Financial Statement and Budget Report 1990–91

HM TREASURY
MARCH, 1990

Anderton

Financial Statement and Budget Report 1990-91

Return to an Order of the House of Commons dated 20 March 1990: for

Copy of Financial Statement and Budget Report 1990-91
as laid before the House of Commons by
the Chancellor of the Exchequer when opening the Budget

Treasury Chambers
20 March 1990 } Peter Lilley

Ordered by the House of Commons to be printed 20 March 1990

LONDON : HMSO

£8·50 net

House of Commons No. 286

Contents

Table 1.1 The Budget measures[1]

	£ million 1990–91 Changes from a non-indexed base	£ million 1990–91 Changes from an indexed base	yield(+)/cost(−) 1991–92 Changes from an indexed base
Income tax			
main allowances indexed	−1 495	—	—
basic rate limit frozen	—	+220	+400
car benefit scales increased by 20%	+160	+160	+200
workplace nurseries benefit exempted	−10	−10	−10
Excise duties			
tobacco duties increased	+330	+75	+85
petrol, derv and other oils duties increased	+795	+175	+195
alcohol duties increased	+310	+20	+25
vehicle excise duty on cars, buses etc unchanged	—	−185	−190
other vehicle excise duty changes	+15	−25	−25
pool betting duty rate reduced	−20	−20	−20
Tax Exempt Special Savings Accounts	−20	−20	−200
Composite rate tax abolished	—	—	+550
Stamp duties on shares abolished	+5	+5	−120
Corporation tax			
small companies' limits increased by a third	⋆	⋆	−25
relief for doubtful sovereign debt phased	⋆	⋆	+200
Value added tax			
bad debt relief	—	—	−150
reform of registration rules	−35	−35	−75
Other tax changes[2]	+35	+70	+115
Capital limits raised for income-related benefits[3]	...	...	...
Total	**+70**	**+430**	**+955**

[1] *The tax measures, and the basis of the costings shown, are described in detail in chapter 4.*

[2] *Mainly life assurance measures already announced: see chapter 4.*

[3] *See chapter 5. Public expenditure costs of around £120 million from 1990–91 will be met from the Reserve.*

— = *Nil.*
⋆ = *Negligible.*
... = *Not applicable.*

1 The Budget

1.01 The objectives of the Government's economic policy are to defeat inflation and to promote output growth and the creation of jobs.

1.02 The Financial Statement and Budget Report (FSBR) supplements the Chancellor's Budget Statement. It presents the Medium Term Financial Strategy (MTFS); describes developments in the economy over the past year and provides economic forecasts to mid-1991; sets out the tax proposals in the Budget; summarises the Government's spending plans; and gives forecasts for the public finances for the year ahead.

The Medium Term Financial Strategy

1.03 Chapter 2 describes the Government's economic strategy for the next four years. Policy will be directed to achieving a substantial reduction in inflation; this will mean a temporary period of slower output growth, but the growth rate is expected to recover over the medium term. Both fiscal and monetary policy will be set to achieve the objective of lower inflation. The Government will continue to target M0, and also to take a range of other indicators into account in assessing the stance of monetary policy. The Government will join the Exchange Rate Mechanism of the European Monetary System when certain conditions are met. Fiscal policy will remain tight; the medium term objective is a balanced budget.

The economy

1.04 Chapter 3 describes the main developments in the economy in 1989 and the prospect to mid-1991. The economy slowed down in 1989, in response to the tightening of policy; it is likely to slow further in 1990, with growth expected to be around 1 per cent. Retail price inflation picked up in 1989; it is likely to rise further in the next few months before falling back to $7\frac{1}{4}$ per cent by the fourth quarter of 1990. It should fall more sharply, to 5 per cent, by mid-1991.

Tax measures

1.05 Chapter 4 sets out the tax proposals in the Budget. They include indexation of the main income tax allowances, broad indexation of the excise duties, the creation of Tax Exempt Special Savings Accounts, the abolition of composite rate tax and stamp duties on shares, an increase of a third in the small companies' corporation tax limits, and phasing of tax relief for doubtful sovereign debt. Table 1.1 summarises the direct effects of these measures on the public sector debt repayment (PSDR).

Public expenditure

1.06 Chapter 5 summarises the Government's spending plans as set out in the 1990 public expenditure White Paper, and describes the proposal to raise the capital limits for income-related benefits. This chapter also provides the latest estimate of outturn for the planning total in 1989–90.

Public sector finances

1.07 Chapter 6 presents the complete financial picture for the public sector. The PSDR is forecast to be £7 billion in 1989–90. This is the third successive year of debt repayment. A further debt repayment of £7 billion is forecast for 1990–91. Table 1.2 shows the main components of general government receipts and expenditures.

Table 1.2 The finances of the public sector[1]

	£ billion 1989–90 1989 Budget[2]	Latest estimate	1990–91 Forecast
RECEIPTS			
Inland Revenue:			
Income tax	46·9	48·7	55·0
Corporation tax[3]	22·4	21·4	20·7
Petroleum revenue tax	1·4	1·1	1·1
Capital gains tax	2·1	1·9	2·1
Inheritance tax	1·1	1·2	1·2
Stamp duties	2·4	2·1	1·9
Total Inland Revenue	**76·3**	**76·4**	**81·9**
Customs and excise:			
Value added tax	30·0	29·7	32·1
Petrol, derv duties etc.	8·8	8·8	9·7
Tobacco duties	5·1	5·0	5·4
Alcohol duties	4·7	4·6	4·9
Betting and gaming duties	1·0	1·0	1·0
Car tax	1·4	1·5	1·5
Customs duties	1·8	1·8	1·9
Agricultural levies	0·1	0·1	0·1
Total Customs and Excise	**52·9**	**52·4**	**56·7**
Vehicle excise duties	2·9	2·9	3·0
Oil royalties	0·6	0·6	0·7
Rates[4]	19·7	20·1	12·2
Other taxes and royalties	3·7	4·4	4·4
Total taxes and royalties	**156·1**	**156·8**	**159·0**
National insurance and other contributions	34·3	33·1	35·9
Community charge	0·8	0·8	11·2
Interest and dividends	7·0	7·2	6·4
Gross trading surpluses and rent	3·3	3·0	3·0
Other receipts	4·8	2·5	3·1
General government receipts	**206·4**	**203·4**	**218·6**

	£ billion 1989–90 1989 Budget[2]	Latest estimate	1990–91 Forecast
EXPENDITURE			
Central government's own expenditure	**125·8**	**127·0**	**137·8**
of which:			
Social security	47·5	47·0	52·0
Health and OPCS	19·8	20·0	22·1
Defence	20·1	20·6	21·2
Scotland	4·0	4·0	4·4
Wales	1·9	1·9	2·1
Northern Ireland	5·2	5·5	5·7
Other departments	27·4	28·0	30·2
Central government support for local authorities	**n.a.**	**38·0**	**41·8[5]**
Financing requirements of public corporations	**0·8**	**1·6**	**1·4**
Privatisation proceeds	**−5·0**	**−4·2**	**−5·0**
Reserve	**n.a.**	**—**	**3·0**
New planning total	**n.a.**	**162·3**	**179·0**
Local authority self financed expenditure	n.a.	13·9	13·3[6]
Central government debt interest	17·0	17·7	17·0
Accounting adjustments	n.a.	3·9	3·4
Other items	55·7		
General government expenditure	**194·3**	**197·7**	**212·7**

Receipts, expenditure and debt repayment

	£ billion 1989–90 1989 Budget[2]	Latest estimate	1990–91 Forecast
General government receipts	206·4	203·4	218·6
General government expenditure	194·3	197·7	212·7
General government debt repayment	12·1	5·7	5·9
Public corporations market and overseas debt repayment	1·7	1·4	1·0
Public sector debt repayment	**13·8**	**7·1**	**6·9**

[1] *In this and other tables constituent items may not add up to totals because of rounding.*
[2] *On current definitions. Some components of the new planning total and some of the items between the new planning total and GGE were not forecast in the 1989 Budget—see annex to chapter 5. Full comparisons of estimated outturn in 1989–90 with the plans in the 1989 Budget are given in tables 5.3 and 5.4.*
[3] *Includes advance corporation tax (net of repayments):* 6·8 7·3 7·5
— also includes North Sea corporation tax after ACT set off and corporation tax on gains.
[4] *Local authority rates and national non-domestic rates.*
[5] *Excludes allocations from Reserve: see footnote 2 to table 5.1.*
[6] *See footnote 3 to table 5.1.*

2 The Medium Term Financial Strategy

2.01 The central objective of the Medium Term Financial Strategy (MTFS) is the defeat of inflation.

2.02 Inflation damages the economy by increasing uncertainty, discouraging investment and reducing profitability. It brings conflict into industrial relations and reduces confidence in the management of the economy, at home and abroad. Action to maintain the soundness of the currency remains a prime duty of government.

2.03 The social effects of inflation are no less destructive. Inflation redistributes income and wealth arbitrarily and capriciously. It erodes savings and is a disincentive to those who wish prudently to provide for their retirement. It bears most heavily on people least able to protect themselves.

2.04 The rise in inflation in the post-war period was put into reverse in the 1980s. This was done by maintaining tight monetary and fiscal policies, complemented by structural policies to improve the responsiveness and flexibility of markets. That remains the right approach to economic policy and the one the Government will follow in the 1990s.

2.05 The MTFS will remain the centrepiece of the Government's economic policy. It will continue to be accompanied by policies which encourage enterprise, flexibility and efficiency, and thus promote the growth of output and the creation of jobs.

2.06 All major western governments have increasingly followed these policies in recent years, giving primacy to the drive against inflation. The means of controlling inflation are fundamentally the same in all countries, whatever their institutional structure. They are based on an effective monetary policy supported by a firm fiscal policy. No other methods have been successful.

2.07 These policies do not guarantee a permanent low rate of inflation. Unforeseen events at home or overseas can cause pressures which may lead to a rise in the general price level, as happened with the increases in oil prices in 1973 and 1979. At other times prudent policy decisions taken for the right reasons on a balance of risks can have unforeseen consequences for inflation. But maintenance of sound monetary policies will always require corrective action to be taken, to reverse the rise in inflation and set it on a downward trend.

2.08 This is the course which monetary policy has followed in the United Kingdom over the past decade. It brought inflation down sharply from the high levels of the 1970s, and was set to bring about a further reduction until the renewed resurgence of inflationary pressures in 1987 and 1988. The Government's response to this renewed threat was to tighten monetary policy sharply.

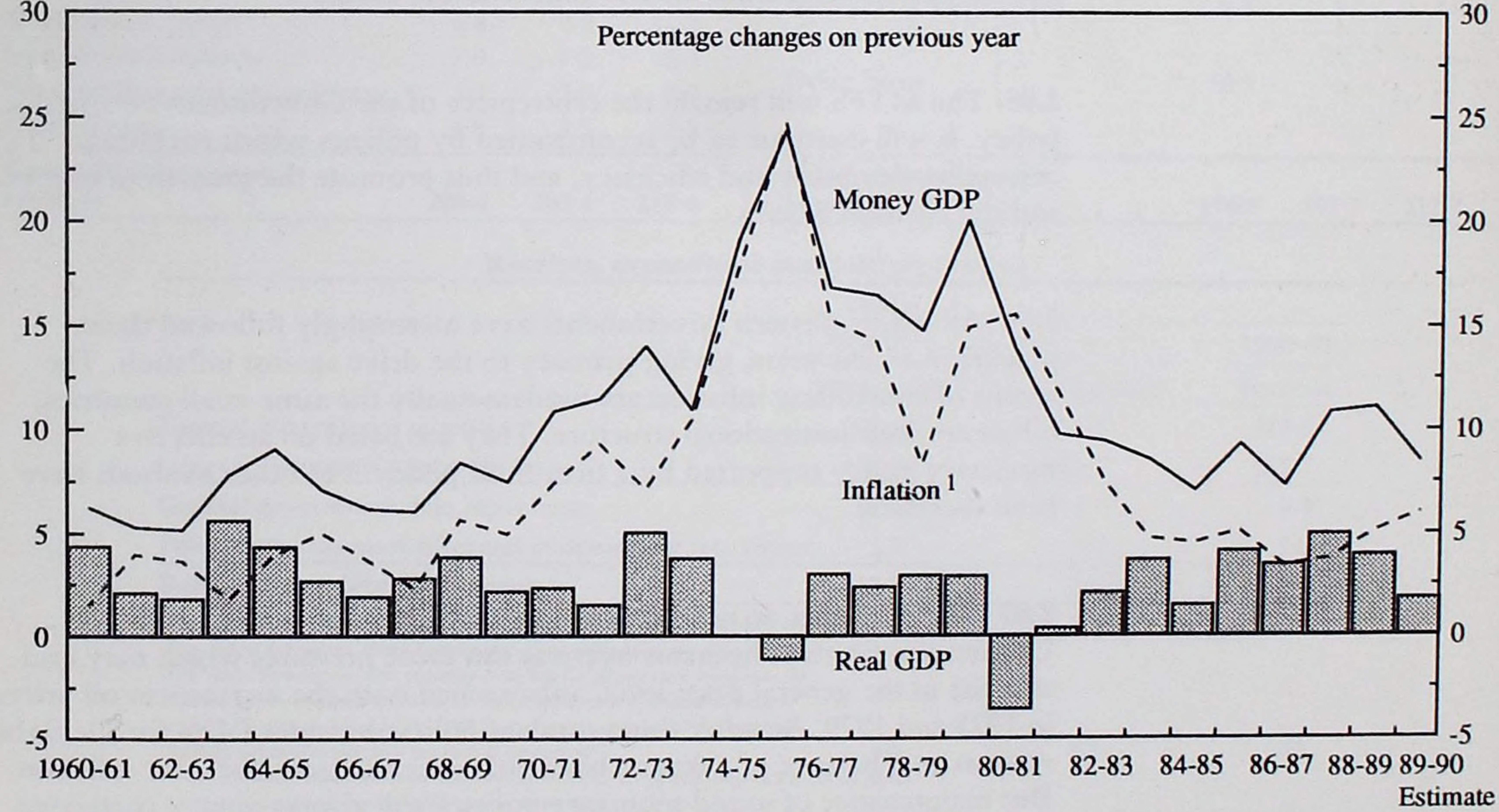
2.09 The Government is determined to bring about a decisive fall in the rate of inflation. But it is not enough simply to state this. It is important for the Government to say clearly how it intends to operate monetary policy, now and in the future, and to set itself realistic objectives which, with determination, will be achieved. In this way the whole economy can work with the grain of the Government's counter-inflation policy.

2.10 The following sections set out the Government's economic policy in more detail, explain how monetary and fiscal policies have been formulated, and how the Government makes decisions about interest rates.

Money GDP and inflation

2.11 The rate of growth of money GDP has averaged some 10 per cent a year over the last three years. This is much too high. The Government's strategy is to keep policy tight enough to secure a much lower rate of growth in money GDP over the next few years. This should bring about a substantial fall in inflation.

Chart 2.1 Money GDP, output and inflation



1 *The all items RPI until 1975-76; after 1975-76 the RPI excluding mortgage interest payments.*
(Mortgage interest payments were included in the RPI from January 1975.)

2.12 Chart 2.1 illustrates the close relationship between growth in money GDP and inflation over the last 30 years. Sharp changes in money GDP growth are often associated in the short term with changes in output. But sustained changes in money GDP growth are reflected in inflation rather than real growth. The extent of the short term impact on output depends on how well markets work. The labour market is particularly important in this respect: if labour costs continue to rise fast well after policy has been tightened, that is bound to result in lost output and higher unemployment.

2.13 The period covered by the MTFS is being rolled forward this year to end in 1993–94: table 2.1 shows the Government's objective for money GDP growth over this period. Real GDP growth is forecast at 1 per cent in 1990–91 (more details are given in chapter 3), but is expected to recover in 1991–92. For 1992–93 and the following year output growth is projected at 2¾ per cent, the same trend as assumed in last year's MTFS. The easing of capacity utilisation that the forecast implies should mean much more moderate inflationary pressures over the medium term.

Table 2.1 Money GDP growth, output and inflation[1]

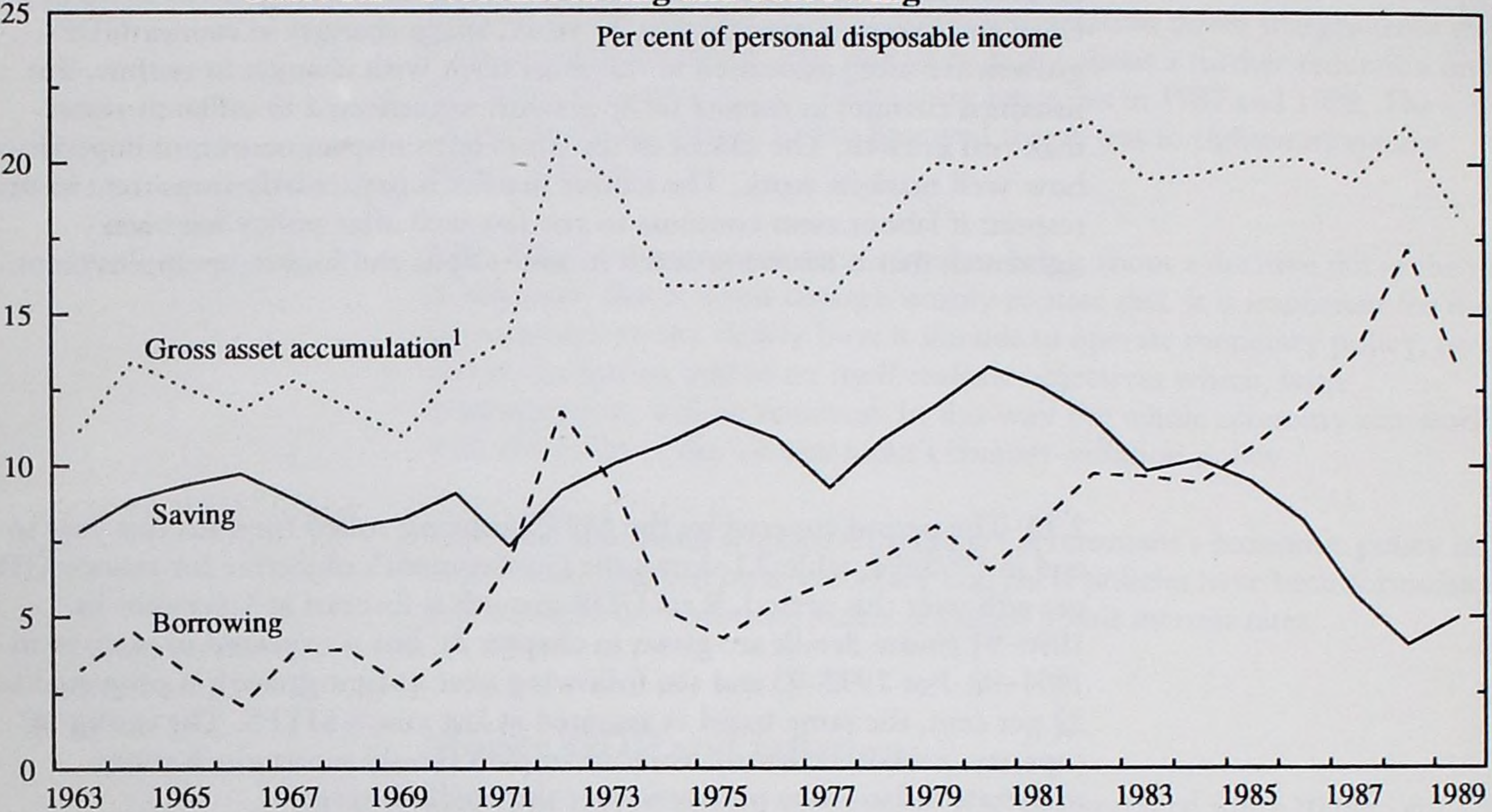
	1989–90[2]	1990–91[2]	1991–92	1992–93	1993–94
Money GDP	**8½(8½)**	**5¾(7½)**	**6¾**	**6¼**	**5¾**
Real GDP:					
Non-North Sea	2½	1	2	2¾	2¾
total	1¾	1	2	2¾	2¾
Inflation:					
GDP deflator	6¼(6½)	4½(6½)	4¾	3½	3

[1] *Percentage changes on previous financial year. The figures for 1990–91 are forecasts; the figures for subsequent years show the Government's medium term objectives for money GDP and consistent assumptions for output and inflation.*

[2] *The figures in brackets for money GDP growth and the GDP deflator adjust for the distortion arising from the abolition of domestic rates. This is explained in the box on page 45.*

2.14 The main factors in the high demand growth of recent years have been a boom in business investment and buoyant consumers' expenditure. The personal saving ratio has fallen sharply since 1985, associated with higher borrowing.

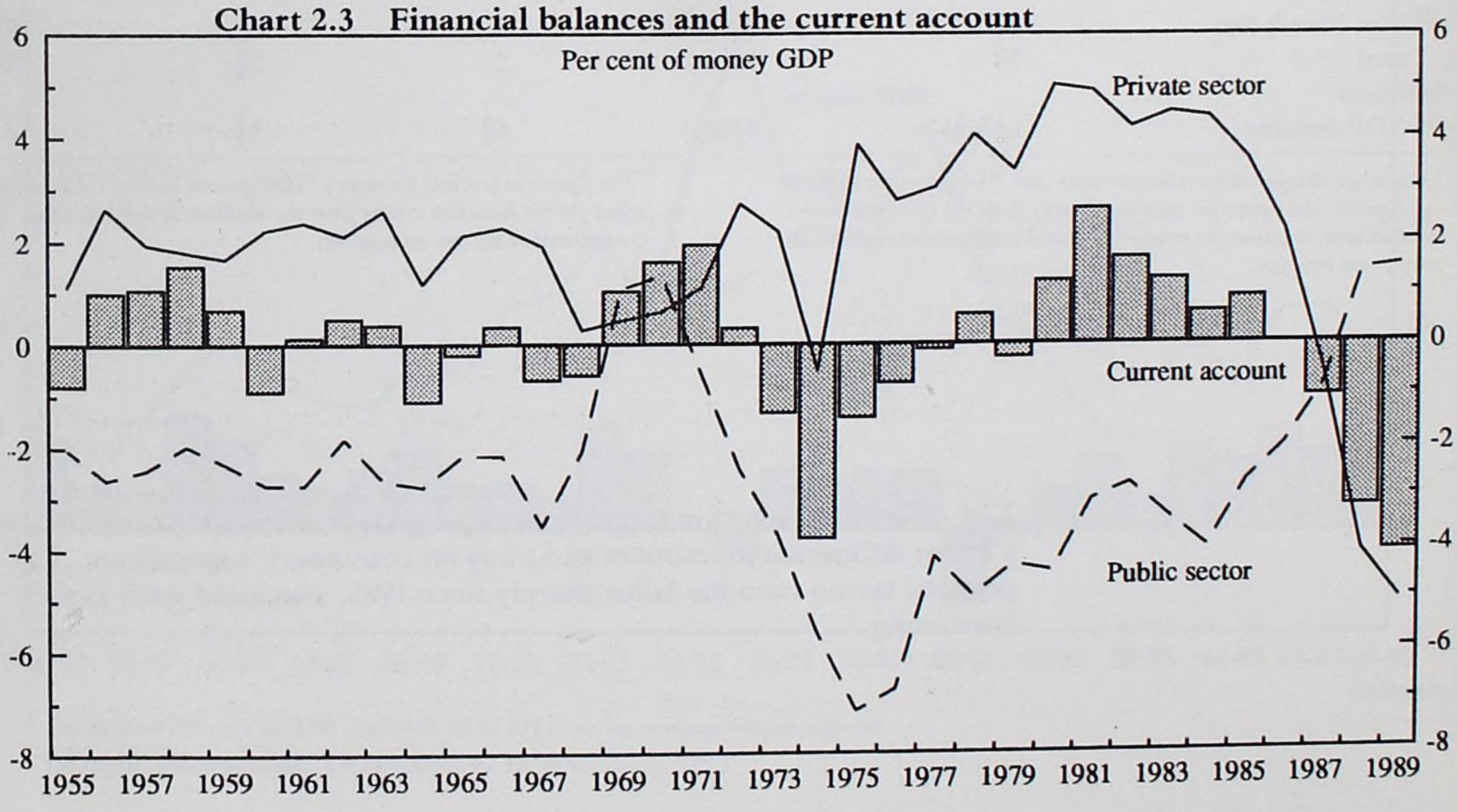
Chart 2.2 Personal saving and borrowing



[1] *Gross asset accumulation equals saving plus borrowing.*

2.15 The private sector as a whole has moved from saving more than it invests (a financial surplus of more than 2 per cent of GDP as recently as 1986) to investing much more than it saves (preliminary estimates suggest a financial deficit of about 5 per cent of GDP in 1989). The extent of this change is without any precedent, at least in the period since the First World War. The recent excess of investment over saving is being financed, in effect, by borrowing from the rest of the world; in other words, it means a large current account deficit on the balance of payments.

Chart 2.3 Financial balances and the current account



2.16 Manufacturing investment reached a new record level in 1989 after growth averaging 8 per cent a year since 1983; total business investment rose by over 40 per cent in the three years to 1989. Published statistics show an unsustainable rate of increase in stocks during most of 1989. The prospects are for some fall in total domestic investment (including stockbuilding) as a share of GDP over the next few years, while saving should rise as the effects of financial liberalisation and past increases in asset prices become weaker. This means that the private sector financial deficit will contract, perhaps quite sharply, and the balance of payments current account will improve in spite of the public sector moving back towards budget balance.

The policy framework

2.17 The function of macroeconomic policy is to create a non-inflationary climate, and the function of supply side policies is to encourage individuals and companies to make the most of it.

2.18 The economy is now much more flexible than it was ten years ago, following a series of reforms that have reduced distortions and improved the way markets work. Reductions in marginal tax rates have increased incentives to work and save, and improved the quality of investment. The extension of owner occupation, measures to revive the private rental market, and the introduction of more flexible pension arrangements are helping labour mobility; while employment and trades union law reforms have facilitated more efficient use of the labour force and the creation of new jobs. The deregulation of financial markets (although adding to the problems of monetary control) and the privatisation programme have contributed to improved performance in the industries directly affected and more widely. Youth training has been extended, and major reforms of education are in progress.

2.19 Tight monetary and fiscal policies are needed to defeat inflation. Inflation is a monetary problem and so monetary policy has to be in the forefront of the battle to conquer it. A firm fiscal policy must complement and support the monetary stance.

2.20 Frequent large changes to fiscal policy instruments are harmful to supply performance and potentially destabilising. So it is best to take a medium term view about the appropriate contribution of fiscal policy, not to use it to offset temporary fluctuations in the economy. These considerations do not apply with the same force to monetary policy, which can be used more flexibly to make short-term adjustments to the policy stance.

2.21 The Government has committed itself to join the Exchange Rate Mechanism (ERM) of the European Monetary System when the level of UK inflation is significantly lower, there is capital liberalisation in the Community and real progress has been made towards completion of the single market, freedom of financial services and strengthened competition policy. It remains committed to that. But membership of the ERM is not a substitute for firm monetary policy. They are complements, with the commitment to the one reinforcing the commitment to the other. Most members of the ERM have their own monetary targets. A medium term financial strategy which follows the principles set out in this chapter is required both to reduce inflation and to sustain the anti-inflationary stance which ERM membership requires.

Monetary policy

2.22 The essential instrument of monetary policy is the level of short-term interest rates. So it is the authorities' job to set interest rates in such a way that the Government's objectives for inflation are achieved. But, as the following paragraphs explain, monetary policy is complex and the authorities' task is far from mechanical.

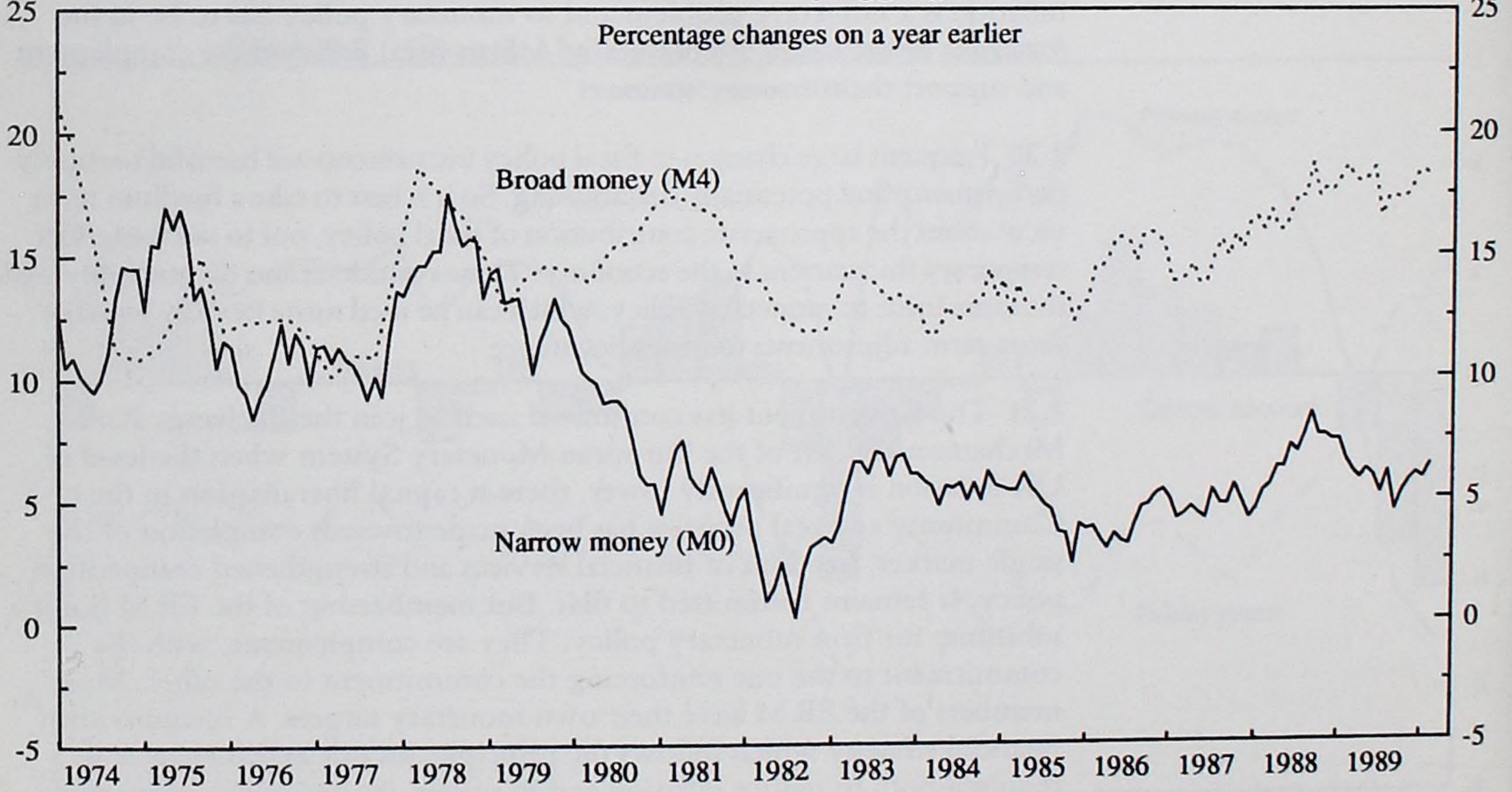
Money and inflation

2.23 Inflation occurs when monetary growth is excessive: "too much money chasing too few goods" is a traditional characterisation. That is why the rate at which money is growing is an essential concern of economic policy.

2.24 In contrast to most other economic statistics, accurate data on all of the monetary aggregates are available quite quickly after the period to which they relate. But there is no unique measure of money, and the various aggregates—narrow ones such as M0 and wider ones like M4—rarely grow at the same rate. Nor should they be expected to do so. They have differing relationships with inflation and each has to be assessed carefully, along with other relevant indicators, to build up the picture of what is happening to monetary conditions.

