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# Autumn Statement 1987

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HM TREASURY  
NOVEMBER, 1987



# Autumn Statement

## 1987

Return to an Order of the House of Commons dated 3 November 1987: for

*Copy of the Autumn Statement 1987  
as laid before the House of Commons by  
the Chancellor of the Exchequer on 3 November 1987*

Treasury Chambers  
3 November 1987



Nigel Lawson

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# 1 Economic prospects for 1988

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# 1 Economic prospects for 1988

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## Summary

**1.01** GDP is forecast to grow by  $2\frac{1}{2}$  per cent in 1988, following growth of 4 per cent this year. Inflation is expected to remain low and there are good prospects for a further fall in unemployment.

### Assumptions

**1.02** The forecast assumes that fiscal and monetary policies are operated within the framework of the Medium Term Financial Strategy (MTFS). It assumes that sterling remains close to recent levels, and that North Sea oil prices will average \$18 a barrel. The PSBR is expected to be about £1 billion in the current financial year, some £3 billion below the figure set in the Budget. The forecast assumes a similar PSBR for 1988–89; the actual PSBR for that year will, as usual, be set in the Budget. The forecast takes account of the recent sharp falls in share prices throughout the world but uncertainty about their effects means that there is an even greater margin of error than usual.

### Demand and activity

**1.03** The economy has been growing strongly during the past year. GDP growth in 1987 is likely to be about 4 per cent, with manufacturing output growing by 5 per cent. Domestic demand has continued to grow at much the same rate as in 1986, but with some change in its composition: investment growth has been higher and consumers' expenditure growth lower than in 1986. Non-oil exports have increased strongly. In 1988 GDP is forecast to grow by  $2\frac{1}{2}$  per cent.

### Labour market

**1.04** Employment has also risen strongly over the past year, with unemployment falling by 400,000, the largest annual decline since the war. There are good prospects for a further fall.

### Inflation

**1.05** Inflation is expected to remain low. The annual increase in the retail prices index (RPI) is forecast at 4 per cent in the fourth quarter of 1987, as envisaged at the time of the Budget, and is expected to rise temporarily to  $4\frac{1}{2}$  per cent in the fourth quarter of 1988. Unit labour costs have increased very slowly over the past year, thanks to rapid productivity growth, and this pattern is expected to continue in 1988.

### World economy

**1.06** GNP in the main industrial countries is forecast to grow by around  $2\frac{1}{2}$  per cent in 1987 and 2 per cent in 1988. World trade in manufactures has picked up this year, reflecting faster growth of industrial production in the industrial countries, and should grow at around 4 per cent in 1988. Inflation is expected to remain low, although there has inevitably been some rebound from the very low figures produced by last year's drop in the oil price.

### UK trade and current account

**1.07** The UK current account is now estimated to have been in deficit by £1 billion in 1986 following the fall in the oil price. So far in 1987 it has been particularly erratic. A current account deficit of £2½ billion is expected this year (about  $\frac{1}{2}$  per cent of GDP), in line with the forecast made at Budget time. With the UK expected to continue growing faster than other main industrial countries for a little while, a current account deficit of £3½ billion (about  $\frac{3}{4}$  per cent of GDP) is forecast for 1988.

## World economy

### Recent developments

**1.08** The major seven OECD economies are now in their fifth year of expansion. There was some weakening in the second half of 1986 from around 3 per cent a year to just below 2½ per cent, but recently growth appears to have strengthened a little.

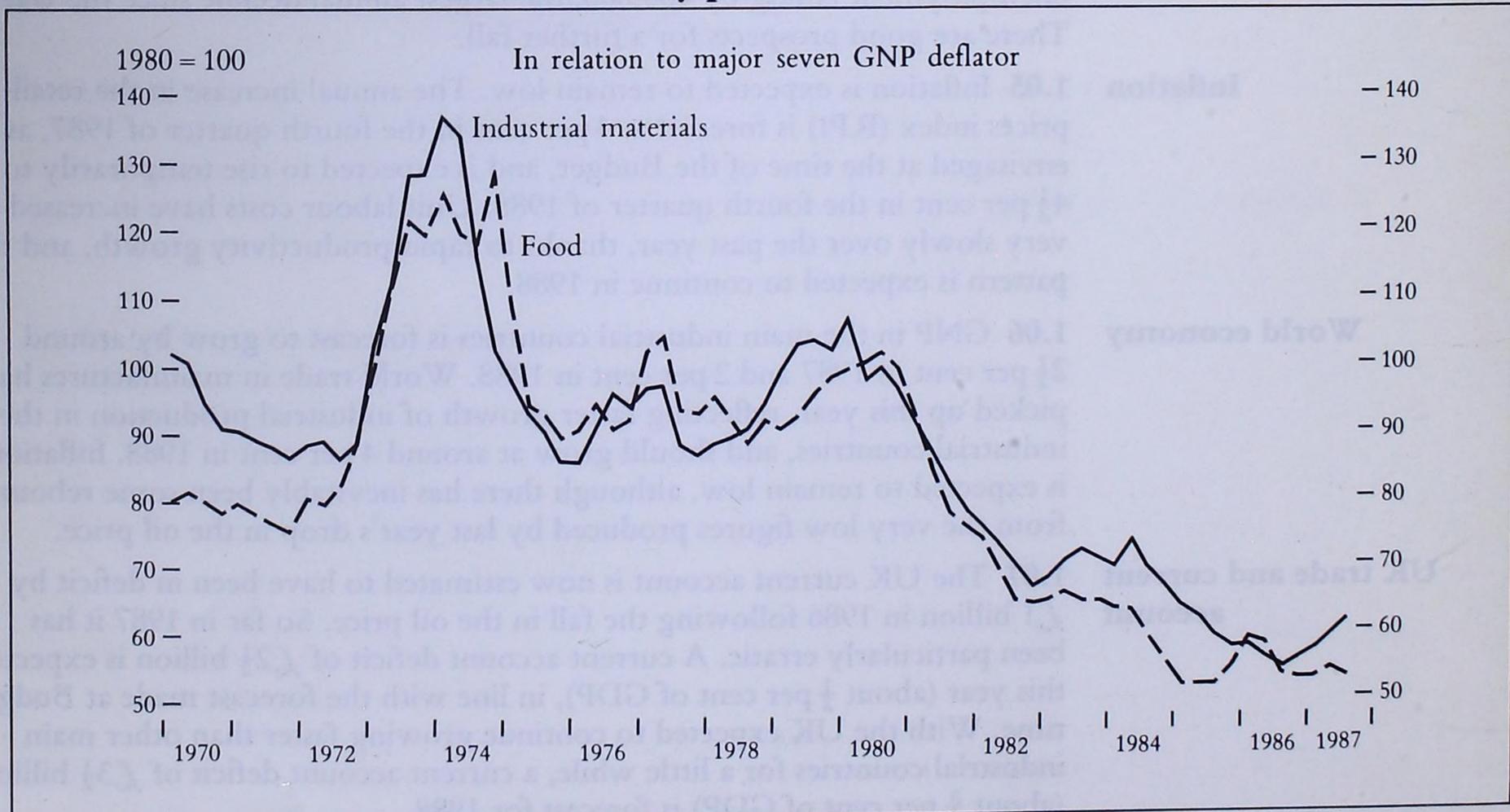
**1.09** The weakness in world growth was largely due to the difficulties of adjusting both to the collapse in oil prices in early 1986 and to large changes in exchange rates. Lower oil prices led oil exporters to cut back their imports sharply. Moreover, with many non-oil commodity prices falling to their lowest post-war levels in real terms, other primary producers also had to restrain their imports severely. As a result, exports from the main industrial countries were depressed, and industrial production rose by only 1 per cent in 1986.

**1.10** Domestic demand in the seven major countries grew strongly in 1986, encouraged by substantial terms of trade gains and lower interest rates, though it slowed in the first half of this year. The slowdown was most marked in the US, reflecting the effects of the dollar's depreciation and some tightening of policy. In Japan and Germany exports have weakened following the appreciation of their currencies and this also produced some weakness in business investment.

**1.11** Activity in the seven major countries appears to have picked up recently, helped by the greater exchange rate stability achieved by the Louvre Accord and by some strengthening in the demand of developing countries for their exports. Aggregate industrial production is now growing by more than 3 per cent a year.

**1.12** Consumer price inflation has increased to just over 3 per cent as a result of some recovery in oil and commodity prices from the very low levels reached in 1986. There has been no pick up in the growth rate of earnings and domestic costs.

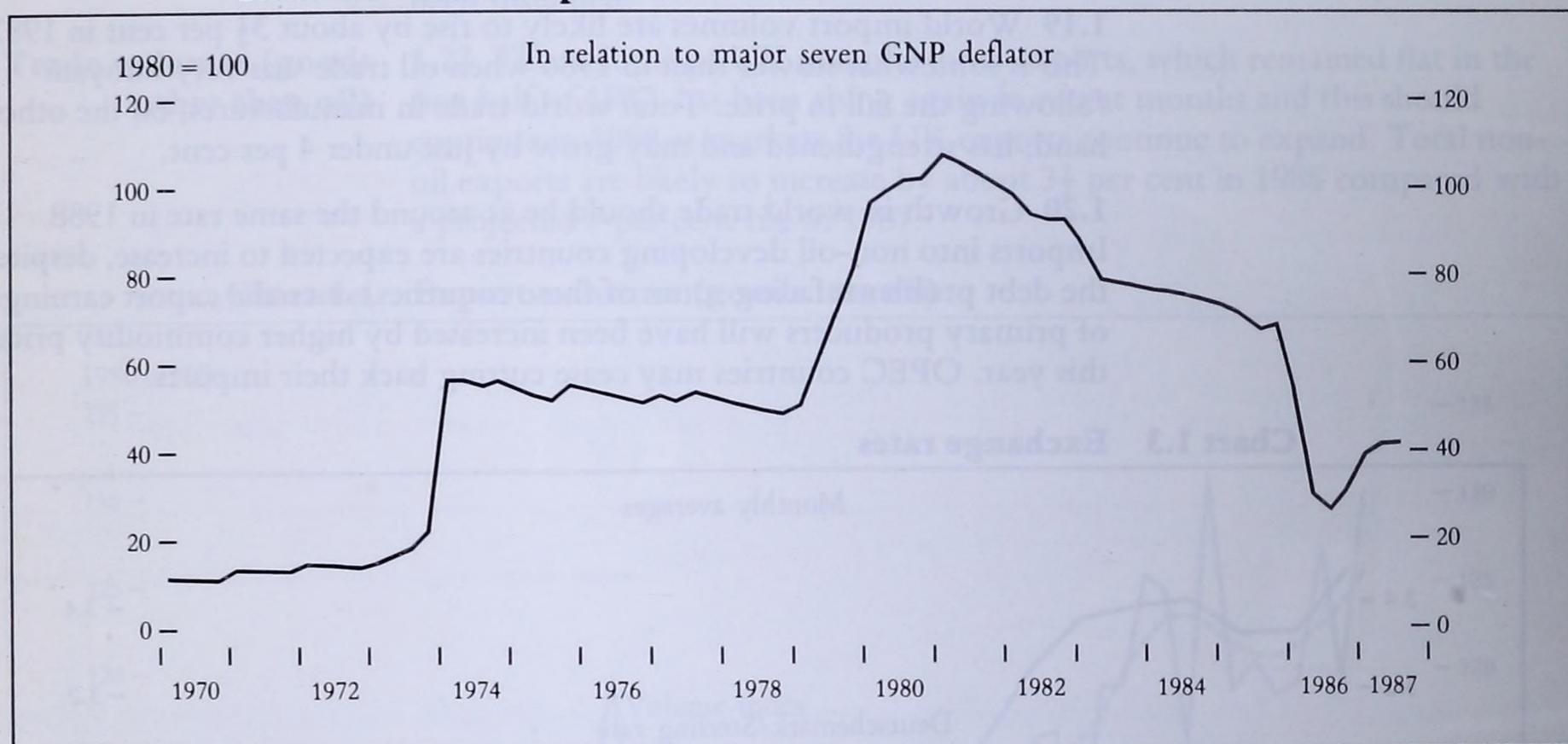
**Chart 1.1 Real commodity prices**



**1.13** The current account surpluses of Japan and, to a lesser extent, Germany have now started to decline. In the United States, trade volumes are responding to the decline in the dollar, but the current account is taking longer to turn round.

**1.14** Oil prices rose to over \$20 per barrel for a short time in the summer before falling back a little to between \$17–19 per barrel as OPEC production expanded. Real non-oil commodity prices have recovered somewhat from the extremely low levels reached in the second half of 1986, but they remain well below their historical average. Food prices are particularly weak.

**Chart 1.2 Real oil price**



**Prospects 1.15** Table 1.1 shows the forecast for activity and inflation in the major seven industrialised countries, and for world trade. The recent sharp falls in securities markets are likely to have a dampening effect on world demand and activity and have contributed to the uncertainties attaching to the forecast.

**Table 1.1 World economy**

	Per cent changes on a year earlier		
	1986	1987	1988
<i>Major seven countries<sup>1</sup>:</i>			
Real GNP	2 $\frac{3}{4}$	2 $\frac{1}{2}$	2
Real domestic demand	3 $\frac{3}{4}$	2 $\frac{3}{4}$	2
Industrial production	1	3	3 $\frac{1}{4}$
Consumer prices	2	2 $\frac{3}{4}$	2 $\frac{3}{4}$
<i>World trade, at constant prices</i>			
Total imports	4 $\frac{3}{4}$	3 $\frac{1}{2}$	3 $\frac{1}{2}$
Total trade in manufactures <sup>2</sup>	2	3 $\frac{3}{4}$	4

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

<sup>2</sup> Excluding trade of centrally planned economies.

**1.16** The forecast assumes that North Sea oil prices average around \$18 per barrel until the end of 1988. No further recovery in real non-food commodity prices is forecast and food prices are expected to remain weak.

