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NBP7

Treasury Chambers, Parliament Street, SW1P 3AG

**CONFIDENTIAL**

Rt Hon Kenneth Baker MP  
Secretary of State for the Environment  
2 Marsham Street  
LONDON  
SW1P 3EB

10<sup>m</sup>.  
December 1985

*Dear Kenneth,*

**WATER CHARGES AND INVESTMENT**

I am not happy with your letter to me dated 2 December proposing that John Patten should look forward to "a more favourable trend" in future water charges when the 1986-87 rates of return Order is debated.

I have seen an extract from John's proposed speech and I am pleased that he will be justifying our decisions for 1986-87 by announcing that water charges will increase rather less than had been expected, by about 8%, while water investment will increase rather more, by about 10%. However, I understand that he then intends to announce that he is "hopeful we shall be able to maintain the more favourable trend in water charges and water investment for 1987-88."

In my view, the expectations that this statement will arouse will be such as to pre-empt effectively our public expenditure discussions next year and I cannot accept this. It is not yet possible to say what will need to be done from 1987-88.

Nor does it seem to me necessary to say anything along these lines. The possibilities we are considering for privatisation offer a very reasonable line to take about prospects for the future. I suggest that the relevant passage is replaced with one along the following lines:

"As for the future, we are considering the possibilities for privatisation which would of course mean reviewing

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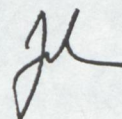
every aspect of water authorities operations."

This passage reflects the point I have consistently made over the last few months that, if it is decided to proceed with water privatisation the whole financial regime applied to water authorities will necessarily have to be reconsidered. I have also said that it does not make sense to separate this out from other work on privatisation and I am not happy with your officials' suggestion that a separate formal review of water authorities' financial targets for 1987-88 should be initiated.

Consideration of the future regime of water authorities should be an integral part of work on privatisation over the next few months and separating it out not only risks wrong decisions but will give the wrong signals to water authorities and others. I cannot therefore agree to this. As long as some water authorities are in the public sector, all decisions that affect their public expenditure requirements will have to be subject to our normal processes.

I am copying this letter to the Prime Minister, other members of the Cabinet and to the Chief Whip, and to Sir Robert Armstrong.

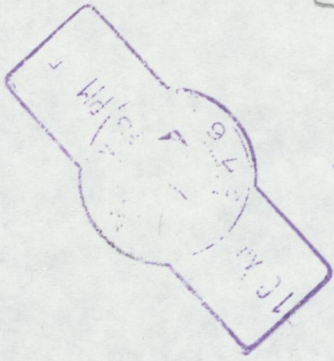
Yours etc,



JOHN MacGREGOR

Local Govt Pt 3

The water industry



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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Kenneth Baker MP  
Secretary of State for the Environment  
Department of the Environment  
2 Marsham Street  
London  
SW1P 3EB

16 December 1985

*Dear Kenneth,*

**WATER CHARGES AND INVESTMENT**

Thank you for your letter of 13 December. We must obviously sort this out quickly.

I have no problems with much of what you say. I entirely agree that there is a widespread hope amongst our supporters for lower water charge increases in future years. But we must not confuse hopes with reality and the plain fact is that we do not yet know what future financial target path and price levels may be necessary. It would not make sense to hold out a hope which we might find we could not deliver, or delivery of which was damaging to our privatisation strategy. I see nothing in the totally non-committal approach I suggested which would give grounds for accusations of fattening up the authorities in advance of privatisation. In fact, the present order with its lower average target than the 1.7 per cent earlier announced is itself adequate rebuttal of this.

I cannot therefore agree that the original line which you proposed is satisfactory. I can only repeat that it is both an unnecessary hostage to fortune and unfair to colleagues in the presumptions it creates. If you believe that the alternative formulation I suggested relies too much on privatisation (although it says nothing more than has already been said and makes a point which will certainly appeal to our supporters in the House), then I remain clear that you can go no further than indicating, without commitment, that water authorities future financing, in common with that of all other nationalised industries, will be considered during next year's public expenditure round.

