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PART A

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PART A

Begins: 5/1/88

DD: 25 years

Ends: 17/6/88 (CONTINUED)

6/9/95

CHANCELLOR'S 1988 PAPERS ON THE NATIONAL LOTTERY

PO -CH /NL/0192

PART A

mjd 3/55m

CONFIDENTIAL

pmp

FROM: MOIRA WALLACE
DATE: 5 January 1988

MR PERETZ

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Sir G Littler
Miss Mueller
Mr Cassell
Mr Kemp
Mr Monck
Mr Scholar
Mr Culpin
Mr Gilmore
Mrs Lomax
Mr Odling-Smee
Mr Spackman
Miss Peirson
Mr Turnbull
Mr Gieve
Mr M Richardson
Miss O'Mara
Mr Parsonage
Mr Rich
Mr Cropper
Mr Call
Mr Tyrie

PS/C&E

NATIONAL LOTTERY

The Chancellor has seen and was grateful for your minute of 23 December, covering an annotated agenda and revised draft paper. He would like one further item for his meeting: a comprehensive table showing, for each of the major countries that have a national lottery -

a. How much it raises gross and net, both in cash terms and as a percentage of GDP;

b. What the money is spent on;

c. Who decides how it is spent.

2. This office will be in touch to arrange the meeting.

mpw.

MOIRA WALLACE

CONFIDENTIAL

pmjo

From : D L C Peretz
Date : 14 January 1988

ECONOMIC SECRETARY

cc Chancellor
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Grice
Miss O'Mara
Mr J Carr
Mr Rich
Mr Cropper

NATIONAL SAVINGS : ADDITIONAL FUNDING IN 1987-88

You have a remit to look at what might be done to increase national savings inflows this year. Although we could leave discussion until the funding meeting at the end of the month, if we were clear now that we wished to stimulate extra national savings flows this financial year then the sooner we were to move the better.

2. Mr Rich's note attached discusses two options :-

a) more advertising of income bonds, which are now pretty competitive.

b) changing the terms on national savings certificates, or introducing a new certificate.

3. For certificates, the cost comparisons (see Annex II) suggest that taking account of tax foregone the interest costs of the current certificate are roughly the same as the interest costs on a 5 year gilt. But one should really add, say, ¼% to the cost of certificates to represent their higher administrative costs, thereby making them slightly more expensive than gilts. Income bonds are also "expensive" as judged by the comparison with interest rates on competing variable rate products, but in this case we would not be locked into the extra cost for long.

4. If we want to give national savings a boost, my vote would go for the switch of advertising expenditure to give income bond sales a boost, proposed in paragraph 12 of Mr Rich's note. But with national savings inflows now benefiting more than we had expected from the decline in building society rates, and the improved PSBR prospect, I am inclined to doubt whether even that is strictly necessary. At least, I doubt whether there is much to be lost from leaving the idea to be discussed on 27 January, when we can at the same time consider the prospect for gilt sales over the rest of the financial year.

Mom
for D L C PERETZ

CONFIDENTIAL

FROM: IAN RICH

DATE: 14 January 1988

1. MR PERETZ ACP 14/1
2. ECONOMIC SECRETARY

cc: Chancellor
Sir P Middleton
~~Mr Cassell~~ Sir T Burns
Mr Scholar Sir G Littler
Mr Grice
Miss O'Mara
Mr Carr
Miss Anderson
Mr Cropper
Mr Patterson) DNS
Mr Ward)

NATIONAL SAVINGS: ADDITIONAL FUNDING IN 1987-88

Introduction

1. At the meeting with the Governor and others on 18 December, the Chancellor asked you to review at the next funding meeting whether we should do more via National Savings, and if so, how. If anything was to be done his preference was to proceed by stepping up advertising.

Background

2. You will wish to take into account the outcome of the gilt auction on 13 January, and our latest assessment of the current funding position and likely PSBR outturn. However, the next funding meeting is not until 27 January, and a decision well before then would be desirable if we are to get the maximum benefit this year from a DNS advertising campaign.

3. The present position is healthier than it looked at the funding meeting in early December, when it appeared that we should raise only £1.5 billion from national savings this year. Since then, sales of savings certificates have increased a little and repayments have tailed off now that 24th issue maturity is behind us. In December, the total inflow from national savings was about

£165 million - about £50 million more than originally forecast. The expected total for 1987-88 is now around £1.8 billion - much more than seemed likely a couple of months ago, but still well below our original figure of £2 billion. The decision not to follow bank and building society interest rates down in December, thereby making national savings rates more attractive, seems to be having a larger impact on flows than we expected.

4. A table with the latest comparison of returns on national savings variable products, those available on CTDs, banks and building societies, and the cost of government borrowing is at Annex I.

Advertising

5. We have been considering with DNS what further stimulus to flows could be given through advertising. The most promising possibility to stimulate significant inflows this financial year would be a TV campaign to sell Income Bonds. Normal practice would be to back this up through press advertising, but the main vehicle would be TV.

6. Since September, sales have been about £150m a month. At present the variable interest rate stands at 10.5%. It is paid gross and is therefore of particular benefit to non-taxpayers. Basic rate taxpayers get 7.66% when they have settled their liability with the Revenue. This makes them very attractive by comparison with rates available elsewhere.

7. In these circumstances, we and DNS believe that an advertising campaign would attract additional sales. Precise estimates are not possible, but experience of an Income Bond campaign a year ago when interest rates were also attractive suggests sales might be boosted by £50 million a month for a period. So if a campaign were set in hand quickly, we might expect a further £100 million in 1987-88.

8. DNS have fresh TV and press advertising material for Income Bonds already available as part of their contingency plans. There would be no direct financial cost for the extra advertising. DNS would substitute spending on advertising designed to produce more immediate results for advertising that would otherwise have been undertaken in February and March on longer term image building for the Investment Account. As to the interest costs, to the extent that interest rates on income bonds are now above competing products, including Treasury Bills, it might be thought to be "expensive" funding. But in fact there is no variable rate borrowing other than DNS products that we would count as funding; and in any case this "cost" would only last so long as we leave the variable interest rate on income bonds above competing rates. It is not like locking ourselves into expensive interest rates for 5 years, as we do when we sell savings certificates at interest rates ahead of the market.

National Savings Certificates

9. All other options for stimulating further rapid inflows into national savings involve changing product terms. In the short term, the obvious candidate would be fixed interest national savings certificates. The latest cost comparisons between national savings products and gilts are shown in Annex II. On a net of tax cost basis, savings certificates compare quite favourably. But when tax forgone is brought into the reckoning, there is little if any room for maneovre. However you will recall two possibilities which Ministers considered in October and again in December.

10. The first was to increase the re-investment limit into the 33rd issue for holders of maturing and matured certificates from £5000 to £10,000. This might make a very small contribution (say £20 million) by stemming outflows. It would also encourage holders to switch from general extension rate money to new 5 year certificates and thereby improve the quality of funding. The second was to increase the £1000 holdings limit for new purchases to say £2000 or even £5000. DNS estimate that £30 million (once

for all) would be attracted for each £1,000 increase in this limit, so we might raise £120 million if we reverted to the £5,000 limit applicable to previous fixed interest issues, and still applicable to IL certificates.

11. At the time, you and the Chancellor decided not to proceed, on the grounds that any new funding would be negligible and, because many takers would be high rate taxpayers, expensive. We assume you would not wish to pursue either of these options again in the present context.

Conclusion

12. The total expected from national savings in 1987-88 is now about £1,800 million - considerably more than forecast at the last funding meeting on 2 December. If we start a television campaign (backed up in the usual way by press advertising) for Income Bonds before the end of this month, and run it until the end of February, we could reasonably expect to secure about another £100 million. Subject to the outcome of the gilts auction, we recommend that DNS should be asked to undertake such a campaign.

13. We doubt whether action on either of the national savings certificates options mentioned in paragraph 10 is necessary as a further stimulus at this time.

Ian Rich

IAN RICH

ANNEX I

CONFIDENTIAL

NATIONAL SAVINGS INSTRUMENTS : VARIABLE RATE PRODUCTS.

Compound Return	Per cent Tax Rate (%) 0	27	60
Income Bond (1)	11.0	8.0	4.4
published rate	10.5	7.7	4.2
Deposit Bond	10.5	7.7	4.2
Investment Account (2)	10.0	7.3	4.0
Premium Bond	7.0	7.0	7.0
Savings Certificate on GER terms	6.5	6.5	6.5
12 Month Cost of Government Borrowing (2)	9.3	6.8	3.7
CTDs	8.8	6.4	3.5
Bank Retail Deposit Rate (3)	6.0	6.0	3.3
Building Society Retail Deposit Rate (3)	7.0	7.0	3.8

(1) Assuming interest reinvested in Investment Account.

(2) Yield on a basket of gilts with maturities clustered around one year.

(3) Average of rates applying to the top bands of selected high interest accounts at 4 January 1988.

 ANNEX II

NATIONAL SAVINGS INSTRUMENTS : FIXED RATE PRODUCTS.

A. Costs of an Initial Borrowing of £100 over Five Years

1987 prices , net of tax

	MTFS Case	Low Inflation Case	High Inflation Case	Weighted Projection	Autumn Case
Fixed Interest National Savings Certificate (FINSC)	121	127	103	119	117
Index-Linked National Savings Certificate (ILNSC)	121	121	121	121	121
Conventional 5 Year Gilt	121- 124	127- 130	104- 107	119- 123	118- 121

B. Equalising National Savings Rates.

Per cent

	MTFS Case	Low Inflation Case	High Inflation Case	Weighted Projection	Autumn Case
Rate on FINSC to match Cost of Conventional Gilt+	7.0- 7.6	6.9-7.5	7.2- 7.8	7.0- 7.6	7.1- 7.7
Current rate on FINSC	7.0	7.0	7.0	7.0	7.0
Rate on ILNSC to match Cost of Conventional Gilt * +	4.0- 4.6	4.9-5.5	0.8- 1.4	3.7- 4.3	3.4- 4.0
Current rate on ILNSC *	4.0	4.0	4.0	4.0	4.0

* In addition to inflation-proofing.

\+ Table B compares the 'direct, net of tax costs' of certificates with those of conventional gilts. If the tax foregone on certificates as holders foresake alternative instruments is taken into account, as in the 'indirect gross of tax' method, figures close to 7 per cent and 4 per cent, emerge for FINSCs and ILNSCs, respectively.

53/2/LPD/3747/061

CONFIDENTIAL

Pmp

FROM: P D P BARNES
DATE: 15 January 1988

MR PERETZ

cc PS/Chancellor
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Grice
Miss O'Mara
Mr J Carr
Mr Rich
Mr Cropper

NATIONAL SAVINGS : ADDITIONAL FUNDING IN 1987-88

The Economic Secretary was grateful for your submission of 14 January.

2. The Economic Secretary would prefer to defer discussion of this until the meeting on 27 January.

PB

P D P BARNES
Private Secretary

FINANCIAL SECRETARY TO THE TREASURY

pmp

FROM: J J HEYWOOD
DATE: 18 January 1988

MR PERETZ

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Kemp
Mr Scholar
Mr Cropper
Mr Tyrie
Mr Call

NATIONAL LOTTERY

I attach some data on the projected 1987 sales volumes of on-line lotteries in a number of jurisdictions.

2. The Financial Secretary received this material from Mr Charles Cousins. It is not clear where Mr Cousins got this information from or on what basis the projections have been made.

JH

JEREMY HEYWOOD
Private Secretary

ENC

United States Lottery Sales
(1987 Projected Annual Figures - U.S. Dollars)

Jurisdiction	Date Started	Population (millions)	Projected $ (millions)	Annual Per Capita
Arizona	1984	3.19	136.08	42.66
California	1986	26.40	1,458.00	55.23
Connecticut	1977	3.17	467.84	147.58
Delaware	1978	0.60	51.36	85.60
Dist. of Col.	1983	0.64	117.56	183.69
Illinois	1980	11.50	1,334.52	116.50
Iowa	1987	2.90	100.16	34.54
Maine	1980	1.16	75.84	65.38
Maryland	1976	4.39	795.20	181.14
Massachussetts	1980	5.82	1,282.52	220.36
Michigan	1976	9.30	1,019.60	109.63
Missouri	1986	5.03	137.16	27.27
New Hampshire	1982	1.00	69.48	69.48
New Jersey	1975	7.56	1,152.68	152.34
New York	1980	17.78	1,541.04	86.67
Ohio	1979	10.74	1,355.72	126.23
Oregon	1985	2.69	132.08	49.10
Pennsylvania	1977	11.85	1,323.68	111.70
Rhode Island	1978	0.95	58.08	61.14
Vermont	1982	0.54	30.76	56.96
Washington	1984	4.41	167.52	37.99
West Virginia	1986	1.94	48.60	25.05
U.S. On-Line		133.56	12,854.38	96.24

Canadian Lottery Sales

(1987 Projected Annual Figures - Canadian Dollars)

Jurisdiction	Date Started	Population (millions)	Projected $ (millions)	Annual Per Capita
Atlantic	1982	1.45	187.20	129.10
British Columbia	1985	2.58	444.80	172.40
Ontario	1978	8.50	1,244.00	146.35
Quebec	1978	6.30	961.60	152.63
Western	1982	4.05	472.40	116.64
Canadian On-Line		22.88	3,310.00	144.67

Other Jurisdictions Lottery Sales

(1987 Projected Annual Figures - U.S. Dollars)

Jurisdiction	Date Started	Population (millions)	Projected $ (millions)	Annual Per Capita
Tattersall's	1983	4.41	388.96	88.20
S. Australia	1984	1.30	80.12	61.63
W. Australia	1986	1.26	87.76	69.65
Singapore	1986	2.48	215.28	86.81
New Zealand	1987	3.40	94.40	36.09
Sweden	1986	8.35	69.52	8.33
Iceland	1987	0.23	15.68	68.17
Caracas, Venez.	1987	3.51	15.36	4.38

On-Line Lottery Suppliers

Terminals Installed and On-line (as of December 1987)

Supplier	Number	Percentage Share
GTECH	40,170	57.3
CDC	12,015	17.1
AmTote	6,130	8.7
Syntech	4,300	6.1
SciGames	3,540	5.1
CSEE	2,500	3.6
ITS	1,500	2.1
Terminals	70,155	100.0

Lottery Jurisdictions Contracted (as of December 1987)

Supplier	Number	Percentage Share
GTECH	26	60.5
CDC	6	14.0
SciGames	5	11.6
AmTote	3	7.0
Syntech	1	2.3
CSEE	1	2.3
ITS	1	2.3
On-Line Jurisdictions	43	100.0

3878K

91G.SCB.4318.1[illegible]

FROM: IAN RICH

DATE: 25 January 1988

[illegible] 25/1

1. MR PERETZ
2. PS/CHANCELLOR

[illegible]

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Sir G Littler
Dame A Mueller
Mr Kemp
Mr Monck
Mr Scholar
Mr Culpin
Mr Gilmore
Mrs Lomax
Mr Odling-Smee
Mr Spackman
Miss Peirson
Mr Turnbull
Mr Gieve
Mr M Richardson
Miss O'Mara
Mr Parsonage
Mr Cropper
Mr Call
Mr Tyrie
PS/C&E

NATIONAL LOTTERY

1. In your minute of 5 January you asked for a table with information about national lotteries run by major countries. I attach a table which brings together all the information we have been able to gather without approaching other departments. Part I covers national lotteries. Part II covers major public lotteries run by states and provinces in certain countries; aggregate turnover and proceeds are in some cases large and it seemed sensible to include this information in the table.

2. The information is drawn from a number of sources - responses to a questionnaire we sent to UK Embassies in OECD countries in 1984; later material sent to us by interested parties; academic

research unearthed in the Treasury Library; OECD main economic indicators; and some statistics supplied by the International Association of State Lotteries in Montreal (who have not in the event proved very helpful). All the money figures are converted to sterling at current exchange rates, for ease of reference.

3. Almost all the figures relate to 1984. Where there are more to up date figures - as for the US - they suggest a considerable increase in revenues since then. But it would be difficult to get more complete up to date figures without involving other departments - which for obvious reasons we have avoided at this stage. The best approach would be another questionnaire to selected British Embassies. It would take some time to complete - in 1984 it took nearly 3 months. But we will of course set this in hand if required.

4. A general point of interest is that it appears that most countries take in national lottery proceeds as general revenue. Hypothecation seems more common in the state or provincial lotteries.

Ian Rich

IAN RICH

91G.SCB.4318.14

I NATIONAL LOTTERIES OVERSEAS

presumably the [illegible] central govt.

Country	Gross sales £m	Net proceeds £m	Net proceeds as proportion of GDP or government revenue %	Proceeds for	Decisions on allocation
Austria (1983-84)	102	10.7	0.07 (revenue)	Government revenue	
Belgium (1984)	250	100	0.43 (revenue)	Government revenue	
Brazil (1986)	520	-	no other information available -		
Czechoslovakia (1986)	235	-	no other information available -		
Denmark (1984)	9	2.3	0.02 (revenue)	Government revenue	
Finland (1984)	not known	86.2	1.25 (revenue)	sport; arts	not known
France (1986)	820	300	0.05 (GDP) 0.25 (revenue)	Government revenue	
Greece (1984)	33	162	0.6 (revenue)	Government revenue	
Ireland	Commenced in 1987; no figures yet available			Paid to the Exchequer to benefit sport; recreation; arts; health	apparently by central government
Italy (1984)	800	310	0.11 (GDP) 0.49 (revenue)	State budget	a "special committee" decides the division of ticket sales between prizes and state budget
Israel (1986)	70	-	no other information available -		
Netherlands (1986)	500	35	0.39 (revenue)	Paid to state "for the eventual benefit of the Dutch people"	
Luxembourg (1983)	4.6	1.2	n.a.	5 charities	the charities are named in legislation

[illegible]

Country	Gross sales £m	Net proceeds £m	Net proceeds as proportion of GDP or government revenue %	Proceeds for	Decisions on allocation
New Zealand (1984)	36	3.6	0.1 (revenue)		
Norway (1986)	80	25	0.01 (GDP) 0.21 (revenue)	Government revenue	
Poland (1986)	40	-	no other information available -		
Sweden (1986)	160	65	0.24 (GDP) 0.4 (revenue)	Government revenue	
Spain (1983-84)	250	76	0.5 (revenue)	Charitable purposes	not known
Turkey (1983)	not known	30	0.22 (revenue)	Government revenue	

9 have national lotteries
3 'hypothecated', 6 state revenues

BL

J Wilson

II OTHER MAJOR PUBLIC LOTTERIES OVERSEAS

Country	Gross sales £m	Net proceeds £m	Net proceeds as proportion of revenue %	Proceeds for	Decisions on allocation
Australia					
Examples of state lotteries					
(1984)					
Victoria	230	80	not known	Victoria State revenue	
New South Wales	390	not known	not known	Started for Sydney Opera House, paid for in 1975. Proceeds now paid to NSW State revenue	
Western Australia	40	10	not known	Approved hospital, sports, cultural projects and nominated charities	State authorities
Canada					
(1985)					
provincial and inter-provincial lotteries					
Aggregate figures	965	340	0.4 to 1.0 of individual provinces' revenue	not known	not known

Country	Gross sales £m	Net proceeds £m	Net proceeds as proportion of revenue %	Proceeds for	Decisions on allocation
Germany (FDR)					
(1984)					
Land (State) lotteries					
Aggregate figures	2700	450	0.68% of Lander revenue on tickets	Lander revenue collected as tax	
USA					
individual state lotteries					
Aggregate figures					
1983 (Office of Legislative Analyst California) -17 states	2900	1185	not known	Retained by states for revenue - purposes not stated	
1985 (reported by G-Tech) -same 17 states	4500	not known	not known	)some states)take proceeds)as revenue.)Others by)hypothecate)to culture,)transport,)education,)charities,)senior)citizen)programmes	
1987 (reported by G-tech) -22 states	7250	not known	not known		
Switzerland					
(1984)					
Canton lotteries					
Aggregate figures	185	75	not known	Charity, sport, public works, tourism, job creation	Canton authorities

PWP

FROM: IAN RICH

DATE: 4 February 1988

PS/CHANCELLOR

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Sir G Littler
Dame A Mueller
Mr Kemp
Mr Monck
Mr Scholar
Mr Culpin
Mr Gilmore
Mrs Lomax
Mr Odling-Smee
Mr Spackman
Miss Peirson
Mr Turnbull
Mr Gieve
Mr M Richardson
Miss O'Mara
Mr Parsonage
Mr Cropper
Mr Call
Mr Tyrie
PS/C&E

Ch/ Annotated agenda flagged behind

MPW

4/2

NATIONAL LOTTERY: EXPERIENCE IN OTHER COUNTRIES

1. Since I submitted my minute of 25 January, we have obtained some further information about the national lottery introduced last year in the Irish Republic. It seemed worth circulating a supplementary note.

2. The following notes keep to the format used in the circulated table. All money numbers are sterling equivalent.

(a) Gross sales estimated at start up to be about £220 million over 2 years (1987 and 1988). Very broadly this might comprise £90 million in year 1 and £130 million in year

2. In 1985, the Irish Government estimated a much lower figure - about £35 million a year.

(b) <u>Net proceeds</u> The government take is 25%; estimate is £55 million for 1987 and 1988 together.

(c) <u>Net proceeds as proportion government revenue</u> Not known. But relative population figures may help - UK 56 million; Irish Republic 3·5 million.

(d) <u>Proceeds for</u>: Sport subsidies (50%), arts and culture (35%), health (10%). These categories were announced by the Government before the lottery started up.

(e) <u>Decisions on allocation</u> Net proceeds paid to Exchequer, and allocated to individual projects within framework in (d) by central government.

Ian Rich

IAN RICH

NH6/31M

CONFIDENTIAL

NOTE OF A MEETING HELD IN THE CHANCELLOR'S ROOM IN THE TREASURY AT 10.15 AM ON FRIDAY 5 FEBRUARY

Present: Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Kemp
Mr Scholar
Mr Gilmore
Mr Peretz
Mr Turnbull
Mr Gieve
Miss O'Mara
Mr Saunders
Mr Cropper
Mr Tyrie
Mr Call

LOTTERIES

The meeting began by considering the pros and cons of a State-run national lottery. The Chancellor said he was interested to note from the figures circulated by Mr Rich (his minute of 25 January) that of the 12 EC countries, 9 had national lotteries, of which only 3 were hypothecated: of the remainder, the proceeds went straight into state revenues. It was noted that there were some attractions in the idea of an un-hypothecated national lottery, as a more popular way of raising revenue than general taxation. The figures were very speculative but the Financial Secretary said he thought a national lottery in the UK might raise considerable sums. But the Economic Secretary noted that in other EC countries net proceeds seemed to average around one-third of gross sales: this had to be seen against the background of the present 42 per cent tax on pool betting. There were also potentially significant political difficulties with an un-hypothecated lottery. Mr Scholar pointed out that the Government could be criticised for raising revenues in an essentially regressive way, at a time when other tax revenues were buoyant and the public sector had no need to borrow.

The Chancellor suggested that an alternative that would avoid some of these disadvantages would be to replace the premium bond scheme with a national lottery, the net proceeds of which could go, for example, to the NHS. But this too had disadvantages: the yield would be likely to fluctuate more, and the Government might be pressed to make up any shortfall. The other problem with any state lottery, whether hypothecated or not, was the extent to which it would involve the Government in highly publicised and controversial decisions on who should benefit. Mr Peretz said this was why he had suggested a more hands-off, deregulatory, approach which would mean raising the at present rather restrictive existing monetary limits. Mr Turnbull suggested that there might be a case for being slightly more permissive, and easing the constraints, so that for example, lotteries could be organised by Regional Health Authorities, or groups of authorities: he questioned whether smaller lotteries would be economically viable. This sort of approach would conceivably ease some of the pressures on central Government finance for Health, and would avoid the Government's being involved in making the decisions. It would also be easier to establish additionality, and there would be less pressure for the Government to make up any shortfalls. However, Mr Tyrie noted that it could still perversely add to the pressures on publicly financed spending: local schemes would tend to focus on large capital items and would still look to central Government to the nurses to run the machines.

