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J. Vereker

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DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

Prime Minister

This clarification of Transport's

obscure letter shows that the BR pay
assumption is 5.5% (6 October 1981
not 7%.

I suggest you say that 5.5% still seems
on the high side for British Rail - but note that
the substantive decision on this is for later - this now is
only an assumption in their EFL arithmetic.

Agree this line? ML 26/10

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

Dear Michael

You wrote to me on 12 October to say that the Prime Minister
had seen Kenneth Clarke's letter of 2 October to the Chief
Secretary and was concerned about the revised pay assumption
which underlines British Rail's external financing requirement
for 1982/3. Yes
not

I fear that there may have been some ambiguity in the
drafting and that the Prime Minister may have gained the
impression that British Rail's revised assumption was for a
pay settlement of about 7%. This is not in fact the case.
British Rail's original assumption was for a settlement of
8.3%, about 2% below their estimate of inflation. The assumption
they are now making is for a settlement of 5.5%, that is some
3% below their previous figure and broadly in line with
assumptions being made elsewhere in the public sector. Since
the railwaymen's pay settlement comes at the end of the pay
round, and is bound to be influenced by the pattern of earlier
settlements, the Board do not consider that it would be realistic
to base their financial planning on the assumption that a
lower settlement will be achievable.

As Mr Clarke's letter said, the increase in the pay bill
resulting from an increase of this size, and taking account
of all changes, including the effect of past settlements, would be
about 5%.

Copies of this letter go to those who received yours.

Yours sincerely

Alice Baker

MRS E A BAKER
Private Secretary

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10 DOWNING STREET

From the Private Secretary

29 October 1981

Dear Alice,

Thank you for your letter of 16 October about the revised pay assumption in the calculation of British Rail's external financing requirement for 1982/83.

I am grateful for the clarification you give about British Rail's revised assumption of 5.5%, i.e. some 3% below their previous figure. The Prime Minister's view, however, is that 5.5% still seems a high figure for British Rail. But since what is at issue is not a substantive pay decision but rather a question about how best to calculate British Rail's external financing requirement, the Prime Minister does not ask that this be pursued further at the present time.

I am sending copies of this letter to the Private Secretaries to the members of E Committee, Roderick Balme (Office of the Parliamentary Under Secretary, Department of Transport), David Wright (Cabinet Office); and to Robin Ibbs.

Yours sincerely,

Michael Scholar

Mrs. Alice Baker,
Department of Transport.

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JWP



10 DOWNING STREET

From the Private Secretary

12 October, 1981

The Prime Minister has seen and noted Mr Kenneth Clarke's letter of 2 October to the Chief Secretary about British Rail External Financing Limits.

She has in particular noted the further reduction in the BR pay assumption described in the fourth paragraph of Mr Kenneth Clarke's letter. She has commented that she hopes that British Rail management can be persuaded to look yet again at this pay assumption, which seems high in relation to the 4 per cent pay factor which has been agreed for the public sector at large.

I am sending copies of this letter to the Private Secretaries to members of E Committee, Roderick Balme (Office of the Parliamentary Under Secretary, Department of Transport), and to David Wright and Robin Ibbs (Cabinet Office).

MS.

Anthony Mayer, Esq
Department of Transport

Rob

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Prime Minister

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MR. SCHOLAR

Yes Mr

Agree that I should write as proposed at X?

cc: Mr. Hoskyns

MLS 7/10

BRITISH RAIL EXTERNAL FINANCING LIMITS

Mr. Clarke sent us a copy of his letter of 2 October to the Chief Secretary about British Rail's EFL. There is an important point concealed in this letter which I think worth drawing to the Prime Minister's attention.

When the Prime Minister held her meeting on nationalised industry pay on 7 September, it was agreed that sponsoring Ministers should make a particular effort to arrange for lower pay assumptions. The Chief Secretary suggested to Mr. Howell that BR's pay assumption of 8.3% should at least be halved. Mr. Howell has now suggested that one percentage point be knocked off the pay assumption, to a level about three points below the RPI percentage, i.e. about 7%. Against the background of BR's rather large settlement (11%) in the last pay round, and the probably phoney productivity deal, together with BR's continuing financial problems, it really does not seem right that we should be proceeding on the assumption that the pay of BR employees will increase by 3% more than in the public services.

If the Prime Minister agrees, therefore, I think it would be appropriate for you to write to the Chief Secretary saying that she has seen Mr. Clarke's letter and that she hopes that BR management can be persuaded to look yet again at the pay assumption.

6 October 1981

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DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EE

My ref:

cc Mr Dupuid
Mr Wallen
J Verker

Your ref:

The Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Parliament Street
LONDON SW1

2 October 1981

Dear Sir,

JMS by m
CST's reply.

BRITISH RAIL: EXTERNAL FINANCING LIMITS

Since David Howell is away this week, I am writing, to meet your timetable, to give you the result of the further discussions with Sir Peter Parker about British Rail's external financing needs for this year and next, following the latest discussion at E Committee, your own letter of 29 September and Mr Ibbs' very helpful participation.

