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17 January 1984
Policy Unit

Transport, Energy, Agriculture, Scotland

Employment

PRIME MINISTER

COMPETITION POLICY

At your meeting tomorrow with Norman Tebbit and Alex Fletcher, the following subjects could be discussed:

1. The need to set out the general argument concerning the virtues of competition and the very real progress that the Government is making in increasing competition in a range of markets.

2. The importance of taking enough measures to encourage competition in nationalised industries that are about to become private sector companies.

3. The need to have a sustained programme of action to deal with private sector monopolies and cartels.

4. The handling of the programme.

1. The General Argument

The case for competition is well known and is generally supported by the public. A choice of producer will mean lower prices than a single supplier. It will mean more choice over the style and standard of service or product. It will encourage faster innovation and change in the delivery of services and products in response to customer needs.

Some of the other benefits are less well known but equally important. Competitive businesses in all but extreme inflationary conditions encourage better working relationships between employers and employees, and usually create fewer union difficulties. Outflanking large labour monopolies is one of the important but wisely understated advantages of a general competition policy. Competitive markets also offer more opportunities for new small businesses to start up if they do not face the daunting competition of a large monopoly which would probably put them off, or alternatively ruin them at a sensitive stage in their development. It is also possible to get a greater degree of worker shareholding and involvement in smaller competitive units than it is in large monopoly enterprises, which are usually bureaucratic in their structure. Competitive markets help in the drive to lower prices, to lower inflation.

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These general arguments need supporting with Ministers spelling out the action that has been taken to give credibility to the Government's general belief in competition.

2. The Importance of Competition to Privatisation

The main burden of criticism of the privatisation programme in the press and amongst the commentators at the moment is that our privatisation programme is returning monopolies and cartels to the private sector in the interests of maximising the proceeds from the sale, in preference to introducing virile competition. This is unfair and needs countering.

In the cases of British Telecom and British Airways - which are under the most intense public scrutiny - the story is not nearly as bad as the critics would suggest. From next year, for example, you have a choice over the phone set in your home and over the carrier of your message.

In the case of the airways, more competition on internal domestic flights has been introduced. The results have included substantial reductions in fares (eg half-fare to Edinburgh if the passenger can book 14 days in advance next month), a major refurbishment of British Ariways' shuttle lounges, and the introduction of meal and drink services on some of the British Airways shuttle flights. This is yet more evidence of the powers of competition.

It is equally important that proposals for National Bus include strong competitive elements in the service and those for the BAA at least include substantial additional private franchising.

3. The Need for a Programme of Widening Competitive Pressures

(a) Professional services

(i) The Stock Exchange cartel has been broken. A minimum consequence of this is going to be a substantial reduction in stockbroking commissions charged to all types of customer, including possibly the small retail customer who only wants a stockbroker to execute a bargain without any additional advice. The Government needs to claim more of the credit for change.

(ii) The solicitors' monopoly has been dented by the decision to open up conveyancing to solicitors employed by other institutions. This should lead to advertising and price competition, which is what the public wants.

(iii) Pushed by the OFT, the accountancy profession moved in 1981 to a half-way house on advertising, and accepted "tombstone" advertisements in local newspapers not more frequently than once a week. It is possible that in the course of this year, the English accountants will accept their President's recommendation to adopt unrestricted advertisements, subject to conditions (that advertisements should not be misleading, should not make comparative claims, should not bring the profession into disrepute). Architects and surveyors have abandoned restrictions on mandatory scale fees; they are still prohibited from revising their tenders in response to lower bids; restrictions on advertising still stand. The Secretary of State could threaten further MMC/OFT pressure if progress is not more rapid.

(iv) The vets obdurately refuse to move on advertising, despite the MMC's finding that their prohibition of advertising was contrary to the public interest. The Secretary of State could either:

- threaten the Royal College of Veterinary Surgeons with an order to desist from this restrictive prohibition; or

- at least write to the College in an effort to persuade the profession to reform.

(b) Car prices

The high price of cars (for the personal buyer) in this country has become a scandal. List prices in Britain (net of taxes) in October 1983 were on average 38 per cent higher than in Belgium, according to the European Bureau of Consumer Unions.

