



CONFIDENTIAL

P.0719

PRIME MINISTER

Nationalised Industry Draft Objectives

(E(NI)(82)11)

BACKGROUND

At its last meeting E(NI) invited Ministers to circulate draft objectives for the industries which they sponsor. In E(NI)(82)11 the CPRS discuss a number of general issues arising from draft objectives; and comment on the draft objectives for the British Steel Corporation, the Post Office and BL attached to the letter of 12 March from the Private Secretary to the Secretary of State for Industry to the Private Secretary to the Chancellor of the Exchequer.

2. An important purpose of the discussion is to clarify the nature of the objective-setting exercise for nationalised industries and to enable Mr Ibbs, who has returned specially for this meeting, to explain more fully to sponsor Ministers the thinking which lay behind this proposal in the CPRS Report and to suggest how certain difficulties which sponsor Ministers have encountered in setting objectives might be overcome. The comments on the draft objectives for the BSC, Post Office and BL are partly included as test cases to bring out general issues about the exercise but also with a view to settling outstanding points in relation to those industries.

MAIN ISSUES

General

3. On the general nature of the objective-setting exercise the CPRS paper makes the following proposals:

- objectives on such matters as return to profitability should be clear, quantified and dated so as to expose difficult issues for Ministerial consideration



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- this may often mean that sensitive objectives are kept within Government on a limited circulation and that less sensitive or shorter term objectives should be discussed with Chairmen and published
- political and commercial objectives should be separated out
- each set of industry objectives should cover the headings a. to i. set out in paragraph 6
- draft objectives for no more than three industries should be discussed at a single meeting of E(NI).

4. As you know, some sponsor Ministers have misgivings about the objective-setting exercise. The difficulties which it throws up indeed go to the heart of the Government's relationship with the nationalised industries. The suggestion that, in sensitive cases, some of the objectives should be kept within Government on a limited circulation ought to help with some of the difficulties. If the exercise were to be abandoned it would mean that the Government was unable to clear its mind on what it wants from the nationalised industries and on what sort of steer it should give to those running the industries. You may therefore feel that, despite the very real difficulties, sponsor Ministers should be encouraged to press on with the exercise and to make what progress they can, taking account of the particular situations in each industry.

British Steel Corporation (BSC)

5. The CPRS suggest three changes to the draft objectives for BSC suggested by the Secretary of State for Industry:

- a. It should be an objective for BSC to meet its external financing limit.
- b. The Secretary of State's suggestion that BSC should aim to pay a "commercial dividend" on its capital should be made more precise.
- c. BSC's objectives should quantify what is meant by 'profitability' and say when the objectives of profitability and privatisation are to be achieved.



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6. E(NI) should not need to discuss the first two of these points: the Secretary of State can be invited to sort out the drafting of "commercial dividend" in correspondence with the CPRS and Treasury Ministers. On the third CPRS suggestion, the Secretary of State for Industry may argue that a precise deadline cannot be set for privatisation: market conditions are important. On the other hand, such uncertainties do not seem to preclude setting target dates against which progress can be measured; the Secretary of State for Industry ought also to be able to define what he means by 'profitability' for BSC.

7. The sub-Committee may have to come back to the subject of profitability and privatisation objectives when it discusses BSC's corporate plan in a few weeks' time.

Post Office

8. The draft objectives annexed to the Secretary of State for Industry's letter include a number of detailed targets, agreed by the Post Office and the Secretary of State, with which the CPRS are generally content; and a number of long term objectives, which the CPRS criticise as being insufficiently precise about the future of the Post Office.

9. The CPRS suggest that Ministers should consider:

- a. the probable conflict between economy and cost effectiveness on the one hand and maintaining a nationwide postal service on the other;
- b. what needs to be done to ensure compatibility between Post Office and British Telecommunications objectives;
- c. the appropriate structure for the Post Office and the scope for privatisation;
- d. the future of Post Office counter services.

This leads to the proposal that there should be a review of the long-term strategy for the Post Office.



