Financial Statement and Budget Report 1992–93

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Financial Statement and Budget Report 1992-93

Return to an Order of the House of Commons dated 10 March 1992: for

Copy of Financial Statement and Budget Report 1992-93 as laid before the House of Commons by the Chancellor of the Exchequer when opening the Budget

Treasury Chambers
10 March 1992

The Hon. Francis Maude

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Contents

Table 1.1 The Budget measures[1]

	£ million		yield(+)/cost(−)
	1992–93		1993–94
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
Income tax			
20p rate	−1 770	−1 770	−2 320
allowances and basic rate limit	−810	+340	+500
car benefit scales raised	+60	+60	+70
Business rates reduced	−480	−480	−590
Value added tax			
monthly payments on account	−200	−200	*
penalties reduced	−35	−35	−35
revised treatment of taxis, driving school and hire cars	−50	−50	−100
Car tax halved	−635	−635	−765
Capital allowance limit for cars raised	*	*	−50
Excise duties raised			
alcohol	+160	—	—
diesel and unleaded petrol	+280	—	—
leaded petrol	+375	+150	+145
tobacco	+540	+305	+345
vehicle excise duty on cars	+240	+135	+140
Inheritance tax			
most business assets exempted	−10	−10	−25
threshold raised to £150 000	−30	−10	−20
Other changes	+70	+30	+105
Extra help for poorer pensioners[2]	...	...	...
Total effect of Budget changes	**−2 295**	**−2 170**	**−2 600**
Tax changes already announced[3]	+680	+680	−15
Total	**−1 615**	**−1 490**	**−2 615**

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

[2] *See Chapter 5. Public expenditure costs of £145 million in 1992–93 and £305 million in 1993–94 will be met from the Reserve.*

[3] *See Table 4A.1 in Annex A to Chapter 4.*

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

1 The Budget

1.01 The Financial Statement and Budget Report (FSBR) supplements the Chancellor's Budget Statement. It presents the Medium Term Financial Strategy (MTFS), describes developments in the economy over the past year and provides economic forecasts to mid-1993. It also sets out the Budget proposals, summarises the Government's spending plans, and gives forecasts for the public finances for the year ahead.

The Medium Term Financial Strategy

1.02 Chapter 2 describes the financial framework for the Government's economic policy decisions. Membership of the Exchange Rate Mechanism (ERM) provides the framework for monetary policy. But the Government will retain a target for narrow money (M0), and will continue to pay careful attention to the growth of broad money and credit. The Government aims to balance the budget over the medium term, while permitting the "automatic stabilisers" to operate. In the short term, given the stage of the cycle, the budget will be in deficit. But it will return towards balance in the medium term as activity recovers.

The economy

1.03 Chapter 3 describes the main developments in the economy in 1991 and the prospect to mid-1993. Economic activity remained weak in 1991, as signs of recovery in the summer and early autumn were not sustained. In 1991 as a whole GDP was nearly $2\frac{1}{2}$ per cent lower than in the previous year, but it is expected to recover in 1992. GDP is forecast to grow by 2 per cent in the year to the second half of 1992, so that for the year as a whole it is up by 1 per cent. Inflation fell sharply in 1991. Retail price inflation is down to 4 per cent, and is forecast to fall further: to $3\frac{3}{4}$ per cent by the fourth quarter of 1992, and to $3\frac{1}{4}$ per cent by mid-1993. Producer price inflation is already down to $2\frac{3}{4}$ per cent, and is forecast to fall to $1\frac{1}{2}$ per cent by mid-1993.

Budget measures

1.04 Chapter 4 sets out the tax proposals in the Budget. The rate of income tax is reduced to 20p on the first £2 000 of taxable income, as the first step to a 20p basic rate. The income tax personal and age-related allowances are indexed. There is extra help for poorer pensioners. Transitional relief for business rates is improved, and there are various measures to help small businesses. Car tax is halved and there are other measures to reduce discrimination in the tax system against cars. Duties on alcohol and unleaded petrol are indexed; duty on leaded petrol is raised by $7\frac{1}{2}$ per cent; and duties on most tobacco products are raised by about 10 per cent. Vehicle excise duty on cars is raised by 10 per cent. Table 1.1 summarises the direct effects on the public finances of these measures and major changes to the tax system announced before the Budget.

Public expenditure

1.05 Chapter 5 sets out the Government's spending plans to 1994–95. This chapter also provides the latest estimate of outturn for the planning total in 1991–92.

Public sector finances **1.06** Chapter 6 presents the complete financial picture for the public sector. A public sector borrowing requirement (PSBR) of £13¾ billion is forecast for 1991–92, £3¼ billion higher than the forecast in the 1991 Autumn Statement. In 1992–93 the PSBR is set at £28 billion, which takes into account the net cost of the Budget measures. Table 1.2 shows the main components of general government receipts and expenditure.

Budgetary reform **1.07** The Government is to change the Budgetary timetable. Revenue and expenditure decisions will be brought together and announced in a December Budget, starting in 1993. The Government's proposals are set out in detail in a White Paper on Budgetary Reform (Cm 1867).

Table 1.2 The finances of the public sector[1,2]

	£ billion		
	1991–92		1992–93
	1991 Budget	Latest estimate	Forecast
RECEIPTS			
Inland Revenue:			
Income tax	59·6	58·0	59·6
Corporation tax[3]	19·5	18·4	16·8
Petroleum revenue tax	0·0	−0·2	0·1
Capital gains tax	1·4	1·2	1·1
Inheritance tax	1·3	1·3	1·3
Stamp duties	2·1	1·7	1·5
Total Inland Revenue	**83·9**	**80·4**	**80·4**
Customs and excise:			
Value added tax	35·7	35·5	40·0
Petrol, derv duties etc.	10·9	10·9	11·8
Tobacco duties	6·1	6·1	6·6
Alcohol duties	5·2	5·0	5·3
Betting and gaming duties	1·1	1·1	1·1
Car tax	1·3	1·2	0·7
Customs duties	1·7	1·8	1·9
Agricultural levies	0·2	0·2	0·0
Total Customs and Excise	**62·2**	**61·8**	**67·4**
Vehicle excise duties	3·0	3·0	3·2
Oil royalties	0·5	0·5	0·5
Rates[4]	14·4	14·4	14·1
Other taxes and royalties	3·8	3·9	4·1
Total tax and royalty receipts	**167·6**	**164·0**	**169·8**
Social security receipts	36·7	36·3	38·7
Community charge receipts	7·6	7·1	8·0
Interest and dividends	6·1	6·1	5·5
Gross trading surpluses and rent	3·3	3·8	3·7
Other receipts[5]	5·1	4·8	4·0
General government receipts	**226·5**	**222·1**	**229·8**

	£ billion		
	1991–92		1992–93
	1991 Budget[6]	Latest estimate	Forecast
EXPENDITURE[6]			
Central government expenditure	**152·2**	**156·6**	**168·7**
of which:			
Social Security	58·3	61·5	66·0
Health and OPCS	24·9	25·7	27·9
Defence	22·8	22·9	24·2
Scotland	5·8	5·9	6·4
Wales	2·5	2·5	2·8
Northern Ireland	6·4	6·4	7·0
Other departments	31·5	31·7	34·5
Central government support for local authorities	**52·5**	**53·3**	**58·5**
Financing requirements of nationalised industries	**2·3**	**2·6**	**3·4**
Privatisation proceeds	**−5·5**	**−7·9**	**−8·0**
Reserve	**3·5**	**—**	**4·0**
Planning total	**205·0**	**204·7**	**226·6**
Local authority self-financed expenditure[7]	9·1	11·1	9·5
Central government debt interest	16·7	16·5	17·6
Accounting adjustments	3·9	4·2	4·7
General government expenditure	**234·8**	**236·5**	**258·5**

Expenditure, receipts and borrowing

	£ billion		
	1991–92		1992–93
	1991 Budget	Latest estimate	Forecast
General government expenditure	234·8	236·5	258·5
General government receipts	226·5	222·1	229·8
General government borrowing requirement	8·3	14·3	28·7
Public corporations' market and overseas borrowing	−0·4	−0·5	−0·6
Public sector borrowing requirement	**7·9**	**13·8**	**28·1**

[1] *In this and other tables constituent items may not add up to totals because of rounding.*
[2] *On a cash basis. See Annex to Chapter 6.*
[3] *Includes advance corporation tax (net of repayments):* 7·9 7·8 8·2
(also includes North Sea corporation tax after ACT set off and corporation tax on gains.)
[4] *National non-domestic rates and local authority rates.*
[5] *Includes accruals adjustment to index linked gilts.*
[6] *On current definitions.*
[7] *See footnotes to Table 5.1.*

2 The Medium Term Financial Strategy

2.01 Successful economic performance requires permanently low inflation and a healthy supply side. The defeat of inflation on a lasting basis is the central objective of the Medium Term Financial Strategy (MTFS). This macroeconomic framework is complemented by microeconomic policies designed to improve the flexibility and efficiency of markets, with a view to increasing the sustainable growth rate of the economy over the medium term.

The policy framework

2.02 The Government is committed to membership of the Exchange Rate Mechanism (ERM) of the European Monetary System, and this provides the framework for monetary policy. Sterling is currently operating within broad (6 per cent) bands, but will in due course move to narrow ($2\frac{1}{4}$ per cent) bands at the current central parity of 2·95 Deutschemarks.

2.03 Fiscal policy is set in a medium term framework. The Government's policy is to maintain a firm fiscal stance by balancing the budget over the medium term. This approach ensures that fiscal policy supports monetary policy in achieving low inflation.

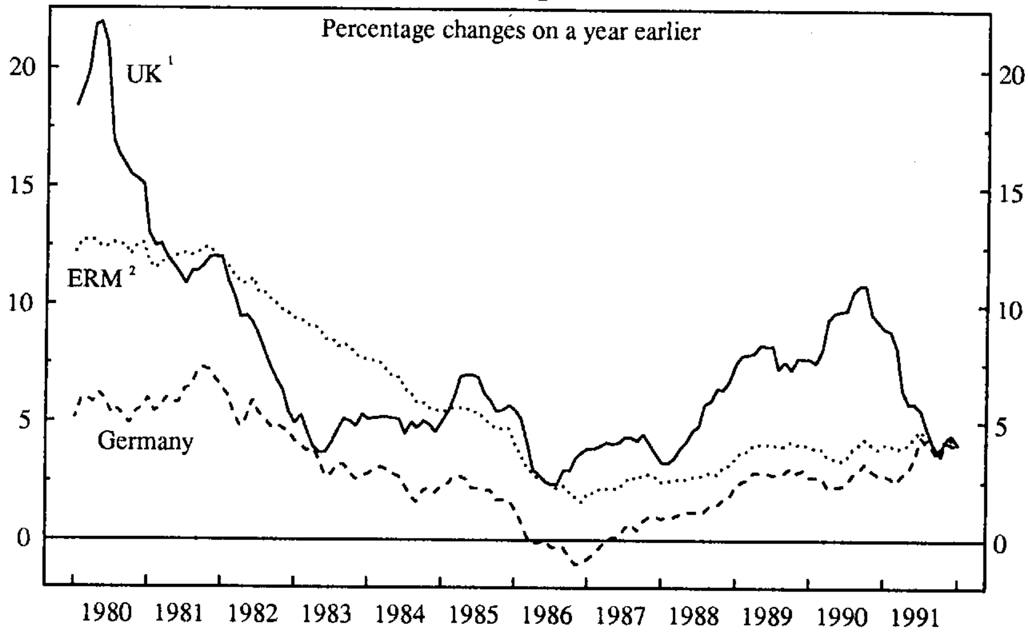
2.04 The UK signed the Maastricht Treaty on European Union on 7 February 1992. That Treaty, which has not yet been ratified by Parliament, sets out the conditions for establishing economic and monetary union (EMU) in the European Community, including the adoption of a single monetary policy and in due course a single currency. The UK has reserved the right to choose whether or not to participate in the final stage of EMU, and in particular whether to move to the single monetary policy and single currency. But whatever choice is made, the Government's policies are designed to ensure that the UK meets the convergence criteria laid down in the Treaty.

2.05 ERM membership will remain the central discipline underpinning UK macroeconomic policy in the medium term. In principle, policy requirements are not fundamentally altered by ERM membership: they would be much the same even if the UK had chosen to pursue the objective of defeating inflation outside the ERM. But ERM membership now provides the medium term nominal framework within which the UK economy must operate.

2.06 The UK is an open economy, with few constraints on international trade in goods and services; and the completion of the single market will further reduce the remaining tariff and non-tariff barriers between the UK and our European Community partners. This freedom of trade, combined with the commitment to the ERM, means that the price of traded goods and services produced in the UK will largely be set in competitive international, and especially European, markets. UK costs and prices will not be able to move independently of those of our competitors for any length of time.

2.07 Maintaining sterling within its ERM bands means that over the next few years UK inflation will move progressively into line with the best inflation performance in other ERM countries. All countries in the European Community are firmly committed to the objective of price stability, and the Government will set monetary and fiscal policy to achieve this outcome. The more rapidly markets, and in particular labour costs, adjust to the new discipline of the ERM, the sooner the UK will be able to achieve a satisfactory growth of output and bring down unemployment.

Chart 2.1 UK, German and ERM consumer price inflation



[1] *RPI all items.*
[2] *Original ERM members: Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands.*

2.08 The sections below set out the Government's approach to monetary and fiscal policy in more detail, and provide fiscal projections over the medium term based on illustrative paths for output and inflation.

Monetary policy

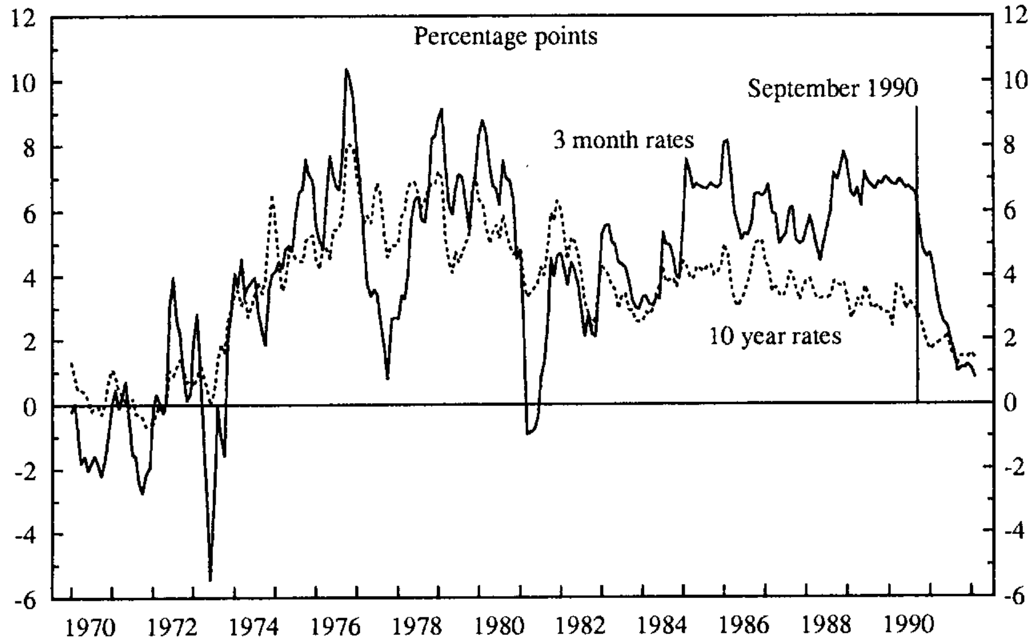
2.09 The UK has been a member of the ERM for almost a year and a half. During that time the Government has demonstrated its commitment to the ERM by setting interest rates to maintain sterling within its ERM bands. The authorities will continue to give overriding priority to the ERM commitment in setting interest rates.

2.10 Sterling will move to narrow bands within the ERM in due course, maintaining its central rate at 2·95 Deutschemarks.

Assessment of monetary conditions

2.11 The authorities continue to assess monetary conditions on the basis of the behaviour of the monetary aggregates and a range of other indicators. Over the past year the position of sterling within its ERM bands has generally allowed the authorities to reduce UK interest rates as warranted by domestic conditions, and particularly by the fall in inflation. Since joining the ERM in early October 1990 the differentials between UK and German interest rates have narrowed markedly. This is a sign of enhanced confidence in the policy for achieving low inflation and the ability of the economy to adapt to the discipline of the ERM.

Chart 2.2 UK and German interest rate differentials



Narrow money 2.12 Narrow money (M0) rose fairly steadily, at an annual rate of a little over 2 per cent, through 1991, having been more or less flat during the steep fall in output in the second half of 1990. For 1991–92 as a whole M0 is forecast to have increased by about $2\frac{1}{4}$ per cent, just above the middle of the 0 to 4 per cent target range set a year ago. The Government proposes to set a target range for M0 growth for the financial year 1992–93 of 0 to 4 per cent, unchanged from 1991–92.

Broad money and credit 2.13 The annual growth of M4 slowed down through 1991 and has flattened out at around 6 per cent in recent months. M4 has thus probably grown only a little faster than money GDP over the past year, following more than a decade of steeply declining M4 velocity. It is unclear how durable this change in the trend of M4 velocity will prove, and the future growth rate of M4 remains very uncertain. As for the past five years, the Government does not intend to set a target for broad money, but will continue to pay careful attention to the growth of broad money and credit.

Funding 2.14 The Government continues to follow the "full fund" policy, discussed in detail in the 1990 MTFS. In 1991–92 the public sector borrowing requirement (PSBR), together with maturing debt, has been funded by increased sales of national savings and gilts. During the year long term yields have fallen significantly as progress has been made in reducing inflation. In 1992–93 gilt sales will again be complemented by an increased contribution from national savings to the total funding programme.

Fiscal policy and projections

2.15 In 1991–92 the public finances moved into deficit, after being in surplus for three years from 1987–88 and close to balance in 1990–91. The PSBR for 1991–92 is now expected to be £13¾ billion, equivalent to about 2¼ per cent of GDP.

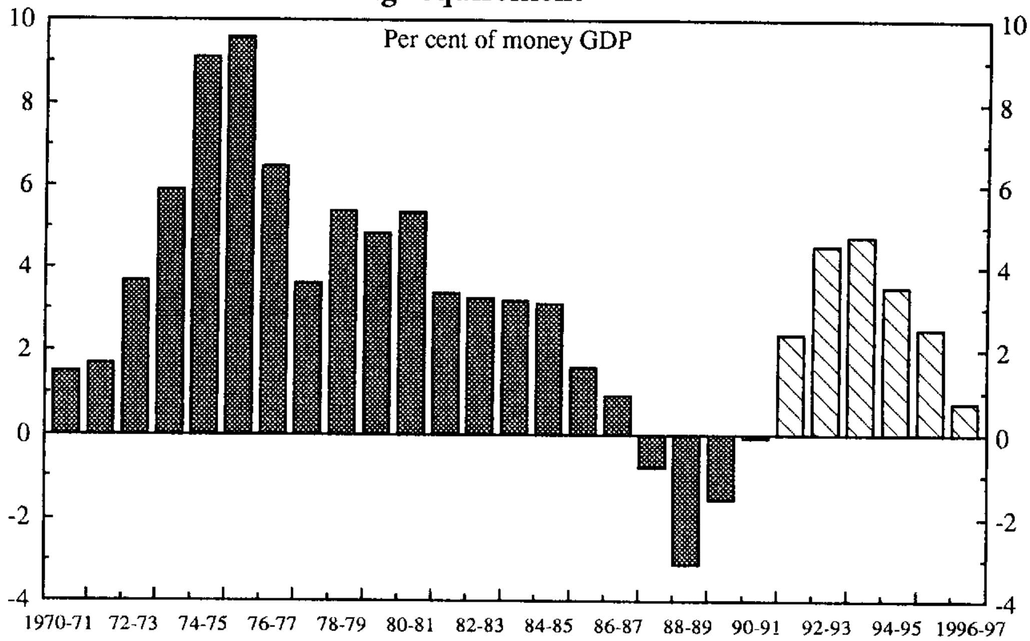
Fiscal policy

2.16 The Government's objective is to balance the budget over the medium term, while permitting the "automatic stabilisers" to operate. This approach means that the PSBR varies with the cyclical position of the economy. The budget surpluses in the late 1980s reflected the strength of domestic demand and activity, while the swing into deficit in 1991–92 reflects the subsequent recession.

2.17 Cyclical developments will continue to determine the evolution of the public finances over the medium term. The budget will return towards balance as activity recovers. But the process of adjustment will take time, and in the short term the level of borrowing will rise because of the lagged impact of the recession on both revenue and expenditure.

2.18 The Government's policy will ensure that the UK meets the requirement set out in the Maastricht Treaty that Member States should endeavour to avoid "excessive budget deficits". The decision on whether an excessive deficit exists rests with the Council of Economic and Finance Ministers, and that judgement must be made in the light of all the circumstances, including the medium term economic and budgetary position. The Treaty recognises that deficits can be affected by temporary and exceptional factors: the intention is to prevent "gross errors" of budgetary policy, and not to constrain deficits which arise for purely cyclical reasons.

Chart 2.3 Public sector borrowing requirement[1]



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

The PSBR in 1992–93

2.19 In the economic forecast described in Chapter 3, non-North Sea GDP in financial year 1992–93 is up $1\frac{3}{4}$ per cent on the previous year, below the sustainable growth rate of the economy. And the recession will still be affecting the public finances: in particular, social security expenditure and corporation tax receipts both lag behind the output cycle. For both these reasons the PSBR will rise in 1992–93: it has been set at £28 billion, equivalent to about $4\frac{1}{2}$ per cent of GDP.

The economy in the medium term

2.20 Assumptions about the path of the economy are required in order to illustrate the possible evolution of the public finances over the medium term. Table 2.1 shows the economic assumptions which form the basis for the fiscal projections set out in Table 2.2.

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

	1991–92[2]	1992–93	1993–94	1994–95	1995–96	1996–97
Money GDP	**5**	**$6\frac{1}{2}$**	**$6\frac{3}{4}$**	**$6\frac{3}{4}$**	**6**	**$5\frac{1}{4}$**
Real GDP:						
Non-North Sea	$-2\frac{1}{4}$	$1\frac{3}{4}$	3	$3\frac{1}{2}$	$3\frac{1}{2}$	$3\frac{1}{2}$
Total	-2	2	$3\frac{1}{4}$	$3\frac{3}{4}$	$3\frac{1}{2}$	$3\frac{1}{4}$
Inflation:						
GDP deflator	7	$4\frac{1}{2}$	$3\frac{1}{2}$	3	$2\frac{1}{2}$	2

[1] *Percentage changes on previous financial year; forecasts for 1992–93 and assumptions thereafter.*

[2] *The 1991 Budget increase in VAT added about 1 per cent to money GDP and the GDP deflator in 1991–92.*

2.21 The level of real GDP is now below trend, following the contraction of demand over the past two years. But in the medium term output is determined primarily by supply factors, and over the next few years there should be scope for more rapid growth accompanied by low inflation.

2.22 The projections assume that non-North Sea GDP grows by $3\frac{1}{2}$ per cent per annum from 1994–95, above the likely trend rate of growth; and that inflation comes down to 2 per cent by 1996–97, close to the best performance in other ERM countries. The output path implies that between 1990–91 and 1996–97 non-North Sea GDP grows on average by around 2 per cent a year, well within the potential growth rate of the economy.

Table 2.2 Fiscal projections[1]

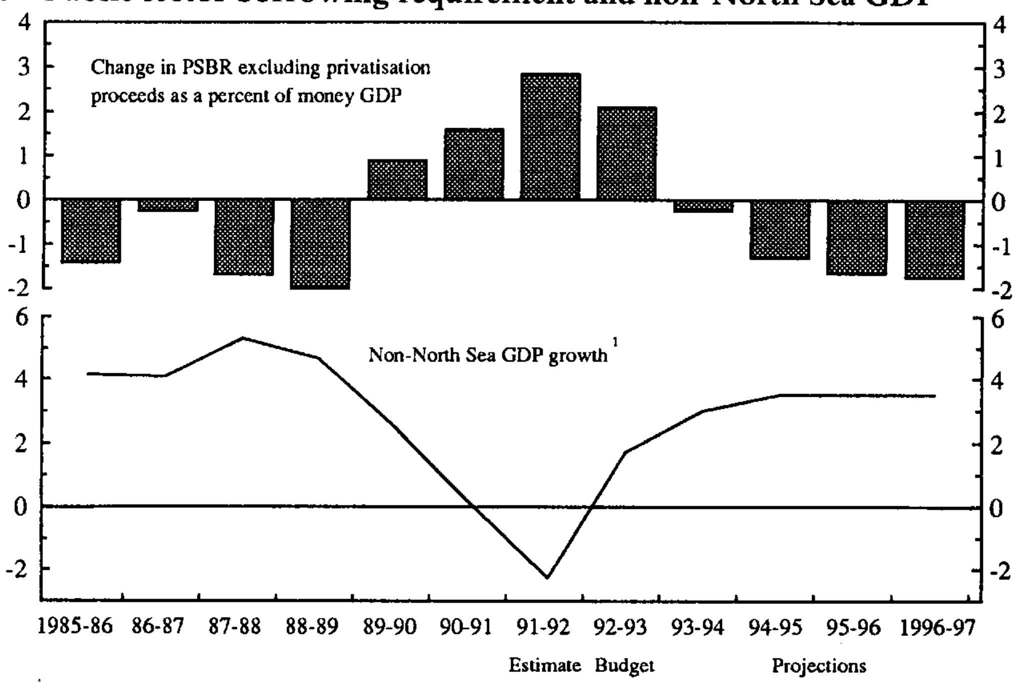
	Per cent of GDP						
	1990–91	1991–92	1992–93	1993–94	1994–95	1995–96	1996–97
General government expenditure excluding privatisation proceeds	39¾	42	43	43	42½	41¼	40
Privatisation proceeds	1	1¼	1¼	¾	¾	¼	¼
General government expenditure	39	40½	41¾	42¼	41¾	41	40
General government receipts	39	38	37	37¼	38	38½	39¼
Cumulative fiscal adjustment[2]	—	—	—	0	0	¼	¼
Public corporations' market and overseas borrowing	0	0	0	0	0	0	0
PSBR	**0**	**2¼**	**4½**	**4¾**	**3½**	**2½**	**¾**
Money GDP at market prices (£ billion)[3]	555·3	584	621	663	709	752	793

[1] *Rounded to nearest ¼ per cent of GDP.*
[2] *See Table 2A.5 and footnote 2 to that table.*
[3] *Rounded to nearest £1 billion from 1991–92 onwards.*

Fiscal projections

2.23 These assumptions underlie the PSBR path shown in Table 2.2. Details of the revenue and expenditure projections are set out in Annex A. The PSBR rises further as a share of GDP in 1993–94, to 4¾ per cent, because of lower privatisation proceeds and the lagged effects of below trend growth in 1992–93. But thereafter it declines steadily towards balance in the medium term.

