

Table 6.9 National Loans Fund Receipts and Payments

	£ million		
	1983-84	1984-85	
	Budget forecast	Latest estimate	Forecast
Receipts			
Interest on loans, profits of the Issue Department of the Bank of England, etc.	5 400	5 400	5 800
Service of the National Debt—balance met from the Consolidated Fund	6 000	6 400	6 800
Total Receipts	11 300	11 800	12 600
Payments			
Service of the National Debt			
Interest	11 200	11 600	12 500
Management and expenses	140	140	140
Total	11 300	11 800	12 600
Loans to Nationalised Industries:			
National Coal Board	600	760	440
Electricity (England, Wales and Scotland)	180	-630	-420
Water (England and Wales)	410	300	330
Other	-110	-250	-220
Total	1 080	180	130
Loans to other Public Corporations:			
New Towns—Development Corporations and Commission	310	210	280
Housing Corporations	230	-20	100
Scottish Special Housing Association	30	30	30
Other	20	-10	-10
Total	600	200	400
Loans to Local Authorities	2 000	4 200	4 400
Other Loans⁽¹⁾	-50	40	-10
Total—Net Lending	3 600	4 600	4 900
Total Payments	15 000	16 400	17 500

⁽¹⁾ To private sector and within central government.

Financial Statement and Budget Report 1985-86

RETURN to an Order of the House of Commons dated 19 March 1985: for

COPY of FINANCIAL STATEMENT AND BUDGET REPORT 1985-86 as laid before the House by the CHANCELLOR OF THE EXCHEQUER when opening the BUDGET

Treasury Chambers,
19 March 1985 } JOHN MOORE

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1. The Budget Proposals

Definition of the Budget

- 1.01 The main proposals in the Budget are summarised in Table 1.1 below and described in detail in Parts 4 and 5. The Budget is defined to include tax changes and changes to national insurance contributions announced in the Budget Speech, together with certain other tax changes which have been announced since last year's Budget. It also includes the expenditure consequences of new measures announced in the Budget Speech for the plans set out in the Public Expenditure White Paper (Cmnd. 9428).

Table 1.1 Budget measures: direct effects on public sector transactions⁽¹⁾

	Effect in 1985-86		Effect in a full year ⁽²⁾	
	Changes from an indexed base	Changes from a non-indexed base	Changes from an indexed base	Changes from a non-indexed base
Tax proposals⁽³⁾				
Income tax allowances and thresholds	-730	-1 590	-910	-2 025
Capital taxes	-20	-30	-215	-260
VED	+130	+230	+130	+230
Other Excise duties ⁽⁴⁾	+105	+590	+110	+605
VAT	+60	+60	+190	+190
Other tax changes	-40	-40	+235	+235
Total tax proposals	-495	-780	-460	-1 025
Proposed changes in National Insurance Contributions				
Employers' NICs	-30	-30	-80	-80
Employees' NICs	-100	-100	-270	-270
Self employed etc. NICs	-30	-30	-100	-100
Total NICs proposals	-160	-160	-450	-450
Expenditure Measures⁽⁵⁾				
Youth Training Scheme	Nil	Nil	-150	-150
Community Programme	-75	-75	-250	-250
Total Expenditure measures	-75	-75	-400	-400
Total Direct Effects⁽⁶⁾	-730	-1 015	-1 310	-1 875

⁽¹⁾ +/— indicates an increase/decrease in revenue, or a decrease/increase in expenditure. All figures are rounded to the nearest £5 million.

⁽²⁾ See footnote (a) to Table 4.2.

⁽³⁾ The figures are estimates of the direct effects of the tax proposals on public sector transactions. They are not estimates of the total effects, both direct and indirect. See footnote (a) to Table 4.2.

⁽⁴⁾ Including bus fuel grants.

⁽⁵⁾ The figures show the direct expenditure consequences of these measures after allowing for consequential savings in unemployment and supplementary benefits as people who would otherwise be claiming benefit join the schemes. The figures shown in the full year columns are estimates of the cost in 1987-88.

⁽⁶⁾ Since these are estimates of direct effects the overall total differs from the effect of these measures on the PSBR—which is shown in paragraph 1.05.

Taxation

- 1.02 The net effect of the tax proposals in the Budget is shown on two alternative bases. The first, conventionally used in the preparation of economic forecasts, allows for the full indexation of 1984-85 excise duty rates and main income tax allowances and thresholds in line with inflation in the year to December 1984. On this basis, the tax proposals in the Budget are expected to cost £495 million in 1985-86. The second basis, which corresponds with the actual changes in tax rates and allowances to be included in the Finance Bill, measures the effects of those changes as compared with existing rates and allowances. On this basis, the increase in income tax allowances and thresholds is estimated to cost £1,590 million and the increase in excise duties to yield an additional £820 million in 1985-86.

National insurance contributions

- 1.03 The cost of the changes to national insurance contributions is expected to be £160 million in 1985-86. Details are given in Part 4.

Expenditure measures

- 1.04 Table 1.1 lists the net costs of the public expenditure measures in the Budget. These will be added to the public expenditure planning totals. Details of these and other changes to the planning totals are given in Part 5.

PSBR

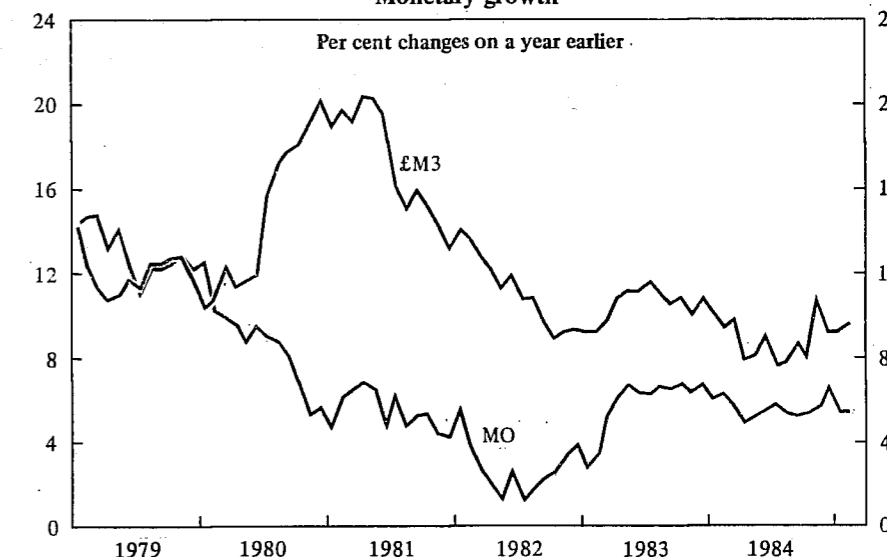
- 1.05 The PSBR for 1985-86 has been set at £7 billion, or 2 per cent of GDP at market prices. The Budget measures are expected to contribute about $\frac{3}{4}$ billion to this figure over and above the cost of simply indexing tax rates and allowances. This allows for indirect as well as direct effects on public sector transactions.

2. Medium-term Financial Strategy

- 2.01 The Medium Term Financial Strategy (MTFS) has provided the financial framework for economic policy since 1980. It is designed to achieve falling inflation, with the ultimate objective of stable prices, through a progressive decline in monetary growth supported by lower public sector borrowing.
- 2.02 Within this framework, the economy has now been growing steadily for nearly four years as inflation has fallen to around 5 per cent. Productivity has risen by 11 per cent over the same period and, since early 1983, employment has increased by nearly half a million. The Government will continue to encourage enterprise, efficiency and flexibility in both the public and private sectors—by promoting competition and the improved working of markets, by pressing ahead with privatisation and by improving incentives. Moderate pay settlements will lead to more jobs and lower unemployment; adherence to the MTFS guarantees that this moderation will not result in a reduction in overall demand.

Recent financial conditions

- 2.03 During the past year, growth of the targeted narrow money aggregate M0 has been near the centre of its range. Growth of the targeted broad money aggregate £M3 has been around the top of its range. Inflation has been broadly as envisaged a year ago; and output has risen by $2\frac{1}{2}$ per cent despite the coal strike. However, the PSBR and interest rates have both been higher than expected, and the exchange rate lower, particularly against a very strong dollar.

CHART 2.1**Monetary growth**

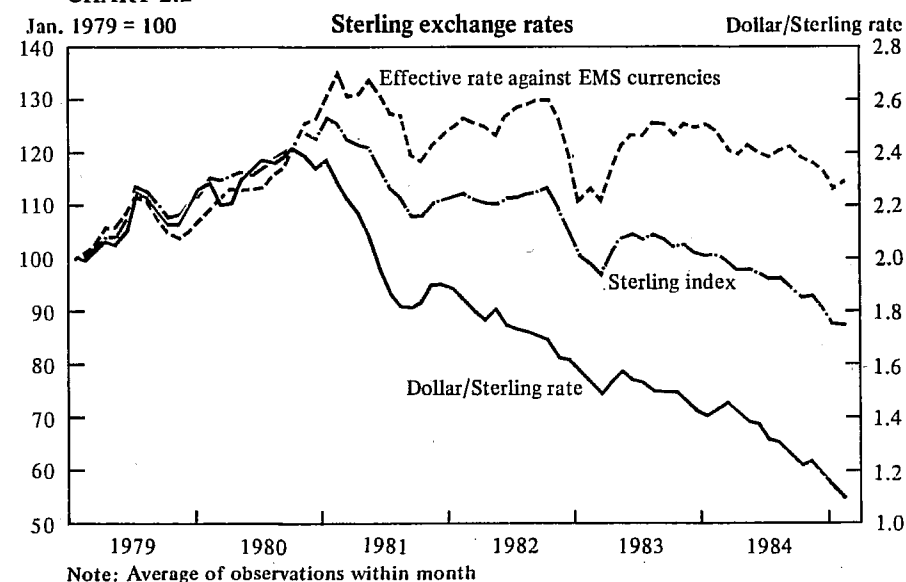
Note: Based on banking months

- 2.04 Other measures of narrow money grew significantly faster than M0, but were distorted by identifiable factors. The growth of M1 continued to be inflated by the rise in its interest-bearing component, particularly wholesale deposits. M2,

of broad money; and interpretation was complicated by changes in the terms of some building society accounts. Neither aggregate provided useful information on narrow money to complement M0.

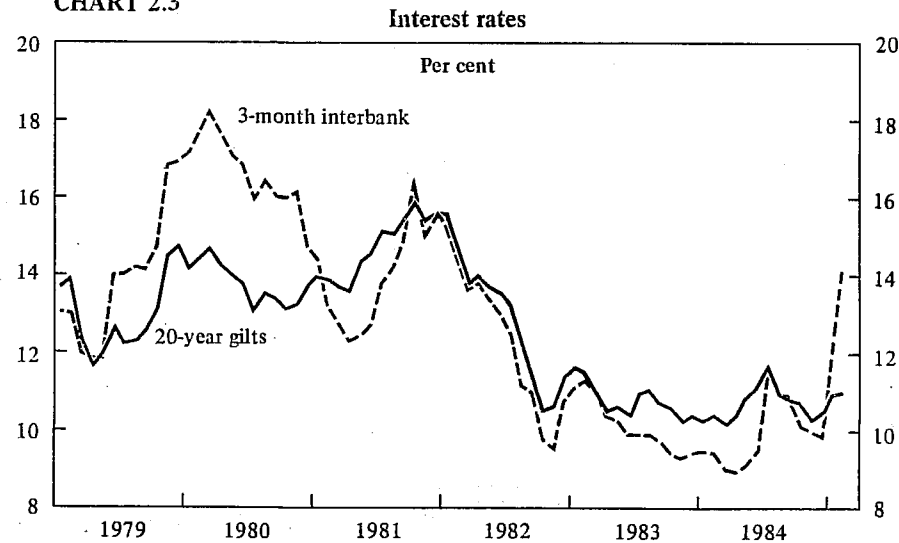
- 2.05 All the measures of broad money, and especially PSL2, have been affected to some extent by financial liberalisation and intensified competition between banks and building societies. Over the past five years, households have increased both their borrowing and their holdings of liquid financial assets. This build-up of wider liquidity seems to have reflected an increase in the demand for liquid assets as a form of savings. It has been consistent with lower inflation and a steady decline in the growth of money GDP. As a result, the significance of the broad aggregates as monetary indicators has somewhat diminished.
- 2.06 The relatively high growth of £M3 last year was associated with a combination of high public sector borrowing and high bank lending, partly offset by substantial sales of Government debt.
- 2.07 The sterling exchange rate index fell by about 10 per cent during 1984-85. During the early months the fall largely reflected the strength of the dollar, although industrial unrest may also have been a contributory factor. Subsequently it was affected by fears about dollar oil prices.

CHART 2.2



- 2.08 There was a sharp rise in interest rates in July, which was fairly rapidly reversed. Short term interest rates again rose sharply in January 1985, and were about 14 per cent in mid-March.

CHART 2.3



(1) 3-month interbank, last Friday of month

Monetary policy

- 2.09 The Government will continue to set targets for M0, as a measure of narrow money, and £M3, as a measure of broad money. As before, there will be separate ranges for each, reflecting their different trend growth rates. The targets for 1985-86 and the illustrative ranges for later years are shown in Table 2.1; they are unchanged from last year's MTFS. No special role will be assigned to PSL2 or M2.

Table 2.1 Growth of the money supply and money GDP⁽¹⁾

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
M0 ⁽²⁾	5.7	5½	3-7	2-6	1-5	0-4
£M3 ⁽²⁾	9.9	9½	5-9	4-8	3-7	2-6
Money GDP ⁽³⁾	7¾	6¾ (8¼)	8½ (7)	6½	5¾	5

⁽¹⁾ The money GDP figure for 1985-86 is a forecast; and in subsequent years the figures are assumptions.

⁽²⁾ 1983-84: percentage change during the year (mid-March to mid-March). 1984-85: percentage change from mid-February to mid-February.

⁽³⁾ Percentage change on previous financial year. See Table 2.4 for further detail. Figures in brackets for 1984-85 and 1985-86 are adjusted for the coal strike. Rounded to nearest ½ per cent.

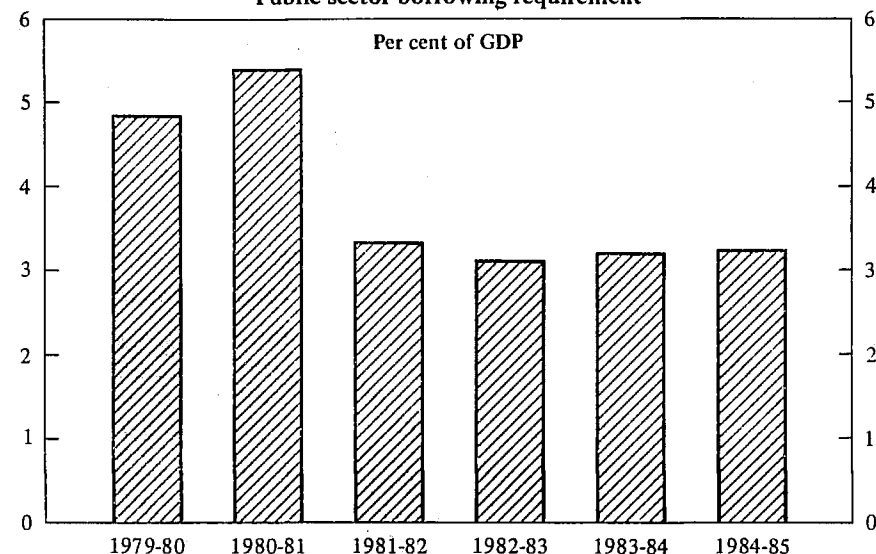
Interpretation of monetary conditions

- 2.10 Precise target ranges for later years will be decided nearer the time and will take account of any changes in the financial structure, such as those affecting building societies, that could alter the significance of particular aggregates. The target ranges will be chosen to maintain downward pressure on the growth of money GDP and thus on inflation. Table 2.1 shows the assumptions about the growth of money GDP on which the present ranges are based. Within a given growth of money GDP, lower inflation will mean faster growth in real output.
- 2.11 Equal weight will be given to the performance of M0 and £M3, which will continue to be interpreted in the light of other indicators of monetary conditions. Significant changes in the exchange rate are also important. It will be necessary to judge the appropriate combination of monetary growth and the exchange rate needed to keep financial policy on track: there is no mechanistic formula.
- 2.12 The Government's overriding aim will be to maintain monetary conditions consistent with a declining growth of money GDP and inflation. Short term interest rates will be held at the levels needed to achieve this.