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10. You will want the sub-Committee to consider this proposal for a review of Post Office strategy (which the Secretary of State for Industry may oppose) taking account of the following points:

a. Is it reasonable at this stage to try and form a long term strategy for the Post Office? The future of postal services depends critically on how telecommunications services develop. Are such developments in too great a state of flux at present to make this sensible? Or, on the other hand, are there long term investment and manpower decisions which the Post Office must take soon and for which it must have some idea of its long term future?

b. If a strategy going beyond the next two or three years is necessary, is a major review called for at this stage? The Government has twice referred the Post Office to the Monopolies and Mergers Commission; there was a departmental review in 1980 which covered at least some of the questions raised by the CPRS and led to the removal of the Post Office monopoly in some areas (for example express mail services). Another possibility, at least as a first step, would be to invite the Secretary of State to report to the sub-Committee, within say three months, on strategy for the Post Office, taking account of the CPRS comments and decisions on the future of British Telecommunications.


11. The CPRS also make comments on the drafting of two of the objectives which the Secretary of State suggests for the Post Office. You will want to invite them to sort out these details in correspondence.

BL

12. The CPRS suggest that Ministers should review the objectives for BL, particularly in so far as they relate to sale to the private sector, before Sir Michael Edwardes leaves the company towards the end of this year.

13. You will probably not want E(NI) to discuss this CPRS proposal. In the past you have preferred to deal with policy towards BL in a small group of Ministers; and any review of objectives will need to take account of what is decided about the future structure of the company, which you will be discussing in a separate meeting on 21 April. You will probably therefore want to say only that you will consider how future policy towards BL would best be handled.

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HANDLING

14. Since Mr Ibbs has returned specially for this meeting, you will probably wish to give him the main opportunity to speak on the CPRS paper, although Mr Sparrow will no doubt also wish to add some points. The Chancellor of the Exchequer and most members of the sub-Committee are likely to comment on the CPRS's general observations on defining objectives. When you move on to the specific points relating to the BSC and Post Office, the Secretary of State for Industry will be the main contributor.

CONCLUSIONS

15. You will want the sub-Committee to reach conclusions on the following points:

- i. The CPRS's general proposals for the way in which objectives should be set, summarised in paragraph 8 of the paper, ie:
 - a. clear objectives on such matters as return to profitability should be put to E(NI) for approval and that Ministers should decide collectively to what extent sensitive objectives are revealed to the industry chairman or published;
 - b. political and commercial objectives should be separated out as far as possible.
 - c. draft objectives should be evaluated against the criteria set out in paragraph 6 of E(NI)(82)11;
 - d. draft objectives for no more than three major industries should be discussed at a single meeting of E(NI);
 - e. draft objectives for all industries should be revised to take account of i., ii. and iii.
- ii. In relation to the draft objectives for BSC (perhaps subject to further consideration when E(NI) discusses the Corporation's corporate plan):



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- a. whether there should be an objective related to external finance;
- b. whether the objective relating to a "commercial dividend" should be made more precise;
- c. whether the objectives of "profitability" and "privatisation" should be made more precise.

iii. In relation to the Post Office, whether a long term strategy should be defined on the lines indicated by the CPRS and, if so, whether there should be a major review of the Post Office or some other procedure (for example, as a first step, an early report by the Secretary of State for Industry on possible strategy for posts).

16. You may also wish to indicate that you will consider what to do about future objectives for BL.

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P L GREGSON

20 April 1982

CONFIDENTIAL



CONFIDENTIAL

P.0718

PRIME MINISTER

Nationalised Industries' Performance and Corporate Reviews:
1982 Programme
(E(NI)(82)12)

BACKGROUND


This paper by the Chancellor of the Exchequer sets out proposals for the first cycle of performance and corporate plans reviews (P & CP Reviews) of the nationalised industries. You will recall that the intention is to supplement the existing annual Investment and Financing Review (IFR) and the quarterly monitoring of External Financing Limits (EFLs) by a thorough examination of how each nationalised industry has performed in relation to its agreed targets, the main forward plans of each industry and trends in pay, pricing and productivity.

MAIN ISSUES

2. The objectives of the Chancellor's paper are threefold, namely:
- i. to seek E(NI)'s endorsement of how the P & CP Review system might operate once it has come properly into effect (paragraphs 2 and 3 and Annex A);
 - ii. to get agreement to the timetable for this year's P & CP Reviews and the list of industries (see Annex C) which are to be the subject of collective Ministerial consideration by E(NI) this year;
 - iii. to encourage sponsor Ministers to get the P & CP Review system into quick and effective operation (progress to date is summarised in Annex B).