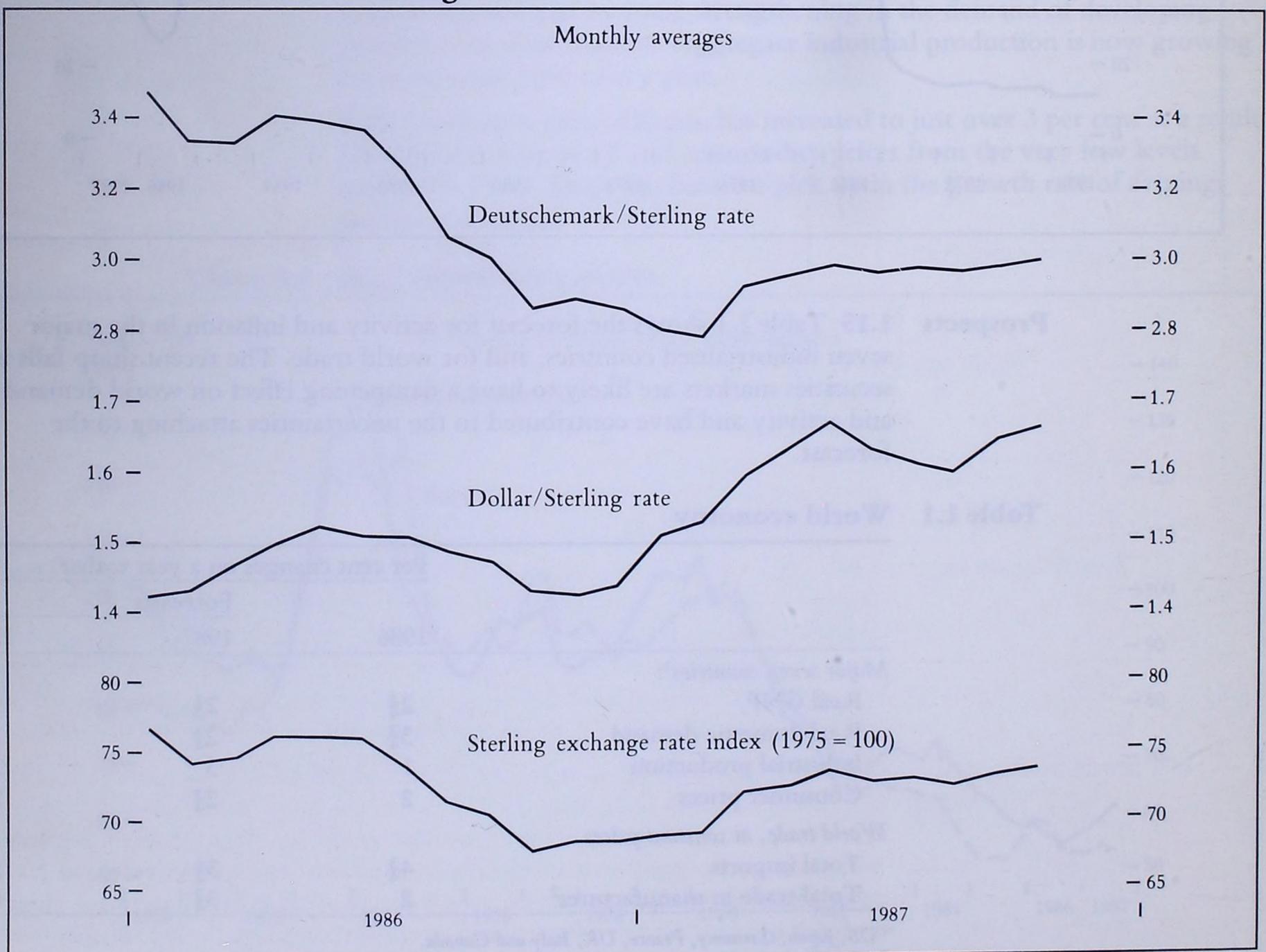
**1.17** Equity prices seem to have been a significant factor behind the continued strength of consumer demand in the US. Following recent sharp falls in equity prices some slowdown in US domestic demand is forecast, despite lower interest rates. The recent fiscal package in Japan and the tax cuts planned in Germany should help sustain the growth of their domestic demand.

**1.18** Industrial production growth in 1988 in the seven major countries should be sustained at around present levels.

**1.19** World import volumes are likely to rise by about 3½ per cent in 1987. This is somewhat slower than in 1986 when oil trade was very buoyant following the fall in price. Total world trade in manufactures, on the other hand, has strengthened and may grow by just under 4 per cent.

**1.20** Growth in world trade should be at around the same rate in 1988. Imports into non-oil developing countries are expected to increase, despite the debt problems facing some of these countries, since the export earnings of primary producers will have been increased by higher commodity prices this year. OPEC countries may cease cutting back their imports.

**Chart 1.3 Exchange rates**



## Trade and the balance of payments

### Exchange rates

**1.21** Exchange rates between major currencies have been broadly stable for most of the period since the Louvre meeting of Finance Ministers of the leading industrial countries in February. Sterling has reflected this general stability, particularly against the Deutschemark, moving within a narrow range for several months. The forecast assumes that sterling remains close to recent levels.

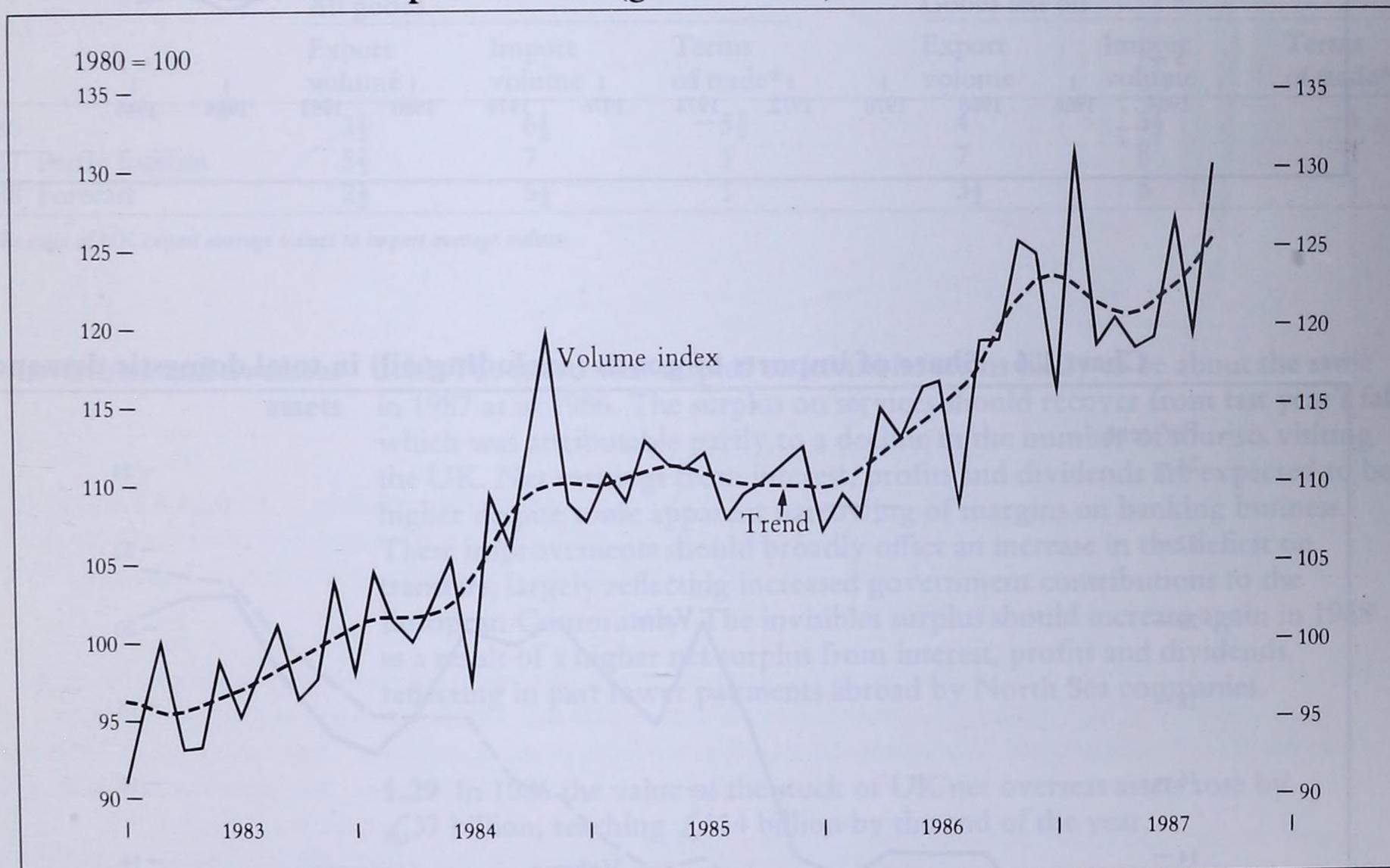
### Relative costs and prices

**1.22** UK unit labour costs in the manufacturing sector have probably been rising more slowly than those of other major industrial countries over the past year. This has meant that the large gain in competitiveness in 1986 has been sustained.

### Trade volumes (goods other than oil)

**1.23** The volume of UK manufactured exports, which remained flat in the first half of 1987, has been rising again in recent months and this should continue in 1988 as markets for UK exports continue to expand. Total non-oil exports are likely to increase by about 3½ per cent in 1988 compared with a projected 7 per cent rise in 1987.

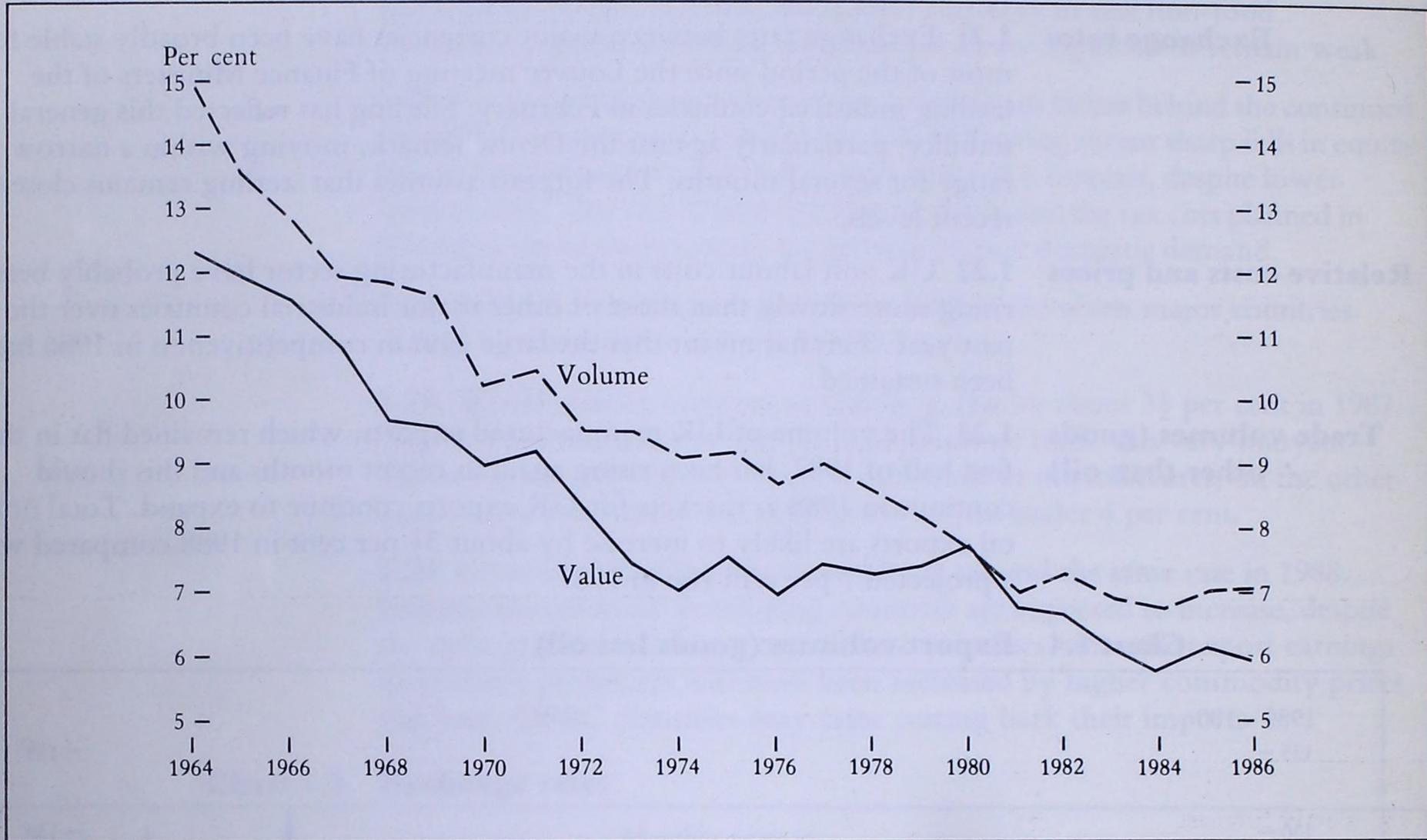
**Chart 1.4 Export volumes (goods less oil)**



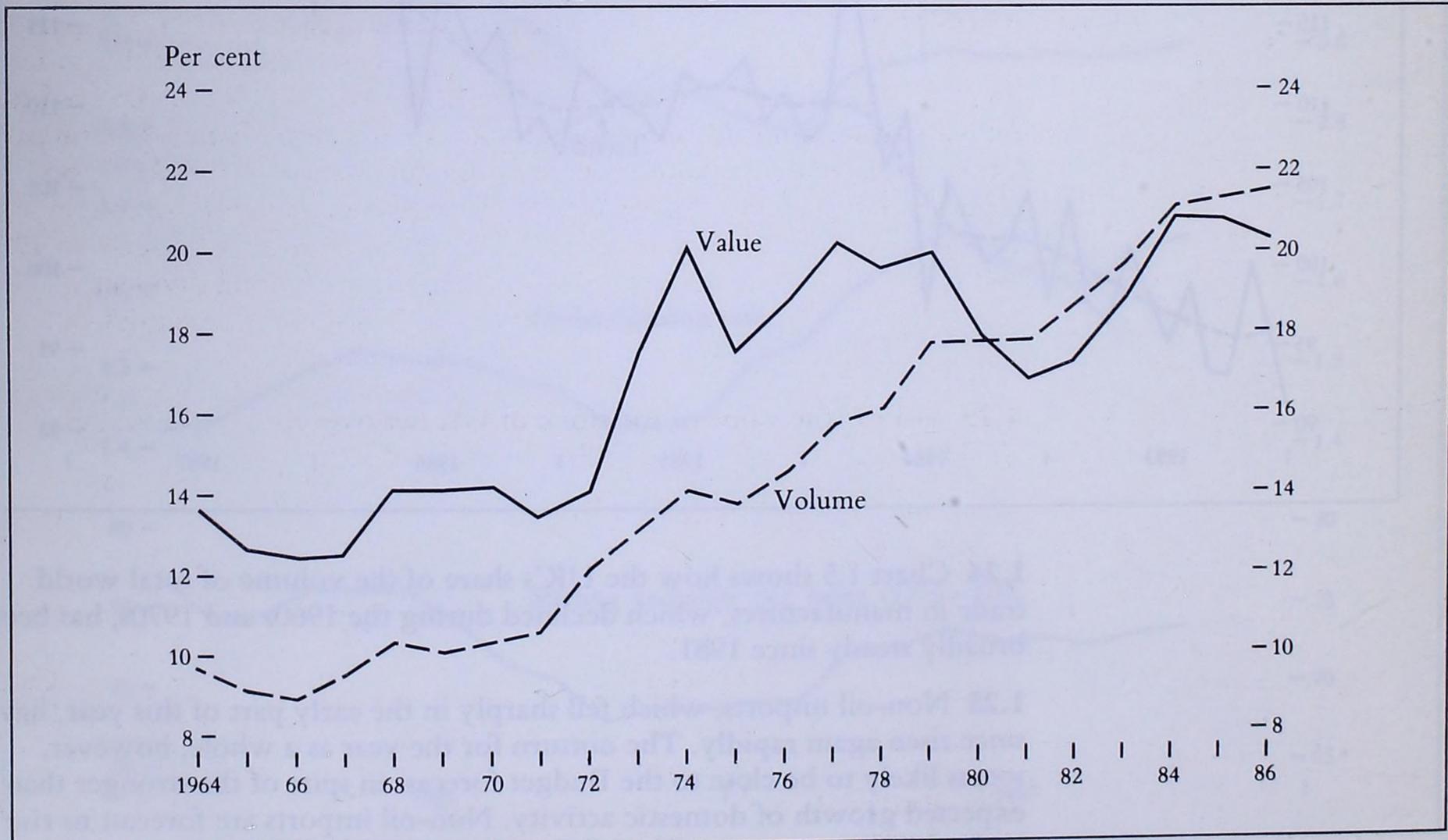
**1.24** Chart 1.5 shows how the UK's share of the volume of total world trade in manufactures, which declined during the 1960s and 1970s, has been broadly steady since 1981.