Chart 2.4 Public sector borrowing requirement and non-North Sea GDP

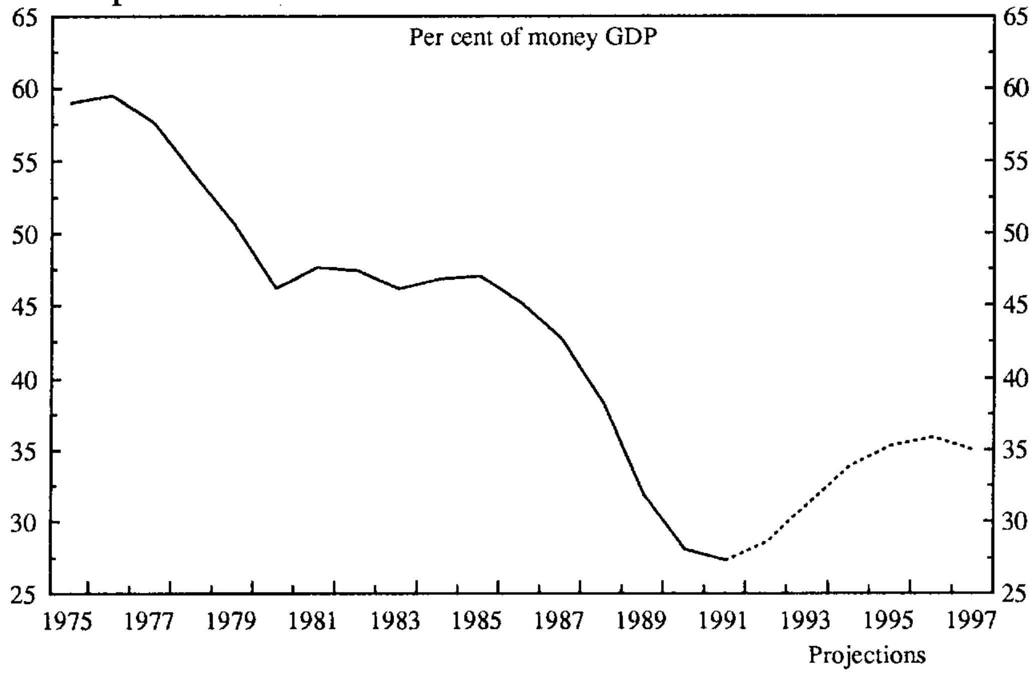


[1] *Percentage changes on previous year*

Public sector debt

2.24 The projected PSBR path implies some increase in the level of net public sector debt over the next few years. As the PSBR declines in response to faster output growth the ratio of net public sector debt to GDP will in due course resume a downward trend. The ratio is projected to peak at about 35 per cent of GDP in the mid-1990s, compared with an average of well over 45 per cent in the first half of the 1980s. Thus the prospective increase in the ratio only partially reverses the sharp fall in the late 1980s which was associated with the cyclical upturn and debt repayments.

Chart 2.5 Net public sector debt ratio[1]



[1] *Net public sector debt at end March as a percent of money GDP in four quarters centred on end March.*

Revenue

2.25 Within this broad medium term fiscal framework the Government's policy is to cut taxes as and when this can be done on a sustainable basis and without prejudice to the Government's objectives on inflation. The projections include fiscal adjustments of £1 billion in 1995–96 and 1996–97. But the precise size and timing of future tax reductions will depend on developments in the economy.

2.26 The revenue projections in Table 2.2 are based on the conventional assumption of constant tax and national insurance rates from 1992–93, except where future changes have already been announced (for example, on contracted out rebates for national insurance contributions). Allowances, thresholds and specific duties are assumed to be indexed from their proposed 1992–93 levels. All proposed Budget changes are taken into account. The ratio of general government receipts to GDP falls further in 1992–93, largely reflecting the delayed impact on tax receipts of the fall in output in 1991–92. But as output recovers towards trend and delays in the payment of taxes work out, the ratio picks up over the medium term. Projections for the tax burden and the components of general government receipts are given in Tables 2A.2 and 2A.4 respectively in Annex A.

Public expenditure

2.27 The Government's objective for public spending is that, over time, it should take a declining share of national income, while value for money is constantly improved. This is consistent with policy on the overall level of taxation within the framework of maintaining a balanced budget over the medium term. The public spending objective is expressed in terms of the ratio of general government expenditure (GGE), excluding privatisation proceeds, to GDP. An underlying downward trend in this ratio was established in the early 1980s. Strong economic growth in the later 1980s led to sharp falls in the ratio. Cyclical influences are now exerting upward pressure on public spending, notably on social security, leading to some rise in the ratio. It should resume its downward trend as the economy recovers. In 1991–92 the ratio is expected to be 42 per cent of GDP, $2\frac{1}{2}$ percentage points above its 1988–89 level, but still $5\frac{1}{2}$ percentage points below the level seen in 1982–83 following the early 1980s recession (see Table 2A.1 in Annex A).

2.28 The projections of general government expenditure in Table 2.2 (and Table 2A.3 in Annex A) include the cash planning totals published in the 1991 Autumn Statement (Cm 1729) for the period to 1994–95. The projections for local authorities' self-financed expenditure take account of latest information on local authorities' spending in 1991–92 and budgets for 1992–93; and the projections of gross debt interest payments and accounting adjustments are consistent with the economic assumptions in Table 2.1. Further explanation of the GGE projections to 1994–95 is given in Chapter 5. For 1995–96 and 1996–97 it is provisionally assumed that the growth of real GGE will slow as cyclical effects continue to unwind: expenditure plans will be settled in future Surveys.

Summary

2.29 The MTFS reaffirms the Government's commitment to bringing inflation down on a sustainable basis within the ERM, and achieving convergence within the European Community. The Government continues to operate fiscal policy consistently with the objective of medium term budget balance. This will provide full support for the Government's commitment to the ERM.

Annex A to Chapter 2

Details of fiscal projections and historical data on government expenditure and tax burden.

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

1963–64	$36\frac{3}{4}$	1975–76	$49\frac{1}{4}$	1987–88	42
1964–65	$36\frac{1}{2}$	1976–77	$46\frac{3}{4}$	1988–89	$39\frac{1}{2}$
1965–66	$37\frac{3}{4}$	1977–78	$43\frac{1}{4}$	1989–90	40
1966–67	$39\frac{1}{2}$	1978–79	44	1990–91	$39\frac{3}{4}$
1967–68	$43\frac{1}{4}$	1979–80	44	1991–92	42
1968–69	$41\frac{1}{2}$	1980–81	$46\frac{3}{4}$		
1969–70	41	1981–82	$47\frac{1}{4}$	1992–93	43
1970–71	$41\frac{1}{4}$	1982–83	$47\frac{1}{2}$	1993–94	43
1971–72	$41\frac{3}{4}$	1983–84	$46\frac{1}{2}$	1994–95	$42\frac{1}{2}$
1972–73	$41\frac{3}{4}$	1984–85	47	1995–96	$41\frac{1}{4}$
1973–74	$43\frac{1}{2}$	1985–86	$45\frac{1}{4}$	1996–97	40
1974–75	$48\frac{3}{4}$	1986–87	44		

[1] *1991–92: latest estimate; 1992–93: forecast; 1993–94 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]

1963–64	$29\frac{1}{2}$	1975–76	$36\frac{3}{4}$	1987–88	$38\frac{1}{4}$
1964–65	30	1976–77	$36\frac{1}{2}$	1988–89	$37\frac{3}{4}$
1965–66	$31\frac{3}{4}$	1977–78	$35\frac{1}{2}$	1989–90	$37\frac{3}{4}$
1966–67	$32\frac{1}{2}$	1978–79	$34\frac{3}{4}$	1990–91	$37\frac{1}{4}$
1967–68	34	1979–80	$35\frac{1}{2}$	1991–92	$36\frac{3}{4}$
1968–69	$35\frac{3}{4}$	1980–81	$36\frac{3}{4}$		
1969–70	$37\frac{1}{2}$	1981–82	$39\frac{1}{4}$	1992–93	$35\frac{3}{4}$
1970–71	37	1982–83	$38\frac{3}{4}$	1993–94	36
1971–72	$35\frac{1}{4}$	1983–84	$38\frac{1}{4}$	1994–95	$36\frac{3}{4}$
1972–73	33	1984–85	$38\frac{1}{2}$	1995–96	$37\frac{1}{4}$
1973–74	$33\frac{3}{4}$	1985–86	$37\frac{1}{2}$	1996–97	38
1974–75	$36\frac{1}{4}$	1986–87	38		

[1] *1991–92: latest estimate; 1992–93: forecast; 1993–94 onwards: MTFS projections (after fiscal adjustment).*
[2] *Based on non-North Sea 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 will replace the community charge.*

Table 2A.3 General government expenditure[1]

	£ billion						
	1990–91	1991–92	1992–93	1993–94	1994–95	1995–96	1996–97
Public expenditure planning total	180·0	205	227	245	258	270	276
Local authorities' self-financed expenditure[2]	14·9	11	9½	10	10	10	10½
Central government debt interest	17·5	16½	17½	19½	21	22½	23½
Accounting adjustments	3·6	4	4½	5½	6	6½	6½
General government expenditure[3, 4]	**215·9**	**236**	**258**	**280**	**295**	**309**	**317**
Privatisation proceeds	5·3	8	8	5½	5½	1	1
General government expenditure excluding privatisation proceeds	**221·3**	**244**	**266**	**285**	**301**	**310**	**318**

[1] *For 1990–91 to 1994–95 the figures are taken from Chapter 5.*
[2] *See footnote 4 to Table 5.1.*
[3] *From 1991–92 onwards general government expenditure (including and excluding privatisation proceeds) and the public expenditure planning total are rounded to the nearest £1 billion; local authorities' self-financed expenditure, debt interest, accounting adjustments and privatisation proceeds are rounded to the nearest £½ billion. General government expenditure excluding privatisation proceeds is assumed to grow by ½ per cent a year in real terms in 1995–96 and 1996–97.*

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

1990–91	*18·2*	*1994–95*	*21½*
1991–92	*17*	*1995–96*	*23*
1992–93	*18½*	*1996–97*	*23½*
1993–94	*20*		

Table 2A.4 General government receipts[1]

	£ billion						
	1990–91	1991–92	1992–93	1993–94	1994–95	1995–96	1996–97
Taxes on income, expenditure and capital[2]	170·4	175	181	195	214	232	251
Social security contributions	35·4	37	39	42	46	49	52
Interest and dividends	6·3	6	6	6	6	5	5
Other receipts	4·4	4	4	4	4	4	4
General government receipts[3,4]	**216·5**	**222**	**230**	**247**	**270**	**290**	**312**

[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 1991–92 onwards.*

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

1990–91	*2·5*	*1994–95*	*2*
1991–92	*1*	*1995–96*	*3*
1992–93	*1*	*1996–97*	*3*
1993–94	*2*		

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

	£ billion						
	1990–91	1991–92	1992–93	1993–94	1994–95	1995–96	1996–97
General government expenditure	215·9	236	258	280	295	309	317
General government receipts	216·5	222	230	247	270	290	312
Fiscal adjustment from previous years	—	—	—	—	0	0	1
Annual fiscal adjustment[2]	—	—	—	0	0	1	1
GGBR	**−0·5**	**14**	**29**	**32**	**25**	**19**	**7**
Public corporations' market and overseas borrowing	0·1	−1	−1	−1	−1	−1	−1
PSBR	**−0·5**	**14**	**28**	**32**	**25**	**19**	**6**
Money GDP	555·3	584	621	663	709	752	793
PSBR as per cent of money GDP	**0**	**2¼**	**4½**	**4¾**	**3½**	**2½**	**¾**

[1] *Rounded to the nearest £1 billion from 1991–92 onwards. Further details for 1992–93 are provided in Tables 1.2 and 6.9.*

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

Annex B to Chapter 2

Changes since the 1991 MTFS

2B.1 The Maastricht Treaty, and in particular the convergence criteria, provides an added discipline for economic policy throughout the European Community, and strengthens the role of the ERM as a means of securing price stability.

Narrow money

2B.2 In 1991–92 the twelve month growth rate of M0 has remained within the target range of 0 to 4 per cent set in last year's MTFS: growth for the year as a whole is expected to be just above the middle of the target range. The same target range of 0 to 4 per cent has been set for 1992–93.

Money GDP, output and inflation

2B.3 The growth of money GDP is expected to be lower in both 1991–92 and 1992–93 than envisaged in last year's MTFS, reflecting lower output growth. The inflation path to 1994–95 in this year's MTFS is more or less the same as projected in the 1991 MTFS; and so higher money GDP growth in 1994–95 simply reflects higher output growth in that year from a lower base.

Table 2B.1 **Money GDP growth, output growth and inflation**

	Differences from 1991 MTFS projections, percentage points			
	1991–92	1992–93	1993–94	1994–95
Money GDP	-1	-1	$-\frac{1}{4}$	$+\frac{1}{2}$
Real GDP:				
Non-North Sea	$-1\frac{1}{4}$	-1	0	$+\frac{1}{2}$
Total	-1	-1	0	$+\frac{1}{2}$
Inflation:				
GDP deflator	0	0	$-\frac{1}{4}$	0

Fiscal projections

2B.4 Table 2B.2 shows changes in the fiscal projections since the 1991 FSBR. Additional information on 1991–92 is given in Table 1.2 in Chapter 1 and in Chapter 6.

Expenditure

2B.5 The planning total outturn in 1991–92 is discussed in Chapter 5. The cash general government expenditure figures for the future have been revised up since last year.

Receipts

2B.6 Revenues in 1991–92 are expected to be lower than forecast in the 1991 FSBR. Much of this change is accounted for by the downward revision to the 1991 FSBR forecast of economic activity. Details are given in Chapter 6. Projections of revenue over the next three years are likewise affected by the lower level of output than projected in the 1991 MTFS.

Table 2B.2 Revenue and expenditure[1]

	Changes from 1991 MTFS projections, £ billion				
	1990–91	1991–92	1992–93	1993–94	1994–95
1 General government expenditure	**0**	**+1½**	**+6**	**+13**	**+16**
Receipts[2]					
2 Taxes and contributions[3]	−½	−2	−7½	−10	−6½
3 Other[4]	+½	−2	−2½	−3	−4½
4 General government receipts	**0**	**−4½**	**−10½**	**−12½**	**−11**
5 Cumulative fiscal adjustment[5]	—	—	0	−1	−2
6 Public corporations' market and overseas borrowing	+½	0	−½	−½	0
7 PSBR	**+½**	**+6**	**+16**	**+24½**	**+25**

[1] *Rounded to the nearest £½ billion. There have been no significant classification changes affecting the items in this table since the last FSBR.*
[2] *Using the same measurement conventions as Table 2A.4: see footnote 1 to that table.*
[3] *Includes social security contributions and the community charge/council tax.*
[4] *Includes debt interest and other items.*
[5] *Line 5 = lines 7 − 6 − 1 + 4.*

3 The economy: recent developments and prospects to mid-1993

Summary

Inflation

3.01 Inflation has fallen sharply over the past year. RPI inflation was 4 per cent in January compared with 9 per cent a year earlier. Producer output price inflation (excluding food, drink and tobacco) fell to $2\frac{3}{4}$ per cent in February. RPI inflation may rise slightly in the next few months, as the effects of last year's Budget and mortgage rate cuts drop out. But it is forecast to fall back to $3\frac{3}{4}$ per cent by the fourth quarter, and to $3\frac{1}{4}$ per cent by the second quarter of 1993. Underlying inflation should continue to fall steadily with producer price inflation expected to fall to $1\frac{1}{2}$ per cent by mid-1993.

Demand and activity

3.02 The level of GDP stabilised in the second half of 1991, but signs of recovery evident in the summer and early autumn were not sustained. GDP fell by nearly $2\frac{1}{2}$ per cent in 1991 as a whole. Activity is expected to recover through 1992 as consumers' expenditure and exports pick up and destocking comes to an end. GDP is forecast to rise by 1 per cent in 1992, but by 2 per cent in the year to the second half.

Labour market

3.03 The rate of increase of unemployment fell sharply through 1991, though progress has slowed in recent months. Unemployment may continue rising for a while yet, though at a slower rate.

Current account

3.04 The current account deficit is forecast to rise from £$4\frac{1}{2}$ billion in 1991 to £$6\frac{1}{2}$ billion in 1992, as domestic demand recovers and invisibles lose the benefit of Gulf contributions and unusually low net EC contributions in 1991.

Financial developments

3.05 Since sterling joined the ERM, UK interest rates have fallen, narrowing sharply the differential with rates in the low inflation ERM countries. M0 was within its target range for the whole of the last year and in the upper half of its range since September.

Public finances

3.06 The PSBR is forecast to be £$13\frac{3}{4}$ billion in 1991–92 and £28 billion in 1992–93.

World economy

3.07 Signs of recovery in the world economy faded towards the end of last year and growth in the major seven economies in 1991 is now estimated at 1 per cent, the lowest since 1982. GDP in the G7 is expected to rise by $1\frac{1}{2}$ per cent in 1992, with growth picking up through the year. Inflation is forecast to be 3 per cent by the end of the year.

Table 3.1 Economic prospects: summary

	Percentage changes on a year earlier unless otherwise stated			
		Forecast		
	1991	1992	1993 H1	Average errors from past forecasts[1]
GDP and domestic demand at constant prices				
Domestic demand	−3	1¼	3¾	1¼
of which:				
Consumers' expenditure	−1¾	1	3	1¼
General government consumption	2¼	1	1¼	1
Fixed investment	−10¼	−½	3½	2½
Change in stockbuilding (per cent of GDP)	−¾	¾	1	½
Exports of goods and services	¾	3½	6½	1¼
Imports of goods and services	−3	4	8¼	2¼
Gross domestic product	−2½	1	3	¾
Non-oil GDP	−2½	¾	3	¾
Manufacturing output	−5¼	½	3¾	1
Balance of payments current account				
£ billion	−4½	−6½	−9[2]	4
per cent of GDP	−¾	−1	−1½	¾
Inflation				
Retail prices index (fourth quarter)	4¼	3¾	3¼[3]	1¼
Producer output prices (fourth quarter)[4]	3¾	2	1½[3]	¾
GDP deflator at market prices (financial year)	7	4½		1
Money GDP at market prices (financial year)				
£ billion	584	621		
percentage change	5	6½		1¼
PSBR (financial year)				
£ billion	13¾	28		6¼
per cent of GDP	2¼	4½		1

[1] *Average errors regardless of sign over the last ten years; they apply to the forecasts for 1992 or 1992–93.*
[2] *At an annual rate.*
[3] *Q2 on Q2.*
[4] *Excluding food, drink and tobacco.*

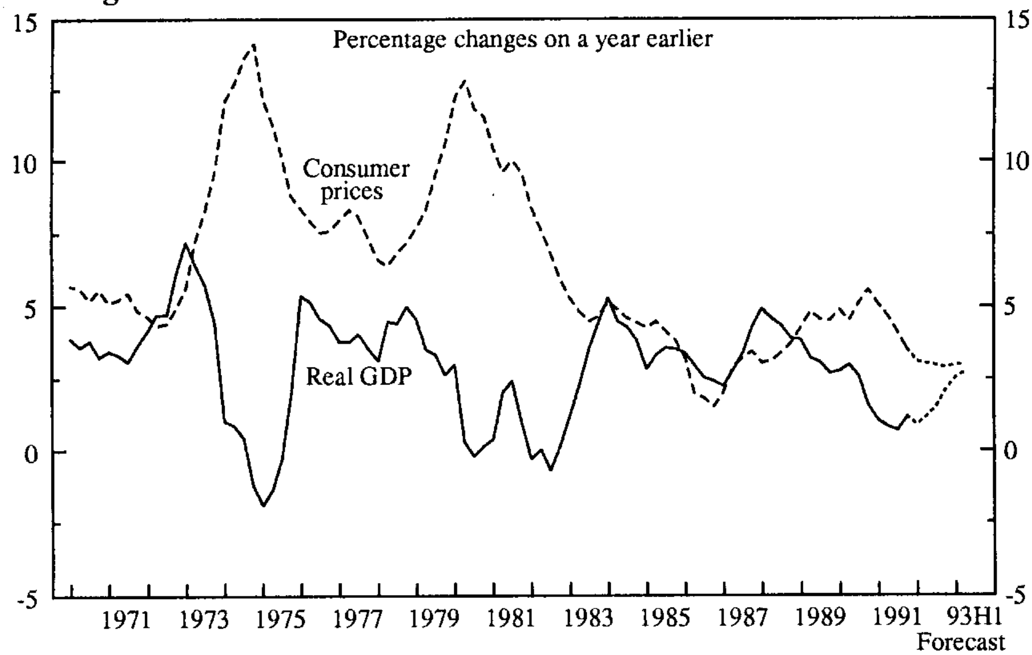
Data to end-1991 used throughout the FSBR for GDP and its components, sectoral saving and financial balances are based on preliminary indications from the CSO of the outturn to the fourth quarter of 1991, including revisions to earlier quarters. The CSO will publish a full and revised set of national accounts to end-1991 on 19 March.

World economy

Activity **3.08** Growth in the G7 economies remained very subdued in the closing months of 1991, with few signs of the recovery expected at the time of the Autumn Statement. The US economy started to recover in the spring, but by the end of the year growth had again slowed. In the second half of last year western Germany registered a fall in output and growth in Japan slowed sharply. For the G7 as a whole, GDP is estimated to have grown by around 1 per cent in 1991, the weakest performance since 1982.

3.09 Industrial production in the G7 countries rose in the summer but stalled in the autumn. There were renewed signs of weakness in most G7 countries around the turn of the year. Business and consumer confidence indicators have fallen sharply in recent months in Japan and Germany. In the US, business confidence improved significantly in February, but consumer confidence was at its lowest since 1974.

Chart 3.1 G7 growth and inflation



Inflation **3.10** The very slow growth and increasing levels of spare capacity in almost all G7 countries have placed continued downward pressure on inflation. In the fourth quarter of 1991 consumer price inflation averaged 3½ per cent in G7 countries, compared with 5½ per cent a year earlier. There were particularly large reductions in the US and Canada, as well as the UK. Against the trend, German inflation rose to a little over 4 per cent in the latest three months, compared with 3 per cent a year earlier. The generally good inflation performance has been helped by continuing weakness of commodity prices, in particular of metals, which have been affected by increased exports to the west from the former Soviet Union.

Policy **3.11** Outside Europe the easing of inflationary pressures has allowed short term interest rates to fall further, by over 1 percentage point since October in the US and Japan. In the US the discount rate is now at its lowest since 1964. In Europe interest rates remain high. Official rates rose in December in all ERM countries except the UK, following the rise in German rates. Government deficits widened in most G7 countries in 1991. Outside Germany this mainly reflected the effects of automatic stabilisers.

Trade and current account **3.12** The US current account moved back into small deficit in the second half of 1991, following the exceptional surplus in the first half, which was entirely accounted for by Gulf war burden-sharing contributions. The Japanese surplus in 1991 was $73 billion, 2¼ per cent of GNP and the highest since 1988. The German current account remained in small deficit throughout the year.

Table 3.2 **World economy**

	Percentage changes on a year earlier			
		Estimate	Forecast	
	1990	1991	1992	1993 H1
Major seven countries[1]				
Real GDP	2½	1	1½	2¾
Domestic demand	2¼	¼	1½	2¾
Industrial production	1¾	−½	¾	3¼
Consumer prices[2]	5½	3½	3	3
World trade volumes				
Total imports	4¼	1¼	3¾	5½
Trade in manufactures[3]	4¾	1¾	4	6¼

[1] *US, Japan, western Germany, France, UK, Italy and Canada.*
[2] *Final quarter of each period.*
[3] *Trade in manufactures is based on a UN series for market economies and therefore excludes exports from former centrally planned economies.*

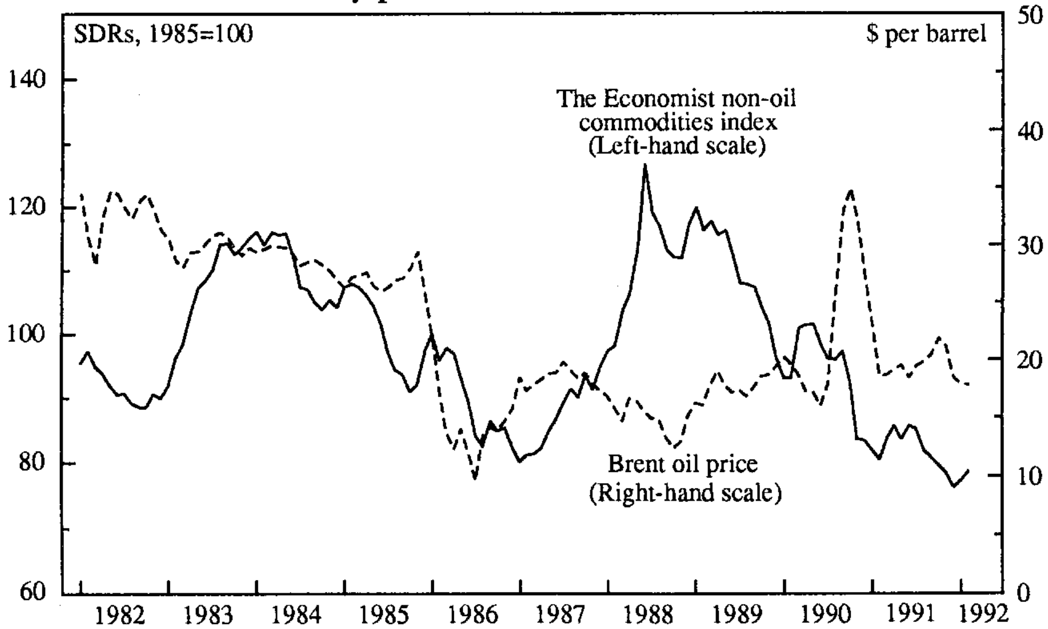
Forecast **3.13** Against a background of falling inflation, lower interest rates outside Europe and widening fiscal deficits, a recovery in output is forecast this year. GDP growth in the G7 is forecast to be 1½ per cent in 1992. It is expected to be stronger in the second half than the first, especially in the US and Germany. In the first half of 1993 G7 GDP growth is forecast to be 2¾ per cent, about the same as the average between 1979 and 1989, the last two cyclical peaks.

