

M.T.

Confidential Filing

Water rates and Water charges

Local Government

February 1981

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
19-2-81							
23-2-81							
27-2-81							
3-3-81							
12-3-81							
28-2-81							
7-3-83							

PREM 19/1085

CLOSED

FD

Prime Minister² 2 PPS

Mis 13/4

DJH



2 MARSHAM STREET
LONDON SW1P 3EB

My ref: K/PSO/11547/83

Your ref:

12 April 1983

[Handwritten signature]

[Handwritten initials]

Request

Thank you for your letter of 10 March about water charges.

The fact is that we are vigorously pursuing the strategy which was endorsed by E(NI) for improving the efficiency of the water authorities. E(NI) will be reviewing what has been achieved and what more might be done in September.

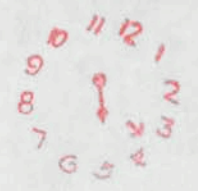
I am copying to the recipients of yours.

2
[Handwritten signature]

TOM KING

The Lord Cockfield

2 APR 1963





B/MIND
P/S/SEC
MR GRAY
MR DUTKE
MR BAZZ

From the Secretary of State

The Rt Hon Tom King MP
Secretary of State for the Environment
2 Marsham Street
London
SW1P 3EB

10 March 1983

Dear Tom,

Thank you for your letter of 2 March.

Relating charges to cost is the perfect formula for encouraging inflation. The higher the costs the higher the charges. Where - as with the Water Authorities - they have powers of taxation, without representation, the system is doubly pernicious. We do not allow Government Departments to have the money they want to meet their costs. You simply get your cash limit and have to accommodate your costs within it. I can see no justification at all for water rates in London going up by 6.1% when we are expecting people to accept wage increases of 4% or less. The inhabitants of Northumbria won't be too pleased with an increase of 10% either.

The Local Authority rates have been a source of great political grief to us. We have tried time and time again to take effective action against excessive increases but our success has been limited because of the power of the Local Authority lobbies. The Water Authorities are much worse than the Local Authorities and they can't even be thrown out at an Election. At the same time they are incredibly vulnerable - particularly at the moment when they are extremely unpopular with the public at large.



From the Secretary of State

I was not suggesting we introduced a price control. I cited the price control mainly to illustrate the point that the water rates have never been regarded as sacrosanct in the way that the local rates have been. My specific suggestion was that they should be capped, in the way that Leon Brittan had suggested that the local rates be capped. A year or two of nil increases would work wonders.

I am sending copies of this to the recipients of your letter.

Yours,
Arthur
LORD COCKFIELD

local Govt.

JD

file

cc Ho	LPSO	LPO
Leo	CSO	Dotrans
CO	DHS	MOD
DOT	MAFF	NIO
CAZ	SO	DES
J/M	WD	FO
D/N	J/ind	HMT

CONFIDENTIAL



10 DOWNING STREET *bc JV*

From the Private Secretary

7 March, 1983.

Dear David,

Water Bill: Water Rates

Your Secretary of State sent the Prime Minister a copy of his letter of 2 March to the Trade Secretary.

The Prime Minister has commented that the 5% increase in water rates which water authorities have budgeted is too high. She has further commented:

"We shall not get inflation down at that rate."

I am sending copies of this letter to the Private Secretaries to Members of the Cabinet and to Richard Hatfield (Cabinet Office).

Yours sincerely,

Michael Scholar

David Edmonds, Esq.,
Department of the Environment.

CONFIDENTIAL

dg

CONFIDENTIAL

cc J.V.



Prime Minister (2)

2 MARSHAM STREET
LONDON SW1P 3EB

01-212 3434

Mus 2/3

My ref:

Your ref: 2nd

March 1983

5% is too high
we should put inflation
down at that rate
not

Dear Arthur,

WATER BILL: WATER RATES

Thank you for your letter of 25 February suggesting that we might now "cap" the water rates through an amendment to the present Water Bill. I have also seen the letter from the Prime Minister's Private Secretary of 28 February.

But I should say that I am not in favour of legislation introducing price control in the water industry. It is basically unnecessary as the existing situation for the industry is that Section 30 of the Water Act 1973 provides that charges must be related to cost. There are no subsidies to water authorities. Each water authority already has a financial target.

