PREM 19/877

Part 5

MT

SECRET

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FUTURE OF POST OFFICE : FINANCES
INDUSTRIAL RELATIONS
POSTAL MONOPOLY
TELECOMMUNICATIONS POLICY

POST AND TELECOMUNICATIONS

Part 1: May 1979

Part 5: July 1982

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~28.7.82~~							
~~2.8.82~~							
~~4.8.82~~							
~~1.9.82~~							
~~6.9.82~~							
~~9.9.82~~							
~~10.9.82~~							
~~22.9.82~~							
~~22.9.82~~							
~~30.9.82~~							
~~1.10.82~~							
4.10.82							
~~18.10.82~~							
21.10.82							

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PART 5 ends:-

A. Walters to MCS of 21/10/82

PART 6 begins:-

RTA to PM (A09907) + att of 28/10/82

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(N1) (82) 21	22.7.82
E(N1) (82) 22	22.7.82
— " — ADDENDUM	23 7.82
E(N1) (82) 6th Mtg Min 1	26.7.82

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed RBonman Date 30 Oct 2012

PREM Records Team

PA CONFIDENTIAL POST AND TELECOM

cc Mr. Wolfson

MR. SCHOLAR

BRITISH TELECOM REGULATION

Yesterday I attended a meeting at DoI which was chaired by the Secretary of State, accompanied by the Minister of State and the Under Secretary. The purpose was to see how to proceed with both the drafting of the regulation component of the British Telecom Bill and what additional work needed to be done before the prospectus stage.

There has been a long and at times acrimonious debate between the civil servants and me. Basically the officials wanted to have a regulatory system based on the maximum rate of return. Under my probing they have changed that a bit, such that the maximum is not absolute, but the essentials of it remain.

I have been at pains throughout to point out that the maximum rate of return regulation is a proven failure. It is not merely that it results in very substantial waste, but it also requires enormous proliferation of bureaucracy, lawyers, economists, etc in order to police it. There is ample evidence of this in the United States and in other countries that have maximum rate of return controls. In the United States it is impossible to find anyone who will say a good word for such regulatory systems.

I proposed an alternative system which required virtually no bureaucracy, no monitoring of costs, no monitoring of prices, and which at the same time was designed to induce the Telecom firm to cut prices and expand output and operate at the lowest possible cost. My system was a combination of output subsidy and profits tax. The Ministers at the meeting said, to a man, that they found my scheme had great attractions. The civil servants, however, were unanimous in condemning it. They preferred the proven failure of the rate of return method to any new method of control. (This was in spite of the fact that their consultant, Michael Beesley, had compared my system with the rate of return system and come down firmly in favour of my mechanism.)

The Ministers, however, although acknowledging many of the arguments, avoided the defeatism of their civil servants. They saw there was a point in at least pressing on to see whether we couldn't do rather better than drift once more into the familiar failures.

Thus they have instructed their officials to allow in the Bill for the setting up of a system of regulation which I had suggested. They also agreed that much more work needed to be done on my alternative system and envisaged engaging a suitable consultant to develop the details of my scheme and examine the likely consequences of it.

I am pleased with this outcome, and readily agreed to it. It is as much as one could have wished.

21 October 1982

ALAN WALTERS

cc

3 pps

CONFIDENTIAL

Qa 06101

To: MICHAEL SCHOLAR 18 October 1982

From: JOHN SPARROW

Telecommunications Bill

1. I have seen a copy of Jonathan Spencer's letter of 13 October to you setting out Patrick Jenkin's views on the break up of BT into separate regional companies. The CPRS has also been considering the advantages of regionalisation more broadly in our study of the State Monopolies, and have had a meeting with David Young, as suggested by the Prime Minister (in your minute of 6 September).

2. Breaking up BT into independent operating units would involve the formation of a number of regional companies, and separate companies for the other activities - "long lines" trunk telecommunications, international telecommunications, research and development (Martlesham) and miscellaneous services (BT Enterprises). The regional and international operations would remain monopolies. Mercury would provide some competition to the trunk company. The other activities would operate in a more competitive environment, making it possible to compare their efficiency, though they would not actually be competing unless perhaps in limited areas at the margin.

3. The formation of independent regional companies with a local monopoly of telephone services seems to us to have a number of advantages:-

(a) it would be easier to manage because the units would be smaller;

(b) it should result in greater attention being given to consumers' interests and complaints than is likely with the large national organisation;

(c) this would facilitate comparison between the regions and, if performance measures are compared and the results highlighted, this should encourage competition between managers and greater consumer pressure for change;

CONFIDENTIAL

(d) the centralised control and single culture, which are typical of the national monopolies, would be removed, thus creating a climate in which individual regional innovation and initiatives could take place;

(e) if coupled with the introduction of franchising, whereby licences are granted to the local telephone companies for a fixed term, this should result in "competition for the field" even if "competition in the field" is not possible;

(f) it would facilitate regulation by the Office of Telecommunications because of the comparisons available, and would be less likely to result in "agency capture" because there would be more than one organisation being regulated;

(g) it would be likely to lead to regional wage bargaining and local productivity schemes, thus bringing pay more in line with local conditions;

(h) it could lead to a reduction of national union power and of the likelihood of national disputes and disruption;

(i) it would eliminate the present monopsony purchasing position, which has arguably made the telecommunications manufacturing industry less competitive internationally.

4. Sir George Jefferson is embarking on a programme of internal decentralisation which will bring benefits as outlined in the DOI note. This should have the advantages at (a) to (c) above. However, unless decentralisation is coupled with the creation of independent regional companies not under common ownership and control, it is unlikely that the benefits described in (d) to (i) above will materialise.

5. It has been suggested that breaking up BT into separate regional companies would damage consumer interests in rural and remote areas. Regionalisation might tend to cause telephone charges to fall in urban

areas and rise in rural areas; this is because tariffs would reflect more closely the cost of providing the services. At present hidden cross-subsidisation takes place between trunk and local calls and between urban and rural users so that the major users, typically the large businesses in urban areas, are discriminated against. Regionalisation would bring these issues out into the open, so that decisions to subsidise rural subscribers and social services could be taken with the financial implications made explicit.

6. The major disadvantage of regionalisation concerns the timing. BT is a highly centralised organisation. It will take some years before separate commercial relationships can develop between the regions and the other companies, and before separate accounting and costing systems can be introduced. There is the related problem of common facilities such as the same premises housing both local and trunk equipment. We do not dissent therefore from the DOI view that privatisation would be delayed for some time, possibly until 1988.

7. There may be further difficulties of the kind put forward by the Home Office over the licensing of Mercury. But the main decision for Ministers, given the present public commitment to privatising BT, is whether the prospect of delay outweighs the benefits that regionalisation could bring. If so, then we recommend that support and encouragement should be given to Sir George Jefferson's plans for a decentralised organisation, with increasing devolution to secure so far as possible the benefits of regionalisation. If we were starting now, my own preference would be to regionalise (and regulate) first, before privatisation - but I recognise that a lot of water has already gone under the bridge.

8. I am sending a copy of this minute to Sir Robert Armstrong.

JS.

cc Mr. Mount
Mr. Vereker

MR. SCHOLAR

BRITISH TELECOM

The letter from the Private Secretary at the Department of Industry of 13 October in answer to the Prime Minister's question about the possibility of having a number of local telephone companies instead of one national monopoly, pursued arguments which are, I think, false.

Breaking up BT would enhance true competition in telecommunications even though each local company would act as a local monopoly as in the case of America. The main point is that you can avoid a local monopoly by moving. To avoid a national monopoly, however, you have to flee the country. There is much less monopoly in a local than a national organisation.

Secondly, as is well known from American experience, the local monopoly is subject much more to local control. An individual consumer can have very little effect on a national British Telecoms, but he may well have much more influence on his local telephone company. That must respond to local needs and local demands and be subject to a local censure.

Thirdly, local companies would have both incentives and opportunities to innovate and try new techniques. Such new innovations may very well be adapted to local circumstances. We know, however, from experience that national organisations, even though subject to considerable competition like British Rail for example, tend to standardise and not innovate. (The British Railway sandwich, for example, is the same unpalatable mess wherever you eat it.)

Fourthly, there would be standards of competition and comparison. British Telecom West Midlands could compare itself with British Telecom East Midlands. Any fall from competitive grace would be a stimulant to great local pressure - as happens at present in some other local monopolies.

Fifthly, I believe there is some evidence of diseconomies of scale in Telecoms. The largest size does not give rise to efficiency, but inefficiency, as bureaucracies become out of touch and coordination becomes more and more difficult.

/The letter of

The letter of 13 October raises the bugaboo of increased charges for rural customers. This is the familiar bogey that is paraded to frighten away any suggestions of change. But the whole point of having any control mechanism, and certainly the control mechanisms which I have been concerned with, is to ensure that the local companies, just as the national company, would have an incentive to provide rural services at low prices. This is a matter which is very largely independent of whether one has a national or local company. It is certainly no argument for a national company as such.

I can well believe, however, that an attempt to break up BT might delay the flotation. This argument might well be correct. I have no evidence on which to make a judgement.

As a footnote, I would add that Hull apparently operates its own telephones under licence from British Telephone. They apparently have charges which are below those of BT. Perhaps there is a lesson in Hull.

Finally, there is a general point. This letter from the Department of Industry reflects still the underlying ethos of the merger mania, bigger is better, integrate and become more efficient, - views which were common and very influential some 10-20 years ago. But the Germans, Japanese and indeed the Americans have shown that size is no substitute for and often inimical to sense. It is worrying but perhaps understandable that the same ethos still persists in the Department.

14 October 1982

ALAN WALTERS

JH 62

Caroline
Pl set up meeting as soon as poss
1630 TUE 26 OCT. Cl. 24/10 1 hour.
M.

cc JV.

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
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Secretary of State for Industry

13 October 1982

(1)

Prime Minister

Please see John Sparrow's and Alan Walters' notes (attached).

The main remaining issue is whether regionalisation would delay privatisation and if so if this is to be borne.

A meeting

Michael Scholar Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1A 0AA

Dear Michael,

Thank you for your letter of 9 September recording the Prime Minister's questions about the scope for breaking up British Telecommunications (BT) into a series of separate regional companies and the impact of the proposed flotation. I enclose a note.

2 My Secretary of State has considered this question carefully. He can see some advantages from breaking up BT into separate companies with separate tariffs and separate published results; this might for example put pressure on local managements to meet special local needs and to attempt to emulate or surpass the performance of other local companies. He thinks, however, that breaking up BT would do nothing to enhance true competition in telecommunications - each local company would continue to be a local monopoly as is the case in America - and could lead to significant increases in telephone bills in rural areas and those areas where Mercury is unlikely to provide competition to BT. He also believes that any attempt to break up BT would delay the flotation and policitise the telecommunications industry to an undesirable extent.

3 In his statement to the House on ~~19~~ Pt 4 July, my Secretary of State announced publicly that the Government intends to privatise BT as a single unit, and the legislation based on this approach is now nearly ready for introduction early in the forthcoming session.

4 I am copying this letter and attachment to John Halliday (Home Office), Margaret O'Mara (Treasury), Richard Hatfield (Cabinet Office) and Gerry Spence (CPRS).

Yours sincerely,
Jonathan Spencer

J P SPENCER
Private Secretary

✓ Mr Jenkin
✓ Mr K Baker
✓ Chancellor
✓ Mr Sparrow
✓ Alan Walters ?

Yes MT

MCS 20/10

THE SCOPE FOR BREAKING UP BRITISH TELECOMMUNICATIONS IN THE LIGHT OF AMERICAN EXPERIENCE

Summary

a) Although there are over 1,600 regional and local telephone companies in the United States, there is no competition between them except in one small area. This state of affairs will not be changed by the Bell antitrust case.

b) Breaking up BT into separate regional companies would damage consumer interests, particularly in rural and remote areas, but there might be some benefits from "emulation" effects.

c) Breaking up BT would be complicated because the network is integrated, (unlike the position in America) but BT is taking internal steps to secure localisation of decision-taking.

d) Breaking up BT into separate companies could not be accomplished for many years, thus delaying flotation, and inclusion in the Telecommunications Bill of a power to break up BT after flotation would create so much uncertainty that flotation would be impossible.

e) Nevertheless, powers will exist under the Fair Trading Act which could be used to break up BT into regional companies if the Government's policies do not work as planned.

American Experience

2 There are over 1,600 regional and local telephone companies in the United States. The largest is American Telephone and Telegraph (ATT or Bell), which controls a number of major regional companies.

General Telephone and Electronics (GTE) and the Continental system both control a smaller number of regional companies. There is also a host of small companies, some of which are active only in individual municipalities. The total number of companies is misleading since the bigger regional companies tend to own separately incorporated subsidiaries in different States; thus the Chesapeake and Potomac company, a regional company in the Bell system, has separate subsidiaries in Washington DC, Virginia and Maryland. Bell also controls the major "long lines" company which links the local and regional companies together.

3 The regional and local companies do not compete with each other; each commands a local monopoly of telephone services in its own area and there is only one case (see below) where there is competition to supply local telephone services. Consequently it is misleading to think in terms of there being "competitive" regional companies in the United States. There is a limited measure of competition in the provision of "long lines" since a small number of companies supply long distance circuits in competition with Bell. One of these long line companies, MCI, has started to supply local telephone services (in the Denver area) in competition with the local monopoly company but only on a small scale. ATT and GTE between them dominate over 90% of the US telephone systems market.

4 The existing arrangement of a number of regional monopoly telephone companies and a dominant "long lines"

company will not be altered by the outcome (whatever that may eventually be) of the antitrust action which is intended to require Bell to divest itself of its regional telephone companies. Each regional company will have the same local monopoly status as before.

Differences Between Britain and America

5 The Department thinks that attention must be paid to the differences between this country and the United States. Here the early local telephone companies gradually evolved under market forces into a nationwide company before being taken over by the Government early this century. America has retained its regional and local companies largely for economic and geographical reasons including the number of genuinely distinct commercial centres and the immense distances between them. The American Federal structure and regulatory environment has meant that the separate companies which evolved in most States were kept distinct from each other and were not permitted to merge as happened in this country. Many of the separate US companies grouped together under the Bell umbrella have been forced to retain separate corporate structures, separate managements and a large measure of separate identity. Consequently it is relatively easy to break up Bell into completely separate local companies but even so the legal and accounting details have already taken some years and look like taking several more.

6 By contrast, the BT system, like most other systems in the world, is a single integrated whole reflecting its history as a centralised Government Department. It has centralised management, centralised purchasing, centralised research etc. BT's local and long distance operations are tightly integrated so that for example a single rack in a telephone exchange may contain equipment handling both local telephone calls and trunk calls. Consequently breaking up BT would be complex; it would be necessary to identify for example which equipment "belongs" to the local company and which to the "long lines" company and the process would take some time; at the end of the day a break up of BT might result in different companies owning different bits of the same building. Whatever solution was adopted the process of separation would take a long time. For example, the separation of BT from the Post Office took a good deal of time even though the postal and telephone business were run separately for some time before separation took place.

Impact on Consumers

7 Against this background the Department does not believe that breaking up British Telecommunications (BT) into a number of regional companies would of itself provide customers with a choice of telephone company; they would still have to go to the local mini-BT to obtain all their telephone services (except in the limited geographical areas where Mercury will operate). Customers in some regions might suffer

positive disadvantages from a break up; different regions generate different amounts of trunk and international calls both of which subsidise local calls. London is the most profitable area and BT's profits there help subsidise the regions and rural areas. So breaking away, say, Scotland from BT could result in Scottish subscribers paying substantially more for telephone calls. The regions which might suffer from BT being broken up are precisely the areas where Mercury (which will aim at the business market) will find it unprofitable to establish operations for many years to come; so customers in areas disadvantaged by breaking up BT could not only suffer a significant increase in prices but would also have little prospect of benefitting from competition.

8 Customers might benefit from a break up of BT only if the "emulation" effects outweighed these disadvantages. Creation of separate regional companies would foster a sense of local identity; management and local staff might set out to make local improvements in service that were frustrated within the present monolithic organisation. This in turn might cause the company in one area to seek to emulate the performance achieved in another area. Consumers might perceive differences in service between areas and press for local improvements in their own area. In management terms, separate local companies could provide an objective yardstick to measure differences of performance. It is highly unlikely that these emulation effects would offset the disadvantages to consumers; emulation effects are already present in

the United States and there is evidence (which is not widely publicised) that many of the smaller companies provide an indifferent service, having been slow to install dialling facilities or to replace out of date equipment. Moreover, it is not necessary to break up BT to secure beneficial emulation effects; these can be secured by internal action.

Internal Decentralisation As An Alternative To Breaking Up BT

9 Whereas breaking up BT into separate companies would be slow, complex and unlikely to promote competition, considerable advantages could be obtained from decentralising decision taking within BT. This could give local managements greater scope for initiative, greater flexibility and a better means of assessing the costs and efficiency of the service they provide than is possible under the present arrangements. The "emulation" effects discussed above would be facilitated. The creation of separate profit centres within BT and the devolution of decision taking to them, if done properly, should improve efficiency, and make the organisation more responsive to customer needs.

10 Largely on his own initiative but also spurred on by liberalisation, Sir George Jefferson has started on the process of introducing devolved management and accounting arrangements within BT. He has been in office for only a short period and has had to introduce the new internal structure virtually from

scratch. BT is therefore in the midst of moving towards a local management structure which should, when it is in place, create a sense of local identity within BT, provide managers with many of the tools of successful management which are lacking in BT at present and ensure that "emulation" effects can occur.

Impact Of A Break Up On Privatisation

11 There is no doubt that any move towards a break up of BT would postpone flotation for many years. The essential problem is that the mechanics of hiving off companies are complex and inevitably take time even in well managed private sector companies. In the case of BT it would be necessary first to decide the overall structure of the successor companies, taking account in BT's case of long term national telecommunication and defence requirements. Second, it would be necessary to identify the assets and liabilities to be allocated to each company, which in BT's case is complicated by the fact that Sir George Jefferson found no asset registers on his arrival. Third, it would be necessary to establish the necessary legal arrangements for the transfer. These measures could not be completed for many years.

12 If it were wished to break up BT before the flotation (which would then be of several separate companies), the flotation would be delayed, probably

until around 1988 to permit the creation of several successor companies and the transfer of assets between them. To secure such a break up it would be necessary to include compulsory powers to achieve this in the Telecommunications Bill. This would add greatly to its complexity and it is already long and complicated. Such a provision would also stir up controversy; both the BT management (whose goodwill is essential to the success of privatisation) and the BT unions (who have scope for inflicting serious industrial damage) would resist the Bill and we would run the risk of making the telephone system, which is an essential national service, into a political football like the steel industry.

13 The alternative to flotation after breaking up BT would be to float BT as a single entity and to take formal powers to break it up at some future date. The Department considers that such a step would jeopardise the flotation. Investors will need to be confident about the company they are buying and this means a stable outlook, particularly when the concept of a privatised telecommunications company is itself novel. The introduction of a power to break up BT would undermine confidence and stability. At its simplest BT's profits and hence its ability to pay a dividend depend on its long line and international businesses which generate sufficient profits to fund the local services which make a loss at present: investors will not want to take up shares in an integrated profitable company like BT if the Government could convert their shares at some unspecified future date into shares in a series of local, unprofitable

companies. The problem of adding to the complexity and controversiality of the Telecommunications Bill would remain.

Possible Break Up of BT In The Future

14 These objections apply to the inclusion of a power to break up BT in the Bill. The Department does not, however, rule out breaking up BT for all time. The Department believes that the combination of liberalisation, competition from Mercury, decentralised accounting and management within BT, and the market disciplines arising from private ownership will transform BT's performance. It will take a few years to test this. If, however, towards the end of the decade BT plc remains a sluggish, inefficient monopolist, the Government will retain the option of asking the MMC whether BT's monopoly operates in the public interest. If the MMC considered that it did not operate in the public interest the Government would then have order making powers which might be used to require BT plc to sell off regional companies. This option is available in the case of any monopoly company. Moreover, action to break up BT at the end of the decade would be much easier than now because Sir George Jefferson's new decentralised management structure, which by then would be in place and operating, should have brought about a substantial degree of regionalisation.

T2
DEPARTMENT OF INDUSTRY
11 October 1982

JV

Prime Minister (2)

MCS 4/10

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

4 October 1982

Kenneth Baker Esq., MP.
Minister of State for Industry and
Information Technology

Dear Kenneth

SYSTEM X

Thank you for sending me a copy of your minute of 29 September to the Prime Minister reporting on BT's latest proposals. My office earlier indicated that I did not wish to raise objection. But I thought I should let you have a somewhat fuller response.

