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CHIEF SECRETARY TO THE TREASURY

PUBLIC EXPENDITURE SURVEY 1986: TRANSPORT

Note of a meeting held in the Chief Secretary's Room, H M Treasury, at 3.30pm on Monday, 22 September

Present:

H M Treasury

Chief Secretary
Mr F E R Butler
Mr Gilmore
Mr D J L Moore
Mr Turnbull
Mr Colman
Mr Revolta
Mr Hoare
Mr Perfect
Mr Boote

Department of Transport

Secretary of State for Transport
Sir Alan Bailey
Mr Yass
Mr Palmer
Mr Jones
Mr Grinsey
Mr Smethurst

Mr Jeremiah (Welsh Office)
Mr Elvidge - (Scottish Office)

Nationalised Industries

The Chief Secretary stressed that this was a very difficult Public Expenditure round. His aim was to hold nationalised industries external finance needs to baseline as endorsed by Cabinet. He could, therefore, accept additional bids above baseline only if absolutely necessary. He proposed considering Department of Transport's industries one by one starting with BR.

British Rail

2. The Secretary of State for Transport agreed to the proposed procedure. BR had made great strides to reduce

the level of PSO grant to £725m in the current financial year. The removal of Intercity from grant planned for 1988-89 was a major achievement. BR had not been able to achieve the large cost reductions achieved by LRT partly because LRT's reductions reflected the high costs inherited from the GLC. Over the past few years cost reductions of 3 per cent per annum had been achieved on both Provincial and Network South East.

3. The <u>Secretary of State</u> explained that he had had many meetings with Sir R Reid to discuss the commercial sector and grant targets for 1989-90. The Chairman had gone to the limit of his ability in agreeing a commercial target of 3% and a grant target of £555m. A 3% rate of return on the commercial sectors would be extraordinarily difficult to achieve. Sir R Reid only had plans to reach a grant target of £580m but was prepared to commit himself to the lower figure of £555m.

4. Mr D J L Moore commented that the proposed target of £555m was consistent with a reduction in basic costs - excluding revenue investment and BREL redundancy costs - of 1½% per annum. Since 1983, however, a reduction in basic costs of 2.2% per annum had been achieved which would be consistent with a target of around £520m proposed by the Chief Secretary. BR had not done as much as they might to control employment costs. The <u>Secretary of State</u> accepted Mr Moore's comments but noted that the Government were also asking BR for improvements in the quality of service. BR were faced with a problem of recruiting sufficient good quality staff and were presently facing a shortage. Sir R Reid had gone beyond the rest of the Board in offering a grant target of £555m. <u>Mr Palmer</u> added that since the Chairman had accepted the original grant target for 1986-87, a number of things had gone against BR but the target would still be achieved.

5. The <u>Secretary of State</u> explained BR's EF bids. The £53m overrun over baseline in 1987-88 resulted from the

agreed decisions on rail redundancy, the Channel fixed link and Stansted. The overrun could be reduced but it would not be possible to hold this bid to baseline. In subsequent years, BR had included more investment than DTp were prepared to accept at this stage; lower inflation assumptions and the effect of the commercial and PSO grant targets would also produce significant reductions. It would, however, be politically difficult to present a reduction below baseline in 1989-90. Nevertheless within a global settlement, the Secretary of State was prepared to reduce BR's overall bid to £20m above baseline in 1987-88, to baseline in 1988-89 and to £50m below baseline in 1989-90.

London Regional Transport

6. Turning to LRT. the Secretary of State stressed the major strides that LRT had made to reduce costs and improve productivity. The Chief Secretary recognised these achievements. Partly as a result, the Secretary of State noted that LRT had been able to absorb the £30m additional costs of the Docklands Light Railway within their bid.