Fiscal policy

- 2.13 One factor underlying the concern over monetary conditions during last year was public sector borrowing. The PSBR in 1984-85 is now forecast to be £10½ billion, equivalent to about 3½ per cent of GDP. This is £2 billion higher than in the Autumn Statement, and £3½ billion higher than expected at the time of the 1984 Budget. By far the most important single factor in the overshoot in 1984-85 has been the coal strike, which is estimated to have added £2½ billion to public sector borrowing. As a result, the PSBR has remained virtually unchanged at around 3½ per cent of money GDP for the last four years. This is considerably less than it was over the previous four years, when it averaged nearly 5 per cent of GDP, but it is still not low enough.
- 2.14 Last year's MTFS indicated the level of the PSBR which the Government considered appropriate over the medium term. A sharp reduction is now needed to keep in line with that projection.

CHART 2.4 Public sector borrowing requirement



2.15 The PSBR for 1985-86 is forecast to be £7 billion, or 2 per cent of GDP, the figure indicated in last year's MTFS. This represents a further decline in the ratio of public sector debt to money GDP and contrasts with a rising trend in debt/income ratios in most other major countries. The PSBR projections summarised in Table 2.4 repeat those given in last year's MTFS and show a further small reduction as a proportion of GDP to 1½ per cent in 1987-88 and 1988-89. The figures after 1985-86 are illustrative, and decisions about the appropriate PSBR in particular years will be taken nearer the time.

Assumptions

2.16 For the period to 1987-88, the fiscal projections in Tables 2.2-2.4 are based on the public expenditure plans shown in the Public Expenditure White Paper (Cmnd. 9428), updated to take account of the changes described below. Output is assumed to grow by about 2½ per cent a year on average over the four years to 1988-89, made up of 2¾ per cent annual growth in the non-North Sea economy partially offset by a decline in North Sea oil output. The general rate of inflation, as measured by the GDP deflator, is put at about 4½ per cent in 1984-85; it is projected to fall to 3 per cent by 1988-89. It is assumed that there is no major change in the sterling exchange rate index from year to year. These assumptions imply growth of money GDP falling to 5 per cent by the end of the period, as shown in Table 2.1.

Public expenditure

2.17 Restraint in public spending is essential both to curb the encroachment of the state and to provide scope for reducing the burden of taxation within the overall financial framework. Lower taxation has an important part to play in improving motivation, efficiency and employment. The Government's objective is to hold public expenditure broadly level in real terms so that continuing economic growth allows further reductions.

2.18 Public expenditure prospects are discussed in detail in Part 5. They are summarised in Table 2.2. The figures for 1985-86 to 1987-88 are significantly higher than those underlying the Public Expenditure White Paper (Cmnd. 9428), for three reasons—they allow for estimating changes reflected in a higher Reserve, for higher forecasts of debt interest, and for the employment and training measures announced in the Budget Speech. The new figures take account both of events since the White Paper, including the continuation of the coal strike until early March and the increase in interest rates, and of the estimated outturns in 1984-85. The planning total remains broadly level in real terms, and continues at approximately the 1984-85 level excluding the costs of the coal strike in that year. The same level is assumed for 1988-89. Over the period as a whole, general government expenditure falls slightly as a share of GDP from nearly 46 per cent in 1984-85 to just over 41 per cent in 1988-89.

2.19 Table 2.2 also shows the relationship between the planning total and general government expenditure in national accounts terms. The latter includes debt interest payments and a number of adjustments to reflect the translation to national accounts definitions. Details are given in Part 5, and changes since the 1984 MTFS are set out in the Annex to Part 2.

Table 2.2 General government expenditure

	£ billion, cash					
	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
Public expenditure						
planning total ⁽¹⁾	120.3	129½	134	139	144	148
Interest payments	14.9	16½	18	18	18½	19
Other adjustments ⁽²⁾	4.8	3½	7½	7	6½	6
General government expenditure in national accounts terms	140.1	149½	159½	164	169	173
of which special sales of assets ⁽³⁾	1.1	2	2½	2	2	2

⁽¹⁾ For 1983-84 to 1987-88, the figures are as in Table 5.1, after Budget and other changes. Assumed to be the same in real terms in 1988-89 as in 1987-88.

⁽²⁾ See Table 5.2 and paragraph 5.13. The purpose of these adjustments is to convert the planning total into general government expenditure on a national accounts basis.

⁽³⁾ See Cmnd. 9428, Table 1.6, for 1983-84 to 1987-88. Assumed to be the same in cash terms in 1988-89 as in the two previous years.

Constituent items may not sum to totals due to rounding.

Revenue

2.20 The growth of 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. Revenue is projected on the conventional assumption of constant tax rates and indexed allowances and thresholds at the proposed 1985-86 levels. All changes proposed in the Budget are taken into account. No change is assumed in national insurance contribution rates beyond those proposed in the Budget.

2.21 On these assumptions, general government receipts are projected to rise slightly less than the growth in money GDP. Government revenue from the North Sea is projected to fall in both real and nominal terms after 1985-86 as North Sea output and real oil prices both fall, but this is more than offset by rising revenues from the growing non-North Sea economy.

Table 2.3 General government receipts

	£ billion, cash					
	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
Taxes on incomes						
expenditure and capital	97.5	105	113½	120½	127½	133
National Insurance and other contributions	21.3	22½	24½	26	27½	29
Interest and other receipts	11.0	11	12	12½	13	13½
Accruals adjustment	+0.2	+1	—	—½	—	—
Total	130.0	140	150	159	168	175½
of which North Sea tax ⁽¹⁾	8.8	12	13½	11½	9½	8½

⁽¹⁾ 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 2 to Table 6.8.

Constituent items may not sum to totals due to rounding.

Public sector borrowing

- 2.22 The projections of Government receipts and expenditure are brought together in Table 2.4 to provide projections of the general government borrowing requirement (GGBR) and the PSBR. The size of the fiscal adjustment depends on the estimates of revenues and expenditure. These are subject to major uncertainties about, for example, the tax yield for an assumed set of tax rates and the behaviour of oil prices; and, for the final year, the level of expenditure has yet to be agreed.
- 2.23 Changes in the fiscal projections since the 1984 MTFS are discussed in the Annex.

Table 2.4 Public sector borrowing⁽¹⁾

	£ billion, cash					
	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
General government expenditure	140.1	149½	159½	164	169	173
General government receipts	130.0	140	150	159	168	175½
Fiscal adjustments from previous years ⁽²⁾	—	—	—	—	3½	7
Annual fiscal adjustment ⁽²⁾	—	—	—	3½	3	3
GGBR	10.1	9½	9½	8½	8	7½
Public corporations' market and overseas borrowing	-0.4	+1	-2½	-1	-1	—
PSBR	9.7	10½	7	7½	7	7½
as % of GDP	3.2	3¼	2	2	1¾	1¾
Money GDP at market prices ⁽³⁾	306	327	354	377	399	419

Constituent items may not sum to totals due to rounding.

⁽¹⁾ Further details for 1984-85 and 1985-86 are provided in Table 6.5.

⁽²⁾ Means lower taxes or higher expenditure than assumed in lines 1 and 2.

⁽³⁾ The assumed paths of prices and output are as follows:

	Percentage change on previous financial year				
	1984-85	1985-86	1986-87	1987-88	1988-89
Real GDP					
Non-North Sea	2	3½	2½	2½	2½
Total	2½	3½	2	2	2
Inflation					
GDP deflator	4½	5	4½	3½	3

Conclusion

- 2.24 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 maintain the progress to lower inflation in the medium term secured by the steady decline in monetary growth which is at the heart of the MTFS, allowing interest rates to be adjusted in line with this objective. This will provide the essential macro-economic framework within which the Government will pursue its micro-economic policies designed to create the conditions for higher output and more jobs.

Annex

Changes from the 1984 revenue and expenditure projections

2A.1 Table 2.5 shows changes in the fiscal projections since the 1984 FSBR.

Table 2.5 Revenue and expenditure

	Changes from 1984 MTFS projections					
	1983-84 ⁽⁵⁾	1984-85	1985-86	1986-87	1987-88	1988-89
Expenditure						
1. Planning total:						
Estimating changes	—	+3½	+2	+2	+2	+2
Budget measures	—	—	—	+½	+½	+½
2. Interest payments	+0.1	+1	+2½	+2½	+2½	+3
Other adjustments:						
3. Public corporations' market and overseas borrowing	-0.2	-1½	+1½	—	+½	—
4. Other ⁽¹⁾	+0.6	—	+½	+½	+1	+1
5. General government expenditure ⁽¹⁾	+0.7	+2½	+7	+5½	+6½	+6
Receipts						
6. North Sea tax ⁽²⁾⁽³⁾	-0.1	+2	+4	+2	+½	-1
7. Other taxes ⁽³⁾	+1.0	-1	-2	-1	+1	+1½
8. National Insurance and other contributions	-0.1	-½	—	—	—	—
9. Interest and other receipts ⁽¹⁾	-0.3	+½	+½	+1	+1	+1½
10. Accruals adjustment	+0.3	—	+½	—	—	—
11. General government receipts ⁽¹⁾	+0.9	+1	+3	+2	+2½	+3
12. General government expenditure less receipts	-0.2	+1½	+3½	+3½	+4	+3½
13. Implied cumulative fiscal adjustment ⁽⁴⁾	—	—	-2	-3	-3	-3½
14. GGBR	-0.2	+1½	+1½	+½	+1	—
15. Public corporations' market and overseas borrowing	+0.2	+1½	-1½	—	-½	—
16. PSBR	—	+3½	—	+½	—	—

⁽¹⁾ Excluding classification changes (see paragraph 2A.2) which add the following amounts to both expenditure and receipts:

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
	0.6	0.6	0.6	0.7	0.7	0.8

⁽²⁾ Before ACT set-off.

⁽³⁾ The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set-off. See footnote ⁽²⁾ to Table 6.8.

⁽⁴⁾ Line (13) = (16) - (15) - (12).

⁽⁵⁾ Comparisons in 1983-84 are with the PSBR on the definition used before 1984-85, i.e. including bank deposits etc.

Constituent items may not sum to totals due to rounding.

- Changes in classification** 2A.2 Some classification changes have been made since the 1984 FSBR which affect the comparison of the 1984 and 1985 projections (see Part 5, paragraph 5.13). In order to make the comparison in Table 2.5 more helpful, differences due to those changes which affect expenditure and receipts by equal amounts have been removed from the figures (see footnote ⁽¹⁾ to Table 2.5).
- Changes in assumptions** 2A.3 The level of nominal GDP in 1984-85 is estimated to be ½ per cent less than expected a year ago. The path of money GDP in the later years of the period is now assumed to be slightly higher than projected last year, reflecting higher assumed inflation in the early years. The PSBR is the same as last year from 1985-86 onwards, as a percentage of GDP.
- Changes in expenditure** 2A.4 The changes in the planning totals, in line 1 of Table 2.5, are discussed in Part 5. The higher outturn in 1984-85 reflects mainly the costs of the coal strike, but also overspending by local authorities. The increases in debt interest payments in line 2 largely reflect the higher starting level of interest rates compared with the 1984 MTFS projections, and partly the higher borrowing now estimated in 1984-85; there is a partially offsetting increase in interest receipts, included in line 9.
- 2A.5 The increase in 1984-85 in public corporations' net market and overseas borrowing (line 3)* is the result of the coal strike: the corporations were in fact net borrowers whereas last year's projections assumed they would be net repayers of such debt. (This change is taken into account in the estimated £2¼ billion cost of the strike to the PSBR.) In subsequent years, some change in the opposite direction is expected, compared with last year's assumptions.
- Changes in receipts** 2A.6 On the receipts side, the increases in North Sea revenues in line 6 are a result of both higher sterling oil prices and higher oil production; these increases tail off sharply after 1985-86. Other taxes (line 7) are lower in the early years than in the 1984 MTFS projections: this partly reflects the effect of the Budget measures, and partly the carrying-through to later years of lower estimates for 1984-85 of corporation tax receipts and higher estimates of income tax repayments (including mortgage interest relief). After 1986-87, however, there is an increase in these revenues, principally as a result of the higher level of money incomes.

* 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 3 and added back in line 15.

3. The Economy: Recent Developments and Prospects to mid-1986

Summary

Demand and output

- 3.01 There was a broadly based expansion in domestic demand in 1984 with real incomes both of persons and of companies rising. Further rises in fixed investment and private consumption are forecast, though the recent rise in interest rates will tend to reduce the growth in spending. For 1985 as a whole, helped by further growth in world trade, the level of GDP should be $3\frac{1}{2}$ per cent up on 1984, including a contribution of about $\frac{3}{4}$ per cent from the ending of the coal strike.

Labour market

- 3.02 Employment, in particular self-employment, has been rising quite strongly since early 1983. But earnings have risen much faster than prices in the UK, to a greater extent than, for example, in the United States or Germany; and this has limited the growth of employment. With the labour force growing quite rapidly the number of those claiming unemployment benefits has continued to increase.

Inflation

- 3.03 Inflation rates stayed around or below 5 per cent for much of 1984, despite the higher costs of imports. As some of these are passed on, the first half of 1985 is expected to see some increase in inflation. But the trend towards lower inflation should be re-established after the middle of 1985. The forecast for the RPI increase between the fourth quarters of 1984 and 1985 is 5 per cent; and for mid 1986, more uncertainly, $4\frac{1}{2}$ per cent.

Assumptions

- 3.04 The basic assumption for the UK forecast is that fiscal and monetary policies are set within the framework of the Medium Term Financial Strategy. The sterling index is assumed not to change much. These assumptions are consistent with a rise in money GDP in the financial year 1985-86 of about $8\frac{1}{2}$ per cent.

Trade and the current account

- 3.05 The current account, on provisional estimates, was in balance in 1984, despite the extra oil imports for electricity production. Further rises in exports, and the end to the coal strike, should make for a sizeable surplus on the current account over the forecast period. With oil production at or near its peak and with high sterling oil prices, the contribution of North Sea oil to the current account of the balance of payments is forecast to be at its maximum in 1985. North Sea oil and gas output represents about 6 per cent of GNP.

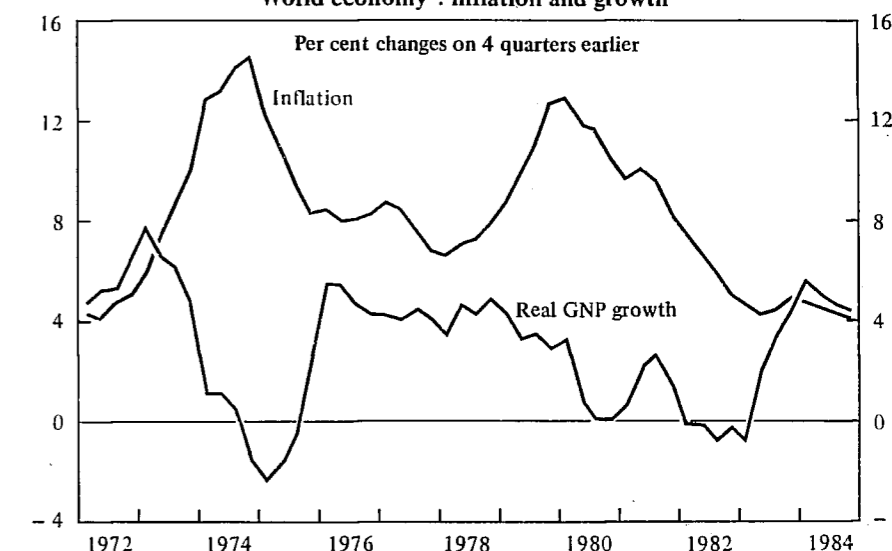
World economy

- 3.06 There was a rapid expansion of world trade and output in 1984, above all in the United States. Output in much of Europe remained quite sluggish. Inflation has in general fallen further and the prices of many commodities (but not oil) have fallen in real terms since mid 1984. More moderate growth in the US this year is unlikely to be fully offset by faster growth in Europe but the outlook overall is for reasonable growth in world output and trade combined with generally low inflation. The extent of the US current account deficit, the strength of the US dollar and the problems facing some major debtor countries are, however, evidence of strains on the world economy.

