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

Telephone Direct Line 01-212 3301
Switchboard 01-212 7676

PS/ Secretary of State for Industry

*Yes - in his stages -
I do not doubt that
none of the prices don't cover the
costs. What's worth examining is
each & every item involved in the
costing and whether
the costs are
containing work.*

24 August 1979

PRIME MINISTER.

Mike Pattison Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Mike,

*The response to your telephone
conversation from 15 Aug. Industry
seek authority for P.O. to go to
POUNC in two stages. Mr Nott
(Flag A) argues that POUNC should
see all. Earlier papers are at B.
Agree reference to POUNC
in two stages? MAF 24/VIII*

THE POST OFFICE

The Prime Minister has asked some further questions following my letter to Nick Sanders of 17 August.

She was concerned about the large percentage increases in some of the first stage tariff proposals which the Post Office is proposing to put to the Post Office Users' National Council (POUNC).

The first point the Post Office make is of course that these are the first increases in four years, since when retail prices will have increased by over 65%. The Post Office feel they have done well to hold prices for so long.

Second they remind us that they are achieving the target set by the last Government of reducing real costs per unit of output at an average annual rate of 5% over the five years to 1982/83. Over the past five years the number of telephone stations has been increased by a third, but the number of staff employed has decreased by over 5%. They recognise that there is continuing room for improvements in efficiency and over the next five years they aim for the system to increase again by more than a third while staff numbers rise by only 2½%, mainly for modernisation and improvements in the quality of service.

The increases proposed in the first tranche are mostly ones which, on grounds of economic pricing, should have been made some years ago. Some of them would have been made in the autumn of 1975 but for the fact that the package of increases made then (the second in that year) had to be introduced in a hurry because of the deteriorating inflationary situation at that time and it was more readily practicable just to increase unit call charges.

As a result there has been an imbalance ever since between call charges and connexion/rental charges and even the present increases proposed do not go all the way to cover costs incurred. In some

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/so cases current charges only cover one-third of costs. While corrective action would have been desirable over the past four years the Post Office has felt unable to take an initiative over the necessary price increases because the telecommunications business has been very profitable and able to meet its financial target without additional tariff revenue. Indeed some two years ago there was much criticism that a refund of £101 million had to be made to customers.

Now, however, the revenue from these increases is essential to meet the Post Office's objectives this year.

... Both the Department of Industry and the Treasury have long been concerned that the Post Office's pricing structure has not so far correctly reflected its costs. The Prime Minister may be interested to see the enclosed extract from this year's published accounts of the Post Office. It vividly demonstrates just how much some telecommunications services are being subsidised by three highly profitable ones: inland subscribers' calls and external telephone and telegraph services. Between them, in 1978/9 the loss-making services had a deficit of £250m. Economic arguments and revenue requirements therefore point to the present need for prices increases contributing to the elimination of losses on particular services.

The Post Office themselves have been very conscious of the percentage scale of the increases necessary and have given a lot of thought to how best the increases could be staged to cause users as little harm as possible. As a result, a number of the increases only go half-way to restoring economic pricing and a further round will be desirable in a year or so. We too have been into these increases in greater detail than we would normally, in view of their size.

The answer to the Prime Minister's question in respect of each increase, in detail, is as follows.

CHARGES AFFECTING RESIDENTIAL USERS

The following proposed increases, in the first tranche, affect residential users:

- 1 connexion charges for exchange service, where the maximum would go up from £45 to £55, and
- 2 connexion charges for extensions and for a plug and socket arrangement, which would increase from £8 to £12 (about half the increase warranted by costs).

POUNC have been aware that the increases in connexion charges made in May 1975 were insufficient to cover costs on many items even during 1975/6. Since then the Post Office have kept POUNC informed and POUNC acknowledge that it is reasonable for customers to pay the cost of connecting them to the system at the outset, and to recover the capital cost of the equipment and maintenance expenditure by means of rental. POUNC was advised informally

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some time ago by the Post Office to expect tariff proposals of the scale now put forward.

