Autumn Statement 1984

HM TREASURY
NOVEMBER, 1984

Autumn Statement 1984

RETURN to an Order of the House of Commons dated 12 November 1984: for

COPY of the AUTUMN STATEMENT 1984 as laid before the House by the CHANCELLOR OF THE EXCHEQUER on 12 November 1984

Treasury Chambers, 12 November 1984 } NIGEL LAWSON

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Summary

World economy

1.01 1984 looks like being the best year since 1976 for growth in world output and trade. Price rises, particularly in commodities but also in industrial products, are low. Next year will see slower growth in the United States, partly offset by somewhat faster growth in parts of Europe. With world interest rates likely to remain high in real terms, and with major debt problems easing only very slowly, many developing countries will have to make further adjustments.

Assumptions

1.02 This forecast is based on the usual assumption that fiscal and monetary policies in 1985–86 will be as indicated in the 1984 Medium Term Financial Strategy in the Financial Statement and Budget Report. It is also based on the formal assumption that the coal strike will be over by the end of 1984.

Demand and output

1.03 In the first half of 1984 total output in the UK was over 3 per cent up on a year earlier despite the losses caused by the coal strike. With rising real incomes benefiting both the personal and company sectors, and with companies having successfully restored their financial positions, domestic demand should grow substantially again in 1985. With further growth in prospect for UK markets overseas, exports should record another rise.

1.04 Total output in the UK is forecast to rise by 3½ per cent in 1985 (of which 1 per cent represents recovery from the coal strike). The rise in employment, over 1 per cent in the year to mid 1984, is expected to continue.

Inflation

1.05 Price rises and wage settlements have been fairly steady since early 1983. Inflation this year has been much as expected in the Budget forecast despite a lower exchange rate. Inflation in 1985 is expected to decline gradually.

External accounts

1.06 Britain's external accounts were in substantial surplus in the period 1980–83, contributing to the rapid build up of overseas assets. In 1984 extra oil imports have contributed to a position of near balance so far; with the ending of the coal strike, a return to surplus is forecast. North Sea oil production in 1985 may be close to its maximum.

Borrowing

1.07 For the 1984–85 financial year as a whole, higher oil revenues are likely to be more than offset by higher expenditure including the extra costs of the coal strike. Although the outturn is still uncertain, the result is forecast to be a PSBR of £8½ billion, some £1¼ billion above the Budget forecast. For next year, 1985–86, latest forecasts suggest that there would be scope for tax cuts of about £1½ billion if the PSBR were to be the £7 billion, or 2 per cent of GDP, assumed in the last MTFS.

The world economy

Recent developments

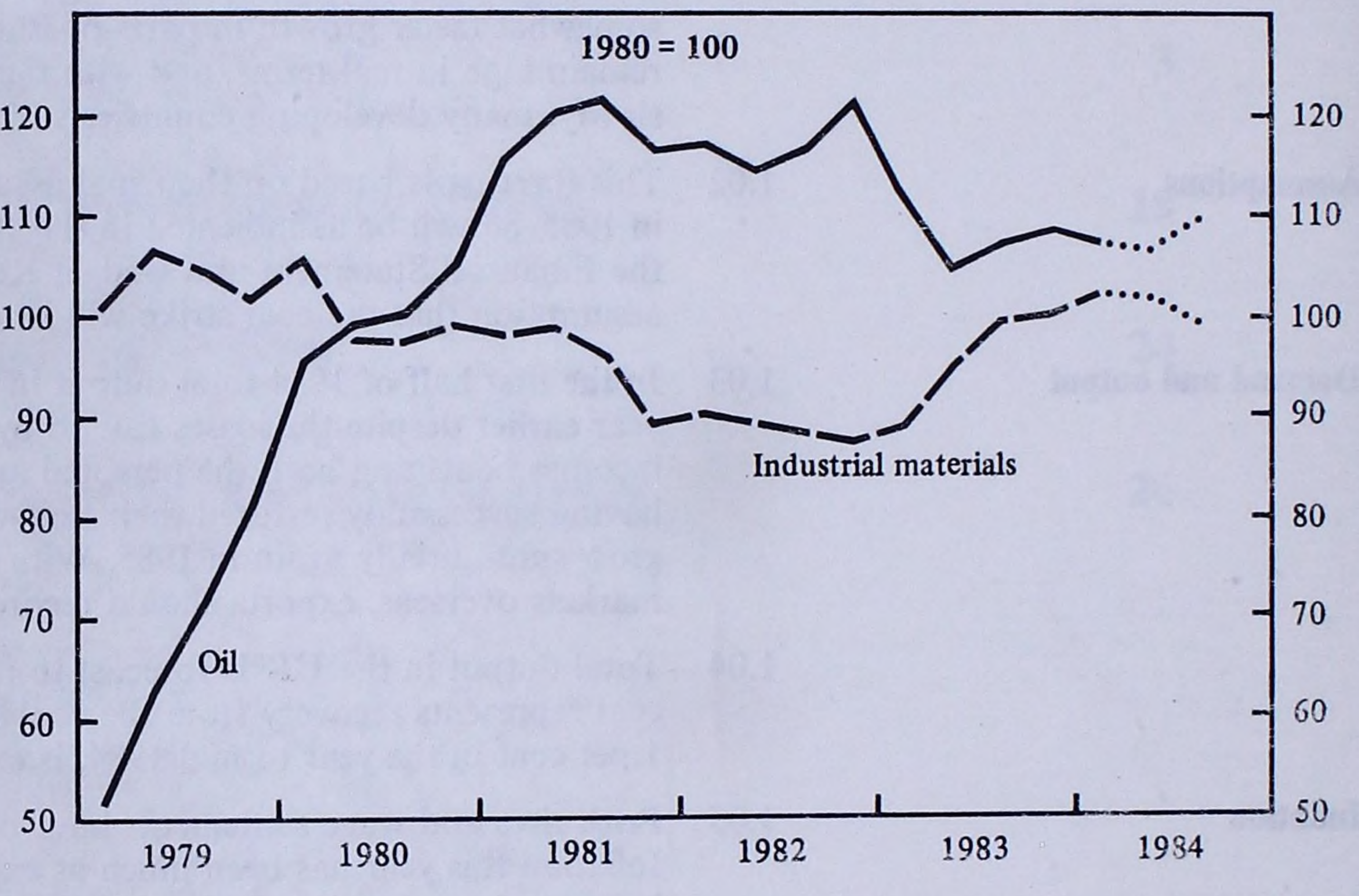
1.08 1984 is showing a rapid growth in world output and trade. The combined GNP of the major six economies other than the UK is likely to grow by about 5 per cent with an increase of nearly 10 per cent in total world imports. At the same time, inflationary pressures have been low: consumer prices are rising at about 4½ per cent, much as in 1983.

1.09 These developments have been heavily influenced by movements in the US economy. This year, total output in the US may be 7 per cent or more by volume above 1983 levels, domestic demand 9 per cent up and total imports up over 25 per cent. Coupled with the continued large budget deficit in the US, the expansion has contributed to the general rise in the level of world interest rates—a major factor constraining activity in Europe and many developing countries.

1.10 Commodity prices picked up sharply in the course of 1983 as expectations of recovery were finally confirmed, but more recently spot prices have fallen back some way: perhaps because many producers are under financial pressures to maximise revenues and output, and because in the industrial countries restocking has been modest. Oil prices, set in terms of the strengthening dollar, rose 5 per cent in real terms between mid 1983 and late 1984, but the resulting imbalance in the market, compounded by higher production and only very limited recovery in demand, may now be bringing about some adjustment. Chart 1.1 shows commodity prices, for oil and industrial materials, expressed in real terms.

CHART 1.1

Commodity Prices
(in relation to prices of manufactured exports)



Prospects

1.11 The US economy seems set for slower growth. As the economy gets nearer to full employment and high rates of capacity utilisation, slower growth is likely, particularly in interest-sensitive areas of domestic demand such as stockbuilding, housing investment and consumer durables. Interest rates have recently fallen from the levels reached in the middle of 1984. But next year, lack of progress in reducing the fiscal deficit would tend to keep interest rates high. It is assumed that the deficits continue to be funded without any major break in confidence. Although the US policy imbalance is unsustainable, it is difficult to foresee when or how it will be resolved.

1.12 In Europe the recovery has not yet gone very far and a growth rate of 3 per cent or so could well be sustained in 1985. In the developing countries, faced with the prospect of continuing high interest rates, a strong dollar and weak terms of trade, growth of domestic demand and imports may again be subdued, with major adjustment problems remaining; and OPEC markets are also liable to be weak.

1.13 Overall, the slowdown in the US will probably not be fully offset by higher growth elsewhere and the fall in unemployment in the US over the past year may not be repeated. Nevertheless, 1985 could well be another year of fair growth and low inflation.

Table 1.1 World Economy

Percentage changes on a year earlier

	1983	1984	1985
World GNP*	$2\frac{1}{2}$	5	4
Consumer prices*	$4\frac{1}{2}$	$4\frac{1}{2}$	4
World trade in manufactures (UK-weighted)	$1\frac{1}{2}$	7	$4\frac{1}{2}$

* US, Canada, Japan, France, Germany, Italy.

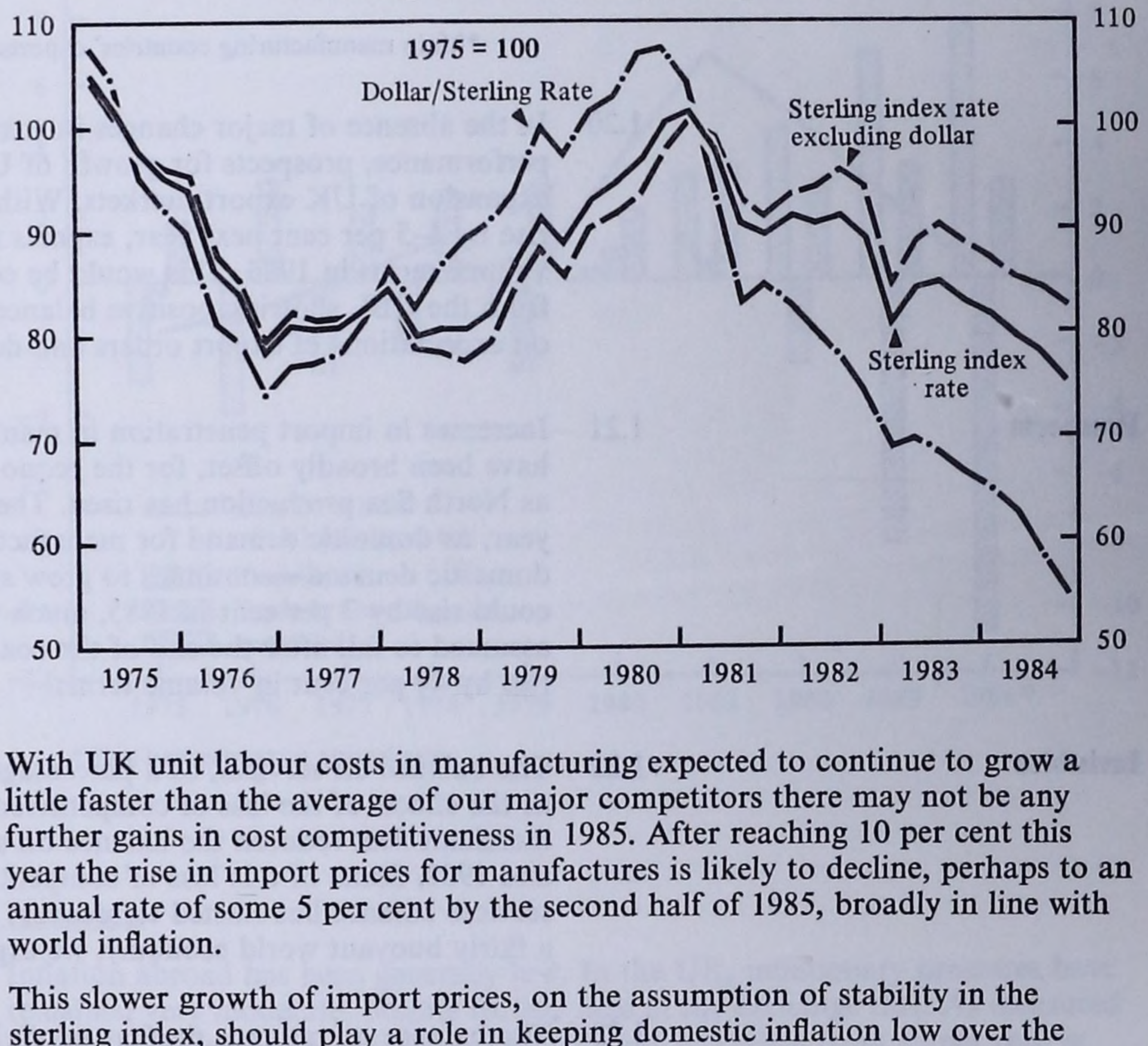
The Exchange Rate and The Balance of Payments

Sterling

1.14 The Budget forecast assumed that the sterling index would be close to its average level last year of 83. In the event, the sterling index has been weaker than this, to a considerable extent because of the unexpected strength of the dollar, but also because of industrial disputes. For this forecast it is assumed that the level of the sterling index in 1985 will not change much from the current level.