3.14 This forecast represents a muted recovery by past standards. This partly reflects the comparatively slow recovery forecast for the US, where high levels of personal and corporate indebtedness and an historically low saving ratio make it unlikely that the rapid growth rates typical of previous recoveries will be repeated. US growth is forecast to be about 2 per cent by the end of this year, after a slow first half. A recovery in real incomes, especially in the second half of the year, is the main factor lying behind this pick-up. US exports are forecast to continue to perform well, benefiting from the lagged effects of a weak dollar.

3.15 Only sluggish growth is forecast in the three main continental European economies this year, averaging about $1\frac{1}{4}$ per cent. Growth in Germany will be rather less than this, but will be helped by the removal of the temporary income tax surcharge in July 1992. However, 1993 looks like being a better year for these countries, particularly Germany.

3.16 Non-oil commodity prices are forecast to remain around present levels in real terms. Oil prices have fallen since the autumn, reflecting weak demand and changing views about the prospects for supplies from Kuwait, Iraq and the former Soviet Union. The recent OPEC agreement is unlikely to lead to a significant change in prices. Brent is assumed to average $18 a barrel, close to recent levels.

Chart 3.2 Nominal commodity prices

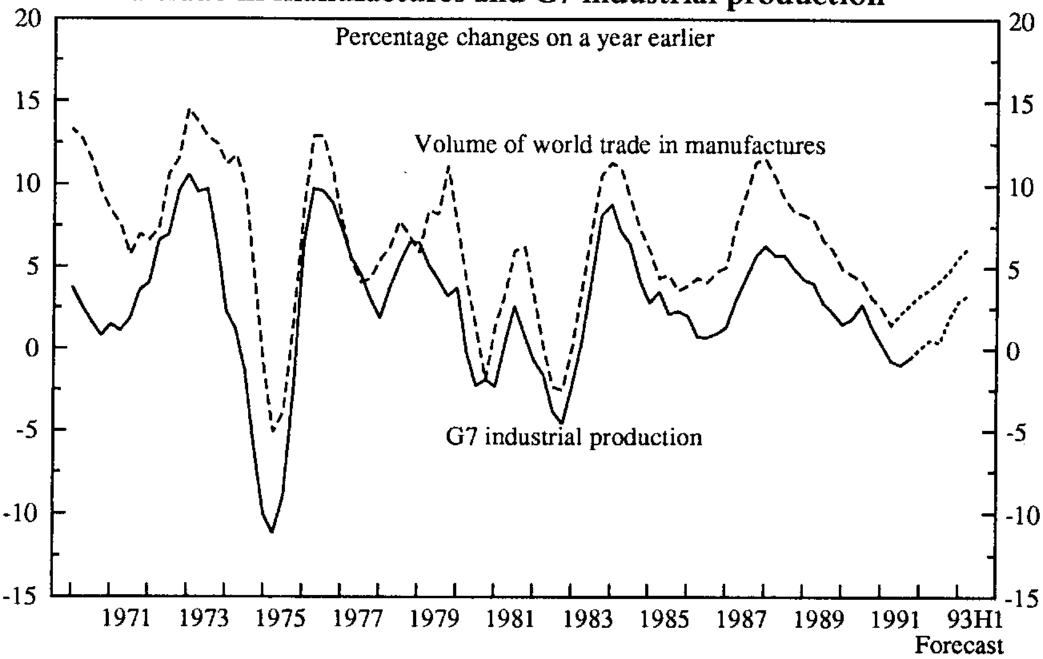


3.17 With activity forecast to remain below trend, and a favourable outlook for commodity prices, downward pressure on inflation is expected to continue. G7 consumer price inflation is forecast to be about 3 per cent by the end of the year, remaining little changed in the first half of 1993. After reaching a peak in the spring, German inflation is forecast to fall back, dropping sharply in July as last year's oil tax rise drops out of the year-on-year calculation. However, it will pick up again at the beginning of 1993 if the proposed 1 point rise in the VAT rate is introduced.

3.18 Subdued growth in all the G7 countries makes it unlikely that there will be large changes in current accounts. The US deficit is forecast to widen, but this largely reflects the one-off nature of the Gulf war burden-sharing contributions in 1991. For Japan much of the rise in the current account surplus last year can be attributed to improvements in the terms of trade. No repeat of this is forecast, and the current account surplus is therefore expected to remain around 2 per cent of GNP.

3.19 Latest information suggests that the growth of total world trade in 1991 was $1\frac{1}{4}$ per cent. The collapse of trade both to and from the economies of eastern Europe and the former Soviet Union contributed to the slow recorded growth in 1991. Growth of total world trade is forecast to pick up to $3\frac{3}{4}$ per cent in 1992. It is not until 1993 that growth again approaches the average for the second half of the 1980s. World trade in manufactures follows a similar pattern.

Chart 3.3 World trade in manufactures and G7 industrial production

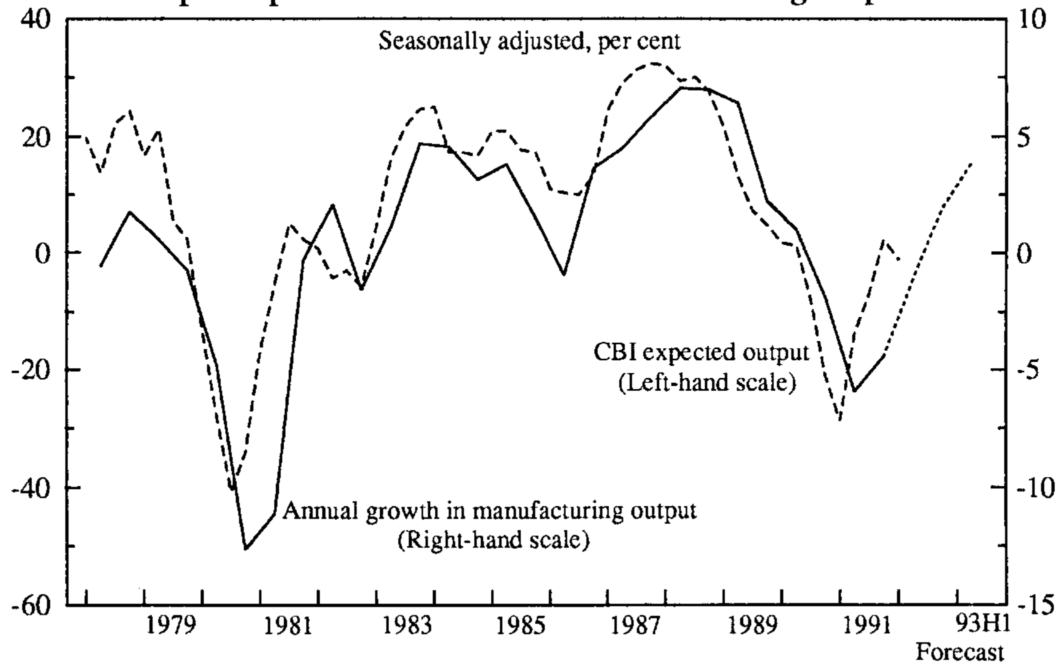


UK demand and output

3.20 GDP levelled out in the second half of 1991; in the fourth quarter it was much the same as in the second quarter. But signs of recovery last summer and early autumn were not sustained. GDP fell by nearly $2\frac{1}{2}$ per cent in 1991 as a whole. Non-oil GDP continued to decline through last year, though at a moderating pace. By the fourth quarter it was $3\frac{3}{4}$ per cent below its peak in the second quarter of 1990.

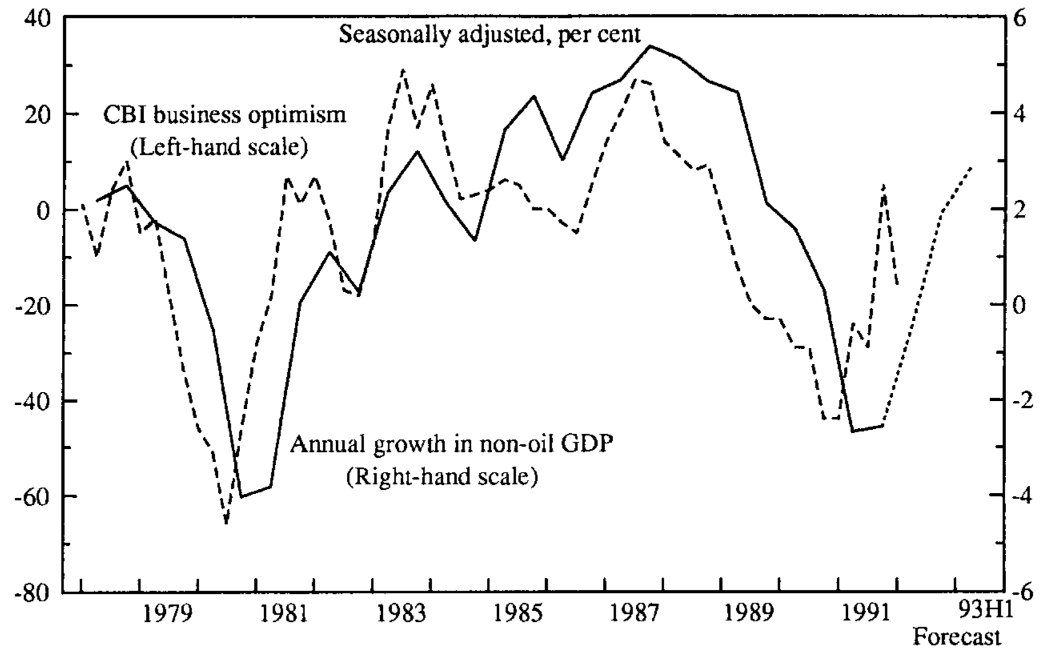
3.21 The failure of the recovery to take hold in the second half of 1991 was part of a pattern of weakening activity in most of the major countries. Similar factors may have been at work in a number of countries, and may have been mutually reinforcing, resulting in a general deterioration in confidence. In the UK this partly reversed the large improvement in business and consumer confidence seen earlier in the year. Weaker activity in the rest of the world meant that exports were lower than they would otherwise have been. And domestic demand remained subdued, as consumers and businesses sought further improvements in their financial position. Despite signs of a pick-up in retail sales around the middle of the year, the expected recovery in consumers' expenditure did not materialise. And although manufacturing investment levelled out, total business investment continued to fall. Domestic demand fell by $\frac{1}{4}$ per cent between the first and second halves, and by 3 per cent in 1991 as a whole.

Chart 3.4 CBI output expectations balance and manufacturing output



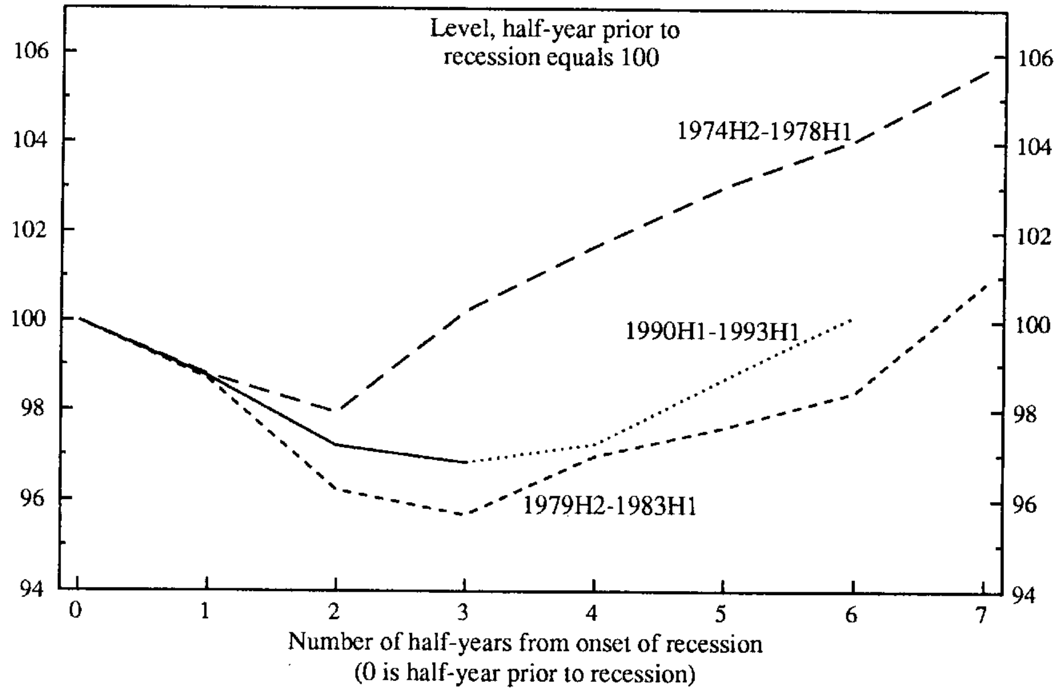
3.22 Within GDP, the output of the service sector continued to fall in the second half of 1991, though at a slower rate. Energy output rose in the third and fourth quarters, as oil output recovered from the effects of safety-related maintenance work which depressed output earlier in the year. However, manufacturing output, after levelling out in mid-year, fell by a further $1\frac{1}{4}$ per cent in the fourth quarter, and by $5\frac{1}{4}$ per cent in 1991 as a whole. This is consistent with CBI survey evidence which showed a steady improvement in manufacturers' output expectations until the autumn, but some deterioration since then, once it became clear that the recovery had not become established.

Chart 3.5 CBI business optimism balance and non-oil GDP



3.23 Nevertheless the forces making for recovery are still in place, including the continuing effects of lower interest rates, falling inflation and the automatic fiscal stabilisers. And consumer and business confidence, though lower than in the autumn, remain well above the levels of a year ago. Although growth may be slow at first it should gather pace through the year, as consumer spending picks up, recovery in the world economy boosts exports, and destocking comes to an end. GDP is forecast to rise by 1 per cent in 1992, but by nearly 2 per cent in the year to the second half, and by 3 per cent in the year to the first half of 1993. The pace of the recovery is expected to be about the same as that following the previous two recessions. Manufacturing output may rise by only $\frac{1}{2}$ per cent in 1992, but is forecast to rise more rapidly than GDP from mid-1992 onwards.

Chart 3.6 GDP: Comparison with earlier recessions and recoveries



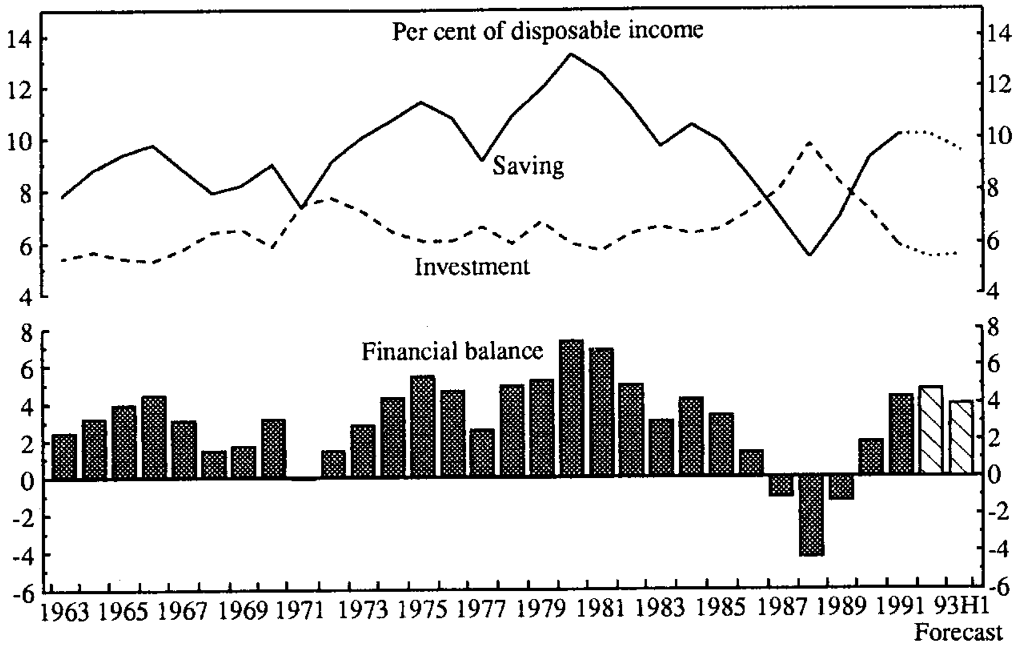
Domestic expenditure

Personal sector

3.24 Consumers' expenditure flattened off in the second half of 1991, having fallen by $2\frac{3}{4}$ per cent in the year to the second quarter. The saving ratio rose sharply through 1990 and levelled off in 1991 at around 10 per cent, historically high for a period of low inflation. Housing investment has also been cut back sharply. The personal sector has therefore moved from substantial financial deficit in 1988 to an estimated surplus of £$17\frac{1}{2}$ billion, over 4 per cent of income, in 1991.

3.25 A number of factors should help to increase consumer spending. Real personal disposable income, down $\frac{3}{4}$ per cent in 1991, is forecast to rise by a similar amount in 1992. The $4\frac{1}{2}$ point reduction in interest rates since October 1990, and the halving of the inflation rate last year, have yet to have their full effect. And although personal wealth has fallen, largely because of lower house prices, it remains high by all but the standards of the late 1980s. There is scope for the saving ratio to fall back from its current high level without damaging personal sector balance sheets, but the forecast assumes only a modest fall, to $9\frac{1}{2}$ per cent by the first half of 1993.

Chart 3.7 Personal sector financial balance



3.26 These positive influences may be offset to some extent by the effects of continuing weakness in the housing market—any recovery here during 1992 is likely to be slow—and by high levels of debt. The rise in the debt-income ratio in the late 1980s was unprecedented, and past relationships provide little guide to how far consumers might now want to retrench. However, a sharp deceleration of personal borrowing stabilised the debt-income ratio in 1991, and some fall is possible during 1992. Lower interest rates mean that the costs of servicing debt have already fallen sharply. As a result, real disposable income for a typical family with a £30 000 mortgage has risen by over 15 per cent since October 1990.

Chart 3.8 Personal sector wealth and debt ratios

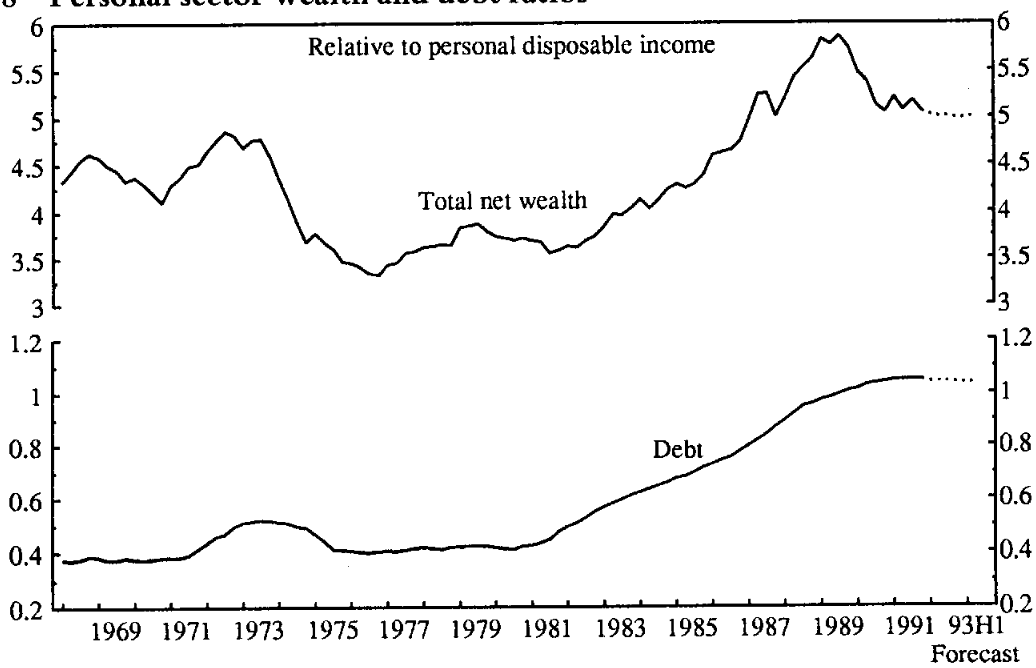
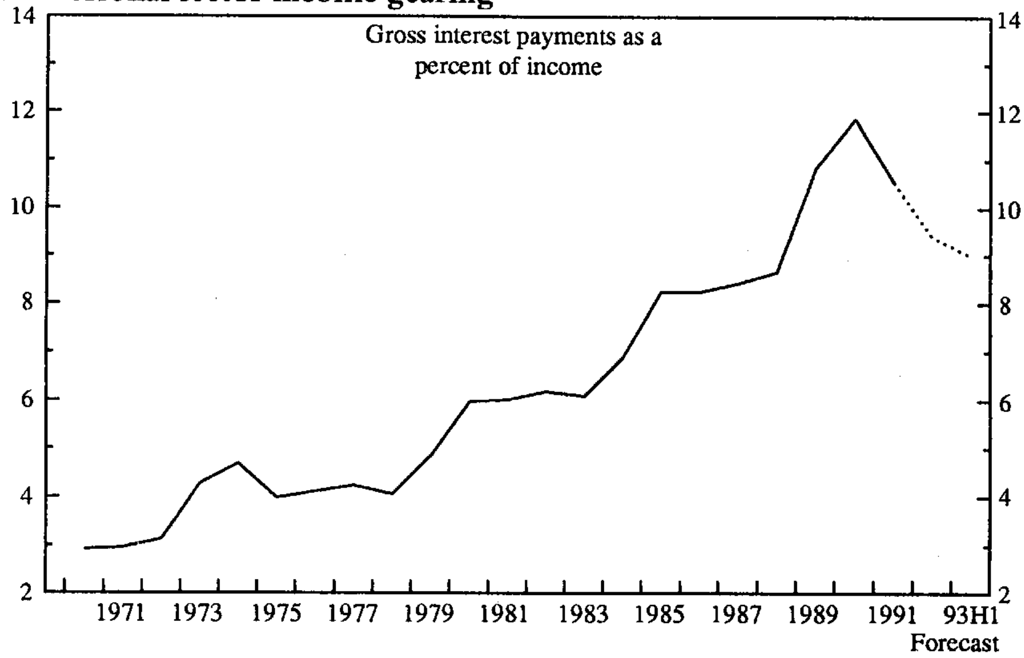
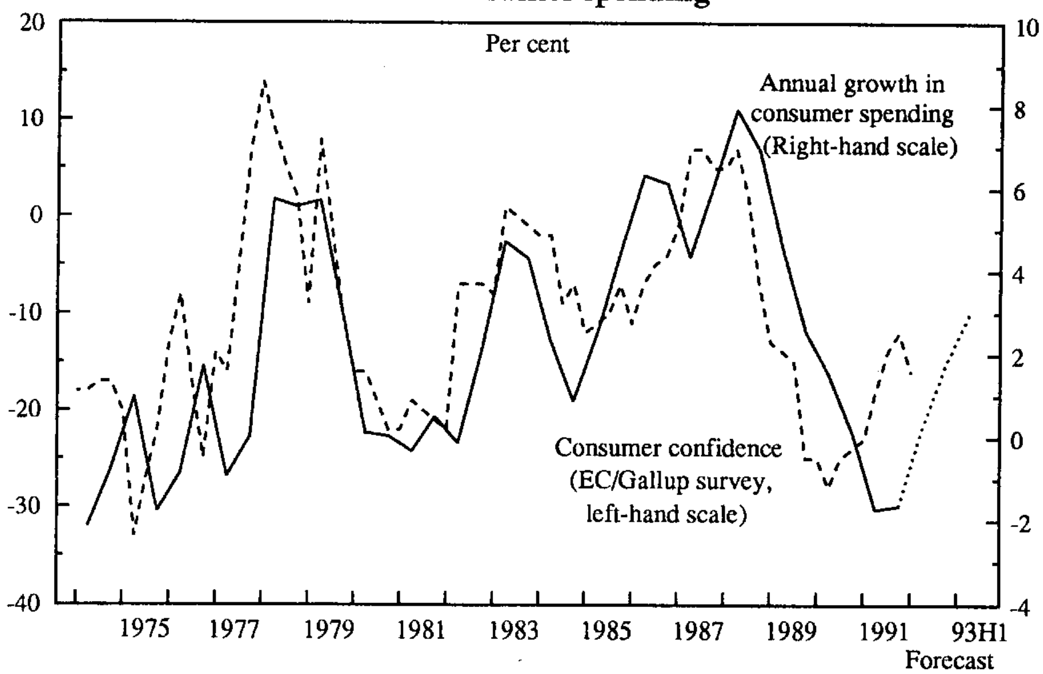


Chart 3.9 Personal sector income gearing



3.27 Consumers' expenditure is forecast to rise by 1 per cent in 1992, though the initial pick-up could be slow and the precise timing is uncertain. It is forecast to rise by 1¾ per cent in the year to the second half of 1992 and by 3 per cent in the year to the first half of 1993. Housing investment is likely to remain weak for a while before picking up later this year. The personal sector is expected to remain in substantial financial surplus.

