

CONFIDENTIAL

PRIME MINISTER

18 April 198

You may recall that we discussed the possibility of a national lottery to raise finance for the NHS earlier in the year. Our conclusion then was that although the specific objections to such a lottery were groundless, many people would regard it as too frivolous and eccentric a method of raising money for the nation's medical care. Unless it was likely to raise really substantial revenue, therefore, it should not be considered further.

In the meantime, however, Oliver Letwin at Rothschilds has continued his study of such a lottery for the Treasury. His first report and a further note on recent developments, which I enclose, suggest that a lottery would raise very large sums in the present and foreseeable financial climate. Privately, Mr Letwin estimates potential revenue to be as high as £3 billion.

Rothschilds make two other significant points. First, that the revenue should be placed in a "National Investment Fund" to avoid the well-known drawbacks of hypothecation. We should be wary of this. It might give a future Government of the Left £3 billion annually to nationalise industries. A lottery hypothecated for the NHS, however, would be untouchable - and £3 billion is equal to 15% of current NHS spending.

Second, the report suggests that a lottery could be run by the Post Office, making full use of the Post Office computers and bolstering the sub-post offices. That is a substantial additional advantage.

Recommendation

There is a good case for studying a lottery seriously while the Health Service Review is in progress. I suggest that we

CONFIDENTIAL

CONFIDENTIAL

ask Norman Lamont at the Treasury to complete his work on
this and report on it as a matter of urgency.

John O'Sullivan
JOHN O'SULLIVAN

CONFIDENTIAL

THE ESTABLISHMENT OF A NATIONAL LOTTERY :

A FURTHER NOTE

NEW DEVELOPMENTS

Since the submission of our memorandum on a national lottery to the Treasury in December 1986, the financial climate has altered considerably. The alteration appears to have increased both the potential demand from prospective punters and the likelihood of interest from major financial institutions:

Potential Demand

In the past year, real personal disposable income has been rising fast - with an aggregate increase (after allowing for seasonal variations) of over 2% in the first quarter of 1987 alone, and with continued growth thereafter. This will clearly have tended to increase the amount of spare cash that is in principle available for personal risk-investment. More recently, however, participation in the equity market - which was steadily increasing its hold on such spare cash - has (for obvious reasons) become somewhat less attractive to small investors. As a result of these two trends, the potential appetite for risk-taking outside the equity market has clearly increased.

There are, of course, enormously significant differences between the form of risk involved in equity investment and the form involved in any kind of soft gambling. However, the fact remains that both are risk-investments from the investor's point of view; and there is some evidence that soft gambling can be regarded as a substitute for the equity market. In Australia, for example, there has been a significant influx of lottery funds since the stock market decline. In the U.K., the continuing popularity of premium bonds will, no doubt, to some extent assuage the appetite for such substitutes - but premium bonds have a relatively staid image: a new form of risk-taking might well excite more enthusiasm and tap a larger proportion of the increased potential demand.

Institutional Interest

During recent months, we have held some discussions with major financial institutions, to investigate the possibility of their taking an interest in the promotion of a national lottery. We have assumed, throughout, that the regulation of the lottery and the vast bulk of the proceeds would lie with the Treasury, but that private promoters would receive some small fraction of the profits. We had originally suspected that such a scheme might be feasible - as we made clear in our original

memorandum. However, we had anticipated difficulty in attracting the most serious institutions. It is now clear from our discussions that there is considerable latent interest in the proposal amongst some of the most reputable institutions. This provides an opportunity to place the management and promotion of the lottery in 'safe' private sector hands - removing any of the connotations that might arise if the backers came from the traditional gaming industry.

DEVELOPMENTS IN OUR OWN THINKING

In addition to these new external developments, we have clarified certain aspects of our own thinking about possible methods of administering a lottery:

Post Office Participation

We had originally imagined that the customer services involved in a national lottery (receipt of money, issuing of certificates etc.) would be run by newsagents or other private sector agencies. It has since occurred to us, that the Post Office could, in fact, become a major participant - or indeed the major participant. This would have a number of advantages. It would represent:

1. a further increase in counter-services, in line with current policy and producing additional revenues;
2. a natural extension of the counter-service computerisation programme - both reducing the costs of installing on-line facilities for the lottery and making better use of the fixed costs involved in the Post Office's computer;
3. a method of reassuring the public that the lottery was in 'safe' hands, and that it was being run comfortably in parallel with the premium bond scheme.

The Hypothecation Problem

We had also originally suggested that the lottery might be more attractive (both to the subscribers and to the public at large) if the proceeds of it were devoted to a particular set of good causes - such as the inner cities, training etc. We recognised, however, that any rigid hypothecation of funds would be regarded as a dangerous precedent by those responsible for the general control of public expenditure. We have since thought of a method which might combine the advantages of hypothecation with the advantages of consolidation:

1. all exchequer proceeds from the lottery would notionally be placed in a 'National Investment Fund';
2. the rules of the Fund would allow the money to be used for a wide variety of purposes, each with popular appeal;
3. decisions about the specific uses of the Fund in any given year would be made at the end of the public expenditure round - acting as a 'gap-plugging' device, to be used at the discretion of the Treasury.

Television

Since our original memorandum, discussions with promoters of lotteries in other countries have also alerted us to television as a potential source of exchequer revenue. It appears that the 'draw' for the lottery can have enormous appeal to television audiences - attracting millions of viewers at prime time to the channel on which it is shown. As a result, an auction could be set up by the promoters of the lottery - with ITV and Channel 4 stations making bids for the right to stage the draw. The funds realised from this auction - which could represent a significant addition to total lottery receipts.

TIMING

Our view that the time is now ripe for a national lottery does not, however, rest solely on the new developments in the external world and in our own thinking. It is also based on the belief that both the political calendar and the likely timing and scale of privatisation receipts make this exactly the right moment to be starting the scheme.

In December 1986, it might have been argued - with some justice - that the establishment of a lottery just before the end of a parliament was inappropriate, since there will no doubt be initial objections from some quarters, whereas the full benefits of the lottery will take two or three years to flow through. The same argument now applies in reverse: if the Government were to establish the statutory framework for a lottery in, for example, the March 1988 Finance Bill, this would enable the promoters to start operating by the end of 1988, with increasing proceeds flowing into the exchequer over 1989, 1990 and 1991 - in time for the benefits to be enjoyed during the lifetime of this parliament.

This timing will also provide an addition to bolster receipts in the years when, some of the major privatisations now planned may have been expected to occur, and which may possibly

(if current market conditions persist) attract rather less cash than was previously imagined. Indeed, if the lottery were to produce a steady stream of net additional revenues, these might have a significant value - with commensurate effects on budget planning for the 1990s.