I agree that the proposals represent in outline a considerable improvement both on present arangements and on earlier proposals for change. In particular, there should be considerable advantage in concentrating responsibility for design in the hands of one company (with BT taking a much less influential role) and in genuine competition between Plessey and GEC at the manufacturing stage. I accept that the consequences for STC are unfortunate but, given the need for change, I do not see how something of this kind could have been avoided. Moreover BT's intention to give STC the lion's share of the remaining work on TXE 4 exchanges give the company a reasonable breathing-space in which to adjust to the new situation.

Everything will depend on how the parties operate the new arrangements. It is essential that the pressures on the companies to reduce the cost of System X to competitive levels should work effectively. The procedure whereby Plessey share information on design with GEC with whom they subsequently compete for orders is a somewhat uncomfortable one. It would be all too easy for the two companies to lapse into a cosy or even collusive relationship. This is something that will need to be very carefully watched. I am glad that George Jefferson seems determined to use the threat of foreign procurement as a means for keeping both companies on their toes. It will also help if you make clear that export or development assistance will depend on the Government being satisfied that System X is an essentially competitive product which the companies are fully committed to marketing.

In the longer term I would hope that the new arrangements will lead to progressively lower procurement and operating costs for BT as System X is produced under conditions of greater competitiveness and as the costly TXE 4 acquisitions are phased out rapidly. This is something which we should certainly want to explore in the context of BT's next Corporate Plan.

I am copying this letter to the Prime Minister and to Sir Robert Armstrong.

GEOFFREY HOWE

RESTRICTED

MR SCHOLAR

FUTURE OF BRIT TEL

10 DOWNING STREET

Mr. M.S. Bradbury,
Department of Industry,
Ashdown House,
123 Victoria Street,
London, SW1.

1 October 1982

Dear Mr Bradbury

BRITISH TELECOM: FUTURE REGULATORY FRAMEWORK

I have now read the report of the Department of Industry chaired Working Group on rate of return regulations and you may wish to be aware of my comments in the attached note, which I am copying to Mr. R.H.F. Croft.

Yours sincerely

Alan Walters

ALAN WALTERS

RESTRICTED

1 October 1982

NOTE ON THE REPORT OF THE DEPARTMENT OF INDUSTRY GROUP ON RATE OF RETURN REGULATION IN TELECOMMUNICATIONS

The report suggests that the BT licence would specify the overall maximum rate of return on capital employed. Furthermore, each business, local, trunk and international, would have a separately specified rate of return. However, by an investigative process, presumably by the DGT, BT management is to be provided some incentive to improve internal efficiency by having the limit on profitability raised in any year in return for "demonstrated improvements made in that year".

A number of points emerge from this paper:

a. Except for vague talk about "flexibility" DoI has not met the powerful criticism that marginal tax rates of 100% are deadly; they are the stuff that Socialists are made of.

b. The DoI system will require a large bureaucracy, comparable to those doing similar jobs in the United States, and will benefit mainly the accountants, economists and lawyers. It would require frequent monitoring of costs, efficiency, and it would also need an allocation of joint costs - which in most cases would have no substantive basis at all.

c. It would be impossible to formulate the DoI conditions in an issue document for BT stock. No-one would know how they would work out or what the conditions would be. There would be immense uncertainty and this must affect the success of the placements or sales of the stock.

I am surprised by the argument, and it seems to be the only argument, that is put against my suggested sliding scale in ANNEX III. It is argued there that my scheme is a "fair weather" one and that if demand does not, in a particular year, increase as much as the average, then there will be deleterious effects on retained profits

/and cash flow.

and cash flow. The argument mixes up a reduction in demand with a reduction in output. The whole point of my scheme is to encourage the Telecom Company to slash prices and expand output when demand falls. Only by these means will they defend their post tax profits. Indeed, it is conceivable that, with the high elasticity of demand which we know exists in certain markets (long distance leisure calls), on a fall in the demand there may well be such an incentive to reduce prices that output of telephone calls actually increases! And this is just what we want - expand in a slump.

The alternative model, seemingly embraced by DoI, is the traditional one of a public monopoly - I suppose British Rail is the current example, but the electricity supply industry is also very close to their model. As demand has fallen relative to expectation, these industries have to put up their real prices in order to attempt to maintain their revenues. I do not think that this is a model we ought to follow.

The DoI also objects to the fact that the weights in the output index would be fixed and there would be little incentive to "diversify into new products". This would, of course, occur if you were silly in fixing the output weights in an inappropriate way. But you are perfectly free to fix them in any way that you believe is appropriate. For example, you could weight local calls more heavily, relative to their gross revenue, and international calls. Similarly, you could put in a large weight for business that you thought it would be advantageous to expand. This objection, therefore, seems to me rather pedestrian and unimaginative.

I do not regard the MMC as either a known quantity or a reliable regulator. There is no track record of them regulating an industry like BT, and where MMC have reported in areas only a short distance removed from their normal sphere of activity, the judgements have been properly and justly criticised. (Examples are the House of Fraser and the Royal Bank of Scotland references).

/CONCLUSION

CONCLUSION

The DoI Group has not produced an adequate report on the various options available. It seems to be trying to find its way to some sort of means of compromise and conventional wisdom. The conclusions lack the required degree of incisiveness, cogent argument and analytical soundness. I find it difficult to recommend support of these conclusions.

1 October 1982

ALAN WALTERS

Post & Telecomms
2 pps
cc. JV.

CONFIDENTIAL

JU816

Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
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1 October 1982

J Sparrow Esq
Central Policy Review Staff
70 Whitehall
London SW1A 2AS

Prime Minister (2)

MCS 1/10

Dear Mr Sparrow,

POSSIBLE PRIVATE SECTOR FUNDING FOR AND PRIVATISATION OF THE POST OFFICE

My Private Secretary's letter of 20 September about objectives for nationalised industries I deliberately did not mention a further study that my Department proposes to undertake. My officials have already talked very briefly to the CPRS and Treasury officials about an exercise to examine the extent to which private sector funding might be introduced into the Post Office and the extent to which privatisation may be possible. Mr Dearing has expressed a readiness to assist in such a study, but understandably he does not want options and possibilities to be the subject of general discussion at the formative stage. It is for this reason that I am now writing separately to advise you of this study.

2 Officials in my Space and Post Office Division will shortly be in touch again with the CPRS and the Treasury.

3 Copies of this letter go to the Prime Minister and the Chancellor of the Exchequer.

Yours sincerely,
Jonathan Spencer

pp PATRICK JENKIN

(Approved by the Secretary of State and signed in his absence)

4B

SECRET

PA
Res 10/12

Prime Minister (1)

Shall I thank* on your behalf Jeffrey Sterling and the others involved?

*notwithstanding the mistake which is the subject of Lord Cockfield's minute (attached)!

Yes please – but let us wait until the other matter is disposed of

SECRET

PRIME MINISTER

I am very glad to be able to report that following discussions this morning between Sir George Jefferson and Jeffrey Sterling, Sir Kenneth Corfield has agreed to the proposals for the future arrangements for System X production and marketing. The news of this whole operation will be released early next week.

This is an encouraging development which will I am convinced lead to a more efficient and competitive switching industry in the UK, accelerate the introduction of digital switching technology into Britain and improve prospects for sales abroad.

The placing of STC shares could proceed on the following Friday but STC is insistent that this placing should not be referred to by anyone until Friday, total secrecy is vital. This whole affair has been a team effort which Jeffrey Sterling has led very well indeed.

I am copying this to Geoffrey Howe, Arthur Cockfield and Sir Robert Armstrong.

K.B.

KENNETH BAKER
1 October 1982

M61/M61AAR

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

4A

cc JV

COPY NUMBER 2 OF 12 COPIES

Prime Minister

From the Secretary of State

An important omission

SECRET

MCS 1/10

Kenneth Baker Esq MP
Minister of State
for Industry and Information Technology
Department of Industry
Ashdown House
123 Victoria Street
London
SW1E 6RB

1 October 1982

Dear Kenneth,

RE: SYSTEM X REORGANISATION

You sent me, somewhat belatedly, your minute of 29 September to the Prime Minister, describing the proposals for re-allocating the development and supply of System X. There are two aspects on which I should comment.

with MCS

First, I am concerned that the arrangements produce a more effective export effort than we have seen to date. The companies, whose record in telecommunications is poor, really do need to be spurred into action and I hope that any decisions on future Government support will very much take this point into account.

Second, there is the separate, but crucial, competition policy aspect of the proposed arrangements. British Telecom are clearly aware that an agreement of the sort proposed will almost certainly be registrable under the Restrictive Trade Practices Act 1976. It could not be kept from the Restrictive Practices Court on the grounds that it was insignificant. But I would be prepared to consider an application for exemption under Section 29 of the Act - which has only once been used - on the grounds that it was of importance to the national economy. No doubt BT will have been advised by their lawyers that I can only make such an Order in respect of a proposed agreement and that the agreement would have to be laid before Parliament and made available for public inspection. If these conditions are not met, or the agreement does not fit the criteria in Section 29, there would be no alternative to the agreement being registered and defended before the Court. This is not a matter which is subject to Ministerial discretion. If the law bites, it goes into action and no-one can stop it. You may also want to remind BT that any announcement they make now should be couched in terms which do not themselves constitute a registrable agreement.

From the Secretary of State

SECRET

The competition rules of the Treaty of Rome also need to be borne in mind. The arrangements would probably be caught by Article 85(1) and the parties will want to consider notifying it to the Commission so that they can seek exemption under Article 85(3). I should not like to predict what attitude the Commission would take and this will need careful handling.

My officials are in touch with yours about how these matters should be handled. Meanwhile, you will want to remind BT that these competition issues have to be faced and that they should not prejudice them in anything which they may say at this or any later stage.

I am copying this letter to the Prime Minister, the Chancellor of the Exchequer, the Secretary of State for Industry and to Sir Robert Armstrong.

Yours,

Arthur

LORD COCKFIELD

Post & Telecoms, Post Office,
Pt 5

Telecom

FILE

da

SECRET

4

Copy No. 7 of 7 Copies

bc JV

10 DOWNING STREET

From the Private Secretary

30 September 1982

Dear Neil,

System X

The Prime Minister saw on her return last night from the Far East your Minister's minute of 29 September about System X.

She agrees that Government endorsement may be given to the arrangements which BT have reached with GEC and Plessey: and to their other proposals as set out by your Minister.

I am sending a copy of this letter to John Kerr (HM Treasury), Jonathan Spencer (Industry) and Richard Hatfield (Cabinet Office).

Yours sincerely,

Michael Scholar

Neil McMillan, Esq.,
Department of Industry.

SECRET

PM

de

Post etds

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 6401
SWITCHBOARD 01-212 7676

FROM THE
MINISTER OF STATE
FOR INDUSTRY AND
INFORMATION TECHNOLOGY

KENNETH BAKER'S OFFICE

NBPM
MCS 1/10

CONFIDENTIAL
COVERING SECRET

John Rhodes Esq
PS/Lord Cockfield
Department of Trade
1 Victoria Street
LONDON SW1

30 September 1982

Dear John,

SYSTEM X

I enclose a copy of the minute which Mr Baker sent to the Prime Minister last night.

NOTE — MCS

As I told you on the telephone, the Prime Minister has now indicated that she is content for BT and the two companies to be given the go-ahead to finalise their discussions.

I understand that officials in this Department were in contact with yours yesterday to seek urgent discussion of both the export and possible competition policy aspects of the proposed agreement between the companies. When these discussions are completed and both your Secretary of State and my Minister have received advice from officials on these aspects, Mr Baker would of course be at Lord Cockfield's disposal should he wish to meet.

I am copying this letter to Michael Scholar, Jonathan Spencer Margaret O'Mara and David Wright.

Yours ever,

Neil McMillan

N M McMILLAN

M59/M59ABW

Copy No...1....of 14 3

Prime Minister
Agree with 'X'
Duty Clerk
pp MCS.
29/9.

Agreed.
MT

SECRET

PRIME MINISTER

SYSTEM X

As Patrick Jenkin's minute of 15 September foreshadowed there have been significant developments and I am writing in Patrick's absence abroad to tell you of these.

BT have, subject to approval by the Government, reached an agreement with GEC and Plessey on the future arrangements for the development and manufacture of System X. This provides for Plessey to be appointed as the prime development contractor with procurement initially being divided between the GEC and Plessey and competitive tendering introduced progressively from 1983 and totally as from end-1985. In turn BT will withdraw from detailed participation in the development programme.

Jeffrey Sterling has played an important role in bringing the industry together with BT and has closely followed the discussions from which this solution has emerged. In his view it represents the best solution on which agreement can be reached and it provides many of the benefits which BT sought in their original proposal to rely solely on a single supplier. In particular a more competitive spur would result from:

(i) the very substantial penalty and bonus arrangements which the companies have accepted for the System X production and delivery programme; and

(ii) fixed price development contracts for the remainder of the existing BT-funded programme with subsequent enhancements of System X being funded entirely by GEC and Plessey.

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Jefferson's confidence in System X is high and when the revised arrangements are made public BT would announce their intention to place very substantial orders for System X. Nevertheless, retention of the freedom to adopt if necessary an alternative (and inevitably foreign) design has been very firmly insisted upon by the BT Board, in part as a counter to any non-competitive practices which might develop in a 'two- supplier, one customer' environment and more importantly, as an insurance against the technical and operational risks involved in BT's major digitalisation programme. I recognise these arguments and the very real possibility that BT during the next two years or so will wish to make at least limited purchases of overseas equipment. If such a situation should arise, Sir George has assured me that his Board would wish to consider how to achieve the maximum economic benefit to the UK.

As I see it the major problem for us to consider is that BT's proposed solution would lead to the immediate exclusion of STC from System X other than completion of its residual development work. However BT would propose to allocate STC a level of alternative business, mainly in existing TXE4a switching, which would in the short/medium term compensate them for the loss of System X business. Concentration of System X responsibility on GEC and Plessey would therefore leave STC's switching volume and profitability unaffected (or even possibly improved) until 1987. In the interim STC would need to build on its submarine cable strengths and its current move into the office automation area to generate new business to compensate for the loss of public switching. Failure to do this could, however, result in the eventual loss of up to five thousand jobs in Northern Ireland and at New Southgate.

We judge that in the shorter term, the new proposal would mean for STC improved prospects for employment in Northern Ireland (because of the increased TXE procurement) and some loss of jobs (5-600) primarily at New Southgate. Most of these however will be skilled engineers who should have good re-employment prospects either elsewhere in STC as it moves into new business or in other information technology companies.

STC is aware that alternative arrangements for System X are under consideration and the possibility of it having no future in this business is one which the company must have recognised.
Sir Kenneth Corfield however is not aware of this agreement reached by BT, GEC and Plessey and I would expect him, possibly with the ITT Chairman Mr Araskog (who is currently in Europe) to make strong remonstrations to the Government when this is made known to him. Sir Kenneth Corfield will undoubtedly argue that despite the additional business which will be offered him, exclusion from digital switching technology will seriously affect

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M12/M12AES

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STC's future technological capability. The logical consequence of the new technology inevitably however is driving the switching industry in the direction of concentration, as Arnold Weinstock now fully recognises, and STC's performance on System X development has undoubtedly been the weakest.

Jeffrey Sterling has pointed out that we need STC's acquiescence to the BT/GEC/Plessey proposal if the alternative arrangements are to be introduced without damage to the System X programme. Furthermore the proposal obviously affects STC's long term business prospects and ITT should be advised of it before a final decision is taken upon the sale of 40% of STC's shares (now proposed to be undertaken within the next week or so).

Sir George Jefferson has therefore asked to know whether the Government is prepared to support the proposals mentioned above so that he can make the position clear to STC. In view of the imminence of the proposed sale of shares he wishes to advise Sir Kenneth Corfield as soon as possible, preferably on the morning of Friday 1 October.

Whatever we do there must be job losses in this industry. These proposals, which have emerged from long discussions between BT and all three companies, would give STC five years of assured and profitable business with which to fund diversification of its business. In turn GEC, Plessey and BT have reached an arrangement of the kind which offers real prospects for a successful home and export System X business.

This situation has been brought about largely through Jeffrey Sterling's efforts and the constructive attitude of the other parties, and above all Arnold Weinstock's personal involvement which has led to much-needed changes in GEC Telecoms management.

X I believe we should give our agreement to these proposals and I should be glad to hear as soon as possible that you are content for me to give our go ahead to BT.

I am copying this to the Chancellor, Patrick Jenkin and to Sir Robert Armstrong. I should be grateful if this could be given the usual limited circulation.

I am sorry to trouble you with this so soon after your return.

K.B.

KB
29 September 1982

M12/M12AES

SECRET

British TELECOM

R29

Public Relations Department
2-12 Gresham Street
London
EC2V 7AG

A public affairs background briefing

BT file.

29/9.

PERFORMANCE IN PERSPECTIVE

Report & Accounts

British Telecom's first Report & Accounts as an independent corporation records a profit of £458 million for the 12 months to 31 March 1982. Every penny will go towards the £2,000 million annual investment now needed to modernise Britain's vital public telecommunications network, to improve services and to meet increased demand.

The 1981-82 turnover of £5,708 million reflected business growth of 5.6%. Improved productivity led to a 2.1% cut in real unit costs. Price increases were kept below the general rate of inflation.

Prices

With performance and financial prospects improving, main service price increases planned for 1 November have been deferred until at least next April.

"A Report to Customers"

This briefing seeks to put British Telecom's 1981-82 performance and prospects into perspective. More details can be found in "A Report to Customers", a companion document to the Report and Accounts (see page 7).

BRITISH TELECOM TODAY

The business is undergoing faster, more radical changes than at any time in the history of the telephone service. It has responded positively to changing market conditions and the challenge of competition.

It is meeting head-on all of today's complex challenges - seizing new business opportunities, rapidly expanding the range of products and services, reorganising to improve efficiency and cut costs, and applying the latest technology to create the multi-purpose telecommunications network essential to Britain's economic revival and future prosperity.

PROFITS

Telecom's 1981-82 profit of £458 million represented a margin of 8p in the £ on turnover - far from excessive by normal commercial expectations.

Commenting on this result, British Telecom's Chairman, Sir George Jefferson, has said:

> "A year ago the Government criticised us for failing to meet our profit target. This year we are pleased to have exceeded our target, despite tariff increases which averaged less than the general rate of inflation.
>
> The level of 1981-82 profits is broadly in line with that necessary to assure a sound trading position for the Corporation and makes a useful contribution towards financing the massive capital requirements for modernisation and growth, now running at £2 billion a year".

Even so, a £458 million profit represents only about one-fifth of Telecom's current annual investment programme.

WHERE PROFITS CAME FROM

Telecom's 1981-82 profits were achieved in a fast-changing environment. Three key elements contributed to the improved financial performance:

1 Efficiency

During the year the business's real unit costs were reduced by 2.1%.

2 Business Growth

Despite the forecast effects of the general economic recession, the volume of business handled grew by 5.6% over 1980-81 - a telling indication of the importance of telecommunications services and of the need for Telecom to prepare now for the eventual economic upturn.

3 Revenue

Telecom's turnover grew from £4,554 million in 1980-81 to £5,708 million in 1981-82, yet price increases introduced in November 1981 averaged less than the general rate of price inflation.

International services contributed £218 million of the overall profits. Inland telephone call business was profitable, but all other sectors of inland services - including business and residential rentals and public telephone kiosks - traded at a loss.

WHERE THE MONEY GOES

All Telecom profits are reinvested in the business for the benefit of its 4 million business and 14 million residential customers. In recent years the business has had to find at least 85% of total annual capital needs from its own resources - that is, from operating profits and depreciation provision. An annual investment programme of £2 billions, at current prices, is the minimum essential if Telecom is to catch up with the legacy of past under-investment and provide a modern total public communications network capable of aiding economic growth and meeting demand for new information technology-based services.

Telecom's 1981-82 investment included £700 million in new exchanges, £400 million in transmission equipment, £84 million in customer equipment and more than £60 million in international cables and equipment.

