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DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON SW1P 3AG

10 May 1985

Dear Peter

CAPITAL EXPENDITURE BY LOCAL AUTHORITY BUS, AIRPORT AND PORT UNDERTAKINGS

- will request if required.

You wrote to me on 25 April underlining the reasons why the capital programmes of the local bus undertakings cannot be taken out of public expenditure and the local authority capital control system. As you indicated, the reasons have been fully discussed in the correspondence between David Mitchell and John Moore, and I accept them.

I am, as you know, very anxious to encourage a more business-like approach by all local authority transport undertakings in order to reduce their subsidies - both financial and in kind - and to facilitate the introduction of private capital. The Transport Bill will establish the PTE and municipal bus operators as "Companies Act" undertakings and the Airports White Paper will include similar proposals for local authority airports. Local authority ports have to produce Campanies Act-type accounts under existing legislation.

I would therefore like to take up your suggestion of ring-fencing. In fact, for airports, we already use the powers covering individual projects under Section 73 of the 1980 Local Government Planning and Land Act to ring-fence almost all their capital expenditure and we have used it occasionally for major public transport schemes. But as you comment, this involves detailed intervention which I would like to avoid except for very large important schemes. I want to be able to make block allocations for each undertaking, which would be ring-fenced. This would ensure that the parent authorities cannot starve the undertaking of capital investment by using that part of their total allocation for other services as they are quite entitled to do under the present capital controls system.

But this alone would not make their investment decisions subject to market forces. As you state, their borrowing is part of the PSBR and so must be controlled just like that of the nationalised industries. But there is no reason why, unlike the nationalised industries, their internally financed capital expenditure should also be controlled. To be able to attract private capital these undertakings must have the incentive to make profits and be able to plough them back into the business. I therefore propose that internally financed investment should no longer count against local authority capital expenditure for PES and capital control purposes. This would put them into a comparable public expenditure basis with the nationalised industries.

This need not mean an Investment and Financing Review for each local trading organisation. That is neither necessary nor practicable. In place of gross capital at present the local authority would bid for an amount of external finance required for the capital programme of each undertaking. The net block allocations made for each undertaking on this basis would be ring-fenced. I would control the allocations to reflect our PES plans, and transport policies. The PES provision would be net of expenditure financed by asset utilisation charges and profits instead of gross as at present. You will recall we discussed the existing "double counting" in our bilaterals last year and asked officials to consider it further. I understand your officials consider that the technical problems can be overcome. It would make a "paper" reduction in PES of about £50m.

The change would be limited to those local authority trading organisations which were required to conform with the Companies Act accounting requirements. We would monitor net spending against our PE plans by checking their audited accounts showing resources and applications of funds. If it encouraged local authorities to put other services onto this basis so much the better.

I appreciate that it has not been possible for our officials to consider these proposals in the review of the capital control system. I understand the review has been jointly with the Associations and has been concentrating on the major options for the whole system. But I hope Patrick Jenkin, to whom I am copying this letter, will agree that it would be appropriate to make the change as part of the changes in the control system he is bringing to Cabinet in due course.

I would be grateful for your agreement to make the PES change in this year's round.

I am copying this letter to other members of E(A) and E(LA), and to Sir Robert Armstrong.

Yours ever

Nicholas

NICHOLAS RIDLEY