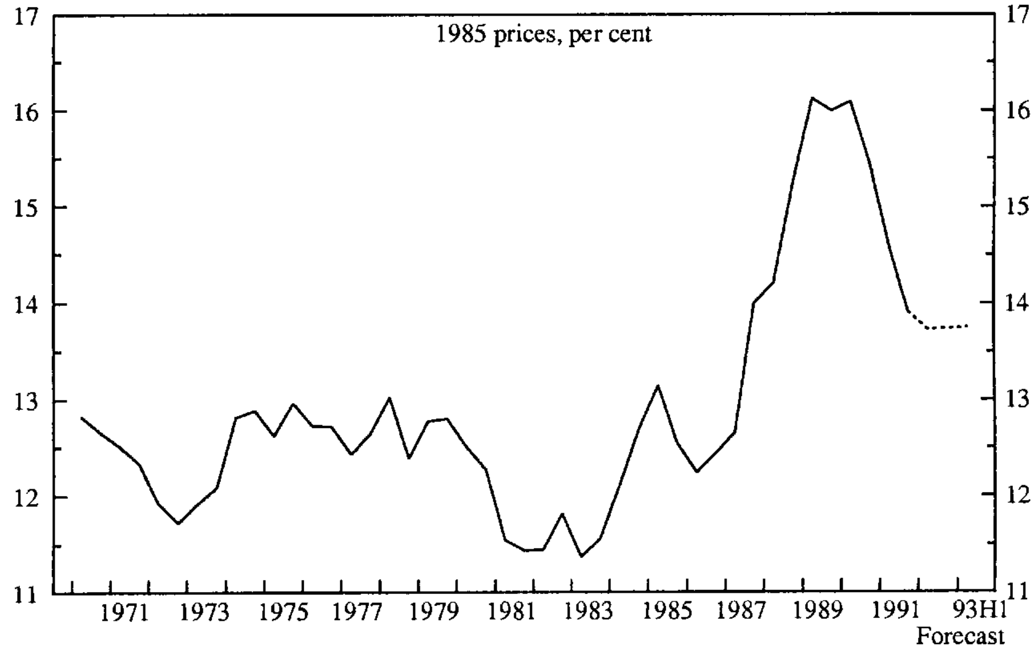
Chart 3.10 Consumer confidence and consumer spending



Company expenditure and income

3.28 Business investment peaked at record levels in early 1990 but has since fallen as companies have sought to improve their financial position against a backdrop of falling incomes. Business investment fell by 11¾ per cent in 1991.

Chart 3.11 Business investment-GDP ratio



3.29 If investment bears its usual relation to the cycle, it may continue to decline for a short time after output has begun to rise, though the fall forecast for 1992 is much less than that seen in 1991. This is consistent with the message from recent business surveys. The CBI balances for optimism and investment intentions have weakened since the Autumn Statement but remain well above their troughs of a year ago.

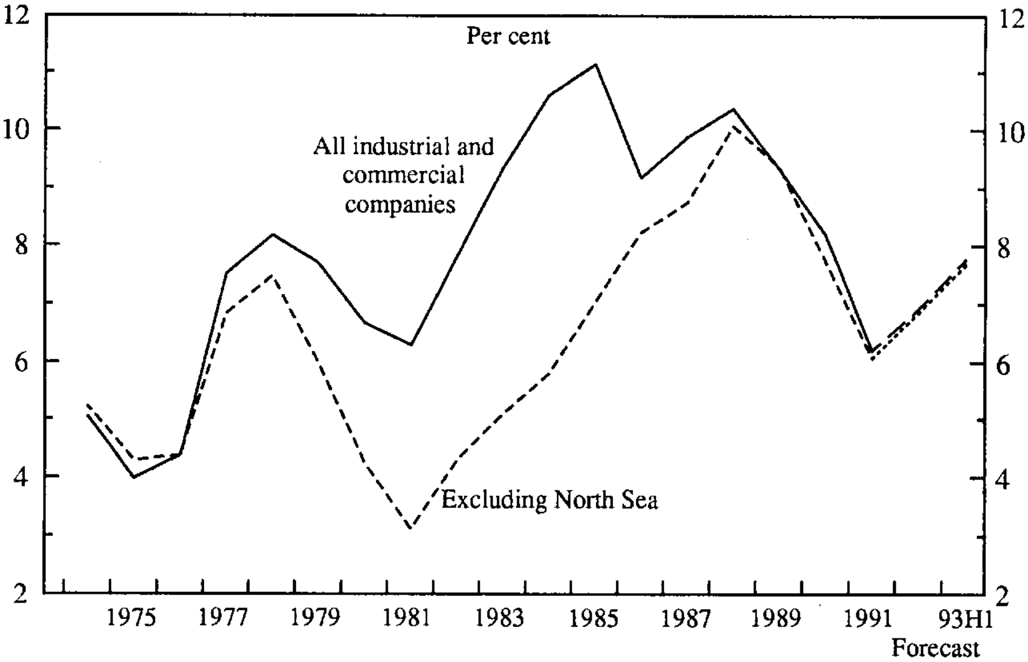
Table 3.3 Gross domestic fixed capital formation at constant prices

		Percentage changes on a year earlier		
			Forecast	
	Weights in 1991	1991	1992	1993H1
Business[1]	69	−11¾	−2¾	3
Private dwellings[2]	16	−3¼	−1¾	4
General government[3]	15	−9¼	10¾	4¼
Total fixed investment	**100**	**−10¼**	**−½**	**3½**

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

3.30 Even at its trough in 1992, the ratio of business investment to GDP is forecast to be higher than in any year during the 1970s and the first half of the 1980s, a consequence of the record growth rates seen in the late 1980s. With profitability increasing and the recovery becoming well established, business investment is forecast to rise by 3 per cent in the year to the first half of 1993. And the conditions should be in place for stronger growth thereafter.

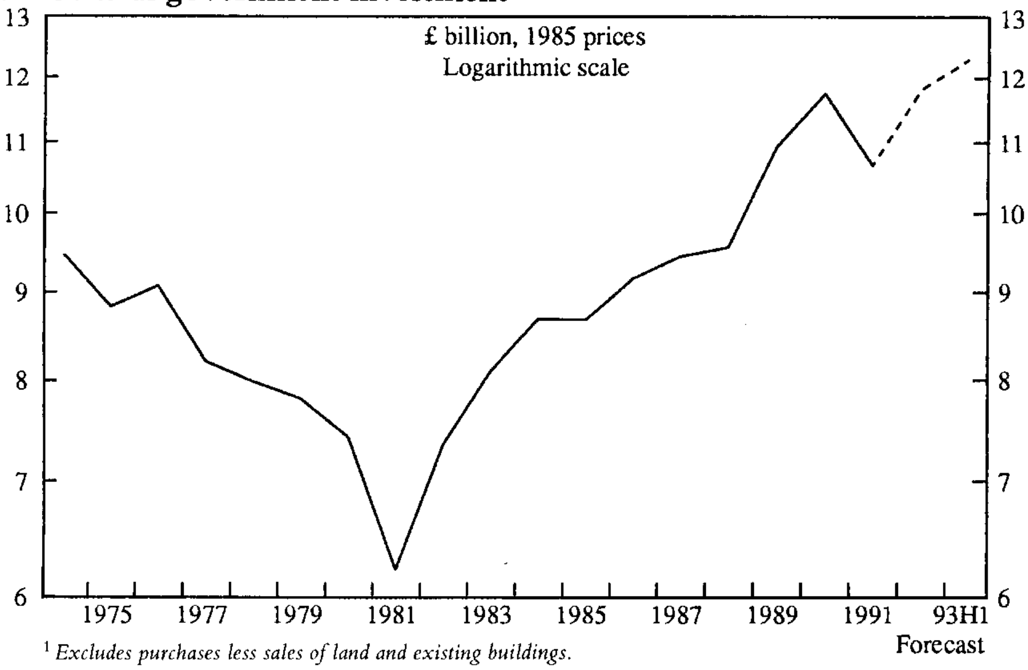
Chart 3.12 Companies' real rates of return



Government investment

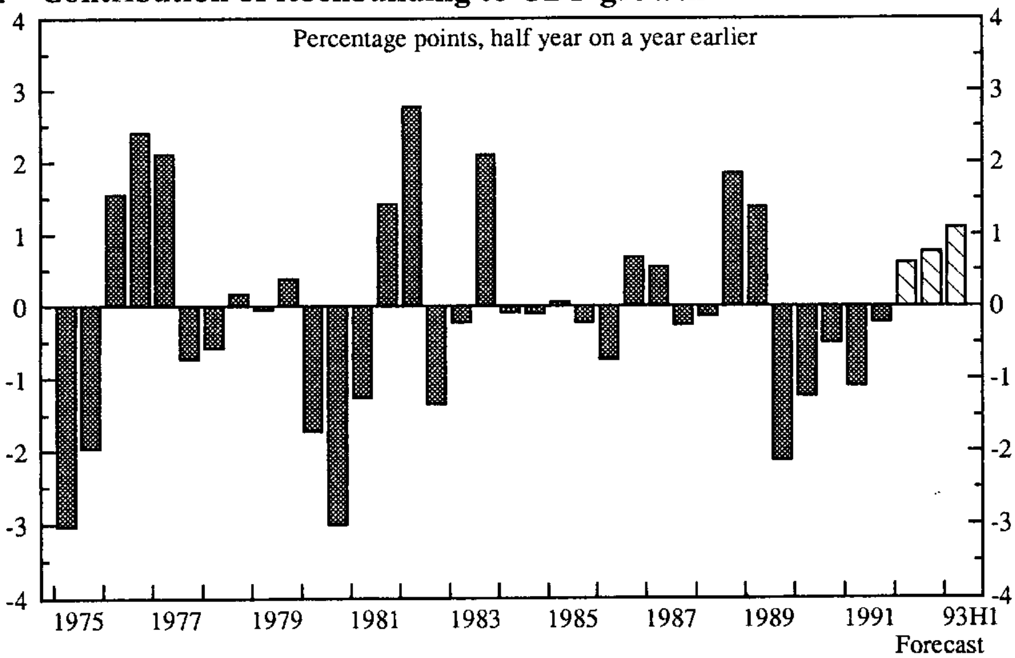
3.31 General government investment fell by 9¼ per cent in 1991, but is forecast to rise by 10¾ per cent in 1992. The year-on-year growth rates have been distorted by fluctuations in the quarterly pattern of local authority investment, and by the surge in local authority investment at the beginning of 1990 as authorities forestalled the new capital control regime introduced in April of that year. The forecast level of general government investment in 1992 is 24 per cent higher than that in 1988 and 50 per cent higher than in 1979.

Chart 3.13 General government investment[1]



[1] *Excludes purchases less sales of land and existing buildings.*

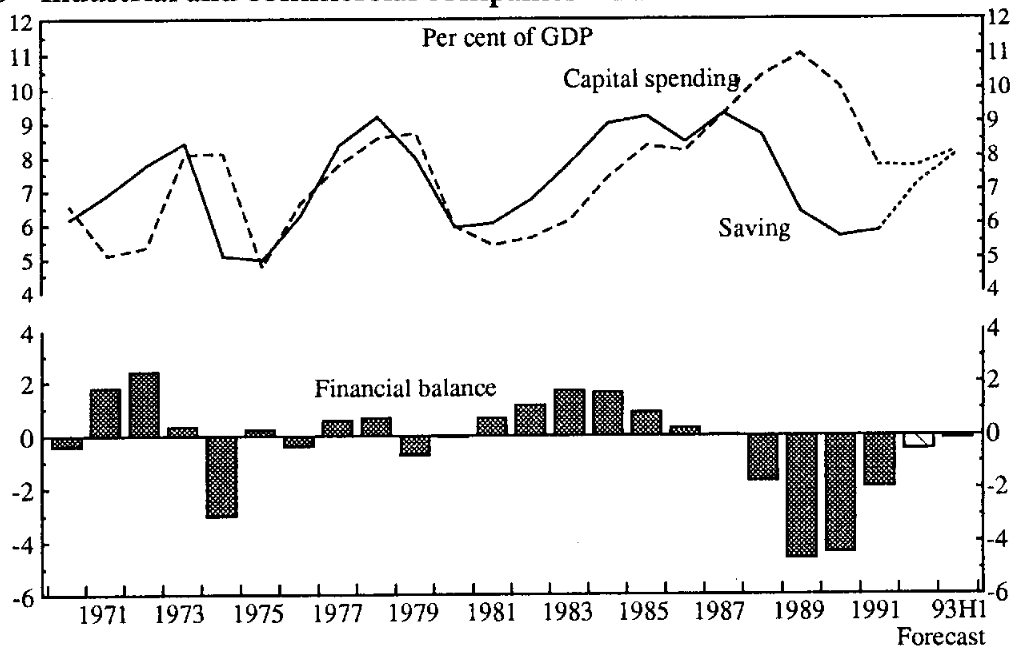
Chart 3.14 Contribution of stockbuilding to GDP growth



Stockbuilding

3.32 Preliminary indications for 1991 suggest that companies continued to cut their stock levels in response to their difficult financial position. But the rate of destocking has eased, and this trend is forecast to continue in 1992. As a result, while stock levels may continue to fall through much of 1992, stockbuilding is forecast to make a positive contribution to growth. Companies may begin to build up stocks from late 1992 to keep pace with rising sales and output. The change in stockbuilding could add 1 per cent to GDP growth in the year to the first half of 1993.

Chart 3.15 Industrial and commercial companies' financial balance



Companies' financial position

3.33 Industrial and commercial companies' profits (net of stock appreciation) are estimated to have fallen by $1\frac{3}{4}$ per cent in 1991. But with a sharp fall in outlays, company saving rose a little. Together with the decline in capital expenditure this led to a halving of the financial deficit in 1991. Adjustment is forecast to continue in 1992, aided by a recovery in profits. By the first half of 1993 industrial and commercial companies could be close to financial balance.

Employment and unemployment

3.34 Companies have reduced employment more quickly relative to output in this recession than in previous downturns. This no doubt reflects their determination to keep costs under control to maintain competitiveness, now that sterling is in the ERM. As a result, productivity has held up better this time than in previous post-war recessions. In the manufacturing sector, productivity rose by $2\frac{3}{4}$ per cent in the year to the fourth quarter of 1991. It is now close to its all time high, even though output is 8 per cent below its peak in the second quarter of 1990. Productivity growth is expected to gather pace in 1992.

3.35 Latest data indicate that employment has fallen by 1 million from its record level in June 1990. It is likely to continue to fall for a while yet, though at a moderating pace. The upward trend in unemployment abated sharply in the course of 1991, much as expected. The trend monthly increase in unemployment levelled off around the turn of the year but is likely to moderate further in the months ahead as activity picks up.

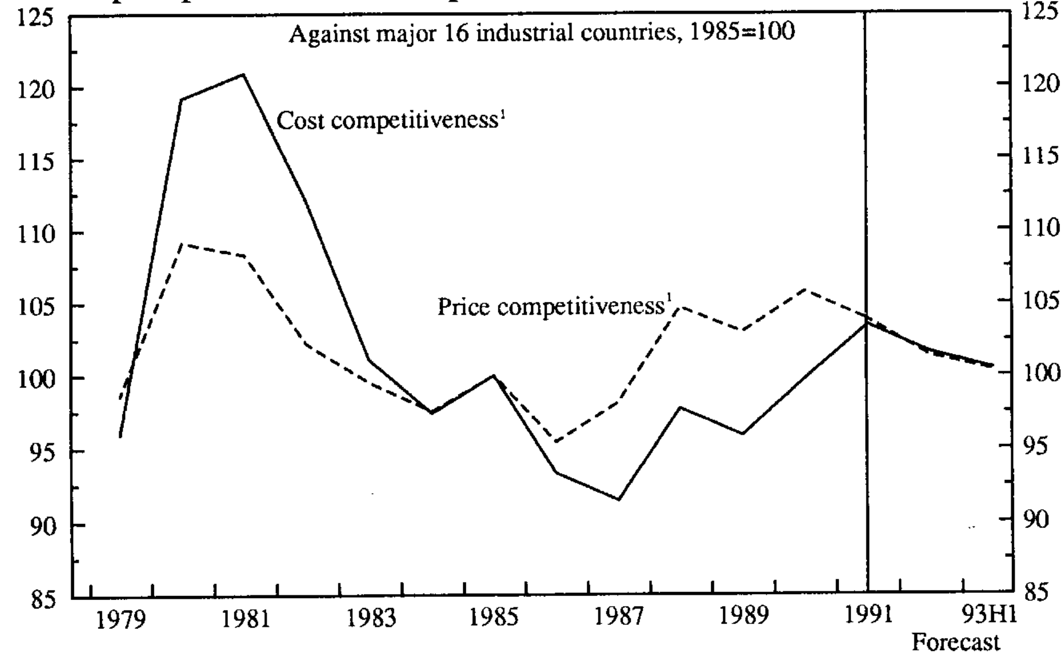
Trade and the balance of payments

3.36 The current account deficit in 1991 is estimated to have been £$4\frac{1}{2}$ billion, sharply down from the £$15\frac{1}{2}$ billion deficit recorded for 1990. The visible deficit nearly halved from £$18\frac{1}{2}$ billion in 1990 to £10 billion in 1991. Exports reached record levels during the year, and low domestic demand held imports down. The surplus on invisibles rose sharply to £$5\frac{1}{2}$ billion in 1991 from £3 billion in 1990, thanks to Gulf receipts and unusually low net EC contributions.

Competitiveness

3.37 Unit labour costs grew much faster in the UK than elsewhere during 1990, and cost competitiveness continued to weaken in early 1991. Since then it has been improving. Price competitiveness deteriorated less than cost competitiveness in 1990 and had already started to improve by the end of the year as UK exporters cut their margins sharply.

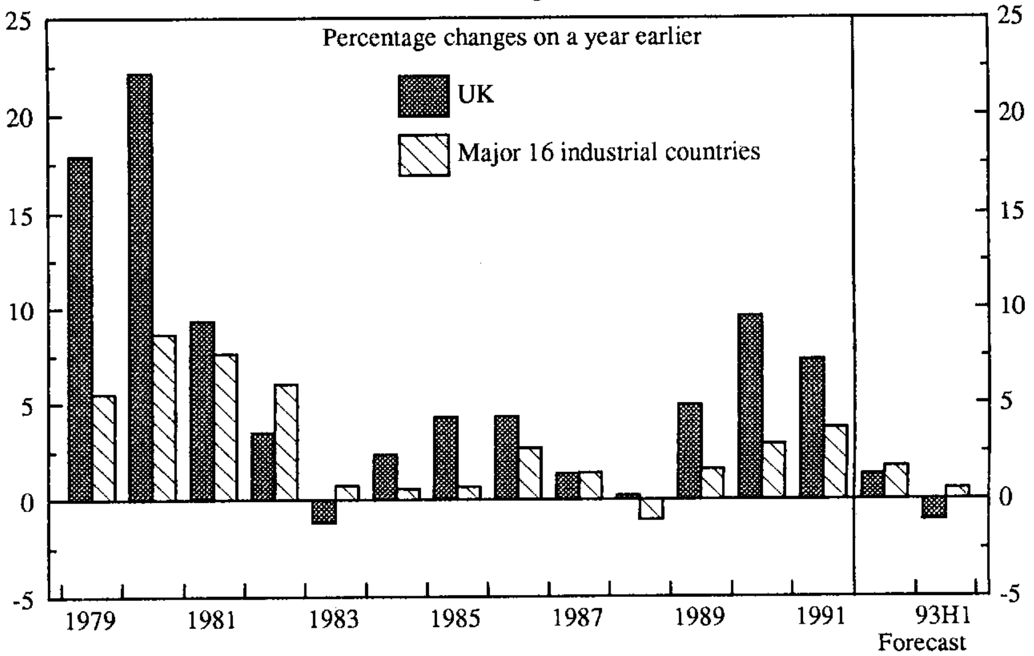
Chart 3.16 Export price and cost competitiveness



[1] *A fall means competitiveness has improved.*

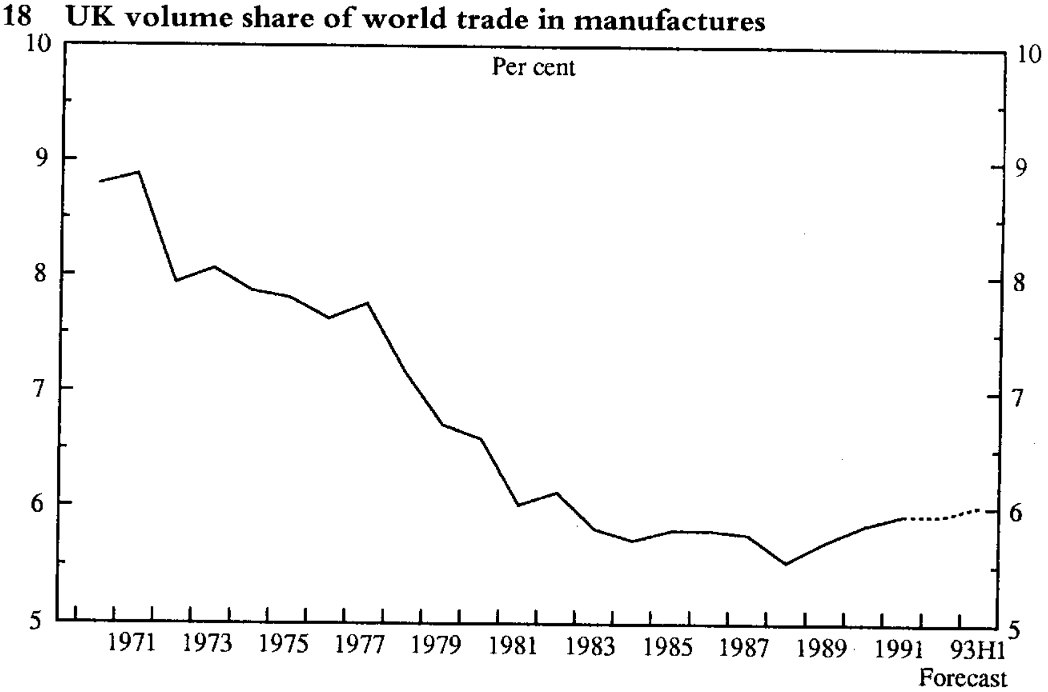
3.38 Over the forecast period UK competitiveness is expected to improve, with manufacturing unit labour costs growing less quickly here than in the other main manufacturing countries. UK manufacturing unit labour cost growth has already fallen to under $4\frac{1}{2}$ per cent from a peak of around 11 per cent. It is expected to slow further in 1992 and to fall in the first half of 1993, reflecting both the slowdown in earnings growth and the pick-up in productivity.

Chart 3.17 Unit labour costs in manufacturing



Non-oil trade **3.39** The volume of exports of manufactures increased by 3¼ per cent in 1991. While this was only around half as fast as in 1990, it nevertheless represents a strong performance when set against estimated world trade growth of manufactures of 1¾ per cent. The UK's share of world trade in manufactures is estimated to have risen in 1991 for the third year running. It may be that firms switched into exports in the face of weak domestic demand. But there also appears to have been an improvement in underlying performance. The favourable trend in competitiveness should keep the share rising in the medium term, though it may be broadly unchanged in 1992 before picking up again in the first half of 1993. Manufactured exports could be 6¾ per cent higher at the end of 1992 than a year earlier, and 4 per cent higher in 1992 as a whole.

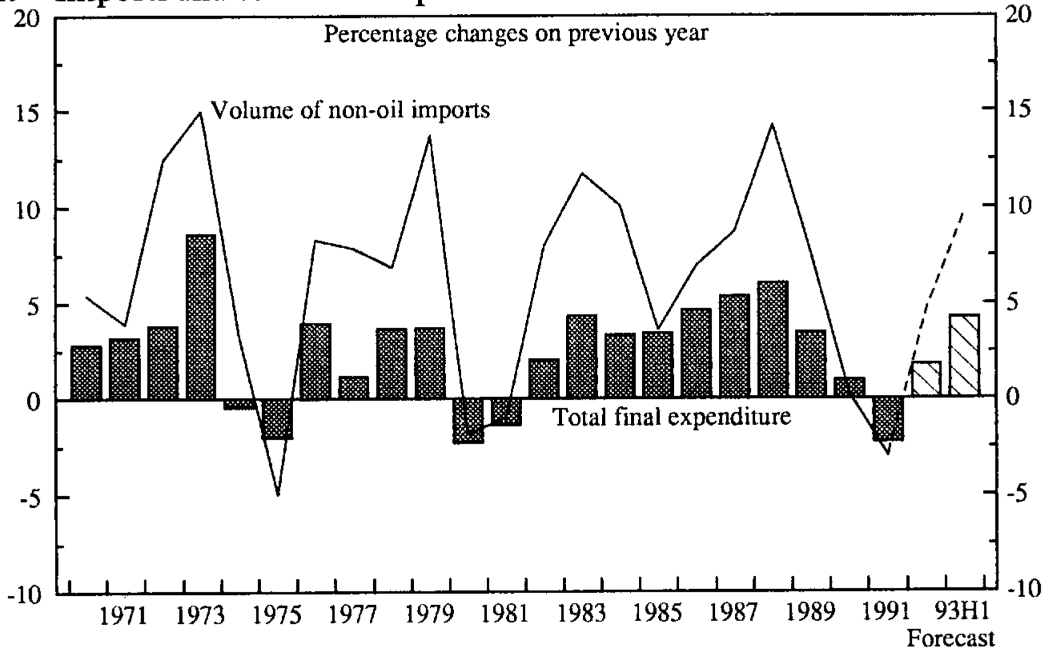
Chart 3.18 UK volume share of world trade in manufactures



3.40 Imports of non-oil goods fell by 3 per cent in volume terms in 1991 following a near standstill in 1990. Nevertheless imports were on a rising trend during the year. The low figure for 1991 as a whole was the consequence of low domestic demand; the upward trend during the year, which was mainly accounted for by imports of basic materials and capital goods, was perhaps a sign that firms were preparing for the recovery.

3.41 Non-oil import volumes could rise by 4¾ per cent overall in 1992. The growth is likely to be uneven—slow in the first half, faster in the second—in line with the projected pattern of demand. Import penetration is likely to continue to rise, but modestly by past standards thanks to the favourable trend in UK competitiveness. The trend in import penetration has been upward for many years in the UK as elsewhere because of the effect on trade patterns of increasing specialisation of world production.

Chart 3.19 Imports and total final expenditure



Trade prices

3.42 The current account in 1991 benefited from an improvement in the non-oil terms of trade. While export prices were hardly changed, import prices fell by 2¾ per cent. Export and import prices are expected to change little in 1992.

Table 3.4 Visible trade volumes

	Percentage changes on a year earlier					
	Non-oil goods		Oil		All goods	
	Exports	Imports	Exports	Imports	Exports	Imports
1990	6½	¼	9½	12	6¾	1¼
1991	2½	−3	−4	−¾	1¾	−2¾
1992 Forecast	3¾	4¾	6¾	3	4¼	4¾

Oil production and trade

3.43 North Sea oil production recovered sharply in the second half of 1991, following the extended shutdowns for safety work which depressed output in 1990 and the first half of 1991. It is expected to remain around this higher level in 1992, with oil production about 6 per cent up on 1991 and close to the centre of the Department of Energy's Brown Book range.

