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A 2% reduction in manpower? This is ridiculously small compared with the private sector. Surely further reductions should be made. The play with the private sector is very lightly by comparison.

Prime Minister

BT have proposed some v. unpalatable tariff increases, though their average effect is 9½%. Sir Keith wants to give the go-ahead. He also warns that the EFL will be exceeded by £120m. Acquiesce with tariff proposals, subject to the Chancellor's views? Norman Tebbit

PRIME MINISTER

BRITISH TELECOMMUNICATIONS (BT) TARIFF INCREASES

Sir George Jefferson has told me of the tariff changes which BT propose to introduce during the period from this November to May next year. BT intend to put the increases to the Post Office Users National Council (POUNC) in the next few days and the formal position is that the Government has no power to intervene.

2 Details of the proposals and their expected yields are given in Annexes 1 and 2. The main features are that in early November rentals for business and residential lines would go up by £25 (37.3%) and £8 (16.7%) respectively, the unit charge for calls would be increased by 0.3p (7.5%) to 4.3p, and peak and standard period (but not cheap rate) local call time allowances would be reduced. Call box charges would remain stable but local and trunk time allowances would be reduced. In February international call charges would be reduced by 15% on average and charges for certain trunk calls would be reduced on average to 8% below current levels at the beginning of May. These tariff changes, which would take effect not less than 12 months after the last corresponding increases, are designed to raise £230 million in 1981/82 and £411 million in 1982/83 (after allowing for reductions of over £300 million in receipts from international and trunk calls). The average increase in telecommunication bills over the year to October 1982 would be about 9½%. The direct effect on the RPI would be an increase of

about 0.2% but the average residential customer would pay a larger increase (13.4%) than the average business customer (6.9%).

3 BT have designed their proposals to anticipate the competitive threat to its businesses which will arise when the supply of telecommunications services is liberalised under the BT Bill. At present different sectors of BT earn widely different rates of return; residential telephone lines for example have a rate of return of minus 2.3%, while international services make plus 20.5%. Broadly, international and trunk calls subsidise all of BT's other activities; since residential customers make far fewer long distance calls than business customers, the effect is that businesses have been subsidising the residential customer for some time. This arrangement could not persist in a fully competitive environment, where competitors could undercut, and cream off, BT's longer distance business, thereby diminishing BT's ability to subsidise domestic and rural services. The only effective way for BT to meet competition is for them to charge more economic prices for each of their different services. Seen against this background, BT's current proposals appear to be a skillful package designed to move a part of the way towards economic pricing. The proposals also provide an element of relief to private businesses and should increase the attractions of the UK as a location for internationally mobile business dependent on telecommunications. This should have benefits both for longer term employment and for our efforts to stimulate information technology.

4 BT's proposals raise several important issues. First, BT are still a nationalised monopoly and we must obviously consider whether BT have done everything in their power to contain costs and to avoid tariff increases of this order. The average increase is below the expected rate of inflation; BT have held their wage settlements to a 9% average increase, which is considerably better than the performance of other nationalised monopoly industries. BT have also introduced some manpower economies compared with previous plans - a 2% reduction - and have made other savings amounting in all to some £230m. Despite this, I have asked through Sir George Jefferson that the two firms of management consultants, which are looking at BT's costs at the moment, should examine carefully whether they can find any further savings in the current financial year.

5 Secondly, these substantial increases are insufficient for BT to avoid exceeding their £380m 1981/82 EFL by an estimated £120m. In the current public expenditure climate this is a most serious development. For the time being there is no way of telling whether BT's estimate is accurate; their revenue is highly sensitive to business conditions, an upturn in international calls could substantially reduce the EFL excess and the current work by management consultants may yield significant economies but we cannot count on this. We cannot contemplate any reduction in BT's investment expenditure. The problem underlines the seriousness of our need to ensure that BT is able

to borrow outside the PSBR and I shall be pressing ahead with Geoffrey Howe to explore the scope for achieving this on terms which do no harm to his overall policies. The threat of an EFL shortfall does suggest, however, that BT's tariff increase proposals are too low rather than excessive.