In addition to the desirability of covering costs incurred, there is a further important argument for increasing these connexion charges. In order to improve its contribution to the PSBR the Post Office has been at pains to cut out uneconomic investment. Low connexion charges encourage uneconomic expansion of the network and increasing them is the most effective means of rationing. Without this increase the Post Office reckon that the waiting list for new connexions would have to increase by 200,000 next year. The Post Office have pointed out that local managers are able to apply local discounts where unused network makes the encouragement of new connexions economic.

No increase in connexion charges is proposed for items designed exclusively for use by the disabled.

3 Minor Service Charges:

- i) The hourly charge for non-standard installations: the Post Office propose an average increase of 79%. (The only increases above this level relate to work done at customers' request on Sundays and bank holidays.) After discussion with the Department the Post Office have decided to make a partial concession in respect of remote (eg rural) locations.
- ii) Disconnexion at customer's request: the Post Office propose to increase this charge from £1 to £2. (The economic cost is £4.50.)
- iii) Reconnexion of a user who has been disconnected for non-payment of bills: the Post Office propose to increase this charge from £3 to £6, but have agreed, after discussion with the Department, to delay its implementation until April in view of the large number of users who may find difficulty in paying the larger bills which will result from the billing dispute.

CHARGES AFFECTING BUSINESS USERS

The other charges in the first tranche (apart from coinboxes) are for items used practically exclusively by businesses. They fall into two categories: connexions and rentals.

The Post Office would have wished to increase all rentals to the full economic level now. They recognise, however, that this would be unfair to users. The only rental increase proposed in the first tranche is one on private circuits: an increase of up to

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50% on short distance circuits and up to 8% on long distance ones. This would still leave these charges well below economic levels. Communications managers are aware of the position and increases of up to 50% will be within their expectations. All customers will be advised of the economic rental and that further price rises will be needed so that they can plan for the future on a basis reflecting actual costs incurred by the Post Office and so induce a sound economic balance between development of the public and private networks. This is important to avoid resources being unnecessarily committed to uneconomic investment and consequently to reduce calls on the PSBR.

In the case of connexion charges on apparatus, telex and private circuits, the Post Office feel there is more justification than in the case of existing services to a customer for moving, immediately, closer to economic charges. Even so, the Post Office are mitigating the increases to some extent.

COINBOXES

On coinboxes, the Prime Minister was content to let the Post Office refer the increases to POUNC but wanted the Department first to cross-examine the Post Office as to why it should take 20 weeks preparation to change the coinboxes.

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The Post Office explain that the conversion involves modification to the mechanism of 356,000 coinboxes as well as adjustments at 6,300 local telephone exchanges. The conversion itself will take at least three weeks. Consultation with Unions is needed on the detailed arrangements, such as training, and cannot be started before POUNC has been approached. The training of the 3,500 men required will span 16 weeks allowing for preparation, training of instructors, and the phased release of staff from their normal work in manageable numbers, to avoid disrupting day to day operations.

The Prime Minister wondered if it might be possible to put up the charges in the 77,000 public call boxes on 2 January leaving the remaining 279,000 rented by private customers to be converted in due course. We put that idea to the Post Office. Unfortunately both types of call boxes use the same equipment in the exchange to permit calls to be set up. Duplication of the equipment in 6,300 local telephone exchanges to permit lower charges for calls from rental coinboxes, apart from an additional expense of several million pounds would take two years to accomplish. It is not therefore a feasible means of shortening the time required to implement 5p charging from public call boxes.

CONCLUSION

We hope that, in the light of these explanations and of the concessions we have extracted from the Post Office for residential users on items 3(i) and (iii) above, the Prime Minister will agree that the Post Office should now approach POUNC on the first tranche. The approach would be in confidence, but of course there

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can ~~not~~ be no assurance that it would not leak.

The Post Office remain very concerned to put the second tranche increases to POUNC as well. They consider that unless this can be done within the next two or three weeks, it would not be possible to implement rental increases in a second tranche by 1 January and it would further aggravate the serious problem we already have over this year's cash limit. We have nevertheless made it clear to them that this tranche must await the further discussions between the Secretary of State and Sir William Barlow. This should just give Ministers time to consider the case for a second tranche for any announcement on it to be made before the period October to January when the Post Office expect the strongest press comment and public reaction to the billing recovery programme to occur.

