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Post e Tels
CJU

Prime Minister (2)

MLS 2/7

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

2 July 1982

Sc. Post + Telecoms - -
Telephone rental + standing charges: March 82

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

MS

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).

JH 729

Original copy filed on Post and Telecomms March 1982 Telephone Rental and Standing Charges

Post & Telecomms

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Secretary of State for Industry

28 June 1982

(2)

Prime Minister

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

I suggest you await Treasury and CPRS reactions to these proposals.

MCS 28/6

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

1) 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. X

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

Patrick

Annex

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.

Post & Tel

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JFF586

Secretary of State for Industry

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.

MS 10/6

Dear Geoffrey,

BT'S FINANCIAL POSITION IN 1982-83

see Post & Tels, April '80, Pay Negotiations 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.

Yours ever

Patrick

Secretary of State for Industry

JFF854

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
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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 corse 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.

Yours ever

Peter

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Prime Minister

Very alarming letter.

MCS 20/4

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

20 April 1982

(Should I write on your behalf expressing great concern and asking that Jefferson be told that there can be no question of a 12% increase for BT staff?

MCS 20/4

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

No Certainty 12½ not

Dear Patrick

BRITISH TELECOMS FINANCIAL POSITION IN 1982-83

E(TP) will shortly be considering future policy on telecommunications. E(NI) will be taking BT's medium term plan in May and no doubt will be influenced by the outcome of E(TP).

Both these discussions will focus on the medium term and beyond. I think we must urgently turn to a subject we touched on at Budget time - BT's finances in 1982-83.

At that time Sir George Jefferson felt that the unexpected buoyancy of BT's financial position could lead to them needing only a £250m EFL in 1982/83, rather than the £340m set as a result of last year's IFR.

As it turned out there was no constraint on BT's investment plans in 1981-82, despite the earlier concern that had led us to increase the EFL from £180m to £380m. Far from being constrained, investment fell short of plan by about £150m and BT underspent their EFL by some £130m. If this had been foreseen last year's tariff increases, which attracted considerable criticism, could have been much lower.

We now have BT's plan for 1982-83. This contains a number of key factors:-

(a) a rate of return on assets employed of 6.2 per cent - well in excess of the target level they have been asked to aim at in recent years

(b) investment of £2510m as against the £2375m approved for 1982-83, implying the BT will be able to achieve a tremendous leap in capital investment, 40.5 per cent up on the £1790m in 1981-82.

(c) tariff changes of 4.3 per cent over 1981-82 levels; although this lower level is to be welcomed, the prospective return like last year's, will still be very open to criticism by consumers.

/(d) a further

(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 evisages 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.

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