

**Table 6.9 National Loans Fund receipts and payments**

	£ million	
	1984-85	
	Budget forecast	Latest estimate
<b>Receipts</b>		
Interest on loans, profits of the Issue Department of the Bank of England, etc.	5 800	5 400
Service of the National Debt—balance met from the Consolidated Fund	6 800	7 500
<b>Total Receipts</b>	<b>12 600</b>	<b>12 900</b>
<b>Payments</b>		
<b>Service of the National Debt</b>		
Interest	12 500	12 800
Management and expenses	140	150
<b>Total</b>	<b>12 600</b>	<b>12 900</b>
<b>Loans to Nationalised Industries:</b>		
National Coal Board	440	390
Electricity (England, Wales and Scotland)	-420	-790
Water (England and Wales)	330	-110
Other	-220	-50
<b>Total</b>	<b>130</b>	<b>-570</b>
<b>Loans to other Public Corporations:</b>		
New Towns—Development Corporations and Commission	280	240
Housing Corporations	100	-170
Scottish Special Housing Association	30	30
Other	-10	—
<b>Total</b>	<b>400</b>	<b>100</b>
<b>Loans to Local Authorities</b>	<b>4 400</b>	<b>2 900</b>
<b>Other Loans<sup>(1)</sup></b>	<b>-10</b>	<b>-50</b>
<b>Total—Net Lending<sup>(2)</sup></b>	<b>4 900</b>	<b>2 400</b>
<b>Total Payments</b>	<b>17 500</b>	<b>15 300</b>
Consolidated Fund deficit (Table 6.6)	5 400	7 300

<sup>(1)</sup> To private sector and within central government.

<sup>(2)</sup> As well as National Loans Fund net lending to local authorities and public corporations, borrowing from central government in Tables 6.3 and 6.4 includes net lending from other funds and accounts (mainly Supply Issues in Table 6.7).

# Financial Statement and Budget Report 1986-87

Return to an Order of the House of Commons dated 18 March 1986: for

*Copy of Financial Statement and Budget Report 1986-87  
as laid before the House of Commons by  
the Chancellor of the Exchequer when opening the Budget*

Treasury Chambers  
18 March 1986

} John Moore

*Ordered by the House of Commons to be printed 18 March 1986*

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# Contents

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Chapter One	The Budget	5
Chapter Two	Medium Term Financial Strategy	9
Annex		17
Chapter Three	The Economy: recent developments and prospects to mid 1987	20
Chapter Four	The Budget tax proposals	42
Annex		48
Chapter Five	Public expenditure	55
Chapter Six	Public sector transactions	58
Annex		64

# 1 The Budget

**Table 1.1 The Budget measures<sup>1</sup>**

	£ million		yield(+)/cost(-)
	1986-87	1987-88	1987-88
	Changes from an indexed base	Changes from a non-indexed base	Changes from a non-indexed base
<b>Tax proposals:</b>			
Income tax basic rate <sup>2</sup>	- 950	- 950	- 1 305
Income tax allowances and thresholds	+ 15	- 1 125	- 1 470
Excise duties			
—petrol/derv	+ 135	+ 465	+ 495
—vehicle excise duty	- 135	+ 5	+ 5
—tobacco	+ 175	+ 315	+ 335
—alcohol	- 175	—	—
—gas oil	+ 25	+ 30	+ 30
—other minor oil duties	- 25	- 20	- 20
Stamp duties			
—reduction in rate	- 70	- 70	- 75
—extension of base	+ 70	+ 70	+ 85
Capital transfer tax (inheritance tax)	- 35	- 55	- 100
Charities			
—package of reliefs	- 10	- 10	- 70
—anti abuse measures	* <sup>3</sup>	*	+ 20
Pension fund surplus rules	+ 20	+ 20	+ 120
Other tax changes	- 25	- 25	+ 65
<b>Total tax measures</b>	<b>- 985</b>	<b>- 1 350</b>	<b>- 1 885</b>
<b>Expenditure measures:</b>			
			cost(+)/saving(-)
Counselling initiative and Jobstart allowance	+ 100	+ 100	+ 70
Community Programme	+ 60	+ 60	+ 120
New Workers Scheme	+ 25	+ 25	+ 50
Enterprise Allowance Scheme	+ 5	+ 5	+ 35
Loan Guarantee Scheme	*	*	+ 5
<b>Total expenditure measures (gross)<sup>4</sup></b>	<b>+ 195</b>	<b>+ 195</b>	<b>+ 290</b>
Offsetting savings in social security benefits	- 95	- 95	- 125
Net call on the Reserve	+ 100	+ 100	+ 165

<sup>1</sup> These measures, and the basis of the costings shown, are described in detail in Chapters 4 and 5.

<sup>3</sup> Negligible.

<sup>2</sup> Figures include the effect of the consequential change in the rate of advance corporation tax.

<sup>4</sup> Including Northern Ireland consequential.

**1.01** The objective of the Government's economic policy is to defeat inflation and establish a vigorous, enterprising economy which will generate sustained growth and increased employment.

**1.02** The Financial Statement and Budget Report (FSBR) supplements the Chancellor's Budget Statement. It describes the Medium Term Financial Strategy (MTFS); outlines developments in the economy over the past year; provides forecasts to mid 1987; details the government's tax proposals; summarises the public expenditure elements in the Budget; and brings together the financial position of the public sector.

## The Medium Term Financial Strategy

**1.03** Chapter 2 describes the MTFS, which provides the framework for all economic policy decisions. Monetary and fiscal policy is set to bring about lower inflation while providing for continued growth in output. Target ranges are set for the growth of narrow and broad money. Micro-economic policies are designed to improve the prospect for output and employment by improving incentives, removing unnecessary controls, ensuring that markets work properly—and generally improving the adaptability of the economy.

**1.04** The measures in the Budget are designed to strengthen these policies and to reduce the burden of taxation and the role of the state in the economy. Both tax and expenditure are on a declining path as a proportion of Gross Domestic Product (GDP).

## Forecast

**1.05** Chapter 3 describes the main developments in the economy and the prospect for the next 18 months. The sharp fall in oil prices will sustain growth and reduce inflation in the world economy, and will help British industry. Inflation is set to fall further—to 3½ per cent in 1986. Output is expected to continue to grow by around 3 per cent. Investment and exports are forecast to grow more rapidly. The balance of payments may be in surplus by £3½ billion in 1986 even though oil prices are low.

## Tax measures

**1.06** Chapter 4 sets out the tax proposals in the Budget. They include a cut of 1p in the basic rate of income tax; a new scheme for tax free investment in equities; the abolition of capital transfer tax on lifetime gifts; and a substantial package of assistance to charitable giving. Table 1.1 opposite summarises the effect of all these measures.

## Public expenditure

**1.07** Chapter 5 summarises the public spending plans, and describes the expenditure measures announced in the Budget which are designed to help the unemployed. The new pilot schemes to help the long term unemployed (counselling and the Jobstart scheme) are to be developed into a single programme (Restart) covering the whole country. The target for the expansion of the Community Programme will be raised to

255 000 places this year. A new scheme—the New Workers Scheme—will be introduced, providing for payments to employers of 18–20 year olds where the wages are below specified limits. The rate of entry into the Enterprise Allowance Scheme will be increased substantially. In addition the Loan Guarantee Scheme is to be extended for three years with a halving of the premium and revised rules.

### Receipts and expenditure

**1.08** Chapter 6 brings together the complete financial picture for the public sector. The public expenditure measures will be financed from the Reserve and thus do not add to the public expenditure planning total. The public sector borrowing requirement (PSBR) is set at some £7 billion, or  $1\frac{3}{4}$  per cent of GDP—slightly below the level indicated in the MTFS published in last year's FSB. The Budget measures are expected to contribute £1 billion to this figure, over and above the cost of indexing tax rates and allowances and revalorising excise duties. Table 1.2 summarises the sources of the receipts and the direction of expenditure.

**Table 1.2 The finances of the public sector**

	£ billion				£ billion		
	1985–86		1986–87		1985–86		1986–87
	1985 Budget <sup>1</sup>	Latest estimate	Forecasts		1985 Budget <sup>1</sup>	Latest estimate	Forecasts
<b>RECEIPTS</b>				<b>EXPENDITURE</b>			
Income taxes	35.3	35.6	38.7	DHSS—Social security	40.0	41.3	42.9
Corporation tax excluding North Sea <sup>2</sup>	8.2	8.4	9.4	Defence	18.0	18.0	18.5
Capital taxes	1.9	2.5	2.8	DHSS—Health and personal social services	16.5	16.7	17.7
Expenditure taxes:				Scotland, Wales and Northern Ireland	14.2	14.5	15.0
Value added tax	18.3	19.3	20.7	Education and science	13.6	14.3	14.3
Local authority rates	13.6	13.7	15.6	Other departments	29.3	31.7	31.2
Petrol, derv, etc., duties	6.5	6.5	7.3	Privatisation proceeds	–2.5	–2.6	–4.7
Spirits, beer, wine, etc.	4.2	4.2	4.4	Reserve	5.0	—	4.5
Cigarettes and other tobacco	4.3	4.3	4.7	Adjustments	—	—	–0.4
Other	8.6	8.6	9.3				
Total expenditure taxes	55.6	56.6	61.9	<b>Public expenditure planning total</b>	<b>134.2</b>	<b>133.9</b>	<b>139.1</b>
North Sea revenues:							
North Sea corporation tax <sup>3</sup>	2.8	3.0	2.7	General government gross debt interest	17.8	17.7	18.2
Petroleum revenue tax	8.2	6.4	2.4	less public corporations' market and overseas borrowing	–2.3	–1.3	–0.4
Oil royalties	2.5	2.1	1.0	Other national accounts adjustments	5.5	5.0	5.7
Total North Sea	13.5	11.5	6.1				
Other <sup>4</sup>	–1.2	–1.4	–1.2				
<b>Total taxes and royalties</b>	<b>113.2</b>	<b>113.1</b>	<b>117.6</b>	<b>General government expenditure<sup>5</sup></b>	<b>159.8</b>	<b>157.7</b>	<b>163.4</b>
National insurance and other contributions	24.6	24.3	26.2				
Interest and dividend receipts	6.4	6.4	6.4				
Gross trading surpluses and rent	3.1	2.9	2.7				
Other	3.1	2.9	3.0				
<b>General government receipts<sup>5</sup></b>	<b>150.4</b>	<b>149.6</b>	<b>155.9</b>				

### Difference between expenditure and revenue financed by borrowing:

	1985–86		1986–87
	1985 Budget	Latest estimate	Forecast
General government expenditure	159.8	157.7	163.4
General government receipts	150.4	149.6	155.9
General government borrowing requirement	9.4	8.1	7.5
Public corporations' market and overseas borrowing	–2.3	–1.3	–0.4
<b>Public sector borrowing requirement</b>	<b>7.1</b>	<b>6.8</b>	<b>7.1</b>

<sup>1</sup> On current definitions.

<sup>2</sup> Including advance corporation tax but excluding corporation tax on capital gains.

<sup>3</sup> Before advance corporation tax set off. See footnote <sup>3</sup> to Table 6 B.3.

<sup>4</sup> Adjustments for advance corporation tax set off against North Sea corporation tax plus accruals adjustments.

<sup>5</sup> In these and other tables, constituent items may not add up to totals because of rounding.

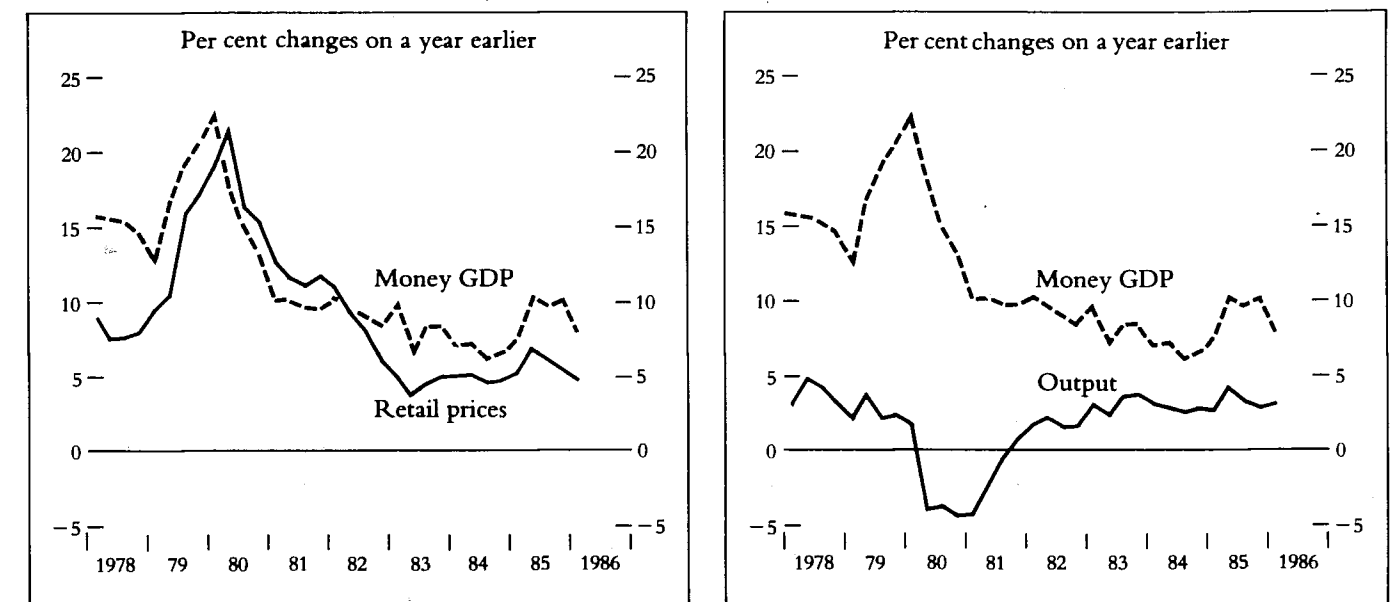
## 2 Medium Term Financial Strategy

**2.01** The Medium Term Financial Strategy provides the framework for economic policy, as it has since 1980. It is intended to bring inflation down further over a period of years, and ultimately to achieve price stability. It is complemented by policies which encourage enterprise, efficiency and flexibility, thus promoting the growth of output and the creation of jobs.

**2.02** Economic policy is set in a nominal framework in which public expenditure is controlled in cash terms and money GDP growth is gradually reduced by monetary and fiscal policy. As the growth of money GDP declines, inflation is squeezed out, and the division of money GDP growth between output growth and inflation is improved.

**2.03** Chart 2.1 shows that over the past six years, money GDP growth has declined from nearly 20 per cent to around 9 per cent. Inflation has come down to around 5 per cent and is set to fall further. And the economy is about to embark on its sixth successive year of growth. For the first time since the 1960s, steady growth is now being combined with low inflation.

**Chart 2.1 Money GDP, output and inflation**



### Objectives and the framework of policy

#### The money GDP path

**2.04** Policy will be directed at maintaining monetary conditions that will bring about a gradual reduction in the growth of money GDP over the medium term, broadly in line with the path shown in Table 2.1 While the

money GDP figures are not targets, and fluctuations will inevitably occur, the aim will be to avoid substantial departures in either direction in the medium term. This is consistent with both a further reduction in inflation and continued growth in real output at a sustainable rate.

Table 2.1 Growth of the money supply and money GDP

	1985-86	1986-87	1987-88	1988-89	1989-90
Money GDP <sup>1</sup>	9½ (8¼)	6¾	6½	6	5½
M0 <sup>2</sup>	3½	2-6	2-6	1-5	1-5
£M3 <sup>2</sup>	14¾	11-15			

<sup>1</sup> Per cent change on previous financial year. See Table 2.2 for assumptions on output and inflation. The figure in brackets is adjusted for the coal strike. The figure for 1986-87 is a forecast; and in subsequent years the figures describe the Government's broad medium term objective.

<sup>2</sup> 1985-86: percentage change from mid-February to mid-February. 1986-87: target ranges. 1987-88 onwards: illustrative ranges for M0.

2.05 The growth of money GDP in 1986-87 is expected to be slightly higher than assumed last year. Partly as a consequence of the sharp fall in oil prices, output growth is higher and inflation lower. In the later years, money GDP growth declines further. The path allows for higher growth of productive potential and a slower decline in oil production than was assumed last year.

Instruments of policy

2.06 While firm monetary policies must be supported by low public sector borrowing in the medium term, there is some scope for varying the balance between fiscal and monetary policy, especially in the short term. In practice, the Budget provides the main opportunity to review fiscal policy, while short term interest rates can be varied more frequently to keep monetary conditions on track.

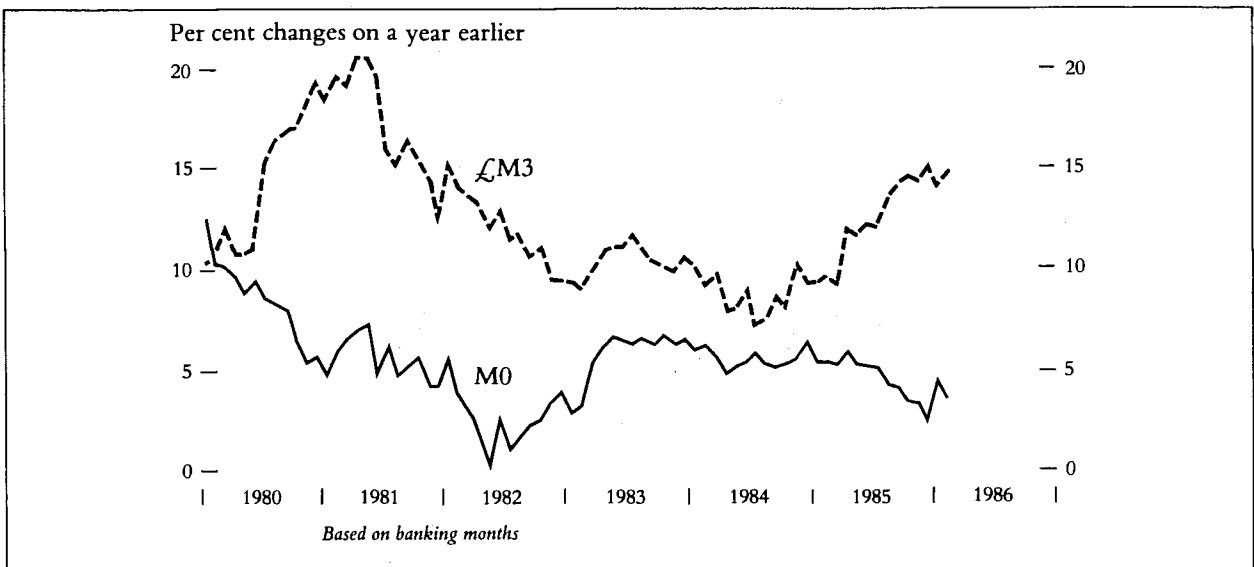
2.07 Until recently the authorities also sought to control the growth of broad money and liquidity by overfunding—that is, selling more debt than needed to fund the PSBR. This was generally seen as a distortion of financial markets, and it was reflected in the rising stock of commercial bills held by the Bank of England.

2.08 On the view that systematic overfunding was neither a sustainable nor an effective medium term means of affecting monetary conditions, the Chancellor announced in October 1985 that sales of debt outside the banking system in any one financial year would be limited to the amount needed to fund the PSBR; and that policy action within the year to influence monetary conditions would take the form of changing short term interest rates.

Monetary policy

2.09 Monetary conditions are assessed in the light of movements in narrow and broad money and the behaviour of other financial indicators, in particular the exchange rate. Chart 2.2 shows the path of M0 and £M3 since 1980.

Chart 2.2 Monetary growth



Narrow money

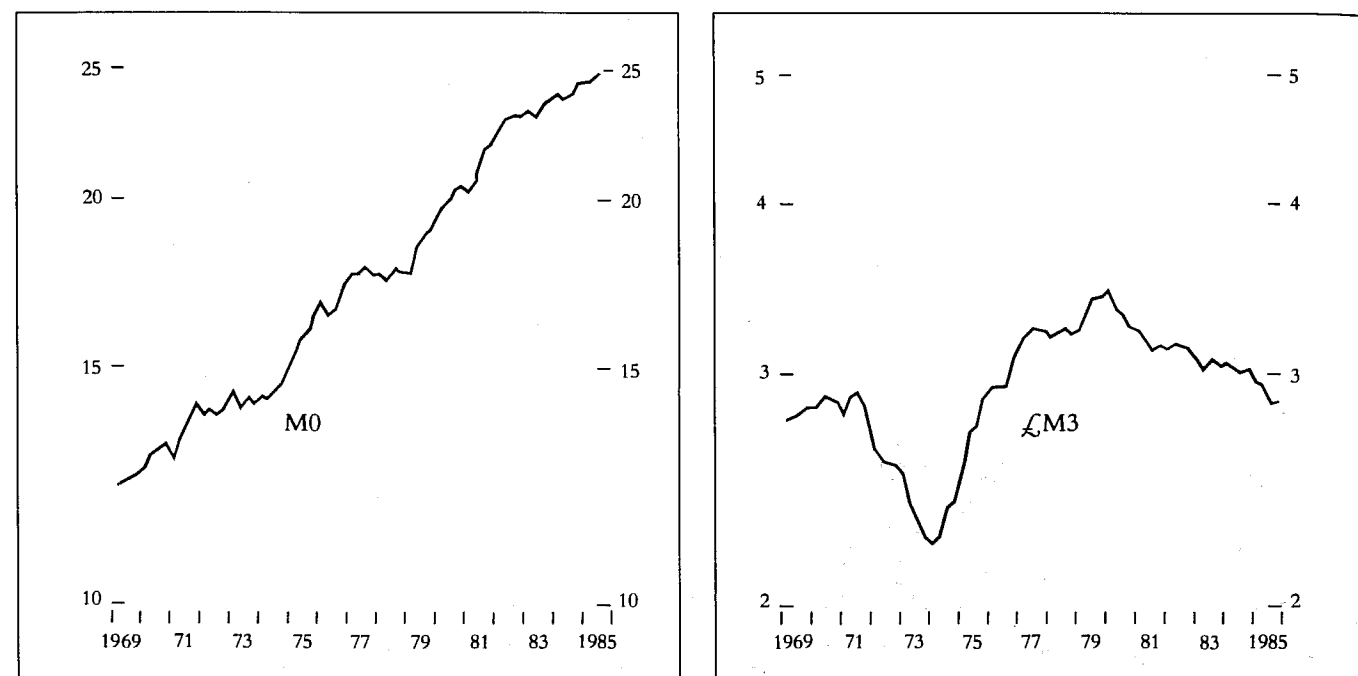
2.10 Ideally, the target aggregate for narrow money should reflect those (principally non-interest bearing) assets that are directly used for making transactions; should respond unambiguously, but not be over sensitive, to interest rate changes; and should have a stable relationship with money GDP. In practice, however, there is no single measure of narrow money that meets all these criteria. As in the United States, M1 has been inflated by a rapid growth of interest bearing sight deposits, previously held in the form of term deposits. The same developments have distorted non-interest bearing M1 which continues to be affected by short term variations in the boundary between interest bearing and non-interest bearing accounts.

