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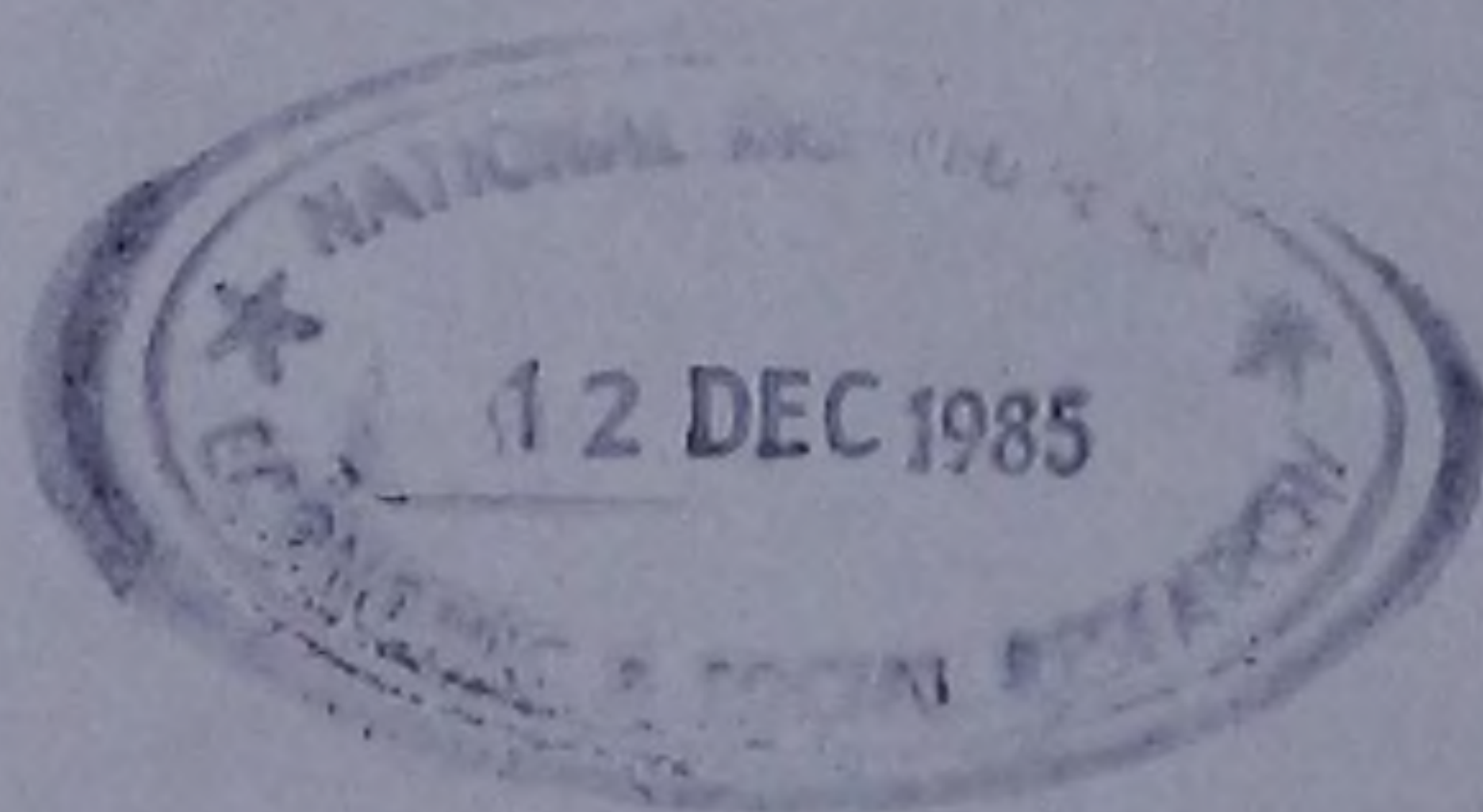
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# Autumn Statement 1985

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HM TREASURY  
NOVEMBER, 1985



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# Autumn Statement 1985

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RETURN to an Order of the House of Commons dated 12 November 1985: for

COPY of the AUTUMN STATEMENT 1985 as laid before the House by the  
CHANCELLOR OF THE EXCHEQUER on 12 November 1985

Treasury Chambers,  
12 November 1985 } NIGEL LAWSON

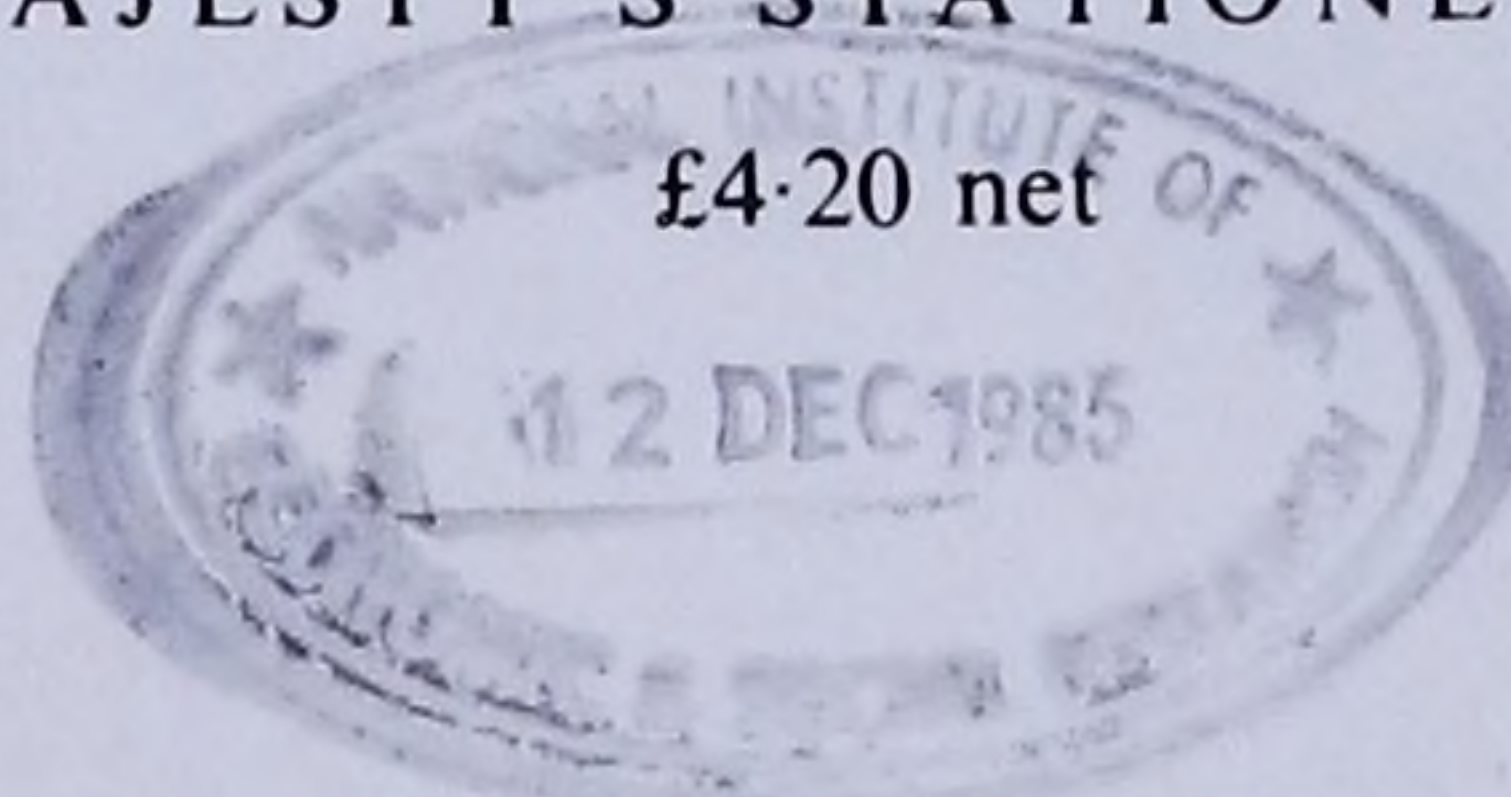
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*Ordered by The House of Commons to be printed  
12 November 1985*

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£4.20 net









# Economic Prospects for 1986

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# 1. Economic Prospects for 1986

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## Summary

- World economy** 1.01 The world economy in the last two years has made substantial, but uneven, gains in output and trade. The rate of inflation has fallen further, helped by steady macro-economic policies in most OECD countries, and weak commodity prices. The recovery in Europe is now strengthening and, despite continuing international debt problems and some major payments imbalances, growth in world output and trade should continue.
- Assumptions** 1.02 The forecast is based on the usual assumption that macro-economic policies in the UK will be as indicated in the Medium Term Financial Strategy (MTFS), set out in the 1985 Financial Statement and Budget Report (FSBR). The forecast is also based on the assumption that the effective exchange rate will not change much from its average level since March.
- Inflation, demand and output** 1.03 Inflation is set to decline further: an increase in the RPI of about 5½ per cent in the current quarter is forecast to fall to under 4 per cent in the course of 1986. Money GDP growth at 9 per cent in 1985–86 and 7 per cent in 1986–87, is expected to be close to that foreshadowed in the MTFS.
- 1.04 Business fixed investment and exports were the fastest growing elements of demand up to the first half of 1985. The fall in inflation in prospect, together with some slowdown in UK exports, is expected to lead to some shift away from exports towards domestic demand. Overall, and with a contribution of almost ½ per cent from the ending of the coal strike, output growth in 1986 is forecast to be close to the 3 per cent annual average experienced since 1981.
- Labour market** 1.05 Further rises in employment are expected as a result of continued growth in the economy and helped by the measures to increase the demand for labour in the 1984 and 1985 Budgets. With the prospect of some slowdown in labour supply growth, and with more people benefiting from employment measures, the trend in unemployment should continue to be more favourable than over the last two years. But no major change is in prospect for the growth of earnings in 1986, implying substantial further increases in real wages.
- Balance of payments** 1.06 A further sizeable surplus is expected to be earned on current account in 1986, helped by recent gains to the terms of trade.
- Borrowing** 1.07 For the current financial year, 1985–86, total government borrowing (the PSBR) is forecast, subject to a substantial margin of uncertainty, at £8 billion, £1 billion higher than forecast at Budget-time. Lower oil revenues are likely to be only partially offset by higher revenues elsewhere. For 1986–87, the forecast follows the MTFS in making the assumption that the PSBR will be set at 2 per cent of GDP, equivalent to £7½ billion.

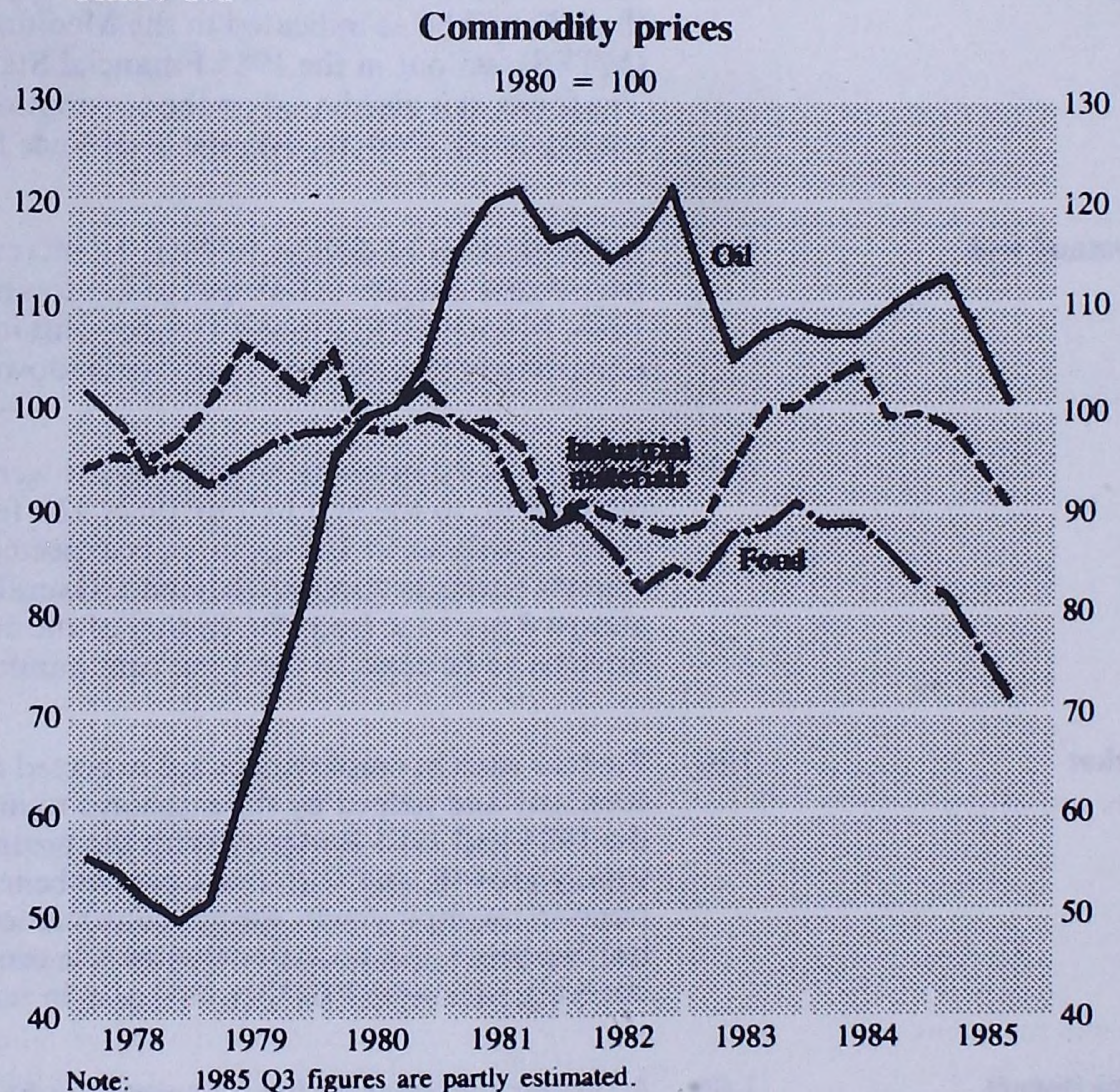


## The World Economy

### Recent developments

- 1.08 World trade and output are growing in a steady but unspectacular way. Real GNP in the major seven countries (including the UK) may be nearly 3 per cent higher in 1985 than in 1984, and world import volumes could increase by 5 per cent. Whereas the rapid expansion in world activity in 1984 was heavily dependent on the US, the growth differential between the US and Europe has been virtually eliminated over the past twelve months. The slowdown in US growth has contributed to lower world interest rates.
- 1.09 At the same time, the rate of inflation continues to fall: consumer prices in the major countries may rise by less than 4 per cent this year, compared with the 4½ per cent increase in 1984. This fall has been aided by weak commodity prices (see Chart 1.1), and bumper harvests which have pushed food prices to their lowest levels for almost a decade. World oil prices expressed in dollars have fallen only modestly in 1985 compared with 1984 and there has been some recovery in recent months. This firmness has occurred despite a marked imbalance between production capacity and demand, in part because of large cuts in production by some Gulf producers. However, the weakening of the dollar since early 1985 has brought about some adjustment of real oil prices.
- 1.10 The fall (of over 15 per cent) in the dollar's effective rate since its peak levels in February was helped by some central bank intervention. Even so, the dollar is still no lower than at the beginning of 1984. The US current account is in large deficit, reflecting the substantial difference in domestic demand growth between the US and other OECD countries since 1983, and the strong dollar.

