Financial Statement and Budget Report 1994-95

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Financial Statement and Budget Report 1994-95

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as laid before the House of Commons by
the Chancellor of the Exchequer when opening the Budget

Treasury Chambers
30 November 1993 } Stephen Dorrell

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1 The Budget

The Budget and the Government's economic strategy

1.01 The Government's economic objective is to promote sustained growth and higher living standards. In delivering this objective, fiscal and monetary policies are complemented by the Government's continuing programme of microeconomic reform. This programme is designed to improve the efficiency of markets and strengthen the long-term supply performance of the economy.

1.02 The central purpose of this Budget is to put the public finances on to a sound basis, so that the economic recovery now under way can be sustained over the medium term. The Budget combines tight public expenditure restraint with measures to raise revenue. It also includes a number of measures to help large and small businesses, thus improving the prospect for jobs.

The public finances

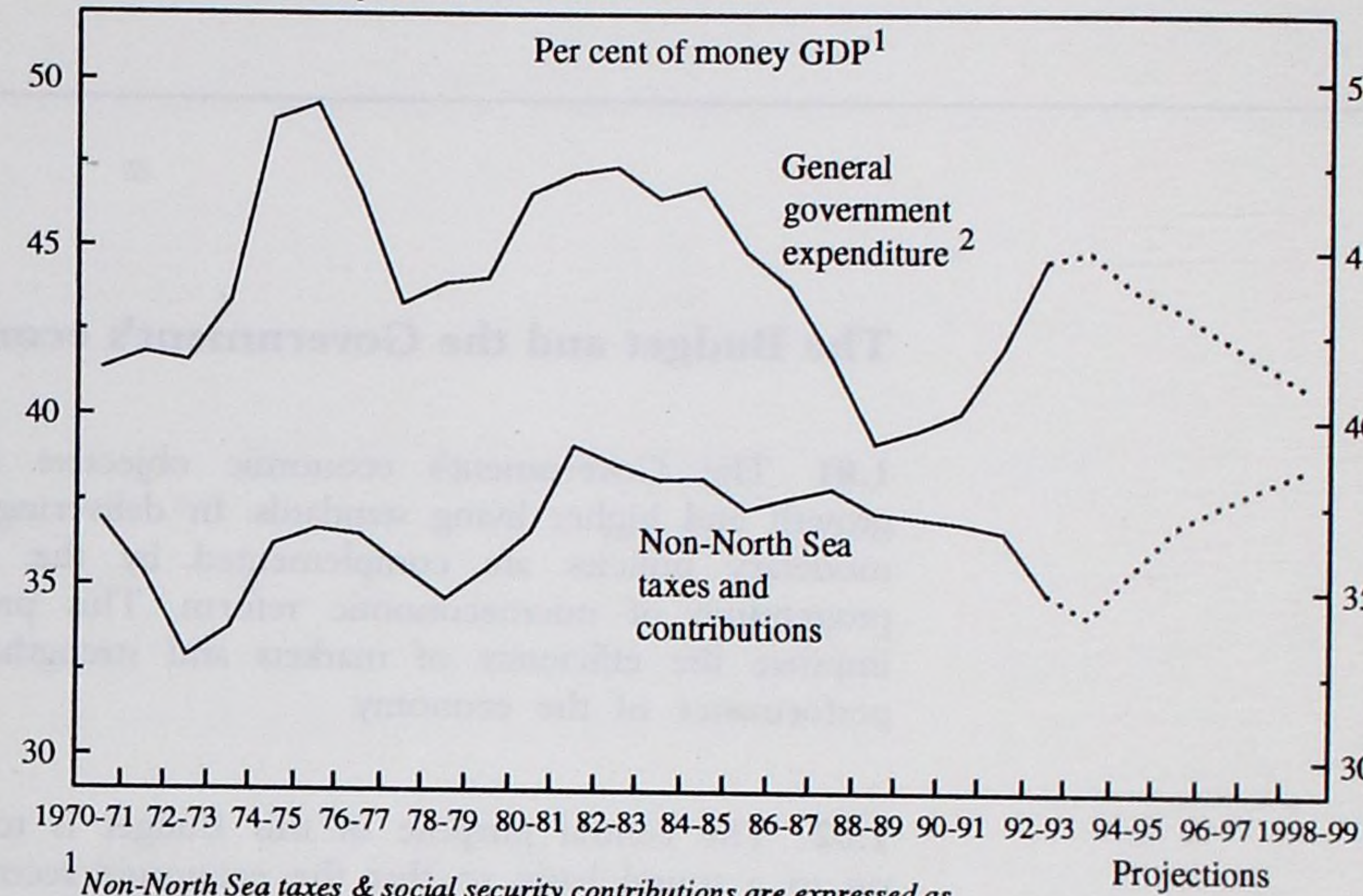
1.03 The Budget measures on taxation and spending will reinforce the fall in the public sector borrowing requirement (PSBR) as the economy recovers. The PSBR path now projected is significantly below that in the March projections. As Table 1.1 illustrates, the Budget should bring the PSBR back close to balance by 1998-99, when the Government will be borrowing only to finance its net capital spending.

Table 1.1 The public sector's finances[1]

	Per cent of GDP					
	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Receipts[2]	36½	37¾	39¼	39¾	40¼	40¾
Current expenditure[2, 3]	42¾	42¼	42	41	40¼	39½
Current balance[2]	**−6½**	**−4½**	**−2¾**	**−1¼**	**–**	**1¼**
Net capital spending[2, 4]	2¼	1¾	1½	1½	1½	1½
Financial deficit[2]	8½	6	4¼	2¾	1½	¼
Privatisation proceeds and other financial transactions	¾	½	–	–	–	–
Public sector borrowing requirement	**7¾**	**5½**	**4¼**	**2¾**	**1½**	**¼**
£ billion	**50**	**38**	**30**	**21**	**12**	**2**

[1] *In this and other tables, constituent items may not sum to totals because of rounding.*
[2] *Figures on a national accounts basis. See Annex to Chapter 6.*
[3] *Includes depreciation of fixed capital.*
[4] *Gross capital spending net of depreciation and capital transfer receipts.*

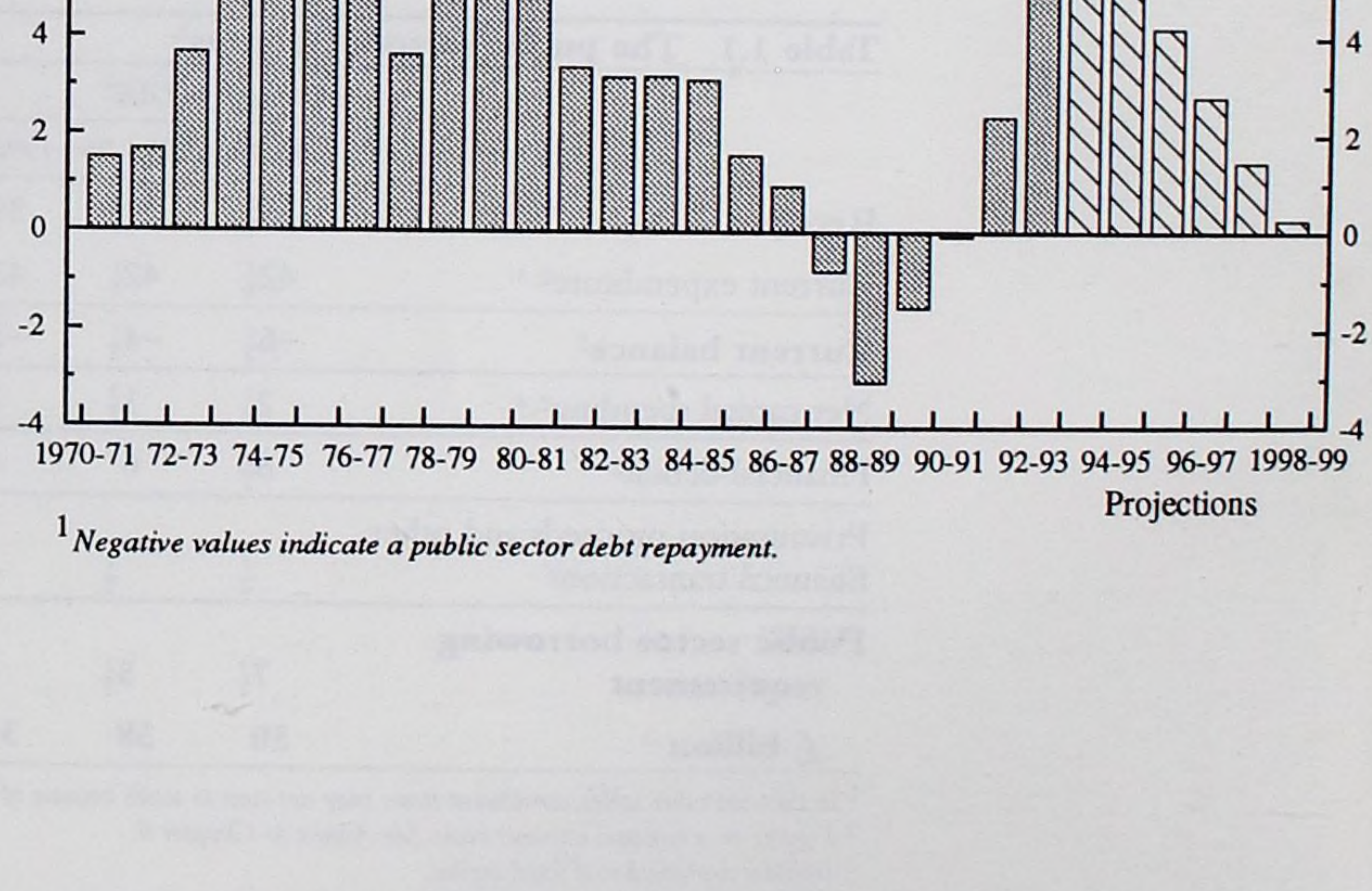
Chart 1.1 Expenditure and revenue



[1] *Non-North Sea taxes & social security contributions are expressed as a percent of Non-North Sea money GDP.*

[2] *Excluding privatisation proceeds.*

Chart 1.2 Public sector borrowing requirement[1]



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

The Budget measures

1.04 Table 1.2 summarises the impact of the Budget measures on the public finances. Spending and revenue measures make broadly similar contributions to lower borrowing, and together the changes build up to around $1\frac{1}{4}$ per cent of GDP by 1996-97.

Table 1.2 Budget changes in spending and revenue

			£ billion
	1994-95	1995-96	1996-97
Public expenditure[1]	−3·8	−2·1	−4·4
Taxes and NICs[5]	+1·7	+4·9	+6·1
[1] *Breakdown of cash effects*			
New control total[2]	−3·6	−1·5	−2·9
Cyclical social security[3]	–	–	−0·3
Debt interest[4]	−0·2	−0·6	−1·2

[2] *Changes from the March FSBR, adjusted for classification changes. See Table 5.1*
[3] *Effect of policy changes. See Chapter 5, paragraph 5.80.*
[4] *Implied effects of other Budget revenue and expenditure measures. See Chapter 5, paragraph 5.82*
[5] *Changes from an indexed base. See Table 1.3.*

1.05 The main Budget measures are summarised below, and described in detail in subsequent chapters. On the spending side, tight control over pay and running costs and savings in a number of programmes contribute to substantial reductions. On the revenue side, the main focus is on broadening the tax base rather than increasing tax rates, while supporting environmental and health objectives.

The supply side

1.06 The Government's strategy for strengthening the supply side aims to make the economy more responsive to market disciplines by enlarging the market sector, increasing competition, deregulating, and improving the climate for enterprise, particularly small businesses. The Budget contains a number of measures which contribute to this aim.

1.07 There is a package of tax and national insurance measures designed to help businesses, particularly smaller businesses, and to reduce the cost of employing lower-paid workers. On the spending side, more resources have been found for education and health; provision has been made for a new apprenticeship scheme and further measures to help people get jobs; and there are reforms to the social security programme, including help with childcare costs for low income working families. Additional help is given to exporters, and the Budget also takes forward the Government's commitment to encourage the private financing of infrastructure projects and other capital expenditure which have hitherto been undertaken by the public sector.

The details of the Budget

1.08 The details of the Budget are set out in subsequent chapters, as described below.

The Medium Term Financial Strategy

1.09 Chapter 2 describes the framework of the Government's macroeconomic policy and sets out fiscal projections on three different assumptions about the path of the economy in the medium term. The objectives for inflation, and the monetary framework for achieving them, remain as described in the March 1993 Financial Statement and Budget Report (FSBR). The aim of fiscal policy is to bring the PSBR back towards balance over the medium term. Attention will also be paid to the public sector's current account balance, and hence to the relationship between public sector borrowing and net capital spending.

The economy

1.10 Chapter 3 describes recent developments in the economy and the prospect to mid-1995. GDP has been a little stronger than expected at the time of the March Budget, and is now forecast to be $1\frac{3}{4}$ per cent higher in 1993 than in the previous year. The Treasury forecast is for growth of $2\frac{1}{2}$ per cent in 1994, slightly below the average forecast by the Panel of Independent Forecasters. Underlying inflation has been significantly lower than forecast in the March Budget. Although it is likely to rise in the early months of 1994, as tax changes feed through, it should remain within the Government's 1 to 4 per cent target range and fall back to $3\frac{1}{4}$ per cent by the fourth quarter of the year.

Taxes and national insurance contributions

1.11 Chapter 4 sets out the tax and national insurance proposals in the Budget. Table 1.3 shows their direct effects on Government revenues. The total effect of these measures builds up from £$1\frac{3}{4}$ billion in 1994-95 to £6 billion by 1996-97.

Public expenditure

1.12 Chapter 5 sets out the Government's spending plans to 1996-97 and a forecast of the outturn for public expenditure in 1993-94. The new plans are below the ceilings for the Survey agreed by the Cabinet in June. The new control total is held to £251·3 billion in 1994-95, and general government spending falls from 45 per cent to $42\frac{1}{2}$ per cent of GDP over the three Survey years. The new plans are summarised in Table 1.4.

Public sector finances **1.13** Chapter 6 presents the financial picture for the public sector in 1993-94 and 1994-95 in more detail, and the figures are summarised in Table 1.5. The PSBR for 1993-94 is forecast at a little below £50 billion, very close to the forecast in the March 1993 Budget. The PSBR for 1994-95 is forecast at £38 billion, after taking account of the Budget measures.

European Community **1.14** Chapters 2, 4 and 5 of this report set out the Government's tax and spending plans in the context of its overall approach to economic, social and environmental objectives. After approval by Parliament for the purposes of section 5 of the European Communities (Amendment) Act 1993, it will form the basis of submissions to the European Commission under Articles 103(3) and 104c of the Treaty establishing the European Community.

Table 1.3 The Budget tax and national insurance measures[1]

£ million				yield (+)/cost (-)
	Changes from a non-indexed base	Changes from an indexed base		
	1994-95	1994-95	1995-96	1996-97
Income tax				
allowances and basic rate limit frozen	—	550	720	770
married couple's allowance restricted to 15 per cent	—	—	830	1060
mortgage interest relief reduced to 15 per cent	—	—	900	950
Incapacity benefit taxed for new recipients from April 1995	—	—	50	110
Business tax measures				
employers' NICs – main rate cut by 0·2 per cent and lower rates by 1 per cent	–810	–830	–940	–960
foreign income dividend scheme	30	30	—	–100
Enterprise Investment Scheme	–10	–10	–35	–50
VAT registration threshold raised to £45,000	–40	–40	–45	–45
Profits limits increased for small companies' corporation tax rate	*	*	–30	–40
CGT reliefs extended	—	—	–15	–20
maximum real increases in business rates halved	–105	–105	. . .	. . .
Measures against avoidance				
PAYE and NIC avoidance	270	270	145	70
profit related pay	100	100	100	100
indexation for capital losses abolished	50	50	200	300
other measures against avoidance	160	160	170	230
Excise duties				
alcohol	10	–70	–75	–80
road fuels	710	710	1 110	1 585
tobacco	485	375	590	835
VED	130	55	60	60
Other taxes				
Insurance premium tax	295	295	775	840
Air passenger duty	115	115	330	355
Other changes	10	20	55	105
Total effect of Budget tax and national insurance changes	**1 400**	**1 675**	**4 895**	**6 075**

[1] *The measures and their revenue effects are set out in more detail in Chapter 4. The revenue effects of measures announced before the Budget are set out in Annex B to Chapter 4.*

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

Table 1.4 The public spending plans

	£ billion						
	Estimated outturn	New plans/projections			Changes from previous plans/projections[1]		
	1993–94	1994–95	1995–96	1996–97	1993–94	1994–95	1995–96
Central government expenditure							
Social security[2]	61·0	62·0	65·3	67·8	1·5	0·9	0·9
Health	29·3	30·8	32·1	33·0	0·2	0·4	0·5
Defence	23·4	23·5	22·7	22·8	−0·1	−0·3	−0·5
Education	6·5	7·6	8·6	9·0	—	0·6	1·1
Scotland, Wales and N. Ireland	17·9	18·9	19·6	20·1	0·2	0·5	0·7
Other departments	32·0	30·1	31·6	31·7	1·7	−1·8	−0·1
Total	**170·1**	**172·9**	**179·9**	**184·4**	**3·4**	**0·4**	**2·6**
Local authority expenditure	70·2	71·7	73·7	75·6	0·9	−0·5	−0·6
Financing requirements of nationalised industries	4·7	3·2	2·4	1·9	−0·4	—	−0·4
Adjustment	−0·3				−0·3		
Reserve		3·5	7·0	10·5	−4·0	−3·5	−3·0
New control total	**244·7**	**251·3**	**263·0**	**272·3**	**−0·4**	**−3·6**	**−1·5**
–real terms[3]	237·0	234·0	236·1	238·5	−1·4	−4·1	−2·3
–real growth[4]	2·0	−1·3	0·9	1·0			
Cyclical social security	14·0	14·8	15·5	16·2	−1·1	−1·3	−1·4
Central government debt interest	19·4	22·5	24·5	25·6	—	−0·8	−1·3
Accounting adjustments	8·0	8·8	10·1	11·0	0·4	—	0·6
GGE excluding privatisation proceeds	**286·1**	**297·3**	**313·1**	**325·2**	**−1·1**	**−5·7**	**−3·6**
–real terms[3]	277·0	276·9	281·0	284·7	−2·3	−6·2	−4·3
–real growth[4]	2·9	−0·1	1·5	1·3			
–per cent of GDP	45	$43\frac{3}{4}$	$43\frac{1}{4}$	$42\frac{1}{2}$			

[1] *For definitions see notes in Annex B to Chapter 5.*
[2] *Excluding cyclical social security.*
[3] *Using GDP deflator 1992-93=100.*
[4] *Per cent.*

The main measures

Measures to help business and improve the supply side

- To **raise skills and improve educational standards**, more resources will go to education programmes to ensure record levels of participation in further and higher education, and a new apprenticeship scheme will be introduced for the training of young people. Spending on basic science and technology will be maintained in real terms.

- To **promote employment** and improve the working of the labour market, employers' national insurance contributions will be reduced by 1 per cent for employees earning less than £200 a week and 0·2 per cent for others. This should more than offset the cost to business of changes to statutory sick pay which will encourage employers to manage sickness absence better. There will also be measures to encourage people to find work, including help with childcare costs for low-income working families and a new Job Seekers Allowance.

- To **promote investment**, more private finance will be levered into capital projects. This will augment direct investment planned by the public sector averaging around £22 billion over the next three years.

- To **help business finances**, a new scheme will be introduced to relieve surplus advance corporation tax (ACT) on dividends paid from foreign income. The maximum real increase in business rates faced by businesses in transition to higher rates will be halved; other businesses face no real increase. The profits limits for the small companies' rate of corporation tax will be raised by 20 per cent. The Government will consult on measures to promote prompt payment by means of legislation for interest on late payment and a British Standard for prompt payment.

- To **cut the regulatory burden** on smaller businesses, the VAT registration threshold will be increased to £45,000, and statutory audit requirements will be abolished for companies with a turnover below £90,000.

- To **promote investment in growing firms**, a new Enterprise Investment Scheme will be introduced; the Government will consult on a Venture Capital Trust scheme; and CGT reliefs will be extended.

- More help will be given to **exporters** through increased export credit cover and lower premiums.

Measures to restrain public spending while redirecting resources to priority programmes

Spending is reduced by £3·8 billion in 1994-95 and £2·1 billion in 1995-96. By 1996-97, total spending is reduced by £4·4 billion as a result of the Budget measures, equivalent to ½ per cent of GDP. This is achieved in particular by:

– tough measures to **restrain public sector paybills and administration costs.** Provision for civil service running costs in the period 1994-95 to 1996-97 is frozen at broadly the 1993-94 level. A similar approach is applied to running costs in the rest of the public sector.

– measures to **restrain the growth of social security to a more affordable level** by reforming invalidity benefit and benefits paid to the unemployed, and making employers fully responsible for paying statutory sick pay with an exemption for small companies.

– **savings on defence, housing, transport and other programmes.**

Within the lower totals more resources will be given to priority programmes. In addition to the measures to boost wealth creation outlined above, the new plans provide extra resources for the Health Service in 1994-95 and allow for increases in real terms in each year of the Survey. A substantial package of extra help will be provided to pensioners and those on income-related benefits to meet the cost of extra fuel bills as a result of the introduction of VAT on fuel. The plans also fully protect the level of Home Office spending on law and order.

Measures to raise revenue in the medium term

The Budget includes a programme of revenue raising measures. The tax changes are designed to:

– **broaden the tax base**. Income tax allowances and the basic rate limit are unchanged for 1994-95. From April 1995 the value of the married couple's allowance will be restricted to 15 per cent and tax relief for mortgage interest payments will be reduced to 15 per cent. Most general insurance premiums will be taxed at a rate of 3 per cent. A duty will be charged on air passengers at a rate of £5 for flights to destinations within the EC, and £10 elsewhere. There are a number of measures to protect revenue and block tax avoidance schemes.

– **support health and environmental objectives**. Tax on road fuels will rise by 3 pence per litre and will be increased on average by at least 5 per cent a year in real terms in future Budgets. The tax on tobacco will rise by 11p on a packet of 20 cigarettes and on average by at least 3 per cent in real terms in future Budgets. VED on cars is raised by £5 to £130.

Table 1.5 The public finances in 1993-94 and 1994-95[1]

	£ billion	
	1993-94	1994-95
RECEIPTS		
Income tax	57·9	64·4
Corporation tax	14·7	17·6
Value added tax	38·7	43·1
Excise duties[2]	24·7	27·1
Other taxes[3]	38·6	41·2
Social security receipts	39·1	42·8
Other receipts	16·1	16·2
General government receipts	**229·7**	**252·4**

	£ billion	
	1993-94	1994-95
EXPENDITURE		
New control total	244·7	251·3
Cyclical social security	14·0	14·8
Central government debt interest	19·4	22·5
Accounting adjustments	8·0	8·8
General government expenditure excluding privatisation proceeds	**286·1**	**297·3**
Privatisation proceeds	-5·4	-5·5
General government expenditure	**280·7**	291·8

Expenditure, receipts and borrowing

	£ billion	
	1993-94	1994-95
General government expenditure	280·7	291·8
General government receipts	229·7	252·4
General government borrowing requirement	51·0	39·4
Public corporations' market and overseas borrowing	–1·2	–1·5
Public sector borrowing requirement	**49·8**	**37·9**

[1] *On a cash basis. See Annex to Chapter 6.*
[2] *Fuel, alcohol and tobacco duties.*
[3] *Includes council tax as well as other central government taxes.*

2 The Medium Term Financial Strategy

2.01 The overall objective of the Government's economic policy is to promote sustained economic growth and higher living standards. This chapter describes the role macroeconomic policy plays over the medium term in delivering that objective. It also sets out projections for the evolution of the economy and the public finances, taking account of the Government's new spending plans and the Budget tax proposals.

Economic policy over the medium term

2.02 Economic growth is generated by businesses and their employees, not by governments. But governments do have the responsibility for ensuring that markets work properly and that the regulatory and tax burden on business is kept to an absolute minimum.

2.03 The Government also has the essential task of establishing a macroeconomic framework which provides the stability that businesses need to plan for the future. Volatile inflation, unsustainable public finances and sharp fluctuations in economic activity are all undesirable. As a major trading economy the UK cannot hope to insulate itself from events abroad. But domestic policies which keep inflation down and stabilise the public finances create the right conditions for sustainable growth. Under the MTFS, the Government therefore directs monetary and fiscal policy towards two key objectives: low inflation on a permanent basis and sound public finances.

Monetary policy

2.04 It is the role of monetary policy to deliver low inflation. The aim is to keep underlying inflation (as measured by the RPI excluding mortgage interest payments) in the range 1 to 4 per cent and to bring it down to the lower half of this range by the end of the present Parliament.

2.05 However, monetary policy influences inflation with a lag. Interest rate decisions are therefore based on an assessment of the prospects for underlying inflation in one to two years time. That assessment is based on a range of monetary indicators and other data. The main monetary indicators are those described in the 1993-94 MTFS, in particular the growth of narrow and broad money and movements in the exchange rate and asset prices. Estimates of the extent of spare capacity in the economy and the overall stance of fiscal policy are also taken into account.

2.06 The medium-term monitoring ranges of 0 to 4 per cent for narrow money (M0) and 3 to 9 per cent for broad money (M4) are unchanged from those set in the 1993-94 MTFS. However, M0's monitoring range will remain under review, as there is still considerable uncertainty about the trend of M0 in relation to GDP.

2.07 Funding policy will continue on the basis set out in the 1993-94 MTFS, with sales of debt to banks and building societies from 1993-94 onwards counting as funding in the same way as sales of debt to other sectors. It was announced in March that sales of gilts to banks and building societies in 1992-93 – which were not at that stage counted as funding and totalled £6·8 billion – would be taken into account in implementing funding policy over the following two to three years. Funding operations so far this year have not made any use of this flexibility. But the Government's intention is that full account will be taken of it between now and the end of 1994-95, so that gilt sales will be some £6·8 billion lower than indicated by the normal operation of the full fund policy. This will help to ease the exceptional degree of cash shortage in the money markets, which has resulted in large part from the gilt sales to banks and building societies in 1992-93.

Fiscal policy

2.08 The objective of the Government's fiscal policy is to bring the PSBR back towards balance over the medium term, and in particular to ensure that when the economy is on trend the public sector borrows no more than is required to finance its net capital spending.

2.09 The public sector accounts now distinguish more clearly between current and capital spending and provide estimates of net capital spending and the public sector's current balance. In addition the Government believes that a steadily rising proportion of capital investment in the public services should be financed by private capital, based on a proper transfer or sharing of risk.

2.10 The direct effects of the tighter public expenditure ceilings and increases in tax revenues announced in the Budget will build up over time and will reduce the PSBR by some $1\frac{1}{4}$ per cent of GDP by 1996-97. But the pace at which the PSBR declines will also depend significantly on the growth of the economy over the medium term. On the basis of the main projections for activity and inflation the PSBR is expected to return steadily towards balance. By 1997-98 the current deficit is eliminated. By the end of the five year period covered by the MTFS the PSBR is broadly in balance.

The economy in the medium term

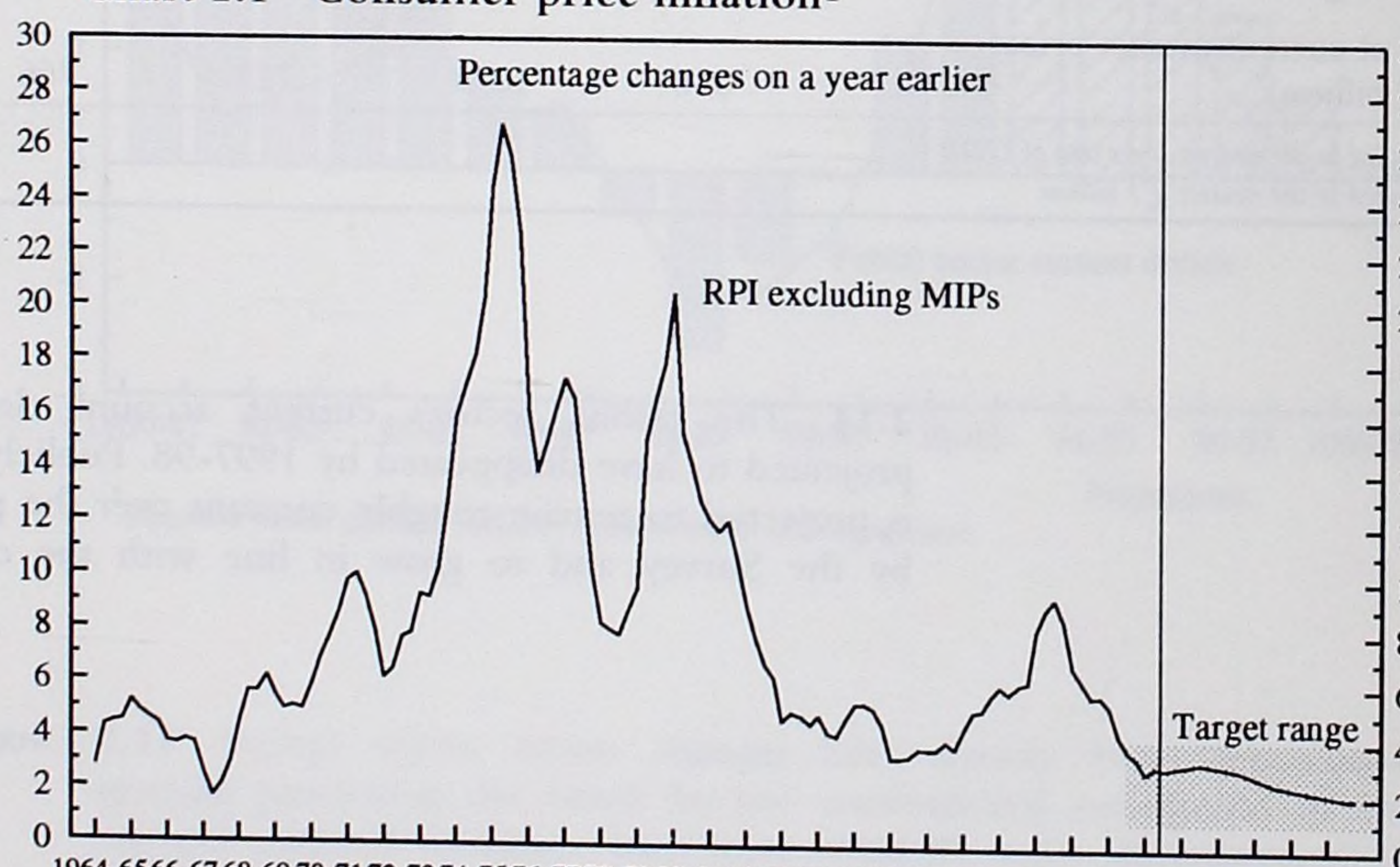
2.11 The main fiscal projections are based on the illustrative path of the economy shown in Table 2.1. Output growth averages around 3 per cent a year over the medium term, as the economy moves back toward trend. These growth assumptions are similar to the average of the projections made by the Panel of Independent Forecasters, and close to those in the March 1993 MTFS.

Table 2.1 Output growth and inflation[1]

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Real GDP						
Non-North Sea	1¾	2¼	2¾	3	3	3
Total	2	2½	2¾	3	3	3
Inflation						
RPI excluding MIPs[2]	3	3¼	3	2½	2¼	2
GDP deflator	3¼	4	3¾	2½	2¼	2
Money GDP	5½	6½	6¾	5¾	5¼	5

[1] *Percentage changes on previous financial year; forecasts for 1993-94 and 1994-95 and assumptions thereafter.*
[2] *Percentage change in year to 1993 Q4 and 1994 Q4; percentage change on previous financial year thereafter.*

Chart 2.1 Consumer price inflation[1]



[1] *Quarterly outturns until 1993Q3; forecast for 1993Q4 and 1994Q4; MTFS projections (financial year averages) thereafter.*

2.12 Spare capacity will continue to put downward pressure on inflation over the medium term and underlying inflation is projected to fall to the lower half of the Government's 1 to 4 per cent target range by 1996-97.

Fiscal projections

2.13 Projections of the public finances consistent with these assumptions about the economy are shown in Table 2.2. The PSBR is projected to fall rapidly over the next few years, and by 1998-99 it is broadly in balance. Details of the revenue and expenditure projections are set out below.

Table 2.2 Fiscal projections[1]

	Per cent of GDP					
	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
General government expenditure excluding privatisation proceeds	45	$43\frac{3}{4}$	$43\frac{1}{4}$	$42\frac{1}{2}$	$41\frac{3}{4}$	41
Privatisation proceeds	$\frac{3}{4}$	$\frac{3}{4}$	$\frac{1}{4}$	$\frac{1}{4}$	$\frac{1}{4}$	$\frac{1}{4}$
General government expenditure	44	43	$43\frac{1}{4}$	$42\frac{1}{4}$	$41\frac{1}{2}$	$40\frac{3}{4}$
General government receipts	36	$37\frac{1}{4}$	$38\frac{3}{4}$	$39\frac{1}{4}$	40	$40\frac{1}{4}$
Public corporations' market and overseas borrowing	$-\frac{1}{4}$	$-\frac{1}{4}$	$-\frac{1}{4}$	$-\frac{1}{4}$	$-\frac{1}{4}$	$-\frac{1}{4}$
PSBR[1]	**$7\frac{3}{4}$**	**$5\frac{1}{2}$**	**$4\frac{1}{4}$**	**$2\frac{3}{4}$**	**$1\frac{1}{2}$**	**$\frac{1}{4}$**
Memorandum items						
General government financial deficit	$8\frac{3}{4}$	$6\frac{1}{4}$	$4\frac{1}{2}$	3	$1\frac{3}{4}$	$\frac{1}{2}$
GDP at current market prices (£ billion)[2]	636	678	723	766	806	846

[1] *Rounded to the nearest $\frac{1}{4}$ per cent of GDP.*
[2] *Rounded to the nearest £1 billion.*

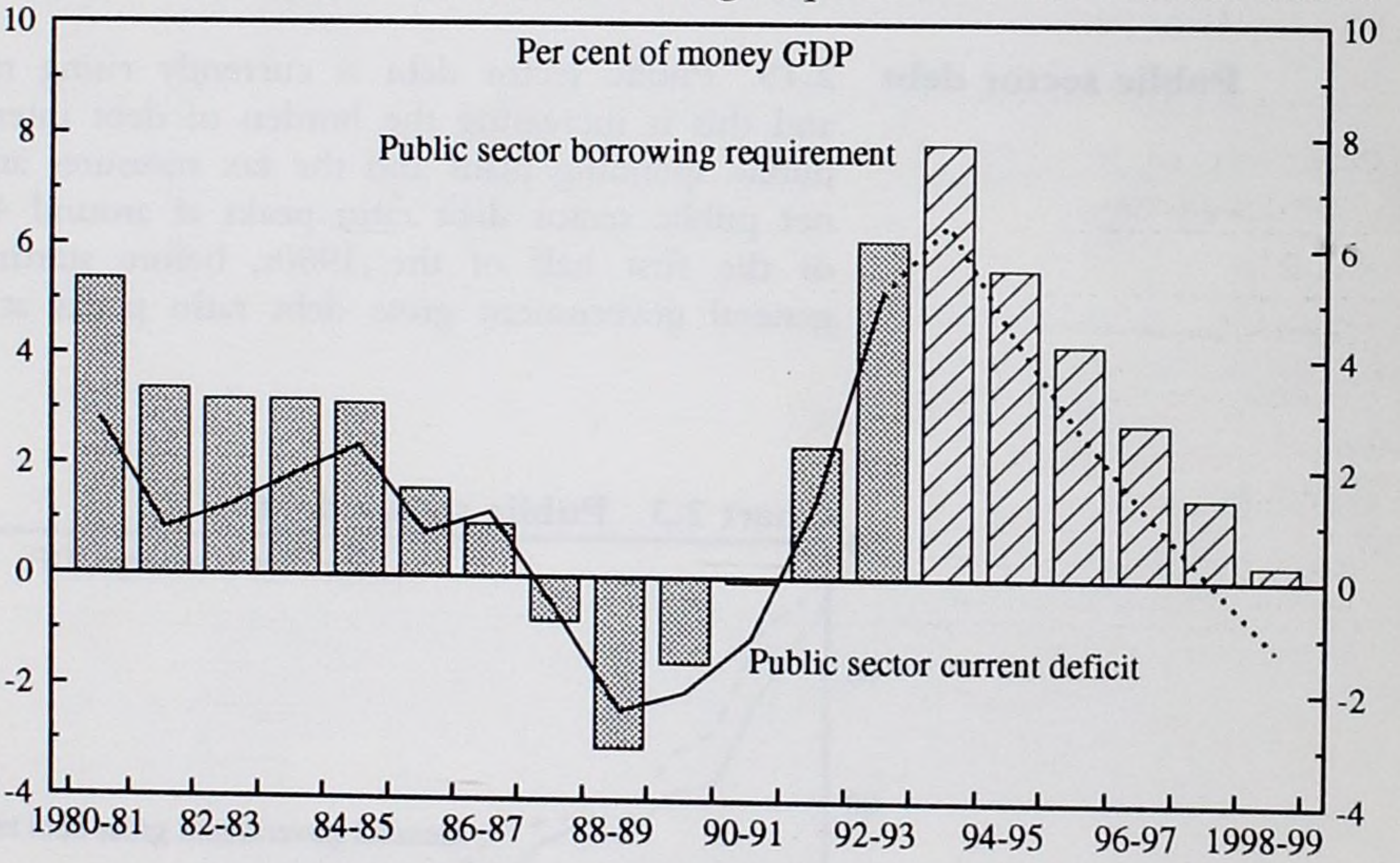
2.14 The public sector's current account deficit falls rapidly and is projected to have disappeared by 1997-98. Publicly financed capital spending is projected to remain roughly constant over the period to 1996-97 covered by the Survey, and to grow in line with the control total thereafter.

Table 2.3 Public sector capital spending and the public finances[1]

Per cent of GDP	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Current balance[2]	$-6\frac{1}{2}$	$-4\frac{1}{2}$	$-2\frac{3}{4}$	$-1\frac{1}{4}$	—	$1\frac{1}{4}$
Net capital spending[2,3]	$2\frac{1}{4}$	$1\frac{3}{4}$	$1\frac{1}{2}$	$1\frac{1}{2}$	$1\frac{1}{2}$	$1\frac{1}{2}$
Financial transactions[4]	$\frac{3}{4}$	$\frac{1}{2}$	—	—	—	—
PSBR	$7\frac{3}{4}$	$5\frac{1}{2}$	$4\frac{1}{4}$	$2\frac{3}{4}$	$1\frac{1}{2}$	$\frac{1}{4}$

[1] *Rounded to nearest $\frac{1}{4}$ per cent of GDP.*
[2] *An allowance for capital depreciation equivalent to roughly $1\frac{1}{2}$ per cent of GDP a year has been deducted from gross capital spending to derive net spending, and added to current expenditure.*
[3] *Includes capital grants to private sector net of receipts of capital transfers from private sector.*
[4] *Includes privatisation proceeds.*

Chart 2.2 Public sector borrowing requirement and current deficit[1]



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

Revenue **2.15** Except where future changes have already been announced, the revenue projections are based on the conventional assumption of constant tax and national insurance rates from 1994-95, with allowances, thresholds and specific duties indexed on the usual formulae. All proposed Budget changes are taken into account.

2.16 The ratio of general government receipts (GGR) to GDP is projected to rise as the economy recovers and the tax increases announced in March and in this Budget are implemented. The cyclical downswing of the early 1990s reduced the GGR ratio significantly. For example, the share of mainstream corporation tax in GDP has halved over the past four years, largely because of the recession-induced fall in taxable profits. But this should be reversed in the upswing, albeit gradually given the lags in tax collection and assessment.

Public expenditure

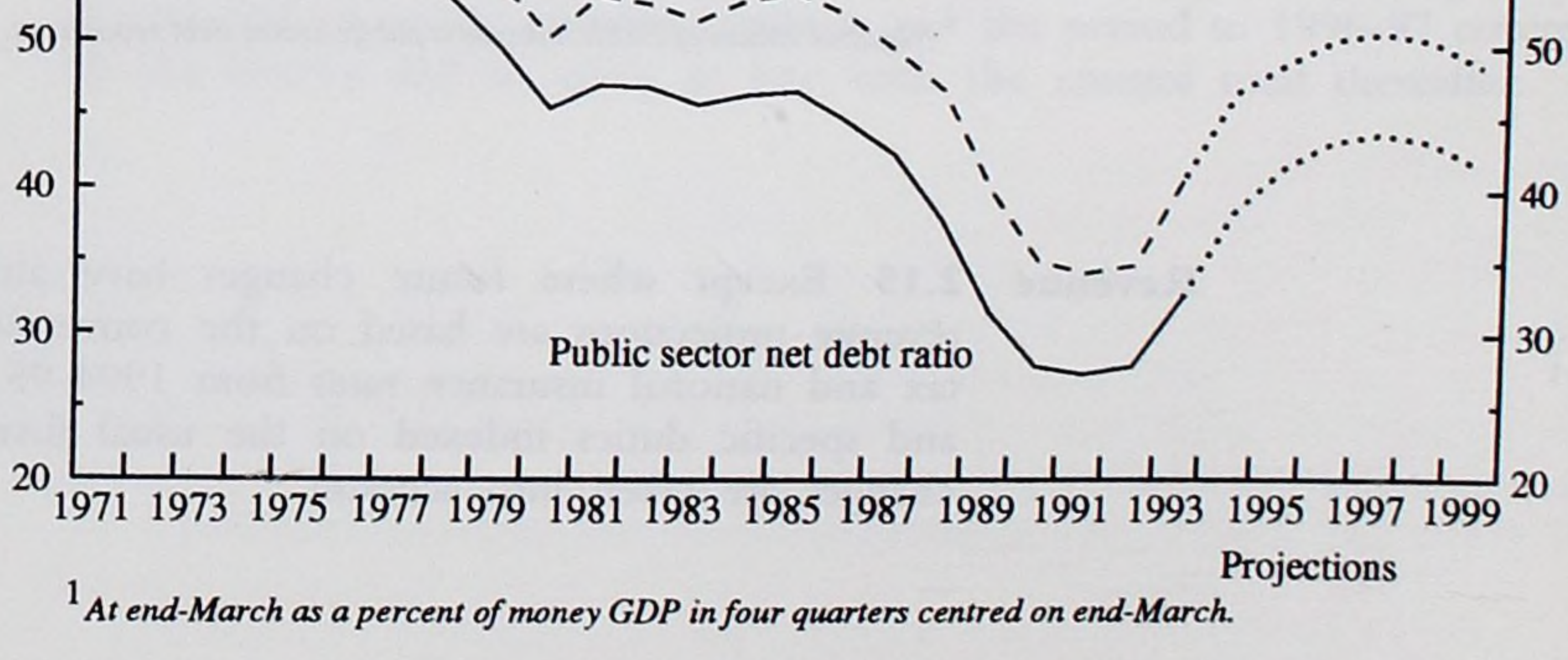
2.17 The Government's public expenditure plans for the period to 1996-97 are set out in detail in Chapter 5. In 1997-98 and 1998-99 the new control total is assumed to grow by 1 per cent a year in real terms.

2.18 The ratio of general government expenditure (GGE), excluding privatisation proceeds, to GDP was on a downward trend for much of the 1980s. In recent years, the impact of the recession has caused it to rise. The new plans will reduce the GGE ratio from 1994-95 onwards.

Public sector debt

2.19 Public sector debt is currently rising rapidly as a percent of GDP and this is increasing the burden of debt interest payments. With the new public spending plans and the tax measures announced in the Budget, the net public sector debt ratio peaks at around 44 per cent, below the levels of the first half of the 1980s, before starting to fall in 1997-98. The general government gross debt ratio peaks at about 51 per cent.

Chart 2.3 Public sector debt[1]



[1] *At end-March as a percent of money GDP in four quarters centred on end-March.*

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FSBR

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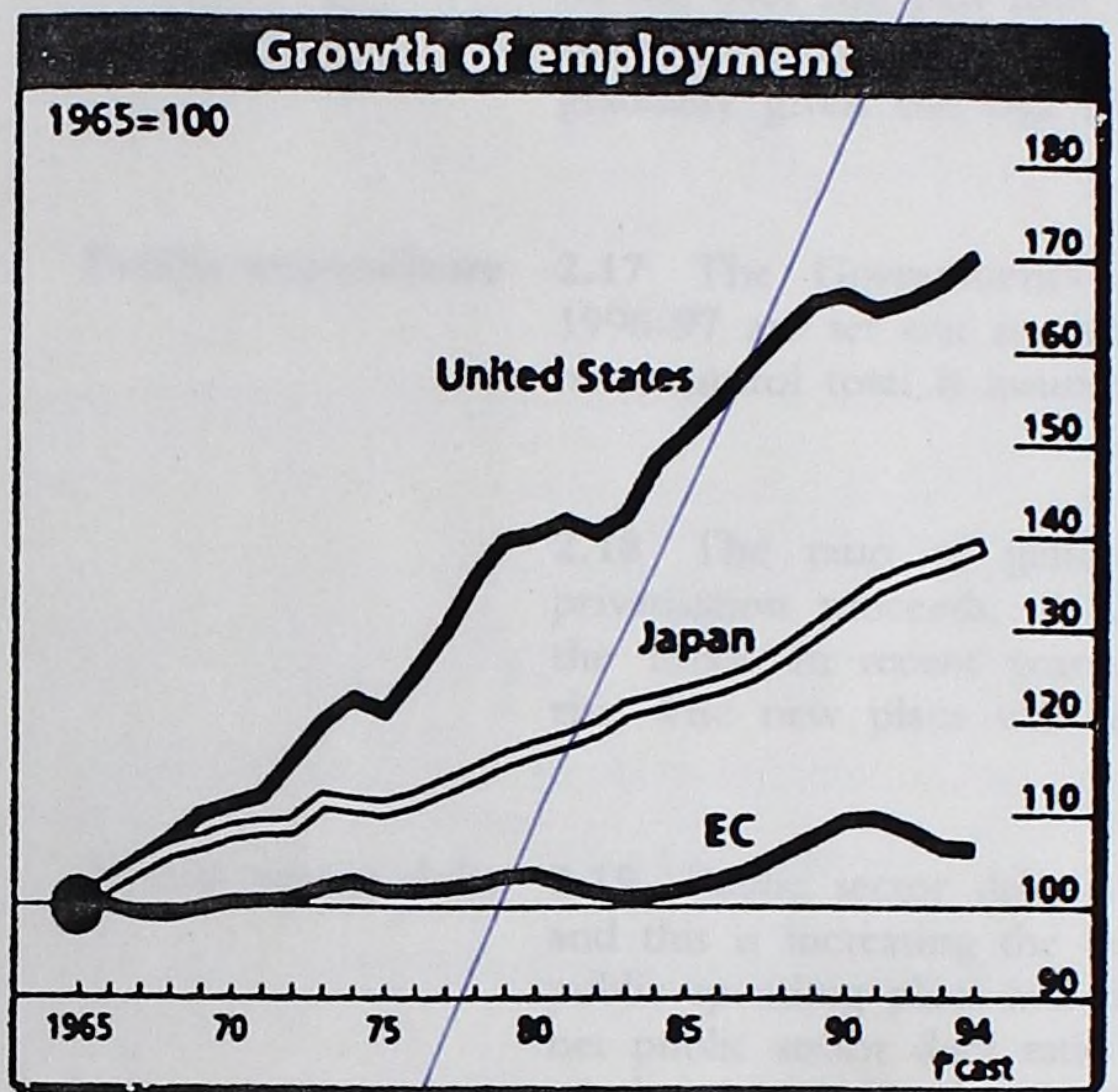
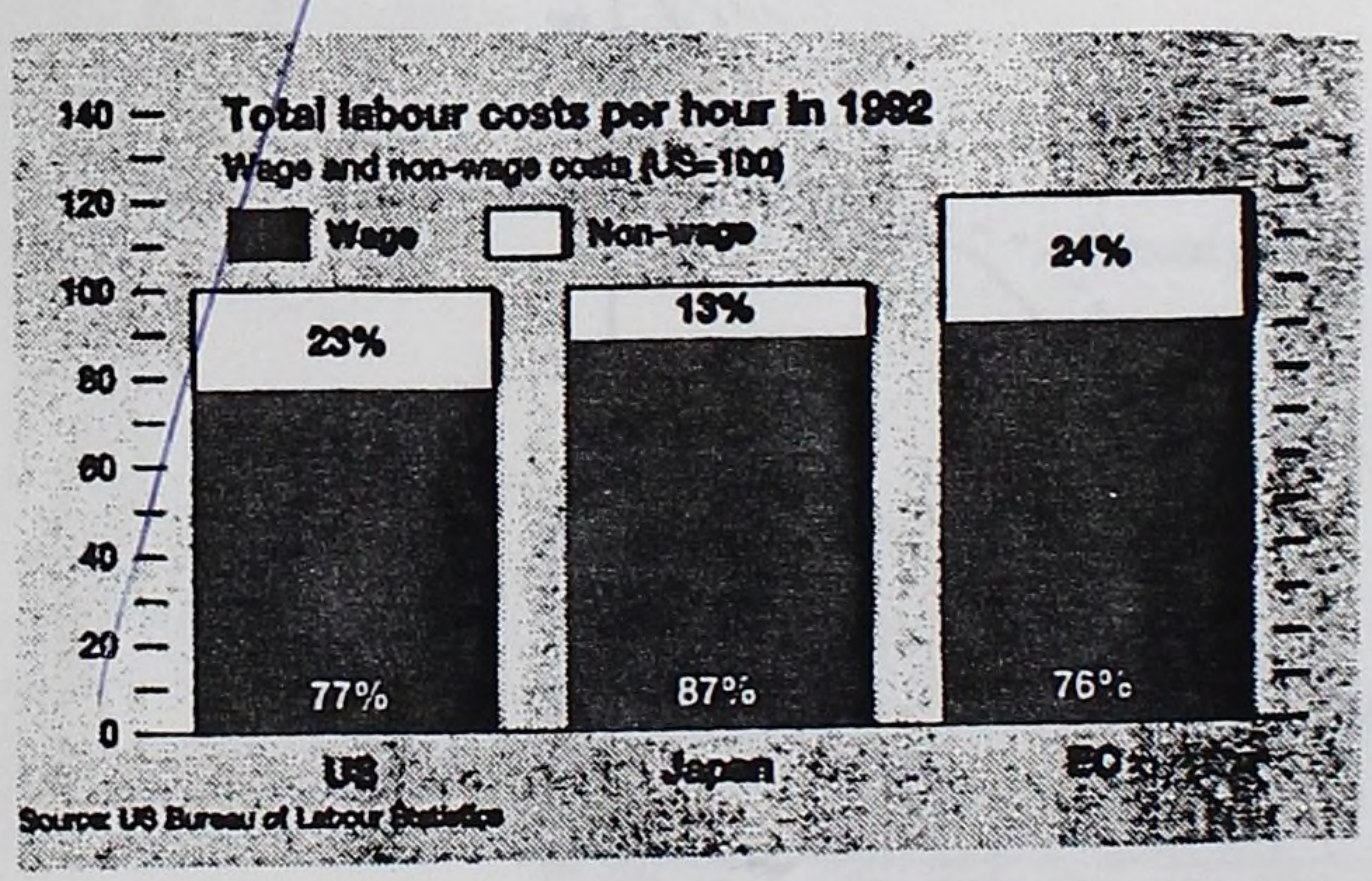
increasing attention. This next sections will concentrate on a number of these issues by referring to both economic theory and the stylised facts.