3.44 In 1992 oil prices are assumed to be close to recent levels, nearly 10 per cent lower than last year. But because production is forecast to be higher than last year, the surplus on trade in oil is expected to rise to around £1½ billion.

Invisibles **3.45** The surplus on invisibles in 1991 turned out a good deal higher than expected at the time of the Autumn Statement, largely because of significant upward revisions to the balance of interest, profits and dividends (IPD). But even after the revisions, the balance of IPD was only £1½ billion in 1991, down from £3 billion in 1990. The low figure was in part accounted for by oil companies' stock losses as oil prices fell from their peak during the Gulf crisis. But unusually low net government transfers offset the effect of this on the invisibles balance. The low transfers were due to lower than usual net payments to the EC and large one-off receipts from overseas governments related to the Gulf war. As a result, the invisibles surplus rose sharply in 1991, masking the weak IPD performance.

3.46 Because the special factors boosting the balance of transfers in 1991 will not be repeated, the invisibles balance is projected to fall back to around £4½ billion in 1992, from £5½ billion in 1991. But the underlying trend is improving. The balance of services is forecast to rise in 1992. IPD should recover from the low 1991 level as the oil price falls of 1991 are assumed not to recur.

Table 3.5 Current account

	£ billion						
	Manufactures	Oil	Other	Total visibles	Invisibles	Current balance[1]	
1990	−11½	1½	−8½	−18½	3	−15½	(−2¾)
1991	−3½	1	−8	−10	5½	−4½	(−¾)
1992 Forecast	−5	1½	−7½	−11	4½	−6½	(−1)

[1] *Figures in brackets are as a percent of GDP.*

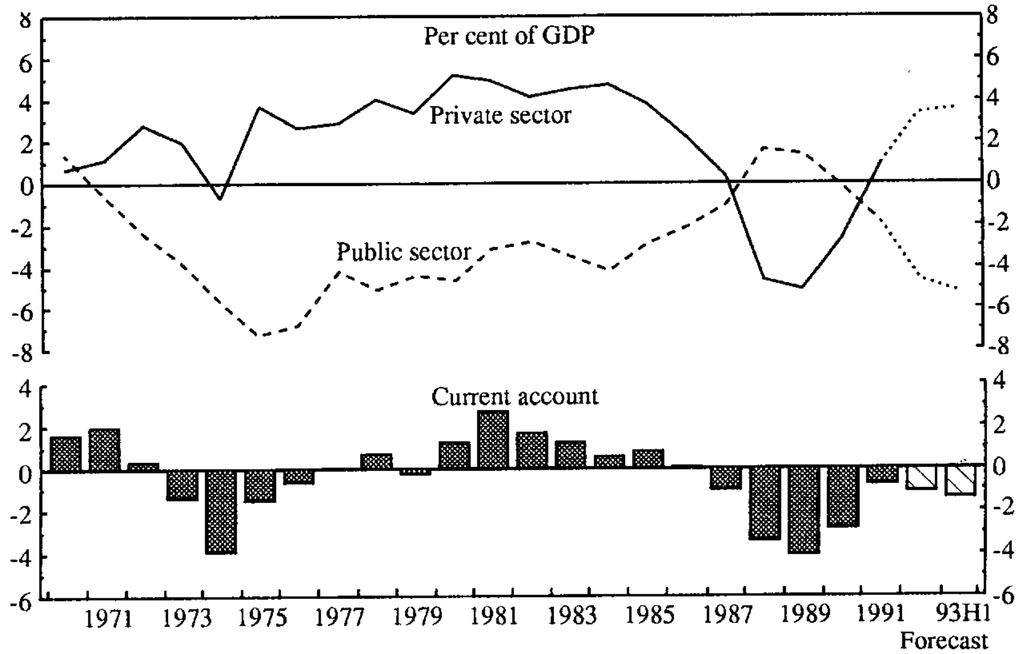
Net overseas assets **3.47** Net overseas assets are estimated to have risen to around £37 billion at the end of 1991 from around £20 billion at the end of 1990. As the current account was in deficit, this rise is more than accounted for by revaluations, mainly reflecting movements in world stock markets. But some capital flows are difficult to measure, and the outstanding stock of assets is difficult to value, which means that estimates of net overseas assets must be interpreted with considerable caution.

Current account **3.48** The current account deficit is expected to widen to £6½ billion in 1992 from £4½ billion in 1991. The fall in the invisibles surplus accounts for half the increase as the special factors in 1991 unwind. Although the deficit on manufactures rises by £1½ billion, the trade performance of the manufacturing sector is nevertheless expected to be strong. This deterioration is relatively gentle given expected world trade and domestic demand growth, because of the improved competitive position of UK industry.

Financial balances and the current account

3.49 Over the period 1988–1990, the private sector's financial position deteriorated sharply as spending outstripped income. The deficits were without precedent in the last seventy years. The position was unsustainable and a correction was inevitable; the private sector reduced its deficit in 1990 and moved into modest surplus in 1991.

Chart 3.20 Financial balances and the current account



3.50 The surplus is forecast to increase in 1992 and the first half of 1993 to levels which, as a percent of GDP, would be comparable with those of the first half of the 1980s. Both companies and persons contributed to the improvement in the private sector's financial position in 1991, and the pattern in 1992 is expected to be much the same.

3.51 The large current account deficits of 1988–1990 were the counterpart of the unprecedentedly large private sector financial deficits. The move of the private sector back into surplus is reflected in lower current account deficits.

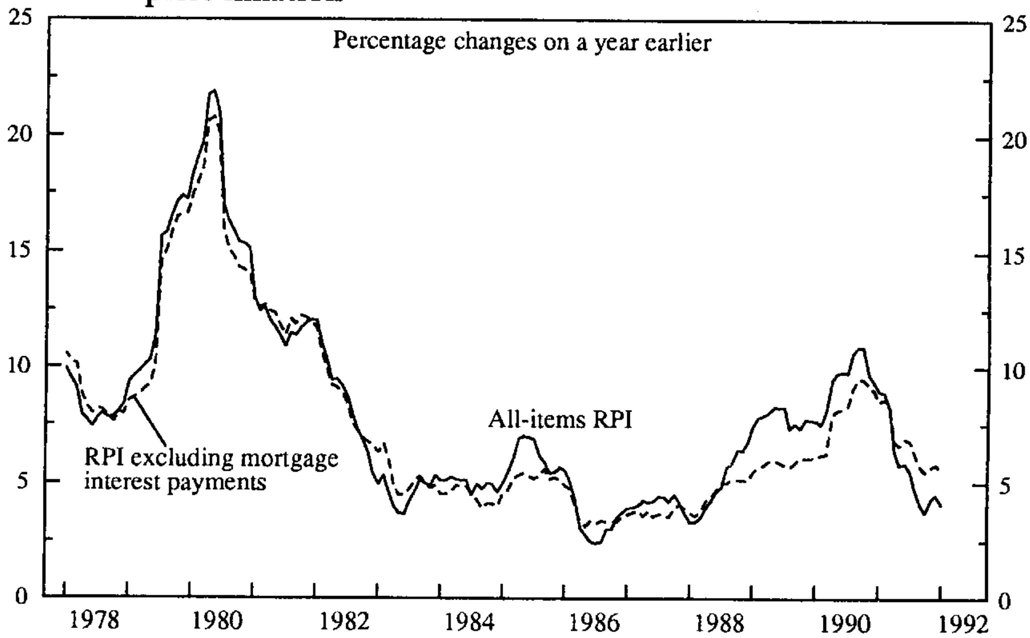
Inflation

Recent developments

3.52 Producer output price inflation (excluding food, drink and tobacco) has continued to fall in recent months, to $2\frac{3}{4}$ per cent in February—the lowest rate since 1969—compared with $6\frac{1}{2}$ per cent early last year. The annualised rate in the latest three months on the previous three months is now down to $2\frac{1}{4}$ per cent. Although unit labour cost growth is well down on a year earlier, profit margins remain under pressure.

3.53 Retail price inflation has also fallen substantially, to 4 per cent in January compared with 9 per cent a year earlier. The all-items rate has fluctuated over the last few months as the effects of changes in mortgage rates and oil prices in late 1990 have dropped out of the calculation. Excluding these, the underlying rate has continued to fall in response to weak consumer demand and smaller rises in food prices. But retail price inflation excluding mortgage interest payments remains at around $5\frac{1}{2}$ per cent, somewhat above producer price inflation. This partly reflects the stubbornness of inflation in some services prices.

Chart 3.21 Retail price inflation



3.54 Pay settlements have fallen in response to falling inflation, weak labour market conditions and pressure on companies to maintain competitiveness. Provisional CBI data show settlements in manufacturing in the last quarter of 1991 averaging 4 per cent compared with 9 per cent a year earlier. Whole economy underlying earnings growth stood at $7\frac{1}{4}$ per cent in December, compared with a peak of $10\frac{1}{4}$ per cent in July 1990. This is the first time since 1967 that underlying earnings growth has been below $7\frac{1}{2}$ per cent.

Prospects

3.55 Earnings growth should continue to fall over the coming year as lower settlements feed through, although there may be some pick-up in wage drift as activity increases. A cyclical recovery in productivity should also help to restrain manufacturers' unit labour costs, which are forecast to fall as the recovery gathers pace. This underpins the forecast of further falls in producer price inflation, to 2 per cent in the fourth quarter of 1992 and $1\frac{1}{2}$ per cent by the middle of 1993. There should still be scope for companies to rebuild profit margins as demand rises.

3.56 Underlying retail price inflation is also expected to fall through 1992 as producer price inflation continues to fall, and services prices increasingly respond to disinflationary pressures. Headline inflation may pick up in the coming months as the effects of last year's mortgage rate cuts and the 1991 Budget switch from the community charge to VAT drop out of the calculation. But RPI inflation is forecast to be down to $3\frac{3}{4}$ per cent by the fourth quarter of 1992 and $3\frac{1}{4}$ per cent by the second quarter of 1993.

Table 3.6 Retail and producer output price inflation

	Weights in 1992[1]	Percentage changes on a year earlier		
			Forecast	
		1991Q4	1992Q4	1993Q2
Food	15	$4\frac{1}{4}$	$3\frac{1}{2}$	3
Housing	$17\frac{1}{2}$	−9	$4\frac{3}{4}$	$5\frac{3}{4}$
Other	$67\frac{1}{2}$	8	$3\frac{1}{2}$	$2\frac{3}{4}$
Total RPI	**100**	**$4\frac{1}{4}$**	**$3\frac{3}{4}$**	**$3\frac{1}{4}$**
Producer output prices[2]		**$3\frac{3}{4}$**	**2**	**$1\frac{1}{2}$**

[1] *Provisional.*
[2] *Excluding food, drink and tobacco.*

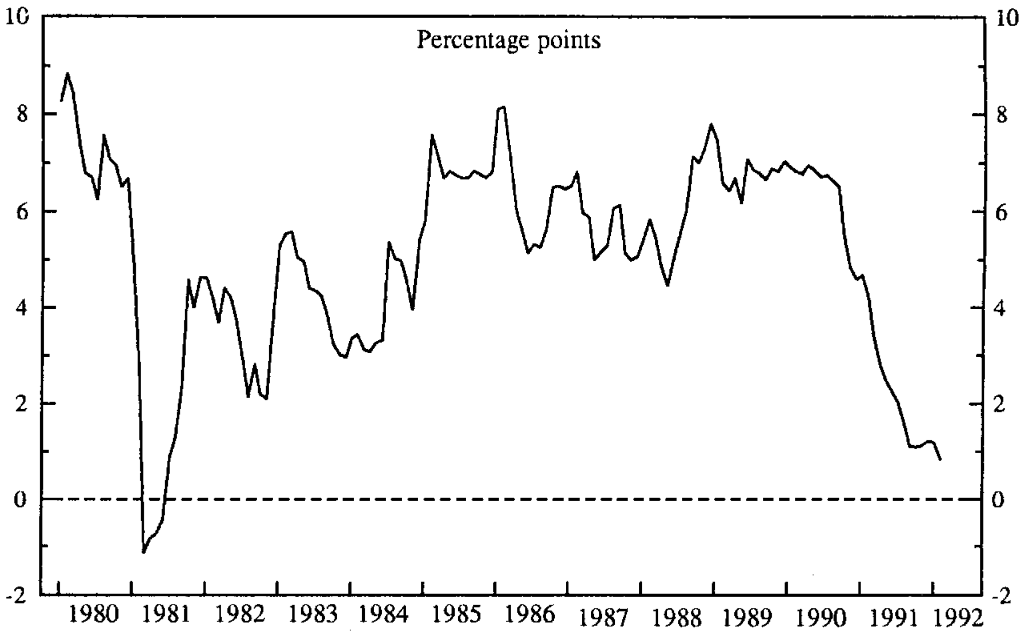
3.57 The expected progress on underlying inflation is also reflected in the forecast for the GDP deflator, which measures the price of domestic value added (principally unit labour costs and profits per unit of output). The GDP deflator is expected to rise by 7 per cent in 1991–92, of which the 1991 Budget VAT increase contributes about 1 per cent, but by only $4\frac{1}{2}$ per cent in 1992–93.

Financial developments

Interest rates

3.58 Since the UK joined the ERM, the gap between UK interest rates and those in the low inflation ERM countries has narrowed sharply as UK base rates have been cut to $10\frac{1}{2}$ per cent from 15 per cent. The gap between base rates and official interest rates in Europe fell further in mid-December last year when all other ERM countries increased their official interest rates, and UK rates were unchanged.

Chart 3.22 UK-German short term interest rate differential[1]



[1] *3-month interbank rate.*

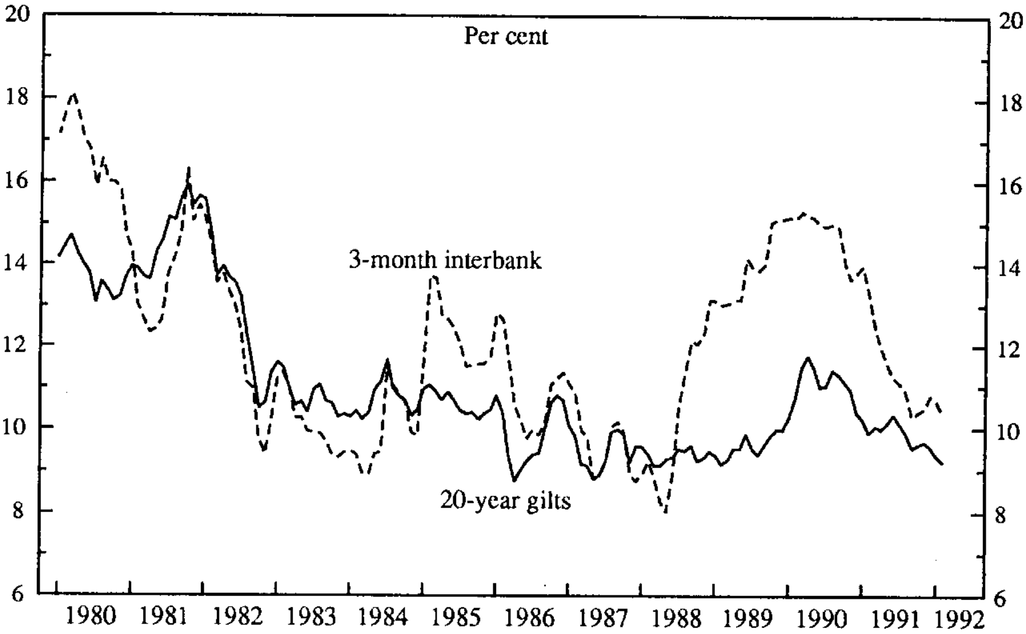
Exchange rates

3.59 Following the December rise in other European interest rates, sterling fell, reaching its lowest value against the Deutschemark since ERM entry. But the Government's firm public commitment to the existing ERM parities and the growing awareness in the foreign exchange markets of the improved prospects for UK inflation helped to ensure that the pressure was short-lived.

Long rates

3.60 Long term interest rates over the last year have been on a downward trend, consistent with market expectations of falling short term rates and inflation. The yield on 20-year gilts has fallen from $10\frac{1}{4}$ per cent at the beginning of last year to little over 9 per cent on average in recent weeks.

Chart 3.23 Interest rates



Equity prices

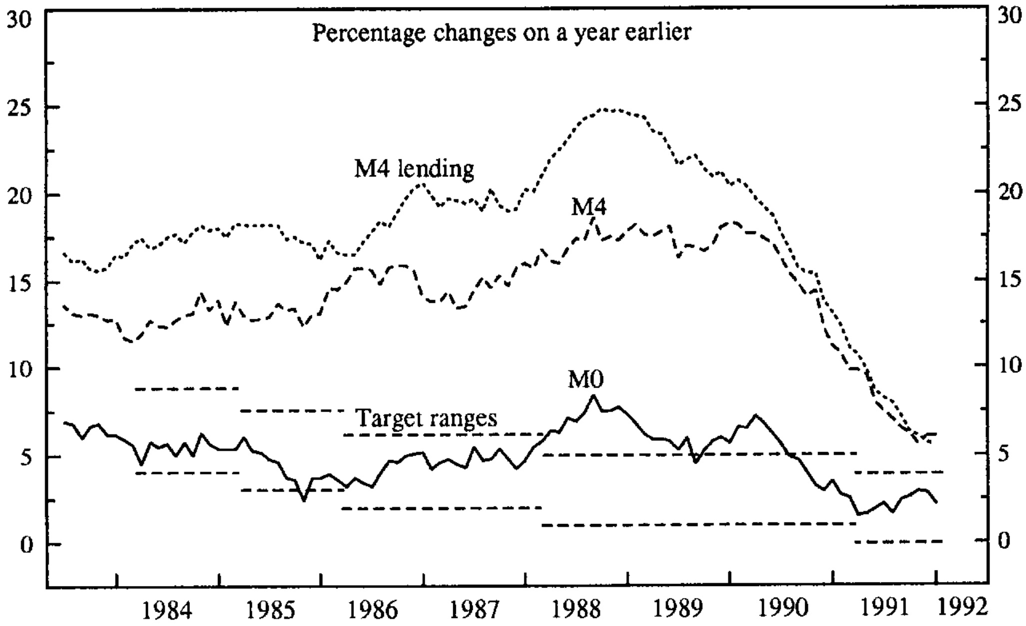
3.61 Equity prices recovered sharply in early 1991, but showed little further growth in the remainder of the year. Equity prices have risen over the last couple of months, perhaps indicating improving expectations of economic growth.

Money and credit

3.62 The annual growth rate of M0 has remained comfortably within its 0–4 per cent target range for the first ten months of 1991–92. In the first half of the financial year M0 growth was a little below the mid-point of the range; in the second half it has been a little above the mid-point. M0 velocity growth has been consistent with its long term trend.

3.63 The annual growth rate of M4 has continued the fall which started in early 1990. Then it was about 18 per cent; in January this year it was about 6 per cent. Bank and building society lending growth peaked at around 25 per cent at the end of 1988; since then it too has fallen to about 6 per cent. Recent figures suggest that the sharp declines in the growth rates of M4 and bank and building society lending may have come to an end. M4 velocity, which has been on a steep downward trend since the early 1980s, appears to have fallen only marginally over the last year.

Chart 3.24 Money and lending



3.64 Lower borrowing for house purchase has played a significant part in the slowdown of lending growth. But persons' other borrowing has remained subdued. The personal sector debt-income ratio, which rose steeply in the 1980s, partly reflecting financial liberalisation, seems now to have stabilised and may even be falling back a little.

3.65 Firms have also been cutting back on bank borrowing. Market conditions in 1991 have led them to prefer capital issues as a source of finance. Although M4 and M4 lending growth rates are at low levels as a result of the slowdown in activity, there is little evidence that the economic recovery in prospect will be inhibited by a shortage of bank or building society credit.

Forecast and outturn

3.66 Table 3.7 compares the main elements of the forecast published in the 1991 FSBR with the outturns for 1991 or the latest estimates for 1991–92.

3.67 Inflation in 1991 was much as forecast. Errors on the forecasts of demand, activity and the current account were within the average errors from past forecasts. GDP in 1991 fell by a little more than forecast. Partly as a result the current account deficit was smaller than forecast. And the public sector borrowing requirement is likely to be well above last year's Budget forecast, though the error was no larger than the past average.

Table 3.7 Forecast and outturn

	Percentage changes on a year earlier unless otherwise stated		
	1991 FSBR	Outturn or latest estimate	Average errors from past forecasts
GDP (1991)	-2	$-2\frac{1}{2}$	$\frac{3}{4}$
Non-oil GDP (1991)	-2	$-2\frac{1}{2}$	$\frac{3}{4}$
Domestic demand (1991)	$-2\frac{3}{4}$	-3	$1\frac{1}{4}$
RPI (1991Q4)	4	$4\frac{1}{4}$	$1\frac{1}{2}$
GDP deflator (1991–92)	7	7	1
Money GDP (1991–92)	6	5	$1\frac{1}{4}$
Balance of payments current account (1991, £ billion)	-6	$-4\frac{1}{2}$	$4\frac{1}{2}$
PSBR (1991–92, £ billion)	8	$13\frac{3}{4}$	6

Risks and uncertainties

3.68 All forecasts are subject to risks and uncertainties. The forecasts published at the time of the last Budget and Autumn Statement both emphasised that these are most acute when the economy is at a turning point. This remains true on this occasion. The forecasts presented here are central forecasts, a balance of upside and downside risks. Average errors from previous forecasts are given in Table 3.1.

Table 3.8 Gross domestic product and its components[1]

	Consumers' expenditure	General government consumption	Total fixed investment	Change in stocks	Domestic demand	Exports of goods and services	**Total final expenditure**	*Less* imports of goods and services	*Less* adjustment to factor cost	*Plus* statistical discrepancy[2]	**GDP at factor cost**
	£ billion at 1985 prices, seasonally adjusted										
1990	272·8	79·6	79·9	−0·4	431·9	123·8	555·7	138·8	60·5	0·5	356·9
1991	268·2	81·5	71·8	−2·8	418·7	124·7	543·3	134·8	60·0	−0·2	348·4
1992	270·9	82·3	71·4	−0·4	424·1	129·1	553·2	140·3	60·9	−0·2	351·8
1990 1st half	136·7	39·5	41·2	0·3	217·8	62·5	280·2	70·4	30·6	0·3	179·6
2nd half	136·1	40·0	38·7	−0·7	214·1	61·3	275·4	68·4	30·0	0·2	177·3
1991 1st half	134·3	40·7	36·3	−1·7	209·6	61·7	271·3	66·8	29·9	0·0	174·5
2nd half	133·9	40·8	35·5	−1·1	209·0	63·0	272·0	67·9	30·1	−0·1	173·9
1992 1st half	134·6	40·9	35·5	−0·6	210·5	63·4	273·9	68·9	30·3	−0·1	174·6
2nd half	136·2	41·3	35·9	0·2	213·7	65·7	279·3	71·4	30·6	−0·1	177·2
1993 1st half	138·7	41·5	36·7	1·3	218·1	67·5	285·6	74·5	31·2	−0·1	179·8
	Percentage changes on a year earlier[3]										
1990	$\frac{3}{4}$	3	$-2\frac{1}{2}$	$-\frac{3}{4}$	0	5	1	1	1	0	1
1991	$-1\frac{3}{4}$	$2\frac{1}{4}$	$-10\frac{1}{4}$	$-\frac{3}{4}$	−3	$\frac{3}{4}$	$-2\frac{1}{4}$	−3	−1	$-\frac{1}{4}$	$-2\frac{1}{2}$
1992	1	1	$-\frac{1}{2}$	$\frac{3}{4}$	$1\frac{1}{4}$	$3\frac{1}{2}$	$1\frac{3}{4}$	4	$1\frac{1}{2}$	0	1
1993 1st half	3	$1\frac{1}{4}$	$3\frac{1}{2}$	1	$3\frac{3}{4}$	$6\frac{1}{2}$	$4\frac{1}{4}$	$8\frac{1}{4}$	3	0	3

[1] *Figures for GDP and its components to end–1991 are based on preliminary indications from the CSO of the outturn to the fourth quarter of 1991, including revisions to earlier quarters. The CSO will publish a full and revised set of national accounts to end–1991 on 19 March.*
[2] *Expenditure adjustment.*
[3] *For stockbuilding and the statistical discrepancy, changes are expressed as a percent of GDP.*

4 The Budget measures

4.01 This chapter summarises the main tax proposals in the Budget. A full list of changes is given in Table 4.1 and they are described in more detail in Annex A. Table 4A.1 in Annex A lists the effects of tax changes announced before the Budget. Annex B lists some of the main tax allowances and reliefs, and gives their estimated costs for 1991–92.

Inland Revenue taxes

Income tax

4.02 The rate of income tax will be reduced to 20 per cent for the first £2 000 of taxable income.

4.03 The personal allowance will be increased in line with the statutory indexation provisions (based on the increase of 4·5 per cent in the Retail Prices Index in the year to December 1991). So will the personal and married couple's allowances for those aged 65 and over. Other allowances, and the basic rate limit, will be unchanged. For 1992–93 the levels will be:

personal allowance £3 445 (up £150);

married couple's allowance, additional personal allowance and widow's bereavement allowance £1 720 (no change);

for those aged 65 to 74: personal allowance £4 200 (up £180) and married couple's allowance £2 465 (up £110);

for those aged 75 and over: personal allowance £4 370 (up £190) and married couple's allowance £2 505 (up £110);

income limit for age-related allowances £14 200 (up £700);

basic rate limit £23 700 (no change).

4.04 Married couples will be able to choose by agreement to give the married couple's allowance to the wife instead of the husband, or to share it equally between them, as from 1993–94. As an alternative, married women will be able to claim half the allowance at their own request.

Benefits-in-kind

4.05 The car benefit scale charges, used both for income tax and employers' national insurance contributions, will be increased by 4·5 per cent from 6 April 1992.

4.06 There will be a new, lower car fuel benefit scale for diesel cars. This will be used both for income tax and employers' national insurance contributions. The existing scales for assessing the benefit of employer-provided petrol will be increased by 4·5 per cent. The fuel scale charges for VAT will be similarly amended.

