

PO-CH/NL/0282

PART A

Part A.

CONFIDENTIAL
(Circulate under cover and notify REGISTRY of movement)

Begins: 23/6/87.
Ends : 29/10/87.


PO -CH /NL/0282

PART A

Chanellor's (Lawson) papers:

THE FUTURE OF WATER
CHARGES FOLLOWING THE
ABOLITION OF DOMESTIC
RATES

Disposal Directions: 25 Year

Phillips

18/10/95.

PO -CH /NL/0282
PART A

CONFIDENTIAL



23/6/87.

CH/EXCHEQUER	
REC.	23 JUN 1987
ACTION	CST
COPIES TO	

PRIME MINISTER

FUTURE OF WATER CHARGES AFTER THE ABOLITION OF THE DOMESTIC RATE

Almost all domestic users of water and sewerage services in England and Wales are charged on a rateable value basis. They can opt to be charged by meter instead (if they pay the installation cost) but take-up is still low. We plan to abolish, or phase out, the domestic rate with effect from 1990. We must therefore decide what provision should be made for domestic water charging thereafter.

In the long run, general domestic metering is almost certainly the right answer. We already propose to remedy defects in water undertakers' metering powers and make provision for large-scale metering trials. I am writing separately to seek colleagues' agreement to the details. But metering 18 million households will be a massive operation. For reasons of cost and logistics, it will need to be phased over many years. Some interim arrangement is therefore needed.

Generally, and subject to adequate consumer safeguards, I believe that decisions on the basis of charging should be left to the commercial judgement of each undertaker, with a minimum of constraints. One quarter of the water supply in England and Wales is already provided by private statutory water companies. We aim to privatise the present water authorities during this Parliament. Government should therefore seek to interfere as little as possible with the undertakers' management decisions both on grounds of principle and because of the danger of impairing flotation prospects. We should ensure that realistic options are open to the water industry rather than imposing any particular method.



Water authorities have the powers to determine their charges as they see fit (subject to a never-used Ministerial power of direction), provided that they have regard to the costs of the service concerned and do not discriminate unduly between different classes of customer. Our metering legislation will give similar powers to the statutory water companies.

There is only one respect in which I think it would be right to circumscribe the industry's power to determine its own charging base. It would not be tolerable in my view for the undertakers to continue to use rateable value for a protracted period once we have abolished the domestic rate as a manifestly inequitable method of financing local government services. Time must of course be allowed for them to put alternative arrangements in place. But I would propose in the rates abolition Bill to prohibit the use of domestic rateable value for water charging from five years after the domestic rate is abolished.

Undertakers will no doubt have made considerable progress with metering by that date, but are very unlikely to have completed the operation. A number of options will in theory be available to them for charging unmetered domestic customers, such as

- i) a uniform flat rate charge for each household
- ii) a charge differentiated in some way by household size
- iii) a charge differentiated by some other proxy measure of consumption, such as floor area or the number of water using appliances.

None is ideal (any more than the present arrangements), and undertakers will need to assess for themselves their relative merits in terms of simplicity, equity and cost. One important consideration will be the effort required to compile and maintain a new data base; and a variant of ii) which may appeal to them



from that point of view is to fix the charge by reference to the number of resident adults at the property shown on the Community Charge Register. This would also be consistent with arrangements in Scotland, where water services are provide by local government and will be paid for through the community charge. I therefore have it in mind to make provison in the rates abolition Bill for water undertakers to be given access to data on the Register if they decide to determine their charges by that method.

To summarise, I propose:

- that water undertakers should generally be free to determine their own basis of domestic water charging following rates abolition, provide that they have regard to cost and do not discriminate unduly between classes of person;
- that they should however be prohibited from using the domestic valuation list for this purpose after a period of say, five years;
- that, if they choose to charge on the basis of the number of adults resident at each property, they should be given access to the Community Charge Register for this purpose.

If you and colleagues agree, I will consult the water industry on that basis, with a view to being able to announce our policy during the Second Reading of the Water (Powers and Charges) Bill. I should accordingly be grateful for any comments by 29 June.

I am copying this minute to members of E(A) and E(LF) and to Sir Robert Armstrong.

N R

23 June 1987

CONFIDENTIAL

CHIEF SECRETARY

FROM: MRS M E BROWN
DATE: 26 June 1987

- cc Chancellor
- Financial Secretary
- Sir P Middleton
- Mr F E R Butler
- Mr Monck
- Mr Hawtin
- Mr Moore
- Mr Turnbull
- Mr Instone
- Mr Potter
- Mr Tarkowski
- Mr Tyrie

In my opinion X (draft letter) checks to much: Mr SLS has rule as to the option of continuing to use the existing basis to use metering is in place. 2. There will be samples of water & links

Support to have 2 from rates & meter v. distribution upwards v. drink look v. clean. then a day

analysis of Mrs. SLS

WATER : METERING AND THE FUTURE OF CHARGES

You will want to consider Mr Ridley's minutes of 23 June to the Prime Minister together. See also further minutes of 26 June attached.

Metering

2. Mr Ridley seeks agreement to those provisions of the Water Paving Bill which enable the 10 water authorities in England and Wales to carry out metering trials. They include rights of entry to install meters, and powers to vary tariff structures.

3. The water authorities are mostly keen to move towards metering domestic properties (industrial concerns are already metered). The Prime Minister strongly favours metering, and Ministers agreed last year that legislation should be introduced to facilitate trials and, subsequently, widespread metering. An initial programme of trials is considered necessary because the relative costs and benefits of metering cannot otherwise be clearly established. It is estimated that investment of some f1 billion, spread over about 10 years, would be needed to install domestic water meters throughout England and Wales. The benefits would lie in

CONFIDENTIAL

reducing total demand for water by matching payments to quantity used, and thus helping to avoid the need for costly marginal additions to water resources (eg. new reservoirs).

4. The need to get on with metering trials has now become pressing because of

(i) The decision to abolish domestic rates from 1990. Water charges are at present based on rateable values. A new basis for charging - whether metering or an alternative approach - will need to be found.

(ii) Privatisation. The first of the water authorities are due to be privatised in either 1989 or 1990. The sale prospectuses will need to describe clearly each authority's charging policy, and the changes which are planned in the light of (i) above.

5. Mr Ridley's legislation is therefore essential, and we recommend you to support it. You will, however, want to consider:

(a) his proposal that DoE should be actively involved in a three-year programme of trials, starting in 1988-89; and

(b) the public expenditure cost of contributing to the trials programme from the DoE research budget, as Mr Ridley proposes.

6. We have discussed these points with DoE officials. We are satisfied that it will be beneficial to the water industry as a whole to launch a well-run trials programme as soon as possible, so that what is said in privatisation prospectuses about water charging is as convincing and well-prepared as possible. However, we have queried whether it is necessary for DoE to be so closely involved in the programme, and to contribute to its cost. Their answer is that the water

CONFIDENTIAL

industry has not yet got its act together on metering, and does not fully appreciate the importance of being able to demonstrate to investors that adequate thought is being given to the future of water charges, once domestic rates are abolished. Metering can only be introduced after full trials, and if they show it to be cost-effective. DoE accordingly believe that the only way to get sufficient momentum into the trials programme before privatisation is to take a prominent part themselves. We reluctantly agree with this. However, the trials will probably still be in progress when water privatisations begin. We therefore consider that it should be emphasised from the start that the trials are primarily being conducted by the water industry; that DoE are being involved initially to provide additional expertise and co-ordinate read-across between different authorities; but that central government's involvement will cease upon privatisation.

