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PART B

SECRET

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PO -CH /NL/0015

PART B

BUDGET 1987 AUTUMN STATEMENT

DD'S 25 years NAzig 23-3-95.

PO -CH /NL/0015
PART B

STARTS 26-10-87
ENDS: 30-10-87

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PART ...C...

C/content? Told C Evans RD

CR 27/10 C content

FROM: **MISS C EVANS**

DATE: 26 October 1987

c.c. Mr Scholar

MRS RYDING

AUTUMN STATEMENT: PRICE AND COVER

HMSO propose a cover price of £5.10 - 6 per cent more than last year's price of £4.80. The document is priced well below its cost to HMSO - the above inflation rise is another step in the catching up process. (Last year the price increased by 14 per cent). We recommend agreeing to £5.10.

2. We propose that the cover should be the same as last year.

3. Is the Chancellor content please? (It would be helpful to know by tomorrow if possible).

Carys Evans

MISS C EVANS

007/3295

PPS in
Alex
PWP

SECRET

CHIEF SECRETARY TO THE TREASURY

FROM: JILL RUTTER
DATE: 26 October 1987

PS/CHANCELLOR

cc:
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Scholar
Mr Turnbull
Mr Gieve
Miss O'Mara
Mr R I G Allen
Mr McIntyre
Miss C Evans

Mr Cropper
Mr Tyrie
Mr Call

AUTUMN STATEMENT: ORAL STATEMENT

The Chief Secretary had the following comments on the Public Expenditure section of the draft attached to Mr Scholar's minute to the Chancellor of 21 October.

Paragraph 17

The Chief Secretary thought that the reference to the income generation scheme should be softened. In cash terms it is much less significant than the cost improvement programmes. He would therefore put this third and do it in a way which raises less of the spectre of charging for hospital visits etc; perhaps Mr Scholar could liaise with Ms Boys to find a suitable formulation.

Paragraph 19

Redraft:" Provision has also been made for the substantial increase and acceleration in the prison building programme which the Home Secretary announced to the House in July".

SECRET

Paragraph 21

Again the Chief Secretary thinks that we should refer back to the RSG announcement to make clear that these are the same numbers as announced by Mr Ridley in July. Therefore redraft the start of that sentence: "As My Rt Hon Friend the Secretary of State for the Environment announced in July, the provision for local authority current spending ...."

Paragraph 23

The Chief Secretary did not like the reference to "higher than planned" capital receipts. He would replaced with "more buoyant".

Jill Rutter

JILL RUTTER
Private Secretary

CE2

SECRET

AUTUMN STATEMENT 1987: ORAL STATEMENT: DRAFT OF 21 OCTOBER

With permission, Mr Speaker, I should like to make a statement.

2. I am laying before the House today an Autumn Statement which [brings together the Government's outline public expenditure plans for the next three years] [gives details of the expenditure plans which I announced in aggregate last Thursday], makes proposals for National Insurance contributions next year, and sets out the forecast of economic prospects for 1988 required by the 1975 Industry Act.

Public Expenditure in 1987-88

3. I turn first to the expected outturn for the current financial year, 1987-88.

4. The public expenditure planning total now looks likely to amount to £147½ billion, or around £1 billion less than was allowed for in last year's public expenditure White Paper. The underspend on the planning total mainly reflects higher capital receipts of local authorities and new towns. ~~In~~ Other ~~respects~~ spending taken together is expected to be in line with plans.

AH
for ACSA

Mr ACS Allan (pages 1, 2, 3) I understand you are revising - Ps see amendments I have received from Mr Turnbull. I have confirmed with Mr Mowl that paras 5, 6 + 7 (as amended) are consistent with the Forecasters' latest estimates.

Carys E
27.10.

Taking account of debt interest and other transactions

5. ~~Debt interest is also expected to be very close to the forecast made at the time of the Budget, so that~~ the total shortfall on the expenditure side is ~~also~~ about £1½ billion.

1987-88 Revenues

6. On the receipts side non-oil revenues are benefitting from the strong growth of the economy and seem likely to be about £~~1½~~2 billion higher than I expected at the time of the Budget. Corporation tax has risen strongly following the surge in profits in recent years. Income tax, national insurance contributions and VAT are also buoyant. North Sea revenues are likely to be £½ billion higher than expected largely because the oil price has been above the $15 assumed in the Budget forecast.

1987-88 PSBR

7. With this increase of £2½ billion in tax revenues, together with the reduction of £1½ billion ~~in~~ on the expenditure side, I expect the PSBR for the current financial year to be about £1 billion in total, about £3 billion less than was forecast at the time of the Budget. This estimate is subject to the normal margin of error at this time of year.

Public Expenditure Plans

8. I turn now to the public expenditure plans for the next three years.

9. Since 1982-83 public spending, both before and after deducting the proceeds of privatisation, has been declining as a proportion of national output. There is likely to be a further substantial fall this year, the fifth in all, producing the longest sustained fall since the war time economy was unwound.

10. In July, the Cabinet reaffirmed the objective of ensuring that public spending ~~declined~~ as a share of national output, was held at or below the ratios ~~at least as fast as envisaged~~ in the last White Paper. The plans that I am about to announce will not only secure that objective but will produce a share even lower than we set ourselves last year.

11. New planning totals have been set at £a billion for 1988-89 and £b billion for 1989-90, increases of £c billion and £d billion over the totals previously published. For 1990-91 the planning total has been set at £d billion.

12. The totals incorporate the proceeds of privatisation, the plans for which are unchanged at £5 billion a year.

13. I have also thought it prudent to set aside within the planning totals larger Reserves than in previous years. These

2184/014

SECRET

FROM: N MONCK

DATE: 22 October 1987

MR SCHOLAR

AHH For ACSA

cc PPS
PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Odling-Smee
Mr Sedgwick
Mr Turnbull
Mr Burgner
Mr M Call

AUTUMN STATEMENT : ORAL STATEMENT

I suggest adding a sentence about the growth of non-oil business investment in 1988 to paragraph 34. This would help to answer the kind of lobbying about investment which Ministers ran into at NEDC earlier this month. The extra sentence could be inserted before the present last sentence on the following lines:

"Within total investment I expect non-oil business investment to rise by about 5½ per cent."

2. I don't see that this will lead critics to arrive at any embarrassing figures by subtraction from the total fixed investment increase of 4½ per cent. The table at the back of Mr Sedgwick's submission of 19 October shows that the other components of investment all rise by 3 per cent or more in 1988.

NM

N MONCK

o275

SECRET

MR A ALLAN AH for ACSA.

FROM: MS P A BOYS
DATE: 27 OCTOBER[

cc Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Scholar
Mr Turnbull
Mr Gieve
Miss O'Mara
Mr R I G Allen
Mr McIntyre
Miss C Evans

Mr Cropper
Mr Tyrie
Mr Call

AUTUMN STATEMENT: ORAL STATEMENT

To remove the point of difficulty on paragraph 17, identified in Miss Rutter's minute of 26 October, I propose revising the second sentence of that paragraph to read:

> " On top of this there will be additional resources from cost improvement programmes etc and from land sales."

Can't say that. Omit altogether, if CST isn't worried.

It is difficult to find a short form of words that describes the new programme for income generation without triggering fears that hospitals will be charging patients for clinical services, or for food or accommodation expenses.

Ha Reeves

pp **P A BOYS**

RC6.46

SECRET AND PERSONAL

1 RAX
2 RP

SCORECARD
COPY NO 3 OF 4 COPIES

FROM: CATHY RYDING
DATE: 26 October 1987

MR GIEVE

cc PS/Chief Secretary

AUTUMN STATEMENT CHAPTER 2

The Chancellor was grateful for your minute of 23 October.

... 2. I attach a copy of the text incorporating the Chancellor's amendments. With these amendments he is then content, subject to the Chief Secretary's views. The Chancellor is content with the graphs.

3. On the tables, the Chancellor has only checked table 2.4 which does not seem to add up. He would be grateful if you could check the other tables.

CR

CATHY RYDING

P/024

CONFIDENTIAL

PUBLIC EXPENDITURE PLANS

MAIN POINTS

Public expenditure will continue to fall as a proportion of the nation's income over the next three years. Before deducting privatisation proceeds, general government expenditure is expected to fall sharply as a percentage of GDP from 44 per cent in 1986-87 to 42½ in 1987-88, and then gradually to 41 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. The public expenditure planning totals have been set at £156.9 billion for 1988-89 and £167.2 billion for 1989-90 increases of £2.7 billion and £5.7 billion over those published in Cm 56. A planning total of £176.6 billion has been set for 1990-91.

3. In real terms, the average growth in general government expenditure before deducting 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.

4. The new plans include increased provision for ~~high~~ 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 housing, education, and roads. 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.

~~[5. Announcing these changes in the House of Commons on November 1987, the Chancellor reaffirmed the Government's commitment to a prudent fiscal stance and said that .... [Statement on policy, if any].]~~

6. The trends of public spending in real terms and as a percentage of GDP are illustrated in Charts 2.1 and 2.2 and summarised in Tables 2.1 and 2.2. Full Details of the spending plans will be published in the forthcoming 1988 public expenditure White Paper.

1987-88 OUTTURN

7. The latest forecast of the planning total ~~spending~~ in the current year, 1987-88, is was planned and ~~that the planning total will be~~ £147.6 billion. This is £1 billion lower than ~~the plan~~ published in Cm 56. The reduction is attributable to ~~unexpected~~ increases in the capital receipts of local authorities and new towns.

CHANGES TO PLANS

8. 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

9. ~~The~~ Significant additions to provision have been made for 1988-89 and 1989-90. ~~recognise the pressures on the programme following the end of the period of substantial real growth.~~ Provision in 1990-91 is £610m 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)

10. 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

11. The increases to the net overseas aid programme provide for modest growth in real terms over the next three years.

European Communities

12. The latest projection of the United Kingdom's net payments to ~~the~~ European Community Institutions, [redacted] assume~~s~~ a continuance of the 1.4% 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 (£1750 million) during 1988. The revisions to the projections since the White Paper result 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

Total provision for spending on agriculture,

13. Small additions to provision have been made in a number of areas, in particular on the farming and rural enterprise [redacted] 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 [redacted] Community Budget receipts which are reflected in UK's net contribution to the EC. including expenditure by the Intervention Board for Agricultural Produce, the Scottish, Welsh and Northern Irish agriculture departments, and the Forestry Commission, ~~there will be net reductions from Cm 56 of~~ is below the Cm 56 levels by £170 million and £140 million respectively in 1988-89 and 1989-90.

Trade and Industry

14. 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.

Export Credit Guarantee Department

15. The changes to the plans reflect the latest estimates of the cost of interest support and tender to contract cover.

Energy

16. 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 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 paragraph 39).

Employment

17. 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

18. Additional provision has been made for expenditure on national roads, particularly for a programme of bridge renovation and repair, and for gross capital expenditure by local authorities.

Housing

19. 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 substantial 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

20. Higher receipts for New Towns and Local Environmental Services will provide for substantially increased expenditure on Urban Development Corporations and on countryside, recreation, heritage and environmental research programmes. In addition

£20 million of extra funds has been provided to the National Heritage Memorial Fund in 1987-88.

Home Office

21. 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

22. 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

23. 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 substantially increased for current and capital expenditure by local authorities.

Arts and Libraries

24. 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

25. Additional provision has been made for the hospitals and community health services. In addition, health authorities will have available extra cash generated by a new programme for increasing hospital income from non-NHS sources. ~~through non-NHS use of goods and services. As well,~~ Health authorities will also 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). 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

26. 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 4.75 per cent in the year to September 1988 (for the uprating in April 1989) and by 3.25 per cent in the year to September 1989 (for the upratings in April 1990).

Scotland, Wales and Northern Ireland

27. 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.

Chancellor's Departments

28. 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

29. 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

Additional provision for spending on science and technology is included in several of the programmes above.

30. Among the increases in provision are additions for universities, Research Councils, launch aid, and other science and technology programmes. ~~Within the~~

~~expenditure plans the amount accounted for by~~ Spending on civil science and technology will rise by over £200 million a year, including increases already announced, compared with the plans in Cm 56.

LOCAL AUTHORITIES

__Relevant__

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

32. 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 3.9%, 3.2% and 3.0%. The allocation to services is based on local authorities' budgets for 1987-88.

33. ~~Relevant public expenditure forms over 90% of expenditure relevant for determining~~ Aggregate Exchequer Grant to local authorities ~~which~~ 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__

34. ~~The~~ Local authorities' other current expenditure, consists largely of Housing Benefit, and Student Awards, which are supported as to ~~by~~ over 90% by specific grants from central Government ~~and are not relevant for Rate Support Grant~~.

35. 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__

36. 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.

37. Gross provision for spending in 1988-89 has been increased by £0.6 billion to £7.0 billion and gross provision of £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.

38. 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 £372 million in 1988-89, 25 per cent higher than in 1987-88, increasing the scope for work on school improvements.

NATIONALISED INDUSTRIES

39. 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 ~~starting~~ 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. This figure includes provision for a number of industries which are candidates for privatisation.

40. 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 2.3). 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.

OTHER PUBLIC CORPORATIONS

41. 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 the 1988-89 by increased estimate of receipts by New Towns.

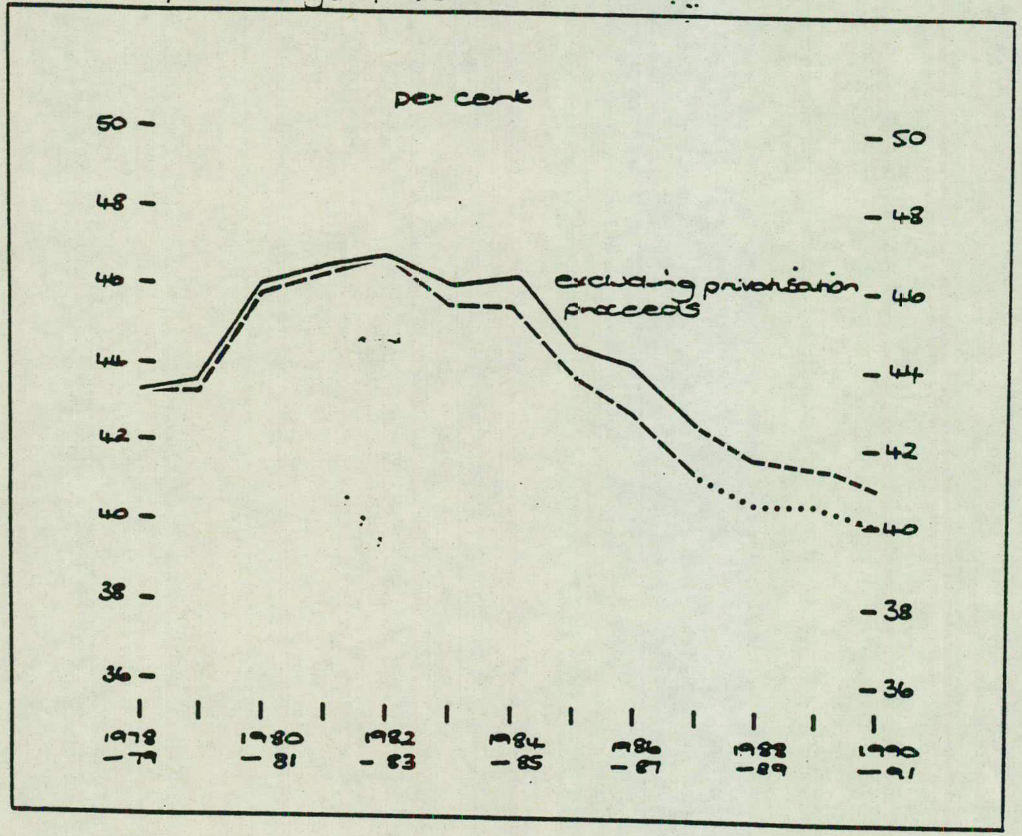
RESERVES

42. 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 White Paper.

PRIVATISATION

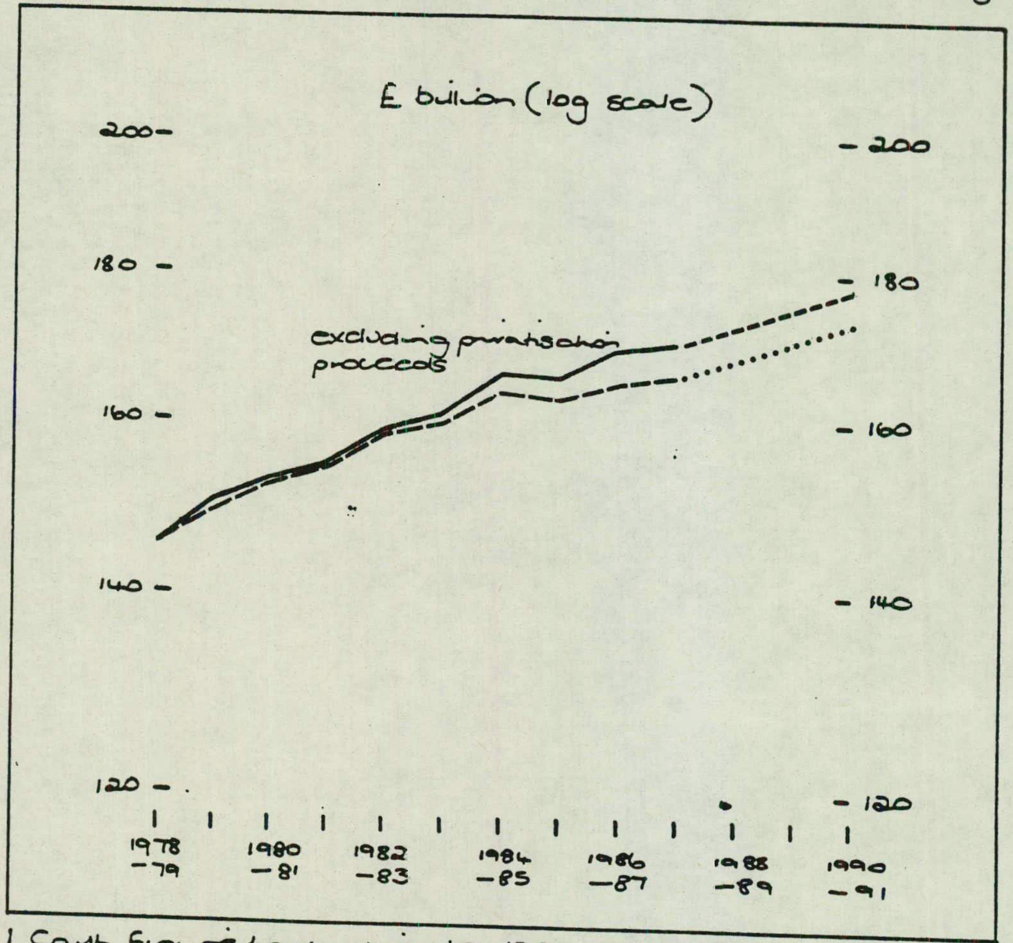
43. The estimate of net proceeds from the privatisation programme is £5 billion a year, the same as in Cm 56. These proceeds are netted off the planning total and general government expenditure. However, in order to show the underlying trends in expenditure more clearly, charts 2.1 and 2.2 show growth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

Chart 2.1 General government expenditure as a percentage of GDP.



ALTERED VERSION.

Chart 2.2 General government expenditure in real terms[1]



1 Cash figures adjusted to 1986–87 price levels by excluding the effect of general inflation as measured by the GDP deflator.

Table 2.1

Public Expenditure Trends

£ billion

	Planning Total		General government expenditure		General government expenditure (excluding privatisation proceeds	
	Cash	Real terms[2]	Cash	Real terms[2]	Cash	Real terms[2]
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	150.0
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	156.9	144.0	183.1	168.1	188.1	172.6
1989-90	167.3	148.4	193.5	171.6	198.5	176.0
1990-91	176.6	152.1	202.5	174.4	207.5	178.7

1. Estimated outturn for 1987-88; plans for 1988-89 onwards.

2. 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, 3 per cent respectively in the years 1988-89 to 1990-91.

Table 2.2

Public expenditure as percentage of GDP

	General government expenditure	General government expenditure (excl 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	46½
1985-86	43¾	44½
1986-87	42¾	44
1987-88	41¼	42½
1988-89	40½	41¾
1989-90	40½	41½
1990-91	40	41

TABLE 2.3: PUBLIC EXPENDITURE

£ million

	Latest estimates of outturn			New plans			Changes 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	18,149.0	18,950.0	801.0	19,201.0	19,949.0	20,556.2	168.0	221.0	485.0
FCO - Diplomatic wing	635.0	700.0	65.0	716.7	735.8	755.8	-30.0	-12.9	-10.8
FCO - Overseas Development Administration	1,290.0	1,325.0	35.0	1,430.0	1,502.7	1,548.9	-27.0	31.2	61.6
European Communities	1,088.0	1,400.0	312.0	803.8	1,594.0	1,333.7	517.0	350.0	520.0
Ministry of Agriculture, Fisheries and Food	1,865.0	2,133.0	268.0	2,283.9	2,392.9	2,545.0	-125.0	-108.6	-99.9
Department of Trade and Industry	2,097.0	925.0	-1,172.0	1,228.1	1,185.7	1,133.4	-196.0	258.2	219.7
Export Credits Guarantee Department	259.0	159.0	-100.0	162.0	113.4	132.8	-5.0	51.4	66.7
Department of Energy	-191.0	274.0	465.0	119.8	-185.7	-415.8	355.0	163.1	51.8
Department of Employment	3,877.0	4,105.0	228.0	4,236.3	4,293.4	4,345.3	83.0	37.7	-6.5
Department of Transport	4,709.0	4,800.0	91.0	5,144.2	5,111.6	5,209.0	-342.0	59.9	-27.2
DOE - Housing	2,605.0	2,520.0	-85.0	3,018.2	3,003.0	3,042.5	-701.0	-14.0	-104.0
DOE - other environmental services	3,915.0	4,023.0	108.0	3,814.2	4,002.0	4,105.0	189.0	-61.5	89.9
Home Office	5,161.0	5,794.0	633.0	6,054.2	6,306.9	6,477.0	256.0	357.1	440.8
Legal departments	673.0	876.0	203.0	964.2	1,032.8	1,095.6	5.0	23.7	30.0
Department of Education and Science	15,691.0	17,170.0	1,479.0	17,962.1	18,631.4	19,160.2	583.0	625.5	804.7
Office of Arts and Libraries	817.0	893.0	76.0	900.5	937.9	969.2	67.0	48.6	64.5
DHSS - health and personal social services	17,918.0	19,556.0	1,638.0	20,677.3	21,684.3	22,641.9	432.0	810.0	933.0
DHSS - social security	44,442.0	46,445.0	2,003.0	48,502.6	50,854.6	53,579.2	443.0	1,050.6	1,535.8
Scotland	7,736.0	8,220.0	484.0	8,511.0	8,608.4	8,762.3	258.0	402.7	387.5
Wales	3,057.0	3,314.0	257.0	3,442.0	3,543.8	3,655.6	122.0	144.0	150.8
Northern Ireland	4,638.0	4,886.0	248.0	5,120.5	5,305.6	5,484.8	15.0	82.7	111.3
Chancellor's departments	2,067.0	2,311.0	244.0	2,438.5	2,553.5	2,637.6	96.0	134.6	141.9
Other departments	1,318.0	1,451.0	133.0	1,636.7	1,921.0	1,776.9	-89.0	8.3	215.6
Reserve				3,500.0	7,000.0	10,500.0	-3,500.0	-2,000.0	-500.0
Privatisation proceeds	-4,403.0	-5,000.0	-597.0	-5,000.0	-5,000.0	-5,000.0	0.0	0.0	0.0
Adjustments	0.0	400.0	400.0	0.0	0.0	0.0	426.0		
PLANNING TOTAL	139,413.0	147,630.0	8,217.0	156,867.8	167,078.0	176,023.1	-1,000.0	2,663.3	5,562.2
General Government gross debt interest	17,400.0	17,800.0	400.0	18,000.0	18,000.0	18,000.0	-200.0	0.0	-1,000.0
Other National Accounts adjustments	8,300.0	7,366.0	-934.0	8,000.0	8,500.0	8,500.0	366.0	500.0	1,000.0
GENERAL GOVERNMENT EXPENDITURE	165,113.0	172,796.0	7,683.0	182,867.8	193,578.0	202,523.1	-834.0	3,163.3	5,562.2

0/037

Ta[illegible]2.4

External Finance Limits for the Nationalised Industries 1988-89

	£million
British Coal	670
Electricity (England and Wales)	-1040
North of Scotland Hyro-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
Total	**1599**

This does not add up.

TABLE 2.5: CENTRAL GOVERNMENT

£ million

	Latest estimates of outturn			New plans			Change from January 1987 White Paper(1)		
	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
CENTRAL GOVERNMENT									
Ministry of Defence	18,161.0	18,950.0	789.0	19,201.0	19,949.0	20,556.2	168.0	221.0	485.0
FCO - Diplomatic wing	631.0	697.0	66.0	716.7	735.8	755.8	-3.0	-12.9	-10.8
FCO - Overseas Development Administration	1,270.0	1,314.0	44.0	1,397.7	1,469.8	1,515.1	-13.0	31.2	61.6
European Communities	1,088.0	1,414.0	326.0	803.8	1,594.0	1,333.7	531.0	350.0	520.0
Ministry of Agriculture, Fisheries and Food	1,667.0	1,946.0	279.0	2,067.0	2,170.2	2,316.3	-113.0	-120.6	-115.4
Department of Trade and Industry	1,844.0	1,050.0	-794.0	1,249.8	1,254.1	1,195.5	80.0	280.0	289.0
Export Credits Guarantee Department	259.0	159.0	-100.0	162.0	113.4	132.8	-4.0	51.4	66.7
Department of Energy	907.0	589.0	-318.0	512.1	458.1	431.3	91.0	41.8	27.2
Department of Employment	3,757.0	3,976.0	219.0	4,106.7	4,157.5	4,206.6	77.0	31.7	-16.2
Department of Transport	1,260.0	1,410.0	150.0	1,453.9	1,489.4	1,530.7	15.0	30.5	35.5
DOE - Housing	1,313.0	1,367.0	54.0	1,315.2	1,375.8	1,461.2	13.0	-8.5	40.0
DOE - other environmental services	363.0	433.0	70.0	442.6	446.6	448.3	26.0	25.8	19.3
Home Office	906.0	1,033.0	127.0	1,120.3	1,196.2	1,212.1	10.0	80.9	110.2
Legal departments	673.0	876.0	203.0	964.2	1,032.8	1,095.7	5.0	23.7	30.0
Department of Education and Science	2,459.0	2,703.0	244.0	2,932.5	3,079.2	3,143.1	72.0	211.7	271.4
Office of Arts and Libraries	337.0	369.0	32.0	403.8	423.8	439.7	13.0	35.6	46.5
DHSS - health and personal social services	15,154.0	16,517.0	1,363.0	17,621.6	18,458.6	19,320.1	333.0	700.0	800.0
DHSS - social security	40,973.0	42,555.0	1,582.0	44,782.7	46,873.2	49,477.8	187.0	908.7	1,333.1
Scottish Office	3,310.0	3,504.0	194.0	3,603.0	3,784.0	3,907.1	66.0	60.9	118.2
Welsh Office	1,453.0	1,556.0	103.0	1,669.7	1,714.0	1,768.9	45.0	91.3	83.6
Northern Ireland	3,593.0	3,796.0	203.0	3,999.9	4,166.0	4,309.3	14.0	66.9	92.2
Chancellor's departments	2,074.0	2,318.0	244.0	2,444.2	2,560.2	2,643.3	96.0	133.5	141.8
Other departments	1,318.0	1,451.0	133.0	1,636.7	1,921.0	1,770.9	-89.0	8.3	215.6
TOTAL	104,769.0	109,983.0	5,214.0	114,607.1	120,422.7	124,971.5	1,620.0	3,242.9	4,644.5

TABLE 2.6: LOCAL AUTHORITY SPENDING

£ million

	Latest estimates of outturn			New plans			Changes 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	186.0	166.0	-20.0	197.2	205.2	210.7	-14.0	12.0	15.5
Department of Trade and Industry	79.0	89.0	10.0	89.9	93.3	95.6	6.0	4.9	6.0
Department of Employment	115.0	126.0	11.0	129.6	135.9	139.6	6.0	6.6	10.3
Department of Transport	2,483.0	2,437.0	-46.0	2,644.3	2,712.6	2,787.2	-239.0	-60.0	-52.0
DOE - Housing	1,274.0	1,141.0	-133.0	1,686.0	1,538.6	1,460.8	-660.0	55.0	-152.0
DOE - Other environmental services	3,424.0	3,665.0	241.0	3,372.1	3,476.2	3,569.8	341.0	15.1	43.1
Home Office	4,254.0	4,762.0	508.0	4,933.9	5,110.7	5,264.8	246.0	276.2	330.6
Department of Education and Science	13,232.0	14,467.0	1,235.0	15,029.6	15,552.1	16,017.2	511.0	413.8	533.3
Office of Arts and Libraries	480.0	524.0	44.0	496.7	514.1	529.5	55.0	13.0	18.0
DHSS - Health and personal social services	2,738.0	3,027.0	289.0	3,127.6	3,225.7	3,321.8	99.0	110.0	133.0
DHSS - Social security	3,470.0	3,790.0	320.0	3,719.9	3,981.4	4,101.4	156.0	141.9	202.7
Scottish Office	3,942.0	4,326.0	384.0	4,524.6	4,627.8	4,770.9	133.0	185.1	162.7
Welsh Office	1,539.0	1,696.0	157.0	1,687.6	1,738.1	1,792.6	98.0	53.4	65.7
Northern Ireland	716.0	700.0	-16.0	736.6	771.6	793.1	0.0	10.1	12.2
TOTAL	37,932.0	40,916.0	2,984.0	42,375.6	43,683.3	44,855.0	738.0	1,237.1	1,329.1
of which -									
Relevant expenditure	29,400.0	32,100.0	2,700.0	33,251.0	34,334.0	35,362.0	1,154.0	1,045.0	1,282.6
Other current	4,800.0	5,100.0	300.0	5,073.4	5,384.7	5,540.3	124.0	142.2	208.8
Capital	3,700.0	3,700.0	0.0	4,065.9	3,977.3	3,957.4	-539.0	64.6	-149.5

TABLE 2.7: PUBLIC CORPORATIONS* £ million

	Latest estimates of outturn			New plans			Changes from January 1987 White Paper £million		
	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
Overseas Development Administration	24.0	14.0	-10.0	32.2	33.0	33.8	-14.0	0.0	0.0
Ministry of Agriculture, Fisheries and Food	13.0	21.0	8.0	19.7	17.5	18.0	2.0	0.0	0.0
Department of Trade and Industry	173.0	-214.0	-387.0	-111.6	-161.7	-157.7	-282.0	-26.7	-75.3
Department of Energy	-1,098.0	-315.0	783.0	-392.3	-643.8	-847.1	264.0	121.3	24.6
Department of Transport	966.0	953.0	-13.0	1,046.1	909.6	891.2	-138.0	89.4	-10.7
DOE - Housing	19.0	12.0	-7.0	17.0	88.6	120.6	-54.0	-60.5	8.0
DOE - Other environmental services	128.0	-75.0	-203.0	-0.5	79.2	86.9	-178.0	-102.4	27.5
Scottish Office	484.0	390.0	-94.0	383.4	196.6	84.3	60.0	156.7	106.6
Welsh Office	65.0	79.0	14.0	84.7	91.7	94.1	-4.0	-0.7	1.5
Northern Ireland	329.0	390.0	61.0	384.0	368.0	378.4	1.0	5.7	6.9
Other	12.0	-2.0	-10.0	-78.6	-6.7	-5.7	0.0	-0.6	-0.6
TOTAL	1,115.0	1,253.0	142.0	1,384.1	972.0	696.8	-343.0	110.9	89.1
of which -									
Nationalised industries	400.0	1,000.0	600.0	687.1	-32.0	-386.2	-105.0	344.5	23.9
Other public corporations	700.0	700.0	-100.0	700.6	1,004.2	1,083.8	-240.0	-158.7	64.8

*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.

MR 3/32

CONFIDENTIAL

1 Alex
2 PLUS

FROM: CATHY RYDING
DATE: 26 October 1987

MR SCOTTER

cc: PS/CST
PS/FST
Sir P Middleton
Mr Cassell
Mr Scholar
Miss O'Mara
Mr Riley
Miss Sinclair
Mr Hibberd
Miss Evans
Mr Eason - IR
Mr Allen - C&E
Mrs Hamill - C&E

AUTUMN STATEMENT: CHAPTER 4

The Chancellor was grateful for your minute of 21 October. 1982-85

2. The Chancellor has queried whether the title "The revenue effects of illustrative tax changes" is the same as usual - he recalls it being "Revenue ready reckoner".

3. The Chancellor also suggests redrafting paragraph 4.01 as follows

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

4. The Chancellor was otherwise content.

CR

CATHY RYDING

004/3295

CONFIDENTIAL

CHIEF SECRETARY TO THE TREASURY

RD

FROM: JILL RUTTER

DATE: 26 October 1987

MR F E R BUTLER

cc:
PS/Chancellor (Mrs C Ryding)
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Mr Turnbull
Mr Sedgwick
Mr Odling-Smee
Mr Gieve
Mrs Butler
Mr Mowl
Mr Pratt

CURRENT YEAR OUTTURN: PRESENTATION IN THE AUTUMN STATEMENT

The Chief Secretary has seen Mr Pratt's minute of 20 October and the Chancellor's comment recorded in Mrs Ryding's minute of 21 October.

2 The Chief Secretary would wish to see the lowest possible underspend consistent with control gross expenditure. This implies an underspend of £1 billion and is consistent with the Chancellor's note of 21 October.

Jill Rutter

JILL RUTTER
Private Secretary

Papers p ae

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I think X. NL

From: I SCOTTER
Date: 27 October 1987

MRS RYDING

cc: Mr Scholar
Mr Riley
Miss Sinclair
Miss Evans

Mr Eason - IR

C/ which title wd you prefer?

CR 27/10

AUTUMN STATEMENT: CHAPTER 4

The Chancellor asked about the title of Chapter 4 (your minute of 26 October).

2. Between 1982 and 1985, Chapter 4 was titled "The revenue effect of illustrative tax changes". In 1986 the title was changed to "Oil taxation and revenue ready reckoner" because of the announcement of the APRT changes. For 1987 we had reverted to the traditional title.

X 3. I think that the alternative title would be "Tax revenue ready reckoner".

4. Could you let Carys Evans know in the course of tomorrow morning (28 October) whether the Chancellor wishes to change the title, as the chapter has to be returned to the printers by lunchtime? (I shall be working at the Revenue again).

Ian Scotter

IAN SCOTTER

7-31

CONFIDENTIAL

Rup

FROM: MRS T C BURNHAMS
DATE: 27 OCTOBER 1987

MR SEDGWICK
MR TURNBULL
MISS PEIRSON
MISS O'MARA
MR SCOTTER
MR DYER
MR FLITTON
MR FRAY
MISS TITMUSS
MISS CRANG

cc Mr Scholar
Mr A C S Allan
Miss Rutter
Mr R I G Allen
Mr Saunders
Mr Rawlings
Mr S J Davies
Mr McIntyre
Mr Gieve
Miss Walker
Miss Evans
Mr P Allum
Mrs Rydng
Mr D Savage
Mr Tyrie (for backbench brief)

AUTUMN STATEMENT

... I attach a revised aide memoire which takes account of comments now received.

2. It has been confirmed that there is no need for a Treasury Press Notice this year and the necessary amendments to the Aide Memoire reflect this.

Teresa Burnhams

MRS T C BURNHAMS

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AIDE MEMOIRE

Tuesday 27 October

(16)	Final version of arranged PQ to Chancellor.	GE
(16a)	Secretary of State for Social Services announces uprating	
(17)	Briefing and speaking note for Cabinet submitted to Treasury Ministers.	FP/EB/GE
(18)	GE sends first draft of Chapter 2 to FP for delivery to printers by 6pm.	GE/FP

Wednesday 28 October

(19)	Chapters 3 & 4 revised and returned to FP who return them to printers by midday.	ST/ETS/FP
(19a)	Arranged PQ tabled.	BD
(19b)	FP provide line to take for PM questions and LPS Business Statement.	FP/BD
(20)	Printers return Chapters 1 & 2 to FP by 6pm. FP submit to Chancellor.	FP
(21)	Conservative Backbenchers' brief drafted. To be decided if brief should be included in AS package for Cabinet Ministers.	AT

Thursday 29 October

(22)	pm. Treasury 1st Order Questions.	
(23)	Chapters 1 & 2 revised and returned to FP who send them to printers by 4pm.	EA/GE/FP

Friday 30 October

(24)	Printers send book proofs (all chapters) to HMT by 6pm.	FP
(25)	Chancellor's Office send OS to PM if necessary.	AA
(26)	EB submit draft AS briefing to Chancellor.	GE/EB
(27)	Chancellor confirms which Radio/TV interviews he and other Treasury Ministers will undertake.	AA/IDT
(28)	FP inform IDT of the number of OGDPNs.	TB
(29)	Letter sent to Deliverer of the Vote, Clerk of Printed Papers and Librarians in Commons and Lords establishing arrangements for release of AS to MPs and Lords at end of OS.	BD
(29a)	Table "Notice of Motion of unopposed Return" for printing order and arrange for Government Whip to nod through.	BD
(31)	Conservative Backbenchers' brief submitted to Chancellor.	AT

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(32) IDT issue operational note to the press inviting them to briefing and finalise arrangements for issuing OS pack. IDT

(33) IF write to Embassies and High Commissions confirming copies of AS material will be available for collection on AS day after OS. DS

(34) Chancellor's Office contact C&E, IR, Bank of England, NEDO, CBI, Conservative Research Department, Nationalised Industries Chairmen's Group, about arrangements for delivery/collection of AS packages. Check with FCO despatch arrangements for overseas copies. NF

(35) Chancellor's Office arrange preparation of addressed envelopes/labels for those on Annex B. NF

Saturday 31 October

(36) am. Book proofs checked by authors and returned to printers by midday. FP/GE/EA/ST/ETS

Monday 2 November

(37) 8am. AS read at press. EA/GE/FP

(38) OS finalised and sent to CRU for copying. AA/CRU

(39) Copies of OGDPNs to Chancellor's Office (FP to chase if not received from Departments). FP/NF

(40) Chancellor returns Conservative Backbenchers' brief and Office Services check with AT when it will be ready for copying and numbers required. RR/AT

(40a) AS brief to CRU for copying - overnight work may be required. EB/RR

Tuesday 3 November **Autumn Statement Day**

(41) 8am. EB distribute copies of AS brief to No 10, Treasury Ministers, Lord Young, and selected Treasury officials. EB

(42) LH to give NF 9 copies of AS brief to include in package B for British Embassy Washington, UKREP Brussels, BIS New York, British Embassy Paris to be despatched as at Annex B. LH/NF

(43) Chancellor's Office confirm length of OS with IDT to guide Radio/TV, and with BD to enable him to inform Speaker. AA/BD

(44) 10am. CRU deliver copies of OS for distribution. See Annex A. CRU/RR

(45) FP authorise HMSO to deliver printed Autumn Statement to the House. FP

(46) HMSO deliver 735 copies of printed AS to HMT by 10am to be distributed as at Annex A. Recipients to collect from post room. RR

(47) Official Box List for Statement and Allocation of Gallery Seats to be given to BD by 10.30 CR

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(48) Copies of Autumn Statement package distributed as at Annex B. BD collects 5 packages - for Speaker (1) and Lords' Whips (4) when notified by NF to be delivered by 12.30 and 2pm respectively; BD also to collect 23 copies of OS to be distributed as at Annex C. NF/BD

(49) CR to arrange for copy of OS to reach Official Report. CR

(50) EB to ensure all officials in Official Box have copies of AS brief. LH

(52) AA to notify PS Lord Young of any changes to AS brief. AA

By 2pm

(53) BD delivers 6 copies of OS to Commons' Government Whips and 8 copies of OS to Lords' Government Whips for Opposition BD

(54) Chancellor's Office to deliver remaining copies of package A to PPS Chancellor's room in House (see Annex B). NF

OS started

(55) IDT collects copies from CS and deliver to Lobby for distribution (see Annex D). IDT implement page by page release to Reuters/Telerate. JF/BC

(56) 2 copies of AS formally laid on the Table of each House. BD

After OS

(57) Release AS package for press, to departmental press officers and to press callers at Main Door. JF

(58) IDT distribute remaining AS package as at Annex D. JF

(59) NF to deliver copies of package B to be collected from Enquiry Room. NF

(60) 8 copies of OS and AS sent to House Libraries. BD

(61) IF to collect 16 copies of package B from Chancellor's Office. DS/NF

(62) Final proofs of Winter Supplementaries sent to Departmental Select Committees in Confidence. GE

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ANNEX A

SOURCE AND INITIAL DISTRIBUTION OF AS MATERIAL

Aide Memoire
Reference 44, 46

	A/S	O/S	OGDPNs
Source			
HMSO	675		
CRU		648	
OGDPs			100

A/S

120 to Library
170 to Chancellor's Office
350 to Committee Section
15 to Parliamentary Branch
20 to FP

O/S

193 to Chancellor's Office
455 to IDT

OGDPs

100 to Chancellor's Office

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ANNEX B

DISTRIBUTION BY CHANCELLOR'S OFFICE

Aide Memoire 42
Reference 35, 48, 54

	A/S	O/S	OGDPN's
Received from			
HMSO	170		
CRU		170	
OGDP's			100

Distributed to

PACKAGE A (A/S, O/S, OGDPN's)

Prime Minister)
Chancellor)
Chief Secretary) By 12.30
Financial Secretary)
Paymaster General)
Economic Secretary)

Sir Peter Middleton)
Sir Terence Burns)
Sir Geoffrey Littler)
Mr F E R Butler)
Miss Mueller)
Mr A Wilson)
Mr Anson)
Mr Cassell)
Mr Kemp)
Mr Monck)
Mr Byatt)
Mr Scholar)
Mr D J L Moore)
Mr Sedgwick)
Mr Peretz) ASAP
Mrs Lomax)
Mr Odling-Smee)
Mr Turnbull)
Miss Peirson)
Mr R I G Allen)
Miss O'Mara (3 copies))
Mr Gieve)
Mr Gilhooly)
Mr M G Richardson)
Mr Easton)
Miss Evans)
Mrs Burnhams)
Mr Cropper)
Mr Call)
Mr Tyrie)

The Speaker* By 12.30

Mr A C S Allan)
Mr J Taylor) By 1.00
Mrs Ryding)

Chancellor of the Duchy of Lancaster) To be
Secretary of State for Trade & Industry) delivered to
Leader of the House of Commons) PPS CX room
Leader of the Lords) at House
Leader of the Opposition) by 3pm
Shadow Chancellor) AA to advise
Mr Steel) on exact time
Mr Maclennan) of release
Mr Molyneux)
Chancellor's PPS)
Chairman of Conservative Finance Cttee)
Chairman PAC)
Chairman TCSC)
Hon Mark Lennon-Boyd)
(Treasury Whip))
Mr McKay (Clerk TCSC))
Vice Chamberlain of the Household)
(Tristan Garel-Jones MP))

Leader of Opposition (Lords)*) BD to take
Leader of Liberals (Lords)*) to Lords
Leader of SDP (Lords)*) Whips Office
Government Chief Whip (Lords)*) by 2pm. AA to
) advise on
) exact time
) of release

Total No of AS Package A - 62 copies

*BD to collect Speaker's package and 4 for Lords' Whips Office - see reference (48)

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ANNEX B (cont)

Aide Memoire
Reference 42, 48, 59, 61

PACKAGE B (A/S, O/S)

Mr Unwin (C&E)		)
Mr Battishill (IR)		) to be collected by C&E, IR and
Customs & Excise	- 2 copies	) B/E messengers from Chancellor's
Inland Revenue	- 2 copies	) messengers' lobby at 2pm
Bank of England	- 6 copies	)
NEDO	- 3 copies	)
CBI	- 3 copies	) After O/S to be collected from
TUC	- 3 copies	) Enquiry Room by own messengers
NICG	- 3 copies	) or despatched as requested
CRD	- 3 copies	)
Diplomatic Missions	- 16 copies	After O/S to be collected by IF
British Embassy Washington	- 3 copies	) After OS to be sent via
UKREP Brussels	- 4 copies	) FCO
British Embassy Paris		After O/S to be sent via FCO by
BIS New York		6pm bag
Principal Finance Officers	- 25 copies	) After O/S
Other Cabinet Ministers	- 25 copies	After O/S

Total Number of AS Package B - 102 copies

	A/S	**O/S**	**OGDPNs**
Remaining copies despatched to			
Parliamentary Branch*		23	
IDT			30
Official Report		1	
Chancellor's Office spares	6	5	8

*To be collected (see 48)

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ANNEX C

DISTRIBUTION BY PARLIAMENTARY BRANCH

Aide Memoire
Reference 48 56 60

	A/S	O/S	OGDPN	
<u>Received from</u>				
HMSO	15			
Chancellor's Office	5	28	5	
<u>Despatched to</u>				
Speaker*	1	1	1	by 12.30
Govt Whips (Commons)		6		by 12.30
Govt. Whips (Lords)	4	12	4	by 2.00
House Libraries	8	8		after O/S
Formal Presentation to Commons/Lords	4			during O/S
TOTAL	17	27	5	
Spares	3	1		

*BD to collect from Chancellor's Office
(see reference (48)

CONFIDENTIAL

ANNEX D

DISTRIBUTION BY IDT

Aide Memoire
Reference 58

	A/S	O/S	OGDPN's	
Received from				
Committee Section	350	455		
Chancellor's Office			30	
Despatched to				
Press Gallery Lobby	130	155		During O/S
Press	90	170		)
Deptl Press Officers	40	40		)
Specialist briefing	40	40	12	) After O/S
Treasury Mailing list	-	-		)
IDT + spares	30	30	18	)
FFJG	20	20		)
Total	350	455	30	

CONFIDENTIAL

nl

FROM: CATHY RYDING

DATE: 28 October 1987

MR SCOTTER

cc Mr Scholar
Mr Riley
Miss Sinclair
Miss Evans
Mr Eason - IR

AUTUMN STATEMENT: CHAPTER 4

The Chancellor has seen your minute to me of 27 October and would prefer the title of Chapter 4 to be "Tax revenue ready reckoner".