Chart 1



Source: OECD

Chart 2



Alternative projections

2.20 There are inevitably uncertainties about medium-term prospects. Given the present margin of spare capacity, growth could be stronger for a period without generating inflationary pressures. On the other hand, a weaker than expected world economy could hold back the pace of recovery.

2.21 The growth rate of output has a significant impact on the PSBR in the absence of any offsetting policy changes. The two variants shown in Table 2.4 are used to illustrate this sensitivity. The growth rates differ from the main projection by $\frac{1}{2}$ per cent in either direction from 1994-95.

Table 2.4 Variant growth assumptions[1]

	1994-95	1995-96	1996-97	1997-98	1998-99
Higher growth	$2\frac{3}{4}$	$3\frac{1}{4}$	$3\frac{1}{2}$	$3\frac{1}{2}$	$3\frac{1}{2}$
Lower growth	$1\frac{3}{4}$	$2\frac{1}{4}$	$2\frac{1}{2}$	$2\frac{1}{2}$	$2\frac{1}{2}$

[1] *Non- oil GDP.*

2.22 Table 2.5 shows the path of the PSBR in these alternative projections. Public expenditure within the new control total is unchanged, but cyclical social security and debt interest payments are allowed to vary. Tax rates, allowances and thresholds are kept at the same levels as in the main projection.

2.23 With higher output growth a significant budget surplus re-emerges by the end of the MTFS period. Even if growth does not pick up so strongly, the PSBR will fall significantly from current levels.

Table 2.5 Variant PSBR projections

	per cent of GDP				
	1994-95	1995-96	1996-97	1997-98	1998-99
Higher growth	$5\frac{1}{4}$	$3\frac{1}{2}$	$1\frac{3}{4}$	—	$-1\frac{1}{2}$
Lower growth	$5\frac{3}{4}$	$4\frac{3}{4}$	$3\frac{3}{4}$	$2\frac{3}{4}$	2

Annex to Chapter 2
Details of the fiscal projections

2A.1 This Annex provides tables setting out the medium-term fiscal projections in more detail and summarises the changes from the projections in the March 1993 MTFS.

Table 2A.1 General government expenditure (excluding privatisation proceeds) as a percent of money GDP[1,2]

1965-66	37¾	1977-78	43¼	1989-90	39¾
1966-67	39½	1978-79	44	1990-91	40¼
1967-68	43¼	1979-80	44	1991-92	42¼
1968-69	41½	1980-81	46½	1992-93	44¾
1969-70	41	1981-82	47¼		
1970-71	41¼	1982-83	47½	1993-94	45
1971-72	41¾	1983-84	46½	1994-95	43¾
1972-73	41½	1984-85	46¾	1995-96	43¼
1973-74	43½	1985-86	45	1996-97	42½
1974-75	48¾	1986-87	44	1997-98	41¾
1975-76	49¼	1987-88	41¾	1998-99	41
1976-77	46¾	1988-89	39¼		

[1] *1993-94: latest estimate; 1994-95: forecast; 1995-96 onwards: MTFS projections.*
[2] *Based on money GDP figures adjusted for the years before 1990-91 to remove the distortion caused by the abolition of domestic rates.*

Table 2A.2 Non-North Sea taxes, social security contributions and the community charge as a percent of non-North Sea money GDP[1,2,3]

1965-66	31¾	1977-78	35½	1989-90	37
1966-67	32½	1978-79	34¾	1990-91	37
1967-68	34	1979-80	35½	1991-92	36¾
1968-69	35¾	1980-81	36½	1992-93	35
1969-70	37½	1981-82	39¼		
1970-71	37	1982-83	38½	1993-94	34¼
1971-72	35¼	1983-84	38¼	1994-95	35½
1972-73	33	1984-85	38¼	1995-96	37
1973-74	33¾	1985-86	37¼	1996-97	37½
1974-75	36¼	1986-87	37¾	1997-98	38
1975-76	36¾	1987-88	38	1998-99	38½
1976-77	36½	1988-89	37¼		

[1] *1993-94: latest estimate; 1994-95: forecast; 1995-96 onwards: MTFS projections.*
[2] *Based on money GDP figures adjusted for the years before 1990-91 to remove the distortion caused by the abolition of domestic rates.*
[3] *Including the council tax from 1993-94, when it replaced the community charge.*

Table 2A.3 General government expenditure[1]

	£ billion						
	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
New control total	232·3	244½	251½	263	272½	281	289½
Cyclical social security	13·2	14	15	15½	16	17	18
Central government debt interest	17·4	19½	22½	24½	25½	26½	27
Accounting adjustments	6·3	8	9	10	11	11½	12
Total general government expenditure[2,3] excluding privatisation proceeds	**269·2**	**286**	**297½**	**313**	**325**	**336**	**346**
Privatisation proceeds	8·1	5½	5½	1	1	1	1
Total general government expenditure	**261·1**	**280½**	**292**	**312**	**324**	**335**	**345**

[1]*For 1992-93 to 1996-97 the figures are taken from Chapter 5. The new control total is assumed to grow by 1 per cent a year in real terms in 1997-98 and 1998-99.*

[2]*From 1993-94 onwards general government expenditure and its components are rounded to the nearest £½ billion.*

[3]*Figures include general government debt interest payments of:*

1992-93	*18·0*	*1996-97*	*26*
1993-94	*20*	*1997-98*	*26½*
1994-95	*23*	*1998-99*	*27*
1995-96	*25*		

Table 2A.4 General government receipts[1]

	£ billion						
	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Taxes on income, expenditure and capital[2]	171·4	176	196	220	237	254	271
Social security contributions	37·4	39	43	46	49	52	54
Interest and dividends	5·0	6	5	5	5	6	6
Other receipts	9·6	9	8	9	10	10	10
General government receipts[3,4]	**223·3**	**230**	**252**	**280**	**301**	**322**	**341**

[1]*Taxes and social security contributions are measured on an accruals basis. Accruals adjustments are included in other receipts. Thus total government receipts are measured on a cash basis.*

[2]*Includes the community charge/council tax.*

[3]*General government receipts, and its components, are rounded to the nearest £1 billion from 1993-94 onwards.*

[4]*Including North Sea revenues as follows (£ billion):*

1992-93	*1·3*	*1996-97*	*3*
1993-94	*1½*	*1997-98*	*3*
1994-95	*2*	*1998-99*	*4*
1995-96	*3*		

Table 2A.5 Public sector borrowing requirement[1]

	£ billion						
	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
General government expenditure	261·1	281	292	312	324	335	345
General government receipts	223·3	230	252	280	301	322	341
General government borrowing requirement	37·8	51	39	32	23	14	4
Public corporations' market and overseas borrowing	−1·1	−1	−1	−2	−2	−2	−2
PSBR	**36·7**	**50**	**38**	**30**	**21**	**12**	**2**
Money GDP	602·5	636	678	723	766	806	846
PSBR as percent of money GDP	**6·1**	**7¾**	**5½**	**4¼**	**2¾**	**1½**	**¼**

[1]*Rounded to nearest £1 billion from 1993-94 onwards.*

Changes since the March 1993 MTFS

Output and inflation

2A.2 There have been some modest changes to the outturns and short-term forecasts for output and GDP deflator inflation as a result of data revisions (including rebasing the national accounts to 1990 prices) and slightly stronger growth than forecast over the last three quarters. There are no substantive changes to the medium-term projections published in the March 1993 MTFS.

Table 2A.6 Output and inflation

	Percentage differences from March 1993 MTFS projections				
	1993-94	1994-95	1995-96	1996-97	1997-98
Real GDP growth:					
Non-North Sea	¼	—	—	—	—
Total	—	—	—	¼	¼
Inflation:					
GDP Deflator	½	−¼	—	—	¼
Money GDP growth	¾	−½	¼	¼	½

Fiscal projections **2A.3** Table 2A.7 shows changes to the fiscal projections since the March 1993 FSBR. More detail on 1992-93 to 1994-95 is given in chapter 6.

Table 2A.7 Revenue and expenditure[1]

	Changes from March 1993 MTFS projections, £ billion				
	1993-94	1994-95	1995-96	1996-97	1997-98
Expenditure					
New control total	$-\frac{1}{2}$	$-3\frac{1}{2}$	$-1\frac{1}{2}$	−3	−4
Other	$-\frac{1}{2}$	−2	−2	−3	−4
General government expenditure	**−1**	**$-5\frac{1}{2}$**	**$-3\frac{1}{2}$**	**−6**	**$-7\frac{1}{2}$**
Receipts[2]					
Taxes and contributions[3]	$-\frac{1}{2}$	2	5	$7\frac{1}{2}$	11
Other[4]	—	$-1\frac{1}{2}$	$-\frac{1}{2}$	−1	$-1\frac{1}{2}$
General government receipts	**−1**	**—**	**$4\frac{1}{2}$**	**$6\frac{1}{2}$**	**$9\frac{1}{2}$**
Public corporations' market and overseas borrowing	—	$-\frac{1}{2}$	$-\frac{1}{2}$	−1	−1
PSBR	**$-\frac{1}{2}$**	**$-6\frac{1}{2}$**	**−8**	**−13**	**−18**

1 *Rounded to the nearest £$\frac{1}{2}$ billion, figures adjust for the change in the classification of the fossil fuel levy.*
2 *Using the same measurement conventions as Table 2A.4: see footnote to that table.*
3 *Includes social security contributions and the community charge/council tax.*
4 *Includes debt interest receipts and other items.*

Expenditure **2A.4** The changes mostly reflect the new public spending plans to 1996-97, which are discussed in detail in Chapter 5 and changes to debt interest. Real growth in the new control total in 1997-98 is now assumed to be 1 rather than $1\frac{1}{2}$ per cent a year.

Receipts **2A.5** The changes to the forecast of receipts in 1993-94 are discussed in Chapter 6. The changes to 1994-95 and subsequent years mostly reflect the tax decisions announced in this Budget, though there have also been estimating changes which have tended to reduce receipts in 1994-95.

3 The economy: recent developments and prospects

Summary

World economy **3.01** G7 growth slowed in the first half of 1993 and is forecast to be only 1 per cent in the year as a whole. Faster, but still modest, growth is projected for 1994. Inflation in the major countries is forecast to continue falling.

UK activity **3.02** In the UK, growth has been stronger than expected at the time of the March Budget and is now forecast to be $1\frac{3}{4}$ per cent in 1993. The forecast for 1994 is an increase in GDP of $2\frac{1}{2}$ per cent, slightly below the average of the forecasts from the Panel of Independent Forecasters.

Inflation **3.03** Underlying RPI inflation has been lower than forecast in the March Budget. It is likely to rise in the first half of 1994 because of the short-run impact of tax changes. But it is forecast to remain within the Government's 1 to 4 per cent target range and to fall back to $3\frac{1}{4}$ per cent by the end of the year. The average forecast from the Independent Panel is marginally lower.

Labour market **3.04** Unemployment has fallen 137,000 since the beginning of the year and is now below 2·9 million. This is a much better outcome than generally expected.

Current account **3.05** The current account deficit in 1992 has been revised down to £$8\frac{1}{2}$ billion, with the invisible surplus stronger than in recent years. Despite a fallback in the invisible surplus and stronger growth in the UK than in continental Europe, our main export market, the current account deficit is expected to increase only slightly in 1993. It is forecast to be £$9\frac{1}{2}$ billion in both 1993 and 1994.

Financial developments **3.06** The sterling index has been fairly steady this year. Long-term interest rates have fallen significantly reflecting lower inflation expectations.

Public finances **3.07** The PSBR in the current financial year is expected to be very close to the £50 billion forecast in March. As a result of Budget measures and economic recovery it is forecast to fall to £38 billion in 1994-95.

Forecast assumptions **3.08** The forecast is based on the conventional assumption that sterling remains close to recent levels. Oil prices are assumed to average $17 a barrel.

Table 3.1 Comparison of Treasury and Independent Panel[1] forecasts

Percentage changes on a year earlier unless otherwise stated

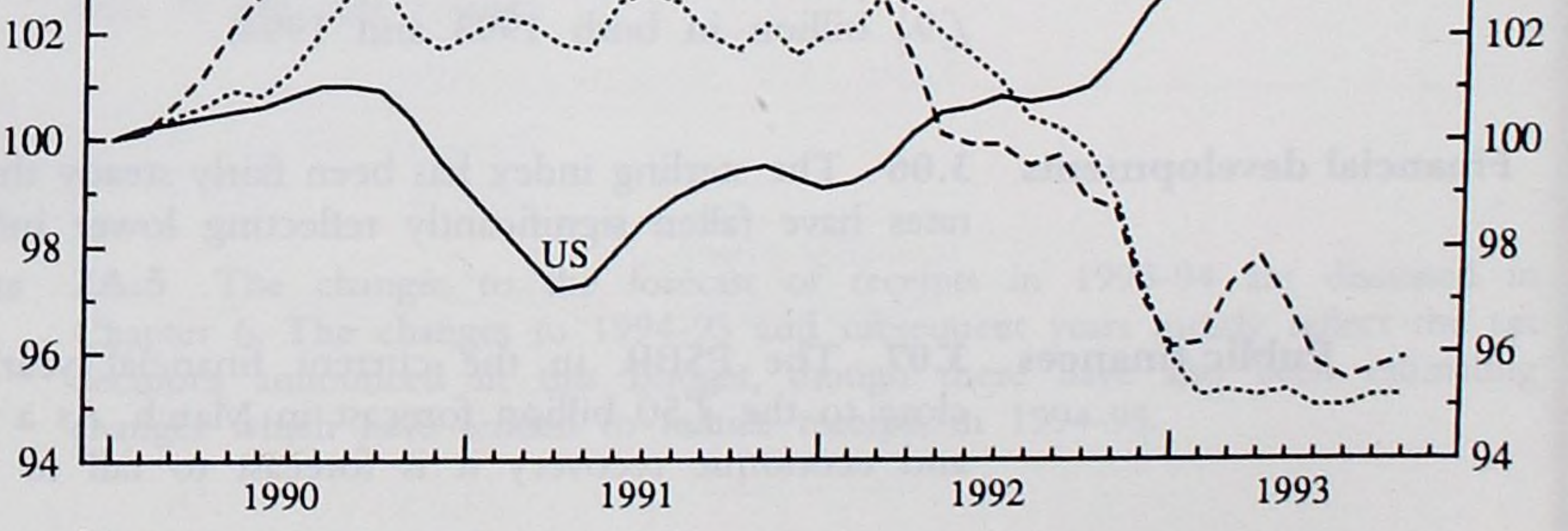
	1993			1994		
	Treasury	Independent Panel		Treasury	Independent Panel	
		Average	Range		Average	Range
Gross domestic product	$1\frac{3}{4}$	$1\frac{3}{4}$	$1\frac{1}{4}$ to 2	$2\frac{1}{2}$	$2\frac{3}{4}$	$1\frac{1}{2}$ to $3\frac{1}{4}$
RPI excluding mortgage interest payments (fourth quarter)	3	$3\frac{1}{4}$	$2\frac{3}{4}$ to $3\frac{1}{2}$	$3\frac{1}{4}$	3	$1\frac{1}{2}$ to $4\frac{1}{2}$
Current account (£ billion)	$-9\frac{1}{2}$	$-12\frac{1}{2}$	-16 to $-10\frac{1}{2}$	$-9\frac{1}{2}$	$-14\frac{1}{2}$	$-19\frac{1}{2}$ to $-7\frac{1}{2}$
PSBR (financial year, £ billion)	50	46	42 to 49	38	36	24 to 41

[1] *Submitted to the Chancellor of the Exchequer on 18 October; see annex for further details.*

World economy

Recent developments 3.09 The pick-up in world economic growth which most forecasters were predicting around the time of the March Budget has been slow to materialise. Growth in the US in the first half of the year was less than forecast, though it seems to have recovered strongly in the second half. Japanese GDP and industrial production fell again in the second quarter. And although activity in continental Europe may have stabilised there are few clear signs of recovery; confidence remains at a low level in most European countries.

Chart 3.1 Industrial production

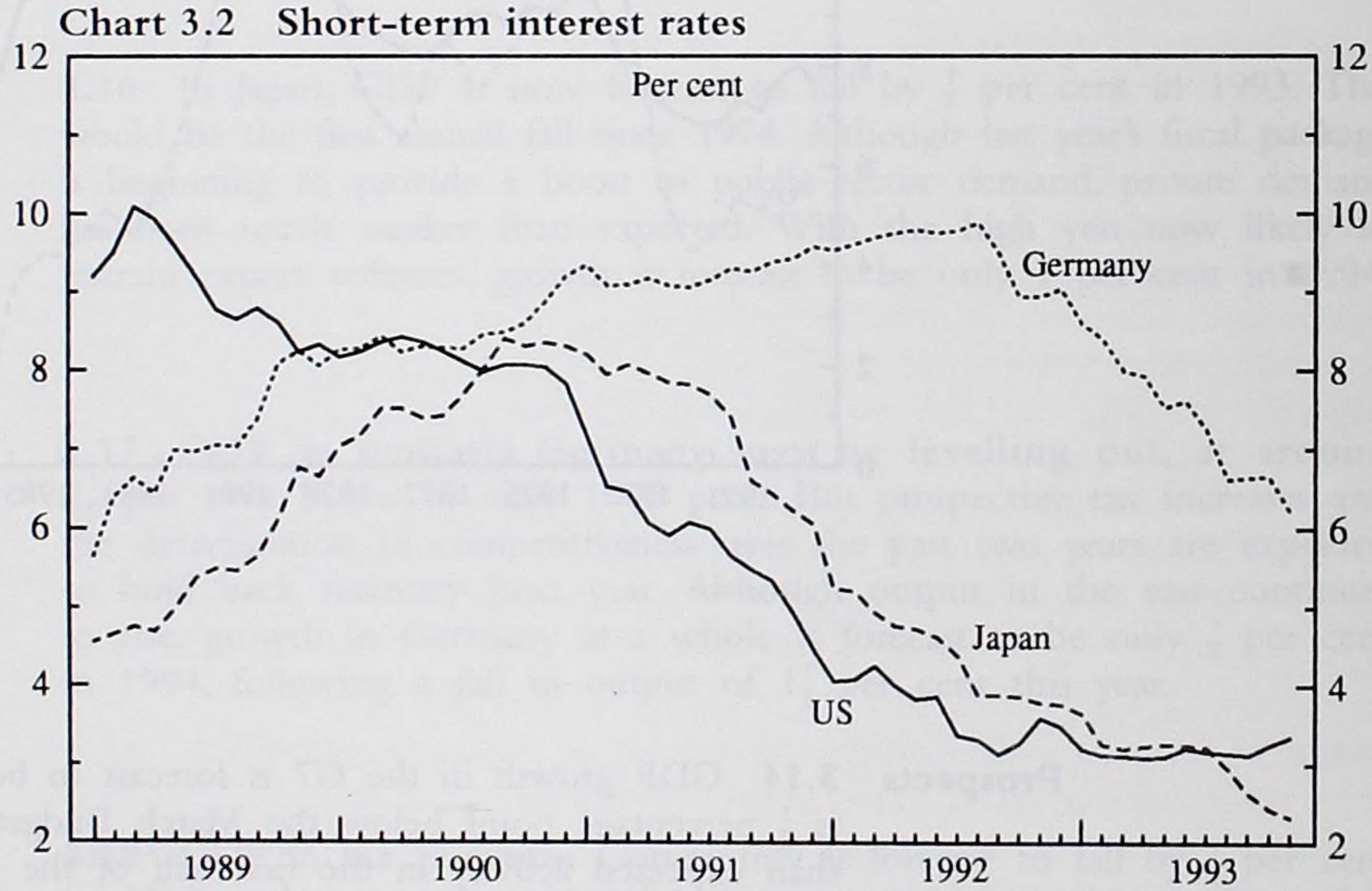


[1] *Western Germany, France, Italy.*

3.10 For the major seven countries (G7) as a whole, industrial production stopped falling towards the end of 1992, but there has been little recovery yet; weakness in Japan and continental Europe has largely offset rises in the US. GDP growth in the G7 between the second half of 1992 and the first half of 1993 slowed to under 1 per cent at an annual rate, compared with growth of $1\frac{3}{4}$ per cent in 1992.

3.11 Against this background, policy has remained expansionary in the US, and there has been a steady easing in continental Europe and Japan. US short-term interest rates have been around 3 per cent for over a year, consistent with a real interest rate close to zero. In Japan the official discount rate has been cut to a record low of $1\frac{3}{4}$ per cent, and the government has introduced a further stimulatory fiscal package – the third in just over a year. In continental Europe, however, despite reductions in nominal rates, real interest rates remain higher than usual at a cyclical trough. Fiscal deficits in Europe have risen sharply, partly as a result of the recession.

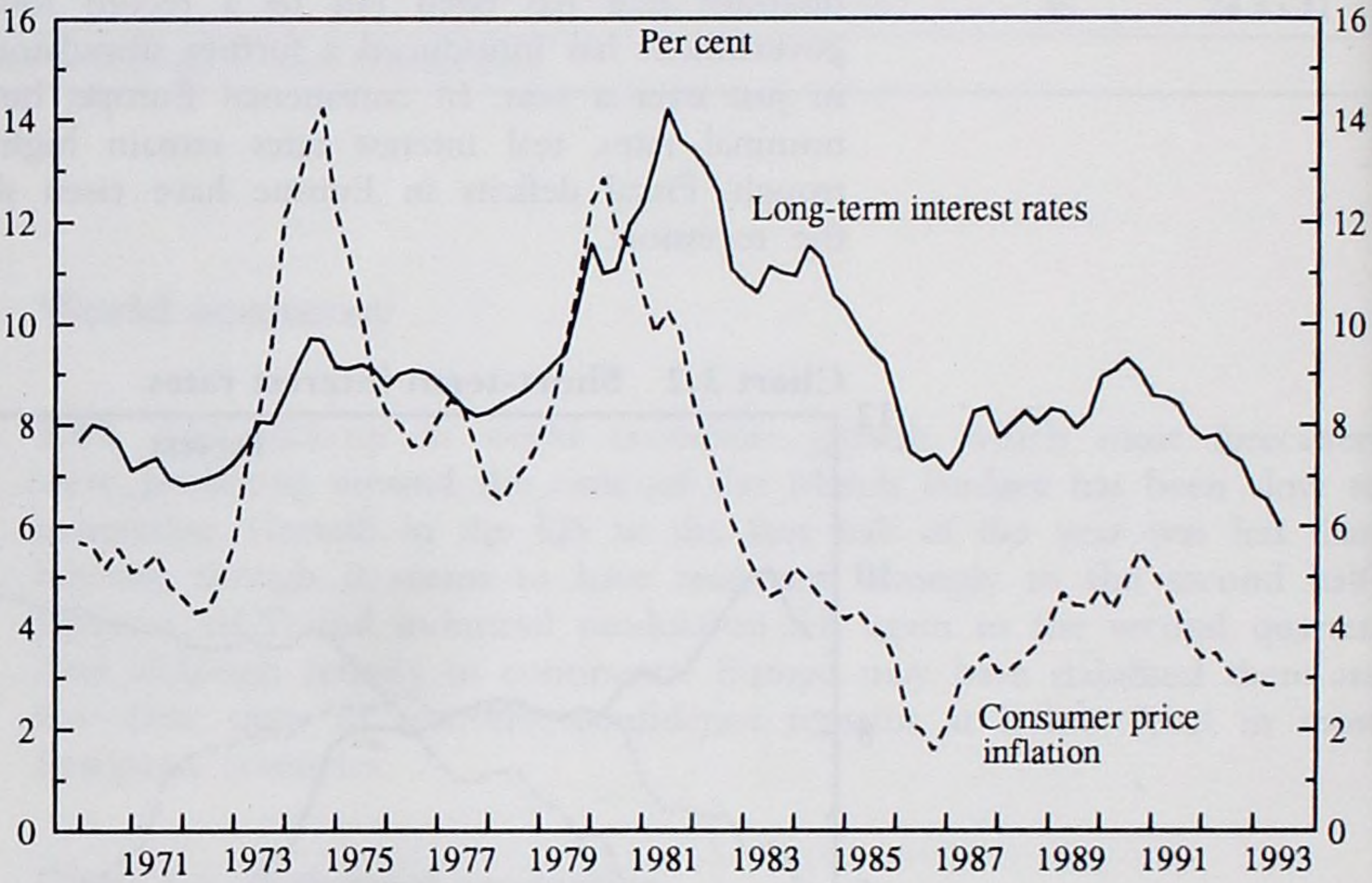
Chart 3.2 Short-term interest rates



3.12 Weak activity in the major countries has kept non-oil commodity prices close to their lowest level in real terms since the early 1970s. The Brent oil price has fallen since the spring, dropping below \$15 a barrel towards the end of November, compared with over \$18 in the first half of the year. It has averaged just under $\$16\frac{1}{2}$ a barrel in the last three months and is assumed to average \$17 a barrel during the forecast period.

3.13 Low commodity prices have contributed to a continued easing of inflationary pressure in the major countries. Since the beginning of the year consumer price inflation has fallen $\frac{3}{4}$ per cent in Germany and $\frac{1}{2}$ per cent in the US, and has been steady at historically low levels in France and Italy. In Japan, inflation fell below 1 per cent in the early summer before rising again as poor weather temporarily boosted food prices. Weak inflationary pressures and falling inflation expectations have contributed to a rally in world bond markets, taking long-term interest rates down to their lowest levels since the late 1960s.

Chart 3.3 Long-term interest rates and inflation in G7 countries



Prospects **3.14** GDP growth in the G7 is forecast to be 1 per cent in 1993. This is $\frac{1}{2}$ percentage point below the March Budget forecast, reflecting weaker than expected activity in the first half of the year and only patchy signs of recovery in the second half. Growth is forecast to rise to 2 per cent in 1994, but with recovery still some way off in Japan and continental Europe, marked differences between the growth rates of individual countries are likely to persist.

3.15 In the United States, growth of around $2\frac{3}{4}$ per cent is forecast for 1993 and 1994, close to the rate in 1992. This continues the pattern of fairly modest recovery since the trough in early 1991. Following substantial upward revisions to past GDP data, the recent US recession looks to have been one of the shallowest since the war, implying less scope for the very rapid growth rates recorded in previous recoveries.

Table 3.2 World economy

	Percentage changes on a year earlier			
		Forecast		
	1992	1993	1994	1995 H1
Major seven countries[1]				
Real GDP	$1\frac{3}{4}$	1	2	$2\frac{1}{2}$
Domestic demand	$1\frac{3}{4}$	1	2	$2\frac{3}{4}$
Industrial production	$-\frac{3}{4}$	0	$2\frac{1}{2}$	$3\frac{1}{2}$
Consumer price inflation[2]	$2\frac{3}{4}$	$2\frac{3}{4}$	$2\frac{1}{2}$	$2\frac{1}{4}$
World trade in manufactures	5	$2\frac{3}{4}$	$5\frac{1}{4}$	$6\frac{1}{2}$
UK export markets[3]	4	$1\frac{1}{4}$	$4\frac{1}{4}$	$5\frac{3}{4}$

[1] *G7: US, Japan, Germany, France, UK, Italy and Canada.*
[2] *Final quarter of each period. For UK, RPI excluding mortgage interest payments.*
[3] *Other countries' imports of manufactures weighted according to their importance in UK exports.*

3.16 In Japan, GDP is now forecast to fall by $\frac{1}{4}$ per cent in 1993. This would be the first annual fall since 1974. Although last year's fiscal package is beginning to provide a boost to public sector demand, private demand has been much weaker than expected. With the high yen now likely to restrain export volumes, growth is forecast to be only 1 per cent in 1994.

3.17 GDP in western Germany may be levelling out, at around $2\frac{1}{2}$ per cent below its early 1992 peak. But prospective tax increases and the deterioration in competitiveness over the past two years are expected to hold back recovery next year. Although output in the east continues to rise, growth in Germany as a whole is forecast to be only $\frac{3}{4}$ per cent in 1994, following a fall in output of $1\frac{1}{2}$ per cent this year.

3.18 GDP in the European Community is forecast to fall by $\frac{1}{2}$ per cent in 1993, and recover by only $1\frac{1}{4}$ per cent in 1994, similar to the recent Commission forecast. Unemployment in the European Community has risen from $8\frac{1}{2}$ per cent in 1990 to $10\frac{3}{4}$ per cent. Growth in 1994 is unlikely to be sufficient to prevent further increases in unemployment over the next year.

3.19 Low commodity prices and spare capacity in G7 countries should continue to exert downward pressure on inflation. Consumer price inflation in the G7 is forecast to fall from its current level of $2\frac{3}{4}$ per cent to $2\frac{1}{2}$ per cent by the fourth quarter of 1994 and $2\frac{1}{4}$ per cent by mid-1995. The largest fall is likely to be in Germany where inflation – currently second highest in the G7 – is forecast to be below $2\frac{1}{2}$ per cent by the first half of 1995.

3.20 Growth of world trade in manufactures is forecast to slow from 5 per cent in 1992 to $2\frac{3}{4}$ per cent in 1993, as a result of the slowdown in continental Europe and Japan. Growth elsewhere in East Asia and in Latin American countries has remained buoyant, and imports to the US have been surprisingly strong. But in Europe – the UK's main export market – weak domestic demand appears to have depressed imports severely (although trade volumes may have been distorted by the introduction of Intrastat, the new system for recording intra-European Community trade). As a result, UK export markets are forecast to grow by only $1\frac{1}{4}$ per cent this year, $1\frac{1}{2}$ percentage points less than world trade. With faster growth in the industrialised countries, growth of world trade is forecast to be stronger in 1994 than in 1993, at around $5\frac{1}{4}$ per cent. Growth of UK export markets is also expected to increase but to remain below that of world trade.

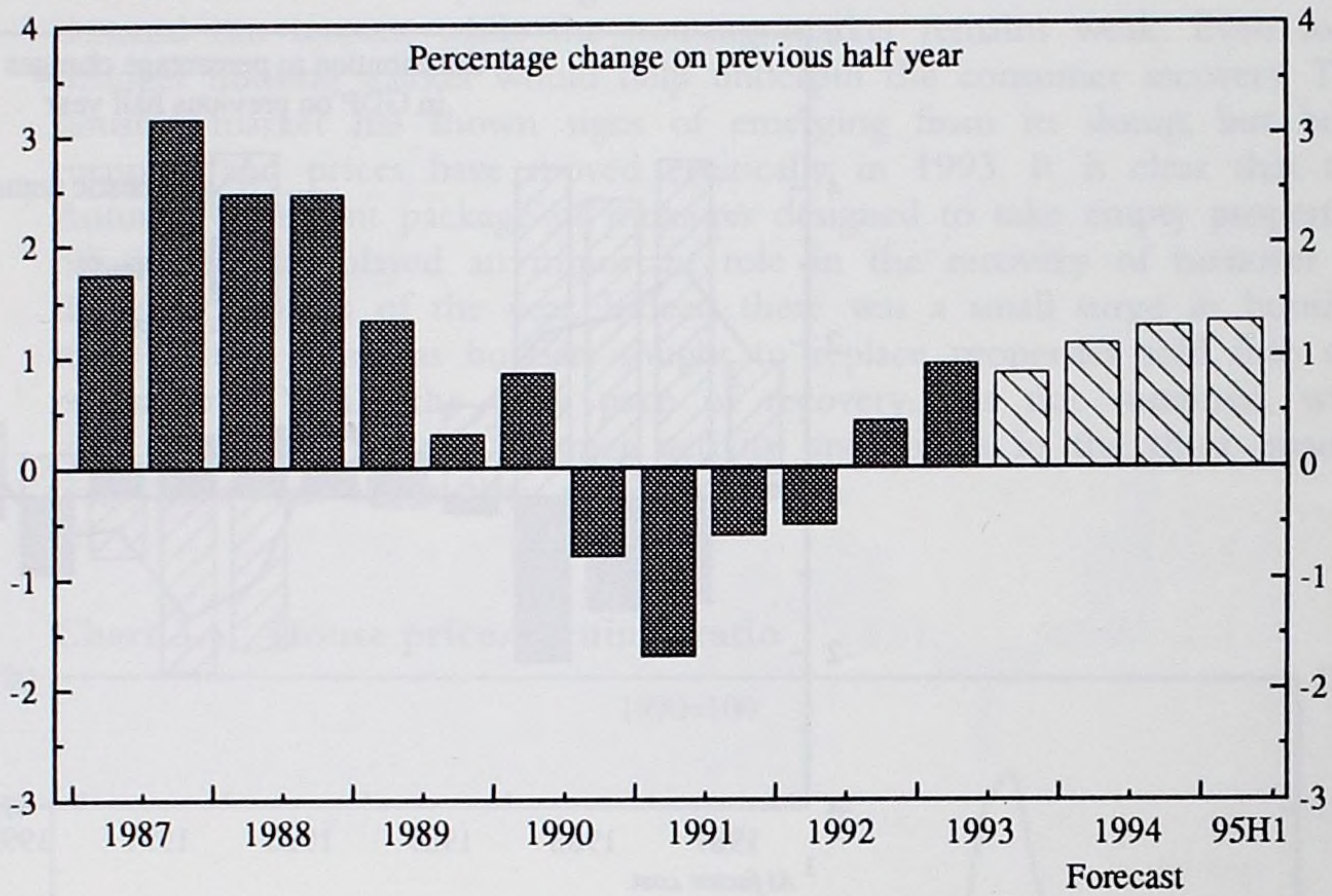
UK demand and output

Recent developments

3.21 As a result of the rebasing of the national accounts to 1990 prices and other data revisions, the trough in GDP is now estimated to have occurred in the first quarter of 1992. During the recession non-oil GDP fell by $3\frac{3}{4}$ per cent, rather less than the $5\frac{1}{4}$ per cent fall in the early 1980s recession.

3.22 The recovery has proceeded fairly steadily so far, with an uninterrupted expansion in GDP of $2\frac{1}{2}$ per cent over the six quarters to the third quarter of 1993. Output has risen in most sectors. North Sea oil and gas output has risen particularly strongly, the fruit of heavy investment in recent years. Output has increased by about $2\frac{1}{2}$ per cent in both manufacturing and services, and service sector output is now above the level seen at the peak of the cycle.

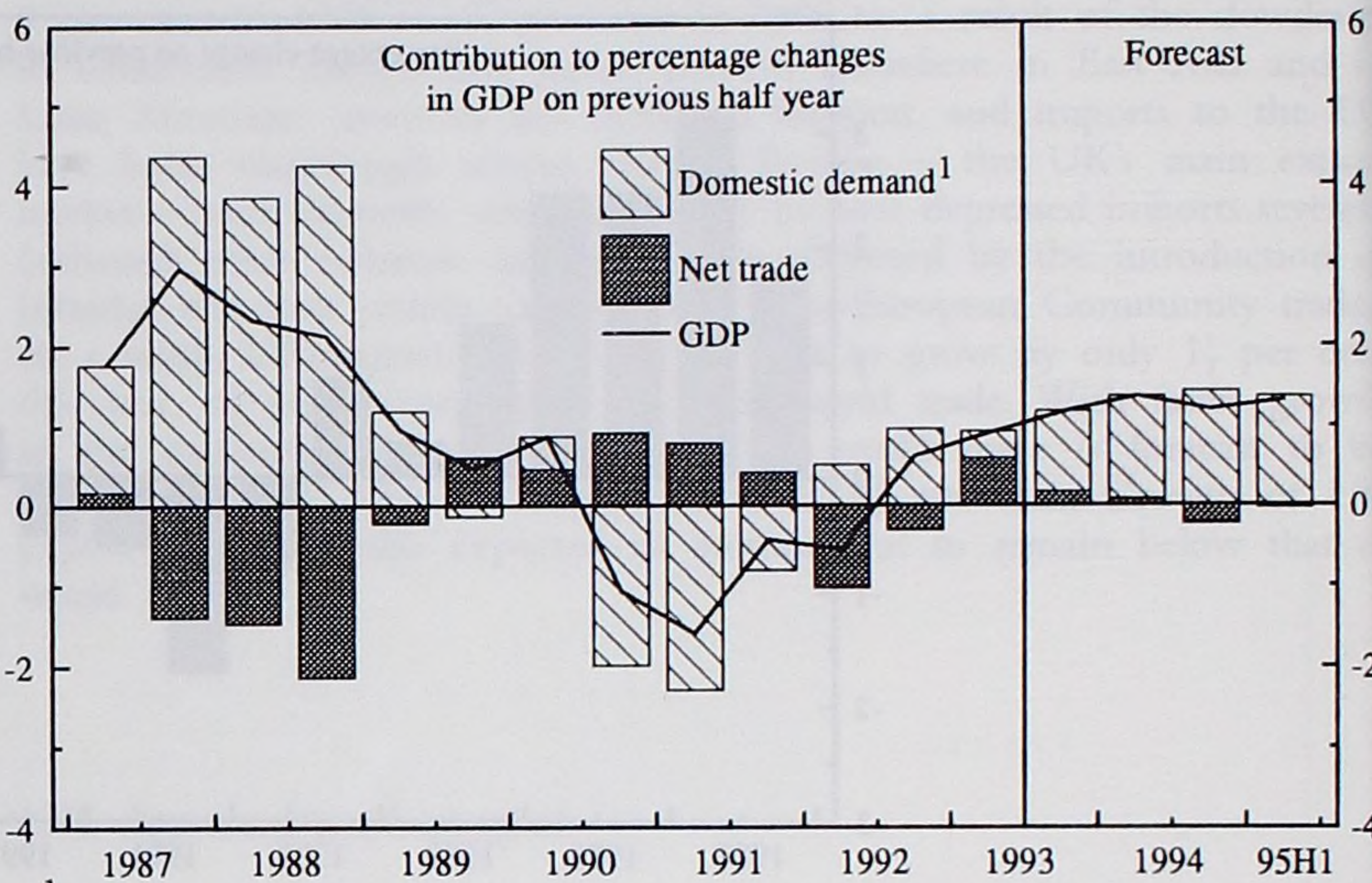
Chart 3.4 Non-oil GDP



3.23 The impetus to recovery has come mainly from consumer spending and exports. Since the trough in output, consumer spending has contributed $2\frac{1}{2}$ per cent to the growth in GDP and exports $1\frac{3}{4}$ per cent. Stocks too made some initial contribution. During 1992 the positive contribution of exports was more than offset by rising imports, but this year exports have accelerated, despite weak demand in continental Europe, and import growth has fallen. Some improvement in trade performance was to be expected in the wake of gains in competitiveness, but its extent is uncertain given the change in the way intra-European Community trade has been recorded since the turn of the year (see paragraph 3.42).

Prospects **3.24** While the recovery so far has been remarkably smooth, it would not be surprising if the profile of output were more uneven from now on. Nevertheless growth is expected to continue in the final quarter of 1993. Although growth in manufacturing output appeared to falter over the summer, business surveys point to resumed expansion, albeit at a modest pace. North Sea output is rising and there is little sign of a break in the upward trend in consumer demand, much of which is reflected in higher output in the service sector. So GDP growth in 1993 is now forecast to be $1\frac{3}{4}$ per cent, a stronger performance than forecast in the March Budget.

Chart 3.5 Domestic demand, net trade and GDP



[1] *At factor cost.*

3.25 Faster growth is forecast for 1994, with GDP increasing by $2\frac{1}{2}$ per cent, $2\frac{1}{4}$ per cent excluding North Sea oil. This acceleration largely reflects a pick-up in business spending: improved company finances and modest increases in capacity utilisation should boost spending on fixed assets and stocks. Export growth should increase a little as continental Europe recovers, although imports are forecast to grow more strongly too. Annual growth in non-oil GDP is forecast to be slightly stronger again in the first half of 1995, but with growth of North Sea output slowing, total GDP growth is forecast to remain at $2\frac{1}{2}$ per cent.

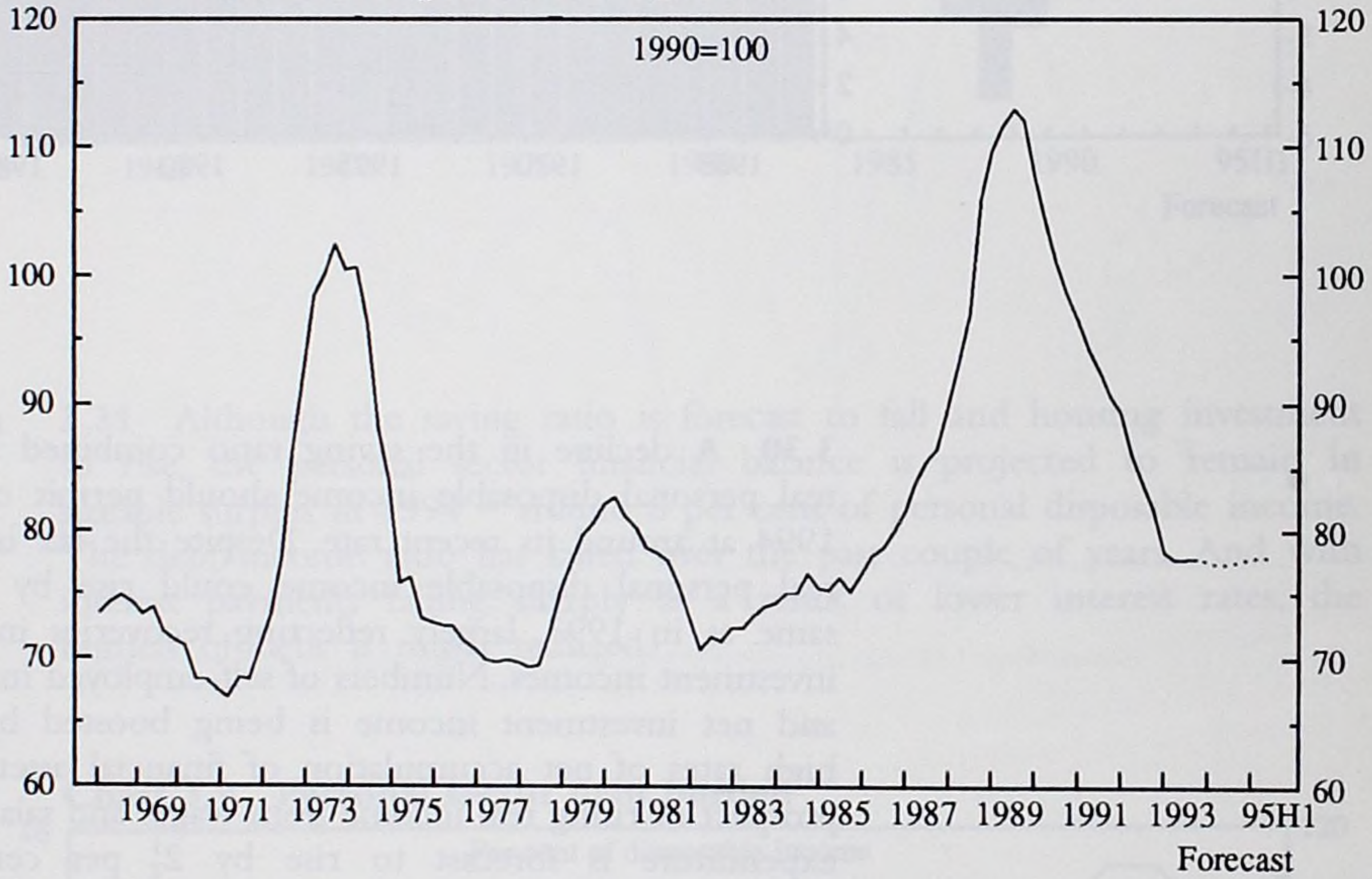
Personal sector and the housing market

Recent developments

3.26 Consumer spending started to recover in the second quarter of 1992, having fallen $3\frac{3}{4}$ per cent in the recession. By the third quarter of 1993 most of this fall had been reversed, with spending rising on average by $\frac{1}{2}$ per cent a quarter. The initial recovery followed a substantial fall in interest rates and was accompanied by strong growth in real personal disposable income. This year, however, growth of aggregate real incomes has weakened and the saving ratio has fallen from $12\frac{3}{4}$ per cent in 1992 to an estimated $11\frac{3}{4}$ per cent in the first three quarters of the year. Weaker real income growth is mainly the result of the slowdown in real average earnings growth and smaller increases in dividend income following strong growth in 1992.

3.27 Events of the past eighteen months have shown that consumer demand can recover while the housing market remains weak. Even so, a stronger housing market would help underpin the consumer recovery. The housing market has shown signs of emerging from its slump, but both turnover and prices have moved erratically in 1993. It is clear that the Autumn Statement package of measures designed to take empty properties off the market played an important role in the recovery of turnover in the early months of the year. Indeed there was a small surge in housing starts in the spring as builders sought to replace properties sold into the programme. While the early pace of recovery was not sustained, with some weakening in the summer, activity and prices in the third quarter were both well above their troughs.

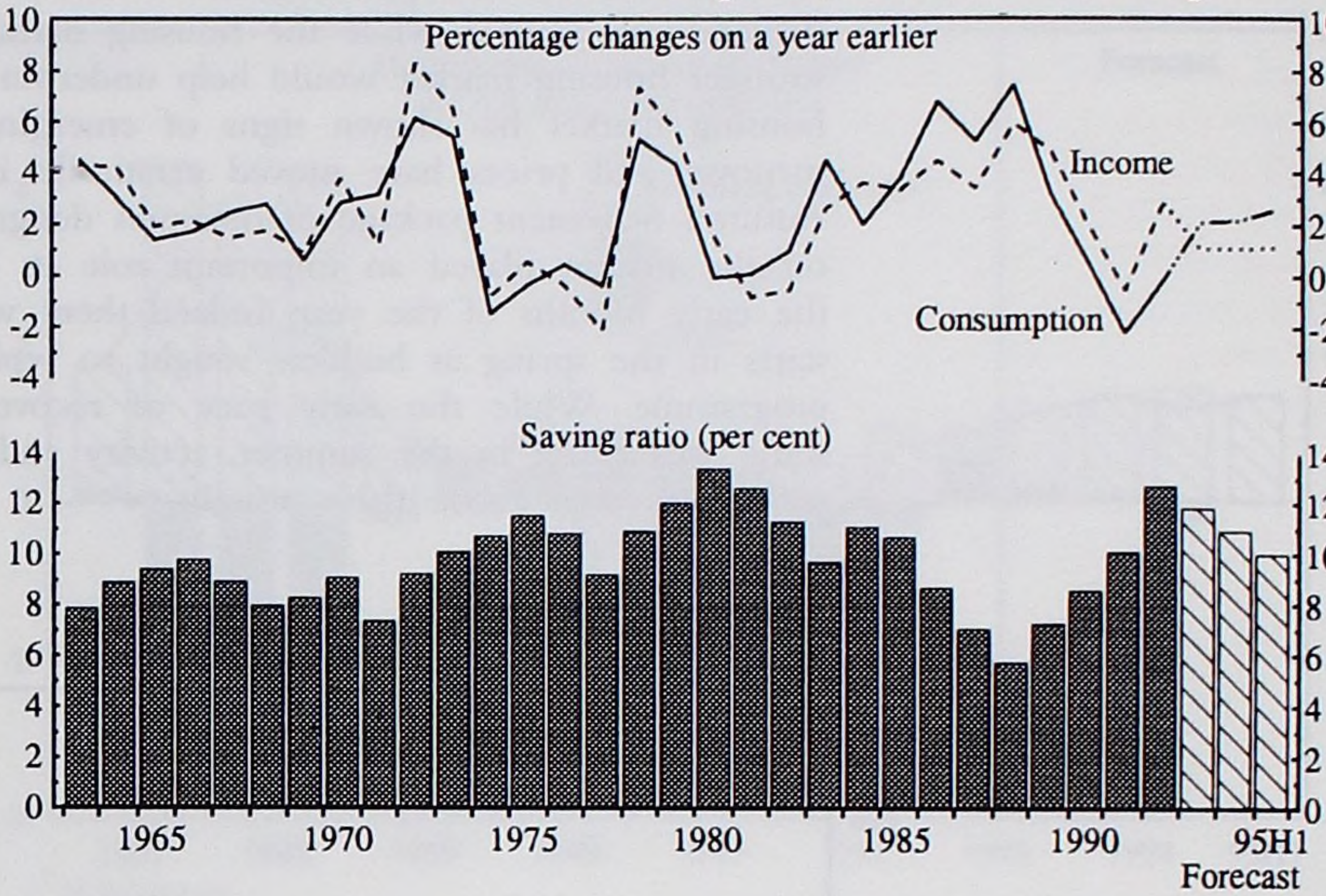
Chart 3.6 House price/earnings ratio



Prospects **3.28** With mortgage rates at their lowest levels since 1969 and house prices lower in relation to incomes than since 1985, home ownership is more affordable than for many years. Now that prices are rising, unemployment is falling and there is a growing perception of more general recovery, increasing confidence should lead to higher activity and prices in 1994.

