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

2 April 1981

T.P. Lankester, Esq.,
No.10 Downing Street
S.W.1

Dear Tim

BRITISH TELECOMMUNICATIONS

..... I enclose a briefing note for the
Prime Minister's use when she sees
Lord Weinstock and Sir Kenneth Bond
of GEC tomorrow morning.

Yours ever

Peter

PS. JENKINS

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BRITISH TELECOMMUNICATIONS : BRIEF FOR PRIME MINISTER

Lord Weinstock, Chairman of one of BT's three main supplier firms, is thought to be worried about Government financing constraints on BT's investment programme. He suspects that the Treasury is being obstructive, both in setting too tight an EFL for 1981-82 and in refusing to relax rules which might allow the EFL to be circumvented. He is likely to argue for some kind of financing device, such as a hire purchase scheme, to get round the problem as he sees it.

2. Nobody doubts that BT's investment programme - they want to spend about £2 billion in 1981-82 - must have high priority. This is profitable investment, geared to the information technology revolution with its pervasive effects on the competitiveness of British industry; geared, too, to hopes that the service sector, given the right infrastructure, can lead an economic revival. It has much to do with exports - our hopes of selling our fully digital "System X" to a rapidly expanding world market, against fierce competition. And the supplier industry, including GEC, are at a critical point of changeover to the new technology, when the momentum of ordering must be maintained.

3. As background: the problem is in part immediate, in part longer-term. Immediately, an EFL set six months ago is now proving too tight for the necessary level of investment, because of falling revenue forecasts; because hopes of privatising peripheral parts of BT in 1981-82 have not been realised; and because BT's cost control has been poor. Longer-term, we aim to reconcile this burgeoning programme with the PSBR constraints partly by privatisation, partly by a new look at how we control nationalised industries.

4. The right way to tackle the immediate problem is to recognise it as one of conflicting claims on available finance within the framework of the monetary target: whether nationalised industries such as BT should get a bigger share

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of available funds, and if so at whose expense (the private sector, the consumer, BT employees, other programmes, or the taxpayer). Ministers are urgently considering a package which will allow BT an EFL increase, probably of £200 million which would have to come out of the contingency fund, and in return for provisos about cost-control and early moves on privatisation. This should not, of course, be revealed, although if agreed it would be announced very soon.

5. There have of course been the suggestions, which seem attractive at first sight, that we should go for a financing device, such as a revenue bond, or some kind of leasing or hire purchase scheme. But on closer examination these devices turn out not to help, since they do not generate extra real resources, do nothing to improve BT's performance, and tend to involve more expensive forms of finance without removing the adverse monetary effects of additional borrowing. Thus, if our rules do not allow leasing schemes to evade the EFL constraint - a point that worries GEC - there are good reasons for this.

Line to take

6. The Prime Minister could make clear that, on the matter of priority for BT's investment programme, there is nothing between the Government and Lord Weinstock. The arguments are well understood and our general objectives are the same.

7. We differ on the financing route. We do not believe that devices such as GEC seek are the answer. The issue is one of conflicting claims on available finance, whether within the public sector or between public and private sectors, and the Government cannot avoid responsibility in either case. Lord Weinstock can rest assured that we have the matter well in hand and that an early announcement can be expected.



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~~PRIME MINISTER~~
MS

BRITISH TELECOMMUNICATIONS BILL

It is hoped that Members will find the attached Brief of use both for the Post Office Engineering Union/Union of Communications Workers lobby on Wednesday 1st April 1981 and for that day's Report stage of the British Telecommunications Bill. For further information, Members may wish to consult the Conservative Research Department's Brief for the Second Reading of the Bill (PCC(80)19: 28th November 1980), copies of which are available at the Whips Office.

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1. A New Framework for Telecommunications

Sir Keith Joseph, Secretary of State for Industry, in his speech on the British Telecommunications Bill's Second Reading noted why a new liberalised framework of telecommunications was necessary:

"Telecommunications is in a stage of rapid development and growth. It is essential that we allow these developments to evolve as rapidly as possible for the benefit of the public. A new revolution is upon us, spurred by the dramatic reduction in the unit cost of computing power and electronic memory. The combination of technical advances in micro-electronics, computing, telecommunications and automation makes the application of these interlocking technologies fundamental to the progress of industrial economies. We have the economic means to put within the reach of everybody the power to store, retrieve and process information on a scale impossible only a few years ago. Telecommunications lies at the heart of this transformation and can play a vital part in the future efficiency of businesses of all kinds everywhere. We cannot afford to lag behind in its development and use" (Hansard, 2nd December 1980, Cols. 209-210).