The world economy

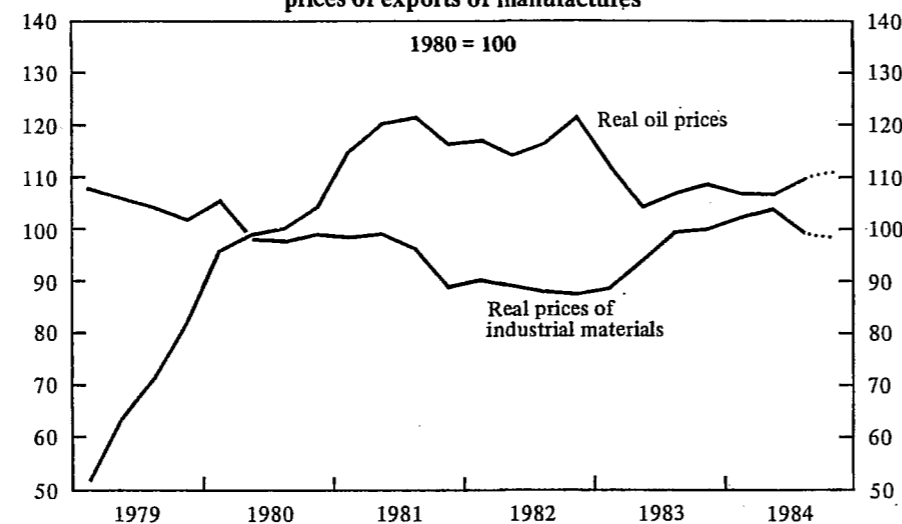
- 3.07 Rapid expansion in North America and Japan helped to make 1984 the best year for economic growth since 1976. GNP in the major seven industrialised countries rose by about 5 per cent and world imports by nearly 10 per cent. Developing countries shared in the expansion of world trade, their exports increasing by perhaps 13 per cent in volume terms.

CHART 3.1 World economy : inflation and growth



- 3.08 The recovery in activity was not accompanied by additional inflationary pressures. Although some commodity prices rose sharply in 1983 and early 1984, most weakened in the second half of the year (see chart 3.2). Consumer price inflation declined in most countries, particularly France and Italy.
- 3.09 The dollar has continued to strengthen against all other major currencies despite some fall in US interest rates in the second half of 1984 and despite an increasing US current account deficit. By the end of February 1985, the effective dollar exchange rate was over 25 per cent above its level of two years ago and over 60 per cent above its 1979 level, despite little difference over these periods between US inflation and the average OECD inflation rate.
- 3.10 Oil prices in dollar terms weakened in 1984, although measured in other currencies they rose. After allowing for the strong dollar and low world inflation, oil prices changed little in real terms. With oil demand picking up only slowly despite the recovery in activity and with non-OPEC oil supplies increasing, balance in the oil market has been sustained by OPEC production falling in 1984 to below 19 million barrels per day (oil and natural gas liquids) compared with over 30 million barrels per day in the late 1970s.
- 3.11 Outside the US, there have been some further moves to cut budget deficits. The disparity in trends of budget deficits between the US and other developed economies has been reflected in growing imbalances on the current account of the balance of payments, although the picture is obscured by large measurement errors. The recorded US current account deficit in 1984 was about \$100 billion, while the Japanese surplus rose to about \$35 billion and the German surplus to \$6 billion. With a sharp growth in exports to the US and elsewhere, and further domestic adjustment, the current account position of developing countries also improved and some of the major debtors moved towards balance or into surplus.

CHART 3.2
Commodity prices relative to
prices of exports of manufactures



Prospects

- 3.12 The world recovery, which began at the end of 1982, seems to be well established. Growth in North America is slowing to a more sustainable rate and GNP in the USA and Canada may rise 3 or 4 per cent between 1984 and 1985. In Japan, another year of growth in the region of 5 per cent is expected. Prospects in Europe are for continued, if still relatively slow, expansion. These developments should enhance the prospect of further adjustment by debtor countries, taken as a whole.
- 3.13 But substantial risks remain. Imbalances may increase in 1985. Government deficits are generally planned to fall in Europe and in Japan; but in the US, despite the prospect of some Budget cuts for fiscal 1986 and lower levels of unemployment, the Federal deficit is expected to remain high. The US deficit and larger corporate borrowing needs could push up short-term interest rates again. The US current account deficit may increase further, with large counterpart surpluses in Germany and Japan. The forecasts for activity and inflation are summarised in Table 3.1. The third line shows the outlook for total world imports of all goods; the fourth line relates only to manufactures and is weighted according to the importance of UK trade.

Table 3.1 World economy

	Per cent changes on a year earlier			
	1983	1984	1985	1986 first half
GNP in Major 7 Countries*	2½	5	3½	3
Consumer Prices in Major 7 Countries*	4½	4½	4	4
World imports	2	9½	5½	5½
World trade in manufactures (UK weighted)	1½	10	5½	4½

* USA, Canada, Japan, France, Germany, Italy and UK.

The exchange rate and the balance of payments

- 3.14 The sterling index is now some way below the levels assumed in both the 1984 FSBR and the Autumn Statement. Almost half of the fall in sterling over the past year has been the counterpart of the dollar's strength against all major currencies. The coal strike and the expectation of a fall in oil prices have also contributed to pressure on sterling. This forecast assumes that the sterling index will not change much from its average level in January and February.

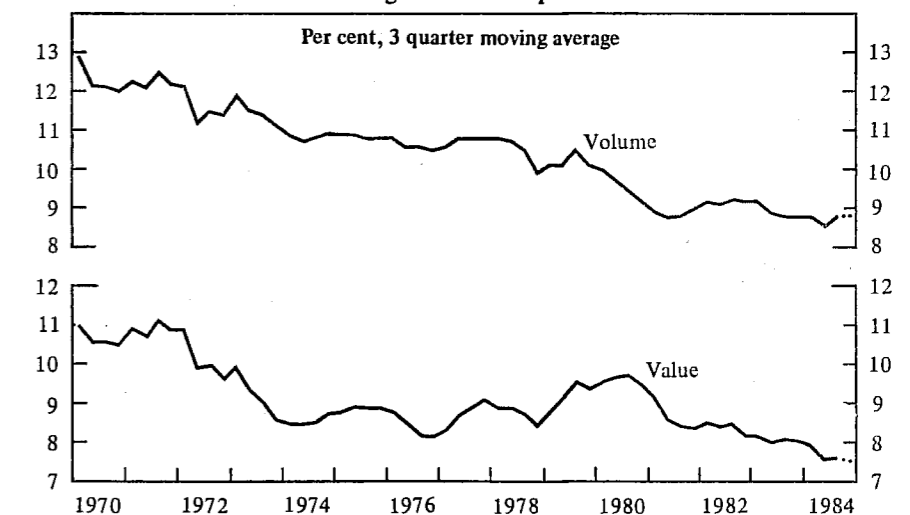
Sterling

Balance of payments in 1984

Export volumes

- 3.15 The lower exchange rate means that over the last year most measures of price and cost competitiveness of UK manufactures have shown gains estimated at about 10 per cent. The gain in labour cost competitiveness has been less than the fall in the exchange rate, as earnings in the UK, particularly in manufacturing, continue to grow faster than those of our major competitors. This trend is expected to continue over the forecast period implying, on the assumption of no major changes in the exchange rate, that some of the recent gains in cost competitiveness will be reversed.
- 3.16 The lower exchange rate has not been fully reflected in import prices because of a reduction in importers' profit margins; nevertheless, import prices of goods and services rose 12 per cent between the fourth quarters of 1983 and 1984. The non-oil terms of trade deteriorated by 2 per cent mainly because of the fall in the exchange rate: little further change is expected over the next year.
- 3.17 The UK current account was in balance (on provisional data) for 1984 as a whole. Deficits on manufactured goods, food and basic materials, and transfers were roughly offset by surpluses on services, oil, and interest, profits and dividends.
- 3.18 The direct effect of the coal strike on the current account in 1984 is estimated to have been about £2¼ billion. Following the ending of the strike, the effect on the 1985 balance will be lower, at about £1½ billion in the first quarter of the year.
- 3.19 Export volumes (excluding oil and erratics) rose by 9 per cent in 1984, the largest increase in a single year since 1976. Exports of manufactures (excluding erratics) rose by some 10½ per cent, largely due to the very rapid growth, probably of 10 per cent or so, in world trade in manufactures. Since 1981, the gradual improvement in cost competitiveness has helped the UK broadly to maintain its volume share of world trade in manufactures. The fall in the exchange rate, which has led to a lowering of UK export prices relative to those of our competitors, has contributed to a fall in the value share. Both volume and value shares are shown in chart 3.3.

CHART 3.3
Share of UK exports
in main manufacturing countries' exports of manufactures



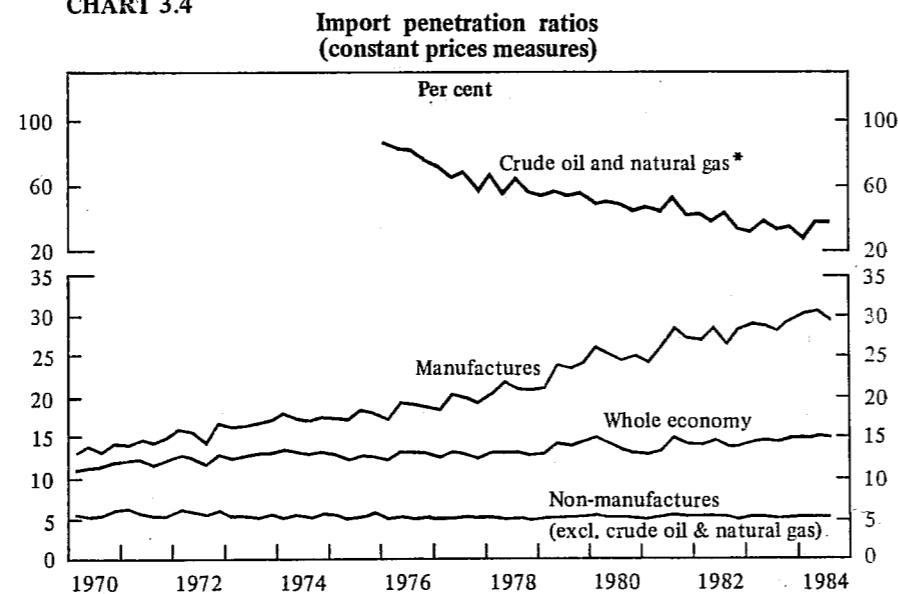
- 3.20 In 1985, UK exports of manufactures are expected to grow somewhat faster than world trade, as recent gains in cost competitiveness help export volumes. Exports of non-manufactures should also continue to grow. Exports of goods (excluding oil) are forecast to grow by 7½ per cent in total.
- 3.21 Import volumes (excluding oil and erratics) also grew rapidly in 1984 as the domestic recovery continued, rising by 10½ per cent. Imports of manufactures grew by a similar amount. This compares with an increase of 5 per cent in

Import volumes

domestic demand for manufactures, implying some further increase in import penetration. This continues the longer term trend with much of the growth in domestic demand for manufactures being met from imports.

- 3.22 For 1985, recent improvements in competitiveness and slower growth in domestic demand for manufactures (which grew rapidly in 1983 and 1984) may lead to a smaller rise in imports of manufactures. Other non-oil imports grew relatively slowly in 1984: imports of food, drink and tobacco rose by 4 per cent and imports of basic materials fell. For 1985, imports of these goods may again grow rather less than total final expenditure. Both developments would be consistent with past trends in import penetration, which are shown in Chart 3.4 in terms of volumes. Value shares generally show similar movements over the medium term.

CHART 3.4



Trade in oil

- 3.23 There is likely to be a small increase in oil production in 1985 when North Sea oil output may reach its peak. With the end of the coal strike, fuel imports should fall in 1985 which may also be the peak year for the contribution of oil to the balance of payments.

Invisibles

- 3.24 The world recovery and improvements in competitiveness have not yet been reflected in provisional estimates of the balance of trade in services: the 1984 balance is estimated to have been close to the 1983 level. Some improvement in the services balance should occur in 1985.
- 3.25 The surplus on interest, profits and dividends (IPD) recovered sharply in the second half of 1984 to give a provisional outturn for the year as a whole of £2½ billion compared to £1½ billion in 1983. A further improvement is expected in 1985 helped by the rising stock of assets and the rise in the dollar over the last year.

Current account forecast

- 3.26 The overall picture is thus one of a sizeable current account surplus both for 1985 and for the first half of 1986, perhaps of the order of £3 billion at an annual rate. Within that total, some further decline in the balance of trade in manufactures is forecast, continuing the trend which has seen the balance fall from a surplus of 5 per cent of GDP in 1970, to one of 3 per cent in 1978, and to a deficit of 1 per cent last year. The balance of trade in oil should show a substantial improvement with the end of the coal strike, and improvements to the services and IPD accounts should raise the surplus on invisibles.

Table 3.2 Current account, balance of payments basis

	Manufacturing	Oil	Other Goods	Invisibles	Total
1983	-2½	7	-5½	3½	2½
1984	-4	7	-7½	4½	0
1985	-4½	10	-8	5½	3

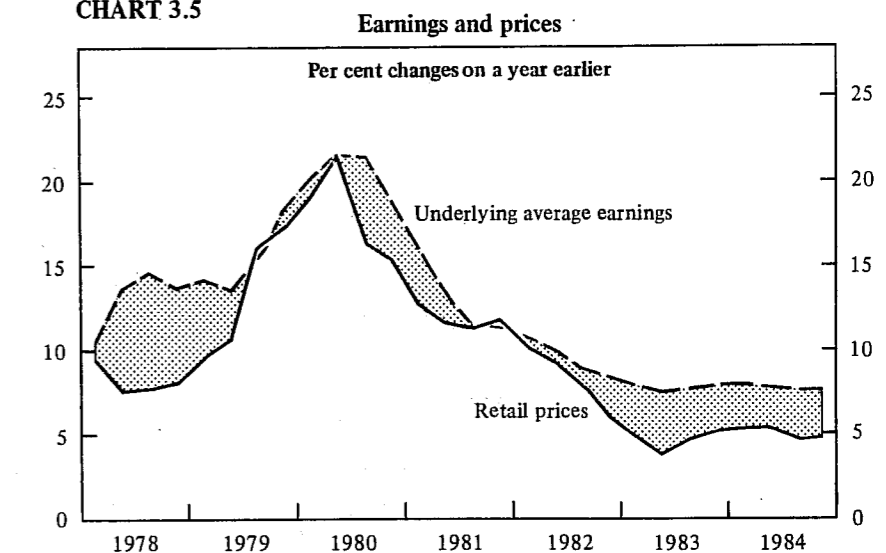
- 3.27 Current account surpluses together with capital gains and currency changes have led to a continuing increase in overseas assets. The UK's net external assets have risen as a percentage of GDP from 7½ per cent at the end of 1979 to an estimated 23 per cent last year, from £13 billion to £75 billion.

Inflation

- 3.28 In 1984, inflation in the UK continued at around the same rate as in 1983; the increase in the RPI of 4½ per cent between the fourth quarters of 1983 and 1984 was in line with earlier Government forecasts. UK inflation remains a little below the European average, which has declined over the last year, but above that in the US, Japan and Germany. 1983 and 1984 were the first two successive calendar years since the late 1960s to record growth in the RPI at 5 per cent or below. In January 1985 the RPI was 5 per cent higher than a year earlier; in January and February producer output prices were over 6 per cent higher.
- 3.29 The sterling exchange rate index fell by some 13 per cent between February 1983 and February 1984, almost half of which was due to the rise in the dollar, bringing its total decline since the peak in early 1981 to over 30 per cent. Import prices in the course of 1984 rose by 12 per cent. The reduction in inflation during the period of sterling depreciation reflected the downward pressure on prices exerted by the Government's macroeconomic financial framework.

Costs

CHART 3.5



- 3.30 In 1984 there was an underlying growth in unit labour costs for the economy as a whole of 4 per cent through the year, close to the 1983 rate. Underlying growth in earnings (*ie* abstracting from the effect of the coal strike, backpay etc.) continued at around 7½ per cent, underlying growth in output per head was around 2½ per cent, while the abolition of the National Insurance Surcharge in the autumn reduced labour costs by about 1 per cent through the year.

