

PREM 19/876

SECRET

CONFIDENTIAL Filing

FUTURE OF POST OFFICES: FINANCES
INDUSTRIAL RELATIONS
POSTAL MONOPOLY
TELECOMMUNICATIONS MONOPOLY

~~Post~~ AND
TELECOMMUNICATIONS
PART 1: MAY 1979
PART 4: MARCH 1982

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
22.3.82							
23.3.82							
25.3.82							
5.4.82							
14.4.82							
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28.6.82							
30.6.82							
2.7.82							
7.7.82							
19.7.82							
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PREM 19/876

Fifth Report from Industry
and Trade Committee 1981-82
is filed in yellow folder at back
of this file

PART 4 ends:-

Household Statement 9.7.82

PART 5 begins:-

Post Office Report & Accounts 81-82

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(TP)(82) 2 nd Meeting	1/7/82
E(TP)(82) 9	28/6/82
E(TP)(82) 8	24/6/82
E(TP)(82) 7	18/6/82
E(TP)(82) 6	18/6/82
E(TP)(82) 5	4/6/82
E(TP)(82) 1 st Meeting	26/4/82
E(TP)(82) 4	19/4/82
E(TP)(82) 3	16/4/82
E(TP)(82) 2	16/4/82
E(TP)(82) 1	14/4/82

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate CAB (CABINET OFFICE) CLASSES

Signed _____ *J. Gray* _____ Date 18/10/2012 _____

PREM Records Team

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

1. House of Commons Paper 343:
Fifth Report from Industry and Trade
Committee, Session 1981-82: The Post Office.
HMSO, 20 May 1982

2. House of Commons Hansard, 19 July 1982,
columns 23 - 32
"Telecommunications Policy"

Signed QWayland Date 18 October 2012

PREM Records Team

PRIME MINISTER

2
MS

TELECOMMUNICATIONS STATEMENT

There was nothing very unexpected in the line that the Opposition took. Stan Orme responded to Patrick Jenkin by saying that his statement would destroy morale in the telecommunications industry. He raised a number of questions: how could the Government be sure they would avoid another "fiasco" like that over the sale of Amersham; what guarantees of continued service would there be for those living in rural areas, or those who made little use of the 'phone like pensioners; what protection would there be for pensions and jobs in BT; and why didn't the Government simply allow BT to raise finance on the capital markets? Since the Government had made this an Election issue, Mr. Orme gave an assurance that the Opposition would fight to maintain a public sector BT.

Opposition MPs came back to these themes in their questions and Charles Morris was particularly concerned about the pensions of those employed in BT. Government backbenchers, such as Michael Grylls and Paul Bryan, welcomed this move to free BT from Treasury control and to place it under the control of market forces instead.

Patrick Jenkin argued that liberalisation was in the interests of consumers, and asked the Opposition whether they would stand up for the consumer's interest. He assured the Opposition that services to rural areas ^{would} ~~did~~ not decline, that the Bill would safeguard the pension rights of existing BT employees, and indicated that it was much too soon to talk about the price of shares. In response to John McWilliam, he said he foresaw no problem over protecting the sensitive services provided to Government by BT.

WH

19 July 1982

PARLIAMENTARY STATEMENT

TELECOMMUNICATIONS POLICY

With permission, Mr Speaker, I would like to make a statement about the future of telecommunications in Britain.

It is the Government's aim to promote consumer choice. Wherever possible, we want industrial and commercial decisions to be determined by the market and not by the state. We believe that consumer choice and the disciplines of the market lead to more stable prices, improved efficiency and a higher quality of service.

Since the British Telecommunications Act 1981 received Royal Assent less than a year ago, some progress has been made in breaking the State monopoly in telecommunications. I have licensed the Mercury Consortium to provide a new telecommunications network in competition with BT. I intend shortly to issue a general licence permitting all bona fide value added network service operators to use the BT and Mercury networks. The way is now opening for the private sector to sell telephone apparatus direct to the public. Liberalisation of telecommunications has started and we intend to see it through.

For BT, the prospect of competition and the advent of new technology are now stimulating them to provide a wider range of competitive services. I pay tribute to the way Sir George Jefferson and his Board are transforming what was not so long ago a Government Department into a commercially oriented business. Mr Speaker, we now want to take the next step.

As a nationalised industry BT does not have direct access to financial markets. Its borrowing is controlled by Government and counts against the PSBR. To bring inflation under control these borrowings have inevitably to be subject to strict limits. But external finance is only part of the picture. In the past monopoly power has allowed BT to raise prices to finance investment without doing all that could be done to increase efficiency. Around 90% of BT's investment programme, about £2,200 million this year, has been self-financed. By "self-financed", I mean of course "customer financed"; BT's charges to customers not only cover current running costs but are also paying for 90% of new investment. As a result, charges have risen steeply while investment is still not enough. Unless something is done radically to change the capital structure and ownership of BT and to provide a direct spur to efficiency, higher investment would mean still higher charges for the customer. The Government, BT and the general public would find that unacceptable. We need to free BT from traditional forms of Government control.

We will therefore take the earliest opportunity to introduce legislation which, while keeping BT as a single enterprise, will enable it to be converted into a Companies Act company, "British Telecommunications plc". The legislation will allow the sale of shares in that company to the public. It is our intention, after the next election, to offer up to 51% of the shares on the market in one or more tranches.

Once half of the shares have been sold, the Government will give up control over the commercial decisions of BT plc. BT plc will be outside the public sector; its borrowing will cease to be subject to Exchequer control, and it will look to its shareholders and the markets for its external financing. It will be for the Board of the company to decide when and how much to borrow, taking account of internal factors and market conditions in the same way as any other private sector company. This will mean not only a greater flexibility for BT and less pressure on consumers and taxpayers, but also that BT will be subject to proper market disciplines. BT will be in a position to provide better services which are more responsive to customer needs like those provided by the privately-owned telephone companies in the United States.

BT plc will nevertheless dominate the British market for telecommunications for some years yet. The Government considers therefore that there will be a need for regulatory arrangements for the industry to balance the interests of those supplying

telecommunications services, their customers, their competitors, their employees, their investors and their suppliers. The legislation will reform the arrangements for licensing telecommunications so as to end BT's exclusive privilege and its role in licensing. Instead, there will be a new Office of Telecommunications, modelled on the Office of Fair Trading, under a Director General appointed by me. He will have powers similar to those of the Director General of Fair Trading. He will operate with the same degree of independence from Government. It will be his job to ensure fair competition and fair prices.

The legislation will contain provisions to safeguard existing pension obligations. There will also be special provisions to ensure that those employed in BT can acquire shares in the company.

Finally, the legislation will reform the Telegraph Acts which were passed in the last century. We need to recast the law to make it relevant to the technology of today and tomorrow. I will be issuing a consultative document on this aspect shortly.

Because these proposals are far-reaching and will affect a lot of people, I am today publishing this statement, with some additional background information, in the form of a White Paper.

Mr Speaker, these proposals follow naturally from the liberalising measures passed by the House last year. It would make no sense to stop half way. If those who work in telecommunications are to provide the range and quality of service which modern technology now permits, and if they are to do so in competition with each other, it cannot be right that BT should remain subject to the web of government interference and controls which are the inevitable lot of an industry which enjoys the privilege of Exchequer finance.

The quality of the service which any enterprise provides depends upon the skills, energy, and leadership of the people who work in it. We want to provide those people with the environment - market, financial, legal and structural - which will free them to give of their best.

In the view of the Government, that is what the proposed legislation will do. I look forward to its early introduction.



Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

16 July 1982

Prime Minister ①

Agree this White

Paper, to be published

on Monday 19 July?

MCS (6/7)

Willie Rickett Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Willie,

WHITE PAPER ON TELECOMMUNICATIONS

As you know, my Secretary of State intends to publish a White Paper on telecommunications policy to coincide with the Statement he expects to make in the House on Monday 19 July.

... 2 I attach a copy of the final version of the White Paper, incorporating comments from the Departments most directly concerned.

3 I am sending copies of this letter and enclosure to the private secretaries to all Members of the Cabinet, the Chief Whip, the Secretary to the Cabinet and to Mr Sparrow; and to Bernard Ingham in No 10 Press Office.

Yours sincerely,

Jonathan Spencer

J P SPENCER
Private Secretary

D E P A R T M E N T O F I N D U S T R Y

THE FUTURE OF TELECOMMUNICATIONS
IN BRITAIN

Presented to Parliament by the
Secretary of State for Industry
by Command of Her Majesty
July 1982

Cmnd.

FUTURE OF TELECOMMUNICATIONS IN BRITAIN

On Monday, July 19 1982 the Secretary of State for Industry, the Rt Hon Patrick Jenkin, MP, made a statement in the House of Commons on the Government's telecommunications policy. That statement is set out below.

PARLIAMENTARY STATEMENT

"With permission, Mr Speaker, I would like to make a statement about the future of telecommunications in Britain.

It is the Government's aim to promote consumer choice. Wherever possible, we want industrial and commercial decisions to be determined by the market and not by the state. We believe that consumer choice and the disciplines of the market lead to more stable prices, improved efficiency and a higher quality of service.

Since the British Telecommunications Act 1981 received Royal Assent less than a year ago, some progress has been made in breaking the State monopoly in telecommunications. I have licensed the Mercury Consortium to provide a new telecommunications network in competition with BT. I intend shortly to issue a general licence permitting all bona fide value added network service operators to use the BT and Mercury networks. The way is now opening for the private sector to sell telephone apparatus direct to the public. Liberalisation of telecommunications has started and we intend to see it through.

For BT, the prospect of competition and the advent of new technology are now stimulating them to provide a wider range of competitive services. I pay tribute to the way Sir George Jefferson and his Board are transforming what was not so long ago a Government Department into a commercially oriented business. Mr Speaker, we now want to take the next step.

As a nationalised industry BT does not have direct access to financial markets. Its borrowing is controlled by Government and counts against the PSBR. To bring inflation under control these borrowings have inevitably to be subject to strict limits. But external finance is only part of the picture. In the past monopoly power has allowed BT to raise prices to finance investment without doing all that could be done to increase efficiency. Around 90% of BT's investment programme, about £2,200 million this year, has been self-financed. By "self-financed", I mean of course "customer financed"; BT's charges to customers not only cover current running costs but are also paying for 90% of new investment. As a result, charges have risen steeply while investment is still not enough. Unless something is done radically to change the capital structure and ownership of BT and to provide a direct spur to efficiency, higher investment would mean still higher charges for the customer. The Government, BT and the general public would find that unacceptable. We need to free BT from traditional forms of Government control.

We will therefore take the earliest opportunity to introduce legislation which, while keeping BT as a single enterprise, will enable it to be converted into a Companies Act company, "British Telecommunications plc". The legislation will allow the sale of shares in that company to the public. It is our intention, after the next election, to offer up to 51% of the shares on the market in one or more tranches.

Once half of the shares have been sold, the Government will give up control over the commercial decisions of BT plc. BT plc will be outside the public sector; its borrowing will cease to be subject to Exchequer control, and it will look to its shareholders and the markets for its external financing. It will be for the Board of the company to decide when and how much to borrow, taking account of internal factors and market conditions in the same way as any other private sector company. This will mean not only a greater flexibility for BT and less pressure on consumers and taxpayers, but also that BT will be subject to proper market disciplines. BT will be in a position to provide better services which are more responsive to customer needs like those provided by the privately-owned telephone companies in the United States.

BT plc will nevertheless dominate the British market for telecommunications for some years yet. The Government considers therefore that there will be a need for regulatory arrangements for the industry to balance the interests of those supplying

telecommunications services, their customers, their competitors, their employees, their investors and their suppliers. The legislation will reform the arrangements for licensing telecommunications so as to end BT's exclusive privilege and its role in licensing. Instead, there will be a new Office of Telecommunications, modelled on the Office of Fair Trading, under a Director General appointed by me. He will have powers similar to those of the Director General of Fair Trading. He will operate with the same degree of independence from Government. It will be his job to ensure fair competition and fair prices.

The legislation will contain provisions to safeguard existing pension obligations. There will also be special provisions to ensure that those employed in BT can acquire shares in the company.

Finally, the legislation will reform the Telegraph Acts which were passed in the last century. We need to recast the law to make it relevant to the technology of today and tomorrow. I will be issuing a consultative document on this aspect shortly.

Because these proposals are far-reaching and will affect a lot of people, I am today publishing this statement, with some additional background information, in the form of a White Paper.

Mr Speaker, these proposals follow naturally from the liberalising measures passed by the House last year. It would make no sense to stop half way. If those who work in telecommunications are to provide the range and quality of service which modern technology now permits, and if they are to do so in competition with each other, it cannot be right that BT should remain subject to the web of government interference and controls which are the inevitable lot of an industry which enjoys the privilege of Exchequer finance.

The quality of the service which any enterprise provides depends upon the skills, energy, and leadership of the people who work in it. We want to provide those people with the environment - market, financial, legal and structural - which will free them to give of their best.

In the view of the Government, that is what the proposed legislation will do. I look forward to its early introduction."

BACKGROUND INFORMATION

The background to this statement is the Government's realisation that technological developments in telecommunications, including digital techniques, fibre optics and the rapidly growing range of terminal attachments and network services mean that state monopoly in telecommunications with all its inevitable disadvantages can become a thing of the past. The British Telecommunications Act 1981 received the Royal Assent less than a year ago and since then substantial progress has been made in five directions.

First, last February, the Secretary of State for Industry licensed the Mercury consortium consisting of Cable and Wireless, British Petroleum and Barclays Merchant Bank to run a new telecommunications network in competition with BT. Mercury plans to start providing services to business subscribers early in 1983.

Second, the BT network is increasingly being used by other firms for a widening range of network services. A general licence permitting all bona fide value-added network service operators to use the BT and Mercury networks is to be issued shortly. The rules in Britain will then be among the most liberal in the world. A whole new industry, with all that means in terms of jobs, is emerging to provide new systems and services, not only here in Britain but for export to the rest of the world.

Third, the way is now opening for the private sector to sell telephone apparatus direct to the public. The first standards for telecommunications apparatus will be approved soon, and the new British Approvals Board for Telecommunications is ready to receive applications from manufacturers seeking approval of apparatus under the new standards. The attachments industry must now grasp the opportunities it is being given to compete with BT to get subscribers' custom. Competition to win market share here at home will make the industry more competitive abroad.

Fourth, Sir George Jefferson and the BT Board have recognised that inefficiencies tolerated when BT was an unchallenged monopoly can no longer be afforded in the new competitive climate.

Fifth, and perhaps most important of all, after decades of monopoly, the prospect of competition and the advent of new technology are stimulating BT to respond to market opportunities. BT is providing a new array of services, especially the City Overlay in the City of London, using microwave radio and other techniques. BT, which has a proud story to tell in the development of optic fibre and submarine cable at its Martlesham Research Centre, is beginning to exploit its technological strengths in the market place.

Need for Change

The Government believe that this is only a beginning. There is a long way to go. Until 1969, the telephone service was run as

a Civil Service Department with all that that meant in terms of organisation, management, and above all attitudes. The BT Act 1981 heralded nothing less than a cultural revolution in BT. The Government now want to take that revolution a stage further.

Sir George Jefferson, the BT Board and the BT unions have been united in criticising the method by which the telecommunications investment programme is financed. Their criticisms have arisen because these borrowings have inevitably to be subject to strict Treasury control. But external finance is only part of the picture. In the past, monopoly power has allowed BT to raise prices to finance investment without necessarily finding every opportunity to save running costs by improving efficiency. It is a fact that around 90% of BT's investment programme, about £2,200 million this year, has been financed out of customer charges. Ultimately, of course, current and capital costs are all borne by the customer, but the present ban on access to external funds means that today's customers are making a bigger contribution to capital costs than would be warranted if normal private sector financial and commercial criteria were applied.

There have been intensive efforts to resolve this dilemma. The Government are considering the possibilities of the "Buzby Bond" but that would still be a form of Government guaranteed borrowing and would leave BT subject to Government interference and control.

Another option would be to relax the PSBR rules. That would be unacceptable since the Government's controls on borrowing are an

essential weapon in the fight against inflation. The Government believe that the only way forward is to free BT from Government control. That means transferring BT's business to a Companies Act company and selling a majority of the shares in it to the public. The company will then be free both to borrow outside the PSBR and to act independently of Government controls. This structural change combined with the introduction of competition will ensure a new partnership between the public and private sectors which the Government believe will be able to take BT forward into the twenty-first century.

Views Invited

The issues are central to much of our industrial future as a country. The Government's policy will determine the shape and direction of telecommunications for many years to come. It is clearly important that the legislative changes made should be right. Accordingly, the Government invite views in writing which should be sent to Miss G M A Lambert, Department of Industry, Ashdown House, 123 Victoria Street, London SW1E 6RB by 30 August 1982.

cc. Ingham

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JU477



DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

16 July 1982

Willie Rickett Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Prime Minister (1)

Agree this statement

on Monday 19 July?

MCS 16/7

Dear Willie,

STATEMENT ON BT LEGISLATION

... I attach the final version of the Statement which my Secretary of State expects to make in the House on Monday, 19 July. This takes into account the comments you made, and those received from other Departments.

2 I am writing separately about the White Paper which my Secretary of State proposes to publish at the same time as his Statement.

3 I am sending copies of this letter to the private secretaries to the Home Secretary, the Foreign Secretary, the Chancellor, the Lord President, the Lord Privy Seal, the Chancellor of the Duchy, the Chief Whip; and to Bernard Ingham (No 10 Press Office) and Michael Powell (Lords Whips Office).

Yours sincerely,
Jonathan Spencer

J P SPENCER
Private Secretary

PARLIAMENTARY STATEMENT

TELECOMMUNICATIONS POLICY

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about the future of telecommunications in Britain.

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meaning?

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Told Mr Spencer.
It is too late: White
Paper has been ^{printed} published

Thank the
Pharm after the next
election will come
not sure with the House.
Have made an
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Once half of the shares have been sold, the Government will give up control over the commercial decisions of BT plc. BT plc will be outside the public sector; its borrowing will cease to be subject to Exchequer control, and it will look to its shareholders and the markets for its external financing. It will be for the Board of the company to decide when and how much to borrow, taking account of internal factors and market conditions in the same way as any other private sector company. This will mean not only a greater flexibility for BT and less pressure on consumers and taxpayers, but also that BT will be subject to proper market disciplines. BT will be in a position to provide better services which are more responsive to customer needs like those provided by the privately-owned telephone companies in the United States.

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In the view of the Government, that is what the proposed legislation will do. I look forward to its early introduction.

Department of Industry

From: THE PRIVATE SECRETARY

Mr. Rickett
16/7
Post + Tel



HOME OFFICE
QUEEN ANNE'S GATE LONDON SW1H 9AT

15 July 1982

Dear Jonathan

FUTURE TELECOMMUNICATIONS POLICY: STATEMENT

The Home Secretary has seen a copy of your letter of 13 July to No 10.

The draft refers to legislation being introduced in the next Session of Parliament. This breaches the convention that The Queen's Speech is not anticipated, and the Home Secretary thinks that the reference should be to legislation being introduced as soon as Parliamentary time permits.

The Home Secretary wonders whether the second sentence at the top of page 3 might end with the word "department". He thinks that the remainder of the sentence may be seen as unnecessarily provocative.

I am sending copies of this letter to the recipients of yours.

C J Walters
C J Walters
C J WALTERS

J P Spencer, Esq.



Foreign and Commonwealth Office

London SW1A 2AH

15 July 1982

NBPM

MA 16/7

Dear Jonathan

Future Telecommunications Policy: Statement TPM

Thank you for copying to me your letter of 13 July to Michael Scholar about the statement your Secretary of State would like to make next week about the Government's intention to privatise British Telecommunications.

Mr Pym is generally content with the draft and welcomes Mr Jenkins's intention to make this statement. There is only one small point which causes us any difficulty. This is the sentence on the fourth page of the draft which reads:

"We also intend that the Memorandum and Articles of Association of the company will limit individual shareholdings to prevent foreign control."

There is a risk that, without qualification, this could be held to be contrary to the provisions on rights of establishment set out in Articles 52 - 58 of the EEC Treaty. Any limitation of EEC shareholding would have to be in accordance with the exceptions permitted by Article 56. However, my Secretary of State thinks that it would be best to avoid raising this issue unnecessarily.

I therefore suggest that the sentence is omitted from the statement. You will however wish to include a supplementary in case the question of foreign control is raised. I suggest that this should follow the wording used by Mr Lawson in the debate on 10 November 1981 on the Oil and Gas (Enterprise) Bill when Mr Douglas Jay asked whether there would be any safeguard to prevent the shares of BNOC falling into the hands of non-British owners (Column 442 of the official report for 10 November). On that occasion Mr Lawson stated that: "we shall ensure that written into the Articles of Association of the new company . . . will be effective safeguards against any undesirable change of control". If pressed on this point, your Ministers could refer to Article 56 of the EEC Treaty. But on the whole it would be preferable if this could be avoided.

/I am sending

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I am sending copies of this letter to recipients of yours.

Yours ever.

A handwritten signature in cursive script, appearing to read 'F N Richards', written in dark ink.

(F N Richards)
Private Secretary

J P Spencer Esq
PS/Secretary of State for Industry



cc. J.V.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

15 July 1982 NBPM

The Rt. Hon. Patrick Jenkin, MP
Secretary of State for Industry

rus 15/7

Dear Secretary of State,

FUTURE TELECOMMUNICATIONS POLICY : STATEMENT

I have a number of suggestions to make on the draft circulated under cover of your Private Secretary's letter of 13 July. These are sidelined in the attached redraft.