The virtues of liberalising the use of the telecommunications network are:- in those areas where the new British Telecommunications (BT) will have to compete with the private sector better service to the customer can be expected;

- BT's monopoly will not be used to stifle the development of new services and equipment.
- BT will be able to concentrate on its most important role, that of providing, modernising and maintaining the main telecommunications network.

In order to achieve these three ends, the Government have brought forward a Bill which will allow maximum flexibility in the future, by granting the Secretary of State for Industry wide powers to grant licences, while ensuring that the integrity of the telecommunications network is safeguarded by retaining aspects of the BT monopoly.

2. The Issue of Licences

The Government have stated that they intend to liberalise by licensing powers in three areas:

- i) There will be liberalisation of the supply, installation and maintenance of all equipment attached to the network, with the exception of the subscriber's first telephone and the maintenance of private branch exchanges (PABXs). In Committee the Government accepted an amendment requiring the Secretary of State to consult BT before exercising this power. General licences will normally be used, though individual licences can deal with one-off installations. To ensure that attachments to the network are technically compatible with it - and so do not impinge upon other users - technical approval will be carried out by a self-financing independent body (the BEAB) working out by standards published by the British Standards Institution. The system which will emerge will be one where BT is not approving equipment. The Government is actively considering the PABX maintenance question.

- ii) The Government intend to liberalise the use of the network for third party 'Value Added Network Services' (VANS). Examples of VANS are: radiophone services, radio paging, message answering systems, facsimile, computer bureaux, word-processing bureaux and Viewdata (e.g. Prestel). VANS also include the resale to third party of capacity, leased or otherwise acquired from the network operator, to provide cut-price telephone calls. General licences are envisaged, supplemented by individual ones where necessary. Professor Beesley will in due course be reporting on the scope for liberalisation.
- iii) The Bill permits the licensing of additional transmission systems - through individual licensing. These would be in co-operation with BT. Sir Keith has said that he would "consider (private sector applications) with sympathy" (ibid, Col. 212).

(See below - Section 4 - for the issues of timing and imports)

3. Financing Telecommunications

Those who repeatedly allege that the Government is failing to support public sector capital investment should look at what is happening in telecommunications.

In 1981-2 over £2 billion of investment by BT in telecommunications is planned to meet consumer demand, modernise the network and introduce new services. That (at constant prices) is a higher figure than any year since 1974-5. Having extended BT's External Financing Limit for 1980-81, the Government has agreed to allow it to borrow £223 million in 1981-8 - less than BT would have liked but a big increase on recent years when net repayments by BT were required.

The Government accepted an amendment to the British Telecommunications Bill which would give BT the legal power to borrow in the money market if the Government agrees. Discussion between the Department of Industry and the Treasury is in progress on this point.

It is also worth noting that BT should be able to raise money outside its EFL (and so unconstrained by PSBR considerations) through participation (without control) in joint ventures with the private sector in those areas where BT will be competing - particularly as regards new attachments and services.

4. Trade Union Anxieties Answered

Members should read the following in the light of the comments contained in the POEU/UCW paper of 19th March 1981 which they will have received.

- a) Pensions: The Unions are opposed to a split pension fund. Mr. Kenneth Baker, Minister of State for Industry, is engaged in continuing consultations with those concerned in this matter.
- b) The Monopolies: The unions claim that "Both telecom and postal services in rural areas will be threatened by the breaking of the monopolies" because the most profitable parts will be "creamed off". In fact, the opposite is the case. The

customer, wherever he lives, will be offered a wider choice of equipment in telecommunications, and services in both telecommunications and in certain categories of mail. Furthermore, because many of BT's activities will now be conducted in competition with the private sector and under the watchful eye of a Secretary of State who has wide powers to liberalise telecommunications and to suspend the Post Office's monopoly, if necessary, of the letter mail, better standards of service can be expected in future.

c) Imports: The Unions also claim that modifying the telecommunications monopoly "will open the way for a flood of imports from America and Japan." The Government is well aware of the need to avoid such an eventuality. Sir Keith has stated that the liberalisation of attachments to the network will be phased over a period of about three years in order to give the British telecommunications manufacturing industry time to adjust (Hansard, 2nd December 1980, Col. 214). It is intended that prior publication of relevant standards for equipment will also do so. In Committee Mr. Baker spelt out the system for the agreement of standards by the BSI and for testing of equipment by the BEAB. This will ensure that all equipment, including imports, will be subject to exacting procedures. Furthermore, the Government will be actively seeking assurances from other countries of reciprocal trading opportunities for our manufacturers. These negotiations will have to be bi-lateral until the EEC agrees to equally liberal proposals for telecommunications terminals throughout the EEC.

