effect, that it is a potential model for dealings between the Government and a public sector monopoly. MAIN ISSUES FLAGH E(NI)(82)19 asks the Sub-Committee to note that the Secretary of State for Trade intends: CONFIDENTIAL

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- (a) to agree the general direction proposed in the BAA's corporate plan;
- (b) to endorse the BAA's investment programme, subject to detailed approval of annual totals;
- (c) to underline the importance of containing current costs and of moving more swiftly towards economic pricing levels;
- (d) to ask for improved performance, keeping external financing within the levels in the 1982 Public Expenditure White Paper.

The main doubts raised in the correspondence are:-

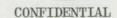
- (i) Are the BAA's control of, and objectives for, current costs sufficiently rigorous?
- (ii) Is their investment planning satisfactory?

It may also be desirable to discuss:

(iii) Is the BAA's pricing policy acceptable?

Current Costs

to achieve an average annual increase of at least 3 per cent in the number of passengers handled per employee; and to achieve an average annual reduction of at least $2\frac{1}{2}$ per cent in operating costs per passenger. The Secretary of State for Trade suggests that the first will be obtained (in fact, exceeded, according to Section 3 of the background note circulated with the DoT letter of 5 August), but not the second. At first sight, this is surprising. According to information on pay settlements in the DoT note, average earnings will have increased by about 32 per cent in the three years 1980,1981 and 1982, compared with an increase in the RPI of 56 per cent - a fall in average real earnings of some 15 per cent. Since the number of passengers handled per employee has been rising, other costs must have increased quite considerably. The DoT letter of 5 August mentions



depreciation, rates and energy costs, and suggests that little can be done about them. That may be true of depreciation. But some economies should be possible in the use of energy; and it may be that BAA could reduce their rate bill, for example by using less, or less expensive, office space (clearly, little can be done about the airport installations themselves, at least in the short run).

- 6. There is also little in the papers about the BAA's future aims for productivity. As the Secretary of State for the Environment has pointed out, it is suggested (paragraph 10 of E(NI)(82)19) that the need to open and staff new terminals will reduce productivity (or its rate of increase). Is this so? If it is, what are the likely effects on profitability; and are they acceptable?
- 7. You will no doubt wish to explore these aspects.

Investment programme

- 8. The letter of 16 August from the Secretary of State for the Environment suggests that the investment programme in the BAA's corporate plan will generate substantial over-capacity, even by comparison with fairly optimistic traffic forecasts. However, the level of investment indicated in E(NI)(82)19, at £675 million, is well below that proposed in the corporate plan (£822 million), so that this point, at least in part, has already been allowed for. The Secretary of State for Trade's letter of 27 August also says that the estimates of over-capacity made by Mr Heseltine are overstated, and points out that it is impossible, because of the "lumpiness" of investment, always to match investment and capacity.
- 9. The Secretary of State for the Environment also suggests that the productivity of existing facilities might be improved as an alternative to increasing capacity.

 However, Heathrow is much more intensively used than the busiest European airports, as the Secretary of State for Trade points out in his letter of 27 August.
- 10. If, following the correspondence and discussion, concern remains about the BAA's investment programme this can be further pursued between the Treasury and the Department of Trade in the context of the nationalised industry investment and financing review.

 Pricing policy
- 11. Both you and the Secretary of State for the Environment have drawn attention to the substantial increase that has taken place over recent years in the BAA's charges to airlines. To the extent that the increase results from a failure to control costs,

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it is obviously undesirable. However, it is only fair to recognise that it also stems from the Government's policy of setting the BAA more stringent financial targets, and restricting its access to external finance to a greater extent, than is the practice in many overseas countries. It is, in fact, these latter aspects which are the main points of contention in the impending litigation, as the Secretary of State for Trade points out in his letter of 27 August.

- 12. Indeed, the Secretary of State for Trade proposes to continue with the policy, despite some resistance from the BAA. In response to the litigation, the BAA has decided to hold its charges in 1982-83 at the level of May 1981. The Secretary of State intends to press the Board to progress 'more swiftly towards economic pricing levels'. Provided that costs are properly controlled, this seems consistent with the Government's general policy towards the nationalised industries, though the litigation is a complication. (To press ahead with the policy could be regarded as provocative; on the other hand, to fail to do so could be taken as an admission that the policy is wrong).
- 13. A related aspect is profitability. The BAA's current financial target is to achieve a 6 per cent rate of return on assets in current cost accounting (CCA) over the period 1980-81 to 1982-83. Paragraph 7 of Part II of the note attached to E(NI)(82)19 speaks of a 3 per cent CCA return over the period to 1986-87. Presumably some decline in the rate of return is inevitable as a result of the need to instal new capacity, which will not at first be fully used. But it is not clear whether the Secretary of State for Trade regards 3 per cent as adequate; or whether he expects it to be increased, by deferring investment, increasing charges, or other means.

HANDLING

14. You will wish to ask the Secretary of State for Trade to open the discussion by reference to his note and the correspondence. You might then invite the Secretary of State for the Environment to enlarge on the points made in his letter of 16 August. Any member of the Sub Committee may wish to comment; the Chief Secretary, Treasury, in particular, is likely to have comments, both on the figures in the context of the investment and financing review and because of possible implications for nationalised industry policy; the Scottish representative (the Secretary of State for Scotland is unlikely to be able to attend himself) may have departmental points to raise. You yourself will wish to be satisfied that the points raised in your Private Secretaries' letters are fully dealt with.

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15. In general, however, I suggest that you will not wish to be drawn too much into details. The Sub Committee's views can be taken into account in the investment and financing review discussions which are currently in train. They are due to be concluded this month; and the Chief Secretary, Treasury will report the conclusions to E Committee for consideration.

CONCLUSIONS

- 16. You will wish the Sub Committee to reach conclusions on the extent to which the recommendations in paragraph 13 of E(NI)(82)19 should be:
 - (a) endorsed as they stand;
 - (b) endorsed, subject to points of emphasis or detail; or
 - (c) remitted for further discussion, at least in the first instance, between the Secretary of State for Trade and the Chief Secretary, Treasury as part of the current investment and financing review discussions.

Py

P L GREGSON

Cabinet Office

6 September 1982

CSV



CABINET OFFICE

Central Policy Review Staff

With the compliments of John Sparrow

70 Whitehall, London SW1A 2AS Telephone 01-233 7765 K S

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From: John Sparrow CONFIDENTIAL

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Qa 06046

The Rt Hon Lord Cockfield Secretary of State for Trade Department of Trade 1 Victoria Street SW1H 6ET 31 August 1982

Prime minister

There win be a chance to

discuss his proposal at

ENI m & September

m

Dear Arthur,

British Airports Authority

I have seen the correspondence, in which doubts have been expressed by the Prime Minister and more recently by Michael Heseltine as to the operating efficiency of the BAA. A question mark also exists over BAA's ability to offer landing rights and other airport services at internationally competitive prices, although this also depends on the financial target expected of the BAA and is currently the subject of litigation.

We might learn more about BAA's efficiency and its international competitiveness if a study were to be carried out of BAA's charges, costs and performance by comparing these with information about other major European and North American international airports.

Inevitably there will be difficulty over such comparisons. The scope of operations may vary and circumstances may differ. However it is difficult to assess in a monopoly situation whether performance targets, including financial targets, are reasonable without comparisons of some sort, and lessons would I am sure be learnt from such an exercise.

The BAA has not yet been referred to the MMC, and there may be good reasons for deferring a reference while the present litigation continues. In those circumstances, could I suggest that one way of carrying out the

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suggested review would be to ask BAA to appoint, jointly with your Department, a firm of consultants who have had some experience of examining the operations and finances of international airports.

I am sending a copy of this letter to the Prime Minister and to the other members of E(NI).

Your sincerder,

John Sparrow





Prime minister

Treasury Chambers, Parliament Street, SWIP 3AG 01-233 3000

PRIME MINISTER

PRIVATE FINANCE

Your personal minute of 28 July commissioned a fresh review in E(DL) of progress and prospects on privatisation for action in this Parliament and preparation for the next. In my letter of 11 August to the Home Secretary I also invited colleagues to report by the end of October on progress with contracting out in the wider public sector, and on further measures which might be taken. In addition to these two exercises, I asked my officials to prepare the attached report on progress on the introduction of private capital into the public sector.

- The criteria for the direct introduction of private capital into the public trading sector were worked out in NEDC last year. We are pressing forward wherever there appear to be advantages to compensate for any additional cost. The picture is quite encouraging. Although the number of schemes which have so far gone ahead is limited, a number of new ideas are coming forward and being examined. I am sure that colleagues should be on the look out for more, especially as they prepare the planned reports on privatisation and contracting out. For example, there may be cases where immediate privatisation is not possible but a joint venture might be a helpful interim measure.
- 3. Progress on the use of private capital in the public services has been slower but there are one or two relatively well-known examples eg the experimental work going forward on road construction and maintenance. But I am sure that more schemes could be found if the scope for them were to be examined imaginatively and thoroughly.
- If there are other examples and areas not mentioned in the attached report, the Treasury would be only too willing to look at them.
- 5. I am copying this letter to other members of Cabinet, to John Sparrow and Sir Robert Armstrong.

(G.H.) 27 August 1982

PRIVATE FINANCE : PROGRESS REPORT

Note by the Treasury

1. This note sets out the position on "private" or unconventional finance ie finance raised by public sector bodies direct from the markets rather than indirectly through the Government. It does not cover privatisation proper on which the Prime Minister has recently initiated a new exercise or contracting out which is the subject of a separate exercise set in hand by the Chancellor.

PUBLIC TRADING SECTOR

- 2. To increase the exposure of the nationalised industries, and other public sector trading bodies, to market disciplines the Government has encouraged them to look for ways of tapping the capital market direct eg by bond or project finance which would bring market pressures to bear on the industries and so secure greater efficiency and improved performance. The value of such schemes depends on their meeting certain key conditions. These were formulated in the NEDC discussions last year as:
 - First, decisions to provide funds for investment must be taken under conditions of fair competition with the private sector, eschewing links with the rest of the public sector, Government guarantees or commitments or use of monopoly power which result in offering investors a degree of security significantly greater than available on private sector projects;
 - second, such schemes should yield benefits in terms of improved efficiency and profit from additional investment commensurate with the extra cost of raising risk capital from financial markets.
- 3. The purpose of these conditions is to ensure that market pressures determine to the maximum extent possible the initial allocation of

investment funds and provide continued pressure for improved performance either by involving the private sector in the operation and management of the asset or by relating the investors' return directly to improved performance.

Department of Transport

(a) Rail

- 4. A Working Party (Department of Transport, BRB, Morgan Grenfell and Treasury) are on the point of reporting on two ideas: private finance for a dedicated Victoria/Gatwick rail link and for electrification. The report's conclusions will need to be discussed by Ministers.
- 5. But further possibilities are coming forward in the rail field eg for franchising and joint ventures and more may arise when the Serpell Committee has reported.

(b) Other Transport Industries

6. There have been two recent initiatives in setting up 51 per cent private sector owned subsideries to finance specific investment projects. BTBD have gone into partnership with CY Tung to develop facilities at Southampton and BWB have entered a partnership with Caywood Hargreaves to move slag on the Aire-Calder canal. The future of BWB's initiative is currently under discussion and may yet prove inadequately based to justify treatment as a private sector venture.

Department of Energy

- (a) <u>Oil</u>
- 7. BNOC is being privatised.
- (b) Gas
- 8. The Department of Energy's main priorities are the abolition of the

monopoly/monopsony, the sale of BGC's onshore and offshore oil interests and the disposal of the appliance retailing business. All this is causing considerable difficulty with Sir Denis Rookeand the Department believe there is nothing to be gained from an effort to find ways of involving private finance in the main business of gas supply. However, the Department are proposing to press the Corporation to hive off all activities not directly related to the main business of gas supply and to make this one of the objectives of the Corporation.

(c) Coal

9. Department of Energy's view remains that any moves of this kind are likely to run into strong opposition from the NUM and that for that reason alone they should not be pursued this year.