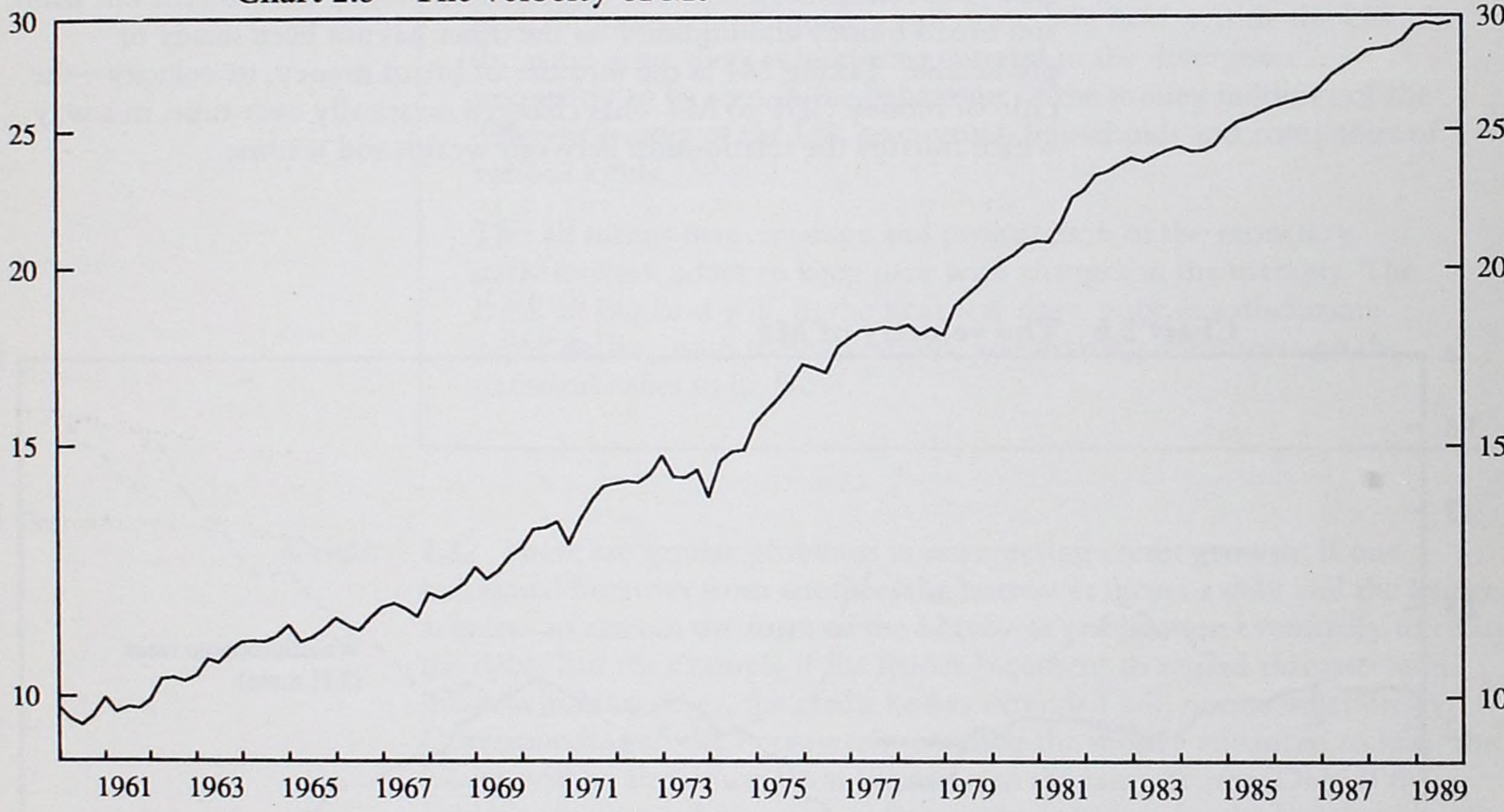
2.25 The underlying point is that growth in the money stock need not be inflationary. It may in part reflect real growth in the economy, and in part long term trends in financial behaviour. Moreover, it may be caused by an increase in savings rather than a build up of money likely to be spent, in which case it would not be a sign of inflationary pressure.

Chart 2.4 Growth rates of monetary aggregates



Narrow money **2.26** Narrow money, best measured by M0, has a simpler relationship with money GDP and inflation than have wider aggregates. It tends to be used predominantly for transactions purposes rather than as a home for savings—99 per cent of M0 is notes and coin—so that one of the complications does not arise. M0 cannot claim to be a comprehensive measure of transactions balances. But it is used pervasively for transactions, and has demonstrated a close relationship with money GDP over a period of 40 years or more. Its velocity has grown in a steady and reasonably predictable way, reflecting a steady trend in the way people make payments. M0 has thus proved a timely and generally dependable indicator of current monetary conditions. Because other indicators are available only with a delay and often subject to revision, this is valuable information to have.

Chart 2.5 The velocity of M0



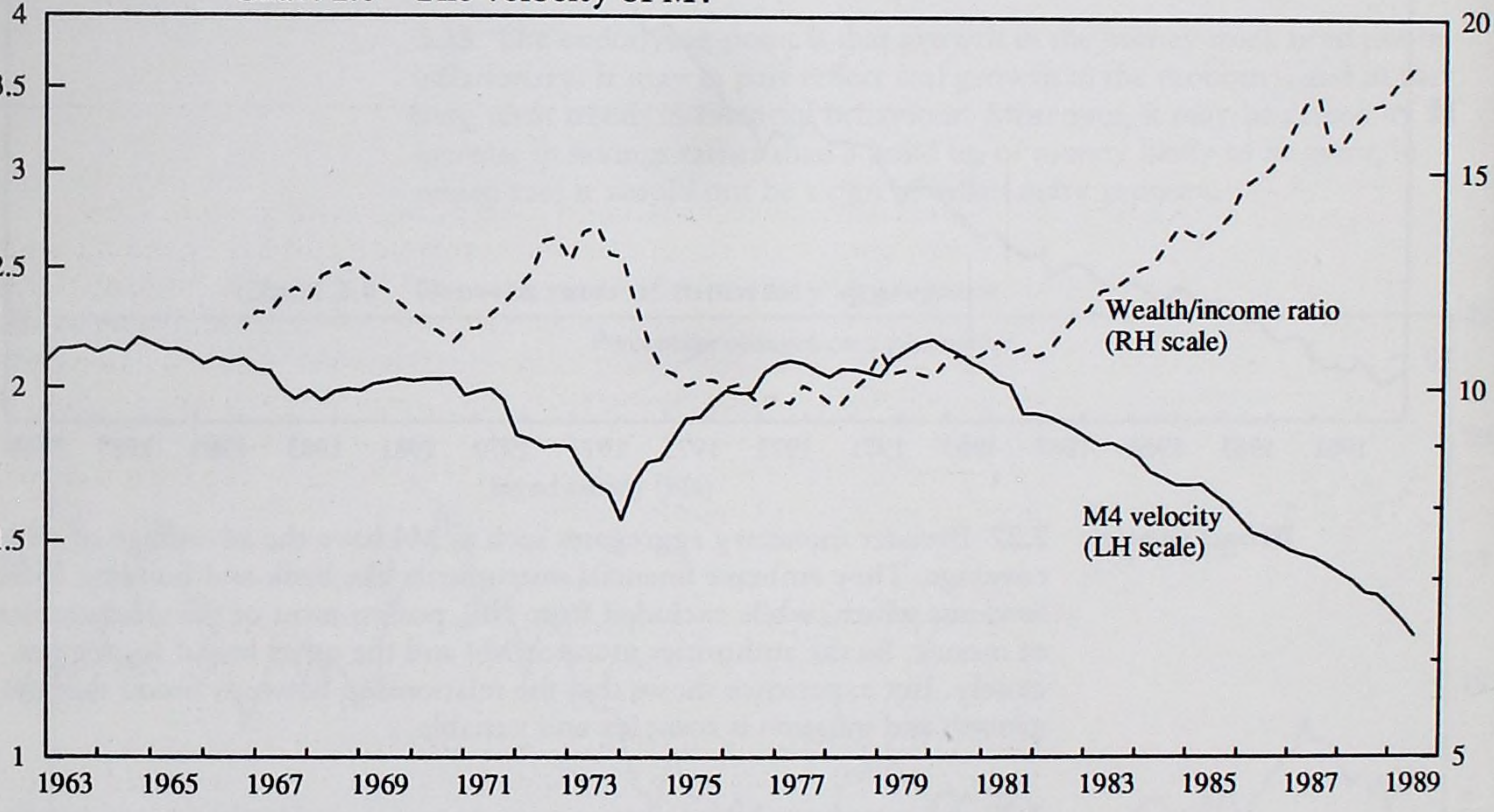
Broad money **2.27** Broader monetary aggregates such as M4 have the advantage of wider coverage. They embrace financial instruments like bank and building society accounts which, while excluded from M0, possess most of the characteristics of money. So the authorities monitor M4 and the other broad aggregates closely. But experience shows that the relationship between broad money growth and inflation is complex and variable.

2.28 An increase in broad money may, or may not, foreshadow an increase in inflation, depending upon why it occurs. If it reflects only a rise in firmly held savings, there will be no increase in inflationary pressures. On the other hand, if it represents an unstable build up of purchasing power, about to be spent on goods and services in excess of the economy's ability to produce them, that will be inflationary. The important point is that the growth rate of broad money and liquidity alone does not indicate clearly the degree of inflationary pressure: it is necessary to interpret it carefully in the light of other information.

2.29 Experience backs up this analysis. Relatively rapid growth in broad money was consistent throughout the 1980s with much lower levels of inflation. For the most part, the build-up of this money has consisted of firmly held savings. Savers have enjoyed a much better return in the 1980s, after the low or negative real interest rates of the 1970s. While the personal saving ratio has fallen, this reflects a rise in borrowing rather than a fall in gross asset accumulation. Wealth has grown rapidly and it is natural that people should wish to hold a proportion of this as interest bearing money. In the future, long term saving in the new Tax Exempt Special Savings Accounts will itself tend to raise the growth of broad money.

2.30 The relationship between inflation and money GDP on the one hand and broad money and liquidity on the other has not been steady or predictable. Taking M4 as the measure of broad money, its velocity—the ratio of money GDP to M4—has changed erratically over time, in a way which mirrors the relationship between wealth and income.

Chart 2.6 The velocity of M4



2.31 Since the early 1980s the decline in velocity has been relatively steady. It seems likely, however, that the fall in velocity is explained in some measure by the unusually rapid growth of wealth. It is doubtful if the upward trend in the ratio of wealth to income will continue, and this uncertainty carries over to the future velocity of broad money as well.

Measuring broad money and liquidity

Broad money and liquidity are among the inputs into the assessment of monetary conditions, and it is important that they are measured in a way which enables all relevant information to be taken fully into account. To date, the authorities have tended to concentrate on measures of sterling liquidity held only by residents, added up to form an aggregate—M4 and, before that, M3.

A number of developments have made it necessary to have regard to the behaviour of other measures of liquidity. The increasing integration of financial markets across national boundaries, for example, makes it the more important to take account of non-residents' holdings of sterling liquidity, and of residents' holdings both of non-sterling liquidity and of sterling held outside the UK. At the same time, there is increasing interest in the divergence frequently to be seen in the behaviour of the money holdings of the different sectors of the UK economy—households and companies of various kinds.

This all means that coverage and presentation of the monetary statistics must adapt to keep pace with changes in the markets. The Bank of England will, in the next few days, publish a discussion paper dealing with these questions, and inviting comments on the statistical issues to be faced.

Credit

2.32 There are similar problems in interpreting credit growth. If one individual borrows from another, the borrower incurs a debt and the lender acquires an asset in the form of the borrower's obligation eventually to repay the debt. But for example if the lender is content to regard this asset as an increase in his savings, the credit he has extended will not be inflationary. Corresponding to the borrower's spending the money advanced to him, the lender will be abstaining from spending to the same degree. Only if the lender tries to spend his asset, adding to the spending by the borrower, will there be any upward pressure on prices.

2.33 None of this is to deny that broad money and credit growth are important indicators. The growth of liquidity and credit since 1987 has been too fast, as is clear from the rise in inflation. Mortgage lending has been particularly buoyant until recently, with associated upward pressure on house prices. But changes in these indicators need to be interpreted carefully alongside other evidence to see what they imply about inflationary pressures, and so for decisions on interest rates.

Monetary targets

2.34 The Government will continue to set a target for M0, as a yardstick for its monetary policy. A target range of 1–5 per cent is being set for M0 in 1990–91, the same as in 1989–90. Although the 12-month growth rate of M0 has fallen from earlier peak levels, it is likely to finish this financial year above the range, and it may be some months before it falls within it.

Table 2.2 Growth of M0[1]

1989–90	1990–91	1991–92	1992–93	1993–94
$5\frac{3}{4}$	1 to 5	0 to 4	0 to 4	−1 to 3

[1] *1989–90: forecast percentage change on previous financial year;*
1990–91: target range for (seasonally adjusted) 12 month growth rate;
1991–92 onwards: illustrative ranges.

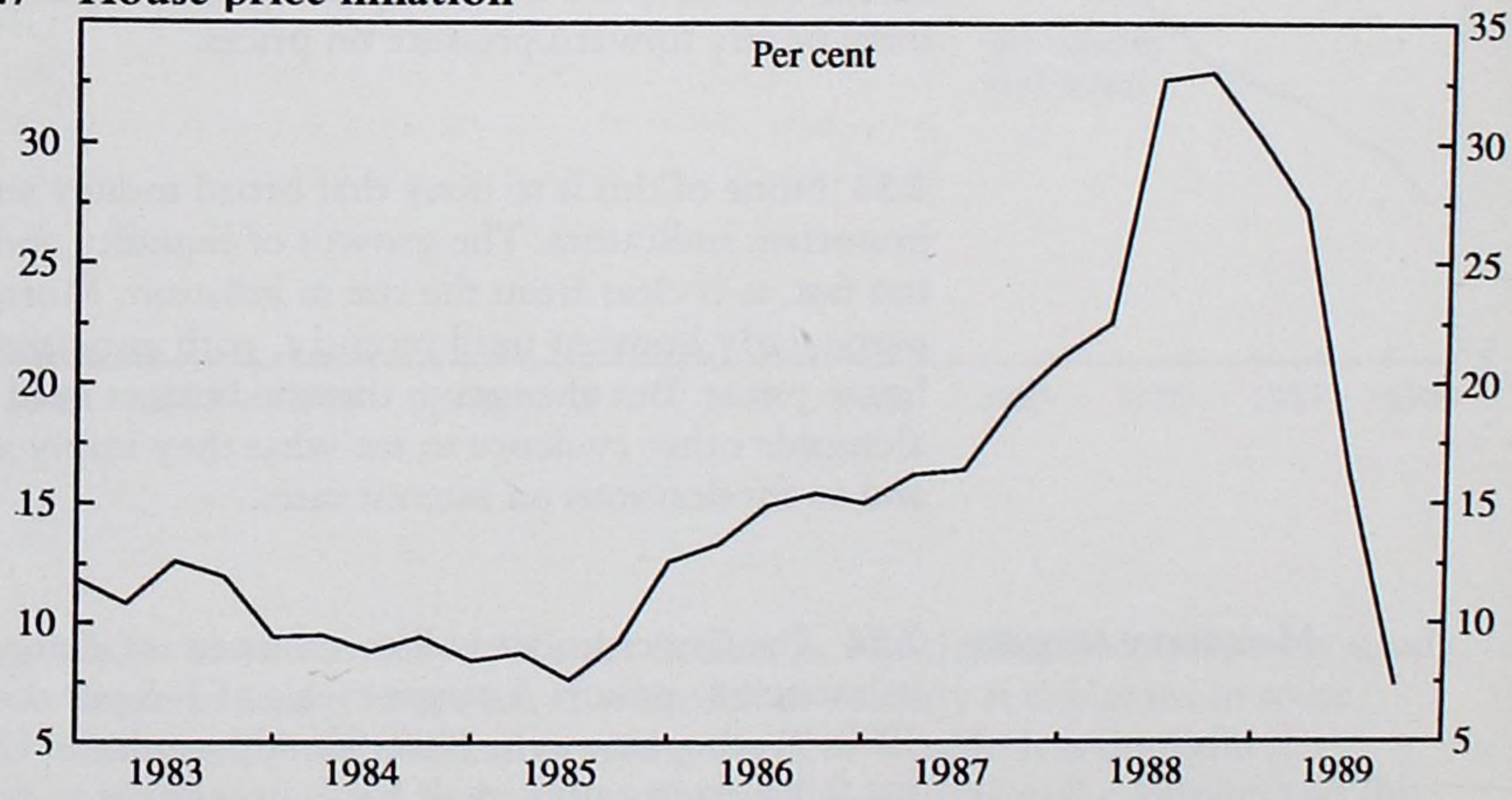
2.35 The Government is not setting a target for broad money in 1990–91.

Other factors bearing on the assessment of monetary conditions

2.36 A range of other indicators supplements the evidence of the monetary aggregates in the interpretation of monetary conditions. The exchange rate is particularly important. If people were to feel that they had too much sterling and tried to reduce their holdings, this would be likely to show up quickly in downward pressure on sterling. More generally, a perceived loosening in the policy stance might show up in this way. Other factors, which may have little to do with domestic monetary conditions, also affect its behaviour, so that the exchange rate is not an infallible guide to the tightness of monetary policy. But appraised carefully with other evidence, the exchange rate is a sensitive and timely indicator. Moreover, it can also play a direct part in raising inflation; a lower pound tends to lead to higher import prices in sterling terms as well as giving more headroom for domestic producers to pass on increased costs. A higher pound has the opposite effect. No government can therefore be indifferent to the exchange rate, though in setting interest rates it would be wrong to give undue weight to the minor short run fluctuations that are inevitable in any financial market.

2.37 Among other indicators, the authorities pay close attention to the behaviour of asset prices. Sharp rises in house prices, in particular, and the consequent increase in housing wealth played an important role in the unexpectedly strong demand of recent years. With the increased access to credit that financial liberalisation has brought, people were more easily able to turn their housing " equity " into spending power. The flattening out of house prices over the last year is a welcome development in this respect, following the progressive tightening of monetary policy.

Chart 2.7 House price inflation[1]



[1] *DOE index.*

2.38 Information relating to the level of economic activity and to the behaviour of inflation itself must also be taken into account, though the indicators are generally available only with a delay. Evidence relating to future behaviour—for example, intentions survey data or confidence indicators—is monitored closely.

2.39 Assessing monetary conditions—deciding whether the monetary stance is appropriately tight or whether a change is required—involves balancing up all the factors discussed in the previous paragraphs. This cannot be a mechanical process and, inevitably, judgement is required.

Implementing monetary policy

2.40 While assessing monetary conditions is a complex task, implementing changes in the monetary stance is in principle simple. Interest rates are the price of money and credit. Changing the price is the best method of influencing the degree of monetary tightness.

2.41 The level of interest rates affects the economy in a wide variety of ways. Higher interest rates increase the reward for saving while raising the cost of borrowing. There are also cash flow effects; higher interest rates reduce the spending power of borrowers after they have paid their interest charges (and increase the incomes of savers). Interest rates also influence asset values and thus the level of wealth. A rise in interest rates makes sterling more attractive than it would otherwise be compared to other currencies, thus raising the exchange rate, and putting downward pressure on domestic costs. Some of these mechanisms are more important than others and not all work in the same direction. Nevertheless, the net effect is that raising interest rates constitutes a powerful way of tightening the monetary stance. Lowering interest rates has the opposite effect.

2.42 Used as a short term instrument, official intervention in the foreign exchanges can also be of value. By buying or selling foreign currency for sterling, as appropriate, the authorities can affect the supply and demand for sterling, and hence the exchange rate, in the short term. Intervention can also on occasion be used to signal the authorities' future intentions, at times dampening or preventing inappropriate and unnecessary movements in sterling. In the longer run intervention is likely to have only modest effects, unless combined with a change in the level of interest rates; but it can be a useful short term tactical weapon.

2.43 In principle, an alternative to using interest rates to regulate monetary conditions would be to return to some form of direct credit control. But such controls would undermine the price mechanism in the credit market which operates through interest rates. They would lead to distortions and inefficiencies and poor resource allocation which would be clearly undesirable. They would also be unfair: some would obtain the credit they wanted; others would find themselves rationed. But, more fundamentally, in today's developed and sophisticated financial markets, and without the support of exchange controls, credit controls would have little effect except in the short term. For all these reasons, the trend in those major countries that still have credit controls is towards dismantling them.

Reserve asset ratios

Because interest rates are the essential instrument of monetary policy, the monetary authorities must be in a position to exercise a high degree of influence over their movements. That means they need to ensure that the financial system is dependent on funds provided by the central bank so that its own lending rate is transmitted more widely into market rates.

To achieve this result, a number of other countries—France and Germany for example—impose minimum reserve asset ratios on their banks. The operation of the ratio increases the banking system's need for funds from the central bank, and thereby helps to ensure that market rates will reflect the rate of interest at which the central bank provides the supply. Only the central bank can meet these needs. It is thus mistaken to see reserve requirements as an alternative monetary instrument to interest rates. In particular, reserve requirements do not serve as a direct credit control. Rather, they provide a means whereby official influence on interest rates is made effective.

In the United Kingdom, benefiting from our well developed money markets, the authorities have in recent years been able to exercise this control simply and flexibly by varying the size of market purchases of bills and the weekly Treasury bill tender. This avoids the distortions that are often inherent in reserve asset ratios.

Funding policy

2.44 Funding policy—the way that the Government finances its own operations—must support monetary policy in attaining the objectives for inflation. The Government will continue to arrange the public sector's financial affairs in accordance with this principle, at the same time financing the public sector so as to minimise any distortion to the financial system. Annex A to this chapter discusses funding policy in more detail.

Fiscal policy

2.45 A budget surplus is expected for 1989–90, the third successive year that the Government has repaid debt. However the PSDR is now estimated at £7 billion, about half what was forecast a year ago. Almost £1 billion of this reduction reflects lower privatisation proceeds. Local authorities' capital spending has increased by about £2 billion more than expected, and an unexpectedly large take-up of personal pensions reduced national insurance contributions by almost £2 billion. These changes taken together account for most of the shortfall in the PSDR compared with last year's forecast.

2.46 The PSDR is set to remain at £7 billion in 1990–91. While there will be a partial reversal of the factors that explain the 1989–90 shortfall, this will be offset by the effects of lower growth in 1990–91 (1 per cent now forecast, almost 2 percentage points below trend). The Government sets tax rates on the basis of medium to long term considerations, and will not normally change them to prevent cyclical swings in the PSDR.

2.47 Fiscal policy will remain tight, and so play an important part in bringing inflation down. The PSDR path now projected for the medium term is shown in table 2.7; the Government's balanced budget objective is reached in 1992–93. The projections imply that the ratio of net public sector debt to GDP, which has fallen by more than a third in the last five years, will show a further substantial decline over the medium term; so there will be a further fall in the burden of debt interest payments.

Public expenditure

2.48 The Government's objective for public spending is that over time it should take a declining share of national income, while value for money is improved. The ratio of GGE excluding privatisation proceeds to GDP has fallen by almost 8 percentage points since 1982–83; over half the fall took place during the period of fast economic growth between 1986–87 and 1988–89. As economic growth moderates, the ratio may show a temporary rise. After adjusting for the distortion arising from the abolition of domestic rates, which will raise the published ratio by about ¾ percentage point, the downward trend in the ratio is projected to continue over the medium term.

Table 2.3 General government expenditure (excluding privatisation proceeds) as a per cent of money GDP[1, 2]

1964–65	35¾	1974–75	48	1984–85	46	
1965–66	37¼	1975–76	48½	1985–86	44½	
1966–67	38¾	1976–77	46	1986–87	43½	
1967–68	42¼	1977–78	42¾	1987–88	41¼	
1968–69	40¾	1978–79	43¼	1988–89	38¾	
1969–70	40¼	1979–80	43½	1989–90	39	(39)
1970–71	40¾	1980–81	45¾	1990–91	39¾	(39)
1971–72	41	1981–82	46½	1991–92	39½	(38¾)
1972–73	41	1982–83	46¾	1992–93	39¼	(38½)
1973–74	42¾	1983–84	45¾	1993–94	39	(38¼)

1 1989–90: latest estimate; 1990–91: forecast; 1991-92 onwards: MTFS projections.

2 Ratios in brackets adjust for the distortion arising from the abolition of domestic rates. This is explained in the box on page 45.

2.49 Projections of government expenditure are shown in table 2.4. Figures for the period to 1992–93, which are explained further in chapter 5, incorporate the public expenditure plans shown in the public expenditure White Paper (Cm 1001–1021). The projections of local authorities' self-financed expenditure (outside the planning total) have been increased to take account of the increase in their spending in 1990–91 indicated by recent information about their budgets. The new projections of gross debt interest payments and accounting adjustments are consistent with the latest economic projections and assumptions. For 1993–94 it is provisionally assumed that general government expenditure will grow by 1¾ per cent in real terms; expenditure plans will be settled in future Surveys.

Table 2.4 General government expenditure[1]

	£ billion, cash					
	1988–89	1989–90	1990–91	1991–92	1992–93	1993–94
Public expenditure planning total	145·5	162	179	192	203	215
Local authorities' self-financed expenditure[2]	10·1	14	13½	14	15	15½
Central government debt interest	17·5	17½	17	15½	15	15
Accounting adjustments	5·0	4	3½	3½	4½	5
General government expenditure[3, 4]	**178·2**	**198**	**213**	**225**	**238**	**250**
Privatisation proceeds	7·1	4	5	5	5	5
General government expenditure excluding privatisation proceeds	**185·3**	**202**	**218**	**230**	**243**	**255**

[1] For 1988–89 to 1992–93, the figures are taken from chapter 5.
[2] See footnote 3 to table 5.1.
[3] General government expenditure, privatisation proceeds and the public expenditure planning total are rounded to the nearest £1 billion from 1989–90 onwards; local authorities' self-financed expenditure, debt interest and accounting adjustments are rounded to the nearest £½ billion. General government expenditure excluding privatisation proceeds is assumed to grow by 1¾ per cent in real terms in 1993–94.

[4] General government expenditure includes debt interest payments to other sectors as follows (£ billion):

1988–89	*18·0*	*1991–92*	*16½*
1989–90	*18½*	*1992–93*	*16*
1990–91	*17½*	*1993–94*	*15½*

Revenue

2.50 The Government's objectives for taxation are to reduce tax rates and bring down tax as a percentage of GDP. Much progress has been made in reducing tax rates and reforming the structure of the tax system, and the ratio of tax to GDP has fallen from the peak of 1981–82. In the second half of the 1980s the ratio was broadly unchanged, in spite of substantial cuts in tax rates, partly reflecting cyclical increases in revenue. The rise in the ratio compared with the end of the 1970s reflects the elimination of borrowing: expenditure is now more than covered by taxation and other government receipts.

Table 2.5 Non-North Sea taxes, national insurance contributions and the community charge as a per cent of non-North Sea money GDP[1,2]

1964–65	29½	1974–75	35½	1984–85	37¾
1965–66	31¼	1975–76	36	1985–86	37
1966–67	32	1976–77	36	1986–87	37½
1967–68	33¼	1977–78	35	1987–88	37¾
1968–69	35¼	1978–79	34	1988–89	37
1969–70	37	1979–80	35	1989–90	36¾ (36¾)
1970–71	36¼	1980–81	36	1990–91	37¾ (37)
1971–72	36¾	1981–82	38½	1991–92	36¾ (36)
1972–73	32½	1982–83	38	1992–93	36 (35½)
1973–74	33¼	1983–84	37½	1993–94	36 (35¼)

[1] 1989–90: latest estimate; 1990–91: forecast; 1991–92 onwards: MTFS projections (after fiscal adjustment).
[2] Ratios in brackets adjust for the distortion arising from the abolition of domestic rates. This is explained in the box on page 45.

2.51 The growth in government revenues over the medium term will depend on the growth of incomes, spending and prices. It will also depend on policy decisions, including measures announced in this year's Budget and other measures that will be implemented over the period, such as the introduction of independent taxation for husbands and wives. Taking account of these factors, non-North Sea revenues may rise less fast than money GDP after 1990–91, even before allowing for any tax cuts in future Budgets. North Sea revenues are not expected to change much over the medium term.

Table 2.6 General government receipts

	£ billion, cash					
	1988–89	1989–90	1990–91	1991–92	1992–93	1993–94
Taxes on incomes, expenditure and capital[1]	144·8	158	170	177	186	196
National insurance and other contributions	33·0	33	36	38	40	43
Interest and dividends	6·5	7	6	6	6	6
Other receipts	5·5	6	6	7	8	8
General government receipts[2]	**189·8**	**203**	**219**	**229**	**240**	**253**
of which North Sea revenues	3·2	2	3	3	3	3

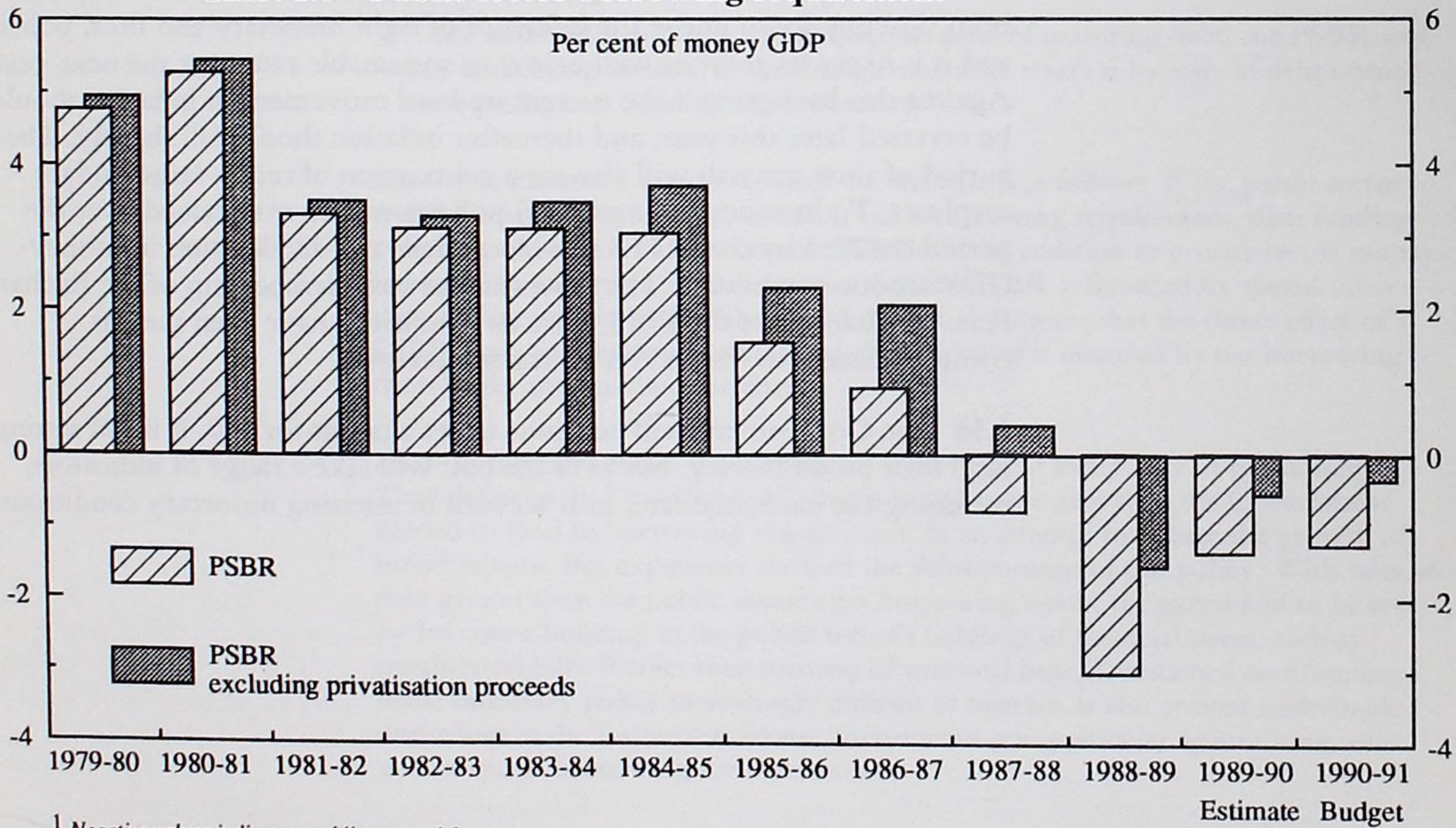
[1] *Includes the community charge from 1989–90 onwards.*
[2] *General government receipts, and its components, are rounded to the nearest £1 billion from 1989–90 onwards.*

Public sector debt repayment

2.52 The projections of government expenditure receipts are brought together in table 2.7 to provide projections of the general government debt repayment (GGDR), the PSDR and the fiscal adjustment.

2.53 Changes since the 1989 MTFS are discussed in annex B of this chapter.

Chart 2.8 Public sector borrowing requirement[1]



[1] *Negative values indicate a public sector debt repayment*

Table 2.7 Public sector debt repayment[1]

	£ billion, cash					
	1988–89	1989–90	1990–91	1991–92	1992–93	1993–94
General government receipts	189·8	203	219	229	240	253
General government expenditure	178·2	198	213	225	238	250
Fiscal adjustment from previous years	—	—	—	—	1	2
Annual fiscal adjustment[2]	—	—	—	1	1	1
GGDR	**11·5**	**6**	**6**	**3**	**0**	**0**
Public corporations' market and overseas debt repayment	3·0	1	1	0	0	0
PSDR	**14·5**	**7**	**7**	**3**	**0**	**0**
Money GDP at market prices[3]	478·1	519 (519)	548 (558)	585 (596)	622 (633)	657 (669)
PSDR as per cent of GDP	**3**	**1¼**	**1¼**	**½**	**0**	**0**

[1] *Rounded to the nearest £1 billion from 1989–90 onwards. Further details for 1990–91 are provided in tables 1.2 and 6.9*

[2] *Means lower taxes or higher expenditure than assumed in lines 1 and 2.*

[3] *Figures in brackets adjust for the distortion arising from the abolition of domestic rates. This is explained in the box on page 45.*

Summary

2.54 This chapter has discussed the Government's economic policy intentions and reaffirmed the Government's determination to bring inflation down.

2.55 There have been clear signs in recent months that the economy has been slowing down under the influence of tight monetary and fiscal policies, and it is likely to grow at well below its sustainable rate over the next year. Against this background the current upward movement in inflation should be reversed later this year, and thereafter inflation should fall sharply. The period of slow growth will also see a contraction of recent large budget surpluses. Tight monetary and fiscal policies will be maintained over the period covered by the MTFS so as to achieve the deceleration in money GDP set out in table 2.1. The Government sees membership of the Exchange Rate Mechanism of the EMS, once its conditions have been met, as complementary to the MTFS policy framework.

2.56 The Government will continue to set a target for M0. It is not setting a target for broad money, but as in the past will take a range of indicators, including the exchange rate, into account in assessing monetary conditions.