7. The planned programme of metering trials will cost about £6.5 million over the 3 years 1988-89 to 1990-91, to which DoE plans to make a direct but as yet unspecified contribution from its research programme. We will expect the water authorities to find their share of the cost from within their planned external financing limits.

8. There is also the question of how Mr Ridley will fund the contribution from his Departmental Research Programme to the cost of the metering trials. In his bidding letter to you of 25 June about the 1987 Public Expenditure Survey he has made additional bids for environmental research of £3m, £3m and £2m, citing the trials as part of the justification. Our advice is that you must at this stage protect your position in the Survey and not give anything away. We recommend that you simply indicate that you have noted his additional survey bid for environmental research but you are unconvinced that his Department's contribution to the trials cannot be met by a reordering of priorities.

Future of water charges

9. As mentioned above, the water authorities will have to

CONFIDENTIAL

decide how to charge for domestic water after 1990, when domestic rates are abolished. Even if all authorities decided to move to universal compulsory metering, this would - for reasons of cost and the logistics of the installation programme - take many years to complete.

10. Mr Ridley is clear that decisions on interim charging arrangements must be left to the authorities. He proposes, however, to stop them pursuing the course they will almost certainly prefer: to continue basing their charges on the last extant domestic valuation list. He proposes instead that they should be prohibited from using the list 5 years after rates are abolished. Alternative options open to the authorities will be a uniform flat rate charge for each household; a charge differentiated in some way by household size; or a charge differentiated by some other measure, such as floor area or the number of water using appliances. One course which may appeal to the authorities is to fix the charge by reference to the number of resident adults at the property shown on the Community Charge Register, and Mr Ridley suggests that the rates abolition bill should provide for water undertakers to be given access to data on the Register for that purpose.

11. You will want to consider the proposals from three viewpoints. First, the Government's wider policy on rates abolition. Mr Ridley is concerned that to allow the water authorities to use the domestic valuation list will perpetuate the concept of "rates" in the public's mind, and get in the way of making a clean move to the community charge. This is understandable. But you might suggest that 7 years, rather than 5, would be a more suitable weaning period. Water authorities would then have had more time to install meters, in areas considered suitable for metering, and could thus avoid the need to switch to an interim method of charging. Investors in the authorities would also be reassured by a longer timescale over which changes would be made.

CONFIDENTIAL

12. Secondly, what are the expenditure implications - whether to central government, if for any reason the authorities are not all privatised by the 1990s, or to the authorities themselves if they have been privatised by then? Mr Ridley makes no direct reference to costs in his minute; but it seems clear that the "effort" (as he describes it) of compiling a new data base would entail significant expense. And metering - the most likely long term charging alternative - would require heavy capital outlay before any subsequent pay-off showed through. I recommend that you draw attention in your reply to this lack of costings, and make clear our starting presumption that any additional expenditure would need to be met from additional charges on consumers, or from borrowings within external finance limits.

13. Thirdly, how will the position on charging affect privatisation, and the level of proceeds which may be expected? From this point of view alone, it would be preferable when prospectuses are being prepared in 1989 or 1990, if there were no uncertainty about future charging policies other than any change to metering which the authorities themselves had decided on. However, the 7 year run-down - if agreed - would be sufficiently far ahead to minimise the effect on investors' expectations.

14. A draft reply to the Prime Minister is attached. It is agreed with LGL and 2 Divisions.

Mary Brown.

MRS M E BROWN

CONFIDENTIAL**DRAFT LETTER FROM THE CHIEF SECRETARY TO THE PRIME MINISTER****WATER : METERING AND THE FUTURE OF CHARGES**

I have seen Nicholas Ridley's minutes to you of 23 June.

On metering, I am content with the proposed provisions of the Bill, including Nicholas's proposal to table an amendment on new connections at Committee Stage, following consultation with the industry. It is clearly desirable that the water industry should be able to get on with metering trials, and with general metering wherever that is cost-effective, as soon as possible. It is particularly important that the water authorities should be able to state clearly in the privatisation prospectuses what is the position on future charging policy, and what cost implications there are.

I agree also that it is desirable for the Department of the Environment to be involved in an early programme of metering trials, in order to inject momentum and to ensure that the lessons are disseminated throughout the industry. But I am concerned that the cost of the Department's contribution to the trials is giving rise to an additional bid in the 1987 Public Expenditure Survey. I am not convinced that Nicholas could not absorb the costs by a reordering of priorities, and I will wish to consider this with him in the Survey discussions. So my agreement is without prejudice to those discussions.

Nicholas speaks of trials lasting 3 years, starting in 1988-89. The first authorities are due to be privatised in 1989 (assuming early legislation) or 1990. In my view it is essential that central government involvement in the programme should cease upon privatisation, and that even

CONFIDENTIAL

before privatisation it should be made clear that the authorities are in the driving seat and will be making up their own minds about metering. They must be seen to stand on their own feet. I hope these points will be made in debates and wider discussion on the Bill.

Given that compulsory metering may not, in the event, be chosen by all authorities, or that trials may throw up some other reason why compulsory metering should not be applied universally, it is important that the industry also makes rapid progress with detailed study of the alternatives. I hope that Nicholas will be impressing this need too on them.

I understand that the initial cost of installing meters in domestic properties throughout the country is estimated at around £1 billion over a period of years. I must stress that if for any reason any water authorities were still within the public sector and wished to go ahead with a general programme of metering, there could be no presumption that central government would fund the cost through higher EFLs. We would seek to finance the additional costs as far as possible from higher charges on consumers, which would be justified by the longer-term savings to be expected.

X | On the future of water charges, I accept that having abolished domestic rates we cannot allow water authorities to continue indefinitely to base charges on the last extant domestic valuation list. At the same time I am concerned to minimise the costs of switching to an alternative data base for an interim period, where authorities may be in/^{the} process of moving to universal metering. I would prefer the period of grace, before they are prohibited from using the domestic valuation list, to be 7 years. That would give more chance for them to complete the trials programme, and to be well advanced with general metering or whatever other long-term charging methods they decided on following the metering trials. Again, privatisation considerations are important here. Investors are likely to regard the water authorities as stable, long-term

CONFIDENTIAL

stock. We do not want to inject any further uncertainty then we have to into the privatisation prospectuses.

Nicholas does not refer to any cost implications. I assume that the effort of compiling a new data base, if that were necessary, would be born from increased charges or otherwise from the authorities' own resources. I agree with Nicholas that from a costing point of view an attractive option, if the authorities were not yet ready to move fully to metering, would be to fix the charge by reference to the number of resident adults at the property shown on the Community Charge Register, and I welcome his suggestion that the rates abolition bill might provide for the water undertakings to have access to the Register for that purpose.

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

[J M]



6/f with
response p

FROM: J J HEYWOOD
DATE: 29 June 1987

PS/CHIEF SECRETARY

cc PS/Chancellor
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Hawtin
Mr Moore
Mr Turnbull
Mrs Brown
Mr Instone
Mr Potter
Mr Tarkowski
Mr Tyrie

WATER : METERING AND THE FUTURE OF CHARGES

1. The Financial Secretary has seen Mrs Brown's minute of 26 June.
2. He has asked whether we have taken professional advice on the idea that a longer transitional period would be beneficial to proceeds. He wonders whether that is Schrodgers' opinion.

J.H.