The Bill provides for the Government to control the timing of liberalisation by (i) the timing of Clause 15 licences, (ii) the timing of approval standards, (iii) the timing of approvals under Clause 16(2), principally for apparatus not covered by an approved standard, (iv) the 'post-dating' of British standards. The fact that equipment, of foreign or domestic origin, will have to be approved by the independent testing authority will prevent low quality foreign equipment flooding the market. It is, of course, in part a reflection of the unsatisfactory effect of having the Post Office as sole customer - which this Bill will end - upon our industry that such extensive measures are necessary.

d) Jobs: The allegation that jobs will be lost as a result of liberalisation is not born out by the experience in the United States, where over the last 15 years, as a result of liberalisation, job opportunities have increased - both as a result of new services and companies coming into existence and as a result of other businesses being able to become more competitive. In fact failing to take advantage of the information technology revolution, through a timid refusal to open up the network to new services and equipment, would be a sure prescription for fewer jobs. The unions allege that "American progress owes more to investment than competition" - but it is the fact that telecommunications has been opened up to the private sector that has allowed direct access to that investment.

e) Unfair Competition: The Unions claim that competition with the private sector will be "unfair to BT". It will not. Indeed, in order to prevent unfair competition to the private sector - such as had to be prevented with Direct Labour Department activities - the Bill ensures in Clause 4 that BT be required to set up self-accounting subsidiaries to stop hidden cross-subsidation of the Corporation's competitive activities. The Director General of Fair Trading will look out for

any evidence of unfair trading practices by public or private sectors. The hidden 'cross-subsidation' danger only applies to BT, not to the private sector, because, of course, unlike BT a private company is constrained by the ultimate threat of bankruptcy - a point which Labour Members refused to grasp at Second Reading.

f) BT's Alleged Cash Starvation: For investment, see above.

APPENDIX

Significant Developments at and after Committee Stage

- i) Acceptance of an amendment to the basic licensing power contained in Clause 15 whereby the Secretary of State must consult with BT before licensing the running of systems which would otherwise infringe BT's exclusive privilege (see above).
- ii) Acceptance of an amendment to give BT power to borrow in the money markets with Government permission (see above).
- iii) Insertion of a sub-section 65(1)(d) allowing conveyance of an overseas letter to an aircraft by a messenger sent for the purpose and the conveyance of the letter out of the UK by that aircraft. This is a development of the original intention that the carriage of all time-sensitive/valuable mail would be permitted by a suspension of the monopoly made by order under Clause 67(1) of the Bill and that carriers would have to charge a fee of at least £1 per item. It gives air couriers the additional security of a statutory exemption.
- iv) On 9th March 1981 the Government's intention to sell just less than 50 per cent of the shares in Cable and Wireless Ltd was announced. It followed extensive consultations with the Governments in the countries involved. The powers are contained in Clause 76. The Government intend to refrain from using their rights as shareholder to intervene in the company's commercial decisions. Net proceeds to the Government should be more than £100 million (Hansard, 9th March 1981, Cols. 619-622).

JU



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

23 March 1981

Lord Weinstock
The General Electric
Company Limited
1 Stanhope Gate
London W1A 1EH

Dear Arnold.

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9/4

With the gist of your letter of March 16, I entirely agree. We and Treasury Ministers have been for months seeking a way to achieve some private sector finance for BT's investment and are still striving. We need no persuasion. I hope that GEC will have useful discussions with officials about your in house ideas.

Cassidy

Kevin

PS/RB
PS/MM
PS/Sec
Mr Croft
Mr Solomon
Mr Nigglesworth
(on file)
PS/Prime Minister ✓

File

259

Lord WEINSTOCK

S/S Industry

19 March 1981

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Chase?
 Yes!
 3/3

Lord Weinstock has sent the Prime Minister a copy of his letter of 16 March to your Secretary of State. about Post Office telecommunications. The Prime Minister would like to see a copy of his reply.

M. A. PATTISON

Ian Ellsion, Esq.,
Department of Industry.

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10 DOWNING STREET

Prime Minister,

We discussed this very
briefly this morning.

The meeting Mr Whitelaw
suggests has now been arranged
for 1730 on Thursday of this
week.

KW

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Therbyson

rw



10 DOWNING STREET

PRIME MINISTER

Lord Weinstock has asked that you should see the attached copy of a letter he has sent to Sir Keith Joseph about the communications network.

