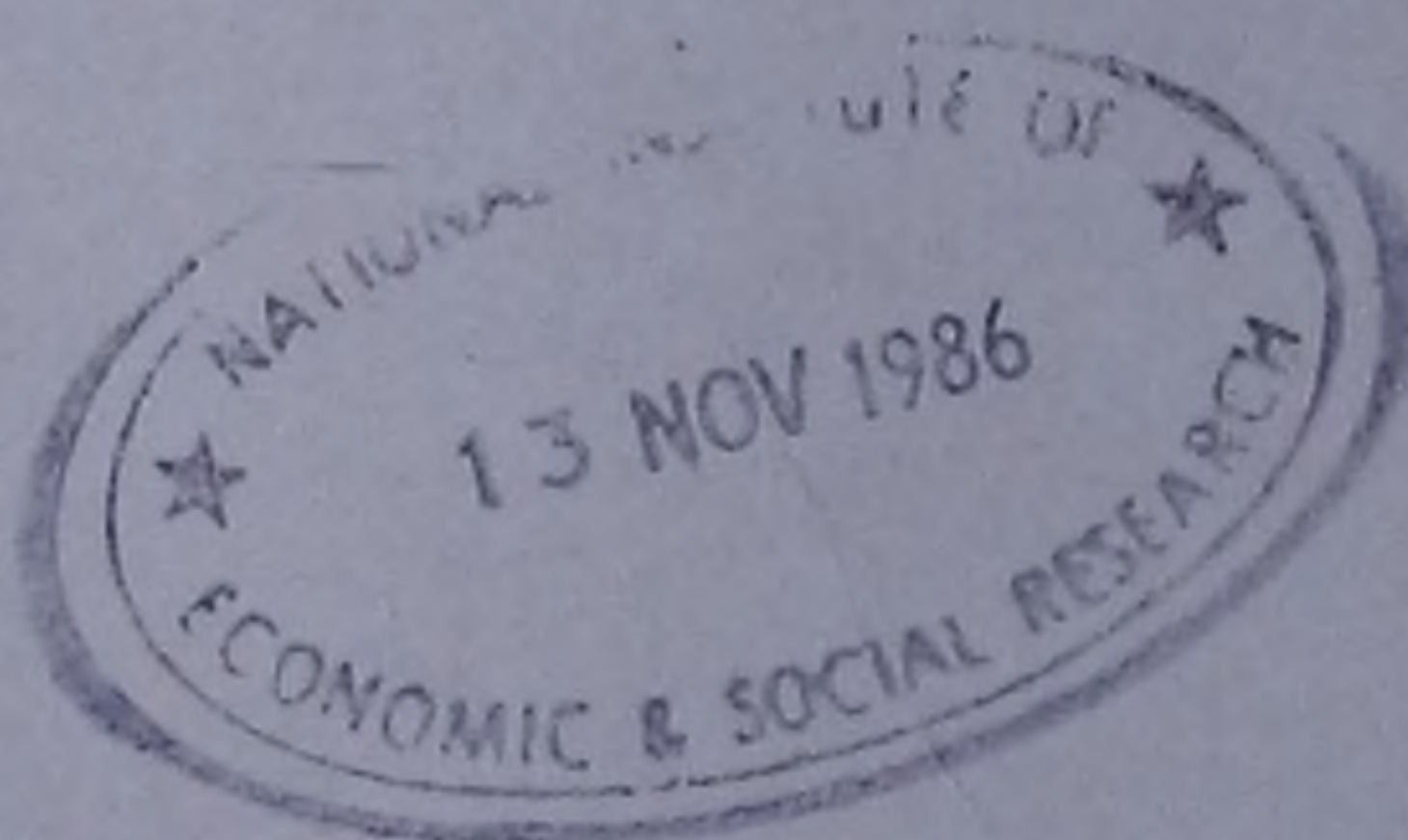


NATIONAL
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Autumn Statement 1986



HM TREASURY
NOVEMBER, 1986



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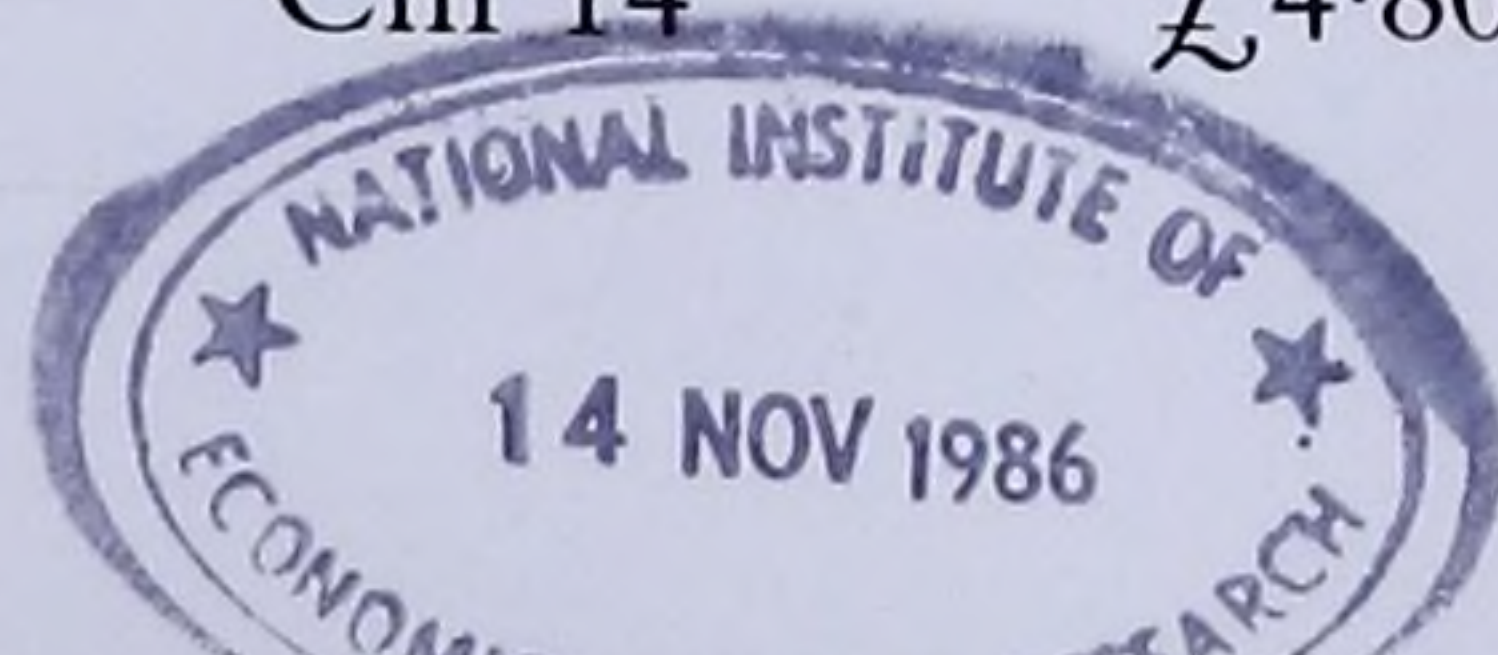
Autumn Statement

1986

*Presented to Parliament by the Chancellor of the Exchequer
by Command of Her Majesty November 1986*

HER MAJESTY'S STATIONERY OFFICE LONDON

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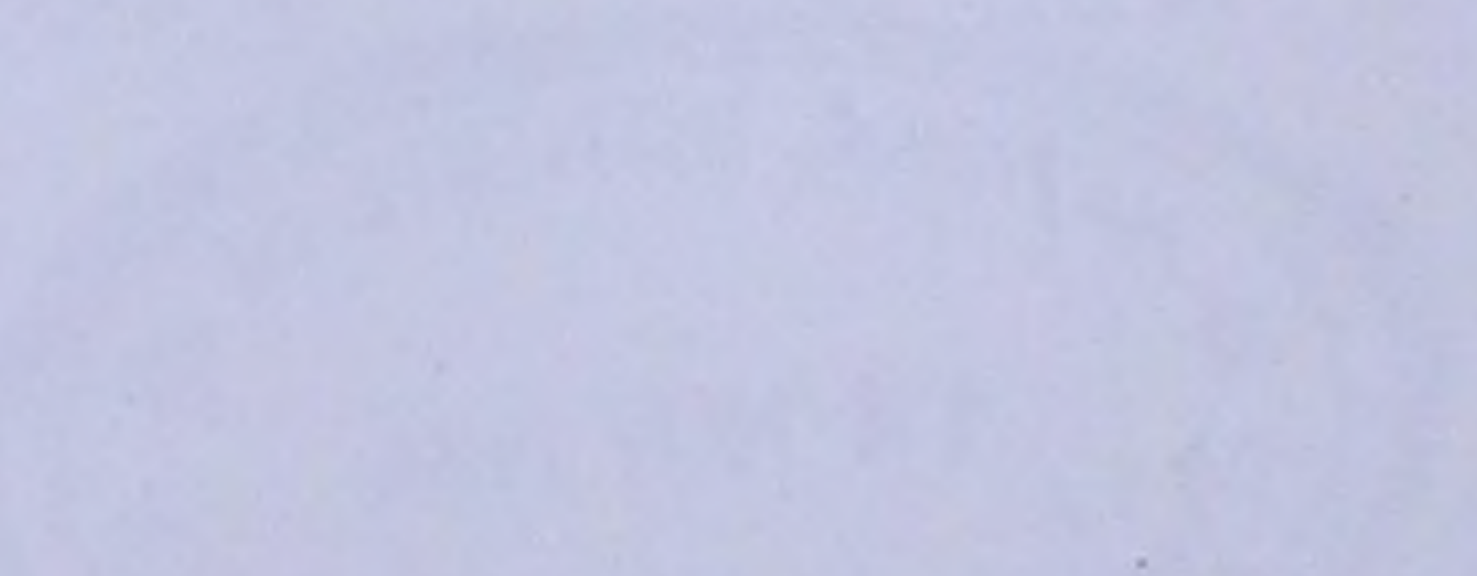


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World economy

1.05 GNP in the major industrial countries has been rising by 2½-3 per cent a year since 1984. Domestic demand has been rising quite strongly over the last year, but a fall in exports to countries outside the OECD area, including OPEC, has held back overall GNP growth and contributed to a large fall in the growth of industrial output. Low inflation seems likely to contribute to the strong growth in domestic demand in most major economies through 1987. While exports to countries outside the OECD area should fall less than this year, industrial growth in particular should pick up. Export markets for UK manufacturers are forecast to grow by about 4½ per cent in 1987, compared to a likely 7 per cent in 1986.

Demand and activity

1.06 UK domestic demand has grown strongly in the last year, but for most of the year sluggish world demand has restrained exports. In 1987 domestic spending is expected to increase at a similar rate to this year and exports to maintain their recent recovery. GDP is likely to rise by close to 3 per cent, with manufacturing output increasing by almost 4 per cent.

Labour market

1.07 Employment has continued to rise with around 200,000 extra jobs in the year to June 1986. Unemployment appears to have stopped rising during the last six months. Prospects for some fall in unemployment are more promising as activity picks up and growth in the labour force slows.

Inflation

1.08 Inflation has fallen this year with the retail prices index (RPI) rising by 2½ per cent in the year to September compared to 5½ per cent in the year to the fourth quarter of 1985. The low rate of inflation is likely to lead to some

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1 Economic prospects for 1987

Summary

1.01 GDP is forecast to grow by 3 per cent in 1987, following growth of $2\frac{1}{2}$ per cent this year. Inflation should remain low: the recent rise in mortgage interest payments will add about half a per cent to RPI inflation for the next year taking it to $3\frac{3}{4}$ per cent in the fourth quarter of 1987.

Assumptions

1.02 The forecast for the UK assumes that fiscal and monetary policies will be as in the Medium Term Financial Strategy (MTFS) in the 1986 Financial Statement and Budget Report (FSBR).

1.03 Total Government borrowing (the PSBR) for 1986–87 is expected to be around £7 billion, as envisaged at the time of the Budget, even after taking account of the proposed change in oil taxation described in Chapter 4. For 1987–88, the forecast assumes, as in the 1986 MTFS, that the PSBR will be $1\frac{3}{4}$ per cent of GDP. The sterling index is assumed to stay at broadly its present level.

1.04 It is assumed that North Sea oil prices average \$15 a barrel over the next year.

World economy

1.05 GNP in the major industrial countries has been rising by $2\frac{1}{2}$ –3 per cent a year since 1984. Domestic demand has been rising quite strongly over the last year, but a fall in exports to countries outside the OECD area, including OPEC, has held back overall GNP growth and contributed to a larger fall in the growth of industrial output. Low inflation seems likely to contribute to the strong growth in domestic demand in most major economies through 1987, while exports to countries outside the OECD area should fall less than this year. Industrial growth in particular should pick up. Export markets for UK manufactures are forecast to grow by about $4\frac{1}{2}$ per cent in 1987, compared to a likely 2 per cent in 1986.

Demand and activity

1.06 UK domestic demand has grown strongly in the last year, but for most of the year sluggish world demand has restrained exports. In 1987 domestic spending is expected to increase at a similar rate to this year and exports to continue their recent recovery. GDP is likely to rise by close to 3 per cent with manufacturing output increasing by almost 4 per cent.

Labour market

1.07 Employment has continued to rise with around 200,000 extra jobs in the year to June 1986. Unemployment appears to have stopped rising during the last six months. Prospects for some fall in unemployment are more promising as activity picks up and growth in the labour force slows.

Inflation

1.08 Inflation has fallen this year with the retail prices index (RPI) rising by 3 per cent in the year to September compared to $5\frac{1}{2}$ per cent in the year to the fourth quarter of 1985. The low rate of inflation is likely to lead to some

reduction in pay settlements. At the end of 1987, RPI inflation is forecast at $3\frac{3}{4}$ per cent, but excluding mortgage interest payments inflation should be much the same as it is now.

Trade and the current account

1.09 The decline in oil prices, coupled with a pause earlier this year in the growth of world trade, means that the current account is likely to be close to balance in 1986. The volume of UK non-oil exports has been growing again, and this should continue in 1987 at a pace reflecting the faster growth in UK markets and the UK's improved competitiveness. At the same time the volume of imports is likely to continue to rise as domestic activity expands. The current account may show a deficit of some £1½ billion next year.