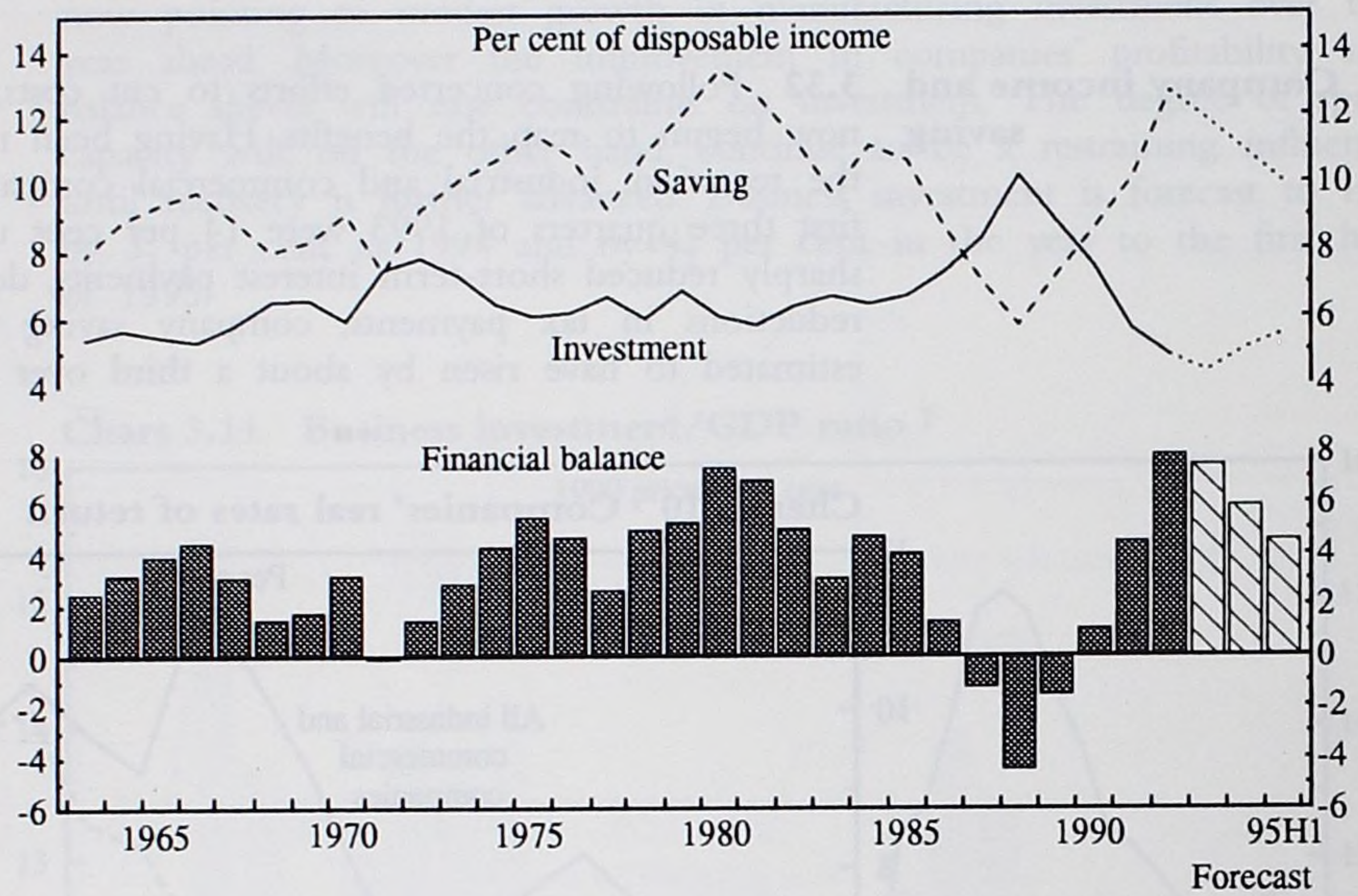
3.29 Personal sector spending is likely to remain restrained by past standards, given a desire for further balance sheet adjustment. Nevertheless there are reasons for expecting a further decline in the saving ratio. Unemployment has begun to fall, reducing the need for precautionary saving. Inflation is forecast to remain low, reducing the need of households to save to maintain the real value of their financial wealth, and lower interest rates have eased the burden of household debt.

Chart 3.7 Personal sector consumption, income and saving



3.30 A decline in the saving ratio combined with continued growth in real personal disposable income should permit consumption to increase in 1994 at around its recent rate. Despite the tax increases due to take effect, real personal disposable income could rise by 1 per cent in 1994, the same as in 1993, largely reflecting recoveries in self-employment and net investment incomes. Numbers of self-employed in work have been increasing and net investment income is being boosted by lower interest rates and high rates of net accumulation of financial assets. In addition there is the prospect of rising real income from wages and salaries before tax. Consumers' expenditure is forecast to rise by $2\frac{1}{4}$ per cent in 1994, following an increase of 2 per cent in 1993. Personal sector investment in dwellings – which includes both new houses and improvements to existing houses – is expected to grow faster than for several years as housing market activity increases.

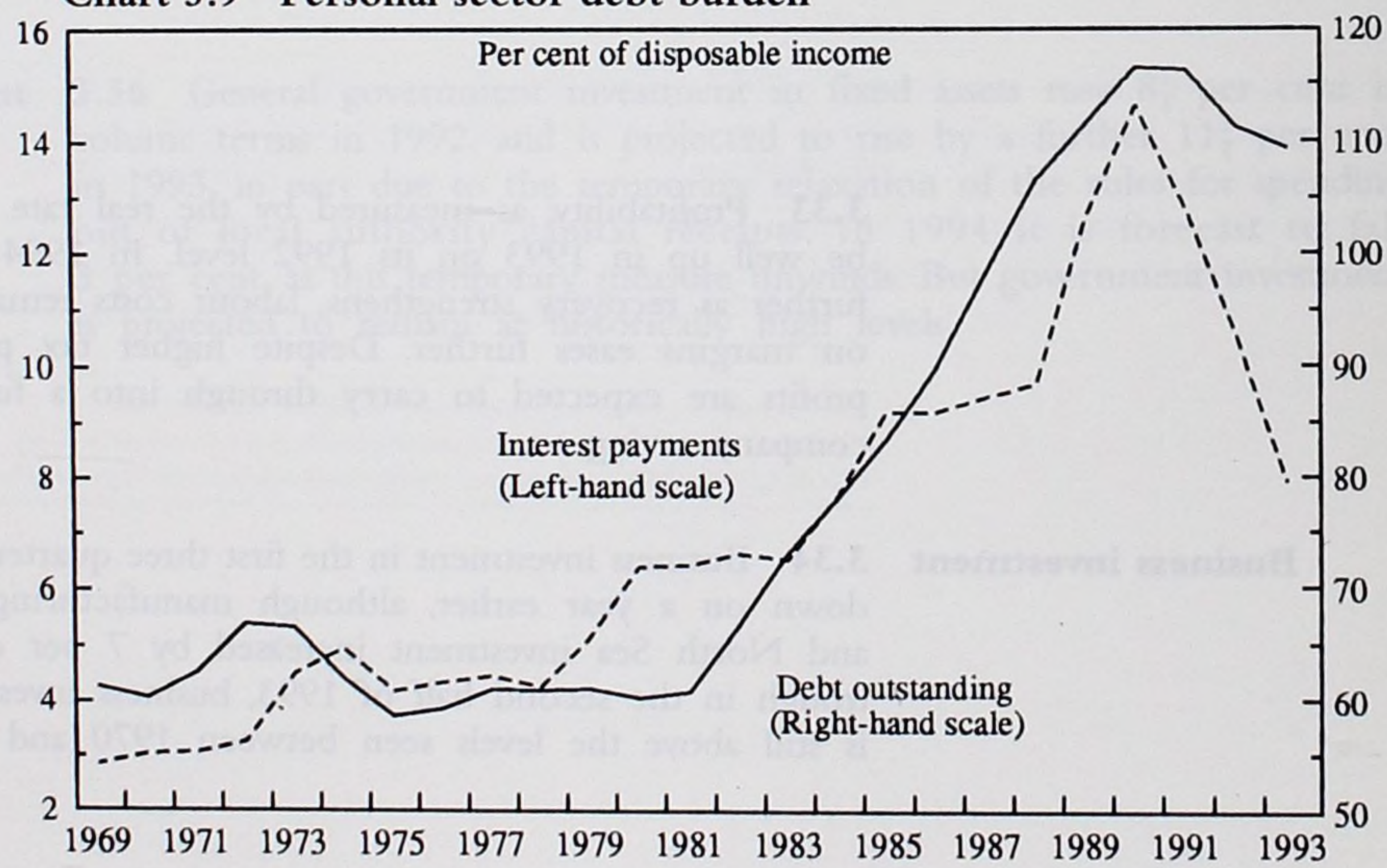
Chart 3.8 Personal sector financial balance



Financial position

3.31 Although the saving ratio is forecast to fall and housing investment to rise, the personal sector financial balance is projected to remain in sizeable surplus in 1994 – around 6 per cent of personal disposable income. The debt/income ratio has fallen over the past couple of years. And with interest payments falling sharply as a result of lower interest rates, the burden of debt is much reduced.

Chart 3.9 Personal sector debt burden

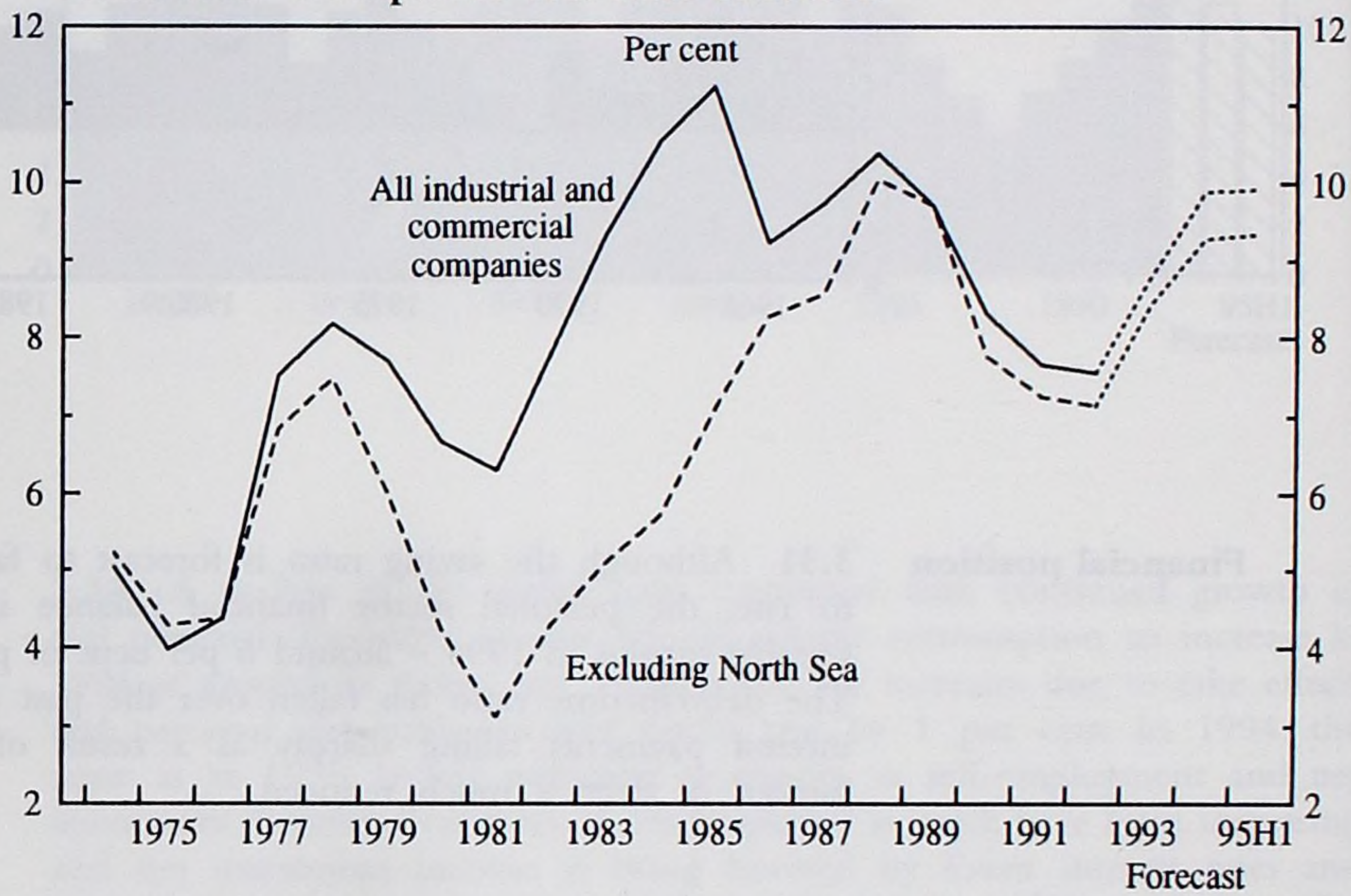


Corporate sector and investment

Company income and saving

3.32 Following concerted efforts to cut costs, the corporate sector has now begun to reap the benefits. Having been more or less static through the recession, industrial and commercial companies' (ICCs) profits in the first three quarters of 1993 were 14 per cent up on a year earlier. With sharply reduced short-term interest payments, down a quarter, and further reductions in tax payments, company saving (undistributed income) is estimated to have risen by about a third over the same period.

Chart 3.10 Companies' real rates of return



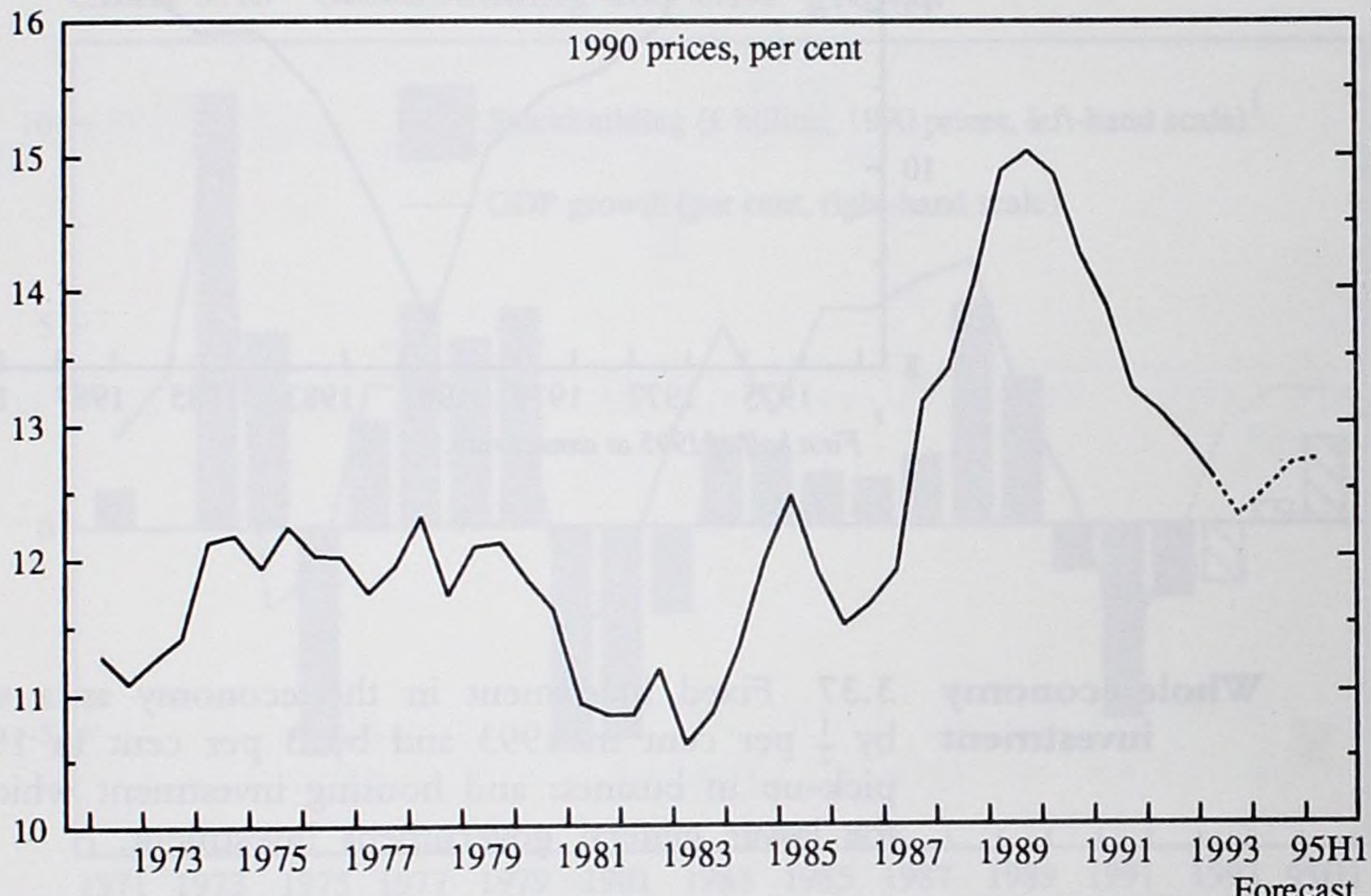
3.33 Profitability, as measured by the real rate of return, is expected to be well up in 1993 on its 1992 level. In 1994 it is forecast to pick up further as recovery strengthens, labour costs remain in check, and pressure on margins eases further. Despite higher tax payments in 1994, higher profits are expected to carry through into a further marked increase in company saving.

Business investment

3.34 Business investment in the first three quarters of 1993 was $1\frac{3}{4}$ per cent down on a year earlier, although manufacturing investment rose slightly and North Sea investment increased by 7 per cent. But at its projected trough in the second half of 1993, business investment as a share of GDP is still above the levels seen between 1970 and the mid-1980s.

3.35 Investment intentions have improved over the past year, and are now pointing to modest growth in manufacturing investment over the year ahead. Moreover the improvement in companies' profitability and balance sheets will ease constraints on investment. The degree of spare capacity will, on the other hand, continue to be a restraining influence until recovery is further advanced. Business investment is forecast to rise by $3\frac{3}{4}$ per cent in 1994 and by $4\frac{1}{2}$ per cent in the year to the first half of 1995.

Chart 3.11 Business investment/GDP ratio [1]

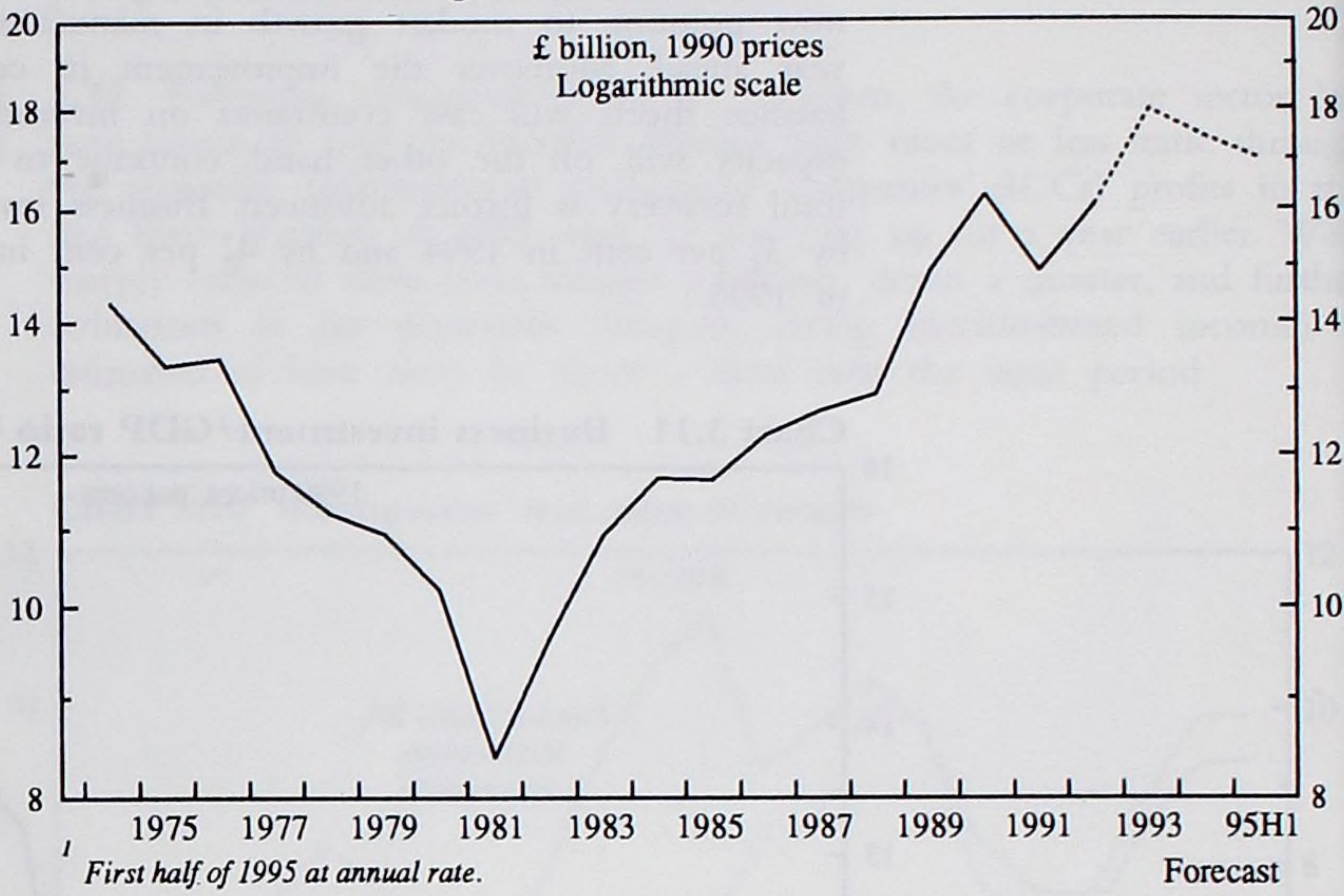


[1] *Business investment includes public corporations, except National Health Trust hospitals.*

Government investment

3.36 General government investment in fixed assets rose $8\frac{1}{4}$ per cent in volume terms in 1992, and is projected to rise by a further $11\frac{3}{4}$ per cent in 1993, in part due to the temporary relaxation of the rules for spending out of local authority capital receipts. In 1994 it is forecast to fall 3 per cent, as this temporary measure unwinds. But government investment is projected to remain at historically high levels.

Chart 3.12 General government fixed investment[1]



[1] *First half of 1995 at annual rate.*

Whole economy investment

3.37 Fixed investment in the economy as a whole is forecast to grow by ½ per cent in 1993 and by 3 per cent in 1994, reflecting the forecast pick-up in business and housing investment which more than compensates for lower general government investment.

Table 3.3 Gross domestic fixed capital formation at constant prices

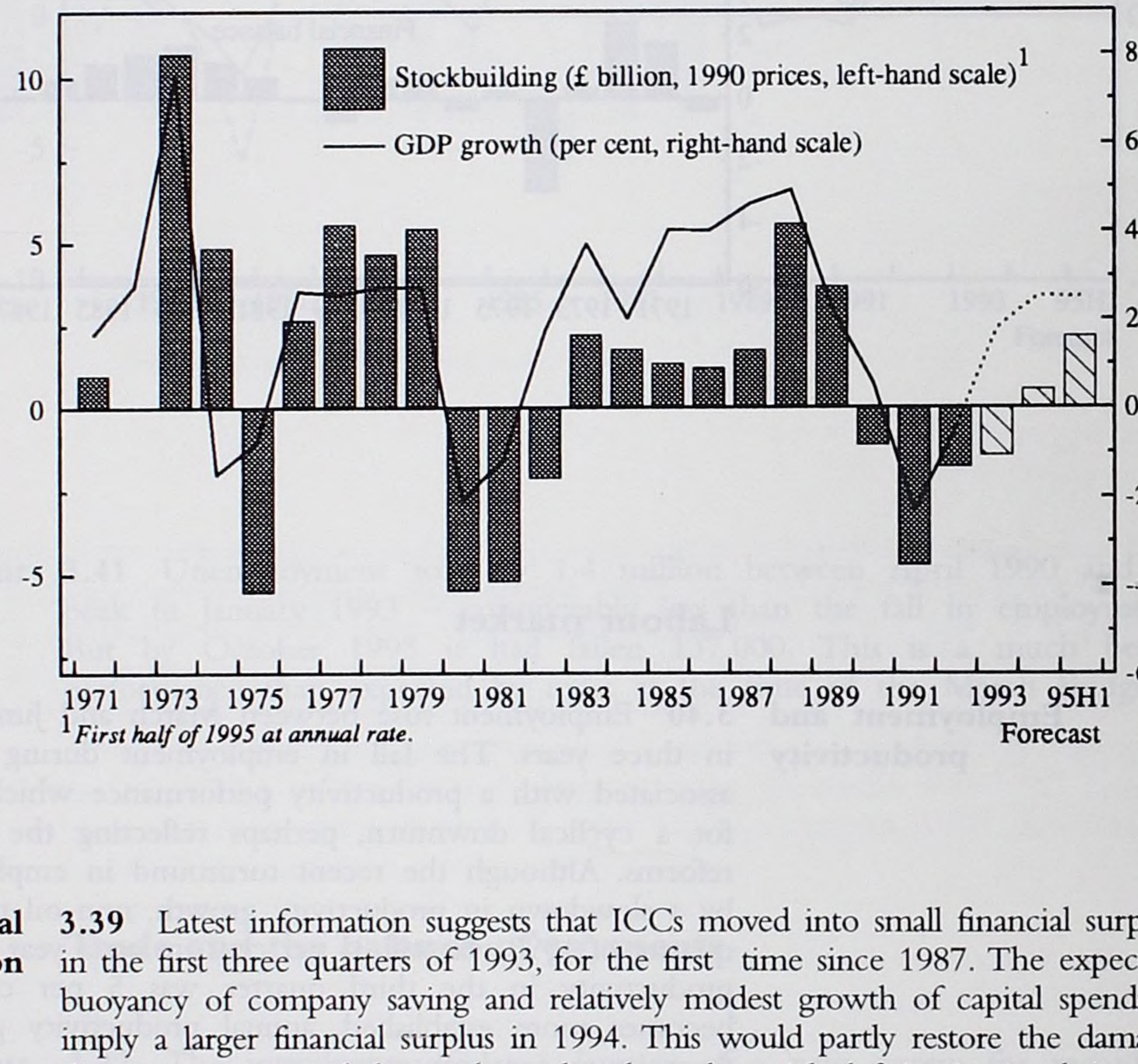
	Percentage changes on a year earlier			
		Forecast		
	1992	1993	1994	1995 H1
Business[1]	$-4\frac{3}{4}$	$-2\frac{1}{4}$	$3\frac{3}{4}$	$4\frac{1}{2}$
Private dwellings and land[2]	$1\frac{1}{4}$	$-\frac{1}{2}$	7	$6\frac{1}{2}$
General government[3]	$8\frac{1}{4}$	$11\frac{3}{4}$	−3	$-3\frac{1}{2}$
Whole economy	$-1\frac{1}{2}$	$\frac{1}{2}$	3	$3\frac{1}{2}$

[1] *Includes public corporations, except National Health Trust hospitals.*
[2] *Includes net purchases of land and existing buildings for the whole economy.*
[3] *Excludes net purchases of land and existing buildings; includes National Health Trust hospitals.*

Stockbuilding

3.38 Typically stockbuilding makes a positive contribution to growth during periods of economic upswing. The slowdown in the rate of destocking in 1992 contributed $\frac{3}{4}$ per cent to GDP growth, following three years when the stock cycle made a negative contribution. But this year, with destocking continuing at much the same rate as in 1992, stocks are expected to make only a small contribution to growth. Stocks are forecast to contribute $\frac{1}{2}$ per cent to growth in 1994 as stockbuilding resumes.

Chart 3.13 Stockbuilding and GDP growth

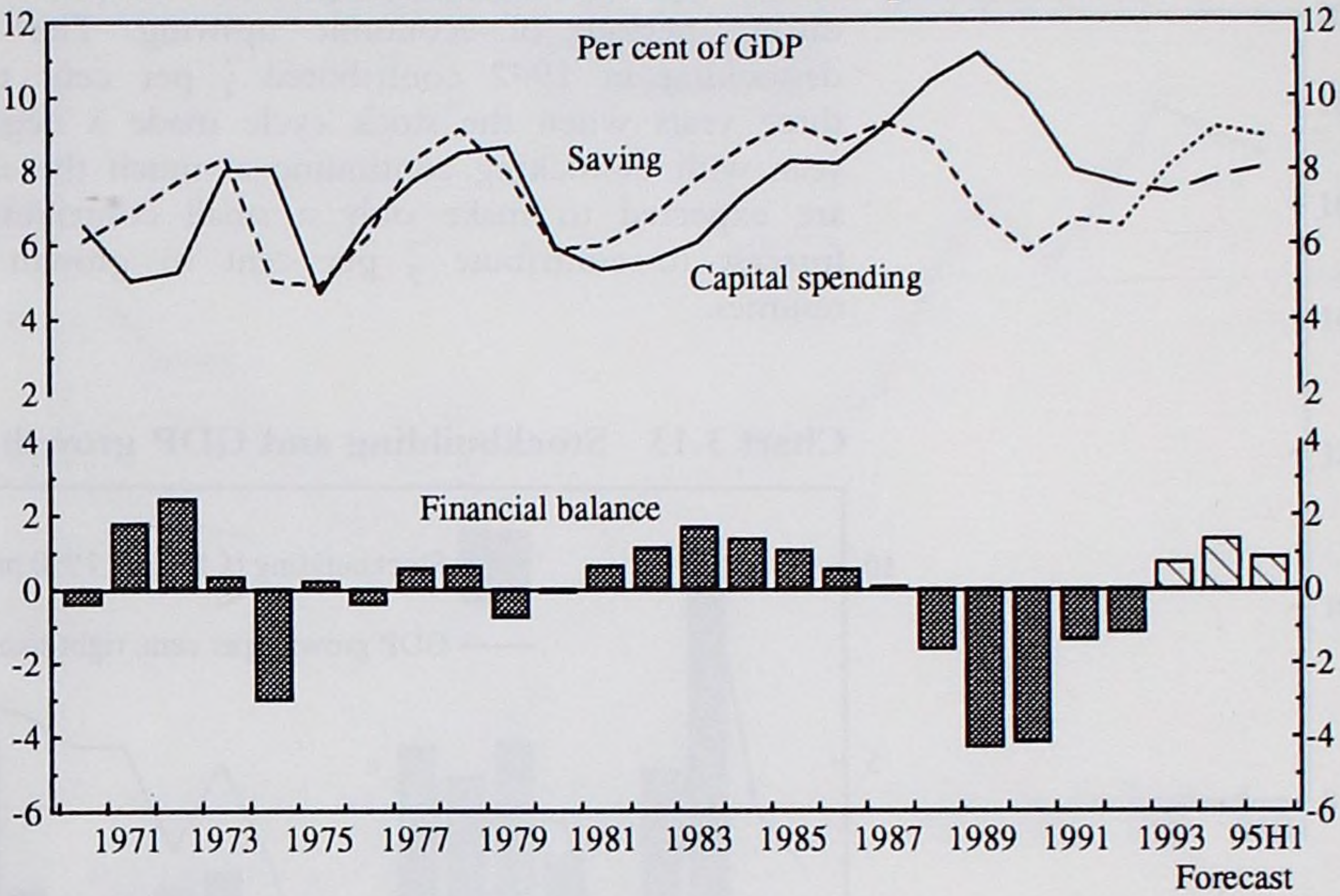


[1] *First half of 1995 at annual rate.*

Companies' financial position

3.39 Latest information suggests that ICCs moved into small financial surplus in the first three quarters of 1993, for the first time since 1987. The expected buoyancy of company saving and relatively modest growth of capital spending imply a larger financial surplus in 1994. This would partly restore the damage done to company balance sheets by the substantial deficits incurred in the five years to 1992, and particularly in 1989 and 1990.

Chart 3.14 Industrial and commercial companies' financial balance

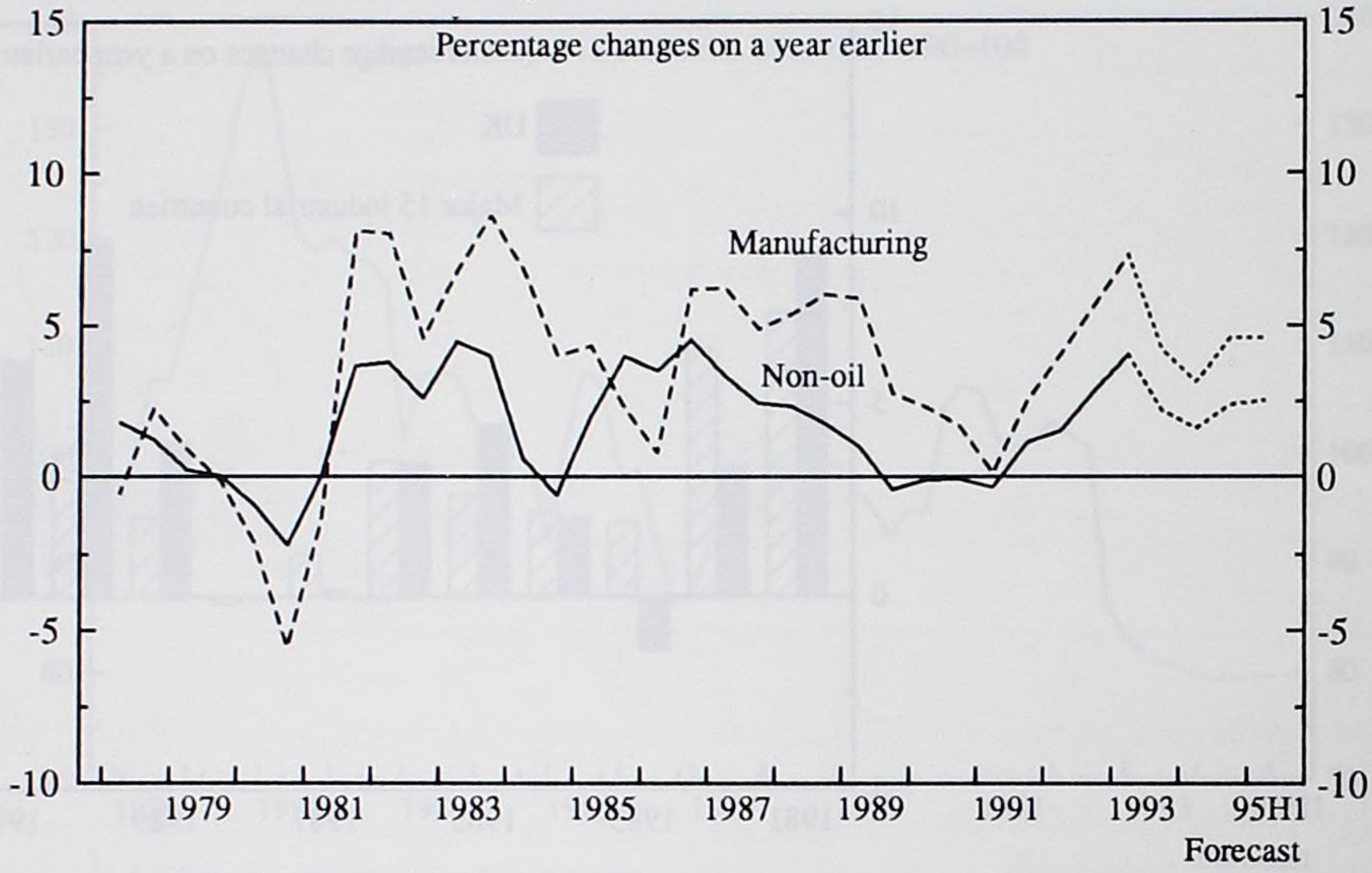


Labour market

Employment and productivity

3.40 Employment rose between March and June 1993, for the first time in three years. The fall in employment during the recession was partly associated with a productivity performance which was abnormally strong for a cyclical downturn, perhaps reflecting the effects of labour market reforms. Although the recent turnround in employment was accompanied by a slowdown in productivity growth, non-oil productivity in the second quarter of 1993 was still $3\frac{3}{4}$ per cent up on a year earlier, and manufacturing productivity in the third quarter was 5 per cent up. As the recovery becomes more established, annual productivity growth could fall further from its recent high rates.

Chart 3.15 Productivity

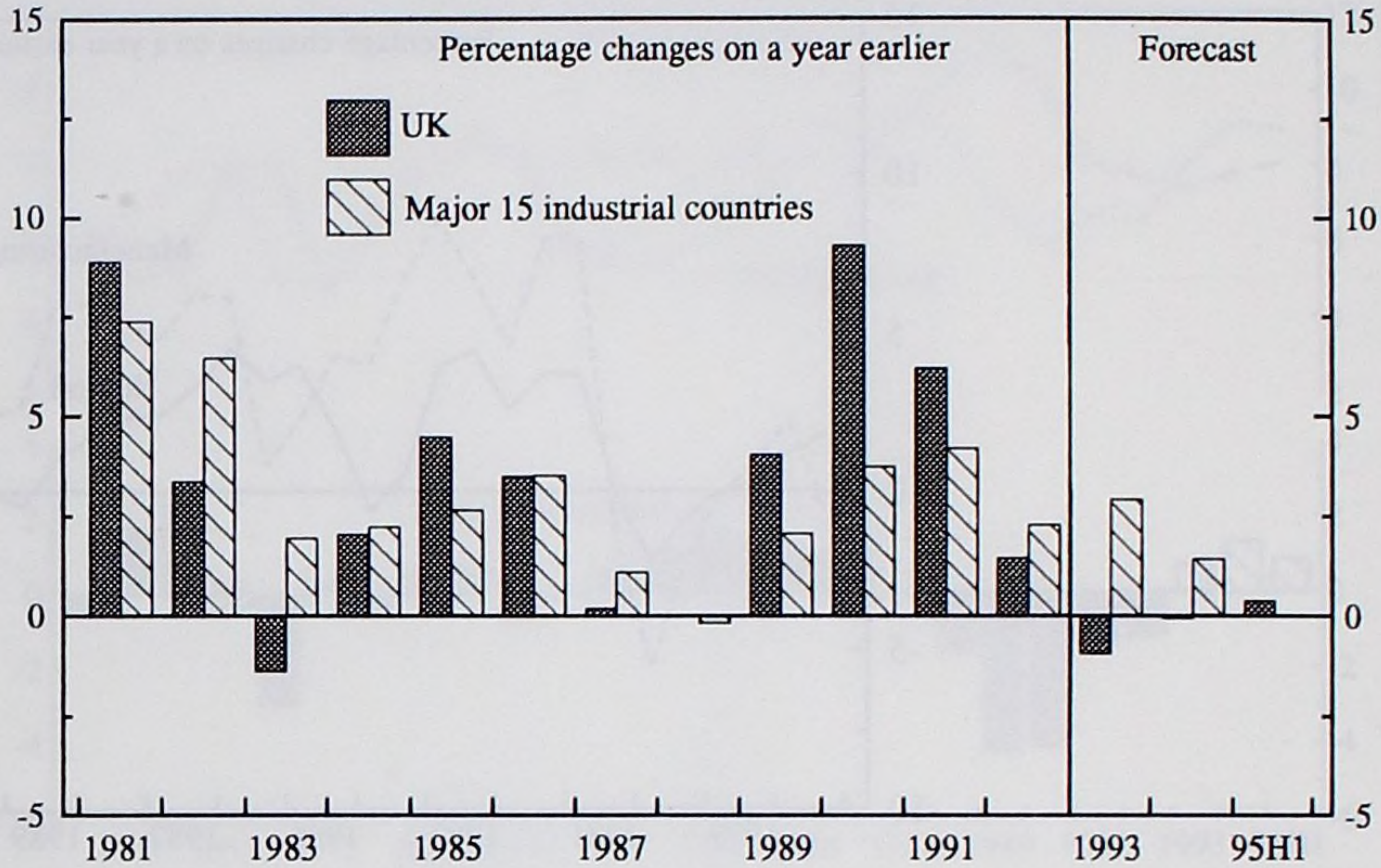


Unemployment 3.41 Unemployment rose by 1·4 million between April 1990 and its peak in January 1993 – considerably less than the fall in employment. But by October 1993 it had fallen 137,000. This is a much better performance than expected by most at the time of the March Budget.

Trade and the balance of payments

Recent developments 3.42 The introduction from 1 January of a new system for recording visible trade with the European Community – Intrastat – has made it extremely difficult to interpret recent trade performance. Not only have the figures recorded in the first few months of the new system been more liable to revision than usual, but some of the movements – such as sharply divergent changes in imports from the European Community and from elsewhere – are difficult to explain. Due to the new method of collection there may well have been a break in the European Community trade figures at the start of the year, implying that year-on-year growth rates in 1993 are unreliable. Part of the problem may lie with the split of values into prices and volumes. As the new system settles down, however, shorter period movements should become more reliable. In the meantime the forecast gives more weight to the fundamental influences on trade performance than to recent outturns.

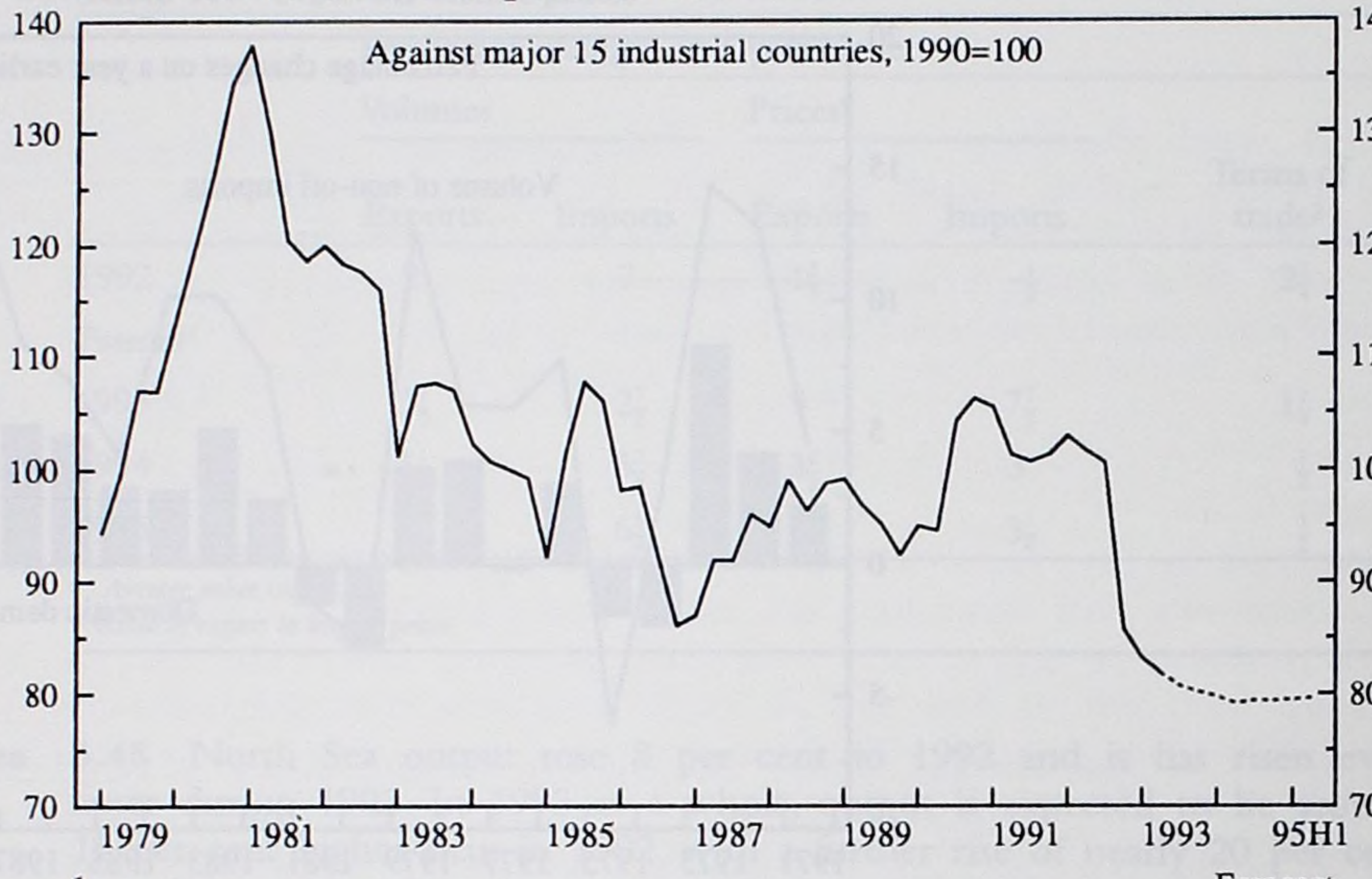
Chart 3.16 Unit labour costs in manufacturing



Competitiveness

3.43 The main influences on actual trade flows over the next year or so are the improvement in competitiveness already achieved and the cyclical position in the UK compared with elsewhere. Cost competitiveness so far in 1993 has turned out much as expected. Unit labour cost performance in the UK has been unusually good. In 1993 as a whole, unit labour costs in manufacturing could be 1 per cent lower than in 1992, and they are forecast to remain unchanged in 1994. By contrast competitors' unit labour costs have been rising and are expected to continue to rise. Cost competitiveness, after allowing for exchange rate changes, was probably around 20 per cent better in the third quarter of 1993 than a year earlier, and is forecast to remain close to that level during 1994. On the recorded figures export price competitiveness has improved much less. This may partly reflect exporters taking the opportunity of the lower exchange rate to widen profit margins which had previously been squeezed, but it is also possible that the recorded increase in export prices is too high.

Chart 3.17 Cost competitiveness[1]

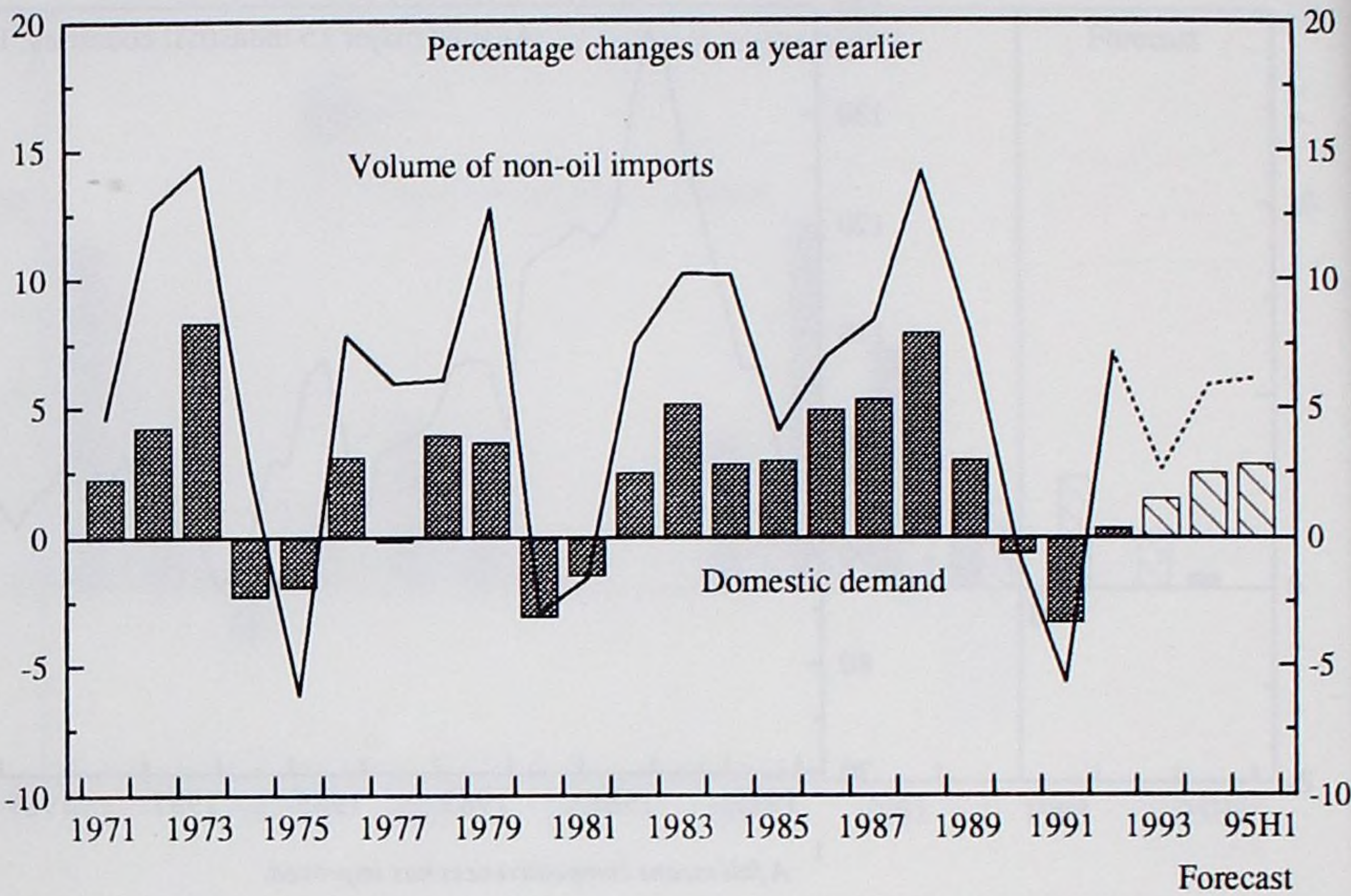


1 *A fall means competitiveness has improved.*

Imports 3.44 The recorded figures for imports so far this year are lower than past experience would have suggested. Although the effect of the improvement in competitiveness may have been stronger than in the past, it is possible that the import volume figures in 1993 are understated by comparison with the figures for earlier years. The sharp fall in imports from the European Community is particularly difficult to understand against a background of little change in imports from elsewhere. Recorded non-oil import volume growth may be only $2\frac{1}{2}$ per cent in 1993, following a rise of 7 per cent in 1992.

