

cc Chief Secretary, Treasury.
Mr. Lankester ✓
Mr. Wolfson
Mr. Hoskyns T
Mr. Duguid



10 DOWNING STREET

8 September 1981

Dear Sir Peter,

As a consequence of the various reviews that have been taking place on British Rail's policies and prospects, I, along with the Policy Unit, have been considering whether it would be advisable to take another look at the method of subsidising rail passenger services.

As we understand it, the passenger grant is fixed in advance and subject to adjustment by reference to predetermined factors. If there is a shortfall in receipts, let us say because there are fewer passengers than anticipated, then the grant is increased, as explained in the third paragraph of your Minister's letter of 28 July.

The difficulty with this system of subsidy is that the subsidy per passenger increases as the number of passengers fall. Even if the additional grant were fixed, the subsidy per passenger would increase. But with the additional financial subvention, the per passenger subsidy increases even more as the number of passengers fall.

For various reasons, it seems to us the best way to operate the subsidy is to fix the amount per passenger or better per passenger mile. (There are obviously a large number of other alternatives, such as per revenue mile, etc. But leave these aside for the moment.) A subsidy per passenger, or per passenger mile, would induce more sensible behaviour on the part of the railways. They would compete more vigorously for passenger traffic by cutting fares, rearranging schedules, etc. Similarly, they would be induced to tailor their services more finely to the demand and the subsidy per passenger, or per passenger mile, would be much more "visible". It would be perhaps a little surprising to discover that on some services the subsidy was perhaps three or four times the fare.

I realise, of course, that there are a lot of administrative difficulties with such a scheme. But we thought it would be worth at least a first review.

Yours sincerely,
A. A. Walters

Sir Peter Baldwin, KCB,
Department of Transport.