Annex A to chapter 2

Funding policy

2A.1 Funding policy determines how the public sector manages its debt. When there is a PSDR, decisions have to be made about how to use the surplus : what debts to repay, or what financial assets to buy. When there is a PSBR decisions have to be made about how the deficit is to be financed. Despite the substantial debt repayment of recent years, and the consequent fall in the ratio of debt to GDP (see chapter 6 for more details), gross public sector debt still amounts to around £190 billion. Public debt thus remains of significant size in relation to financial flows in the economy, and its management is clearly of considerable importance.

Underlying principles

2A.2 Three principles underlie the Government's funding policy:

(a) it must support and complement monetary policy in pursuit of the Government's objectives for inflation;

(b) subject to (a) it should operate in a way which avoids distorting financial markets;

(c) subject to (a) and (b) it should be conducted at least cost and risk.

The funding rule

2A.3 In recent years, the implementation of the first two of these principles has been embodied in the " full fund " rule that:

" The authorities will seek to fund the net total of maturing debt, the PSBR and any underlying increase in the foreign exchange reserves by sales of debt outside the banking and building society sectors."

2A.4 The monetary policy rationale for the rule is as follows. If the public sector spends more than it receives, so that it has a borrowing requirement, then funding policy should ensure that this is not financed by an addition to private sector money holdings. In particular the rule ensures that the PSBR is financed by means other than any increase in issue of notes and coin. It also means that the direct effect of a PSBR on broad money is neutralised, with none of it financed by net borrowing from banks and building societies.

2A.5 In the early 1980s, the authorities went beyond this policy of full funding. They deliberately " overfunded ", that is issued more debt than the Government needed to fund its borrowing requirement, in an attempt to reduce the growth of broad money. But experience showed the shortcomings of this policy. With sales of debt greater than the public sector's net borrowing needs, the excess had to be re-cycled into a build up in the public sector's holdings of financial assets, such as commercial bills. Rather than proving of practical benefit, sustained overfunding made monetary policy increasingly difficult to operate. It also created undesirable distortions in the financial markets, discriminating in particular against long term private sector borrowing for investment.

2A.6 So, in summary, policy as it has been operated in recent years has been designed to ensure that over time the potential effect of public sector borrowing or debt repayment on broad and narrow money has been offset. Operation of the full fund rule has also helped meet the second objective in paragraph 2A.2, limiting any distortions to the capital markets. This applies whether the public sector is in deficit or surplus. When there is a surplus, as now, the public sector repays debt—"unfunding". The alternative of using the surplus to acquire assets would amount to overfunding which, if sustained, would have the same adverse effects as in the early 1980s.

2A.7 The operation of such a rule gives guidance to the markets as to how much debt the authorities can be expected to issue, or redeem, in relation to the development of the public finances generally. That increases the degree of market certainty, to the benefit both of investors in Government debt and of the Government.

Application of the rule in practice

2A.8 The funding rule cannot be applied rigidly. The aim has always been to achieve full funding over each financial year as a whole. Within the financial year, temporary under- or overfunding has occurred, depending on conditions at the time. The authorities have not regarded it as sensible to offset the effect on sterling liquidity of foreign exchange intervention operations by funding that intervention immediately or necessarily even within the financial year in which it occurs.

Money market position

2A.9 The authorities must also ensure that funding operations do not lead to money market conditions that complicate the arrangements for setting short-term interest rates—the essential instrument of monetary policy. In 1985 these arrangements were beginning to be undermined by the size of the authorities' holdings of bills, the "bill mountain", which reached a peak of over £17 billion. At that time market holdings of Treasury bills were only just above £1 billion. Since then, official holdings of commercial bills have fallen to £6½ billion and market holdings of Treasury bills increased to £8½ billion.

2A.10 The main reason for this change in the money market position has been a swing in the position of the local authorities. Over the period since 1985, local authorities as a group have borrowed large amounts from the central government, through the Public Works Loan Board (PWLB), while at the same time putting capital receipts and other funds into the money market by repaying bank loans and increasing their deposits with banks and building societies. A second factor tending to ease the money market position, and hence requiring an increase in the Treasury bill issue, has been the scale of net gilt sales in recent years by banks and building societies.

2A.11 The change in the local authority position may have related in part to measures taken in the early 1980s to ease the terms and conditions of borrowing from the PWLB, partly with the aim of reducing the scale of money market shortages at the time. The money market position is now very different. The Chancellor therefore announced on 15 February a range of measures intended to limit borrowing from the PWLB, particularly where authorities have investments available with which to finance their capital expenditure.

2A.12 This change should in due course allow a reduction in the size of the Treasury bill issue. But in the meantime the Government will if necessary adjust its funding operations, increasing gilt sales or reducing gilt purchases, so as to prevent an excessive Treasury bill issue.

Other considerations bearing on funding decisions

2A.13 The general point is that no funding policy rule could provide a comprehensive guide to a sensible funding policy. Just as monetary policy itself cannot be a mechanical process, so the authorities must bear in mind a number of considerations in their funding strategy. The factors mentioned in paragraphs 2A. 8–12 above may require temporary or longer term departures from the funding policy rule followed in recent years. There are other considerations that affect the way public debt is managed, but which do not imply any departure from the overall guideline. In particular :

(i) because the underlying intention is that the public sector does not finance itself by creating money, the authorities need to ensure that funding is not concentrated in very short term debt, where the public liabilities concerned have some of the attributes of money and liquidity, even where these liabilities are not sold to banks and building societies. Treasury bills, which have such characteristics, no longer count as funding, even when sold to others than banks or building societies.

(ii) due regard must also be given to expected servicing costs. If the Government's medium and long term view of interest and inflation rates differs from that of the market as a whole, there will be implications for the type and maturity of debt that the Government wishes to issue or purchase;

(iii) but, equally, reducing risk is important both for the Government and investors. The existence of a range of maturities for debt issued in the past is helpful in this respect. Indexed debt also has the advantage of reducing uncertainty, for both the borrower and investor, about future real yields, and the proportion of gilts in indexed form has risen steadily since 1981;

(iv) because over the longer term the Government will have continuing borrowing or refinancing needs, it is in the general interest that the gilts market retains adequate capacity and liquidity. The series of conversion operations designed to enhance market liquidity have proceeded well and they will be continued.

Annex B to chapter 2

Changes since the 1989 MTFS

Money GDP

2B.1 After adjusting for the distortion arising from the abolition of domestic rates, the growth rate of money GDP is expected to be somewhat higher in both 1989–90 and 1990–91 than envisaged in last year's MTFS, with growth in the GDP deflator 1 percentage point higher in 1989–90 and $2\frac{1}{2}$ points higher in 1990–91. Inflation is projected to remain above last year's path but with the difference from last year falling to 1 percentage point by 1992–93. The projected trend in output growth over the medium term is the same as in last year's MTFS.

Table 2B.1 **Money GDP growth**

Differences from 1989 MTFS projections, percentage points

1989–90[1]	1990–91[1]	1991–92	1992–93
$+\frac{3}{4}$ $(+\frac{3}{4})$	$-\frac{1}{4}$ $(+1\frac{1}{2})$	$+\frac{3}{4}$	$+\frac{3}{4}$

[1] *Figures in brackets show the comparison after adjusting for the distortion arising from the abolition of domestic rates (see the box on page 45).*

Monetary aggregates

2B.2 M0 growth has declined from earlier peak levels but has remained above its target range. The target range for 1990–91 is the same as in 1989–90, 1 percentage point higher than the illustrative range given last year. Illustrative ranges for future years have also been adjusted.

Table 2B.2 **Growth of M0**

	Percentage changes on a year earlier			
	1989–90	1990–91	1991–92	1992–93
1990 MTFS	$5\frac{3}{4}$	1 to 5	0 to 4	0 to 4
1989 MTFS	1 to 5	0 to 4	0 to 4	−1 to 3

Fiscal projections

2B.3 Table 2B.3 shows changes in the fiscal projections since the 1989 FSBR. Additional information on 1989–90 is given in chapter 6.

Expenditure

2B.4 The planning total outturn in 1989–90 is discussed in chapter 5. The planning totals for 1990–91 onwards are as in the public expenditure White Paper (Cm 1001–1021); this year's MTFS is the first to show the planning total on its new definition. The cash general government expenditure figures for the future have been revised up since last year.

Receipts

2B.5 Revenues in 1989–90 have in total been somewhat lower than forecast. Income tax receipts were higher, but corporation tax receipts were lower, as were National Insurance contributions, reflecting about £2 billion more personal pension rebates than forecast. Revenues over the next two years or so will be affected by growth in the economy falling below the rate assumed in the 1989 MTFS.

Table 2B.3 Revenue and expenditure[1]

	Changes from 1989 MTFS projections, £ billion				
	1988–89	1989–90	1990–91	1991–92	1992–93
1 General government expenditure	**−1**	**+3½**	**+7½**	**+9½**	**+15**
Receipts[2]					
2 North Sea taxes	0	−½	0	0	0
3 Other taxes and contributions	+½	+½	+6½	+6	+8
4 Other[3]	−1½	−2½	−3	−1½	−½
5 General government receipts	**−1**	**−3**	**+4**	**+4½**	**+7½**
6 Implied cumulative fiscal adjustment[4]	—	—	−1	−2	−4
7 Public corporations' market and overseas debt repayment	+1	−½	−½	0	½
8 PSDR	**+½**	**−6½**	**−3**	**−3**	**−3**

[1] *Rounded to the nearest £½ billion. A change in the treatment of rebates of national insurance contributions has increased other taxes and contributions and reduced other receipts by under £½ billion in each year. There have been no other significant classification changes made since the 1989 FSBR.*
[2] *The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set off.*
[3] *Includes changes in debt interest and other items.*
[4] *Line 6 = lines 7 − 8 − 1 + 5.*

3 The economy: recent developments and prospects to mid-1991

Summary

3.01 GDP is forecast to grow by 1 per cent in 1990, following above trend growth in the non-North Sea economy for several years. Retail price inflation should begin to fall by the end of 1990, reaching 5 per cent by mid-1991.

Assumptions

3.02 The forecast assumes that fiscal and monetary policies are operated within the framework of the Medium Term Financial Strategy. It assumes that both North Sea oil prices and sterling remain close to recent levels. The public sector debt repayment (PSDR) is forecast to be about £7 billion in both 1989–90 and 1990–91.

Demand and activity

3.03 GDP growth slowed to $2\frac{1}{4}$ per cent in 1989, partly because of a large fall in North Sea oil output. Growth of consumers' expenditure slowed markedly through 1989 and fixed investment flattened off. But exports accelerated sharply in the second half of 1989, while import growth fell.

3.04 Domestic demand is forecast to fall slightly in 1990. But this is likely to be offset by strong growth in net exports, and GDP is forecast to rise by 1 per cent.

Inflation

3.05 Retail price inflation was $7\frac{1}{2}$ per cent in the fourth quarter of 1989; excluding mortgage interest payments it was 6 per cent. Total retail price inflation is expected to rise further in the coming months, before falling to $7\frac{1}{4}$ per cent by the fourth quarter of 1990 in response to the continued slow-down in the economy. It is forecast to fall to 5 per cent by mid-1991 and further thereafter.

Trade and current account

3.06 The current account deficit was nearly £21 billion in 1989. It has begun to fall in recent months and is forecast to be £15 billion in 1990.

Labour market

3.07 Employment has continued to rise rapidly, while unemployment has fallen. With a forecast of low output growth, unemployment could level off in the coming months and may rise, although much depends on the behaviour of wage bargainers.

World economy

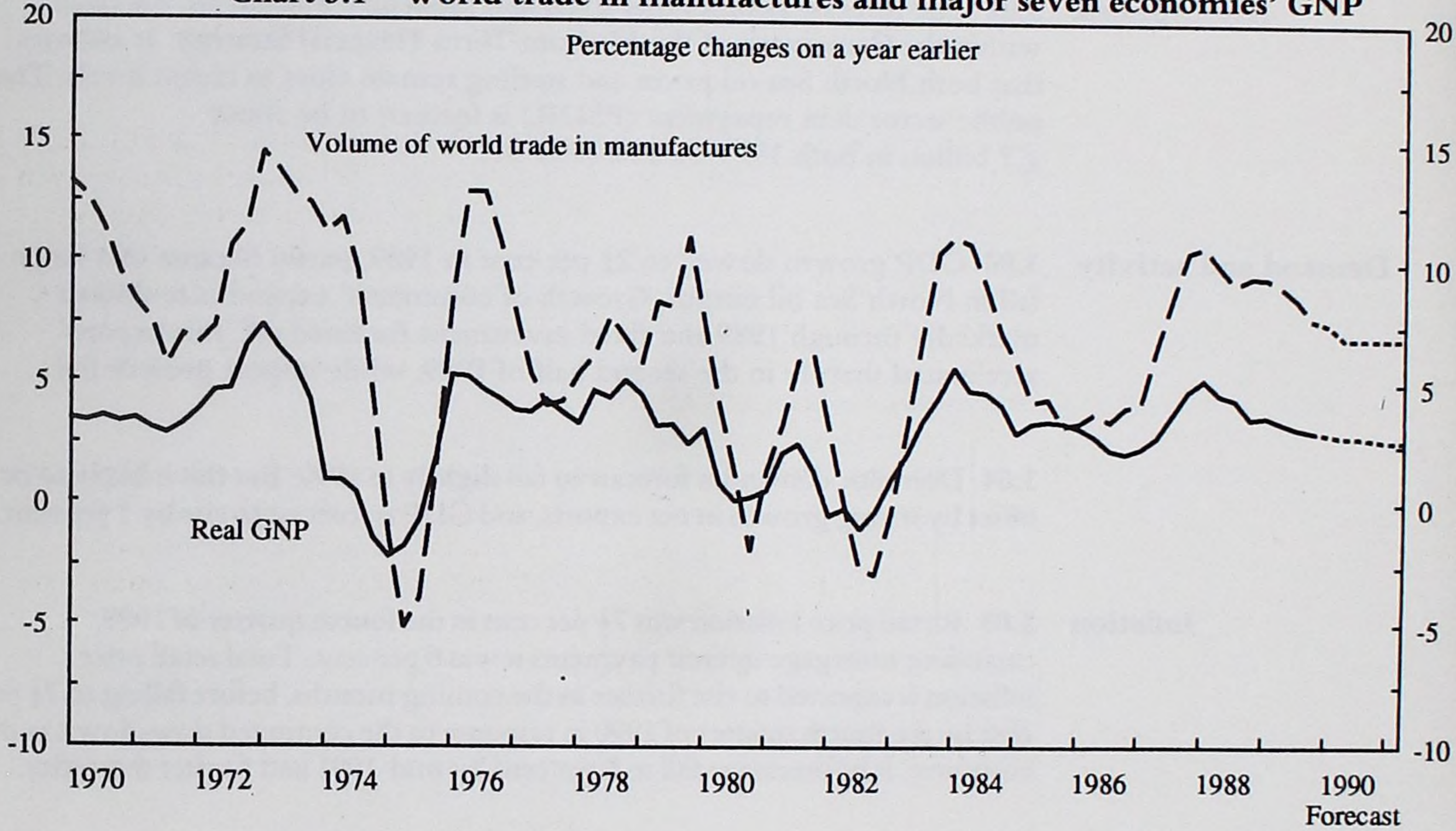
3.08 Growth of world trade and GNP slowed in 1989, but both were still above the trends for the 1970s and 1980s. They are forecast to slow further in 1990. Inflation in the major economies picked up in 1989 and is now generally as high as or higher than a year ago. It is forecast to moderate slightly in 1990.

World economy

Recent developments

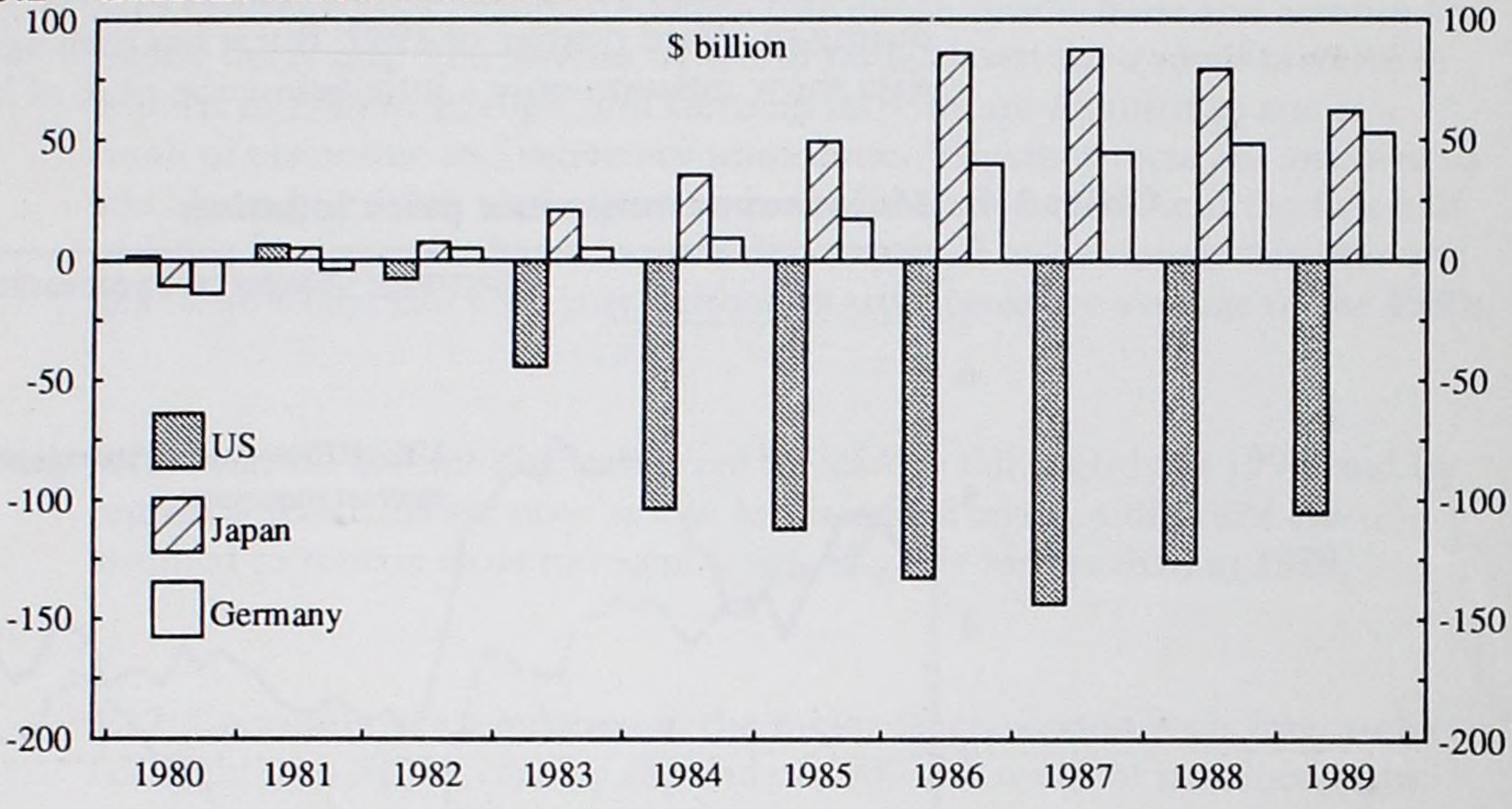
3.09 GNP growth in the major seven economies is estimated to have slowed from $4\frac{1}{2}$ per cent in 1988 to $3\frac{1}{2}$ per cent in 1989 in response to tighter monetary policy. The slow-down began in North America from mid-1988, and spread to continental Europe in the second half of 1989. GNP was weak in the US at the end of 1989, while in Japan it continued to grow at an estimated 5 per cent, little changed from the first half of the year. Most of the smaller OECD economies experienced strong growth in 1989, slightly faster in aggregate than in 1988. The growth of world trade in manufactures fell slightly, from $9\frac{1}{2}$ per cent in 1988 to around 9 per cent in 1989.

Chart 3.1 World trade in manufactures and major seven economies' GNP



3.10 Both the US current account deficit and the Japanese surplus fell sharply in 1989 in dollar terms. The slowing of growth in the US contributed to this. It is also likely that the weakness of the yen against the dollar was a factor—the J curve effect—especially for the US current account.

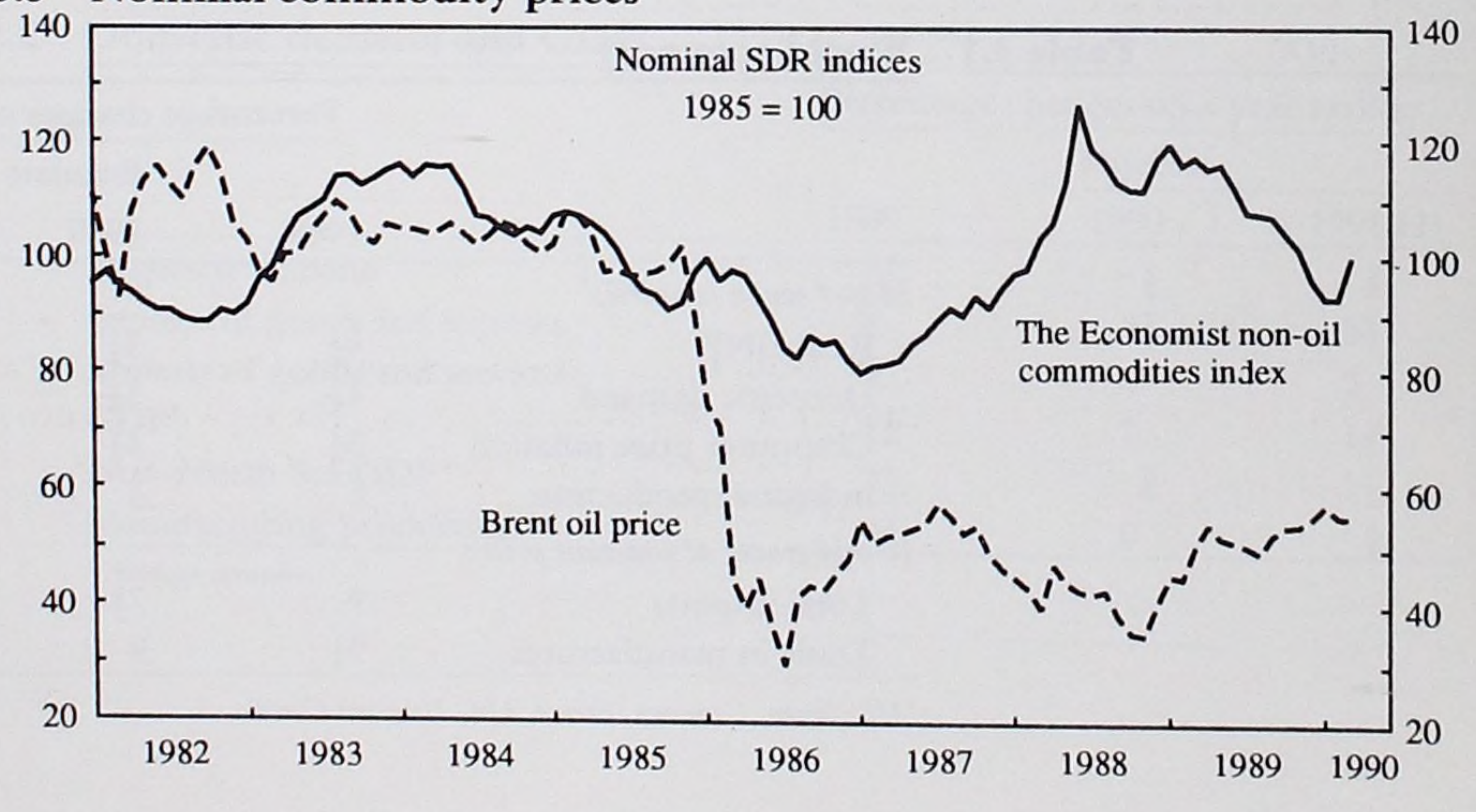
Chart 3.2 Current account balances



3.11 Increased inflation, and fears of overheating in continental Europe, led to increases in short term interest rates through 1989 in all the major seven economies except the US, where interest rates had risen earlier. Real short term interest rates have also risen in the major seven, but by somewhat less. Long term interest rates have risen since the beginning of 1990, reflecting worldwide concern about future inflation. The rise has been most notable in Germany where uncertainty about the effects of economic and monetary unification has been an additional factor.

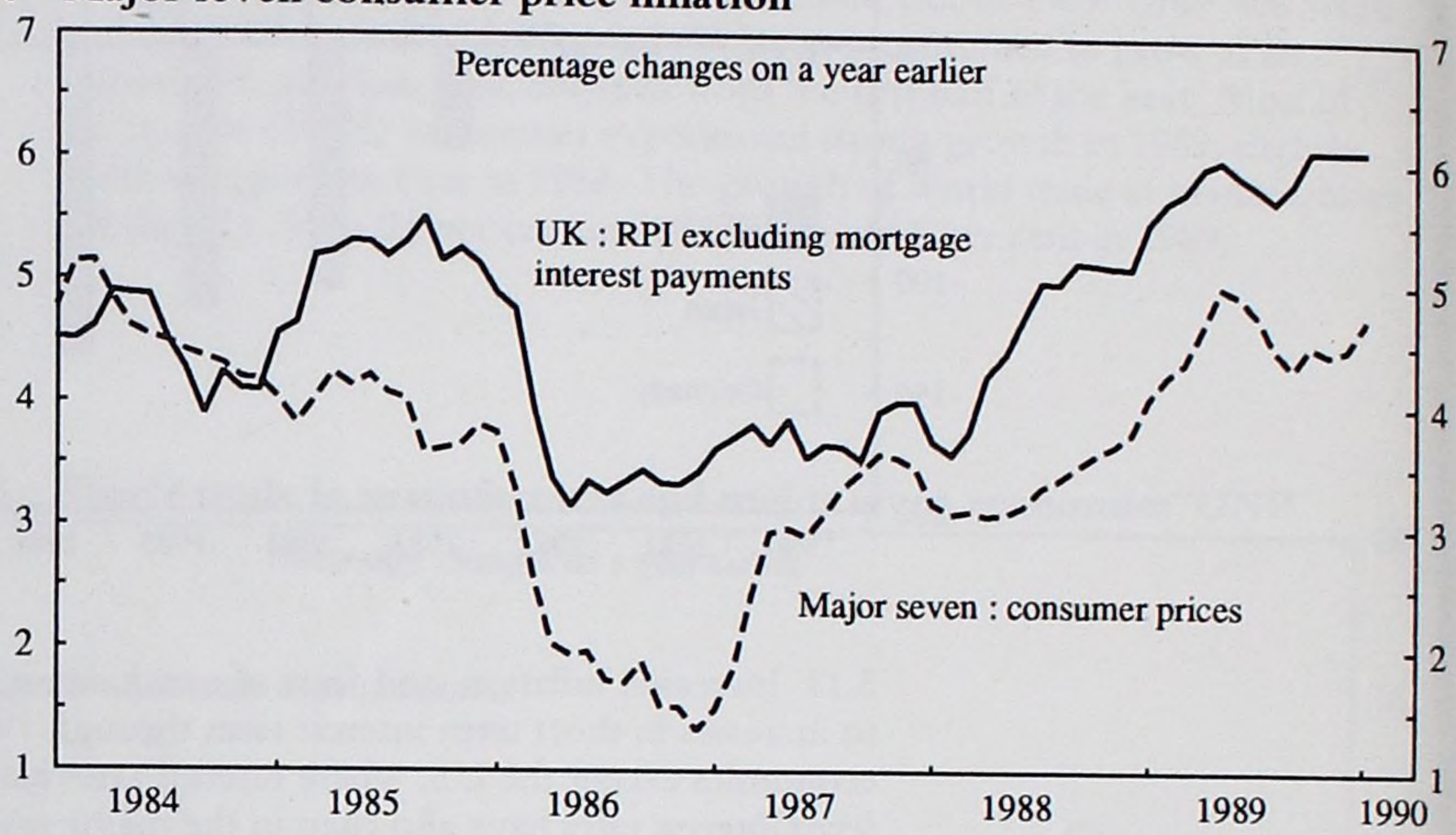
3.12 Slower economic growth and the tighter stance of monetary policy led to a continued fall in non-oil commodity prices in the second half of 1989 after the supply-led reductions in the first half. *The Economist* non-oil commodity price index in SDR terms fell by 25 per cent at an annual rate through the second half of 1989. Oil prices remain strong, although they have fallen back from their early January peak.

Chart 3.3 Nominal commodity prices



3.13 Consumer price inflation in the major seven economies fell back during the third quarter of 1989. But it has risen again since then, and latest data show inflation only a little below the peak of last summer.

Chart 3.4 Major seven consumer price inflation



Forecast **3.14** Real GNP growth is forecast to slow further in 1990, to around the estimated growth of productive potential. The significant easing of US monetary policy in the second half of 1989 should prevent growth in North America falling much below 2 per cent. Japanese growth is expected to fall in 1990, mainly because of labour shortages and slower investment growth. But growth is unlikely to fall much below that of productive potential. In Germany, GNP growth is expected to remain at about 4 per cent in 1990, as immigration and moves toward unification lead to increased domestic demand. Little change in the German current account surplus is expected. The US deficit and Japanese surplus could widen in 1990.

Table 3.1 World economy

	Percentage changes on a year earlier			
		Estimate	Forecasts	
	1988	1989	1990	1991 H1
Major seven countries[1]				
Real GNP	4½	3½	2¾	2¾
Domestic demand	4¾	3¼	2¾	2¾
Consumer price inflation	3¼	4½	4	3¾
Industrial production	6	4	2¾	3
World trade, at constant prices				
Total imports	9	7½	6	6
Trade in manufactures	9½	9	7	7

[1] *US, Japan, Germany, France, UK, Italy and Canada.*

3.15 The effects of events in Eastern Europe on world trade and activity are highly uncertain. The forecast of world trade allows for a small increase in exports to Eastern Europe; and German imports are assumed to rise as a result of economic and monetary unification. Together these are assumed to add about $\frac{1}{2}$ per cent to the growth in world trade in 1990 and the first half of 1991. Even so, world trade growth is expected to be slower this year and next than in the past two years, although still above the average of the 1980s.

3.16 Non-oil commodity prices are forecast to fall slightly in 1990, and by historical standards are now at low levels in real terms. Oil prices are assumed to remain close to recent levels, slightly higher than in 1989.

3.17 Consumer price inflation in the major seven economies is forecast to fall slightly to $3\frac{3}{4}$ per cent by the end of 1990 as a result of sustained tight monetary policy and slowing demand.

UK demand and output

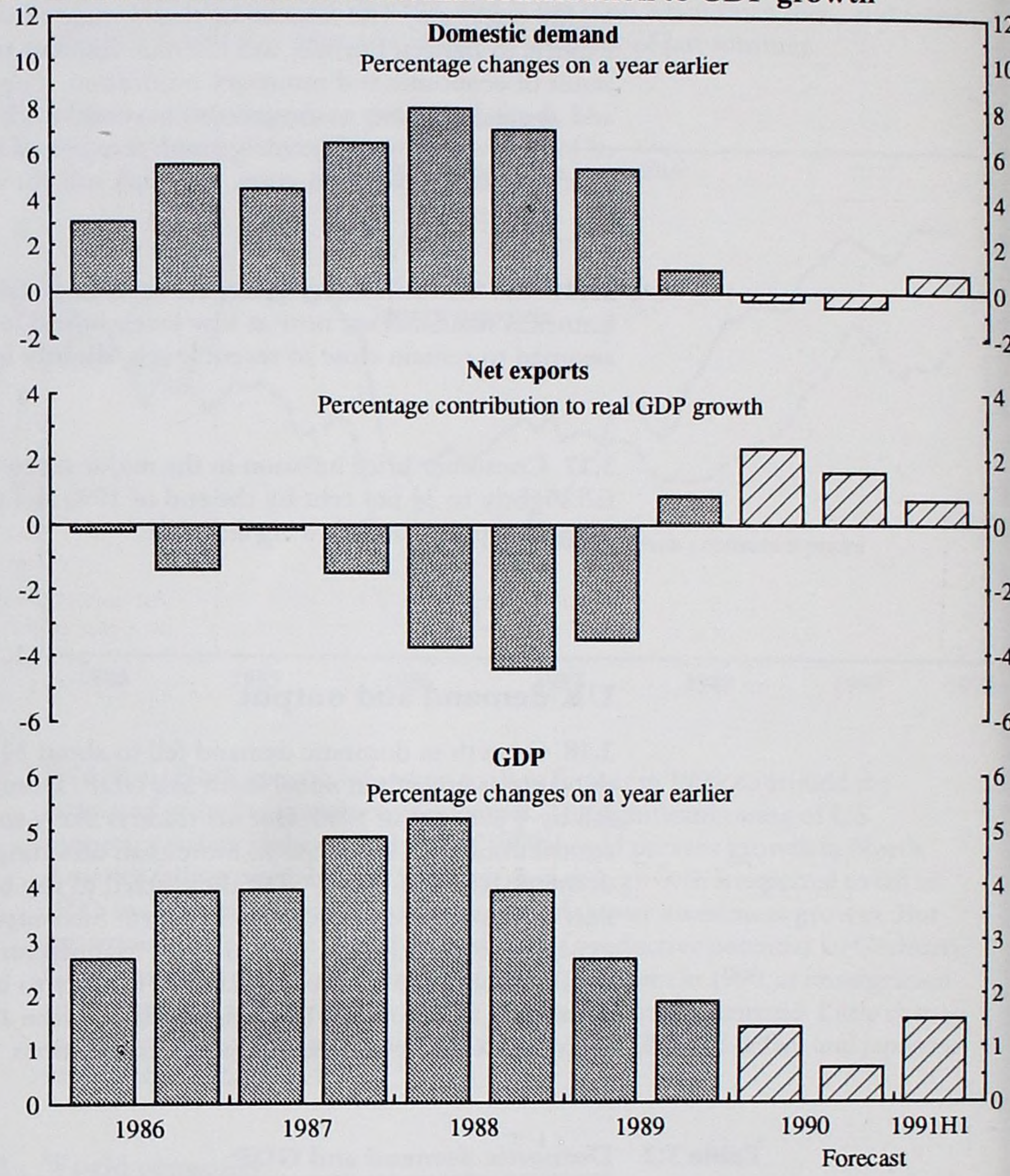
3.18 Growth in domestic demand fell to about $3\frac{1}{4}$ per cent in 1989, about the same as growth in non-North Sea GDP. Domestic demand is forecast to fall by $\frac{1}{2}$ per cent in 1990. But net trade is likely to make a significant contribution to GDP growth, more than offsetting the projected fall in domestic demand. Total GDP is expected to rise by about 1 per cent in 1990. Part of this is due to a recovery in North Sea output; non-North Sea GDP is expected to rise by $\frac{3}{4}$ per cent in 1990. Manufacturing production, which is usually more cyclical than total GDP, is likely to be restrained by destocking. It is forecast to change little between 1989 and 1990, consistent with recent CBI evidence on output expectations.