The Chancellor said that, realistically, in the present climate, he thought the only conceivable form of national lottery that would be publicly acceptable would be one hypothecated to the NHS. It was agreed that this idea should not be actively pushed by the Treasury at this stage. But it would be bound to be considered as part of the second phase of the Health Review, which would consider financing. The Treasury's attitude might depend to a great extent on how that Review progressed, although the Chancellor's initial inclination was that, if necessary, the Treasury could live with a national lottery so long as it was properly conducted. To avoid any accusation of bad faith, the reply to the Home Office had better make clear that the issue might arise in the context of the health Review. But in the meantime, and whatever happened on that front, we ought to press the Home Office to raise the existing restrictive monetary limits. Officials would prepare a draft in this sense, for the Financial Secretary to send.

MPW.

MOIRA WALLACE

91/G.LOLD.4501.025

FROM: IAN RICH

DATE: 8 February 1988

1. MISS O'~~M~~ARA MOM 9/2

2. FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Kemp
Mr Scholar
Mr Culpin
Mr Gilmore
Mr Peretz
Mr Turnbull
Mr Gieve
Mr Saunders
Miss Sinclair
Mr Call
Mr Cropper
Mr Tyrie

LOTTERIES

The Home Secretary's letter of 22 December to the Arts Minister proposes, as a first step, to raise by order some of the monetary limits in the Lotteries and Amusements Act 1976. This follows up some correspondence last year about an arts lottery, when it was decided not to pursue the matter until after the election. Copies of the Treasury and Home Office contributions to last year's correspondence are attached for reference.

2. We delayed submitting advice pending the Chancellor's internal meeting on 5 February about a possible national lottery. The conclusion then was that such a lottery would probably be a starter only if its principal or even sole beneficiary were to be the NHS; the idea should therefore be looked at by the NHS review team. Meanwhile, for the short term, it seemed sensible to stimulate good cause lotteries by "freeing up" the present restrictions on local and society lotteries in the Lotteries and Amusements Act 1976.

3. The Home Secretary's proposal is consistent with this approach. It would help make local lotteries more successful; it could also provide a forum for developing a quite significant measure of deregulation, eg if the size of the lotteries and maximum prizes were increased. We recommend that you support the Home Secretary's proposal, and urge that officials should meet soon to work up detailed proposals.

4. I attach a draft reply on these lines. It avoids new comment about a national lottery, but draws attention to the views in your letter of 25 February 1987.

Ian Rich

IAN RICH

91/G.LCLD.4501.024

DRAFT LETTER:

The Rt Hon Douglas Hurd CBE MP
Secretary of State for the Home Department
Home Office
20 Queen Anne's Gate
LONDON
SW1H 9AT

February 1988

LOTTERIES

Thank you for sending me a copy of your letter of 22 December to Richard Luce. I am sorry not to have responded earlier.

[My ~~general views on this subject remain as set out in my letter of 25 February last year.~~] I [~~therefore very much~~] welcome your proposal that[~~, as a first step,~~] we should raise the monetary limits set out in the 1976 Lotteries and Amusements Act.

It seems to me this could achieve a significant measure of deregulation. ~~For example,~~ if we were to increase substantially the present limits on the size both of lotteries and of the maximum prizes they can offer, I believe they could raise much larger sums for the causes they support. I would strongly favour doing this and suggest that our officials get in touch to discuss the details.

I am copying this letter to Malcolm Rifkind, John Wakeham, Richard Luce, Colin Moynihan and Tony Newton.

c Miss O'Mara
Mr Rich

HOME SECRETARY

23 DEC 1987 84/G

MR Peretz
PPS CST PMG EST
Sir P. Middleton
MR Anson MR Culpin
MR Gilmore MR Turnbull
Miss Peirson MR Cropper
MR Tyrie MR Call
PS/C&E.

QUEEN ANNE'S GATE LONDON SWIH 9AT

December 1987

Dear Minister

LOTTERIES

You may recall that we corresponded on lotteries before the General Election. We have now given careful consideration to the issues here, in the light of responses to my letter of 25 February, and I want to let you and other colleagues know how I see the prospects.

In my letter I said I would be prepared to look at the case for substantial new legislation on lotteries, and again at the arguments for a national lottery, if there was a general view among colleagues that these issues should be explored. It does not seem to me that the comments received show that a general view on these lines does exist at present. Malcolm Rifkind and Norman Tebbit, while recording a personal interest in a national lottery, reminded us of the potential adverse effects of large lotteries on other sources of revenue and on national savings.

For my part, I am not convinced that there are benefits to be gained here to offset the undoubted unease that we recognise the necessary public consultations would cause among charities, which profit from the present law and which may be ill-equipped to compete with the large lotteries that the better-endowed charities could offer. Recent work undertaken by the Gaming Board has underlined the problems lotteries encounter, both in terms of incompetent management and susceptibility to fraud. It seems clear that, at the same time as deregulating lotteries in the sense of removing some of the monetary limits, other fresh regulations would have to be put in place. This would reduce the potential benefits to charities and sporting bodies, as well as create new calls on resources in providing for the regulation which would apparently be necessary to ensure that standards of propriety were observed.

I intend to see instead if we can raise the present monetary limits, which can be changed without fresh primary legislation. They might provide some useful information against which to test the view that lotteries with bigger prizes will tap a demand not touched by small lotteries at present. We might then return to the wider issue later in the Parliament.

/I think

The Rt Hon Richard Luce, MP

I think this would be a sensible way to proceed and one which recognises that the pressures on the legislative programme are such that it would be unrealistic to think of having a major Bill on lotteries, soon, anyway. I could not give it any priority as against other social topics, including Sunday trading, to which we are committed to return this Parliament.

I am sending copies of this letter to Willie Whitelaw, Malcolm Rifkind, Norman Lamont and Colin Moynihan. I am also copying this to Tony Newton, who may have a view on the part which lotteries could play as an additional source of funding for the National Health Service.

Yours sincerely

N. Sanderson.
(approved by the Home Secretary and signed in his absence).

HOME SECRETARY

QUEEN ANNE'S GATE LONDON SW1H 9AT

Our Ref: BG2/86 1/1/2

MR. RICH
PS/Chancellor
PS/EST SIR. P. Middleton
MR. CASSELL. MR. GILMORE [redacted]
MR. PERETZ MR. SCHOLAR
MR. TURNBULL MISS. SINCLAIR
MR. CROPPER
MR. ROSS. GOOBEY
MR. KELLY → 105/G
MR. TYRIE

25 February 1987

Dear Richard,

LOTTERIES

Thank you for your letter of 8 January.

I see the attractions of large scale lotteries, both as a way of easing pressure on the Arts budget and as an encouragement to private giving for other purposes. Experience overseas suggests that they can be popular, though this is not conclusive in judging what might happen here. Often the opportunities for big prize gambling in those countries are more limited than they are here.

We would have to recognise that proposals in this area would be controversial. The football pools companies, in particular, see the prospect of large lotteries as a threat and are quick to point out the adverse effects on employment and on their ability to help football clubs with much needed ground improvements and measures against hooligans. Many charities - the less well endowed - would be firmly opposed, fearing that they would lose the custom they have at present for their small lotteries offering modest prizes. The reaction from these and other interests could be damaging.

I accept that few people now see lotteries as a worrying form of gambling and there is a strong case for saying that it is no part of our business to prevent people from spending money in this way, if they choose to do so. In practice I would be faced with two cross currents to this approach. The first is that the overseas evidence is that big lotteries require a lot of promotion and high profile advertising. The cornerstone of the policy on gambling has been to allow various gambling activities to go ahead, but only to the extent needed to meet unstimulated demand. This means we have placed tight restrictions on the opportunities for encouraging gambling through advertising. The betting and gaming industries would see a decision to permit big lotteries as a shift away from this policy, and pressure would grow for compensating relaxations for them in this and other areas. The small anti-gambling lobby would also be vocal. The other consideration is that I could not ignore the experience of fraud involving lotteries. We would have to devise more effective controls to reduce the risk of scandals arising from the misappropriation of proceeds.

There are a number of open questions, on which it would be helpful to have information. It is not clear how successful large lotteries would be in this country. This might depend on whether there was one lottery with a national character or several large lotteries. The effects of a successful lottery on revenue are also unclear and Nigel Lawson may wish to comment.

If there is a general view among colleagues that these and other issues should be explored, I would be prepared to take this forward. I am sending copies of this letter (and yours) to Norman Tebbit, Malcolm Rifkind and Lord Whitelaw, as well as Nigel Lawson, in view of the more cautious comments expressed when the prospect of large lotteries was last considered, in relation to art unions. A copy of my letter and yours also goes to Richard Tracey.

My firm conclusion, in any event, is that in view of the uncertain and in some cases adverse reaction any proposals will receive, we should avoid arousing speculation by taking this forward this side of an election. In the meantime, however, I would propose to look again at the monetary limits in the present legislation, which are variable to some extent by Order to see if some movement is possible.

Yours,

Douglas.

cc: PS/Chancellor
PS/EST
Sir P. Middleton
Mr. Cassell
Mr. Gilmore
Mr. Peretz
Mr. Scholar.
Mr. Turnbul
Miss. Sinclair
Mr. Cropper
Mr. Ross. Goober
Mr. Tyrie
Ian Rich
Mr. Kelly.

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Douglas Hurd CBE MP
Secretary of State for the Home Department
Home Office
50 Queen Anne's Gate
LONDON
SW1H 9AT

25 February 1987

Dear Douglas

LOTTERIES

Richard Luce sent Nigel Lawson a copy of his letter of 8 January, proposing that the financial limit in the Lotteries and Amusements Act 1976 be reviewed, so that an arts lottery could be set up.

I am not entirely clear what Richard Luce has in mind. It may be that he envisages merely a relaxation of the present limit which applies to lotteries already run by various organisations for the benefit of arts, sports, charitable casues and so on. The other possibility is the establishment of a national lottery.

Expenditure on lotteries is not taxed - it is liable neither to VAT or general betting tax. It seems likely that any expenditure on lotteries would be diverted either from other forms of betting, from which the present annual tax take is £700m, or from other taxable consumer expenditure. Thus there is a potential revenue loss. There could also be an adverse effect on national savings. If the existing limits were raised, any revenue loss would be absolute, though the amount would depend on the extent of the relaxation. If we were to introduce a national lottery, there could still be a revenue loss if the proceeds were hypothecated to additional expenditure.

I myself am inclined to favour a national lottery but before there is any question of introducing one we need to work out firm proposals, and undertake research to establish the likely total proceeds; the extent of any hitherto untapped market; how much of the proceeds would be diverted from other taxable sources

RESTRICTED

or from national savings; and the net Exchequer effect. We should also need to give careful consideration to the means of conducting the lottery and recovering the full costs.

There are large uncertainties to be resolved and I think it would be premature to make any immediate changes. There is no reason why officials should not discuss and attempt to cost the various possibilities. But I suggest we defer any decision until after the election.

I have copied this letter to Richard Luce.

Yours

Norman

NORMAN LAMONT

3978/16

PS/FST ask FST to redraft letter – in [illegible] redrafts – completely; the [illegible] version [illegible] taken on Mr Tyrie's point.

FROM: A G TYRIE
DATE: 9 February 1988

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Kemp
Mr Scholar
Mr Turnbull
Mr Saunders
Miss O'Mara
Mr Rich
Mr Cropper
Mr Call

Ch/ draft letter pretty awful, but I have given up trying to amend – FST will have views. Perhaps worth including Andrew Tyrie's point – "bound to be raised in context of health review" – so that we are not accused of bad faith. MPW 9/2

LOTTERIES

I saw Ian Rich's minute of 8 February. [behind]

2. I think the decisions at the 5 February meeting were good ones. My concern is that the Home Secretary would use the "freeing-up" of mini-lotteries as a means of blocking any subsequent decision on a National NHS Lottery. He could argue that just at the moment that we allowed these mini-lotteries to stretch their legs they would be put out of business by the Government's new National NHS Lottery.

but would they? and might be a Turnbull-style collection of regional lotteries

3. With this in mind, notwithstanding his likely opposition, might we not be better off telling the Home Secretary that the idea of a national lottery for the NHS is [bound] to be considered in parallel, as part of the health review?

A G TYRIE

CONFIDENTIAL

FROM: MISS M O'MARA
DATE: 19 FEBRUARY 1988

ECONOMIC SECRETARY

cc Chancellor
Sir P Middleton
Sir G Littler
Mr Scholar
Mr Peretz
Mr Grice
Mr Rich
Miss Anderson o/r
Mr Cropper
Mr Patterson - DNS

NATIONAL SAVINGS: GENERAL EXTENSION RATE (GER)

At the last funding meeting, we were asked to consider the case for a reduction in the GER from 1 March. This submission, which reflects in broad terms discussions with DNS, recommends an initial reduction of ¾ per cent as the first in a series of steps.

2. GER is paid to holders of savings certificates not cashed at the 5 year maturity point. It is tax-free and variable. Since 1 October 1987, it has been set at 6.51 per cent.

3. Until last year, the main thrust of GER policy was to protect the existing stock. GER was therefore frequently set at or above the return available on current issue certificates. This served to increase the stock as certificates matured. Between April 1986 and April 1987, there were £3.5 billion of maturities and the GER stock increased by £2.9 billion to reach £6.4 billion, a rise of 83 per cent.

4. However, the GER stock is in theory liquid and poor quality funding: as with other savings certificates, it is capital certain and repayment is available at about 8 days' notice but there is no lock-in through a raked interest rate structure. Thus

since the end of 1986-87, the policy has been to encourage outflows from the GER stock. In April 1987, we reduced the rate by 1.2 per cent and have subsequently made two further reductions of 0.5 per cent. Over the same period, the average bank retail deposit rate fell by rather less. However, as the attached chart shows, GER has become more competitive since October, as it has remained constant while bank (and building society) deposit rates have fallen by 1 per cent. At the same time, we have tried to divert withdrawals from the existing stock into current issue certificates by means of an additional holdings limit of £5,000.

5. These measures have reduced the rate of growth of the stock, despite some very large maturities in the autumn of 1987 (from high sales in 1982), but it has still risen by 14 per cent from £6.4 billion to £7.3 billion in the first nine months of 1987-88. Repayment near maturity currently accounts for only about 10 per cent of maturing stock.

6. Maturities in 1988-89 will be around £1.7 billion. If GER remained at its present rate, DNS estimate that up to £1.5 billion would find its way into the GER stock from new maturities and we could expect only a trickle of further withdrawals from the existing stock. But our aim must be, at the least, to prevent any further increase by encouraging holders of newly-matured stock to cash in at the maturity point.

7. Large increases in the stock are the result of big maturities: experience suggests that the GER stock is in practice not very sensitive to interest rate changes. We therefore suspect the rate could be reduced significantly, without provoking substantial withdrawals (although we may well find that we are still not wholly successful in discouraging further inflows on maturity). If this is the case, we should be able to fund around £7 billion rather more cheaply than by the other means currently available to us (and every 1% off the rate would save £75 million on the present stock).

8. However, while we see scope for a substantial reduction in the rate over time, there is a risk that by moving too far too fast, we would draw attention to the poor return the GER offers and so stimulate larger outflows, with the risk that any action we had to take to offset their impact could prove more costly. We would therefore prefer to make a series of reductions over the year, beginning with a reduction of ¾ per cent to 5.76 per cent on 1 March. DNS would want to make an announcement in the press on Thursday or Friday of next week. (For administrative reasons, GER needs to be divisible by 3 and changes need to be made on the 1st of the month.)

9. As on the last occasion, we would present and defend such a decision as a move to improve the quality of funding and as a cost-conscious response to the Government's reduced need for this funding generally, which carried no signals of intentions about the level of market interest rates.

10. If GER is to be reduced by ¾ per cent, DNS would like at the same time to increase the re-investment limit from £5,000 to £10,000, to remove an obstacle to reinvestment for those whose holdings plus accrued interest in previous issues now exceed £5,000. In their view, this would demonstrate positively that the main purpose of the move was to improve the quality of funding. Otherwise, they would prefer a GER reduction of only ½ per cent at this stage.

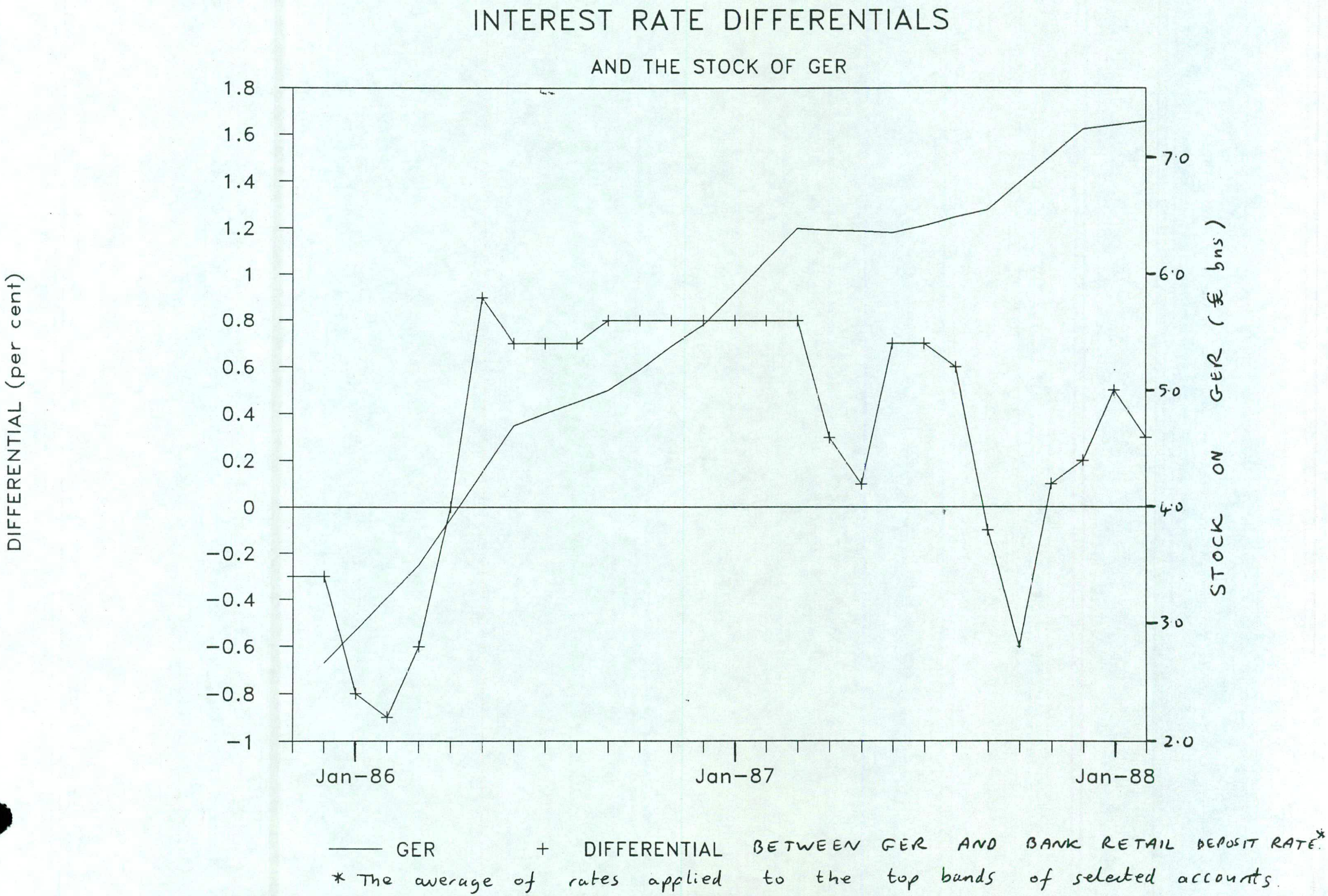
11. An increase in the limit should encourage a little more re-investment into better quality (but more costly) funding. However, the Treasury would not favour any change, given the prospective negligible funding requirement. Moreover, Ministers decided not to increase the limit in isolation when it was suggested recently.

12. If our assessment proves wrong and this, or subsequent reductions in the rate, dislodges a substantial proportion of the stock, DNS could face some uncomfortable workload problems. However, a rundown would be quite manageable in funding terms and would enable us to improve the quality.

13. Such a move would be consistent with our overall approach to funding next year on which we shall be submitting a note to Ministers shortly. This will discuss, inter alia, to what extent National Savings should share in the burden of adjusting to the dramatic reduction in our funding needs.

MOM

MISS M O'MARA


INTEREST RATE DIFFERENTIALS
AND THE STOCK OF GER
DIFFERENTIAL (per cent)
STOCK ON GER (£ bns)
1.8
1.6
1.4
1.2
1
0.8
0.6
0.4
0.2
0
−0.2
−0.4
−0.6
−0.8
−1
7·0
6·0
5·0
4·0
3·0
2·0
Jan−86
Jan−87
Jan−88
GER
\+ DIFFERENTIAL BETWEEN GER AND BANK RETAIL DEPOSIT RATE*
* The average of rates applied to the top bands of selected accounts

3744/68

CONFIDENTIAL

pmp

FROM: P D P BARNES
DATE: 22 February 1988

MISS O'MARA

cc PS/Chancellor
Sir P Middleton
Sir G Littler
Mr Scholar
Mr Peretz
Mr Grice
Mr Rich
Miss Anderson
Mr Cropper
Mr Patterson - DNS

NATIONAL SAVINGS: GENERAL EXTENSION RATE (GER)

The Economic Secretary was grateful for your submission of 19 February.

2. The Economic Secretary agrees that we should cut the GER by ¾ per cent, but not change the investment limit.

PB

P D P BARNES
Private Secretary

eog5.ay1.3cr2

SECRET

NOTE OF A MEETING IN ROOM 29/2 AT 2.15PM, TUESDAY 1 MARCH

Those present:

Economic Secretary
Mr Scholar
Mr Peretz
Mr Grice
Mr Rich
Mrs Ryding
Mr Barnes
Mr Tyrie

Mr Patterson)
Mr Wilson) DNS

Mr George)
Mr Althaus) Bank of England

National Savings

1. Mr Patterson explained that net inflows in January had totalled £290 million and February was likely to see inflows nearer £250 million than £200 million. Inflows were above expectations, and were running at an annual rate of £2½ to 3 billion, which was well above the rate needed. He recommended an early look at the variable interest rates after the Budget, with particular attention paid to Invac. He agreed with Mr Peretz that reductions of 1% of more were needed first to allow for the December reduction in competitive rates, and second to take account of the reduced funding need in 1988-89. Proposals would be put to the Economic Secretary for action after the Budget.

2. As to the outlook for the remainder of 1987-88, Mr Patterson said his forecast was still £2.1 billion, with some risk of a larger figure though the ¾% cut in GER from 1 March might shave this down a little.

Funding Arithmetic

3. Mr Peretz explained that on the latest figures, around £350 million of gilt sales were needed in the remainder of the financial year to achieve a full fund. However, there were still large unknowns - in particular the PSBR and banking sector purchases of gilts. These would not be known until after the end of the financial year. Mr George noted that the decision on the

published reserve figures for March would be another factor in the equation.

Gilt Edged Market

4. Mr George said that the gilts market was currently being pulled in two directions. The market had a good underpinning from the realisation that the supply of gilts was likely to be limited, but fears of overheating worked the other way. It was a good climate for the Bank because there was no need to bring gilts for market management reasons. Ideally, he would like to announce a partly paid short - probably £800 million - on the Friday before the Budget for applications post-Budget, with the second call falling next financial year. This should help control the market over the Budget period, and complete the year's funding. It would not control the long end of the market which was potentially very strong, but he saw less need to worry about that. Even if next year's funding requirement was very small, the second call could be offset by buying in during the course of the year. Mr Peretz agreed. He favoured a short on cost of funding grounds, and agreed that a second call of say £500m could be accommodated within the 1988-89 arithmetic.

5. Mr Peretz noted that from now on there would be regular monitoring of the funding need for the rest of the financial year and it was agreed that gilt sales or buying it should be adjusted as necessary to seek to achieve a full fund over the financial year.

Cost of Funding

6. Mr Peretz noted that it would be sensible to take a retrospective look at funding this year as part of the work currently underway on next year's funding strategy and guidelines. The Treasury, Bank and DNS would be discussing this with a view to preparing papers for the post-Budget funding meeting.

Auctions

7. Mr George said that the experimental series of three auctions had been discussed with the gilt edged market makers and the Bank had also received responses from the institutional investors.