CR

CATHY RYDING

ps2/78R

CONFIDENTIAL

cc PS/Chief Secretary
Mr Scholar
Mr Turnbull
Mr Dyer
Miss C Evans

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

28 October 1987

Steven Wood Esq
PS/Leader of the House
Lord Privy Seal's Office
Privy Council Office
Whitehall
LONDON SW1A 2AT

Dear Steven,

TIMING OF THE AUTUMN STATEMENT

Subject to Cabinet's agreement tomorrow the intention is for the Chief Secretary to announce during Treasury Questions tomorrow afternoon that the date of the Autumn Statement will be 3 November. This will be in response to a question from Mr Terry Patchett, to be taken with a question from Mrs Joan Ruddock.

In the unlikely event that neither of these Members are present to ask their questions the Chancellor would be grateful if the Leader of the House could make an announcement as part of his Business Statement tomorrow along the following lines:

> "Following the decisions taken by Cabinet this morning, my Rt Hon Friend the Chancellor will be presenting his Autumn Statement to the House on Tuesday."

Copies go to Nigel Wicks at No.10 and to the Private Secretaries to the Lord President and Chief Whip.

Yours sincerely

Cathy Ryding

CATHY RYDING
Private Secretary

CE6

FROM: MISS C EVANS
DATE: 28 OCTOBER 1987

MRS RYDING

cc PS/Chief Secretary
Mr Scholar
Mr Turnbull
Mr Dyer

DATE OF THE AUTUMN STATEMENT

Mr Dyer has suggested that we need to provide the Leader of the House with a form of words announcing the date of the Autumn Statement against the (unlikely) contingency that the questions tabled on public expenditure by Messrs Patchett~~, McAllison, Livingstone or~~ Mrs Ruddock are not in fact asked. I attach a draft.

CE

MISS C EVANS

CONFIDENTIAL

To be dated 28 October

DRAFT LETTER FROM PS/CHANCELLOR TO PS/LEADER OF THE HOUSE

Steven Wood Esq
PS/Leader of the House

TIMING OF THE AUTUMN STATEMENT

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CR

PND

FROM: P N SEDGWICK
DATE: 28 OCTOBER 1987

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Monck
Mr H Evans
Mr Moore
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Turnbull
Mr R Allen
Mr Bottrill
Mr S Davies
Mr Hibberd
Mr Matthews
Mr Mowl
Miss O'Mara
Mr Allum
Ms C Evans
Mr Owen
Mr Ritchie
Mr Cropper
Mr Tyrie
Mr Call

CHAPTER 1 OF THE AUTUMN STATEMENT: ECONOMIC PROSPECTS FOR 1988

Sir T Burns has held a series of meetings to assess the implications of the recent fall in stock markets for the forecast to be published in the Autumn Statement. The attached version of chapter 1 of the AS includes proposed changes to the text and numbers agreed at these meetings. The changes are marked in manuscript on a printed version of Chapter 1 that already includes all the changes you had suggested earlier. We have to send a corrected version to the printers by no later than 4 pm tomorrow. I would be grateful if we could have your comments on the attached text and numbers by lunch time.

2. The main summary table (table 1.12) gives an impression of the changes to the numbers for the UK. (Tables 1.2, 1.4, 1.5, 1.6, and 1.13 show the more detailed changes.) Table 1.1 has the changes to the forecasts for the world economy.

3. The main characteristics of the changes to the numbers are as follows.

(a) The changes to world (major 7) and UK GNP/GDP are of the same size, with ½ per cent off growth in 1988.

(b) This symmetry is largely responsible for there being no change to the forecast UK trade balance in 1988. In view of the uncertainties about the effects of recent developments on net IPD earnings we have made no change to the forecast for invisibles : the current account in 1988 is therefore unchanged.

(c) RPI inflation is slightly (¼ per cent) lower in 1988(4), mainly as a result of a change to the housing component. (Following past practice we would not disclose the market interest rate or mortgage rate assumptions underlying the forecast. The change to the housing component of the RPI is consistent with a ½ per cent cut in the mortgage rate from its present level - which is possible if market rates stay at or below current levels.) Factors other than the mortgage rate affect the housing component of the RPI - eg the forecast for rates and the past increase in house prices.

(d) In table 1.13 we have adjusted the numbers for the three half years to the second half of 1988 in order to produce GDP growth on a year earlier of between 2¼-2½ per cent in the second half of 1988. To avoid giving the impression that there is a sharp slowdown in activity during 1988 we have slightly reduced GDP in the second half of 1987.

(e) Growth of money GDP is a little lower in both 1987-88 and 1988-89. (The small change to the figure for 1987-88 is the result of the change to the second half of 1987 discussed in (d).)

(f) The published forecast for the world economy does not contain specific numbers for individual economies. The discussion in paragraph 1.17 of the US, Japan, and Germany implies that it is growth in the US that is particularly likely to be hit by recent stock market developments.

4. It is worth noting some other points that relate mainly to the text.

(i) There is nothing in the tables or text that might be construed as a ready reckoner of the effects of falls in stock markets. The recent fall in stock markets are presented as one amongst a number of factors influencing prospects.

(ii) The level of the sterling index (though not the £/DM rate) has begun to drift away from the level assumed when first constructing the forecast. We have not altered the forecast numbers on this account, but have slightly altered the text in paragraph 1.21.

(iii) Given the enormous uncertainties involved in valuing assets (particularly equities) we have deleted discussion in paragraph 1.29 of changes in the UK's net external asset position during this year. Net external assets could conceivably be lower by the end of the year than at the end of 1986. Figures for end-1987 will not be published until the Pink Book next August, though we will probably have to hazard a guess in the FSBR.

(iv) The text has an additional paragraph (1.53) which assesses the impact of the fall in the stock market on monetary conditions and mentions the fall in short term interest rates. The argument is similar to that used in your statement to the House of Commons yesterday.

5. There are two other changes that are not related even indirectly to stock market developments.

(i) In table 1.8 we have deleted the productivity numbers for full time equivalents because these hardly differ from the output per head figures.

(ii) There is an additional sentence in paragraph 1.15 on the national accounts adjustments.

P.N.S

P N SEDGWICK

1 Economic prospects for 1988

Summary

2½

1.01 GDP is forecast to grow by ~~3~~ 2½ 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 ~~continued~~ 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 ~~3~~ 2½ 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 ~~continued~~ 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~~¼~~½ 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 2½ per cent in ~~both~~ 1987 and 2 per cent in 1988. World trade in manufactures has picked up this year, and should grow at ~~just under 5~~ around 4 per cent in 1988, reflecting faster growth of industrial production in the industrial countries. 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 ½ 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 ¾ 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 ~~now~~ appears to have ~~be~~ strengthen~~ing~~ed a little.

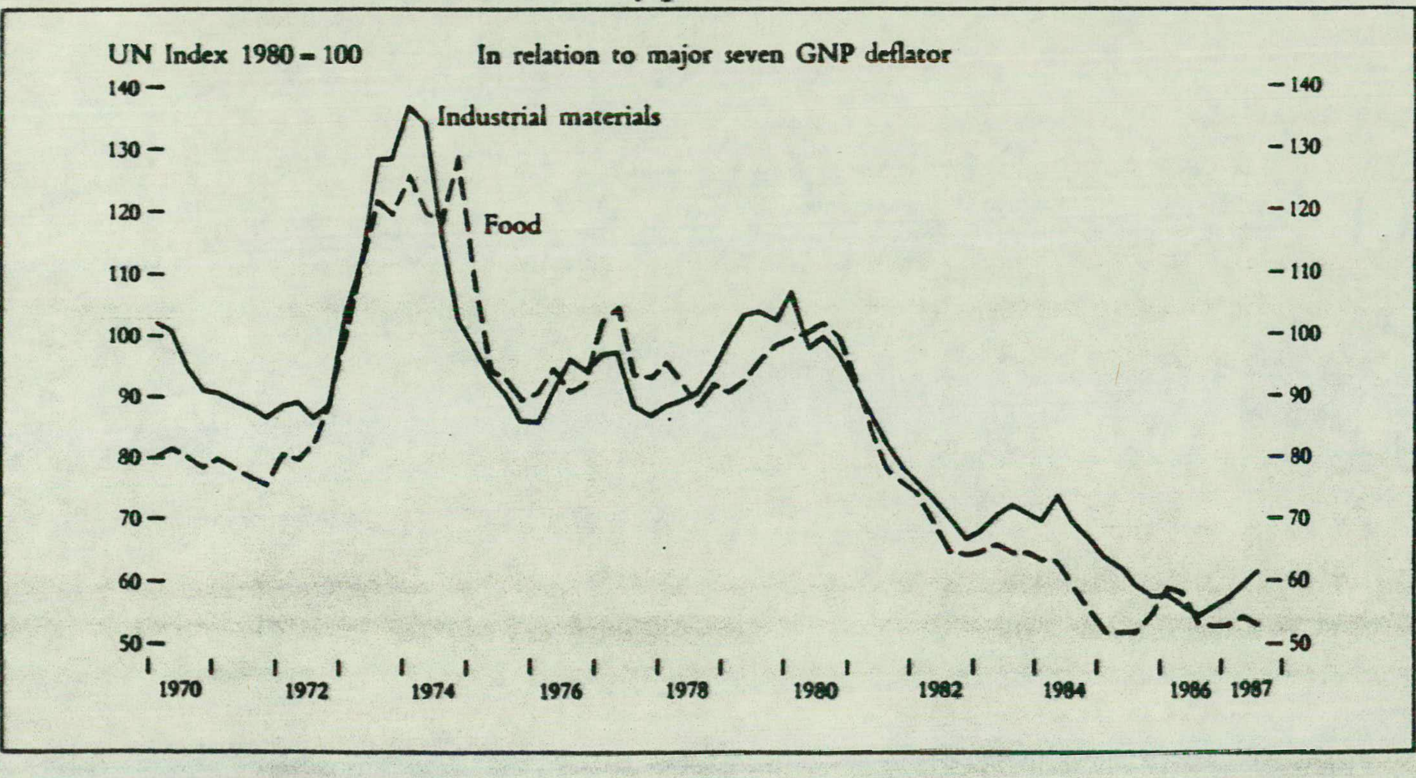
1.09 The weakness in world growth was largely due to the difficulties of adjusting both to the collapse in oil prices in early 1986 and to large changes in exchange rates. Lower oil prices led oil exporters to cut back their imports sharply. Moreover, with many non–oil commodity prices falling to their 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 ~~has~~ slowed in the first half of this year ~~more recently~~. 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.

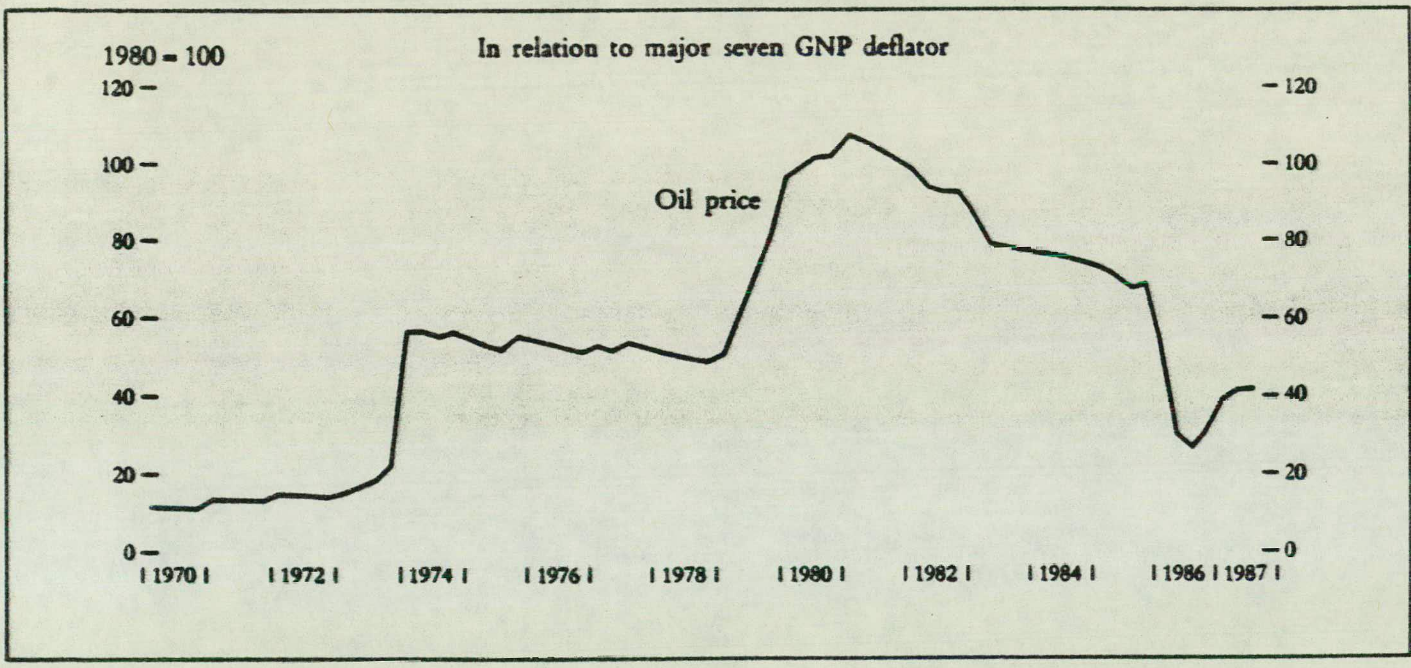
Chart 1.1 Real commodity prices



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 $1~~8~~ 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 prices



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		
		Forecasts	
	1986	1987	1988
Major seven countries[1]:			
Real GNP	2¾	2½	~~2½~~ 2
Real domestic demand	3¾	2¾	~~2½~~ 2
Industrial production	1	3	~~3¾~~ 3¼
Consumer prices	2	2¾	~~3~~ 2¾
World trade, at constant prices			
Total imports	4¾	3½	~~4~~ 3½
Total trade in manufactures[2]	2	3¾	~~4¼~~ 4

[1] *US, Japan, Germany, France, UK, Italy and Canada.*
[2] *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 ~~may continue~~

is forecast and
~~to increase slightly over the next year or so, especially if industrial production in the major OECD countries grows reasonably strongly, but~~ food prices ~~are forecast to~~ remain weak.

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

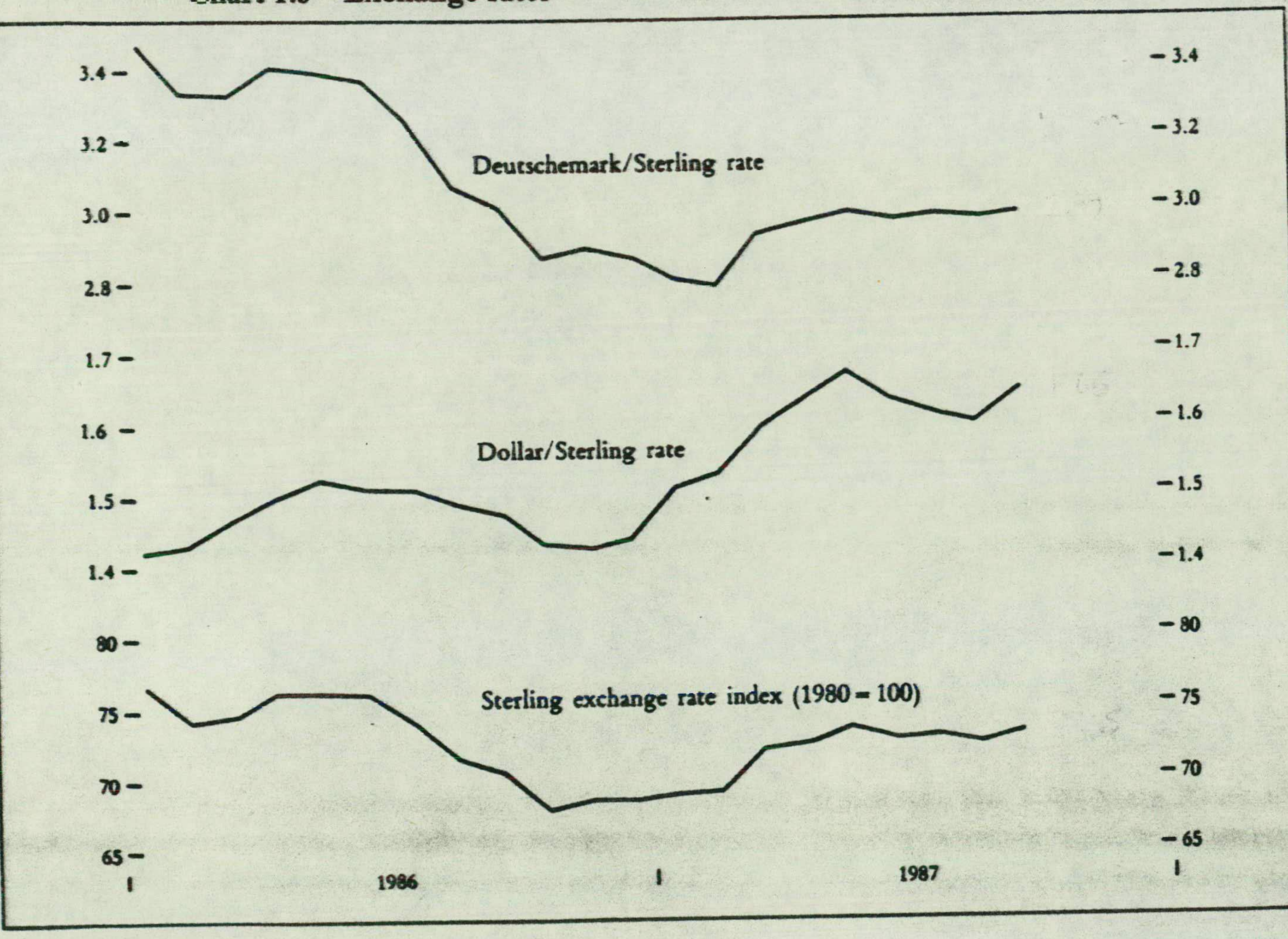
1.17 ~~In the US there is little likelihood of more rapid growth of domestic demand in 1988 as the economy adjusts to the reduction of its twin deficits, though the probable slowdown in consumers' expenditure could be in part offset by higher investment buoyed by rapid growth in export volumes.~~ The 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. ~~increase again in 1988, helped by a continued recovery in their exports.~~

1.19 World import volumes are likely to rise by about $3\frac{1}{2}$ 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 ~~in 1987~~.

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

Chart 1.3 Exchange rates



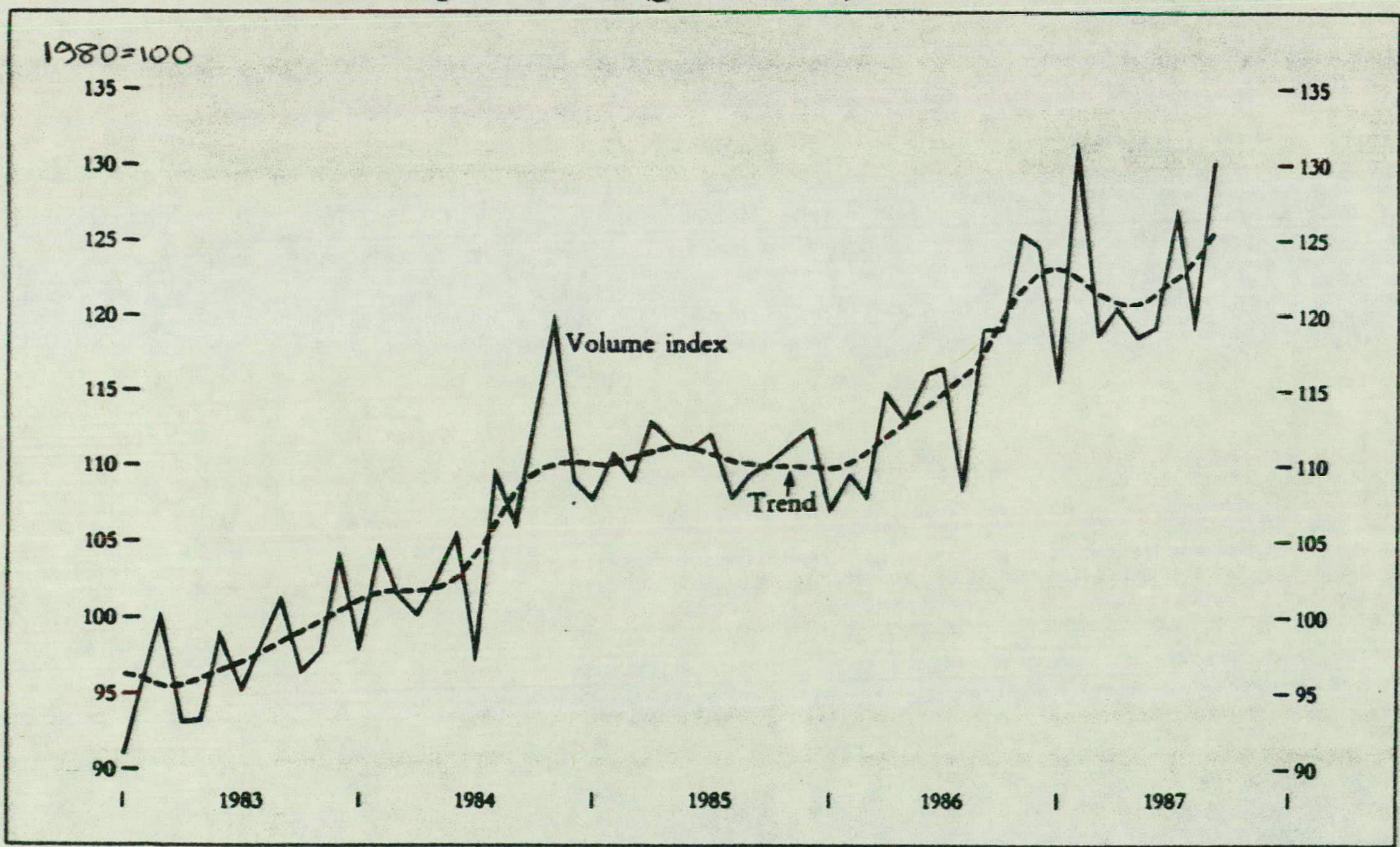
Trade and the balance of payments

Exchange rates 1.21 Exchange rates between major currencies have ~~remained broadly~~ been more stable following the Louvre meeting of Finance Ministers of the leading industrial countries in February. Sterling has reflected this general stability, particularly against the ~~d~~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 ~~7~~ 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 5¼ per cent next year compared to 8 per cent in 1987.

Chart 1.5 UK shares of total world trade in manufactures

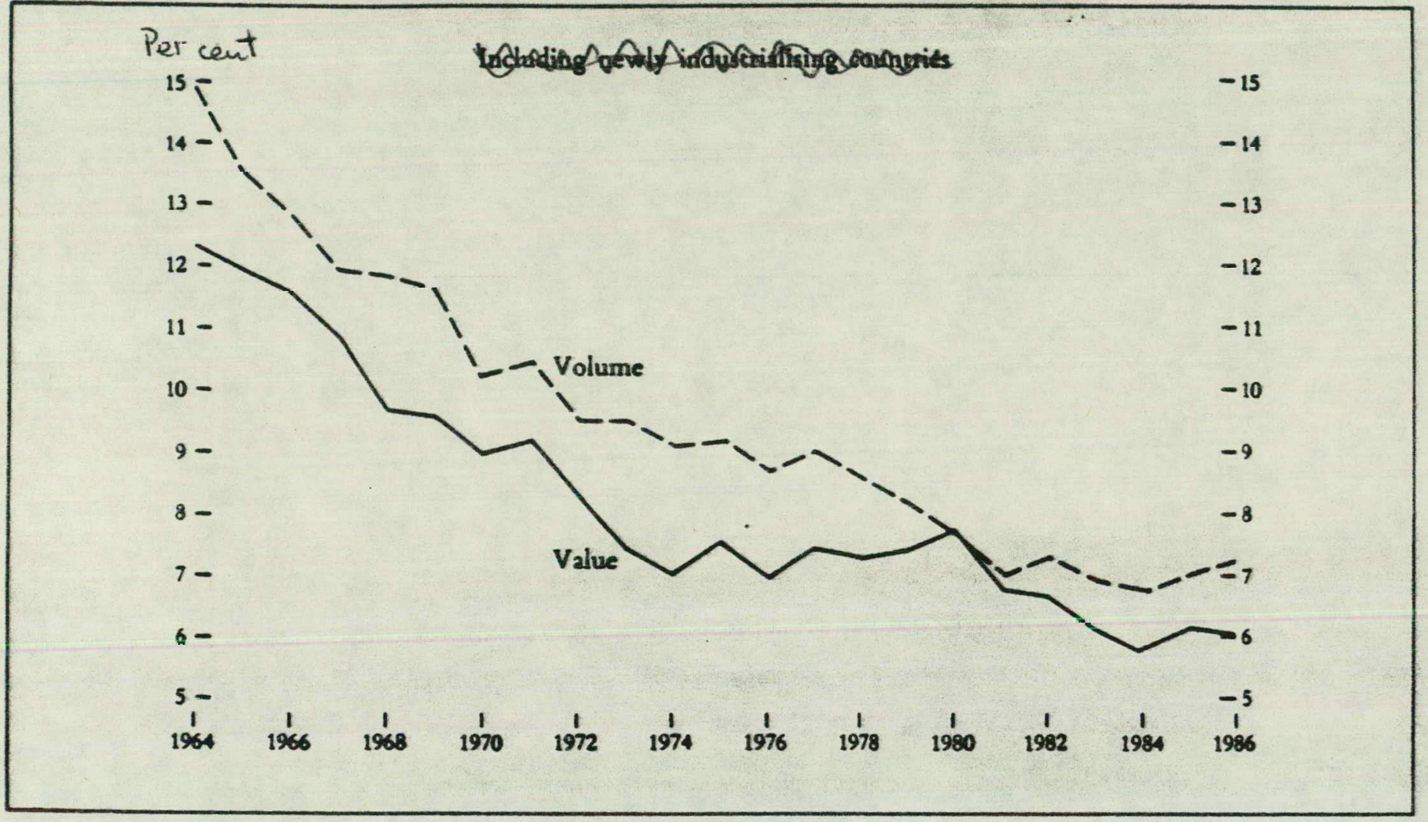
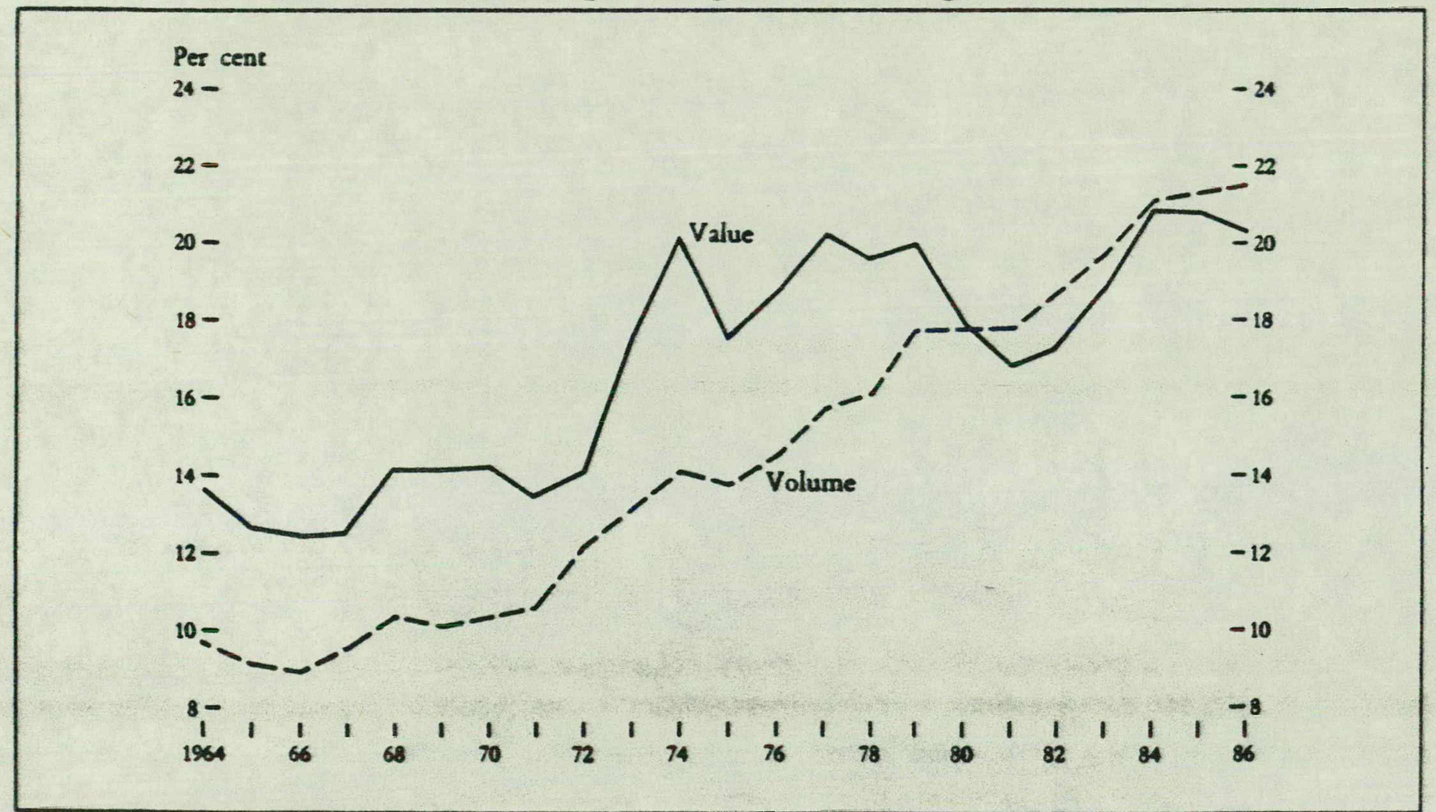


Chart 1.6 Share of imports of goods (excluding oil) in total domestic demand



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 ~~North Sea~~ 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. ~~Little~~ A small improvement ~~change~~ in the terms of trade ~~from the present level~~ 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	$3\frac{1}{2}$	$6\frac{1}{2}$	$-5\frac{1}{2}$	4	$5\frac{1}{2}$	−1
1987 Partly forecast	$5\frac{1}{2}$	7	1	7	8	1
1988 Forecast	~~3~~ 2½	~~6~~ 5½	1	~~4~~ 3½	5~~½~~	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 ~~which~~ rose by £37 billion, ~~to~~ reaching £114 billion by the end of ~~1986,~~ the year ~~has been affected during 1987 on both sides of the account by movements in financial markets in the UK and overseas, as well as by exchange rate changes, but the net position has probably changed little compared with the end of 1986~~.

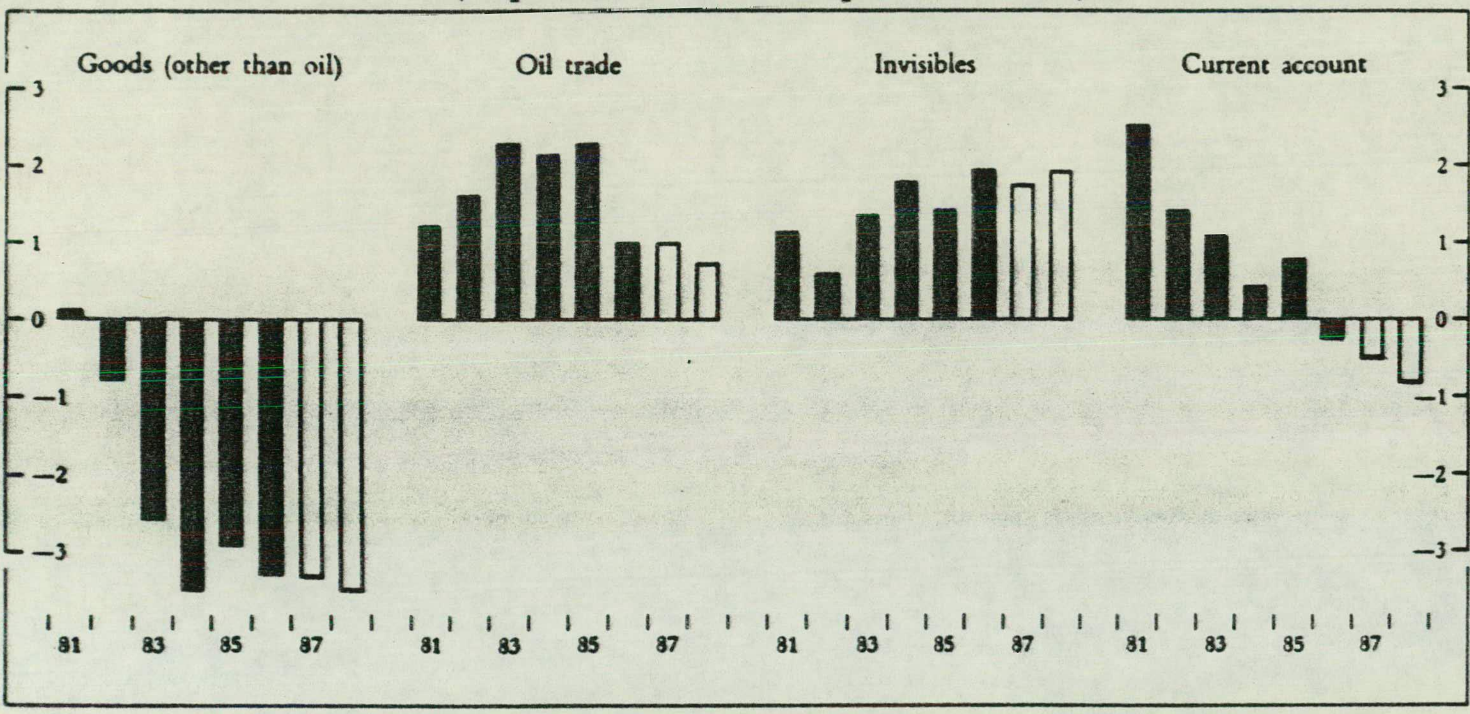
Current account

Table 1.3 Current account

	£ billion				
	Non oil goods		Oil	Invisibles	Current balance
	Manufactures	Other			
1986	$-5\frac{1}{2}$	−7	4	$7\frac{1}{2}$	−1
1987 Partly forecast	$-7\frac{1}{2}$	$-6\frac{1}{2}$	4	$7\frac{1}{2}$	$-2\frac{1}{2}$
1988 Forecast	−9	−6	3	$8\frac{1}{2}$	$-3\frac{1}{2}$

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 per cent 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.

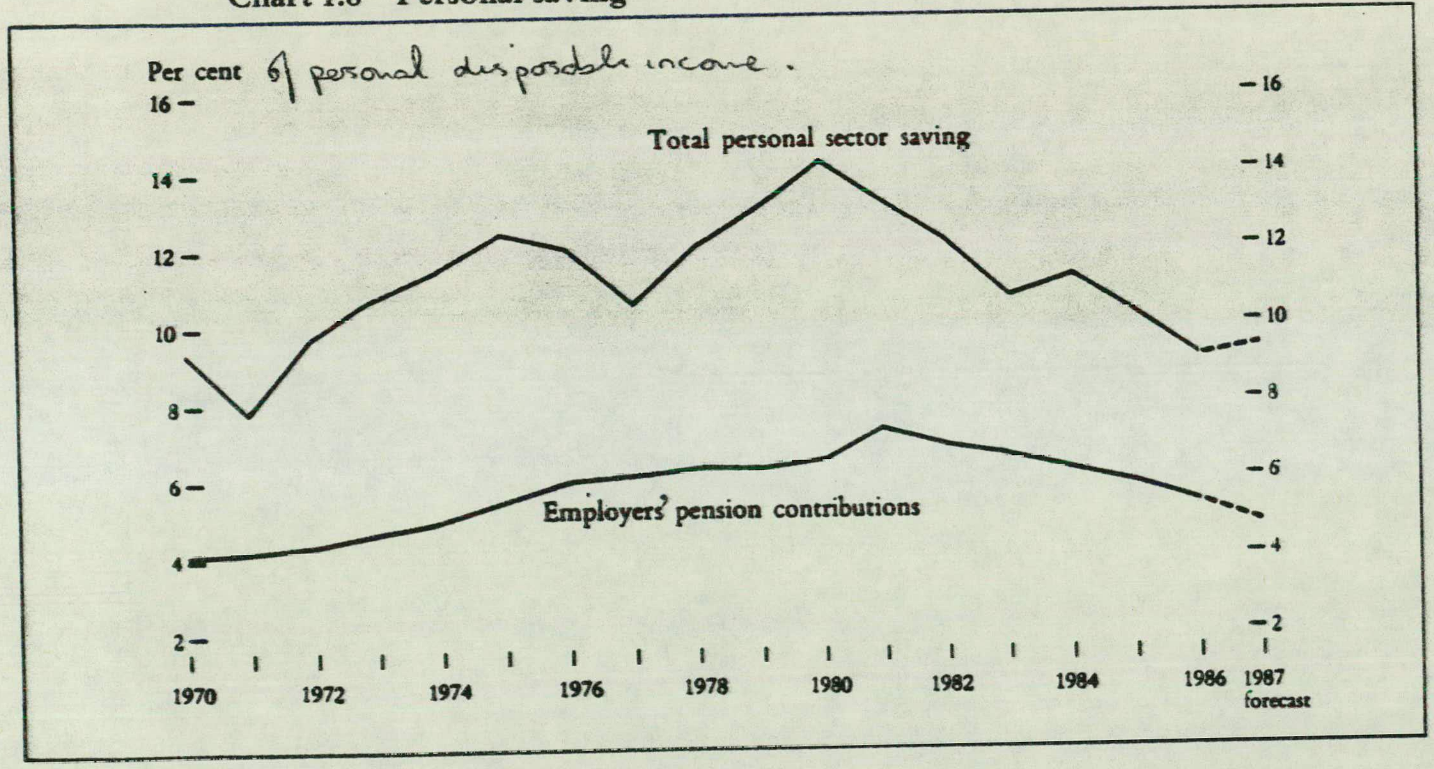
1.32 Over that period output growth has been strong in all sectors of the economy other than the North Sea where production has fallen. Output of the service industries rose by 5 per cent between the first halves of 1986 and 1987, manufacturing output by over 4½ per cent and construction output by 7½ 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 ~~latest~~ 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 5½ 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 4½ per cent, with ~~little change~~ some rise in the savings ratio, as consumers react to the fall in financial wealth.