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

*Yours ever,*  
*JG*

JOHN MacGREGOR

CONFIDENTIAL

LOCAL GOVT

WATER INDUSTRY

PT 3





2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

13 December 1985

*Dear Chief Secretary,*

WATER CHARGES AND INVESTMENT

I am sorry to prolong correspondence on a matter which I thought had been satisfactorily resolved in MISC 120 but your letter of 10 December and the imminent debate on the Rate of Return Order leave me no option.

You will recall that the policy decided by E(NI) in 1984 would have required water authorities' average financial targets to rise from 1.4% in 1985/6 to 1.7% in 1986/7 and 1.9% in 1987/8, implying charges increases of about 11½%, 10% and 9% respectively. I argued in this year's PES that this prospect was politically untenable and I believe that you and other colleagues broadly accepted my view. Indeed the Lord President said, after we had reached an agreement which would allow the 1986/7 increase to come down to about 8%, "I would not mind if the charges increase were rather lower...".

There is little doubt in my mind that colleagues want, and expect, a lower charges increase next year. That hope is of course widely shared by our supporters in Parliament. For John Patten to say that he hopes we shall be able to maintain the more favourable trend is no more than the truth.

Your formulation on the other hand appears to me to rest too heavily on the possibility of privatisation, on which no announcement will have been made. It would moreover give no comfort to our supporters who may fear that the E(NI) policy of 1.9% for 1987/8 announced last year still holds; and it will expose us to the accusation that we are planning to fatten up the water authorities at the expense of water consumers in preparation for privatisation. That would damage the privatisation programme and discredit the Government.

I hope on reflection you will agree that the words we proposed would better meet the situation.

As for the substance of the review which is to take place early next year, our officials need to discuss the details further. But MISC 120 recorded that it would cover "future financial strategy for the water authorities" (Not "every aspect of water authorities operations"). As

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we have no policy for water authorities financial targets in 1987/8 at present I do not see how it can avoid dealing with that question. We shall also now need to take into account the cost of metering trials.

I am copying this letter to the Prime Minister, other Members of the Cabinet and to the Chief Whip and Sir Robert Armstrong.

*Yours sincerely*

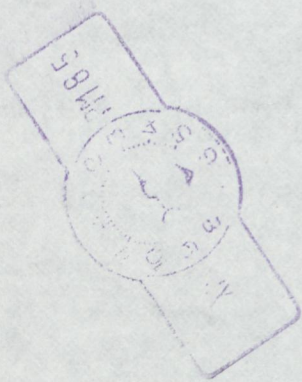
*SWendenon*

*for*

KENNETH BAKER

(Approved by the Secretary of  
State and signed in his absence)

The Rt Hon John MacGregor OBE MP



Local Govt.  
Water Industry #3



CIBG



2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

December  
2 November 1985

NBDM

In Min.

## WATER CHARGES AND INVESTMENT

Thank you for your letter of 25 November.

The hostages to fortune we need to be concerned about are the figures for water authorities' rates of return up to 1987/8 which Ian Gow gave to the House last February. Happily we have been able to ease back the 1986/7 figure from 1.7% to 1.6%. However as Early Day Motion No 129 shows, our supporters are more concerned about 1987/8. There will inevitably be questions about this if our Order is debated and we should do what we can to reassure backbenchers about the prospects. If there has been no announcement about water privatisation, it will not be possible to refer to that so it will be all the more important for John Patten to have something positive to say about the charges prospect, and it is in that context that I believe it will be necessary to refer to our review. Whether or not there is a debate, I will be bound to tell the water authority Chairmen what we have in mind.

I suggest that our officials should be in touch to agree a suitable passage for inclusion in the Government speech in the debate on the Order.

I am copying this letter to the Prime Minister, other members of the Cabinet, the Chief Whip and Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Kenneth Baker', with a flourish underneath.

KENNETH BAKER

LOCAL GOVT  
WATER  
PT 2





Private Secretaries' Office

Kenneth Baker wrote  
to John Macgregor on 2/12  
about water charges and  
investment. Unfortunately  
the letter was dated  
2 November. It will be  
grabbed if this could be  
amended.

PSO1 / DOE

2/24252

3/12

NB

Copied as before.