In his statement accompanying the Report and Accounts, the Chairman listed some of the 1981-82 achievements reflecting this investment. They included:

- four modern electronic exchanges opened every week and the first four digital System X exchanges brought into service

- the world's longest link using lightweight optical fibre glass cable, for voice, data and visual services, installed between London and Birmingham

- International direct dialling extended to all UK customers, giving them the best overseas service in the world

- an almost nationwide radiopaging service completed, plus an automatic car radiophone service in London

- nine new telephone models introduced, including a special handset for the disabled, and extension phones offered on sale as well as rental terms, with plug and socket installation for easier portability

- half a million new phone lines installed, with 72% of small business orders met within two weeks and 70% of residential orders within three weeks

- eight out of ten line faults put right inside one working day

- the waiting list for phones of two months or more through equipment and cable shortages cut from 122,000 to 20,000 - and now down to 13,000

PRICES

During 1981-82 Telecom cut the prices of many international and inland trunk calls over major routes by up to 33% - benefits worth more than £200 million in a full year to customers.

There is now more good news on prices for 1982-83. British Telecom has accepted the challenge of deferring main service price increases planned for 1 November 1982 until at least April 1983. This means that main service prices will have stayed unchanged for at least 17 months from November 1981.

The November 1982 price proposals would have added 3.3% overall to average bills - well below current general price inflation - but three significant developments since they were announced in early July have enabled Telecom to defer the entire package:

1. There have been continuing good results from the internal efficiency and cost-cutting drives

2. Interest rates have fallen rapidly, saving Telecom millions of pounds on loan repayments

3. The rate of inflation has fallen and the fall is forecast to continue

Another factor influencing the deferment decision was that Telecom would have operated the new prices for only four months of the current financial year - bringing in an estimated extra £45 million - with most of the revenue benefit coming in the full year 1983-84.

But Sir George Jefferson warned, in announcing the deferment, that looking forward to 1983-84 is subject to considerable uncertainty.

He said that charges for some services were still running well below actual costs, and that the maximum profit level recently suggested for Telecom by the Post Office Users' National Council would fall far short of meeting the Government's new 5½% real rate of return target set for the business.

HOW TELECOM PRICES COMPARE

This is British Telecom's current ranking among the seven largest world operators for typical single-line bills, using purchasing power parity currency conversions and indexing UK figures to 100:

Business		Residential	
Italy	132	West Germany	160
West Germany	123	France	148
France	115	Italy	134
UK	100	Japan	108
Japan	81	USA (New York)	108
USA (New York)	80	UK	100
Netherlands	61	Netherlands	88

Compared with the cost of most other everyday goods and services, British Telecom's prices have risen more slowly since 1970. The Telecom Tariff Index, adjusted for inflation, shows that Telecom prices have fallen in real purchasing power terms by 17½% since 1970.

THE FUTURE

The realities of competition require a rebalancing of some British Telecom prices to bring them into line with costs. Nevertheless, Telecom's aim is to keep prices down and further reduce the real cost to customers of its services, consistent with earning a proper level of return on capital.

"REPORT TO CUSTOMERS"

British Telcom's 1981-82 achievements and business objectives are explained and illustrated in more detail in "A Report to Customers", published as a companion to the Report and Accounts. It contains information on finance, prices and profits, service and performance, new technology and how customers can get the best out of Telecom's services. For a copy please write to British Telecom (Ref RTC), Room 110, 85 Watling Street, LONDON EC4M 9BN.

British Telecom Report and Accounts 1981-82 is available through Her Majesty's Stationery Office bookshops, price £1.50.

If you have any enquiries about this briefing please call:

Ivor Mills	on	01-357 3734
	or	
Peter Carver	on	01-357 3168

Press and Broadcasting enquiries should be made on 01-357 3814-9.

CONFIDENTIAL

Already pointed
this out to PM (PA)

MR. SCHOLAR

c. Mr. Mount

MCS 27/9

THE POST OFFICE

There is just one point in Mr. Jenkin's letter of 21 September to the Chancellor, enclosing the papers on the Post Office Corporate Plan and Performance Review, to which you may feel the Prime Minister's attention should be drawn (although I see no particular reason to trouble her with this on the way back from Delhi).

Mr. Jenkin points out in paragraphs 5 and 6 that the success of the Plan is heavily dependent on containing real wages, and that the Post Office assumes 6% for 1983/84. The papers he encloses shows that the wage bill is about 80% of the Post Office's total costs, so that Post Office costs, and therefore tariffs, are very sensitive to the wage assumption. If we are to achieve another step down in inflation, we must restrain nationalised industry tariff increases.

The Prime Minister may feel that you should write to Mr. Jenkin's office indicating that she would wish him to speak to Mr. Dearing in rather firmer terms than he proposes: Mr. Dearing was not particularly responsive to similar pressure earlier this year, but Mr. Jenkin could, for instance, point to the considerably improved prospects for inflation since the Corporate Plan was prepared, and to the Government's own intention of setting a pay factor well below 6%.

J.M.M. VEREKER

27 September 1982

CONFIDENTIAL

CONFIDENTIAL

cc for information
Mr Flesher
Sir Derek Rayner
Mr Cassels

NOTE FOR THE FILE

23/9

EFFICIENCY IN BRITISH TELECOM

1. Before I went on leave I had a visit from Mr V H B Macklen, CB (63), formerly a Deputy Secretary on the scientific side of MOD. He is personal adviser to the Chairman of BT, Sir George Jefferson, where his remit is on the efficiency side. The purpose of the meeting was to discuss matters of common interest.

2. Mr Macklen said that he had virtually no staff of his own but that he had a call on five people in BT and one outsider; the outsider appears to be Sir William Cook, formerly Chief Adviser (Projects and Research), MOD, although I may have got this wrong.

3. Mr Macklen said that implementing recommendations was a major problem. BT had a civil service system but worse. The organisation was more centralised than it had been when the Post Office was in Whitehall and "no redundancy" agreements with the trades unions were a great impediment. He felt that he was tackling large questions with few weapons.

4. BT is a huge organisation, employing some 0.25 million people. The HQ comprises 25,000 staff. So far Mr Macklen has looked at the Corporate Personnel Branch at HQ; it employs some 1,500 people, a number which he thinks can and should be reduced to 50 - 150.

5. The method of examination is to interview officers, asking what their functions are, what they do and what they should do under the new circumstances in prospect for BT. Other questions include what can be put outside, rather than being done in-house; the effect of the working relationships with HMSO and PSA; and the question whether Telephone Areas could be made cost or profit centres.

6. Mr Macklen said that his reports went to the Chairman and the Board Member responsible; the Board Member was allowed two months to get his ideas straight, after which decisions were taken. The review method had worked reasonably well in the Corporate Personnel Branch, but he thought that the pace of change required a more rapid response than BT could easily manage.

7. At HQ the main needs were to slim down the size of the organisation, which was huge; to define management responsibility much more clearly; and to obtain better managers. Throughout the organisation there seemed to be substantial grade-drift and he doubted whether the sort of changes needed could be managed without resort to early retirement.

8. Looking beyond HQ, Mr Macklen had in mind reviews of the Materials Division; the fleet of heavy good vehicles; and the cadre of network executives.

9. I provided Mr Macklen with a copy of the Notes of Guidance for scrutiny examining officers.* We agreed to remain in touch. We both thought that a half-day exchange of experience after the holiday period when Mr Macklen had got more review experience under his belt would be helpful. I offered to put Mr Phillips in touch with him in connection with his interests in both stores and transport economy.

CP

C PRIESTLEY
22 September 1982

* Also of the Management Guidelines for transport etc

JH 956

PA
PM Seen.

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

21 September 1982

The Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Prime Minister (2)

The Corporate Plan assumes a 6% earnings increase in 1983-84 (para 6).

MCS 23/9

Dear Geoffrey,

POST OFFICE (POSTAL BUSINESS) CORPORATE PLAN AND PERFORMANCE REVIEW

On 11 May, ENI(82)4th agreed that sponsor Ministers should submit an annual report to the Sub Committee based on industry's corporate plan, which would cover its performance and prospects and bring out strategic options. The Sub Committee agreed that industries' plans would best be discussed against the background of agreed objectives.

2 I therefore attach a review of the Post Office five year strategic plan and a performance review drawn up by officials of my Department. The plan is consistent with the objectives we have been developing for the Post Office, although these objectives have yet to be discussed with the Corporation.

The Strategic Plan

3 The 1981/82 Report and Accounts show that the Post Office begins the plan period in a sound financial position and the re-constituted Board has shown a readiness to act in a cost-conscious and commercial manner. I believe that the measures we took last year with respect to the postal monopoly, though modest in themselves, have done much to stimulate greater efficiency and a more commercial outlook. Volume generally in 1981/82 held up well, but the performance on parcels, an area where the Post Office is subject to strong competition, was especially good, with a volume increase of 7%.

4 Although the picture is in this respect generally encouraging, there are areas where I shall be looking for further improvement. First, there is quality of service, where even

allowing for the ASLEF disputes, performance in the last few months has been below target. I shall also expect to see a better performance against the new real unit cost objective than was recorded against the previous performance aim. Moreover, I believe there is scope for better management of the property estate. The Post Office has already set up a new estates executive, with a property consultant recruited from the private sector at its head, and I shall expect to see improvements in this area, although if there is to be progress the Post Office will have to be given a clear financial incentive to dispose of surplus assets in the context of the rules relating to external financing limits.

5 It is probably unrealistic to see the postal business in terms of strategic options, since the basic pattern is established, and the parameters within which the business should operate have been agreed by Ministers. The Corporation has, however, been asked to look at the sensitivities of the Plan, so that an indication can be gained of its robustness. The analysis demonstrates that the success of the plan is heavily dependent on maintaining volume and containing real wages. Failure to achieve adequate volume or to contain real wages will result in failure to achieve the real unit cost objective and lead to an increase in real tariffs. Some of the assumptions on volume in the plan may be on the optimistic side, although the financial and operating position established in 1981/82 should enable the Corporation to come through the plan period in reasonably good shape, provided that the drive to contain real unit costs can be maintained.

and tariffs if they are to maintain volume

6 Thus the key factor is wages, allied to productivity. The assumed earnings increase of 6% for 1983/84 represents a cut in real earnings against the 7% RPI assumption and the Post Office claims that it would not be inconsistent with a lower figure for rates. I am, however, making it clear to Mr Dearing that we will expect to see a lower figure - in the region of 4% or less - both for target and settlement when the negotiations take place.

7 As for productivity, this is improving, and the slide of the 1970s appears to have been reversed, with a marked turn round in Inner London, an area where in their report of April 1980 the Monopolies and Mergers Commission identified a number of serious shortcomings. (Officials have been monitoring closely the Post Office's compliance with the agreed plan of action to put these matters right.) I believe, however, that there is still room for further progress. The current productivity scheme covers only mails operations staff and although the Post Office is seeking to implement schemes in other areas, eg the counters. I

shall make clear to Mr Dearing that we will expect to see early progress in the extension of productivity schemes. In addition, I shall be pressing Mr Dearing to review the arrangements in areas already covered in order to implement provisions for sharing benefits more in favour of the business itself and its customers.

8 Our immediate task is to devise a strategy for the next eighteen months or so. I believe we should seek to build on the ground already gained as a result of the holding of prices from 1 February 1982 to at least 1 April 1983. Our priority should be to keep the next tariff increase to a minimum particularly on second class letter. This will mean looking very carefully at the relationship between tariffs, the investment programme, the new financial target and the external financing limit.

9 In the longer term the Post Office will face the challenge of new technology. The Board is already taking steps to introduce this into Post Office operations and there seem grounds to believe that the Post Office can meet the challenge of the new technology provided it can respond flexibly and imaginatively. But the impact of new methods of communications could be far reaching and I have accordingly arranged for a study of the impact of new technology on the Post Office to be undertaken jointly between my Department, the CPRS and the Post Office.

10 I am copying this letter and attachments to the Prime Minister, other members of E(NI), to Sir Robert Armstrong and to John Sparrow.

Yours ever

Patrick

THE POST OFFICE (POSTAL BUSINESS) CORPORATE PLAN 1982-83

The Post Office (postal business) Corporate Plan sets out the key aims and strategies of the Corporation and then looks at each of the main areas of the business.

Assumptions

i Targets agreed with Government

The plan assumes that the postal business will meet the targets which have been agreed with Government, namely:

(a) a financial target of 2% profit on turnover (this target ends in 1982/83; negotiations on a new target have begun);

(b) a performance aim of a reduction in real unit costs of 5% over the period 1982/83 to 1984/85, taking 1981/82 as the base; 2% of the reduction to take place in 1982/83;

(c) to operate within agreed external financing limits;

(d) to contain price rises within RPI.

The Plan assumes continuation of the quality of service targets for 1st and 2nd class mail, now formally agreed with the Government. (OR HoC Col 445 25.2.82) These are consistent with the objectives developed between the Department of Industry and CPRS.

ii Macro Economic Assumptions

The most important of the Post Office's macro economic assumptions relate to RPI; which is at 7% for 1983/84 - 1985/86.

iii Economic Assumptions for the Business

The most important assumptions here relate to average earnings per employee. The figures for 1983/84 over 1982/83 assume an

increase of 6% in average earnings per employee. This could, according to the Post Office mean rather less on rates - around 5% - due to some of the increase coming from productivity payments. Such increases would represent a further fall in real wages of postmen in 1983/84, but Ministers may consider that, particularly in later years, which assume constant or slightly increasing real wages, these assumptions need to be brought to the Chairman's attention as being on the high side.

iv Business Assumptions

The Post Office has also made certain assumptions about the trend of its business in key areas which are (figures relate to 1982/83 - 1986/87):-

(a) letter volume will grow about 5% overall; inland letter volume increasing by 4.5%, overseas by 17%;

(b) parcel volume will increase by about 20%;

(c) mail operations and total business productivity will grow by 8.5%;

(d) real prices for the business as a whole will fall by just over 3%, but real letter prices will be roughly constant;

(e) counter business volume will grow by 4%.

The Plan

In general terms the Post Office, given Ministers' decision on the monopoly at the recent review and their expressed policy of keeping an adequate sub post office network, has seen its role over the next five years as one of consolidation, with emphasis being laid on increasing letter and parcel volume, gaining new counter business, improving productivity, completing the letter mechanisation programme, most of the parcels mechanisation programme, and modernising its estate. Towards the end of the period, with the beginning of counter mechanisation the development of optical character reading in mail sorting, and increasing moves into electronic transmission of mail, the Corporation will begin to adopt more advanced technology in a significant way.

In the mails service, emphasis in the immediate future will be on increasing volume through a more commercially orientated marketing approach, including the development of new services - particularly premium services; completion of letter mechanisation; the establishment of a more efficient letter circulation network; and an examination of delivery patterns which could involve fundamental changes. Improvements in the productivity of mails operations staff, already well under way, will continue.

On the counters, the main thrust will be to secure adequate new business to replace that likely to be lost as a result of the changes in DHSS methods of paying social security benefits, together with essential improvements in productivity, where to date less has been achieved than in the mails operations area. These improvements should be assisted by the move away from a cost-plus system of charging for counter services to a new more commercially based system.

The Post Office has set up an estates executive with responsibility to maintain and enhance the value of the Post Office estate. A senior appointment from the private sector has just been made to head the executive. The new executive, which is introducing a much greater awareness of property values into the Corporation, should result in greater cost effectiveness in the Post Office's use of its property resources.

In total, the continuing drive to reduce overtime through increased productivity, based on a greater emphasis on payment geared to effort, will reduce man-equivalents by some 5%. over the five year period. Actual numbers employed will to some extent be determined by externally imposed obligations - for example the growth in new addresses through building of new housing estates with lower population densities.

Sensitivities

Unlike a manufacturing concern, where there are possible alternative strategies, over the next five years the course of the postal business is largely fixed, and the main alternatives are matters of degree rather than kind. Officials have therefore asked the Post Office to provide a range of sensitivies on key assumptions, including RPI; productivity; volume for letters and parcels; and real earnings, in order to try to get an idea of the robustness of the plan should the assumptions on which it is based not be fulfilled. The assumptions on growth in letter and parcel volume over the period certainly appear to be at the upper end of the range of likely outturns although the most recent volume returns are encouraging.

The Post Office's sensitivity analysis examined the effects of changes in volume, productivity, real earnings and RPI on the real price of letters and on real unit costs. It was assumed that profits and external financing requirements would not be affected, as any shortfall/surplus arising from changes in the variables would be met by adjustments in tariffs.

The sensitivity analysis shows the crucial importance of volume and real earnings.

(i) Volume

If there is no increase in volume over the period of the plan and other variables are unchanged, the Post Office will fail to meet its real unit cost objective, although real unit costs would be reduced compared to 1981/82. Real prices of letters between 1981/82 and 1986/87 would also be roughly constant, rather than falling by some 3%.

(ii) Real Earnings

The other crucial factor is real earnings. A change of 1% p.a. cumulative in real earnings could after the change in real unit costs be almost 1% p.a. if other variables are constant, as wages are 80% or so of total costs. There would be a similar effect on real letter prices.

(iii) RPI

In contrast to the significant effects of changes in assumptions relating to real earnings and volume, changes in RPI have less effect on the achievement of the real unit cost objective, or on real letter prices. If, however, the changes in RPI were combined with changes in real earnings, which as RPI moves down tend to move upward, the effect on prices and real unit costs might be greater. The forecasts of lower RPI are therefore likely to make it more difficult to achieve the real unit cost target, and to contain real earnings, which in turn could affect real tariffs.

(iv) Productivity

Changes in productivity have little effect on real unit costs, and do not greatly affect real letter prices.

Productivity changes have so little effect on real unit costs, and to a lesser degree on prices, because at present the scheme only applies to mails operations. Thus non mails operations costs and non-labour costs are not affected. In addition, the sharing of productivity gains is currently slanted towards the workforce (70:30 direct, 55:45 if overheads are taken into account). The Post Office regarded this scheme as an essential first step in order to get its workers to accept the concept, but will need to look for a more even sharing arrangement when the arrangements come to be renegotiated.

The Post Office is increasing the scope of productivity schemes within the business and is currently involved in a major O&M review of counters by outside consultants. As a result of this it is intended to develop a new scheme for counters. The Chairman also intends to seek the advice of management consultants on the possibilities for relating the pay of senior white-collar staff to their performance.

Discussion of the Plan

After a discussion of the assumptions on which the plan was based, and particularly the pay assumption for 1983/84, discussion of the plan concentrated largely on investment appraisal and in particular consideration of the Post Office's proposal for letter and parcel mechanisation and development in counter automation. Officials have made clear that any increased bids for capital investment will need to be accompanied by a demonstration that they have been thoroughly appraised and satisfy the appropriate criteria. Much of the Post Office's investment, some 75%, is in system related areas, which are investments required to keep the system going and include substantial refurbishing of what is at present a run-down estate. Officials are currently discussing with the Post Office the way in which such investment is appraised. On parcel mechanisation the Post Office has explained that each office is appraised separately against an 8% TDR and unlike letter mechanisation, the system is not evaluated as a whole. Of the thirteen projects in the £41m parcel mechanisation plan, seven had been appraised. Since the lead time for completing a parcels concentrateion office was 12-18 months, and the programme is a five year one, it seems reasonable that not all individual projects should have yet been appraised in detail.

On letter mechanisation, officials have asked for an updated evaluation of the project, indicating in particular the assumptions on which the appraisal is based, and the sensitivity of the appraisal to changes in those assumptions. This appraisal will be submitted shortly.

Counter mechanisation is still at the trial stage, and the earliest expenditure of any significance is scheduled for 1984/85. The Post Office is thus at present not in a position to appraise expenditure in this area.

Invesment Bids

The 1983/84, and 1984/85, bids for investment in fixed assets and for external finance are well in excess of those in the 1981/82 White Paper. For 1983/84 the additional bid compared to the White Paper baseline is £90m, the bulk of which (£73m) is in the form of an increased bid for capital investment, the remainder is in the form of lower internal resources. For 1984/85 the additional bid for external finance is £69m, of which £61m is in the form of an increased bid for capital investment. (The Treasury has taken as the baseline the White Paper less £13m to reflect the reduction in the National Insurance Surcharge, but the DoI has taken the view that the baseline should remain at the White Paper level, except in 1982/83, since for the later years the reduction in the NIS would be offset by lower tariffs).

The Post Office has been asked for a breakdown of the additional investment and a justification for the additional bids as compared to the White Paper.

Conclusions

Some of the business assumptions on which the plan is based appear to be optimistic, and the sensitivity analysis undertaken by the Post Office indicates that these assumptions are central to achieving the aims set out in the plan. Similarly the analysis of variations in the assumptions on earnings, RPI, and productivity, shows that although none of these variables will affect external financing requirements, changes in real earnings would affect the Post Office's ability to meet its real unit cost objective and to hold its real tariffs.