World economy

Recent developments

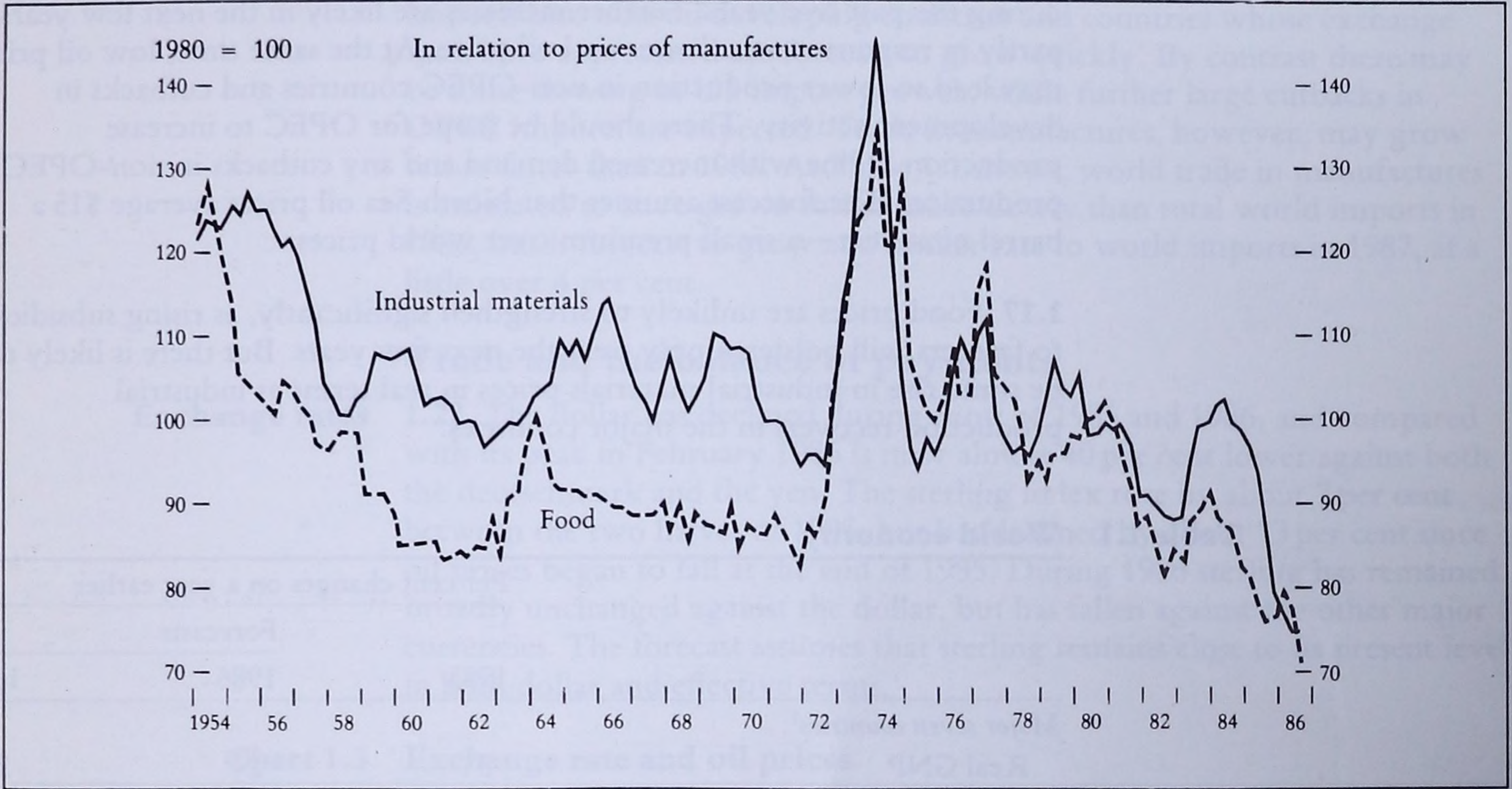
1.10 Real GNP in the major seven OECD economies has been growing at $2\frac{1}{2}$ –3 per cent a year since the end of 1984. Industrial production in 1986 has grown slowly, reflecting the weakness in exports to OPEC and other developing countries.

1.11 In the second quarter of 1986 domestic demand in the seven major countries was about 4 per cent higher than a year earlier. But exports have been weak, while imports have grown rapidly. Both these developments are in part the result of the fall in primary commodity prices and the collapse in oil prices. The producers of oil and other primary commodities have had to reduce their imports while consumers in the industrial countries, enjoying lower inflation and large increases in real incomes, have now started to spend more. Consumer prices in the major economies are now only $1\frac{1}{2}$ –2 per cent higher on average than a year ago; in Japan and Germany they are lower.

1.12 In the US, lower inflation and interest rates have given a further fillip to demand, after one of the longest post-war periods of expansion. Only in recent months has there been any sign of improvement in the trade deficit despite the dollar's decline since March 1985. A number of reasons have been suggested. The strong growth in consumers' expenditure has sucked in imports from abroad. Oil imports have risen to replace high cost domestic production. The dollar has not depreciated significantly against the currencies of some important trading competitors (e.g. Taiwan and Korea). Finally the US has probably been experiencing some of the normal "J-curve" effects of currency movements, which have been exacerbated by the size of the initial trade imbalance—the value of US merchandise imports is half as large again as that of its exports.

1.13 Japan and Germany are both experiencing a contraction in the net external demand for their products as a result of the strength of their currencies and the weaknesses in the developing world. In Germany the growth of consumption has risen, which, together with an investment recovery, has helped to raise the growth of domestic demand and counter the external slowdown. In Japan, however, investment has weakened and real GNP growth has fallen well short of potential. Largely as a result of sharply reduced oil import bills and the initial J-curve effects of their exchange rate appreciations, both countries are seeing large increases in their current account surpluses this year.

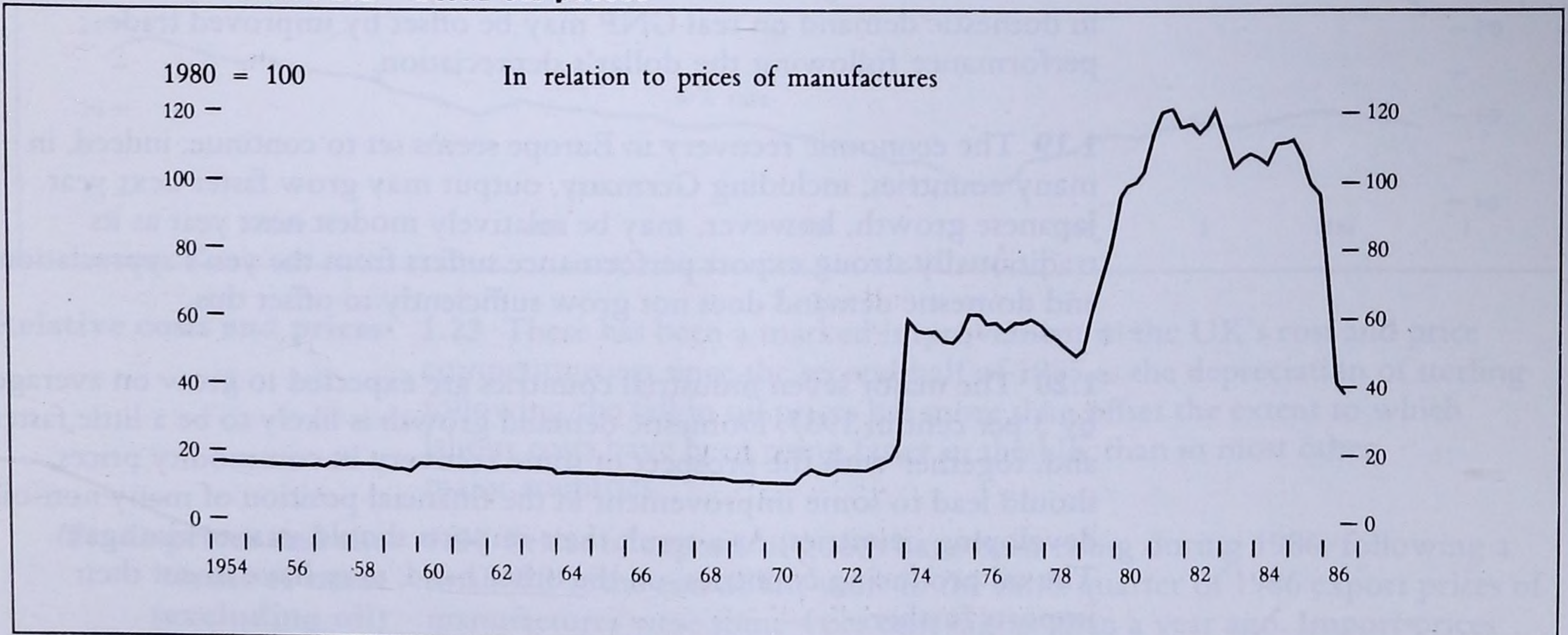
Chart 1.1 Real commodity prices



1.14 Oil prices fluctuated in the \$8–\$15 per barrel range over the summer months, moving towards the top end of the range when OPEC announced a short-term production agreement for September and October—now extended to December. Non-oil commodity prices, particularly food prices, fell during the first half of this year; industrial materials prices reached post-war lows in real terms in mid-1986. Since August the prices of industrial materials have risen slightly. Charts 1.1 and 1.2 show past developments in real non-oil and oil commodity prices.

1.15 World import volumes seem likely to rise by about 4½ per cent in 1986, partly as a result of increased trade in oil. The growth of world trade in manufactures has probably been below the growth of total world imports in 1986.

Chart 1.2 Real oil prices



Prospects 1.16 World oil demand may have increased this year, following the decline during the past five years. Further increases are likely in the next few years partly in response to the lower real oil price. At the same time, low oil prices may lead to lower production in non-OPEC countries and cutbacks in development activity. There should be scope for OPEC to increase production in line with increased demand and any cutbacks in non-OPEC production. The forecast assumes that North Sea oil prices average \$15 a barrel next year—a small premium over world prices.

1.17 Food prices are unlikely to strengthen significantly, as rising subsidies to farmers will bolster supply over the next few years. But there is likely to be some rise in industrial materials prices in real terms as industrial production recovers in the major countries.

Table 1.1 World economy

	Per cent changes on a year earlier		
	1985	Forecasts	
		1986	1987
<i>Major seven countries¹:</i>			
Real GNP	3	2½	3
Industrial production	3	1	4
Exports of goods (volume)	4	2	3
Consumer prices	4	2	2
<i>World trade, at constant prices</i>			
Total imports	3	4½	4
Trade in manufactures ²	4	2	4½

¹ US, Japan, Germany, France, UK, Italy and Canada.

² UK weighted.

1.18 Table 1.1 shows the forecast for world activity and trade, and for consumer price inflation. Low inflation should continue to sustain domestic demand in the major economies. However in the US the combination of a fall in the dollar and an end to the once-and-for-all effects of lower oil prices may lead to a modest rise in inflation. This could contribute to some slowdown in the growth of domestic demand. The effect of a lower growth in domestic demand on real GNP may be offset by improved trade performance following the dollar's depreciation.

1.19 The economic recovery in Europe seems set to continue; indeed, in many countries, including Germany, output may grow faster next year. Japanese growth, however, may be relatively modest next year as its traditionally strong export performance suffers from the yen's appreciation and domestic demand does not grow sufficiently to offset this.

1.20 The major seven industrial countries are expected to grow on average by 3 per cent in 1987. Domestic demand growth is likely to be a little faster and, together with the prospect of some recovery in commodity prices, should lead to some improvement in the financial position of many non-oil developing countries. As a result their imports should start to rise again. The oil producing countries, on the other hand, may have to cut their imports further.

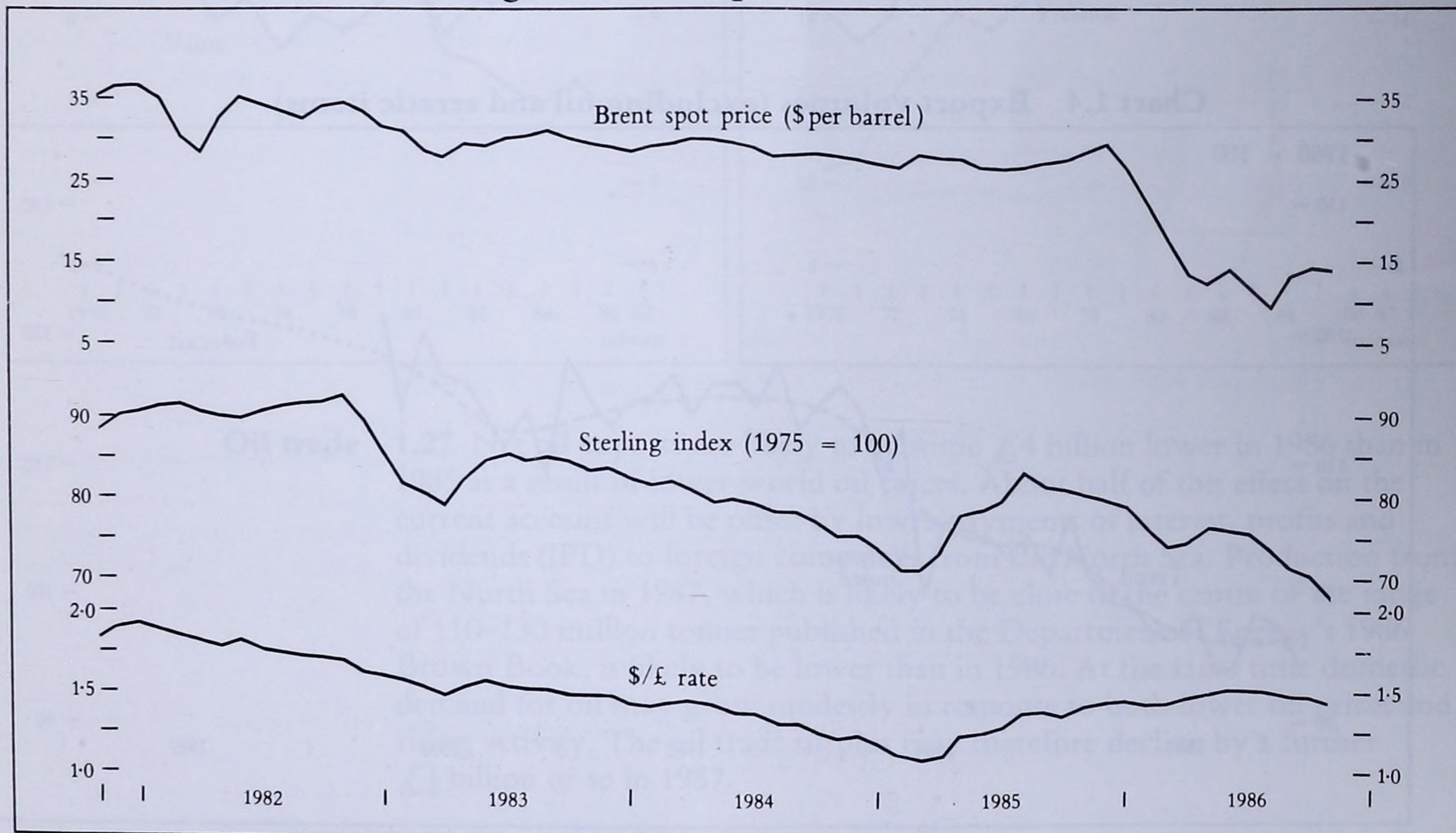
1.21 Growth of total world trade in 1987 may be slightly less than this year. Imports into non-oil developing countries and countries whose exchange rates have appreciated are forecast to grow quickly. By contrast there may be some slowing in US import growth, while further large cutbacks in OPEC imports are expected. Trade in manufactures, however, may grow rather faster than in 1986. As Table 1.1 shows, world trade in manufactures is estimated to have grown rather more slowly than total world imports in 1986, but is forecast to grow at a similar rate to world imports in 1987, at a little over 4 per cent.

Trade and the balance of payments

Exchange rates

1.22 The dollar has declined during most of 1985 and 1986, and compared with its peak in February 1985 is now almost 40 per cent lower against both the deutschmark and the yen. The sterling index rose by about 7 per cent between the two halves of 1985, but has declined by about 13 per cent since oil prices began to fall at the end of 1985. During 1986 sterling has remained broadly unchanged against the dollar, but has fallen against the other major currencies. The forecast assumes that sterling remains close to its present level in both dollar and effective terms.

Chart 1.3 Exchange rate and oil prices



Relative costs and prices

1.23 There has been a marked improvement in the UK's cost and price competitiveness since the second half of 1985 as the depreciation of sterling following the fall in oil prices has more than offset the extent to which labour costs have been rising faster in the UK than in most other major countries.