My concern is two-fold. Firstly to spell out the shortcomings that BT (or more properly the Post Office) has exhibited in its monopoly past and how we believe that these can best be corrected by the pressures of market forces that privatisation and liberalisation will bring to bear. Secondly, to avoid the potentially misleading slant that the neglect of these points in the draft circulated by your Private Secretary gave to the system of financial control of nationalised industries to which we are all committed, while recognising the need for further improvement and refinement of the system.

Your proposals to E(TP) did not go beyond selling 51 per cent of the equity in BT plc. We spoke the other day about the kind of legal bar that might be desirable to prevent Government going further than this and agreed that it would certainly not make sense to enshrine such a provision in primary legislation. I now wonder whether even the order-making power that we visualise would be desirable. At this stage, at all events, there is no need to say more than we propose to achieve privatisation by selling 51 per cent of the equity in BY pic.

This statement may well lead to supplementaries on whether the privatisation of BT signals the beginning of a programme of privatisation of the major utilities. Even if it is not to be seen as the signal for a swift and all-embracing advance, it is certainly far from being our last word. You will need to be prepared for questions about this from both sides of the House. Because of his interest in the power utilities I am copying this letter to Nigel Lawson as well as to the recipients of yours.

Yours sincerely
Peter Jenkins

if GEOFFREY HOWE

(Approved by the Chancellor and signed in his absence).

PARLIAMENTARY STATEMENT
TELECOMMUNICATIONS POLICY

With permission Mr Speaker I would like to make a statement about the future of telecommunications in Britain.

This Government aims to promote consumer choice and to ensure that wherever possible, industrial and commercial decisions are determined by the market and not by the state. We believe that consumer choice and the disciplines of the market will lead to more stable prices, improved efficiency and a higher quality of service.

The technological revolutions in telecommunications, including digital techniques, fibre optics and the rapidly growing range of terminal attachments and network services mean that state monopoly in telecommunications with all its inevitable disadvantages can become a thing of the past. Since the British Telecommunications Act 1981 received the Royal Assent less than a year ago, progress has been made in five directions.

First, last February, I licensed the Mercury consortium to provide a new telecommunications network in competition with BT. Mercury plans to launch a service for business subscribers next year.

Second, the BT network is increasingly being used by other firms for a widening range of network services. I hope shortly to issue a general licence permitting all bona fide value-added service operators to use the BT and Mercury networks. The rules in Britain will then be among the most liberal in the world. A whole new industry is emerging to provide new systems and services, not only here in Britain but for export to the rest of the world.

Third, the way is now opening for the private sector to sell telephone apparatus direct to the public. The first standards for telecommunications apparatus will be approved very soon and the new British Approvals Board for Telecommunications is ready to receive applications from manufacturers seeking approval of apparatus under the new standards. The attachments industry must now begin to compete with BT to get subscribers' custom. Competition to win market share here at home will make the industry more competitive abroad.

Fourth, Sir George Jefferson and his Board have recognised that inefficiencies tolerated in BT's monopoly past can no longer be afforded in the competitive climate that BT must adapt to.

Fifth, and perhaps most important of all, after decades of monopoly, the prospect of competition and the advent of new technology are stimulating BT to respond to market opportunities. BT is providing a new array of services, especially the City Overlay in the City of London, using microwave radio and other techniques. BT has also joined with other partners in an all-British consortium to set up an independent British satellite system which will include among other things new international telecommunications channels.

Mr Speaker, I stress that this is only a beginning. There is a long way to go but the House must remember that until 1969 the telephone service was run as a Civil Service department with all that that meant in terms of organisation, management and, above all, attitudes. Under Sir George Jefferson's able leadership, the talents which exist in BT are being given new incentive. The BT Act heralded nothing less than a cultural revolution in BT. I now want to take that revolution a stage further.

As a nationalised industry BT does not have direct access to financial markets. Its borrowing is controlled by Government and counts against the PSBR. To bring inflation under control

these borrowings have inevitably to be subject to strict limits. But external finance is only part of the picture. In the past monopoly power has allowed BT to raise prices to finance investment without adequately exploiting opportunities for improved efficiency. One effect of these factors is that around 90% of BT's investment programme, around £2,200 million this year, has been self-financed. By "self-financed", I mean of course "customer financed." BT's charges to customers not only cover current running costs and depreciation, but also currently pay for 90% of new investment. Another effect is that by international standards BT's costs are unacceptably high. As a result, charges have risen steeply while investment is still insufficient. Unless something is done radically to change the capital structure and ownership of BT and to provide a direct spur to efficiency increased investment would mean still higher charges for the customer. The Government, BT and the general public would find that unacceptable.

For all these reasons the Government have been examining how best to free BT from the traditional forms of Government control so as to allow it to compete in the market for finance on equal terms with other growing businesses and be subject with them to common disciplines.

We have, therefore, decided to introduce a Bill in the next session of Parliament which, while keeping BT as a single enterprise, will enable it to be converted into a Companies Act company, "British Telecommunications plc". The Bill will make possible the sale of shares in that company to the public. It is our intention, after the next election, to offer up to 51% of the shares on the market in one or more tranches. We also intend that the Memorandum and Articles of Association of the company will limit individual shareholdings to prevent foreign control.

Once half of the shares have been sold, the Government will relinquish control over the commercial decisions of BT plc. BT will be outside the public sector and its borrowing will cease to be subject to Exchequer control. The company will look to the markets for its external financing. It will be for the Board of the company to decide when and how much to borrow taking account of internal factors and market conditions in the same way as any other private sector company. All in all, this will mean not only a greater flexibility for BT and less pressure on consumers and taxpayers but also that BT increasingly will be subject to proper market disciplines.

Because of the advent of competition from Mercury, because of competition from the new value added network services and from privately supplied apparatus, and because it will be freed from Government controls, BT will be able to provide better services which are more responsive to customer needs like those provided by privately-owned telephone companies in the United States.

Given its present and potential strength BT plc will dominate the British market for telecommunications for some years yet. The Government considers therefore that there will be a need for regulatory arrangements to balance the interests of the company's investors, its customers, its employees and its suppliers. The Bill will therefore reform the arrangements for licensing telecommunications so as to end BT's exclusive privilege and its role in licensing. It will also establish a new Office of Telecommunications, modelled on the Office of Fair Trading, under a Director General appointed by me. He will have powers similar to those of the Director General of Fair Trading and will operate with the same degree of independence from the Government. Among other things he will have important functions in relation to the regulation of the telecommunications market, and the rate of return permissible for BT plc.

The Bill will safeguard BT's existing pension obligations. There will also be special provisions to ensure that those employed in BT will have an opportunity to buy shares in the company and it is my hope that these arrangements will have special regard to those with long service in BT.

Finally, the Bill will reform the Telegraph Acts which were passed in the last century. We need to recast the existing law to make it relevant to the technology of today and of tomorrow. I will be issuing a consultative document on this aspect shortly.

Mr Speaker, the proposals which I have announced follow naturally from the liberalising measures passed by the House last year. It would make no sense to stop half way. If those who work in the telecommunications industries are to provide the range and quality of goods and services which modern technology now permits, and if they are to do so in competition with each other, it cannot be right that BT should be subject to Government controls on the detailed running of its business, investment and borrowing decisions which are the inevitable lot of a nationalised industry which has the privilege of Exchequer finance. At the same time, as a dominant enterprise, it is right that BT plc should be subject to a sufficient regulatory control to ensure fair competition, fair prices and a fair return. The House will clearly want to give careful consideration to these provisions during the passage of the Bill.

Because of the widespread interest which I anticipate these proposals will arouse, I am today publishing this statement in the form of a White Paper.

Perhaps I may end on this note. As always, the quality of the service which any enterprise provides depends entirely upon the skills, energy, imagination and leadership of the people engaged in it. All the Government can do is to provide those people with the environment - market, financial, legal and structural - which will encourage those people to give of their best.

In the view of the Government, that is what the proposed Bill will do. I look forward to its introduction early in the next session of Parliament.



10 DOWNING STREET

Prime Minister

This statement on future
Telecommunications policy is
very long. As you will see,
Patrick Jenkin is proposing to
publish it as a White Paper.
I would have thought it would
be much more sensible for
him to publish this draft
as a White Paper, and to make
a short statement referring to
it. Agree that I should
pursue this possibility with
his office?

I think he is
going to shorten
it considerably
WJ
13/11

JU435

cWR
BI

cc JV



DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

13 July 1982

1

Michael Scholar Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

1. Mr Rickett
2. Prime Minister

Dear Michael,

In substance this looks acceptable. Alan Walters and the Policy Unit are content, subject to the deletion

FUTURE TELECOMMUNICATIONS POLICY: STATEMENT

of the square-bracketed words on

At E(TP)(82) 2nd meeting on 30 June, it was agreed that my Secretary of State should make a statement about the Government's intention to privatise British Telecommunications shortly before the Summer Recess. I attach a draft statement which my Secretary of State would like to make.

Agree?

2 As regards timing, I have already been in touch with Nick Huxtable in the Lord President's office, and it has been agreed provisionally that the statement should take place in the week beginning Monday 19 July. The Secretary of State's own particular preference would be Tuesday 20 July. I should therefore be grateful for any comments you and other recipients of this letter may have on the draft statement by 4.00pm on Thursday 15 July at the latest.

MUS 13/7

3 Since the statement is likely to arouse considerable public interest, my Secretary of State would like to issue it in the form of a short White Paper on the same day as the statement is made to the House. The text would be identical to the text of the statement itself, with the addition of a short list of issues on which the Government would welcome views from outside interests, and an address to which such comments should be sent. I should be grateful if you would confirm that the Prime Minister is content that the Secretary of State should proceed in this way.

4 I am sending copies of this letter to the private secretaries to the Members of E(TP), to Francis Richards (FCO), to Keith Long (Chancellor of the Duchy's office), David Wright (Cabinet Office), Gerry Spence (CPRS), and to Bernard Ingham (No 10, Press Office).

Yours sincerely,
Jonathan Spencer

J P SPENCER
Private Secretary

PARLIAMENTARY STATEMENT

TELECOMMUNICATIONS POLICY

With permission Mr Speaker I would like to make a statement about the future of telecommunications in Britain.

This Government aims to promote consumer choice and to ensure that wherever possible, industrial and commercial decisions are determined by the market and not by the state. We also aim to facilitate private financing of public sector investment so that less of the money has to come from higher-than-necessary consumer prices or from the taxpayer. We believe that consumer choice and private finance will lead to more stable prices and a higher quality of service.

The technological revolutions in telecommunications, including digital techniques, fibre optics and the rapidly growing range of terminal attachments and network services mean that state monopoly in telecommunications with all its inevitable disadvantages can become a thing of the past. Since the British Telecommunications Act 1981 received the Royal Assent less than a year ago, progress has been made in four directions.

First, last February, I licensed the Mercury consortium to provide a new telecommunications network in competition with BT. Mercury plans to launch a service for business subscribers next year.

Second, the BT network is increasingly being used by other firms for a widening range of network services. I hope shortly to issue a general licence permitting all bona fide value-added service operators to use the BT and Mercury networks. The rules in Britain will then be among the most liberal in the world. A whole new industry is emerging to provide new systems and services, not only here in Britain but for export to the rest of the world.

Third, the way is now opening for the private sector to sell telephone apparatus direct to the public. The first standards for telecommunications apparatus will be approved very soon and the new British Approvals Board for Telecommunications is ready to receive applications from manufacturers seeking approval of apparatus under the new standards. The attachments industry must now begin to compete with BT to get subscribers' custom. Competition to win market share here at home will make the industry more competitive abroad.

Fourth, and perhaps most important of all, after decades of monopoly, the prospect of competition and the advent of new technology are both stimulating BT to respond to market opportunities. BT is providing a new array of services, especially the City Overlay in the City of London, using microwave radio and other techniques. BT has also joined with other partners in an all-British consortium to set up an independent British satellite system which will include among other things new international telecommunications channels.

Mr Speaker, I stress that this is only a beginning. There is a long way to go but the House must remember that until 1969 the telephone service was run as a Civil Service department with all that that meant in terms of organisation, management and, above all, attitudes. Under Sir George Jefferson's able leadership, the talents which exist in BT are being given new incentive. The BT Act heralded nothing less than a cultural revolution in BT. I now want to take that revolution a stage further.

The House will know that Sir George, his Board and the BT unions have been united in criticising the method by which the telecommunications investment programme is financed. As a nationalised industry BT does not have direct access to financial markets. Its borrowing is controlled by the Treasury and counts against the PSBR. To bring inflation under control, these borrowings have inevitably to be subject to strict limits. One effect of this has been that around 90% of BT's investment programme, around £2,200 million this year, has been self-financed. By "self financed", I mean of course "customer financed". BT's charges to customers not only cover current running costs and depreciation, but also pay for some 90% of BT's new investment. As a result, charges have risen steeply while investment is still insufficient. Unless something is done radically to change the capital structure and ownership of BT, increased investment would mean still higher charges for the customer. The Government, BT and the general public would find that unacceptable.

For all these reasons the Government have been examining how best to free BT from the traditional forms of government control so as to allow it to compete in the market for finance on equal terms

with other growing businesses.

We have, therefore, decided to introduce a Bill in the next session of Parliament which, while keeping BT as a single enterprise, will enable it to be converted into a Companies Act company, "British Telecommunications plc". The Bill will make possible the sale of shares in that company to the public. It is our intention, after the next election, to offer up to 51% of the shares on the market in one or more tranches. Sale of the remaining 49% would not be possible without further legislation. We also intend that the Memorandum and Articles of Association of the company will limit individual shareholdings to prevent foreign control.

Once half of the shares have been sold, BT's borrowing will cease to count against the PSBR and BT will cease to look to the Exchequer for most of its external financing. It will also be able to finance its investment in ways which provide a more normal self-financing ratio. All in all, this will mean not only a greater flexibility for BT and less pressure on consumers and taxpayers but also that BT will be subject to proper market disciplines.

Because of the advent of competition from Mercury, because of competition from the new value added network services and from privately supplied apparatus, and because it will be freed from government controls, BT will be able to provide better services which are more responsive to customer needs like those provided by privately-owned telephone companies in the United States.

BT plc will nevertheless dominate the British market for telecommunications for some years yet. The Government considers

therefore that there will be a need for regulatory arrangements to balance the interests of the company, its investors, its customers, its employees and its suppliers, where these conflict. The Bill will therefore reform the arrangements for licensing telecommunications so as to end BT's exclusive privilege and its role in licensing. It will also establish a new Office of Telecommunications, modelled on the Office of Fair Trading, under a Director General appointed by me. He will have powers very similar to those of the Director General of Fair Trading and will operate with the same degree of independence from the Government.

The Bill will safeguard BT's existing pension obligations. There will also be special provisions to ensure that those employed in BT will have an opportunity to buy shares in the company and it is my hope that these arrangements will have special regard to those with long service in BT.

Finally, the Bill will reform the Telegraph Acts which were passed in the last century. We need to recast the existing law to make it relevant to the technology of today and of tomorrow. I will be issuing a consultative document on this aspect shortly.

Mr Speaker, the proposals which I have announced follow naturally from the liberalising measures passed by the House last year. It would make no sense to stop half way. If those who work in the telecommunications industries are to provide the range and quality of goods and services which modern technology now permits, and if they are to do so in competition with each other, it cannot be right that BT, the dominant enterprise in the industry, should be subject to a web of government control and

interference which is the inevitable lot of a nationalised industry. Nor can it be right that BT should be free from the disciplines of the market which is the privilege of those who look only to the Exchequer for their finance. At the same time, as a dominant enterprise, it is right that BT: plc should be subject to a minimum regulatory control (to ensure fair competition, fair prices and a fair return). The House will clearly want to give careful consideration to these provisions during the passage of the Bill.

Because of the widespread interest which I anticipate these proposals will arouse, I am today publishing this statement in the form of a White Paper.

Perhaps I may end on this note. As always, the quality of the service which any enterprise provides depends entirely upon the skills, energy, imagination and leadership of the people engaged in it. All the Government can do is to provide those people with the environment - market, financial, legal and structural - which will encourage those people to give of their best.

In the view of the Government, that is what the proposed Bill will do. I look forward to its introduction early in the next session of Parliament.

SUBJECT
ce Maris



MISS STEPHENS

Please arrange meeting
MS

10 DOWNING STREET

From the Private Secretary

Mr Scholer

7 July 1982

1730 on 2 to 26-1
Tuesday 27-01

Dear Jonathan:

SYSTEM X

The Prime Minister had a word with your Secretary of State yesterday morning about System X. The Chancellor of the Exchequer was also present.

The Prime Minister said that, following a discussion she had had with Lord Weinstock, she was most concerned about the moves the Government was making to improve the arrangements for development and marketing of System X. She had seen a copy of the letter which BT had written to GEC, Plesseys and STC, and there seemed to be a considerable discrepancy between what was said in this letter and the terms of her summing up of the ETP meeting on 22 April.

Lord Weinstock had made particular criticism of the proposal to open up 30% of BT's procurement to overseas competition. She had been impressed by these and by other points which Lord Weinstock had put to her, and now questioned the wisdom of the course upon which the Government were embarked.

Your Secretary of State said that he had made it clear from the start that the Government's attempts to improve the arrangements for System X would be controversial with the companies concerned. But it was necessary to act in this way to get the right result. There was no question of it being the case, as Lord Weinstock had alleged, that there was a pre-arranged plan to give all this business to Plesseys. The fact was that the marketing of System X had been going very badly, that the arrangements between the companies were cumbersome and ineffectual, and that it was necessary to bring about some improvement.

The Prime Minister said that she would be convening a small meeting before the Recess with your Secretary of State, together with Mr. Baker, to consider these matters further.

I am sending copies of this letter to John Kerr (HM Treasury), Neil McMillan (Department of Industry) and David Wright (Cabinet Office).

Yours sincerely,

Michael Scholer

Jonathan Spencer, Esq.,
Department of Industry.

①
CF. pl bf 13/7
MCS 5/7

PRIME MINISTER

SYSTEM X

I attach, as you requested, the papers on System X which we were discussing earlier this afternoon.

The first we heard of the proposal to reorganise the handling of the development of System X was Kenneth Baker's minute to you of 30 March. Mr. Baker reported BT support for the proposal that one company - Plessey - should have sole responsibility for System X at home and abroad and he expressed some doubts about Plessey's management, but sought colleagues' approval to agreeing to BT's proposals. He sought this as a matter of urgency.

We suggested that this be discussed at E(TP) and this happened on 22 April. You were recorded as summing-up in the following terms:-

"THE PRIME MINISTER, summing up the discussion, said that the Sub-Committee agreed that the present arrangements for developing, producing and selling System X were unsatisfactory. They therefore welcomed the Minister of State's proposal that he should authorise BT to seek proposals from GEC, Plessey and STC for a single focus for management responsibility for System X. There should however be no suggestion that the Government had decided on any particular way of reorganising work on System X, still less that the Government took the view that one particular company should become solely responsible for future work. The best way forward might well be that proposed by the Minister of State; but the companies might come up with other possible schemes; and the wider implications of giving sole responsibility for work on System X to one company would have to be properly examined before any decision could be taken. The Minister of State

/should

should report to the Sub-Committee on BT's discussions with the System X manufacturers, if possible before the Summer Recess."

I have secured a copy of a letter with which BT communicated this decision to the three companies. This is attached at Flag A. You will see that it is a flat-footed and obtuse letter. We expected from the start that the whole initiative would cause trouble with the industry. Mr. Baker's minute said "there would be a major political row inspired by the other two companies". But the BT letter of 18 May seems almost designed to exacerbate the difficulties. It is certainly a long way away from the terms of the E(TP) discussion.

It was also agreed by E(TP) on 22 April that the results of the consultations with the companies should be reported back by Mr. Baker to E(TP), if possible before the Summer Recess. I am enquiring about how soon Mr. Baker can make this report. Perhaps the best way forward would be for him to report to an early meeting of E(TP)?

MCS

I had letter
see S of S and
Kenneth Baker
about this
mb

5 July 1982

British

TELECOM

cc Mr Scholer, No. 10

British Telecommunications

2-12 Gresham Street
LONDON
EC2V 7AG

Telephone

National 01-357 3344

International +44 1 357 3344

Telex 883051 BTHQ

J S Whyte CBE, MSc(Eng), F Eng, FIEE

Engineer-in-Chief
Managing Director: Major Systems

COMMERCIAL IN STRICTEST CONFIDENCE

Mr J Samson
STC Ltd, 190 Strand, WC2

Mr W D Morton
GEC, Telephone Works, Coventry

Mr D H Pitcher
Plessey, Edge Lane, Liverpool

Zi
18 May 1982

Dear Doug,

As you know the Government has recently been reviewing the organisation and prospects for System X and has held discussions with all parties concerned. They have recently notified us of their conclusions.

I understand that there was a strong view in industry that a major international business in public switching systems could only be built on a highly efficient production base with an output considerably larger than that currently available to any of our 3 existing suppliers and that the existing collaborative arrangements were less than satisfactory. The Government has told us that they are anxious for the UK to establish a strong position in world markets and they are ready to give financial and political support to achieve this objective. They are however only willing to do so if the industrial base is concentrated so that it has the scale necessary to give it the possibility of success, and if the management arrangements are changed to introduce strong unitary management. Accordingly the Secretary of State has asked BT to revise its plans to secure this result.

These objectives of the Government are consistent with BT's own needs. It remains our wish and intention to purchase System X on a large scale for use in the UK network subject to acceptable price, performance and delivery. However, in the competitive environment that we now face it is imperative that the switching equipment that we buy is highly cost-effective when judged against the best that the world can offer. We are not prepared to be party to domestic arrangements that do less than this.

The Minister of State has accordingly invited us to consider placing all of our System X business with a single company in order that it should be in a position to establish an adequate base in the UK.