Our approach has therefore been to work on the cost side, with a direct impact on prices. The evidence suggests that we have made major advances in the last 3½ years. Our aim has been to tackle charges by reducing costs and improving efficiency. Since we were elected in 1979 we have twice employed consultants to review the budget of all the water authorities, reducing their budgetted operating costs for 1981/2 and 1982/3 by £17m and £15m respectively. In this year's discussions of charges and budgets for 1983/4 Giles Shaw and I have followed up the specific practical and physical recommendations in the consultants' reports. On two occasions now we have referred water authorities to the Monopolies and Mergers Commission, and as your Department knows we have followed up with all the water authorities the Commission's main recommendations on management control and capital investment planning. I should be interested to know if you disagree with any of these recommendations.

We are abolishing inter-authority cross-subsidies by repealing the Water Charges Equalisation Act 1977; we have maintained a continuous pressure on manpower numbers, and the regional water authority headcount has fallen by 6.5% since March 1979; in the industry overall (including the water companies) in 1979 there were 75,507 employees. By December 1982 this figure had been reduced to 70,485; we have introduced performance aims for water authorities' operating costs, and those for 1983/4 are at a lower level, in real terms, than in any year since 1979/80.

For 1983/4, the authorities have budgetted increases in main charges to meet their financial targets. The increase in charges for each

Local Govt: water rates 2/87

authority are as follows:

North West	3.5%	Thames	6.1%
Severn Trent	4.9%	Anglian	0
Wessex	3.4%	Yorkshire	5.3%
South West	4.8%	Northumbrian	10.0%
Southern	4.6%		

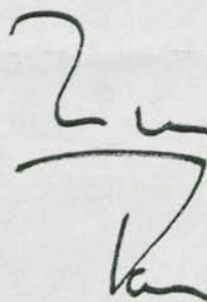
These increases will not be adjusted in the light of the recent wage settlement. The performance aims will still hold and the increased costs will be found through savings in manpower or other operating costs.

It is noticeable that last year when the wage increase was 8.8%, the actual increase on the outturn pay bill was 5.7%.

The average increase in prices in 1983/4 will be around 5%. This price increase comes at a time when in many regions demand from industry for water has declined sharply. The financial targets are also gradually being raised so as to reduce external financing requirements and this has been one element in the increase in charges.

In conclusion, I should say that I am not yet satisfied that water authorities are in a fully efficient shape. The pressure will continue but statutory price control is surely not the right answer. My understanding is that it is our general policy to rely so far as possible on the price mechanism - which is fundamentally weakened by price controls - and the adoption by Government of price limitation powers inevitably leads either to subsidies to the authority, if not by injections of cash, then by relaxing the financial target. All future price rises become the fault of Government.

I am copying this to the Prime Minister, Cabinet colleagues and to Sir Robert Armstrong.



TOM KING

Local Govt

CONFIDENTIAL

DA



FILE

10 DOWNING STREET

From the Private Secretary

28 February 1983

Dear David,

Water Strike : Water Bill : Water Rates

The Secretary of State for Trade has sent the Prime Minister a copy of his letter to your Secretary of State of 25 February, in which he suggested capping the Water Rates.

The Prime Minister is much attracted to this proposal, and would be grateful if your Secretary of State would pursue it vigorously.

I am sending copies of this letter to the Private Secretaries to the Members of Cabinet and to Richard Hatfield (Cabinet Office).

Yours sincerely,

Michael Scholar

David Edmonds, Esq.,
Department of the Environment.

CONFIDENTIAL

RM



Handwritten initials/signature

From the Secretary of State

Prime Minister ⁽²⁾
ms 25/2

CONFIDENTIAL

The Rt Hon Tom King MP
Secretary of State for the Environment
2 Marsham Street
London
SW1P 3EB

Please pursue vigorously

Handwritten initials

25th February 1983

Dear Tom,

WATER STRIKE : WATER BILL : WATER RATES

The Water Bill is still in Committee in the Lords.

Is not this the ideal opportunity for capping the Water Rates?

The Water Authorities are the worst example of an irresponsible, unelected bureaucracy with taxing powers we have. They have no lobby to support them and none of the arguments that persuaded us not to cap the Local Authority rates apply.

It only needs a simple, two line, sledgehammer amendment.

There is ample precedent. The water rates were subject to the Price Control; and as the Rev Roland Hill said "Why should the devil have all the good tunes?"

I am sending copies to Cabinet colleagues.