Trade prices and the terms of trade (excluding oil)

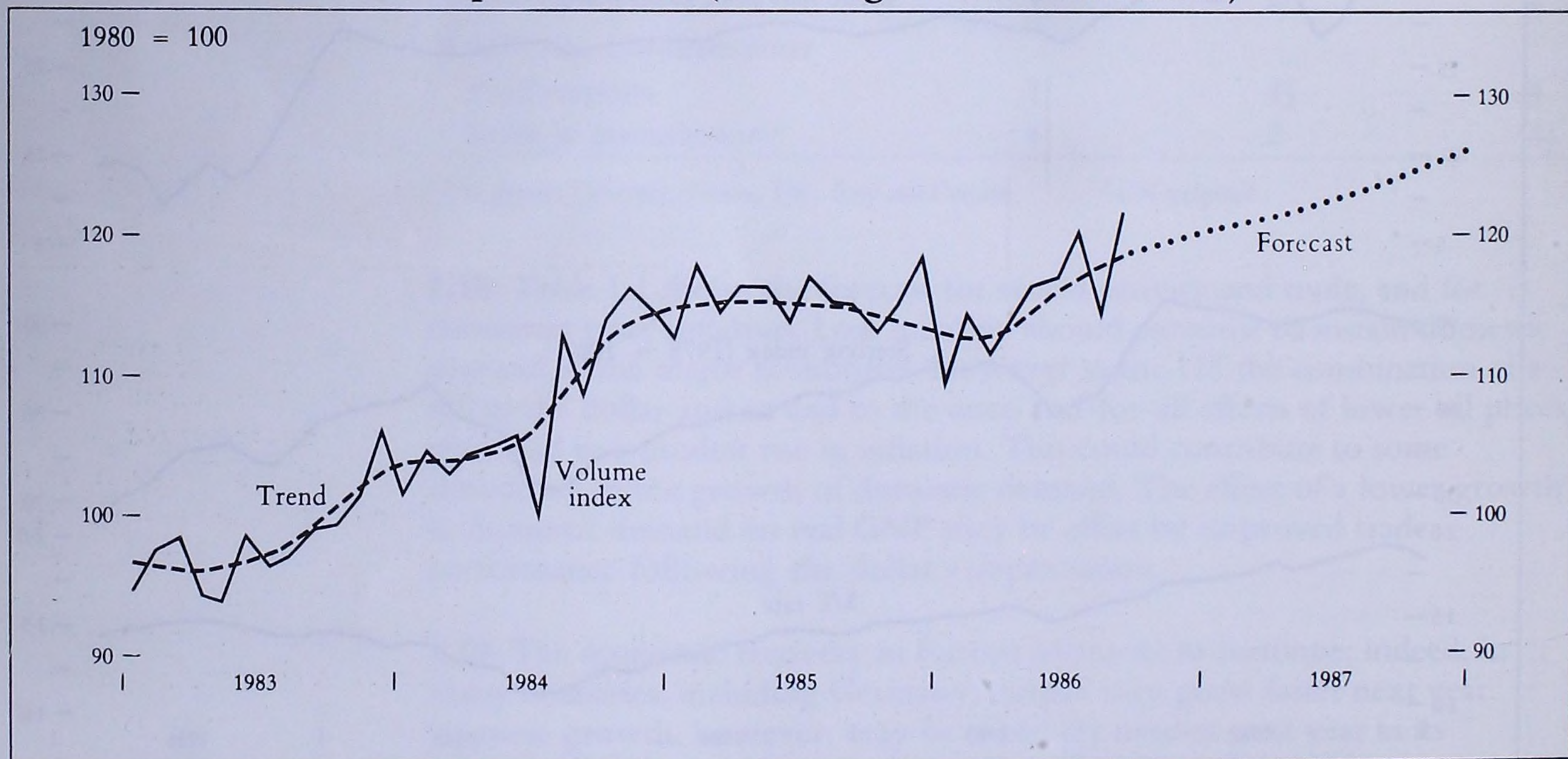
1.24 Prices of exports of goods have been rising during 1986, following a small fall at the end of last year. In the third quarter of 1986 export prices of manufactures were some 4 per cent higher than a year ago. Import prices

were weak until very recently since lower world prices for many commodities offset the effects of sterling's depreciation. The non-oil terms of trade, therefore, have remained relatively steady. They may worsen slightly over the next year as a result of rises in some commodity prices and the recent depreciation of sterling.

Trade volumes (goods other than oil and erratics)

1.25 As Chart 1.5 shows, the share of UK manufactured exports in the volume of world trade has been broadly steady since 1980—following the decline of earlier years. Non-oil export volumes fell in the early months of 1986 when world trade growth was sluggish but have risen again in recent months. In the third quarter of 1986 exports of manufactures were some 3 per cent higher than in the first half of this year. World markets for UK manufactures are expected to grow more rapidly in 1987. This, together with the lagged benefits from this year's gain in competitiveness, suggests that exports should continue to grow steadily. As can be seen from Chart 1.4, a rising trend in UK non-oil exports has been evident since the second quarter of 1986 when world trade began to recover from its slowdown during the winter. The forecast is that a continuation of this trend will bring growth of $5\frac{1}{2}$ per cent between 1986 and 1987—a sharp rise over the 1 per cent growth between 1985 and 1986.

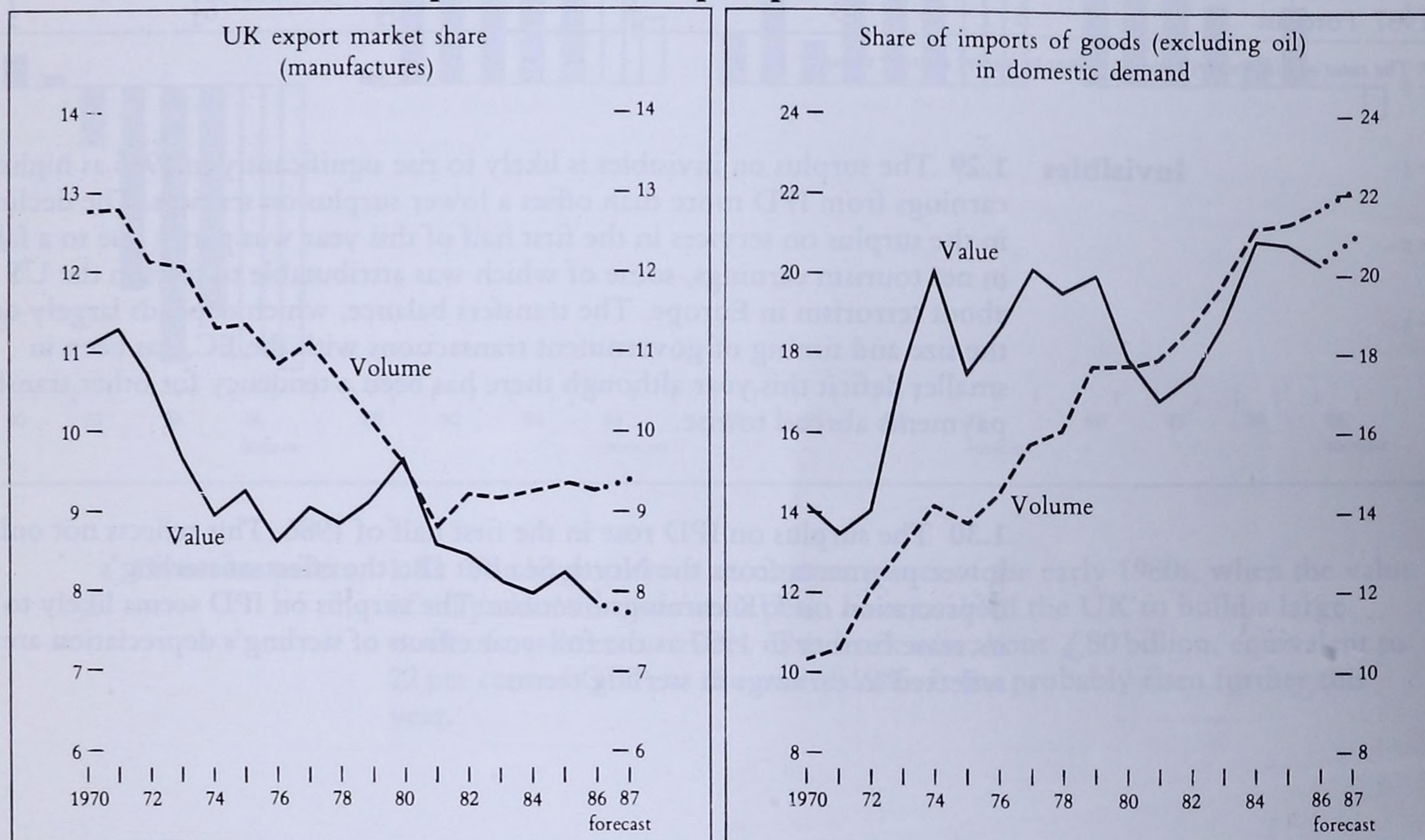
Chart 1.4 Export volumes (excluding oil and erratic items)



1.26 Non-oil imports grew relatively slowly in the first half of this year, but have tended to rise more rapidly in recent months. The volume of imports has risen rather more rapidly than domestic demand, although the increase in import penetration has been less rapid than during some previous periods with similar growth of domestic demand. Manufactured imports rose particularly fast: some $8\frac{1}{2}$ per cent up in the third quarter over the first half of the year. Imports of food have also been unusually high this year as a

result of the poor quality of last year's harvest. Imports seem likely to continue to rise strongly in 1987 as domestic activity expands, although the lower exchange rate together with a return to more normal levels of food imports will tend to slow the rate of growth. Imports of goods are forecast to rise by $6\frac{1}{2}$ per cent in 1987 compared to 5 per cent in 1986.

Chart 1.5 Export share and import penetration



Oil trade 1.27 Net oil exports are likely to be some £4 billion lower in 1986 than in 1985 as a result of lower world oil prices. About half of this effect on the current account will be offset by lower payments of interest, profits and dividends (IPD) to foreign companies from the North Sea. Production from the North Sea in 1987, which is likely to be close to the centre of the range of 110–130 million tonnes published in the Department of Energy's 1986 Brown Book, is likely to be lower than in 1986. At the same time domestic demand for oil may grow modestly in response to both lower oil prices and rising activity. The oil trade surplus may therefore decline by a further £ $\frac{1}{2}$ billion or so in 1987.

Total trade in goods 1.28 Table 1.2 shows the main movements in the terms of trade and trade volumes for both total visible trade and trade excluding oil and erratics. The UK's terms of trade in visible trade have declined in 1986, as a result of lower oil prices, and are forecast to show little overall change next year. The volume of visible exports, which has been recovering in recent months, is forecast to rise further in 1987, although the overall growth will be held back by a lower volume of oil exports. The volume of visible imports, which was almost 5 per cent higher in the first three quarters of 1986 than a year earlier, is forecast to show similar growth in 1987.

Table 1.2 Trade in goods

	Per cent changes on previous year					
	All goods			Goods less oil and erratic items		
	Export volume	Import volume	Terms of trade*	Export volume	Import volume	Terms of trade*
1985	5½	3	1½	7	4	1½
1986 Partly forecast	2	5	-6	1	5	1
1987 Forecast	3	5	½	5½	6½	-½

* The ratio of UK export average values to import average values.

Invisibles 1.29 The surplus on invisibles is likely to rise significantly in 1986 as higher earnings from IPD more than offset a lower surplus on services. The decline in the surplus on services in the first half of this year was partly due to a fall in net tourism earnings, some of which was attributable to fears in the US about terrorism in Europe. The transfers balance, which depends largely on the size and timing of government transactions with the EC, has been in smaller deficit this year although there has been a tendency for other transfer payments abroad to rise.

1.30 The surplus on IPD rose in the first half of 1986. This reflects not only lower payments from the North Sea but also the effect of sterling's depreciation on UK earnings overseas. The surplus on IPD seems likely to increase further in 1987 as the full-year effects of sterling's depreciation are reflected in earnings in sterling terms.

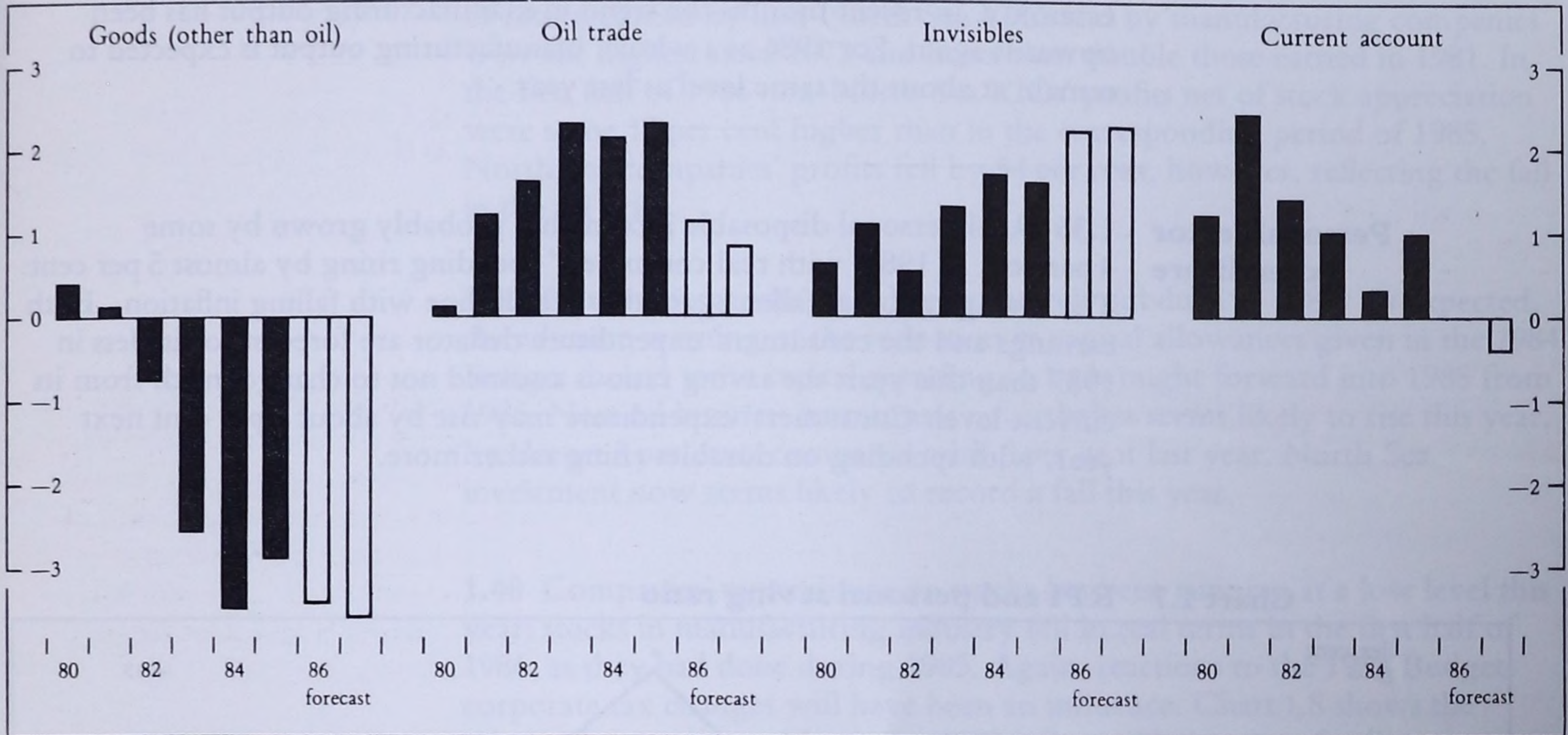
Current account

Table 1.3 Current account

	£ billion				
	Manufactures	Oil	Other goods	Invisibles	Current balance
1985	-3	8	-7½	5½	3½
1986 Partly forecast	-5½	4	-7	8½	0
1987 Forecast	-7½	3½	-6½	9	-1½

1.31 The current balance of payments recorded a deficit in the third quarter of 1986, following a surplus of about £1 billion in the first half of the year; for the year as a whole the forecast is for broad balance. In 1987 the current account is forecast to be in deficit by around £1½ billion. The main factors behind the changes between 1985 and 1986 have been described in paragraphs 1.22 to 1.30 above. Between 1985 and 1986 the fall in the net oil surplus and the increase in the deficit on manufactures more than offset a rise in invisibles. The forecast for 1987 is that with rising world trade and the benefits of improved competitiveness the current account may show no further deterioration from the second half of 1986.

Chart 1.6 The current account of the balance of payments (surpluses and deficits as a per cent of GDP)



Overseas assets 1.32 The large current account surpluses of the early 1980s, when the value of oil production was at its peak, have enabled the UK to build a large stock of net overseas assets. This stock was about £80 billion, equivalent to 22 per cent of GDP, at the end of 1985. It has probably risen further this year.

Demand and activity

1.33 Over the five years since the end of the 1979–81 recession, GDP growth has averaged $2\frac{3}{4}$ per cent a year. After adjusting for the coal strike, GDP grew by $3\frac{1}{2}$ per cent in 1983 and by about 4 per cent in 1984, but slowed down during 1985 as exports weakened. GDP in the first half of 1986 is estimated to have been around 2 per cent higher than in the first half of 1985, and about $1\frac{1}{4}$ per cent higher after excluding the direct effects of the recovery from the coal strike. Economic activity has started to rise more quickly again, at an annual rate of about $2\frac{1}{2}$ per cent over the two most recent quarters.