7. The Secretary of State noted that LRT would be announcing fare increases of 4½% on . 23 September . Increases of 6% per year in the last 2 years of the Survey were now being assumed. On investment, the introduction of new trains to reduce congestion was a top priority. Some increased expenditure on measures to improve security was also unavoidable. He had assumed, however, some squeeze on expenditure on station modernisation. He accepted that expenditure on a new coach terminal and access to Heathrow could be removed as decisions had not yet been taken on these two items. Both, however, were important and once decisions were made could result in a specific claim on the Reserve. Taking all these savings into account, he could accept LRT's EF needs as £9m below baseline in 1987-88, £52m below baseline in 1988-89 and £100m below baseline in 1989-90.

8. Mr Colman noted that a lot of doubts about the investment in new trains to reduce congestion had been removed as a

result of discussions with DTp officials. Mr Palmer added that LRT had made very strong assumptions on the level of pay. If these could not be achieved, LRT would have difficulty meeting these EF targets.

National Bus Company

9. The Secretary of State had had discussions with the Chairman of NBC, Mr Lund. He was committed to the difficult operation of breaking up and selling NBC which was the government's priority. This required bus companies to be viable operations which in turn necessitated the purchase of new buses. If proceeds could be maximised by these buses being leased, this was obviously preferable. Consistent with the disposals programme, the maximum saving he could envisage was a reduction below baseline of £20m in 1987-88.

10. Mr Colman queried whether it was envisaged that NBC would still purchase outright any buses. Mr Yass replied that NBC intended to lease all new buses though the question remained whether such leasing would be on or off NBC's balance sheet. In the former case, it would count against NBC's EFL.

11. The Chief Secretary asked the Secretary of State whether there were any sales proceeds that could be scored beyond 1987-88. The Secretary of State confirmed that it was his prime aim to maximise the proceeds proper of the sales. There was some danger, however, that scoring proceeds in the later years of the IFR could be counter-productive particularly given that the department would be under some pressure to reveal the EF levels assumed. It was agreed that officials would consider further the scope for savings from NBC in 1988-89 and 1989-90 as well as the EF treatment of finance leases.

Civil Aviation Authority

12. The Secretary of State saw no scope for a reduction in the CAA's EF bid. The overshoot of £5m in 1986-87 resulted

from the Stansted control tower and £4m for the repayment of excess receipts from Euro Control from which the Treasury had received a benefit in the current year. He was frankly worried about air safety and saw it difficult to justify any cut. Room for manouevre on the CAA's investment programme was limited as was the ability to cover costs through higher fees. In general, the CAA had learned from past mistakes in managing investment.

Conclusions

13. The Chief Secretary was grateful for the way the Secretary of State had responded on his nationalised industries. While a problem remained for 1987-88, agreement was very close for subsequent years particularly if higher savings from NBC could be realised. He would wish to review the totals in light of the overall position on Department of Transport expenditure.

Programme Expenditure

14 The Secretary of State pointed out that Department of Transport had reduced its total expenditure by 12% in real terms since the present Government came into office. It had reduced spending on subsidies and increased capital expenditure (particularly on roads) in line with the Government's policy. 70% of the Department's expenditure was now capital. This was a success story but it had the effect of reducing the scope for funding offsetting savings to accommodate new demands. The Chief Secretary said that there were severe constraints on every programme.

15 It was agreed that local authority capital should be considered first, then the other programme expenditure in the order of the bidding letter table.

B3, B4, B5: Local Authority Capital

16 The Secretary of State said that he considered his bid of £100m in each year for local authority capital to

be quite different from his other bids. It was forced on him by the need to prevent a drastic reduction in his allocations, arising from the increase in spending power from receipts. This spending power had not led to additional expenditure on transport: it was used to generate overspending on other services, particularly housing. In effect transport was being penalised for the sins of others. The Secretary of State circulated graphs showing the close relationship between net expenditure and allocations for transport in 1981-82 to 1985-86, and the discrepancy between the distribution of overspending between services and the share of the cut in allocations.