Charitable giving **4.07** The minimum limit for the Gift Aid scheme (tax relief on single charitable donations from close companies or individuals) will be reduced from £600 to £400 from 1 July 1992.

Savings **4.08** Savings of up to £6 000 a year, instead of £3 000 as at present, will be allowed in qualifying unit or investment trusts through a general Personal Equity Plan from 6 April 1992.

4.09 The capital gains tax annual exempt amount for 1992–93 will be increased in line with the statutory indexation provisions from £5 500 to £5 800 in the case of individuals and from £2 750 to £2 900 in the case of most trusts.

Business taxation **4.10** The limit of £8 000 on the cost of cars, above which capital allowances and tax relief for lease rental payments are restricted, will be raised to £12 000 from 11 March 1992.

4.11 The limit below which employers may pay PAYE/NIC quarterly rather than monthly will be raised from an average monthly bill of £400 to £450, for deductions made after 6 April 1992.

4.12 The Business Expansion Scheme will be abolished from the end of 1993, when relief for private rented housing expires. In the meantime the scheme will be amended to make it easier for companies to use the relief for mortgage rescue schemes.

4.13 Banks, brokers and other agents who deduct tax from payments of foreign dividends and interest will have to account for the tax which they deduct on a monthly basis from October 1992; the statutory remuneration to agents will be abolished.

4.14 Provisions will be introduced with effect from 10 March 1992 to prevent loss of tax through arrangements involving the payment of rent between connected persons.

Film expenditure **4.15** The tax treatment of film production costs will be amended for films completed after 10 March 1992. Production costs may be written off at a flat rate of $33\frac{1}{3}$ per cent starting on completion of the film. Pre-production costs incurred after 10 March 1992 will be written off as they are incurred.

Inheritance tax **4.16** Most business assets which currently qualify for 50 per cent relief from inheritance tax will be granted 100 per cent relief from 10 March 1992. Assets which currently qualify for 30 per cent relief will be granted 50 per cent relief.

4.17 The threshold for inheritance tax will be raised from £140 000 to £150 000 from 10 March 1992.

Tax appeals **4.18** Procedural rules will be introduced for appeal hearings. There will be powers to award costs where either party has acted wholly unreasonably, from 1 April 1993.

Customs and Excise taxes

Car tax

4.19 Car tax will be halved from 10 per cent to 5 per cent of the wholesale price of new cars from 11 March 1992.

Excise duties

4.20 Most excise duties will rise from 6 pm on 10 March 1992.

4.21 The duties on alcoholic drinks will rise by 4·5 per cent, in line with the increase in the Retail Prices Index in the year to December 1991.

4.22 The duty on unleaded petrol and derv will rise by 4·5 per cent, in line with the increase in the Retail Prices Index in the year to December 1991.

4.23 The duty on leaded petrol will rise by 7·5 per cent.

4.24 The duty on cigarettes will rise by about 10 per cent, putting 13p on the price of a packet of 20 cigarettes. The duty on pipe tobacco will rise by 4·5 per cent and on other tobacco products by 10 per cent.

4.25 The rate of general betting duty will be cut from 8 per cent to 7·75 per cent from 1 April 1992.

4.26 Duties on matches and mechanical lighters will be abolished from 1 January 1993.

4.27 Members' clubs will be exempt from bingo duty from 3 August 1992.

Vehicle excise duties

4.28 Duty on cars, light vans and taxis will rise from £100 to £110 from 11 March 1992. Duty on lorries and most other vehicles will not change.

Value added tax

4.29 The registration threshold will rise from turnover of £35 000 to £36 600 from 11 March 1992, in line with the increase in the Retail Prices Index in the year to December 1991.

4.30 Traders who meet the other conditions for cash accounting (including annual turnover of £300 000 or less) will be able to join the scheme from 1 April 1992 even if they owe Customs and Excise up to £5 000, rather than a maximum of £1 000 as at present.

4.31 Large VAT payers will be required to make monthly payments on account from autumn 1992. They will not be required to make monthly returns and may continue to submit quarterly returns.

4.32 The rate of serious misdeclaration penalty will be cut from 20 per cent to 15 per cent on assessments calculated from 11 March 1992. Penalties will not normally be levied on under-declarations of £2 000 or less. The maximum rate of default surcharge will be cut from 30 per cent to 20 per cent from 1 April 1992.

4.33 Private taxi firms, self-drive hire firms and driving schools will be able to reclaim VAT paid on cars purchased for their businesses from 1 August 1992. They will be required to account for VAT on any private use of these cars and on their resale under the normal VAT rules.

4.34 VAT will no longer be charged on the salary forgone when employees are offered a choice between the private use of a company car or additional salary, from 1 April 1992.

Business rates

England and Wales

4.35 There will be amendments to the transitional arrangements for properties in England and Wales which face large changes in national non-domestic rate bills as a result of the 1990 reforms. These changes will reduce the total rates bill in England and Wales for 1992–93 by $3\frac{1}{4}$ per cent.

4.36 For 1992–93 only, rate bills for properties in transition to higher bills will not increase in real terms. Instead bills will increase by only 4·1 per cent, in line with the increase in the Retail Prices Index in the year to September 1991 used in setting the uprating of business poundages already announced in November 1991.

4.37 New occupiers will be able to inherit the transitional relief due to the previous occupier, from 11 March 1992.

4.38 For properties in transition to lower rate bills, the maximum reduction in rate bills in real terms for 1992–93 will be 22 per cent for large properties and 27 per cent for smaller properties. This is 9 percentage points higher in each case than in 1991–92. All properties gaining from the 1990 reforms will benefit from fully reduced bills from 1993–94.

Scotland and Northern Ireland

4.39 Scotland and Northern Ireland have different arrangements for business rates but their total rates bills for 1992–93 will also be reduced by $3\frac{1}{4}$ per cent.

Table 4.1 Direct effects of Budget measures

See Annex A paragraph numbers	£ million Estimated effect on receipts in: 1992–93 Changes from a non-indexed base	1992–93 Changes from an indexed base	1993–94 Changes from an indexed base
INLAND REVENUE			
Income tax			
1 Increase of £150 in personal allowance	−710	—	—
2 No change in married couple's allowance (for those aged under 65), additional personal allowance and widow's bereavement allowance	—	+160	+210
3 Increases for those aged 65 to 74 of £180 in personal allowance and £110 in married couple's allowance	−60	—	—
4 Increases for those aged 75 and over of £190 in personal allowance and £110 in married couple's allowance	−35	—	—
5 Increase of £700 in income limit for age-related allowances	−5	—	—
6 New lower rate of 20 per cent on first £2 000 of taxable income	−1 770	−1 770	−2 320
7 No change in basic rate limit	—	+180	+290
8 New option to share or transfer married couple's allowance from 1993–94	—	—	−10
9 Benefits in kind: increase in car scales of 4·5 per cent	+60	+60	+70
10 Benefits in kind: new lower scale for diesel fuel	*	*	*
11 Benefits in kind: increase in car fuel scales of 4·5 per cent for petrol fuel	+5	+5	+5
12 Child Support Agency: consequential changes in tax relief for maintenance payments	—	—	*
13 Changes to tax rules for certificates of deposit	—	—	—
14 Changes to tax rules for dividend vouchers	—	—	—
15 Changes to tax rules for returns of interest paid to non-residents	—	—	—
16 Monthly accounting for paying and collecting agents	+70	+70	*
17 Increase in threshold for quarterly payments by small employers (PAYE)	−5	−5	*
Income tax and corporation tax			
18 Increase to £12 000 in capital allowance limit for business cars	*	*	−50
19 Capital allowances for computer software	*	*	−15
20 Relief for expenditure on production of films	−5	−5	−15
21 Changes to treatment of payments of rent between connected persons	+30	+30	+200
22 Relief for insolvent former deposit takers in compulsory liquidation	−10	−10	−5
23 Reduction to £400 in minimum limit for relief on single donations to charities	−5	−5	−10
24 Charitable covenants: revised rules on powers of termination	*	*	*
25 Power to inspect charities' records	—	—	—
26 Friendly Societies Bill: consequential tax changes	—	—	—
Income tax and capital gains tax			
27 Changes to Personal Equity Plans	*	*	−10
28 Business Expansion Scheme: relaxation for mortgage rescues	*	*	−5
29 Abolition of the Business Expansion Scheme for trading companies	—	—	*
30 Retirement benefits schemes: indexation of earnings cap	*	—	—
Capital gains tax			
31 Indexation of the annual exempt amount	—	—	—
Inheritance tax			
32 Increase of £10 000 in threshold	−30	−10	−20
33 Increases to 100 per cent and 50 per cent in rates of business and agricultural relief	−10	−10	−25
Tax appeals			
34 Procedural rules for appeal hearings	—	—	—
TOTAL INLAND REVENUE	**−2 480**	**−1 310**	**−1 710**

* = *Negligible* — = *Nil*

Table 4.1 Direct effects of Budget measures—*continued*

See Annex A paragraph numbers	£ million Estimated effect on receipts in: 1992–93 Changes from a non-indexed base	 Changes from an indexed base	 1993–94 Changes from an indexed base
CUSTOMS AND EXCISE			
Value added tax			
35 Increase in registration threshold	★	★	★
36 Introduction of monthly payments on account instead of monthly returns	−200	−200	★
37 Reduction in penalties	−35	−35	−35
38 Removal of restriction on input tax recovery for certain business cars	−50	−50	−100
39 Removal of VAT charge on employee's salary forgone in return for provision of company car	★	★	★
40 Amendment of VAT fuel scale charges	+5	+5	+5
41 Reliefs for charities	★	★	★
42 Relaxation of rules for cash accounting	★	★	★
43 Treatment of supplies for non-monetary consideration: revised rules	—	—	—
44 Donated goods and equipment: revised treatment	—	—	—
Car tax			
45 Reduction in rate to 5 per cent	−635	−635	−765
Excise duties			
46 Increase in duty on beer of 4·5 per cent	+80	—	—
47 Increase in duty on wine and made wine of 4·5 per cent	+30	—	—
48 Increase in duty on spirits of 4·5 per cent	+50	—	—
49 Increase in duty on cider and perry of 4·5 per cent	★	—	—
50 Increase in duty on unleaded petrol of 4·5 per cent	+175	—	—
51 Increase in duty on derv of 4·5 per cent	+105	—	—
52 Increase in duty on rebated oils of 4·5 per cent	+10	—	—
53 Increase in duty on leaded petrol of 7·5 per cent	+375	+150	+145
54 Increase in duty on cigarettes of 10·4 per cent	+510	+290	+325
55 Increase in duty on cigars and hand-rolling tobacco of 10 per cent	+30	+15	+20
56 Increase in duty on pipe tobacco of 4·5 per cent	★	—	—
57 Reduction in rate of general betting duty to 7·75 per cent	−15	−15	−15
58 Abolition of match and mechanical lighter duties	−5	−5	−15
59 Exemption of members' clubs from bingo duty	−5	−5	−5
TOTAL CUSTOMS AND EXCISE	**+425**	**−485**	**−440**
Vehicle excise duty			
60 Increase of £10 in rate for cars, light goods vehicles and taxis	+240	+135	+140
61 Introduction of three new classes for heavy goods vehicles	+5	+5	+5
62 Introduction of new class for small tricycles	★	★	★
63 No change in rates for other vehicles	—	−30	−30
64 Minor changes to legislation for selling special registration marks	★	★	★
TOTAL VED	**+245**	**+110**	**+115**
Business rates			
65 Changes to transitional arrangements and consequential changes for Scotland and Northern Ireland	−480	−480	−590
TOTAL BUSINESS RATES	**−480**	**−480**	**−590**
National insurance contributions			
66 Consequential effects of changes to car and fuel benefit scales on employers' contributions	—	—	+25
67 Increase in threshold for quarterly payments for small employers	−5	−5	★
TOTAL NATIONAL INSURANCE CONTRIBUTIONS	**−5**	**−5**	**+25**
TOTAL BUDGET CHANGES IN TAXATION AND NATIONAL INSURANCE	**−2 295**	**−2 170**	**−2 600**

★ = *Negligible* — = *Nil*

Annex A to Chapter 4

This annex explains the general approach used in Table 4.1 to estimate the effects on receipts of Budget measures. It also provides more detail on specific measures. Table 4A.1 shows the effects of tax changes announced before the Budget.

Explanatory notes to Table 4.1

Table 4.1 gives the direct effects on receipts of changes in taxation and national insurance. Estimates are rounded to the nearest £5 million. "Negligible" means less than £3 million. Measures are costed in the order in which they appear in the table.

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

Thus the direct effects are estimated subject to the constraint that, in general, total incomes and total expenditure are fixed at their post-Budget levels. In other words the estimates in the table do not include income effects—that is, effects arising solely from the impact of changes in taxes on disposable income. Nor do they include the effects of changes in the tax base arising from changes in pre-tax incomes, the general level of prices or other macro-economic variables which may result from the proposed tax changes.

Other behavioural effects are taken into account where it is thought that they will have a significant effect on the yield, for example tax changes which alter the allocation of savings between different financial instruments or affect the composition of expenditure. Some change between the pre- and post-Budget tax bases is thus implicitly allowed for in these cases, subject to the overall constraint on total incomes and expenditure outlined above.

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

Most of the figures for direct effects shown in Table 4.1 represent the change in the yield of the tax in question. Where appropriate, however, the effects on the yield of other taxes are also incorporated. For example, the direct effect of a change in the excise duties on tobacco incorporates, in addition to the change in the yield from tobacco duties, the change in the yield of VAT and other excise duties resulting from changes in the composition of consumers' expenditure. As a general rule, only repercussions on the yield of other taxes of the same type are allowed for, such as other taxes on expenditure in the case of tobacco duties but not taxes on income or profits.

The post-Budget forecast of each tax given in Table 1.2 and Chapter 6 takes account of all the effects of the measures announced in the Budget, and not just the direct effects included in Table 4.1.

The figures in the first column of Table 4.1 show the direct effect of the Budget proposals on receipts in 1992–93. Budget proposals are compared with a non-indexed base—that is, with the pre-Budget regime of allowances, thresholds and rates of duty at 1991–92 levels.

The figures in the second column show the direct effect of the Budget proposals on receipts in 1992–93 measured against an indexed base. The indexed base for 1992–93 is obtained by increasing allowances, thresholds and rates of duty in line with the increase in the RPI over the year to December 1991 (4·5 per cent).

The figures in the third column show the direct effect on receipts in 1993–94, also measured against an indexed base. For this comparison, both the Budget proposals and the indexed base for 1992–93 have been further indexed by the forecast movement in the RPI between the fourth quarters of 1991 and 1992 (shown in Table 3.1)

The following notes refer by number to individual line entries in Table 4.1 and to paragraphs in Chapter 4.

Income tax

1–5 and **7** See 4.03.

6 See 4.02. The cost in 1993–94 includes the effects of statutory indexation of the lower rate limit for 1993–94. There is also a public expenditure cost of £30 million in 1992–93 and £35 million in 1993–94 in respect of mortgage interest relief at 25 per cent for those liable to tax only at the new lower rate. This will be charged to the Reserve.

8 From April 1993 married couples will, by agreement, be able to choose to set all of the married couple's allowance against the wife's instead of the husband's income, or to share it equally. Alternatively, married women will be able to choose to set half of the married couple's allowance against their own income instead of their husband's. If none of these options is taken, the allowance will be given to the husband, as now. The cost of £10 million is based on the assumption that couples will choose to set the allowance against the wife's income where she is a higher rate taxpayer and he is not, thus reducing the couple's total tax liability.

9–11 See 4.05 and 4.06. The effect of the changes in car and fuel benefit scales on employers' national insurance contributions is at line 66 in Table 4.1. The effect of the similar change to VAT fuel scales is at line 40 in Table 4.1.

12 The rules for tax relief on maintenance payments will be changed to take account of the establishment of the Child Support Agency in 1993.

13 The tax rules governing certificates of deposit will be amended to enable paperless, or "dematerialised", certificates of deposit to be treated in the same way as paper certificates.

14 The current rules which require payers of dividends to forward vouchers to the payee along with the payment itself will be updated to take account of changes in the handling of dividend payments and in particular electronic transfer.

15 The provisions governing the making of returns on interest paid to non-residents will be brought into line with those on the deduction of tax from this interest.

16 See 4.13. The abolition of the statutory remuneration to paying and collecting agents will give a public expenditure saving of some £1½ million a year.

17 See 4.11. This line shows the effect on income tax receipts. The effect on receipts of national insurance contributions is at line 67 in Table 4.1.

Income tax and corporation tax

18 See 4.10. The cost of relaxing the restrictions on capital allowances for most business cars is expected to rise to a maximum of £220 million in later years.

19 Capital expenditure on computer software acquired under licence will qualify for 25 per cent plant and machinery capital allowances from 10 March 1992, bringing it into line with computer software acquired outright.

20 See 4.15.

21 With effect from 10 March 1992 where rent for a chargeable period is payable in arrear between connected persons, and the rent is an allowable expense of the payer, the recipient of the rent will be chargeable to tax on the rent which accrued in that period. The yield arises from the change in the basis of liability to tax on rent payable under existing arrangements; a further yield of £100 million is expected in 1994–95. Without this measure there could be a significant loss of tax in the future.

22 Insolvent former deposit takers which have ceased trading and are in compulsory liquidation will be allowed relief, against income arising from their former trade, for losses carried forward and for certain expenses. Relief will apply for chargeable periods ending after 10 March 1991.

23 See 4.07.

24 The rules for tax relief for charitable covenants will be amended so that a power to terminate a covenant will be ignored until it is exercised, provided that it cannot be exercised within the minimum period.

25 The power to inspect charities' records of donations under the Gift Aid scheme will be extended to cover other income on which charities claim tax repayments.

26 The 1992 Friendly Societies Bill, when enacted, will enable registered friendly societies to incorporate, form subsidiaries and generally extend the scope of the financial services they can provide. The Budget measures will eliminate the tax charges which would otherwise arise on incorporation, and which would act as a disincentive to incorporation. They will also extend to incorporated societies the limited tax exemptions which apply to registered societies.

Income tax and capital gains tax

27 With effect from 6 April 1992 it will be possible to subscribe up to £6 000 a year to a general PEP in investment or unit trusts with at least half of their holdings in EC equities. The cost of this measure is expected to rise in later years.

28 See 4.12. Some technical changes concerning property management subsidiaries will also be made.

29 See 4.12. The relief on private rented housing was already due to expire at the end of 1993. The saving in later years from also abolishing relief for trading companies is £15 million. In 1994–95 there will be some extra cost as a result of acceleration of investment to 1993–94. The total saving from the abolition of all reliefs under the Business Expansion Scheme will be £130 million in later years.

30 The maximum level of earnings for which pension provision may be made with tax relief under the Finance Act 1989 will be increased. It will rise to £75 000 in line with the statutory indexation provisions (based on the increase of 4·5 per cent in the Retail Prices Index in the year to December 1991).

Capital gains tax

31 See 4.09. The estimated full year cost of indexation of the capital gains tax annual exempt amount in respect of 1992–93 liabilities is £5 million.

Inheritance tax

32 See 4.17. The estimated full year cost of the increase in the inheritance tax threshold attributable to taxable estates in 1992–93 is £25 million, measured against an indexed base.

33 The new 100 per cent rate of business and agricultural relief will apply to business assets and farmlands that currently qualify for 50 per cent relief with two changes. It will be extended to holdings of more than 25 per cent without control in Unlisted Securities Market (USM) companies. But controlling holdings in fully quoted companies will continue to receive 50 per cent relief. 50 per cent relief will also apply to business assets and farmland that currently qualify for 30 per cent relief and to holdings of 25 per cent or less without control in USM companies. These changes to business and agricultural relief will take effect from 10 March 1992. The estimated full year cost of these changes attributable to transfers in 1992–93 is £55 million.

Tax appeals

34 Procedural rules for hearing tax appeals, including powers for the Special Commissioners to award costs where either party has acted wholly unreasonably in pursuing an appeal, will be introduced. The new rules will not come into effect before 1 April 1993.

Value added tax

35 The turnover threshold for VAT registration will be raised from £35 000 to £36 600 from 11 March 1992, and the deregistration threshold from £33 600 to £35 100 from 1 May 1992.

36 See 4.31. There is a cost to this measure because the once-off cashflow gain from the system of monthly payments on account will be less than that from the system of monthly returns which had been announced. The main reason is that the size of payments on account will be determined by past, not present, VAT payments. See also Table 4A.1.

37 See 4.32.

38 See 4.33.

39 See 4.34.

40 See 4.06.

41 From 1 April 1992 VAT relief for charities and the disabled will be extended to boats built or substantially adapted for use by handicapped people; the provision of special toilet facilities for handicapped people in charity-run buildings used for charitable purposes; repairs and maintenance of equipment used for talking books for blind people; and replacement engines, spare parts and accessories for lifeboats.

42 See 4.30.

43 The wording of the VAT law regarding supplies made for a non-monetary consideration will be revised to bring the provision into line with the relevant European Community Directive. No change in practice is involved.

44 Certain supplies made for no consideration (such as obsolete computer equipment donated to educational establishments) will be valued for VAT purposes at their current value rather than their original cost, after Royal Assent to the Finance Bill.

Car tax 45 See 4.19.

Excise duties 46 The increase in duty plus VAT is equivalent to about 1p on a pint of beer.

47 The increase in duty plus VAT is equivalent to about 5p on a 75cl bottle of still wine, about 8p on a 75cl bottle of sparkling wine, about 8p on a 70cl bottle of sherry and about 10p on a 75cl bottle of port.

48 The increase in duty plus VAT is equivalent to about 28p on a 70cl bottle of spirits.

49 The increase in duty plus VAT is equivalent to about 1p on a pint of cider or perry.

50 The increase in duty plus VAT is equivalent to 1·2p on a litre of unleaded petrol. The tax differential in favour of unleaded petrol will consequently rise from 4·0p to 5·1p a litre.

51 The increase in duty plus VAT is equivalent to 1·2p on a litre of derv.

52 The duty on gas oil and fuel oil will rise by 4·5 per cent, equivalent to about 0·06p and 0·04p respectively a litre. (Gas oil and fuel oil supplied to domestic users are zero-rated for VAT.)

53 The increase in duty plus VAT is equivalent to 2·3p on a litre of leaded petrol.

54 The increase in duty plus VAT is equivalent to 13p on a packet of 20 cigarettes.

55 The increase in duty plus VAT is equivalent to about 6p on a packet of five small cigars and about 38p on a 50 gram packet of hand-rolling tobacco.

56 The increase in duty plus VAT is equivalent to about 8p on a 50 gram packet of pipe tobacco.

57 See 4.25.

58 See 4.26.

59 See 4.27.

Vehicle excise duty 60 The duty on vehicles registered in the private and light goods class, and the duty on taxis, will increase to £110, from 11 March 1992.

61 Three new VED classes for lorries will be introduced from 1 January 1993, to deal with vehicles that will be able to operate in the UK from that date. The rate for the heaviest lorry will be £5 000.

62 A new VED rate of £15 will be introduced for small motorized tricycles with an engine capacity of under 150cc, from 11 March 1992.

63 All other VED rates will remain unchanged.

64 The arrangements for charging fees for special vehicle registration marks will be reformed, to enable a charge to be made when a mark is not transferred to a vehicle within 12 months of it having been reserved.

Business rates 65 See 4.35–4.39.

National insurance contributions 66 See 4.05 and 4.06. This line shows the consequential effects on national insurance receipts. The effects on income tax receipts are at lines 9–11 in Table 4.1.

67 See 4.11. This line shows the effect on national insurance receipts. The effect on income tax receipts is at line 17 in Table 4.1.

Direct effects of tax changes already announced

Table 4A.1 shows the current estimates of changes in tax receipts arising from major tax changes announced before the Budget. These effects have not been included in Table 4.1 but are shown in Table 1.1. The estimates are based on the same conventions as Table 4.1.

Table 4A.1 **Direct effects of tax changes already announced**

		£ million Changes from an indexed base Estimated effect on receipts in: 1991–92	1992–93	1993–94
A.1	PAYE: new coding arrangements (K codes)	—	—	+270
A.2	Enterprise Zone capital allowances	—	−5	−75
A.3	Stamp duty on securities: abolition postponed	+5	+810	+40
A.4	Stamp duty on property: temporary rise in threshold	−110	−290	—
A.5	VAT: monthly returns	—	+1 500	*
A.6	VAT: postponed accounting	—	−1 300	*
A.7	VAT and excise duties: abolition of duty-paid allowances	—	−35	−250
Total		−105	+680	−15

— = *Nil* * = *Negligible*

Explanatory notes to Table 4A.1

A.1 The arrangements announced on 24 October 1991 introduced a new type of PAYE code (K codes) as a means of collecting tax on large benefits packages through PAYE, instead of by assessment at the end of the tax year. Although, in some cases, this will lead to earlier payment of tax and a once-off cash flow gain in 1993–94, there is no change to tax liabilities.

A.2 These effects are due to the relaxation of qualifying conditions for allowances announced on 16 December 1991. The total cost of this measure is estimated to be in the range £150–£300 million spread over 4 or 5 years. The actual cost will depend on a number of factors which cannot reliably be foreseen. The cost arising in the first two years will also be affected by the speed with which Enterprise Zone properties are let and sold. The estimated cost shown for 1993–94 is therefore particularly tentative.

A.3 Under the Finance Act 1990 the abolition date for the duties on securities is to be appointed by Order; it will coincide as closely as possible with the introduction of the Stock Exchange's new system for paperless share transfers (TAURUS). Under the Finance Act 1991 duties on transfers of property other than land and buildings will be abolished from the same date as the duties on securities. In the 1991–92 FSBR abolition was assumed to take effect from 1 April 1992 but, in the light of progress on the TAURUS system, the Chancellor confirmed on 19 December 1991 that the abolition date would be delayed until at least April 1993.

The figures below show how the additional receipts shown in Table 4A.1 have been estimated. The first column shows the latest estimate of the change in receipts if abolition had taken place in April 1992, as envisaged in the 1991 Budget. (They assume TAURUS would be implemented from 1 April 1993.) The second column shows the estimated effect of abolition in April 1993. The final column is the difference between the first and second columns, and represents the gain in receipts from the postponement of abolition. The figures in this column are shown in Table 4A.1.