**1.25** Non-oil imports, which fell sharply in the early part of this year, have since risen again rapidly. The outturn for the year as a whole, however, seems likely to be close to the Budget forecast in spite of the stronger than expected growth of domestic activity. Non-oil imports are forecast to rise by 5 per cent next year compared to 8 per cent in 1987.

**Chart 1.5 Share of UK exports in total world trade in manufactures**



**Chart 1.6 Share of imports of goods (excluding oil) in total domestic demand**



**Oil trade** 1.26 Net oil trade is likely to show a surplus of £4 billion in 1987—similar to 1986. Lower North Sea oil output has been offset by higher oil prices and a fall in domestic demand for oil. In 1988 oil production is likely to decline again and be close to the centre of the range published in the Department of Energy's 1987 Brown Book. At the same time, domestic oil demand is likely to rise somewhat in response to rising activity. The oil trade surplus may decline by about £1 billion in 1988.

**Trade prices and the terms of trade** 1.27 The terms of trade, which fell sharply during 1986 as a result of the fall in oil prices and sterling's depreciation, have recovered somewhat during 1987 as a result of higher oil prices, lower food prices and the rise in the exchange rate in the immediate aftermath of the Louvre Accord. A small improvement in the terms of trade is forecast for 1988.

**Table 1.2 Visible trade**

	Per cent changes on previous year					
	All goods			Goods less oil		
	Export volume	Import volume	Terms of trade*	Export volume	Import volume	Terms of trade*
1986	3½	6½	-5½	4	5½	-1
1987 Partly forecast	5½	7	1	7	8	1
1988 Forecast	2½	5½	1	3½	5	1

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

**Invisibles and overseas assets** 1.28 The substantial surplus on invisibles seems likely to be about the same in 1987 as in 1986. The surplus on services should recover from last year's fall which was attributable partly to a decline in the number of tourists visiting the UK. Net earnings from interest, profits and dividends are expected to be higher despite some apparent narrowing of margins on banking business. These improvements should broadly offset an increase in the deficit on transfers, largely reflecting increased government contributions to the European Community. The invisibles surplus should increase again in 1988 as a result of a higher net surplus from interest, profits and dividends, reflecting in part lower payments abroad by North Sea companies.

1.29 In 1986 the value of the stock of UK net overseas assets rose by £37 billion, reaching £114 billion by the end of the year.

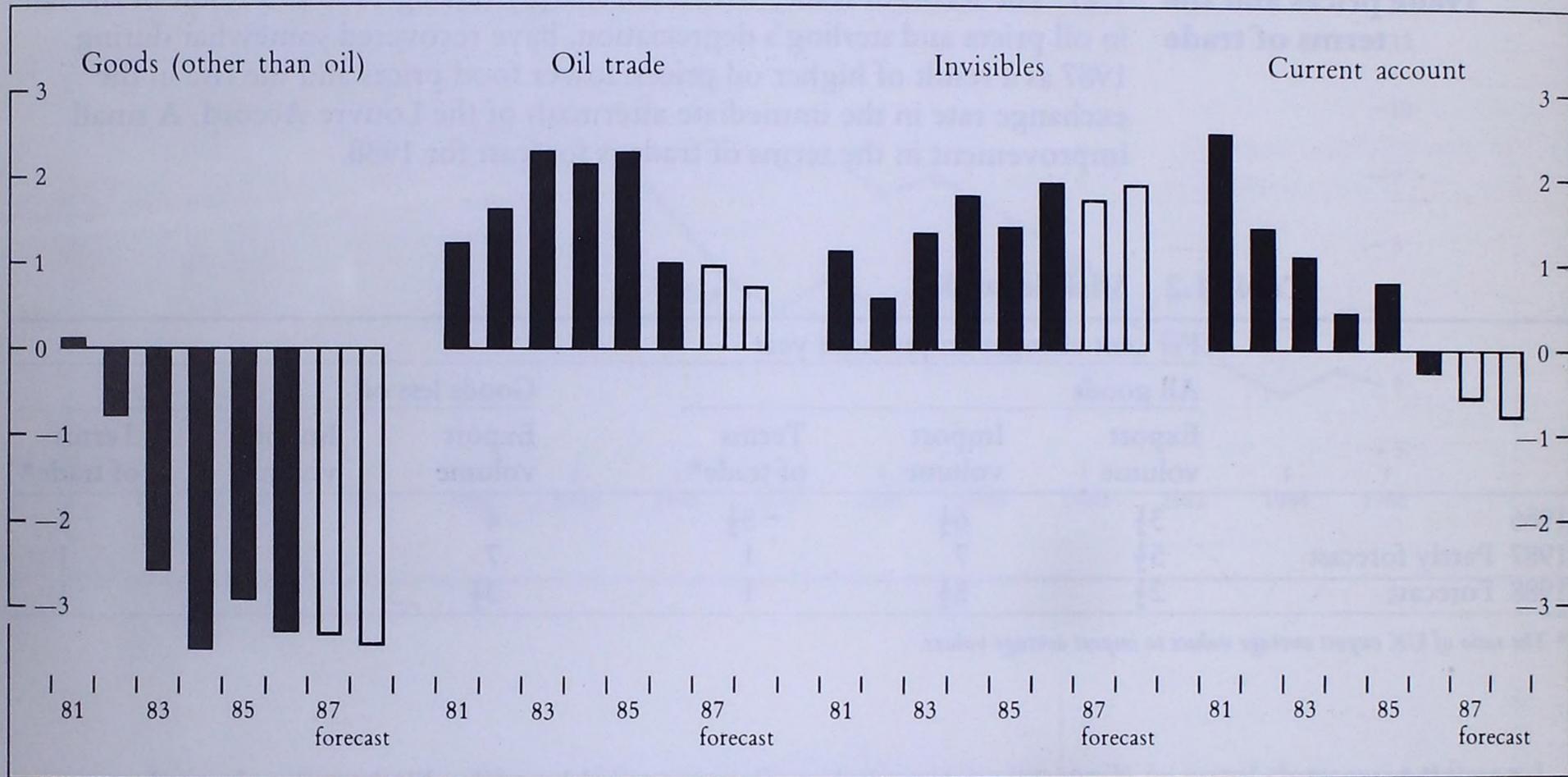
**Table 1.3 Current account**

	£ billion				
	Non oil goods		Oil	Invisibles	Current balance
	Manufactures	Other			
1986	-5½	-7	4	7½	-1
1987 Partly forecast	-7½	-6½	4	7½	-2½
1988 Forecast	-9	-6	3	8½	-3½

**Current account**

**1.30** The current account was in deficit by £1¼ billion in the third quarter of this year after a surplus of £½ billion in the first half of the year. The forecast for the year as a whole is for a deficit of £2½ billion, in line with the projection made at the time of the Budget. This is equivalent to about ½ per cent of GDP. The forecast for 1988 is for a slightly higher deficit of £3½ billion, reflecting the fall in the oil surplus.

**Chart 1.7 The current account of the balance of payments (surpluses and deficits as a percentage of GDP)**



**Demand and activity**

**1.31** The UK economy has been growing steadily at around 3 per cent a year on average since early 1981, with only minor fluctuations. Over the year to the first half of 1987 growth has been above this average rate, at close to 4 per cent.

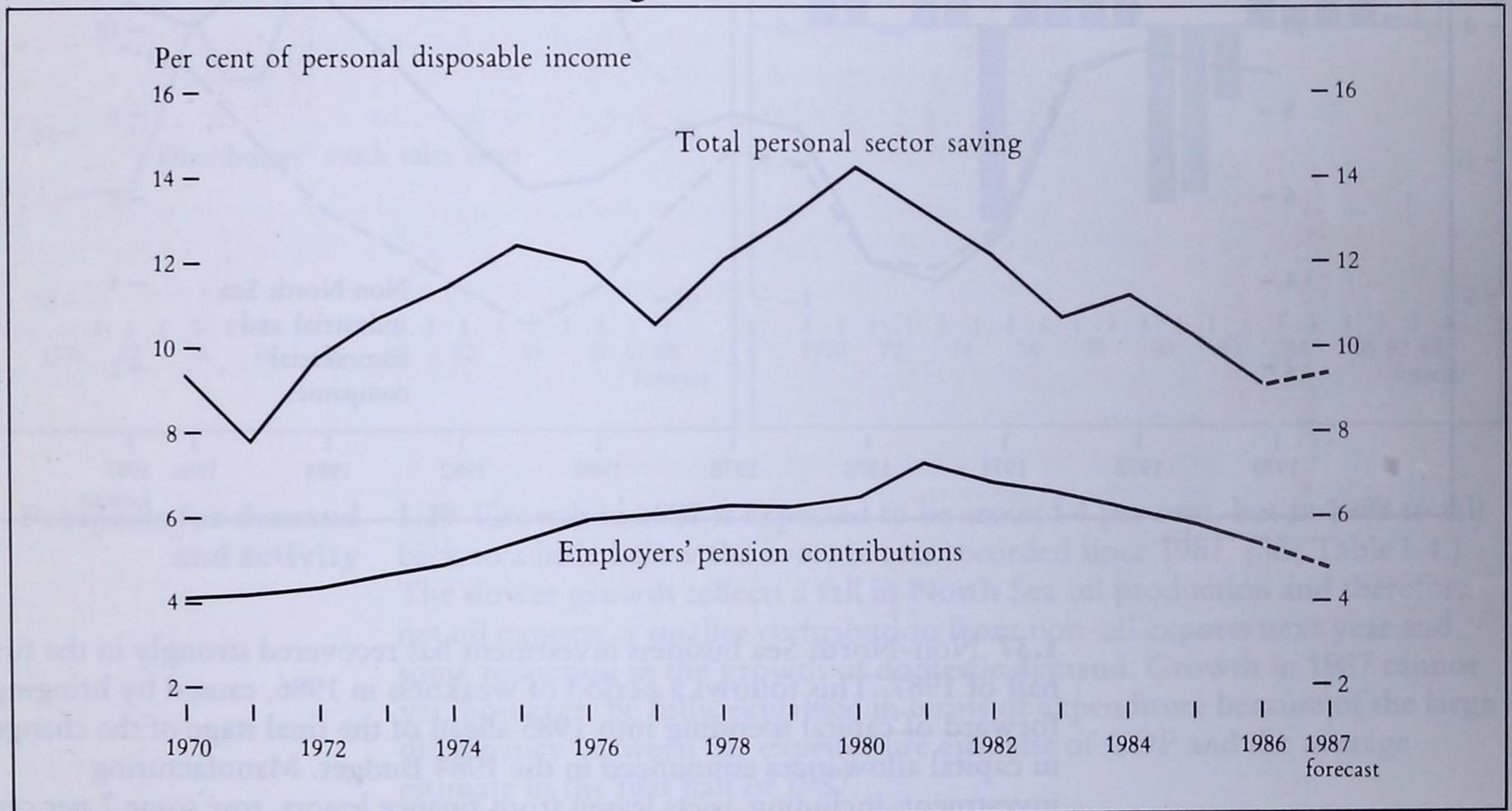
**1.32** Over that period output growth has been strong in all sectors of the economy other than the North Sea where production has fallen. Output of the service industries rose by 5 per cent between the first halves of 1986 and 1987, manufacturing output by over 4½ per cent and construction output by 7½ per cent. The recent rise in construction output has reflected not only growing private sector housebuilding, but also higher commercial building activity. Results of the last DTI investment intentions survey and the CBI quarterly industrial trends enquiry, together with recent figures for construction orders, suggest that commercial and industrial building is likely to be an important source of further growth in construction output over the next year or so.

**Personal sector expenditure**

**1.33** Consumers' expenditure is now estimated to have increased by nearly 6 per cent in 1986, substantially more than growth in real personal disposable income. The personal savings ratio fell by about 1½ percentage points between 1985 and 1986, bringing it back to around the average level

of the late 1960s and early 1970s. There are at least two major reasons why the savings ratio has fallen in recent years. First, the decline in inflation has reduced the extent to which households need to save simply to make good the erosion of past savings. Secondly, employers' contributions to pension funds have been falling relative to personal disposable income in recent years as companies have reacted to the surpluses that many funds have been showing: these contributions are treated in the national accounts as part of personal income and saving. This fall is unlikely to have had a large effect on consumers' expenditure and hence will have shown up as a fall in the recorded personal savings ratio. Chart 1.8 shows the savings ratio and the share of employers' contributions to pension funds in personal disposable income.

**Chart 1.8 Personal saving**



**1.34** For 1987 as a whole consumer spending may rise by about 5 per cent, similar to the rise in real personal disposable income. In 1988 consumer spending may grow by about 4 per cent, with some rise in the savings ratio.