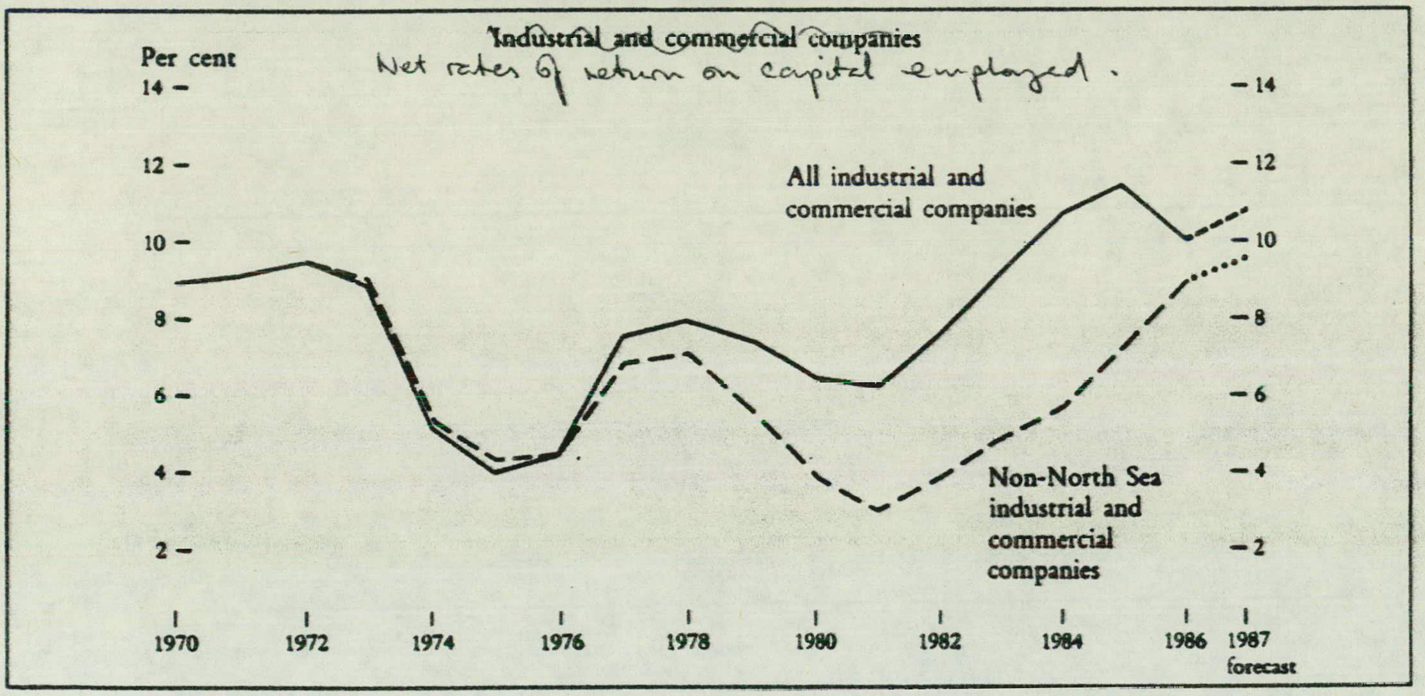
1.35 The housing market remains very buoyant. Although private housing starts have fallen back from their high first quarter levels, for the first eight months of 1987 as a whole they were 7 per cent higher than the year before, while private completions were 8½ per cent higher. With investment in improvements 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 on 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~~, below net earnings in 1985~~. 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.

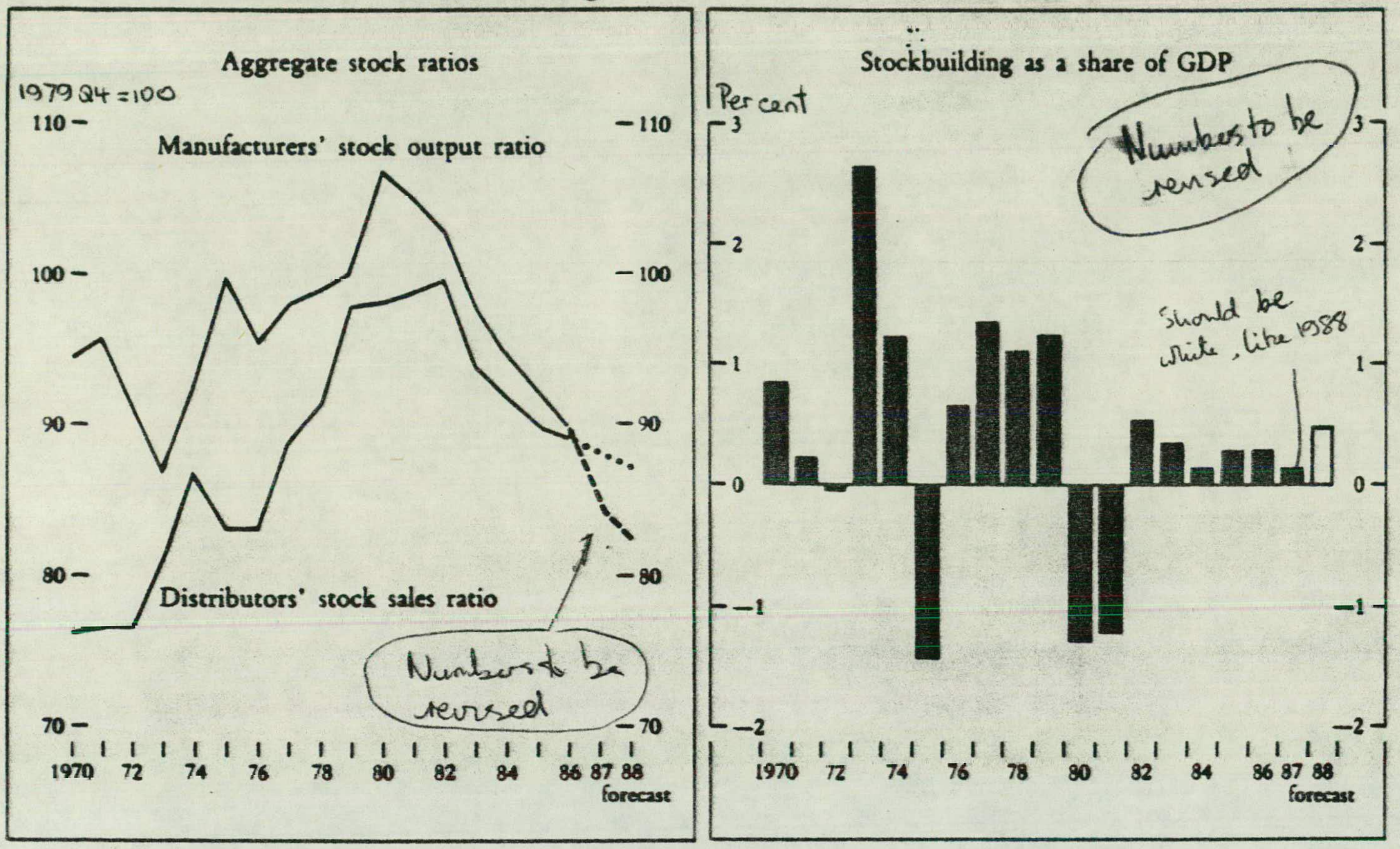
Chart 1.9 Companies' rate of return



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 ~~in 1987~~ 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 suggest ~~that~~ faster growth of manufacturing investment ~~could well accelerate~~ 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~~, and a more positive trend in stockbuilding may be in prospect~~. 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 make a small positive contribution to growth next year but~~ to remain on a modest scale compared with many years in the 1960s and 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 ~~closer to~~ 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, ~~and also~~ a smaller contribution from non-oil exports next year and some reduction in the growth of domestic demand. Growth in 1987 ~~and 1988~~ 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 ~~per cent~~ 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		
		Forecasts	
	1986	1987	1988
Domestic demand	4	4	~~4~~ 3½
Exports of goods and services[1]	3 (3½)	5½ (6½)	2~~½~~ (3~~½~~)
Imports of goods and services[1]	6 (5½)	6½ (7)	5~~½~~ (~~5~~) 4½
Domestic production: GDP[1,2]	3 (3)	4 (4½)	2½ ~~3~~ (3~~½~~)
Manufacturing production	1	5	~~4~~ 3½

[1] *Non-oil shown in brackets.* [2] *Average measure.*

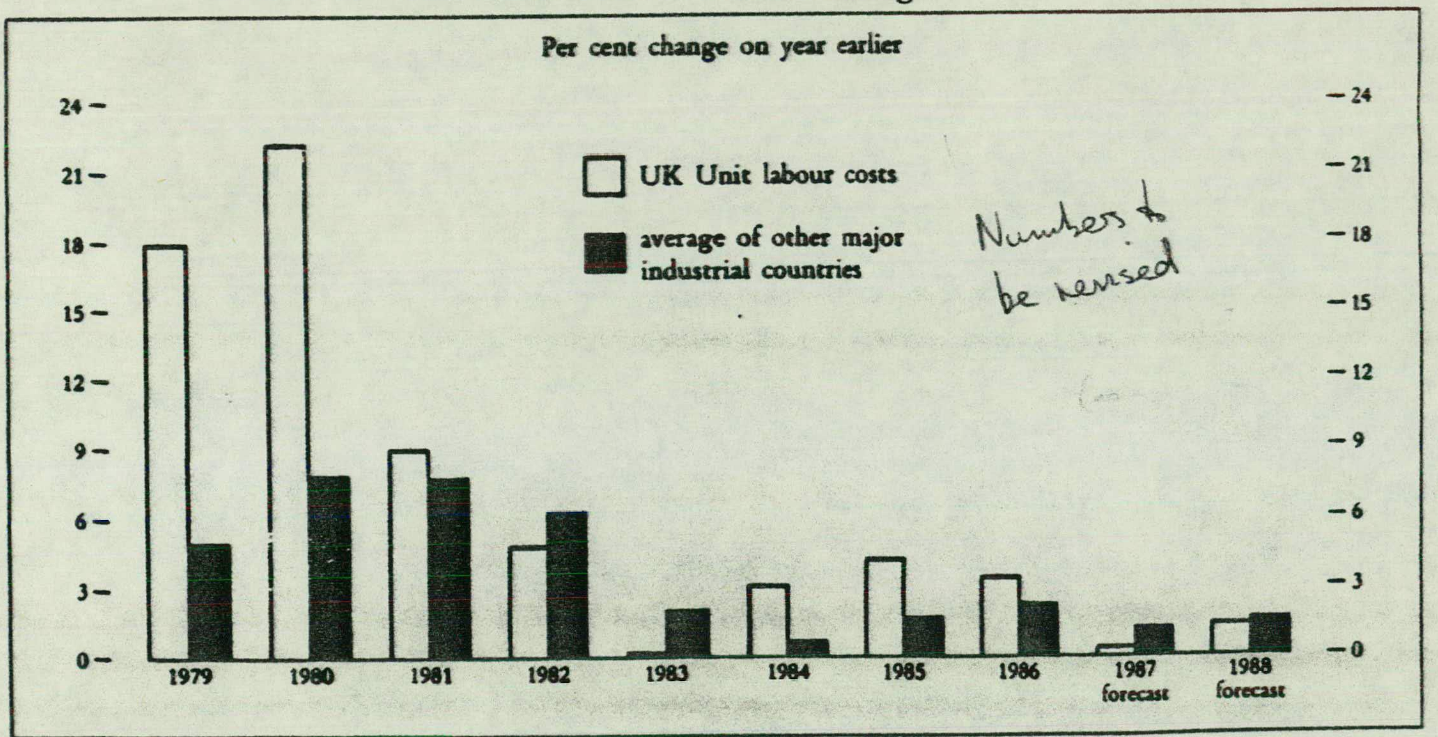
Inflation

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[1]	Estimated total unit costs[2]	Output prices[1]
1985	3½	4	4	6½
1986	4	−11	−½	4½
1987 Partly forecast	½	5½	1½	4½
1988 Forecast	1½	~~3~~ 2½	2	4½

[1] ~~Producer prices~~ *excluding food, drink and tobacco* industries. [2] *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 given 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 electricity prices to finance the industry's investment programme there is likely to be a temporary rise in the annual rate of increase in the RPI after the first quarter of 1988. In the light of this, the forecast is for the RPI to increase by 4~~¾~~½ per cent over the year to the fourth quarter of 1988.

Table 1.6 Retail prices index

	Per cent changes on a year earlier			
			Forecasts	
	Weight in 1987	1986 Q4	1987 Q4	1988 Q4
Food	16½	3¼	3½	3
Nationalised industries	6	3½	2¼	6¼
Housing	15	7	7¼	~~8½~~ 7
Other	62½	2½	3½	4¼
Total	**100**	**3½**	**4**	**4~~¾~~½**

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 ~~full-time equivalent~~ man hour has risen by about ~~1½~~ 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[1,2]	3	½ ~~(1)~~	1½ ~~(1½)~~
Whole economy[2]	2¾	1 ~~(1¼)~~	2 ~~(2¼)~~
Non-North Sea economy[2]	2¾	½ ~~(¾)~~	1¾ ~~(2)~~

[1] *Excludes public services and North Sea oil and gas extraction.*
~~[2] *Figures for output per full-time equivalent in brackets.*~~

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 ~~encouraging~~ prospects for the UK economy over the next year mean that a further ~~continued~~ 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 £9 billion. ~~Short-term interest rates remain historically high in real terms. Long-term rates throughout the world, which fell in the early part of the year, were edging up again until the stock market fall in October. In the UK, unlike the US and most other countries, the yield curve is flat.~~

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. ~~On the balance of evidence, monetary conditions remain firm~~.

1.53 The sharp fall in share prices will tighten monetary conditions somewhat. Short term interest rates however have fallen and long term rates have also eased. On the balance of the evidence monetary conditions remain firm.

Fiscal developments

1.5~~3~~4 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, nearly £¾ billion lower than estimated in the 1987 FSBR. Lower central government borrowing, more than accounted for by higher than expected tax revenues, was responsible for about two-thirds of this downward revision, with the remaining one-third due to lower than expected local authority borrowing.

1.5~~4~~5 In the first six months of 1987-88 the PSBR was £1½ billion. Excluding privatisation proceeds, borrowing was about £1½ 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 FSBR. This is mainly due to higher than expected tax revenues but there is also likely to be a shortfall on the expenditure side.

1.5~~5~~6 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

The forecast of the adjustments between the planning total and general government expenditure has increased by about £1½ billion since the Budget, leaving general government expenditure £½ billion lower than previously forecast.

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 Outturn	1987–88 Budget Forecast	1987–88 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	6·9	6·2	6·8
General government expenditure	**165·1**	**173·5**	**172·9**
of which Privatisation proceeds	−4·4	−5·0	−5·0

1.5~~6~~7 Table 1.10 shows the forecast for general government receipts. The forecast of tax and national insurance revenues has been increased by just over £2¾ billion since the Budget. The forecast of on-shore corporation tax, including ACT, is about £¾ 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 £½ 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 £½ 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 5½ per cent in 1986-87 (when North Sea revenues more than halved).

Table 1.10 General government receipts

	£ billion		
	1986–87 Outturn	1987–88 Budget Forecast	1987–88 Latest Forecast
Taxes on income, expenditure and capital	119·6	127·8	130·2
National insurance and other contributions	26·7	28·5	28·9
Interest and other receipts	13·3	12·6	12·3
Accruals adjustment	0·5	0·0	−0·2
Total receipts	**160·2**	**168·8**	**171·2**
of which North Sea revenues	4·8	3·9	4·5

8
1.57 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 ½ 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	172·9
General government receipts	160·2	168·8	171·2
General government borrowing requirement	4·9	4·7	1·7
Public corporations' market and overseas borrowing	−1·5	−0·8	−0·7
PSBR	**3·4**	**3·9**	**1·0**
PSBR as per cent of GDP	**1**	**1**	**¼**
Memorandum item:			
PSBR excluding privatisation proceeds	7·9	8·9	6·0
As per cent of GDP	2	2¼	1½

Table 1.12 Economic prospects: summary

	Forecast		Average errors from past forecasts[1]
	1986 to 1987	1987 to 1988	
	per cent changes		percentage points
Output and expenditure at constant 1980 prices			
Domestic demand	4	~~4~~ 3½	1
of which:			
Consumers' expenditure	5	~~4½~~ 4	1¼
General government consumption	½	~~1~~ ½	1
Fixed investment	5½	4½	2¼
Change in stockbuilding (as per cent of level of GDP)	0	~~½~~ 0	½
Exports of goods and services	5½	~~2½~~ 2	2½
Imports of goods and services	6½	~~5½~~ 5	2¾
Gross domestic product: total	4	~~3~~ 2½	¾
manufacturing	5	~~4~~ 3	2¼
Inflation			
Retail prices index	per cent changes		
1986 Q4 to 1987 Q4	4		¼
1987 Q4 to 1988 Q4	~~4¾~~ 4½		2
Deflator for GDP at market prices	per cent changes on a year earlier		
Financial year 1987–88	4¼		1
Financial year 1988–89	4½		2
Money GDP at market prices	£ billion[2]		
Financial year 1987–88	418 ~~419 (8¾)~~ 8½		1
Financial year 1988–89	448 ~~452 (7¾)~~ 7¼		1½
Balance of payments on current account			
1987	−2½		1½
1988	−3½		3

[1] *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.*

[2] *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[1]	**Gross domestic product at factor cost**	GDP index 1980=100
1982	138·4	49·6	39·5	63·1	−1·0	**289·7**	59·2	30·6	0·9	**200·8**	100·5
1983	144·0	50·6	41·6	64·4	0·7	**301·2**	62·7	31·6	0·5	**207·4**	103·9
1984	147·1	51·0	45·0	68·9	0·3	**312·2**	68·8	32·8	2·0	**212·7**	106·5
1985	152·5	50·9	46·4	72·8	0·6	**323·3**	70·7	33·9	1·7	**220·4**	110·4
1986	161·3	51·4	46·5	75·1	0·7	**335·0**	75·1	35·4	2·7	**227·1**	113·8
1987	169·0	51·6	49·0	79·2	0·2	**348.9**	80·0	37·1	4·3	**236·2**	118·3
1988	176·0	51.9	51·2	~~81·2~~ 80.8	0.8	**360.6**	84·1	38·4	4·5	**242.6**	~~122·1~~ 121.5
1986 H1	79·6	25·7	22·9	36·6	0·4	**165·2**	35·9	17·4	0·8	**112·7**	112·9
H2	81·6	25·7	23·7	38·5	0·3	**169·8**	39·2	18·0	1·9	**114·5**	114·7
1987 H1	83·0	25·6	23·9	39·0	−0·3	**171·3**	38·3	18·3	2·2	**116·8**	117·1
H2	86·1	~~26·2~~ 25.9	25·1	40·1	0·4	**177.7**	41·7	18·8	2·2	**119·4**	119·5
1988 H1	87·3	~~26·2~~ 25.9	25·3	40·1	0·3	~~**180·0**~~ 179.0	41·7	19·1	2·2	~~**121·3**~~ 120.4	~~121·3~~ 120.6
H2	88.7	~~26·2~~ 25.9	25·9	~~41·0~~ 40.8	0·4	**181.7**	42·4	19·3	2·2	**122·2**	122·4

Per cent changes

1985 to 1986	6	1	½	3	—	3½	6	4½	—	3	3
1986 to 1987	5	½	5½	5½	—	4~~½~~	6½	4½	—	4	4
1987 to 1988	4~~½~~	~~1~~ ½	4½	2~~½~~	—	3½	5~~½~~	~~4~~ 3½	—	~~3~~ 2½	~~3~~ 2½

1 *The average measure of gross domestic* product *—the preferred measure of growth in economic activity—grew by some 3¾ 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 GDP(E).*

MP

FROM: MISS M O'MARA
DATE: 28 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

cc
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Ms Evans
Mr Hudson
Miss Simpson
B/002

AUTUMN STATEMENT BRIEFING: AWKWARD ISSUES

We realise that, with other preoccupations, you will be unable to look at much of the Autumn Statement briefing, if any, and certainly not before the weekend.

2. With Mr Hudson's help, we have therefore tried to identify in the attached note some of the most awkward issues in the macro-economic area, together with a proposed line to take, where one has been devised.

3. If you have time to glance through this by Friday evening, it would be most helpful to us to have your reaction. We plan to submit the key briefs for your weekend box.

cc Mr Allan

MISS M O'MARA

Miss O'Mara

This looks v. useful to me, & I haven't much to add. Mr Allan confirms that it would be worth ~~[illegible]~~ putting in today, with the key briefs to Ministers tomorrow. Worth bringing in CST and (?) other Ministers?

AH 29.10

Forecast

These points are based on the old numbers which are likely to change. But the awkward issues are fairly easy to identify.

(i) Impact of stock market fall: Underlying economic prospects remain sound. Precise impact of recent fall difficult to evaluate but seems likely that fall in interest rates in US and elsewhere will offset at least part of effect of lower share prices.

We shall need to look at this again, of course, in the light of whatever goes into Chapter 1.

(ii) Current account deficit no longer temporary. Deficit reflects faster growth of UK economy relative to other major economies. No reason to suppose deficit will not decline as growth rates converge. Forecast deficit in 1988 smaller than deficit in 1987H2 at annual rate.

We have plenty of other material on the deficit as a proportion of GDP and international comparisons.

h Do we want anything on the visible trade deficit?

(iii) What does exchange rate assumption imply for future of Louvre Accord? Forecast assumes sterling remains close to recent levels, consistent with Louvre Accord.

Fiscal policy

(i) Government deliberately published pessimistic forecast of 1987-88 PSBR/tax revenues at Budget time. No. Budget forecast reflected central view based on economic prospects as seen then. In event, economy been performing better than expected, so tax revenues higher. But have always stressed margins of error on PSBR forecasts - still £2½ billion for current year.

(ii) Forecast of 1987-88 tax revenues over-cautious? Of course, outturn may be higher than forecast but could be lower too. Considerable uncertainties remain, [particularly about mainstream corporation tax - where, as usual, very few receipts received during first half of financial year.]

I'm not sure I would pull out MCT, since the profits on which the forecast is based are known, even though the tax hasn't come in. It shouldn't be difficult to rest on "Considerable uncertainties" now. Could add "Government has always taken prudent view of fiscal policy and prospects."

(iii) Higher VAT/taxes on expenditure indicative of consumer boom? No. VAT/taxes on expenditure rising no faster than tax revenues in total. Overall picture one of balanced economic growth. [Consumer spending increasing no faster than last year, and in line with growth of economy as a whole.]
We have figures to support claim of balance elsewhere in the brief.

(iv) Buoyant revenue indicates massive fiscal adjustments in prospect. Too early to say. Wait for Budget. Government committed to reducing tax burden but only when prudent to do so.

(v) Forecast implies PSBR for 1988-89 will be lower than MTFS path

[Perhaps this is pedantic, but PSBR a judgement not a forecast.]

- ~~No forecast made for PSBR in 1988-89.~~
~~PSBR for 1988-89 will be set in 1988 Budget.~~

- But assumption always required for PSBR/GDP ratio to construct Industry Act forecast for following year.

[I assume we can defend the word "Convention" to TCSC if asked. Have we made it clear in past?]

- Convention that use lower of MTFS path or forecast outturn for current year. In past, MTFS figure was lower. In 1987, current year forecast lower for first time, so assumption is for same PSBR in 1988-89 as in 1987-88.

- PSBR for 1988-89 will be set at Budget time in accordance with 1988 MTFS.

(vi) Money GDP growth and PSBR forecasts imply change to MTFS and fiscal stance

- MTFS updated at Budget time, not in Autumn Statement.

- MTFS objective unchanged: ~~designed~~ to bring inflation down further over period of years. Always allowed for short term fluctuations - what matters is medium term trend.

- Higher money GDP growth path in 1987-88 and 1988-89 than in MTFS mainly result of higher than expected real GDP growth. ~~No change implied in primary MTFS objective of further reducing inflation over period of years.~~ Fiscal stance over medium term set in accordance with MTFS and hence reviewed only at Budget time.

(vii) Money GDP path higher than in MTFS: Higher money GDP growth in 1987-88 and 1988-89 mainly reflects better real growth prospects, not higher inflation. No change to money GDP growth in later years.

(viii) Government abandoned commitment to eventual price stability? Price stability still remains ultimate objective of MTFS.

We assume we have to say this, if asked. But do you want to soft-pedal at all? More references simply to "further reducing inflation"?

(A)

(See final page)

(ix) Chancellor no longer aiming at PSBR/GDP ratio of 1 per cent? 1 per cent PSBR/GDP ratio published for future years in 1987 MTFS ~~but~~ and in Bgt speech, NB. always acknowledged may be fluctuations in short term. MTFS not reviewed in autumn but PSBR path for medium term will be published in 1988 MTFS as usual and PSBR for 1988-89 will be set in 1988 Budget in light of prevailing circumstances.

(x) Forecast shows non-oil tax burden rising: Larger rise than earlier forecast is result of better than expected economic performance - and consequential buoyant tax revenues. Government policy remains to reduce tax burden further as soon as prudent to do so.

(xi) PSFD

We shall, of course, focus on the PSBR, excluding privatisation proceeds but do you have any objection to us revealing the PSFD (£6.1 billion, 1¼ per cent of GDP), if asked? It is probably less sensitive now: indeed, it is expected to be the lowest figure since 1971-72.

Expenditure

(i) How do we present the increase in planning totals? The LTPE Green Paper said "It would, of course, always be open to the Government to decide, once the virtuous circle of lower taxes and higher growth had been established to devote some of these resources to improved public services rather than reduced taxation." How do we react if this is quoted back at us? — I would use it, & make a virtue of necessity. "Within falling share of GDP, able to increase resources for priority programmes."

(vii A) ~~Forecast shows inflat~~ No sign of further reduction in inflation?
[N.B. ~~Last two~~ 1986 and 1987 Autumn Statement forecasts show inflation going up.]
Objective of fiscal and monetary policy remains to apply steady downward pressure on inflation. ~~Never~~ Bound to be fluctuations in path. But ~~we~~ will take no risks with inflation — as actions have shown.

(ii) GGE for 4 years from 1986-87 growing at faster annual average rate (1¼ per cent) than envisaged in 1987 PEWP (1 per cent).

This raises a similar issue.

GEP's suggested answer

- Always said that real growth in GDP could allow more spending on priority programmes.
- GGE as percentage of GDP lower than in 1987 PEWP plans.

Do you want to use the first point? In the past, we have talked of room for more spending on priority programmes within overall constraints. [I agree - basically, reverse the order of the GEP points.]

(iii) Did Star Chamber meet?

(iv) Government now reversing very policies which underpinned steady economic growth.
[Will anybody ask this?]

(v) Principle of cash planning clearly abandoned.

- No.
- Public expenditure still planned in cash; Survey conducted in cash terms and cash plans for first year become cash limits. Procedure still strictly enforced.
- Apart from demand-led programmes, no Department entitled to increase in provision because of inflation.

(vi) Concentration on GGE/GDP ratio implies accommodating inflation

Suggested line - Whole aim of MTFS is ~~downward pressure on~~ reduction of inflation.

- No automatic adjustment for inflation.
- GDP deflator for 1987-88 and 1988-89 taken together in any case shows similar growth to 1987 PEWP plans.
- Ratio reduced below 1987 PEWP path.
- Government will accelerate decline in ratio, if conditions permit.

Are you happy with the undertaking in the last indent? - Seems vague enough to me.

(vii) Government cutting benefits to poor to pay for tax cuts for rich

- Nonsense.
- Spending on social security benefits up by 40 per cent in real terms since Government took office.
- For future level of taxes, wait for Budget. But as general principle, lower taxes improve incentives and so boost wealth and job creation to benefit of all.

(vii[illegible]et to become first Government for over 30 years to have reduced public spending as percentage of GDP over time in office.

You were considering whether to reserve this for the Budget Speech. Even if you do not use it in your Oral Statement, are you content for it to be used in briefing? (In practice, this means it is bound to appear in a number of Ministerial speeches before the Budget.)

(ix) Problems of BP sale put future of privatisation programme in jeopardy.

We can draft an answer nearer the time!

A (viiia) With PSBR so low, why are real interest rates so high

[UK has even GGFD below G7 average, and real interest rates above (or thereabouts)]

No risks with inflation.

CONFIDENTIAL

I, too have made a few essential changes...

FROM: P N SEDGWICK
DATE: 28 OCTOBER 1987

CHANCELLOR

Ch
I have marked a few comments on (revised) text
AA

cc
Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Monck
Mr H Evans
Mr Moore
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Turnbull
Mr R Allen
Mr Bottrill
Mr S Davies
Mr Hibberd
Mr Matthews
Mr Mowl
Miss O'Mara
Mr Allum
Ms C Evans
Mr Owen
Mr Ritchie
Mr Cropper
Mr Tyrie
Mr Call

CHAPTER 1 OF THE AUTUMN STATEMENT: ECONOMIC PROSPECTS FOR 1988

Sir T Burns has held a series of meetings to assess the implications of the recent fall in stock markets for the forecast to be published in the Autumn Statement. The attached version of chapter 1 of the AS includes proposed changes to the text and numbers agreed at these meetings. The changes are marked in manuscript on a printed version of Chapter 1 that already includes all the changes you had suggested earlier. We have to send a corrected version to the printers by no later than 4 pm tomorrow. I would be grateful if we could have your comments on the attached text and numbers by lunch time. — not v likely

2. The main summary table (table 1.12) gives an impression of the changes to the numbers for the UK. (Tables 1.2, 1.4, 1.5, 1.6, and 1.13 show the more detailed changes.) Table 1.1 has the changes to the forecasts for the world economy.

3. The main characteristics of the changes to the numbers are as follows.

(a) The changes to world (major 7) and UK GNP/GDP are of the same size, with ½ per cent off growth in 1988.

(b) This symmetry is largely responsible for there being no change to the forecast UK trade balance in 1988. In view of the uncertainties about the effects of recent developments on net IPD earnings we have made no change to the forecast for invisibles : the current account in 1988 is therefore unchanged.

(c) RPI inflation is slightly ($\frac{1}{4}$ per cent) lower in 1988(4), mainly as a result of a change to the housing component. (Following past practice we would not disclose the market interest rate or mortgage rate assumptions underlying the forecast. The change to the housing component of the RPI is consistent with a $\frac{1}{2}$ per cent cut in the mortgage rate from its present level - which is possible if market rates stay at or below current levels.) Factors other than the mortgage rate affect the housing component of the RPI - eg the forecast for rates and the past increase in house prices.

(d) In table 1.13 we have adjusted the numbers for the three half years to the second half of 1988 in order to produce GDP growth on a year earlier of between $2\frac{1}{4}$-$2\frac{1}{2}$ per cent in the second half of 1988. To avoid giving the impression that there is a sharp slowdown in activity during 1988 we have slightly reduced GDP in the second half of 1987.

(e) Growth of money GDP is a little lower in both 1987-88 and 1988-89. (The small change to the figure for 1987-88 is the result of the change to the second half of 1987 discussed in (d).)

(f) The published forecast for the world economy does not contain specific numbers for individual economies. The discussion in paragraph 1.17 of the US, Japan, and Germany implies that it is growth in the US that is particularly likely to be hit by recent stock market developments.

4. It is worth noting some other points that relate mainly to the text.

(i) There is nothing in the tables or text that might be construed as a ready reckoner of the effects of falls in stock markets. The recent fall in stock markets are presented as one amongst a number of factors influencing prospects.

(ii) The level of the sterling index (though not the £/DM rate) has begun to drift away from the level assumed when first constructing the forecast. We have not altered the forecast numbers on this account, but have slightly altered the text in paragraph 1.21.

(iii) Given the enormous uncertainties involved in valuing assets (particularly equities) we have deleted discussion in paragraph 1.29 of changes in the UK's net external asset position during this year. Net external assets could conceivably be lower by the end of the year than at the end of 1986. Figures for end-1987 will not be published until the Pink Book next August, though we will probably have to hazard a guess in the FSBR.

(iv) The text has an additional paragraph (1.53) which assesses the impact of the fall in the stock market on monetary conditions and mentions the fall in short term interest rates. The argument is similar to that used in your statement to the House of Commons yesterday.

5. There are two other changes that are not related even indirectly to stock market developments.

(i) In table 1.8 we have deleted the productivity numbers for full time equivalents because these hardly differ from the output per head figures.

(ii) There is an additional sentence in paragraph 1.15 on the national accounts adjustments.

P.N.S

P N SEDGWICK

008/3295

Alex. To be aware
I put X in last
night's box.

FROM: JILL RUTTER
DATE: 29 October 1987

MR R I G ALLEN

cc:
Chancellor
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Scholar
Mr Turnbull
Mr Sedgwick
Mr Pickford
Mr Cropper
Mr Tyrie
Mr Call

AUTUMN STATEMENT: MEDIA ARRANGEMENTS

The Chief Secretary has seen your minute to the Chancellor of
X 28 October.

2 He is content with the media arrangements you propose for him subject to two caveats:

(a) he has now been invited to address the backbench Finance Committee at 6.00pm on Tuesday 3 November. He feels this is unavoidable. You had asked him to take on some radio interviews. Will the timing of those be such as to permit him to attend the backbench Finance Committee?

(b) He is not happy with the idea of doing a live interview on 'This Week Next Week' on Sunday 8 November, since he is obliged to attend a Remembrance Day Service in his constituency. We discussed this and you agreed to explore other possibilities should you still want to use the Chief Secretary for that slot.

Jill Rutter

JILL RUTTER
Private Secretary

3693/24

CONFIDENTIAL

1 Alex
2 I propose to PS/GP
await book proofs tomorrow.

FROM: COLIN MOWL
DATE: 29 October 1987

MR SEDGWICK

cc PPS
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Turnbull
Mr Scholar
Mrs R Butler
Mr Ritchie
Miss C Evans
Mr D Owen

BIF 30/10

Alex You might like to be aware of this for when book proofs arrive.

AUTUMN STATEMENT CHAPTER 1: FISCAL DEVELOPMENTS SECTION

Last night I agreed with GEP a small change to the forecast of the national accounts adjustments and GGE in 1987-88. Both are reduced by £0.1 billion. An offsetting reduction has been made to taxes leaving the PSBR unchanged. These changes will be incorporated in the version of Chapter 1 sent to the printers today. There is only one minor consequential for the text, in paragraph 1.57.

2. I attach an amended version of the fiscal developments section - changes from the version sent to the Chancellor last night are side-lined. (I have omitted the additional sentence on the national accounts adjustments in paragraph 1.56 which we proposed yesterday but which the Chancellor deleted.)

3. The change to the national accounts adjustments involves the removal of an upward adjustment designed to help presentation of the public expenditure plans. Other recent changes have made this less necessary. The other adjustments are still £½ billion higher than in the FSBR but there are specific factors we could point to, if pressed, to explain most of the revision.

Colin Mowl

COLIN MOWL

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 encouraging prospects for the UK economy over the next year mean that a continued 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 £9 billion. Short-term interest rates remain historically high in real terms. Long-term rates throughout the world, which fell in the early part of the year, were edging up again until the stock market fall in October. In the UK, unlike the US and most other countries, the yield curve is flat.

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. On the balance of evidence, monetary conditions remain firm.

Fiscal developments

1.5~~3~~4 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, nearly £¾ billion lower than estimated in the 1987 FSBR. Lower central government borrowing, more than accounted for by higher than expected tax revenues, was responsible for about two-thirds of this downward revision, with the remaining one-third due to lower than expected local authority borrowing.

1.5~~4~~5 In the first six months of 1987–88 the PSBR was £1½ billion. Excluding privatisation proceeds, borrowing was about £1½ 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 FSBR. This is mainly due to higher than expected tax revenues but there is also likely to be a shortfall on the expenditure side.

1.5~~5~~6 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 Outturn	1987–88 Budget Forecast	1987–88 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	6·9	6·2	6·~~8~~ 7
General government expenditure	**165·1**	**173·5**	**172·~~9~~ 8**
of which			
Privatisation proceeds	−4·4	−5·0	−5·0

1.5~~6~~ 7 Table 1.10 shows the forecast for general government receipts. The forecast of tax and national insurance revenues has been increased by ~~just over~~ £2¾ billion since the Budget. The forecast of on-shore corporation tax, including ACT, is about £¾ 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 £½ 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 £½ 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 5½ per cent in 1986–87 (when North Sea revenues more than halved).

Table 1.10 General government receipts

	£ billion		
	1986–87 Outturn	1987–88 Budget Forecast	1987–88 Latest Forecast
Taxes on income, expenditure and capital	119·6	127·8	130·~~2~~ 1
National insurance and other contributions	26·7	28·5	28·9
Interest and other receipts	13·3	12·6	12·3
Accruals adjustment	0·5	0·0	−0·2
Total receipts	**160·2**	**168·8**	**171·~~2~~ 1**
of which	4·8	3·9	4·5
North Sea revenues			

1.5~~7~~8 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 ½ 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·~~9~~ 8
General government receipts	160·2	168·8	171·~~2~~ 1
General government borrowing requirement	4·9	4·7	1·7
Public corporations' market and overseas borrowing	−1·5	−0·8	−0·7
PSBR	**3·4**	**3·9**	**1·0**
PSBR as per cent of GDP	**1**	**1**	**¼**
Memorandum item:			
PSBR excluding privatisation proceeds	7·9	8·9	6·0
As per cent of GDP	2	2¼	1½

ps2/2R

CONFIDENTIAL

pmp

FROM: CATHY RYDING
DATE: 29 October 1987

MR P N SEDGWICK

cc Sir T Burns

CHAPTER 1 OF THE AUTUMN STATEMENT: ECONOMIC PROSPECTS FOR 1988

The Chancellor was grateful for your minute of 28 October.

2. The Chancellor has made a few additional changes to the text - which he thinks are essential. A copy of the text with the ... Chancellor's comments marked is attached.

CR

CATHY RYDING

1 Economic prospects for 1988

Summary

1.01 GDP is forecast to grow by ~~3~~ 2½ 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 ~~continued~~ 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 ~~3~~ 2½ 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 ~~continued~~ 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~~¼~~½ 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 2½ per cent in ~~both~~ 1987 and 2 per cent in 1988. World trade in manufactures has picked up this year, and should grow at ~~just under 5~~ around 4 per cent in 1988, reflecting faster growth of industrial production in the industrial countries. 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 ½ 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 ¾ 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 ~~now~~ appears to have ~~be~~ strengthen~~ing~~ed a little.

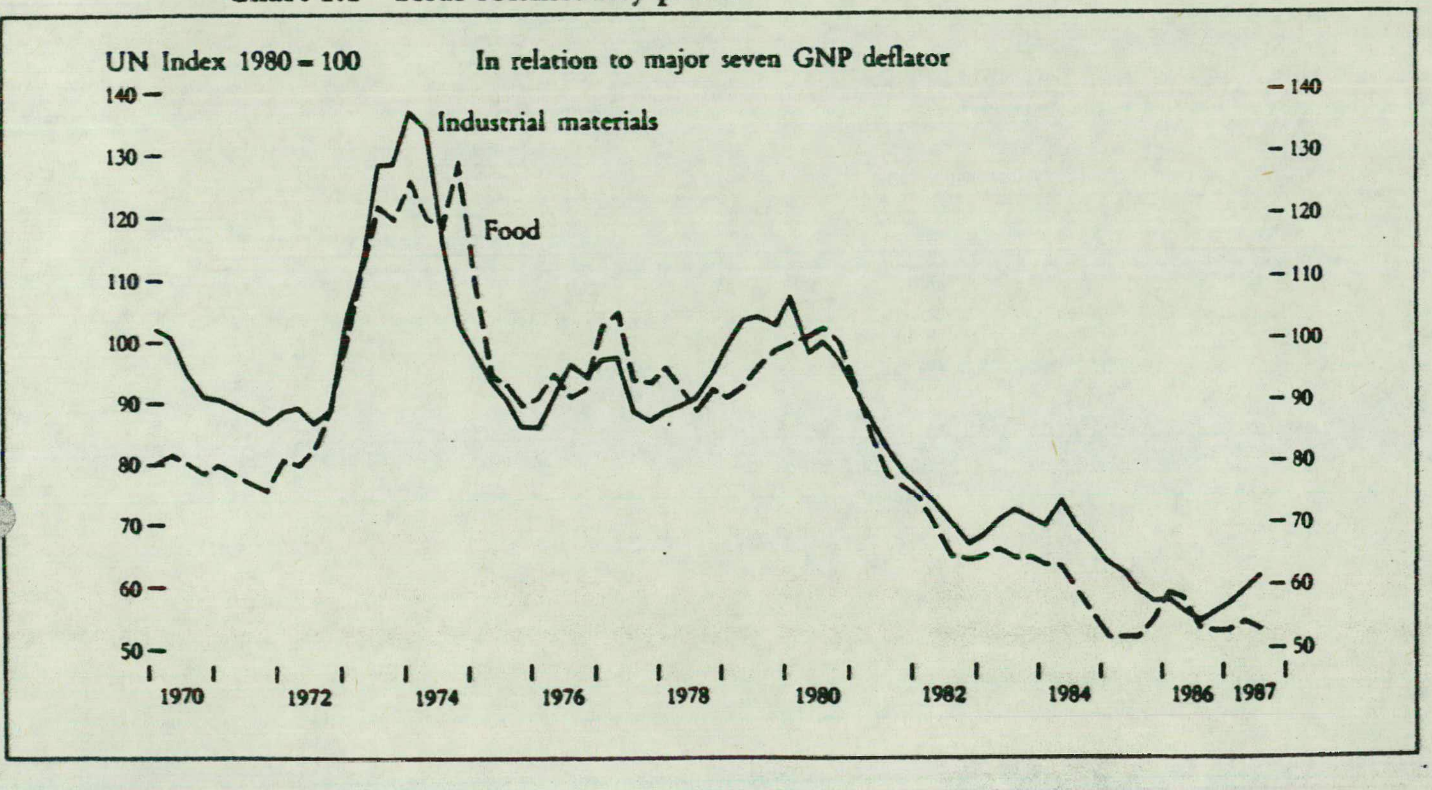
1.09 The weakness in world growth was largely due to the difficulties of adjusting both to the collapse in oil prices in early 1986 and to large changes in exchange rates. Lower oil prices led oil exporters to cut back their imports sharply. Moreover, with many non–oil commodity prices falling to their 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 ~~has~~ slowed in the first half of this year ~~more recently~~. 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.