1.34 Spending by the personal sector has been strong this year. In the first three quarters of 1986 consumers' expenditure was almost 5 per cent higher than a year earlier, and the buoyancy of demand in the housing market has started to show up in higher private residential investment.

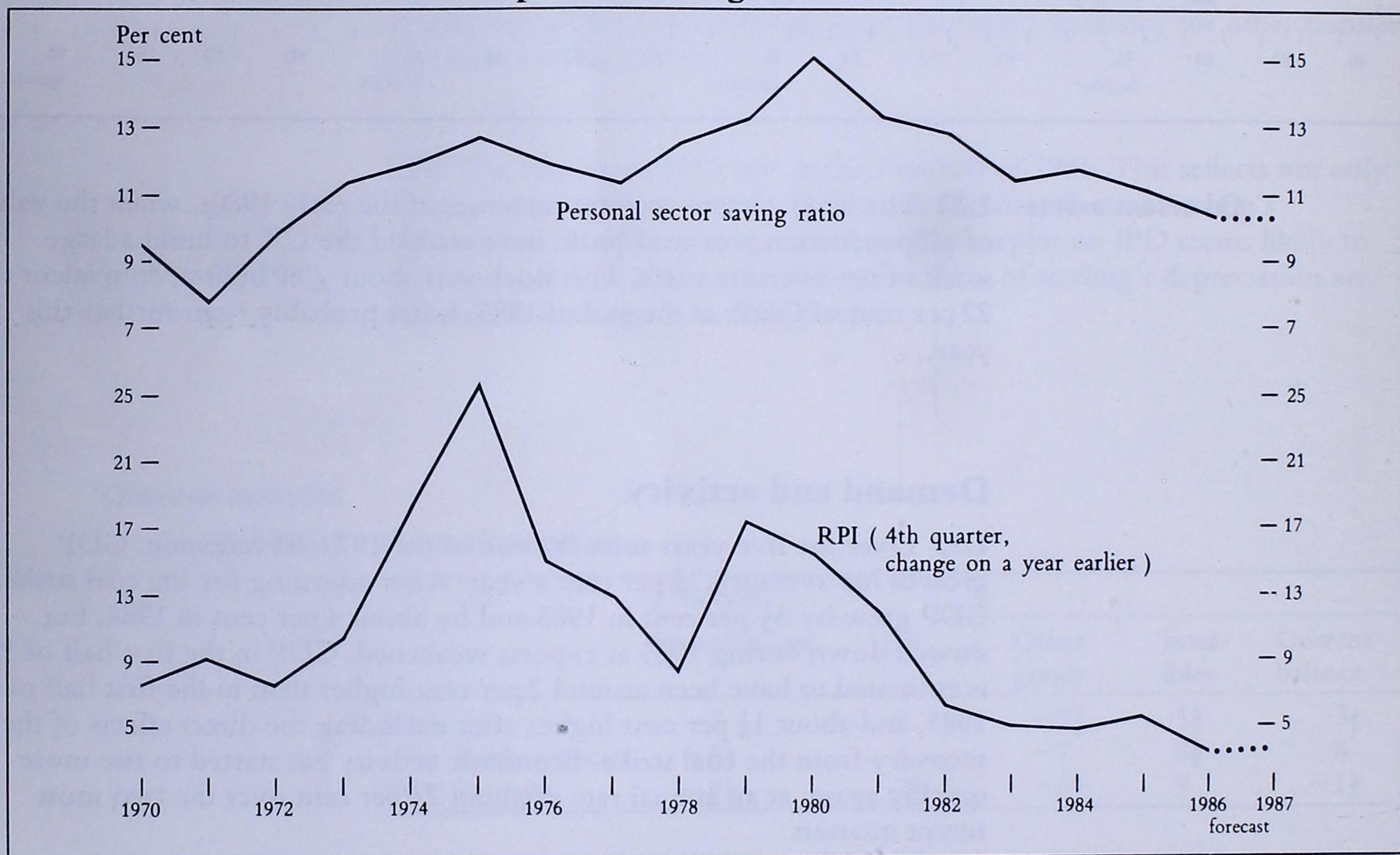
1.35 Output of the service industries (accounting for 56 per cent of the economy's total output in 1985) continues to expand quite rapidly: the estimated $3\frac{1}{2}$ per cent growth over the year to the second quarter of 1986 is only a little less than the growth rate recorded over the previous two years. Manufacturing output is estimated to have fallen by about 1 per cent over

the year to the second quarter of 1986, after a two year period in which output in manufacturing had been expanding faster than the rest of the economy. In recent months the trend in manufacturing output has been upwards again. For 1986 as a whole, manufacturing output is expected to remain at about the same level as last year.

Personal sector expenditure

1.36 Real personal disposable income has probably grown by some 4 per cent in 1986, with real consumers' spending rising by almost 5 per cent. The saving ratio has fallen again this year in line with falling inflation. Both earnings and the consumers' expenditure deflator are forecast to rise less in 1987 than this year: the saving ratio is assumed not to change much from its current level. Consumers' expenditure may rise by about 4 per cent next year, with spending on durables rising rather more.

Chart 1.7 RPI and personal saving ratio



1.37 Increased demand for housing has led to a pick up in house prices over the last year and housebuilding has risen as a result. Private housing starts were about 10 per cent higher in the first three quarters of 1986 than in the same period of 1985. The rise in starts since early 1985 is beginning to show up in the number of houses completed. Spending on improvements to dwellings should continue to reflect the general buoyancy of personal sector demand, so that total private investment in dwellings should show growth of more than 5 per cent both this year and next.

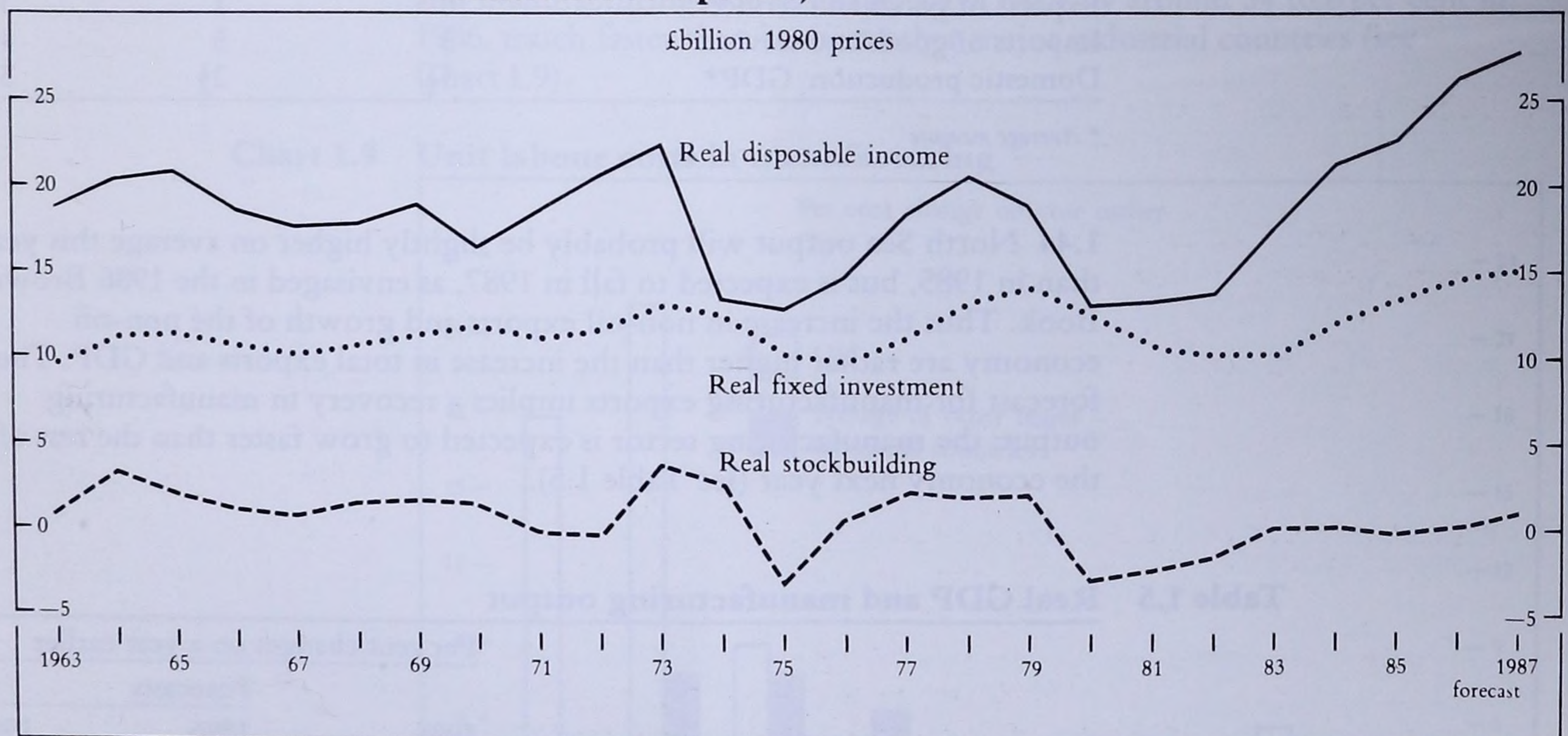
Company incomes and expenditure

1.38 The net real rate of return earned by industrial and commercial companies (ICCs) in 1985 was 11.9 per cent, the highest since 1964. The rates of return earned by non-North Sea ICCs and by manufacturing companies were the highest since 1973 and more than double those earned in 1981. In the first half of 1986 non-North Sea ICCs' profits net of stock appreciation were some 17 per cent higher than in the corresponding period of 1985. North Sea companies' profits fell by 54 per cent, however, reflecting the fall in the oil price.

1.39 Company spending has been relatively subdued in 1986. As expected, the advance warning of the reduction in capital allowances given in the 1984 Budget caused some capital spending to be brought forward into 1985 from 1986. Non-oil business investment nevertheless seems likely to rise this year, by almost 3 per cent, compared with 6 per cent last year. North Sea investment now seems likely to record a fall this year.

1.40 Companies' expenditure on stocks has been running at a low level this year: stocks in manufacturing industry fell in real terms in the first half of 1986, as they had done during 1985. Again, reactions to the 1984 Budget corporate tax changes will have been an influence. Chart 1.8 shows the relation between non-North Sea ICCs' disposable income, fixed investment, and stockbuilding.

Chart 1.8 Company income and expenditure (non-North Sea industrial and commercial companies)



Note: 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.

1.41 In 1987 non-oil business investment is expected to grow at a similar rate to, or slightly faster than, this year reflecting the current high level of profitability and the recovery in demand in domestic and foreign markets.

A further sizeable fall in North Sea investment is expected: without this, growth in total investment next year would be about half a percentage point higher.

1.42 Stock ratios have been falling since 1980, and surveys suggest that stocks have not yet reached desired levels in relation to output or sales. Stock ratios are expected to fall further over the next year; but less steeply than in recent years as most of the adjustment to higher costs of stockholding may now have taken place. Higher stockbuilding next year than this is likely to make a positive contribution to growth.

Prospects for demand and activity

1.43 The strength of consumer spending evident in European economies in recent months suggests that the benefits of the oil price cut are starting to come through, so that UK exporters should face a more favourable world environment next year. At home stronger growth in investment should offset an expected slowdown in consumer spending, so that domestic demand in total is expected to grow next year at much the same rate as this year. The prospects overall are for balanced growth, at a rate very slightly above the average experienced over the last five years (see Table 1.4).

Table 1.4 Domestic demand and GDP

	Per cent changes on a year earlier		
	1985	Forecasts	
		1986	1987
Domestic demand	3	3½	3½
Exports of goods and services	6	1	3
Imports of goods and services	3	5	4½
Domestic production: GDP*	3½	2½	3

* *Average measure*

1.44 North Sea output will probably be slightly higher on average this year than in 1985, but is expected to fall in 1987, as envisaged in the 1986 Brown Book. Thus the increase in non-oil exports and growth of the non-oil economy are rather higher than the increase in total exports and GDP. The forecast for manufacturing exports implies a recovery in manufacturing output; the manufacturing sector is expected to grow faster than the rest of the economy next year (see Table 1.5).

Table 1.5 Real GDP and manufacturing output

	Per cent changes on a year earlier		
	1985	Forecasts	
		1986	1987
GDP (average measure)	3½	2½	3
GDP, adjusted for coal strike*	3	2	3
GDP, adjusted for coal strike and excluding oil output*	3	2	3½
Manufacturing output	3	0	4

* *Adjustments are approximate*

Inflation

1.45 The RPI rose by 3 per cent in the year to September, compared with a rise of 5½ per cent in the year to the fourth quarter of 1985. Falls in mortgage interest rates earlier in the year have contributed to lower RPI inflation: retail prices excluding mortgage payments rose by 3¼ per cent in the year to the third quarter of 1986.

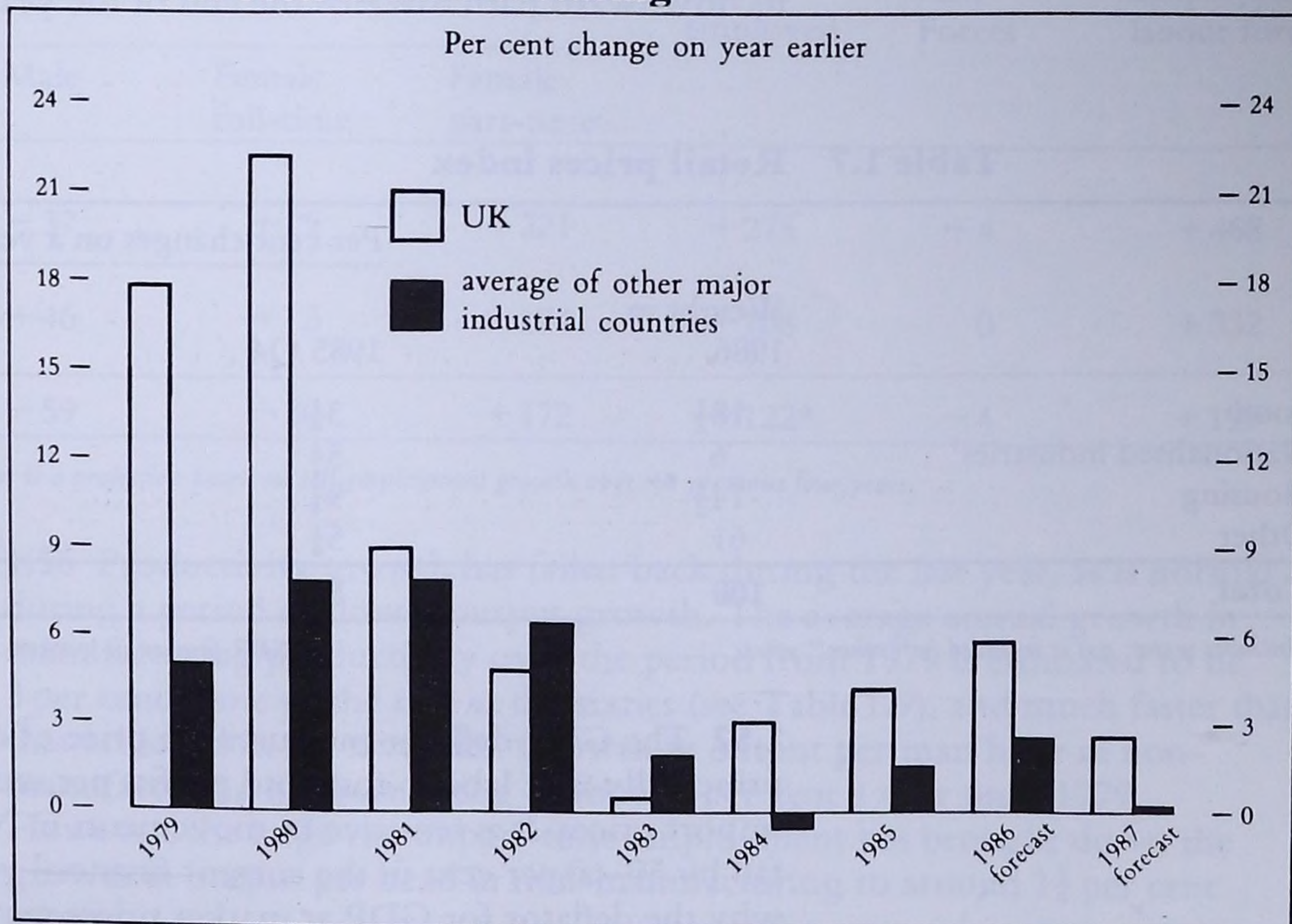
1.46 Other price indices have also recorded substantial falls in inflation this year. The deflator of GDP at market prices is expected to rise by only 3 per cent in the present financial year, compared with a 6 per cent rise in financial year 1985–86; and in September producer output prices (for manufactures, excluding food, drink and tobacco) were 4 per cent higher than a year earlier, compared with an increase of 6 per cent in the year to the fourth quarter of 1985.