CHART 1.2

Sterling Index and Dollar/Sterling Rate



Relative costs and prices

1.15 With UK unit labour costs in manufacturing expected to continue to grow a little faster than the average of our major competitors there may not be any further gains in cost competitiveness in 1985. After reaching 10 per cent this year the rise in import prices for manufactures is likely to decline, perhaps to an annual rate of some 5 per cent by the second half of 1985, broadly in line with world inflation.

1.16 This slower growth of import prices, on the assumption of stability in the sterling index, should play a role in keeping domestic inflation low over the next year, and in maintaining the terms of trade close to current levels.

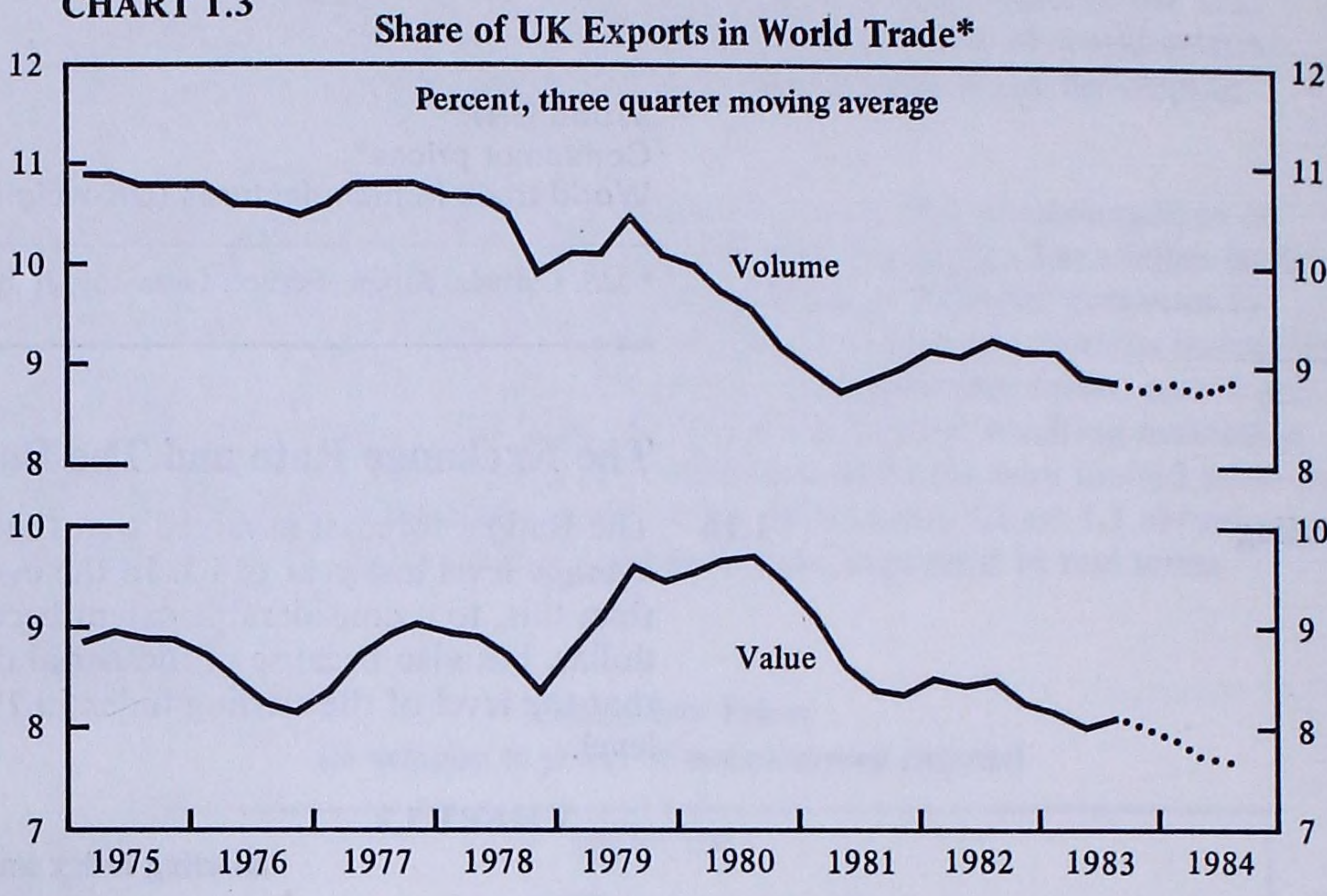
Trade in goods

1.17 Despite the effect of the coal strike in raising oil imports this year by some £2 billion, the outturn for the balance of trade in oil may exceed last year's surplus of £7 billion, helped by higher sterling oil prices and higher North Sea oil production.

1.18 Trade statistics have been distorted by the dock strikes but the underlying trends have shown a slower growth in volumes of both exports and imports than at the turn of the year. Nonetheless, it is likely that the volume of exports of goods will be 7 per cent higher this year than in 1983, the best performance since 1977. Imports of manufactures have also been growing strongly this year as a result of the continuing recovery in domestic demand.

1.19 Chart 1.3 shows the trends in UK manufacturing exports as a share of main manufacturing countries' trade measured in both value and volume terms.

CHART 1.3



*Main manufacturing countries' exports of manufactures

1.20 In the absence of major changes in cost competitiveness or other aspects of trade performance, prospects for growth of UK exports will depend mainly on expansion of UK export markets. With world trade in manufactures forecast to rise by 4–5 per cent next year, exports might well grow by 3–4 per cent in volume terms in 1985. This would be consistent with recent survey evidence from the CBI, showing positive balances on the exports optimism indicator, and on expectations of export orders and deliveries.

Prospects

1.21 Increases in import penetration in manufactures in both volume and value terms have been broadly offset, for the economy as a whole, by falls in imports of oil as North Sea production has risen. These trends are expected to continue next year, as domestic demand for manufactures—noticeably more cyclical than total domestic demand—continues to grow strongly. Imports of goods other than oil could rise by 7 per cent in 1985, much the same as in 1984. With oil imports assumed to fall after the end of the coal strike, total imports of goods may rise by 4½ per cent in volume terms.

Invisibles

1.22 The balance on services, as a percentage of GDP, reached a low point in 1983, as the effects of the loss of competitiveness were felt, and the decline in the UK merchant fleet reduced the balance on sea transport by £1 billion between 1980 and 1983. Some of this loss of competitiveness has now been regained and the services balance has started to recover: with a slower decline in the UK fleet and a fairly buoyant world economy, we expect a continued improvement next year.

1.23 The balance on interest, profits and dividends (IPD) has risen from zero in 1980 to an estimated £1½–2 billion in 1983, with the build up of the UK's net assets overseas following the abolition of exchange controls: see table 1.2. (Estimates for the first half of 1984, which put the IPD balance at only £1·2 billion at an annual rate, are provisional and liable to be revised upwards.) This in turn has been made possible by the capital outflows, which reflected the large current account surpluses of the 1980–1983 period, assisted by rises in stock market prices and currency revaluations, especially the fall in sterling against the dollar (in which roughly half of the UK's overseas assets are denominated). If, as is assumed, the fall in the dollar/sterling rate comes to an end, the ratio of net assets to GDP may grow more slowly. But the assets will continue to provide a stream of income in future years, when North Sea oil production may be lower than at present.

Table 1.2 Net UK External Assets, end year

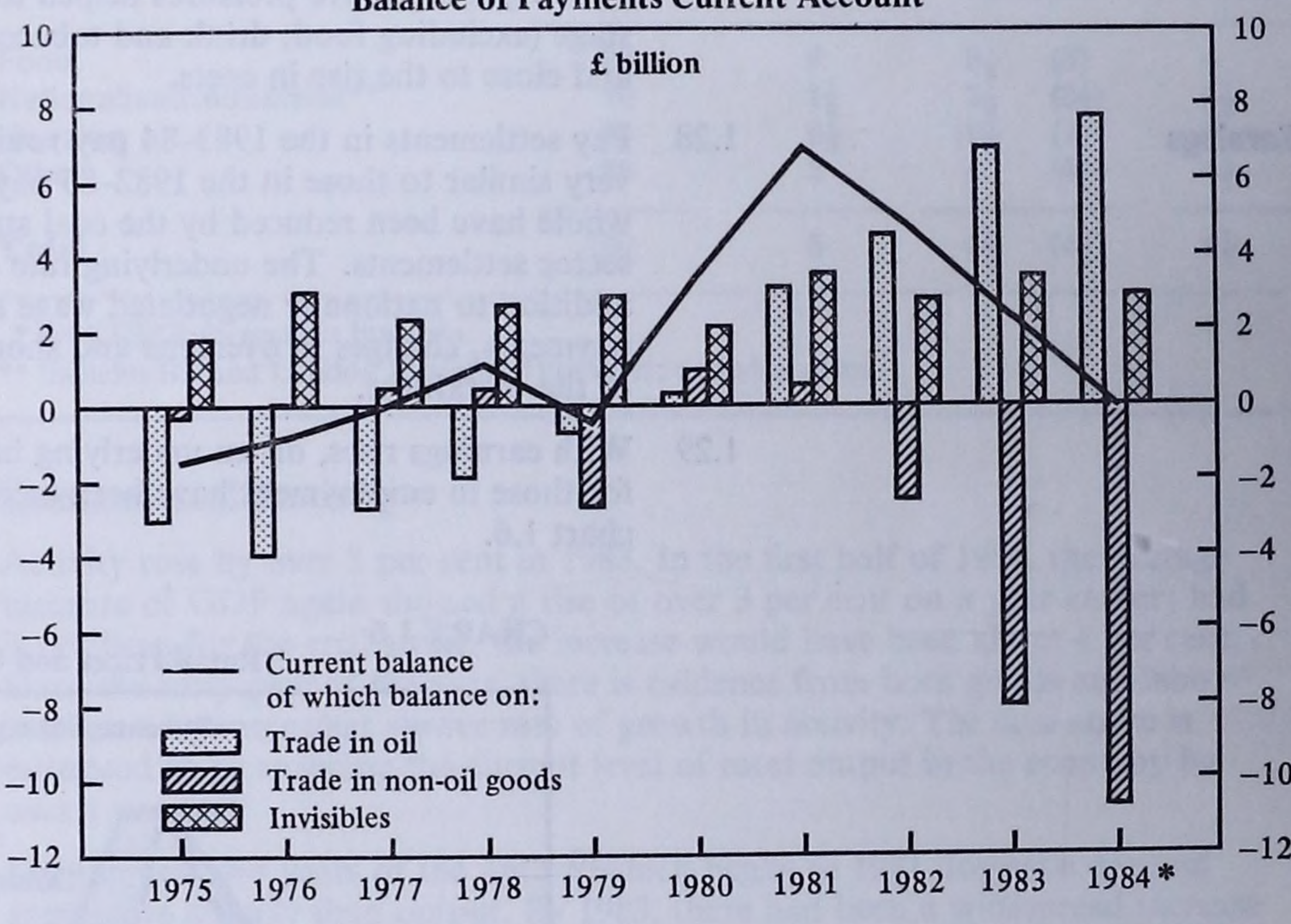
	£ billion	per cent of GDP
1979	15	7½
1983	56	18½
1984 (estimate)	70	22

Current account

1.24 The estimate of a current account balance in 1984 compares with a CSO estimate of a deficit of £½ billion for the first nine months. The forecast allows for the receipt of EC refunds and a rise in exports in the fourth quarter; and a better outcome on invisibles than indicated by recent data and CSO projections. An improvement in the surplus forecast for the current account in 1985 reflects in particular lower oil imports after the assumed ending of the coal strike, low commodity prices, and a rising surplus on invisibles. The sectoral composition of the current account in recent years is shown in chart 1.4.

CHART 1.4

Balance of Payments Current Account



*First half year at an annual rate

Inflation

1.25 Inflation abroad has been generally low. In the UK, inflationary pressures have remained very moderate, despite further falls in the exchange rate. As measured by the GDP deflator at market prices, inflation has fallen from 12 per cent in 1981 to 5 per cent in 1983 with a further fall in the first half of 1984.