Yours,
Arthur
LORD COCKFIELD

26 FEB 1954

10 11 12 13
14 15 16 17
18 19 20 21
22 23 24 25





Local Govt

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/11780/81

Your ref:

12 March 1981

See below

n
143

WATER CHARGES: WIDER LESSONS

Thank you for your letter of 23 February.

will request if required

As you will know from my letter of 26 February to Michael Havers, of which I sent you a copy, I have arranged informally for one or two local authorities to re-examine their budgets with the help of management consultants; and I am considering the possibility of appointing private sector accountants as District Auditors for particular assignments. And as you imply, I would want the proposed Accounts Commission to have a remit in the management consultancy area; no doubt we shall be discussing this further now that the PAC has reported on the Role of the C&AG.

You also mention housing associations and new towns. As regards new towns, in relation to their income from the private sector (apart from housing) they are already subject to commercial disciplines. The bulk of this income is in the form of rents for shops, offices and building plots, which have to be negotiated in the open market. However, there is clearly some scope for looking at the efficiency of their management through improving the efficiency and effectiveness of their audit, which is carried out by private firms of accountants. I am considering how the present guidance to these auditors can be improved, with a view to issuing new guidance in time for the audit of the 1981/82 accounts. There may also be scope for consultants to look at management and maintenance costs of housing associations - though the fact that there are some 3000 registered associations of widely differing types does mean that such an exercise would be much more complex. We have already had consultants (Deloitte Haskins & Sells) looking at the budgeting arrangements for housing associations, and their report, which is expected shortly, could well provide a basis for a further examination of this kind. The relationship between such a study and the rents charged to tenants would however be much less direct than in the case of the water authorities.

You will appreciate that what I have done so far is very superficial. I wish I had acted earlier in the water industry but I felt constrained by the delicacy of the wage negotiations.

However, I am sure we should consider this technique for nationalised industries. It would probably only require the existing auditors to be more ambitious in their approach which should be to produce a genuine report to shareholders - ie us. But perhaps we should be more convincing in pointing to the mote in everyone else's eye if we had actually put management accountants into one of our

own Departments. Shall we toss for the Treasury or the Department of the Environment?

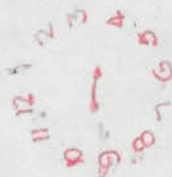
I am copying this to the recipients of your letter.

Yours ever



MICHAEL HESELTINE

12 MAR 1981





DEPARTMENT OF THE ENVIRONMENT

2 MARSHAM STREET

LONDON SW1P 3EB

01-212 3434

Local Gov.

MINISTER FOR LOCAL GOVERNMENT
AND ENVIRONMENTAL SERVICES

6 March 1981

D. Lea

*R
47*

REGIONAL WATER AUTHORITIES

Thank you for your letter of 23 February to Michael on announcing the outcome of the exercise to reduce the increase in water charges next year.

We were able to say that the 1981-82 overall financial target for the RWAs remained unchanged at 1.2%. I understand also that the Welsh WA's target has not been reduced. As for the two longer term questions you pose, we are looking again at the proposed performance aims in the light of the outcome of the charges exercise. As regards the 'rising tide' approach, this seems to remain undisturbed. All the WAs who were below the 1.25% figure remain as before apart from Thames WA who have now moved forward already to 1.24% in 1981-82. The other two targets we amended were above the 1.25%, viz Anglian WA down from 1.50% to 1.38% and Northumbrian WA down a bit more from 2.95% to 2.52%.

I think that it could be said that we have not breached the 'rising tide' principle; there was already a precedent for one Authority, ie the Welsh WA, proceeding at a different rate from the others. There was also the precedent for allowing a WA with a rate above 1.25% to step back a bit, ie the original adjustment down of Northumbrian WA from 3.08% to 2.95%. In announcing the financial targets last December, we said that those Authorities already earning more than 1.25% would continue generally at their present level, in order to allow for such particular adjustments.

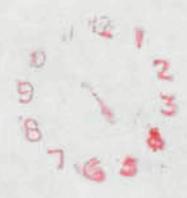
/ Copies go to the recipients of your letter.

Tom King

TOM KING

The Rt Hon Leon Brittan QC MP

1987



✓ Press office

PA

Local
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Sat

MS PRIME MINISTER

To see MS
2/3



2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

2 March 1981

On Tony

I attach for information a copy of the reply that my Secretary of State proposes to make this afternoon on water charges.

I am copying this to Mike Pattison (No 10), David Heyhoe (Leader of the House), John Craig (Wales), and Godfray Robson (Scotland).

*for vicy
David*

D A EDMONDS
Private Secretary

Terry Mathews Esq
PS/Chief Secretary

DRAFT QUESTION

What is the outcome of the exercise, assisted by consultants, to reduce increases in water charges next year.

