

✓ NO

16.1.84



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

E(A) PRIVATISATION REVIEW

- You may like to have an advance copy of my Memorandum to E(A) .. Committee on Competition and Privatisation (attached). As you will see, it covers the Financial Secretary's report on the individual privatisation exercises following his recent bilateral discussions with sponsor Ministers, plus a chart which shows the main components of the privatisation programme for the lifetime of this Parliament.
2. All this represents useful progress. We now have clearly set out the shape of the prospective privatisation programme for future years and the implications for the legislative timetable and capital markets. You will also see from my covering Memorandum my proposal that, in the future, all residual shareholdings should be held by the Treasury. This will become particularly important as the privatisation programme proceeds; we must counteract the temptation for sponsor Departments to retain shareholdings in order to influence privatised companies' future activities.
3. I doubt that the E(A) meeting which will consider this Memorandum will be able usefully to discuss detailed issues concerning individual privatisation candidates. Rather, I hope that we can obtain unqualified endorsement for the overall programme. Detailed issues will need to be dealt with separately over the coming months. However, you may like to be forewarned



of one or two problem areas which the Financial Secretary has uncovered in discussion:

(a) British Leyland We are concerned at BL's proposals to dispose of only 75 per cent of Jaguar in May and of only 60 per cent of Unipart and then not until next year. The Financial Secretary will shortly be meeting DTI Ministers again to see what can be done.

(b) Royal Ordnance Factories The generally agreed aim is for incorporation in October followed by flotation in autumn 1985. The Secretary of State for Defence assures us that his recently announced intention to reorganise the ROFs structure into a holding company with four subsidiaries will not jeopardise this timescale. But it will undoubtedly put it under more pressure.

(c) Gas and Electricity Although privatisation may still be some time off, the next few months will be critical. We must ensure that discussion in E(A) next month leads to a thorough review of the options and the setting of a firm timetable for action.

(N.L.)

16 January 1984



JH 749

PS/ Secretary of State for Trade and Industry

REC NO.

CONFIDENTIAL

NAPM AT 1/2

DEPARTMENT OF TRADE AND INDUSTRY

1-19 VICTORIA STREET

LONDON SW1H 0ET

Telephone (Direct dialling) 01-215 5422

GTN 215

(Switchboard) 215 7877

1 February 1984

Margaret O'Mara
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Dear Margaret,

COMPETITION AND PRIVATISATION

The Annex to the Chancellor's paper E(A)(84)3, which was discussed last week, contained a summary on each of the principal candidates for privatisation in my Secretary of State's field of responsibility. Although he is broadly content with the way in which the position was described, he has asked me to let you have the enclosed note, clarifying a number of points.

2 I am copying this letter to the private secretaries to all other members of E(A) and to Richard Hatfield (Cabinet Office).

Yours ever,

A. D. Lansley

ANDREW D LANSLEY
Private Secretary

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DTI PRIVATISATION CANDIDATES

DTI Comments on the Treasury summaries in the
attachment to E(A)(84)3

BL

- In paragraph A privatisation is defined solely in terms of sale of the component businesses. The understanding between the Government and the Board refers instead to the introduction of private sector equity into the business, and this need not necessarily involve sale, at least in the first instance.
- Paragraph D refers to the possibility of Honda equity participation in Austin Rover. This seems to us a somewhat remote possibility which should not be overstated.
- Paragraph F refers to BL's becoming independent of Government finance after 1983-84. Ministers have not yet agreed whether the final £50m originally pencilled in for 1984-85 but deleted from the Estimates should be paid; we cannot prejudge this question, on which separate decisions, taking into account developments on eg Leyland Trucks, will be needed.

British Shipbuilders

- Paragraph C should say that MOD's desire for competitive tenders may need to be taken into account. As it stands, the summary implies that some form of competition is definitely to be preserved - which prejudices one of the policy decisions that Ministers have yet to take collectively.
- Paragraph D: we are hoping to link our E(DL) paper to MOD's proposals for ordering 2 frigates. Our latest information is that MOD will not be ready to make proposals until the end of February. The presentation of this E(DL) paper is our next action on this.

BTG Holdings

INMOS

- It is most unlikely that there will be a 'sale' of INMOS within six months which will generate proceeds for the Exchequer. What is likely to happen is first the raising of new capital from the private sector to fund the company's development, involving progressive dilution of the BTG's equity. This would lead eventually to the BTG selling their shares, with proceeds payable to the Exchequer, but this second stage may not occur for a year or more, depending on the state of the markets and the company's progress.
- The next action, which will occur in conjunction with the company and the BTG is likely to be agreement within the next few months to an investment of new capital, possibly by a consortium of industrial and institutional investors for a minority equity stake.