6 I have explored whether BT should be discouraged from introducing substantial reductions in trunk and international call charges at a time when it is exceeding its EFL. Unfortunately, the timing of the proposed reductions means that they will have no significant impact on BT's revenue in the current financial year. Call charges are collected in arrears, so the reductions in international charges in February will not be reflected in reduced revenue until after bills have been issued and paid at the end of the financial year. If BT were to limit the reduction in international call charges to 10% and the reduction in certain trunk charges to 6%, they might gain some £50 million extra revenue in 1982/83. This would provide no relief in 1981/82, would go against BT's commercial judgement in the new competitive environment and might do longer term damage to employment.

7 Thirdly, there is the presentational point that the increase in residential rentals (16.7%) will affect pensioners and others who make few calls but who rely on the telephone as a lifeline. This impact will be cushioned to some extent because cheap rate calls will only go up by 7.5% and a wide range of trunk calls

will be coming down quite substantially. But we can expect criticisms and BT themselves may attempt to attribute all or part of the increase to the advent of competition. We should not be deflected by these considerations; rentals for residential telephone lines have for years been uneconomic; the last Government's Nationalised Industries White Paper of 1978 (Cmnd 7131) recognised that charges should be properly related to the relative costs of supply so as to avoid arbitrary cross-subsidisation between different groups of consumers; and BT, as a commercial business, cannot be expected to subsidise one part of its activities as a social service. If we wanted to subsidise pensioners' telephones, we should do so through the DHSS vote and not through BT's pricing structure. The Chairman has pointed out that, in order to increase the rate of return on residential lines to the 5% expected of BT as a whole, residential rentals would have to be raised by some 60% compared with the 16.7% increase in fact proposed.

8 Fourthly, there is the question as to whether the tariff increases affecting business users may be excessive. The increases will be unwelcome but businesses will benefit from the reduction in trunk and international charges. I have paid special attention to the 26% average increase in rentals for inland leased circuits and the increases averaging 250% in connection charges for business circuits leased by new customers. I am assured that the present connection charges do not reflect the cost of installation and that rentals for leased circuits

Many of them do not make such calls

do not reflect costs, particularly for short distance circuits. The changes therefore represent a step towards economic pricing and the additional cost to industry and commerce is relatively small. Meanwhile, I think we can look to POUNC to examine closely the cost justification for the proposed tariff changes.

9 In all the circumstances, therefore, I would like to indicate immediately to the Chairman that the Government has no objection to his putting BT's proposals to POUNC. I would tell him that we would expect him to press ahead with securing as many internal economies as possible to stay within the EFL and that we might want to look at BT's tariff proposals further in the light of POUNC's comments. Since any delay in BT going to POUNC might delay the introduction of the rental increases and so aggravate BT's EFL problems, I think we should give BT the go ahead as soon as possible.

10 I am sending copies of this minute to the Chancellor of the Exchequer, to Mr Robin Ibbs and to Sir Robert Armstrong.

K J
10 July 1981

Department of Industry
Ashdown House

IN STRICTEST CONFIDENCE

SUMMARY OF PROPOSED TARIFF CHANGES

Annex 1

From 1 October 1981

- third phase of adjustments to charges for maritime services, following changes in April 1980 and January 1981;

From 1 November 1981

- the maximum connection charge for an exchange line increased by £5 to £80 for a business line and £70 for a residential line; the present reduction of £15 for removing customers will be maintained;

- maximum connection charges for leased circuits, extensions, and customer apparatus increased by varying amounts to reflect current installation costs;

- annual rentals for telephone exchange lines increased by £25 to £92 (£23 per quarter) for business lines, and by £8 to £56 (£14 per quarter) for residential lines; the present reduction of £4 for shared service will be maintained;

- rentals for extension telephones, and customer apparatus increased by varying amounts to reflect current capital and maintenance costs;

From 2 November 1981

- unit fee for dialled telephone calls increased from 4.0p to 4.3p with corresponding changes on calls connected by operators;