Real earnings

- 3.31 Most people in work again experienced a substantial increase in living standards. In the current round, settlements on average are not very different from those in the last two years. Over and above the basic increases negotiated under pay settlements, additional elements—such as productivity deals, bonus payments, and changes in overtime and short-time—have contributed to average earnings growing at a rate of about 7½ per cent. The underlying pre tax growth in real earnings during 1984 was approaching 3 per cent, much the same rate of increase as over the previous two years.

Prospects

- 3.32 There is not much sign of any major change, up or down, in the rate of pay settlements and earnings increases. On this basis, labour costs may rise by about 5 per cent over the next year, a little faster than during 1984 when NIS was abolished. With some fall in growth in the world economy expected, increases in world prices are likely to remain very modest; on the assumption of not much change in the sterling index, the rate of growth of import prices may be less than 5 per cent over the next year.
- 3.33 Profit margins on domestic sales fell towards the end of 1984 and at the beginning of 1985, although increasing profit margins on exports and a generally higher level of output permitted a continuing healthy growth of profits. There may be some recovery of domestic margins during the early part of 1985. The rate of growth of the RPI may be about 6 per cent in the second quarter. Before the end of the year overall conditions in the economy should be consistent with inflation moving down again. By the fourth quarter, the rise in the RPI may be about 5 per cent, broadly in line with costs. By mid 1986, with a slower growth in import costs, inflation may be around 4½ per cent. The rises in mortgage rates in late 1984 and early 1985 have had a marked effect on the housing component.

Table 3.3 Retail prices index

	Weight	Per cent changes on a year earlier			
		1983 Q4	1984 Q4	Forecast	
				1985 Q4	1986 Q2
Food	20	6	3½	4	4½
Nationalised Industries (including water)	10 (9*)	2	4	5½*	5½*
Housing	14	6½	10½	7	2
Other	56 (57*)	5	4	5*	4½*
Total	100	5	4¾	5	4½

* BT is included in "other" prices in the forecast, and in the weights given in brackets.

- 3.34 Other price indices have moved somewhat differently from the RPI. The differences reflect mainly:
- (a) changes in world prices and the exchange rate: those indices which give a substantial direct weight to export or import prices (such as the deflator for total final expenditure), or which are strongly influenced by import prices (such as the producer price index for manufacturers' output) have tended to rise faster than the RPI; and
- (b) the movement of mortgage rates, which affect only the RPI.
- 3.35 The GDP deflator—a measure of the rise in prices of UK inputs, above all of wages and profits—has been rising particularly slowly in 1984. In part this reflects delays in public sector pay settlements, and it has also been affected by the fall in electricity profit margins during the coal strike. There may also have

been some fall in profit margins on domestic sales during the second half of 1984 as output prices lagged behind import costs when the exchange rate fell. The GDP deflator is forecast to rise by 5 per cent in 1985–86, a little more than the previous year, as profit margins recover and the other special factors unwind.

- 3.36 Recent figures are shown in Table 3.4:

Table 3.4 Price indices

	Per cent changes on a year earlier			
	RPI	GDP deflator at market prices	Deflator for total final expenditure	Producer output prices ⁽¹⁾
1983	4.6	5.2	5.8	5.4
1984	5.0	4¼ ⁽²⁾	5¼ ⁽²⁾	5.6

⁽¹⁾ Manufacturing industry other than food, drink and tobacco.

⁽²⁾ Estimate.

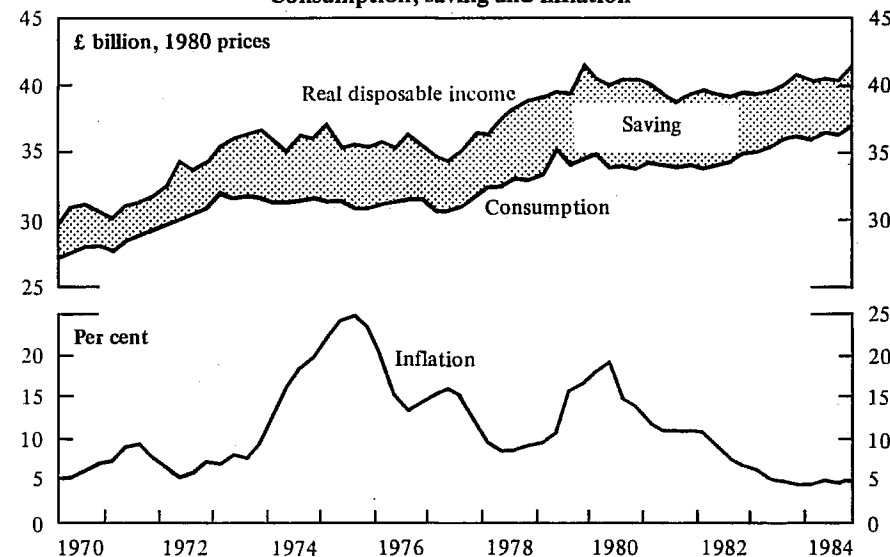
Demand and activity

- 3.37 Latest estimates suggest that growth of GDP was about 2½ per cent in 1984. The different measures of GDP have been telling rather different stories about growth in recent quarters; the income measure has shown stronger growth and the expenditure measure weaker growth than the average measure. This needs to be borne in mind when interpreting figures for saving by persons and companies, which rely on the (uncertain) difference between income and expenditure measures. Recent statistics of GDP should also be interpreted in the light of the tendency for initial estimates of GDP growth to be subjected to upward revision.
- 3.38 Statistics on the economy over the last year have been distorted by the coal strike. The overtime ban and subsequent strike reduced output in the coal industry in 1984 by well over half. There has been some effect on the output of other industries; in particular, net output (value added) in the electricity industry has been reduced by substitution of higher cost oil for coal. The direct effect of the coal strike on domestic output in 1984 is estimated at about 1 per cent. In terms of components of expenditure the main effects of the strike were lower net exports of fuel and lower stockbuilding (principally the run down in stocks of coal at power stations). Estimates of the effect of the strike on output do not include indirect effects through its impact on financial, business and consumer confidence, or through loss of output in businesses dependent on the custom of those miners on strike.
- 3.39 The upswing which started in the first half of 1981 is now about to enter its fifth year. In the early stages of the recovery the major contribution to growth came from consumers' expenditure, as the personal saving ratio declined in response to the fall in inflation and interest rates between 1980 and 1983. Since the latter part of 1983, however, private investment and exports have played a more important part in the growth of GDP. A feature of the present upswing has been the continuing decline in stock-output ratios; apparently many firms are still adjusting stocks towards lower desired levels. When this process of adjustment is completed, a stabilisation of stock-output ratios should itself add to GDP growth.
- 3.40 Between 1980 and 1983 the personal saving ratio fell by almost a third. Since the first half of 1983, however, the growth of spending has been more closely in line with the growth in income. Chart 3.6 shows spending and saving in recent years.

Coal strike**Composition of demand****Personal sector expenditure**

- 3.41 Borrowing by the personal sector from banks and building societies increased by about 18 per cent in 1984. Thus, the ratio of the personal sector's financial liabilities to income continued the rise which began in 1981 as households adjusted to financial liberalisation. The growth in liabilities has been more than matched by growth in holdings of financial assets, partly because of capital gains on equities and gilts. The value of tangible assets, including housing and consumer durables, is also rising quickly, partly because of the high level of sales of council houses.

CHART 3.6 Consumption, saving and inflation



- 3.42 With earnings growth continuing well ahead of inflation and with some continued growth in employment and allowing for the tax reductions announced in the Budget, growth of real personal disposable income of about 3½ per cent is expected in 1985. There may be a small rise in the saving ratio, in part because of the increase in interest rates in early 1985; but most of the rise in incomes should be reflected in growth in consumers' expenditure, of perhaps 3 per cent in 1985.
- 3.43 Investment in dwellings by the personal sector continued to rise quite strongly in the first half of 1984, but fell back in the second half; and no rise in this component of expenditure is expected in 1985. The high level of mortgage rates is likely to restrain growth in investment in new dwellings. Spending on improvements was high in the first half of 1984 in anticipation of the extension of VAT.
- 3.44 Industrial and commercial companies' (ICCs) profits net of stock appreciation in the first three quarters of 1984 were about 20 per cent higher than in the corresponding period of 1983, with profits from North Sea activities rising at much the same rate as non-North Sea profits. The net pre-tax real rate of return earned by non-North Sea ICCs in 1984 was probably about double the 3½ per cent they earned in 1981 at the trough of the cycle.
- 3.45 Tax payments follow profits with a lag, and dividend payments have also risen much less than profits over the last two years. In line with the normal cyclical pattern, companies' capital expenditure has also lagged behind the growth in profits. As a result there appears to have been a big increase in ICCs financial surplus. Companies' outgoings on tax, dividends and capital expenditure may rise faster than company incomes over the next year. Nevertheless, a large financial surplus is expected to persist. The recorded figures are, however, subject to very large margins of error, as indicated by the large balancing item in the industrial and commercial company accounts in the first three quarters of 1984.

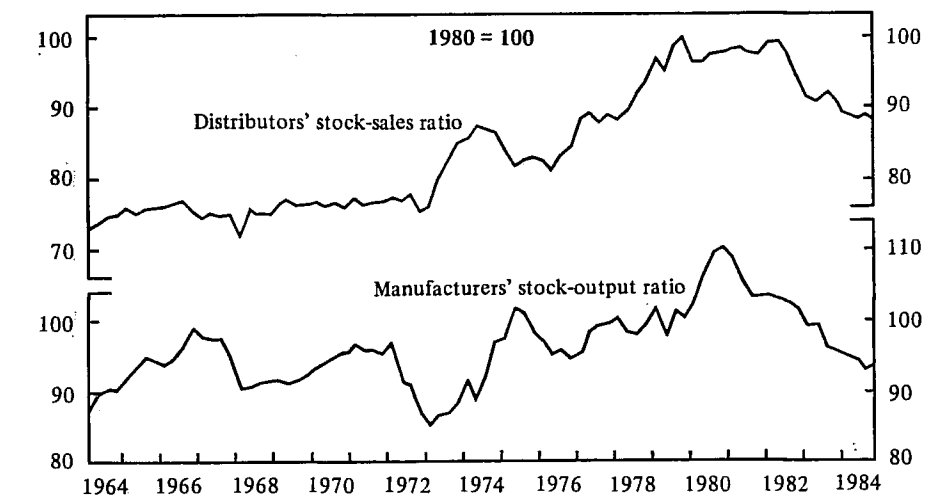
Company income and expenditure

Fixed investment

Stockbuilding

- 3.46 Investment by manufacturing and service industries rose, on provisional figures, by 12 per cent in 1984, which means that for the first time it exceeded the previous cyclical peak reached in 1979. Business investment seems set to show a further large increase in 1985; the most recent DTI intentions survey suggested an 8 per cent growth in investment by non-North Sea companies in 1985.
- 3.47 Including investment by the personal and public sectors, which may decline in 1985, total fixed investment is forecast to rise by about 2 per cent in 1985.
- 3.48 Company expenditure on stocks remained low in 1984 despite the rise in sales. The high level of real interest rates, and the reduction of stock relief in the 1980 Budget, followed by its complete abolition in the 1984 Budget, have raised the cost of holding stocks; both manufacturers' and distributors' stock output ratios continued to fall for most of 1984. Coal stocks have been run down over the past year. Recent surveys suggest that on balance companies still intend to reduce stock levels further relative to output, and the forecast allows for a continued rundown of stocks by manufacturers in 1985. Stock ratios are shown in Chart 3.7: in 1984 the level of manufacturers' stocks was some 50 per cent higher than that of distributors'.

CHART 3.7 Stocks



Prospects for demand and activity

- 3.49 Domestic demand is expected to rise further through the forecast period. Even though world trade growth is expected to be less than in 1984, it should still be above the average growth recorded over the previous decade. The decline in sterling over the past year should help UK exports to show substantial growth between 1984 and 1985 following the improved performance seen towards the end of last year. The growth in imports in 1984 was inflated by the coal strike. A return of imports of fuel to more normal levels during the course of 1985 will bring down the growth in total imports of goods and services. The recovery of output following the end of the coal strike may raise GDP growth in 1985 by about ¾ per cent; excluding this, the forecast of GDP growth in 1985 would be 2½ per cent.

Table 3.5 Domestic demand and GDP*

	Per cent changes on a year earlier		
	1984	1985	1986 First half
Domestic demand	2	3	3
Exports of goods and services	6½	6½	3
Imports of goods and services	8½	3½	3½
Domestic production: GDP*	2½	3½	2½
Manufacturing output	3½	2½	2

* Average measure.

- 3.50 The ratio of the output of manufacturing industry to total output has tended to fall since a peak reached in the late 1960s. Recent figures for manufacturing output have been subject to several upward revisions during the last year: latest figures suggest that over the current upswing taken as a whole manufacturing output has risen at much the same rate as total GDP. Manufacturing output is currently estimated to have risen by about 9 per cent between the first half of 1981 and the second half of 1984. Over the same period domestic demand for manufactures is estimated to have risen by over 20 per cent in real terms, and overseas demand for UK manufactures by about 12 per cent. During 1984, manufacturing output, relatively unaffected by the coal strike, rose faster than GDP. Manufacturing output is expected to continue growing over the next year at close to the underlying rate of growth of total GDP.

Productivity and the labour market

- 3.51 Estimates of the level of employment in recent years have recently been revised in the light of the results of the 1984 Labour Force Survey (LFS) and a correction to an earlier Survey. The new figures imply that in the period from mid 1981 to mid 1983 employment fell by more and productivity growth was higher than had previously been estimated. The new estimates for the period since mid 1983—which are based on changes between the 1983 and 1984 LFS—indicate stronger growth in the employed labour force than previously estimated. Over the year ending in the third quarter of 1984, total employment is now estimated to have risen by nearly 350,000, including almost a 250,000 increase in the self-employed. Employment in manufacturing industries stabilised during the second half of 1984, having fallen steadily since 1977. The figures for employees will be subject to further revision when the 1984 Census of Employment becomes available.
- 3.52 There has been much discussion about the extent to which productivity growth since 1980 represents an improvement in the underlying productivity of the UK economy, and the extent to which it reflects normal cyclical behaviour, combined with the effect of the pressures that industry experienced during 1980 and 1981. As expected, productivity growth has moderated as the upswing has progressed. But the recent revisions to employment data—as well as upward revisions to output—tend to support the view that there has been some improvement in underlying productivity growth, particularly in manufacturing. The table below shows growth rates of output per head: with falling hours, especially outside manufacturing, output per man hour has risen faster.

Table 3.6 Output per head of the employed labour force

	Annual averages, per cent changes		
	1964-73	1973-79	1979-84
Manufacturing	$3\frac{3}{4}$	$\frac{3}{4}$	$3\frac{1}{2}$
Non-manufacturing ⁽¹⁾	$3\frac{1}{2}$	$\frac{1}{2}$	$1\frac{1}{4}$ ⁽²⁾

⁽¹⁾ Excluding public services and oil.

⁽²⁾ Adjusted for the coal strike.

- 3.53 Faster growth in productivity in the 1980s has partly been a response to faster growth in labour costs, both in real terms and in relation to other business costs. This has slowed down the potential recovery in employment. Underlying productivity growth is expected to remain above the rate achieved

Working population

between the two "oil shocks" of 1973 and 1979, but below that of the 1960s. This, together with the prospective growth in output, is consistent with continued growth in employment.

- 3.54 The figures for employment and unemployment taken together now imply growth in the working population of about 450,000 in the year to mid 1984. This is considerably larger than the growth in the labour force that would have been expected on the basis of demographic changes and suggests a significant rise in participation rates. This reflects in particular increased job opportunities for women and part-timers. Demographic factors are expected to lead to slower growth in the labour force over the next few years.

Forecast and outturn

- 3.55 The table below compares the main elements of the forecast published in the 1984 FSBR with outturn or latest estimate:

Table 3.7 Forecast and outturn

	Forecast	Outturn	Average error from past forecasts
RPI: per cent increase between the fourth quarters of 1983 and 1984	$4\frac{1}{2}$	$4\frac{3}{4}$	2
	Forecast	Latest estimate/forecast	Average errors from past forecasts
Total output: per cent change between 1983 and 1984	3	$2\frac{1}{2}$ ($3\frac{1}{2}$)*	1
Current account of the balance of payments in 1984, £ billion	2	0 ($2\frac{3}{4}$)*	$2\frac{1}{2}$
PSBR, financial year 1984-85, £ billion	$7\frac{1}{4}$	$10\frac{1}{2}$ ($7\frac{3}{4}$)*	$4\frac{1}{2}$

* Figures in brackets adjust the latest estimates for the direct effects of the coal strike.