8. The third auction had proved the most interesting and had pushed yields up to 10% which had encouraged retail buyers. It was quite clear that market participants had been surprised by the low level at which the Bank had allocated some stock. In future, there would be more low bids in the hope of obtaining cheap stock. This would not be the end of the learning process because next time many bids might prove too low to obtain stock. The Bank had discussed with the GEMMs whether they would be prepared to take on an underwriting commitment, which was after all in their own interest. About ten of the GEMMs had agreed, but the remainder would only undertake an underwriting commitment if they were paid. Although the Bank had argued originally that an underwriting agreement was necessary, and that it was worth paying a fee for it, Mr George concluded that in the light of experience it was not. However, as the learning process continued, he thought that more of the GEMMs would come to see that agreeing to voluntary underwriting was in their own interest.

✓!

9. Continuing, Mr George said that if it were possible to achieve voluntary underwriting, then it would probably take the form of an understanding that market makers would bid in proportion to their capital at "reasonable" prices. The Bank would be reluctant to define "reasonable" in a precise way, but if one market maker were out of line with the others this would be brought to their attention. The argument the GEMMs had originally put forward was that they could not commit themselves to underwriting because they did not have the information on which to base their bids unless there was some inducement (ie commission) for the retail sector to bid through them. However, the lesson of the auction experiment was that most bids had in fact taken place through the GEMMs.

Ie. a cartel will be organised

10. Continuing, Mr George said that it was not easy to accommodate auctions next year, and this was something that would have to be considered in the context of next year's funding strategy. However, he hoped it would be possible to have two auctions - perhaps of up to £1 billion each, but probably rather less. These would be described as a continuation of this year's experiment. He suggested one auction for a short and one for a long.

11. The Economic Secretary asked whether it was possible to give much shorter notice of timing, so as to target auctions towards more difficult market conditions. Mr George replied that he doubted it would be possible to reduce notice to as little as one week. It was inherent in the auction system that there was some assurance when auctions were likely to come. An unexpected auction would imply that the Bank were desperate to sell stock and would risk a sharp rise in yield. However, one possibility would be to give much broader initial advance indications of timing - possibly announcing at the outset one auction in "the summer" and one in "the winter", and one a short and one a long without saying in advance which was which-in exchange for a week or so's extra notice of the details. Mr Peretz said he was attracted by this approach.

12. On a technical point, Mr George explained that the market makers were keen to be able to bid in 1/32s rather than 5p's as at present. This presented a programming problem for the Registrar's Department, but should be possible.

13. Mr Scholar asked what kind of disruption would have occurred if the third auction had been under-subscribed. Mr George explained that the low coverage had led to some setback in the market, but this had triggered retail demand. A large under-subscription would probably have led to a much sharper setback and it would have taken longer for retail demand to emerge. GEMMs who had bought stock would have been forced to hold it for longer at a more significant loss.

14. Mr Peretz asked whether there were any lessons from the auction experiment for conventional tenders, eg bid price allocation. Mr George said there were no direct lessons. The Bank did not have information on the extent to which GEMMs were bidding for stock which was then sold on to institutional investors at firm prices. Some institutions had said they did not use auctions because of the bid price allocation system. The bid price system could be extended to tenders, but the price might be the loss of bids from some institutions or smaller bidders. The advantage of tenders was that applicants obtained stock at the best price that

anyone paid. Another problem would be how to price taps if the tender was under-subscribed.

15. It was agreed that final decisions on auctions in 1988-89 had to await the overall assessment of funding strategy for 1988-89.

Cathy Ryding

CATHY RYDING

CIRCULATION: Those present
PPS
Sir P Middleton
Sir T Burns
Sir G Littler
Prof. Griffiths - No 10

91G.SCB.221.6

CONFIDENTIAL

FROM: MISS M O'MARA

DATE: 11 March 1988

ECONOMIC SECRETARY

cc Chancellor
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Peretz
Mr R I G Allen
Mr Grice
Mr Rich
Mrs Ryding
Miss Anderson
Mr Cropper
Mr Patterson - DNS

NATIONAL SAVINGS: POST-BUDGET PACKAGE

As you know, we are preparing papers on the next financial year's funding strategy for submission once the Budget and next year's PSBR have been announced. They will be discussed at the March funding meeting. However, as we noted at last month's funding meeting, it is already clear that we shall not want to maintain inflows into National Savings at their current rate, and we therefore recommend removing as soon as possible after the Budget the competitive advantage National Savings gross products have enjoyed, particularly since building society rates were cut last December. Moving quickly after the Budget will make it easier to present the changes as a delayed response to the earlier fall in building society rates, putting them in the context of the 1988-89 PSBR.

Variable rates

2. DNS variable rate products are relatively liquid and hence in general offer poor quality funding. They are therefore the natural place to look for immediate reductions in rates in the light of next year's reduced funding needs.

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3. Income and Deposit Bonds both currently pay 10.5 per cent a year. We recommend a reduction of 1½ percentage points in both rates. They would then offer the basic rate taxpayer a return of 6.6 per cent at 1987-88 tax rates, within the range of returns available from banks' and building societies' retail accounts (see Table A below). Non-taxpayers, for whom the gross products are now primarily designed, would, of course, continue to receive a return well in excess of that available to them from banks or building societies, although without the option of instant access normally available from National Savings' competitors.

4. It has already been announced that CRT will fall from 24.75 per cent in 1987-88 to 23.25 per cent in 1988-89. If the basic rate were therefore to be reduced by more than 1½ percentage points in the Budget, National Savings would become that much more competitive, although depending on Budget decisions, the difference might not be very significant.

5. The Investment Account currently pays 10 per cent a year. We recommend this rate too should be cut by 1½ per cent. On 1987-88 tax rates, the return for the basic rate taxpayer would fall to 6.2 per cent, roughly equivalent to the average bank retail deposit rate, although below the building society average (see Table A). Again the return to non-taxpayers would remain substantially above what is available elsewhere.

6. Following these changes, and subject to the effect of any Budget measures, these variable rate products would be slightly less competitive than when we last altered rates on Income and Deposit Bonds on 23 May 1987:

	Gross* per cent	
	23 May 1987	**New rates**
Income Bond	10.5	9.0
Deposit Bond	10.5	9.0
Bank	9.2	8.4
Building Society	10.7	9.4

* with CRT of 25.25 per cent.

However, this would be quite consistent with the lower contribution to funding we shall be seeking from National Savings in 1988-89.

7. DNS would initially have preferred a more gradual approach, cutting the gross variable rates by not more than 1¼ per cent, and taking rather more off the Investment Account to reflect the penalties for repayment of the Income and Deposit Bonds in the first year and their long notice of withdrawal. But they accept the case for relating the reductions to movements in market rates and the need to reduce inflows to the Income Bond and the Investment Account and they accept the 1½ per cent proposal.

8. For the rest of 1988-89, we shall probably want to keep the rates on National Savings gross variable products in line with the market, so we would want to consider further changes quickly, if market rates were to move after the Budget. This will be one of the issues addressed in the funding strategy review.

General Extension Rate

9. We have announced a ¾ per cent cut in the variable tax-free GER from 1 March. We envisage this as one of a continuing series of reductions but do not propose a further move at this stage.

Certificates

10. Certificates offer us good quality funding and given their short life, are attractive to us on cost grounds too, for the same reason that we prefer 5 year to 20 year gilts. The 7.0 per cent tax-free offered by the 33rd issue over its full term is currently in line with the net return on a conventional 5-year gilt. (Indeed, we might compare it even more favourably with the cost of issuing longer-term gilts, since we have not been able to sell as many shorts over the last year as we should have wished.) Any Budget cuts in personal tax rates would shift the balance marginally in favour of certificates, reducing their all-in cost to the Government, compared with gilts. The current index-linked certificate is probably more expensive than a

conventional certificate, but is still cheaper than longer term borrowing. We therefore recommend no immediate change in certificate rates. We shall need to review this if yields move after the Budget.

11. DNS would like to issue a new fixed interest and index-linked certificate, both offering a return ¼ percentage point below that currently available. As noted above, we see no argument for any immediate reduction in rates on certificates. They are already a relatively cheap form of funding. Moreover, the effect of issuing new certificates, even with lower interest rates, might actually be to produce an initial surge of rather more expensive funding - they would be particularly attractive to higher rate taxpayers, many of whom will currently be constrained by the £1,000 limit on the 33rd issue and the £5,000 limit on the 4th index-linked issue. We see no case for giving this group an unwarranted subsidy when our funding requirement is likely to be so low.

Yearly Plan

12. This is a variant of the fixed-interest certificate under which the investor makes regular monthly payments. It currently offers the same 7 per cent return and we do not recommend any change. Investment in Yearly Plan is limited to £2,400 a year, the current ceiling for PEPs. However, even if there were an increase in the PEP ceiling, we would not propose a similar increase for Yearly Plan, although some parallel was originally drawn between the two.

Premium Bonds

13. Although we do not propose a reduction in the return on certificates, we do see this package of interest rate moves as an opportunity to reduce the Premium Bond prize fund rate, currently 7 per cent of eligible bonds. Premium Bonds are very expensive to administer (management costs were 1.1 per cent of funds invested in 1986-87), so that on these grounds we might look to see the

prize fund 1 per cent below the interest rate payable on certificates. However, in practice we can only reduce the rate by ½ percentage point without changing the prize structure and this is what we recommend as an initial step, with perhaps a further ½ percentage point later in the year.

Other rates

14. We do not propose changes in any other rates at this stage.

Timing and presentation

15. We recommend that changes in National Savings rates should be announced as soon as possible after the Budget, on Thursday 17 March. (The reduction in the rate on the Investment Account would come into force 2 weeks later; that on Income and Deposit Bonds would take 6 weeks and that for Premium Bonds 3 months.) This would enable the changes to be viewed in the context of 1988-89's negative PSBR. We would make it clear in briefing that the cuts reflected the falls in market rates which took place last December and were simply designed to remove the competitive advantage National Savings have since enjoyed. Mr Patterson attaches importance to an early announcement for these reasons. You could make some reference to the reductions in your wind-up speech in the Budget Debate on the evening of 17 March, if you wished, although we recommend the actual announcement should be made earlier in the day.

Proposals

16.

per cent

	Current rate	Proposed rate
Income Bonds	10.5	9
Deposit Bonds	10.5	9
Investment Account	10.0	8.5
Premium Bonds	7.0	6.5

17. We should be grateful to have your reaction to this package.

MOM

MISS M O'MARA

CONFIDENTIAL

TABLE A : NATIONAL SAVINGS INSTRUMENTS : VARIABLE RATE PRODUCTS.

Compound Return	Per cent		
	Tax Rate (%)		
	0	27	60
Income Bond (1)	11.0	8.0	4.4
Deposit Bond	10.5	7.7	4.2
Investment Account (2)	10.0	7.3	4.0
Premium Bond	7.0	7.0	7.0
Savings Certificate on GER terms	5.8	5.8	5.8
12 Month Cost of Government Borrowing (2)	9.0	6.6	3.6
CTDs	8.3	6.1	3.3
Bank Retail Deposit Rate (3)	6.3	6.3	3.5
Building Society Retail Deposit Rate (3)	7.0	7.0	3.8

(1) Assuming interest reinvested in Investment Account.

(2) Yield on a basket of gilts with maturities clustered around one year.

(3) Average of rates applying to the top bands of selected high interest accounts at 7 March 1988.

53/2/LPD/3757/064

CONFIDENTIAL

FROM: P D P BARNES
DATE: 14 March 1988

MISS O'MARA

cc PS/Chancellor
PS/Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Peretz
Mr R I G Allen
Mr Grice
Mr Rich
Mrs Ryding
Miss Anderson
Mr Cropper

Mr Patterson - DNS

NATIONAL SAVINGS : POST BUDGET PACKAGE

The Economic Secretary was grateful for your submission of 11 March.

2. The Economic Secretary agrees with the proposals in paragraph 16 of your submission.

3. The Economic Secretary is at the moment disinclined to include anything on National Savings in his wind-up speech, but he would be grateful for a line to take on these proposals in case they are raised.

PB

P D P BARNES
Private Secretary

pmp

CONFIDENTIAL

FROM: IAN RICH

DATE: 16 MARCH 1988

1. ~~MISS O'MARA~~ agreed in draft

2. ECONOMIC SECRETARY

cc PS Chancellor
PS Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Peretz
Mr R I G Allen
Mr Grice
Mrs Ryding
Miss Anderson
Mr Cropper

Mr Patterson - DNS} By
Mr Ward - DNS}Fax

NATIONAL SAVINGS PACKAGE

Mr Barnes' minute of 14 March asked for a line to take in your wind-up speech in the Budget debate on Thursday 17 March, if the reductions in national savings interest rates (which DNS plan to announce that day) are raised.

2. To summarise, the reductions are not across the whole national savings range. The products affected are Income and Deposit Bonds (reduced by 1.5% a year to 9% a year); Investment Account (reduced by 1.5% a year to 8.5% a year) and Premium Bonds (prize fund to be calculated as 6.5% instead of 7% of eligible bonds).

3. We suggest the following:-

(a) **Why the reductions?** They reflect the fall in market rates last December, and remove the competitive advantage National Savings have since enjoyed. Given the Government's budget surplus forecast for 1988-89, this is a sensible move.

(b) **Role of DNS in balanced budget climate?**
There will be a continuing need to sell Government securities, for example to refinance part of maturing stocks or withdrawals. DNS have an important contribution to make in the debt management field.

Ian Rich

IAN RICH

53/2/LPD/3759/032

cc Chancellor
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Peretz
Mr RIG Allen
Mr Grice
Miss O'Mara
Mr Rich
Mrs Ryding
Miss Anderson
Mr Cropper
Mr Bush
Mr Patterson-DNS
Mr Ward -DNS

CONFIDENTIAL

Treasury Chambers, Parliament Street SW1P 3AG

Paul Gray Esq
10 Downing Street
LONDON
SW1

17 March 1988

Dear Paul,

NATIONAL SAVINGS : REDUCTION IN INTEREST RATES

This is to let you know that we have decided to make the following reductions in National Savings interest rates which will be announced at 5.30pm today:-

(a) Investment Account - reduced by 1.5% a year to 8.5% from 31 March. It is usual to give 2 weeks' notice of changes in Investment Account rates.

(b) Income and Deposit Bonds - reduced by 1.5% a year to 9.0% a year from 1 May. The prospectus for each requires us to give 6 weeks' notice of changes in interest rates.

(c) Premium Bonds - the rate of interest used to calculate the prize fund is to be reduced from 7.0% a year to 6.5% a year from 1 July. This will not result in fewer prizes.

These changes bring the rates offered to personal savers by National Savings into line with those offered by banks and building societies. These decisions were made in advance of today's reduction in base rates, but are not affected by that reduction.

Yours sincerely,

Peter Barnes

P D P BARNES
Private Secretary

53/2/LPD/3762/004

CONFIDENTIAL

FROM: G R WESTHEAD
DATE: 12 April 1988

MR RICH

cc PS/Chancellor
PS/Sir P Middleton
Sir G Littler
Mr Scholar
Mr Peretz
Mr Grice
Miss O'Mara
Mr Bush
Miss Anderson
Mr Cropper

Mr Patterson - DNS
Mr Ward - DNS

NATIONAL SAVINGS : GENERAL EXTENSION RATE (GER)

The Economic Secretary has seen and was grateful for your minute of 8 April. He agrees that the GER should be cut by ¾ per cent from 5.76 per cent to 5.01 per cent on 1 May and that the announcement should be made at noon tomorrow.

2. The Economic Secretary had no comments on the draft press release or Private Secretary letter to No.10, the latter of which will be sent today.

Guy Westhead

GUY WESTHEAD
Assistant Private Secretary

53/2/LPD/3762/005

Treasury Chambers Parliament Street SW1P 3AG

Paul Gray Esq
10 Downing Street
LONDON
SW1

12 April 1988

Dear Paul,

NATIONAL SAVINGS : GENERAL EXTENSION RATE

This is to let you know that it has been decided to reduce this interest rate, which is paid to holders of matured savings certificates, from 5.76% to 5.01% from 1 May. The Department for National Savings will be announcing this reduction at noon on Wednesday 13 April.

Matured certificates earning the GER can be repaid at about 8 days' notice. Unlike unmatured certificates, there is no disincentive to early repayment through a raked interest rate structure. In the light of this, and our much lower borrowing needs, we aim to reduce the total GER stock (at present about £7.3 billion) by some £2-3 billion by the end of 1988-89. We are therefore making a series of reductions in GER, to encourage repayments and to divert some of these into the current issue certificate which offers a guaranteed tax free return if held to maturity (5 years).

The last reduction in this rate was from 6.51% to 5.76% on 1 March 1988. We expect further reductions over the year will be necessary to bring our aim for the GER stock within reach.

Yours sincerely,

Guy Westhead.

G R WESTHEAD
Assistant Private Secretary

I understand from MG that there are earlier [illegible] *

5 DARNAWAY STREET EDINBURGH EH3 6DW TELEPHONE 031-225 9677 TELEX 727321 NOBLE G FAX 031-225 5479

*(briefings for [illegible] mtg with these guys) [illegible] from PS/EST [illegible]

ECONOMIC SECRETARY 9/5
REC'D 05 MAY 1988
ACTION Mr Peretz
COPIES TO PS/Chancellor, Miss O'Mara, Mr Ilett, Miss Noble, Mr Gilm, Mr Cropper

MPW

MC/VB

4 May 1988

Peter Lilley Esq
Economic Secretary to the Treasury
H M Treasury
Parliament Street
London SW1P 3AG

Dear Mr Lilley

You may have seen the attached press cuttings in the newspapers during the last week. Our Steering Committee, consisting of Professor Robert Jack, Professor Donald MacKay, Graeme MacLennan, Charles Fraser and myself, has been discussing the role of National Savings for several months now. Our attention has centred on the development of the National Savings Bank but we believe that our ideas are applicable to the whole of the National Savings movement.

We have carried out a detailed review of the accounts and promotional literature of National Savings, spoken to several interested parties, including the Secretary of State for Scotland, and discussed the matter at length amongst ourselves. It is unfortunate that our work has been leaked to the press at such an early stage, but we would like to make you aware of our preliminary thoughts on the potential of National Savings and why we think the government should consider privatising it.

<u>Background</u>

To date, National Savings have been a vehicle for individuals to lend money to the government to help fund part of the Public Sector Borrowing Requirement (PSBR). Given the government's Medium Term Financial Strategy (MTFS) this historical role is becoming less important, although there is an on-going need to rollover and refinance the existing national debt.

National Savings also has strong links with the Post Office, given that its business is transacted largely over the Post Office counter. It is our understanding that the government intends to privatise certain services provided by the Post Office (i.e. the Girobank and counter services) and this will also affect the future of National Savings.

The government's MTFS and its plans to privatise part of the Post Office create both a treat and an opportunity for National Savings. National Savings employs almost 8,000 people at Glasgow, Durham and Lytham St Anne's. This represents a major resource in terms of administrative skills and information processing. The potential for the development and exploitation of these skills and capabilities outwith the public sector appears very substantial.

We appreciate that any changes in the role and functions in National Savings as presently constituted may face considerable administrative and legal difficulties, given its existing links with Treasury and the Post Office and the tax concessions available to individual investors. Nonetheless, in the context of the government's own plans for privatisation, the rapid development of the financial services sector and the scale of National Savings, it is important to consider whether there are new market opportunities which would increase the range and scale of its services and so provide for a more effective exploitation of the potential of the operation.

These new market opportunities fall into two categories: extended agency arrangements for the government and non-government related development. We consider the available option more fully below:

Agency

The Steering Committee have particularly focused on the possibility that National Savings could act as an Agent for the Government in certain areas, which if profitable would enhance the realisable value of the bank and also meet what is believed to be a perceived public need. The principal tasks which have been identified so far include:

- Contining its present activities as a conduit for public savings to refinance National Debt, by selling savings products, and collecting deposits from savers through the existing National Savings mechanisms whilst receiving an agency fee for this.

- Administering a student loan scheme: The banks existing clerical and administrative resources would it is believed be able to administrate for a fee a student loan scheme which could be regarded as a form of saving scheme, using state funds provided by the government for this purpose.

- Administering a small Business Enterprise Scheme: In order to implement official policies aimed at encouraging small businesses, National Savings Bank could administrate government loans designed to assist the existing Local Enterprise Boards. It is presumed that funds would be made available by the government at low rates of interest, and an administration fee would be paid to National Savings on commercial terms.

These and other Agency functions could be a permanent feature of the bank, or could be awarded on a five year contract basis. Such contracts would be expected to be on normal commercial terms and this would enhance the capital value of the National Savings organisation in the event of privatision.

New Market Opportunities

If new market opportunities were considered outwith these "Agency" functions then a major restructuring of the National Savings' resources base would seem to be required. Even if National Savings offered only "back office" functions to private sector organisations, major changes in management structure and controls would appear necessary.

There is a wide range of possibilities which might be open to the National Savings Organisation but the Steering Committee believe that particular emphasis should be placed on market opportunities where the organisation has some competitive advantage, rather than considering proposals which resulted in the National Savings duplicating functions already well provided for by existing institutions. The Steering Committee's preliminary ideas here include:

- Adding ordinary banking and lending functions through National Savings Bank, though this will call for new management skills to be introduced.

- Grafting on other savings techniques such as life insurance products, using existing administrative and hardware skills.

- Adding other savings accounts for investment in non-government instruments including commercial bonds. This would of course necessitate the creation of an equity capital base.

- Developing new savings products for investment in equities, through creating and offering unit trusts to its existing customer base. This would help to widen share ownership in line with government policies. It would also serve to channel public savings in a new direction, but one of growing importance. The government no longer requires borrowings to fund annual deficits, but it needs savings with which to fund privatisation on a larger scale than previously because of its substantial programme of state divestment for the coming years. National Savings with its strong customer base could tackle this function with benefits to future government privatisation issues.

- National Savings could therefore become a Unit Trust Manager, engaged in the organisation and distribution of unit trusts for which its hardware and software resources as well as its existing clerical staff would be very relevant. For this purpose investment management functions could be contracted out to one or a number of independent organisations on an arms length contractual basis.

- In due course investment management skills could also be added to the existing deposit management operations, which the existing hardware may be capable of handling.

- It may be that an extended National Savings Organsation would seek other commercial outlets in addition to Post Office counters.

The Case for Privatising National Savings

It appeared that there were a number of arguments for privatising National Savings as follows:-

- The essential need for funding large government deficits has disappeared, at least for the time being, and therefore the necessity for the organisation has diminished.

- As a result at least some of its 8000 jobs might be in jeopardy. They are almost all located in areas of relatively high unemployment and so there is an important social and regional argument for securing an expanding rather than a contracting role for National Savings.

- It is understood that consideration is being given to privatising some Post Office services including certain counter services which are National Savings main marketing outlets. This has implications for National Savings.

- It would be possible to reduce by some 8000 the number of employees in the public sector by privatising National Savings.

- To ensure a continuing and even growing function for the organisation, new products and commercial activities are needed. These could more easily be introduced and developed under professional commercial management in the private sector.

- The operation should be profitable and in view of the large sums of money involved the business could be sold for a major sum. Since the value of National Savings would be linked to that of its deposits and investments rather than to tangible assets its disposal would enable the State to realise a significant price which would in effect be "good will".

The committee would be very pleased to meet you to discuss this subject at a mutually suitable date possibly towards the end of May, ideally in Edinburgh which would suit us all, or alternatively in London if that would be more convenient for yourself.

We are sending a copy of this to Malcolm Rifkind for information and to Peter Cropper in the Chancellor's office and look forward greatly to hearing from you.

Yours sincerely

Iain Noble

Sir Iain Noble

Scots businessmen plan bank shake-up

by Gerry Malone
Glasgow

Sunday Times
24/4/88
(Page 2)

A GROUP of leading Scottish businessmen are to launch a plan to privatise the £36 billion National Savings Bank, known as the sleeping giant of British banking.

The proposal has been discussed with Malcolm Rifkind, the Scottish secretary of state, who has encouraged the businessmen to develop their plans.

The National Savings Bank which has offices in Durham, Lytham St Annes and Glasgow, sells investment schemes ranging from savings certificates to premium bonds. It also runs a banking operation with 19m customers and investments of £36 billion. Although commonly thought of as a bank, it is in fact a department of government for which the Treasury has responsibility.