The general approach

3. The general timetable for the operation of P & CP Reviews (Annex A to the paper)


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has been the subject of extensive inter-departmental discussions at official level, as has the detailed timetable for this year's programme of reviews (annex C), and ought to be broadly acceptable to Ministers. But the proposed timetable will raise difficulties for those industries whose financial years are coincident with the calendar year, principally British Rail, the National Coal Board and the British Steel Corporation, or whose corporate planning cycles have for some other reason been geared to a different timetable to that now proposed, namely British Shipbuilders, the National Bus Company, the Scottish Transport Group and the Electricity Supply Industry in England and Wales. As paragraph 5 of the Chancellor's paper acknowledges, sponsor Ministers will need to agree with their industries on how the planning cycles of the industries concerned can best be adjusted to fit in with the P & CP Review system. In some of the big industries considerable upheaval may be involved and it may not, therefore, be possible for the necessary changes to have taken effect in time for the 1983 P & CP Review cycle. The industries concerned may also prove resistant to making the changes involved.

4. At this stage no specific decisions arise for Ministers on this aspect of the Chancellor's paper. No doubt sponsor Ministers will alert colleagues if the problems thrown up by individual industries prove particularly serious.

The 1982 Programme

5. This is summarised in Annex C to the Chancellor's paper. It ought again to be possible to reach agreement quickly on the Treasury's proposals, which seem to be sensible. The proposed work programme, however, is a heavy one involving discussion of one major nationalised industry, and the clearance in correspondence of two minor ones, each month during May to July. Moreover, in later years the programme will be heavier since this year discussion of British Shipbuilders and of the Railways Board will have to wait until the autumn; and this year there will be no proper P and CP review of the National Coal Board, because of the change of chairman and the preparation of strategic objectives for the industry. It will therefore be important for P and CP reviews to be submitted to timetable if a log-jam of major reviews just before the summer holiday period is to be avoided.

6. The Chancellor suggests in his paper that the draft of the proposed policy letter to the new chairman of the National Coal Board should be the subject of collective Ministerial discussion because of the major strategic and financial questions which it will need to address. The Secretary of State for Energy is


CONFIDENTIAL

likely to argue that it should be cleared in correspondence. But this letter will effectively map out the Government's strategy for the coal industry for the next five years and will therefore be of crucial importance. It seems unlikely that it will prove possible to clear it in correspondence. I suggest, therefore, that you might support the Chancellor of the Exchequer's proposal that a draft should be put to E(NI) before the end of this month.

Progress to date with P AND CP REVIEWS

7. Annex B to the Chancellor's paper summarises the work that has been undertaken so far with the preparation of the P & CP review for each industry. Since that Annex was prepared there have been a number of developments. Work on the review for the British Airports Authority (BAA) has now been set in hand; and the Department of Industry has undertaken to start the review for British Shipbuilders and for Girobank within the next few weeks. So work is now in hand or about to start on all the reviews, or agreed alternatives to them, planned for this year.

8. Finally, the Chancellor of the Exchequer may raise the question whether the chairmen of the nationalised industries should each be given an opportunity to discuss the corporate plan of the industry concerned with Ministers collectively. You may recall that the Chancellor of the Exchequer floated this proposal when Ministers were considering how best to follow up the CPRS report on the nationalised industries, but it got a mixed reception; and in further discussion at official level departmental reactions to it have continued to be divided. What the Chancellor had in mind is that after Ministers collectively had considered the corporate plan of an individual industry and reached conclusions about it, the chairman of the industry concerned should have the opportunity to put his points about the plan to Ministers collectively so as to avoid any impression that the views of the industry were given insufficient weight by the Ministers in reaching an assessment of the performance and plans of each nationalised industry.

9. It ought to be the case that chairmen of the nationalised industries feel they have an adequate opportunity to put their case in their regular discussions with sponsor Ministers. The danger in introducing a new level of discussion between chairmen and Ministers collectively is that if a sponsor Minister fails to reach agreement with the chairman of an industry on an issue of major importance the chairman may press for an opportunity to put his case to Ministers collectively



CONFIDENTIAL

which would seriously undermine the relationship between sponsor Ministers and their industries. Furthermore, major changes have already occurred this year in the relationship between the Government and nationalised industries following the CPRS report and with the introduction of the P and CP system. It might therefore be preferable to allow these changes to work properly through and, in particular, to allow the P and CP system to get properly under way before introducing a further major change which this proposal would represent.

