PO/CH/NL/0018 PART B

SECRET

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PO -CH /NL/0018

PART B

1987 BUDGET FINANCIAL STATEMENT AND BUDGET REPORT AND PUBLIC SECTOR BORROWING REQUIREMENT

DD's 25 years N Aziz 25-3-95

9/03/87

11/03/87

PO -CH /NL/0018
PART B

PWP

FROM: MISS C E C SINCLAIR
DATE: 9 March 1987

CHANCELLOR

cc
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Culpin
Miss O'Mara
Miss Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Battishill - IR
Mr Calder

Sir A Fraser - C&E

FSBR CHAPTER 4: ANNEX INTRODUCTION

You asked for an urgent explanation of exactly how the Budget changes are measured against an indexed base for 1988-89. You found the text proposed for the second paragragh of the introduction very unclear.

2. I attach a revised explanation which has been agreed with Mr Calder in the Revenue. We agree with you that this could best replace the present paragraph 6 in the introduction to the annex.

3. We hope that you find the paragraphs clearer. We do not see any particular difficulties in clarification. It is necessary to refer to the assumption on inflation between the fourth quarter of 1986, and the fourth quarter of 1987. But this figure is published anyway in Chapter 3. In the attached wording we have not mentioned the figure, but simply referred readers to the relevant table.

CAROLYN SINCLAIR

The figures in the first column of table 4.1 show the direct effect of the Budget proposals on receipts in 1987-88. Budget proposals are compared with a non-indexed base - that is, with the pre-Budget regime of allowances, thresholds and rates of duty at 1986-87 money levels.

The figures in the second column show the direct effect of the Budget proposals on receipts in 1987-88, measured against an indexed base. The indexed base for 1987-88 is obtained by increasing 1986-87 allowances, thresholds and rates of duty by 3.7 per cent, the increase in the RPI over the year to December 1986.

The figures in the third column show the direct effect on receipts in 1988-89, also measured against an indexed base. For this comparison, both the Budget proposals and the indexed base for 1987-88 have been further indexed by the forecast movement in the RPI between the fourth quarters of 1986 and 1987 [shown in table 3.14].

019/2765

RESTRICTED

CHIEF SECRETARY TO THE TREASURY

PMP

FROM: JILL RUTTER

DATE: 9 March 1987

MR TURNBULL

cc:
Principal Private Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Mr F E R Butler
Mr Scholar
Mr Culpin
Mrs R J Butler
Miss O'Mara
Miss C Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Ross Goobey

2

FSBR CHAPTER 5

You raised with me the Chancellor's comment on the table in chapter 5 (replicated in chapters 2 and 6) on public expenditure.

2 I discussed this with the Chief Secretary. He did not wish to revert to including Scotland, Wales and Northern Ireland, nor did he feel that there was any difficulty with the size of the "other departments" line. He did not want to extend the table to show more departments. This is not intended to be a surrogate for the Public Expenditure White Paper. He therefore asked you and Mrs Butler to stick with the presentation agreed at his discussion with you last week i.e. to delete Scotland and Wales and Northern Ireland and to insert the Home Office.

Jill Rutter

JILL RUTTER

Private Secretary

PWP

COPY NO 20 OF COPIES 31

FROM: A C S ALLAN
DATE: 9 March 1987

MR SCHOLAR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Sir G Littler
Mr F E R Butler
Mr Wilson
Mr Cassell
Mr Monck
Mr Sedgwick
Mr Olding-Smee
Mr Culpin
Miss O'Mara
Miss Sinclair
Mr Mowl
Miss Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Sir Angus Fraser -C&E
Mr Knox - C&E

FSBR: CHAPTERS 4, 5 AND 6

The Chancellor was grateful for your minute of 6 March. He had the following comments on the points you raised in your cover note:-

(i) In your paragraph 6(iii) you said that the figure we are likely to publish for the LABR in 1986-87 is lower than could be justified by the Local Authority Borrowing Intentions Survey. The Chancellor would be grateful for an explanation of why this is so.

(ii) In your paragraph 6(v) and paragraph 8 you raised the question of the text describing the shares of different taxes in the financing of expenditure, and the earlier chart which had been dropped. The Chancellor is content for the chart to be restored, but feels that paragraph 6.17 should be dropped.

(iii) He was content with the new Guinness Chart you attached (though notes that the key is missing).

(iv) The Chancellor now feels that the passage on pensions in Chapter 1 should read "the introduction of a favourable tax regime for personal pensions" (your paragraph 11).

... 2. I attach separately the Chancellor's comments on Chapters 4, 5 and 6.

ACSA

A C S ALLAN

CHANCELLOR'S COMMENTS ON FSBR CHAPTER 4

Paragraph 4.06: Delete the top line (ie the basic rate band) in this table.

Paragraph 4.09: Amend this to read "The duty on petrol will be reduced by the equivalent of about 5p a gallon in respect of unleaded petrol only.

Paragraph 4.10: Make the gaming machine licence proposal a separate paragraph.

Paragraph 4.12: In the table change "Rate on death" to "Rate of tax".

Paragraph 4.15: Say "may be valued" not "will be valued".

Paragraph 4.35 (ie Lloyds): Change the end of the last sentence to read "... will first apply to premiums payable in respect of the 1985 Lloyds account closing at 31 December 1987".

Insertion A to second paragraph of Annex introduction: The Chancellor would be grateful for an urgent explanation of exactly how the Budget changes are measured against an indexed base for 1988-89. The text as drafted is very unclear, but suggests that there may be problems - perhaps explaining why we eventually went for a non-indexed base last year.

Annex to Chapter 4: Inland Revenue paragraph in introduction: The Chancellor wondered whether there were no examples from this year's Budget of behavioural changes allowed for in the costings. If so, we should quote one. If not, he feels it would be best to leave out the last two sentences of this paragraph.

<u>Sixth paragraph of introduction to Annex</u>: The Chancellor feels that once we know what we are doing with the third columns of Tables 1.1 and 4.1, it may be better to describe the presentation in this paragraph (deleted in manuscript from the circulated version).

<u>Annex paragraph 43</u>: Delete "depends on the behavioural effect this measure has, but" from the manuscript insert, and make sure all figures are central estimates.

<u>Annex paragraph 52(a)</u>: Change "will be calculated" to "may be calculated".

CHANCELLOR'S COMMENTS ON FSBR CHAPTER 5

Table 5.1: While the Chancellor agrees that "Scotland, Wales and Northern Ireland" should not be shown separately, he feels that the line for "other Departments" now is far too large. Strong candidates for separate lines are Employment and DOE housing. The Chief Secretary may be able to think of others.

Paragraph 5.03: Change "over" in the second line to "in each of". Change the sentence beginning after the semicolon to start "this would still be the case even without any proceeds from privatisation".

Paragraph 5.04: Change the second sentence so that it reads simply "It is the key public expenditure aggregate used in the Medium Term Financial Strategy". In the next sentence delete the second "general government".

Paragraph 5.05: Amend the passage at the top of page 3 to read "The additions to programmes amount to some [£5.3] billion and, together with a shortfall of £400 million on privatisation proceeds, exceed the Reserve of £4.5 billion. The consequent overrun on the planning total amounts to about [£1.2] billion.

CHANCELLOR'S COMMENTS ON FSBR CHAPTER 6

Note: The Chancellor has not yet taken a final decision on the precise PSBR to show for either 1986-87 or 1987-88. He would be grateful to know what the deadline is.

He does not feel it is at all clear why some headings should be beside, and some above, the text. An example is the heading "Receipts" to paragraph 6.06. He would be grateful for an explanation of the logic here.

Paragraph 6.06: Given the comment in the last sentence, the Chancellor feels it would be much better if stamp duty were given a line of its own in table 1.2.

Paragraph 6.07: It would be better to go back to saying the short-fall in oil revenues "mainly" reflects lower than assumed oil prices, rather than adding "and production" - which is not an assumption.

Paragraph 6.08: Delete "probably" at the end of the third last line.

Paragraph 6.11: The second reason given for the increase in GGE is that "public corporations have met a higher proportion by general government finance". Does this mean "borrowing from the Government"? If so, it would be better to say so.

Table 6.2: The heading to this table should read "taxes and National Insurance contributions (NICs) as a percentage of GDP.

Paragraph 6.16: The Chancellor feels that this paragraph should be deleted: table 6.2 (and paragraphs 6.10) make it otiose.

Table 6.3: Change line one to read "Central government borrowing on own account". Can the roundings on local authority borrowing in 1985-86 be adjusted so that the two components sum to the total?

Paragraph 6.25: Change the last sentence to read "An accruals adjustment is accordingly made in line 28."

Table 6.8.3: The Chancellor would be grateful for a short note explaining footnote 8.

MR 9/74

UNCLASSIFIED

PWP

FROM: A C S ALLAN
DATE: 10 March 1987

MISS SINCLAIR

cc: CST
FST
EST
MST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Culpin
Miss O'Mara
Miss Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Ross Goobey
PS/IR
Mr Calder
PS/C&E

FSBR CHAPTER 4: ANNEX INTRODUCTION

The Chancellor was grateful for your minute of 9 March, and the revised explanation of how the Budget changes are measured against an indexed base for 1988-89. He found the new explanation much clearer, and is content for it to replace the present paragraph 6 in the introduction to the Annex.

ACSA

A C S ALLAN

COPY NO 11 OF 12 COPIES

FROM: A C S ALLAN
DATE: 11 March 1987

SIR T BURNS

cc Sir P Middleton
Mr Cassell
Mr Odling Smee
Mr Scholar
Mr Sedgwick
Mr Culpin
Miss O'Mara
Mr Ross Goobey

BUDGET STATEMENT: PSBR

The Chancellor now proposes to use the following passage in place of paragraph D7 in the fifth draft of the Budget statement.

"Indeed, I believe it is right to go below it. Since its inception in 1980, the MFTS has indicated a steadily declining path for the PSBR expressed as a percentage of GDP. We have now reached what I judged to be its appropriate destination: a PSBR of 1 per cent of GDP. I intend to stick to that figure. That will maintain a degree of fiscal prudence that, until this year, had been recorded on only two occasions since the War."

2. I should be grateful for any comments as soon as possible.

ACSA

A C S ALLAN

RA7.79

BUDGET SECRET

COPY NO 16 OF 17 COPIES

FROM: A C S ALLAN

DATE: 11 March 1987

MR SEDGWICK

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Odling Smee
Mr Scholar
Mr Peretz
Mr Culpin
Mr Mowl
Mr Ritchie
PS/IR
PS/C&E

THE PSBR IN 1986-87 AND 1987-88

The Chancellor was most grateful for the minute of 10 March by you and Mr Mowl. After some reflection, he has plumped for a PSBR of £4.1 billion in 1986-87 and £3.9 billion in 1987-88.

ACSA

A C S ALLAN

psl/33A

BUDGET SECRET

COPY NO. 10 OF 10 .

FROM: A C S ALLAN
DATE: 11 March 1987

MR ODLING-SMEE

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Sedgwick
Mr Riley

NOTE FOR THE PRIME MINISTER ON MTFS ETC.

The Chancellor needs to send a minute to the Prime Minister recording his proposals on the PSBR and on the MTFS. I attach a draft and would be grateful for any comments as soon as possible.

2. The drafting of the passages on the PSBR clearly has to await a final decision on the numbers.

ACSA

A C S ALLAN

BUDGET SECRET No of Copies

DRAFT MINUTE FROM THE CHANCELLOR

PRIME MINISTER

1987 BUDGET: MTFS

In my minute of [ ] March, I set out my tax proposals and said I would let you have a further minute on the PSBR and monetary targets for 1987-88.

Public Sector Borrowing

The latest estimates of the February PSBR show that cumulative borrowing in the first eleven months of the year was only £0.1 billion. Borrowing in March will, as usual, be heavy, although the likely out-turn remains very uncertain, ~~though the~~ Local authorities always undertake substantial borrowing in March, and we shall be making a £680 million payment to Rover. But it seems likely that borrowing over the year as a whole will be no more than about [£4¼] billion.

I believe it is right to set the PSBR for 1987-88 below that; it would give the wrong signal if we were to increase the PSBR at a time when growth was demonstrably strong. Even with the £2.6 billion tax package we have agreed, there should be no difficulties over this. I propose to set the PSBR for 1987-88 at [£4] billion, or 1 per cent of GDP, and the arithmetic underpinning this is based on cautious estimates of revenue yields and on an assumption of a $15 oil price.

For the remaining years of the MTFS period, I plan to show the PSBR remaining at 1 per cent of GDP. This was the level we used as our goal in the illustrative path for the PSBR in the Green Paper on long-term pubic expenditure, published in March 1984. It was then the assumption for 1993-94, and it is a remarkable achievement to be able to reach that goul so far in advance of our earlier planning.

Monetary Targets

For the monetary targets in 1987-88, I intend to stick to M0 but not to set a formal target for £M3, ~~for 1987-88~~. As you know, we have had increasing difficulties in interpreting changes in broad money, and £M3 has for several years showed a tendency to grow more rapidly than money GDP. This year, £M3 has grown consistently above its target range. I do not think that dropping the £M3 target will cause any surprise at all.

The velocity of M0 has been much more stable, and M0 has remained within its target range of 2 to 6 per cent. The illustrative range for M0 in 1987-88 which we set out in last year's FSBR was also 2 to 6 per cent, and I see no reason to change that now. I shall also be publishing the same illustrative ranges as in last year's FSBR for the future years of the MTFS.

The dropping of a broad money target does not mean that the whole weight of monetary policy is thrown on to M0, though that has a very important role to play. We shall continue to assess monetary conditions in the light of all the available indicators, including in particular the exchange rate. And we shall make it clear that, although we are not setting a formal target for £M3, we shall continue to take it into account in assessing monetary conditions.

This approach has been fully discussed with the Bank who support these recommendations.

N.L.

ps1/31A

CONFIDENTIAL

PVP

FROM: A C S ALLAN
DATE: 11 March 1987

PS/CHIEF SECRETARY

cc Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mrs R Butler
Mr Pratt
Mr Mowl
Mr Riley
Mr Parkinson

PRESENTATION OF THE 1986-87 PLANNING TOTAL OUTTURN IN THE FSBR

The Chancellor has seen Mr Pratt's minute of 10 March. He notes that the overrun on the planning total is now slightly more than accounted for by "below the line" items - ie a fall of £350 million in privatisation proceeds and an extra £650 million for Rover (scored as a purchase of company securities). This should be useful in presentation - especially to the TCSC.

ACSA

A C S ALLAN

1515/030

CONFIDENTIAL
Covering **BUDGET SECRET**

Copy No 3 of 17 Copies

FROM: R Pratt
DATE: 10 March 1987

1. MR F E R BUTLER

Copies attached for

Chancellor
Sir P Middleton

2. CHIEF SECRETARY

cc Sir T Burns
Mr Anson
Mr Cassell
Mr Odling-Smee
Mr Scholar
Mr Turnbull
Mr Sedgwick
Mrs R Butler
Mr Riley
Mr Mowl
Mr Parkinson

This shows that the overrun on the planning total is slightly less than accounted for by the 'below the line' items — ie privatisation proceeds down 350 & Rover (purchase of co securities, technically) 650. 1 billion. This sh be used in presentation — esp to TCSC etc.

PRESENTATION OF THE 1986-87 planning total OUTTURN IN THE FSBR

This submission considers the figure to show in the FSBR for the 1986-87 planning total outturn.

2. Our latest forecast is that the 1986-87 planning total outturn will be £140.0 billion - an overspend of £0.9 billion. This is a decrease of £0.3 billion on the figure in my February monthly report. It is £0.4 billion below the figure of £140.4 billion shown in the public expenditure White Paper.

3. The main reasons for the decrease since last month's report are reductions in estimated expenditure by IBAP, an increase in MOD shortfall and a reduction in LA capital. The attached regular monthly note on the Reserve for March discusses this and also considers the implications for the 1987-88 Reserve of the latest decrease in our forecast outturn for 1986-87. This submission considers the presentation of the 1986-87 outturn in the FSBR and Budget briefing and hence concentrate on the comparison with the last published outturn figure in the public expenditure White Paper.

4. Although there is scope for the outturn to vary in future, we do not believe we can regard £140.0 billion as being insignificantly different from the White Paper figure of £140.4 billion, despite the presentational advantage in sticking to the outturn figure already published. We therefore recommend that you publish our best estimate of £140.0 billion for the following reasons:

(i) £140.0 billion is our best guess, but there may well be further changes in a downward direction on the horizon - MOD may have a larger shortfall, for example, and EC net contributions could be rather lower. — or higher ?

(ii) The White Paper included an 'adjustments' line, which included -£400 million for the BGC and BAB EFLs, an allowance for Rover of +£650 million and a further allowance for shortfall. The EFL and Rover figures have now been included in the relevant departmental lines. Provided that our central estimate of total outturn is used, it will not be necessary to show, or explain, an 'adjustments' line for 1986-87 in the FSBR.

(iii) Because of changes in the GDP deflator, the real terms year on year increase between 1986-87 and 1987-88 is still less than the figure shown in the PEWP, despite the reduction in the base year 1986-87. The figures are set out at Annex A.

(iv) The figure of £140.0 billion is consistent with the figures for Supply expenditure and cash limits outturn shown in the Estimates and Summary and Guide. These are based on the latest (F10) returns from departments and cannot now be changed.

5. The reduction in the planning total outturn brings GGE to £164.8 billion. As Annex A shows, however, this is unlikely to alter the run of figures showing GGE as a proportion of ~~GGE~~. GDP This is because both money GDP and GGE are slightly higher than in the PEWP. GGE is higher than in the PEWP because public corporations are taking more of their finance from government, which adds to GGE, and repaying more to the market (see Mr Monck's minute of 4 March to the Chancellor).

Presentation of the Revised Outturn

6. In addition to showing the main reasons for the overshoot, we will need to explain the £400 million reduction in estimated

outturn since the PEWP. In fact there have been a large number of changes, both up and down, and so the main items to show are, to some extent, a matter of choice. In the briefing we propose to draw attention to the following main changes (rounded):

MOD	-£400m	(increased shortfall)
LA capital	-£300m	(increased receipts)
Offset by		
Privatisation proceeds	+£350m	(reduced proceeds)

We would also point out that, as was made clear in the text of the PEWP, an allowance had been made for Rover.

<u>Conclusion</u>

7. The implications of this lower forecast planning total outturn on the 1986-87 PSBR will be considered by Mr Sedgwick in a submission to be put forward tomorrow, 11 March. A decision both on the planning total and the PSBR figures to show in the FSBR is needed by close tomorrow.

8. Do you agree that we should publish an outturn figure of £140.0 billion in the FSBR?

R PRATT

BUDGET SECRET

ANNEX A

CHANGES FROM 1987 PEWP

	1986-87	1987-88	1988-89	1989-90	1990-91
Planning total (cash)					
1987 PEWP	140.4	148.6	154.2	161.5	-
1987 FSBR	140.0	148.6	154.2	161.5	168
Planning total (real terms, 1985-86 prices)					
1987 PEWP	136.5	139.3	139.7	142.1	-
% change on year earlier	+2.2	+2.1	+0.3	+1.7	
1987 FSBR	136.0	138.0	131.7	139.2	140.6*
% change on year earlier	+1.8	+1.5	-0.2	+1.1	+1.0
General government expenditure					
1987 PEWP	164.4	173.7	179.6	187.8	-
1987 FSBR	164.8	173.5	180	188	196
General government expenditure as proportion of GDP					
1987 PEWP	43¼	42¾	41¾	41¾	-
1987 FSBR	43¼	42¼	41¼	40½	40

* Not separately shown in FSBR but can be calculated.

NB. The figures in this annex are still not final.

CONFIDENTIAL

FROM: R PRATT
DATE: 10 March 1987

(1) MR F E R BUTLER

Copies attached for:
Chancellor of the Exchequer
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton

(2) CHIEF SECRETARY

cc Sir T Burns
Mr A Wilson
Mr Cassell
Mr Monck
Mr Sedgwick
HEGs
Mr Mowl
Mrs R J Butler
Mr Culpin
Mr Gilhooly
Mr Parkinson
Mr I Taylor
Miss Adamson

PLANNING TOTAL AND STATE OF THE RESERVE

This note outlines GEP's March assessment of the outturn of the planning total and implied claims on the Reserve for 1986-87.

2. The total claims on the Reserve are assessed to be £5.4 billion (rounded), **ie £0.9 billion** over the Reserve in plans. This compares with an overspend of £1.3 billion shown in the PEWP and of £1.2 billion in last month's report. Table 1 compares the latest position with last month.

Table 1: Claims on the Reserve, March 1987 (£ billion, rounded)

	Total	**Change since last month's assessment**
LA current	2.8	-
of which Housing Benefit	(0.3)	-
LA capital	0.2	-0.1
Demand-led central government exp	1.1	-0.1
of which		
Social Security	(1.2)	-
IBAP(gross)	(-0.4)	(-0.1)
End year flexibility	0.3	-
Other discretionary	1.2	-
Cash limit underspend	-0.8	-0.1
Nat Industries EFLs	-0.1	-0.1
Other (incl EC)	0.3	+0.1
Privatisation proceeds	0.4	-
TOTAL	5.4	-0.3

3. The main increase since last month is £150 million in our estimated net EC contribution, mainly associated with expected overdraft provisions of which you are aware. The main decreases are: -£75 million on net LA capital (reflecting the latest DOE/LA1 estimate); -£100 million on cash limited underspend (made up of -£185 million for MOD, offset by lower than expected shortfall on other cash limits); -£100 million on demand-led Supply expenditure (mainly further reductions on IBAP); -£70 million on nationalised industries (including -£55 million on improved BA prospects); -£75 million on various CFERs. This assessment incorporates the F10 information on departmental estimated Supply outturn figures.

4. A summary of the demands on the Reserve distinguishing formally agreed and potential discretionary and non-discretionary claims is shown in the Annex.

Effect on 1987-88 Reserve

5. Although there has been a reduction in estimated outturn for 1986-87, this is not expected to lead to increased pressure on the 1987-88 Reserve. The increased shortfall on the MOD cash limit is partly the result of the new Levene regime with stricter emphasis on payment by results and a general effort to reduce end-year surge. It will almost certainly result in a corresponding increase in MOD's cash limit next year, through end-year flexibility, but we do not expect MOD to alter their spending plans to take up this increased carry-forward in 1987-88. Other things being equal, therefore, we expect the increased carry-forward into 1987-88 to be offset, in large part, by increased carry-forward into 1988-89.

6. On the other hand, the increase in our net EC contributions in 1986-87 is more than accounted for by the likely call this month by the Community for advance own resources payments and overdraft facilities. The increase in 1986-87 will directly reduce expenditure in 1987-88.

Conclusion

6. This month's estimate indicates a planning total outturn figure of £140.0 billion, £0.9 billion higher than plans, and a net decrease of £0.3 billion since last month. The estimated outturn remains subject to some uncertainty, however. The next published figure will appear in CSO's Financial Statistics in June.

RP

R PRATT

ANNEX

SUMMARY OF DEMANDS ON THE RESERVE

(i) Formal Position

The total of claims which have been formally charged to the Reserve is £3,585 million, £800 million higher than last month. This reflects the formal charging of the late spring Supplementaries including Rover and social security (£680 million), and £114 million for the BS EFL. All but £30 million was anticipated in last month's assessment.

(ii) Potential claims: discretionary

Total estimated expected discretionary claims stand at £195 million, down by £725 million since last month. This reflects the formal charging of the Rover Supplementary (for which £650 million had been included as a potential claim last month) and a reduction in DOE's estimate of net LA capital expenditure (-£75 million).

(iii) Potential claims: non-discretionary

Potential non-discretionary claims are estimated at £1,625 million, a net decrease of £370 million since last month. The main increase is £150 million as a result of EC's latest assessment of our expected EC contributions. The main decreases are:

(a) -£120 million for demand-led central government expenditure, reflecting the latest F10 and other information, including reduced IBAP.

(b) -£185 million for nationalised industries' expected outturn, of which -£114 million simply reflects the formal charging of the BS increase and -£55 million is for improved BA prospects.

(c) -£100 million on increased cash limit underspend, reflecting latest F10 information on MOD and other votes.

(d) -£75 million on various increased CFERs.

(e) -£40 million on LA current (mainly revised assessment of LA budgets).