The businessmen say the bank, set up to assist the government fund public sector borrowing, needs a new role if it is to survive now that it is no longer needed to perform its original function. The government's policy of containing the public sector borrowing requirement has called the bank's role into question. It is feared that unless immediate steps are taken to revitalise the bank and exploit its potential, the jobs of its 8,000 employees, including 3,000 at Cowglen in Glasgow, could be at risk.

The group includes Sir Ian Noble, a leading figure on the Edinburgh merchant banking scene, Graeme MacLennan, managing director of Edinburgh Fund Managers, and Professor Donald Mackay, of Planning Industrial Economic Development Advisers.

Rifkind: encouragement

A Treasury spokesman confirmed yesterday that it had "heard that leading Scottish financial figures were intending to make this proposal". An influential London banker added: "They are a very strong group and would obviously know what they are doing."

MacLennan, who brought the group together last July, describes the bank as a sleeping giant with enormous potential. The group is preparing a paper to the Treasury that will set out its ideas in detail.

MacLennan and other group members say their first objective is to open public debate on the whole future of the national savings movement. They reject any suggestion that they have prepared a detailed blueprint to bid for the bank.

The group has identified a number of areas in which the potential of the savings bank could be developed. The range of savings products is seen as dowdy and inflexible compared with those which are found in the private banking sector.

Mackay also sees an important future role for the bank in acting as a government agent to help implement such policies as student loans schemes. He claims that these services will be needed increasingly by the government and could be provided more efficiently by a privatised concern which would work for the government on a fee basis.

Scots look at bank's future

By ARTHUR MACDONALD

Scotsman
25/4/88.
(Page 1)

A GROUP of Scottish businessmen, headed by Mr Graeme MacLennan, the joint managing director of Edinburgh Fund Managers, is looking into the possibility of privatising the National Savings Bank and extending the range of services it provides.

The group includes the merchant banker, Sir Ian Noble, the corporate lawyer, Mr Charles Fraser, Professor Jack of Strathclyde University and Professor Donald Mackay of Pieda, the consultancy group.

The bank has seen its traditional role decline as the Government has reduced public sector borrowing. Since last summer, the Scottish group has been looking at possible new roles for the bank, which is a department of Government under the control of the Treasury. The group has had a private meeting with the Scottish Secretary, Mr Malcolm Rifkind, who expressed support for its ideas.

Prof Mackay said: "It is early days yet and we need a wider discussion but clearly its traditional role is going to diminish. We have been looking at areas not covered by commercial organisations. If it was privatised it could move into new areas with new management."

He described the NSB as a vast paper processor with good computer power and suggested there were a number of areas these facilities could be put to good use.

The Government is considering providing top-up loans to student grants, and Prof Mackay sees the NSB as well suited to disburse, administer and track these loans, which would be funded by the Government.

The NSB employs about 8,000 people at its headquarters at Lytham St Annes, Durham and Cowglen in Glasgow where 3,000 people work.

3632/6

FROM: P J CROPPER
DATE: 5 May 1988

ECONOMIC SECRETARY

NATIONAL SAVINGS

You are receiving a letter from Sir Iain Noble about development of the National Savings movement. Quite accidentally, I know something about this.

2. One of Sir Iain Noble's working party is Graeme MacLennan, Managing Director of Edinburgh Fund Managers; he was one of the lunch guests at Adam & Co, in Charlotte Square, when I went up with John Major on 11 April. At lunch, MacLennan enrolled my interest in their proposals.

3. I think this has to be seen as a constructive effort on the part of a group of Scottish businessmen to try and protect several thousand jobs in areas of high unemployment such as Glasgow and Durham. I have said to them that I think their proposals - in any other context - might read a little like officiously struggling to keep the National Savings Movement alive. Things such as adding "ordinary banking and lending functions" to the National Savings Bank, and grafting on life insurance products. They did not demur from this assessment, and agreed with me that the essential point of their campaign is (and should be seen as) the job saving/job improvement one.

4. Professor Donald MacKay is known to the Chancellor, who agrees with me that he is "a good egg". Graeme MacLennan is a strong personality. The Chairman of Edinburgh Fund Managers is, of course, Angus Grossart.

5. I seem accidentally to have struck up a good relationship: they are pressing me to go up to Edinburgh to talk about it. I told them I thought it unlikely that, with the Finance Bill on your plate, you would want to go up there in the immediate future. They are quite happy to come down to see you here.

6. I have given them no suggestion of how I think Ministers would see this - partly because I don't know! But it does look as if Malcolm Rifkind has encouraged them.

P J CROPPER

91G/SCB/4318/52

CONFIDENTIAL

* This is of influence to Bldg Socs. It cannot start to make their move (unless bldg socs move first) until they have. N.

FROM: IAN RICH

DATE: 6 May 1988

1. ~~MISS~~ O'MARA

2. ECONOMIC SECRETARY

We have considered, and discussed with the Bank, whether the reductions in National Savings rates proposed below might encourage the building societies to make a further, unwelcome, cut in their own rates. On balance, we think this unlikely, provided the National Savings changes are presented as recommended below as a response to earlier falls in bank and building society rates and to the Government's low funding needs in 1988-89

Mary 6/5

cc: Chancellor
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Peretz
Mr Grice
Mr Bush
Miss Anderson
Mr Cropper

Mr Patterson (DNS)
Mr Ward (DNS)

NATIONAL SAVINGS INTEREST RATES

Background

1. At the funding meeting on 27 April, it was agreed we should give early consideration to making further reductions in some national savings interest rates. Despite the reduction of 1½% in the rates payable on National Savings gross products announced immediately after the Budget (but which for Income and Deposit Bonds only came into effect on 1 May), inflows remain uncomfortably high. Recent reductions in retail deposit rates paid by the banks and building societies are now giving National Savings gross products a competitive advantage. In line with the strategy agreed for national savings funding in 1988-89, we recommend removing this advantage as soon as possible. This submission has been agreed with the DNS.

CONFIDENTIAL

2. Current rates on National Savings gross products, and the premium bond prize fund, are as follows:

Income/Deposit Bonds	-	9% gross (from 1 May)
Investment Account	-	8½% gross (from 31 March)
Premium Bond Prize Fund	-	7% (but we announced on 17 March a reduction to 6½% from 1 August)

A reduction of 1½% in all gross product rates was announced on 17 March, to bring them broadly in line with the deposit rates then being paid by banks and building societies.

3. In much the same period, there have been two separately presented reductions of ¾% each in the tax free General Extension Rate (GER) paid on matured savings certificates - from 6.51% to 5.76% on 1 March, and from 5.76% to 5.01% on 1 May.

Present Position

4. Since the Budget, there have been two reductions in the banks' base rate, which now stands at 8%. These cuts have now been reflected in bank retail deposit rates, which have moved down by ¼%, and now typically stand at 5.6%. Building societies have been slower to react, but some major societies have just announced reductions of ½% net in most of their retail deposit rates from 1 May. Representative reductions announced so far are from 7% to 6.5% for premium high interest accounts at 3 months' notice. Others are set to follow. A table giving more detailed comparisons between National Savings and competing interest rates is at Annex A.

The Gross Products

5. These bank and building society moves restore something of the competitive advantage enjoyed by National Savings gross products, which the post-Budget reductions were designed to remove.

Moreover in practice, inflows into the gross products have remained high. There has been no tail off in Income Bond sales, which have remained at £50-55 million a week since January. Neither has there been reduction of inflow into the Investment Account. The strong implication is that if National Savings gross product rates remain unchanged, there will be even higher inflows into these relatively liquid forms of funding.

6. We therefore see a strong case for a further reduction in the interest rates paid on the gross products, which we would present as a response to the recent market moves. We therefore recommend:

(a) Reductions of ¾% gross (from 9% to 8¼%) in the Income and Deposit Bond rates.

(b) Reduction of 1% gross (from 8½% to 7½%) in the Investment Account rate.

Under these proposals, the return paid to basic rate taxpayers would be 5.6% (Investment Account) and 6.2% (Income and Deposit Bonds), against 6.5% from broadly comparable building society investments. The products will remain attractive to non-taxpayers, even if a little below the return which taxpayers might expect from a building society.

7. You will see also that we propose widening the existing ½% differential in the Investment Account rate, reflecting its higher liquidity.

8. If you agree with these recommendations, DNS propose to announce them at noon on Wednesday 11 May. We are obliged by the prospectus to give 6 weeks' notice of changes in Income and Deposit Bond rates, so the effective date would be 23 June. DNS customarily gives 2 weeks' notice of changes in the Investment Account rate, so the effective date here would be 24 May.

General Extension Rate (GER)

9. We think it better on balance not to make a further immediate reduction in the GER this time round. DNS report that the reductions already made this year have stimulated a marked demand both for repayment and reinvestment. They would like a little time to assess this (the most recent reduction only took effect on 1 May), but agree that the reductions in bank and building society deposit rates may require a further GER reduction in the near future. Treasury officials favour taking stock of the position in early June, with a view to a further reduction in GER from 1 July.

Savings Certificates

10. Present cost of funding calculations suggest that fixed interest national savings certificates look marginally expensive against short gilts, though they remain cheaper - and therefore very attractive on cost grounds - than medium or long gilts.

11. However, although sales of fixed interest and index linked certificates have picked up somewhat both from new money and as a result of re-investments following the GER cuts, they remain modest. They are more than offset by repayments, mainly stimulated by the GER cuts, so there is a continuing net outflow. Overall, it is in our interest to encourage new money into certificates, since it is good quality funding.

12. The introduction of a new fixed interest certificate, even with a lower return, would encourage some inflows from maximum holders of the current issue. However, there is no immediate need for such a boost in funding. Moreover, we are working up proposals for a Growth Bond, which would provide funding of equivalent quality to that of savings certificates but without the attendant tax disadvantages. We therefore see no immediate need to introduce another fixed interest certificate. We should however keep the position under constant review, so that we are ready to move whenever it seems necessary.

13. In the case of index-linked certificates, we need to decide and announce within the next 2 months the size of the supplement to be paid in August 1989 to holders of the first two issues. That will provide a suitable opportunity for a more general review of the way ahead on index-linked certificates.

Summary of Recommendations

14. We recommend:

(a) Reductions in the gross product rates of ¾% (Income and Deposit Bonds) and 1% (Investment Account) to be announced by DNS Press Notice (draft attached at Annex B) on Wednesday 11 May.

(b) Separate consideration in early June of further reduction in GER from 1 July.

(c) No immediate change in terms of fixed interest or index linked savings certificates.

15. We seek your agreement to these recommendations, and the timing and terms of the draft DNS Press Notice. If you are content, we will prepare and submit draft Q and A briefing and a draft letter informing No 10.

Ian Rich

IAN RICH

ANNEX A

TABLE 4B : NATIONAL SAVINGS INSTRUMENTS : VARIABLE RATE PRODUCTS.

Compound Return	Per cent Tax Rate (%) 0	 25	 40	Administrative costs
Income Bond (1)	9.5	7.1	5.7	0.2
Deposit Bond	9.0	6.8	5.4	0.3
Investment Account	8.5	6.4	5.1	0.4
Premium Bond	6.5	6.5	6.5	1.1
Savings Certificate on GER terms	5.0	5.0	5.0	0.2
12 Month Cost of Government Borrowing (2)	8.8	6.6	5.3	-
CTDs	7.5	5.6	4.5	-
Bank Retail Deposit Rate (3)	5.6	5.6	3.0	N/A
Building Society Retail Deposit Rate (3)	6.7	6.7	3.6	N/A

(1) Assuming interest reinvested in Investment Account.

(2) Yield on a basket of gilts with maturities clustered around one year.

(3) Average of rates applying to the top bands of selected high interest accounts at 4 May 1988.

(4) The Premium Bond rate will be lowered on 1 July 1988.

ANNEX B

DRAFT

CONFIDENTIAL

NEW RATES

National Savings announce that some of their rates will go down, as follows:

National Savings Investment Account from 8.5% p.a. to 7.5% p.a. from 24 May 1988.

National Savings Income Bonds and National Savings Deposit Bonds from 9% p.a. to 8.25% p.a. from 23 June 1988.

Note to Editors

No tax is deducted at source from the interest on Investment Accounts, Income Bonds and Deposit Bonds. Taxpayers pay the tax when it is due.

psl/47A

CONFIDENTIAL

py

FROM: A C S ALLAN

DATE: 9 May 1988

PS/ECONOMIC SECRETARY

cc Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Peretz
Mr Grice
Miss O'Mara
Mr Bush
Mr Rich
Miss Anderson
Mr Cropper
Mr Pattison - DNS
Mr Ward - DNS

NATIONAL SAVINGS INTEREST RATES

The Chancellor has seen Mr Rich's submission of 6 May. He feels that the recommended reductions in National Savings interest rates are bound to influence the building societies, and he feels it cannot make sense to make them unless and until the building societies have moved first.

ACSA

A C S ALLAN

53/2/MAD/3766/57

CONFIDENTIAL

pw

FROM: P D P BARNES
DATE: 11 May 1988

ECONOMIC SECRETARY TO THE TREASURY

PS/CHANCELLOR

[Peter wants to raise this]

cc: Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Peretz
Mr Grice
Miss O'Mara
Mr Bush
Mr Rich
Miss Anderson
Mr Cropper
Mr Patterson, DNS
Mr Ward, DNS

NATIONAL SAVINGS INTEREST RATES

The Economic Secretary has seen your minute to me of 9 May, and Mr Rich's submission of 6 May.

2. The Economic Secretary fully understands the Chancellor's view on this subject. However, he thinks it would be sensible to reconsider this question if the building societies make no move in the next couple of weeks, particularly if it looks as if large and expensive inflows into liquid National Savings products are continuing. He is also conscious that the further removed we are in time from the falls that have already occured in banks and building society rates, the more difficult it will be to present a move as a reaction to them.

PB

P D P BARNES
Private Secretary

3632/13

Pse ask EST to look @ this, along with the Scottish proposal.

FROM: P J CROPPER
DATE: 11 May 1988

CHANCELLOR

MR GILMOUR'S PROPOSITION

I attach the promised paper from Sandy Gilmour. Will you be asking for it to be looked at? Economic Secretary?

2. They say that they have considered the option of proceeding without Treasury approval, but that they would prefer to do it with Treasury approval. I did make the point that Treasury approval would be essential if Post Offices were going to be required to accept books of (privately produced) 'Ernie Stamps' as payment for Premium Bonds, rather than cash.

3. Obviously, their ambitions go beyond the 'Ernie Stamp' alone, but the later proposition seems to me fairly harmless. Even if we do not actually have a pressing PSBR, we would not want to stand in their way?

P J CROPPER

Ch
Peter tells me he knows of no links between Gilmour's group & Noble's (paper below)

THE PROPOSAL

is to launch a savings stamp, to be called the

'ERNIE STAMP'

which will be

* collected by the public into savings books

* redeemed at Post Offices and sub Post Offices or direct from the Promoters

  - for Premium Bonds

* used by organisations as a means of promotion:

  - as a traditional trading stamp by retailers and service organisations

  - as a give-away with their products by manufacturers.

The Stamp could also be sold directly to the public.

BENEFITS

We believe such a stamp

* represents, for companies, a coming together of commercial and the National interests in a manner particularly in tune with the changed spirit of today's Britain

* allows savers - as was the original philosophy behind Premium Bonds themselves - a means of serving both their self interest and the public interest

* giving them a risk free and socially acceptable gamble - and one which is preferable to imported ideas like lotteries

* would significantly increase sales of Premium Bonds, both directly via the stamp and indirectly, by the heightened promotion and awareness encouraging normal sales.

OTHER ADVANTAGES

* Ernie Savings Stamps would not need the costly merchandise and catalogue operations of traditional trading stamps and would therefore be able to give better value to both savers and promoting companies.

* Expenditure on the stamp by the latter would also represent a direct transfer of some part of today's vast promotional budgets, without loss of commercial efficiency, into National Savings.

* There would be a favourable influence on the level of personal savings, of which the current decline is causing concern.

* Valuable business would be put the way of the Post Office and, of even greater interest, of sub post offices.

* The Excise would obtain additional VAT revenue.

BACKGROUND

The concept was first developed in the early 1970's. Following approval in principle from the Department for National Savings, the many administrative problems were solved, the Post Office and the Association of Sub Postmasters agreed their involvement and its terms, the Promoters obtained the interest of sufficient commercial organisations to ensure the project's financial viability and the necessary finance was raised. However the Treasury withheld final approval, probably, in the Promoters' view, because of opposition from some elements in the then National Savings Movement.

TODAY

The same Promoters believe that the changed spirit of the Britain of 1988 creates an environment in which the idea should flourish and more readily gain approval. They have carried out an initial feasibility study which confirms the continuing commercial viability of the Stamp. This study included canvassing the opinions of a number of prospective user companies. Also the recent, successful re-launch of Green Shield Stamps is an encouragement so far as that part of the Ernie Stamp proposed usage is concerned.

APPROVAL

Before they re-embark upon establishing the required operation and structures, the Promoters seek the policy approval of HM Treasury. It is accepted that this would be contingent upon their providing evidence of financial and operational feasibility. However they emphasise their confidence in providing such evidence once again.

It should be mentioned that they have considered the option of proceeding without such approval but believe that to do so would conflict with the essential spirit of the project as defined earlier, of something uniquely combining commercial and the National interests , and that the fullest realisation of its potential requires official agreement.

AN ULTIMATE CONSIDERATION

The concept as discussed stands perfectly by itself. However the Promoters have also considered with their merchant bankers, and would like to discuss with HM Treasury, the much larger question of their acquiring the Premium Bond operation, or even the whole of National Savings, whereupon Ernie Stamps would be seen as simply one, albeit important, element in a wide range of promotional options.

13 MAY 1988

OFFICE OF ARTS AND LIBRARIES
Horse Guards Road
London SW1P 3AL
Telephone 01-270 5929

From the Minister for the Arts

C88/2606

The Rt Hon Douglas Hurd CBE MP
Secretary of State for Home Affairs
50 Queen Anne's Gate
LONDON
SW1H 9AT

FINANCIAL SECRETARY
REC. 13 MAY 1988
ACTION Mr. Pecet 3
COPIES TO PPS, CST, PMG, EST
Sir. P. Middleton
Mr. Anson Mr. Culpin
Mrs. Case Mr. Turnbull.

12 May 1988

Dear Douglas,

LOTTERIES

Your letter of 22 December suggested that we should raise the monetary limits on lotteries rather than pursue the idea of a national lottery for the present. I have delayed responding in order to give further thought to this.

I very much welcome your suggestion that the monetary limits under existing legislation should be reviewed. From my point of view a move of this kind towards deregulating lotteries could be a very useful new opportunity for individual arts bodies and an important part of our overall strategy of unlocking major new sources of private funding, encouraged in the recent Budget. Experience of lotteries in other countries suggests however that a substantial increase in the ceiling is necessary to make it really effective. A five fold increase for instance would enable a weekly lottery to raise just over £4 million.

At the same time I do not think we should lose sight of the possibility of a national lottery. The recent announcement of an independent lottery intended to benefit the National Health Service suggests that the climate of opinion is shifting in favour. The opportunities for arts lotteries were noted at a recent conference of European Ministers of Culture and the idea clearly finds supporters there. We could be missing a substantial opportunity if we ignore the potential here.

cc:- Miss. Peirson
Mr. Kreppel
Mr. Tyrie
Mr. Call
PS/C+E

I conclude therefore that we should look again at the establishment of a national lottery in the longer term, building on the experience of countries like Finland, where the national lottery has a turnover of £140 million. Meanwhile we should press ahead with a revision of the existing monetary limits on lotteries. My own Office would be ready to help in any review of either the present legislative framework or possible longer term trends.

I am copying this letter to John Wakeham, Malcolm Rifkind, Peter Walker, Norman Lamont, Colin Moynihan and Tony Newton.

RICHARD LUCE

CONFIDENTIAL

Separate health lotteries?

CX Premium Bonds.

HOME SECRETARY

CHIEF SECRETARY

REC. 16 MAY 1988

QUEEN ANNE'S GATE LONDON SWIH 9AT

13 May 1988

Pup.

Mr Revolta Mr Saunders
CX Sir Peter Middleton
Mr Anson Mr H Phillips
Mrs Case Miss Peirson

Mr Turnbull Mr Griffiths
Mr Call

Dear Lord President

"NATIONAL" LOTTERIES

The announcement last month of a "National Health Service" Lottery, with benefits to be distributed by a National Hospital Trust headed by Sir Douglas Black (past president of the Royal College of Physicians) has attracted considerable publicity, most of it either favourable or at least "wait and see". The current law on lotteries (the Lotteries and Amusements Act 1976) envisages, and therefore provides in detail for the regulation of, single lotteries only with, among other controls, specific limits on turnover and prizes. To be lawful, a lottery must be registered with the appropriate authority. Where the maximum first prize does not exceed £2,000, the society promoting the lottery is to be registered with the local authority (registration where the first prize is higher, up to a maximum of £6,000, is with the Gaming Board for Great Britain).

The NHS Lottery advertises a first prize of £200,000. The promoters, Loto Ltd, claim that their scheme will keep within the law by being the function of 100 separate lotteries, each offering a maximum prize of £2,000. If the scheme succeeds, the policy reflected by the 1976 Act will effectively have been circumvented, and the pressure by other potential promoters, already evident, to follow suit would increase.

If, as seems possible, the scheme fails, the public perception may nonetheless be that the principle of "national" lotteries remains intact. In either event, we may come under pressure to amend the law. I thought, therefore, that you and colleagues would wish to have the best assessment of the NHS lottery which can at present be made and an outline of its possible wider implications.

Neither the National Hospital Trust nor Loto Ltd consulted my Department, the Gaming Board for Great Britain or, I understand, the DHSS, about the detail of their scheme in advance. My officials have, however, been approached for advice by the legal department of the Royal Borough of Kensington and Chelsea, to whom Loto Ltd have applied for registration of five societies initially, with an expressed intention to seek registration of one hundred in all. We have indicated to the

/Borough

The Rt Hon John Wakeham, MP

Borough officials that we share their view that registration should be given provided they are satisfied that each society is, indeed, a separate entity; and subject to satisfaction of the only other requirements of the law relating to the registration of societies (the only role which the Borough has at this stage), viz that the societies are established for a charitable purpose or purposes, and that the promoters have no conviction for lottery offences. We understand that the Council have called for further information from Loto Ltd and that a decision on registration will not be taken until the next scheduled meeting of the appropriate Committee, on 24 May. That is only one day before the date of 25 May on which the promoters have said they propose to hold the first draw, on television, of the lottery.

or other?

My Department (and the Board) are coming under some pressure to give a view on the lawfulness or otherwise of the scheme. This is difficult in the absence of full details. We had hoped to obtain these via Kensington and Chelsea, but the promoters have become coy about providing the Borough with information. I had intended that my officials should therefore make a low-key approach to Loto Ltd, to ask them for details of the scheme as a matter of interest for policy. But that tactic has now been compromised by the promoters' action in distributing the vouchers or tickets with which to enter the lotteries. Promotion of a lottery by an unregistered society is an offence under the 1976 Act, and the Gaming Board have argued strongly to me that they should refer the evidence of Loto Ltd's apparent offence to the Crown Prosecution Service. I have not thought it right to stand in their way, and it would be wrong for my officials to make an approach to the promoters which would cut across enquiries which the investigating authorities may make. Moreover, the action by the Gaming Board safeguards us from the prospect of allegations that the authorities ignored doubts about the lawfulness of the scheme.

Whilst the success or otherwise of the NHS lottery remains in doubt, I believe we should continue to take a holding line on questions about it and, if asked, say that we are considering its implications for our policy on "national" lotteries and that the legality of the particular Loto Ltd scheme is a matter for the prosecuting authorities.

The indications are that the policy on major lotteries will have to be reviewed in depth. Hitherto the arguments against them have held sway. Work last year by the Gaming Board underlined the problems that even lotteries on the scale contemplated by the 1976 Act can encounter, both in terms of incompetent management and susceptibility to fraud. (The regulatory machinery provided by the Act is unlikely to bear the weight of a scheme on the scale of the NHS lottery.) It has also seemed questionable whether one or more "national" lotteries would tap a new demand, or simply divert funds which now find their way to other forms of gaming, most obviously the football pools, which provided considerable funds, by duty, to

/the Exchequer

in the light of the NHS lottery. But it will be timely to have colleagues' views at this stage on the directions we might take. For my part, I will keep H Committee informed of any further, major developments on the NHS lottery which come to light.