3.45 The forecast assumes that the usual relationships between the growth of imports, domestic demand, and competitiveness are re-established from now on. These point to UK imports growing faster than UK domestic demand, reflecting the progressive specialisation of world production. Increased specialisation is evident in the consistently higher rates of growth for measures of world trade than for measures of world demand and output. Although improved competitiveness will be a moderating influence on import growth, its effect is unlikely to be strong enough to bring underlying import growth below domestic demand growth. Non-oil imports are forecast to increase by $5\frac{3}{4}$ per cent in 1994.

Chart 3.18 Imports and domestic demand



Exports **3.46** The sustained improvement in competitiveness will help UK exporters to increase their market penetration. But overseas demand is itself weak. UK export markets may grow by only a little more than 1 per cent in 1993 because of the particular weakness of demand in continental Europe. In 1994, however, UK export markets are forecast to rise 4 per cent. Recorded non-oil exports may be around $3\frac{1}{2}$ per cent higher in volume terms in 1993 than in 1992. But the statistical problems discussed earlier may have reduced recorded export growth – actual growth may have been somewhat stronger. In 1994 non-oil export growth is forecast to be around $5\frac{1}{4}$ per cent.

Trade prices **3.47** Recorded prices for both exports and imports have moved erratically in 1993, with no clear trends. Non-oil import prices have risen about 10 per cent in the year to the third quarter, less than exchange rate and world price changes would imply. This may be because importers are finding it difficult to pass on the exchange rate effects fully in the face of low consumer and producer price inflation in the UK. Non-oil export prices have also risen 10 per cent – again a good deal slower than world prices measured in sterling. Comparing 1993 as a whole with 1992, the terms of trade, as recorded, may improve by around $1\frac{1}{4}$ per cent, recovering from their sharp fall in the immediate aftermath of last year's devaluation. Little change is expected in 1994.

Table 3.4 Non-oil visible trade

	Percentage changes on a year earlier				
	Volumes		Prices[1]		
	Exports	Imports	Exports	Imports	Terms of trade[2]
1992	2	7	$1\frac{3}{4}$	$-\frac{1}{2}$	$2\frac{1}{4}$
Forecast					
1993	$3\frac{1}{2}$	$2\frac{1}{2}$	9	$7\frac{1}{2}$	$1\frac{1}{4}$
1994	$5\frac{1}{4}$	$5\frac{3}{4}$	$3\frac{1}{2}$	3	$\frac{1}{2}$
1995 H1	6	$6\frac{1}{4}$	$3\frac{3}{4}$	$3\frac{1}{4}$	$\frac{1}{2}$

1 *Average value indices.*
2 *Ratio of export to import prices.*

The North Sea **3.48** North Sea output rose 8 per cent in 1992 and it has risen even faster during 1993. In 1993 as a whole, output is expected to be around 15 per cent higher than in 1992, with a further rise of nearly 20 per cent forecast in 1994. Oil output is expected to be in the upper half of the 1993 Brown Book range. Gas output, which has increased strongly this year, is forecast to rise further. As a consequence of higher production, the surplus on trade in oil is forecast to rise to £4 billion in 1994, its highest since 1987.

Invisibles **3.49** The surplus on invisibles in 1992 was £5 billion, well above early estimates. The surplus on net interest, profits and dividends (IPD) was particularly strong in the second half of the year, at £4 billion, compared with under £2 billion in the first half. But much of the increase probably resulted from abnormally high activity in the foreign exchange markets around the time of last year's ERM crisis. High IPD surpluses have not been sustained in the first half of 1993. And the balance of transfers – consisting largely of net transfers to the European Community and aid and other government spending overseas – has continued to deteriorate.

3.50 The balance on services, on the other hand, which was depressed by insurance claims relating to Hurricane Andrew in the second half of 1992, rebounded strongly in the first half of 1993. It should also benefit from the improvement in competitiveness. Exports of services are forecast to rise by 4 per cent in volume terms in 1994, slightly more than in 1993. Imports of services could grow by $4\frac{3}{4}$ per cent in 1994 following a small fall in 1993. But an increase in the services balance is unlikely to be sufficient to offset the deterioration in IPD and transfers. Overall the surplus on invisibles is projected to be £2 billion in 1993, well down on the previous year. It is forecast to fall a little further in 1994.

Table 3.5 Current account

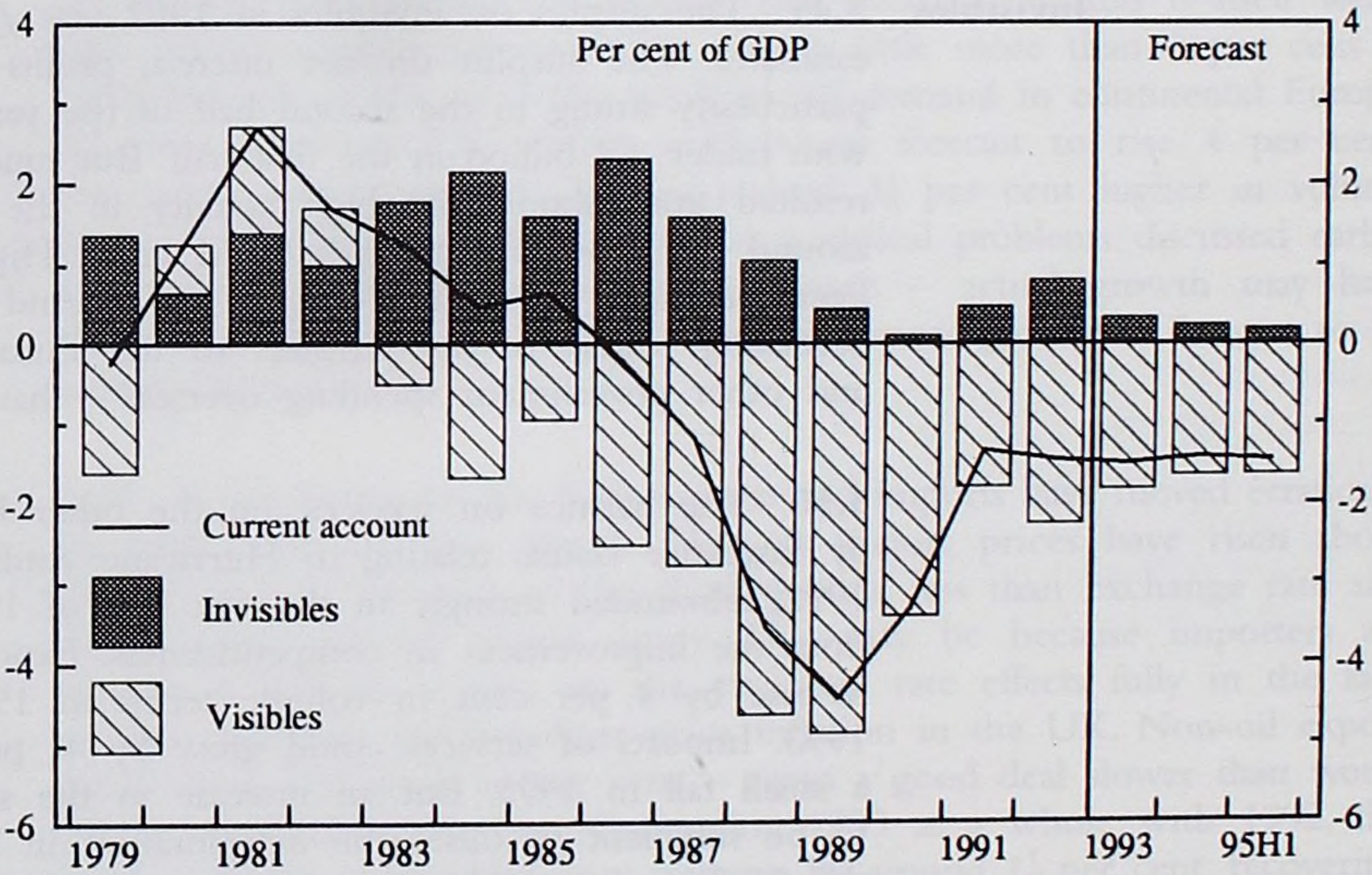
	£ billion					
	Manufactures	Oil	Other	Total visibles	Invisibles	Current balance
1992	−7½	1½	−7½	−13½	5	−8½
Forecast						
1993	−6	2½	−8	−11½	2	−9½
1994	−6½	4	−9	−11	1½	−9½
1995 H1[1]	−6½	4	−9	−11½	1½	−10

[1] *At annual rate.*

The current account

3.51 The current account deficit in 1992 has been revised down to £8½ billion, from £12 billion estimated at the time of the March Budget. The deficit is forecast to widen slightly to £9½ billion in 1993, with a fall in the invisible surplus partly offset by a smaller visible deficit, and to remain at that level in 1994.

Chart 3.19 Current account



Inflation

3.52 Both cost and price inflation have been significantly lower during 1993 than forecast a year ago and in the March Budget. Despite the depreciation of sterling, underlying inflation, as measured by the RPI excluding mortgage interest payments (MIPs), is expected to be lower at the end of 1993 than at the end of 1992. There are clearly considerable domestic disinflationary pressures.

Earnings

3.53 Underlying average earnings growth was 3 per cent in September, down from $5\frac{1}{2}$ per cent a year earlier. Pay settlements have also continued to fall. Latest data from the CBI show the average of settlements in manufacturing and services at about $2\frac{1}{2}$ per cent in the third quarter, compared to over 4 per cent a year earlier. On its own, this would point to further falls in earnings growth because settlements take time to feed through fully. On the other hand, there may be some upward pressure on earnings as profits increase and labour markets become less slack.

Costs and producer prices

3.54 Falling earnings growth combined with strong productivity growth has led to exceptionally good unit wage cost performance this year. Unit wage costs in manufacturing were $\frac{1}{2}$ per cent lower than a year earlier in the third quarter, and in the year as a whole are forecast to be around 1 per cent lower than in 1992. In the private sector, unit wage costs are forecast to increase only marginally between 1992 and 1993.

3.55 Falling unit wage costs in large part explain why producer prices[1] have remained unexpectedly subdued, despite higher import prices and some rebuilding of profit margins. Producer output price inflation rose to 3·2 per cent in October, from a low point of 2·0 per cent in the autumn of 1992. Producer input prices had shown more of an impact from import prices earlier this year. But in the year to October they increased by only 1·0 per cent, further evidence of a squeeze on importers' margins.

Table 3.6 Retail and producer output price inflation

	Percentage changes on a year earlier			
		Forecast		
	1992 Q4	1993 Q4	1994 Q4	1995 Q2
RPI excluding MIPs	$3\frac{3}{4}$	3	$3\frac{1}{4}$	3
Producer output prices	2	$3\frac{1}{4}$	3	$2\frac{3}{4}$

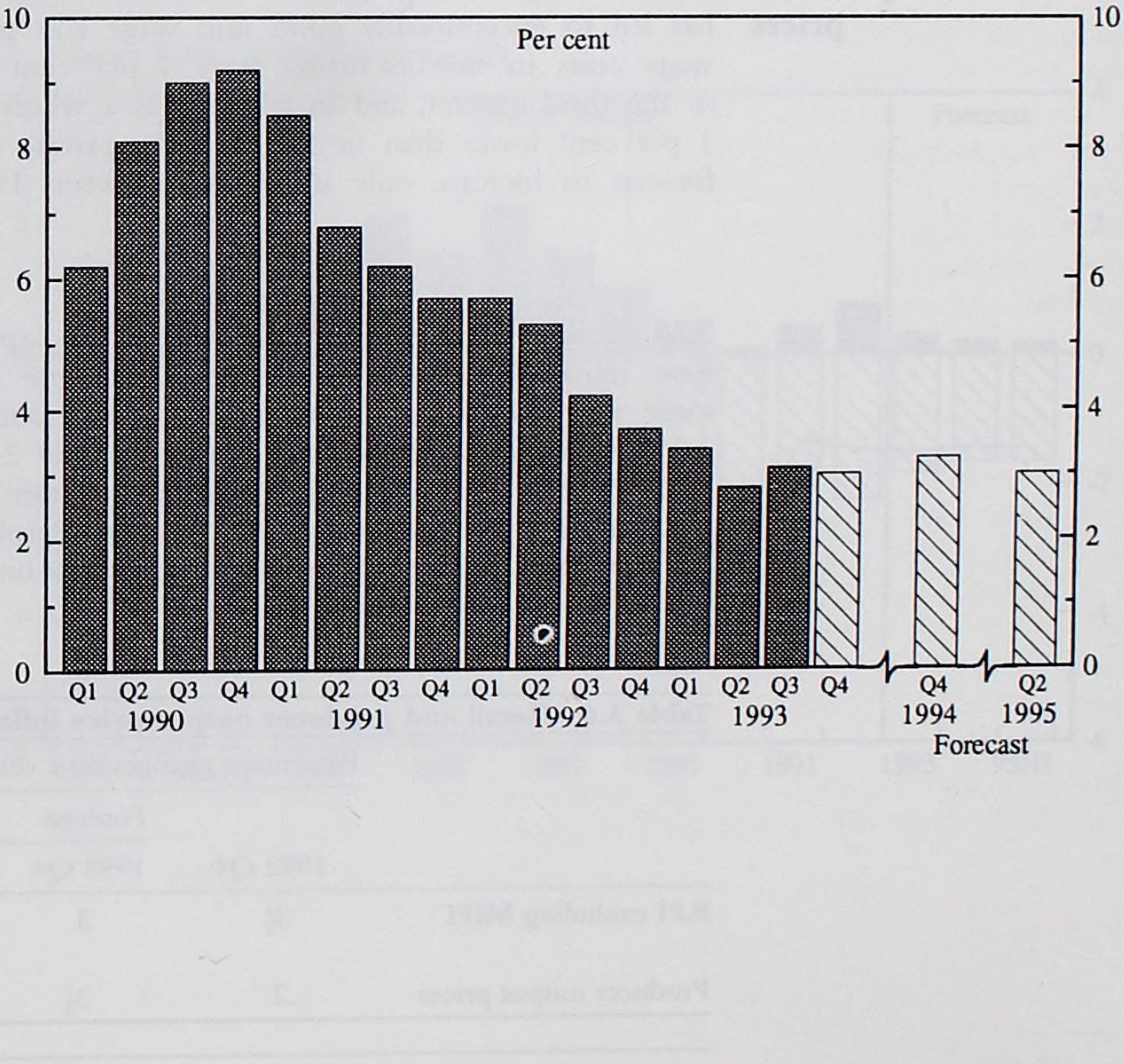
[1] *Throughout this chapter the producer price figures exclude food, beverages, tobacco and petrol.*

3.56 Producer output price inflation is forecast to be $3\frac{1}{4}$ per cent in the fourth quarter of 1993. It may then rise a little, as manufacturers continue to rebuild margins against the background of less favourable movements in unit wage costs and adjustment to higher import prices. But as these factors run their course, producer output price inflation is forecast to fall back to 3 per cent in the fourth quarter of 1994 and $2\frac{3}{4}$ per cent by mid-1995.

Retail prices

3.57 Underlying inflation, as measured by the RPI excluding MIPs, fell to 2·8 per cent in early summer; its lowest rate since 1968. It rose subsequently, but this was fully reversed by a sharp fall back to 2·8 per cent in October. Underlying inflation is forecast to rise somewhat during the first half of 1994, while remaining within the Government's 1 to 4 per cent target range, before falling back to $3\frac{1}{4}$ per cent by the end of the year. This temporary increase in underlying inflation reflects the short-run impact of tax changes. Over-indexation of excise duties, the new taxes in the Budget, and the first tranche of VAT on domestic fuel and power announced in the March Budget, are together estimated to add $\frac{3}{4}$ percentage point to the annual rate of underlying inflation in the fourth quarter of 1994. Underlying inflation is forecast to fall further by the second quarter of 1995, to 3 per cent.

Chart 3.20 Retail price inflation excluding MIPs



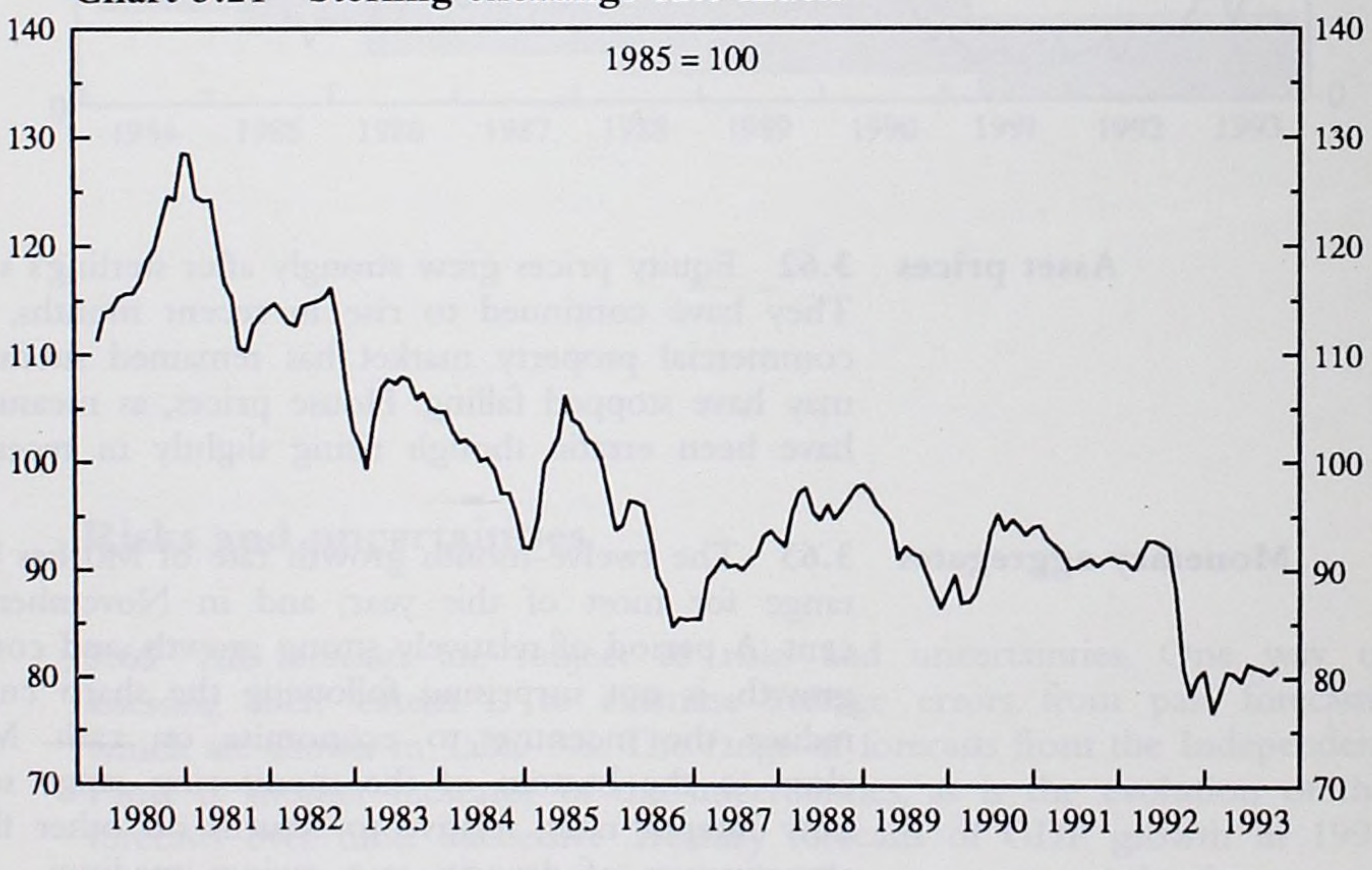
3.58 Given the path of underlying RPI inflation, the outlook for the all-items rate will depend on what happens to mortgage rates. Other things being equal a 1 percentage point change in mortgage rates changes the level of the all-items RPI by just over $\frac{1}{2}$ per cent.

GDP deflator **3.59** The prospects for the GDP deflator (which measures the price of domestic value added – principally unit labour costs and profits per unit of output) differ from those for retail prices primarily because of its wider coverage. The GDP deflator is forecast to rise by $3\frac{1}{4}$ per cent in 1993-94, increasing to 4 per cent in 1994-95. This mainly reflects a forecast acceleration in investment goods prices from very low levels.

Financial developments

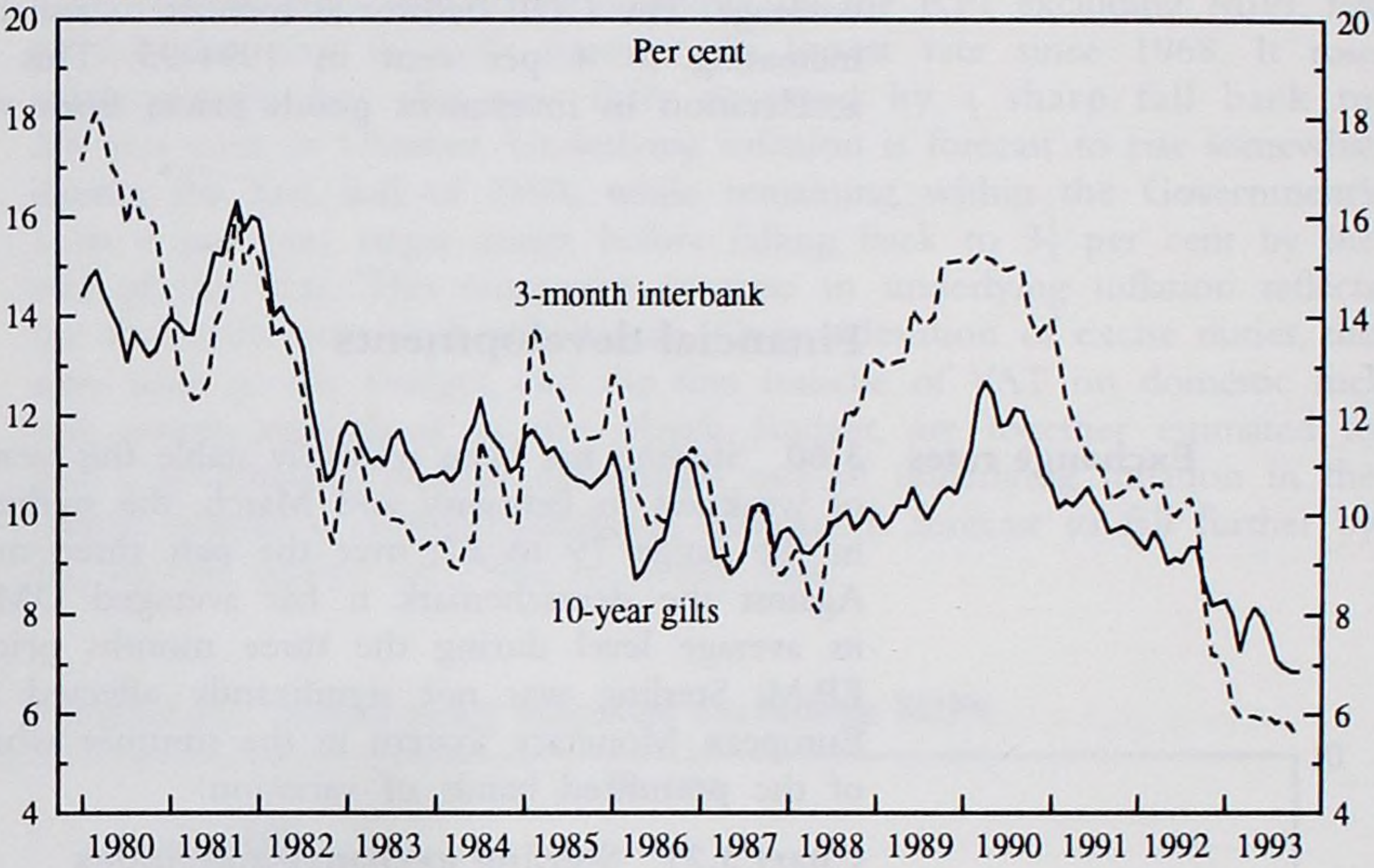
Exchange rates **3.60** Sterling has been relatively stable this year. Following a short period of weakness in February and March, the sterling index has mostly traded in the range 79 to 82; over the past three months it has averaged $80\frac{1}{2}$. Against the deutschemark it has averaged DM2.48, $12\frac{1}{2}$ per cent below its average level during the three months prior to suspension from the ERM. Sterling was not significantly affected by the turbulence in the European Monetary System in the summer which ended in the widening of the permitted bands of variation.

Chart 3.21 Sterling exchange rate index



Interest rates **3.61** Base rates have been reduced twice this year, in January and November. Short-term interest rates in the UK are currently the lowest in the European Community. Long rates have fallen significantly. Ten-year gilt yields, which stood at $8\frac{1}{4}$ per cent at the beginning of the year, have recently been under 7 per cent. The fall in long rates reflects improved confidence in the prospects for sustained low inflation.

Chart 3.22 Interest rates

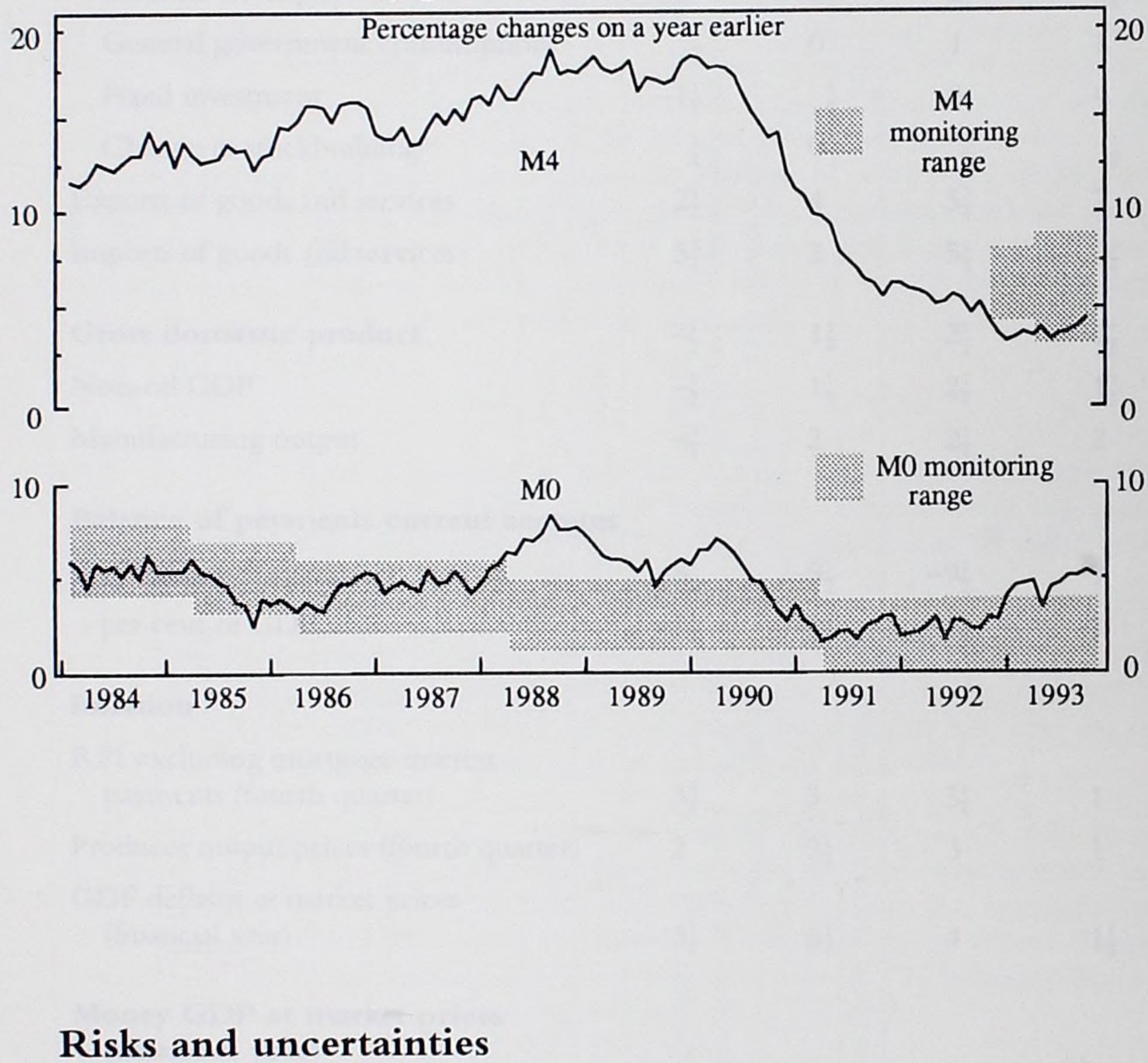


Asset prices **3.62** Equity prices grew strongly after sterling's suspension from the ERM. They have continued to rise in recent months, reaching new highs. The commercial property market has remained subdued, though capital values may have stopped falling. House prices, as measured by the Halifax index, have been erratic though rising slightly in recent months.

Monetary aggregates **3.63** The twelve-month growth rate of M0 has been above its monitoring range for most of this year; and in November it was just over 5 per cent. A period of relatively strong growth, and correspondingly low velocity growth, is not surprising following the sharp cuts in interest rates which reduce the incentive to economise on cash. M4 growth has remained close to the bottom of the monitoring range set in the March Budget. Low interest rates, relative to returns on other financial assets, reduce the attractiveness of deposits as a savings medium.

Credit **3.64** The growth of M4 lending – bank and building society lending to the private sector – has remained weak. The twelve-month growth rate has mostly been between 3 and 4 per cent throughout 1993. Company sector borrowing in particular has remained weak, with industrial and commercial companies repaying bank borrowing. Companies have moved into financial surplus, reducing their need to borrow, and capital issues have been substantial, probably reflecting the strength of the stock market. Lending for house purchase has been one of the stronger areas, reflecting the rise in housing turnover.

Chart 3.23 Monetary growth



Risks and uncertainties

3.65 All forecasts are subject to risks and uncertainties. One way of assessing their extent is to examine average errors from past forecasts, which are shown in Table 3.8. The range of forecasts from the Independent Panel is another indicator of the uncertainties, as is the evolution of the forecasts over time. Successive Treasury forecasts of GDP growth in 1993 have been progressively revised up over the past year, whilst forecasts of underlying inflation in the year to the fourth quarter of 1993 have been revised down. The projected current account deficit for 1993 was increased in March, but has since been revised down below last year's Autumn Statement forecast, reflecting revisions to 1992 and lower than expected outturns so far this year.

Table 3.7 Recent Treasury forecasts

	Percentage changes on a year earlier unless otherwise stated		
	1992 Autumn Statement	March Budget	November Budget
Gross domestic product (1993)	1	$1\frac{1}{4}$	$1\frac{3}{4}$
RPI excluding mortgage interest payments (1993 Q4)	$3\frac{3}{4}$	$3\frac{3}{4}$	3
Current account (1993, £ billion)	$-15\frac{1}{2}$	$-17\frac{1}{2}$	$-9\frac{1}{2}$
PSBR (1993-94, £ billion)	45	50	50

Table 3.8 Summary of economic prospects[1]

	Percentage changes on a year earlier unless otherwise stated			
		Forecast		Average errors from
	1992	1993	1994	past forecasts[2]
GDP and domestic demand at constant prices				
Domestic demand	$\frac{1}{4}$	$1\frac{1}{2}$	$2\frac{1}{2}$	$1\frac{3}{4}$
of which:				
Consumers' expenditure	0	2	$2\frac{1}{4}$	$1\frac{3}{4}$
General government consumption	$\frac{3}{4}$	0	1	1
Fixed investment	$-1\frac{1}{2}$	$\frac{1}{2}$	3	4
Change in stockbuilding[3]	$\frac{3}{4}$	0	$\frac{1}{2}$	$\frac{1}{2}$
Exports of goods and services	$2\frac{1}{2}$	4	$5\frac{3}{4}$	2
Imports of goods and services	$5\frac{3}{4}$	2	$5\frac{1}{4}$	$3\frac{1}{4}$
Gross domestic product	$-\frac{1}{2}$	$1\frac{3}{4}$	$2\frac{1}{2}$	$1\frac{1}{2}$
Non-oil GDP	$-\frac{1}{2}$	$1\frac{1}{2}$	$2\frac{1}{4}$	$1\frac{1}{2}$
Manufacturing output	$-\frac{3}{4}$	2	$2\frac{1}{4}$	2
Balance of payments current account				
£ billion	$-8\frac{1}{2}$	$-9\frac{1}{2}$	$-9\frac{1}{2}$	7
per cent of GDP	$-1\frac{1}{2}$	$-1\frac{1}{2}$	$-1\frac{1}{2}$	1
Inflation				
RPI excluding mortgage interest payments (fourth quarter)	$3\frac{3}{4}$	3	$3\frac{1}{4}$	1
Producer output prices (fourth quarter)	2	$3\frac{1}{4}$	3	1
GDP deflator at market prices (financial year)	$3\frac{3}{4}$	$3\frac{1}{4}$	4	$1\frac{1}{4}$
Money GDP at market prices (financial year)				
£ billion	602	636	678	
percentage change	4	$5\frac{1}{2}$	$6\frac{1}{2}$	2
PSBR (financial year)				
£ billion	$36\frac{1}{2}$	50	38	10
per cent of GDP	6	$7\frac{3}{4}$	$5\frac{1}{2}$	$1\frac{1}{2}$

[1] *Data in this chapter are consistent with output, income and expenditure estimates and other series for the period to the third quarter of 1993 released by the Central Statistical Office (CSO) on 19 November 1993. On the basis of this information the Treasury has carried through revisions to further series, such as personal saving and sectoral financial balances. The CSO will be publishing full national accounts estimates on 20 December.*

[2] *Average absolute error in Autumn Statement forecasts over past ten years; they apply to the forecasts for 1994 or 1994-95.*

[3] *Per cent of GDP.*

Table 3.9 Gross domestic product and its components

£ billion at 1990 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Stock-building	Domestic demand	Exports of goods and services	**Total final expenditure**	*Less* imports of goods and services	*Less* adjustment to factor cost	*Plus* statistical discrepancy[1]	**GDP at factor cost**
1992	339·6	116·6	94·7	−1·8	549·2	135·5	684·8	148·3	70·3	−0·7	465·6
1993	346·7	116·8	95·1	−1·4	557·2	140·9	698·2	151·3	72·0	−0·9	474·0
1994	354·3	118·0	98·0	0·6	570·9	149·1	719·9	159·3	73·7	−0·9	486·0
1992 1st half	168·9	58·7	47·4	−1·6	273·4	67·5	340·9	73·5	35·0	−0·3	232·1
2nd half	170·7	57·9	47·4	−0·2	275·8	68·0	343·8	74·7	35·2	−0·4	233·5
1993 1st half	172·2	58·1	47·5	−0·5	277·2	69·6	346·9	75·0	35·8	−0·4	235·6
2nd half	174·6	58·7	47·6	−0·9	280·0	71·3	351·3	76·3	36·2	−0·5	238·3
1994 1st half	176·2	58·9	48·5	−0·2	283·5	73·6	357·1	78·5	36·6	−0·5	241·6
2nd half	178·1	59·1	49·5	0·7	287·4	75·4	362·8	80·8	37·1	−0·5	244·4
1995 1st half	180·8	59·3	50·2	1·1	291·3	77·2	368·5	82·7	37·7	−0·5	247·7
Percentage changes on a year earlier[2]											
1992	0	$\frac{3}{4}$	$-1\frac{1}{2}$	$\frac{3}{4}$	$\frac{1}{4}$	$2\frac{1}{2}$	$\frac{3}{4}$	$5\frac{3}{4}$	−1	0	$-\frac{1}{2}$
1993	2	0	$\frac{1}{2}$	0	$1\frac{1}{2}$	4	2	2	$2\frac{1}{2}$	0	$1\frac{3}{4}$
1994	$2\frac{1}{4}$	1	3	$\frac{1}{2}$	$2\frac{1}{2}$	$5\frac{3}{4}$	3	$5\frac{1}{4}$	$2\frac{1}{4}$	0	$2\frac{1}{2}$
1995 1st half	$2\frac{1}{2}$	$\frac{1}{2}$	$3\frac{1}{2}$	$\frac{1}{2}$	$2\frac{3}{4}$	5	$3\frac{1}{4}$	$5\frac{1}{2}$	3	0	$2\frac{1}{2}$

1 *Expenditure adjustment.*
2 *For stockbuilding and the statistical discrepancy, changes are expressed as a percent of GDP in previous period.*

Annex to Chapter 3
The Panel of Independent Forecasters[1]

Short-term economic outlook

Monetary and fiscal assumptions

3A.1 Projections of the future course of economic policy are necessary to our forecasts. We do not attempt to base our forecasts on a common set of assumptions, so some of the differences between our forecasts reflect different policy settings. The six of us at the meeting discussed the view expressed in Godley's submission that our forecasts should be based on an assumption of unchanged policy and, on balance, we reject it. We regard it as part of the forecaster's task to predict the behaviour of the government, as it is to predict the behaviour of other economic agents. And (as Godley points out) what is meant by 'unchanged policy' depends on how current policy is interpreted.

3A.2 It is of course important to set out clearly what policy settings have been used in our forecasts. (These do not necessarily coincide with the policy recommendations made later in the report.) Our assumptions may be summarised as follows:

— We all assume some reduction in **short-term interest rates** within the next year, though in some cases the cuts are reversed by the end of 1994. Our projections range from 5 to 6 per cent at the end of this year and from 5 to 7 per cent at the end of next year.

— Apart from Currie, who based his forecast on cuts of £2 billion, we all assume that the announced plans for **government expenditure** will be met in 1994-95. Sentance and Minford assume no aggregate **tax** change in 1994-95 beyond the increases announced in the March Budget. The rest of us assume further tax rises, Britton of £2½ billion, Congdon and Currie of £2 billion, and Davies of £1 billion.

The world economy

3A.3 The latest evidence suggests that output in continental **Europe** may now be close to its trough. However, the prospects are for only a slow recovery, with growth below potential and thus continuing disinflationary pressure for some time to come. The recession in Europe may turn out to share the prolonged profile experienced in the UK. Factors responsible for dragging out the recession include high labour costs, high debt levels in some regions, and tight policy pursued by many governments. Inflexible labour markets are likely to be a hindrance to growth in mainland Europe for the foreseeable future, particularly in view of strong competition from the newly developed Far East economies.

[1] *This annex reproduces the section on the short-term economic outlook from the report of the Panel of Independent Forecasters submitted to the Chancellor of the Exchequer on 18 October. The full report, which includes members' individual submissions on the economic outlook and policy, is available from HM Treasury.*

Table 3A.1 Summary of short-term forecasts

		Percentage changes on a year earlier unless otherwise stated		
		Average	Range	
			Lowest	Highest
Real GDP	1993	1·7	1·3	2·0
	1994	2·7	1·6	3·3
Unemployment (millions)	1993Q4	2·9	2·9	3·0
	1994Q4	2·8	2·5	3·0
RPI excluding MIPs	1993Q4	3·2	2·8	3·6
	1994Q4	3·0	1·6	4·5
Current account (£ billion)	1993	−12·7	−15·9	−10·3
	1994	−14·4	−19·6	−7·3
PSBR (£ billion)	1993–94	46	42	49
	1994–95	36	24	41

3A.4 The tightness of monetary policy on the continent shows that members of the ERM have not taken advantage of the relaxation of the ERM bands to cut interest rates significantly if at all relative to Germany. For their part, the German authorities have responded to declining inflationary pressures with considerable caution. We expect more significant cuts in European interest rates in time, in response to sluggish activity and declining inflation, but this is likely to continue to be a gradual process.

3A.5 Interest rates have been reduced sharply in the **US**, and now in **Japan**, although broad money has yet to respond. Weak and patchy recovery continues in the US, and we expect Japanese growth to resume weakly over the next year or so, although this depends on the degree of fiscal loosening introduced by the new government.

3A.6 **World trade** growth is likely to pick up in 1994. But UK export markets are likely to grow more slowly than total world trade, being concentrated in weak European markets. In addition world trade growth is boosted by strong growth in trade between the signatories of the North America Free Trade Agreement, and within Eastern Europe, both of which are largely irrelevant to the UK.

Rebasing of UK statistics

3A.7 Since we last met in the summer the national accounts have been revised and rebased to 1990. This has changed the profiles of constant price GDP and its components. Non-oil GDP now shows fairly steady growth since the trough in the first quarter of 1992 – previously it had been flat through 1992 before rising in 1993. But the more significant changes to the national accounts come from methodological changes to manufacturing output and trade statistics introduced at the same time as the rebasing. These are discussed below.

Table 3A.2 Forecasts of domestic demand

		Percentage changes on a year earlier		
		Average	Range	
			Lowest	Highest
Domestic demand	1993	1·0	0·4	1·2
	1994	2·6	1·1	3·6
Consumer spending	1993	1·8	1·4	2·4
	1994	1·9	0·7	2·5
Fixed investment	1993	1·1	–0·3	2·1
	1994	2·8	0·6	5·1
Government consumption	1993	–0·1	–1·0	0·4
	1994	1·0	0·3	1·4

Demand and activity

3A.8 The upward revision to growth to the first half of the year is reflected in our forecasts of **GDP** growth in 1993, most of which are slightly higher than in July. We all expect the slow recovery we have seen so far to continue in the second half of the year, and our forecasts now average $1\frac{3}{4}$ per cent growth in the year as a whole. On the whole we expect growth in 1994 to be a bit faster than in 1993.

3A.9 But the pace of recovery is likely to be uneven, and we would draw attention in particular to the risk that domestic demand growth may falter towards the end of this year, perhaps because of the ending of the Autumn Statement investment incentives, further destocking, or because of weak consumption as tax increases loom. The latest, weak, manufacturing output figures are not encouraging in this respect.

3A.10 In measuring **manufacturing output**, the CSO now use separate price deflators for exported output and for output for the domestic market. Previously domestic producer prices were used for both. Because export prices rose faster than domestic prices in the wake of sterling's depreciation last autumn, this has led to a significant downward revision to manufacturing output growth in the first half of 1993. This makes the manufacturing figures somewhat more plausible – in our last report we discussed the inconsistency between the then very strong growth of manufacturing output and the apparently much weaker demand for manufactures. However, it may be that the CSO have overdone the downward revision to manufacturing output, because (for reasons discussed below) the trade data they have used for export prices are not, in our view, entirely reliable.

3A.11 We expect the chief source of growth in 1994 to be **consumers' expenditure**. But our forecasts all depend, to differing degree, on falls in personal sector saving both this year and next, as we generally anticipate only weak growth in personal incomes. Some of us feel some unease at this aspect of our forecasts – it is clearly possible that saving may remain higher for longer than our central views. This is likely to depend on households' attitudes to their continuing weak balance sheet position (associated with lower property prices and high levels of debt) and their reactions to possible future rises in taxes – both factors which are very hard to model successfully.

3A.12 We all expect **investment** to rise in 1994 but our forecasts range quite widely. Congdon and Sentance are relatively pessimistic, citing variously falls in construction and North Sea investment, continuing weakness of companies' balance sheets, the ending of the temporary investment incentives introduced in the last Autumn Statement, and low survey responses for investment intentions. The rest of us foresee a more normal cyclical upswing in investment, due mainly to improved company profitability.

3A.13 The path of **stockbuilding** is difficult to interpret in the recent past, and thus causes us problems in forecasting. Following slight positive stockbuilding in the second half of 1992 (which accords with typical cyclical movements), the latest statistics show a resumption of heavy destocking in the first half of this year. The scale of destocking in the second quarter looks particularly strange. Given the first-half data, we all expect destocking in 1993 as a whole. But in 1994 – when the recovery is into its third year – we expect to see firms restocking. This turnround forms an important contribution to our growth forecasts – but it is one we cannot be sure of, given the uncertainty over the stocks data for the first half of this year. The fall in stocks in the first half of this year is mirrored in an unexpected improvement to net trade, to which we now turn.

Trade

3A.14 Following the introduction of the Single Market, statistics for trade within the EC are now collected under a new system, **Intrastat**, based on firms' VAT returns. The new figures (even after their recent revision) show sharp falls in volumes of both exports and imports from the EC in the first half of 1993, while non-EC trade – still measured under the old Customs-based system – continued to grow. The recession on the continent might explain some of the relative weakness of UK exports to the EC, but we can see no similar factor to explain the very low imports from the EC. It seems most likely that the change of methodology has caused a break in the series, but as there was no period of parallel running of the two systems we cannot know for sure.

3A.15 Net trade is less affected than the gross flows but the new data still imply a dramatic turnround in the contribution of net trade to GDP growth – in July our forecasts averaged a negative contribution of $\frac{1}{4}$ per cent in 1993 whereas with the new data our forecasts average a positive contribution of $\frac{3}{4}$ per cent.

3A.16 The uncertainty engendered by the switch to the Intrastat system has very real costs in terms of economic decision making, and we record our deep concern over the failure to allow any overlap between the old and new trade statistics systems.

Table 3A.3 Forecasts of net trade and the current account

		Average	Range	
			Lowest	Highest
Net trade[1]	1993	0·8	0·4	1·1
	1994	–0·2	–0·8	0·5
Current account (£ billion)	1993	–12·7	–15·9	–10·3
	1994	–14·4	–19·6	–7·3

[1] *Contribution to GDP growth, per cent.*

3A.17 How we treat the new trade data is probably the key issue for the short-term forecast. Congdon and Sentance expect further improvement in net trade in 1994, while the rest of us expect trade flows to revert to 'normal' levels in 1994, with a consequent reversal of this year's improvement in net trade. But none of us feels confident of his projections in this area.

3A.18 Our forecasts of the **current account** deficit in 1993 have been revised down significantly, not only because of the more favourable visible trade figures but also because we expect a higher surplus on invisibles, following the large revision to IPD in 1992. Our forecasts for 1993 now average a deficit of £12$\frac{1}{2}$ billion. Where in July we mostly forecast an improvement in the balance of payments in 1994, now all but Congdon expect a deterioration, with our forecasts averaging a deficit of £15 billion.

The labour market **3A.19** Developments in the labour market now look much less odd than they did in July. Then we saw fairly large falls in **unemployment** virtually coincident with the upturn of activity in the first quarter of 1993. But unemployment has since levelled off, and the profile of non-oil GDP has been revised to show it rising from three quarters earlier than before. Also the Labour Force Survey has confirmed that total, not just claimant, unemployment fell in the spring and this was more than matched by a rise in employment. It now looks increasingly likely that the falls in unemployment were rooted in a collective loss of business confidence in the autumn of 1992, which resulted in many firms either bringing forward labour shedding or delaying hiring. This led to fewer redundancies, and more hiring, in early 1993, and consequently a fall in unemployment.

3A.20 None of us expects much movement in unemployment between now and the end of the year. We all expect some fall in unemployment through 1994, but only Minford expects a fall of over $\frac{1}{4}$ million.

Monetary developments **3A.21** **M4** growth remains only just above the bottom of the Government's 3-9 per cent monitoring range. Most of us interpret this as evidence that the trend fall in broad money velocity in the 1980s has now come to an end, perhaps because of lower interest rates or because the distortions caused by financial liberalisation have run their course. We note that the slowdown in real broad money growth has been a worldwide phenomenon. Congdon recognises these arguments but regards the slow growth of M4 as an unnecessary (given the absence of inflationary pressure) risk to recovery. He sees slow money growth as likely to hamper recovery in the housing market and in company expenditure. We expect broad money growth to pick up in 1994, to around 6-7$\frac{1}{2}$ per cent, but we continue to differ on the implications of this, as discussed in our last report.