Chart 1.1



### Prospects

- 1.11 The growth of private investment and consumers' expenditure in the US, although still faster than in other OECD countries, has slowed down compared with 1984. Domestic demand may weaken in 1986, but a recession seems unlikely: interest-sensitive sectors of the economy such as housing investment and consumer durables may still have some benefit to come from the fall in interest rates over the past year; inflation remains low; consumers' confidence is still relatively buoyant; and fiscal policy seems likely to be tightened only gradually. The decline in the dollar's exchange rate in the



course of 1985 should help net exports next year to offset the slowdown in domestic demand, but may have relatively little immediate impact on the current account deficit.

- 1.12 Output is picking up in both Germany and France. Continuing progress in reducing inflation in the major European countries, coupled with recent reductions in interest rates, should make for faster growth in domestic demand in 1986. Weakness in commodity prices, especially oil, and the appreciation of the yen this year will reduce Japanese inflation; in consequence, Japanese growth is likely to come more from domestic demand and less from exports than in recent years.
- 1.13 Little increase in the demand for oil is expected in 1986 and in view of the difficulties OPEC is experiencing in sharing present levels of output between its members, there could well be some excess of supply over demand, which could bring about a fall in oil prices, as indicated by the futures market.
- 1.14 In developing countries, weak terms of trade and continuing high debt servicing costs will constrain domestic demand and import growth. The lower dollar will ease debt burdens, but major adjustment problems will remain. Some OPEC countries are also likely to have to cut back their imports.
- 1.15 Overall, the major economies should grow by about 3 per cent in 1986.

**Table 1.1 World economy**

	Percentage changes on a year earlier		
	1984	1985	1986
Major countries*:			
GNP	5	3	3
Consumer prices	4½	4	3½
World import volume	8½	5	5
World trade in manufactures (UK-weighted)	8½	5	5

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

### The Exchange Rate and the Balance of Payments

- Sterling** 1.16 The average level of the sterling index since March has been close to the average of 1983 and 1984. For this forecast it is assumed not to change much from this level.
- Relative costs and prices** 1.17 Costs and prices have been rising rather faster in the UK than in most of the other major economies and may do so again in 1986. With the exchange rate little different from the 1983 and 1984 level, and labour costs per unit of output in the UK increasing relative to those overseas, manufacturers' price and cost competitiveness worsened to some extent in the course of 1985.
- Trade prices and the terms of trade (excluding fuel)** 1.18 Import prices of goods have on average fallen over 7½ per cent since their peak in March, largely because of the appreciation of sterling but also because of weak world commodity prices. Over the same period, prices of imported manufactures have fallen by 5½ per cent. This is less than the rise in the exchange rate, suggesting that as usual importers widened their profit margins as sterling rose. In the year to the final quarter of 1986, import prices are expected to rise slowly (perhaps by 3–4 per cent), reflecting a low rate of inflation in the major industrial countries.
- 1.19 Export prices have barely risen since the end of 1984, but there has probably been only a limited fall in exporters' margins because rises in labour costs have been partly offset by falls in the cost of imported materials. Over the next



year export prices are expected to rise at much the same rate as import prices. The terms of trade in goods (other than fuel) may therefore remain close to the current level, which is some 4 per cent better than the 1983 and 1984 average. The terms of trade in services may follow broadly the same pattern.

#### Trade volumes (goods other than oil and erratics)

- 1.20 Export volumes rose strongly in the second half of 1984 at a time when world trade was also rising strongly. Since then, during a period of slower growth in world trade, they have fallen back somewhat but in the three months to September were  $7\frac{1}{2}$  per cent higher than a year earlier. Next year, exports are expected to rise gently. World trade is expected to continue expanding. The worsening of price and cost competitiveness this year may restrain exports next year, but experience of the past five years suggests that export volumes have not been very responsive to price and cost changes. Exports of goods are forecast to rise by some 2–3 per cent in volume terms in 1986, after a rise of  $7\frac{1}{2}$  per cent in 1985.
- 1.21 Although domestic demand for manufactures has probably been growing more slowly this year, the level of imports has risen less than expected. The deficit on trade in manufactures in 1985 is now expected to be much the same as in 1984. There may be a fairly sharp rise in imports in 1986 due to further increases in domestic demand, and to rising import penetration in manufactures—the main factor in which is the continuation of a longstanding trend in most of the developed economies. Imports of goods are projected to increase in 1986 by 5–6 per cent in volume terms, compared with 4 per cent in 1985.

#### Trade in oil

- 1.22 Domestic demand for oil was boosted temporarily in 1984 and in the early months of 1985 by the coal strike. In underlying terms demand for oil has been broadly flat, despite rising GDP, as the economy continues to adjust to the large rises in oil prices in the seventies. This decline in oil demand, relative to GDP, may continue next year. UK oil production may be at much the same level this year as in 1984 and there may be little change next year. Net oil export volume is expected to be higher in 1986. But with sterling oil prices currently below the average so far in 1985, and futures markets pointing to some further decline, the balance of trade in oil at current prices may fall a little (see Table 1.2).

#### Invisibles

- 1.23 The balance on services has been improving since 1982. Travel and tourism earnings, strong this year, are particularly sensitive to price changes. Some improvement in the services terms of trade is expected to be broadly offset by a deterioration in the services balance at constant prices. The profile of the transfers balance depends largely on the timing and size of government transactions with the EC.
- 1.24 The surplus on interest, profits and dividends (IPD) increased in 1984 but fell back in the first half of 1985. The data for both 1984 and 1985 are however liable to substantial revision. In particular, the implied rate of return on direct investment overseas looks low and it has been assumed that the provisional data for the first half of 1985 will be revised upwards. The IPD balance in 1985 may be similar to 1984. A rise in UK interest rates relative to those overseas, and an increase in North Sea debits, are offset by a higher level, for 1985 as a whole, of net overseas assets. With a further rise in net overseas assets and little change in relative returns, the IPD balance should increase in 1986.

#### Current account

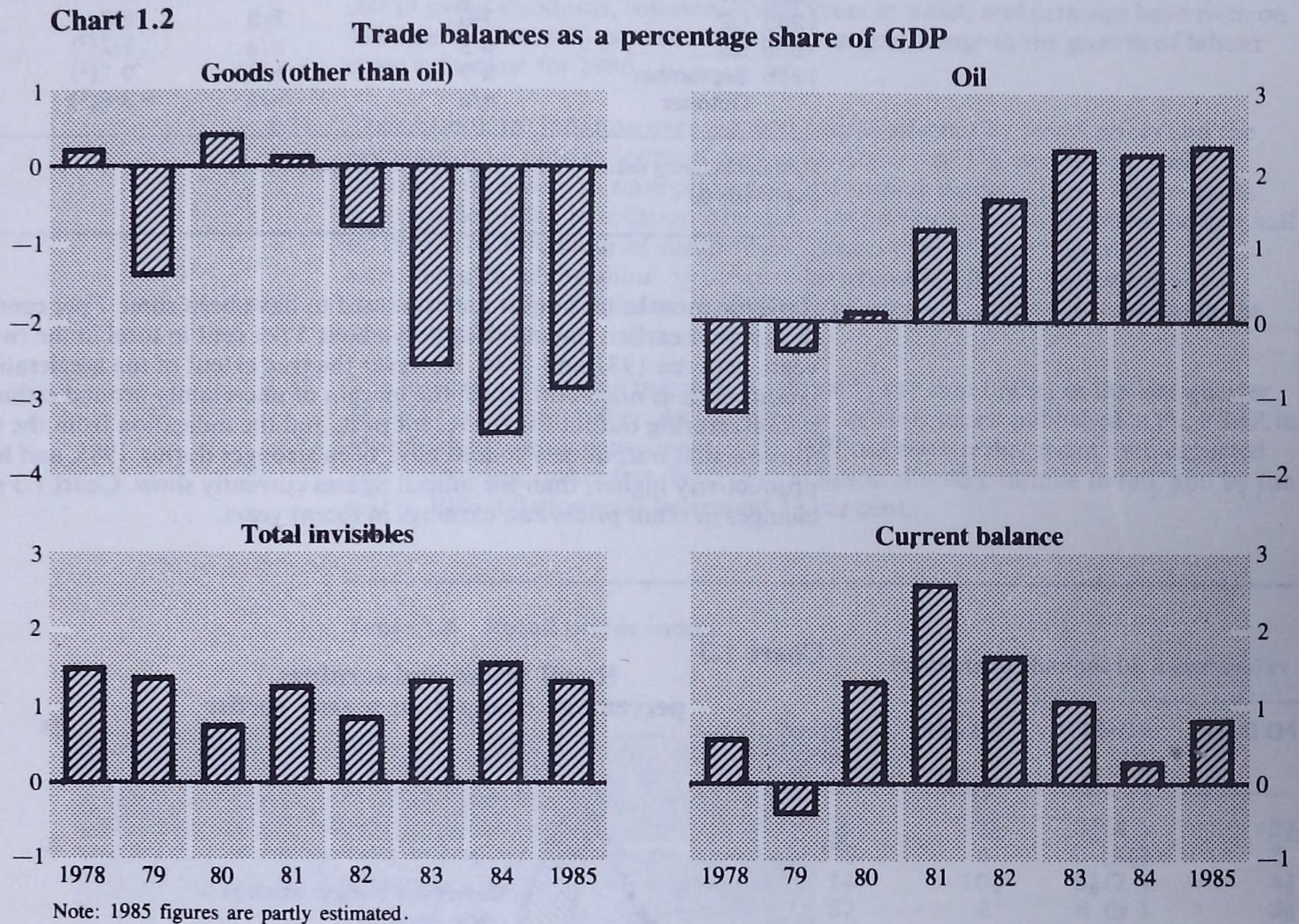
Table 1.2 Current account — balance of payments basis

	Manu- factures	Oil	Other goods	Invisibles	Total
1984	-4	7	-7	5	1
1985	-3 $\frac{1}{2}$	8 $\frac{1}{2}$	-7	5	3
1986	-4 $\frac{1}{2}$	8	-5 $\frac{1}{2}$	6	4

£ billion



- 1.25 The outlook is for a sizeable current account surplus in 1985, much as expected in the Budget forecast and for another substantial surplus in 1986. The profile of the surplus would be smoother if allowance were made for the coal strike which reduced the surplus by £2¼ billion and £1¼ billion in 1984 and 1985 respectively. Table 1.2 summarises the forecast of the main components of the current account. Chart 1.2 shows the components of the account over a longer period, relative to GDP.



### Inflation

- 1.26 As shown in Table 1.3 there has been a wide disparity in the rate of change of different price indices over the last year. While the RPI rose by 7 per cent between the second quarter of 1984 and the second quarter of 1985, the deflator of GDP at market prices — which measures the rise in prices of UK inputs, above all of wages and profits — increased by little more than 5 per cent over the same period. Producer input prices have fallen since February, while producer output prices have continued to rise, albeit at a slower rate since the spring.
- 1.27 The differences between the indices reflect two factors in particular. Firstly changes in building society mortgage rates and house prices affect the RPI but not the other price indices. Secondly, the price indices all show different speeds of response to changes in the exchange rate and in world prices. The producer input price index is the most sensitive to the latter influences in the short term: both the fall in the sterling index up to February of this year and its subsequent recovery have been picked up more quickly here than in the other indices.

### Costs

- 1.28 Input costs have fallen over the last year because of the weakness in world prices of commodities (including oil), and because of a higher level of sterling. The growth in labour costs, at least in manufacturing, appears to have increased over the last year. As recorded, wage costs per unit of output in manufacturing in



**Table 1.3 Price indices**

	Percentage changes on a year earlier			
	RPI	GDP deflator at market prices	Producer price indices <sup>(1)</sup> : input prices	output prices
1983	4.6	5.1	7.9	5.4
1984	5.0	4.5	8.7	5.6
1985 Q1	5.5	4.7	14.7	6.4
1985 Q2	7.0	5.3	6.8	6.4
1985 Q3	6.3	n/a	1.2 <sup>(2)</sup>	6.4 <sup>(2)</sup>
1985 September	5.9	n/a	0.1 <sup>(2)</sup>	6.3 <sup>(2)</sup>
October	n/a	n/a	-3.8 <sup>(2)</sup>	6.1 <sup>(2)</sup>

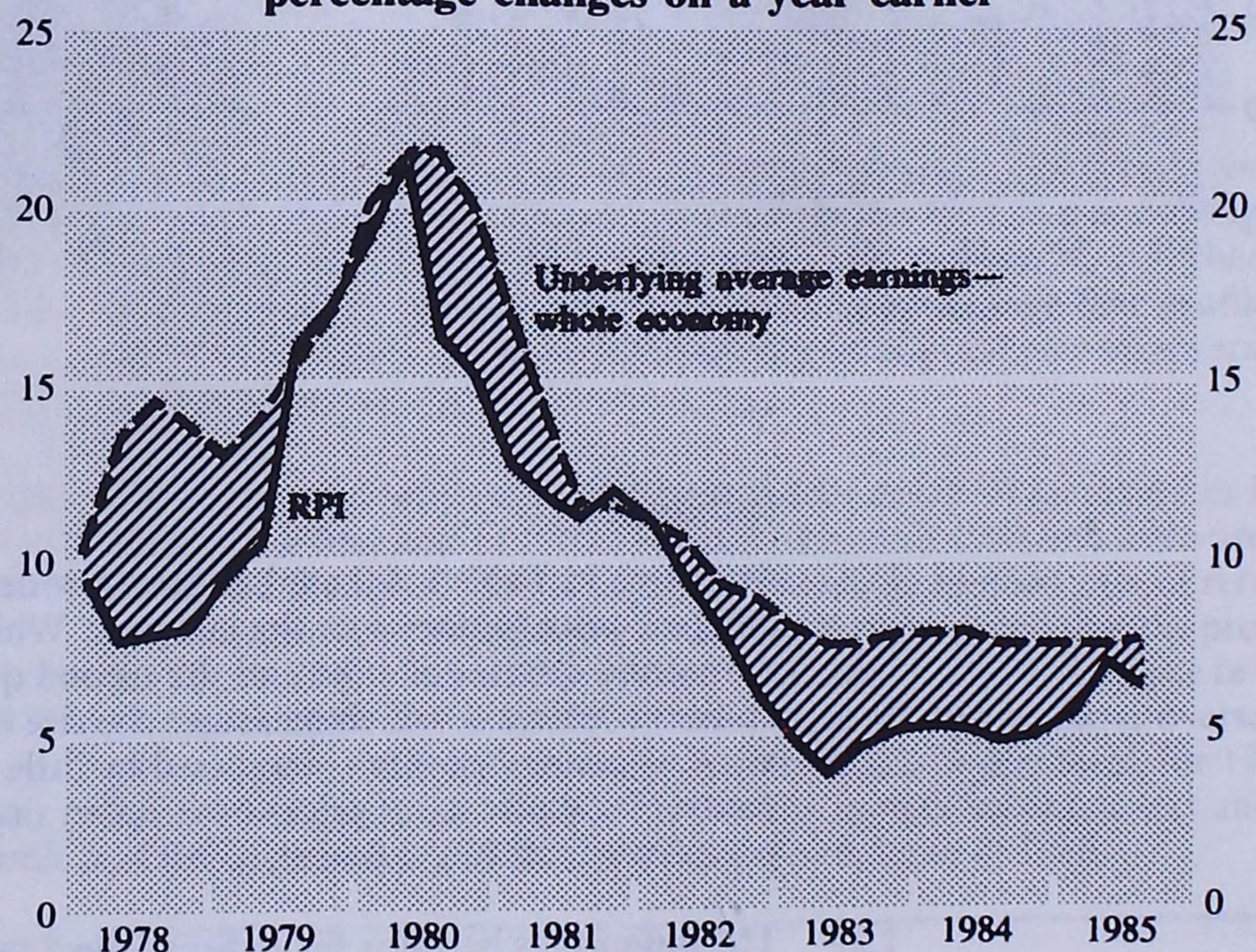
<sup>(1)</sup> Manufacturing industry other than food, drink and tobacco.