- on local calls we propose also to reduce the time allowed for the unit fee from 2 mins to 1½ mins at the peak rate (9.0am to 1.0pm) and from 3 mins to 2 mins at the standard rate; the cheap rate allowance will be held at 9 mins;

- there will be corresponding adjustments on coin box charges with the time allowance for 5p reduced from 3 minutes to 2 minutes at all times and some adjustments to time allowances on trunk calls; the minimum fee for calls from our new payphones will be increased from 6p to 8p but more time will be allowed on trunk calls than from pay on answer boxes; we plan to increase the minimum fee for calls from coin box/payphones to 10p from the autumn of 1982;

- on trunk calls the higher unit fee will increase charges by 7½% but we will announce the introduction of lower prices for some calls from May 1982;

- on international telephone calls, introduction of a common charge to all existing EEC countries (except Eire which is covered by the lower inland charge structure) and reductions on some inter-continental call charges with adjustments to offset the increased fee on other international call charges;

From 1 February 1982

- a further stage of increases on inland leased circuit annual rentals up to a maximum of 50%, as already notified to customers;

- changes to the charge structure for international leased circuits with reductions on intercontinental routes;

- reductions on other inter-continental telephone call charges;

- reductions on inter-continental telex call charges with some increases on continental rates and other adjustments;

From 1 April 1982

- adjustments to inland and international telegram rates;

From the beginning of May 1982

- introduction of route pricing on inland trunk calls over 56 km using an intermediate charge band between the present under and over 56 km rates.

YIELDS

The yields from these adjustments are summarised at Annex 2.

IN STRICTEST CONFIDENCE

Annex 2

YIELDS FROM PROPOSED TARIFF CHANGES

	Average Increase %	Yield (Revenue) 1981-82 £m	1982-83 £m
From 1 October 1981			
- third phase of adjustments to various maritime charges		0.5	1.0
From 1 November 1981			
Telephone Exchange Lines:			
- Connection Charges: Business +£5 to £80	+6.7	2.1	7.6
Residential +£5 to £70	+7.7		
- Rentals: Business +£25 to £92	+37.3	30.8	96.1
Residential Exclusive +£8 to £56	+16.7	40.8	125.6
Shared +£8 to £52	+19.0		
Customer Apparatus			
- Connection charges and rentals	+18.3	27.3	82.0
Inland Leased Circuits			
- Connection charges for main circuits increased by 180 to 500%	+250	0	6.0
Miscellaneous Charges		1.5	5.0
From 2 November 1981			
Telephone Calls - unit fee 4.0p to 4.3p	7.5	68.7	177.0
- Local calls: time allowances reduced peak - 2 mins to 1½ mins standard - 3 mins to 2 mins cheap - 9 mins unchanged	+26 (including higher unit fee)	69.0	167.0
- Coin box calls: local time allowance reduced at all times 3 mins to 2 mins : adjustments to trunk time allowances : new payphone initial fee increased from 6p to 8p		2.5	6.0
- International calls: adjustments to telephone call charges		(2.7)	(see below)
From 1 February 1981			
Inland Leased Circuits: rental increases	+26	1.0	47.0
International:			
leased circuits: changes to charge structure		(1.5)	(4.0)
telephone calls: further reductions on charges		(9.3)	(70.0)
telex calls : changes to charge structure		(1.0)	(10.0)
From 1 April 1982			
Telegrams: changes to rates: inland international		-	net nil
from beginning of May 1982			
Inland Trunk Telephone Calls: introduction of route pricing on calls over 56km	-8 (including higher unit fee)	-	(225)
NET TOTAL YIELD		230	411
CASH YIELD IN 1981-82		172	

Treasury Chambers, Parliament Street, SW1P 3AG

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

20 July 1981

Dear Keith,

BRITISH TELECOMS' TARIFF INCREASES

You sent Geoffrey Howe a copy of your minute dated 10 July to the Prime Minister. Your minute raises important questions both about the structure and the level of the tariff increases proposed.