I am copying this letter to the other members of H Committee, the Chief Whips in both Houses and to Sir Robin Butler.

Yours sincerely,

Approved by the Home Secretary
and signed in his absence.

the Exchequer and also make donations to sport. A compensating "tax" on lottery income provided for genuinely charitable purposes could be difficult to defend publicly. There could also be problems for smaller charities, which profit from the present law, but which would be ill-equipped to complete with large lotteries such as the better endowed-charities might offer. Before the announcement of the NHS lottery I had, therefore, as colleagues know, intended to see if we might proceed by raising the present monetary limits under the 1976 Act, which can be changed without fresh primary legislation. The aim would have been to test the view that lotteries with bigger prizes would tap a new demand.

That position may not now be tenable and, whilst it is premature to propose a change of policy at this immediate stage, I should find it helpful to have any preliminary views on the merits of a national lottery which you and colleagues may have.

There would, I believe, be broadly a choice of three positions for us to take. The first would be to confirm our current policy. That would entail legislating to end the NHS lottery if it does not collapse of its own accord.

The second option would be to contemplate schemes on the scale at which the NHS lottery promoters are aiming, but to amend the law to provide for their proper regulation. This would need primary legislation. I have already mentioned the likelihood that the current law may be inadequate to police the handling of the large sums which the promoters are soliciting. Equally doubtful is their intention to take 15% of the turnover in administration costs. That is the percentage provided under the 1976 Act, but it would be quite unwarranted for an exercise on the intended scale or for any properly-conceived national lottery if the law were to allow such. This second option would require expansion of regulatory resources, either at the Gaming Board or in local authorities or both.

The third option would be to introduce a state lottery, that is one promoted and run by the Government itself. That could ensure the financial probity of the operation. But it would be a major and controversial departure for us to stimulate a form of gambling; and the evidence from other countries is that state lotteries require intensive advertising and promotional activity to succeed and to be sustained. We could encounter stiff opposition to the enterprise from critics who have mustered against us on issues such as liquor licensing and Sunday trading. The Government would be setting itself up as a target to be shot at. It would require a bureaucracy, albeit self-financing, and it would fly in the face of our policies of privatisation and deregulation.

All these issues raise fairly major policy questions. Furthermore, there is at present no provision for a Bill on lotteries in the legislative programme. For that reason alone we must be wary of being rushed into any legislative commitment

/in the light

91G/SCB/4322/7

pps p1 (on BF (I think)

FROM: IAN RICH

DATE: 19 May 1988

MOM 19/5

1. MISS O'MARA

2. ECONOMIC SECRETARY

cc: PS/Chancellor — 12/2
Mr Peretz
Mr Ilett
Miss Noble
Mr Cropper

Mr Patterson (DNS)

ROLE OF NATIONAL SAVINGS: APPROACH FROM SCOTTISH BUSINESS GROUP

1. Sir Iain Noble wrote on behalf of this Group on 4 May. The Group would like to privatise the National Savings operation, which would then be run on an agency basis for the Government. The Group envisages the privatised agency would also undertake additional functions for the Government, such as administering student loans, and develop a wide range of banking, finance and investment services.

2. The Group have already explained their ideas to the Scottish Secretary, mainly in relation to the National Savings Bank at Glasgow. At his suggestion, they have now approached the Economic Secretary as Minister responsible for National Savings. Mr Cropper's minute of 5 May shows the essential point of their campaign to be job saving/job improvement.

3. The Group does not appear to have a very clear grasp of the current tasks of National Savings. Their reference to a national savings "movement" is many years out of date. The voluntary committee structure which supported national savings was disbanded in 1978. The Group's ideas are far from fully thought through in other ways - for example what is actually planned in the three DNS operating divisions; who would be the buyer; what existing legislation would need to be replaced, and what new legislation would be required.

4. The Group seem to believe that the Government will let the National Savings operation die if action of the kind they advocate is not taken. This is not so. Your reply to Mr Jack's PQ on 4 March made it plain that DNS have important continuing tasks, even though the Government's funding needs are lower than in the past.

5. We recommend a reply with a hint of discouragement. The attached draft offers alternatives, depending on how forthcoming you wish to be.

Ian Rich

IAN RICH

91G/SCB/4322/8

DRAFT LETTER TO:

Sir Iain Noble
5 Darnaway Street
EDINBURGH
EH1 6DW

Thank you for your letter of 3 May which I read with great interest.

At present the funding of the Government's borrowing, and the contribution to this from National Savings, is lower than in the past. But the Department for National Savings has important continuing work to do. As I told Michael Jack in the House on 4 March, the Department's tasks are to contribute towards both the funding of Government borrowing and the refinancing of maturing stock through sales of a range of products to personal investors, and to continue to offer customers who have invested in National Savings the best possible service within the resources available.

I know that you have already discussed your ideas with Malcolm Rifkind, and understand that you see them as a way of both saving and improving jobs in areas of high unemployment. So let me assure you at the outset that the Government has no intention of dismantling the National Savings operation. Nevertheless, if you still think it would be useful to discuss your proposals with me, I should be happy to see you.

I am afraid that I cannot fit a visit to Edinburgh into my diary for the time being, but if you feel a meeting would be worthwhile:

> Either [perhaps my office could contact yours next time I plan to travel north of the border.]
>
> Or [I should be happy to see you in London. Your office might like to contact mine on 01-270-5127 to arrange a suitable date.]

pmp

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

Noble

Sarah

pl dig out the papers on War Savings policy which were circulating amongst PEM / EST / + us before I left on hols. [Includes, I think note of a mtg at No 11?]

M.

~~BSO2 Ave~~
~~7.7 [gm~~
9.0 Inv
8½ Inv a/c

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

BF to M 19/8

9.6

JT

2 questions:

1) What will the difference between the yield for the non-taxpayer @ the present time from Nat Savings Investment Account, Nat Savings Income Bonds, & ~~[illegible]~~ placing money with a Bldg Society? (Incidentally, following minutes from both me & Perry, am I not owed a note reassessing Nat Savings policy?) (And when, incidentally, is it planned to introduce the new instrument?)

2) If base rates were to remain @ 11% for the rest of the yr, what wd be the avge level of base rates for 1988?

N.

3633/7

pup

CONFIDENTIAL

Re 2, I fear the problem goes a little deeper than you imply! I'd be grateful for CST's views.

FROM: P J CROPPER
DATE: 23 May 1988

CHANCELLOR

cc Sir T Burns
Mr Culpin
Mr Tyrie
Mr Call

TAXATION OF SAVINGS

Some reflections on this morning's meeting.

1. **Personal v Institutional Investment**. It depends on what one is trying to align the personal portfolio regime with. If one is trying to set up an alternative to pension funds, then I suppose the personal portfolio, having been ring-fenced, would want to be exempt from income tax and CGT. On the other hand, the capital invested in it would have, in some sense, to be alienated from the individual concerned. He could not just withdraw money from the portfolio when he felt like it - any more than he could from a pension fund.

If one were using the unit trust as a comparator, then CGT roll-over relief would be the prize.

As a hybrid, one could offer front-end tax relief plus CGT roll-over. In this case there would have to be an exit charge to CGT, unless the portfolio were held within the ring-fence until death.

2. **The Public Sector**. Tom Luce put up a good show, but we must not let the special problems of the public sector overwhelm us. The non-contributory parts of the public sector will always require special treatment because the employer is not a taxpayer. What we are seeing is an understandable reluctance on the part of the civil service for anything to happen which might remotely

illuminate the cost of their unique combination of final salary plus post-retirement indexation.

3. **Sir Terence Burns**. The real point is that home grown food is better for you than packaged stuff from the Co-op.

P J CROPPER

CONFIDENTIAL

V24/5

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

23 May 1988

Dear Philip,

"NATIONAL" LOTTERIES

The Prime Minister was grateful for a copy of the Home Secretary's letter to the Lord President of 13 May which you forwarded with your letter to Andy Bearpark of the same date.

The Prime Minister has noted that there are continuing legal uncertainties about the position of the National Hospital Trust Lottery. Pending the outcome of the current legal deliberations, she does not think further detailed work should be carried out on options for "official" national lotteries. She thinks that smaller lotteries at the local voluntary level, geared to specified projects, are likely to be a more appropriate and successful means of raising additional finance.

I am copying this letter to Alison Smith (Lord President's Office), Alex Allan (HM Treasury) and Geoffrey Podger (Department of Health and Social Security).

Yours sincerely,

Paul Gray

PAUL GRAY

Philip Mawer, Esq.
Home Office

CONFIDENTIAL

A

CONFIDENTIAL

BF 30/5

FROM: A C S ALLAN

DATE: 23 May 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Economic Secretary
Mr Call

NHS LOTTERIES AND PREMIUM BONDS

The Chancellor would be grateful for advice on the option of turning premium bonds over to the National Health Service, as an alternative idea to a national lottery for the NHS. Premium bonds would be renamed, relaunched and the (net) proceeds would be passed to the NHS. (It would be important to establish the public expenditure treatment of this scheme.) An idea on these lines was
... floated in "Today" last Friday (attached).

ACSA

A C S ALLAN

Friday May 20 1988

TODAY

£2 TO SEE YOUR GP

ERNIE health bonds could rescue cash crisis NHS

F

by PHILIP JOHNSTON
Political Correspondent

PATIENTS may soon have to pay £2 every time they see their doctor.

The charge would stop malingerers wasting GPs' time and raise £452 million a year, ministers believe.

A further £90 million could be raised by turning over the ERNIE premium bond lottery to the NHS.

The "health bonds" would be entered in the weekly computer draw which currently pays out £11 million in tax-free prizes every month.

The radical plans are being considered under Mrs Thatcher's crisis review of NHS funding.

The plan to charge for visits to GPs could cost an average family of four £34 a year. Ministers say the fee would drum home the importance of a doctor's time while not deterring genuine cases. GPs would be left free to concentrate their care on those who need it.

But the idea was attacked by doctors last night.

A spokesman for the British Medical Association said: "We would not like to see any development that would deter a patient from visiting a doctor. A charge, even a small one, could have this effect.

"This is an especially important point if preventive health work is to be extended which is a stated aim of the Government."

The Royal College of Nursing added: "Charging people at source to see a doctor could well put off the very people who need help most, like the very poor and the elderly. No patient must ever be in the position of having to consider money when he needs to use the service."

Lottery

A series of cash-raising options are being considered to cope with a health budget which is expected to rise at least £20 billion by 1995.

"Health bonds" were suggested by SDP leader Dr David Owen. As well as winning prizes, the bonds could also be cashed in at face value.

Dr Owen said: "This idea could triple, or in the long run bring about a five-fold increase in, the amount of private money going into the NHS."

He thinks health bonds would be warmly supported by the public. The extra cash would also reduce pressure on the Government to introduce a controversial scheme to give tax refunds to people using private health care.

The Royal College of Nursing said: "Whatever peripheral measures might be taken to increase NHS money the health service must continue to be funded through taxes.

"Even in places like New York where they have the biggest sweepstake in the world the sum raised is minimal."

Since ERNIE was switched on in 1956, over £1.8 billion has been invested in premium bonds.

The odds of landing the £250,000 jackpot are 1,800,000,000-1.

42/2.BTW.4376/39

CONFIDENTIAL

MP

FROM: J J HEYWOOD
DATE: 23 May 1988

MR PERETZ

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Scholar
Miss Peirson
Mrs Case
Mr Turnbull
Mr Cropper
Mr Tyrie
Mr Call

NATIONAL LOTTERY

The Financial Secretary has seen Douglas Hurd's letter of 13 May.

2. The Financial Secretary believes that we should now write to the Home Secretary supporting a national lottery.

JEREMY HEYWOOD
Private Secretary

3633/9

CONFIDENTIAL

Clearly this will have to be taken into account. But I doubt there is much in (3). L

FROM: P J CROPPER
DATE: 24 May 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Tyrie
Mr Call

NATIONAL LOTTERY

Declaring my interest as friend of Littlewoods, have we really seriously estimated the effect of a National Lottery on:

1. the football pool industry, which employs a lot of people in Liverpool.

2. the Revenue, which takes 42½% of pool stake money.

3. football itself, which gets another slice of the stake money?

2. I am not aware of any serious study having been done on the broader implications of a move which might reverberate right through the football industry, and could quite possibly leave us no better off in terms of revenue. The condition of British football is certainly ghastly, but it could be worse. If football packed up completely, we might have the hooligans out on the streets like in Beirut.

P J CROPPER

53/2/LPD/3768/044

CONFIDENTIAL

pmp

FROM: P D P BARNES
DATE: 24 May 1988

MR RICH

cc PS/Chancellor
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Peretz
Mr Grice
Miss Anderson
Mr Cropper

Mr Patterson - DNS
Mr Ward - DNS

NATIONAL SAVINGS INTEREST RATES

The Economic Secretary was grateful for your submission of 23 May.

2. The Economic Secretary would like to discuss this at tomorrow's Funding meeting. He thinks it would be useful, in reaching a decision, to have some feel for why the Building Societies have not yet moved their savings rates, and when and how much they are likley to do so.

PB

P D P BARNES
Private Secretary

MC5.41

FROM: MARK CALL
DATE: 25 MAY 1988

pps pl

FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Chancellor
PS/Paymaster General
PS/Economic Secretary
Mr Cropper
Mr Tyrie

LOTTERIES

I was asked to a Lotteries lunch by Geoffrey Tucker (attendees attached). He is lobbying on behalf of G-Tech, which operates lotteries in the US.

2. Simon Burns and G-Tech's PR man argued strongly for the idea of a monopoly national lottery (provided, of course, that G-Tech run it), and argue that without that scale it wouldn't work. Personally, I remain sceptical.

3. Regarding the distribution of proceeds, they are very clearly tying themselves to the NHS (not even 'health services' generally defined). It was slightly depressing that the two main advocates had little understanding of the complexities of allocation, additionality, substitution etc caused by putting the money into the public expenditure pot. They simply proposed to hand over the money and let the Government worry about the impact on the PES process. On the other hand, they would want to have a plaque above a machine or intensive care cot noting the source of funding. When I raised the knock-on revenue costs to the Exchequer of large capital donations, they said they could throw in the revenue cost as well.

4. To my mind, should a national lottery be established, it would be best if the proceeds came nowhere near the Treasury. They could be disbursed by an independent trust or through an organisation such as the Charities Aid Foundation. This way the money could be directed to activities which were clearly not being done by the State. This would make life easier for the Treasury, and presumably make the marketing of the lottery more straightforward.

MC

MARK CALL

ENC

From Geoffrey Tucker

GUEST LIST

National Lotteries Lunch - Brooks's 12.45 for 1 pm.

Tuesday May 24th 1988.

Mr Simon Burns MP	Chelmsford.
Mr Mark Call	Special Adviser to the Chief Secretary to the Treasury.
Mr Charles Cousins	Consultant to G-Tech.
Mr Neville Gaffin	Adviser to Geoffrey Tucker Ltd.
~~Mr Charles Hendry~~	~~Special Adviser to the Rt Hon Mr John Moore, MP.~~
Dame Jill Knight DBE MP	Edgbaston.
Mr Graham Mather	Director General, Institute for Economic Affairs.
Mr Peter Stothard	Deputy Editor, The Times.
Mr Nicholas Timmins	Health Services Correspondent, The Independent.
Mr Geoffrey Tucker CBE	Geoffrey Tucker Ltd.

CONFIDENTIAL Chief Sec

NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

SECRETARY OF STATE
FOR
NORTHERN IRELAND

CHIEF SECRETARY

Mr Peretz.
CX FST EST
Sir Peter Middleton
Mr Anson Mr H Phillips
Mrs Case Mrs Peirson
Mr Turnbull Mr Revolta
Mr Saunders Mr Cropper
Mr Tyrie Mr Call

Rt Hon Douglas Hurd CBE MP
Home Secretary
Home Office
50 Queen Anne's Gate
LONDON
SW1H 9AT

25 May 1988

Dear Home Secretary

'NATIONAL' LOTTERIES

Thank you for copying to me your letter of 13 May to John Wakeham on this subject.

Clearly, the emergence of the NHS lottery brings to the forefront the whole question of the Government's policy towards 'national' lotteries. Although the problem has surfaced on your side, there would be implications over here since the Northern Ireland law on lotteries is very similar to the Great Britain law. Our law is contained in the Betting, Gaming, Lotteries and Amusements (Northern Ireland) Order 1985. It allows societies to run lotteries for charitable and similar purposes, grossing up to £1 million per annum. There are limits of £80,000 on the turnover and £8,000 on the first prize, of a single lottery. We have no Gaming Board and societies must register with the appropriate local authority.

I have an open mind on the question of national lotteries. Indeed, as I explain later, your third option would be my preferred one, taking Northern Ireland interests into account. The problem I saw with your first option, which I take to be continuation of established policy, was that it effectively closed the door on further debate; but latest developments appear to have removed it anyway. The second option would rest easily with the Government's privatisation and deregulation initiatives whereas the third option clearly would not. But both these options carry the innate objection that they fly directly in the face of the Government's philosophy on gambling in general. I believe that a move now in either of these last two directions would be such a radical departure from existing policy that it would simply be viewed as a panic reaction to developments in the wake of the Loto affair. While I would not be opposed to the idea of a national lottery, I have reservations about the pace at which we might move in that direction. I therefore see considerable merit in going back to your original option of testing the public climate and demand through a raising of the lottery limits. As this could be done by subordinate legislation it would avoid the Parliamentary timetable difficulty, be seen as a positive step by the Government, and in due course we would have a better measure of the feasibility of a national lottery.

I have a particular interest in this question. The Irish Republic runs a very successful national lottery, grossing about £100m a year. Some of this we know is coming from Northern Ireland pockets and I would rather it was spent here. I am therefore examining the possibilities of fund-raising for health and social services purposes though lotteries, maybe sponsored by the Boards themselves in their income generation role or by appropriate voluntary bodies. This should minimise the risk of fraud or racketeering and maximise the return to the relevant purposes. I want to explore this carefully and would prefer that national policy did not preclude any Northern Ireland developments in that direction. In any case, I think we should aim to preserve flexibility.

I am copying this letter to other members of H Committee, the Chief Whips in both Houses and to Sir Robin Butler.

yours sincerely

pp TK

(Approved by the Secretary of State and signed in his absence)

BF ~~F6~~ 2/6 1

N M Rothschild & Sons Limited

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Telephone 01-280 5000
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Direct Line:

27 MAY 1988

our reference
your reference N21/10/MJdeRR/AMF/MJJ/8405

26th May, 1988

The Rt Hon Norman Lamont MP
Financial Secretary to the Treasury
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1

FINANCIAL SECRETARY
REC. 27 MAY 1988
ACTION Mr. Peretz
COPIES TO PPS, ~~CST~~, PMG, EST
Sir P. Middleton
Mr. Anson
Mr. Phillips
Mr. Scholar
Miss Peirson
Mrs Case

Dear Financial Secretary.

The Establishment of a National Lottery

Since we last talked in November about the possibility of establishing a National Lottery, we have continued to pursue the ideas which we set out in our memoranda dated December 1986 and November 1987 (copies of which we enclose for your convenience).

There have, of course, been significant developments since then, principally the announcement and subsequent withdrawal of the "local" lottery on behalf of the National Hospitals Trust and now the amendment to the Finance Bill which has apparently been tabled.

In our view, the attractions of a properly run National Lottery are substantial and we have endeavoured to provide some fresh information to you in the attached memorandum. In particular, we have highlighted:

* the significant revenues to HM Government from a National Lottery with gross revenues in excess of £2.5 billion per annum after an introductory period of 12 months, increasing to as much as £4 billion per annum over a 3 year period;

Mr. Turnbull
Mr. Cropper
Mr. Tyrie
Mr. Call

* the potential for consolidation of such revenues whilst giving the appearance of hypothecation through the creation of a "National Investment Fund";

* the dangers that such revenues could not be achieved if the "local" lottery is re-launched or, after 1992, European state lotteries are introduced into the United Kingdom; and

* the acceptability of lotteries devoted to good causes, as demonstrated both by the 1976 Royal Commission on Gambling and by popular reaction to the "local" lottery.

These points are covered briefly in the attached memorandum. In our opinion, there is at present a unique window of opportunity for the Government to establish a National Lottery.

I would, of course, be delighted to discuss the National Lottery with you or your officials at any time.

Yours Sincerely

Michael Richardson

Michael Richardson

DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Richmond House, 79 Whitehall, London SW1A 2NS

Telephone 01-210 3000

From the Secretary of State for Social Services

CHIEF SECRETARY

REC. - 1 JUN 1988

ACTION Mr Revolta / Mr Saunders

COPIES TO CX FST EST Sir Peter Middleton Mr Anson Mr M Phillips Mrs Case Mrs Pierson Mr Turnbull Mr Griffiths Mr Cropper Mr Tyrie Mr Call

The Rt Hon Douglas Hurd CBE MP
Secretary of State for the
Home Department
Home Office
50 Queen Anne's Gate
LONDON
SW1H 9AT

31 May 1988

Dear Douglas

"NATIONAL" LOTTERIES

I am responding to your letter dated 13 May addressed to the Lord President, and copied to H Committee colleagues.

You dealt first with the 'National Health Service' lottery, launched by the National Hospital Trust and promoted by Loto Ltd. As you know, events have been moving fast, and I am grateful for the close liaison between officials of your Department and mine. I am glad that the matter is being brought to a head; we will continue to follow the holding line set out on the second page of your letter, although I believe it is now clear that we will have quite soon to declare our policy on national lotteries. Incidentally I ought to add that although we were not consulted on the detail of the scheme in advance, my officials were informed about it shortly before it became public.

Your letter went on to seek preliminary views on the merits of a national lottery, and canvassed various options. I assume that your first option (confirming current policy) would embrace raising the present monetary limits. If we decide not to proceed with the major policy changes envisaged in the other two options I would support raising these limits.

In considering your options for major change from a DHSS viewpoint it is apparent that there are a number of (sometimes conflicting) factors. I am especially concerned that a national lottery, be it state or private, would divert income from generally well targeted national and local fundraising efforts.

E.R.

We have said many times, and we remain of the view, that we wish to encourage the long standing tradition of charitable support for the NHS. Such support is often aimed at specific goals such as research into or treatment of particular conditions or the provision of improved facilities or new equipment for a particular hospital, and such effort is very effective.

We need also to take account of the fact that income from lotteries is likely by its very nature to be unpredictable and not conducive to our system of longer term service planning. It would also almost certainly be derided, particularly by our opponents, as being a wholly inappropriate means of financing a statutory health service.

But I believe that there is likely to be a large measure of popular support for national lotteries - particularly those aimed at providing additional funds for the NHS, and we should not lightly forego such income. As the Prime Minister said in the House on 21 April "If [the lottery] raises extra money for the Health Service, that would be a very good thing".

As far as a state lottery is concerned (third option), I believe that the major consideration is the general political issue of the extent to which we should rely on such a scheme to raise revenue either implicitly or explicitly for NHS funding, and/or other public services. I am not attracted to this course. Your second option - privately run national lotteries - seems to me to give rise to rather fewer objections in principle although I remain concerned about the possible impact on other fund raising. I acknowledge that this option would be likely to require the expansion of regulatory resources but I should like to see the arguments for and against this approach worked up further.

I am copying this letter to the Lord President, the other members of H Committee, the Chief Whips in both Houses and to Sir Robin Butler.

JOHN MOORE

MC5.53

FROM: MARK CALL
DATE: 26 MAY 1988

papers please (minute from me to? EST)

CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary

NHS LOTTERIES AND PREMIUM BOND

I'm not convinced that the 'Premium Health Bond' is the answer. The potential lottery operators would be disappointed. Those of the public who support the lottery idea would feel cheated of a gamble (buying a premium bond doesn't give the same thrill as a lottery, the elapsed time between purchase and knowing whether you've won is too long).

2. Finally, and more seriously, I can see serious difficulties on the public expenditure control side. Not only might this be large, but I'm guessing that the revenues could be more volatile, making planning more difficult.