(d) Electricity

- 10. The Bill permitting private generators of electricity is now in the legislative programme for the next session. This will place the Electricity Boards under a statutory obligation to make available their transmission and distribution systems to private generators of electricity on fair terms.
- 11. A consultants' report on the feasibility of major combined heat and power schemes in up to nine cities will be coming forward this month but the forecast rates of meturn do not look likely to be attractive generally to private investment.

Department of Industry

(a) British Telecommunications

12. The decision to privatise British Telecommunications effectively overtakes any proposals for introducing private capital into BT through such devices as the BT Bond. By exposing BT directly to market forces, privatisation obviates the need for other more artifical devices intended to bring such pressures to bear, provided we continue to press ahead with our plans for liberalisation in other directions.

(b) Post Office

13. In the case of the Post Office the Secretary of State for Industry is reviewing possibilities, including a programme of disposals or joint ventures for the Crown Offices, joint ventures in the parcels field and setting up a property subsidiary with private participation to manage the Corporation's property estate.

(c) Other Industries

14. In the case of steel and ship builders, the object of policy is to move as rapidly as possible towards a situation in which total privatisation is possible and to dispose of parts of the businesses, where possible, on the way.

Department of Trade

(a) British Airways

15. The object is to privatise as soon as practicable.

(b) British Airports Authority

16. A joint BAA/DOT/Treasury Working Group is to examine in detail the two most promising ideas for private sector finance to emerge from an examination by merchant bankers. These are i) a performance bond on the lines recently proposed for BT and ii) equity finance linked to income from duty free and other airport concessions. The working group will report in October.

Department of the Environment

(a) Water

17. The Secretary of State for the Environment is keen to see the introduction of private finance in the water industry but the main proposal examined so far - a private sewage treatment company for Merseyside - seems to offer little or no scope for efficiency savings

or other benefits to outweigh the extra cost of private finance. But the conclusion follows from the physical characteristics of this particular scheme and would not necessarily apply to other areas of water authorities' activities.

FUBLIC SERVICES

18. The criteria are less clear cut in this area but the responsible authorities (whether central or local government or authorities such as the NHS) will want to ensure either that the involvement of the private sector imposes no extra outlay or that where it does, this is outweighed by greater efficiency, improved service etc.

Department of Transport

(a) Roads

- 19. Following discussions in E Committee the Secretary of State for Transport has been authorised to consult construction companies and other interests about the possibility of tapping private sector capital as a reinforcement to conventional public sector funding of road construction.
- 20. The scheme that has figured most in these consultations and in the work of the Civil Engineering EDC is one in which the private investment would be remunerated by a royalty per vehicle paid by the Department for a fixed period after the road is opened.
- 21. Until the results of the consultations are known the additional cost which may be involved compared to conventional funding cannot be assessed nor can the efficiency gains to be achieved. But the construction companies opening position is that the privately financed project should be additional to those financed by conventional public expenditure and should benefit from guarantees from the Government as to their minimum rate of return.

22. A number of local authority privately financed road schemes have also been put forward, their justification is not entirely clear. Some local authorities may see them as a way to avoid capital control. The Department of Transport and the Treasury are discussing how these should be handled.

Department of the Environment

(a) Government Construction

- 23. A decision was taken earlier this year not to construct the International Conference Centre with private funds because of the cost. More recently, the Secretary of State for the Environment has suggested that the Bridge Street Site should be redeveloped with private funds. The scheme has yet to be examined in detail.
- 24. Whether private funds would be good value depends largely on whether substantial part of the building will be occupied by the public sector (in this case Parliament). If so, then public funds for at least part of the development would almost certainly be the cheapest option. If, on the other hand, the development will be occupied almost entirely by the private sector, then outright sale of the site would appear to be an obvious option.

(b) Inner Cities

25. The Secretary of State for the Environment has also been making considerable efforts to attract more private finance into the inner cities. He has invited local authorities to bid for the new Urban. Development Grants, announced in the Budget, which will be paid towards projects offering a high contribution by the private sector. Bids have been invited by the end of September for implementation in 1983-84. A similar scheme was operated for derelict land grants in 1982-83 and about £10 million of grant is likely to be paid out on development projects involving more than £70 million of private money.

(c) Housing

26. A number of schemes for the use of private finance in housing association projects are under consideration. In most cases, schemes offer no offsetting benefit to the higher cost, in terms of Government grant, of using private finance. However, approval has recently been given to a pilot scheme in which an insurance company will finance most of a housing association shared-owner project instead of the housing corporation in return for a claim to capital appreciation on the remaining share of the property.

(d) Other

27. The Department of the Environment also recently published a pamphlet 'Bringing in Business" which describes a variety of individual schemes in which local authorities and other public bodies are working or have worked together in partnership with private sector developers and financial institutions. The aim of the brochure is to show to other institutions, developers and local authority what can be achieved and to encourage them to exploit the many similar opportunities that exist.

Department of Industry

Factory Building

28. Discussions have taken place between officials about the appropriate criteria for greater private sector involvement in the Government's factory building programme. It has been agreed that short term rent guarantees and leases may be appropriate ways for the various agencies to act as catalysts in stimulating the private sector to invest in areas where they would otherwise not contemplate doing so. But long term lease backs and the various tax based schemes of finance offer little more than a more expensive way of raising Government finance.

Department of Health

29. For the near future policy is to encourage provision and financing

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of health care in the private sector rather than privatisation of the NHS itself or to seek private financing for NHS development. However privatising the general opthalmic, dental and pharmaceutical services is under consideration. So too are various aspects of contracting out: these could have particular importance in this area.

HM TREASURY
19 August 1982

Prime minister

From the Secretary of State

alle mile

and

The Rt Hon Michael Heseltine MP Secretary of State for the Environment Department of the Environment 2 Marsham Street London SWIP 3EB

27 August 1982

Dear Scenetary of State,

- Thank you for your letter of 16 August in which you express your concern at my apparent broad-brush treatment of the British Airport Authority's Corporate Plan. I really cannot believe that any purpose would have been served by burdening you and E(NI) colleages with a detailed account of our review of the Authority's performance and Corporate Plan a review incidentally which had been discussed and agreed on a bilateral basis with the Treasury especially since my remit was to clear this matter by correspondence this year, and since I had recommended some strong measures. However in the circumstances I am sending you a copy of our report with this letter.
- Of course I understand your concern that we should make sure there are adequate surrogates where market pressures are absent. It is for this reason, as well as the need to price at economic levels, that the Authority were given in 1980 a tough financial target plus two performance aims each covering the three year period 1980/81 to 1982/83. These targets were:-
 - (a) To achieve an average of 6% per annum CCA return on average net assets:
 - (b) To achieve a growth in the number of passengers handled per employee of an average of 3% per annum;

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(c) To achieve a reduction in real terms of operating costs per passenger handled of an average of $2\frac{1}{2}\%$ per annum.

The results so far and forecasts for the current year as as follows:

				Forecasts	
	Target				Outturn
		80/81	81/82	82/83	
	<u>Av/pa</u>				<u>Av/pa</u>
Passengers/employee	+ 3%	- 1.1%	+ 4.9%	+ 6.6%	+ 3.4%
Costs/Passenger	- 2½%	+ 1.3%	- 0.7%	- 4.5%	- 1.3%
Financial target	6%	5.9%	5.6%	4.7%	5.4%

- 3 As you will see the first performance target has been comfortably met. After a poor start the improvement last year and that expected this year are substantial.
- The second performance target, that of costs, has been missed by a margin of about 1% but the Authority has had to face escalating costs quite outside its control, not least an astronomical increase in rates, 62% in two years, a matter which falls within your responsibility not mine. Despite these difficulties we expect by next year the cost target will be met that is averaged over four years there will be an improvement of $2\frac{1}{2}\%$ per annum.
- The financial target has been missed but only by a very small margin the average is expected to come out at 5.4% per annum compared with the target of 6%. This shortfall is due almost entirely to the Authority's decision, under pressure from the airlines and the threat of international arbitration by the United States Government, to freeze its airport charges this year.



- In summary, of the three targets the first was met with something to spare. The second was not met in the three years but will be met by the fourth. The third target has been narrowly missed. In the circumstances I cannot accept the bald statement in your letter that "the BAA has failed to meet the targets it has been set".
- There are two other general comments I would make. First the targets were set in February 1980 when economic circumstances and in particular the position of the aviation industry were much more favourable than they have turned out to be. Second, as you will see from Leon Brittan's paper E(NI)(82)24, which reviews the performance of the nationalised industries generally, the financial target set for BAA was a great deal tougher than those set for most of the nationalised industries and BAA's outturn a great deal better.
- You also say in your letter that "landing fees per passenger have risen 17.6% in real terms in the last ten years". This is not a fair comparison. If adjustment is made, as it should be, for the change in the way that airport security has been financed the Authority's landing fees per passenger declined in real terms between 1971/72 and 1979/80 by $2\frac{1}{2}\%$. The whole, and indeed more than the whole, of the 17% increase you refer to was the result of the very big increase in landing charges made in April 1980. This was in response to Treasury pressure on the Authority to introduce economic prices which would earn the required rate of return and reflect long run marginal costs. It was this increase which prompted a case which is now before the Court.
- I am surprised and concerned at your comments about the Authority's investment programme bearing in mind it reflects our present airport policy, endorsed in Cabinet, and the succession of public inquiries concerned with the three main elements of the programme: Terminal 4 at Heathrow, the second terminal at Gatwick and the development of Stansted. This last Inquiry is of course still in progress. The question of the need for additional capacity in the South East airports has been the subject of intensive examination in two inquiries, and indeed



in each case the Inspector recommended the need to provide the proposed additional capacity though in the case of Gatwick he also recommended phasing the development to meet demand as it developed. You and I have not yet given our decision on that Inquiry since we decided to allow further representations in the light of the revised traffic forecasts which were produced last year. I cannot of course prejudge the outcome of the Stansted Inquiry though the Inspector is aware that in the Government's view the additional capacity which this development would provide will be needed in due course.

- But neither the Authority nor I would want to commit capital expenditure in developing this new capacity until it was necessary. But it is simply not possible to avoid there being some excess capacity for a time when a major investment of this sort takes place. Even if the new terminals were built at the earliest possible time however the excess capacity on our present forecasts would be a great deal less than you claim: in 1986 only 11%, falling to 5% in 1987 and 1988 taking no account of the difficulty of matching precisely the supply and demand at each airport. Clearly there is a limit to the congestion which can be tolerated in existing facilities beyond which costs increase and severe delays in processing both aircraft and passengers are experienced, and possibly safety hazarded. At Heathrow for instance we expect the traffic to exceed present capacity before the new Terminal is completed, due largely to the delays caused by the excessively long planning processes: it will have taken ten years from start to finish to provide this Terminal and had it not been for the recession which has temporarily slowed traffic growth, and which was not foreseen at the time, Heathrow would already be impossibly congested.
- As I pointed out in my note E(NI)(82)19 in recognition that the Corporate Plan programme is now unlikely to proceed as planned, the proposed expenditure was cut by 20% overall to allow for slippage and other factors. None of us can forecast demand with any certainty and, given the very long lead times, it is vital to set planning in hand at a very early stage in the knowledge that investment can always be delayed but not advanced. Adequate control over timing can then be exercised through the normal investment approval processes.



From the Secretary of State

- Certainly I do not accept that planning investment early enough implies a monopolistic weakness it is simply a recognition of the need to allow adequate time for consideration on matters of considerable public interest. In our examination of the Authority's past performance we were unable to find any evidence that the Authority had invested unwisely. I believe the progressive development of its airports in line with traffic demand is proof in itself but this is further emphasised by the fact that its capital expenditure per passenger declined in real terms by 56% between 1975/76 and 1978/79, and though it is now increasing it was still, in 1981/82, 26% lower than in 1975/76.
- By comparison with some of its competitor airports, the capacity of the Authority's two main airports is highly utilised. Thus at present Heathrow is about 91% utilised compared with Frankfurt, now the second busiest airport in Europe, which is only 59% utilised, Schipol less than 50%. The Authority constantly seeks to remove capacity constraints in its existing facilities and accepts some degree of congestion at peak hours is unavoidable. But it is constrained in what it can achieve by the capacity of its runways and the demands of scheduled airline carriers. I have no doubt the Authority will continue to strive to use space and facilities more effectively and my officials examine in detail each year its capital programme which itemises every project costing over £1 million.
- I am just as concerned as you are that we should not over-provide airport capacity. There is no evidence that we are so doing. Indeed the evidence points the other way. Nevertheless this is a matter which I propose exploring further.
- My note also indicated that I am not happy with the Authority's pricing policy and I believe that there is some scope for further cost cutting; to this end I have recommended that the Authority should not receive the additional external finance it sought for the agreed investment programme and should be limited to the existing base line, a saving of £50 million over the three year period. It is not for me to tell the Board how to achieve the necessary savings but I shall expect it to take some tough decisions on pay and prices. It is inevitable that major investments



From the Secretary of State

in new capacity will affect productivity for a time, since costs will increase commensurately faster than revenue from the build up in traffic. But each investment is subject to a thorough appraisal to see whether it generates an appropriate rate of return allowing for risks. I am afraid there is little scope for achieving economies of scale in this case and the timing of capital expenditure and the control of operating costs are both necessary if these major investments in terminal capacity are to be profitable.