	£ million		
	1 April 1992 abolition	1 April 1993 abolition	Effect of postponement
1991–92	+20	+25	+5
1992–93	−770	+40	+810
1993–94	−830	−790	+40

These estimates take account of the impact which the announcement of abolition is expected to have had on the value of share transactions and the consequential effect of these changes on stamp duties and other taxes.

A.4 The threshold is increased to £250 000 from 20 December 1991 to 19 August 1992.

A.5 The system of monthly returns for the largest VAT traders, announced on 21 October 1991, would have led to earlier payment of tax and a once-off cashflow effect in 1992–93, but no change to VAT liabilities. The cost of the Budget measure which substitutes a system of monthly payments on account, instead of monthly returns, is shown at line 36 in Table 4.1.

A.6 The reintroduction of postponed accounting for goods and services coming from other European Community countries from 1 January 1993 will lead to later payment of tax and a once-off cashflow effect in 1992–93. However, there is no change to VAT liabilities. Lower forecasts of imports have reduced the estimated cost.

A.7 The abolition of duty-paid allowances with the establishment of the Single Market on 1 January 1993 will result in increased cross-border shopping. This will reduce receipts from VAT and excise duties on goods bought in the UK. The effects shown take no account of possible implications of the abolition of frontier controls on the scope for fraud. Control systems to replace frontier controls have been developed and will be in place from 1 January 1993.

Annex B to Chapter 4

Tax allowances and reliefs

4B.1 This annex provides estimates of the revenue cost of some of the main tax allowances and reliefs. The larger the reliefs, the higher rates of tax have to be in order to finance Government expenditure, other things being equal.

4B.2 Tax reliefs can serve a number of purposes. In some cases they may be used to assist or encourage particular individuals, activities or products. They may thus be an alternative to public expenditure. In this case they are often termed " tax expenditures ". There may, for instance, be a choice between giving relief as an allowance or deduction against tax, or by an offsetting cash payment (as in the previous investment grant arrangements and in the present MIRAS scheme). Reliefs most evidently designed to support particular policy objectives include the reliefs for owner occupation, pensioners and charities.

4B.3 Many allowances and reliefs can reasonably be regarded as an integral part of the tax structure. Some do no more than recognise the expenses incurred in obtaining income. Others reflect a more general concept of " taxable capacity ": the personal allowances are a good example. To the extent that income tax is based on ability to pay, it does not seek to collect tax from those with the smallest incomes. But even with structural reliefs of the latter kind, the Government has some discretion about the level at which they are set.

4B.4 Many other reliefs combine both structural and discretionary components. Capital allowances, for example, provide relief for depreciation at a commercial rate as well as an element of accelerated relief. It is the latter element which represents additional help provided to business by the Government, and is a " tax expenditure ".

4B.5 The estimates in Table 4B.1 below show the total cost of each relief. They do not distinguish the elements which can be regarded as " tax expenditures ".

4B.6 The loss of revenue associated with tax reliefs and allowances cannot be directly observed, and estimates have to be made. This involves calculating the amount of tax that individuals or firms would have had to pay if there were no exemptions or deductions for certain categories of income or expenditure, and comparing it with the actual amount of tax due. The Government regularly publishes such estimates for Inland Revenue taxes, most recently in Appendix D of the Statistical Supplement to the 1991 Autumn Statement. Largely because of the difficulties of estimation, the published table does not provide a comprehensive coverage of all reliefs.

4B.7 The estimated costs for 1991–92 of some of the main Inland Revenue allowances and reliefs are reproduced in Table 4B.1. In many cases the estimated costs are extremely tentative, and based on simplifying assumptions. The figures are not directly comparable with those in Table 4.1; for example, they are on an accruals basis rather than a receipts basis. But more importantly, they make no allowance for the fact that changes in tax reliefs may cause people to change their behaviour. For example, removing the tax privileges of one form of saving may lead people to switch to another tax privileged form of saving.

4B.8 Table 4B.1 also gives details of reliefs relating to VAT, which is collected by Customs and Excise. It shows the estimated yield forgone in 1991–92 by not applying the standard rate of VAT ($17\frac{1}{2}$ per cent) to goods and services which are currently zero-rated. The figures are estimates and must be treated with caution. In line with the treatment of Inland Revenue taxes, they make no allowance for changes in behaviour.

4B.9 The estimated costs of reliefs and allowances given in Table 4B.1 cannot be added up to give a meaningful total. For example, in the case of income tax, many more taxpayers would be charged at the higher rate of 40 per cent (and the value of tax reliefs available at the higher rate would be correspondingly greater) if there were no personal allowances. The combined yield of withdrawing personal allowances and these reliefs would therefore be higher than the sum of individual costs.

Table 4B.1 Tax allowances and reliefs: estimated costs in 1991–92

	£ billion
Personal tax	
income tax allowances	32·4
mortgage interest relief	6·1
life assurance premiums[1]	0·3
pension schemes, relief for:	
—occupational pension schemes	9·1
—personal pensions	1·3
other savings[2]	1·0
employee participation[3]	0·3
charities[4]	0·9
capital gains tax:	
—annual exemptions	0·3
—main residence relief	2·0
inheritance tax nil rate band	4·0
Business tax	
capital allowances	
—public corporations	0·3
—North Sea oil and gas production	1·2
—other companies and self-employed	10·7
double taxation relief[5]	2·3
VAT zero rates[6]	
food	7·0
domestic fuel and power	2·5
construction of new dwellings[7]	3·4
passenger transport[8]	2·3
books, newspapers etc	1·0
children's clothing	0·6
water and sewerage services	0·5
drugs and medicines on prescription	0·4

[1] *For policies taken out before 14 March 1984.*
[2] *Includes various National Savings instruments, BES, PEPs, SAYE and TESSAs.*
[3] *Includes approved profit sharing schemes, savings-linked share option schemes, share option schemes and profit-related pay.*
[4] *Includes reliefs under income tax, inheritance tax and VAT.*
[5] *For accounting periods ending 1988–89.*
[6] *Not all expenditure under these headings is zero-rated.*
[7] *Includes zero-rated expenditure on land purchased for construction of new dwellings.*
[8] *Includes aviation (which was omitted from the corresponding figure last year).*

Detailed notes for Inland Revenue taxes are provided in Appendix D of the Statistical Supplement to the 1991 Autumn Statement (Cm 1920). These figures have been taken from there with one exception. The figure for "income tax allowances" is slightly higher than the sum of the published figures for the constituent parts, for the reason given in 4B.9.

5 Public expenditure

5.01 The Government's expenditure plans for the next three years were announced in the 1991 Autumn Statement (Cm 1729) and set out in detail in Departmental Reports and the Supplement to the Autumn Statement (Cm 1901–1920). They are summarised in Table 5.1.

Table 5.1 Public expenditure

	£ billion				
	1990–91 Outturn	1991–92 Estimated outturn	1992–93 Plans	1993–94 Plans	1994–95 Plans
Central government expenditure[1]	**140·6**	**156·6**	**168·7**	**178·1**	**185·4**
Of which:					
Department of Social Security	52·0	61·5	66·0	71·2	74·5
Department of Health and OPCS	22·4	25·7	27·9	29·8	31·5
Ministry of Defence[2]	21·8	22·9	24·2	24·5	24·8
Scotland	5·0	5·9	6·4	6·7	6·9
Wales	2·2	2·5	2·8	3·0	3·1
Northern Ireland	5·8	6·4	7·0	7·4	7·7
Other departments	31·4	31·7	34·5	35·6	36·9
Central government support for local authorities[3]	**42·5**	**53·3**	**58·5**	**61·1**	**63·9**
Of which:					
revenue/rate support grant	13·1	13·6	21·6	39·7	41·5
non-domestic rate payments	12·1	14·3	14·1		
current specific grants	12·3	19·8	16·6	15·3	16·1
credit approvals	4·0	4·3	4·5	4·5	4·6
capital grants	1·1	1·3	1·6	1·6	1·6
Financing requirements of nationalised industries	**2·2**	**2·6**	**3·4**	**2·9**	**2·2**
Privatisation proceeds	**−5·3**	**−7·9**	**−8·0**	**−5·5**	**−5·5**
Reserve			**4·0**	**8·0**	**12·0**
Planning total[1]	**180·0**	**204·7**	**226·6**	**244·5**	**258·0**
Local authority self-financed expenditure[4, 5]	14·9	11·1	9·5	10	10
Central government debt interest[5]	17·5	16·5	17·6	19½	21
Other adjustments[5]	3·6	4·2	4·7	5½	6
General government expenditure	**215·9**	**236·5**	**258·5**	**280**	**295**

[1] *Includes the financing requirements of public corporations other than the nationalised industries.*
[2] *Spending by Ministry of Defence in 1990–91 and 1991–92 is shown net of overseas governments' contributions to the cost of the Gulf conflict.*
[3] *Total planned support for local authorities between 1992–93 and 1994–95 is unaffected by the proposed changes in non-domestic rates, and remains at the levels set out in the Supplement to the 1991 Autumn Statement.*
[4] *Local authority self-financed expenditure is the difference between total local authority expenditure and central government support for local authorities. Total local authority expenditure is estimated at £57·4 billion and £64·4 billion respectively in 1990–91 and 1991–92. For 1992–93 to 1994–95 it is projected at £68 billion, £71 billion and £74 billion.*
[5] *1993–94 and 1994–95 figures rounded to nearest £½ billion.*

Changes from the previous Budget

5.02 The planning total for 1992–93 was set in the Autumn Statement at £226·6 billion, an increase of £5·6 billion over the level shown in the last Budget. For 1993–94 the planning total was increased by £13 billion. The new plans reflect the unavoidable pressures of the economic cycle, especially on social security, and honour the Government's commitments in full. They also provide for increases in spending in priority areas, particularly the NHS, and maintain the rising public transport investment programmes.

Budget measures

5.03 In October 1992, all income support rates for pensioners will be increased by £2 a week for single people and £3 a week for couples. The cost will be £145 million in 1992–93 and £305 million in 1993–94. This will be charged to the Reserve within the existing planning totals.

Projections of general government expenditure

5.04 The projections of general government expenditure (GGE) in Table 5.1 take account of the latest information on local authority spending in 1991–92 and on budgets for 1992–93. Total local authority spending next year is now expected to be £68 billion, compared with £67 billion in the Supplement to the 1991 Autumn Statement. The levels of local authority spending for the following two years have been projected forward using assumptions of real growth similar to those made in the Supplement. Central government debt interest projections have been increased from those in the Supplement to reflect the latest fiscal projections.

Public spending trends

5.05 General government spending, excluding privatisation proceeds, fell as a proportion of GDP from 47½ per cent in 1982–83 to 40 per cent in 1989–90, during a period of strong economic growth. Since then the recession has added to spending on social security and elsewhere and reduced national income relative to trend. In 1991–92 the ratio is likely to be 42 per cent; this is ½ per cent higher than the estimate shown in the Supplement to the 1991 Autumn Statement, mainly because of lower money GDP. The ratio is expected to be 43 per cent in 1992–93 and 1993–94, well below the levels seen following the recessions of 1974–75 and 1980–81, and then to resume a downward trend.

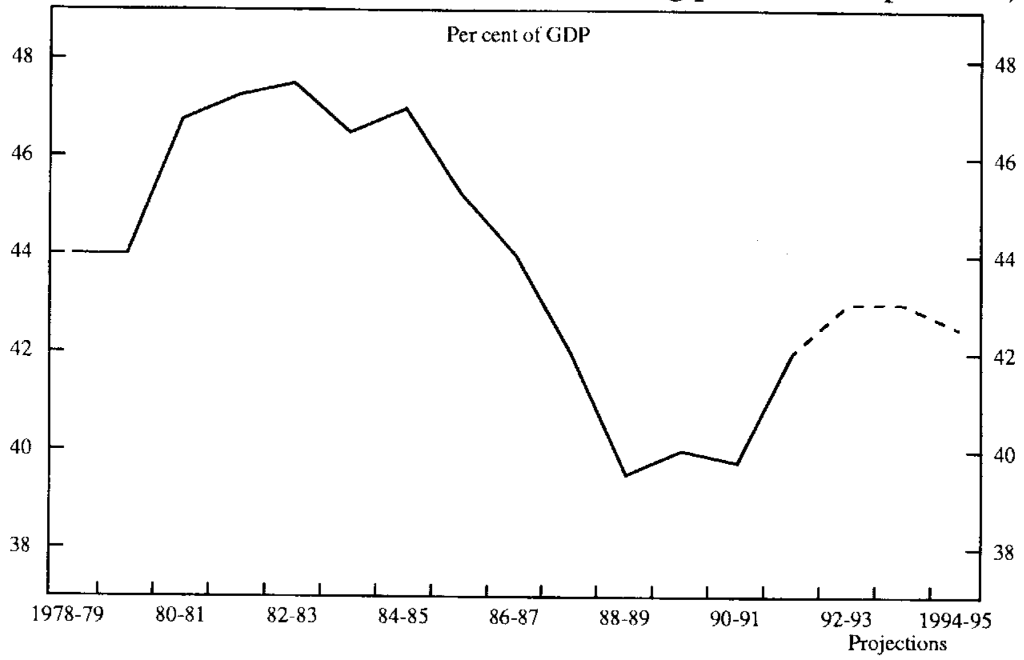
5.06 Table 5.2 shows the projected path of real GGE and the GGE ratio, taking account of the new assumptions about money GDP shown in Chapter 2. Chart 5.1 shows the GGE ratio between 1978–79 and 1994–95.

Table 5.2 General government expenditure

	£ billion				
	1990–91	1991–92	1992–93	1993–94	1994–95
General government expenditure, excluding privatisation proceeds					
cash	221·3	244·4	266·5	285	301
real terms[1]	221·3	228·5	238·6	247	253
per cent of GDP	39¾	42	43	43	42½

[1] *Base year 1990–91.*

Chart 5.1 General government expenditure (excluding privatisation proceeds)



1991–92 outturn

5.07 Table 5.3 shows the estimated outturn in 1991–92 for programme spending by spending sector and for privatisation proceeds. The estimated outturn for the planning total, which is still subject to some uncertainty, is £204·7 billion. This represents an underspend of £0·3 billion on the plans set out in the 1991 FSBR and the forecast outturn in the Supplement to the 1991 Autumn Statement. GGE is projected to be £236·5 billion, marginally above the forecast in the Supplement.

Table 5.3 Comparisons of plans and estimated outturn for 1991–92, by spending sector

	£ billion		
	Plans[1]	Estimated outturn	Outturn minus plans
Central government expenditure[2]	152·2	156·6	4·5
Central government support for local authorities	52·5	53·3	0·8
Financing requirements of nationalised industries	2·3	2·6	0·3
Privatisation proceeds	−5·5	−7·9	−2·4
Reserve	3·5	—	−3·5
Planning total	**205·0**	**204·7**	**−0·3**

[1] *Plans set out in the 1991 Budget, adjusted for classification changes.*
[2] *See footnote 1 to Table 5.1.*

5.08 The major changes between the 1991–92 programme plans in the 1991 Budget and the estimated outturn are:

Central government: higher social security spending, reflecting the effects of the economic cycle (£3·3 billion); higher health spending (£0·8 billion); higher spending on employment programmes (£0·2 billion); and higher spending on legal aid (£0·2 billion); partly offset by lower net contributions to the European Communities (£0·3 billion).

Support for local authorities: higher housing benefit (£0·3 billion); higher rent rebates (£0·2 billion); and increased grants for police, magistrates courts and probation (£0·2 billion).

Financing requirements of the nationalised industries: higher external finance for British Rail (£0·3 billion) reflecting lower revenues and receipts from land sales.

Composition of the planning total

5.09 About three-quarters of the planning total will be voted by Parliament. Voted expenditure covers the spending of government departments for their own activities, their funding of other bodies such as the National Health Service and most of central government's support for local authorities. Most of the rest consists of social security benefits paid out of the National Insurance Fund.

5.10 Table 5.4 shows voted and other expenditure, by spending sector, for 1990–91 and 1991–92, together with the plans for future years set out in the Supplement to the 1991 Autumn Statement.

Table 5.4 The planning total: voted and other expenditure, by spending sector

£ billion	1990–91 Outturn	1991–92 Estimated outturn	1992–93 Plans	1993–94 Plans	1994–95 Plans
Central government expenditure[1]	**140·6**	**156·6**	**168·7**	**178·1**	**185·4**
Of which:					
Voted in Estimates	100·3	113·8	119·6	126·0	131·2
Other	40·3	42·8	49·2	52·1	54·3
Central government support for local authorities[2, 3]	**42·5**	**53·3**	**58·5**	**61·1**	**63·9**
Of which:					
Voted in Estimates	37·4	47·8	52·8	na	na
Other	5·1	5·6	5·7	na	na
Financing requirements of nationalised industries	**2·2**	**2·6**	**3·4**	**2·9**	**2·2**
Of which:					
Voted in Estimates	3·6	2·5	3·0	2·8	2·4
Other	−1·4	0·1	0·4		−0·2
Privatisation proceeds	**−5·3**	**−7·9**	**−8·0**	**−5·5**	**−5·5**
Reserve			**4·0**	**8·0**	**12·0**
Planning total	**180·0**	**204·7**	**226·6**	**244·5**	**258·0**

[1] *Includes the financing requirements of public corporations other than the nationalised industries as follows:*

1·1	*1·2*	*1·2*	*1·3*	*1·5*

[2] *The split between voted and non-voted support for local authorities in 1993–94 and 1994–5 is not available. For these years plans have been set for the total of revenue support grant and non-domestic rate payments combined. In England and Wales all payments from the non-domestic rates pool are voted but in Scotland local authorities continue to receive business rates direct from business rate payers.*

[3] *See footnote 3 to Table 5.1.*

Supply Estimates **5.11** The total main Estimates provision for 1992–93 for which the Government is seeking Parliamentary approval is shown in Table 5.5. The main Estimates are published in a series of booklets on 10 March 1992 with a Summary and Guide (Cm 1844) which explains how they relate to the planning total and describes the Supply procedure.

5.12 Of the £184·5 billion included in the main Supply Estimates, £176·6 billion is within the planning total. The remaining £7·9 billion is mostly transfers between public sector bodies which do not score in the planning total. Over 60 per cent of the money voted in Estimates is subject to cash limits.

Table 5.5 Supply expenditure

	£ billion			
	1990–91		1991–92	1992–93
	Expected outturn in 1991 Budget	Final outturn	Expected outturn	Provision in main Estimates
Main Supply Estimates	138·7	138·7	156·7	184·5
Supplementaries and net underspending	6·9	6·8	11·7[1]	
Total Supply expenditure	**145·6**	**145·4**	**168·5**	

[1] *Includes the additions to support for local authorities announced in the 1991 Budget.*

6 The public sector finances

6.01 This chapter brings together revenue (discussed in chapter 4) and spending (chapter 5) and provides an analysis and forecast of the public sector's overall financial position in 1991–92 and 1992–93. It begins with the latest forecasts for the public sector borrowing requirement (PSBR) in 1991–92 and 1992–93 and for the associated stock of debt outstanding. It then explains where the latest forecast for 1991–92 differs from those in the last Budget and Autumn Statement. The remaining sections analyse in more detail:

general government receipts and expenditure;

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

revenue and expenditure by economic category.

Public sector borrowing requirement and the stock of debt

PSBR **6.02** The latest forecast for 1991–92 is for a PSBR of £13·8 billion, equivalent to $2\frac{1}{4}$ per cent of GDP. This follows four years of debt repayments totalling £$26\frac{1}{2}$ billion. The estimate for 1991–92 is still subject to considerable uncertainty.

Table 6.1 Public sector borrowing requirement

	1990–91	1991–92		1992–93
	Outturn	1991 Budget	Latest estimate	Forecast
Public sector borrowing requirement				
£ billion	−0·5	7·9	13·8	28·1
per cent of GDP	0	$1\frac{1}{4}$	$2\frac{1}{4}$	$4\frac{1}{2}$
PSBR excluding privatisation proceeds				
£ billion	4·9	13·4	21·7	36·1
per cent of GDP	1	$2\frac{1}{4}$	$3\frac{3}{4}$	$5\frac{3}{4}$

6.03 The move from a small debt repayment in 1990–91 to a borrowing requirement of $2\frac{1}{4}$ per cent of GDP in 1991–92 is explained by the fall in economic activity. This reduced the growth in revenues—general government receipts are now estimated to be only $2\frac{1}{2}$ per cent higher than in 1990–91—and increased public expenditure.

6.04 Although the forecast is for a recovery in economic activity during 1992, the impact of the recession on the public finances will continue to increase the PSBR in 1992–93. Some tax receipts—including mainstream corporation tax, income tax from self-employment income and capital taxes—are collected in arrears, and these will be depressed by falling activity in 1990 and 1991. And the recession will still be raising public expenditure, because of the lagged effects on, for example, social security. As a result of these factors, and taking into account the net reduction in taxation announced in the Budget, the PSBR in 1992–93 is forecast at £28·1 billion, 4½ per cent of GDP. This estimate is subject to a wide margin of error; the average error over the past ten years on Budget forecasts of the PSBR for the year ahead is £6¼ billion at present-day prices.

Public sector debt

6.05 At the beginning of the current financial year, the net stock of public sector debt stood at £155½ billion, 27¼ per cent of GDP. The latest estimate of the PSBR for 1991–92 implies a small rise in the ratio of net public sector debt to GDP taking it to 28½ per cent of GDP at end-March 1992. The forecast for 1992–93 implies a further rise in the debt-income ratio to 31¼ per cent, well below the levels seen following the recessions of 1974–75 and 1980–81. At the end of 1984–85, the debt to income ratio stood at 47 per cent. (See Chart 2.5.)

Changes since last Budget and Autumn Statement

6.06 The latest forecast for the PSBR in 1991–92 is £6 billion higher than the forecast in last year's Budget and £3¼ billion higher than the forecast in the Autumn Statement. As Table 6.2 shows, the revisions since last year's FSBR mostly take the form of lower receipts, reflecting weaker than expected economic activity. General government expenditure is also higher than in last year's FSBR, reflecting higher spending outside the planning total. The public expenditure planning total is slightly lower than the estimate in last year's FSBR. The change to the PSBR since the Autumn Statement is almost entirely on the receipts side.

Table 6.2 Changes since 1991 Budget and Autumn Statement

	£ billion		
	Changes since 1991 Budget		Changes since Autumn Statement
	1990–91	1991–92	1991–92
Expenditure			
Privatisation proceeds	—	−2·4	+0·1
Other general government	−0·1	+4·1	+0·3
Public corporations' market and overseas finance	+0·3	−0·1	−0·3
Total expenditure	**+0·2**	**+1·6**	**—**
Receipts			
Inland Revenue taxes	−0·3	−3·5	−2·0
Customs and Excise taxes	+0·1	−0·4	−0·8
Social Security receipts	—	−0·4	−0·2
Other receipts	—	—	−0·2
Total receipts	**−0·1**	**−4·3**	**−3·2**
PSBR	**+0·4**	**+5·9**	**+3·3**

6.07 General government expenditure (GGE) excluding privatisation proceeds is now expected to be £4 billion higher than forecast in last year's Budget. Privatisation proceeds are £2½ billion higher mainly as a result of the BT share sale. The planning total is £¼ billion lower than last year's FSBR. Local authorities self-financed expenditure (LASFE) is £2 billion higher than the forecast in last year's FSBR, because of both higher current spending and higher capital expenditure. The latest forecast for GGE excluding privatisation proceeds in 1991–92 is £¼ billion up on the forecast in the Autumn Statement. The position on public corporations' market and overseas finance has not changed significantly from last year's Budget forecast.

6.08 Total Inland Revenue and Customs and Excise receipts are now forecast to be £4 billion lower than in last year's Budget forecast. Most of the downward revision to the Budget forecast is on Inland Revenue taxes, which are down by £3½ billion. Lower income tax receipts account for about half of this reduction; corporation tax, stamp duties, capital taxes and petroleum revenue tax (PRT) are also down. Customs and Excise taxes are £½ billion lower than in the Budget forecast; around half of this is due to lower VAT receipts. Much of the downward revision to the forecast of tax receipts reflects weaker current activity in one form or another—lower consumer spending (VAT), lower earnings growth and lower employment (PAYE income tax), lower house prices and housing turnover (stamp duties) and lower equity prices (stamp duties). North Sea revenues overall are down by £¼ billion, and stamp duty receipts have also been reduced by the temporary suspension of duty on most house sales. But there have also been downward revisions for certain other taxes mainly related to past activity, for example mainstream corporation tax and income tax on the self-employed.

6.09 Social Security receipts are expected to be £½ billion lower than forecast in the 1991 Budget, reflecting lower earnings growth and lower employment. The latest forecast of general government receipts for 1991–92 is £3¼ billion lower than the Autumn Statement forecast, reflecting the downward revision to the forecast of economic activity in the second half of 1991.

Public sector finances: receipts and expenditure

6.10 Table 1.2 gives the latest estimates for 1991–92, and forecasts for 1992–93, of general government expenditure and receipts, and their components.

Receipts

6.11 General government receipts are estimated to have risen by only 2½ per cent in 1991–92, about 2½ per cent below the estimated growth of money GDP. Receipts are forecast to rise by 3½ per cent in 1992–93, around 3 per cent below the forecast rise in money GDP. The Budget measures will reduce aggregate receipts by over £2 billion, but this will partially be offset by additional receipts of nearly £¾ billion from other measures announced since the last Budget. In addition, the second year effects of the 1991 Budget are likely to yield over £1½ billion additional receipts in 1992–93, mainly from the full year effect of the VAT rate rise. However, the lagged effects of earlier Budgets—for example the abolition of composite rate tax—will tend to reduce receipts.

6.12 More specifically, the forecast for 1992–93 is for:

—a 2½ per cent increase in income tax receipts;

—an 8½ per cent fall in receipts of corporation tax (including ACT and North Sea corporation tax);

—a 12½ per cent increase in VAT receipts;

—a 7½ per cent increase in receipts from excise duties on petrol, tobacco and alcohol;

—a 40 per cent fall in car tax receipts;

—a 2 per cent fall in receipts from business rates;

—a 6½ per cent increase in social security receipts;

—a 13½ per cent increase in net community charge receipts.