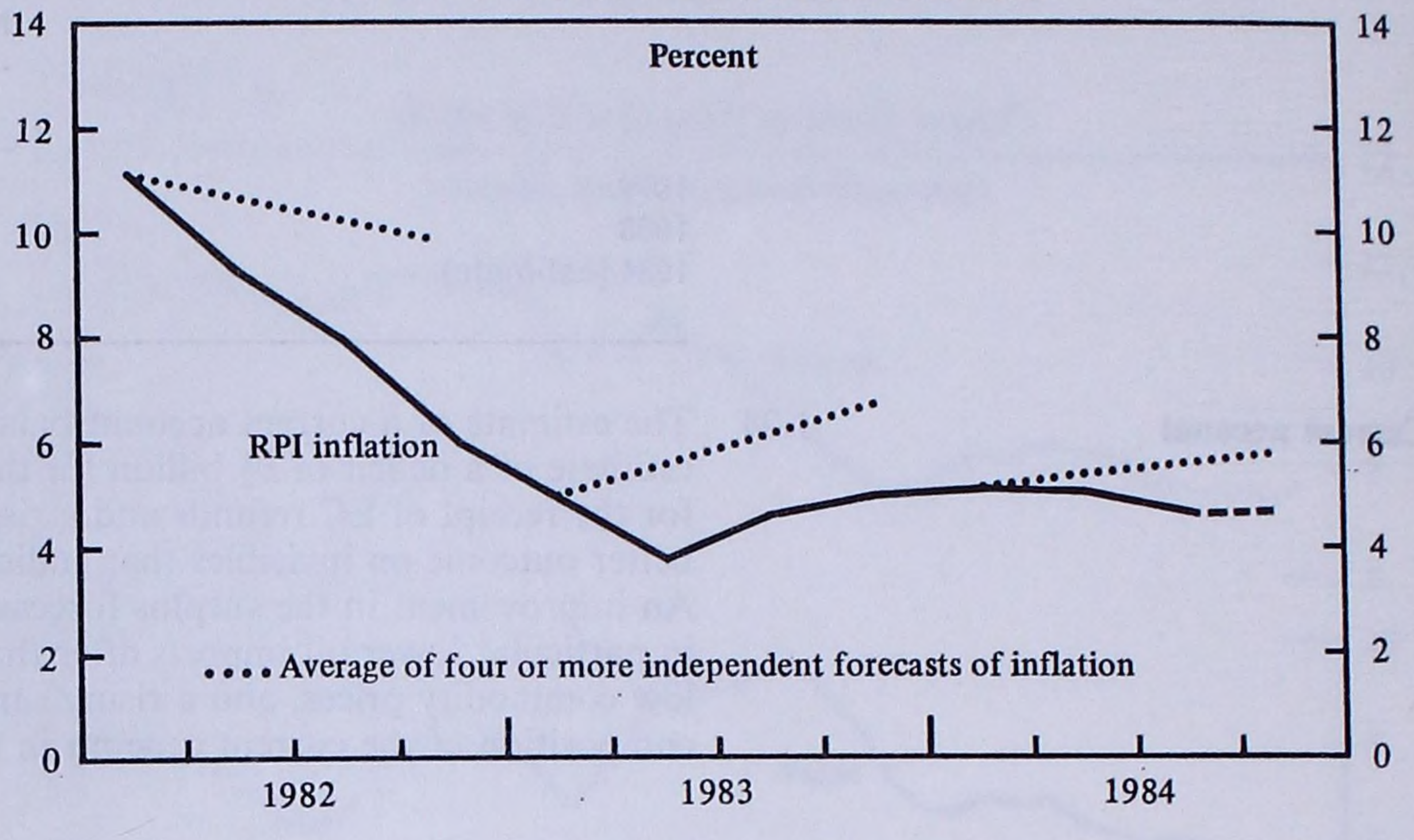
1.26 The recent tendency among forecasters to overestimate price rises can be seen in chart 1.5 (the dotted lines show forecasts, made early in the year, of inflation at the end of the year).

Costs

1.27 The recent falls in spot commodity prices have not, as yet, made much impact on domestic prices. Import prices for basic materials in the third quarter of 1984 were 15 per cent up on a year earlier, reflecting earlier rises in commodity prices and falls in the exchange rate. Domestic costs have not benefited as much as in 1983 from productivity gains, but the cuts in and subsequent abolition of the national insurance surcharge are helping to limit cost increases this year. Despite a 10 per cent rise in the prices of imported manufactures in the course

CHART 1.5

Inflation: RPI Path and Recent Predictions



of 1984, competitive pressures helped to limit the rise in prices at the wholesale stage (excluding food, drink and tobacco) to 5½–6 per cent, much as in 1983 and close to the rise in costs.

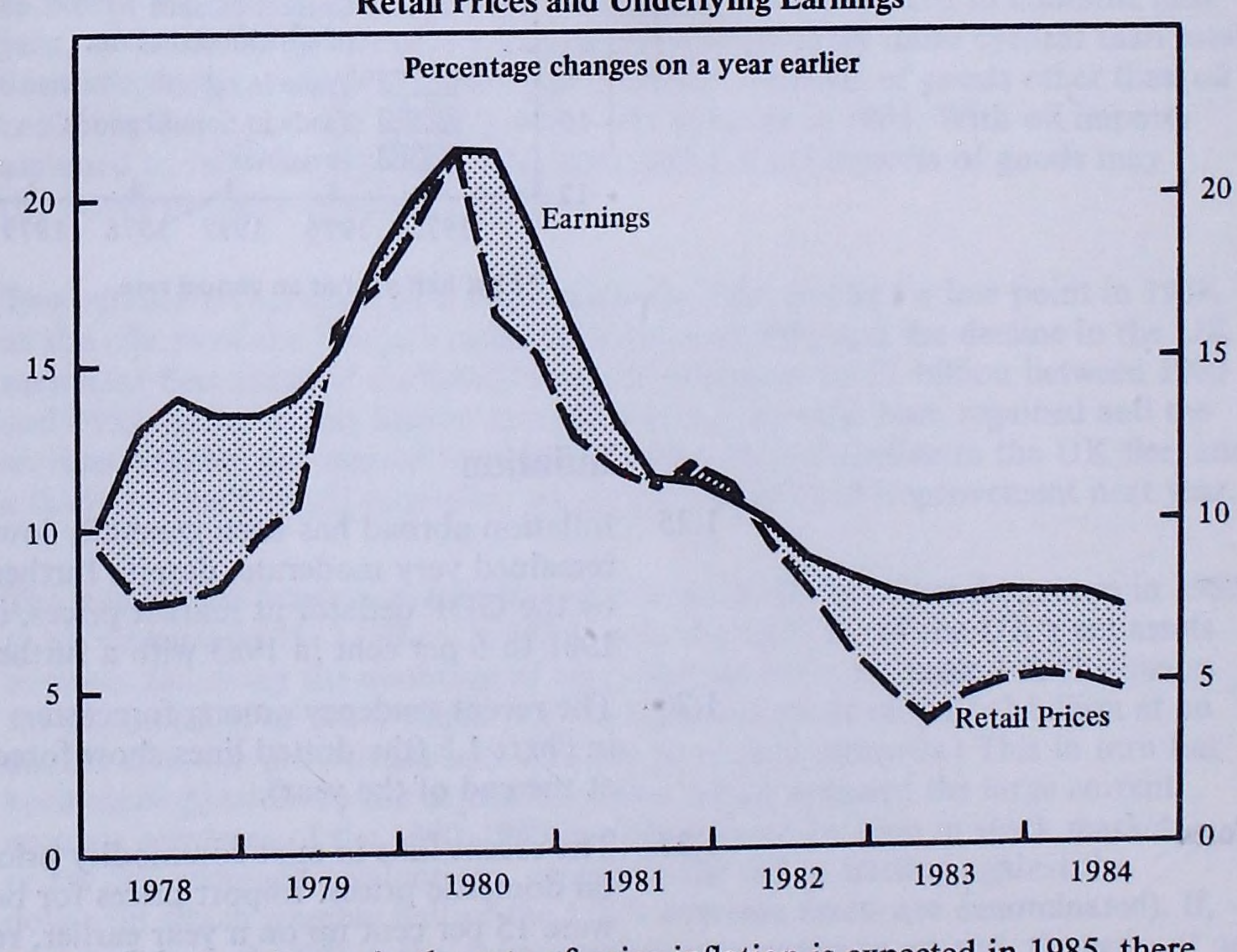
Earnings

1.28 Pay settlements in the 1983–84 pay round were generally around 5½ per cent, very similar to those in the 1982–83 pay round. Earnings in the economy as a whole have been reduced by the coal strike and by delays in some public sector settlements. The underlying rate of increase, about 7½ per cent, reflects—in addition to nationally negotiated wage settlements—productivity deals, bonus payments, changes in overtime and short time, and changes in the composition of the workforce.

1.29 With earnings rises, on an underlying basis, well above price rises, real earnings for those in employment have been increasing since mid 1982, as shown in chart 1.6.

CHART 1.6

Retail Prices and Underlying Earnings



Prospects

1.30 While no major change in the rate of price inflation is expected in 1985, there is likely to be some gradual decline, in the absence of a fall in the exchange rate and as the effects of recent falls in commodity prices come through. In a generally weak labour market, there have been substantial rises in real take-home pay over the past two years; and further increases in real take-home pay would be consistent with a flat or slowly falling trend in wage settlements. Unit labour costs, taking account of the abolition of the national insurance surcharge from October 1984, may rise by about 4 per cent in 1985.

1.31 The recovery in domestic demand and output since 1981 has been reflected in, and encouraged by, a recovery in profit margins on home sales. With sterling assumed to be steadier, costs and domestic prices may move more nearly in line in 1985.

1.32 The annual increase in the RPI may stay near to its recent rate of around 4¾ per cent through the first half of 1985 before falling in the fourth quarter. The housing component is strongly affected by changes in the mortgage interest rate: by the fourth quarter of 1985, the annual increase in the RPI will no longer be influenced by the sharp rise in mortgage rates in the summer of 1984. Table 1.3 shows changes in the main components of the RPI. Wholesale price inflation should also decline slowly in the course of 1985.

Table 1.3 Retail Prices

Per cent changes on a year earlier

	Weight	1983 Q4	1984 Q4 Forecast*		1985 Q4 Forecast
Food	20	6	3½	(3)	4
Nationalised industries**	10	1½	3½	(3½)	4½
Housing	14	6½	10½	(7)	4
Other	56	5	4	(4½)	4½
Total	100	5	4¾	(4½)	4½

* 1984 FSBR forecast in brackets.
** Includes BT and London Regional Transport; excludes water.

Demand and Activity

1.33 Activity rose by over 3 per cent in 1983. In the first half of 1984, the average measure of GDP again showed a rise of over 3 per cent on a year earlier; had it not been for the coal strike, the increase would have been about 4 per cent. Since the early part of the year, there is evidence from both goods and labour markets of a somewhat slower rate of growth in activity. The coal strike is estimated to be reducing the current level of total output in the economy by over 1 per cent.

1.34 For the first two years of the upturn which began in 1981 domestic demand grew more quickly than output. By 1983, there had been a widespread increase in all components of domestic demand, with a large rise in consumer spending. This year the growth of domestic demand has been slower, partly because the coal strike has led to lower stocks, and the balance has as expected shifted away from consumer spending towards investment, while overseas markets have grown more rapidly. The increases in GDP and domestic demand are now much more in line.

