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CCNO 2 Mr S NBPM AT 10/7

DEPARTMENT OF TRANSPORT
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01-212 3434

The Rt Hon Patrick Jenkin MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON SW1P 3EB

10 July 1984

Dear Patrick

Thank you for your letter of 4 July about LRT and TSG.

I agree that we will have to be very careful about handling LRT fare increases and service cuts in the context of the Abolition Bill. You do not need me to tell you how difficult the situation will be. As you know, the GLC were able to keep their precept artificially low this year and however tightly we set their expenditure limit - and I agree with Peter Rees that we should make it as tight as possible - it looks as though we shall have to allow a GLC precept next year which is higher than this year's even though they are no longer responsible for public transport. The GLC precept plus the LRT levy could therefore be 30% or more higher than this year's GLC precept. These increases will follow soon after the LRT fares increase, which is planned for 1 January. Although I am aiming to reduce LRT's revenue support by some £60m compared with this year the GLC will claim that the transfer of responsibility has led to an increase in the burden on ratepayers.

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Final decisions on LRT's finances will have to wait for the end of the public expenditure round. But there are two decisions which cannot wait until then. One is what we tell the local authority associations later this month about the size of the PES transfer for LRT and our decision on the aggregate exchequer grant (AEG). The other is the size of the January fares increase, which has to be settled in September. Although I hope that it will be possible to achieve a substantial reduction in LRT's figures, it would not be prudent for us to take decisions now on an over-optimistic basis.

As I see it, the choices now before us are:

i. to increase the resources available to LRT from the total of local authority current expenditure to £152m to meet their transitional costs so as to keep the January fares increase in single figures, and to provide enough cash to meet the transitional costs plus a third of the rest of LRT's budget, say £130m in total;

ii. to find the transitional costs by increasing fares by 12% - 15%, and to restrict the Exchequer contribution to £101m, as you suggest, with a correspondingly higher ratepayer levy - this would imply a 70% ratepayer contribution, requiring an affirmative resolution next January, which would certainly not be politically tolerable; or

iii. increase the resources available to LRT as in i. but accept that we might have to allow them to borrow up to, say, £50m for the next two years to hold down the transfer from AEG and the ratepayer levy; we had not envisaged such a major element of borrowing, which would be difficult to justify for an unremunerative undertaking and would involve increasing fares by perhaps 3% more over the period to meet the interest charges.

These figures make no allowance for the Exchequer contribution to the GLC's share of the Docklands Light Railway and the electrification of the North Woolwich Line. These projects would have been grant-aided by me had the GLC continued to be responsible and I shall need to pay this grant to LRT now that it has taken over from the GLC. We have to find the cash to support these projects, whether we call it part of TSG or an addition to the LRT grant.

So far as TSG is concerned, I am grateful for your agreement that we should in future stabilise the grant and that officials should consider whether TSG should continue to be included in the AEG totals. But it would be totally unsatisfactory to continue with a threshold. The reduction in the TSG quantum over the last three years has certainly exacerbated the problems, but any grant with a high marginal rate over a threshold is bound to be unstable because small changes in expenditure by an authority from one year to another are bound to lead to much bigger changes in grant. The only way I can achieve our policy objectives with a limited amount of grant is to be selective about the expenditure I accept for grant. But there are limits both politically and legally to how selective I can be. I should certainly be straining these if I had to provide for the docklands commitments out of the £175m available.

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

Yours ever
Nicholas

NICHOLAS RIDLEY

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Transport 11/R3 London Regional

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FILE WITH AT.
CG NO.

SECRETARY OF STATE FOR THE ENVIRONMENT

NDPM
AT 5/7

2 MARSHAM STREET
LONDON SW1P 3EB

01-212 3434

My ref:

Your ref:

4 July 1984

Dear Secretary of State

Thank you for copying to me your letter of 19 June to Nigel Lawson about the financial objectives of LRT, and your letter of 25 June to Peter Rees about TSG. Perhaps I may comment on both letters together.

will request if required.

LRT

When Peter Rees and I agreed that the Exchequer should contribute as much as ⅓ to LRT's budget, that was on the express condition that the LRT's budget for 1985/86 would be at, or very close to, £290 million. On that basis, as we agreed, the implied corresponding reduction in AEG would have been £97 million, of which £80 million was to come from TSG and £17 million from block grant. Since then we have of course decided to move to a capital-only TSG, and this means that the offset to AEG to take account of LRT must come off block grant entirely. On 15 June, your officials proposed a reduction in AEG of £101 million. Even though that is £4 million higher than the figure subscribed to last November, I would be prepared to agree to it. Similarly, on PES provision, I would be prepared to agree to the £132 million deduction from the local authority current expenditure provision which our officials have discussed.

I now see, however, from your letter that you want to increase LRT's budget by a further £20 million in respect of severance payments, and by an unspecified amount in respect of extra capital expenditure. I should make it clear that I am not prepared to agree to reducing AEG by more than £101 million; nor do I think it reasonable that the additional PES cover for this proposed increase in the LRT budget should be found from within the local authority current expenditure provision which we are discussing in the E(LA) context. If therefore Exchequer assistance to LRT is to be increased as you propose, in my view neither block grant, nor local authority current expenditure PES provision, should be reduced to accommodate that.

TSG

At our meeting on 23 May it was left that you would consider the implications of setting TSG at £175 million. This was, I think, a very generous figure. If London is excluded from the calculations, and if a capital-only TSG is set pro rata to the proportion of accepted expenditure accounted for by capital schemes, the resultant TSG figure is about £115-£120 million. So even with TSG at £175 million block grant is already

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£50 million lower than it might otherwise have been. I must stress that all reductions in AEG to take account of LRT can only come from block grant. On that basis I feel unable to agree the extra £25 million TSG which you propose in your letter of 25 June. The better course would still seem to me to be to continue with thresholds, and pay higher marginal rates of grant on expenditure above them. A major reason for the fluctuations in TSG entitlements in recent years has been the large year on year changes in the TSG quantum: I agree with you that if we could agree to stabilize year on year grant changes, that would be an important step forward.

Two technical points. I am content that our officials should consider whether TSG should continue to be included in the AEG totals. Second, I am content with the terms of your draft consultation paper on the future of TSG, subject to one minor change which has been given to your officials.

Finally, we must be very careful about the presentation of all this. LRT's actions will have a direct bearing on people's attitudes towards the main abolition Bill. If LRT are to introduce their fare increases or to make service cuts, the announcements will need to be very carefully worded and timed, to ensure that the abolition of the GLC is not to be blamed by the general public.

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

Yours sincerely

A H Davis

for PATRICK JENKIN

Approved by the SofS and signed in his absence

- 4 JUL 1984

The Rt Hon Nicholas Ridley MP