Inflation **3A.22** Our views on inflation prospects in the short term have changed little since July. Our forecasts of underlying inflation at the end of 1994 average 3 per cent. But Britton and Congdon are significant outliers above and below respectively. Britton sees the recent low levels of inflation as due in part to temporary factors such as high street sales and short-term pay restraint. Congdon bases his view on empirical work which suggests that falls in inflation will continue as long as spare capacity remains high. The rest of us see the opposing forces (among them the indirect tax increases already announced for next year) acting on underlying inflation leaving it more or less flat in the short term. Only Britton has a breach of the Government's inflation target at the end of 1994 as his central forecast, but most of the rest of us see this possibility as well within the margins of error, and Currie and Davies both expect temporary breaches during the course of 1994.

Table 3A.4 Inflation forecasts

		Percentage changes on a year earlier		
		Average	Range	
			Lowest	Highest
RPI excluding MIPs	1993Q4	3·2	2·8	3·6
	1994Q4	3·0	1·6	4·5
RPI	1993Q4	2·1	1·7	2·5
	1994Q4	3·2	1·5	4·9
Average earnings	1993	3·7	3·3	4·2
	1994	4·0	3·2	4·9

Public finances

3A.23 We generally expect the **PSBR** to turn out a little better than the Budget forecast of £50 billion in 1993-94, but given the margins of error around PSBR forecasts we would not regard them as significantly different. Our forecasts average £46 billion. We expect some improvement in the public finances in 1994-95 as the growth we have experienced this year takes effect, but as in July only Minford predicts a large fall in the PSBR.

Risks and uncertainties

3A.24 While it is now clear that the recovery in the UK has been under way for at least a year, we would still identify a number of pitfalls which could cause growth to falter:

- Real personal disposable incomes are likely to grow slowly if at all. This could lead to very subdued growth of consumers' expenditure, if the falls in the saving ratio we project do not materialise.
- There are worrying signs in the housing market, which has failed to pick up convincingly, that may also undermine consumption growth.
- The ending of the Autumn Statement incentives may cause sluggish or negative investment growth.
- Broad money growth may remain low, hampering the improvement in companies' balance sheets and so tending to prolong the period of below-trend economic activity.
- Stockbuilding may not recover to the degree we project.
- The apparent statistical break in the trade figures makes us very unsure of our forecasts in general.
- Growth in the world economy, and Europe in particular, may be weaker than our projections.

Table 3A.5 Summary of panel members' short-term forecasts

Percentage changes on a year earlier unless otherwise stated

		Britton	Congdon	Currie	Davies	Godley	Minford	Sentance	Average
GDP	1992	−0·4	−0·4	−0·4	−0·4	−0·4	−0·4	−0·4	−0·4
	1993	2·0	1·8	1·6	2·0	1·3	1·5	1·7	1·7
	1994	2·9	2·5	2·5	2·8	1·6	3·3	3·0	2·7
Domestic demand	1992	0·4	0·4	0·4	0·4	0·4	0·4	0·4	0·4
	1993	1·1	1·1	1·1	1·0	1·2	0·4	1·1	1·0
	1994	3·6	2·0	3·0	3·3	1·1	2·9	2·4	2·6
Net trade[1]	1992	−1·0	−1·0	−1·0	−1·0	−1·3[2]	−1·0	−1·0	−1·0
	1993	0·9	0·8	0·7	1·1	−0·2[2]	1·1	0·4	0·8
	1994	−0·7	0·5	−0·8	−0·8	0·3[2]	0·1	0·4	−0·2
Unemployment (millions)	1992Q4	2·92	2·92	2·92	2·92	2·92	2·92	2·92	2·9
	1993Q4	2·91	2·9	2·96	2·89	2·94	2·9	2·91	2·9
	1994Q4	2·88	2·8	2·88	2·72	3·01	2·5	2·86	2·8
RPI	1992Q4	3·1	3·1	3·1	3·1	3·1	3·1	3·1	3·1
	1993Q4	2·3	1·7	2·1	2·1	2·5	2·0	1·7	2·1
	1994Q4	4·9	1·5	3·3	3·7	3·0	2·7	3·3	3·2
RPI excluding MIPS	1992Q4	3·7	3·7	3·7	3·7	3·7	3·7	3·7	3·7
	1993Q4	3·6	2·8	3·2	3·4	3·5	2·9	2·8	3·2
	1994Q4	4·5	1·6	3·1	3·6	2·8	2·7	3·0	3·0
Short-term interest rates (per cent)	1992Q4	7·6	7·6	7·3	7·6	7·6	7·2	7·6	7·5
	1993Q4	5·8	5·7	5·8	5·5	6·0	5·5	5·0	5·6
	1994Q4	6·5	5·0	6·9	6·0	5·0	5·5	5·5	5·8
Current account (£billion)	1992	−8·6	−8·6	−8·6	−8·6	−8·6	−8·6	−8·6	−8·6
	1993	−12·0	−10·7	−14·0	−12·4	−15·9	−10·3	−13·5	−12·7
	1994	−16·0	−7·3	−17·5	−19·6	−13·9	−11·2	−15·5	−14·4
PSBR (£billion)	1992–93	36·7	36·7	36·7	36·7	36·7	36·7	36·7	36·7
	1993–94	46·0	45·0	49·1	49·0	42·0	43·3	46·1	45·8
	1994–95	35·6	34·0	37·7	40·0	40·0	23·8	41·1	36·0

[1] *Contribution to GDP growth, per cent.*
[2] *Non-oil trade.*

4 The Budget tax and national insurance measures

4.01 This chapter summarises the tax and national insurance proposals in the Budget. The measures will raise extra revenue building up over the next three years to around $\frac{3}{4}$ per cent of GDP, while minimising any damage to incentives and to the long term performance of the economy. They include a number of proposals to help business and in particular to encourage investment in small and growing businesses.

4.02 The effect of the measures on government revenues is set out in Table 4.1 (†). Annex A explains the costings and Annex B details a number of tax changes which were announced before the Budget, including measures announced in the March Budget but not yet implemented.

Inland Revenue taxes

Income tax

4.03 There will be no change to the main income tax allowances or the income limit for age-related allowances for 1994-95 (1). The blind person's allowance will be increased to £1,200 (*).

Income tax allowances (£)	**1993-94**	**1994-95**
Personal allowance	3 445	3 445
Married couple's allowance, additional personal allowance, widow's bereavement allowance	1 720	1 720
Blind person's allowance	1 080	1 200
For those aged 65 to 74:		
personal allowance	4 200	4 200
married couple's allowance	2 465	2 665 (‡)
For those aged 75 and over:		
personal allowance	4 370	4 370
married couple's allowance	2 505	2 705 (‡)
Income limit for age-related allowances	14 200	14 200

(†) The number in brackets after each proposal below refers to the line in Table 4.1 where its yield or cost is shown. The symbol "-" means the proposal has no effect on revenue. "*" means it has negligible effects on revenue amounting to less than £3 million a year.

(‡) Increase announced in March Budget. See Annex B.

4.04 The basic rate limit is unchanged at £23,700 (2). The new tax bands are:

Bands of taxable income (£)	1993-94	1994-95
Lower rate — 20 per cent	0 – 2 500	0 – 3 000 (‡)
Basic rate — 25 per cent	2 501 – 23 700	3 001 – 23 700
Higher rate — 40 per cent	over 23 700	over 23 700

(‡) Increase announced in March Budget. See Annex B.

4.05 From 6 April 1995 tax relief for the married couple's allowance, and allowances linked to it, will be restricted to 15 per cent. There will be no change to the amount of the married couple's allowance for those aged under 65, and the allowances linked to it. The married couple's allowance for those aged 65 and over will be increased by £330. Tax relief for the first £1,720 of maintenance payments will also be restricted to 15 per cent from 1995-96 (3).

4.06 Tax relief for mortgage interest payments will be restricted to 15 per cent with effect from 6 April 1995. Relief will remain at 25 per cent for those aged 65 and over who take out a loan to buy a life annuity (4).

4.07 Sickness benefit and invalidity benefit will be replaced by a new benefit, to be known as incapacity benefit, from 6 April 1995. The new benefit will be liable to tax for new recipients from that date. The element which replaces sickness benefit will not be taxed (5).

4.08 Tax relief for private medical insurance for those aged 60 and over will be restricted to the basic rate with effect from 6 April 1994 (*).

4.09 Tax relief for vocational training will be extended to National Vocational Qualifications and Scottish Vocational Qualifications at level 5 from 1 January 1994. From the same date, tax relief will no longer be available to children under 16; to 16 to 18 year olds at school full time; or for training which is mainly for recreation or leisure (6).

Benefits in kind

4.10 The scales for assessing the benefit of fuel provided by employers for private use in company cars will be increased by 6 per cent from 6 April 1994 (7). The scales are also used for employers' national insurance contributions (46). The fuel scales for VAT will be similarly amended (26).

4.11 The tax treatment of cheap loans provided by employers will be revised from 6 April 1994. Employees will be taxed as if they had received cash instead of a cheap or interest free loan, and will receive tax relief for the interest they would have paid. Loans of up to £5,000 will be exempt. There will be a new exemption for certain commercial loans and provision to set an "official rate" of interest to measure the benefit of some loans in currencies other than sterling (*).

Simplification and reform of tax

4.12 As announced in the March Budget, the assessment and collection of personal tax will be simplified from 1996-97. The main measures will abolish the "preceding year" basis of assessment for income tax, and tax income as it arises from 1997-98, with a transitional year in 1996-97; offer the option of self-assessment to all who complete tax returns; align payment dates for assessed income tax from all sources and for capital gains tax; introduce separate assessment for partners; and introduce clear rules for filing tax returns and paying tax, and penalties for failing to comply with them (8).

4.13 Other measures are:

– the existing requirements to provide information about offshore trusts will be clarified (–);

– the procedure by which lenders are admitted to the MIRAS scheme will be simplified, with effect from Royal Assent (–);

– the capital gains tax rules for payments under certain financial and commodity options and futures contracts will be amended for contracts entered into from 30 November 1993 (*);

– improvements will be made to the operation of the tax regime for approved pension schemes (*);

– amendments will be made to the rules for approved profit sharing schemes to equalise the tax treatment of men and women in schemes approved before 25 July 1991 and to improve the treatment of qualifying corporate bonds (*);

– stamp duty legislation will be amended to clarify the meaning of execution (with effect from 8 December 1993); and to relax the penalties on the late stamping of agreements for lease (with effect from 6 May 1994) (*).

Limits and exempt amounts

4.14 The capital gains tax annual exempt amount will remain at £5,800 for individuals and £2,900 for most trusts (9).

4.15 The threshold for inheritance tax will remain at £150,000 (10).

4.16 The maximum level of earnings for which pension provision may be made with tax relief (the earnings cap) will be increased in line with inflation to £76,800 (*).

Investment in small businesses

4.17 A new Enterprise Investment Scheme will be introduced from 1 January 1994 to encourage equity investment by individuals in unquoted trading companies. The scheme will provide relief on investments at a rate of 20 per cent, and income or capital gains tax relief on losses. Capital gains will be tax free. It will not be available for investments in private rented housing. Investors previously unconnected with the company will be able to become paid directors. The maximum amount that can be invested in any one tax year will be £100,000. (For 1993-94 the limit will be £40,000 for total investments in the Business Expansion Scheme and in the new scheme). The maximum amount a company can raise under the scheme in any 12 month period will be £1 million (11).

4.18 A consultative document will be issued on a scheme for Venture Capital Trusts to encourage investment in unquoted trading companies.

4.19 Liability to capital gains tax arising on the disposal of assets on or after 30 November 1993 by individuals and most trustees will be deferred when the gains are reinvested in unquoted shares of qualifying trading companies (12).

4.20 The limits for capital gains tax retirement relief are to be increased. For qualifying disposals made on or after 30 November 1993 full relief will be available on the first £250,000 of gains, and 50 per cent relief on the next £750,000 (13).

4.21 Lifetime gifts of business and agricultural property sold by a donee qualify for relief under inheritance tax where they are replaced by similar assets within one year. This period will be extended to three years, for deaths on or after 30 November 1993 (*).

Business taxation

4.22 Following consultation announced in the March Budget, a foreign income dividend (FID) scheme will be introduced to help companies with surplus advance corporation tax (ACT) arising from dividends paid out of foreign profits. From 1 July 1994 a company may opt to classify a dividend as a FID. ACT will be payable in the usual way, but where the dividend is paid out of foreign profits, surplus ACT may be reclaimed. Unlike an ordinary dividend, a FID will not carry a tax credit, but will be treated as having borne tax at the lower rate. There will be special rules for international headquarters companies (14).

4.23 The profits limits for the small companies' rate of corporation tax will be increased by 20 per cent to £300,000 and £1·5 million from 1 April 1994 (15).

4.24 Two changes are proposed to help businesses faced with insolvency. From 30 November 1993 a creditor will not be denied tax relief for trade debts given up as part of a voluntary arrangement under the 1986 Insolvency Act, solely because the creditor could have recovered more of the debt by putting the debtor into liquidation or bankruptcy. For the debtor, the amount given up will no longer be liable to tax (*). The rules for reducing VAT repayments from Customs to take account of tax due to them will be relaxed, from shortly after Royal Assent. This will have the effect of putting VAT debts on a similar footing to debts owed to other creditors (24).

4.25 Tax relief for business donations to Training and Enterprise Councils and similar bodies, which was due to expire on 1 April 1995, will be extended to 1 April 2000. In addition, tax relief will be available for business donations to "Business Links" made from 30 November 1993 to 1 April 2000 (*).

4.26 All payments made on or after 30 November 1993 as a result of extortion by terrorist groups or other criminals will be disallowed for tax purposes (*).

4.27 Improvements will be made to the new rules for foreign exchange gains and losses announced in the March Budget. The new rules will come into force on a date to be announced (*).

4.28 The tax treatment of financial instruments used by companies for managing interest rate and currency risk will be reformed so that all the profits and losses on these instruments will be taxed or relieved as income as they accrue. The reforms will be implemented from the same date as the new rules on foreign exchange gains and losses (*).

4.29 The Inland Revenue will review the rules for the taxation of interest paid and received by companies. The review will also consider taxation of the return to investors in securities.

4.30 Other minor changes are:

- tax provisions will be made for British Rail and Northern Ireland Airports Ltd, in line with earlier privatisations (*);
- the capital allowances provisions for connected persons will be amended to include transfers of enterprise zone commercial buildings and qualifying hotels prior to 16 March 1993 (–). The March Budget made similar provisions for such transfers on or after that date.

Oil taxation

4.31 The technical rules governing the price of oil or gas charged to petroleum revenue tax (PRT) and, where appropriate, corporation tax and royalty, will be modified with effect from 1 January 1994 to take account of changes in the markets (16).

4.32 In certain circumstances companies will be able to elect that a proportion of expenditure on assets, such as pipelines, providing services to other fields will be ineligible for PRT relief, and that tariffs received from new fields exempt from PRT will be outside the PRT charge (*).

Anti-avoidance and revenue protection measures

4.33 Employers who pay their employees in marketable assets such as gold bars will be obliged to account for income tax under PAYE when the payment is made. Such payments are currently treated as benefits in kind on which employees pay income tax after the end of the tax year (17). Parallel measures will be applied to national insurance contributions (45).

4.34 Changes will be made to the rules for profit related pay schemes. These will affect the upper limit on the profits which an employer may disregard in calculating profit related pay, and the requirements which have to be met if a "special scheme" (a scheme for a particular unit within a business) is to qualify for tax relief (18).

4.35 For disposals of assets on or after 30 November 1993, capital gains indexation allowance will only be able to extinguish a gain, and will not be able to create or augment a loss (19).

4.36 Where a company fails to meet corporation tax liabilities which arise prior to its sale to another company, the Inland Revenue will be able to collect the unpaid tax from the previous owners of the company or from other companies in the same group. This will apply to contracts entered into on or after 30 November 1993 (20).

4.37 In order to pursue an acceptable distribution policy non-trading foreign companies controlled by UK companies will have to distribute at least 90 per cent of their taxable profits less capital gains and foreign taxes, for accounting periods ending on or after 30 November 1993 (21).

4.38 Changes will be made, with effect from 8 December 1993, to counter avoidance of stamp duty on exchanges of interests in land; on property transferred for a price which is not ascertainable at the time the document is executed; and on agreements to surrender a lease (other than by a deed) (22).

4.39 Provisions will be introduced, with retrospective effect, to ensure that tax continues to be collected under PAYE from certain groups of foreign employees coming to work in the UK (–).

4.40 New capital allowance rules will be introduced to limit the extent to which taxpayers can backdate claims for assets reclassified as plant; and to prevent buildings and structures being reclassified as plant in future (–).

4.41 The rules for taxing payments made in lieu of dividends or interest will be clarified with effect from 30 November 1993. The scope of the rules will also be extended, with effect from a date to be announced, to cover compensation for dividends or interest which takes the form of a price adjustment rather than a payment (–).

4.42 Measures will be taken to deter avoidance of petroleum revenue tax through transfers of pipelines or other tariff-earning assets between fields (*).

4.43 Companies which are resident in the UK, but which would be regarded as resident in another country for the purposes of a double taxation agreement, will be treated as not resident in the UK for all tax purposes from 30 November 1993 (*).

4.44 Non-residents carrying on business in the UK will not be able to claim relief for losses incurred as a result of the exemption of royalty income under a double taxation convention. The restriction will apply to accounting periods beginning on or after 30 November 1993 (–).

4.45 A benefit received from a funded unapproved retirement benefit scheme will be taxed if the scheme itself has not been subject to UK tax (*).

Customs and Excise taxes

Value added tax

4.46 The turnover threshold above which traders are required to register for VAT will rise from £37,600 to £45,000, and the deregistration threshold will rise from £36,000 to £43,000, from 1 December 1993 (23).

4.47 The minimum supplement paid to traders when VAT refunds are unduly delayed by Customs will rise from £30 to £50, from one month after Royal Assent. Customs will be allowed less time to investigate repayment claims before becoming liable to pay the supplement (*).

4.48 Businesses leasing cars to private taxi and self-drive hire firms and to driving schools will be able to recover the VAT they pay on cars bought for this purpose from 1 January 1994 (25).

Excise duties

4.49 The duties on tobacco and fuel will be increased from 6pm on 30 November 1993. Duty on wines and cider will rise and duty on fortified wines will be reduced on 1 January 1994. Duty on beer and spirits will remain unchanged. The change in duty and its effect on the price of each product is set out below:

Excise duty changes

	Change in duty (per cent)	Effect on price of typical item (pence)	Unit	
Alcohol				
Beer	0	0	pint	(27)
Wine	1·9	2	75cl bottle	(28)
Sparkling wine	1·9	4	75cl bottle	(28)
Fortified wine	–5·9	–12	75cl bottle	(28)
Cider and perry	1·9	1	2 litre	(29)
Spirits	0	0	70cl bottle	(30)
Fuel				
Leaded petrol	8·4	3	litre	(31)
Unleaded petrol	9·9	3	litre	(32)
Diesel	10·2	3	litre	(33)
Gas oil	10·1	0·15	litre	(35)
Fuel oil	10·5	0·11	litre	(35)
Tobacco				
Cigarettes	7·3	11	pkt of 20	(36)
Cigars	7·3	5	pkt of 5 (small)	(37)
Hand rolling tobacco	7·3	16	25 grams	(37)
Pipe tobacco	7·3	7	25 grams	(37)

4.50 The duty on road fuels will be raised on average by at least 5 per cent in real terms in future Budgets, an increase from the 3 per cent commitment given in the March Budget (34). Developments in charging for road use will be taken into account in determining the appropriate level of duty.

4.51 Duty on tobacco will be increased on average by at least 3 per cent in real terms in future Budgets, as a contribution towards meeting the targets for reductions in smoking in the "Health of the Nation" White Paper (38).

4.52 There are a number of measures to modernise tax law and reduce burdens on business:

– the administration of gaming machine licence duty will be restructured. This will apply from 1 March 1994 for traders operating only over the summer season, and from 1 May 1994 for others (–);

– powers relating to customs offences will be modernised and brought into line with those for VAT and excise. This will allow an audit based system of control (–);

– criminal penalties for many of the less serious excise offences are to be replaced by a system of fixed penalties (–);

– the jurisdiction of VAT tribunals will be extended to cover traders' appeals against decisions on excise and customs matters, by 1 January 1995 (–).

Insurance premium tax

4.53 A new tax will be introduced at a rate of 3 per cent on insurance premiums for most general risks in the UK, from 1 October 1994. It will not apply to life insurance, pensions and other defined classes of long term insurance; insurance of certain ships and aircraft, international railway rolling stock, and goods in international transit; export credit insurance, or reinsurance. (39).

Air passenger duty

4.54 A new duty will be payable by passengers travelling by air from UK airports from 1 October 1994. It will be charged at £5 per passenger for destinations in the UK or the EC, and £10 for destinations elsewhere. There will be exemptions for the return leg of journeys within the UK on a return ticket, children under two who travel free, transit and transfer passengers, and passengers in small aircraft (40).

Vehicle excise duty

4.55 Duty on cars, light goods vehicles, vans and taxis will rise from £125 to £130 from 1 December 1993 (41). New rates will be set for combined transport lorries, to come into force in 1994 (*). Rates of duty for other lorries are unchanged (42).

Business rates

England and Wales

4.56 Poundages will be increased in line with the increase in the RPI in the year to September 1993.

4.57 The maximum real increase in bills faced by properties in England and Wales which are in transition to higher bills as a result of the 1990 reforms will be reduced by half. This means that real increases will be limited to 10 per cent for large properties and $7\frac{1}{2}$ per cent for small properties. Rates bills for small properties in transition which are used for both business and domestic purposes will be frozen in real terms. This change will reduce the total rates bill in England and Wales by 0·8 per cent (43).

Scotland and Northern Ireland

4.58 Scotland and Northern Ireland have different arrangements for business rates but their total rates bill for 1994-95 will also be reduced by 0·8 per cent (43).

National insurance contributions

4.59 The main rate of employers' national insurance contributions will be reduced by 0·2 per cent, and the lower rates by 1 per cent, from April 1994 (44).

4.60 From April 1994 the lower earnings limit will be increased from £56 to £57 a week, in line with the single person's rate of retirement pension; the earnings thresholds for the employers' lower rate bands will each be increased by £5 to £100, £145 and £200; and the upper earnings limit will be increased from £420 to £430 a week. The proposed structure of contributions is:

Structure of national insurance contributions from April 1994

	Percentage NIC rate[1]	
Weekly earnings	Employees	Employers[2]
Below £57	0	0
£57 to £99·99	2% of £57	3·6
£100 to £144·99	plus	5·6
£145 to £199·99	10% of earnings	7·6
£200 to £430	between £57	10·2
Above £430	and £430	10·2

[1] *Not contracted out rates.*
[2] *Rates apply to all earnings.*

4.61 Treasury grant not exceeding 16 per cent of contributory benefit expenditure will be made available to the National Insurance Fund in 1994–95.

4.62 The Government Actuary will report on the likely effect of these changes on the National Insurance Fund. The working assumptions provided to the Government Actuary for use in preparing his report are set out in Annex C to Chapter 5. Estimates of receipts are set out below.

Estimated payments of national insurance contributions[1]

	£ million	
	1993–94	1994–95
Employers	22 980	23 600
Employees	14 530	17 590
Total	37 510	41 190

[1] *Figures are for the UK and are rounded to the nearest £10 million. They are estimates of receipts excluding self-employed and voluntary contributions; and including NHS allocated contributions. Employers' contributions are gross of deductions for statutory sick pay and statutory maternity pay. Detailed figures will be included in the Government Actuary's report on the draft of the Social Security (Contributions)(Re-rating) Order.*

Table 4.1 Direct effects of Budget measures (†)

	£ million		yield (+)/cost (–) of measure	
	Changes from a non-indexed base	Changes from an indexed base		
	1994-95	1994-95	1995-96	1996-97
INLAND REVENUE				
Income tax				
1 Allowances – unchanged	—	430	550	560
2 Basic rate limit – unchanged	—	120	170	210
3 Married couple's allowance – restricted to 15% etc	—	—	830	1 060
4 Mortgage interest relief – restricted to 15%	—	—	900	950
5 Incapacity benefit – tax new recipients from April 1995	—	—	50	110
6 Tax relief for vocational training	*	*	*	–5
7 Fuel scales – up 6%	10	10	15	15
Other personal taxation				
8 Simplified assessing	—	—	—	50
9 CGT annual exempt amount – unchanged	—	—	5	5
10 Inheritance tax threshold – unchanged	—	10	20	25
Investment in small businesses				
11 Enterprise Investment Scheme	–10	–10	–35	–50
12 CGT relief for gains reinvested in unquoted trading companies	*	*	–5	–10
13 CGT retirement relief – changed	*	*	–10	–10
Business taxation				
14 Foreign income dividend scheme	30	30	—	–100
15 Limits for small companies' corporation tax rate	*	*	–30	–40
Oil taxation				
16 Valuation and pricing changes	5	5	5	5
Anti-avoidance measures				
17 Payments in marketable assets – taxed under PAYE	200	200	75	—
18 Profit related pay – restricted	100	100	100	100
19 Indexation of capital losses – reformed	50	50	200	300
20 Company purchase schemes	100	100	100	100
21 Controlled foreign companies	—	—	—	50
22 Measures to counter avoidance of stamp duty	60	60	70	80
Total Inland Revenue taxes	**545**	**1 105**	**3 010**	**3 405**

Table 4.1 Direct effects of Budget measures—*continued*

	£ million			yield (+)/cost (–) of measure
	Changes from a non-indexed base	Changes from an indexed base		
	1994–95	1994–95	1995–96	1996–97
CUSTOMS AND EXCISE				
Value added tax				
23 Registration threshold raised to £45,000	–40	–40	–45	–45
24 Concession on insolvencies	–15	–15	–15	–15
25 Input tax recovery on cars leased to driving schools etc	–15	–15	–5	–5
26 Amendment to VAT fuel scales	10	10	10	10
Excise duties on:				
27 beer unchanged	—	–55	–60	–65
28 wine and made wine up 1·9%; fortified wine down 5·9%	10	—	—	—
29 cider and perry up 1·9%	*	—	—	—
30 spirits unchanged	—	–15	–15	–15
31 leaded petrol up 8·4%	175	175	175	175
32 unleaded petrol up 9·9%	275	275	330	380
33 diesel up 10·2%	175	175	185	215
34 road fuels up 5% in real terms in future Budgets	85	85	420	815
35 gas and fuel oil up 10·1/10·5%; other rebated oils up 8·4%	15	15	15	15
36 cigarettes – specific duty up 7·3%	400	295	310	325
37 other tobacco products up 7·3%	30	25	25	25
38 tobacco up 3% in real terms in future Budgets	55	55	255	485
Other taxes				
39 Insurance premium tax	295	295	775	840
40 Air passenger duty	115	115	330	355
Total Customs and Excise taxes	**1 570**	**1 380**	**2 690**	**3 495**
VEHICLE EXCISE DUTY				
41 Duty on cars etc up to £130	130	65	70	70
42 Freeze lorry rates	—	–10	–10	–10
Total vehicle excise duty	**130**	**55**	**60**	**60**
BUSINESS RATES				
43 Halve maximum real increases due under transitional arrangements	–105	–105	...	...
Total business rates	**–105**	**–105**	**...**	**...**
NATIONAL INSURANCE CONTRIBUTIONS				
44 Cut employer NICs from April 1994	–810	–830	–940	–960
45 Anti-avoidance measure	70	70	70	70
46 Car fuel scales	—	—	5	5
Total national insurance contributions	**–740**	**–760**	**–865**	**–885**
TOTAL	**1 400**	**1 675**	**4 895**	**6 075**

(†) *Annex A explains how the revenue effects are calculated.*

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

Annex A to Chapter 4
Explaining the costings

4A.1 This annex explains how the effects of Budget measures on tax yield are calculated.

The general approach

4A.2 The direct effect of a tax change is the difference between the tax yield from applying the post-Budget and pre-Budget tax regimes to the levels of income, profit etc expected after the Budget.

4A.3 Since total income and total spending at factor cost are assumed to be fixed at their post-Budget levels, the estimates do not include any effect the tax changes themselves may have on levels of income and spending.

4A.4 Other effects on behaviour are taken into account only where they are likely to have a significant effect on the yield. For example, changes to excise duties influence the pattern of consumer spending.

4A.5 The estimates take account of any consequential changes in receipts from related taxes. For example, the estimated yield from increasing the excise duty on tobacco includes the change in the yield of VAT on that duty, and the change in the yield of VAT and other excise duties resulting from the new pattern of spending.

4A.6 The direct effect of some tax changes is affected by the implementation of others. Where this happens, measures are costed in the order in which they appear in Table 4.1.

4A.7 In the first column of the table the pre-Budget regime is the regime of allowances, thresholds and rates of duty which applied before this Budget. The remaining three columns strip out the effects of inflation by assuming that allowances, thresholds and rates of duty are increased in line with prices in this and in future Budgets. In each case the base takes account of measures previously announced but not yet implemented (see Annex B). Measures announced in this Budget are assumed to be indexed in the same way in future Budgets.

4A.8 The assumptions made in calculating the indexed base are:

- **November 1993 Budget:** allowances and thresholds raised in April 1994 in line with the increase in the RPI over the year to September 1993 (1·8 per cent). Rates of excise duty rise on 30 November 1993 (1 January 1994 for alcohol) in line with the increase in the RPI over the nine months to September 1993 (1·9 per cent).
- **In each subsequent year:** excise duties rise in December (January for alcohol), and allowances and thresholds rise in April, in line with the assumed increase in the RPI over twelve months to the previous September. The assumptions are $3\frac{1}{4}$ per cent, $3\frac{1}{4}$ per cent and $2\frac{1}{2}$ per cent for September 1994, 1995 and 1996 respectively.

Notes on individual Budget measures

Inland Revenue taxes

1,2 Under statutory indexation the allowances and limits would have risen in line with the increase in the RPI over the year to September 1993 (1·8 per cent).

4 Assumes interest rates are unchanged from recent levels. There will also be a reduction in public spending of £70 million in 1995-96 and £80 million in 1996-97 on mortgage interest relief for borrowers who are non-taxpayers.

5 The yield will increase in future years as the number of new claimants rises.

8 The yield in 1996-97 reflects changes in the method of calculating profits of unincorporated businesses, and income not taxed at source, on which income tax is due in January 1997. For subsequent years the measures are expected to produce a greater yield.

9,10 Under statutory indexation the capital gains tax annual exempt amount and the inheritance tax threshold would have risen in line with the increase in the RPI over the year to September 1993 (1·8 per cent).

11 The cost will depend on the level of take up.

14 The benefits to companies and their shareholders will depend on the dividend decisions taken by companies. The yield in 1994-95 occurs because payments of tax credits are reduced before surplus ACT is repaid.

16 The yield could be significantly greater at times of exceptional oil price volatility.

17–22 The yields represent the estimated direct effect of the measures on the existing level of activity. Without these measures there could be a more significant loss of revenue in the future.

Customs and Excise taxes

28 The reduction in duty on fortified wines reflects the Government's intention, announced in December 1992, to reduce the duty differential between fortified wine and table wine.

31–33 These rows show the additional yield from the duty increases specified, compared with the yield from raising duty by 3 per cent in real terms, as envisaged in the commitment given in the March Budget.

34 This shows the additional yield from raising road fuel duties by 5 per cent in future Budgets, compared with the 3 per cent real increases envisaged in the commitment given in the March Budget.

Business rates

43 The costs in 1995-96 and 1996-97 are not known since they will depend on the transitional arrangements, if any, following the 1995 revaluation.

Revenue effects in 1993-94 A number of the Budget measures have effects on revenue yield in 1993-94. These are summarised below:

Direct effects of Budget measures in 1993-94 £ million

		Yield (+)/cost (–) of measure
		Changes from an indexed base
18	Profit related pay – restricted	40
22	Stamp duty – measures to counter avoidance	10
23	VAT threshold	–5
27–30	Alcohol duty	–10
31–33	Road fuel duties – up 3p a litre	170
35	Other fuels	5
36–37	Tobacco duty	35
41–42	Car VED up by £5, lorry VED frozen	20
45	NICs anti-avoidance measure	20
	Total	**285**

Annex B to Chapter 4
Changes announced before the Budget

This annex sets out a number of tax and national insurance changes which were announced before the Budget, the effects of which are taken into account in the forecasts.

Direct effects of measures announced since the March 1993 Budget

£ million				yield (+)/cost (-)
	Changes from a non-indexed base	Changes from an indexed base		
	1994-95	1994-95	1995-96	1996-97
Inland Revenue taxes				
B1 Postponed abolition of stamp duty on securities	950	950	1 000	1 050
B2 Authorised unit trusts	*	*	5	5
Customs and Excise taxes				
B3 VAT on beverages – new borderline	5	5	5	5
B4 VAT exemption for sporting services	-55	-55	-55	-55
B5 VAT exemption for cultural services	-15	-15	-15	-15
Total	**885**	**885**	**940**	**990**

* = *Negligible*

Inland Revenue taxes

B1 The abolition of stamp duties on securities and on transfers of property other than land and buildings was announced in the 1990 and 1991 Budgets respectively. The intention was that this should coincide with the start of the TAURUS system of paperless trading. The Stock Exchange cancelled the TAURUS project in March 1993 and the Bank of England is now working on plans for a new system known as Crest. Stamp duties on securities etc will not be abolished before the start of Crest which is unlikely to be before mid-1996. The March FSBR assumed that duties continued to the end of 1993-94. It is now assumed that the duties continue beyond that date. The revenue effects include the consequential effects on other taxes.

B2 Changes to the tax rules for authorised unit trusts were announced in June 1993. From 1994-95 the rate of corporation tax paid by authorised unit trusts will be realigned with the basic rate of income tax. There will be new rules for trusts which invest in assets paying interest.

Customs and Excise taxes

B3 The borderline between beverages which are zero-rated and standard-rated for VAT has been clarified by a Treasury Order which comes into effect on 1 December 1993. The main effect is to tax freshly pressed and pasteurised fruit juices.

B4,5 On 22 July 1993 the Paymaster General announced the Government's intention to exempt from VAT sporting services provided by non profit making bodies and cultural services supplied by public bodies.

Direct effects of measures announced in the March 1993 Budget or earlier which take effect on or after 30 November 1993

£ million	Changes from a non-indexed base	Changes from an indexed base		yield (+)/cost (-)
	1994-95	1994-95	1995-96	1996-97
Inland Revenue taxes				
B6 Married couple's allowance – restricted to 20%	910	970	1 260	1 330
B7 Lower rate band – increased to £3,000	–420	–330	–410	–510
B8 Mortgage interest relief – restricted to 20%	820	820	900	950
B9 Car scales – price based charge from 1994-95	—	—	35	85
B10 Abolition of BES	15	15	55	75
B11 Reduction in ACT rate to 20%	–1 000	–1 000	–200	–200
Customs and Excise taxes				
B12 VAT on domestic fuel and power	950	950	2 300	2 850
B13 Road fuel duties to be increased by 3% real	810	545	1 035	1 605
Vehicle excise duty				
B14 Rate for special type vehicles increased	*	*	*	*
National insurance contributions				
B15 Increase in employees' contributions	1 760	1 760	2 030	2 130
B16 Increase in self-employed Class 4 rate	50	50	115	130
B17 Changes to car benefit scales	—	—	—	15
Total	3 895	**3 780**	**7 120**	**8 460**

*— = Nil * = Negligible*

Inland Revenue taxes

B6 From 6 April 1994 tax relief for the married couple's allowance, and allowances linked to it, will be restricted to 20 per cent. The married couple's allowance for those aged 65 and over will be increased by £200. Tax relief on the first £1,720 of maintenance payments will also be restricted to 20 per cent.

B7 The lower rate band will be widened to £3,000 for 1994-95.

B8 From 6 April 1994 tax relief for mortgage interest payments will be restricted to 20 per cent. This will reduce public spending on mortgage interest relief for borrowers who are non-taxpayers or liable only at the lower rate of income tax by £70 million a year in 1994-95 and 1995-96, and by £80 million in 1996-97. Relief will remain at 25 per cent for those aged 65 and over who take out loans to buy life annuities.

B9 From 6 April 1994 the car benefit scale charges will be replaced by a charge of 35 per cent of the price of a car, with discounts for business mileage and older cars. The revenue effects assume a 3 per cent a year increase in the average price of company cars for 1995-96 and 1996-97.

B10 As announced in the 1992 Budget the Business Expansion Scheme will be abolished from the end of 1993.

B11 The rate of advance corporation tax (ACT) will be reduced from $22\frac{1}{2}$ per cent to 20 per cent from 1994-95. This was part of a package of changes to the taxation of dividends announced in the March Budget. The package as a whole is expected to yield £100 million in 1994-95, £900 million in 1995-96 and £1,000 million in 1996-97.

Customs and Excise taxes

B12 VAT will be charged on domestic fuel and power at 8 per cent from 1 April 1994, and at the standard rate from 1 April 1995.

B13 The Chancellor said in the March Budget that road fuel duties would be increased on average by at least 3 per cent in real terms in future Budgets.

Vehicle excise duty

B14 The rate for special type vehicles increases from £4,250 to £5,000 on 30 November 1993.

National insurance contributions

B15, 16 It was announced in the March Budget that the main rate of employees' national insurance contributions would rise by 1 percentage point to 10 per cent from 1 April 1994, and the Class 4 rate of contributions for the self-employed would rise by 1 percentage point to 7·3 per cent.

B17 The new charges for company cars (see B.9) are used for employers' national insurance contributions as well as income tax.

5 Public spending

Introduction

5.01 The Government's objective is to reduce public spending as a share of national income over time. The public spending plans set out in this Budget are consistent with that. In each of the three Survey years, the new plans are well below the figures set out in the last Financial Statement and Budget Report (FSBR). Control of public spending will therefore contribute significantly more to reducing the public sector borrowing requirement than expected at the time of the last Budget.

New control total

5.02 The Government's plans for public spending are set in terms of the new control total (NCT). This covers 85 per cent of total spending, but excludes the two areas of expenditure most affected by the cycle. A full description of the NCT and its components was given in the 1992 Autumn Statement, Chapter 2, Annex C.

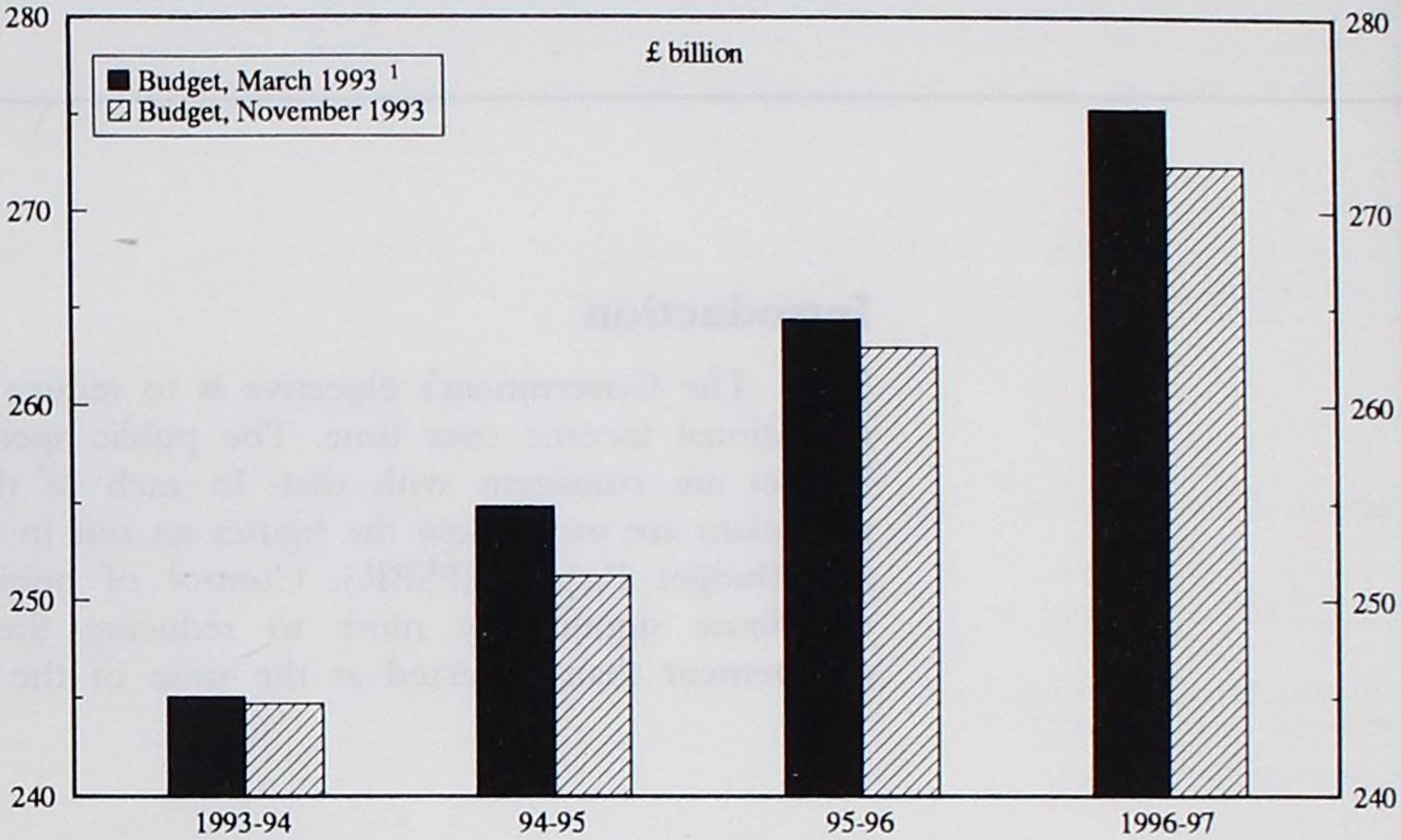
5.03 The control totals for the three Survey years 1994-95 to 1996-97 have been set at £251·3 billion, £263·0 billion, and £272·3 billion. These are £3·6 billion, £1·5 billion and £2·9 billion below the figures in the last FSBR (see Table 5.1 and Chart 5.1, and also Table 1.2). The control totals include Reserves of £3½ billion in 1994-95, £7 billion in 1995-96 and £10½ billion in 1996-97.

Table 5.1 The new control total

	£ billion			
	1993-94	1994-95	1995-96	1996-97
Plans in March 1993 Budget	243·8	253·6	263·3	274·1
Classification changes since March Budget[1]	1·3	1·3	1·2	1·1
Plans after classification changes	245·1	254·8	264·5	275·3
New control total set out in this report	244·7	251·3	263·0	272·3
Reductions	–0·4	–3·6	–1·5	–2·9

[1] *The main classification change reflects the changed national accounting treatment of the fossil fuel levy (see paragraph 5B.8).*

Chart 5.1 The new control total

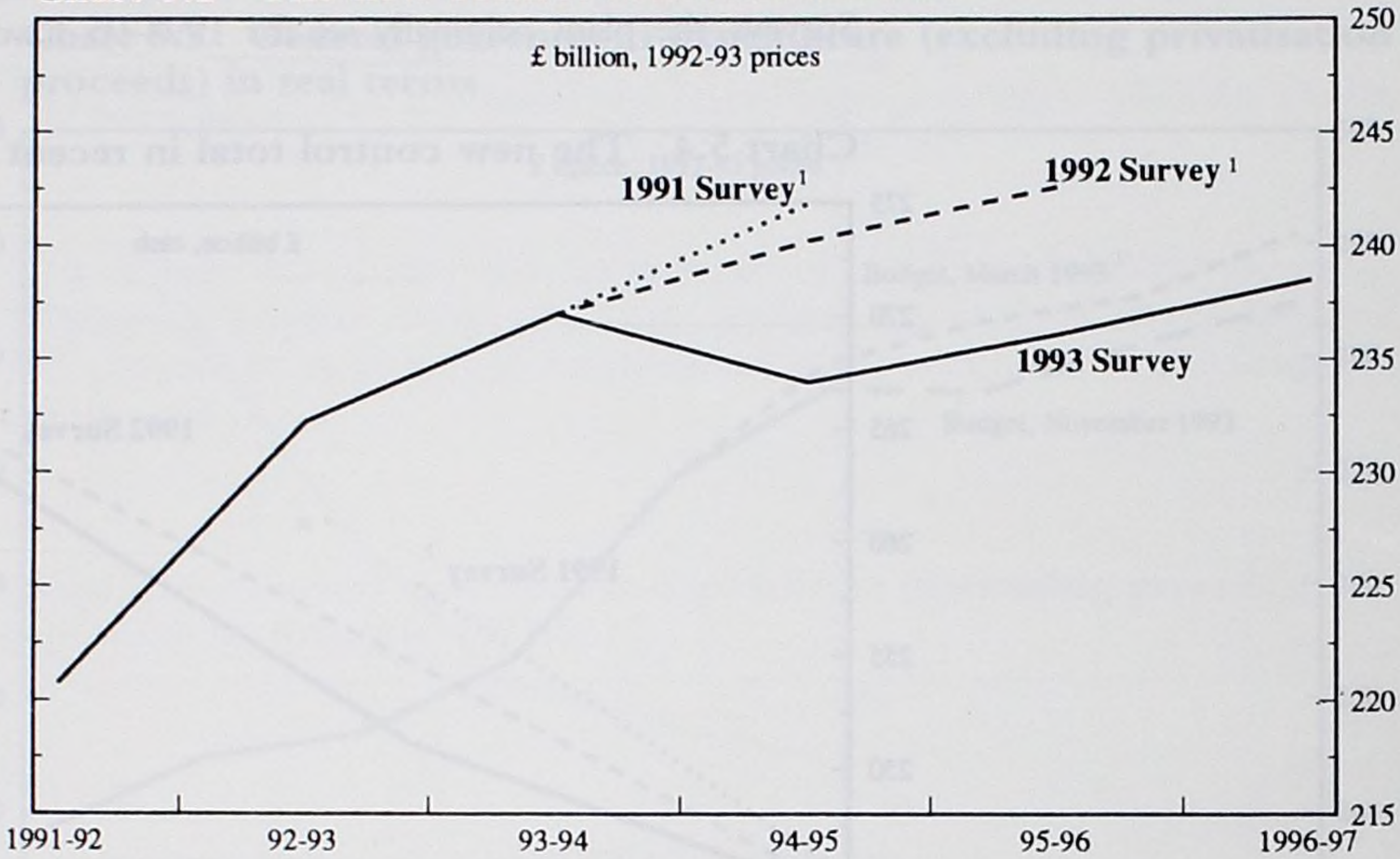


1 *Adjusted for classification changes.*

5.04 In real terms (ie deflated by the GDP deflator) these figures imply a fall of $1\frac{1}{4}$ per cent in the NCT in 1994-95 and rises of 1 per cent in 1995-96 and 1996-97. Average real growth over the three year period is less than $\frac{1}{4}$ per cent a year, well below the $1\frac{1}{2}$ per cent ceiling established by the Government last year.

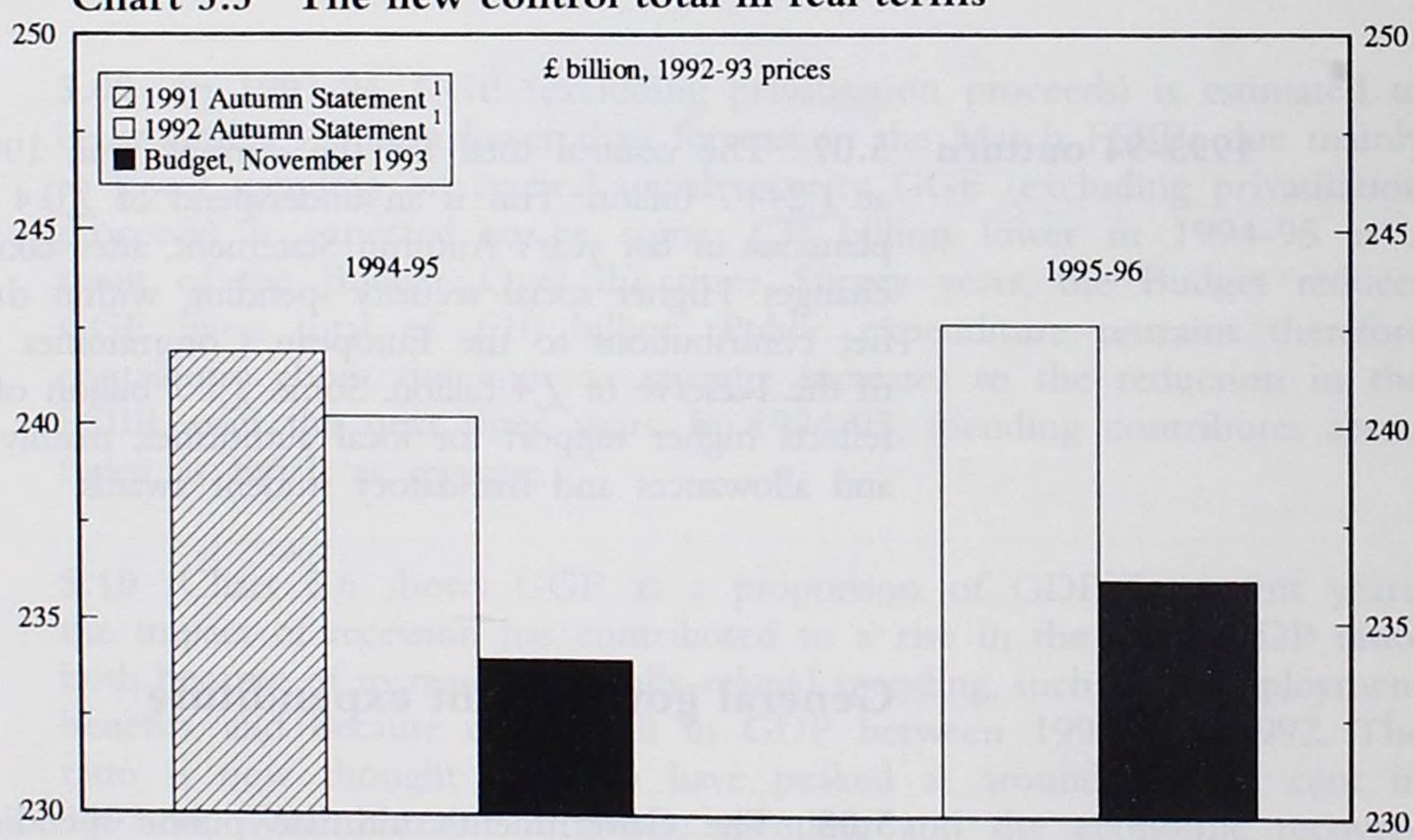
5.05 The effect is to lower the path of real NCT growth for the second successive Survey (see Chart 5.2). Chart 5.3 shows that public spending levels for 1994-95 and 1995-96 will now be well below original plans.