DRAFT REPLY

There has been an extremely successful outcome for which much credit must go to the water authorities, as well as the consultants.

As a result, the total of water rates to be collected in England in 1981/82 will be some £86m. lower than had been planned. For the nine Authorities as a whole, the average increase in main charges has been reduced from a planned 19.4% to 13.3%.

Within these average figures, the charges of the individual authorities vary considerably. But the average increases in main charges for individual Authorities has been reduced from a range of 14-29% down to 10-16.5%:-

<u>WATER AUTHORITY</u>	<u>Original</u> <u>%</u>	<u>Revised</u> <u>%</u>
North West	29.0	16.5
Northumbrian	27.8	15.1
Yorkshire	22.0	13.5
Severn-Trent	17.7	13.7
Anglian	19.8	12.4
Thames	14.0	12.5
Southern	16.2	12.6
Wessex	14.7	11.4
South West	17.3	10.0

Average domestic charges were expected to range from [] to [] as part of the move to the more equitable charging required by Section 30 of the Water Act 1973 and also as a result of the

effects of the abolition of the equalisation scheme. Now the range is expected to be between 10.9% and 18.4%; though there will still be a considerable range in the increases for particular consumers around these averages.

Four main areas of economy were found to contribute to the £86m. saving.

First, individual authorities have reduced their budgets for operating costs in 1981/82 by £17m.

Secondly, the more recent forecasts of reductions in the rate of inflation enabled more realistic figures to be included for the cost of capital works to be carried out in 1981/82, allowing a reduction of £27m.

Thirdly, it was found that some authorities had under-used their borrowing facilities in 1980/81 and the reallocation of these to other Authorities enables them to reduce their rate demands next year. Together with one or two other changes, this has provided a reduction of £17m.

Finally, a scrutiny of capital expenditure programmes showed that schemes totalling some £25m. could be deferred, leaving a total investment programme of about £725m.

The Government had already set Water Authorities their targets for next year amounting to a 1.2% return overall on revalued net assets. Although there has been some variation in targets for a few authorities, the overall percentage return will still be achieved. Similarly, although there has been some reallocation of the 1981/82 external financing limit, the total of £424m. remains unaltered.

CONFIDENTIAL



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local
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10 DOWNING STREET

From the Private Secretary

27 February 1981

The Prime Minister read the Chancellor's letter of 23 February to Mr. Heseltine on the wider lessons of the water charges exercise.

When they met to discuss the Budget on 24 February, the Prime Minister suggested that the accountants might be asked to examine certain Departments' budgets as well as local government and water authorities. She suggested that, for example, the DHSS budget might be worth their looking at.

T. P. LANKESTER

A. J. Wiggins, Esq.,
H.M. Treasury.

CONFIDENTIAL

12



Local
Cost

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Michael Heseltine MP
Secretary of State
Department of the Environment
2 Marsham Street
London SW1P 3EB

23 February 1981

R
24/2

R. Brittan

REGIONAL WATER AUTHORITIES

In your minute of 18 February to the Prime Minister you reported on, and discussed the public presentation of, your and Tom King's discussions with regional water authority chairmen.

As you know I have throughout been concerned by the possible repercussions on nationalised industries' financial targets of any suggestion that individual authorities' targets were being eased to hold back charges. It will therefore be important, in presenting publicly the charges reductions, to emphasise the substantially unchanged "average target" for the authorities as a whole (including the Welsh Water Authority) even though the concept of an "average target" for the industry as such is not one which has hitherto had any place in the decisions on these matters. (All the targets have of course been for individual authorities). We may also need to point out that none of the changes slows down the rate at which those authorities below the "rising tide" move towards it.

There are two respects in which the consultants' reports and the consequential changes in five authorities' targets raise questions for the slightly longer term. The first is the effect which reductions in operating costs ought to have on the performance aims for the authorities, work on which is at an advanced stage. Secondly, the "rising tide" approach to financial targets imperfect though it was, had the effect of moving authorities as a whole towards earning realistic rates of return on their assets. We need to consider how to return to that pattern, endorsed by E(EA), for years after 1981-82. Perhaps our officials could be in touch very soon on both these points.

I am copying this letter to the Prime Minister, Keith Joseph, George Younger and Nicholas Edwards.