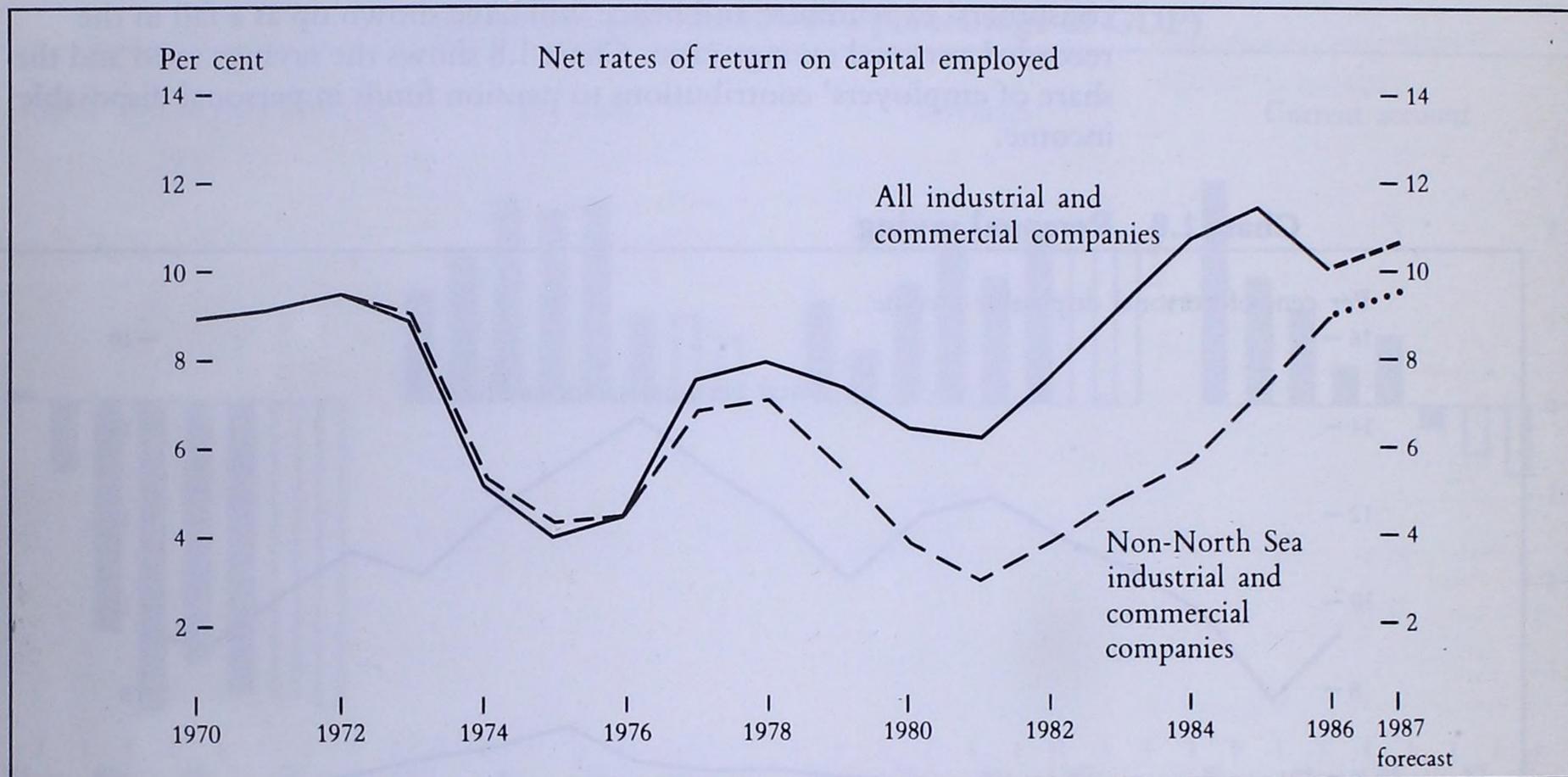
**1.35** The housing market remains very buoyant. Although private housing starts have fallen back from their high first quarter levels, for the first eight months of 1987 as a whole they were 7 per cent higher than the year before, while private completions were 8½ per cent higher. With investment in improvements rising fast, private housing investment in 1987 as a whole may record an increase only a little below the 12 per cent rise seen in 1986. Housing investment is expected to rise further in 1988.

**Company incomes and expenditure**

**1.36** The rate of return of non-North Sea industrial and commercial companies (ICCs) rose sharply again last year, and was back almost to the level recorded in 1973, while the rate of return of manufacturing companies

was more than 3½ times the level recorded in 1981. The sharp fall in North Sea companies' profits brought about a reduction in the net real rate of return earned by all ICCs in 1986 to some 10 per cent. But North Sea profitability appears to have improved this year as a result of the partial recovery in the oil price while the rate of return of non-North Sea companies has continued to rise, helped by strong growth in productivity.

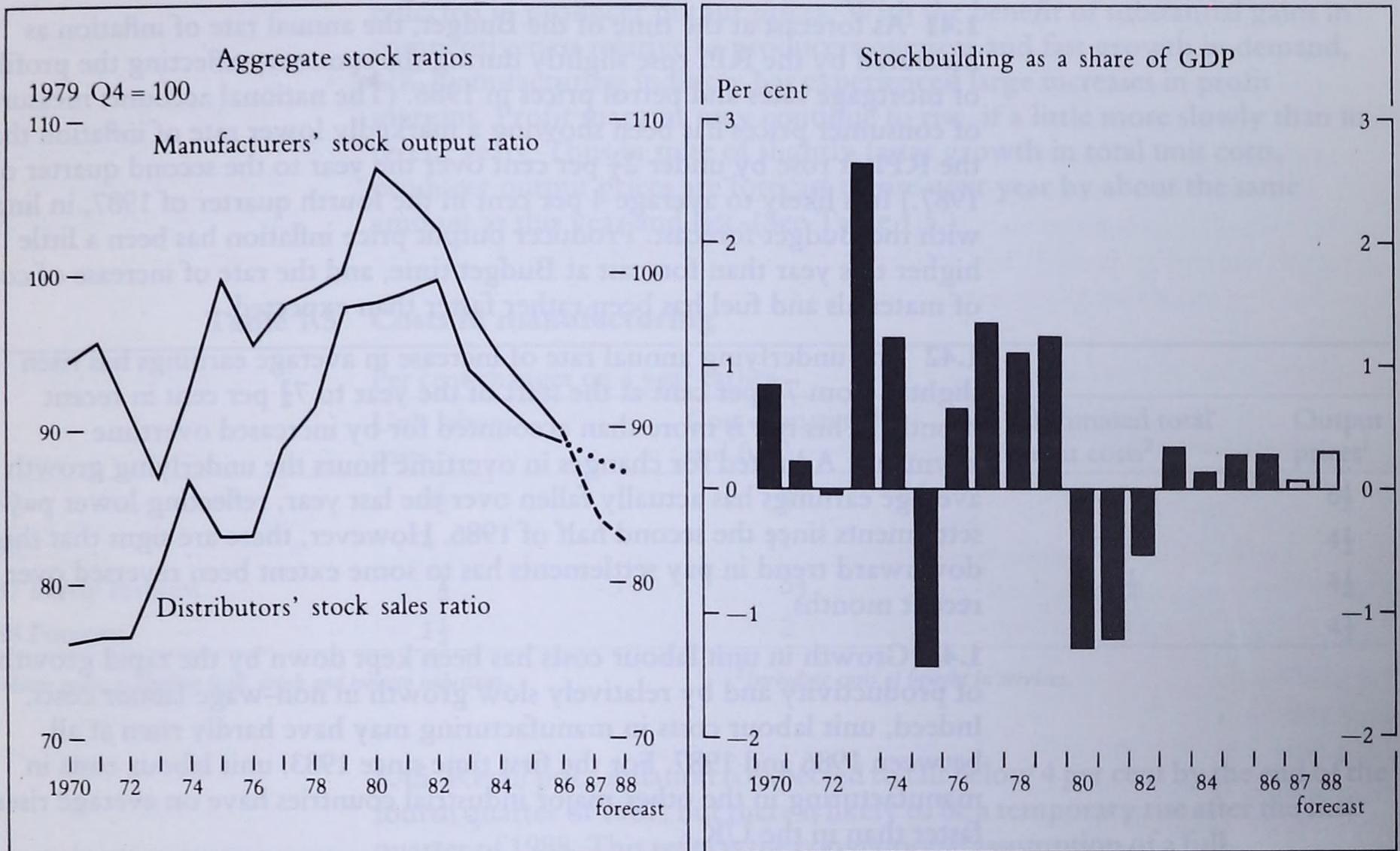
**Chart 1.9 Companies' real rates of return**



**1.37** Non-North Sea business investment has recovered strongly in the first half of 1987. This follows a period of weakness in 1986, caused by bringing forward of capital spending into 1985 ahead of the final stage of the changes in capital allowances announced in the 1984 Budget. Manufacturing investment, including assets leased from finance lessors, rose some 7 per cent between the second half of 1986 and the first half of 1987. The projections of the DTI's June investment intentions survey for 1987 (4 per cent growth in manufacturing investment and 8 per cent growth in investment on average in all industries covered) now seem likely to be exceeded. The recent performance of output and profitability suggests faster growth of manufacturing investment next year. North Sea investment seems likely to fall again this year, to less than two thirds of the 1984 level, but may change little further next year.

**1.38** Stocks fell in the first half of 1987. Given the sharp rise in sales, there may have been some involuntary element in the fall in manufacturing stocks. The full effect of the abolition of stock relief in the 1984 Budget may now have largely fed through. Thus while stock output ratios are expected to fall further over the second half of 1987 and in 1988, the absolute level of stocks could rise. Stockbuilding is forecast to remain on a modest scale compared with many years in the 1970s (see Chart 1.10).

Chart 1.10 Stockbuilding



**Prospects for demand and activity**

**1.39** Growth in 1987 is expected to be around 4 per cent, but in 1988 to fall back to a little below the average rate recorded since 1981. (See Table 1.4.) The slower growth reflects a fall in North Sea oil production and therefore net oil exports, a smaller contribution from non-oil exports next year and some reduction in the growth of domestic demand. Growth in 1987 cannot yet, however, be fully explained in terms of expenditure because of the large discrepancy between the expenditure estimate of GDP and the average estimate in the first half of 1987.

**1.40** North Sea output fell by some 2 per cent between the first halves of 1986 and 1987 and is expected to decline further in 1988. In 1988 declining output in the North Sea may reduce GDP growth by a little over ½ percentage point, rather more than in 1987. Manufacturing output is forecast to rise faster than total non-North Sea GDP in both 1987 and 1988.

Table 1.4 Domestic demand and GDP

	Per cent changes on a year earlier		
	1986	Forecasts	
		1987	1988
Domestic demand	4	4	3½
Exports of goods and services <sup>1</sup>	3 (3½)	5½ (6½)	2 (3)
Imports of goods and services <sup>1</sup>	6 (5½)	6½ (7)	5 (4½)
Domestic production: GDP <sup>1,2</sup>	3 (3)	4 (4½)	2½ (3)
Manufacturing production	1	5	3½

<sup>1</sup> Non-oil shown in brackets.

<sup>2</sup> Average measure.

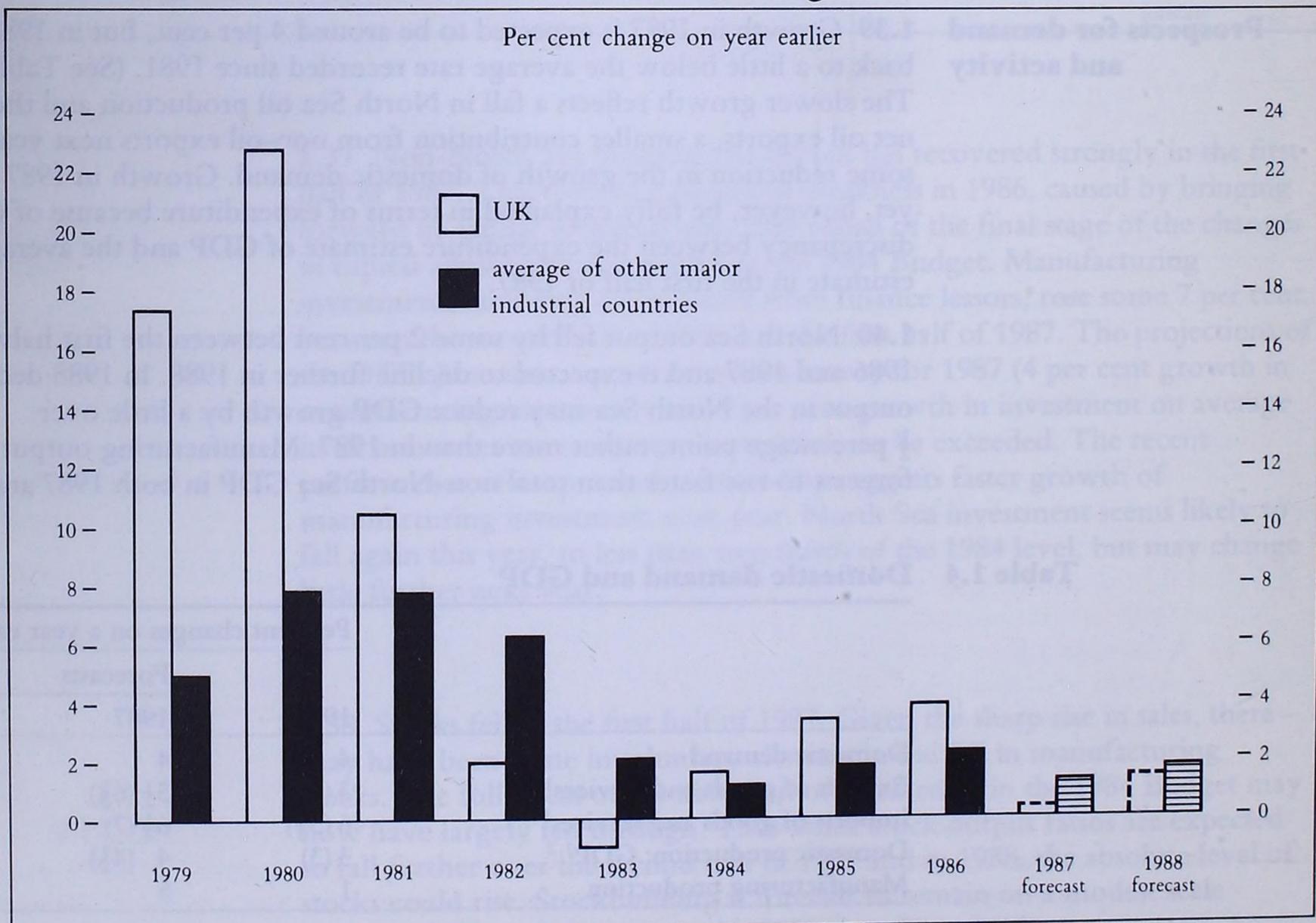
### Inflation

1.41 As forecast at the time of the Budget, the annual rate of inflation as measured by the RPI rose slightly during the summer, reflecting the profile of mortgage rates and petrol prices in 1986. (The national accounts measure of consumer prices has been showing a markedly lower rate of inflation than the RPI: it rose by under 2½ per cent over the year to the second quarter of 1987.) It is likely to average 4 per cent in the fourth quarter of 1987, in line with the Budget forecast. Producer output price inflation has been a little higher this year than forecast at Budget time, and the rate of increase of costs of materials and fuel has been rather faster than expected.

1.42 The underlying annual rate of increase in average earnings has risen slightly from 7½ per cent at the start of the year to 7¾ per cent in recent months. This rise is more than accounted for by increased overtime payments. Adjusted for changes in overtime hours the underlying growth in average earnings has actually fallen over the last year, reflecting lower pay settlements since the second half of 1986. However, there are signs that this downward trend in pay settlements has to some extent been reversed over recent months.

