



*At the request
of the Secretary*

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon David Howell MP
Secretary of State
Department of Transport
2 Marsham Street
London SW1P 3EB

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29 September 1981

Dear Secretary of State,

BRITISH RAIL: EXTERNAL FINANCING LIMITS

TPM

You wrote to the Chancellor before E(NF) on 16 September about the prospects for reducing BR's prospective overshoot of £84 million of their 1981-82 EFL. You also wrote to me on 22 September, in the context of our discussions of the nationalised industries' Investment and Financing Review, setting out proposals for BR's 1982-83 EFL and their estimated financing requirements in later years. I hope you agree that it is convenient to look at the scope for containing BR's financing requirements in the current and in the future years together.

I appreciate the efforts you have made to bring the Board to face the realities of their financial position and to start making the changes necessary to improve it. The £95 million savings which you have already secured from the Board are a significant step forward. Nevertheless, the further deterioration in business prospects now foreseen by the Board underlines the need to explore every possibility for further savings, unpalatable as some of these may be to the industry. E concluded on 23 September that Ministers should reconsider with their industries the scope for securing the savings we agreed in July should be found from the nationalised industries. It might be useful before you resume your discussions with Sir Peter Parker if I set out here some of the areas where I hope in particular you will press the Board to consider further the scope for savings.

My comments are also relevant to the position in 1981-82, although I am conscious that practical constraints bear more heavily on the ability of the Board to implement further measures to reduce their prospective EFL overshoot. As you say, we shall need to consider the possibility of increasing the EFL when we come to settle a revised level of grant for BR, but I shall be extremely reluctant

to agree to this. In the meantime, I hope you will also review the position in 1981-82 further in your discussions with the Board. If there are options which could significantly reduce the prospective overshoot, I think these should be identified if we then decide their disadvantages outweigh the benefit in particular cases: even modest savings would be worthwhile and I certainly cannot agree at this stage that any overshoot of this year's EFL, should not be offset against next year's EFL.

With these thoughts in mind, one of the areas which I hope could be explored further with the Board is pay. Realistically, the scope for reducing the cost of the current year's settlement (about which I wrote to your predecessor on 28 August) must be limited. But I believe the Board should be pressed to reconsider their assumption of a settlement of 8.3% next year. I do not favour simply writing down the Board's assumption, but their financial position and developments in the pay field, particularly amongst hard pressed private sector companies, provide ample evidence to place before the Board of the necessity of a substantial revision of their own plans. Any private sector business in the Board's position would think twice about a settlement at even half the level presently assumed by the Board. So should the Board.

I know you have looked carefully at current costs but in the circumstances I think it is worth examining the possibility of bringing forward or extending the scope of planned measures in some areas. One of these is administration costs, where I do not think anyone disputes the availability of savings, depending on the management's ability and will to secure them. In this context I question whether the Board are doing everything to shed administration costs as rapidly as possible in the sort of way which, for example, we have recently seen with British Airways. I am sure this is an area that should be explored further with the Board.

Other areas which I think should be considered with the Board with a view to making substantial further cost reductions include the timing and extent to which overcapacity in British Rail Engineering Limited is being rationalised; and the scope for increasing and bringing forward reductions in services to match demand. On this latter point, it would be useful to know what reductions are assumed in the Board's planning figures as well as the scope for improving on these.

While I appreciate that working capital has been squeezed fairly steadily over the last 18 months, I wonder whether there is scope for a further sustained reduction. Even a modest reduction in the level of stocks, for example, in an industry the size of British Rail can secure significant financial benefit.

Finally, I think a further look at the Board's investment programme is unavoidable. I know you have pressed the Board on investment, but equally one would expect a rapid scaling down of capital programmes by an industry in BR's position. I think the Board must demonstrate that investment plans in the commercial businesses (including subsidiaries) are being rapidly and sufficiently adjusted in line with the deterioration foreseen in the Board's

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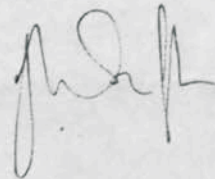
business results as a result of lower freight and passenger traffic. And while much of the Board's investment is inevitably non-commercial in nature, the appalling decline in the Board's financial position argues strongly for deferment of anything other than absolutely essential items.


You also touched in your letters on the position of the three other transport industries which are your responsibility. So far as the current year is concerned, I agree that the sensible course is to review the position of the British Transport Docks Board when we are clearer about the extent to which they have benefited from the special severance scheme. With regard to the later years, the progress you have made in securing the required savings in 1982-83 is most welcome but I am concerned about the deteriorating position, relative to the reductions required, in the last two years of the period. The National Freight Company is clearly in a special position and in view of the prospect of imminent privatisation I do not suggest you pursue further with them now the question of reductions in later years. If privatisation fell through, we would need to reopen the issue. But I hope you will consider with NBC and BTDB whether the later years offer scope for further reductions. In the latter case in particular, there is some suggestion that the Board is taking an overly pessimistic view of the outlook and that a more balanced assessment would provide some scope for improving their results.

If you feel there are problems in proceeding on these lines, it might be useful if we had an early meeting. I am bound to say however, that I shall be extremely reluctant to agree to an EFL for 1982-83 any higher than that implied by proposals in E(81)79 which E endorsed last July.

I am copying this letter to the Prime Minister, members of E and Sir Robert Armstrong.

yours sincerely



 LEON BRITTAN

[Approved by the Chief Secretary
and signed in his absence]

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