Leon Brittan
LEON BRITAN

24 FEB 1987

9 8 7 6 5 4 3 2 1

PRIME MINISTER

Enthusiasm for

following up the water

exercise

MS

23/2

cc Mr Wolfson
Mr Ingham



Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

23 February 1981

The Rt. Hon. Michael Heseltine, MP.,
Secretary of State for the Environment

WATER CHARGES: WIDER LESSONS

I was very interested in the account of the professional accountants' review of water authorities' proposed water charges, in your minute of 18 February to the Prime Minister and in Tom King's letter to me of 13 February, in your letter of 13 February. There have been further discussions about this, but I am writing about the wider issue raised in your minute.

You suggest that the techniques of this exercise could be used to find savings in other parts of the public sector, notably local government where you have already taken steps to advance the idea in one local authority. I am very much in favour of applying this kind of technique wherever we can. In some ways the water authorities are most like the nationalised industries, and I want to explore ways of putting these under some form of closer efficiency scrutiny.

I am particularly interested in your suggestion that similar techniques could be used to influence local authority spending. You can certainly rely on Treasury Ministers' support for your efforts in this direction. How do you see it being carried forward generally? Would it link up with the proposal for an Accounts Commission, bringing management services and outside accountants to bear on local authority audit including wider questions of efficiency and effectiveness? Can anything useful be done in advance of that? Could a similar approach be helpful in other parts of the Environment area (housing associations? - new towns??)

→ In view of the promising results in the water case, it is obviously right to consider without delay how we might apply the same techniques more widely.

I am sending copies of this letter to the recipients of your minute of 18 February to the Prime Minister.

GEOFFREY HOWE

21 FEB 1991

BR 7 4 5
0 0 2 3 4 5



Local Gov.

Prime Minister

WATER RATES

I have seen a copy of Michael Heseltine's minute of 18 February to you about water rates.

You should be aware that I have asked Arthur Andersen and Company to look at the accounts of the Welsh Water Authority and they have undertaken to report to us very shortly. I am pleased to say that the Welsh Water Authority have offered their full co-operation and I do not anticipate any problem arising in our relationship with them.

I hope that this exercise will enable us to bring about a reduction of the proposed increases in the WWA's water rate, though I also hope that this can be done without material damage to the Authority's capital programme or the construction industry. I should also make the point that the WWA's financial position is particularly difficult, partly because of the ending of the equalisation scheme, and that they may therefore need cover from the inter-Authority arrangements referred to in the fourth paragraph of Michael Heseltine's minute.

I take Michael's point about adopting a low profile, but you will know that these investigations are newsworthy and we do not want to be seen to be attempting any concealment. Certainly in the case of the Welsh Water Authority, I think the way to handle the situation will be to emphasise that the examination is a joint Welsh Office/Welsh Water Authority exercise.

/ I am copying this to the Chancellor and other colleagues to whom Tom King's letter of 13 February was copied.

NS.

RNE

19 February 1981

Prime Minister

Mr Kideroch's comments on
or 'Play A'.

Are you ready to write to
Arthur Anderson, as Mr
Henderson proposes?
Prime Minister

Yes
MS
19:1



1.
C. N. D. N. D. N. D.

18 February 1981

WATER RATES

We have now completed the latest phase in the operation we have mounted with the team of accountants to look at the increases in water charges proposed by the Regional Water Authorities. Tom King has held separate meetings with each RWA Chairman, several of which I have also attended. On the basis of the work carried out by the accountants we put forward proposals involving substantial reductions in spending and lower increases in charges. The attached schedule summarises the changes we have suggested should be made.

The Chairmen have all agreed to go back to the members of their authorities to put the proposals to them. This should happen within the next week or so.

As you will see from the schedule, the RWAs were originally proposing an average increase in main charges of 19.3%. The range was from 14% to 29%. If the suggestions we have made are accepted, the average falls to about 13% with a range of 10% to 16%. It would mean that bills to consumers would be £91 million less than would otherwise have been the case. This includes reductions in working expenses of £28 million, volume savings in capital expenditure of £25 million and a further saving of capital expenditure due to revaluation of £24 million. We would expect commerce and industry to benefit by about half of this reduction in charges.

The target rate of return which Ministers had agreed for the industry of 1.2% has not been reduced, although there have been some adjustments between authorities. Nor have we increased the 1981-82 EFL, though again there have been adjustments as between authorities.