Over the course of the next six months I shall hope to agree a set of objectives with the Authority, in accordance with the E(NI) remit, and also a new financial target and performance aims. These will, of course, have to reflect in a realistic way the forecast traffic growth as well as the timing of capital expenditure in deciding on the appropriate level and period over which these targets should be achieved. I shall keep colleagues informed.

17 I am copying this letter to colleagues in E(NI).

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NORD COCKFIELD

[approved by the secretary of State and signed in his absence]

PERFORMANCE REVIEW OF THE BRITISH AIRPORTS AUTHORITY - 1982 Nature of Business The British Airports Authority was established in 1966 to own and operate three of the four main London area airports (Heathrow, Gatwick and Stansted) and Prestwick in Scotland. were formerly under direct Departmental control. Subsequently it has also acquired responsibility for Glasgow, Edinburgh and Aberdeen airports. Under the Airports Authority Act 1975, the general function of the BAA is to manage these aerodromes and its duty is to provide such services and facilities as are in its opinion necessary or desirable for their operations. In carrying out

- this duty the Authority is required to have regard to the development of air transport and to efficiency, economy and safety of operations. Except with Ministerial consent, the BAA is precluded from providing air navigational services, which are provided by the Civil Aviation Authority (CAA).
- There are a wide range of other activities conducted at its airports for which the BAA is not directly responsible. For example, at the London airports virtually all baggage-handling, check-in and passenger-handling services are provided by the airlines or appointed handling agents while the requirements of the regulatory authorities (eg Customs, Immigration etc) are an important determinant of the numbers of passengers which can be handled within the airport terminals in any given period. In addition, the BAA has a policy of hiving off to the private sector as many as possible of the ancillary functions required at its airports. Thus car parking, shops, fuel supplies, transport, catering facilities etc are all normally provided on a concessionary basis which reduces the BAA's exposure to a fall in traffic and enables changes to be made if the quality of service falls below acceptable levels. The result of this complex system of inter-relating organisations is
 - that there is a considerable problem of co-ordination which is off-set to a large extent by the flexibility of the system to continue to operate even when one part is operating less effectively (eg during industrial disputes). Unlike other forms of transport, the major airports have very rarely been brought to a complete halt despite their vulnerability to some forms of disruption (eg if fire cover were ever to be withdrawn).
 - that the BAA is able to keep its staff numbers to the minimum. For example at Heathrow in 1980/81 the number of employees by category of employer was as follows:-

BAA 3767 Government 2715 5% Concessionaires 6467 12% Airlines 40822 75.6% Contractors 231 0.4% Total 54002 100.%

Corporate Objectives

The BAA have prepared annual Corporate Plans for many years to provide a strategic framework within which the Authority plans its activities. Considerable efforts are made to ensure that the staff are involved in discussions over the Authority's corporate objectives.

Primary Objective

5 The BAA's primary objective has remained essentially unchanged since it is based on the statutory duties set out in the Airports Authority Act 1975. It is stated as follows:

"To operate, plan, and develop its airports efficiently and profitably to meet the present and future needs of air transport, both international and domestic, so that air travellers and cargo may pass through safely, swiftly and as conveniently as possible".

- This general objective is supported by more specific policies each of which is considered in more detail below. However the achievement of its primary objective is linked inextricably with the policy the Government itself has formulated to cope with the growth in demand for air transport, and with the fact that demand is largely determined by developments in the civil aviation industry which are beyond its control. The main determinant is the growth of traffic demand and a note on this and the changes in the forecasts over a number of years is shown at Appendix 1. There is little scope for improving revenue by more effective marketing since, ultimately, the use of its airports is dependent upon the success or failure of its airline customers who, in turn, operate in a highly regulated environment.
- A statement on the development of airports policy since the abandonment of the Maplin Project in 1974, is attached at Appendix 2. The BAA's specific corporate objectives must be viewed in the light of that policy and of the regulatory framework within which the air transport industry must must necessarily operate.

Examination of Specific Policies

Service to Customers

"To maintain high standards of safety for aircraft, passengers and airport staff, and to ensure that these standards match development in the air transport industry".

The Authority maintains a Department of Airside Safety and Operations whose task it is to initiate improvements to installed equipment and operating practices with the objective both of improving standards of safety and of operational efficiency. At the international level the Authority has links with the Western European Airports Association, the Airport Operators Council International and the International Civil Aviation Organisation (ICAO) where it represents the Airports Association Co-ordinating Council at meetings of a number of divisions of the organisation concerned with safety and standardisation of equipment and procedures. Specific areas in which the Authority has been active have included extended trials of the Precision Approach Path Indicator system at Heathrow and Gatwick and of the new Mark II Vasis lighting system. Improved facilities and procedures have been agreed with the CAA over the last three years in respect of both Gatwick and Edinburgh, raising their ILS and lighting equipment from Category II to Category III and joining Heathrow and Glasgow in the higher category. Particular attention has been paid to fire fighting. A major new fire fighting foam tender (the Javelin) has been built to the Authority's specification and is on trial. All runways at BAA airports have been closed down for varying periods during the last three years for the purpose of completing maintenance works necessary to aircraft and passenger safety but there has been no significant loss of operating capability. The general assessment of the BAA's achievements in the safety field is that its standards are high and well up to those to be found at airports in any other developed country. "To ensure, within the limits of the Authority's powers, high standards against terrorism and crime in its airports". Anti-terrorism BAA assumed responsibility from the airlines for passenger search in 1978. At about the same time the financing of the activity was transferred from the taxpayer to the air transport industry and an appropriate levy was placed on arriving passengers from which BAA (and other airport authorities) reimbursed. The total employed at BAA airports on all security duties (passenger search and access control) in March 1979 was 2,037 increasing to 2,222 a year later: the number reported to have fallen in 1982 to 1,695. To aid baggage searching a mechanised systems incorporating X-Ray machines installed at the major BAA airports: these machines, BAA report that efficiency of security procedures won approval in their 1978/79 passenger surveys. In March 1981 centralised search procedures were introduced at Heathrow at Terminal 3 and at Gatwick: these are reported by BAA to have greatly helped passenger processing and significantly reduce

security costs which in 1980/81 totalled just over £24 million (about 75% of costs are said to be for searching). The average total cost per passenger (including civil police and other costs) were lower at BAA airports than the average of other UK airports in 1980/81. To date there have been no successful hijackings from BAA airports. Prevention of Theft and Other Crime Prior to 1974 policing of BAA airports was carried out by the BAA Constabulary assisted, in cases of serious crime, by the local police. In that year the BAA Constabulary was transferred to local forces (funding remaining with the Authority). Airside access control remains with the BAA. In 1980, the Metropolitan Police reported 2,262 crimes at Heathrow of which thefts from baggage accounted for 120. Total thefts of or from passenger baggage at all BAA airports rose from 514 in 1978 to 559 in 1979 with thefts at Gatwick in both years (342 and 308) substantially outweighing those at Heathrow (137 and 202). In 1980 baggage thefts reported at Heathrow represented 0.0003 per cent of the 40 million pieces of baggage handled at that airport or 0.006 per cent of its estimated total value and were about one fifth of the levels recorded in 1972. "As the airport's owner, to accept general responsibility for the range and quality of all services available to all air travellers, cargo shippers and airlines using the airports". This is the most nebulous of the BAA's objectives and performance is difficult to measure. The Department and the BAA have been unable so far to implement a recent recommendation from the Public Accounts Committee that the Authority's performance aims should be extended to cover consumer satisfaction and that more should be done to secure information enabling valid

- 16 This is the most nebulous of the BAA's objectives and performance is difficult to measure. The Department and the BAA have been unable so far to implement a recent recommendation from the Public Accounts Committee that the Authority's performance aims should be extended to cover consumer satisfaction and that more should be done to secure information enabling valid comparisons of efficiency to be made with other countries' airports. In both cases the difficulty lies in the fact that there are considerable organisational differences between airports as to responsibility for handling the passenger and there are no internationally agreed measures in this field. Even within the BAA's own airports, the responsibility for baggage-handling (a vital service to the passenger) varies from airport to airport.
- 17 So far, it has not proved possible to identify a single measure of consumer satisfaction within the area of BAA's direct responsibilities which can be translated into a performance aim. But as a result of discussions with the Department, the BAA now provides in it Annual Report an analysis of the consumer complaints it receives at each airport. The first such published analysis pointed to a significant decline in the level of complaints received during 1980/81 compared to the previous year but this result may well have been influenced by the absence in that year of any significant air traffic control disputes in Europe. In addition to this analysis, the BAA has commissioned a

survey of passengers' reactions to its facilities, the results of which should be published in the next annual report. Further work needs to be done in the area of international comparisons of performance but the difficulties are formidable.

"To market the BAA's skills and experience in its own specialist field as a consultancy service and thus generate increased export opportunities for British consultants, contractors and suppliers".

- 18 In April 1978, the BAA and International Aeradio Limited (IAL), a subsidiary of British Airways, formed a joint company called British Airports International Limited (BAIL). Initially, its activities did not extend to wider participation in airport development and management for which the BAA then lacked the statutory powers. These powers were acquired later in Section 24 of the Civil Aviation Act 1980.
- 19 BAIL was set up so that BAA and IAL might compete, jointly, more effectively for consultancy and management-type contracts abroad. BAA were able to bring their expertise in the management and development of large handling international traffic, which IAL lacked; IAL on the other hand, already had a wide experience in foreign markets, especially in airport management abroad. The company was also set up to promote more effective competition in overseas markets against other national organisations such as Aeroport de Paris (France) and NACO (Netherlands), by providing an "arrow-head" for British consortia in any aspect of airport design, construction, equipping or manning, managing and training.

In view of its quasi-governmental nature, BAIL is attractive to overseas clients and it frequently supports private sector consultants in their bids. Such cases include projects in Abu Dhabi, Brunei, Morocco and Yemen where BAIL have joined consortia with private sector consultants. Since its establishment in 1978 BAIL has become recognised as a major force in airports consultancy and has successfully challenged the hitherto dominant position of Aeroport de Paris. Major projects obtained include the management consultancy contract for a new Athens Airport, a master plan for an expanded Bahrain airport, and the preparation of a complete national airport plan for Malaysia.

Performance

21 The company made a small profit, for the first time, in the year ending 31 December 1981 reducing its cumulative deficit to £137,827. It is financed by equity capital which is now all issued and fully paid, a second issue of 500 shares at £100 having been made during 1981 to provide increased working capital.