2. Total call on reserve in 1986-87 implied by the latest estimate by spending authority and Department (Dept A)

£ billion

1986-87	Central government	Local authorities	NI external finance	L1&11PCs external finance	List 111 public corps	Total call on reserve
Ministry of Defence	-.3	-	-	*	-	-.3
Foreign & Commonwealth Office - ODA	*	-	-	*	-	*
Foreign & Commonwealth Office - other	*	-	-	-	-	*
European Community	.5	-	-	-	-	.5
Intervention Board for Agricultural Produce	-.4	-	-	-	-	-.4
Agriculture	.1	*	*	-	-	.1
Forestry Commission	-	-	-	-	-	-
Department of Trade & Industry	.7	*	*	*	-	.8
Department of Energy(1)	.1	-	-.1	-	-	-.1
Export Credits Guarantee Department	-.1	-	-	-	-	-.1
Department of Employment	*	*	-	-	-	.1
Department of Transport(1)	*	.1	*	*	-	.1
DOE - Housing	.1	-.1	-	-	-.1	-.1
DOE - Property Services Agency	*	-	-	-	-	*
DOE - Other Environmental Services	*	.3	*	*	*	.3
Home Office	*	.3	-	-	-	.3
Lord Chancellors Department	*	-	-	-	-	*
Department of Education and Science	*	1.4	-	-	-	1.4

(continued overleaf)

TABLE 2 (continued)

2. Total call on reserve in 1986-87 implied by the latest estimate by spending authority and Department (Dept A)

£ billion

1986-87	Central government	Local authorities	NI external finance	L1&11PCs external finance	List 111 public corps	Total call on reserve
Office of Arts and Libraries	*	.1	–	–	–	.1
DHSS-Health & Personal Social Services	.1	.1	–	–	–	.2
DHSS - Social Security	1.3	.3	–	–	–	1.7
Civil Superannuation	-.1	–	–	–	–	-.1
Scotland	.1	.2	*	*	*	.3
Wales	.1	.1	*	–	*	.1
Northern Ireland	.1	*	–	-.1	*	.1
Chancellors Departments	.1	–	–	–	*	.1
Minor Departments	*	–	–	–	–	*
Local Authority current not allocated to departments	–	–	–	–	–	–
Total expenditure on programmes	2.4	3.0	-.1	-.1	-.1	5.0
Privatisation proceeds	–	–	–	–	–	.4
Plans/Estimated outturn	–	–	–	–	–	5.4

(1) Includes adjustment for external finance of nationalised industries to be privatised this year.
* Indicates less than +/- £50 million.

TABLE 3

3.1986-87 Public expenditure planning total

£billion

1986-87	Cmnd 9702 (1)	Cm56 est. (2)	Feb est. (3)	FSBR est. (4)	Call on reserve (5)
Central government(6)	102.6	104.8	105.1	105.0	2.4
Local authorities(6)	35.2	38.7	38.2	38.1	3.0
Nationalised industries external finance(7)	.5	.5	.5	.5	-.1
List 1 & 11 public corporations external finance.	.5	.4	.4	.4	-.1
List 111 public corporations subsidies and capital expenditure	.6	.5	.5	.5	-.1
Total expenditure on programmes	139.4	145.1	144.7	144.4	5.0
Privatisation proceeds	-4.8	-4.8	-4.4	-4.4	.4
Plans/Estimated outturn	134.6	140.4	140.3	140.0	5.4
Reserve not allocated above	4.5	-	-	-	
Planning Total	139.1	140.4	140.3	140.0	
Implied overspend on plans	-	5.8	5.7	5.4	
Reserve available	-	4.5	4.5	4.5	
Implied overspend on planning total	-	1.3	1.2	.9	

(1) Cmnd 9702 adjusted for the effects of classification changes.
(2) Includes in the total an allowance for the Adjustment shown in Table 2.1.
(3) Consistent with PEPR(86) 12.
(4) Consistent with PEPR(86) 13.
(5) Column 5= Column 4- Column 1, calculated on unrounded figures and independently rounded.
(6) Excluding finance to nationalised industries and other public corporations treated similarly.
(7) Includes adjustment for external finance of nationalised industries to be privatised this year.
* Indicates less than +/- £50 million.

Table 4: Claims on the Reserve 1986-87

£million

	Formally charged	Potential bids Discretionary/	non-Discretionary	Total
Central Govt (voted)	**3110**	**20**	**-1240**	**1890**
of which:				
- cash limited votes	1485	10	-760	735
- social security (voted)	1265	5	-30	1240
- IBAP (gross)	-30		-325	-355
- ECGD	-10		-30	-40
- RMPS	+130	0		130
- FPS	25		-10	15
- other non cash limited votes	240	5	-85	160
National Insurance Fund	**-50**		**115**	**65**
LA expenditure	**380**	**160**	**2405**	**2945**
of which:				
- LA current	360		2405	2765
- LA capital	20	160		180
EFLs - nationalised industries	**250**		**-325**	**-75**
Privatisation proceeds			**365**	**365**
Other (net)	**-110**	**15**	**310**	**215**
TOTAL CLAIMS	3580	195	1630	5405
RESERVE				4500
Net potential overspend				**905**

197/014

BUDGET CONFIDENTIAL

From: N MONCK

Date: 12 March 1987

prp

MR SCHOLAR

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr F E R Butler
Mr Culpin
Miss O'Mara
Mr P Gray
Mr Cropper
Mr Ross Goobey
Mr Tyrie

Mr Isaac, IR

FSBR SECOND PROOF

I have two suggestions on PRP.

2. In paragraph 4.08 I think we should come clean on the exclusion of the public sector. The point is already in the Inland Revenue press release but is not in the speech. We do not want to expose ourselves to charges of letting this news out in a hole and corner way. This could be done in the first sentence either by inserting "private sector" before "employees in profit-related pay (PRP) schemes"; or by inserting "in the private sector" after "schemes". I understand the Minister of State agrees with this.

3. Secondly, there is a pure drafting point on the manuscript insertion into para 9 of the annex to Chapter 4. At the moment this includes the sentence "It will build up substantially in later years ...". This text might originally have appeared as a footnote to the summary table 1.1. In that context "later years" would have made sense. It makes very little sense, however, in a sentence following the detailed explanation of the upper ceiling on the PRP tax relief. It would read perfectly well if "in later years" is deleted.

N MONCK

CONFIDENTIAL

FROM: **P N SEDGWICK**
DATE: 13 MARCH 1987

PRINCIPAL PRIVATE SECRETARY

Use (b) if true (ie consistent with 'cast'), drop it if not.

cc Sir P Middleton
Sir T Burns
Mr Scholar
Mr Bottrill
Mr Davies
Ms Evans

FSBR : CHAPTER 3

The Chancellor added a sentence to paragraph 3.47 last night which read

> "For the first time since 1983 unit labour costs in manufacturing in the UK are expected to rise less in 1987 than those of the other major industrial nations".

I am afraid that Chart 3.9 on which this statement was based contained some errors. I attach a corrected version which Stephen Davies has checked meticulously. In the light of this the options are

(a) to drop this sentence,

or (b) to amend the Chancellor's sentence to read.

> "For the first time since 1983 unit labour costs in manufacturing in the UK are expected in 1987 to rise ~~in line with~~ no faster than those in the other major industrial countries."

My preference is for option (a). If the Chancellor prefers option (b) Ms Evans would need to ring it through to the printers today. - Done CE

P.N.S

P N SEDGWICK

Ch
OK to (a)?
AA

Chart 3.9 Unit labour costs in manufacturing

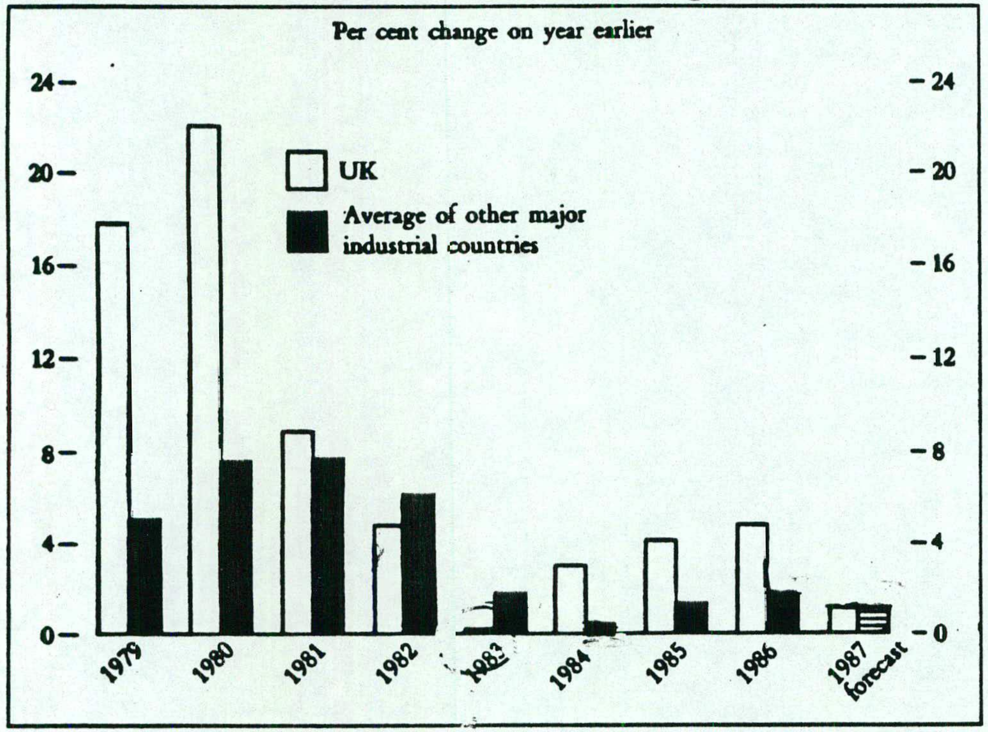
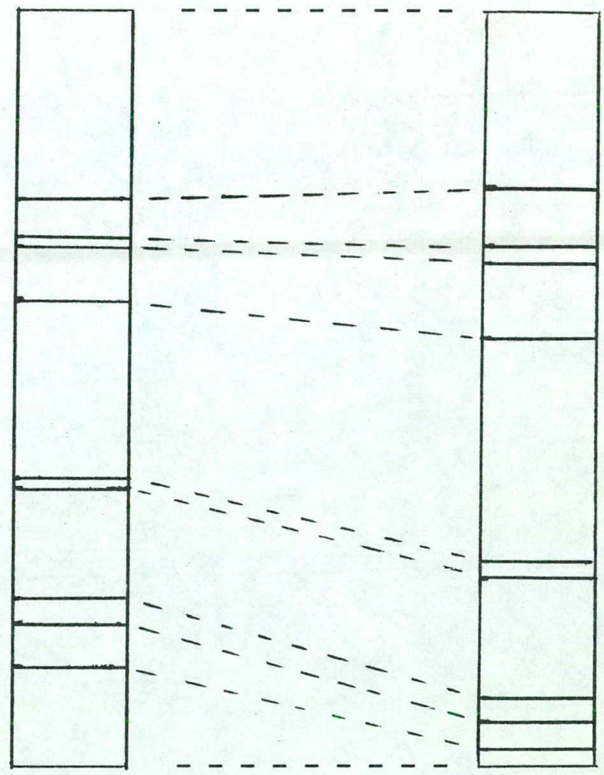
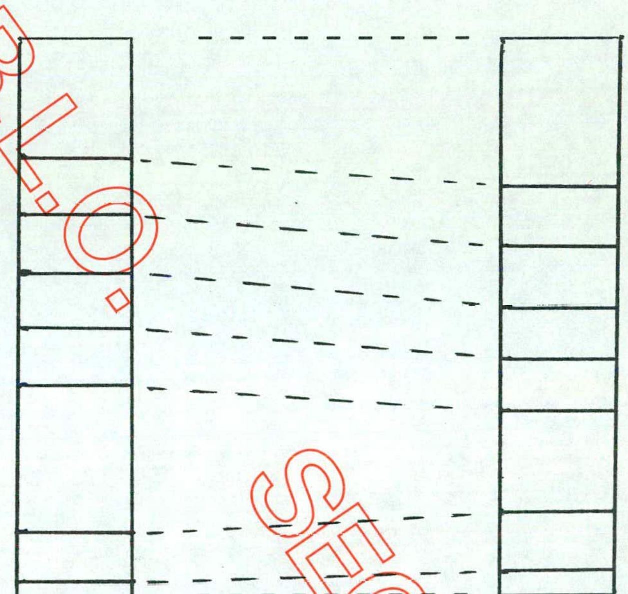


Chart 6.1 The structure of receipts and expenditure[1]



Receipts and borrowing	1978-79 %	1987-88 %
Income taxes	25	23
Corporation tax (excl. North Sea)	5	8
Capital taxes	1	2
Local authority rates	8	10
Central government expenditure taxes	24	30
North Sea revenues	1	2
National Insurance Contributions	14	16
Interest and dividends	4	3
Other receipts	6	4
Borrowing[2]	12	2
TOTAL RECEIPTS AND BORROWING	100	100



Expenditure	1978-79 %	1987-88 %
DHSS - Social security	22	26
Defence	10	11
DHSS - Health and personal social services	10	11
Scotland, Wales, N. Ireland	10	9
Education and science	10	10
Other Departments	26	18
Interest	10	10
Other adjustments	2	5
TOTAL EXPENDITURE	100	100

1 This table is based on the presentation in table 1.2. For 1987-88 the cash totals of receipts and borrowing and expenditure are £[ ] billion.

2 By general government

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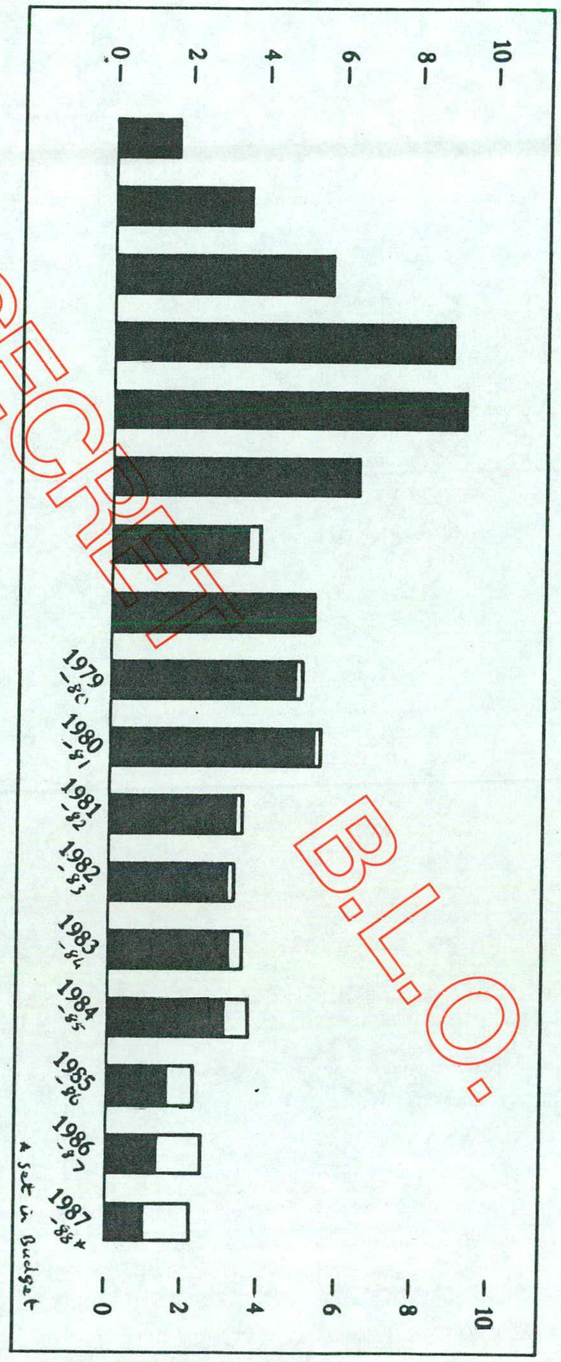
Chart 2.5 Public sector borrowing requirement and privatisation proceeds



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2 Medium Term Financial Strategy

2.01 The Medium Term Financial Strategy (MTFS) continues to provide the framework for the Government's economic policy, as it has done since 1980. It is intended to bring inflation down further over a period of years, and ultimately to achieve price stability. It is complemented by policies designed further to improve other aspects of the UK's economic performance.

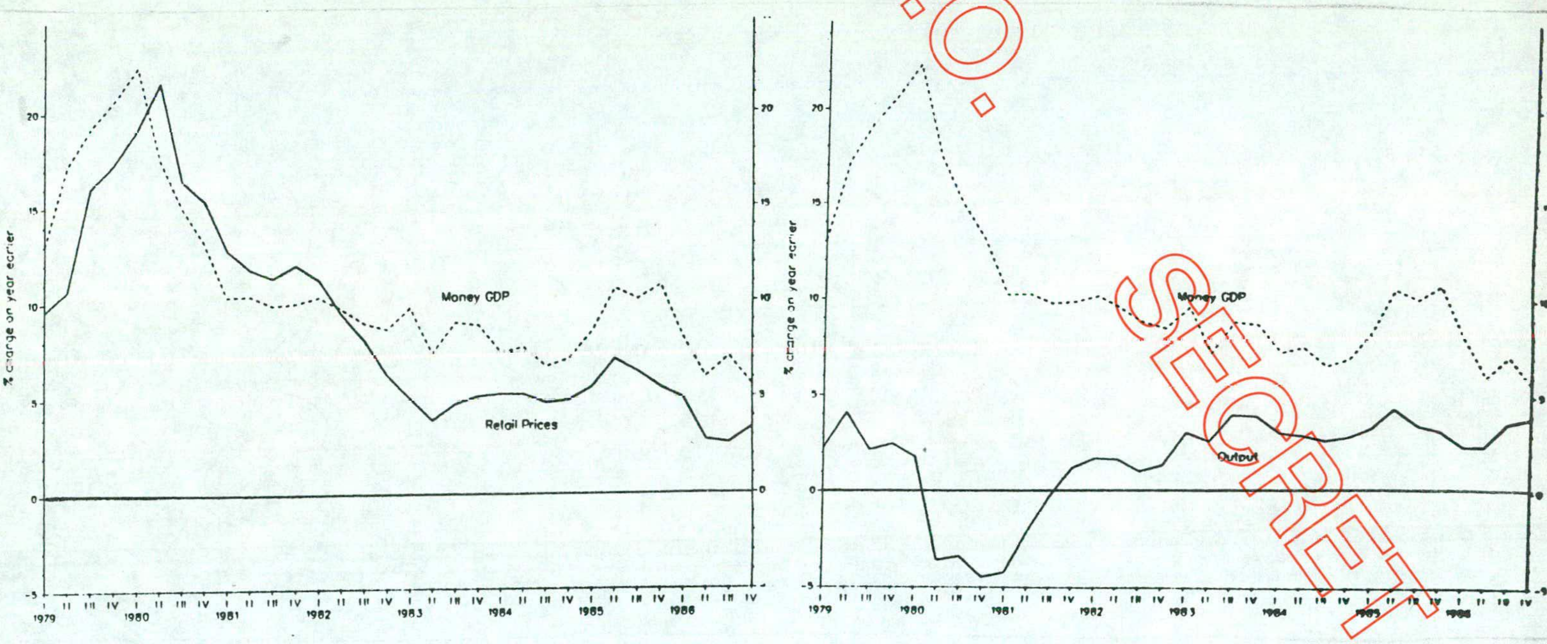
Economic policy is set in a nominal framework

2.02 Monetary and fiscal policies are designed to reduce the growth of money GDP, so bringing down inflation. They are complemented by policies to encourage enterprise, efficiency and flexibility. These policies improve the division of money GDP growth between output growth and inflation, and help the creation of jobs.

Over the past seven years, money GDP growth has come down from over 20 percent to around 6 percent. But in real terms,

2.03 Since 1981, the economy has grown at ~~around~~ approaching 3 per cent a year on average, with little variation in the growth rate from year to year. This is the longest period of steady expansion since ~~the 1960s~~ before 1973, and it has been achieved while inflation has come down sharply—from a peak of over 20 per cent in 1980 to 4 per cent now. Productivity is rising rapidly, at a rate which compares very favourably with our major competitors. The economy has weathered the fall in oil prices last year without disruption, and is about to embark on a seventh year of steady growth, combined with low inflation.

Chart 2.1 Money GDP output and inflation



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Objectives and the framework of policy

Money GDP

2.04 Policy is directed at maintaining monetary conditions that will bring about a gradual reduction in the growth of money GDP over the medium term. In the short term there will be fluctuations, but it is the medium term trend which is important. The government will aim to avoid ~~substantial~~ departures in the medium term from the path set out in table 2.1

Table 2.1 Money GDP ~~and Monetary~~ Growth[1]

	1986–87	1987–88	1988–89	1989–90	1990–91
~~Money GDP~~[1]	6	7½	6½	6	5½
~~M0~~[2]	~~4½~~	~~2–6~~	~~1–5~~	~~1–5~~	~~0–4~~

[1] *Per cent change on previous financial year. See table 2.2 for assumptions on output and inflation. The figure for 1987–88 is a forecast; and in subsequent years the figures describe the Government's broad medium term objectives.*

[1] *1986–87: per cent change on previous financial year.*
1987–88: target range.
1988–89 onwards: illustrative ranges.

to ta 2·2

2.05 The growth of money GDP in 1986–87 is expected to be ~~a little~~ somewhat below the 6¾ ~~per cent~~ forecast at the time of the last Budget. The forecast for 1987–88, described in Chapter 3, is ~~slightly~~ correspondingly higher than the 6½ per cent indicated last year. Over the two years to 1987–88 the growth rate is little changed. In the later years the growth of money GDP declines at the same rate as in last year's MTFS.

Instruments of policy

2.06 The Government sets monetary and fiscal policies to achieve monetary conditions which will deliver its objectives for money GDP. A declining path for money GDP growth, as in Table 2.1, requires firm monetary policies supported by low public sector borrowing.

2.07 Fiscal policy is reviewed each year at Budget time. Short-term interest rates, which can be varied more frequently, are the essential instrument of monetary policy. They will continue to be maintained at levels necessary to keep monetary conditions on track.

2.08 The authorities seek to fund the PSBR fully, and no more, over each financial year by sales of debt outside the monetary sector. This will continue to be the basis for funding policy.

Monetary policy

2.09 Monetary conditions are assessed in the light of movements in narrow and broad money, and the behaviour of other financial indicators, in particular the exchange rate. There is no mechanical formula for taking these factors into account; a balance must be struck between the exchange rate and domestic monetary growth consistent with the Government's aims for money GDP and inflation.

2.10 Over the past two years, the dollar has depreciated substantially against most other major currencies. At a meeting of Finance Ministers and Central Bank Governors of six major industrial nations in Paris on 21/22 February, it was ~~agreed~~ concluded that a period of stability would ~~now~~ be desirable. Accordingly, the UK and other countries represented there agreed ~~in current circumstances~~ to co-operate closely to ~~foster stability of exchange rates around current levels~~ that end. The MTFS projections assume that there is no major change in either the sterling exchange rate index or the sterling/dollar exchange rate from year to year.

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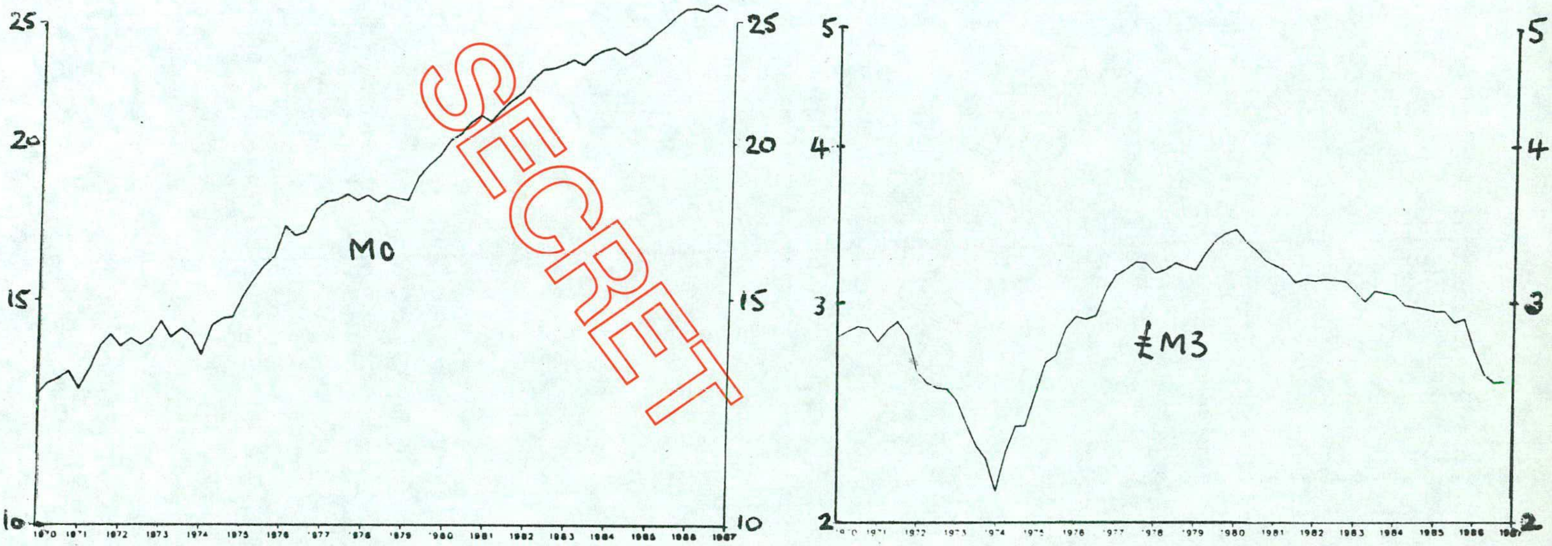
Narrow money

2.11 Last year's MTFS set out the properties desired of a target aggregate for narrow money. In particular it should have a stable relationship with money GDP. As Chart 2.2 shows, the velocity of M0 has grown relatively steadily over a long period of time. M0 has proved a reliable indicator of monetary conditions.