2.11 M0 covers only a narrow range of transactions balances. It has however demonstrated a relatively stable velocity trend over a long period as is shown in Chart 2.3; and it responds in an unambiguous manner to changes in interest rates. Its velocity has risen as institutional change and technological developments have led to a progressive reduction in the use of cash, but this has been occurring at a fairly steady and predictable pace. M0 has proved a good indicator of monetary conditions in recent years and remains the best choice of narrow aggregate for target purposes.

Broad money

2.12 Measures of broad money have persistently grown faster than money GDP over the last six years, in contrast with experience in the 1970s. High real interest rates have increased the relative attractiveness of financial assets; and financial liberalisation and increased competition between banks and building societies have led to a rapid build up of both liquidity and debt. Yet this has proved consistent with a decline in both inflation and money GDP growth. At the same time the high proportion of interest bearing deposits within broad money has meant that the immediate response of broad liquidity aggregates to changes in short term interest rates is highly uncertain.

Chart 2.3 Velocity of the monetary aggregates



**Monetary targets** 2.13 As in the past two years, the Government is setting targets for the year ahead, 1986–87, both for M0 as a measure of narrow money, and for £M3 as a measure of broad money. The ranges are shown in Table 2.1

2.14 For M0 the target range of 2–6 per cent is the same as indicated in last year's MTFS. Illustrative ranges are also given for M0 in later years, consistent with the declining path of money GDP growth.

2.15 For £M3, the target range has been raised to 11–15 per cent reflecting the rapid fall in velocity observed in recent years. Illustrative ranges for future years are not given for £M3 because the uncertainties surrounding its velocity trend are at present too great.

**Interpretation of monetary conditions** 2.16 In implementing policy and in making decisions about short term interest rates, the Government has to make a careful assessment of the behaviour of the monetary aggregates in relation to their targets, together with other relevant evidence, especially the exchange rate.

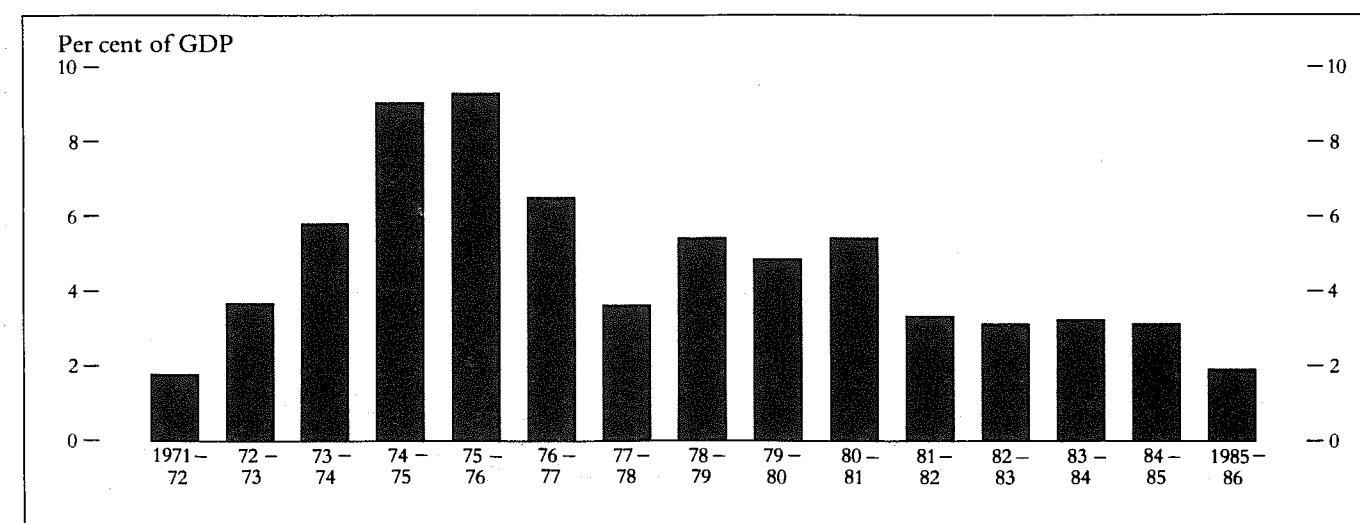
2.17 There is no mechanical formula for taking the exchange rate into account in assessing monetary conditions; a balance must be struck between the exchange rate and domestic monetary growth consistent with the Government's aims for money GDP and inflation.

2.18 If the underlying growth of M0 or £M3 were to move significantly outside their target ranges, the Government would take action on interest rates unless other indicators suggested clearly that monetary conditions remained satisfactory. Experience has shown that a change in short term rates is unlikely to alter the growth of £M3 significantly within the target period. But such action clearly affects the tightness of monetary conditions, which is what matters, and this would be likely to show up in the behaviour of M0 and the exchange rate.

### Fiscal policy

2.19 The PSBR in 1985–86 is expected to be about 2 per cent of GDP, in line with last year's projection. This follows four years when the PSBR remained at about 3½ per cent of GDP. The sharp reduction this year would have taken place in 1984–85 but for the coal strike. It is the second significant downward step since the MTFS began in 1980. The figure of 2 per cent is the lowest recorded since 1971–72 (Chart 2.4). This would still have been the case even if there had been no proceeds from privatisation.

Chart 2.4 Public sector borrowing requirement



**The PSBR path** 2.20 The fiscal projections for the next four years are set out in Tables 2.3 to 2.5. The profile of the PSBR is much as suggested in last year's MTFS. As usual, account has been taken of the composition of receipts and expenditure.

2.21 The PSBR for 1986–87 is set at £7 billion, or 1½ per cent of GDP—slightly below the level indicated in last year's MTFS. North Sea revenues are projected to decline steeply in 1986–87 to about £6 billion, roughly half their level in 1985–86. The proceeds from the Government's privatisation programme are expected to rise from £2½ billion in 1985–86 to £4½ billion in 1986–87, as set out in the Autumn Statement.

2.22 A further slight reduction in the PSBR to 1½ per cent of GDP is projected for 1988–89 and 1989–90. The figures after 1986–87 are illustrative, and decisions about the appropriate PSBR in particular years will be taken nearer the time.

**Assumptions** 2.23 For the period to 1988–89, the expenditure projections in Table 2.3 incorporate the public expenditure plans set out in the Public Expenditure White Paper (Cmnd. 9702). It is assumed that the planning total for 1989–90 will remain broadly flat in real terms. The revenue projections in Table 2.4 are based on the conventional assumptions of constant 1986–87 tax and national insurance contribution rates, and allowances and thresholds indexed from the proposed 1986–87 levels. All changes proposed in the Budget are taken into account.



**2.24** The assumptions about output growth and inflation that underlie the revenue projections are shown in Table 2.2. They are consistent with the figures for money GDP growth in Table 2.1. Oil prices are assumed to average \$15 a barrel for the rest of 1986 and throughout 1987, and thereafter to remain broadly unchanged in real terms. It is assumed that there is no major change in either the sterling exchange rate index or the sterling/dollar exchange rate from year to year.

**Table 2.2 Output and inflation assumptions**

	Percentage change on previous financial year				
	1985-86	1986-87	1987-88	1988-89	1989-90
<b>Real GDP</b>					
Non-North Sea	3½	3	2½	2½	2½
Total	3½	3	2½	2½	2½
<b>Inflation</b>					
GDP deflator	6	3½	3½	3½	3

### Public expenditure

**2.25** Continued restraint in public spending plays a vital role in the Government's economic strategy. The cash planning totals set by the Government in the White Paper are designed to hold total spending broadly level in real terms. The projection given in Table 2.3 extends to 1989-90, one year longer than the published plans. The assumption for the final year implies that the planning total remains broadly flat in real terms over the whole MTFs period.

**2.26** As a proportion of GDP, general government expenditure has already fallen significantly from its peak of over 46 per cent in 1982-83. Given the assumed growth of output, it is projected to decline further from 44 per cent in 1985-86 to less than 40 per cent in 1989-90. This will enable a continued low level of borrowing to be combined with reductions in the burden of taxation, so improving motivation, efficiency and employment. The plans for public expenditure are set out more fully in Chapter 5.

**Table 2.3 General government expenditure**

	£ billion, cash					
	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
Public expenditure planning total <sup>1</sup>	129.6	134	139	144	149	153
Gross debt interest	16.1	18	18	19	19	19
Other adjustments <sup>2</sup>	4.3	6	6	7	7	7
<b>General government expenditure<sup>3</sup></b>	<b>150.0</b>	<b>158</b>	<b>163</b>	<b>170</b>	<b>175</b>	<b>180</b>
of which						
Privatisation proceeds <sup>4</sup>	2.1	2½	4½	4½	4½	4½

<sup>1</sup> For 1984-85 to 1988-89, the figures are equivalent to those in Table 5.1. They are assumed to be the same in real terms in 1989-90 as in 1988-89.

<sup>2</sup> See paragraph 5.04.

<sup>3</sup> General government expenditure, and its components, are rounded to the nearest £1 billion from 1985-86 onwards.

<sup>4</sup> See the Public Expenditure White Paper (Cmd. 9702), Table 1.4. Proceeds are assumed to be the same in cash terms in 1989-90 as in 1988-89.

### Revenue

**2.27** The growth in government revenues in cash terms over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. On the unchanged policy assumptions set out above, general government receipts are expected to increase somewhat less than money GDP. Government revenues from the North Sea are projected to fall sharply in 1986-87 from the peak levels of 1984-85 and 1985-86 mainly because of the drop in oil prices. But the decline in revenues from this source is offset by buoyant non North Sea revenues.

**Table 2.4 General government receipts**

	£ billion, cash					
	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
Taxes on incomes, expenditure and capital	105.4	113	118	124	132	139
National insurance and other contributions	22.9	24	26	28	29	31
Interest and dividends	5.0	6	6	6	6	6
Other receipts	6.4	6	6	6	7	7
Accruals adjustment	1.1	—	—	—	—	-1
<b>General government receipts<sup>1</sup></b>	<b>140.9</b>	<b>150</b>	<b>156</b>	<b>164</b>	<b>174</b>	<b>182</b>
of which						
North Sea tax <sup>2</sup>	12.0	11½	6	4	4	4

<sup>1</sup> General government receipts, and its components, are rounded to the nearest £1 billion from 1985-86 onwards.

<sup>2</sup> Royalties, petroleum revenue tax (including advance payments), and corporation tax from North Sea oil and gas production (before advance corporation tax set-off). This does not correspond exactly to tax receipts in the same financial year in respect of North Sea production. See footnote <sup>3</sup> to Table 6.B.3.

### Public sector borrowing

**2.28** The projections of government expenditure and receipts are brought together in Table 2.5 to provide projections of the general government borrowing requirement (GGBR) and the PSBR. The size of the fiscal adjustment depends upon the estimates of revenues and expenditure. As always, these are subject to major uncertainties. Apart from the general difficulty of projecting the yield from a given set of tax rates, recent events in world oil markets make the projection of oil revenues particularly uncertain. On the expenditure side, the planning total for the final year has yet to be agreed.

**2.29** Changes since the 1985 MTFs are discussed in the Annex to this Chapter.



Table 2.5 Public sector borrowing<sup>1</sup>

	£ billion, cash					
	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
General government expenditure	150.0	158	163	170	175	180
General government receipts	140.9	150	156	164	174	182
Fiscal adjustment from previous years <sup>2</sup>	—	—	—	—	2	6
Annual fiscal adjustment <sup>2</sup>	—	—	—	2	4	3
<b>GGBR</b>	<b>9.1</b>	<b>8</b>	<b>7</b>	<b>8</b>	<b>7</b>	<b>7</b>
Public corporations' market and overseas borrowing	1.0	-1	—	-1	—	—
<b>PSBR</b>	<b>10.1</b>	<b>7</b>	<b>7</b>	<b>7</b>	<b>7</b>	<b>7</b>
Money GDP at market prices	327	358	382	407	431	455
<b>PSBR as per cent of GDP</b>	<b>3.1</b>	<b>2</b>	<b>1½</b>	<b>1½</b>	<b>1½</b>	<b>1½</b>

<sup>1</sup> Rounded to the nearest £1 billion from 1985-86 onwards. Further details for 1985-86 and 1986-87 are provided in Tables 1.2 and 6.5.

<sup>2</sup> Means lower taxes or higher expenditure than is assumed in lines 1 and 2.

### Conclusion

**2.30** Events both at home and abroad may modify some of the assumptions on which the projections have been based. But the Government is committed to maintaining the progress to lower inflation in the medium term, secured by appropriate financial policies. The MTFS provides the framework within which the Government will pursue its economic policy. It provides as firm a guarantee against inadequate money demand as it does against excessive money demand.

## Annex to Chapter 2

### Changes since the 1985 MTFS

#### Money GDP

**2A.1** The level of money GDP in 1985-86 is now expected to be higher than was projected in last year's MTFS, reflecting both higher output and a higher deflator. The level from 1986-87 onwards is also higher. The decline in the growth rate of money GDP from 1985-86 to 1988-89 is similar to that assumed last year. Non North Sea output growth is assumed to be slightly faster, and oil production is projected to decline more slowly. The GDP deflator is projected to grow more slowly in 1986-87, but very slightly faster in the subsequent years than assumed last year.

Table 2A.1 Level of money GDP

Per cent changes from 1985 MTFS projections			
1985-86	1986-87	1987-88	1988-89
+1	+1½	+2	+2½

#### Monetary aggregates

**2A.2** The growth of M0 is now towards the bottom half of its target range for 1985-86. The target range for 1986-87 is the same as the illustrative range given last year. The illustrative ranges for subsequent years decline less rapidly.

**2A.3** The growth of £M3 in 1985-86 is well above the target range originally set last year, and the range set for 1986-87 is considerably higher than the illustrative range in last year's MTFS.

Table 2A.2 Monetary aggregates

	Per cent changes on a year earlier			
	1985-86	1986-87	1987-88	1988-89
<i>M0</i>				
1986 MTFS	3½	2-6	2-6	1-5
1985 MTFS	3-7	2-6	2-5	0-4
<i>£M3</i>				
1986 MTFS	14½	11-15		
1985 MTFS	5-9	4-8	3-7	2-6

#### Fiscal projections

**2A.4** Table 2A.3 shows changes in the fiscal projections since the 1985 FSBR, after allowance for classification changes.

#### Expenditure

**2A.5** The expected underspend on the planning total in 1985-86 is referred to in Chapter 5. The planning totals for 1986-87 onwards are as in the Public Expenditure White Paper (Cmnd. 9702), which incorporates a slightly higher figure in 1988-89 than assumed last year. General government expenditure is lower in 1985-86 than projected last year, mainly because of the slightly lower planning total and a change in the pattern of public corporations' borrowing. They borrowed less from general government and more from the market and overseas, and this pattern is projected to continue in 1986-87. In 1988-89, the changes in the planning total and public corporations' borrowing both add to general government expenditure. There are no changes to the path of gross debt interest.

**Receipts** 2A.6 The reductions in North Sea revenues are due to lower sterling oil prices. Other taxes are higher throughout the period, mainly because of the higher level of money GDP. The reductions in other receipts reflect minor changes in a number of items, including gross trading surpluses, rent and capital consumption.

**Table 2A.3 Revenue and expenditure<sup>1</sup>**

	Changes from 1985 MTFS projections £ billion				
	1984-85	1985-86	1986-87	1987-88	1988-89
<i>Expenditure</i>					
1 Planning total	—	— $\frac{1}{2}$	—	—	+ $\frac{1}{2}$
2 Other <sup>2,5</sup>	+0.3	-2	-1	+ $\frac{1}{2}$	+1
<b>3 General government expenditure</b>	<b>+0.3</b>	<b>-2</b>	<b>-1</b>	<b>+ <math>\frac{1}{2}</math></b>	<b>+1 <math>\frac{1}{2}</math></b>
<i>Receipts<sup>3</sup></i>					
4 North Sea taxes	—	-2	-5 $\frac{1}{2}$	-5 $\frac{1}{2}$	-4
5 Other taxes and contributions	+0.7	+1 $\frac{1}{2}$	+2 $\frac{1}{2}$	+3	+4
6 Other <sup>2</sup>	+0.1	- $\frac{1}{2}$	- $\frac{1}{2}$	-1	-1 $\frac{1}{2}$
<b>7 General government receipts</b>	<b>+0.8</b>	<b>-1</b>	<b>-3</b>	<b>-4</b>	<b>-2</b>
8 Implied cumulative fiscal adjustment <sup>4</sup>	—	—	-3 $\frac{1}{2}$	-4 $\frac{1}{2}$	-3 $\frac{1}{2}$
9 Public corporations' market and overseas borrowing <sup>5</sup>	+0.1	+1	+1	—	- $\frac{1}{2}$
<b>10 PSBR</b>	<b>-0.4</b>	<b>—</b>	<b>- <math>\frac{1}{2}</math></b>	<b>—</b>	<b>- <math>\frac{1}{2}</math></b>

<sup>1</sup> Classification changes since the 1985 FSBR add the following amounts to both expenditure and receipts:

£ billion				
+0.2	+0.3	+0.2	+0.2	+0.2

The main changes are in respect of the treatment of transactions in certain public sector pension funds and of National Savings Bank management expenses.

<sup>2</sup> Includes changes in debt interest and other items.

<sup>3</sup> The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set-off. See footnote <sup>3</sup> to Table 6B.3.

<sup>4</sup> Line 8 = lines 10 - 9 - 3 + 7.

<sup>5</sup> Public corporations' market and overseas borrowing is included in the planning total and in the PSBR, but not in general government expenditure. Changes in it are therefore deducted in line 2 and added back in line 9.

# 3 The economy: recent developments and prospects to mid 1987

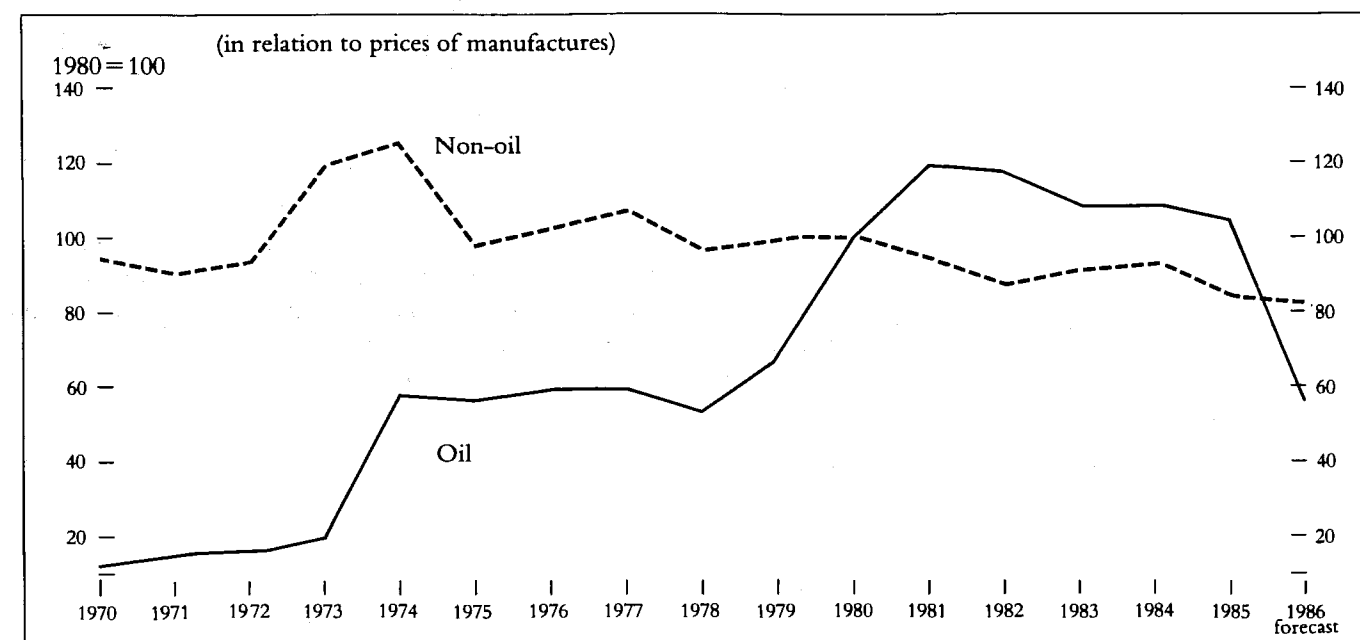
## Summary

- Demand and activity** 3.01 There were further sizeable increases in both exports and business investment in 1985. For the forecast period, substantial growth is likely not only in most areas of domestic spending but also in exports. Total domestic production and manufacturing output are both expected to record further growth of some 2½–3 per cent.
- Labour market** 3.02 Employment has continued to rise, with over 200 000 extra jobs in the year to September 1985. In spite of this, there has been some further rise in unemployed claimants over the last year. However, the labour force is now expected to grow less rapidly, and prospects for unemployment are better than for some years.
- Inflation** 3.03 After rising in the early months of 1985, inflation has been on a downward path since June, and in January 1986 the RPI increase over the previous year was 5½ per cent. The inflation rate is expected to fall quite sharply over the coming months and is forecast to be 3½ per cent in the fourth quarter of 1986.
- Assumptions** 3.04 The UK forecast is based on the assumption that fiscal and monetary policies are set within the framework of the MTFS. Oil prices, both North Sea and world, are assumed to average \$15 per barrel for the rest of 1986. Neither the sterling index nor the sterling/dollar exchange rate is assumed to change much.
- World economy** 3.05 Output in the world economy has now been rising since early 1983, and inflation has been coming down since 1980. Assisted by further moves to lower interest rates, a period of low inflation and good growth in output and trade is in prospect. Many of the problems arising from payments imbalances and debt repayments will remain. But the benefits to trade, output and inflation from the fall in oil prices should prove substantial.
- Trade and the current account** 3.06 Exports have grown strongly over the last two years. The current account of the balance of payments is expected to remain in sizeable surplus despite the big fall in oil prices. Offsets include higher export earnings on other goods, lower profits earned by foreign oil companies in the North Sea, and higher earnings from the UK's stock of overseas assets.