- 3.56 The downward pressures on inflation in 1984 again proved strong: the forecast turned out very close to the mark, despite the fall in sterling during 1984, which had not been anticipated in last year's Budget forecast, and a higher level of mortgage interest rates than expected.
- 3.57 Despite the effects of the coal strike, growth in GDP was only slightly weaker than expected last year. World trade growth in 1984 is now estimated to have been twice as fast as expected this time last year. As a consequence UK exports of goods and services in 1984 were well above forecast. The latest estimates for GDP and the invisibles component of the current account are, however, liable to revision.

The prospects

Table 3.8 Short-term economic prospects

	Forecast	Average errors from past forecasts*
A. Output and expenditure at constant 1980 prices		
Per cent changes between 1984 and 1985:		
Gross domestic product (at factor cost)	3½	1
Consumers' expenditure	3	1
General Government consumption	2	1½
Fixed investment	2	2
Exports of goods and services	6½	2½
Imports of goods and services	3½	2½
Change in stockbuilding (as per cent of level of GDP)	0	¾
B. Balance of Payments on current account		
£ billion:		
1984	0	—
1985	3	2½
1986 first half (at an annual rate)	3	4
C. Public Sector Borrowing Requirement		
£ billion (in brackets per cent of GDP at market prices):		
Financial year 1984-85	10½ (3½)	1 (¼)
Financial year 1985-86	7(2)	4½ (1½)
D. Retail Prices Index		
Per cent change:		
Fourth quarter 1984 to fourth quarter 1985	5	2
Second quarter 1985 to second quarter 1986	4½	3½

* The errors relate to the average differences (on either side of the central figure) between forecast and outcome. The method of calculating these errors has been explained in earlier publications and government forecasts (see Economic Progress Report June 1981). The calculations for the constant price variables are derived from forecasts made during the period between June 1965 and October 1982. For the current balance and the retail prices index, forecasts made between June 1970 and October 1982 are used. For the PSBR, Budget forecasts since 1967 are used. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.

Risks and uncertainties

3.58 No forecast is complete without an indication of error margins. Table 3.8 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide the best indication of possible errors in the current forecast: while the size of errors will change over time as the economy fluctuates, and as forecasting techniques change, in most cases the averages have not shifted very much since 1976. For the RPI, however, average errors are derived from a period of high inflation, averaging 12 per cent and subject to large fluctuations, and overstate likely errors at current rates of inflation. In 1983 and 1984 errors in budget forecasts—looking ahead to the end of the year—were respectively—1 per cent and ¼ per cent.

3.59 The forecasts of 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 approach £200 billion; and for the current account of the balance of payments exceed £100 billion.

Table 3.9 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
1980	136.8	48.8	41.6	63.3	-2.9	287.6	57.6	30.9	-0.3	198.9	100.0
1981	136.4	48.9	38.1	62.1	-2.7	282.8	55.6	30.3	-0.9	196.0	98.6
1982	137.6	49.3	40.6	62.8	-1.2	289.1	57.8	31.4	0.2	200.1	100.6
1983	143.1	50.8	42.3	63.6	0.2	299.9	60.9	32.5	-0.3	206.2	103.7
1984	145.4	51.2	45.1	67.8	-0.7	308.8	66.3	33.2	2.1	211.3	106.3
1985	149.8	52.3	46.1	72.1	-0.3	319.9	68.5	34.1	1.0	218.3	109.8
1983 H1	70.7	25.3	20.9	31.5	-0.1	148.3	29.8	16.2	-0.2	102.1	102.7
H2	72.4	25.5	21.4	32.1	0.3	151.6	31.1	16.3	-0.1	104.1	104.7
1984 H1	72.4	25.5	22.9	33.3	-0.8	153.2	32.2	16.5	0.6	105.1	105.7
H2	73.1	25.7	22.2	34.5	0.0	155.6	34.1	16.7	1.5	106.2	106.8
1985 H1	74.2	26.2	22.9	35.8	-0.2	158.8	34.0	16.9	0.5	108.4	109.0
H2	75.6	26.1	23.1	36.4	-0.1	161.1	34.5	17.2	0.5	109.9	110.5
1986 H1	77.1	26.0	23.2	36.9	0.2	163.4	35.2	17.4	0.5	111.2	111.8
% changes:											
1982 to 1983	4	3	4	1½	—	4	5½	3½	—	—	3
1983 to 1984	1½	1	6½	6½	—	3	8½	2½	—	—	2½
1984 to 1985	3	2	6½	3½	—	3½	3½	2½	—	—	3½
1985 H1 to 1986 H1	4	—	1	3	—	3	3½	3	—	—	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. Totals in £ billion may not add due to rounding. Figures beyond 1984 are forecasts. Earlier figures include some revisions which will be incorporated in the full set of national accounts to be published by CSO on 22 March.

4. The Budget Tax and National Insurance Proposals in Detail

4.01 The following paragraphs describe the Budget proposals for tax and national insurance contributions in detail (for a summary see Table 1.1). Among the proposals are substantial increases in the main income tax personal allowances, which will take 800,000 individuals out of tax (compared with the position if allowances had remained at their 1984-85 levels), improve incentives and support the other measures being proposed to encourage employment. These include changes to the structure of national insurance contributions for employers, employees and the self-employed. The proposals also continue the process of tax reform and simplification of the tax system. The description of proposed changes in Inland Revenue taxes is followed by those for Customs and Excise, and Vehicle Excise Duty. Finally, there is a description of the changes proposed to the structure of national insurance contributions. The direct effects of the proposed changes are shown in Table 4.2.

Inland Revenue

Income tax

- 4.02 It is proposed—
- to increase the single person's allowance and the wife's maximum earned income relief from £2,005 to £2,205 and the married allowance from £3,155 to £3,455.
 - to increase the additional personal allowance and widow's bereavement allowance from £1,150 to £1,250.
 - to increase the age allowance for the single person from £2,490 to £2,690, for the married from £3,955 to £4,255 and the age allowance income limit from £8,100 to £8,800.
 - to increase the basic rate limit to £16,200.
 - to increase the width of the 40 per cent band to £3,000, of the 45 per cent band to £5,200 and of the 50 per cent and 55 per cent bands to £7,900.

As a consequence of these changes, the structure of personal tax rates in operation in 1985-86 will be:

Bands of Taxable Income	
£	Per cent
0 — 16 200	30
16 201 — 19 200	40
19 201 — 24 400	45
24 401 — 32 300	50
32 301 — 40 200	55
over 40 200	60

- 4.03 It is also proposed—
- to increase, with effect from 1986-87, the scales which determine the cash equivalent of car and car fuel benefits of directors and of employees whose remuneration is at the rate of £8,500 a year or more.
 - to reduce from seven to five years the period after which shares appropriated to employees under approved profit sharing schemes may be sold without income tax liability.
 - to introduce a tax allowance for half of the Class 4 national insurance contributions payable by the self-employed.
 - to extend the Business Expansion Scheme to companies carrying on research and development and to exclude certain property development companies from the Scheme.
 - to change the basis under which certain partnerships are assessed in the early years following a change in the persons carrying on the business.
 - to increase the limit on tax relief at the higher rates allowed to individuals for covenants in favour of charities.
 - to amend the legislation relating to life assurance policies issued outside the United Kingdom.
 - to provide for mortgage interest relief (within the tax relief limit) to be given at source on new loans exceeding the limit, with effect from April 1987 unless the lender opts to start earlier.
 - to make minor amendments to the composite rate scheme for bank interest.

Income tax and corporation tax

- 4.04 It is proposed—
- to change the special "composite rate" arrangements for Building Societies.
 - to introduce provisions for balancing adjustments where certain plant or machinery, particularly that with a short life, is depooled and disposed of within a specified number of years.
 - to allow writing down allowances on expenditure incurred after 13 March 1984 on new ships to be postponed and claimed at a later date, and to extend the arrangements for the postponement of allowances to expenditure incurred on or after 1 April 1985 on second-hand ships.
 - to exclude expenditure on land and houses from the scientific research allowance with effect from 1 April 1985.
 - to charge to tax on an accruals basis the discount on certain deep discount bonds issued principally to fund investment in United Kingdom Government securities.
 - to restrict the amount of a limited partner's share of the losses of a limited partnership which may qualify for tax relief.
 - to raise from £2 to £10 the limit on certain gifts which are excepted from the disallowance of business entertaining expenses and gifts.
 - to amend the rules providing for the set-off of first year allowances against profits of the three preceding years.
 - to amend the rules concerning the date on which expenditure is incurred for capital allowance purposes (announced on 18 December 1984).

Income tax, corporation tax and capital gains tax

- 4.05 It is proposed—
- to bring within the charge to capital gains tax instead of income tax the gains from certain transactions in commodity and financial futures and traded options.
 - to charge to tax as income rather than as capital gain that part of the price of any security which reflects accrued interest (announced on 28 February 1985).

Corporation tax

4.06 It is proposed to provide that certain of the accumulated tax losses of London Regional Transport shall be disregarded for the purposes of calculating future liability to corporation tax.

Corporation tax and capital gains tax

4.07 It is proposed—
to amend the indexation provisions so that relief is based on the March 1982 market value of assets acquired before 1 April 1982 (for companies) or 6 April 1982 (for individuals).
to extend the indexation allowance from the date on which an asset is acquired or from March 1982, if later, and to allow indexation to create or augment a loss.
to amend the rules which apply to a series of transactions between connected persons.

Oil taxation

4.08 It is proposed—
to remove onshore activity from the scope of immediate petroleum revenue tax exploration and appraisal relief.
to restrict immediate petroleum revenue tax exploration and appraisal relief in respect of extended production tests by reference to the value of oil produced in such tests; and to make other minor amendments.

Capital gains tax

4.09 It is proposed—
to increase the annual exempt amount in line with the increase in the retail prices index so that for 1985–86 an individual will be exempt on the first £5,900, and most trusts on the first £2,950, of capital gains.
to reform the retirement relief.

Development land tax

4.10 It is proposed to abolish development land tax with effect from 19 March 1985.

Capital transfer tax

4.11 It is proposed—
to increase the chargeable values for death and lifetime transfers in line with the increase in the retail prices index as follows:

Band of chargeable value £'000		Rate on death per cent	Lifetime rate per cent
Over	Not over		
0 – 67		Nil	Nil
67 – 89		30	15
89 – 122		35	17½
122 – 155		40	20
155 – 194		45	22½
194 – 243		50	25
243 – 299		55	27½
299		60	30

It is also proposed to extend the exemption for amenity land associated with a building of outstanding historic or architectural interest.

Stamp duties

4.12 It is proposed—
to repeal, effectively from 19 March 1985, the 1 per cent duty on gifts.
to exempt from the 1 per cent duty, with effect from 26 March 1985, deeds of family arrangement, and transfers of property on the break-up of a marriage.
to repeal, with effect from 26 March 1985, the duty on contract notes.
to repeal, effectively from 19 March 1985, certain fixed duties.
to exempt, effectively from 19 March 1985, share exchanges on a takeover.

Customs and Excise

Value added tax

- 4.13 It is proposed that from 1 May 1985 the standard rate of VAT will apply to the publication of advertisements in newspapers, journals and periodicals and associated services. Group 5 of Schedule 5 to the Value Added Tax Act 1983 will be repealed.
- 4.14 It is proposed to increase the registration and deregistration limits by order made under Schedule 1, paragraph 12 of the Value Added Tax Act 1983. From 20 March 1985 the registration limits will become £19,500 per annum and £6,500 per quarter. From 1 June 1985 the deregistration limits will become £18,500 per annum where estimated future turnover is concerned and £19,500 per annum where past turnover is concerned.
- 4.15 It is proposed to amend the law to implement certain recommendations relating to VAT in volumes 1 and 2 of the Report of the Keith Committee on the Enforcement Powers of the Revenue Departments.
- 4.16 It is proposed that from 1 June 1985 there will be relief from VAT on importation for certain goods imported solely for repair or processing which does not change their identity and return to their owners overseas. Further, goods reimported into the UK after processing will bear VAT only on the value of that process. Amending regulations will be made under powers in the Value Added Tax Act 1983.
- 4.17 It is proposed to extend relief from the liability to VAT in respect of bad debts. Section 22 of the Value Added Tax Act 1983 will be amended accordingly.
- 4.18 It is proposed that from 1 May 1985 transactions between companies providing services in connection with credit and charge cards and similar payment cards and the outlets accepting the cards will be exempt from value added tax. This will increase revenue by restricting the scope for input tax recovery. Group 5 (Finance) of Schedule 6 to the Value Added Tax Act 1983 will be amended by Treasury Order.
- 4.19 It is proposed from 1 May 1985 to extend zero-rating to computer equipment bought with donated funds for use by hospitals and other eligible bodies in medical research, diagnosis or treatment. Group 16 of Schedule 5 to the Value Added Tax Act 1983 will be amended by Treasury Order.

Alcoholic drinks

- 4.20 It is proposed, from midnight 19–20 March 1985, to increase:
- the rate of duty on spirits from £15.48 to £15.77 per litre of alcohol;
 - the rate of duty on beer from £24.00 to £25.80 per hectolitre and the charge for each additional degree of original gravity above 1030° per hectolitre from £0.80 to £0.86;
 - the rate of duty on cider and perry from £14.28 to £15.80 per hectolitre;
 - the rates of duty on wine and made-wine by the following amounts per hectolitre:
Still wine and made-wine of an alcoholic strength:
less than 15 per cent: from £90.50 to £98.00;
not less than 15 per cent but not exceeding 18 per cent: from £157.50 to £169.00;
exceeding 18 per cent but not exceeding 22 per cent: from £183.30 to £194.90;
exceeding 22 per cent: £194.90 plus £15.77 (instead of £15.48) for every 1 per cent, or part of 1 per cent, in excess of 22 per cent.
- Sparkling wine and made-wine of an alcoholic strength of less than 15 per cent from £149.40 to £161.80.
- Sparkling wine of an alcoholic strength of 15 per cent and above bears the same rates of duty as still wine.

Hydrocarbon oil

- 4.21 It is proposed, from 6 pm on 19 March 1985, to increase:
- the rate of duty on light hydrocarbon oil from £0.1716 to £0.1794 per litre;
 - the rate of duty on heavy hydrocarbon oil for use as road fuel from £0.1448 to £0.1515 per litre.

The duty on petrol substitutes and spirits used for making power methylated spirits is charged at the same rate as on light hydrocarbon oil, and aviation gasoline and gas for use as road fuel are charged at half the rate on light hydrocarbon oil.

Tobacco

- 4.22 It is proposed, from midnight 21–22 March 1985, to increase:
- the specific rate of duty on cigarettes from £24.97 to £26.95 per 1,000 cigarettes (the *ad valorem* rate remaining unchanged);
 - the duty on hand-rolling tobacco from £40.60 to £43.73 per kilogramme.

Table 4.1 Approximate direct effect of increases in duty rates on certain product prices

(All except VED inclusive of 15 per cent VAT)

Spirits duty	10p on a bottle of whisky
Beer duty	1½p on a pint of beer
Wine duty	6p on a bottle of table wine
Fortified wine duty	10p on a bottle of sherry
Cider duty	1p on a pint of cider
Petrol duty	4p on a gallon of petrol
Derv duty	3½p on a gallon of derv
Tobacco duty	6p on a packet of 20 cigarettes
Vehicle excise duty	£10 on a car licence

Vehicle Excise Duty

- 4.23 It is proposed to increase the excise duty on mechanically-propelled vehicles, other than goods vehicles, chargeable under Section 1 of the Vehicles (Excise) Act 1971 and under Section 1 of the Vehicles (Excise) Act (Northern Ireland) 1972 by about 11 per cent. The duty on most cars and light commercial vehicles will rise by £10 to £100, but the duty on pre-1947 cars will remain unchanged at £60.
- 4.24 The rates of duty for articulated heavy goods vehicles and for smaller rigid lorries will remain the same as for 1984–85 but those for about 150,000 vehicles in some of the heavier rigid classes will rise from their present levels by 7 to 29 per cent. These changes will bring the tax paid by the different categories of goods vehicle into a relationship more closely matching that of their respective road track costs. Duty rates on farmers' lorries over 7.5 tonnes will also be increased by varying amounts as the first stage of aligning them more closely with the use those vehicles make of the roads. The VED rate applying to 3-wheeled cars which currently applies to cars weighing up to 425 kilogrammes is to be extended to cars weighing up to 450 kilogrammes.
- 4.25 It is proposed to introduce legislation to enable designated post offices to charge for issuing temporary licences.