We have in mind therefore to place an initial single contract with one company for the supply of approximately 70% of our inland digital public exchange orders over the next three years. This contract would also include an option to increase the volume of supply above this level. I invite you to put your proposals to me for giving effect to this concept. I shall be looking in your reply for full information on the production facilities that you would make available, the approach you would apply to securing international business, and the reasons why you feel your company should be entrusted with this responsibility.

We recognise that the two companies who are not selected - which I will call companies B and C - will face a period of readjustment of their business as System X comes into volume production, and I propose to discuss with them ways in which we may help them through this period. These discussions could include a review of the whole field of our other telecommunications purchases to see if there are ways open to us to offer additional business to B and C for a transitional period, perhaps by transferring some business from Company A.

I turn now to the development situation. Many System X development contracts are in progress and BT will expect all companies to complete the work for which they have contracted within the agreed timescales, and to pass over all the resultant information promptly in the established manner. It may well be that it would be appropriate to appoint Company A as prime contractor for the remaining development process, but this would be for discussion. As you know so far BT has met the whole cost of the development of System X. When these new arrangements come into operation I propose to ask company A to fund 50% of future switching system development expenditure, all existing development contracts would however continue to be 100% funded by BT.

These new arrangements would of course eventually result effectively in a single large volume indigenous switching supplier to BT. You will wish to know that to provide a competitive yard-stick against which to monitor the performance of company A we would intend to offer a proportion of our switching business to international tender, but subject to the British company developing into a competitive supplier we would expect this proportion to be small.

The decision to invite proposals along these lines was not taken lightly, and we recognise that there will be many difficulties to overcome during the transition phase. However I am sure that you will share the view that the worst possible situation for the industry would be uncertainty and I hope you will join with us in securing a speedy and clearcut resolution of the way ahead, which will lay the foundations for enduring export success and a reliable supply for British Telecom.

I have written in the same terms to Jeff Samson of STC and Des Pitcher of Plessey. I would be glad to have your proposals by 17 June.

Yours sincerely

J S Whyte

J S WHYTE

Copy to: Rt. Hon. Christopher Chataway

Post e Tels
✓CTU

Prime Minister (2)

Hus 2/7

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

2 July 1982

✓ Post + Telecoms - -

The Rt. Hon. Patrick Jenkin MP
Secretary of State for Industry

✓ phone rental + standing
charges - March 82

Dear Secretary of State,

BT FINANCIAL TARGET AND PRICES

In your letter of 28 June you sought my agreement to the revised tariff package that Sir George Jefferson has put to you; to the setting of a two year financial target for BT, and expressed the view that a BT bond issue this Autumn could no longer be regarded as a realistic option.

I am content with the modest tariff proposals that BT now have in mind for November 1982, and note that they expect to come forward in due course with similarly modest proposals in 1983.

On the financial target, I am persuaded that our intentions on privatisation make it sensible to set a two year target now, leaving the way clear to set a target for the whole transition period at a later date. BT's willingness to work within (I would hope well within) the external financing projections in the White Paper is of course crucial. In the light of this I agree that the target should be set at 5½ per cent for 1982-83 and 1983-84. You may wish to indicate to Sir George Jefferson that if by achieving greater cost savings he is able to increase BT's self-financing in 1983-84, he should not feel constrained from doing so by the fact that this would lead to his overshooting the target. His objective should be low tariffs and high returns and we can support the achievement of the latter provided it is not at the expense of the former or a higher requirement for external finance.

On the BT Bond, I share your disappointment but accept that there is now no case for an issue this Autumn, and hence no need for an immediate decision on the effect of Clause 52 of the Finance Bill on the bond. My mind is not totally closed to an issue at a later date, but the picture has been transformed by our decision to go for the ultimate goal directly and sell equity. I do not underestimate the size of the task you and BT now have to draft and carry the legislation we agreed at E(TP). This must obviously have priority.

/Finally,



Finally, I note that you will be having further discussions with BT on this year's EFL. In the light of these discussions we will be able to determine when, and to what extent BT will require access to NLF finance this year.

I am copying this letter to the Prime Minister and Sir Robert Armstrong.

Yours sincerely,

Jim Rutter

PP GEOFFREY HOWE

(Seen and approved by the Chancellor
and signed in his absence).

Press Office?

with compliments

C/F?

NBPM

JF

S17

SIR FRED DAINTON



The British Library Board

2 Sheraton Street

London W1V 4BH

Telephone 01-636 1544

The British Library Board

2 Sheraton Street
London W1V 4BH
Telephone 01-636 1544

1st July, 1982.

The Rt. Hon. Paul Channon, MP.,
Department of Education and Science,
Elizabeth House,
York Road,
London, SE1 7PH.

Dear Paul,

Scientific Documentation Centre

You will recall that Dr. P.S. Davison, Director of SDC, has conducted a campaign through the Press and Parliament maintaining that the policies of the British Library Research and Development Department and its antecedent the Office of Scientific and Technical Information were gravely mistaken in their policies for scientific information, storage and retrieval and had thereby wasted public funds. Almost two years ago he wrote to the Prime Minister at some length and I believe you have a copy of that letter. ^{P41} Following her reply he wrote requesting a meeting with me (copy letter enclosed). ^{P42} After discovering the substance of his correspondence with the Prime Minister I responded to his letter by asking him to state the subjects he wished to discuss. Some 14 months later he wrote a long letter and I enclose a copy.

Now after a further long delay on his part he and his Chairman have been to The British Library and I enclose a note recording what took place together with copies of his Chairman's letter to me and his own letter to Mr. Perry who is the Director of our Research and Development Department and was present at the meeting. As you will see the meeting was reasonably satisfactory in tone and content and we now await proposals from Dr. Davison. I cannot say whether any of these proposals will succeed in securing grant support from the Library because they will have to be judged on exactly the same criteria as other grant applications i.e. on the scientific merit of the proposal, the capacity of the investigator to carry out the study and the importance in relation to the purposes for which the British Library was set up.

I felt that you and, because her office has been involved, the Prime Minister should know the stage that has been reached with Dr. Davison. For the moment all is calm in our relations with Dr. Davison and I am sure that Dr. McIntosh will do his best to restrain Dr. Davison in any further outbursts. I think it would be unduly optimistic to expect that Dr. Davison would abandon entirely the views about the British Library Research and Development Department and OSTI which he has held for so many years and that he will not write to the Press or to you or to the Prime Minister or activate his Member of Parliament to speak on his behalf but I am absolutely certain that he has no grounds whatsoever for complaint that he has been unfairly treated or discriminated against. I have taken a personal interest in this matter and will continue to do so in order to satisfy myself and you that he is dealt with even handedly and that you or the Prime Minister could affirm this without fear of contradiction and fully supported by the evidence. I had hoped to tell to this personally at our meeting on Tuesday 29th but this had to be cancelled because of the rail strike.

Yours sincerely,

Fred Dainton.

SCIENTIFIC DOCUMENTATION CENTRE LTD.

Director of Research, P. S. Davison, Ph.D., B.Sc., A.R.I.C., M.I.Inf.Sc.

HALBEATH HOUSE,
DUNFERMLINE, FIFE, KY12 0TZ,
UNITED KINGDOM.



Telephone: Dunfermline 23535

Reference:

Sir Frederick Dainton,
Chairman,
British Library Board,
Store St.,
LONDON, WC1E 7DG

12 - 10 - 80

Dear Professor Dainton,

Following correspondence with the Prime Minister, she has suggested that I ask for a meeting with you.

My Chairman is in Canada, and I wondered therefore, if it might be possible for us to meet you some time after his return at the end of October?

Yours faithfully,

A handwritten signature in cursive script that reads 'P.S. Davison'.

P.S. Davison.

E

The British Library Board

Store Street

London WC1E 7DG

Telephone 01-636 1544

16th October 1980

P.S. Davison Ph.D., B.Sc., ARIC., MI., Inf., Sc.,
Director of Research
Scientific Documentation Centre Ltd
Halbeath House
Dunfermline, Fife KY12 0TZ
United Kingdom

Thank you for your letter of 12 October. I would be grateful if you would let me know what you and your Chairman wished to see me about.

Yours sincerely

Fred Dainton.

This office will move to

2 Sheraton Street
London W1V 4BH

ON 1 NOVEMBER 1980

The telephone number remains
the same: 01-636 1544



Handwritten note: *Check/ attach similar covers and show to H.M. for comment*

SCIENTIFIC DOCUMENTATION CENTRE LTD.

Director of Research, P.S. Davison, Ph.D., B.Sc., A.R.I.C., M.I.Inf.Sc.

HALBEATH HOUSE,
DUNFERMLINE, FIFE, KY12 OTZ
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Telephone: Dunfermline 23535

Your Ref:
Our Ref: PSD/EMM

Sir Frederick Dainton, F.R.S.,
Chairman,
British Library Board,
2 Sheraton Street,
London. W1V 4BH

Handwritten date: 14/10/81

Dear Sir Frederick,

The reply to your letter of 16th October is given below and indicates in detail the reasons why my Chairman and I wish to follow the Prime Minister's advice and seek a meeting with you to request the support of the British Library for our research programme. To give the reasons for this approach I have also had to lay out the relevant background to the development of information retrieval in the period in which I have been involved.

Background - The Traditional Publication Systems

The last three decades have seen major changes in retrieval, storage and dissemination of scientific and technical information. Traditional means developed and used by the Learned Societies, were based on publication of abstracting journals and indexes in periodical/book form. Viewed as information systems these had theory-based maximum intrinsic effectiveness potential; practical application characteristics, operational parameters, limitations and constraints (such as interface losses reducing this potential in practice) in this rôle, and cost structures imposed by the attributes of their production and storage methods. These production methods are text preparation/composition/printing/binding/publication - distribution. Among the most important of these attributes was the requirement to achieve viability, that a substantial number of identical publications giving the same (rather large) selection of information had to be sold, and this attribute requires that publications are given attractiveness to a large number of users. This meant dissemination of very large amounts of unwanted information to each user at high composition and printing costs and at a low information-required to information-supplied correlation characteristic.

Emerging Systems: The Concept of Selective Dissemination of Information

In the 1950's, emphasised by two international conferences, it was realised that Selective Dissemination of Information (SDI) could avoid dissemination of most of the unwanted information, might avoid much of its high cost, and would provide systems with entirely different characteristics imposed by the different attributes of their different production methods. Great reduction in the volume of disseminated information till it correlated much more closely with the actual needs of the individual user, might offset higher unit costs and might give much lower total system costs for the same needed dissemination for the nation.

Two production systems came forward which could build round the SDI concept the retrieval, storage and dissemination mechanisms which (perhaps with central filing of less needed reports) could provide major alternative systems, and fulfil a major part of the role of the traditional system - perhaps effectively and perhaps at lower cost.

IBM/

Members of Council: - Dr. D.M. McIntosh, C.B.E., Chairman; J.R. McNally, M.B.E., J.P., Vice-Chairman; C.J.V. Roberts (Kodak) Vice-Chairman; R.M. Anthony (DCL); Dr. A.J. Barnes (Salford Univ.); S. Barrows (formerly DCL); Prof. D. Bryce-Smith (Reading Univ.); J. Davison; Dr. W.D. Fordham (Bush, Books Allen Ltd.); F.H. Truscott (ITT); P.S. Davison, Secretary.



IBM had seen the financial opportunities in information retrieval that they could exploit, and research by Luhn in the late 1950's proposed the application of computers,^{1,2} and had large financial benefits to computer firms through over twenty years of publicly-funded research on this, which has still failed to produce systems which are more effective at disseminating the information the user needs, than traditional facilities. In the mid 1960's the British 'Establishment' adopted computerisation as the method it proposed to develop for SDI. It did so following the introduction of operational, interdisciplinary SDI services by this Research Association using a system worked out in the late 1950's and early 1960's, which achieved selectivity by storing and handling each reference on a separate piece of paper, and by providing systems and equipment able to produce and select this information economically and on the substantial scale needed.³ This system has been operational ever since and has been able, for example, to accumulate about two million references on a quite small number of subjects, for a tiny investment by computer standards. This could be extended hugely, and for a small part of comparable computer costs.

Computer Macro Systems

Viewed as systems, the computer macrosystems required, also have constraints and limitations imposed on them by their production and storage methods. These methods, which differ in current awareness and retrospective search rôles, are broadly (text preparation)/selection and coding in some cases/digitisation/transfer to store/computer search and selection/print out and despatch of print out (after on-line or off-line display by video or teleprinter). The attributes; parameters (including limitations and constraints²) and characteristics of these processes enable one to assess the potential performance of the systems in different situations. Quantitative assessment such as the Oxford Evaluation^{4,5}, showed the computer system costing more, even discounting subsidy, and able to give only half the relevant recall of the SDC system. More recent versions of the computer system (on-line) have been described as both absolutely and in cost terms less effective than any other existing means of information retrieval. The danger to research and industry of wide acceptance of incompetent systems obstructing its R & D and management growth points is obvious and most serious.

The SDC System

Viewed as a system the method developed and used by SDC⁶, also had constraints imposed on it by production and storage methods. These methods are broadly (text preparation)/selection and coding/reproduction/sorting/despatch, or, (text preparation)/coding/reproduction/(storage)/selection for user/despatch, depending on rôle. The quantitative assessment of the current awareness rôle by the Oxford Evaluation mentioned above showed this system able to obtain double the relevant recall of two much larger computer systems, one of which was currently very heavily subsidised, and that it would do this at lower cost - substantially lower than the real costs of the other systems. We have seen a number of smaller assessments comparing the computerised and SDC systems and all, including one carried out without our knowledge by Birmingham University, showed a large advantage of recall of relevant information for the SDC system.⁷ We are disappointed that the British Library failed to follow up the Oxford Evaluation on chemical information services with proper comparative evaluations of the SDC system and computerised retrieval systems in other subjects as requested.

SDC's Research Status/



SDC's Research Status

Since SDC was incorporated in 1962 we have applied a vigorous research activity to information retrieval. Our publications were probably the first to prove quantitatively the startling ineffectiveness in recall etc. of the traditional information retrieval systems;^{6, 8-10}, these studies covered first a single subject, next a single sub-discipline and lastly a complete major discipline. The great increase in expenditure on R & D for information retrieval in recent years, shows acceptance of the weaknesses in the traditional existing system which we established. We have published comparative unit costs for dissemination of information using a whole range of print-based systems including production by both the above-specified systems and this, yet again, confirmed the high unit cost of computer systems.^{9,11,13} We have, and are, carrying out cost studies on major computer centres like Swansea, systems like Prestel, on machine translation and other important matters affecting major libraries.² Two papers² I recently presented at a Luxembourg Symposium established expenditures of, at least, £800,000,000 on computer macro-systems, established the very long research periods of all (up to thirty years) and it seems widely accepted that these systems are still not generally more effective than what they could replace in information retrieval terms. Later support by OSTI/BLR&DD of ideas like those embodied in earlier SDC descriptions appears at least to give the compliment of emulation to our research ideas. Publications from here also laid out a substantial part of the reasoning and basis of what has become the Parents' Charter policies in education of this Government.¹⁴⁻²²

Unbalanced Research and Development Programmes

The fates of the two SDI systems since the 1960's differ remarkably. The computer system has been developed in a variety of different ways, one following the other in a continuing expensive succession, all with the help of public funding of a generosity never before seen in research for information retrieval in Britain. Research funding of experimental computer services of the mid 1960's, of the computer data processing centre and of specialised information centres (some computerised), was followed by generous funding for SDI and liaison experiments, statistical analyses, re-packaging, integration, evaluation, correlated structure text searching, reviews, free indexing, development of thesauri, machine profile construction, alternative strategies - all for computer systems - and even user reactions and user education for (computer systems) attracted widespread funding. Now computerised on-line and networks are big money receivers.²³ A journal very recently led the very pertinent question that expenditure on promotion of on-line services should be evaluated against the actual income of those services: The extremely high proportion of sales/promotion costs to turnover and profit, and sources of funds and comparison with normal commercial practice would be fascinating results of this study.²⁴

During the same period the systems, whose operational introduction preceded this generous expenditure, found a remarkable and entirely consistent impossibility of obtaining any funds from the same main sources for its R & D. Two systems exist. They offer different potentialities for effectiveness, have different attributes, characteristics and different cost structures for operational application and both can meet an essential and important function with very important benefits for science and industry. It seems to us that there is a most unsatisfactory state of imbalance when one receives almost unlimited funding and the other none, and the latter because of withholding of funds remains largely undeveloped. This is especially unsatisfactory when there is substantial factual evidence that/



the unsupported system is more effective and more cost effective than the supported one.^{4,5,6,7,8,9,10,11.}

Research and Development Areas Proposed by SDC

It is our belief that funds should be available for support of research and development on the following in the order of priority given:-

1) Overall Systems - Pilot Study

Based on 20 years experience and existing well-known practical operating systems, it is our belief that an overall system of information retrieval for the next few decades could be established using a combination of techniques, including SDC's input method, COM index, micro film or fiche or printing, which would provide effective recall at lower cost than in comparable alternatives. The systems would provide the effective recall proved by SDC practice and frequently obtained in the traditional systems, but at which computer services have repeatedly failed. Its output could set standards. Its development costs are believed to be around 1/10th of computerised development costs. We believe that a feasibility study on this is needed urgently. We believe it would point the way to very large savings in public funds.

2) Theoretical Research

Knowledge of large systems for information dissemination in practical operation depends on the level of theoretical knowledge established in this field. It is, and has for some years, been our belief that it would be possible to establish at a fundamental level the theoretical relationships between the different parameters, characteristics, attributes and cost structures of systems so that the potentialities of different systems applied to a particular rôle or situation could be calculated on a theoretical basis in advance of spending large sums on their establishment. This research should, in our view, be supported in an on-going manner, as only when it succeeds, can we avoid the long string of expensive experiments in the past. The proposal therefore could avoid large and wasteful future public expenditures.

3) Library Information Officers' Camera

It has long been our view that it would be feasible and not excessively expensive to develop a small personal hand-held strobe-operated camera, which a librarian or information officer could use to copy individual abstracts or small entries, or possibly whole pages, direct on to film or paper - producing a continuous search record directly. The last two decades of development of computer systems have succeeded in showing the way to remove a little of the drudgery of copying out references - at the cost of losing effective recall - and at the cost of £6,000,000 (£7,500,000 including the Infoline losses) in the UK alone. This proposal would give a great reduction in drudgery without losing the effective recall which the human search allows, and that the computer system loses. The proposal could increase the/



the efficiency of research.

4) Unnecessary Publications

Pilot studies ²² carried out by SDC some years ago showed that in one social science subject, a large proportion of papers published were purely opinionative and contained no substantial new proven fact. Storage and retrieval of scientific and technical information is an expensive necessity for the nation, whose efficiency is also reduced if a large part of that information is of low or no intrinsic value. This has important bearings on the size of all information stores and on the attitudes to what is acceptable for publication as science or technology. We believe, that fuller studies should be commissioned to assess the proportion of material published in areas of social science and education that is of proper scientific standards, or that contains other material that is of real value and worth recording for posterity. This could reduce expenditure on storage and retrieval of material of no permanent value.

5) Stability of Ultra Micro Storage

Many years ago SDC carried out a literature study on the stability of magnetic storage media. ²⁵ This showed that the media used 15 years ago were largely stable. They could be affected by electric motors and perhaps occasional radiation occurrences. There is now much talk about extreme high density in magnetic and optical storage media which might be used to store vital national permanent information resources. We believe that the stability of these media to modern hazards should be fully checked, by a research study. This project would check that essential records are not liable to be put at risk in new media.

We estimate that the cost of the above project would at S.D.C. approximate to £70,000 over six years.

We believe that the fact that SDC information services continue and are now nearly twenty years old, and have accumulated a retrospective data bank input of two million references, with very tiny resources, proves that they are highly cost-effective in their operation, because none of our European competitors has done this or operates without assistance for its R & D.

The British Parliament makes funds available for R & D in information retrieval for British organisations. As the British Library at present controls in effect all these public funds for R & D for information retrieval in Britain, we seek a meeting to obtain a decision in principle from you to now support SDC's research in a way SDC can use.

Yours sincerely,

A handwritten signature in dark ink, appearing to read "P. S. Davison", is written over a horizontal line.

P. S. Davison.

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SDC
5-10-81

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SDC AND RESEARCH - NOTE OF A MEETING HELD AT THE BRITISH LIBRARY ON THURSDAY,
10 JUNE 1982

Present: Dr D M McIntosh, CBE - Chairman of Council, SDC Ltd
Dr P S Davison - Director of Research, SDC Ltd
Sir Fred Dainton, FRS - Chairman, British Library Board
Mr B J Perry, Director, Research and Development Department

1. BACKGROUND

Dr McIntosh opened discussions by outlining the history of SDC Ltd and its achievements to date, including winning two contracts with the EEC. He said that basically SDC was looking for two forms of support:

- (i) funds to meet the increased requirements for accommodation to house SDC collections;
- (ii) support for research that would improve their products and activities.

Dr Davison said SDC was a non-profit-making limited company with capital limited by guarantee. He confirmed that it was not officially approved as a research association. Sir Fred stated that the British Library could not help with funds for accommodation and suggested that the small firms scheme, or the British Technology Group might be able to help. However, the Library could use its research funds to support acceptable proposals provided that the results were of general applicability and were made available for public use. BL research funds could not be used to subsidise the activities of an individual organisation. Research proposals would be refereed in the normal way.

