Ref. A05087

PRIME MINISTER

British Rail: Commercial Businesses and Electrification Proposals

E(81) 63 and 64

BACKGROUND

At their meeting on 14 April, the Committee agreed to defer consideration of the Secretary of State for Transport's proposals for a major rail electrification programme until the Central Policy Review Staff had examined the prospects of British Rail's inter-City and freight businesses in relation to the report on electrification (E(81) 15th Meeting).

2. The CPRS report (E(81) 63) was prepared with the help of the Department of Transport and of Coopers and Lybrand; they were asked not to consult British Rail. They conclude that, on present plans, Inter-City is most unlikely to meet its present commercial target and that the freight services will make continuing losses at least until 1985. Their recommendations to deal with this situation are in paragraph 3 of the summary covering their report. In paragraph 4 of that summary they recommend that, while there are benefits to be had from some selective electrification, the Government should not be committed to an extensive electrification network programme but that British Rail should be invited to submit proposals for approval on a route by route basis covering the 10 years ahead. Their proposals, and the options they have examined, are set out in more detail in section 6 of their report.

3. The Secretary of State for Transport, in E(81) 64, accepts these conclusions. The Committee may, however, feel that his claim that the CPRS report is entirely in line with his own approach does not give sufficient credit to the very serious problems facing the commercial businesses, which the CPRS have identified, or to the fact that a route by route approach is rather more cautious than his own recommendation in April for recognising 'that the right future for the main line railway is an electrified one, with commitments to that staged according to productivity improvements and better results' (paragraph 19(iii) of E(81) 41).

4. The Secretary of State for Transport warns that because of falling traffic there is a threat of £80-100 million to British Rail's External Financing Limit of £920 million in the current year, which could be made worse if there were an unfavourable outcome to the current arbitration over British Rail's offer of 7 per cent pay and the union's claim for 13 per cent - each percentage point costs about £15 million.

5. He further warns, in his paragraph 3, of the increasing possibility of a strike over cuts in services. You will recall that the Civil Contingencies Unit have already assessed the consequences of industrial action by rail workers. The Home Secretary, in his cover note to their report (E(81) 49), warned that the two key areas would be the London commuter service and movements of coal to power stations. He advised that, in the light of current stocks and of the time of year, coal movements were the less important of the two but that the effect of a rail strike would be to reduce power stations endurance for next winter; and that the effect on commuters would be more immediately serious.

6. In the light of this situation, the Secretary of State for Transport recommends that later this month, and before the Rail Union Conference, he should make a statement bringing out the reality of the position on Inter-City and freight businesses and making clear that progress with electrification must depend on productivity and will be on a route by route basis. He has attached a draft of his statement as an Annex to E(81) 64.

7. I understand that, while Treasury Ministers will probably support the CPRS' recommendations, they will wish to emphasise the very serious short term problems faced by British Rail - over pay (depending on the outcome of the arbitration proceedings); the prospective increase in the EFL for 1981-82; the problem of keeping British Rail's financing within the limits assumed in the Public Expenditure White Paper for the later years; and the status of their borrowing (if the state of their commercial businesses is so bad that it is uncertain that they can service loans from the National Loans Fund, the question arises of the propriety of continuing to make advances from the NLF). Treasury Ministers will probably want to see a strengthening of the draft statement and might also question whether it should be made at this stage.

HANDLING

8. After Mr Ibbs and the Secretary of State for Transport have spoken to their papers you might ask the Chancellor of the Exchequer to comment. If there seems to be broad agreement on the CPRS' proposals, a long discussion may not be necessary - on the understanding, that is, that the Committee will have to return later to the separate issues of pay, the EFL, investment and financing in the later years, and to the further proposals from British Rail following the CPRS' recommendations.

9. The main questions are:-

(i) Is the CPRS' recommended approach to the Inter-City and freight businesses and to electrification acceptable?