Use of Resources "To provide new facilities at its airports as are necessary to enable them to meet the needs of air transport safely, efficiently and economically". 22 The major problem facing the BAA has been how to plan for the growth of traffic particularly at its London airports and at Aberdeen which has experienced substantial growth as a result of North Sea oil development. Although the BAA has powers as a statutory undertaker under the General Development Order 1977 which should allow it to develop its facilities with fewer constraints constant pressure from environmentalists concerned with the problem of aircraft noise meant that since the 1978 White Paper it has become the practice for the Secretary of State for the Environment to direct the BAA to seek specific planning permission for any proposal to build a new terminal. The fourth terminal at Heathrow was the first major project to be subjected to the normal planning procedures. The result is that it can now therefore take a decade or more from the first proposals for additional capacity to the completion of construction. Thus the plans for the Fourth Terminal at Heathrow were drawn up in the mid - 1970's; were subjected to a public inquiry in 1978 and obtained outline planning permission in 1979 and detailed planning permission in 1981. Construction will not be completed before 1985. The outline planning application for a second terminal at Gatwick was submitted in 1979; the public inquiry took place in 1980 and a Ministerial decision on the Inspector's report is still awaited. The terminal cannot now be available before 1987. The lead-times on the Stansted project (involving a proposed new terminal beside the existing runway with a capacity to handle up to 15 million passenger a year) have also constantly slipped back as a result of the planning procedures and it now seems improbable that a planning decision will be taken inside the life of the present Government despite the rapid initial decision by the Government to invite the BAA to proceed. The capacity of airports to handle growth in demand is governed by a number of constraints which include: a) the number of aircraft movements which can be handled on a runway by air traffic control in any given hour. environmental controls which restrict the number of b) aircraft movements at night and, in the case of Heathrow, are intended to limit the annual number of air transport movements to 275,000 when Terminal 4 opens. terminal capacity which is measured in terms of the c) number of passengers which can be handled at each stage at acceptable standards during one hour. 6

A note on the capacity of the BAA's South East and Scottish Airports is at Appendix 3.

The Authority's Corporate Plan sets out each year a five year investment programme designed to improve its airport facilities with the purpose of removing constraints, raising the standard of service and providing additional capacity when this is needed. Table 1 illustrates the continuous process of revision of investment programmes to take account of changes in forecast demand and planning delays. In this respect the table shows the changes in timing of the start of expenditure on the major projects planned at the South East Airports.

Table 1 Corporate Plan Investment Programmes

Plan: 19	977	1978	1979	1980	19	981	Actu	nal S	lippage
£m (March	81)								
77/78 78/79 79/80 80/81 81/82 82/83 83/84 84/85 85/86	75 71 76 70 78	70 90 (T4 91 84 95) 92 (T4) 149 119 (T2) 131 115 (TLA	109 164 169	(T4/2) (TLA)	124 153 161 177 151	(T4) (T2) (TLA)	54 45 63 78 79 113(E)	29 % 36 % 32 % 28 % 38 %

Conclusion

To date the BAA has managed to fulfill this part of its Corporate objectives. The severe congestion at Heathrow which peaked in 1978-79 has not recurred there partly because of the unanticipated depth of the current recession (and its effect on inbound tourism), the success of the Government's policy of switching growth to Gatwick and a continuous programme of improvements designed to remove constraints. Against an assessed capacity of 30 mppa when the present central area improvements are completed , Heathrow handled 26.5 million passengers in 1981-82, a fall of 8.3 per cent from the peak of 28.9 million in 1979-80. Demand at Gatwick, however, has continued to increase sharply by about a million passengers a year and reached 10.9 millions in 1981-82 against an assessed capacity of 16 mppa (when the satellite now under construction is completed) and is now the world's fourth largest international airport. In Scotland, Aberdeen has coped with a doubling of traffic over the last five years to 1.54 mppa in 1980-81 through a constant programme of improvements to the terminal and other facilities. The Authority's ability to provide new facilities to continue to meet growth in demand depends on the granting of the necessary planning permissions. The unexpected depth of the economic recession has provided a breathing-space which compensated for the delays imposed by the planning process. The most serious problem over the next few years will be at Gatwick (the base for the major private-sector UK carriers) where the second terminal, originally intended to open in 1985, cannot now be completed before 1987 even if planning permission were granted soon.

Use of Resources "(b) As a public enterprise, to maintain a competitive and commercial approach to its operations and to ensure as far as possible that it meets the financial and other targets agreed with the Government from time to time". The first part of this objective has been one of the Authority's corporate policies for many years. The second part however was first expressed in this form in 1980 reflecting the agreement reached with the Government that year on a new financial target, after a gap of 4 years, of an average of 6% over the three year period 1980/81 to 1982/83 on average net assets valued at current cost. Also in 1980 two performance aims were agreed with Government which were intended to supplement the financial target as a means of demonstrating that the Authority was making productivity gains and not achieving its target solely through higher prices or increases in traffic. These aims, (the first of which is discussed in the Section on labour), are; a growth in the number of passengers handled per employee (allowing for changes in activities) of an average 3% per annum and a decrease in expenditure (before depreciation) per (b) passenger of an average of 21% per annum. Size of the Business It would be possible to analyse performance over the whole period of the Authority's existence but it is more appropriate to consider only the period from 1975/76 when the Authority acquired Glasgow Airport (its seventh airport) since which there has been no expansion by acquisition. However any analysis should be seen in relation to the size and growth of the business Table 2 below shows the growth since 1975/76. Table 2: Growth of Business 1971/72 = 10075/76 76/77 77/78 78/79 79/80 80/81 81/82 Passengers 134 147 150 172 186 183 181 Cargo 129 139 151 162 164 157 154 Air Transport Movements 128 123 129 145 158 156 152 Employees 109 119 127 164 172 168 160 Three points are worth noting. First, growth in traffic has been continuous over the period through until 1980/81. Secondly, the growth rate in air transport movements until 1978/79 was very much slower than that of passenger traffic reflecting the introduction of 8

wide-bodied jets, and therefore more passengers per movement, on international services. But the growth rate in air transport movements since 1978/79 has been very similar due to the considerable increase in the number of new air services and destinations served from the Authority's airports. Thirdly the growth in number of employees is distorted by the introduction of passenger search procedures which in 1978/79 increased the number employed by over 2000, an increase of about 40%.

32 In numerical terms the size and growth over the same period is shown in Table 3 below

Table 3: Size of Business: numerical growth

	1975/76	1980/81	1981/82
Passenger (millions)	31.8	43.3	42.9
Cargo (1000 tonnes) Air Transport Movement	580.7 695.3	706.6 763.3	618.4 536.7
(1000's)			
Employees (excluding security)	4,870	5,428	5,139

33 The business should also be seen in unit terms as a means of judging performance. It is appropriate to do so by taking a passenger as the unit though a more precise analysis would take cargo traffic into account. Table 4 shows the two most useful measures, revenue and expenditure (before depreciation), that is to say operating costs, at constant prices per passenger (total) over the period from 1975/76.

Table 4: Business Performance in Unit Terms

	1975/76	76/77	77/78	78/79	79/80	80/81	81/82
£ (March 81 price per passenger	es)	Carry NA		1. 1. 1. 1. 1. 1. 1. 1. 1. 1. 1. 1. 1. 1	Al Talanti		
Revenue	4.68	4.91	5.13	5.38	5.05	5.97	6.02
Expenditure	3.04	2.88	3.05	3.58	3.47	3.82	4.04
(excluding depres	ciation)						

Three points are worth noting First the reduction (at constant prices by reference to the RPI) in expenditure per passenger in 1976/77 though there is no immediately obvious explanation of this. Secondly, the real increase in revenue per passenger in 1980/81 is an indication of the considerable increases in user charges imposed in November 1979 and April 1980. Thirdly, the increases in income and expenditure per passenger from 1977/78 reflects the introduction of the security levy, and the security costs incurred, amounting to £0.67 per passenger by 1980/81.

Performance aim

35 This excess of security levy must also be discounted in considering the Authority's performance against the aim of reducing expenditure per terminal passenger by $2\frac{1}{2}$ % pa. In 1980/81 the first year of the aim, the Authority reported an adverse result of + 1.3% partly reflecting a decrease in the number of passengers that year but

mainly the continuing real increase in fixed costs in particular rates and utilities. In 1981/82 the result improved to -0.7%.

Generation of Surplus Funds

36 This part of the Corporate objective is now stated in the form of the financial target of 6% CCA return on net assets. The target was derived from the required rate of return of 5% on new investment as a whole as specified in Cmnd 7131. In the period from 1976/77 to 1981/82 BAA achieved financial self-sufficiency in all but the final year when a NLF loan of £5 million was needed to supplement internal resources. Table 5 shows capital expenditure, trading profit before depreciation both in total and in unit terms at constant prices.

Table 5:

Investment

1975/76 76/77 77/78 78/79 79/80 80/81 81/82

(March '81 prices)

million

Table 3.		111	ves mien	_				
	1975/76	76/77	77/78	78/79	79/80	80/81	81/82	
(March '81 prices) £ million								
Capital expenditure Trading profit (excl depr) (1) In CCA terms	81.06 52.45	70.3	53.48 74.02	44.98	62.85	78.39 88.45 (1)	78.87 90.28 (1)	
<u>£</u>			Arrola					
Capex/passenger T. Profit/passenger	2.55	2.01	1.51 2.08	1.11	1.43	1.81 2.04 (1)	1.83 2.10 (1)	

- In real terms 1975/76 was the peak year for capital expenditure since the Authority was created. Indeed although annual capital expenditure is increasing again in real terms, even in 1981/82 it has not reached the 1975/76 peak. Also notable is the unit capital expenditure which declined quite sharply until 1978/79 even though growth in passenger traffic was increasing over that period at an average rate of 9% per annum. This contrast reflected the pause created by the formulation of a new airports policy in the period leading up to the 1978 White Paper.
- 38 Until 1980/81 the Authority's cash limit/EFL was zero but in 1980/81 an EFL of £20 million was agreed of which £19 million was in the form of money on local authority deposit. The Authority has stayed within its cash limits but it is doubtful that these imposed any real constraints on capital expenditure until 1979/80 when the Authority had to cancel a number of projects under construction at Heathrow and Gatwick in order not to breach its EFL. Generally it seems likely that capital expenditure was held back by other factors of which delays in formulating policy and granting planning permission were the most significant.

Return on Investment It is not possible to measure directly the Authority's achievement in relation to its corporate target internal rate of return - 10% on traffic projects and 8% on commercial projects - and thus its performance in relation to the Government's required rate of return of 5% on new investment as a whole. Virtually all revenue earning investments have been incremental and thus largely concerned with improving and expanding facilities which were constructed some time previously; Terminal 4 at Heathrow will be the first identifiably independent major revenue earning project for many years. But a useful indirect measure of return on investment, are the initial calculations carried out in deriving the Authority's financial target suggested a traffic revenue (excluding security levy) per passenger of £2.34 at March 1979 prices would be required to earn the 5% RRR on new investment; or £3.16 at March 1981 prices. This assumed that the major part of the investment would be concerned with airports (traffic) operations and would include the Second Terminal at Gatwick and that revenue from commercial sources would be excluded. The Authority however assumes that all its revenue is traffic-related and therefore should be taken into account. Table 6 below shows the income (excluding security levy) per passenger both in total and by source. (excluding security levy) per passenger Table 6: £ (March 81) 1975/76 76/77 77/78 78/79 79/80 80/81 81/82 Landing fees 2.23 2.47 2.53 2.42 2.16 2.81 2.81 2.60 Commercial 2.33 2.44 2.44 2.34 2.35 2.52 4.68 4.91 5.13 4.50 Total 4.86 5.16 5.33 As may be seen the revenue from landing fees in 1980/81 and 1981/82 fell somewhat short of the target; and even though there had been a considerable real increase in landing fees in 1980 and a consequential real increase in landing fee revenue of about 28% over the previous year, the unit revenue is some 10% below the required level. But by its own standards the Authority's unit revenues have been well in excess of the required level to achieve the 5% RRR and probably approached the level required to achieve the IRR stated in its Corporate Plan. The figures for the previous years are shown for comparison only since the target revenue does not apply to those years. In accordance with internationally - approved practice the 42 Authority seeks to maximise non-aeronautical revenue with the result that the profits from activities have allowed landing fee revenue to fall short of expenditure on traffic operations (except recently at Heathrow). The Authority's policy for determining the structure of its landing fees undoubtedly reflects the principles embodied in marginal costing eg peak/off-peak pricing, differentials between 11

airports to reflect in the same way fully utilised under utilised capacity. But it seems unlikely that the actual charging level fully reflects these costs.

44 Whilst the Authority continues to generate substantial profits its accounting rate of return is somewhat below the present target which was agreed in 1979 before the current recession in economic activity. In 1980/81 the first year of the new target period the Authority the return shown was 5.9% though discounting factors not envisaged in the determination of the financial target such as re-lifing of assets and interest receivable, which was high that year, the comparable return was probably about 4.5%. In 1981/82 the return was 4.7%. But CCA rate of return on net assets at its South East Airports alone has increased from 5.3% in 1977/80 to 7.6% in 1980/81.