2. RESEARCH PROPOSALS

In introducing the research proposals set out in his letter of 14 October 1981, Dr Davison said he would like to withdraw proposals numbers 1 and 3 because British Library conditions on exploitation of results could prove detrimental to SDC's financial interests. Mr Perry suggested that Dr Davison might like to contact Mr Ken Cunningham of British Technology Group on his interesting suggestion for a library information officer's camera. The remaining three proposals were then discussed in detail, the main points being:

- (i) Theoretical research - Dr Davison said he was interested in this because of his belief that it should be possible to develop mathematical models as an aid to selecting particular systems for retrieval of particular information. If successful, this could mean that there would be a potent guide to evaluating the cost of efficiency of systems. He estimated that this work would take the equivalent of 1½ man years at the cost of approximately £15,000. Sir Fred outlined the purposes of the seminar on economics of information being held by the BL on June 24 and 25. He thought that the discussions could be helpful to Dr Davison and invited him to attend. Dr Davison accepted and said that he would work up his proposal in more detail after this seminar.
- (ii) Unnecessary publications - SDC's interest in this work had developed from previous research they had carried out into four specific areas of educational practice by following up references in the British Education Index, when they had been able to show that only in the case of "continuous assessment" had properly-conducted research been evaluated to produce new practice. He thought that this situation could exist for many areas, particularly in the social sciences. Indicators of non-research papers were the length of the paper, ie 3 to 4 pages are not enough to cover discussion of research findings, the number of references and tables and graphs, etc. SDC had a large amount of basic material in this field and Dr Davison wished to extend the previous research into other areas. He would use panels of experts to look at the assessment made on the basis of indicators and confirm, or otherwise, the judgement as to the value of the papers. This research project would again take about 1½ man years and would produce results that could be used by secondary services to judge whether or not they should include articles in their coverage. He thought, for instance, that it could produce data for decision on inclusion of material in BEI.

Sir Fred, whilst admitting to no specialist knowledge in the social sciences, expressed a fear that some conceptual papers with original ideas could possibly be excluded from secondary services. It was ^{first} thought worthwhile for Dr Davison to discuss his ideas with the Social Science Research Council, who were more expert in the methodology of research in the social sciences than any members of the BL. They might after discussion refer a project in this area back to the British Library. Mr Perry suggested that Mr David Allen of SSRC could be a useful first contact.

- (iii) Stability of ultra micro storage - Dr Davison explained his interest in this area as being, particularly, the possible effects of both background radiation and increased radiation on the permanency of micro storage media. Sir Fred said that the Library was interested in problems of permanence of all storage media and, after some discussion, it was agreed that Dr Davison would contact the National Computer Centre, Dr Lewis Roberts, Director of Harwell and Sir Fred, in his capacity as Chairman of the Radiological Production Board, to find out what relevant research had been done on this subject. Mr Perry mentioned that the British National Bibliography Research Fund had commissioned NRC¹ to carry out a literature search on the archival properties of new media and agreed to send a copy of the report to Dr Davison as soon as it was available. It was generally agreed that when all this background material had been brought together it would be valuable to issue a contract for the production of a pamphlet on the relevance of this work to librarians and information workers.

Following these discussions, Dr Davison raised the problem of paying research staff at a rate different from that of the staff already working at the Centre. Sir Fred agreed that it would be possible to issue a grant that worked on the basis of

man-time equivalents and that it might be possible to use university scales for research assistants' salaries or their equivalent. If overheads were requested, then money would be awarded in the form of a contract rather than a grant. The British Library representatives outlined the current difficult financial position and the fact that many requests were at present competing for very limited funds. Dr Davison indicated that he would not wish to start on research projects immediately since there is a heavy work-load at SDC at the moment. Mr Perry explained the various forms of publication that were used by the R&D Department.

It was generally agreed that this had been an extremely useful meeting, which had served to remove much of the communication difficulties that had occurred in the past and Sir Fred stressed that the facility for such discussions with the BL was always available.

750 17/6/82

B. J. Perry

Research & Development Department

15 June 1982

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Your Ref:

Our Ref:

*Mr Perry to me
then file
YSD
18/6*

14 June, 1982

Sir Frederick Dainton, FRS.,
Chairman,
British Library Board,
2 Sheraton Street,
London W1V 4BH

I should like to offer my sincere thanks for the very friendly and helpful reception you gave us on our visit to the British Library. Not only did you provide us with straight answers to our questions, but you went out of your way to make suggestions as to how we could further our efforts. This was one of the most constructive meetings I have been present at as a beggar for many a long day!

Yours sincerely,

Douglas M. McIntosh.

Douglas M. McIntosh.

Members of Council: - Dr. D.M. McIntosh, C.B.E., Chairman; J.R. McNally, M.B.E., J.P., Vice-Chairman; C.J.V. Roberts (Kodak) Vice-Chairman; R.M. Anthony (DCL); Dr. A.J. Barnes (Salford Univ.); S. Barrows (formerly DCL); Prof. D. Bryce-Smith (Reading Univ.); J. Davison; Dr. W.D. Fordham (Bash, Boske Allen Ltd.); F.H. Truscott (ITT); P.S. Davison, Secretary.

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14th June, 1982.

B. J. Perry, Esq., BSC., FLS.,
Director,
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2 Sheraton Street,
London W1V 4BH.

Dear Mr. Perry,

PSD
21 JUN 1982

I was very glad to renew our acquaintance at the meeting with Sir Frederick a few days ago, and I should like to offer my sincere thanks for the friendly and very helpful way you both received us. I believe it augers well for the future, and I look forward to meeting you at Banbury.

Yours sincerely,

P. S. Davison.

P.S. Dr. McIntosh has sent a letter of thanks to Sir Frederick.

Ref. A08867

PRIME MINISTER

Regulation of Telecommunications: Nature of Regulatory Body

There is general agreement that, with the privatisation of British Telecommunications (BT), it will be necessary to set up a new body to carry out regulatory functions.

2. The Secretary of State for Industry proposes that the new body should be a non-Ministerial Department with a Director General, on the lines of the Office of Fair Trading. He has in mind the possibility that at some later date the new body and the Office of Fair Trading might be amalgamated.

3. The CPRS would prefer a non-Departmental body, which should be seen as distanced from and independent of Government and should be staffed not by civil servants but by experts.

4. There is an interception dimension to this issue which is not mentioned in either of the papers. It is unlikely that the new body will have any powers in relation to interception, but it may be very important that it should be aware of the implications for interception of its activities and decisions. This could clearly be more easily and effectively ensured if the body was a Government Department (albeit a non-Ministerial Department) than if it was a non-Departmental agency.

5. Making it a non-Ministerial Department does not mean that it need be deprived of experts. If the right kind of experts do not exist within the Civil Service, they can always be brought in, or engaged on contract terms.

RTA

ROBERT ARMSTRONG

30th June, 1982



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PRIME MINISTER

Liberalisation of Telecommunications

(E(TP)(82)5)

BACKGROUND

At its previous meeting, on 22 April, E(TP) discussed future telecommunications policy and in particular the Secretary of State for Industry's proposal that British Telecommunications (BT) should be privatised. The Sub-Committee concluded that, whatever the attractions of privatisation, the Government's most important aim for telecommunications must be to increase competition and efficiency. You asked whether, in addition to the Government's existing plans to liberalise telecommunications, there was scope for further substantial measures to increase competition without privatising BT.

2. In E(TP)(82)5 the Secretary of State for Industry argues that the Government's policies on liberalisation are correct, although he identifies a number of detailed legislative changes which would make it easier for the Government in due course to insist on liberalisation against opposition from BT, should this become necessary.

3. You will be aware from your meeting on Friday 25 June that if Ministers were to press further and faster on liberalisation than the Secretary of State for Industry envisages, for example in relation to additional alternative networks, there would be some important security implications.

MAIN ISSUES

4. You will want the Sub-Committee to consider whether it agrees with the Secretary of State for Industry's judgement that present policies are broadly satisfactory subject to the various detailed legislative changes which he proposes.

5. In three areas, the paper describes existing policies and what is being done to implement them (ie alternative networks, network services, and apparatus). It

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then goes on to identify four areas where more might be done (interconnect, resale, international, and the prime instrument and PABX maintenance) and explains the constraints affecting further progress. Each of these items is discussed below in turn.

Alternative networks

6. Present policy is to make Mercury an effective competitor to BT. To go further and permit other competing networks might make the return on the heavy investment involved in setting up a new network unattractive and, perversely, safeguard BT's monopoly.

Network services

7. The Secretary of State for Industry licenses operators. But BT have a statutory right to be consulted about licence applications; potential competitors may be put off by the fear that BT will learn their commercial secrets. The Secretary of State for Industry plans to introduce a general licence which would avoid BT's being involved in individual applications. This is an important and valuable step in exposing BT to more competition in the business sector of the market. You may therefore wish to ask the Secretary of State for Industry when the general licence will be in force.

Apparatus

8. New arrangements for approving apparatus, based on a new British Approvals Board for Telecommunications, will start to come into effect in July. The Department of Industry are trying to liberalise before then the supply of some pieces of equipment which BT have already approved and used.

9. It is not clear from the Secretary of State's memorandum how long it will take for the new approvals machinery completely to replace the present arrangements under which BT approves equipment and is able to inhibit competition by preventing manufacturers from supplying it other than to the Corporation. If there is to be a fairly long transitional period then it would seem to be important to keep up the pressure on BT to "release" items of equipment it has

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approved: the Secretary of State records that Mr Baker has written to Sir George Jefferson to this end.

Interconnect

10. The Secretary of State for Industry wants to have interconnection between BT and Mercury. This would mean that Mercury customers would be able to dial over Mercury circuits and link up with any BT subscribers, and that BT subscribers would be able to do the reverse. This is most important for the commercial future of Mercury. The policy at present is to leave this to negotiation between BT and Mercury; in the last resort the Secretary of State has no powers to direct BT to provide interconnect with Mercury. It is clearly desirable that, whether or not BT is privatised, BT's freedom to deny interconnection to Mercury on reasonable grounds should be removed. The CPRS paper, E(TP(82)9, strongly supports this.

Resale

11. Permitting the resale of capacity on lines leased from BT would ultimately be a very radical means of providing more competition. In effect spare capacity on the tie-lines of major companies could be used to provide the customer with several alternative telephone services. The Secretary of State for Industry is however disposed to move gradually. Rapid liberalisation of resale could undermine the viability of Mercury before it has become established. It might also force down BT's tariffs for business customers so far that the impact on tariffs for domestic customers would be undesirable; this latter effect cannot be assessed properly until BT has better management accounts. The Secretary of State for Industry therefore intends to take powers to require BT to permit resale but not to force resale until Mercury has become established and there is a better basis for assessing the impact on domestic customers. It seems unlikely therefore that significant resale would occur until the late 1980s.

International

12. Mercury has at present been allowed an international outlet on a restricted basis - the provision of international tie-lines but not international switched services. The Secretary of State hopes to permit Mercury to provide



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an international switched service in due course and he is also exploring whether the operators of network services referred to in para 7 above might be able to use BT's international circuits. At present however he merely proposes a study with options for consideration by Ministers at the end of this year.

Prime instrument and PABX maintenance

13. The main area in which there would be scope for further liberalisation of apparatus is the prime instrument (ie the first telephone attached to each direct exchange line; for most domestic customers this is the only apparatus they have) and PABX maintenance. There are at present no plans to remove BT's monopoly of supply of the prime instrument, or of PABX maintenance. The arguments against liberalisation are the maintenance of good customer service, protection of domestic supplies, and national security. The CPRS paper E(TP)(82)9 argues for keeping liberalisation of the prime instrument under review.

General assessment

14. The policy set out in E(TP)(82)5 was thoroughly examined by the Official Committee on Telecommunications Policy. In general the Committee endorsed the view that the first priority is to put Mercury on a viable basis as an alternative network. Speedy action should also be taken to bring into force a general licence for network services and to get the new system for approving apparatus into smooth and effective operation. On the four areas where more could be done the Committee:

- i. was keen that BT should not be allowed to drag its feet over providing interconnect facilities to Mercury; unless progress is achieved quickly the intention to legislate should be made known;
- ii. accepted the arguments about a gradual approach to resale but there was a feeling among some members that the pace might be somewhat more adventurous than the Secretary of State seemed to have in mind; this will need to be kept under review;
- iii. accepted that the issues about international services needed to be examined but hoped that the study available at the end of this year would provide a way forward; this again will need to be watched to ensure adequate progress towards liberalisation;



SECRET

iv. was sceptical that liberalisation of the prime instrument and PABX maintenance would in fact be detrimental to consumers and UK suppliers of apparatus but accepted that there might be other reasons (ie national security grounds) for going no further at present.

In general therefore the feeling was that the policy was broadly right; the main need was to keep up the pressure in implementing it, so that maximum feasible liberalisation was achieved within the constraints (including national security constraints).

HANDLING

15. You will wish to invite the Secretary of State for Industry to introduce his memorandum and then seek comments related to the main policy points listed in para 17(a) to (c) of E(TP)(82)5. Mr Sparrow may wish to comment.

CONCLUSIONS

16. You will want to reach conclusions on the following main questions:

a. Does the Sub-Committee agree that the Government's present policy on liberalisation, as described in E(TP)(82)5, is correct; or are there any modifications which should be made or which the Secretary of State for Industry should be invited to consider further?

b. Does the Sub-Committee agree that there should be legislation in the next Session of Parliament to remove the particular barriers to liberalisation mentioned in E(TP)(82)5?

Pg

P L GREGSON

28 June 1982



DEPARTMENT OF INDUSTRY
 ASHDOWN HOUSE
 123 VICTORIA STREET
 LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
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Secretary of State for Industry

The Rt Hon Sir Geoffrey Howe QC MP
 Chancellor of the Exchequer
 HM Treasury
 Treasury Chambers
 Parliament Street
 London SW1P 3AG

28 June 1982

Prime Minister (2)

BT is now proposing
a rebate scheme for low
users (see X overlay).

I suggest you await Treasury and

CCRS reactions to these proposals.

MS 28/6

MS
 Dear Geoffrey,

BT'S FINANCIAL TARGET AND PRICES

You will recall that I wrote to Sir George Jefferson on 10 June setting out my views on BT's target, prices and EFL. I have now met Sir George and in the light of that meeting I am now seeking colleagues' agreement to making an early announcement setting BT a financial target of 5½% real return on assets on their new accounting base for the two years 1982-83 and 1983-84.

2 Setting the target raises two issues - the duration of the target and its level. BT have suggested the target be set for two years only, since the prospects for 1984-85 are so uncertain. I see some attraction in a three year target - covering rather more of the likely interim period before 50% of the shares would be sold; giving potential investors rather more of a longer-term view of the Corporation while at the same time reassuring consumers that we do not wish to allow BT to make excessive profits in order to encourage private capital. I have to say, however, that while BT are prepared to work within the parameters of the external financing projections in the White Paper for 1983-84 and 1984-85 they are perhaps necessarily rather guarded about the latter year and might conceivably hold that a 5½% target for that year required more external financing. So I would be inclined to accept the BT view, recognising that we shall need to announce a target for 1984-85 sometime in the course of the next year.

3 Second, I think 5½% on the new accounting base is the right level whether the target is to be for a two or three year period. It is probably closer than 6% would be to the kind of return which would be indicated by the 5% real rate of return criterion; it is what BT have been working on; but most important it minimises the case BT might have for price increases in November 1983 of a higher level than those proposed for this year.



4 Turning now to prices, I accept BT's arguments both that it is preferable to keep to a regular pattern of annual adjustments in November, and that a zero increase this year would have unacceptable consequences next year. Sir George has suggested a package which will result in a 3.3% increase in average bills in November with a 5.4% increase in domestic bills and a 1.6% increase in business bills. He has abandoned plans to increase the minimum public call box charge to 10p. Finally, he proposes to introduce a rebate scheme for low users, which will result in about two million low users receiving rebates. I welcome this and believe it is a sensible and practical step towards meeting the pressure from pensioners in particular for some relief. Details of the proposed package are annexed: I hope you can agree.

5 It is clear there will need to be further discussions with BT on this year's EFL. However, Sir George made it clear that he saw no need for additional finance this year, and that in particular there was no need for a bond issue this Autumn. While I am disappointed that BT will not have an early chance to test the market, I accept this. BT accept that any increase in their EFLs for 1983-84 and 1984-85 is extremely unlikely, and will be looking for ways - including among other things the Bond - to fill what they see as a financing gap.

6 British Telecom are anxious to put their proposed tariff package to POUNC in the next two weeks (when it will effectively become public) against the background of a financial target set by Government. I would be grateful therefore for comments on these proposals by 2 July.

7 I am copying this letter to the Prime Minister and Sir Robert Armstrong.

Yours ever
R
Patel

BT'S PROPOSED TARIFF PACKAGE FOR NOVEMBER 1982

1 BT propose a package which will add 3.3% to average bills, with a 5.4% increase in average domestic bills and 1.6% increase in average business bills. Some of the main components of this are given below.

2 The basic domestic rental, currently £54 per year, will be raised to £60 (an 11% increase). The basic charge per unit will be raised from 4.3p to 4.5p (a 4.6% increase). For local calls the unit will retain its present duration, but for trunk calls it will be lengthened so as roughly to compensate for this increase.

3 Under the rebate scheme, small users will automatically receive a rebate amounting to 3p per unit for every unit less than 100 units per quarter used. Thus, at the extreme case someone who does not make any outgoing calls will receive an annual rebate of £12, reducing the £60 annual standing charge to £48. Thereafter the first 100 units per quarter will effectively cost 7.5p.

4 The increase in charges for individuals with a single telephone and different numbers of units used is set out below.

Number of units used per quarter	Percentage increase
nil	-11%
50	0.6%
100	9.5%
200	8.8%
1,000	6.1%

5 There is no increase proposed in call box charges.



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P.0791

PRIME MINISTER

Privatisation of British Telecommunications

(E(TP)(82)6, 7, 8 and 9)

BACKGROUND

At its previous meeting on 22 April the Sub-Committee agreed to reconsider the Secretary of State for Industry's proposal that control of British Telecommunications (BT) should be transferred to the private sector in the light of further work on:

- i. the scope for liberalisation of telecommunications without privatising BT;
 - ii. how telecommunications should be regulated if BT were privatised;
 - iii. what transitional arrangements would be necessary to define the relationship between the Government and BT if it was not possible to sell a majority shareholding in one go, so that there would be a transitional period in which less than half of BT's shares were owned by the private sector.
2. E(TP)(82)6 and 7, both reports by the Official Committee on Telecommunications Policy (TP(0)) respectively discuss regulation and interim arrangements. The Sub-Committee will ready have discussed liberalisation as the first subject on the agenda. The views of the CPRS on these issues are set out in E(TP)(82)9.
3. In E(TP)(82)8 the Secretary of State for Industry restates his case for privatising BT. He proposes that the Government should introduce legislation in the next Session of Parliament to make this possible, with a first sale of shares as soon as possible after the next General Election; that he should make an early statement to Parliament outlining the Government's intentions for BT; and should begin appropriate consultations as soon as possible thereafter.



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MAIN ISSUES

4. The main issues are:

i. whether BT should be privatised, notwithstanding the fact that new regulatory arrangements for telecommunications will need to be introduced, and that provision will have to be made for an interim regime for the Government's relations with the new company during the period when less than half the shares might be owned by the private sector;

If so

ii. what should be the nature of the regulatory arrangements;

iii. what should be the method and timing of the sale of shares, and the interim regime;

iv. what should be the timing of the legislation, and the steps leading up to that.

5. If the Sub-Committee concludes that BT should not be privatised, or at least that there should not be legislation to this end in the next Session of Parliament, there may still be a case for a Telecommunications Bill in 1982-83 to make the detailed legislative changes to facilitate liberalisation to which the Secretary of State refers in E(TP(82)5 and to reform the Telegraph Acts; and perhaps to change the arrangements for regulating telecommunications. But you will not want at this meeting to get into the question of what if any telecommunications legislation should be introduced in this Parliament if the decision goes against privatisation; that can be pursued later.

Should BT be privatised?

6. The Secretary of State for Industry gives three arguments for privatising BT:

a. Transfer to the private sector would in itself increase BT's efficiency and the quality of its decisions.



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b. The amount of investment in telecommunications would be determined by the market and not constrained by the PSBR and by the Government's policies on public expenditure.

c. A private sector successor to BT might be able to reduce telecommunications charges in real terms by financing less of its investment from retained earnings than BT is now obliged to.

7. Against this it might be argued as follows:

a. Privatisation of BT can only bring limited benefits in incentives to efficiency and changed attitudes since telecommunications will remain a regulated market.

b. It will be several years before a majority of the shares can be sold and BT's external borrowing can be freed from Government control.

e. The management effort involved, and the union opposition which may be provoked, may make further progress towards liberalisation more difficult, although this may in any event be constrained for other reasons.

8. The Sub-Committee will wish to weigh these conflicting considerations and also the Government's general predisposition in favour of privatisation. There is no doubt that privatisation of BT will be a much more extensive and complex undertaking than any privatisation which the Government has yet attempted. The legislation will be substantial and will raise some difficult issues about the best way to regulate a very large private sector monopoly. The benefits may be thought somewhat speculative and attainable only over a very long period. Nevertheless the considerable detailed work which has been done since the proposal was first put forward by the Secretary of State for Industry in March suggests that there are no insuperable problems in going ahead, if Ministers think it advantageous to do so.

Regulation

9. The report by the Official Committee (E(TP)(82)6) argues that special regulatory arrangements will be necessary to prevent BT abusing its dominant market

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position to hinder competition, charge excessive prices to its customers (either to generate monopoly profits or to permit inefficiency) or to put unreasonable pressure on its suppliers. In paragraph 5 of E(TP)(82)8 the Secretary of State for Industry accepts that there should be such arrangements. In E(TP)(82)9 the CPRS urges that a regulatory body should be established as soon as possible. It is unlikely that any member of the Sub-Committee will dissent; it would seem difficult to justify letting loose a monopoly like BT without adequate powers to prevent it from overcharging consumers or keeping out competitors.