However, the general financial situation from which the Business starts the Plan period is sound. Provided the Business is able to continue to reduce real unit costs (particularly through keeping a grip on earnings) and to keep tariff increases to a bare minimum in order to encourage volume growth the medium term outlook appears satisfactory.

Department of Industry

21 September 1982

POST OFFICE POSTAL BUSINESS PERFORMANCE REVIEW

1. Attached as Annexes 1 to 13 are tables giving information on the Post Office's performance. It is proposed to consider the information under the following items:

a. Performance against Financial Target (Annexes 1 and 2)

Performance against target (2% on turnover) has been generally satisfactory except in 1980/81 when the outturn was affected by delays in approving the tariff increase and a reduction in the level of increase sought. This year's estimated outturn is 3.1%. The excess on target is due to a number of factors - better than expected volume, savings in labour and other costs. It is reasonable to expect a monopoly to meet this target but it is noteworthy that in real terms letter prices have fallen since 1975/76, after a rise in the early 1970s.

b. Performance against EFL (Annex 1)

The Postal business in the years 1979/80 and 1980/81 failed to meet its share of the Post Office external financing limit. In 1981/82 a surplus is expected as a result of the higher profits. It has been agreed that the first call on the surplus should be the repayment of the shortfall on the Post Office EFL in 1980/81. Taking into account National Girobank's surplus on its share of the EFL, the shortfall for the Post Office was £10.5m. The shortfall in 1980/81 was due to the same factors as caused the shortfall in profits. The 1979/80 shortfall can be seen in the context of the difficulty of meeting precisely a target which is the difference of two very large sums. The shortfall represents about ·25% of turnover.

c. Productivity and Staffing (Annexes 3, 3A, 4, 5, 6, 7 and 8)

The Post Office is a labour intensive industry. About 80% of costs are accounted for by wages and associated costs. Between 1969/70 - a year when productivity was particularly high - and 1976/77 when productivity was at a particularly low level, there was a fall in terms of items handled per mails operations employee of 15%, and in items handled per member of staff of 20%. Since then there has been some recovery, but the declines compared to 1969/70 in 1980/81 were still about 13% and 16% respectively.

Productivity is closely related to volume, and since 1969/70 volume of mail handled has fallen by about 15%. The position with regard to mails operations staff is slightly better than in the case of all staff, and the increase in non mails operations staff is illustrated at Annex 3A. The rise in non mail operations staff is the subject of separate discussion with the Post Office.

The physical productivity position is broadly paralleled by the increase in real unit staff costs, which grew rapidly in the early 1970s but have been fairly stable since the mid 1970s. Productivity does now appear, in the mails operations side, to be on the increase but there are still problems to be overcome - full acceptance of improved working methods; employment of adequate numbers of part-timers, direct recruitment to postman higher grade; getting the full savings from mechanisation. On the staff side, attention is being given to the increase in numbers. Whether, with the fall in volume compared to 1969/70, productivity can ever be raised to the levels of 1969/70 is doubtful.

d. Counters (Annexes 11 and 12)

Counters have hitherto generally made more than 2% on turnover. With the change from a cost plus agency services agreement, achievement of a return above 2% may be more difficult in future. The new agreement, which incorporates a requirement to reduce real unit costs in line with the target for the Corporation as a whole, should result in increased counter efficiency. Since 1975/76 counter costs in real terms have risen by some 15%, and an increase in efficiency is therefore overdue, as counters have been one of the reasons for the Post Office's failure to meet its previous real unit cost objective. So far there is no clear evidence on whether the losses of DHSS business and the gains from additional/new business will be of the orders predicted during the review of the DHSS proposals to change the arrangements for the payment of social security benefits. Annex 11 includes a breakdown of sub post offices by income on a 1981 basis. It can be seen that 3000 of the 21,000 are on a minimum scale payment rate ie they receive a basic minimum remuneration, regardless of the amount of work done.

e. Letter Mechanisation

i. The 1968 plan centred on the creation of 120 mechanised letter offices and was launched in 1969. Disagreements with firstly the UPW in the early 1970s and the POEU in the late 1970s forced considerable delays in the implementation of the plan (with the number of planned MLOs reduced to 84), and it is only since 1979 that mechanisation has proceeded at all rapidly.

ii. Delays in the implementation of the letter mechanisation programme have greatly reduced the net value of the project. Estimates in early 1981 showed that not only was postcode penetration only 50% compared with the planned 70% but also that coding desk throughput was about 10% below target, and that mechanised traffic as a proportion of the total was about 50% (compared with a target of 75%). This poor performance in achieving targets is mostly explained by delays in introducing mechanisation - by the end of 1982 about 50 offices will be operational, with 34 still remaining to be mechanised. However continued poor performance in achieving these targets will greatly reduce the savings resulting from mechanisation.

iii. It is very difficult, in the absence of detailed knowledge, to assess how much of the expenditure on buildings, which might have been required in any event, should be attributed to letter mechanisation. In the absence of new information on the savings associated with letter mechanisation but with updated estimates of costs (including an assumption that further expenditure amounts to no more than £100m at 1981/82 prices) the current best estimate of the NPV for the letter mechanisation project as a whole would be about - £100m. If there is no further improvement in the penetration of postcodes and coding desk throughputs, this figure could exceed - £170m.

iv. Regarding previous expenditure on and savings resulting from letter mechanisation as sunk, future expenditure completing the programme may have a small positive NPV if planning savings and improvements in performance are achieved. If such future investment amounted to £100m, the figure quoted to the Select Committee on Industry and Trade by the Post Office, but which includes some expenditure on buildings which may not be fully attributable to mechanisation, (at 1981/82 prices) the NPV of this would be about zero. Failure to achieve performance targets however would very likely mean that even future investment in letter mechanisation would produce a negative return. Therefore any further investment in this sector will need to be closely examined.

f. Trends in Average Real Earnings (Annex 6)

The use of 1974/75 as a base year when earnings were exceptionally high gives a slightly misleading impression, in that if almost any other year than 1974/75 or 1975/76 is used, Posts can be seen to have roughly kept pace with the national average over the period 1965/66 - 1980/81.

g. Real Unit Cost Objectives (Annex 7)

On 25 February the Secretary of State advised the House that a new performance objective had been agreed with the Post Office. The objective is: taking 1981/82 as a base to reduce real unit costs by 5% over the years 82/83 - 84/85 with a 2% reduction in 82/83.

Post Office forecasts on RUCs in 1979/80 and 1980/81 underestimated the extent to which costs were likely to rise, but in 1981/82 the Post Office appears to have failed to forecast improvements in productivity.

As illustrated by the table real unit costs have risen since 1977/78, and the Post Office at the end of 1981/82 is likely to be 4.3% above 1977/78 levels. Its objective was that taking 1977/78 as a base, real unit costs should be kept constant until 1982/83. The reasons for this are both internal and external. External factors include the reduction of the BR network, entailing more own carriage of mails; increased terminal dues; and an increase in the number of addresses. The most important internal factor has been failure to get enough improvements in productivity, where the performance on counters in particular has not been good.

Ability to meet the present objective will depend crucially on the extent to which productivity can be improved. Since under the improved working methods scheme about 70% of the savings go to the work force, and other non mails operations costs affect the outturn, a given improvement in real unit costs requires a much larger increase in productivity.

h. Tariffs (Annexes 7 and 8)

After a rise in the early 1970s, real prices for inland letters have moved slightly downward over the last few years. Real parcels prices where the Post Office competes with other carriers have moved upwards and real prices for Agency Services have also increased by some 15% over the last 5 years. The new Agency Services Agreement should halt the trend of an increase in real prices. So far as letter prices are concerned, the Chairman has undertaken to keep them within the rate of inflation and to keep increases to intervals of at least twelve months.

i. Investment (Annex 9)

Investment levels are likely to be a central issue in the coming year. The Post Office claims that the cuts to its bids in this year's IFR will delay the mechanisation programme and prevent it from bringing its buildings up to standard. The main areas of investment are letter mechanisation; accommodation, which accounts for about 50% of investment, and vehicles.

ii. The Postal business capital investment is small in relation to annual turnover. Over the past five years investment in fixed assets (including capitalised value of leasing) has been:

	£m (outturn prices)	80/81 prices
1976/77	38.9	62.8
1977/78	34.7	51.4
1978/79	42.5	57.3
1979/80	64.0	72.0
1980/81	76.0	76.0
1981/82	121.0*	108.0*

*estimate

In the mid 1970s until 1978/79, the Post Office consistently underspent on investment compared to its approved programme. It is proposed that in future more rigorous checks will be made on selected projects to ensure that spending within the programme meets cost effective criteria. The reasons for the large increase in the programme in real terms includes the awareness of the amount of maintenance necessary on buildings when the transfer for responsibility for this work was taken over from the PSA; a new programme of parcel mechanisation, and investment in areas related to new technology such as electronic mail.

j. Quality of Service (See Graph : Annex 10)

Quality of service for the Post Office has improved. Present targets are for 90% of first class mail to be delivered by the first working day after collection (day B) on a Monday to Saturday basis and 96% second class mail to be delivered by the third working day after collection (day D). Once second class mail is being delivered on target, it may be appropriate to consider setting a day C target within the day D target. Currently the Post Office is a point or two off its targets for both first and second class mail. To some extent this has been due to factors outside its control such as the rail strikes and bad weather, but it should normally be able to meet the targets and we would expect them to be met.

k. MMC Report on the Inner London Letter Post

Of the 45 recommendations of the MMC, 30 have been adopted and implemented (these include most of the significant recommendations) 3 have not been accepted, 6 accepted in part, 2 delayed due to lack of investment and there are 4 of the less significant recommendations where the position is uncertain. The Post Office submits reports at intervals of six months and these are followed up.

On the major issues, productivity is on target for a 15% increase in the three years to the end of 82/83. Management is taking a firmer stance with the trade unions and on a number of occasions has been prepared to resist industrial action in the interest of ending restrictive working practices.

l. New Technology

The Post Office is looking at the opportunities presented by new technology in a number of areas. The main items are:

i. Packet sorting. Plessey Controls Limited have a research contract and it is hoped to develop a prototype sorting machine by 1984/85.

ii. Optical Character Reading. A prototype has been produced in conjunction with Plessey and should be field tested in the autumn of 1982. It is is hoped that future machines will be manufactured in the UK by Plessey in conjunction with AEG Telefunken.

iii. Electronic Computer Originated Mail. An experimental service has been set up between London and Manchester last year, and a further four installations are to be added. This service has been developed in conjunction with GEC, although much of the equipment is of US origin.

iv. Intelpost. This facsimile service for both inland and overseas has been extended to cover 54 inland counters. Encouraging progress has been made on transatlantic routes but the domestic network has been slower to attract traffic. The equipment is produced by Rapicom.

v. Counter Computers/dispensers

The Post Office is studying the use of such equipment and with funding provided by Information Technology division of DoI, field tests will soon take place in four selected Post Offices with equipment from four different suppliers. The new equipment is intended to reduce the amount of paperwork required of Post Office counter clerks. The Post Office would like:

a. to have a system for counter balancing;

b. to introduce plastic cards;

c. to investigate the possibility of getting the counters on line to eg Girobank at Bootle.

m. Forecasting Against Actuals : RPI and GDP, Volume (Annex 13)

Post Office forecasting of GDP between 1976-1978 proved remarkably accurate. For the years 1979-1981 the Post Office has been 1-1.5% too optimistic. Forecasting aginst RPI by contrast was fairly accurate in the last two years, and in 1976, but between 1977-79 was rather less accurate, being too high in 1977 and 1978 and well below in 1979. Volume forecasts have been reasonable though volume during recession has held up better than expected.

FINANCIAL

ANNEX 1

Current Prices

	Turnover £m	Profit/ (Loss) £m	Profit as % of Turnover 2% Target	Expenditure on fixed assets £m	EFL £m* Target Actual	Performance against target
1976 - 1977	1200	24.3	2 x	38.9	(22.4) (0.7)	- 21.7
1977 - 1978	1325.1	40.4	3 x	34.7	1.8 (21.5)	+ 23.3
1978 - 1979	1447.4	33.1	2.3	42.5	1.2 (16.7)	+ 17.9
1979 - 1980	1708	34.1	2	64	(40.5) (34.0)	- 6.5
1980 - 1981	2125.2	23.3	1.1	76	(20) (7.7)	- 12.3
1981 - 1982 estimate	2403.8	75	3.1	121	10.5 (11.5)	+ 22

* Figures for the three earlier years to be treated with caution
x No formal target

Financial Results by Service	1975-1976			1976-1977			1977-1978			1978-1979			1979-1980			1980-1981		
	Income	Profit/ (Loss)	Profit/ (Loss) as % of Income	Income	Profit/ (Loss)	Profit/ (Loss) as % of Income	Income	Profit/ (Loss)	Profit/ (Loss) as % of Income	Income	Profit/ (Loss)	Profit/ (Loss) as % of Income	Income	Profit/ (Loss)	Profit/ (Loss) as % of Income	Income	Profit/ (Loss)	Profit/ (Loss) as % of Income
INLAND																		
Letters etc	677	20.7	3	717.4	28.3	3.9	768.2	23.3	3	30.6	15.9	1.9	976.3	18	1.84	1233.2	16.8	1.4
Parcels	87.2	(42.8)	(49.1)	102.2	(23.6)	(23.3)	126.7	(7.7)	(6.1)	145.3	1.9	1.3	175.9	1.1	0.6	211	(5.9)	(2.8)
OVERSEAS	130.0	7.9	6.1	162.2	13.4	8.3	170.8	8.9	5.2	169.6	6.9	4.1	188.7	0.2	0.1	222.2	1.2	0.5
COUNTERS:																		
Agency	124.2	46	3.7	141.8	5.1	3.6	169.3	11.5	6.8	149.4	7.0	3.5	236	9.6	4.1	286.9	9.4	3.3
Giro	20.7	0.7	3.4	26.0	1.1	4.2	35.9	2.5	7.0	42.4	0.5	1.2	53.4	0.3	0.6	75.3	0.1	0.1
Remittance	15.7	(1.1)	(7.0)	15.7	0.1	0.6	17.2	2.6	15.1	17.5	-	-	17.9	(0.6)	3.4	23.4	0.1	0.4
Telecom/DPS	33.8	0.8	2.4	35.7	(0.1)	(0.3)	37	(0.7)	(1.9)	42.6	0.9	2.1	59.8	5.5	9.2	73.2	1.6	2.2
TOTAL	1088.6	(9.2)	(0.8)	1,200.0	24.3	3.0	1,325.1	40.4	3.0	1,447.4	33.1	2.3	1,708.0	34.1 x	2.0	2,125.2	23.3 x	1.1

x Before exceptional items

ANNEX 3

PHYSICAL PRODUCTIVITY MEASUREMENT

(MAIL OPERATIONS)

	Staff Hours (m)	Evaluated Traffic (m)	Items Per Staff Hour (Mails Ops)
1969/70	352.1	12,646	35.9
1970/71	strike year - data corrupt		
1971/72	347.5	11,682	33.6
1972/73	346.1	11,956	34.5
1973/74	353.6	12,179	34.4
1974/75	359.4	12,081	33.6
1975/76	344.4	10,922	31.7
1976/77	331.1	10,358	31.3
1977/78	332.0	10,444	31.5
1978/79	341.7	10,994	32.2
1979/80	353.2	11,103	31.4
1980/81	347.0	10,855	31.9
1981/82 (Est)	336.0		

PRODUCTIVITY OF MAIL SERVICE HANDLED PER HOUR

(Change over previous year)

1976 - 1977	- 1.3%
1977 - 1978	+ 0.6%
1978 - 1979	+ 2.2%
1979 - 1980	- 2.5%
1980 - 1981	+ 1.0%

Annex 5A

POSTS	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82 1 Qtr	1982/82 2 Qtrs	Change & % 1978/79 - 1980/81	
1. Total Employed (2 + 3)	174287	171038	168287	172122	176486	179795	179076	178481	7673	4
Mails Operations staff	124398	122233	119837	122533	125255	126504	126600		3971	3
Mails Operations hours (m)	344	331	332	342	353	347	334 (target)		5m	1
Total Correspondence posted	100	95	96	101	101	100				
Non Mails Operations staff (4 + 5 + 6)	49889	48805	48450	49589	51231	53291x			3702x	7
Post Offices (counters)	35685	35006	34973	35682	36352	37414			1732	4
Counter Business volume	100	98	101	103	104	104				
Total non-counter staff (ex NTVRO)	13519	13181	12932	13460	14318	15287x			1927	14
of which										
Postal HQ	3464	3407	3311	3331	3470	3983x			652	19
Regional HQ	3280	3094	3012	3205	3468	3580			375	11.
Engineering	3724	3675	3638	3713	4057	4269			556	15.
Motor Transport	3051	3005	2971	3111	3323	3455			344	11.
[illegible]	685	681	545	547	561	590			43	7.
[illegible] Business	100	96	[illegible]	[illegible]	[illegible]					

Year	Total letters and parcels (Millions)	of which parcels	Number of mails operations staff (Thousands)	Number of items handled per mails operation employee (000) per year	Total number of all staff (000)	Items handled per employee (000)	Index of items handled per mails operation employee 1969/70 = 100	Index of items handled per employee
1950/51	8733	232.6	109.6	79.7	-	-	86.5	-
1954/55	9743	242.7	109.9	89.4	-	-	97.1	-
1959/60	10435	256.7	114.5	91.1	-	-	98.5	-
1964/65	11416	229.9	121.9	93.7	-	-	101.7	-
1969/70	11608	212.3	126.1	92.1	172.9	67.1	100	100
1970/71	10681	180.8	125.5	85.1	173.1	61.7	92.4	91.9
1971/72	10739	188.6	124.7	86.1	173.5	61.9	93.5	92.3
1972/73	10984	194.3	123.7	88.8	172.6	63.6	96.4	94.8
1973/74	11205	194.9	121.4	92.3	170.1	65.9	100.2	98.2
1974/75	11089	200.5	127.1	87.2	177.6	62.4	94.7	93.0
1975/76	10073	169.8	124.7	81.0	174.3	57.8	88.0	86.1
1976/77	9546	162.9	122.2	78.1	171.0	53.8	84.8	80.2
1977/78	9645	159.9	119.8	80.5	168.3	57.3	87.4	85.4
1978/79	10137	171.5	122.5	82.8	172.1	58.9	89.9	87.8
1979/80	10202	(1) 180.2	125.3	81.4	176.5	57.8	88.4	86.1
1980/81	10142	172.4	126.5	80.2	179.8	56.4	87.1	84.0

(1) excludes 185.3m General and European election postings

REAL UNIT STAFF COSTS

71/72 = 100

	Bus Vol	Wages	Unit Costs	RPI	Unit Staff Costs Deflated by RPI	GDP	Unit Staff Costs Deflated by GDP
71/72	100	100	100	100	100	100	100
72/73	102	116	114	108	106	108	106
73/74	102	137	134	116	116	116	116
74/75	102	180	176	130	135	133	132
75/76	94	228	242	162	149	169	143
76/77	90	243	270	189	142	194	136
77/78	92	262	285	219	130	221	128
78/79	95	287	302	237	127	245	123
79/80	96	337	351	269	130	282	124
80/81	95	422	442	317	139	335	132

ANNEX 6

Trend in average earnings 1974/5 = 100

	At current prices			Deflated by RPI		
	Posts	Telecom	National Average	Posts	Telecom	National Average
5/6	34.7	37.5	39.4	66.8	72.2	75.8
6/7	35.4	38.4	41.5	65.8	71.4	77.1
7/8	37.5	40.7	43.5	68.1	74.	79.
8/9	40.	43.6	46.9	68.9	75.	80.7
9/70	44.	46.9	50.9	71.8	76.7	83.2
0/1	*	51.1	57.4	*	77.7	87.4
1/2	58.2	60.9	63.4	81.2	85.	88.5
2/3	65.1	70.1	71.9	84.8	91.2	93.6
3/4	75.7	78.	81.3	89.2	92.	95.9
4/5	100.	100.	100.	100.	100.	100.
5/6	120.6	122.5	123.6	96.8	98.7	99.2
6/7	129.	138.4	140.5	89.9	96.4	97.9
7/8	137.4	152.2	153.1	83.9	93.	93.6
8/9	162.4	177.1	174.3	91.5	99.8	98.2
9/80	186.8	202.9	203.8	91.	98.8	99.3
0/1	226	255.6	244.2	94.6	107.	102.3
1/2	249.3	293.9	275.6	94.	110.9	102.3

ected by strike

REAL PRICES BY SERVICE 76/77 = 100

	75/76	76/77	77/78	78/79	79/80	80/81
Inland Letters	107	100	101	95	96	104
Inland Parcels	104	100	97	93	95	103
Overseas Mails	94	100	110	102	105	118
Agency Services	102	100	101	108	106	118