(ii) If so, is the Secretary of State for Transport's draft statement annexed to E(81) 64 acceptable?

The Committee may question whether paragraph 5 of the draft brings out sufficiently sharply the points made in paragraph 4 of the Secretary of State's cover note where he emphasises that electrification decisions will be on a route by route basis and subject to individual authorisation. You may feel that the last sentence of paragraph 5 of the statement carries too much the flavour of a generalised approval.

(iii) Subject to any redrafting, should the statement be made this month?

The Secretary of State for Transport will press for this. It is known that the Government has been considering for a long time the proposals on electrification and there is increasing pressure for the outcome to be known. A tough statement now could help to put the unions on warning that strikes and pressure for excessive pay settlements will be damaging to the industry's commercial prospects and, therefore, to the case for electrification.

CONCLUSIONS

10. In the light of the discussion you will wish to record conclusions on:-

(i) The CPRS' recommendations in paragraph 3 and 4 of the summary note in E(81) 63.

(ii) The draft statement annexed to the Secretary of State for Transport's paper, E(81) 64.

You might invite the Secretary of State for Transport to circulate, for clearance in correspondence by the Committee, a revised draft taking account of the points made in discussion.

RTA

ROBERT ARMSTRONG

16 June 1981

Qa 05392 15 June 1981

To: MR LANKESTER

From: J R IBBS

BRITISH RAIL

1. I have already circulated the CPRS report which is to be discussed at E on Wednesday 17 June. I am pleased to see that in his paper E(81)64 Mr Fowler has accepted our recommendations. I feel I should emphasise that this represents a major change from views and proposals that existed before our study. For example, there has been a downward step change in the perceived financial prospects for BR and there is now a willingness to consider radical changes of policy to cope with this. Also, further electrification will now have to be justified rigorously scheme by scheme. There are, however, two matters relating to BR which go beyond our remit and which I should like to draw to the Prime Minister's attention.

2. The first relates to the measurement of commercial viability. It is clear from our work that, because of the difficulties in allocating costs, what truly constitutes commercial viability is not yet adequately defined in the complex situation where several sectors of the railway make common use of track, signalling and administration. Coopers & Lybrand, who worked with us as consultants, have gone some way towards refining the method of determining commercial viability but further development is needed. Until commercial viability is properly defined, we shall never really know how well BR is doing. It is important that this aspect should be pursued further by the Department of Transport and BR and I propose to write to Mr Fowler suggesting this.

3. The second matter relates to the cash requirement for BR as a whole. It is clear from our work that the "commercial" sector (Intercity and freight) has in practice been partly subsidised by the PSO Grant. Closer definition of objectives and tighter

monitoring of how this aid is used are clearly needed. If, as we recommend, the commercial sector is reduced to a core that genuinely has a commercial future, a consequence will be that the non-commercial sector will be larger. Efficiency improvement and reduction in some of the services should make possible some cut in costs, although BR's recent record on productivity improvement does not engender confidence. Based on our findings, my personal belief is that the cost of maintaining the social railway is likely to increase unless some substantial fundamental cuts are made in it. I appreciate the political difficulty in closing uneconomic lines. However, compared with a great number of the other commitments for public funds, many of these lines command extremely low priority by any economic test and are used by very few people. Infact I believe some reduction in the extent of the railway is ultimately inevitable: - the sooner this happens, the better. It seems therefore, important to avoid unnecessary fresh commitments to maintaining the network as it is.

4. The work done by the consultants, Coopers & Lybrand, provided an important part of the basis for our recommendations. Without their assistance we could not have gone into the subject in such depth in the time available. Although I doubt whether the Prime Minister will wish to have this degree of detail, I am enclosing for your information a copy of the Coopers & Lybrand report. I am also sending copies to the Chancellor of the Exchequer, the Secretary of State for Transport and Alan Walters.

5. I am sending a copy of this Minute and of the Coopers & Lybrand report to Sir Robert Armstrong.

JR