1.47 Between the spring of 1985 and August this year the prices of materials and fuels purchased by manufacturing industry fell almost continuously. The recent falls in sterling and a modest recovery in some non-food primary commodity prices mean that this decline in industry's input costs may have come to an end.

1.48 In spite of the fall in price inflation there has been no decline so far in published figures for the underlying rate of growth in average earnings. The underlying growth of real pre tax earnings is likely to be above 4 per cent in 1986.

1.49 Even though employers' other labour costs (in particular their contributions to pension funds) have been growing more slowly than average earnings, unit labour costs in both the non-oil economy as a whole and manufacturing will probably have risen by around 5½ to 6 per cent in 1986, much faster than in most other major industrial countries (see Chart 1.9).

Chart 1.9 Unit labour costs in manufacturing



Prospects 1.50 With RPI inflation 3 percentage points lower than it was at the start of the last pay round, pay settlements are expected to be a little lower than last year: indeed, there have already been signs of a move towards lower settlements in the private sector in recent months. Despite an increase in overtime working, growth in average earnings is expected to fall somewhat in the present pay round. Productivity growth should pick up as compared with this year: actual unit labour costs for the non-oil private sector may rise by around 4 per cent next year, and manufacturing unit labour costs by rather less.

Table 1.6 Costs in manufacturing

	Per cent changes on a year earlier			
	Unit labour costs	Cost of materials and fuel ¹	Estimated total unit costs ²	Output prices ¹
1984	3	8½	5	5½
1985	4	4	4½	6½
1986 Partly forecast	6	-11½	½	4
1987 Forecast	2½	2	3½	3½

¹ Producer prices excluding food, drink and tobacco.

² Including costs of bought in services.

1.51 The increase in retail prices excluding mortgage interest payments over the next year is not likely to be very different from what it has been over the last year. However, the increase in mortgage rates in the second half of October will add just over ½ a percentage point to RPI inflation. Nationalised industry prices in aggregate continue to reflect lower energy costs, and food prices the general weakness of world prices. The pattern of price increases this year and that expected next year means that the annual rate of inflation may rise slightly in the middle of next year before resuming its downward path towards the end of the year.

Table 1.7 Retail prices index

	Weight in 1986	Per cent changes on a year earlier		
		1985 Q4	Forecasts	
			1986 Q4	1987 Q4
Food	18½	3¼	4	2½
Nationalised industries ¹	6	5½	3½	1¾
Housing	14½	9¼	6½	10¼
Other	61	5¼	2¼	3
Total	100	5½	3¼ (3½)²	3¾

¹ Includes water: gas is included in "other" prices.

² FSBR forecast in brackets.

1.52 The GDP deflator measures the price of domestic value added—principally unit labour costs and profits per unit of output—and excludes import prices. It is sensitive to movements in North Sea profits, which may fall by 50–60 per cent in the current financial year: this is part of the reason why the deflator for GDP at market prices may rise by only 3 per cent in the

current financial year. In 1987–88 the assumption of a stable oil price, and hence little further change in North Sea profits, implies a slightly higher increase in the GDP deflator than this year, at about $3\frac{3}{4}$ per cent, the same as was assumed in the MTFS.

1.53 Money GDP is forecast to grow by $5\frac{1}{2}$ per cent in 1986–87, less than was expected at Budget time. Both inflation and, to a lesser extent, output growth have been revised down since the Budget. Money GDP is forecast to grow by 7 per cent in 1987–88, as output growth picks up and the growth of the GDP deflator reverts to its underlying path following the temporary effect of falling North Sea profits in 1986–87.

Productivity and the labour market

1.54 The results from the 1985 Labour Force Survey have led to an upward revision of the estimated growth in employment since 1983. Total employment in Great Britain is estimated to have grown by about 1,050,000 between March 1983 and June 1986. Almost half of this increase is accounted for by growth in self-employment. Estimates of the number of employees are subject to revision when the results of the 1984 Census of Employment become available.

1.55 Over the last year growth in employment has slowed down, reflecting the weakness of output during 1985. In the year to June 1986, the employed labour force grew by around 200,000 (see Table 1.8). Employment growth in the service industries remains very strong: the number of employees in the service industries increased by almost 250,000 in the year to June. However, the number of employees in manufacturing industries fell by 90,000 while almost 50,000 jobs were lost in the energy and water supply industries.

Table 1.8 Employment

	Thousands, change in 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	- 37	+ 5	+ 221	+ 275	+ 4	+ 468
June 1984 to June 1985	+ 46	+ 3	+ 174	+ 108	0	+ 332
June 1985 to June 1986	- 59	- 30	+ 172	+ 122*	- 4	+ 199

* Figure for self-employment over the last year is a projection based on self-employment growth over the previous four years.

1.56 Productivity growth has fallen back during the last year, as is normal during a period of slower output growth. The average annual growth in manufacturing productivity over the period from 1979 is estimated to be 3 per cent, close to the rate in the sixties (see Table 1.9), and much faster than that achieved in the seventies. Growth in output per man hour in non-manufacturing has been rising at about 2 per cent a year since 1979. However, the large rise in part-time employment has brought down the growth in output per head in non-manufacturing to around $1\frac{1}{4}$ per cent a year.

Table 1.9 Output per head of the employed labour force

	Annual averages, per cent changes		
	1964-73	1973-79	1979-86
Manufacturing	3 $\frac{3}{4}$	$\frac{3}{4}$	3
Non-manufacturing*	3	$\frac{1}{2}$	1 $\frac{1}{4}$

* Includes private sector and nationalised industries other than in manufacturing and oil.

Unemployment

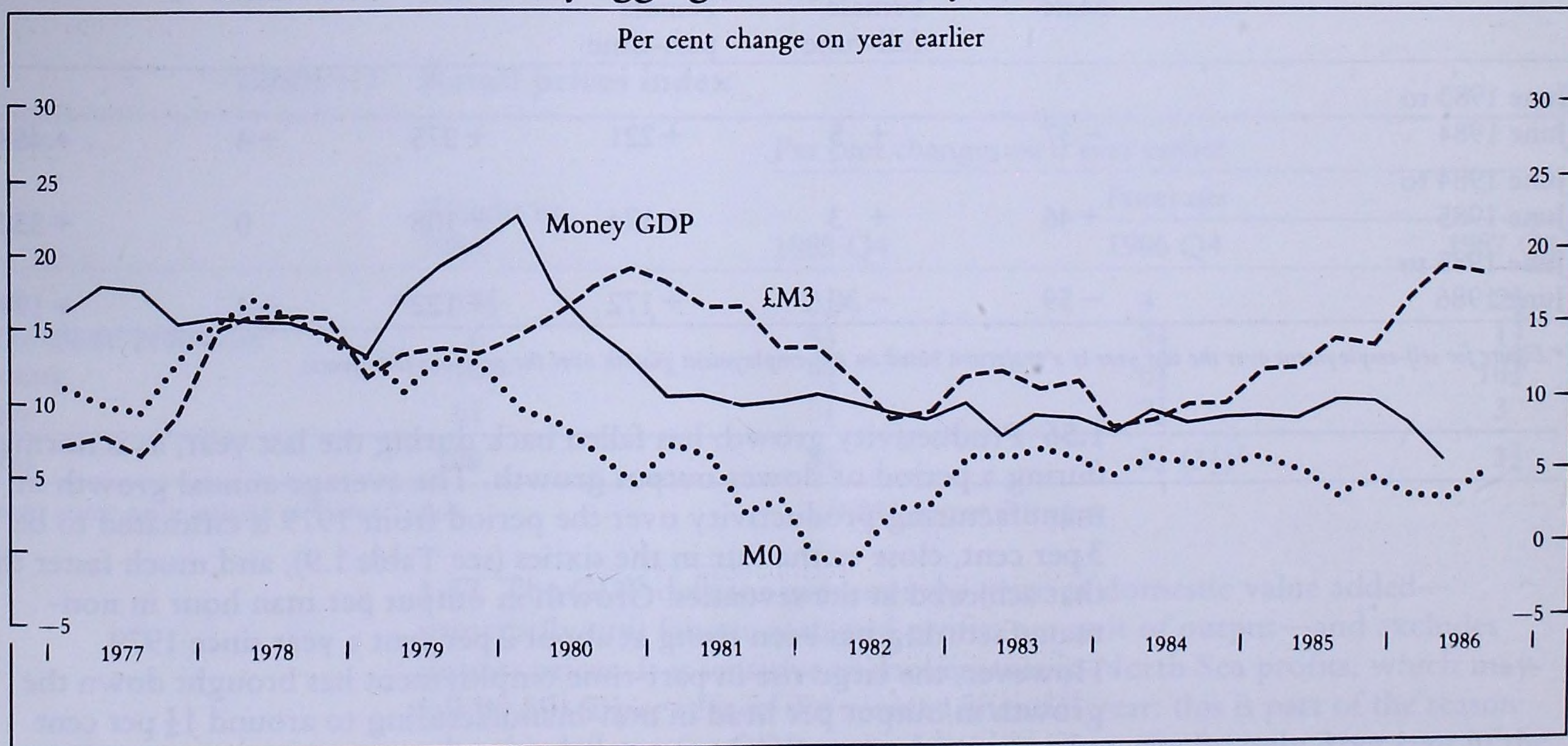
1.57 The increase in unemployment has slowed down over the past year, and seasonally adjusted adult unemployment was at the same level in September 1986 as it had been in March.

1.58 The impact of the employment measures announced in the Budget, including the Restart scheme to help the long term unemployed, and the pick up in economic growth now underway, mean that the immediate prospects of reducing unemployment are more favourable. The slower growth in the labour force projected for the rest of the decade should improve the chance of a reduction in unemployment over the next few years. The extent of any reduction will, however, depend crucially on what happens to pay.

Financial conditions

1.59 Market short term interest rates, which fell by nearly 2 percentage points after the Budget, have risen by about 1 percentage point since the end of August. Real short term rates remain high. Long term interest rates fell sharply in the spring, dropping below 9 per cent in April, but in the last two months the weakening in world bond markets and the rise in UK short term rates have caused them to move back above 10 $\frac{1}{2}$ per cent. The forecast assumes that short term interest rates will be set to maintain monetary conditions that are consistent with the counter-inflationary aims of the MTFs.

Chart 1.10 Monetary aggregates and money GDP



1.60 The year-on-year growth in M0 moved slightly above the midpoint of its target range of 2–6 per cent over the last few months mainly reflecting earlier falls in nominal interest rates and strong growth in personal incomes and expenditure. Following the recent rise in interest rates M0 is expected to grow more slowly.

1.61 Throughout the current financial year growth in £M3 has been above the target range in the MTFs, with growth in excess of 18 per cent in the year to mid-September. In part this has reflected the increased attractiveness of interest-bearing bank deposits relative to other retail deposits. PSL2, which includes most of these other deposits, rose by 14 per cent during the year to mid-September. For the past six years, high rates of growth of broad money—largely the result of financial innovation and liberalisation—have been consistent with appropriately tight monetary conditions and thus a substantial fall in inflation.

Fiscal developments

1.62 Tables 1.10 to 1.13 show details of general government expenditure and receipts and of public sector borrowing for 1985–86 and 1986–87, together with changes from the FSR estimates. The PSBR in 1985–86 was £5.8 billion, just over £1 billion lower than the estimate in the 1986 FSR. Lower central government borrowing accounts for the major part of this downward revision. In the first six months of 1986–87 the PSBR was £6 billion, in line with expectations at Budget time. Taking into account the proposed change in oil taxation described in Chapter 4, the PSBR forecast for the year as a whole is unchanged at around £7 billion.

1.63 Table 1.10 shows the relationship between the planning total and general government expenditure in national accounts terms. The estimated outturn for the cash planning total in 1986–87 is £1¼ billion more than expected at Budget time, implying a rise between 1985–86 and 1986–87 of 5 per cent. The projected increase in general government expenditure is smaller, at under 4 per cent. The difference between general government expenditure and the planning total is little changed from the FSR forecast.

Table 1.10 General government expenditure

	£ billion	
	1985–86	1986–87
Public expenditure planning total	133½	140½
Interest payments	17½	17½
Less public corporations' market and overseas borrowing	–1	–1
Other adjustments	6½	5½
General government expenditure in national accounts terms	158½	164½

1.64 The estimates in Table 1.11 of taxes on income, expenditure, and capital depend on the estimated growth in money incomes as well as tax rates and allowances. The projected fall in North Sea revenues of just under £7 billion to £4½ billion in 1986–87 means that the forecast increase in general government receipts for 1986–87, at 3 per cent, is significantly below the 5½ per cent rise forecast for money GDP. North Sea revenues in 1986–87 are now expected to be £1½ billion lower than forecast at Budget time. Part of this downward revision is the result of the change in the arrangements for the repayment of Advance Petroleum Revenue Tax (APRT) described in Chapter 4, which reduces revenue in 1986–87 by £0.3 billion. Most of the rest of the shortfall is accounted for by a lower dollar oil price so far this year than assumed at Budget time. Non-North Sea taxes and national insurance contributions are forecast to increase by over 9 per cent in 1986–87—3½ per cent more than the increase in money GDP. The forecast of non-oil receipts in 1986–87 has been revised upwards by nearly £2 billion since the 1986 FSNR, largely as a result of buoyant VAT and corporation tax receipts.

Table 1.11 General government receipts

	£ billion	
	1985–86	1986–87
Taxes on income, expenditure and capital	114½	118
National insurance and other contributions	24½	26½
Interest and other receipts	13	12
Accruals adjustment	— ½	—
Total receipts	151½	156½
of which North Sea revenues (including allowance for the change in APRT in 1986–87)	11½	4½

1.65 Table 1.12 shows revised estimates of government receipts, expenditure and borrowing in 1985–86 and 1986–87.

Table 1.12 Public sector borrowing

	£ billion	
	1985–86	1986–87
General government expenditure	158½	164½
General government receipts	151½	156½
General government borrowing requirement	7	8
Public corporations' market and overseas borrowing	—1	—1
Public sector borrowing requirement	6	7
as percentage of GDP	1½	1¾
Money GDP at market prices	360	380

1.66 Table 1.13 summarises the changes since the 1986 FSBR.

Table 1.13 Changes to the estimates of public sector receipts, expenditure, and borrowing

	£ billion	
	1985-86	1986-87
<i>Expenditure</i>		
General government	+1	+1
Public corporations' market and overseas borrowing	—	- ½
Total	+1	+ ½
<i>Receipts</i>		
Non-North Sea receipts	+2	+2
North Sea revenues (including effect of policy change for 1986-87)	—	-1½
Total receipts	+2	+ ½
PSBR	-1	—

Table 1.14 Economic prospects

	Forecast		Average errors from past forecasts ¹
	1985 to 1986	1986 to 1987	
per cent changes			
A. Output and expenditure at constant 1980 prices			
Domestic demand	3½	3½	1
of which:			
Consumers' expenditure	5	4	1¼
General government consumption	1½	1½	1
Fixed investment	2	2½	2¼
Change in stockbuilding (as per cent of level of GDP)	0	½	¾
Exports of goods and services	1	3	2½
Imports of goods and services	5	4½	3
Gross domestic product: total	2½	3	¾
: manufacturing	0	4	2½
	£ billion		
B. Balance of payments—current account	0	-1½	3
C. Inflation			
	per cent changes Q4 to Q4		
Retail prices index	3¼	3¾	2¼
	1986-87	1987-88	
	per cent changes on previous financial year		
Deflator for GDP at market prices	3	3¾	2
	per cent changes on previous financial year		
D. Money GDP at market prices	5½	7	1¾

¹ The errors relate to the average differences (on either side of the central figure) between forecast and outturn; they are relevant to the forecast for next calendar or financial year. The method of calculating these errors has been explained in earlier publications and Government forecasts (see

Economic Progress Report June 1981). The calculations of average errors are based on forecasts made between 1975 and 1984. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.