Chart 5.2 The new control total in real terms



[1] *Adjusted for classification changes.*

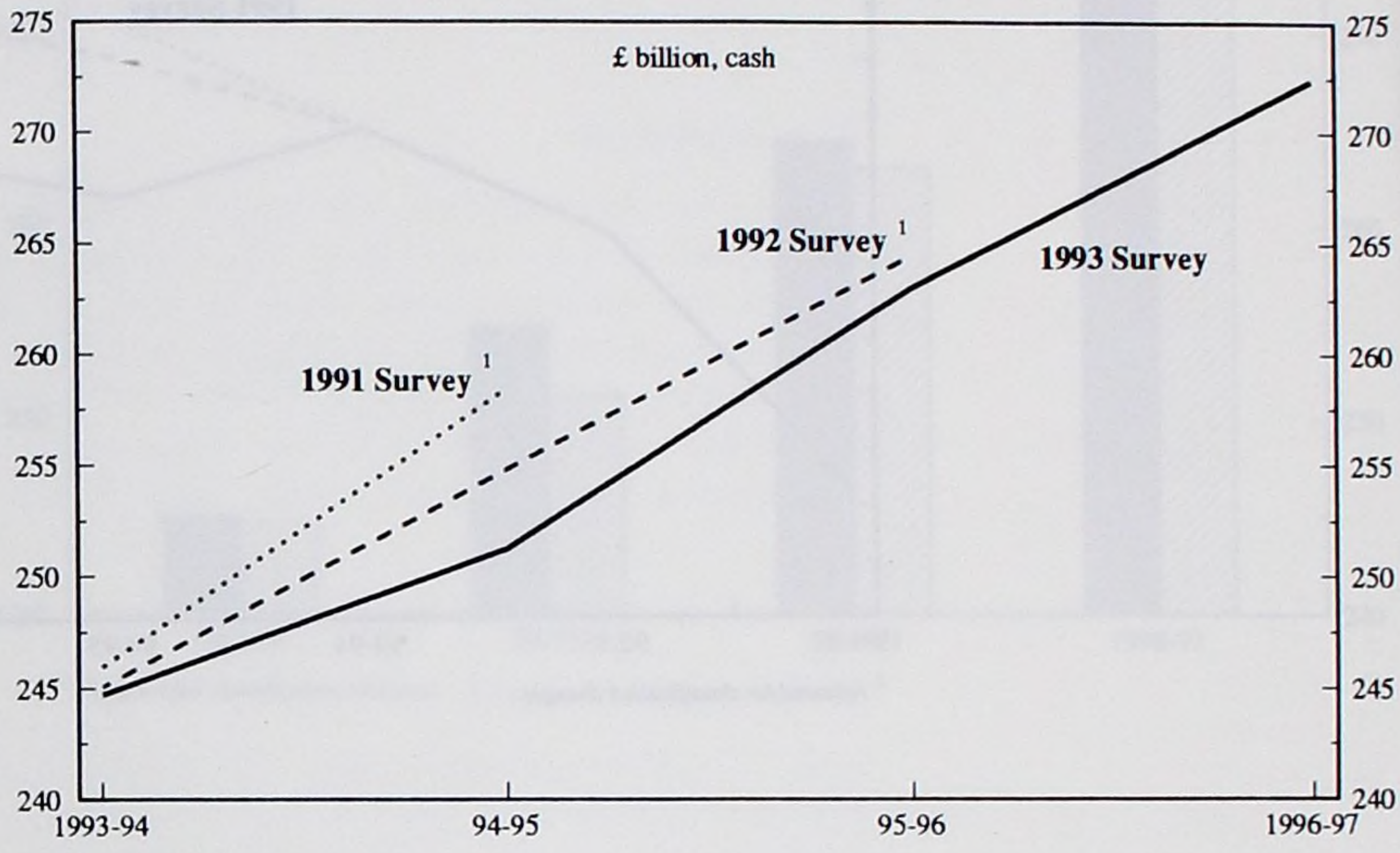
Chart 5.3 The new control total in real terms



[1] *Adjusted for classification changes.*

5.06 Chart 5.4 shows the same effect in cash terms. Over the past two Surveys, the plans originally set for 1994-95 have been reduced by £7 billion.

Chart 5.4 The new control total in recent Surveys



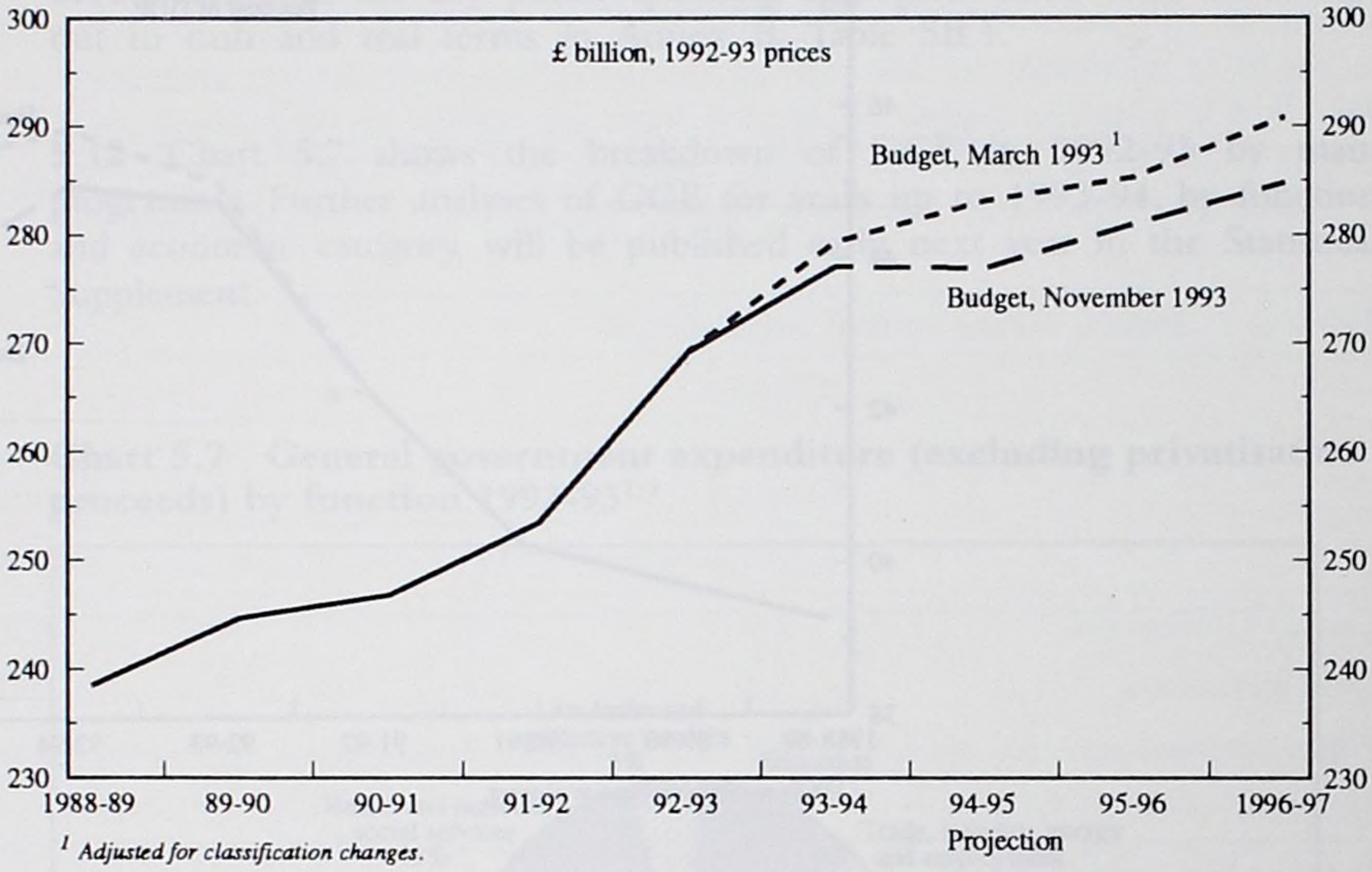
[1] *Adjusted for classification changes.*

1993-94 outturn **5.07** The control total for the current year, 1993-94, is currently forecast at £244·7 billion. This is an underspend of £0·4 billion compared with the plans set in last year's Autumn Statement, after taking account of classification changes. Higher social security spending within the control total and higher net contributions to the European Communities together account for most of the Reserve of £4 billion. Some £1·7 billion of the claim on the Reserve reflects higher support for local authorities, mainly in respect of rent rebates and allowances and mandatory student awards.

General government expenditure

5.08 The Government's ultimate public spending objective is expressed in terms of general government expenditure (GGE) excluding privatisation proceeds. This is a wider aggregate than the NCT and includes debt interest, elements of social security spending which are significantly affected by the cycle and various accounting adjustments needed for consistency with the national accounts. GGE is now expected to grow by just under 1 per cent a year on average over the three Survey years, substantially below the expected growth of the economy. As with the NCT, the rate of growth is sharply down on the projected path in the last FSBR, and represents a marked slowdown on the growth seen over recent years (see Chart 5.5).

Chart 5.5 General government expenditure (excluding privatisation proceeds) in real terms

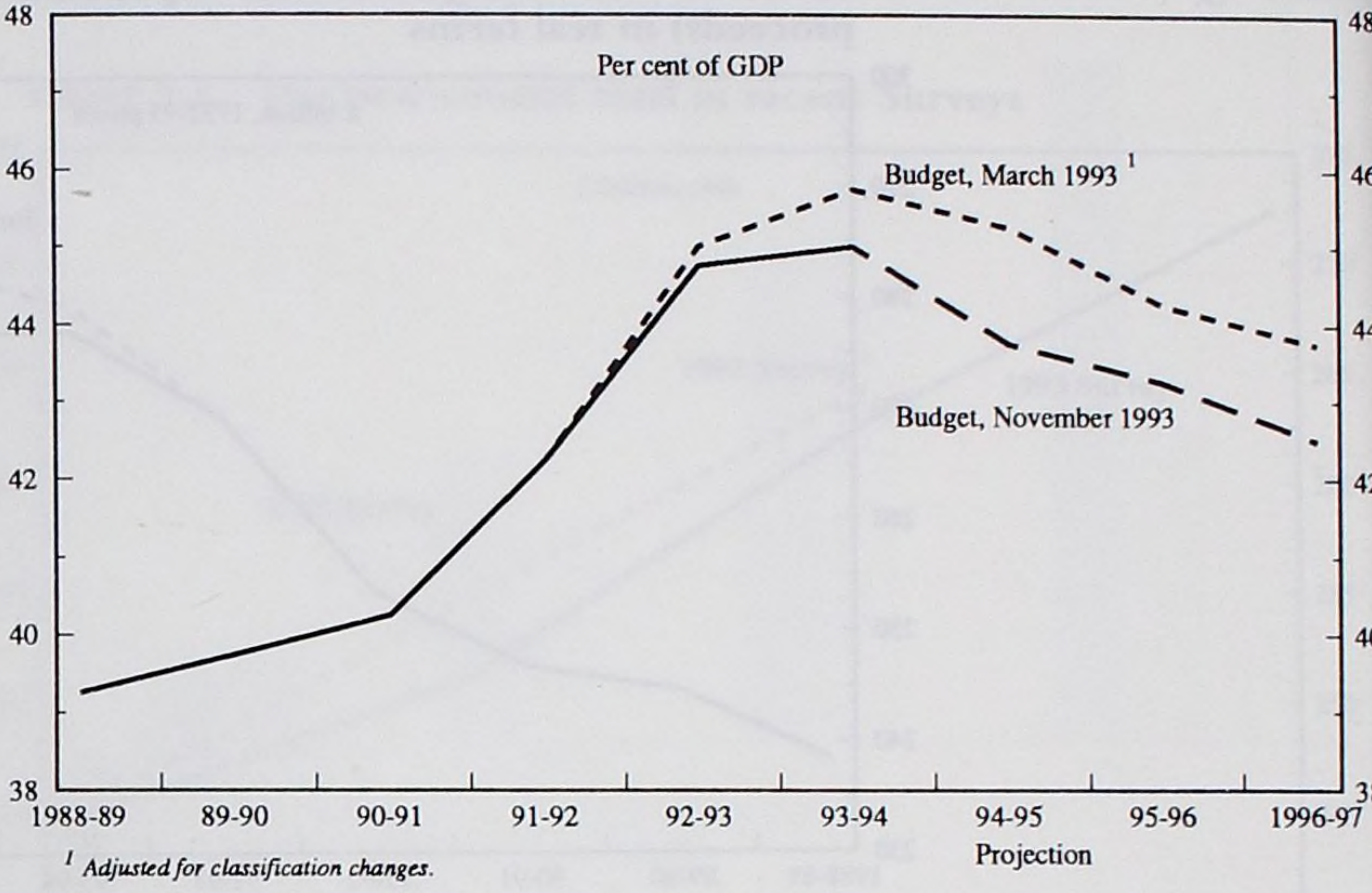


[1] *Adjusted for classification changes.*

5.09 In 1993-94, GGE (excluding privatisation proceeds) is estimated to be around £1 billion lower than forecast in the March FSBR, due mainly to lower spending on cyclical social security. GGE (excluding privatisation proceeds) is expected to be some £3$\frac{3}{4}$ billion lower in 1994-95 as a result of the Budget. Over the three Survey years, the Budget reduces GGE by a total of £10 billion. Public expenditure restraint therefore contributes about the same as revenue increases to the reduction in the PSBR over the next three years. In 1994-95, spending contributes about twice as much as revenue.

5.10 Chart 5.6 shows GGE as a proportion of GDP. In recent years, the impact of recession has contributed to a rise in the GGE/GDP ratio, both because of increased cyclically-related spending, such as unemployment benefits, and because of the fall in GDP between 1990 and 1992. The ratio is now thought likely to have peaked at around 45 per cent in 1993-94. With restraint in public spending and the economic recovery gathering pace, the ratio is projected to fall to 43$\frac{3}{4}$ per cent in 1994-95, and to 42$\frac{1}{2}$ per cent in 1996-97 (see Table 5.2). This represents considerably faster progress on the Government's public spending objective than expected in the 1992 Autumn Statement or the March FSBR.

Chart 5.6 General government expenditure (excluding privatisation proceeds)



[1] *Adjusted for classification changes.*

Table 5.2 The new control total and general government expenditure (excluding privatisation proceeds)[1]

£ million

	Outturn	Estimate outturn	New plans/projections			Changes from previous plans/projections		
	1992-93	1993-94	1994-95	1995-96	1996-97	1993-94	1994-95	1995-96
Central government expenditure[2]	158 134	170 100	172 900	179 900	184 400	3 400	400	2 600
Local authority expenditure[3]	69 373	70 200	71 700	73 700	75 600	900	–500	–600
Financing requirements of nationalised industries	4 757	4 690	3 190	2 440	1 870	–430	30	–420
Reserve			3 500	7 000	10 500	–4 000	–3 500	–3 000
Adjustment		–300				–300		
New control total	**232 264**	**244 700**	**251 300**	**263 000**	**272 300**	**–400**	**–3 600**	**–1 500**
Cyclical social security	13 194	14 000	15 000	15 500	16 000	–1 100	–1 500	–1 500
Central government debt interest	17 446	19 400	22 500	24 500	25 500	0	–1000	–1 500
Accounting adjustments	6 319	8 000	9 000	10 000	11 000	400	0	500
General government expenditure excluding privatisation proceeds	**269 223**	**286 100**	**297 300**	**313 100**	**325 200**	**–1 100**	**–5 700**	**–3 600**
GGE excluding privatisation proceeds as a per cent of GDP	44¾	45	43¾	43¼	42½			

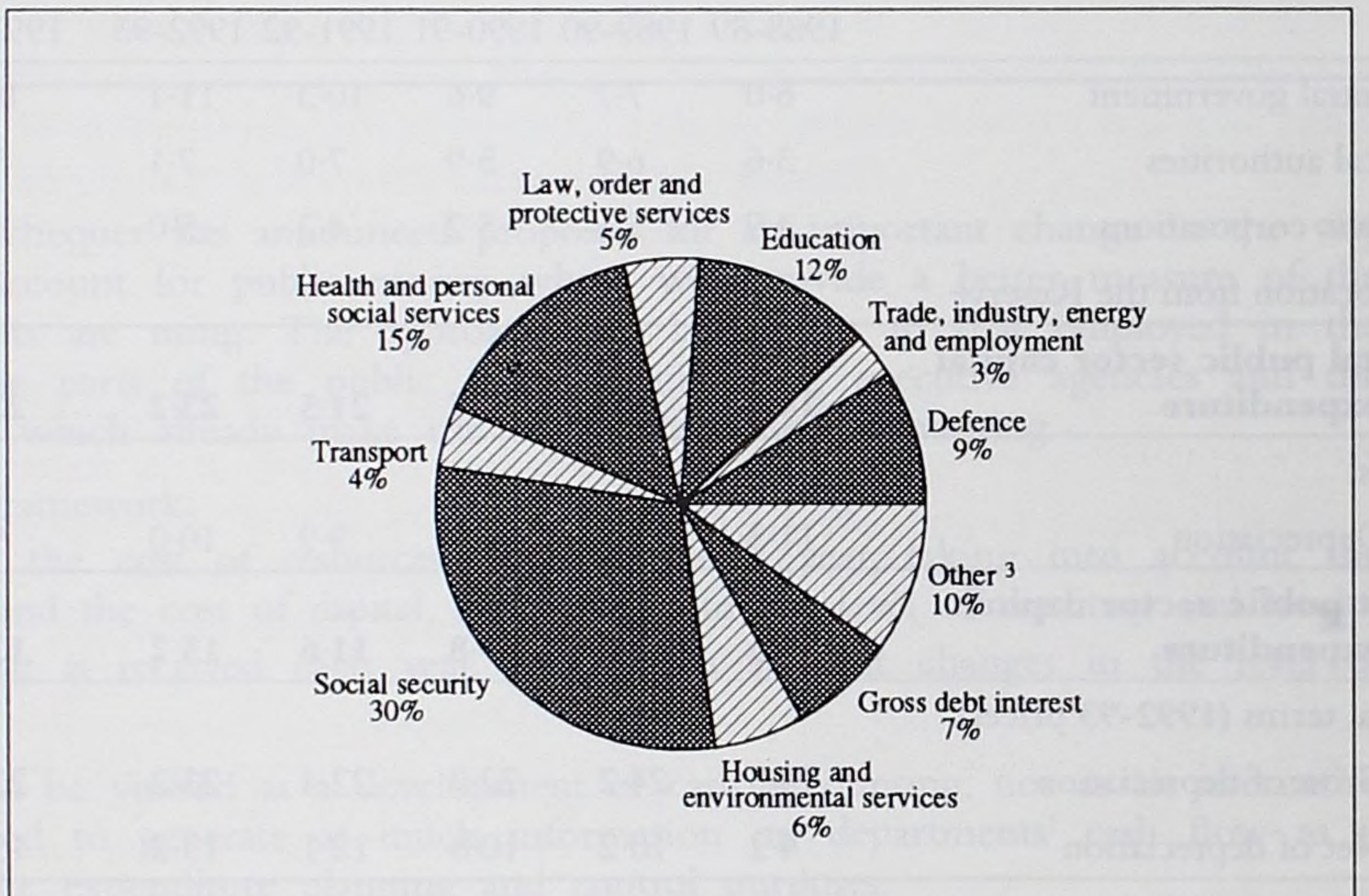
[1] *For definitions, rounding and other conventions, see notes in Annex B (page 113).*
[2] *Excluding cyclical social security.*
[3] *Comprises total central government support for local authorities and local authority self-financed expenditure.*

Public spending trends

5.11 Trends in the key public spending aggregates since 1963-64 are set out in cash and real terms in Annex B, Table 5B.1.

5.12 Chart 5.7 shows the breakdown of GGE in 1992-93 by main programme. Further analyses of GGE for years up to 1993-94, by function and economic category, will be published early next year in the Statistical Supplement.

Chart 5.7 General government expenditure (excluding privatisation proceeds) by function 1992-93[1, 2]



[1] *Spending in Scotland, Wales and Northern Ireland has been allocated to the appropriate fuctions.*
[2] *Local authority spending accounts for 27 per cent of the total.*
[3] *Includes national accounts adjustments.*

Main features

Public sector pay and running costs

5.13 As announced by the Chancellor on 14 September 1993, central government departments will be expected next year to cover pay and running costs increases from efficiency savings of at least 2 per cent and other economies. Increases for higher workload in areas such as the prison service and tax compliance are offset by reductions elsewhere.

5.14 Provision for the running costs of central government departments in the period 1994-95 to 1996-97 is frozen at broadly the 1993-94 level of £20·1 billion. Compared with previous plans, provision has been cut by around £400 million in 1994-95 and £600 million in 1995-96.

5.15 Provision for pay throughout the rest of the public sector has been set on a comparable basis. The general government paybill is not therefore expected to change much next year, except where major workload changes are projected.

Capital spending

5.16 Total public sector capital spending in 1993-94 is expected to total £23·8 billion, up from £23·2 billion in 1992-93 and £21·5 billion in 1991-92. Details are set out in Table 5.3.

Table 5.3 Public sector capital expenditure[1]

	£ billion								
	Outturn					Estimated outturn	Projections		
	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Central government	6·0	7·7	9·6	10·3	11·1	10·8	$9\frac{3}{4}$	$9\frac{1}{4}$	10
Local authorities	3·6	6·9	5·9	7·0	7·1	7·7	$6\frac{1}{2}$	$6\frac{1}{4}$	$6\frac{1}{4}$
Public corporations	4·9	5·6	5·2	4·2	5·0	5·3	$5\frac{3}{4}$	$5\frac{1}{4}$	$5\frac{1}{4}$
Allocation from the Reserve							0·4	0·7	1·0
Total public sector capital expenditure	**14·6**	**20·3**	**20·7**	**21·5**	**23·2**	**23·8**	**$22\frac{1}{4}$**	**$21\frac{1}{2}$**	**$22\frac{3}{4}$**
Less:									
Depreciation	11·3	11·7	10·9	9·9	10·0	9·9	$10\frac{1}{2}$	$10\frac{1}{2}$	11
Net public sector capital expenditure	**3·3**	**8·6**	**9·8**	**11·6**	**13·2**	**13·9**	**$11\frac{3}{4}$**	**11**	**$11\frac{3}{4}$**
Real terms (1992-93 prices)									
Gross of depreciation	18·6	24·2	22·9	22·4	23·2	23·1	$20\frac{3}{4}$	$19\frac{1}{4}$	20
Net of depreciation	4·2	10·2	10·8	12·1	13·2	13·5	11	10	$10\frac{1}{4}$

[1] *Figures are shown for the national accounts definition of capital spending described in Annex A. They include the capital spending of industries now privatised, or planned to be privatised before 31 March 1997, while they remained in the public sector.*

5.17 In 1994-95 public sector capital spending, which is measured net of receipts from asset sales, is expected to be £$22\frac{1}{4}$ billion. The fall compared with this year mainly reflects the profile of capital spending by local authorities. This follows the decision announced in the last Autumn Statement to relax for a limited period the rules governing the use of receipts by local authorities. Spending financed by this measure will continue for a number of years, but at a steeply diminishing rate. In addition, investment associated with a number of large-scale projects, particularly in relation to the Channel Tunnel, has now passed its peak of activity.

5.18 The level of public sector capital spending beyond 1994-95 is particularly uncertain. After allowing for a stylised allocation from the Reserve, based on historic expenditure shares (see Annex A, paragraph 5A.3), it is expected to be at about the same level in 1996-97 as in 1994-95. There is a temporary dip in 1995-96, reflecting the expected sale of married quarters by the Ministry of Defence.

5.19 Public sector capital spending was maintained at high levels during the recession. As the recovery continues, capital spending by the private sector is likely to rise and that in the public sector to fall. The overriding need for public spending to contribute towards the reduction in public borrowing means that capital spending will not be sustained at levels as high as in 1993-94. Even so, tight control of public sector pay and civil service running costs has enabled the Government to sustain capital spending at a level higher than would otherwise have been possible.

Resource accounting

The Chancellor of the Exchequer has announced proposals for an important change in the way Government departments account for public money which will provide a better measure of the resources which departments are using. The approach will be similar to that employed in the private sector and in those parts of the public sector – including executive agencies and the National Health Service – which already make use of accruals-based accounting.

In a resource accounting framework:

- expenditure represents the cost of resources consumed each year, taking into account the depreciation of assets and the cost of capital, and changes in the level of creditors and stocks;
- income represents what is received each year, taking into account changes in the level of debtors.

Resource accounting should be viewed as a development of cash accounting, not as an alternative system. It can thus be used to generate as much information on departments' cash flow as is necessary for essential public expenditure planning and control purposes.

The proposed move to resource accounting is part of the development of a more strategic relationship between the centre of government and departments and agencies, following principles originally set down in the Financial Management Initiative in 1982. Linked to parallel changes in a department's organisational structure and management information systems, resource accounting will help departments manage their finances and resources more effectively, and facilitate the further development of measures of departmental output and performance.

It is proposed that departments should introduce resource accounting over the next 3-5 years. The Chancellor will publish detailed proposals in the first half of 1994. In the meantime, further work is being done with departments to establish:

- the framework of accounting principles and conventions, based on private sector practice, that is required;
- the handling of various practical issues (information technology systems, staff training, etc) associated with developing resource accounting in departments;
- the implications for public expenditure planning and control arrangements; and
- the Parliamentary implications of any changes.

5.20 The figures above take no account of the investment programmes of the former nationalised industries, which amounted to over £10 billion in 1992-93, nor of the large amount of private sector investment stimulated by Government policies, including housing and urban programmes. Over the medium term, the Government intends that an increasing proportion of the capital invested in public services will be delivered through private finance.

5.21 Annex A describes various alternative measures of capital spending and some historical trends.

Private finance

5.22 The aim of the private finance initiative is to involve the private sector in new investment and service provision in areas traditionally regarded as the responsibility of the public sector. This will produce projects which are better designed and better managed. The initiative is based on two fundamental principles: to receive rewards the private sector must genuinely assume risk, and value for money must be demonstrated for any expenditure by the public sector.

5.23 Spending by the public sector, by way of a contribution to a privately financed project or a payment for services, counts against a department's spending allocation or its external financing limit in the case of a nationalised industry. But the private sector's contribution is additional to public provision. This means that, for a given amount of public expenditure, new and better quality capital investment will be secured by the nation.

5.24 In March the Government announced that the Channel Tunnel Rail Link and Heathrow Express would proceed as joint ventures between the public and private sectors and that the Government would examine how the private sector could become fully involved in Crossrail and the second Forth road bridge. Work on building the Heathrow Express began in October 1993; the Secretary of State for Scotland's feasibility studies into how the proposed second Forth road bridge might be privately financed are nearing completion; and the Secretary of State for Transport has recently announced the basis on which the Channel Tunnel Rail Link will be transferred to the private sector, with the competitive process starting in early 1994.

5.25 In addition, the Home Secretary has said that he will invite the private sector to put forward proposals for custodial service "packages" involving the finance, design, construction and operation of six new prisons. A briefing pack for those interested in tendering for the first two prisons will be issued in December 1993.

5.26 The Government is committed to expanding further the scope of private finance. The initiative offers, for example, major opportunities for improved services in the NHS, and the prospect of improved water and sewerage infrastructure in Scotland and Northern Ireland.

5.27 In this Budget, the Chancellor has announced that the refurbishment of the West Coast Main Line will be privately financed; that the Lewisham extension of the Docklands Light Railway will proceed as a joint venture; and that a new air traffic control centre for Scotland will be developed as a financially free-standing private sector project. The Chancellor also announced that the Government intends to introduce contracts under which the private sector will design, build, finance and operate roads. Electronic motorway charging will be introduced when the technology is ready. In addition, a scheme now going to tender for the rationalisation of NHS trust facilities at Aintree in Liverpool may serve as a model for similar schemes; and the private sector is to provide nursing home accommodation for NHS patients in Eastbourne.

5.28 The Chancellor has recently established a joint public/private sector working group, with Sir Alastair Morton as chairman, to stimulate the flow of private finance projects. The group is intended to identify new areas of activity where the private sector can get involved and find solutions to any obstacles which may impede progress.

The new plans: departmental detail

5.29 The new plans reflect a careful consideration of priorities. Additional resources are being made available for health, education and science and technology, while the Home Office law and order budget is being maintained at the level previously planned. Those additions have been achieved despite demand-led pressures, in particular on social security spending, running to several billion pounds.

Fundamental expenditure reviews

The Government announced in February 1993 that it would conduct in-depth reviews of all public spending by every department of state. This work, expected to take much of the period of this Parliament to complete, goes well beyond traditional Survey arrangements. It examines long term trends in spending on individual programmes to assess whether these are sustainable. It seeks out areas from which the State might withdraw altogether or where better targeting is now appropriate.

This work is focused on the medium term; but the early results of the first four reviews (into social security, health, education and the Home Office) have helped inform the decisions taken during this Survey affecting those four departments.

The next batch of reviews will cover employment and transport programmes, the legal departments, Trade and Industry, Inland Revenue, Customs and Excise, HM Treasury and urban expenditure.

5.30 To ensure that the remit was achieved and priority programmes were protected, a dual strategy was adopted during the Survey. First, drawing on the programme of fundamental expenditure reviews, the Government looked to reductions within the demand-led programmes themselves. This approach has been largely successful: the proposals on social security in particular will deliver substantial savings later in the decade. But, given the lead-times involved in reform, the demand-led programmes on their own could not deliver the totals required. The second part of the Government's strategy was therefore to seek savings from efficiency improvements and in lower priority areas. Public sector pay and running costs were identified as key candidates for reductions: the greater the restraint on paybills the more the resources available for service provision and capital spending. This approach has enabled priority areas of spending to be protected even in departments where total budgets have been reduced.

5.31 Table 5.4 analyses the control total by department showing changes from previous plans. Central government support for local authorities and the financing requirements of nationalised industries have been attributed to appropriate departments.

Table 5.4 New control total by department[1]

£million

	Outturn	Estimated outturn	New plans			Changes from previous plans		
	1992-93	1993-94	1994-95	1995-96	1996-97	1993-94	1994-95	1995-96
Defence	23 620	23 410	23 490	22 700	22 790	–110	–260	–520
Foreign Office	1 371	1 490	1 220	1 240	1 240	270	10	20
Overseas Development	2 235	2 280	2 310	2 360	2 360	10	0	0
Agriculture, Fisheries and Food	2 198	3 050	2 810	2 990	2 990	360	40	70
Trade and Industry	3 039	3 630	2 270	1 800	1 390	–170	–70	–390
ECGD	117	–40	–90	–80	–70	0	–20	–50
Employment[2]	3 352	3 620	3 770	3 660	3 650	40	70	–90
Transport	6 586	6 150	5 850	5 570	5 370	–290	–210	–290
DOE—Housing	8 179	7 720	7 430	7 580	7 560	310	–250	–100
DOE—Environment[2]	2 163	2 320	1 980	1 650	1 640	150	80	–150
DOE—PSA	–69	110	110	60	40	0	90	20
DOE—Local government[3]	30 991	29 340	29 920	30 890	32 470	–20	–860	–1 550
Home Office	5 824	6 010	6 260	6 430	6 430	–30	0	0
Legal departments	2 314	2 550	2 730	2 880	2 980	–40	–50	–60
Education	7 122	9 820	10 490	11 060	11 390	310	390	580
National Heritage	1 006	990	980	1 000	970	0	0	–10
Health	28 271	30 090	31 730	32 950	33 270	200	480	650
Social security[4]	61 776	67 300	68 800	72 900	76 200	2 300	1 600	2 100
Scotland	12 656	13 630	14 110	14 520	14 820	90	0	–60
Wales	5 992	6 330	6 650	6 890	7 040	10	30	60
Northern Ireland[4]	6 597	7 110	7 390	7 740	7 940	170	270	370
Chancellor's departments	3 431	3 450	3 430	3 370	3 400	50	–130	–280
Cabinet Office—OPSS	1 126	1 250	1 320	1 350	1 360	0	10	20
Cabinet Office—other, etc.	430	480	500	500	550	0	20	10
European Communities	1 813	2 450	1 350	2 890	2 930	1 040	–1 300	890
Local authority self-financed expenditure	10 125	10 400	11 000	11 100	11 200	–700	0	300
Reserve			3 500	7 000	10 500	–4 000	–3 500	–3 000
Adjustment		–300				–300		
New control total	**232 264**	**244 700**	**251 300**	**263 000**	**272 300**	**–400**	**–3 600**	**–1 500**

[1] *For definitions, rounding and other conventions, see notes in Annex B (page 113). See Annex D for the composition of each departmental grouping.*
[2] *The plans for 1994-95 to 1996-97 take account of a transfer of provision from the Department of the Environment to the Department of Employment in respect of the Careers Service. The amounts involved are some £120 million in each year.*
[3] *The entry for the Department of the Environment includes payments of Revenue Support Grant and National Non-Domestic Rates to English local authorities. These finance, at local authorities' discretion, a range of local services, including education, social services and other environmental services.*
[4] *Excluding cyclical social security.*

5.32 Spending by each department since 1988-89 is set out in Annex B, Table 5B.3 (cash terms) and 5B.4 (real terms).

5.33 The following paragraphs briefly describe the new plans for each department. The departmental reports published in the first half of March 1994 will give more details.

Defence

5.34 Planned spending on defence in 1994-95 and 1995-96 will be £23·5 billion and £22·7 billion respectively, £260 million and £520 million lower than previously published figures. Defence spending in 1996-97 will be £22·8 billion, broadly the same in cash terms as the new 1995-96 plan.

5.35 These plans will be delivered in part by lower procurement and employment costs than previously assumed, and by the planned sale to a private sector housing trust of married quarters for service personnel. The Government also intends to place greater emphasis on the efficiency with which our forces are supported. The Defence Secretary has set in hand a major study to identify those aspects of the support given to the front line where costs can be reduced without affecting the Government's commitments in the UK and overseas.

Foreign and Commonwealth Office

5.36 The additions to previous plans are £10 million and £20 million in 1994-95 and 1995-96 respectively. They reflect the importance attached to diplomatic activity and take account of various pressures on the diplomatic budget, including increased international subscriptions and relative overseas price movements.

Overseas Development

5.37 Planned provision for overseas aid will rise by £30 million in 1994-95 and £50 million in 1995-96. The higher level is maintained in 1996-97.

5.38 The UK aid programme is one of the largest in the world and widely recognized as providing high quality aid. It will continue to focus on the poorest countries, generating sustainable economic growth and social development, the promotion of good government and the direct reduction of poverty.

Agriculture, Fisheries and Food

5.39 Spending on agriculture in the UK is to a large extent determined by the European Community's Common Agricultural Policy (CAP). Expenditure on CAP agriculture market support in the UK increases substantially, largely due to the depreciation of sterling since Autumn 1992, which results in an increase in the value of CAP payments and prices in sterling terms. This increase is partly offset by expected savings due to policy changes.

5.40 Against a background of higher farm incomes, support for domestic agriculture has been reduced. Capital grant rates will be significantly reduced and the designation of some new environmentally sensitive areas will be deferred. There are also reductions in research and development spending. Hill livestock compensatory allowances will be lower, following the autumn review of economic conditions in the hills and uplands.

Trade and Industry

5.41 The department has refocused its efforts to match industry's needs more closely. The provision of advice to exporters has been reorganised to include up to 100 secondees from the private sector. The full range of DTI's functions has been reviewed to see whether improvements in the delivery of services can be made by transferring functions to the private sector.

5.42 Provision is made for the external financing limits (EFLs) of Nuclear Electric, the Post Office, British Coal and British Shipbuilders. Nuclear Electric's EFLs are substantially lower due to its increased efficiency and reflect the reclassification of payments from the fossil fuel levy as external finance (see paragraph 5B.8). The figures for the Post Office, which take account of the proposed sale of Parcelforce, show an increase in its cash surplus. The figures for British Coal, which for planning purposes assume privatisation at the end of 1994-95, show a decrease in the need for external finance compared with 1993-94.

Export Credits Guarantee Department

5.43 ECGD provides credit insurance facilities for UK exporters. It supports the provision by banks of export finance at fixed rates of interest. The new plans largely reflect changes in the estimated cost of interest support. (Details of help for exporters are in a box at the end of the chapter.)

Employment

5.44 The department will continue to finance a wide range of training measures for young people and the unemployed and other help with work preparation and job search. These are delivered mainly by Training and Enterprise Councils and the Employment Service. The new plans provide for spending of £3·8 billion in 1994-95, an increase of £30 million on the previous year after excluding the transfer of provision for the Careers Service to the department from 1994-95. The Scottish and Welsh Offices have separate provision for the main training and enterprise programmes.

5.45 The plans allow for the introduction of a new apprenticeship initiative, an extension of present Employment Service measures and additional opportunities on the Community Action programme over the next two years. The new apprenticeship initiative will enable over 40,000 young people a year in England to achieve national vocational qualifications at level 3 (equivalent to A level).

Transport 5.46 The Government retains a substantial road building programme. Total spending on trunk roads and motorways in England will average nearly £2 billion a year throughout the Survey period, although it will be reduced from previous plans by £140 million in 1994-95 and £100 million in 1995-96. The roads programme is still benefiting from low construction prices and the baseline for 1994-95 is worth more in volume terms than when it was set in 1991.

5.47 Central government support for spending on local roads will amount to £2.7 billion in the Survey period, but will be reduced from previous plans by £120 million in 1994-95 and £70 million in 1995-96.

Transport – nationalised industries 5.48 The department's programmes also include the external financing limits of British Rail (BR), London Transport (LT) and the Civil Aviation Authority (CAA). Total funding for BR (including Railtrack) over the Survey period will average over £900 million a year. This should allow investment of over £1 billion in 1994-95. The new plans for LT show total EFLs of £900 million in 1994-95, £930 million in 1995-96 and £990 million in 1996-97. These include £493/437/417 million for the Jubilee Line extension and £34/16/14 million to support the Crossrail project. CAA plans have been reduced over the period largely as a result of the new air traffic control centre in Scotland proceeding as a financially free-standing private sector project.

DOE – Housing 5.49 The Housing Corporation's capital programme has been reduced from previous plans but will comfortably meet the manifesto commitment to provide more than 153,000 additional social rented homes through housing associations between 1992-93 and 1994-95. The Housing Corporation's overall spending continues at a level of over £1·6 billion a year from 1994-95 to 1996-97.

5.50 Provision for local authority capital spending on housing in 1994-95 and 1995-96 has also been reduced from last year's plans, but remains substantial. It rises from around £900 million in each of these years to over £1 billion in 1996-97. Estate Action spending has been transferred to the single regeneration budget (SRB – see paragraph 5.51).

DOE – Environment 5.51 The new plans show the resources being brought together from DOE's programme and other departmental programmes into the SRB, announced on 4 November, which will be used to support local partnerships carrying out regeneration measures. The SRB is over £1·4 billion in 1994-95 and over £1·3 billion in both 1995-96 and 1996-97, and will be administered through new integrated regional offices.

5.52 The budget for countryside, water and environmental protection programmes has been set at over £400 million a year over the Survey period. Further information about the Government's environmental policies is given in "This Common Inheritance – The Second Year Report" (Cm 2068).

DOE – PSA services **5.53** PSA Projects was privatised in December 1992 and the five PSA building management businesses were privatised in September and October 1993. The new plans provide for the cost of residual central functions, including the redundancy costs of staff returning from secondment.

Home Office **5.54** The new plans reflect the priority the Government gives to maintaining law and order and tackling crime. Provision for the police allows current levels of policing to be maintained and for the introduction of the reforms announced in the recent White Paper. Over the next three years £100 million will be spent on measures to tackle juvenile crime. Over the same period the number of places at existing prisons will be increased by over 2,000. Six new prisons and secure training centres for persistent juvenile offenders will be privately financed.

Legal departments **5.55** Reductions of £50 million in 1994-95 and £60 million in 1995-96 compared with previous plans have been achieved despite forecast workload growth in the courts and prosecution services. Provision increases by £100 million in 1996-97. Within these totals legal aid provision has been increased to cover increases in workload while reflecting the Lord Chancellor's policy of limiting growth in unit costs from 1996-97 to the increase in inflation. The level of court services will be maintained in line with anticipated demand. Prosecution services will also be producing efficiency gains while responding to demand.

Education **5.56** Total spending by central government in England (including support for local authorities) will rise by over £$1\frac{1}{2}$ billion between 1993-94 and 1996-97.

5.57 Current expenditure on higher education will increase by 3 per cent in real terms over the Survey period. This should maintain at almost one in three the proportion of young people entering higher education compared with one in eight in 1979, stabilising student numbers after the recent rapid expansion. Total support available for individual students from loans and maintenance grant will be maintained in real terms while the shift from grant to loans will be accelerated. Capital funding to higher education institutions will rise by 20 per cent in real terms between 1993-94 and 1996-97.

5.58 The new plans also provide for a 19 per cent increase in student numbers in further education and sixth form colleges over the Survey period.

5.59 Provision for capital and other special purpose grants to self-governing (grant-maintained) schools is planned to rise from £160 million in 1993-94 to £590 million in 1996-97 in support of this growing sector. Government support for capital spending on all maintained schools in 1994-95 will remain at broadly the same level as in 1993-94.

National Heritage **5.60** The plans include finance for the new British Library building and the costs associated with the move, and for restoring Windsor Castle. Priority will be given to projects which attract matching private finance. There is a small increase in provision for the Arts Council compared with previous plans.

Health **5.61** Provision for the programme as a whole will be £31·7 billion in 1994-95, an increase of £1·8 billion over 1993-94 plans. Cash provision for the NHS in England will be £1·6 billion (5·6 per cent) higher in 1994-95 than in 1993-94 plans, while for the UK as a whole it is likely to rise by nearly £2 billion.

5.62 Total current spending on hospital and community health services (HCHS) in England is planned to be 5·4 per cent higher in 1994-95 than in 1993-94. As announced by the Secretary of State for Health on 21 October, the management structure of the NHS in England will be streamlined to maximise the proportion of NHS expenditure devoted to direct patient care. HCHS capital provision of £1·8 billion remains at near-record levels and allows for the full costs of rationalising London's health services. Provision for the family health services allows for forecast demand while reflecting the Government's determination to restrain the growth in the drugs bill to what is necessary to meet patients' needs. Centrally financed services will continue to be funded in line with Government priorities, after a fundamental re-examination to eliminate low priority and unnecessary expenditure.

Social Security **5.63** The Government proposes a number of changes to the benefit system which affect both cyclical social security and spending within the NCT. Policy changes directly affecting planned spending on cyclical social security are described in paragraph 5.80.

5.64 The new plans include extra help for the higher fuel bills of pensioners following the introduction of VAT next April. The Government proposes to restructure invalidity benefit and increase the contributions made by non-dependent members of households in assessing housing benefit. It intends to make employers fully responsible for paying statutory sick pay, with an exemption for small companies. Costs to business will be lower after the Budget because of reductions in employer national insurance contribution rates. The Government will also introduce in 1994 a disregard in family credit to meet part of the cost of childcare.

5.65 The plans allow for revised estimates of the number of beneficiaries, and provide for further uprating of benefits in April 1995 and April 1996. The assumptions used for benefit upratings, and for unemployment, are set out in Annex C.

5.66 The Government also intends to equalise the state pension age at 65. The change will be phased in over 10 years, starting in the year 2010.

Scotland, Wales and Northern Ireland

5.67 Changes in these programmes mainly reflect the effect of changes in comparable programmes for England. As in past years, the decisions of the Secretaries of State for Scotland, Wales and Northern Ireland on the distribution of resources within their responsibilities will be announced later. For present purposes, a notional split between programmes has been assumed, taking account of the pattern of spending in 1993-94.

Chancellor's departments

5.68 Most of the spending of the Chancellor's departments is accounted for by the Inland Revenue and Customs and Excise and is largely running costs. The new plans for the Chancellor's departments include substantial running costs savings reflecting further increases in efficiency and containment of costs. The new plans also reflect reduced estimates of expenditure on mortgage interest relief to non-taxpayers.

Office of Public Service and Science

5.69 Provision for basic and strategic research will be slightly higher in real terms in 1994-95. This will provide the resources required to implement the policies in the recent White Paper on Science, Engineering and Technology.

European Community

5.70 Net payments are lower in 1994-95, but higher in other years, compared with the previous forecast. The uneven profile arises because contributions are paid on the basis of agreed estimates and adjusted in the light of outturn, and because of the consequential effects on the UK abatement. The main reason for the higher level of net payments in 1993-94 is the likely advance of contributions within the 1994 EC budgetary year, to reflect the timing of reimbursements of CAP expenditure to Member States.

5.71 The lower level of net payments in 1994-95 is largely due to adjustments for 1993 contributions. In the later years, factors affecting the profile include higher levels of EC spending, reflecting decisions at the Edinburgh European Council in December 1992, and higher contributions in 1995 because of the United Kingdom's higher growth relative to other Member States.

Science and technology

5.72 Spending on the science base (basic research in science, engineering and technology funded through the Research Councils and the Higher Education Funding Councils) will increase slightly in real terms to £2·3 billion in 1994-95. Total planned central government spending on civil science and technology will be about £3·7 billion, broadly in line with last year's plans.

Local authorities

5.73 Total local authority spending is made up of expenditure financed through central government support and expenditure net of capital receipts financed by local authorities out of their own resources (local authority self-financed expenditure).

5.74 The level of total local authority spending in future years will be substantially for local authorities themselves to decide in the light of central government support, finance available from their own resources and the implications for local taxation. The Government intends to use its powers to cap local authority budgets should that be necessary.

5.75 Total Standard Spending (TSS) – the amount which the Government thinks local authorities should spend on revenue expenditure – in England in 1994-95 has been set at £42,660 million. The Government has for the first time also announced TSS levels for the later years of the Survey to assist local authorities in their financial planning. The figures are £44,050 million in 1995-96 and £45,210 million in 1996-97. These figures include amounts for care in the community, part of which will be paid as a special grant. Excluding care in the community and adjusting for other function changes, the increases on the preceding year are 2·3 per cent in 1994-95, 2 per cent in 1995-96 and 1·75 per cent in 1996-97.

5.76 Aggregate External Finance (AEF) – central support for revenue expenditure – is planned to be 1·7 per cent higher in 1994–95 (after adjusting for function changes).

5.77 Gross capital expenditure by local authorities in 1994-95 is assumed to be around £8½ billion. It is expected to be lower than spending in 1993-94, which was boosted considerably by the temporary relaxation of the capital receipts rules announced in the 1992 Autumn Statement. Capital receipts in 1994-95 are projected to be around £2¾ billion, giving net capital expenditure of £5¾ billion.