British Telecom

- The summary is misleading in its statement (in D) that officials are 'currently working towards' flotation in the Autumn: DTI Ministers are determined that this objective is reached and the timing of the flotation has been announced.
- It is, in our view, doubtful indeed if a figure approaching the £5 billions mentioned in F can be achieved - it certainly cannot if none of the present debt is converted into equity.
- On the need for collective Ministerial attention, the Secretary of State intends to keep in very close touch throughout with the Chancellor and his Treasury colleagues, and will consider as time passes whether any of the choices which come to him could usefully be referred to E(A) for collective discussion; at present he is rather doubtful whether such a discussion is likely to prove necessary.

Post Office and Girobank

DTI aim to prepare a paper on the issues in consultation with the Treasury for discussion in mid-1984.

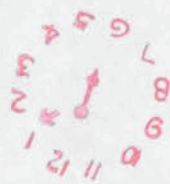
British Aerospace (residual holding)

- Unlike privatisation of a majority stake, disposal of a residual holding does not bring efficiency gains: it is merely a cash raising exercise and deserves a lower priority. In the case of British Aerospace, the possibility of a further disposal can only be examined after decisions have been taken on the A320 and will have to take account of the impact on customer and investor confidence. If shares fell sharply that would limit the company's ability to raise equity capital.

- Creation of a Special Share, and an announcement of the Government's intentions is therefore not under active consideration by DTI. The timing of any further disposal cannot realistically be predicted at present.

Leon PDS Privatization

Pr-9



1 FEB 1984



Chancellor of the Duchy of Lancaster

PRIME MINISTER

COMPETITION AND PRIVATIZATION - Paper by the Chancellor of the Exchequer for E(A) Committee

1. Number (iv) of the Conclusions in paragraph 10 reads:

"to ensure that increasing competition and deregulation continue to be the dominant themes of the privatization programme".

2. You ought to know that we have run into a great deal of flak on the British Telecommunications Bill on this point. Our opponents (largely our own supporters) argue that per contra the Bill restricts competition and entrenches monopoly.
3. Lord Weinstock, one (but only one) of the proponents of this view, argues that what we are doing is selling a monopoly: to the extent that we restrict that monopoly we are reducing the proceeds of sale: that the Treasury requirement for money is regarded as paramount: and that therefore we are doing everything we can to maintain the monopoly.
4. Weinstock's argument is quite right. There is an inescapable conflict here between competition and the Treasury. In the Telecommunications Bill, despite what we say, the conflict has been resolved largely in the Treasury's favour. We shall face exactly the same problem when we come to privatize other monopolies such as gas and electricity.

A.C.

A C

23 January 1984

● PRIME MINISTER

THE PRIVATISATION PROGRAMME

The arrival of a timetable should be welcomed by E(A). It should be used to keep up the pressure to denationalise a major proportion of the state trading sector.

How much can be sold?

Colleagues should not be too worried by the question of what the stock market can bear. "Informed" Stock Exchange opinion 3 years ago said that it would be quite impossible to sell more than a few hundred million pounds in any given issue, and more than £1,000 million in any given year. "Informed" Stock Exchange opinion now believes that £2,000 million per annum is a feasible maximum, and that an individual issue can reach at least £1,000 million.

The institutions (pension funds and insurance companies) will have more than £14,000 million of other people's money to spend on new investments in the next financial year. Their appetite for overseas securities is likely to decline, following 3 years of rapid build-up in their overseas portfolios. It will decline both because they have reached the higher level of overseas exposure they were seeking (20 per cent of a typical pension fund is invested outside the UK) and because overseas stock market returns for the UK investor have been very good over the last 18 months, meaning that prices now look quite high. The amount of new gilt-edged stock that will need to be supplied to UK markets will be reduced by the extent to which the Government deficit is funded through sales of extra equity assets. We would be wrong, therefore, to be too timorous on the grounds that the market will not stand further issues. Any issue of less than £150 million can be accommodated relatively easily. Issues in the £500 million-plus category do need careful spacing, but we should not assume that you can only do one in any given year. Looking at the timetable, I think we could increase the targets for 1985-86 and 1986-87 above the £2,000 million pencilled in. The Bank of England will argue strongly against this, but their advice on this matter should not be accepted.

Competition and Privatisation

Increasing competition is a vital part of the privatisation programme. The competition initiative undertaken as a result of your recent

meeting should run in parallel with the Financial Secretary's denationalisation programme, so that we avoid the criticism that we are in the business of selling monopolies. It is therefore appropriate that both the competition and the denationalisation initiatives are monitored regularly by E.

Residual shareholdings

We welcome the idea that the remaining shareholdings in companies that have been partly denationalised should be held by the Treasury, and that they should be used flexibly to assist with funding policy. They should not be part of the firm programme in such a way that they become used as an argument against making the initial sale of shares in a new target company for denationalisation.