Would you like to see Sir Keith's reply?

Yes please

MAJ

ms

16 March 1981



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bc MR WALFSON

jfh

MR DAVID

16 March 1981

Thank you for your letter addressed to my colleague Caroline Stephens, with which you enclosed a copy of one to the Secretary of State for Industry about the communications network. I will place this before the Prime Minister.

MAP

The Lord Weinstock.

THE GENERAL ELECTRIC COMPANY LIMITED
1 STANHOPE GATE · LONDON W1A 1EH
01-493 8484

16th March, 1981

Dear Miss Stephens,

... The Prime Minister once told me that a letter meant for her eyes would be sure of reaching its destination if addressed through you. I enclose a copy of the letter I have written to the Secretary of State for Industry about the communications network. I believe the subject to be quite important. The letter is not long, and because I think it would be helpful if the Prime Minister saw it, I would be grateful if you would show it to her.

Yours sincerely,

Lord Weinstock

Miss C. M. Stephens,
Personal Assistant to the Prime Minister,
10, Downing Street,
LONDON, S.W.1.

TO: DIRECTOR
FROM: ASSISTANT
SUBJECT: [Illegible]

16 MAR 1951

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UNITED STATES GOVERNMENT
OFFICE OF THE DIRECTOR
[Illegible]



16th March, 1981

Dear Keith,

During the many years I have been familiar with the Post Office, it has been impossible not to observe its lack of operating efficiency, the technical conservatism of its engineers and management with regard to the standards to be met in telecommunications equipment and, most particularly, the ineptitude of its decisions concerning the switching systems to be used in telephone exchanges.

In the early 1960's, we tried to persuade them to adopt a computer controlled crossbar system. Towards the end of the decade they decided to use crossbar without computer control. In 1971, we argued against the introduction of TXE4 as an alternative system, because it was based on old technology, was without computer control and, like the

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unsophisticated crossbar system, was unexportable. We tried to persuade the Post Office to push ahead faster with development of System X for the longer term and to buy computer controlled crossbar in the interim. The Post Office rejected this line of argument, on the basis of unreliable output from a computer study of the economic case.

At May, 1980, the connections provided from telephone exchanges to subscribers in the UK were in the following proportions:

| | |
|---------------|-----|
| Strowger | 89% |
| Crossbar | 6% |
| TXE4 and TXE2 | 5% |

(see British Telecom Business Plan 1980-90).

Strowger connections in Japan were 19%, United States 26%, France 27%, Sweden 40%, Italy 74% and The Netherlands 85%.

Other indicators confirm the backward nature of our telecommunications network in terms of penetration and fault

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rates; and we have many out-dated private automatic branch exchanges and telephone handsets connected to the network.

These issues were discussed extensively with Sir William Barlow when he became Chairman of the Post Office Corporation. There were marked changes in the attitude of the Post Office and a plan was set in train to modernise the network and the terminal equipment. We fully support this plan to provide an advanced, reliable, cost-effective network capable of handling speech, television and data as vital to the national infrastructure of a modern country and as necessary to provide an adequate base for our industry's exporting effort. Without it, the development and marketing of systems and ancillary equipment to provide for modern information systems, the so-called "office of the future", will be at best delayed.

I have no doubt that Sir George Jefferson is fully seized of the crucial importance of expanding and modernising the network.

But these things cost money; in the present economic climate, British Telecom cannot generate out of its current revenue the cash for such a programme. The steps already taken to increase the British Telecom borrowings within the Public Sector

Borrowing Requirement are necessary to meet the contractual commitments for purchases entered into some time ago. Projecting forward into 1981-82 and beyond, it is not difficult to foresee the need for further funding for capital equipment. In the light of the new limits HM Government has set on the PSBR, either British Telecom will have to resort to the private money market or cut back its capital equipment purchases dramatically.

George Jefferson is surely pursuing this subject vigorously with the Treasury, and in case it makes any difference, I want to support him. GEC has some ideas in-house which may be helpful, including providing financial assistance with respect to equipment supplied by GEC, and we would welcome the opportunity of exploring these possibilities with HMG as soon as possible.

I hope you will not read this letter as just another plea to change your general line of policy; it means only to suggest that if constructive minds are set to the problem, there are ways in which British Telecom can be supported in

: 5 :

a sensible manner without upsetting the Government's economic strategy or losing important benefits in terms of employment and exports.

Lord Weinstock

The Rt. Hon. Sir Keith Joseph, BT., MP.,
Secretary of State,
Department of Industry,
Ashdown House,
123, Victoria Street,
LONDON, SW1E 6RB.