Table 5.5 Local authority expenditure[1]

	Outturn	Estimated outturn	New plans			Changes from previous plans		
£ million	1992-93	1993-94	1994-95	1995-96	1996-97	1993-94	1994-95	1995-96
Current								
Aggregate External Finance[2,3,4]								
England								
National non-domestic rate payments	12 306	11 560				0		
Revenue support grant	16 623	17 050	34 310	35 420	36 410	0	–780	–1 420
Specific grants	4 535	4 660				20		
Total England	**33 464**	**33 270**				**20**		
Scotland[5]								
Non-domestic rate payments	1 213	1 190				0		
Revenue support grant	3 499	3 620	5 270	5 380	5 500	30	–140	–220
Specific grants	383	400				10		
Total Scotland	**5 095**	**5 210**				**50**		
Wales								
National non-domestic rate payments	536	470				0		
Revenue support grant	1 616	1 670	2 420	2 500	2 560	0	–40	–80
Specific grants	225	210				0		
Total Wales	**2 377**	**2 350**				**0**		
Total Aggregate External Finance	**40 936**	**40 830**	**42 000**	**43 300**	**44 470**	**70**	**–960**	**–1 720**
Other current grants[6]	12 216	13 090	13 180	13 740	14 330	1 580	740	1 010
Total current	**53 151**	**53 900**	**55 200**	**57 000**	**58 800**	**1 600**	**–200**	**–700**
Capital								
Capital grants	1 533	1 750	1 510	1 530	1 470	70	10	30
Credit approvals	4 564	4 170	4 050	4 010	4 120	–60	–260	–250
Total capital	**6 098**	**5 920**	**5 560**	**5 540**	**5 590**	**10**	**–250**	**–220**
Total central government support to local authorities	**59 249**	**59 800**	**60 700**	**62 600**	**64 400**	**1 700**	**–500**	**–900**
Local authority self-financed expenditure	**10 125**	**10 400**	**11 000**	**11 100**	**11 200**	**–700**	**0**	**300**
Total local authority expenditure	**69 373**	**70 200**	**71 700**	**73 700**	**75 600**	**900**	**–500**	**–600**

[1] *For definitions, rounding and other conventions, see notes in Annex B (page 113).*

[2] *Aggregate External Finance (AEF) includes revenue support grant, distribution of non-domestic rate revenue and a number of specific grants which fund part of the expenditure on a specific service or activity. The figures for 1992-93, 1993-94 and 1994-95 include residual payments of the community charge grant which financed the £140 reduction in community charges in 1991-92 announced in the 1991 Budget. AEF also includes the transitional grants to assist with the transfer of responsibility for education to Inner London boroughs and with the introduction of the new local authority finance system (low rateable area grant and area protection grant).*

[3] *Comparisons between years are distorted by the effects of transfers between departments and spending sectors. The main changes reflect the transfer of responsibility for community care to local authorities and the transfer of responsibility for the funding of further education colleges and sixth form colleges from local authorities to the new Further Education Funding Councils and the Scottish Office.*

[4] *From 1995-96 onwards contains provision for restructuring costs, some of which may be capital costs. The current/capital split for these costs is not yet known.*

[5] *Scottish figures for 1995-96 and 1996-97 are illustrative; final figures will depend on the Secretary of State's decisions on the allocation of resources.*

[6] *Most current grants outside AEF finance wholly, or almost wholly, expenditure on certain national policies which local authorities administer, such as community charge benefit, housing benefit and student awards.*

Other public expenditure

5.78 In addition to expenditure within the control total, GGE also includes cyclical social security, privatisation proceeds and debt interest (see Table 5.2).

Cyclical social security

5.79 Cyclical social security is defined as unemployment benefit and income support paid to people of working age. Planned spending on cyclical social security in 1994-95 is 1·8 per cent higher in real terms than 1993-94. The average annual growth in the three years to 1996-97 is 1·6 per cent. The plans are based on the assumptions for inflation and the number of unemployed people set out in Annex C.

5.80 The plans also take account of the effect of the Government's proposed Job Seekers Allowance. This will replace unemployment benefit and income support for unemployed people from April 1996. The benefit will be paid either on a contributory basis for six months without a means test or as income support is at present. Thereafter benefit will be paid on a means tested basis. There is also help with higher fuel bills for those on income-related benefits. The Budget measures reduce cyclical social security by £0·3 billion in 1996-97.

Privatisation proceeds

5.81 Privatisation proceeds are projected to be £5½ billion in 1994-95, £1 billion in 1995-96 and £1 billion in 1996-97.

Debt interest

5.82 The spending and revenue measures in the Budget will reduce government borrowing and debt. This is estimated to reduce debt interest payments by £0·2 billion in 1994-95, £0·6 billion in 1995-96 and £1·2 billion in 1996-97.

5.83 General government gross debt interest is projected to rise from £18 billion in 1992-93 to about £26 billion in 1996-97. Gross debt interest payments declined as a proportion of GDP from 5¼ per cent in 1981-82 to about 3 per cent in 1992-93. But with the public finances moving into deficit in recent years debt interest payments are projected to rise to about 3½ per cent by 1996-97. Annex Table 5B.6 shows the total for gross and net general government debt interest.

Help for exporters

For the remainder of this year and 1994-95 premiums paid by exporters for medium- or long-term ECGD cover on certain important markets and on markets for which cover has been restored in 1993 will be reduced. In addition, for markets where ECGD's exposure is already large taking account of the risk involved, the cover provided in 1995-96 will be rolled forward in 1996-97 and increased by £200 million, taking the total in 1996-97 to £3.2 billion. This cover does not count as public expenditure nor against the PSBR, but could lead to additions to the PSBR in future years if ECGD's guarantees are called.

Annex A to Chapter 5
Capital spending

Introduction

5A.1 Capital spending differs from current expenditure in two main respects. First, it augments the stock of public sector assets, which can be set alongside the public sector's liabilities in assessing its overall balance sheet. Second, unlike most current spending, capital spending generates a flow of benefits in the future. These benefits vary depending on the nature of the investment. For businesses, investment typically yields a flow of future income. For government – where little output is traded – the returns on capital spending are often less direct. Public investment in infrastructure benefits the private sector directly, but the return to the public sector comes indirectly through economic growth and higher revenues. In some areas, for example the social benefits deriving from investment in hospitals and health care or recreation and leisure facilities, the returns are not readily quantifiable.

5A.2 Although information on historic levels of capital spending has routinely been published, this year the Government is publishing information on the projected levels for the current Survey period and beyond. Figures for central government departments, public corporations and nationalised industries will be subject to refinement before the publication of the Statistical Supplement early in 1994. The analyses in this report include broad projections of local authority capital spending, consistent with the overall projections of total spending. However, detailed plans for local authority capital spending will be determined by authorities themselves in the light of local priorities.

5A.3 The aggregate projections include a stylised allocation from the Reserve. This is set at 10 per cent of the Reserve in each year, broadly in line with the share of capital in the NCT over recent years. This should not be regarded as a forecast – decisions on future levels of capital spending will be taken at the appropriate time in future Surveys.

Measurement of capital spending

5A.4 The main presentation used in this report is based on standard national accounting conventions. However this annex outlines some of the alternative presentations. A more comprehensive analysis was included in the Winter 1991-92 edition of the Treasury Bulletin.

5A.5 The main analysis set out in Table 5.3 shows the expenditure components of the public sector's capital account, on national accounting definitions, measured net of estimated depreciation. The figures include:

(i) gross domestic fixed capital formation (GDFCF), ie expenditure on fixed assets – schools, hospitals, roads, computers, plant and machinery etc. This is measured net of receipts from sales of fixed assets (eg council houses and surplus land);

(ii) grants in support of capital spending by the private sector;

(iii) the value of the physical increase in stocks (for central government, primarily agricultural commodity stocks); *less*

(iv) an estimate of depreciation on the public sector's stock of fixed assets.

5A.6 Departments' capital spending provision within the control total is recorded *gross* of depreciation and so makes no allowance for wear and tear or obsolescence. The public expenditure cost of purchasing a new asset is the same in the year of purchase whether the item represents an increase in asset stock, or a replacement of worn out equipment. This treatment reflects the national accounting measure of gross domestic product (GDP), which is measured *gross* of depreciation: the public sector's gross capital formation makes a direct contribution to the expenditure measure of GDP.

5A.7 By deducting an estimate of depreciation, the main presentation differs from the more common analyses of public sector capital spending. It has been adopted because measuring aggregate capital formation net of depreciation corresponds more closely to the annual change in the public sector's capital stock.

Depreciation

5A.8 The measurement of depreciation is not straightforward. Although public corporations and trading bodies do produce estimates of depreciation within their trading accounts, separate depreciation estimates do not exist for the bulk of government departments' capital assets. It is not possible to produce estimates of depreciation for the public sector as a whole by aggregating detailed figures. As a consequence, the depreciation estimates used here are based on the national accounts series produced by the Central Statistical Office (eg in Table 14.3 of the Blue Book), together with projections by the Treasury.

5A.9 These depreciation figures permit the construction of a broad measure of net capital spending, but they do not take account of the actual experience of departments and public corporations. They are produced in a stylised way based on general assumptions on asset lives. Improvements in the quality of these estimates will depend on new information becoming available to allow a "bottom up" assessment, rather than the present "top down" approach.

5A.10 The work on resource accounting in departments announced by the Chancellor in the Budget should in future lead to departmental estimates of capital consumption, supplementing those that already exist for areas such as the National Health Service and for trading operations. Development of resource accounts should lead to better estimates of levels and changes in net capital stock.

Public sector asset creation

5A.11 An alternative measure of capital spending – Public Sector Asset Creation (PSAC) – has been used in previous public expenditure publications. This measures the public sector's contribution to the formation of *new* fixed assets in the whole economy. The main differences between PSAC and the net public sector capital measure shown in Table 5.3 are:

(i) PSAC excludes stockbuilding and all purchases of land and existing buildings: it concentrates on public sector purchases of new fixed assets and capital grants made to the private sector;

(ii) it is also measured gross of receipts from disposal of fixed assets – primarily land and existing buildings;

(iii) it includes MOD expenditure on equipment which is considered as current spending in the national accounts; and

(iv) it is measured gross of depreciation.

5A.12 PSAC is a larger aggregate than the equivalent national accounts measure, for two reasons. Receipts from sales of physical assets, which reduce the national accounts measure, have been significant since the early 1980s, peaking at over £6 billion in 1988-89. PSAC also applies a wider definition of defence capital spending than the national accounts. Only a very small proportion of defence spending counts as investment in the national accounts, though a much higher proportion contributes to the provision of a (defence) service over a period of years, for example through the purchase of equipment. Within PSAC much of the spending excluded from the national accounts measure is treated as capital.

5A.13 Reflecting these differences, PSAC in 1992-93 was £29 billion, compared to the equivalent gross national accounts measure of £23 billion. Table 5A.1 sets out projections of public sector asset creation for years up to 1996-97, consistent with the new spending plans.

Table 5A.1
Public Sector Asset Creation

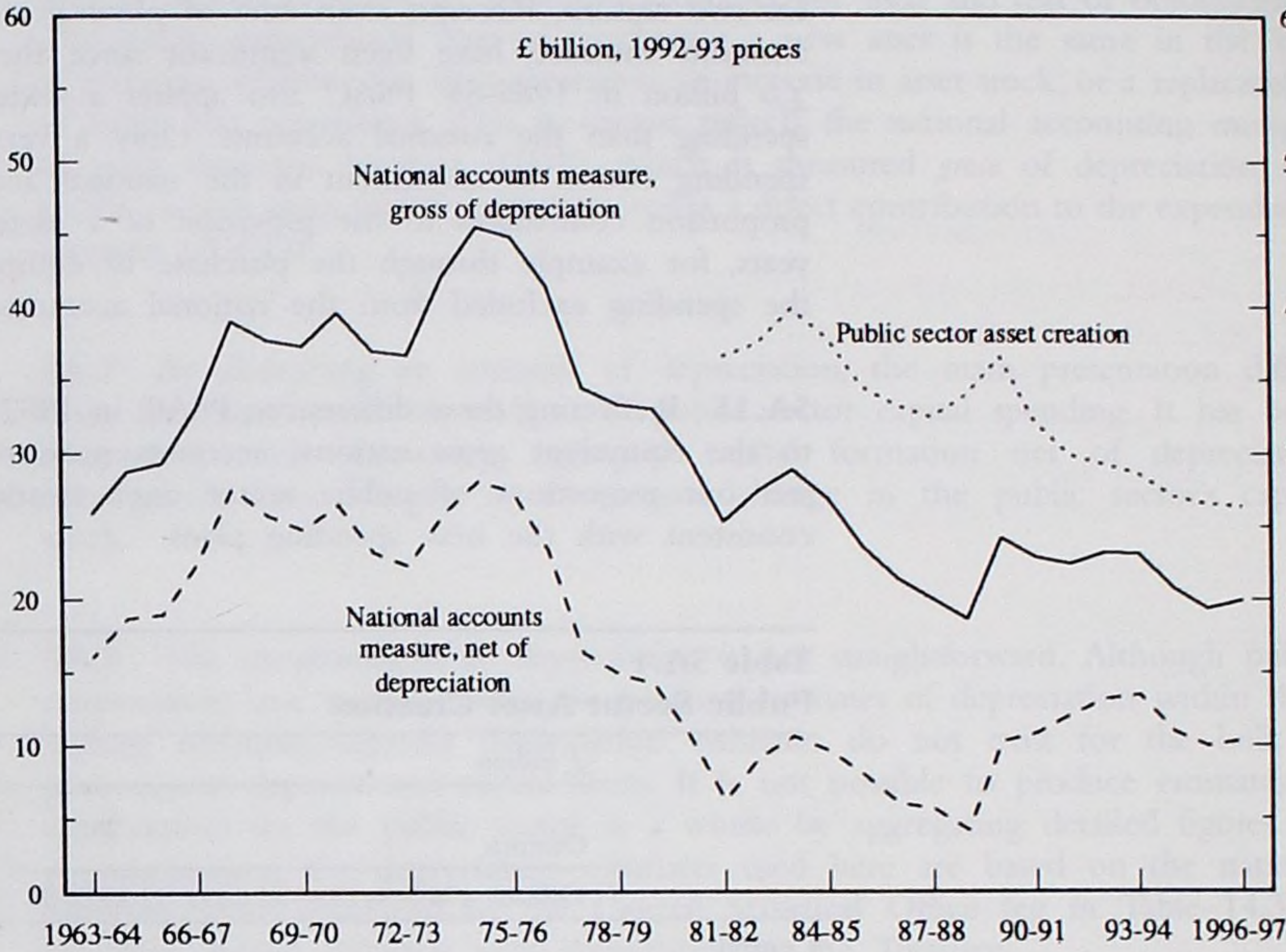
£ billion

	Outturn					Estimated Outturn	Projections		
	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Central government[1]	13·5	14·6	16·5	17·5	17·7	17·8	18	18¾	18¾
Local authorities	8·2	10·7	8·2	8·1	8·1	8·7	7¾	7¾	8
Nationalised industries[2]	2·9	3·8	4·1	2·9	3·3	2·9	2¾	2¼	2¼
Allocation from the Reserve							0·4	0·7	1·0
Total	**24·6**	**29·2**	**28·8**	**28·5**	**29·1**	**29·4**	**29**	**29½**	**30**
Real terms (1992-93 prices)	31·4	34·8	31·8	29·6	29·1	28·5	27	26½	26¼

[1] *Including the asset creation of public corporations other than the nationalised industries.*
[2] *Excluding industries now privatised, or planned to be privatised before 31 March 1997, other than the electricity industries.*

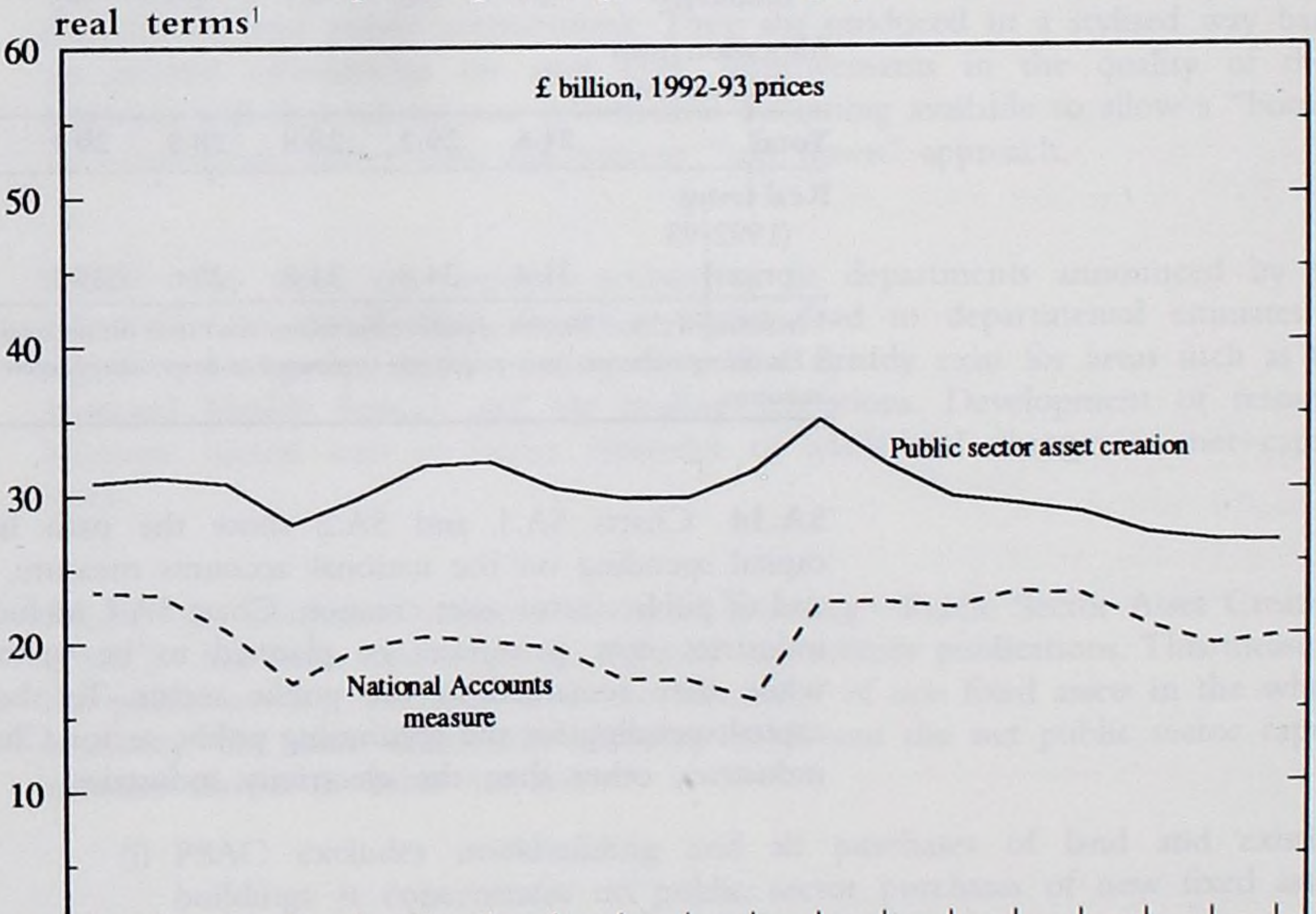
5A.14 Charts 5A.1 and 5A.2 show the path in real terms of public sector capital spending on the national accounts measure, gross and net of depreciation, and of public sector asset creation. Chart 5A.1 includes the spending of nationalised industries now privatised, or planned to be privatised before 31 March 1997, while they remained in the public sector. To show more clearly the trend of capital spending for the continuing public sector Chart 5A.2 excludes the privatised industries, other than the electricity industries.

Chart 5A.1 Capital spending in real terms[1]



[1] *Including the capital spending of nationalised industries now privatised, or planned to be privatised before 31 March 1997, while they remained in the public sector.*

Chart 5A.2 Capital spending, excluding privatised industries, in real terms[1]



[1] *Excluding the capital spending of nationalised industries now privatised, or planned to be privatised before 31 March 1997, other than the electricity industries.*

Investment in human capital

5A.15 The national accounts and PSAC measures of capital spending focus only on physical capital. But some spending that is conventionally considered as current, such as that on education and training, research and development, or health care, can be considered to produce a stream of future benefits in much the same way as purchase of physical assets.

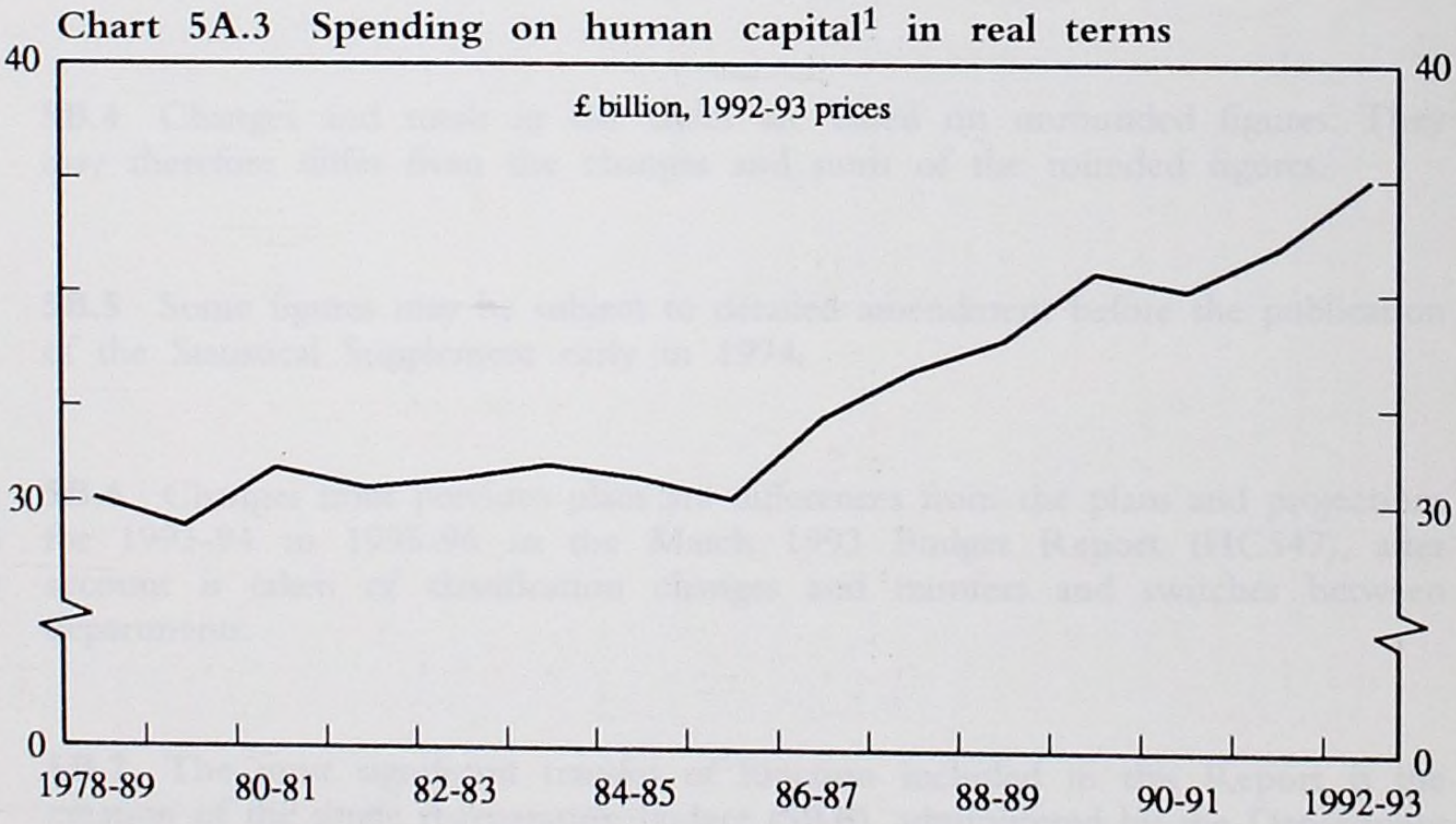
5A.16 This spending on so-called "human capital" is an important and significant element of public expenditure. For example, in 1992-93 general government spending on education was £32 billion, larger than public sector gross capital spending on physical assets; general government spending on training for employment and on civil science and technology was £2 billion and £3 billion, respectively.

5A.17 However, assessing the investment element of such spending raises some extremely difficult measurement questions. The depreciation of physical capital can be relatively straightforwardly assessed following readily applicable rules. The boundary between maintenance and new investment is also normally reasonably clear for fixed assets. This is not true for human capital. For example, the proportions of spending on education which go to maintaining educational standards and to raising them are not independently measurable.

5A.18 The focus on physical capital in the main capital spending aggregates mirrors commercial accounting practice where, for example, spending on research and development and training is treated as current. But, despite these conventions, it is important to bear in mind that future productive capacity in the economy is supported and developed by spending that is not covered by the normal capital spending definitions.

5A.19 Chart 5A.3 shows the recent trend for one possible measure of spending on human capital, bringing together total general government spending on education, employment training and civil science and technology.

Chart 5A.3 Spending on human capital[1] in real terms



[1] *General government spending on education, employment training and civil science and technology.*

Investment in human capital

5A.15 The national accounts and [illegible] definitions of capital spending focus only on physical capital. But some spending which is conventionally considered as current spending — for example on education and training, research and development, or health care, can be considered to produce a stream of future benefits in much the same way as purchases of physical assets.

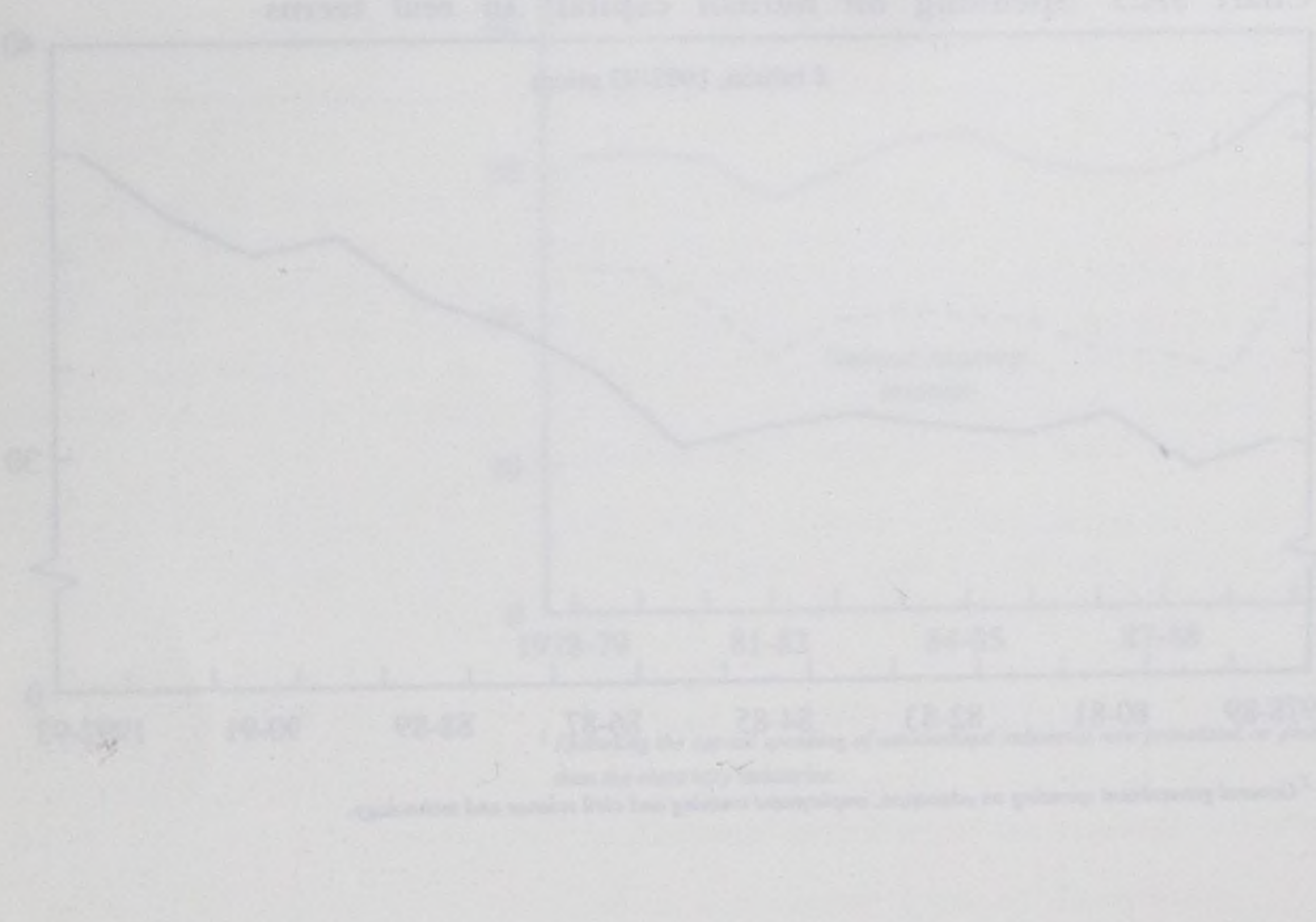
5A.16 The spending on so-called 'human capital' is an important and significant element of public expenditure. For example, in 1992-93 general government spending on education was £32 billion, larger than public sector gross capital spending on physical assets; general government spending on training for employment and on civil science and technology was £2 billion and £3 billion, respectively.

5A.17 However, assessing the investment element of such spending raises some extremely difficult measurement questions. The depreciation of physical capital can be relatively straightforwardly assessed following readily applicable rules. The boundary between maintenance and new investment is also normally reasonably clear for fixed assets. This is not true for human capital. For example, the proportions of spending on education which go to maintaining educational standards and to raising them are not unambiguously measurable.

5A.18 [illegible] current commercial accounting practice where, for example, spending on research and development and training is treated as current. But, despite these conventions, it is important to bear in mind that future productive capacity in the economy is enhanced, and that spending on this is not covered by the normal capital spending definitions.

5A.19 Chart 5A.3 shows the recent trend for one possible measure of spending on human capital, bringing together total general government spending on education, employment training and civil science and technology.

Chart 5A.3 Spending on 'human capital'[1] in real terms



[1] General government spending on education, employment training and civil science and technology.

Annex B to Chapter 5
Public expenditure analyses

5B.1 This annex includes a number of more detailed analyses of expenditure. It also explains the conventions used in presenting the figures throughout Chapter 5.

Rounding conventions

5B.2 For tables presenting the new plans the following conventions apply:

Future years: Departments' spending totals within the control total are rounded to the nearest £10 million (except for non-cyclical social security, which is rounded to £100 million). The control total and spending sector totals (except financing requirements of the nationalised industries) are rounded to the nearest £100 million.

Figures for items outside the control total are rounded to the nearest £500 million. However, the total for GGE (excluding privatisation proceeds) is rounded to the nearest £100 million. In this latter case this does not imply accuracy to that degree. Projections of capital spending are rounded to the nearest £250 million.

1993-94: The rounding conventions adopted for items within the control total for future years also apply to figures for 1993-94, to reflect their provisional nature.

Figures for items outside the control total and for estimated capital spending are rounded to the nearest £100 million.

5B.3 For tables which show the control total and GGE in real terms, all figures are rounded to the nearest £100 million. Projections of capital spending in real terms are rounded to the nearest £250 million.

5B.4 Changes and totals in the tables are based on unrounded figures. They may therefore differ from the changes and sums of the rounded figures.

5B.5 Some figures may be subject to detailed amendment before the publication of the Statistical Supplement early in 1994.

Calculation of changes from previous plans and projections

5B.6 Changes from previous plans are differences from the plans and projections for 1993-94 to 1995-96 in the March 1993 Budget Report (HC547), after account is taken of classification changes and transfers and switches between departments.

5B.7 The most significant transfer of function included in this Report is the creation of the single regeneration budget (SRB), administered by the Department of the Environment. This has involved transfers of provision into the "Other Environmental Services" programme from DOE-Housing and from the Departments of Employment, Trade and Industry, the Home Office and the Department for Education.

5B.8 There is only one significant classification change affecting the public expenditure figures. Reflecting the changed national accounting treatment introduced in the 1993 "Blue Book", the benefit of the fossil fuel levy arrangements to Nuclear Electric is no longer treated as contributing to the industry's internal resources. As a consequence, Nuclear Electric's recorded external finance is increased by the amount of their receipts derived from the levy, approximately £1 billion each year. This change has been applied to all years since 1990-91, when the levy was introduced. This classification change applies also to general government expenditure, which also now includes fossil fuel levy payments to private sector electricity generators. There is no change in the underlying financial positions of the companies concerned.

Real terms figures

5B.9 Figures in real terms are cash levels adjusted to 1992-93 price levels by excluding the effects of general inflation as measured by the GDP deflator. The deflator series used is adjusted to remove the distortion caused by the abolition of domestic rates. A description of the method of adjustment was set out in Annex C to Chapter 1 of the 1990 Autumn Statement.

Central government expenditure

5B.10 This includes the financing requirements of trading funds and public corporations other than the nationalised industries. Cyclical social security spending is excluded from the measure of central government spending within the new control total.

Central government support for local authorities

5B.11 This includes such items as mandatory student awards and community charge benefit which are administered by local authorities but all or most of the cost of which is paid by central government.

Local authority self-financed expenditure

5B.12 Local authority self-financed expenditure is the difference between total local authority expenditure, including debt interest but net of capital receipts, and central government support to local authorities.

Adjustment

5B.13 Tables setting out the estimated outturn for the new control total in 1993-94 include an adjustment for the difference between the assessment of likely outturn and the sum of the other components shown.

Table 5B.1 Public expenditure, 1963-64 to 1996-97

	New control total[1]		General government expenditure (excluding privatisation proceeds)			Privatisation proceeds	General government expenditure		Money GDP[2]		Adjusted GDP deflator
							Capital	Total		Adjusted series, Index (1990-91 =100)	Index (1992-93 =100)
	£ billion	Real terms[3] £ billion	£ billion	Real terms[3] £ billion	Per cent of GDP[2]	£ billion	£ billion	£ billion	£ billion		
1963-64			11·3	120·1	36¾		1·4	11·3	31·4	5·5	9·4
1964-65			12·3	124·2	36½		1·6	12·3	34·2	6·0	9·9
1965-66			13·6	131·6	37¾		1·7	13·6	36·6	6·5	10·3
1966-67			15·1	139·8	39½		2·0	15·1	38·9	6·9	10·8
1967-68			17·5	157·5	43¼		2·6	17·5	41·2	7·3	11·1
1968-69			18·2	156·6	41½		2·9	18·2	44·6	7·9	11·6
1969-70			19·3	157·7	41		3·1	19·3	48·0	8·5	12·3
1970-71			21·6	162·9	41¼		3·4	21·6	53·2	9·4	13·3
1971-72			24·4	168·3	41¾		3·5	24·4	59·3	10·5	14·5
1972-73			27·6	176·5	41½		3·9	27·6	67·6	11·9	15·7
1973-74			32·0	191·1	43½		5·0	32·0	75·0	13·2	16·7
1974-75			42·9	214·2	48¾		5·6	42·9	89·4	15·8	20·0
1975-76			53·8	214·4	49¼		6·5	53·8	111·2	19·6	25·1
1976-77			59·6	209·1	46¾		6·8	59·6	130·0	23·0	28·5
1977-78			64·4	198·9	43¼	–0·5	6·6	63·9	151·3	26·7	32·4
1978-79			75·0	208·4	44		6·6	75·0	173·7	30·7	36·0
1979-80			90·4	215·1	44	–0·4	7·3	90·0	208·6	36·8	42·0
1980-81			108·8	219·0	46½	–0·2	8·0	108·6	237·7	42·0	49·7
1981-82			121·0	222·0	47¼	–0·5	6·8	120·5	261·0	46·1	54·5
1982-83			133·1	228·0	47½	–0·5	8·4	132·7	285·8	50·5	58·4
1983-84			141·6	231·7	46½	–1·1	9·9	140·4	310·0	54·7	61·1
1984-85	126·0	196·4	152·8	238·2	46¾	–2·0	10·7	150·8	332·1	58·6	64·2
1985-86	129·6	191·3	161·2	238·0	45	–2·7	10·8	158·5	365·1	64·5	67·7
1986-87	136·0	195·1	169·3	242·8	44	–4·5	10·2	164·8	392·7	69·3	69·7
1987-88	148·6	202·4	178·4	242·9	41¾	–5·1	10·7	173·2	434·7	76·8	73·4
1988-89	156·1	199·1	186·9	238·5	39¼	–7·1	10·4	179·8	484·1	85·5	78·4
1989-90	175·1	208·9	205·0	244·7	39¾	–4·2	18·9	200·8	525·7	92·9	83·8
1990-91	193·4	213·5	223·5	246·7	40¼	–5·3	20·2	218·1	556·2	100·0	90·6
1991-92	212·5	220·7	244·1	253·5	42¼	–7·9	20·3	236·2	579·6		96·3
1992-93	232·3	232·3	269·2	269·2	44¾	–8·1	21·6	261·1	602·5		100·0
1993-94	244·7	237·0	286·1	277·0	45	–5·4		280·7	636		103·2
1994-95	251·3	234·0	297·3	276·9	43¾	–5·5		291·8	678		107·4
1995-96	263·0	236·1	313·1	281·0	43¼	–1·0		312·1	723		111·4
1996-97	272·3	238·5	325·2	284·7	42½	–1·0		324·2	766		114·2

[1] *Figures for the new control total are only available on a consistent basis for the years shown. Figures are estimated outturn for 1993-94 and plans for 1994-95 onwards.*

[2] *An adjusted series for money GDP is used in the calculation of the ratio for years up to 1989-90. This has been constructed to remove the distortion caused by the abolition of domestic rates. A description of the adjustment method was given in Annex C to Chapter 1 of the 1990 Autumn Statement. The adjusted series is shown here as an index, based on the level of money GDP in 1990-91. From 1990-91 onwards the adjusted series is identical to the figures shown for money GDP. For any earlier year the adjusted GDP figures can be calculated by applying the index level relevant for the year in question to the level of money GDP in 1990-91.*

[3] *Cash figures adjusted to price levels of 1992-93. See paragraph 5B.9.*

Table 5B.2 General government expenditure (excluding privatisation proceeds): plans and outturn[1]

Per cent of GDP

Plans

Outturn

	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
March 1989 FSBR[2]	**40**	39¾	40	39½	38¾				
January 1990 White Paper (Cm 1021)	**39¾**	**39½**	40	39¾	39½				
February 1991 Supplement (Cm 1520)	**39¼**	**39½**	**40**	39¾	39¾	39¼			
February 1992 Supplement (Cm 1920)	**39½**	**40**	**40**	**41¾**	42	42	41½		
January 1993 Supplement (Cm 2219)	**39¼**	**39¾**	**40¼**	**42¼**	**45**	45¾	45	44¼	
This Budget	**39¼**	**39¾**	**40¼**	**42¼**	**44¾**	**45[3]**	43¾	43¼	42½

[1] *To avoid the distortion caused by the abolition of domestic rates, the ratios for years before 1990-91 are based on the adjusted series for money GDP (see footnote 2 to Table 5B.1). The figures from earlier publications are based on the figures underlying those publications, but the GDP figures on which they were based have been similarly adjusted. Figures for GGE in previous publications have been adjusted for the reclassification of the fossil fuel levy.*

[2] *Financial Statement and Budget Report.*

[3] *Estimated.*

Table 5B.3 New control total by department[1]

£ million

	Outturn					Estimated outturn	New plans			Changes from previous plans		
	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1993-94	1994-95	1995-96
Defence	19 221	20 777	21 816	23 032	23 620	23 410	23 490	22 700	22 790	–110	–260	–520
Foreign Office	772	898	968	1 132	1 371	1 490	1 220	1 240	1 240	270	10	20
Overseas Development	1 544	1 672	1 748	1 989	2 235	2 280	2 310	2 360	2 360	10		
Agriculture, Fisheries and Food	1 607	1 487	2 137	2 159	2 198	3 050	2 810	2 990	2 990	360	40	70
Trade and Industry	927	1 620	3 512	3 152	3 039	3 630	2 270	1 800	1 390	–170	–70	–390
ECGD	115	358	372	215	117	–40	–90	–80	–70	0	–20	–50
Employment[2]	3 660	3 594	3 656	3 486	3 352	3 620	3 770	3 660	3 650	40	70	–90
Transport	2 752	3 559	4 679	5 355	6 586	6 150	5 850	5 570	5 370	–290	–210	–290
DOE—Housing	2 774	2 923	6 724	7 451	8 179	7 720	7 430	7 580	7 560	310	–250	–100
DOE—Environment[2]	985	1 374	1 597	1 700	2 163	2 320	1 980	1 650	1 640	150	80	–150
DOE—PSA			60	50	–69	110	110	60	40	0	90	20
DOE—Local government	18 823	19 531	20 392	28 177	30 991	29 340	29 920	30 890	32 470	–20	–860	–1 550
Home Office	3 586	4 074	4 836	5 514	5 824	6 010	6 260	6 430	6 430	–30	0	0
Legal departments	1 142	1 373	1 635	2 000	2 314	2 550	2 730	2 880	2 980	–40	–50	–60
Education	3 518	4 865	5 655	6 340	7 122	9 820	10 490	11 060	11 390	310	390	580
National Heritage	688	714	783	887	1 006	990	980	1 000	970	0	0	–10
Health	18 487	20 003	22 524	25 657	28 271	30 090	31 730	32 950	33 270	200	480	650
Social security[3]	42 806	46 000	48 820	54 858	61 776	67 300	68 800	72 900	76 200	2 300	1 600	2 100
Scotland	8 530	8 948	9 743	11 723	12 656	13 630	14 110	14 520	14 820	90	0	–60
Wales	3 579	3 800	4 441	5 308	5 992	6 330	6 650	6 890	7 040	10	30	60
Northern Ireland[3]	5 109	5 403	5 523	6 041	6 597	7 110	7 390	7 740	7 940	170	270	370
Chancellor's departments	2 692	3 154	3 346	3 394	3 431	3 450	3 430	3 370	3 400	50	–130	–280
Cabinet Office—OPSS	789	904	990	1 061	1 126	1 250	1 320	1 350	1 360	0	10	20
Cabinet Office—other, etc	240	264	302	349	430	480	500	500	550	0	20	10
European Communities	1 006	2 318	2 026	705	1 813	2 450	1 350	2 890	2 930	1 040	–1 300	890
Local authority self-financed expenditure	10 704	15 508	15 078	10 816	10 125	10 400	11 000	11 100	11 200	–700	0	300
Reserve							3 500	7 000	10 500	–4 000	–3 500	–3 000
Adjustment						–300				–300		
New control total	**156 055**	**175 120**	**193 363**	**212 549**	**232 264**	**244 700**	**251 300**	**263 000**	**272 300**	**–400**	**–3 600**	**–1 500**

[1] *For definitions, rounding and other conventions see notes on page 113. See Annex D for the composition of each departmental grouping.*

[2] *The plans for 1994-95 to 1996-97 take account of a transfer of provision from the Department for the Environment to the Department of Employment in respect of the Careers Service. The amounts involved are some £120 million in each year.*

[3] *Excluding cyclical social security.*

Table 5B.4 New control total by department in real terms[1]

£ billion

	Outturn					Estimated outturn	New plans		
	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Defence	24·5	24·8	24·1	23·9	23·6	22·7	21·9	20·4	20·0
Foreign Office	1·0	1·1	1·1	1·2	1·4	1·4	1·1	1·1	1·1
Overseas Development	2·0	2·0	1·9	2·1	2·2	2·2	2·1	2·1	2·1
Agricultural, Fisheries and Food	2·1	1·8	2·4	2·2	2·2	3·0	2·6	2·7	2·6
Trade and Industry	1·2	1·9	3·9	3·3	3·0	3·5	2·1	1·6	1·2
ECGD	0·1	0·4	0·4	0·2	0·1	0·0	–0·1	–0·1	–0·1
Employment[2]	4·7	4·3	4·0	3·6	3·4	3·5	3·5	3·3	3·2
Transport	3·5	4·2	5·2	5·6	6·6	6·0	5·5	5·0	4·7
DOE—Housing	3·5	3·5	7·4	7·7	8·2	7·5	6·9	6·8	6·6
DOE—Environment[2]	1·3	1·6	1·8	1·8	2·2	2·2	1·8	1·5	1·4
DOE—PSA			0·1	0·1	–0·1	0·1	0·1	0·1	0·0
DOE—Local government	24·0	23·3	22·5	29·3	31·0	28·4	27·9	27·7	28·4
Home Office	4·6	4·9	5·3	5·7	5·8	5·8	5·8	5·8	5·6
Legal departments	1·5	1·6	1·8	2·1	2·3	2·5	2·5	2·6	2·6
Education	4·5	5·8	6·2	6·6	7·1	9·5	9·8	9·9	10·0
National Heritage	0·9	0·9	0·9	0·9	1·0	1·0	0·9	0·9	0·9
Health	23·6	23·9	24·9	26·6	28·3	29·1	29·5	29·6	29·1
Social security[3]	54·6	54·9	53·9	57·0	61·8	65·2	64·0	65·4	66·7
Scotland	10·9	10·7	10·8	12·2	12·7	13·2	13·1	13·0	13·0
Wales	4·6	4·5	4·9	5·5	6·0	6·1	6·2	6·2	6·2
Northern Ireland[3]	6·5	6·4	6·1	6·3	6·6	6·9	6·9	6·9	7·0
Chancellor's departments	3·4	3·8	3·7	3·5	3·4	3·3	3·2	3·0	3·0
Cabinet Office—OPSS	1·0	1·1	1·1	1·1	1·1	1·2	1·2	1·2	1·2
Cabinet Office—other, etc	0·3	0·3	0·3	0·4	0·4	0·5	0·5	0·4	0·5
European Communities	1·3	2·8	2·2	0·7	1·8	2·4	1·3	2·6	2·6
Local authority self-financed expenditure	13·7	18·5	16·6	11·2	10·1	10·1	10·2	10·0	9·8
Reserve							3·3	6·3	9·2
Adjustment						–0·3			
New control total	**199·1**	**208·9**	**213·5**	**220·7**	**232·3**	**237·0**	**234·0**	**236·1**	**238·5**

[1] *1992-93 prices. For definitions, rounding and other conventions, see notes on page 113. See Annex D for the composition of each departmental grouping.*
[2] *See footnote 2 to Table 5B.3.*
[3] *Excluding cyclical social security.*

Table 5B.5 External financing requirements of the nationalised industries, by department and industry[1]

£ million

	Outturn					Estimated outturn	New plans			Changes from previous plans		
	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1993-94	1994-95	1995-96
Trade and Industry	**–1 265**	**17**	**1 903**	**1 702**	**1 679**	**2 280**	**950**	**480**	**60**	**–150**	**–60**	**–370**
British Coal[2]	840	1 292	890	605	778	1 750	700	470	350	–150	200	–30
British Shipbuilders	144	4	28	–9	–10	–10	0	0	0	0	0	0
Electricity (England and Wales)[3 4]	–1 773	–1 262	985	1 180	991	730	480	220	–110	0	–210	–290
Post Office	–60	0	0	–74	–80	–180	–230	–210	–180	0	–50	–60
Other[5]	–417	–17										
Transport	**635**	**1 016**	**1 617**	**2 056**	**3 003**	**2 320**	**2 220**	**1 950**	**1 750**	**–270**	**90**	**–50**
British Rail[6]	376	711	1 077	1 443	2 038	1 470	1 220	960	730	–20	140	0
Union Railways[7]				21	26	40	40	20	10	40	40	20
Civil Aviation Authority[8]	21	47	66	38	56	100	60	40	20	0	–30	–50
London Transport	240	259	474	554	883	720	900	930	990	–290	–60	–20
Other[5]	–2											
DOE—Environment	**27**	**19**	**48**	**50**	**48**	**50**	**50**	**50**	**50**	**0**	**0**	**0**
British Waterways Board	45	47	48	50	48	50	50	50	50	0	0	0
Other[5]	–18	–27										
Scotland	**123**	**–143**	**–116**	**–39**	**27**	**30**	**–30**	**–30**	**20**	**0**	**0**	**0**
Caledonian MacBrayne	9	6	5	9	13	10	10	10	10	0	0	0
Electricity (Scotland)[9]	123	–149	–108	–45	14	–30	–40	–40	10	0	0	0
Scottish Transport Group	–8	0	–13	–2	0	40				0		
Agriculture, Fisheries and Food[5]	**20**	**8**										
Wales[5]	**9**	**15**										
Total	**–451**	**932**	**3 452**	**3 770**	**4 757**	**4 690**	**3 190**	**2 440**	**1 870**	**–430**	**30**	**–420**

[1] *For definitions, rounding and other conventions, see notes on page 113.*
[2] *Assumes for planning purposes, privatisation at end 1994-95. Figures thereafter are total public sector liability following privatisation.*
[3] *The Regional Electricity Companies, the National Grid Company, PowerGen and National Power were privatised during 1990-91. From 1991-92 comprises Nuclear Electric.*
[4] *Payments from the fossil fuel levy have been reclassified to count as part of Nuclear Electric's external finance. The levy payments began in 1990-91.*
[5] *These items include the external financing requirements of nationalised industries privatised before 1993-94, other than the non-nuclear electricity industries.*
[6] *British Rail's external financing requirement will be split between BR, Railtrack and the budget of the Office of Passenger Rail Franchising.*
[7] *Data for Union Railways is shown from October 1991 when the route was decided.*
[8] *The total external financing requirement for the Civil Aviation Authority is shown in this row. This includes subsidies from the Scottish Office Industry Department for Highlands and Islands Airports Ltd (eg £5·2 million in 1992-93) which are included in the total for Scotland in Tables 5.4, 5B.3 and 5B.4.*
[9] *Scottish Power and Scottish Hydro-Electric were privatised during 1991-92. From 1992-93 comprises Scottish Nuclear.*

Table 5B.6 General government debt interest

	Outturn		Projections			
£ billion	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
General government gross debt interest[1]	16·9	18·0	19·9	23	25	26
of which: central government	16·2	17·4	19·4	22½	24½	25½
General government interest and dividend receipts	5·5	5·0	5·6	5½	5½	5½
General government net debt interest	11·4	13·0	14·3	17½	19½	20½
Per cent of GDP						
General government gross debt interest	3	3	3¼	3¼	3½	3½
General government net debt interest	2	2¼	2¼	2½	2¾	2¾
[1] *Of which: servicing of indexed securities (gilts plus national savings).*	*2·0*	*1·7*	*1·6*	*2·3*	*2·7*	*2·5*

Annex C to Chapter 5
Economic assumptions

5C.1 This annex brings together the economic assumptions which underlie the public expenditure figures, and compares them with the assumptions from the 1992 Autumn Statement.