6.13 The further fall in corporation tax receipts forecast for 1992–93 partly reflects the 1991 Budget changes, but is mostly due to a fall in company profits in 1991. The small increase forecast for income tax receipts primarily reflects the Budget changes. It also reflects the start of repayments to non-taxpayers of tax deducted at source on bank and building society interest, following the abolition of composite rate tax from April 1991. Growth in consumer spending is forecast to resume in 1992, benefitting receipts of expenditure taxes. 1992–93 will also be the first full year of VAT receipts at the new 17½ per cent rate set in the 1991 Budget, which boosts growth in VAT receipts. Excluding the last effect, the forecast growth in VAT receipts is 9 per cent. The fall in car tax receipts reflects the Budget reduction in this tax.

6.14 North Sea revenues in 1991–92, at £1 billion, are £1½ billion lower than in 1990–91, because of lower oil prices and higher investment. This fall is £½ billion larger than forecast in last year's Budget. The net PRT repayment of £¼ billion in 1991–92 results from particularly high tax-relievable expenditure claimed on some oil fields. North Sea revenues in 1992–93 are forecast to be much the same as in 1991–92. Output in 1992 is expected to be somewhat higher than in 1991, but a fall in the average price of oil is forecast. North Sea revenues now represent around ½ per cent of total taxes, as compared with over 9 per cent in 1984–85 when they were at their peak.

Table 6.3 North Sea revenues

	£ billion			
	1990–91	1991–92		1992–93
	Outturn	1991 Budget	Latest estimate	Forecast
North Sea corporation tax[1]	1·0	0·9	0·7	0·6
Petroleum revenue tax	0·9	0·0	−0·2	0·1
Oil royalties	0·6	0·5	0·5	0·5
Total North Sea revenues	**2·5**	**1·4**	**1·0**	**1·2**
[1] *Before ACT set-off of:*	*0·5*	*0·5*	*0·4*	*0·3*

Taxes as a share of GDP

6.15 Table 6.4 and Chart 6.1 show both total taxes and social security contributions as a percent of GDP, and non-North Sea taxes and social security contributions as a percent of non-North Sea GDP. With North Sea revenues falling back after 1984–85, there is now little difference between the total and non-North Sea tax ratios. Both ratios were broadly flat over the latter 1980s, but both are expected to show a significant fall in 1991–92. This largely reflects the impact of the recession, particularly on corporation tax receipts which are estimated to have fallen by around ½ per cent of GDP.

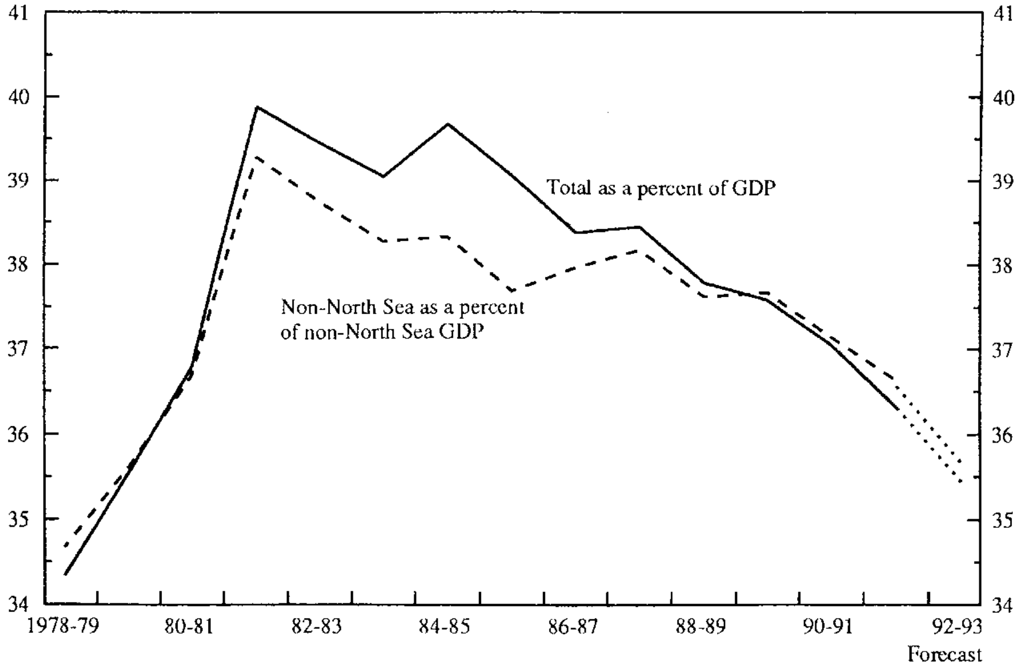
Table 6.4 Taxes[1] and social security contributions as a percent of GDP

	1986–87	1987–88	1988–89	1989–90	1990–91	1991–92 Latest estimate	1992–93 Forecast
Total taxes[1] and social security contributions as a share of total GDP	38½	38½	37¾	37½	37	36¼	35½
Non-North Sea taxes[1] and social security contributions as a share of non-North Sea GDP	38	38¼	37¾	37¾	37¼	36¾	35¾

[1] *Including community charge.*

6.16 Further falls for both ratios are projected for 1992–93. The Budget measures reduce the ratios by around ¼ per cent. Again there is a significant fall in corporation tax receipts. Part of this reflects the 1991 Budget measures, but most of it is attributable to the continuing impact of the recession. Corporation tax receipts are markedly cyclical.

Chart 6.1 Taxes and social security contributions



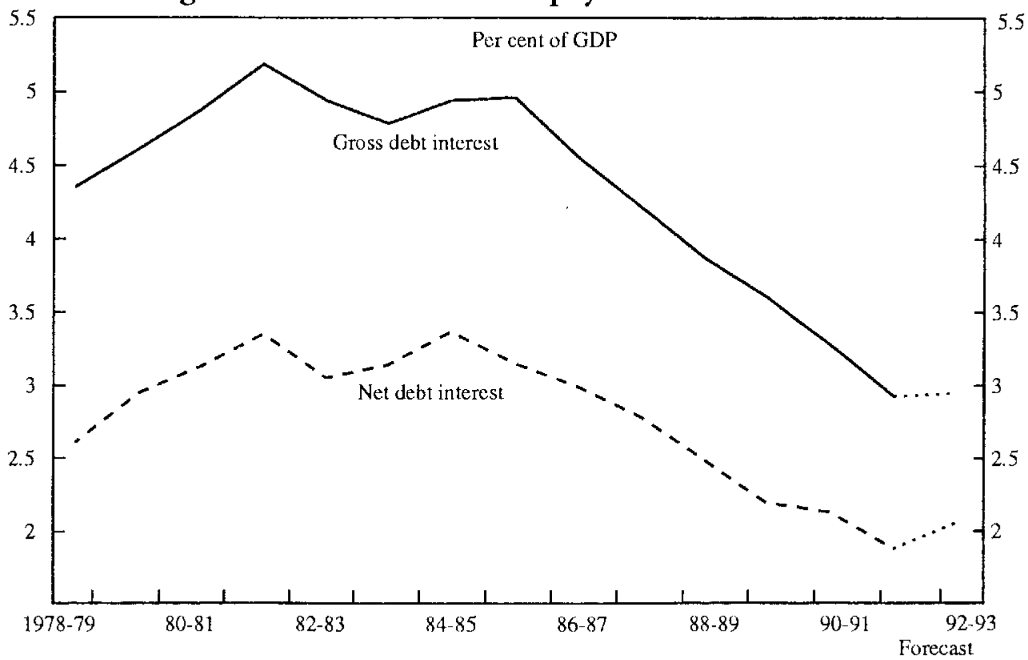
Expenditure

6.17 GGE excluding privatisation proceeds is now estimated to have increased by $10\frac{1}{2}$ per cent in 1991–92, rather faster than the growth in money GDP. As a result, the ratio of GGE excluding privatisation proceeds to GDP is estimated to have risen by around 2 percentage points, to 42 per cent. This rise in the ratio reflects the impact of the recession, which has pushed up spending in areas such as social security and reduced GDP.

6.18 The projections of spending trends set out in Chapter 5 show continued real growth in GGE up to 1994–95, reflecting the outcome of the last public expenditure Survey, and in particular the higher allocations for the Social Security and Health programmes. Local authority spending is now projected to be somewhat higher than assumed in the Autumn Statement. The GGE/GDP ratio is forecast to rise by a further 1 per cent in 1992–93, as spending continues to grow faster than economic activity. (See Chart 5.1.)

6.19 Within GGE, debt interest payments are estimated to have continued falling in 1991–92, both in cash terms and as a percent of GDP. But with the stock of debt now expected to rise again, the fall in debt interest payments in cash terms is forecast to be reversed in 1992–93. As a percent of GDP, however, gross debt interest payments are expected to be broadly flat between 1991–92 and 1992–93.

Chart 6.2 General government debt interest payments



Public sector's finances: analysis by sector

6.20 Table 6.5 shows borrowing in 1990–91 and 1991–92 by central government, local authorities and public corporations. The estimates for 1991–92 incorporate outturns for the first 10 months of the year and a provisional estimate of central government borrowing in February. Nevertheless, there is still a wide margin of error around the estimates for the year as a whole.

6.21 The increase in the PSBR between 1990–91 and 1991–92 is more than explained by a large increase in central government own account borrowing. The local authorities' borrowing requirement in 1991–92 is now forecast to be £1¾ billion lower than in 1990–91. And although there is an estimated increase of around £¾ billion in the public corporations' borrowing requirement, this is more than explained by special grants in 1990–91 to British Coal and Scottish New Towns totalling £1¾ billion, which were used to repay debt to central government. Excluding the effects of these grants, which are PSBR-neutral, public corporations' borrowing in 1991–92 is expected to be around £1 billion lower than in 1990–91. Although nationalised industries external finance in 1991–92 is likely to be £¼ billion higher than the 1991 plans, most of the overspend has been financed by extra grant from central government, which contributes to central government own account borrowing, rather than by higher borrowing by public corporations.

Table 6.5 Public sector borrowing requirement by sector

	£ billion			
	1990–91 Outturn		1991–92 Latest estimate	
1 Central government borrowing requirement on own account	**−2·9**		**12·3**	
2 Local authority borrowing requirement	**3·4**		**1·7**	
3 of which from: central government		1·5		0·7
4 market and overseas		2·0		1·0
5 Public corporations' borrowing requirement	**−1·0**		**−0·2**	
6 of which from: central government		−1·0		0·3
7 market and overseas		0·1		−0·5
8 Public sector borrowing requirement	**−0·5**		**13·8**	
Central government borrowing requirement (lines 1+3+6)	−2·5		13·4	

6.22 The reduction in the local authorities' borrowing requirement in 1991–92 mainly reflects the pattern of collection of the community charge and national non-domestic rates (NNDR). Problems with collection resulted in substantial shortfalls on budgeted receipts for both NNDR and community charge in 1990–91, which were financed through temporary borrowing. Most of the money not received in 1990–91 appears to have been collected in arrears during the course of 1991–92. In-year non-collection of 1991–92 community charge appears to be running at a similar rate to that seen in 1990–91, and the collection rate for NNDR has exceeded last year's level.

6.23 Tables 6.6 to 6.8 summarise the estimated outturns and forecasts for receipts and expenditure for each of the three sectors. (More detail is given in Table 6.9.) Table 6.6 sets out the forecast for central government transactions in the cash receipts and payments format which is used for the monthly outturn figures. (Figures on the accruals basis used in the Central Statistical Office's national accounts are in Table 6.9.) The forecast of the PSBR for 1992–93 assumes that the Reserve is fully spent, though the Reserve is unallocated and is not included in the expenditure estimates for individual sectors.

Central government **6.24** Growth in central government cash receipts, at $3\frac{1}{2}$ per cent, has been exceptionally low in 1991–92. This reflects the unusually small rise in tax receipts, because of falling economic activity in 1990 and 1991. On the expenditure side of the account, growth in net departmental outlays has been quite fast, at 14 per cent; the increase in total outlays, at $11\frac{1}{2}$ per cent, is smaller, reflecting a rise in privatisation proceeds. The result of this large gap between growth in cash outlays and growth in cash receipts has been a large rise in central government borrowing. The forecasts for 1992–93 are for a rise of $4\frac{1}{2}$ per cent in cash receipts and a rise of $10\frac{1}{2}$ per cent (excluding any allocation from the Reserve) in net departmental outlays.

Table 6.6 **Central government transactions on a cash receipts basis**

	£ billion		
	1990–91 Outturn	1991–92 Latest estimate	1992–93 Forecast[1]
Receipts			
Inland Revenue[2]	82·3	80·4	80·4
Customs and Excise[2]	55·3	61·8	67·4
Social security contributions (GB)	33·0	34·4	37·1
Interest and dividends	9·5	9·7	9·5
Other	14·8	15·9	16·6
Total receipts	**194·9**	**202·2**	**211·0**
Outlays			
Interest payments	15·9	15·4	16·7
Privatisation proceeds	−5·3	−7·9	−8·0
Net departmental outlays	181·4	207·0	229·0
Total outlays	**192·0**	**214·5**	**237·7**

[1] *Excluding any allocation from the Reserve.*
[2] *Payments to the Consolidated Fund.*

Local authorities **6.25** Local authorities total revenues are estimated to have increased by 16 per cent in 1991–92. This in part reflects the collection of some 1990–91 revenues in arrears (scored as other receipts in Table 6.7). Excluding 1990–91 arrears of NNDR and community charge, receipts increased by 13 per cent. Within this total, there has been a switch from community charge to central government current grants, as a result of the 1991 Budget. For 1992–93, total receipts include commutation grants of £4 billion from central government, most of which will be used to repay debt to central government and are therefore PSBR-neutral. (This item scores in Table 6.7 as capital grants.) Excluding these commutation grants, the forecast rise in local authorities' receipts in 1992–93 is around $6\frac{1}{2}$ per cent. The net revenue due from the community charge for 1992–93 is forecast to rise by 14 per cent. Taking account of collection of arrears for earlier years, and allowing for non-collection of next year's charge, actual community charge receipts may rise by $13\frac{1}{2}$ per cent.

6.26 Local authorities' current expenditure (including current grants, subsidies and interest) is estimated to have risen by 11½ per cent in 1991–92, and is forecast to increase by 6½ per cent in 1992–93. Gross capital spending is estimated to have risen by 2 per cent in cash terms in 1991–92 and is projected to remain about the same level in 1992–93. Local authority capital receipts fell in 1991–92, reflecting the depressed state of the domestic and commercial property markets; thus net capital spending recorded a substantial increase. A modest increase in capital receipts is anticipated for 1992–93, which will reduce net capital expenditure.

Table 6.7 Local authority transactions

	£ billion		
	1990–91 Outturn	1991–92 Latest estimate	1992–93 Forecast
Receipts			
Community charge[1]	11·4	7·4	8·4
Current grants from central government[2]	39·9	50·6	54·8
Capital grants from central government	2·3	2·7	7·1
Other[3]	4·6	6·9	5·8
Total receipts	**58·2**	**67·5**	**76·1**
Expenditure			
Current expenditure on goods and services	43·8	47·9	50·8
Current grants and subsidies	7·0	9·1	10·1
Interest	5·2	5·6	5·5
Capital expenditure[4] and net lending	5·5	6·7	6·5
Total expenditure[5]	**61·6**	**69·2**	**72·9**
	(57·4)	(64·4)	(68)

[1] *Net of rate rebates, community charge benefit, transitional relief and community charge reduction scheme. Includes district council rates in Northern Ireland.*
[2] *Including non-domestic rate income in 1991–92 and 1992–93.*
[3] *Includes interest receipts, rent, gross trading surplus and accruals adjustments, plus other miscellaneous receipts.*
[4] *Gross capital expenditure less capital receipts.*
[5] *The expenditure figures in this table are on a national accounts basis; the figures in brackets are equivalent figures on the public expenditure measurement basis used in Chapter 5.*

Public corporations

6.27 Trends in public corporations' finances have been obscured in recent years by changes in coverage of the sector arising from privatisations and other changes. The regional electricity companies are excluded from the figures in Table 6.8 from December 1990, National Power and PowerGen from March 1991, and Scottish Power and Scottish HydroElectric from June 1991. NHS trusts, which are classified as public corporations, are included from April 1991. Much of the reductions both in expenditure and in gross trading surplus shown in Table 6.8 for 1991–92 can be explained by the net impact of these changes. Capital spending by the remaining nationalised industries increased slightly in 1991–92. A substantially larger rise is forecast for 1992–93, reflecting the capital expenditure programmes of British Rail and London Regional Transport.

Table 6.8 Public corporations' transactions

	£ billion		
	1990–91 Outturn	1991–92 Latest estimate	1992–93 Forecast[1]
Receipts			
Gross trading surplus (including subsidies)	3·9	2·8	3·7
Capital grants from central government	3·2	2·0	2·0
Other	1·5	0·8	0·6
Total receipts	**8·7**	**5·5**	**6·3**
Expenditure			
Interest, dividends and taxes on income	2·9	1·6	1·8
Net lending and capital expenditure	4·9	3·7	5·0
Total expenditure	**7·8**	**5·3**	**6·8**
Public corporations' contribution to planning total:			
nationalised industries external finance	*2·2*	*2·6*	*3·4*
other public corporations.	*1·1*	*1·2*	*1·2*

[1] *Excluding any allocation from the Reserve.*

Public sector's finances: analysis by economic category

6.28 The full analysis of receipts and expenditure by economic category is shown in Table 6.9, with a breakdown between central government, local authorities and public corporations. This analysis, which distinguishes between current and capital transactions (and within the latter between physical and financial investment) shows the derivation of the public sector financial deficit. The financial deficit, unlike the PSBR, is not wholly a measure of cash transactions because certain items above line 25 in Table 6.9 (for example some taxes included in lines 1 and 2) are measured on an accruals basis. Accruals adjustments are accordingly made in lines 29 and 30.

6.29 The Reserve for 1992–93 is assumed to be spent on transactions that fall above the financial deficit line. In practice allocations from the Reserve can also affect financial transactions (lines 26–31).

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

	Line[1]	£ billion 1991–92 Latest estimate General government Central government	Local authorities	Total	Public corporations	Public sector
Current and capital receipts[2]						
Taxes on income, and oil royalties	*1*	76·2	—	76·2	−0·1	76·2
Taxes on expenditure	*2*	88·2	0·1	88·3	—	88·3
Taxes on capital	*3*	3·1	—	3·1	—	3·1
Social security contributions	*4*	37·1	—	37·1	—	37·1
Community charge	*5*	—	7·3	7·3	—	7·3
Gross trading surplus	*6*	−0·5	0·5	—	2·8	2·8
Rent and miscellaneous current transfers	*7*	0·6	3·6	4·3	0·6	4·9
Interest and dividends from private sector and abroad	*8*	4·0	1·2	5·1	0·6	5·7
Interest and dividends within public sector	*9*	5·9	−5·0	0·9	−0·9	—
Imputed charge for non-trading capital consumption	*10*	1·6	2·2	3·8	—	3·8
Capital transfers	*11*	—	0·1	0·1	—	0·1
Total receipts	*12*	**216·2**	**10·0**	**226·2**	**3·0**	**229·2**
Current and capital expenditure[2]						
Current expenditure on goods and services	*13*	76·2	47·9	124·1	—	124·1
Subsidies	*14*	5·8	0·6	6·4	—	6·4
Current grants to personal sector	*15*	66·7	8·5	75·2	—	75·2
Current grants paid abroad	*16*	2·1	—	2·1	—	2·1
Current grants within public sector	*17*	50·6	−50·6	—	—	—
Debt interest	*18*	16·5	0·6[3]	17·1	0·2[3]	17·2
Gross domestic fixed capital formation	*19*	7·2	6·0	13·2	3·4	16·6
Increase in stocks	*20*	0·2	—	0·2	0·3	0·5
Capital grants to private sector	*21*	3·3	0·8	4·1	0·1	4·1
Capital grants within public sector	*22*	4·6	−2·7	2·0	−2·0	—
Total expenditure	*23*	**233·3**	**11·2**	**244·4**	**1·9**	**246·3**
Reserve	*24*	—	—	—	—	—
Financial deficit	*25*	**17·1**	**1·1**	**18·2**	**−1·1**	**17·1**
Financial transactions						
Net lending to private sector and abroad	*26*	0·1	−0·1	—	—	—
Cash expenditure on company securities (including privatisation proceeds)	*27*	−8·3	—	−8·3	—	−8·3
Transactions concerning certain public sector pension schemes	*28*	−0·1	—	−0·1	—	−0·1
Accruals adjustments on receipts	*29*	5·0	−0·4	4·6	—	4·6
Other accruals adjustments	*30*	−0·9	−0·2	−1·1	−0·4	−1·5
Miscellaneous financial transactions	*31*	−0·6	1·3	0·6	1·2	1·9
Borrowing requirement	*32*	**12·3**[4]	**1·7**	**14·0**[4]	**−0·2**	**13·8**

[1] *Financial deficit (line 25) = expenditure (line 23) + Reserve (line 24) − receipts (line 12).*
Borrowing requirement (line 32) = financial deficit (line 25) + financial transactions (lines 26 to 31).
[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 requirements. (See Annex, para. 6A.14)*

Line[1]	£ billion 1992–93 Forecast General government Central government	Local authorities	Total	Public corporations	Public sector	
						Current and capital receipts[2]
1	76·8	—	76·8	−0·1	76·7	Taxes on income, and oil royalties
2	92·9	0·1	93·0	—	93·0	Taxes on expenditure
3	3·0	—	3·0	—	3·0	Taxes on capital
4	39·1	—	39·1	—	39·1	Social security contributions
5	—	8·3	8·3	—	8·3	Community charge
6	−0·5	0·5	—	3·7	3·7	Gross trading surplus
7	0·6	3·6	4·2	0·6	4·9	Rent and miscellaneous current transfers
8	3·5	0·8	4·3	0·7	5·0	Interest and dividends from private sector and abroad
9	6·0	−4·8	1·2	−1·2	—	Interest and dividends within public sector
10	1·6	2·2	3·8	—	3·8	Imputed charge for non-trading capital consumption
11	—	0·1	0·1	—	0·1	Capital transfers
12	**223·0**	**10·7**	**233·7**	**3·7**	**237·4**	**Total receipts**
						Current and capital expenditure[2]
13	80·0	50·8	130·9	—	130·9	Current expenditure on goods and services
14	5·5	0·6	6·1	—	6·1	Subsidies
15	71·4	9·6	81·0	—	81·0	Current grants to personal sector
16	5·4	—	5·4	—	5·4	Current grants paid abroad
17	54·8	−54·8	—	—	—	Current grants within public sector
18	17·6	0·7[3]	18·3	0·1[3]	18·4	Debt interest
19	7·4	6·2	13·5	4·7	18·2	Gross domestic fixed capital formation
20	0·2	—	0·2	0·2	0·4	Increase in stocks
21	3·5	0·5	4·0	0·1	4·1	Capital grants to private sector
22	9·1	−7·1	2·0	−2·0	—	Capital grants within public sector
23	**254·9**	**6·4**	**261·3**	**3·0**	**264·3**	**Total expenditure**
24					4·0	Reserve
25					**30·9**	**Financial deficit**
						Financial transactions
26	0·3	−0·2	—	0·1	0·1	Net lending to private sector and abroad
27	−8·0	—	−8·0	—	−8·0	Cash expenditure on company securities (including privatisation proceeds)
28	0·3	—	0·3	—	0·3	Transactions concerning certain public sector pension schemes
29	3·4	0·2	3·6	—	3·6	Accruals adjustments on receipts
30	−0·9	−0·2	−1·1	−0·2	−1·2	Other accruals adjustments
31	−0·2	1·3	1·1	1·3	2·5	Miscellaneous financial transactions
32					**28·1**	**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.

Cash basis

6A.2. 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 framework also corresponds closely to the way public expenditure is planned, controlled and accounted for.

6A.3. The main presentation of the public finances on a cash basis is given in Table 1.2. As far as possible, the figures in this table relate to actual cash flows. The estimates of taxes for example are for tax payments received during the year, rather than for liabilities incurred.

6A.4. There are however, a number of minor items within the definition of general government receipts (GGR) which are not on a cash basis:

—VAT which is refunded to central and local government, included in "other taxes and royalties";

—imputed contributions for statutory sick pay and statutory maternity pay, included in "social security receipts";

—an imputed flow for capital consumption by general government, included in "other receipts".

These flows also appear on the expenditure side of the account in "accounting adjustments", so that their effects cancel out when calculating the PSBR.

6A.5. The other remaining departure from a cash basis is the "central government debt interest" line, which scores the capital uplift on index-linked gilts as interest at the time it accrues. To correct for this, an accruals adjustment is made to "other receipts" which removes the accrued uplift scored and adds back any actual payments of uplift on redemptions.

6A.6. Tables 2A.1, 2A.3 and 2A.5 and 5.1 are all on the same basis as Table 1.2.

6A.7. The other cash-based table is Table 6.6, which shows the finances of central government. Unlike the earlier tables, this is genuinely a cash presentation; 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.8. 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 6.7 and 6.8, are presented on the national accounts basis described below.

National accounts basis

6A.9. This is the internationally agreed framework within which the accounts for the UK economy as a whole are produced by the CSO. 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 sectors.

6A.10. Table 6.9 provides 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, are recorded on an accruals rather than a cash payments basis;

—current and capital transactions are separately identified, and both are grouped by economic category (so that, for example, transfer payments are distinguished from expenditure on goods and services);

—the value of some transactions is imputed where no money changes hands.

6A.11. Tables 2A.2, 2A.4, 2B.2, 6.4, 6.7 and 6.8 are all on the same basis as Table 6.9.

6A.12. An accruals basis is used to calculate taxes (and social security contributions and community charge) as a percent of GDP (Table 6.4), 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.

6A.13. As Table 6.9 shows, it is still possible to build up the PSBR in terms of national accounts concepts, even though these include imputed and accrued flows. This is because the imputed flows appear on both sides of the account and so cancel out, and the financial transactions include adjustments for the difference between accruals and cash flow (lines 29 and 30 of Table 6.9).

Borrowing requirements

6A.14. The PSBR can be disaggregated into component borrowing requirements in different ways. Table 1.2 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 6.9 (line 32), 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 this table 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 Table 6.5).

6A.15. General government expenditure is derived from the planning total, as shown in Table 1.2. But it can also be derived from the general government column of Table 6.9 by taking total expenditure (line 23) and adding:

—the Reserve (line 24, all assumed to be general government);

—net lending to the private sector and abroad (line 26);

—cash expenditure on company securities (line 27);

—and net lending to public corporations (from Table 6.5).

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