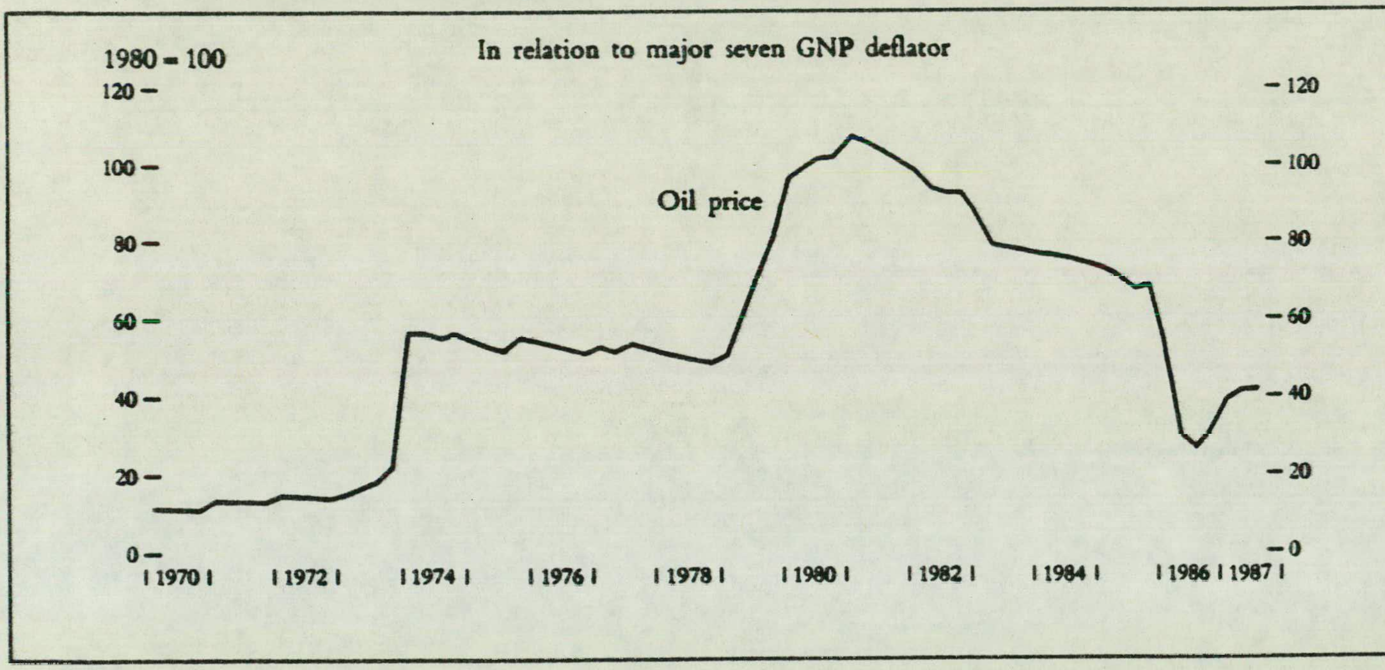
Chart 1.1 Real commodity prices



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 $1~~8~~7-19 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 prices



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		
		Forecasts	
	1986	1987	1988
Major seven countries[1]:			
Real GNP	2¾	2½	~~2½~~ 2
Real domestic demand	3¾	2¾	~~2½~~ 2
Industrial production	1	3	~~3¾~~ 3¼
Consumer prices	2	2¾	~~3~~ 2¾
World trade, at constant prices			
Total imports	4¾	3½	~~4~~ 3½
Total trade in manufactures[2]	2	3¾	~~4¾~~ 4

[1] *US, Japan, Germany, France, UK, Italy and Canada.*
[2] *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 ~~may continue~~

are expected to

is forecast and ~~to increase slightly over the next year or so, especially if industrial production in the major OECD countries grows reasonably strongly, but~~ food prices ~~are expected to~~ remain weak.

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

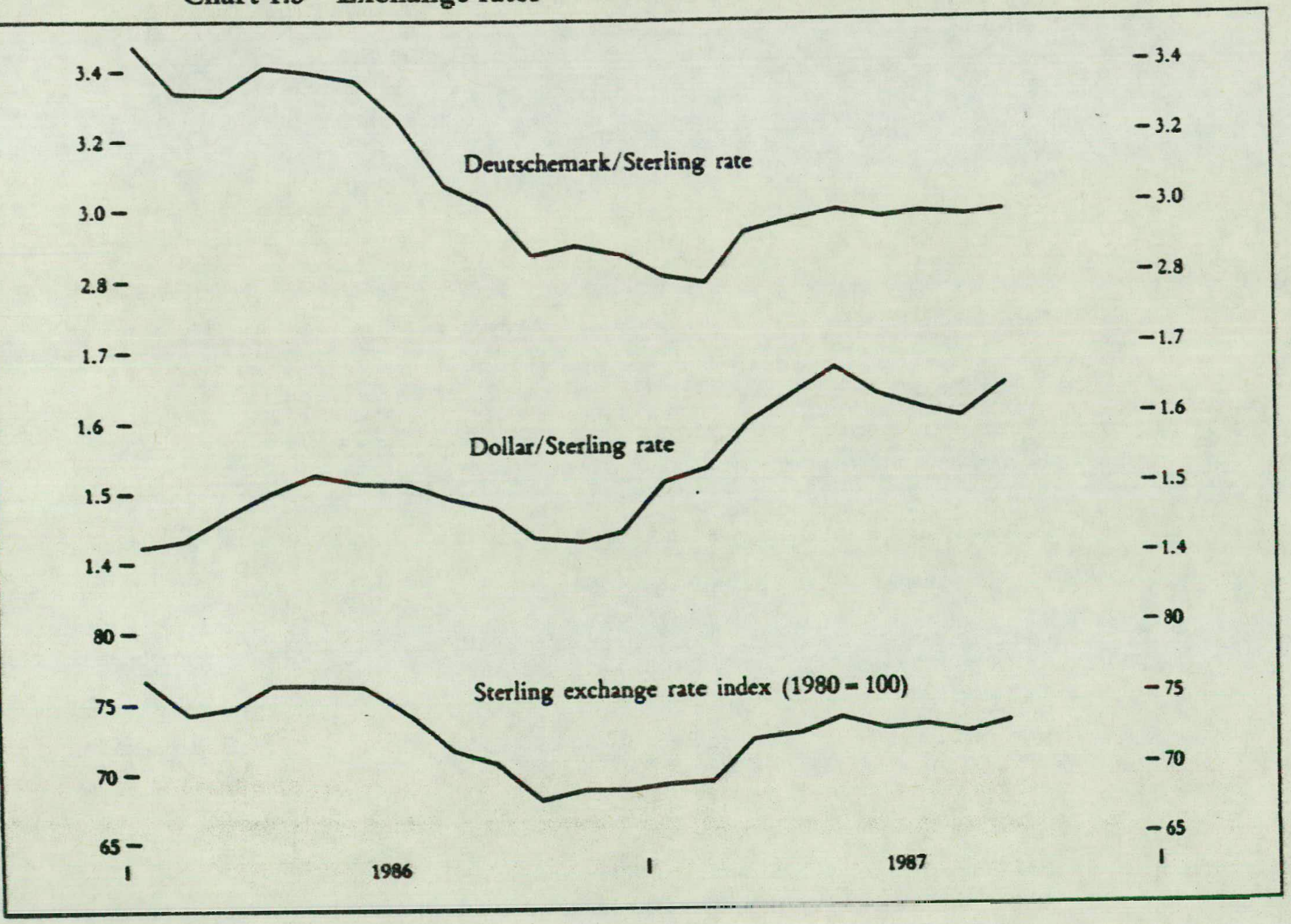
1.17 ~~In the US there is little likelihood of more rapid growth of domestic demand in 1988 as the economy adjusts to the reduction of its twin deficits, though the probable slowdown in consumers' expenditure could be in part offset by higher investment buoyed by rapid growth in export volumes.~~ The 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 ~~increase again in 1988, helped by a continued recovery in their exports~~.

1.19 World import volumes are likely to rise by about $3\frac{1}{2}$ 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 ~~in 1987~~.

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

Chart 1.3 Exchange rates



for most of the period since

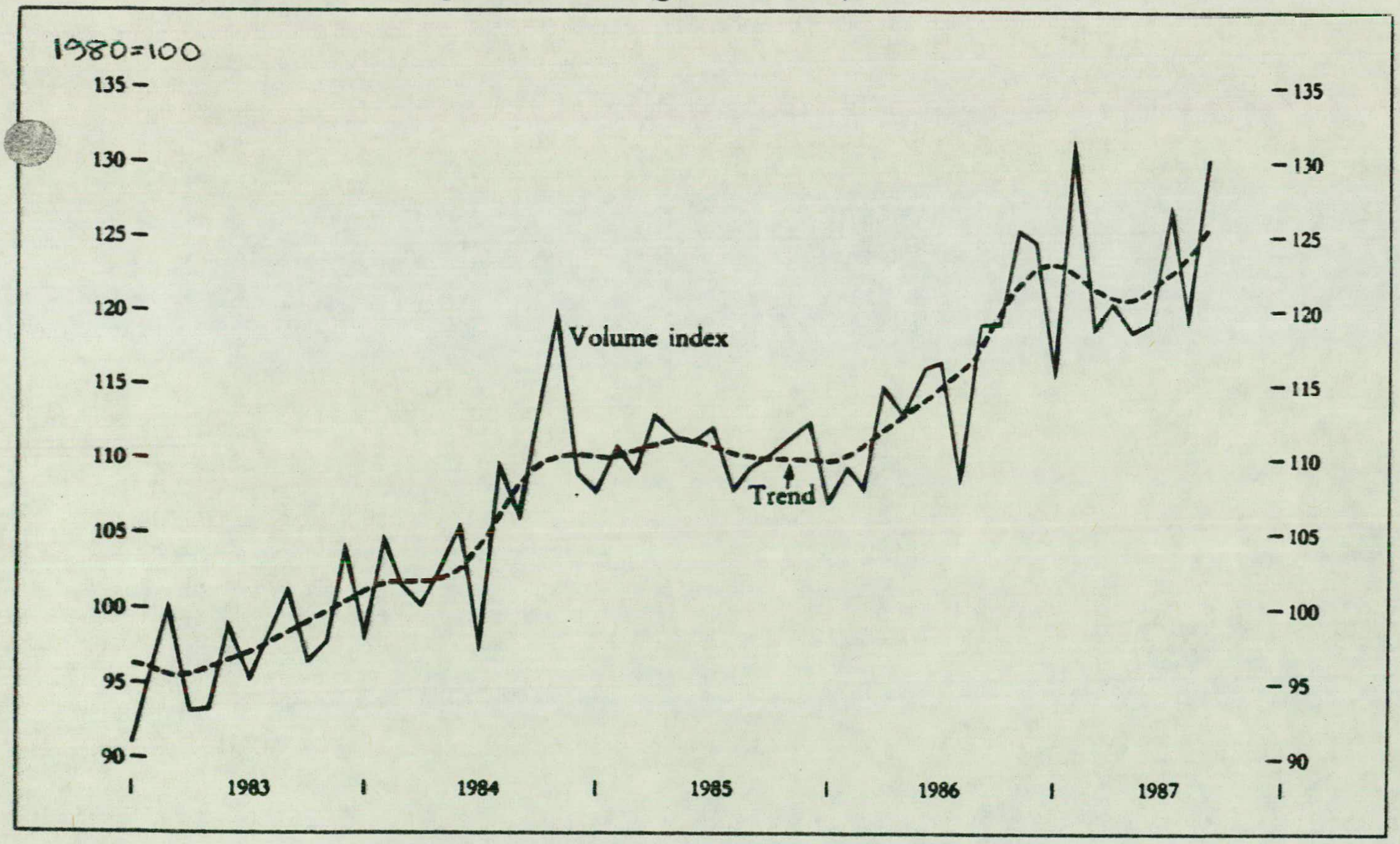
Trade and the balance of payments

Exchange rates 1.21 Exchange rates between major currencies have been ~~remained broadly~~ broadly stable ~~following~~ 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 ~~4~~ 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 5½ per cent next year compared to 8 per cent in 1987.

Chart 1.5 UK shares of total world trade in manufactures

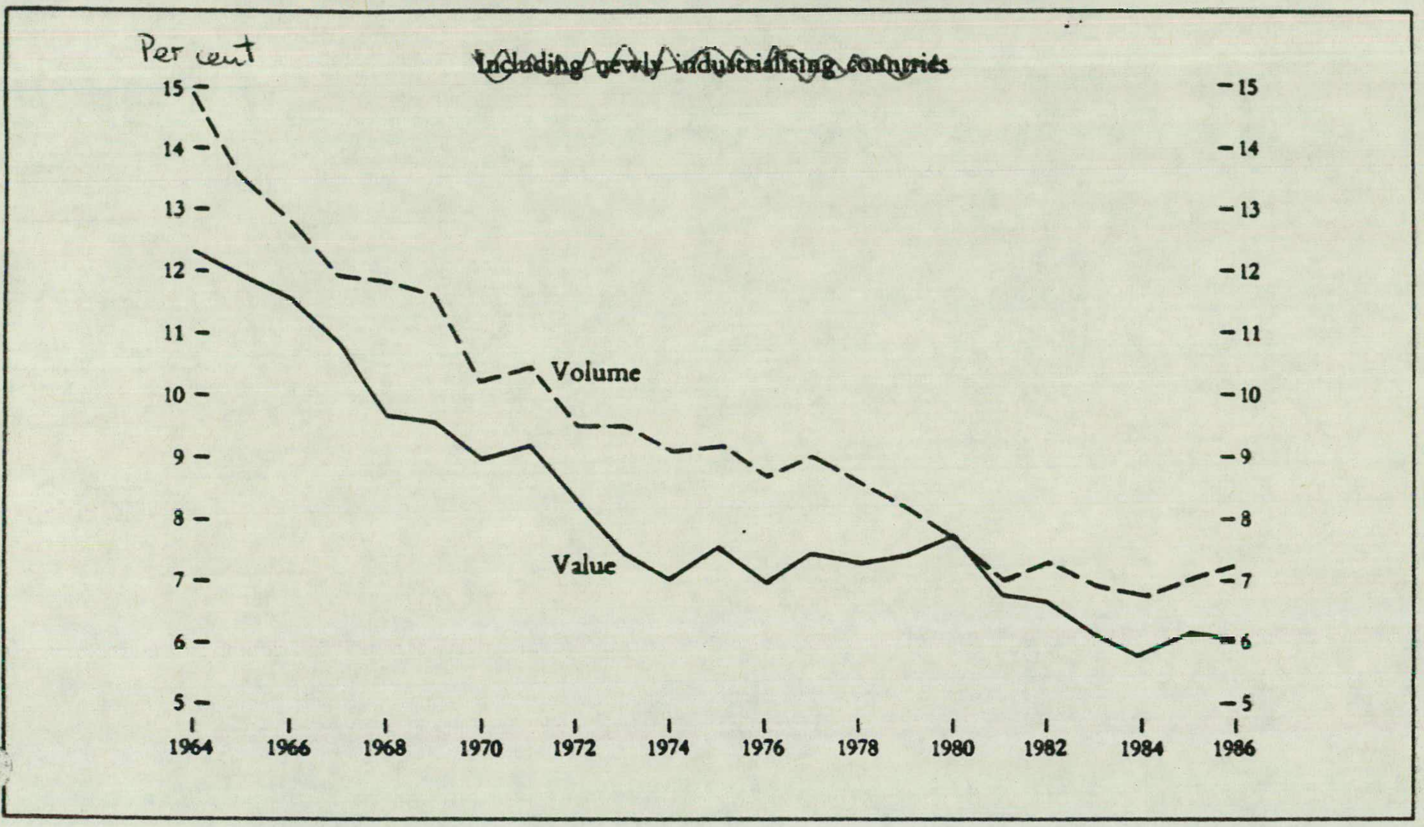
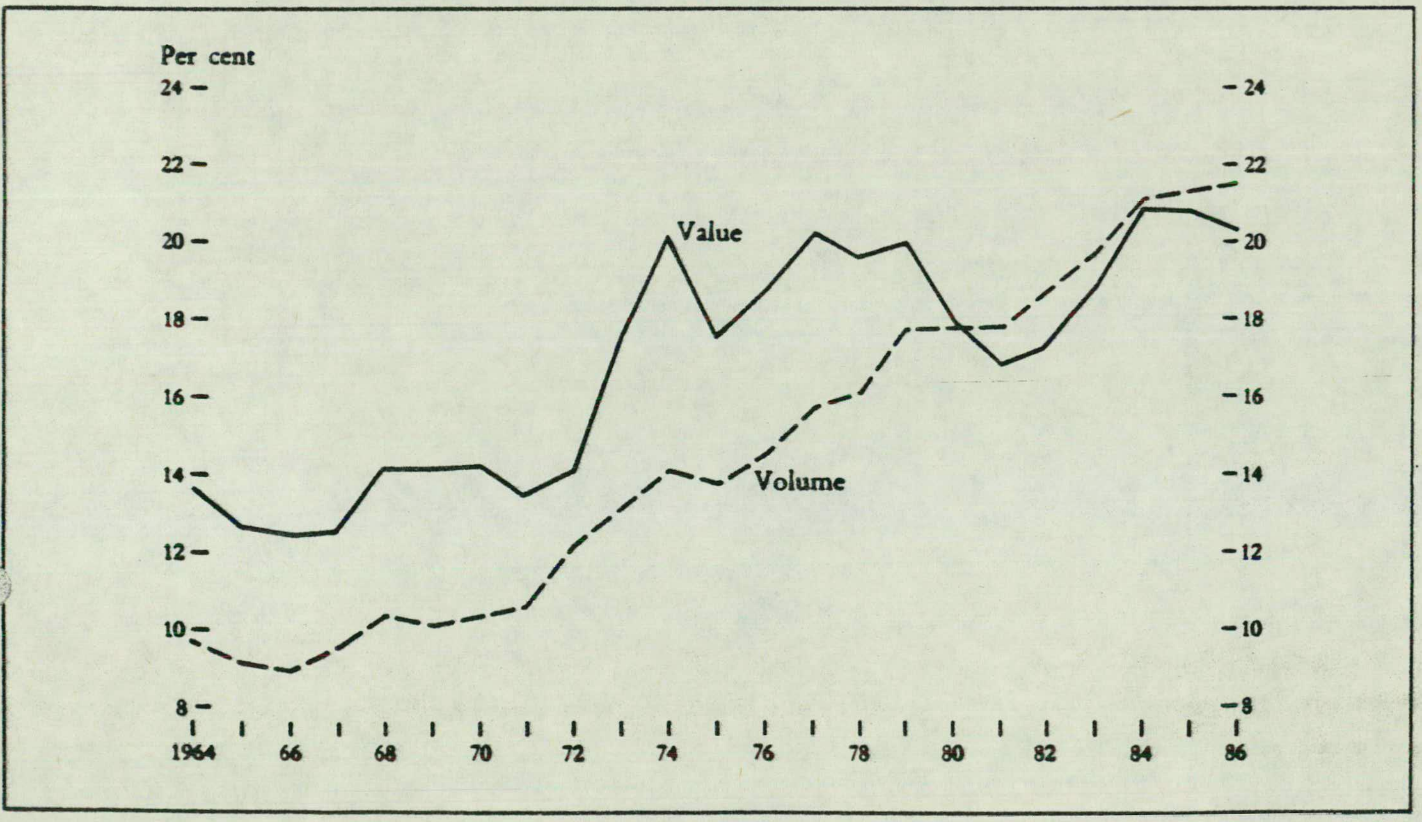


Chart 1.6 Share of imports of goods (excluding oil) in total domestic demand



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 ~~North Sea~~ 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. ~~Little~~ A small improvement ~~change~~ in the terms of trade ~~from the present level~~ 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	~~3~~ 2½	~~6~~ 5½	1	~~4~~ 3½	5~~½~~	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~~ the value of the stock of UK net overseas assets ~~, which~~ rose by £37 billion, ~~to~~ reaching £114 billion by the end of ~~1986;~~ the year. ~~has been affected during 1987 on both sides of the account by movements in financial markets in the UK and overseas, as well as by exchange rate changes, but the net position has probably changed little compared with the end of 1986.~~

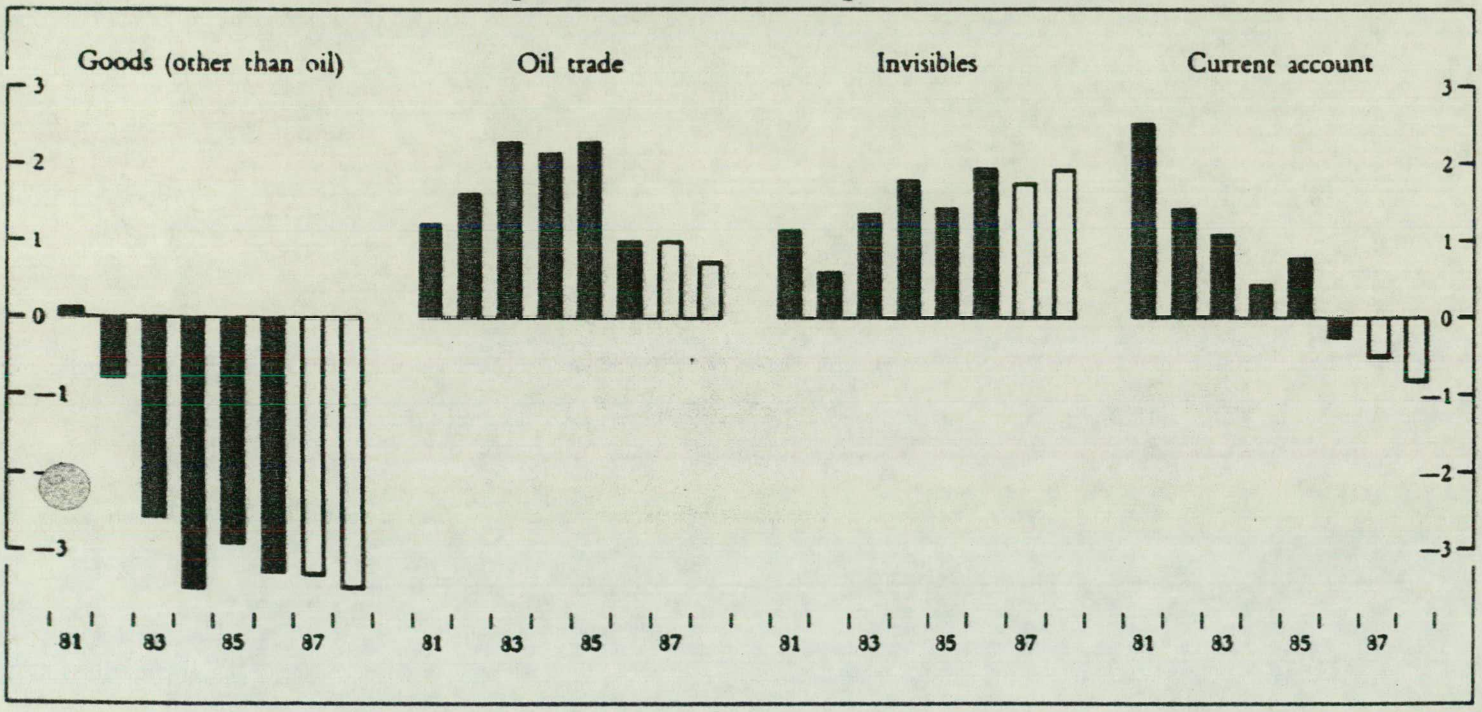
Current account

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

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 per cent 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.

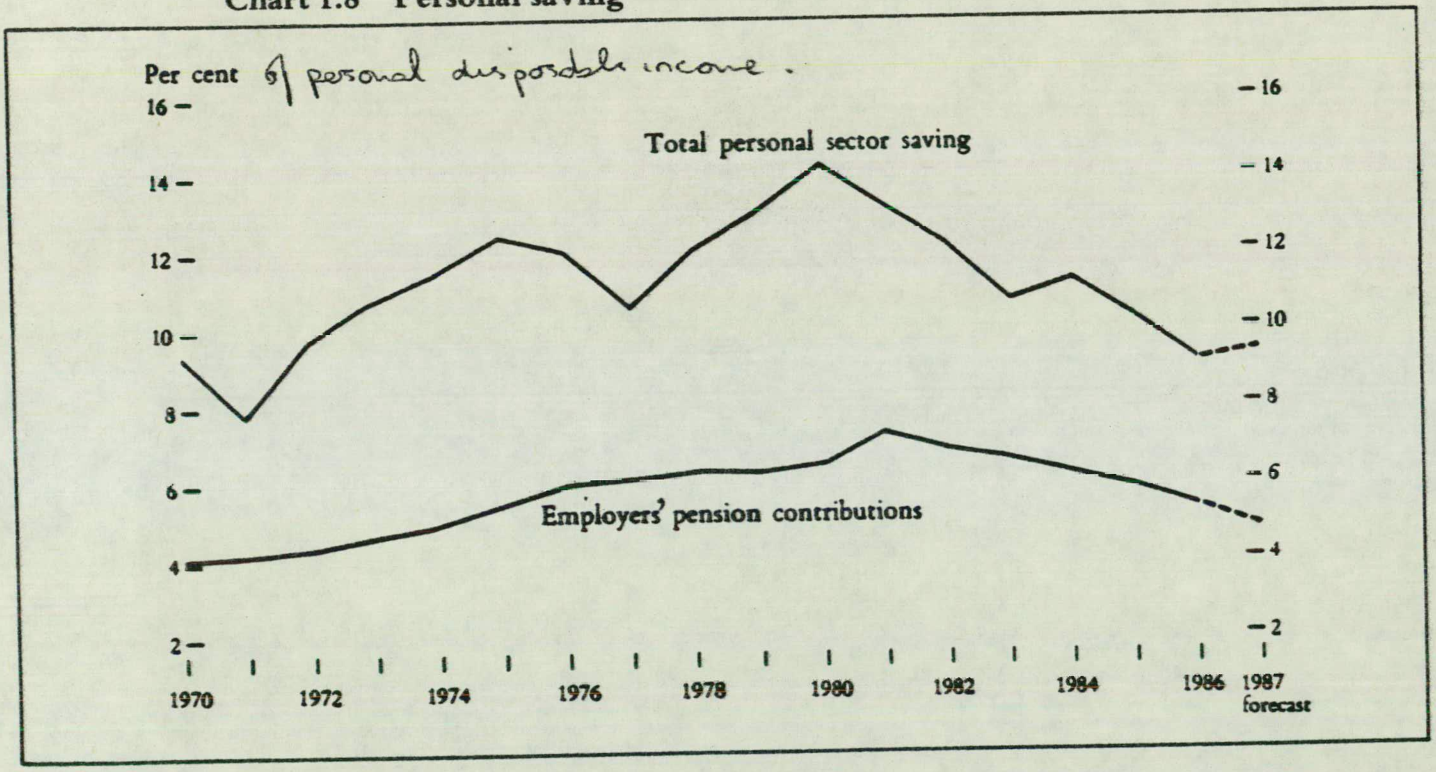
1.32 Over that period output growth has been strong in all sectors of the economy other than the North Sea where production has fallen. Output of the service industries rose by 5 per cent between the first halves of 1986 and 1987, manufacturing output by over 4½ per cent and construction output by 7½ 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 ~~latest~~ 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 5½ 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 4½ per cent, with ~~little change~~ some rise in the savings ratio. ~~as consumers react to the fall in financial wealth~~.

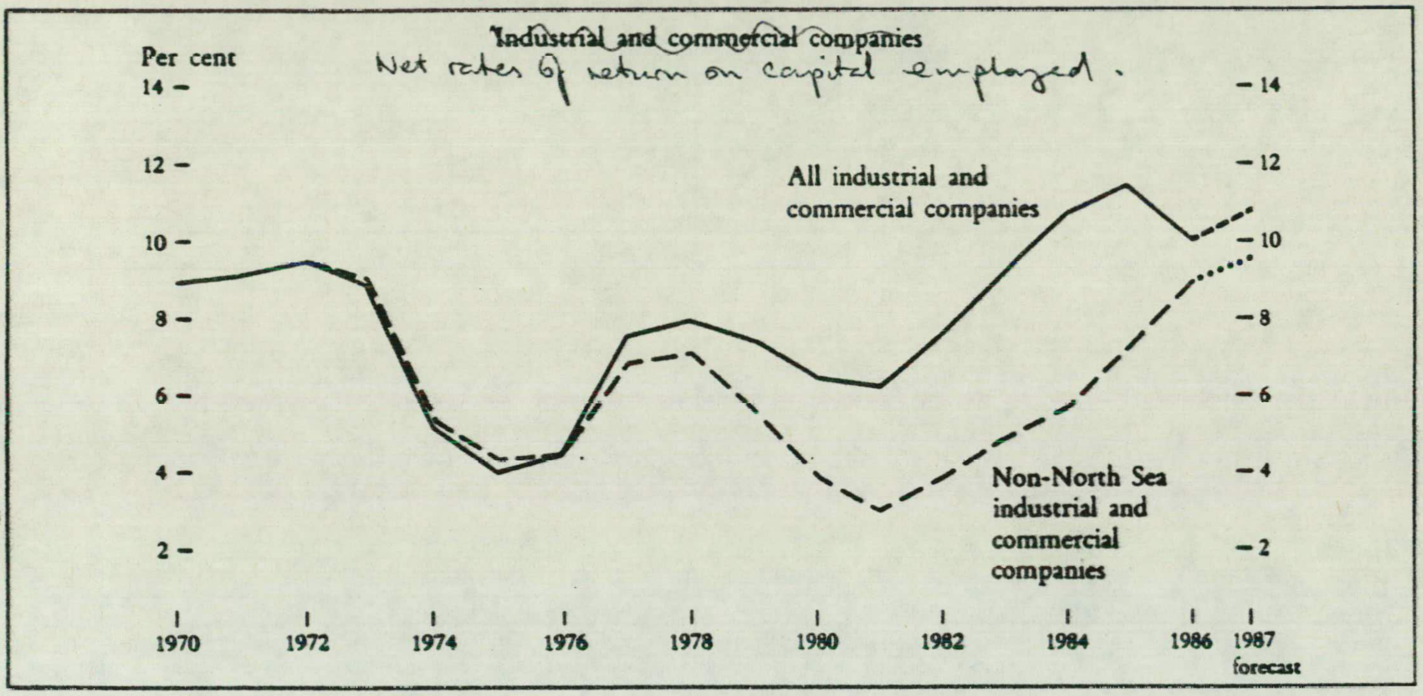
1.35 The housing market remains very buoyant. Although private housing starts have fallen back from their high first quarter levels, for the first eight months of 1987 as a whole they were 7 per cent higher than the year before, while private completions were 8½ per cent higher. With investment in improvements 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 on 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~~, below net earnings in 1985~~. 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.

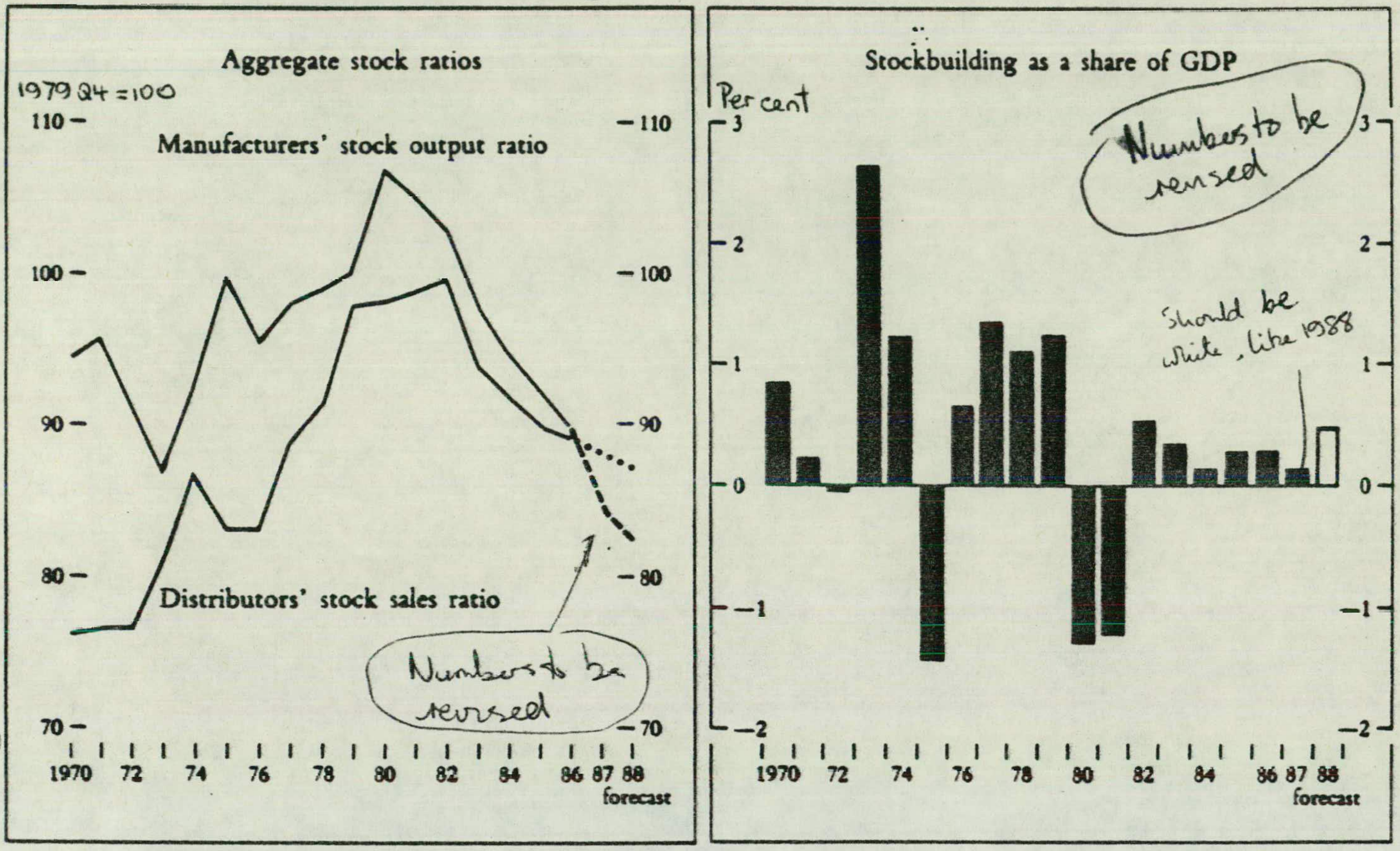
Chart 1.9 Companies' rate of return



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 ~~in 1987~~ 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 suggest ~~that~~ faster growth of manufacturing investment ~~could well accelerate~~ 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~~, and a more positive trend in stockbuilding may be in prospect~~. 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 make a small positive contribution to growth next year but~~ to remain on a modest scale compared with many years in the 1960s and 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 ~~closer to~~ 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, ~~and also~~ a smaller contribution from non-oil exports next year and some reduction in the growth of domestic demand. Growth in 1987 ~~and 1988~~ 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 ~~per cent~~ 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		
		Forecasts	
	1986	1987	1988
Domestic demand	4	4	~~4~~ 3½
Exports of goods and services[1]	3 (3½)	5½ (6½)	2½ (3½)
Imports of goods and services[1]	6 (5½)	6½ (7)	5½ (5) 4½
Domestic production: GDP[1,2]	3 (3)	4 (4½)	2½ ~~3~~ (3½)
Manufacturing production	1	5	~~4~~ 3½

[1] *Non-oil shown in brackets.*
[2] *Average measure.*

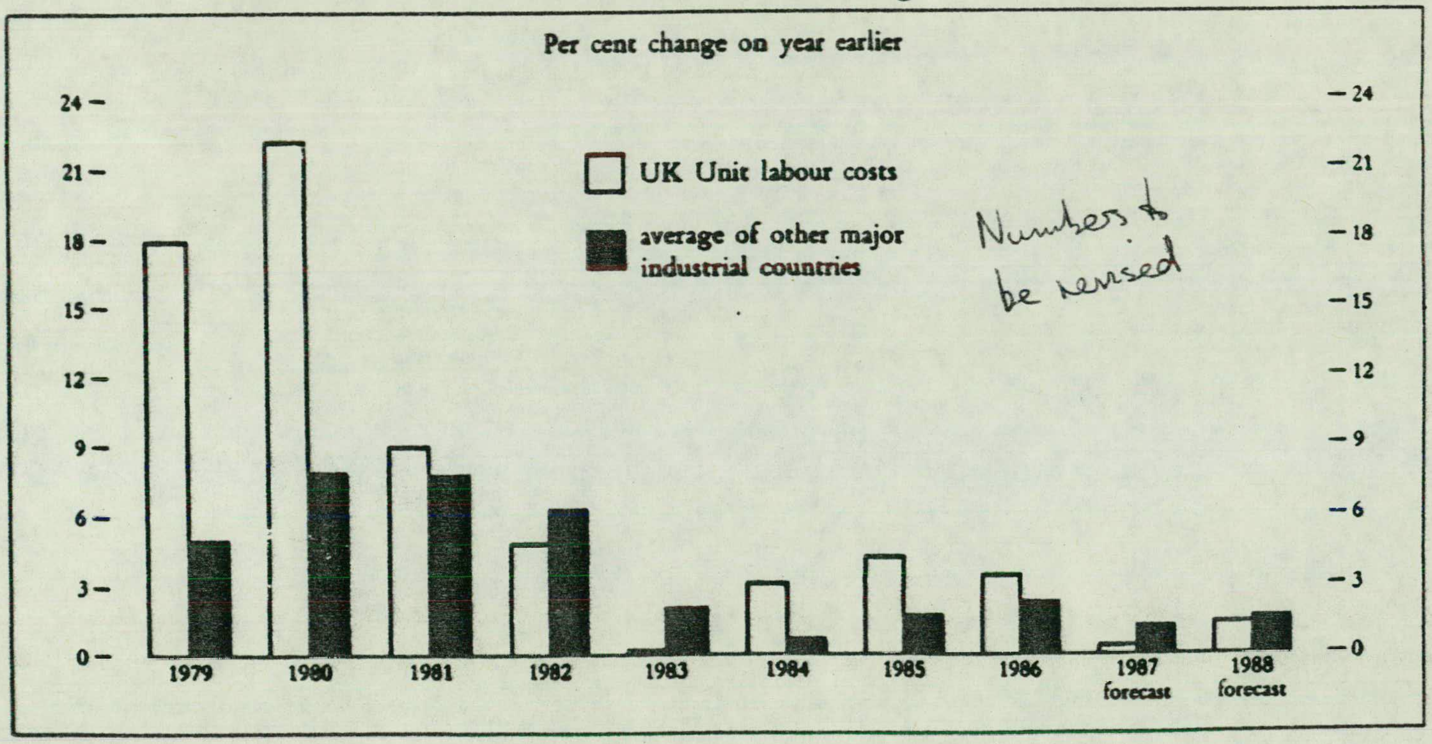
Inflation

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 $2\frac{1}{2}$ 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 $7\frac{1}{2}$ per cent at the start of the year to $7\frac{3}{4}$ 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[1]	Estimated total unit costs[2]	Output prices[1]
1985	3½	4	4	6½
1986	4	−11	− ½	4½
1987 Partly forecast	½	5½	1½	4½
1988 Forecast	1½	~~3~~ 2½	2	4½

[1] *~~Producer prices~~ excluding food, drink and tobacco* industries.   [2] *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 given 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 electricity prices to finance the industry's investment programme there is likely to be a temporary rise in the annual rate of increase in the RPI after the first quarter of 1988. In the light of this, 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

	Per cent changes on a year earlier			
	Weight in 1987	1986 Q4	Forecasts 1987 Q4	1988 Q4
Food	16½	3¼	3½	3
Nationalised industries	6	3½	2¼	6¼
Housing	15	7	7¼	~~8½~~ 7
Other	62½	2½	3½	4¼
Total	**100**	**3½**	**4**	**4½**

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 ~~full-time equivalent~~ man hour has risen by about ~~1½~~ 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[1,2]	3	½ ~~(1)~~	1½ ~~(1½)~~
Whole economy[2]	2¾	1 ~~(1¼)~~	2 ~~(2¼)~~
Non-North Sea economy[2]	2¾	½ ~~(¾)~~	1¾ ~~(2)~~

[1] *Excludes public services and North Sea oil and gas extraction.*
[2] ~~*Figures for output per full time equivalent in brackets.*~~

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 ~~encouraging~~ prospects for the UK economy over the next year mean that a further ~~continued~~ 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

This will to some extent be offset by the fall in

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 £9 billion. ~~Short-term interest rates remain historically high in real terms. Long-term rates throughout the world, which fell in the early part of the year, were edging up again until the stock market fall in October. In the UK, unlike the US and most other countries, the yield curve is flat.~~

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. ~~On the balance of evidence, monetary conditions remain firm.~~

1.53 The sharp fall in share prices will tighten monetary conditions somewhat. Short term interest rates; and ~~however~~ ~~fallen and~~ long term rates have also eased. On the balance of ~~the~~ evidence monetary conditions remain firm.