10. The following paragraphs discuss the detailed questions on regulation on which an early decision is necessary and which are listed in paragraph 27 of E(TP)(82)6.

11. There is likely to be general agreement that:

a. as a Companies Act company, BT should cease to enjoy its present statutory privileges and powers to license and approve equipment and should need a licence, like other operators:

b. that licences should contain conditions designed to reduce the chances of anti-competitive behaviour (paragraph 12 of E(TP)(82)6 gives examples of the sort of conditions which might be attached); this would be underpinned by reference to the MMC of prima facie anti-competitive behaviour of types not specified in the relevant licence.

12. The report by TP(0) suggests that licences should specify a maximum real rate of return to prevent excessive charges to BTL's customers. The Secretary of State for Industry agrees. He envisages that the rate of return would be set by the Government according to criteria contained in BT's licence. The maximum rate would be reviewed from time to time, perhaps by the MMC, to take account of technological developments, BTL's efficiency and changes in rates of return generally.

13. In his minute of 23 June to Mr Scholar, Professor Walters argues that:

a. setting a maximum rate of return will lead to over investment;

b. it is equivalent to proposing a tax with a 100 per cent marginal rate which would remove incentives to efficiency.

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He advocates instead a graduated tax on BTL's profits designed to enable the company to retain a significant proportion of its efficiency gains. In this latter respect, Professor Walters' proposal has something in common with the proposal tentatively aired in the officials' paper and supported by the CPRS for a two-tier maximum rate of return, allowing BTL to keep some of the benefits between the lower maximum and the upper maximum. The problem of encouraging over-investment was recognised in the officials' paper as something which would have to be tackled through powers to investigate efficiency.

14. This is a difficult issue on which Ministers need not take a detailed decision at present. It would be sufficient for Ministers to agree on the principle of restricting BTL's profits, while trying to find the best ways of retaining incentives to efficiency. Further work could then be done by officials, taking account of Professor Walters' ideas and other variants.

15. So far as the responsibility for the new regulatory arrangements is concerned, there is likely to be general agreement that the Secretary of State for Industry should be responsible for licensing (subject to powers to delegate) but that monitoring performance against licence conditions would be better entrusted to a body not under direct Ministerial control.

16. On the choice of regulatory body there are two questions to consider.

a. Should existing bodies (in practice the Office of Fair Trading and MMC) be used or should a new organisation be set up?

b. If a new authority is chosen should it be a non-departmental body (a body corporate, headed by a board, staffed by non-civil servants - like the Civil Aviation Authority) or a non-Ministerial Department (headed by an officer appointed by the Secretary of State for Industry, staffed by civil servants - like the OFT)?

17. The Secretary of State for Industry endorses the Official Committee's that it would be better to set up a new agency to regulate telecommunications given the technical difficulty of the work and the possibility that it would unbalance the OFT and MMC's other functions; although he suggests that in time it might be



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possible to unite the new body with the OFT.

18. The Secretary of State parts company with the majority view in the TP(0) report in preferring the new body to take the form of a non-Ministerial Department rather than a non-departmental body. He argues that:

a. Licence conditions could be drawn tightly; the regulatory body's discretion would therefore be limited and an independent board would not be necessary.

b. Control should not be surrendered entirely in this area to a totally independent body.

The CPRS, on the other hand, favours a non-departmental body on the grounds that the agency should be distanced from Government and will need to be staffed by experts.

19. This is a finely balanced issue. It may well be the kind of point on which the Government would be prepared to fall in with the preferences of outside opinion when these become known. If however Ministers opt in favour of a non-Ministerial department, they should bear in mind that its staff (which could well number 50 or more) would count as an addition to the civil service.

Method and timing of a possible sale of shares; and interim regime

20. These issues are linked. Special interim arrangements between the Government and a partly privatised BT, only a minority of whose shares had been sold to the private sector, would only be necessary if it were impossible to sell a majority shareholding in BT in one go. The feasibility of any interim arrangements (and indeed the prospects for a successful sale) also depend on the timing of the sale: in particular it would seem very difficult to arrange the successful sale of a first tranche of say 25 per cent of BT's equity during the present Parliament: it seems likely that if a successful sale were to take place before the next General Election, it would have to involve a controlling interest in BT.

21. Paragraph 16 of E(TP(82)7, which lists the questions requiring early decision in this area, therefore begins by asking:

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- i. whether Ministers wish to keep open the option of privatising BT by a single issue of shares;
- ii. whether Ministers wish to keep open the option of such a sale in the autumn of 1983;
- iii. whether legislation to privatise BT should in any case provide for the possibility of a sale in more than one tranche and for an appropriate interim regime;
- iv. whether if the sale is to be in more than one tranche a first flotation before the next General Election should be ruled out because it would have to take place in conditions of political uncertainty?

22. The Secretary of State for Industry's answers are:

- i. the possibility of a single sale of a majority shareholding in BT should be further explored; but
- ii. it would be both technically difficult and politically risky to try to force through a single sale before the next General Election;
- iii. the most likely outcome is that a sale will have to take place in two stages and legislation will therefore need to provide for an appropriate interim regime;
- iv. a first tranche of shares could not be sold before the General Election.

23. The CPRS agrees on the timing and also on the desirability of exploring further the scope for a single sale. It may possibly be suggested that the size of BT is such that there is no chance of a single sale of half its shares except by devices whose effects would be to depress the proceeds of sale. On the other hand the Secretary of State for Industry might wish to argue that some of the approaches suggested by merchant banks and which TP(0) considered could be more feasible in a single post Election sale than in the peculiar circumstances of a single sale before the Election.



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24. The major difficulty in devising satisfactory arrangements for the interim period when the Government would be the majority but not the only shareholder in BT is of reconciling:

- a. the need to maintain a proper control over BT's finances so long as it remains in Government control and in the public sector; and
- b. the need to allow BT sufficient commercial freedom even in this interim period to make it an attractive proposition to purchasers and allow the Government to get a good price for its shares.

The CPRS questions the need for the requirement at a. but the Treasury is likely to argue strongly in favour of it.

25. Drawing on merchant bank advice, the TP(0) report on this subject (E(TP)(82)7) suggests that the interim regime might have the following features:

- a. assurances that, subject to the need to ensure that BTL's external financing adequately takes account of the Government's policies for public expenditure and public sector borrowing, the Government will not use its powers as major shareholder and creditor to prevent BTL from acting commercially;
- b. reliance on the new regulatory arrangements discussed in E(TP)(82)6 to deal with competition, efficiency, return on assets and pricing matters;
- c. the setting of external financing figures for each year of the public expenditure planning period, which would be set out for the information of investors in the prospectus for the initial sale of shares;
- d. retention of the Government's existing powers in the British Telecommunications Act 1981 to control BTL's borrowing, suitably modified, until the Government had disposed of 50 per cent of BTL's shares;
- e. arrangements between the Government and BTL providing for BTL to supply information about its future investment plans and internal resources as a basis for the Government's exercise of its powers over borrowing; and for

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the Government to call for such other information about BTL's financial plans and progress as it thinks fit.

The Official Committee left open the questions whether the Government should in addition retain its statutory powers to call for information from BT; and (though this need not be decided now) whether the Government should retain the freedom on public expenditure grounds to restrict BT's external finance to a greater degree than envisaged in the external financing figures that would be included in the prospectus.

26. In E(TP(82)8 the Secretary of State for Industry says that he sees no objection to retaining powers to control BT's borrowing in the interim period (d. above); appears to be content with a., b., c. and e. above (although it would be desirable to establish his views on c. in particular); and agrees that it is not necessary to decide now the extent to which the Government will be able to cut back projected borrowing in the interests of restraining public expenditure: that will be for discussion, in the first instance between Department of Industry and Treasury Ministers, nearer the time when shares are sold. Other Ministers present are likely to be content on these points.

27. The Secretary of State for Industry does not say whether in his view the Government should in addition keep its statutory powers to call for information from BT, though this is a point that would have to be covered in legislation. The Chief Secretary, Treasury is likely to be the main advocate of this idea: unless agreement on it can be reached quickly, he and the Secretary of State for Industry might be invited to try and sort the point out outside the Sub-Committee.

Timing and procedure

28. The Secretary of State for Industry proposes a Telecommunications Bill in the next Session of Parliament to permit the conversion of BT into a Companies Act company and the sale of its shares. Even if Ministers were to decide to postpone the flotation until after the Election, there would still be merit in getting the legislation through beforehand. It is clear that such legislation will be contentious and complex. Whether it could be got through Parliament in the next Session would seem to depend in part on how soon legislation could be introduced. You will therefore probably want to explore how soon, realistically, it will be

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possible for the Department of Industry to prepare instructions to Counsel and for Parliamentary Counsel to draft the Bill. There would have to be consultation with BT, the unions and other interested parties about the detailed provisions of the legislation. There must be some doubt about the chances of having a Bill ready for introduction at the beginning of the next Session. If major issues were left unresolved at this meeting, the chances of having the legislation ready in time would be negligible.

29. If the Sub-Committee decides that legislation should be introduced in the 1982-83 Session, it would seem appropriate for the Secretary of State for Industry to make an early statement to Parliament outlining the Government's plans and to begin formal consultations as soon as possible thereafter, as he suggests. If it is thought that legislation would not be appropriate in the next Session it seems largely a matter of political judgement whether Ministers should announce soon that the Government wishes to transfer BT to the private sector or, for example, include such a proposal in the Conservative Party manifesto for the next General Election.

HANDLING

30. When the Secretary of State for Industry has introduced E(TP(82)8 it would be best to work through the main issues in the order in which they are discussed above, ie:

- i. Should BT be privatised?
- ii. If so, what regulatory arrangements should there be?
- iii. How and when might a majority shareholding be sold and what arrangements would there be during an interim period in which the Government remained the majority shareholder in BT?
- iv. Should legislation be included in the 1982-83 Session?

31. Any of those present may wish to comment on the questions at issue and especially their political aspects. In particular the Secretary of State for Trade will want to comment on regulation, The Chief Secretary, Treasury on the sale of



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shares and interim arrangements; and the Lord President on the Parliamentary aspects. You will probably want to invite comments from Mr Sparrow.

CONCLUSIONS

32. You will want to reach conclusions on the following issues:

a. should it be the Government's policy to privatise BT?

b. if so, should the necessary legislation be introduced in the 1982-83 Session of Parliament; or should any legislation be put off until the next Parliament?

c. should the Secretary of State for Industry make an early statement to Parliament of the Government's intentions for BT's future; and begin formal consultations as soon as possible thereafter with the Board of BT, the unions and other interested parties about the detailed provisions to be included in legislation?

d. on regulation, what are the Sub-Committee's views on the issues set out in para 27 i. to vi. of E(TP(82)6?

e. on the sale of shares and the interim regime, what are the sub-Committee's views on the issues set out in para 16 i. to vi. of E(TP(82)7)?

PLG

P L GREGSON

28 June 1982

CONFIDENTIAL

Qa 05968

To: ALAN WALTERS

From: JOHN SPARROW

28 June 1982

Regulations in Telecommunications

1. You kindly gave me a copy of your minute to Michael Scholar on the subject of telecoms. I read it over the weekend and thought you might like some comments.
2. I agree with you about the difficulties, particularly of definition, associated with the use of a rate of return concept and I also agree that there are dangers in setting a maximum rate of return. However, I think we must assume that the proposed regulatory authority will be skilled at its job and if it is, I would hope that it would be able to cope with the difficulties and dangers, by setting limits which pragmatically reflect its view of Telecom's policies with regard to cost control, increasing output, and capital expenditure. If it can form a clear view about the propriety of the objectives which Telecom is setting itself and about its success or failure in pursuing those objectives, then a well run regulatory body ought to be able to cope with the problems. At any rate, I hope that this is the case because I cannot see a better alternative. You suggest a differential tax scheme, but I am always worried about one-off tax schemes and, as we have seen at Mossmorran, these things tend not to be one-off. I have also thought a bit about the right to switch into gilts at a future date: whilst I can see the attractions of this, particularly as a hedge against expropriation, it does remove from the shares of Telecom the element of risk of complete loss which I think is an essential part of an equity share. I would quite like to keep the idea if it could be limited to the circumstances of expropriation, but I am not sure that that is constitutionally possible.

P.

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Mr Walters

PS. By mistake the PM saw this! and wrote

I think this is

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cc Mr. Gregson
Mr. Mount
Mr. Vereker

a bit technical for the PM? May I suggest you

MR. SCHOLAR

make it into a letter to Patrick Jenkin?

MCS 24/6

Will need a
technical
note

REGULATIONS IN TELECOMMUNICATIONS: NOTE BY THE CHAIRMAN
OF THE OFFICIAL COMMITTEE ON TELECOMMUNICATIONS POLICY

But I think
to
my
suggestion

1. The Committee suggests (a) there should be a new body to regulate entry and market behaviour, and BT should lose this power, and (b) that the main method of regulation would be through specifying a maximum rate of return for the undertaking as a whole.
2. As the Committee point out, the maximum rate of return method has been used extensively in the United States. Research has shown that it resulted in considerable waste of investment, as the utility companies increased the denominator of the rate of return to earn margins considerably above other comparable assets. Over-capitalisation, typical in public sector and publicly controlled industries, was the widespread consequence.
3. The imposition of a maximum rate of return has many of the characteristics of the tax rate which is fairly low until the maximum rate is achieved, then it becomes a hundred per cent. We all know the consequences of that sort of tax system on cost control and enterprise.
4. It is not clear from the Committee's report whether they are referring to a real rate of return or a nominal rate of return as the method of regulation. It seems that, implicitly, they are talking about a nominal rate of return (see the discussion in para 17 on the analogue of "a fixed interest stock"). But this at least ought to be made clear. Obviously for legal and practical purposes a nominal rate of return is the easiest to regulate. But in an environment where inflation is high and uncertain, the nominal return is clearly misleading. On the other hand, a specified real rate of return would involve complex and controversial issues about accounting practices. If they are pursuing a real rate of return, have the Committee faced these issues, particularly plant revaluation etc?

MCS 25

/5. But ignoring

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5. But ignoring the real versus nominal issue for a moment, it seems to me that there is a good case for imposing a tax regime on excessive profits which does not have all the disadvantages associated with the suggested 100% marginal rate. The objective ~~of policy~~ should be to encourage the entity to keep prices down, expand output and reduce costs. We could do this by having a graduated profits tax which has rates, all less than 100%, which vary according to the extent to which the entity has expanded output. The greater the expansion of output over the year the lower the profits tax. To illustrate this, supposing we agree that the average expansion of output in the next five year period is, let us say, 5%. Then that will be the standard for our profits tax of, say, 50% of profits. If, however, the entity achieves, let us say, a 7% growth rate, then the profits tax will fall to, say, 40%. If, on the other hand, a growth rate is achieved of only 3%, then the profits tax rises to 60%.
6. In order to work this sort of rule, all we need are the standard accounts together with the total sales revenue and a price index of the services. While I agree that these are all standard accounting and statistical measures, there may be some difficulties of interpretation. But no more, and I think considerably less, than in the case of the maximum rate of return.
7. The Committee considered also having a minimum rate of return. The idea of this is clearly to offset possibly onerous regulation imposed by some future government. Although the Committee came down against minimum rates of return, I can well see the point of allowing owners of the equity of British Telecom (and perhaps other companies) to have the option of converting after 1985 every £100 nominal equity into, say, 8%-10% Treasury's 2011 at par. This would provide a floor to their losses and would guard against at least total expropriation by an incoming Socialist Government.
8. Some of these ideas may have been aired to the Committee, but I thought that I would put them down in case they were not.

23 June 1982

Alan Walters
ALAN WALTERS



10 DOWNING STREET

Prime Minister

You were very disappointed by
Patrick Jenkin's BT liberalisation
paper, and wanted to consult some
friends in the industry before next
Thursday's E(TP).

When you see this interuption
paper I think you will see why
Patrick Jenkin's paper is as it is.
It is essentially a compromise between
what he would like to do and what
these considerations point to him doing.

Do you still wish to see friends
TOVER

in the industry & before the
E(TP) meeting?

Please also see the attached
note by John Verker which - without
taking account of ~~the~~ interception
points - suggests that the Do I
paper goes quite a long way in
the right direction.

MCS 16/6

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~~MR. SCHOLAR~~

Prime Minister
→

Liberalisation of Telecommunications

We had a word about the Prime Minister's reaction to the Department of Industry's paper for E(TP) on the scope for further liberalisation of telecommunications, and I have discussed it further with Peter Gregson. Since the Policy Unit was in the van of those urging further liberalisation at the first meeting of E(TP), it may be helpful if I offer now some brief comments on this paper.

The issues were thoroughly worked over in the official group under Peter Gregson's chairmanship, and the CPRS was given - and took - every opportunity to press for specific further liberalisation measures. The outcome is a paper which to my mind does not do justice in its presentation to its actual content. Peter Gregson chose to let DoI write it, and it therefore seems needlessly defensive. But the same material could have been presented as a paper by the official group, which I think would have concluded that the DoI had now agreed to take what further measures were available and had identified where going further still would have involved reversing previous decisions or taking additional legislative powers. I am satisfied that the area of possible controversy is now narrowed to issues of the pace of liberalisation, or very marginal measures.

The Prime Minister will recall that at the first meeting of E(TP) three main areas of potential liberalisation were identified:

(i) Alternative networks.

Officials are agreed that the day may well come for the licensing of rivals to Mercury; but the first objective must be to get Mercury off the ground, and it will be several years

/before

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before we can safely license a further full network. To do so now would probably run counter to liberalisation, because the rival newcomers would destroy each other, leaving BT with a complete monopoly.

(ii) Apparatus.

I believe you have separate advice for the Prime Minister explaining the national security reasons for proceeding cautiously over the liberalisation of the prime instrument market, which is the main piece of apparatus left. DoI would also argue that BT's monopoly of the prime instrument is a major element in its profits, and will therefore make privatisation more attractive: it is an open question whether, security considerations apart, that would outweigh the need for competition.

(iii) Network services.

The Prime Minister should know that the present liberalisation policy for network services will provide quite extensive competition over a wide range of services. Together with resale and inter-connect, which are under negotiation, they will provide some degree of competition in telecoms as a whole.

I do not wish to exaggerate the significance of all these measures. However fast we go, BT is always likely to retain some 95 per cent of the market up to the mid-1980s, just as in the United States AT & T and GTE still dominate 95 per cent of the market after 13 years of liberalisation. But I believe that DoI have taken the message of the first meeting of E(TP) to heart. Their Ministers wrote immediately to BT asking them to behave less restrictively over the supply of attachments by rivals; and the Department has arranged a full scale seminar to discuss all aspects of liberalisation - the Prime Minister may care to see the programme, attached.

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I think the CPRS would take a similar view, while continuing to press for improvements at the margin. They made four specific proposals in the official discussions; two - a statement of intent to liberalise prime instruments, and licensing further operators - ^{are} covered above; one - concerning regulation of common carrier frequency - turned out not to be an issue because the Government do it already; and the remaining one - denying BT access to commercially confidential information - will be covered by the proposed new licensing arrangements.

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v.

J. M. M. VEREKER

15 June, 1982

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Telecommunications industry seminar, July 13 1982 : proposed programme

Telecommunications in transition :
from the Act to the Actuality.

9.00 a.m. for a 9.30 a.m. start.

Early morning session : legislative progress one year on.

- | | | |
|------------|--|--|
| 9.30 a.m. | Chairman's opening address : Government's concern to push ahead with implementation of the BT Act. | John Butcher MP. Parliamentary Under-Secretary of State for Industry. |
| 9.40 a.m. | Ministerial address : the BT Act : a turning point. | The Rt. Hon. Patrick Jenkin MP. Parliamentary Secretary of State for Industry. |
| 9.50 a.m. | British Telecom's point of view. | Sir George Jefferson, Chairman, British Telecom |
| 10.00 a.m. | Questions/discussion. | |
| 10.10 a.m. | The unions' viewpoint. | B. C. Stanley, Esq. General Secretary Post Office Engineering Union |
| 10.20 a.m. | The private sector's viewpoint. | S. C. Finch, Esq. Senior Regulatory Affairs Advisor, British Petroleum |
| 10.30 a.m. | Questions/discussion. | |
| <hr/> | | |
| 10.40 a.m. | Coffee | |

Mid-morning session : the supply industry's progress.

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|------------|--|---|
| 11.00 a.m. | Extension telephones : taking advantage of the pre-liberalisation initiative. To be confirmed. | |
| 11.10 a.m. | Extension telephones : the approvals procedure is hindering market development. | M. E. Percival, Esq. Managing Director, Conversation Pieces Ltd. Chairman, ITSA |
| 11.20 a.m. | Questions/discussion. | |

- 11.30 a.m. Key systems : gearing up for massive market growth. C. C. W. Box-Grainger, Esq.
Marketing Director
Telephone Rentals Ltd.
- 11.40 a.m. Key systems : a legislative minefield favouring entrenched positions. J. R. Harrold, Esq. Chairman,
Shipton Communications Ltd.
- 11.50 a.m. Questions/discussion.
- 12.00 noon Data transmission : liberalisation is in everyone's best interests. E. B. Stuttard, Esq. Technical
Director, Racal Milgo Ltd.
- 12.10 p.m. Data transmission : why can't the bureaucrats let us get on with it? To be confirmed.
- 12.20 p.m. Questions/discussion.
- 12.30 p.m. Telex : the opportunities. C. K. Rushton, Esq. Managing Director,
Transtel Communications Ltd.
- 12.40 p.m. Teletex : new equipment in a new environment. P. Breen, Esq. Chief Executive,
ITT Business Systems (UK) Ltd.
- 12.50 p.m. Questions/discussion.
-
- 13.00 p.m. Lunch
-
- Early afternoon session : progress on networks and VANS.
- 14.00 p.m. Chairman's address : Government's position on public network liberalisation. John Butcher MP. Parliamentary
Under-Secretary of State for Industry.
- 14.05 p.m. Project Mercury : providing a new dimension to consumer choice. J. L. W. Bird, Esq. Managing
Director, Cable & Wireless Ltd. plc.
- 14.15 p.m. Questions/discussion.