1.43 Growth in unit labour costs has been kept down by the rapid growth of productivity and by relatively slow growth in non-wage labour costs. Indeed, unit labour costs in manufacturing may have hardly risen at all between 1986 and 1987. For the first time since 1983, unit labour costs in manufacturing in the other major industrial countries have on average risen faster than in the UK.

Chart 1.11 Unit labour costs in manufacturing



**Prospects 1.44** The very low growth in costs over the last two years has not been fully reflected in producer output prices. With the benefit of substantial gains in competitiveness relative to producers overseas and fast growth in demand, UK manufacturing industry has experienced large increases in profit margins. Profit margins may continue to rise, if a little more slowly than in recent years. Thus in spite of slightly faster growth in total unit costs, producer output prices are forecast to rise next year by about the same amount as this year and last. (See Table 1.5.)

**Table 1.5 Costs in manufacturing**

	Per cent changes on a year earlier			
	Unit labour costs	Cost of materials and fuel <sup>1</sup>	Estimated total unit costs <sup>2</sup>	Output prices <sup>1</sup>
1985	3½	4	4	6½
1986	4	-11	-½	4½
1987 Partly forecast	½	5½	1½	4½
1988 Forecast	1½	2	2	4½

<sup>1</sup> Producer prices excluding food, drink and tobacco industries.

<sup>2</sup> Including costs of bought in services.

**1.45** Retail price inflation is expected to fall below 4 per cent by the end of the fourth quarter of 1987, but there is likely to be a temporary rise after the first quarter of 1988. This reflects the conventional assumption of a full revalorisation of specific duties in the 1988 Budget, compared with the standstill in the 1987 Budget; and the need for higher increases in nationalised industry prices in 1988 after the fall in real terms this year in order to improve profitability and help finance investment. The forecast is for the RPI to increase by 4½ per cent over the year to the fourth quarter of 1988.

**Table 1.6 Retail prices index**

	Weight in 1987	Per cent changes on a year earlier		
		1986 Q4	Forecasts	
			1987 Q4	1988 Q4
Food	16½	3¼	3½	3
Nationalised industries	6	3½	2¼	6¼
Housing	15	7	7¼	7
Other	62½	2½	3½	4¼
<b>Total</b>	<b>100</b>	<b>3½</b>	<b>4</b>	<b>4½</b>

**1.46** The GDP deflator measures the price of domestic value added—principally unit labour costs and profits per unit of output—and excludes import prices. The GDP deflator at market prices is forecast to rise by 4¼ per cent in the current financial year, just below the Budget forecast, following an increase of 3 per cent last year. The higher rate of increase this year is more than accounted for by a recovery in North Sea profits following their fall of over 50 per cent in 1986–87. The GDP deflator is now forecast to rise by 4½ per cent in 1988–89.

## Productivity and the labour market

1.47 The growth in the employed labour force in Great Britain has been gathering pace over the last year: in the twelve months to June 1987 it is estimated to have risen by 372,000. Since 1983, there has been an increase of over 1,350,000 in the number of jobs. The strong growth in manufacturing and construction output this year has been reflected in particular in a rise in male employees: the 86,000 rise in the six months to June was the largest half yearly rise since the first half of 1973.

**Table 1.7 Employment**

	Thousands, change in GB seasonally adjusted				
	Employees in employment		Self-employed	HM Forces	Employed labour force
	Male	Female			
June 1984 to June 1985	+ 82	+ 191	+ 115	0	+ 387
June 1985 to June 1986	- 56	+ 151	+ 17	- 4	+ 108
June 1986 to June 1987	+ 72	+ 200	+ 102*	- 3	+ 372

\* Figures for self-employment over the last year are a projection based on self-employment growth over the previous five years.

1.48 Productivity has been growing strongly, with manufacturing productivity now estimated to have risen by 4 per cent a year on average since 1979. Underlying growth in labour productivity in manufacturing industry now appears to be if anything higher than the rate experienced in the 1960s. This has been accompanied recently by a substantial improvement in capital productivity. Non-manufacturing output per man hour has risen by about 2 per cent a year since 1979, and by about 2½ per cent a year since 1983. Output per head has grown less than this as a result of the large rise in part-time employment.

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

	Annual averages, per cent change		
	1964-73	1973-79	1979-87
Manufacturing	3¾	¾	4
Non-manufacturing <sup>1</sup>	3	½	1½
Whole economy	2¾	1	2
Non-North Sea economy	2¾	½	1¾

<sup>1</sup> Excludes public services and North Sea oil and gas extraction.

**Unemployment** 1.49 Since June 1986 seasonally adjusted adult unemployment in the UK has fallen for fifteen months in succession, by some 437,000 in total; the number of unemployed school leavers has also fallen, by some 48,000 over the last year. The greater part of the improved trend in unemployment this year is attributable to the strong growth of output and employment. The remainder is due to various government measures to provide training or work experience for the unemployed, or to help them to find jobs. The prospects for the UK economy over the next year mean that a further fall in unemployment is likely. The main danger to the chances of further progress in reducing unemployment is of pay settlements being too high.

**Financial developments** 1.50 The sterling exchange rate, as already noted, has been broadly stable over the past eight months, following the conclusion of the Louvre agreement. During that time there has been a substantial inflow into the Reserves amounting to some \$16 billion.

1.51 The year-on-year growth of M0 has been somewhat above the midpoint of its 2–6 per cent target range in recent months, in part reflecting earlier falls in interest rates. M0 is expected to continue to grow quite briskly in the immediate future before slowing down again.

1.52 Broad money has continued to rise rapidly. This has reflected, at least in part, increased deposits by companies and financial institutions. The strong growth of broad money, which has been evident in recent years, is to a considerable extent the consequence of financial innovation and liberalisation.

1.53 The sharp fall in share prices will tighten monetary conditions somewhat. This will to some extent be offset by the recent fall in short term interest rates; and long term rates have also eased. On the balance of evidence, monetary conditions remain firm.

**Fiscal developments** 1.54 Tables 1.9 to 1.11 show both the Budget projections and latest forecasts for general government expenditure and receipts and public sector borrowing in 1987–88. They show also the 1986–87 outturn. The PSBR in 1986–87 was £3½ billion, £¾ billion lower than estimated in the 1987 FSR. Lower central government borrowing, more than accounted for by higher than expected tax revenues, was responsible for over half of this downward revision, with the remainder due to lower than expected local authority borrowing.

1.55 In the first six months of 1987–88 the PSBR was £1½ billion. Excluding privatisation proceeds, borrowing was about £1¼ billion lower than in the first half of 1986–87. The revised forecast for 1987–88 as a whole is a PSBR of £1 billion, about £3 billion lower than forecast in the FSR. This is mainly due to higher than expected tax revenues but there is also likely to be a shortfall on the expenditure side.

1.56 Table 1.9 shows the relationship between the public expenditure planning total and general government expenditure. The outturn for the public expenditure planning total is expected to be £1 billion lower than

was forecast in the FSBR. This is largely accounted for by higher capital receipts of local authorities and new towns. Excluding privatisation proceeds, general government expenditure is now projected to increase by 5 per cent in 1987–88, a little less than the increase in 1986–87.

**Table 1.9 General government expenditure**

	£ billion		
	1986–87	1987–88	
	Outturn	Budget Forecast	Latest Forecast
Public expenditure planning total	139.4	148.6	147.6
Interest payments	17.4	17.9	17.8
Less public corporations' market and overseas borrowing	-1.5	-0.8	-0.7
Other adjustments	6.8	6.2	6.7
<b>General government expenditure</b>	<b>165.1</b>	<b>173.5</b>	<b>172.8</b>
of which			
Privatisation proceeds	-4.4	-5.0	-5.0

**1.57** Table 1.10 shows the forecast for general government receipts. The forecast of tax and national insurance revenues has been increased by £2 $\frac{3}{4}$  billion since the Budget. The forecast of on-shore corporation tax, including ACT, is about £ $\frac{3}{4}$  billion higher, mainly reflecting upward revisions, since the FSBR, to profits estimates for 1986 and, in the case of ACT, a higher level of dividend payments so far in 1987. The upward revision of £ $\frac{1}{2}$  billion to North Sea revenues is more than accounted for by the higher dollar oil price than was assumed at Budget time. The forecasts of personal income tax, VAT and national insurance contributions are also each about £ $\frac{1}{2}$  billion higher than in the FSBR. General government receipts in total are now forecast to rise by nearly 7 per cent in 1987–88, following an increase of 6 per cent in 1986–87 (when North Sea revenues more than halved).

**Table 1.10 General government receipts**

	£ billion		
	1986–87	1987–88	
	Outturn	Budget Forecast	Latest Forecast
Taxes on income, expenditure and capital	119.6	127.8	130.1
National insurance and other contributions	26.7	28.5	28.9
Interest and other receipts	13.4	12.6	12.3
Accruals adjustment	0.5	0.0	-0.2
<b>Total receipts</b>	<b>160.3</b>	<b>168.8</b>	<b>171.1</b>
of which			
North Sea revenues	4.8	3.9	4.5

1.58 Table 1.11 shows the old and new forecasts for borrowing. The PSBR forecast is still subject to a great degree of uncertainty: the average error on PSBR forecasts for the current financial year made in the autumn is  $\frac{1}{2}$  per cent of GDP, or £2½ billion. But on the basis of this forecast, the PSBR, both including and excluding privatisation proceeds, will be lower as a proportion of money GDP than in any year since 1970–71.

**Table 1.11 Public sector borrowing**

	£ billion		
	1986–87	1987–88	
	Outturn	Budget Forecast	Latest Forecast
General government expenditure	165.1	173.5	172.8
General government receipts	160.3	168.8	171.1
General government borrowing requirement	4.9	4.7	1.7
Public corporations' market and overseas borrowing	-1.5	-0.8	-0.7
<b>PSBR</b>	<b>3.4</b>	<b>3.9</b>	<b>1.0</b>
<b>PSBR as per cent of GDP</b>	<b>1</b>	<b>1</b>	<b><math>\frac{1}{4}</math></b>
Memorandum item:			
PSBR excluding privatisation proceeds	7.8	8.9	6.0
As per cent of GDP	2	2½	1½

Table 1.12 Economic prospects: summary

	Forecast		Average errors from past forecasts <sup>1</sup>
	1986 to 1987	1987 to 1988	
	per cent changes		percentage points
<b>Output and expenditure at constant 1980 prices</b>			
Domestic demand	4	3½	1
of which:			
Consumers' expenditure	5	4	1¼
General government consumption	½	½	1
Fixed investment	5½	4½	2¼
Change in stockbuilding (as per cent of level of GDP)	0	0	½
Exports of goods and services	5½	2	2½
Imports of goods and services	6½	5	2¾
Gross domestic product: total	4	2½	¾
manufacturing	5	3½	2¼
<b>Inflation</b>			
Retail prices index	per cent changes		
1986 Q4 to 1987 Q4	4		¼
1987 Q4 to 1988 Q4	4½		2
<b>Deflator for GDP at market prices</b>			
	per cent changes on a year earlier		
Financial year 1987-88	4¼		1
Financial year 1988-89	4½		2
<b>Money GDP at market prices</b>			
	£ billion <sup>2</sup>		
Financial year 1987-88	418 (8½)		1
Financial year 1988-89	448 (7¼)		1½
<b>Balance of payments on current account</b>			
1987	-2½		1½
1988	-3½		3

<sup>1</sup> The errors relate to the average differences (on either side of the central figure) between forecast and outturn; the errors given for constant price output and expenditure 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 1985.

<sup>2</sup> Per cent change on previous financial year in brackets; average error shown relates to the forecast of the percentage change.

**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 <sup>1</sup>	GDP index 1980 = 100
1982	138.4	49.6	39.5	63.1	-1.0	<b>289.7</b>	59.2	30.6	0.9	<b>200.8</b>	100.5
1983	144.0	50.6	41.6	64.4	0.7	<b>301.2</b>	62.7	31.6	0.5	<b>207.4</b>	103.9
1984	147.1	51.0	45.0	68.9	0.3	<b>312.2</b>	68.8	32.8	2.0	<b>212.7</b>	106.5
1985	152.5	50.9	46.4	72.8	0.6	<b>323.3</b>	70.7	33.9	1.7	<b>220.4</b>	110.4
1986	161.3	51.4	46.5	75.1	0.7	<b>335.0</b>	75.1	35.4	2.7	<b>227.1</b>	113.8
1987	169.0	51.6	49.0	79.2	0.2	<b>348.9</b>	80.0	37.1	4.4	<b>236.3</b>	118.3
1988	176.0	51.9	51.2	80.9	0.8	<b>360.7</b>	84.1	38.4	4.5	<b>242.7</b>	121.6
1986 H1	79.6	25.7	22.9	36.6	0.4	<b>165.2</b>	35.9	17.4	0.8	<b>112.7</b>	112.9
H2	81.6	25.7	23.7	38.5	0.3	<b>169.8</b>	39.2	18.0	1.9	<b>114.5</b>	114.7
1987 H1	83.0	25.6	23.9	39.0	-0.3	<b>171.3</b>	38.3	18.3	2.2	<b>116.9</b>	117.1
H2	86.1	25.9	25.1	40.1	0.4	<b>177.7</b>	41.7	18.8	2.2	<b>119.4</b>	119.6
1988 H1	87.3	25.9	25.3	40.1	0.3	<b>179.0</b>	41.7	19.1	2.2	<b>120.5</b>	120.7
H2	88.7	25.9	25.9	40.8	0.4	<b>181.7</b>	42.4	19.3	2.2	<b>122.2</b>	122.4
Per cent changes											
1985 to 1986	6	1	$\frac{1}{2}$	3	—	$3\frac{1}{2}$	6	$4\frac{1}{2}$	—	3	3
1986 to 1987	5	$\frac{1}{2}$	$5\frac{1}{2}$	$5\frac{1}{2}$	—	4	$6\frac{1}{2}$	$4\frac{1}{2}$	—	4	4
1987 to 1988	4	$\frac{1}{2}$	$4\frac{1}{2}$	2	—	$3\frac{1}{2}$	5	$3\frac{1}{2}$	—	$2\frac{1}{2}$	$2\frac{1}{2}$

<sup>1</sup> The average measure of gross domestic product—the preferred measure of economic activity—grew by some  $3\frac{3}{4}$  per cent between the first halves of 1986 and 1987. The output-based measure, the most reliable indicator of short period GDP movements, similarly suggests growth of around 4 per cent.

Timing and other measurement difficulties in the national accounts make it difficult to relate directly the three measures of GDP; it seems appropriate to discount the lower growth rate currently shown by the expenditure measure of GDP.