I attach brief notes concerning the main privatisation candidates in the order in which they appear in the Treasury paper.

How long a gap should there be between legislation and sale?

Where legislation is planned for a year or more's time, the preparatory work on improving the accounts, management, profit and loss and balance sheet could be undertaken in parallel. This could then reduce the very long time allocated between legislation and sale.

Wider Share Ownership

The sale of shares in large corporations like BT requires innovation in the style of sale and in the means of reaching the buying public.

In order to capture the imagination and the cash of the general public, those selling BT shares will need to solve the questions of how a person not used to owning shares and not equipped with a stockbroker can buy and sell them with ease, and can be persuaded to do so. The Treasury are working on this: their conclusions and experiences should be drawn on as widely as possible when considering other candidates for sale.

The draft legislative programme to QL does not include any of the privatisation bills for 1984-85 needed for the programme. I have alerted your Private Office to this problem.

Should the timetable be accelerated?

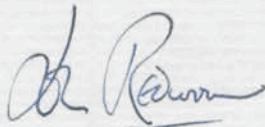
If you agree with the proposition about there being more scope for sales than the £2,000 million allocation in the timetable for 1984-85, and 1985-86, it will be easy to accommodate the speeding up envisaged in the attached notes. The sales of gas and electricity retailing (estimated around £120 million for gas), NCB ancillaries, Land Rover, the extra 49 per cent of ROF, and earlier sale of National Bus subsidiaries, could all be added without strain. The aim should be to bring as much forward into 1984-85 as possible to allow sale of part of gas in 1985-86.

The whole programme without firm decisions on the energy industries is like Hamlet without the Prince. The E(A) which considers the energy options should reconsider the complete timetable using a higher figure for total sales in 1984-85 and 1985-86 (eg £3,000 million).

The argument that the energy industries are unduly complex because they will need extensive regulation needs questioning. The aim should be to create better markets in the sale of gas and electricity to the grid, to reduce the need for regulation.

Follow-up

It is vital that the Financial Secretary should maintain oversight of the programme, and that there should be regular reports to E(A), if only to inform colleagues that targets are being hit. The programme should be a regular review item on a quarterly basis. John Moore has worked long and hard on this programme, and his efforts have made a substantial impact on the momentum of the policy.



JOHN REDWOOD

1. Royal Ordnance Factories. If their sale is to be delayed until autumn 1985, there is a strong case for selling the whole thing in one go.

- 2a. Wytch Farm. No comment.

2. British Gas Corporation. Privatisation of the whole on the BT model would be undesirable, as it would pose competition problems and would be an extremely large issue. We will have to await the option paper which has been much delayed. Our researches lead us to favour splitting the Gas Corporation into separate transmission and distribution companies; and at the same time injecting further competitive pressures by using the grid as a common carrier. Segregated distribution companies could be sold with the grid remaining as a public asset.

- 2b. Gas appliance retailing is a prime candidate for sale. BGC have consistently blocked this proposal over the years, but their time should now have run out.

3. British Nuclear Fuels Ltd. The paper to E(DL) should be speeded up, and should consider the political sensitivities in a reasoned way in view of recent nuclear problems.

4. Electricity. We await the E(A) paper. Our researches lead us to favour introducing competition in generation by splitting up the CEGB and selling some of the competitive units to different groups of private shareholders. This would have the great advantage of taking out of the ambit of Government and of the CEGB the task of forecasting future electricity demand, of building enormously expensive and complex power stations, and of dealing with the problems of over-capacity that we currently have. Energy Department arguments that over-capacity and the existence of a merit order prevent this option ignore the possibility of selling a package of differently ranked generating stations to each investment consortium. The price for the marginal stations would reflect the over-capacity, whilst the merit order could be preserved based on unit generation cost figures. There might be an argument for keeping the nuclear stations in the public sector, given the obvious sensitivities. The electricity showrooms should be sold as soon as possible.

5. Enterprise oil. No comment.
6. The programme for selling the non-mining subsidiaries of the NCB should be accelerated and should be the subject of an early paper to E(DL). NCB are still involved in the distribution of solid fuel, of heating appliances and building supplies and brick manufacture: turnover is around £400 million per annum in these activities.
7. The BL 1984 Corporate Plan which we have seen is still unsatisfactory. There is undue delay in segregating 4-wheel drive from Trucks, and undue delay in the sale of the 4-wheel drive business. Recent figures from Trucks demonstrate how hopeless it is to anticipate 4-wheel drive and Trucks together being a saleable proposition in the foreseeable future. Truck output has fallen steadily from 41,359 in 1975 to 11,000 in 1983.