## World economy

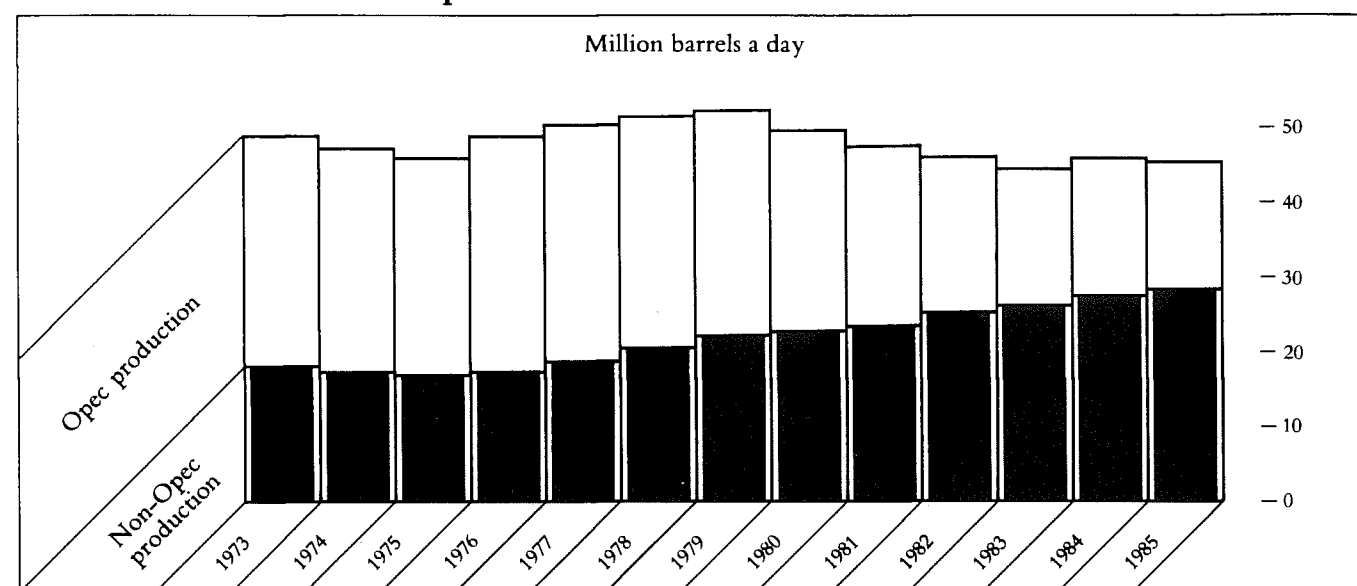
- Recent developments** 3.07 After a spurt in 1983 and the first half of 1984, US economic growth has slowed down sharply. By the final quarter of 1985 real GNP was 2½ per cent higher than a year earlier. The performance of the United States economy has strongly influenced the pattern of economic growth in other major industrialised countries. In Japan and Germany, in particular, output grew significantly faster than domestic demand in both 1984 and 1985, thanks to the substantial external contribution to demand, stemming in large part from the US. More recently the recovery in Europe has strengthened and growth has become less dependent on exports to the US. In Japan, growth has shown some signs of slackening, although remaining high by European standards.
- 3.08 Domestic demand is now growing at similar rates in the US and other major industrialised countries. But the effect of much faster growth between 1982 and 1984 in the US, together with the effects of the rise—still only partially reversed—in the dollar, are seen in the pattern of current account balances: a large deficit in the US and large surpluses in Germany and Japan. There have, though, been a number of helpful steps towards reducing these imbalances over the past year. Slower growth in the US has not only reduced the increase in US imports, but also contributed to lower interest rates and a fall in the dollar. The latter was helped by the Plaza Agreement of 22 September 1985 between the Finance Ministers of the Group of Five.
- Inflation** 3.09 The rate of world inflation fell further in 1985: consumer prices in the major industrialised countries increased on average by about 4 per cent, compared with over 4½ per cent in 1984. This has been associated with a continuing weakness in primary product prices (see Chart 3.1).

Chart 3.1 Commodity prices



**3.10** Since November 1985, oil prices have fallen sharply. Before the first oil price shock the non-communist world demand for oil was around 48 million barrels per day, and about 30 mbd of this was produced by OPEC members. Despite the 1973-74 increase in oil prices OPEC managed to maintain roughly this level of production throughout the 1970s. After falling in 1974 and 1975 total demand for oil rose again during the rest of the decade, while non-OPEC supply grew by roughly the same amount in absolute terms. Chart 3.2 shows total oil production: this is the sum of OPEC and non-OPEC production (the latter defined to include net exports of oil from the communist bloc) and is equal to non-communist world consumption plus stockbuilding.

**Chart 3.2 Oil production**



**3.11** Experience since the second sharp increase in oil prices in 1979 has been very different. Demand for oil has fallen and non-OPEC supplies have continued to rise steadily. OPEC's pricing policy made it effectively the residual source of supply, and demand for OPEC oil nearly halved: from about 31½ mbd in 1979 to less than 17½ mbd on average in 1985. Saudi Arabia's production fell particularly sharply.

**3.12** Towards the end of 1985, Saudi Arabia indicated that it was no longer prepared to hold its own production at very low levels in order to maintain the existing level of prices. The resulting increase in supply, combined with no sign that other producers were prepared to make offsetting cuts in their production, has produced a sharp fall in prices.

**Prospects 3.13** Total demand and supply for oil may respond only gradually even to the large fall in price, and so excess capacity is likely to be present for some time. This forecast assumes that prices will average \$15 per barrel for the rest of 1986 and throughout 1987—rather below, in real terms, the level between 1974 and 1979.

**3.14** The prices of most other primary products are also unlikely to strengthen significantly over the next year or so, since with some exceptions (for example a temporary shortfall in the coffee crop), supplies are abundant and stocks relatively high. The industrial countries can therefore expect further improvements in their terms of trade, raising real incomes and enabling inflation to fall further (see Table 3.1).

**Table 3.1 World economy**

	Per cent changes on a year earlier			
	1984	Estimates 1985	Forecasts 1986	1987 H1
<i>Major Seven countries<sup>1</sup>:</i>				
Real GNP	4½	2½	3½	4
Consumer prices	4½	4	2½	1½
<i>World trade, at constant prices</i>				
Total imports	10	3	5½	5½
UK export markets <sup>2</sup>	8½	4½	5	5

<sup>1</sup> US, Japan, Germany, France, UK, Italy and Canada.

<sup>2</sup> Manufactures.

**Growth 3.15** The growth of real GNP in the **US** should pick up in 1986, benefiting from lower oil prices and from the effect of the lower dollar on trade. Consumers' expenditure, while growing more slowly than in recent years, should be helped by the lagged effects of lower interest rates and rises in asset prices.

**3.16** Growth in **Japan** may be weaker than usual in 1986 as the expansion of domestic demand may not be sufficient to compensate for a slowdown in the growth of exports. In most **European** countries the economic recovery should strengthen in 1986, with the rate of growth increasing, particularly in Germany.

**3.17** As shown in Chart 3.3, the major industrialised countries may grow by about 3½-4 per cent over the next year. Together with lower inflation and interest rates in the major countries and the reduced cost of oil imports, this should provide a better prospect for the non-oil developing countries, despite weak commodity prices. On the other hand, countries heavily dependent on oil exports, particularly those with debt problems, face severe difficulties and will have to cut their imports further.

**Chart 3.3 Growth and inflation**

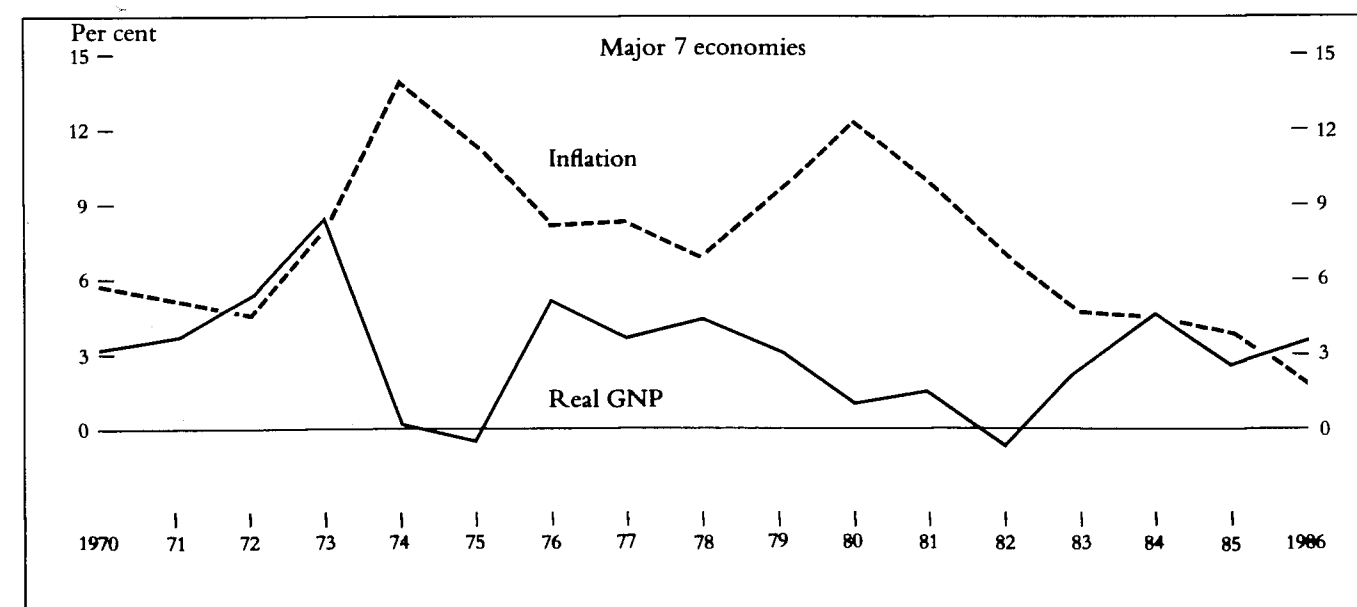


Table 3.2 World import volumes, annual growth rates

	US	Japan	Europe*	OPEC	Developing countries	Other	Total
Weights in 1984	19	8	31	7	14	21	100
Per cent changes on a year earlier							
1984	24	11	6	-10	8	11	10
1985 Estimates	3	1	5	-8	1	6	3
1986 Forecasts	7	9	8	-16	7	6	5½

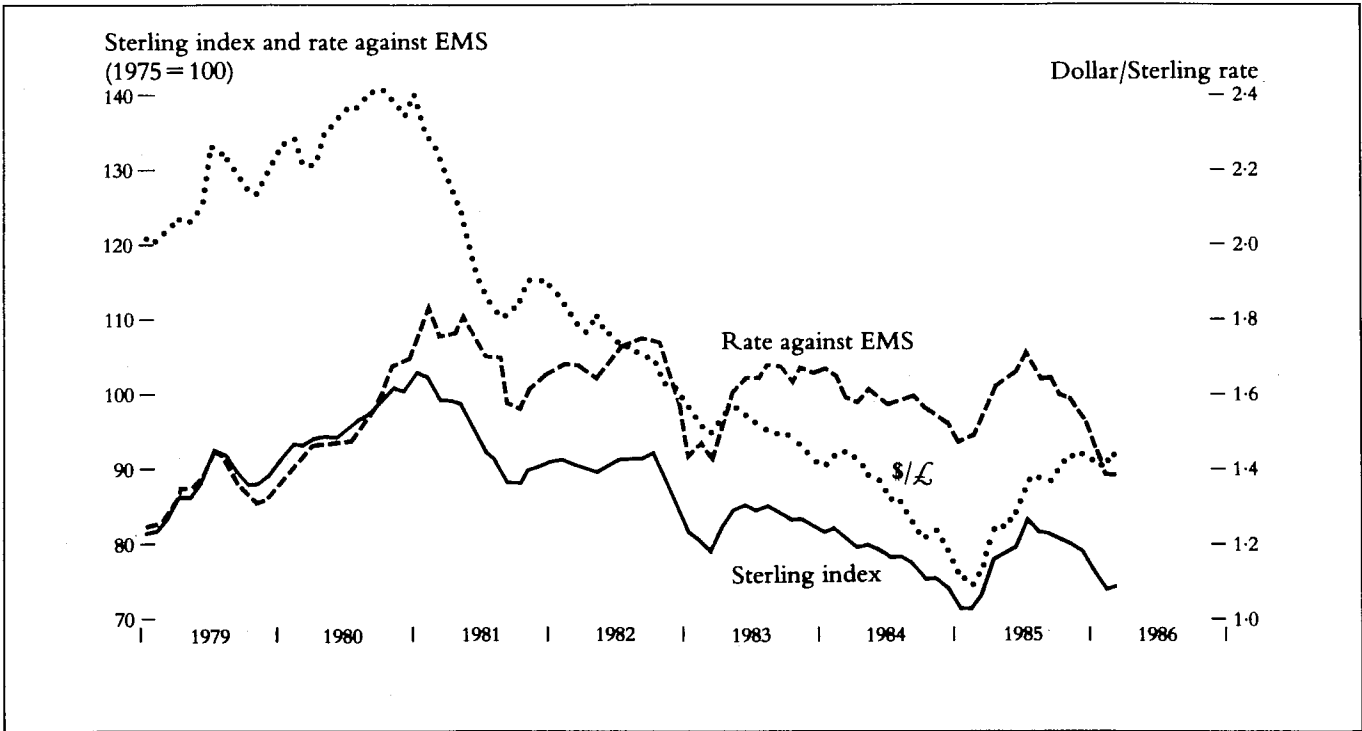
\* Germany, France, UK, Italy, Netherlands and Belgium.

3.18 This picture of world activity is reflected in the pattern of world trade growth. Import growth is likely to be strongest in oil-importing countries and where exchange rates have appreciated most over the past year. This points to rapid growth of imports into Europe, Japan and many developing countries, but to large falls in oil producers' imports. Overall import growth in 1986 should be well above that of 1985.

Financial conditions

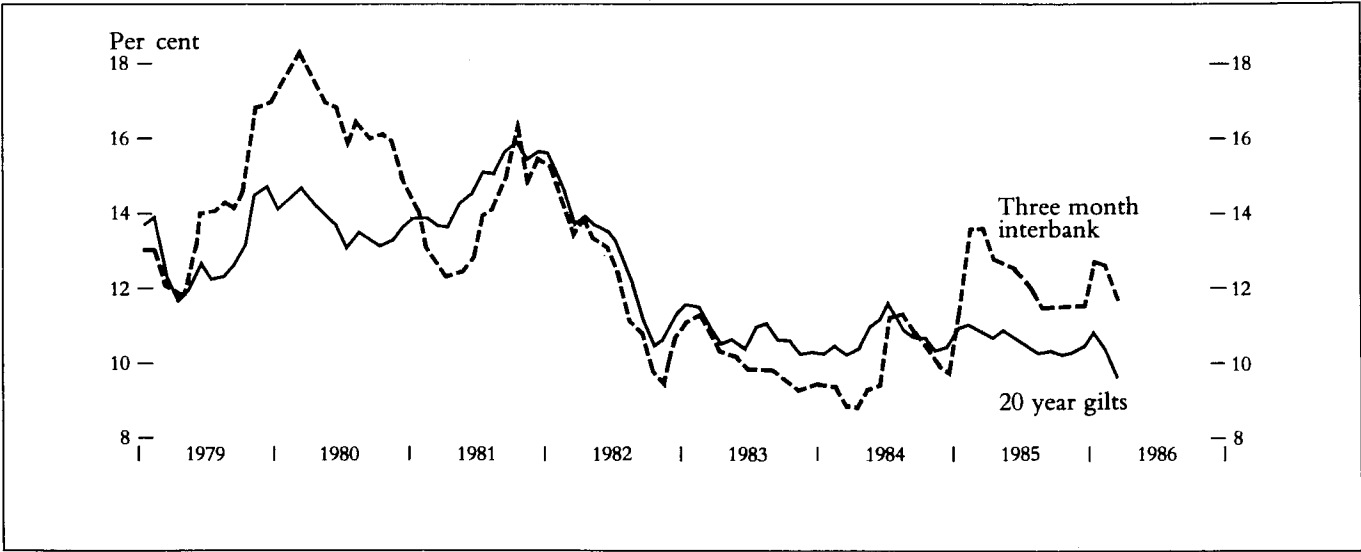
Exchange rates 3.19 The **dollar** has declined substantially (by over 20 per cent against a basket of other currencies) since its peak in early 1985. In 1985 as a whole the **sterling** index was little different from 1984. There were however some sizeable swings during the course of the year. The index rose from a low point of 70½ in January to a high of 84½ in July before declining to 78 in December. The index declined further in the opening months of this year, as oil prices fell. Over the past year sterling has risen by about 30 per cent against the dollar, but fallen against most other currencies. The forecast assumes that sterling will not change much, either in dollar or effective terms.

Chart 3.4 Sterling exchange rates



Interest rates 3.20 Short-term interest rates fell during much of 1985 from the peak levels reached in February and March. They rose again in January this year as sterling weakened but in 1986 so far they have been a little below levels a year earlier. However, on average in 1985-86 short rates, at 12 per cent, have been a point or so above the levels of 1984-85 and several points above levels in the US and most other industrialised countries. Long rates have been much more stable. Yields on 20 year gilts have been within the 10-11 per cent range for almost all of the last three years, but they have recently fallen below 10 per cent for the first time since 1973. Real yields on index-linked gilts have also been relatively stable.

Chart 3.5 Interest rates in the UK



Narrow money 3.21 M0 was near the centre of its target range in the early months of 1985-86, but growth slowed during the course of the year, mainly in response to the increase in interest rates last winter. In recent months M0 growth has generally been just above the bottom of its target range. The annual increase in M0 velocity has been relatively stable for many years now, and is expected to remain so.

3.22 Growth in the non-interest bearing component of M1, 3 per cent over the last year, has also slowed. This has been in response to higher interest rates and the increased availability of high interest cheque accounts which are in M1, contributing to an acceleration in M1 in total.

Broad money 3.23 The rate of growth of £M3 has risen during the course of 1985-86 and has been well above both the target range set in the 1985 MTFS and the growth of money GDP. With the funding objective now set at the level needed to cover the PSBR, £M3 growth, at 14-15 per cent on a year earlier in recent months, has reflected a continued strong expansion of bank credit. Other broad aggregates have grown at much the same rate.

**3.24** The rapid expansion of broad money and credit reflects to a large extent the pace of financial innovation and liberalisation. Since over two-thirds of £M3 bears interest and is now an attractive means of holding financial wealth, the high level of real interest rates may have contributed to higher bank deposits. The higher levels of broad money and debt in relation to incomes probably reflect a permanent and continuing shift in the private sector's portfolio which is not likely to be reversed through higher spending. They are thus consistent with the slower growth of nominal incomes and fall in inflation contained in this forecast.

### Trade and the balance of payments

**Relative costs and prices** **3.25** The last two to three years as a whole have exhibited relatively little change in most measures of cost and price competitiveness, although there have been large short-term swings associated with movements in the nominal exchange rate. As Table 3.3 shows, the effects of a lower nominal exchange rate have been broadly offset by unit labour cost increases at home above those in the UK's main overseas competitors, despite a good UK productivity performance. Assuming not much change in the exchange rate, the UK's cost and price competitiveness in 1986 may be little different from the average of the last three years.

**Table 3.3 The exchange rate and competitiveness\***

	Sterling Index (1975 = 100)	Relative unit labour costs (1980 = 100)	Relative export prices (1980 = 100)	Import price competitiveness (1980 = 100)
1983	83½	85	89	94½
1984	78½	83½	87½	92
1985 estimates	78	86½	90	91½

\* Ratio of costs/prices in UK manufacturing to those overseas.