Chart 2.2 Velocity of monetary aggregates



2.12 In principle there is a case for moving to a wider measure of non-interest bearing money, such as the non-interest bearing component of M1. But the velocity of this aggregate exhibits considerable fluctuations which are currently exacerbated by the rapid growth of interest bearing sight deposits, and it is ultra-sensitive to interest rate changes. ~~So~~ In these circumstances M0 remains the best choice of narrow aggregate for target purposes.

Chart 2.3 Growth of M0 and money GDP

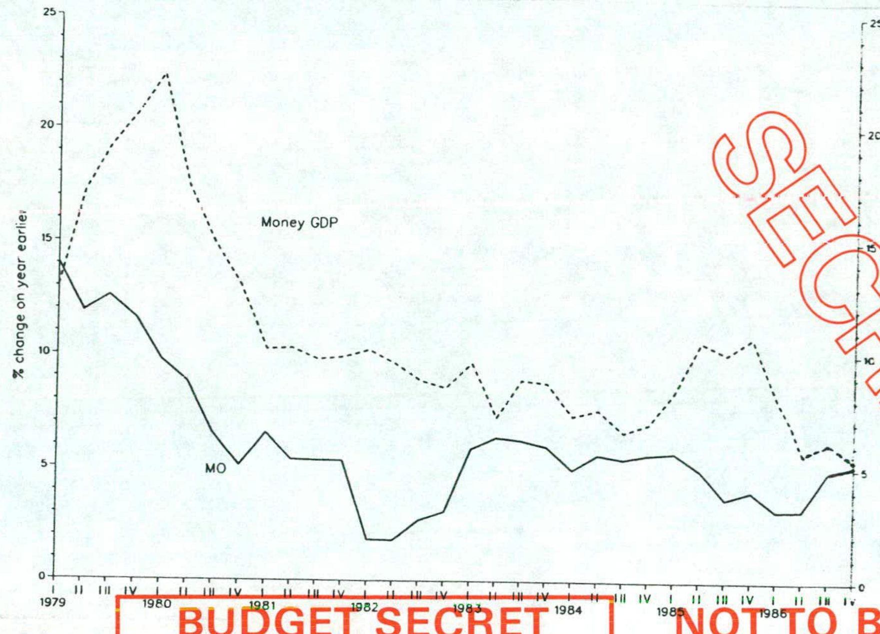


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Table 2.2 Growth of M0

1986-87	1987-88	1988-89	1989-90	1990-91
4	2-6	1-5	1-5	0-4

2.13 The target range for M0 growth in 1987–88 is 2–6 per cent, unchanged from the range indicated in last year's MTFS. Ranges for the later years are illustrative, but have a downward profile consistent with the declining path for money GDP growth.

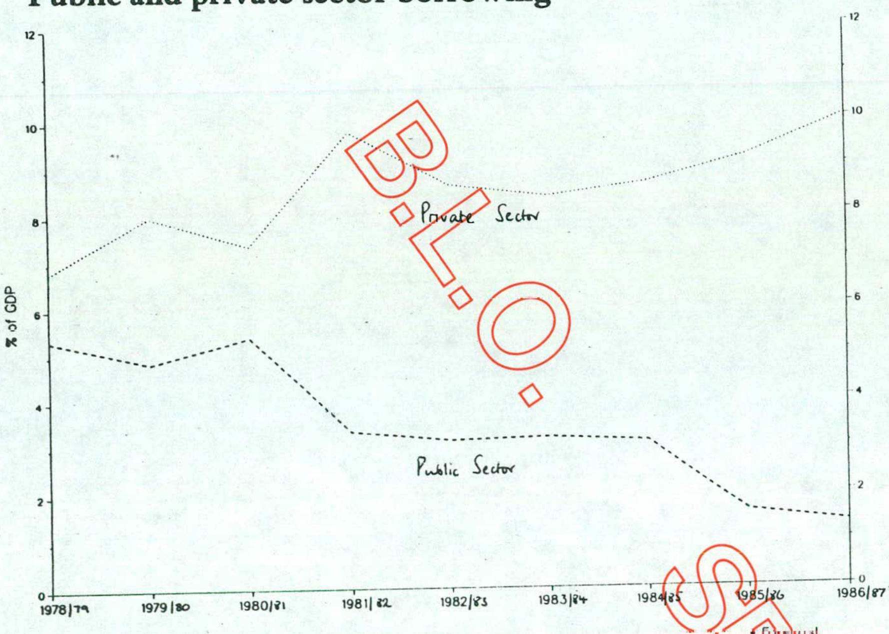
Table 2.2 to go here, with footnote

2.14 If the underlying growth of M0 threatens to move significantly outside its target range in 1987–88 there is a presumption that the Government will take action on interest rates unless other indicators suggest that monetary conditions remain satisfactory.

Broad money

2.15 Broad money has been growing considerably faster than money GDP in recent years. In part this has reflected high real interest rates, which have added to the attractiveness of financial assets in general; and the end of overfunding in 1985 has also contributed. But perhaps most important, the increasing competition in financial markets in recent years has led to rapid growth of private sector liquidity and borrowing. Private sector borrowing has been rising and is now ~~over~~ about 10 per cent of GDP (Chart 2.4). It has clearly contributed more than public borrowing to upward pressure on real interest rates. These trends are likely to persist, so that broad money growth may continue at around its recent rate, well in excess of the growth rate of money GDP.

Chart 2.4 Public and private sector borrowing



2.16 The 1986 Building Societies Act marks a further step in the evolving status of building societies. As their behaviour becomes closer to that of banks, wider aggregates which include building society liabilities are likely to continue to be less erratic than £M3.

2.17 Both the Chancellor and the Governor of the Bank of England have drawn attention to the increasing difficulties in interpreting changes in broad money. With rapid and pervasive changes in financial practices, there is no simple relationship between broad money growth and money GDP. For this reason, the Government has decided that there should be no formal target

for broad money in 1987–88. But the rate of growth of broad money cannot be ignored, and the Government will continue to take it into account in assessing monetary conditions.

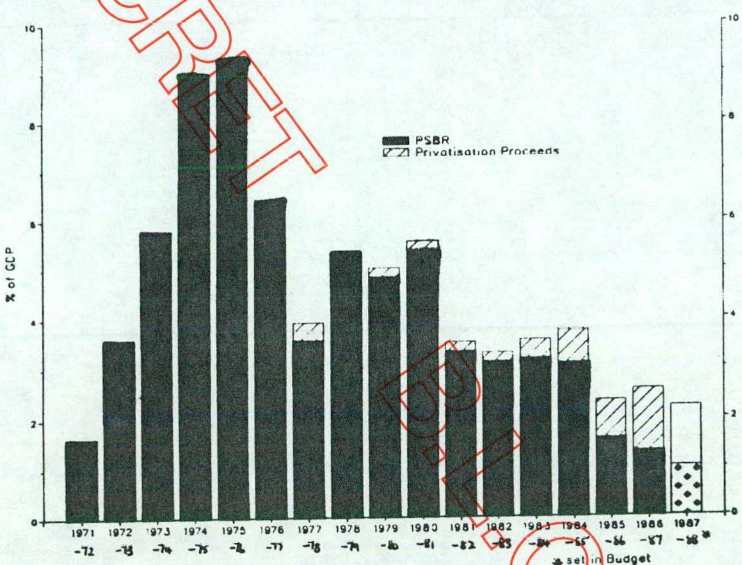
Fiscal policy

appreciably less than was set at the time of last year's Budget,

2.18 The PSBR in 1986–87 is expected to be about 1¼ per cent of GDP. This is ~~somewhat lower than~~ ~~in last year's projection~~, in spite of lower oil revenues. After remaining at about 3¼ per cent of GDP between 1981–82 and 1984–85, the PSBR ~~has now come down in each of the last two years.~~ As Chart 2.5 shows, even if privatisation proceeds are added back, it has been lower as a share of GDP in ~~1985–86 and 1986–87~~ the past two years than ~~in~~ at any ~~year~~ time since 1971–72.

was reduced sharply in 1985-86 and has come down further in 1986-87

Chart 2.5 **Public sector borrowing requirement and privatisation proceeds**



As usual,

× **The PSBR path**

2.19 The fiscal projections for the next four years ~~are~~ set out in Tables ~~2.[illegible]~~ 2.4-6 take account of the composition of receipts and expenditure. The path of the PSBR is below that shown in last year's MTFS. The buoyancy of revenues experienced in 1986–87 and projected for 1987–88 has made it possible to ~~aim to achieve the desired low level of the PSBR as a percentage of GDP by 1987–88. As usual, account has been taken of the composition of receipts and expenditure.~~

set a PSBR in 1987-88 which reflects the Government's long term objective for the level of public borrowing.

2.20 The PSBR for 1987–88 is thus set at £4 billion, or 1 per cent of GDP. North Sea revenues in 1987–88 are forecast at about £4 billion, ~~the same level as~~ slightly lower than in 1986–87. The proceeds from the Government's privatisation programme are expected to be £5 billion, as set out in the Autumn Statement.

4

2.21 The PSBR is projected to remain at 1 per cent of GDP ~~after 1987–88~~ thereafter. If privatisation proceeds are added back the ratio gradually falls from 2¼ per cent in 1987–88 to 2 per cent in the final year. ~~These figures illustrate the desired position over a period of years; decisions about the PSBR in particular years will be taken nearer the time.~~

The PSBR to be set in future Budgets for the year ahead will be reviewed in the light of circumstances at the time.

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Assumptions

2.22 For the period to 1989–90, the public expenditure projections in Table 2.4 follow the plans set out in the Public Expenditure White Paper (Cm 56). It is provisionally assumed that the planning total will grow by 1 per cent in real terms in 1990–91. Decisions on the planning total for that year will be taken in the 1987 Survey. The revenue projections in Table 2.5 are based on the conventional assumptions of constant 1987–88 tax and national insurance contribution rates, and allowances and thresholds indexed from the proposed 1987–88 levels. All changes proposed in the Budget are taken into account.

2.23 The assumptions about output growth and inflation that underlie the revenue projections are shown in Table 2.3. They are consistent with the figures for money GDP growth in Table 2.1. As last year, oil prices are assumed to average $15 a barrel in 1987, and thereafter to remain broadly unchanged in real terms.

Table 2.3 Output and inflation assumptions

	Percentage change on previous financial year				
	1986–87	1987–88	1988–89	1989–90	1990–91
Real GDP					
Non-North Sea	3	3½	2¾	2¾	2¾
Total	3	3	2½	2½	2½
Inflation					
GDP deflator	3	4½	4	3½	3

Public expenditure

2.24 Continued restraint in public spending is a vital element of the Government's economic strategy. General government expenditure has fallen steadily as a proportion of GDP from its peak of over 46 per cent in 1982–83. ~~Given the path for money GDP~~, The plans in the White Paper imply a continuing fall. This will enable a low level of borrowing to be combined with reductions in the burden of taxation, so improving motivation, efficiency and employment. Public expenditure is discussed more fully in Chapter 5.

Table 2.4 General government expenditure

	£ billion, cash					
	1985–86	1986–87	1987–88	1988–89	1989–90	1990–91
Public expenditure planning total[1]	133.6	140	149	154	162	168
Gross debt interest	17.7	18	18	18	19	19
Other adjustments[2]	7.2	7	7	8	8	8
General government expenditure[3]	158.5	165	174	180	188	196
of which Privatisation proceeds[4]	2.7	4½	5	5	5	5

[1] For 1985–86 to 1989–90, the figures are taken from Table 5.1. The planning total is assumed to grow by 1% in real terms in 1990–91.
[2] See paragraph 5.04.
[3] General government expenditure, and its components, are rounded to the nearest £1 billion from 1986–87 onwards.
[4] See the Public Expenditure White Paper (Cm 56), Table 1.4. Proceeds are assumed to be the same in cash terms in 1990–91 as in 1989–90.

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Revenue

2.25 ~~The growth in government revenues in cash terms over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. On the policy assumptions set out above, general government receipts are expected to increase somewhat less than money GDP.~~ Government revenues from the North Sea, however, are ~~projected~~ expected to remain more or less unchanged in cash terms, having fallen sharply in 1986–87. Over the period as a whole, non-North Sea revenues are ~~projected~~ assumed to grow broadly in line with money GDP.

Thus total general government receipts are projected to increase somewhat less than money GDP.

Table 2.~~4~~5 General government receipts

	£ billion, cash					
	1985–86	1986–87	1987–88	1988–89	1989–90	1990–91
Taxes on incomes, expenditure and capital	114.4	120	128	136	145	153
National insurance and other contributions	24.7	26	29	30	32	34
Interest and dividends	6.5	6	6	6	6	6
Other receipts	6.4	6	7	6	6	6
Accruals adjustment	−0.5	-	-	-	−1	−1
General government receipts[1]	151.5	159	169	178	188	198
of which						
North Sea tax[2]						

[1] *General government receipts, and its components, are rounded to the nearest £1 billion from 1986–87 onwards.*

[2] *Royalties, petroleum revenue tax (including advance payments), and corporation tax from North Sea oil and gas production (before advance corporation tax set-off). This does not correspond exactly to tax receipts in the same financial year in respect of North Sea production. See footnote 3 to Table 6.B.3.*

Public sector borrowing

2.26 The projections of government expenditure and receipts are brought together in Table 2.~~5~~6 to provide projections of the general government borrowing requirement (GGBR), ~~and~~ the PSBR and the fiscal adjustment. ~~The size of the fiscal adjustment depends upon the estimates of revenues and expenditure. The projections of yields from a given set of tax rates are subject to considerable margins of error, as witnessed by the unexpectedly strong rise in non-oil tax receipts in 1986–87. On the expenditure side, the planning total for the final year has yet to be agreed.~~

2.27 Changes since the 1986 MTFS are discussed in the Annex to this Chapter.

Table 2.6 Public sector borrowing[1]

	£ billion, cash					
	1985–86	1986–87	1987–88	1988–89	1989–90	1990–91
General government expenditure	158·5	165	174	180	188	196
General government receipts	151·5	159	169	178	188	198
Fiscal adjustment from previous years[2]	-	-	-	-	3	5
Annual fiscal adjustment[2]	-	-	-	3	2	2
GGBR	6·9	6	5	5	6	6
Public corporations' market and overseas borrowing	−1·1	−2	−1	−1	−1	−1
PSBR	5·8	5	4	4	5	5
Money GDP at market prices	361	382	412	439	466	491
PSBR as per cent of GDP	1·6	1¼	1	1	1	1

[1] *Rounded to the nearest £1 billion from 1986–87 onwards. Further details for 1986–87 and 1987–88 are provided in Tables 1.2 and 6.6.*

[2] *Means lower taxes or higher expenditure than is assumed in lines 1 and 2.*

Conclusion

2.28 Events both at home and abroad may modify some of the assumptions on which the projections have been based. But the Government is committed to maintaining progress towards lower inflation, lower public expenditure as a share of GDP and lower taxes in the medium term. The MTFS provides the framework within which the financial policies to achieve this are set.

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Annex to Chapter 2

Changes since the 1986 MTFS

Money GDP **2A.1** The growth rate of money GDP in 1986–87 is expected to be somewhat lower than envisaged in last year's MTFS, with ~~faster growth of output but a~~ a smaller increase in the GDP deflator. A bounce-back is projected in 1987–88 leaving money GDP growth over the two years to 1987–88 much as projected last year. After 1987–88, inflation and money GDP growth are ½ point higher than assumed last year, though declining at the same rate. The projection of output growth is unchanged.

Table 2A.1 **Money GDP Growth**

Per cent changes from 1985 MTFS projections

1986–87	1987–88	1988–89	1989–90
–3/4	+1	+½	+½

Monetary aggregates **2A.2** The growth of M0 in 1986–87 is expected to be ~~slightly above~~ at the centre of its target range. The target range for 1987–88 is the same as the illustrative range given last year. The illustrative ranges for subsequent years are also the same.

Table 2A.2 **The Growth of M0**

	Per cent changes on a year earlier			
	1986–87	1987–88	1988–89	1989–90
1987 MTFS	4	2–6	1–5	1–5
1986 MTFS	2–6	2–6	1–5	1–5

Fiscal projections **2A.3** Table 2A.3 shows changes in the fiscal projections since the 1986 FSBR, after allowance for classification changes.

Expenditure **2A.4** The expected overspend on the planning total in 1986–87 is referred to in Chapter 5. The planning totals for 1987–88 onwards are as in the Public Expenditure White Paper (Cm 56), which incorporate higher figures than assumed last year. General government expenditure is rather higher in 1986–87 than projected last year, partly because of the higher planning total and partly because of a change in the level and pattern of public corporations' borrowing. Within a reduced level of total borrowing, they borrowed more from ~~general~~ government and less from the market and overseas than projected last year. From 1987–88 onwards, the higher levels of general government expenditure are due to higher planning totals. ~~offset by slight reductions in gross debt interest [and other adjustments].~~

Receipts **2A.5** The reduction in North Sea revenues in 1986–87 is due to last summer's fall in dollar oil prices. Little change on last year's projections is expected in later years. Other taxes ~~, especially corporation tax and VAT,~~ are higher throughout the period.

Table 2A.3 **Revenue and expenditure**[1]

	← Changes from 1986 MTFS projections £ billion				
	1985–86	1986–87	1987–88	1988–89	1989–90
Expenditure					
1 Planning total	−0.2	+1	+4½	+5½	+8
2 Other[2,5]	+0.4	+½	−½	+½	+½
3 General government expenditure	+0.1	+1½	+4	+6	+8½
Receipts[3]					
4 North Sea taxes	−0.1	−1½	-	−½	-
5 Other taxes and contributions	+1.8	+3½	+4½	+5½	+7
6 Other[2]	+0.3	+½	-	−½	−1
7 General government receipts	+2.0	+3	+4½	+4½	+6½
8 Implied cumulative fiscal adjustment[4]	-	-	−2½	−3	−4
9 Public Corporations' market and overseas borrowing[5]	+0.1	−1	-	−½	−½
10 PSBR	−1.1	−2	−3	−2½	−2½

[1] *Classification changes since the 1986 FSBR.*

The main changes are:
[2] *Includes changes in debt interest and other items.*
[3] *The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set-off. See footnote 9 to Table 6B.3.*
[4] *Line 8 = lines 10 − 9 − 3 + 7.*
[5] *Public corporations' market and overseas borrowing is included in the planning total and in the PSBR, but not in general government expenditure. Changes in it are therefore deducted in line 2 and added back in line 9.*

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MR CALDER

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4 The Budget tax proposals

4.01 The main tax changes proposed in the Budget are summarised below. A full list of changes is given in Table 4.1

Income tax 4.02 The basic rate of income tax will be reduced to 27 per cent.

4.03 The main income tax personal allowances will be increased in line with the statutory indexation provisions (based on the increase of 3.7 per cent in the RPI in the year to December 1986). This will mean that:

- the single person's and wife's earned income allowances will rise from £2,335 to £2,425.

- the married allowance will rise from £3,655 to £3,795.

- the age allowance will rise from £2,850 to £2,960 (single) and from £4,505 to £4,675 (married) and the income limit from £9,400 to £9,800.

- the additional personal allowance and widow's bereavement allowance will rise from £1,320 to £1,370.

4.04 For those aged 80 and over the age allowance will be further increased to £3,070 (single) and £4,845 (married)

4.05 The allowance for the blind will be increased from £360 to £540.

4.06 ~~Thresholds for~~ The higher rates of income tax will be charged as follows:

line up £ over hyphens.

Tax rate per cent	Taxable Income £
27	0-17,900
40	17,901–20,400
45	20,401–25,400
50	25,401–33,300
55	33,301–41,200
60	over 41,200

Insert commas.

4.07 Car benefit scale charges will be increased by 10 per cent from 6 April 1988.

Profit related pay 4.08 An income tax relief will be introduced for employees in profit-related pay (PRP) schemes which meet certain conditions, and which have been registered with the Inland Revenue. The maximum amount of PRP eligible for relief will be £3,000, or 20 per cent of total PAYE pay, whichever is lower. Relief will be given on half the eligible amount.

Excise duties

4.09 A duty differential will be created for unleaded petrol, equivalent to 5p a gallon less than for leaded petrol.

4.10 Duty will no longer be levied on on-course betting. The rates of duty ~~duties~~ on gaming machine licences will be increased by between 25 and 28 per cent.

Vehicle excise duty

4.11 The rates of duty on farmers' heavy goods vehicles over 7.5 tonnes will be increased by between 5 and 34 per cent. The rate~~s~~ of duty for trade licences will be increased to £85 for cars and £17 for motor cycles. A new taxation class will be created for recovery vehicles. The duty rate will be £50.

Inheritance tax

4.12 From Budget Day the threshold will be increased from £71,000 to £90,000 and the number of chargeable bands reduced from seven to four. The new scale will be as follows:

7s

space
0- 90

Rate on death per cent	Band~~s~~ of chargeable value £000
0	0–90
30	90–140
40	140–220
50	220–330
60	Over 330

l.c.

4.13 Lifetime gifts of "interests in possession" in settled property will be exempt from Inheritance Tax (IHT) if the donor survives for seven years. Measures against abuse will be incorporated.

7"

4.14 Trust property in which there is an "interest in possession" will not be taxed on the death of a life tenant if the property is put into a heritage maintenance fund not later than two years after the death.

4.15 Property accepted in lieu of tax will be valued at ~~the~~ the date of the offer, and interest will cease to accrue on that date, at the option of the offeror.

4.1~~5~~6 From Budget Day, the rate of business relief on transfers of holdings of more than 25 per cent (other than control holdings) in unquoted companies will be increased from 30 to 50 per cent. Companies dealt in on the Unlisted Securities Market (USM) will from Budget Day be treated for IHT purposes in the same way as companies with a full listing on the Stock Exchange.

Corporation tax

nb. change para numbers from here on

4.16 The main rate of corporation tax for the financial year 1987 will be 35 per cent. The small companies' rate of corporation tax will be reduced to 27 per cent. The rate of advance corporation tax (ACT) will go down automatically to 27/73rds as a consequence of the reduction in the basic rate of income tax.

4.17 All companies, ~~and~~ building societies and other bodies chargeable to corporation tax will become liable, after a phasing-in period, to pay the ~~corporation~~ tax nine months after the end of the accounting period for which tax is due.

4.18 From Budget Day there will be changes in the tax treatment of companies' capital gains. They will be taxed without adjustment, other than the indexation that applies to post-1982 gains, at the rates applying to other profits (including, where appropriate, the small companies' rate) and credit for payment of ACT will be allowed against liability to tax on them.

4.19 From 1 April 1987, credit for any foreign withholding tax actually paid or deemed to be paid on interest received by banks on any new loan made by them to a non–resident will be allowed only against corporation tax due on the profit from that loan. This rule will apply to existing loans with effect from 1 April 1988.

/,

4.20 From 1 April 1987, dual resident companies will not be allowed a double deduction for interest payments. This change will not apply to trading companies.

4.21 Legislation will be introduced for a new scheme, known as Pay and File, to streamline the assessment and collection of corporation tax. The scheme will be implemented when the necessary computerisation is complete.

Oil taxation

4.22 Two relaxations to the expenditure relief rules are proposed:

97a /certain
/s

~~a~~ to allow a proportion of the costs up to payback of developing ~~a~~ certain new fields against petroleum revenue tax (PRT) liabilities in another field; and

~~b~~ to allow certain research expenditure which is not specifically for the purpose of any determined oil field to be set against PRT liabilities in any field after three years.

