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PRIME MINISTER

I have seen the Secretary of State for Industry's minute to you of 2 October and your note of 6 October giving your reaction to the 19% package of postal tariff increases for which the Deputy Chairman of the Post Office is seeking approval.

2. In my view, there is real cause for concern in the Post Office's proposals, not only because this rise would come less than 12 months after the last one and exceed the overall rate of inflation over that period, but because it would appear to be underpinning a lamentable productivity performance (as borne out by the recent MMC Report on the Inner London Letter Post) when every effort should be made to improve efficiency and cut costs. I share your view that we cannot accept whatever tariff increases industries claim to need to stay within their EFLs without being satisfied that these are predicated on substantial efforts to reduce costs.

3. On the other hand, we have to protect the public expenditure position and maintain effective control over borrowing. If in considering price increases we demand cost reductions which are unrealistic and in the event unattainable, the result will be breaches in EFLs, unplanned increases in borrowing and a rise in public expenditure. In order to protect the public expenditure position, it is important that in responding to proposed tariff packages the scale of cost savings demanded should be testing but ultimately attainable.

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4. In the Post Office's case, the proposed 19% rise (2p/2p) would enable them to meet this year's EFL, and in the absence of further tariff increases next autumn would require them to achieve some £90 million savings next year (against a total pay bill of some £1800m) if the 81-82 EFL was not to be breached. One possibility would therefore be to allow the proposed increases this January as the Secretary of State for Industry has suggested, but with the proviso that there should be no further tariff increases next year. A second course however, which seems to me preferable, would be to trim the proposal to 2p and 1p increases for first and second class mail respectively. This would require the Post Office to make some economies immediately, and much larger savings (over £150m) next year to stay within their EFL.

5. Given the size of the target for savings implied by this second course and the risks for public expenditure and borrowing totals should it not be met, we would need to leave open the possibility of a further tariff review next autumn. This possibility need not be displayed to the Post Office at present, but it will need to be available to safeguard the public expenditure position if the tariff package is restricted to 2p/1p.

(G.H.)

16th October 1980