**Trade prices** **3.26** Prices of most categories of imports fell during the course of 1985. The exchange rate appreciated during the course of the year, inflation in the developed world was low and commodity prices were weak. By the final quarter of 1985 import prices of all goods and services were 5½ per cent lower than a year earlier. About half of the fall seems likely to be reversed by the end of 1986.

**Terms of trade** **3.27** For 1985 as a whole, the terms of trade for goods were 1 per cent above those of 1984 because of the weakness of commodity prices (see Table 3.4). But the terms of trade are likely to be worse in 1986 because the price of oil has fallen relative to other goods and services. As oil has a greater share in UK exports than in imports, a fall in its price reduces export prices relative to import prices. The fall in oil prices on its own worsens the terms of trade in goods by 5 per cent.

**Table 3.4 Trade in goods**

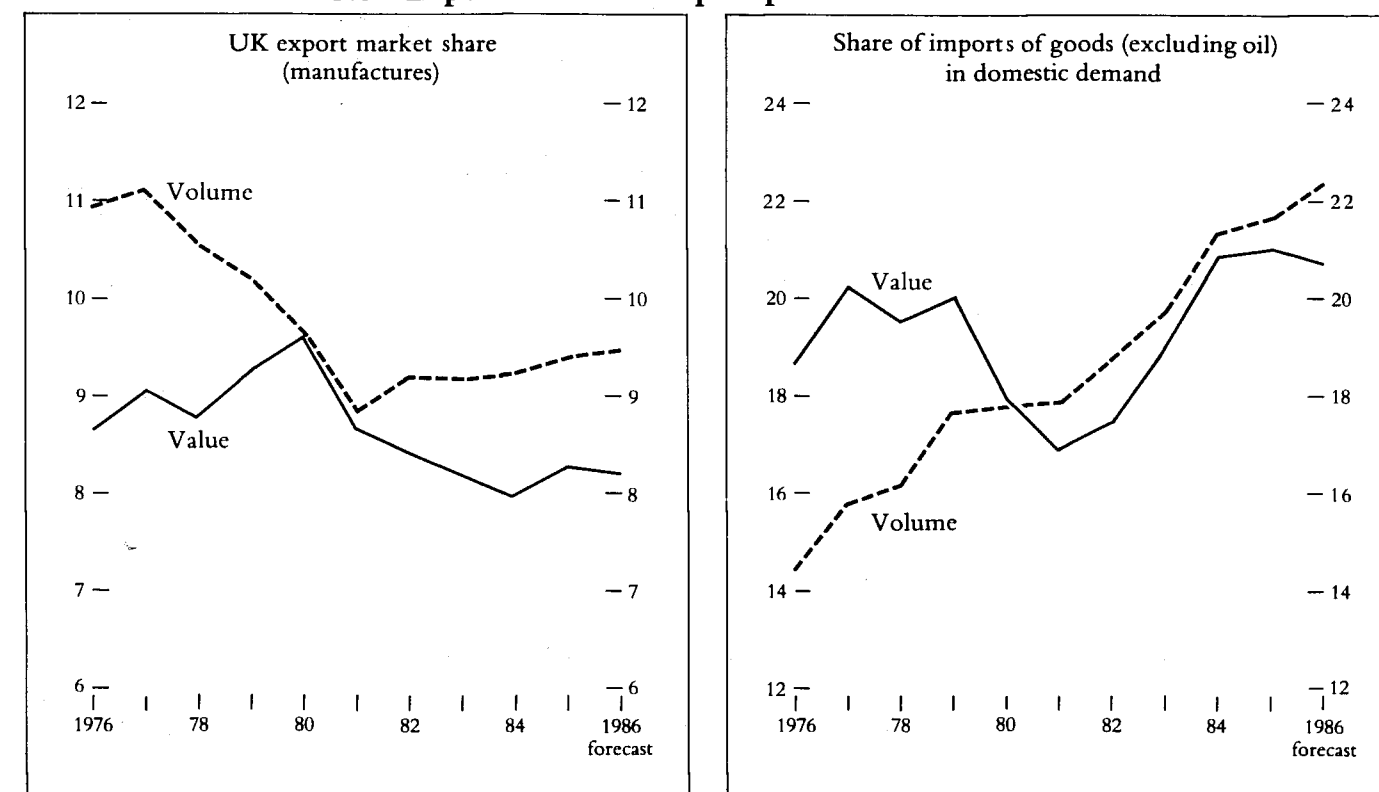
	Per cent changes on a year earlier		
	Export volume	Import volume	Terms of trade*
1983	2	8	1 (1)
1984	8½	11	-2½ (-1½)
1985	5½	3	1 (1½)
1986 forecasts	6	5½	-3 (2)

\*The ratio of UK export to import prices (average values); the figures in brackets exclude oil.

### Trade volumes (goods other than oil)

**3.28** As shown in Chart 3.6 UK exporters of manufactures have gradually improved their market share in volume terms since 1981. The value share fell for a time after 1980 as UK export prices fell relative to those of other countries, but since 1983 there has been little change. The forecast of exports of manufactures in volume terms is for further growth of 6 per cent in 1986, a little faster than the growth of UK export markets.

**Chart 3.6 Export share and import penetration**



**3.29** Between 1982 and 1985 the growth in demand for manufactures (5½ per cent at an annual rate) has been shared by importers and domestic producers, with importers continuing to increase their share. Domestic demand for manufactures is expected to grow in 1986, because of further growth in investment and expenditure on consumer durables in particular. Growth in imports of manufactures in 1986 is forecast to be over 7 per cent, twice as fast as domestic demand growth, a relationship similar to that between 1982 and 1985.



**Trade in oil** 3.30 The prospect is for a substantial fall in the surplus on trade in oil in 1986 as a result of lower oil prices, partly offset in the current account as a whole by reduced invisible earnings of foreign owned companies operating in the North Sea. Little change in oil production is expected and domestic demand for oil may be below the 1985 level which was boosted by the coal strike.

**Invisibles** 3.31 The surplus on trade in **services** has more than doubled since 1982. 1985 was an exceptionally good year, with large gains in earnings from financial services, tourism and travel. With imports of services, particularly tourism, likely to grow faster, the balance on services may show only a modest gain in 1986.

3.32 The profile of the **transfers** balance is affected by the timing of official transactions with the European Community. As the bulk of the UK's rebate on its 1984 contribution was delayed into the first few days of 1986, the transfers balance was unusually low in 1985, by about £½ billion. A correspondingly high figure is projected for 1986.

3.33 On provisional estimates, the surplus on **interest, profits and dividends** (IPD) fell in 1985. Earnings on UK investment overseas were depressed by a once-for-all write off of losses on BP's Sohio subsidiary and UK banks' net earnings on their foreign currency business fell. In 1986 the surplus on IPD is expected to rise sharply. Lower oil prices will reduce the profits of foreign oil companies operating in the North Sea more than they reduce the profits of UK oil companies' overseas operations, and there should be a net rise in the other components of IPD as a result of a projected further increase in the UK's net overseas assets.

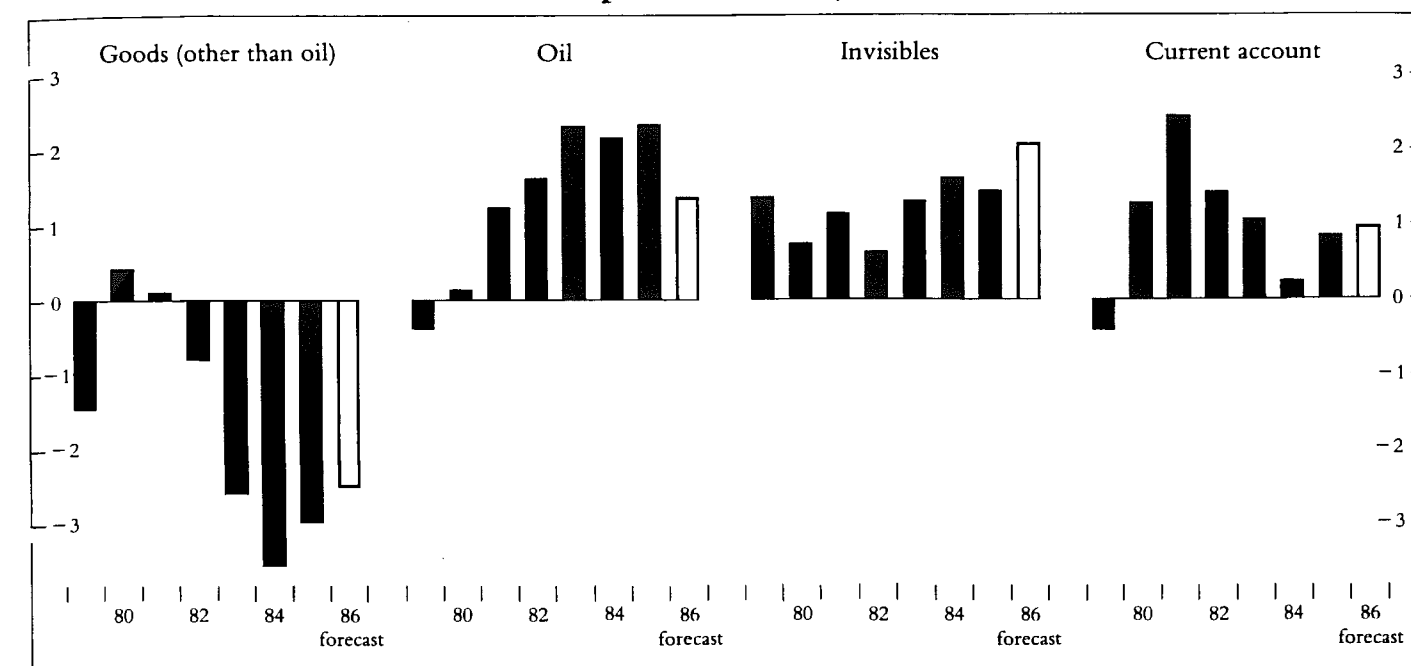
**Table 3.5 Current account of the balance of payments**

	£ billion				
	Oil	Manufactures	Other goods	Invisibles	Total*
1983	7	-2½	-5½	4	3 (3)
1984	7	-4	-7½	5½	1 (3½)
1985	8	-3	-7	5	3 (4½)
1986 Forecasts	5	-3	-6½	8	3½(3)

\* Figures in brackets are after adjustment for the effects of the coal strike and the timing of EC rebates.

3.34 Table 3.5 summarises the current account and its main components. Allowing for the effects of the coal strike the current account was in sizeable surplus in each of the last three years and a substantial surplus is again forecast for 1986, and a further but reduced surplus is forecast for the first half of 1987. On an underlying basis, the surplus in 1986 is expected to be lower than in 1985, as a result of the big fall in oil prices. The contribution of North Sea oil to the current account—defined here as the visible surplus on oil less North Sea profits due abroad—is forecast to fall from £4½ billion in 1985 to £3 billion in 1986. Chart 3.7 shows the components of the account over a longer period, relative to GDP.

**Chart 3.7 The current account of the balance of payments (surpluses and deficits as a per cent of GDP)**



**Overseas assets** 3.35 The UK's stock of net overseas assets is estimated to have been 25 per cent of GDP (almost £90 billion) at the end of 1985, compared with 6 per cent of GDP (£12 billion) in 1979.

#### Inflation and costs in 1985

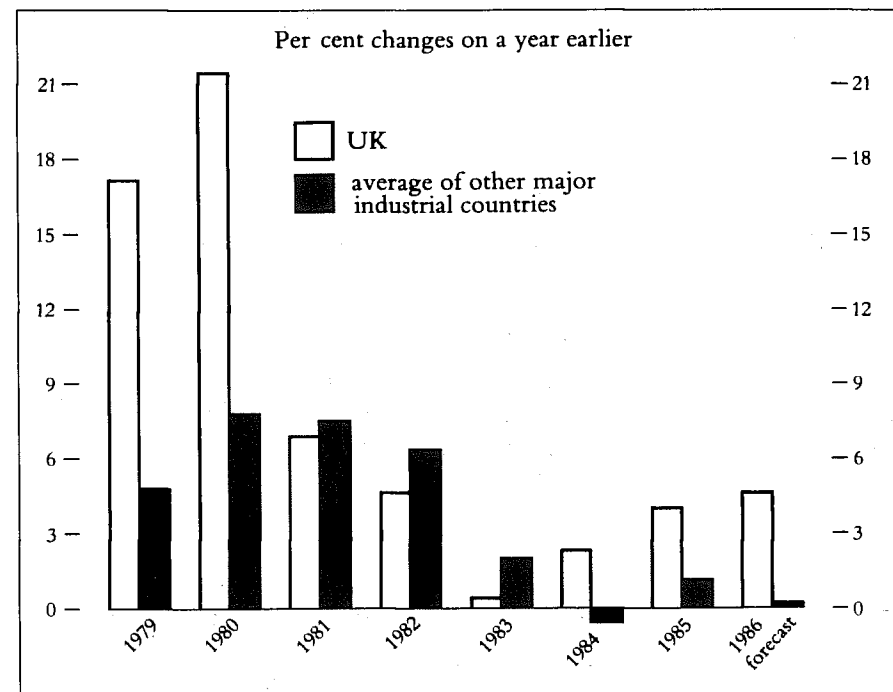
#### Inflation

3.36 In the year to the fourth quarter of 1985 the RPI increased by 5½ per cent, a little more than forecast in last year's FSNR. In the middle of the year retail price inflation touched 7 per cent, reflecting, in particular, increases in mortgage interest rates in February and April 1985 and the weakness of sterling in late 1984 and early 1985. Between May 1985 and January 1986 retail prices rose by only 1.1 per cent in total, helped by a fall in mortgage rates, by lower petrol prices, and a general easing of cost pressures.

3.37 Import prices declined during 1985 and in the final quarter were about 5 per cent lower than a year earlier. Prices of the manufacturing sector's materials and fuel inputs fell rapidly from their peak in February and by the end of the year were 6 per cent below their December 1984 level. The rate of increase in manufacturing output prices started to slow down in the second half of 1985.

3.38 The underlying growth of **average earnings** (that is, abstracting from the effects of strikes, delayed settlements and other temporary factors) continued at about 7½ per cent in 1985 — little changed from 1984. With output per head growing at about 2 per cent (after allowing for the effects of the coal strike) the growth in unit wage costs was about 5½ per cent in 1985. Unit labour costs rose by about 1 per cent less, mainly because of the abolition of the national insurance surcharge in October 1984. In the manufacturing sector, average earnings increased by 8½–9 per cent and unit labour costs by 4 per cent. This was much faster than in most other major industrial countries (see Chart 3.8). Pre-tax real earnings of employees increased by an average of 2–2½ per cent a year between 1982 and 1985.

Chart 3.8 Unit labour costs in manufacturing



**Prospects 3.39** So far the current pay round is showing little sign of any significant change in the level of pay settlements or in the underlying rate of growth of average earnings in the private sector. Unit labour costs for the economy as a whole may rise by around 5 per cent in 1986. World commodity prices are likely to remain weak in 1986. With oil prices in sterling terms falling by almost a half between 1985 and 1986, the overall cost of manufacturers' material and fuel inputs should fall quite sharply between the two years. The prospects are for little change in manufacturers' total costs and a further widening of profit margins on domestic sales, as shown in Table 3.6.

Table 3.6 Costs in manufacturing

	Per cent changes on a year earlier			
	Unit labour costs	Cost of materials and fuel*	Estimated total costs	Output prices*
1983	$\frac{1}{2}$	8	3	$5\frac{1}{2}$
1984	$2\frac{1}{2}$	$8\frac{1}{2}$	$4\frac{1}{2}$	$5\frac{1}{2}$
1985	4	4	4	$6\frac{1}{2}$
1986 Forecasts	$4\frac{1}{2}$	-11	0	4

\* Producer prices excluding food, drink and tobacco.

**3.40** The fall in import prices since the spring of 1985 has contributed to the recent low monthly growth in retail prices; it will continue to contribute to low increases in prices over the coming months, so that the annual rate of inflation will fall quite sharply. In the last quarter of the year RPI inflation may be about  $3\frac{1}{2}$  per cent, with little change likely in the first half of 1987. The fall in oil prices is expected to work its way fully through to petrol prices in the course of 1986. The forecast increase in the housing component of the RPI (which covers mortgage payments, rents, rates, and other housing costs) includes the effect of a substantial rise in local authority rates in 1986-87.

Table 3.7 Retail prices index

	Weights in 1985	Per cent changes on a year earlier			
		1984 Q4	1985 Q4	1986 Q4	1987 Q2
Food	19	$3\frac{1}{2}$	3	3	$3\frac{1}{2}$
Nationalised industries*	9	4	$5\frac{1}{2}$	4	3
Housing	14	$10\frac{1}{2}$	$9\frac{1}{2}$	$7\frac{1}{2}$	5
Other	58	4	$5\frac{1}{2}$	3	$3\frac{1}{2}$
<b>Total</b>	<b>100</b>	<b>5</b>	<b><math>5\frac{1}{2}</math></b>	<b><math>3\frac{1}{2}</math></b>	<b><math>3\frac{1}{2}</math></b>

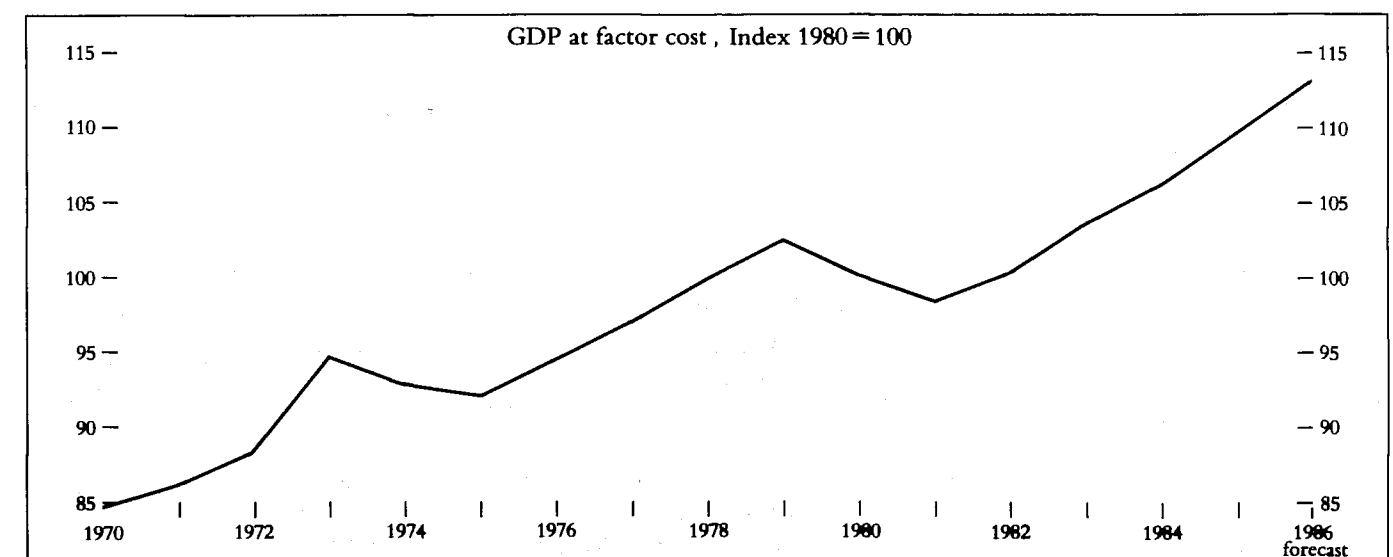
\* Including water.

**3.41** The **GDP deflator** measures the price of domestic value added—principally unit labour costs and profits per unit of output—and excludes imports altogether. The GDP deflator covers all sectors of the economy, including oil output in the North Sea, and so is sensitive to the fall in world oil prices. This contributes to a marked slowdown in the growth of the GDP deflator over the coming year. The deflator for GDP at market prices is estimated to have increased by 6 per cent in 1985-86, about  $1\frac{1}{2}$  per cent more than in 1984-85. In 1986-87, inflation on this measure is expected to fall to about  $3\frac{3}{4}$  per cent.

### Demand and activity

**3.42** Latest estimates suggest that **GDP** rose by about  $3\frac{1}{2}$  per cent in 1985, or  $2\frac{1}{2}$  per cent after making allowance for the effect of the recovery from the coal strike. Over the year to the first quarter of 1985, GDP is estimated to have risen by almost 4 per cent in strike adjusted terms; since then the path of GDP has been flatter. The rise in GDP between the first and third quarters of the year was more than accounted for by recovery from the coal strike, but growth seems to have picked up again in the fourth quarter: the preliminary estimate of the output measure of GDP showed growth at an annual rate of  $2\frac{1}{2}$  per cent between the third and fourth quarters of the year. The flattening out of strike adjusted GDP during the middle of 1985 reflected in part the high level of business investment and North Sea output in the first quarter of the year. Output in most sectors of the economy, including manufacturing, continued on an upward trend throughout 1985.