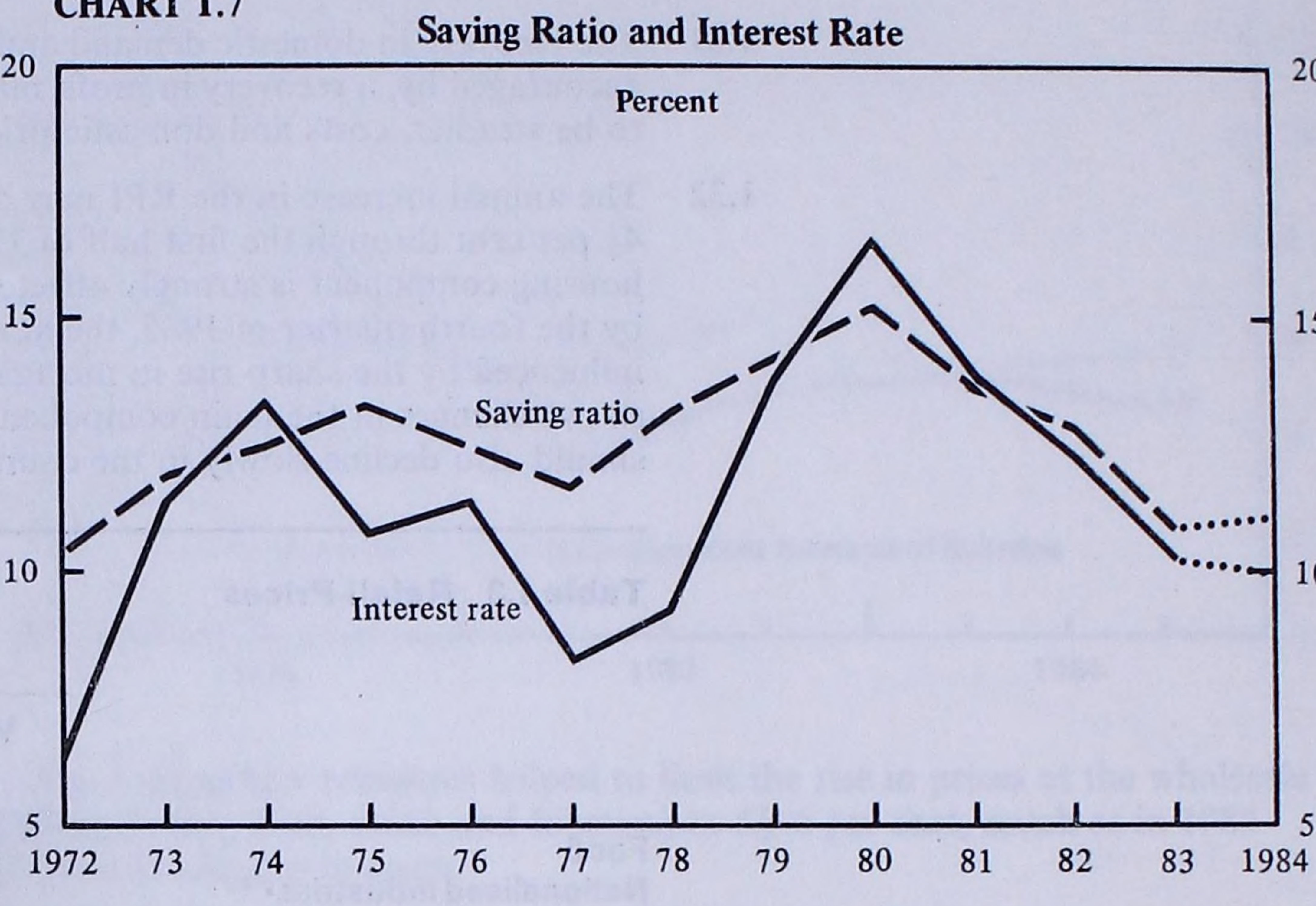
Personal income and expenditure

1.35 In 1983 real personal disposable income recovered to its 1980 level. But in order to finance higher spending, consumers reduced their rate of saving by 4½ percentage points. Between 1982 and 1983 the increase in consumer spending was almost 4½ per cent, helped by renewed growth in personal income.

1.36 The fall in saving was encouraged by the fall in inflation (which had been steadily eroding the real value of existing assets), by the drop in interest rates, and by easier access to credit. Chart 1.7 compares the saving ratio with a nominal interest rate: both the saving ratio and interest rates reflect, amongst other things, the rate of inflation. The high growth in spending in 1983 included a large increase in expenditure on durables, particularly on motor cars, in part, no doubt, a delayed replacement of the existing stock.

1.37 In 1984 personal income growth has continued in spite of the effects of the coal strike, and spending on non-durables seems likely to record another sizeable rise. Durables consumption seems likely to stay near last year's high level with a rise in total consumer spending of perhaps 2 per cent, rather less than in 1983.

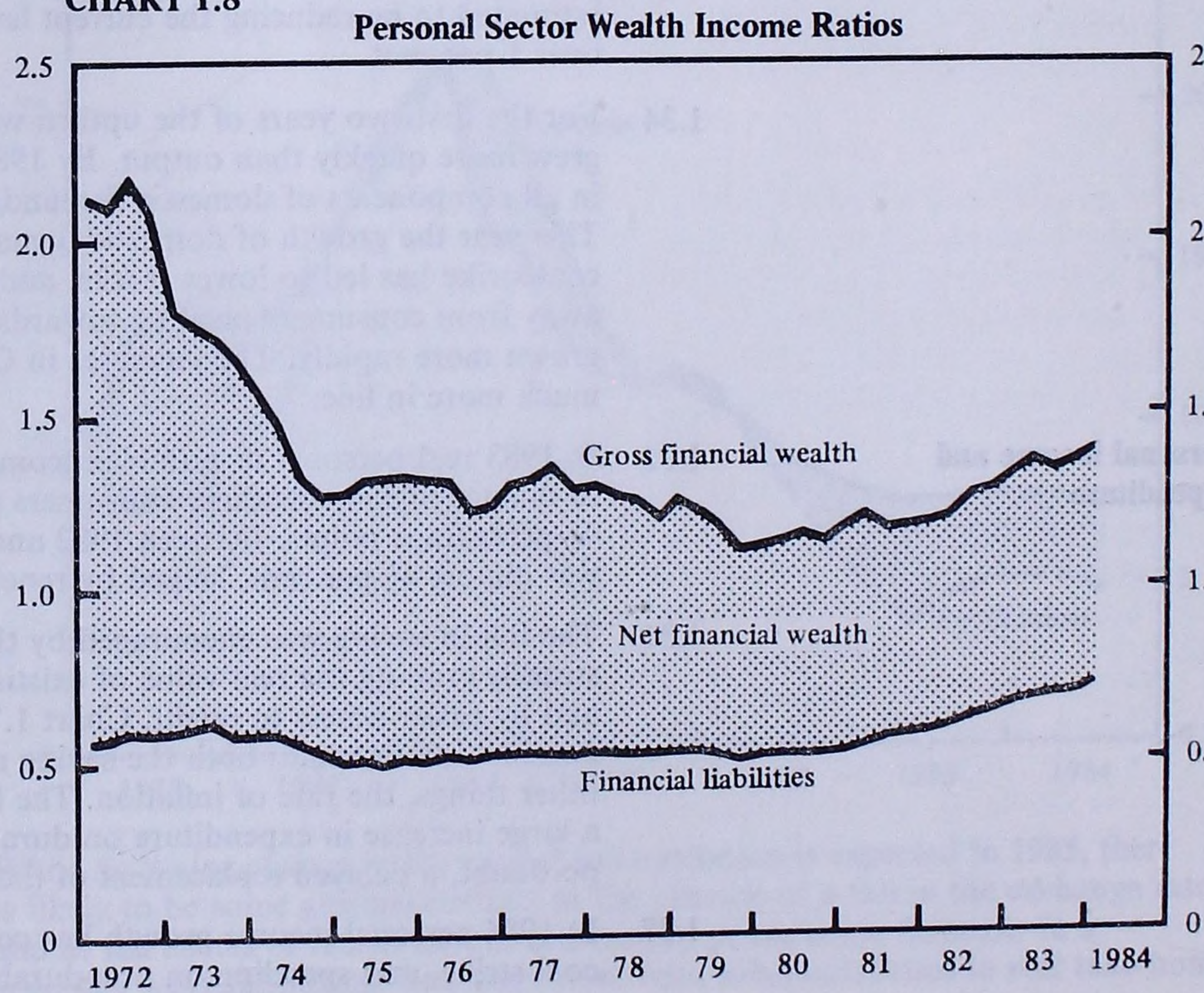
CHART 1.7



1.38 Paragraph 1.56 below indicates that there might be scope for a fiscal adjustment in 1985–86 of some £1½ billion. The assumption that this is used to cut income tax raises real personal disposable income in 1985 by nearly ½ per cent. This, combined with increases in employment and most other sources of income, suggests a forecast rise of RPDI of 4 per cent. As usual when income grows strongly the saving ratio is expected to rise and personal consumption may grow by 3 per cent.

1.39 The personal sector has more than doubled its borrowing since 1979, the major part of the increase being attributed to loans for house purchase from banks and building societies. Not all the lending, however, has directly financed spending: personal liquidity has been built up. Chart 1.8 shows that since 1980 net financial wealth has increased in relation to income, partly as a result of the strength of the gilt and stock markets, but, with increased borrowing, gross financial wealth has increased a little faster.

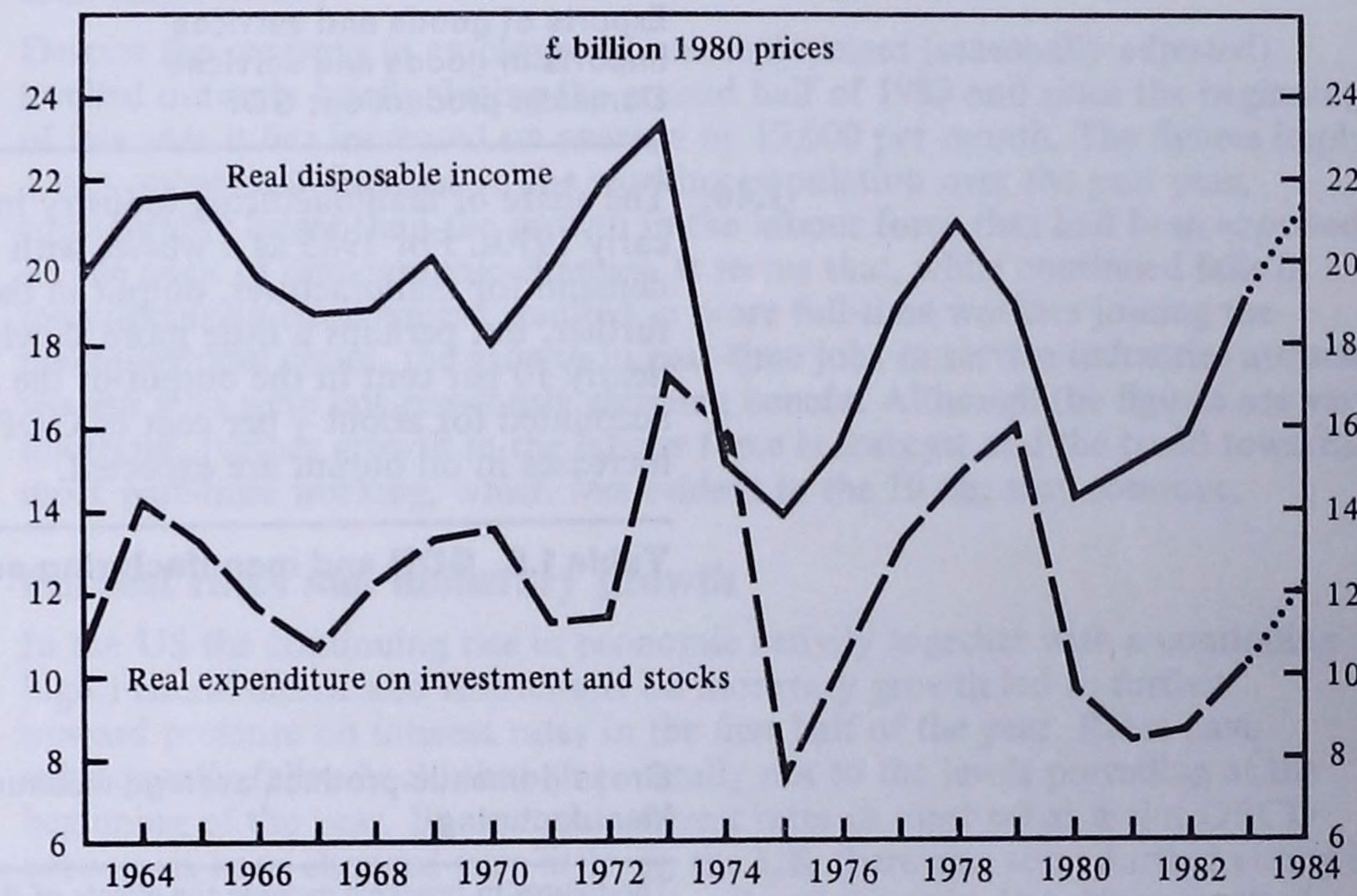
CHART 1.8



Company income and expenditure 1.40 The last eighteen months have seen a major recovery in company incomes as sales and profit margins have improved, particularly in overseas markets. This increase has not yet been fully reflected in tax payments, and in the twelve months to June 1984, non-North Sea company disposable incomes were up 28 per cent on the previous twelve months.

1.41 As usual at this stage of the cycle, company expenditure has lagged behind incomes so that the company sector has been running a large financial surplus, with a substantial improvement in corporate liquidity. This surplus can be expected to diminish as the growth in company incomes moderates and as expenditure rises. But in the absence of any sizeable stock rebuild, the company sector's financial surplus is likely to remain high by past standards.

CHART 1.9 **Company* Income and Expenditure**



*Industrial and commercial companies (excluding those operating in the North Sea)

Fixed investment 1.42 Business investment is now growing strongly: in the first half of 1984 it was up 13 per cent in real terms on the first half of 1983. The recovery in manufacturing investment this year has been particularly marked. For 1984 as a whole, fixed investment by non-North Sea industrial and commercial companies may be 11 per cent up on 1983. With North Sea expenditure increasing rapidly from the low level seen in 1983, 1984 seems likely to record a substantial increase in total private fixed investment. A further good year for private fixed investment is expected in 1985. North Sea investment is likely to increase further although not by as much as this year; and investment by non-North Sea industrial and commercial companies may grow by 7 per cent.

