



Treasury Chambers, Parliament Street, SW1P 3AG  
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PRIME MINISTER

I have been considering the steps I shall need to take in order to recoup the £85 million of revenue lost as a result of the concession on derv that I announced on 30 April.

2. The right time to introduce the necessary amendments to the Finance Bill will be at Report Stage. This is likely to be in the second week of July. We shall have to make our intentions known a little sooner so that the necessary Ways and Means Resolution(s) can be tabled and debated before the amendments are taken in the House. I shall need to discuss the precise timing with the Leader of the House and the Chief Whip. But I would hope that we could delay taking any action until shortly before Report Stage.

3. It follows that we do not need to take firm decisions now on the taxes that are to be increased to pay for the derv concession. As you are aware however from our previous discussions, the options open to me are extremely limited. In my view we have no alternative but to raise the money from the other excise duties. My provisional conclusion is that we should go for a combination of increases in the betting and gaming duties and a further increase in the tobacco duty.

4. A more substantial contribution from gambling would involve changing the structure of the taxes, which would be difficult, and, in any event, is simply not possible this year. But it would be possible to get another £20 million or so from betting and gaming this year by raising the "off course" rate of general betting duty from  $7\frac{1}{2}$  per cent to 8 per cent, the bingo duty from

$7\frac{1}{2}$  per cent

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You will want  
to discuss this  
with the Chancellor

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7½ per cent to 10 per cent and by ad hoc increases in the gaming machine licence duty. I believe that it would accord with the wishes of our supporters to obtain the maximum revenue that is available from these sources. And there is the further advantage that increases in the gambling taxes would not add to the RPI.

5. For tobacco, I have in mind an increase of 3p on a packet of cigarettes. This would raise £55 million this year, giving a total for 1981-82 of some £75 million. That is some £10 million short of the cost this year of the derv concession, but the revenue raised in a full year would be only £5 million short of the full year cost of the concession. The effect of the tobacco duty increase would be to add 0.15 per cent to the RPI.

6. The alternative to an increase of 3p on cigarettes would be to put another 1p on beer. This would raise approximately the same revenue at a marginally smaller cost of 0.10 per cent on the RPI. But it would be difficult politically to increase beer duty without at the same time increasing the duty on spirits. The balance of the arguments, including those of health policy, points in my view to concentrating the increases on tobacco.

7. Given that getting inflation down is one of our major policy aims, and having regard to the inevitable fragility of our success so far, it is of course most unwelcome that my proposal should add 0.15 per cent to the RPI. But I think we have to accept this. I have said publicly that the loss resulting from the concession on derv will have to be recovered, and in my view the course I propose is the best way of doing this. I should make it clear, of course, that the 0.15 per cent is within the margins of forecasting error on the RPI, and that I shall stand by my judgement made at the time of the Budget that inflation over the year to the fourth quarter of 1981 is expected to be 10 per cent.



8. I am sure it is right that we should insist that the cost of the derv concession be met by offsetting increases in other taxes. But I should wish to make equally plain to our colleagues that there are no easy options available for paying for additional public expenditure out of higher taxation. By way of illustration I may perhaps mention the measures to assist industrial energy prices which we are considering in MISC 56. These could cost up to £150 million this year. To find sums of that order from the excise duties, in addition to the £85 million needed to offset the derv concession, would require both an increase on beer (2p on a pint of beer with commensurate increases on other drinks would raise about £160 million this year) and a substantial increase on tobacco. Increases on that scale would add something like  $\frac{1}{2}$  per cent to the RPI. That would probably call for a revision of my Budget inflation forecast of 10 per cent and, as a consequence, raise the issue of a compensating adjustment of social security upratings. It would also begin to call in question the Budget judgement.

9. To embark on additional public expenditure financed through higher taxation would at one and the same time undermine two of our central policy objectives - the reduction of public expenditure and the reduction of taxation. Since we came to office circumstances have forced us to go in the wrong direction on both of these, and we must try to call a halt. This means in my view that any addition to public expenditure this year will either have to be matched by savings on other programmes or charged to the Contingency Reserve.

10. As you are aware, the position, on this year's contingency reserve is already tight. Very large additional requirements are in prospect for the nationalised industries, such as coal and British Telecoms, and a wide range of bids can already be foreseen in other areas. The totals involved represent a real

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threat to the reserve. In these circumstances we must take a very rigorous attitude towards any proposals for additional expenditure that cannot be met from offsetting savings.

11. I am sending this to you on a personal basis.

*R. Toke*

for,

(G.H.)

19 May 1981

[Approved by the Chancellor and  
signed in his absence]

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