A minor technical change is also proposed to the rules for allocating oil allowance.

4.23 It is [also] proposed to restrict the set–off against ring fence profits of ACT paid by an oil extraction company in respect of certain dividends on preference shares where the capital raised has not been used for oil extraction purposes.

[4.24 It is proposed to mitigate the effects of Section 16 of the Oil Taxation Act 1975, which restricts set–off of ACT against ring fence profits, by allowing limited carryback of surrendered ACT and by allowing surrender of ACT to a ring fence company by a 50/50 joint venture owning that company.]

Business Expansion Scheme~~s~~

97s

4.25 Two amendments will be made to the Business Expansion Scheme:

~~a~~ for investments made in the first half of the tax year, the investor will be able to opt for part of the relief to be given for the previous year; and

~~b~~ the rules governing the special relief for film production will be relaxed.

italics not bold

Pensions

4.26 **Personal Pensions**: In the light of the reform of Social Security, a new tax regime for personal pensions (ie pensions taken out by an individual independently of his employer) will be introduced, to replace & extend the ~~broadly~~ ~~come into effect on next year.~~ ~~[1 January 1988]. The new regime will include the present~~ retirement annuities. ~~Its~~ The main features will be:

present, broadly similar, legislation for.

The new regime will come into effect next year.

~~a~~ benefits based on the actual return from invested contributions ('money purchase');

~~b~~ no limits on pension benefits;

—a tax-free lump sum, subject to a limit;

—annual contributions limited to 17.5 per cent of earnings (more for people over 50) with employers free to contribute within the limit; and

—tax relief for contributions, tax exemption for fund income and gains.

4.27 Employees will be able to "contract-out" of the State Earnings Related Pension Scheme (SERPS) by joining a personal pension scheme, to which the DHSS will pay a "minimum contribution".

italics

4.28 **"No frills" occupational schemes**: Employers will be able to establish simplified "no frills" occupational schemes which may be "final salary" or "defined contribution". Under the new Social Security rules, the latter may be "contracted out money purchase" schemes.

4.29 There will be greater transferability between different types of pension arrangements.

italics

4.30 Additional voluntary contributions (AVCs): Members of occupational pension schemes will be able to pay AVCs—on which tax relief will be available—to arrangements outside their employer's scheme. As with in-scheme AVCs, contributions will be subject to existing limits on contributions and benefits.

italics

4.31 **Exploitation of tax reliefs**: A number of changes in current pensions law and practice will be made, to counter certain types of exploitation particularly by high earners. These include:

~~i~~ a limit ~~"cap"~~ on lump sums of ~~above~~ £150,000;

~~ii~~ changes in the rules on "final salary" for pension purposes; and

~~iii~~ changes in the rules relating to accelerated accrual of benefits.

Employee share schemes

4.32 The rules for the 1980 and 1984 employee share option schemes will be changed to make it possible, in the event of a takeover, for participants to exchange their existing share options for options over shares in the acquiring company.

Capital gains tax

4.33 The capital gains tax annual exempt amount is to be increased in accordance with the statutory indexation provisions from £6,300 to £6,600 in the case of individuals, and from £3,150 to £3,300 in the case of most trusts.

4.34 The ceiling for retirement relief will be raised from £100,000 to £125,000.

Lloyd's: reinsurance to close

4.35 Legislation is proposed to bring the tax treatment ~~on the taxation~~ of members of Lloyd's into line with ~~to ensure that~~ the normal tax treatment of financial provisions for outstanding liabilities made by ordinary ~~is applied to them as to~~ insurance companies and of similar provisions made by other traders. These proposals would ~~will~~ affect the tax treatment of Lloyd's reinsurance to close and will first apply to premiums payabl for the 1985 Lloyd's account closing at 31 December 1987.

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Table 4.1 Direct effects of changes in taxation

See Annex 1 Paragraph numbers		£ million Estimated effect on receipts in: 1987-88 Changes from a non-indexed base	1987-88 Changes from an indexed base	1988-89 Changes from an indexed base
	INLAND REVENUE			
	Income tax			
1	Reduction of 2p in basic rate	-1910	-1910	-2690
2	Increase in single allowance of £90 and married allowance of £140	-610	-	-
3	Increase in additional personal allowance and widow's bereavement allowance of £50	-5	-	-
4	Increase in age allowance of £110 (single) and £170 (married) and income limit of £400	-80	-	-
5	Further increase in age allowance of £110 (single) and £170 (married) for those aged 80 and over	-10	-10	-10
6	Increase in blind allowance of £180	*	*	*
7	Increase in basic rate limit of £700 to £17,900	-60	-	-
8	Changes to further higher rate thresholds	-5	+40	+80
9	Profit Related Pay	*	*	-35
10	Fringe benefits - car scale	-	-	+30
11	[Fringe benefits - official rate of interest	-	-	*]
12	Income support paid to the unemployed and to strikers	-	-	*
13	Approved employee share schemes + takeovers	*	*	*
14	Payroll giving to charities - increase in donation limit to £120 a year	*	*	*
15	Legislation on Lloyd's reinsurance to close	-	-	†
16	Apportionment of income etc of close companies	*	*	*
17	Foreign partnerships - removal of possible anomaly	-	-	-
	Income tax and capital gains tax			
18	Business Expansion Scheme changes	-5	-5	-5
19	Amendment to offshore fund rules	*	*	*
	Income tax and corporation tax			
20	Personal pensions	[-]	[-]	-25
21	Changes in pensions law and practice	[-]	[-]	-40
22	Friendly societies	*	*	*
23	Keith Committee - PAYE and subcontractors	+5	+5	+45
24	Interest payments between related companies	*	*	*
25	Increase in exemption limits for trade union provident funds	*	*	*
26	Capital allowances - extension of assured tenancies relief	*	*	*
27	Relief for the costs of training	*	*	*
	Income tax, corporation tax and capital gains tax			
28	Securities - Financial Services Act consequentials	-	-	-
	Income tax, corporation tax, capital gains tax, inheritance tax and stamp duties			
29	Unit trusts - Financial Services Act consequentials	-	-	-

* = Negligible   - = Nil

† Details of measure subject to consultation, so no estimate possible at present.

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Table 4.1 Direct effects of changes in taxation

See Annex 4 Paragraph numbers		£ million Estimated effect on receipts in: 1987-88 Changes from a non-indexed base	1987-88 Changes from an indexed base	1988-89 Changes from an indexed base
	Corporation tax			
30	Reduction in rate of ACT to 27/73rds of the amount of the distribution	-290	-290	-130
31	Reduction in small companies' rate to 27 per cent	*	*	-45
32	Harmonisation of payment dates for corporation tax	*	*	+100
33	Taxation of indexed gains in full at normal corporation tax rates	*	*	+80
34	ACT set-off against tax on companies' gains	*	*	-20
35	Dual resident companies - non-allowance of double deduction	*	*	+125
36	Foreign withholding tax on interest received by banks	*	*	+20
37	[Relaxation of set-off of surrendered ACT against ring fence profits	-20	-20	-20]
38	ACT set-off against ring fence profits (certain preference share dividends)	[-]	[-]	[+15]
39	Building societies - groups of companies and capital gains	*	*	*
40	Pay and file	-	-	-
41	[Amendment to controlled foreign companies legislation	+10	+10	+10]
	Corporation tax and capital gains tax			
42	Financial futures and traded options	-	-	*
	Oil taxation			
43	10 per cent cross field allowance	-5	-5	-15
44	Petroleum revenue tax relief for certain research expenditure	-	-	-
45	Oil allowance - final adjustments	*	*	*
	Capital gains tax			
46	Indexation of annual exempt amount	-	-	-
47	Retirement relief	-	-	*
	Inheritance tax			
48	Changes to rates and bands	-90	-75	-170
49	Business relief and Unlisted Securities Market	*	*	*
50	Abolition of lifetime charge on interest in possession trust property	*	*	*
51	Heritage maintenance funds	*	*	*
52	Property accepted in lieu of tax	*	*	*
	Stamp duties			
53	Changes to stamp duties and the reserve tax	*	*	*
	TOTAL INLAND REVENUE	-3080	-2265	2705

* = Negligible   - = Nil

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Table 4.1 Direct effects of changes in taxation

See Annex 4 Paragraph numbers		£ million Estimated effect on receipts in: 1987-88 Changes from a non-indexed base	1987-88 Changes from an indexed base	1988-89 Changes from an indexed base
	CUSTOMS AND EXCISE			
	Value added tax			
54	Revised treatment of tour operators' margins	-	-	+20
55	New rules on deduction of input tax by partly exempt traders	+300	+300	+400
56	Cash accounting for small businesses	-100	-100	-10
57	Increase in registration limits	*	-	*
58	Revised registration requirements	-15	-15	-25
59	Annual accounting for small businesses	-	-	-25
60	Simplified retail schemes	-	-	-
61	Removal of loophole on imported services	*	*	+5
62	Relief for charities	-5	-5	-5
	Excise duties			
63	No change in rate of spirits duty	-	-25	-25
64	No change in rate of beer duty	-	-60	-65
65	No change in rate of duty on cider and perry	-	*	*
66	No change in rates of wine and made-wine duties	-	-20	-20
67	No change in rates of duty on petrol etc	-	-190	-210
68	No change in rate of duty on derv	-	-50	-50
69	No change in rates of minor oil duties	-	-5	-5
70	No change in rate of tobacco products duties	-	-105	-110
71	Duty differential in favour of unleaded petrol	*	*	*
72	Abolition of on-course betting duty	-20	-20	-20
73	Increase in rates of gaming machine license duties	+20	+20	+20
	TOTAL CUSTOMS AND EXCISE	+180	-275	-125
	Vehicle excise duty			
74	No change in VED on car, light van and main lorry rates	-	-95	-100
75	Increase in other VED rates	+5	+5	+5
76	Recovery vehicles	*	*	*
77	VED back orders	*	*	+5
	Other			
78	Bus fuel grants	-	+5	+5
	TOTAL VED AND OTHER	+5	-85	-85
	TOTAL CHANGES IN TAXATION	-2895	-2625	-2315

* = Negligible   - = Nil

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Annex to Chapter 4

How the figures in Table 4.1 have been calculated

Table 4.1 gives the direct effects of changes in taxation. Estimates are rounded to the nearest £5 million. "Negligible" means less than £3 million.

Insert (A) here.

The **direct** effect of a tax change is the difference between the yield of the tax which would arise on the basis of the rates of tax, allowances, etc prevailing before the Budget (the pre-Budget regime) and the yield after the changes proposed in the Budget (the post-Budget regime).

For **Inland Revenue** taxes (and VED) the difference in yield for each tax is generally calculated by applying the pre- and post-Budget tax regimes to the same tax base. This base is the post-Budget base—that is the levels of income, profits etc forecast for future years on the assumption that all the measures proposed in the Budget take effect. In certain cases, however, the difference in yield also takes account of changes in taxpayers' behaviour arising from the tax change where these behavioural changes can be directly attributed to the change in tax. For example, the estimate of the direct cost of the cut in stamp duty rate in last year's FSBR allowed for the expected increase in chargeable transactions.

For **Customs and Excise** taxes and duties, the calculation takes into account, where possible, the effect of the tax change on the pattern of consumers' expenditure and the resulting impact on other expenditure taxes but makes no allowance for secondary effects: in particular, it is assumed that total consumers' expenditure does not change. A fuller description of the methodology is in Economic Trends, March 1980.

Table 4.1 shows the expected change in **receipts** of tax resulting from the Budget proposals. Additional information is provided in the commentary below for those proposals where the effect on tax **liabilities** in the first complete year to which the change applies (full year effect) is substantially different from the effect on **receipts** in either 1987–88 or 1988–89; or where the impact of the proposal is expected to build up over a period of years.

~~The direct effects shown in the third column of Table 4.1 assume that the levels of allowances, rates of duty etc proposed in the Budget for 1987–88 continue to apply for 1988–89 and compare the effect on receipts in that year with allowances and rates of duty unchanged from their money levels in 1986–87 (the unindexed base).~~

The estimates shown in Table 4.1 do not reflect changes in the tax base arising from changes in money incomes and in the general level of prices and other economic variables which may result from the proposed tax change. These secondary effects are, of course, taken into account in estimating the impact of the tax change on the PSBR. The base for the post-Budget forecast of each tax (given in Table 6.B.3) takes account of the effects, direct and secondary, of all the measures announced in the Budget.

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Table 4.1 does not include certain measures announced and implemented before Budget day. These are the amendment of the material interest test for approved employee share schemes and other purposes, tax relief for the cost of seconding

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Insertion A: (to second para of Annex introduction)

The estimates in the first column of table 4.1 show the direct effect of the Budget measures on receipts in 1987-88. The comparison is with the non-indexed base - that is the pre-Budget regime of allowances, thresholds and rates of duty at their 1986-87 money levels. The estimates in the second and third columns assume indexation of both the pre- and post-Budget regimes as appropriate. The changes are therefore measured from an indexed base and, for 1988-89, assume the tax rates and indexation of the allowances, thresholds and rates of duty proposed in the Budget for 1987-88.

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employees to educational bodies, the tax treatment of invalid care allowance paid to married women, and changes in the pricing and valuation rules for petroleum revenue tax. These measures are reflected in the baseline for costing the effect of tax changes in the Budget.

The remainder of this annex provides a commentary on the Budget proposals in Table 4.1. The paragraph numbers refer to the lines in this table.

Income tax

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1 The basic rate will be reduced from 29 per cent to 27 per cent. The cost figures in the table for this item assume that the changes in items [2–7] have been made first. They include the saving in public expenditure on mortgage interest relief to those below the tax threshold. The effect of the consequential change in the rate of advance corporation tax (ACT) is shown in line [~~29~~ 30] of Table 4.1.

2 The single person's allowance and the wife's maximum earned income relief will be increased from £2,335 to £2,425 and the married allowance from £3,655 to £3,795.

3 The additional personal allowance and widow's bereavement allowance will be increased from £1,320 to £1,370.

4 The age allowance will be increased for the single person from £2,850 to £2,960 and for the married from £4,505 to £4,675; the age allowance income limit will be increased from £9,400 to £9,800.

5 There will be a new, higher level of age allowance for those aged 80 or over. The allowance will be £3,070 for the single person and £4,845 for the married.

Cost will depend on take-up. In 1988-89, costs will still be low, but could be £50 million. They will build up in later years, when they could be measured in hundreds of millions of pounds.

6 The blind allowance will be increased from £360 to £540. This will cost about £2 million per year.

7 The basic rate limit will be increased to £17,900.

8 The threshold for the 45 per cent higher rate will be raised by £200 to £20,400. The thresholds for the 50 per cent, 55 per cent and 60 per cent rates will remain at £25,400, £33,300 and £41,200 respectively.

9 One half of profit related pay (PRP) paid to an employee under a registered scheme will be relieved from income tax, subject to the lower of two annual limits: where the total PRP exceeds 20 per cent of total PAYE pay, PRP will be regarded for tax relief purposes as limited to that amount, and the maximum annual amount of PRP which may be taken into account will be £3,000. ~~The build-up of costs~~ for the proposed income tax relief is inevitably uncertain, but is expected to exceed £100 million in later years. It will depend ~~upon the~~ number of PRP schemes introduced by employers and registered by the Inland Revenue, the number of employees covered by them, the ~~amount~~ of PRP ~~in question~~, and employers' arrangements for the timing of PRP payments. paid

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10 For 1988–89, the scale for taxing car benefits in respect of company cars provided for directors, and for employees whose remuneration is at a rate of £8,500 a year or more, will be increased by 10 per cent. No change is proposed for 1988–89 to the scale charges for car fuel benefit, also—from 6 ~~April~~ 198~~6~~7—used for VAT purposes.

6 April 1987

11 [With effect from 6 April 1987 the official rate of interest for taxing cheap or interest-free loans provided for directors, and for employees whose remuneration is at a rate of £8,500 a year or more will follow more closely movements in banks' base rates.]

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12 Legislation providing for the taxation of supplementary benefit paid to the unemployed and to strikers will be amended to reflect the replacement in 1988 of supplementary benefit by income support.

or discretionary

13 Approved savings-related ~~share option~~ ~~and approved~~ share option schemes will be permitted to enable directors and employees, when their company is taken over, to exchange their existing options for options over shares in the acquiring company.

14 The limit on charitable donations qualifying for relief under payroll deduction schemes will be increased to £120 from April 1987.

which closes at the end of 1987,

15 The tax treatment of Lloyd's reinsurance to close will be made consistent with the treatment of provisions for outstanding liabilities made by insurance companies and similar provisions made by other financial traders. The legislation will first take effect for the Lloyd's 1985 Account. This is assessable for the year 1985–86, the tax for which does not become payable until 1 January and 1 July 1989. The estimate of receipts ~~in 1988–89 is subject to a considerable degree of uncertainty. So is the estimate of the rate at which receipts will build-up in subsequent years; but they may reach £60 million in 1991–92 and subsequently stabilise at about £30 million.~~

depends on the details of the new arrangements, which are still to be established.

16 The Inland Revenue's powers to apportion the income and annual payments of a close company to its participators will be made obligatory (a recent Court case held that they were discretionary).

17 A possible anomaly in the law relating to the taxation of foreign partnerships will be removed to prevent substantial potential revenue loss.

Income tax and capital gains tax

18 Relief under the Business Expansion Scheme for investments made in the first half of the tax year will, in part, be able to be claimed against the income of the previous tax year. The special relief for film production, which requires the company to be producing films throughout the three year qualifying period, will be relaxed so that the requirement can be satisfied by the distribution of films produced in this period.

19 The Revenue will be given a limited discretion in certifying offshore funds as distributing funds.

07,

Income tax and corporation tax

20 A new tax regime for personal pensions will be introduced to replace and extend the present, broadly similar, legislation for retirement annuities. The estimated cost assumes an initial take-up of 200,000 rising to 400,000 by April 1989.

07,

21 The changes proposed for pensions include some tightening up to guard against exploitation of the tax reliefs and some relaxations, in particular to allow members of occupational schemes to pay additional voluntary contributions to pension plans outside their employer's scheme ("freestanding AVCs"). The estimated overall cost of the package assumes an initial take-up of "freestanding AVCs" of 250,000 and includes a modest yield from the tightening up measures.

22 A change is proposed in the limit applicable to tax exempt life or endowment business carried on by friendly societies. The present limit of £750 gross sum assured will be changed to £100 annual premium.

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Insertion B: Income tax, corporation tax, capital gains tax, inheritance tax and stamp duties.

29. Changes in the tax rules for unit trusts are necessary to cater for the definitional and regulatory changes relating to unit trusts introduced in the Financial Services Act.

23 The PAYE and subcontractor deduction schemes will be slightly amended. In particular, there will be an interest charge where PAYE tax, or an amount that should have been paid under deduction by a contractor, has to be formally determined.

24 Where certain interest is paid between companies which are members of a group or under common control, it will be treated in all cases as being paid and received on the same day. Without this measure there could have been widespread avoidance.

25 The exemption limits for trade union provident funds will be increased from £2,400 to £3,000 (for lump sums) and from £500 to £625 (for annuities).

26 Capital allowances for construction costs of properties provided for letting on assured tenancy terms by "approved bodies" were introduced in 1982 for a period of five years ending 31 March 1987. ~~It is proposed to extend~~ That period will be extended by a further five years ending 31 March 1992.

27 With effect from 6 April 1987, training costs borne by an employer to equip with new work skills a worker who is to ~~be made redundant~~ leave his present employment will normally no longer be treated as a taxable benefit received by the employee and the circumstances in which such costs will be allowed in computing the employer's taxable profits will be correspondingly widened.

Income tax, corporation tax, ~~and~~ capital gains tax 1,

28 Legislation will enable securities quoted on new Recognised Investment Exchanges to be treated in the same way as comparable securities quoted on the Stock Exchange.

Insert B

Corporation tax ~~29~~ 30 As a consequence of the reduction in the basic rate, the rate of advance corporation tax (ACT) for 1987–88 will be 27/73rds of the amount of the distribution. This reduction in ACT will be balanced by an increase in the subsequent liability to mainstream corporation tax.

~~30~~ 1 The small companies' rate of corporation tax for the financial year 1987 will be reduced to 27 per cent.

~~31~~ 2 All companies ~~and~~ building societies and other bodies chargeable to corporation tax will be liable to pay ~~corporation~~ the tax nine months after the end of each accounting period. For individual companies ~~and building societies~~ etc. the change will be phased in over a period of up to three years.

~~32~~ 3 Under present law capital gains by companies are reduced by one-seventh before being charged to corporation tax at 35 per cent. Gains realised from Budget Day will cease to be reduced. Instead they will be taxed in full (with indexation allowance) at normal corporation tax rates. For small companies, the small companies' rate will apply to gains. The yield represents the difference between receipts at the level of capital gains before the change and receipts at the level of capital gains expected as a result of the change.

~~33~~ 4 Credit for the payment of ACT will be allowed against liability for tax on gains realised from Budget Day. The cost shown against this measure is extremely tentative.

~~34~~ 5 Dual resident companies are companies which are simultaneously resident in two countries. It is proposed that, unless they are trading companies, they should no longer enjoy a deduction in both countries for the interest which they pay.

~~35~~ 6 The rules for calculating banks' taxable income from making a loan to a non-resident will be changed so that any tax credit for foreign withholding tax paid or deemed to be paid on the interest they receive may be offset only against UK tax due on the turn on that loan. The yield will build up over time to about £60 million by 1990–91.

(close-up) offset

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[3~~6~~7 Effects of Section 16 of the Oil Taxation Act 1975 will be mitigated by allowing limited carry back of ACT surrendered to a ring fence subsidiary by its parent (initially restricted by a monetary ceiling of £10 million per company), or, in the case of a company owned by a consortium which is a 50/50 joint venture, by allowing surrender of ACT to the ring fence consortium company.]

certain

3~~7~~8 ACT in respect of dividends paid on or after Budget Day on preference shares where the capital raised has not been used for ring fence purposes will no longer be available for set-off against corporation tax on ring fence profits. Without this measure, there could have been widespread avoidance of the ring fence provisions, possibly costing tens of £million.

3~~8~~9 The capital gains provisions for groups of companies will be amended to include building societies.

~~39~~40 Under Pay and File companies will estimate and pay their corporation tax on the normal due date without the need for the Inland Revenue to make estimated assessments. Interest will run from the normal due date on tax paid late by the company and on tax repaid to the company. Returns will be due twelve months after the accounting period with automatic penalties for delay. This measure will not be implemented ~~for some years.~~

before 1992.

4~~0~~1 [The legislation affecting controlled foreign companies is to be amended to prevent avoidance of a UK tax charge on dividends. Without this provision, there could be a significant loss of tax.]

Corporation tax and capital gains tax i.e.

4~~1~~2 The provisions concerning financial futures dealt in on Recognised Futures Exchanges and with traded options will be amended.

Oil taxation

certain

4~~2~~3 Up to 10 per cent of expenditure incurred in developing new oil fields will be allowed against a participator's PRT liability in another field. The cost ~~builds~~ up to £40 million in 1989–90, and to £80 million in 1990–91.

depends on the behavioural effect this measure has, but could

4~~3~~4 Research expenditure will be allowed against a participator's PRT liability in any field if, three years after it is incurred, it has not yet become allowable for any field. No cost therefore arises until 1990–91, when it will amount to about £30 million, and £25 million thereafter (taking account of CT clawback).

4~~4~~5 The scope for redistributing oil allowance amongst participators, in order to correct imbalances, will be extended. The cumulative total of oil allowance will be unchanged.

Capital gains tax

4~~5~~6 The capital gains tax annual exempt amount is to be increased in accordance with the statutory indexation provisions from £6,300 to £6,600 in the case of individuals, and from £3,150 to £3,300 in the case of most trusts.

4~~6~~7 The limit for retirement relief will be increased from £100,000 to £125,000.

Inheritance tax

£220 million

4~~7~~8 The estimated full year cost for the proposed rate structure in paragraph [4.1~~3~~2] attributable to transfers in 1987–88 is £2~~1~~20 million, measured against the indexed base.

4~~8~~9 The rate of relief on transfers of holdings of more than 25 per cent and up to 50 per cent in unquoted companies is to be increased from 30 to 50 per cent from Budget Day. Minority holdings in USM companies will no longer qualify for business relief, but shares in such companies will be treated for all IHT purposes like shares in companies with a full listing. The revenue effects of these changes is likely to be broadly neutral.