1.43 This rapid growth of private investment is likely to be offset in part by lower public investment, particularly by local authorities following the likely overspend in 1984–85. Personal investment in housing—now redefined by the CSO to include improvement work—grew rapidly to mid 1984. 1982 and 1983 saw a substantial recovery, now slowing down, in new housing investment. There may be a check to the growth of improvement work. But the level of total personal housing investment in 1985 is likely to be a little higher than in 1984. For the economy as a whole, investment growth is expected to continue in 1985 at a rate close to the overall growth of output.

Stockbuilding 1.44 In contrast to fixed investment, company expenditure on stocks has shown little tendency towards the recovery usual at this stage of the cycle: real interest rates are high, and the tax changes in the Budget reduced the incentive to hold stocks. Manufacturers' and distributors' stocks fell during the first half of 1984, reversing the rise seen over the previous six months. Recent surveys do not suggest much desire to change stock levels, and the forecast sees no more than a modest resumption of stockbuilding in 1985 as the growth in output and sales continues.

Domestic demand and activity

1.45 With real incomes of both persons and companies rising, domestic demand is expected to continue to grow during the forecast period. The effects of the assumed recovery from the coal strike seem likely to make the increase in demand and output larger than in 1984. The continuing recovery in world markets is allowing exports to grow more in line with imports; and GDP in line with domestic demand. Export growth is expected to slow a little next year as world markets grow less rapidly and import growth falls because less oil is required for electricity production.

Table 1.4 Domestic demand and GDP

Percentage changes on a year earlier

	1983	1984	1985
Domestic demand	$4\frac{1}{2}$	$2\frac{1}{2}$	$3\frac{1}{2}$
Exports of goods and services	1	$5\frac{1}{2}$	$4\frac{1}{2}$
Imports of goods and services	$5\frac{1}{2}$	$7\frac{1}{2}$	4
Domestic production: GDP	3	$2\frac{1}{2}$	$3\frac{1}{2}$

1.46 The share of manufacturing industry in total output has been falling since the early 1970s. For 1985 as a whole, with substantial growth continuing in the demand for manufactures, output in the manufacturing sector should rise further, but perhaps a little more slowly than output in total. Increases averaging nearly 10 per cent in the output of the North Sea oil sector in 1983 and 1984 accounted for about $\frac{1}{2}$ per cent of GDP growth in each year; no further sizeable increases in oil output are expected.

Table 1.5 GDP and manufacturing output

Percentage changes on a year earlier

	1983	1984	1985
Gross domestic product, average measure	3	$2\frac{1}{2}(3\frac{1}{2})$	$3\frac{1}{2}(2\frac{1}{2})$
Manufacturing	$2\frac{1}{2}$	2	$2\frac{1}{2}$

The figures in brackets exclude the effects of the coal strike.

Productivity and the labour market

1.47 As the economic recovery became firmly established during 1983, total employment began to rise. By June 1984 the employed labour force is estimated to have been almost 300,000 higher than at the trough in March 1983. Most of the increase was in the services sector: many of the new jobs were part-time and filled by women. In the manufacturing sector, which accounted for much of the labour shedding of the previous three years, employment continued to fall, though at a much reduced rate. The rise in productivity in manufacturing—up over 20 per cent since the end of 1980—has gone beyond that usually expected in cyclical recovery.

1.48 Underlying trends in productivity are hard to identify because of the strong cyclical influences. In part the strong recovery in output per head in recent years reflects normal adjustment following the large fall between 1979 and 1981. During 1983 manufacturers may have been a little more cautious than usual, preferring initially to meet the increased demand for output with substantial increases in overtime working rather than by taking on new workers. Table 1.6 shows average annual growth rates of output per head, for manufacturing and non-manufacturing, over longer periods of time.

Table 1.6 Output per head

Annual averages, percentage changes

	1964–73	1973–79	1979–83
Manufacturing	$3\frac{3}{4}$	$\frac{3}{4}$	$2\frac{3}{4}$
Non-manufacturing*	$3\frac{1}{2}$	$\frac{1}{4}$	1

* Excluding public services and oil.

1.49 Even over complete cycles the path of actual output per head can be significantly influenced by the relative strength of booms and recessions. Thus the apparent slowdown in productivity between 1973 and 1979 may in part reflect the (unsustainable) strength of the 1973 peak in activity, to which firms did not fully adjust their labour force, and the relative weakness of the 1979 peak. Nevertheless, it seems clear there has been a pick up in underlying productivity growth since the late 1970s. This may have been a response to the more rapid growth of labour costs both in real terms and in relation to other business costs. Changes in working practices and attitudes to innovation may be having a permanent effect on the rate of growth of productivity, though the evidence is not conclusive. The forecast assumes that underlying productivity growth in manufacturing and non-manufacturing will continue at a faster rate than in the 1973–79 period but rather slower than recorded in the last four years. Taken together with the forecast of output this is consistent with continued growth in total employment.

Unemployment

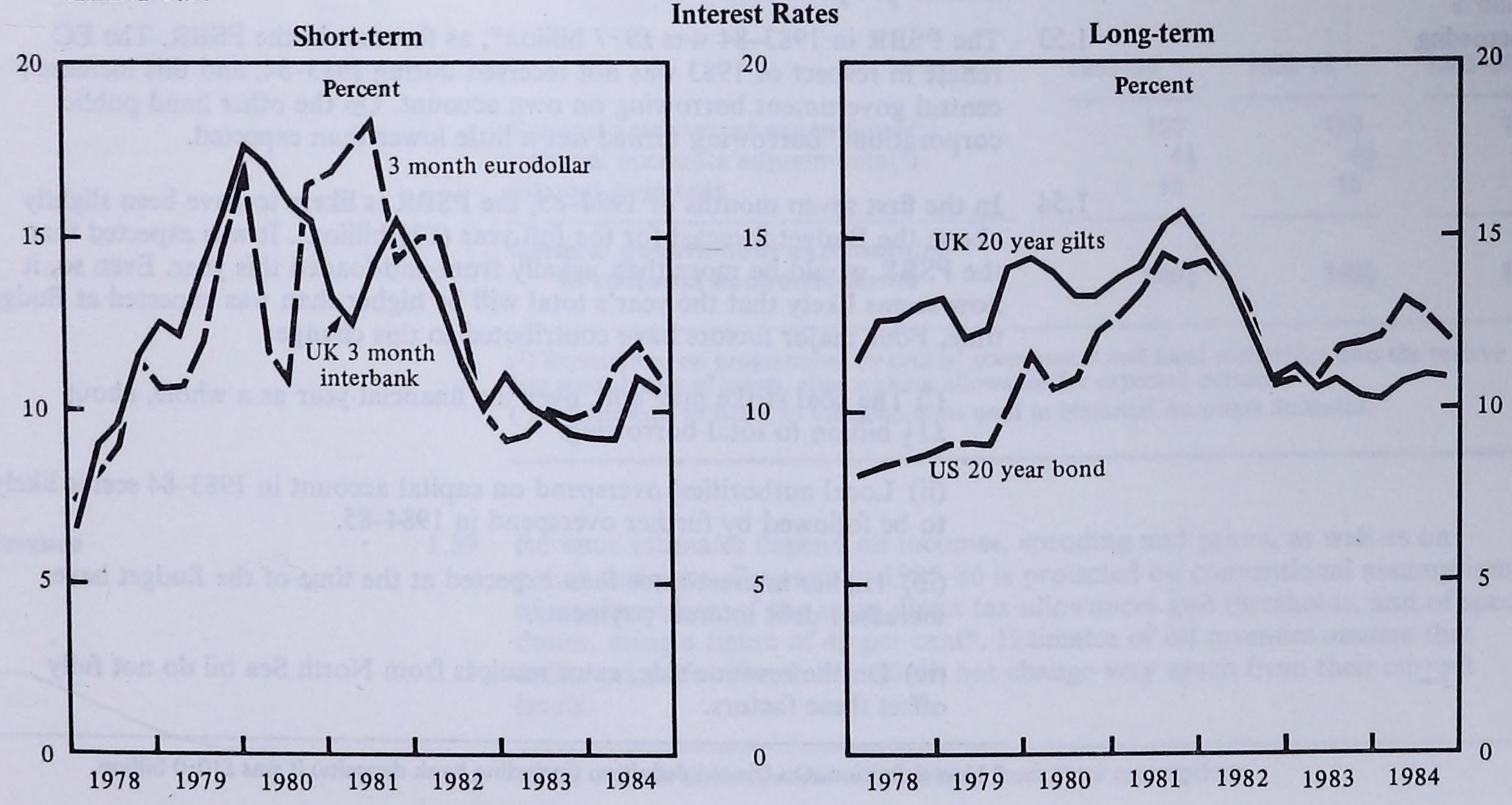
1.50 Despite the recovery in employment, unemployment (seasonally adjusted) levelled out only briefly during the second half of 1983 and since the beginning of this year it has increased on average by 15,000 per month. The figures imply a very substantial increase in the working population over the past year, considerably larger than the growth in the labour force that had been expected on the basis of demographic changes. It seems that, while continued falls in manufacturing employment resulted in more full-time workers joining the unemployment count, the growth in part-time jobs in service industries attracted women who were not previously claiming benefit. Although the figures are very uncertain, further growth in the labour force is forecast and the trend towards more part-time working, which was evident in the 1970s, may continue.

Interest rates and monetary growth

Interest rates

1.51 In the US the continuing rise in economic activity together with a continuing high Federal deficit and restrictions on monetary growth led to further upward pressure on interest rates in the first half of the year. Rates have subsequently fallen back, though generally not to the levels prevailing at the beginning of the year. By contrast interest rates in most other major OECD economies have changed very little. In the UK there was some further easing in short-term interest rates in the early months of the year, but strong upward pressure emerged in the money markets in July, associated with a weakening of the sterling/dollar exchange rate and market worries about industrial disputes and the pace of monetary growth. With the subsequent easing of the latter worries, rates have fallen back, reversing most of the July increase.