Table 1.15 Constant price forecasts of expenditure, imports and gross domestic product

£ billion at 1980 prices, seasonally adjusted											
	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	Total final expenditure	Less Imports of goods and services	Less Adjustment to factor cost	Plus Statistical adjustment	Gross domestic product at factor cost	GDP index 1980=100
1981	136.9	49.0	37.8	62.7	-2.5	284.0	56.4	30.1	-0.5	197.0	98.7
1982	138.2	49.6	39.4	63.3	-1.1	289.3	59.5	30.4	0.7	200.1	100.3
1983	143.8	50.5	41.7	64.7	0.7	301.3	62.8	31.5	-0.1	207.0	103.8
1984	146.9	50.9	45.5	69.0	-0.1	312.2	68.5	32.7	1.8	212.8	106.6
1985	152.0	51.1	46.3	73.3	0.6	323.4	70.6	33.8	1.5	220.4	110.5
1986	159.3	52.0	47.3	74.1	0.7	333.4	74.1	35.0	1.2	225.5	113.0
1987	165.6	52.8	48.4	76.5	1.4	344.7	77.5	36.2	1.2	232.2	116.4
1985 H1	75.1	25.6	23.4	36.8	0.5	161.3	35.2	16.8	0.5	109.9	110.2
H2	76.9	25.5	22.9	36.5	0.2	162.1	35.4	17.1	1.0	110.5	110.8
1986 H1	78.5	25.7	23.4	36.5	0.4	164.5	35.9	17.3	0.6	111.9	112.2
H2	80.8	26.3	23.9	37.6	0.3	168.8	38.3	17.7	0.6	113.5	113.8
1987 H1	81.6	26.4	23.9	38.0	0.7	170.5	38.3	17.9	0.6	114.9	115.2
H2	84.0	26.4	24.4	38.5	0.8	174.2	39.2	18.3	0.6	117.3	117.6
Per cent changes											
1984 to 1985	3½	½	2	6	—	3½	3	3½	—	3½	3½
1985 to 1986	5	1½	2	1	—	3	5	3½	—	2½	2½
1986 to 1987	4	1½	2½	3	—	3½	4½	3½	—	3	3

2 Outline public expenditure plans for 1987–88 to 1989–90

2.01 The public expenditure planning totals for 1987–88 and 1988–89 are £148.6 billion and £154.2 billion respectively, compared with £143.9 billion and £148.7 billion in the FSBR. The planning total for 1989–90 is set at £161.5 billion. These plans should ensure a continued deceleration in the growth of public spending. In real terms, the average growth in general government expenditure compared with the forecast outturn for 1986–87, excluding privatisation proceeds in order to show the underlying trend, is expected to be 1 per cent a year over the next three years ($1\frac{1}{4}$ per cent for the planning total). This compares with growth averaging almost 3 per cent in the decade up to 1978–79, around $2\frac{1}{4}$ per cent in the period 1978–79 to 1982–83 and around $1\frac{3}{4}$ per cent in the period 1982–83 to 1986–87. The plans also provide for public spending to decline as a proportion of GDP, as it has done over the last four years. Between 1982–83 and 1986–87 there was a decline of $2\frac{1}{2}$ percentage points. With economic growth continuing at present rates, there will be a further decline of more than 2 percentage points by 1989–90, bringing the ratio back to the levels of the early seventies. These trends are set out in Tables 2.1 and 2.2.

1986–87: outturn

2.02 The estimated outturn of the planning total for 1986–87 is £140.4 billion, around 1 per cent above the plans set out in the Financial Statement and Budget Report (FSBR). The main increases in expenditure compared with those plans are in local authority expenditure and in demand-led programmes, notably social security. Details are given in Table 2.3.

Future years: main changes

2.03 Compared to the plans published in Cmnd 9702 there have been increases in planned expenditure on services to which the Government attaches high priority, such as education, health, and law and order. Extra provision has also been made for capital expenditure, approaching £1 billion in 1987–88, in particular on housing, schools and roads. In addition provision has been made to cover substantial growth in demand-led areas, the most significant of which is social security. The plans envisage a substantial uplift in provision for local authority current expenditure. This in part reflects the fact that last year no decisions were taken about appropriate levels of local authority current expenditure in 1987–88 and 1988–89, and provision was set at the same cash level as in 1986–87. This was reflected in the higher level of Reserves for those two years in last year's plans. There are also increases in the external finance for some nationalised industries in 1987–88 and 1988–89, particularly the energy industries.

Table 2.1 Public expenditure trends

	£ billion				
	Planning total ¹		General government expenditure ²		
	Cash	Real terms ³	Cash	Real terms ³	Per cent of GDP
1978-79	65.7	124.0	74.6	140.7	43¼
1979-80	77.6	125.2	89.7	144.7	43¼
1980-81	92.6	126.1	108.3	147.4	46
1981-82	103.9	128.7	120.1	148.8	46¼
1982-83	113.4	131.0	132.6	153.1	46¾
1983-84	120.3	132.9	140.2	155.0	45¾
1984-85	129.8	137.6	150.1	159.1	45½
1985-86	133.6	133.6	158.6	158.6	44
1986-87	140.4	136.5	164.4	159.9	43¼
1987-88	148.6	139.3	173.7	162.8	42¾
1988-89	154.2	139.6	179.6	162.7	41¾
1989-90	161.5	142.1	187.8	165.2	41¼

¹ Estimated outturn for 1986-87; plans for 1987-88 onwards.

² General government expenditure as defined in the National Accounts and in the Medium Term Financial Strategy (MTFS).

³ Cash figures adjusted to 1985-86 price levels by excluding the effect of general inflation as measured by the GDP deflator at market prices. The GDP deflator is assumed to increase by some 3 per cent in 1986-87, and by 3¾, 3½ and 3 per cent respectively in the years 1987-88 to 1989-90.

Table 2.2 Public expenditure trends excluding privatisation proceeds

	£ billion				
	Planning total ¹		General government expenditure ²		
	Cash	Real terms ³	Cash	Real terms ³	Per cent of GDP
1978-79	65.7	124.0	74.6	140.7	43¼
1979-80	77.9	125.8	90.0	145.3	43½
1980-81	93.0	126.6	108.7	147.9	46
1981-82	104.4	129.3	120.6	149.4	46½
1982-83	113.9	131.6	133.1	153.7	47
1983-84	121.4	134.2	141.4	156.3	46¼
1984-85	131.9	139.8	152.1	161.3	46¼
1985-86	136.3	136.3	161.3	161.3	44¾
1986-87	145.2	141.1	169.2	164.5	44½
1987-88	153.6	144.0	178.7	167.5	44
1988-89	159.2	144.2	184.6	167.2	42¾
1989-90	166.5	146.5	192.8	169.6	42¼

¹ Estimated outturn for 1986-87; plans for 1987-88 onwards.

² General government expenditure as defined in the National Accounts and in the Medium Term Financial Strategy (MTFS).

³ Cash figures adjusted to 1985-86 price levels by excluding the effect of general inflation as measured by the GDP deflator at market prices. The GDP deflator is assumed to increase by some 3 per cent in 1986-87, and by 3¾, 3½ and 3 per cent respectively in the years 1987-88 to 1989-90.

2.04 These increases are in part offset by reductions, for example in planned expenditure in respect of the latest estimates of the United Kingdom's net contribution to the European Communities and of the cost of interest support for fixed rate export finance. The expected level of receipts from the Government's privatisation programme has been increased from £4¾ billion to £5 billion in each year.

2.05 When he announced these changes to the public expenditure plans in the House of Commons on 6 November 1986 the Chancellor of the Exchequer reaffirmed the Government's commitment to the fiscal stance set out in the Medium Term Financial Strategy published at the time of the 1986 Budget. The Chancellor said that there would be no relaxation of that stance, and that the PSBR in 1987–88 would be held to 1¾ per cent of GDP.

Reserves

2.06 The plans include Reserves of £3.5 billion in 1987–88, £5.5 billion in 1988–89 and £7.5 billion in 1989–90. The Reserves will be available to meet contingencies not covered elsewhere in the plans, including estimating changes.

Public expenditure White Paper

2.07 Full details of spending plans, including detailed information on the outputs expected to be achieved from individual programmes, together with information on running costs and manpower, will be published in the forthcoming 1987 public expenditure White Paper.

Departments

2.08 Table 2.3 sets out spending plans by department including local authority spending and nationalised industry external finance. Tables 2.3.A to 2.3.C show separately the elements within the departmental totals—nationalised industries' external finance, local authority expenditure relevant for rate support grant, and other departmental spending. The following paragraphs indicate, in brief, the main changes to departmental programmes.

Defence **2.09** The estimated outturn for 1986–87 reflects an increase in provision as a result of carry-forward of capital underspend from 1985–86. This increase has been met from the Reserve. For 1987–88 and 1988–89 the provision remains as planned in the last public expenditure White Paper (Cmnd 9702) after allowing for the net effect of minor changes, including a reduction in estimated Falklands costs. These costs fall markedly over the period and will in future be subsumed in the defence budget. Provision for 1989–90 represents an increase of £490 million over the previous year.

Table 2.3 Public expenditure plans^{1, 2}

Departments (including local authority spending and nationalised industries' external finance)	£ million				
	Outturn	Cmnd 9702 plans ³	Estimated outturn	Changes from 1985–86	Changes from plans
	1985–86	1986–87	1986–87	1986–87	1986–87
Ministry of Defence	17 972	18 530	18 600	630	70
FCO—Diplomatic wing	605	640	670	60	30
FCO—ODA	1 245	1 320	1 320	70	0
European Communities	831	650	1 090	260	440
IBAP and other CAP expenditure	1 857	1 540	1 520	–330	–20
Domestic agriculture, fisheries and food	912	840	920	10	80
Forestry Commission	51	50	50	0	0
Department of Trade and Industry	1 524	1 300	1 370	–160	60
Export Credits Guarantee Department	319	300	250	–70	–50
Department of Energy	677	120	170	–510	50
Department of Employment ⁴	3 342	3 920	3 970	630	40
Department of Transport	4 572	4 790	4 920	350	130
DOE—Housing	2 861	2 760	2 850	–10	90
DOE—Other environmental services	3 910	3 660	4 070	160	420
DOE—Property Services Agency	–97	–90	–90	10	0
Home Office	4 728	4 960	5 260	530	300
Lord Chancellor's Department	525	590	620	100	30
Department of Education and Science	14 480	14 320	15 950	1 470	1 630
Office of Arts and Libraries	721	730	800	80	70
DHSS—Health and personal social services	16 640	17 720	17 960	1 320	230
DHSS—Social security	41 466	42 800	44 500	3 000	1 600
Civil superannuation	1 017	1 190	1 140	120	–60
Scotland	7 221	7 570	7 810	590	240
Wales	2 780	2 900	3 060	280	150
Northern Ireland	4 262	4 520	4 530	270	10
Chancellor's departments	1 819	2 010	2 070	250	60
Other departments	334	430	450	110	20
Privatisation proceeds	–2 702	–4 750	–4 750	–2 050	0
Reserve	—	4 400	—	—	–4 400
Adjustments ⁵	–290	–670	–700	–410	–30
Planning total	133 580	139 100	140 400	6 800	1 300
General government expenditure	158 551	163 400	164 400	5 900	1 000

¹ In this and Tables 2.3.A to 2.3.C some figures may be subject to detailed technical amendment before publication of the 1987 public expenditure White Paper.

² The rounding and other conventions used in this Table and Tables 2.3.A to 2.3.C are as follows: planned figures are rounded to the nearest £10 million, except for social security, the planning and spending authority totals (except nationalised industries) and general government expenditure which are rounded to the nearest £100 million. In the case

of general government expenditure, this does not imply accuracy to this degree. Outturn figures for 1986–87 have also been rounded to reflect their provisional nature. Differences have been calculated on unrounded figures and rounded in the same way as their equivalent total: figures may therefore not sum to totals or changes shown.

³ Plans as set out in the last public expenditure White Paper (Cmnd 9702) adjusted for Budget measures and other minor changes of classification and allocation.

2 Outline public expenditure plans for 1987–88 to 1989–90

Table 2.3 Public expenditure plans^{1, 2}—continued

Cmnd 9702 plans ³		New plans			Changes between Cmnd 9702 and new plans		Departments (including local authority spending and nationalised industries' external finance)
1987–88	1988–89	1987–88	1988–89	1989–90	1987–88	1988–89	
18 820	18 990	18 790	18 980	19 470	– 20	– 10	Ministry of Defence
660	690	700	730	750	40	40	FCO—Diplomatic wing
1 350	1 390	1 360	1 400	1 440	10	10	FCO—ODA
1 150	950	870	440	1 060	– 280	– 510	European Communities
1 630	1 660	1 660	1 780	1 880	40	120	IBAP and other CAP expenditure
830	840	880	900	900	50	60	Domestic agriculture, fisheries and food
50	60	50	50	60	0	0	Forestry Commission
1 090	940	1 110	960	950	20	20	Department of Trade and Industry
220	130	160	110	50	– 60	– 20	Export Credits Guarantee Department
– 550	– 280	– 90	– 50	– 250	460	230	Department of Energy
4 030	4 220	4 050	4 240	4 340	20	20	Department of Employment ⁴
4 840	4 810	5 140	5 080	5 140	300	270	Department of Transport
2 840	2 890	3 200	3 020	3 090	360	130	DOE—Housing
3 560	3 580	3 850	3 890	3 930	290	310	DOE—Other environmental services
– 130	– 130	– 90	– 90	– 90	40	40	DOE—Property Services Agency
5 010	5 050	5 540	5 700	5 870	530	650	Home Office
610	650	670	720	770	60	70	Lord Chancellor's Department
14 400	14 470	16 600	17 350	17 840	2 200	2 870	Department of Education and Science
740	760	810	830	860	60	80	Office of Arts and Libraries
18 460	19 140	19 100	19 840	20 720	630	700	DHSS—Health and personal social services
44 300	45 800	46 000	47 400	49 300	1 700	1 700	DHSS—Social security
1 310	1 400	1 240	1 330	1 410	– 70	– 70	Civil superannuation
7 410	7 430	7 950	8 100	8 220	540	670	Scotland
2 940	3 000	3 190	3 300	3 390	250	300	Wales
4 690	4 820	4 810	4 980	5 150	120	160	Northern Ireland
2 050	2 070	2 230	2 320	2 420	180	250	Chancellor's departments
490	510	570	600	620	70	90	Other departments
– 4 750	– 4 750	– 5 000	– 5 000	– 5 000	– 250	– 250	Privatisation proceeds
6 080	7 870	3 500	5 500	7 500	– 2 580	– 2 370	Reserve
– 260	– 270	– 260	– 270	– 280	0	0	Adjustments ⁵
143 900	148 700	148 600	154 200	161 500	4 700	5 500	Planning total
169 500	174 700	173 700	179 600	187 800	4 200	4 900	General government expenditure

⁴ Compared with the last White Paper overall provision for the Department of Employment shown under columns headed ' Cmnd 9702 plans ' has been increased by £180 million in 1986–87, £240 million in 1987–88 and £240 million in 1988–89, mainly reflecting measures in the 1986 Budget.

⁵ Removal of double counting of agricultural spending in Scotland and Wales which is also included in the totals for domestic agriculture, fisheries and food and IBAP and other CAP expenditure in all years. The 1986–87 plans and estimated outturn figures include external finance of – £400 million for nationalised industries to be privatised that year; the estimated outturn figure also includes an allowance for shortfall.