The presentation of this exercise will be critical in the next week or so. One obvious reaction is that the RWAs should have carried out this exercise themselves and that it should not have been necessary for us to take the initiative. We can therefore rightly take some credit. On the other hand, the more credit we take now the more resentment there will be amongst the members of the authorities who will have to agree to our proposals. We therefore propose that during the next week or so we should continue to adopt a very low profile. This fits with Francis Pym's advice that, at this stage, we should not make an oral statement. On the other hand, if the results do start to become public knowledge we should need to respond constructively and what we would aim for is a carefully drafted statement which would underline the Government's commitment to the reduction of inflation and the extent to which this can be achieved in this particular area, while maintaining the maximum amount of goodwill with the water industry.

See Mr Kideroch's comment. Agree with Mr Henderson's approach, in principle.

On the evidence to date, this exercise demonstrates what can be

done in one area of the public sector. I have no doubt that there are wider implications. I am already looking at the implications for local government, and will report to you as a matter of urgency. In a discussion yesterday with Councillor Pym, the Leader of Barnet, I suggested that a similar exercise might be mounted in his Borough and I introduced him to Ian Davison. Accountants moved into Barnet today. The team leader has been briefed in my Department.

As a footnote, we have been immensely fortunate in the effort which the teams of accountants have put in at very short notice. I think it would be much appreciated by the team if you were able to write to their leader, Mr Ian Davison. I enclose a short draft for your consideration.

I am copying this to the Chancellor and other colleagues to whom Tom King's letter of 13 February was copied.

MH

MH

RWA	THAMES	SEVERN TRENT	NORTH WEST	ANGLIAN	YORKSHIRE	SOUTHERN	NORTHUMBRIAN	WESSEX	SOUTH WEST	TOTAL RWAs
Original Increase in Main Charge	14.0%	17.7%	29.0%	19.8%	22.0%	16.2%	25.4%	14.7%	17.3%	19.3%
ECONOMIES										
Operating Costs	10.0	4.0	5.0	2.0	2.8	1.5	-	1.5	0.9	27.7
Capital (Real)	7.0	2.0	(3.0)	6.6	6.0	-	4.2	-	2.4	25.2
Capital (Repricing)	1.3	10.0	3.0	1.6	1.0	2.5	2.8	0.5	0.8	23.5
Reallocation of existing remaining 1980-81 EFL			6.0		6.0					12.0
Reallocation of 1981-82 EFL	(9.7)	(4.7)	15.4	3.3	(2.3)	1.0	-	-	-	3.0*
TOTAL REDUCTION IN REVENUE EXPENDITURE	8.6	11.3	26.4	13.5	13.5	5.0	7.0	2.0	4.1	91.4
Revised Increase in Main Charges	12.5	13.5	16.0	12.7	13.5	12.0	15.0	11.5	10.0	13.1
ORIGINAL TARGET RATE OF RETURN BEFORE ABOVE ADJUSTMENTS	1.06	1.02	0.80	1.50	0.85	1.09	2.95	1.65	2.17	OVERALL TARGETS 1.20
REVISED RATE OF RETURN AFTER ADJUSTMENTS	1.35	1.02	0.80	1.38	0.85	1.16	2.52	1.87	2.17	1.22

*Previously unallocated

DRAFT LETTER FOR THE PRIME MINISTER TO SEND TO MR IAN DAVISON,
ARTHUR ANDERSON AND CO LTD

Michael Heseltine and Tom King have kept me in touch with the exercise which you have been leading for them over the last week or so. I should like to add my thanks to theirs for the willingness with which you took on the task, and for the very great enthusiasm which you and all your colleagues displayed in carrying it out. We shall be looking very carefully at the implications of the results you have achieved for other parts of the public sector.

I do hope you will pass on my personal thanks to all of your colleagues who were involved.

A Reed
ms.



Phoned
ENV 18/2

wvw.

"Coming 18/2"

10 DOWNING STREET

~~Twin~~

Nothing coming over from CST tonight. Terry Matthews says the DOE Ministers + officials are still "crawling over the figures."

The general tone of the meeting this morning was that there need be no increase in EFLs and the CST was not in favour of any relaxation of financial targets.

It seemed possible to get charges down to a reasonable level (perhaps not 10% but possibly 12-13%) without breaking financial targets or EFLs. The figures are being worked on.