<sup>(2)</sup> Provisional.

the three months to August are estimated to have been some 7 per cent higher than a year earlier, having risen only about 5 per cent in total in the two years between 1982 and 1984. However the true extent of the acceleration in labour costs is uncertain, given the margin of uncertainty around estimates of manufacturing output for the recent past, and the indication from the CBI Surveys that output may indeed have been stronger during 1985, and hence productivity higher, than the official figures currently show. Chart 1.3 shows changes in retail prices and earnings in recent years.

**Chart 1.3**

**Retail prices and earnings  
percentage changes on a year earlier**



- 1.29 For the economy as a whole underlying growth in earnings (ie abstracting from special factors such as the coal strike) was about  $7\frac{1}{2}$  per cent in the pay round ending in the summer of 1985, virtually the same as in the previous two years. Underlying growth in output per head has probably been around  $2-2\frac{1}{2}$  per cent, while the abolition of NIS was worth about 1 per cent off labour costs in the first three quarters of 1985, compared with the corresponding period in 1984. Thus over this period, after making allowance for the coal strike, unit labour costs for the economy as a whole have grown at a rate of around 4 per cent.



## Prospects

- 1.30 The rise in RPI inflation during the latter part of the last pay round seems to have had little effect on pay settlements: no doubt in part because it was widely expected that inflation would soon fall back from the peak levels of the early summer. RPI inflation at the start of the new pay round has been roughly a point higher than it was a year ago; but with companies finding it increasingly difficult to raise prices, and a substantial fall in inflation next year widely forecast, there may not be much change in the general level of pay settlements in the current pay round. The prospect is for strong growth in real earnings, 3–4 per cent, over the next year. Once more, most of those in work will enjoy a substantial rise in living standards, following three years in which real earnings have risen on average by almost  $2\frac{1}{2}$  per cent a year. No major change in the growth of labour costs is forecast for 1986.
- 1.31 The outlook for inflation over the next year is affected by world prices and the exchange rate, both in terms of costs and in terms of UK producers' and distributors' ability to raise prices on the domestic market. These factors point to a significant fall in inflation from now on, reversing the situation in the first half of 1985. The behaviour of competitors' prices—the price of imported manufactures fell by about  $5\frac{1}{2}$  per cent between March and September—means that profit margins are unlikely to go on rising at the same rate as in the first half of 1985.
- 1.32 The forecast is for retail prices to be about  $5\frac{1}{2}$  per cent higher in the last quarter of 1985 than a year earlier. As compared with the forecast published in the FSBR in March, the housing component of the RPI has risen rather more than expected and food prices rather less. Next year inflation should continue to fall, and by the end of 1986 inflation may be around  $3\frac{3}{4}$  per cent.

Table 1.4 Retail prices index

	Weight in 1985	Percentage changes on a year earlier		
		1984 Q4	1985 Q4 ( <sup>1</sup> )	1986 Q4
Food	20	$3\frac{1}{2}$	$3\frac{1}{2}$ (4 )	$3\frac{1}{2}$
Nationalised industries( <sup>2</sup> )	9	4	5 ( $5\frac{1}{2}$ )	5
Housing	14	$10\frac{1}{2}$	$9\frac{1}{2}$ (7 )	$4\frac{1}{2}$
Other	57	4	5 (5 )	$3\frac{1}{2}$
<b>Total</b>	100	$4\frac{3}{4}$	$5\frac{1}{2}$ (5 )	$3\frac{3}{4}$

(<sup>1</sup>) 1985 FSBR forecast in brackets.

(<sup>2</sup>) Includes water; BT is included in "other" prices throughout.

- 1.33 The deflator of GDP at market prices, which increased by  $4\frac{1}{2}$  per cent in 1984–85, is expected to rise by 5 per cent in 1985–86 and by  $4\frac{1}{2}$  per cent in 1986–87.

## Demand and Activity

- 1.34 Economic activity rose by about  $2\frac{1}{2}$  per cent in 1984, when the coal strike depressed economic growth by over 1 per cent. After allowing for the estimated effects of the strike, the average measure of GDP grew by  $3\frac{1}{2}$  to 4 per cent in the year to the first half of 1985, and at an annual rate of about  $3\frac{1}{2}$  per cent between the first half of 1983 and the first half of 1985.
- 1.35 Over the year to the first half of 1985 both exports and business investment made a major contribution to the growth in demand. Consumers' expenditure, which had flattened out after the middle of 1983, has recently been showing signs of renewed growth. Falling stock levels during much of 1984 and early 1985 reflected the impact of the coal strike; but quite apart from this, stock output

## Composition of demand



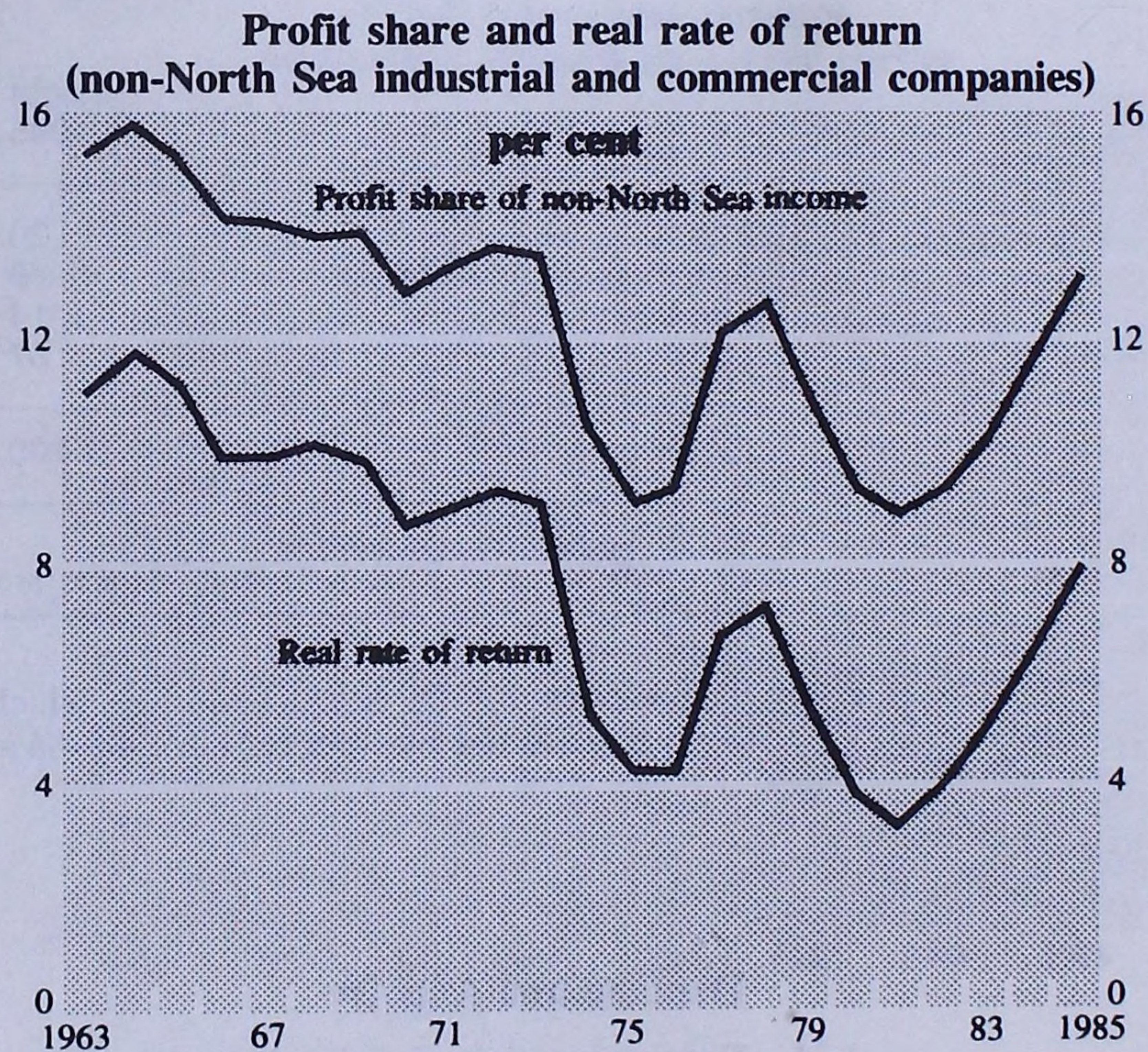
and stock sales ratios have continued to fall in both manufacturing industry and distribution, and published surveys suggest that they are not yet down to desired levels. The atypical behaviour of stockbuilding in the current cycle, while dampening down total growth in demand and output so far, means there is less danger of a stock correction causing or intensifying a cyclical slowdown.

### Personal income and expenditure

- 1.36 Between the first halves of 1984 and 1985 real personal disposable income rose by about 2½ per cent, and consumers' expenditure rose by about 1½ per cent in real terms. The personal saving ratio, which fell by about 5 points between the end of 1980 and early 1983 has risen a little over the last year. In the last few months there has, however, been evidence of renewed strength in expenditure on consumer durables, with a high level of car registrations and retail sales of durable goods in the third quarter of 1985.
- 1.37 As inflation falls over the next year growth in real personal disposable income is likely to pick up further. Eventually the fall in inflation should lead to a lower personal saving ratio; but over the immediate future consumers' expenditure may not quite keep up with the growth in incomes. Consumer durable expenditure is normally highly responsive to changes in personal income, and could grow by 10 per cent or so in 1986; overall consumers' expenditure may rise by some 4 per cent in 1986.
- 1.38 Households' investment in dwellings may also grow quite strongly next year. Private housing starts have been running more than 5 per cent above last year's average in the last two quarters and also above completions. Despite the level of real interest rates, demand for mortgages has remained quite strong in 1985. The rising stock of dwellings under construction should be reflected in the figures for investment in new dwellings during 1986. Expenditure on repairs, maintenance and improvements of dwellings is also likely to reflect the growth in personal incomes.

### Company income and expenditure

**Chart 1.4**



Notes: Adjusted for estimated effects of privatisation.  
1985 figures are partly estimated.

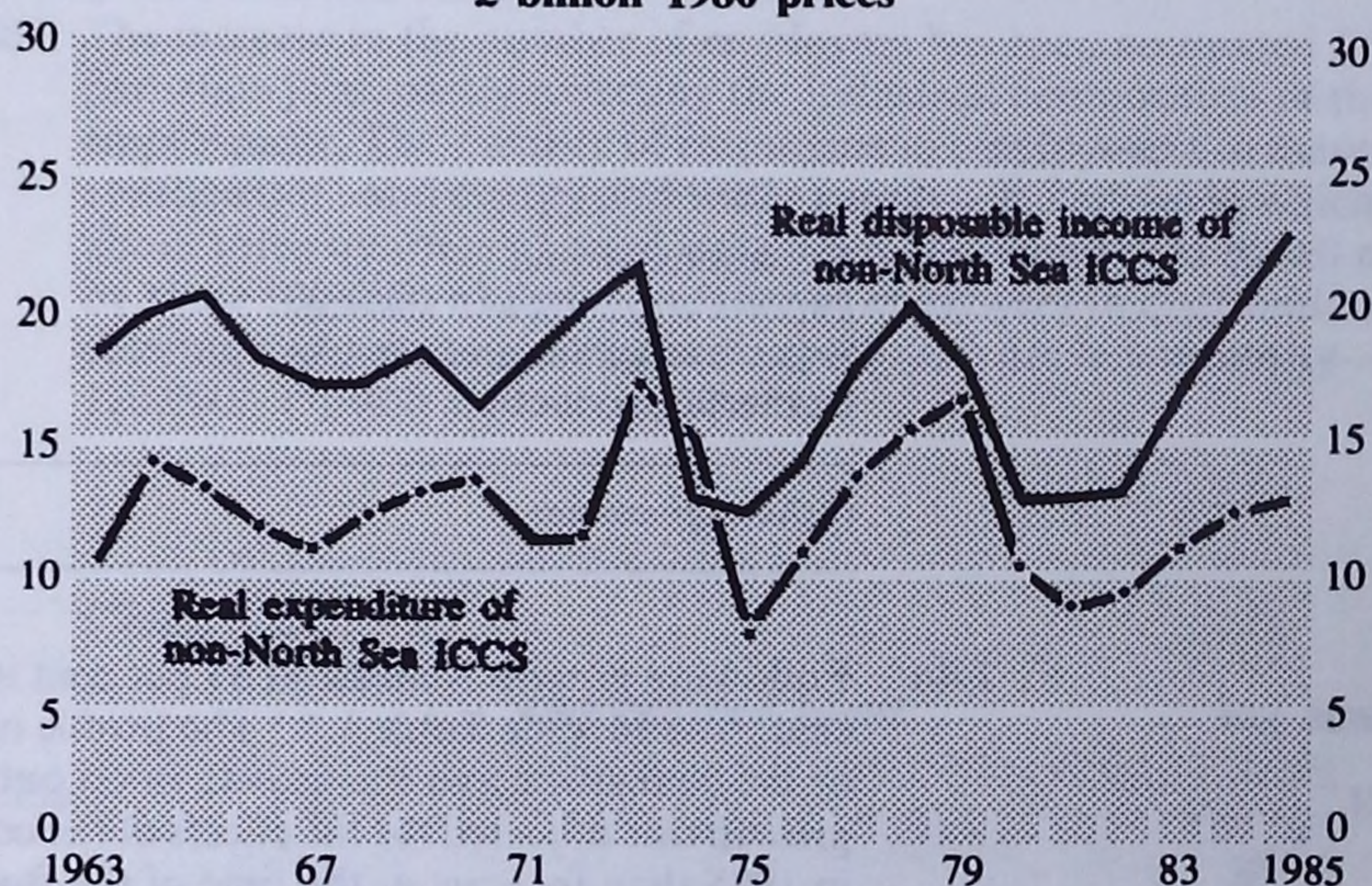
- 1.39 Company incomes have grown very strongly since 1981. Between 1981 and 1984, profits of industrial and commercial companies (ICCs), net of stock appreciation and excluding North Sea oil companies, rose by almost 70 per cent, and the rate of return on assets of these companies rose from under 3½ per cent to 6½ per cent. Between the first half of 1984 and the first half of 1985 profits rose by about a quarter (excluding British Telecom's profits which were included



in the ICCs figures from 28 November 1984). Chart 1.4 shows the recovery since 1981 in both the profit share and the rate of return, to a level in 1985 which is expected to be the highest seen since 1973. The figures in this chart exclude North Sea profits which have been rising strongly since 1975.