Foreign and Commonwealth Office (diplomatic wing)	2.10 Changes include extra provision for security works to protect diplomatic staff and property overseas, and for the introduction of the visa regime announced on 1 September and reported to the House of Commons on 21 October by the Home Secretary. The costs of the new visa regime are expected to be largely recovered from fees.
Overseas Development Administration	2.11 The net overseas aid programme is being maintained in real terms at its 1986-87 level throughout the three years.
European Communities	2.12 The changes since Cmnd 9702 represent the effects of the latest projection of the United Kingdom's net payments to European Community (EC) institutions. The profile implies a drop in payments in 1988-89, followed by an increase in 1989-90. This mainly reflects the assumption that the United Kingdom will benefit from a large correction to its 1987 abatement during 1988. The estimate of outturn in 1986-87 includes subscriptions to the European Investment Bank of £48 million, of which £33 million is to maintain the ecu value of paid in capital.
Intervention Board for Agricultural Produce and other CAP expenditure	2.13 Provision has been made to meet the cost of operating the Common Agricultural Policy in the UK. Most of market support expenditure is ultimately financed from EC Budget receipts which are reflected in the UK's net contribution to the EC.
Domestic agriculture, fisheries and food	2.14 Small additions to provision have been made in a number of areas, in particular on flood defences.
Forestry Commission	2.15 The provision reflects increased estimates of receipts from harvesting of timber.
Trade and Industry	2.16 Allowance has been made for increased spending on industrial support measures including research and development.
Export Credits Guarantee Department	2.17 The net reductions reflect latest estimates of the cost of interest support for fixed rate export finance.
Energy	2.18 The increases in provision relate mainly to the external finance of British Coal and Electricity (England and Wales), partly offset by reduced expenditure on mineworkers' redundancy costs.
Employment	2.19 Major new enterprise and employment measures since last year's Autumn Statement were announced in the 1986 Budget and these are now reflected in existing plans (See footnote to Table 2.3.). Additional expenditure since then on central government programmes (notably on the Technical and Vocational Education Initiative, on an increase in the number of Job Clubs, and on payments from the Redundancy Fund) is offset by savings elsewhere.
Transport	2.20 Additional provision has been made for capital expenditure on roads. Provision for local authorities' current expenditure has also been increased. External finance for transport nationalised industries has been reduced over the Survey period.

- Environment—Housing** 2.21 Provision for gross capital expenditure on housing has been increased by about £450 million in 1987-88. The Government is fully meeting its commitment to local authorities that initial allocations in 1987-88 would be no less than 80 per cent of the 1985-86 level. Extra resources are being provided for the renovation of the local authority housing stock through the Urban Housing Renewal Unit. The Housing Corporation will also have additional funds and will be able to embark on privately financed housing association schemes. The success of the Government's right to buy policy is reflected in the higher level of capital receipts over the Survey period.
- Environment—Other environmental services** 2.22 Provision for capital spending on local environmental services in 1987-88 has been increased by £50 million. In each year provision has been made for £40 million more to be spent on urban renewal, and there will be increased resources for rural employment and environmental protection. These increases in gross expenditure are partly the results of the extra capital receipts which are expected from the sale of new town assets. Increased provision has also been made for local authority current expenditure.
- Environment—PSA** 2.23 The revised plans take account of increases in rent payments, and additional expenditure on maintenance, on "spend to save" estate rationalisation projects which have the highest rate of return and on some major new works projects for which PSA retains financial responsibility.
- Home Office** 2.24 Provision in 1987-88 and 1988-89 has been increased substantially. This will allow for increases in police establishments; for the design work on further new prisons, bringing the number of prisons in the building programme to twenty; and for other law and order initiatives; these increases are partly offset by savings and additional receipts. Provision has been increased for fire service capital. Additional provision has been made to cover the increasing demands on the Criminal Injuries Compensation Scheme.
- Lord Chancellor's Department** 2.25 Allowance has been made for extra staff to meet the expanding workloads of both criminal and civil courts (partly offset by fees) and for the cost of legal aid.
- Department of Education and Science** 2.26 Provision has been increased for both current and capital expenditure on schools. The enhancement includes the extra provision needed to cover the costs of the package on teachers' pay and conditions of service announced by the Secretary of State on 30 October 1986. New funds have been made available for the initiative on City Technology Colleges. Funding for the universities has been increased, on the basis of a commitment to greater selectivity, rationalisation, better financial management and improved teaching standards. Additional provision has been made for science.
- Office of Arts and Libraries** 2.27 Additional provision has been made for local authority expenditure on museums, galleries and libraries; and there is also an increase in Government grants-in-aid to national institutions. The arts will also benefit from the measures on charitable donations in the last Budget.

Health and personal social services

2.28 Additional provision has been made to allow for demographic pressure and service improvements in the Hospital and Community Health Service. In addition health authorities will have available extra cash released by their continuing cost improvement programmes (expected to yield a further £150 million in 1986–87 on top of the £390 million cumulative savings achieved prior to that). Planned provision for the Family Practitioner Services allows for higher forecast demand. Provision for personal social services has also been increased.

Social security

2.29 The provision has been increased in the light of this year's experience and reflects the latest estimates of benefit expenditure over the Survey period. Most of the increase represents higher expected expenditure on existing means tested benefits. The provision takes account of the uprating and other changes to benefits announced by the Secretary of State on 22 October 1986 and allows for further upratings of benefits in April 1988 and April 1989. For the purpose of these estimates the number of unemployed (GB, excluding school-leavers etc.) is assumed to average 3.1 million in 1986–87 and 3.05 million in 1987–88, 1988–89 and 1989–90. The RPI is assumed to rise by 3.75 per cent in the year to September 1987 (for the upratings in April 1988) and by 3.5 per cent in the year to September 1988 (for the upratings in April 1989).

Scotland, Wales and Northern Ireland

2.30 The net changes in these programmes mainly reflect the effects of changes in comparable programmes in England. The Secretaries of State have discretion to allocate this expenditure taking account of local factors.

Chancellor's departments

2.31 Allowance has been made for additional staff in the revenue departments required to deal with increases in work load and to strengthen controls against drug smuggling. Around one third of the overall increases reflects the changes in the estimates of the cost of providing relief on life assurance premiums and mortgage interest to non-taxpayers.

Other departments

2.32 Most of the additional provision is for revised estimates of the cost of the new Crown Prosecution Service. Allowance has also been made for increases for Parliament and for the cost of the new Serious Fraud Office.

Nationalised industries

2.33 External Financing Limits (EFLs) for nationalised industries in 1987–88 are listed in Table 2.4. In total, there is an increase from provision in Cmnd 9702 of £680 million. This reflects a number of changes but is primarily the result of additional provision for Electricity (England and Wales), the South of Scotland Electricity Board, and for British Coal (formerly the National Coal Board). Table 2.3.A shows the total provision for nationalised industries' external finance in each of the three years and how this is allocated between departments. A progressive reduction in the external financing requirements of the industries from the level in 1987–88 is expected in 1988–89 and 1989–90.

Table 2.4 External finance limits for the nationalised industries 1987–88

	£ million ¹
British Coal	727
Electricity (England and Wales)	– 1305
North of Scotland Hydro-electric Board	– 1
South of Scotland Electricity Board	84
British Steel Corporation	66
Post Office	– 57
National Girobank	– 3
British Railways Board	751
British Waterways Board	45
Scottish Transport Group	1
British Shipbuilders	49
Civil Aviation Authority	15
Water (England and Wales)	35
London Regional Transport	275
Other industries ²	10
Total	692

¹ Figures are shown rounded to the nearest £1 million.

² Allowance for BAA plc (formerly the British Airports Authority), which is expected to be privatised in 1987–88 and for National Bus Company, where external financing requirements will depend on the progress and timing of the industry's disposals programme.

Local authorities

Current 2.34 In 1986–87, local authorities in Great Britain have budgeted to exceed Cmnd 9702 provision for local authority current expenditure relevant for rate support grant by around £2.2 billion. Estimated outturn—as shown in Table 2.3.B—is £2.7 billion over plans; this includes sums for teachers' pay and rate fund contributions to housing revenue accounts. No decision was taken last year on provision for 1987–88 and 1988–89 and the figures in Cmnd 9702 were set at the same cash levels as for 1986–87. This was taken into account in setting the level of the Reserves for those years.

2.35 Provision for the three forward years has now been set at levels which show annual increases on the estimated outturn for 1986–87 of 4½ per cent, 4 per cent and 2¾ per cent.

2.36 For 1987–88, Aggregate Exchequer Grant to local authorities has been set at £16.4 billion, £1.4 billion above the level for 1986–87. The Government also proposes to abolish grant recycling in England and Wales—the process whereby grant underclaimed as authorities increase spending is redistributed to all authorities. This will give authorities greater certainty about their grant entitlements and will provide a tougher regime for high spenders. Guidelines and grant penalties for exceeding them will continue in Scotland.

Capital 2.37 Local authority gross capital spending in Great Britain in 1986–87 is forecast to be £6.5 billion. After allowing for capital receipts, net spending is forecast to be £4.1 billion, £0.5 billion higher than provided for in Cmnd 9702. These figures remain subject to some uncertainty.

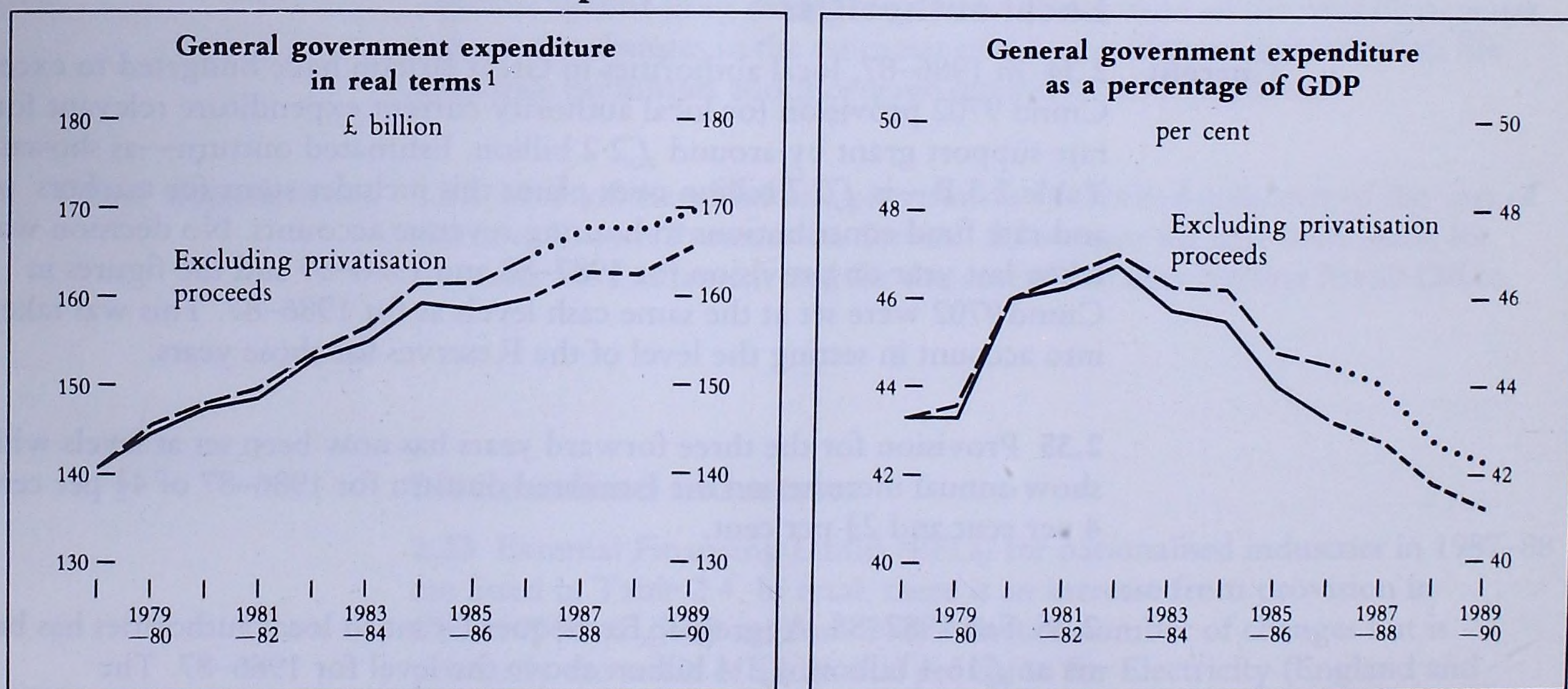
2.38 Gross provision for spending in 1987–88 has been increased by £0.7 billion to £6.6 billion. Provision of £6.4 billion and £6.5 billion has been made for 1988–89 and 1989–90 respectively. Within this provision the amount which is issued as allocations will take account of the expected use by local authorities of the spending power available to them from other sources, notably capital receipts.

2.39 On the main local authority capital cash limit in England—DoE/LAI—allocations of over £2.6 billion will be issued in 1987–88. The reduction from the £2.7 billion issued in 1986–87 will be more than offset by the growing spending power from capital receipts—estimated to be £2.8 billion in 1987–88, £0.2 billion higher than in 1986–87.

Privatisation

2.40 The estimate of net proceeds from privatisation in Cmnd 9702 has been increased to £5 billion in each of the three years. The effects of excluding privatisation proceeds from the public expenditure figures are shown in Table 2.2.

Chart 2.1 Public expenditure trends



¹ Cash figures adjusted to 1985–86 price levels by excluding the effect of general inflation as measured by the GDP deflator.

Table 2.3.A Nationalised industries' external financing by department

	£ million											
	Outturn	Cmnd	Estimated	Changes	Changes	Cmnd 9702		New plans			Changes between	
	1985-86	1986-87	1986-87	from 1985-86	from plans	1987-88	1988-89	1987-88	1988-89	1989-90	1987-88	1988-89
Ministry of Defence	-2	—	—	0	—	—	—	—	—	—	—	—
Ministry of Agriculture, Fisheries and Food	16	10	20	0	0	10	10	20	20	20	10	10
Department of Trade and Industry ¹	388	120	90	-300	-30	70	-70	60	-100	-100	-10	-30
Department of Energy	-197	-690	-690	-490	0	-1 140	-880	-580	-510	-660	560	370
Department of Transport ²	1 033	1 090	1 110	80	20	1 020	990	1 050	910	860	30	-80
DOE—Other environmental services	214	140	120	-90	-20	30	30	50	40	-10	10	0
Scotland ³	233	240	240	10	0	0	-120	90	-20	-170	90	100
Wales ⁴	28	20	20	-10	0	10	10	10	10	10	0	0
Total⁵	1 712	530	510	-1 200	-20	10	-30	690	350	-60	680	380

¹ The figures for 1985-86 include all receipts from Post Office in respect of pre paid envelopes.

² The figures for 1985-86 include public expenditure which is both local authority relevant current spending and nationalised industries' external finance. The sum involved is £115 million. In 1986-87 and subsequent years the public expenditure figures count this money as local authority relevant only.

³ As for footnote ²; the sum involved is £40 million.

⁴ As for footnote ²; the sum involved is £7 million.

⁵ Totals include an allowance of -£400 million in 1986-87 in respect of British Gas Corporation and British Airways Board which are due to be privatised in that year; similarly, allowances are included for National Bus Company and BAA plc (formerly British Airports Authority) in 1987-88 and for National Bus Company in 1988-89.