MC

MARK CALL

PERSONAL AND CONFIDENTIAL

PMP

FROM: A C S ALLAN
DATE: 26 May 1988

PS/ECONOMIC SECRETARY

cc Mr Cropper

FUTURE OF NATIONAL SAVINGS

The Economic Secretary has already seen the approach from the Scottish Business Group. Separately, Mr Cropper has received a ... proposition from Sandy Gilmour - attached. The Chancellor would be grateful if the Economic Secretary could look at this alongside the Scottish proposal.

ACSA

A C S ALLAN

FROM: P J CROPPER
DATE: 11 May 1988

CHANCELLOR

MR GILMOUR'S PROPOSITION

I attach the promised paper from Sandy Gilmour. Will you be asking for it to be looked at? Economic Secretary?

2. They say that they have considered the option of proceeding without Treasury approval, but that they would prefer to do it with Treasury approval. I did make the point that Treasury approval would be essential if Post Offices were going to be required to accept books of (privately produced) 'Ernie Stamps' as payment for Premium Bonds, rather than cash.

3. Obviously, their ambitions go beyond the 'Ernie Stamp' alone, but the later proposition seems to me fairly harmless. Even if we do not actually have a pressing PSBR, we would not want to stand in their way?

P J CROPPER

THE PROPOSAL

is to launch a savings stamp, to be called the

'ERNIE STAMP'

which will be

* collected by the public into savings books

* redeemed at Post Offices and sub Post Offices or direct from the Promoters

  - for Premium Bonds

* used by organisations as a means of promotion:

  - as a traditional trading stamp by retailers and service organisations

  - as a give-away with their products by manufacturers.

The Stamp could also be sold directly to the public.

BENEFITS

We believe such a stamp

* represents, for companies, a coming together of commercial and the National interests in a manner particularly in tune with the changed spirit of today's Britain

* allows savers - as was the original philosophy behind Premium Bonds themselves - a means of serving both their self interest and the public interest

* giving them a risk free and socially acceptable gamble - and one which is preferable to imported ideas like lotteries

* would significantly increase sales of Premium Bonds, both directly via the stamp and indirectly, by the heightened promotion and awareness encouraging normal sales.

OTHER ADVANTAGES

* Ernie Savings Stamps would not need the costly merchandise and catalogue operations of traditional trading stamps and would therefore be able to give better value to both savers and promoting companies.

* Expenditure on the stamp by the latter would also represent a direct transfer of some part of today's vast promotional budgets, without loss of commercial efficiency, into National Savings.

* There would be a favourable influence on the level of personal savings, of which the current decline is causing concern.

* Valuable business would be put the way of the Post Office and, of even greater interest, of sub post offices.

* The Excise would obtain additional VAT revenue.

BACKGROUND

The concept was first developed in the early 1970's. Following approval in principle from the Department for National Savings, the many administrative problems were solved, the Post Office and the Association of Sub Postmasters agreed their involvement and its terms, the Promoters obtained the interest of sufficient commercial organisations to ensure the project's financial viability and the necessary finance was raised. However the Treasury withheld final approval, probably, in the Promoters' view, because of opposition from some elements in the then National Savings Movement.

TODAY

The same Promoters believe that the changed spirit of the Britain of 1988 creates an environment in which the idea should flourish and more readily gain approval. They have carried out an initial feasibility study which confirms the continuing commercial viability of the Stamp. This study included canvassing the opinions of a number of prospective user companies. Also the recent, successful re-launch of Green Shield Stamps is an encouragement so far as that part of the Ernie Stamp proposed usage is concerned.

APPROVAL

Before they re-embark upon establishing the required operation and structures, the Promoters seek the policy approval of HM Treasury. It is accepted that this would be contingent upon their providing evidence of financial and operational feasibility. However they emphasise their confidence in providing such evidence once again.

It should be mentioned that they have considered the option of proceeding without such approval but believe that to do so would conflict with the essential spirit of the project as defined earlier, of something uniquely combining commercial and the National interests , and that the fullest realisation of its potential requires official agreement.

AN ULTIMATE CONSIDERATION

The concept as discussed stands perfectly by itself. However the Promoters have also considered with their merchant bankers, and would like to discuss with HM Treasury, the much larger question of their acquiring the Premium Bond operation, or even the whole of National Savings, whereupon Ernie Stamps would be seen as simply one, albeit important, element in a wide range of promotional options.

CONFIDFENTIAL

FROM: P D P BARNES
DATE: 27 May 1988

MISS O'MARA

cc PS/Chancellor
Mr Scholar
Mr Peretz
Mr Rich
Mr Cropper

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The Economic Secretary would be grateful for your views on Mr Sandy Gilmour's proposal for a new "ERNIE Stamp" (attached). I understand that Mr Gilmour is a former Senior partner of a firm of stockbrokers, and the brother of Sir Ian Gilmour MP.

2. The Economic Secretary's initial reactions to the proposal are mixed:

(i) he is sceptical about the commercial viability of a stamp backed by premium bonds. This would make the prize doubly remote. But this is clearly primarily Mr Gilmour's problem.

(ii) The Economic Secretary is uneasy about a joint DNS/commercial operation along these lines. It is not clear at the moment who would be endorsing who. But he thinks this problem would probably be capable of resolution.

(iii) He is unenthusiastic generally about promoting premium bonds. But so long as they are on our books, he does not think that we can reasonably object to others doing so. He suspects in any case that the inflow would be modest.

(iv) He thinks that we should have a predisposition in favour of initiatives from Scottish business.

(v) If there were really a serious prospect of privatising Premium Bonds, then he thinks that this would be welcome.

(vi) He thinks that notwithstanding his comments in (v) above, we should be very cautious not to make a positive response that might become public, given the danger of arousing fear amongst the workforce when the prospect of privatisation still seems so remote.

3. The Economic Secretary would welcome your comments on these points.

PB

P D P BARNES
Private Secretary

FROM: P J CROPPER
DATE: 11 May 1988

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53/2/LPD/3769/029

CONFIDENTIAL

BF 1/6

FROM: P D P BARNES
DATE: 27 May 1988

MR CROPPER

MP

cc PS/Chancellor
Mr Peretz
Miss O'Mara
Mr Rich

NATIONAL SAVINGS : SIR I NOBLE

The Economic Secretary has now responded to Sir I Noble along the lines attached. We spoke.

2. As I said, the Economic Secretary would be grateful if you would have a private word with Sir Iain on the phone to let him know that:

(i) if he wants the Government to consider his ideas seriously then he will need to do a lot more work on them before we can give a substantive response one way or the other; and

(ii) it would be a condition of any discussion that the Government has with Sir Iain on these issues that the existence of the discussions is not disclosed.

PB

P D P BARNES
Private Secretary

53/2/LPD/3768/038

PS/CHANCELLOR
MR PERETZ
MISS O'MARA
MR ILETT
MISS NOBLE
MR RICH
MR CROPPER

MR PATTERSON - DNS

Sir Iain Noble
5 Darnaway Street
EDINBURGH
EH1 6DW

27 May 1988

Dear Sir Iain

Thank you for your letter of 3 May which I read with great interest.

Although the Government's finances are now in balance National Savings continues to have an important role to play. The Department's tasks are to contribute towards both the funding and the refinancing of Government borrowing through sales of a range of products to personal investors, and to continue to offer customers who have invested in National Savings the best possible service within the resources available. So there is no question of the Government dismantling the National Savings operation.

I know that you have already discussed your ideas with Malcolm Rifkind, and understand that you see them as a way of both saving and improving jobs in areas of high unemployment. Malcolm will have explained we are always willing to consider ideas which are intended to enhance services to customers and improve the prospects for staff.

I do hope to be visiting Edinburgh after the Finance Bill is enacted and would welcome the opportunity to meet you then. I will contact you when a date is being fixed. If prior to that you should be coming to London we could of course meet here.

Yours sincerely

Peter Barnes

pp PETER LILLEY

(Approved by the Economic Secretary and signed in his absence).

53/2/LPD/3769/030

CONFIDFENTIAL

PWP

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DATE: 27 May 1988

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cc PS/Chancellor
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Mr Peretz
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Mr Cropper

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53/2/LPD/3768/038

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PS/CHANCELLOR 14/2
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Yours sincerely

Peter Barnes

pp PETER LILLEY

(Approved by the Economic Secretary and signed in his absence).

dti

the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

CHIEF SECRETARY
REC. - 2 JUN 1988
Mr Peretz
CX FST EST
Sir Peter Middleton
Mr Anson Mr H Phillips
Mrs Case Mrs Pierson
Mr Turnbull Mr Revolta
Mr Saunders Mr Cropper
Mr Tyrie Mr Call

Rt Hon Douglas Hurd MP
Home Secretary
Home Office
50 Queen Anne's Gate
LONDON
SW1H 9AT

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard 01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5147
Our ref
Your ref
Date 1 June 1988

Dear Secretary of State,

Thank you for sending me a copy of your letter of 13 May to John Wakeham asking for preliminary views on the merits of a national lottery. The National Health Trust scheme which provoked considerable unfavourable comment appeared throughout to be an unwise and ill-judged attempt to evade the present law and appears now to have collapsed. I would be very reluctant to leap into any announcement linked to that failed scheme as it would be yet another way of lending force to the argument that the NHS is desperately short of money. That is the argument of all our critics and the Government should not indirectly reinforce it.

However I think it is arguable that the current law on lotteries may be more detailed and restrictive than strictly necessary. Any revision of the law should obviously take would-be participants interests fully into consideration. There is an obvious need for consumer protection, but also a wider interest in providing additional choice for those who want to gamble. I tend to favour the second option you identify, of amending the law to provide for the proper regulation of large lotteries. I would hope that this would also provide an opportunity to simplify and streamline the law. I do not favour a state run lottery.

MY4ABN

dti

the department for Enterprise

I certainly agree that this is an issue which will cause controversy and I would be happy for you to proceed by reviewing the policy.

I am sending a copy of this letter to other members of H Committee, the Chief Whips in both Houses and to Sir Robin Butler.

Yours sincerely,

pp KENNETH CLARKE

(Approved by the Chancellor of the Duchy and signed in his absence)

MY4ABN

CONFIDENTIAL

Let Hurd better have a [illegible] (an [illegible]) as suggested by Mr P. in para 22.

From : D L C Peretz
Date : 3 June 1988

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Scholar
Miss Peirson
Mrs Case
Mr Turnbull
Mr Saunders
Miss O'Mara
Mr MacAuslan
Mr Rich
Mr Cropper
Mr Tyrie

Ch/as far as the health angle is concerned would seem to be a case for pushing Home Office back onto the deregulation tack - would be consistent with emerging ideas of independent hospitals, money going to the most efficient & those prepared to raise money from private sector etc

MPW 8/6.

LOTTERIES

The Home Secretary's letter of 13 May on "national" lotteries seeks comments from colleagues. Mr Hurd reports developments on the "National Health Service" lottery devised by Loto Ltd for the National Hospital Trust. He had, earlier, concluded - with our support - that he should take action by secondary legislation under the 1976 Act to raise the monetary limits on the operation of small and local lotteries; and we were ready to press the Home Office for as big an increase as could be achieved without new legislation.

2. He concludes that the "National Health Service" lottery episode, whatever its eventual outcome, means this approach may no longer be tenable (though it is not clear why he says this); and therefore seeks views on options that would involve new primary legislation either to permit private sector "national" lotteries; or to establish a state lottery.

3. There are three comments so far on Mr Hurd's letter. Mr Gray's letter of 23 May from No.10 records the Prime Minister as being opposed to any further detailed work on options for "official" national lotteries; and in favour of smaller lotteries at the local voluntary level geared to specific projects. The Secretary of State for Health and Social Security, in his letter

of 26 May, rehearses arguments against a national lottery devoted to raising money for the NHS, but says he would like to see further work done on the option of privately run "national" lotteries. And the Chancellor of the Duchy of Lancaster, in his letter of 1 June also comes down against a state run lottery but supports a policy review.

4. For completeness, I should also mention:

(i) The letter of 26 May which you received from Michael Richardson of Rothschilds, with a further paper (not attached) advocating the establishment of a national lottery. This suggests that the net proceeds from such a lottery would reach £1 billion a year after an introductory period of 12 months, rising to as much as £1½ billion a year after a 3 year period (assuming 40% of the gross take is available to the Government, the NHS, or chosen good causes). It also raises the possibility that "after 1992" European state lotteries might come to be marketed in the United Kingdom.

(ii) The amendment to the Finance Bill that has been tabled by Mrs Rosie Barnes MP authorising the Social Services Secretary to promote a national lottery run by a contractor to provide additional revenue for the NHS (copy attached at Annex A). Parliamentary Counsel's view is that the clause will be ruled as being outside the scope of the Finance Bill, and will not be debated.

5. We need to consider what our response to Mr Hurd's letter should be. You suggested, but before seeing the No.10 letter, that we should take this opportunity to write supporting a national lottery. The Chancellor has separately asked for advice on the option of turning premium bonds over to the National Health Service, as an alternative idea to a national lottery for the NHS. This note tries to draw all the threads together.

Background and Recent developments

6. It is worth remembering, as a starting point, that our conclusion at the Chancellor's meeting on 5th February was that :-

i) the only context in which there was any real prospect of getting a national lottery launched was in support of the NHS. We expected that this possibility would have to be covered in the course of the NHS review.

ii) but in the meantime we agreed that we should support as radical a deregulation of the rules for "local" lotteries as could be achieved without new primary legislation.

7. I understand that the idea of lottery based finance for the NHS has not, in fact, been considered in the course of the NHS review. And Mr Hurd appears to have made no progress with his deregulation proposals: and now suggests this approach may no longer be "tenable".

8. On the "NHS" lottery, promoted by Loto Ltd, events have moved on since the Home Secretary wrote. Loto decided not to proceed with their lottery following a warning from the DPP that they would otherwise face prosecution because the projected prizes were well in excess of the legal limits, and because they were still not registered with a local authority or with the Gaming Board. They are now having to return £½ million to 43,000 people who bought tickets following the initial promotion. Loto say they still hope to save their project, but to do so they will have to challenge successfully the DPP's claim that the potential size of the prizes makes the project illegal. We understand they are now seeking advice from the Gaming Board about what their understanding is of the legal position - something they might have done before launching their scheme in public.

Options for Government Action

9. The Home Secretary has identified three possible options :

(i) confirm existing policy;

(ii) legislate to permit private "national" lotteries and to provide for their regulation;

(iii) legislate to introduce a state lottery.

(i) **Confirm existing policy**

10. This is the only option that would not involve new primary legislation (unless the "NHS" lottery proposal reveals severe defects in the existing legislation). It is a pity that the Home Secretary appears to be trying to use the new development as a reason to drop the initiative he already had in hand, to raise the monetary limits under the 1976 Act to try to give a new lease of life to local lotteries. This looks like the line of action most consistent with the Prime Minister's view; is the only action which could be taken quickly (since it does not require new primary legislation); and would not necessarily rule out new primary legislation later on.

11. There seems no reason why we should not proceed as quickly as possible with a review of these monetary limits, and I would like to urge the Home Secretary to continue with this.

(ii) **Legislate for private sector "national" lotteries**

12. The Home Secretary says this would require legislation because the 1976 Act is not appropriate for regulating really large national scale lotteries, even though in theory the monetary limits could be raised to any level by secondary legislation. He is probably right: certainly the 15-25% of take that is permitted by the rules to cover administrative costs looks generous for a large lottery.

13. It does of course raise a number questions, some of which are very much for the Treasury. For example :

- how much money would be diverted from forms of gambling that currently produce useful tax revenue, including the football pools?

- public expenditure treatment of proceeds if handed over to the NHS rather than used to make contributions in kind.

- extra regulatory resources said to be required : what has the Home Secretary in mind in this respect?

- possible adverse effect on smaller charitable lotteries and charitable giving : and possible consequential pressures on public expenditure.

14. There appears to be some support from colleagues for examining this option further, and it is not at first sight ruled out by the Prime Minister's wish that there should be no further work on "official" national lotteries. If there is to be further work, clearly the Treasury needs to be involved.

(iii) <u>Official lottery for the NHS</u>

15. At the Chancellor's meeting in February we assumed that this would be considered at some point in the course of the NHS review. In fact this now seems unlikely unless we press for it. ST are not keen to do so, on the grounds that it would divert the (indeed!) attention of the NHS review from its main task. On the other hand, once the review is complete (if not before) the Government will need to be ready to say what it thinks about the idea of raising extra finance for the NHS by means of a lottery or lotteries.

16. So we might press for consideration to be given at least to what line should be taken in defending a decision <u>not</u> to establish a state run NHS lottery. The question is whether, in the light of colleagues' and the Prime Minister's reaction, we want to go further and press the merits of a state lottery. Are there any new arguments or ideas to advance?

17. The latest Rothschilds letter has half a new argument, about "1992". Promoters of overseas state lotteries are prevented under our lotteries legislation from advertising them in the UK, and there is no likelihood of this position - which is non-discriminatory - being changed by EC legislation in the near future. Nevertheless there is nothing to stop UK residents taking part in overseas state lotteries, and as European integration proceeds this may become more common. So there is something in the point that we might increasingly find a potential source of revenue being captured by overseas state lotteries if no UK equivalent is established.

Premium bonds and the NHS

18. Then there is the possibility - on which the Chancellor has asked for advice - of turning premium bonds over to the national health service as an alternative to a state lottery for the NHS.

19. There is a basic difficulty with this idea. The NHS is looking for money to finance current expenditure. The premium bond scheme raises capital, which is repayable on demand. Premium bonds at present merely pool the interest and pay it out unequally to holders: there is no flow of net income which could be made over to the NHS. It is hard to see how the NHS could accept the risk of having to meet net outflows from premium bonds; or indeed the continuing cost of servicing the prizes on the outstanding stock of bonds.

20. Annex B discusses various possible approaches. The most promising would seem to be to convert the premium bond scheme into a form of endowment fund - this could either be within the public sector or privatised - that would receive income from investing eg in gilts. Of this income, say, half might be paid out in prize money and the other half made over to the NHS. This would mean less paid out in prizes than at present. And the amounts available to the NHS would be very modest - less than £100m a year even if by aggressive marketing the fund could be built up to something like the £2bn at present invested in premium bonds.

21. That said, we have always thought that if we were to proceed with a national lottery then it would make sense to reconsider the future of the premium bond scheme. It would provide an obvious context in which to wind the scheme up. Alternatively it might be possible for a state lottery to take over the running of the premium bond scheme as well, perhaps creating the kind of endowment fund arrangement envisaged above. Although the amounts produced might be modest, it might still be a worthwhile addition to the proceeds of a lottery. And it might be presentationally useful in establishing a lottery to be able to point to an element of continuity with an existing Government scheme.

Summary and Conclusions

22. You or the Chancellor may want to hold a meeting to discuss. The key question is whether, given reactions so far to Mr Hurd's letter, Treasury Ministers want to take this opportunity to press the case for a state run lottery, devoted to the NHS. If so we could develop the argument about competition from overseas state lotteries. And we might be able to develop the thought that a revamped premium bond scheme could play a role - though I would not want to go far in that direction without discussing the idea further with the Director of Savings at DNS, which I have not yet done.

23. If not, I would suggest writing to the Home Secretary on the following lines:-

i) press him to continue the work on reviewing the present monetary limits on local lotteries. There is a case in its own right for raising these by a substantial amount. This is the only action that can be taken in the short-term, since other options involve primary legislation; and would not close off any of the other options.

ii) support the idea that further work should be done on the possibility of legislation to enable "national" private sector lotteries to be established. This is a natural extension of the idea of raising the limits on "local" lotteries..

iii) note that by the time the NHS review is complete, we will need to have developed a Government line to take on the idea of a state run lottery to support the NHS. This will not necessarily take a great deal of work, but we do need to establish a reasoned and defensible position.

iv) Note that all the ideas raise a number of tax, public expenditure and other points of interest to the Treasury, so that Treasury officials should be involved in any further work. [It is not at all clear how the Home Office intend to take any further work forward, and we might try to flush them out on that].

v) we could note that if the idea of a state run national lottery were to be pursued further, then we would want to review the future of the premium bond scheme at the same time [but this is an optional point].

24. We will also in due course need to agree with the Home Office and others a line to take on the Rosie Barnes Finance Bill amendment, if against expectations a debate were allowed. And we need to reply to Michael Richardson of Rothschilds. I would be very happy to talk to Michael Richardson and his team if you thought that would be appropriate : but unless we are going to press the idea of a state lottery now, I would not want to encourage them to do much more work.

DLCP

D L C PERETZ

Finance (No. 2) Bill *continued*

Annex A

Total reliefs (No. 3)

Mr John Smith
Mr Gordon Brown
Mr Nicholas Brown
Dr John Marek
Mr Chris Smith
Mr Adam Ingram

NC25

To move the following Clause:—

'An overall restriction of £30,000 shall be imposed on the total reliefs, allowances, offsets and deductions available to an individual in each year to reduce his total income for income tax purposes.'.

Restriction on reliefs

Mr John Smith
Mr Gordon Brown
Mr Nicholas Brown
Dr John Marek
Mr Chris Smith
Mr Adam Ingram

NC26

To move the following Clause:—

'The Income & Corporation Taxes Act 1988 shall be amended to the restriction of all allowances, reliefs, offsets and deductions which are currently available to reduce the total income of an individual for the purposes of computing his liability to income tax so that they cannot generate relief from income tax at higher than the basic rate.'.

National Health Service lottery

Mrs Rosie Barnes

NC27

To move the following Clause:—

'A National Lottery to provide additional revenue for the National Health Service shall be promoted by the Secretary of State for Health and Social Security who shall by regulation provide for—

(a) the appointment of a contractor to operate the lottery;

(b) the maximum expenses to be charged to the proceeds of the lottery;

(c) the maximum prize level (which shall not exceed £250,000 per month);

(d) publication in appropriate form of the results of each lottery;

(e) audit of the annual accounts of the contractor in respect of the operation of the lottery;

(f) the distribution of the proceeds to the district health authorities of the United Kingdom;

Finance (No. 2) Bill *continued*

(g) any other matters relevant to the operation and management of the lottery as he thinks fit.'.

Removal of obstacles to employee ownership

Mr Ian Taylor

To move the following Clause:— **NC28**

'(1) This section shall have effect to encourage share ownership by employees and employee benefit trusts.

(2) After section 85 of the Taxes Act 1988 (payment to trustees of approved profit sharing schemes) there shall be inserted—

"85A Payments to trustees of employee trusts.

(1) Any sum expended in making a payment to the trustees of an employee benefit trust by a company—

(a) shall be deducted in computing for the purposes of Schedule D the profits or gains of a trade carried on by that company; or

(b) if that company is the holding company of a trading group and also an investment company or a company in case of which section 75 applies by virtue of section 76, shall be treated as expenses of management, if, and only if, one of the conditions in subsection (2) below is fulfilled.

(2) The conditions referred to in subsection (1) above are that before the expiry of the relevant period the sum in question is applied by the trustees—

(a) in the acquisition of employee shares in the company from—

(i) former employees; or

(ii) employees who have beneficially owned the shares for ten years or more,

(b) in the payment of interest on a loan to the trustees to defray money applied in the acquisition of shares in the company; and

(c) the sum is necessary to meet the reasonable expenses of the trustees in administering the trust.

(3) For the purposes of this section, the trustees of an employee benefit trust shall be taken to apply sums paid to them in the order in which the sums are received by them.

(4) In this section—

'the relevant period' has the meaning given by section 85(3)

'employee shares' means shares in a body corporate beneficially owned by an employee or former employee of that body corporate and acquired through a scheme or in any circumstances from the trustees of an employee benefit trust.

'holding company' has the meaning given in section 576(5):

'trading group' means a group the business of whose members, taken together, consists wholly or mainly of the carrying on of

ANNEX B

Premium Bonds and the NHS

It would, of course, as a purely accounting device be possible to hypothecate to the NHS the net proceeds from premium bonds (ie purchases less repayments). The net inflow into premium bonds in 1987-88 was £165 million, so they would need to be repackaged and marketed quite aggressively to produce amounts of money substantial in NHS terms.

2. If this were successful, however, and we increased net inflows to say £½ billion or £1 billion a year there are further issues that would arise :-

a) in future years withdrawals from premium bonds might exceed new sales. Would the NHS be expected to find the money?

b) how would the running costs, including the prize money, be financed? They currently amount to over £150 million a year.

c) if carried by the NHS they could exceed the net inflow in future, if the stock of bonds did not rise fast enough.

d) so would the Treasury finance them separately?