HANDLING

10. You will want to invite the Chancellor of the Exchequer to introduce his paper. I suggest that you might then focus the discussion on paragraphs 8 and 9 of the paper which summarise his proposals and recommendations. You may then wish to ask Mr Sparrow whether he wishes to comment. As time will be short you will wish to invite comments only from those sponsor Ministers who see difficulty about the Chancellor's proposals.

CONCLUSIONS

11. You will want to record conclusions on:

- i. the general arrangements for the performance and corporate plan review cycle in future years set out in Annex A to E(NI)(82)12;
- ii. the programme of P & CP reviews (and analogous arrangements) for this year set out in paragraph 8 and Annex C to E(NI)(82)12;
- iii. whether the draft of the proposed policy letter to the new Chairman of the National Coal Board should be considered by E(NI) or cleared in correspondence.
- iv. the Chancellor's proposals in paragraph 9 for ensuring that the P & CP process is brought into effective operation as soon as possible.

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P L GREGSON

20 April 1982

4

CONFIDENTIAL



Nat. Industries

CONFIDENTIAL

P.0717

PRIME MINISTER

Progress on Nationalised Industries

(E(NI)(82)10)

In this note the CPRS review progress in implementing the proposals in their report on Government/Nationalised Industry relations. The three most important points in the paper are the procedural suggestions on board size and composition (paragraphs 3 and 4), improving expertise in sponsor Departments (paragraphs 8 and 9) and handling of future E(NI) business (paragraph 10).

2. The paper also touches on setting objectives and performance and corporate plan appraisals, the subject of the other two items on E(NI)'s agenda. The annex contains a comprehensive summary of progress so far and further action which the CPRS considers necessary.

MAIN ISSUES

Board Size and structure

3. The CPRS report recommended that industries should have smaller boards than at present, with a majority of appropriately qualified non-executive directors particularly concerned with efficiency. E(NI)(82)10 proposes that sponsor Ministers should consider how they intend to apply these proposals to each industry; and that they should report to the sub-Committee on their proposed timetable for doing so in July (as part of the reports which E(NI) commissioned at its last meeting on progress on implementing proposals in the CPRS report).

4. Although the CPRS proposal on board size and structure has been accepted in general by Ministers, it is possible that some Ministers may wish to argue that there are special reasons which make it inappropriate or impracticable in particular industries. If so, you will not wish the sub-Committee to be drawn into detailed discussion of particular cases. Sponsor Ministers might therefore be invited to make out the case for any proposals for exceptional treatment when they



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report back to E(NI) in July on the timetable for implementing changes in board size and structure. Subject to this point (if it arises), there ought not to be disagreement with the CPRS proposal.

Improving expertise in sponsor Departments

5. The CPRS report recommended that greater understanding of business is needed in Departments, notably by increasing the length of time for which officials deal with nationalised industries; having career paths providing for more business training and a succession of 'industrial' postings (including outward secondments to business); and inward secondments of businessmen. E(NI) agreed in December to review in November 1982 the adequacy of the business expertise available in sponsoring Departments. The CPRS now propose that Management and Personnel Office and other Departments' officials should report specifically on the means for implementing the CPRS proposals for improving the business expertise of officials.

6. The Lord Privy Seal, as the Minister responsible for the MPO, could be invited to report to the sub-Committee on how the CPRS's proposals for improving the business expertise of officials could be implemented. It would be preferable to have this report in say July for the guidance of departments. Departments can then report in November on what they are doing to implement the proposals.

Handling of future E(NI) business

7. The CPRS propose that the Chancellor might handle meetings of E(NI) which consider the objectives and corporate plans of smaller nationalised industries. You had it in mind from the outset that the Chancellor might chair meetings of E(NI) on some of the less important issues and this proposal fits in with that. It is however a matter to be arranged between you and the Chancellor, rather than to be decided by E(NI).

HANDLING

8. Since time will be short and the paper is straightforward you may feel that there is no need to have it introduced and you could simply invite comments in turn on the CPRS proposals on:



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- a. board size and composition;
- b. improving business expertise of officials;
- c. any other proposals included in the annex to E(NI)(82)10, which Ministers wish to raise.