Table 3.2 Domestic demand and GDP

	Percentage changes on a year earlier		
		Forecast	
	1989	1990	1991 H1
Domestic demand	$3\frac{1}{4}$	$-\frac{1}{2}$	$\frac{3}{4}$
Exports of goods and services	4	$7\frac{1}{4}$	$5\frac{1}{2}$
Imports of goods and services	7	1	3
GDP[1]	$2\frac{1}{4}$	1	$1\frac{1}{2}$
Non-North Sea GDP[1]	$3\frac{1}{4}$	$\frac{3}{4}$	$1\frac{1}{2}$
Manufacturing production	$4\frac{3}{4}$	0	$\frac{3}{4}$

[1] *Average measure.*

Chart 3.5 Domestic demand and external contribution to GDP growth



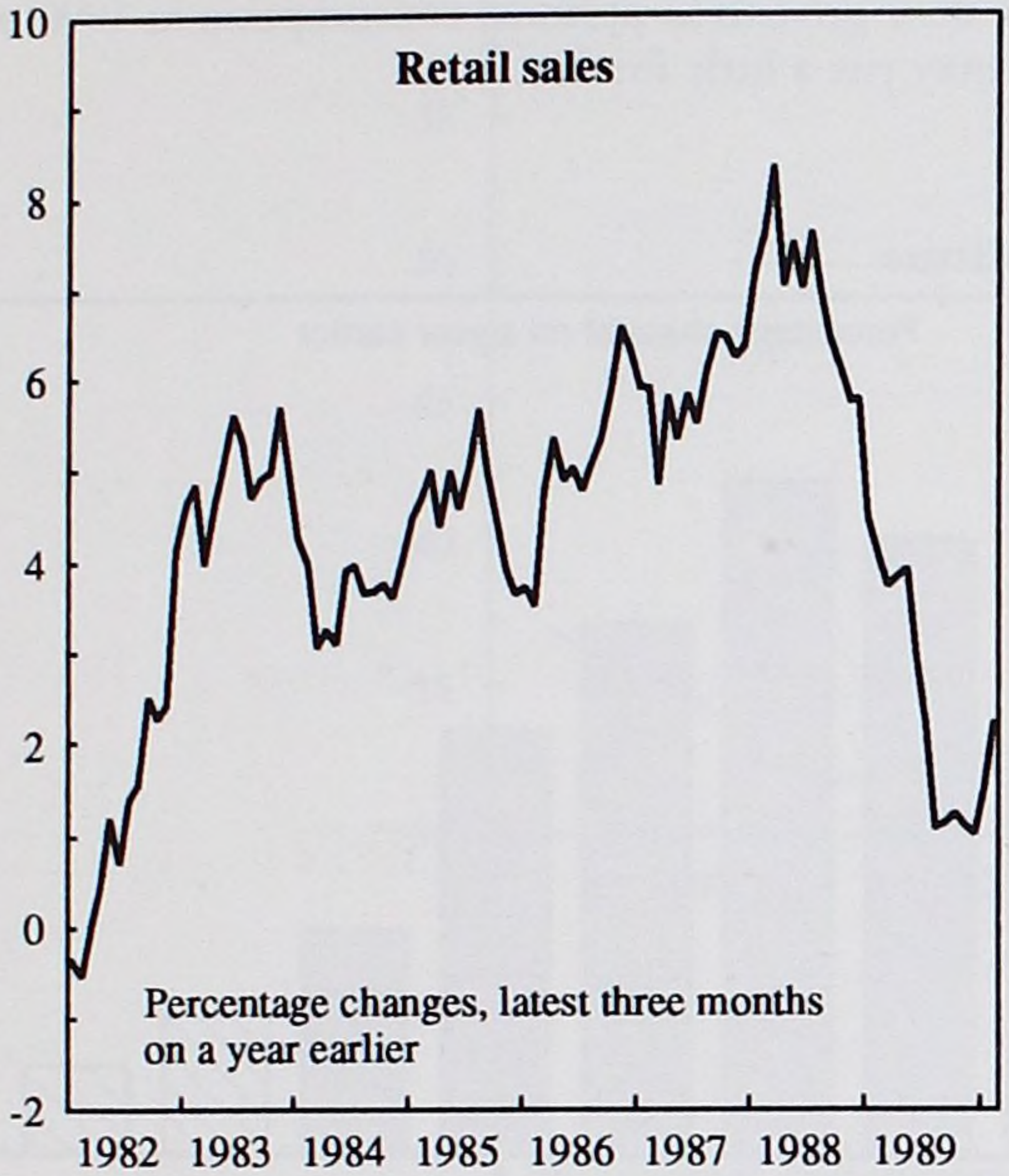
Domestic expenditure

Personal sector

3.19 Consumer spending in the UK slowed sharply during 1989, and the personal saving ratio rose slightly. The slow-down in spending was most evident in retail sales and, since late summer, lower demand for new cars.

3.20 Real personal disposable incomes are expected to rise much more slowly this year, after rising by nearly 5 per cent a year between 1987 and 1989. The main factors behind this slow-down are the slower overall growth of the economy, and a rising debt service burden associated with the sharp increase in personal sector borrowing (mainly mortgage borrowing) of the last few years. Real personal sector wealth, the rapid growth of which probably contributed to strong consumer spending over the last three years, may fall in 1990 with the weakening of house prices.

Chart 3.6 Indicators of consumer demand



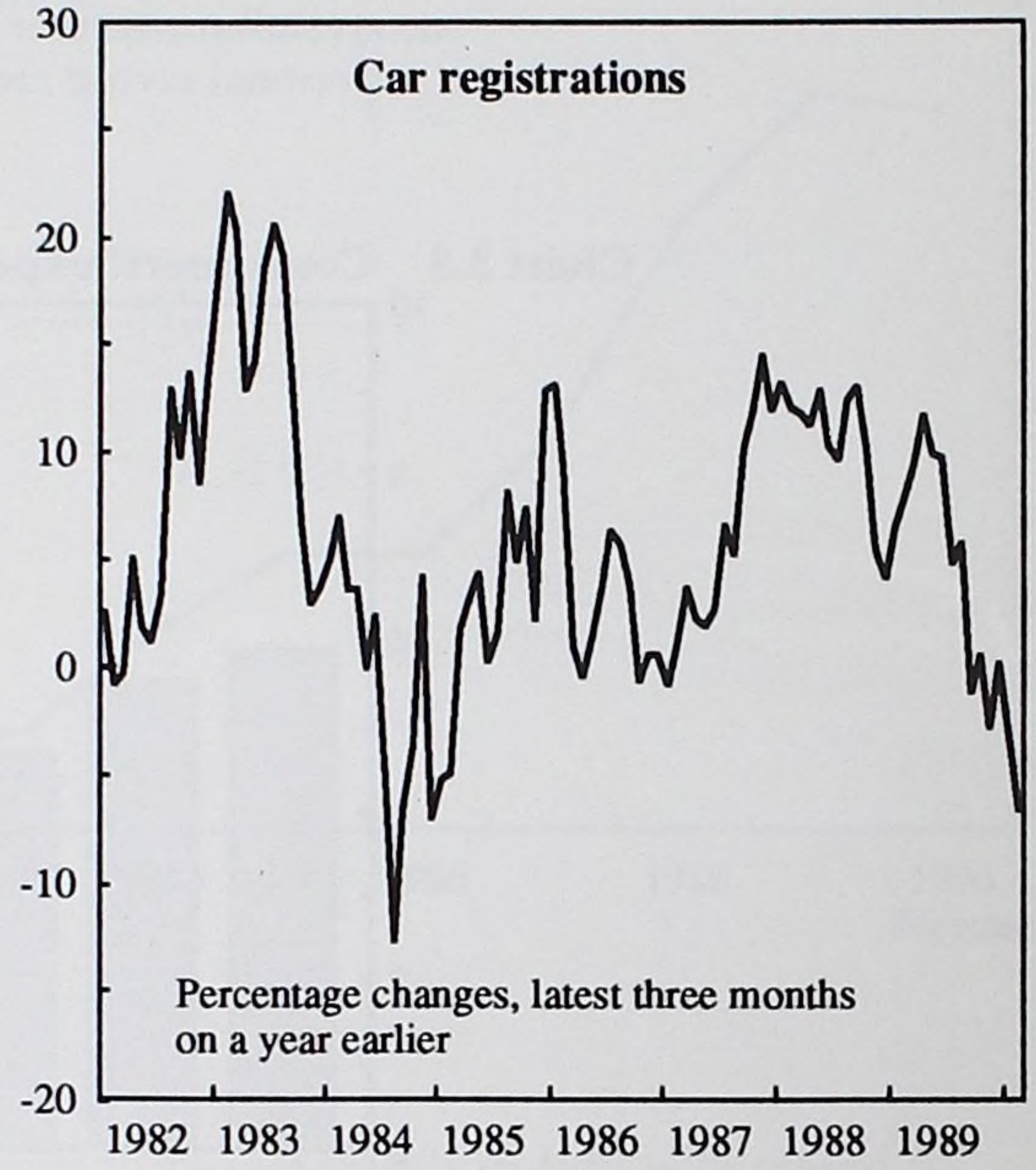
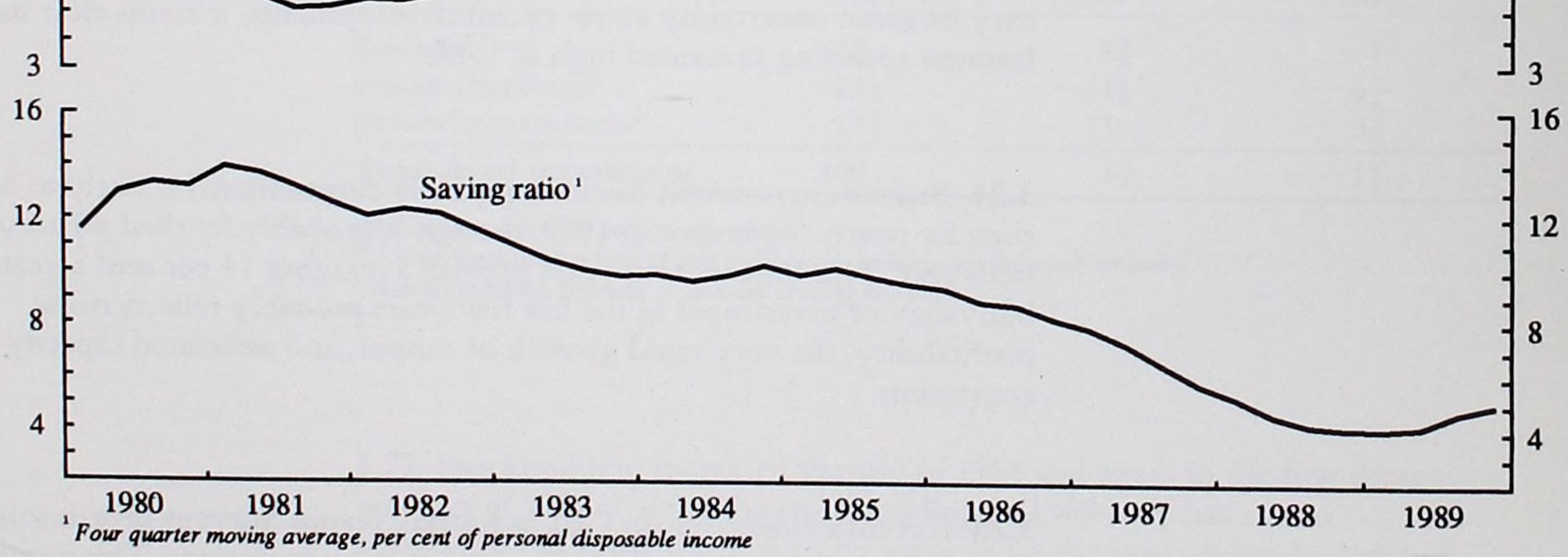


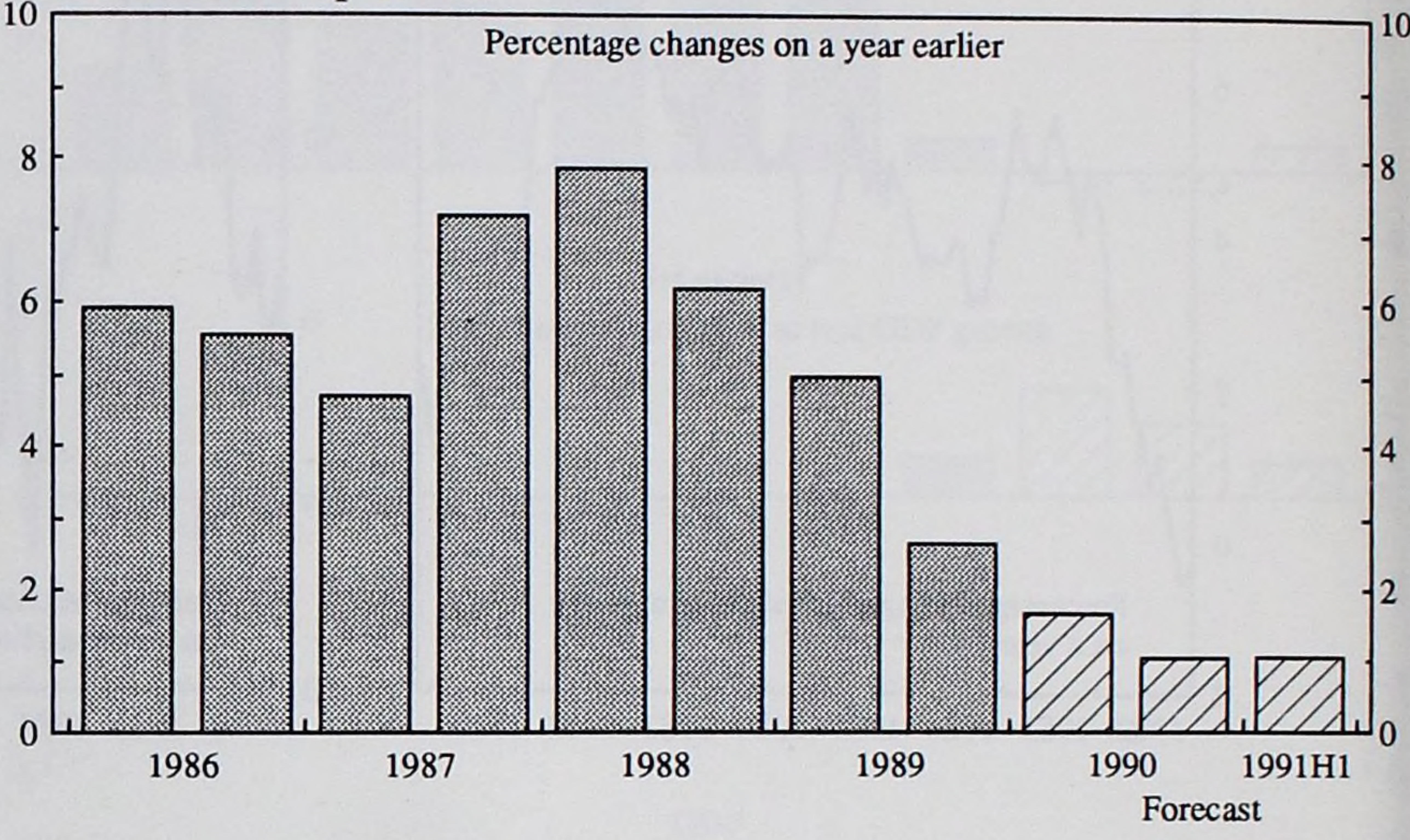
Chart 3.7 Personal sector wealth and saving ratio



[1] *Four quarter moving average, per cent of personal disposable income*

3.21 Despite some pick-up in retail sales growth in recent months, the overall prospect is for slow growth in personal consumption in 1990, and the personal saving ratio may rise a little further.

Chart 3.8 Consumers' expenditure



3.22 The housing market weakened in 1989. House prices have fallen recently, after exceptionally strong increases between 1987 and early 1989, and may fall further in 1990. Total investment in new housing fell last year, and is likely to do so again this year, given recent developments in new housing starts and completions.

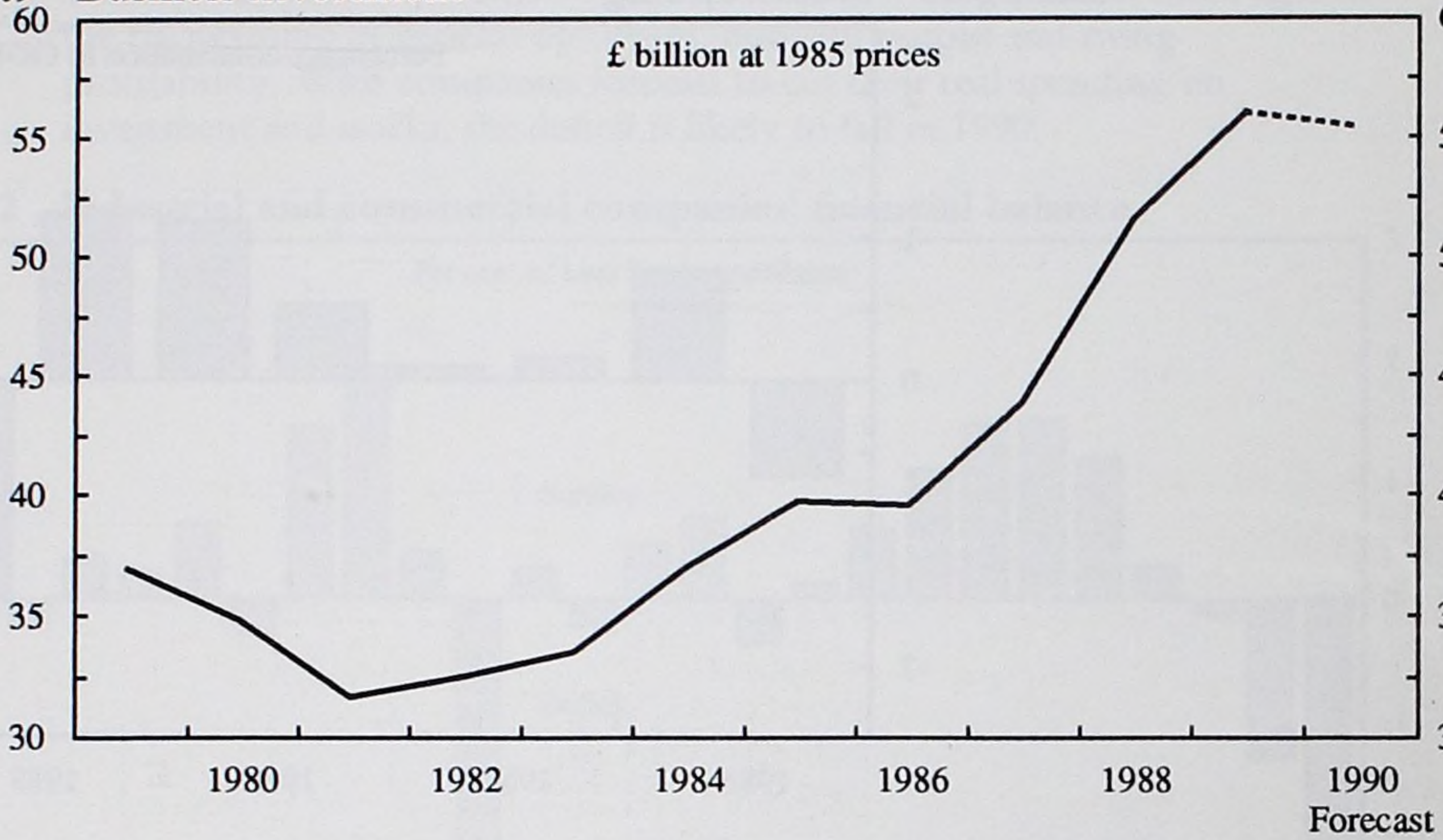
Company expenditure and income

3.23 The latest estimates of business investment and stockbuilding include upward adjustments by the Central Statistical Office (CSO). Though there may be some uncertainty about recent developments, it seems clear that business spending remained high in 1989.

3.24 Business investment (including public corporations) is likely to have risen by nearly 9 per cent in 1989, though it probably levelled off around mid-year. This follows two years growth averaging 14 per cent a year. The buoyancy of investment in the last few years probably reflects rising profitability, the very rapid growth of output, and associated capacity constraints.

3.25 Recent evidence from CBI Industrial Trends Surveys reveals some weakening of business optimism and investment intentions. This is only to be expected as the economy enters a period of slower growth, after the exceptionally buoyant output of the last few years. Business investment may fall slightly in 1990 as output growth slows further.

Chart 3.9 Business investment



3.26 General government investment rose sharply in 1989 with central government and local authorities increasing their investment strongly. A further large increase in central government investment is projected for 1990, which more than offsets a fall back in local authorities' investment. Along with the prospects for private dwellings and business investment, this suggests that total investment may show a small fall in 1990.

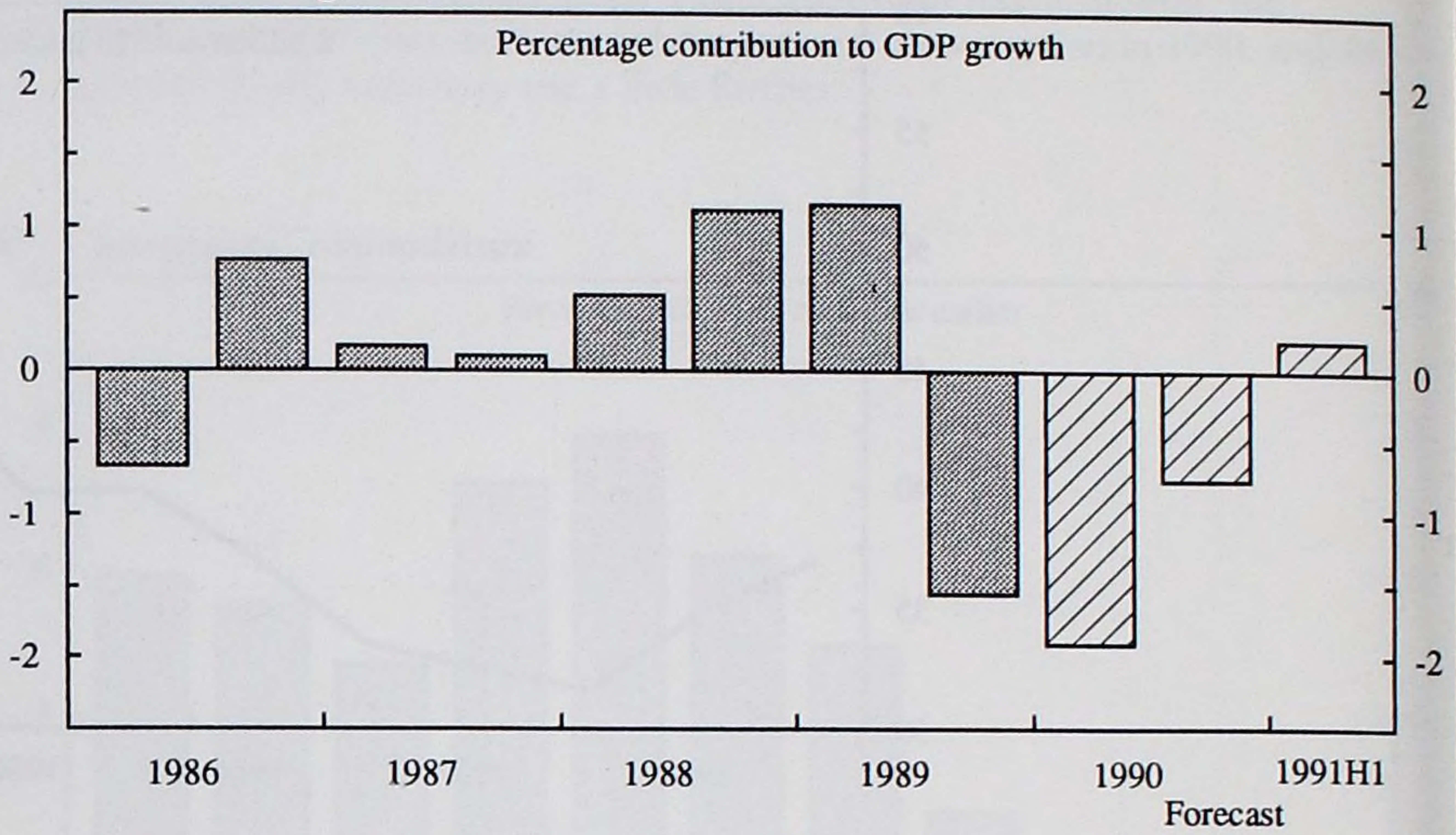
Table 3.3 Gross domestic fixed capital formation

	Weights in 1988	Percentage changes on previous year 1989	Forecast 1990
Business[1]	68	8¾	−1
Private dwellings[2]	20½	−11¼	−6¼
General government[3]	11½	11	3¾
Total fixed investment	**100**	**4¾**	**−1¼**

[1]*Includes investment by public corporations.*
[2]*Includes purchases less sales of land and existing buildings for the whole economy.*
[3]*Excludes purchases less sales of land and existing buildings.*

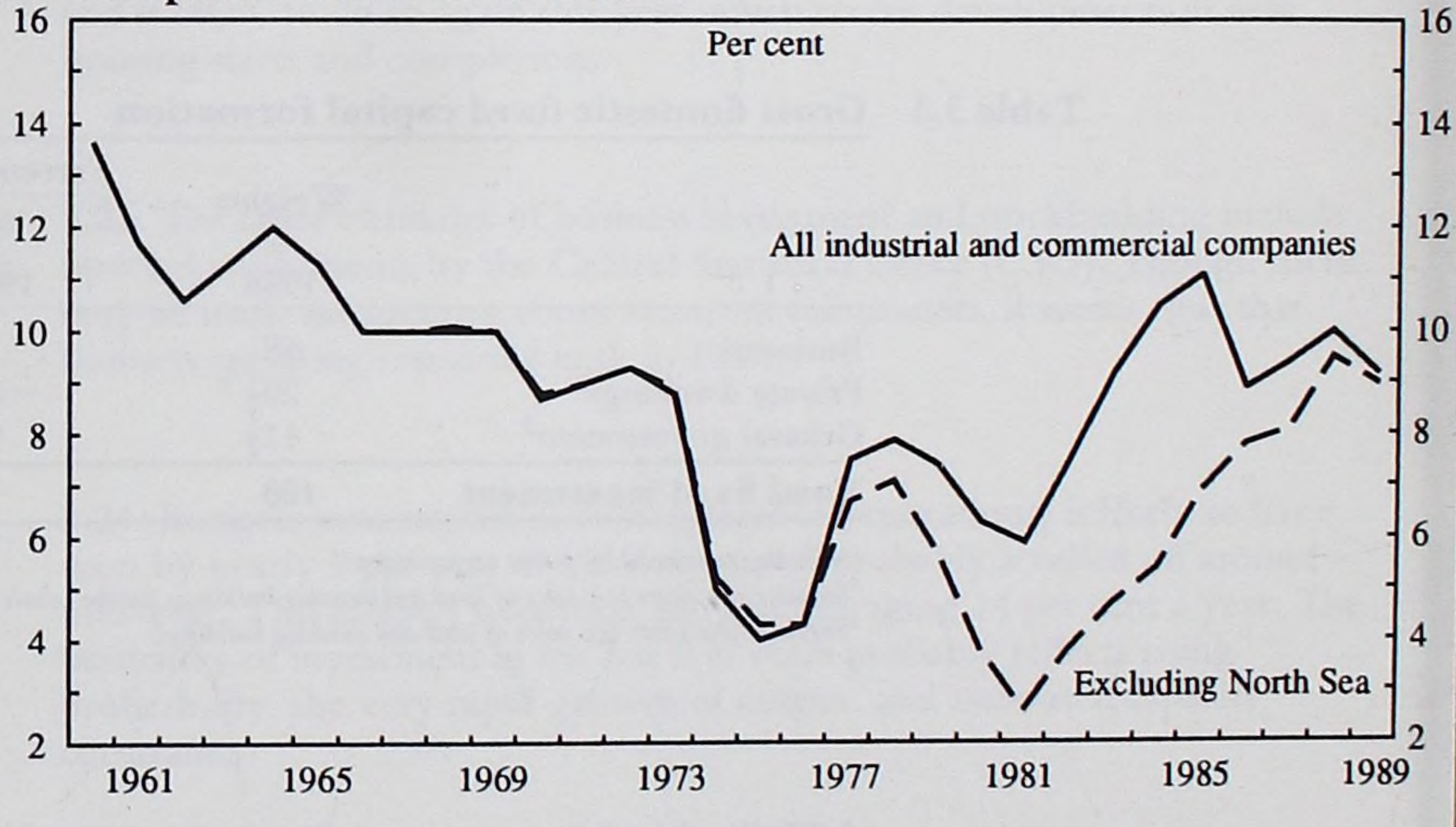
3.27 Stockbuilding increased sharply in 1988 and again in the first three quarters of 1989. Part of the stockbuilding in 1989 may have been involuntary as firms were taken by surprise by the slow-down in demand through the year. Companies apparently destocked in the fourth quarter of 1989, and are forecast to continue to do so in 1990 as domestic demand slows down and sustained high interest rates keep the cost of holding stocks high.

Chart 3.10 Stockbuilding



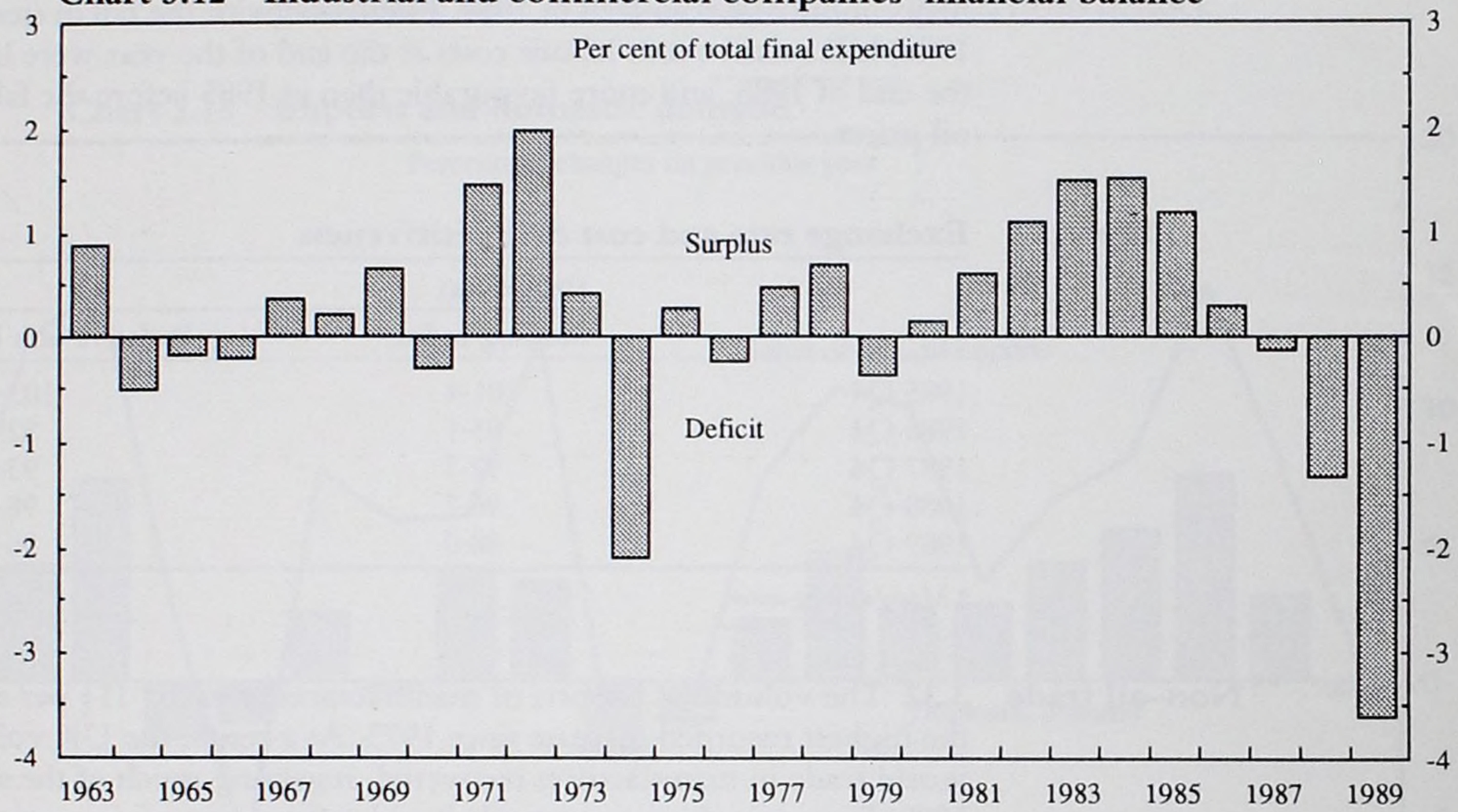
3.28 Non-North Sea industrial and commercial company profits (net of stock appreciation) are estimated to have risen by 6 per cent in 1989, after growth averaging nearly 20 per cent a year between 1981 and 1988. With the slow-down in demand and output growth, and a rise in unit labour costs, companies may have faced some pressure on profit margins last year after several years of increase. As a result, the rate of return on capital may have fallen a little, although it was still high by the standards of the 1970s and early 1980s.

