Ref: A02576

PRIME MINISTER

Investment and Financing Review: Telecommunications
(E(80) 65)

BACKGROUND

The Secretary of State for Industry discusses the case for implementing cuts on the investment programme proposed by the Post Office and also the level of the telecommunications' financial target.

2. Telecommunications have put in additional bids for finance totalling nearly £500 million over the three years. These result from an expected reduction in the contribution from internal resources (due to changes in their depreciation provision) and additional bids for capital investment. Under their proposals total capital expenditure on fixed assets would be:-

£ million 1980 prices

1981-82	1982-83	1983-84
1545	1500	1578

The Chief Secretary in his table of option cuts in his paper E(80) 64 (which will have been discussed generally under Item 2 of the Agenda) proposes that these totals should be cut by

a.	-	50	100
b.	100	100	100

a. would come from allowing for some privatisation and for a lower share of the non-monopoly market;

b. would result from a general squeeze on investment including delayed completion of Strowger replacement from 1992 to 1995.

3. The Secretary of State for Industry offers only £100 million cuts in 1983-84. He points out that telecommunications investment shows a good return; that it is necessary to maintain standards; and that the Post Office has "a pivotal role to play in the development and promotion of the nation's information technology hardware and software". This latter point is of central concern to the CPRS who are, as you know, deeply worried

that we may be losing out, especially as against the French, in this important growth area of economic activity. Cuts in new exchange equipment orders would affect the cash flow to manufacturing industry, and employment in it - see the figures in paragraphs 9 and 10 of his paper. There may be some scope for privatising some of the new services such as Prestel or Radiopaging. But this is uncertain and is unlikely to be practicable before 1983-84.

4. The present borrowing forecasts already assume that the financial target in real terms will be a return on net assets of 6½ per cent in each year. This is arguably high but if it were to be reduced to 5½ per cent, as the Post Office would wish, the bids for extra finance would go up by £160 million in 1981-82 rising to £200 million in 1983-84. The Department of Industry, the Treasury, and Post Office appear willing to accept 6½ per cent subject to reviewing it after 1982-83. But last year the Secretary of State for Trade was opposed to anything higher than 6 per cent.

5. After the Secretary of State for Industry has introduced his paper, the Chief Secretary will wish to reply. The Secretary of State for Employment will want to comment on the employment consequences of cutting investment. Mr Tebbit will wish to speak on the financial targets.

6. In discussion you will wish to deal with the two main questions -

i. How far should investment be cut?
Ministers may well feel that there is a strong case for not making large cuts which would have unwelcome repercussions on private sector manufacturing industry. But with an investment programme of £1½ billion a year there must be scope for cuts in relatively non-sensitive areas and from improvements in efficiency. The Committee may wish to press the Secretary of State for Industry to explore further possibilities for something more than the £100 million he has offered in 1983-84.

ii. Should the financial target be 6½ per cent?
Discussion of this is highly relevant to the next item on the agenda - pay and the EFL in the current year. Ministers may well feel bound to accept the 6½ per cent proposal on the grounds that

anything less would substantially increase the overall problem of financing the nationalised industries. Moreover, telecommunications charges are not among the more sensitive prices so far as the consumer is concerned. If Trade Ministers were to persist in arguing against it, you might ask what they can offer from their programmes by way of offset. (The answer is of course nothing.) The Committee may wish to consider accompanying the decision, and the decisions they will be taking on the current year, with a reference of telecommunications to the Monopolies and Mergers Commission.

CONCLUSIONS

7. In the light of the discussion you will wish to record conclusions -

i. On the investment cuts to be made, and in particular on whether there should be exploration of the possibilities of anything beyond the £100 million in 1983-84 offered by the Secretary of State for Industry;

ii. endorsing the financial target of $6\frac{1}{2}$ per cent; and

iii. possibly, on a reference to the Monopolies Commission.

RA

ROBERT ARMSTRONG

8 July 1980