REAL UNIT COSTS

1977-78	100
1978-79	97
1979-80	97
1980-81	104
1981-82	104*

*est

POST OFFICE PERFORMANCE ON REAL UNIT COSTS

ANNEX 7A

77-78 = 100

5 YEAR PLAN	79-80	80-81	81-82	82-83	83-84	85-86	87-88
79-80	95	97	98	99	100		
80-81		103	101	99	100	101	
81-82		104	108	107	104	103	103
ACTUAL	97	104	104*				

Excludes supplementary depreciation on buildings allowed for from 79-80

* Estimate

TARIFFS

INLAND LETTER RATES FROM INTRODUCTION OF 2 TIER SYSTEM

Date of Price Change	Weight	First	Index	Second	Index	RPI Year Ending	RPI Index	REAL PRICES (Year ending) First	REAL PRICES (Year ending) Second
16.9.68	4 oz	5d (1)	100	4d (1)	100	68	100	100	100
15.2.71	"	3p	144	2½p	150	69	105	95	95
						70	111	90	90
6.3.72	2 oz	3	144	2	120	71	120	120	125
						72	130	111	92
10.9.73	"	3½	168	3	181	73	140	120	129
24.6.74	"	4½	216	3½	211	74	157	138	134
10.3.75	"	7	337	5½	331	75	195	210	201
29.9.75	60 g	8½	409	6½	392				
7.6.76	"	8½	409	6½	392	76	227	180	173
13.6.77	"	9	433	7	422	77	263	165	160
20.8.79	"	10	481	8	482	78	285	152	148
						79	323	149	149
4.2.80	"	12	577	10	602	80	380	152	158
26.1.81	"	14	673	11½	693				
1.2.82	"	15½	745	12½	753	81	426	1158	163
						82 (e)	475	157	159

POST OFFICE EXPENDITURE ON FIXED ASSETS

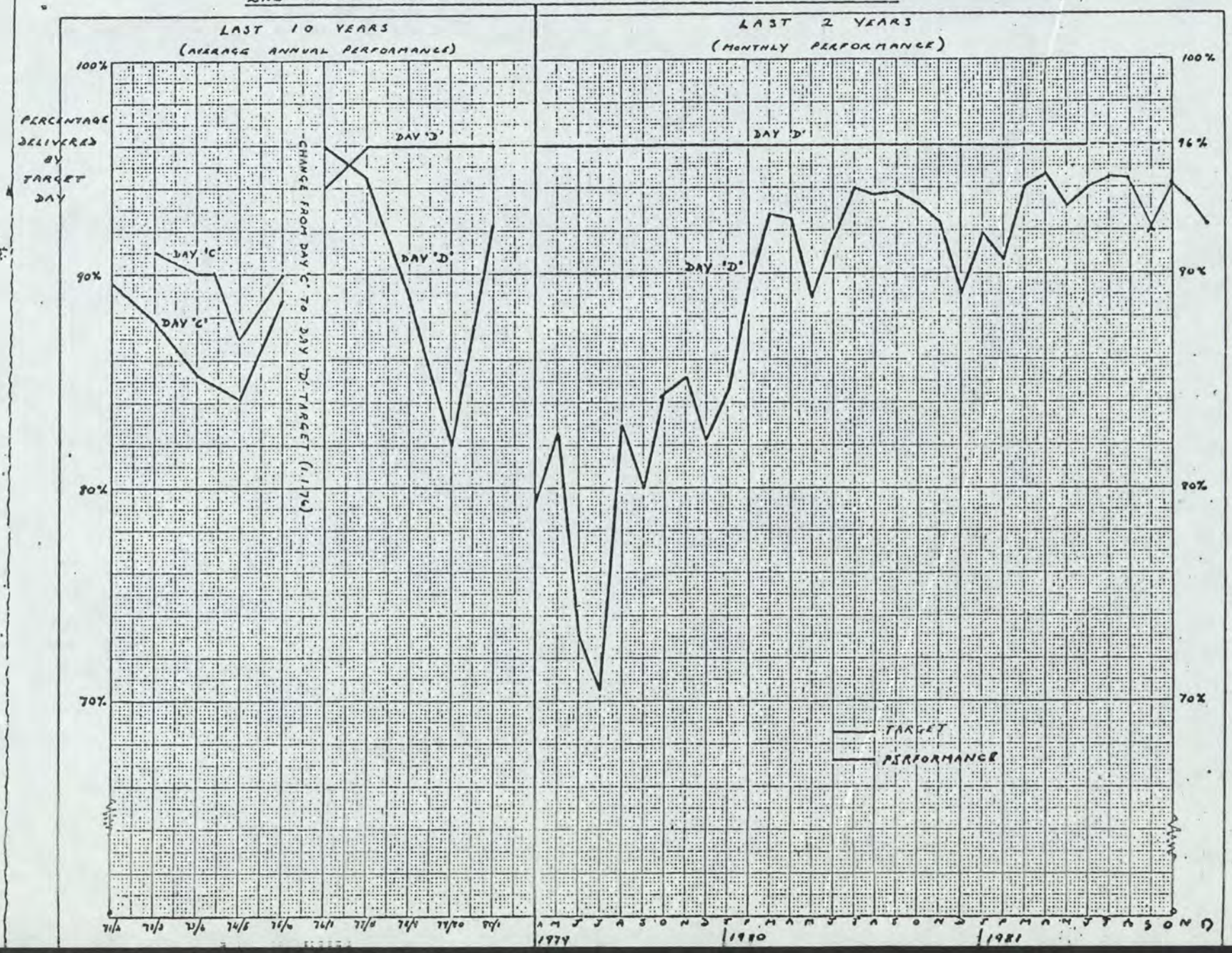
OUTTURN

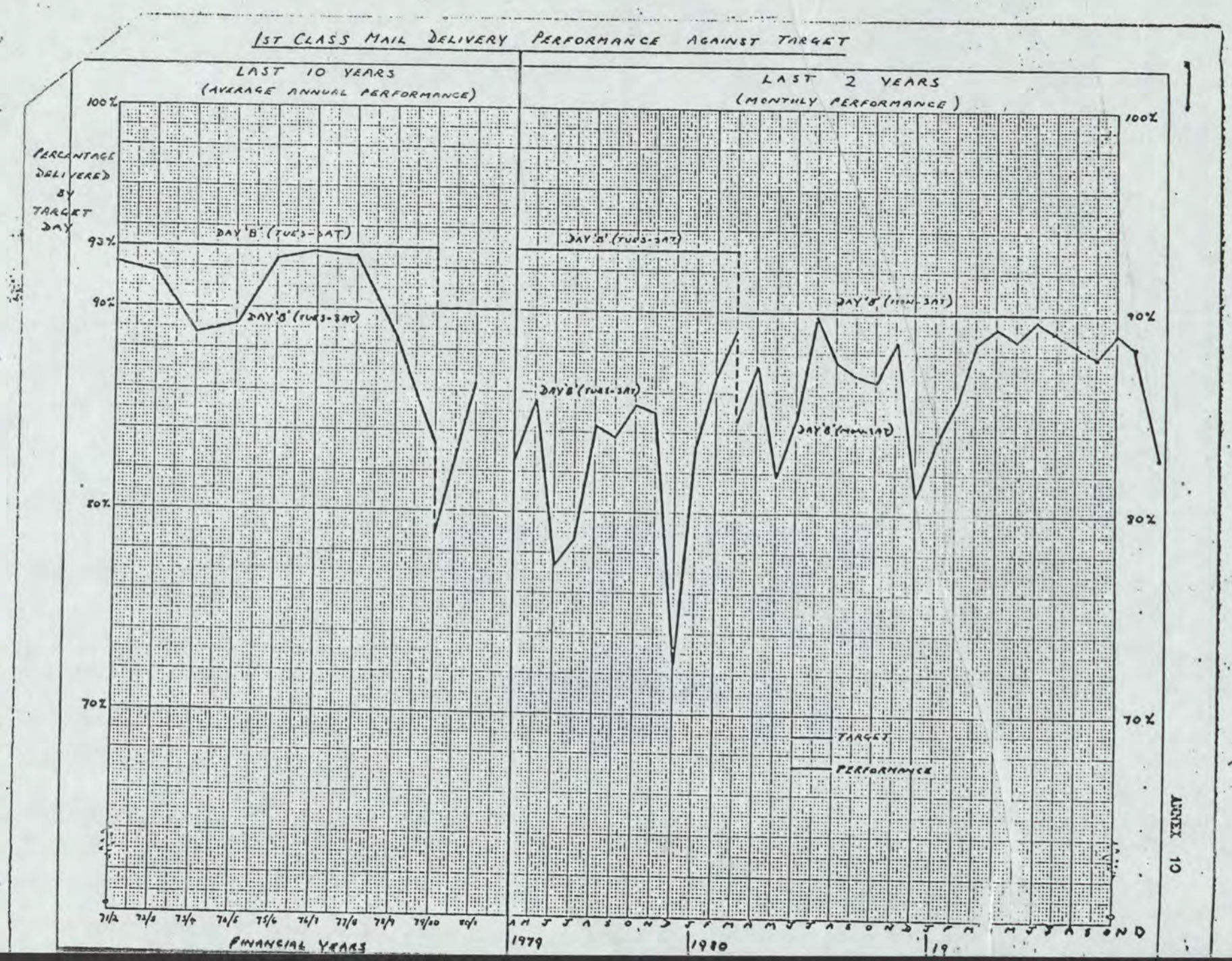
Item	76-77	77-78	78-79	79-80	80-81	81-82 (1)
New Construction	13.1	7.8	9.2	21	25.5	44
Purchase of Land & Existing Buildings	4.3	2.2	1.3	3.5	1.7	4
Vehicles	1.2	5.2	5.2	3.7	5.1	5
Plant & Machinery	14.4	14.6	19.4	19.3	29.4	43.5
Sub-Total	33	29.8	35.1	47.5	61.5	96.5
Capital Value of Leased Assets (2)	5.9	4.9	7.4	16.6	14.6	24.5
Total	38.9	34.7	42.5	64.1	76.3	121

(1) estimate

(2) leasing of vehicles

2ND CLASS MAIL DELIVERY PERFORMANCE AGAINST TARGET




1ST CLASS MAIL DELIVERY PERFORMANCE AGAINST TARGET
LAST 10 YEARS
(AVERAGE ANNUAL PERFORMANCE)
LAST 2 YEARS
(MONTHLY PERFORMANCE)
PERCENTAGE DELIVERED BY TARGET DAY
100%
95%
90%
80%
70%
DAY 'B' (TUES-SAT)
DAY 'B' (MON-SAT)
TARGET
PERFORMANCE
71/2
72/3
73/4
74/5
75/6
76/7
77/8
78/9
79/80
80/1
FINANCIAL YEARS
1979
1980
19
ANNEX 10

P[illegible] OFFICE: COMPOSITION

CROWN

1976-77	1580
1977-78	1578
1978-79	1577
1979-80	1571
1980-81	1581

SUB-POST OFFICES: BREAKDOWN BY INDIVIDUAL OFFICE

	No	Renumeration	Indices deflated by RPI (1)	Indices deflated by GDP (1)
1976-77	21543	100.5	100	100
1977-78	21342	113.8	98	101
1978-79	21213	127.5	99	102
1979-80	21056	144.2	103	100
1980-81	20894	189.3	115	111

(1) Adjusted for numbers of offices

Sub Post Offices : Breakdown of Pay

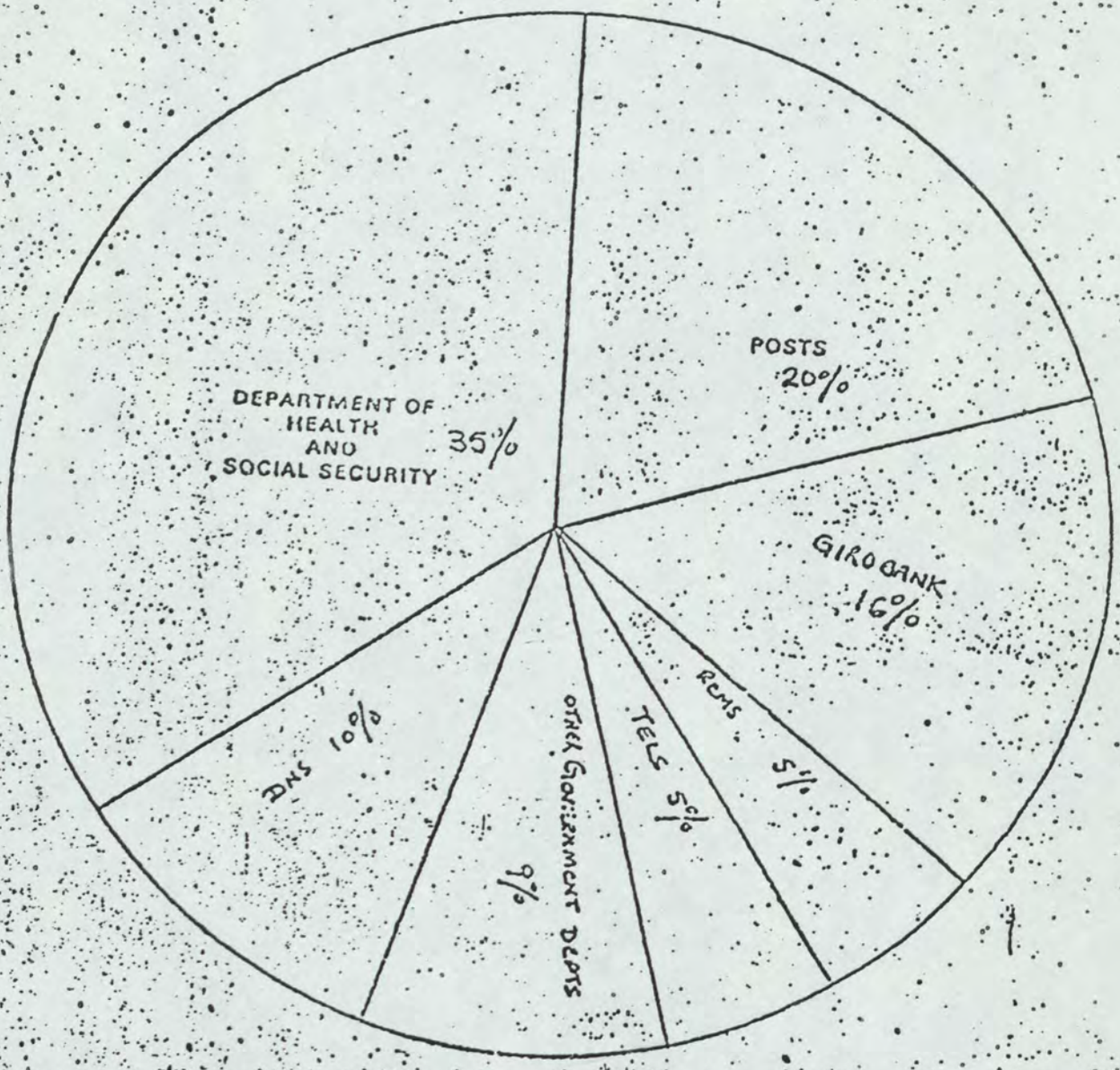
3,500 : Minimum Payment (£1500)

7,500 : Would qualify for DHSS Funding (£1600 - £5500)

10,000 : Pay over £5,500

1981 Figures

WHO PAYS FOR THE COST OF COUNTERS— 1980/81



POST OFFICE PERFORMANCE ON ECONOMIC FORECASTS

5 year Plan	1976 GDP	1976 RPI	1977 GDP	1977 RPI	1978 GDP	1978 RPI	1979 GDP	1979 RPI	1980 GDP	1980 RPI	1981 GDP	1981 RPI
1975	3	18	3	16	3.5	14	3.5	15				
1976			2	14	4.3	12	3	10	2.5	10		
1977					4.3	12	4	10	1.5	8	3	6
1978					3	12	3.5	12	1.5	10	3.0	10
1979							3	9	1	10	3.5	10
1980									.5	13	2	9
1981											(0.8)	11
Actual	2.8	16.2	2.1	9.9	3.1	9.5	1.8	18.4	(-2.1)	13	(-2) e	12 e

POST OFFICE BUSINESS VOLUME FORECASTS

5 year plan	79-80	80-81	81-82	82-83	83-84	84-85	85-86
79-84	100	100	101	101	100		
80-85		98	100	102	102	103	
81-86			100	102	105	107	109

POST OFFICE: OBJECTIVES

Long-Term Objectives

1. To keep under active review the structure of operational requirements in light of rapid changes in the technology of paper transmission and of message communication with a view to reducing the costs of each message delivered while expanding the range of message services on offer.

2. To plan manpower and accommodation requirements in accordance with changes in operational parameters created by new developments in communication environment.

3. To restructure the Post Office where practicable into separate profit centres each with its own performance indicators and to create where possible separate Companies Act subsidiaries with a view to forming joint ventures with the private sector to accelerate the introduction of new technology and new services.

4. To provide throughout the United Kingdom the most cost effective postal service consistent with maintaining the highest quality of service demanded by the customer.

Targets Agreed with the Secretary of State

5. To achieve its financial targets and to operate within borrowing limits set by the Secretary of State with the approval of the Treasury.

6. To improve operating efficiency in accordance with, where applicable, the real unit cost objective agreed with the Secretary of State, namely that taking 1981/82 as a base, real unit costs should fall by 5% in the three years to 1984/85, 2% of which should be achieved in 1982/83.

7. To achieve quality of service targets of delivering 90% of first class letters by the first working day after collection and 96% of second class letters by the third working day after collection, as agreed with the Secretary of State after consultation with the Post Office Users' National Council.

8. To achieve levels of overtime in the Postal Business to the lowest level consistent with efficient operation and the attainment of quality of service targets by means of more flexible working practices and where appropriate, by the use of part-time labour.

9. To ensure that tariff increases are contained as far below the rate of inflation as possible and to maintain a minimum interval of at least a year between increases.

Competition

10. Where competing with the private sector to do so on fair and equal terms.

Statutory Constraints

11. To provide as far as practicable and to the extent that no other person offers a service, such services throughout the UK for the conveyance of letters that satisfy all reasonable demands. In providing such services to have regard to efficiency and economy and to the social, industrial and commercial needs of the UK (BT Act 1981 Section 59(1)(2)).

12. To perform over its counters and to arrange to have performed over the counters of the sub Post Office network, at a fee to be mutually agreed, such

services for central and local Government and for National Health Authorities in the UK as those bodies may require. In performing such services to have regard to efficiency and economy and to the economic, social and commercial needs of the UK (BT Act Section 58 Post Office Act 1969 Section 12).

Not Ind, Policy, Pt 7

vb

SECRET

Z

16 September 1982

The Prime Minister was grateful for your Secretary of State's minute of 15 September about System X, which she read without comment.

I am sending copies of this letter to John Kerr (HM Treasury) and Richard Hatfield (Cabinet Office).

MCS

Jonathan Spencer, Esq.,
Department of Industry.

SECRET

010

Prime Minister (2)

To note.
MCS 15/9

PRIME MINISTER

I wish to bring you up to date with the situation on System X, which we last discussed on 27 July, in view of the role you may be invited to play in signing STC's contract with the Chinese.

2 You will recall our concern at the over-capacity in the industry (GEC, Plessey and STC) and, in particular, fear that the present management and procurement arrangements for System X were unlikely to result in internationally competitive industry. Following our discussion Jeffrey Sterling took on the task of exploring possible solutions of the problem with the companies and British Telecom. While it is still far from clear what the outcome will be, he has clearly gained the confidence of the industry, all parts of which are now agreed that the present situation cannot continue. Not the least of Jeffrey's successes is Arnold Weinstock's acceptance, despite his earlier denials, that the industry does have a very real problem which needs to be resolved. Arnold has replaced the Managing Director at GEC Telecommunications and is taking a close personal interest. He is discussing with Sir Kenneth Corfield the possibility of their putting their main switching interests together. He has also suggested privately to Jeffrey a solution which would place System X design leadership with Plessey, with GEC and Plessey sharing the actual manufacture of System X. Jeffrey is pursuing

the possibility with the other parties.