Steve 16/2

010



DEPARTMENT OF THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

2

MINISTER FOR LOCAL GOVERNMENT
AND ENVIRONMENTAL SERVICES

Prime Minister

This is politically

13 February 1981 *A considerable importance -*

if we can secure lower water increases. But I don't see how moderating the target rate of return will leave EPL's unaffected. DoE Ministers will discuss

*a Mr. Heseltine
Mr. Lyden*

This is urgent - must give it top priority on Monday

Dear Geoffrey,

In his minute to you on 9 February, Michael Heseltine set out the arrangements we had made for professional accountants to review the water authorities' proposed 1981/82 water charges. He and I met the team led by Ian Davison this morning. In Michael's absence from London this afternoon, I am with his agreement reporting to you our immediate reactions to the team's report. *with Leon Britton on Monday morning.*

Making all allowances for the fact that this exercise has been carried out over an extremely tight timescale, the results in terms of the implications for the finances of the water industry, both short and longer term, are profound. The great value of the analysis lies in the fact that the rigour of an examination carried through by private sector accountants into management levels below the Chief Executive in the authorities has elicited a fund of management information which should enable us to argue with some confidence with the individual Chairmen that their scope for reducing charges is much greater than they had hitherto led us to believe.

P... 13/2

Not only do the results and techniques of this exercise appear to offer pointers to our ability to influence expenditure in the water industry but potentially in other parts of the public sector, notably local government.

In his minute, Michael indicated that I had set the team the question of what would need to be done to ensure that charges in 1981/82 would not rise by more than 10%. The team has in fact produced three options at 10%, 13% and 15% respectively. I attach copies of the relevant figures.

Inevitably the lower the increase the more changes that will be required in the patterns of expenditure by the individual authorities. Over this weekend we and the Treasury must resolve a number of issues.

Clearly we should secure the maximum realisable savings in operating expenditure within the estimates produced by the team.

The capital programmes theoretically offer even greater scope for reductions; the £66m in the 10% option is, of course, less than the total thus far uncommitted.

But of course anything more than a modest reduction in the existing planned level of investment would be an immense blow to the construction industry and neither Michael nor I would want to recommend any such course to our colleagues.

What the team do believe is that there is slack in the capital programme resulting from the fact that the inflation assumptions originally built into the budgets have been proved to be too high.

Whilst some redistribution of EFLs within the existing total is obviously possible, we do not favour any increase in the total because of the PSBR implications.

This leaves the question of the rate of return. We have introduced this regime for the nationalised industries for reasons the accountants fully understand. What they express strong doubts about is the way in which the regime has been applied to the water industry which is very different to the general run of Nationalised Industries. First they question the wisdom of setting sharply increased targets at a time of recession and with serious consequences for the costs of private sector industry. Secondly they point to the need, if increases in authority charges are to be reduced to uniform levels, to apply the rate of return differentially. Thirdly, as an issue to be considered in the longer term, they doubt the sense of applying CCA to calculating the depreciation of assets such as reservoirs and whose life is measured in a hundred or more years.

While I recognise that changes in the rate of return proposals are thus involved, the potential prize in a substantial reduction of water charges is very attractive in political terms. It could set a climate for the fixing of other public sector charges over the coming months which could be of inestimable value. The critical question therefore seems to be whether the arrangements for the authorities to achieve the rate of return should be moderated. It was clear from a brief informal discussion with your officials after our meeting that they did have reservations about any moderation of the targets, as setting a possible precedent for the main Nationalised Industries. However it is crucial to the success of this exercise that we do show some flexibility on this point, whilst maintaining the total of the EFLs, and thus not affecting the PSBR, and I hope that it can be sympathetically considered.

This whole exercise as Michael explained in his minute has to be fast moving. We have prevailed on the water authorities to delay the issue of their demands; but we cannot hold them beyond Tuesday night. To do so would affect their cash flow and we would get the blame. If we are to secure the maximum advantage from the accountants' review therefore, we need to take decisions on Monday. Michael and I have already arranged to meet Leon Brittan at 10 am to establish what steps are practicable in the brief time before we meet the authority Chairmen again on Monday evening and Tuesday morning.

/ I am copying this to the Prime Minister, Keith Joseph, George Younger, Nicholas Edwards and Leon Brittan.