- 1.40 Company spending (on fixed investment and stocks taken together) has also risen in the last two years, but has not kept up with the growth in income. Industrial and commercial companies, excluding North Sea oil companies, are estimated to have run a financial surplus of some £4½ billion in 1984, with a further surplus of perhaps some £3½ billion in the first half of 1985. Chart 1.5 shows company income and spending.

**Chart 1.5**  
**Company income and expenditure**  
**£ billion 1980 prices**



Notes: Figures are approximate, adjusted for estimated effects of privatisation and do not take account of certain transactions between North Sea oil companies and other industrial and commercial companies. 1985 figures are partly estimated.

### Fixed investment

- 1.41 Business investment—adjusted for privatisation and excluding North Sea companies—was some 15 per cent higher in the first half of 1985 than in the same period of 1984: the first quarter figure was boosted by some bringing forward of expenditure before the reduction in capital allowances at the beginning of April. For 1985 as a whole, business investment will probably be 7–8 per cent higher than in 1984—close to the rate suggested by the June DTI intentions survey. For 1986, the strength of the recovery in profits, the buoyancy of the stock market and the generally healthy state of company liquidity all point to a further rise in business investment; though the indications are that it will not be as large a rise as seen in 1984 and 1985.
- 1.42 Public investment is expected to fall slightly in 1985 and may rise a little in 1986. Fixed investment (in real terms) for the economy as a whole may rise by 4 per cent in 1985 and 3½ per cent next year.

### Stockbuilding

- 1.43 In recent years both manufacturers and distributors have been reducing the volume of stocks relative to the level of their business. Important influences have been changes in inflation, interest rates and in the tax treatment of stocks. In particular the abolition of stock relief announced in the 1984 Budget has contributed to the recent fall in stock ratios, and may not yet have had its full impact. The stockbuilding figures for the whole economy also reflect the rundown of coal stocks during the coal strike. With recovery of production in the coal industry and some attenuation of the fall in the stock ratio in industry generally, there may be some limited additions to stocks in 1986. The change in stockbuilding may be equivalent to almost ½ per cent on GDP growth in 1986.



**Prospects for demand and activity**

- 1.44 The composition of growth is now reverting more to the pattern experienced in the early part of the upswing, with external demand and business investment becoming relatively less important and with an increasing contribution from personal sector spending. To some extent this simply reflects developments in the world economy: the slowdown in the US means weaker world trade growth than in 1984 but weaker world prices provide a boost to domestic demand in the industrial countries.
- 1.45 Overall the economy is forecast to grow at close to the average rate of the last two years. Almost without exception, forecasters have failed to predict the strength and durability of the current upswing. Against the background of falling inflation, rising profits and recent strength in investment, further steady expansion of the economy is expected.

**Table 1.5 Domestic demand and GDP**

	Percentage changes on a year earlier		
	1984	1985	1986
Domestic demand	2½	2½	3½
Exports of goods and services	7	7	2
Imports of goods and services	9½	3½	4
Domestic production: GDP(*)	2½	3½	3

(\*) Average measure.

- 1.46 Following growth forecast at 3½ per cent in 1985, the forecast is for about 3 per cent in 1986. (See Table 1.5.) The profile of growth reflects in part the effect of the coal strike and the growth in oil output. Table 1.6 shows the forecast growth rate adjusted for the effects of the coal strike. Oil output may be a little lower in 1985 than forecast at the time of the Budget, but may not change much between 1985 and 1986. On this basis growth in non-oil GDP is expected to be roughly the same as total GDP growth in both 1985 and 1986. Between 1983 and 1986 manufacturing output is expected to grow at a rate close to that of GDP.

**Table 1.6 GDP, and manufacturing output**

	Percentage changes on a year earlier		
	1984	1985	1986
GDP (Average measure)	2½	3½	3
GDP, adjusted for coal strike(*)	3½	3	2½
Manufacturing output	4	2½	2½

(\*) Adjustments are approximate.

**Productivity and the Labour Market**

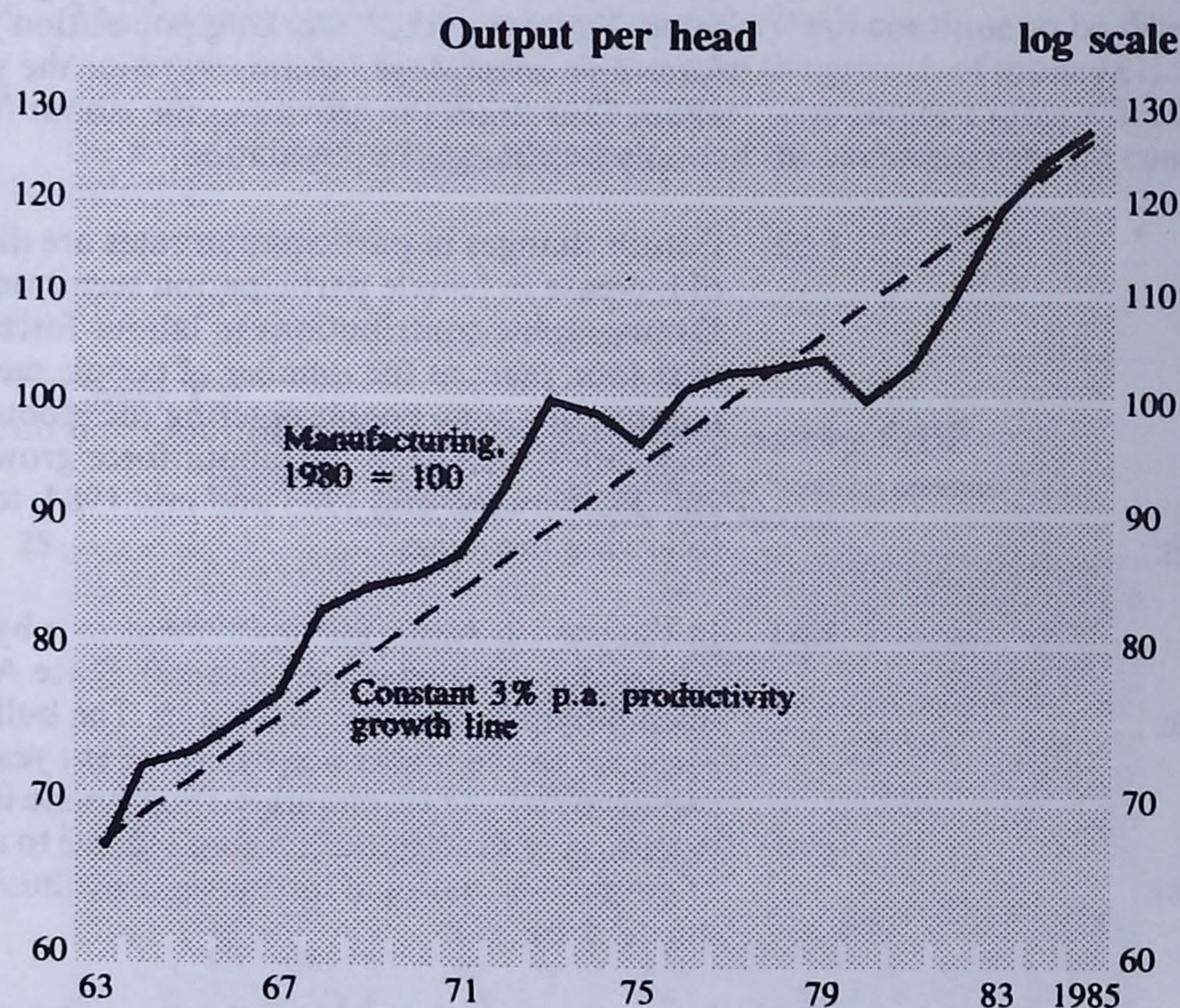
- 1.47 In the year to the end of the second quarter of 1985, the employed labour force in Great Britain is estimated to have risen by some 260,000, bringing the total increase in jobs since the first quarter of 1983 to 677,000. Growth of total employment over the most recent twelve months appears to have slowed down as compared with the previous year; but, as Table 1.7 makes clear, all of this slowdown is attributable to a deceleration assumed in the numbers in self employment. Survey data on self employment is available only up to mid 1984. Thereafter, growth in self employment has been projected at the average rate of the previous three years (126,000 a year) which is lower than the recorded rate of growth between mid 1983 and mid 1984.



**Table 1.7 Estimated changes in employment (GB, seasonally adjusted)**

	Employees in employment			Self employed	HM Forces	Employed labour force
	Male	Female full-time	Female part-time			
	June 1983 to June 1984	- 95	+ 7			
June 1984 to June 1985	- 71	+ 42	+ 162	+ 126	0	+ 260

- 1.48 The increase in the number of employees has been accounted for by women in part-time jobs, partly reflecting the industrial composition of the changes in employment. The number of employees in employment in manufacturing, construction, and energy and water supply—industries in which on average about three quarters of employees are male—continued to fall over the last year, by some 100,000; while the number of employees in distribution, hotels, catering and repairs—where male employees are in a minority—rose by some 120,000.

**Chart 1.6**

- 1.49 Productivity growth in manufacturing appears to have slowed down somewhat over the last year, subject to revisions to the current estimate of manufacturing output. However, even over the last year growth in manufacturing productivity has been close to the average rate recorded in the sixties, and well above the rate of growth achieved between 1973 and 1979. (See Chart 1.6.). Table 1.8 shows output per head in manufacturing and non-manufacturing. The relatively low growth in recent years in output per head in non-manufacturing in part reflects the rise in part-time employment.



**Table 1.8 Output per head of the employed labour force**

	Annual averages, percentage changes		
	1964-73	1973-79	1979-84
Manufacturing	3 $\frac{3}{4}$	$\frac{3}{4}$	3 $\frac{1}{2}$
Non-manufacturing <sup>(1)</sup>	3	$\frac{1}{2}$	1 <sup>(2)</sup>

<sup>(1)</sup> Excludes public services and oil, includes nationalised industries (except steel).

<sup>(2)</sup> Adjusted for the coal strike.

- 1.50 Results from the 1984 Labour Force Survey show an increase in the civilian labour force between mid 1983 and mid 1984 of just over 500,000, with an increase of almost 400,000 in the number of women in the labour force. Of the total increase in the labour force about three fifths was attributable to changes in activity rates: in particular, there were large increases in the proportion of women between the ages of 25 and 45 who were either in work or looking for work. This rise in female participation rates has been caused by the growth in demand for part-time female labour: to a large extent the rise in part-time female employment has been met from women who were previously neither recorded as looking for work nor in the unemployment count.
- 1.51 Although no direct evidence will be available until early next year, the continuing rise in part-time female employment over the last year suggests that there has probably been a further significant rise in female participation rates. The rise in the "working population" (ie the sum of the employed labour force and unemployed claimants) over the year to June 1985 was some 400,000, about four times the growth in the labour force that could be accounted for simply by changes in population.
- 1.52 Future changes in participation rates are difficult to forecast, but the recent rate of increase in female participation seems unlikely to persist for very long. Demographic contributions to labour force changes are expected to fall in the next four years as the number of people reaching retirement age increases and the number of young people entering the labour force declines. The contribution of population change to the labour force growth is expected to fall from over 200,000 between mid 1983 and mid 1984, to under 100,000 on average over the following five years.
- 1.53 In the year to April, unemployment rose by just over 160,000 (seasonally adjusted, excluding school leavers). Since April, on this basis, unemployment has stopped rising. The bulk of the improvement seems to be a response to the higher activity of recent years; the main impact of the expansion of the Community Programme is still to be felt. In addition the extension of the Youth Training Scheme to a two-year scheme and the restructuring of employers' national insurance contributions will both start to have an effect during 1986.