National Insurance Contributions

- 4.26 From 6 October 1985, changes are proposed to the structure of national insurance contributions. Unless otherwise stated, the decisions announced on 12 November 1984 will apply.

Class 1

- 4.27 The lower and upper earnings limits are due to rise to £35.50 a week and £265 a week respectively from April 1985. The main contribution rates will remain unchanged at 10.45 per cent for employers and 9 per cent for employees; but from 6 October 1985 a graduated structure of rates will be introduced above £35.50 as follows:

Employer		Employee	
Earnings £ p.w.	Rate payable on all earnings %	Earnings £ p.w.	Rate payable on all earnings %
35.50 to 55	5	35.50 to 55	5
55 to 90	7	55 to 90	7
90 to 130	9	90 to 265	9
130 and over	10.45		

- 4.28 For employers' contributions only, the full rate will become payable on all earnings above the upper earnings limit. The contracted-out rebate will continue to apply, for both employers' and employees' contributions, between the lower and upper earnings limits.

Class 2

- 4.29 The flat rate Class 2 contributions paid by the self employed will be reduced from £4.75 per week to £3.50 per week, from 6 October 1985.

Class 3

- 4.30 The Class 3 voluntary contributions will be reduced from £4.65 per week to £3.40, from 6 October 1985.
- 4.31 These changes will be included in the Social Security Bill now before Parliament.

Table 4.2 Direct effects of changes in taxation and national insurance ^(a)

	Forecast for 1985-86	Forecast for a full year (a)
INLAND REVENUE		
Income tax		
Increase in single allowance of £200 and married allowance of £300	-1 370 (b)	-1 700 (b)
Increase in additional personal allowance and widow's bereavement allowance of £100	-10 (b)	-10 (b)
Increase in age allowance of £200 (single) and £300 (married) and income limit of £700	-120 (b)	-160 (b)
Increase in basic rate limit of £800 to £16,200	-50 (b)	-80 (b)
Increase in further higher rate thresholds	-40 (b)	-75 (b)
Fringe benefits—car and car fuel scales	Nil	+45 (d)
Reduction in share retention period under approved profit sharing schemes	-4 (e)	-10 (e)
Relief for self employed national insurance contributions	-25	-55
Business Expansion Scheme—inclusion of research and development and exclusion of property development	Negligible	-1
Basis of assessment of partnerships	Negligible	Negligible (f)
Change in relief on covenanted gifts to charities	Negligible	-1
Offshore life assurance	Nil	Negligible
Extension of mortgage interest relief at source	Negligible	-2 (g)
Composite rate for bank interest—minor changes	Negligible	Negligible
Income tax and corporation tax		
Building Society special arrangements	Nil	-20 (h)
Short life assets	Nil	(i) (j)
Postponement of allowances on ships	Negligible	(k)
New rules for scientific research allowance	Negligible	Negligible
Charge to tax in respect of certain deep discount bonds	Negligible	Negligible
Limited partners' losses	Negligible	(l)
Limit on gifts for business entertaining	Negligible	Negligible
Set-off of first year allowances	Nil	Nil
*New rules for date capital expenditure incurred	-15	-25
*Reduction in allowances for agricultural buildings	(i) (m)	(i) (m)
*Reduction in rate of initial allowance for hotels	(i) (m)	(i) (m)
*Changes in allowances for patent rights and know-how	(i) (m)	(i) (m)
*Reduction in rate of initial allowance for dredging	(i) (m)	(i) (m)
*Abolition of use requirement for writing down allowances	Negligible	Negligible
*Capital allowances on fixtures	Negligible	Negligible
*Relief for investment managers acting for non-residents	Negligible	Negligible
*Friendly Societies life assurance business	Nil	Nil
Income tax, corporation tax and capital gains tax		
Commodity and financial futures, and traded options	Negligible	Negligible
*Accrued income charge on securities	Negligible	+300 (n)
Income tax, capital gains tax, capital transfer tax and stamp duties		
Minor exemptions for securities issued by European Communities	Nil	Nil (o)
Corporation tax		
London Regional Transport—accumulated tax losses	Nil	Nil
Corporation tax and capital gains tax		
Indexation relief based on March 1982 values	Nil	-105 (p)
Other changes to indexation relief	Nil	-50 (q)
Transactions between connected persons	Nil	Negligible
Oil taxation		
Removal of immediate PRT exploration and appraisal relief for onshore fields	+10	+6
Restriction of immediate PRT relief for extended production tests, and other minor changes	+10	+10
Capital gains tax		
Indexation of annual exempt amount	Nil (b)	-10 (b)
Reform of retirement relief	Nil	-4
Development land tax		
Abolition	-20	-50 (r)

Table 4.2 Direct effects of changes in taxation and national insurance ^(a) (continued)

	Forecast for 1985-86	Forecast for a full year (a)
INLAND REVENUE (continued)		
Capital transfer tax		
Indexation of chargeable rate bands	-12 (b)	-35 (b)
Extension of exemption for amenity land	Negligible	-5
Stamp duties		
Repeal of duty on gifts	-10	-10
Repeal of duty on contract notes	-4	-4
Other changes	Negligible	Negligible
TOTAL INLAND REVENUE	-1 660	-2 050 (s)
CUSTOMS AND EXCISE		
Value added tax		
Withdrawal of zero-rating of advertisements in newspapers, journals and periodicals	+30	+50
Increase in registration limits	Negligible	Negligible
*Implementation of Keith recommendations	+50	+150 (t)
Relief for certain goods temporarily imported for process or repair	-30	Nil
Extension of bad debt relief	Nil	-25
Exemption of transactions between credit and charge card companies and participating retailers	+15	+20
Relief for certain computer equipment bought with donated funds	-5	-5
Excise duties		
Increase in rate of spirits duty	+10 (c)	+10 (c)
Increase in rate of beer duty	+115 (c)	+120 (c)
Increase in rate of duty on cider and perry	+5 (c)	+5 (c)
Increases in rates of wine and made-wine duties	+45 (c)	+45 (c)
Increases in rates of duty on light oil, etc.	+200 (c)	+200 (c)
Increase in rate of duty on heavy oil for use in road vehicles	+50 (c)	+50 (c)
Increases in rates of tobacco products duties	+170 (c)	+180 (c)
TOTAL CUSTOMS AND EXCISE	+655	+800
Vehicle excise duty		
Changes in rates of duty	+230	+230
VED on 3 wheeled cars	Nil	Nil
VED: Temporary First Licensing	Negligible	Negligible
Other		
Bus fuel grants	-5	-5
TOTAL CHANGES IN TAXATION	-780	-1 025 (s)
National insurance contributions		
Reduction in rates for employers	-30	-80
Reduction in rates for employees	-100	-270
Reduction in rates for self-employed and voluntary rates	-30	-100
TOTAL CHANGES TO NATIONAL INSURANCE CONTRIBUTIONS	-160	-450

* Items so marked were announced before Budget Day.

(a) The direct effects of tax changes are generally estimated by applying the new and old tax rates and allowances to the taxable income and expenditure expected in the economic forecast in Part 3, taking account of changes in taxpayers' behaviour arising from the tax change where these behavioural changes can be readily estimated. For the meaning of a full year see the note on page 9 of the FSR 1981-82. The full year figure for national insurance contributions is the difference between the revenue that would have been received in respect of 1985-86 on the basis of the contribution rates and earnings limits announced in November 1984, and the revenue that would have been received in respect of 1985-86 if the new arrangements had been fully in place at the start of that year.

Table 4.2 Direct effects of changes in taxation and national insurance (continued)

(b) *Taxes subject to statutory indexation.* The table below shows the direct revenue effects of indexing the income tax main allowances and thresholds (which are shown as the first five lines in Table 4.2 above), the capital gains tax exempt amount and the capital transfer tax threshold and bands by reference to the increase in the general index of retail prices between December 1983 and December 1984 (4.6 per cent), rounded in accordance with the statutory provisions, together with the costs of the proposed changes on top of indexation:

	Direct Revenue Effects				£ million	
	Indexation		Proposed changes on top of indexation		Total	
	1985-86	Full Year	1985-86	Full Year	1985-86	Full Year
<i>Income tax</i>						
Main allowances	-770	-960	-730	-910	-1 500	-1 870
Basic rate limit	-50	-80	Nil	Nil	-50	-80
Further higher rate thresholds	-40	-75	Nil	Nil	-40	-75
Total income tax	-860	-1 115	-730	-910	-1 590	-2 025
<i>Capital gains tax</i>						
Exempt amount	Nil	-10	Nil	Nil	Nil	-10
<i>Capital transfer tax</i>						
Thresholds and bands	-12	-35	Nil	Nil	-12	-35

(c) The table below shows the direct revenue effects of indexing the excise duties by reference to the increase in the general index of retail prices between December 1983 and December 1984 (4.6 per cent):

	Direct Revenue Effects				£ million	
	Indexation		Proposed changes compared with indexation		Total	
	1985-86	Full year	1985-86	Full Year	1985-86	Full Year
<i>Commodity</i>						
Beer, cider and perry	+70	+75	+50	+50	+120	+125
Wine	+25	+25	+20	+20	+45	+45
Spirits	+30	+30	-20	-20	+10	+10
Tobacco	+105	+110	+65	+70	+170	+180
Petrol	+200	+200	Nil	Nil	+200	+200
Derv	+50	+50	Nil	Nil	+50	+50
VED	+100	+100	+130	+130	+230	+230
Minor duties	+10	+10	-10	-10	Nil	Nil
Bus fuel grants	-5	-5	Nil	Nil	-5	-5
Total	+585	+595	+235	+240	+820	+835

- (d) Effect on tax liabilities in respect of 1986-87; the yield in 1986-87 will be £40 million.
- (e) These estimates are highly uncertain.
- (f) The proposal affects partnership changes taking place after 19 March 1985, but the basis of assessing liabilities for 1985-86 will for most cases be the same as before. Receipts will build up from about £5 million in 1986-87 to about £30 million in 1988-89.
- (g) In addition in 1986-87 and in 1987-88 there will be £5 million and £20 million respectively of relief brought forward from the following year. These estimates are highly uncertain.
- (h) Reduction in corporation tax. The proposal brings forward payments of composite rate income tax within the financial year. This reduces the earnings of societies (and therefore the corporation tax on those earnings). There is also a reduction in the cost of funding the PSBR.
- (i) Affects tax liabilities from 1986-87.
- (j) The cost will depend upon the proportion of expenditure on machinery or plant which is depooled. If the proportion were 25 per cent and the disposal value of assets sold were 10 per cent of their cost, revenue costs could rise from nil in the first two years to about £300 million by 1991-92.
- (k) Highly uncertain and depends upon take-up by industry. The cost could be up to £40 million by 1990-91.
- (l) Indeterminate saving, possibly about £30 million. Depends partly on the outcome of current litigation.
- (m) These items were included as part of the 1984 Budget corporation tax measures and their effects were included in the forecast published in the 1984-85 FSR.
- (n) Effective from 28 February 1986. Effect on tax liabilities in respect of the year from that date.
- (o) Essentially a codifying measure.
- (p) Capital gains tax -£75 million; corporation tax -£30 million. The cost in 1986-87 will be £35 million (capital gains tax £25 million; corporation tax £10 million).
- (q) Capital gains tax -£40 million; corporation tax -£10 million. The cost in 1986-87 will be £20 million (capital gains tax £15 million; corporation tax £5 million).
- (r) Development land tax -£75 million; capital gains tax +£10 million; corporation tax +£15 million. The cost in 1986-87 will be £40 million (development land tax -£45 million; capital gains tax +£2 million; corporation tax +£3 million).
- (s) Includes +£345 million in respect of items not taking effect until 1986. Components will not necessarily sum to total because of rounding.
- (t) The yield in 1985-86 will come from larger assessments raised against certain persistently defaulting traders. Implementation of the Keith Committee proposals will lead to additional revenue from improved compliance amounting to £600 million by 1988-89. The full year yield will accrue from penalties, surcharges and interest, building up over time to an annual total of £150 million. There will also be a continuing reduction of Government debt interest.

5. Public Expenditure

The Government's Strategy

5.01 The government's expenditure plans, which are drawn up within the framework of last year's Green Paper, *The Next Ten Years* (Cmnd. 9189), and the medium-term financial strategy (MTFS), are a key element in the drive to create the right conditions for sustained economic growth. Spending must be contained within the available financial resources.

5.02 The annual Public Expenditure Survey takes as its starting point the prospects and plans set out in the MTFS. The results of the 1984 Survey, carried out against the background of the 1984 MTFS published a year ago, were set out in the 1985 Public Expenditure White Paper (Cmnd. 9428) published on 22 January. This gave public expenditure planning totals and details of programmes for the three years 1985-86 to 1987-88.

5.03 The prospects for expenditure, as well as for revenue and borrowing, are reviewed annually in the Budget. This year the review has had to take account of a number of significant changes in the economic scene since the Survey was completed. These changes include a lower exchange rate and higher interest rates as well as the costs of the prolonged coal strike. It has also become clear that, coal strike effects apart, public expenditure in 1984-85 is likely to exceed the planning total (see paragraph 5.15 below). Having reassessed prospects in the light of these changes, the Government has decided—as the Chancellor of the Exchequer announced in his Budget Speech—to make adjustments to the Cmnd. 9428 White Paper planning totals for 1985-86 to 1987-88, adding £2 billion to the Reserve and thus to the total in each year.

5.04 These estimating changes are not additions to individual departments' cash plans. They are, rather, adjustments to the totals to reflect a realistic assessment of the implications of present policies in major demand-led areas, and the prospects for spending by authorities outside the direct control of central government.

Employment and training measures

5.05 Included in the announcements in the Budget Speech was provision for further expansion of some employment and training schemes. The net cost to public expenditure of these policy changes will be added to the planning total.

5.06 The number of places in the Community Programme, which is targeted at long term unemployed adults, will be increased from 130,000 to 230,000. The net costs of this, after allowing for reduced expenditure on unemployment and supplementary benefit, will be £75 million in 1985-86, £235 million in 1986-87 and £250 million in 1987-88.

5.07 Following a review of provision for the 14-18 age group, an expanded Youth Training Scheme for 16 and 17 year olds is proposed for introduction in April 1986 with the aim of increasing the flow of qualified new entrants to the labour market each year. The new scheme will be the subject of consultations through

the Manpower Services Commission. Some additional provision for in-service teacher training to improve the quality of relevant teaching in schools is also proposed for 1986-87. After allowing for reduced expenditure on unemployment and supplementary benefit and the closure of the Young Workers Scheme, these proposals will involve additional net public expenditure of £65 million in 1986-87 and £150 million in the following year.

Public expenditure and GDP

- 5.08 Table 5.1 sets out the new cash expenditure totals, and expresses them both in real terms and as a percentage of GDP, using respectively the GDP deflator and money GDP figures from Part 2. The figures in the last line incorporate not only the changes in the planning totals but also increases in net debt interest, taking account of interest rate increases since Cmnd. 9428 was prepared and of the increase in the estimate of borrowing in 1984-85 (see paragraph 2.13).

Table 5.1 Public expenditure in cash and cost terms and as a percentage of GDP

	£ billion				
	1983-84	1984-85	1985-86	1986-87	1987-88
Public expenditure planning total shown in Cmnd. 9428	120.3	128.1	132.1	136.7	141.5
Increase in Reserve	—	—	2.0	2.0	2.0
Other estimating changes	—	1.6	—	—	—
Revised planning total	120.3	129.7⁽¹⁾	134.1	138.7	143.5
Budget measures	—	—	0.1	0.3	0.4
Planning total after Budget and other changes	120.3	129.7	134.2	139.0	143.9
GDP deflator	..	4½	5	4½	3½
(% increase on previous year)					
Planning total in real terms ⁽²⁾ (base year = 1983-84)	120.3	124.2	122.4	121.5	121.6
Public expenditure ⁽³⁾ as percentage of GDP	42½	43½	41½	40½	39½

⁽¹⁾ Revised estimated outturn, mainly reflecting higher coal strike costs.