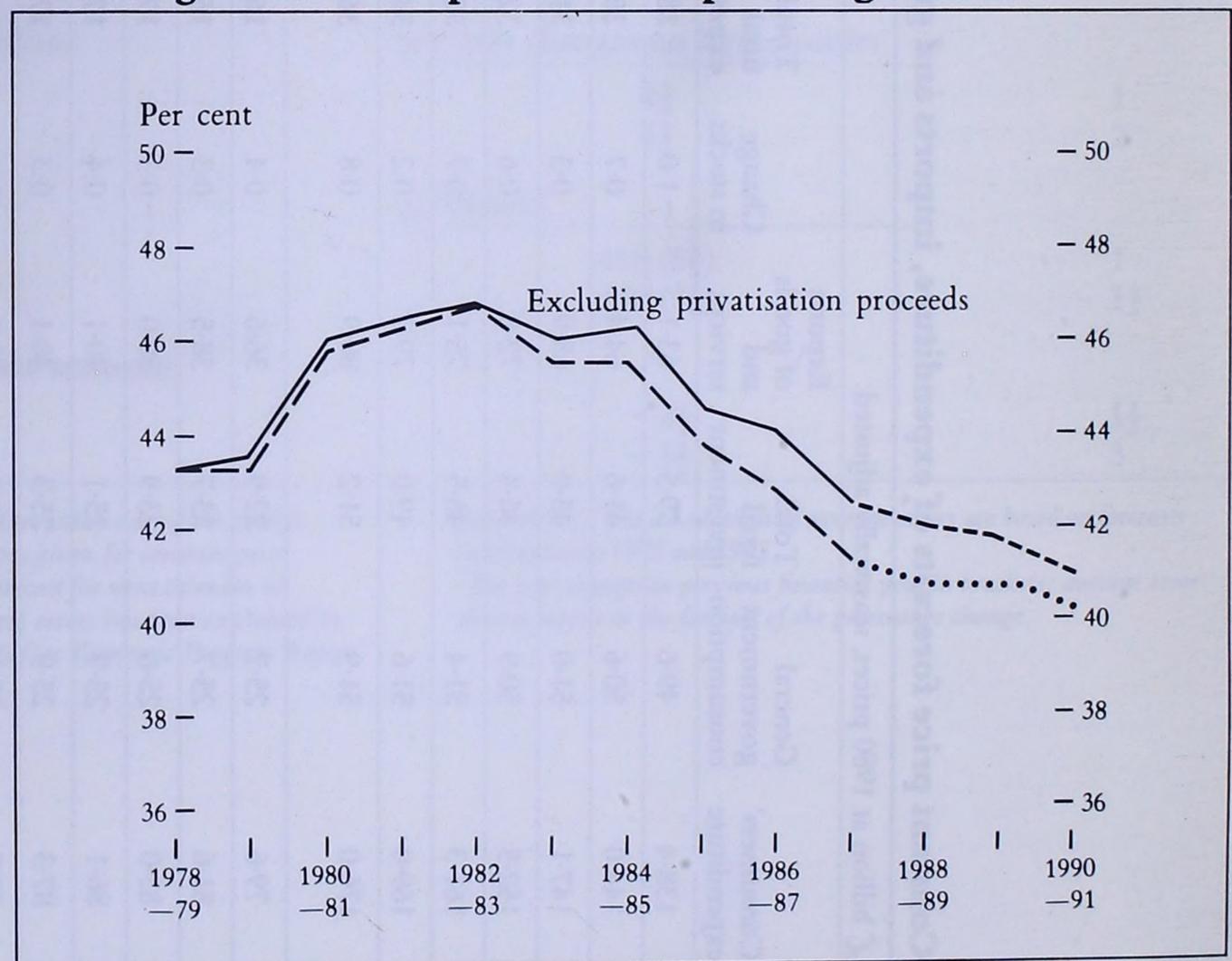
# 2 Public expenditure plans

## Main points

**2.01** Public expenditure will continue to fall as a proportion of the nation's income over the next three years. Excluding privatisation proceeds, general government expenditure is expected to fall sharply as a percentage of GDP from 44 per cent in 1986–87 to 42½ per cent in 1987–88 and then gradually to 41¼ per cent in 1990–91, the lowest it has been since the early 1970s. The new ratios are lower in each year than those envisaged in the last public expenditure White Paper (Cm 56).

**2.02** The public expenditure planning totals have been set at £156·8 billion for 1988–89 and £167·1 billion for 1989–90, increases of £2·6 billion and £5·6 billion over those published in Cm 56. A planning total of £176·1 billion has been set for 1990–91.

**Chart 2.1** General government expenditure as a percentage of GDP

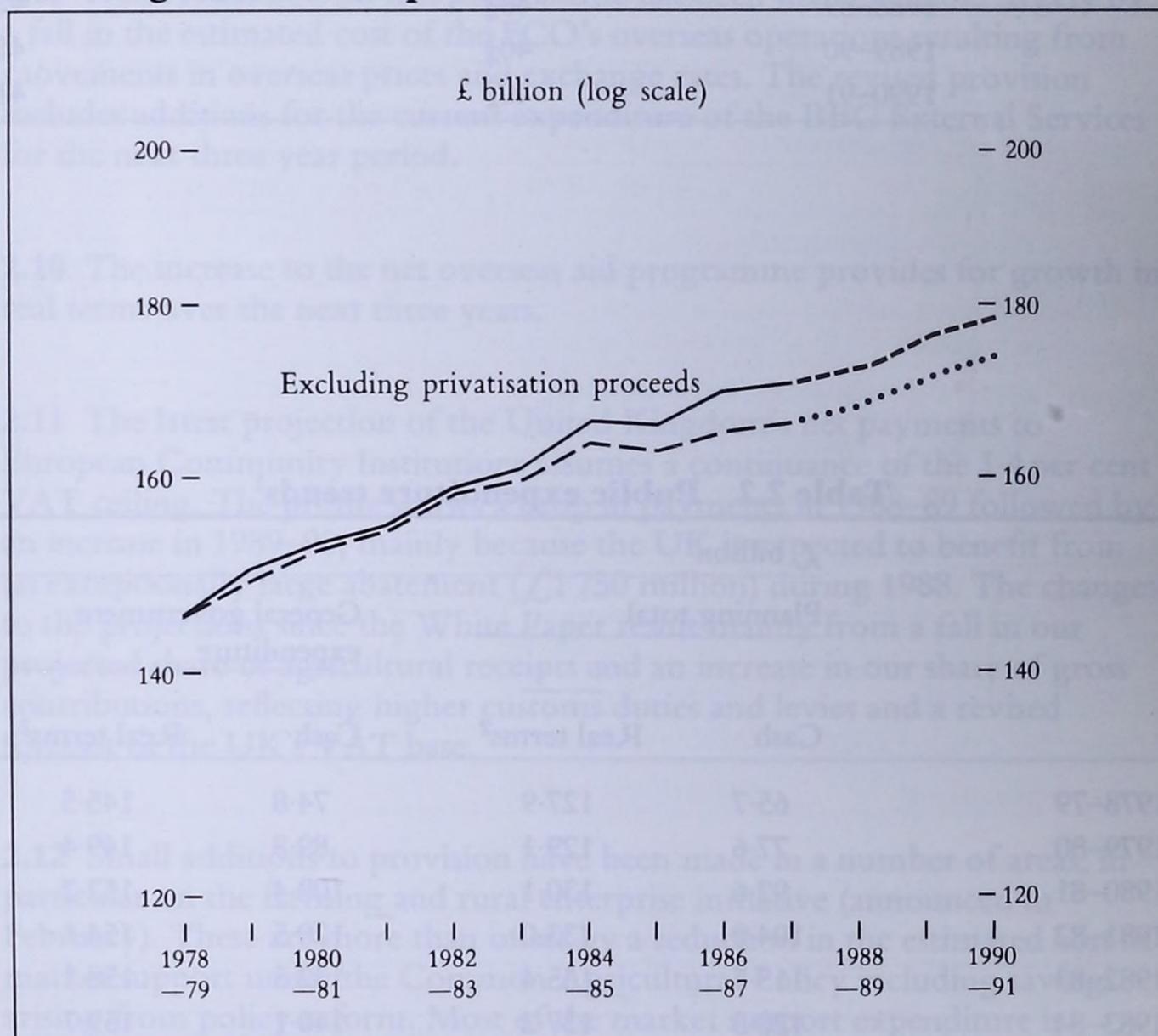


**2.03** In real terms, the average growth in general government expenditure excluding privatisation proceeds in the four years from 1986–87 to 1990–91 is expected to be 1¼ per cent a year. This compares with growth averaging almost 3 per cent in the decade up to 1978–79, around 2¼ per cent in the four years from 1978–79 to 1982–83 and around 1¾ per cent in the four years from 1982–83 to 1986–87.

**2.04** The new plans include increased provision for priority services such as health, law and order, defence, and education. Extra provision of some £1 billion has also been made for capital spending in each year; this includes large increases for the nationalised industries and for housing, education, and inner cities. The plans include substantial uplifts for local authority current and social security expenditure. They also provide for larger uncommitted Reserves in the two later years. Full details of the spending plans will be published in the forthcoming 1988 public expenditure White Paper.

**2.05** The trends of public spending as a percentage of GDP and in real terms are illustrated in Charts 2.1 and 2.2 and summarised in Tables 2.1 and 2.2.

**Chart 2.2 General government expenditure in real terms<sup>1</sup>**



<sup>1</sup> Cash figures adjusted to 1986-87 price levels by excluding the effect of general inflation as measured by the GDP deflator.

**1987-88: outturn**

**2.06** The latest forecast of the planning total in the current year, 1987-88, is £147.6 billion. This is £1 billion lower than was planned and published in Cm 56. The reduction can be attributed to increases in the capital receipts of local authorities and new towns.

**Table 2.1 Public expenditure as percentage of GDP**

	General government expenditure	General government expenditure (excluding privatisation proceeds)
1978-79	43¼	43¼
1979-80	43¼	43½
1980-81	45¾	46
1981-82	46¼	46½
1982-83	46¾	46¾
1983-84	45½	46
1984-85	45½	46¼
1985-86	43¾	44½
1986-87	42¾	44
1987-88	41¼	42½
1988-89	40¾	42
1989-90	40¾	41¾
1990-91	40¼	41¼

**Table 2.2 Public expenditure trends<sup>1</sup>**

	£ billion					
	Planning total		General government expenditure		General government expenditure (excluding privatisation proceeds)	
	Cash	Real terms <sup>2</sup>	Cash	Real terms <sup>2</sup>	Cash	Real terms <sup>2</sup>
1978-79	65.7	127.9	74.8	145.5	74.8	145.5
1979-80	77.6	129.1	89.8	149.4	90.1	150.1
1980-81	92.6	130.1	108.4	152.2	108.8	152.8
1981-82	104.0	133.0	120.5	154.1	121.0	154.7
1982-83	113.5	135.4	132.5	158.1	133.0	158.6
1983-84	120.3	137.2	140.1	159.7	141.2	161.0
1984-85	129.8	141.8	150.1	164.0	152.2	166.3
1985-86	133.7	137.8	158.3	163.0	161.0	165.8
1986-87	139.4	139.4	165.1	165.1	169.5	169.5
1987-88	147.6	141.6	172.8	165.8	177.8	170.6
1988-89	156.8	143.9	183.0	168.0	188.0	172.6
1989-90	167.1	148.2	193.2	171.3	198.2	175.8
1990-91	176.1	151.6	202.1	174.0	207.1	178.3

<sup>1</sup> Estimated outturn for 1987-88; plans for 1988-89 onwards.

<sup>2</sup> Cash figures adjusted to 1986-87 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 4¼ per cent in 1987-88, and by 4½, 3½ and 3 per cent respectively in the years 1988-89 to 1990-91.

### Changes to plans

**2.07** Table 2.3 sets out the revised spending plans and the changes since Cm 56 for each departmental programme. Tables 2.5, 2.6 and 2.7 show a breakdown of these totals by three spending authorities: central government, local authorities, and public corporations (including nationalised industries). The following paragraphs briefly report the main changes.

**Defence** **2.08** Additions to provision have been made of £230 million in 1988–89 and £490 million in 1989–90. Provision in 1990–91 is £600 million higher than in 1989–90. The increase over plan in the current year is a result of the carry forward of capital underspending from 1986–87 under the end-year flexibility scheme.

**Foreign and Commonwealth Office (Diplomatic Wing)** **2.09** A net reduction on this programme has been made possible largely by a fall in the estimated cost of the FCO's overseas operations resulting from movements in overseas prices and exchange rates. The revised provision includes additions for the current expenditure of the BBC External Services for the next three year period.

**Overseas Development Administration** **2.10** The increase to the net overseas aid programme provides for growth in real terms over the next three years.

**European Communities** **2.11** The latest projection of the United Kingdom's net payments to European Community Institutions assumes a continuance of the 1.4 per cent VAT ceiling. The profile shows a drop in payments in 1988–89 followed by an increase in 1989–90, mainly because the UK is expected to benefit from an exceptionally large abatement (£1 750 million) during 1988. The changes to the projections since the White Paper result mainly from a fall in our projected share of agricultural receipts and an increase in our share of gross contributions, reflecting higher customs duties and levies and a revised forecast of the UK's VAT base.

**Ministry of Agriculture, Fisheries and Food** **2.12** Small additions to provision have been made in a number of areas, in particular on the farming and rural enterprise initiative (announced in February). These are more than offset by a reduction in the estimated cost of market support under the Common Agricultural Policy including savings arising from policy reform. Most of the market support expenditure is ultimately financed from the Community Budget receipts which are reflected in the UK's net contribution to the EC. Total provision for spending on agriculture including expenditure by the Intervention Board for Agricultural Produce, the Scottish, Welsh and Northern Irish agriculture departments, and the Forestry Commission is below the Cm 56 levels by £170 million and £140 million respectively in 1988–89 and 1989–90.

**Trade and Industry** **2.13** Increased provision is made for launch aid for the new Airbus (as announced in July), for revised estimates of the costs of commitments under demand-determined schemes of industrial assistance, and for the expansion of some advisory services.

