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PRIME MINISTER

BNO, PRIVATISATION AND THE PSBR

Following the meeting of E Committee on 12th December 1979, there were discussions with you and other interested Ministers about the future of BNO at which I was invited to re-examine the accounting conventions which determined whether or not the proceeds of a sale of shares in BNO (Operating) counted as a reduction in the PSBR. The particular point at issue was the Treasury's view that for the proceeds to count as a PSBR reduction, it would have to be made clear at the outset that the public sector was immediately relinquishing control over Operating and that it intended to sell at least 51 per cent of the shares eventually.

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2. My officials, in consultation with the CSO, have prepared the note attached which describes the national accounting conventions relevant to the classification of proceeds from privatisation exercises as PSBR reductions. Colleagues may like to have it as background to the discussion on BNO in E Committee planned for 11th March.

3. Two points stand out from this highly technical subject:

(i) If our programme to control the PSBR is to retain credibility, we must not put ourselves in a position where we can be accused of producing PSBR reductions by massaging the definitions.

/Paragraph 4



Paragraph 4 of the officials' note points out that there are already awkward anomalies (e.g. BL and Rolls Royce) in the PSBR classifications. We should not introduce more.

(ii) The more genuine and thorough-going the act of privatisation (in the sense that the public sector is seen to relinquish control), the easier it is to defend counting privatisation proceeds as a PSBR reduction. There were particular reasons for the announcement of a sale of only a minority of shares in BA, but this was coupled with unambiguous statements about the relinquishment of Government control, including a statement that the Government would not mobilise its voting power to appoint directors. In view of the past history of close control by Government over BNOC as a whole and probable suspicions that whatever we say we may intervene in the company's affairs because of the public sensitivities about security of oil production and supply, it would be more convincing to go further and announce our intention to sell more than 51 per cent of Operating shares in order to provide evidence of relinquishment of public sector control.

4. My strong preference therefore, if we are to have a credible case for counting the proceeds from a BNOC (Operating) share sale as reducing the PSBR, is to make clear our intention that the Company should act completely independently of BNOC and of the Government and our intention to sell ultimately at least 51 per cent of the shares, as David Howell does indeed do in the draft statement attached to his paper for E Committee.

/Otherwise

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Otherwise we create the risk that the financial commentators and market analysts would argue that our privatisation of BNOC is essentially bogus in that the Government has no intention of relinquishing control; Operating should properly be classified to the public sector; and that the proceeds of the sale should therefore be counted as financing rather than reducing the PSBR.

5. I am sending a copy of this minute to Members of E Committee, the Secretary of State for Scotland, the Attorney General and Sir Robert Armstrong.

G.H.

(G.H.)
7 March, 1980

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PRIVATISATION AND THE PSBR

(Note by Treasury Officials)

Following the meeting of E Committee on 12 December 1979 (E(79)19th Meeting) there were discussions with the Prime Minister and other interested Ministers at which the Chancellor of the Exchequer was invited to re-examine the accounting conventions which determined whether or not the proceeds of sale counted as a reduction of the PSBR. A particular point at issue was the Treasury's view that for the proceeds to count as a PSBR reduction, it would have to be made clear at the outset that the public sector was immediately relinquishing control over Operating and that it intended to sell at least 51 per cent of the shares eventually.

2. Background

The PSBR is a relatively young concept. The Radcliffe Report of the 1950s led to the development in the 1960s of an organised framework of financial accounts for the economy. By the end of the decade the concept of the PSBR had been developed following work in the Treasury, Bank of England and Central Statistical Office. Since then the significance of the PSBR has been much debated, but there is general agreement that it needs to be measured as consistently as possible over a period of time.

3. "Privatisation" is a new activity. But the various transactions involved are not essentially different from transactions already handled in the system of financial accounts for the economy. The PSBR conventions for dealing with privatisation transactions must therefore be consistent with PSBR conventions generally. If they are not, not only is the measurement of the PSBR discredited, but the Government's claims to be reducing the PSBR will also be discredited. Producing PSBR "reductions" by changing definitions, which cannot be justified on their own merits, would not convince the commentators and market experts, who take a very close interest in these matters.

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4. Public Sector or Private Sector?

In this country every "economic unit" (eg firms, companies) has to be assigned either to the public or the private sector in the national accounts. There is not an intermediate category for mixed enterprises and inevitably classification is arbitrary at the edges. Some decisions under previous Governments to classify certain new "economic units" to the private sector when set up (eg British Nuclear Fuels Limited) or to leave firms in the private sector when taken into public ownership and effective public control (eg BL, part of Rolls Royce) cannot be reconciled with national accounting orthodoxy. But these decisions were made at a time when less attention was focussed on the PSBR. The credibility of the PSBR (and of the Government's policies linked with its reduction) would be undermined if these anomalies were claimed as a useful precedent. In any case, a decision not to re-classify (as in the case of BL and RR) into the public sector is a very different matter from a decision to put out of the public sector a concern that manifestly is within it, without real change in its control and ownership.

5. Ownership and Control

The two basic criteria for deciding whether an economic unit is in or out of the public sector are control and ownership, in that order. The reverse order may seem more natural at first sight. The actual order has become accepted internationally. In our case it caters for cases such as BP when the Government held more than half the shares in the company but did not exercise control.

6. The PSBR and an Economic Unit in the Public Sector

The borrowing requirement of an economic unit in the public sector is the difference between its revenues and its expenditures; the latter includes its net acquisition of financial assets, eg any loans it makes, or any company securities it buys. If a public corporation were to add to its liabilities - or convert some of its present liabilities - by means of a sale of equities in itself, this would score as part of its borrowing just as would its borrowing from, say, the National Loans Fund.

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7. The PSBR and an Economic Unit in the Private Sector

If privatisation is to reduce the PSBR, it is therefore necessary to do more than introduce private capital into a corporation or company which is in the public sector.

8. This requires the economic unit concerned to be classified to the private sector from the outset by:

a) total sale; or

b) general acceptance that there is and will be a sufficient sale and be a withdrawal from control reinforced by a sufficient sale for it to be reasonable for the economic unit to be deemed to be in the private sector. Once the unit is reclassified, the Government/parent corporation finds itself the owner of financial assets - namely the capital of the new private sector entity. Sale, or partial sale, of this asset then reduces the PSBR.

In either case, the sale has to be for cash, as the PSBR is a cash concept. (That is why the act of nationalisation has not normally increased the PSBR, because the payment (compensation) has been in the form of stock.)

9. The need to reclassify an economic unit into the private sector before selling shares inevitably requires a case by case scrutiny. Even though absence of control is more important than loss of ownership, the smaller the eventual shareholding, the easier it is to carry conviction about loss of control. If the public sector retains and is expected to retain a substantial shareholding in a firm, the harder it is to carry conviction that the public sector will in practice keep its hands off.

10. Conclusion

A public sector shareholding under 50 per cent, or at least an announced intention of going below 50 per cent, is therefore always

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to be preferred to help sustain credibility that a firm has passed out of the "public sector" and hence that its borrowing (other than from the Government) no longer counts for the "PSBR".

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