⁽²⁾ Cash figures adjusted for general inflation as measured by the GDP deflator at market prices.

⁽³⁾ Planning total plus net debt interest, non-trading capital consumption and certain payments of VAT by local authorities and central government (see Cmnd. 9428, Volume II, page 299). Constituent items may not sum to totals due to rounding.

- 5.09 These cash plans imply that the level of spending will fall slightly in real terms between 1985-86 and 1987-88, following a significant fall between 1984-85 and 1985-86. However, after excluding the £2½ billion estimated cost of the coal strike in 1984-85, the planning total is broadly constant in real terms over this period.

- 5.10 Public expenditure as a percentage of GDP is now estimated to have risen in 1984-85 because of the coal strike costs, temporarily reversing the downward trend established since 1981-82. But the revised spending plans point to a substantial renewed fall in this percentage over the next three years. This will free an increasing share of the nation's income and resources to the private sector, and provide the basis for further reductions in the tax burden.

General government expenditure

- 5.11 General government expenditure includes gross debt interest payments and various national accounts adjustments as well as the planning total, and it excludes some public corporations' transactions which are included in the planning total.

Table 5.2 Public expenditure planning total and general government expenditure

	£ billion				
	1983-84	1984-85	1985-86	1986-87	1987-88
Planning total after Budget and other changes	120.3	129.7	134.2	139.0	143.9
Interest payments ⁽¹⁾	14.9 ⁽²⁾	16.5	18.0	18	18½
Public corporations ⁽¹⁾⁽³⁾	0.1 ⁽²⁾	-1.0	2.3	1.2	1.0
Other national accounts adjustments ⁽¹⁾	4.7	4.3	5.0	5½	5½
General government expenditure in national accounts terms	140.1⁽²⁾	149.5	159.5	164	169

⁽¹⁾ Adjustments necessary to translate to general government expenditure as defined in the National Accounts. These adjustments are listed in Cmnd. 9428, Volume II (Table 2.16 and Part 6, paragraph 33). The interest payments are for general (i.e. central and local) government and are not the same as those on gross and net definitions involving all public sector debt interest payments shown in Cmnd. 9428, Volume II, Table 2.15.

⁽²⁾ For 1983-84 see Table 2.4, *Financial Statistics*, February 1985.

⁽³⁾ Nationalised industries and List I public corporations' market and overseas borrowing and leasing (see paragraph 5.13).

Constituent items may not sum to totals due to rounding.

- 5.12 The debt interest estimates in Table 5.2 take account of the interest rate increase since Cmnd. 9428 was prepared and of the increase in the estimate of borrowing in 1984-85. The increases in estimated debt interest from year to year are more than accounted for by the further costs of net borrowing each year, and are consistent with a decline in interest rates over the period from current levels.

- 5.13 Public corporations' market and overseas borrowing has to be deducted from the planning total to convert to general government expenditure as defined in Part 2. This element is usually negative (i.e. a net repayment which is expected to be particularly large in 1985-86) but in 1984-85 it is estimated to be positive as a result of the coal strike. There are additions to the national accounts adjustments as a result of classification changes; the major one has the effect of redefining certain notional public sector pension funds transactions as expenditure rather than negative receipts⁽¹⁾. This increases expenditure and revenue in all years by equal amounts. The increase in revenue is included in "other miscellaneous receipts" in Table 5.4.

- 5.14 Table 5.4 (page 39) shows how general government expenditure is expected to be financed. It also provides a disaggregation of summary figures of receipts and expenditure given in Tables 2.2, 2.3 and 5.1.

- 5.15 Table 5.4 shows the latest estimate of the 1984-85 planning total nearly £3½ billion higher than that in the 1984 Budget forecast. The chief reason for this overrun is the coal strike, which has added £2½ billion to expenditure in 1984-85. The Autumn Statement and Public Expenditure White Paper adopted the assumption that the strike would finish by the end of 1984; these updated figures reflect the later finish. Other demands on the Reserve include local authorities overspend on current and capital account, and the impact of economic developments on demand-led programmes. The overrun, together with the impact of high interest rates on debt interest costs, is an important contributor to the increase in the latest forecast of the PSBR (paragraph 6.04). General government receipts are shown in the table to be about £1½ billion higher than predicted a year ago but some of this reflects the classification change affecting "other miscellaneous receipts" (see paragraph 5.13 above and the Annex to Part 2).

⁽¹⁾ See *Financial Statistics Explanatory Handbook*, 1985 edition, page 33.

The planning total and the PSBR

Supply Estimates

5.16 For 1985-86, Table 5.4 shows an increase in general government expenditure of about £10 billion over the latest estimate for 1984-85; £1½ billion of this is increased interest payments. The big change in "other adjustments" is largely affected by the swing in public corporations' market and overseas borrowing between the two years (see paragraph 5.13 above).

5.17 The Supply Estimates set out the amounts of money the Government asks Parliament to vote for expenditure by Government Departments and certain other bodies. The details for 1985-86 are published on 19 March 1985 with a *Summary and Guide* (Cmnd. 9450) which summarises the Estimates and explains how they relate to the public expenditure planning total. Just over one-half of the planning total is voted expenditure, which in turn represents about three-quarters of Supply Estimates. The remaining quarter consists mainly of transfers within the public sector, which finance expenditure counted in the planning total, eg Rate Support Grant finances local authority expenditure. The following table shows the latest estimate for Supply expenditure in 1984-85. The 1985-86 figure relates to provision in Main Supply Estimates only; outturn figures of Supply expenditure during the coming year will reflect any subsequent Supplementary Estimates, partially offset by underspending on some Votes.

Table 5.3 Supply expenditure	£ billion	
	1984-85	1985-86
	Budget forecast	Latest estimate
Main Supply Estimates	90.4 ⁽¹⁾	90.4 ⁽¹⁾
General allowance for Supplementaries and net underspending	1.3	3.4
Total Supply Expenditure⁽²⁾	91.7	93.8⁽²⁾⁽³⁾
(of which, planning total element)	(69.4)	(70.6) ⁽⁴⁾

⁽¹⁾ Adjusted for abolition of NIS.

⁽²⁾ See Table 1.1 of *Estimates 1985-86: Summary and Guide*, Cmnd. 9450, for an analysis by Class.

⁽³⁾ These figures are shown in Table 6.7 as "Supply Issues". Supply Issues are monies paid from the Consolidated Fund to Departments' cash accounts with the Paymaster General for spending on Supply. Supply Expenditure equates closely to total Supply Issues in most years, although there may sometimes be slight timing differences between the two.

⁽⁴⁾ Taking into account supplementary provision granted during the year and departments' forecasts of excesses or shortfalls.

Constituent items may not sum to totals due to rounding.

Table 5.4 The public expenditure planning total, general government transactions and the PSBR

	1984-85		1985-86	£ billion		
	Budget forecast	Latest estimate	Forecast	Budget forecast	Latest estimate	Plan/Forecast
Receipts⁽¹⁾						
General government taxation						
Income tax	33.8	32.7	35.2			
Value added tax	18.0	18.4	18.3			
Local authorities rates	12.9	12.8	13.6			
Corporation tax	8.4	8.2	10.1			
Oil duties	6.1	6.1	6.5			
Petroleum revenue tax	6.0	7.2	8.2			
Spirits, beer, wine, cider and perry duties	4.0	3.8	4.2			
Tobacco duties	4.1	4.1	4.3			
Vehicle excise duty	2.1	2.2	2.5			
National Insurance surcharge	0.9	0.9	—			
Taxes on capital	1.7	1.8	1.9			
European Community duties	1.4	1.4	1.5			
Other (including accruals adjustments)	2.9	2.9	4.6			
Total⁽⁴⁾	102.3	102.5	110.9			
North Sea oil royalties, etc.	2.0	2.6	2.5			
National Insurance, etc. contributions	23.0	22.7	24.6			
Gross trading surplus and rent	3.0	3.1	3.0			
Interest and dividend receipts	4.8	5.3	6.4			
Other miscellaneous receipts	2.4	2.6	2.5			
Accruals adjustment	0.8	1.1	0.2			
Total general government receipts	138.3	139.9	150.1			
General government borrowing requirement ⁽⁴⁾	7.9	9.6	9.4			
Total general government receipts and borrowing	146.2	149.5	159.5			
Memo						
Public corporations' market and overseas borrowing ⁽⁴⁾⁽⁸⁾	-0.7	0.9	-2.3			
Public sector borrowing requirement⁽⁴⁾	7.2	10.5	7.1			
Expenditure						
Central government						
Social security	34.7	35.2	37.2			
Defence	17.0	17.1	18.1			
Health and personal social services	13.1	13.4	14.1			
Other	25.8	26.5	27.1			
Local authorities						
Education and science	10.8	11.5	11.2			
Other	21.2	23.2	21.9			
Nationalised industries' external finance	1.8	4.1	1.3			
List I and II public corporations ⁽²⁾	0.4	0.4	0.4			
List III public corporations ⁽³⁾	0.6	0.4	0.3			
Adjustments						
Special sales of assets	-1.9	-2.1	-2.5			
Reserve	2.8	—	3.0			
Public expenditure planning total (Cmnd. 9428 basis)⁽⁵⁾	126.3	129.7	132.1			
Increase in Reserve	—	—	2.0			
Budget measures	—	—	0.1			
Planning total after Budget and other changes	126.3	129.7	134.2			
Interest payments	15.4	16.5	18.0			
Other adjustments ⁽⁷⁾	4.6	3.3	7.3			
General government expenditure	146.2	149.5	159.5			

Constituent items may not sum to totals due to rounding.

⁽¹⁾ See Tables 6.5 and 6.8.

⁽²⁾ List I and II public corporations' external finance, which is detailed in Cmnd. 9428, Volume II, Tables 2.3 and 2.11.

⁽³⁾ List III public corporations' capital expenditure and subsidies, which are detailed in Cmnd. 9428, Volume II, Tables 2.3 and 2.11.

⁽⁴⁾ Total taxes on income, expenditure and capital on a national accounts basis as in lines 1, 2 and 3 of Table 6.5. Together with North Sea oil royalties, etc., this total corresponds to the first line of Table 2.3.

⁽⁵⁾ Figures in the first column up to this row are consistent with Table 5.6 in the *Financial Statement and Budget Report 1984-85* translated from Cmnd. 9143 to Cmnd. 9428 definitions. Figures in the second column are the Treasury's latest estimate of outturn. Figures in the third column up to this row are from Cmnd. 9428, Volume II, Table 2.2.

⁽⁶⁾ PSBR = GGBR + public corporations' market and overseas borrowing.

⁽⁷⁾ Adjustments to the planning total figures after Budget and other changes to translate to general government expenditure as defined in the national accounts. These adjustments are described in Cmnd. 9428, Volume II, Part 6, paragraph 33.

⁽⁸⁾ Including public corporations' transactions in general government debt.

6. Public Sector Transactions

The Public Sector Borrowing Requirement

- 6.01 The tables⁽¹⁾ in Part 6 provide further information on transactions of the public sector in 1984-85 and 1985-86. They elaborate the more rounded and summary figures shown in Parts 2, 3 and 5. The forecasts for 1985-86 incorporate the effects of the Budget measures. The basis of the tables and the relationship between them is outlined in paragraphs 6.14 to 6.16.
- 6.02 Table 6.1 shows the composition of the PSBR in 1984-85 and 1985-86. The composition in 1985-86 is based on a notional allocation of the expenditure Reserve (see footnote ⁽⁸⁾ to Table 6.5).

Table 6.1 Public sector borrowing requirement

	1984-85		£ billion
	Budget forecast	Latest estimate	Forecast
Central government on own account ^(*)	5.3	6.8	5.8
Local authorities	1.3	2.4	1.5
Public corporations	0.6	1.3	-0.2
Public Sector Borrowing Requirement	7.2	10.5	7.1

^(*) Central government borrowing less on-lending to local authorities and public corporations.

1984-85 estimates

- 6.03 The forecast a year ago for the PSBR in 1984-85 was £7½ billion, increased to £8½ billion in the Autumn Statement. The latest estimate of the outturn is £10½ billion, but the scale of borrowing towards the end of the financial year is always difficult to predict⁽²⁾.
- 6.04 The chief reasons for the increase of £3½ billion since the 1984 Budget forecast are:
- The cost of the coal strike, adding £2½ billion to total borrowing (including £2½ billion public expenditure costs).
 - Other increases totalling nearly £1 billion in the public expenditure planning total (see Part 5, paragraph 5.15).
 - An increase of £1 billion in debt interest payments because of higher interest rates and higher borrowing than expected a year ago.

On the revenue side, expected extra receipts of £1½ billion from North Sea oil, owing both to higher production and to higher sterling oil prices, are only a partial offset to these factors.

⁽¹⁾ Because of rounding, constituent items in tables may not always sum to totals.

⁽²⁾ The average margins of error on PSBR forecasts made at this time are ±£1 billion for the current year and ±£4½ billion for the year ahead. See Table 3.8 and *Economic Progress Report*, September 1983.

1985-86 projections

Sectoral split of PSBR

Central government

- 6.05 The PSBR in 1985-86 is forecast to be £7 billion⁽¹⁾, a decline of £3½ billion from the expected outturn in 1984-85. A large part of the turnaround is because of the ending of the coal strike. Excluding strike effects, public expenditure (including the £5 billion Reserve and debt interest) is expected to rise a little in real terms. On the other hand, revenues are forecast to rise considerably faster, despite the extra receipts in 1984-85 from the withdrawal of postponed VAT accounting for imports. The forecast rise in revenues includes a £1½ billion rise in North Sea oil taxes and a £1½ billion rise in onshore company tax receipts (reflecting increased profits in 1983 and 1984). Consequently, central government borrowing should be lower. In addition, local authorities' capital expenditure is expected to be lower than in 1984-85, resulting in lower borrowing by these authorities. Public corporations' borrowing is expected to become a small net repayment in 1985-86: following the end of the strike, and with continued growth in the economy, trading surpluses should recover strongly.

- 6.06 As in 1984-85, both expenditure and receipts are expected to be higher than projected a year ago. The increase in the public expenditure planning total is discussed in Part 5. Other changes are discussed in the Annex to Part 2.

- 6.07 Tables 6.2 to 6.4 show the forecasts of the receipts and expenditure of central government, local authorities and public corporations respectively, which produce the PSBR projections in Table 6.1. The forecasts for 1985-86 incorporate a notional allocation of the expenditure Reserve (see footnote ⁽⁸⁾ to Table 6.5).

Table 6.2 Central government transactions

	1984-85		£ billion
	Budget forecast	Latest estimate	Forecast
Receipts			
Taxes	89.4	89.7	97.3
National insurance, etc. contributions	23.0	22.7	24.6
Other	10.2	12.1	12.2
Total	122.7	124.5	134.1
Expenditure			
Current expenditure on goods and services (including capital consumption)	43.5	44.1	46.3
Current grants and subsidies	66.1	68.2	69.6
Interest	13.9	14.8	16.4
Net lending and capital expenditure, excluding on-lending to local authorities and public corporations	4.5	4.3	4.0
Unallocated Reserve	—	—	3.6
Total	128.0	131.3	139.9
Central Government Borrowing Requirement on own account	5.3	6.8	5.8

- 6.08 Total central government receipts in 1984-85 are currently expected to be some £1½ billion higher than forecast a year ago, excluding classification changes (see the Annex to Part 2). The increase is more than accounted for by higher North

⁽¹⁾ See footnote ⁽²⁾ on page 40.

Sea taxes. Expenditure, excluding on-lending to local authorities and public corporations, is expected to be some £2½ billion above forecast, excluding the classification changes. About £1 billion of this is due to the coal strike (the remaining costs of which affect tax receipts and public corporations' borrowing, discussed below) and is reflected in the increase in grants and subsidies: the rest of that increase is largely due to higher social security payments. Debt interest payments are also higher than forecast, because of higher interest rates.

- 6.09 In 1985-86 central government expenditure (including the notional allocation of the Reserve) is forecast to rise less rapidly than receipts, for the reasons given in paragraph 6.05, and borrowing therefore declines.