Chart 3.9 Gross domestic product

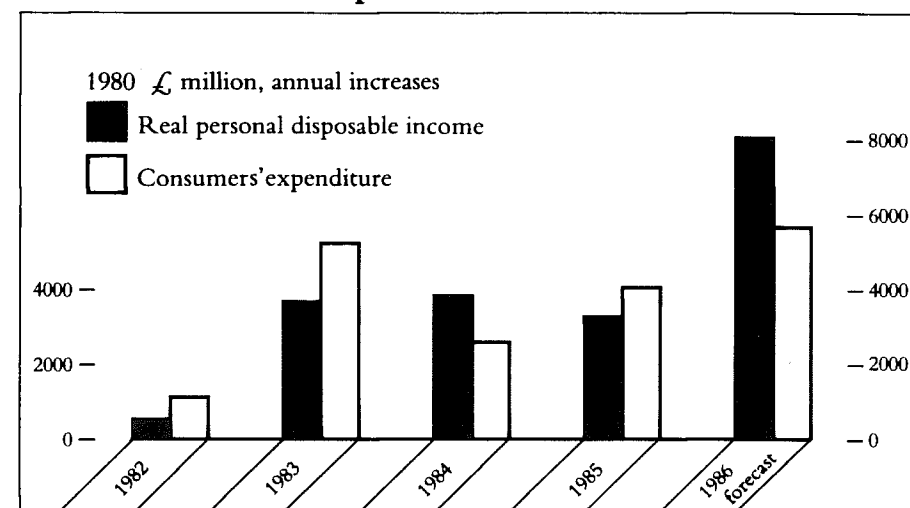


**Personal sector expenditure**

**3.43** Between 1980 and 1983 the inflation rate fell by about three-quarters and the personal saving ratio fell by almost a quarter. In 1984, with the uncertainties caused by the long coal strike, consumers were more cautious and saving rose. During 1985 spending picked up again, particularly spending on durables which was some 7-8 per cent higher in the second half of 1985 than in the second half of 1984.

**3.44** The combination of lower price inflation and little change in earnings growth, together with the Budget reduction in the standard rate of income tax and higher dividend income reflecting the buoyant profitability of the company sector, is expected to lead to substantial growth of **real personal disposable income** of about 5 per cent in 1986. There may be some increase in the saving ratio, as consumers adjust to higher levels of income; but most of the rise in incomes should be reflected in higher spending, with continuing strength in purchases of durables. Chart 3.10 shows recent and forecast changes in personal income and consumer spending.

**Chart 3.10 Personal income and expenditure**



**3.45 Investment in dwellings** by the personal sector fell between 1984 and 1985, but a resumption in growth is expected for 1986. Investment in housing improvements started to recover during 1985, and is expected to show further growth in 1986 as personal incomes rise. In spite of the increases in mortgage interest rates early in 1985, house prices remained firm; private housing starts which had fallen during 1984 were rising throughout 1985, and the total for the year was well above the number of completions. This trend in starts should show up in investment in new houses during 1986.

**3.46** The demand for housing (as reflected in house prices) and spending on consumer durables have both been resilient in the last year or so, in spite of the high level of real interest rates. The personal sector has been responding to the financial liberalisation of recent years and the greater availability of credit as well as to changes in interest rates. Borrowing from banks and building societies by the personal sector increased by about 18 per cent in 1985, and by 20 per cent a year on average between 1980 and 1985. This borrowing has not only helped to finance current consumption and spending on tangible assets, but has also been

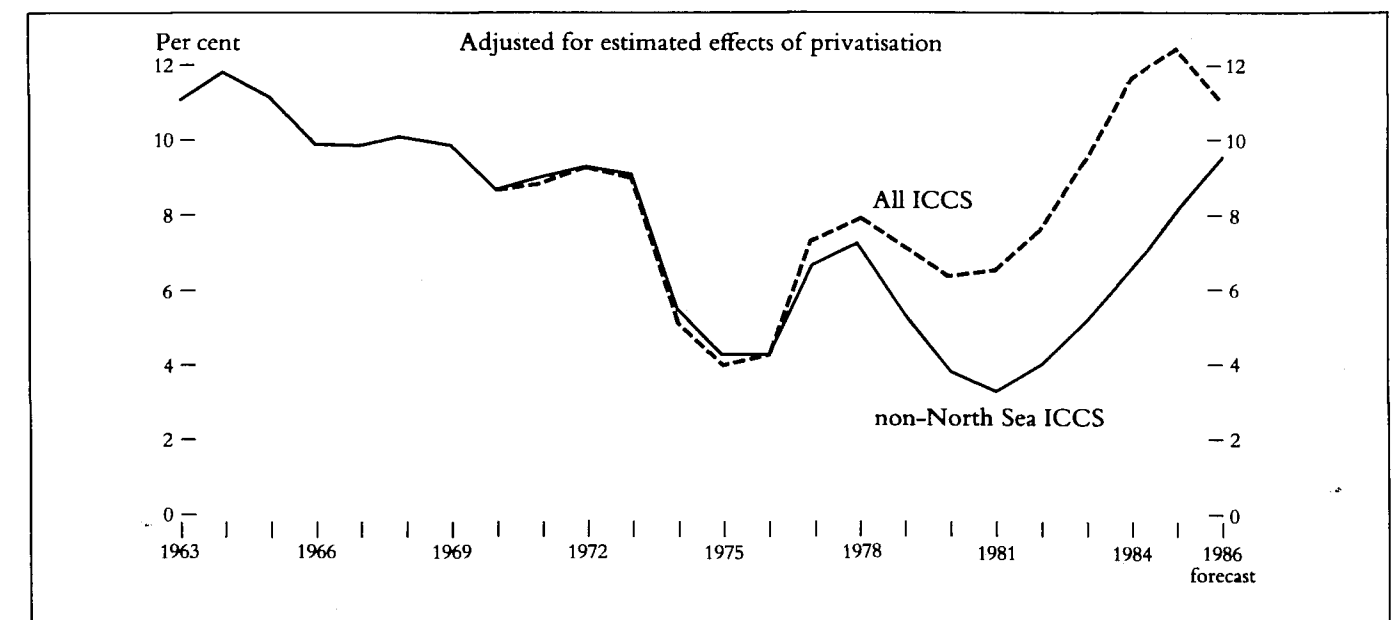
accompanied by substantial acquisition of financial assets: in fact the growth in the personal sector's financial assets has in recent years more than matched the growth in its liabilities, partly because of capital gains on holdings of equities and gilts.

**Company income and expenditure**

**Profitability 3.47** Company profitability has continued the recovery that began in 1981. The net real rate of return for all industrial and commercial companies (ICCs) for 1985 is estimated to have been the highest since 1960. For non-North Sea ICCs, profitability in 1985 was higher than any time since 1973.

**3.48** The recent sharp fall in oil prices will mean a substantial reduction in North Sea profits in 1986, and the overall return earned by ICCs may fall. However, non-North Sea ICCs will be prime beneficiaries of the fall in oil prices, as they have been of the weakness of other commodity prices during 1985; their profitability is expected to increase further in 1986 (see Chart 3.11).

**Chart 3.11 Real rate of return Industrial and commercial companies**



**Fixed investment 3.49 Total business investment**, including North Sea investment and investment by public corporations, grew by about 2 per cent in 1985. Within this total, manufacturing investment increased by about 6 per cent, after taking into account the increase in assets leased by manufacturing companies. This was a somewhat smaller increase than intentions surveys had earlier suggested was likely. The path of investment during 1985 was greatly influenced by the reduction in capital allowances which became effective at the end of the first quarter of the year. Leasing business was particularly buoyant in the first quarter and fell back heavily thereafter.

**3.50** 1986 is likely to see a similar quarterly pattern. The level of business investment in 1986 as a whole will be affected by the transition to

the reformed system of company taxation announced in the 1984 Budget: this gave firms an incentive to bring investment forward that would otherwise have taken place during 1986. The fundamental prospects for business investment remain very favourable. Profitability has been rising strongly: one indication of the past and prospective recovery in profits is the buoyancy of the stock market. In addition, there is evidence from CBI surveys that an expansion of capacity will be needed in a number of industries.

**3.51** The DTI survey published last December indicated an increase in manufacturing and service industries' investment of about 1 per cent, within which total manufacturing investment is expected to fall by about 2 per cent. By contrast the CBI interpret their most recent survey as implying a 5 per cent rise in manufacturing investment in the first three quarters of 1986 compared with the corresponding period of 1985. With the additional boost to profits of most companies from lower oil prices, a rise in business investment in 1986 of 5 per cent is forecast, rather more than suggested by the DTI survey.

**3.52** Table 3.8 provides details of the forecast for total investment and its major components. North Sea investment is expected to recover this year to a similar level to that in 1984, reflecting the development of new fields approved in 1985 and early 1986. Overall 1986 is expected to be a year of good growth in fixed investment.

**Table 3.8 Gross fixed domestic capital formation**

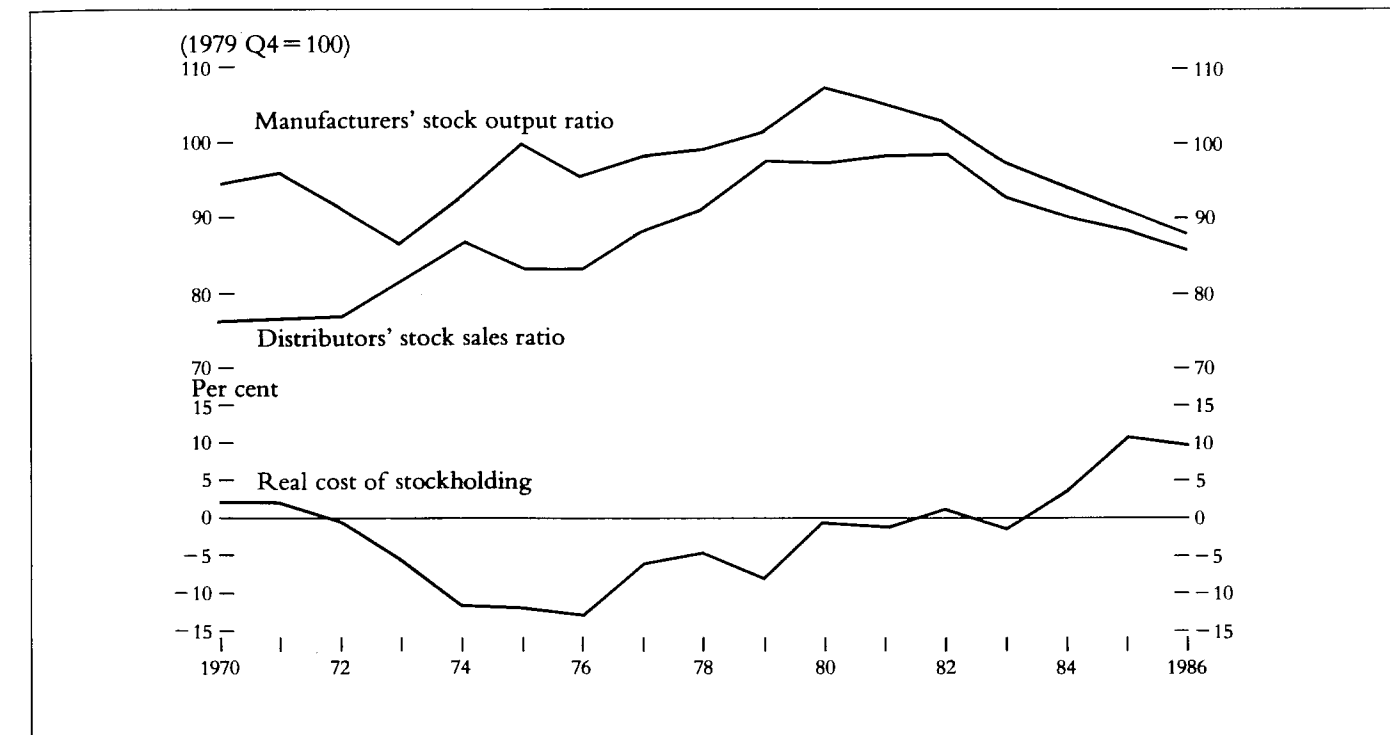
	£ billion at 1980 prices	Per cent changes on a year earlier		
		1984	1985	Forecast 1986
Business <sup>1</sup>	29.2	10	2	5
Private dwellings <sup>2</sup>	9.5	4	0	5
General government	6.8	4	5	2
<b>Total fixed investment</b>	<b>45.5</b>	<b>8</b>	<b>1</b>	<b>5</b>

<sup>1</sup>Including investment by public corporations

<sup>2</sup>Includes purchases less sales of land and existing buildings by persons, companies and public corporations, other than purchases of council houses.

**Stockbuilding** **3.53** Survey evidence suggests that despite the relatively low expenditure on **stock building** in 1985, most companies still regard their current stock levels as more than adequate in relation to output and sales. The fall in stock ratios in recent years may reflect in part cautious behaviour by companies after the last recession. Another factor has been the high cost of holding stocks as a result of the high level of real interest rates and the abolition of stock relief in the 1984 Budget. Stock ratios and the estimated real cost of holding stocks are illustrated in Chart 3.12.

**Chart 3.12 Stock ratios**



#### Prospects for demand and activity

**3.54** Strong growth in exports has made an important contribution to GDP growth over the last two years. In 1985 the increase in manufactured exports was well above the estimated increase in UK export markets, while UK imports of manufactures grew less than usual in relation to the growth in demand.

**3.55** The fall in oil prices has improved the prospects for world trade, and the adjustment of the exchange rate to lower oil prices has made British manufactures more competitive. As in most other industrial countries, higher domestic demand (stimulated by lower inflation) is expected to make an important contribution to growth in 1986, but exports should also show substantial growth (see Table 3.9). The slowdown forecast for export growth in the first half of 1987 reflects the path of North Sea oil output and hence oil exports.

**Table 3.9 Domestic demand and trade**

	Per cent changes on a year earlier (at constant prices)		
	Forecasts		
	1985	1986	1987 H1
Domestic demand	2½	3½	3
Exports of goods and services	6	5	3
Imports of goods and services	3	6	5

**3.56** Total domestic production is expected to increase by 3 per cent in 1986, following 3½ per cent growth in 1985. After allowance for the coal strike, growth is close to 2½ per cent in both years as shown in Table 3.10. The average level of oil production in 1986 is likely to be close to its level

in 1985 and 1984, but the fall forecast for oil output between the first half of 1986 and the first half of 1987 may cut total GDP growth by about  $\frac{1}{2}$  per cent. Output growth in the non-oil economy in 1986 and the first half of 1987 is expected to be comparable to that seen in 1985. Manufacturing output has grown slightly faster than GDP since 1983. The composition of demand growth in the forecast suggests that growth in manufacturing output may continue at around the underlying rate of growth of GDP.

**Table 3.10 Real GDP and manufacturing output**

	Per cent changes on year earlier		
	1985	Forecasts	
		1986	1987 H1
GDP (average measure)	3 $\frac{1}{2}$	3	2 $\frac{1}{2}$
GDP, adjusted for coal strike*	2 $\frac{1}{2}$	2 $\frac{1}{2}$	2 $\frac{1}{2}$
GDP, adjusted for coal strike and excluding oil output*	2 $\frac{1}{2}$	2 $\frac{1}{2}$	3
Manufacturing output	3	3	2 $\frac{1}{2}$

\* Adjustments are approximate

### Productivity and the labour market

**3.57 Total employment** in Great Britain is estimated to have grown by about 220 000 over the year ending September 1985, giving a total increase since March 1983 of over 700 000.

**3.58** The published figures show an increase of 12 000 in the number of employees in employment during the first nine months of 1985: a further rise in the number of employees in the service industries was largely offset by falls in the production and construction industries. Self employment is assumed to have risen by about 31 000 a quarter since the middle of 1984, the same as the estimated quarterly increase over the previous three years. This compares with an increase of about 68 000 a quarter recorded between the middle of 1983 and the middle of 1984. The estimates of growth in employment over the recent past shown in Table 3.11 are subject to revision when the Census of Employment for 1984 and the Labour Force Survey for 1985 become available.

**Table 3.11 Employment**

	Thousands, change in GB seasonally adjusted					
	Employees in employment			Self employed	HM Forces	Employed labour force
	Male	Female full-time	Female part-time			
September 1983 to September 1984	- 84	+ 19	+ 174	+ 236	+ 3	+ 348
September 1984 to September 1985	- 105	+ 20	+ 181	+ 125	- 2	+ 219

**3.59** Following upward revisions to the output estimates, output per head in manufacturing now appears to have risen by about 3 $\frac{3}{4}$  per cent in 1985, close to the annual average of 3 $\frac{1}{2}$  per cent for the period 1979-85. This marks a major improvement on the productivity performance recorded

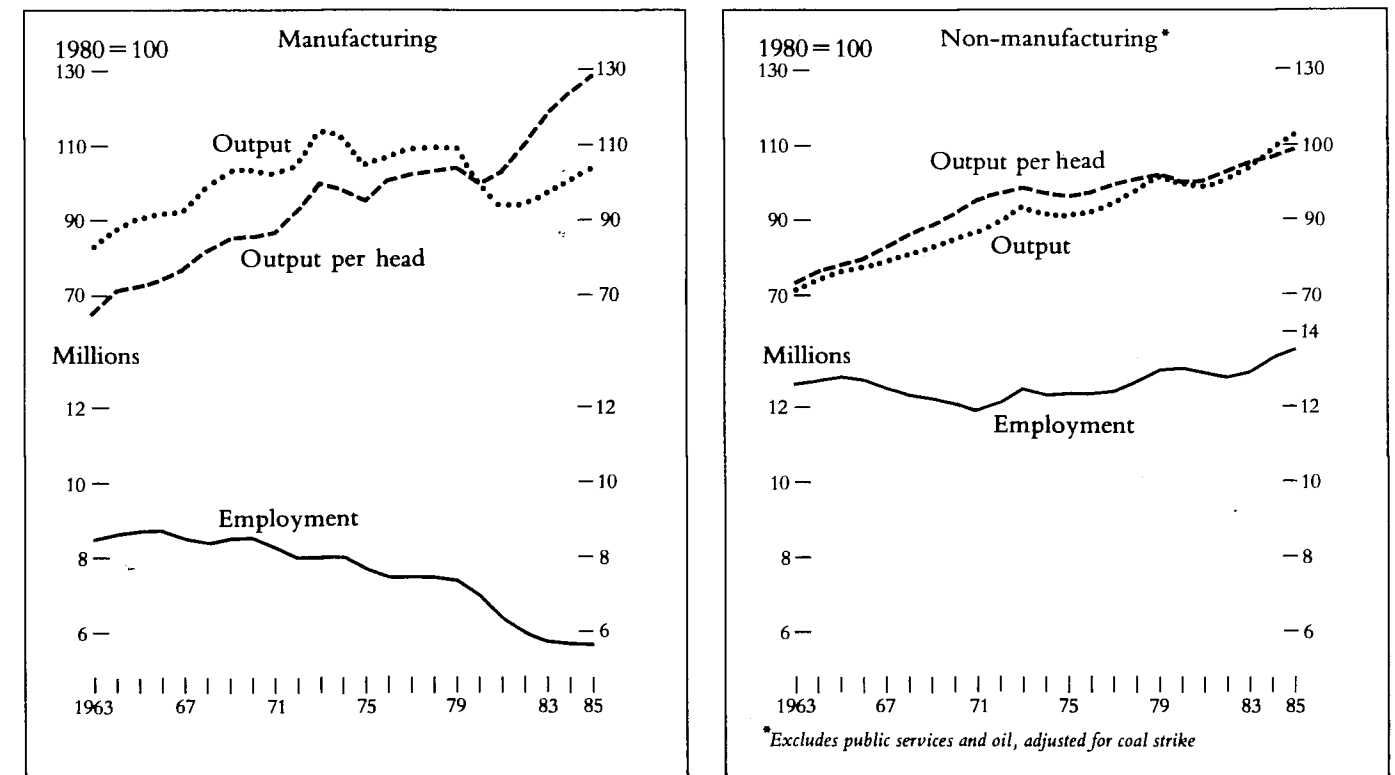
between 1973 and 1979: the trend growth in productivity in manufacturing now appears to be close to the rate achieved during the sixties (see Table 3.12). Non-manufacturing productivity has also been rising faster of late than in the 1973 to 1979 period. Growth in output per man hour has been rising at about 2 per cent per annum since 1979. However, the rise in part-time employment is currently bringing down growth in output per head in non-manufacturing, to about 1 per cent a year.

**Table 3.12 Output per head**

	Employed labour force (millions)	Per cent changes in output per head (annual averages)		
	1984	1964-73	1973-79	1979-85
Manufacturing	5 $\frac{1}{2}$	3 $\frac{3}{4}$	$\frac{3}{4}$	3 $\frac{1}{2}$
Non-manufacturing*	13 $\frac{1}{2}$	3	$\frac{1}{2}$	1

\* Excludes public services and oil, and includes nationalised industries except steel.

**Chart 3.13 Output, employment and output per head**



**Unemployment 3.60** The increase in employment since 1983 has not so far prevented a continuing rise in **unemployment**, as growth in the labour force has been exceptionally large. However, the rise in unemployment has slowed down over the last year: the average increase in adult unemployment was about 5 000 a month over the twelve months to February.

**3.61** Pay increases have generally been well above price rises and well above the rise in pay in most other industrialised countries (see Chart 3.8), thus contributing to the rise in unemployment in recent years. With output



and employment continuing to grow, and growth in the labour force slowing down, the prospects for unemployment are better than they have been for some years.

### Forecast and outturn

3.62 The table below compares the main elements of the forecast published in the 1985 FSBR with outturn or latest estimate:

Table 3.13 Forecast and outturn

	Forecast	Latest estimate/ forecast	Average errors from past forecasts
Total output: per cent change between 1984 and 1985	3½	3½	¾
RPI: per cent increase between the fourth quarters of 1984 and 1985	5	5½*	1½
Money GDP, per cent change between 1984-85 and 1985-86	8½	9½	1½
Current account of the balance of payments in 1985, £ billion	3	3	2½
PSBR, financial year 1985-86 £ billion	7	7	5

\* Outturn.