TK
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TK

TOM KING

WATER AUTHORITY CHARGES - EFFECT OF REDUCING ALL INCREASES TO 10%

12 FEB 1981

	T	S-T	NW	A	Y	S	N	W	SW	ALL ENGLAND
CURRENT PROPOSAL	15%	19%	29%	18.6%	22.0%	16.1%	25.4%	14.7%	17.3%	19.5%
REVISED PROPOSAL	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%
ACHIEVED BY: (£M)										
CUTS IN WORKING EXPENSES	17.8	7.3	6.2	2.0	2.7	2.5	-	2.2	0.9	41.6
USE OF BALANCES	6.0	-	-	-	4.0	-	-	1.2	1.2	12.4
CUTS IN FINANCIAL TARGET AND ADJUSTMENT TO DEPRECIATION POLICIES	(7.2)	16.2	34.8	14.8	12.1	4.8	10.8	-	2.0	88.3
REQUIRED CUT IN CAPITAL EXPENDITURE (£M)	7.0	10.0	1.8	10.0	20.0	2.0	12.0	-	3.5	66.3
INCREASE (DECREASE) IN E.F.L. (£M)	(8.2)	6.2	33.0	4.8	(3.9)	2.8	(1.2)	1.2	(0.3)	34.4
TARGET RATE OF RETURN	1.06%	1.02%	0.80%	1.50%	0.85%	1.09%	2.95%	1.65%	2.17%	1.20%
REVISED RATE OF RETURN	1.29%	0.61%	(0.08)%	1.01%	0.37%	0.78%	1.98%	1.65%	1.83%	0.77%

E.J.O.E.

WATER AUTHORITY CHARGES - EFFECT OF REDUCING LARGEST INCREASES TO 15-18 %

12 FEB 1981

		T	S-T	NW	A	Y	S	N	W	SW	ALL ENGLAND
CURRENT	PROPOSAL	15%	19%	29%	18.6%	22.0%	16.1%	25.4%	14.7%	17.3%	19.5%
REVISED	PROPOSAL	15%	16%	18%	15%	16%	14.8%	17%	14.7%	15.0%	15.8%
ACHIEVED BY: (£M)											
	CUTS IN WORKING EXPENSES	17.8	7.3	6.2	2.0	2.7	2.5	-	2.2	0.9	41.6
	USE OF BALANCES	-	-	-	-	4.0	-	-	-	0.4	4.4
	CUTS IN FINANCIAL TARGET AND ADJUSTMENT TO DEPRECIATION POLICIES	(17.8)	0.5	17.6	3.5	2.0	(1.0)	5.9	(2.2)	-	8.5
	REQUIRED CUT IN CAPITAL EXPENDITURE (£M)	-	0.5	-	3.5	7.9	-	3.5	-	0.4	15.8
	INCREASE (DECREASE) IN E.F.L. (£M)	(17.8)	-	17.6	1.5	(1.9)	(1.0)	2.4	(2.2)	-	NO CHANGE
	TARGET RATE OF RETURN	1.06%	1.02%	0.80%	1.50%	0.85%	1.09%	2.95%	1.65%	2.17%	1.20%
	REVISED RATE OF RETURN	1.63%	1.01%	0.45%	1.38%	0.77%	1.15%	2.42%	1.92%	2.17%	1.16%

E. J. O. E.

WATER AUTHORITY CHARGES - EFFECT OF REDUCING ALL INCREASES TO 13%

13 FEB 81

	T	S-T	NW	A	Y	S	N	W	SW	ALL ENGLAND
CURRENT PROPOSAL	15%	19%	29%	18.6%	22%	16.1%	25.4%	14.7%	17.3%	19.5%
REVISED PROPOSAL	13%	13%	13%	13%	13%	13%	13%	13%	13%	13%
ACHIEVED BY: (£M)										
CUTS IN WORKING EXPENSES	17.8	7.3	6.2	2.0	2.7	2.0	-	2.2	0.9	41.1
USE OF BALANCES	6.0	-	-	-	4.0	-	-	1.2	1.2	12.4
CUTS IN FINANCIAL TARGET AND ADJUSTMENT TO DEPRECIATION POLICIES	(17.2)	8.4	28.4	9.0	7.5	1.7	8.7	(2.2)	0.3	44.8
REQUIRED CUT IN CAPITAL EXPENDITURE (£M)	7.0	10.0	1.8	7.0	20.0	1.0	7.0	-	3.5	57.3
INCREASE (DECREASE) IN E.F.L.	(18.2)	(1.6)	26.6	2	(8.5)	0.7	1.7	(1.0)	(2.0)	(0.3)
TARGET RATE OF RETURN	1.06%	1.02%	0.80%	1.50%	0.85%	1.09%	2.95%	1.65%	2.17%	1.20%
REVISED RATE OF RETURN	1.61%	0.81%	0.08%	1.20%	0.55%	0.98%	2.17%	1.92%	2.12%	0.98%

E.L.O.E.