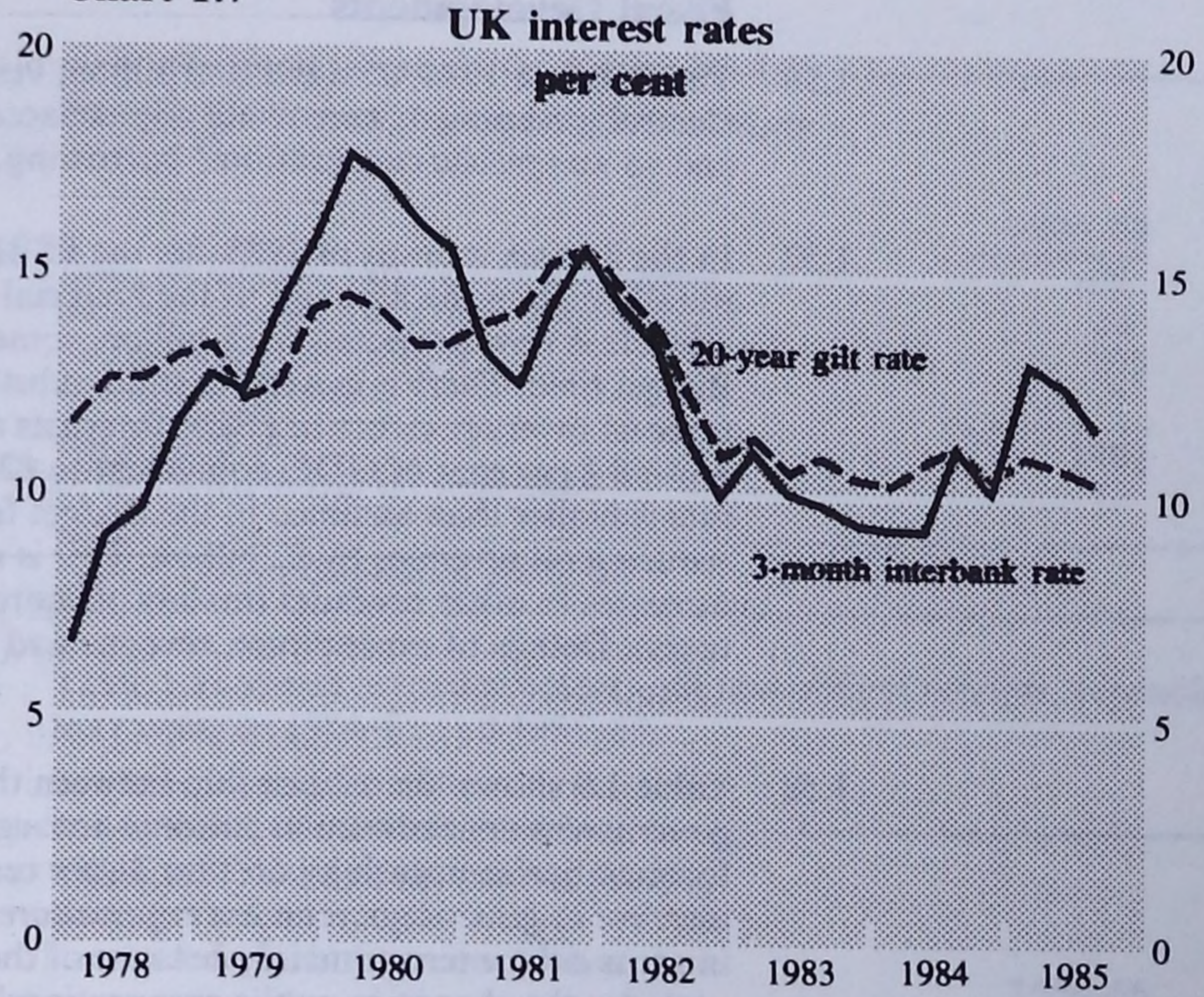
## Unemployment

### Financial Conditions

- 1.54 This year short term interest rates overseas eased further. Monetary conditions in the UK appear consistent with the expected further fall in the rate of inflation. Short-term interest rates have fallen from their January peak, but are high in real terms. Long rates have not changed much over the past three years. The exchange rate has been relatively stable since the early spring, at a level close to the average for 1983 and 1984, and M0 is well within its target range. £M3 is well above its target, but the range did not allow for the continued downward trend in velocity associated with financial liberalisation and positive real interest rates. Chart 1.7 shows UK short and long interest rates. Chart 1.8 shows £M3, M0, and money GDP.



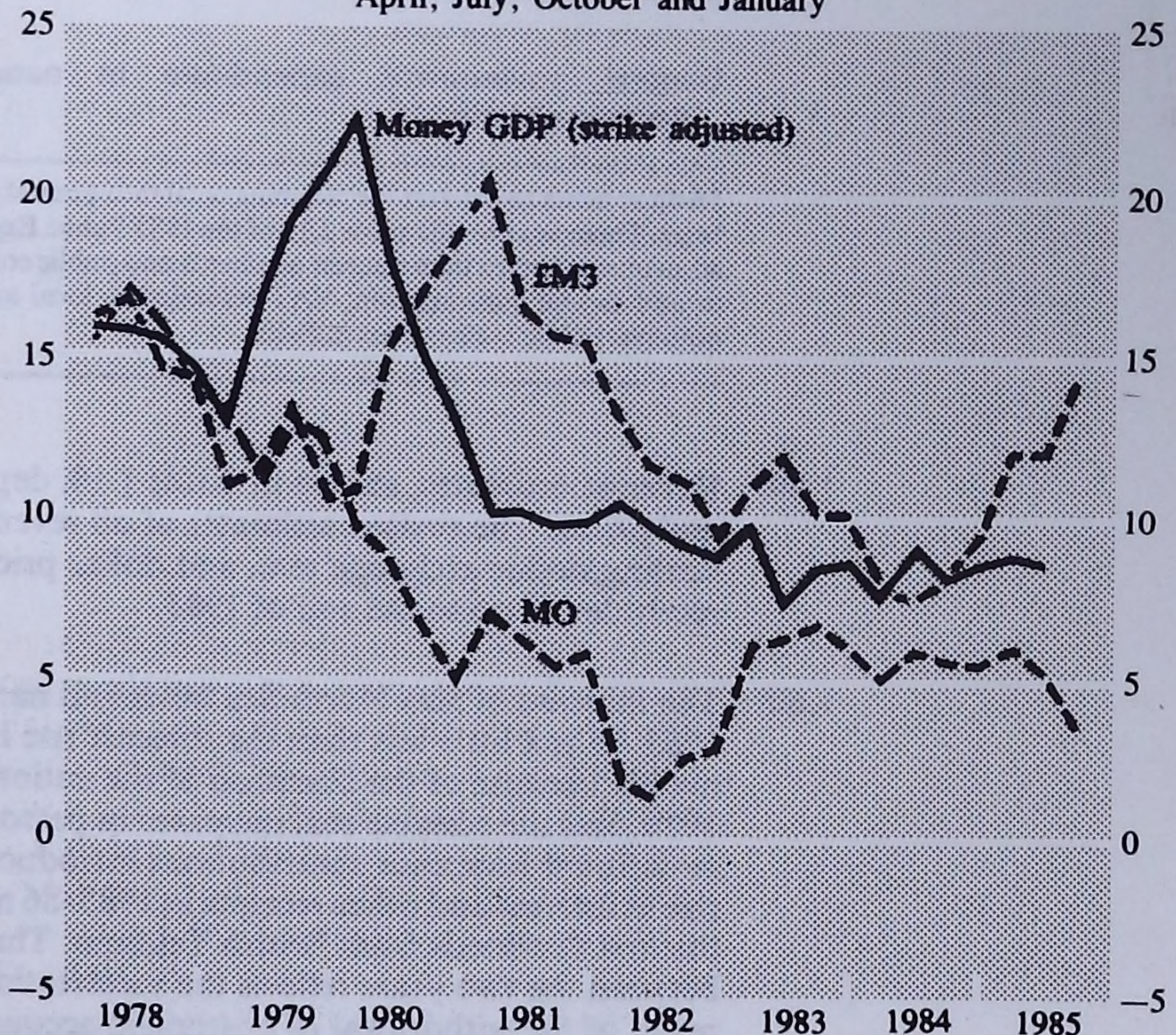
**Chart 1.7**



1.55 The forecast assumes that monetary policy will continue to be directed towards sustaining further downward pressure on the growth of money GDP and hence on inflation, as in the MTF5, and that short term interest rates will be set so that the paths of the monetary aggregates and the exchange rate are consistent with this objective.

**Chart 1.8**

**Monetary aggregates and money GDP**  
 Percentage change on year earlier for banking months  
 April, July, October and January





## Fiscal Developments

- 1.56 The PSBR in 1984–85 was £10.2 billion, very close to the forecast in the FSBR. Central government borrowing on own account was slightly lower than forecast, and so was public corporations' borrowing.
- 1.57 In the first six months of 1985–86, the PSBR was £5.6 billion (borrowing is usually high in the first half of the financial year). The total for the year as a whole is now projected at £8 billion, some £1 billion higher than forecast at Budget time. There is inevitably still a substantial margin of error surrounding this forecast (average errors in PSBR forecasts at this time of year have been around  $\frac{3}{4}$  per cent of GDP, equivalent to £2½ billion). The sterling/dollar exchange rate is higher than assumed in the Budget forecast, and is the main factor reducing oil revenues by £2 billion. This is not expected to be fully offset by increases in other revenues (mainly onshore company taxes and expenditure taxes). Details of expenditure, revenue and borrowing are shown in Tables 1.9 to 1.11.
- 1.58 Table 1.9 shows the relationship between the planning total and general government expenditure in national accounts terms. The planning total is forecast to rise in cash by around 3½ per cent between 1984–85 and 1985–86. The increase in general government expenditure is bigger because it includes a large rise in gross debt interest (mainly because of the increase in gross borrowing) and excludes the change in public corporations' market and overseas borrowing, which was high in 1984–85 (because of the coal strike) but has changed to net repayment in 1985–86. Expenditure figures in both years (but particularly 1984–85) are higher because of the coal strike: making a rough adjustment gives an underlying rate of increase in the planning total between 1984–85 and 1985–86 of around 4½ per cent. Details of the prospective outturn for the planning total in 1985–86 are provided in Part 2.

## Expenditure

**Table 1.9 General government expenditure**

	1984–85	1985–86
Public expenditure planning total	129½	134
Interest payments*	16	18
Less public corporations' market and overseas borrowing*	1	-1
Other adjustments*	5	5
General government expenditure in national accounts terms	149½	158

\*Adjustments to convert the planning total into general government expenditure on a national accounts basis. These are listed in table 2.16 of the 1985 Public Expenditure White Paper (Cmnd 9428). The major adjustments (other than interest payments and public corporations' market and overseas borrowing) are to add capital consumption, VAT refunded to local authorities, and transactions concerning certain notional public sector pension funds.

## Revenue

- 1.59 Revenue estimates, shown in Table 1.10, depend mainly on incomes, spending and prices. The revised estimates of oil revenues in 1985–86 assume that the sterling/dollar exchange rate, and dollar prices for North Sea oil, remain near recent levels up to the end of 1985.
- 1.60 The increase in non North Sea taxes and national insurance contributions in 1985–86 is a little less than the forecast rise in money GDP of 9 per cent, mainly because of the abolition of the national insurance surcharge in October 1984, and the sizeable real increases in personal tax allowances and changes in national insurance contributions introduced in the 1985 Budget. The marked rise in interest and other receipts in 1985–86 mainly reflects higher interest rates and the first dividends from British Telecom. The change in the accruals adjustment between the two years reflects the acceleration of VAT payments in 1984–85 as a result of the withdrawal of postponed accounting for VAT on imports.



**Table 1.10 General government receipts**

	£ billion	
	1984-85	1985-86
Taxes on income, expenditure and capital	106	112½
National insurance and other contributions	23	24½
Interest and other receipts	10½	12½
Accruals adjustments	1	-½
<b>Total receipts</b>	<b>140½</b>	<b>149</b>
of which North Sea tax revenues*	12	11½

\* Before Advance Corporation Tax set off.

**Borrowing**

1.61 Table 1.11 shows revised estimates of Government receipts, expenditure and borrowing in 1984-85 and 1985-86.

**Table 1.11 Public sector borrowing**

	£ billion	
	1984-85	1985-86
General government expenditure	149½	158
General government receipts	140½	149
General Government Borrowing Requirement	9	9
Public corporations' market and overseas borrowing	1	-1
Public Sector Borrowing Requirement	10	8
as percentage of GDP	3	2¼
Money GDP at market prices	328	357



## The Prospects: summary

1.62 Table 1.12 presents a summary of the economic prospects.

**Table 1.12 Economic prospects**

	Percentage changes		Average errors from past forecasts <sup>(1)</sup>
	1984 to 1985	1985 to 1986	
<b>A Output and expenditure at constant 1980 prices</b>			
Gross domestic product (at factor cost)	3½	3	1
Consumers' expenditure	2½	4	1
General government current expenditure	0	½	1
Fixed investment	4	3½	2½
Exports of goods and services	7	2	3
Change in rate of stock-building as a percentage of the level of GDP	0	½	1
Imports of goods and services	3½	4	3
	1985	1986	
<b>B Balance of payments on current account (£ billion)</b>	3	4	3
<b>C Retail prices index (4th quarter)</b>	5½	3¾	3 <sup>(2)</sup>

<sup>(1)</sup> The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications 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 forecasts.

<sup>(2)</sup> The average error for inflation was calculated from a period of much higher inflation and overstates the likely margin of error at low rates of inflation. Over the period since 1979, the average error in autumn Industry Act forecasts has been 1 per cent.



**Table 1.13 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	137.0	48.9	41.6	63.1	-2.9	287.8	57.7	30.8	0	199.3	100.0
1981	136.6	48.8	37.7	62.0	-2.6	282.6	55.8	30.2	-0.4	196.2	98.4
1982	137.6	49.3	40.1	62.8	-1.0	288.7	58.5	30.6	0.5	200.1	100.4
1983	143.1	50.2	41.9	64.1	0.7	300.1	62.0	31.6	0.1	206.6	103.7
1984	145.5	50.7	45.4	68.5	0.1	310.1	67.8	32.8	2.1	211.6	106.2
1985	149.1	50.8	47.3	73.4	0.4	321.0	70.4	33.3	2.1	219.4	110.1
1986	155.4	51.0	49.0	75.0	1.0	331.5	73.0	34.7	2.0	225.8	113.3
1984 H1	72.5	25.2	22.6	33.6	-0.3	153.6	32.9	16.3	0.7	105.0	105.4
H2	72.9	25.5	22.8	34.9	0.3	156.5	34.9	16.5	1.5	106.6	107.0
1985 H1	73.8	25.5	23.5	37.0	0.2	159.9	35.5	16.5	1.2	109.1	109.5
H2	75.4	25.3	23.8	36.5	0.2	161.1	34.9	16.9	0.9	110.3	110.7
1986 H1	76.7	25.6	24.6	37.2	0.4	164.5	36.0	17.2	0.8	112.1	112.5
H2	78.7	25.4	24.4	37.8	0.7	166.9	37.1	17.5	1.2	113.6	114.0
% changes:											
1983 to 1984	1½	1	8	7		3½	9½	4		2½	2½
1984 to 1985	2½	0	4	7		3½	3½	1½		3½	3½
1985 to 1986	4	½	3½	2		3½	4	4		3	3

\*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 1985 H1 are forecasts.



## 2. Outline Public Expenditure Plans for 1986-87 to 1988-89

- 2.01 The Government has confirmed the cash totals for public expenditure for 1986-87 and 1987-88 at the levels set out in the 1985 Financial Statement and Budget Report (FSBR). Plans have now been formulated for 1988-89. After allowing for inflation, the public expenditure planning totals will remain broadly constant over the three years. With continuing economic growth over the planning period, public expenditure will continue to account for a steadily declining proportion of GDP. By 1988-89 it will be lower than at any time since 1972-73.