3.63 Inflation in the fourth quarter of 1985 turned out a little higher than forecast a year ago. The forecasts made at the time of the last Budget for output growth and the current balance in 1985, and for the PSBR in 1985-86, are all very close to the latest estimates for these variables. In each case such error as there appears to have been is considerably smaller than the average error from past forecasts.

3.64 This years' forecast is summarised in Table 3.14.

### Risks and uncertainties

3.65 No forecast is complete without an indication of error margins. Table 3.14 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide an indication of possible errors in the current forecast. Those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR, including the revenues of the public corporations, are about £200 billion; and for the current account of the balance of payments exceed £150 billion.

Table 3.14 The prospects: summary

	forecast	Average errors from past forecasts <sup>1</sup>
<b>A. Output and expenditure at constant 1980 prices</b>	per cent changes 1985 to 1986	
Domestic demand	3½	1
of which:		
Consumers' expenditure	4	1
General government consumption	1	1
Fixed investment	5	2
Change in stockbuilding (as per cent of level of GDP)	0	¾
Exports of goods and services	5	2½
Imports of goods and services	6	3
Gross domestic product: total	3	¾
manufacturing	3	2
<b>B. Inflation</b>		
Retail prices index	per cent changes	
1985Q4 to 1986Q4	3½	1½
1986Q2 to 1987Q2	3½	2½
Deflator for GDP at market prices	per cent changes on a year earlier	
Financial year 1985-86	6	1
Financial year 1986-87	3¾	2
<b>C. Money GDP at market prices</b>	per cent changes on a year earlier	
Financial year 1985-86	9½	1¼
Financial year 1986-87	6¾	1½
<b>D. Balance of payments on current account</b>	£billion	
1986	3½	2½
1987 first half (at an annual rate)	1½	3
<b>E. PSBR</b>	£ billion <sup>2</sup>	
Financial year 1985-86	7 (2)	1 (¼)
Financial year 1986-87	7 (1¾)	5 (1¼)

<sup>1</sup> The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications and government forecasts (see Economic Progress Report June 1981). The calculations of average errors are based on forecasts made between 1975 and 1984. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.

<sup>2</sup> Per cent of GDP at market prices shown in brackets.



Table 3.15 Constant price forecasts of expenditure, imports and gross domestic product\*

£ billion at 1980 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	Total final expenditure	Less Imports of goods and services	Less Adjustment to factor cost	Plus Statistical adjustment	Gross domestic product at factor cost	GDP index 1980=100
1981	136.5	48.9	37.9	62.0	− 2.5	282.9	55.9	30.0	− 0.5	196.5	98.6
1982	137.6	49.4	40.1	62.8	− 1.1	288.7	58.7	30.6	0.7	200.1	100.4
1983	142.9	50.2	42.2	64.4	0.7	300.4	62.1	31.5	0.1	206.7	103.7
1984	145.6	50.9	45.5	69.1	− 0.1	310.9	68.0	32.7	2.0	212.1	106.4
1985	149.6	51.2	45.9	73.2	0.9	320.9	70.1	33.6	1.8	219.0	109.9
1986	155.5	51.6	48.2	76.8	0.8	332.8	74.2	34.8	1.8	225.8	113.3
1984 H1	72.6	25.2	22.7	33.7	− 0.3	153.9	32.9	16.3	0.6	105.3	105.6
H2	73.0	25.7	22.8	35.4	0.1	157.0	35.1	16.4	1.4	106.9	107.3
1985 H1	74.0	25.5	23.2	36.8	0.2	159.7	35.0	16.6	1.0	109.1	109.4
H2	75.7	25.7	22.7	36.4	0.7	161.2	35.1	17.0	0.9	110.0	110.4
1986 H1	76.9	25.7	24.1	38.1	0.2	165.1	36.5	17.2	0.8	112.2	112.6
H2	78.6	25.8	24.0	38.7	0.6	167.7	37.6	17.5	1.0	113.6	114.0
1987 H1	79.9	25.9	24.2	39.3	0.7	170.0	38.3	17.7	0.9	114.9	115.3
Per cent changes											
1983 to 1984	2	1½	8	7	—	3½	9½	3½	—	2½	2½
1984 to 1985	3	½	1	6	—	3	3	3	—	3½	3½
1985 to 1986	4	1	5	5	—	3½	6	3½	—	3	3
1986 H1 to 1987 H1	4	½	0	3	—	3	5	3	—	2½	2½

\* GDP figures in the table are based on “ compromise ” estimates of gross domestic product, reflecting, for the past, average movements in constant price expenditure, output and income estimates of GDP. Percentage changes are calculated from

unrounded levels and then rounded to half per cent. Figures for 1986 H1 and beyond are forecasts. Figures for periods up to the end of 1985 are based mainly on the national accounts published earlier this year (covering periods up to 1985 Q3)

and incorporate some revised and later data and forecasts. A full set of national accounts, to end 1985, will be published by CSO on 21 March.

# 4 The Budget tax proposals

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

**Income tax** **4.02** The basic rate of income tax will be reduced to 29 per cent.

**4.03** Income tax personal allowances will be increased in line with the statutory indexation provisions (based on the increase of 5.7 per cent in the RPI in the year to December 1985). This will mean that:

—the single person's and wife's earned income allowances will rise from £2 205 to £2 335;

—the married allowance will rise from £3 455 to £3 655;

—the age allowance will rise from £2 690 to £2 850 (single) and from £4 255 to £4 505 (married) and the income limit from £8 800 to £9 400;

—the additional personal allowance and widow's bereavement allowance will rise from £1 250 to £1 320.

**4.04** Thresholds for the higher rates of income tax will be as follows:

Tax rate per cent	£
29	0–17 200
40	17 201–20 200
45	20 201–25 400
50	25 401–33 300
55	33 301–41 200
60	over 41 200

**Social security uprating** **4.05** The uprating date for social security benefits is being changed from November to April. As part of the transitional arrangements there will be an additional interim uprating in July 1986. Exceptionally, the Government has decided to exempt from income tax the amount of the increase payable in 1986–87 on retirement pensions and linked long term benefits.

**Visiting entertainers and sportsmen** **4.06** UK practice on the taxation of visiting entertainers and sportsmen will be brought into line with that in most other OECD countries by the introduction of deduction of tax at source, and other measures. The new arrangements will not come into effect until 1987–88.

**Excise duties** **4.07** The specific duties on cigarettes and hand rolling tobacco will rise by about 13½ per cent, equivalent to just over 11p on a packet of 20 cigarettes. Those on pipe tobacco and cigars will remain unchanged.

**4.08** Duties on alcoholic drinks will remain unchanged.

## 4 The Budget tax proposals

**4.09** Duties on road fuels will go up by a little more than 8 per cent or the equivalent of approximately 7½p on a gallon of petrol and 6½p on a gallon of derv.

**Vehicle excise duty** **4.10** The duty on cars, light vans, motor cycles and most lorries will remain unchanged. The duty rates on buses, coaches and taxis will rise by 5 per cent.

**Business Expansion Scheme** **4.11** The Business Expansion Scheme (BES) was due to come to an end on 1 April 1987. It is proposed to continue it indefinitely and to exempt new BES shares from capital gains tax on first sale. Certain low risk activities including those with high asset-backing are to be excluded. Certain forms of chartering of UK-registered ships are to be included.

**Capital transfer tax** **4.12** The lifetime capital transfer tax charge is to be abolished for all gifts between individuals made on or after Budget day. There will, however, remain a tax on transfers made on death. Gifts made within seven years of death will be charged but with taper relief. To reflect its new structure, the tax will be known as the inheritance tax.

**4.13** Under the new arrangements, there will continue to be a charge on transfers involving trusts and companies. Provision will be made to charge gifts in relation to which the donor may continue to enjoy a benefit. The exempt amount and rate bands of the tax will be increased from Budget day, as follows:

Rate on death per cent	Bands of chargeable value £000
0	0–71
30	71–95
35	95–129
40	129–164
45	164–206
50	206–257
55	257–317
60	Over 317

**Personal Equity Plans** **4.14** A new scheme, known as Personal Equity Plans, will be introduced to encourage individuals to invest directly in equities. Shares held in such plans will be free of any tax on both capital gains and reinvested dividend income. Investment of up to £2 400 will be permitted each year and the shares will have to be held for a minimum period of not more than two years.

**Stamp duties** **4.15** The rate of stamp duty on share transactions is to be reduced in the Autumn from 1 per cent to ½ per cent. The scope of the duty will be widened to cover the following transactions (currently exempt):

—Takeovers including mergers (but excluding company reconstructions): from 19 March;

—Certain loan stock: from 19 March;

—Letters of allotment: partly from 19 March and partly from the autumn;

—Intra account dealing: from the autumn;

—Company purchase of own shares: from the autumn.

A 5 per cent duty is being imposed where shares are converted into depositary receipts, from 19 March.

**Employee share schemes** 4.16 The following measures will be taken to encourage further the spread of approved employee share schemes:

—the extension of the present tax reliefs to shares which must be disposed of when the employment ends;

—changes to enable employee controlled companies and worker co-operatives more easily to take advantage of existing schemes;

—a more liberal regime for savings-related share options.

**Pension fund surpluses** 4.17 The present rules relating to pension fund surpluses will be clarified and revised as follows:

—pension funds' assets and liabilities will be valued, for tax purposes only, on standard assumptions advised by the Government Actuary;

—where such valuation shows an actuarial surplus of assets over liabilities of more than 5 per cent, the trustees shall be required to reduce it to not more than 5 per cent by (i) an increase in pension benefits (within existing limits), or (ii) a contribution reduction or holiday by either employer or employee, or (iii) a refund to the employer, or (iv) by any combination of these measures, the choice of method being for the trustees to decide;

—where a refund is made to the employer, it will be subject to tax in the employer's hands at a rate of 40 per cent;

—no refund will be permitted which would reduce the surplus to less than 5 per cent.

**Charitable giving** 4.18 Four new types of tax relief will be introduced:

—Companies, other than close companies, will for the first time be able to claim tax relief for single gifts to charity. The relief will be on single gifts up to a maximum equal to 3 per cent of the ordinary dividends paid by the company in the accounting period;

—The present annual limit of £10 000 on the amount of charitable giving through deeds of covenant for which an individual taxpayer may claim higher rate relief will be abolished—restrictions will remain only where the measures against abuse apply;

—There will be a new scheme from April 1987 to encourage individuals to make donations to charity through deductions from their wages and salaries. Employees whose employers participate in the scheme will be able to get tax relief on donations of up to £100 a year;

—VAT relief will be available on distress alarms and lifts for the handicapped and their charities, non-classified press advertising by charities, medicinal products supplied to charities, video and refrigeration

equipment used in medical applications by certain eligible bodies including charities, welfare vehicles used by such bodies to transport the deaf, blind and mentally handicapped, and recording equipment used by charities for the blind.

4.19 Measures are also to be taken to prevent abuse of the tax reliefs for charities.

**Business taxation** 4.20 The small companies' rate of corporation tax will be reduced to 29 per cent. As a consequence of the reduction in the basic rate of income tax, the rate of advance corporation tax (ACT) will be reduced to 29/71sts of the distribution. To reinforce this link between the rates, the Finance Bill will contain a provision for the ACT rate to be adjusted automatically in line with future changes in the basic rate of income tax.

4.21 The final stage in the business tax reforms introduced in 1984 will take effect on 1 April 1986 with the reduction in the main corporation tax rate to 35 per cent and (with a few mainly transitional exceptions) the full implementation of the new system of capital allowances. These reforms will be completed by updating the mines and oil wells capital allowances code, and adapting the system of allowances for agricultural buildings. In order to provide a full measure of tax depreciation for agricultural buildings and works with a short life, taxpayers may choose to take balancing adjustments on their disposal or destruction.

**Oil taxation** 4.22 Except for the updating of the mines and oil wells capital allowances code, no other changes are being proposed to oil taxation apart from technical changes to remove some anomalies.

**Capital gains tax** 4.23 The capital gains tax annual exempt amount is to be increased in accordance with the statutory indexation provisions from £5 900 to £6 300 in the case of individuals, and from £2 950 to £3 150 in the case of most trusts.

**Car and car fuel benefits** 4.24 The scales which determine the taxable cash equivalents of car and car fuel benefits in respect of company cars provided for directors, and for employees earning £8 500 a year or more, are to be changed from 6 April 1987. The present (1 300cc and 1 800cc) engine-size break points are to be aligned, on a revenue-neutral basis, with those (1 400cc and 2 000cc) in the proposed European Community Directive on car exhaust emissions. The resulting scale charges for car benefits (but not car fuel benefits) will be increased by 10 per cent for 1987–88. From April 1987 the car fuel benefit scale is to be used both for income tax purposes and to assess the VAT chargeable on fuel used for private journeys in business cars.

**Value added tax** 4.25 From 19 March 1986 the registration limits will become £20 500 per annum and £7 000 per quarter.

Table 4.1 Direct effects of changes in taxation

See Annex 4 Paragraph numbers	£ million		
	Estimated effect on receipts in: 1986-87		1987-88
	Changes from an indexed base	Changes from a non-indexed base	Changes from a non-indexed base
<b>INLAND REVENUE</b>			
<b>Income tax</b>			
1 Reduction of 1p in basic rate	-830	-830	-1 245
2 Increase in single allowance of £130 and married allowance of £200	—	-895	-1 130
3 Increase in additional personal allowance and widow's bereavement allowance of £70	—	-10	-10
4 Increase in age allowance of £160 (single) and £250 (married) and income limit of £600	—	-115	-145
5 Increase in basic rate limit of £1 000 to £17 200	—	-70	-115
6 Changes to further higher rate thresholds	+15	-35	-70
7 Abolition of higher rate relief limit for charitable covenants	*	*	-5
8 Relief for charitable donations through payroll deduction schemes	—	—	-20
9 Changes in rules for the tax treatment of visiting entertainers and sportsmen	—	—	+75
10 Fringe benefits—car and car fuel scales	—	—	+15
11 Changes to relief for overseas travel expenses	-10	-10	-5
12 Exemption for 1986-87 of July increase in retirement pensions and linked long term benefits	-15	-15	*
13 Changes in taxation of employee share acquisitions	*	*	*
14 Use of restricted shares in approved employee share schemes	*	*	*
15 Use of shares providing employee control in approved employee share schemes	*	*	*
16 Worker co-operatives' use of redeemable shares in approved profit-sharing schemes	*	*	*
17 Exercise of options granted under approved savings-related share option schemes	*	*	*
18 Change in basis of assessment of enterprise allowance	*	*	-5
19 Exemption of pensions paid to victims of Nazi persecution	*	*	*
<b>Income tax and capital gains tax</b>			
20 Tax relief for Personal Equity Plans	*	*	-25
21 Business Expansion Scheme—continuation beyond April 1987 and changes in coverage	*	*	+10
<b>Income tax and corporation tax</b>			
22 Rules for pension funds surpluses	+20	+20	+120
23 Mines and oil wells capital allowances	*	*	-45
24 Changes in agricultural buildings allowance rules	*	*	*
25 Changes in capital allowance rules for leased assets	*	*	*
26 VAT penalties, interest, surcharges and repayment supplement	*	*	*
<b>Income tax, corporation tax and capital gains tax</b>			
27 Charities: anti-avoidance measures	*	*	+20
28 Limiting scope of anti-bondwashing provisions	*	*	*
29 Amendments to accrued income scheme	*	*	*
<b>Income tax, corporation tax, capital gains tax and capital transfer tax</b>			
30 Changes in relation to securities	*	*	*
<b>Corporation tax</b>			
31 Reduction in rate of ACT to 29/71sts of the amount of the distribution	-120	-120	-60
32 Reduction in small companies rate to 29 per cent	*	*	-20
33 Relief for single donations to charity by companies	*	*	-35
34 Loans by close companies	*	*	*
35 Transfer of losses on company reconstruction	*	*	+5
<b>Corporation tax and capital gains tax</b>			
36 Small part disposals of land	—	—	-5

\* = Negligible — = Nil

Table 4.1 Direct effects of changes in taxation—continued

	£ million		
	Estimated effect on receipts in: 1986-87		1987-88
	Changes from an indexed base	Changes from a non-indexed base	Changes from a non-indexed base
<b>Oil taxation</b>			
37 Technical changes to remove anomalies	*	*	*
<b>Capital gains tax</b>			
38 Indexation of annual exempt amount	—	—	-5
39 Restriction of holdover relief for dual resident trusts	—	—	+5
<b>Capital transfer tax (inheritance tax)</b>			
40 Abolition of lifetime charge on transfers between individuals and consequential changes	-35	-35	-55
41 Indexation of chargeable rate bands	—	-20	-45
<b>Stamp duties</b>			
42 Reduction in rate on shares to $\frac{1}{2}$ per cent from autumn 1986	-70	-70	-75
43 Changes from 19 March 1986	+50	+50	+50
44 Other changes from autumn 1986	+20	+20	+35
<b>TOTAL INLAND REVENUE</b>	<b>-975</b>	<b>-2 135</b>	<b>-2 790</b>
<b>CUSTOMS AND EXCISE</b>			
<b>Value added tax</b>			
45 Increase in registration limits	—	*	*
46 Revised treatment of motoring expenses	—	—	+40
47 New rules on disaggregation of registrations	*	*	+20
48 Revised treatment of hotels and tourism	—	—	+10
49 Reliefs for charities and the handicapped	-10	-10	-10
50 Direct exports	—	—	—
51 Transfer of import relief	—	—	—
<b>Excise duties</b>			
52 No change in rate of spirits duty	-45	—	—
53 No change in rate of beer duty	-95	—	—
54 No change in rate of duty on cider and perry	-5	—	—
55 No changes in rates of wine and made wine duties	-30	—	—
56 Increases in rates of duty on petrol etc	+110	+380	+400
57 Increase in rate of duty on derv	+30	+95	+105
58 No change in rate of fuel oil duty	-5	—	—
59 Abolition of duty on most lubricating oils	-10	-10	-10
60 Abolition of duty on AVTUR	-10	-10	-10
61 Increase in rate of duty on gas oil	+25	+30	+30
62 Increases in rates of tobacco products duties	+175	+315	+335
63 Abolition of certain excise licences	*	*	*
64 Northern Ireland betting and gaming	*	*	*
65 Excise warehousing regulations	—	—	—
<b>TOTAL CUSTOMS AND EXCISE</b>	<b>+130</b>	<b>+790</b>	<b>+910</b>
<b>Vehicle excise duty (VED)</b>			
66 No change in VED on car, light van and main lorry rates	-135	—	—
67 Increases in other VED rates	—	+5	+5
68 Changes in trade licensing arrangements	*	*	*
<b>Other</b>			
69 Bus fuel grants	-5	-10	-10
<b>TOTAL CHANGES IN TAXATION</b>	<b>-985</b>	<b>-1 350</b>	<b>-1 885</b>

\* = Negligible — = Nil

# Annex to Chapter 4

## How the figures in Table 4.1 have been calculated

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

The **direct** effect of a tax change is the difference between the yield of the 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).

For **Inland Revenue** taxes (and VED) the difference in yield for each tax is generally calculated by applying the pre- and post-Budget tax regimes to the same tax base. This base is the post-Budget base—that is the levels of income, profits etc forecast for future years on the assumption that all the measures proposed in the Budget take effect. In certain cases, however, the difference in yield also takes account of changes in taxpayers' behaviour arising from the tax change where these behavioural changes can be directly attributed to the change in tax. For example, the estimate of the direct cost of the cut in stamp duty rate allows for the expected increase in chargeable transactions.

For **Customs and Excise** taxes and duties, the calculation takes into account, where possible, the effect of the tax change on the pattern of consumers' expenditure and the resulting impact on other expenditure taxes but makes no allowance for secondary effects: in particular, it is assumed that total consumers' expenditure does not change. A fuller description of the methodology is in Economic Trends, March 1980.

Table 4.1 shows the expected change in **receipts** of tax resulting from the Budget proposals. Additional information is provided in the commentary below for those proposals where the effect on tax **liabilities** in the first complete year to which the change applies (full year effect) is substantially different from the effect on **receipts** in either 1986–87 or 1987–88; or where the impact of the proposal is expected to build up over a period of years.

The direct effects shown in the third column of Table 4.1 assume that the levels of allowances, rates of duty etc proposed in the Budget for 1986–87 continue to apply for 1987–88 and compare the effect on receipts in that year with allowances and rates of duty unchanged from their money levels in 1985–86 (the unindexed base).

The estimates shown in Table 4.1 do not reflect changes in the tax base arising from changes in money incomes and in the general level of prices and other economic variables which may result from the proposed tax change. These secondary effects are, of course, taken into account in estimating the impact of the tax change on the PSBR. The base for the post-Budget forecast of each tax (given in Table 6.B.3) takes account of the effects, direct and secondary, of all the measures announced in the Budget.

The remainder of this annex provides a commentary on the Budget proposals in Table 4.1. The paragraph numbers refer to the lines in this table.