Scottish Airports

45 Over a number of years it has been corporate policy that the

Over a number of years it has been corporate policy that the Scottish Airports as a Group should move towards break even: in the 1981 Corporate Plan it was to do so in CCA terms by 1983/84. In fact as Table 7 shows the performance in 1980/81 was lower than that achieved in 1975/76 - the first full year of operation of the Group in its present form as a result of the substantial deadline in traffic at the Scottish airports. A similar result is expected in 1981/82. The Group is however a net cash generator for the BAA.

le 7: So	cottish A	irports:	Group p	erforman	се	
£'000	1975/76	76/77	77/78	78/79	79/80	80/81
Revenue Expenditure	8,837	11,863	14,492	19,587	23,842	32,960
(incl. capital costs)	9,001	17,170	16,465	22,357	32,358.	35,841
Revex ratio	0.98	0.69	0.88	0.88	0.74	0.92

"As a good employer to ensure fair pay and conditions of service for employees and to encourage a working partnership leading to higher productivity and higher standards of service to the public through proper arrangements for participation, consultation and negotiation".

46 BAA's performance in the area of staff pay and performance must be measured against a variety of criteria. There have been no serious stoppages by BAA staff during the review period and our impression is that during the last two years in particular there has been a successful tightening of controls over staff costs which has, for example, enable the transfer of BAA's headquarters from London to Gatwick to take place with a net reduction in the labour force.

Pay The comprehensive review of the pay and grading structure which was carried out in the mid-1970's to achieve a more rational system of relativities and differentials was introduced during 1978/79 accompanied by a self-financing productivity structure. The scheme, formulated on the basis of the ratio of "added value" to employee costs gives variable payments to staff, dependent on the BAA's performance and employees' co-operation with agreed efficiency measures. Since the new grading and productivity scheme was introduced annual pay awards have been as follows consistently moderate compared with the annual rate of inflation: 1979: 9% increase in basic rate, including overtime. A bonus was offered to all staff prepared to accept monthly pay at a net lost of 1% of the wage bill. An attendance condition was introduced in the productivity scheme. In return, productivity payments were increased from $7\frac{1}{2}$ % to 10%. Estimated increase in average earnings 10.5% (RP1 14%). 1980: 15% increase in basic rates from the operative date of 1st January with a further 2% from 1st April. Estimated increase in average earnings rather less than 15% (RPI 20%). 1981: 9% increase in basic rates. Payments under the productivity scheme to continue at 10% of the new rates of pay conditional on payments not being made for absences other than approved annual leave and special leave. Estimated increase in average earnings 9% (RPI 16%). 1982: 6% increase in basic rate and shift allowance; productivity payments frozen at 1981 level. Estimated increase in average earnings 5.6% (RPI 12%). Consultation with Employees There has been continuing development of the role of the unions in the greater involvement of employees both in the formal consultative machinery and in participative exercises such as the design of new uniforms, airport ancillary furniture and planned preventive maintenance. The importance of communicating with employees was recognised by, an extensive programme for involving the staff in consultations on the Corporate Plan each year and for informing them about the results announced in the annual report. Staff Numbers and Costs The number of staff employed fell in 1980/81 and again in 1981/82: Table 9 shows the number of staff employed over the past five years. The increase in 1978/79 was largely accounted for by the BAA staff taking over responsibility for passenger searching at Gatwick, Stansted and the four Scottish airports in 1978. 13

Table 8: Staff Numbers (31 March) All Staff % increase Excluding Security Staff % increase 5351 4.6 4746 NK 1976/77 1977/78 5789 8.2 4902 3.3 1978/79 7298 26.0 5261 7.3 5433 1979/80 7655 4.9 3.3 (2.0)1980/81 7459 (2.6)5322 1981/82 7120 (4.5)5139 (3.4)

This is an indication of the success of the Authority's productitivy arrangements and tight control of recruiting. This is further illustrated in Table 9, Staff costs; which also show the measure in costs due to the new pay and grading structure introduced in 1978/79 during the previous Government's pay policy.

Table 9:

Staff Cost	ts	(March 1981)	Prices)	
	Total £'000	% increase	Av employee £	% increase
1976/77	45,797		9,167	
1977/78	47,292	3.26	8,872	(3.2)
1978/79	67,250	42.20	10,722	21.9
1979/80	77,910	15.85	10,929	1.9
1980/81	75,755	(2.77)	10,482	(4.1)
1981/82	75,368	(0.51)	10,339	(1.4)

52 Finally a breakdown of staff costs reveals that overtime now accounts a decreasing proportion of total costs: Table 11 shows this and for comparison basic pay as a proportion of total staff costs.

Table 10: Percentage of Staff Costs

	Overtime	Basic Pay
1976/77	7.8	57.2%
1977/78	8.5	55.2%
1978/79	10.0	55.1%
1979/80	9.5	52.9%
1980/81	6.9	54.1%
1981/82	6.4	53.5

Performance Against Target Aims: Labour Productivity

53 In 1980/81, the first year of the target period, despite a reduction in budgeted staff numbers and cost, the outcome was -1.1%, due mainly to a substantial reduction in the number of passengers during the years. In 1981/82 the result was much better at + 4.9%.

Impact on Others "To live in harmony with the communities adjoining the BAA's airports and to take action to maintain a balance of interest between the communities and the needs of air transport." Commentary Living in harmony with neighbouring communities is probably the most difficult task of all since the BAA's airports together handle 60% of all air transport movements at UK airports and its London airports alone account for 42%. Moreover, in accordance with the Government's policy, the Authority is responsible for planning, and eventually implementing the largest airport development projects in the country, indeed in Europe, and securing public acceptance of its proposals. Because of their size and growing activity, it is not surprising that the environmental impact of the BAA's airports is a matter of constant concern to the communities adjoining them and a source of friction. The problem requires careful attention, first because of the human suffering involved which requires effective mitigating measures, and secondly because nearby communities represented by their local authorities, MP's and amenity groups tend to be vocal objectors at Public Inquiries into airport expansion proposals. Thus, if the Authority is to fulfill its statutory duty to meet the needs of air transport at its airports, it must seek to foster a better

understanding by all concerned of conflicting interests such as the needs of the travelling public, the national benefit of developing tourism, trade and employment opportunities and, on the other hand, the disturbance cause by airports to local residents. These objectives are pursued by the Authority through the airport Consultative Committees and by taking action (voluntarily or in implementation of Government policies) to reduce environmental disturbance.

Conclusion

Within the statutory framework, the Authority has achieved a good measure of understanding with neighbouring communities and has implemented effectively measures to reduce the environmental impact of its airports.

Appendix 1

Traffic Forecasts

Given the long lead times involved in airports planning, it is clearly essential that there should be forecasts of the long term growth in demand for air transport to guide the Authority both in its Corporate Planning and in its assessment of the need for additional airports capacity. The present air traffic forecasting model of the BAA was developed in 1976 and fresh forecasts are prepared at least once a year both for the Corporate Plan and for the series of public inquiries in which the Authority has been engaged in recent years. Some assessment of the Authority's forecasts can be provided by a comparing forecasts made in previous years with the latest projections:

Forecast for South East Airports
(Including Luton)
Millions of passengers per annum (MPPA)

	1975	1976	1977	1978	1979	1980	1981	1982
1981							39.3*	
1984	50.5	52.4	53.4	55.4	57.0	52.5	49.9	46.8
1989	75.1	74.5	75.0	77.1	75.4	69.3	66.9	62.8

* Actual

The Department's economists can find no evidence that, over the longer term, BAA forecasts have been consistently over-optimistic. Since 1979 however, forecasts have been revised downwards to reflect the depth of the current recession which was unforeseen by either the BAA, or most other forecasters. The final outcome for 1981 reflects closely the forecasts made in the mid-1970's. As a comparison, the forecasts prepared by the Department of Trade in 1977 for the Airports Policy White Paper projected a high forecast of 41.9 mppa for 1980 and a low of 36.7 mppa. The actual out-turn was well within the forecast range.

To reflect the economic climate since the recession began the BAA's longer term forecasts have also been revised downwards in recent years:

London Area "Planning" Forecasts (MPPA)

Corporate Plan	1985	1990	1995
1979	59	82	
1980 1981	59 53	78 70	87
(Stansted statement of case)			
1982	49	67	85

Again a comparison can be provided with the three most recent air traffic forecasts published by the Department of Trade:

London Area Airports (MPPA rounded)

	1	985	199	0	1999	5
	H	L	H	L	Н	L
1978 White Paper	64	51	89	66	-	_
1979 ACAP	61	55	81	69	100	82
1981 ATFWP	51	45	70	52	89	60
1982 Ec2	54	46	71	53	89	58

It will be seen that the forecasts have also been substantially revised in the light of more pessimistic economic assumptions. More recent work within the Department suggests that the 1981 ATFWP forecasts, particularly for 1985, may be too low.

Following the 1981 revision of its air traffic forecasts, the Department of Trade presented a paper to the Stansted Inquiry which stated that for policy purposes the Department was adopting a narrower band of values symmetrically disposed within the ATFWP range of forecasts, as follows:

		MPPA
	<u>UK</u>	LONDON AREA
1985 1990 1995	65 - 71 79 - 96 91 - 119	46 - 50 56 - 67 65 - 84

In assessing proposals for long term expansion of capacity, the Department has stated that it will use values towards the top of this narrower band. This is not a judgement about the most likely outcome, but a prudent reflection first of the possibility that the actual traffic may prove to be close to the top end of the forecasts; and secondly of the consequences of under-estimation of demand. This range encompasses the BAA's Planning forecasts.

Appendix 2

Airports Policy

Following the abandonment of the Maplin Project in 1974, the Government undertook a comprehensive review of airports policy in Great Britain to serve as a basis for consultations on the way in which future air traffic might be handled. It was felt essential to ensure that decisions concerning the development of particular airports were reached after taking full account of the views of all those who would be affected by them. To facilitate this process the Government produced a two part Consultation Document entitled Airport Strategy for Great Britain. Part I published in November 1975 covered the London area airports and Part II published in June 1976 dealt with the regional airports. Nearly 1,000 organisations throughout Great Britain were invited to comment on these documents which set out a number of possible scenarios for future airports development.

- The results of the Government's consideration of comments received during the consultative process were presented in February 1978 in the White Paper Airports Policy. The strategy for a national airports policy outlined in this White Paper was based on the recognition that the air transport industry made an invaluable contribution to the ecnomy; the principle that air transport facilities should not in general be subsidised by taxpayer or ratepayer, the need to take careful account of the environmental impact of airport development; the adoption of a flexible approach in planning and development related to the growth in demand; and the importance of consulting those concerned with airports in the development of policy.
- 3 The White Paper concluded that additional airports capacity would be necessary in the South East in the 1980's to meet the forecast demand for air travel. It stated that the diversion of passengers with origins and destinations in the South East to airports in other parts of the country neither made sense in transport terms nor would it lead to an overall decrease in the numbers of people affected by aircraft noise. The limited scope for diverting passengers from the London area airports to those in other regions did not remove the need for additional airport capacity in the South East. It was therefore proposed that foreseeable demand in the region should be met by the expansion of the existing London area airports. Outside London, air services would be encouraged to concentrate at a few selected airports which might thereby be able to offer a range and frequency of service to meet local demand and at the same time provide a stimulus to air travel outside the South East.
- The White Paper confirmed the decision to abandon the Maplin project and concluded that to meet forecast demand in the 1980's proposals for a fourth terminal at Heathrow should be examined at a public inquiry and that proposals for a second terminal at Gatwick should be brought forward. The Government accepted that limits should be placed on the growth of the existing airports and concluded that Heathrow would be limited to not more than

four terminals and that the proposal for a second runway at Gatwick should not be revived thereby effectively limiting development at Gatwick to a maximum of two terminals. Luton was not considered suitable for development beyond a single terminal with an estimated capacity of 5 million passengers a year.