Chart 3.11 Companies' real rates of return



3.29 Over the last two years non-North Sea industrial and commercial companies' income growth has failed to keep pace with their spending on investment, stockbuilding and dividend payments. As a result, they ran large financial deficits. These deficits were probably willingly undertaken against the background of general optimism, buoyant output and rising profitability. With companies forecast to cut their real spending on investment and stocks, the deficit is likely to fall in 1990.

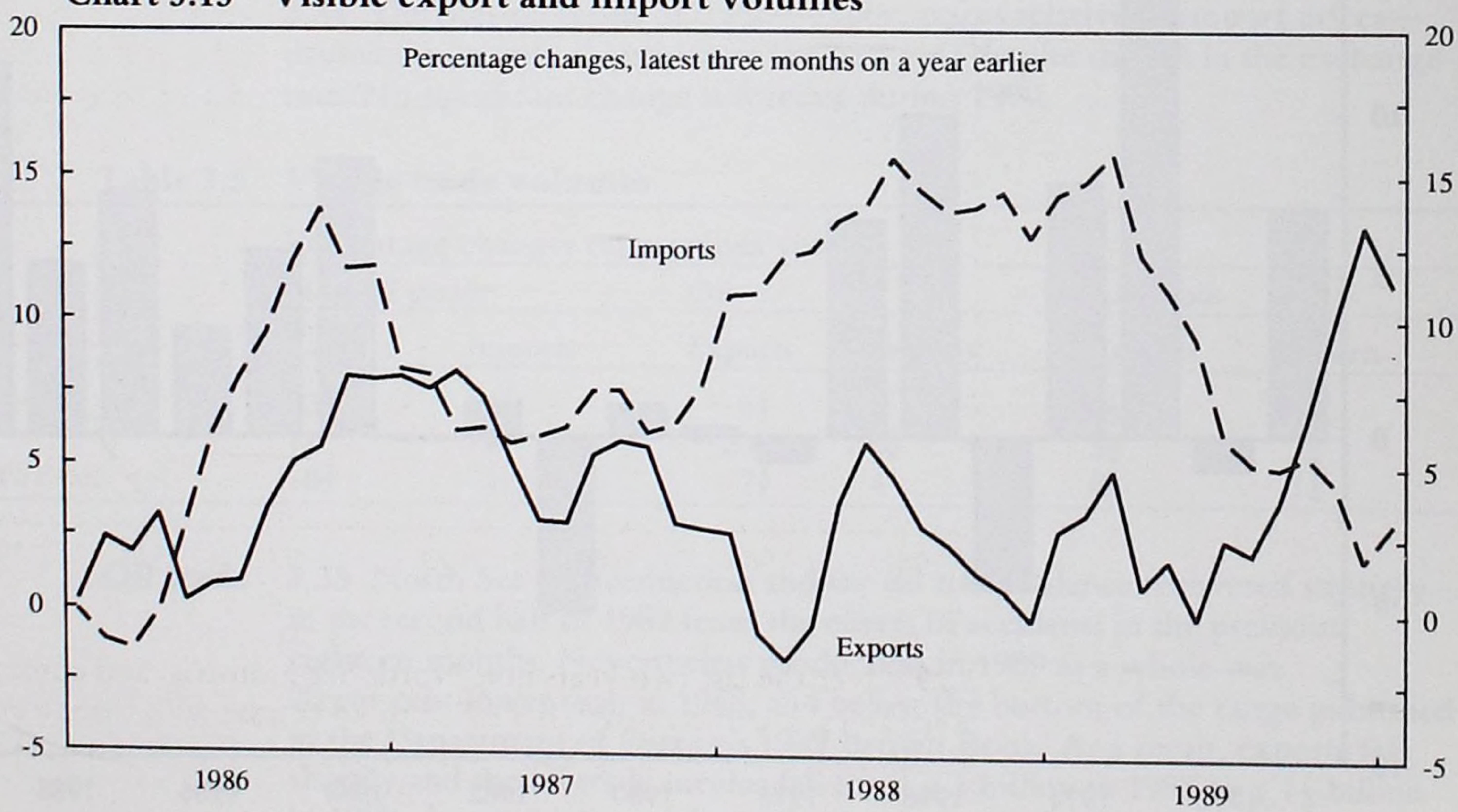
Chart 3.12 Industrial and commercial companies' financial balance



Trade and the balance of payments

3.30 The current account is estimated to have been in deficit by nearly £21 billion in 1989. The visible trade deficit fell more rapidly than expected in the final months of the year, as the growth of imports slowed and that of

Chart 3.13 Visible export and import volumes



exports picked up strongly. Offsetting this, the invisibles balance fell more sharply than expected in the second half of 1989—preliminary estimates indicate that it moved into deficit.

Relative costs **3.31** Unit labour costs in manufacturing rose faster in the UK than in other major industrial countries in 1989. However, with the fall in sterling during 1989, UK relative unit labour costs at the end of the year were lower than at the end of 1988, and more favourable than in 1985 before the fall in world oil prices.

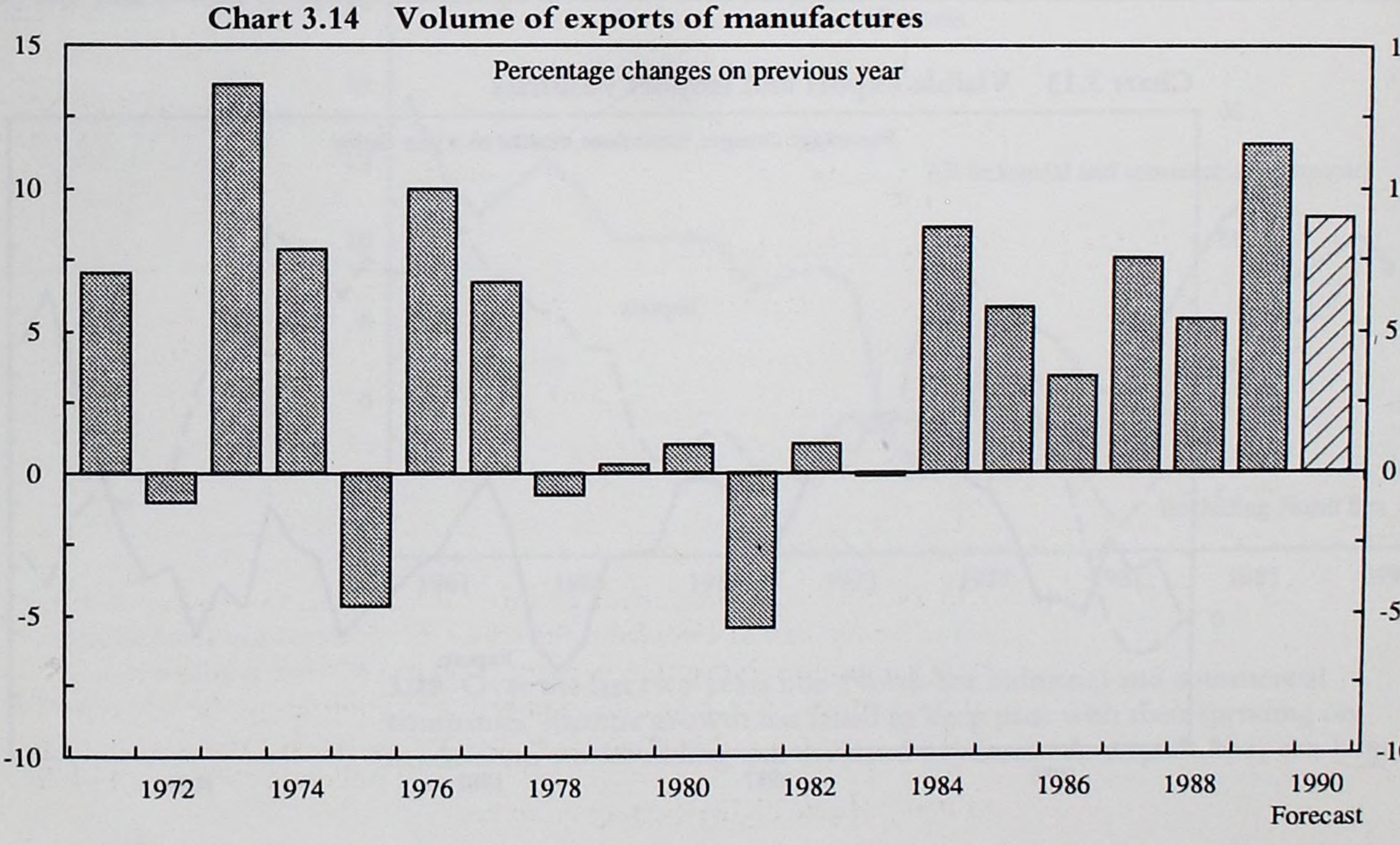
Table 3.4 Exchange rate and cost competitiveness

	1985=100	
	Sterling index	Relative unit labour costs *
1985 Q4	101·4	103·6
1986 Q4	85·1	82·6
1987 Q4	92·7	93·0
1988 Q4	96·7	98·1
1989 Q4	88·0	96·2

* *Manufacturing sector*

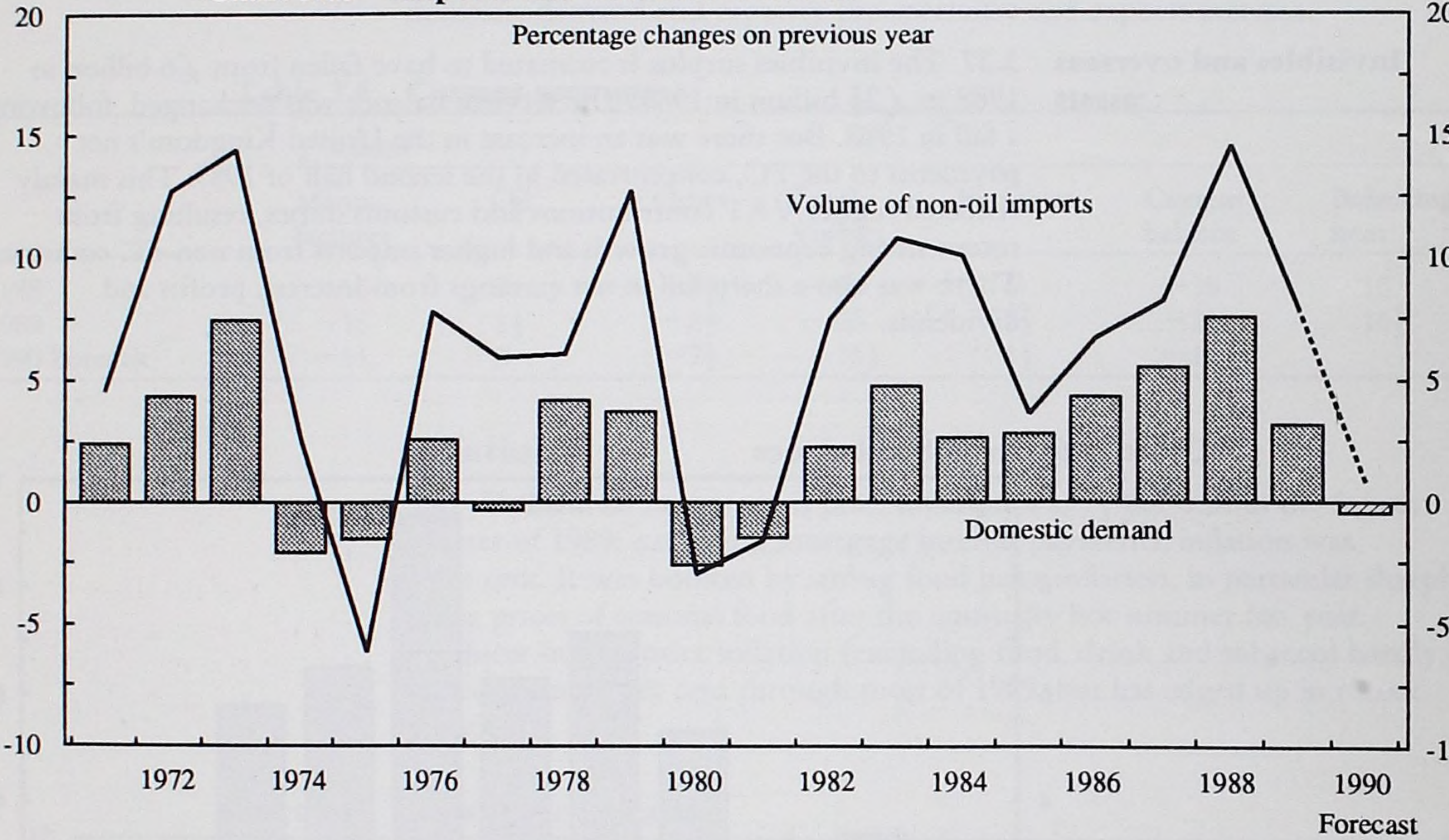
Non-oil trade **3.32** The volume of exports of manufactures grew by $11\frac{1}{2}$ per cent in 1989, the highest recorded increase since 1973. As a result, the UK volume share of world trade in manufactures recovered, regaining much of the share lost in 1988. Export performance was helped by the easing of domestic capacity pressures, which held back growth in 1988. In 1990 the volume of exports of manufactures is forecast to rise by 9 per cent and the world trade share is expected to recover further as capacity pressures continue to ease.

Chart 3.14 Volume of exports of manufactures



3.33 Non-oil import volumes rose by 8 per cent in 1989. But growth slowed through the year, and most categories of imports have been flat in recent months as both companies and households have responded to tight policy. With falling domestic demand forecast in 1990, imports are expected to rise only slowly over the next year. Imports of non-manufactures, particularly basic materials, could fall in 1990 as firms destock.

Chart 3.15 Imports and domestic demand



3.34 The non-oil terms of trade—export prices relative to import prices—drifted down only slightly over the past year despite the fall in the exchange rate. No significant change is forecast during 1990.

Table 3.5 Visible trade volumes

	Percentage changes on previous year					
	Non-oil goods		Oil		All goods	
	Exports	Imports	Exports	Imports	Exports	Imports
1988	3½	14½	−6½	1	1½	13¼
1989	11	8	−20½	6¾	5½	7¾
1990 Forecast	8¾	1	7¾	4	8½	1¼

Oil trade

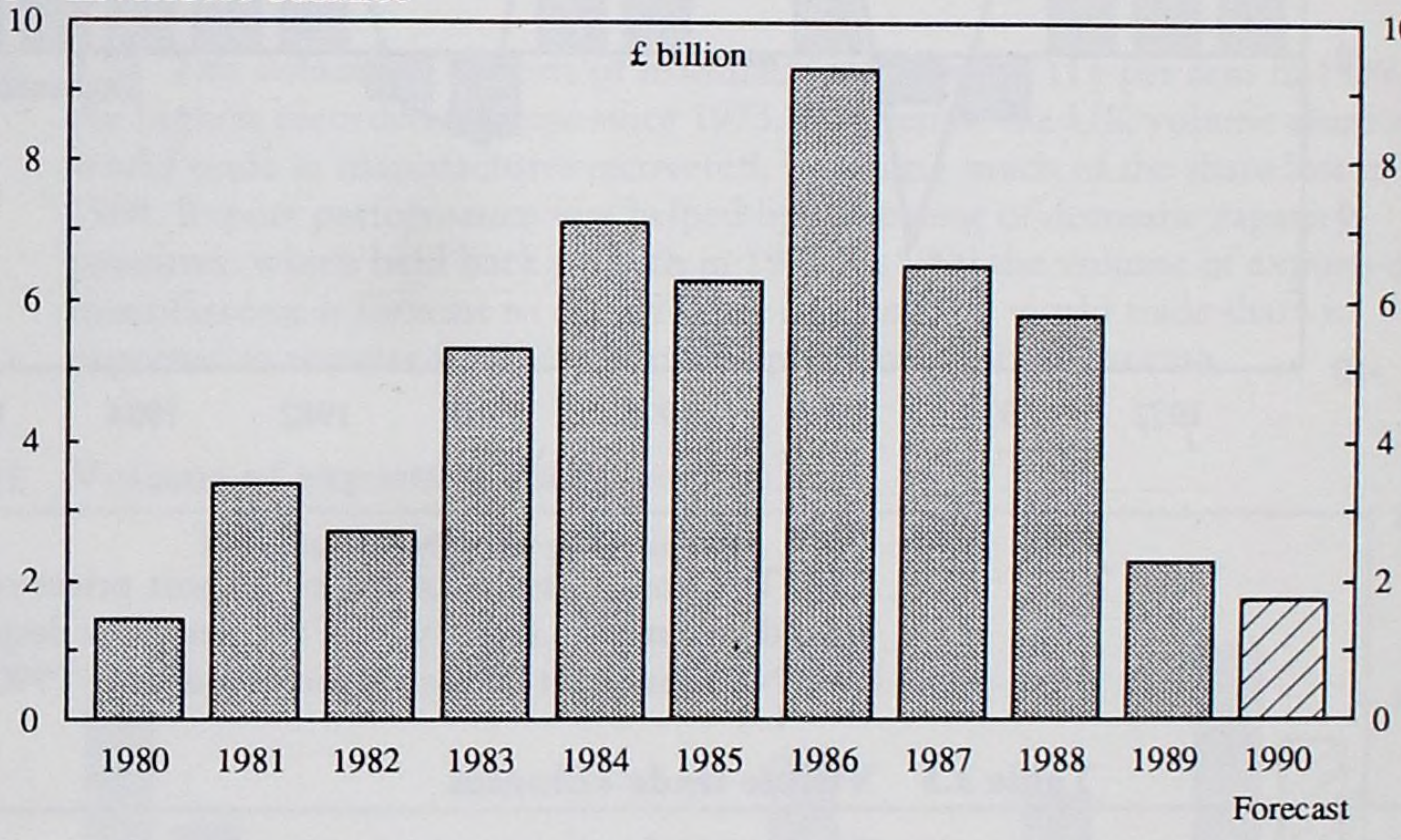
3.35 North Sea oil production and the oil trade balance recovered strongly in the second half of 1989 from the effects of accidents in the previous eighteen months. Nevertheless production in 1989 as a whole was 20 per cent lower than in 1988, and below the bottom of the range published in the Department of Energy's 1989 Brown Book. As a result, exports fell sharply and the oil trade surplus fell from £3 billion in 1988 to £1½ billion in 1989, despite higher sterling oil prices.

3.36 Oil prices in 1990 are assumed to remain close to recent levels. Production is expected to be higher in 1990 than in 1989, even though the need for safety-related investment, following recent accidents, means that extended shutdowns are likely in some fields. And with domestic demand for oil likely to be restrained by slow economic growth, oil exports are forecast to recover in 1990 while oil import growth should slow. The oil trade surplus is forecast to rise to £2 billion.

Invisibles and overseas assets

3.37 The invisibles surplus is estimated to have fallen from £6 billion in 1988 to £2½ billion in 1989. The services balance was unchanged, following a fall in 1988. But there was an increase in the United Kingdom's net payments to the EC, concentrated in the second half of 1989. This mainly reflected higher VAT contributions and customs duties, resulting from recent strong economic growth and higher imports from non-EC countries. There was also a sharp fall in net earnings from interest, profits and dividends.

Chart 3.16 Invisibles balance



3.38 The invisibles surplus is forecast to be £1½ billion in 1990. The services surplus is expected to rise slowly and net EC contributions are likely to be lower in 1990 than in 1989, partly because the UK's abatement under the Fontainebleau mechanism is expected to be larger. However net earnings from interest, profits and dividends are expected to fall in 1990.

3.39 The fall in net earnings on overseas assets in 1989 occurred despite a rise in the recorded sterling value of net overseas assets, from a revised estimate of £81 billion at end-1988 to around £110 billion at end-1989. The rise is more than accounted for by favourable revaluations, as world stock markets rose and sterling fell, boosting the sterling value of foreign currency assets. However, the difficulties in measuring certain capital flows—reflected in the large balancing item in the overseas account—and with the valuation of direct investments mean that estimates of net overseas assets are subject to a wide margin of error.

Current account **3.40** The current account deficit is forecast to fall to £15 billion in 1990, mainly reflecting a sharp fall in the deficit on trade in manufactures, as domestic demand and capacity pressures ease and exports increase.

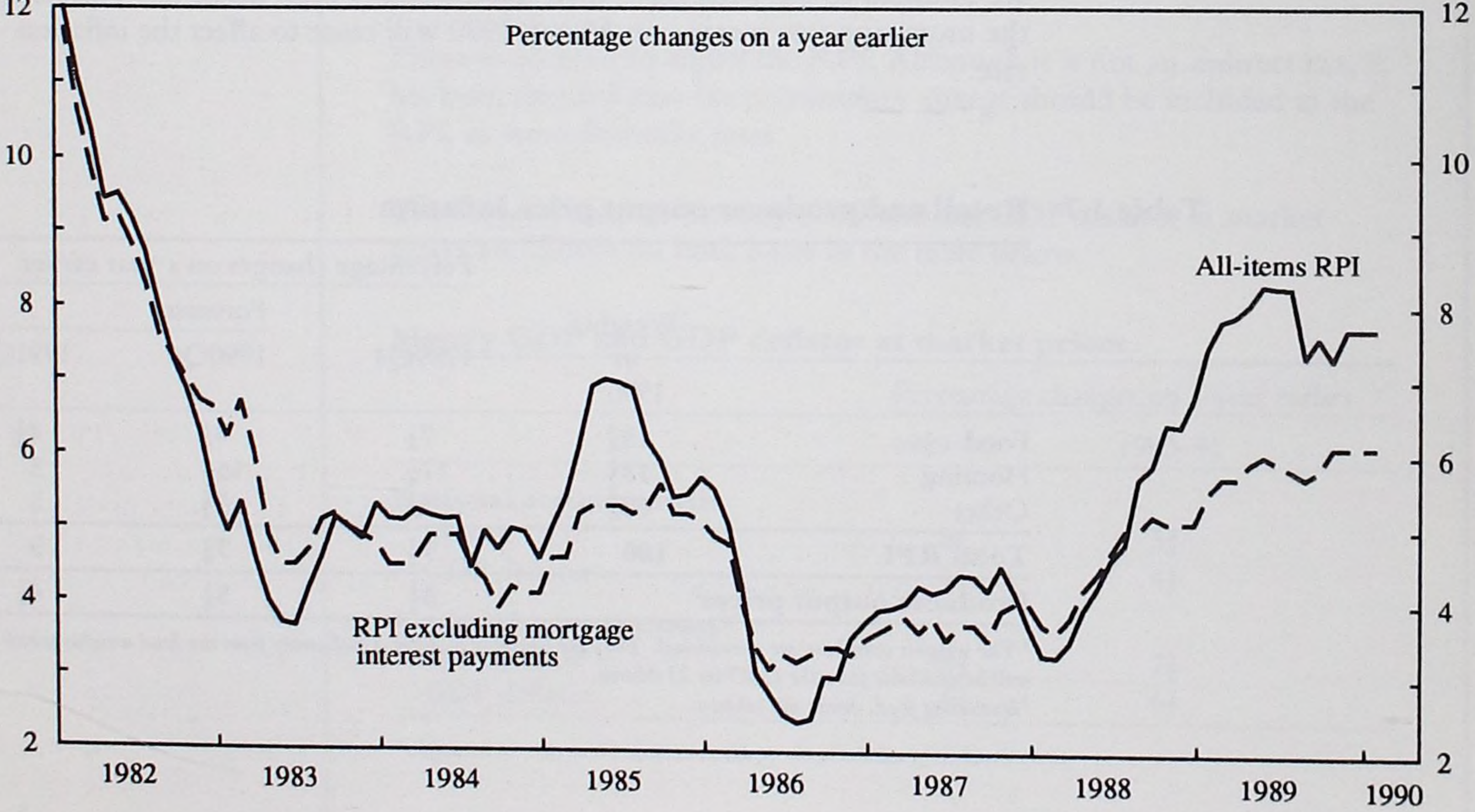
Table 3.6 Current account

	£ billion						
	Manu-factures	Oil	Other	Total Visibles	Invisibles	Current balance	Balancing item
1988	−15	3	$-8\frac{1}{2}$	−21	6	−15	10
1989	−16	$1\frac{1}{2}$	$-8\frac{1}{2}$	−23	$2\frac{1}{2}$	−21	$16\frac{1}{2}$
1990 Forecast	−11	2	$-7\frac{1}{2}$	$-16\frac{1}{2}$	$1\frac{1}{2}$	−15	

Inflation

3.41 The annual rate of retail price inflation was $7\frac{1}{2}$ per cent in the fourth quarter of 1989; excluding mortgage interest payments, inflation was 6 per cent. It was boosted by strong food price inflation, in particular sharply rising prices of seasonal food after the unusually hot summer last year. Producer output price inflation (excluding food, drink and tobacco) hardly varied from $5\frac{1}{2}$ per cent through most of 1989, but has edged up in recent months.

Chart 3.17 Retail price inflation



3.42 CBI data show pay settlements in manufacturing to have risen to just over 8 per cent in the second half of 1989, about 1½ per cent more than a year earlier. Whole economy underlying earnings rose by 9¼ per cent in the year to January 1990, with earnings growth in manufacturing moderated by lower overtime working.

3.43 Unit labour costs in manufacturing are estimated to have risen by about 4 per cent in 1989. There is some evidence that manufacturers' profit margins may have come under pressure in the second half of 1989. Unit labour costs are likely to rise faster in 1990 as productivity growth declines with the slow-down in output. Margins are likely to remain subdued, given the forecast for domestic demand and activity.

Prospects

3.44 Retail price inflation is likely to rise quite sharply in the next few months. This mainly reflects recent increases in mortgage rates, continued high food price inflation, and, especially, a large increase in the community charge. The average community charge per head set by local authorities in Great Britain is estimated to be around £350, a rise of over 30 per cent on domestic rates per head in 1989.

3.45 Retail price inflation is forecast to fall back to 7¼ per cent by the fourth quarter of 1990. Marketed retail price inflation is expected to abate, as slow growth in personal spending squeezes retailers' margins. Food price inflation is expected to come down towards more normal levels. Retail price inflation is likely to drop further by the middle of 1991; community charge increases are assumed to fall back from their exceptionally high levels this year, and the mortgage rate increase in March 1990 will cease to affect the inflation rate.

Table 3.7 Retail and producer output price inflation

	Weights in 1990[1]	Percentage changes on a year earlier		
			Forecasts	
		1989Q4	1990Q4	1991Q2
Food	15¾	7¼	4¾	4¼
Housing	18½	17¼	16½	5
Other	65¾	5¼	5½	5
Total RPI	**100**	**7½**	**7¼**	**5**
Producer output prices[2]		**5½**	**5¼**	**4¾**

[1] *The weights used here are provisional. They are unlikely to differ significantly from the final weights which will be available from the CSO on 23 March.*
[2] *Excluding food, drink and tobacco.*

Money GDP and the abolition of domestic rates

Money GDP at market prices includes taxes on expenditure. It therefore includes domestic rates, which are regarded as a tax on the consumption of housing services. As in Scotland in 1989, domestic rates are due to be replaced by the community charge in England and Wales from April 1990. The Central Statistical Office (CSO) has decided that the community charge will not be treated in the national accounts as a tax on expenditure, and thus not included in money GDP at market prices. (For a fuller account of this, see the August 1989 issue of Economic Trends.)

The abolition of domestic rates thus reduces the *level* of money GDP marginally in 1989–90 and by 1¾ per cent in 1990–91 and subsequent years. The *growth rate* of money GDP will accordingly be reduced slightly in 1989–90 and by 1¾ per cent in 1990–91. The year on year growth rate will be unaffected thereafter by the once-and-for-all distortions.

The level and growth rate of the GDP deflator at market prices are similarly affected by the abolition of domestic rates, by the same percentage amounts as for money GDP. Real GDP is not affected by the change.

Throughout this document, all figures which involve money GDP or the GDP deflator at market prices are presented both on the national accounts basis, and adjusted to remove the distortion due to the abolition of domestic rates. It is the adjusted figures which show the underlying movements.

There is no need to adjust the RPI. Although it is not an indirect tax, it has been decided that the community charge should be included in the RPI, as were domestic rates.

The forecast levels of money GDP and the GDP deflator at market prices are shown on both bases in the table below.

Money GDP and GDP deflator at market prices

	Percentage changes on a year earlier	
	1989–90	1990–91
National accounts basis		
Money GDP	8½	5¾
GDP deflator	6¼	4½
Underlying movement*		
Money GDP	8½	7½
GDP deflator	6½	6½

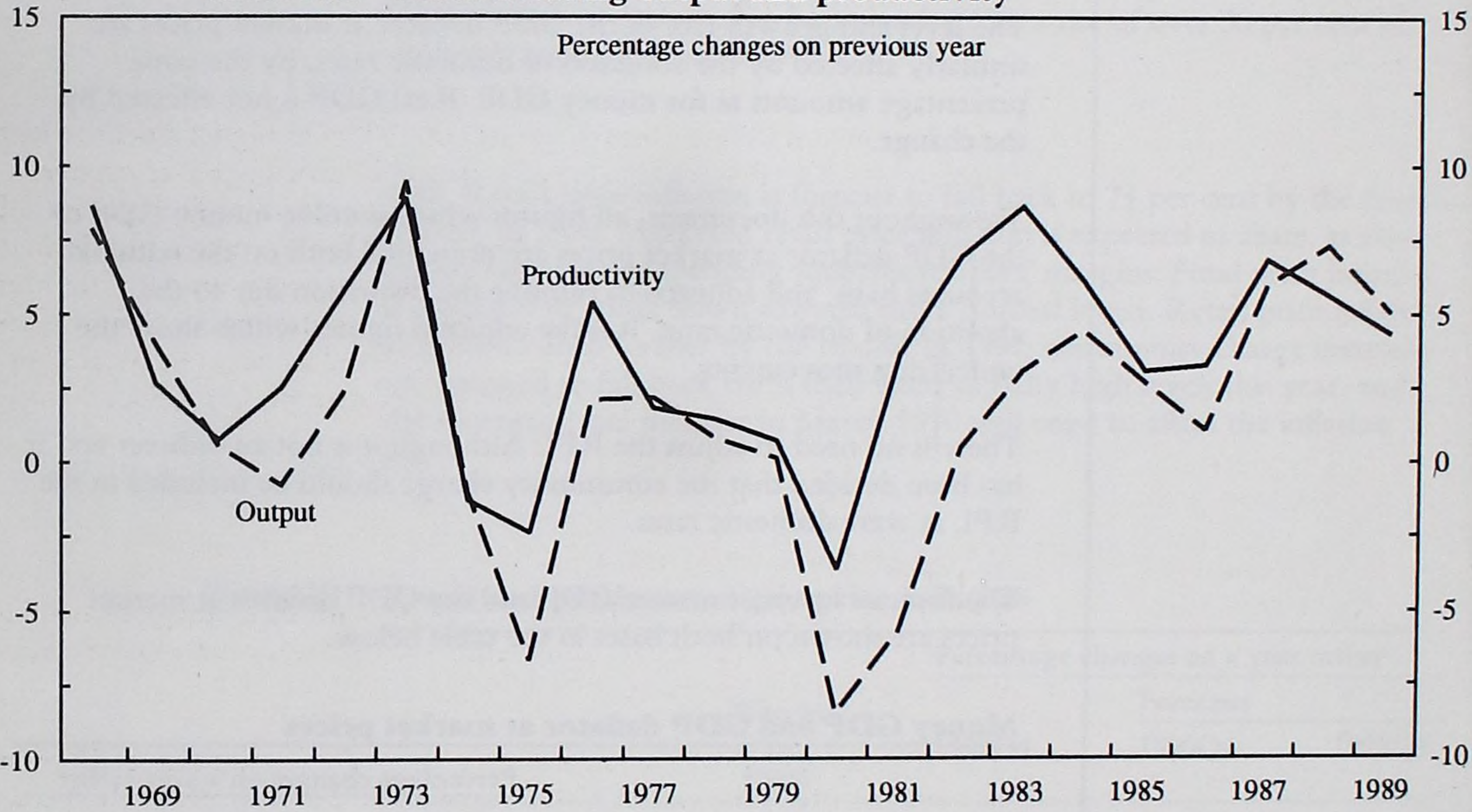
**Adjusted to remove the distortion due to the abolition of domestic rates.*

Labour market

Employment **3.46** Buoyant output growth since 1983 has led to large increases in the workforce in employment (including those on government training programmes). It rose by nearly $3\frac{1}{2}$ million between March 1983 and September 1989, and by $2\frac{1}{4}$ million in the three years to September 1989. Excluding those on training programmes the corresponding increases were 3 million and 2 million respectively.