- Income tax**
- 1 The basic rate will be reduced from 30 per cent to 29 per cent. The cost figures in the table for this item assume that the changes in items 2–5 have been made first. They include the saving in public expenditure on mortgage interest relief to those below the tax threshold. But they do not include ACT, which is shown in line 31 of Table 4.1.
  - 2 The single person's allowance and the wife's maximum earned income relief will be increased from £2 205 to £2 335 and the married allowance from £3 455 to £3 655.
  - 3 The additional personal allowance and widow's bereavement allowance will be increased from £1 250 to £1 320.
  - 4 The age allowance will be increased for the single person from £2 690 to £2 850, and for the married from £4 255 to £4 505; the age allowance income limit will be increased from £8 800 to £9 400.
  - 5 The basic rate limit will be increased to £17 200.
  - 6 The width of the 40 per cent higher rate band will be maintained at £3 000; the 45 per cent band at £5 200 and the 50 per cent and 55 per cent bands at £7 900.
  - 7 The £10 000 limit on higher rate relief for covenanted donations to charities will be abolished.
  - 8 From April 1987 relief will be introduced for charitable donations of up to £100 a year made through payroll deduction schemes. The cost estimate depends on take up.
  - 9 New rules will be introduced for the tax treatment of visiting entertainers and sportsmen who derive income from the UK. In later years, the yield from this measure is expected to be in excess of £100 million a year.
  - 10 (a) With effect from 1987–88, the present engine size breakpoints in the scales for taxing car and car fuel benefits in respect of company cars provided for directors, and for employees whose remuneration is at a rate of £8 500 a year or more, will be changed on a revenue neutral basis and the new scale for car benefits will be increased by 10 per cent. The scale charges for expensive cars and for cars without an engine rated in ccs will also be increased by 10 per cent, and the market value breakpoints for these cars will remain unchanged.  
(b) There will be a simplification of the return employers have to make of those directors, and employees whose remuneration is at a rate of £8 500 a year or more, who are not in receipt of benefits or expenses payments.
  - 11 The relief for certain overseas travel expenses incurred by UK resident employees working abroad and by expatriates working in the UK will be extended from 1984–85. Reliefs for overseas travel and subsistence, comparable to those that are available to UK resident employees working wholly abroad, will be extended to UK resident self employed persons with businesses wholly abroad. The higher first year cost arises from the proposal to apply these improvements with effect from 6 April 1984.
  - 12 For 1986–87 the increase in retirement pensions and linked long term benefits payable from July 1986 will be exempted from income tax.
  - 13 The tax charging provisions relating to directors' and employees' acquisitions of shares and interests in shares in their companies will be amended.
  - 14 The use of shares subject to restrictions on their retention by ex-directors and ex-employees will be permitted in approved employee share schemes.



15 The use of shares of a class, the majority of which is held by directors and employees and which gives them control of the company, will be permitted in approved employee share schemes.

16 Registered worker co-operatives will be able to use redeemable shares in approved profit sharing schemes.

17 Approved savings-related share option schemes will be enabled to permit exercise of options within three years in certain circumstances.

18 The basis of assessment of the enterprise allowance will be changed from Case I or Case II to Case VI of Schedule D.

19 Certain pensions paid to victims of Nazi persecution will be exempted from income tax.

**Income tax and capital gains tax**

20 A new tax relief will be introduced for individuals investing in equities. The cost will build up over a number of years and will depend on take up.

21 The duration of the Business Expansion Scheme will be extended indefinitely; an exemption from capital gains tax will be introduced on the first sale of new qualifying shares and certain changes will be made to the coverage of the scheme. The scheme has a full year cost at current levels of investment of about £100 million. The 1987-88 figure includes a small first year cost for continuing the scheme after April 1987.

**Income tax and corporation tax**

22 The rules relating to occupational pension fund surpluses will be clarified and refunds from overfunded schemes to sponsoring employers will be charged to tax at 40 per cent. The figure for 1987-88 includes a yield of £70 million in corporation tax and income tax reflecting changed levels of contributions to or benefits paid from pension funds. The overall yield, including the charge on refunds, may be about £250 million in each of the following three years.

23 The mines and oil wells capital allowances code will be amended, in particular to change to percentage based writing down allowances on a reducing balance and incurred basis, instead of the existing output-related allowances. The cost will decline gradually in later years.

24 The provisions governing the agricultural buildings allowance will be amended. The cost will be up to £5 million in the early 1990s and up to £20 million in the longer term.

25 The legislation relating to capital allowances on machinery or plant which is leased and on certain vehicles will be amended.

26 Deductions for VAT penalties, interest and surcharges will be disallowed and VAT repayment supplement will be disregarded. The yield will build up over time to about £40 million by 1991-92.

**Income tax, corporation tax and capital gains tax**

27 Provisions to counter abuse of the tax reliefs for charities will be introduced.

28 Certain securities within the accrued income scheme will be removed from the scope of the anti-bondwashing provisions.

29 Changes will be made to the accrued income scheme.

**Income tax, corporation tax, capital gains tax and capital transfer tax**

30 Changes will be made in relation to securities including replacing special rules for Stock Exchange jobbers by rules for market makers.

**Corporation tax**

31 The rate at which advance corporation tax for 1986-87 will be payable will be fixed at 29/71sts of the amount of the distribution. This will increase subsequent liability to mainstream corporation tax. The full year cost is £10 million.

32 The small companies rate of corporation tax for the financial year 1986-87 will be reduced to 29 per cent.

33 A relief from tax will be introduced for single donations to charity by companies which are not close. The cost may rise to about £100 million depending on take up.

34 An anomaly in the taxation of loans to participators in close companies will be corrected. Without this measure there could have been widespread avoidance, costing tens of £ millions.

35 The transfer of tax losses on a company reconstruction will be restricted. The yield will rise eventually to about £50 million a year.

**Corporation tax and capital gains tax**

36 The provisions dealing with small part disposals of land will be amended.

**Oil taxation**

37 (a) The allocation of tariff charge in cases of fields in common ownership which received development consent on the same day will be clarified.

(b) The onshore/offshore boundary for oil tax purposes will be defined to coincide with the UK coastline.

(c) An alternative basis for determining the market value of certain light gases will be provided.

**Capital gains tax**

38 The annual exempt amount will be increased in line with the increase in the retail prices index during 1985 so that for 1986-87 an individual will be exempt on the first £6 300, and most trusts on the first £3 150, of capital gains.

39 The hold-over relief for gifts to dual resident trusts will be amended.

**Capital transfer tax (inheritance tax)**

40 (a) The charge on transfers between individuals made on or after 18 March 1986 and more than seven years before the transferor's death will be abolished. Inheritance tax will be charged on other transfers on or after that date. The estimated eventual effect attributable to transfers in 1986-87 is £70 million. If increased lifetime giving reduces the amounts in the death estates of donors, the CTT yield from those death estates will be reduced.

(b) Transfers made on or after 18 March 1986 but within seven years of the transferor's death will be charged according to the scale for transfers on death; the charge will be reduced in the case of transfers more than three years before death.

(c) For events on or after 18 March 1986 the period for cumulation of a transferor's or settlor's previous chargeable transfers for the purpose of the rate of tax on transfers into trust and on property held in trust will be reduced from ten to seven years.

(d) Gifts with reservation of benefit made on or after 18 March 1986 will be taxed in connection with the donor's death as if the whole of the gifted asset had remained in his estate until the reservation was finally given up.

41 (a) The tax will in future be known as the inheritance tax. The bands of chargeable value for transfers on death occurring on or after 18 March 1986 will be increased broadly in line with the increase of 5.7 per cent in the retail prices index in the year to December 1985. The proposed rate structure is shown in paragraph 4.13.



(b) Transfers (other than between individuals) not within seven years of the transferor's death will be charged at half the death rates.

**Stamp duties**

42 The rate of duty on transfers of shares will be reduced from 1 per cent to  $\frac{1}{2}$  per cent with effect from the autumn. The duty on additional transactions expected to follow from the reduction in the rate is taken into account in the costing. The figure for 1987-88 takes account of the increased yield in capital gains tax arising on the additional transactions. This yield may be expected to increase in subsequent years.

43 With effect from 19 March 1986:

—Duty will be charged at a rate of  $\frac{1}{2}$  per cent on takeovers and certain other company reorganisations;

—A new exemption for company reconstructions will be introduced;

—Exemptions from sale duty for certain categories of loan stock will be withdrawn;

—The exemption from bearer instrument duty for bearer letters of allotment will be withdrawn;

—Duty will be charged at 5 per cent on the conversion of shares into depositary receipts and on the transfer of shares to certain clearing houses.

44 With effect from a date in the autumn:

—A charge will be imposed on intra-account and other share transactions which do not at present pay stamp duty;

—The exemption from sale duty for most letters of allotment and for purchases by a company of its own shares will be withdrawn;

—There will be an exemption for market makers.

**Value added tax**

45 The registration limit will be increased to £20 500 per annum and £7 000 per quarter.

46 The Inland Revenue fuel benefit scale will be used to assess VAT chargeable on fuel used for private journeys in business cars from 6 April 1987.

47 The law will be changed to counter tax avoidance by artificial disaggregation of businesses.

48 The VAT provision relating to long stays in hotels by individuals will be restricted, with effect from 1 November 1986.

49 VAT relief will be made available for distress alarms and lifts for the handicapped and their charities; non-classified press advertising by charities and medicinal products supplied to charities; video and refrigeration equipment used in medical applications by certain eligible bodies, including charities; welfare vehicles used by such bodies to transport the deaf, blind or mentally handicapped; and recording equipment used by charities for the blind.

50 The law will be amended to enable regulations to be made specifying conditions to be satisfied for the zero rating of certain exports.

51 The law will be amended to allow for the transfer of VAT import relief and its obligations to a person other than the original importer.

**Excise duties** 52-55 There will be no changes in the duties on alcoholic drinks.

56 The duty on petrol will be increased by 7½p a gallon (inclusive of consequential VAT.)

57 The duty on derv will be increased by 6½p a gallon (inclusive of consequential VAT.)

58 There will be no change in the duty on fuel oil.

59 The duty on most lubricating oils will be abolished.

60 The duty on aviation kerosene will be abolished.

61 The duty on gas oil will be increased by 1½p per gallon.

62 The duties on cigarettes (and hand rolling tobacco) will be increased by 11.1p per packet of 20 cigarettes (inclusive of consequential VAT).

63 The duties on excise licences under the Alcoholic Liquor Duties Act 1979 and the Matches and Mechanical Lighters Duties Act 1979 will be abolished.

64 The provisions of the Betting and Gaming Duties Act 1981 relative to general betting duty, pool betting duty and bingo duty will be extended to Northern Ireland.

65 Powers will be taken to make certain amendments to regulations relating to goods in warehouses or travelling to or from them.

**Vehicle excise duties**

66 There will be no change in the duties on cars, light vans and most lorries.

67 From 19 March 1986 the rate of duty for hackney carriages of up to 20 seats will be increased to £52.50, and the additional payment for each additional seat to £1.05. The concessionary rates of duty for farmers' heavy goods vehicles over 7.5 tonnes will be increased by varying amounts as a second stage in the process of bringing them into line with the proportion of average mileage covered by these vehicles on public roads.

68 From 1 January 1987 the rate of duty for trade licences will be increased to £70 for cars and £14 for motorcycles. The increase in trade licence rates will be part of a package of measures reforming trade licence arrangements, including widened availability and changes in the duration for which they are available to six months and 12 months. A new type of probationary trade licence is also to be introduced for new businesses and for businesses where there is a doubt whether there is sufficient business to justify a full licence.

**Bus fuel grants**

69 Bus fuel grants to certain bus service operators will automatically be increased to compensate them for the increase in duty on derv.

# 5 Public expenditure

**Public spending trends** 5.01 The public expenditure planning total is the measure on which the Government's spending controls are based. Table 5.1 and Chart 5.1 show the path of the planning total in cash and in real terms ie after adjusting for the rate of inflation as measured by the GDP deflator. (Assumptions for money GDP and the growth of the GDP deflator are given in Chapter 2.)

**Table 5.1 Public expenditure**

	£ billion				
	1984-85 Outturn	1985-86 Estimate	1986-87 Provision	1987-88 Plans	1988-89 Plans
<b>Department</b>					
DHSS – Social security	38.1	41.3	42.9	44.4	45.9
Defence	17.2	18.0	18.5	18.8	19.0
DHSS – Health and personal social services	15.8	16.7	17.7	18.4	19.1
Scotland, Wales and Northern Ireland	13.7	14.5	15.0	15.0	15.2
Education and science	14.0	14.3	14.3	14.4	14.5
Other	33.0	31.7	31.2	31.2	31.6
Privatisation proceeds	-2.1	-2.6	-4.7	-4.7	-4.7
Reserve			4.5	6.3	8.0
Adjustments			-0.4 <sup>1</sup>		
<b>Public expenditure planning total</b>	<b>129.6</b>	<b>133.9</b>	<b>139.1</b>	<b>143.9</b>	<b>148.7</b>
General government gross debt interest <sup>2</sup>	16.1	17.7	18.2	19	19
Other adjustments <sup>2</sup>	4.3	6.2	6.1	7	7
<b>General government<sup>2</sup> expenditure</b>	<b>150.0</b>	<b>157.7</b>	<b>163.4</b>	<b>170</b>	<b>175</b>
<b>Planning total in real terms (base year 1984-85)</b>	<b>129.6</b>	<b>126.3</b>	<b>126.6</b>	<b>126.2</b>	<b>126.0</b>
<b>General government expenditure as percentage of GDP</b>	<b>46</b>	<b>44</b>	<b>42½</b>	<b>41½</b>	<b>40½</b>

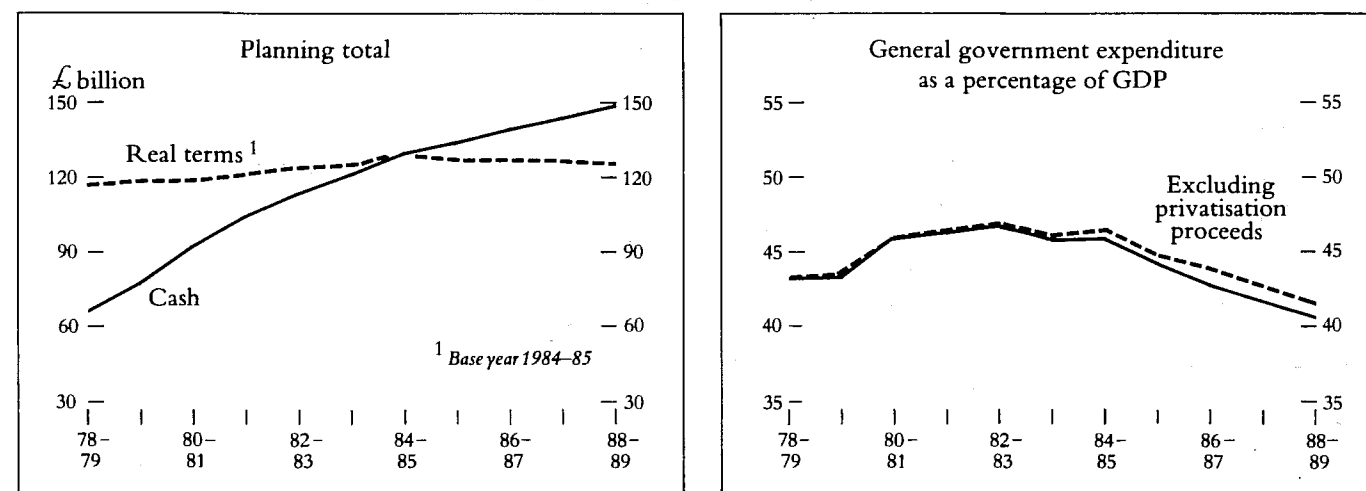
<sup>1</sup> External finance of - £400 million for nationalised industries to be privatised in 1986-87.

<sup>2</sup> 1987-88 and 1988-89 figures rounded to nearest £ billion.

5.02 The latest estimates suggest that the planning total outturn in 1985-86 is likely to be slightly below the figure set at the time of the 1985 Budget. Even after allowing for the effects of the miners' strike, spending in real terms in 1985-86 should be below the level of 1984-85, the first time since 1977-78 that there has been no increase in real terms. For the three following years the expenditure plans in cash terms are as set out in the 1986 Public Expenditure White Paper. In real terms the planning total is expected to remain broadly constant over the period to 1988-89.

**5.03** Table 5.1 and Chart 5.1 also show that general government expenditure as a percentage of GDP is projected to continue the downward trend established since 1982-83, with a substantial further fall over the next three years. By 1988-89 the percentage is expected to be the lowest since 1972-73. This would be the case even without any proceeds from privatisation.

**Chart 5.1 Trends in public expenditure 1978-79 to 1988-89**



**5.04** General government expenditure covers spending by central government and local authorities. It is the definition of government spending used in the national accounts, the forecasts and the MTFS. The main difference between general government expenditure and the planning total is general government gross debt interest, amounting to some £18 billion in 1986-87. There are also a number of other definitional differences and adjustments which are described in Part 7 of the 1986 Public Expenditure White Paper, paragraph 42. In 1986-87, these adjustments account for a further £6 billion.

#### Employment measures

**5.05** The Budget includes new public expenditure measures to assist enterprise and employment. The gross cost of these measures for the UK as a whole (see Table 1.1) will be about £195 million in 1986-87, £290 million in 1987-88 and £320 million in 1988-89. The net public expenditure cost after allowing for offsetting savings on social security benefits will be of the order of £100 million in 1986-87, £165 million in 1987-88 and £180 million in 1988-89. These net costs will be charged against the Reserves provided in the White Paper, and thereby met within unchanged planning totals. Summer Supplementary Estimates will be presented to Parliament in due course for the extra resources required by the Department of Employment and the Manpower Services Commission in 1986-87.

**5.06** The counselling scheme for the long term unemployed, and the Jobstart scheme, also for the long term unemployed, both of which were introduced in January 1986 on a pilot basis, are to be developed into a single programme (Restart) covering the whole country as soon as possible. The costs of this extension will be about £100 million in 1986-87 and £70 million in 1987-88.

**5.07** The number of places on the Community Programme, which is also targeted at long term unemployed adults, is being raised to 255 000 from the existing level of nearly 200 000 places. Extra provision for this and for an increase in the average wage limit to £67 per week will be £60 million in 1986-87 and £120 million in 1987-88.

**5.08** A new scheme has been announced to help 18-20 year olds to find jobs. This scheme, the New Workers Scheme, will provide for an allowance of £15 per week for employers taking on 18 to 19 year olds on earnings of £55 per week or less and 20 year olds on earnings of £65 per week or less. The cost of this scheme is expected to be £25 million in 1986-87 and £50 million in 1987-88.

**5.09** The Enterprise Allowance Scheme for those unemployed who set up in business on their own account is to be expanded to an annual rate of 100 000 entrants by April 1987, as against the current rate of about 65 000. The cost of this will be about £5 million in 1986-87 and about £35 million in 1987-88.

#### Loan Guarantee Scheme

**5.10** The Loan Guarantee Scheme, under which the Government guarantees 70 per cent of qualifying loans to small businesses, is being extended for a further three years, with revised rules. The premium is being halved to 2½ per cent, and there are to be ceilings on the portfolio of loans covered of £90 million in 1986-87 and £130 million in the two subsequent years. The cost will be about £5 million in 1987-88.

#### Supply Estimates

**5.11** For 1986-87, the plans set out in the Public Expenditure White Paper have now been translated into detailed control totals. The Supply Estimates set out the sums that the Government asks Parliament to vote for most expenditure by Government departments and certain other bodies. The main Estimates for 1986-87 are published on 18 March 1986 with a Summary and Guide (Cmnd. 9742) which summarises the Estimates and explains how they relate to the public expenditure planning total. Of the £99.1 billion included in the Supply Estimates, £74.6 billion is direct public expenditure in line with the plans published in the White Paper for public expenditure to be voted in Estimates. Nearly 60 per cent of the money voted in Estimates is subject to cash limits, which provide the Government with greater control over its cash expenditure during the financial year.

**Table 5.2 Supply expenditure**

	£ billion		1985-86 Expected outturn	1986-87 Provision
	1984-85 Expected outturn in 1985 Budget	Final outturn		
Main Supply Estimates	90.4 <sup>1</sup>	90.4 <sup>1</sup>	96.0	99.1
Supplementaries and net under-spending	3.4	3.2	2.0	
<b>Total Supply expenditure</b>	<b>93.8</b>	<b>93.6</b>	<b>98.1</b>	
(public expenditure element)	(70.6)	(70.6)	(74.9)	

<sup>1</sup> Adjusted for abolition of NIS.

# 6 Public sector transactions

**6.01** The tables in Chapter 6 provide further information on transactions of the public sector in 1985-86 and 1986-87. They elaborate the more rounded and summary figures shown in other Chapters. The forecasts for 1986-87 incorporate the effects of the Budget measures. The basis of the tables and the relationship between them is outlined in the Annex to this chapter.

## The PSBR 1985-86 estimates

**6.02** The forecast a year ago for the PSBR in 1985-86 was £7.1 billion. Borrowing in the 11 months to February totalled £2.8 billion, but the scale of borrowing in March is always high, with high expenditure and in some cases low income (for example, local authorities have low rate income in that month), and is expected to be higher than usual because of low oil revenues. The latest estimate of the outturn for the year is £6.8 billion or 2 per cent of GDP, but there remains substantial uncertainty surrounding the estimates both of the PSBR itself and of its components (expenditure and revenue). Table 6.1 shows the sectoral composition of the PSBR.

**Table 6.1 Public sector borrowing requirement\***

	£ billion	
	1985-86	Latest estimate
1 Central government on own account		4.9
2 Local authority borrowing from central government	4.8	
3 Local authority borrowing from market and overseas	-2.7	
4 Total local authority borrowing		2.1
5 Public corporations' borrowing from central government	1.1	
6 Public corporations' borrowing from market and overseas	-1.3	
7 Total public corporations' borrowing		-0.2
<b>8 Public sector borrowing requirement</b>		<b>6.8</b>
Memorandum item:—		
Central government borrowing requirement (lines 1 + 2 + 5)		10.7

\*The average errors in PSBR forecasts made at this time of year, over the last ten years, are  $\pm$  £1 billion for the current year and  $\pm$  £5 billion for the year ahead. See Table 3.14. Over the last five years, the error for the year ahead has averaged nearer 1 per cent of GDP, equivalent to  $\pm$  £4 billion in 1986-87.

