



CONFIDENTIAL

PRIME MINISTER

THE POST OFFICE

We spoke on Friday about the situation in the Post Office and I have also now seen the comments in your Private Secretary's letter of 10 August. There are three closely related issues involved.

Telephone billing dispute

The Post Office are working on a formula which they hope will get the computer staff back to work, despite their recent adverse ballot, without the offer of more cash. The clerical staff, who are also involved, are currently balloting and the indications are that they will accept their offer. I therefore do not expect any major confrontation.

However, even if the dispute is settled in the next few weeks as I hope it will, the billing backlog will continue to rise until December. The Post Office are taking vigorous steps to ensure that the borrowing this entails can be kept within their statutory borrowing limit. The cost in interest however will be about £70 million this year and this has been the main reason for bringing forward the telephone tariff package from next financial year to 1 January. I agree with you that it is unfortunate that these increases should be hitting consumers just when they are

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facing bills swollen by the delay. But I also believe it is important to bring home to the public quickly what the cost of such industrial action is so as to bring more pressure of public opinion to bear on union membership. In fact, for reasons I shall go on to later in this minute, I believe it could become necessary to make the increases even earlier, or larger.

Reasons for the telephone increases

The last Government set the Post Office a performance aim of reducing real unit costs in telecommunications by 5% a year. The Post Office have so far been achieving this aim and a bit over. It does however entail that when inflation exceeds 5% some tariff increases become necessary unless productivity gains over and above those required for the 5% aim can be achieved. In fact this year the telecommunications business have found themselves faced with costs of £158 million more than they had reckoned on in their annual plan (including the £70 million which, as I have said, is due to interest payments resulting from the billing delay). Of this total they are passing on only £47 million to consumers in increased tariffs this year. The remaining £111 million is being absorbed by a variety of economies.

So far as 1980/81 is concerned, there was never any doubt that a major increase would be necessary. Increases were staved off by the last Government, first by accepting the ingenious solution the Post Office devised to the pre-Corporation pension fund deficiency, which had been a serious burden on telecommunications, and then by reducing the financial target from 6% to 5%. Any

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further measures of this kind would have unacceptable consequences for the PSBR.

Most of the increases proposed have in fact a sound commercial justification. For example, coinbox calls can be made at the moment more cheaply than subscriber calls and the adjustment is long overdue; rental charges have not been at an economic level for some years; and most of the other services whose charges are being increased have been subsidised by other services. I know, however, that the Chairman himself was very anxious to avoid subscriber call charge increases and has looked for every possible means of finding the £150 million involved in other ways. I am asking him to continue to look at the problem. The Chairman and I are at one in trying to squeeze more productivity from management and workforce. But this will take time. Meanwhile it is essential that the Post Office should achieve the ambitious PSBR contribution which we agreed in Cabinet for 1980/81, and more immediately that they should meet their cash limit this year.

#### Postal deficit in 1979/80

This brings me to the serious problem in the postal business, about which I have been speaking to Sir William Barlow again this afternoon. Despite the postal increases coming into effect this month, posts expect, on present forecasts, to be up to £30 million in the red this year; this would put them £62 million short of their financial target and make the Post Office £100 million short of its cash limit. While about £13 million of this deficit is due to the Budget (VAT, fuel tax, etc), and there are also

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certain substantial unexpected changes in working capital requirements which affect the cash limit outcome, the bulk of the deficit is due to pay settlements unjustified by productivity, which were not taken into account when the Post Office were deciding on the size of the postage increases required. I have told Sir William Barlow that this is intolerable. But there can be no doubt that we face either a major showdown with the UPW or additional tariff increases, either in posts or telecommunications, if there is to be any hope of holding the cash limit this year.

Conclusions for telecommunications tariff increases

Sir William Barlow will therefore be reporting to me again with proposals for improving the overall situation early in September. In the meantime, however, I think the Post Office must acquaint the Users' Council with recent developments and put the telecommunications tariff proposals to them in confidence so that, subject to any modification in the light of the Chairman's further report, the increases can be proceeded with promptly and not be delayed unnecessarily by the statutory requirement to consult POUNC. (The Chairman hopes that the consultations with POUNC can be carried out without publicity; we cannot, of course, be sure of this).

With your agreement, and that of colleagues, I propose therefore that the Post Office be given immediately the go-ahead to consult POUNC without any commitment from Government as yet as to the size of the total package required. We can take a final view on that when we have heard the views of POUNC and have Sir William Barlow's

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further proposals for improving the cash limit situation arising from the deficit in posts.

I am copying this minute to the Chief Secretary and the Secretary of State for Trade, and also to the Secretary of the Cabinet.

PJS

PP K J

13 August 1979

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

Department of Industry  
Ashdown House  
123 Victoria Street  
London SW1

14 AUG 1979