JEREMY HEYWOOD
Private Secretary

CONFIDENTIAL



FROM: A W KUCZYS
 DATE: 29 June 1987

b/f with response

PS/CHIEF SECRETARY

cc: PS/FST
 Sir P Middleton
 Mr F E R Butler
 Mr Monck
 Mr Hawtin
 Mr D J L Moore
 Mr Turnbull
 Mrs M E Brown
 Mr Instone
 Mr Potter
 Mr Tarkowski
 Mr Tyrie

WATER: METERING AND THE FUTURE OF CHARGES

The Chancellor has seen Mr Ridley's three minutes of 23 June to the Prime Minister and Mrs Brown's note of 26 June. In his view the first sentence of the sixth substantive paragraph of the draft letter for the Chief Secretary to send ("On the future of water charges.....on the last extant domestic valuation list.") concedes too much: we should not rule out the option of continuing to use the "rating" basis until metering is in place.

2. There will be significant winners and losers in any switch from rates to metering. To have two such redistributive upheavals does not look very clever. Has anyone done any analysis of this?

A handwritten signature in black ink, appearing to be 'A W K'.

A W KUCZYS



Important
that
John
Shannon
is
not

Ch

① Mary Brown is responsible for the water industry generally, not just privatisation. But on this aspect, where there is an interaction with domestic rates, she works closely with Barry Pottes (LG).

ASAP!

② DoE are best placed to carry out the distributional analysis — and presumably Mr Ridley will be just as interested as you. We shd get a progress report v. soon. (No-one had done any work up to now; but the effects of metering may be quite similar to the switch from

rates to community charge
— on which work has been done.)

DK

1/7

CONFIDENTIAL

~~6/1/7 A~~
6/1/7 A

PS/CHIEF SECRETARY

FROM: MRS M E BROWN
DATE: 29 June 1987

Ch
See also letter from
David Nargore below;
PM wants a meeting on
this point
DWK

- cc PS/Chancellor
- PS/Financial Secretary
- Sir P Middleton
- Mr F E R Butler
- Mr Monck
- Mr Hawtin
- Mr Moore
- Mr Turnbull
- Mr Instone
- Mr Potter
- Mr Tarkowski
- Mr Tyrie

gms w/v.
MS this is w/v a
parallel is w/v a
now: why
deal
can be
passed by
Att.?

WATER: METERING AND THE FUTURE OF CHARGES

Mr Kuczys and Mr Heywood have minuted you on this today.

2. I attach amended paragraphs on water charges and retention of the domestic valuation list. They suggest that water undertakings should be able to continue to base charges on the valuation list for 10 years after domestic rates are abolished, rather than the 5 years proposed by Mr Ridley. They also suggest that this period should be subject to review.

3. The Chancellor has commented that we should not rule out the option of continuing to use the rating base until metering is in place. There is a carrot and stick issue here. Unless the water authorities are told that after a certain date they will have to move off the valuation list, there will not be enough incentive on them to go ahead rapidly with metering trials, or with finding some other acceptable alternative. This is a real worry, since most authorities have so far shown marked reluctance to grapple in practical terms with the charges question, despite their expressions of enthusiasm in principle for metering. I therefore think

PS. A
who is
Jan
look
disturb
with
know
affects?

CONFIDENTIAL

What the furthest you should go is to suggest that the ^{10 year} cut-off period should be subject to review. It would then be possible to extend the period if the transition to metering (or alternative long-term forms of charging) were taking longer than expected.

4. DoE have not done any detailed analysis of the upheaval which would be involved in switching the water charging base twice in about 10 years. But there would clearly be considerable costs for the water undertakings themselves; and disruptive effects on consumers.

5. The Financial Secretary has asked whether a longer transitional period would be beneficial to proceeds. I have not been able to discuss this specifically with Schroders this evening. But DoE officials confirm that a longer period would either spare the water authorities the cost of moving to a transitional charging base whilst installing meters for the longer term; or would enable them to spread the investment in meters over a longer time period. Either way, we would be able to tell a more reassuring story in the privatisation prospectuses about future charging policies, and this should have a beneficial effect on the sales.

Mary Brown.

MRS M E BROWN

CONFIDENTIAL

" On the future of water charges, Nicholas suggests that we should prohibit the water undertakings from continuing to base charges on the domestic valuation list for more than 5 years after rates are abolished. I understand his concern here. But it will take 10 years or more to move to universal compulsory metering; and in the meantime water undertakings and their customers would have to bear all the cost and disruption of moving to an interim charging base. That would be both inefficient, and a potentially damaging prospect at the time of privatisation. I would prefer the period of grace to be 10 years, and subject to review.

Nicholas does not refer specifically to the cost implications of his proposals. I must assume that, if the authorities did have to compile new, interim, data bases, the costs would be borne from increased charges or otherwise from their own resources. I agree with Nicholas that from a costing point of view an attractive option, if the authorities were not given time to move straight to metering, would be to fix the charge by reference to the number of resident adults at the property shown on the Community Charge Register. I therefore agree with his suggestion that the rates abolition bill might provide for the water undertakings to have access if necessary to the Register; although as I have explained I hope they can be spared the need to make such interim arrangements.

I am copying this letter to members of E(A) and E(LF) and to Sir Robert Armstrong. "

CONFIDENTIAL



PSI Chancellor
 PSI FST
 Sir P Middleton
 MR F.E.R. Butler
 MR Monck
 MR Hawtin

FROM: CHIEF SECRETARY Mr Moore
 DATE: 29 June 1987 Mr Turnbull
 Mrs Brown
 Mr Instone
 Mr Potter
 Mr Tarkowski
 Mr Tynie

PRIME MINISTER

WATER: METERING AND THE FUTURE OF CHARGES

I have seen Nicholas Ridley's minutes to you of 23 June.

2 On metering, I am content with the proposed provisions of the Bill, including Nicholas's proposal to table an amendment on new connections at Committee Stage, following consultation with the industry. It is clearly desirable that the water industry should be able to get on with metering trials, and with general metering wherever that is cost-effective, as soon as possible. It is particularly important that the water authorities should be able to state clearly in the privatisation prospectuses what is the position on future charging policy, and what cost implications there are.

3 I agree also that it is desirable for the Department of the Environment to be involved in an early programme of metering trials, in order to inject momentum and to ensure that the lessons are disseminated throughout the industry. But I am concerned that the cost of the Department's contribution to the trials is giving rise to an additional bid in the 1987 Public Expenditure Survey. I am not convinced that Nicholas could not absorb the costs by a reordering of priorities, and I will wish to consider this with him in the Survey discussions. So my agreement is without prejudice to those discussions.

4 Nicholas speaks of trials lasting 3 years, starting in 1988-89. The first authorities are due to be privatised in 1989 (assuming early legislation) or 1990. In my view it is essential that central government involvement in the programme should cease

CONFIDENTIAL

upon privatisation, and that even before privatisation it should be made clear that the authorities are in the driving seat and will be making up their own minds about metering. They must be seen to stand on their own feet. I hope these points will be made in debates and wider discussion on the Bill.

5 Given that compulsory metering may not, in the event, be chosen by all authorities, or that trials may throw up some other reason why compulsory metering should not be applied universally, it is important that the industry also makes rapid progress with detailed study of the alternatives. I hope that Nicholas will be impressing this need too on them.