97s

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~~49~~ 50 **(a)** The charge on transfers made by individuals to interest in possession trusts on or after 17 March 1987 and more than seven years before the death of the transferor will be abolished.

(b) The charge on termination of an interest in possession in settled property in favour of another individual on or after 17 March 1987 and more than seven years before the death of the person beneficially entitled to the interest will be abolished.

(c) An alternative basis will be provided for determining the rate of charge on the termination of an interest in possession in settled property in favour of a discretionary trust on or after 17 March 1987.

5~~0~~1 **(a)** IHT will not be payable in respect of settled property on the death on or after 17 March 1987 of a person beneficially entitled to an interest in possession in that property if the property becomes subject to the trusts of a qualifying heritage maintenance fund within two years (or if a Court Order is needed, within three years) after the death.

(b) The charge where property formerly subject to an interest in possession leaves a heritage maintenance fund will be altered: if the tax given up when the property entered the maintenance fund was tax on the termination of an interest in possession, the exit charge will be based on the cumulated chargeable transfers of the person whose interest was terminated.

Insert C here

~~51 Changes in the tax rules for unit trusts are necessary to cater for the definitional and regulatory changes relating to unit trusts introduced in the Financial Services Act.~~

Stamp duties

5~~2~~3 Certain technical changes are proposed to the legislation governing stamp duties and the reserve tax.

Value Added Tax

5~~3~~4 The gross margins earned by tour operators on sales of tours within the European Community will be brought within the scope for VAT with effect from 1 April 1988.

5~~4~~5 The law will be changed to strengthen the rules relating to the deduction of input tax by partly exempt traders; and to exempt the underwriting of, and making of arrangements for, capital issues.

5~~5~~6 Businesses with annual turnover below £250,000 will have the option of accounting for VAT on the basis of payments made and received. It is intended that this system should be introduced on 1 October 1987.

5~~6~~7 The registration limit will be increased to £21,300 per annum and £7,250 per quarter.

5~~7~~8 The time allowed to notify for registration will be extended to 30 days, and it will be made easier to deregister.

5~~8~~9 Businesses with annual turnover below £250,000 will have the option of making a single VAT return each year (instead of the present four) with nine advance payments based on the VAT paid in the previous year. This system will be introduced in the second half of 1988. Certain recommendations of the Keith Committee which were due to be implemented in 1988 will, as a result, be deferred until 1989. The cost of deferral will be £25 million in 1988–89 and some £50 million to £75 million in 1989–90.

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Insertion C: (under inheritance tax items)

52 (a) The tax satisfied by acceptance of pre-eminent heritage property in lieu of IHT will be calculated, at the option of the offeror, by reference to the value of the property at the date of the offer instead of the value at the date of acceptance.

(b) Where this option is selected, the tax will be regarded as having been paid on the date of the offer and so will not bear interest after that date.

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Not bold type for "directly"

60 The simpler ~~59 Simplified~~ special schemes for retailers will be made available for use by many more small and medium-sized businesses.

1 ~~60~~ The law will be changed to prevent the avoidance of tax on imported services by exempt businesses.

2 ~~61~~ VAT relief for charities will be extended to certain welfare vehicles used by hospices to transport the terminally ill; to specialised location and identification equipment used by mountain rescue and first aid services; to goods donated for export by a charity for relief of distress or animal welfare; to installing or adapting ~~lavatory or~~ bathroom washroom or lavatory facilities in charity residential homes ~~for the disabled~~ for the handicapped; and to drugs and chemicals ~~supplied to charities and~~ **directly** used by a charity in medical care or research.

Excise duties 63–~~69~~ 70 ~~62–69~~ There will be no changes in the duties on alcoholic drinks, tobacco products and most hydrocarbon oils.

1 ~~70~~ The duty on unleaded petrol will be ~~increased~~ reduced by ~~0·2p~~ 5p a gallon (inclusive of consequential VAT).

2 ~~71~~ The duty on bets placed on-course at horse and greyhound racetracks will be abolished.

3 ~~72~~ The rate of gaming machine licence duty will be increased as follows:

for 5p "amusement with prizes" machines by £30
for 10p "amusement with prizes" machines by £75
for 5p jackpot machines by £75
for 10p jackpot machines by £210

The amount of refund on surrender of a licence will be increased and the arrangements for collecting the duty will be changed.

Vehicle excise duties 4 ~~73~~ There will be no change in the duties on cars, light vans, taxis, buses, coaches, motor cycles and most lorries.

5 ~~74~~ The concessionary rates of duty for farmers' heavy goods vehicles over 7·5 tonnes will be increased by varying amounts as the final stage in the process of bringing them into line with the proportion of average mileage covered by these vehicles on public roads. From 1 January 1988 the rate of duty for trade licences will be increased to £85 for cars and £17 for motor cycles, as the second stage in the process of increasing these rates to the rates for ordinary licences for cars and motor cycles between 150 and 250cc, respectively.

6 ~~75~~ From 1 January 1988 a new taxation class will be created for recovery vehicles. The rate of duty will be set at £50.

7 ~~76~~ The law will be amended so that, on conviction for VED evasion, the Courts will be required to order payment of all back duty due from that offender from the expiry of the last licence or date of acquisition of the vehicle, without regard for any non-use of the vehicle during the period.

8 ~~77~~ There will be no change in bus fuel grant.

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5 Public Expenditure

Public spending plans

5.01 The 1987 public expenditure White Paper (Cm 56-I and II) set out plans for public spending for the next three years and provided the basis for the more detailed Supply Estimates, cash limits and other spending controls for 1987–88. These plans are summarised in Table 5.1.

Changes since previous Budget

5.02 Since the last FSBR, extra funds have been allocated to priority services including education, health and law and order. The estimated costs of some demand-led programmes, such as social security, have also risen.

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Table 5.1 Public expenditure

£ billion

	1985–86 Outturn	1986–87 Estimated Outturn	1987–88 Plans	1988–89 Plans	1989–90 Plans
Department					
DHSS – Social security	41·5	[44·6]	46·0	47·5	49·3
Defence	18·0	[18·4]	18·8	19·0	19·5
DHSS – Health and personal social services	16·6	[18·0]	19·1	19·9	20·8
~~Scotland, Wales and Northern Ireland~~	~~14·3~~	~~[15·5]~~	~~16·0~~	~~16·5~~	~~16·8~~
Education and science	14·5	[15·7]	16·6	17·4	17·8
Other departments	~~31·4~~ 40·5	~~[32·5]~~ [42·2]	~~33·6~~ 43·4	~~33·6~~ 43·6	~~34·8~~ 45·0
Privatisation proceeds	−2·7	[−4·4]	−5·0	−5·0	−5·0
Reserve			3·5	5·5	7·5
Adjustments[1]		[ ]			
not bold **Public expenditure planning total**	**133·6**	**[140·3]**	**148·6**	**154·2**	**161·5**
General government gross debt interest[2]	17·7	[17·5]	[18·~~3~~]0	[18]	[19]
Other adjustments[2]	7·2	[7·~~5~~]3	[~~6·8~~]7·0	8 [~~7½~~]	8 [~~7½~~] 88
General government expenditure[2]	**158·5**	**[165·~~3~~]** 1	**[173·~~7~~]** 5	**[180]**	**[188]**
not bold **Planning total in real terms (base year 1985–86)**	**133·6**	**[136·~~8~~]** 2	138·0 ~~[139·3]~~	137·7 ~~[139·7]~~	139·2 ~~[142·1]~~
General government expenditure as a percentage of GDP	**44**	**[43½]**	**[42~~½~~]** ¼	**[41~~½~~]** ¼	40½ ~~[41¼]~~

1988-89 and 1989-90 figures rounded to nearest £billion

[1] [Comments on adjustment line if required]

[2] ~~[Comments on rounding conventions]~~

Home Office (and ~~including~~ Lord Chancellor's Department)	5·3	[5·8]	6·2	6·4	6·6

Public spending trends

5.03 The plans show a further fall in general government spending as a percentage of GDP over the next three years (see Table 5.1); this is the case with or without any proceeds from privatisation. By 1989–90, the

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percentage should be back to the level of the early seventies. This reflects the Government's continued objective of reducing steadily the State's share of the nation's income.

5.04 General government expenditure covers spending by central government and local authorities. It is the ~~definition of government spending~~ key public expenditure aggregate used in the ~~national accounts, forecasts of the economy and the MTFS~~. The main difference between general government expenditure and the planning total is the inclusion in the former of general government gross debt interest, amounting to some [£18] billion in 1987–88. There are also a number of other definitional differences and adjustments, which are described in the Annex to Part 2 of the 1987 public expenditure White Paper. In 1987–88, these adjustments account for a further £7 billion.

Medium Term Financial Strategy where public expenditure is set into the context of the economy as a whole.

1986–87 outturn

5.05 The latest estimates, which still remain subject to some uncertainty, suggest that the planning total outturn in 1986–87 is likely to be about [£140.3 billion], [£1.2] billion above the plans shown in the 1986 public expenditure White Paper and the 1986 Budget. [This is very close to the estimated outturn figure shown in the Autumn Statement and this year's White Paper.] The details are shown in Table 5.2.

Table 5.2 Comparison of plans and estimated outturn for 1986–87

	£ billion 1986–87 Plans[1]	Estimated outturn	Outturn minus plans
Central government	102·6	[105·2]	[+2·5]
Local authority	35·2	[38·2]	[+3·1]
of which			
Relevant expenditure	27·0	[29·5]	[+2·5]
Other current	4·5	[4·8]	(+0·3]
Capital	3·7	[3·9]	[+0·3]
Nationalised industries and other public corporations	1·6	[1·4]	[−0·2]
Privatisation proceeds	−4·8	[−4·4]	[+0·4]
Reserve	4·5	–	[−4·5] δ
Adjustment[2]		[ ]	[ ]
Public expenditure planning total	**139·1**	**[140·3]**	**[+1·2]**

[1] Plans from The Government's Expenditure Plans 1986–87 to 1988–89, Cmnd 9702, adjusted for classification changes.

[2] [ ].

The major changes between plans and estimated outturn are:—

i. an increase of [£3 billion] in local authority expenditure including an overrun of [£2½] billion on expenditure relevant for Aggregate Exchequer Grant (relevant expenditure);

ii. an increase in social security expenditure of [£1½] billion; δ

iii. ~~a payment of [£650] million [comment on nature of payment to Rover]~~ additional equity of £680 million in Rover Group to meet debt and restructuring costs associated

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Additions to programmes amount to some [£5.3] billion and, after allowing for a shortfall of £400m on privatisation proceeds and allocation of the Reserve of £4.5 billion, the overrun on the planning total amounts to about [£1.2] billion.

Table 5.3 Public expenditure by spending authority

£ billion	1985–86 Outturn	1986–87 Estimated Outturn	1987–88 Plans	1988–89 Plans	1989–90 Plans
Central government[1]	98·5	[105·1]	108·3	111·2	115·7
of which Voted in Estimates	71·3	[74·7]	76·3	78·7	81·1
Other	27·1	[30·4]	32·0	32·5	34·6
Local authorities[1]	35·2	[38·2]	40·2	41·1	42·4
of which Relevant expenditure	26·9	[29·5]	31·0	32·2	33·1
Other current	4·5	[4·8]	4·9	4·9	5·2
Capital	3·9	[3·9]	4·3	4·0	4·1
Nationalised industries	1·7	[0·5]	0·7	0·3	−0·1
Other public corporations	0·9	[~~0·5~~] 0.9	1·0	1·0	1·1
Privatisation proceeds	−2·7	[−4·4]	−5·0	−5·0	−5·0
Reserve			3·5	5·5	7·5
Adjustments[2]		[ ]			
Public expenditure planning total	**133·6**	**[140·3]**	**148·6**	**154·2**	**161·5**

[1] Excluding finance for public corporations (including nationalised industries).
[2] [ ].

Public expenditure by spending authority

5.06 Central government spending makes up about three quarters of the planning total. About 70 per cent of this is voted by Parliament through the annual Supply Estimates and covers the expenditure of government departments for their own activities as well as their funding of other bodies such as the National Health Service. Most of the remainder consists of social security payments paid out of the National Insurance Fund. Spending by local authorities accounts for about one quarter of public expenditure. Nationalised industries and other public corporations account for the remainder of the total. Table 5.3 gives outturn figures for the last two years and the plans as published in the public expenditure White Paper.

Supply Estimates

5.07 For 1987–88, the plans set out in the public expenditure White Paper have now been translated, where appropriate, into detailed control totals in Supply Estimates. The total Estimates provision for 1987–88 for which the Government is seeking Parliamentary approval is shown in Table 5.4. The main Estimates for 1987–88 are published in a series of booklets on 17 March 1987 with a Summary and Guide (Cm [94]) which explains the Supply procedure and summarises the Estimates. It also explains how they relate to the public expenditure planning total. SS £94

SS **5.08** Of the £[~~105.0~~] 104.5 billion included in the Supply Estimates, £[78.8] billion is direct public expenditure. The remaining £[~~26.3~~] 25.6m does not feature directly as public expenditure because it consists of grants to local authorities and finance for other bodies whose spending is counted as public SS

0202

just over 60

expenditure. ~~Nearly [59]~~ per cent of the money voted in Estimates is subject to cash limits, which provide the Government with greater control over its cash expenditure during the financial year.

Table 5.4 Supply expenditure

	£ billion			
	1985–86		1986–87	1987–88
	Expected outturn in 1986 Budget	Final outturn	Expected outturn	Provision
Main Supply Estimates	96·0	[96·0]	[99·0] 1	~~[105·0]~~ 104·5
Supplementaries and net under-spending	2·0	[2·1]	~~[2·9]~~ 2·8	
Total Supply expenditure	**98·1**	**[98·1]**	~~**[102·0]**~~ 101·9	
(public expenditure element)	(74·9)	[75·0]	~~[77·5]~~ 77·4	

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6 The public sector's finances

The scope of this chapter

6.01 This ~~C~~c hapter brings together revenue (discussed in Chapter 4) and spending (in Chapter 5), and provides an analysis and forecast of the public sector's finances in 1987–88, together with new estimates of outturn in 1986–87. It also comments on the main features of the public sector's finances in those two years, including the most important changes that have taken place since last year's projections. Table 6.1 is a summary.

Table 6.1 Public Expenditure, Receipts and Borrowing

£ billion	1985–86 Outturn	1986–87 1986 Budget	1986–87 Latest estimate	1987–88 Forecast
General government expenditure	158·5	163·4	165·~~3~~ 1	173·~~7~~ 5
General government receipts	151·6	155·9	158·~~6~~ 7	~~169·7~~ 168.7
General government borrowing requirement	6·9	7·5	6·~~7~~ 4	4·~~1~~ 8
Public corporations' market and overseas borrowing	−1·1	−0·4	−1·~~8~~ 5	−0·~~6~~ 8
Public sector borrowing requirement	**5·8**	**7·1**	**4·9**	~~**3·4**~~ 4.0

6.02 The PSBR is now estimated to be just under £5 billion in 1986–87, compared with the forecast of £7 billion made a year ago. The PSBR is forecast to be about £~~3½~~ 4 billion in 1987–88.

Public sector's finances: three-fold analysis

6.03 The public sector's finances can be analysed in a number of different ways:

~~—~~ by type or activity, showing on the one hand the different types of receipts (income taxes, corporation taxes, capital taxes, expenditure taxes, North Sea revenues, and so on); and on the other hand the spending (on social security, defence, health, education and so on) financed by those receipts and by borrowing;

~~—~~ by sector, showing the authority which undertakes the financing or spending: central government, local authorities or public corporations;

~~—~~ by economic category, showing, for example, whether the receipts and spending are current or capital transactions and whether current spending is on goods and services or transfer payments.

6.04 This three-fold analysis of the public sector's finances is analogous to the three-fold presentation of public spending that has become an established feature of the Public Expenditure White Paper: see paragraph 13 of Cm 56-I. The rest of this ~~C~~hapter c sets out these three analyses in detail.

Analysis by type or activity

6.05 Table 1.2 analyses the public sector's finances by type or activity. The main receipts of "general government" (ie central plus local government) are grouped according to the kind of activity which gives rise to them, while spending is shown, by department, as in Chapter 5 and in the Public Expenditure White Paper. Its bottom line, the public sector borrowing requirement, is derived from those two totals. This derivation is repeated in Table 6.1.

Receipts

6.06 The Autumn Statement said that general government receipts in 1986–87 were likely to be higher than forecast in the 1986 Budget. The size of the overshoot now appears to be ~~rather bigger~~ greater than envisaged then. Total general government receipts are now estimated to be over ~~£2½~~ 2¾ billion higher than the 1986 Budget forecast, despite a shortfall of £1¼ billion in oil receipts. As Table 1.2 shows non-North Sea corporation tax (£1¾ billion) and VAT (£¾ billion) account for most of the additional receipts. Stamp duty, included in "other" expenditure taxes in Table 1.2, accounts for nearly a further £½ billion.

not bold

and production

6.07 The shortfall in **oil revenues** reflects lower than assumed oil prices in ~~the first half of~~ 1986~~–87~~ and ~~also~~ the £0·3 billion repayment of advanced petroleum revenue tax announced in the Autumn Statement. Oil revenues are now estimated to have fallen from £11½ billion in 1985–86 to £4¾ billion in 1986–87. They are forecast to fall ~~a little further in 1987–88,~~ in 1987-88. This reduction is more than accounted for by to £4¼ billion, ~~because of~~ lower receipts of North Sea corporation tax. This reflects the fall in oil prices in 1986, as corporation tax is paid with a lag. ~~Other oil revenues in 1987–88, determined mainly by oil prices and production in 1987, are forecast to increase.~~ The sterling oil price is assumed to be somewhat higher in 1987 than in 1986 and oil production is forecast to fall slightly.

not bold

6.08 The 1986 Budget expected total **non-oil receipts** to rise a little less than the projected rise in non-oil money GDP. They are now estimated to have risen slightly more, by 9¾ per cent, compared with an estimated 9 per cent rise in non-oil money GDP. Corporation tax receipts in 1986–87 largely depend on profits and other income earned in calendar year 1985. On currently recorded data non-North Sea company incomes rose strongly in 1985. The rise, however, is insufficient to explain the whole of the increase in corporation tax receipts. One possibility is that the recorded data understate the full rise in company income. Another possibility is that the distribution of total income growth among individual companies was such that less use was made of capital allowances and other tax offsets than the forecast implied. The greater than expected buoyancy of VAT is partly attributable to total consumer spending rising a little faster than forecast, but probably also reflects a change in the composition of consumption towards spending on goods and services subject to VAT.

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both

6.09 In 1987–88 total and non-oil money GDP are forecast to increase at much the same rate, about 7½ per cent. Non-oil receipts are ~~also~~ forecast to rise by 7½ per cent, after taking account of the Budget proposals. As Table 1.2 shows there is within this overall increase:

not bold

- a further rise, of 21 per cent, in receipts of **corporation tax** (excluding North Sea mainstream corporation tax). This reflects continued growth of company incomes in 1986.

receipts from — not bold

- a 4½ per cent increase in **income taxes**—lower than the increase in personal incomes, reflecting the income tax reductions announced in the Budget.

not bold

- an 8½ per cent increase in **VAT** receipts, following an 11 per cent increase in 1986–87. The rate of increase in consumer spending on goods and services subject to VAT is forecast to be lower in 1987–88 than in 1986–87.

net — not bold — income

- a ~~7½~~ 9½ per cent increase in **local authority rates**; a ~~much~~ smaller increase than in 1986–87.

2½ — revenue from excise duties.

- a 5½ per cent increase in ~~other expenditure taxes~~.

TAKE IN NEW PARA 6.10 AND NEW TABLE 6.2, attd

Expenditure **6.10** Total **general government expenditure** is expected to have been £165½ billion in 1986–87, a little higher than in the Autumn Statement and Public Expenditure White Paper, and ~~nearly~~ 1¾ £2 billion higher than in the 1986 Budget forecast. There are two main reasons for the overspend compared with the Budget forecast. First, as explained in Chapter 5, the planning total is expected to be £1¼ billion higher than planned. Secondly within public corporations' external financing requirement, a component of the planning total, public corporations have met a higher proportion by general government finance and a smaller proportion by market and overseas borrowing. Partially offsetting these factors is an estimated £¾ billion reduction in the forecast of general government **debt interest payments**.

not bold

6.11 General government expenditure is expected to rise by 5 per cent in 1987–88, to £173½ billion. The planning total, at £148·6 billion, is the same as in the Public Expenditure White Paper. General government gross debt interest payments are ~~is~~ forecast to rise from £17½ billion in 1986–87 to nearly £18½ billion in 1987–88.

Borrowing **6.12** The difference between general government receipts and expenditure is the general government borrowing requirement (GGBR), as shown in Table 6.1. As general government lending to public corporations is included in general government expenditure, the GGBR together with public corporations' market and overseas borrowing, gives the ~~public sector borrowing requirement (PSBR).~~ PSBR.

6.13 A year ago the PSBR in 1986–87 was forecast at £7·1 billion. Borrowing in the eleven months to February is provisionally estimated to have been £[1·6] billion. Borrowing in March is always relatively high. Central government expenditure is likely to be unusually high this March as a result of transactions related to the Rover Group, ~~And central government~~ while revenue is expected to be less than last year, with lower receipts from the North Sea ~~oil revenues~~, as a result of the fall in oil prices~~, and lower receipts of building society composite rate tax as a result of the change in payments~~.

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Taxes in relation to GDP

6.10 Table 6.2 shows taxes (including rates) and national insurance contributions as a percentage of GDP. While, overall, the percentage is estimated to have fallen in 1986-87 and is forecast to fall further in 1987-88, non-oil taxes are estimated to have risen in 1986-87 as a percentage of non-oil GDP, and are likely to stay much the same in 1987-88.

Table [6.2]: Taxes and National Insurance Contributions (NICs) Relative to GDP - %

	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87 Estimated Outturn	1987-88 Forecast
Total taxes and NICs as a share of total GDP	39.4	39.2	38.6	39.1	38.6	38.3	38.1
Non-oil taxes and NICs as a share of non-oil money GDP	38.8	38.4	37.9	37.8	37.1	37.8	37.8

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~~arrangements~~. Local authority borrowing is always high in the closing weeks of the financial year. ~~and could be higher than usual this year.~~ The latest estimate of the outturn for the PSBR in 1986–87 as a whole is £[4·9] billion, or [1·3] per cent of money GDP.

6.1~~4~~ 5 The PSBR in 1987–88 is forecast to be about £~~3~~ 4 billion, or ~~3~~ 1 per cent of money GDP.

~~**Earlier years**~~

6.1~~5~~ 6 Both general government expenditure and receipts are estimated to have fallen as a proportion of money GDP in 1986–87, the latter because of the fall in oil revenues. In 1987–88 expenditure is projected to fall again as a proportion of money GDP, as it has done since 1982–83, while general government receipts are forecast to be [the same as] a proportion of money GDP as in 1986–87.

6.1~~6~~ 7 There have been significant changes in the ~~structure of receipts~~ financing of expenditure over the past eight years. In particular:

- borrowing has become a much less important means of financing public expenditure, its share falling from 12 per cent of expenditure in 1978–79 to ~~1~~ 3 per cent in 1987–88.
- North Sea revenues have grown, but in 1987–88 they are expected to finance only 2 per cent of expenditure compared with 8 per cent at their peak in 1984–85.
- there has been a switch away from direct to indirect taxation; expenditure taxes, including rates, financed 28 per cent of expenditure in 1978–79 but are expected to finance ~~40~~ 39 per cent in 198~~6~~7–8~~7~~8.
- the contribution of income tax has fallen from 25 per cent to 23 per cent.
- the contribution of national insurance contributions has risen but this is broadly offset by the fall in the contribution of the national insurance surcharge (counted as a tax on expenditure)

Analysis by sector

6.1~~7~~ 8 The PSBR may also be analysed by the authority or sector which will be undertaking (or repaying) the borrowing: central government, local authorities and public corporations. Table 6.~~2~~ 3 shows the sectoral composition of the PSBR in 1986–87, in summary form.