I am glad to say that the Board's continuing efforts to counter the abrupt fall in revenue this year are producing results. The latest forecast for their external finance requirement this year shows that the overshoot, above their EFL of £867m, has now been pulled back to £70m. The Board are seeking to make further progress, but David and I are satisfied there are no further options which could significantly reduce the overshoot in the remainder of this fiscal year. The moment has of course now passed at which we could have pressed the Board to go for higher increases in commuter fares even if we had wished to, since they must very soon announce the changes on which they have decided for the end of November.

At our insistence, Sir Peter Parker has thoroughly reviewed with his Board the best forecast they can make about the level of pay settlement they can aim to achieve next year. We put to them their own trading position, the Government's decision about the pay factor for the public services, the efforts of the CBI in the private sector and the possible range of settlements among the nationalised industries. At the same time, we made sure that all the costs in subsequent years of earlier settlements are properly included in the forecast of the paybill for next year (David Howell will be writing to you separately about your letter of 28 August to Norman Fowler).

The Board's planning so far had assumed that they could next year achieve a pay settlement some 2% below the rate of inflation. The result of their fresh review is that they will now aim some three percentage points less than that, and (seeing that there is very little wage drift on the Railway) the net cash increase in the paybill, taking account of all changes including the effects of past settlements, would be about five per cent. They regard this as a very demanding target and it means that they have accepted a new and hard negotiating strategy. Whether they can achieve

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this result depends of course very much on conditions at the time and in particular on how things go in other industries earlier in the pay round.

I now turn to the other points that you covered in your letter of 29 September. I begin by setting out what the Board themselves had identified by September, as a result of work earlier this year, as additional savings to be made in all the fields you mention. They had decided to reduce Inter-City train miles by some ten per cent in successive cuts up to October next year, and there will be reductions in the commuter rolling stock fleet, from shortening train lengths. They will cut some £90m from their planned engineering expenditure, some of it capital and some of it revenue. Overall, their planned investment had been reduced by over £100m to £400m. They had doubled, to some £20m, the reductions they were going for in administration costs. They were planning to cut manpower on the railway by a further 5,400 over the twelve months, and the management was determined to do better than that. In BREL, they were in the process of reducing manpower this year by some 1,600, they have cut out practically all overtime, and they are closing the Ashford Works. They have been examining what further reductions in BREL are needed to match the new levels of requirements.

This was the position before Norman Fowler and I had a meeting with the full Board at the beginning of September. David Howell and I had a further detailed discussion with Sir Peter Parker and his colleagues before writing to you on 22 September. It was in the light of this, that David concluded that he could press the Board for further savings totalling £40m in the fields of administration, train services, and workshops, together with some savings in working capital. To achieve these operating economies would certainly require further substantial reductions in manpower.

At the same time David concluded that he could impose a further cut of £15m in investment, so that in total provision for all major new projects (Jumbo Ferries, main line electrification, APT) has been cancelled or deferred, approaching £20m has been taken out of the investment plans of the subsidiaries, major reductions have been made in the plans for engineering equipment and maintenance depots, and the rolling stock builds have already been scaled down, particularly on the freight side. David and I are now quite convinced that there is really nothing to go for here without precipitating a confrontation with the Board about the future size of the railway.

We have to consider the effect of the new pay assumption on top of the savings that have been identified. The Board are very concerned indeed that the new bargaining strategy to achieve the pay objective could slow down the achievement of economies in other fields. They argue that some allowance must be made for the prospect that the other savings cannot all be achieved in the time. The Board now propose therefore that their external financing requirement can be reduced from £1,018m to £990m. Their strong view is that any lower figure would be imposed and unreal. We should not underestimate the difficulties they will face to reach this figure. The full savings from the new pay assumption would

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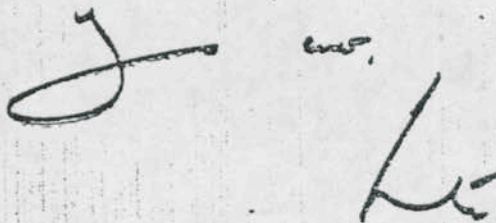
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produce an EFL of £975m; but this assumes that everything goes well inside and outside the railways. I do not see how we could put forward any lower figure, as arrived at from any considered judgement of the Board's situation. The danger of an arbitrary figure is the temptation to management to ignore it in policy and pay bargaining.

It will be clear from what I have said that these figures do not allow for any carry-over from this year.

Finally, we have reviewed the position of the British Transport Docks Board and the National Bus Company in the later years, though we certainly hope that the BTDB will move into the private sector during the period. The proposals which we have made represent a significant cut on what both of the industries have themselves proposed, despite the worsening trading prospects to which David Howell's letter of 22 September drew attention. We are quite prepared to explain to the Boards the basis of the cuts we have made; but to impose figures which are lower still would take us beyond that point. I hope therefore that you can agree that our proposed figures should stand.

I am sending copies of this letter to the Prime Minister, other members of E Committee and to Sir Robert Armstrong and Mr Ibbs.

A handwritten signature in black ink, appearing to be 'K. Clarke', written in a cursive style.

KENNETH CLARKE

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