3 There is, however, a new complication of which you should be aware. You should know that last Friday (10 September) STC advised my Department that ITT, who wishes to reduce its holding inSTC from 75% to 35%, have been given a slot for a placing on 28 September. Current share prices suggest the sale would raise about £230 million. However, it is difficult to see how ITT can go to the market when STC's principal business - which is responsible for more than 80% of STC's profits - is surrounded by such uncertainty. My view on this has been made very clear to Kenneth Corfield; he fully recognises the problem. There could be pressure from ITT on us to resolve the uncertainty to allow them to go ahead with the placing, but I see no way in which we could do this which would not put at risk the prospects which are now beginning to emerge of a long-term solution to the System X problem.

4 The situation is still very fluid and the next few weeks are likely to see considerable activity. I hope that by the time you return from the Far East, I shall be able to put a fuller report to you. Meanwhile, in view of the great commercial sensitivity of these issues (especially for STC's share price), I should be grateful if this minute could be given a very limited circulation.

5 I am copying this to the Chancellor and to Sir Robert Armstrong.

PJ

P J

15 September 1982

Department of Industry

CONFIDENTIAL

Asst Secs Sec
Dr. Vereker

10 DOWNING STREET

From the Private Secretary

9 September 1982

Telecommunications Bill

As I mentioned to you on the telephone yesterday, the Prime Minister has asked me whether it might be possible for the Telecommunications Bill to allow an arrangement like that in the United States where there could be a number of regions providing competitive telecommunications services. The Prime Minister understands that the Department of Industry view is that if the Government took powers in the Bill to enable it to break up BT plc into separate regional companies, this would have a serious impact on privatising telecommunications: if BT were broken up before flotation took place, the mechanics would take several years, thereby postponing privatisation probably until towards the end of the next Parliament; on the other hand, if the Government attempted to float BT plc as a single unit whilst retaining in the Bill the power to break it up at some future date, the flotation itself would be jeopardised.

The Prime Minister would be grateful for a note on this whole issue. In particular, she has asked why it would take several years to break up BT into several regional companies, thus postponing privatisation until towards the end of the next Parliament.

I am sending a copy of this letter to Peter Jenkins (HM Treasury), Richard Hatfield (Cabinet Office) and Gerry Spence (CPRS).

M. C. SCHOLAR

Jonathan Spencer, Esq.,
Department of Industry.

CONFIDENTIAL

cc JV

CONFIDENTIAL

Qa 06058

To: MICHAEL SCHOLAR

From: JOHN SPARROW

8 September 1982

Telecommunications Bill

1. Thank you for your minute of 6 September, conveying the Prime Minister's suggestion that we should talk to David Young on this subject. This is a good idea, but I have a little personal difficulty in that I am going on leave this weekend (apart from putting in an appearance on Monday evening). I am therefore asking Alan Bailey to open up a discussion with David Young so that I can pick the matter up again on my return.

2. It so happens that I met George Jefferson at Farnborough on Monday, and I got the impression that regionalisation in some form is also part of his thinking. He is very anxious not to disturb his relationship with Patrick Jenkin, but would nonetheless welcome an opportunity to meet the Prime Minister in order to talk to her about what he is seeking to achieve and how he is setting about it. I can see considerable advantage in such a discussion if it can be arranged, and I wonder, if the Prime Minister likes the idea, if an invitation might not be conveyed by way of Patrick Jenkin. But my ideas on protocol are still a little hazy.

3. I am sending a copy of this minute to Sir Robert Armstrong.

B.

Note/ Discussed with Mr Sparrow and told him that I thought it would be a bad idea for the PM to see Sir G Jefferson — ~~repetition~~ (this was Jonathan Spencer's / Mr Jenkin's private advice to me). Jefferson had already floated this idea with Mr Jenkin, who had turned it down. PA

MCS 9/9

CONFIDENTIAL

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 6401
SWITCHBOARD 01-212 7676

FROM THE
MINISTER OF STATE
FOR INDUSTRY AND
INFORMATION TECHNOLOGY

KENNETH BAKER'S OFFICE

(2)

Prime Minister

I'm asked if BT's charges were the highest in Europe – as asserted on BBC

Willie Rickett Esq
10 Downing Street

7 September 1982

On these figures they are 5th and 7th highest.

Dear Mr Rickett

TELEPHONE CHARGES AND BT PROFITS MCS 7/9

As requested when we spoke on the telephone recently, I now attach a defensive line to take and explanatory background notes on BT Profits and Telephone Charges.

Of course since we spoke BT have deferred their proposed tariff increases but you may still find the attached useful. One point I ought to make is that straight tariff comparisons of the sort made in the Sunday Times article attached at Annex 2, and I suspect mentioned also on BBC world service are misleading because of the degree of cross-subsidisation between services by telecommunications administrations. A much more realistic comparison can be gained by using a "basket" of typical charges which are set out in the table in Annex A.

Yours sincerely
Gene Robertson

M57/M57ABP

APPROVED BY MR MCMILLAN AND SIGNED IN HIS ABSENCE

ST

BRITISH TELECOM: TELEPHONE CHARGES AND BT PROFITS

Line to take

British Telecom's £458m profits and the rapidly falling inflation rate have allowed the Corporation to defer its proposed increases in standing charge and unit fee from 1 November until at least 1 April next year. This is welcome news for all consumers.

Typical British residential and business telephone bills are about average compared with those in other western countries. The typical British subscriber would, for example, be charged more in West Germany, Italy and France. However, this is not good enough: we want the most competitive service in the world and that is why we have introduced competition and intend to privatise British Telecom.

Background Note

1 Profits

British Telecom's profits were £458m in 1981-82 on £5,700m turnover. All the profit was re-invested contributing towards financing capital requirements now running at £2 billion a year.

2 Deferral of tariff increases

BT's decision on 31 August to defer its tariff increases came after considerable criticism from consumers including the statutory Post Office Users' National Council. BT, however, stressed the improving economic situation - lower interest rates and inflation forecasts - and its own operating success as the most important factors contributing to the decision.

3 International comparisons

Comparisons of tariff details can be misleading due to cross-subsidisation between services in different administrations and different tariff structures. BT for example have larger differences between peak and off peak unit charges - so comparison of peak charges as in the attached Sunday Times article show BT to be disproportionately expensive. More accurate comparisons are possible using a "basket" of charges reflecting a typical UK subscriber's call habits.

BT surveys using typical UK bills show UK ranking in a "league table" of 10 countries, putting the cheapest at the top, to be seventh for a typical business bill and fifth for a typical residential bill. If the proposed tariff increases had gone ahead in November the UK's ranking would not

have changed for the business bill but would have dropped one place for a residential bill. A table is annexed.

Telecoms Division

Department of Industry

TYPICAL UK BILLS SEPTEMBER 1982

INDEXED TO UK = 100

	TYPICAL SINGLE LINE BUSINESS BILL	RANKING	TYPICAL SINGLE LINE RESIDENTIAL Bill	RANKING
UK	100	7	100	5
SWEDEN	45	2	75	2
BELGIUM	72	5	102	6
FRANCE	112	8	147	9
W GERMANY	123	9	162	10
NETHERLANDS	59	3	87	3
SWITZERLAND	64	4	93	4
ITALY	128	10	134	8
DENMARK	37	1	55	1
USA (New York Bell)	77	6	107	7

NOTES:

1 The Residential and Single Line business typical bills are calculated using 10% of connexion fee, the rental charge, and a package of inland telephone calls which impose a typical UK subscribers call habits on the foreign pricing structure.

2 Overseas tariffs have been converted to a common currency using the purchasing power indicies produced by the W German Federal Statistical Office.

Sunday Times 25 July 1982

Buzby coins it in —and pips the world

by David Beake

BRITISH TELECOM'S tariff increases this autumn will place the United Kingdom's telephone system firmly at the top of an international price league, a Sunday Times survey shows.

From November 1, private subscribers will be paying some 69 per cent more than two years ago. In the same period, none of the other leading industrialised countries has increased the price of its phone rentals by even half as much —and in some cases charges have actually been reduced.

Over the past five years, the gap between Britain and the rest in the basic cost of local calls is still more marked.

Although exchange rates and the differing facilities offered make exact international comparisons difficult, the picture emerging from our survey reinforces just how out of step British Telecom's charges have become. In this five-year period:

- The price of local calls in Japan has been unchanged and there have been considerable increases in the range of off-peak tariffs.
- France and New York have both held price increases to 23 per cent.
- In San Francisco, the rental (which includes the price of local calls) has risen by only 13 per cent.
- In the Netherlands, the cost of local calls is down by 12 per cent.
- West Germany has made no change in the cost of local calls, has reduced rental charges by 14 per cent and has expanded the off-peak hours.
- Italy, our nearest "rival" in the price league, is expected to raise the cost of local calls this autumn by about 30 per cent, in line with increases already made in charges for longer-distance calls.

Seen against the 74.4 per cent rise in the cost of living in Britain during the same period, our phone tariffs may not seem so extreme. But the overall 69 per cent increase in charges to private subscribers which becomes effective this November will have been imposed entirely in the last two years, during which time the rise in the cost of living was down to 32 per cent.

Moreover, the fact remains that the Netherlands, West Germany and Japan either cut their prices or kept them unchanged despite their own five-year cost-of-living rises (respectively: 30.3, 25.2 and 23.9 per cent).

Even in France, where the cost-of-living increase, at 75 per cent, was slightly higher than our own, the rise in phone charges has been well under one-third of that rate.

This autumn's new charges will add significantly to British Telecom's profits of £450 million a year and contribute to an investment programme costing more than £1,500 million. Again, though, many of its principal counterparts abroad have succeeded in linking profit and investment to a price structure in favour of the customer.

Notwithstanding their price cuts, for instance, the German phone system remained self-supporting and the publicly owned Dutch system handed money back to the government and also reinvested.

A spokesman for British Telecom, which regards the 69 per cent rise as "a catching up exercise", explained: "Over the past 10 years, we've had four years without any increase whatever and one year in which we gave back a million pounds to the customer."

British Telecom says its subscribers are paying for tomorrow's technology. "By the end of the century, we will have replaced the entire system. Our interest charges on money we borrow are massive and these have to be passed on to the customer."

	Local peak 3min	50Km peak 3min	International 1000Km 6min	Rental per quarter residential	Rental per quarter business
UK	10p	30p	£3.18	£13.50	£21.00
JAPAN	6.8p	14p	£6.09	£12.00	£17.00
ITALY	4p*	31p	£2.10	£14.85	£5.30
W GERMANY	5.5p	48p	£1.90	£18.50	
NEW YORK	5.2p*	75p	£4.87	£19.20	
HOLLAND	1.5p*	12p	£2.00	£15.00	
FRANCE	4.5p*	11.5p	£1.65	£10.00	

* UNLIMITED TIME

file

JR

bc: Mr. Vickers
Post + Tele

10 DOWNING STREET

From the Private Secretary

CONFIDENTIAL

MR. SPARROW

TELECOMMUNICATIONS BILL

Thank you for your minute of 3 September to Robin Butler.

We showed this to the Prime Minister over the weekend. She has asked why it would take several years to break up BT into separate regional companies, thus postponing privatisation probably until towards the end of the next Parliament. The Prime Minister has suggested that you should have a talk with Mr. David Young some time; the Prime Minister knows that he has a number of ideas on this subject, from his days in the Department of Industry.

I am sending a copy of this minute to Richard Hatfield in the Cabinet Office.

MCS

6 September 1982

DSS

YdS

Prime Minister (2) cc JV

MCS 6/9

DEPARTMENT OF HEALTH & SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

Kenneth Baker Esq MP
Minister of State for Industry and
Information Technology

5 September 1982

MT

Dear Ken.

Thank you for your letter of 20 August. I have no quarrel with your argument that long distance calls have in the past subsidised all other telephone services and that services should be properly related to the costs of supply. My concern is that fixed rental charges may not necessarily be the best or fairest way of meeting some of those costs. What also worries me somewhat is the prospect that in seeking to sharpen their competitive edge in the business sector British Telecom may be tempted to increase the real cost of calls and rental charges for residential subscribers too fast and too steeply when we ought to be encouraging wider participation in the telephone network.

I am glad to hear that Sir George Jefferson has been asked to provide full justification for any further rebalancing of the tariff structure in bringing forward next year's price proposals and hope that the points I have raised can be borne in mind.

I also note that the Post Office Users' National's critical comments on this year's tariff proposals have led to an immediate and welcome decision by Sir George to defer the proposed increases to next April.

Yours ever
Norman

NORMAN FOWLER

cc PM + Chancellor
Mr Luxton
Mr Evans
Mr ~~Stapes~~ Roe
Mr Partridge
Mr Nodder
Mr McGinnis
Mr Heppell
Miss Winterton
Mr Bird
Mr Walmsley
Mr Tuck

Would you have a word with David Young? Prime Minister mentioned this. We have no. 1 item from his DOI days. MT

WR 3/9

Qa 06053

To: ROBIN BUTLER

From: JOHN SPARROW

3 September 1982

Telecommunications Bill

1. We have made enquiries of the Department of Industry about the specific point on the Telecommunications Bill raised by the Prime Minister and set out in your minute of 1 September.

2. The Prime Minister's understanding is correct. In accordance with the decision, taken collectively by Ministers and announced, that BT would remain as one entity, the Bill is being drafted to provide for the transfer of assets from BT to a single successor, BT plc. Theoretically the Government could take powers in the Bill to enable it to break up BT plc into separate regional companies. In the view of Department of Industry officials, this would have a serious impact on privatising telecommunications. On the one hand, if BT were broken up before flotations took place, the mechanics would take several years, thereby postponing privatisation probably until towards the end of the next Parliament. On the other, if the Government attempted to float BT plc as a single unit whilst retaining in the Bill the power to break it up at some future date, it is highly unlikely that the City would invest in an institution whose future structure was so uncertain. Of the two, my personal preference would be for the first, but we would need first to decide whether or not regionalisation is the best course of action.

why? why?

3. Ministers would retain the option to break BT up into regional companies after flotation without specific powers in this Bill, but only by new legislation or by an order under the Fair Trading Act following an MMC investigation which concluded that the continuation of BT plc as a single entity was contrary to the public interest.

4. On licensing the situation is simpler. Under the Bill the Secretary of State for Industry will have a power to license which could be used, if Ministers so decided, for local companies or further Mercuries. For the time being it is intended that licences be restricted to BT, Hull and Mercury.

5. I am sending a copy of this minute to Sir Robert Armstrong.

JB.

CONFIDENTIAL

FILE

HL

Post & Tel

10 DOWNING STREET

From the Principal Private Secretary

MR. SPARROW

Telecommunications Bill

This minute records a specific point which the Prime Minister discussed with you yesterday during your general discussion with her about the CPRS work programme.

The Prime Minister said that her understanding was that the Telecommunications Bill would prescribe a monopoly telecommunications company and would prevent an arrangement like that of the United States where there could be a number of regions providing competitive services.

You agreed that the CPRS would look quickly into this and let the Prime Minister know what the position is.

E. E. R. BUTLER

1 September 1982

CONFIDENTIAL

Prime Minister

WR 23/8 cc JV

2

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 6401
SWITCHBOARD 01-212 7676

FROM THE
MINISTER OF STATE
FOR INDUSTRY AND
INFORMATION TECHNOLOGY

KENNETH BAKER MP

The Rt Hon Norman Fowler MP
Secretary of State
Department of Health & Social Security
Alexander Fleming House
Elephant and Castle
LONDON SE1 6BY

20 August 1982

Last week, I heard on BBC ordered series that the tariff increase in Nov. was scrapped as planned - B.T. charges would be the highest in the world. True or false? Not.

Dear Norman,

I am writing on behalf of Patrick Jenkin to thank you for your letter of 22 July about telephone rental charges. British Telecom's latest proposals are currently being considered by the Post Office Users National Council and I await their conclusions and in particular their comments on the rebate scheme with interest.

attached -

It surely must be common ground between us that, except where there are clear reasons to do otherwise, BT should price their services at levels properly related to the costs of supply and avoid any cross-subsidisation between their services. In the past, long distance telephone calls have been subsidising everything else. Residential subscribers make far fewer long distance calls than business subscibers. Business subscribers have therefore subsidised residential subscribers.

Recent tariff changes, reflecting a shift in the balance between rental and call charges and reductions in trunk and international calls, have resulted in smaller increases in business bills. This shift should help in our efforts to enable industry to regain competitiveness. I believe that there was ample justification for the rental concession BT have made in favour of very low users, but I would be reluctant to seek to influence BT to enlarge this concession further.

I share your concern that this tariff rebalancing should produce a system which is fair to all users. To this end we have asked Sir George Jefferson to let us have full justification for any further rebalancing in the tariff structure which he may consider necessary in next year's price proposals.

I am copying this letter to the Prime Minister and the Chancellor.

Yours ever

Kenneth.

M55/M55AAN

cc CO

Post
Tels

10 DOWNING STREET

From the Private Secretary

4 August 1982

TELEGRAPH ACTS

The Prime Minister was grateful for your Secretary of State's minute of 2 August. She is content for him to circulate a consultative document on the reform of the Telegraph Acts.

I am copying this letter to Richard Hatfield (Cabinet Office).

W. F. S. RICKETT

Jonathan Spencer, Esq.,
Department of Industry.

Willie have told DOI PM's response. P. 5/8

cc JV

JF1325

RESTRICTED

Prime Minister

A summary of this consultation document is attached. Content for Mr Jenkin to issue it?

Yes mb

on A4.

LWh 2/8

PRIME MINISTER

TELEGRAPH ACTS

One of the minor issues discussed at E(TP) on 22 April and 30 June was the need to reform the Telegraph Acts.

2 There are twelve of these Acts, mostly dating from the middle of the last century. They set out the powers under which British telecommunications and other telecommunications undertakings may place telegraph poles and other plant in and under streets and elsewhere. The Acts are seriously out of date and in many places they are obscure; the Law Commission has described them as "a blot on the statute book". The Acts also need to be recast in a form which can apply to a privatized BT. The reform can be undertaken without in any way prejudicing the decisions we take on local cable systems.

3 E(TP) has already agreed that Parliamentary Counsel should draft the part of the Telecommunications Bill necessary for the reform of these Acts. This task is well in hand. It would be undesirable to introduce the Bill without first consulting those whose interests are affected by the Bill's provisions. I have consulted those of our colleagues who are directly concerned, and they have agreed to the policy I propose and to the circulation of a consultative document.

4 This minute seeks your formal agreement to my circulating the consultative document. It is not controversial and I doubt whether it will attract press attention. To give those concerned a chance to comment in time for their views to be taken into account before the Bill is introduced at the start of the next Session, we need to issue the consultative document quickly.

My Press Office will be in touch with yours about timing.

5 I am sending copies of this minute to the Home Secretary, the Lord Chancellor, the Chancellor of the Exchequer, the Lord President, and the Secretaries of State for Northern Ireland, Defence, Environment, Scotland, Wales, Trade, Transport, Energy, and also to the Attorney General, Sir Robert Armstrong and John Sparrow.

PJ

P J

2 August 1982

Department of Industry
Ashdown House
123 Victoria Street

REFORM OF THE TELEGRAPH ACTS

Introduction

The reform of the Telegraph Acts is an essential, if mundane, part of the proposed Telecommunications Bill. The existing framework of powers permitting authorised telecommunications undertakings to place their poles and underground cables in streets etc must be revised to bring it up to date, to make it consistent with the Government's policy on liberalisation and to provide consumers with more open access to telecommunications services. Reform is prerequisite to privatisation but also highly desirable on general grounds.

2 At present British Telecommunications (BT) place their apparatus such as telegraph poles and underground plant in the street, on private land and elsewhere under powers given by the Telegraph Acts (Annex A). The Acts were passed between 1863 and 1916 and are profoundly unsatisfactory:-

(a) The powers in the Acts are available only to BT or those such as the Hull Telephone Company that BT authorise to use them. The powers have not been made available to Project Mercury, BT's recently licensed private sector competitor, or to companies running cable networks. It would clearly be inappropriate for the gift of these powers to remain in BT's hands following the introduction of competition and, more especially, privatisation.

(b) The law is contained in 12 separate Acts and is hard or sometimes impossible to establish. Many provisions

are inconsistent, duplicated or are unnecessarily complicated or archaic and there are obvious gaps in the legislation. Parts of the Acts are spent, obsolete, superseded or no longer of practical utility.