Local authorities

Table 6.3 Local authorities' transactions

	£ billion		
	1984-85	1985-86	
	Budget forecast	Latest estimate	Forecast
Receipts			
Rates (net of rate rebates)*	12.9	12.8	13.6
Rate support grant	11.3	11.3	11.7
Other grants from central government	8.5	9.3	9.1
Other	5.1	5.0	5.1
Total	37.9	38.4	39.6
Expenditure			
Current expenditure on goods and services (including capital consumption)	26.8	27.3	27.6
Current grants and subsidies	4.9	5.1	4.7
Interest	3.8	4.1	4.3
Net lending and capital expenditure	3.6	4.4	3.1
Unallocated Reserve	—	—	1.3
Total	39.2	40.8	41.1
Local Authority Borrowing			
Requirement	1.3	2.4	1.5
of which:			
Borrowing from central government	4.4	2.9	2.2
Other borrowing	-3.1	-0.5	-0.7
*Memo: rate rebates	1.5	1.5	1.6

- 6.10 Local authority expenditure in 1984-85 is currently expected to be about £1½ billion more than forecast a year ago. The latest forecast takes account of overspend on both current and capital account and of extra policing costs arising from the coal strike and higher debt interest payments. Receipts are expected to be about £½ billion higher than forecast, reflecting increased grant for policing costs and housing benefit. The LABR is expected to be about £1 billion higher than forecast, at nearly £2½ billion. This estimate is particularly uncertain as local authorities usually borrow heavily in the final weeks of the year and the forecast for the year as a whole is very dependent on those weeks.

- 6.11 In 1985-86, capital expenditure is expected to be lower than in 1984-85, and this is reflected in lower forecast borrowing.

Public corporations

Table 6.4 Public corporations' transactions*

	£ billion		
	1984-85	1985-86	
	Budget forecast	Latest estimate	Forecast
Receipts			
Gross trading surplus†	9.4	6.5	7.6
Other	1.9	2.2	2.7
Total	11.3	8.8	10.4
Expenditure			
Interest, dividends and taxes on income	3.6	3.5	3.8
Net lending and capital expenditure	8.3	6.5	6.4
Unallocated Reserve	—	—	0.1
Total	11.9	10.0	10.2
Public Corporations' Borrowing			
Requirement	0.6	1.3	-0.2
of which:			
Borrowing from central government	1.4	0.4	2.1
Other borrowing	-0.7	0.9	-2.3

* British Telecom transactions are excluded from November 1984.

† Including subsidies.

Explanatory notes on Part 6 tables

- 6.12 In 1984-85, some £½ billion of the costs to the corporations of the coal strike are expected to be met from higher central government grant. The remaining costs are reflected in the increase in public corporations' borrowing since last year's forecast.
- 6.13 In 1985-86 public corporations' borrowing is expected to become a small net repayment. Following the end of the coal strike, and with continued growth in the economy, trading surpluses should recover strongly. The corporations are expected to resume repaying market and overseas debt, whilst borrowing from central government.
- 6.14 Tables 6.1 to 6.5 are based on the definitions used to compile the national accounts. Table 6.5 is the most detailed, and is the source of Tables 6.1 to 6.4. In order to show the financial deficit (which is usually used in international comparisons), lending by the public sector and other financial transactions are omitted from the analysis of receipts and expenditure in lines 1-23 of Table 6.5, and shown separately in lines 25-29. These lines show the relationship between the financial deficit and the borrowing requirement.
- 6.15 Tables 6.2 to 6.4 show how the borrowing requirements in each sector (line 30 of Table 6.5) are determined. Since these tables show the borrowing requirement rather than the financial deficit, the figures for expenditure and receipts in each sector are shown inclusive of the financial transactions in lines 25-29 of Table 6.5. (See footnote (3) of Table 6.5.)
- 6.16 Tables 6.6 to 6.9, covering central government transactions only, are based on the statutory funds and accounts (see *eg* HC 90, 1984-85). 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* (1985 edition, p 38), which also has a bibliography of other useful sources. Since the expenditure Reserve has not been allocated within sectors (see Table 6.5), Tables 6.6, 6.7 and 6.9 exclude forecasts for 1985-86.

Table 6.5 Public sector transactions⁽¹⁾ by sub-sector and economic category

		1984-85 Latest estimate			£ billion	
		General government			Public corporations	Public sector
	Line ⁽²⁾	Central government	Local authorities	Total ⁽³⁾		
Current and capital receipts						
Taxes on income ⁽⁴⁾	1	48.1	—	48.1	-0.1	48.0
Taxes on expenditure ⁽⁴⁾	2	39.8	12.8	52.6	—	52.6
Taxes on capital ⁽⁴⁾	3	1.8	—	1.8	—	1.8
National insurance, etc. contributions	4	22.7	—	22.7	—	22.7
Gross trading surplus	5	-0.4	0.3	-0.1	6.5	6.4
Rent and oil royalties etc.	6	2.7	2.8	5.6	0.6	6.1
Interest and dividends from private sector and abroad	7	2.1	0.6	2.7	1.0	3.7
Interest and dividends within public sector	8	4.8	-2.3	2.5	-2.5	—
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
Total	11	122.6	15.7	138.3	5.6	143.9
Current and capital expenditure						
Current expenditure on goods and services ⁽⁵⁾	12	-44.1	-27.3	-71.4	—	-71.4
Subsidies	13	-5.7	-1.3	-7.0	—	-7.0
Current grants to personal sector	14	-39.8	-3.7	-43.5	—	-43.5
Current grants paid abroad	15	-2.4	—	-2.4	—	-2.4
Current grants within public sector	16	-20.2	20.2	—	—	—
Debt interest	17	-14.8	-1.7	-16.5	-0.5	-17.0
Gross domestic fixed capital formation	18	-2.8	-3.1	-6.0	-6.9	-12.9
Increase in stocks	19	-0.2	—	-0.2	0.1	—
Capital grants to private sector	20	-2.3	-1.1	-3.5	—	-3.5
Capital grants within public sector	21	-0.8	0.2	-0.5	0.5	—
Unallocated Reserve	22	—	—	—	—	—
Total	23	-133.1	-17.9	-151.0	-6.8	-157.8
Financial surplus/deficit⁽⁶⁾	24	-10.6	-2.1	-12.7	-1.2	-13.9
Financial transactions						
Net lending to private sector and abroad	25	-0.2	0.1	-0.1	—	-0.1
Cash expenditure on company securities (net)	26	2.0	—	2.0	0.3	2.3
Transactions concerning certain public sector pension schemes	27	0.5	—	0.5	—	0.5
Accruals adjustments	28	1.1	—	1.1	—	1.1
Miscellaneous financial transactions	29	0.4	-0.4	-0.1	-0.4	-0.5
Borrowing requirement⁽⁷⁾	30	6.8	2.4	9.2	1.3	10.5

(1) Sign convention: receipts positive, payments negative.

(2) Relationship between lines: Current balance = sum of lines (1), (2), (4) to (9), (12) to (21) and part of (22)
(24) = (11) + (23) = -{(25) to (30)}.

Outturn data

6.17 Outturns for the PSBR, and for the detailed central government transactions as in Tables 6.6 to 6.9, 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*. Outturns for the details of the PSBR on national accounts definitions, as in Tables 6.2 to 6.5, are compiled quarterly and published in Sections 2 to 5 of *Financial Statistics* three months after the end of the quarter. The first national accounts outturns for 1984-85 will appear in the June issue of *Financial Statistics*, including Supplementary Table 13 which is based on Table 6.5 above.

		1985-86 Forecast			£ billion	
		General government			Public corporations	Public sector
	Line ⁽²⁾	Central government	Local authorities	Total ⁽³⁾		
Current and capital receipts						
Taxes on income ⁽⁴⁾	1	53.2	—	53.2	-0.3	52.9
Taxes on expenditure ⁽⁴⁾	2	42.2	13.6	55.8	—	55.8
Taxes on capital ⁽⁴⁾	3	1.9	—	1.9	—	1.9
National insurance, etc. contributions	4	24.6	—	24.6	—	24.6
Gross trading surplus	5	-0.4	0.4	-0.1	7.6	7.6
Rent and oil royalties etc.	6	2.6	3.0	5.6	0.6	6.2
Interest and dividends from private sector and abroad	7	3.0	0.7	3.7	1.0	4.7
Interest and dividends within public sector	8	5.3	-2.6	2.7	-2.7	—
Imputed charge for non-trading capital consumption	9	0.9	1.6	2.5	—	2.5
Capital transfers from private sector	10	—	—	—	0.2	0.2
Total	11	133.2	16.7	150.0	6.5	156.5
Current and capital expenditure						
Current expenditure on goods and services ⁽⁵⁾	12	-46.3	-27.6	-73.9	—	-73.9
Subsidies	13	-4.7	-0.8	-5.5	—	-5.5
Current grants to personal sector	14	-42.1	-3.9	-46.0	—	-46.0
Current grants paid abroad	15	-2.4	—	-2.4	—	-2.4
Current grants within public sector	16	-20.4	20.4	—	—	—
Debt interest	17	-16.4	-1.6	-18.0	-0.5	-18.5
Gross domestic fixed capital formation	18	-3.1	-2.6	-5.7	-6.1	-11.8
Increase in stocks	19	-0.1	—	-0.1	-0.3	-0.4
Capital grants to private sector	20	-2.2	-0.6	-2.8	—	-2.8
Capital grants within public sector	21	-0.9	0.4	-0.5	0.5	—
Unallocated Reserve ⁽⁶⁾	22	-3.6	-1.3	-4.9	-0.1	-5.0
Total	23	-142.2	-17.6	-159.9	-6.4	-166.3
Financial surplus/deficit⁽⁶⁾	24	-9.0	-0.9	-9.9	0.1	-9.8
Financial transactions						
Net lending to private sector and abroad	25	-0.1	0.1	-0.1	—	-0.1
Cash expenditure on company securities (net)	26	2.5	—	2.5	0.1	2.6
Transactions concerning certain public sector pension schemes (net)	27	0.2	—	0.2	—	0.2
Accruals adjustments	28	0.2	—	0.2	—	0.3
Miscellaneous financial transactions	29	0.5	-0.7	-0.2	0.1	-0.1
Borrowing requirement⁽⁷⁾	30	5.8	1.5	7.3	-0.2	7.1

(3) General government expenditure in Tables 2.2, 2.4, 5.2 and 5.4 = (23) + (25) + (26) + public corporations' borrowing from central government (Table 6.4). General government receipts in Tables 2.3 and 2.4 = (11) + (27) + (28) + (29).

(4) Lines (1) + (2) + (3), first column = first line of Table 6.2 = central government taxation in national accounts terms. It includes, besides Consolidated Fund taxation receipts (see footnote (7) to Table 6.8), the gas levy, accruals adjustments and VAT paid by but refunded to local authorities and government departments, as well as some other small items. The first line of Table 2.3 also includes oil royalties and local authorities' rates.

(5) Including non-trading capital consumption.

(6) The balance of receipts and expenditure, financed by net borrowing/lending shown in lines (25) to (30).

(7) Borrowing by central government on own account and total borrowing by local authorities and public corporations. Borrowing by local authorities and public corporations from central government is shown in Tables 6.3 and 6.4.

(8) Expenditure estimates for 1985-86 in lines (12) to (21) are based on the programme plans in Cmnd. 9428, plus the Budget measures. The £5 billion Reserve in line (22) has been notionally allocated to the central government, local authorities and public corporations sectors, pro rata to the programme plans for those sectors. This notional allocation carries no implications for the degree to which the Reserve will actually be spent in those sectors. The allocation and the resulting totals, both in this and in earlier tables, are therefore shown in italics.

Table 6.6 Summary of central government transactions

	£ billion	
	1984-85	
	Budget forecast	Latest estimate
Consolidated Fund		
Revenue (Table 6.8)	98.0	98.4
Expenditure (Table 6.7)	-103.4	-105.8
Deficit met from National Loans Fund	-5.4	-7.3
National Loans Fund (Table 6.9)		
Receipts	12.6	12.9
Payments	-17.5	-15.3
Consolidated Fund deficit (as above)	-5.4	-7.3
Total net borrowing by the National Loans Fund	-10.3	-9.7
Other funds and accounts (net)	-0.8	-0.4
Central Government Borrowing Requirement (including borrowing for on-lending to local authorities and public corporations)	-11.1	-10.1

Table 6.7 Consolidated Fund expenditure

	£ million	
	1984-85	
	Budget forecast	Latest estimate
Supply Issues⁽¹⁾	91 700	93 800⁽²⁾
Standing Services		
Payment to the National Loans Fund in respect of services of the national debt	6 800	7 500
Northern Ireland—share of taxes etc.	1 700	1 600
Payments to the European Communities	3 200	2 800 ⁽²⁾
Other services	60	60
Total Standing Services	11 700	12 000
Total	103 400	105 800

⁽¹⁾ 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 5.3) equates closely to total Supply Issues in most years, although there may sometimes be slight timing differences between the two.

⁽²⁾ £½ billion was paid to the European Communities from Supply Issues instead of Standing Services.

Table 6.8 Consolidated Fund revenue

	£ million		
	1984-85	1985-86	
	Budget forecast	Latest estimate	Forecast
Taxation			
<i>Inland Revenue—</i>			
Income tax	33 800	32 700	35 200
Corporation tax ⁽¹⁾⁽²⁾	8 400	8 200	10 100
Petroleum revenue tax ⁽³⁾	6 000	7 200	8 200
Capital gains tax	710	720	790
Development land tax	75	80	55
Capital transfer tax ⁽⁴⁾	680	680	760
Stamp duties	860	910	1 100
Total Inland Revenue	50 500	50 500	56 200
<i>Customs and Excise—</i>			
Value added tax	18 000	18 400	18 300
Oil	6 100	6 100	6 500
Tobacco	4 100	4 100	4 300
Spirits, beer, wine, cider and perry	4 000	3 800	4 200
Betting and gaming	650	670	700
Car tax	700	750	760
Other excise duties	20	20	20
EC own resources ⁽⁵⁾			
Customs duties, etc.	1 230	1 300	1 400
Agricultural levies	200	120	100
Total Customs and Excise	35 000	35 300	36 300
<i>Vehicle excise duties⁽⁶⁾</i>	<i>2 140</i>	<i>2 200</i>	<i>2 500</i>
<i>National insurance surcharge</i>	<i>900</i>	<i>920</i>	<i>30</i>
Total⁽⁷⁾	88 500	88 900	95 100
Miscellaneous Receipts			
Oil royalties	2 000	2 400	2 500
Gas levy	510	500	520
Broadcasting receiving licences ⁽⁸⁾	770	790	790
Interest and dividends	400	500	870
Other ⁽⁹⁾	5 800	5 300	6 700
Total Revenue	98 000	98 400	106 500

⁽¹⁾ Includes advance corporation tax (net of repayments)

3 000 3 100 3 600

⁽²⁾ Corporation Tax (CT), before advance corporation tax (ACT) set-off, attributable to North Sea oil and gas production, is estimated to be £2,400 million in 1984-85 and £2,800 million in 1985-86. (Payments of mainstream CT by North Sea companies are expected to be £1,200 million in 1984-85 and £1,600 million in 1985-86, with the remaining £1,200 million in 1984-85 and £1,200 million in 1985-86 of the CT being satisfied by setting off ACT.) Thus, total revenues from the North Sea, inclusive of royalties, petroleum revenue tax (including advance payments) and CT before any ACT set-off, are estimated to be £12,000 million in 1984-85 and £13,500 million in 1985-86. The CT figures do not correspond exactly to the tax received in these financial years in respect of North Sea production. Total receipts of CT (onshore and offshore) in any year include ACT on current dividends rather than the amount available to be set-off from previous dividends. Dividends and ACT associated with North Sea activities alone cannot be identified.

⁽³⁾ Includes advance payments of petroleum revenue tax.

⁽⁴⁾ Includes estate duty 6 6 4

⁽⁵⁾ Customs duties and agricultural levies are accountable to the European Communities as "own resources"; actual payments to the Communities are recorded in Table 6.7.

⁽⁶⁾ Includes driving licence receipts.

⁽⁷⁾ This total is the main component of central government taxation in national accounts terms. See footnote ⁽¹⁾ to Table 6.5.

⁽⁸⁾ Based on existing rates.

⁽⁹⁾ 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 and proceeds from the special sales of assets.

Table 6.9 National Loans Fund receipts and payments

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

⁽¹⁾ To private sector and within central government.

⁽²⁾ 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

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