Allowing for discounts and differences in specifications (eg whether radios included) DTI judge that the differentials are 25-30 per cent for BL models, 12-18 per cent for Ford and Vauxhall models. For the fleet market (50-70 per cent of the UK market) the differential is 9 per cent on average. It is also fair to point out that Belgium is a low-price market.

These excessive prices represent additional payments to foreign suppliers, and to foreign shareholders of the UK multinationals. The Institute of Fiscal Studies calculated that the additional costs amounted to £1 billion in 1981. More recently, the DTI calculate that if UK car prices fell by 10 per cent, we would save £400 million a year in payments to foreign car producers.

The European Commission is proposing a measure intended to reduce these differentials, by allowing the car producers to retain their exclusive franchising arrangements with their dealers (the so-called "block exemption") on certain conditions, the most important of which are that:

- pre-tax recommended prices of comparable cars should not differ between member states by more than 12 per cent; and
- producers must supply dealers with specifications appropriate to another member state in which the same models are marketed ("full line availability") at the same prices as those obtaining in domestic market, save for differences in specifications.

The Commission's clear intention is that where prices differ significantly between member states, parallel trade can develop via unauthorised dealers, so reducing the price differentials.

The problem may disappear by 1986 if sterling depreciates further against European currencies and BL improves its productivity faster than continental producers. Our options are broadly:

(i) try to dissuade the Commission from pursuing this approach;

(ii) do nothing, in the hope that the measure fails;

(iii) take the initiative ourselves to reduce differentials, possibly by persuading the UK industry to modify its traditional price structure (high recommended prices and high discounts), in order to reduce the apparent differentials.

If we adopt the first option, we will appear to condone the existing price structure. If we fail to dissuade the Commission, and its approach succeeds, we will have the worst of both worlds - vilification for trying to bolster an arrangement which is expensive for the car-buyer and for the UK, while failing to protect BL's profitability. We favour pursuing the third.

(c) Milk prices

Milk prices have risen more sharply than food prices over the last 10 years. In part, this reflects the cosy marketing arrangements of bottled milk. The OFT are forcing registration of their restrictive practices, and are probing the activities of the Co-ops and others. In part, this reflects the Milk Marketing Board pricing decisions. The European Commission is trying to establish the illegality of their pricing practices in order to disallow sizeable UK expenditure from reimbursement. This matter is under separate review.

(d) Banking

The clearing bank arrangements have been cosy through the Bankers Clearing House restrictions on membership. There are currently 10 members. Citibank, an aggressive US bank, are applying for membership. If the Association turns them down, the DTI/Bank of England should consider how the clearing system can be invigorated by new entrants. The DTI should also consider the banks' responses to the recommendations in the National Consumer Council Report.

(e) Travel

National Bus Company is currently exempted from the restrictive Trade Practices Act. This exemption should be repealed as part of the prelude to a more competitive private sector industry.

In the case of airways, more national routes can be licensed by the CAA for competitive services.

4. Handling

Competition policy needs a stronger steer if it is not to become snagged by particular departmental interests, or overtaken by press and public misunderstanding. The unsatisfactory response to the House-buyers' Bill illustrates the consequence of not co-ordinating the policy (DTI were not consulted by the Lord Chancellor's Department about the Government's reply in the debate on 16 December).

We suggest that you ask the Secretary of State to propose the development of a programme of action. This should be a matter of priority and be brought up before E(A) as soon as possible for collective discussion.

A letter from you to the relevant Secretaries of State could underline the importance of this policy and of pre-empting further adverse criticism or other Private Members' Bills.

John Redwood

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This meeting should have two objectives:

(i) To develop a systematic approach in Whitehall for identifying where there are competition black-spots which need to be challenged; and for securing Government action;

(ii) To discuss particular cases which are live at present, e.g. car pricing, accountants, vets, etc.

On (i), there could be an E(CP), conducting an exercise very like E(A) and E(DL) on privatisation, with Tebbit and Fletcher forming a similar team to that of Lawson and Moore. This will probably require a letter from you to launch it, but I would involve the Chancellor first. You could do this yourself later in the day.

On (ii), I would avoid discussion of milk marketing. This is being tackled from a different direction and there is a risk that wires will get crossed. Banking also needs to be handled carefully, as this is as much Treasury business as DTI.

JG

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