CHART 1.10

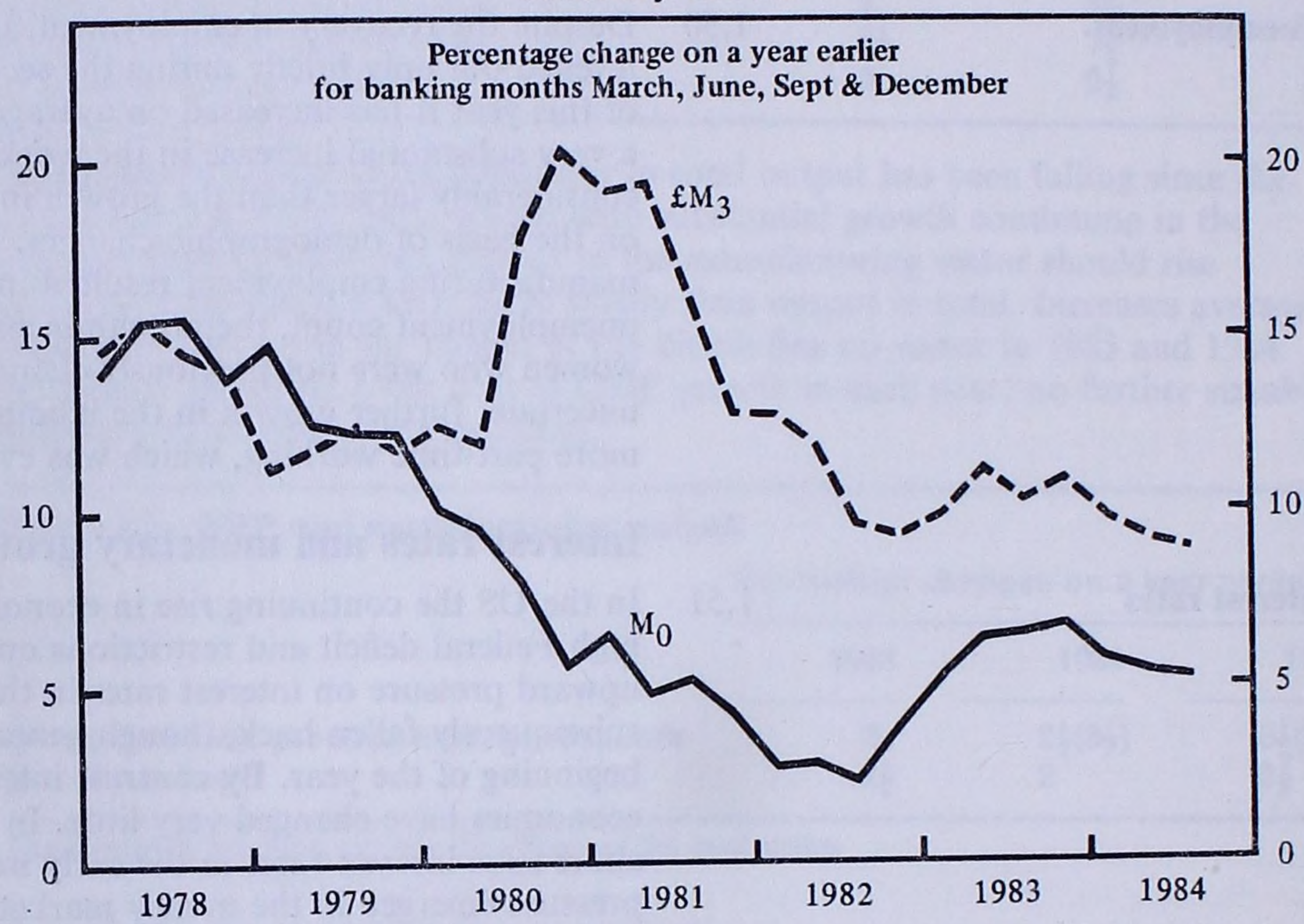


Monetary growth

1.52 Growth in both M0 and £M3 was within the target ranges over the first eight months of the current target period (to mid-October). M0 growth has been in the lower half of the 4–8 per cent range, while £M3 growth has fluctuated more widely, remaining generally in the upper half of the 6–10 per cent range. PSL2 has been growing faster than £M3, mainly as a result of the relatively rapid growth of building society deposits. Limited experience with M2 still makes it difficult to interpret, as does the reclassification of certain building society accounts from outside to within M2. The forecast assumes that the 1985–86 target ranges for M0 and £M3 will be the same as the illustrative ranges in this year's Medium Term Financial Strategy, 3–7 per cent for M0 and 5–9 per cent for £M3.

CHART 1.11

Monetary Growth



Fiscal projections

Borrowing

1.53 The PSBR in 1983–84 was £9·7 billion*, as forecast in the FSBR. The EC rebate in respect of 1983 was not received during 1983–84, and this increased central government borrowing on own account. On the other hand public corporations' borrowing turned out a little lower than expected.

1.54 In the first seven months of 1984–85, the PSBR is likely to have been slightly above the Budget forecast for the full year (£7¼ billion). It was expected that the PSBR would be more than usually front-end-loaded this year. Even so, it now seems likely that the year's total will be higher than was expected at Budget time. Four major factors have contributed to this change:

(i) The coal strike may add, over the financial year as a whole, about £1½ billion to total borrowing.

(ii) Local authorities' overspend on capital account in 1983–84 seems likely to be followed by further overspend in 1984–85.

(iii) Higher interest rates than expected at the time of the Budget have increased debt interest payments.

(iv) On the revenue side, extra receipts from North Sea oil do not fully offset these factors.

* New definition. On the old definition (including bank deposits) it was £10·0 billion.

1.55 As a result, the PSBR for 1984–85 as a whole is now projected at £8½ billion, some £1¼ billion higher than the Budget forecast. There is, as always, a substantial margin of error surrounding this forecast (average errors in PSBR forecasts at this time of year exceed £2 billion).

1.56 The projections in tables 1.7–1.9 take account of the Government's spending plans shown in Part 2. The usual assumption is made that tax thresholds, allowances and specific duties are indexed in 1985–86. The forecast also makes the same assumption as in the MTFS about the PSBR in 1985–86: 2 per cent of GDP, equivalent to £7 billion. On the basis of the current projections of expenditure and revenue, this would leave room for a fiscal adjustment, perhaps of the order of £1½ billion. (The forecast assumes, conventionally, that the fiscal adjustment takes the form of a reduction in income tax, which is then incorporated in the projections of personal income and spending, etc.) Although the fiscal adjustment for 1985–86 is not very much changed since the Budget projection, both expenditure and revenues seem likely to be higher. In the case of revenue, this mainly reflects higher North Sea oil revenues, as a result of higher sterling prices and production. It will be necessary to review nearer the time and in the light of updated forecasts the appropriate level for the PSBR in 1985–86.

1.57 Any estimate of the extent of the fiscal adjustment for 1985–86 is extremely uncertain: it depends on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions. For the public sector as a whole, the flows on either side of the account approach £200 billion.

Expenditure

1.58 General government expenditure in national accounts terms, shown in table 1.7, is forecast to rise, in cash, by around 6½ per cent in 1984–85 and 3½ per cent in 1985–86. These figures are affected by the coal strike: the underlying rates of increase are around 5 per cent for both years. Details of expenditure programmes in 1985–86 are provided in Part 2. The additional claims on expenditure in 1984–85 mean that the prospective outturn for the planning total, at nearly £128 billion, may exceed plans (shown in table 2.1) by about £1½ billion.

Table 1.7 General Government Expenditure

£ billion

	1983–84	1984–85	1985–86
General government expenditure(1)	120	128	132
National accounts adjustments(2)	4½	4½	5½
Interest payments	15	16	16½
General government expenditure in national accounts terms	**139½**	**148½**	**154**

(1) Expenditure on programmes by central government and local authorities plus the reserve less special sales of assets, after making allowance for expected outturn.
(2) Adjustments to line 1 to the definitions used in National Accounts Statistics.

Revenue

1.59 Revenue estimates depend on incomes, spending and prices, as well as on policy decisions. Revenue in 1985–86 is proiected on conventional assumptions of revalorisation of the main direct tax allowances and thresholds, and of specific duties, using a figure of 4¾ per cent*. Estimates of oil revenues assume that dollar prices for North Sea oil do not change very much from their current levels.

* Part 4 shows direct revenue effects arising from these assumptions.

1.60 The revenue projections are shown in table 1.8. Real GDP (average measure) is forecast to grow by $2\frac{1}{4}$ per cent in 1984–85 and by $3\frac{1}{4}$ per cent in 1985–86; these estimates are affected by the coal strike, and the underlying increases are 3 per cent and $2\frac{1}{4}$ per cent. The general rate of inflation, as measured by the GDP deflator, is put at $4\frac{3}{4}$ per cent in 1984–85 and $4\frac{1}{2}$ per cent in 1985–86. The increase in tax revenues—before fiscal adjustment—in 1985–86 is close to the forecast rise in money GDP of 8 per cent.

Table 1.8 General Government Receipts(1)

£ billion

	1983–84	1984–85	1985–86
Taxes on income, expenditure and capital	$97\frac{1}{2}$	$105\frac{1}{2}$	$113\frac{1}{2}$
National insurance and other contributions	$21\frac{1}{2}$	23	25
Interest and other receipts	$11\frac{1}{2}$	$10\frac{1}{2}$	$10\frac{1}{2}$
Accruals adjustments	$-\frac{1}{2}$	1	$-\frac{1}{2}$
Total Receipts	$129\frac{1}{2}$	140	$148\frac{1}{2}$
of which North Sea tax revenues(2)	9	12	12

(1) Constituent items may not sum to totals because of rounding to the nearest £½ billion.
(2) Before Advance Corporation Tax set off.

1.61 Table 1.9 provides projections of Government receipts, expenditure and borrowing.

Table 1.9 Public Sector Borrowing(1)

£ billion

	1983–84	1984–85	1985–86
General government expenditure(2)	$139\frac{1}{2}$	$148\frac{1}{2}$	154
General government receipts	$129\frac{1}{2}$	140	$148\frac{1}{2}$
Implied fiscal adjustment(3)	—	—	$1\frac{1}{2}$
General Government Borrowing Requirement	10	9	7
Public Sector Borrowing Requirement	$9\frac{3}{4}$	$8\frac{1}{2}$	7
as percentage of GDP	$3\frac{1}{4}$	$2\frac{1}{2}$	2
Money GDP at market prices	306	327	353

(1) Constituent items may not sum to totals because of rounding to the nearest £½ billion.
(2) In national accounts terms—see bottom line of table 1.7.
(3) On the same assumption as in the 1984 MTFS about the PSBR as a proportion of GDP in 1985–86.

The Prospects: summary

1.62 Table 1.10 presents a summary of the economic prospects.

Table 1.10 Economic Prospects(1)

	Percentage changes 1983 to 1984	1984 to 1985	Average errors(2) from past forecasts
A Output and expenditure at constant 1980 prices			
Gross domestic product (at factor cost)	2½	3½	1
Consumers' expenditure	2	3	1½
General government current expenditure	1½	1	1½
Fixed investment	7½	3	2½
Exports of goods and services	5½	4½	3
Change in rate of stock-building as a percentage of the level of GDP	−½	1	1
Imports of goods and services	7½	4	3
	1984	1985	
B Balance of payments on current account (£ billion)	0	2½	3½
C Retail prices index (4th quarter)	4¾	4½	3(3)

(1) The forecast includes the effect of the fiscal adjustment in 1985–86.

(2) The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on Government forecasts, notably in the Economic Progress Report, June 1981. The errors are after adjustment for the effects of major changes in fiscal policy, where excluded from the forecast.

(3) The average error for inflation was calculated from a period of much higher inflation and probably overstates the margin of error at low rates of inflation.

Table 1.11 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
1979	137·3	48·1	43·9	63·4	2·5	295·1	59·9	32·2	0·7	203·8	102·4
1980	136·8	48·8	41·6	63·3	−2·9	287·6	57·4	30·9	−0·3	199·0	100·0
1981	136·7	48·8	38·1	62·1	−2·7	283·0	55·4	30·0	−0·9	196·6	98·8
1982	138·1	49·2	40·6	62·7	−1·2	289·5	57·6	31·6	0·4	200·7	100·9
1983	144·0	50·5	42·3	63·3	0·2	300·4	60·8	32·5	0·1	207·2	104·1
1984	147·0	51·4	45·6	67·0	−1·0	310·0	65·5	32·7	0·4	212·2	106·6
1985	151·8	51·9	47·0	69·9	1·0	321·5	68·1	33·9	0	219·5	110·3
1983 H1	71·1	25·2	20·9	31·5	−0·1	148·6	29·8	16·2	0	102·6	103·1
H2	72·9	25·3	21·4	31·8	0·3	151·8	31·0	16·2	0·1	104·7	105·2
1984 H1	72·9	25·5	23·0	33·3	−0·8	153·8	32·2	16·1	0·4	105·9	106·4
H2	74·1	25·9	22·7	33·7	−0·2	156·1	33·3	16·5	0	106·4	106·9
1985 H1	75·1	25·9	23·4	34·7	0·5	159·5	33·6	16·8	0	109·1	109·6
H2	76·7	26·0	23·6	35·3	0·5	162·0	34·5	17·1	0	110·4	110·9
% changes:											
1982 to 1983	4½	2½	4	1		4	5½	3		3	3
1983 to 1984	2	1½	7½	5½		3	7½	½		2½	2½
1984 to 1985	3	1	3	4½		3½	4	3½		3½	3½

* 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 H1 are forecasts.

2. Outline Public Expenditure Plans for 1985-86

2.01 The Government has reviewed the public expenditure plans for 1985–86 published in the 1984 Public Expenditure White Paper (Cmnd 9143). Table 2.1 shows the public expenditure plans as now decided and for purposes of comparison the 1984–85 and 1985–86 plans. All figures are in cash.

The planning total

2.02 The outcome of the review is to set the public expenditure planning total for 1985–86 at £132·0 billion, slightly below the figure in the 1984 White Paper. After allowing for inflation, public expenditure will be broadly the same in real terms as planned for this year, 1984–85. Table 2.2 shows the planning totals 1979–80 to 1985–86 in cash and cost terms; and public expenditure expressed as a ratio to GDP. The plans imply the ratio falling from 43½ per cent in 1981–82 to 41 per cent in 1985–86.

Changes in plans

2.03 Within the total for 1985–86 there are increases in social security, health, export credit and the UK's contributions to the European Communities. These are offset by reductions in other programmes including housing, employment services and the urban programme, together with an increase in estimated receipts from special sales of assets. Full details of the plans will be given in the forthcoming Public Expenditure White Paper.

Programmes

Defence 2.04 The provision for 1985–86 is unchanged from Cmnd 9143 and allows for annual growth of some 3 per cent in real terms, with an addition for Falklands costs.

FCO (including Overseas Development Administration) 2.05 The provision remains as planned.

European Community 2.06 The estimated net contribution in 1985–86 takes account of the Fontainebleau agreement on budget abatements and new own resources. The figures in Cmnd 9143 were based on a stylised assumption about budget refunds, and no increase in the 1 per cent VAT ceiling. As a rough order of magnitude, in future years the UK's adjusted net contribution might be around half what it would have been if there had been no agreement, no abatements and the 1 per cent VAT ceiling had been maintained.