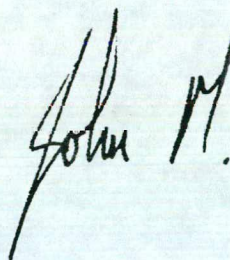
6 I understand that the initial cost of installing meters in domestic properties throughout the country is estimated at around £1 billion over a period of years. I must stress that if for any reason any water authorities were still within the public sector and wished to go ahead with a general programme of metering, there could be no presumption that central government would fund the cost through higher EFLs. We would seek to finance the additional costs as far as possible from higher charges on consumers, which would be justified by the longer-term savings to be expected.

7 On the future of water charges, Nicholas suggests that we should prohibit the water undertakings from continuing to base charges on the domestic valuation list for more than 5 years after rates are abolished. I understand his concern here. But it will take 10 years or more to move to universal compulsory metering; and in the meantime water undertakings and their customers would have to bear all the cost and disruption of moving to an interim charging base. That would be both inefficient, and a potentially damaging prospect at the time of privatisation. I would prefer the period of grace to be 10 years, and subject to review.

CONFIDENTIAL

8 Nicholas does not refer specifically to the cost implications of his proposals. I must assume that, if the authorities did have to compile new, interim, data bases, the costs would be borne from increased charges or otherwise from their own resources. I agree with Nicholas that from a costing point of view an attractive option, if the authorities were not given time to move straight to metering, would be to fix the charge by reference to the number of resident adults at the property shown on the Community Charge Register. I therefore agree with his suggestion that the rates abolition bill might provide for the water undertakings to have access if necessary to the Register; although as I have explained I hope they can be spared the need to make such interim arrangements.

9 I am copying this minute to members of E(A) and E(LF) and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to read "John M.", with a stylized flourish at the end.

JOHN MAJOR



M

CH/EXCHEQUER	
REC.	18 SEP 1987 ✓ 1875
ACTION	CST
COPIES TO	

PRIME MINISTER

WATER METERING TRIALS

Last July we introduced the Public Utilities Transfers and Water Charges Bill which, amongst other things, will enable water authorities and companies to conduct compulsory trials of domestic water metering. There was surprisingly little press speculation at the time about the potentially controversial issue of the identities of the trial sites, even though the water industry in consultation with my department had already reached agreement on a provisional list of sites for one large scale and ten small scale trials.

In order to get the trials underway well in advance of rates abolition in 1990, it has been necessary, and will become increasingly necessary over the coming months, for the water industry to carry out preparatory work on the design of the trials, tariffs and technology to be used, public relations aspects and so on. More importantly the authorities and companies taking part need to collect base data on consumption patterns in the provisional selection of trial areas. The fact that there is a list of sites has now become known to the press and I have decided that it would be best to pre-empt further speculation by making an announcement.

The main announcement will be made by the Water Authorities' Association in about ten days' time. The water authorities and water companies involved will make a co-ordinated series of local statements at the same time. All of the statements will be at pains to emphasise that the current work on measuring base consumption will not involve metering of individual households, which cannot begin until the Public Utility Transfers and Water Charges Bill is on the statute book. Nor will it pre-empt the formal decisions I will be required to make under the Bill on details of each trial scheme. These points will be repeated in my Department's press notice and in the letters which I intend to write to local MPs in the areas chosen.



As a pump priming measure I expect to contribute towards the costs of the co-ordinated series of trials, but I shall not announce any decision on that until the Bill has been debated in the House, at Second Reading.

Copies go to other members of E(A) and Sir Robert Armstrong.

Deborah Lamb

pp NR

18 September 1987

(approved by the Secretary of State)
(in draft > signed in his absence)



CH/EXCHEQUER	
REC.	29 SEP 1987 ✓ 299
ACTION	CST
COPIES TO	

29/9/87

Prime Minister

FUTURE OF WATER CHARGES AFTER THE ABOLITION OF THE DOMESTIC RATE

In my minute to you of 23 June, I proposed

- that water undertakers should generally be free to determine their own basis of domestic water charging following rates abolition, provided that they have regard to cost and do not discriminate unduly between classes of person
- that they should however be prohibited from using the domestic valuation list for this purpose after a period of, say, five years and
- that, if they choose to charge on the basis of the number of adults resident at each property, they should be given access to the Community Charge Register for this purpose.

It has not yet been possible to arrange the discussion you wished to have. Meanwhile, however, I have reviewed the position in the light of comments from other colleagues, recent developments in our rates abolition policy, and further study of the practical and legislative implications of basing domestic water charges on the community charges register.

I have explained before that general domestic metering, the most promising option for the longer term, would take many years to implement; and also that we would risk serious damage to the flotation prospects of the proposed Water Services PLCs if we were seen to be forcing upon the industry the general adoption of



metering before its consequences had been fully assessed through trials and without regard to the undertakers' own commercial judgment. My City advisers continue to express concern on this score.

It had seemed to me therefore that some interim arrangement would be necessary to bridge the gap between rates abolition and the completion of the metering programme. Since then, however,

- the Chief Secretary, Treasury, in his minute of 29 June has pointed to the cost and disruption which would be entailed by a move to an interim charging base. He therefore suggests that we allow water undertakers to continue to use the rateable value base for at least 10 years, rather than five, after abolition. The Secretary of State for Social Services, in his letter of 30 June, has also reminded us that in future the social security system will provide no cushion against any adverse redistributive effects on low income households arising from changes in the basis of water charging.

- we have agreed that the distributional consequences of rates abolition should be smoothed by phasing them over a four year period. Colleagues will no doubt also be equally anxious to avoid sharp changes in the incidence of water charges which can be attributed directly to rates abolition, though the sums at stake will be considerably smaller.

While I would be reluctant to allow use of the valuation list for any purpose to continue after rates abolition for longer than strictly necessary, I see force in these considerations. Recent work, besides, has highlighted the shortcomings of the various options for an interim charging base.



The most attractive of these in principle would be to relate water charges to household size. This would provide a reasonable proxy for essential water consumption. Additional charges could be made, as they are already in some areas, for inessential uses such as garden sprinklers. But it would necessitate comprehensive, reliable and up-to-date information on the occupancy of each connected property which is not available at present and would be expensive to compile and to maintain: undertakers would probably have to be given intrusive new powers for that purpose. The same is true of other possible proxy measures such as the number of rooms, or water-using appliances, at each property.

Since water undertakers lack adequate information on household size, I had envisaged that we might instead make the machinery of the community charge available to them, so that at least their charges could reflect the number of adult consumers. The community charge is however designed to meet the requirements of a local tax base, in particular to reflect the 'people' related nature of many local services, and to enhance the accountability of local authorities to their electorate. The desiderata for a system of commercial charges for services which are available only to occupants of connected properties are quite different, and on further consideration I have come to the view that we would only risk bringing discredit on the community charge if we sought to adapt it to a purpose for which it was never designed. In particular, the exclusion from the register of under-18s and of exempted categories such as members of foreign armed services would make the community charge base a demonstrably inadequate proxy for usage of water services and leave gaps in the required data which it would be difficult and expensive for water undertakers to fill in other ways. Finally, I am advised that undertakers could be at serious risk of successful challenge if they sought to operate a community charge based scheme under



their general charging powers: it would therefore be necessary to make specific provision for this in either the rates abolition Bill or the main water privatisation Bill. The right of access to the Community Charges Register which I earlier proposed would not suffice. I would not wish to complicate further preparation of either Bill in this way.

A much more straight forward possibility would be a flat rate charge per connected property. This would be administratively simple and would require no special provision to be made for it. But it would be demonstrably quite unrelated to consumption, and its distributional effects would be correspondingly difficult to defend.