Fiscal developments

1.5~~3~~4 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, nearly £¾ billion lower than estimated in the 1987 FSBR. Lower central government borrowing, more than accounted for by higher than expected tax revenues, was responsible for about two-thirds of this downward revision, with the remaining one-third due to lower than expected local authority borrowing.

1.5~~4~~5 In the first six months of 1987-88 the PSBR was £1½ billion. Excluding privatisation proceeds, borrowing was about £1½ 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 FSBR. This is mainly due to higher than expected tax revenues but there is also likely to be a shortfall on the expenditure side.

1.5~~5~~6 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

~~[The forecast of the adjustments between the planning total and general government expenditure has increased by about £1½ billion since the Budget, leaving general government expenditure £½ billion lower than previously forecast.]~~

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	6·9	6·2	6·8
General government expenditure	**165·1**	**173·5**	**172·9**
of which			
Privatisation proceeds	−4·4	−5·0	−5·0

1.~~56~~7 Table 1.10 shows the forecast for general government receipts. The forecast of tax and national insurance revenues has been increased by just over £2¾ billion since the Budget. The forecast of on-shore corporation tax, including ACT, is about £¾ 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 £½ 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 £½ 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 5½ 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	130·2
National insurance and other contributions	26·7	28·5	28·9
Interest and other receipts	13·3	12·6	12·3
Accruals adjustment	0·5	0·0	−0·2
Total receipts	**160·2**	**168·8**	**171·2**
of which			
North Sea revenues	4·8	3·9	4·5

1.5~~7~~8 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 ½ 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	172·9
General government receipts	160·2	168·8	171·2
General government borrowing requirement	4·9	4·7	1·7
Public corporations' market and overseas borrowing	−1·5	−0·8	−0·7
PSBR	**3·4**	**3·9**	**1·0**
PSBR as per cent of GDP	**1**	**1**	**¼**
Memorandum item:			
PSBR excluding privatisation proceeds	7·9	8·9	6·0
As per cent of GDP	2	2¼	1½

Table 1.12 Economic prospects: summary

	Forecast		Average errors from past forecasts[1]
	1986 to 1987	1987 to 1988	
	per cent changes		percentage points
Output and expenditure at constant 1980 prices			
Domestic demand	4	~~4~~ 3½	1
of which:			
Consumers' expenditure	5	~~4½~~ 4	1¼
General government consumption	½	~~1~~ ½	1
Fixed investment	5½	4½	2¼
Change in stockbuilding (as per cent of level of GDP)	0	~~½~~ 0	½
Exports of goods and services	5½	~~2½~~ 2	2½
Imports of goods and services	6½	~~5½~~ 5	2¾
Gross domestic product: total	4	~~3~~ 2½	¾
manufacturing	5	~~4~~ 3	2¼
Inflation			
Retail prices index	per cent changes		
1986 Q4 to 1987 Q4	4		¼
1987 Q4 to 1988 Q4	~~4¾~~ 4½		2
Deflator for GDP at market prices	per cent changes on a year earlier		
Financial year 1987–88	4¼		1
Financial year 1988–89	4½		2
Money GDP at market prices	£ billion[2]		
Financial year 1987–88	418 ~~419~~ (~~8¾~~) 8½		1
Financial year 1988–89	448 ~~452~~ (~~7¾~~) 7¼		1½
Balance of payments on current account			
1987	−2½		1½
1988	−3½		3

[1] *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.*

[2] *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[1]	**Gross domestic product at factor cost**	GDP index 1980=100
1982	138·4	49·6	39·5	63·1	−1·0	**289·7**	59·2	30·6	0·9	**200·8**	100·5
1983	144·0	50·6	41·6	64·4	0·7	**301·2**	62·7	31·6	0·5	**207·4**	103·9
1984	147·1	51·0	45·0	68·9	0·3	**312·2**	68·8	32·8	2·0	**212·7**	106·5
1985	152·5	50·9	46·4	72·8	0·6	**323·3**	70·7	33·9	1·7	**220·4**	110·4
1986	161·3	51·4	46·5	75·1	0·7	**335·0**	75·1	35·4	2·7	**227·1**	113·8
1987	169·0	51·6	49·0	79·2	0·2	**348·9**	80·0	37·1	4·3	**236·2**	118·3
1988	176·0	51·9	51·2	~~81·2~~ 80·8	~~1·2~~ 0·8	**360·6**	84·1	38·4	4·5	**242·6**	~~122·1~~ 121·5
1986 H1	79·6	25·7	22·9	36·6	0·4	**165·2**	35·9	17·4	0·8	**112·7**	112·9
H2	81·6	25·7	23·7	38·5	0·3	**169·8**	39·2	18·0	1·9	**114·5**	114·7
1987 H1	83·0	25·6	23·9	39·0	−0·3	**171·3**	38·3	18·3	2·2	**116·8**	117·1
H2	86·1	~~26·2~~ 25·9	25·1	40·1	0·4	**177·7**	41·7	18·8	2·2	**119·4**	119·5
1988 H1	87·3	~~26·2~~ 25·9	25·3	40·1	0·3	~~**180·0**~~ 179·0	41·7	19·1	2·2	~~**121·3**~~ 120·4	~~121·3~~ 120·6
H2	88·7	~~26·2~~ 25·9	25·9	~~41·0~~ 40·8	0·4	**181·7**	42·4	19·3	2·2	**122·2**	122·4
Per cent changes											
1985 to 1986	6	1	½	3	—	3½	6	4½	—	3	3
1986 to 1987	5	½	5½	5½	—	4	6½	4½	—	4	4
1987 to 1988	4	½	4½	2	—	3½	5	3½	—	2½	2½

1 *The average measure of gross domestic product—the preferred measure of growth in economic activity—grew by some 3¾ 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 GDP(E).*

PWP

FROM: MISS M O'MARA
DATE: 29 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

cc
Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Ms Evans
Mr Hudson
Miss Simpson
Mr Cropper
Mr Tyrie
Mr Call
B/002

Cl
A few comments from me. Most difficult issues are in expenditure section
AA

AUTUMN STATEMENT BRIEFING: AWKWARD ISSUES

We realise that, with other preoccupations, you will be unable to look at much of the Autumn Statement briefing, if any, and certainly not before the weekend.

2. With Mr Hudson's help, we have therefore tried to identify in the attached note some of the most awkward issues in the macro-economic area, together with a proposed line to take, where one has been devised.

3. If you have time to glance through this by tomorrow evening, it would be most helpful to us to have your reaction. We plan to submit the key briefs for your weekend box.

MOM

MISS M O'MARA

Forecast

(i) Impact of stock market fall: Forecast takes account of recent sharp falls in share prices throughout world but uncertainty about their effects means even greater margin of error than usual.

This follows Chapter 1.02 as currently drafted.

No, provided major industrial countries cooperate in pursuing appropriate policies.

(ii) Collapse in share prices worldwide means world recession. Fundamentals remain encouraging - low inflation, little sign of capacity constraints, current account imbalances being reduced. Unclear at this stage whether fall in share prices will be sustained and how it will affect other financial markets. [Major countries will work together to achieve financial stability and to avoid recession.]

(iii) Co-ordinated world fiscal expansion/monetary relaxation needed. Lesson of 1929 is that must avoid undue tightening of monetary policy - Fed has responded accordingly but Germans reluctant to ease their policies. Co-ordinated fiscal expansion inappropriate.

[As in AS Ch 1]

This will to some extent be offset by the fall

(iv) Effect of stock market fall on monetary conditions: Sharp fall in share prices will tighten monetary conditions somewhat. [But] short term interest rates [have fallen] and long term rates also eased. On balance of evidence, monetary conditions remain firm.

This follows the current draft of Chapter 1.53.

(v) What does exchange rate assumption imply for future of Louvre Accord? Forecast assumes sterling remains close to recent levels, consistent with Louvre Accord.

Reaffirmed recently by all participants, who have acted to help stabilise exchange rates.

(vi) Louvre Accord breaking down: No. [Fiscal policy changes have been in right direction. Surplus countries (Japan and Germany) taking action to strengthen domestic demand. US to cut its budget deficit by more than $23 billion provided for under revised Gramm-Rudman. Closer co-operation needed on monetary policy.] ??

Further action will be taken as appropriate

(vii) Current account deficit no longer temporary. Deficit reflects faster growth of UK economy relative to other major economies. No reason to suppose deficit will not decline as growth rates converge. Forecast deficit in 1988 smaller than deficit in 1987H2 at annual rate.

We have plenty of other material on the deficit as a proportion of GDP and international comparisons.

Fiscal policy

(i) Government deliberately published pessimistic forecast of 1987-88 PSBR/tax revenues at Budget time. No. Budget forecast reflected central view based on economic prospects as seen then. In event, economy been performing better growth has been faster than expected, so tax revenues higher and expenditure lower. But have always stressed margins of error on PSBR forecasts (estimated on past experience at ± £2½ billion for current forecast for 1987-88).

(cts — asset sales!)

(ii) Forecast of 1987-88 tax revenues over-cautious? Of course, outturn may be higher than forecast but could be lower too. Considerable uncertainties remain, particularly about mainstream corporation tax - where, as usual, very few receipts received during first half of financial year.

(iii) Higher VAT/taxes on expenditure indicative of consumer boom? No. VAT/taxes on expenditure rising no faster than tax revenues in total. Overall picture one of balanced economic growth.

We have figures to support claim of balance elsewhere in the brief.

(iv) Buoyant revenue indicates massive fiscal adjustments in prospect. Considerable uncertainties. Wait for Budget. Government committed to reducing tax burden but only when prudent to do so.

(v) Forecast implies PSBR for 1988-89 will be lower than MTFS path

- No forecast made for PSBR in 1988-89. Will be set at Budget time in accordance with 1988 MTFS.

- But assumption always required for PSBR/GDP ratio to construct Industry Act forecast for following year.

- Convention that use lower of MTFS path or forecast outturn for current year. In past, MTFS figure was lower. In 1987, current year forecast lower for first time, so assumption is for same PSBR in 1988-89 as in 1987-88.

Isn't this being too clever?
Can simply say that seemed appropriate to assume PSBR for 1988-89 @ same level as in 1987-88.

(vi) Higher revenues would permit higher expenditure growth

- Continued restraint in public spending vital element of [Government's] economic [strategy.] success.
- Falling ratio of GGE to GDP essential to enable low level of borrowing to be combined with reduction in tax burden, so improving motivation and efficiency and creating more job opportunities.
- Only for first time in 1987-88 is ratio excluding privatisation proceeds planned to fall below that in 1978-79, so scope for further reduction.

Are you happy for us to flag up the point in the last indent, provided it is used defensively?

(vii) Money GDP growth and PSBR forecasts imply change to MTFS and fiscal stance

- MTFS updated at Budget time, not in Autumn Statement.
- MTFS designed to bring inflation down further over period of years. Always allowed for short term fluctuations [- what matters is medium term trend.] doesnt look good @ present
- Higher money GDP growth path in 1987-88 and 1988-89 than in MTFS mainly result of higher than expected real GDP growth in 1987-88 and some temporary factors leading to slightly higher inflation in 1988-89.
- No change implied in primary MTFS objective of further reducing inflation over period of years. Fiscal stance over medium term set in accordance with MTFS and hence reviewed only at Budget time.

(viii) Government abandoned commitment to eventual price stability? Price stability still remains ultimate objective of MTFS.

We assume we have to say this, if asked. But do you want to soft-pedal at all? More references simply to "further reducing inflation"?

(ix) Chancellor no longer aiming at PSBR/GDP ratio of 1 per cent? 1 per cent PSBR/GDP ratio published for future years in 1987 MTFS but always acknowledged may be fluctuations in short term. MTFS not reviewed in autumn but PSBR path for medium term will be published in 1988 MTFS as usual and PSBR for 1988-89 will be set in 1988 Budget in light of prevailing circumstances.

(x) Forecast shows non-oil tax burden rising: Larger rise than earlier forecast is result of better than expected economic performance - and consequential buoyant tax revenues. Government policy remains to reduce tax burden as [soon as] and when it is prudent to do so.

(xi) PSFD

We shall, of course, focus on the PSBR, excluding privatisation proceeds but do you have any objection to us revealing the PSFD (£6.1 billion, 1½ per cent of GDP), if asked? It is probably less sensitive now: indeed, it is expected to be the lowest figure since 1971-72.

Expenditure

(i) How do we present the increase in planning totals? The LTPE Green Paper said "It would, of course, always be open to the Government to decide, once the virtuous circle of lower taxes and higher growth had been established to devote some of these resources to improved public services rather than reduced taxation." Do we want to claim we are now in the virtuous circle?

(ii) GGE for 4 years from 1986-87 growing at faster annual average rate (1½ per cent) than envisaged in 1987 PEWP (1 per cent).

This raises a similar issue.

One suggested answer is:

- Always said that real growth in GDP could allow more spending on priority programmes.
- GGE as percentage of GDP lower than in 1987 PEWP plans.

Do you want to use the first point? In the past, we have talked of room for more spending on priority programmes within overall constraints.

(iii) Did Star Chamber meet?

It met once, to be briefed by the Chief Secretary on the position on the various programmes. It was not in the event necessary to convene it again to discuss any individual programmes. [or is this too forthcoming?]

(iv) Principle of cash planning clearly abandoned.

- No.
- Public expenditure still planned in cash. Survey conducted in cash terms and cash plans for first year become cash limits. Procedure still strictly enforced.
- Apart from statutorily-indexed programmes, no Department entitled to increase in provision because of inflation.

(v) Revenue now determining expenditure with a vengence? ?? Is this a serious question.

(vi) Government cutting benefits to poor to pay for tax cuts for rich

- Nonsense.
- Spending on social security benefits planned to rise 4 per cent in real terms between 1986-87 and 1990-91.
- For future level of taxes, wait for Budget. But as general principle, lower taxes improve incentives and so boost wealth and job creation to benefit of all.

(vii) Set to become first Government for over 30 years to have reduced public spending as percentage of GDP over time in office.

You were considering whether to reserve this for the Budget Speech. Even if you do not use it in your Oral Statement, are you content for it to be used in briefing? (In practice, this means it is bound to appear in a number of Ministerial speeches before the Budget.)

(viii) Problems of BP sale put future of privatisation programme in jeopardy. No!

This awaits the announcement!

SECRET

pup

FROM: MISS M O'MARA

DATE: 29 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Odling-Smee
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Mr Sedgwick
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Ms Evans
Mr Hudson
Miss Simpson
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B/002

AUTUMN STATEMENT BRIEFING: AWKWARD ISSUES

We realise that, with other preoccupations, you will be unable to look at much of the Autumn Statement briefing, if any, and certainly not before the weekend.

V. little - MOM's work.

2. With Mr Hudson's help, we have therefore tried to identify in the attached note some of the most awkward issues in the macro-economic area, together with a proposed line to take, where one has been devised.

3. If you have time to glance through this by tomorrow evening, it would be most helpful to us to have your reaction. We plan to submit the key briefs for your weekend box.

MOM

MISS M O'MARA

53:1

Forecast

(i) Impact of stock market fall: Forecast takes account of recent sharp falls in share prices throughout world but uncertainty about their effects means even greater margin of error than usual.

No need why this should happen, provided appropriate policies pursued, preferably within context of international co-operation. The [illegible] [illegible] the same slowdown.

This follows Chapter 1.02 as currently drafted.

(ii) Collapse in share prices worldwide means world recession. Fundamentals remain encouraging - low inflation, little sign of capacity constraints, current account imbalances being reduced. Unclear at this stage whether fall in share prices will be sustained and how it will affect other financial markets. Major countries need to ~~will~~ work together to achieve financial stability and to avoid recession.

(iii) Co-ordinated world fiscal expansion/monetary relaxation needed. Lesson of 1929 is that must avoid undue tightening of monetary policy - Fed has responded accordingly as Louvre [illegible] but Germans reluctant to ease their policies. Co-ordinated fiscal expansion inappropriate.

(iv) Effect of stock market fall on monetary conditions: Sharp fall in share prices will tighten monetary conditions somewhat. But short term interest rates have fallen and long term rates also eased. On balance of evidence, monetary conditions remain firm.

This follows the current draft of Chapter 1.53.

(v) What does exchange rate assumption imply for future of Louvre Accord? Forecast assumes sterling remains close to recent levels, consistent with Louvre Accord.

Concerted intervention has taken place, and

(vi) Louvre Accord breaking down: No. ~~Fiscal policy changes have been in right direction. Surplus countries (Japan and Germany) taking action to strengthen domestic demand.~~ US to cut its budget deficit by more than $23 billion provided for under revised Gramm-Rudman. ~~Closer co-operation needed on monetary policy.~~ policy changes are in the right direction, though more must be done.

Not yet in the bag.

(vii) Current account deficit no longer temporary. Deficit reflects faster growth of UK economy relative to other major economies. No reason to suppose deficit will not decline as growth rates converge. Forecast deficit in 1988 smaller than deficit in 1987H2 at annual rate.

We have plenty of other material on the deficit as a proportion of GDP and international comparisons.

cal policy

(i) Government deliberately published pessimistic forecast of 1987-88 PSBR/tax revenues at Budget time. No. Budget forecast reflected central view based on economic prospects as seen then. In event, economy been performing better than expected, so tax revenues higher and expenditure lower. But have always stressed margins of error on PSBR forecasts (estimated on past experience at $\pm$ £2½ billion for current forecast for 1987-88).

(ii) Forecast of 1987-88 tax revenues over-cautious? Of course, outturn may be higher than forecast but could be lower too. Considerable uncertainties remain~~, particularly about mainstream corporation tax - where, as usual, very few receipts received during first half of financial year.~~

I wouldn't pull out MCT, since we know the profits on which tax will be charged.

(iii) Higher VAT/taxes on expenditure indicative of consumer boom? No. VAT/taxes on expenditure rising no faster than tax revenues in total. Overall picture one of balanced economic growth.

We have figures to support claim of balance elsewhere in the brief.

(iv) Buoyant revenue indicates massive fiscal adjustments in prospect. Much too early to say, especially in light of wider events. Wait for Budget. Government committed to reducing tax burden but only when prudent to do so.

(v) Forecast implies PSBR for 1988-89 will be lower than MTFS path

[PSBR ~~set~~ a judgement, not a forecast.]

- ~~No forecast made for~~ PSBR in 1988-89, ~~W~~will be set at Budget time in accordance with 1988 MTFS.

- But assumption always required for PSBR/GDP ratio to construct Industry Act forecast for following year.

- Sensible convention is assume ~~Convention that use~~ lower of MTFS path or forecast outturn for current year. In past, MTFS figure was lower. In 1987, current year forecast lower for first time, so assumption is for same PSBR in 1988-89 as in 1987-88.

P.Sedgwick is checking whether this has been done before. If not "Sensible practice to use..."

It hasn't

(vi) Higher revenues would permit higher expenditure growth

- Continued restraint in public spending vital element of Government's economic strategy.

- Falling ratio of GGE to GDP essential to enable low level of borrowing to be combined with reduction in tax burden, so improving motivation and efficiency and creating more job opportunities.

- ~~Only for first time in 1987-88 is~~ ratio excluding privatisation proceeds ~~planned~~ forecast for first time in 1987-88. to fall below that in 1978-79~~, so scope for~~ further reduction. essential if tax burden is to fall.

×

yes

Are you happy for us to flag up the point in the last indent, provided it is used defensively?

(vii) Money GDP growth and PSBR forecasts imply change to MTFS and fiscal stance

- MTFS updated at Budget time, not in Autumn Statement.

- MTFS designed to bring inflation down further over period of years. Always allowed for short term fluctuations - what matters is medium term trend.

- Higher money GDP growth path in 1987-88 and 1988-89 than in MTFS mainly result of higher than expected real GDP growth in 1987-88 and some temporary factors leading to slightly higher inflation in 1988-89.

- No change implied in primary MTFS objective of further reducing inflation over period of years. Fiscal stance over medium term set in accordance with MTFS and hence reviewed only at Budget time.

(viii) Government abandoned commitment to eventual price stability? Price stability still remains ultimate objective of MTFS.

We assume we have to say this, if asked. But do you want to soft-pedal at all? More references simply to "further reducing inflation"?

Trickier question may be "No sign of further reduction in inflation. Govt happy with 4-5%"
(Line I heard from Harwood, of Warburgs, recently.)

(ix) Chancellor no longer aiming at PSBR/GDP ratio of 1 per cent? 1 per cent PSBR/GDP ratio published for future years in 1987 MTFS but always acknowledged may be fluctuations in short term. MTFS not reviewed in autumn but PSBR path for medium term will be published in 1988 MTFS as usual and PSBR for 1988-89 will be set in 1988 Budget in light of prevailing circumstances.

(x) Forecast shows non-oil tax burden rising: Larger rise than earlier forecast is result of better than expected economic performance - and consequential buoyant tax revenues. Government policy remains to reduce tax burden as soon as prudent to do so.

PSFD

We shall, of course, focus on the PSBR, excluding privatisation proceeds but do you have any objection to us revealing the PSFD (£6.1 billion, 1½ per cent of GDP), if asked? It is probably less sensitive now: indeed, it is expected to be the lowest figure since 1971-72.

Expenditure

(i) How do we present the increase in planning totals? The LTPE Green Paper said "It would, of course, always be open to the Government to decide, once the virtuous circle of lower taxes and higher growth had been established to devote some of these resources to improved public services rather than reduced taxation." Do we want to claim we are now in the virtuous circle?

(ii) GGE for 4 years from 1986-87 growing at faster annual average rate (1¼ per cent) than envisaged in 1987 PEWP (1 per cent). OR "Only microscopic reduction in GGE/GDP ratio in later years"

This raises a similar issue.

One suggested answer is:

- Always said that real growth in GDP could allow more spending on priority programmes.
- GGE as percentage of GDP lower than in 1987 PEWP plans.

Do you want to use the first point? In the past, we have talked of room for more spending on priority programmes within overall constraints.

(iii) Did Star Chamber meet?

(iv) Principle of cash planning clearly abandoned.

- No.
- Public expenditure still planned in cash. Survey conducted in cash terms and cash plans for first year become cash limits. Procedure still strictly enforced.
- Apart from statutorily-indexed programmes, no Department entitled to increase in provision because of inflation.

(v) Revenue now determining expenditure with a vengence?

Answer something like "Nonsense".

(vi) Government cutting benefits to poor to pay for tax cuts for rich

- Nonsense.
- Spending on social security benefits planned to rise 4 per cent in real terms between 1986-87 and 1990-91.
- For future level of taxes, wait for Budget. But as general principle, lower taxes improve incentives and so boost wealth and job creation to benefit of all.

(vii) Set to become first Government for over 30 years to have reduced public spending as percentage of GDP over time in office.

You were considering whether to reserve this for the Budget Speech. Even if you do not use it in your Oral Statement, are you content for it to be used in briefing? (In practice, this means it is bound to appear in a number of Ministerial speeches before the Budget.)

(viii) Problems of BP sale put future of privatisation programme in jeopardy.

This awaits the announcement!

ps2/2R CONFIDENTIAL

PWP

FROM: CATHY RYDING
DATE: 29 October 1987

MR P N SEDGWICK cc Sir T Burns

CHAPTER 1 OF THE AUTUMN STATEMENT: ECONOMIC PROSPECTS FOR 1988

The Chancellor was grateful for your minute of 28 October.

2. The Chancellor has made a few additional changes to the text - which he thinks are essential. A copy of the text with the Chancellor's comments marked is attached.

CR

CATHY RYDING

1 Economic prospects for 1988

Summary

1.01 GDP is forecast to grow by ~~3~~ 2½ 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 ~~continued~~ 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 ~~3~~ 2½ 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 ~~continued~~ 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 4½ 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 2½ per cent in ~~both~~ 1987 and 2 per cent in 1988. World trade in manufactures has picked up this year and should grow at ~~just under 5~~ around 4 per cent in 1988, reflecting faster growth of industrial production in the industrial countries. 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 ½ 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 ¾ 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 ~~now~~ appears to have ~~be~~ strengthen~~ing~~ed a little.

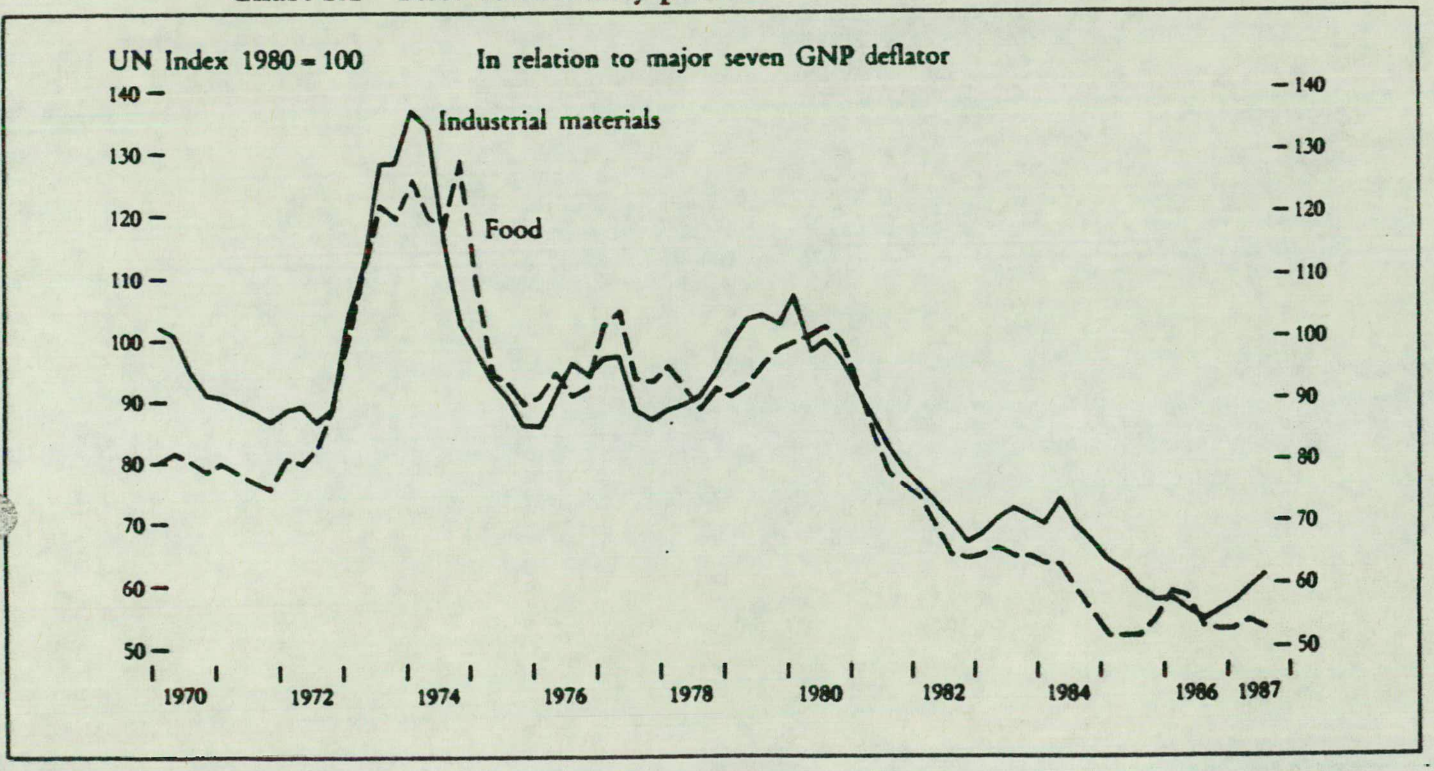
1.09 The weakness in world growth was largely due to the difficulties of adjusting both to the collapse in oil prices in early 1986 and to large changes in exchange rates. Lower oil prices led oil exporters to cut back their imports sharply. Moreover, with many non–oil commodity prices falling to their 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 ~~has~~ slowed in the first half of this year? ~~more recently~~. 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.

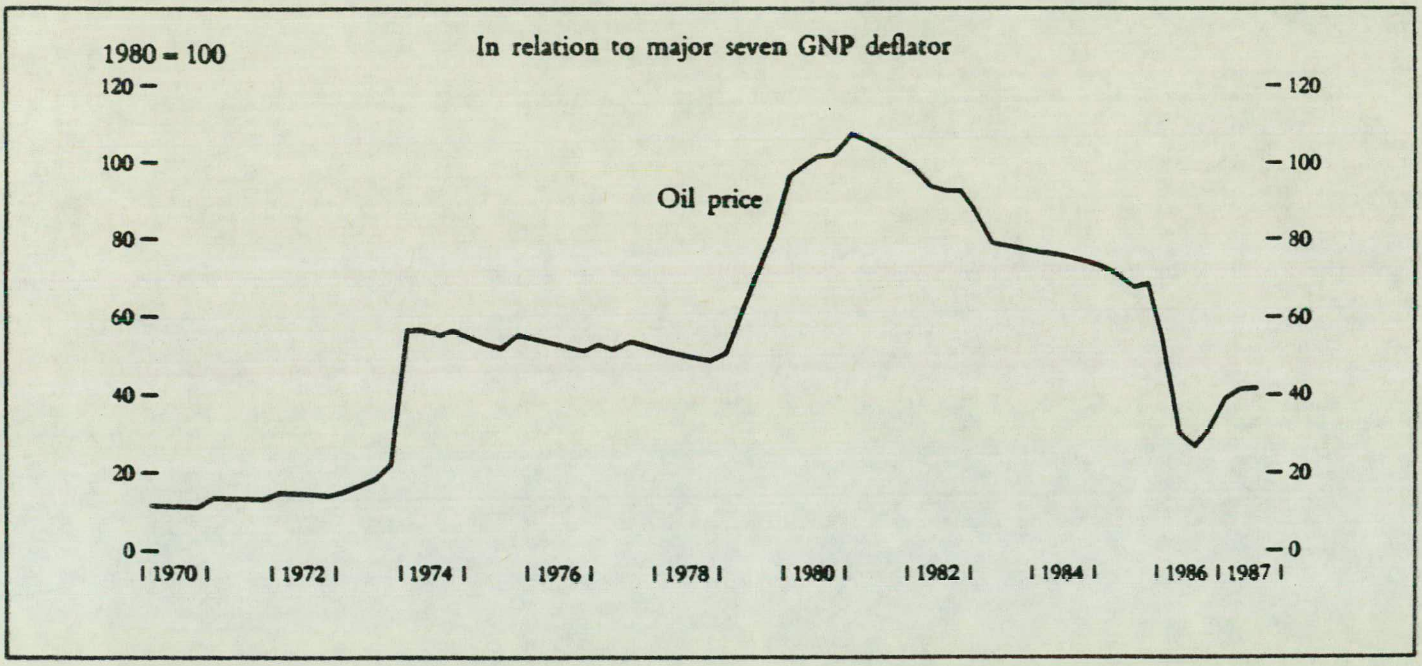
Chart 1.1 Real commodity prices



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 $1~~8~~7-19 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 prices



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		
		Forecasts	
	1986	1987	1988
Major seven countries[1]:			
Real GNP	2¾	2½	~~2½~~ 2
Real domestic demand	3¾	2¾	~~2½~~ 2
Industrial production	1	3	~~3¾~~ 3¼
Consumer prices	2	2¾	~~3~~ 2¾
World trade, at constant prices			
Total imports	4¾	3½	~~4~~ 3½
Total trade in manufactures[2]	2	3¾	~~4¾~~ 4

[1] *US, Japan, Germany, France, UK, Italy and Canada.*
[2] *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 ~~R~~real non-food commodity prices ~~may continue~~

are expected to

is forecast and ~~to increase slightly over the next year or so, especially if industrial production in the major OECD countries grows reasonably strongly, but~~ food prices ~~are expected to~~ remain weak.

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

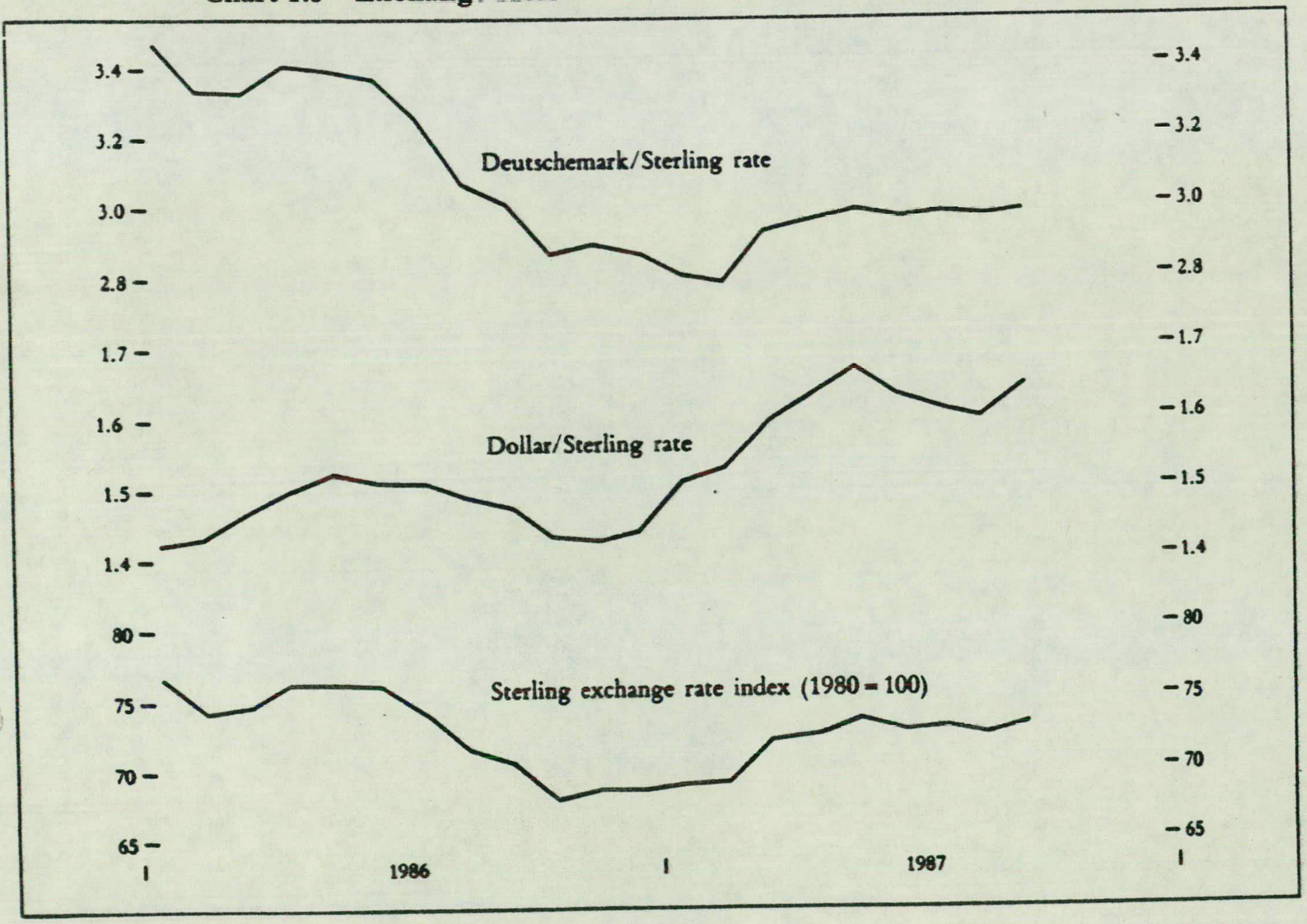
1.17 ~~In the US there is little likelihood of more rapid growth of domestic demand in 1988 as the economy adjusts to the reduction of its twin deficits, though the probable slowdown in consumers' expenditure could be in part offset by higher investment buoyed by rapid growth in export volumes.~~ The 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 ~~increase again in 1988, helped by a continued recovery in their exports~~.

1.19 World import volumes are likely to rise by about $3\frac{1}{2}$ 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 ~~in 1987~~.

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

Chart 1.3 Exchange rates



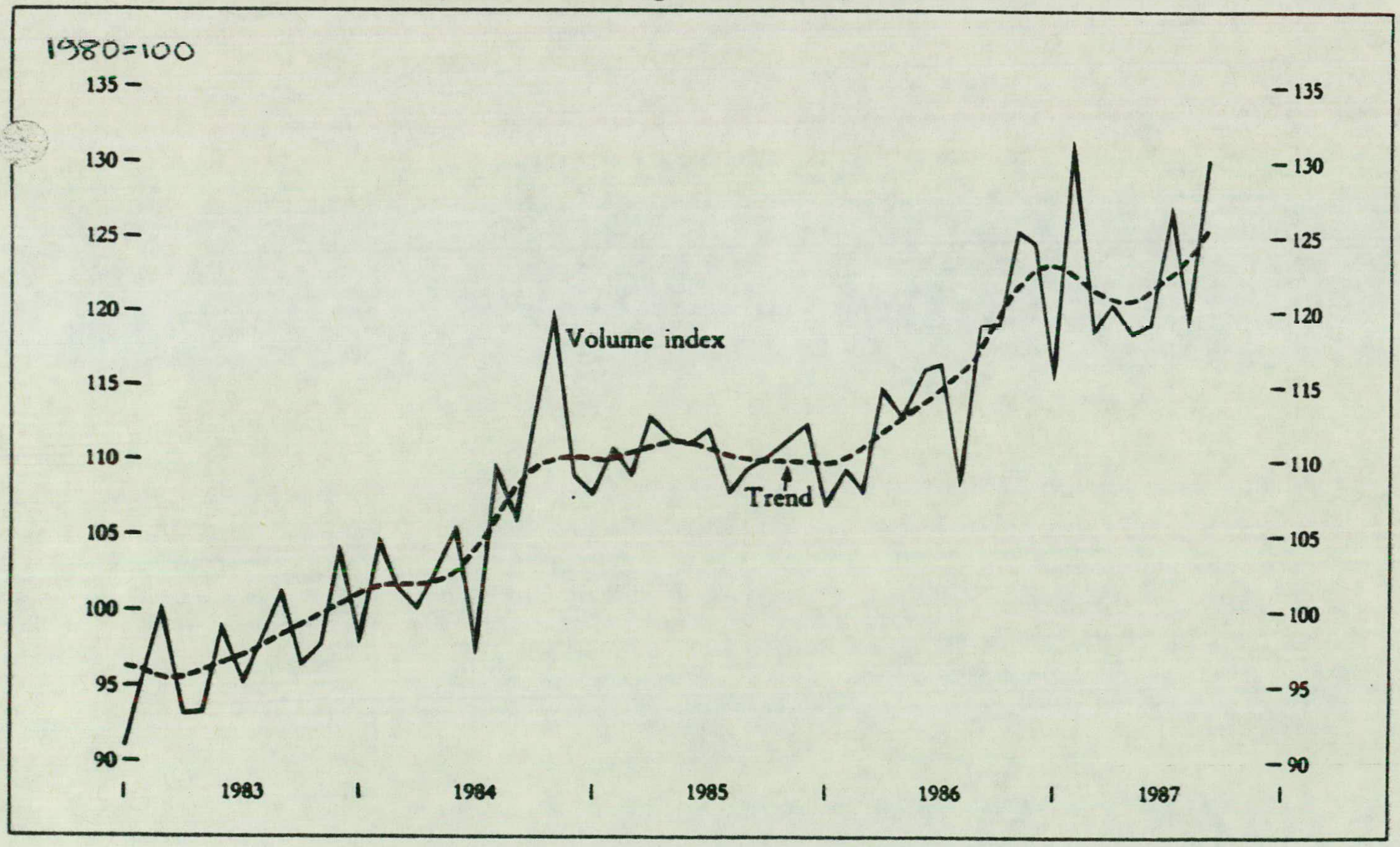
Trade and the balance of payments

Exchange rates **1.21** Exchange rates between major currencies have ~~remained broadly~~ been broadly stable following the Louvre meeting of Finance Ministers of the leading industrial countries in February. Sterling has reflected this general stability, particularly against the ~~d~~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 ~~7~~ 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[illegible] per cent next year compared to 8 per cent in 1987.