14.25 p.m.	VANS : British Telecom's own commercial response.	J. Morris, Esq. Managing Director, Telecom Gold
14.35 p.m.	VANS : VANS suppliers as customers of British Telecom.	J. G. Graham-Smith, Esq. Managing Director, Answering Ltd.
14.45 p.m.	VANS : an opportunity for a major new service industry.	R. C. Smythe, Esq., Manager, Communication Services B. L. Systems Ltd.
14.55 p.m.	Questions/discussion.	

15.05 p.m. Tea

Mid-afternoon session : guidelines for the future from overseas.

15.20 p.m.	The USA : the market leader on innovative apparatus.	To be confirmed.
15.30 p.m.	The USA : experience on the development of network services.	To be confirmed.
15.40 p.m.	The commercial opportunities of international cooperation.	K. Edwards, Esq. Director of Technology, Northern Telecom (UK) Ltd.
15.50 p.m.	Questions/discussion.	
16.00 p.m.	Japan : land of communications and computing.	NEC film.
16.10 p.m.	The European scene.	Sir William Barlow, Managing Director, Thorn E.M.I. Ltd.
16.20 p.m.	Questions/discussion.	

Final session : the critical need to get the market-place moving.

- | | | |
|------------|---|--|
| 16.30 p.m. | The UK Market : role of the City in a growth market. | A. Hugh-Smith, Esq. Senior Partner,
Capel-Cure Myers. |
| 16.40 p.m. | The UK Market : union support for British industry. | R. Sanderson, Esq. National Officer,
E.E.P.T.U. |
| 16.50 p.m. | A consultant's view of Liberalisation : "too little, too late,
too slow". | J. Anderson, Esq.
Microelectronics Design Associates. |
| 17.00 p.m. | Chairman's panel session : questions/discussion. | |
| 17.30 p.m. | Chairman's closing address : summary of the day's proceedings and
resultant Government considerations. | John Butcher MP. Parliamentary
Under-Secretary of State for Industry. |



JFF586

Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

10 June 1982

The Rt Hon Sir Geoffrey Howe
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Prime Minister

(4)

cc J.V.

MSW/6

[Handwritten scribble]

Dear Geoffrey,

BT'S FINANCIAL POSITION IN 1982-83

*see Post & Tel, April '80,
any negotians in the
Post Office.*

My reply to your letters of 20 and 21 April concentrated on the immediate issue of pay and I did not comment on the points you made about BT's financial target, pricing policy and borrowing.

2 I do very largely agree with what you say on these questions and Leon Brittan and I had the chance to go over some of the ground with the BT Board at a meeting on 20 May. I have however now made the main points in writing to Sir George Jefferson and I attach a copy of the letter I have sent. I think you will agree that my proposals correspond in essentials to those in your letter and I thought it right to get the letter off rightaway without checking the detail of it with you.

3 I am copying this letter to the Prime Minister and Sir Robert Armstrong.

Your ever

Patel



JFF854

Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

10 June 1982

Sir George Jefferson
Chairman
British Telecom
2-12 Gresham Street
LONDON
EC2V 7AG

Dear George,

BT FINANCIAL TARGET AND PRICES

Following our Corporate Plan Review meeting on 20 May and the provisional pay settlement you have reached with POEU and SPOE I think I should now turn to the question of setting BT a financial target for 1982-83.

I would like to suggest that BT be set the financial target for 1982-83 of achieving a real rate of return on assets of a minimum of 5.5%. I would propose to announce this later this month. The asset base for this purpose would be whatever new asset base we may fix; we shall need to conclude our discussions on this within this time-frame and Kenneth Baker will be in touch with you very shortly. We shall also need to check with Warburgs on any implication for the BT bond.

I would propose to announce at the same time a provisional financial target of the same amount, 5.5%, for the subsequent two years, but subject to urgent discussions at official level to confirm that this is on a sound basis. We would need to conclude these discussions before any announcement on the bond is made.

In the light of this I do not believe that given the pay settlement any overall tariff increase this year will be justified. Indeed it seems that even with no increase in average tariffs BT should, in view of their efforts to reduce operating costs, easily exceed the financial target. While pricing policy is of course a matter for the BT Board, and there may well be changes you wish to make (eg to introduce your interesting two tier tariff idea), I would hope that you might be prepared in a year when your average prices are being held to hold back from making further substantial moves towards re-balancing.



You will want to know whether, in the light of these decisions, I would wish to adjust your EFL of £320m. I do not, at least at this stage. You have pointed out to me that if the financial target is adjusted either the capital requirement or the EFL must be adjusted. I am however, as you will have seen, regarding the target as a lower limit and I would not wish you to be inhibited on that account from pursuing cost savings. Furthermore some contribution towards reducing the capital requirement should be possible without affecting fixed capital investment by, for example, aiming for no increase, or even a reduction, in working capital. (I understand that you estimate no more being due to creditors at the end of the year than at the beginning despite considerably increased spending). I would propose a review of the position in early September; I am likely at that stage to propose some reduction in the EFL and I should like you in the meantime to do all you can to ensure that the changes in the working capital item turn out to be more favourable to you than you have been projecting so far. That of course will also be the stage when final decisions on a bond issue fall to be made and we can examine together then what scope there may be for actually increasing investment in fixed capital assets.

In the meantime I have to let you know that, unless BT can show a clear need for them, no further NLF funds will be made available. I do recognise that you want to have reasonable flexibility on how your financing needs are met, but I have to take this step if a decision to reduce the EFL is to be deferred. My officials are already in touch with yours about the type of information we would find necessary to establish a case for a drawing.

I would be grateful for any comments you may have on these proposals.

You are
Ratne

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Prime Minister (4)

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

E(TP)(82)5

COPY NO 1

- 4 JUN 1982

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

SUB-COMMITTEE ON TELECOMMUNICATIONS POLICY

SCOPE FOR FURTHER LIBERALISATION OF TELECOMMUNICATIONS

Memorandum by the Secretary of State for Industry

This is very disappointing. I should like to consult some friends with the

1 At E(TP)(82)1st Meeting, I was invited to report on what further progress could be made to liberalise and achieve greater efficiency in telecommunications under existing institutional arrangements.

industry before this is discussing no

2 We set out our policy on telecommunications liberalisation in July 1980. Our aims were liberalisation of the supply of all apparatus except for the prime instrument (first telephone) and certain private automatic branch exchanges (PABXs) by July 1983, liberalisation of access to BT networks for network services and examination of the scope for alternative transmission systems.

Networks

3 I issued a licence to the Mercury partners - Cable and Wireless, BT and Barclays Merchant Bank - in February 1982 -

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only 7 months after the passage of the Act. The licence is unique in the world and provides the Consortium with an opportunity to run a second national telecommunications network to compete with BT for services both at home and abroad. The licensing of Mercury has had a dynamic effect on BT as it responds to the perceived competitive threat. BT's participation in the British satellite project, its deal with Satellite Business Systems in America, its significant reduction in international and some trunk tariffs and its digital overlay can all be ascribed to potential competition from Mercury for the lucrative business market.

4 Mercury plans a gradual build-up from a City of London base in 1983. It is not easy to establish a competitive network; there have been several failures in the United States. It will take Mercury at least until 1985 to reach even 1% of BT's overall turnover. In these circumstances, I am sure that our best policy for the foreseeable future is to concentrate effort on making Mercury effective rather than contemplating more competitive networks which would only fragment what is bound to be a limited market to such an extent that Mercury itself would cease to be viable.

Network Services

5 We announced our policy to introduce liberalisation of network services such as mailbox, store and forward, videotext etc, in two phases in July 1981. The first phase, under which operators were licensed only to run services which would not compete with BT, is over. Since 1 April all network services, excluding resale of capacity over circuits leased from BT (see Annex) and international services, are free to apply to the Department direct for a licence.

6 I am now preparing a general licence to provide operators who wish to provide communication/computer services over the BT

3rd June, 1982

IN STRICTEST CONFIDENCE

Dear Patrick,

I am writing to you following the receipt by my colleague W. D. Morton, Managing Director of GEC Telecommunications Ltd., of a letter from British Telecom about System X. It says that you have made Government support for the Telecommunications industry conditional upon "the industrial base" being "concentrated", and "management arrangements" changed. And the Minister of State has invited BT to place all its System X business with a single company. BT accordingly has it in mind to place a single initial contract for 70 per cent of its digital inland public exchange orders over the next three years and to put the rest to tender from overseas suppliers.

I daresay you have read the letter in question, but I enclose a copy in case you haven't seen it. Our Telecommunications Company will naturally respond with an offer as requested by BT, and GEC is, of course, by far the best equipped company in the UK to fill such a role. I might add that our commitment to telecommunications is such that GEC will guarantee to provide the Telecommunications company for all practical purposes with unlimited resources of finance, technological, managerial and marketing skills, and would support the activity with the GEC worldwide organisation, including our companies in the United States, to which further additions may be expected in the course of time.

/.....

The wish to purchase System X for the UK network on a cost effective basis and to see System X established in a strong position in world markets is entirely laudable. But notwithstanding the strength of our claim to undertake the whole UK industrial function, I have to tell you that the implications of the proposal to do this by depriving two of the three participating firms of access to the telephone switching business of BT are horrendous, and very far from guaranteed to achieve the desired objects.

I suppose one should not be surprised that the proposals imply the total rejection of all the System X arrangements and objectives mutually nurtured and established between BT and the industry over the last twelve years, or that they are based on subjective and highly questionable assumptions, since that is typical of bureaucratic attempts to get involved in industrial structuring. The form book indicates that the odds are very, very long against any DOI nap selection coming off. At any rate, long before its implementation can be complete, the proposed course could easily bring about the virtual collapse of the System X development programme. The present development needs the collaboration of all three parties for some time to bring an acceptable system into service. Upon two of them being told that they have no future in the field, would you expect them to press on urgently with their effort and to continue to invest capital, skill and managerial expertise at the required level in a business from which they are to be excluded? There is also the question of how, within a short time, it would be possible to concentrate the presently dispersed technological effort into a single unit. What degree of eagerness and collaboration would you expect from the two losers?

The BT letter talks of a "strong view in industry" that we cannot produce System X unless the scale of output is much larger than is available to any particular supplier, and that the existing collaborative arrangements are less than satisfactory. I don't know who holds that "strong view", but the fact is that very little to do with BT, either in its present or its previous Post Office incarnation, is satisfactory, and

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this has been the case for over thirty years. It was the Post Office which destroyed the British manufacturers' export markets and, in due course, their export potential. It was the Post Office which would not allow us to bring modern Crossbar switching into the network in 1963/64. It was the Post Office which in 1973 produced a surprise agreement with STC which resulted in the mistaken adoption of the TXE reed relay system. It was BT which insisted on the collaborative shared arrangements which we are now told are inconsistent with its own needs. It was BT which in 1966 would not support GEC's development work on computer control for telephone exchanges, and it was GEC which carried on with it, successfully, at its own risk until its subsequent adoption by the Post Office. It was BT which insisted on a specification for System X which they were warned by GEC (and possibly others) was unnecessarily wasteful and inefficient, as well as unsaleable abroad, so that what we are now talking about is not System X as conceived, but Mark II as modified at considerable expense. And it was GEC, at considerable cost, which eliminated, after it bought AEI, obsolete capacity then being maintained at the expense of the Post Office with a backward looking development programme. Incidentally, GEC was rewarded by seeing part of the traditionally AEI share of the business going to to its competitors.

I freely acknowledge that recently, very recently, things at BT have improved a great deal. But that august organisation cannot expect to be allowed to slough off its gargantuan shortcomings by visiting upon its suppliers the consequences of its innumerable sins of omission and commission over many years under governments of both major political parties.

The "case" for a single System X supplier is stated on three assumptions:

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- (1) that the prospective production base of any one existing supplier is inadequate to achieve cost-effectiveness;
- (ii) that the existing collaborative development arrangements are less than satisfactory; and
- (iii) that the existing export arrangements through BTS and the lead contractors are unlikely to meet with success in world markets.

As to (1) above, certainly, in theory, production costs are lower at higher volume, provided all other things are equal. But all other things rarely are equal. When advanced production and test equipment are used on a multi-shift basis, and factory and other overheads are correctly structured, the cost benefits of increased volume become, after a given point, relatively unimportant. Of course, the bought-in parts comprise a substantial proportion of total cost in capital electronics equipment, but here too benefits are available to a large company such as GEC using its total purchasing power to good purpose. In general, the difference in cost effectiveness between a well-run business and a not-so-well-run business is, beyond a certain level, likely to be greater than economies available merely from increment in volume.

The concept of a single UK supplier of System X to BT, and the abolition of UK competition, contrasts sharply with BT's current practice with regard to standardised designs of transmission equipment. BT's total purchases of transmission equipment are substantially less than of switching. Yet BT purchase 140 Mbt. line systems from two manufacturers, digital multiplex equipment from three manufacturers, TEPI(E) 30-channel PCM from potentially four manufacturers, and are planning the development of standardised fibre optic systems with three equipment manufacturers and three fibre/cable manufacturers. Are we going to see another hare-brained notion for "re-structuring" the design and manufacture of transmission systems like that suggested for System X? Is this what is meant in the reference to "transitional measures"?

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As to (ii), the successful joint BT/Plessey/GEC programme with Monarch, for which GEC has secured a three-year contract in New Zealand against worldwide competition, shows quite clearly that a product can be standardised and produced competitively by two UK suppliers working in collaboration.

We may also observe the four manufacturers in Japan who collaborated with one another and the NTT to develop a digital switching system for Japan, and have elected to develop - or are already developing - their own individual systems for export.

Having said all that, let me concede at once that the existing collaborative development arrangements are not wholly satisfactory. They reflect the problems of the past, the need to put to work and train a large number of engineers with hardware and software skills, the problems of defining standards, applications and sub-systems and managing on a multi-unit, multi-site basis. There is some bureaucracy, some duplication and genuinely held differences of view about technical aspects of the development programme. But for all the defects of these arrangements, they were evolved as the best way to handle the job in the circumstances obtaining, and it should be remembered that none of the firms had at the time sufficient development resources to do the whole thing alone. Nor in any circumstances would BT have allowed them to do so. The arrangements can certainly be improved, but to make any major change before the SEP development programmes for BT and export have been realised would have unforeseeable consequences. I have already referred to this, but nearly all the engineers presently engaged in this massive programme throughout the industry will be needed for the continuing development and cost reduction of System X. The potential destruction of this invaluable resource would be irretrievable.

So far as (iii) above is concerned, the arrangements have provided a vehicle for the promotion of System X as a UK system, and a mechanism to offer

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earlier deliveries than would have been obtainable if we had waited until full information transfer had taken place between the companies. These arrangements will undoubtedly need to be changed in due course, but there is no point in doing it in such a way as to undermine the considerable efforts made by the participating firms and BTS to lay the foundations for overseas business for System X. It is also worth noting the enormous improvement in recent months in the level of constructive collaboration between the companies to enable each of us to quote overseas.

In general terms, the DOI proposal would decide quite arbitrarily and for all time (for practical purposes) the structure of development and manufacture of switching equipment, based on a system which does not yet exist, the early manifestation of which has been produced in limited quantities and multilaterally, and when no one UK manufacturer has yet had a chance to demonstrate its full capability to produce the whole system. Presently employed and still expanding resources would be scrapped on the basis of your subjective judgement of one manufacturer's capability as against another's, and on that manufacturer's promise of future performance from limited experience. And even if that choice were right today, it would have to stay right for ever, or, to follow the other element of your proposal, there would be no important UK telecommunications industry at all.

This would be the absolute negation of competition; it would be the ultimate triumph of corporatism imposing monopoly supply on a monopoly supplier; it runs entirely counter to the proposition that competition benefits the customer.

The offer of up to thirty per cent of the switching business to international tender is also remarkable. No other PT authority has behaved with such generosity as to reserve a material part of its business for foreign firms at the expense of its own, even without having first excluded from the business two out of three of its suppliers; and, of course, if BT does not reward foreign tenderers with contracts, they will soon cease to tender.

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You might wish to refer to the study carried out in the early 70's, under the aegis of the Advisory Group on Systems Definitions, which indicated that the costs of using alternative switching systems in the UK network would be very high; indeed, the conclusion was central to the decision to have one basic digital system, from which arose the collaborative development of System X. Nothing has changed in the meantime to invalidate the conclusion.

In making his proposals to BT, the Minister of State cannot conceivably have taken into account, or he has failed to appreciate, the knock-on effects of eliminating in due course two suppliers of telephone exchange equipment. It is not impossible that such manufacturers may be encouraged to give up the greater part, or even all of their telecommunications business, including transmission and telephone instruments. Side effects might well be felt in PABX's. This would have fundamental consequences in the field of Information Technology, and in due course, on solid state components. There would be potential overspill into defence equipment capability and the whole field of electronics technology.

I have not yet dealt with the employment aspects of the proposals, and their political implications. I realise that the impact on jobs may not be immediate, but you are deluded if you believe it would be long delayed. Can you then seriously propose when there are in this country three million unemployed to offer up to thirty per cent of a nationally owned undertaking's purchases to foreigners? Do you think there will be no repercussions from the companies, and the Trades Unions representing their people, who are to be excluded, and who must inevitably in due course shut down factories and sack workers? Do you believe that investment on the part of those dispossessed companies in the communications and electronics fields will continue unaffected by the very fact that a Conservative government is even capable of allowing such administrative arbitrariness in a decision so drastic and far reaching as this one?

And do you not think that someone, somewhere, will notice that the need for such a decision has been invented by your Department?

/.....

The dangers of the Minister of State's proposed cure are in fact so much greater than the effects of the supposed disease, even if it exists, that to persist with it would be the height of foolishness. The proper way to proceed is to make available now to all three suppliers all necessary information to enable all of them to produce the whole of System X, or any improved derivative of it. Then let them compete, at home and abroad. The industry will by that route arrive at a condition of health and efficiency, backed by adequate investment in plant and technology. That will be better than the route to ruin proposed in BT's letter.

Lord Weinstock

The Rt. Hon. Patrick Jenkin, MP.,
Secretary of State,
Department of Industry,
Ashdown House,
123, Victoria Street,
LONDON, SW1E 6RB.

Post & Tels

MR. RICKETT

c.c. Mr. Scholar ✓
Mr. Mount

BT TARIFFS

We had a word earlier today about the Prime Minister's desire to see changes in BT's tariff structure which would enable those such as pensioners who make infrequent calls, but have a high degree of need for a telephone, to be able to afford to maintain a set.

The Prime Minister may wish to know that BT told Mr. Jenkins this afternoon, in the course of a presentation of their medium-term plan, of their intention to propose an alternative to the present ratio between standing charges and tariffs, which would offer the option of lower rentals and higher charges with a "cross-over point" at 1 unit per day (i.e. anyone expecting to make less than one local call each day would benefit). BT estimate that between 2 and 3 million people might accept this tariff.

Before going firm on this proposal, I think we would be well advised to look both at its timing - I suspect that its public impact will be soon forgotten - and at BT's wider proposals for their tariff structure. I will not trouble you with the details now, but BT's proposals for rebalancing and de-averaging, designed to get away from cross subsidisation, will have a considerable effect, largely by raising the cost of domestic tariffs relative to business and long distance.

J. M. M. VEREKER

20 May 1982

Post + Telecomm's

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dl

~~SECRET~~



~~bc J Verker~~

10 DOWNING STREET

From the Private Secretary

SIR ROBERT ARMSTRONG
CABINET OFFICE

Ministerial Committee on Economic Strategy:
Sub-Committee on Telecommunications Policy

The Prime Minister was grateful for your minute of 26 April about the interest of the Foreign and Commonwealth Office in the matters considered by the Sub-Committee on Telecommunications Policy.

The Prime Minister agrees that the Foreign and Commonwealth Office should see all the Sub-Committee's minutes and papers, and that the Foreign and Commonwealth Secretary should have the right to ask to attend meetings of the Sub-Committee at which items of concern to his Department are to be taken.

M. C. SCHOLAR

27 April 1982

~~SECRET~~

SP

3
①
Prime Minister

Ref. A08220

Agree to X?

PRIME MINISTER

Yes not

ML 26/4

Ministerial Committee on Economic Strategy: Sub-Committee on
Telecommunications Policy

This Sub-Committee of the Economic Strategy Committee was set up some weeks ago under your chairmanship "To consider questions of policy on telecommunications and to report as appropriate to the Ministerial Committee on Economic Strategy". The members of the Committee are the Home Secretary, the Secretary of State for Industry, the Lord President, the Chief Secretary, the Secretary of State for Trade and the Minister of State in the Department of Industry responsible for Information Technology.

2. The work of this Committee and the issues which it will be considering are certain to have a bearing on the Government's policy on interception. For this reason, the Committee's deliberations will be of considerable interest to the Foreign and Commonwealth Office. (The Home Secretary is also concerned with the interception aspects of the Committee's work, but he is a member of the Committee in view of the Home Office's wider interest in telecommunications policy.) The Foreign and Commonwealth Office's interest will be only intermittent and does not justify the Foreign and Commonwealth Secretary being a member of the Committee. In view however, of the ramifications on new technological developments in this field and their consequent effect on Government policy

I should like your authority to ensure that they see all the Sub-Committee's minutes and papers and also that the Foreign and Commonwealth Secretary should have the right to ask to attend meetings of the Sub-Committee at which items of concern to his Department are to be taken.