## 2 Public expenditure plans

**Table 2.3 Public expenditure<sup>1, 2</sup>**

	£ million		
	Latest estimates of outturn		
	1986-87 outturn	1987-88 estimated outturn	Change 1986-87 to 1987-88
Ministry of Defence	18 149	18 950	800
FCO—Diplomatic wing	631	700	70
FCO—Overseas Development Administration	1 294	1 330	30
European Communities	1 088	1 400	310
Ministry of Agriculture, Fisheries and Food <sup>4</sup>	1 865	2 130	270
Department of Trade and Industry	2 097	920	-1 170
Export Credits Guarantee Department	259	160	-100
Department of Energy	-191	280	470
Department of Employment	3 877	4 100	230
Department of Transport	4 709	4 800	90
DOE—Housing	2 605	2 520	-80
DOE—Other environmental services	3 915	4 020	110
Home Office	5 161	5 790	630
Legal departments <sup>5</sup>	673	880	200
Department of Education and Science	15 691	17 170	1 480
Office of Arts and Libraries	817	890	80
DHSS—Health and personal social services	17 918	19 560	1 640
DHSS—Social security	44 442	46 400	2 000
Scotland	7 736	8 220	480
Wales	3 057	3 310	260
Northern Ireland	4 638	4 890	250
Chancellor's departments	2 067	2 310	240
Other departments	1 318	1 450	130
Reserve	0	0	0
Privatisation proceeds	-4 403	-5 000 <sup>6</sup>	-600
Adjustment <sup>7</sup>	0	350	350
<b>Planning total</b>	<b>139 413</b>	<b>147 600</b>	<b>8 200</b>
General government gross debt interest	17 409	17 800	400
Other national accounts adjustments	8 298	7 400	-900
<b>General government expenditure</b>	<b>165 120</b>	<b>172 800</b>	<b>7 700</b>

<sup>1</sup> The rounding and other conventions used in this table and Tables 2.5, 2.6 and 2.7 are as follows: plan figures are rounded to the nearest £10 million, except for social security (in this table and Table 2.5), the planning and spending authority totals (except public corporations) 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. Debt interest and other national accounts adjustments for future years are rounded to the nearest

£ billion. Outturn figures for 1987-88 have also been rounded to reflect their provisional nature. The changes and totals are based on the unrounded figures. They may differ therefore from the changes and sums of the rounded figures.

<sup>2</sup> In this and Tables 2.5, 2.6 and 2.7 some figures may be subject to detailed technical amendment before publication of the 1988 public expenditure White Paper.

## 2 Public expenditure plans

New plans			Change from January 1987 White Paper <sup>3</sup>			
1988-89 plans	1989-90 plans	1990-91 plans	1987-88	1988-89	1989-90	
19 210	19 960	20 560	170	230	490	Ministry of Defence
720	740	760	0	- 10	- 10	FCO—Diplomatic wing
1 430	1 500	1 550	- 30	30	60	FCO—Overseas Development Administration
800	1 470	1 320	520	350	400	European Communities
2 210	2 330	2 500	- 120	- 180	- 160	Ministry of Agriculture, Fisheries and Food <sup>4</sup>
1 230	1 190	1 140	- 200	260	220	Department of Trade and Industry
130	140	120	0	20	90	Export Credits Guarantee Department
120	- 190	- 420	360	160	50	Department of Energy
4 250	4 300	4 360	80	50	0	Department of Employment
5 150	5 110	5 210	- 340	60	- 30	Department of Transport
3 020	3 000	3 040	- 700	- 10	- 100	DOE—Housing
3 820	4 000	4 110	190	- 60	90	DOE—Other environmental services
6 060	6 310	6 480	260	360	450	Home Office
970	1 040	1 100	0	30	30	Legal departments <sup>5</sup>
17 960	18 630	19 160	580	630	800	Department of Education and Science
900	940	970	70	50	60	Office of Arts and Libraries
20 680	21 670	22 650	430	810	920	DHSS—Health and personal social services
48 500	51 200	53 700	400	1 000	1 900	DHSS—Social security
8 510	8 600	8 770	260	400	380	Scotland
3 450	3 550	3 660	120	150	160	Wales
5 130	5 310	5 470	20	90	110	Northern Ireland
2 460	2 600	2 690	100	160	180	Chancellor's departments
1 640	1 660	1 730	- 90	10	- 40	Other departments
3 500	7 000	10 500	- 3 500	- 2 000	- 500	Reserve
- 5 000	- 5 000	- 5 000	0	0	0	Privatisation proceeds
0	0	0	350	0	0	Adjustment <sup>7</sup>
<b>156 800</b>	<b>167 100</b>	<b>176 100</b>	<b>- 1 000</b>	<b>2 600</b>	<b>5 600</b>	<b>Planning total</b>
18 000	18 000	18 000	- 300	+ 100	- 800	General government gross debt interest
8 000	8 000	8 000	+ 500	+ 600	+ 600	Other national accounts adjustments
<b>183 000</b>	<b>193 200</b>	<b>202 100</b>	<b>- 800</b>	<b>3 300</b>	<b>5 400</b>	<b>General government expenditure</b>

<sup>3</sup> Plans as set out in the last public expenditure White Paper (Cm 56) adjusted for minor changes of classification and allocation.

<sup>4</sup> Includes Intervention Board for Agricultural Produce and Forestry Commission.

<sup>5</sup> Legal departments comprise: the Lord Chancellor's Department, the Northern Ireland Court Service, the Crown Prosecution Service, the Serious Fraud Office and the Crown Office.

<sup>6</sup> This assumes the full proceeds of the first instalment of the BP share offer. If some of the BP shares were purchased by the Issue Department of the Bank of England and were still held by it at the end of the financial year, the effect would be to reduce privatisation proceeds, and increase the planning total, general government expenditure, and the PSBR by the same amount.

<sup>7</sup> An adjustment for the difference between the assessment of the likely outturn for 1987-88 and the sum of the other items shown.

- Export Credit Guarantee Department** 2.14 The changes to the plans reflect the latest estimates of the cost of interest support and tender to contract cover.
- Energy** 2.15 The departmental totals include both departmental expenditure and the external finance for the energy industries (which is negative in some years). There are increases to reflect growth in essential safety related work by the Atomic Energy Authority on decommissioning and nuclear waste management and the costs of moving to new departmental accommodation, and changes in estimates of payments under the redundant mineworkers' payments scheme. There are also increases in the external financing requirements of the electricity industry in England and Wales (see paragraphs 2.38 and 2.39).
- Employment** 2.16 There are a number of broadly balancing increases and reductions within the new totals. There is increased provision for support for tourism, Jobclubs, the Health and Safety Executive, adult training (as a result of the employment measures announced in January) and the Youth Training Scheme (reflecting the withdrawal of income support for school leavers). The Job Release Scheme and New Workers Scheme will be closed for applications from 31 January 1988.
- Transport** 2.17 Additional provision has been made for expenditure on national roads, particularly for a programme of bridge maintenance, and for gross capital expenditure by local authorities.
- Housing** 2.18 Provision for gross capital expenditure on housing has been increased by £380 million in 1988–89 and £280 million in 1989–90. This will enable the Housing Corporation to provide extra aid for housing associations and will make available resources for the setting up of Housing Action Trusts. It will also provide for increases in planned spending by local authorities and new towns. The continuing success of the Government's right to buy policy is reflected in further significant increases in the forecast level of capital receipts.
- Other environmental services** 2.19 Substantially increased expenditure on Urban Development Corporations and increases for countryside, recreation, heritage and environmental research programmes are offset by higher new town receipts. Extra local authority receipts have also made possible an increase in gross capital provision for local environmental services. In addition £20 million of extra funds has been provided to the National Heritage Memorial Fund in 1987–88.
- Home Office** 2.20 Provision in all years has been increased to finance an acceleration and expansion of the prison building programme. Provision for local authority expenditure, principally on the police, has also been increased substantially.
- Legal departments** 2.21 Provision has been increased mainly to cover the cost of a larger court building programme and a permanent 'payments on account' scheme for lawyers; the plans also cover the increased costs of the Crown Prosecution Service and the cost of setting up the Serious Fraud Office.
- Education and Science** 2.22 Additional provision has been made for the implementation of the Government's education reforms, including the introduction of the national curriculum; and for universities, mainly for a programme of restructuring. The science budget is being increased. Provision has also been increased substantially for current and capital expenditure by local authorities.

**Arts and Libraries** 2.23 Additions have been made for incentive funding and for increased estimates of the cost of the British Library new building project. Increased provision has also been made for local authority expenditure on museums, galleries and libraries.

**Health** 2.24 Additional provision has been made for the hospital and community health services. Health authorities will have available extra cash released by land sales and by their continuing cost improvement programmes. The latter are expected to yield £150 million in 1987–88 (on top of the £500 million achieved prior to that). In addition, health authorities will have available extra cash generated by a new programme for increasing hospital income from non-NHS sources. Provision for the Family Practitioner Services allows for higher forecast demand and for further service improvements. There is also increased provision for local authority spending on personal social services.

**Social security** 2.25 The new plans reflect the latest estimates of benefit expenditure over the Survey period. They reflect the decision announced last May to include within income-related benefits the average cost to claimants of paying 20 per cent of rates. The provision also takes account of the statement on benefits by the Secretary of State on 27 October 1987 and allows for further upratings of benefits in April 1989 and April 1990. For the purpose of these estimates, the number of unemployed (GB, excluding school-leavers etc) is assumed to average 2.7 million in 1987–88 and 2.6 million in 1988–89, 1989–90, and 1990–91. The RPI is assumed to rise by 4½ per cent in the year to September 1988 (for the upratings in April 1989) and by 3¼ per cent in the year to September 1989 (for the upratings in April 1990).

**Scotland, Wales and Northern Ireland** 2.26 The net changes in these programmes mainly reflect the effects of changes in comparable programmes in England. The Secretaries of State will allocate this expenditure taking account of local factors. The breakdown of figures between central Government, local authorities, and public corporations, is based on previous patterns of expenditure and may be varied except in the case of local authority relevant expenditure in 1988–89, where the provision for Scotland and Wales is as announced in July in the RSG settlement for that year. For the later years the Scottish and Welsh local authority relevant figures reflect changes in the comparable totals for England.

**Chancellor's departments** 2.27 Additional resources have been provided for the Revenue departments to deal with increases in workload and to strengthen controls against drug smuggling. A third of the overall increase reflects changes in the estimates of relief on life assurance premiums and mortgage interest to non-taxpayers.

**Other departments** 2.28 This line in the tables covers a miscellany of minor departments and programmes, civil superannuation costs, and the Property Services Agency. The revised plans provide for additional expenditure on maintenance of the Government estate which should enable the PSA to reduce the present backlog of major repairs over the next three years.

**Science and technology** 2.29 Additional provision for spending on science and technology is included in several of the programmes above. Among the increases in provision are additions for universities, Research Councils, launch aid, and other science and technology programmes. Spending on civil science and technology will rise by some £200 million a year, including increases already announced, compared with the plans in Cm 56.

### Local authorities

**Relevant** 2.30 Local authority relevant public expenditure accounts for over three quarters of total local authorities' expenditure. It comprises current spending on a wide range of services, and contributions to housing revenue accounts in England and Wales.

2.31 It is forecast to exceed provision in Cm 56 by £1.2 billion in 1987-88. From the estimated outturn for 1987-88, the provision set for the three forward years shows annual increases of 3.5 per cent, 3.3 per cent and 3.0 per cent. The allocation to services is based broadly on local authorities' budgets for 1987-88.

2.32 Aggregate Exchequer Grant to local authorities for 1988-89 has been set at £17.4 billion, as announced by the Secretaries of State for the Environment, Scotland and Wales on 23 July.

**Other current** 2.33 Local authorities' other current expenditure consists largely of Housing Benefit and Student Awards which are supported by specific grants from central Government.

2.34 The plans reflect revised estimates of the costs of Housing Benefit. They take into account the proposed changes in benefit entitlement announced by the Secretary of State for Social Services on 27 October.

**Capital** 2.35 Local authority gross capital spending in Great Britain in 1987-88 is forecast to be £7.1 billion. After allowing for capital receipts, the net cost of programmes is forecast to be £3.7 billion.

2.36 Gross provision for spending in 1988-89 has been increased by £0.6 billion to £6.9 billion and gross provision of £6.8 billion and £6.7 billion has been made for 1989-90 and 1990-91. Within this provision the amount 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.

2.37 For the main local authority capital cash limit in England, allocations of over £2.6 billion will be issued in 1988-89. Of the total, housing authorities will receive £1.3 billion. Education allocations will rise to £369 million in 1988-89, 24 per cent higher than in 1987-88, increasing the scope for work on school improvements.

### Nationalised industries

2.38 External financing limits for nationalised industries in 1988-89 are listed in Table 2.4. In total there is an increase of £340 million from provision in Cm 56. This reflects a number of changes but the main additions are for the electricity industries in England and Wales and Scotland. Investment plans have been substantially increased, particularly in the electricity industry, which is embarking on a major programme of building new capacity, and the water industry. The plans also allow for

additional investment by British Rail, London Regional Transport and the Post Office to improve the quality of service. Total nationalised industries' investment is expected to rise from about £4½ billion in 1987–88 to around £6 billion in 1990–91.

**2.39** Despite the substantial level of investment planned, total provision for nationalised industries' external finance is expected to decline in 1989–90 and 1990–91, with net repayments of debt overall by the end of the decade (Table 2.7). This trend is in line with the Government's objective of minimising the burden which the industries place on the taxpayer, and strengthening them as businesses earning an adequate rate of return. External finance for nationalised industries has already been significantly reduced, from nearly £3 billion in 1979–80 to an estimated £590 million in 1987–88. The Government will continue to require improvements in the industries' profitability and further progress in reducing costs and increasing productivity by setting demanding financial targets and performance aims.

**Table 2.4 External financing limits for the nationalised industries 1988–89**

	£ million <sup>1</sup>
British Coal	670
Electricity (England and Wales)	-1 040
North of Scotland Hydro-Electric Board	-2
South of Scotland Electricity Board	131
British Steel Corporation	-100
Post Office	-97
National Girobank	-8
British Railways Board	753
British Waterways Board	47
Scottish Transport Group	2
British Shipbuilders	80
Civil Aviation Authority	21
Water (England and Wales)	10
London Regional Transport	221
<b>Total</b>	<b>687</b>

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

### Other public corporations

**2.40** Provision is included under this heading for a large number of public corporations including Urban Development Corporations (UDCs), the Scottish and Welsh Development Agencies, the Northern Ireland Electricity Service, new towns and the Northern Ireland Housing Executive. Substantial increases to provision have been made for UDCs. These and other increases are offset in 1988–89 by increased estimates of receipts by new towns.

### Reserves

2.41 The plans include Reserves of £3.5 billion in 1988–89, £7 billion in 1989–90, and £10.5 billion in 1990–91. These will be available to meet unforeseen requirements including estimating changes. The Reserves for the two later years are higher than in any previous plans.

### Privatisation

2.42 The estimate of net proceeds from the privatisation programme is £5 billion a year, the same as in Cm 56. These proceeds are netted off the planning total and general government expenditure. However, in order to show the underlying trends in expenditure more clearly, Charts 2.1 and 2.2 show growth rates and ratios to national income both including and excluding privatisation proceeds.