(c) The law in this area must take account of the rights of landowners but must balance these against the need of others to receive telecommunications services. The present Acts reflect the lesser importance of telecommunications when the Acts were first passed and pay little regard to the need for open access to telecommunications services, which will become increasingly important with the prospective development not only of wideband cable systems but also the office of the future which will enable many people to do their work at home. So far the archaic provisions of the law have not frustrated the development and application of new technology but this has been possible to a significant extent only because certain provisions in the present Acts are largely ignored.

Proposals

3 The Department of Industry has consulted the Law Commission about the option of consolidating the Telegraph Acts as they stand. However, the Law Commission, which has described the Telegraph Acts as a blot on the statute book, does not think it practicable to go down this route because the present law is so unsatisfactory. Also consolidation would not meet most of the major concerns listed above. Consequently it is proposed that all the existing Acts should be repealed and replaced by new provisions in primary legislation. Subordinate legislation would not be appropriate since the existing provisions are in primary legislation and the rights of some property owners are affected by the proposals.

4 The main proposals are:-

(a) the existing provisions of the Telegraph Acts should be retained wherever practicable and only the minimum of changes should be made to reflect modern developments and eliminate obscurities;

(b) the Secretary of State should have transferred to him the powers currently held by BT under existing legislation to place apparatus etc and to authorise others to do so. Initially the Secretary of State should authorise only those already permitted to run telecommunications systems (BT and Kingston upon Hull) to use the powers;

(c) authorisation of any additional persons to carry out the works listed in sub-paragraph (d) below would be by the granting of a special licence subject to conditions controlling the way in which eg the authorised licensee could disturb the surface of trunk roads. The names of authorised bodies would be published;

(d) Since wideband cable systems are legally regarded as telecommunications systems, it would be open to the Government to authorise those whom it licensed to operate local wideband cable systems to place their apparatus using the powers given by the amended Telegraph Acts discussed in this paper. It is intended that any purely local telecommunications system, including local cable systems, could be authorised to use these powers only after:-

(i) the Secretary of State had consulted local authorities in the area concerned; and

(ii) the imposition as necessary of conditions to meet local requirements and environmental concerns (eg maximum diameters for overhead cables, compulsory underground cables in Conservation Areas and minimal interruption of traffic flows).

None of this need pre-empt the Government's ability to make other provision for authorising cable system operators to use the powers in the amended Telegraph Acts if it decided in due course that it wanted such provision;

(e) the new Telecommunications Code would reproduce the existing provisions that:-

(i) authorised persons need the consent of the highway authorities for the placing of <u>overhead</u> apparatus in public streets;

(ii) authorised persons may install <u>underground</u> apparatus in public streets if they follow the procedures set out in the Public Utilities Street Works Act (PUSWA);

(iii) special provisions apply to railways, canals, etc;

(iv) apparatus can be placed on private land only with consent;

(f) the provisions on consents for the placing of telegraph lines in or over private land should be amended so that only the occupier of land and, in the case of short-term tenants, his landlord need consent to the placing of a telecommunications line to the premises he occupies. The provisions covering short-term tenants would apply the same principles as the Government introduced in the Housing Act 1980[1] permitting tenants to install television aerials etc. There would be a proviso that the consent of the landlord should not be unreasonably refused. At present all those with an interest in the land (including long-term lessees and freeholders) must give their consent to the placing of telegraph lines;

(g) the existing provision enabling the Courts to direct that persons with an interest in private land should consent to the placing of apparatus where this is in the public interest should be amended so that the occupier will be required to give consent where the Courts are satisfied that refusal of consent prevents a person receiving telecommunications services and the person refusing consent can be adequately compensated;

(h) a number of existing provisions - concerning poles near dwelling houses, objection procedures for pole routes in rural areas, protection for the amenities of parks and pleasure grounds and the views from "mansions" - should be removed and replaced by a clearly defined objection procedure. Objectors should be able to apply to the Cour and be able to obtain the relocation of poles, or compensation if th

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1 The Tenants' Rights Etc (Scotland) Act 1980 in Scotland.

telecommunications undertaker can demonstate that damage to amenity could not have been avoided at reasonable cost by placing the poles elsewhere in a way that would not significantly prejudice service to, or adversely affect the amenities of, others;

(i) the new legislation would subject telecommunications undertakings to PUSWA in exactly the same way as other undertakings;

(j) unlike the present Acts, the new legislation will be uniform for the whole of the United Kingdom (with the exception of plant placed in any street or public road in Northern Ireland where there is no equivalent of PUSWA and where the Telegraph Acts will need to be re-enacted in modernised form).

Issues Arising From These Proposals

5 Current public interest in the Telegraph Acts is negligible. Although the legislation gives individuals considerable theoretical protection, many of its provisions have simply not been observed for years. The original Acts, however, aroused considerable controversy and the proposed revision contains more contentious issues than might appear at first sight. The main points are these:-

(a) behind the legislation lies a major environmental issue, which is whether telephone lines and cable system lines should go overhead or underground. At present British Telecom normally places service lines (that is single lines to individual subscribers) overhead, except in town and city centres. Other

plant, eg trunk lines and lines serving more than one subscriber, is generally placed underground, mainly for its own protection. Cost is the main factor (in an existing street it might cost about 10 times as much to provide service underground as overhead) and underground works damage street surfaces etc. The present proposals assume that telecommunications lines to most individual subscribers will continue to be provided overhead. Any overhead wires and associated poles may be thought to cause loss of visual amenity and, although existing wires tend not to be obtrusive, the wires for cable systems may be considerably thicker than telephone wires. There may therefore need to be a limitation on the diameter of wires which are strung overhead to protect visual amenities, should the Government decide at a later date that the powers of the amended Telegraph Acts should be conferred on local cable system operators;

(b) the present legislation contains provision concerning unlawful interception of telecommunications. The Act should do no more than consolidate and re-enact these in modern form. Nevertheless there will be pressure to go further;

(c) the reduction in specific rights of property owners and their replacement by in some cases an objection procedure may cause controversy. In particular landlords will lose their present right effectively to veto a tenant's access to a telephone which is a minor way in which some landlords can harass tenants. The proposal is that telecommunications undertakings and subscribers would need to obtain landlords' prior consent to the placing of plant in private land only in the case of short-term tenants, with the rider that consent should not be unreasonably refused;

(d) people may be concerned that the new Telegraph Act powers may be conferred on private companies, but this will be inevitable if BT is privatised, the Telegraph Acts were drafted for the benefit of private telegraph companies and the present Telegraph Act powers can be conferred on private companies.

DEPARTMENT OF INDUSTRY
July 1982

TELEGRAPH ACTS

Telegraph Act 1863	(c 112)
Telegraph Act 1868	(c 110)
Telegraph Act 1870	(c 88)
Telegraph Act 1878	(c 76)
Post Office (Protection) Act 1884	(c 76)
Telegraph (Isle of Man) Act 1889	(c 34)
Telegraph Act 1892	(c 59)
Telegraph Act 1899	(c 38)
Telegraph (Construction) Act 1908	(c 33)
Telegraph (Arbitration) Act 1909	(c 20)
Telegraph (Construction) Act 1911	(c 39)
Telegraph (Construction) Act 1916	(c 40)

WR

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212
SWITCHBOARD 01-212 7676

JF1328
Secretary of State for Industry

2 August 1982

The Rt Hon William Whitelaw CH MC MP
Home Secretary
The Home Office
50 Queen Anne's Gate
LONDON
SW1H 9AT

Dear Willie,

TELECOMMUNICATIONS BILL: REFORM OF THE TELEGRAPH ACTS

Thank you for your letter of 24 July commenting on the paper which summarised proposals for the reform of the Telegraph Acts.

2 I agree with your view that in presenting our proposals we should make no refrence to the possible application of the reformed Telegraph Acts to the development of cable systems. The Consultative Document itself does not pre-judge the decisions we have still to take on cable. As you point out, there is a good case for the reform of the Telegraph Acts without any consideration of cable, and it is this case which we shall continue to emphasise in any public discussion.

3 In your letter you also mention the assumption in paragraph 4(b) of my paper that the Government would undertake the licensing of cable systems. As you correctly point out, this is just one possibility, since we may decide that some other authority should undertake this task. Whatever we decide on the question of licensing, however, it would not prevent us authorising cable operators to use the provisions in the reformed Telegraph Acts if we wish to do so.

4 Following the agreement which has been given by you and colleagues I shall be consulting the Prime Minister and I hope to issue the Consultative Document within the next few days.

5 I am sending copies of this letter to the recipients of earlier correspondence.

Yours ever
Patrick

cc Master

DSG/JR

bc JV

Subject

10 DOWNING STREET

From the Private Secretary

28 July 1982

Dear Jonathan,

SYSTEM X

The Prime Minister held a meeting with Ministers to discuss your Secretary of State's minute of 23 July about System X. Apart from your Secretary of State, the Minister of State for Industry (Mr. Baker), the Minister of State, Treasury (Mr. Wakeham) and Mr. Sparrow were also present.

Your Secretary of State said that the UK telecommunications industry was no longer world-class. It had too long enjoyed a cosy relationship with British Telecommunications (BT). System X showed many signs of being a commercial failure, particularly overseas. Half a dozen rival systems were already being sold in export markets, and without major export orders BT's own procurement would not be nearly enough to provide for the three British companies the minimum production levels for competitive international pricing. The present situation was very stark. Neither the Government nor the industry had the luxury of doing nothing, not least because the freedom to procure in the most competitive markets which a privatised BT would have would further point up the essential weakness of the industry. There was no doubt about the technical merits of System X. But could it be produced on time and at the right price? It was certain that, however the industry was organised, far less labour would be required for System X than for earlier telecommunications systems. Technological innovation was leading to a sharp decline in equipment costs so that by 1990 BT's annual public switching procurement would have fallen to a total about 80% of GEC or Plessey's current switching orders. If therefore the three companies were to maintain their present order books, exports would need to rise by £300 million a year. This would be a huge task.

Your Secretary of State went on to say that there were now signs that the industry were beginning to recognise the starkness of the position. Lord Weinstock had told Mr. Baker privately that GEC would be prepared to separate off its public switching and transmission activities and merge them with Plessey's public switching business to form a 50:50 controlled company. Plessey's initial reaction was one of disinclination to enter any such arrangement. It was difficult to see what role STC would have. It was essential that the relationship between BT and the companies be redefined: the companies must be free to design and develop at their own risk and in competition:

/ BT

JR

BT should specify only functional requirements and then procure competitively from the companies. Your Secretary of State said that he had concluded that a one-company solution was not politically acceptable. The companies must themselves put together a deal, with BT. He proposed that Mr. Jeffrey Sterling should assist in this process, acting as an honest broker between GEC, Plessey and BT, in an attempt to overcome the mutual distrust between the two companies.

Mr. Baker said that in a recent conversation with him, Lord Weinstock had strongly attacked the privatisation of BT, which he had said would do great damage to GEC. He had made three proposals. First, the part-merger with Plessey which the Secretary of State had described. Second, he had canvassed the idea of selling 50 per cent of the GEC telecommunications business to BT, lending BT the money to make this purchase, in exchange for BT's shares after privatisation. Third, he had suggested that GEC might purchase a large stake in BT, in order to influence or control its procurement. There was no doubt that Plessey were some way ahead of GEC in this area, in both research and production capability. Neither Plessey nor GEC saw any role for STC. It would be necessary for BT to find some alternative work to allot to STC if they were to be eased out of the System X business altogether.

The Prime Minister said that she saw disadvantage in either a one-company or a two-company solution. Both solutions involved inadequate competition. Mr. Sparrow said that BT should be allowed to arrive at an industrial solution to what was an industrial problem. When BT's view was clear, Ministers could decide whether there was a need to intervene on political grounds; but at that stage it would be necessary to remember that any solution to the problem which had been outlined would require rationalisation and the shedding of labour.

Summing up the discussion, the Prime Minister said that she agreed that it would be politically very difficult to assign sole responsibility for System X development and production to any single company at this time. The Department of Industry should proceed as your Secretary of State had proposed in attempting to assist the industry, together with BT, to restructure itself in order to improve its capacity to meet the challenges ahead. But, in her view, the responsibility for these changes lay with the industry and with BT; and the manner of the Government's intervention should take full account of that view.

I am sending copies of this letter to John Kerr (HM Treasury), Neil McMillan (Minister of State's Office, Industry), Peter Michael (Minister of State's Office, HM Treasury), John Rhodes (Department of Trade), Gerry Spence (CPRS) and David Wright (Cabinet Office).

Yours sincerely,

Michael Scholar

Jonathan Spencer, Esq.,
Department of Industry.

CONFIDENTIAL
COMMERCIAL - IN CONFIDENCE

Qa 05998

To: PRIME MINISTER

From: JOHN SPARROW

26 July 1982

System X

1. The minute of 23 July by the Secretary of State for Industry reviews a number of options for rationalising System X production, and proposes that he should discuss some of these options with BT and the three companies, reporting back in the Autumn.

2. I agree that to do nothing is not a realistic option. The domestic (BT) market will shrink by more than 60 per cent in money terms over the rest of the decade, although as part of this is due to low prices it is not clear whether GEC or Plessey could meet it on their own. The fragmented UK industry is not at present competitive internationally, and after privatisation BT will be under strong competitive pressure to buy abroad. Hence the industry will in any case need to rationalise and shed labour. How far it needs to shrink depends on exports - but in a tough world environment economies of scale look necessary and exports will only grow, from their present low level, if there is unified management and far more effective effort than has been shown by the firms so far.

3. It must be remembered that BT has the prime responsibility. As well as being sole customer, it has taken the lead in developing System X. It should therefore take the lead in rationalisation, and Ministers should only intervene if there is a clear need. But in deciding whether or not to intervene, they should have full knowledge of BT's assessment of the companies' proposals (mentioned in paragraph 2 of the Secretary of State's paper).

4. Of the two options put forward by Lord Weinstock, the second - GEC to sell 50 per cent of its telecommunications business to BT, to be paid back in BT shares after privatisation - seems to me impossible to reconcile with Ministers' objectives. It would take BT heavily into manufacturing, with a commitment to GEC on procurement policy which would reduce UK competition and do nothing for exports.

5. This leaves three options:

(i) Single company: to allow BT to assign sole responsibility for the development and production of System X to one of Plessey, GEC and STC.

(ii) Joint venture: to get two or three of the companies to merge their public switching activities into a single business.

(iii) Competitive procurement: to pass over to the companies full responsibility for design and development work and then allow BT complete freedom to purchase from the most competitive supplier.

6. Single company. BT's assessment is that Plessey is the only credible leader. The arguments are set out in paragraph 11 of the paper - it would provide an effective world-scale producer, with the necessary financial strength and enthusiasm, but management skills are more doubtful, and Plessey are asking for £30m. for further R and D. The Secretary of State has concluded that to shut out GEC and STC, on whatever terms, would be unacceptable because of the inherent political and industrial difficulties. But the underlying industrial difficulty of reducing capacity in the industry will arise under any option.

7. Joint venture. This is GEC's preferred option, and is discussed in paragraph 3 of the covering note and 14b. of the main paper. In brief, Plessey oppose it because they see insuperable difficulties in splitting public from private switching, and because past co-operative ventures with GEC have been unsuccessful. The present joint sales promotion company (British Telecommunications Systems Ltd.) has not been a success.

8. Competitive Procurement. (Paragraph 14c. of the main paper). This would eventually force some rationalisation on the companies, but would waste perhaps another year while they were forced to exchange information enabling them to compete. It has the merit of requiring the surviving companies to fund their own development, e.g. for exports, although this would be possible, and desirable, under the other two options. But each surviving company might still remain uneconomically small for world markets.

9. Conclusion

In effect the Secretary of State is asking for agreement that he should explore the last two options with BT and the companies. He will report back in the early Autumn. Ministers will want to consider whether it is right to eliminate the first (single company) option at this stage. They may also want to ask to see a full BT assessment of the options, when the Secretary of State reports back; and to stress that the Government should seek to avoid appearing to take over from BT the prime responsibility.

10. I am sending a copy of this minute to Sir Robert Armstrong.

B.

P.0822

PRIME MINISTER

British Telecommunications (BT)
(E(NI)(82)21 and 22)

BACKGROUND

The Secretary of State for Industry seeks E(NI)'s agreement to objectives for BT and to the response which he proposes to make to the corporation's corporate plan.

MAIN ISSUES

2. I understand that the objectives which the Secretary of State proposes in E(NI)(82)21 have been largely agreed with the Treasury and the Central Policy Review Staff. They probably need not therefore be discussed; and any points of difficulty which are raised would probably be best left to be sorted out in correspondence.

3. You will however want the Sub-Committee to consider the Secretary of State for Industry's proposed response to BT's corporate plan. His proposals are listed in paragraph 3 of E(NI)(82)22, and discussed in the following paragraphs.

Manpower, wages and efficiency

4. The Secretary of State for Industry proposes that he should set BT a performance target which requires them to reduce real unit costs and manpower considerably more rapidly over the next five years than BT's plan assumes. He suggests that BT might aim to reduce manpower to 230,000 by 1984/85 as against 1986/87. He also intends to make it clear that it is unacceptable for BT to plan to increase wages in real terms, especially when the absolute level is already high.

5. The Sub-Committee will probably want to reinforce even more strongly the Secretary of State's efforts to secure these improvements. It should be recognised however there is bound to be a period of increasing strain in BT's industrial relations, not just because of efforts to improve efficiency but also because of liberalisation and privatisation.

Financial targets, external finance, prices

6. The Secretary of State proposes that BT should be encouraged not to increase charges next year by more than the 3.3 per cent average increase which they plan for November this year. This includes some further loading of tariffs against the domestic customer. There is however concern, as the Secretary of State suggests, about whether this process is to continue and whether it is genuinely justified by differences in costs, or may develop into milking the captive domestic customer so as to permit underpricing in the business sector, now open to competition. Ministers are therefore likely to endorse the intention of keeping average tariff increases to modest levels and the Secretary of State's desire to see figures from BT to justify any further loading of tariffs against the domestic customer.

Areas in which BT should operate

7. The Sub-Committee is likely to endorse the Secretary of State's view that BT should not abuse their market power to thwart competitors. They may however be less sympathetic than the Secretary of State to BT's plans to enter new markets, and activities, for example:

a. to acquire International Aeradio Ltd (IAL) from British Airways;
(the Secretary of State says that he will consider BT's case for doing so)

b. to begin manufacturing telephones;
(to which the Secretary of State does not intend to object).

Bearing in mind that even with its present activities and the plans for liberalisation BT will inevitably remain one of the largest undertakings in the UK for the next decade and will retain some 95 per cent of the telecommunications market, Ministers may feel that further diversification should be discouraged - both to avoid stretching BT's management resources and to reduce the scope for anti-competitive practices.

8. There are passing references in E(NI)(82)22 to the possibilities of BT's being involved in broad band cable; and their manufacturing exchange systems. But these points should not need discussion. Any decisions on cable must await the Hunt report; and BT appear to have no plans at present to get involved in major systems manufacturing.

Research and development

9. BT has co-operated with British firms in R and D work on a range of new equipment, largely through its research centre at Martlesham. The Secretary of State for Industry proposes that BT should be left to operate Martlesham as it sees fit. It is not however clear whether such a 'hands off' policy is the best approach, bearing in mind liberalisation and privatisation. Should the Secretary of State be asked to consider whether the present arrangements for R and D, dominated for historical reasons by BT, will be in the best interests of British industry as a whole, in the changed circumstances?

Investment

10. There is likely to be general support for the Secretary of State for Industry's view that substantial investment in telecommunications is necessary over the next few years on modernisation grounds. Ministers are likely to have doubts as to whether BT can successfully invest 40 per cent more in 1982-83 than they did last year. They are also likely to share the Secretary of State's concern that, even by 1986-87, expenditure on digital System X equipment and optical fibres together account for only £250 million out of total planned investment of over £3,000 million. The Secretary of State proposes to ask BT to reconsider whether they could not get on much more quickly with installing fully digital exchanges and optical fibres and Ministers may wish to endorse this.

HANDLING

11. You might begin by asking whether any member of the Sub-Committee wishes to comment on E(NI)(82)21, the draft objectives for BT. If not, the Secretary of State for Industry could confine his introduction to his comments on BT's corporate plan. The Chancellor of the Exchequer will want to comment on Mr Jenkin's proposals; so will Mr Sparrow and, probably, other members of the Sub-Committee.