Given the desirability of introducing increased competition into Telecommunications, we can certainly welcome the general direction of BT's proposals towards the reduction of cost subsidisation. This is an essential step in preparing for the more competitive environment in which the corporation will have to operate. However we will also need to be assured that BT are not loading their charges in such a way as to make competition totally unrewarding for any other potential supplier of telecommunications services. I hope that this is an aspect that POUNC will have in mind. We might also consider whether the charges proposed suggest fresh areas where competition can be encouraged (for example, on telephone connection charges).

While the proposals put forward would raise significant sums, they are already taken into account in BT's bids in the current IFR. As you know those bids are very large indeed and form part of an exceptionally difficult public expenditure prospect. I cannot therefore rule out the possibility that BT may eventually have to seek to increase their tariffs by amounts greater than what is now proposed, if they are not to have to reconsider their investment in modernisation. But what would of course be far preferable is for BT to look for cost savings as widely and as vigorously as possible. I hope that the work being done by the two firms of management consultants currently employed by BT will produce real benefits in this respect.

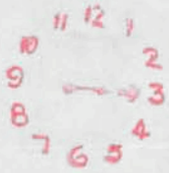
Action of this kind will also help to minimise the continuing risk of a £120 million overshoot on BT's EFL for the current year. Sir George Jefferson must be left with no illusions about the difficulties that such an overshoot would create.

Subject to these comments I am content that Sir George Jefferson's proposals should be put in POUNC.

I am copying this minute to the recipients of yours.

Yours ever
Leon

LEON BRITTAN



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Post & Telecom

10 DOWNING STREET

From the Private Secretary

2o July, 1981.

British Telecommunications Tariff Increases

The Prime Minister has now fully considered your Secretary of State's minute of 20 July; she has also had the benefit of the advice in your letter of 14 July about the impact of the proposals on small business users.

The Prime Minister is prepared to go along with the proposals, albeit reluctantly - though this is subject to any points the Chancellor of the Exchequer may wish to make. However, the Prime Minister thinks it would be helpful if your Secretary of State could indicate to the Post Office Users National Council that the Government would like that body to look carefully at the size of the rental increases for business.

I am sending copies of this letter to John Wiggins (HM Treasury), David Wright (Cabinet Office), and Gerry Spence (CPRS).

T. P. LANKESTER

Ian Ellison, Esq.,
Department of Industry.

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PRIME MINISTER

Very reluctantly acquiesce. MT.

British Telecommunications Tariffs

You raised some questions about Sir Keith Joseph's BT tariff proposals at Flat A.

At Flag B is the further note which Sir Keith promised you. He confirms his view that it would be a mistake to try to persuade BT to abate the increase on business rentals. Even if Jefferson were prepared to do so (which I am told is unlikely), it would add to BT's EFL. It is also relevant that, while the very smallest businesses will be hard hit in percentage terms by the package of increases, the average increase in telephone bills for business customers will be only 6.9%. Nonetheless, Sir Keith could still ask POUNC to look carefully at the size of the rental increases for businesses. In this way, BT would at least be under some pressure from the media.

I have checked your point about the need for further manpower economies. BT will employ 4,000 fewer people this year than they had originally intended to, which is perhaps not a very large reduction. But DOI say that they have done, and are continuing to do, everything they can to put pressure on BT in this regard. It is at their instigation that two firms of management consultants have been brought in. And it is clear from the complaints from BT - that their EFL is too low for their investment needs - that they are under financial pressure.

Robin Ibbs (Flag C) recommends that the proposals "strike a good balance" between the long term aims of economic pricing in a competitive market and the short term need to minimise BT's external financing requirement." Robert Armstrong has sent you a separate submission on telecommunications liberalisation (which is in the hot box). He suggests that, if Sir Keith's further liberalisation proposals were to be turned down on security grounds, the tariff package would be worth looking at again. His point is that the package is a good deal more favourable to businesses than to private subscribers (6.9% average increase compared with 13.4%)

/ because

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because BT are already anticipating the need to compete with a new privately run business network. In effect, he is suggesting that the increases might be made smaller for private subscribers and larger for business subscribers. However, given the view you had expressed that the increases already hurt the business sector too much, I doubt whether you will want the proposals to be held up on this account.