17 The Secretary of State said that he saw no grounds whatsoever for assuming that local authorities would change their past behaviour and start using spending power from receipts for transport. Besides, their ability to do so was limited. About half of all transport expenditure was in the shire counties and these had only 8% of the spending power from receipts. He concluded that it would be quite impossible to achieve spending at the existing baseline with the allocations offered. Taking account of expenditure already committed to existing road construction, his own priorities for new starts and the needs of buses and airports, there would only be allocations of £19m left for other local authority roads in 1987-88, as against £134m in the current year. This was politically very damaging.

18 The Chief Secretary said that he recognised the dilemma but his freedom of action was constrained by the overall growth in spending power from receipts and the 80% commitment on housing and other services. He noted that the baseline allowed allocations for transport above 80% of the 1985-86 figure. His proposal to distribute allocations in proportion to net provision had been designed to assist services like transport where receipts were modest. He saw

no choice of agreement on a formula which divided existing allocations up in a way more favourable to transport.

19 Local authorities had the choice of using spending power from receipts for transport and if they did not do so it was because their priorities were elsewhere. This suggested that additional provision for transport could well be used for other services, merely increasing the overspend in these areas. Nevertheless he understood Department of Transport's problem and was prepared to consider some increase in provision, but it would be a good deal less than the amount bid for and would inevitably leave less for other bids.

B1, B2:National roads

20 The Secretary of State said that although the road programme appeared superficially to have done well in recent years, that had to be set against a large increase in the number of vehicles and in road mileage. Moreover 1979-80 was a low base; expenditure on roads had been higher in the mid-1970s. Since his original bid a number of additional priority schemes had been identified or brought forward but he was unhappy about displacing schemes already in the programme. Bridge maintenance was a special problem. There was no choice but to undertake it. All in all roads had been one of the Government's successes and it would be a great mistake not to carry this forward to the next election by making the necessary resources available.

21 The Chief Secretary said comparisons with the mid-1970s were beside the point. Public expenditure had been too high then. In terms of the present Government's public expenditure policies, the road programme had been favoured and had received a very considerable cash increase. There were demands from many other programmes in the present Survey and it was impossible to do everything. The decision on

Dartford eased the pressure on the road programme. For the rest, he would have to ask the Secretary of State to decide on his priorities.

Small bids

22 The Secretary of State said that he was prepared to drop his shipping bid (B6) on the understanding that he expected to put forward fresh proposals to E(A) later on and if these were accepted, he would be looking for additional resources. The Chief Secretary welcomed the withdrawal of the bid and noted the possibility of subsequent developments without commitment.

23 The Chief Secretary proposed that discussion of the bids for running costs (B7) and administrative capital, (B8) and the marine services reduction (C5) should be left for a further meeting. However he accepted the reclassification of expenditure on local authority staff from the roads programme to running costs. This was PES neutral but would increase the gross running costs limit by £1m in 1987-88.

24 He found the bid for the fees shortfall (B9) most unwelcome and pressed for its absorption. The Secretary of State replied that although the bid might be shaded down a fraction, he could not find the necessary offsetting savings for the rest elsewhere. He had enquired about the scope for making good the shortfall from increased fees but was advised that this would not be legally possible.

25 On the abolition of Freight Facilities Grant (C5) the Secretary of State said that this would require legislation. The level of expenditure could be reduced but he considered that the Government obtained political advantages out of proportion to the small amount of money involved. The Chief Secretary queried the economic benefit of the grant and pressed for its continuation at present levels to be reconsidered

in the light of other priorities.

Conclusions

26 The Chief Secretary said that he would now write to the Secretary of State with proposals for an overall settlement. They could then have a further meeting (if necessary) in the light of the letter.

27 He would write separately about the exclusion of DTT from gross running costs controls but in principle he accepted the proposal.

pp **JILL RUTTER**
Private Secretary

H M Treasury
26 September 1986

Distribution

Those present
Principal Private Secretary
PS/Sir Peter Middleton