Table 6.~~2~~ 3 Public sector borrowing requirement

bold

	£ billion			
	1985–86 outturn		1986–87 Latest estimate	
1 Central government on own account	4·1		~~5·7~~ 4	
2 Local authority borrowing from central government		5·7		4·9
3 Local authority borrowing from market and overseas		−4·1		−4·~~0~~ 1
4 Total local authority borrowing	1·7		0·~~8~~ 3	
5 Public corporations' borrowing from central government		1·1		0·~~3~~ 2
6 Public corporations' borrowing from market and overseas		−1·1		−1·~~8~~ 5
7 Total public corporations' borrowing	0·0		−1·3	
8 Public sector borrowing requirement	**5·8**		**4·9**	
Memorandum item:—				
Central government borrowing requirement (lines 1+2+5)	10·9		10·~~6~~ 5	

6.1~~8~~9 Tables 6.~~3~~4 to 6.~~5~~6 show estimated outturns and forecasts of receipts and expenditure in 1986–87 and 1987–88 for each of the three sectors. These tables include some of the analysis by economic category in paragraph 6.27 and Table 6.~~6~~7. Expenditure in 1987–88 does not include the Reserve, which has not been allocated. The forecast of the PSBR assumes however that the Reserve is fully spent.

6.~~19~~20 Central government spending includes grants and subsidies to local authorities and public corporations (including nationalised industries), which are included in the receipts of those sectors, shown in Tables 6.~~4~~5 and 6.~~5~~6.

Table 6.~~3~~4 Central government transactions

	£ billion		
	1985–86 Outturn	1986–87 Latest estimate	1987–88 Forecasts
Receipts			
Taxes and royalties	100·6	104·3	111·~~8~~ 4
National insurance and other contributions	24·7	26·~~5~~ 4	28·6
Other	10·5	10·~~2~~ 3	9·~~6~~ 7
Total receipts	**135·8**	**~~140·9~~** 141.0	**~~150·4~~** 149.7
Expenditure			
Current expenditure on goods and services	46·6	49·2	52·~~0~~ 1
Current grants and subsidies	72·2	76·9	79·~~0~~ 4
Interest	16·1	16·6	17·~~0~~ 3
Net lending and capital expenditure, excluding on-lending to local authorities and public corporations	4·2	3·5	2·3
Total expenditure	**139·1**	**146·2**	**~~150·9~~*** 151.1

**Excluding any allocation from the Reserve*

6.2~~0~~1 Local authority receipts consist primarily of the rate income plus grants from central government. The forecast increase in net rate income between 1986–87 and 1987–88 takes account of ~~recent~~ available information about rate decisions by ~~a sample of~~ local authorities.

6.2~~1~~2 The local authority borrowing requirement (LABR) in the first eleven months of 1986–87 is provisionally estimated to have been a surplus of £[0·4] billion. The estimated outturn for the year as a whole is borrowing of £0·~~9~~8 billion. This estimate takes account of the ~~Borrowing Intentions Survey of a sample of local authorities~~. If the estimated outturn is correct, and the margin of error surrounding the forecast is inevitably very large, the LABR in 1986–87 will be ~~£1~~ nearly £1 billion lower than in 1985–86. This fall in borrowing appears to have been the result of current receipts rising more than current expenditure and a small fall in net capital spending. In 1986–87, as in 1985–86, local authorities replaced substantial amounts of market and overseas borrowing by borrowing from the central government.

usual high level of borrowing in March.

Table 6.~~4~~5 Local authority transactions

	£ billion		
	1985–86 Outturn	1986–87 Latest estimate	1987–88 Forecasts
Receipts			
Rates (net of rate rebates)[1]	13·8	15·5	~~16·7~~ 17.0
Rate support grant	11·3	11·8	13·0
Other grants from central government	10·0	11·4	~~12·0~~ 11.8
Other	5·6	5·6	5·~~1~~5
Total receipts	**40·7**	**44·3**	**~~46·7~~** 47.3
Expenditure			
Current expenditure on goods and services	28·5	31·~~2~~5	~~32·9~~ 33.3
Current grants and subsidies	5·3	5·8	5.6
Interest	3·7	4·4	4·6
Net lending and capital expenditure	4·2	3·8	4·~~2~~0
Total expenditure	**41·7**	**45·2**	**47·~~2~~**[2] 5
[1] *Memo: Rate rebates*	*1·6*	*1·7*	*1·9*

[2] *Excluding any allocation from the Reserve*

6.2~~2~~3 Table 6.~~5~~6 shows public corporations' transactions. The public corporations' receipts include subsidies and capital grants from central and local government. For the nationalised industries (and the majority of other public corporations) their net external finance, ie their borrowing plus subsidies and grants, is included in the planning total. Changes from one year to another are affected by privatisations. During the course of 1986–87 British Gas and British Airways were privatised and ceased to be classified as public corporations.

Table 6.~~5~~6 Public corporations' transactions

	£ billion		
	1985–86 Outturn	1986–87 Latest estimate	1987–88 Forecasts
Receipts			
Gross trading surplus (including subsidies)	8·1	7·0	~~6·9~~ 7.0
Other	1·8	3·~~2~~6	2·~~6~~4
Total receipts	**9·9**	**10·~~2~~**6	**9·~~5~~**4
Expenditure			
Interest, dividends and taxes on income	4·3	3·~~6~~7	3·~~8~~5
Net lending and capital expenditure	5·6	5·~~3~~6	~~4·8~~ 5.0
Total expenditure	**9·9**	**~~8·9~~** 9.3	**8·~~6~~**[1] 5

[1] *Excluding any allocation from the Reserve*

6.2~~3~~4 Public corporations' borrowing requirement in the first eleven months of 1986–87 is provisionally estimated at a net repayment of £[1·1] billion. The estimated outturn for the year as a whole is a net repayment of £1·3 billion, compared with a zero borrowing requirement in 1985–86.

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The reduction in borrowing appears to have been due to a number of factors including rising output, further improvements in productivity, the effect on profit margins of the decline in sterling and higher ~~a rise in~~ net receipts of trade credit. ~~receipts~~

Analysis by economic category

6.2~~4~~5 The transactions leading up to the PSBR may also be analysed by economic category (some details of which are given in Tables 6.~~3~~4 to 6.~~5~~6 above). This analysis is shown in Table 6.~~6~~7, with a breakdown between central government, local authorities and public corporations. This analysis, which distinguishes between current and capital transactions (and within the latter between physical and financial investment) shows the derivation of the public sector financial deficit. The ~~public sector~~ financial deficit, unlike the PSBR, is not wholly a measure of ~~actual~~ cash transactions because certain taxes included in lines 1 and 2 of Table 6.~~6~~7 are measured on an accruals basis. An accruals adjustment is made in line 28 before the PSBR is derived.

6.2~~5~~6 The unallocated Reserve is assumed to be used up by spending on current items or physical capital formation—ie in transactions that fall above the financial surplus/deficit line. In practice allocations from the Reserve can affect financial transactions (lines 25 to 29). For example expenditure in 1986–87 associated with Rover Group is classified as cash expenditure on company securities and appears in line 26.

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Table 6.~~6~~7 Public sector transactions by sub-sector and economic category

£ billion[1]

	Line[2]	1986–87 Latest estimate: General government: Central government	Local authorities	Total	Public corporations	Public sector
Current and capital receipts						
Taxes on income, and oil royalties	1	53·4	—	53·4	−0·1	53·3
Taxes on expenditure	2	48·~~2~~1	15·5	63·~~7~~6	—	63·~~7~~6
Taxes on capital	3	2·7	—	2·7	—	2·7
National insurance and other contributions	4	26·4 stat	—	26·5	—	26·5
Gross trading surplus	5	−0·3	0·~~3~~4	0·1	7·~~1~~0	7·~~2~~1
Rent and miscellaneous current transfers	6	0·~~3~~2	3·1	3·3	0·5	3·8
Interest and dividends from private sector and abroad	7	2·7	0·7	3·~~4~~3	~~1·1~~ 0.9	4·~~3~~2
Interest and dividends within public sector	8	5·7	−3·3	2·4	−2·4	—
Imputed charge for non-trading capital consumption	9	1·0	1·4	2·4	—	2·4
Capital transfers from private sector	10	—	—	—	0·~~1~~2	0·~~1~~2
Total	11	**140·0**	**17·8**	**157·8**	**6·~~2~~0**	**~~164·0~~** 163.8
Current and capital expenditure						
Current expenditure on goods and services	12	−49·~~2~~5	−31·~~2~~5	~~−80·4~~ −81.0	—	~~−80·4~~ −81.0
Subsidies	13	−5·1	−1·3	−6·4	—	−6·4
Current grants to personal sector	14	−46·~~6~~2	−4·5	~~−51·1~~ −50.8	—	~~−51·1~~ −50.8
Current grants paid abroad	15	~~−2·9~~ −3.2	—	~~−2·9~~ −3.2	—	~~−2·9~~ −3.2
Current grants within public sector	16	−22·3	22·3	—	—	—
Debt interest	17	−16·~~6~~5	−0·9	−17·5	−0·8	−18·3
Gross domestic fixed capital formation	18	−3·4	−3·7	−7·1	−5·3	−12·4
Increase in stocks	19	0·1	—	0·1	~~—~~ 0.1	0·1
Capital grants to private sector	20	−2·2	−0·6	−2·8	0·1	−2·9
Capital grants within public sector	21	−1·~~5~~6	0·9	−0·~~6~~7	0·~~6~~7	—
Total	22	**~~−149·6~~** −150.0	**−19·~~1~~3**	**~~−168·7~~** −169.3	**−5·~~6~~5**	**−174·~~3~~8**
Unallocated Reserve	23	—	—	—	—	—
Financial surplus/deficit	24	**~~−9·6~~** −10.0	**−1·~~2~~5**	**~~−10·8~~** −11.5	**0·~~6~~5**	**~~−10·2~~** −11.0
Financial transactions						
Net lending to private sector and abroad	25	−0·2	0·5	0·3	~~—~~ −0.2	~~0·3~~ —
Cash expenditure on company securities (net) (including privatisation proceeds)	26	3·~~7~~9	—	3·~~7~~9	—	3·~~7~~9
Transactions concerning certain public sector pension schemes	27	0·8	—	0·8	—	0·8
Accruals adjustments	28	−0·1	~~−0·3~~ —	~~−0·4~~ —	—	~~−0·3~~ —
Miscellaneous financial transactions	29	0·2	0·~~1~~2	0·~~3~~4	~~0·7~~ 1.0	1·~~0~~4
Borrowing requirement	30	**5·~~3~~4**	**0·~~9~~8**	**6·2**	**−1·3**	**4·9**

[1] *Sign convention: receipts positive, payments negative.*

[2] *Relationship between lines: (24) = (11) + (22) + (23) ~~= −(25) to (30)~~*
(30) = −(24 to 29)

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£ billion[1]

1987–88 Forecasts

Line[2]	General government: Central government	Local authorities	Total	Public corporations	Public sector	
						Current and capital receipts
1	57·~~3~~4	—	57·~~3~~4	−0·1	57·~~2~~3	Taxes on income and oil royalties
2	51·~~3~~5	~~16·7~~ 17.0	68·~~0~~5	—	68·~~0~~5	Taxes on expenditure
3	3·2	—	3·2	—	3·2	Taxes on capital
4	28·~~5~~6	—	28·~~5~~6	—	28·~~5~~6	National insurance and other contributions
5	−0·3	0·5	0·2	~~6·9~~ 7.0	7·1	Gross trading surplus
6	0·~~2~~3	3·1	3·~~3~~4	0·5	3·~~8~~9	Rent and miscellaneous current transfers
7	2·~~9~~8	0·7	3·~~6~~5	0·~~8~~7	4·~~4~~2	Interest and dividends from private sector and abroad
8	5·9	−3·7	2·2	−2·2	—	Interest and dividends within public sector
9	1·0	1·5	2·5	—	2·5	Imputed charge for non-trading capital consumption
10	—	—	—	0·~~1~~3	0·~~1~~3	Capital transfers from private sector
11	**150·~~0~~4**	**~~18·7~~** 19.0	**~~168·7~~** 169.4	**6·~~0~~1**	**~~174·7~~** 175.4	**Total**
						Current and capital expenditure
12	−52·~~0~~1	~~−32·9~~ −33.3	~~−84·9~~ −85.4	—	~~−84·9~~ −85.4	Current expenditure on goods and services
13	~~−4·5~~ −5.1	−1·0	~~−5·5~~ −6.1	—	~~−5·5~~ −6.1	Subsidies
14	−47·8	−4·6	−52·4	—	−52·4	Current grants to personal sector
15	−2·~~7~~9	—	−2·~~7~~9	—	−2·~~7~~9	Current grants paid abroad
16	~~−24·0~~ −23.6	~~24·0~~ 23.6	—	—	—	Current grants within public sector
17	−17·~~6~~3	−0·7	−18·~~3~~0	~~−1·1~~ −0.9	~~−19·4~~ −18.9	Debt interest
18	−3·5	−3·~~5~~6	−7·0	−4·6	−11·~~7~~6	Gross domestic fixed capital formation
19	−0·2	—	−0·2	−0·1	−0·3	Increase in stocks
20	−2·0	−0·7	−2·7	−0·1	−2·8	Capital grants to private sector
21	−1·~~4~~8	~~0·8~~ 1.1	−0·~~6~~7	0·~~6~~7	—	Capital grants within public sector
22	**~~−155·7~~ −156.2**	**~~−18·7~~ −19.2**	**~~−174·4~~ −175.5**	**−5·~~3~~0**	**~~−179·7~~ −180.5**	**Total**
23					3·5	Unallocated Reserve
24	**~~−5·7~~**	~~—~~	**~~−5·7~~**	**~~0·7~~**	**−8·5**	**Financial surplus/deficit**
						Financial transactions
25	−0·2	0·4	0·2	−0·~~1~~2	—	Net lending to private sector and abroad
26	5·0	—	5·0	—	5·0	Cash expenditure on company securities (net) (including privatisation proceeds)
27	0·~~7~~5	—	0·~~7~~5	—	0·5	Transactions concerning certain public sector pension schemes
28	−0·~~2~~3	~~—~~ 0.1	−0·2	—	−0·2	Accruals adjustments
29	−0·~~1~~6	— −0.1	−0·~~1~~8	~~0·5~~ —	~~0·2~~ −0.8	Miscellaneous financial transactions
30					~~3·4~~ 4.0	**Borrowing requirement**

Annex to Chapter 6

Part A: Relationship between tables in Chapter 6, and with Table 1.2; and outturn data

Relationship between tables

6A.1 Table 6.~~6~~7 is based on the definitions used to compile the national accounts. In order to show the financial deficit for each sector, lending and other financial transactions are separated from the analysis of receipts and expenditure in lines 1–23 and shown in lines 25–29. These lines show the relationship between the financial deficit (line 24) and the borrowing requirement for each sector (line 30).

6A.2 Tables 6.~~3~~4–6.~~5~~6 are summary versions of the sectoral columns of Table 6.~~6~~7. The information in Table 6.~~6~~7 is rearranged so that, for example, central government grants to local authorities (which appear as negative expenditure in the local authorities column of Table 6.~~6~~7, lines 16 and 21) appear as receipts in Table 6.~~4~~5. Interest paid by local authorities to central government (which appears as negative receipts in the local authorities column of Table 6.~~6~~7, line 8) appears as expenditure in Table 6.~~4~~5. Finally, lending and other financial transactions (lines 25–29 of Table 6.~~6~~7) are included in the receipts and expenditure of Tables 6.~~3~~4–6.~~5~~6.

6A.3 Table 1.2 in Chapter 1 uses the same information as Table 6.~~6~~7, but again rearranges it. To derive general government expenditure, it starts by giving a functional breakdown of the public expenditure planning total: that includes not only general government expenditure items in the third column of Table 6.~~6~~7 (including the "financial transactions" in lines 25–26), but also borrowing or capital expenditure by public corporations in the fourth column. General government expenditure as shown in Table 1.2 is then obtained by adding general government debt interest from the third column of Table 6.~~6~~7 and the national accounts adjustments already included in Table 6.~~6~~7, and deducting public corporations' borrowing from the market and from overseas.

6A.4 Alternatively, general government expenditure in Table 1.2 (and Table [2.~~3~~4]) can be obtained as the sum of lines 22, 23, 25 and 26 (third column) in Table 6.~~6~~7 and on-lending to public corporations in Table 6.~~2~~3.

6A.5 To derive general government receipts, Table 1.2 takes the receipts shown in the third column of Table 6.~~6~~7 (lines 11, 27, 28 and 29) and rearranges them according to the type of activity which gives rise to them. For example, oil revenues comprise North Sea corporation tax and petroleum revenue tax (included in "taxes on income" in Table 6.~~6~~7) plus oil royalties. The sub total "total taxes and royalties" is the same as the first line of Table [2.~~4~~5] in Chapter 2.

Outturn data

6A.6 Outturns for the PSBR and the statutory central government accounts (as in Tables 6.B.1–4 in Part B of the Annex) are compiled monthly and published by press notice 12 working days after the end of the month and then in more detail in Tables 2.5 and 3.12 to 3.16 of the following issue of Financial Statistics. ~~Outturn for the~~ Details of the PSBR on national accounts definitions, as in Table 6.6, are compiled quarterly and published in sections 2 to 5 of Financial Statistics three months after the end of the quarter.

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6A.7 The first outturn for the PSBR in 1986–87 will accordingly be published on April 16. The first national accounts outturns for 1986–87 will appear in the June issue of Financial Statistics, including supplementary Table 13 which is based on Table 6.6.

Part B: Central government transactions

Commentary on the tables

6B.1 The tables in Part B of this Annex are confined to central government transactions only, and are based on the statutory funds and accounts. Their relationship to the accounts of central government on a national accounts basis (as in Table 6.3) is described in the Financial Statistics Explanatory Handbook (1987 edition, p38). The receipts and payments in the Part B tables are all shown on a cash basis, not accrued. Table 1.2, however, shows the main categories of taxes on an accrued basis as in the national accounts: for instance the item "income taxes" in Table 1.2 differs slightly from " income tax " in Table 6.B.3.

Table 6.B.1 Summary of central government transactions

	£ billion 1986–87 latest estimate	
Consolidated Fund		
Revenue (Table 6.B.3)	111·4	
Expenditure (Table 6.B.2)	−116·1	2
~~Deficit met from National Loans Fund~~	~~−4·8~~	
National Loans Fund (Table 6.B.4)		
Receipts	15·6	
Payments	−25·4	2
Total net borrowing by the National Loans Fund	**−9·8**	6
Other funds and accounts (net)	−0·8	9
Central government borrowing requirement[1] (Table 6.1) (Including borrowing for on-lending to local authorities and public corporations)	**−10·6**	4

not bold
Footnote
3

Table 6.B.2 Consolidated Fund expenditure

	£ million 1986–87 latest estimate	
Supply issues[1]	~~102 000~~	101 9
Standing services		
Payment to the National Loans Fund in respect of service of the national debt	8 900	
Northern Ireland—share of taxes etc.	2 000	
Payments to the European Communities[2]	~~3 000~~	3 300
Other services	~~100~~	110
Total standing services	~~14 100~~	14 300
Total Consolidated Fund expenditure	~~116 100~~	116 20

not bold
4

[1] *Supply Issues are monies paid from the Consolidated Fund to Departments' cash accounts with the Paymaster General for spending on Supply. Supply Expenditure (see Table 5.4) equates closely to total Supply Issues in most years, although there may sometimes be slight timing differences between the two.*

[2] *£~~499~~ 500 million was paid to the European Communities from Supply Issues instead of Standing Services.*

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Table 6.B.3 Consolidated Fund revenue

	£ million		
	1986–87		1987–88
	Budget	Latest estimate	Forecast ~~estimate~~
Inland Revenue			
Income tax[1]	38 500	38 300	~~40 000~~ 39 900
Corporation tax[2 3]	11 700	13 ~~3~~00 4	15 000
Petroleum revenue tax[4]	2 400	~~1 350~~ 1 290	~~2 000~~ 1 690
Capital gains tax	1 050	1 050	1 250
Development land tax	35	55	20
Inheritance tax[5]	910	990	1 060
Stamp duties	1 430	~~1 810~~ 1 840	2 000
Total Inland Revenue	**56 000**	**56 900**	~~**61 300**~~ 60 900
Customs and Excise			
Value added tax	20 700	21 ~~6~~00 5	23 ~~3~~00 2
Petrol, derv etc. duties	7 300	7 500	~~8 100~~ 7 800
Cigarettes and other tobacco	4 700	~~4 900~~ 5 000	5 ~~1~~00 0
Spirits, beer, wine, cider and perry	4 400	4 200	4 ~~4~~00 3
Betting and gaming	800	760	800
Car tax	980	980	~~1 090~~ 1 110
Other excise duties	20	~~10~~ 5	~~5~~ 20
EC own resources[6]	1 300	1 290	1 3~~6~~0 1
Customs duties, etc. (move)			
Agricultural levies	160	220	230
Total Customs and Excise	**40 400**	**41 400**	~~**44 100**~~ 43 9
Vehicle excise duties[7]	2 500	2 500	2 600
~~National Insurance surcharge~~		~~—~~	~~—~~
Gas levy	500	~~500~~ 520	490
Broadcasting receiving licences	1 000	1 010	1 030
Interest and dividends	840	880	1 020
Other[8]	7 400	8 ~~2~~00 1	7 ~~4~~00 6
Total Consolidated Fund revenue	**108 600**	**111 400**	~~[illegible]~~ 117 50

not bold

not bold

not bold

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[1] *See paragraph 6.B.1.*

[2] *Includes advance corporation tax (net of repayments)*	*4 100*	*4 400*	~~*4 400*~~ 4 800
[3] *North Sea corporation tax*	*2 700*	~~*1 330*~~ 2 670	~~*610*~~ 1 410
of which satisfied by setting off ACT	*1 200*	*1 100*	*800*

Liability to corporation tax arising in respect of North Sea production may be satisfied by setting off ACT arising on dividends paid in previous periods in respect of both onshore and offshore activities. Dividends and ACT associated with North Sea activities alone cannot be identified.

[4] *Includes advance payments of petroleum revenue tax.*

[5] *Includes estate duty and capital transfer tax.*

[6] *Customs duties and agricultural levies are accountable to the European Communities as 'own resources'; actual payments to the Communities are recorded in Table 6.B.2.*

[7] *Includes driving licence receipts.*

[8] *Includes the 10 per cent of 'own resources' refunded by the European Communities to meet the costs of collection, privatisation proceeds and oil royalties (see Table 1.2).*

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Table 6.B.4 National Loans Fund receipts and payments

		£ million 1986–87 Latest estimate	
italics	**Receipts**		
	Interest on loans, profits of the Issue Department of the Bank of England, etc.	6 700	
	Service of the National Debt—balance met from the Consolidated Fund	8 900	
	Total receipts	**15 600**	
italics	**Payments**		
not italics	*Service of the National Debt*		
indent	Interest	15 400	
indent	Management and expenses	170	
not bold, not italics	*Total Service of the National Debt*	*15 600*	
not bold, not italics	*Loans to:*		
indent	Nationalised industries	~~-100~~	-39[illegible]
indent	Other public corporations	~~210~~	170
indent	Local authorities	4 900	
indent	Private sector and within central government	100	
not bold, not italics	*Total National Loans Fund lending*[1]	~~5 100~~	4 7[illegible]
	Consolidated Fund deficit	4 800	
	Total payments	~~25 400~~	25 [illegible]

x

[1] *On-lending to local authorities and public corporations in Table 6.3 includes, in addition to National Loans Fund lending, net lending from other funds and accounts (mainly Supply Issues in Table 6.B.2).*

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DATE: 11 MARCH 1987

CHANCELLOR OF THE EXCHEQUER

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr F E R Butler
Mr Wilson
Mr Cassell
Mr Monck
Mr Sedgwick
Mr Odling-Smee
Mr Culpin
Mr S Davies
Mr Riley
Miss O'Mara
Miss Sinclair
Mr Mowl
Miss Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Ross Goobey
Mr Evans
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Calder - IR
Mr Ko - IR
Sir Angus Fraser - C&E
Mr Knox - C&E
Mr Bone - C&E

FSBR: SECOND PROOF

... I attach the second proof of the FSBR. We need to return this to the printer tomorrow (Thursday) night and would therefore be grateful for your amendments tomorrow. This is the last opportunity for substantive amendments to the text - minor changes can be taken on board at proof reading on Saturday.

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2. The proof assumes a PSBR of £4.3 billion in 1986-87 and £4.1 billion in 1987-88. (Now out of date.)

CHAPTER 2

3. Mr Riley points out that £4.3 billion can only just be made to round to $1\frac{1}{4}$ per cent of GDP (rather than 1 per cent) if we exploit roundings to the fullest extent possible.

4. We have brought the reference to the UK's growth record (paragraph 2.03) in line with today's formulation in the Budget Speech.

CHAPTER 4

5. We have included in the Annex (note 9) a new reference to the expected growth in take-up of Profit Related Pay. This is in line with the latest formulation in the Speech.