Chart 1.5 UK shares of total world trade in manufactures

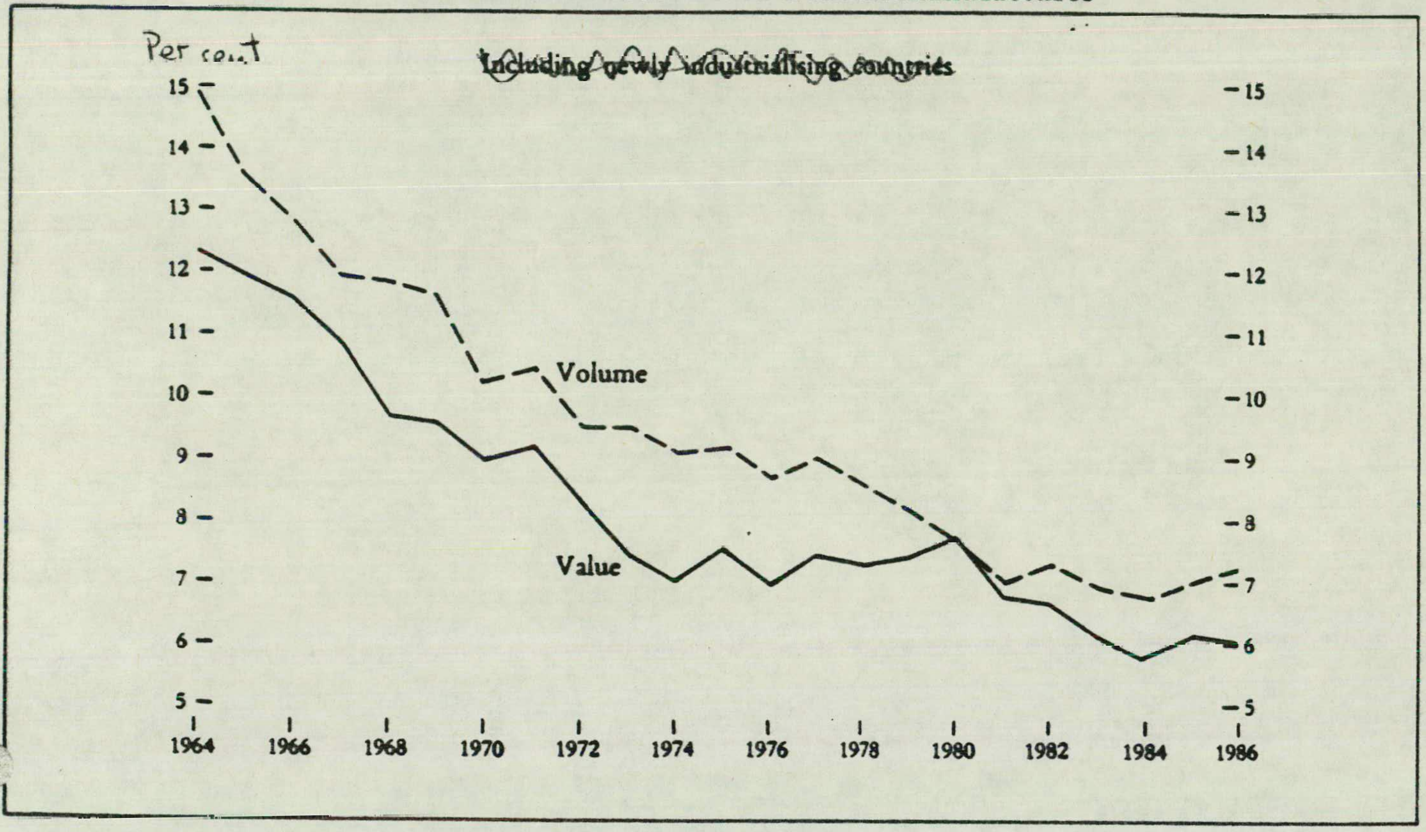
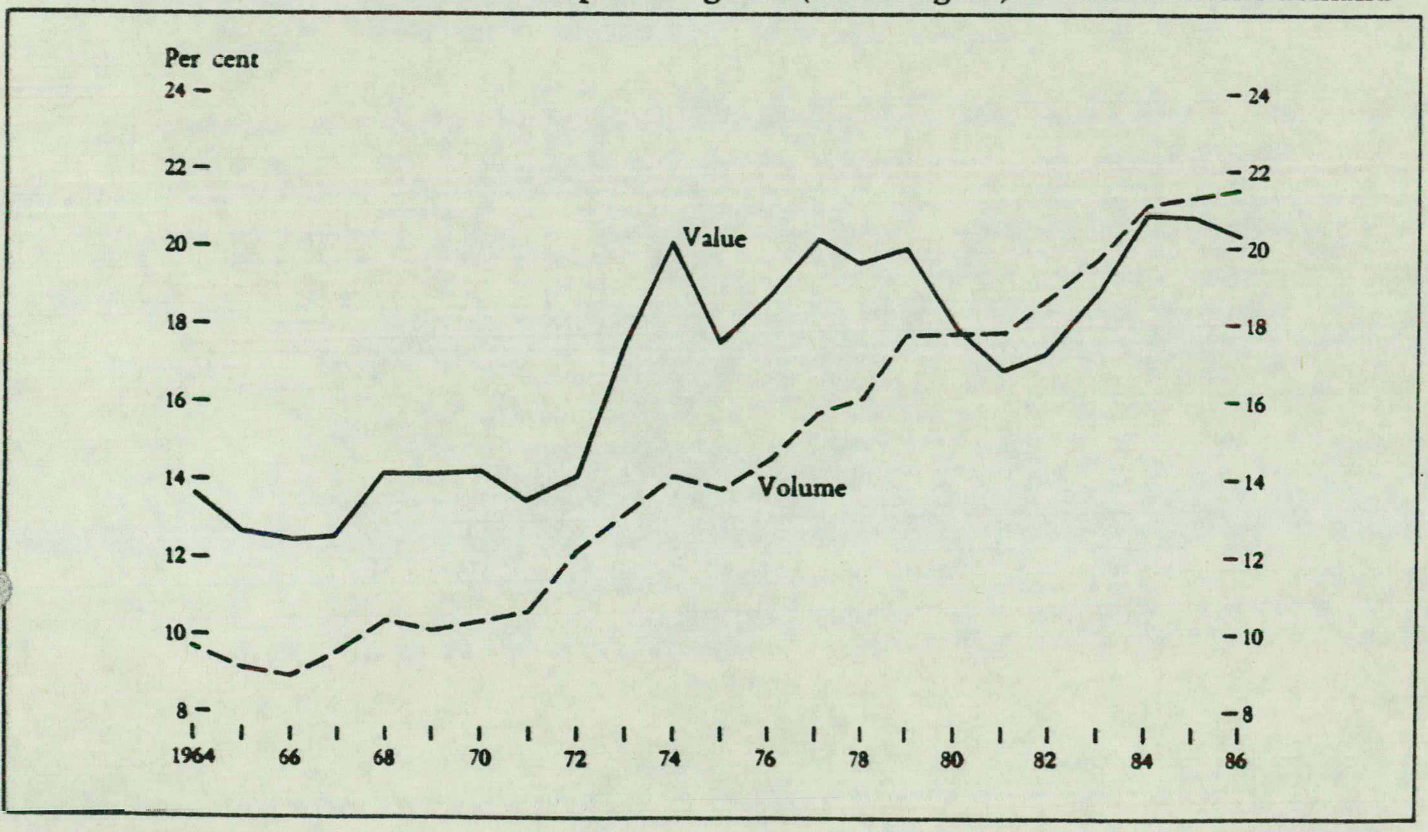


Chart 1.6 Share of imports of goods (excluding oil) in total domestic demand



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 ~~North Sea~~ 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. ~~Little~~ A small improvement ~~change~~ in the terms of trade ~~from the present level~~ 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	~~3~~ 2½	~~6~~ 5½	1	~~4~~ 3½	5~~½~~	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 ~~which~~ rose by £37 billion, ~~to~~ reaching £114 billion by the end of ~~1986,~~ the year. ~~has been affected during 1987 on both sides of the account by movements in financial markets in the UK and overseas, as well as by exchange rate changes, but the net position has probably changed little compared with the end of 1986.~~

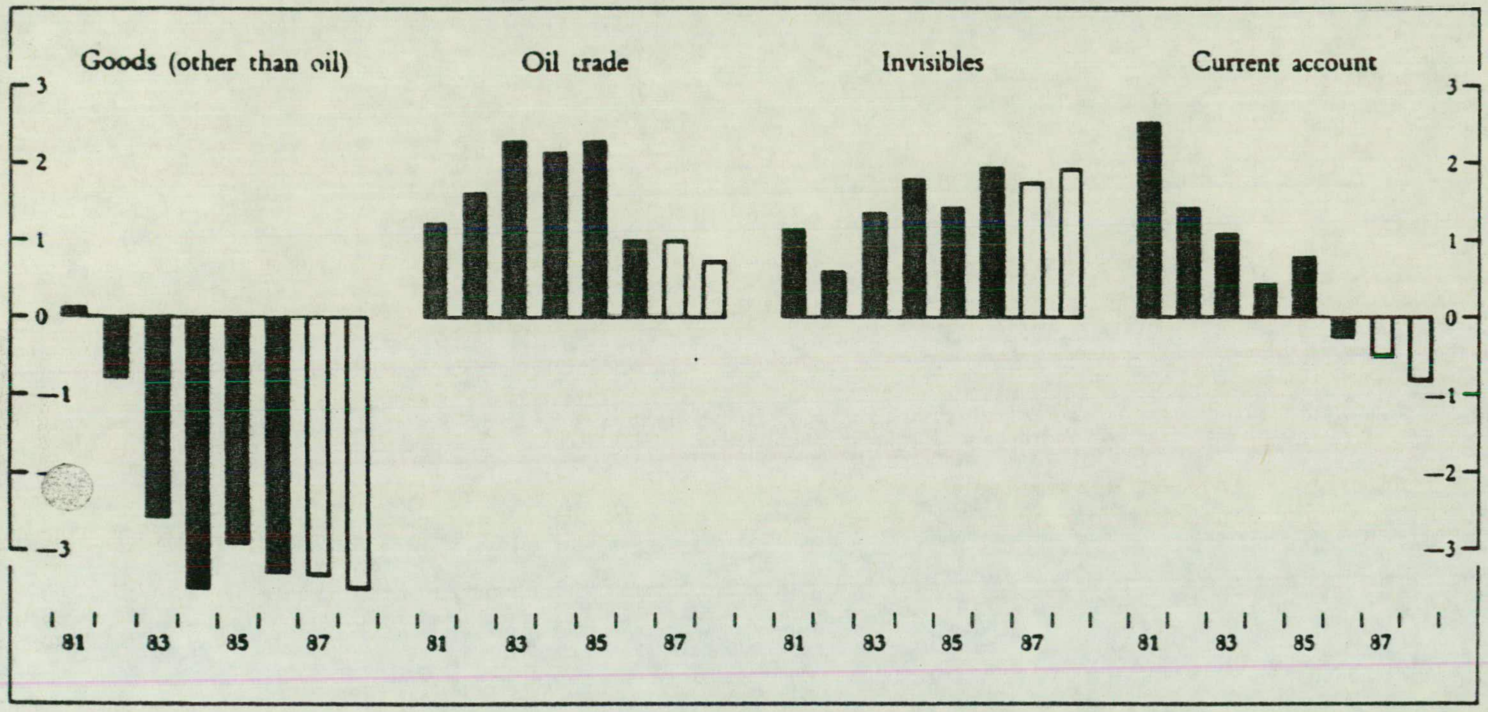
Current account

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

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 per cent 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.

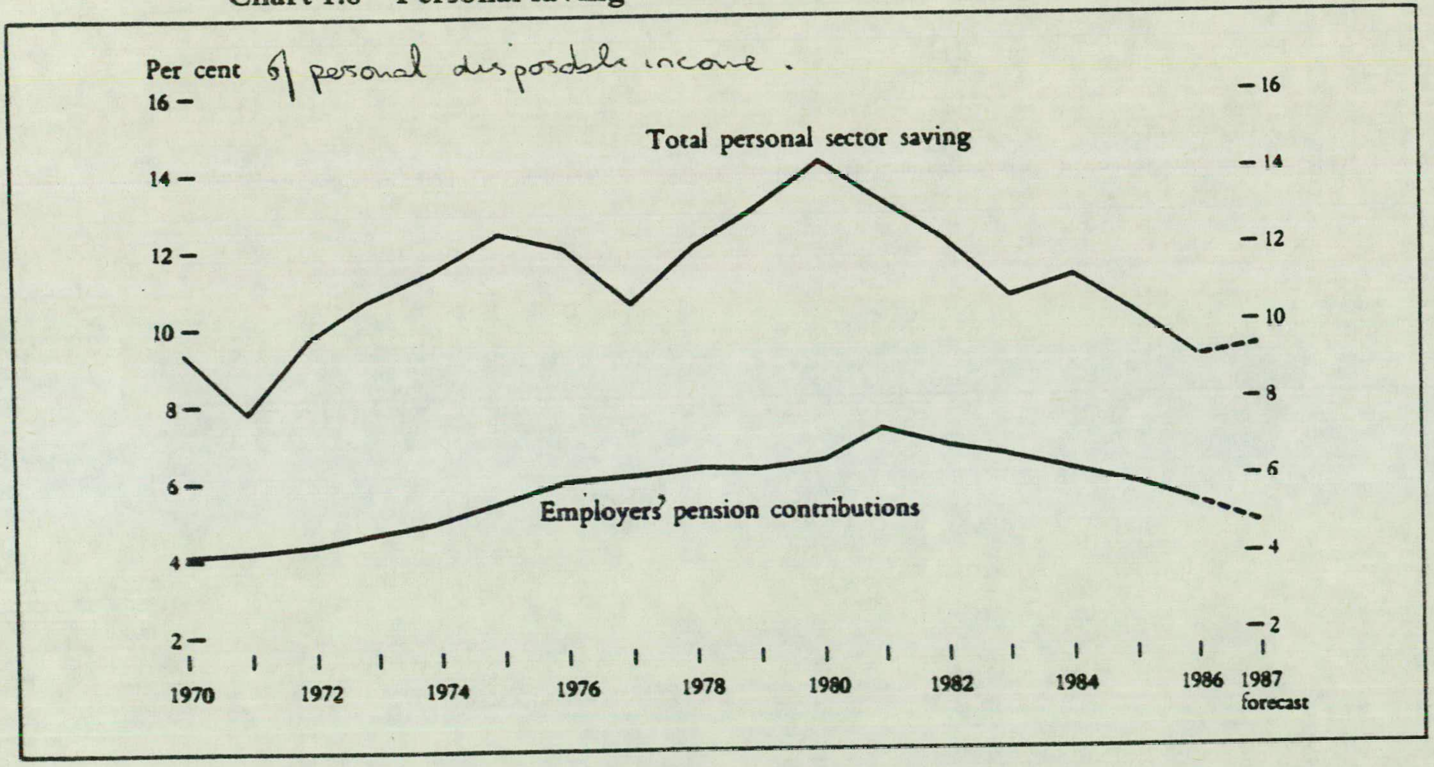
1.32 Over that period output growth has been strong in all sectors of the economy other than the North Sea where production has fallen. Output of the service industries rose by 5 per cent between the first halves of 1986 and 1987, manufacturing output by over 4½ per cent and construction output by 7½ 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 ~~latest~~ 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 5½ per cent in 1986, substantially more than growth in real personal disposable income. The personal savings ratio fell by about 1¼ 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 4½ per cent, with ~~little change~~ some rise in the savings ratio ~~as consumers react to the fall in financial wealth~~.

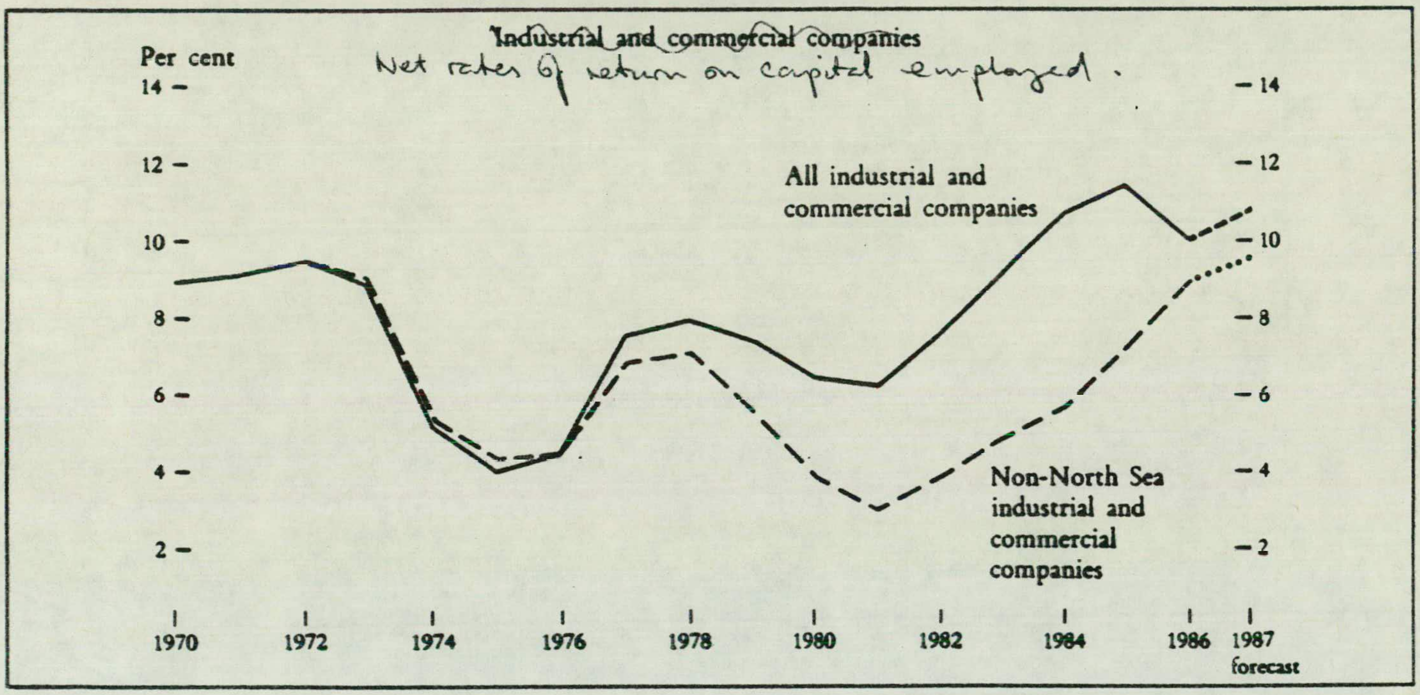
1.35 The housing market remains very buoyant. Although private housing starts have fallen back from their high first quarter levels, for the first eight months of 1987 as a whole they were 7 per cent higher than the year before, while private completions were 8½ per cent higher. With investment in improvements 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 on 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~~, below net earnings in 1985~~. 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.

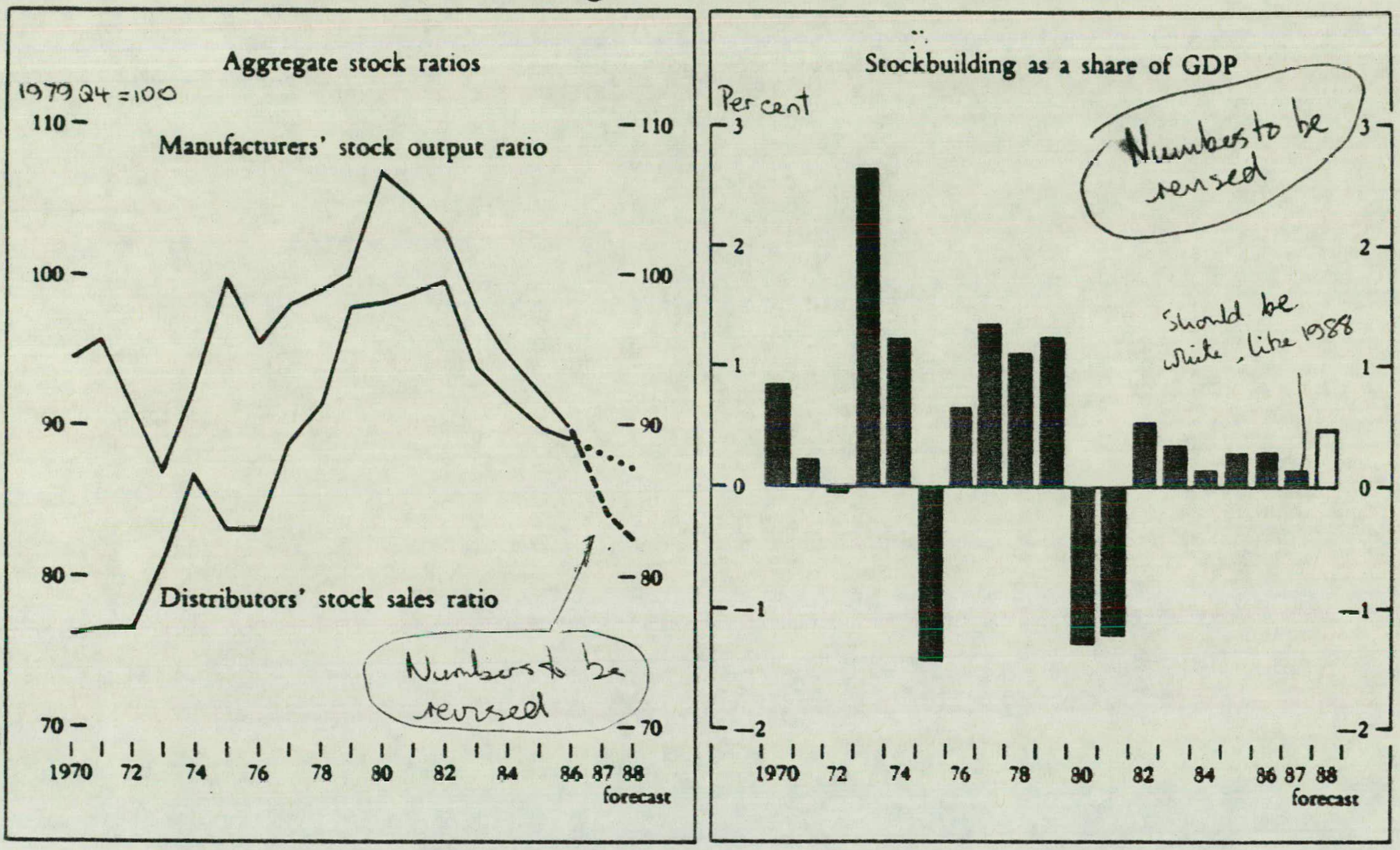
Chart 1.9 Companies' rate of return



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 ~~in 1987~~ 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 suggest ~~that~~ faster growth of manufacturing investment ~~could well accelerate~~ 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~~, and a more positive trend in stockbuilding may be in prospect~~. 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 make a small positive contribution to growth next year but~~ to remain on a modest scale compared with many years in the 1960s and 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 ~~closer to~~ 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, ~~and also~~ a smaller contribution from non-oil exports next year and some reduction in the growth of domestic demand. Growth in 1987 ~~and 1988~~ 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 ~~per cent~~ 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		
		Forecasts	
	1986	1987	1988
Domestic demand	4	4	~~4~~ 3½
Exports of goods and services[1]	3 (3½)	5½ (6½)	2½ (3½)
Imports of goods and services[1]	6 (5½)	6½ (7)	5½ (5) 4½
Domestic production: GDP[1,2]	3 (3)	4 (4½)	2½ ~~3~~ (3½)
Manufacturing production	1	5	~~4~~ 3½

[1] *Non-oil shown in brackets.*
[2] *Average measure.*

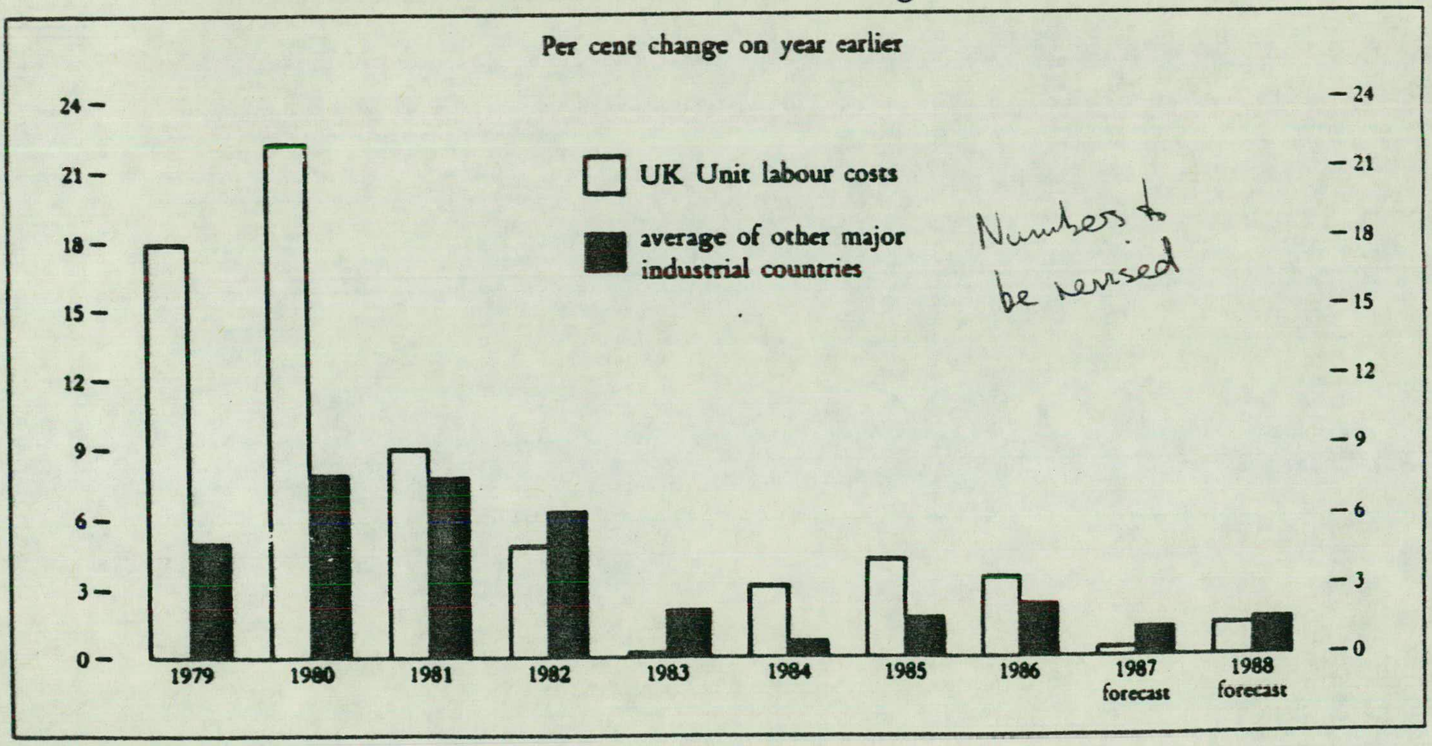
Inflation

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[1]	Estimated total unit costs[2]	Output prices[1]
1985	3½	4	4	6½
1986	4	−11	− ½	4½
1987 Partly forecast	½	5½	1½	4½
1988 Forecast	1½	~~3~~ 2½	2	4½

[1] *~~Producer prices~~ excluding food, drink and tobacco* industries.

[2] *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 given 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 electricity prices to finance the industry's investment programme there is likely to be a temporary rise in the annual rate of increase in the RPI after the first quarter of 1988. In the light of this, the forecast is for the RPI to increase by 4~~¼~~ ½ per cent over the year to the fourth quarter of 1988.

Table 1.6 Retail prices index

	Per cent changes on a year earlier			
			Forecasts	
	Weight in 1987	1986 Q4	1987 Q4	1988 Q4
Food	16½	3¼	3½	3
Nationalised industries	6	3½	2¼	6¼
Housing	15	7	7¼	~~8½~~ 7
Other	62½	2½	3½	4¼
Total	**100**	**3½**	**4**	**4~~¼~~** ½

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 ~~full-time equivalent~~ has risen by about 2 ~~1½~~ 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[1,2]	3	½ ~~(1)~~	1½ ~~(1½)~~
Whole economy[2]	2¾	1 ~~(1¼)~~	2 ~~(2¼)~~
Non-North Sea economy[2]	2¾	½ ~~(¾)~~	1¾ ~~(2)~~

[1] *Excludes public services and North Sea oil and gas extraction.*
~~[2] *Figures for output per full-time equivalent in brackets.*~~

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 ~~encouraging~~ prospects for the UK economy over the next year mean that a further ~~continued~~ 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 £9 billion. ~~Short-term interest rates remain historically high in real terms. Long-term rates throughout the world, which fell in the early part of the year, were edging up again until the stock market fall in October. In the UK, unlike the US and most other countries, the yield curve is flat.~~

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. ~~On the balance of evidence, monetary conditions remain firm.~~

This will to some extent be offset by the fall in

1.53 The sharp fall in share prices will tighten monetary conditions somewhat. Short term interest rates; ~~however~~ and ~~have fallen and~~ long term rates have also eased. On the balance of ~~the~~ evidence monetary conditions remain firm.

Fiscal developments

1.5~~3~~4 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, nearly £¾ billion lower than estimated in the 1987 FSBR. Lower central government borrowing, more than accounted for by higher than expected tax revenues, was responsible for about two-thirds of this downward revision, with the remaining one-third due to lower than expected local authority borrowing.

1.5~~4~~5 In the first six months of 1987-88 the PSBR was £1½ billion. Excluding privatisation proceeds, borrowing was about £1½ 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 FSBR. This is mainly due to higher than expected tax revenues but there is also likely to be a shortfall on the expenditure side.

1.5~~5~~6 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

~~[The forecast of the adjustment between the planning total and general government expenditure has increased by about £1½ billion since the Budget, leaving general government expenditure £½ billion lower than previously forecast.]~~

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	6·9	6·2	6·8
General government expenditure	**165·1**	**173·5**	**172·9**
of which Privatisation proceeds	−4·4	−5·0	−5·0

1.5~~6~~7 Table 1.10 shows the forecast for general government receipts. The forecast of tax and national insurance revenues has been increased by just over £2¾ billion since the Budget. The forecast of on-shore corporation tax, including ACT, is about £¾ 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 £½ 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 £½ 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 5½ 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	130·2
National insurance and other contributions	26·7	28·5	28·9
Interest and other receipts	13·3	12·6	12·3
Accruals adjustment	0·5	0·0	−0·2
Total receipts	**160·2**	**168·8**	**171·2**
of which North Sea revenues	4·8	3·9	4·5

1.5~~7~~8 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 ½ 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 Outturn	1987–88 Budget Forecast	1987–88 Latest Forecast
General government expenditure	165·1	173·5	172·9
General government receipts	160·2	168·8	171·2
General government borrowing requirement	4·9	4·7	1·7
Public corporations' market and overseas borrowing	−1·5	−0·8	−0·7
PSBR	**3·4**	**3·9**	**1·0**
PSBR as per cent of GDP	**1**	**1**	**¼**
Memorandum item:			
PSBR excluding privatisation proceeds	7·9	8·9	6·0
As per cent of GDP	2	2¼	1½

Table 1.12 Economic prospects: summary

	Forecast 1986 to 1987	Forecast 1987 to 1988	Average errors from past forecasts[1]
	per cent changes		percentage points
Output and expenditure at constant 1980 prices			
Domestic demand	4	~~4~~ 3½	1
of which:			
Consumers' expenditure	5	~~4½~~ 4	1¼
General government consumption	½	~~1~~ ½	1
Fixed investment	5½	4½	2¼
Change in stockbuilding (as per cent of level of GDP)	0	~~½~~ 0	½
Exports of goods and services	5½	~~2½~~ 2	2½
Imports of goods and services	6½	~~5½~~ 5	2¾
Gross domestic product: total	4	~~3~~ 2½	¾
manufacturing	5	~~4~~ 3	2¼
Inflation			
Retail prices index	per cent changes		
1986 Q4 to 1987 Q4	4		¼
1987 Q4 to 1988 Q4	~~4¾~~ 4½		2
Deflator for GDP at market prices	per cent changes on a year earlier		
Financial year 1987–88	4¼		1
Financial year 1988–89	4½		2
Money GDP at market prices	£ billion[2]		
Financial year 1987–88	418 ~~419~~ (~~8¾~~) 8½		1
Financial year 1988–89	448 ~~452~~ (~~7¾~~) 7¼		1½
Balance of payments on current account			
1987	−2½		1½
1988	−3½		3

[1] *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.*

[2] *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 1	**Gross domestic product at factor cost**	GDP index 1980 = 100
1982	138·4	49·6	39·5	63·1	−1·0	**289·7**	59·2	30·6	0·9	**200·8**	100·5
1983	144·0	50·6	41·6	64·4	0·7	**301·2**	62·7	31·6	0·5	**207·4**	103·9
1984	147·1	51·0	45·0	68·9	0·3	**312·2**	68·8	32·8	2·0	**212·7**	106·5
1985	152·5	50·9	46·4	72·8	0·6	**323·3**	70·7	33·9	1·7	**220·4**	110·4
1986	161·3	51·4	46·5	75·1	0·7	**335·0**	75·1	35·4	2·7	**227·1**	113·8
1987	169·~~1~~0	51·6	49·0	79·2	0·~~3~~2	**348.9**	80·0	37·1	4·3	**236·~~0~~2**	118·~~1~~3
1988	176·~~6~~0	51.9	51·2	~~81·2~~ 80.8	~~1·2~~ 0.8	**360.6**	84·~~3~~1	38·~~6~~4	4·5	**242.6**	~~122·1~~ 121.5
1986 H1	79·6	25·7	22·9	36·6	0·4	**165·2**	35·9	17·4	0·8	**112·7**	112·9
H2	81·6	25·7	23·7	38·5	0·3	**169·8**	39·2	18·0	1·9	**114·5**	114·7
1987 H1	83·0	25·6	23·9	39·0	−0·3	**171·3**	38·3	18·3	2·2	**116·~~9~~8**	117·~~0~~1
H2	86·~~2~~1	~~26·2~~ 25.9	25·1	40·1	0·~~6~~4	**177.7**	41·7	18·8	2·2	**119·~~8~~4**	119·~~9~~5
1988 H1	87·~~6~~3	~~26·2~~ 25.9	25·3	40·~~2~~1	0·~~5~~3	~~**180·0**~~ 179.0	41·7	19·1	2·2	~~**121·3**~~ 120.4	~~121·3~~ 120-6
H2	88.7	~~26·2~~ 25.9	25·9	~~41·0~~ 40.8	0·~~6~~4	**181.7**	42·~~7~~4	19·~~4~~3	2·~~3~~2	**122·~~8~~2**	122·~~8~~4

Per cent changes

1985 to 1986	6	1	½	3	—	3½	6	4½	—	3	3
1986 to 1987	5	½	5½	5½	—	4½	6½	4½	—	4	4
1987 to 1988	4~~½~~	~~1~~ ½	4½	2~~½~~	—	3½	5~~½~~	~~4½~~ 3½	—	~~3~~ 2½	~~3~~ 2½

1 The average measure of gross domestic product—the preferred measure of growth in economic activity—grew by some 3¾ 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 GDP(E).

Nigel

CONFIDENTIAL

SECRETARY OF STATE FOR EMPLOYMENT

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CHIEF SECRETARY

REC. 30 OCT 1987

ACTION Mr Gieve

COPIES TO CX Sir Peter Middleton Sir Terence Burns Mr Butler Mr Anson Mr Monck Mr Burgner Mr Luce Mr Scholar Mr Turnbull Mr Sedgwick Mr Mowl Mrs Butler Mr Pratt Mr Gray Miss S Walker Mr G C White

Max Felstead
Chief Secretary's Office
H M Treasury
Great George Street
London
SW1

30 October 1987

Dear Max

AUTUMN STATEMENT

I enclose a copy of the Press Notice we intend to issue on Tuesday.

It has been approved by my Secretary of State and incorporates amendments suggested by him.

Yours

Peter Baldwinson

Peter Baldwinson
Private Secretary

CONFIDENTIAL

DRAFT PRESS RELEASE

The public expenditure figures for the Department of Employment Group are published today.

The Rt Hon Norman Fowler, Secretary of State for Employment, said:

"Total provision for the Department of Employment Group in 1988/89 is broadly unchanged at £4250m, rising to £4360m in 1990/91.

Unemployment has now fallen for 15 successive months and by a record 400,000 over the last year with particularly significant reductions in unemployment among young people. I am therefore taking this opportunity to reassess priorities, particularly in the employment and training area and I am carrying out a review of adult training.

The top priority must be to tackle long term unemployment both through the new Employment Service and the Manpower Services Commission's programmes. In the Employment Service Restart counselling will be available for all people who have been unemployed for six months and at six monthly intervals thereafter. Provision is also being made for a further expansion of Jobclubs.

The Manpower Services Commission will continue to expand the new Job Training Scheme and will improve the training provide within the Community Programme for long term unemployed. The development of these programmes will help us to meet our Manifesto commitments to guarantee opportunities for all 18-25 year olds who have been unemployed for six to 12 months and to aim to provide more opportunities for those under 50 who have been unemployed for over two years.

Expenditure on YTS is being increased to give effect to the guarantee of a place for all unemployed 16 and 17 year olds. A measure of the growing success of YTS is that school leaver unemployment was at its lowest this September than in any September for 13 years.

As part of this reordering of priorities, it has been decided that the Job Release Scheme and the New Workers Scheme will be closed for applications on 31 January 1986. The coverage of the Job Release Scheme has been in decline for some time, from a peak of 95,000 to the current figure of 20,000. Take-up of the New Workers Scheme has been disappointing and has now dropped to 18,000. Neither scheme specifically helps the long term unemployed and neither involves any training. I have therefore decided that the resources devoted to these programmes can be better used on other programmes which provide training for unemployed people.

There will be further increases in the Department's assistance for small firms and tourism to support the continued growth of employment in these important and expanding sectors.

The Health and Safety Commission are getting a substantial increase on the previously planned provision for 1988/89 which was itself an increase on the 1987/88 expenditure. This means they will be fully able to maintain their inspection standards."

CE40

RD

SECRET

FROM: M C SCHOLAR
DATE: 30 OCTOBER 1987

Prep

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary (all chapters)
Financial Secretary "
Paymaster General "
Economic Secretary "
Sir Peter Middleton "
Sir Terence Burns "
Mr F E R Butler "
Mr Cassell "
Mr Sedgwick "
Mr Peretz (Chapter 1)
Mr Turnbull (Chapters 1 & 2)
Miss Peirson (Chapter 3)
Mr S J Davies (Chapters 1 & 2)
Mr Gieve (Chapters 1 & 2)
Mr Mowl (Chapters 1 & 2)
Mr Hibbard (Chapters 1 & 2)
Miss O'Mara (all Chapters)
Mr McIntyre (Chapter 3)
Mr R I G Allen (all Chapters)
Miss C Evans

Phone numbers

	Work	Home
Michael Scholar	4419	01 - 690 3491
Margaret O'Mara	4549	01 - 668 2681
Carys Evans	5170	— should be @ work on Saturday.

Ch
Numbers above for people to contact.
AA

Spoken over w/e.

AUTUMN STATEMENT: FINAL PROOFS

... I attach the Autumn Statement book proof. These incorporate your amendments to the first proofs together with some other changes mentioned below. We shall be checking the text and numbers this evening and tomorrow morning before returning the proofs to the printer by noon tomorrow. This is now the last opportunity to make significant changes although minor corrections can be taken on board at read at press (8am on Monday). We need therefore to have your comments on the attached by early tomorrow.

Chapter 1

2. We have changed the reference to the exchange rate in paragraph 1.21 as you agreed with Sir Terence Burns. We have also suggested a slight change to the reference to interest rates in paragraph 1.53, in order to avoid any possible implication that we are foreshadowing a further fall in interest rates.

Table
1.38, 1.8, 2.19, 2.24, 2.38,

3. We have amended the figure in the second line of paragraph 1.33, because the recorded increase in consumers' expenditure referred to in the first sentence rounds to 6 per cent, not 5½ per cent. (This can be worked out from Table 1.13.)

4. We have revised paragraph 1.45 in the light of your response to Mr Monck's minute of today.

5. Reserves figures for October will be published at 11.30am on the morning of the AS. Paragraph 1.50 as it stands show the recorded "underlying" growth in the Reserves over the past eight months in sterling. Published figures for the Reserves are in dollars: there is no published source for the "underlying" increase in sterling. The text therefore shows the increase in dollars not sterling, and takes account of the October figures.

What are they ?!

Chapter 2

6. We have incorporated the BP/Issue Department footnote to Table 2.3 as agreed at your meeting this afternoon.

MCS

M C SCHOLAR

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

Ordered by the House of Commons to be printed 3 November 1987

HER MAJESTY'S STATIONERY OFFICE LONDON

£5·10

House of Commons No. 110

Contents

Tables and charts

✓EA

1 Economic prospects for 1988

Summary

1.01 GDP is forecast to grow by 2½ 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 2½ 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 4½ 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 2½ 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 ½ 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 ¾ 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 $2\frac{1}{2}$ per cent, but recently growth appears to have strengthened a little.