### 1985-86 Outturn

- 2.02 The estimated outturn for 1985-86 is £134.2 billion—as in the FSBR.

### Future Years: the Planning Total

- 2.03 The public expenditure planning total for 1986-87 has been set at £139.1 billion, and the totals for 1987-88 and 1988-89 at £143.9 billion and £148.7 billion respectively. In 1984-85 prices the public expenditure planning total is expected to remain broadly stable at around £127 billion a year, slightly lower than in 1984-85 and 1985-86. As a percentage of GDP, public expenditure falls from its peak of 46½ per cent in 1982-83 to 41 per cent in 1988-89, compared to 43 per cent in 1978-79.

**Table 2.1 Public expenditure trends**

	Planning total (£ billion) <sup>(1)</sup>		General government expenditure as % of GDP <sup>(3)</sup>
	Cash	Real terms <sup>(2)</sup> (base year 1984-85)	
1978-79	65.7	117.4	43
1979-80	77.0	117.6	43½
1980-81	92.7	119.3	46
1981-82	104.6	122.3	46
1982-83	113.4	123.8	46½
1983-84	120.3	125.8	45½
1984-85	129.7	129.7	45½
1985-86	134.2	127.8	44½
1986-87	139.1	126.8	43
1987-88	143.9	126.7	41½
1988-89	148.7	127.1	41

<sup>(1)</sup> Figures up to 1985-86 are outturn; for 1986-87 onwards they are plans.

<sup>(2)</sup> Cash figures adjusted for general inflation as measured by the GDP deflator at market prices—base year 1984-85. The GDP deflator is assumed to increase by some 5 per cent in 1985-86, and by 4½, 3½ and 3 per cent respectively in the years 1986-87 to 1988-89.

<sup>(3)</sup> General government expenditure as defined in the national accounts and presented in the Medium Term Financial Strategy (MTFS). The background to the use of general government expenditure in this ratio was set out in *Economic Trends*, August 1985. Table 1.9 shows the relationship between general government expenditure and the public expenditure planning total.



### Future Years: Main Changes

- 2.04 Within unchanged planning totals a significant increase in receipts from the Government's privatisation programme has been matched by increases in departmental programmes. In addition the passage of time allows part of the Reserve for unforeseen contingencies in any given year to be allocated to programmes as their costs become known more accurately.
- 2.05 Within this increased programme provision, priority has been given to capital spending on roads and renovation of local authority housing; and to spending on health and science. In addition, scope has had to be found for demand-led increases in social security, agricultural support under the CAP and for export credit. Spending on defence remains at the level of previous plans.
- 2.06 Full details of spending plans, together with details on running costs and manpower, will be given in the forthcoming Public Expenditure White Paper.

### Departments

- 2.07 Table 2.2 sets out spending plans by department including local authority spending and nationalised industry external finance. The breakdown into departments will be carried through into separate chapters of the Public Expenditure White Paper and into the classes for Estimates, thereby making it easier to make comparisons between the various documents. Subsidiary Tables 2.2A to C at the end of Part 2 show separately the three elements within the departmental totals—nationalised industries' external finance, local authority relevant current spending and other departmental spending (including local authority capital).

- Defence** 2.08 The estimated outturn for 1985–86 reflects an increase in provision as a result of carry-forward of capital underspend from 1984–85 and the determination of the external financing requirement of Royal Ordnance plc, which had not been fixed at the time of the last Public Expenditure White Paper (Cmnd 9428). This increase has been met from the Reserve. For 1986–87 and 1987–88 the provision remains as planned. For 1988–89 the provision represents a continuation of these plans. The figures for each year include provision for Falklands costs, which decline over the period.
- Overseas Development Administration** 2.09 Additions have been made to the overseas aid programme. Their effect will be to maintain the programme to 1988–89 at its 1985–86 level in real terms. Part of the additions will be used to increase Aid and Trade Provision.
- Foreign and Commonwealth Office (Other)** 2.10 Additional provision has been made in the FCO (Other) programmes to offset increases in overseas costs, and for BBC external services. In the last year an extra £20 million is included to compensate for the ending of loan repayments by Yugoslavia.
- European Community** 2.11 The estimate of the United Kingdom's net payments to European Community institutions has increased, mainly because of a decline in our assumed share of receipts from the Community budget (particularly in respect of agricultural expenditure). The uneven pattern in net payments compared with the figures in Cmnd 9428 mainly reflects special financial arrangements earlier this year as a result of the failure of the European Parliament to adopt the 1985 Community budget on time, and the fixing of a relatively low sterling/ecu exchange rate for determining our VAT liability in the 1986 Community budget.
- Intervention Board for Agricultural Produce and other CAP expenditure** 2.12 Increased provision is made to meet the cost of intervention buying which is forecast to go on rising under present CAP policies. Most of the expenditure should be recouped eventually from sales and from EC budget receipts which are reflected in the forecast UK net contribution to the EC.



**Table 2.2 Public expenditure plans<sup>(1)</sup>(<sup>2</sup>)**

Departments (including local authority spending and nationalised industries' external finance)	White Paper (Cmnd 9428 adjusted for Budget measures <sup>(3)</sup> )			Estimated outturn	Changes between Cmnd 9428 (adjusted) and outturn
	1985-86	1986-87	1987-88	1985-86	1985-86
Ministry of Defence	18 060	18 520	18 820	18 200	+ 200
FCO—ODA	1 260	1 300	1 320	1 250	0
FCO—Other	610	600	620	620	+ 10
European Community	750	640	830	800	+ 50
IBAP and other CAP expenditure	1 440	1 280	1 300	1 900	+ 450
Domestic Agriculture, Fisheries and Food	850	820	800	880	+ 30
Forestry Commission	50	50	50	50	0
Department of Trade and Industry	1 490	1 380	1 140	1 650	+ 150
Export Credits Guarantee Department	130	80	- 40	340	+ 210
Department of Energy	- 70	- 940	- 880	1 000	+ 1 100
Department of Employment	3 370	3 830	4 020	3 300	- 50
Department of Transport	4 540	4 830	4 790	4 500	0
DOE—Housing	2 280	2 530	2 630	2 700	+ 400
DOE—Property Services Agency	- 100	- 100	- 110	- 110	- 10
DOE—Other Environmental Services	3 450	3 560	3 500	3 950	+ 500
Home Office	4 590	4 790	4 870	4 750	+ 150
Lord Chancellor's Department	540	570	610	540	0
Department of Education and Science	13 600	14 020	14 230	14 400	+ 800
Office of Arts and Libraries	640	710	730	700	+ 70
DHSS—Health & Personal Social Services	16 490	17 410	18 120	16 700	+ 200
DHSS—Social Security	40 040	41 650	43 660	41 200	+ 1 200
Civil Superannuation	1 070	1 110	1 230	1 050	0
Scotland	7 160	7 340	7 320	7 400	+ 200
Wales	2 740	2 880	2 930	2 800	+ 50
Northern Ireland	4 250	4 460	4 600	4 300	+ 50
Chancellor's Departments	1 750	1 850	1 870	1 800	+ 50
Other Departments	360	380	400	350	- 10
<b>Reserve</b>	5 000	6 000	7 000	0	- 5 000
<b>Special sales of assets</b>	- 2 500	- 2 250	- 2 250	- 2 500 <sup>(4)</sup>	0
<b>Adjustments<sup>(5)</sup></b>	330	- 250	- 250	- 300	- 630
<b>PLANNING TOTAL</b>	<b>134 200</b>	<b>139 100</b>	<b>143 900</b>	<b>134 200</b>	<b>—</b>

(<sup>1</sup>) Some figures may be subject to detailed technical amendment before publication of the 1986 Public Expenditure White Paper.

(<sup>2</sup>) Departments' figures are generally rounded to the nearest £10 million and the planned Social Security figures are rounded to the nearest £100 million. Outturn figures for 1985-86 have been rounded to reflect their provisional nature. Figures up to £1 billion have been rounded to the nearest £10 million, figures from £1 billion to £10 billion to the nearest £50 million and figures of £10 billion or more to the nearest £100 million. Differences have been calculated on unrounded figures and rounded in the same way as their equivalent outturn. Figures may not sum to totals or changes due to rounding. The same conventions apply to Tables 2.2A, 2.2B and 2.2C.

(<sup>3</sup>) Includes minor changes of classification and allocation.

(<sup>4</sup>) Cmnd 9428 planned figure.

(<sup>5</sup>) Double counting of agricultural spending in Scotland and Wales which is also included in the totals for Domestic Agriculture, Fisheries and Food and IBAP etc. The 1985-86 White Paper figure includes £590 million for unallocated local authority spending in England. The 1986-87 plan figure includes external finance of -£400 million for nationalised industries to be privatised this year.



Plans			Changes between Cmnd 9428 (adjusted) and plans		£ million
1986-87	1987-88	1988-89	1986-87	1987-88	Departments (including local authority spending and nationalised industries' external finance)
18 520	18 820	18 990	0	0	Ministry of Defence
1 320	1 350	1 390	+20	+30	FCO—ODA
640	660	700	+40	+40	FCO—Other
650	1 150	950	+10	+320	European Community
1 550	1 640	1 670	+270	+340	IBAP and other CAP expenditure
830	820	830	+10	+10	Domestic Agriculture, Fisheries and Food
50	50	60	0	0	Forestry Commission
1 300	1 080	940	-80	-70	Department of Trade and Industry
280	170	100	+200	+210	Export Credits Guarantee Department
110	-550	-290	+1 050	+330	Department of Energy
3 760	3 810	3 990	-70*	-210*	Department of Employment
4 810	4 840	4 830	-20	+50	Department of Transport
2 750	2 830	2 880	+220	+200	DOE—Housing
-90	-110	-110	+10	0	DOE—Property Services Agency
3 620	3 530	3 560	+60	+30	DOE—Other Environmental Services
4 960	5 010	5 040	+170	+140	Home Office
590	650	700	+20	+40	Lord Chancellor's Department
14 320	14 400	14 480	+300	+170	Department of Education and Science
730	750	760	+20	+20	Office of Arts and Libraries
17 720	18 450	19 140	+310	+330	DHSS—Health & Personal Social Services
42 900	44 400	45 900	+1 250	+740	DHSS—Social Security
1 180	1 310	1 400	+70	+80	Civil Superannuation
7 540	7 390	7 420	+200	+70	Scotland
2 910	2 940	3 000	+30	+10	Wales
4 520	4 690	4 820	+60	+90	Northern Ireland
2 010	2 050	2 070	+160	+180	Chancellor's Departments
450	460	470	+70	+60	Other Departments
4 500	6 250	8 000	-1 500	-750	Reserve
-4 750	-4 750	-4 750	-2 500	-2 500	Special sales of assets
-650	-250	-260	-400	0	Adjustments <sup>(5)</sup>
<b>139 100</b>	<b>143 900</b>	<b>148 700</b>	—	—	<b>PLANNING TOTAL</b>

(\*) Compared with the last Public Expenditure White Paper (Cmnd 9428) overall provision for the Department of Employment has been increased by about £600 million in both 1986-87 and 1987-88.



<b>Domestic Agriculture, Fisheries and Food</b>	2.13	The small addition relates mainly to capital expenditure on airborne sea fisheries protection patrols in 1986–87.
<b>Forestry Commission</b>	2.14	The provision remains as planned.
<b>Trade and Industry</b>	2.15	Reductions in the external finance of nationalised industries have been made, principally British Steel and the Post Office.
<b>Export Credits Guarantee Department</b>	2.16	Provision has been substantially increased, mainly due to the higher expected cost of interest support for fixed rate export finance.
<b>Energy</b>	2.17	The increase in 1986–87 relates mainly to the external finance of the National Coal Board and Electricity (England and Wales) and expenditure on the Redundant Mineworkers Payments Scheme.
<b>Employment</b>	2.18	In the Budget, substantial increases in provision for the Youth Training Scheme and the Community Programme were announced. These increases, which are included in the figures in Table 2.2 for Cmnd 9428 as adjusted for Budget changes amounted to about £600 million in 1986–87 and about £785 million in 1987–88. In addition, provision has now been made for an expansion in the Enterprise Allowance Scheme and for extra support for small firms and tourism. Savings result from a number of changes including lower projected expenditure on the Job Release Scheme than previously expected, and from a planned reduction in expenditure from the Redundancy Fund. Compared with the last Public Expenditure White Paper (Cmnd 9428) overall provision for the Department of Employment has been increased by about £600 million in each of 1986–87 and 1987–88 (and these increases have been carried through into 1988–89 for which provision is £180 million higher than for 1987–88).
<b>Transport</b>	2.19	Additional provision is made for capital spending on national and local roads (£37 million in 1986–87 and £52 million in 1987–88 for national roads, and £20 million a year for local roads), and for other local authority capital spending on transport. There are savings on nationalised industries' external finance. Following the new competitive framework for local bus companies (under the Transport Act 1985), and for local airports (as proposed in the White Paper on Airports Policy) these bodies will be treated similarly to nationalised industries and their capital expenditure financed by income, totalling some £39 million, will no longer be classified as public expenditure.
<b>Environment — Housing</b>	2.20	Increased provision is made for capital expenditure on renovating the local authority housing stock and for the effect of revised economic assumptions on housing subsidies. This increase is partly offset by a reduction in provision for other local authority capital and current expenditure, in provision for the Housing Corporation and by a higher forecast of capital receipts.
<b>Environment — PSA</b>	2.21	Extra maintenance and new works have been provided for in the first year.
<b>Environment — Other</b>	2.22	Additional provision has been made for capital and current expenditure by local authorities on local environmental services and for extra expenditure by the Department on the environment and the heritage. These additions are more than offset by an increase in new towns capital receipts. The Government is reviewing the level and effectiveness of assistance for the inner cities. Meanwhile provision for the urban programme remains unchanged.
<b>Home Office</b>	2.23	The net increase is mainly for local authority expenditure on police, probation and magistrates' courts. Additional provision has been made for spending on the prison service, reflecting the growth in the number of prisoners and the increased costs of the prison building programme; on immigration control; and on the fight against drugs.
<b>Lord Chancellor's Department</b>	2.24	The revised figures reflect the increased costs of legal aid and its administration by the Law Society.