CONCLUSIONS

12. You will want to reach conclusions on the following questions.

a. Does the Sub-Committee agree to the objectives for BT set out in E(NI)(82)21?

b. Does the Sub-Committee agree with the Secretary of State for Industry's assessments of and proposed response to BT's corporate plan, particularly in regard to:

i. manpower, wages and efficiency;

ii. financial targets, external finance, prices;

iii. areas of business in which BT should operate;

iv. research and development;

v. investment.

13. Any Minister who has comments of detail on either the draft objectives or the corporate plan could be invited to sort them out outside the meeting with the Secretary of State for Industry, by Ministers and the CPRS.

14. If major doubts are expressed, for example about BT's investment strategy or R and D arrangements, the Secretary of State for Industry could be invited to report back to the Sub-Committee in the autumn.

P L GREGSON

23 July 1982

Qa 05996

To: PRIME MINISTER

23 July 1982

From: JOHN SPARROW

BT's Corporate Plan and Corporate Objectives

1. The Secretary of State for Industry circulated yesterday two papers for discussion at E(NI) on Monday 26 July. This leaves little time for Ministers to consider what are fundamental issues involving, not only the future of BT, but of telecommunications generally and other topics such as broadband cable, information technology and the development and supply of telecommunications equipment.

2. The CPRS is content with the paper on Objectives for BT.

3. However, the paper on the Corporate Plan raises issues requiring further detailed consideration. Even after the present liberalisation measures have been put into effect and after privatisation, BT will remain, for most of its business, a monopoly supplier. BT is not an efficient organisation. Wage levels are high, there are bad working practices and there is a shortage of information about the business. Sir George Jefferson has called for improvements in 'operating efficiency'. There is evidence that manufacturers have suffered because of BT's dominance as the main customer. As a result their products are of too high a specification and are not competitive in world markets. BT has also dominated their research and development efforts.

4. The Secretary of State asks the Committee to note that he will be keeping the question of BT's future diversification into major systems manufacture under continuing review. We believe that this continuing review should cover all BT's ideas on diversification, because we put great emphasis on the Secretary of State's proviso (paragraph 15) that BT 'should not abuse their monopoly power to undermine potential and actual competitors'. This does not ride comfortably with his earlier view that 'we should not seek to restrict BT's freedom', and we believe that the proviso should prevail.

5. A number of specific areas are discussed in paragraphs 16-17 of the paper:

Agreed

(a) In our view there are several arguments against allowing BT to acquire International Aeradio from British Airways; it is in an area not closely linked to BT's traditional business.

So have I

(b) We also have doubts about allowing BT to become involved in vertically integrated business such as manufacturing. The aim must be to create a strong telecommunications manufacturing industry, and BT's entry into this field may inhibit that.

(c) BT wish to be involved in broadband cable developments, and this might be seen as a natural development for them. But if responsibility for broadband cable were given to organisations other than BT, a rival telecommunications system might be developed, in competition with BT. As the paper proposes, we should await the outcome of the Hunt Committee report and the review of this topic by officials.

(d) Information technology is not mentioned in any detail in the paper, but it is possible that here too BT may cause harm if given a dominant role. We should await the report of the Alvey Committee, and restrain BT until then.

6. The CPRS recommends that the question of BT's future diversification into these areas should be kept under continuing review. In view of their importance to the telecommunications industry as a whole, we recommend that Ministers collectively should be kept informed of major developments. For the time being BT should be restrained from expanding its activities, given its dominant position.

7. I am sending a copy of this minute to Sir Robert Armstrong.

MT.

cc JV

CONFIDENTIAL

COMMERCIAL IN CONFIDENCE

JF1243

Prime Minister (2)

I have asked the CPRS to let you have advice on this.

MCS 23/7

PRIME MINISTER

SYSTEM X

We had a brief discussion of System X on 6 July (your Private Secretary's letter of 7 July refers). This minute and the attached paper set out the position as I currently see it.

2 Following E(TP)'s decision on 22 April, British Telecommunications have sought and evaluated proposals from the three System X manufacturing companies, GEC, Plessey and STC, for a single focus for management responsibility for System X. BT have advised me that Plessey is the only credible leader and that System X production should be concentrated in Liverpool. The implication of BT's assessment is that whatever the nature of the transition arrangements, GEC and STC would be obliged, effectively as a consequence of administrative fiat, to withdraw from the public switching business over the next few years.

3 While I am deeply concerned that this industry has failed in the main to appreciate the serious situation it faces I am convinced - as I believe you are - that such an action by Government is unacceptable. Having said that neither we nor the industry have the luxury of doing nothing, not least because the freedom to procure in the most competitive markets which a privatised BT will have will further point up the essential

weakness of the industry. I am encouraged however by signs that, prompted by recent events, the companies are recognising the dilemma. Within the past 48 hours Arnold Weinstock has told Kenneth Baker privately that GEC would be prepared to separate off its public switching and transmission activities and merge them with Plessey's public switching business to form a 50/50 controlled company which would be responsible for all home and overseas main switching business, including research and development; or to sell 50% of the GEC telecommunications business to BT, - he would lend BT the money to do this now, in exchange for BT shares after privatisation (he felt strongly that BT should have an investment in the manufacturing side of the industry). Without disclosing the source of the proposal Kenneth has sounded out Plessey on this. Their initial reaction is to be disinclined to enter any such arrangement, partly because of the difficulty they see in separating the public and private switching businesses and also because of GEC's alleged long record of failure in such joint arrangements. Both companies have made it clear that they see no role for STC although both may be interested in buying it at a suitably low price.

4 It is apparent that a more positive attitude is emerging at least in some parts of the industry and this should enable hitherto unlikely options to be considered.

5 I shall wish to report to E(TP) after the Recess on BT's assessment and to explore with colleagues alternative courses.

There will however be no easy solution to the System X problem. Over-capacity in the industry and the sharp impact of technology upon equipment cost, unfortunately ensures this. The starkness of the situation is set out in the attached draft memorandum, which I envisage as the basis for a paper for E(TP) in due course. The options set out are necesarily tentative and represent our thinking at an early stage; they will of course be amended in the light of reactions to proposals such as Arnold Weinstock has just mooted. We shall also need to explore them with BT and the companies and we may have other possibilities to add then.

6 I am copying this to the Chancellor, Kenneth Baker, John Sparrow and Sir Robert Armstrong.

J. P. Spencer

P J

23 July 1982

Department of Industry
Ashdown House
123 Victoria Street
LONDON
SW1E 6RB

DRAFT

SYSTEM X AND THE UK TELECOMMUNICATIONS INDUSTRY

MEMORANDUM BY THE SECRETARY OF STATE FOR INDUSTRY

The UK telecommunications industry is no longer world class; its share of world exports has steadily fallen from 25% to 6%. System X, which was meant to revive the industry, shows many signs of being a commercial failure, particularly overseas. In 6 years British Telecommunications (BT) has spent over £200m on development; further development requiring comparable expenditure will be needed until the late 1980s. Yet only four trial exchanges are operating in the network; these are preproduction systems with no export potential: the first commercial exchanges will not be ready until end 1983.

2. Half a dozen rival systems are already being sold in export markets. There is, as yet, no prospect of serious System X export business: even when it comes it is likely to need substantial financial support from Government. And exports are not the 'icing on the cake'; without major export orders BT's own procurement will not be nearly enough to provide, for the 3 companies, the minimum production levels for competitive international pricing. Either continuing subsidy of the home switching industry by BT will be needed (with its obvious impact on the financial prospects for the privatisation of BT) or a regenerated, competitive industry must evolve - and quickly.

3. This position needs to be achieved against the inevitable contraction of each company's revenue base as technology leads to a sharp decline in equipment cost. Currently BT's annual public switching procurement totals ca £500m; by 1990 it will have fallen to £190m, a total which is about 80% of GEC or Plessey's current BT

switching orders. For the 3 companies to maintain their present order books by 1990 exports will need to rise by £300m per year. In 1981 our main switching exports totalled £14m. Given that the accessible world switching market in 1990 is estimated to be less than £1000m and there are half a dozen international switching companies already established in the markets the magnitude of the task is clear. There will be a major loss of jobs (15,000?) unless we secure very substantial exports. In the long term only one - at best two - companies can hope to survive.

4 There is little doubt that System X is - or will be - a technical success. Its obvious shortcomings are attributable to:

a. the nature of the development arrangements. There is no focus of management: no single person or authority is clearly in charge. The consensus basis of development has resulted in unnecessarily long and costly timescales. BT funding the programme means that the companies are not subject to the discipline of commiting their own resources.

b. inadequate commitment to exports. There are far too few people, including those of the right calibre, on the ground overseas and directing operations from home. The companies at heart regard exports as 'gravy' rather than the crucial factor generating the volume essential for competitive pricing and furthermore call for large sums from Government to support their export programmes. In general the attitude of the companies is unenthusiastic; by contrast our rivals are almost hyperactive: in India where a £200m digital switching contract is under consideration (for which GEC has bid, and is seeking Government support altogether totalling £55m) CIT-Alcatel has a team of around 30 technical and marketing experts supporting their bid.

c. production is divided over 3 sites. As a consequence economies of scale cannot be achieved and management problems are exacerbated.

5. In November 1981 the companies applied to my Department for assistance towards the cost of developing export variants of System X. Kenneth Baker made clear to them that he was not prepared to provide assistance unless there were changes in the arrangements for exports. He made a number of relatively modest proposals (including the setting up of an adequately funded joint export company) and invited the companies to suggest alternative solutions. They were unable to agree collectively on their response. Subsequently Plessey advised me of their serious intention to enter the North American market by the acquisition of a US main switching company(negotiations are still in progress) and proposed that they should be given the sole responsibility for the development and manufacture of System X at home and overseas.

6. Over the past month I have visited the main System X centres of all 3 companies and held discussions with senior management. All agree that there are serious shortcomings in the existing arrangements and that a strongly export-orientated business is essential for the medium/long term viability of their respective companies. I endorse this view.

7. My observations have confirmed me in the view that the current unsatisfactory position, both from BT's and the companies' standpoint stems from the central role in System X design, specification, project management (and 100% funding of development) which BT assumed in 1976 at the outset. It is essential that the relationship between BT and the companies be redefined: the companies must be free to design and develop at their own risk and in competition; BT should specify only functional requirements and then procure competitively from the

companies. The market, both domestic and overseas, will then determine the survivors. Without this realignment of proper responsibilities and functions the industry cannot hope to be successful nor indeed can BT have the freedom of action which as a privatised company it will increasingly seek.

8. A new dimension has been added to the problem with our intention to privatise BT. While for the next 2-3 years BT's aspirations to purchase equipment in the most competitive markets can be moderated by Government and public pressure, this will not obtain for a privatised BT: the price deficiencies of an unreformed British industry will then be starkly revealed. We face the risk of the world's fourth largest public switching market being satisfied by imports within a ten year period.

9. E(TP)(82)1st, item 2 on 22 April, considered my paper E(TP)(82)3 which reported on the current position of the System X programme and suggested that it could not be successful unless fundamental changes were made to the arrangements for development and manufacture. It was made clear in discussion that we were not committed to any particular solution to this problem and that the wider implications of any one company being given sole responsibility for System X would need to be examined by colleagues before any decision could be taken. The Sub-Committee agreed however that BT should be authorised to seek proposals from the 3 companies for a single focus for management responsibility for System X and asked me to report on BT's discussions and evaluation of the proposals.

10. Following the E(TP) decision, the companies were approached by BT and subsequently submitted their proposals. BT have advised me that Plessey is the only credible leader and that System X production should be concentrated in Liverpool. BT have already moved in this direction: partly due to STC's shortcomings, Plessey have recently been made responsible for almost two-thirds of the research and development work on System X. BT's view is alternative solutions would do nothing to resolve the underlying problems.

11. Concentration of most if not all, of BT's System X procurement upon Plessey, as recommended by BT, certainly offers a route towards the establishment of a world class company in production terms. A financial appraisal of Plessey's ability to undertake sole responsibility for System X made by the Industrial Development Unit of my Department has confirmed that the company has the necessary financial strength. That they also have the enthusiasm for it is also clear. However I am less sure that this is matched by the management skills essential for a task of this magnitude. Furthermore their financial projections indicate that they would be seeking £30m, in roughly equal shares from BT and my Department, for the funding of System X export variants and the development of a successor to System X.

12. A further aspect of the BT 'single focus' proposal disturbs me: as a check on the competitiveness of their chosen supplier, BT would wish to procure 10% or so of their main switching equipment from another source, possibly an overseas supplier. While recognising BT's arguments, to permit this course when the traditional suppliers have been forced to shed labour would present major difficulties. I have pointed out already in this paper however that a privatised BT could not be constrained in its procurement.

13. Something must be done - and soon. The companies' response to BT has indicated a way forward. There is no doubt that BT's proposal for Plessey be given sole development and production responsibility for System X has several attractions, not least in enabling BT's procurement power and Government's development and export assistance to be concentrated upon a financially sound company with a good technical record: the combination could be successful. I am unhappy however at the prospect of Government being seen to put companies out of business, for whatever reason, effectively by administrative fiat. I am convinced that to proceed along this path would be fraught with political and commercial difficulties which may be insurmountable.

14. Nevertheless BT's approach to the companies has served to concentrate their minds upon the dilemma facing the industry and, uncomfortable though it will certainly be, the preference for the companies rather than Government to resolve it. It is in this light that we need to consider and explore alternative options urgently. These include:

a. do nothing. This option has no attraction: System X management will remain diffuse; over-capacity in the industry will continue; few exports will be generated; for two or three years BT will continue to purchase (at considerable profit to the companies) uncompetitively priced British equipment; thereafter a privatised BT will increasingly look elsewhere. Coupled with the sharp fall in the cost of switching equipment expected at that time (BT's procurement forecasts show a fall from ca £380m to £200m in the period 1986-89), this option is likely to result in the industry facing a rapid and probably irreversible decline.

b. a merger of the telecommunications activities of two or more of the companies. A single jointly-owned company has several attractions although fundamental difficulties would remain, not least that the interests of the partners are competitive not complementary; for some time there would inevitably be multiple site production and resistance to plant closures, and access to capital would be via the parent companies and would delay decisions. Most importantly, true integration of two (or three) such widely different business attitudes would probably take longer than the industry has to put itself right. The first company to express interest in the merger route was STC, but only last week Lord Weinstock said that GEC would be prepared to merge its public switching and transmission activities with Plessey's to form a 50/50 controlled company. Plessey have expressed initial oppostion to this idea in view of what they see as past GEC failures in cooperative ventures. They also see insuperable difficulties in distinguishing between private and public switching. The GEC proposal could however form the basis for rationalisation of the industry, and despite the attendant problems further refinement of this proposal should be encouraged. Another possibility put forward by Lord Weinstock is for BT to buy 50% of GEC's telecommunications business in return for BT shares after privatisation. GEC has also expressed interest in acquiring a block of BT shares sufficient for it to influence or control BT's procurement policy.

c. To move to competitive procurement as quickly as possible. The essence of this option is that there should be a speedy move to competitive procurement by BT and that the companies should have responsibility for design and development work (and the funding of it) squarely placed upon them individually as soon as possible.

Division of the development work means that no company is currently able to design and manufacture all of System X. Not until end-1983 will there have been sufficient interchange of information between the companies to permit production of System X by each company. BT's procurement plans then envisage each company being given 25% of the business with the remaining 25% going to the most competitive bidder.

The option of moving to a full exchange of information as soon as possible, linked to more competitive procurement and with the companies funding 50% (or more) of the remaining development and themselves being responsible for all future development, is an attractive one. It is unlikely to be welcomed warmly by the companies who have grown used to the 'cost plus' regime of BT. Company-funded development, coupled with truly competitive procurement, should provide a powerful spur, not least to the necessity to win exports to provide the volumes essential for competitive pricing.

BT's concern over this option is the risk of delay to the System X programme because the companies will jockey for position by hindering the full information exchange. They estimate this delay could amount to 3-10 months although a threat by BT to use its procurement power (eg for TXE 4A exchanges) to penalise non-cooperation should minimise slippage. This option should however also stimulate the companies to complete their full in-house System X capability by funding themselves the areas of development crucial to their business and where they are currently dependent upon the others. Weighed against the establishment of a competitive environment, coupled with the adoption by BT of a proper customer/contractor relationship, the possible delay to BT would seem acceptable. Certainly should closer scrutiny prove this option to be feasible it would seem to me to offer

the most helpful route forward.

In the shorter term this course would do nothing to resolve the economies of scale and the multiplicity of production sites; it will also lead to 3 separately developed variants of System X which could compete against one another in all markets. The provision of export assistance to companies could however be tied to their performance. In time the likelihood is that this option would see at least one company wither on the vine in the 1980s.

CONCLUSION

There is a clear need to resolve the System X dilemma. I invite colleagues to agree that:

a. the inherent political and industrial difficulties make impracticable the assignment of sole responsibility for System X development and production to any single company at this time;

b. the companies should be encouraged to consider how they might together rationalise their public switching activities to ensure a viable UK industry with substantial overseas business;

c. arrangements for System X exports should be reviewed by the companies and BT;

d. BT should be asked to:

i. advise on how to ensure the earliest possible exchange of information between the companies to enable System X to be produced independently by each company;

ii. explore how an early move to a competitive procurement situation can be achieved;

iii. place responsibility for future design and development and its funding with the industry;

iv. consider whether on completion of the export review proposed in sub-paragraph (c) above it should withdraw from British Telecommunications Systems Ltd.

With the agreement of colleagues I would propose to initiate discussions with BT and the three companies along these lines and to report in the early autumn.

DEPARTMENT OF INDUSTRY

22 July 1982

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Prime Minister (2)
x Relevant to Monday's E(NI) discussion?
Yes MCS 23/7

The Rt Hon Patrick Jenkin MP
Secretary of State
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22 July 1982

Dear Patrick.

In the light of your earlier reports of March and April to the Prime Minister on the question of telephone rental charges and their effects on pensioners and other subscribers I took particular interest in the latest proposals from British Telecom for raising their tariffs, as set out in your letter of 28 June to the Chancellor, as an indication of their present thinking.

I note that once again the biggest increase is loaded on to the rental charge, and the increased call charges are weighted in favour of the business user and those who make extensive use of trunk call facilities. The proposal to introduce a small user rebate is a welcome step to ameliorate the effects of the high rental on those who make least use of their telephone, but I fear that the complexity of the scheme, and the steep clawback of its benefit over a narrow band of users, will lead to justified criticism that disproportionate increases are once more loaded on to those least able to bear them. Taking the rental, call charges and VAT together the new tariffs will mean less to pay for those whose present quarterly bills are under £18. But the largest percentage increase of 9.5 per cent is to be applied to those with a quarterly bill of only £20.50, who will have to pay nearly £2 extra each quarter, in order to continue to make one short local call each day. In fact all domestic users using between 75 and 2250 units a quarter will pay more than the average increase of 5.4 per cent.

Since 1979 we have not been increasing pensions and most other social security benefits in real terms, so I think we will find it difficult to explain to pensioners and others on low incomes why their telephone charges should be increasing at a much faster rate than average and by significantly more than those for business users and those who make extensive trunk or international calls. You will know from Family Expenditure Survey figures that single household pensioners already apply a much higher proportion of their total disposable income to the cost of the telephone than households generally, so that it bears much harder on them when standing charges increase faster than call charges. In saying this I am not arguing for any special treatment for pensioners, since only a minority have a telephone and the problems which arise in meeting telephone costs go well beyond my Department's customers. Nor am I arguing for any subsidies towards the telephone service from the taxpayer, since the service is well able to generate all the income it requires from its subscribers.

E.R.

What I would like to see is a considerable simplification of charging arrangements with a progressive reduction in the importance of the rental charge income relative to call charge income. The real terms reduction of rental charges in the last decade is very welcome but it calls into question the continuing need to weight telephone costs per call in favour of the heavy user and at the expense of those for whom the decision to install a telephone in order to maintain necessary but occasional contact with family, friends or essential services often involves considerable financial sacrifice. In my view in the strategic review of policy options we should be inviting British Telecom to consider changes in their charging arrangements so that a reducing share of telephone costs are raised through the rental, leading if possible to the eventual disappearance of the latter. The detailed structure would obviously be for British Telecom to decide, within the constraints of continuing to provide a commercially viable service, and of establishing a charging system that was fair in its impact on the heavy and light user alike. At present I feel they simply do not have the balance right.

I am copying this letter to the Prime Minister and the Chancellor.

Yours Norman

NORMAN FOWLER

PART 4 ends:-

Hansard Statement 9.2.82.

PART 5 begins:-

Post Office Report & Accounts 81-82


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