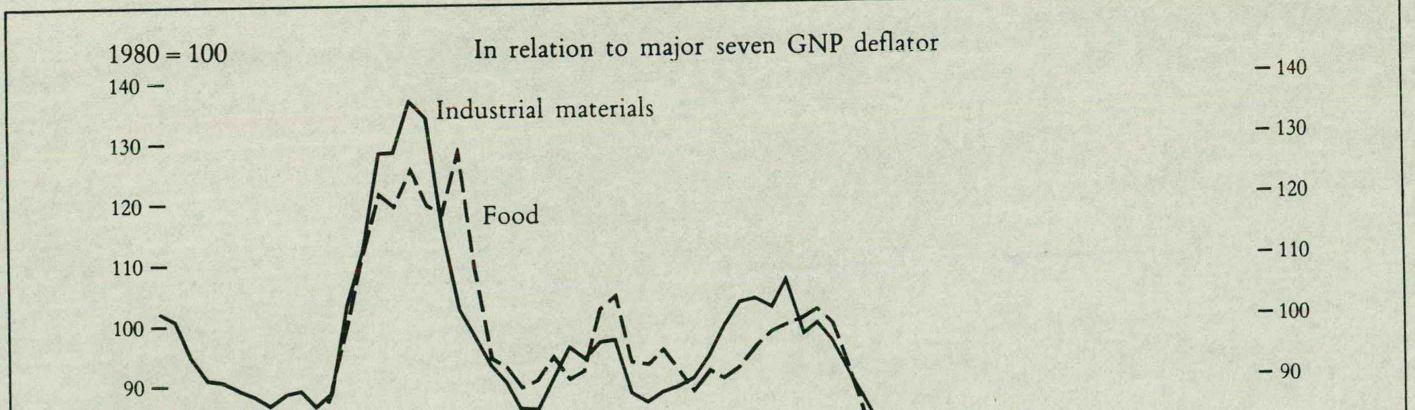
1.09 The weakness in world growth was largely due to the difficulties of adjusting both to the collapse in oil prices in early 1986 and to large changes in exchange rates. Lower oil prices led oil exporters to cut back their imports sharply. Moreover, with many non–oil commodity prices falling to their 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

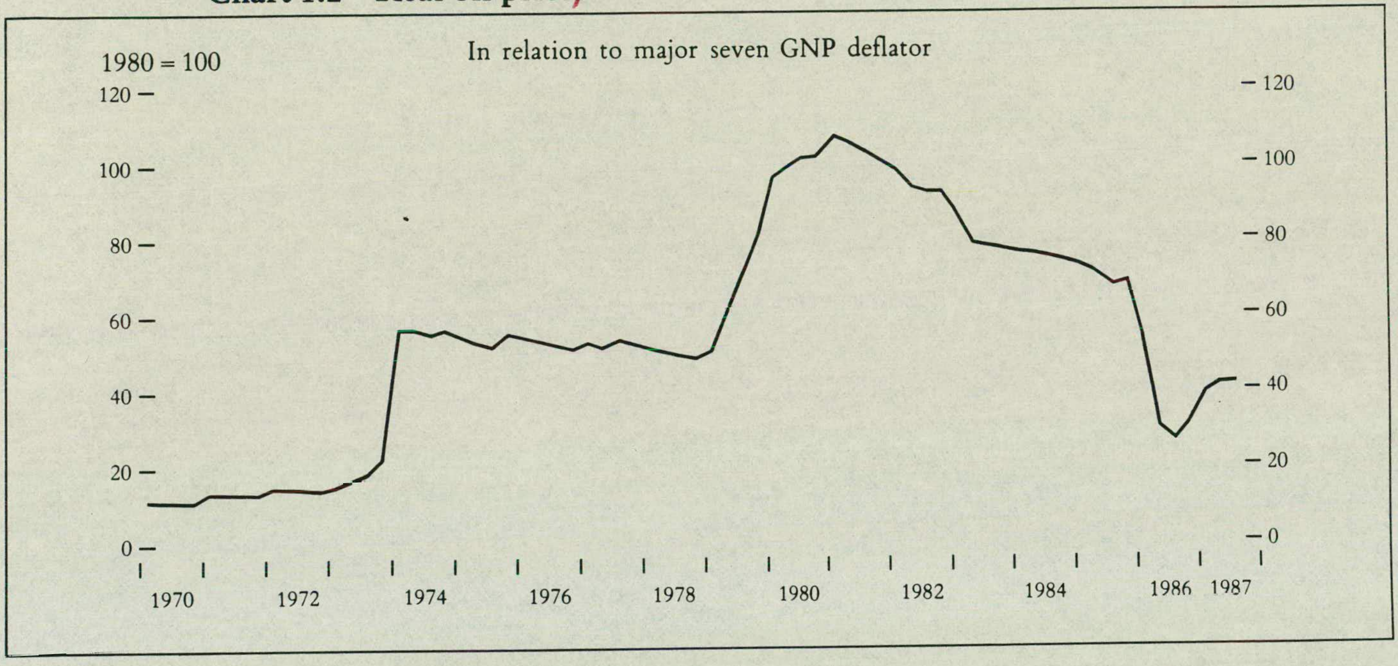


1.13 The current account surpluses of Japan and, to a lesser extent, Germany have now started to decline. In the United States, trade volumes are responding to the decline in the dollar, but the current account is taking longer to turn round.

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.

X

Chart 1.2 Real oil prices



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		
		Forecasts	
	1986	1987	1988
Major seven countries[1]:			
Real GNP	2¾	2½	2
Real domestic demand	3¾	2¾	2
Industrial production	1	3	3¼
Consumer prices	2	2¾	2¾
World trade, at constant prices			
Total imports	4¾	3½	3½
Total trade in manufactures[2]	2	3¾	4

[1] *US, Japan, Germany, France, UK, Italy and Canada.*
[2] *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.

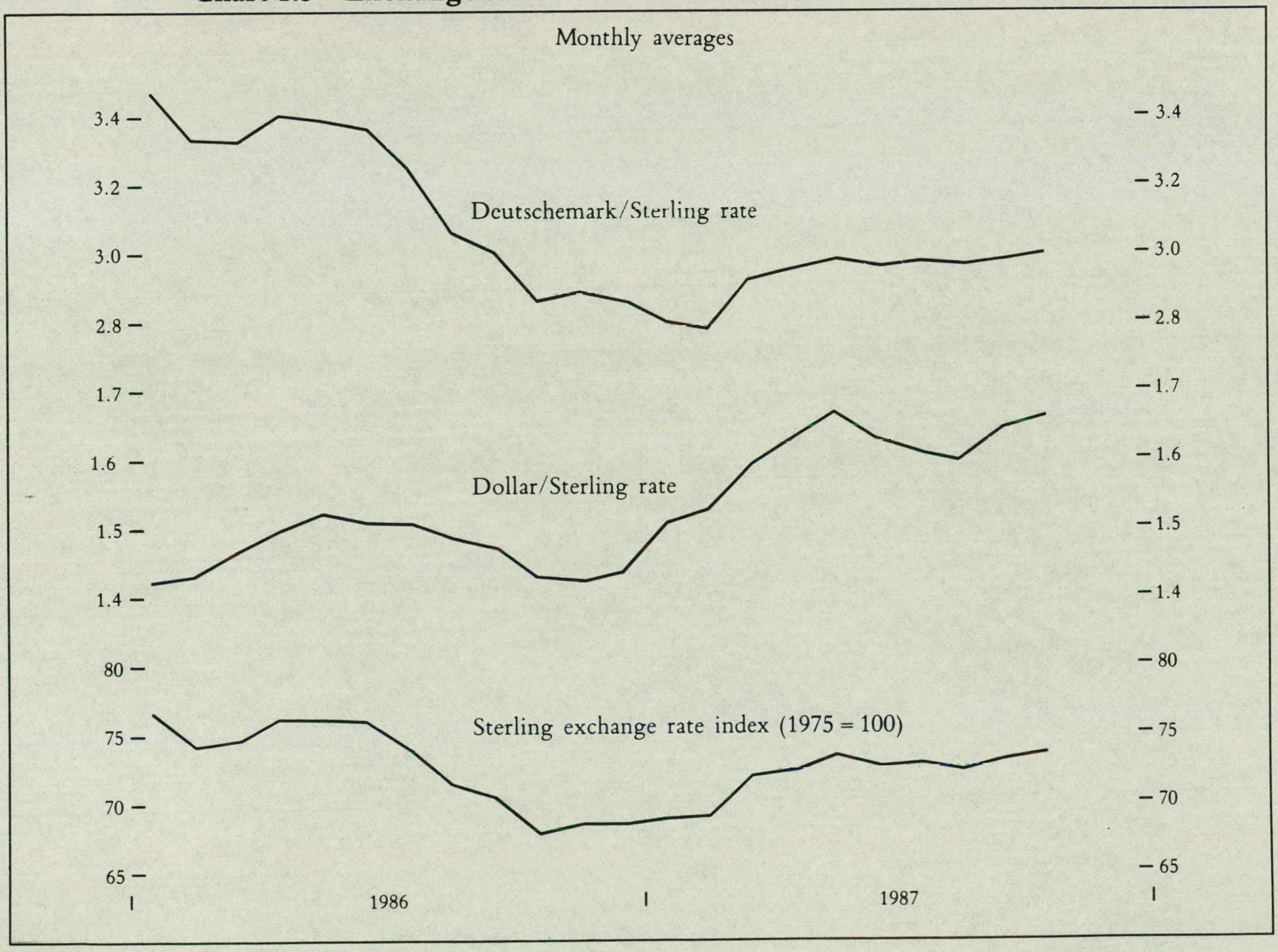
1.17 Equity prices seem to have been a significant factor behind the continued strength of consumer demand in the US. Following recent sharp falls in equity prices some slowdown in US domestic demand is forecast, despite lower interest rates. The recent fiscal package in Japan and the tax cuts planned 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 $3\frac{1}{2}$ 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
for most of the period since

1.21 Exchange rates between major currencies have been broadly stable ~~following~~ 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.

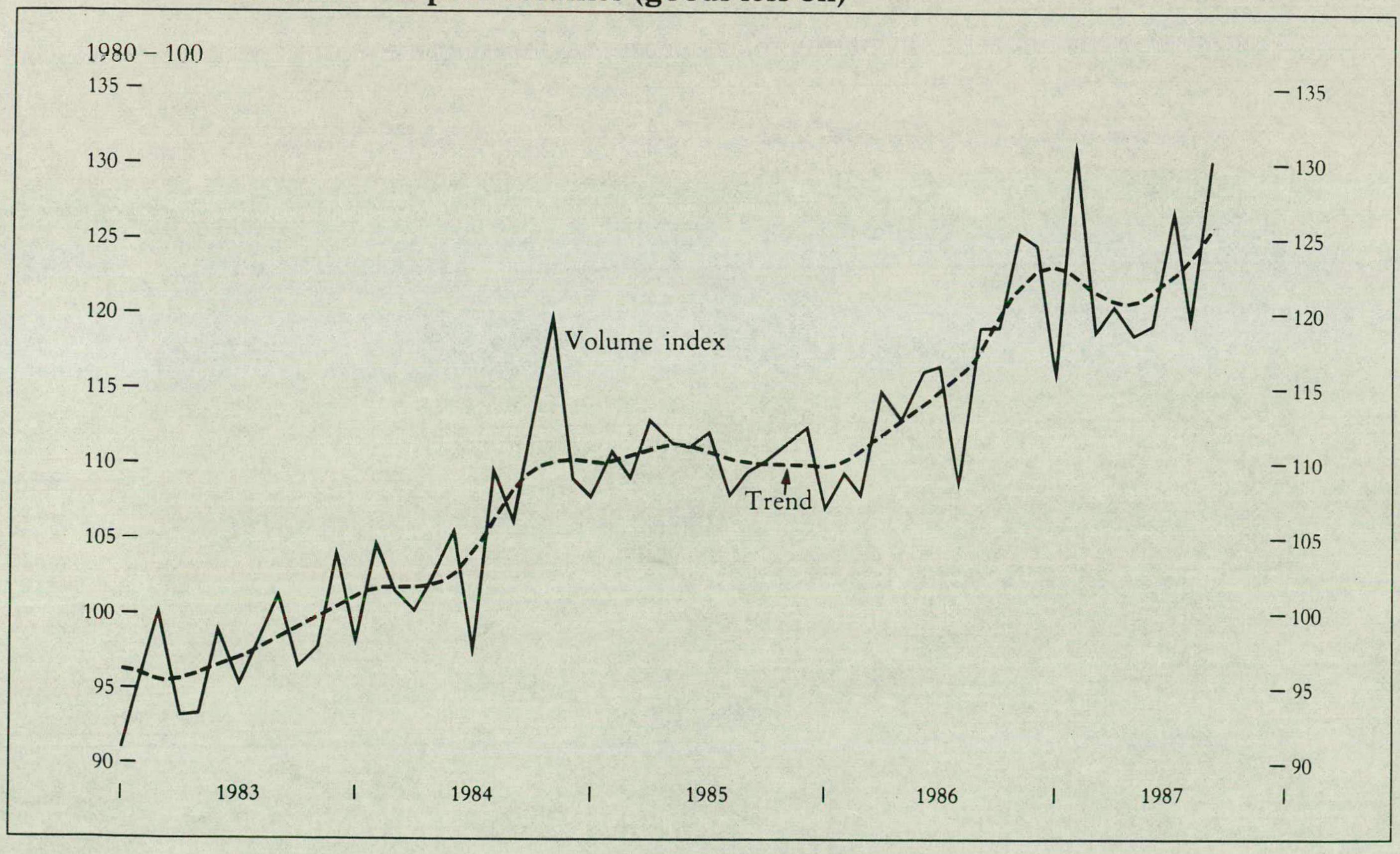
Relative costs and prices

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

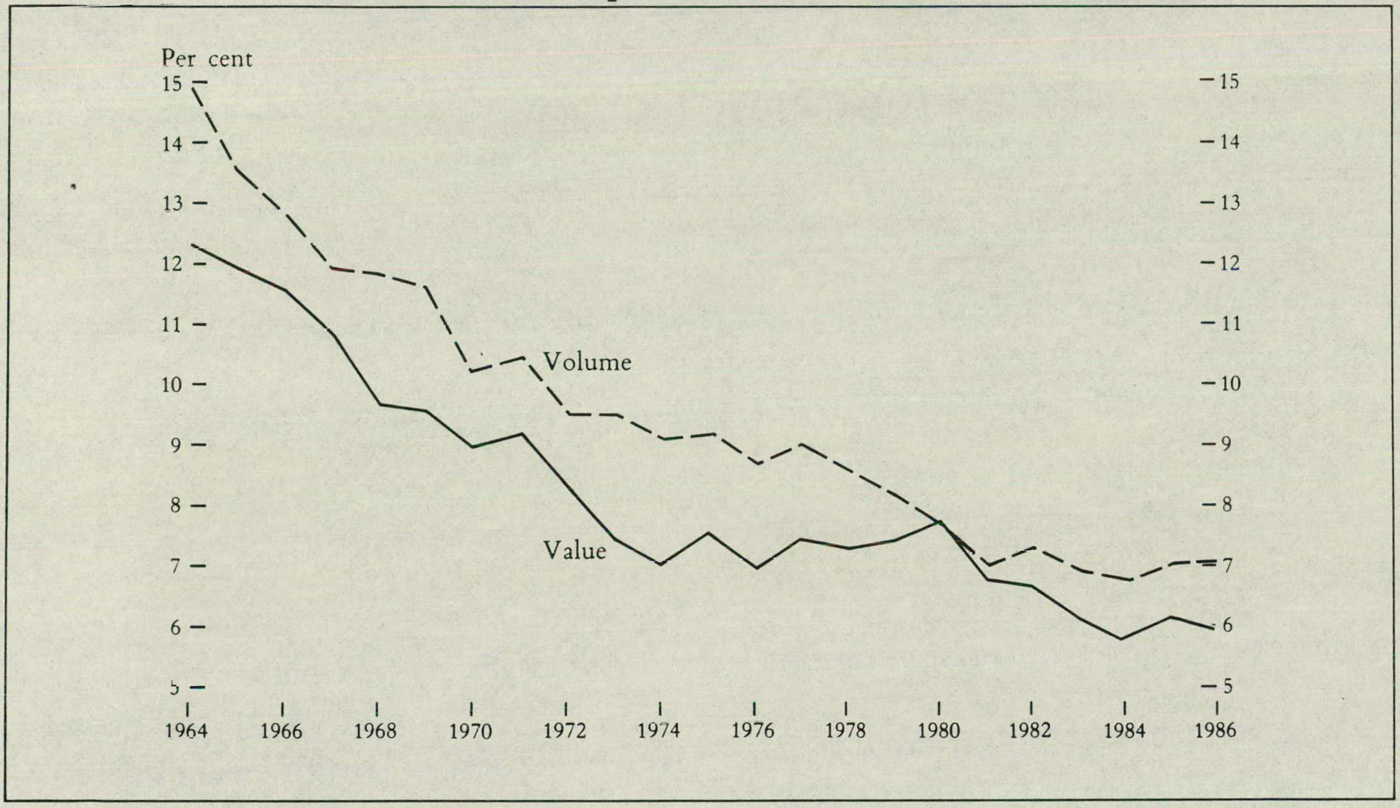
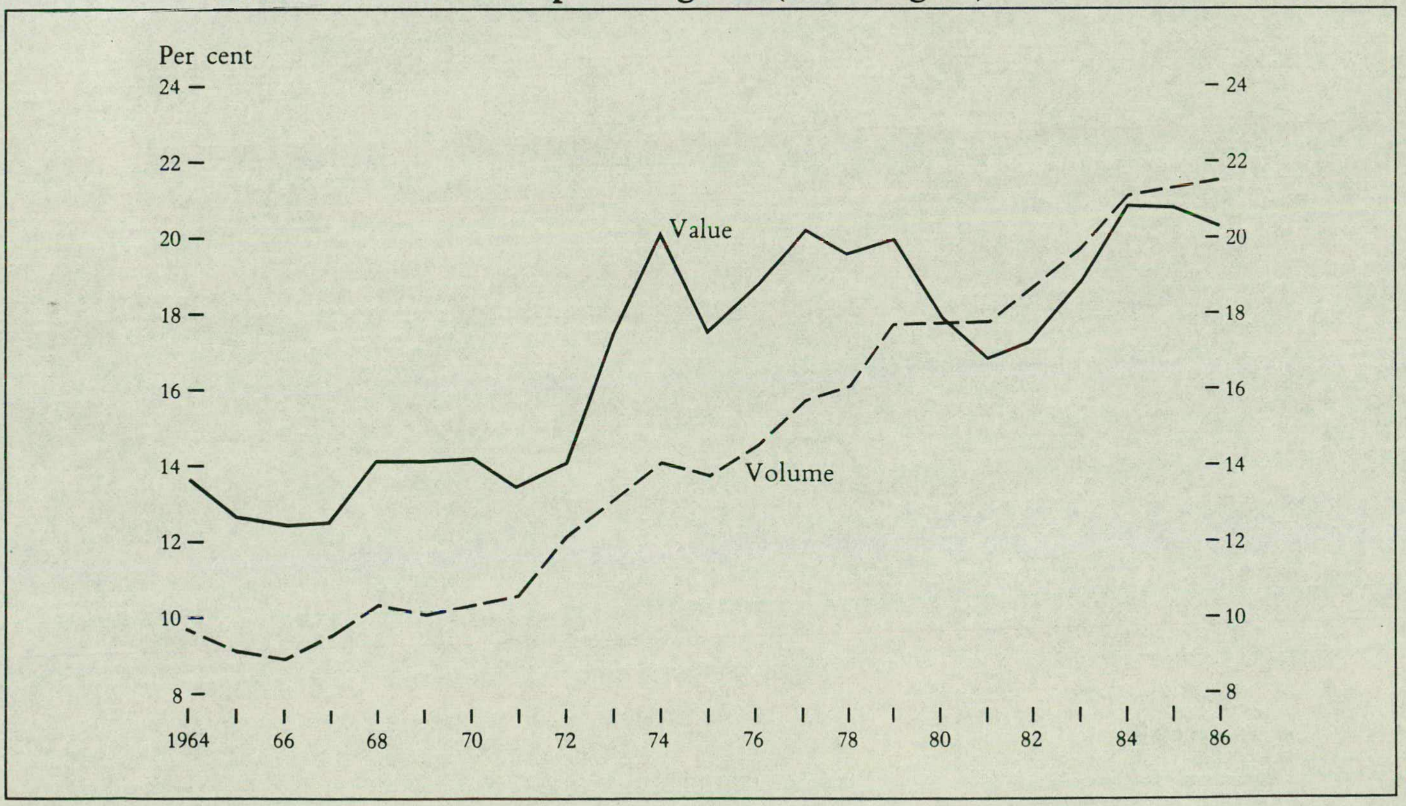


Chart 1.6 Share of imports of goods (excluding oil) in total domestic demand



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.

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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.

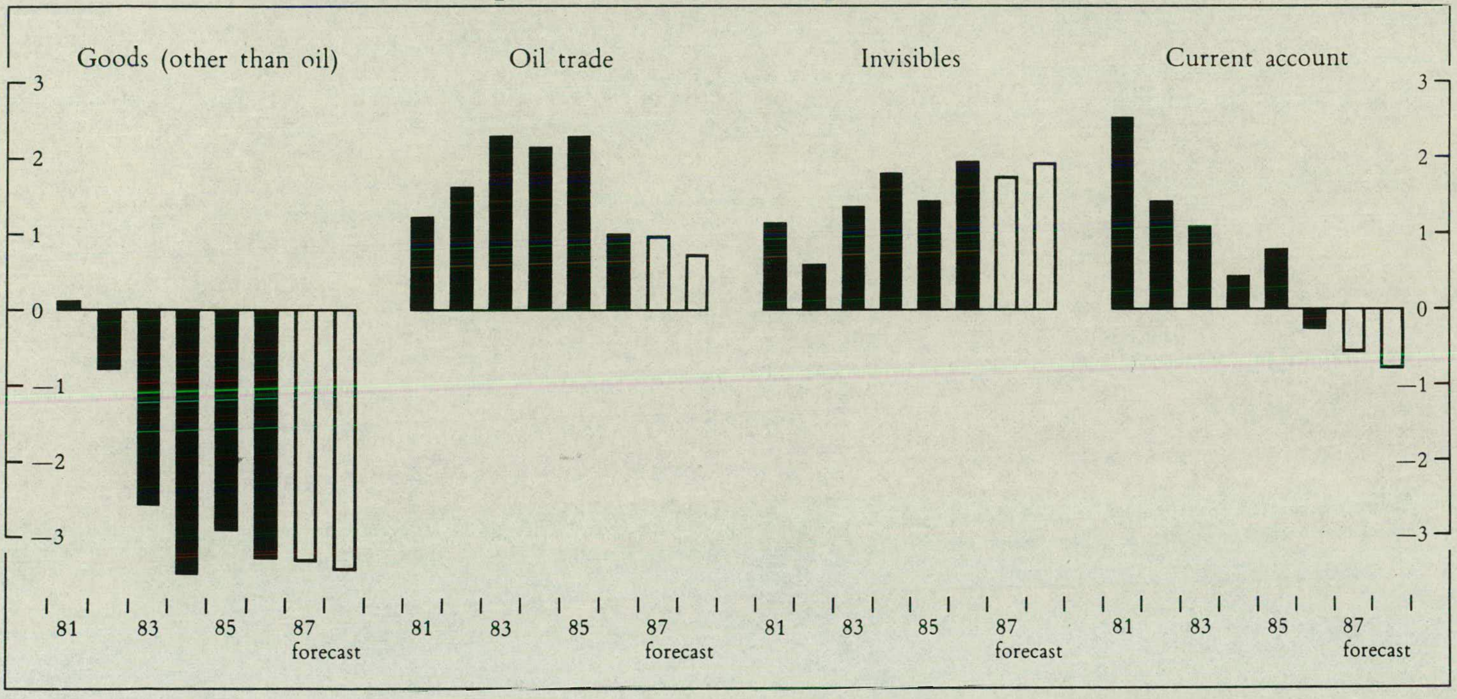
Table 1.3 Current account

	£ 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

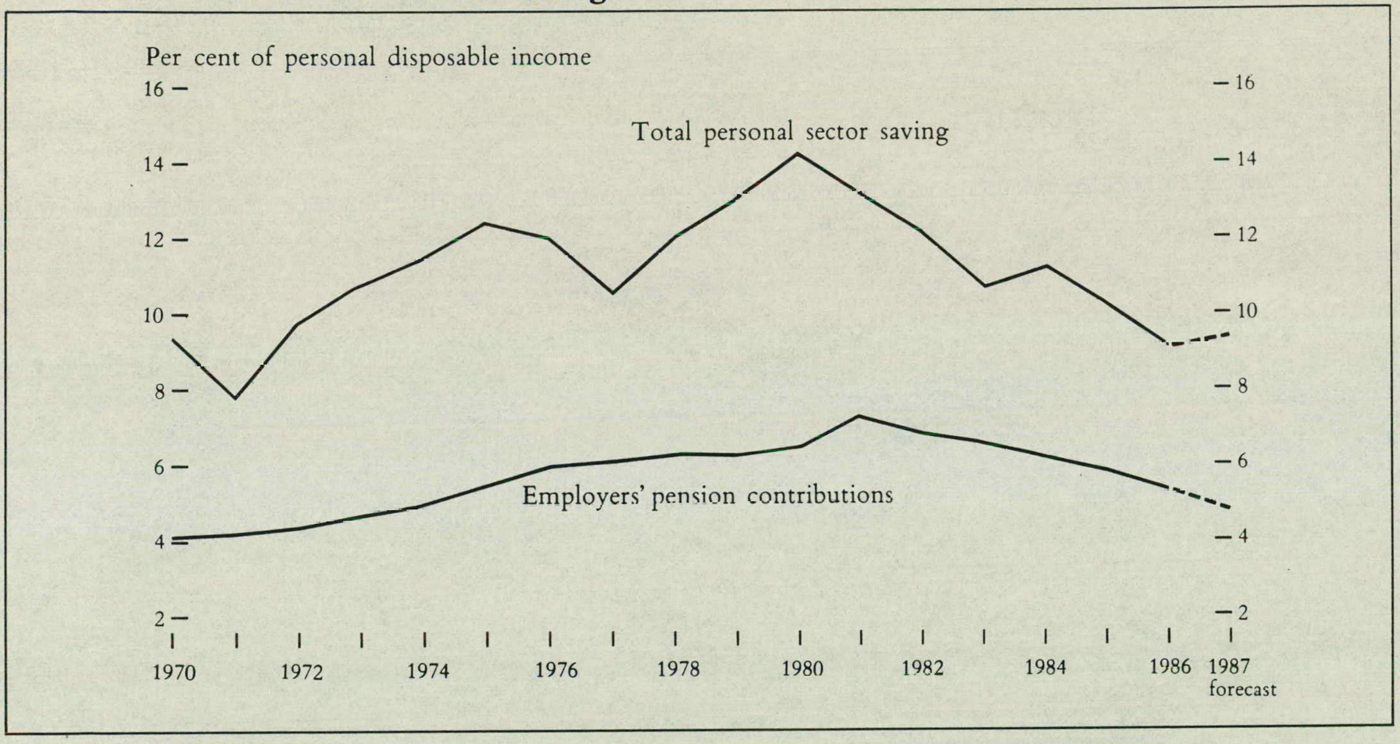
1.31 The UK economy has been growing steadily at around 3 per cent a year on average since early 1981, with only minor fluctuations. Over the year to the first half of 1987 growth has been above this average rate, at close to 4 per cent.

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 ~~5½~~ 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.

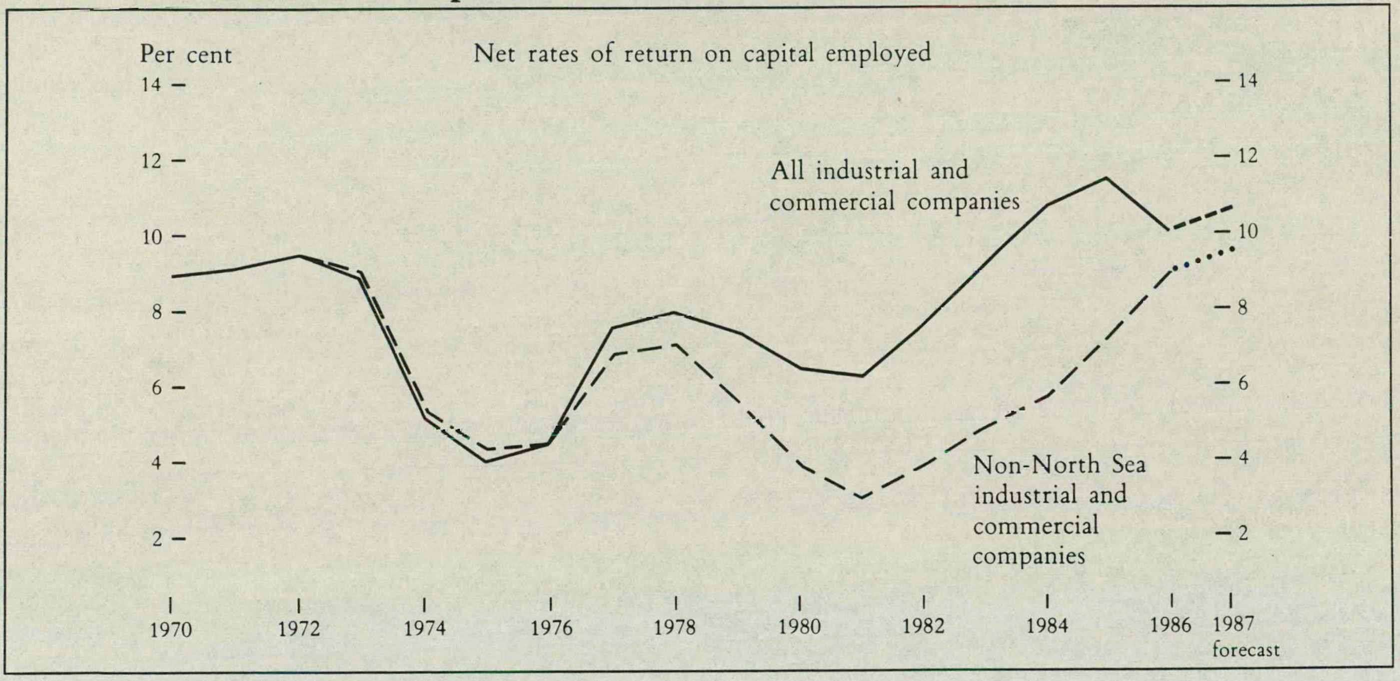
1.35 The housing market remains very buoyant. Although private housing starts have fallen back from their high first quarter levels, for the first eight months of 1987 as a whole they were 7 per cent higher than the year before, while private completions were $8\frac{1}{2}$ per cent higher. With investment 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 on 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.

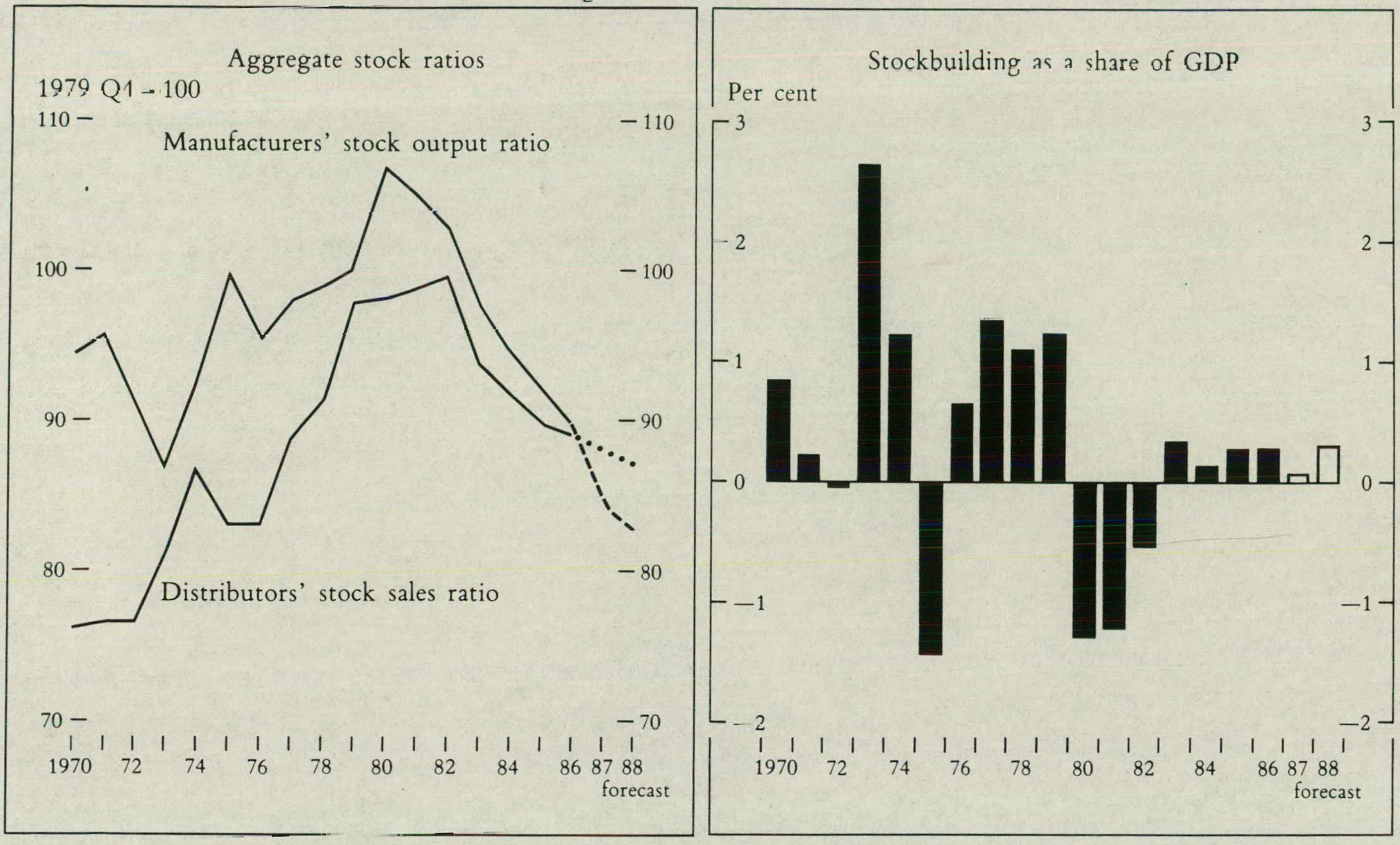
Chart 1.9 Companies' real rates of return



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 ~~1960s and~~ 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		
		Forecasts	
	1986	1987	1988
Domestic demand	4	4	3½
Exports of goods and services[1]	3 (3½)	5½ (6½)	2 (3)
Imports of goods and services[1]	6 (5½)	6½ (7)	5 (4½)
Domestic production: GDP[1,2]	3 (3)	4 (4½)	2½ (3)
Manufacturing production	1	5	3½

[1] *Non-oil shown in brackets.* [2] *Average measure.*

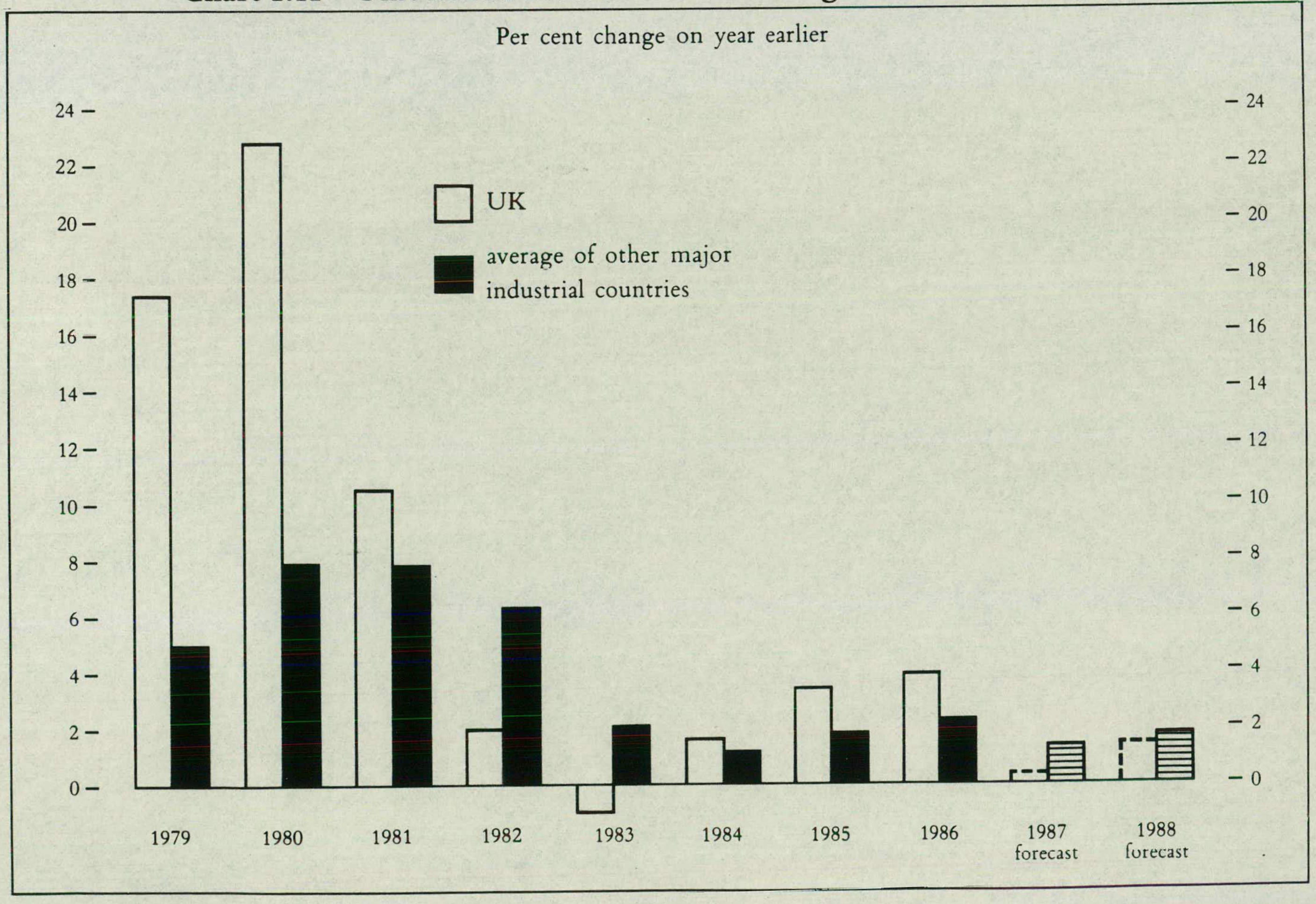
Inflation

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 $2\frac{1}{2}$ 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 $7\frac{1}{2}$ per cent at the start of the year to $7\frac{3}{4}$ 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[1]	Estimated total unit costs[2]	Output prices[1]
1985	3½	4	4	6½
1986	4	−11	−½	4½
1987 Partly forecast	½	5½	1½	4½
1988 Forecast	1½	2	2	4½

[1] *Producer prices excluding food, drink and tobacco industries.* [2] *Including costs of bought in services.*

there is likely to be a temporary rise after the first quarter of 1988. This reflects

1.45 Retail price inflation is expected to fall below 4 per cent by the end of the fourth quarter of 1987, but ~~given~~ 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 ~~electricity prices to finance the industry's investment programme there is likely to be a temporary rise in the annual rate of increase in the RPI after the first quarter of 1988. In the light of this,~~ the forecast is for the RPI to increase by 4½ per cent over the year to the fourth quarter of 1988.

increases in nationalised industry prices in 1988 after the fall in real terms this year in order to improve profitability and help finance investment.

Table 1.6 Retail prices index

	Weight in 1987	Per cent changes on a year earlier		
			Forecasts	
		1986 Q4	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
Total	**100**	**3½**	**4**	**4½**

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 $2\frac{1}{2}$ 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	$3\frac{3}{4}$	$\frac{3}{4}$	4
Non-manufacturing[1]	3	$\frac{1}{2}$	$1\frac{1}{2}$
Whole economy	$2\frac{3}{4}$	1	2
Non-North Sea economy	$2\frac{3}{4}$	$\frac{1}{2}$	$1\frac{3}{4}$

[1] *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 ~~£9~~ $16 billion.

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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 ~~a~~ 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, nearly £¾ billion lower than estimated in the 1987 FSBR. Lower central government borrowing, more than accounted for by higher than expected tax revenues, was responsible for about two-thirds of this downward revision, with the remaining one-third 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 FSBR. 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 Outturn	1987–88	
		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·~~9~~8	6·2	6·7
General government expenditure	**165·1**	**173·5**	**172·8**
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 $5\frac{1}{2}$ per cent in 1986–87 (when North Sea revenues more than halved).

Table 1.10 General government receipts

	£ billion		
	1986–87 Outturn	1987–88	
		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	13·3	12·6	12·3
Accruals adjustment	0·5	0·0	−0·2
Total receipts	**160·2**	**168·8**	**171·1**
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 ½ 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	160·2	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
PSBR	**3·4**	**3·9**	**1·0**
PSBR as per cent of GDP	**1**	**1**	**¼**
Memorandum item:			
PSBR excluding privatisation proceeds	7·9	8·9	6·0
As per cent of GDP	2	2¼	1½

Table 1.12 Economic prospects: summary

	Forecast		Average errors from past forecasts[1]
	1986 to 1987	1987 to 1988	
	per cent changes		percentage points
Output and expenditure at constant 1980 prices			
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
Inflation			
Retail prices index	per cent changes		
1986 Q4 to 1987 Q4	4		¼
1987 Q4 to 1988 Q4	4½		2
Deflator for GDP at market prices	per cent changes on a year earlier		
Financial year 1987–88	4¼		1
Financial year 1988–89	4½		2
Money GDP at market prices	£ billion[2]		
Financial year 1987–88	418 (8½)		1
Financial year 1988–89	448 (7¼)		1½
Balance of payments on current account			
1987	−2½		1½
1988	−3½		3

[1] *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.*

[2] *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**[1]	GDP index 1980 = 100
1982	138·4	49·6	39·5	63·1	−1·0	**289·7**	59·2	30·6	0·9	**200·8**	100·5
1983	144·0	50·6	41·6	64·4	0·7	**301·2**	62·7	31·6	0·5	**207·4**	103·9
1984	147·1	51·0	45·0	68·9	0·3	**312·2**	68·8	32·8	2·0	**212·7**	106·5
1985	152·5	50·9	46·4	72·8	0·6	**323·3**	70·7	33·9	1·7	**220·4**	110·4
1986	161·3	51·4	46·5	75·1	0·7	**335·0**	75·1	35·4	2·7	**227·1**	113·8
1987	169·0	51·6	49·0	79·2	0·2	**348·9**	80·0	37·1	4·~~3~~4	**236·~~2~~** 3	118·3
1988	176·0	51·9	51·2	80·~~8~~9	0·8	**360·~~6~~** 7	84·1	38·4	4·5	**242·~~6~~** 7	121·~~5~~6
1986 H1	79·6	25·7	22·9	36·6	0·4	**165·2**	35·9	17·4	0·8	**112·7**	112·9
H2	81·6	25·7	23·7	38·5	0·3	**169·8**	39·2	18·0	1·9	**114·5**	114·7
1987 H1	83·0	25·6	23·9	39·0	−0·3	**171·3**	38·3	18·3	2·2	**116·~~8~~** 9	117·1
H2	86·1	25·9	25·1	40·1	0·4	**177·7**	41·7	18·8	2·2	**119·4**	119·~~5~~6
1988 H1	87·3	25·9	25·3	40·1	0·3	**179·0**	41·7	19·1	2·2	**120·~~4~~** 5	120·~~6~~7
H2	88·7	25·9	25·9	40·8	0·4	**181·7**	42·4	19·3	2·2	**122·2**	122·4
	Per cent changes										
1985 to 1986	6	1	½	3	—	3½	6	4½	—	3	3
1986 to 1987	5	½	5½	5½	—	4	6½	4½	—	4	4
1987 to 1988	4	½	4½	2	—	3½	5	3½	—	2½	2½

[1] *The average measure of gross domestic product—the preferred measure of economic activity—grew by some 3¾ 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.