Productivity **3.47** Productivity growth moderated in 1989 as it usually does when output growth slows down. Even so, manufacturing productivity rose by 4 per cent last year. It has risen by an average of over 5 per cent a year since 1980, higher than in the 1960s and faster than in any other major country. Despite a sharp slow-down last year, whole economy productivity growth has still risen by an average of over 2 per cent a year since 1980, second only to Japan of all the major economies.

Chart 3.18 Manufacturing output and productivity



Unemployment **3.48** By February 1990, seasonally adjusted adult unemployment had fallen for 43 successive months, by over $1\frac{1}{2}$ million in total. With output growth expected to be low in 1990, the sharp rise in employment of the last few years is likely to tail off and unemployment may rise. But the employment and unemployment outlook depends crucially on wage settlements. The higher wage settlements are, the greater the squeeze on company profitability and the weaker employment prospects will be.

Forecast and outturn

3.49 Table 3.8 compares the main elements of the forecast published in the 1989 FSBR with the outturn for 1989 or the latest estimate for 1989-90.

Table 3.8 Forecast and outturn

	Percentage changes on a year earlier unless otherwise stated		
	1989 FSBR	Outturn or latest estimate	Average errors from past forecasts
GDP (1989)	$2\frac{1}{2}$	$2\frac{1}{4}$	1
Non-North Sea GDP (1989)	3	$3\frac{1}{4}$	1
Domestic demand (1989)	$2\frac{1}{2}$	$3\frac{1}{4}$	1
RPI (1989Q4)	$5\frac{1}{2}$	$7\frac{1}{2}$	1
Money GDP (1989–90)	$7\frac{3}{4}$	$8\frac{1}{2}$*	$1\frac{3}{4}$
Balance of payments current account (1989, £ billion)	$-14\frac{1}{2}$	-21	$4\frac{1}{2}$
PSDR (1989–90, £ billion)	14	7*	$5\frac{1}{4}$

* *Partly forecast.*

3.50 RPI inflation in the fourth quarter of 1989 was higher than forecast in last year's FSBR, mainly because of increases in mortgage interest rates during the year and much faster than expected growth in food prices. GDP grew by $2\frac{1}{4}$ per cent in 1989, only slightly less than expected, but domestic demand growth was higher than forecast and the contribution of net trade lower. As a result the current account deficit was also higher than forecast. The PSDR is expected to be lower than expected a year ago, because of both higher government spending and slower growth in receipts (see paragraphs 6.07–6.11).

Risks and uncertainties

3.51 Table 3.9 summarises the forecast along with the average errors from past forecasts. It is important to remember the relevant margins of error when assessing the forecasts.

3.52 The forecast for 1990 takes as given the CSO's estimates of GDP and its components to the end of 1989. These include adjustments to expenditure components—consumers' expenditure, fixed investment, stockbuilding and net exports of services. These bring growth in the expenditure measure of GDP in the last three years more closely into line with that of the output measure, which the CSO regards as the most reliable indicator of recent movements in GDP. Although they improve the overall coherence of recent economic statistics, these adjustments are of necessity based on judgement, and therefore add to the uncertainty that inevitably surrounds any economic forecasts.

Table 3.9 Economic prospects: summary

	Percentage changes on a year earlier unless otherwise stated			
		Forecast		Average errors from past forecasts[1]
	1989	1990	1991 H1	
GDP and domestic demand at constant prices				
Domestic demand	3¼	−½	¾	1¼
of which:				
Consumers' expenditure	3¾	1¼	1	1¼
General government consumption	½	¼	¾	1
Fixed investment	4¾	−1¼	−¾	3
Change in stockbuilding (as percent of GDP)	−¼	−1¼	¼	½
Exports of goods and services	4	7¼	5½	1½
Imports of goods and services	7	1	3	2¾
Gross domestic product (average measure)	2¼	1	1½	¾
Manufacturing output	4¾	0	¾	1¾
Balance of payments current account (£ billion)	−21	−15	−12[3]	5½
Inflation				
Retail prices index (Q4 on Q4)	7½	7¼	5[4]	1¼
GDP deflator at market prices (financial year)[2]	6¼(6½)	4½(6½)		1
Money GDP at market prices (financial year)[2]	8½(8½)	5¾(7½)		1¾
£ billion	519 (519)	548 (558)		
PSDR (financial year)				
£ billion	7	7		5¾
per cent of GDP	1¼	1¼		1

[1] *The errors relate to the average differences (on either side of the central figure) between FSBR Industry Act Forecasts and outturn over the last ten years, and apply to the forecasts for 1990.*
[2] *The figures in brackets adjust for the distortion to money GDP and the GDP deflator arising from the abolition of domestic rates. This is explained in the box on page 45.*
[3] *At an annual rate.*
[4] *Q2 on Q2.*

Table 3.10 Gross domestic product and its components[1]

£ billion at 1985 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	**Total final expenditure**	*Less* imports of goods and services	*Less* adjustment to factor cost	*Plus* statistical adjustment	**GDP at factor cost (average measure)**	GDP index 1985 = 100
1985	217·0	73·9	60·3	102·6	0·6	454·5	99·2	49·4	0·0	305·9	100·0
1986	229·4	75·3	61·6	106·9	0·8	474·0	105·9	52·0	−0·1	316·0	103·3
1987	243·1	76·1	66·9	112·4	1·2	499·7	114·0	55·4	−0·4	330·0	107·9
1988	260·2	76·4	76·0	113·1	3·9	529·7	128·3	57·7	1·4	345·0	112·8
1989	270·0	76·8	79·7	117·8	3·2	547·5	137·4	59·3	2·0	352·8	115·4
1990	273·6	77·0	78·6	126·2	−1·5	554·0	138·9	60·7	2·0	356·4	116·5
1988 H1	128·3	38·3	36·8	56·7	0·8	260·8	61·9	28·4	0·5	171·0	111·8
H2	131·9	38·2	39·3	56·4	3·1	268·9	66·4	29·3	0·8	174·0	113·8
1989 H1	134·6	38·2	39·5	57·7	2·8	272·8	68·9	29·3	1·0	175·5	114·8
H2	135·4	38·7	40·2	60·1	0·4	274·7	68·5	30·0	1·1	177·3	115·9
1990 H1	136·8	38·5	39·7	62·3	−0·6	276·7	69·3	30·4	1·0	178·0	116·4
H2	136·8	38·6	38·9	64·0	−0·9	277·3	69·5	30·4	1·0	178·4	116·7
1991 H1	138·3	38·7	39·4	65·7	−0·2	281·9	71·4	30·8	1·0	180·7	118·2
Percentage changes on a year earlier[2]											
1988	7	½	13¾	¾	¾	6	12½	4¼	½	4½	4½
1989	3¾	½	4¾	4	−¼	3¼	7	2¾	¼	2¼	2¼
1990	1¼	¼	−1¼	7¼	−1¼	1¼	1	2½	0	1	1
1991 H1	1	¾	−¾	5½	¼	2	3	1¼	0	1½	1½

[1] *The GDP figures are averages of constant price expenditure, output and income estimates of GDP. Percentage changes are calculated from unrounded levels, then rounded to the nearest quarter per cent.*

[2] *For stockbuilding and the statistical adjustment, changes are expressed as a per cent of GDP.*

4 The Budget tax proposals

4.01 The main tax changes proposed in the Budget are summarised below. A full list of changes is given in table 4.1.

Income tax

4.02 The main income tax allowances will be increased in line with the statutory indexation provisions (based on the increase of 7·7 per cent in the RPI in the year to December 1989). Independent Taxation of husband and wife will be introduced on 6 April 1990, as already announced. The allowances for 1990–91, and the increase over the equivalent allowances for 1989–90, will be

personal allowance £3 005 (up £220);

married couple's allowance, additional personal allowance and widow's bereavement allowance £1 720 (up £130);

for those aged 65 to 74: personal allowance £3 670 (up £270) and married couple's allowance £2 145 (up £160);

for those aged 75 and over: personal allowance £3 820 (up £280) and married couple's allowance £2 185 (up £160);

income limit for age-related allowances £12 300 (up £900).

4.03 The basic rate limit will remain at £20 700 of taxable income.

4.04 The blind person's allowance will be doubled to £1 080.

Benefits-in-kind

4.05 The benefit-in-kind of workplace nurseries will be exempt from tax from 6 April 1990.

4.06 Car benefit scale charges will be increased by 20 per cent from 6 April 1990.

Charitable giving

4.07 The limit on charitable donations qualifying for tax relief under the payroll giving scheme will be increased from £480 to £600 a year from 6 April 1990. Income tax relief will be introduced for single donations of £600 or more by individuals to charities from 1 October 1990, up to a maximum of £5 million a year per donor. Corporation tax relief will be introduced on similar lines for donations by companies.

Savings

4.08 Tax Exempt Special Savings Accounts will be introduced from 1 January 1991. Individuals will be able to deposit up to £9 000 over a five year period. In the first year up to £3 000 may be deposited and in subsequent years £1 800 a year (£150 a month), subject to the overall limit.

Provided no withdrawal of capital is made during the five years, the interest will be totally exempt from tax. There will be an option to withdraw some interest as it arises, but if capital is withdrawn early, then all the interest will be subject to tax.

Personal equity plans

4.09 The annual limit on investment in Personal Equity Plans will be increased from £4 800 to £6 000. The annual limit on investment in qualifying unit and investment trusts will be increased from £2 400 to £3 000 and the limit for non-qualifying unit and investment trusts will be increased from £750 to £900.

Business taxation

4.10 The profits limit for the small companies' corporation tax rate of 25 per cent for the financial year 1990 will be raised from £150 000 to £200 000 and the limit for marginal relief will be raised from £750 000 to £1 million.

4.11 Rules for calculating tax relief for doubtful debts owed by sovereign and related debtors will be laid down broadly on the basis of guidelines issued by the Bank of England. In addition, in 1990–91 relief will not be allowed to exceed the amount which these rules produce in respect of 1989–90; in later years this limit will be increased by 5 per cent of the full value of debt each year. Relief for losses on disposals will be phased in a similar way.

Business expansion scheme

4.12 The general limit for investment in a company in any tax year will be increased from £500 000 to £750 000 from 1 May 1990.

Life assurance

4.13 Measures to complement the changes to life assurance taxation in the 1989 Finance Act were announced on 20 December 1989 to take effect from 1 January 1990.

Oil taxation

4.14 The tax treatment of future expenditure on abandoning offshore oil fields will be improved.

Capital gains tax

4.15 The capital gains tax annual exempt amount will remain at £5 000 in the case of individuals and £2 500 in the case of most trusts.

Employee share ownership plans (ESOPs)

4.16 Capital gains roll-over relief will be given for certain sales of shares to qualifying ESOP trusts.

Inheritance tax

4.17 From 6 April 1990 the threshold for inheritance tax will be increased in line with the statutory indexation provisions from £118 000 to £128 000.

Stamp duties

4.18 Stamp duties on share transactions will be abolished from a date late in 1991–92 to coincide as far as possible with the introduction of paperless share transfers.

VAT

4.19 The present turnover requirements for VAT registration will be replaced for most businesses by a single limit based on turnover in the previous twelve months.

4.20 From 21 March 1990 the VAT registration limit will be raised to £25 400 a year.

4.21 A comprehensive system will be introduced to provide relief from VAT on bad debts.

4.22 VAT relief for charities will be extended to all lifeboats and related capital items, the sale or export of donated goods by certain charities' trading companies, and preparatory work for certain types of advertising. Existing relief for equipment used in medical work, bought with donated funds, will be widened.

Excise duties

4.23 The tax (duty and VAT) on beer, wines and spirits will rise by just under 2p on a typical pint of beer, just under 7p on a bottle of table wine and just over 54p on a bottle of whisky.

4.24 The tax (duty and VAT) on leaded petrol will be increased by 2·3p a litre (11p a gallon) and on unleaded petrol by 2p a litre (9p a gallon), increasing the tax differential in favour of unleaded petrol to 3.4p a litre (15½p a gallon). The tax on derv will rise by 2p a litre (9p a gallon).

4.25 The tax (duty and VAT) on cigarettes, cigars and hand-rolling tobacco will rise by just under 10p on a packet of 20 cigarettes, just under 5p on a packet of five small cigars and just under 30p on a 50 gram packet of hand-rolling tobacco. The duty on pipe tobacco will remain unchanged.

4.26 The rate of pool betting duty will be reduced from 42½ per cent to 40 per cent provided the pools promoters pass the full amount saved to the Football Trust for use in improving safety and conditions at football grounds.

Vehicle excise duties

4.27 Duty for most vehicles will remain unchanged. Duty for some lorries will be changed to continue the process of bringing the balance of taxation of different types of lorry more into line. Duty on lorries under 3·5 tonnes will be reduced to £100.

Composite rate

4.28 Composite rate tax will be abolished from 6 April 1991. The details are set out in the box opposite.

Abolition of composite rate tax

Under the present system of taxing interest, a fixed rate of tax—known as composite rate tax—is charged on interest paid to individuals by building societies, banks and certain other deposit-takers. It is not repayable in any circumstances, even to depositors who are not liable to tax. The rate is set at a level which achieves revenue neutrality as far as liability to tax at the basic rate is concerned—that is, it produces the same total tax as would be payable if investors who are liable to tax were charged at basic rate and those who are not liable paid no tax at all. Higher rate taxpayers remain liable for the additional tax between the basic rate of 25 per cent and the higher rate of 40 per cent. The composite rate (set at 22 per cent for 1990–91) is lower than the basic rate because many depositors are not liable to income tax.

Composite rate has a long history—a century in the case of building societies. Although it has been a convenient and cost-effective system of collecting tax, it has become increasingly unfair because some 14 million people on low incomes, who otherwise would not pay tax, are subsidising investors with higher incomes. If the system continued, there would be some 14 million people paying too much tax, mainly pensioners, married women and children.

It is therefore proposed to reform the system. From 6 April 1991 composite rate tax will be abolished and basic rate tax will be deducted from interest. Those not liable to tax will not have to bear the basic rate tax. There will be arrangements, to be discussed with the financial institutions, under which non-taxpayers will be able to receive interest free of tax; but any non-taxpayers who are unable to take advantage of these arrangements will be able to reclaim the tax deducted.

The switch from composite rate tax to the new system will, in principle, produce the same yield of tax. But there will be a significant timing effect where tax is deducted from interest received by non-taxpayers and repaid at a later date. The size of this effect will depend upon the details of the arrangements to be introduced and the build-up over time of the number of non-taxpayers receiving their interest gross. Table 4.1 shows that receipts could be about £550 million higher in 1991–92 than if the composite rate system had remained in place. This is, however, a temporary effect, and in 1992–93 receipts are likely to be somewhat lower than they would have been had composite rate continued.

Table 4.1 Direct effects of changes in taxation

See annex 4 paragraph numbers	£ million Estimated effect on receipts in: 1990–91 Changes from a non-indexed base	 Changes from an indexed base	 1991–92 Changes from an indexed base
INLAND REVENUE			
Income tax			
1 Increase in personal allowance of £220	−1 070	—	—
2 Increase in married couple's allowance, additional personal allowance and widow's bereavement allowance of £130	−280	—	—
3 Increases for those aged 65 to 74 of £270 in the personal allowance and £160 in the married couple's allowance	−90	—	—
4 Increases for those aged 75 and over of £280 in the personal allowance and £160 in the married couple's allowance	−45	—	—
5 Increase in income limit for age-related allowances of £900	−10	—	—
6 No change in basic rate limit	—	+220	+400
7 Doubling of the blind person's allowance	*	*	*
8 Benefits-in-kind—exemption of workplace nurseries	−10	−10	−10
9 Benefits-in-kind—car scales	+160	+160	+200
10 Tax Exempt Special Savings Accounts	−20	−20	−200
11 Abolition of composite rate	—	—	+550
12 SAYE—extension to banks	*	*	*
13 Payroll giving to charities—increase in donation limit to £600 a year	*	*	*
Income tax and corporation tax			
14 Relief for single donations to charities	—	—	*
15 Life assurance companies—changes in tax rules	+50	+50	+100
16 Claims under Pay and File	—	—	—
17 Friendly societies	*	*	*
18 Relief for expenditure on waste disposal sites	−5	−5	−10
19 Relief for business contributions to Training and Enterprise Councils	*	*	*
20 Dual resident companies	*	*	*
21 Futures and options—exemption for authorised unit trusts and pension schemes	—	—	*
Income tax and capital gains tax			
22 Personal Equity Plans	*	*	*
23 Business Expansion Scheme—increase in limit	*	*	−5
24 Business Expansion Scheme—locality rule	*	*	*
25 Index-linked bonds	*	*	*
Income tax, corporation tax and capital gains tax			
26 Rules for European Economic Interest Groupings	*	*	*
27 Changes affecting collective investment schemes and their investors	*	*	*
28 Convertible bonds	*	*	*
29 Post-consolidation amendments etc	*	*	*
30 Assessing procedures and returns	—	—	—
Income tax, corporation tax, capital gains tax and inheritance tax			
31 European Community—tax information powers	*	*	*
Corporation tax			
32 Increase in profits limits for small companies' rate and marginal relief	*	*	−25
33 Phasing of tax relief for doubtful sovereign debt	*	*	+200
34 Subsidiarisation of UK branches	*	*	*
35 Definition of group	*	*	*

* = *Negligible* — = *Nil*

Table 4.1 Direct effects of changes in taxation—*continued*

See annex 4 paragraph numbers	£ million Estimated effect on receipts in: 1990–91 Changes from a non-indexed base	 Changes from an indexed base	 1991–92 Changes from an indexed base
Capital gains tax			
36 No change in annual exempt amount	—	—	+10
Capital gains tax and corporation tax			
37 Relief for irrecoverable bonds	*	*	*
38 Roll-over for sales of shares to employee share ownership trusts	*	*	*
Oil taxation			
39 Revised tax regime for oilfield abandonment	—	—	—
40 Restriction of oil industry capital losses	*	*	*
41 Time limits for reopening decisions on certain PRT expenditure claims	+20	+20	+10
Inheritance tax			
42 Indexation of threshold	−35	—	—
Stamp duties			
43 Abolition of duties on share transactions	+5	+5	−120
TOTAL INLAND REVENUE	**−1 330**	**+420**	**+1 100**
CUSTOMS AND EXCISE			
Value added tax			
44 Simplification of registration requirements	−35	−35	−75
45 Increase in registration limit	*	*	*
46 Revised bad debt relief provisions	—	—	−150
47 Reliefs for charities	−5	−5	−5
48 Stores for private boats and aircraft	+5	+5	+5
49 Revised treatment of domestic accommodation for directors	+5	+5	+10
50 Adjustment of VAT on capital goods	*	*	*
Excise duties			
51 Increase in duty on cigarettes, cigars and hand-rolling tobacco	+330	+80	+90
52 No change in rate of duty for pipe tobacco	—	−5	−5
53 Increase in duty on leaded and unleaded petrol	+635	+145	+160
54 Increase in duty on derv	+145	+30	+35
55 Increase in duty on beer	+155	—	—
56 Increase in duty on wine and made wine	+50	—	—
57 Increase in duty on spirits	+100	+20	+25
58 Increase in duty on cider and perry	+5	—	—
59 Increase in duty on rebated oils	+15	—	—
60 Reduction in rate of pool betting duty	−20	−20	−20
TOTAL CUSTOMS AND EXCISE	**+1 385**	**+220**	**+70**
Vehicle excise duty			
61 Increase in VED rates for certain lorries	+20	−20	−20
62 Reduction in VED rates for lorries under 3·5 tonnes	−5	−5	−5
63 Exemption for passenger vehicles for disabled people	*	*	*
64 No change in VED rates for cars, buses, motor cycles, and other vehicles	—	−185	−190
TOTAL VED	**+15**	**−210**	**−215**
TOTAL CHANGES IN TAXATION	**+70**	**+430**	**+955**

* = *Negligible* — = *Nil*

Annex to chapter 4

Explanatory notes to table 4.1

Table 4.1 gives the direct effects of changes in taxation. Estimates are rounded to the nearest £5 million. "Negligible" means less than £3 million.

The direct effect of a tax change is the difference between the yield of tax which would arise on the basis of the rates of tax, allowances, etc prevailing before the Budget (the pre-Budget regime) and the yield after the changes proposed in the Budget (the post-Budget regime). The difference in yield is generally calculated by applying the pre- and post-Budget regimes to the same tax base. This base is the post-Budget base—that is, the levels of income, consumption, profits, etc forecast for future years on the assumption that all the measures proposed in the Budget take effect.

Tax changes may cause changes in taxpayers' behaviour, which in turn can alter the tax base and hence revenue. The direct effects are estimated subject to the constraint that, in general, total incomes and total expenditure are fixed at their post-Budget levels. Thus the estimates in the table do not include income effects—that is, effects arising solely from the impact of changes in taxes on disposable incomes. Nor do they include the effects of changes in the tax base arising from changes in pre-tax incomes, the general level of prices or other macro-economic variables which may result from the proposed tax change. But other behavioural effects are taken into account where it is thought that they will have a significant effect on the yield.

For Customs and Excise taxes and duties, all the estimates of yield incorporate the effects of the tax changes on relative prices and associated changes in the pattern of consumers' expenditure. Aggregate income and consumers' expenditure at factor cost are assumed not to change. Examples where behavioural effects are taken into account for Inland Revenue taxes include the abolition of stamp duties on share transactions and changes involving the take-up of a new or modified relief.

The post-Budget forecast of each tax given in table 1.2 takes account of all the effects of the measures announced in the Budget, and not just the direct effects included in table 4.1.

The figures in the first column of table 4.1 show the direct effect of the Budget proposals on receipts in 1990–91. Budget proposals are compared with a non-indexed base—that is, with the pre-Budget regime of allowances, thresholds and rates of duty at 1989–90 levels.

The figures in the second column show the direct effect of the Budget proposals on receipts in 1990–91, measured against an indexed base. The indexed base for 1990–91 is obtained by increasing 1989–90 allowances, thresholds and rates of duty by 7·7 per cent, the increase in the RPI over the year to December 1989.

The figures in the third column show the direct effect on receipts in 1991–92, also measured against an indexed base. For this comparison, both the Budget proposals and the indexed base for 1990–91 have been further indexed by the forecast movement in the RPI between the fourth quarters of 1989 and 1990 (shown in table 3.9).

The remainder of this annex provides a commentary on the Budget proposals in table 4.1; the paragraph numbers refer to the lines in this table. Additional information is provided for those proposals where the effect on tax liabilities in the first complete year to which the change applies (full year effect) is substantially different from the effect on receipts in either 1990–91 or 1991–92; or where the impact of the proposal is expected to build up over a period of years.

Income tax

The structure of the main income tax allowances will change from 6 April 1990 following the introduction of Independent Taxation. For the purposes of the statutory indexation provisions, the amounts of the new allowances were set last year at 1989–90 levels corresponding to the equivalent allowances under the old system. Comparisons in items 1 to 5 are on this basis.

1 to 5 The increases in the main income tax allowances and income limit for the age-related allowances are in line with the statutory indexation provisions (based on the increase of 7·7 per cent in the RPI in the year to December 1989).

6 The basic rate limit is unchanged at £20 700 of taxable income.

7 The blind person's allowance will be doubled to £1 080 at an annual cost of about £2 million.

8 The benefit-in-kind of workplace nurseries will be exempt from income tax from 6 April 1990. The figures are based on very tentative estimates of the current level of provision.

9 For 1990–91 the scales for taxing car benefits will be increased by 20 per cent from their 1989–90 levels.

10 From 1 January 1991 any individual over 18 will be able to open one Tax Exempt Special Savings Account with a bank or building society. The maximum which can be paid in will be £9 000 over a 5 year period, with no more than £3 000 in the first year, and not more than £1 800 in any subsequent year. There will be an option to withdraw some interest as it arises, but the capital must be left in the account until the end of the 5 year period, or all the tax relief will be lost.

11 Composite rate tax will be abolished from 6 April 1991. From that date basic rate tax will be deducted from interest paid to depositors. There will be special arrangements for depositors who are not liable to tax to obtain gross interest and avoid any need to claim repayment of tax deducted. In principle the change will be revenue neutral, but it will affect the timing of tax receipts in 1991–92 and later years.

12 Banks (in addition to building societies and National Savings) will be able to operate Save-As-You-Earn schemes.

13 The limit on charitable donations qualifying for relief under payroll deduction schemes will be increased from £480 to £600 from 6 April 1990.

Income tax and corporation tax

14 Income tax relief will be introduced for single donations of £600 or more by individuals to charities from 1 October 1990, up to a maximum of £5 million a year per donor. Corporation tax relief will be introduced on similiar lines for donations by companies. The cost will depend on take-up and may rise to about £15 million.

15 Changes to the tax rules for life assurance consequential to changes in Finance Act 1989 were announced on 20 December 1989; they are expected to yield £50 million in 1990–91 and £100 million in 1991–92. A further measure will be introduced to "ring-fence" long-term business assets. Without this measure, there could be a significant loss of tax.

16 Various changes will be made to the procedural rules for claims by companies to capital allowances and group relief under Pay and File, which will come into effect in 1993 on present plans.

17 The limit on premiums payable under a tax-exempt life insurance policy with a friendly society will increase from £100 a year to £150 a year for policies taken out from 1 September 1990.

18 Expenditure on or after 6 April 1989 on preparing a waste disposal site to receive waste and on making a site good will be made deductible for tax purposes. This measure provides a new basis for relief for this expenditure following a recent Court decision. The estimate of cost is measured against the practice before the Court decision and is highly uncertain.

19 Relief will be provided for contributions by businesses to Training and Enterprise Councils from 1 April 1990 to 1 April 1995; and the existing relief for business contributions to Local Enterprise Agencies, due to expire on 1 April 1992, will be extended to 1 April 1995.

20 Provisions will be introduced to prevent the use of certain dual resident companies to avoid a number of tax charges. Without these changes, there could be a substantial loss of tax.

21 Profits from transactions in futures and options by pension schemes and authorised unit trusts will be exempted from income tax and corporation tax.

Income tax and capital gains tax

22 With effect from 6 April 1990 the maximum annual investment in a personal equity plan will be increased to £6 000; the maximum investment in qualifying unit and investment trusts will be increased to £3 000; and the maximum investment in non-qualifying unit and investment trusts will rise from £750 to £900. The necessary proportion of investment in ordinary UK shares for a unit or investment trust to qualify will be reduced from 75 to 50 per cent.

23 The annual limit of £500 000 for investment raised under the Business Expansion Scheme by a company (other than those engaged in chartering or operating ships or in letting residential property) will be increased to £750 000 for share issues made on or after 1 May 1990.

24 The rule which requires changes in the locality in which a residential property is situated to be taken into account in valuing the property for the purposes of the Business Expansion Scheme will be abolished with effect from 20 March 1990.

25 Certain bonds indexed to a recognised Stock Exchange index of share prices and issued after 8 June 1989 will be treated as "qualifying indexed securities" within Schedule 11 Finance Act 1989.

Income tax, corporation tax and capital gains tax

26 Changes will be introduced (with effect from 1 July 1989) in order to implement fully the provisions of EC Regulation No 2137/85 concerning European Economic Interest Groupings.

27 The main changes are:

from 1 January 1991 all authorised unit trusts will be subject to corporation tax on their income at a rate of 25 per cent: this special reduced rate currently applies only to trusts that are freely marketable within the European Community;

indexation will be removed from units in unit trusts or offshore funds that are mainly invested in capital gains tax exempt assets and/or building society shares;

the distribution rules for investment trusts will be relaxed;

unit trust managers will be given an exemption from the anti-bondwashing rules.

28 Bonds with "put options" exercisable by the investor and convertible into equity capital of a company, which meet certain qualifying conditions and were issued after 8 June 1989, will cease to be treated as "deep gain securities" within Schedule 11 Finance Act 1989. The difference between cost and realisation price will no longer be taxed entirely as income. Where a bond meets the qualifying conditions:

for an investor who converts the bond into shares, sells the bond after all put options have expired or redeems the bond when it matures, the normal capital gains tax rules will apply;

for an investor who exercises a put option or sells the bond before all put options have expired, the accrued yield to the put redemption will be taxed as income. Any excess or shortfall will be treated as a capital gain or loss.

A trading or investment company issuing qualifying convertible bonds will be allowed a deduction for corporation tax purposes for any premium paid to investors who exercise put options. Revenue effects in the longer term are uncertain and will depend on the issue of such bonds.

29 Legislation will be introduced to correct minor errors found following the consolidation of tax law in the Income and Corporation Taxes Act 1988 and the Capital Allowances Act 1990; and to make consequential technical changes.

30 Minor changes will be made to the rules on administrative procedures.

Income tax, corporation tax, capital gains tax and inheritance tax

31 Legislative changes will be made

to enable certain information powers in Section 20 Taxes Management Act 1970 to be used on behalf of European Community tax authorities;

to introduce a restriction on the use of Section 20(2) Taxes Management Act 1970, the Board of Inland Revenue's first party information power;

to enable the inheritance tax (IHT) information powers to be used on behalf of European Community tax authorities from some future date;

to introduce a requirement for an Appeal Commissioner's prior consent to the exercise of the IHT information power.

Corporation tax

32 The profits limit for the small companies' corporation tax rate of 25 per cent for the financial year 1990 will be raised from £150 000 to £200 000 and the limit for marginal relief will be raised from £750 000 to £1 million.

33 Rules for calculating relief on doubtful sovereign debt will be laid down and a limit placed on the amount allowable in any one year. Relief for losses on disposal will be phased. The yield in 1991–92 depends on the increase, if any, in the proportion of debt allowable for relief under the present law and on the level of disposals of debt. These cannot be forecast; for illustrative purposes it has been assumed that the proportion of debt allowable for relief without the change would increase by about a tenth in 1990–91 and that disposals of debt amount to around £300 million per annum. The changes will not reduce the total of the tax relief available over the years but will postpone relief in 1991–92 and later years on the assumptions made above.

34 Provisions will be introduced to enable non-resident companies to transfer UK branch activities to UK subsidiaries without facing an immediate charge on capital gains.

35 A technical change will be made to the definition of a group for capital gains purposes.

Capital gains tax

36 The capital gains tax annual exempt amount will remain at £5 000 in the case of individuals and £2 500 in the case of most trusts.

Capital gains tax and corporation tax

37 Lenders will be able to claim a capital loss where part or all of a loan in the form of a bond has become irrecoverable.

38 Roll-over relief will be available for certain sales of shares to employee share ownership trusts if the proceeds are reinvested in chargeable assets.

Oil taxation

39 For periods ending after 30 June 1991:

expenditure incurred in closing down an oil or gas field under an abandonment programme will attract a 100 per cent corporation tax allowance;

losses attributable to the allowance may be carried back up to 3 years;

expenditure eligible for this allowance incurred within 3 years after cessation of a North Sea oil trade will be treated as incurred in the period when the trade ceased;

interest on repayment of petroleum revenue tax (PRT) when any PRT loss is carried back will be restricted, so that repayment plus interest does not exceed 85 per cent of the loss carried back;

where PRT is repaid because a loss is carried back, the resulting corporation tax underpayment will be treated as arising in the period the loss accrued, rather than in the period to which it was carried back.

The long term revenue effects of these measures are very uncertain. They are likely to fluctuate from year to year, but are expected to be broadly revenue neutral overall.

40 Measures were announced on 22 January 1990, with immediate effect, restricting the availability of capital losses on disposal of certain oil industry assets and shares.

41 In cases of fraudulent or negligent conduct by claimants, the three year time-bar on the Inland Revenue reopening decisions on PRT expenditure claims will be removed.

Inheritance tax

42 The estimated full year cost of indexation attributable to taxable estates in 1990–91 is £90 million.

Stamp duties

43 The following duties will be abolished late in 1991–92 from a date to be appointed by Treasury Ministers to coincide as far as possible with the introduction of the Stock Exchange's new system for paperless share transfers (TAURUS):

the 0·5 per cent *ad valorem* duty on the transfer of UK registered securities;

stamp duty reserve tax;

the 1·5 per cent duties on the conversion of UK shares into depository receipts or their transfer into clearance services;

associated charges on bearer shares and unit trusts units; and

certain fixed (50p) duties on share transfers.

The figures assume abolition of the duties from 1 January 1992. The cost in the first full year is expected to be £800 million, in addition to the estimated £80 million loss of duty already anticipated from the planned switch to paperless share transfers. Announcement of the abolition of the duties on shares is expected to lead to some rise in the value of share transactions. The figures take account of these changes on the receipts from stamp duties and other taxes. In particular it is this factor which accounts for the small yield in 1990–91.

Value added tax

44 The present VAT registration rules will be replaced by a single requirement based on turnover in the previous twelve months. Revised rules based on anticipated turnover will apply to large businesses and short term events which exceed the annual turnover limit in a single month.

45 From 21 March 1990, the registration limit will become £25 400 a year.

46 A comprehensive system will provide relief from VAT on all bad debts more than 2 years old which have been written off in the trader's accounts.

47 From 1 May 1990, VAT relief for charities will be extended to all lifeboats and related capital items, the sale or export of donated goods by certain charities' trading companies, and preparatory work for certain types of advertising. Existing relief for equipment used in medical work, bought with donated funds, will be widened.

48 To give effect in the UK to the European Community 18th VAT Directive, VAT at the standard rate will be charged on supplies of stores for foreign-going private voyages and flights.