- The White Paper did not suggest a solution to the longer term provision of capacity in the South East but instead proposed the establishment of a formal consultative machinery to include consumers, local authorities and amenity groups, to consider the longer-term airport options. As a result two bodies (ACAP and SGSEA) with representatives from a wide range of organisations, were set up in 1978, and reported to the Secretary of State for Trade in November 1979. ACAP concluded that the effective capacity of the existing four London area airports, even taking into account a fourth terminal at Heathrow and a second terminal at Gatwick, was likely to be exhausted towards the end of the 1980's. SGSEA evaluated sites for a Third London Airport but reached no conclusion on which of the short-listed six sites should be chosen as it considered that this was a political decision.
- On 17th December 1979 the Secretary of State for Trade announced that the Government had decided not to build a major new airport of the kind considered by the Roskill Commission nor would it resurrect the Maplin project, even in a revised form. The Government would, however, encourage the fullest use of regional airports and provide additional airport capacity as the traffic developed, based on the existing airports in the South East, particularly Heathrow, Gatwick and Stansted. It was announced that the Government had decided to accept the Inquiry Inspector's recommendation to construct a fourth terminal at Heathrow but that, in accordance with the Inspector's .. recommendation, the Government had concluded that a fifth terminal at Heathrow should not be provided. The BAA were therefore invited to bring forward detailed proposals for the construction of a new terminal and associated facilities at Stansted capable of handling up to 15 mppa. The Stansted Public Inquiry opened in September 1981 and is unlikely to conclude before the Spring of 1983.
- The 1978 White Paper did not reach any firm conclusions on the futute of the Scottish airports because responsibility for Scottish airports policy was expected to pass to the Scottish Assembly after the desolution referendum. It noted, however, that there was no shortage of runway or terminal capacity in Scotland and that all the major airports had extensive modern facilities. It also noted that any substantial transfer of passenger and cargo services away from Prestwick would affect the viability of Prestwick. Successive Governments and the BAA have taken the view that the Scottish Lowland airports should operate as complements to each other with Prestwick as the Gateway international airport for long-haul flights serving the whole of Scotland, Glasgow catering for domestic and short-haul services

for the West of Scotland and Edinburgh serving a similar function for the East of Scotland. The present Government has, on a number of occasions, confirmed this allocation of traffic as part of their airports policy.

Appendix 3

Capacity of the London and Scottish Airport London Airports

London Airports

The existing capacity of the central area terminals at Heathrow is assessed by the BAA at 30 mppa. The provision of a fourth terminal, currently under development, will increase the capacity of the airport as a whole to about 38 mppa in the late 1980's. The distribution of capacity between the three Central Area terminals and the fourth terminal will depend on the nature of the traffic distribution within the airport.

The existing capacity at Gatwick when current developments are completed is assessed at 16 mppa. The provision of a second terminal at Gatwick would enable capacity to be increased ultimately to about 25 mppa. In practice a throughput of 25 mppa will not be achieveable at Gatwick until aircraft loads have increased sufficiently for the runway capacity to match terminal capacity and this is unlikely until the mid-1990's. The second terminal can therefore be phased to take this constraint into account.

The present capacity of Stansted airport is assessed at 2 mppa and of Luton airport at $3\frac{1}{2}$ mppa (once the current terminal improvement programme is completed). Thus the present aggregate capacity of the London area airports system totals about 511 mppa and will ultimately rise to $68\frac{1}{2}$ mppa once the fourth terminal at Heathrow and the the second terminal at Gatwick (assuming planning permission is granted) and completed. There may be scope for further increases in the capacity of Heathrow in the early 1990's but this will be more than offset by the delay in fully utilising the terminal capacity at Gatwick (as a result of the runway constraint) and the impossibility of perfectly matching demand to supply. This so called mismatch factor reflects the fact that the licensing of new services and frequencies is not in the hands of the BAA and that airlines do not switch services between airports to reflect changing patterns of constraint. There is a general Government policy of transferring demand from Heathrow to Gatwick which has been highly successful in recent years. Traffic at Gatwick has increased at over a million passengers a year in the last few years so that by 1981 it had become the fourth busiest international airport in the world. This policy has only been operable because there has been ample spare capacity at the latter airport. Individual airlines already operating at Heathrow have fought long and bitter campaigns against being required to switch their services to Gatwick often with the open support of their Governments in the case of foreign carriers.

Because of the problems of matching air transport demand to supply it is not practicable to direct the airlines (who often operate under international air service agreements which give them considerable freedom to expand frequencies as they see fit) in such a way that as demand reaches the aggregate of individual

airport capacities it will precisely match those capacities. For this reason, additional capacity within the system should become available before total demand falls short of total capacity. Inspector at the Gatwick Second Terminal Inquiry concluded that a 10 per cent allowance should be made for this mismatch problem in assessing future cpacity requirements. The Government invited the BAA to bring forward its proposals for Stansted because the 1979 ATFWP forecasts suggested the need for still further capacity by 1988. The subsequent recession and revised air traffic forecasts now suggest that the need for the Stansted Development has receded to 1990 at the earliest but, as with the earlier projects, such delays are likely to be more than compensated for by slippage in the planning process. The detailed case for Stansted and the alternatives which have been proposed (a fifth terminal at Heathrow, for which a planning application has been submitted by the local authorities around Stansted, and now airports at Maplin and Severnside) is being scrutinised in great detail at the current Stansted Public Inquiry.

Scottish Airports

As elsewhere, the regional airports in Scotland have, for the most part, ample capacity for foreseeable traffic demand. Following extensive modernisation and improvement by the BAA during the 1970s the three lowland airports have estimated capacities as follows:

	Approx. Terminal Building Capacity (mppa)	Runway Length (Metres)	Terminal Passengers ('000's)
Prestwick	1.5	2987	392.8
Edinburgh	2.0	2560	1162.9
Glasgow	3.75	2566	2340.4

The main problem for these airports is an excess of capacity over foreseeable demand. The Government's policy towards these airports was stated most recently by the Secretary of State for Trade in his statement on 13 May 1981. No significant additional traffic is expected to be created in Scotland if demand is diverted from the South East and the present capacity of the three lowland airports is more than sufficient to cope with foreseeable demand in their local catchment area.

Aberdeen airport faces particular pressures as a result of North Sea oil development. Its present terminal capacity is assessed by the BAA at 1.2 mppa but the Authority has a major investment programme of £10.8 million in hand to cope with forecast increases in oil related traffic. Inter alia, this programme will increase terminal capacity to 1.5 mppa.



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Treasury Chambers, Parliament Street, SWIP 3AG 01-233 3000

26 August 1982

Jonathan Spencer, Esq.,
Private Secretary to the Secretary of State
for Industry,
Department of Industry

Deu Jundu.

CONTRACTING OUT IN THE NATIONALISED INDUSTRIES

You will have seen the Chancellor's letter to the Home Secretary of 11 August about contracting out public sector functions.

In that letter the Chancellor asked for reports from colleagues by the end of October carrying forward the earlier work done in MISC 14 on contracting out central government functions and extending this to local authorities and the National Health Service.

The Chancellor feels that it is important that this work should also cover nationalised industries. No doubt some of the ground, e.g. franchising of rail catering, will be covered by sponsor Ministers in preparing reports on privatisation proper which the Prime Minister asked should be co-ordinated by HDI) in her personal minute of 28 July. But as explained in the Chancellor's 11 August letter the issues are rather separate. He therefore suggests that EDI) should take a separate look at contracting out after the main privatisation work has been completed. He would therefore be grateful if nationalised industries sponsor Ministers would let him have a report on progress and prospects on contracting out by the end of October.

I am copying this letter to Michael Scholar in No.10 and to the Private Secretaries of other nationalised industry Ministers, of Mr. Sparrow at the CPRS, and of Sir Robert Armstrong.

Jullen.

J.O. KERR

OR THE ENVIRONMENT

Prime minister 2

Low cockfields proper and this letter from our Hereltine (as well as any response from Law Cockfield) are to be discussed at E(NI) on 8 September.

2 MARSHAM STREET LONDON SWIP 3EB

My ref: H/PSO/15309/82 Your ref:

16 August 1982

My Sewer

ch 23/8

In A.K.

I have already let you know that I am unhappy about the note you circulated on the British Airports Authority on 23 July, because it is so broad-brush in character. I would have hoped for more specific proposals about the ways in which the BAA might achieve the targets it has been set but, so far, has failed to meet. And I would have expected its investment programme to be more critically reviewed, when its implementation seems liable to produce massive over-capacity among the south-eastern airports.

My principle concern is that we get a model for these exercises that is universally tough. I am in many ways trying to learn from the ways in which you are tackling problems that I face in other fields.

These are the problems of improving the efficiency of organisations which are not much affected by market pressures. The BAA, with a virtual monopoly at least of south-eastern airports, is such an organisation. The figures you circulated show that is has failed, over the last 2 years, to meet the relatively modest aim of reducing real costs by 2.5% a year. In the longer term, measures of performance are confused by the addition of security staff to its payroll in 1978-9; but they present a rather unflattering picture before 1978. They only show a marked improvement since 1979, despite its failure to cut costs. Landing fees per passenger have risen 17.6% in real terms in the last 10 years, despite an increase of 84% in passengers. These figures must raise a question mark about its efficiency and cost-consciousness.

The BAA's attitude to planning future capacity also suggests some lack of concern with costs. The investment proposed in its corporate plan would give it over-capacity in the south-east, compared even to the top end of your department's traffic forecasts, which amounted to 18% in 1985-6, 26% in 1986-7 and 32% in 1988. I am glad that you say that the timing is flexible though you approve the plan; the BAA's own proposed timing seems very far from optimal.

This evidence is worrying, because it implies that the BAA has at least some of the weaknesses to which a monopolist is prone. It therefore presents us with that most intractable of problems, how to induce an organisation to adopt uncomfortable measures to improve efficiency when it has little incentive to do so. I would have hoped that your note might have discussed this problem, and perhaps proposed some more specific objectives for the BAA's future performance.

The case for such an approach seems all the stronger when I see that



the summary of the corporate plan that you circulated does not discuss ways of improving efficiency, and that your own note suggests that future improvements in productivity will be smaller than those in the past because of the new terminals which will be opened. The BAA also expects to miss its 3-year target for cost reductions, though it hopes that increasing traffic will let it meet its target for productivity.

the implication of this evidence is that real costs are liable to rise in future, especially if the BAA is allowed to equip itself with the capacity proposed in its plan.

I am glad we shall now have an opportunity to discuss the BAA's plans at E(NI) next month. I am sure it would help our discussion then if you could consider how far you can amplify your note to take account of the worries I have expressed, and in particular whether you can discuss possible ways of reducing real costs in future. For example, could productivity of existing facilities be improved, as an alternative increasing capacity; and could the effects of higher traffic be exploited more effectively, to obtain greater improvements in productivity. There should, I imagine, be some scope for economies of scale in the airports business, as there is in most others.

Lastly, I think we would be mistaken if we weakened our pressure on the BAA to reduce costs and plan realistically for new capacity because it is under so many external attacks. Our objective should rather be to encourage the BAA to eliminate any justification there may be for these attacks.

Mel

MICHAEL HESELTINE

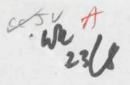
2 3 AUG 1982



GCC: Mr. Walters
No. Voveber. 10 DOWNING STREET 13 August, 1982 From the Private Secretary The Contracting Out of Public Sector Functions The Prime Minister was grateful for the Chancellor of the Exchequer's minute of 10 August. She agrees that Departmental Ministers should personally review the progress that their Departments have made, and the opportunities for new initiatives on the contracting out of public sector functions, and she agrees that this review should cover the NHS and local government. But she does not feel that it would be right to initiate the exercise by a personal minute from her to the Chancellor. As I told you on the telephone, she would prefer the Chancellor to write to the Home Secretary suggesting that this review should be set in hand, and to say that he is doing so with her agreement. I am copying this to Richard Hatfield (Cabinet Office). W. F. S. RICKETT Peter Jenkins, Esq., H.M. Treasury CONFIDENTIAL







Treasury Chambers, Parliament Street, SWIP 3AG 01-233 3000

11 August 1982

The Rt. Hon. William Whitelaw, CH, MC, MP Secretary of State for the Home Department, Home Office

In Willi

THE CONTRACTING OUT OF PUBLIC SECTOR FUNCTIONS

During the course of the last two years the Ministerial Group on Government strategy (MISC 14) has considered on a number of occasions, on the basis of reports by the CPRS, the scope for contracting out to the private sector some of the functions performed by central government, and the progress being made in doing so. The most recent CPRS progress report was circulated with the letter to me of 13 July 1981 from the then Head of the CPRS.