CHAPTER 5

6. Mr F E R Butler has suggested a new final sentence to paragraph 5.01 to indicate that the Budget contains no spending measures.

CHAPTER 6

7. You thought the headings and side headings needed further thought. We have brought them into line with the treatment in other chapters.

... 8. I attach notes on Chapters 3 by Mr Davies and on Chapter 6 by Mr Mowl.

9. We have redesigned the contents page to include details of the FSBR tables and charts. Although this makes the first pages rather crowded we think it is worth making the contents more accessible in this way.

MCS

M C SCHOLAR

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FROM: S J DAVIES
DATE: 11 MARCH 1987

CHANCELLOR OF THE EXCHEQUER

cc : Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Sir G Littler
Mr F E R Butler
Mr Cassell
Mr Kemp
Mr Monck
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Bottrill
Mr Matthews
Mr Mowl
Mr Riley
Ms Evans
Mr Cropper
Mr Tyrie
Mr Ross Goobey

FSBR CHAPTER 3

1. This minute takes up some of your comments on FSBR Chapter 3, as recorded in Mr Allan's minute of 6 March to Mr Sedgwick, and notes other changes made in the latest draft.

Inflation

2. You raised the question of the timing of the cut in mortgage rates and the reference to inflation peaking at about 5 per cent that appeared in last week's draft. Particularly in view of Monday's ½ point cut in bank base rates, the mortgage rate assumption that we have been working with in the forecast - a ½ point cut at the beginning of July - no longer seems central. We are now assuming an earlier cut in mortgage rates - a ½ point cut effective from the beginning of May. (We prefer not to assume either an earlier or a larger interest rate cut than this. Either change would make it more difficult to produce a forecast in which inflation is no higher in 1988Q2 than in 1987Q4 - a cut in mortgage rates in April this year would reduce inflation in 1987Q4 but not in 1988Q2.)

sd-ch
fsbr-chpt3

3. With a May cut in mortgage rates our latest monthly RPI forecast is:

February	4.0
March	4.1
April	4.3
May	4.4
June	4.8
July	4.8
August	4.6
September	4.3
October	4.4
November	3.7
December	3.6

4. Thus RPI inflation is not now forecast to reach 5 per cent, although the forecast is still just about consistent with a description of inflation peaking at "around 5 per cent". However, bearing in mind the possibility that the cut in mortgage rates by June might exceed ½ a percentage point, it does not seem sensible to put a figure as high as 5 per cent into public circulation. The references in the FSBR (paragraphs 3.03 and 3.50) have therefore been changed; the summary now says that "inflation may rise temporarily to over 4½ per cent", where before it said "inflation may rise temporarily to about 5 per cent by the summer". One possibility would be to go still further and say only that "inflation may rise temporarily to about 4½ per cent", although Chart 3.8 shows the RPI peak fairly obviously above 4½ per cent.

5. In spite of the small cut in mortgage rates now assumed, the housing component of the RPI (shown in FSBR Table 3.9) is forecast to rise much faster than the rest of the index - by 9 per cent in the year to 1987Q4, and by 7½ per cent in the year to 1988Q2. Thus few readers are likely to think that the forecast includes a cut in mortgage rates from looking at the RPI table (although they might speculate on why the forecast growth in the housing component of the RPI in 1987Q4 has come down from the 10¼ per cent increase forecast in the Autumn Statement).

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6. The reference to the TPI (paragraph 3.50) has been changed to be consistent with the lower RPI inflation peak. The TPI forecast has also been refined with the help of Inland Revenue estimates of post budget net of tax incomes at the various gross income levels used in construction of the index. The 4.8 per cent June peak for the RPI should give a 3.2 per cent increase in the TPI; the RPI forecast for the fourth quarter should give 2.1 per cent on the TPI.

7. The reference to the effect of mortgage interest payments on the RPI in the last sentence of paragraph 3.44 has been revised since the previous draft:

> "The annual inflation rate reached a low point of 2.4 per cent in July and August: most of its subsequent rise has reflected a higher contribution from the mortgage interest payments components of the RPI" replaces
>
> "The annual inflation rate .... most of its subsequent rise has reflected higher mortgage interest payments".

The shorter version was technically incorrect as both the fall in interest rates in September 1985 and the rise in November 1986 have contributed to the rise in inflation since last summer.

Oil and non-oil business investment

8. The table below shows the requested split between oil and non-oil business investment.

	£ billion at 1980 prices	Percent changes on a year earlier		
	1985	1985	1986	1987
Business	30.5	4	- 3	4
Oil	2.4	-16	-16	-18
Non-oil	28.1	7	- 2	5

Saving ratio

9. You asked for "saving ratio" to be changed to "savings ratio" in paragraphs 3.34 and 3.35. I think that the convention normally observed in the Treasury is that "saving" refers to a flow and "savings" to a stock: the draft's "saving ratio" follows this convention. The convention was followed passim in the recent EPR article on consumers'spending and saving, and in the Autumn Statement (paragraph 1.36). It is also followed by the CSO (eg the fifth column on page 10 of January's Economic Trends is headed "personal saving ratio".) I should therefore prefer to retain "saving ratio" in the FSBR.

Revised National Accounts data

10. We have just received revised national accounts data from the CSO (not yet the final figures to be published on Friday week). GDP(A) growth now looks fairly safe at 2½ per cent for 1986. The main changes to the components of expenditure are:

- consumers' expenditure has been revised down for 1986Q4, and this affects the rounded annual total increases in consumers' expenditure for both 1986 and 1987. The 1986 increase is now 4½ per cent instead of 5; the 1987 increase is 4 instead of 3½;

- a big change to the price/volume split of general government consumption has brought its real growth down from 2 per cent in 1986 and 1987 to 1 per cent and 1½ per cent respectively;

- fixed investment now rises by ½ per cent in 1986; previously it showed no change.

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GDP measures

11. You asked whether the reference (paragraph 3.32) to differences between the three separate estimates of GDP should be retained. I think it should, given the different quarterly profiles of growth through 1986 that they display; but it might be better to refer simply to "differences" than to "large differences".

Export shares

12. You asked us to check whether, as in your redraft, the UK export share had declined "in the decades up to 1981". The UK value share of main manufacturing countries' exports fell by about 20 per cent between 1955 and 1963, and by about 30 per cent between 1963 and 1970. So the reference to decades seems correct, and has been taken into the latest draft.

13. On the question of exports in 1986, we would prefer not to say that the UK "appears to have increased its share of developed countries' exports of manufactures" as in your redraft. It is true that the rapid rise in UK manufactured export volumes in the fourth quarter of 1986 appears to imply a rising share, although the figures for other countries' exports are far from complete. The more cautious wording in last week's draft - "UK manufactured export volumes appear to have increased in line with developed countries' exports of manufactures" - reflects our current estimate that total UK manufactured exports in 1986 as a whole rose by the same amount ($2\frac{1}{2}$ per cent, rounded to the nearest $\frac{1}{2}$) as main manufacturing countries' exports.

World imports/LDC debt problem

14. A sentence on LDC imports and debt has been added to the paragraph on prospects for world trade (paragraph 3.21):

> "Imports by non-oil developing countries seem likely to rise more quickly in 1987 after little change in 1986: despite continuing debt problems for some of these countries, commodity prices and hence export earnings are expected not to be as weak as in 1986".

S J D

S J DAVIES

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CE6

FROM: COLIN MOWL
DATE: 11 MARCH 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Sedgwick
Mr Odling-Smee
Mr Turnbull
Mr Scholar
Mr Riley
Mr Ritchie

FSBR: CHAPTER 6

The draft is provisionally based on a PSBR of £4.3 billion for 1986-87 and £4.1 billion for 1987-88. We would be able to change to 4.1 and 3.9 tomorrow morning should you decide to go for this option.

Paragraph 6.21

We have added a phrase to the end of the paragraph to explain that the increase in net rate income between 1986-87 and 1987-88 of 8½ per cent is due not only to available information about rate decisions but also to additions to rateable value. The increase in net rate income is consistent with rate poundage increases of about 7½ per cent, as suggested by the latest rates monitor.

Paragraph 6.24: Public corporation borrowing

It is now clear that the factors mentioned in the last sentence of the previous draft are not consistent with the aggregate estimates in table 6.6, which show a lower gross trading surplus in 1986-87 than in 1985-86 even adjusting for privatisation. They apply to individual industries but do not help to explain the total. The suggested replacement sentences, which have been agreed with PE, are optional and could be omitted. Last year's FSBR did not offer any commentary on the figures.

Colin Mowl

C MOWL

MASTER

0581

Financial Statement and Budget Report 1987-88

Return to an Order of the House of Commons dated 17 March 1987: for

Copy of Financial Statement and Budget Report 1987-88
as laid before the House of Commons by
the Chancellor of the Exchequer when opening the Budget

Treasury Chambers
17 March 1987 } Norman Lamont

Ordered by the House of Commons to be printed 17 March 1987

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Table 1.1 The Budget measures[1]

	£ million 1987–88 Changes from a non-indexed base	Changes from an indexed base	yield(+)/cost(−) 1988–89 Changes from an indexed base
Tax proposals			
Income tax			
basic rate[2]	−2 200	−2 200	−2 820
personal/ allowances	−705	−10	−10
higher rate/ thresholds	−65	+40	+80
Excise duties			
oils	—	−240	−~~260~~ 265
vehicle excise duty	+5	−90	−90
tobacco	—	−105	−110
alcohol	—	−105	−~~110~~ 120
on-course betting duty	−20	−20	−20
gaming machine licence ~~duties~~ duty	+20	+20	+20
VAT			
partial exemption rules	+300	+300	+400
small business package	−115	−115	−60
other	−5	−5	+20
Inheritance tax	−90	−75	−170
Corporation tax			
small companies' rate	*	*	−45
capital gains	*	*	+60
dual resident companies	*	*	+125
~~other~~ payment dates	~~−10~~ *	~~−10~~ *	+~~125~~ 100
Profit related pay	*	*	−~~35~~ 50
Pensions	~~*~~ —	~~*~~ —	−65
Other changes	−~~10~~ 20	−~~10~~ 20	+~~50~~ 75
Total	**−2 895**	**−2 625**	**−~~2 915~~ 2945**

[1] *These measures and the basis of the costings shown, are described in detail in Chapter 4.*

[2] *Figures include the effect of the consequential change in the rate of advance corporation tax.*

~~[3] Negligible.~~ * = negligible — = nil

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1 The Budget

1.01 The objective of the Government's economic policy is to defeat inflation and maintain a vigorous, enterprising economy which will generate sustained growth and increased employment.

1.02 The Financial Statement and Budget Report (FSBR) supplements the Chancellor's Budget Statement. It describes the Medium Term Financial Strategy (MTFS); outlines developments in the economy over the past year; provides forecasts to mid-1988; details the tax proposals in the Budget; summarises the government's spending plans and brings together the financial position of the public sector for the year ahead..

The Medium Term Financial Strategy

1.03 Chapter 2 describes the MTFS which has been in place since 1980. It provides the framework for the government's economic policies, which are designed to bring inflation down further and improve other aspects of the UK's economic performance. Monetary and fiscal policy is set to reduce the growth of money GDP, so bringing down inflation. The Budget contains new measures to encourage enterprise, efficiency and flexibility which will improve the prospect for output and jobs. Public expenditure is on a declining path as a percentage of Gross Domestic Product (GDP) and taxes have again been reduced, as they have in each year since 1981.

Forecast

1.04 Chapter 3 describes the main developments in the economy in 1986 and the prospect until mid-1988. GDP is forecast to grow by 3 per cent in 1987, the sixth successive year of steady growth. A strong rise is forecast in investment, in manufacturing output and in non-oil exports. Inflation is forecast to be about [4] per cent in the fourth quarter of 1987. There are good prospects for a continuing decline in unemployment.

Tax measures

1.05 Chapter 4 sets out the tax proposals in the Budget. They include a reduction of 2p in the basic rate of income tax, a new incentive to encourage the growth of profit related pay, the introduction of a favourable tax regime for personal pensions, and measures to simplify tax collection and to make it fairer and more effective. Table 1.1 opposite summarises the effect of all these measures.

Public expenditure

1.06 Chapter 5 summarises the government's spending plans for the next three years. The plans show a continuing fall in general government spending as a percentage of GDP. This chapter also provides the latest estimates of the outturn for the public expenditure planning total in 1986–87 and includes a comparison of outturn and plans for the different spending authorities.

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Receipts and expenditure

1.07 Chapter 6 brings together the complete financial picture for the pu sector. The public sector borrowing requirement (PSBR) for 1986–87 is forecast to be [just ~~under~~ over £~~5~~ 4 billion, over £~~2~~ 3 billion] lower than indicat the 1986 FSBR. The PSBR for 1987–88 is forecast to be ~~some £[3½] bil~~ £ just under £4 billion or [~~¾~~ 1] per cent of GDP, £[3 ~~½~~] billion below the illustrative level in last y MTFS. The Budget measures are expected to contribute £[2] billion to borrowing requirement, over and above the net cost of indexing tax rat and allowances. Table 1.2 summarises the sources of the receipts and the direction of expenditure.

to be updated

Table 1.2 The finances of the public sector[1]

RECEIPTS	£ billion 1986–87 1986 Budget[2]	1986–87 Latest estimate	1987–88 Forecasts
Income taxes	38·7	38·6	40·1
Corporation tax excluding North Sea[2]	9·4	11·2	13·6
Capital taxes	2·8	2·7	3·2
Expenditure taxes:			
Value added tax	20·7	21·5	23·2
Local authority rates	15·6	15·5	17·0
Petrol, derv, etc.	7·3	7·5	7·8
Spirits, beer, wine, etc.	4·4	4·2	4·3
Cigarettes and other tobacco	4·7	5·0	5·0
Stamp duties	1·4	1·8	2·0
Other	7·9	8·3	8·5
Total expenditure taxes	61·9	63·7	68·0
North Sea revenues:			
North Sea corporation tax[3]	2·7	2·7	1·4
Petroleum revenue tax	2·4	1·3	2·0
Oil royalties	1·0	0·9	0·9
Total North Sea	6·1	4·8	4·3
Other[4]	−1·2	−1·2	−0·8
Total taxes and royalties	**117·6**	**119·8**	**128·4**
National insurance and other contributions	26·2	26·4	28·6
Interest and dividend receipts	6·4	5·8	5·7
Gross trading surpluses and rent	2·7	3·2	3·3
Other	3·0	3·5	2·7
General government receipts	**155·9**	**158·7**	**168·7**

close up

EXPENDITURE	£ billion 1986–87 1986 Budget[2]	1986–87 Latest estimate	1987–88 Forecasts
DHSS—Social security	42·9	44·6	46·0
Defence	18·5	18·2	18·8
DHSS—Health and personal social services	17·7	18·0	19·1
Education and science	14·3	15·7	16·6
Home Office (and Lord Chancellor's department)	5·6	5·8	6·2
Employment	—	—	—
Other departments	40·7	42·1	43·4
Privatisation proceeds	−4·8	−4·4	−5·0
Reserve	4·5	—	3·5
Adjustments	−0·4	—	—
Public expenditure planning total	**139·1**	**140·0**	**148·6**
General government gross debt interest	18·2	17·5	17·9
less public corporations' markets and overseas borrowing	−0·4	−1·5	−0·8
Other national accounts adjustments	5·7	6·1	6·2
General government expenditure	**163·4**	**164·8**	**173·5**

Difference between expenditure and revenue financed by borrowing:

	1986–87 1986 Budget	1986–87 Latest estimate	1987–88 Forecast
General government expenditure	163·4	165·1	173·5
General government receipts	155·9	158·7	168·7
General government borrowing requirement	7·5	6·4	4·8
Public corporations' market and overseas borrowing	−0·4	−1·5	−0·8
Public sector borrowing requirement	**7·1**	**4·9**	**4·0**

[1] *In these and other tables, constituent items may not add up to totals because of rounding.*
~~[2] *On current definitions.*~~
[2] *Including advance corporation tax but excluding corporation tax on capital gains.*
[3] *Before advance corporation tax set off. See footnote* [3] *to Table 6 B.3.*
[4] *Adjustments for advance corporation tax set off against North Sea corporation tax plus accruals adjustment.*

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2 Medium Term Financial Strategy

2.01 The Medium Term Financial Strategy (MTFS) continues to provide the framework for the Government's economic policy, as it has done since 1980. It is intended to bring inflation down further over a period of years, and ultimately to achieve price stability. It is complemented by policies designed further to improve other aspects of the UK's economic performance.

2.02 Economic policy is set in a nominal framework. Monetary and fiscal policies are designed to reduce the growth of money GDP, so bringing down inflation. They are complemented by policies to encourage enterprise, efficiency and flexibility. These policies improve the division of money GDP growth between output growth and inflation, and help the creation of jobs.

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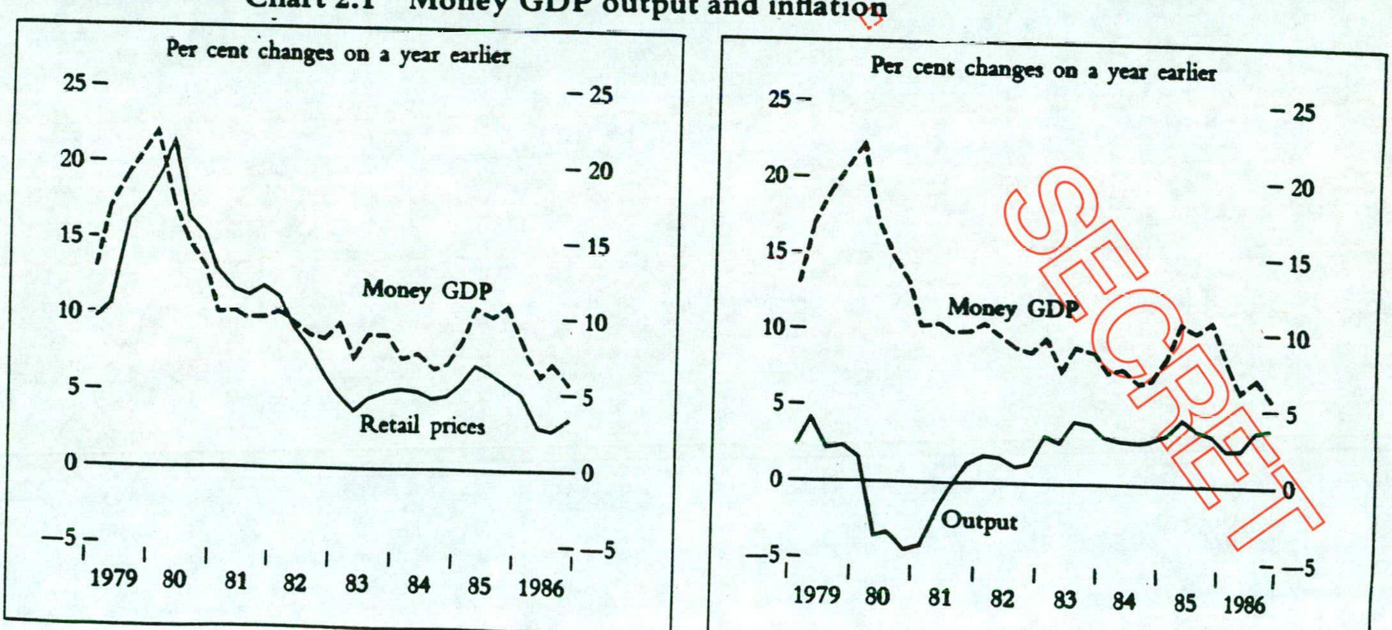
at a rate approaching 3 per cent

2.03 Over the past seven years, money GDP growth has come down from over 20 per cent to around 6 per cent. ~~But~~ In real terms, the economy has grown at approaching 3 per cent a year on average since 1981, with little variation in the growth rate from year to year. This is ~~the~~ The longest period of steady expansion since ~~before 1973~~ 1945, and it has been achieved while inflation has come down sharply—from a peak of over 20 per cent in 1980 to 4 per cent now. Productivity is rising rapidly, at a rate which compares very favourably with our major competitors. The economy has weathered the fall in oil prices last year without disruption, and is about to embark on a seventh year of steady growth, combined with low inflation.

Chart 2.1 Money GDP output and inflation



Objectives and the framework of policy

Money GDP

2.04 Policy is directed at maintaining monetary conditions that will bring about a gradual reduction in the growth of money GDP over the medium term. In the short term there will be fluctuations, but it is the medium term trend which is important. The government will aim to avoid departures in the medium term from the path set out in table 2.1

Table 2.1 **Money GDP Growth***

1986–87	1987–88	1988–89	1989–90	1990–91
6	7½	6½	6	5½

**Per cent change on previous financial year. See table 2.1 for assumptions on output and inflation. The figure for 1987–88 is a forecast; and in subsequent years the figures describe the Government's broad medium term objectives.*

2.05 The growth of money GDP in 1986–87 is expected to be somewhat below the 6¾ per cent forecast at the time of the last Budget. The forecast for 1987–88, described in Chapter 3, is correspondingly higher than the 6½ per cent indicated last year. Over the two years to 1987–88 the growth rate is little changed. In the later years the growth of money GDP declines at the same rate as in last year's MTFS.

Instruments of policy

2.06 The Government sets monetary and fiscal policies to achieve monetary conditions which will deliver its objectives for money GDP. A declining path for money GDP growth, as in Table 2.1, requires firm monetary policies supported by low public sector borrowing.

2.07 Fiscal policy is reviewed each year at Budget time. Short-term interest rates, which can be varied more frequently, are the essential instrument of monetary policy. They will continue to be maintained at levels necessary to keep monetary conditions on track.

2.08 The authorities seek to fund the PSBR fully, and no more, over each financial year by sales of debt outside the monetary sector. This will continue to be the basis for funding policy.

Monetary policy

2.09 Monetary conditions are assessed in the light of movements in narrow and broad money, and the behaviour of other financial indicators, in particular the exchange rate. There is no mechanical formula for taking these factors into account; a balance must be struck between the exchange rate and domestic monetary growth consistent with the Government's aims for money GDP and inflation.

2.10 Over the past two years, the dollar has depreciated substantially against most other major currencies. At a meeting of Finance Ministers and Central Bank Governors of six major industrial nations in Paris on [redacted] 22 February, it was concluded that a period of stability would be desirable. Accordingly, the UK and other countries represented there agreed to co-operate closely to that end. The MTFS projections assume that there is no major change in either the sterling exchange rate index or the sterling/dollar exchange rate from year to year.