9. Any of the sponsor Ministers present may wish to comment on what the CPRS propose. The Chancellor of the Exchequer is likely to express general support for them. The Lord Privy Seal will want to comment on the procedure suggested in relation to improving departmental expertise.

CONCLUSIONS

10. You will want the sub-Committee to reach conclusions on:

- i. whether sponsor Ministers should be invited to report back to E(NI) by July on how they are implementing the CPRS proposals on board size and composition together with a timetable for implementation;
- ii. whether the Lord Privy Seal should be invited to report back to E(NI) in July on how the CPRS proposals for improving the business expertise of officials could be implemented;
- iii. any other points raised in discussion.

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20 April 1982

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20 April 1982

Policy Unit

PRIME MINISTER

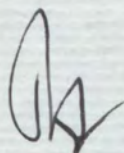
E(NI): NATIONALISED INDUSTRY DRAFT OBJECTIVES

The draft objectives proposed so far are scarcely worth the paper they are written on. There is no chance that they will concentrate the minds of NI top management to produce different attitudes or performance.

The correspondence suggests no shared understanding of the CPRS proposals, so that constructive discussion may be very difficult.

I therefore attach a paper designed to increase understanding of what is, unfortunately, quite a complicated subject.

I am copying this minute and the paper to members of E(NI), John Sparrow, and Sir Robert Armstrong.



JOHN HOSKYNS

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NATIONALISED INDUSTRY OBJECTIVES1. INTRODUCTION

1.1 The correspondence and draft objectives to date suggest a lot of misunderstanding among colleagues. The evident confusion shows how little thinking has been done, within Departments, about these massive industries. There is a real danger that sponsor Departments, knowing nothing about business planning, will successfully rubbish the first attempt to impose it.

1.2 If we are to avoid a dialogue of the deaf, we need a properly understood model of what we are trying to do. This means greater precision about the meanings of the words we use. This paper briefly outlines a possible model (following, as far as possible, the format used in the CPRS paper E(NI(82)11). What matters is not whether the model suggested below is the right one, but that we do have an agreed model.

2. THE ROLE OF OBJECTIVES

2.1 We should not confuse "objectives" and "strategy". There may be several strategies which would achieve a particular set of objectives. But we cannot set the objectives in isolation or they will be meaningless.

2.2 To start, we should extrapolate the semi-monopoly industries' performance (prices, service quality, taxpayers' subsidy) into the future on unchanged policies.

2.3 We can then have a first shot at establishing objectives which are economically and politically acceptable. It is the gap between the extrapolation (what business planners call the "momentum line") and the objectives, which must be closed by an appropriate strategy. (If there was no such gap-closing, an industry would only need operating management, not strategic management.)

2.4

But all this has to be done in the real world - that is within constraints: time; money; social/political; and statutory requirements. Since it may not be possible to achieve the desired objectives within these constraints (ie it may not be possible to get from "here to there") the establishing of objectives, constraints and strategy will be iterative (ie trial and error) on paper. And they have to be negotiated with those who must carry them out.

2.5

But all this is still not enough if there are no penalties for failure and no rewards for success. Somehow, these have to be built into the system.

3.

CLARITY OF OBJECTIVES

3.1

Types of objective

3.1.1

We agree with CPRS that we will need Ministerial Objectives. We think it most unlikely that, in practice, they can be covert objectives - that is, not revealed to the Chairmen concerned. They will often be subsidiary to the main performance objectives. For example, if we believed that the NCB could satisfy customers without ripping off the taxpayer, we would not need to consider increasing imports; privatising open-cast mines; regionalising NCB to get internal competition. The aim is to change the competitive environment in a way that no NCB Chairman would volunteer to do. So we do it for him.

3.1.2

Another Ministerial Objective might be to ensure that the British Rail Board was not in the business of "running a railway", but of using BR's assets, real estate and rights of way to produce the most cost-effective public transport. Such thinking will never come from BRB. (Privatisation, it goes without saying, is the only total solution to the NI monopoly problem. But its impact is only marginal.)

3.1.3

Performance Objectives might be set in absolute (real money) terms; or by reference to earlier historic performance; or

by comparison with other industries, or best practice in similar industries in other counties.