Intervention Board for Agricultural Produce 2.07 Extra provision has been made to take account of the grain stocks expected to be bought into intervention following the large 1984 cereals harvest.

Agriculture	2.08	The net decrease reflects savings on market support measures and capital grants. Provision is included for the milk outgoers scheme and the enhanced rates of suckler cow subsidy announced earlier this year.
Forestry Commission	2.09	The reduction will be achieved mainly by improvements in efficiency and trading performance.
Trade and Industry	2.10	Additional provision is made for launch aid and for shipbuilding.
Energy	2.11	Higher expenditure on the Redundant Mineworkers Payment Scheme is partly offset by reductions in other areas including nuclear research and development.
Export Credits Guarantee Department	2.12	The increase in the cost of this programme mainly reflects higher estimates of interest support costs for fixed rate export credit.
Employment	2.13	Additional provision of £260 million is made to finance the expansion of some employment and training measures, including the Enterprise Allowance Scheme; a higher level of redundancy payments; and the transfer, from local authorities to the MSC, of part of the provision for work-related non-advanced further education. The cost is more than offset by savings of £330 million from revised estimates of demand for special measures, including the Youth Training Scheme, and a reduction in the rebate to employers from the Redundancy Fund.
Transport	2.14	The £370 million lower total reflects transfers out of the programme. Trust ports will be transferred to the private sector; and, on the establishment of London Regional Transport, planned expenditure on transport in London has been transferred to the Nationalised Industries sector. After taking account of these changes there is virtually no net change in provision.
Environment—Housing	2.15	Net housing provision is £310 million lower than provided for in Cmnd 9143, mainly as a result of a higher estimate of capital receipts, partly offset by increased subsidies to local authority housing. The reduction in gross capital provision is £65 million.
Environment—PSA	2.16	Additional provision has been made for new works and maintenance of the civil estate.
Environment—Other Environmental Services	2.17	There is a reduction in the Urban Programme and some other minor adjustments.
Home Office	2.18	The net increase is mainly for local authority expenditure on police, fire, probation and magistrates courts. Various changes within provision for central government expenditure include an increase for control of immigration.
Lord Chancellor's Department	2.19	The provision has been adjusted to reflect underspending on the court building programme.
Education and Science	2.20	The main changes are increased provision for local authority current expenditure (four-fifths of the total), for science and, on a selective basis, for equipment in universities, with some reduction in student awards and local authority capital expenditure.
Office of Arts and Libraries	2.21	Additional provision has been made for public expenditure on the arts, museums and libraries.
Health and Personal Social Services	2.22	Provision for the Hospital and Community Health Service in 1985–86 represents a 5·5 per cent cash increase over 1984–85 plans: 1 per cent more than forecast inflation. Cost-improvement programmes building on those achieved this year should release substantial additional resources to enable health authorities further to develop services and improve patient care. Some charges will be increased. Planned provision for the Family Practitioner Services allows for estimated demand and takes account of measures to curb the sharply rising drugs bill. Provision for personal social services has also been increased.

Social Security

2.23 The provision reflects the latest estimate of benefit expenditure in 1985–86 including an allowance for an up-rating in November 1985 based on the assumed rise in prices in the twelve months to next May. The actual up-rating of individual benefits will be announced in June when the May RPI is known. The main policy changes affecting 1985–86 will be in the payments made to supplementary benefit claimants for board and lodging and for residential care, and in the rules affecting invalidity benefit, including restoration from November 1985 of the 5 per cent abatement of invalidity pension which has applied since 1980. The Secretary of State for Social Services will also be introducing legislation to extend the duration of statutory sick pay to 28 weeks with effect from April 1986.

Scotland, Wales, Northern Ireland

2.24 The net changes in these programmes mainly reflect changes in comparable programmes in England. The Secretaries of State have discretion to make allocations of this expenditure which take account of local factors.

Other Departments

2.25 The provision covers the costs of small departments including the initial cost of setting up the Independent Prosecution Service. It also takes account of savings that will result from the decision to cease to issue the £1 note.

Nationalised Industries

Nationalised Industries

2.26 External Financing Limits (EFLs) for nationalised industries in 1985–86 are set out in table 2.3. Overall there is an increase of £180 million in expected external financing requirements. This reflects a number of changes including the reclassification of London Regional Transport as a nationalised industry; decreased requirements for Electricity (England and Wales), British Shipbuilders, British Railways Board, and Water (England and Wales); and increases for the British Steel Corporation and British Gas Corporation.

Local Authorities

Current Expenditure

2.27 Local authority expenditure, except for the unallocated margin, is subsumed in the departmental totals shown in table 2.1. In 1984–85 local authorities are budgeting to exceed Cmnd 9143 provision for current expenditure relevant for Rate Support Grant by around £1·2 billion. For 1985–86 the Government has increased provision (adjusted for changes in the responsibilities of local authorities) by around £950 million to £25·5 billion. This implies in aggregate a reduction of about 3 per cent in real terms below 1984–85 budgets.

2.28 Local authorities have again been given provisional expenditure targets in England and Wales and guidelines in Scotland. Grant before holdback for 1985–86 will be about the same in cash (after adjustments) as the corresponding cash figure for 1984–85. Penalties for exceeding target or guidelines will be more severe than in 1984–85.

Capital Expenditure

2.29 The outlook for local authority capital spending in 1984–85 is uncertain. Early returns suggested a large overspend on cash limits in England and Wales, and local authorities were asked to restrain spending, and to generate extra receipts. Net provision for Great Britain in 1985–86 is about £3·1 billion. This is a reduction from Cmnd 9143 of about £600 million, to take account of the 1983–84 overspend and of increased receipts.

Special Sales of Assets

Special Sales of Assets

2.30 Net proceeds from special sales of assets are estimated to increase by £500 million to £2½ billion, reflecting revised forecasts of receipts. There are considerable uncertainties attached to this figure which is dependent on market conditions at the time of sales.

Reserve

Reserve

2.31 The plans include a Reserve of £3 billion for 1985–86, £¼ billion higher than that included in Cmnd 9143 for 1984–85. The Reserve will be available to meet all contingencies and unavoidable increases, including estimating changes. At this stage, the estimates of expenditure in 1985–86 on some demand-led services are inevitably still uncertain.

Table 2.1 Public Expenditure Plans(1)(2)(3)

£ million

	1984–85	1985–86			
	White Paper (Cmnd 9143) with Budget changes	White Paper (Cmnd 9143)	White Paper (Cmnd 9143) with Budget changes	Revised plans	*Changes between Cmnd 9143 and revised plans*
Departments (excluding nationalised industries' external finance)(4)					
Ministry of Defence	17 000	18 060	18 010	18 060	*0*
Foreign and Commonwealth Office (including ODA)	1 800	1 870	1 870	1 870	*0*
European Community	380	550	550	750	*+200*
Intervention Board for Agricultural Produce	1 250	1 130	1 120	1 310	*+180*
Agriculture	1 000	1 020	1 020	930	*−90*
Forestry Commission	60	60	60	50	*−10*
Department of Trade and Industry	1 350	1 290	1 290	1 360	*+70*
Department of Energy	560	570	590	680	*+110*
Export Credits Guarantee Department	160	30	30	190	*+160*
Department of Employment	3 130	3 250	3 240	3 180	*−70*
Department of Transport	3 540	3 660	3 650	3 290	*−370*
DOE—Housing	2 500	2 610	2 600	2 300	*−310*
DOE—Property Services Agency	−90	−100	−100	−90	*+10*
DOE—Other Environmental Services	3 170	3 270	3 260	3 250	*−20*
Home Office	4 360	4 540	4 510	4 590	*+50*
Lord Chancellor's Department	500	550	550	540	*−10*
Department of Education & Science	13 050	13 450	13 380	13 590	*+140*
Office of Arts and Libraries	600	620	620	640	*+20*
DHSS—Health & Personal Social Services	15 420	16 270	16 200	16 480	*+210*
DHSS—Social Security	37 200	39 520	39 510	39 990	*+470*
Civil Superannuation	1 050	1 130	1 130	1 070	*−60*
Scotland	6 550	6 720	6 700	6 810	*+90*
Wales	2 560	2 650	2 640	2 660	*+10*
Northern Ireland	4 030	4 220	4 210	4 240	*+20*
Other Departments	2 070	2 160	2 150	2 130	*−30*
Nationalised Industries	1 830	1 140	1 060	1 320	*+180*
Local authority current expenditure not allocated to departments	660	400	400	600	*+200*
Special sales of assets	−1 900	−2 000	−2 000	−2 500	*−500*
Reserve	2 750	3 750	3 750	3 000	*−750*
PLANNING TOTAL(5)	**126 300**	**132 100**	**131 700**	**132 000**	*−100*

Notes

(1) Some figures may be subject to detailed technical amendment before publication of the 1985 Public Expenditure White Paper.

(2) Departments' figures shown are rounded to the nearest £10 million; the planning total is rounded to £100 million.

(3) All columns include minor classification changes since Cmnd 9143. The revised plans column also includes a transfer of provision for London Regional Transport of some £330 million from Department of Transport to Nationalised Industries; and a transfer for work-related non-advanced further education of some £60 million from Department of Education and Science to Department of Employment (see paragraphs 2.13, 2.14 and 2.26).

(4) Provision in these programmes reflects an assumption that central government rates of pay and allowances will increase on average by 3 per cent from due settlement dates.

(5) Excludes double counting of £290 million of agricultural spending in Scotland and Wales which is also included in the Agriculture total.

Public spending 1979–80 to 1985–86

Table 2.2 Public Expenditure Planning Totals 1979–80 to 1985–86

Planning total £ billion

	Cash([1])	Cost terms([1],[2]) base year 1983–84	Public([3]) expenditure as % of GDP
1979–80([4])	76·9	111·7	39½
1980–81([4])	92·7	113·5	42
1981–82([4])	104·7	116·5	43½
1982–83([4])	113·4	118·4	43
1983–84([4])	120·3	120·3	42½
1984–85([5])	126·3	120·6	42
1985–86([6])	132·0	120·6	41

([1]) Figures are rounded to the nearest £0·1 billion.

([2]) Cash figures adjusted for general inflation as measured by the GDP deflator at market prices. The GDP deflator is forecast to increase by some 4¾ per cent in 1984–85 and 4½ per cent in 1985–86 as shown in para 1.60.

([3]) Planning total plus net debt interest, refunded payments of VAT by local authorities and central government and an allowance for non-trading government capital consumption, expressed as a percentage of GDP at market prices.

([4]) Outturn/estimated outturn.

([5]) Plans in Financial Statement and Budget Report 1984–85, table 5.5, adjusted for subsequent classification changes. For estimated outturn, see paragraph 1.58.

([6]) Plans as in Table 2.1.

External Financing Limits

Table 2.3 External Financing Limits for the Nationalised Industries (1985–86)

	£ million([1])
National Coal Board([2])	723
Electricity (England and Wales)	−1 128
North of Scotland Hydro-Electric Board	9
South of Scotland Electricity Board	191
British Gas Corporation	−352
British Steel Corporation	360
Post Office	−70
National Girobank	−3
British Airports Authority	−21
British Railways Board	918
British Waterways Board	45
National Bus Company	48
Scottish Transport Group	13
British National Oil Corporation([3])	−3
British Shipbuilders([4])	36
Civil Aviation Authority	27
Water (England and Wales)	203
London Regional Transport	323
Total	**1 319**

([1]) Figures are shown rounded to the nearest £1 million.

([2]) Provisional. To be reviewed at the end of the current industrial dispute.

([3]) The figure for BNOC is not a limit. BNOC's trading results are likely to fluctuate from year to year given the uncertainties of oil trading.

([4]) This single figure for British Shipbuilders includes an allowance for some receipts from the privatisation of warshipbuilding yards.

3. National Insurance Contributions

3.01 The Secretary of State for Social Services has conducted his annual review of national insurance contributions, as required by the provisions of the Social Security Act 1975. Full details are set out in the statement made by the Secretary of State in connection with the necessary orders, laid on 12 November 1984 with an accompanying report by the Government Actuary. The main proposals are:

—that the full Class 1 national insurance rates should remain unchanged for 1985–86 at their present level of 9 per cent for employees and 10·45 per cent for employers;

—that the lower earnings limit should be uprated, from April 1985, from the present level of £34 a week to £35·50 a week in line with the single rate retirement pension;

—that the upper earnings limit should be increased from £250 a week to £265 a week;

—that the Treasury Supplement should be reduced in 1985–86 from its present level of 11 per cent of gross contributions to 9 per cent.

—that employers should be relieved of the cost of the national insurance contributions they make on payments under the statutory sick pay scheme.