- Department of Education and Science** 2.25 Increased provision has been made for local authority expenditure on schools and further education (including money for midday supervision); for student awards; and for science in the research councils and universities. Provision has been made to continue the Engineering and Technology Programme beyond the initial three year period.
- Office of Arts and Libraries** 2.26 A number of changes have been made in the provision for arts and libraries including extra money for the Arts Council to help sustain funding of the arts in the period following the abolition of the GLC and Metropolitan County Councils.
- Health and Personal Social Services** 2.27 Provision for the Health Service has been increased above the level described in Cmnd 9428, by £250 million in 1986–87 and by £300 million in 1987–88. Health authorities' cost improvement programmes are expected to grow above the estimated £150 million they plan to achieve in 1985–86. From within the total additional resources in 1986–87, health authorities will be expected to meet pay and price increases, to provide for more old people and to improve services. Planned provision for the Family Practitioner Services has been increased to allow for expected levels of demand; some charges will be raised. Provision for personal social services has also been increased.
- Social Security** 2.28 The provision reflects the latest estimates of benefit expenditure over the Survey period, and allows for upratings of benefits in July 1986, April 1987 and April 1988, on the basis of the assumed rise in prices over the relevant periods. The main policy changes will be those flowing from the Social Security Review on which a White Paper will be published shortly. The provision for 1987–88 and 1988–89 is accordingly subject to adjustment in the light of decisions yet to be taken on that Review.
- 2.29 For the purpose of these estimates, it has been assumed that the RPI will rise by 1 per cent between May 1985 and January 1986, by a further 2½ per cent by September 1986 and by 3½ per cent in the year to September 1987. The actual upratings of individual benefits will be announced when the relevant RPI figures are known.
- Scotland, Wales and Northern Ireland** 2.30 The net changes in these programmes in part reflect changes in comparable programmes in England. The Secretaries of State have discretion to allocate this expenditure taking account of local factors. The Scottish provision for 1986–87 also includes around £150 million for capital spending by the South of Scotland Electricity Board on the Torness Power Station.
- Chancellor's Departments** 2.31 Additional provision relates mainly to increased work of the revenue departments to combat drug abuse and prevent fraud; and expenditure on computers and staff to deal with increased work loads, especially work arising from higher levels of self employment.
- Other Departments** 2.32 Most of the additional provision is to cover the cost of the new Crown Prosecution Service. Allowance has also been made for higher running costs of the House of Commons and the House of Lords.

### **Nationalised Industries**

- 2.33 External Financing Limits (EFLs) for nationalised industries in 1986–87 are set out in Table 2.3. Overall, there is an increase from provision in Cmnd 9428 of £450 million in expected external financing requirements. This reflects a number of changes but is primarily the result of additional requirements for the National Coal Board and the Electricity Supply Industry. Table 2.2A shows nationalised industry external finance that is included in Departments' plans. Some overall reduction is expected in 1987–88 and 1988–89 compared to 1986–87.



**Table 2.3 External financing limits for the nationalised industries (1986-87)**

	£ million <sup>(1)</sup>
National Coal Board	730 <sup>(2)</sup>
Electricity (England and Wales)	-1 416
North of Scotland Hydro-Electric Board	-4
South of Scotland Electricity Board	236
British Steel Corporation	146
Post Office	-93
National Girobank	-6
British Airports Authority	15
British Railways Board	771
British Waterways Board	45
National Bus Company	-13
Scottish Transport Group	4
British Shipbuilders	73
Civil Aviation Authority	14
Water (England and Wales)	123
London Regional Transport	304
Other industries <sup>(3)</sup>	-400
<b>Total</b>	<b>529</b>

<sup>(1)</sup> Figures are shown rounded to the nearest £1 million.

<sup>(2)</sup> This figure is provisional and will be reviewed.

<sup>(3)</sup> Allowance for British Gas Corporation and British Airways which are expected to be privatised during 1986-87. Actual outturn will depend on decisions yet to be taken about the timing and circumstances of privatisation. No formal EFL is being set for either industry.

### Local Authorities

- 2.34 In 1985-86 local authorities in Great Britain have budgeted to exceed Cmnd 9428 provision for current expenditure relevant for Rate Support Grant by around £1 billion. For 1986-87 the Government has increased provision by nearly £600 million to £26.6 billion.
- 2.35 For 1986-87, aggregate exchequer grant to local authorities has been set at the same level in England as in 1985-86 (before holdback and penalties), with small increases in Scotland and Wales. In England and Wales the Government has announced that it will no longer set expenditure targets. It will be using tougher block grant mechanisms to encourage restraint in expenditure. In Scotland the system of guidelines and penalties will be retained.
- 2.36 No decision has been taken on provision for 1987-88 and 1988-89. The figures for those years shown in Table 2.2B and included in departmental totals in Table 2.2 therefore repeat those for 1986-87. They will be reconsidered in the 1986 Survey in the light of local authorities' budgets for 1986-87 and other factors. Account has been taken of this in setting the level of the Reserves.
- 2.37 Local authority capital expenditure is included within the totals for departmental expenditure in Table 2.2 and Table 2.2C. For 1985-86, local authority capital spending is forecast to be £3.7 billion and exceed Cmnd 9428 provision by some £600 million, but the position remains uncertain. Plans for spending in 1986-87 and 1987-88 have been increased to £3.7 billion and £3.9 billion and the new figure for 1988-89 is £4 billion. This means that spending will continue at or above the level of the forecast outturn for 1985-86.

### Reserves

- 2.38 The plans include Reserves of £4½ billion in 1986-87, £6¼ billion in 1987-88 and £8 billion in 1988-89. The Reserves will be available to meet contingencies not covered elsewhere in the plans, including estimating changes.



## Privatisation

- 2.39 Net proceeds from privatisation are estimated to increase to £4½ billion in each of the three years, reflecting an expansion of the Government's programme. Receipts from the sale of British Gas Corporation are now included.

**Table 2.4 Public expenditure trends excluding special sales of assets**

	Planning total (£ billion) <sup>(1)</sup>		General government expenditure as % of GDP <sup>(3)</sup>
	Cash	Real terms <sup>(2)</sup> (base year 1984-85)	
1978-79	65.7	117.4	43
1979-80	78.0	119.1	44
1980-81	93.1	119.8	46
1981-82	104.6	122.2	46
1982-83	113.9	124.4	47
1983-84	121.5	126.9	46
1984-85	131.8	131.8	46
1985-86	136.7	130.2	45
1986-87	143.9	131.1	44
1987-88	148.7	130.9	43
1988-89	153.5	131.2	42

<sup>(1)</sup> Figures up to 1985-86 are outturn; for 1986-87 onwards they are plans.

<sup>(2)</sup> Cash figures adjusted for general inflation as measured by the GDP deflator at market prices—base year 1984-85. The GDP deflator is assumed to increase by some 5 per cent in 1985-86, and by 4½, 3½ and 3 per cent respectively in the years 1986-87 to 1988-89.

<sup>(3)</sup> General government expenditure as defined in the national accounts and presented in the MTFS. The background to the use of general government expenditure in this ratio was set out in Economic Trends, August 1985. Table 1.9 shows the relationship between general government expenditure and the public expenditure planning total.

**Chart 2.1**

### Public expenditure trends

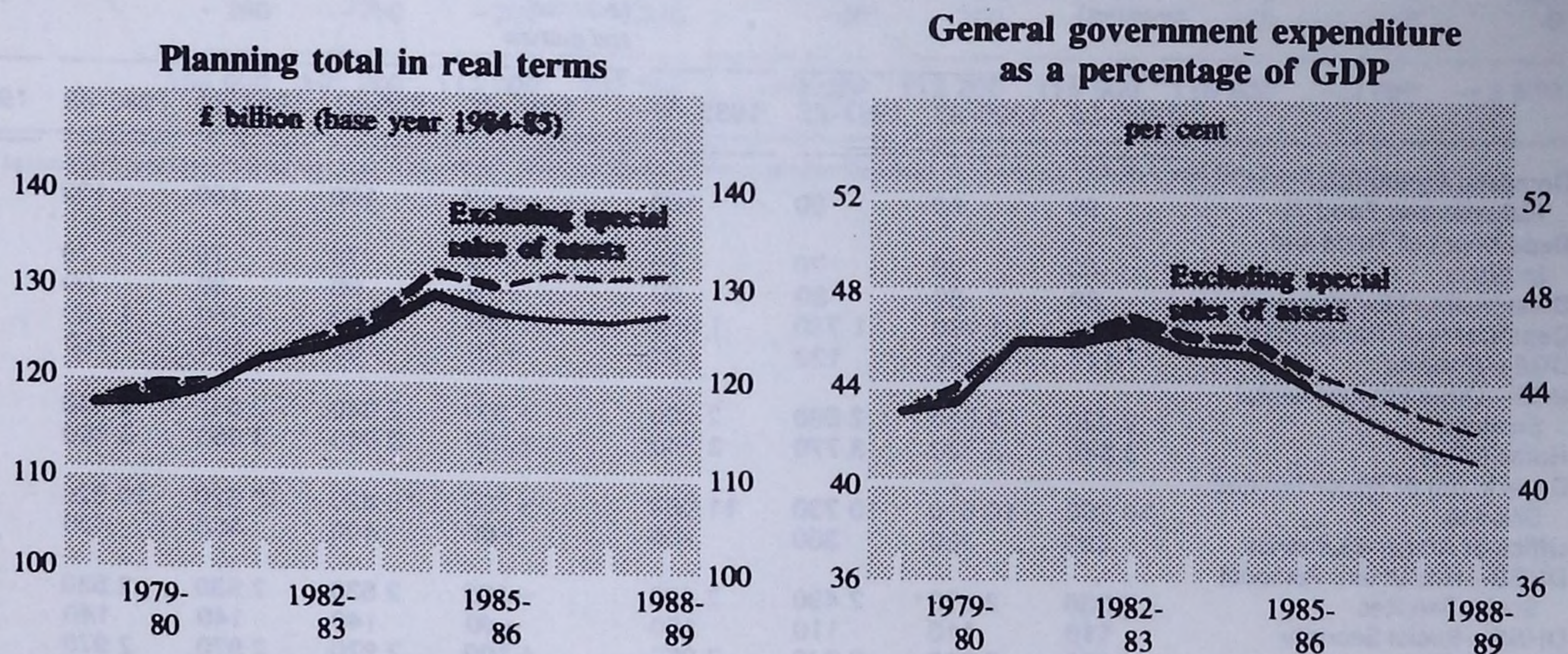




TABLE 2.2A. Nationalised industry external finance provided for by department

£ million

	White Paper (Cmnd 9428 adjusted for Budget measures)			Estimated outturn	Changes between Cmnd 9428 (adjusted) and outturn	Plans				Changes between Cmnd 9428 (adjusted) and plans	
	1985-86	1986-87	1987-88			1985-86	1985-86	1986-87	1987-88	1988-89	1986-87
Ministry of Defence	10	—	—	10	0	—	—	—	—	—	—
Domestic Agriculture, Fisheries and Food <sup>(1)</sup>	10	10	10	10	0	10	10	10	0	0	
Department of Trade and Industry <sup>(2)</sup>	320	190	130	470	+150	120	70	-70	-70	-70	
Department of Energy	-760	-1 540	-1 490	200	+960	-690	-1 140	-880	+850	+350	
Department of Transport <sup>(3)</sup>	1 260	1 130	1 080	1 050	-250	1 090	1 080	990	-40	0	
DOE—Other Environmental Services	210	140	40	230	+10	140	30	30	0	0	
Scotland <sup>(4)</sup>	250	130	10	260	+20	240	0	-120	+110	-10	
Wales <sup>(5)</sup>	30	20	10	30	0	20	10	10	0	0	
Adjustments <sup>(6)</sup>	—	—	—	—	—	-400	—	—	-400	—	
<b>Total</b>	<b>1 320</b>	<b>80</b>	<b>-200</b>	<b>2 250</b>	<b>+900</b>	<b>530</b>	<b>70</b>	<b>-30</b>	<b>+450</b>	<b>+270</b>	

## Notes:

(1) All Ministry of Agriculture, Fisheries and Food.

(2) Includes all receipts from Post Office in respect of prepaid envelopes.

(3) The Department of Transport figures for 1985-86 Cmnd 9428 (adjusted) and outturn include public expenditure which is both local authority relevant current spending and nationalised industries' external finance. The sums involved are about £130 million and £120 million for Cmnd 9428 adjusted and estimated outturn respectively. In 1986-87 and subsequent years the public expenditure figures count this money as local authority relevant only.

(4) As for footnote (3); the sums involved are £40 million for both Cmnd 9428 adjusted and estimated outturn.

(5) As for footnote (3); the sums involved are £10 million for both Cmnd 9428 adjusted and estimated outturn.

(6) Adjustment in 1986-87 is in respect of BGC and BA which are due to be privatised during that year (see footnote (3) to Table 2.3).

TABLE 2.2B. Local authority relevant current expenditure provided for by department

£ million

	White Paper (Cmnd 9428 adjusted for Budget measures)			Estimated outturn	Changes between Cmnd 9428 (adjusted) and outturn	Plans				Changes between Cmnd 9428 (adjusted) and plans	
	1985-86	1986-87	1987-88			1985-86	1985-86	1986-87	1987-88	1988-89	1986-87
Domestic Agriculture, Fisheries and Food <sup>(1)</sup>	90	90	90	100	+10	100	100	100	+10	+10	
Department of Trade and Industry	60	70	70	70	+10	70	70	70	0	0	
Department of Employment	80	80	80	90	+10	90	90	90	+10	+10	
Department of Transport <sup>(2)</sup>	1 540	1 760	1 730	1 800	+250	1 750	1 750	1 750	-10	+20	
DOE—Housing	110	120	120	130	+20	150	150	150	+30	+30	
DOE—Other Environmental Services	2 420	2 570	2 590	2 600	+200	2 640	2 640	2 640	+70	+50	
Home Office	3 580	3 730	3 770	3 750	+150	3 860	3 860	3 860	+130	+90	
Department of Education and Science	10 260	10 610	10 730	11 000	+700	10 820	10 820	10 820	+210	+90	
Office of Arts and Libraries	350	380	380	400	+60	400	400	400	+20	+10	
DHSS—Health and Personal Social Services	2 330	2 470	2 490	2 400	+100	2 530	2 530	2 530	+60	+40	
DHSS—Social Security	110	110	110	150	+40	140	140	140	+30	+30	
Scotland <sup>(2)</sup>	2 850	2 910	2 940	2 950	+100	2 970	2 970	2 970	+60	+30	
Wales <sup>(2)</sup>	1 120	1 150	1 190	1 150	0	1 160	1 160	1 160	+10	-30	
Adjustments	590	—	—	—	-590	—	—	—	—	—	
<b>Total<sup>(3)</sup></b>	<b>25 490</b>	<b>26 030</b>	<b>26 300</b>	<b>26 550</b>	<b>+1 050</b>	<b>26 680</b>	<b>26 680</b>	<b>26 680</b>	<b>+630</b>	<b>+390</b>	

## Notes:

(1) All Ministry of Agriculture, Fisheries and Food except for less than £1 million in each year. These sums are Welsh Office Agricultural Department provision (also in the total for Wales).

(2) Includes nationalised industries external finance described in footnotes (3), (4) and (5) to Table 2.2A together with the sums involved.

(3) Excludes double counting referred to in footnote (1).