We recommend the sale of the whole of Jaguar. We are delighted to see the proposal to sell 75 per cent of it as early as May 1984, and think it vital this timetable is adhered to. It is more important to sell 75 per cent as early as May 1984 than to allow delay to achieve the sale of 100 per cent.

We need a better review of the options concerning the eventual fate of the Austin-Rover Group. BL should come forward with serious options for introducing private capital and for reducing their cash requirements. We are happy with the Unipart proposal.

8. British Shipbuilders. The timetable on the warship-building sale is too relaxed. It would be desirable that a firm commitment should be made to sell warship-builders at the beginning of 1985 and no later. The original commitment to this decision was in the 1979 Manifesto, and we still await the result.
9. The British Steel activities in setting up separate Companies Act companies and gaining a clearer view of the extent of the losses in individual business areas is to be welcomed. What the Government should also be doing is encouraging the sale of more shares in those companies currently in 50-50 ownership between the public and private sectors set up under the various Phoenix ventures whenever this is possible. An early paper to E(DL) on the exact state of the various Phoenix companies, the state of segregation on the other activities, and the prospects for sale of shares in these areas is essential.

10. British Technology Group. It is important to stress the desirability of getting rid of INMOS within the next 6 months.
11. British Telecom. No comment.
12. Post Office and National Girobank. No comment.
13. The papers seem to be saying that there is no hope of Rolls Royce becoming profitable and independent within this Parliament, despite the Manifesto commitment. More serious consideration should therefore be given to further partnership, including risk-sharing and the injection of private capital.
14. Airports. A reasonable and well-intentioned approach.
15. British Airways. We agree that the improvement to BA's balance sheet which is necessary for sale should, where possible, come from the Group's own efforts. This could be helped by the transfer of some routes to BCal or other smaller airlines, assuming the Department of Transport can find a way of allowing CAA approval for the new operators.
16. British Rail Engineering. A paper should come to E(DL) following receipt of the Chairman's report in the middle of 1984.
17. Scottish Airports. No comment.
18. National Bus could be sold more quickly than envisaged. There is no need for a gap of more than a complete year between primary legislation and the sale. We support substantial deregulation and early progress on separate accounts for the 36 operating subsidiaries.
19. Sealink. Agreed.
20. Shorts. In view of the unsatisfactory financial and trading state of the Group, should the sale of the missile division be pursued?
21. Scottish Transport Group. No comment.

Prospective Disposals of Residual Shareholdings

Reduction of these holdings should be carried out whenever suitable market opportunities present themselves (as they do this month, with a buoyant Stock Market and no major issue). We are particularly keen to see HMG's holding in British Aerospace reduced, as this is a high-risk business, and think the Government should change its intention to hold 25 per cent.

Minor Candidates

Forestry Commission. Disposals since the Forestry Act 1981 of only £40 million out of total assets of over £1 billion are disappointing. The market response has not been very favourable, partly because the properties chosen have often been poor, and partly because of investor fears of a much larger sale under the Act later. The tax shelter available makes the assets even more attractive.

Mrs Linda Whetstone, a former Commissioner, believes management changes are necessary to ensure a purposeful approach to forestry management and disposal. The Forestry Commission does make a loss, needs an annual grant of £60 million, and shelters behind amenity arguments. Access to the countryside can, however, be guaranteed by covenants under new private owners.

E(DL) should consider:

- (a) a more vigorous programme of disposals and better management of the existing resource; and
- (b) the possibility of wholesale denationalisation with more commercial management

at an early opportunity.

Water. Should we not add the water industry to the list of those being monitored under this programme?

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BARCLAYS MERCHANT BANK LIMITED

REGISTERED IN LONDON ENGLAND - REG. NO. 181866 REG. OFFICE: 54 LOMBARD STREET, LONDON, EC3P 3AH

TELEGRAPHIC ADDRESS: BARCLOSEA LONDON EC3V 0BA
TELEPHONE NO. 01-623 4321
TELEX: 8812124 BMB G

P.O. BOX NO. 188

15/16 GRACECHURCH STREET
LONDON, EC3V 0BA

Our Ref:- LMR/JEC

3rd February, 1984

PRIVATE AND CONFIDENTIAL

Andrew Turnbull
10 Downing Street
London SW1

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Dear Mr Turnbull

PRIVATISATION OF BRITISH TELECOM

We have today submitted the enclosed memorandum to the Secretary of State for Trade and Industry. It proposes an active role for the Barclays Group in the privatisation of British Telecom.

Copies of the memorandum and the covering letter to the Secretary of State have been sent to the Prime Minister and to Treasury Minister. We are seeking a meeting with the Secretary of State in the near future.

Yours sincerely

L M Rouse

L M ROUSE

Enclosure