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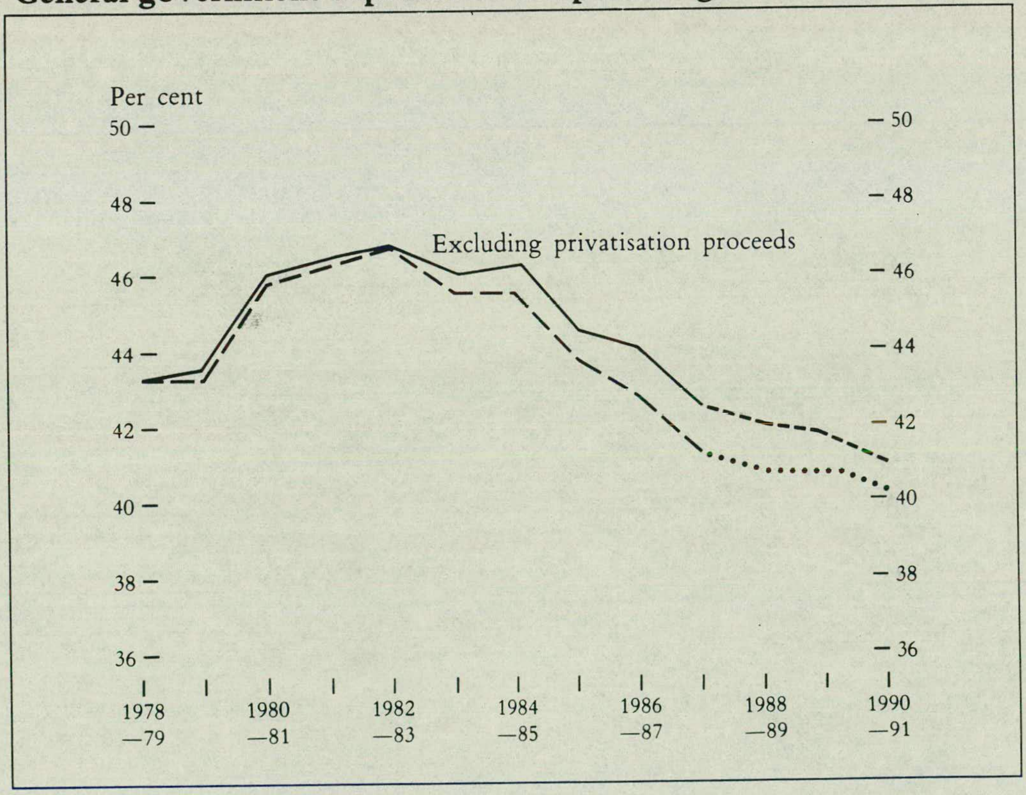
2 Public expenditure plans

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**

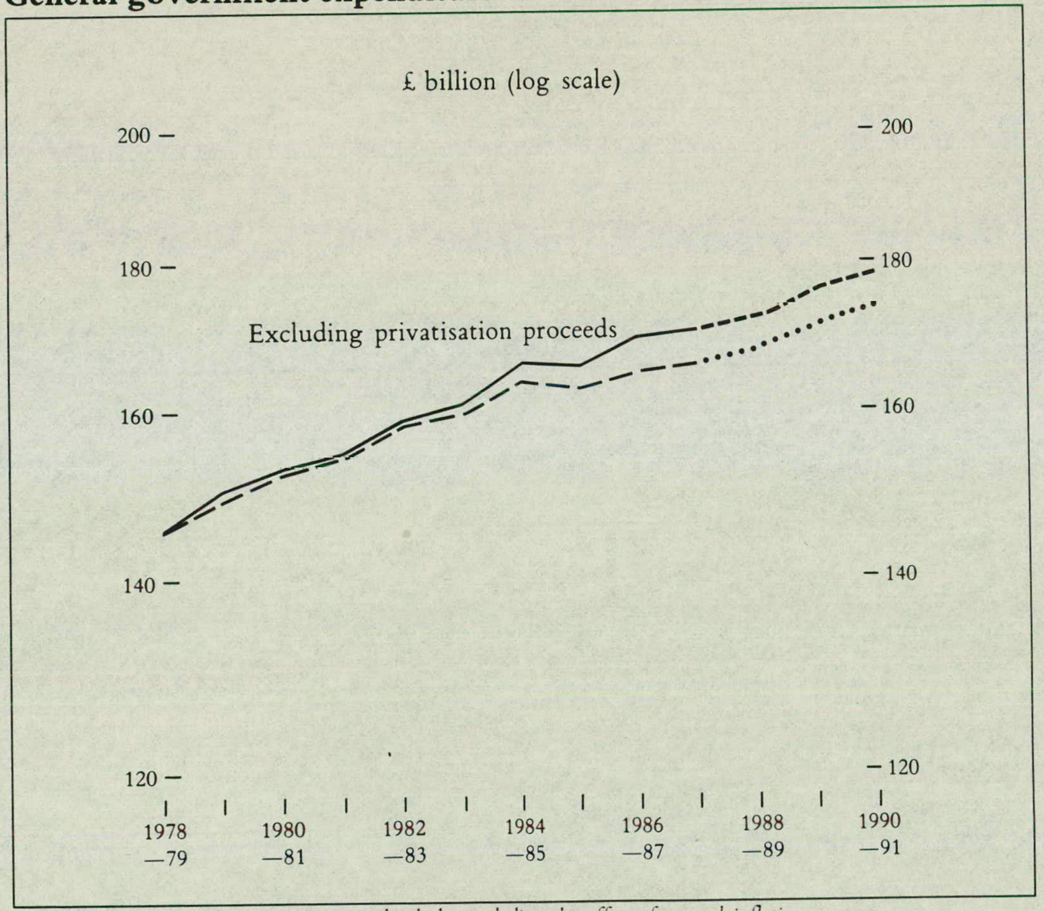


2.03 In real terms, the average growth in general government expenditure excluding privatisation proceeds in the four years from 1986–87 to 1990–91 is expected to be 1¼ per cent a year. This compares with growth averaging almost 3 per cent in the decade up to 1978–79, around 2¼ per cent in the four years 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 roads. 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[1]



1. 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[1]

	£ billion					
	Planning total		General government expenditure		General government expenditure (excluding privatisation proceeds)	
	Cash	Real terms[2]	Cash	Real terms[2]	Cash	Real terms[2]
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

[1] *Estimated outturn for 1987–88; plans for 1988–89 onwards.*

[2] *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 in1989–90. 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 ~~the~~ 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 projection~~s~~ 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.

Table 2.3 Public expenditure[1, 2]

	£ 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[4]	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[5]	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[7]	−600
Adjustment[6]	0	350	350
Planning total	**139 413**	**147 600**	**8 200**
General government gross debt interest	17 409	17 800	400
Other national accounts adjustments	8 298	7 400	−900
General government expenditure	**165 120**	**172 800**	**7 700**

[1] *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.*

New plans			Change from January 1987 White Paper[3]			
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[4]
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 2~~4~~50	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 ~~440~~	Home Office
970	1 040	1 100	0	30	30	Legal departments[5]
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	~~8 610~~ 8600	~~8 780~~ 8770	260	400 ~~410~~	380 ~~390~~	Scotland
3 4~~6~~50	3 550	3 660	120	150 ~~160~~	160	Wales
5 130	5 310	5 470	20	90	110	Northern Ireland
2 460	2 600	~~2 670~~ 2690	100	160	180	Chancellor's departments
1 640	1 660	1 730	− 90	10	− 40	Other departments
3 500	7 000	10 ~~0~~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[6]
156 800	**167 100**	**176 100**	**− 1 000**	**2 600**	**5 600**	**Planning total**
* **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
183 000	**193 200**	**202 100**	**− 800**	**3 300**	**5 400**	**General government expenditure**

[2] *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.*
[3] *Plans as set out in the last public expenditure White Paper (Cm 56) adjusted for minor changes of classification and allocation.*
[4] *Includes Intervention Board for Agricultural Produce and Forestry Commission.*
[5] *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.*
[6] *An adjustment for the difference between the assessment of the likely outturn for 1987–88 and the sum of the other items shown.*

7. ~~See Footnote to Table 1.9~~.
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 [illegible] general government expenditure, and the PSBR by the same

* * not in GGD

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

departmental

management and the costs of moving to new 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 ~~renovation and repair~~, and for gross capital expenditure by local authorities. (maintenance)

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

n t

~~N~~ew ~~T~~owns. 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

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environmental research programmes are offset by higher receipts of ~~N~~ew

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t

~~T~~owns. 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 hospitals and community health services. In addition, health authorities will have available extra cash generated by a new programme for increasing hospital income from non-NHS sources. Health authorities will have available ~~also~~ 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). 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 ~~4·5~~ 4½ per cent in the year to September 1988 (for the upratings in April 1989) and by ~~3·25~~ 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~~ 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 ~~3·9~~ per cent, ~~3·2~~ per cent and 3·0 per cent. The allocation to services is based broadly on local authorities' budgets for 1987–88. 3·5 3·3

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 ~~as to over 90 per cent~~ 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 £~~372~~ million in 1988–89, ~~25~~ 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. This figure includes provision for ~~a number of~~ industries which are candidates for privatisation.

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 financ~~e~~ing limits for the nationalised industries 1988–89

	£ million[1]
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
Total	**687**

[1] *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 ~~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[1]

	£ 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
Central government									
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 ~~630~~ 550	18 450	19 330	330	700	790
DHSS—Social security	40 973	42 700	1 700	44 ~~9~~5 00	47 ~~4~~9 00	49 ~~8~~2 00	300	~~1 000~~ 650	~~1 900~~ 1400
Scotland[2]	3 310	3 500	190	3 600	3 780	3 920	70	50	120
Wales[2]	1 453	1 560	100	1 680	1 720	1 780	40	100	90
Northern Ireland[2]	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	~~1 650~~ 1640	~~1 670~~ 1660	~~1 740~~ 1730	−90	~~20~~ 10	~~−30~~ −40
Total central government	**104 768**	**110 100**	**5 300**	**114 ~~7~~2 00**	**120 ~~6~~2 00**	**~~125 300~~** 124,700	**1 700**	**~~3 300~~** 2900	**~~4 800~~** 4400

[1] *See footnotes to Table 2.3.* [2] *See paragraph 2.26.*

Table 2.6 Local authority spending[1]

	£ 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	−50	−40
DOE—Housing	1 274	1 140	−130	1 690	1 540	1 460	−660	50	−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	230	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	4010 ~~3 720~~	4250 ~~3 980~~	~~4 100~~ 4490	160	~~140~~ 430	~~200~~ 470
Scotland[2]	3 942	4 330	380	4 510	4 620	4 760	130	170	150
Wales[2]	1 539	1 680	140	1 690	1 730	1 790	80	50	60
Northern Ireland[2]	716	700	−20	740	770	790	0	10	10
Total	**37 932**	**40 900**	**3 000**	**42 ~~600~~** 700	**43 900**	**45 200**	**800**	**1 500**	**1 600**
of which:—									
Relevant expenditure[3]	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

[1] *See footnotes to Table 2.3.* [2] *See paragraph 2.26.* [3] *Public expenditure relevant for Aggregate Exchequer Grant.*

Table 2.7 Public corporations[1,2]

	£ 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[3]	484	390	−90	400	200	90	60	170	110
Northern Ireland[3]	329	390	60	380	370	380	0	10	10
Other	77	90	10	~~−10~~ 90	~~−~~90	~~−~~90	0	0	0
Total	**1 115**	**~~1 200~~** 1230	**~~100~~** 110	**~~1 400~~** 1480	**980**	**710**	**−380**	**200**	**100**
of which:—									
Nationalised industries	387	590	200	690	−30	−390	−100	340	20
Other public corporations	729	640	−90	~~710~~ 790	1 010	1 090	−300	−150	70

[1] *See footnotes to Table 2.3.*

[2] *For nationalised industries and most public corporations, the planning total includes their external finance. For nationalised industries' external finance limits for 1988–89, see Table 2.4.* 2

[3] *See paragraph 2.26.*

4. Ministry of Defence, Department of Employment, DHSS, Wales and Chancellor's Departments.

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 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[1]

	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
of which:			
Change in contributions from increased earnings, etc[2]	+1 1~~9~~80	+860	+2 0~~5~~40
Change in contributions from lower contracted-out rebate[3]	+220	+110	+330
Change in contributions from increase in earnings limits	−1~~2~~10	+40	−~~8~~70

[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 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.*
[2] *Including population and employment changes.*
[3] *As announced by Secretary of State for Social Services on 16 March 1987.*

✓ IS

4 Tax revenue ready reckoner

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 £'000	
Per cent	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[1]

	£ million	
	1988–89 cost/yield	1989–90 cost/yield
Income tax		
Rates		
Change basic rate by 1p[2]	1 250	1 600
Change all higher rates by 1p	85	165
Personal allowances[3]		
Change single and wife's earned income allowance by £100	295	380
Change married allowance by £100	240	310
Change single age allowance[4] by £100	23	30
Change married age allowance[4] by £100	22	26
Change aged income limit by £200	4	5
Change all main personal allowances by 1 per cent	180	2~~5~~35
Change all main personal allowances by 10 per cent:		
increase (cost)	1 775	2 3~~7~~25
decrease (yield)	1 825	2 4~~25~~00
Higher rate thresholds[3]		
Change all higher rate thresholds by 1 per cent: increase (cost)	31	55
decrease (yield)	32	~~55~~ 60
Change all higher rate thresholds by 10 per cent:		
increase (cost)	280	52~~5~~0
decrease (yield)	365	6~~35~~50
Allowances and thresholds[3]		
Change all main personal allowances and higher rate thresholds by 1 per cent	215	~~310~~ 295
Change all main personal allowances and higher rate thresholds by 10 per cent:		
increase (cost)	2 050	2 8~~7~~25
decrease (yield)	2 250	3 075
Corporation tax[5]		
Change full rate by 1 percentage point	360	560
Change small companies' rate by 1 percentage point[6]	25	45

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

3 Percentage changes are calculated with reference to 1987–88 levels.

4 Including higher age allowance for those aged 80 or over.

5 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.

6 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

		4% Revalorisation[1]			Changes from present levels of duty			
	Current level of duty on typical items	Price change inc. VAT[2]	£m yield in[3]		Price change inc. VAT[2]	Actual percentage change in duty	£m cost/yield in[3]	
			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)[4]	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)[5]	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)[6]	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

[1] *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.*
[2] *VAT is payable in addition to the duty except in the case of VED.*
[3] *Assuming implementation on 1 April 1988.*
[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.*
[6] *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[1]	940	1 310

[1] *Assuming implementation on 1 April 1988.*

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SECRET

PM

FROM: A P HUDSON

DATE: 30 October 1987

MR SCHOLAR

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr Gieve
Mr R I G Allen
Mr MacIntyre (paras 26-29 only)
Mr A C S Allan
Miss C Evans
Mr Cropper
Mr Tyrie
Mr Call

AUTUMN STATEMENT: ORAL STATEMENT

As you will appreciate, the Chancellor has had very little time this week to work on the Oral Statement.

2. He did, however, make some general comments over the weekend, and I attach a redraft which attempts to take account of these.

3. The Chancellor will want to work on this over the weekend. Please could I have any comments by <u>6.00 pm tonight</u>.

AH

A P HUDSON

AUTUMN STATEMENT 1987: ORAL STATEMENT:

DRAFT OF 31 OCTOBER

With permission, Mr Speaker, I should like to make a statement.

2. I am laying before the House today an Autumn Statement which brings together the Government's outline public expenditure plans for the next three years, makes proposals for National Insurance contributions next year, and sets out the forecast of economic prospects for 1988 required by the 1975 Industry Act.

Public Expenditure in 1987-88

3. I turn first to the expected outturn for the current financial year, 1987-88.

4. The public expenditure planning total now looks likely to amount to £147½ billion, or around £1 billion less than was allowed for in last year's public expenditure White Paper. The main reason for this is higher capital receipts by local authorities and new towns. Spending on other programmes, taken together, is expected to be in line with plans.

5. Taking account of debt interest and other items, the total shortfall on the expenditure side is likely to be about £½ billion.

1987-88 revenues

6. On the receipts side, non-oil revenues are benefitting from the strong growth of the economy and seem likely to be about £2 billion higher than I expected at the time of the Budget. Corporation tax revenues have risen strongly following the surge in profits in recent years. Income tax, national insurance contributions and VAT are also buoyant. North Sea revenues are likely to be £½ billion higher than expected, largely because the oil price has been above the $15 assumed in the Budget forecast.

1987-88 PSBR

7. This increase of £2½ billion in tax revenues, together with the reduction of £½ billion in expenditure, means that I now expect the Public Sector Borrowing Requirement for the current financial year to be about £1 billion, representing ¼ per cent of GDP. This is some £3 billion lower than the figure I set in the Budget, and lower than the PSBR in all but two years since 1950.

Public Expenditure plans

8. I turn now to the public expenditure plans for the next three years.

9. Since 1982-83 public spending, both including and excluding privatisation proceeds, has been declining as a proportion of national output. There is likely to be a further substantial reduction this year, which will make this the longest sustained fall since the War time economy was unwound.

10. In July, the Cabinet reaffirmed the objective of ensuring that public spending as a share of national output was held at or below the ratios in the last White Paper. The plans that I am about to announce will not only secure that objective but will ensure that the share is actually lower than in the plans we set last year.

11. New planning totals have been set at £a billion for 1988-89 and £b billion for 1989-90, increases of £c billion and £d billion over the totals previously published. For 1990-91 the planning total has been set at £d billion.

12. The totals incorporate an estimate for privatisation proceeds of £5 billion a year, unchanged from last year.

13. I have also thought it prudent to set aside larger Reserves within the planning totals than in previous years. These will be £3½ billion in 1988-89, rising to £10½ billion in 1990-91.

14. These plans mean that public spending, excluding privatisation proceeds, continues to fall as a share of

national output, as it has done since 1982-83. From the peak of 47 per cent in that year, it has come down to under 43 per cent this year, and by 1990-91 will be down to 41¼ per cent, the lowest since 1972-73. The new ratios are lower, in each year, than those published in the last White Paper.

15. This achievement has been founded on our success in cutting back the rate of growth of spending. In the 1960s and 1970s public spending (using the same measure) grew by around 3 per cent a year in real terms. In the four years to 1982-83 the growth was 2¼ per cent; in the four years to 1986-87 just under 1¾ per cent; and in the succeeding four years, that is the current year plus the three Survey years, the growth is planned to be less than 1¼ per cent a year, the lowest [for thirty years], and well within the prospective growth of the economy as a whole.

16. But while public spending as a whole is growing more slowly, the substantial reduction in public borrowing this Government has brought about has reduced debt interest, and thus made more room for programme spending. The Government has therefore again been able to provide additional resources for a number of priority services.

17. An extra £700 million is being provided for the National Health Service in England in 1988-89, and an extra £800 million in 1989-90. On top of this the Health Service will benefit from additional resources from the

cost improvement programmes and from land sales. All this will enable the NHS to continue to improve services. [What about the NHS in the rest of the UK?]

18. Provision has also been made for the substantial increase and acceleration in the prison building programme, which my RHF the Home Secretary announced to the House in July. [Can we say, very briefly, how many more prisons we get?].

20. As my RHF the Secretary of State for the Environment announced in July, the provision for local authority current spending has been increased by £1 billion in 1988-89 and £1¼ billion in 1989-90. Nearly half of this is accounted for by education. [Again, is there a short, telling example of what the money buys? Or is it all teachers' pay?] In addition, an extra £60 million a year has been provided for the improvement of school buildings. There will also be additional spending on the universities, including the restructuring of academic pay already announced, of £115 million in 1988-89 and £130 million in 1989-90; and a further £45 million and £65 million for science.

21. Gross provision for housing investment is being increased by nearly £400 million next year. [This will not only sustain the rising trend of spending on local authority renovation, but provide additional resources for housing associations, much of it to be used in

conjunction with private finance.] £5 million next year, rising to £50 million the year after, is being made available for Housing Action Trusts. Provision for Urban Development Corporations is being increased by £65 million next year. [These additional amounts are offset by more buoyant capital receipts from sales of houses under the Right to Buy, and from commercial property and land.]

22. £1 billion extra in 1988-89 and £1.9 billion in 1989-90 is being set aside for social security expenditure. This takes account of the decision announced last May to increase income-related benefits to reflect the average cost to claimants of paying 20 per cent of rates. It also reflects the statement on benefits made by my RHF the Secretary of State for Social Services on 27 October.

23. Provision for defence has been increased by £230 million in 1988-89 and £490 million in 1989-90, an increase of some 2 per cent in cash terms over previous plans.

24. Taking all the programmes together, the additions to planned capital expenditure amount to over £1 billion in each of the next two years. [Is there a bull point on capital spending compared to 1978-79?]

25. Further information about these and other changes are contained in the printed Autumn Statement which will be available shortly in the Vote Office. Full details, together with information on running costs and manpower will be given in the public expenditure White Paper early in the New Year.

National Insurance contributions

26. I turn now to National Insurance contributions.

27. The Government have conducted the usual autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the National Insurance Fund, and taking account of the statement on benefits which my RHF the Secretary of State for Social Services made on 27 October.

28. The Lower Earnings Limit will be increased next April to £41 a week, in line with the single person's pension, and the Upper Earnings Limit will be raised to £305 a week. The limits for the reduced rate bands will also be increased. The upper limit for the 5 per cent and 7 per cent bands will be raised to £70 and £105 respectively. The upper limit for the 9 per cent rate for employers will be raised to £155.

29. The taxpayer's contribution to the National Insurance Fund - the so-called Treasury supplement -

will be reduced by 2 per cent to 5 per cent, but this will not require any change in contribution rates. Thus, the main Class I contribution rates will be unchanged at 9 per cent for employees and 10.45 per cent for employers.

Industry Act Forecast

30. Finally, I turn to the Industry Act Forecast.

31. Growth this year looks to be turning out at 4 per cent, above the trend of the steady upswing which began in 1981, and faster than any other major economy. Strong growth in domestic demand has been more than matched by the rapid rise in exports. Manufacturing industry has done particularly well, with output rising by 5 per cent.

32. This strong performance has led to a substantial fall in unemployment, which is now over 400,000 lower than a year ago - the largest fall on record. Unemployment is falling faster here than in any other major country.

33. As I expected at Budget time, inflation in the fourth quarter of this year is likely to be 4 per cent. The current account of the balance of payments is likely to show a modest deficit this year of £2½ billion, or about ½ per cent of GDP, again in line with the Budget forecast.

34. Looking ahead to 1988, the prospect is for a continuation of the steady growth, with low inflation, that we have now seen for over five years. The Forecast takes account of the recent falls in the stock market. It is clearly too early to say what the precise effects will be, but the strength of the British economy puts us in a strong position to weather any storm.

35. Growth next year is likely to be around 2½ per cent. Domestic demand should continue to expand at [much the same rate as this year], with both consumer spending and investment growing at similar rates. Business investment outside the North Sea is expected to be particularly strong, rising by 5½ per cent. With other major countries' likely to grow more slowly than the UK, export growth ~~should~~ may be lower than this year.

36. With the UK continuing to grow faster than other countries, there is likely to be a further small increase in the current account deficit to about £3½ billion, or ¾ per cent of GDP.

37. Inflation, as measured by the retail price index, may be a little higher next year than this, at 4¾ per cent in the fourth quarter, but I expect it to be on a downward trend by the end of next year. The control and reduction of inflation remains at the heart of the Government's economic strategy.

38. With continuing healthy growth, the prospect is good for the fall in unemployment to carry on next year, provided always that labour costs remain under control.

Peroration

39. Mr Speaker, the progress and prospects I have described demonstrate once again the soundness of the policies we have followed, now over two Parliaments. This first Autumn Statement of our third term offers a clear prospect of further sustained growth and steadily rising living standards with unemployment continuing to fall. We have brought this about by promoting enterprise, with sound money and with strong public finances. We will st~~o~~ick to these policies.

2184/026

CONFIDENTIAL

I am content with Mr Monck's revised text @ X provided the words in square brackets are kept in.

(Otherwise it is too nakedly pre-election/post-election) N.

Passed this on to Mr Sedgwick + MO'M. 30/10

FROM: N MONCK

DATE: 30 October 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Moore
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr M Williams
Miss O'Mara
Miss C Evans

C/ Content with revised text at X?

CR 30/10

CHAPTER 1 OF THE AUTUMN STATEMENT : PROSPECTS FOR 1988

Paragraph 1.45 specifically mentions higher electricity prices as one of the reasons for a temporary rise in the annual rate of increase in the RPI after the first quarter of 1988. I suggest that it would be preferable to generalise this by referring to the average price increase for the industries which is set out in the accompanying table, 1.6 (see attached page). Prices will rise faster than the RPI for water, British Rail and LRT as well as for electricity. Also, although Mr Parkinson is presenting higher electricity prices as necessary to finance investment, this is not the normal Treasury doctrine and I would prefer that it did not appear in a Treasury document quite so nakedly. It is also relevant that the Chapter 2 table of EFLs shows a negative figure for electricity of over £1 billion.

2. I suggest a revised text below. I have taken the opportunity to break up and re-order the present second sentence which is more than six lines long. I would prefer to leave out the justification in square brackets. The reference to catching up on the real fall in 1987/88 fits quite well with the explanation of a temporary rise in the RPI:

X

> "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 stand-still 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 increased investment). The forecast is for the RPI to increase by 4½ per cent over the year to the fourth quarter of 1988".

3. If you prefer to stick to the existing structure of the paragraph my suggestion would be reduced to substituting "... and the need for higher increases in nationalised industry prices in 1988 after the fall in real terms this year" for "... the need for higher electricity prices to finance the industry's investment programme".

4. Although there are already press reports about electricity price increases, partly as a result of what Mr Parkinson has said, it seems to me preferable not to highlight these now, since this would lead to many detailed questions after the Autumn Statement. We could otherwise hope to have attention mainly focussed on them later on when price increases are actually announced: and rely now on the normal briefing line that nationalised industry price increases are for the industries to decide in the light of their EFLs and Financial Targets.

5. DEn officials tell me that Mr Parkinson would be very disturbed by the existing reference to electricity prices and would feel that it would make his problems unnecessarily difficult.

6. A decision is, I'm afraid, needed today.

NM

N MONCK

Extract from Chapter 1 of the Autumn Statement : Economic Prospects for 1988

1.45 Retail price inflation is expected to fall below 4 per cent by the end of the fourth quarter of 1987, but given 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 electricity prices to finance the industry's investment programme there is likely to be a temporary rise in the annual rate of increase in the RPI after the first quarter of 1988. In the light of this, the forecast is for the RPI to increase by 4~~¼~~ ½ per cent over the year to the fourth quarter of 1988.

Table 1.6 Retail prices index

Per cent changes on a year earlier

	Weight in 1987	1986 Q4	Forecasts 1987 Q4	Forecasts 1988 Q4
Food	16½	3¼	3½	3
Nationalised industries	6	3½	2¼	6¼
Housing	15	7	7¼	~~8¼~~ 7
Other	62½	2½	3½	4¼
Total	**100**	**3½**	**4**	**4~~¼~~ ½**

ps4/33H

RLP

CHANCELLOR OF THE EXCHEQUER'S AUTUMN STATEMENT, 3 NOVEMBER 1987

With permission, Mr Speaker, I should like to make a statement.

I am laying before the House today an Autumn Statement which, as usual, contains first, the Government's outline public expenditure plans for the next three years and the expected outturn for this year; second, proposals for National Insurance contributions next year; and, third, the forecast of economic prospects for 1988 required by the 1975 Industry Act. The forecast of course takes into account the likely effect of the recent worldwide falls in equity markets.

I turn first to the expected outturn for the current financial year, 1987-88.

The public expenditure planning total now looks likely to amount to £147½ billion, or around £1 billion less than was allowed for in THE last ~~year's~~ Public Expenditure White Paper. The main reason for this shortfall is higher capital receipts by local authorities and new towns. Total spending on programmes, apart from this, is expected to be broadly in line with plans.

Taking account of miscellaneous items not included in the planning total, the net shortfall on the expenditure side is likely to be slightly in excess of £½ billion.

On the receipts side, total tax revenues are likely to exceed the Budget forecast by almost £2½ billion. This buoyancy reflects higher than forecast economic growth, greater than expected profitability, and an oil price above the $15 a barrel assumed at the time of the Budget.

At that time, I set a Public Sector Borrowing Requirement for 1987-88 of some £4 billion, or 1 per cent of GDP. As a result of the higher tax revenues and lower spending, I now expect the PSBR for the current financial year to be only £1 billion, or ¼ per cent of GDP: the third successive year of significant undershoot. Privatisation proceeds have, of course, made an important contribution to this year's low PSBR. But even if there had been no privatisation proceeds at all, it would still be the lowest PSBR for 17 years.

I turn now to the public expenditure plans for the next three years.

Since 1982-83 public spending, both including and excluding privatisation proceeds, has been declining as a proportion of national income. There is likely to be a further substantial reduction this year, which will make this the longest sustained fall in public expenditure as a proportion of national income since the early 'fifties.

In July, Cabinet reaffirmed the objective of ensuring that public spending as a share of national income continued to fall and in particular did not exceed the ratios published in the last White Paper. The plans that I am about to announce secure that objective.

New planning totals have been set at £156¾ billion for 1988-89 and £167 billion for 1989-90, increases of £2½ billion and £5½ billion respectively over the totals previously published. For 1990-91 the planning total has been set at £176 billion.

For the later years, I have judged it prudent to set aside larger Reserves within the planning totals than I have done previously. The Reserves will therefore rise from £3½ billion in 1988-89, to £7 billion in 1989-90 and £10½ billion in 1990-91.

The planning totals also incorporate an estimate for privatisation proceeds of £5 billion a year, unchanged from the last White Paper.

As I have indicated, these plans mean that public spending, excluding privatisation proceeds, will continue to fall as a share of national income. From nearly 47 per cent in 1982-83, that share has come down to around 42½ per cent this year, and by 1990-91 will b[illegible] down to 41¼ per cent, the lowest since 1972-73. The new proportions are lower, for each year, than those published in the last White Paper.

This progress has been founded on our success in reining back the rate of growth of public spending. In the 1960s and 1970s public spending grew by around 3 per cent a year in real terms. In our first Parliament the real rate of growth averaged 2¼ per cent a year; in our second Parliament it was just under 1¾ per cent; and in the succeeding four years, that is the current year plus the three Survey years, the real growth of public spending is planned to be around 1¼ per cent a year, well within the prospective growth of the economy as a whole.

But while public spending as a whole is growing more slowly, the substantial reduction in public borrowing this Government has brought about, has, by reducing the burden of debt interest payments, made more room for programme spending. The Government has, therefore, once again been able to provide additional resources for a number of priority services. In each case, the figures I am about to give represent increases over the plans published in the last Public Expenditure White Paper.

First, health. An extra £700 million is being provided for the National Health Service in England in 1988-89, and an extra £800 million in 1989-90. On top of this the Health Service will benefit from additional resources from the cost improvement programmes and from land sales. All this will enable the NHS to continue to improve services.

Second, law and order. Provision has been made for the substantial increase and acceleration in the prison building programme, which my right hon. Friend the Home Secretary announced to the House in July. This will provide 4,200 extra places by 1993. Provision for local authority spending on the police has also been increased significantly.

Third, education. Provision for local authority current spending has again been increased substantially. In addition, an extra

£6[illegible] million a year has been provided for the improvement of school buildings. Spending on the universities will be increased by £115 million in 1988-89 and by £130 million in 1989-90. There will also be an additional £45 million in 1988-89 and £65 million in 1989-90 for science.

Gross provision for housing investment is being increased by nearly £400 million next year. This will not only sustain the rising trend of spending on local authority renovation, but will also provide additional resources for housing associations, much of it to be used in conjunction with private finance. Provision for Urban Development Corporations is being increased by £65 million next year, to help tackle the problems of the inner cities.

There are also substantial increases in provision for social security spending, which has been increased by £1 billion for 1988-89 and £1.9 billion for 1989-90. This is partly because the take-up of benefits is likely to be higher than was previously envisaged. It also takes account of the uprating of benefits announced by my right hon. Friend the Secretary of State for Social Services last week, including the cost of compensating income support claimants for their average contribution to rates.

Spending on defence is to be increased by £230 million in 1988-89 and £490 million in 1989-90.

The additions to planned capital expenditure, for the public sector as a whole, amount to some £1 billion in each of the next two years. About half of this is for the nationalised industries, principally for the large scale investment programmes of the electricity and water industries.

Further information about these and other changes is contained in the printed Autumn Statement which will be available from the Vote Office as soon as I have sat down. Full details, together with information on running costs and manpower, will be given in the Public Expenditure White Paper early in the new year.

I turn now to National Insurance contributions.

The Government have conducted the usual autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the National Insurance Fund, and taking account of the statement on benefits which my right hon. Friend the Secretary of State for Social Services made on 27 October.

The Lower Earnings Limit will be increased next April to £41 a week, in line with the single person's pension, and the Upper Earnings Limit will be raised to £305 a week. The limits for the reduced rate bands will also be increased. The upper limit for the 5 per cent and 7 per cent bands will be raised to £70 a week and £105 a week respectively. The upper limit for the 9 per cent rate for employers will be raised to £155 a week.

The taxpayer's contribution to the National Insurance Fund - the so-called Treasury supplement - will be reduced from 7 per cent to 5 per cent, but this will not require any change in contribution rates. Thus, the main Class I contribution rates will once again remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

Finally, I turn to the Industry Act Forecast.

Growth this year looks to be turning out at 4 per cent, compared with the 3 per cent growth I forecast at the time of the Budget. This is well above the trend of the steady upswing which began in 1981, and faster than any other major economy. Strong growth in domestic demand has been more than matched by the rapid rise in exports. Manufacturing industry is doing particularly well, with output rising by 5 per cent.

This strong performance has led to a substantial fall in unemployment, which is now more than 400,000 lower than a year ago - the largest annual fall on record. Indeed, unemployment has been falling faster in the UK than in any other major country.

As I forecast at the time of the Budget, inflation in the fourth quarter of this year is likely to be 4 per cent. I also see no need to amend my Budget forecast of a modest current account deficit of some £2½ billion, or about ½ per cent of GDP.

Looking ahead to 1988, the prospect is for a continuation of the steady growth with low inflation that we have now enjoyed for over five years. As I have already indicated, the full forecast I am publishing today takes into account the likely implications of the recent falls in world stock markets insofar as it is possible to do so at this early stage. This is clearly a time when economic forecasting is a more than usually hazardous business. But what is clear is that the strength of the British economy, and of our public finances, puts us in the best possible position to weather any storm. And that strength will also enable us to play a full part in the international co-operation which is more than ever needed today.

Subject to the uncertainties to which I have just referred, the economy is forecast to grow next year by around 2½ per cent. With North Sea oil output now declining, this implies 3 per cent growth for the non-North Sea economy as a whole. Domestic demand should continue to expand, though at a slightly lower rate than this year, with consumer spending and investment growing at a similar pace. Business investment is likely to be particularly strong, rising by 5½ per cent.

With the UK continuing to grow faster than other major countries, and the oil surplus declining, there is likely to be a further small increase in the current account deficit, to about £3½ billion, or ¾ per cent of GDP.

Inflation may rise a little next year, reaching 4½ per cent in the fourth quarter, by which time it should be on a downward trend again. The defeat of inflation remains at the heart of the Government's economic strategy.

With continuing healthy growth in 1988, unemployment should continue to fall.

The progress and prospects I have described demonstrate once again the soundness of the policies we have followed over the past two Parliaments. We will continue to pursue these policies in our third. Despite the recent deterioration in the world economic climate, the prospect I am able to offer the House is one of further sustained growth and steadily rising living standards, with inflation low and unemployment continuing to fall. We have brought this about by promoting enterprise, sound money and strong public finances. And that is what we will stick to.

Covering SECRET and PERSONAL

[US debt interest]
[line on G7 PSFDs]
[~~other adjustments~~ STET (GGE)]
[Historically low yes]

FROM: MISS M O'MARA
DATE: 30 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

Ch

cc Chief Secretary
Financial Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Anson
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Mr Gieve
Miss Evans
Mr Hudson
Mr Patterson
Miss Simpson
B/002

1987 AUTUMN STATEMENT BRIEF

I attach a copy of the Autumn Statement briefing in draft.

2. As for the Budget, we have produced a two-stage brief. The main brief covers the key issues; detailed information available in the supplementary section.

3. Work is still in progress on the individual briefs and we have not yet been able to reflect all the comments you made at your meeting this afternoon. Nevertheless, if you have time, you might care to glance through

A1 Strategy
B1 Industry Act forecast
C1 Fiscal policy
C2 Revenue prospects: 1987-88
E2 Public expenditure: 1988-89 to 1990-91

The Chief Secretary may like to look at some of the more detailed expenditure briefs.

4. We aim to submit the final version of the full brief on Monday evening.

MOM

MISS M O'MARA

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CHIEF SECRETARY
REC. 30 OCT 1987
ACTION Mr Gieve
COPIES TO CX Sir Peter Middleton
Sir Terence Burns Mr Butler
Mr Anson Mr Monck
Mr Luce Miss Peirson Mr Scholar
Mr Turnbull Mr Sedgwick Mr Pratt Mrs S Walker
Mr Mowl Mrs Butler Mr A M White Mr G C White.

Alex
Do we need to show C?
pp

Jill Rutter
Private Secretary to the Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

30 October 1987

Dear Ms Rutter

AUTUMN STATEMENT ON PUBLIC EXPENDITURE

I attach a copy of the comment which my Secretary of State is proposing to make on the figures for the Scotland programme in parallel with the Chancellor's Autumn Statement; and of the notes issued for the consumption of media editors.

These documents have been cleared with Treasury officials save for two minor presentation changes which have been made to the last paragraph subsequent to the draft they have seen.

Yours sincerely

pp **DAVID CRAWLEY**
Private Secretary

Heather Parker

CHANCELLOR OF THE EXCHEQUER'S AUTUMN STATEMENT: COMMENT BY THE SECRETARY OF STATE FOR SCOTLAND

Commenting on the public expenditure figures for Scotland announced by the Chancellor of the Exchequer in his Autumn Statement today, the rt hon Malcolm Rifkind QC MP, Secretary of State for Scotland, said:

"The Chancellor's Statement today confirms that the Government are continuing to ensure that taxpayers' money is being directed to where our national priorities lie. That additional resources are available is a reflection of the underlying health of the national economy, and is testimony to the careful management of public expenditure since we came to office.

Scotland is benefiting from the Government's financial management. For my own programme I will have some £8,514m next year. This is almost 7% above provision for the current year, and well above the rate of inflation.

The figures include provision for the services within the Scottish block which has been fully enhanced by the application of the territorial formula to changes in spending on comparable English programmes. The formula increase for local authority current expenditure in 1988-89 is less than the extra cost of the generous RSG settlement which I have already announced in July, because of the level of spending of Scottish local authorities so I have made up the balance from the rest of my block. As a consequence in that year the amount available for non-local authority expenditure in Scotland is lower than it would otherwise be. I will now be considering how the remainder of the resources at my disposal should be allocated among my services, and I will announce my detailed decisions in December."

Notes for Editors

CHANCELLOR OF THE EXCHEQUER'S AUTUMN STATEMENT: SCOTLAND PROGRAMME

1. The figures for the Scotland programme which appear in the Autumn Statement published today are:

£ million

1986-87 Outturn	1987-88 Estimated Outturn	1988-89 Provision	1989-90 Provision	1990-91 Provision
7736	8220	8510	8610	8780

2. The figures differ from those in the Public Expenditure White Paper (Cm56) because of budget and other changes since the White Paper was published; revised economic assumptions; and the outcome of this year's Public Expenditure Survey including the consequences for Scottish programmes of applying the population-based formula whereby changes in comparable English or English and Welsh programmes are reflected in the total amount available for public expenditure in Scotland.

3. There is an increase of 6.9% in provision between 1987-88 and 1988-89 and the increase over estimated outturn in 1987-88 is 3.5%. The difference is due to several factors including the settlement in health service pay, higher than expected electricity board costs and continued spending by local authorities above the level provided for. However, the estimated outturn figures may be reduced as firmer information becomes available.

4. The figure of £4,520m for local authority expenditure in Scotland [in Table 2.6] for 1988-89 reflects the generous RSG settlement which the Secretary of State announced in July. The settlement will cost more in Scotland than in England because of higher overspending by Scottish authorities. The cost exceeds the amount produced by application of the formula by £71m and the Secretary of State has made up the difference by transferring that amount from the rest of his block. He hopes that overspending in Scotland will not be repeated in the later years so the figures shown for local authority expenditure in 1989-90 and 1990-91 are

those produced arithmetically by the application of the formula to the equivalent English figures. No attempt has been made to anticipate next year's RSG settlement.

5. The detailed breakdown of the figures is subject to confirmation; the Secretary of State will announce in December his decision and the allocation of his total expenditure provision among the services within his responsibility.