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DEPARTMENT OF TRANSPORT
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Prime Minister } Mr Howell's office assure me,

This proposal does not affect the agreement that, to the extent that this year's EFL is exceeded because of ASLEF,

29 March 1982 next year's will be reduced (by about

£40m, probably),

Agree the draft statement, amended to make this point? Should it not be

ML330/3 an oral statement? Try written statement?

Michael Scholar Esq
Private Secretary to
the Prime Minister
10 Downing Street
LONDON
SW1

is there no hope of including a reference in Pect's terms to meet some of the maintenance expenditure?
not

BRITISH RAIL

My Secretary of State would like the Prime Minister to know of the steps he has now to take in regard to the BR grant for passenger services in 1982.

The claim for grant which British Rail has submitted, is not acceptable, since it provides for a substantial increase in grant for this year over the unprecedented level of last year. This is despite the Board's efforts in continuing to reduce manpower, and despite the fact that they have placed an embargo on all commitment of new investment. It is therefore a matter of particular concern that the claim shows a continuing rise in the Board's unit costs, and only modest adjustments to be achieved in the level of services. Mr Howell has therefore concluded, and agreed with the Chief Secretary, that the right course is to impose on the Board a grant figure for 1982, so as to exert immediate pressure on them to contain their costs. Mr Howell thinks it imperative to act now, so that the grant level will not continue unsettled while the Board move into dealing with this year's pay claim.

The grant figure that Mr Howell has determined with the Chief Secretary's assent makes no provision for the extra losses of the ASLEF strikes in January and February. At £804m it represents a cut equivalent to £10m on last year's level. Also, the benefit of the reduction in the National Insurance surcharge (£6m) is fully offset.

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Mr Howell has at the same time decided to commission a special inquiry from the senior London partner of Peat Marwick Mitchell (who are the Department's auditors for the grant) on how this position has been reached and the steps immediately available to the Board to correct it. This investigation must lead onto the wider and more fundamental review of the finances of British Rail which Mr Howell discussed with the Prime Minister. Unfortunately, Sir Maurice Hodgson was not able to take that on, and the second candidate, Sir David Orr, will be seen immediately on his return to this country tomorrow. But whatever the result of that, Mr Howell feels it necessary to give the Board a decision on the grant this week, so that at their monthly meeting on Thursday they can start to consider the action needed.

It follows that the House should be informed at the same time, and I attach the draft of what Mr Howell proposes to say. In view of the rather technical nature of some of the material, Mr Howell thinks it best this should be done by Written Answer to an Arranged Question. You will see that the statement also takes the opportunity to inform the House, as Mr Howell has agreed with the Chief Secretary, that long-term lending to the Board will continue in appropriate circumstances - that is to say, these financial problems do not require the Government to suspend normal lending to the Board for capital purposes within the EFL already set.

In the public presentation of these steps on the grant and the Peat Marwick investigation, Mr Howell will be making it clear that the grant for 1982 represents a cut on the 1981 level; that it gives no cover for the losses from the ASLEF strike; that it is within the existing external financing limits and that he is pursuing with BR the need for further reductions in the grant in 1983 to which of course the investigation will contribute.

I am copying this letter to the Private Secretaries of the Chancellor of the Exchequer, the Chief Secretary, the Leader of the House and the Chief Whip.

Yours,

Anthony Mayer

R A J MAYER
Private Secretary

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DRAFT STATEMENT ON GRANT TO BRITISH RAIL

1. I informed the House on 24 November last of an exceptional increase of some £110.4m in the grant paid to the British Railways Board for the operation in 1981 of the passenger railway system as a public service under Section 3 of the Railways Act 1974 and EEC Council Regulation 1191/69. This increase recognised the serious deterioration in passenger revenue in 1981, and I made clear that I expected the Board in their claim for grant for 1982 to demonstrate that firm action had been taken on unit costs, which had been rising, and on service levels in light of the change in demand.

2. The Board have submitted to me a claim for grant for 1982 of £885.2m, which allowing for inflation, is some £60m above the total grant provided in 1981. Most of this results from increases in cost rather than a fall in revenue.

3. Under Article 12 of the EEC Regulation, the grant is to be calculated on the basis of efficient management of the undertaking and the provision of transport services of an adequate quality. After discussion of their claim with the Board, and in compliance with my statutory obligations, I judge that the grant for 1982 should be at a figure, lower than the Board's claim, of £810m. This now falls to be reduced, because of the change announced by the Chancellor in his Budget statement with regard to the National Insurance surcharge, by £6m. The grant for the passenger railway will accordingly be £804m for 1982. This amount includes, as in previous years, provision for a Special Replacement Allowance - this year £87.6m - for the replacement of the assets of the passenger business. It is estimated that a further £80.3m will be paid to the Board by Passenger Transport Executives in respect of services provided in their areas under Section 20 of the Transport Act 1968. The separate grant for level crossings will be £18.1m.

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4. I do not intend - and I am sure the Board would not wish - that this decision should result in yet further reductions in expenditure on necessary renewal and maintenance of the equipment and particularly of the infrastructure, and I will therefore this year earmark a part of the grant to this purpose.

5. Because the grant has been determined in this way, and not on the basis of the Board's Budget, I am not able to publish a breakdown of the grant between business sectors, as in previous years.

6. The need to decide on a level of grant in this way reflects a new, and serious development in the financing of the railways, and raises questions that require urgent answers. I have therefore asked Mr P J Butler, of Messrs Peat Marwick Mitchell, to make an immediate investigation, and report to me, with the following terms of reference:

"Following the Board's rising losses on their railway operations and the claim for grant in 1982, to examine the Board's rail budget for 1982 in the light of their performance in earlier years, their plans for improvement and the extent to which they were achieved; and to recommend what steps are open to the Board to make early improvements in the trading results by increased efficiency, cost reductions and improvements in financial control, whilst complying with the Public Service Obligation."

7. This investigation will provide an important element of the review of railway finances referred to in paragraph 3.71 of Cmnd 8494-II and to which both the Board and I attach the greatest importance.

8. At the same time I should make clear to the House that long-term lending to the Board will continue where the circumstances are appropriate.

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10 DOWNING STREET

From the Private Secretary

31 March, 1982.

Dear Anthony,

British Rail

Thank you for your letter of 29 March about the British Rail grant for passenger services in 1982.

The Prime Minister is content with the draft statement (which she thinks might best be issued as a Written Answer), subject to it being clarified that the level of grant now settled accords with the decision announced on 4 March that the loss caused by the ASLEF dispute should not be met at the taxpayers expense, and that any excess on the 1981/82 EFL will be offset against the limit for 1982/83. The Prime Minister also suggested that a reference should be included in the Peat Marwick terms of reference to the need for accelerated disposals of assets in order to meet the Board's higher current costs. You have explained to me that the proceeds from disposals affect the Board's EFL, but not its trading position. There was also a risk that BRB might use the involvement of Peat Marwick in the disposals issue as a reason for delaying further progress in the matter. You have accordingly included the reference to accelerated disposals elsewhere in the Written Answer.

I am sending copies of this letter to John Kerr (HM Treasury), Terry Mathews (Chief Secretary's Office), David Heyhoe (Lord President's Office), Murdo Maclean (Chief Whip's Office), and David Wright (Cabinet Office).

Yours sincerely,

Michael Scholar

R.A.J. Mayer, Esq.,
Department of Transport.

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