I am copying this letter to Alistair Pirie, Tom Harris and Martin Vile.

*Yours sincerely,
Pete*

PETER STREDDER
Private Secretary

24 AUG 1979

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10 9 8 7 6 5 4



TELECOMMUNICATIONS

FINANCIAL RESULTS BY SERVICES

| SERVICE | 1978/79 | | |
|--------------------------------|---------|-------------------|----------------------|
| | Income | Profit/ (loss) | Return on capital |
| | £m | £m | % |
| Inland | | | |
| Rentals: | | | |
| business | 141.9 | (36.1) | (0.8) |
| residence | 450.3 | (106.0) | (0.4) |
| apparatus | 270.6 | (29.6) | 1.7 |
| | 862.8 | (171.7) | - |
| Subscribers' calls | 1500.5 | 428.9 | 11.0 |
| Call Office receipts | 66.2 | (38.8) | (7.7) |
| Private circuits | 92.0 | (13.7) | 1.1 |
| Telegrams | 7.7 | (11.9) | (89.8) |
| Telex | 45.7 | (14.3) | (1.0) |
| Agency and miscellaneous items | 81.1 | 1.1 | - |
| | 2656.0 | 179.6 | 5.6 |
| External | | | |
| Telephone services | 410.6 | 136.2 | 27.4 |
| Telegraph services | 177.3 | 31.3 | 31.7 |
| Total | 3243.9 | 347.1 | 6.9 |

Proposals

| Yields | |
|------------------|---------------|
| 1979-80 Accounts | 1980 Accounts |

FIRST STAGE

From 15 October 1979
Connection Charges:

| | | | | | |
|-----------------------|---|------|-------|-------|-------|
| - Exchange Lines | New Customers £45 to £55 | +22% | £m | £m | £m |
| - Apparatus | Max increase 120% | +53% | 2.5 | 1.8 | 7 |
| - Private Circuits | Max increase 100% | +36% | 1.6 | 1.1 | 9 |
| - Telex | Uniform increase 20% | +20% | 0.5 | 0.5 | 1.3 |
| Minor Service Charges | Up to 100% increases on loss making items | - | Small | Small | Small |

From 15 November 1979
Rentals:

- Private Circuits (2 months notice to customers) Long distance; max increase 50% ...
Short distance; up to +8% ...

From 2 January 1980
Coinbox Charges:

- Local calls From 2p for 2 mins to 5p for 3 mins
- Trunk calls Same time for 5p as currently allowed from ordinary line for unit fee

TOTAL (ROUNDED)

SECOND STAGE

From 1 January 1980
Rentals:

- Exchange Lines Business Excl from £39 to £45, ...
Res Excl from £33 to £38 ...
Res Shared from £29 to £34 ...
Max increase 50% ...
Increases of 25-30% ...
Increases of 20-25% on telephone, telex and telegram services ...
Details to be determined ...

TOTAL (ROUNDED)

SECOND STAGE BOTH STAGES

| | Average % Increase | Yields | | |
|------------------------------------|--------------------|------------------|-------|---------------|
| | | 1979-80 Accounts | Cash | 1980 Accounts |
| Exchange Lines | +22% | £m | £m | £m |
| Apparatus | +53% | 2.5 | 1.8 | 7 |
| Private Circuits | +36% | 1.6 | 1.1 | 9 |
| Telex | +20% | 0.5 | 0.5 | 1.3 |
| Minor Service Charges | - | Small | Small | Small |
| Private Circuits (2 months notice) | +19% | 0.4 | 1.8 | 19.3 |
| Local calls | +2% | 14 | 11 | 81 |
| Trunk calls | local + trunk +30% | 7.5 | 5.0 | 40 |
| Exchange Lines | +15% | 15.0 | 16.5 | 97 |
| Apparatus | +17% | 10.0 | 10.5 | 61 |
| Telex | +29% | 2.3 | 1.7 | 9 |
| Maritime Services | +26% | 0.3 | - | 1.7 |
| Ordinary Call Charges | +8% | 34.0 | 7.0 | 150 |
| TOTAL (ROUNDED) | +8% | 62 | 36 | 319 |
| SECOND STAGE BOTH STAGES | +10% | 76 | 47 | 400 |