## 6 Public sector transactions

**6.03** Although there is little net change in the estimated PSBR in 1985-86 since the forecast made a year ago, there are some sizeable changes in its components:

- (i) A reduction of about £2 billion in **oil revenues** (as forecast in the Autumn Statement), to £11½ billion, mainly because the dollar/sterling exchange rate has turned out higher than assumed in the 1985 Budget. (The sharp drop in the dollar oil price since December has had little effect on revenues in 1985-86, because of the lags in payments.)
- (ii) An increase in **other revenues** of around £1½ billion. VAT receipts are expected to be some £1 billion higher, mainly reflecting some increase in the proportion of consumers' spending on goods subject to VAT. Capital tax receipts are expected to be some £½ billion higher, because of higher receipts from capital gains and a greater number of estates subject to capital transfer tax. Corporation tax receipts (excluding North Sea tax receipts) are expected to be some £¼ billion higher, because of increased dividend payments.
- (iii) A slight shortfall in the estimated **planning total** outturn.

## 1986-87 projections

**6.04** The PSBR in 1986-87 is forecast to be £7.1 billion, or 1½ per cent of GDP, slightly below the projection for 1986-87 in the 1985 MTFS. Again there are sizeable changes in the components, both since the 1985 MTFS projections (see Annex to Chapter 2) and between 1985-86 and 1986-87:

- (i) **Oil revenues** are now forecast at around £6 billion in 1986-87, compared with £11½ billion estimated in 1985-86. The reason is mainly the drop in the dollar oil price. (The forecast assumes that the price of North Sea crude averages \$15 per barrel for the rest of 1986\*, and that the dollar/sterling exchange rate does not change much.)
- (ii) **Non-oil revenues** are forecast to rise by 9 per cent between 1985-86 and 1986-87, a little under the 9½ per cent rise in non-oil money GDP. Within the overall increase there is:

- a rise of 13 per cent in **corporation tax receipts** (excluding North Sea tax receipts), reflecting the estimated rise of around 20 per cent in non North Sea company incomes between 1984 and 1985;
- a rise of 8½ per cent in **income tax receipts** (the buoyancy from the expected real growth in incomes is more than offset by the reduction in the basic rate);
- a rise of 9 per cent in **expenditure tax receipts**, reflecting further real growth in consumers' expenditure;
- a rise of 12 per cent in **capital tax receipts**, mainly on capital gains.

(iii) **Expenditure**, on the other hand, is little changed from the 1985 PSBR projections. In particular, the **planning total** remains the same, and represents only a 4 per cent increase in cash terms on the estimated outturn for 1985-86.

\* If prices were \$1 per barrel lower on average in 1986, but other things—including the exchange rate—were unchanged, North Sea revenues would be around £½ billion lower in 1986-87.

**Government transactions by sector**

**6.05** Tables 6.2 to 6.4 show forecasts of receipts and expenditure for central government, local authorities and public corporations respectively, in both 1985–86 and 1986–87. Expenditure in 1986–87 is understated since the expenditure Reserve has not been allocated.

**Table 6.2 Central government transactions**

	£ billion	
	1985–86 Latest estimate	1986–87 Forecasts
<i>Receipts</i>		
Taxes and royalties	99.4	102.0
National insurance and other contributions	24.3	26.2
Other	9.9	10.2
<b>Total receipts</b>	<b>133.6</b>	<b>138.4</b>
<i>Expenditure</i>		
Current expenditure on goods and services	46.4	49.1
Current grants and subsidies	71.6	74.3
Interest	16.1	17.0
Net lending and capital expenditure, excluding on-lending to local authorities and public corporations	4.4	2.3
<b>Total expenditure</b>	<b>138.5</b>	<b>142.7*</b>

\*Excluding any allocation from the expenditure Reserve

**6.06** Central government spending includes grants and subsidies to local authorities and public corporations (including nationalised industries), which are included in the receipts of those sectors, shown in Tables 6.3 and 6.4.

**Table 6.3 Local authority transactions**

	£ billion	
	1985–86 Latest estimate	1986–87 Forecasts
<i>Receipts</i>		
Rates (net of rate rebates) <sup>1</sup>	13.7	15.6
Rate support grant	11.2	11.8
Other grants from central government	9.6	10.0
Other	5.1	5.1
<b>Total receipts</b>	<b>39.6</b>	<b>42.6</b>
<i>Expenditure</i>		
Current expenditure on goods and services	28.2	28.5
Current grants and subsidies	5.3	5.1
Interest	4.2	4.5
Net lending and capital expenditure	4.0	3.7
<b>Total expenditure</b>	<b>41.7</b>	<b>41.8<sup>2</sup></b>

<sup>1</sup> Memo: Rate rebates

<sup>2</sup> Excluding any allocation from the expenditure Reserve

**6.07** Local authority receipts consist primarily of rate income plus grant from central government. The forecast increase in net rate income between 1985–86 and 1986–87 is based on recent information about rate decisions by individual local authorities.

**6.08** The latest estimate of local authority borrowing in 1985–86 (shown in Table 6.1) takes account of the Borrowing Intentions Survey of a sample of authorities. However, borrowing in the last month of the financial year is always very high and the margin of error is correspondingly great. The source of their borrowing is still more uncertain: in 1985–86 they are expected to have borrowed much more from central government than forecast in the 1985 Budget, and to have repaid correspondingly more to the market, but in 1984–85 it was the other way round.

**Table 6.4 Public corporations' transactions**

	£ billion	
	1985–86 Latest estimate	1986–87 Forecasts
<i>Receipts</i>		
Gross trading surplus (including subsidies)	7.5	7.7
Other	3.1	2.7
<b>Total receipts</b>	<b>10.7</b>	<b>10.4<sup>1</sup></b>
<i>Expenditure</i>		
Interest, dividends and taxes on income	4.1	3.7
Net lending and capital expenditure	6.4	5.8
<b>Total expenditure</b>	<b>10.5</b>	<b>9.4<sup>1</sup></b>

<sup>1</sup> Excluding any allocation from the expenditure Reserve

**6.09** The public corporations' receipts include subsidies and capital grants from central and local government. For the nationalised industries (and the majority of other public corporations), their net external finance—that is their borrowing plus those subsidies and grants—is included in the planning total. The effects of the coal strike have continued in 1985–86, adding about £1 billion to the industries' financing needs, for example for coal stock rebuilding by the Electricity Supply Industry.

**Analysis by economic category**

**6.10** Table 6.5 overleaf gives further details of the public sector transactions underlying Tables 6.2 to 6.4.

Table 6.5 Public sector transactions by sub-sector and economic category

	Line <sup>2</sup>	£ billion <sup>1</sup>			Public corpora- tions	Public sector
		1985-86 Latest estimate				
		General government				
		Central govern- ment	Local authori- ties	Total		
<i>Current and capital receipts</i>						
Taxes on income, and oil royalties	1	54.0	—	54.0	- 0.3	53.8
Taxes on expenditure	2	42.9	13.7	56.6	—	56.6
Taxes on capital	3	2.5	—	2.5	—	2.5
National insurance and other contributions	4	24.3	—	24.3	—	24.3
Gross trading surplus	5	- 0.3	0.3	- 0.1	7.5	7.4
Rent and miscellaneous current transfers	6	0.3	2.9	3.2	0.5	3.7
Interest and dividends from private sector and abroad	7	2.9	0.6	3.5	1.1	4.7
Interest and dividends within public sector	8	5.5	- 2.6	2.9	- 2.9	—
Imputed charge for non-trading capital consumption	9	0.9	1.4	2.3	—	2.3
Capital transfers from private sector	10	—	—	—	0.2	0.2
<b>Total</b>	<b>11</b>	<b>133.0</b>	<b>16.3</b>	<b>149.2</b>	<b>6.2</b>	<b>155.5</b>
<i>Current and capital expenditure</i>						
Current expenditure on goods and services	12	- 46.4	- 28.2	- 74.6	—	- 74.6
Subsidies	13	- 5.6	- 1.2	- 6.8	—	- 6.8
Current grants to personal sector	14	- 43.2	- 4.1	- 47.2	—	- 47.2
Current grants paid abroad	15	- 2.6	—	- 2.6	—	- 2.6
Current grants within public sector	16	- 20.2	20.2	—	—	—
Debt interest	17	- 16.1	- 1.5	- 17.7	- 0.6	- 18.2
Gross domestic fixed capital formation	18	- 3.1	- 3.5	- 6.6	- 6.0	- 12.6
Increase in stocks	19	- 0.5	—	- 0.5	- 0.1	- 0.6
Capital grants to private sector	20	- 2.1	- 0.7	- 2.9	- 0.1	- 3.0
Capital grants within public sector	21	- 1.2	0.7	- 0.6	0.6	—
<b>Total</b>	<b>22</b>	<b>- 141.1</b>	<b>- 18.4</b>	<b>- 159.4</b>	<b>- 6.2</b>	<b>- 165.7</b>
Unallocated Reserve	23	—	—	—	—	—
<b>Financial surplus/deficit</b>	<b>24</b>	<b>- 8.1</b>	<b>- 2.1</b>	<b>- 10.2</b>	<b>—</b>	<b>- 10.2</b>
<i>Financial transactions</i>						
Net lending to private sector and abroad	25	- 0.1	0.2	0.1	- 0.2	—
Cash expenditure on company securities (net) (including privatisation proceeds)	26	2.7	—	2.7	—	2.7
Transactions concerning certain public sector pension schemes	27	0.4	—	0.4	—	0.4
Accruals adjustments	28	- 0.4	0.1	- 0.3	0.4	0.1
Miscellaneous financial transactions	29	0.5	- 0.3	0.3	- 0.1	0.2
<b>Borrowing requirement</b>	<b>30</b>	<b>4.9</b>	<b>2.1</b>	<b>7.0</b>	<b>- 0.2</b>	<b>6.8</b>

<sup>1</sup> Sign convention: receipts positive, payments negative.<sup>2</sup> Relationship between lines: (24) = (11) + (22) + (23) = - (25) to (30)

	£ billion <sup>1</sup>					
	1986-87 Forecasts					
	General government			Public corporations	Public sector	
Line <sup>2</sup>	Central government	Local authorities	Total			
						<i>Current and capital receipts</i>
1	52.9	—	52.9	- 0.2	52.8	Taxes on income and oil royalties
2	46.3	15.6	61.9	—	61.9	Taxes on expenditure
3	2.8	—	2.8	—	2.8	Taxes on capital
4	26.2	—	26.2	—	26.2	National insurance and other contributions
5	- 0.6	0.3	- 0.3	7.7	7.4	Gross trading surplus
6	0.3	2.9	3.3	0.5	3.8	Rent and miscellaneous current transfers
7	3.2	0.6	3.8	1.0	4.8	Interest and dividends from private sector and abroad
8	5.7	- 3.1	2.6	- 2.6	—	Interest and dividends within public sector
9	1.0	1.4	2.4	—	2.4	Imputed charge for non-trading capital consumption
10	—	—	—	0.2	0.2	Capital transfers from private sector
11	<b>137.8</b>	<b>17.8</b>	<b>155.6</b>	<b>6.7</b>	<b>162.2</b>	<b>Total</b>
						<i>Current and capital expenditure</i>
12	- 49.1	- 28.5	- 77.6	—	- 77.6	Current expenditure on goods and services
13	- 5.8	- 0.9	- 6.7	—	- 6.7	Subsidies
14	- 44.9	- 4.2	- 49.1	—	- 49.1	Current grants to personal sector
15	- 2.5	—	- 2.5	—	- 2.5	Current grants paid abroad
16	- 21.1	21.1	—	—	—	Current grants within public sector
17	- 17.0	- 1.2	- 18.2	- 0.6	- 18.7	Debt interest
18	- 3.3	- 3.4	- 6.7	- 5.6	- 12.2	Gross domestic fixed capital formation
19	- 0.2	—	- 0.2	—	- 0.2	Increase in stocks
20	- 2.1	- 0.6	- 2.7	- 0.1	- 2.8	Capital grants to private sector
21	- 1.4	0.7	- 0.6	0.6	—	Capital grants within public sector
22	<b>- 147.3</b>	<b>- 17.0</b>	<b>- 164.3</b>	<b>- 5.6</b>	<b>- 169.9</b>	<b>Total</b>
23					- 4.5	Unallocated Reserve
24					<b>- 12.2</b>	<b>Financial surplus/deficit</b>
						<i>Financial transactions</i>
25	- 0.2	0.3	—	- 0.1	—	Net lending to private sector and abroad
26	4.8	—	4.8	—	4.8	Cash expenditure on company securities (net) (including privatisation proceeds)
27	0.6	—	0.6	—	0.6	Transactions concerning certain public sector pension schemes
28	- 0.1	—	- 0.1	—	- 0.1	Accruals adjustments
29	0.2	- 0.4	- 0.2	- 0.1	- 0.3	Miscellaneous financial transactions
30					<b>7.1</b>	<b>Borrowing requirement</b>



# Annex to Chapter 6

## Part A: Relationship between tables in Chapter 6, and with Table 1.2; and outturn data

### Relationship between tables

**6A.1** Table 6.5 is based on the definitions used to compile the national accounts. In order to show the financial deficit (which is often used in international comparisons), lending and other financial transactions are separated from the analysis of receipts and expenditure in lines 1–23 and shown in lines 25–29. These lines show the relationship between the financial deficit (line 24) and the borrowing requirement (line 30).

**6A.2** Tables 6.2–6.4 are summary versions of the sectoral columns of Table 6.5. The information in Table 6.5 is rearranged so that, for example, central government grants to local authorities (which appear as negative expenditure in the local authorities column of Table 6.5, lines 16 and 21) appear as receipts in Table 6.3. Interest paid by local authorities to central government (which appears as negative receipts in the local authorities column of Table 6.5, line 8) appears as expenditure in Table 6.3. Finally, lending and other financial transactions (lines 25–29 of Table 6.5) are included in the receipts and expenditure of Tables 6.2–6.4.

**6A.3** Table 1.2 in Chapter 1 uses the same information as Table 6.5, but again rearranges it. To derive general government expenditure, it starts by giving a functional breakdown of the public expenditure planning total: that includes not only general government expenditure items in the third column of Table 6.5 (including the “financial transactions” in lines 25–26), but also borrowing or capital expenditure by public corporations in the fourth column. General government expenditure as shown in Table 1.2 is then obtained by adding general government debt interest from the third column of Table 6.5 and the national accounts adjustments already included in Table 6.5, and deducting public corporations’ borrowing from the market and from overseas.

**6A.4** Alternatively, general government expenditure in Table 1.2 (and Table 2.3) can be obtained as the sum of lines 22, 23, 25 and 26 (third column) in Table 6.5 and on-lending to public corporations in Table 6.1.

**6A.5** To derive general government receipts, Table 1.2 takes the receipts shown in the third column of Table 6.5 (lines 11, 27, 28 and 29) and rearranges them according to the type of activity which gives rise to them. For example, oil revenues comprise North Sea corporation tax and petroleum revenue tax (included in “taxes on income” in Table 6.5) plus oil royalties. The sub total “total taxes and royalties” is the same as the first line of Table 2.4 in Chapter 2.

### Outturn data

**6A.6** Outturns for the PSBR and the statutory central government accounts (as in Tables 6.B.1–4 in Part B of the Annex) are compiled monthly and published by press notice 12 working days after the end of the month and then in more detail in Tables 2.5 and 3.12 to 3.16 of the following issue of Financial Statistics. Outturn for the details of the PSBR on national accounts definitions, as in Table 6.5, are compiled quarterly and published in sections 2 to 5 of Financial Statistics three months after the end of the quarter.

**6A.7** The first outturn for the PSBR in 1985–86 will accordingly be published on April 16. The first national accounts outturns for 1985–86 will appear in the June issue of Financial Statistics, including supplementary Table 13 which is based on Table 6.5.

## Part B: Central government transactions

### Commentary on the tables

**6B.1** The tables in Part B of this Annex are confined to central government transactions only, and are based on the statutory funds and accounts. Their relationship to the accounts of central government on a national accounts basis (as in Table 6.2) is described in the Financial Statistics Explanatory Handbook (1986 edition, p38). The receipts and payments in the Part B tables are all shown on a cash basis, not accrued. Table 1.2, however, shows the main categories of taxes on an accrued basis as in the national accounts: for instance “income tax” differs slightly between Table 1.2 and Table 6.B.3.

**Table 6.B.1 Summary of central government transactions**

	£ billion 1985–86 latest estimate
<i>Consolidated Fund</i>	
Revenue (Table 6.B.3)	105·8
Expenditure (Table 6.B.2)	– 110·2
Deficit met from National Loans Fund	– 4·5
<i>National Loans Fund (Table 6.B.4)</i>	
Receipts	14·3
Payments	– 23·9
<b>Total net borrowing by the National Loans Fund</b>	<b>– 9·7</b>
Other funds and accounts (net)	– 1·1
<b>Central government borrowing requirement (Table 6.1)</b> (including borrowing for on-lending to local authorities and public corporations)	<b>– 10·7</b>

**Table 6.B.2 Consolidated Fund expenditure**

	£ million 1985–86 latest estimate
<b>Supply issues<sup>1</sup></b>	<b>98 100<sup>2</sup></b>
<i>Standing services</i>	
Payment to the National Loans Fund in respect of service of the national debt	7 700
Northern Ireland—share of taxes etc.	1 800
Payments to the European Communities	2 600 <sup>2</sup>
Other services	60
<b>Total standing services</b>	<b>12 200</b>
<b>Total Consolidated Fund expenditure</b>	<b>110 200</b>

<sup>1</sup> Supply Issues are monies paid from the Consolidated Fund to Departments’ cash accounts with the Paymaster General for spending on Supply. Supply Expenditure (see Table 5.2) equates closely to total Supply Issues in most years, although there may sometimes be slight timing differences between the two.

<sup>2</sup> £960 million was paid to the European Communities from Supply Issues instead of Standing Services.

Table 6.B.3 Consolidated Fund revenue

	£ million		
	1985-86		1986-87
	Budget forecast	Latest estimate	Forecast
<i>Inland Revenue</i>			
Income tax <sup>1</sup>	35 200	35 100	38 500
Corporation tax <sup>2 3</sup>	10 100	10 700	11 700
Petroleum revenue tax <sup>4</sup>	8 200	6 400	2 400
Capital gains tax	790	930	1 050
Development land tax	55	60	35
Capital transfer tax (inheritance tax) <sup>5</sup>	760	890	910
Stamp duties	1 100	1 230	1 430
<b>Total Inland Revenue</b>	<b>56 200</b>	<b>55 300</b>	<b>56 000</b>
<i>Customs and Excise</i>			
Value added tax	18 300	19 300	20 700
Petrol, derv etc. duties	6 500	6 500	7 300
Cigarettes and other tobacco	4 300	4 300	4 700
Spirits, beer, wine, cider and perry	4 200	4 200	4 400
Betting and gaming	700	730	800
Car tax	760	880	980
Other excise duties	20	20	20
EC own resources <sup>6</sup>			
Customs duties, etc.	1 400	1 200	1 300
Agricultural levies	100	160	160
<b>Total Customs and Excise</b>	<b>36 300</b>	<b>37 300</b>	<b>40 400</b>
Vehicle excise duties <sup>7</sup>	2 500	2 400	2 500
National Insurance surcharge	30	30	—
Gas levy	520	520	500
Broadcasting receiving licences	790	990	1 000
Interest and dividends	870	910	840
Other <sup>8</sup>	9 200	8 400	7 400
<b>Total Consolidated Fund revenue</b>	<b>106 500</b>	<b>105 800</b>	<b>108 600</b>

<sup>1</sup> See paragraph 6.B.1.<sup>2</sup> Includes advance corporation tax (net of repayments)<sup>3</sup> North Sea corporation tax of which satisfied by setting off ACT

Liability to corporation tax arising in respect of North Sea production may be satisfied by setting off ACT arising on dividends paid in previous periods in respect of both onshore and offshore activities. Dividends and ACT associated with North Sea activities alone cannot be identified.

<sup>4</sup> Includes advance payments of petroleum revenue tax.<sup>5</sup> Includes estate duty.<sup>6</sup> Customs duties and agricultural levies are accountable to the European Communities as 'own resources'; actual payments to the Communities are recorded in Table 6.B.2.<sup>7</sup> Includes driving licence receipts.<sup>8</sup> Includes the 10 per cent of 'own resources' refunded by the European Communities to meet the costs of collection, other receipts from the European Communities, privatisation proceeds and oil royalties (see Table 1.2).

Table 6.B.4 National Loans Fund receipts and payments

	£ million 1985-86 Latest estimate
<b>Receipts</b>	
Interest on loans, profits of the Issue Department of the Bank of England, etc.	6 600
Service of the National Debt—balance met from the Consolidated Fund	7 700
<b>Total receipts</b>	<b>14 300</b>
<b>Payments</b>	
<i>Service of the National Debt</i>	
Interest	14 100
Management and expenses	170
<b>Total Service of the National Debt</b>	<b>14 300</b>
<i>Loans to:</i>	
Nationalised industries	90
Other public corporations	260
Local authorities	4 800
Private sector and within central government	90
<b>Total National Loans Fund lending<sup>1</sup></b>	<b>5 200</b>
Consolidated Fund deficit	4 500
<b>Total payments</b>	<b>23 900</b>

<sup>1</sup> On lending to local authorities and public corporations in Table 6.1 includes, in addition to National Loans Fund lending, net lending from other funds and accounts (mainly Supply Issues in Table 6.B.2).