3. If the money was made available as "extra money" to the NHS in this way we would have to accept a corresponding increase in public expenditure on the NHS and in the PSBR. Since we would never know in advance how much would be available from this source it would make NHS financial planning difficult (a comment Mr Moore makes in respect of lottery proceeds generally) and there might be pressures on the Treasury to underwrite some level of proceeds.

4. The same would be true if the operation were privatised. This is a special case of the general proposition about the proceeds of private lotteries. So long as the money is paid to the NHS it would count as public expenditure when the NHS spend it. One way round this would be to ensure that the private sector operator made the donations to the NHS in kind rather than in cash.

but we'd still have to pay public expenditure to the nurses to run the kidney machines eh

5. In any event, it is hard to see that any privatised operation could work under the kind of arrangements suggested immediately above. It could not simply hand over the capital proceeds from premium bond borrowing, since it would need to be ready to repay people who cashed their premium bonds in. One possibility would be for it to operate more like an endowment fund, investing the borrowed money (eg in gilts) and making contributions to the NHS out of the income from the fund. To get a reasonable level of net income, prize money paid out would need to be set some way below its present level. The amount of money available to the NHS from this kind of arrangement, however, would be very modest indeed, at least to start with while a reasonable sized "fund" was being built up. Even if the fund could be built up to the same level as the £2 billion of existing premium bonds, the net income to be paid over to the NHS would be only of the order of £100 million a year or so.

6. To summarise, the premium bond scheme is a scheme for borrowing money, that is repayable : and the NHS has no way of providing the cash for repayments. And if converted into an endowment fund arrangement the amount of prize money would need to be reduced, and even then the net proceeds available for funding the NHS would be very modest - certainly compared to the claims from Rothschilds and others about the amounts that might be raised from a national lottery.

91G/SCB/4322/14

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FROM: IAN RICH

DATE: 3 June 1988

1. MR PERETZ
2. ECONOMIC SECRETARY

I very much hope we can go ahead with this. As recent discussions illustrate, it would be very useful to have a high quality N.S. instrument of this kind available, without the tax complication of the present certificate.

DLP 3/6

cc: Chancellor
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Grice
Miss O'Mara
Mr Riley
Miss Hay

Mr Patterson (DNS)
Mr Ward (DNS)

Mr Johns (Inland Revenue)
Mr O'Connor (Inland Revenue)

NATIONAL SAVINGS: A NEW TAXABLE FIXED RATE INSTRUMENT

Introduction

At the April funding meeting you agreed that we should work up proposals for a new National Savings fixed rate instrument. The aim is to attract good quality funding (ie encouraging investors to retain holdings for 5 years) without the "tax breaks" available in the case of savings certificates. This submission has been prepared in consultation with DNS, Inland Revenue and other Treasury colleagues.

Background

2. The Government's reduced funding needs have provided an opportunity to reconsider the competitive position of National Savings, and attempt to improve the quality of funding. At present, National Savings inflows are dominated by Income Bonds and Investment Account (total stock nearly £15bn). These have the advantage of variable interest rates which should be cost-effective

if, as we expect, yields decline over the medium term. But the quality of funding is relatively poor. These are capital value - certain products which can be cashed at short notice with no interest rate penalty, except for Income Bonds cashed within a year of purchase. Similarly, matured savings certificates held on the general extension rate (GER) (total stock over £7 billion) which have earned their maximum return after 5 years can be cashed at a few days' notice (though holders may risk the loss of 3 months' interest).

3. National Savings Certificates up to maturity represent much better quality funding because their raked interest rate structure provides a substantial incentive for investors to hold them to maturity. They also have cost advantages compared to longer term gilts. But their tax treatment - with a higher rate taxpayer and a non-taxpayer both receiving the same return - has made us reluctant to sell certificates aggressively. If we retain the present £1000 holding limit on the current issue, imposed to restrict the tax shelter, sales will remain modest (even allowing for the additional £5,000 for those re-investing matured certificates earning the GER). Thus we feel a further move is required if we are to achieve a significant shift to better quality national savings funding, without offering the higher rate taxpayer, in particular, a windfall gain.

A new product

4. In order to secure better quality funding, we propose a fixed rate instrument which would retain many of the features of savings certificates. We would encourage investors to hold securities for, say, 5 years by means of a raked interest rate structure as for savings certificates. However there would be no extension beyond the maximum term. Thus we would avoid worsening the problems we currently encounter when, as an apparent consequence of inertia, large but potentially liquid amounts of matured savings certificates are held on the general extension rate (GER). The novel feature for a new National Savings product with a guaranteed return is that interest, though payable gross, would be taxable.

5. On quality of funding grounds there is a strong case for replacing the Deposit Bond by the new product. Deposit Bonds were introduced in October 1983, and sales have always been relatively modest. Total stock is now £0.8bn, compared with £7.3bn in the highly popular Income Bond introduced in August 1982. Like Income Bonds and the Investment Account, the quality of funding is relatively poor - encashment is at 3 month's notice, and (apart from the first year) there is no interest rate penalty. There is no specific design feature designed to encourage investors to hold Bonds for a period of years.

6. We have also identified a market gap which the new product would fill. Deposit Bonds appeal to the same groups as Income Bonds and the Investment Account. The new replacement product could be marketed successfully to basic rate taxpayers, and would fill a clear market gap left by the remaining gross variable rate products - offering an attractive return to basic and higher rate taxpayers without the windfall gain these groups obtain from the tax free savings certificate. It would also offer alternative attractions to gilts, which also pay a guaranteed interest rate while held, but where the capital is guaranteed only at maturity.

7. The new product would be operated from the National Savings Bank in Glasgow. As you know, we have plans to speed up the decline of the Ordinary Account, for example by reducing it to a simple withdrawal/deposit savings account for personal investors. We want to discuss further with you the future of the Ordinary Account. But since it is also run from Glasgow, the launch of a new product there could help to soften the blow and reassure staff, already disturbed by privatisation rumours, that National Savings does have a future.

Tax Treatment

8. We and DNS believe the new product should, like Deposit Bonds (which we propose should be withdrawn to make room for it) Income Bonds and the Investment Account, pay interest with no tax deducted at source. In addition to tapping an important new market, we

would avoid reducing the number of National Savings products offering an attractive home for the savings of the non-taxpayer. The provision of gross of tax savings instruments by DNS is an objective to which Ministers attached some importance when CRT was introduced. It may assume a greater significance as we move towards independent taxation; non-working wives, and couples wishing to make use of the woman's personal allowance, may be expected to show interest in investments paying interest gross of tax.

9. We have discussed with Inland Revenue the possible staffing consequences. There are many uncertainties, not least the number of additional holders and their tax status. The Inland Revenue take the view that 10 additional staff could be required to deal with tax re-coding or assessments of each 10,000 holders of the new product liable to basic rate tax. This would apply only to additional DNS customers. It is relevant to set against any extra work arising from the new instrument that no new money would be coming in from Deposit Bonds (which would cease to be sold), and that as part of the overall funding strategy agreed in April we have been aiming to take in less money from Income Bonds and the Investment Account than we have in the past.

10. Annex A shows the net annual increase in the number of holdings of the three gross products since 1982-83. DNS project an increase of 475,000 in 1988-89, of which 50,000 is for Deposit Bonds. The projected total is significantly less than that experienced in 3 of the last 6 years.

11. It is not possible to say to what extent sales of the new product would be additional, or how funds which would otherwise be invested in Deposit Bonds or the other gross products might be redeployed. But a broad order of magnitude can be illustrated, assuming new product sales of £½ billion a year to 100,000 holders; half the sales are additional; and the rest drawn in from the other gross products. On this basis there would be 50,000 new holdings of which 35-40,000 might be basic rate taxpayers. This is very small in relation to the total average annual increase of over 500,000 in holdings of gross products in the past six years.

Since we are also aiming to run down the intake into the other gross products the implication is that the annual decline in the number of new holdings of gross products since 1986-87 will be slowed rather than reversed. On this basis, there seems to be no reason to suppose that the new product would require additional Inland Revenue manpower.

12. Inland Revenue would prefer tax to be deducted before payment of interest, either by imposing composite rate tax on the new product or by charging basic rate income tax at source. In their view, the proposed maximum holding of £100,000 (£200,000 for married couples) would give the product an unfair competitive advantage over other products, provoking complaints from the banks and building societies. This route would also minimise any staff implications for the Inland Revenue.

13. We do not believe that the tax treatment we propose for the new product risks serious criticism from the banks and building societies. The Government's intentions of maintaining a range of national savings products paying interest gross of tax is well-established and accepted. The new product would be a replacement for Deposit Bond, not an extension of the gross product range, and the proposed maximum holding is the same as the existing Deposit Bond maxmium. Although we would hope to make substantial sales, many would be through diversion of money which would otherwise have flowed into the other gross products. DNS are very strongly opposed to the introduction of a CRT or other tax regime in any National Savings area. They believe it would call into question the Government's continued intention to provide non-taxpayers with products not liable to deduction of tax at source, and might damage confidence in National Savings as a whole. Moreover it would look particularly odd not to treat the new product for tax purposes in the same way as gilts sold on the NSSR, on which interest is also paid gross of tax. DNS would also have to meet some additional administrative costs if for the first time they had to deduct tax before paying interest to investors. We do not therefore recommend this approach.

Further details of the proposed new product

14. These are set out in Annex B.

Name of the new product

15. If we decide to go ahead, we will need to take an early decision about a name for the new product. We and DNS already have a few ideas, but would welcome suggestions.

Timing

16. If we can make an early decision, it would be possible to launch the new product in late autumn.

Conclusion

17. We should welcome the opportunity to discuss these ideas with you.

Ian Rich

IAN RICH

ANNEX A

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NET ANNUAL INCREASE IN HOLDINGS (000s)

	Income Bonds	Deposit Bonds	Investment Account	Total
1982-83	118	-	288	406
1983-84	84	32	3[illegible]1	507
1984-85	101	42	281	424
1985-86	107	46	305	458
1986-87	160	88	350	598
1987-88	125	69	461	655
Current Projection for 1988-89	125	50	300	475
Holdings at 31 March 1988	695	277	4103	5075

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ANNEX B

Features of the proposed new National Savings product

1. Brief description and essential features

A product which accumulates interest over a five year period at rates of interest which are fixed at the time of purchase. All the interest is taxable as income but no tax is deducted at source. On the fifth anniversary of purchase the investment will be repaid and no further interest can be earned.

2. Terms

Minimum investment of £100 on each occasion. Repayment at 3 months notice with £100 minimum repayment. No interest earned on amounts repaid before the first anniversary of purchases. Maximum holding £100,000 of purchase value. All purchases of all Issues aggregated within the £100,000 limit. Value of holding can exceed £100,000 only as a result of accrued interest.

3. Interest

Five separate annual rates of interest applied sequentially over the life of the investment. Progressive rise in rates from year to year to encourage retention for the full five years. All interested earned daily and compounded annually on the anniversary of purchases. Customers will receive annual interest statements to enable them to make a return of income to Inland Revenue. The five annual rates of interest, which define the return, will have an equivalent overall compound rate which will be used in advertising and promotional material. Sums repaid between anniversaries will attract interest during the part year at the rate applicable to the preceding year. Inland Revenue have pointed out that under present assessment rules, there could be a loss of tax arising from the stepping of interest rates. It could be avoided by having no stepping for years 2 and 3.

Rates would be set by reference to competing rates and those on other public debt instruments, within the overall framework of the Government's funding programme. On occasion they might need to be changed frequently. Rates would be changed by the withdrawal of one Issue and the launch of a new Issue. When rates were falling withdrawal would be made without prior notice to the public.

4. **Target Market**

Available to: individuals (no age limit) and trustees. In marketing terms the main market would be 50 + basic rate and higher rate taxpayers. This would help in widening the appeal of National Savings products to the general body of taxpayers. A subsidiary market would be non-taxpayers looking for guaranteed growth for whom savings certificates may not be a good investment.

5. **Method of Sale**

At Post Office counters or by direct remittance to National Savings using forms available at post offices. Documents issued centrally by National Savings direct to purchasers following receipt of purchase applications either from post offices or directly. Purchases would not be available at banks. 1½ days' advance notice of withdrawal of an Issue would have to be given to the Post Office.

6. **Repayment**

On written application to National Savings on forms available at post offices. Repayment by crossed warrant or direct credit to a bank or building society account. Automatic repayment on fifth anniversary of purchase.

7. **Administration**

At National Savings Glasgow. The National Savings Deposit Bond would be withdrawn from sale prior to the launch of the new product. So far as possible the new product would use procedures and resources derived from Deposit Bonds. DNS have undertaken to find the additional resources needed for the new product (money and manpower) by running down Deposit Bonds and by redeploying resources released by the "managed decline" of the Ordinary Account.

8. Legal Framework

No primary legislation necessary. The new product would be prospectus-based using powers in the National Loans Act 1968. It would be part of the National Savings Stock Register in the same way as Income Bonds and Deposit Bonds. The existing NSSR Regulations would probably serve for the new products.

9. Timetable

The launch of the new product and the withdrawal of Deposit Bonds might be announced in early December. Announcement could be in any convenient form eg a National Savings Press Release. The rate applicable to the first Issue would be set about 2 weeks prior to launch and announced in time to permit a suitable advertising campaign and the production and distribution of point of sale material; prospectuses and publicity leaflets.

53/2/LPD/3769/053

pps pl

CONFIDENTIAL

FROM: P D P BARNES
DATE: 6 June 1988

MISS O'MARA o/r

cc PS/Chancellor
Mr Scholar
Mr Peretz
Mr Ilett
Miss Noble
Mr Rich
Mr Cropper

Mr Patterson - DNS

NATIONAL SAVINGS

I returned a call this morning from Sir Iain Noble, and spoke to Mary Campbell, the Secretary of Sir Iain's Steering Committee on the future of National Savings.

2. Sir Iain had rung in response to the Economic Secretary's letter of 27 May, and wished to arrange a date for a meeting with the Steering Committee in Edinburgh when the Economic Secretary would next be visiting Scotland. Ms Campbell hoped that it would be possible to arrange a lunch or dinner in July or August. I told Ms Campbell that the date of the Economic Secretary's intended visit to Scotland had not yet been arranged but that I would contact her as soon as a date had been fixed.

3. I understand that Mr Cropper will be lunching with Sir I Noble on 15 June. I do not intend to contact Ms Campbell again before that, so as to give Mr Cropper the chance to emphasise again the need for Sir Iain to work up his proposals in much greater detail if the Government is to be able to consider them seriously.

4. The Economic Secretary has a standing invitation to visit the Committee of Scottish Clearing Bankers in Edinburgh. I would

be grateful for advice from yourself or copy recipients of any other engagements which it would be worth the Economic Secretary's including in a trip to Scotland.

P D P BARNES
Private Secretary

OFFICE OF ~~ARTS AND LIBRARIES~~
Horse Guards Road
London ~~SW1P 3AL~~
Telephone 01-270 5929

CHIEF SECRETARY
7 JUN 1988
ACTION / COPIES TO: Mr Rich
CX, EST, FST,
Sir P Middleton
2
Mr Anson, Mr H Phillips
Miss Case, Miss Pierson,
Mr Turnbull, Mr Revolta
Mr Saunders, Mr Cropper
Mr Tyrie, Miss O'Mara
Mr Call

From the Minister for the Arts

C88/2983

The Rt Hon Douglas Hurd CBE MP
Secretary of State for Home Affairs
50 Queen Anne's Gate
LONDON
SW1H 9AT

7 June 1988

Dear Secretary of State,

"NATIONAL" LOTTERIES

I have been most interested to see the correspondence which has followed your letter to John Wakeham of 13 May.

I agree that 'official' lotteries raise major issues. I am interested in a full examination of a national lottery for the arts, though I fully recognise the presentational and control problems. This is why, as I have previously said, I am particularly interested in the possibility of a substantial increase in the monetary limits under existing legislation. I hope that this will still be considered, even if (under the second option in your letter of 13 May) you need to take primary ligislation to regulate schemes of the kind being promulgated by the NHS lottery promoters. Such evidence as we have on the arts front indicates that individual arts bodies would be most likely to make use of lotteries for fund-raising if there were a significant increase in the amount of money that could be generated. I do not think that we should underestimate the potential for extra resources for the arts and other services.

... I am copying this letter to the recipients of yours, and to Nicholas Ridley and Colin Moynihan.

Yours sincerely

[signature]

RICHARD LUCE
(approved by the Minister
and signed in his absence)

3633/14

Rso pl

CONFIDENTIAL

FROM: P J CROPPER
DATE: 7 June 1988

PS/ECONOMIC SECRETARY

cc PS/Chancellor
Mr Scholar
Mr Peretz
Miss O'Mara
Mr Rich

FUTURE OF NATIONAL SAVINGS

I note your minute of 27 May to Miss O'Mara.

2. It should be mentioned that there are two proposals in orbit. One from Mr Gilmour, the other from Sir Iain Noble's group of Scottish businessmen. They are unconnected. In your note of 27 May, which deals with the Gilmour proposal, you refer to the Economic Secretary's predisposition to favour initiatives from Scottish business. That is, of course, to confuse the two sets of proposals. Is Miss O'Mara actually looking at both.?

3. As regards the Scottish DNS scheme, I have arranged to have a private lunch with Sir Iain Noble in London on 15 June. This is intended as a warm-up for the Economic Secretary's meeting with that group which - everybody quite understands - cannot take place until the Finance Bill is out of the way.

P J CROPPER

5770/12

CONFIDENTIAL

1. ~~Alex~~
2. pup

FROM: P D P BARNES

DATE: 7 JUNE 1988

MR RICH

cc PS/Chancellor
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Peretz
Mr Grice
Miss O'Mara
Mr Riley
Miss Hay
Mr Patterson - DNS
Mr Ward - DNS
Mr Johns - IR
Mr O'Connor - IR

NATIONAL SAVINGS: A NEW TAXABLE FIXED RATE INSTRUMENT

THe Economic Secretary was very grateful for you submission of 3 June.

2. Economic Secretary is content for DNS to proceed with preparations for an Autumn launch of this product.

PB

P D P BARNES
Private Secretary

CONFIDENTIAL

FROM: IAN RICH
DATE: 8 June 1988

We would welcome an early discussion
PP/
8/6

1. MR PERETZ
2. ECONOMIC SECRETARY

cc Sir P Middleton
Sir G Littler
Sir T Burns
Mr Scholar
Mr Grice
Miss O'Mara o/r
Miss Anderson
Mr Cropper
Mr Tyrie

NATIONAL SAVINGS: SOME STRATEGIC ISSUES

We had expected by now that the DNS corporate plan would be available, to provide a basis for a discussion with you of various general national savings issues, in particular the future of the Ordinary Account and the Premium Bond scheme.

2. Mr Patterson's timetable has slipped somewhat. He now hopes to complete his main planning document by the end of June, but in the meantime has sent a "trailer" (letter of 17 May, copy attached) of fairly brief notes on some of the ground he intends to cover.

3. We should welcome the opportunity of an early Treasury discussion with you (next week if at all possible) on some of the issues on which we need to take stock or move forward quickly. These are:

(a) Privatisation. In answer to Mr Rooker's PQ on 25 May about privatising the management of National Savings, you said the Government had no such plans. And in reply to Sir Iain Noble's group of Scottisih businessmen about their ideas for privatising and extending the services offered by the National Savings Bank and other DNS divisions, you confirmed that the Government had no intention of dismantling National Savings. There is, however, an offer of confidential discussions with the Group to explore their ideas further. DNS are not aware of this.

(b) Improving the quality of funding. You have approved the proposals in my submission of 3 June for a new fixed rate taxable product to replace the Deposit Bond. We should like to discuss with you briefly the next steps. Paragraph 9 of Mr Patterson's letter describes 5 other ways of helping. These are largely existing agreed policies. We would put a question mark against aggressive marketing of the gross products, which are poor quality funding.

(c) Increasing national savings flows to take money out of the housing market. The Chancellor has asked you to look at this further (it is related to (b)).

(d) Additional bid in the 1988 Public Expenditure Survey. DNS have bid for £9m over the next three years for repairs to the National Savings Bank building at Glasgow. Some repair work is inescapable. We are assessing the options, and asking DNS for a view on whether they could sue the original contractors for defective construction. DNS say they cannot find any offsetting savings, but we are not yet convinced. We shall be putting a recommendation to you later.

(e) The future of the Ordinary Account and Premium Bonds. This is mentioned in paragraphs 14-20 of Mr Patterson's letter. He does not advocate radical change. We think there are further options worth discussing. Separate papers are at Annexes A and B. On Premium Bonds there is a read across to the separate papers on lotteries (Mr Peretz' minute of 3 June). And we might consider Mr Sandy Gilmour's recent proposal for an "Ernie Stamp" in the context of the likely longer term development of Premium Bonds.

Ian Rich

IAN RICH

ORDINARY ACCOUNT

Background

1. The Ordinary Account is an instant access passbook account largely operated over Post Office counters. It contributes nothing to funding. Total stock is £1.67 billion, and is declining at around £50m a year. In any event, it is doubtful whether Ordinary Account money should score as funding. Ordinary Account is expensive to administer. It cost £65 million in 1987-88 (split roughly 50:50 between DNS and Post Office/other agents) - almost 4% of the stock. There were over 32 million transactions so the unit cost is £2. But low interest rates partly offset this. At present, they are 2½% on balances below £500; 5% on others. The first £70 of interest is tax free.

2. Ordinary Account originally served social purposes and encouraged thrift, providing a convenient basic banking service to those living in rural and urban areas without nearby alternative facilities, and a handy savings medium for the "small man". These advantages have been steadily eroded since the 1960s particularly since the establishment and development of Girobank, which also operates over Post Offices counters, and now provides a current account, a conventional deposit account, and a high interest savings account. Thus the social rationale for the Ordinary Account has now largely disappeared. Nor does it serve any purpose as a funding instrument.

Present Position

3. The Ordinary Account is in "managed decline". In the last 5 years, annual turnover has remained constant in cash terms at about £1.4 billion, but the number of transactions has fallen by 18%. 13 million of the 15 million accounts have balances of less than £100. Most of these have been inert for many years. Ordinary Account gets little publicity beyond the descriptive leaflets available on the public side of post office counters.

4. The minimum deposit is to be increased from £1 to £5 in 1989. This should prevent some trivial transactions, and be a modest help in accelerating decline. DNS estimate that it will save 75 staff in Glasgow. They will bid to redeploy them, either on the new product if it is approved or to ease pressure they claim to face on the Investment Account. But the Ordinary Account decline has been slow, and without further action seems likely to remain so. The rest of this paper considers options for hastening the process.

Legal position of the National Savings Bank

5. Ordinary Account is governed by the National Savings Bank Act 1971. This stipulates that:

> "the establishment known as the National Savings Bank shall continue in existence for the receipt and repayment of deposits."

and that:

> "a deposit with the National Savings Bank may be made either as an ordinary deposit or as an investment deposit.

Options

6. The most radical option for Ordinary Account is abolition. To secure this, it seems that the Act would at the very least need heavy amendment - particularly if the Investment Account were to be retained.

7. The mechanics of abolition would be quite complex, and it would need to be phased in. The first step would be to take no new deposits after a stipulated date. Withdrawals might be allowed for a further period (say 1 year): then -

(a) Make Press TV and radio announcements inviting applications for repayment/reinvestment of all remaining balances. It would be far too expensive to write letters to all 15 million account holders for this purpose.

(b) Any balances still remaining after, say, 6 months would be transfered to a "service account" earning a low rate of interest (the now-defunct TSB Ordinary Account was treated in this way - interest on their "service accounts" is 2%).

(c) Take stock after, say, 5 years with a view to transferring a tranche, or all, of any remaining "service account" stock to the Consolidated Fund.

8. Another option would be <u>privatisation</u> which should be feasible if a buyer could be found. This too would need legislation, since the Act requires that NSB business shall be carried on by the Director of Savings. <u>Contracting out</u> the headquarters administration might be another option, but we should first need to obtain evidence that a reputable contractor (? Girobank, Post Officer Counters) could undertake the work as efficiently and more cheaply than DNS do at present.