RIA

ROBERT ARMSTRONG

26th April 1982

THIS IS A COPY. THE ORIGINAL IS
RETAINED UNDER SECTION 3 (4)
OF THE PUBLIC RECORDS ACT

SECRET



Foreign and Commonwealth Office

London SW1A 2AH

21 April 1982

Sir Robert Armstrong KCB CVO
CABINET OFFICE

① AJC to see

Seen.

② PA

MUS.

My dear Robert,

CABINET MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY
(SUB-COMMITTEE ON TELECOMMUNICATIONS POLICY)

1. I see from your minute E(TP)(82)1 of 14 April 1982 that a new Cabinet Sub-Committee on this topic has been established.
2. I would not want the legitimate interests of the Foreign and Commonwealth Office to be overlooked in this Committee, although the Foreign and Commonwealth Secretary has agreed that we need not ask to be made full members of it. It is quite likely that a fair proportion of the papers that come before this Committee will have substantive international ramifications; and we would also wish to have an opportunity to comment on the possible implications for interception of any major new developments in this field.
3. I would be grateful therefore if we could be sent as a matter of course all papers that are circulated to this Sub-Committee. Perhaps you could also kindly confirm that the Foreign and Commonwealth Secretary would have the right to attend meetings at which items of concern to us for either of the reasons outlined above are due to be taken?
4. I am sending copies of this letter to Brian Cubbon at the Home Office and to John Coles at Number 10.

Antony Acland

Antony Acland





P.0722

PRIME MINISTERSystem X

E(TP)(82)3 and 4

BACKGROUND

This item of business is concerned mainly with the structure and future of the telecommunications supply industry rather than the development of the telecommunications network.

2. System X is a system of digital telephone exchanges developed by British Telecommunications (BT) in collaboration with GEC, Plessey and STC. Each company is responsible for developing part of the total system, with development costs borne by BT. One of them acts as lead contractor in each export market, and has to bear all the costs and risks of exporting while only receiving part of any profits.

3. On present plans BT will purchase System X equipment worth some £5 billion over the next decade. No export sales have yet been agreed (recent press reports of a possible sale to China have yet to be confirmed).

4. In E(TP)(82)3 the Minister of State, Department of Industry argues that although System X is technically sound the division of responsibility among three companies is seriously holding back progress; and that without a clearer focus for the development, production and sale of System X, the telecommunications supply industry is unlikely to achieve success in world markets. If the Government lets this situation continue BT will have either to purchase British equipment which is uncompetitive because of costly triplication of development and production and small production runs; or buy exchanges developed overseas.

5. Mr Baker therefore discusses four ways in which responsibility for developing or at least exporting System X could be unified. He dismisses three.

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- (a) Make British Telecommunications Systems (BTS), a jointly owned export market company, responsible for export sales. But this would reduce the three manufacturers' control over their own activities; Plessey, STC and GEC, who would have to provide BTS with substantial capital, would not agree. In any case development and manufacturing would still be fragmented.
- (b) A merger of the three manufacturers. But it would inevitably be difficult and take a long time to rationalise the three companies satisfactorily - and there are serious personal rivalries between the top management of GEC and Plessey.
- (c) A merger of the System X interests of two of the companies. There would still be practical problems in bringing about a merger; and control of System X would still be divided. But Mr Baker takes the view that this option would be more likely to work than the previous two.

6. The Minister of State's (and BT's) preferred approach is for one company to have sole responsibility for System X both at home and abroad. Mr Baker suggests that Plessey would be the most likely candidate: they have proposed this course; in practice they have the lion's share of current development work; and they plan to purchase a United States telecommunications company which would assist them in attacking the North American market. Whichever company was given responsibility for System X part (perhaps 30 per cent) of BT's switching requirement could go to open tender to preserve competition; and thus could probably be imported.

7. The Minister of State invites E(TP) to agree:

- i. that BT should invite proposals from each of the three companies that they should be given sole management responsibility for System X;
- ii. that BT should consider these proposals, allocate responsibility for System X to one company and place all their future orders for the System with that company;



iii. that Government support for the export of System X should be concentrated on the company which BT choose.

8. In E(TP)(82)4 the CPRS endorse the Minister of State's proposal (i). They recommend however that when BT have considered proposals from the three companies the Minister of State should report to the Sub-Committee again, assessing BT's recommendation.

MAIN ISSUES

9. E(TP) is likely to agree to the Minister of State's first proposal. GEC and STC may complain that it is unreasonable for BT, with Government support, to seek to alter existing arrangements, partly at the suggestion of Plessey; but Ministers can reasonably answer such criticism by saying that System X's continuing failure to win export orders and delays in the project mean that BT and the Government must examine its scope for changing the present arrangements.

10. The main question for E(TP) is therefore likely to be whether the Sub-Committee should endorse Mr Baker's proposals (ii) and (iii) or rather, as the CPRS propose, invite him to report back to E(TP) on BT's discussions with the companies. There is likely to be general support for the procedure which the CPRS recommend. But you will in any case want the Sub-Committee to discuss the main considerations which bear on decisions on System X and which the Minister of State would need to cover when reporting back.

11. The discussion should cover the following points.

(a) Other Possible Solutions

It may be suggested that the other options discussed in E(TP)(82)3 are not so unattractive as Mr Baker makes out; or that there are other possible solutions: for example a link up between one of the British producers and a foreign company. One of the results of BT's inviting proposals from GEC, STC and Plessey should however be to flush out any such ideas.



(b) Feasibility of the "one company" solution

There are two questions:

- (i) How well would the management of Plessey, GEC or STC cope with the additional problems caused by concentrating responsibility for System X in one company? Are there particular problems on the export side? (For example, press reports have suggested that STC has particularly good connections in China. What - continuing the example - would happen to such links if GEC or Plessey became solely responsible for System X?) If Plessey were the chosen company, would they be able to cope both with full responsibility for System X and with their proposed American takeover?
- (ii) What sort of price might the two companies which had to disengage from System X try to extract? How difficult could and might they make the necessary transfer of software and other information?

(c) BT procurement

Would competition procurement of say 30 per cent of BT switching equipment ensure that BT got good value for money from its System X purchases?

(d) BT and Government financial support

- (i) Would BT continue to pay the research and development costs of System X? As the CPRS point out, one implication of a more competitive approach to procurement seems to be that suppliers should pay their own research and development costs.
- (ii) Mr Baker argues that even a single company would need Government support for exports of System X, over and above normal ECGD and Aid and Trade Provision assistance. On what basis would such support have to be provided?



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(e) Wider industrial and political implications

How serious would be the "major political row" which Mr Baker fears might be caused if the Government and BT prosecuted the single company option? Are there not likely to be implications for the structure of the British electronics industry generally and should not the Government assess these carefully rather than leaving it to BT to take a narrow decision related to System X?

HANDLING

12. You will want the Minister of State, Department of Industry and Mr Sparrow to introduce their papers. The Chancellor of the Exchequer will wish to comment; so too, probably, will the Secretaries of State for Trade and Industry.

CONCLUSIONS

13. You will want to reach conclusions on the following points:

i. Does E(TP) agree that BT should be authorised to seek proposals from STC, GEC and Plessey that they should be given sole management responsibility for System X?

If so,

ii. Should BT also be authorised to allocate responsibility for System X with one company, with which it would in future place all future orders; and should Government assistance in support of System X be concentrated on that company?

Or

iii. Should the Minister of State report back to E(TP) before the summer recess on BT's discussion with the three companies?

14. If the Minister of State is to report back, what points should his report cover (probably those in paragraph 11 above and any others raised in discussion)?

PLG

P L GREGSON

21 April 1982

5

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P.0716

PRIME MINISTER

Future Telecommunications Policy
(E(TP)(82)2)

BACKGROUND

✓ — You will recall that on 16 March E Committee considered a paper by the Secretary of State for Industry (E(82)23) seeking policy approval for the introduction of legislation next session to convert British Telecommunications (BT) into a Companies Act company. He envisaged that 20-25 per cent of the equity would then be sold and the proceeds used to finance BT's investment instead of relying so heavily on revenue raised from charges; and that, subsequent to this sale, the Government would give up "commercial control as we have with British Aerospace and Cable and Wireless". The Chief Secretary, Treasury argued (E(82)26) that any proceeds of privatisation should accrue to the Exchequer and not to the enterprise itself, and that the Government would have to retain control over investment and borrowing until the Government had properly relinquished responsibility for BT, rather than merely disposing of 20-25 per cent of the equity. The CPRS in E(82)29 argued that privatisation of BT should not get ahead of solving the regulatory problems arising from BT's dominant market position. In addition the Home Secretary, the then Foreign and Commonwealth Secretary and the Secretary of State for Northern Ireland sent you minutes (not circulated to all) drawing attention to the need to explore the implications of the proposals for national security.

✓ — 2. The main outcome of the discussion on 16 March (E(82)9th meeting, item 1) was the setting up of the sub-Committee on Telecommunications Policy. You agreed also to the setting up of an Official Committee, chaired by the Cabinet Office, which has produced the report (E(TP)(82)2) for discussion at this meeting. The report seeks to set out the issues for Ministers in a neutral way.

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3. Meanwhile arrangements have been made for officials separately to examine the national security implications of proposals on telecommunications policy and to put issues to Ministers, as necessary, at the appropriate stage. At present there is no suggestion that there are insuperable objections to the privatisation of BT on national security grounds but solutions will need to be found to certain problems. The first step is for Ministers to decide whether, on grounds other than national security, they wish to pursue the privatisation proposals.

MAIN ISSUES

4. The main issues for consideration by Ministers are set out in paragraph 19 of E(TP(82)2, ie:

- i. are the advantages to be gained from the privatisation of BT sufficient to justify any possible disadvantages and penalties?
- ii. can more be done in other ways to assist achievement of the Government's objectives for telecommunications?
- iii. if privatisation is justified, what should be the nature of the new regulatory regime to accompany it?
- iv. should the legislation to privatise BT and change the regulatory regime be introduced in the 1982-83 session?
- v. what should be the next steps?

5. The most important issues are the issues of broad policy at i and ii. Should the Government, as the Secretary of State for Industry proposes, place the main priority over the next few years on privatising BT, with little further progress, apart from action already in hand, on the liberalisation of telecommunication activities, and the introduction of more competition for BT?

Pros and cons of privatisation

6. You will wish to probe carefully the extent of the contribution which privatisation is likely to make to the two objectives of telecommunications policy identified in paragraph 3 of E(TP())82)2, ie:

i. that adequate resources are available for the modernisation and development of our telecommunications systems;

ii. that the provision of telecommunications is so regulated, structured and exposed to competitive pressures that resources will be used as efficiently as possible and that there will be a flexible response to market opportunities.

7. On i the paper makes it clear that it will not be feasible to transfer the majority or more of BT's shares to private ownership before 1986 or even later. Even if legislation can be enacted next session, the initial flotation of shares in British Telecommunications Ltd (BTL) is unlikely to be feasible in the lifetime of this Parliament for the reasons set out in paragraph 13 of the paper. The initial flotation would have to be limited to 20-25 per cent because this is all the market could absorb; subsequent flotations to achieve private sector ownership of more than 50 per cent of the shares would have to take place two or more years later. It is agreed by Departments (paragraph 20 of the paper) that until 1986 or later the Government would have to retain ultimate control of BTL's access to external finance.

8. The question of whether, before majority private ownership is achieved, any additional resources would be made available for investment by BTL would depend on the resolution of two matters in dispute between the Department of Industry and the Treasury, ie:

a. should BTL be permitted a higher level of external finance during the transitional period when some of its shares are privately owned than BT, as a public corporation, would have been allowed in those years?

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b. should part of the proceeds of the sale be made available to BTL as additional finance for investment?

The Treasury view on both these points is that, until a majority of the shares in BTL are privately owned, its financing requirements will have to be considered in the normal way against other claims for public expenditure. They might agree that it could be presented that more finance would be available because of progress towards privatisation, so as to assist in reducing union opposition to privatisation (the Secretary of State for Industry's "partnership" concept). The Treasury would however be reluctant to agree that more finance should in reality be provided. Unless this view is rejected by the sub-Committee, it follows that no additional resources will be provided for investment as a result of the privatisation of BT until 1986 or later; it could indeed, depending on the timing, rule out the issue of the BT bond, and the additional resources for investment provided by it.

9. On the second objective (ie more efficiency and market responsiveness) it is agreed by Departments (paragraph 21 of the paper) that, even if BT were privatised, it would still have a dominant position in telecommunications services and that the commercial prospects of the new company would be influenced by regulatory decisions taken either by the Government or Government agencies. Although the Department of Industry would argue that the status of a Companies Act company rather than a corporation would put pressure on BT to speed up the process of making itself more commercial, for example by the reform of its accounts and management structure, it seems unlikely that privatisation would, of itself, do much to improve BT's efficiency and market responsiveness. The main obstacle in that direction is likely to be BT's dominant market position.

10. There are also some possible disadvantages of privatising BT. There is likely to be a major diversion of effort from other useful progress on liberalisation and improving efficiency, and an increased risk of difficulty with BT's unions (paragraph 24 of the paper). The fact that there will have to be a twilight period between the initial flotation of shares in BT and majority private sector ownership creates some awkward problems; although a

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transitional regime could be devised, on the lines indicated in paragraph 14 of the paper, this would both worsen the prospects for the initial flotation and complicate the Government's relationship with an enterprise for which it still has responsibility for two years or more. Finally, as paragraph 25 of the paper explains, the flotation of BT, even when staged over some years, may reduce the market's ability to provide equity finance to the private sector (this is a worry particularly of the Bank of England) and limit the scope for other flotations of publicly owned enterprises for several years.

Scope for progress in other ways

11. If Ministers take the view that the benefits to be derived from privatisation are outweighed by the disadvantages, or that the benefits are too marginal or too long term to justify making this a high priority of telecommunications policy, the case is reinforced for exploring how far the Government's objectives for telecommunications can be achieved in other ways, notably by more liberalisation. In his minute of 20 April (not copied to the sub-Committee) Mr Sparrow has stressed that, whatever Ministers decide about privatisation, this will be a long and complex exercise, and that it is important to make more progress in reducing BT's monopoly powers and increasing competition.

12. The progress already being made to liberalise the telecommunications market is summarised in paragraph 4 of E(TP)(82)2. It should be noted however that these developments are unlikely to affect more than about 5 per cent of BT's overall turnover by 1985/86; BT's plans assume that in 1985 over 90 per cent of business telephones and 95 per cent of domestic telephones will continue to be connected to their network. Further action to reduce BT's share in the market could take the following forms:

- a. There could be legislation to remove BT's powers to licence others to run telecommunications systems and to approve apparatus for connection to its network.

(The Department of Industry do not think that legislation would be justified for this purpose alone and that there is adequate scope for liberalisation within the existing legislative framework.)

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b. Liberalising the supply of international services to permit "value added network service" operators to operate across national frontiers and Mercury to offer switched international services.

(This is already under consideration by the Department of Industry.)

c. Permitting private firms to re-sell to third parties capacity from circuits they lease from BT, in effect providing competition for trunk traffic.

(Also already under consideration by the Department of Industry.)

d. Permitting further competing networks in addition to Mercury.

(The Department of Industry do not favour this and it could have difficult implications for national security.)

e. Privatising parts of BT.


(The Department of Industry believe that the deficiencies of BT's accounting arrangements prevent such partial privatisation for several years.)

13. If Ministers favour more action on liberalisation either in addition to privatisation or as an alternative, more work will need to be done by officials in drawing up a package of proposals, identifying what could be done under existing legislation and what would require new legislation.

Regulatory regime

14. In the light of their decision on the major policy issue of whether to privatise BT, the sub-Committee will need to consider the nature of the regulatory regime for telecommunications. In the event that privatisation were to be approved paragraphs 15-18 of E(TP)(82)2 discuss the nature of the regulatory regime which would be needed. More detailed work will have to be done on this. At present it will be helpful to have guidance from Ministers on two points:

a. whether, as proposed in the paper, regulations should be confined so far as possible to the minimum requirements (ie restraining BTL from


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abusing its market dominance to oppress its competitors or its customers);

b. whether, subject to further work on feasibility, responsibility for regulation should be entrusted to existing bodies, adapted as necessary, in preference to the creation of a new body.

Timing of legislation

15. In the Home Secretary's paper for the Cabinet on the legislative programme 1982-83 (C(82)10) a Telecommunications Bill is listed as one of the 14 "programme" Bills recommended for inclusion in the 1982/83 legislative programme although it is recognised in the Home Secretary's detailed companion paper (C(82)11) that the policy is still under consideration. Paragraph 29 of E(TP)(82)2 explains the difficulties involved in getting the legislation ready in time. It is in any case relevant that, as noted above, the first flotation of shares in BTL is unlikely to be feasible within the lifetime of this Parliament, although Ministers may still feel it worthwhile to get the enabling legislation onto the Statute Book before the election.

16. The chances of getting the legislation ready in time will be further reduced if Ministers are unable to take a firm policy decision in favour of privatisation very soon. If Ministers were to opt instead for the approach of more liberalisation, further work would be needed to identify the need for legislation in the next session.

Next steps

17. If Ministers decide in favour of legislation in the 1982/83 session to privatise BT, they will need to authorise the next steps set out in paragraph 31 of E(TP)(82)2. It should be noted in particular that, although there is to be no consultative document and no early statement of policy, the Department of Industry envisages informal consultation with the Chairman and Board of BT, and subsequently with the unions. As soon as this takes place the Government's intentions to privatise BT are likely to become public and the Government will probably have to make some interim statement.



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HANDLING

18. You will wish to give the Secretary of State for Industry the first opportunity to comment, particularly bearing in mind that the paper before the sub-Committee is an inter-departmental official report prepared on a neutral basis. The Chancellor of the Exchequer (who will be substituting on this occasion for the Chief Secretary, Treasury) is likely to be the other main contributor but you will wish to invite comments from all those present, ie the Home Secretary, Lord President, Secretary of State for Trade, Minister of State, Department of Industry (Mr Baker) and Mr Sparrow.

CONCLUSIONS

19. You will wish to reach conclusions on the main points listed in paragraph 32 of E(TP(82)2, ie:

- i. whether legislation should be introduced to change BT from a public corporation to a Companies Act company, to permit the sale of a majority at least of its shares to the private sector, together with a transitional regime of control during the interim period, and to introduce appropriate regulatory arrangements for telecommunications;
- ii. whether they wish more work to be done on exploring the scope for achieving the Government's objectives for telecommunications in other ways, for example by further action to reduce BT's monopoly;
- iii. if legislation is to go ahead, whether the regulatory arrangements should be broadly on the lines indicated in paragraphs 15 to 18 subject to further work by officials;
- iv. whether the legislation should be in the 1982-83 session;
- v. if so, whether the next steps should be as outlined in paragraph 31.

PLG

P L GREGSON

20 April 1982



(d) a further increase of £150m in working capital, following last year's £400m (only £300m of which was planned)

(e) underlying the plan provision enabling earnings in BT to be increased as a result of their impending wage negotiations by over 12 per cent.

BT should not be left in a position where it can finance such a damaging settlement and we must act before negotiations get fully under way. While I share your views that investment in modernisation of the telephone system is a major national priority I am very concerned that funds which we make available for investment should not be directed into high pay settlements or other costs. I am also concerned that tariff increases should be kept as low as possible, given their impact on the RPI and on the costs of industry.

There are a number of steps which we must take immediately. Firstly, we should not let the difficulties we are already experiencing on Post Office pay negotiations spill over into BT. We should remind Sir George Jefferson of his previous undertaking to go for a low pay settlement and make it clear that anything approaching 12 per cent would be quite unacceptable in the current pay round and at a time when inflation is moderating.

Secondly, we need to take practical steps now to demonstrate our concern and to buttress Jefferson's position by making it clear that he is operating within a tight financial framework.

I propose that we should immediately set BT's financial target for the current year at 5 per cent - the same level as they have been set for the past five years. (This would be equivalent to 5.3 per cent on the basis of the accounting policies proposed in their medium term plan.) We should also make it clear to Sir George Jefferson that he should not plan to exceed that level - his plan at present assumes a rate of return of 6.2 per cent. It is not ideal to be setting a financial target for one year only but in the present circumstances we cannot afford to wait any longer before setting one for 1982-83.

The effect of this would be to put BT on warning that we will expect a very low or zero tariff increase this year.

This action alone may not be enough. There must also be a considerable risk that BT will not actually achieve the level of investment that they forecast - which would again leave surplus funds available for them for pay and other current expenditure of lower priority. One way to guard against this would be to reduce their EFL now and only increase it later if BT demonstrate that they are on target for their ambitious capital plans. Because this would be open to misinterpretation I am inclined against it. But I do not want to arrive later

/in the year



in the year at a position where an EFL designed to meet essential investment is eaten up by pay and poor control of working capital.

I therefore propose that we should take administrative steps. I suggest that we tell Sir George Jefferson that none of the £195m that his plan envisages as coming from NLF and long term borrowing will be made available to BT in the early months of 1982-83, and that subsequently it will be made available only on evidence of investment need.

There then should be a mid-year review of BT's financing needs which would take into account progress on investment plans to date and up to date forecasts of investment achievement for the rest of the year. In the light of that review we could consider what BT's long term borrowing requirement for 1982-83 should be and how it should be funded - by NLF, foreign borrowing, or the Bond.

BT's high labour costs - in many cases a quarter as much again as comparable organisations - and its manifest inefficiencies in working practices, have been widely published by the Chairman himself. I am sure you agree there can be no relaxation of discipline. So long as their situation persists BT must continue to give high priority to reversing it, in spite of the many other important developments taking place in telecommunications at the same time.