The need to redress the balance between the public and private sectors through privatisation and contracting out remains an essential part of the Government's strategy. It is, therefore, important to improve on the impetus of MISC 14's earlier work on this subject, if we are to make more progress on this than we have so far.

The Prime Minister's minute to me of 28 July (M8/82) invited me as Chairman of E(DL) to co-ordinate a thorough review of the prospects for further privatisation. She agrees that we need with equal urgency to review the progress being made with contracting out and to identify where new opportunities exist. (The aims of these two exercises are, of course, similar; the distinction is that privatisation involves transferring responsibility for a function to the private sector, whereas contracting out means that the public sector retains responsibility but employs a private sector agent to carry it out.)

I should be grateful therefore if colleagues would report to me by the end of October on progress to date with contracting out and the further measures that might be taken. Norman Fowler and Michael Heseltine will no doubt also wish to report on the situation in the National Health Service and





Local Government respectively. The aim would then be to prepare, in the light of these reports and of further bilateral discussions with individual Ministers, a report to the Ministerial Committee on Economic Strategy in time for a discussion before the end of this year setting out a detailed programme of the further measures that might be taken during the remainder of the Government's term of office and summarising the main prospects in the longer term.

In preparing their reports I hope colleagues will consider personally what more can be done to improve on the relatively limited progress that has been made to date and suggest areas for new initiatives.

I am copying this letter to the Prime Minister, to all Members of the Cabinet, the Attorney General, the Lord Advocate, Sir Robert Armstrong and John Sparrow.

I Jun

GEOFFREY HOWE



Treasury Chambers, Parliament Street, SWIP 3AG 01-233 3000

Prime minister 3

If you agree to lamuch a further finitiative on "contracting out", a personal minute to the Chancellor is attached.

THE CONTRACTING OUT OF PUBLIC SECTOR FUNCTIONS

The Ministerial Group on Government Strategy at its meeting on 29 July (MISC 14(82)3rd Meeting, Item 2) considered briefly the progress that had been achieved so far with contracting out public sector functions and whether more could be done. The Group agreed that although progress had been made following the various reports which the CPRS produced for MISC 14, much more could and should be done; and that if real progress were to be made the Government would need to launch a new initiative covering not just central government but also the NHS and local authorities. I know from your reaction when I mentioned the topic last week that you take the same view of its urgency. I have been considering what can best be done to stimulate early and effective action.

As the progress report circulated with Robin Ibbs' letter to me of 13 July 1981 illustrated, the work undertaken previously by the CPRS identified a wide range of functions that might in principle be contracted out to the private sector. But much too little has been done to turn principle into practice. The main task, at this stage, is to ensure that Departments, the NHS and local authorities realise that the Government remains committed to contracting out as much as possible; and that sufficient political priority is attached to this work. In my view, the right first step is



for Departmental Ministers personally to review the progress that their Departments have made and the opportunities for new initiatives; the Secretaries of State for Social Services and the Environment might be invited to co-ordinate similar reviews for the NHS and local government respectively. In the light of these reviews, which might be completed by, at the latest, the end of October. and of further bilateral discussions which I might need to have with individual Ministers, I would intend to put a report to E Committee for discussion before the turn of the year, setting out a detailed programme of the further measures that might be taken during the remainder of the Government's term of office and also identifying the main prospects in the longer term.

- 3. To ensure that Departmental Ministers take a personal interest in this work I think it would be helpful if you were to initiate the exercise by a personal minute to me along the lines of your minute of 28 July (M6/82) on privatisation. I attach the draft of such a minute.
 - 4. I am sending a copy of this minute to Sir Robert Armstrong.

1/4

(G.H.) /0 August 1982 CONFIDENTIAL



10 DOWNING STREET

THE PRIME MINISTER

Personal Minute

No.

THE CHANCELLOR OF THE EXCHEQUER

The Contracting Out of Public Sector Functions

During the course of the last two years the Ministerial Group on Government strategy (MISC 14) has considered on a number of occasions, on the basis of reports by the CPRS, the scope for contracting out to the private sector some of the functions performed by central government, and the progress being made in doing so. The most recent CPRS progress report was circulated with the letter to you of 13 July 1981 from the then Head of the CPRS.

The need to redress the balance between the public and private sectors through privatisation and contracting out remains an essential part of the Government's strategy. It is, therefore, important to improve on the impetus of MISC 14's earlier work on this subject, if we are to make more progress on this than we have so far.

My minute to you of 28 July (M6/82) invited you in your capacity as Chairman of E(DL) to co-ordinate a thorough review of the prospects for further privatisation. We need with equal urgency to review the progress being made with contracting out and to identify where new opportunities exist. The aims of these two exercises are, of course, similar; the distinction is that privatisation involves transferring responsibility for a function to the private sector, whereas contracting out means that the public sector retains responsibility but employs a private sector agent to carry it out.

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Ministers should report to you by the end of October on progress to date with contracting out and the further measures that might be taken. The Secretaries of State for Social Services and the Environment should also report on the situation in the National Health Service and local government respectively. I should be grateful if you would then prepare, in the light of these reports and of further bilateral discussions between you and individual Ministers, a report to the Ministerial Committee on Economic Strategy in time for a discussion before the end of this year. This should set out a detailed programme of the further measures that might be taken during the remainder of the Government's term of office and should summarise the main prospects in the longer term.

In preparing their reports to you colleagues should consider personally what more can be done to improve on the relatively limited progress that has been made to date and suggest areas for new initiatives.

I am sending a copy of this minute to all members of the Cabinet, the Attorney General, the Lord Advocate, Sir Robert Armstrong and Mr. Sparrow.

fie . 10 DOWNING STREET 9 August 1982 From the Private Secretary Dear Jonathan British Airports Authority: E(NI)(82)19 Thank you for your letter to Michael Scholar of 5 August. I have consulted the Prime Minister, and she still wishes to have a discussion of this paper, and of your letter, at a further meeting of E(NI) after the Recess. I understand the meeting has been provisionally fixed for 8 September. You will also have seen David Edmonds letter of 2 August, in which he explains that Mr. Heseltine wishes to comment in detail on this subject: The Prime Minister has also noted the comment in your letter that quite a large proportion of the BAA's costs is fixed or externally imposed, and that this limits the scope for making substantial reductions in current operating costs. She remains, however, unconvinced that the BAA could not achieve further reductions through efficiency, and particularly through the efficient use of space (thereby reducing rates) and energy. I am copying this to the Private Secretaries to the other members of E(NI) and to Richard Hatfield (Cabinet Office).

> Jonns ever Coillie Richett

Jonathan Rees, Esq., Department of Trade.

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SWIH OET Telephone 01-215 7877 Prime minister 1 mr Heseltine Gas already From the Secretary of State Said mat he wishes to comment CONFIDENTIAL in detail on Low Cockfield's envier paper, and I mink we should keep this as the E(NI) agenda. A neeting Michael Scholar Esq 10 Downing Street has been provisionally fixed for London SWI Wednesday, 8 September. Agree? Dear Michael, Yes me Con BRITISH AIRPORTS AUTHORITY: E(NI) (82)19 Thank you for your letter of 26 July in which you reported the doubts expressed by the Prime Minister about my Secretary of State's paper on the British Airports Authority. I attach, as requested, a note on the points raised by the Prime Minister. In your letter, you referred to the current legal action over the BAA's airport charges, in particular at Heathrow. This litigation has been brought against both the BAA and my Secretary of State. It was initiated following the very sharp increases in airport charges which were introduced in April 1980 following our decision in 1979 to set a zero EFL for the Authority and to establish a financial target of 6% CCA for the three financial years 1980/81 to 1982/83. The points at issue are complex but, from the Government's point of view, the most serious are the allegations: (i) that the increases in airport charges were caused by unlawful directions by the Government whose dominant purpose was the implementation of a policy to reduce the public sector borrowing requirement; (ii) that the Government's approach to BAA's finances has resulted in its maintaining in force a measure requiring the BAA to abuse a dominant position in the EEC in breach of Article 90 of the Treaty of Rome. The trial date has just been postponed again until February 1983 at the earliest. We shall defend the action as vigorously as possible since, if the airlines were to succeed in their case, it could have serious consequences for our policy towards the rest of the nationalised industry sector.



From the Secretary of State

Our analysis of BAA's performance over the last three years suggests that while the real increase in prices in April 1980 has been a substantial factor in the improved financial performance of the BAA, there have also been real improvements in keeping costs under control. This is exemplified by their success in keeping pay settlements below the rate of inflation for four successive years.

costs is fixed (eg depreci rates and energy) which limits the costs. Moreover staff and other costs cannot be reduced instant to match reductions in traffic: there is a time lag, as Section of the attached paper shows, before the adjustments can be made.

BAA's traffic charges are high compared with those at airports because we are alone in seeking to other countries. Quite a large proportion of the BAA's costs is fixed (eg depreciation) or externally imposed (eg rates and energy) which limits the costs. Moreover staff and other costs cannot be reduced instantly to match reductions in traffic: there is a time lag, as Section 3

subsidisation is normal.

If, as is suggested in E(NI)(82)19, we are to reduce the IFR bid by £50 million to keep within the White Paper ceilings on external finance, without further reducing the planned capital investment programme, there would almost certainly have to be further real increases in airport charges next April. The precise amount of that increase will depend on the extent to which traffic continues to increase over the next year or so and is something we shall be considering with the Authority once final decisions are taken in the Autumn on the EFL for 1983/84.

Perhaps you could let me know if the Prime Minister would like any further information and whether she wishes to have a discussion at a further meeting of E(NI) after the recess.

I am copying this letter and attachment to the Private Secretaries to other members of E(NI) and to David Wright (Cabinet Office).

JONATHAN REES

Private Secretary



BRITISH AIRPORTS AUTHORITY

BACKGROUND NOTE

1. Pricing Policy

The Government's approach to the pricing policies of the BAA has been based on the main principles set out in the White Paper on Nationalised Industries (Cmnd 7131) which required:-

- (a) that nationalised industries should price to cover their long run marginal costs;
- (b) that the industries should earn the 5% required rate of return on the whole of their new investment programme;
- (c) that within the overall level of prices, industries should ensure that peak and off-peak usage are related to the relative costs of supply; and
- (d) that there should not be arbitrary cross-subsidisation between different groups of consumers.

The application of these principles to the BAA is complicated by the dual sources of revenue - from traffic operations on the one hand and commercial operations (e.g. duty free shops) on the other. Since 1974-75 the BAA has made a trading loss on its traffic operations, and a substantial trading profit on commercial operations. Despite the substantial increase in airport charges in April 1980, this pattern persists:-

	CCA Trading Profit - £m						
	1978-79	1979-80	1980-81	1981-82			
Traffic	(£17.6)	(£25.7)	(£4.0)	(£9.2)			
Commercial	£30.0	£35.3	£41.9	£49.0			
Total	£9.5	£12.4	£37.9	£39.7			

The present financial target was agreed on the assumption that the BAA would increase its charges so that the estimated revenue from traffic operations would produce a 5% RRR on the investment related to these operations alone. In practice, as a result of airline



pressure, the BAA held prices in 1981/82 slightly below the current level of inflation and have made no increase for the current financial year. This will inevitably affect performance against the financial target and future financial performance unless there are further real increases in charges.

Comparisons with airport charges overseas are invalidated by the existence of extensive overt and covert subsidies designed to prevent airlines paying the full cost of the facilities provided. Moreover most other airports do not impose peak/off-peak prices to reflect differences in costs. The trend overseas is, however, to follow the UK pattern and in the USA the Reagan Administration is also currently seeking to reduce the level of Federal subsidies to the air transport industry and to increase user charges.

2. Privatisation

Following the E(DL) remit (Meeting 27 November 1981) the then Secretary of State wrote about disposal prospects for BAA in his letter of 21 December 1981. His view, which was accepted by the Financial Secretary, was that it would be impossible to write a prospectus for the sale of equity in the Authority until there was a resolution of the current litigation over user charges and the uncertainties over the development of the South East Airports. BAA have received similar advice from their merchant bank.