Table 2.3.B Local authority expenditure relevant for RSG by department

Local authority expenditure relevant for RSG	£ million											
	Outturn	Cmnd 9702 plans	Estimated outturn	Changes from 1985-86	Changes from plans	Cmnd 9702 Plans		New plans			Changes between Cmnd 9702 and new plans	
	1985-86	1986-87	1986-87	1986-87	1986-87	1987-88	1988-89	1987-88	1988-89	1989-90	1987-88	1988-89
Domestic agriculture, fisheries and food	105	100	130	20	30	100	100	120	120	130	20	30
Department of Trade and Industry	71	70	80	10	10	70	70	80	80	80	10	20
Department of Employment	92	80	100	10	20	80	80	100	110	110	20	20
Department of Transport ¹	1 785	1 750	1 880	90	130	1 750	1 750	1 950	2 010	2 060	200	260
DOE—Housing	155	140	130	-30	-20	140	140	140	140	140	-10	-10
DOE—Housing-rate fund contributions to housing revenue accounts	522	320	460	-60	140	330	330	440	450	460	110	120
DOE—Other environmental services	2 683	2 640	2 760	80	120	2 640	2 640	2 850	2 940	3 010	210	290
Home Office	3 742	3 860	4 150	410	290	3 860	3 860	4 330	4 460	4 580	470	600
Department of Education and Science	10 987	10 820	12 280	1 300	1 470	10 820	10 820	12 850	13 500	13 880	2 030	2 690
Office of Arts and Libraries	408	400	430	30	40	400	400	450	470	480	60	70
DHSS—Health and personal social services	2 406	2 520	2 680	270	150	2 520	2 520	2 850	2 940	3 010	320	410
DHSS—Social security	162	140	180	20	40	140	140	210	190	200	70	60
Scotland ¹	2 870	2 970	3 150	280	180	2 970	2 970	3 310	3 440	3 530	330	460
Wales ¹	1 126	1 160	1 230	100	60	1 160	1 160	1 300	1 350	1 390	130	190
Wales—Rate fund contributions to housing revenue accounts	4	0	0	0	0	0	0	0	0	0	0	0
Total local authority expenditure relevant for RSG	27 117	27 000	29 600	2 500	2 700	27 000	27 000	31 000	32 200	33 000	4 000	5 200

¹ For 1985-86 includes nationalised industries' external finance described in footnotes ^{2,3} and ⁴ to Table 2.3.A.

Table 2.3.C Other departmental spending

Departments (excluding local authority spending relevant for RSG and nationalised industries' external finance)	£ million											
	Outturn	Cmnd 9702 plans	Estimated outturn	Changes from 1985-86	Changes from plans	Cmnd 9702 Plans		New plans			Changes between Cmnd 9702 and new plans	
	1985-86	1986-87	1986-87	1986-87	1986-87	1987-88	1988-89	1987-88	1988-89	1989-90	1987-88	1988-89
Ministry of Defence	17 975	18 530	18 600	620	70	18 820	18 990	18 790	18 980	19 470	-20	-10
FCO—Diplomatic wing	605	640	670	60	30	660	690	700	730	750	40	40
FCO (including ODA)	1 245	1 320	1 320	70	0	1 350	1 390	1 360	1 400	1 440	10	10
European Communities	831	650	1 090	260	440	1 150	950	870	440	1 060	-280	-510
IBAP and other CAP expenditure	1 857	1 540	1 520	-330	-20	1 630	1 660	1 660	1 780	1 880	40	120
Domestic agriculture, fisheries and food	791	730	770	-20	40	720	740	740	760	760	20	20
Forestry Commission	51	50	50	0	0	50	60	50	50	60	0	0
Department of Trade and Industry	1 045	1 120	1 200	160	80	960	940	980	970	970	20	30
ECGD	319	300	250	-70	-50	220	130	160	110	50	-60	-20
Department of Energy	874	800	850	-20	50	590	600	480	460	420	-100	-140
Department of Employment	3 251	3 840	3 870	620	30	3 950	4 130	3 950	4 130	4 230	0	0
Department of Transport	1 870	1 960	1 940	70	-20	2 070	2 080	2 140	2 160	2 210	80	90
DOE—Housing	2 184	2 290	2 260	80	-30	2 370	2 410	2 630	2 430	2 490	260	10
DOE—Other environmental services	1 014	870	1 190	170	310	880	910	950	920	930	70	10
DOE—Property Services Agency	-97	-90	-90	10	0	-130	-130	-90	-90	-90	40	40
Home Office	986	1 100	1 110	120	0	1 150	1 190	1 210	1 230	1 290	60	50
Lord Chancellor's Department	525	590	620	100	30	610	650	670	720	770	60	70
Department of Education and Science	3 493	3 500	3 670	180	170	3 590	3 660	3 750	3 840	3 960	160	190
Office of Arts and Libraries	313	340	370	60	30	350	360	360	370	380	10	10
DHSS—Health and personal social services	14 234	15 200	15 280	1 050	80	15 940	16 620	16 250	16 910	17 720	310	290
DHSS—Social security	41 308	42 700	44 300	3 000	1 600	44 200	45 600	45 800	47 300	49 100	1 600	1 600
Civil superannuation	1 017	1 190	1 140	120	-60	1 310	1 400	1 240	1 330	1 410	-70	-70
Scotland	4 158	4 360	4 420	260	50	4 440	4 580	4 560	4 680	4 860	120	100
Wales	1 629	1 720	1 810	180	90	1 760	1 820	1 880	1 930	1 990	120	110
Northern Ireland	4 262	4 520	4 530	270	10	4 690	4 820	4 810	4 980	5 150	120	160
Chancellor's departments	1 834	2 010	2 070	230	60	2 050	2 070	2 230	2 320	2 420	180	250
Other departments	334	430	450	110	20	490	510	570	600	620	70	90
Adjustments ¹	-290	-270	-300	-10	-30	-260	-270	-260	-270	-280	0	0
Total	107 615	112 000	115 000	7 400	3 000	115 600	118 600	118 500	121 100	126 000	2 900	2 600

¹ Removal of double counting of agricultural spending in Scotland and Wales which is also included in the totals for domestic agriculture, fisheries and food and IBAP and other CAP expenditure.

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 were set out in a statement by the Secretary of State on 6 November 1986. The main proposals are as follows:

- the Class 1 insurance rates for employers and employees should remain unchanged for 1987–88.
- the lower earnings limit should be increased from April 1987 from the present level of £38 a week to £39 a week in line with the single rate retirement pension.
- the upper earnings limit should be increased from £285 a week to £295 a week.
- the earnings limit for the reduced rate brackets should also be increased from £60, £95 and £140 a week to £65, £100 and £150 a week.
- the Treasury supplement should be cut from 9 per cent of contributions to 7 per cent.

This would give the following structure of national insurance contributions:

Weekly earnings	Percentage NIC rate on all earnings	
	Employees	Employers
Below £39	(No NICs payable)	
£39 to £64.99	5	5
£65 to £99.99	7	7
£100 to £149.99	9	9
£150 to £295	9	10.45
Above £295	9 on £295	10.45

3.02 The necessary orders will be laid shortly with a report by the Government Actuary on the likely effect of the changes on the National Insurance Fund. 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, will be summarised in his report and include the following:

- the number of unemployed (GB, excluding school leavers etc) averages 3.1 million in 1986–87 and 3.05 million in 1987–88.

—the increase in average earnings is expected to decline from about $7\frac{1}{2}$ per cent between tax years 1985–86 and 1986–87 to about $6\frac{1}{2}$ per cent between tax years 1986–87 and 1987–88. Figures for settlements are of course lower than these earnings figures in both years; the earnings figures for 1987–88 reflect the decline in settlements which has already taken place, and the further decline now expected.

The report will also allow for an uprating of benefits in April 1987 on the basis of the 2.1 per cent increase in the RPI over the eight months ending in September 1986, as announced by the Secretary of State on 22 October 1986.

3.03 The estimated effects of the proposed changes are shown in Table 3.1.

Table 3.1 Estimated total payments by employers and employees of national insurance contributions in 1986–87 and 1987–88¹

	Great Britain (£ million)		
	Employers	Employees	Total
National insurance contributions:			
1986–87	12 310	11 590	23 900
1987–88	13 120	12 460	25 580
Total change	+ 810	+ 870	+ 1 680
<i>of which:</i>			
Change in contributions from increased earnings, etc ²	+ 960	+ 850	+ 1 810
Change in contributions from increase in earnings limits	– 150	+ 20	– 130

¹ Figures are rounded to the nearest £10 million. Detailed figures for national insurance contributions will be included in the Government Actuary's report on the draft of the Social Security (Contributions, Re-rating) (No. 2) Order 1986. 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 and, for 1987–88, statutory maternity pay.

² Including population and employment changes.

4 Oil taxation and revenue ready reckoner

Repayment of Advance Petroleum Revenue Tax (APRT)

4.01 The Government announced on 6 November its intention to introduce a Bill early in the new session of Parliament to bring forward certain repayments of APRT due to the oil companies which under the present law would have been spread over the next three financial years.

4.02 APRT advances the payment of Petroleum Revenue Tax (PRT) into the early years of an oil field's production. These advance payments may be set against future PRT. Under the provisions of the 1983 Finance Act, these payments were, in any event, coming to an end: the last period for which APRT is payable ends on 31 December 1986. The fall in the oil price means that some fields will not start to produce profits on a scale sufficient to generate PRT liabilities until much later than expected (if at all) and so will not be able to utilise their APRT credits. Under current law, APRT would not be repaid until 1988 or later. The proposed measure would bring forward to March 1987 repayments of APRT credits on fields that had not reached payback by 30 June 1986, up to a limit of £15 million per company per field.

4.03 This measure would have a revenue cost in 1986–87 of up to £310 million, which would be fully recouped over the next three years (£130 million in 1987–88, £120 million in 1988–89 and £60 million in 1989–90).

Revenue ready reckoner

4.04 The tables below show the effects of various illustrative tax changes on receipts of tax in 1987–88 and 1988–89.

4.05 The effects of tax changes depend on economic variables, such as prices, earnings and consumer expenditure. The estimates shown are consistent with the economic forecast given in Chapter 1.

4.06 An illustrative rate of inflation of $3\frac{1}{4}$ per cent has been used to show the effects of indexation and revalorisation in 1987–88. This is in line with the annual rate of increase in the RPI forecast for the fourth quarter of 1986.

4.07 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 effects are not, therefore, the same as the effects on the PSBR. The approach used here is explained in the Annex to Chapter 4 of the Financial Statement and Budget Report published in March 1986.

4.08 The estimates of the effects in 1988–89 assume that the levels of allowances, rates of duty etc set for 1987–88 continue to apply in 1988–89.

Indexation of allowances, thresholds and bands for 1987–88

4.09 Tables 4.1 to 4.3 show tax allowances, thresholds, and bands for 1987–88 after $3\frac{1}{4}$ per cent indexation. For income tax, rounding follows the rules laid down in the 1980 Finance Act; for inheritance tax and capital gains tax those laid down in the 1982 Finance Acts. Estimates of the revenue effects of these changes are shown in Table 4.4.

Table 4.1 Income tax

	£	
	1986–87	1987–88
Allowances:		
Single and wife's earned income allowance	2 335	2 415
Married allowance	3 655	3 775
Additional personal and widow's bereavement allowance	1 320	1 360
Single age allowance	2 850	2 950
Married age allowance	4 505	4 655
Aged income limit	9 400	9 800
<hr/>		
<u>Income tax rates</u>	<u>Bands of taxable income</u>	
	£	
Per cent	1986–87	1987–88
29	0–17 200	0–17 800
40	17 201–20 200	17 801–20 900
45	20 201–25 400	20 901–26 300
50	25 401–33 300	26 301–34 500
55	33 301–41 200	34 501–42 700
60	Over 41 200	Over 42 700

Table 4.2 Inheritance tax

<u>Rate on death</u>	<u>Bands of chargeable value</u>	
	£'000	
Per cent	1986–87	1987–88
Nil	0–71	0–74
30	71–95	74–99
35	95–129	99–134
40	129–164	134–170
45	164–206	170–213
50	206–257	213–266
55	257–317	266–328
60	Over 317	Over 328

Table 4.3 Capital gains tax

	£	
	1986-87	1987-88
Annual exempt amount:		
Individuals	6 300	6 600
Trusts	3 150	3 300

Table 4.4 Costs of indexation in 1987-88

	£ million	
	1987-88	1988-89
Indexation of income tax allowances and thresholds	710	950
Of which:		
Increases in main personal allowances	600	760
Increase in the basic rate limit*	70	110
Increases in further higher rate thresholds*	40	80
Indexation of inheritance tax thresholds and bands	18	40
Indexation of capital gains exempt amounts	—	5

* Additional costs after previous changes have been introduced.

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

4.10 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 are from the indexed levels for 1987-88.

4.11 The effects of the illustrative changes can be scaled up or down over a reasonably wide range. However, the extra cost of increasing allowances and, in particular, higher rate thresholds tends to fall as the allowances or thresholds rise. For this reason, effects are given for different percentage changes.

4.12 The total cost of a group of income tax allowance changes can be broadly assessed by adding together the revenue effects of 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 general guide.

Table 4.5 Direct effects of illustrative changes in income tax and corporation tax¹

	£ million	
	1987-88 cost/yield	1988-89 cost/yield
Income tax		
<i>Rates</i>		
Change basic rate by 1p ²	1 100	1 450
Change all higher rates by 1p	65	150
<i>Personal allowances</i> ³		
Change single and wife's earned income allowance by £100	290	380
Change married allowance by £100	235	300
Change single age allowance by £100	24	32
Change married age allowance by £100	23	30
Change aged income limit by £200	4	6
Change all main personal allowances by 1 per cent	175	225
Change all main personal allowances by 10 per cent:		
increase (cost)	1 725	2 200
decrease (yield)	1 800	2 275
<i>Higher rate thresholds</i> ³		
Change all higher rate thresholds by 1 per cent:		
increase (cost)	25	50
decrease (yield)	25	50
Change all higher rate thresholds by 10 per cent:		
increase (cost)	215	450
decrease (yield)	290	575
<i>Allowances and thresholds</i> ³		
Change all main personal allowances and higher rate thresholds by 1 per cent	200	275
Change all main personal allowances and higher rate thresholds by 10 per cent:		
increase (cost)	1 925	2 650
decrease (yield)	2 100	2 900
Corporation tax ⁴		
Change full rate by 1 percentage point	210	390
Change small companies' rate by 1 percentage point ⁵	20	40

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 Including the effect of the change on receipts of advance corporation tax and on consequent liability to mainstream corporation tax.

³ For simplicity, percentage changes are calculated with reference to 1986-87 levels.

⁴ Assessment to corporation tax normally relates to the preceding year. These estimates are, therefore, the changes to revenue that would occur if the changed rates were applied to incomes from 1 April 1986.

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

Indirect taxes 4.13 Table 4.6 shows estimates of the effects of changes in excise duties. The first part shows the extra revenue from the individual duties if they were to be increased by exactly $3\frac{1}{4}$ per cent, together with the price increase that would result (after allowing for consequential VAT). The second part 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.

4.14 Table 4.7 shows the revenue effects of a 1 percentage point change in the rate of VAT.

4.15 Within limits the illustrative changes for specific duties 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

	Current level of duty on typical items	3¼% Revalorisation ¹		Changes from present levels of duty				
		Price change inc. VAT ²	£m yield in ³		Price change inc. VAT ²	Actual percentage change in duty	£m cost/yield in ³	
			1987-88	1988-89			1987-88	1988-89
Beer (pint)	18.6p	0.7p	55	60	1p	4.7	75	90
Wine (70 cl bottle of table wine) ⁴	68.6p	2.6p	20	20	5p	6.3	35	40
Spirits (bottle)	£4.73	17.7p	25	30	10p	1.8	15	15
Cigarettes (20 kingsize) ⁵	92.7p	3.0p	75	85	1p	1.1	25	30
Petrol (gallon)	88.1p	3.3p	165	185	1p	1.0	50	55
Derv (gallon)	74.5p	2.8p	40	45	1p	1.2	15	15
VED (cars and light vans)	£100.00	£3.25	65	65	£1.00	1.0	20	20

¹ An 'across the board' revalorisation by $3\frac{1}{4}$ per cent (including the minor duties not shown above) would yield about £475m in 1987-88 and £525m in 1988-89, and the impact on the RPI would be to raise it by 0.3 per cent.

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

³ Assuming implementation on 1 April 1987.

⁴ Revenue effects include all wines.

⁵ 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

	£m cost/yield in	
	1987-88	1988-89
1% change in rate of VAT ¹	800	1 130

¹ Assuming implementation on 1 April 1987.

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