

CONFIDENTIAL

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

E(80)79

25 July 1980

COPY NO 55

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

POST OFFICE PAY, FINANCING AND PRICES

Memorandum by the Secretary of State for Industry

1 As a result of pay settlements and other developments, the Post Office faces a significant shortfall in its external financing limit (EFL) this year. The Post Office Chairman has written to me to say that, unless the Government allows part of the Corporation's forecast gap to be met either by borrowing or by some device like factoring debts or a scheme for financing equipment work in progress, the Post Office will impose a surcharge on all telephone subscribers. Against this background, we need to consider the package of measures proposed by the Post Office and in particular whether a surcharge is acceptable.

Recent Telecommunications Pay Settlement

2 The recent settlement with the Post Office Engineering Union (POEU) and the Society of Post Office Executives (SPOE) is for 18% from 1 July plus a 2% consolidated increase for 1979/80 productivity. A further 1% productivity payment will be made on 1 December and a final 2% on 1 April 1981. The costs this financial year will therefore be under 21%. There are additional relativity payments for SPOE members. Both POEU and SPOE executives have accepted the settlement and the Post Office have advised that the unions have called off their programme of industrial action, due to start on 4 August. The settlement appears therefore to be a firm one.

Finances and Prices

3 On this basis, the Post Office faces a financing gap of around £470 million on its telecommunications business. Increasing the next price rise to about 20% and bringing it forward to 1 November would contribute around £160 million towards bridging this gap, and the Corporation expects to make a further £100 million economies explained in my minute of 23 July to the Prime Minister. I am assured by the Corporation that these economies will not affect the speed of payments of bills to small firms. Other measures

/such ...

CONFIDENTIAL

309

80
82
84
86
88

such as cuts in investment and stocks may further reduce the remaining gap of around £200 million to some extent but the greater part of it remains unresolved.

4 The surcharge which the Corporation has in mind would be levied at a flat rate on each telephone line used by a subscriber and would be charged in bills sent to subscribers between November 1980 and the end of February 1981. I understand that the Corporation would hope to charge it at a rate of about £5 per telephone line, which would raise around £90-£100 million though this could rise to about £8 if they cannot find all the remaining £100 million in other ways. A £5 surcharge would temporarily add a varying amount of up to 0.2 percentage points to the retail price index (RPI) over a six-month period, in addition to the estimated 0.23 percentage points which will be added to the RPI by the Post Office's proposed 20% price rise.

5 If the Corporation goes ahead with a surcharge, it will be essential that we as a Government should place the blame for it firmly on excessive pay rises. This argument will need careful presentation if, as is possible, the amount that the Corporation will raise from the surcharge is greater than the cost of the extra pay increases above 15% for the engineers which has been at stake recently in the pay negotiations. Nevertheless, I believe that we would have a good general case for arguing that the need for both the major price rise and a surcharge was the consequence of the size of the pay settlement with the Post Office Engineers.

6 The Post Office Chairman has indicated that he would require a direction from me before implementing a surcharge. While I have no powers to issue such a direction, I would be prepared to send him a letter reiterating that the Government cannot accept his proposed financing schemes for evading the Corporation's EFL but could accept whatever measures the Corporation finds necessary, including its proposal for a surcharge to bridge the financing gap.

7 If the Corporation does not go ahead with a surcharge, we are faced with the alternative of its implementing its schemes for obtaining credit for equipment supplies, or for factoring debts, to enable it to pay its bills at the year end. Officials have confirmed previous advice that such schemes would place an additional burden on the money supply, and I believe that we must reject them on these grounds.

8 The Post Office Chairman may seek to lay the blame for the surcharge at our door, on the grounds that we should have allowed the Corporation to raise more external finance in one way or another. He has argued in a letter to me that it is illogical for the Government to encourage nationalised industries to form subsidiaries with private sector equity, while preventing the provision of private capital to nationalised industries by such schemes as he has in mind. We will need to make clear in reply that our financial disciplines in the public sector are essential to combat inflation, and that within this framework increased costs of providing public services have to be met by the public as customer or taxpayer.

/9 ...

Conclusion

9 I recommend that we should confirm to Sir William Barlow, whom I am seeing later on Monday (28 July), our rejection of devices like the supplier credit scheme as a way of solving the Post Office's difficulties, and accept the proposed package of measures including if necessary a surcharge of the order of £5-£8 per subscriber on condition that the package as a whole is sufficient to meet the EFL gap in its entirety. I should if necessary be prepared to write to the Post Office Chairman saying this. Our line, which we should take every opportunity of underlining publicly, would be to attribute the surcharge to excessive pay increases.

K J

Department of Industry
Ashdown House
123 Victoria Street

25 July 1980