3.1.4 It is a waste of paper to set down normal management practice (eg maintaining good industrial relations) as if it was a Performance Objective. The test is simple. Would exemplary performance in IR compensate for massive failure on, say, break-even/profitability? Good industrial relations are a means, not an end. Similarly, an objective (like that in British Shipbuilders' draft objective, item 3) "to take early firm corrective action", is meaningless. Objectives are about results, not conduct.

3.2 Constraints

3.2.1 Time. Many of the draft objectives refer to returning to profitability, privatising peripheral operations etc, but without any time limit. Nothing will happen unless there are time limits, and explicit consequences for failure to meet them.

3.2.2 Money. The bottom line constraints (break-even/profitability, EFLs, subsidies, public dividend capital etc) are not objectives. Some draft objectives refer to "meeting the EFL" as if it were one. Not to break a financial constraint cannot itself be an objective, any more than it would be sensible for ICI to say that, over the next 5 years, one of its major objectives was not to run out of cash. Breathing, like cash flow, is necessary for survival. But we don't live in order to breathe.

3.2.3 An example: do we simply accept the momentum line of BR's future subsidies, or do we set a constraint (rather like the MTFS) where the annual subsidy to British Rail is a steadily declining percentage of GDP? If we set such a constraint, how do we enforce it? For we know that, in the real world, we may also have to impose some constraint on NI prices, despite all our original hopes of an "arm's length" relationship.

3.2.4 This brings us to pay. If prices are to be curbed and subsidies reduced, pay must be constrained. (And we

want that anyway, to reduce its knock-on effects elsewhere in the public sector.) So pay constraints will have to be explicit. This in turn will mean close co-operation between Departments and NIs to resist excessive pay claims and, if necessary, fight and win major strikes. (This affects restrictive practices too.)

3.2.5 Other constraints. NIs may have to operate uncommercially for political or social reasons, and that will have to be separately costed and paid for. But this must not allow NI management to muddy the waters and conceal poor performance elsewhere.

3.3 Objectives and constraints should be as specific as possible

3.3.1 Because of all these complications, it is tempting to resist "over-precise" objectives. They are fine, the argument runs, for private sector companies where life is simpler. But the reverse is true. It is the very ambiguity of the NIs' position that makes clear objectives so necessary. But thinking out those objectives will be hard work.

3.3.2 Resistance to this thinking is shown by the vagueness of the draft objectives in their present form. For example, there is frequent reference to use of the words ". . . as agreed with the Secretary of State". Indeed, some of the objectives are little more than a repetition of the check list suggested in the original CPRS paper, without any of the numbers, company names or dates which would give them meaning. The test is simple. How do you know when you have achieved an objective? If it's not possible to tell, then you haven't got any objective. And be quite clear, that's the way some NI Chairmen like it.

4. OBJECTIVES HAVE TO BE NEGOTIATED

4.1 The Department cannot simply hand a set of objectives to the NI Chairman. It will need his and his management's know-how to work out attainable objectives and then approve his strategy. The problem is that no-one knows what realistic objectives for a nationalised industry would be,

because all concerned, in the industries and the Departments, have for years accepted, without question, a frame of reference in which there are no objectives, no measurable achievement, and no sanctions.

- 4.2 Once a new framework exists, NI Chairmen will start to sweat about objectives. Indeed, they may become clearer in their own minds about the level of remuneration (as opposed to Knighthoods). They may also become less complacent and corporatist about trade union power, rather than simply settling for "doing their best", as far as their trade unions will permit.
- 4.3 The NI Chairmen have said that they would welcome clear objectives and a clear strategic framework. We should take them at their word on the basis that, once the new regime is functioning, they will themselves have some interest in defending it.

5. CONCLUSION

- 5.1 The difficulty Departments are having in producing objectives is not evidence that objectives are a waste of time. If the objectives could be knocked out in an afternoon (and that is what some of the drafts look like) they would be of little value.
- 5.2 The process of thinking about the objectives will be more valuable, in the end, than the resulting pieces of paper. There is no real solution to the problem of semi-monopoly NIs, once we have privatised all that can be privatised. We cannot talk about objectives without talking about what is politically possible in the long term, and about constraints of time and money, and the selection and remuneration of Chairmen. Almost certainly, the relationship between Government and NI Boards has to become closer, not more distant. And the need for business thinking within the Departments becomes increasingly obvious. The NI problem is indivisible. So is the solution.

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