Sir Keith is pressing for a decision. The longer we delay, the more difficult it makes BT's EFL problem for this year. Can I say you reluctantly acquiesce, subject to any further points the Chancellor may make?

15 July 1981

B

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DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
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PS/ Secretary of State for Industry

14 July 1981

Prime Minister

Tim Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Tim

BRITISH TELECOMMUNICATIONS (BT) TARIFFS

My Secretary of State agreed last night to provide the Prime Minister with information about the impact of BT's tariff proposals on small business users.

2 You will see from the attached note prepared by BT that, as the Prime Minister suspected, some small business users would experience high percentage increases in their overall telephone bills if the BT proposals go ahead. But in cash terms the increases are not so great and those most affected use their telephones very little.

3 My Secretary of State does not wish to interfere with Sir George Jefferson's commercial judgment about the proposed tariff increases. He has no statutory powers to prevent BT going ahead in the way proposed and to seek to persuade Sir George to change his mind would risk rebuttal. Sir George is attempting to act commercially in the new competitive environment being created by the BT Bill. On the other hand, if BT were persuaded to alter their proposals, this would have implications for their EFL. If, for example, the increase on business rentals were limited to that proposed for domestic rentals, the cost to BT would be up to £20 million in the current financial year and over £50 million in 1982-83. This would add to the prospective EFL excess and the public expenditure problem generally.

4 For these reasons, my Secretary of State considers that BT should be given the go ahead to approach the POUNC as soon as possible.

5 I am copying this letter to John Wiggins (Treasury), Robin Ibbs and to David Wright.

Yours ever
Ian Ellison

I K C ELLISON
Private Secretary

Small businesses would incur greater than average increases on their total bill for exchange line rentals and calls because the higher rental would be the dominant factor. The increases would be greatest for those business customers making predominantly local calls.

For the 9% of business customers with present call bills of less than £4 per quarter (oursmallest business customers) the present total bill of about £25 per quarter (including vat) would be increased by about £8 per quarter if the calls were predominantly local or by about £7 per quarter with an average mixture of trunk and local calls. Although the percentage increases (about 35% and 30% respectively) seem high, we do not believe that the actual increases in terms of cash are great enough to cause serious difficulty to the customer.

The increases on bills would be proportionately less for customers making more calls. For one-third of business customers, with present call bills of less than £20 per quarter, the present total bill of about £42 per quarter (including vat) would be increased by £13 per quarter (31%) if the calls were predominantly local, or by about £16 per quarter (14%) after May 1982 if there were an average mixture of trunk and local calls. The latter figure is, of course, very close to the average increase on the bills of residential customers.

In general, therefore, we believe that even in the case of the small business user, the absolute cash increase to be paid is not sufficiently great to depart from the overall strategy of our tariff proposals and is fair in relation to what we are asking residential customers to pay.

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Qa 05622 13 July 1981

To: MR LANKESTER

From: J R IBBS

British Telecom Tariff Increases

1. The Secretary of State for Industry's minute to you dated 10 July describes a complex tariff package. We regard this as a sensible move towards re-balancing of charges to different users. The main proposals are that the residential sector be expected to pay its way - moves towards this are bound to be painful; that some trunk tariffs should be reduced to help the business sector; and that international tariffs should be reduced to make the UK a more desirable place for inward investment.

2. The package contains on certain relatively minor items increases very much higher than the RPI which will affect the business sector; principally to exchange rentals, private circuit connection charges and private circuit rentals. These are clearly unpalatable but represent correction of pricing which has hitherto been too low. Their effect on the overall business telephone bill would be small, and far outweighed by the proposed reductions in 1982 in charges for international and some trunk calls. It is call charges which form the largest component in business bills; average business bills will increase by only 6.9%.

3. In summary, we think the tariff package strikes a good balance between the long term aims of economic pricing in a competitive market and the short term need to minimise BT's external financing requirement.

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

JRI

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