49 From Royal Assent VAT incurred by companies in the provision of domestic accommodation for directors will not be deductible as input tax.

50 From 1 April 1990, as a consequence of the introduction of a scheme of input tax adjustment for computers, computer equipment, land and buildings, these assets will no longer be liable to the self-supply charge which arises when a business is transferred as a going concern to a member of a partly exempt group.

Excise duties

51 The specific duty on cigarettes, cigars and hand-rolling tobacco will be increased by 10 per cent, equivalent to 9·6p on a packet of 20 cigarettes, 4·8p on a packet of 5 small cigars and 29·6p on a 50 gram packet of hand-rolling tobacco (inclusive of VAT).

52 The duty on pipe tobacco remains unchanged.

53 The duty on leaded and unleaded petrol will be increased by 10 per cent, equivalent to a VAT inclusive increase of 2·3p a litre (10·7p per gallon) for leaded petrol and 2·0p a litre (9·3p per gallon) for unleaded petrol. The tax differential in favour of unleaded petrol will rise to 3·4p a litre (15·6p per gallon).

54 The duty on derv will be increased by 10 per cent, equivalent to a VAT inclusive increase of 2·0p per litre (9p per gallon).

55 The duty on typical beer will be increased by 7·7 per cent, equivalent to a VAT inclusive increase of 1·7p a pint.

56 The duties on wine and made wine will be increased by 7·7 per cent, equivalent to a VAT inclusive increase of 7p on a 75cl bottle of still wine, 11p on a 75cl bottle of sparkling wine, 11p on a 70cl bottle of sherry and 14p on a 75cl bottle of port.

57 The duty on spirits will rise by 10 per cent, equivalent to a VAT inclusive increase of 54·4p on a 75cl bottle of spirits.

58 The duty on cider and perry will be increased by 7·7 per cent, equivalent to a VAT inclusive increase of 0·9p a pint.

59 The duty on gas oil and fuel oil will rise by 7·7 per cent, equivalent to 0·1p a litre (0·4p per gallon). These increases are exclusive of VAT. Gas oil and fuel oil supplied to domestic users is not liable to VAT; supplies to commercial users will, from 1 July 1990, be liable to VAT at the standard rate.

60 The rate of pool betting duty will be reduced from 42½ per cent to 40 per cent for an initial period of 5 years providing the pools promoters and the Football Trust agree that the duty saved will be used to improve safety and conditions at football grounds.

Vehicle excise duties

61 From 21 March 1990, the rates of duty on certain rigid lorries will be increased to bring their total motoring taxation more into line with that of articulated vehicles of similar gross weight. The number of duty rates for articulated vehicles will be reduced from 270 to 108.

62 From 1 October 1990, lorries under 3·5 tonnes will be brought within the private and light goods class. Their VED will therefore fall from £130 to £100.

63 From 21 March 1990, a new taxation class will be created for passenger vehicles for disabled people which will be exempt from VED.

64 There will be no change in the duties on cars, light vans, motor cycles, taxis, buses and coaches, three-wheelers and most lorries. The number of duty rates for general haulage vehicles will be reduced from eight to one and for trailers from five to two.

6 Public expenditure

Changes since the previous Budget

Table 6.1 Public expenditure

5 Public expenditure

5.01 The Government's expenditure plans for the next three years were announced in the 1989 Autumn Statement (Cm 879) and set out in detail in the 1990 public expenditure White Paper (Cm 1001–1021). They are summarised in table 5.1.

Changes since the previous Budget

5.02 The plans set out in table 5.1 are presented on the new definition of the planning total, first used in the 1989 Autumn Statement (see the annex to this chapter). The planning total has been set at £179·0 billion in 1990–91 and at £192·3 billion and £203·4 billion in the following two years. Within the new plans extra resources have been allocated to priority areas including health, roads and transport, homelessness, less well-off families and the disabled.

Table 5.1 Public expenditure[1]

£ billion	1988–89 Outturn	1989–90 Estimated outturn	1990–91 Plans	1991–92 Plans	1992–93 Plans
Central government's own expenditure	**116·3**	**127·0**	**137·8**	**145·3**	**152·3**
of which:					
Department of Social Security	44·5	47·0	52·0	56·2	59·5
Department of Health and OPCS	18·4	20·0	22·1	23·4	24·5
Ministry of Defence	19·1	20·6	21·2	22·4	23·4
Scotland	3·8	4·0	4·4	4·7	4·9
Wales	1·7	1·9	2·1	2·2	2·3
Northern Ireland	5·1	5·5	5·7	6·0	6·3
Other departments	23·6	28·0	30·2	30·5	31·5
Central government support for local authorities	**36·4**	**38·0**	**41·8**	**43·7**	**44·8**
of which:					
Revenue/Rate Support Grant	12·8	13·0	13·1	25·9	26·7
Non-domestic rate payments	10·4	11·2	12·1		
Current specific grants[2]	8·9	9·9	11·5	12·4	12·8
Capital grants	0·5	0·6	1·3	1·3	1·3
Credit approvals	3·7	3·4	3·8	4·0	4·0
Financing requirements for public corporations	**−0·1**	**1·6**	**1·4**	**2·3**	**2·3**
Privatisation proceeds	**−7·1**	**−4·2**	**−5·0**	**−5·0**	**−5·0**
Reserve			**3·0**	**6·0**	**9·0**
Planning total	**145·5**	**162·3**	**179·0**	**192·3**	**203·4**
Local authority self-financed expenditure[3,4]	10·1	13·9	13·3	14	15
Central government debt interest[4]	17·5	17·7	17·0	15½	15
Other adjustments[4]	5·0	3·9	3·4	3½	4½
General government expenditure	**178·2**	**197·7**	**212·7**	**225**	**238**

[1] *On the new planning total basis (see the annex to this chapter).*
[2] *Excludes allocation from the Reserve to meet higher payments of community charge benefit than assumed in Cm 1021. The estimated cost in 1990–91 is £0·7 billion, assuming an average community charge of around £350 (GB). A similar figure has been added for later years. This will be charged to the Reserve.*
[3] *Local authority self-financed expenditure is the difference between total local authority expenditure and central government support to local authorities. Total local authority expenditure is estimated at £46·6 billion and £51·8 billion respectively in 1988–89 and 1989–90. For 1990–91 to 1992–93 it is projected at £55·8 billion, £58½ billion and £60½ billion. The calculation of local authority self-financed expenditure takes account of the higher estimates of central government support in 1990–91 to 1992–93 reflecting higher payments of community charge benefit.*
[4] *1991–92 and 1992–93 figures rounded to nearest £½ billion.*

5.03 The projections of general government expenditure in table 5.1 take account of the latest information on local authority budgets for 1990–91. Total local authority spending next year is now expected to be £55·8 billion, compared with £53½ billion in the White Paper; the levels for the following two years have been projected forward using similar assumptions about real growth as made in the White Paper. The calculation of self-financed expenditure allows for higher payments of community charge benefit than provided for in the plans; these increases will be charged to the Reserve and will not add to planning totals. Debt interest projections have also been increased since the White Paper, to reflect the latest fiscal projections.

Public spending trends

5.04 General government expenditure (excluding privatisation proceeds) fell as a proportion of GDP from 46¾ per cent in 1982–83 to 38¾ per cent in 1988–89. Table 5.2 shows the projected path of real GGE and the GGE ratio up to 1992–93, taking account of the new assumptions about money GDP shown in chapter 2. The ratio in the current year is likely to be 39 per cent, ¼ per cent higher than the estimate shown in the 1990 White Paper, reflecting higher expenditure and higher money GDP.

5.05 As explained in chapter 3, comparisons with later years are distorted by the statistical effect of the abolition of domestic rates on money GDP. This raises the GGE ratio by ¾ per cent in each year from 1990–91 onwards. Table 5.2 shows the ratios adjusted to remove this discontinuity. On an adjusted basis, the ratio is now expected to be 39 per cent next year and to decline to 38½ per cent in 1992–93, the same as the ratios shown in the 1990 White Paper. Chart 5.1 shows the GGE ratios between 1978–79 and 1992–93.

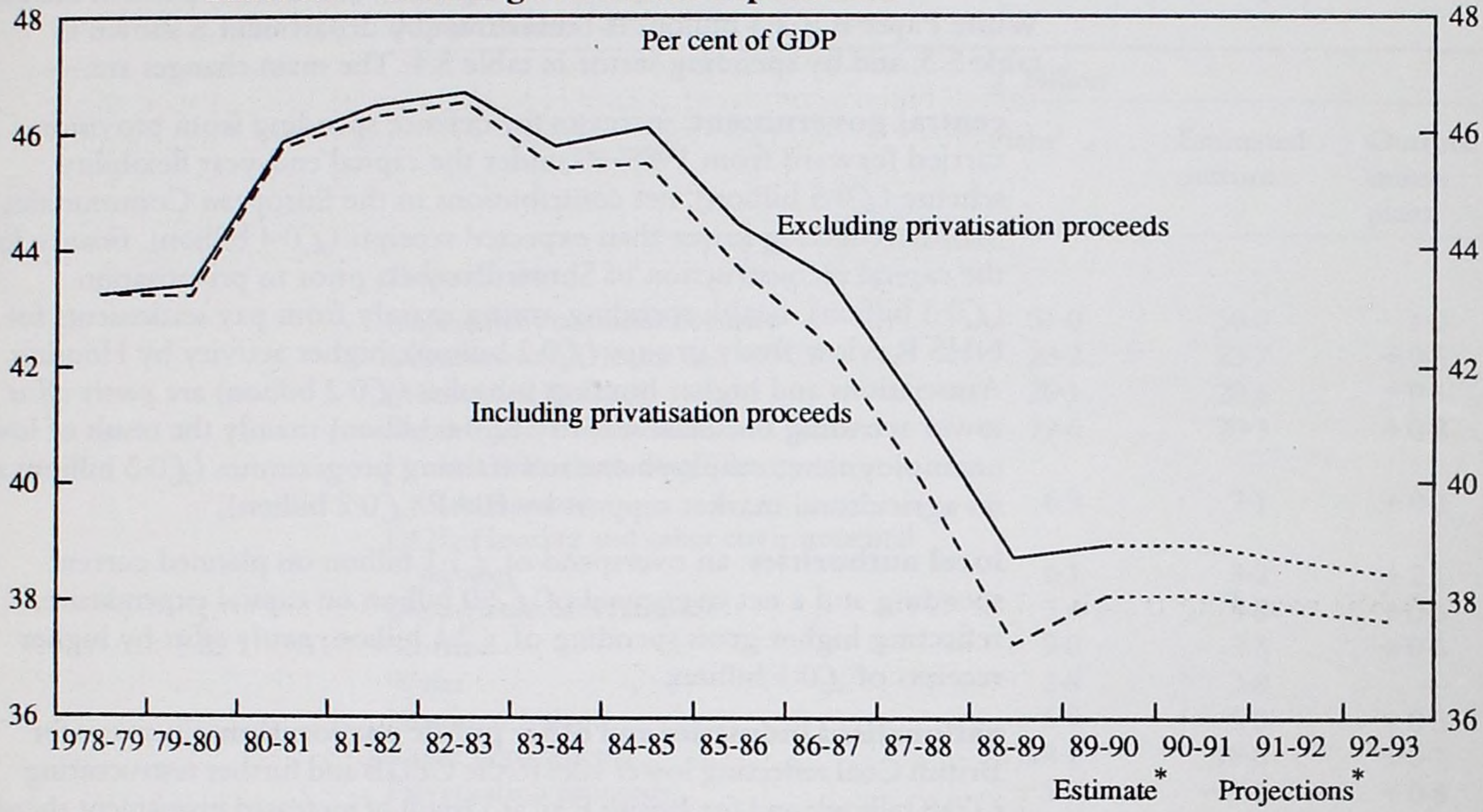
Table 5.2 General government expenditure

	£ billion				
	1988–89	1989–90	1990–91	1991–92	1992–93
General government expenditure, excluding privatisation proceeds:					
cash	185·3	201·9	217·7	230	243
real terms[1,2]	185·3	189·9	195·7	198	202
		(189·8)	(192·3)	(194)	(198)
per cent of GDP[1]	38¾	39	39¾	39½	39¼
		(39)	(39)	(38¾)	(38½)

[1] *The figures in brackets use figures for money GDP and the GDP deflator which adjust for the distortion arising from the abolition of domestic rates. This is explained in the box on page 45.*

[2] *Base year 1988–89.*

Chart 5.1 General government expenditure



** These figures are adjusted for the distortion to money GDP arising from the abolition of domestic rates (see box on page 45)*

Budget consequences **5.06** There will be an increase in the amount of savings which claimants of means-tested social security benefits are allowed to have before they lose all entitlements. At present, the upper capital limit for income support and family credit is £6 000; this will be increased to £8 000. For housing benefit and community charge benefit, the upper limit will be increased from £8 000 to £16 000. The public expenditure cost of increasing the limits will be around £120 million a year from 1990–91; this will be charged to the Reserve and not add to planning totals.

1989–90 outturn **5.07** The estimated outturn for 1989–90, which is still subject to some uncertainty, is £162·3 billion on the new definition of the planning total. However, plans for the current year were set on the old definition and on this basis the latest estimate is £169·4 billion, about £1·0 billion higher than the estimated outturn in the 1990 White Paper. This difference is largely due to higher expected capital expenditure by local authorities (£0·4 billion), and increases for nationalised industries (£0·3 billion).

5.08 The difference between the estimated outturn and the plans in the 1989 White Paper is £2·3 billion. A breakdown by department is shown in table 5.3, and by spending sector in table 5.4. The main changes are:—

central government: increases for defence spending from provision carried forward from 1988–89 under the capital end-year flexibility scheme (£0·5 billion), net contributions to the European Communities mainly reflecting lower than expected receipts (£0·4 billion), finance for the capital reconstruction of Shorts Brothers prior to privatisation (£0·3 billion), health spending arising mainly from pay settlements for NHS Review Body groups (£0·2 billion), higher activity by Housing Associations and higher housing subsidies (£0·2 billion) are *partly offset* by lower spending on social security (£0·6 billion) mainly the result of lower unemployment, employment and training programmes (£0·3 billion) and on agricultural market support by IBAP (£0·2 billion);

local authorities: an overspend of £1·1 billion on planned current spending and a net overspend of £2·0 billion on capital expenditure, reflecting higher gross spending of £2·1 billion, *partly offset* by higher receipts of £0·1 billion;

nationalised industries and other public corporations: increases for British Coal reflecting lower sales to the CEGB and further restructuring (£0·8 billion); and for British Rail as a result of increased investment ahead of the opening of the channel tunnel (£0·2 billion), *partly offset* by a lower expected outturn for the electricity industries in England and Wales arising mainly from a revised assessment of their tax liability (£0·4 billion);

privatisation proceeds: a shortfall in privatisation proceeds (£0·8 billion) as a result of the government's subscription prior to privatisation for new shares in the ten water companies of England and Wales and reflecting the actual sale price achieved for industries and other bodies privatised during the year.

Table 5.3 Comparison of plans and estimated outturn for 1989–90, by department

	£ billion		
	Plans[1]	Estimated outturn	Outturn minus plans
Department			
Department of Social Security	51·0	50·0	−1·0
Department of Health and OPCS	23·2	23·7	+0·5
Ministry of Defence	20·1	20·6	+0·5
Department of Education and Science	19·6	20·3	+0·8
Home Office (including Charity Commission)	6·9	7·1	+0·2
DOE–Housing and other environmental services	6·1	8·2	+2·1
Department of Transport	5·4	5·8	+0·5
Scotland	9·0	9·3	+0·3
Wales	3·8	3·8	—
Northern Ireland	5·5	5·8	+0·3
Other departments	18·1	18·8	+0·7
Privatisation proceeds	−5·0	−4·2	+0·8
Reserve	3·5	—	−3·5
Planning total (on old definition)	**167·1**	**169·4**	**+2·3**
General government debt interest	17·1	18·5	+1·4
Other adjustments	10·1	9·8	−0·3
General government expenditure	**194·3**	**197·7**	**+3·4**

[1] *Plans from the Government's Expenditure Plans 1989–90 to 1991–92 (Cm 621), on the old planning total basis adjusted for minor classification changes, but with current departmental groupings.*

Table 5.4 Comparison of plans and estimated outturn for 1989–90, by spending sector

	£ billion		
	Plans[1]	Estimated outturn	Outturn minus plans
Spending sector			
Central government[2]	123·7	124·8	+1·1
Local authorities[2]	44·0	47·2	+3·2
of which:			
current expenditure	41·4	42·5	+1·1
capital expenditure	2·6	4·6	+2·0
Public corporations	0·8	1·6	+0·8
Privatisation proceeds	−5·0	−4·2	+0·8
Reserve	3·5	—	−3·5
Planning total (on old definition)	**167·1**	**169·4**	**+2·3**

[1] *Plans from The Government's Expenditure Plans 1989–90 to 1991–92 (Cm 621), on the old planning total basis, adjusted for minor classification changes.*

[2] *Excludes finance for nationalised industries and other public corporations.*

Planning total by spending sector

5.09. The plans for 1990–91, set out in the public expenditure White Paper, have now been translated where appropriate into detailed control totals in Supply Estimates. About threequarters of the new planning total will be voted by Parliament, compared with only about 50 per cent on the old definition. Voted expenditure covers the spending of government departments for their own activities, their funding of other bodies such as the National Health Service and most of central government's support for local authorities. Most of the rest consists of Social Security expenditure paid out of the National Insurance Fund.

5.10 Table 5.5 shows voted and other expenditure by spending sector for the last two years and the plans given in the 1990 public expenditure White Paper for future years.

Table 5.5 The planning total[1]: voted and other expenditure by spending sector

£ billion	1988–89 Outturn	1989–90 Estimated outturn	1990–91 Plans	1991–92 Plans	1992–93 Plans
Central government's own expenditure of which:	116·3	127·0	137·8	145·3	152·3
voted in Estimates	81·2	88·3	95·6	100·2	104·8
other	35·1	38·7	42·2	45·1	47·5
Central government support for local authorities[2] of which:	36·4	38·0	41·8	43·7	44·8
voted in Estimates	31·4	33·3	36·8	na	na
other	5·0	4·6	5·0	na	na
Financing requirements for nationalised industries of which:	−0·4	0·7	0·5	1·5	1·5
voted in Estimates	3·3	5·9	1·8	1·6	1·6
other	−3·7	−5·2	−1·3	−0·1	−0·1
Financing requirements for other public corporations of which:	0·3	0·8	0·9	0·8	0·8
voted in Estimates	0·7	1·1	1·2	1·2	0·9
other	−0·4	−0·2	−0·3	−0·4	−0·2
Privatisation proceeds	−7·1	−4·2	−5·0	−5·0	−5·0
Reserve			3·0	6·0	9·0
Planning total	**145·5**	**162·3**	**179·0**	**192·3**	**203·4**

[1] *On the new planning total basis (see the annex to this chapter).*

[2] *The figures for the forward years exclude any allocation from the Reserve to community charge benefit grant: see footnote 2 to table 5.1. The proxies for non-domestic rate payments in England and Wales in 1988–89 and 1989–90 (£9·2 billion and £10·0 billion) are treated as if they had been voted in Estimates, to match their treatment from 1990–91. For 1991–92 and 1992–93 plans have been set for the total of revenue support grant and non-domestic rate payments combined. In England and Wales all payments from the non-domestic rates pool will be voted from next year but in Scotland local authorities will continue to receive business rates direct from business rate payers.*

Supply Estimates **5.11.** The total Estimates provision for 1990–91 for which the Government is seeking Parliamentary approval is shown in table 5.6. The main Estimates are published in a series of booklets on 20 March 1990 with a Summary and Guide (Cm 980) which summarises the Estimates and explains how they relate to the planning total. It also describes the Supply procedure.

5.12. Of the £138·7 billion included in the Supply Estimates, £136·6 billion is within the planning total. The remaining £2·1 billion mostly comprises transfers between public sector bodies which do not score in the planning total. Just under 65 per cent of the money voted in Estimates is subject to cash limits.

Table 5.6 Supply expenditure[1, 2]

	£ billion			
	1988–89		1989–90	1990–91
	Expected outturn in 1989 Budget	Final outturn	Expected outturn	Provision
Main Supply Estimates	108·3	108·3	116·5	138·7
Supplementaries and net underspending	2·4	2·2	6·3	
Total Supply expenditure	**110·7**	**110·5**	**122·8**	

[1] *This table reflects the actual coverage of the Supply Estimates in each year. Thus proxies for non-domestic rates in England and Wales are not included in the figures for 1988–89 and 1989–90. The main Supply Estimates for 1990–91 include non-domestic rate payments in England and Wales.*

[2] *The estimated outturn for 1989–90 includes £3·5 billion for payments to British Coal. This payment is conditional on the 1989 Coal Industry Bill receiving Royal Assent before 31 March 1990.*

Annex to chapter 5

The new planning total

5A.1 The plans for public expenditure set out in chapter 5 are presented on the basis of the new definition of the planning total, announced in July 1988 (Cm 441). The 1989 Autumn Statement presented plans on this basis for the first time. The change in the definition of the planning total does not affect the Government's overall objectives for public expenditure which, as before, are expressed in terms of general government expenditure, excluding privatisation proceeds.

5A.2 The change in the definition of the planning total was made at the same time as the reform of local government finance in England and Wales, effective from 1 April 1990. A full description of the relationship between the old and new definitions of the planning total, the new local government finance arrangements, and a number of classification changes made to bring closer alignment with the treatment in the national accounts, was given in chapter 21 of the 1990 public expenditure White Paper (Cm 1021).

Effect on tables in this report

5A.3 The introduction of the new definition of the planning total affects the presentation of a number of comparisons in this document. This applies to table 1.2, in particular, which shows plans for 1990–91 on the new basis compared with estimated outturn and the plans for 1989–90 given in last year's Budget. No plans were included in the last Budget for central government support for local authorities and the Reserve was set on the basis of the old planning total. Consequently, comparisons with Budget plans are not possible for these two items or for the planning total, local authority self-financed expenditure and the accounting adjustment. Table 1.2 includes in the 1989 Budget column a balancing entry of "other items" not included in the table (£55·7 billion). This comprises: local authority expenditure (£44·0 billion), the Reserve set under the old planning total (£3·5 billion) and other accounting adjustments (£8·2 billion).

5A.4 Tables 5.1 and 5.5 provide analyses of outturn and plans on the new definition. These tables include proxies for non-domestic rate payments and credit approvals for 1988–89 and 1989–90. Comparisons with the plans for 1989–90 shown in the 1989 public expenditure White Paper and the 1989 Budget are given on the old definition in tables 5.3 and 5.4. Table 5.6 presents total Supply expenditure as voted by Parliament.

6 The public sector's finances

6.01 This chapter brings together revenue (discussed in chapter 4) and spending (chapter 5) and provides an analysis and forecast of the public sector's overall financial position in 1989–90 and 1990–91. It begins with the latest forecasts for the public sector debt repayment (PSDR) in 1989–90 and 1990–91 and for the associated stock of debt outstanding. It then explains why the latest forecast for 1989–90 differs from those in the last Budget and Autumn Statement. The remaining sections analyse in more detail:

general government receipts and expenditure;

the behaviour of individual sectors: central government, local authorities and public corporations; and

revenue and expenditure by economic category.

Public sector debt repayment and the stock of debt

PSDR

6.02 The outturn for the PSDR in 1989–90 is still uncertain. The latest forecast is for a PSDR of about £7 billion, $1\frac{1}{4}$ per cent of GDP, making this the third successive year of debt repayment.

Table 6.1 Public sector debt repayment

	1988–89	1989–90		1990–91
	Outturn	1989 Budget	Latest estimate	Forecast
Public sector debt repayment				
£ billion	14·5	13·8	7·1	6·9
per cent of GDP	3	$2\frac{3}{4}$	$1\frac{1}{4}$	$1\frac{1}{4}$
PSDR excluding privatisation proceeds				
£ billion	7·4	8·8	2·9	1·9
per cent of GDP	$1\frac{1}{2}$	$1\frac{3}{4}$	$\frac{1}{2}$	$\frac{1}{4}$

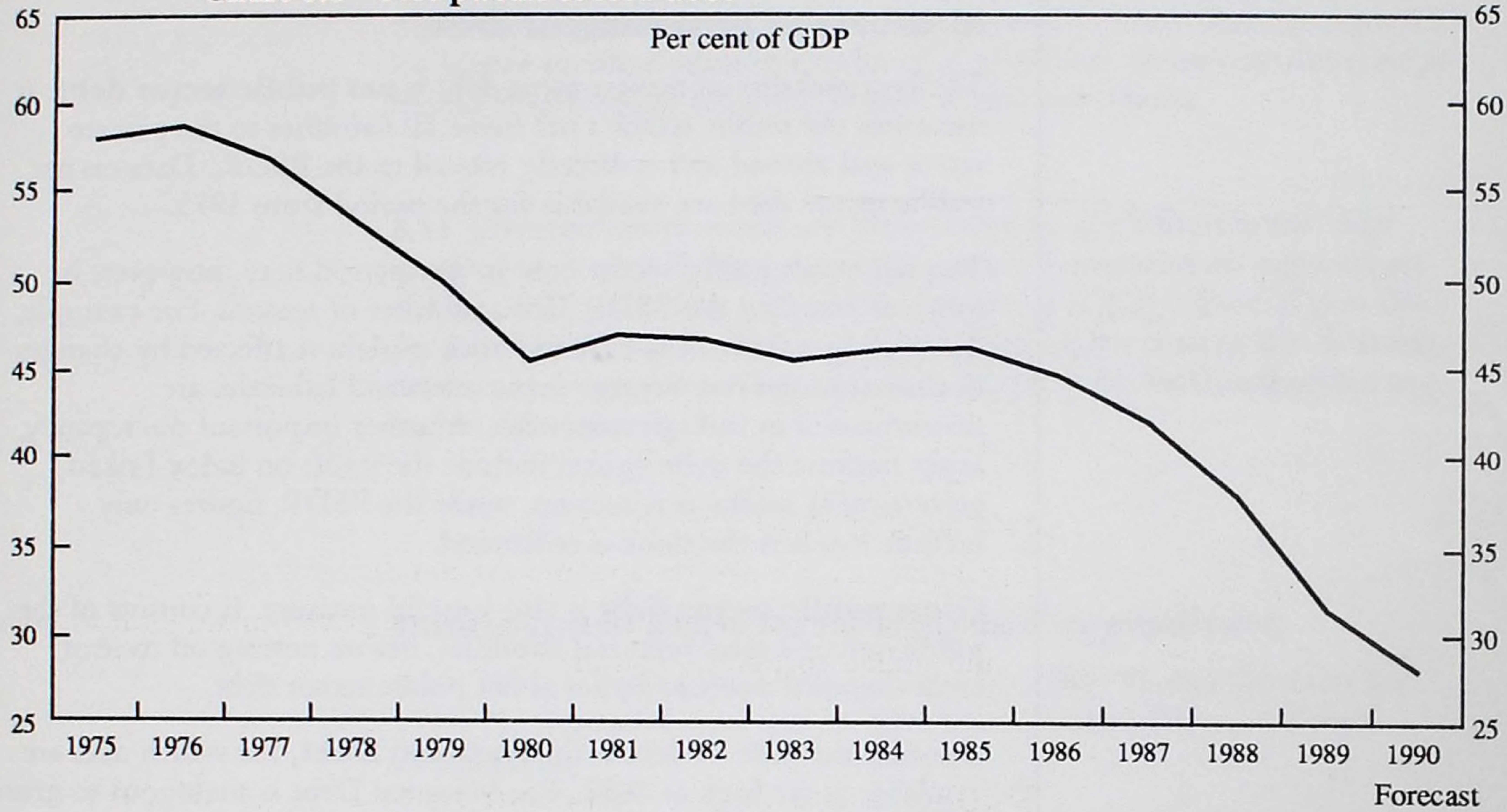
6.03 Growth in overall demand and output slowed sharply in 1989–90. But the fall in the PSDR is largely due to three factors unconnected with the economic cycle—lower privatisation proceeds, higher personal pension rebates, and a sharp rise in local authority capital spending.

6.04 These three downward influences on the PSDR are expected to be partially reversed in 1990–91. But economic growth is expected to slow further, reducing the PSDR. Taking account of all these factors the PSDR for 1990–91 is forecast to remain at about £7 billion, equivalent to $1\frac{1}{4}$ per cent of GDP.

Public sector debt

6.05 With large public sector surpluses in recent years, the net stock of public sector debt has fallen sharply, both in absolute terms and relative to GDP. At the start of the current financial year it was £158 billion, or 32 per cent of money GDP, compared with 46 per cent at the start of 1985–86. It is forecast to fall to £152 billion, 28 per cent of GDP, at the end of 1989–90.

Chart 6.1 Net public sector debt



6.06 National Debt as a share of GDP has now fallen back close to the levels prevailing before the First World War. In contrast to some earlier periods, the fall in debt as a share of GDP in the 1980s has owed little to the erosion by inflation of the real value of the outstanding stock of debt, but has largely been the result of prudent fiscal policy. The box on page 76 explains the various concepts of government debt.

Changes since last Budget and Autumn Statement

6.07 The PSDR in 1989–90 is now forecast to be £6¾ billion lower than forecast in last year's Budget and £5½ billion lower than forecast in the Autumn Statement. As table 6.2 shows, the downward revisions are the result of both lower receipts and higher expenditure.

Table 6.2 Changes since 1989 Budget and Autumn Statement[1]

	£ billion		
	Changes since 1989 Budget		Changes since Autumn Statement
	1988–89	1989–90	1989–90
Receipts			
Inland Revenue and Customs and Excise receipts	−0·4	−0·4	−2·5
National insurance contributions	−0·2	−1·3	0·3
Other receipts	−0·5	−1·3	−1·4
Total receipts	**−1·1**	**−3·0**	**−3·5**
Expenditure			
Privatisation proceeds	—	+0·8	—
Other general government	−0·8	+2·6	+1·4
Public corporations' market and overseas finance	−0·8	+0·3	+0·5
Total expenditure	**−1·7**	**+3·7**	**+2·0**
PSDR	**+0·6**	**−6·7**	**−5·5**

[1] *+ higher receipts, higher expenditure, or higher debt repayment;*
− lower receipts, lower expenditure, or lower debt repayment.

Measures of government debt

The best measure of government debt is **net public sector debt.** It measures the public sector's net financial liabilities to the private sector and abroad and is directly related to the PSDR. Data on net public sector debt are available for the period from 1975.

The fall in net public sector debt in any period may, however, be more or less than the PSDR, for a number of reasons. For example, the sterling value of the existing stock of debt is affected by changes in the exchange rate because some assets and liabilities are denominated in foreign currencies. Another important discrepancy arises because the debt figures include the uplift on index-linked government stocks as it accrues, while the PSDR figures only include it when the stock is redeemed.

Gross public sector debt is also a useful measure. It consists of the public sector's total financial liabilities, before netting off its short term financial assets to arrive at net public sector debt.

Another measure of debt is the **National Debt,** for which data are available as far back as 1855. The National Debt is analogous to gross public sector debt in that it measures gross liabilities before netting off financial assets. But it has certain drawbacks as a measure of government debt:

it does not cover the whole of the public sector ie, it excludes the liabilities of local authorities and public corporations;

it excludes certain central government liabilities such as the money owed to National Savings Bank depositors.

it includes certain liabilities held within central government itself and by other parts of the public sector; such liabilities are not included in net or gross public sector debt because they represent debt owed by one part of the public sector to another.

6.08 Inland Revenue and Customs and Excise receipts are only a little lower than forecast in last year's Budget, but as table 1.2 shows there have been some large variations in the components. Higher income tax receipts—reflecting higher wages and salaries—are more than offset by lower than forecast receipts of other taxes, particularly corporation tax. The downward revision to Inland Revenue and Customs and Excise receipts since the Autumn Statement mainly reflects corporation tax, but VAT and other Customs and Excise receipts are also lower than expected in the autumn.

6.09 Corporation tax receipts again rose strongly in 1989–90, by 15½ per cent, but not by as much as the 22 per cent forecast in the last Budget. Within the total, advance corporation tax (ACT) receipts were higher than forecast, reflecting high dividend payments in 1989, but mainstream corporation tax receipts rose less than expected. The latter is likely to be mainly the result of lower profits growth and higher investment growth in 1988 than shown by earlier estimates.

6.10 National insurance contributions are expected to be £1¼ billion lower than forecast in the 1989 Budget. This shortfall is more than accounted for by higher personal pension rebates of £1¾ billion. Gross contributions are higher than forecast reflecting higher wages and salaries.

6.11 Privatisation proceeds are expected to be £¾ billion lower than assumed in the last Budget, increasing general government expenditure (GGE). GGE excluding privatisation proceeds is £2½ billion higher than projected in the last Budget and £1½ billion higher than in the Autumn Statement, largely as a result of higher spending by local authorities and higher debt interest.

Public sector finances: receipts and expenditure

6.12 Table 1.2 gives the latest estimates for 1989–90, and forecasts for 1990–91, of general government receipts and expenditure, and their components.

Receipts

6.13 General government receipts are estimated to have risen by 7¼ per cent in 1989–90, about 1 per cent below the growth of money GDP. They are forecast to increase by 7½ per cent in 1990–91, similar to the forecast growth of money GDP (after adjusting for the effect of the abolition of domestic rates). The forecast takes into account two factors tending to reduce receipts in 1990–91, namely the introduction of independent taxation and the full year effect of last year's reform of national insurance contributions.