If a water undertaker can identify an alternative unmeasured basis for water charging which it considers preferable to present arrangements, it would be wrong to stand in its way. But in view of the unsatisfactory nature of the candidates which have so far been suggested, it now seems to me equally wrong to compel undertakers to change their charging arrangements before they have absorbed and been able to act upon the lessons of the metering trials. I therefore agree with the Chief Secretary, Treasury that we should allow water undertakers to continue to use domestic rateable value for charging purposes for a reasonable period. I believe that it would be best to provide for a ten year period on the face of the Bill. This will give a clear signal that the use of the rate base must come to an end.

I would expect to be closely questioned about our intentions during the passage of the Public Utility Transfers and Water Charges Bill, and I therefore hope that it will be possible to discuss these issues well before the end of the recess.



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

A handwritten signature in dark ink, consisting of a stylized capital letter 'R' with a long, sweeping tail that curves downwards and to the right.

NR

September 1987



CH/EXCHEQUER	
REC:	08 OCT 1987 H10
ACTION	CST
COPIES TO	

PRIME MINISTER

FUTURE OF WATER CHARGES AFTER THE ABOLITION OF THE DOMESTIC RATE

I have seen Nicholas Ridley's recent minute to you and fully support his conclusion that we should allow water undertakers to continue to use domestic rateable value for charging purposes for a reasonable period.

However, I feel it is essential that water undertakers should be free to adopt whatever base for charging they wish, provided it meets the statutory requirements. Welsh Water argue strongly for a flat rate per household, on the grounds that 80% of the cost of providing water in their area is fixed and is not related to consumption. The flat rate charge is by far the simplest and least costly option to administer.

The need in Wales to decide what to do with water charges after the abolition of domestic rates is more acute than in England since the community charge is to be fully introduced in Wales in 1990, after which no new domestic hereditaments will be added to the valuation list.

I should therefore wish to be involved in any discussions on these issues.

/ I am copying this minute to Nicholas Ridley, other members of E(LF) and to Sir Robert Armstrong.

6 October 1987

P W

CONFIDENTIAL

FROM: T TARKOWSKI

DATE: 14 October 1987

- 14
10
1. MRS BROWN
 2. CHIEF SECRETARY

cc Chancellor
 Financial Secretary
 Sir P Middleton
 Mr F E R Butler
 Mr Monck
 Mr Moore
 Mr Hawtin
 Mr Turnbull
 Ms Peirson
 Mr Potter
 Mr Lyne
 Mr Parr
 Mr Sharp
 Mr Tyrie
 Mr Call

Sh/ You may like to glance at the note attached at Annex A - which responds to your earlier concerns about the redistributional effects of changing the method of water charging. 25 11/10

FUTURE OF WATER CHARGES AFTER THE ABOLITION OF THE DOMESTIC RATE

Mr Ridley's recent (undated) minute to the Prime Minister makes a number of revisions to the proposals in his 23 June minute, on which you commented in a letter of ~~30~~ June.

29

Background

2. Water charges to domestic consumers are currently based on rateable values. The abolition of the rating system poses the need for an alternative charging base. In the long-term, domestic metering is the most promising option, and Ministers have agreed that co-ordinated trials should proceed. The necessary legislation was introduced before the Recess and has its Second Reading on 21 October.

3. However, conversion to full-scale metering will take time (perhaps 10 years) and money (perhaps £1 billion). It is crucial to successful privatisation that the industry is not seen to be rushed into ill-considered or forced decisions. So decisions are needed about the basis on which the authorities (and successor companies) may set their charges once rating abolition begins.

4. Mr Ridley's June proposals were that:

- i) the water undertakers should be generally free to choose their own basis for charges; but
- ii) access to the rating list should be withdrawn after 5 years;
- iii) access to the new community charge list should be provided as a possible substitute charging base.

5. You argued for access to the rating list to be extended to 10 years, to allow for a smooth transition from the current charging base direct to metering, for those utilities choosing universal metering.

Current proposal

6. Mr Ridley has now agreed that access to the rating list should continue for 10 years. But he has had second thoughts about access to the Community charge list. He now thinks its use by the water industry (for which it was not, of course, designed) would risk discrediting it generally, since it would not be a particularly close proxy for consumption. It also now appears that specific legislation would be required, either in the rates abolition Bill or the water privatisation Bill, both of which are already extremely long and contentious. Accordingly he no longer intends to provide access to the community charge list. We see no reason to query this judgement.

7. This leaves the water industry with the choice of a move - within 10 years - from rateable values to metering, or to some other basis unconnected with Local Government finance.

8. An appearance of free choice is essential. Schrodgers advise strongly that sale prospectuses will have to set out considered strategies (it will be impractical to complete a move to metering before sales begin), and it would seriously damage flotations if it were believed that changes were being forced on the industry before they had been properly considered by the managers of the authorities.

9. In practice, the alternatives to metering are not very attractive. If the Community charge basis is ruled out, there are only two obvious ones:

- i) total household size (including children), possibly with supplementary charges for sprinklers etc. This seems the fairest, since it would proxy consumption closely, but it would be expensive to compile lists and difficult to police.
- ii) Flat-rate per connected property. This would be easy and cheap, but not obviously more fair than the existing rateable value basis. It could be difficult to defend the effects on losers. However, Mr Walker's minute of 6 October reveals that Welsh Water Authority will want to charge on this basis, on the grounds that 80 per cent of the costs of water supply are fixed, and because it will be cheaper to administer. This could be presentationally difficult (see 10c below).

Assessment

10. There are three main angles:

a) Local Government finance

We accept that it is probably not worth introducing special legislation to provide powers for the water industry to use the Community registers.

b) Water privatisation

The need, as far as city perceptions are concerned it for all reasonable options to be left open for the water authorities to make up their own minds, and for a reasonable period of grace before they are obliged to decide. Mr Ridley's proposals achieve this.

c) Consumer perceptions of metering

It will not help privatisation if metering is seen as something wished on the industry by Government. The Welsh argument threatens to do this by undermining the case for metering. However on balance we think it would be more damaging to sales to try to influence their decision (eg by blocking the option of a flat rate charge per house). We think the better course would be to alert the Authorities to the dangers of appearing to knock one another's policies, and the consequent need for care. The attached draft makes the point.

Distributional effects

X

11. Consumer perceptions of metering will also be affected by the distributional impact of changing the charging basis. This is virtually impossible to gauge. The Chancellor was concerned (Mr Kuczy's 29 June minute to Ms Rutter) that Mr Ridley's previous proposals threatened two redistributional upheavals - the first when the industry was obliged to abandon rateable values after 5 years, the second later, as widescale compulsory metering became possible. The present proposals should allow for a rather smoother transition, but you and the Chancellor may be interested in the attached paper which we put together in the light of the Chancellor's original concern.

Annex A

CONFIDENTIAL

12. The main conclusions, briefly, are that domestic bills could change significantly (up or down 50 per cent, or £1 on the average weekly bill of £2) though it is impossible to be certain, and that substantial numbers would be affected to at least some extent. On the other hand, the sums would be small relative to average family income and expenditure (because water charges are still very low). In particular, they would be much smaller than the distributional effects of introducing the community charge. The other main point is that the upheaval would be a long-drawn out and confusing process, even though we think we have now avoided the threat of two separate upheavals.