I am copying this letter to the Prime Minister and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

GEOFFREY HOWE

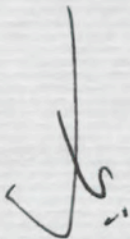
MR. SCHOLAR

cc: Mr. Hoskyns

BRITISH TELECOM'S FINANCIAL POSITION IN 1982/82

The Chancellor's letter of 20 April to Patrick Jenkin sets out some highly desirable action to bring pressure to bear on BT management to stop them siphoning Government funds into excessive pay settlements. It may not be necessary for the Prime Minister to intervene in this correspondence, if Patrick Jenkin accepts what is proposed; but the Prime Minister ought to be aware of the serious nature of BT's plans.

The DOI tell me that the latest BT plan does not contain an explicit assumption for the 1982/83 pay rise, but they do not dispute the 12% calculated by the Treasury; and they tell me that BT are also assuming 10.9% the following year, and 11.9% the year after that. These figures are, frankly, shocking; and the more so because of assurances given by Sir George Jefferson, which have been relayed to the Official Group on Withstanding a Telecommunications Strike (MISC 69), to the effect that substantial increases in productivity and competitiveness would be required in the organisation if it were to retain its market share. MISC 69 has, indeed, been working against the background of the possibility that BT might stick at 5.5% for this year's settlement, although we recognise that they might be prepared to increase it somewhat to avoid industrial action. That a nationalised industry board is contemplating pay settlements well into double figures over each of the next three years even before pay negotiations start demonstrates yet again the gap between the Government's perception of what national economic circumstances require for pay settlements, and what the employers regard as reasonable.



20 April 1982

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MR. SCHOLAR

cc Mr. Hoskyns

TELECOMMUNICATIONS POLICY

I have seen John Sparrow's comments on E(TP)(82)2, the paper by the Official Group on Future Telecommunications Policy, of which I am a member. It may be helpful if I offer these additional comments, in preparation for the meeting of E(TP) planned for Thursday afternoon.

- (i) The main, and difficult, issue for Ministers is whether or not to introduce a Bill for the privatisation of British Telecom (BT) before the end of this Parliament, given that actual privatisation could not take place until the new one. I think all concerned with BT agree with John Sparrow that privatisation would have to take place in at least two stages, because of the volume of the flotation, and that there will be a transitional period raising a number of awkward issues of control. Most potential investors are going to want to wait until the second flotation, and the transitional regime may well have to last two years. But John Sparrow's reference to "two years to prepare legislation, devise an interim control regime and write the prospectus" will be challenged by DOI, who consider that they have the work well advanced, and are confident that a Bill could be introduced this autumn. It will be essential to explore that at E(TP).

Electoral considerations apart, and provided Ministers are satisfied it is practicable, there is a case for getting this Bill under the Government's belt in the coming Parliamentary Session, because the legislative programme at the beginning of the next Parliament may well be crowded, so that ultimate privatisation would be even further delayed.

/ (ii) But

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- (ii) But, as the Official Group's report indicates, privatisation is by no means the whole, or even the most important part, of the story. We agree very much with John Sparrow that we need to take all possible steps to promote increased competition in the telecommunications industry. The DOI are putting up a substantial rearguard action in defence of BT's monopoly, arguing, for instance, against further liberalisation measures such as attachments, other mercury systems, and removal of BT's regulatory powers. The work recommended in paragraph 32(ii) of the Official Report ought to go ahead regardless of the decision on privatisation.

Jk.

20 April 1982



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g/c 50
Prime Minister

MCS 20/4

Qa 05894

To: PRIME MINISTER

20 April 1982

From: JOHN SPARROW

Future Telecommunications Policy

1. You asked for my comments on the paper by Officials E(TP)(82)2, in which the crucial question seems to me to be the timing of the proposed privatisation of British Telecom (BT).

2. Given the valuation likely to be placed on BT in any privatisation, it is clear that the stock market could not absorb even 51 per cent of the undertaking in a single tranche, let alone the whole of BT. The most that can reasonably be contemplated in any one step is that 25 per cent of BT could be sold to private investors, and even that figure depends on very debatable assumptions as to price.

3. Given that, there is unlikely to be an enthusiastic reception for an offering this side of the General Election which left 75 per cent or more of BT in Government hands; investors would, I think, take a gloomy view of the political risk involved. If, on the other hand, a first tranche offering was made relatively early in a new Parliament, the expectation that the Government holding would be reduced below 50 per cent in the life of that Parliament would have a much more positive effect on investor attitudes.

4. In any event, privatising BT will be a long, complex and politically sensitive exercise. It would take about two years to prepare legislation, devise an interim control regime and write the prospectus for even one-quarter of BT to be offered for sale. This work could begin now so as to be ready to privatise after the Election, or it could be deferred. The decision whether or not to set in hand the necessary preparatory work and find legislative time in this Parliament to turn BT into a Companies Act company is one for Ministers. The recommendations in paragraph 32 (i), (iii), (iv) and (v) all relate to this and to Ministerial priorities.



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5. But in the interim to bring about greater efficiency in the use of resources entrusted to BT, it will be very important to promote increased competition. A start has been made in the liberalisation of attachments, value added services and the licensing of Mercury. But BT must be prevented from using their dominant position in these markets to frustrate the emerging competition, and further progress should be made in liberalising international services and the re-sale of BT's leased line capacity. It would also be desirable to remove from BT its powers to license competitors, so that the Government becomes the only licensing authority. It is, therefore, important to go ahead with the recommendation in 32 (ii) that work be done on reducing BT's monopoly powers and increasing competition.

6. I am sending a copy of this minute to Sir Robert Armstrong.

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F.

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Prime Minister (4) *Poste de la*

Spence's mt.

Non-sequitur!

APR 1982

Foreign and Commonwealth Office

MCS 7/41



London SW1A 2AH

6 April 1982

From the Parliamentary Under Secretary of State

[Handwritten signature]

1 *Dear Kenneth,*

SYSTEM X

Thank you for copying to Peter Carrington your minute of 30 March to the Prime Minister about System X.

It is obviously important that we should have a strong indigenous manufacturer of digital telephone equipment. Digital exchanges will be the heart of future telecommunications systems and we must be able to manufacture and market them ourselves if our industry is to retain its present relatively strong position. I therefore agree to your proposal that Plessey should have sole responsibility for System X at home and abroad.

??

I am copying this minute to recipients of yours.

Yours,
David

(Trefgarne)

Kenneth Baker Esq MP
Minister of State
Department of Industry
Ashdown House
123 Victoria Street
London SW1

CONFIDENTIAL



10 DOWNING STREET

D/N		JD
CS, HMT		D/M
PGO		DES
MOD		D/IND
DOE		HMT
NIO		FCO
CDL		HO
TRANSPORT		CO
TRADE		
MAFF		

From the Private Secretary

5 April, 1982.

Dear Neil,

System X

The Prime Minister has seen your Minister's minute of 30 March about the latest developments over System X.

The Prime Minister would be grateful if Industry Ministers would bring this matter for discussion at an early meeting of E(TP). The Prime Minister recognises that given the pressures of time this week, and absences next week, this meeting will be some weeks away.

I am sending copies of this letter to the Private Secretaries to the Members of E, and to David Wright (Cabinet Office).

Yours sincerely,

Michael Scholar

Neil McMillan, Esq.,
Department of Industry.

CONFIDENTIAL



CONFIDENTIAL

WJSV

2

Prime Minister

rus 6/4

[Handwritten signature]

PRIME MINISTER

SYSTEM X STRATEGY

[Handwritten signature]

I have seen Kenneth Baker's minute to you of 30 March recommending the adoption of Plessey as lead company for System X development and supply at home and overseas.

I agree that the current arrangements for marketing System X overseas are far from satisfactory and - while it raises a number of potentially serious problems - I consider his option (f) the most sensible of those presented to us. It is clearly vital that the situation be resolved without delay and I therefore endorse Kenneth's request for an early discussion.

I am copying this to members of E Committee and to Sir Robert Armstrong.

WJB

Department of Trade
1 Victoria Street
London, SW1H 0ET

WJB

5 April 1982

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CONFIDENTIAL

Prime Minister (2)

I have already recorded
your decision in this sense

MUS 5/4
5 April 1982

Qa 05880

To: PRIME MINISTER

From: JOHN SPARROW

ms

System X

with MCS

1. I have read Kenneth Baker's minute to you dated 30 March. I agree with the two general arguments underlying his minute: first, that for System X to be sold successfully abroad, we need a more authoritative marketing agency than BTS; and second, that for System X to be a satisfactory product, both for BT and in overseas markets, action must be taken to reduce its unit manufacturing costs. But I have grave doubts as to whether effectively selecting Plessey as the sole supplier is the appropriate solution. As well as sharing Kenneth Baker's reservations about the management of Plessey, I would expect strong and public protest both from STC and GEC and this itself cannot help the prospects for System X.

2. Any solution will depend for its success on acquiescence, however grudging, from the three major suppliers, and continued support from BT's Research Station at Martlesham, at least in the short term. The problem is to find a sufficient lever to achieve this acquiescence - and given such a lever, some version of options (c) and (d), merging the export and manufacturing interests, looks the most attractive, as Kenneth Baker implies.

3. These issues need exploring more fully and have clearly needed a full paper for some time. Plessey claim to want an urgent decision because of a planned acquisition. But it would be unwise to rush this decision, or indeed to take any irrevocable steps in the home market without being sure to accompany them with better export arrangements than exist at present.

4. Before a decision is put to Ministers I should like to see the following questions explored more fully:



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- what part does the Government need to play in improving the export prospects for System X;
- what should be the role of British Telecoms (including its Martlesham Research Station) in restructuring the telecommunications supplying industry.

5. Perhaps a paper could be prepared by the Official Committee on Telecommunications Policy (TPO) for Ministerial consideration. This may take a little time, but should come before the Ministerial Committee, E(TP), as soon as possible.

6. I am sending a copy of this minute to the members of E Committee and to Sir Robert Armstrong.

Jan Sparrow

CONQUEROR



✓ JV

Prime Minister

(1)

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PRIME MINISTER

This proposes taking a highly commercial decision at breakneck speed. I cannot see (nor can Mr Greyson) the urgency. Should Mr Jenkin be asked to bring this to an early meeting of E (i.e. after Easter)?

Yes

MLs 31/3

In Patrick Jenkin's absence abroad I wish to inform you of the latest developments over System X which require urgent consideration. I have spoken to Patrick on the telephone, who is also anxious that we proceed quickly on this issue, and that we do not necessarily delay consideration of it for his return.

The Chairman of British Telecom has been concerned for some time about the arrangements for the development, manufacture and sale of the System X range of new digital telephone exchanges. He is concerned that the present arrangements will not ensure a viable UK involvement in future world markets for this equipment. We agree with this assessment.

System X is the heart of the modern telecommunications network which BT is installing during this decade and beyond. By the late 1980s BT will be spending some £400 million per annum on procurement of System X; already its development costs for BT have reached some £200 million. For BT's expenditure to be contained it is vital that System X is competitive in world markets.

System X is run as a collaborative venture between BT and the three manufacturers GEC, STC and Plessey. This grouping was considered necessary because of the scale of System X development. Our manufacturers are small by world standards and have lacked the technical expertise to develop such equipment independently of BT. To set the telecom capabilities of the UK companies in perspective, Annex A compares them to their major international competitors. Although System X is good technically, it is unlikely to be a commercial success because the existing arrangements require that all decisions are taken on the basis of consensus. There is no focus of executive authority, and inadequate cooperation between the companies, each of which makes vital elements of the exchange. Furthermore, economies of scale are essential; these cannot be achieved with three independent companies.





System X concerns Government for two reasons. First, BT is operating, as a result of our liberalisation policies, in an increasingly competitive environment. It can no longer afford to prop up an uncompetitive supplying industry. Nor is it appropriate that it should be so closely involved in the development of equipment - at present the programme is entirely BT-funded. Secondly, we have been asked for support for exports. There is a jointly owned export marketing company, British Telecommunications Systems (BTS); it has no executive authority nor the resources to take the inevitable risks of exporting. Export sales in any country are undertaken by one of the companies acting as lead contractor. I am convinced that System X needs a single authority responsible for all aspects of exporting. This view is shared by Christopher Chataway, the Chairman of BTS.

We have been asked for support to fund the further development of export additions to the basic System X. There will also inevitably be a need for support of individual export projects. The cost may well amount to about £25 million in addition to ECGD and ATP finance. I have made it clear to the industry that funding of the export variants will not be available to them while the existing arrangements continue.

There are the following options :

(a) Do nothing. This has the advantage of minimum disruption. If we refused support for exports there would be no immediate Exchequer cost, but no substantial export orders would be won. BT would either have to procure uncompetitive equipment or buy exchanges developed overseas. This would lead to the slow death of the heart of the telecommunications equipment industry. Some 30,000 jobs could be at risk;

(b) Let the market decide. By 1984 each company will be able to make System X on its own. They could compete for BT and export business. However, the market is far from perfect. BT would effectively remain a monopsonist. Exports would require substantial Government support. In the meantime, duplication of development and production will require additional public money. The likelihood is that all three of our companies would go to the wall during the mid-1980s, leaving BT having to buy foreign equipment.

(c) The companies could give BTS executive authority to export and provide it with the resources to do so. This is an initially attractive option which in theory minimises



disruption. BTS would need authority to override the sectional interests of the individual companies and sufficient capital provided by the companies to bear the risks involved in exporting. The three companies are, however, not prepared to agree to this. Moreover, at home we would still be left with a fragmented manufacturing and development base.

(d) A merger of System X interests of the three manufacturers to form a company with full responsibility for System X. This would give Britain a world scale company with control over development and production. Government would help with the funding of exports. This is perhaps the most attractive option, but again none of the companies appears ready to concede control. Personality differences between the companies mean that this would be very difficult to achieve in an acceptable timescale, and there is the danger that any merger would only turn out to be cosmetic, with the individual units retaining their original identities and corporate loyalties. Obviously, rationalisation would result in some job losses;

(e) Merger of the System X interests of two of the manufacturers. This option has some of the attractions of (d) and reduces the practical problems. Although having the attraction of reducing the number of companies to two, this option does little to resolve the economy of scale problems, and the divided control of System X would remain. Inevitably in time the smaller of the two companies would cease to be viable. Only STC show any interest in this option. BT doubt that any merger would be effective.

(f) One company to have sole responsibility for System X at home and abroad. Plessey has proposed this and it is the course which BT supports. Plessey's plan of action envisages:

- i) the development with BT's cooperation of the next generation of System X, and as a concomitant to this,
- ii) completion of their plans to acquire a US telecommunications company from which to attack the large North American market. They have identified the company and require a decision quickly - if possible before Easter - as other companies are showing an interest in it.

This plan could provide effective management of System X, and would give Plessey the chance to become a world-league



company. The other companies could, if they wished, act as subcontractors, but would be gradually phased out of the exchange business with inevitable job losses, although these would be mitigated by the redistribution of work on other BT contracts. This is in many ways the cleanest solution.

My doubts centre round weaknesses in Plessey's management (although STC's and GEC's managements are no better). There would be a major political row inspired by the other two companies. However, if BT made clear that this was their desired course I have no doubt that all three companies would offer to take the lead.

BT and I are loath to intervene, but large sums of public money are at stake. If nothing is done, slow death is inevitable. Some major change is essential and can only be carried through by BT if they have the full support of Government. The Chairman of BT has made it clear that he considers (f) the only feasible option. He intends to invite each company to submit proposals urgently along these lines. He would want to put this to the three company chairmen before Easter, giving them some two weeks to respond. BT will then give one company the management responsibility for System X and place all future orders for System X with them. However, to apply competitive pressure, part of BT's requirement would be put out to open tender. It is possible that a British company could win this order, thereby reducing their job losses in the UK. Government export assistance would have to be concentrated on the System X company.

Sir George Jefferson has asked for the Government's full backing in the course he proposes to take. I therefore seek colleagues' approval to my agreeing to BT's proposals. Clearly these discussions could have major commercial implications for all the companies involved, not least on the Stock Exchange. We therefore need to consider this matter urgently.

I am copying this to Members of E Committee and to Sir Robert Armstrong.

K.S.

KENNETH BAKER

30 March 1982

M35/M35ACZ

Annex A

MAIN SWITCHING - WORLD MARKET POSITION (HISTORICAL)

DIGITAL ORDER INTAKE
(MILLION LINES)

2.3

WESTERN ELECTRIC - USA

20%

1.0

INTERNATIONAL TELEPHONE & TELEGRAPH (ITT) - USA

12%

2.9

L MERICSSON - SWEDEN

7%

0.5

SIEMENS - GERMANY

6%

0.7

GENERAL TELEPHONE & ELECTRONICS (GTE)
- USA

6%

NIPPON ELECTRIC Co. (NEC)
- JAPAN

4%

OKI - JAPAN

4%

HITACHI - JAPAN

4%

FUJITSU - JAPAN

4%

2.0

THOMSON/CSF
- FRANCE

3%

7.7

CIT/ALCATEL
- FRANCE

3%

4.9

NORTHERN TELECOM
- CANADA

3%

PLESSEY - UK

3%

GEC - UK

2%

ITALTEL -
ITALY

2%

PHILIPS -
HOLLAND

2%

STROM-
BERG
CARLSON
- USA

1%

ALL OTHERS

15%

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Poste Telecom

MR. HOSKYNS

c. Mr. Walters
Mr. Scholar

TELECOMMUNICATIONS POLICY

We had a word, in the context of the recent E discussion on telecommunications policy, about the extent of the Policy Unit's involvement in future work. I explained that it was not at that time the intention to establish an official committee to mirror the new sub-committee of E which the Prime Minister is to chair, and we agreed that it would be difficult for (what is left of) the Policy Unit to make a useful contribution.

Peter Gregson now tells me that Sir Robert Armstrong, who is somewhat displeased with DOI's handling of telecoms policy so far, has instructed him to establish an official committee after all. It will be under Peter Gregson's chairmanship and will contain representatives from DOI, DOT, Home Office, Treasury, CPRS, MPO, the Bank of England and the Cabinet Office IT Unit. Peter Gregson would be quite happy to have a Policy Unit representative on it.

I think it is still true that it is unlikely that we will be able to make much of a contribution. But telecommunications policy is an area of substantial, and increasing, importance; the Prime Minister ought to have some knowledge, if not expertise, within her office if she is to chair the Ministerial Committee; and the Policy Unit's future resources are unknown. I think, therefore, it would be right for us to keep a seat warm in this group, and I would be happy to do so, and gradually to read myself into the subject.^x If you agree, I will so tell Peter Gregson, and we can look at it again when the forthcoming staffing decisions are taken.

J.

x | am of course already sitting on RISC 72

25 March 1982

~~CONFIDENTIAL~~

Post x Telecoms



File AH

10 DOWNING STREET

From the Principal Private Secretary

SIR ROBERT ARMSTRONG

TELECOMMUNICATIONS POLICY

The Prime Minister has seen your minute A07865 of 22 March 1982 and has approved the arrangements you propose for handling telecommunications policy.

JRW.

23 March 1982

AH

~~CONFIDENTIAL~~

SECRET

Prime Minister

1

Ref. A07865

PRIME MINISTER

✓ membership and terms of reference of the Sub-Committee?

Consistent with the proposed

Agree that the security and

✓ will discuss aspects of telecommunications should continue to be dealt with at Telecommunications Policy loc?

14/12/82

The Ministerial Committee on Economic Strategy, at its meeting on 16th March, approved your proposal that a small group of Ministers should be set up, under your chairmanship, to consider future policy on telecommunications.

2. There is likely to be a continuing requirement for a Ministerial group on this subject, and I therefore recommend that we set it up as a Sub-Committee of the Ministerial Committee on Economic Strategy.

3. Its terms of reference might be:

"To consider questions of policy on telecommunications, and to report as appropriate to the Ministerial Committee on Economic Strategy".

4. In addition to you as Chairman, the membership should include the Home Secretary, the Chancellor of the Exchequer (if he wants to - the Chief Secretary, Treasury, if he doesn't) and the Secretary of State for Industry.

5. I think that we should also include the Secretary of State for Trade (to cover regulatory, monopoly and export/import issues) and the Minister of State, Department of Industry (Minister for Information Technology, Mr. Baker). You will no doubt wish also to invite the Head of the CPRS to be a regular attender. Though there will be legislative and political considerations, they can be considered when the Sub-Committee reports to the main Committee, and I do not think you need include the Lord President, the Chancellor of the Duchy, or the Paymaster General.

6. On this basis the membership would be

- Prime Minister
- Home Secretary
- Chancellor of the Exchequer (or Chief Secretary)
- Secretary of State for Trade
- Secretary of State for Industry
- Minister of State, Department of Industry (Mr. Baker)

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7. I think we should start on the basis that this is a purely Ministerial Sub-Committee; but it may later on be convenient, at any rate on occasion, to allow each Minister to bring an official with him. This will be a fairly technical subject.

8. I propose to set up a group of officials to oversee the preparation of submissions to the Ministerial Sub-Committee. The Department of Industry has demonstrated its capacity for producing half-baked papers in an excess of zeal; and an official group should help to make sure that papers coming to the Ministerial Sub-Committee are properly prepared.

9. We should not handle the security and intelligence aspects in this Ministerial Sub-Committee. They should be considered ad hoc by you, the Home Secretary and the Foreign and Commonwealth Secretary, with the Secretaries of State for Northern Ireland and for Industry being brought in as necessary. I am arranging to have a first discussion of these aspects with the Permanent Secretaries and heads of agencies concerned; we shall no doubt commission a full study, which should be under Home Office direction (though I shall ask Sir Antony Duff to take part in it).

RA

ROBERT ARMSTRONG

22nd March, 1982

SECRET

PART 3 ends:-

S/S Ind to Home Sec 16.3.82

PART 4 begins:-

RTA to Ppt A04865 22.3.82