Table 2.5 Central government spending<sup>1</sup>

	£ million								
	Latest estimates of outturn			New plans			Change from January 1987 White Paper		
	1986-87 outturn	1987-88 estimated outturn	Change 1986-87 to 1987-88	1988-89 plans	1989-90 plans	1990-91 plans	1987-88	1988-89	1989-90
Ministry of Defence	18 161	18 950	790	19 210	19 960	20 560	170	230	490
FCO—Diplomatic wing	631	700	70	720	740	760	0	-10	-10
FCO—Overseas Development Administration	1 270	1 310	40	1 400	1 470	1 520	-10	30	60
European Communities	1 088	1 400	310	800	1 470	1 320	520	350	400
Ministry of Agriculture, Fisheries and Food	1 667	1 940	280	1 990	2 110	2 280	-120	-190	-180
Department of Trade and Industry	1 844	1 050	-790	1 250	1 250	1 190	80	280	280
Export Credits Guarantee Department	259	160	-100	130	140	120	0	20	90
Department of Energy	907	590	-320	510	460	430	90	40	30
Department of Employment	3 757	3 980	220	4 110	4 170	4 210	80	40	-10
Department of Transport	1 260	1 410	150	1 460	1 490	1 530	40	30	40
DOE—Housing	1 313	1 370	50	1 320	1 380	1 460	10	-10	40
DOE—Other environmental services	363	430	70	440	450	450	30	30	20
Home Office	906	1 030	130	1 120	1 200	1 210	10	80	110
Legal departments	673	880	200	970	1 040	1 100	0	30	30
Department of Education and Science	2 459	2 700	240	2 930	3 080	3 150	70	210	280
Office of Arts and Libraries	337	370	30	400	420	440	10	40	50
DHSS—Health and personal social services	15 154	16 520	1 360	17 550	18 450	19 330	330	700	790
DHSS—Social security	40 973	42 700	1 700	44 500	47 000	49 200	300	600	1 400
Scotland <sup>2</sup>	3 310	3 500	190	3 600	3 780	3 920	70	50	120
Wales <sup>2</sup>	1 453	1 560	100	1 680	1 720	1 780	40	100	90
Northern Ireland <sup>2</sup>	3 593	3 800	200	4 010	4 170	4 300	10	80	90
Chancellor's departments	2 074	2 320	240	2 470	2 600	2 700	100	160	180
Other departments	1 318	1 450	130	1 640	1 660	1 730	-90	10	-40
<b>Total</b>	<b>104 768</b>	<b>110 100</b>	<b>5 300</b>	<b>114 200</b>	<b>120 200</b>	<b>124 700</b>	<b>1 700</b>	<b>2 900</b>	<b>4 400</b>

<sup>1</sup> See footnotes to Table 2.3.<sup>2</sup> See paragraph 2.26.

**Table 2.6 Local authority spending<sup>1</sup>**

	£ million								
	Latest estimates of outturn			New plans			Change from January 1987 White Paper		
	1986-87 outturn	1987-88 estimated outturn	Change 1986-87 to 1987-88	1988-89 plans	1989-90 plans	1990-91 plans	1987-88	1988-89	1989-90
Ministry of Agriculture, Fisheries and Food	186	170	-20	200	200	210	-10	10	20
Department of Trade and Industry	79	90	10	90	90	100	10	10	10
Department of Employment	115	130	10	130	140	140	10	10	10
Department of Transport	2 483	2 470	-10	2 650	2 720	2 800	-200	-60	-40
DOE—Housing	1 274	1 140	-130	1 690	1 540	1 460	-660	60	-150
DOE—Other environmental services	3 424	3 660	240	3 370	3 480	3 570	340	20	40
Home Office	4 254	4 760	510	4 940	5 110	5 270	250	280	330
Department of Education and Science	13 232	14 470	1 240	15 030	15 550	16 010	510	410	530
Office of Arts and Libraries	480	520	40	500	510	530	60	10	20
DHSS—Health and personal social services	2 738	3 030	290	3 120	3 230	3 320	100	110	130
DHSS—Social security	3 470	3 790	320	4 010	4 250	4 490	160	430	470
Scotland <sup>2</sup>	3 942	4 330	380	4 510	4 620	4 760	130	170	150
Wales <sup>2</sup>	1 539	1 680	140	1 690	1 730	1 790	80	50	60
Northern Ireland <sup>2</sup>	716	700	-20	740	770	790	0	10	10
<b>Total</b>	<b>37 932</b>	<b>40 900</b>	<b>3 000</b>	<b>42 700</b>	<b>43 900</b>	<b>45 200</b>	<b>800</b>	<b>1 500</b>	<b>1 600</b>
of which:—									
Relevant expenditure <sup>3</sup>	29 396	32 100	2 700	33 200	34 300	35 400	1 200	1 000	1 300
Other current	4 792	5 100	300	5 400	5 600	5 900	100	400	500
Capital	3 743	3 700	0	4 000	4 000	3 900	-500	0	-200

<sup>1</sup> See footnotes to Table 2.3.<sup>2</sup> See paragraph 2.26.<sup>3</sup> Public expenditure relevant for Aggregate Exchequer Grant.

Table 2.7 Public corporations<sup>1,2</sup>

	£ million								
	Latest estimates of outturn			New plans			Change from January 1987 White Paper		
	1986-87 outturn	1987-88 estimated outturn	Change 1986-87 to 1987-88	1988-89 plans	1989-90 plans	1990-91 plans	1987-88	1988-89	1989-90
FCO—Overseas Development Administration	24	10	-10	30	30	30	-10	0	0
Ministry of Agriculture, Fisheries and Food	13	20	10	20	20	20	0	0	0
Department of Trade and Industry	173	-210	-390	-100	-150	-140	-280	-20	-70
Department of Energy	-1 098	-320	780	-390	-640	-850	260	120	20
Department of Transport	966	920	-50	1 040	900	880	-170	80	-20
DOE—Housing	19	10	-10	20	90	120	-50	-60	10
DOE—Other environmental services	128	-80	-200	0	80	90	-180	-100	30
Scotland <sup>3</sup>	484	390	-90	400	200	90	60	170	110
Northern Ireland <sup>3</sup>	329	390	60	380	370	380	0	10	10
Other <sup>4</sup>	77	90	10	90	90	90	0	0	0
<b>Total</b>	<b>1 115</b>	<b>1 230</b>	<b>110</b>	<b>1 480</b>	<b>980</b>	<b>710</b>	<b>-380</b>	<b>200</b>	<b>100</b>
of which:—									
Nationalised industries	387	590	200	690	-30	-390	-100	340	20
Other public corporations	729	640	-90	790	1 010	1 090	-270	-150	70

<sup>1</sup> See footnotes to Table 2.3.<sup>2</sup> For nationalised industries and most public corporations, the planning total includes their external finance. For nationalised industries' external financing limits for 1988-89, see Table 2.4.<sup>3</sup> See paragraph 2.26.<sup>4</sup> Ministry of Defence, Department of Employment, DHSS, Wales and Chancellor's Departments.

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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 were set out in a statement by the Secretary of State on 3 November 1987. The main proposals are as follows:

- the Class 1 insurance rates for employers and employees should remain unchanged for 1988–89.
- the lower earnings limit should be increased from April 1988 from the present level of £39 a week to £41 a week in line with the single rate retirement pension.
- the upper earnings limit should be increased from £295 a week to £305 a week.
- the earnings limit for the reduced rate brackets should also be increased from £65, £100 and £150 a week to £70, £105 and £155 a week.
- the Treasury supplement should be cut from 7 per cent of contributions to 5 per cent.

This would give the following structure of national insurance contributions:

Weekly earnings	Percentage NIC rate on all earnings	
	Employees	Employers
Below £41	(No NICs payable)	
£41 to £69.99	5	5
£70 to £104.99	7	7
£105 to £154.99	9	9
£155 to £305	9	10.45
Above £305	9 on £305	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 2.7 million in 1987–88 and 2.6 million in 1988–89.

—the increase in average earnings is expected to decline from about 7½ per cent between tax years 1986–87 and 1987–88 to about 6½ per cent between tax years 1987–88 and 1988–89. Figures for settlements are of course lower than these earnings figures in both years.

The report will also allow for an uprating of benefits in April 1988 on the basis of the 4.2 per cent increase in the RPI over the year ending in September 1987, as announced by the Secretary of State on 27 October 1987.

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 1987–88 and 1988–89<sup>1</sup>**

	Great Britain (£ million)		
	Employers	Employees	Total
National insurance contributions:			
1987–88	13 510	12 540	26 050
1988–89	14 800	13 550	28 350
Total change	+ 1 290	+ 1 010	+ 2 300
<i>of which:</i>			
Change in contributions from increased earnings, etc <sup>2</sup>	+ 1 180	+ 860	+ 2 040
Change in contributions from lower contracted-out rebate <sup>3</sup>	+ 220	+ 110	+ 330
Change in contributions from increase in earnings limits	- 110	+ 40	- 70

<sup>1</sup> 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 1987. 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 statutory maternity pay.

<sup>2</sup> Including population and employment changes.

<sup>3</sup> As announced by Secretary of State for Social Services on 16 March 1987.

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# 4 Tax revenue ready reckoner

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**4.01** The tables below show the effects of various illustrative tax changes on tax receipts in 1988–89 and 1989–90.

**4.02** 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.

**4.03** An illustrative rate of inflation of 4 per cent has been used to show the effects of indexation and revalorisation in 1988–89. This is in line with the annual rate of increase in the RPI forecast for the fourth quarter of 1987.

**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 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 1987.

**Indexation of allowances,  
thresholds and bands for  
1988–89**

**4.05** Tables 4.1 to 4.3 show tax allowances, thresholds, and bands for 1988–89 after 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 Act. Estimates of the revenue effects of these changes are shown in Table 4.4.

**Table 4.1 Income tax**

	£	
	1987-88	1988-89
Allowances:		
Single and wife's earned income allowance	2 425	2 525
Married allowance	3 795	3 955
Additional personal and widow's bereavement allowance	1 370	1 430
Single age allowance (age 65-79)	2 960	3 080
Married age allowance (age 65-79)	4 675	4 865
Single age allowance (age 80 and over)	3 070	3 200
Married age allowance (age 80 and over)	4 845	5 045
Aged income limit	9 800	10 200

Income tax rates	Bands of taxable income	
Per cent	£	
	1987-88	1988-89
27	0-17 900	0-18 700
40	17 901-20 400	18 701-21 300
45	20 401-25 400	21 301-26 500
50	25 401-33 300	26 501-34 800
55	33 301-41 200	34 801-43 100
60	Over 41 200	Over 43 100

**Table 4.2 Inheritance tax**

Rate on death	Bands of chargeable value	
Per cent	£'000	
	1987-88	1988-89
Nil	0-90	0-94
30	90-140	94-146
40	140-220	146-229
50	220-330	229-344
60	Over 330	Over 344

**Table 4.3 Capital gains tax**

	£	
	1987-88	1988-89
Annual exempt amount:		
Individuals	6 600	6 900
Trusts	3 300	3 450

Table 4.4 Costs of indexation for 1988–89

	£ million	
	1988–89	1989–90
Indexation of income tax allowances and thresholds	940	1 420
Of which:		
Increases in main personal allowances	770	1 120
Increase in the basic rate limit*	110	170
Increases in further higher rate thresholds*	60	130
Indexation of inheritance tax thresholds and bands	25	60
Indexation of capital gains exempt amounts	—	10

\* 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 are changes from an indexed base.

**4.07** 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.

**4.08** The total cost of a group of income tax allowances 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 tax<sup>1</sup>

	£ million	
	1988-89 cost/yield	1989-90 cost/yield
<b>Income tax</b>		
<i>Rates</i>		
Change basic rate by 1p <sup>2</sup>	1 250	1 600
Change all higher rates by 1p	85	165
<i>Personal allowances<sup>3</sup></i>		
Change single and wife's earned income allowance by £100	295	380
Change married allowance by £100	240	310
Change single age allowance <sup>4</sup> by £100	23	30
Change married age allowance <sup>4</sup> by £100	22	26
Change aged income limit by £200	4	5
Change all main personal allowances by 1 per cent	180	235
Change all main personal allowances by 10 per cent:		
increase (cost)	1 775	2 325
decrease (yield)	1 825	2 400
<i>Higher rate thresholds<sup>3</sup></i>		
Change all higher rate thresholds by 1 per cent:		
increase (cost)	31	55
decrease (yield)	32	60
Change all higher rate thresholds by 10 per cent:		
increase (cost)	280	520
decrease (yield)	365	650
<i>Allowances and thresholds<sup>3</sup></i>		
Change all main personal allowances and higher rate thresholds by 1 per cent	215	295
Change all main personal allowances and higher rate thresholds by 10 per cent:		
increase (cost)	2 050	2 825
decrease (yield)	2 250	3 075
<b>Corporation tax<sup>5</sup></b>		
Change full rate by 1 percentage point	360	560
Change small companies' rate by 1 percentage point <sup>6</sup>	25	45

<sup>1</sup> 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.

<sup>2</sup> Including the effects of the change on receipts of advance corporation tax and on consequent liability to mainstream corporation tax.

<sup>3</sup> Percentage changes are calculated with reference to 1987-88 levels.

<sup>4</sup> Including higher age allowance for those aged 80 or over.

<sup>5</sup> 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 1987.

<sup>6</sup> These figures ignore any possible associated changes in the imputation system.

**Indirect taxes 4.09** 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 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.

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

**4.11** 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	4% Revalorisation <sup>1</sup>		Changes from present levels of duty				
		Price change inc. VAT <sup>2</sup>	£m yield in <sup>3</sup>		Price change inc. VAT <sup>2</sup>	Actual percentage change in duty	£m cost/yield in <sup>3</sup>	
			1988-89	1989-90			1988-89	1989-90
Beer (pint)	18.6p	0.9p	65	70	1p	4.7	75	85
Wine (70 cl bottle of table wine) <sup>4</sup>	68.6p	3.2p	20	20	5p	6.3	30	35
Spirits (bottle)	£4.73	21.8p	25	30	10p	1.8	15	15
Cigarettes (20 kingsize) <sup>5</sup>	93.4p	3.7p	95	110	1p	1.1	25	30
Petrol (gallon)	88.1p	4.1p	210	240	1p	1.0	55	60
Derv (gallon) <sup>6</sup>	74.5p	3.4p	50	55	1p	1.2	15	15
VED (cars and light vans)	£100.00	£4.00	85	90	£1.00	1.0	20	25

<sup>1</sup> An 'across the board' revalorisation by 4 per cent (including the minor duties not shown above) would yield about £590m in 1988-89 and £655m in 1989-90, and the impact on the RPI would be to raise it by 0.3 per cent.

<sup>2</sup> VAT is payable in addition to the duty except in the case of VED.

<sup>3</sup> Assuming implementation on 1 April 1988.

<sup>4</sup> Revenue effects include all wines.

<sup>5</sup> 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.

<sup>6</sup> Revenue effects allow for offsetting increase in bus fuel grants.

**Table 4.7 VAT**

	£m cost/yield in	
	1988-89	1989-90
1% change in rate of VAT <sup>1</sup>	940	1 310

<sup>1</sup> Assuming implementation on 1 April 1988.

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