13. These very tentative conclusions do not change the advice in this submission.

Proposed ministerial discussion

14. It is not clear that the ministerial discussion proposed by Mr Ridley is essential, and Cabinet Office have received no instruction from No 10 as yet. However, the Treasury would need to be represented if this went ahead.

15. The attached draft reflects this advice.

16. This submission has been agreed with LG.

Tanwed Tarkowski
T TARKOWSKI

**DRAFT MINUTE FROM: CHIEF SECRETARY
TO: PRIME MINISTER**

FUTURE OF WATER CHARGES AFTER THE ABOLITION OF DOMESTIC RATES

I have seen Nicholas Ridley's recent minute to you, and Peter Walker's comments.

I am glad Nicholas has accepted my suggestion that we allow the water undertakers to continue to use domestic rateable values for 10 years.

I entirely agree that, to ensure successful flotations, we must be seen to leave the choice of a replacement for the present system to the commercial judgement of the water undertakers. However I think the arguments advanced by Welsh Water could risk discrediting metering generally if advanced in the form quoted by Peter Walker. This points to the danger of the water authorities appearing to contradict one another's policies, and the consequent need for care. This is a general point, which goes wider than the metering issue. We must clearly take steps to ensure that the city's confidence in the judgement of the authorities is not put at risk unnecessarily. Ill-considered statements will risk damaging not one flotation but all of them. I trust the industry's Chairmen will be alerted to the risks.

If you feel a meeting is necessary I would be glad to take part.

I am copying his minute to Nicholas Ridley, Peter Walker, other members of E(LF) and Sir Robert Armstrong.

[JM]

CONFIDENTIAL

DISTRIBUTIONAL EFFECTS OF CHANGING THE BASIS OF WATER CHARGES

In the absence of data from large-scale trials, it is not possible to quantify the re-distributional effects of metering. Most other changes to the basis of water charges - with the exception of the community charge - are also almost impossible to quantify.

2. This paper is therefore in three sections:

A - looks at the likely pattern of effects, without attempting to quantify them.

B - looks at the limited numerical evidence, which relates to a move to community charging rather than to metering.

C - draws some general conclusions.

3. Three general points are worth noting at the outset, however:

(i) water charges are very low in relation to family income and expenditure. The average annual bill of £99 is around one per cent of average annual household expenditure of £10,000 in 1987-88. (Contrast domestic rates, where the average annual bill is in the region of £400). So even relatively large percentage changes involving large numbers of gainers and losers would be fairly small in cash terms. Under some scenarios, bills might vary considerably - up or down over 50 per cent in some cases, or 0.5 per cent of average household expenditure. And up to 20 million adults could be adversely affected. But the sums involved are unlikely, except in rare cases, to exceed about £50 a year, at present levels of charges, and would probably be much smaller for the majority.

CONFIDENTIAL

(ii) At present levels of charges, it is likely that not all water authorities would decide in favour of universal metering, (eg, metering might be made compulsory only in some parts of their areas, or not at all) though the economics remain unclear till large scale trials are possible. Even where a privatised company chose universal metering, its introduction would have to be phased over a period of up to 10 years, depending on the pace at which the company felt able to proceed. So the impact would fall on different consumers at different times (or not at all).

(iii) The effects would take place over the same period as the public were becoming used to:

(a) the effects of RPI-X type price regulation;

(b) Any experimenting (on both metered and non-metered tariffs) which the privatised companies decided on (eg, peak or seasonal pricing, differential charges for different parts of their Regions, average charges rising with marginal use, changes to standing/minimum charges etc), thus further confusing public perceptions.

A. RE-DISTRIBUTIONAL PATTERNS

Present System

4. Ideally, domestic water charges would be based on consumption (with a standing charge to reflect fixed costs). UK industry is already charged according to its consumption, as are most domestic users in other western countries. At present domestic charges are based on a crude proxy for consumption, rateable values.

5. The shortcomings of the rate valuation system as a basis for charging are well known. Rateable Values (RVs)

CONFIDENTIAL

were last updated in 1973 (though new properties will have been added to the list at the values prevailing when they were built). At a time of rapid and uneven house price escalation, they are now a heavily distorted measure of property values.

6. Even updated RVs would be only a very crude guide to consumption, which is more closely related to household size, and the ownership of water using appliances (washing machines, dishwashers, garden sprinklers), than property values.

7. As a result the present water charging system generally favours large households at the expense of smaller ones, and particularly at the expense of small households in high RV properties. The effect is theoretically mitigated by the present right to opt to be metered. But in practice under one per cent of domestic users have opted (they have to pay for the meter installation).

A direct move to universal metering

8. A universal move to compulsory general metering would iron out these unintended redistributive effects. Consumers would pay for what they used. In general large households would pay more, small households less.

9. A key difference from the effects of rates abolition, is that all changes would be intra-regional (that is within the area of each Authority), so there would be no major effects between North and South. However the effects within each Region would include the elimination of the present advantage enjoyed by low rateable-value areas over higher rateable-value areas.

10. It would be open to authorities to smooth the consequences of redistribution, eg. by manipulating tariffs or standing charges to provide the volume of water judged essential at a fixed price, with incremental charges for

additional consumption. The water industry has shown some interest already in such ideas.

Permanent or transitional alternatives to metering

11. Moving towards metering through a transitional phase would, of course, have the same ultimate distributional consequences. The difference is that the distributional effect on any one household would come in two smaller stages rather than one bigger one, provided that the transitional arrangements are a better proxy for consumption than the existing RV basis. (If the transitional method were, in any respect, a worse proxy, individual households could first gain, and subsequently lose, or vice-versa).

12. In practice, we believe the authorities would be unlikely to go through a transitional phase, if it could be avoided, because of the costs of adapting their billing systems, and training staff, as well as the general problem of maintaining customer relations through the transition.

13. Whether they regarded them as interim measures on the way to general metering, or a permanent replacement for the present RV basis, the options are limited. DOE have identified four alternative proxies for consumption which the utilities might consider:

- (a) a charge differentiated by household size
- (b) a charge differentiated by floor area
- (c) a charge differentiated by number of water using appliances.
- (d) a uniform flat rate charge per household

14. The following paragraphs consider the possible distributional consequences of each in turn, considered both as permanent charging regimes, and as possible interim regimes on the way to full metering. In general the effects can only be guessed at. The complications discussed in paragraph 3 above would again apply, confusing both the

CONFIDENTIAL

actual effects, and the public's likely perceptions. But taking them in turn:

(a) (differentiating by household size) is undoubtedly a much better proxy for water use, so one would expect much the same impact as in metering. If it were adopted as an interim arrangement, one would expect most of the impact to come at that stage rather than from the subsequent move to metering. Administratively, the easiest basis for such a charge would be the community charge register, if the utilities were allowed to use it. However, since the community charge will fall only on adults, it is not a true measure of total household size and would not eliminate the existing subsidy to families with children at the expense of those without. So those advantaged by the change would be one-adult households (with or without children). It is therefore possible that a large one-parent family might gain under a community charge system, but lose if metering subsequently came in. A water charge based on total numbers of household residents including children would be a much better proxy for consumption, but the water companies would probably be deterred from this approach by the costs of setting up and maintaining such a register.

(b) (differentiating by floor area) looks like a close substitute for Rateable Values. It is probably too crude to be chosen, as well as difficult to establish and to police. If it were chosen, however, one would expect much less redistribution than would be caused by metering, and a correspondingly larger effect in any subsequent change to metering. It could disadvantage households in large but dilapidated properties with low Rateable Values.