Discussions have therefore focused on the short-term prospects for greater private sector involvement in BAA's capital expenditure programme and on 29 July it was announced in Parliament that the BAA, the Department of Trade and the Treasury were to establish a working group to consider urgently the prospects for either a general performance bond along the lines of that agreed for British Telecom or an equity sale in a subsidiary company with a royalty agreement linked to BAA's commercial revenues.

Prospects for privatisation of the airports industry in the longer-

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term are being considered in the light of the Prime Minister's minute to the Chancellor of 28 July and the MISC(79) exercise which relates to local authority regional airports. A separate report will be circulated to the E(DL) Committee in September in response to the Prime Minister's request.

3. Productivity

The BAA agreed two productivity targets with the Government in early 1980. These requires an average increase of 3% per annum in passengers handled per employee and an average reduction of 2½% per annum in operating costs per passenger over the three financial years 1980/81 to 1981/82. Results in the first year were affected by the recession in the air transport industry but, as a result of reductions in costs and staff, it is likely that the BAA will achieve the first target but miss the second:

	Target	1980/81	1981/82	1982/83 (Forecast	Forecast Out-Turn (a) Average
Passengers per employee	+3%	-1.1%	+4.9%	+6.6%	+3.4%
Cost per passenger	-21/2%	+1.3%	-0.7%	-4.5%	-1.3%

Staff numbers have been cut by 2.6% (1980/81) and 4.5% (1981/82) and staff costs reduced from 36.9% of total expenditure in 1979/80 to 34.1% in 1981/82. Average staff costs per employee have been reduced from £10,929 in 1979/80 to £10,339 in 1981/82 (both at March 1981 prices) and other current costs (e.g. utility and general services) have been held below increases in inflation in those areas. However the amount of local rates paid on BAA airports has increased by 62.4% since 1979/80 and this has just about offset the reductions in controllable costs with the overall result that the increase in total expenditure over the two-year period has almost exactly matched the increase in retail prices.

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Pay Settlements

BAA's annual pay settlements since 1979 have been as follows with the current rate of inflation at each settlement date in brackets:

1979

9% increase in basic rate coupled with certain productivity payments. Estimated increase in average earnings 10.5% (RPI 14%).

1980

15% increase in basic rates from 1 January with a further 2% from 1 April. Estimated increase in average earnings rather less than 15% (RPI 20%).

1981

9% increase in basic rates with certain improved productivity arrangements. Estimated increase in average earnings 9% (RPI 16%).

1982

6% increase in basic rate and shift allowance; productivity payments frozen at 1981 level. Estimated increase in average earnings 5.6% (RPI 12%).

Over the same period, the proportion of staff costs represented by overtime has been reduced as follows:

1979/80 9.5% 1980/81 6.9% 1981/82 6.4% *5 AUG 1982

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10 DOWNING STREET

From the Private Secretary

PRIVATISATION

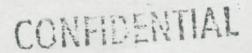
The Prime Minister was grateful for your Secretary of State's minute of 3 August. She agrees with him that in their responses to her personal minute to the Chancellor of 28 July (M6/82), Ministers should interpret "privatisation" in a broad sense, and should feel free to make proposals to the Chancellor that go wider than the public trading sector. In particular, your Secretary of State should feel free to make proposals to enable universities to become less dependent upon the taxpayer.

The Prime Minister has, however, commented that E(DL) may not be a suitable place in which to discuss each and every one of these proposals, and she would be grateful if the Chancellor of the Exchequer could consider how these proposals should be handled when Ministers report to him in mid-September.

I am copying this letter to the Private Secretaries to members of the Cabinet and Richard Hatfield (Cabinet Office).

LW. F. S. RICKETT

Mrs Imogen Wilde Department of Education and Science





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PRIME MINISTER

I suggest that Tarite to Private Secretaries

saying that ministers are of course free to

interpret "privatisation" in a broad sense, and to

make proposals to the Chanceler accordingly, but that the

Chanceler with probably much to consider whether EDL is the

best place to disturb all these proposals when they have been

I hope that under the umbrella of "privatisation" - the subject of your finally minute to the Chancellor of the Exchequer of which you sent me a copy - Wheeled in might be included conceptually the aim to enable universities to become the future. less dependent upon the taxpayer. I do not suggest that many of them Agree?

need necessarily be totally privatised but some move in that direction seems desirable for a whole range of reasons which I am not seeking to set out in this minute.

- 2 My purpose is only to ensure that we look wider than the public trading sector.
- 3 I am copying this to the Chancellor and to other members of E(DL).

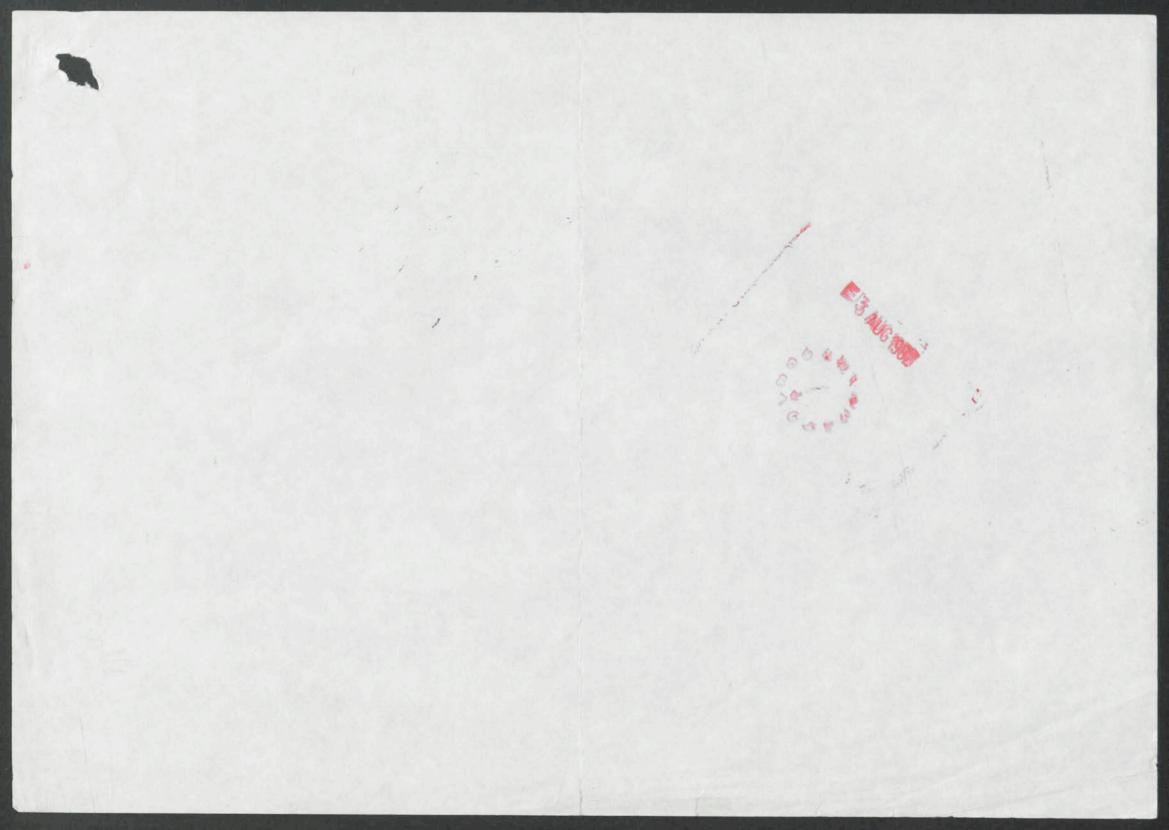
you man

19.

3 August 1982

We so en. MG 2 MARSHAM STREET LONDON SW1P 3EB My ref: Your ref: 2 august 19182 Da- gol As I mentioned to you on the phone this morning, my Secretary of State is not at all happy with the note circulated on the British Airports Authority (E(NI)(82)), referred to by your Secretary of State in his minute to the Prime Minister of 23 July 1982. He believes that the document as it stands is so broad brush as to be beyond any realistic scrutiny. He will wish to comment in more detail, and will write to Lord Cockfield shortly. I am copying letter to the Private Secretaries to the Prime Minister, the members of E (NI) and to Sir Robert Armstrong. D A EDMONDS Private Secretary

John Rhodes Esa



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cc (OL)

10 DOWNING STREET

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THE PRIME MINISTER

Personal Minute No. M6/82

THE CHANCELLOR OF THE EXCHEQUER

PRIVATISATION

We must sustain the momentum of the privatisation programme.

Two aspects need particular attention. Suitable candidates

(institutions and functions) need to be identified. And subsequent preparations for privatisation need to be pursued as vigorously as possible.

At this stage in the life of the Government, we should have two main objectives:

- (i) to accelerate the smaller but not insignificant privatisation opportunities where we could hope to make substantial progress before the election; and
- (ii) to ensure that sufficient planning and preparation is carried out now to allow potential major candidates to be privatised during the next Parliament.

E(NI) DTde CO DEmp-HMT DEngy CS-HMT DTrans DT

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bc Vereker &M
Walters

Econ P.

10 DOWNING STREET

26 July 1982



BRITISH AIRPORTS AUTHORITY: E(NI)(82)19

Your Secretary of State minuted the Prime Minister on 23 July seeking to clear in correspondence his E(NI) paper on the performance and current position of the British Airports Authority (E(NI)(82)19).

The Prime Minister has expressed a number of doubts about this paper. She has enquired as to whether the BAA's success in keeping its costs under control is more apparent than real, on the grounds that it has done so by charging very high fees to airport users. The Prime Minister has commented that the fact that a number of foreign airlines have brought a major legal action against the Board is itself an indictment of the BAA's performance. Mrs. Thatcher notes that there is no reference in this paper to privatisation of the BAA. She has also enquired, in relation to the reference in paragraph 4 to "further" improvements in productivity, what productivity improvements have already been achieved. Finally, she would be grateful for information about the pay settlements which BAA have made over the last three years; she endorses the Secretary of State's view that it would be necessary to make adjustments to the Board's assumption that pay will rise in line with inflation.

I would be grateful if you would let me have a note on these points. The Prime Minister's present view is that it would be necessary to discuss this paper at a meeting of E(NI), after the recess.

Private Secretaries to the I am sending copies of this letter to the other members of E(NI) and to David Wright (Cabinet Office).

M. C. SCHOLAR

Jonathan Rees, Esq., Department of Trade.

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Treasury Chambers, Parliament Street, SWIP 3AG 01-233 3000

PRIME MINISTER

PRIVATISATION: SUSTAINING THE MOMENTUM

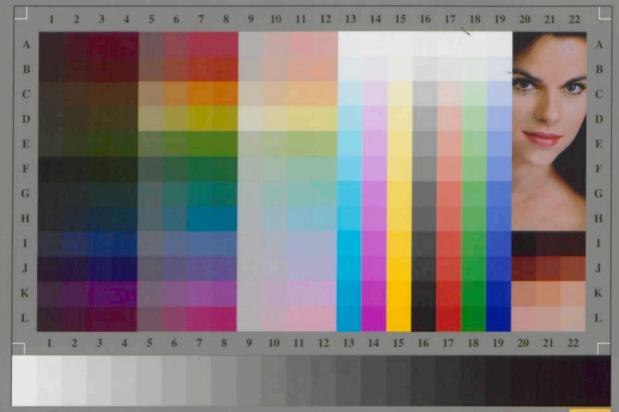
Despite the important progress being made in many areas of our privatisation programme, I am concerned that, unless we maintain pressure from the centre, Departmental Ministers may fail to give sufficient attention to sustaining the momentum of the programme. Some important opportunities may be attracting less attention than they deserve. In particular I am not sure that we have yet surveyed the functions or bodies which might be privatised as comprehensively as is possible: there may still be important candidates which have not been investigated or even identified. And even where candidates have been agreed, we cannot be confident that preparations are always proceeding as fast as can reasonably be expected. We need a hard push now if we are to achieve maximum progress before the election and to put ourselves in the best position to make further progress on major candidates after it.

2. What would best get things moving would be an explicit request from you for greater effort in this area. I attach q draft of the kind of message which, as Chairman of E(DL), I would find very useful to receive.

Si

(G.H.) 26 July 1982





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