9. Short of outright abolition there are a number of options for hastening the rate of decline which could be introduced by regulation or administrative action. Mr Patterson's letter mentions a few. They seem unexceptionable, but are hardly far reaching. Additional ideas are:

(a) <u>Interest rates</u>. Abolish the higher tier (at present 5%) and pay all investors the statutory minimum of 2½%. About £1 billion is held at 5% by 0.8m investors. This option should shake some higher tier money out, though it would have little impact on the actual number of accounts, most of which have small balances. However, there would be an annual saving of £25 million in interest costs.

(b) Pay interest on multiples of £5 rather than £1. This would complement the change in the minimum deposit, and might also be extended to the Investment Account. It should mean slightly tidier administration but seems unlikely to yield measureable savings in costs.

(c) Designate fewer Post Offices as handlers of Ordinary Account business. Since there is no longer a social case for wide spread availability of Ordinary Account facilities, they might be restricted to (say) the 1600 Crown Post Office (ie withdraw them from the 19000 sub-Post Offices). This would cut down agency costs significantly from the present level of £32m. But there would be a big political fuss from the National Federation of Sub-Postmasters, who see Ordinary Account as crucial to the viability of many rural sub-Post Offices. There would also be a difficult a "selling" job to persuade those in rural or urban areas that their access to cash in local post offices had not been impaired.

(d) Transaction charges and opening fee. Would help reduce administration costs. Transaction charges could be deducted when annual interest was added to the account, though we would have to have to accept that total charges should not exceed the interest. A refinement might be to charge an "administration fee" for opening an account. In general, both ideas would be out of step with banking and building society practice, though unit trust and insurance companies frequently charge "administration fees" in one way or another.

ANNEX B

PREMIUM BONDS

Background

1. Premium Bonds were introduced in 1956. There are now 24 million holdings, worth £2.1 billion. Contributions to funding (ie excess of sales over repayments) were £83 million in 1986-87 and £165 million in 1987-88 - small enough to be of no consequence. Quality of funding is poor, since bonds are capital certain and repayable on demand, though in practice many retain their bonds indefinitely in the hope of winning a prize.

2. This summer the interest rate or prize fund will be reduced from 7% to 6½%. The four biggest prizes are £250,000 (monthly) and £100,000, £50,0000 and £25,000 (weekly). There are some 185,000 smaller monthly prizes (mainly £50, but some ranging up to £10,000).

3. Administration is very expensive - about £21m a year in DNS costs and £2m a year in agency payments. DNS run the scheme from Lytham St Annes and Marton, employing over 1300 staff. About 400 on "common services" - eg ADP systems and support, management services, training, office services, security. The remaining 900 undertake the following main operational tasks.

Customer records	240
Death claims	190
General corrspondence	150
Repayments	130
Prizes	110
Purchases	80

Legislation

4. The scheme operates under secondary legislation - the Premium Bond Regulations 1972. Major changes would not entail amending or repealing existing primary legislation, though new Finance Bill legislation might be necessary.

What future for premium bonds?

5. Until late in 1986, Ministers were minded to pep up the scheme, mainly by introducing one or more very large prizes (say £1m) and freeing-up the present total ban on publicity for winners. An examination of administrative costs showed there was little scope for savings, but increasing the present minimum purchase of £10 and making bonds transferable when a holder dies found some favour in the Treasury (not in DNS).

6. Before the last election the Chancellor asked us to look at the possibility of winding the scheme up; and more recently at the idea of turning the scheme into an NHS lottery. The scheme could be wound down by taking new bonds off sale and allowing the existing stock to wither away over time, this would yield some immediate savings eg in staff processing new applications, agency payments and publicity. Other savings would accrue more gradually as the stock was run down. But all these could easily be swamped by extra costs in the transitional period, for example to handle extra correspondence from holders worried about the safety of their holdings or in redundancy costs if the staff cuts could not be met by natural wastage or deployment elsewhere. But the real difficulty is the politics of abolition. Premium Bonds are part of the popular consciousness. We could expect a considerable amount of protest (in which the Sub-Postmasters would no doubt be prominent) if we tried we get rid of them. But there should be no refinancing problem if the £2 billion stock were to be run down over a period of years. It would perhaps be easier to secure phasing out if the Government were to introduce a state lottery: for example holders might be offered the option of having their money returned or conversion into a number of free entries in the state lottery.

Other options

7. Other options for change are:

(a) Reducing prize money and/or altering the number of prizes. Under the prospectus, the Treasury reserves the right to vary the rate of interest, which automatically leads to some variation in the prize structure. But we might find we needed Finance Bill legislation if we wanted to adjust the rate solely to make the bonds less attractive. Such action could be judged to be a change in the implied terms of the contract. In any event, it seems likely to lead to charges of bad faith.

(b) Privatisation. This might be done by selling the existing bond portfolio to a private sector company. New primary legislation would be needed. At first sight it is hard to see this as an attractive commerical proposition to a potential buyer. Profit would be the difference between the investment proceeds from the portfolio of bonds, and the amount paid in prizes after meeting adminstrative costs. The buyer could probably operate profitabi~~lity~~ly on this basis with new purchases, but seems unlikely to be able to do so in the case of 24 million existing holders whose contracts (including implied terms) would have to be honoured. There would be political opposition to such a change, which could include industrial action by DNS staff. We would need to be certain that there was a serious potential buyer before giving any public hint that this option was a starter.

(c) Contracting out registration and sales. This would be feasible in principle though messy in practice. A tidier approach would be to contract out the whole administrative operation. The terms of the contract would need to be negotiated carefully, with the aim of ensuring the public that present high standards of security and impartiality were being fully maintained. It would also seem to be necessary to amend existing regulations in at least two respects:

- To permit the contractor to undertake on behalf of the Director of Savings the task of maintaining the register.

- To require the contractor to observe the standard of confidentiality (ie no publicity for prize winners).

(d) Mr Sandy Gilmour's proposal for an "Ernie Stamp". This would run counter to the Chancellor's desire to wind up the Premium Bond Scheme. It seems most unlikely to generate big inflows but it would attract money which on quality of funding grounds we do not want. Its main catchment would almost certainly be small investments. It seems likely that savings books or cards would take £10 worth of stamps - the present minimum investment in Premium Bonds, and administratively the most costly. There would be no cost saving for DNS - they would still have to meet the handling, registration and servicing charges, though the promoters would have to bear any Post Office charge for accepting stamps in lieu of cash. We have not sought DNS views at this stage. But they are likely to be opposed, both on administrative cost grounds and because they would see such a venture as "undignified".

129/5

J A Patterson

CONFIDENTIAL

NATIONAL SAVINGS

17 May 1988

D L C Peretz Esq
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Mr Rich

Dear David

NATIONAL SAVINGS CORPORATE PLAN 1988
A TRAILER

1. I have headed this letter a 'trailer' for the 1988 corporate plan. I know that you need some material on a number of our products in the next few days as a basis for consulting the Economic Secretary. So I am sending you some notes now in advance of the main document. In paras 16-20 I refer to the Ordinary Account.

2. We are in the thick of a big upheaval with the move to Public Sector Debt Repayment. And there is a big gap in our armoury in the pursuit of 'high quality' funding, because we do not yet know whether the new taxable five-year guaranteed instrument will find favour with Treasury Ministers. If it does there may be very important consequences in a number of areas, ranging from

(a) the balance between gilts and National Savings for new funding and refunding, to

(b) the internal management of our operation, and the scope for releasing change on the Ordinary Account front.

<u>Capital Expenditure - Information Technology and Accommodation</u>

3. One area which we cannot fill in in the next couple of weeks in our planning is a clear-cut information technology strategy, with a framework for a computer mainframe replacement programme for the end of the 1980s and the early 1990. My present aim is to let you have a corporate plan by the end of June, but I think that the information technology aspect will remain pretty sketchy until next year.

cc Miss O'Mara
Mr Rich
18/5

4. Since we are already $97\frac{1}{2}\%$ dispersed several hundred miles from London I am not proposing to deal with office location in the corporate plan. But I should put down a marker that we are beginning to run into expensive problems with our 20-year old buildings (the cladding of our Glasgow building is the first example). A few years ago we would not have had the cost ending up on our budget (either the Ordinary Account Fund or the PSA would have paid).

Post Office Counters

5. The biggest gap in any corporate plan written in the summer of 1988 is that it will precede the outcome of the Monopolies and Mergers Commmission report on post office counters services (due to be published in a few weeks) and our negotiation later this year and early in 1989 with the counters business on the new Agency Services Agreement to take effect from 1 April 1989. Since this accounts for nearly one-third of our running costs the outcome of our negotiation with Post Office Counters Ltd will have a profound effect on just how tightly we are squeezed by the PES baseline/cash limit/running cost limits over the period of the corporate plan (1989-90 to 1991-92), which is also the most likely duration of the next Agency Services Agreement.

Aims of National Savings

6. I am assuming that the formulation recently sent to Margaret O'Mara and included in my draft Annual Report for 1987-88 is on the right lines. It is based on the Economic Secretary's response to Mr Michael Jack MP on the PSDR and all that.

Personal Savers

7. The new aims stress personal savers. There is a trailer here that we should like to cut back on our 'corporate' business. There are some difficult dividing lines ranging from (a) individuals and trusts for individuals (clearly personal) and (b) group savings schemes, charities etc to (c) building societies etc. We are going through our existing legislation to see where we can best draw dividing lines, which for legislative reasons may not be the same for all products. But our general aim would be to confine eligibilities in future as nearly as possible to (a) for all existing products. And we would want to stick to (a) for any new product.

Refinancing Public Debt

8. The refinancing role has always been there. But it has only really become overt since our staff started to ask after the 1987 Budget whether there is a continuing role for National Savings at all with a very low PSBR (as they could see it last year). We were glad that the Economic Secretary put this role on the public record in his recent reply to Mr Jack.

9. It is now much clearer than it was a year ago how we can best help to engineer the outflow (from 'lower quality' funding). An unknown proportion of this needs to be refinanced by 'good quality' funding:

(i) by depressing the General Extension Rate as low as we decently can (without getting attacked for taking advantage of the ignorant or producing an avalanche with which we cannot cope);

(ii) by positive advertising of the low General Extension Rate in contrast to the 33rd or other concurrent new five-year Certificate;

(iii() by having a high 'reinvestment' limit on the 33rd Issue and successor Issues and setting this 'new money' limit very low by recent standards;

(iv) by marketing the Investment Account solely to non-taxpayers;

(v) by a generally lower interest rate level - this will be bound to push up the level of repayment from Income Bonds in particular (and Deposit Bonds which have the same interest rate) and also from the Investment Account, adding to the Glasgow workload as well as (iv).

10. I have deliberately left out the Premium Bond and Ordinary Account. One simple and novel table may show why:

Product	**Average Repayment** (£)	**No of Transactions to repay £500 million**
Ordinary Account	57	8,772,000
Premium Bonds	265	1,887,000
Investment Account	1,227	407,000
Savings Certificates	2,721	184,000
Income Bonds	6,536	76,000

11. We must expect a very high level of repayment from mature Savings Certificates and withdrawals from the Investment Account. At the same time the 'non-taxpayer' policy is bound to encourage heavy inflow work on that product. So we would be particularly nervous about encouraging withdrawals from the Ordinary Account, when we can predict both heavy inflows and heavy outflows on the other big Glasgow product, the Investment Account.

12. Now for a few notes on three particular products.

Index-linked Savings Certificates

13. We have in the next few weeks to fix the amount of the previously promised supplement for 1 August 1989 and indicate our position on any new annual supplements for index-linked certificates (and SAYE) for later years. From 1 August I should like to have a policy which takes more account of 'quality of funding' and aims to steer holders of mature index-linked certificates into the new Issue. To achieve this I suggest:

(a) that the supplement for 1 August 1989 should be a very modest one

(b) that we should aim to launch a 5IL on the day the 'old' supplement is earned (1 August) more on the lines of 33rd Issue, ie

(c) there would be a 'new money' limit confined to £1,000 and a reinvestment limit of £5,000.

Premium Bonds

14. I see no obvious scope for making much change to Premium Bonds - it would be extremely difficult eg to increase the minimum purchase from £10 without upsetting the 'grandparent purchase' and many other lobbies. We shall obviously wish to reduce the variable prize fund interest rate again if it gets too competitive. But I think that we should see it as a rate which changes infrequently - in either direction.

15. Since the middle of 1987 we have radically changed our marketing stance, and have virtually given up the 'small flutter' market, though that will always be one incentive to buy whether we address it in our marketing or not. Instead we are going for an 'investment with a bit of fun' market, eg in recent mailshots which brought in a lot of business averaging over £1,000 a time which of course is very much more cost effective. The long-term aim would be a run-down in the mass holdings (still over 24 million) and in the number of transactions. But the figures in para 10 on average repayments show just how vulnerable we would be in workload terms to a surge of work in that area.

Ordinary Account

16. In management terms by far our biggest problem area is the Ordinary Account. There is one change on the purchase side agreed last year which I should now like to bring in on 2 January (preferably to coincide with the launch of a new Glasgow product). This would achieve a significant reduction in transaction numbers. This means that it will be very unpopular with

(a) Glasgow staff

(b) the Post Office Counters Business

(c) the National Federation of Subpostmasters

17. We would in addition like to cut back the Ordinary Account to remove its 'pseudo-bank' activities in future (eg free standing orders, Paybill) while doing something positive to limit the number of transactions and to keep the Ordinary Account as a place for a few hundred pounds to be left undisturbed for a 'rainy day', or even £1,400 (at 5% achieves the £70 annual tax exemption) to be left totally undisturbed as a tax-free lump sum.

18. The one positive change we would like to make would be to increase the Regular Customer Account limit from £250 to £500. This enables a customer to withdraw large amounts but only at a single nominated post office. The scheme has been virtually fraud-proof since its launch in 1981 and it is economical because it cuts down on the number of withdrawal transactions. It also reduces the number of times a bank book needs to be sent to Glasgow. To improve the scheme in this way would also help us to rebut criticism of the proposed abolition of Paybill.

19. There are a number of other restrictions we are considering - mainly on relics from the past - (eg the special facilities still on offer to the armed forces and possibly restrictions on* 'corporate' business). But the main aim (apart from some very useful economies) would be to remove the features that have the flavour of a rather inadequate current account at a bank. One aim of the Regular Customer Account limit of £500 would be to encourage customers to put more money in as savings. But the psychological point is that it is difficult to manage a scheme if everything we do to it is negative.

20. The average size of withdrawals from the Ordinary Account shows why we are particularly nervous of a sudden collapse of confidence in the Ordinary Account let alone a drive to encourage a lot of money to get out for 'PSDR' reasons. The strategic aim as we see it is to encourage a run-down in transactions, but not to stimulate a significant net outflow.

Conclusion

21. I hope that this 'trailer' will give you sufficient indication of our 'product' thinking for the next few weeks.

Yours ever
John

J A Patterson

* our present legal advice is that to make this change for Ordinary Account and Investment Account would require primary legislation. But I hope that this would not automatically rule it out.

53/2/LPD/3770/021

CONFIDENTIAL

pup

FROM: P D P BARNES
DATE: 8 June 1988

MR CROPPER

cc PS/Chancellor
Mr Scholar
Mr Peretz
Miss O'Mara
Mr Rich

FUTURE OF NATIONAL SAVINGS

Thank you for your minute of 7 June.

2. The Economic Secretary is aware that Sir Iain Noble's proposal is distinct from that of Mr Gilmour. But he may have supposed that Mr Gilmour was himself a Scot, and I am afraid that, when minuting out the Economic Secretary's remarks, I incorrectly deduced from Mr Gilmour's membership of the Hon Company of Edinburgh Golfers that Mr Gilmour's Scottish affiliations were more substantial than now appears to be the case. I apologise for any confusion caused by this Sassenach inaccuracy.

3. On your substantive point, Miss O'Mara (who is now on leave) has indeed seen the letter from Sir Iain Noble. But as I explained, officials cannot make a considered analysis of Sir Iain's proposals unless he spells out in greater detail precisely what he is suggesting. You kindly undertook to explain to Sir Iain that for this reason these would be little point in a Ministerial meeting until he had thought through his proposals a bit further.

PB

P D P BARNES
Private Secretary

MAP

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

#The Rt Hon Douglas Hurd CBE MP
Secretary of State for Home Affairs
50 Queen Anne's Gate
LONDON
SW1H 9AT

CHIEF SECRETARY
REC. 10 JUN 1988
ACTION Mr Rich,
COPIES TO KR, FST, EST, Sir P Middleton
2 Mr Anson, Mr Phillips, Mrs Case,
Miss Pierson, Mr Turnbull, Mr Revolta
Mr Saunders, Mr Cropper, Miss O'Mara
Mr Tyrie, Mr Call

9 June 1988

Dear Douglas,

LOTTERIES

You kindly copied to me your letter of 13 May to John Wakeham inviting views on how best to take forward the consideration of our policy on lotteries.

You will recollect the view expressed in your letter of 22 December 1987 (which, as you know, I shared) that any move away from the present policy of strict monetary limits was likely to be extremely controversial. You were concerned about the possible diversion of monies away from smaller charities which relied significantly on income from local lotteries; about the scale of publicity and promotion which would necessarily attach to any national lottery, going well beyond provision for unstimulated demand; and about the susceptibility of such large scale concerns to fraud and other criminal activity.

I do not see that the recent abortive attempt to mount an illegal "National Health Service" lottery has changed that situation in any way and, while we should of course be prepared to review our policy here as in any other area, any major change would remain controversial and hazardous and should be approached with caution.

For that reason, notwithstanding the doubts expressed in your letter of 13 May, I remain attracted to the idea floated in your earlier letter of an increase - possibly very substantial - in present limits on prize and stake monies. This could be achieved without recourse to legislation: it would demonstrate our flexibility without incurring the kind of opposition which a more radical statutory remedy would meet: it could provide useful information about the consequences of larger lotteries for local charities and for Gaming board and local authority supervisory procedures: and it would give a pointer to the probable acceptability or otherwise of a less restrictive policy for the future.

I would therefore favour an option which avoided any commitment to legislation but which acknowledged that there might be scope for some review of policy for the future in light of changing public attitudes towards large scale lotteries: and which, in light of that trend, proposed an early and substantial increase in present monetary limits.

Copies of this letter go to Kenny Cameron, other members of H, the Chief Whips in both Houses and to Sir Robin Butler.

Yours ever,
Mal

MALCOLM RIFKIND

3633/29

CONFIDENTIAL

FROM: P J CROPPER
DATE: 10 June 1988

PS/ECONOMIC SECRETARY

cc PS/Chancellor
Mr Scholar
Mr Peretz
Miss O'Mara
Mr Rich

FUTURE OF NATIONAL SAVINGS

I attach copies of further correspondence with Mr Gilmour.

P J CROPPER

3633/28

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-270 3000

Direct Dialling 01-270 4359

P J Cropper CBE
Special Adviser

10 June 1988

A C Gilmour Esq
99 Bishopsgate
LONDON EC2M 3XD

Dear Mr Gilmour,

Thank you for your letter of 6 June.

Your proposals are very definitely in the system, but I cannot encourage you to expect an answer for a little while yet. Even your more limited ideas have implications which have to be carefully worked out.

Yrs sincerely

Peter Cropper

P J CROPPER

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6th June 1988

P J Cropper Esq CBE
HM Treasury
Parliament Street
London SW1P 3AG

Dear Mr Cropper,

Thank you so much for passing the message to me on Thursday.

As you no doubt heard from my message, we had been to Hill Samuel to discuss the project. As far as I am aware, they are waiting for me to re-do the business plan before formally committing themselves to the project.

Jim Macfarlane, Tony Good and myself, who are the inner cabal on this project, are firmly of the view that we have to start off the Ernie Stamp scheme as soon as possible, as according to our market surveys, the time is ripe.

We believe that the idea of "privatising" the Department of National Savings is probably a complete non-starter and anyway would take a very long time to deal with, as Government would have to take a lot of decisions and most of them would be difficult ones.

The third idea of becoming the marketing arm of Premium Bonds is still one that we would like to pursue, especially as we believe that Ernie Stamps will be a tremendous success and thereby, in its way, promote Premium Bonds.

Yours ever
Sandy Gilmour

A C Gilmour.

ACG/IAM.

3633/7

pps pt
Pn

PRIVATE AND CONFIDENTIAL

FROM: P J CROPPER
DATE: 13 June 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Tyrie
Mr Call

NATIONAL SAVINGS

Reading Mr Rich's minutes to the Economic Secretary of 3 June (A new taxable fixed rate instrument) and 8 June (Some Strategic Issues), I kept think of Clough: "Thou shalt not kill; but needs't not strive officiously to keep alive".

2. If one compares the utility of 8,000 people employed in the DNS, with the contribution they could make to revenue and to national efficiency if they were re-deployed in the Inland Revenue or Customs, one must wonder.

3. Surely there is little of real value going on at DNS, which the private sector would not readily undertake.

P J CROPPER

15 JUN 1988

10 DOWNING STREET

LONDON SW1A 2AA

mp

THE PRIME MINISTER

FINANCIAL SECRETARY
REC. 15 JUN 1988
~~ACTION~~ Mr. Peretz
COPIES TO PPS, CST, PMG, EST
Sir P. Middleton
Mr. Anson
Mr. Saunders
~~Mr. MacAuslan~~
Mr. Tyrie ; Mr. Call

13th June, 1988

Dear Simon

Thank you for your letter of 26th May asking me to consider the establishment of a national lottery to raise additional money for the NHS.

I recognise the current interest in lotteries, and you may rest assured that your proposals will be taken into account alongside other ideas which are being considered. Available options would seem to range from leaving the law as it is, through increasing the limits on turnover and prizes under the Lotteries and Amusements Act 1976, to changing the law to enable one or more major lotteries on a national scale.

An important factor to be taken into account in reviewing our policy is the possible impact on those lotteries which already exist, not least those directed to health projects, and on other voluntary fundraising efforts directed to specific health facilities.

I hope that this reply is helpful and I am grateful for your interest.

Yours ever

Margaret

Simon Burns Esq MP

3633/26

CONFIDENTIAL

FROM: P J CROPPER
DATE: 17 June 1988

ECONOMIC SECRETARY

cc PS/Chancellor
Mr Scholar
Mr Peretz
Mr Ilett
Miss Noble
Miss O'Mara
Mr Rich

Mr Patterson DNS

SAVINGS

I had my lunch with Sir Iain Noble on Wednesday, and told him that there was not a lot we could say without him and his group working up their proposals in more detail. It was clear to me that he and his immediate group would find difficulty in doing that in the form we would look for: they have little idea of how the system works. This would not, perhaps, matter very much if they were just another crowd from EC2. But they are from Edinburgh and this may be the nearest thing we shall see to a competent privatising initiative from Scotland.

2. It becomes fairly urgent, to my mind, that the Noble group be seen by either Treasury Ministers or officials. From my mid-stream position there is a limit to what I can do or say. Of their earnestness and respectability I have no doubt at all, but I am not sure that they really know how they would turn DNS into a viable profit-making institution if they found themselves with it on their hands. I may under-estimate them, and one recalls particularly that their Professor McKay made a very good impression at the Chancellor's conference table when he came to see us with the whisky lobby eighteen months ago.

3. A considerably more tricky holding situation has arisen in the case of Mr Gilmour. The other day he rang my secretary to ask whether he could come and see me: when he arrived

yesterday he was accompanied by five others. They included a Director of Hill Samuel, and the Deputy Chairman of Lowe Bell Communications. I was appalled, but had to accept the situation.

4. I played an entirely straight bat, saying I could say nothing and reminding them that things moved at a somewhat different pace in government: people cannot give snap answers to complex questions in the manner of a market dealer. This group are impatient to get going with their Earnie stamp thing, which is - I think - fairly well worked out. They are limiting their objectives to that at present, although interested in the broader possibilities of taking on management of the Premium Bond, or DNS as a whole. One sometimes needs to remind oneself that Hill Samuel are part of TSB.

5. I am putting this note in to you ahead of Monday's meeting because I do not think I can be left holding either of these two babies much longer. I might drop one. In my view, it is highly desirable that both groups be seen by proper people before the end of July.

6. Standing back, my suspicion is that what both groups are seeing in DNS is a crock of inactive gold. It is no surprise that their fingers itch.

PJC

P J CROPPER