(c) (differentiating by number of water using appliances) is probably a slightly better proxy

CONFIDENTIAL

for consumption than Rateable Values though still very crude. One would expect any subsequent change to metering to result in further significant changes. There could also be swings and roundabouts, but probably small, and not affecting any specifically identifiable class of consumers. Again, it would be costly to police, and might require intrusive powers of entry to be given to the utility companies.

(d) (a flat rate per household) is clearly regressive compared with the present system, since it makes no attempt to tailor the charge to level of consumption. It would benefit those in high Rateable Value properties at the expense of those in low Rateable Value properties. Subsequent metering would almost certainly undo these effects, on top of righting the present subsidy from small to large households.

Social Security

15. At present, around 2½ to 2¾ million people get help with water charges through supplementary benefit (SB). At present SB recipients' actual water charges are met separately. But from next year water charges will be subsumed in the general level of support. Any adverse distributional consequences of metering would therefore have to be absorbed by claimants. Conversely, they would keep any benefits. We would not expect increased metering (or other changes to charges) to change the RPI significantly, even if the capital costs of metering were met by significant increases in charges. Each one per cent on charges increases RPI by only 0.007 per cent.

B. QUANTITATIVE EVIDENCE

16. It is not possible to model the effects of a general move to metering in advance of data from trials. But illustrative modelling work has been done in DOE on the effect of a move to a community charge basis. This suggests that the effect of such a move, for over 90 per cent of

CONFIDENTIAL

households, could, at the present level of water charges, could be anywhere between 0 and 100 pence per week for over 90 per cent of households. At the top end of the range this could mean increases of over 50 per cent (60 per cent for the Authority with the lowest charges) on the annual bill (ie, £52 on top of the present average of £99 pa). The effects on some individuals would, of course, be larger. It should also be borne in mind that if charges continue to increase in real terms, the effects in cash terms would be larger (though not in percentage terms, unless higher charges had a more significant effect on consumption than previous research would lead us to expect).

17. Numbers of households gaining and losing would probably be very broadly matched, though it is impossible to be certain of this. Since it is the households with many adults which will tend to lose, however, the proportion of adults losing would be larger than the proportion of households losing. The modelling work suggests individual losers might outnumber gainers by 60 to 40 or more. Over 20 million adults could lose.

18. These results need to be treated with caution. In practice, the effects would be more complex than crude illustrations can suggest. Each privatised company will be free to introduce its own tariff structures for metering (including standing/minimum charges, peak pricing, seasonal rates, average charges rising with marginal use, etc) which could significantly affect the figures. Decisions by consumers could also have some impact (eg any effects of metering on consumers' demand for water, or under a non-metered regime, any increased opting into metering).

19. We have argued above (paragraph 14(a)) that the Community charge base would go a considerable way to eliminating the present cross-subsidies between consumers, though it still ignores children. This suggests that the effects of a move to metering could be of the same order, or even greater.

CONFIDENTIAL

20. However, it is clear that the redistributational effect could be mitigated (under both the community charge base and metering) if standing, or minimum, charges were adjusted upwards, or if tariffs offered cheaper marginal rates for large consumers. The privatised companies might be expected to take such considerations into account in deciding their charging policies.

C. CONCLUSIONS

21. Clearly, the privatised companies will need to look very carefully at the options, and at the results of the large-scale metering trials once they become available from around the end of 1990. Their choices of charging basis and tariff structure will remain very politically sensitive, both locally and nationally.

22. At the national level, the picture will be confused. Some authorities will certainly proceed with metering, others may not. Those that do are likely to proceed at very different speeds. From end 1989 or early 1990, there will also be progressive privatisations, accompanied by the imposition of an RPI plus or minus x rule which may differ between the authorities. We would expect all this to be accompanied by diverging practices, and some innovation, in tariff setting.

23. Even locally, the picture will be confused since universal metering could take an authority up to 10 years to install, and some authorities may decide to meter only parts of their regions, or introduce other geographical variations in charging.

24. If any of the utilities decided on interim arrangements leading later on to full metering two changes of charging base could introduce swings and roundabouts for some individuals. But for others it would be likely to phase the correction of present cross-subsidies more gently than a single upheaval.

CONFIDENTIAL

25. If, for any reason, individual households are unfairly affected by some change in the charging basis (ie, their charges become less closely related to actual consumption than before), the right to opt for metering will continue to provide a means of redress, though the costs of installation will remain an obstacle.

PE2

20

CONFIDENTIAL

FROM: T TARKOWSKI
DATE: 21 October 1987

PS/CHIEF SECRETARY

cc PPS ✓
PS/FST
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Moore
Mr Hawtin
Mr Turnbull
Ms Peirson
Mrs Brown
Mr Potter
Mr Lyne
Mr Parr
Mr Sharp
Mr Tyrie
Mr Call

FUTURE OF WATER CHARGES AFTER THE ABOLITION OF DOMESTIC RATES

The Financial Secretary discussed my submission of 14 October with officials this afternoon, and approved the attached revision of the draft minute for you to send to the Prime Minister, which now spells out the nature of our concerns more fully than the earlier draft.

Tanwed Tarkowski
T TARKOWSKI

DRAFT MINUTE FROM: CHIEF SECRETARY

TO: PRIME MINISTER

FUTURE OF WATER CHARGES AFTER THE ABOLITION OF DOMESTIC RATES

I have seen Nicholas Ridley's recent minute to you, and Peter Walker's comments.

I am glad Nicholas has accepted my suggestion that we allow the water undertakers to continue to use domestic rateable values for 10 years.

I entirely agree that, to ensure successful flotations, we must be seen to leave the choice of a replacement for the present system to the commercial judgement of the water undertakers, in the light of the results emerging from the trials now planned.

In this connection, I have to say I am surprised to see that Welsh Water are prejudging the outcome of trials, and I think it most undesirable that they - or any other water authority - should take such a line in the public debate on metering which we must now expect.

x Looking ahead, we must plan for the possibility that, when we come to sales, some at least of the Authorities

may already be committed to metering plans, and will need to present and defend the associated expenditure in prospectuses. It would be damaging if others were at the same time advancing arguments which appeared to cast doubt generally on the sense of proceeding with metering. If any of the authorities decide against, they should as far as possible present their arguments, in terms of their particular circumstances and take care to avoid generalised claims which could call into question the strategies adopted by other authorities.

I appreciate that the Community Charge policy may oblige Welsh Water to take a decision sooner than the English authorities, though the problem of levying charges on new properties will, I assume, arise in England too, before long. I would very much hope that we could find a way to extend the period of grace before strategic choices have to be made.

If this really cannot be done, a decision by Welsh Water should be presented as a response to the specific problem faced by them, and not as reflecting on the value of metering trials or plans elsewhere.

The danger that the water authorities may appear to contradict one another's policies, and the consequent need for care, is a general one, which goes wider than the metering issue. We must clearly take steps

to ensure that the City's confidence in the judgement of the authorities is not put at risk unnecessarily. Ill-considered general statements risk damaging not one flotation but all of them. I trust the industry's Chairmen will be alerted to this risk.

If you feel a meeting is necessary I would be glad to take part.

I am copying his minute to Nicholas Ridley, Peter Walker, other members of E(LF) and Sir Robert Armstrong.