5C.2 Assumptions for the following variables are given in Table 5C.1:

- general inflation as measured by the GDP deflator at market prices;
- the retail prices index (RPI);
- the Rossi index—ie RPI excluding mortgage interest payments, rent and the council tax;
- the increase in average earnings;
- the level of unemployment (GB and Northern Ireland).

5C.3 The assumptions for the GDP deflator in 1993-94 and 1994-95 are consistent with the Industry Act forecast shown in Chapter 3. Those for later years, and all of the other figures, are working assumptions, not forecasts.

Table 5C.1 Economic assumptions

Percentage changes on a year earlier unless otherwise stated

		1993–94	1994–95	1995–96	1996–97
GDP deflator at market prices	1993 B	$3\frac{1}{4}$	4	$3\frac{3}{4}$	$2\frac{1}{2}$
	1992 AS	$2\frac{3}{4}$	$3\frac{1}{4}$	$2\frac{3}{4}$	
Retail prices index[1] (September)	1993 B	1·8	$3\frac{1}{4}$	$3\frac{1}{4}$	
	1992 AS	2	$3\frac{1}{2}$		
Rossi index[1] (September)	1993 B	3·5	$3\frac{1}{4}$	3	
	1992 AS	$3\frac{3}{4}$	$2\frac{1}{2}$		
Average earnings	1993 B	$3\frac{1}{2}$	4		
	1992 AS	5			
GB unemployment (millions)	1993 B	2·75	2·75	2·75	2·75
	1992 AS	2·8	2·8	2·8	
Northern Ireland unemployment (thousands)	1993 B	105	105	105	105
	1992 AS	110	110	110	

[1] *Used for projecting social security benefit expenditure in following financial year.*

Annex D to Chapter 5
Departmental groupings

Short title used in tables	Departments covered
Defence	Ministry of Defence
Foreign Office	Foreign and Commonwealth Office—Diplomatic Wing
Overseas Development	Foreign and Commonwealth Office—Overseas Development Administration
Agriculture, Fisheries and Food	Ministry of Agriculture, Fisheries and Food The Intervention Board
Trade and Industry	Department of Trade and Industry Office of Fair Trading Office of Telecommunications Office of Electricity Regulation Office of Gas Supply
ECGD	Export Credits Guarantee Department
Employment	Department of Employment Advisory, Conciliation and Arbitration Service Health and Safety Commission
Transport	Department of Transport Office of Passenger Rail Franchising Office of the Rail Regulator
DOE—Housing	Department of Environment—Housing
DOE—Environment	Department of Environment Other Environmental Services Office of Water Services Ordnance Survey Property Holdings
DOE—PSA	Department of Environment PSA Services
DOE—Local government	Department of Environment—mainly block and transitional grants to English local authorities
Home Office	Home Office Charity Commission
Legal departments	Lord Chancellor's Department Crown Office, Scotland Crown Prosecution Service Land Registry Northern Ireland Court Service Public Record Office Serious Fraud Office Treasury Solicitor's Department
Education	Department for Education Office for Standards in Education

National Heritage	Department of National Heritage Office of the National Lottery
Health	Department of Health Office of Population Censuses and Surveys
Social Security	Department of Social Security
Scotland	Scottish Office Forestry Commission General Register Office (Scotland) Registers of Scotland Scottish Courts Administration Scottish Record Office
Wales	Welsh Office Office of Her Majesty's Chief Inspector of Schools in Wales
Northern Ireland	Northern Ireland Office and Departments
Chancellor's departments	HM Treasury Central Statistical Office Department for National Savings Government Actuary's Department HM Customs and Excise Inland Revenue National Investment and Loans Office Paymaster General's Office Registry of Friendly Societies Royal Mint
Cabinet Office—OPSS	Office of Public Service and Science Central Office of Information Her Majesty's Stationery Office
Cabinet Office—other, etc	Cabinet Office House of Commons House of Lords National Audit Office Parliamentary Commissioner and Health Service Commissioners Privy Council Office
European Communities	Net payments to European Community institutions

6 The public sector finances

6.01 This chapter brings together the detailed forecasts of revenue, spending, borrowing and debt for 1993-94 and 1994-95.

6.02 The presentation of the public sector accounts now reflects the Chancellor's commitment to draw a clear distinction between current and capital transactions. The main national accounts presentation in Table 6.11 includes rows for current and capital expenditure and the current deficit. There is also an additional table (Table 6.2) summarising the relationship between the current deficit, the financial deficit and the borrowing requirement.

The budget deficit and public sector debt

PSBR **6.03** The outturn for the public sector borrowing requirement (PSBR) in 1992-93 was £36·7 billion, £1½ billion more than estimated in the March Budget. The latest forecast for 1993-94 is a PSBR of £49·8 billion, equivalent to 7¾ per cent of GDP. This forecast is only marginally changed from the March Budget, although there have been offsetting changes to some components. Taking into account the new public expenditure plans and the tax changes announced in this Budget, the PSBR in 1994-95 is forecast to come down to £37·9 billion, or 5½ per cent of GDP, the first year-on-year reduction since 1988-89.

6.04 Receipts in 1994-95 are expected to rise faster than money GDP, reflecting both economic recovery and the tax increases announced in the March and November Budgets. And tight control of public expenditure is expected to bring general government expenditure (GGE) growth below that of GDP, despite a further sharp rise in debt interest payments.

Table 6.1 Public sector borrowing requirement

	1992-93	1993-94		1994-95
	Outturn	March Budget	Latest forecast	Forecast
Public sector borrowing requirement (PSBR)				
£ billion	36·7	50·1	49·8	37·9
per cent of GDP	6	8	$7\frac{3}{4}$	$5\frac{1}{2}$
PSBR excluding privatisation proceeds				
£ billion	44·8	55·6	55·2	43·4
per cent of GDP	$7\frac{1}{2}$	$8\frac{3}{4}$	$8\frac{3}{4}$	$6\frac{1}{2}$

Other measures of the budget deficit

6.05 Table 6.2 sets out the forecasts of the current deficit and financial deficit for both general government and the public sector as a whole, and shows how these relate to the PSBR.

Table 6.2 Budget deficits

	£ billion			
	1993-94		1994-95	
	General government	Public sector	General government	Public sector
Current deficit	39·7	40·8	28·9	29·7
Net capital expenditure[1]	15·3[2]	13·7	13·7[2]	11·5
Financial deficit	**55·0**	**54·5**	**42·7**	**41·3**
Financial transactions	−5·6[3]	−4·7	−4·3[3]	−3·3
Borrowing requirement	**49·4**[4]	**49·8**	**38·4**[4]	**37·9**

[1] *Net of depreciation and less capital transfer receipts.*
[2] *Including capital grants to public corporations.*
[3] *Excluding net lending to public corporations.*
[4] *Own account borrowing.*

6.06 The public sector financial deficit (PSFD) is forecast at $8\frac{1}{2}$ per cent of GDP in 1993-94, falling to 6 per cent of GDP in 1994-95. The gap between the PSBR and the PSFD – around $\frac{3}{4}$ per cent of GDP in 1993-94 – represents various financial transactions, notably privatisation proceeds.

6.07 The difference between the public sector's financial deficit and its current deficit is net capital expenditure (net of depreciation), less capital transfers (see Table 6.11, footnote 1). The current deficit is expected to stand at $6\frac{1}{2}$ per cent of GDP in 1993-94, falling to $4\frac{1}{2}$ per cent of GDP in 1994-95. The forecast reduction in the PSFD in 1994-95 is primarily due to a lower current deficit.

6.08 The general government financial deficit (GGFD) is expected to be a little higher than the PSFD in 1993-94 at $8\frac{3}{4}$ per cent of GDP, reflecting the small financial surplus projected for the public corporations sector. It is forecast to fall to $6\frac{1}{4}$ per cent of GDP in 1994-95.

Public sector debt

6.09 The stock of net public sector debt at end-March 1993 was £$201\frac{1}{2}$ billion, $32\frac{3}{4}$ per cent of GDP. The latest forecast of the PSBR for 1993-94 implies a rise to $38\frac{1}{2}$ per cent at end-March 1994, marginally lower than projected in March mainly because of a higher forecast level of GDP. A further rise is in prospect to $41\frac{3}{4}$ per cent at end-March 1995. General government gross debt is projected to rise from 41 per cent of GDP at end-March 1993 to 49 per cent at end-March 1995.

Table 6.3 Public sector debt[1]

	1992-93	1993-94		1994-95
	Outturn	March Budget	Latest forecast	Forecast
Net public sector debt				
£ billion	$201\frac{1}{2}$	255	253	292
per cent of GDP	$32\frac{3}{4}$	$39\frac{1}{4}$	$38\frac{1}{2}$	$41\frac{3}{4}$
General government gross debt				
£ billion	$253\frac{1}{2}$	. . .[2]	308	342
per cent of GDP	41	. . .[2]	47	49

[1] *At end-March.*
[2] *Not forecast.*

Changes since March Budget

1992-93 outturn

6.10 The PSBR in 1992-93 was around £1½ billion higher than forecast in the March Budget. This was more than explained by lower receipts – principally other receipts, a disparate collection of non-tax items, including identified financial transactions and timing and accounting adjustments.

Table 6.4 Changes since March 1993 Budget

	£ billion	
	Changes since March Budget	
	1992-93	1993-94
Expenditure		
New control total[1]	+0·1	–0·4
Other general government expenditure[1,2]	–0·2	–0·7
Public corporations' market and overseas finance	–0·2	–0·2
Privatisation proceeds	—	+0·1
Total expenditure[1]	**–0·3**	**–1·1**
Receipts		
Inland Revenue	+0·5	+0·2
Customs and Excise	–0·2	–0·8
Social security contributions	–0·6	—
Other receipts[1]	–1·6	–0·1
Total receipts[1]	**–1·9**	**–0·8**
PSBR	**+1·6**	**–0·3**

[1] *On current definitions*
[2] *Excluding privatisation proceeds*

1993-94 forecast

6.11 The latest forecast of the 1993-94 PSBR is marginally lower than the March Budget. Expenditure is now forecast at around £1 billion lower than in March; there is a slightly smaller downward revision to the forecast of receipts. Although GDP growth is now expected to be a little higher than forecast in March, revenues from most taxes have been running at or below expectations. VAT receipts in particular have been weaker than expected.

General government receipts and expenditure

6.12 Table 6.5 shows the outturns for 1992-93, latest forecasts for 1993-94 and forecasts for 1994-95 for general government receipts and its components.

Table 6.5 General government receipts[1]

£ billion

	1992-93	1993-94		1994-95
	Outturn	March Budget[5]	Latest forecast	Forecast
Inland Revenue:				
Income tax	56·8	57·5	57·9	64·4
Corporation tax[2]	15·8	14·6	14·7	17·6
Petroleum revenue tax	0·1	0·6	0·5	1·0
Capital gains tax	1·0	1·0	1·0	1·3
Inheritance tax	1·2	1·3	1·3	1·4
Stamp duties	1·3	1·7	1·7	1·8
Total Inland Revenue	**76·1**	**76·7**	**76·9**	**87·5**
Customs and Excise				
Value added tax	37·2	39·9	38·7	43·1
Car tax	0·6	—	—	—
Fuel duties	11·2	12·7	12·7	14·5
Tobacco duties	6·0	6·6	6·8	7·2
Alcohol duties	5·1	5·1	5·2	5·4
Betting and gaming duties	1·0	1·1	1·1	1·2
Customs duties	1·8	1·9	2·0	2·0
Agricultural levies	0·2	0·2	0·2	0·1
Air passenger duty	—	—	—	0·1
Insurance premium tax	—	—	—	0·3
Total Customs and Excise	**63·2**	**67·5**	**66·7**	**73·9**
Vehicle excise duties	3·3	3·7	3·7	3·8
Oil royalties	0·6	0·7	0·6	0·6
Business rates[3]	13·9	13·3	12·7	13·0
Other taxes and royalties[5]	5·4	5·9	5·9	5·9
Total taxes and royalty receipts[5]	**162·4**	**167·8**	**166·5**	**184·8**
Social security receipts	36·8	39·1	39·1	42·8
Council tax and community charge	8·3	8·2	8·1	8·6
Interest and dividends	5·0	4·8	5·6	5·4
Gross trading surpluses and rent	4·0	4·1	4·2	4·3
Other receipts[4]	6·9	6·4	6·2	6·4
General government receipts[5]	**223·3**	**230·5**	**229·7**	**252·4**
Memo item				
North Sea revenues[6]	1·3	2·2	1·4	2·1
[2] *Includes advance corporation tax (net of repayments):*	*8·7*	*7·8*	*8·1*	*7·4*

[1] *On a cash basis. See Annex.*
[2] *Includes advance corporation tax (net of repayments): (also includes North Sea corporation tax after ACT set-off, and corporation tax on gains).*
[3] *Includes district council rates in Northern Ireland.*
[4] *Includes accruals adjustments for index-linked gilts.*
[5] *On current definitions.*
[6] *North Sea corporation tax (before ACT set-off), petroleum revenue tax and oil royalties.*

Receipts in 1993-94

6.13 General government receipts are now expected to rise by 3 per cent in 1993-94. This is below the forecast growth in money GDP ($5\frac{1}{2}$ per cent), but compares with a rise in receipts of only $\frac{1}{2}$ per cent recorded in 1992-93. Within this total:

- the forecast of Inland Revenue receipts is more or less unchanged from the March Budget forecast;

- income tax receipts are expected to be up on 1992-93, as are receipts of petroleum revenue tax and stamp dutes. But this is partly offset by lower corporation tax;

- the rise in Customs and Excise receipts in 1993-94 is weaker than in the March Budget forecast. This is explained by a substantially lower forecast of VAT receipts, in line with the outturn observed so far this year;

- social security receipts are much as expected in March. But the forecast of interest and dividend receipts is higher reflecting the buoyant outturn to date.

Receipts in 1994-95

6.14 General government receipts are forecast to rise by 10 per cent in 1994-95, significantly more than money GDP growth ($6\frac{1}{2}$ per cent). Tax increases are an important factor. The measures announced in the March Budget but not due to be implemented until 1994-95 will increase taxes by around £$3\frac{3}{4}$ billion (mostly from income tax, social security contributions and VAT) as compared with indexed 1993-94 levels. The November Budget measures will increase taxes in 1994-95 by a further £$1\frac{3}{4}$ billion.

6.15 Even without these measures, the projected increase in general government receipts in 1994-95 would still be around $7\frac{1}{2}$ per cent, which is higher than money GDP growth.

6.16 Within this forecast total for 1994-95:

- Inland Revenue receipts are forecast to increase by 14 per cent from their 1993-94 level. Around a quarter of this is due to higher corporation tax, reflecting a cyclical recovery. Most of the rest of the increase is due to income tax, where receipts are boosted by the two sets of Budget measures;

- Customs and Excise receipts are forecast to rise by 11 per cent, of which about half reflects the tax measures in the March and November Budgets. Without the two sets of Budget measures, receipts would grow slightly faster than consumer spending;

- social security receipts are forecast to rise by 10 per cent, of which around a third reflects the net impact of the two sets of Budget changes.

North Sea revenues

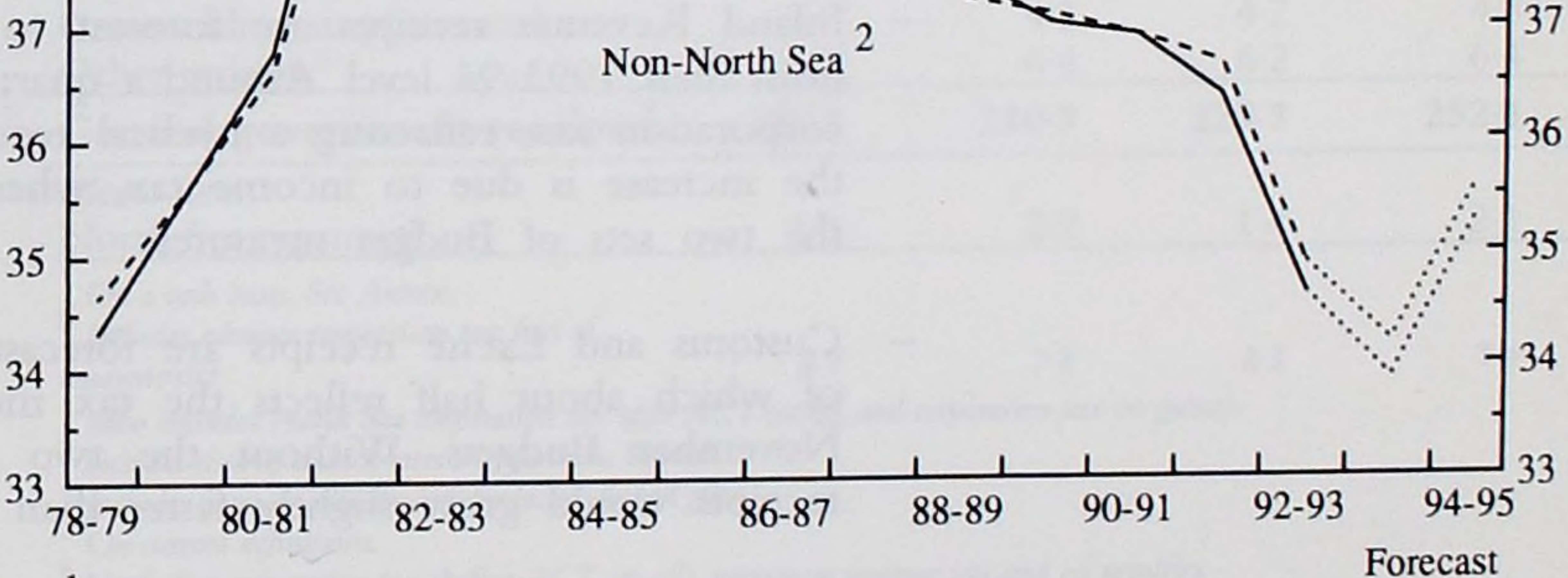
6.17 North Sea revenues in 1993-94, at under £1½ billion, are expected to be little higher than last year's outturn and £¾ billion lower than forecast in the March Budget. Petroleum revenue tax (PRT) receipts are expected to be marginally lower than forecast reflecting the lower oil price. But corporation tax receipts are now expected to be over £½ billion lower, because of higher repayments of tax (caused by lower settlements for old years) and lower liabilities in 1992. North Sea revenues are expected to rise to over £2 billion in 1994-95, as oil and gas production picks up, and following the reforms to PRT in the March Budget. This would still represent less than ½ per cent of GDP, as compared with a peak of 3¾ per cent of GDP in the mid-1980s.

Taxes as a share of GDP

6.18 Chart 6.1 shows recent movements in the ratio of tax and social security revenues to GDP. The ratio has fallen quite sharply since the onset of recession, from 37 per cent in 1990-91 to 34¾ per cent in 1992-93. A further reduction to 34 per cent is expected for 1993-94. Although output has been growing since mid-1992, the cycle in tax revenues tends to lag behind that in economic activity. Certain taxes – for example mainstream corporation tax and income tax on self-employment income – are collected a year or so in arrears, and these taxes are among those which show the greatest variability over the cycle.

6.19 With economic recovery continuing through 1993 and 1994, and the tax measures announced in the March and November Budgets taking effect, the tax to GDP ratio should rise sharply in 1994-95. The forecast is for an increase of nearly 1½ percentage points in 1994-95.

Chart 6.1 Tax[1]/GDP ratio



1 *On a national accounts accruals basis.*

2 *As a per cent of non-North Sea GDP.*

Expenditure

6.20 General government expenditure (GGE) in 1993-94 is now put at around £1 billion below the March Budget forecast. The control total is expected to turn out between £$\frac{1}{4}$ and £$\frac{1}{2}$ billion below the public spending plans. The main explanation of lower GGE outside of the control total is lower cyclical social security spending which mainly reflects a lower outturn for unemployment than assumed in the March Budget forecast.

Table 6.6 General Government Expenditure

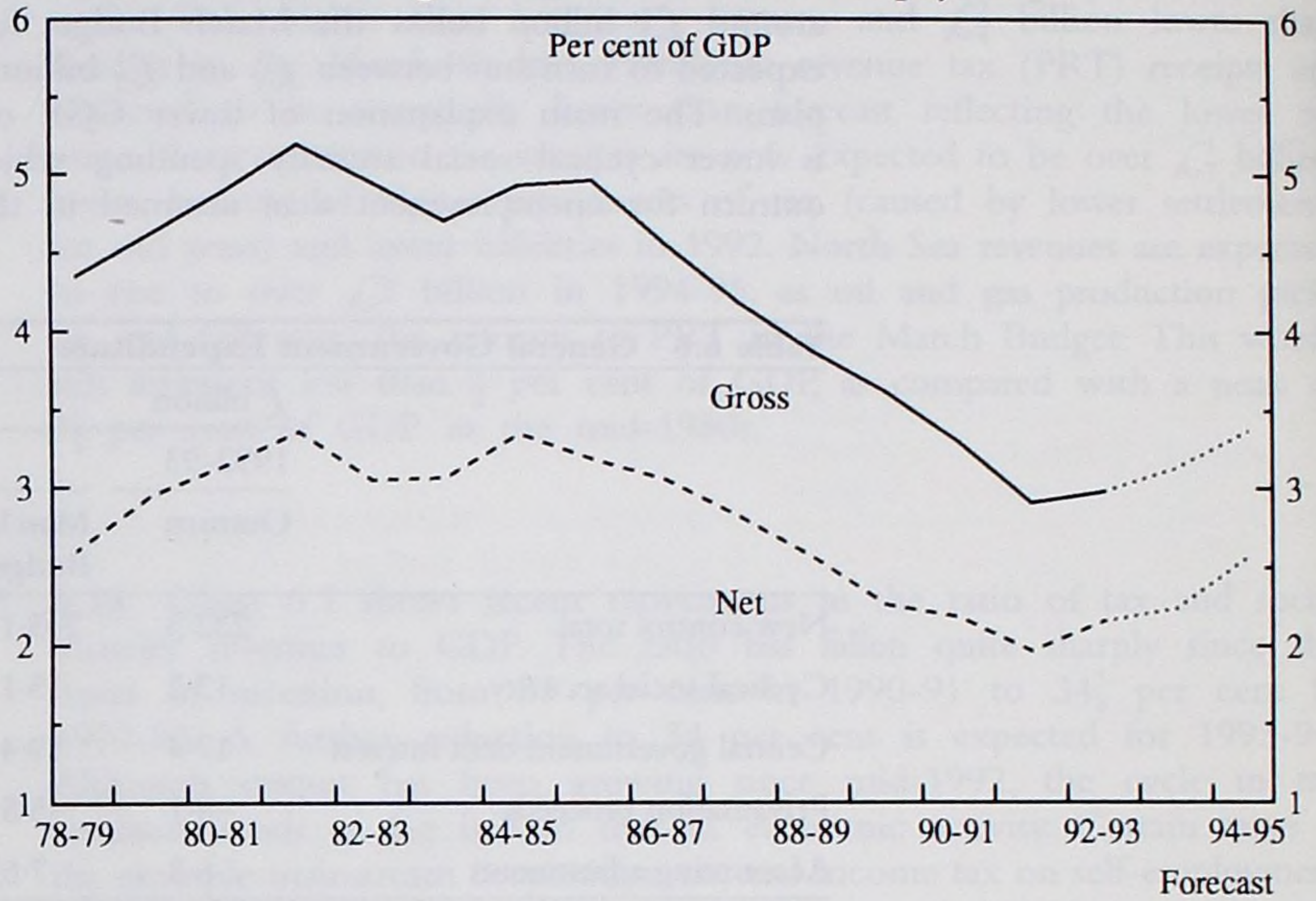
£ billion	1992-93	1993-94		1994-95
	Outturn	March Budget	Latest forecast	Forecast
New control total	232·3	245·1[1]	244·7	251·3
Cyclical social security	13·2	15·1	14·0	14·8
Central government debt interest	17·4	19·4	19·4	22·5
Privatisation proceeds	–8·1	–5·5	–5·4	–5·5
Accounting adjustments	6·3	7·6[1]	8·0	8·8
General government expenditure	**261·1**	**281·6[1]**	**280·7**	**291·8**
Memo items:				
Public sector net capital expenditure[2]	13·2	. . .[3]	13·9	11·7
Public corporations' market and overseas borrowing	–1·1	–1·0	–1·2	–1·5

[1] *On current definitions.*
[2] *Net of depreciation.*
[3] *Not forecast in March, because no forecast of depreciation.*

6.21 For 1994-95, new control total spending is to be held to a cash rise of $2\frac{3}{4}$ per cent, which represents a fall of $1\frac{1}{4}$ per cent in real terms. And although expenditure outside the control total is expected to rise somewhat faster, the forecast growth in GGE excluding privatisation proceeds—4 per cent in cash terms, or zero in real terms—is much lower than for 1993-94.

6.22 Much of the growth in spending outside the control total is expected to come from debt interest payments, reflecting the rising level of public sector debt. Central government debt interest is expected to rise by 11 per cent in 1993-94, and by 16 per cent in 1994-95. General government debt interest payments (which also includes local authorities' interest payments on borrowing from the market) are now rising as a percent of GDP following a period of six years when the ratio was falling.

Chart 6.2 General government debt interest payments



6.23 The forecast assumes privatisation proceeds of £5½ billion in 1994-95, a similar level to the expected outturn for 1993-94.

6.24 Public sector capital expenditure, net of depreciation, is expected to total around £14 billion in 1993-94, an increase of £¾ billion on 1992-93. There will be a reduction in 1994-95 from the high real level of spending maintained during the recession. However, this will be offset to some extent by the impact of the private finance initiative, which will lead to additional investment financed by the private sector in areas previously regarded as public sector.

Borrowing by sector

6.25 Table 6.7 shows the outturn for borrowing in 1992-93 and the forecast for 1993-94 broken down between central government, local authorities and public corporations.

Table 6.7 Public sector borrowing requirement by sector

£ billion	1992-93			1993-94		
	Outturn			Outturn	Forecast	
	Apr-Oct	Nov-Mar	Total	Apr-Oct	Nov-Mar	Total
CGBR(O)[1]	26·4[4]	16·0	42·4[4]	28·4	21·8	50·2
LABR[2]	–6·6[4]	0·8	–5·8[4]	–1·8	1·0	–0·8
PCBR[3]	0·2	–0·1	0·1	0·2	0·1	0·4
PSBR	**20·0**	**16·7**	**36·7**	**26·9**	**22·9**	**49·8**

[1] *Central government borrowing requirement on own account.*
[2] *Local authority borrowing requirement.*
[3] *Public corporations' borrowing requirement.*
[4] *Includes commutation grant of £5·1 billion which increases central government borrowing and reduces local authority borrowing.*

Central government borrowing

6.26 The sectoral position in 1992-93 was distorted by a PSBR-neutral commutation grant of over £5 billion from central government to local authorities, which was used to repay debt to central government. But, even abstracting from this, central government borrowing on its own account (ie excluding borrowing for on-lending to local authorities and public corporations) more than accounted for the total PSBR in 1992-93 and is expected to do so again in 1993-94. Central government borrowing on own account in the first seven months of 1993-94 was £7 billion higher than in the same period of 1992-93 (after adjusting for the commutation grant). The forecast for 1993-94 as a whole implies borrowing in November to March which is about £6 billion higher than in the same period last year.

Central government transactions on a cash basis

6.27 The monthly outturn figures for central government borrowing are measured from the cash flows into and out of central government's funds and accounts, consolidated across funds and accounts. Table 6.8 sets out the 1992-93 outturn and 1993-94 and 1994-95 forecasts for central government borrowing in terms of this cash flow presentation.

Table 6.8
Central government transactions on a cash receipts and outlays basis

£ billion	1992-93	1993-94		1994-95
	Outturn	March Budget	Latest forecast	Forecast
Receipts				
Inland Revenue[2]	76·3	76·7	76·9	87·5
Customs and Excise[2]	63·4	67·8	66·9	74·2
Social security contributions (GB)	35·4	37·2	37·1	41·3
Interest and dividends	9·0	8·7	9·1	9·0
Other	16·7	18·3	18·4	17·8
Total receipts	**200·8**	**208·7**	**208·4**	**229·8**
Outlays				
Interest payments	16·6	18·8	18·8	21·6
Privatisation proceeds	–8·1	–5·5	–5·4	–5·5
Net departmental outlays	234·7[3]	241·2[1]	245·2	250·2[1]
Total outlays	**243·2[3]**	**254·5[1]**	**258·6**	**266·3[1]**
Net own account borrowing[4]	**42·4[3]**	**. . .[5]**	**50·2**	**. . .[5]**

[1] *Excluding any allocation from the Reserve.*
[2] *Payments to the Consolidated Fund.*
[3] *Includes commutation grant to local authorities of £5·1 billion.*
[4] *Excludes net lending to local authorities and public corporations.*
[5] *No comparable estimate because Reserve not allocated across sectors.*

6.28 Central government own account borrowing is forecast to rise by £13 billion in 1993-94, after adjusting for the commutation grant to local authorities in 1992-93. The rise in cash outlays ($8\frac{1}{2}$ per cent, adjusted for commutation grant) is expected to be more than twice that in cash receipts ($3\frac{3}{4}$ per cent). This relative position should be reversed in 1994-95; a sharp rise in tax will boost cash receipts and the tight public expenditure plans will restrain growth in cash outlays.

Local authorities and public corporations borrowing

6.29 Local authorities made a net repayment–excluding the commutation grant–of £$\frac{3}{4}$ billion in 1992-93 and a similar net repayment is forecast for 1993-94. Public corporations' borrowing was close to zero in 1992-93; the forecast for 1993-94 is for borrowing of £$\frac{1}{2}$ billion.

6.30 A cash flow presentation along the lines of Table 6.8 is not feasible for local authorities and public corporations, but a national accounts presentation of local authority and public corporations' transactions is shown in Tables 6.9 and 6.10.

Public sector finances by economic category

6.31 Table 6.11 shows a full analysis of receipts and expenditure by economic category, with a breakdown between central government, local authorities and public corporations. The Annex to this chapter explains the conventions used, which follow in most respects those in the UK national income and expenditure accounts.

6.32 Table 6.11 makes the assumption that the Reserve for 1994-95 is spent entirely on transactions that fall above the financial deficit line, although in practice allocations from the Reserve can also affect financial transactions. The Reserve for 1994-95 has been further apportioned between current and capital expenditure, as described in Chapter 5. A working assumption has been made that all of the Reserve will be spent by general government, in order to produce the projections of the general government financial deficit and current deficit shown in Table 6.2, and the general government gross debt projections in Table 6.3. There is, however, no apportionment of the Reserve in Table 6.11 between central government and local authorities.

Local authorities

6.33 Table 6.9 summarises the information on local authority transactions in Table 6.11, and also provides outturn figures for 1992-93. Most of local authorities' receipts come from central government in the form of current and capital grants. On the expenditure side, just over 10 per cent – £$7\frac{3}{4}$ billion – in 1993-94 was capital spending (gross of depreciation). Capital spending in 1993-94 has been boosted by the temporary relaxation of the rules governing spending of capital receipts which was announced in the 1992 Autumn Statement. With the ending of this relaxation on 31 December 1993, gross capital spending is expected to fall back somewhat in 1994-95.

6.34 Adjusting for the commutation grant paid in 1992-93 (see paragraph 6.26), local authorities recorded a small financial deficit of around £$\frac{3}{4}$ billion in 1992-93, and are also expected to record a small deficit in 1993-94. However, the accounts show a net repayment on the same basis of £$\frac{3}{4}$ billion for 1992-93, which mainly reflects a large unidentified balancing item. The forecast of local authority borrowing for 1993-94 is primarily based on outturn information to date and implies a further, larger balancing item for 1993-94. In order not to distort forecast trends in the borrowing requirement, the forecast for 1994-95 assumes a similar balancing item to 1993-94. On past experience, the balancing items in the outturn data will be reduced over time by revisions to the income and expenditure figures, as more and better data become available.

Table 6.9 Local authority transactions

	1992-93 Outturn	1993-94 Latest forecast	1994-95 Forecast
£ billion			
Receipts:			
Community charge and council tax[1]	8·2	8·1	8·8
Current grants from central government	55·0	55·2	57·3
Other current receipts[3]	7·0	7·0	7·1
Capital grants from central government	8·0[2]	3·2	3·0
Total receipts	**78·2[2]**	**73·5**	**76·1**
Expenditure:			
Current expenditure on goods and services	50·7	49·8	51·8
Current grants and subsidies	11·3	12·7	14·2
Interest	4·8	4·4	4·2
Capital expenditure before depreciation	7·1	7·7	6·6
Total expenditure	**73·9**	**74·6**	**76·8[4]**
Financial deficit	**–4·3[2]**	**1·1**	**. . .[5]**
Net financial transactions	–1·5	–1·9	–1·9
Net borrowing	**–5·8[2]**	**–0·8**	**. . .[5]**

[1] *Net of rebates, community charge benefit, transitional relief and community charge reduction scheme. Includes district council rates in Northern Ireland shown in 'Taxes on Expenditure' in Table 6.11 (line 2).*
[2] *Includes commutation grant of £5·1 billion, used to repay debt.*
[3] *Includes interest receipts, rent and gross trading surplus.*
[4] *Excluding any allocation from Reserve.*
[5] *No forecast shown because Reserve not allocated between central government and local authorities.*

Public corporations

6.35 Table 6.10 is a similar summary presentation of the information in Table 6.11 for public corporations. Public corporations recorded a small financial surplus in 1992-93, and are forecast to run further surpluses in 1993-94 and 1994-95. These correspond to small borrowing requirements in 1992-93 and 1993-94, and a small repayment of debt in 1994-95. Year-on-year increases in both the expenditure and revenue sides of the account of Table 6.11 are being distorted at present by the creation of further NHS trusts, which are classified to this sector.

Table 6.10 Public corporations' transactions

	£ billion		
	1992–93 Outturn	1993–94 Latest forecast	1994–95 Forecast
Receipts:			
Gross trading surplus (including subsidies)	2·5	3·2	4·5
Other current receipts	0·6	1·1	1·1
Capital grants from general government	3·4	3·1	3·4
Total receipts	**6·5**	**7·4**	**9·0**
Expenditure:			
Interest, dividends and taxes on income	1·4	1·7	2·0
Capital expenditure before depreciation	5·0	5·3	5·7
Total expenditure	**6·4**	**7·0**	**7·6**[1]
Financial deficit	**–0·1**	**–0·5**	**–1·4**
Net financial transactions	0·2	0·9	1·0
Net borrowing	**0·1**	**0·4**	**–0·5**

[1] *Assumes no allocation from the Reserve.*

Margins of error

6.36 The earlier date of the Budget means that the PSBR forecasts for both the current year and the year ahead are subject to a larger margin of error than previous Budget forecasts. Some indication of how much larger can be gained by looking at the errors on previous Autumn Statement projections. Over the past ten years, the absolute error on Autumn Statement forecasts of the current year PSBR has averaged $\frac{1}{2}$ per cent of GDP, equivalent to £4 billion in today's terms. On projections for the year ahead, the average absolute error, adjusted for subsequent Budget measures, is $1\frac{1}{2}$ per cent of GDP, or £$10\frac{1}{4}$ billion in today's terms. The equivalent average errors on March Budget forecasts are £$\frac{3}{4}$ billion for the current year and £8 billion for the year ahead.

Table 6.11 Public Sector transactions by sub-sector and economic category

		£ billion				
		1993–94 Latest Forecast				
		General government				
	Line[1]	Central government	Local authorities	Total	Public corporations	Public sector
Current receipts[2]						
Taxes on income and oil royalties	1	74·0	—	74·0	–0·1	73·9
Taxes on expenditure	2	91·6	0·2	91·7	—	91·7
Taxes on capital	3	2·6	—	2·6	—	2·6
Social security contributions	4	39·3	—	39·3	—	39·3
Council tax	5	—	8·0	8·0	—	8·0
Gross trading surplus	6	–0·4	0·7	0·3	3·2	3·6
Rent and miscellaneous current transfers	7	0·6	3·7	4·4	0·6	5·0
Interest and dividends from private sector and abroad	8	3·6	0·4	4·0	0·5	4·5
Interest and dividends within public sector	9	5·5	–3·9	1·6	–1·6	—
Imputed charge for non-trading capital consumption	10	1·4	1·9	3·3	—	3·3
Total current receipts	11	**218·2**	**11·0**	**229·2**	**2·6**	**231·8**
Current expenditure[2]						
Current expenditure on goods and services	12	90·3	49·8	140·0	—	140·0
Depreciation	13	1·7	4·4	6·1	3·8	9·9
Subsidies	14	6·9	0·7	7·6	—	7·6
Current grants to personal sector	15	77·4	12·0	89·5	—	89·5
Current grants abroad	16	5·8	—	5·8	—	5·8
Current grants within public sector	17	55·2	–55·2	—	—	—
Debt interest	18	19·4	0·5[3]	19·9	–0·1[3]	19·8
Apportionment of Reserve	19	—	—	—	—	—
Total current expenditure	20	**256·7**	**12·2**	**268·9**	**3·7**	**272·6**
Current deficit	21	**38·4**	**1·2**	**39·7**	**1·1**	**40·8**
Capital transfers	22	**—**	**0·3**	**0·3**	**—**	**0·2**
Capital expenditure[2]						
Gross domestic fixed capital formation	23	6·8	6·4	13·2	4·7	17·9
Less Depreciation	24	–1·7	–4·4	–6·1	–3·8	–9·9
Increase in stocks	25	0·1	—	0·1	0·1	0·2
Capital grants to private sector	26	4·0	1·3	5·3	0·5	5·7
Capital grants to public sector	27	6·3	–3·2	3·1	–3·1	—
Apportionment of Reserve	28	—	—	—	—	—
Total capital expenditure	29	**15·4**	**0·1**	**15·6**	**–1·7**	**13·9**
Financial deficit	30	**53·9**	**1·1**	**55·0**	**–0·5**	**54·5**
Financial transactions						
Net lending to private sector and abroad	31	0·4	–0·3	0·2	0·1	0·2
Cash expenditure on company securities (including privatisation proceeds)	32	–5·5	—	–5·5	—	–5·5
Transactions concerning certain public sector pension schemes	33	0·6	—	0·6	—	0·6
Accruals adjustments on receipts	34	2·1	–0·1	1·9	—	1·9
Other accruals adjustments	35	–0·6	–0·2	–0·7	–0·2	–0·9
Miscellaneous financial transactions	36	–0·7	–1·3	–2·0	1·0	–1·1
Borrowing requirement	37	**50·2[4]**	**–0·8**	**49·4[4]**	**0·4**	**49·8**

[1] *Current deficit (line 21) = current expenditure (line 20) – current receipts (line 11)*
Financial deficit (line 30) = current deficit (line 21) – capital receipts (line 22) + capital expenditure (line 29).
Borrowing requirement (line 37) = financial deficit (line 30) + financial transactions (lines 31 to 36).
[2] *On an accruals basis.*
[3] *Excluding local authorities' payments to central government and public corporations' payments to general government, which are in row 9.*
[4] *Own account borrowing requirement.*

Table 6.11 Public Sector transactions by sub-sector and economic category—*continued*

	£ billion					
	1994–95 Forecast					
	General government					
Line[1]	Central govern-ment	Local authori-ties	Total	Public Corpora-tions	Public sector	
						Current receipts[2]
1	83·9	—	83·9	−0·2	83·8	Taxes on income and oil royalties
2	100·1	0·2	100·2	—	100·2	Taxes on expenditure
3	3·3	—	3·3	—	3·3	Taxes on capital
4	43·3	—	43·3	—	43·3	Social security contributions
5	—	8·6	8·6	—	8·6	Council tax
6	−0·3	0·7	0·4	4·5	5·0	Gross trading surplus
7	0·9	3·8	4·7	0·6	5·3	Rent and miscellaneous current transfers
8	3·1	0·3	3·4	0·5	4·0	Interest and dividends from private sector and abroad
9	5·8	−3·8	2·0	−2·0	—	Interest and dividends within public sector
10	1·2	2·0	3·2	—	3·2	Imputed charge for non-trading capital consumption
11	**241·4**	**11·7**	**253·1**	**3·5**	**256·6**	**Total current receipts**
						Current expenditure[2]
12	93·4	51·8	145·2	—	145·2	Current expenditure on goods and services
13	1·4	4·6	6·0	4·5	10·5	Depreciation
14	6·5	0·7	7·3	—	7·3	Subsidies
15	79·4	13·5	92·9	—	92·9	Current grants to personal sector
16	4·7	—	4·7	—	4·7	Current grants abroad
17	57·3	−57·3	—	—	—	Current grants within public sector
18	22·5	0·4[3]	22·8	−0·2[3]	22·6	Debt interest
19	—	—	3·2	—	3·2	Apportionment of Reserve
20			**282·1**	**4·3**	**286·3**	**Total current expenditure**
21			**28·9**	**0·8**	**29·7**	**Current deficit**
22	**—**	**0·3**	**0·3**	**—**	**0·2**	**Capital transfers**
						Capital expenditure[2]
23	5·8	5·4	11·2	5·3	16·4	Gross domestic fixed capital formation
24	−1·4	−4·6	−6·0	−4·5	−10·5	*Less* Depreciation
25	—	—	—	—	—	Increase in stocks
26	3·8	1·2	5·1	0·4	5·5	Capital grants to private sector
27	6·4	−3·0	3·4	−3·4	—	Capital grants to public sector
28	—	—	0·4	—	0·4	Apportionment of Reserve
29			**14·0**	**−2·3**	**11·7**	**Total capital expenditure**
30			**42·7**	**−1·4**	**41·3**	**Financial deficit**
						Financial transactions
31	0·6	−0·2	0·4	0·1	0·5	Net lending to private sector and abroad
32	−5·7	—	−5·7	—	−5·7	Cash expenditure on company securities (including privatisation proceeds)
33	0·6	—	0·6	—	0·6	Transactions concerning certain public sector pension schemes
34	3·5	−0·3	3·2	—	3·2	Accruals adjustments on receipts
35	−0·9	−0·1	−1·0	−0·2	−1·2	Other accruals adjustments
36	−0·5	−1·2	−1·8	1·1	−0·7	Miscellaneous financial transactions
37			**38·4**[4]	**−0·5**	**37·9**	**Borrowing requirement**

Annex to Chapter 6
Conventions used in presenting the public finances

6A.1 The FSBR presents the public finances in two main ways: on a cash basis and on a national accounts, or accruals, basis. This annex briefly describes the two approaches and outlines the relationships between the various public finances tables in Chapters 1, 2, 5 and 6.

6A.2 An important point to note at the outset is that the key expenditure and receipts aggregates, general government expenditure (GGE) and general government receipts (GGR), are national accounts concepts. But they can be disaggregated on both a national accounts basis and on a largely cash basis.

Cash basis

6A.3 The cash approach concentrates on the actual cash transactions between the public sector and the rest of the economy in any given period of time. It is particularly useful for analysing the components of the PSBR, which is itself almost entirely a cash concept. A cash basis also corresponds closely to the way public expenditure is planned, controlled and accounted for at present.

Tables 1.5, 5.4 and 6.5

6A.4 The main–albeit summary–presentation of the public finances on a cash basis is given in Table 1.5. Supporting disaggregation of the new control total is shown in Table 5.4, while Table 6.5 provides a detailed breakdown of general government receipts.

6A.5 As far as possible, the figures in these tables relate to actual cash flows. The estimates of taxes, for example, are for tax payments received during the year, rather than for liabilities incurred. There are however, a number of items which are not on a cash basis:

– "social security receipts" are scored gross of amounts netted off by employers as reimbursement in respect of statutory sick pay and statutory maternity pay. These payments count as expenditure rather than negative receipts;

– VAT refunded to central and local government is included in "other taxes and royalties" (Table 6.5);

– an imputed flow for capital consumption by general government is included in "other receipts" (Table 6.5);

These latter two flows have no impact on the PSBR as they also appear on the expenditure side of the account in "accounting adjustments" (Table 1.5). This line also includes various other adjustments needed to get back to the national accounts basis required for GGE.

6A.6 The final departure from a cash basis is the "central government debt interest" line of Table 1.5, which scores the capital uplift on index-linked gilts as interest at the time it accrues. Because the PSBR is on a cash basis, an offset is made in the form of an accruals adjustment to "other receipts" (Table 6.5). This removes the accrued uplift scored and adds back any actual payments of uplift on redemptions.

6A.7 Tables 1.4, 2.2 (except the memo item GGFD), 2A.3, 2A.5, 5.2 and 6.6 are all on the same basis as Table 1.5.

Table 6.8

6A.8 The other cash-based table is Table 6.8, which shows the finances of central government. Unlike the earlier tables, this is genuinely a cash presentation, based on information from central government funds and accounts. The imputed flows for refunded VAT, social security contributions and capital consumption are all excluded, and the "interest payments" line takes account of actual payments of capital uplift on index-linked gilts, rather than the accrued uplift.

6A.9 Similar tables cannot be produced for local authorities or public corporations because the available cash data are not comprehensive. The finances of these sectors, shown in Tables 6.9 and 6.10, are presented on the national accounts basis described below.

National accounts basis

6A.10 The national accounts are produced by the CSO for the UK as a whole using an internationally agreed framework. Public finances shown on this basis can thus be placed more easily into the context of the rest of the economy, highlighting the inter-relationships between different sectors.

Table 6.11

6A.11 Table 6.11 gives the main national accounts presentation of the public finances in the FSBR. Under the measurement conventions used in the national accounts:

– most transactions, including most taxes (although not corporation tax), are recorded on an accruals rather than a cash payments basis;

– transactions are grouped by economic category. So, for example, transfer payments are distinguished from expenditure on goods and services;

– the value of some transactions is imputed where no money changes hands (for example, non-trading capital consumption).

6A.12 The public sector financial deficit is the balance between expenditure and income in the combined current and capital accounts (line 30 of Table 6.11). Unlike the PSBR, the financial deficit is not wholly a measure of cash transactions because certain items above line 30 are measured on an accruals basis. The appropriate accruals adjustments are made in lines 34 and 35. Certain other financial transactions, notably net lending and privatisation proceeds, are also excluded from the financial deficit, but included in the PSBR.

6A.13 As the national accounts distinguish between current and capital transactions, they provide the natural framework in which to identify the current balance and capital spending. The current and capital breakdown shown in Table 6.11 differs from the usual national accounts conventions in two respects. First, capital taxes (line 3) are counted as current rather than capital receipts on the grounds that they are not strictly speaking pure taxes on capital. And second, an estimate of depreciation is deducted from capital expenditure and added to current expenditure. (For a more detailed discussion of different definitions of capital spending, see Annex A to Chapter 5).

6A.14 GGE can be derived from the general government column of Table 6.11 by taking current expenditure (line 20) plus capital expenditure (line 29) and adding:

- the Reserve (lines 19 and 28, all assumed to be general government);
- net lending to the private sector and abroad (line 31);
- cash expenditure on company securities (line 32);
- and net lending by central government to public corporations (£1·6 billion in 1993-94 and £1·0 billion in 1994-95).

6A.15 Correspondingly, GGR comprises general government current receipts (line 11) plus capital transfers (line 22), less:

- transactions concerning public sector pension schemes (line 33);
- accruals adjustments (lines 34 and 35);
- miscellaneous financial transactions (line 36).

Table 1.1

6A.16 A summary version of the public sector column of Table 6.11 provides the framework for Table 1.1. So, for example, "receipts" and "current expenditure" in this table correspond to lines 11 and 20 of Table 6.11. "Public sector net capital spending" represents the balance on the capital account; that is, total captial expenditure (line 29 of Table 6.11) net of capital transfers (line 22). GGE and GGR cannot be derived from Table 1.1 because it shows figures for the public sector, rather than just general government, and because it gives insufficient detail of the various financial transactions.

6A.17 Tables 1.1, 2.3 and 6.2 show the current balance and capital spending in the same way as Table 6.11. Tables 2A.2, 2A.4, 6.9 and 6.10 are also on a national accounts basis.

Table 2A.2

6A.18 An accruals basis is used to calculate taxes (and social security contributions and council tax) as a percent of GDP (Table 2A.2), because this gives a measure of the underlying burden of taxation stemming from a particular period of economic activity. It is not affected, for example, by the precise timing of tax receipts.

Tables 6.9 and 6.10

6A.19 Table 6.11 shows local authoritites' self-financed expenditure (net of their receipts from central government – line 17) and their receipts from outside the public sector (net of debt interest payments to central government – line 9). Table 6.9, in contrast, provides figures for total local authority expenditure and receipts. It also gives a summary presentation of the income and expenditure flows in the local authority accounts, which it is not practical to put together from any other sources.

6A.20 Table 6.10 serves the same purposes for public corporations as Table 6.9 does for local authorities. Because public corporations are trading bodies, the national accounts presentation is a little different from that for general government. Most current expenditure is netted off from income to leave the gross trading surplus (shown under receipts). The expenditure side of the account only shows interest, dividend and tax payments, plus capital spending.

Borrowing requirements

6A.21 The PSBR can be disaggregated into component borrowing requirements in different ways. Table 1.5 shows the PSBR as the sum of the general government borrowing requirement (GGBR) and market and overseas borrowing by public corporations (PCMOB). An alternative is to split it, as in Table 6.7 and Table 6.11 (line 37), between central government borrowing on its own account (the CGBR(O)), and borrowing by local authorities and public corporations (the LABR and PCBR respectively). The borrowing requirement shown in the general government column of Table 6.11 is not in fact the GGBR, but the GGBR(O). The GGBR can be calculated from the GGBR(O) by adding in public corporations' borrowing from central government (given in paragraph 6A.14).

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