Table 2.2C Other departmental spending

£ million

Departments (excluding local authority relevant current expenditure and nationalised industries' external finance)	White Paper (Cmnd 9428 adjusted for Budget measures)			Estimated outturn	Changes between Cmnd 9428 (adjusted) and outturn	Plans				Changes between Cmnd 9428 (adjusted) and plans	
	1985-86	1986-87	1987-88			1985-86	1985-86	1986-87	1987-88	1988-89	1986-87
Ministry of Defence	18 050	18 520	18 820	18 200	+200	18 520	18 820	18 990	0	0	
FCO—ODA	1 260	1 300	1 320	1 250	0	1 320	1 350	1 390	+20	+30	
FCO—Other	610	600	620	620	+10	640	660	700	+40	+40	
European Community	750	640	830	800	+50	650	1 150	950	+10	+320	
IBAP and other CAP expenditure	1 440	1 280	1 300	1 900	+450	1 550	1 640	1 670	+270	+340	
Domestic Agriculture, Fisheries and Food	750	710	700	760	+20	720	710	720	+10	+10	
Forestry Commission	50	50	50	50	0	50	50	60	0	0	
Department of Trade and Industry	1 110	1 120	950	1 100	0	1 100	950	940	-20	0	
Export Credits Guarantee Department	130	80	-40	340	+210	280	170	100	+200	+210	
Department of Energy	690	600	610	820	+130	800	580	590	+200	-30	
Department of Employment	3 290	3 750	3 940	3 250	-50	3 670	3 730	3 910	-80	-210	
Department of Transport	1 870	1 950	1 990	1 800	-50	1 980	2 020	2 090	+30	+30	
DOE—Housing	2 160	2 410	2 510	2 550	+400	2 610	2 690	2 730	+200	+180	
DOE—Property Services Agency	-100	-100	-110	-110	-10	-90	-110	-110	+10	0	
DOE—Other Environmental Services	810	860	870	1 100	+300	840	850	880	-20	-20	
Home Office	1 010	1 060	1 100	1 000	0	1 100	1 150	1 190	+40	+50	
Lord Chancellor's Department	540	570	610	540	0	590	650	700	+20	+40	
Department of Education and Science	3 340	3 420	3 510	3 450	+150	3 510	3 590	3 660	+90	+80	
Office of Arts and Libraries	290	330	340	300	+10	340	350	360	+10	+10	
DHSS—Health and Personal Social Services	14 160	14 950	15 620	14 300	+100	15 200	15 920	16 610	+250	+300	
DHSS—Social Security	39 930	41 540	43 550	41 100	+1 100	42 800	44 300	45 800	+1 260	+750	
Civil Superannuation	1 070	1 110	1 230	1 050	0	1 180	1 310	1 400	+70	+80	
Scotland	4 100	4 300	4 370	4 200	+100	4 330	4 420	4 570	+30	+50	
Wales	1 600	1 710	1 730	1 650	+50	1 730	1 760	1 820	+20	+30	
Northern Ireland	4 250	4 460	4 600	4 300	+50	4 520	4 690	4 820	+60	+90	
Chancellor's Departments	1 750	1 850	1 870	1 800	+50	2 010	2 050	2 070	+160	+180	
Other Departments	360	380	400	350	-10	450	460	470	+70	+60	
Adjustments <sup>(1)</sup>	-260	-250	-250	-300	-40	-250	-250	-260	0	0	
<b>Total</b>	<b>105 000</b>	<b>109 200</b>	<b>113 000</b>	<b>108 100</b>	<b>+3 000</b>	<b>112 200</b>	<b>115 500</b>	<b>118 600</b>	<b>+2 900</b>	<b>+2 500</b>	

<sup>(1)</sup> Double counting of agricultural spending in Scotland and Wales which is also included in the totals for Domestic Agriculture, Fisheries and Food and IBAP etc.



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## 3. National Insurance Contributions

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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 order, laid on 12 November 1985 with an accompanying report by the Government Actuary. The main proposals are as follows:

- The Class 1 insurance rates for employers and employees should remain unchanged for 1986–87.
- The lower earnings limit should be uprated, from April 1986, from the present level of £35.50 a week to £38 a week in line with the single rate retirement pension.
- The upper earnings limit should be correspondingly increased from £265 a week to £285 a week.
- The earnings limits for the reduced rate brackets should be similarly uprated from £55, £90 and £130 a week to £60, £95 and £140 a week.

This would give the following structure of national insurance contributions:

Weekly earnings	Percentage NIC rate on all earnings	
	Employees	Employers
Below £38	(No NICs payable)	
£38 to £59.99	5	5
£60 to £94.99	7	7
£95 to £139.99	9	9
£140 to £285	9	10.45
Above £285	9 on £285	10.45

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:

- The number of unemployed (GB, excluding school leavers etc) averages 3.05 million in 1985–86 and 3 million in 1986–87. (3 million has also been assumed for 1987–88 and 1988–89 in the estimates of social security spending shown in Part 2).
- The increase in average earnings is expected to decline from about 8 per cent between tax year 1984–85 and 1985–86 to about 7 per cent between tax years 1985–86 and 1986–87.
- Benefits will be uprated in July 1986 on the basis of the increase in the RPI over the eight months ending in January 1986. This is consistent with the proposal in the Green paper “Reform of Social Security” (Cmnd 9517), that the annual uprating of benefits should move to the beginning of April and that as an interim measure, the uprating due in November 1986 would be brought forward to July 1986.



The RPI is forecast to be 5½ per cent higher in the last quarter of 1985, than a year earlier, and it is assumed that that same level holds for January 1986. On that basis the movement in prices over the eight months to January 1986 would be of the order of 1 per cent.

3.03 The estimated effects of the proposed changes are shown in the table below.

**Table 3.1 Estimated total payments by employers and employees of national insurance contributions in 1985–86 and 1986–87<sup>(1)</sup>**

	Great Britain (£ million)		
	Employers	Employees	Total
National insurance contributions			
1985–86 <sup>(2)</sup>	11 420	10 670	22 090
1986–87	12 110	11 460	23 570
<b>Total change</b>	<b>+ 690</b>	<b>+ 790</b>	<b>+ 1 480</b>
<i>of which:</i>			
Change in contributions from increased earnings, etc <sup>(3)</sup>	+ 900	+ 870	+ 1 770
Change in contributions from full year effect of 1985 Budget measures <sup>(4)</sup>	– 50	– 170	– 220
Change in contributions from increase in earnings limits	– 160	+ 90	– 70

<sup>(1)</sup> 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, Rating) Order 1985. 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.

<sup>(2)</sup> Excludes £30 million national insurance surcharge receipts, paid in respect of liabilities which accrued in the tax year 1984–85.

<sup>(3)</sup> Including population and employment changes.

<sup>(4)</sup> The difference between the full year effect of the measures in 1986–87 and the part year effect in 1985–86.



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## 4. The Revenue Effects of Illustrative Tax Changes

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- 4.01 The tables below show various illustrative tax changes and estimates of their direct revenue effects. Estimates are given of the effect on taxpayers' liabilities (full year effect) and of the effect on receipts of tax in 1986–87 (first year effect).
- 4.02 The effect of tax changes depends on economic variables, such as prices, earnings and consumer expenditure. The estimates shown are consistent with the economic forecast given in Part 1.
- 4.03 An illustrative rate of inflation of  $5\frac{1}{2}$  per cent has been used to show the effects of indexation and revalorisation. This is in line with the annual rate of increase in the RPI forecast for the fourth quarter of 1985.
- 4.04 The tables show estimates of the *direct* effects of tax changes. In practice, tax changes will themselves affect economic variables, which in turn will have further effects on tax yields and on the PSBR. The estimated direct effect is not, therefore, the same as the effect on the PSBR. The approach used here to estimate the direct effect of tax changes is explained in note (a) to Table 4.2 of the Financial Statement and Budget Report published in March 1985.

### **Indexation of Allowances, Thresholds and Bands for 1986–87**

- 4.05 Tables 4.1 to 4.3 show tax allowances, thresholds, and bands for 1986–87 after  $5\frac{1}{2}$  per cent indexation. Rounding follows the rules laid down in the 1980 Finance Act for income tax and the 1982 Finance Act for capital transfer tax and capital gains tax. Estimates of the revenue effects of these changes are shown in Table 4.4.



**Table 4.1 Income tax**

	1985-86	1986-87
	£	£
<b>Allowances</b>		
Single and wife's earned income allowance	2 205	2 335
Married allowance	3 455	3 655
Additional personal and widow's bereavement allowance	1 250	1 320
Single age allowance	2 690	2 840
Married age allowance	4 255	4 495
Aged income limit	8 800	9 300
<b>Income tax rates</b>		
	<b>Bands of taxable income</b>	
Per cent	1985-86	1986-87
	£	£
30	0-16 200	0-17 100
40	16 201-19 200	17 101-20 300
45	19 201-24 400	20 301-25 800
50	24 401-32 300	25 801-34 200
55	32 301-40 200	34 201-42 600
60	over 40 200	Over 42 600

**Table 4.2 Capital transfer tax**

Rate on death	Lifetime rate	Bands of chargeable value	
Per cent	Per cent	1985-86	1986-87
		£'000	£'000
Nil	Nil	0-67	0-71
30	15	67-89	71-94
35	17½	89-122	94-129
40	20	122-155	129-164
45	22½	155-194	164-205
50	25	194-243	205-257
55	27½	243-299	257-316
60	30	over 299	over 316

**Table 4.3 Capital gains tax**

	1985-86	1986-87
	£	£
Annual exempt amount:		
Individuals	5 900	6 300
Trusts	2 950	3 150

**Table 4.4 Costs of indexation**

£ million at forecast 1986-87 prices, incomes and capital values

	First year cost	Full year cost
Indexation of income tax allowances and thresholds	1 115	1 425
Of which:		
Increases in main personal allowances	1 000	1 245
Increase in the basic rate limit <sup>(1)</sup>	75	95
Increases in further higher rate thresholds <sup>(1)</sup>	40	85
Indexation of capital transfer tax thresholds and bands	15	45
Indexation of capital gains exempt amounts	Nil	10

<sup>(1)</sup> Additional costs after previous changes have been introduced.



### Direct Revenue Effects of Illustrative Changes in Income Tax and Corporation Tax

- 4.06 Table 4.5 shows estimates of the direct revenue effects of illustrative changes in income tax and corporation tax. For income tax allowances and thresholds, these assume that the previous year's levels have been indexed. The estimates show the additional cost of making each change on top of indexation.
- 4.07 Estimated revenue effects are rounded, generally to the nearest £1m or £5m. It should not be assumed, however, that they are accurate to this degree.
- 4.08 Effects of other sizes of tax changes can be estimated by assuming linearity over a reasonably wide range. For example, the cost or yield of a change in an allowance of £200 will be approximately twice the level for £100. The cost of increasing higher rate thresholds, however, is less linear; the extra costs tend to reduce as the thresholds rise. For this reason, effects are given for both 1 per cent and 10 per cent changes in higher rate thresholds and for both increasing and decreasing thresholds.
- 4.09 The total cost of a group or package of income tax allowance changes can be broadly assessed by adding together the revenue effects for each change. However, if allowances are increased substantially and combined with a reduction in basic or higher rates, the effects of the rate reductions will be reduced. In such cases, the cost or yield obtained by adding components from the ready-reckoner should be considered only as a very general guide.



**Table 4.5 Direct effects of illustrative changes in income tax and corporation tax (1)**

£ million at forecast 1986-87 income levels

	First year cost/yield	Full year cost/yield
<b>Income tax (2)</b>		
<b>Rates</b>		
Change basic rate by 1p (3)	1 125	1 200
Change all higher rates by 1p	50	105
<b>Personal allowances</b>		
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	25	31
Change married age allowance by £100	20	25
Change aged income limit by £200	3	4
Change all main personal allowances by 1 per cent	175	215
Change all main personal allowances by 10 per cent:		
increase (cost)	1 675	2 075
decrease (yield)	1 725	2 150
<b>Higher rate thresholds</b>		
Change all higher rate thresholds by 1 per cent:		
increase (cost)	16	29
decrease (yield)	17	30
Change all higher rate thresholds by 10 per cent:		
increase (cost)	145	265
decrease (yield)	190	335
<b>Allowances and thresholds</b>		
Change all main personal allowances and higher rate thresholds by 1 per cent	190	245
Change all main personal allowances and higher rate thresholds by 10 per cent:		
increase (cost)	1 800	2 325
decrease (yield)	1 950	2 500
<b>Corporation tax (4)</b>		
Change full rate by 1 percentage point	180	310
Change small companies' rate by 1 percentage point (5)	16	30

(1) The estimated revenue effects of changes in the basic rate of income tax and in the main personal allowances of 10 per cent are rounded to the nearest £25m; other effects over £50m are rounded to the nearest £5m; effects of less than £50m are rounded to the nearest £1m.

(2) Changes are from the indexed levels of allowances and thresholds shown in table 4.1. Percentage changes are, however, of 1985-86 levels.

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

(4) 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 1985-86 income levels.

(5) These figures ignore any possible associated changes in the imputation system.



### Indirect Taxes

- 4.10 Figures for changes in 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 5½ per cent, together with the price increase that would result (after allowing for consequential VAT). The second shows the revenue yield from changing current levels of duty so that (after VAT) the price of a typical item is changed by the amount shown.
- 4.11 Table 4.7 shows the revenue effects of a 1 percentage point change in the rate of VAT.
- 4.12 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. 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 at forecast 1986-87 price and income levels)

	Current level of duty on typical item	5½% Revalorisation (¹)		Unit changes from present levels of duty		
		Price change including VAT(²)	Full year yield (³) £m	Price change including VAT(²)	Actual percentage change in duty	Full year yield/cost(³) £m
<b>Indirect Taxes</b>						
Beer (pint)	18.6p	1.2p	95	1p	4.7	80
Wine (70 cl bottle of table wine)	68.6p	4.3p	30	1p	1.3	7
Spirits (bottle)	£4.73	29.9p	40	10p	1.8	15
Tobacco (20 kingsize cigarettes) (⁴)	82.7p	4.5p	140	1p	1.2	35
Petrol (gallon)	81.6p	5.2p	260	1p	1.1	55
Derv (gallon)	68.9p	4.4p	65	1p	1.3	15
VED (cars and light vans)	£100.00	£5.50	110	£1.00	1.0	20

(¹) An 'across the board' revalorisation by 5½ per cent (including the minor duties not shown above) would yield about £785m 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 VED; for beer and tobacco the first year yield would be approximately eleven twelfths of the full year yield; and for wine and spirits, petrol and derv, 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 subsequent increase in *ad valorem* duty and VAT.

**Table 4.7 VAT**

	First year yield/cost(¹)	Full year yield/cost
1% change in rate of VAT	675	925

(¹) Assuming implementation on 1 April.



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