6.14 Within the total for 1990–91, income tax receipts are forecast to rise relatively quickly whilst corporation tax receipts are forecast to fall. More specifically, there is:

a 13 per cent increase in income tax receipts;

a 3½ per cent fall in receipts of corporation tax (including ACT and North Sea corporation tax);

an 8½ per cent increase in VAT receipts;

a 9 per cent increase in receipts from excise duties on petrol, tobacco and alcohol;

a 7 per cent increase in receipts of non-domestic rates;

a 17 per cent increase in community charge receipts net of rebates (compared with the level of domestic rates and community charge in 1989–90); the increase gross of rebates is 27 per cent;

an 8½ per cent increase in national insurance contributions (net of personal pension rebates, which are projected to be £2 billion in 1990–91 compared with £2½ billion in 1989–90).

6.15 Forecasts of corporation tax are always subject to wide margins of error. But there is added uncertainty at present because of the particular uncertainty surrounding the national accounts estimates of profits and investment in 1988 and 1989. The projected fall in corporation tax receipts in 1990–91 reflects a number of factors:

a smaller increase in company incomes, net of short-term interest payments, in 1989 than in previous years;

high levels of investment in recent years, raising capital allowances;

a forecast slowdown in the growth of dividends in 1990, leading to slower growth of ACT;

tax relief on banks' sovereign debt provisions in their 1989 accounts;

postponement of payments by some building societies as a result of the 1987 Budget change which standardised the period between the end of a company's accounting year and the due date for tax.

6.16 North Sea revenues are estimated to have fallen by £¾ billion in 1989–90, mainly reflecting lower corporation tax following falls in sterling oil prices and production in 1988. North Sea revenues are estimated to account for 1 per cent of total general government receipts in 1989–90 compared with over 8 per cent in 1984–85 when they were at their peak. An increase in revenues is forecast for 1990–91. This assumes that North Sea oil prices will remain close to recent levels and that oil production will recover in 1990, as implied by the Department of Energy's new Brown Book ranges.

Table 6.3 North Sea revenues

	£ billion			
	1988–89	1989–90		1990–91
	Outturn	1989 Budget	Latest estimate	Forecast
North Sea corporation tax[1]	1·2	0·8	0·7	1·0
Petroleum revenue tax[2]	1·4	1·4	1·1	1·1
Oil royalties	0·6	0·6	0·6	0·7
Total North Sea revenues	**3·2**	**2·9**	**2·3**	**2·8**
[1] *Before ACT set off of:*	*0·7*	*0·5*	*0·4*	*0·5*

[2] *Includes advance petroleum revenue tax*

Taxes as a share of GDP

6.17 Table 6.4 and chart 6.2 show taxes and national insurance contributions (NICs) as a per cent of GDP. The total percentage has fallen steadily since 1984–85, but initially much of this fall was due to falling North Sea revenues. The non-North Sea percentage changed very little between 1984–85 and 1987–88, but has fallen since then.

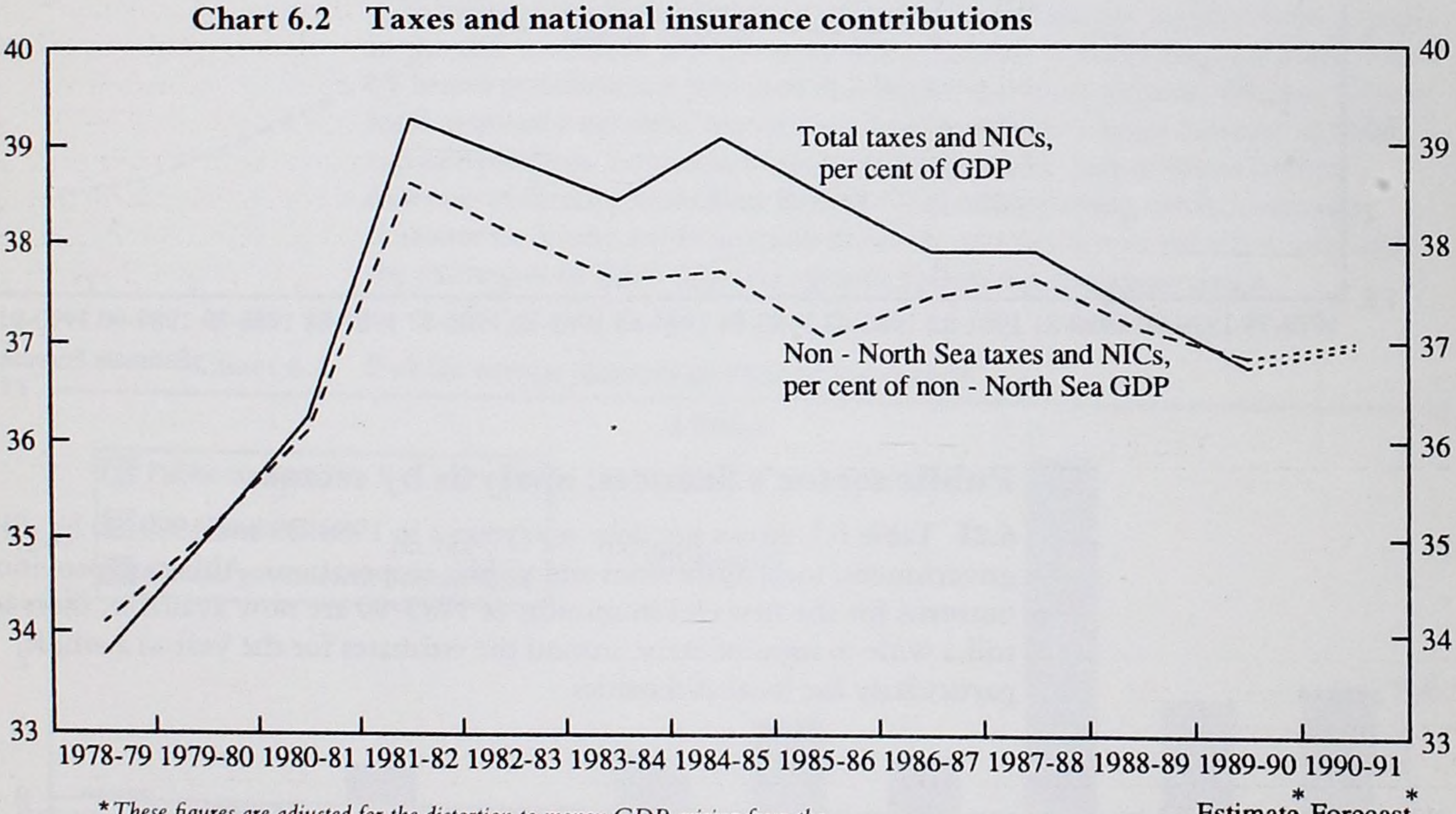
Table 6.4 Taxes and national insurance contributions as a percent of GDP[1]

	1984–85	1985–86	1986–87	1987–88	1988–89	1989–90 Latest estimate[2]	1990–91 Forecast[2]
Total taxes and NICs as a share of total GDP	39	$38\frac{1}{2}$	38	38	$37\frac{1}{4}$	$36\frac{3}{4}(36\frac{3}{4})$	$37\frac{1}{2}(37)$
Non-North Sea taxes and NICs as a share of non-North Sea GDP	$37\frac{3}{4}$	37	$37\frac{1}{2}$	$37\frac{3}{4}$	37	$36\frac{3}{4}(36\frac{3}{4})$	$37\frac{3}{4}(37)$

[1] *Includes the community charge with taxes in 1989–90 and 1990–91.*
[2] *Figures in brackets adjust for the distortion to money GDP arising from the abolition of domestic rates. This is explained in the box on page 45.*

6.18 Total and non-North Sea taxes and NICs are forecast to rise marginally in 1990–91 as percentages of GDP, after adjusting for the distortion to money GDP arising from the abolition of domestic rates (see box on page 45). It should be noted, however, that if the effect on money GDP of the abolition of domestic rates is included, the total and non-North Sea percentages both increase rather more.

Chart 6.2 Taxes and national insurance contributions



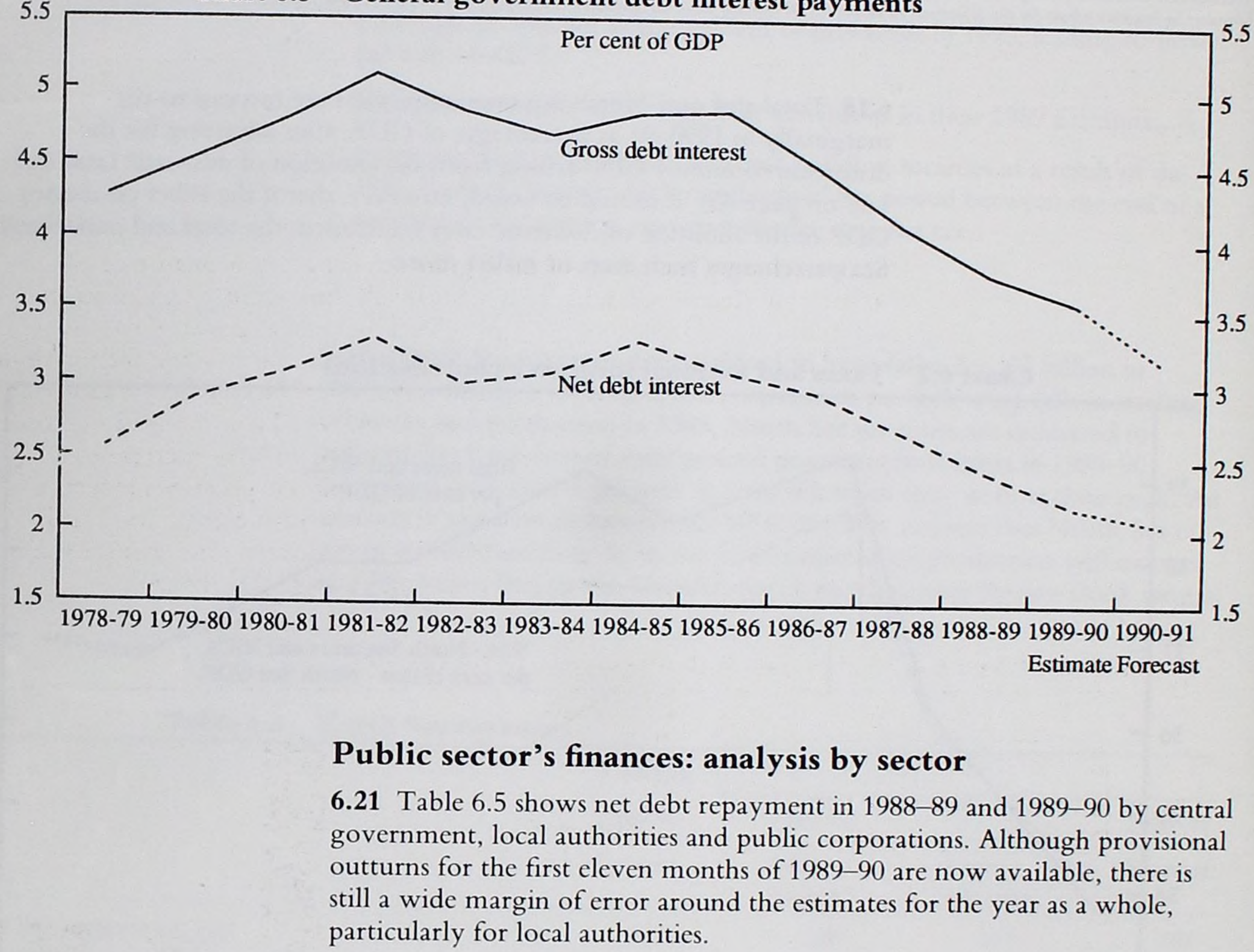
**These figures are adjusted for the distortion to money GDP arising from the abolition of domestic rates (see box on page 45).*

Expenditure

6.19 GGE excluding privatisation proceeds is now estimated to have grown by 9 per cent in 1989–90, a little faster than the growth of money GDP. The ratio of GGE excluding privatisation proceeds to GDP is thus estimated to have risen slightly from the 1988–89 figure, to a level nearly 8 percentage points below the level of seven years ago. GGE excluding privatisation proceeds is projected to rise by nearly 8 per cent in 1990–91, similar to the growth of money GDP (after adjusting for the distortion from the abolition of domestic rates).

6.20 Within GGE, general government interest payments rose in 1989–90 in cash terms, with the effect of a reduced stock of debt more than offset by higher interest rates and inflation (which raises the cost of servicing indexed debt). Relative to GDP, however, they continued the decline begun in 1986–87. With the outstanding stock of debt continuing to fall, a fall in interest payments is forecast for 1990–91, both absolutely and relative to GDP.

Chart 6.3 General government debt interest payments



Public sector's finances: analysis by sector

6.21 Table 6.5 shows net debt repayment in 1988–89 and 1989–90 by central government, local authorities and public corporations. Although provisional outturns for the first eleven months of 1989–90 are now available, there is still a wide margin of error around the estimates for the year as a whole, particularly for local authorities.

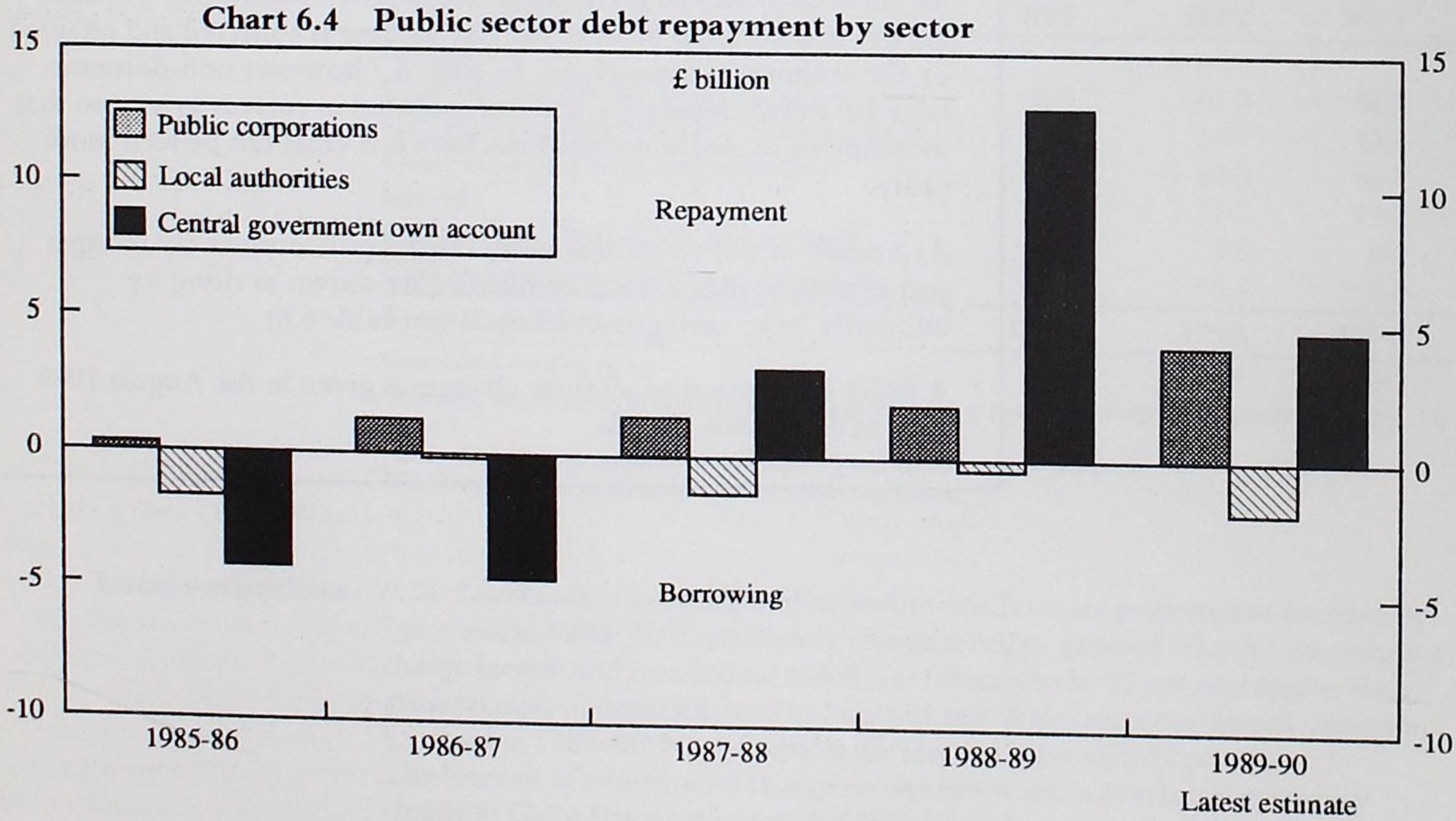
6.22 The sectoral positions in 1989–90 are affected by substantial, PSDR-neutral, transfers between central government and the other two sectors. First, there was a capital grant of £0·9 billion from central government to Scottish local authorities for the capitalisation of housing loans. The grants were used to repay borrowing from central government. As a result the central government debt repayment on own account was reduced, and the local authority debt repayment increased, leaving the PSDR unchanged. Second, allowance has been made for a grant of £3·5 billion to British Coal in March 1990, which will similarly be used to repay borrowing from central government. This will reduce the central government own account repayment and increase the public corporations debt repayment.

Table 6.5 Public sector debt repayment

	£ billion			
	1988–89 Outturn		1989–90 Latest estimate	
1 Central government debt repayment on own account	**12·9**		**4·8**	
2 Local authority debt repayment	**−0·4**		**−1·9**	
3 of which to: central government		−4·9		−2·7
4 market and overseas		4·6		0·8
5 Public corporations' debt repayment	**2·0**		**4·2**	
6 of which to: central government		−1·0		2·8
7 market and overseas		3·0		1·4
8 Public sector debt repayment	**14·5**		**7·1**	
Central government debt repayment (lines 1+3+6)		7·0		4·9

6.23 Excluding the effects of these grants to get a better picture of underlying trends, net debt repayment by all three sectors was lower in 1989–90 than in 1988–89—by £3¾ billion for central government, by £2½ billion for local authorities and by £1¼ billion for public corporations. In the case of central government this reduction is more than accounted for by lower privatisation proceeds and higher personal pension rebates. Lower local authority net debt repayment largely reflects a large increase in their capital spending. Lower net repayment by public corporations reflects a number of factors, including British Coal restructuring costs, increased investment, lower profit growth from the slowdown in the economy and the exclusion of BSC debt repayment following its privatisation.

Chart 6.4 Public sector debt repayment by sector



Treatment of the community charge and national non-domestic rates in the public sector accounts

Local authority rates, both domestic and non-domestic, are currently treated as a local authority tax on expenditure in the national and public sector accounts.

The **community charge** does not fall satisfactorily within the current system of classification of taxes in the national accounts. It is not a tax on expenditure; nor is it a tax on income or capital. The Central Statistical Office (CSO) has therefore decided that it should appear as a separate category. This is the treatment adopted in tables 1.2 and 6.9. The community charge is, however, included with the figures for taxes and national insurance contributions as a percent of GDP in tables 2.5 and 6.4 and chart 6.2.

Receipts of community charge, like receipts of domestic rates, are included in the national accounts net of rebates, ie community charge benefit and transitional relief. These rebates are funded by central government grant and are included in current grants from central government to local authorities in tables 6.6, 6.7, and 6.9.

Non-domestic rates (national non-domestic rates in England and Wales and non-domestic rates in Scotland) will continue to be treated as a tax on expenditure. But the CSO has decided that it will no longer be appropriate to show them as local authority tax receipts, and that from 1 April 1990 all non-domestic rates should be treated as central government tax receipts. In the national accounts, local authorities will receive the proceeds of non-domestic rates in the form of a current grant from central government (for Scotland the grant is notional because the rate income is collected and retained by the authorities themselves). In table 6.7 however non-domestic rates are shown separately and not included in current grants, so that movements in non-domestic rates between years can be seen more easily.

As a result of this re-classification, central government tax receipts and current grants to local authorities are shown as rising by unusually large amounts in 1990–91 (see table 6.6).

A fuller description of all these changes is given in the August 1989 issue of Economic Trends.

6.24 Tables 6.6 to 6.8 summarise the estimated outturns and forecasts for receipts and expenditure in 1989–90 and 1990–91 for each of the three sectors. (More detail is given in table 6.9.) Central government expenditure in table 6.6 includes grants and subsidies to local authorities and public corporations, which are included in the receipts of these sectors shown in tables 6.7 and 6.8. The forecast for 1990–91 assumes that £0·7 billion of the Reserve is allocated to community charge benefit grant. The forecast of the PSDR assumes that the Reserve is fully spent.

Central government

6.25 The unusually large forecast rise in central government tax receipts and expenditure on current grants to local authorities in 1990–91 reflects the introduction of national non-domestic rates (see box on page 82). Current expenditure on goods and services is forecast to rise by 8 per cent in 1990–91, a similar increase to 1989–90. Within capital expenditure, gross domestic fixed capital formation is forecast to rise strongly in both 1989–90 and 1990–91, by 37 per cent and 19 per cent respectively. The movements in cash expenditure on company securities reflect changes in privatisation proceeds.

Table 6.6 Central government transactions

	£ billion		
	1988–89 Outturn	1989–90 Latest estimate	1990–91 Forecast[1]
Receipts			
Taxes and royalties	125·7	136·7	158·9
National insurance and other contributions	33·0	33·1	35·9
Other	11·1	11·5	11·5
Total receipts	**169·7**	**181·2**	**206·3**
Expenditure			
Current expenditure on goods and services	56·8	61·3	66·2
Current and capital grants to LAs and PCs	25·3	31·7	43·4
Other current grants, and subsidies	57·3	62·3	66·9
Interest	17·6	17·7	17·0
Capital expenditure[2] and net lending[3]	6·9	7·8	8·9
Cash expenditure on company securities	−7·1	−4·4	−5·0
Total expenditure	**156·8**	**176·5**	**197·3**
Consolidated Fund revenues	*133·6*	*145·9*	*163·9*

[1] *Excluding any allocation from the Reserve, except in respect of community charge benefit grant: see footnote 3 to table 6.7.*
[2] *Gross domestic fixed capital formation, capital grants to private sector and stocks.*
[3] *Excluding lending to local authorities and public corporations.*

Local authorities

6.26 Local authority receipts of non-domestic rates are projected to increase by 7 per cent in 1990–91. Community charge receipts, gross of rebates (community charge benefit and transitional relief), are forecast to be 27 per cent higher than gross receipts of domestic rates in England and Wales and community charge in Scotland in 1989–90. Net of rebates the forecast increase is 17 per cent. The forecast of community charge receipts assumes an average community charge in Great Britain of around £350 and makes some small allowance for non-collection as authorities themselves have in setting the charges.

6.27 The increase in current expenditure on goods and services in 1989–90 is lower than it would otherwise have been because of the transfer of polytechnics from the local authority to the private sector from 1 April 1989. It is forecast to rise by 10 per cent in 1990–91; again this increase is lower than it would otherwise have been because of functional changes. Capital expenditure is estimated to have risen strongly in 1989–90 as authorities attempted to get in spending ahead of the introduction in 1990–91 of the new capital finance regime. Capital spending is forecast to fall back once the new regime is in place.

Table 6.7 Local authority transactions

	£ billion		
	1988–89 Outturn	1989–90 Latest estimate	1990–91 Forecast
Receipts			
Domestic rates and community charge[1]	8·5	9·6	11·3
Non-domestic rates	10·4	11·2	12·1
Current grants from central government[2]	23·8	24·8	27·5[3]
Capital grants from central government	0·8	2·3	2·3
Other	5·6	5·6	5·7
Total receipts	**49·1**	**53·6**	**58·8**
Expenditure			
Current expenditure on goods and services	36·4	38·9	42·8
Current grants and subsidies	5·8	6·4	6·9
Interest	4·6	5·1	5·4
Capital expenditure and net lending	2·6	5·2	4·6
Total expenditure[4]	**49·5**	**55·5**	**59·6**
	(46·6)	(51·8)	(55·8)

[1] *Net of rate rebates, community charge benefit and transitional relief.*
[2] *Excluding NNDR payments in 1990–91.*
[3] *The figure for community charge benefit grant in 1990–91 (included within current grants from central government) is consistent with the latest estimates of the average community charge, and higher than provision for community charge benefit grant in the public expenditure plans published in Cm 1021. The extra cost will be a charge on the Reserve. The figures for local authority expenditure in 1990–91 take account of the latest information on local authority budgets. See footnotes 2 and 3 to table 5.1.*
[4] *The expenditure figures in this table are on a national accounts basis; the figures in brackets are equivalent figures on the public expenditure measurement basis used in chapter 5.*

Public corporations

6.28 Trends in public corporations' finances are difficult to discern because of changes in coverage of the sector associated with privatisations. During the period covered by table 6.8 British Steel was excluded from the figures from December 1988 and the ten regional water authorities from December 1989. The forecast for 1990–91 assumes that the electricity distribution and generating companies in England and Wales will be privatised during the course of the year. Excluding the effect of the privatisations, gross trading surpluses are forecast to fall only a little in 1989–90 and to increase in 1990–91. Capital expenditure is estimated to have risen strongly in 1989–90, after adjusting for the effects of privatisation. And although table 6.8 shows a fall in 1990–91, capital expenditure by those industries remaining in the public sector is forecast to rise.

Table 6.8 Public corporations' transactions

	£ billion		
	1988–89 Outturn	1989–90 Latest estimate	1990–91 Forecast[1]
Receipts			
Gross trading surplus (including subsidies)	7·4	6·2	4·9
Capital grants from central government	0·7	4·6	1·5
Other	2·3	2·1	2·2
Total receipts	**10·4**	**12·8**	**8·6**
Expenditure			
Interest, dividends and taxes on income	3·1	3·2	2·7
Net lending and capital expenditure	5·4	5·4	4·9
Total expenditure	**8·5**	**8·6**	**7·6**
Public corporations' contribution to planning total:			
nationalised industries	*−0·4*	*0·7*	*0·5*
other public corporations	*0·3*	*0·8*	*0·8*

[1] *Excluding any allocation from the Reserve*

Public sector's finances: analysis by economic category

6.29 The full analysis of receipts and expenditure by economic category is shown in table 6.9, with a breakdown between central government, local authorities and public corporations. This analysis, which distinguishes between current and capital transactions (and within the latter between physical and financial investment), shows the derivation of the public sector financial surplus. The financial surplus, unlike the PSDR, is not wholly a measure of cash transactions because certain items above line 26 in table 6.9, for example some taxes included in lines 1 and 2, are measured on an accruals basis. An accruals adjustment is accordingly made in line 30.

6.30 The Reserve is assumed to be spent on transactions that fall above the financial surplus line. In practice allocations from the Reserve can also affect financial transactions (lines 27 to 31).

Table 6.9 Public sector transactions by sub-sector and economic category

		£ billion				
		1989–90 Latest estimate				
		General government			Public corporations	Public sector
	Line[1]	Central government	Local authorities	Total		
Current and capital receipts						
Taxes on income, and oil royalties	1	70·3	—	70·3	−0·1	70·1
Taxes on expenditure	2	61·1	20·1	81·2	—	81·2
Taxes on capital	3	5·3	—	5·3	—	5·3
National insurance and other contributions	4	33·1	—	33·1	—	33·1
Community charge	5	—	0·8	0·8	—	0·8
Gross trading surplus	6	−0·5	0·4	−0·1	6·2	6·1
Rent and miscellaneous current transfers	7	0·4	3·0	3·4	0·6	4·1
Interest and dividends from private sector and abroad	8	3·4	1·6	5·1	0·7	5·8
Interest and dividends within public sector	9	6·4	−4·3	2·2	−2·2	—
Imputed charge for non-trading capital consumption	10	1·4	1·7	3·1	—	3·1
Capital transfers from private sector	11	—	—	—	0·2	0·2
Total receipts	12	**180·8**	**23·4**	**204·3**	**5·4**	**209·6**
Current and capital expenditure						
Current expenditure on goods and services	13	61·3	38·9	100·2	—	100·2
Subsidies	14	4·8	0·9	5·7	—	5·7
Current grants to personal sector	15	53·0	5·4	58·4	—	58·4
Current grants paid abroad	16	4·5	—	4·5	—	4·5
Current grants within public sector	17	24·8	−24·8	—	—	—
Debt interest	18	17·7	0·8	18·5	0·5	19·0
Gross domestic fixed capital formation	19	5·2	4·6	9·7	4·9	14·7
Increase in stocks	20	−0·3	—	−0·3	0·2	−0·1
Capital grants to private sector	21	2·3	0·6	2·9	0·1	3·1
Capital grants within public sector	22	6·9	−2·3	4·6	−4·6	—
Total expenditure	23	**180·3**	**24·1**	**204·4**	**1·1**	**205·5**
Reserve	24	—	—	—	—	—
Adjustment for community charge benefit	25	—	—	—	—	—
Financial surplus	26	**0·5**	**−0·7**	**−0·1**	**4·2**	**4·1**
Financial transactions						
Net lending to private sector and abroad	27	0·6	−0·1	0·5	0·1	0·6
Cash expenditure on company securities (including privatisation proceeds)	28	−4·4	0·1	−4·3	—	−4·3
Transactions concerning certain public sector pension schemes	29	—	—	—	—	—
Accruals adjustments	30	0·4	−0·2	0·3	−0·2	0·1
Miscellaneous financial transactions	31	−0·8	1·4	0·6	0·1	0·7
Debt repayment	32	**4·8**	**−1·9**	**2·9**	**4·2**	**7·1**

[1] *Financial surplus (line 26) = receipts (line 12) − expenditure (line 23) − Reserve (line 24) — adjustment (line 25).*
Debt repayment (line 32) = financial surplus (line 26) − financial transactions (lines 27 to 31).

	£ billion					
	1990–91 Forecast					
	General government			Public corporations	Public sector	
Line[1]	Central government	Local authorities	Total			
						Current and capital receipts
1	75·7	—	75·7	−0·3	75·4	Taxes on income, and oil royalties
2	77·2	0·1	77·3	—	77·3	Taxes on expenditure
3	6·0	—	6·0	—	6·0	Taxes on capital
4	35·9	—	35·9	—	35·9	National insurance and other contributions
5	—	11·2	11·2	—	11·2	Community charge
6	−0·6	0·4	−0·2	4·9	4·7	Gross trading surplus
7	0·5	3·1	3·6	0·7	4·2	Rent and miscellaneous current transfers
8	3·6	1·6	5·2	0·7	5·9	Interest and dividends from private sector and abroad
9	5·8	−4·6	1·2	−1·2	—	Interest and dividends within public sector
10	1·4	1·8	3·3	—	3·3	Imputed charge for non-trading capital consumption
11	—	—	—	0·4	0·4	Capital transfers from private sector
12	**205·5**	**13·6**	**219·1**	**5·2**	**224·3**	**Total receipts**
						Current and capital expenditure
13	66·2	42·8	109·0	—	109·0	Current expenditure on goods and services
14	4·9	0·5	5·5	—	5·5	Subsidies
15	57·9	6·4	64·2	—	64·2	Current grants to personal sector
16	4·1	—	4·1	—	4·1	Current grants paid abroad
17	39·6	−39·6	—	—	—	Current grants within public sector
18	17·0	0·7	17·7	0·9	18·6	Debt interest
19	6·2	3·8	9·9	4·7	14·7	Gross domestic fixed capital formation
20	−0·2	—	−0·2	—	−0·2	Increase in stocks
21	2·7	0·8	3·5	0·1	3·6	Capital grants to private sector
22	3·8	−2·3	1·5	−1·5	—	Capital grants within public sector
23	**202·1**	**13·1**	**215·1**	**4·3**	**219·4**	**Total expenditure**
24					3·0	Reserve
25					−0·7	Adjustment for community charge benefit[2]
26					**2·6**	**Financial surplus**
						Financial transactions
27	0·3	—	0·3	—	0·3	Net lending to private sector and abroad
28	−5·0	—	−5·0	—	−5·0	Cash expenditure on company securities (including privatisation proceeds)
29	−0·1	—	−0·1	—	−0·1	Transactions concerning certain public sector pension schemes
30	0·1	−0·1	—	−0·1	—	Accruals adjustments
31	−0·7	1·4	0·6	—	0·6	Miscellaneous financial transactions
32					**6·9**	**Debt repayment**

[2] *The local authority expenditure figures include expenditure financed from higher estimated community charge benefit grant than assumed in the public expenditure plans published in Cm 1021. This estimate reflects the latest information on community charges. Extra grant will be charged to the Reserve within the existing planning total. The adjustment in line 25 makes total expenditure consistent with the planning total shown in Cm 1021 and chapter 5.*

Printed by HMSO
Dd 0000286 C85 3/90 3195551

HMSO publications are available from:

HMSO Publications Centre
(Mail and telephone orders only)
PO Box 276, London SW8 5DT
Telephone orders 01-873 9090
General enquiries 01-873 0011
(queuing system in operation for both numbers)

HMSO Bookshops
49 High Holborn, London, WC1V 6HB 01-873 0011 (Counter service only)
258 Broad Street, Birmingham, B1 2HE 021-643 3740
Southey House, 33 Wine Street, Bristol, BS1 2BQ (0272) 264306
9-21 Princess Street, Manchester, M60 8AS 061-834 7201
80 Chichester Street, Belfast, BT1 4JY (0232) 238451
71 Lothian Road, Edinburgh, EH3 9AZ 031-228 4181

HMSO's Accredited Agents
(see Yellow Pages)

and through good booksellers

From 6 May 1990 the London telephone numbers above carry the prefix '071' instead of '01'

ISBN 0 10 228690 6