CONFIDENTIAL

1 Alex
2 PUP

C. P. S., F. S. T., Sir P. M. H. O. G. W. O. N.
 Mr. M. A. W. I. C. K., Mr. M. B. O. O. E., Mr. H. A. W. I. N.
 Mr. T. A. W. A. N. I., Miss P. A. R. S. O. N., Mrs. B. R. A. W. N.
 Mr. P. O. T. T. E. R., Mr. L. I. N. E., Mr. T. A. R. K. O. W. E. R.
 Mr. P. A. E. R., Mr. S. H. A. R. P., Mr. T. R. I. E.
 Mr. C. A. W.



FROM: CHIEF SECRETARY

DATE: 26 October 1987

PRIME MINISTER

FUTURE OF WATER CHARGES AFTER THE ABOLITION OF DOMESTIC RATES

I have seen Nicholas Ridley's recent minute to you, and Peter Walker's comments.

2 I am glad Nicholas has accepted my suggestion that we allow the water undertakers to continue to use domestic rateable values for 10 years.

3 I entirely agree that, to ensure successful flotations, we must be seen to leave the choice of a replacement for the present system to the commercial judgement of the water undertakers, in the light of the results emerging from the trials now planned.

4 In this connection, I have to say I am surprised to see that Welsh Water are prejudging the outcome of trials, and I think it most undesirable that they - or any other water authority - should take such a line in the public debate on metering which we must now expect.

5 Looking ahead, we must plan for the possibility that, when we come to sales, some at least of the Authorities may already be committed to metering plans, and will need to present and defend the associated expenditure in prospectuses. It would be damaging if others were at the same time advancing arguments which appeared to cast doubt generally on the sense of proceeding with metering. If any of the authorities decide against, they should as far as possible present their arguments, in terms of their particular circumstances and take care to avoid generalised claims which could call into question the strategies adopted by other authorities.

CONFIDENTIAL

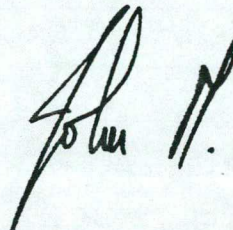
6 I appreciate that the Community Charge policy may oblige Welsh Water to take a decision sooner than the English authorities, though the problem of levying charges on new properties will, I assume, arise in England too, before long. I would very much hope that we could find a way to extend the period of grace before strategic choices have to be made.

7 If this really cannot be done, a decision by Welsh Water should be presented as a response to the specific problem faced by them, and not as reflecting on the value of metering trials or plans elsewhere.

8 The danger that the water authorities may appear to contradict one another's policies, and the consequent need for care, is a general one, which goes wider than the metering issue. We must clearly take steps to ensure that the City's confidence in the judgement of the authorities is not put at risk unnecessarily. Ill-considered general statements risk damaging not one flotation but all of them. I trust the industry's Chairmen will be alerted to this risk.

9 If you feel a meeting is necessary I would be glad to take part.

10 I am copying this minute to Nicholas Ridley, Peter Walker, other members of E(LF) and Sir Robert Armstrong.

A handwritten signature in black ink, appearing to read 'John Major', with a stylized flourish at the end.

JOHN MAJOR

CONFIDENTIAL

FROM: T TARKOWSKI
DATE: 29 October 1987

- 29
13
1. MRS BROWN
 2. CHIEF SECRETARY

cc Chancellor
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Moore
Mr Hawtin
Mr Turnbull
Mr Potter
Mr Instone
Mr Lyne
Mr Parr
Mr Fellgett
Mr Tyrie
Mr Call

E(LF) TUESDAY 3 NOVEMBER: FUTURE OF DOMESTIC WATER CHARGES

You are attending the E(LF) discussion on Tuesday on the future of water charges after domestic rates are abolished.

2. Mr Ridley's proposals are set out in his (undated) September minute to the Prime Minister. Peter Walker and you minuted in response on 6 October and 26 October respectively.

Treasury objectives

3. The main objectives are:

(i) to allow maximum freedom of choice to the water authorities in the choice of future domestic charging bases to replace rateable values; and

(ii) to allow them adequate time (a) to decide and (b) to implement their decisions on future bases for charging domestic water users, in the light of results emerging from metering trials from around the end of 1990.

Line to take

4. (i) Support Mr Ridley's proposals that:

CONFIDENTIAL

(a) the water authorities should be generally free to choose individually their own basis for charges; and

(b) to preserve maximum flexibility, the industry should be allowed to go on using the rate valuation list for 10 years. This will enable choices to be made after a proper consideration of the alternatives, and allow those authorities which choose compulsory metering to make the change at a sensible pace without running into a need for interim arrangements.

(ii) do not question Mr Ridley's proposal not to legislate to allow the industry to charge on the basis of the community charge registers. We see few attractions for the industry in adopting a politically contentious and administratively untested base, which would not even be a particularly close proxy for water consumption (numbers of children, which affects water consumption, are irrelevant for community charge purposes). Mr Ridley's reason for keeping water and the community charge separate is that basing water charges on it would only risk bringing the community charge into disrepute. In Scotland water charges will, however, be based on the Community charge, because water is a local authority responsibility there. So far as local Government finance is concerned we see no particular difficulty in basing water charges on the Community charge in England as well, but we see no advantage in this context in disputing Mr Ridley's judgement. For the average household, water charges of around £100 a year are roughly a fifth of the size of its Community charge bill.

(iii) urge the need for water authorities to avoid making generalised statements about commercial policy issues which might cut across what other authorities will want to do and will have to defend in detail in sale prospectuses. As vendors we cannot afford to let the authorities undermine one another's plans in the eyes of the investing public. In the case of metering, this

CONFIDENTIAL

means authorities should wait for the outcome of trials before making strategic decisions, each authority justifying its decisions by reference to its individual circumstances, and avoiding making generalised claims as far as possible. A short speaking note recapitulating the arguments in your minute to the Prime Minister is attached.

Other issues

5. There may be discussion of Peter Walker's claim that Welsh Water will need to move to a new charge base before metering trials are complete, because full rate valuations will not be made on new properties after 1990. We suggest you argue that a similar problem will also apply in England from 1990 and a way must be found to make the 10 year period of grace effective. One possible method would be to allow the WAS to assign a rateable value to new properties, for the purpose of levying a charge, and subject to appeal, for 10 years, but this would be seen as preserving rating.

6. This brief has been agreed with LG. The full background is set out in my submission of 14 October.

Tancred Tarkowski

T TARKOWSKI

SPEAKING NOTE

1. Important that, to ensure successful flotations, we must be seen to leave the choice of a replacement for the present system to the commercial judgement of the water undertakers, in the light of the results emerging from the trials now planned. Investors will need to see carefully reasoned charging strategies detailed in sale prospectuses if confidence in their prospects is to be maintained. Surprising therefore to see that Welsh Water appear to have pre-judged the outcome of metering trials. Most undesirable that they - or any other water authority - should take such a line in the public debate on metering which we can now expect.

2. Looking ahead, must bear in mind that, when we come to sales, some at least of the authorities may already be committed to metering plans, and will need to present and defend the heavy associated expenditure in prospectuses. It would be damaging if others were at the same time advancing arguments which appeared to cast doubt generally on the sense of proceeding with metering. If any of the authorities decide against, they should as far as possible present their arguments in terms of their particular circumstances and take care to avoid generalised claims which could call into question the strategies adopted by other authorities.

3. Point clearly applies generally to matters where the authorities may choose to adopt different policies. Must clearly take steps to ensure that the City's confidence in the judgement of the authorities is not put at risk unnecessarily. Ill-considered generalised statements risk damaging not one flotation but all of them. The industry's Chairmen should be alerted to such risks.