

cc. A. Duguid.



PRIME MINISTER

POSTAL TARIFF INCREASES

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A significant tariff increase seems inescapable. The question is whether to agree a 2p/2p increase (favoured by Sir Keith and the P.O. Chairman) or 2p/1p increase with the possibility/probability of a further increase in the late summer/autumn (favoured by the Chancellor see Page A). Notwithstanding Sir Keith's arguments,

1 Your Private Secretary wrote on 6 October recording your concern at the magnitude of the Post Office's proposed increases in postal tariffs set out in my minute of 2 October.

I imagine you will back the Chancellor.

2 In the light of your comments I have seen Mr Dearing and have gone over the ground again with him. He knows our deep concern, particularly at a time when the private sector has been obliged to cut its costs and moderate its price increases. I had already pressed him to make savings in a number of areas, including property disposals, improved productivity, lower manning levels, and a cut in overtime, in order to reduce the proposed tariff increases, but we once again reviewed the options.

Shall I say 2p/1p, or do you want to discuss with Sir Keith tomorrow (Saturday)?

*DL
17/10*

3 I think we must remember that we have no powers to prevent the Post Office increasing its charges. We have only just appointed Mr Dearing and he is making a vigorous start on reforming the postal service. He has inherited a position in which his scope for action is severely circumscribed. We require him to keep within a strict external financing limit and a financial target (2% on turnover). We also require him to hold prices steady in real terms and to meet delivery targets. There is strong pressure on the Post Office to avoid industrial action since this can prevent achievement of their targets and impose an added burden on the PSBR. On top of all this the

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Post Office unions have, despite their "moderate" image, been slow to accept the need for improved productivity. An experimental scheme is getting under way after years of resistance but it is only modest in scope and 70% (or possibly more) of the benefits go to the workforce!

4 At our meeting Mr Dearing explained that he had examined all possible means of making further savings but that it would be misleading for him to give the impression that any significant extra economies could be made in the short term. Indeed, as I mentioned in my minute of 2 October, the proposed 2p/2p tariff increases represent a risk in that they are insufficient to meet the business' financial objectives without a considerable economy drive. I understand that the management of the postal business have argued strongly that a larger increase (3p/2p) is necessary to balance the books; but that the Board led by Mr Dearing decided to reject this advice and to propose lower increases. The Board's aim is to bring home to everyone working in the Post Office that inefficiency could no longer be paid for out of automatic tariff increases.

5 Increases of 2p/2p are as low as Mr Dearing believes he can go. Any reduction on this would, if the business were to stand any chance of meeting its financial objectives, require savings of a level which could reverse the improvements made so far in the quality of the postal service and would put in jeopardy the changes in working practices and productivity on which the Post Office has made a start. We must accept that short term economies are

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difficult to make in the postal business, which, by its very nature as a universal network service, carries a high level of fixed costs. Thus, if we seek to depress prices at this stage, we would risk piling up the need for much bigger increases in prices soon after.

6. Much of the present need for tariff increases stems from a large increase in the 1979/80 wage bill which was caused not so much by the last settlement with the Union of Communications Workers (UCW) - which at 17% with some improved working methods was not seriously out of line with other public sector settlements - but by 'flow through' increases agreed in the 1978/79 pay round. These in turn were a reflection of the effect on postal workers pay of our predecessors' incomes policies. Mr Dearing assures me that this catching up process is now complete; that the next pay settlement will be free from any such effects; and that he will do everything possible to contain the increase in wages in 1981 to well within single figures, adding that his chances of success will be greatly influenced by our success in containing civil service pay.

7. An alternative might be to persuade Mr Dearing to seek an increase calculated to cover only the additional costs of wage increases already in the pipeline, but with no allowance for any increase in wage costs in the pay settlement due on 1 April 1981. On this basis we could reduce the increase to 2p on first class and 1p on second class, overall about 15%. This would mean that any further tariff increase required to meet financial objectives in 1981/82 would be clearly shown to be the direct result of wage



increases and productivity performance.

8 I am initially attracted to this course but it would have two disadvantages. First, unless the Post Office can find some previously undiscovered savings, the postal business would fall some £20 million short of making its contribution to the Corporation's External Financing Limit and £35 million short of its financial target in 1980/81. Secondly, wage increases of 6 to 7% would necessitate either a further increase of 1p/1p in about July 1981, or a substantially larger increase before the end of calendar 1981, if the postal business is to meet its EFL and financial objectives.

9 I have, as I mentioned in my previous minute to you, asked Mr Dearing to tell me at an early date of his plans for making economies in the business without a decline in the service offered to the public. Moreover, I intend to make it clear beyond doubt that the Government will be watching progress closely, and in particular is determined to see that the Post Office meets the undertaking to improve productivity levels in Inner London by 15% over 3 years, which it gave in response to criticism by the Monopolies and Mergers Commission.

10 In addition I have already told Mr Dearing that, if satisfactory progress is not achieved, I shall seriously consider early use of the powers I am taking to make derogations from the

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postal monopoly in such a way as to enable business customers in particular to avoid the impact of ever increasing postal charges. I cannot use these powers until about July next year when the relevant legislation should have received the Royal Assent. By that time we should know the outcome of the main wage settlements for 1981 and should be able to see in outline at least whether the Post Office is bringing their costs under control. The threat is two-edged; by making it we should influence the performance of management and unions but, if we put it into effect, it would risk putting the postal service into loss or causing higher prices still because of the impact of reduced volume on largely fixed costs.

11. With this in mind I take the view, albeit with the greatest reluctance, that we have no alternative to early and substantial postal tariff increases. Insofar as there is a choice - and Mr Dearing argues that he has none - the options are for 2p/1p in January 1981, followed by a further 1p/1p in July 1981, or for 2p/2p in January. Mr Dearing is firmly in favour of the second option. I believe that the constraints on him are too great at this stage to expect him to make significant further savings and that we should at all costs avoid pressing him into a situation in which he would need next year to propose higher increases even than those he has currently in mind in order to wipe out the effects of too low an adjustment at this stage..

12. Despite the attractions of 2p/1p, I think we must rely on



Mr Dearing's judgment. There is, alas, a need of speed in decision. The cost of delay is £5 million per week. I should like to authorise Mr Dearing to approach POUNC on the basis of a 2p/2p increase this week.

13. Copies of this minute go to Members of (E) Committee, the Secretary of State for Health and Social Services and to Sir Robert Armstrong.

KJ

K J

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