3.02 In accordance with normal practice, the Government Actuary has been provided with working assumptions for use in preparing his report. These assumptions, which are not forecasts or predictions, are summarised in his report and include the following:

—that the number of unemployed (GB, excluding school leavers etc.) averages 3 million in 1984–85 and in 1985–86;

—that the underlying rate of increase in earnings will decline from about $7\frac{1}{2}$ per cent between 1983–84 and 1984–85 to about 7 per cent between 1984–85 and 1985–86;

—that as a result of lost earnings in the coal industry, actual earnings in 1984–85 are 7 per cent higher than in 1983–84, and consequently average earnings in 1985–86 are assumed to be $7\frac{1}{2}$ per cent higher than in 1984–85;

—that the movement in prices between May 1984 and May 1985, which is the relevant period for the November 1985 benefit uprating, will be $4\frac{3}{4}$ per cent.

3.03 The estimated effects of the proposed changes are shown in the table opposite. The table includes the effects of the abolition of the national insurance surcharge announced in the 1984 Budget.

Table 3.1 Estimated Total Payments by Employers and Employees of National Insurance Contributions and National Insurance Surcharge in 1984–85 and 1985–86(1)

Great Britain (£ million)

	Employers	Employees	Total
1984–85			
National Insurance Surcharge	880	—	880
National Insurance Contributions	10 730	10 120	20 850
Total	**11 610**	**10 120**	**21 730**
1985–86			
National Insurance Surcharge	30	—	30
National Insurance Contributions	11 650	11 040	22 690
Total	**11 680**	**11 040**	**22 720**
Analysis of change			
Change from abolition of NIS(2)	−850	—	−850
Change in NI contributions from increased earnings etc(3)	+860	+820	+1 680
Change in NI contributions from increase in earnings limits	+100	+100	+200
Change from rebate of employers NI contributions on statutory sick pay	−40	—	−40
Total change	**+ 70**	**+920**	**+990**

(1) Figures are rounded to the nearest £10 million. Detailed figures for National Insurance Contributions are included in the Government Actuary's report on the draft of the Social Security (Contributions, Re-rating) Order 1984. As in previous years, figures in this table are on a receipts basis excluding self-employed and voluntary contributions. Figures include NHS and Employment Protection Allocation contributions. Employers' contributions are net of deductions in respect of statutory sick pay.

(2) NIS was abolished as from 1 October 1984 for all employers except local authorities and related bodies, who will continue to pay NIS until the end of this tax year. Receipts of NIS in 1985–86 will be entirely in respect of liabilities which accrued before the end of this tax year.

(3) Including population and employment changes.

4. The Revenue Effects of Illustrative Tax Changes

4.01 The tables below show various illustrative changes to the major taxes and estimates of their direct revenue effects at forecast 1985–86 price and income levels. Figures are given for full year effects and also for the effect in the first year (1985–86)—that is, the part of the full year effect which would be expected to come through in tax receipts in that financial year. Neither of these is the same as the effect on the public sector borrowing requirement (PSBR) because of the second round effects of tax changes on the economy.

4.02 Estimates of the size of the direct effects of tax changes depend on economic variables, such as prices, earnings, consumer expenditure, etc, and thus may alter as the prospects change. The illustrative tables which follow are based on a view of the economy that is consistent with Part 1.

4.03 There are, in principle, a number of ways of measuring the direct effects on revenue of a tax change, depending on the assumptions made about changes in the tax base and whether revenue from other taxes is included. The definitions used here are explained in note (*a*) to Table 4.2 of the 1984–85 Financial Statement and Budget Report; and a fuller description for indirect taxes is given in an article in Economic Trends, March 1980.

4.04 Where appropriate the figures set out below show the effect of indexation by an illustrative 4¾ per cent. This is in line with the annual rate of increase in the RPI forecast for the fourth quarter of this year (table 1.10).

Indexation of allowances, thresholds and bands for 1985-86

4.05 With indexation by 4¾ per cent, the 1985–86 levels of allowances, thresholds and bands would be as shown below. The rules for rounding up set out in the 1980 Finance Act (for income tax) and the 1982 Finance Act (for capital transfer tax and capital gains tax) have been followed. 1984–85 figures are shown for comparison.

Indexation: Income Tax

Table 4.1 Income Tax

	1984–85	1985–86
Allowances	£	£
Single and wife's earned income allowance	2005	2105
Married allowance	3155	3305
Additional personal and widow's bereavement allowance	1150	1200
Single age allowance	2490	2610
Married age allowance	3955	4145
Aged income limit	8100	8500

Income tax rates	Bands of taxable income	
Per cent	1984–85	1985–86
	£	£
30	0–15 400	0–16 200
40	15 401–18 200	16 201–19 200
45	18 201–23 100	19 201–24 400
50	23 101–30 600	24 401–32 300
55	30 601–38 100	32 301–40 200
60	over 38 100	over 40 200

Indexation: Capital Taxes

Table 4.2 Capital Transfer Tax

Rate on death	Lifetime rate	Bands of chargeable value	
		1984–85	1985–86
per cent	per cent	£'000	£'000
Nil	Nil	0– 64	0– 68
30	15	64– 85	68– 90
35	$17\frac{1}{2}$	85–116	90–122
40	20	116–148	122–156
45	$22\frac{1}{2}$	148–185	156–194
50	25	185–232	194–244
55	$27\frac{1}{2}$	232–285	244–299
60	30	over 285	over 299

Table 4.3 Capital Gains Tax

	1984–85	1985–86
	£	£
Annual exempt amount		
Individuals	5600	5900
Trusts	2800	2950

Indexation: Costs

4.06 Estimates of the costs of the changes shown above are as follows:

Table 4.4. Costs of Indexation

£ million at forecast 1985–86 prices, incomes and capital values

	First year cost		Full year cost	
Indexation of income tax allowances and thresholds of which:	860		1115	
Increases in main personal allowances		770		960
Increase in the basic rate limit(1)		50		80
Increases in further higher rate thresholds(1)		40		75
Indexation of capital transfer tax thresholds and bands	15		45	
Indexation of capital gains exempt amounts	Nil		10	

(1) Additional costs after previous changes have been introduced.

Direct revenue effects of other illustrative changes in income tax and corporation tax

4.07 Table 4.5 gives estimates of the direct costs and yields (at forecast levels of 1985–86 prices and incomes) of changes in the main personal allowances, thresholds and rates of *income tax*. It shows the costs and yields resulting from individual allowance changes of £100, and of changes in all allowances and higher rate thresholds by 1 per cent and 10 per cent of their 1984–85 values. The table also illustrates the effects of changing both the main personal allowances *and* higher rate thresholds by 1 per cent and 10 per cent of their 1984–85 values. All the cost and yield figures assume that the 1984–85 levels are first indexed and are therefore in addition to the costs arising from indexation as set out in table 4.4. For *corporation tax* the table shows the effects of a 1 percentage point change in the rate of tax and in the small companies' rate.

4.08 The estimated revenue effects of each allowance and threshold change are shown to the nearest £1 million or £5 million, to avoid undue magnification of rounding errors when using the ready reckoner to calculate larger changes. The figures should not, however, be assumed to be accurate to this degree.

4.09 Costs and yields are linear over a fairly broad range of changes. Reasonably accurate estimates can be obtained by pro-rating the ready reckoner figures for *increases* in personal allowances of less than about 20 per cent and for *reductions* of less than about 5 per cent from the indexed values. The additional cost of an increase in the higher rate threshold, however, tends to fall as the total increase rises, so estimates have been provided for two different changes, 1 per cent and 10 per cent on top of indexation. The effects of changes in higher rate thresholds are not symmetrical between increases and decreases. The table indicates that decreases would yield rather more than corresponding increases would cost.

4.10 The *income tax* changes have been costed on the assumption that each is introduced in isolation. In practice, there is little interaction between the personal allowances, so an estimate of the revenue effect of more than one allowance change can be obtained by combining the individual costs or yields for each item. The effect of a change in the basic or higher rates of tax, or in the higher rate thresholds, however, would be smaller than the amount shown in the table, if those changes were introduced at the same time as an increase in one or more allowances (and larger if combined with a decrease in allowances). Estimates derived from this ready reckoner for a combination of more than one tax change should, therefore, be taken only as a general guide to the revenue effect, particularly where a number of interacting changes are included.

Table 4.5 Direct effects of specimen changes in income tax and corporation tax

£ million at forecast 1985–86 income levels

	First year Cost/Yield	Full year Cost/Yield
Ready Reckoner: Income Tax		
Income Tax(1)		
Rates		
Change basic rate by 1p(2)	1050	1125
Change all higher rates by 1p	48	95
Personal Allowances		
Change single and wife's earned income allowance by £100	290	360
Change married allowance by £100	260	320
Change single age allowance by £100	24	32
Change married age allowance by £100	21	26
Change aged income limit by £200	3	5
Change all main personal allowances by 1 per cent	160	195
Change (raise−/lower+) all main personal allowances by 10 per cent	−1540/+1600	−1915/+1995
Higher Rate Thresholds		
Change (raise−/lower+) all higher rate thresholds by 1 per cent	−15/+15	−27/+28
Change (raise−/lower+) all higher rate thresholds by 10 per cent	−135/+170	−245/+310
Allowances and Thresholds		
Change all main personal allowances and higher rate thresholds by 1 per cent	170	225
Change (raise−/lower+) all main personal allowances and higher rate thresholds by 10 per cent	−1650/+1775	−2150/+2315
Ready Reckoner: Corporation Tax		
Corporation Tax(3)		
Change rate by 1 percentage point(4)	140	240
Change small companies' rate by 1 percentage point	14	25

(1) Changes are from the indexed levels of allowances and thresholds shown in table 4.1. Percentage changes are, however, of 1984–85 levels.

(2) Including the effect of the change on receipts of Advance Corporation Tax and on consequent liability to Mainstream Corporation Tax.

(3) Assessment to Corporation Tax normally relates to the preceding year. These are, therefore, the changes to revenue that would occur if the changed rates were applied to forecast 1984–85 income levels.

(4) Assuming small companies' rate unchanged.

Indirect Taxes

4.11 Figures for changes in the excise duties (table 4.6) are shown in two sections. The first shows the extra revenue from the individual duties if they were to be increased by exactly $4\frac{3}{4}$ per cent, together with the price increase that would result (after allowing for consequential VAT).

4.12 The second section shows for most duties the revenue yield from changing current levels of duty so that (after VAT) the price of a typical item is changed by exactly one penny. For VED, a £1 change for cars and light vans is shown. Table 4.7 shows the revenue effects of a 1 percentage point change in the rate of VAT.

4.13 The estimates are direct effects. They do, however, allow for alterations, due to relative price changes, in the composition of consumers' expenditure within a fixed total.

4.14 Within limits the illustrative changes for specific duties shown here can be scaled up or down to give a reasonable guide to the revenue effects. For example, a unit change could be combined with a revalorisation change to show the effects of a different percentage movement in duty. However, with large changes the margins of uncertainty surrounding the effects on sales and hence on revenue become progressively larger, and scaled estimates will be less reliable.

Table 4.6 Revenue effects of indirect tax changes (£ million 1985–86 prices and income levels)

	4¾% Revalorisation[1]			Unit changes from present levels of duty		
	Current level of duty on typical item[2]	Price change inc. VAT (pence)	Full year yield[3] £m	Price change inc. VAT	Actual percentage change in duty %	Full year[3] yield/cost £m
Beer (pint)	17·3p	0·9	85	1p	5·0	90
Wine (bottle of table wine 70 cl)	63·4p	3·5	25	1p	1·4	7½
Spirits (bottle)	£4·64	25·4	30	1p	0·2	1
Tobacco (20 kingsize cigarettes)[4]	76·2p	3·6	115	1p	1·3	35
Petrol (gallon)	78·0p	4·3	210	1p	1·1	50
Derv (gallon)	65·8p	3·6	55	1p	1·3	15
VED (cars and light vans)	£90·00	£4·27½	80	£1	1·1	19

(1) An 'across the board' revalorisation by 4¾ per cent (including the minor duties not shown above) would yield about £625 million in a full year, and the impact on the RPI would be to raise it by less than ½ per cent.

(2) VAT is payable in addition to the duty except in the case of VED.

(3) Assuming for illustrative purposes implementation on 1 April, the first and full-year yield of changes in excise duties would be identical for petrol, derv and VED; for beer and tobacco the first-year would be approximately eleven twelfths of the full-year; and for wine and spirits it would be approximately twenty-three twenty-fourths.

(4) The duty on cigarettes has *ad valorem* and specific elements; the percentage change relates only to the specific element, but the price change includes the consequent increase in *ad valorem* duty and VAT.

Table 4·7 VAT

	First year[1] yield/cost	Full year yield/cost
1% point change in rate of VAT	625	840

(1) Assuming implementation on 1 April.

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