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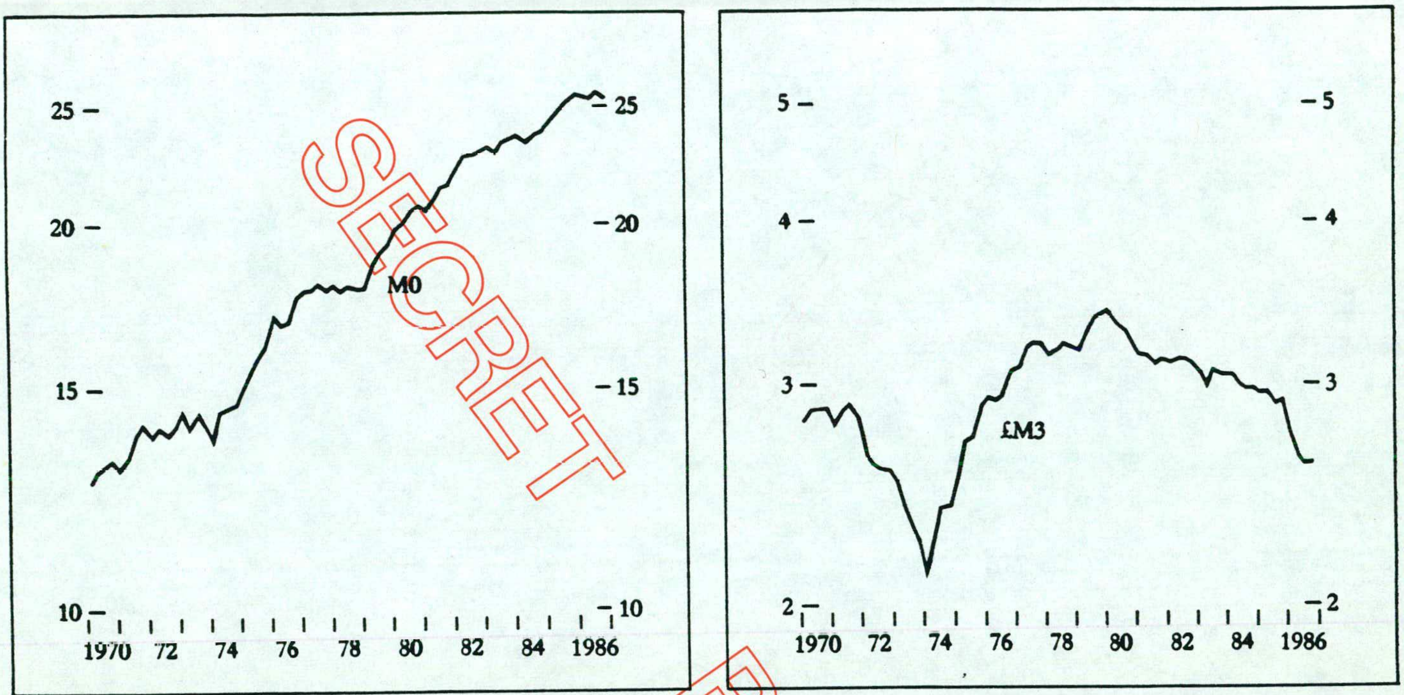
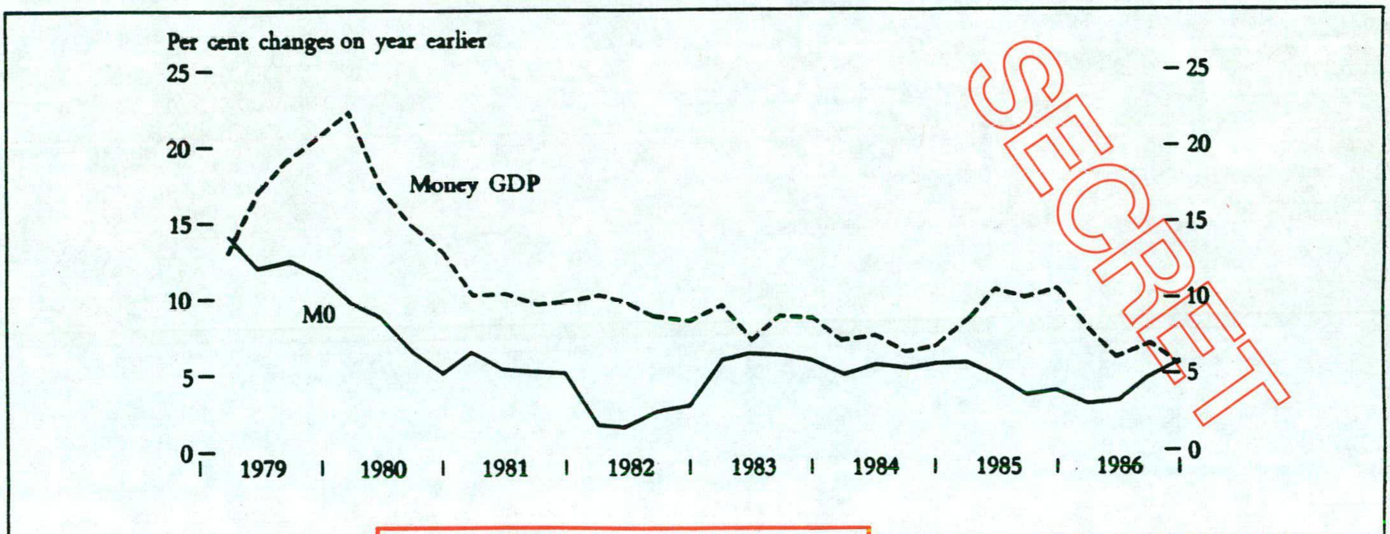
Narrow money **2.11** Last year's MTFS set out the properties desired of a target aggregate for narrow money. In particular it should have a stable relationship with money GDP. As Chart 2.2 shows, the velocity of M0 has grown relatively steadily over a long period of time. M0 has proved a reliable indicator of monetary conditions.

Chart 2.2 Velocity of monetary aggregates



2.12 In principle there is a case for moving to a wider measure of non-interest bearing money, such as the non-interest bearing component of M1. But the velocity of this aggregate exhibits considerable fluctuations which are currently exacerbated by the rapid growth of interest bearing sight deposits, and it is ultra-sensitive to interest rate changes. In these circumstances M0 remains the best choice of narrow aggregate for target purposes.

Chart 2.3 Growth of M0 and money GDP



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2.13 The target range for M0 growth in 1987–88 is 2–6 per cent, unchanged from the range indicated in last year's MTFS. Ranges for the later years are illustrative, but have a downward profile consistent with the declining path for money GDP growth.

Table 2.2 Growth of M0*

not bold

1986–87	1987–88	1988–89	1989–90	1990–91
4	2–6	1–5	1–5	0–4

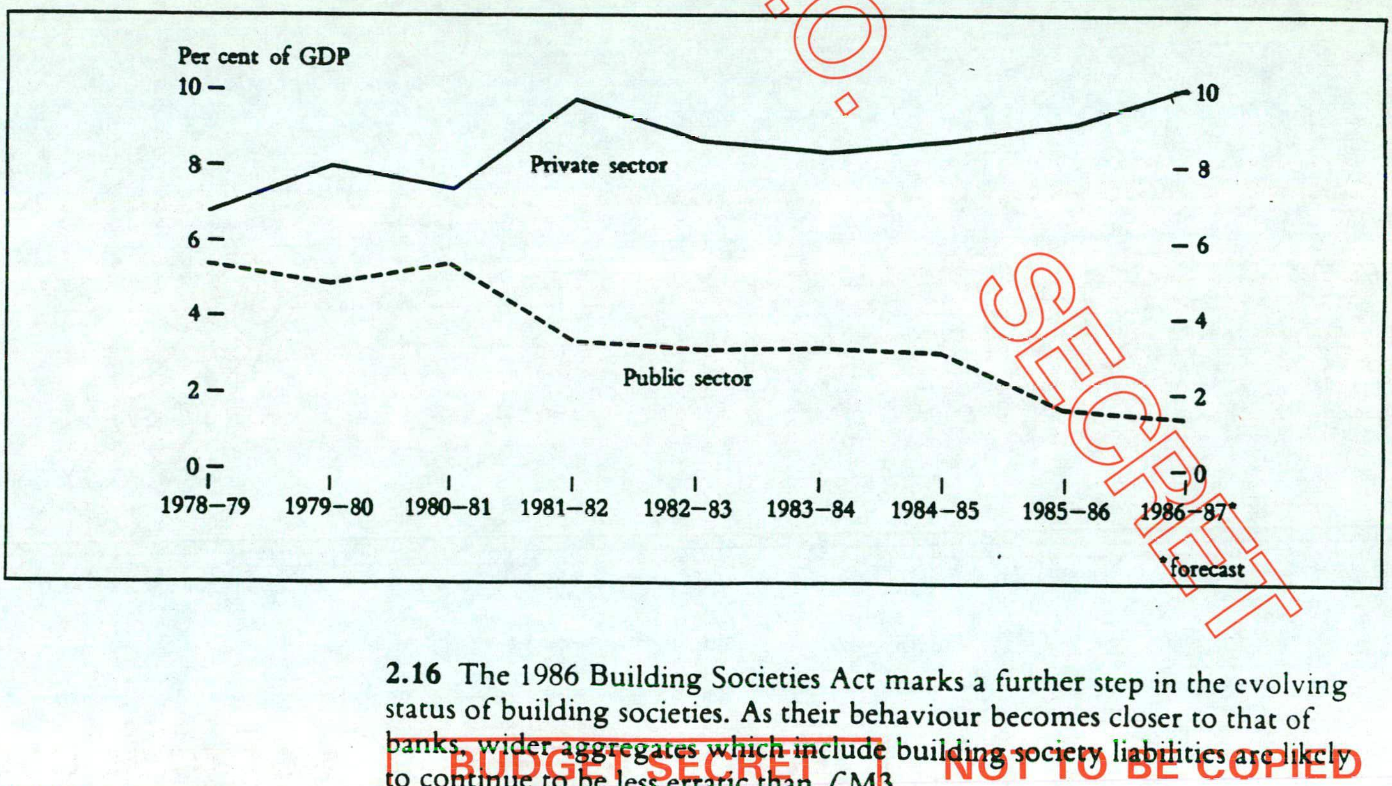
**1986–87: per cent change on previous financial year. 1987–88: target range. 1988–1989 onwards: illustrative ranges.*

2.14 If the underlying growth of M0 threatens to move significantly outside its target range in 1987–88 there is a presumption that the Government will take action on interest rates unless other indicators suggest that monetary conditions remain satisfactory.

Broad money

2.15 Broad money has been growing considerably faster than money GDP in recent years. In part this has reflected high real interest rates, which have added to the attractiveness of financial assets in general; and the end of overfunding in 1985 has also contributed. But perhaps most important, the increasing competition in financial markets in recent years has led to rapid growth of private sector liquidity and borrowing. Private sector borrowing has been rising and is now about 10 per cent of GDP (Chart 2.4). It has clearly contributed more than public borrowing to upward pressure on real interest rates. These trends are likely to persist, so that broad money growth may continue at around its recent rate, well in excess of the growth rate of money GDP.

Chart 2.4 Public and private sector borrowing



2.16 The 1986 Building Societies Act marks a further step in the evolving status of building societies. As their behaviour becomes closer to that of banks, wider aggregates which include building society liabilities are likely to continue to be less erratic than £M3.

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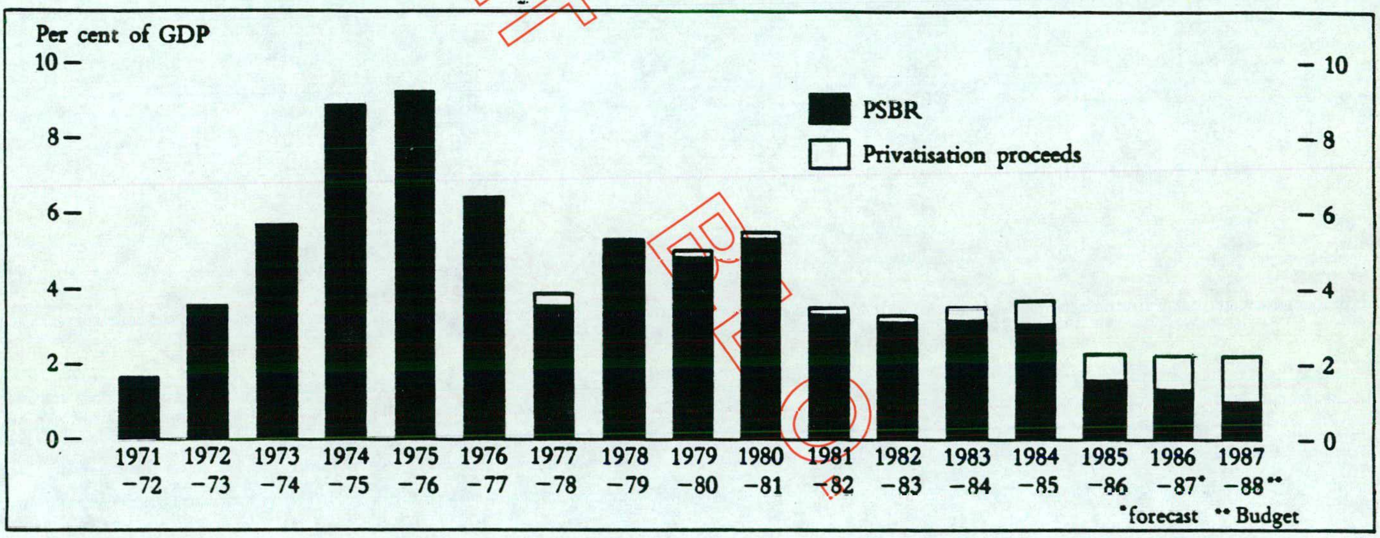
2.17 Both the Chancellor and the Governor of the Bank of England have drawn attention to the increasing difficulties in interpreting changes in broad money. With rapid and pervasive changes in financial practices, there is no simple relationship between broad money growth and money GDP. For this reason, the Government has decided that there should be no formal target for broad money in 1987–88. But the rate of growth of broad money cannot be ignored, and the Government will continue to take it into account in assessing monetary conditions.

Fiscal policy

2.18 The PSBR in 1986–87 is expected to be about 1¼ per cent of GDP. This is appreciably less than was set at the time of last year's Budget, in spite of lower oil revenues. After remaining at about 3¼ per cent of GDP between 1981–82 and 1984–85, the PSBR was reduced sharply in 1985–86 and has come down further in 1986–87. As Chart 2.5 shows, if privatisation proceeds are added back, it has been lower as a share of GDP in the past two years than at any time since 1971–72.

Chart 2.5 **Public sector borrowing requirement and privatisation proceeds**



The PSBR path

2.19 As usual, the fiscal projections for the next four years set out in Tables 2.4–6 take account of the composition of receipts and expenditure. The path of the PSBR is below that shown in last year's MTFS. The buoyancy of revenues ~~experienced in 1986–87 and projected for 1987–88~~ has made it possible to ~~set~~ a PSBR ~~in 1987–88~~ which reflects the Government's long term objective for the level of public borrowing.

x

project

x

2.20 The PSBR for 1987–88 is ~~thus~~ set at £4 billion, or 1 per cent of GDP. North Sea revenues in 1987–88 are forecast at about £4 billion, slightly lower than in 1986–87. The proceeds from the Government's privatisation programme are expected to be £5 billion, as set out in the Autumn Statement.

2.21 The PSBR is projected to remain at 1 per cent of GDP thereafter. If privatisation proceeds are added back the ratio gradually falls from 2¼ per cent in 1987–88 to 2 per cent in the final year. The PSBR to be set in future Budgets for the year ahead will be reviewed in the light of circumstances at the time.

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Assumptions

2.22 For the period to 1989–90, the public expenditure projections in Table 2.4 follow the plans set out in the Public Expenditure White Paper (Cm 56). It is provisionally assumed that the planning total will grow by 1 per cent in real terms in 1990–91. Decisions on the planning total for that year will be taken in the 1987 Survey. The revenue projections in Table 2.5 are based on the conventional assumptions of constant 1987–88 tax and national insurance contribution rates, and allowances and thresholds indexed from the proposed 1987–88 levels. All changes proposed in the Budget are taken into account.

2.23 The assumptions about output growth and inflation that underlie the revenue projections are shown in Table 2.3. They are consistent with the figures for money GDP growth in Table 2.1. ~~As last year~~, Oil prices are assumed to average $15 a barrel in 1987-88, and thereafter to remain broadly unchanged in real terms.

Table 2.3 Output and inflation assumptions

	Percentage change on previous financial year				
	1986–87	1987–88	1988–89	1989–90	1990–91
Real GDP					
Non-North Sea	3	3½	2¾	2¾	2¾
Total	3	3	2½	2½	2½
Inflation					
GDP deflator	3	4½	4	3½	3

Public expenditure

2.24 Continued restraint in public spending is a vital element of the Government's economic strategy. General government expenditure has fallen steadily as a proportion of GDP from its peak of over 46 per cent in 1982–83. The plans in the White Paper imply a continuing fall. This will enable a low level of borrowing to be combined with reductions in the burden of taxation, so improving motivation, efficiency and employment. Public expenditure is discussed more fully in Chapter 5.

Table 2.4 General government expenditure

	£ billion, cash					
	1985–86	1986–87	1987–88	1988–89	1989–90	1990–91
Public expenditure planning total[1]	133·6	140	149	154	162	168
Gross debt interest	17·~~7~~6	1~~8~~7	18	18	19	19
Other adjustments[2]	7·~~2~~6	7	7	8	8	8
General government expenditure[3]	**158·~~5~~8**	**165**	**17~~4~~3**	**180**	**188**	**196**
of which						
Privatisation proceeds[4]	2·7	4½	5	5	5	5

[1] *For 1985–86 to 1989–90, the figures are taken from Table 5.1. The planning total is assumed to grow by 1% in real terms in 1990–91.*

[2] *See paragraph 5.04.*

[3] *General government expenditure, and its components, are rounded to the nearest £1 billion from 1986–87 onwards.*

[4] *See the Public Expenditure White Paper (Cm 56), Table 1.~~1~~6. Proceeds are assumed to be the same in cash terms in 1990–91 as in 1989–90.*

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Revenue

2.25 Over the period as a whole, non-North Sea revenues are assumed to grow broadly in line with non-North Sea money GDP. Government revenues from the North Sea, however, are expected to remain more or less unchanged in cash terms, having fallen sharply in 1986–87. Thus total general government receipts are projected to increase somewhat less than money GDP.

Table 2.5 General government receipts

	£ billion, cash					
	1985–86	1986–87	1987–88	1988–89	1989–90	1990–91
Taxes on incomes, expenditure and capital	114·4	119	128	136	144	152
National insurance and other contributions	24·7	26	29	30	32	34
Interest and dividends	6·5	6	6	6	6	6
Other receipts	6·7	7	7	6	6	6
Accruals adjustment	−0·5	–	–	–	−1	−1
General government receipts[1]	**151·9**	**159**	**169**	**178**	**188**	**197**
of which North Sea tax[2]	11·4	5	4	4	4	4

[1] *General government receipts, and its components, are rounded to the nearest £1 billion from 1986–87 onwards.*

[2] *Royalties, petroleum revenue tax (including advance payments), and corporation tax from North Sea oil and gas production (before advance corporation tax set-off). This does not correspond exactly to tax receipts in the same financial year in respect of North Sea production. See footnote 3 to Table 6.B.3.*

Public sector borrowing

2.26 The projections of government expenditure and receipts are brought together in Table 2.6 to provide projections of the general government borrowing requirement (GGBR), the PSBR and the fiscal adjustment.

2.27 Changes since the 1986 MTFS are discussed in the Annex to this Chapter.

Table 2.6 Public sector borrowing[1]

	£ billion, cash					
	1985–86	1986–87	1987–88	1988–89	1989–90	1990–91
General government expenditure	158·8	165	173	180	188	196
General government receipts	151·9	159	169	178	188	197
Fiscal adjustment from previous years[2]	–	–	–	–	3	5
Annual fiscal adjustment[2]	–	–	–	3	2	2
GGBR	**6·9**	**6**	**5**	**5**	**6**	**6**
Public corporations' market and overseas borrowing	−1·1	−2	−1	−1	−1	−1
PSBR	**5·8**	**4**	**4**	**4**	**5**	**5**
Money GDP at market prices	360	382	421	438	464	489
PSBR as per cent of GDP	**1·6**	**1¼**	**1**	**1**	**1**	**1**

[1] *Rounded to the nearest £1 billion from 1986–87 onwards. Further details for 1986–87 and 1987–88 are provided in Tables 1.2 and 6.7.*

[2] *Means lower taxes or higher expenditure than is assumed in lines 1 and 2.*

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Conclusion

2.28 Events both at home and abroad may modify some of the assumptions on which the projections have been based. But the Government is committed to maintaining progress towards lower inflation, lower public expenditure as a share of GDP and lower taxes in the medium term. The MTFS provides the framework within which the financial policies to achieve this are set.

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Annex to Chapter 2

Changes since the 1986 MTFS

Money GDP

2A.1 The growth rate of money GDP in 1986–87 is expected to be somewhat lower than envisaged in last year's MTFS, with a smaller increase in the GDP deflator. A bounce-back is projected in 1987–88 leaving money GDP growth over the two years to 1987–88 much as projected last year. After 1987–88, inflation and money GDP growth are ½ point higher than assumed last year, though declining at the same rate. The projection of output growth is unchanged.

Table 2A.1 **Money GDP Growth**

Per cent changes from 1986 MTFS projections

1986–87	1987–88	1988–89	1989–90
$-\frac{3}{4}$	$+1$	$+\frac{1}{2}$	$+\frac{1}{2}$

Monetary aggregates

2A.2 The growth of M0 in 1986–87 is expected to be at the centre of its target range. The target range for 1987–88 is the same as the illustrative range given last year. The illustrative ranges for subsequent years are also the same.

Table 2A.2 **The Growth of M0**

	Per cent changes on a year earlier			
	1986–87	1987–88	1988–89	1989–90
1987 MTFS	4	2–6	1–5	1–5
1986 MTFS	2–6	2–6	1–5	1–5

Fiscal projections

2A.3 Table 2A.3 shows changes in the fiscal projections since the 1986 FSBR, after allowance for classification changes.

Expenditure

2A.4 The expected overspend on the planning total in 1986–87 is referred to in Chapter 5. The planning totals for 1987–88 onwards are as in the Public Expenditure White Paper (Cm 56), which incorporate higher figures than assumed last year. General government expenditure is rather higher in 1986–87 than projected last year, partly because of the higher planning total and partly because of a change in the level and pattern of public corporations' borrowing. Within a reduced level of total borrowing, they borrowed more from the government and less from the market and overseas than projected last year. From 1987–88 onwards, the higher levels of general government expenditure are due to higher planning totals.

Receipts

2A.5 The reduction in North Sea revenues in 1986–87 is due to last summer's fall in dollar oil prices. Little change on last year's projections is expected in later years. Other taxes are higher throughout the period.

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Table 2A.3 Revenue and expenditure[1]

	Changes from 1986 MTFS projections £ billion				
	1985–86	1986–87	1987–88	1988–89	1989–90
Expenditure					
1 Planning total	−0·2	+1	+4½	+5½	+8
2 Other[2,5]	+0·8	–	−1½	−½	–
3 General government expenditure	+0·6	+1	+3½	+5	+8
Receipts[3]					
4 North Sea taxes	−0·1	−1½	—	− ½	—
5 Other taxes and contributions	+1·8	+3½	+4½	+5½	+7
6 Other[2]	+0·1	+1	−½	−1	−1
7 General government receipts	+1·9	+3	+4	+4	+5½
8 Implied cumulative fiscal adjustment[4]	—	—	−2½	−3	−4
9 Public corporations' market and overseas borrowing[5]	+0·1	−1	—	− ½	− ½
10 PSBR	−1·1	−3	−3	−2½	−2½

[1] *Classification changes since the 1986 FSBR,* add the following amounts to both expenditure and Receipts ~~*The main changes are*~~ in respect of the treatment of central government VAT refunds and local authority housing subsidies.

£ billion				
+0·5	+0·5	+0·6	+0·6	+0·6

[2] *Includes changes in debt interest and other items.*

[3] *The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set-off. See footnote 3 to Table 6B.3.*

[4] *Line 8 = lines 10 − 9 − 3 + 7.*

[5] *Public corporations' market and overseas borrowing is included in the planning total and in the PSBR, but not in general government expenditure. Changes in it are therefore deducted in line 2 and added back in line 9.*

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3 The economy: recent developments and prospects to mid 1988

Summary

Demand and activity

3.01 The economy has been growing at around 3 per cent since last spring as exports have recovered strongly. For 1986 as a whole, recorded GDP growth was about 2½ per cent. A substantial rise in investment and non-oil exports is forecast for 1987, and GDP is expected to grow by 3 per cent, with manufacturing output rising slightly faster.

Labour market

3.02 Employment has continued to grow, particularly since the middle of 1986. There has been a reversal of the previous rising trend in unemployment, and there are good prospects for a continuing decline this year.

Inflation

3.03 Inflation fell last year to 3½ per cent, its lowest level for nearly 20 years. During 1987, inflation may rise temporarily to over 4½ per cent, as last year's movements in petrol prices and in mortgage interest rates affect the year-on-year comparisons. But it is expected to fall back to around 4 per cent by the fourth quarter.

World economy

3.04 Output in the major industrial countries has been rising by 2½–3 per cent a year since 1984, and is likely to continue at that rate in 1987. Imports by developing countries (other than oil exporters) should rise this year. Markets for UK exports of manufactures may grow a little faster in 1987 than in 1986.

UK trade and the current account

3.05 Following the fall in oil prices a year ago, the current account of the balance of payments recorded a deficit of around £1 billion in 1986. Both export and import volumes rose sharply in the second half of last year. A further relatively modest current account deficit of £2½ billion (some ½ per cent of GDP) is forecast for 1987.

Assumptions

3.06 The forecast for the UK assumes that fiscal and monetary policies are set within the framework of the MTFS. It makes the conventional assumption of a $15 per barrel oil price, as in last year's forecast, and assumes that the exchange rate will remain close to its current level.

Financial conditions

Exchange rates

3.07 The dollar fell further during 1986, particularly against the deutschemark and the yen. These changes will, over time, help to reduce the size of the US current account deficit and the Japanese and German surpluses. As paragraph 2.10 above explained, Finance Ministers of six of the leading industrialised nations agreed last month to seek a period of stability in exchange rates. Sterling fell in the summer of 1986, in the wake of the fall in the oil price. It remained steady between October and mid-February, but has since strengthened a little (see Chart 3.1).

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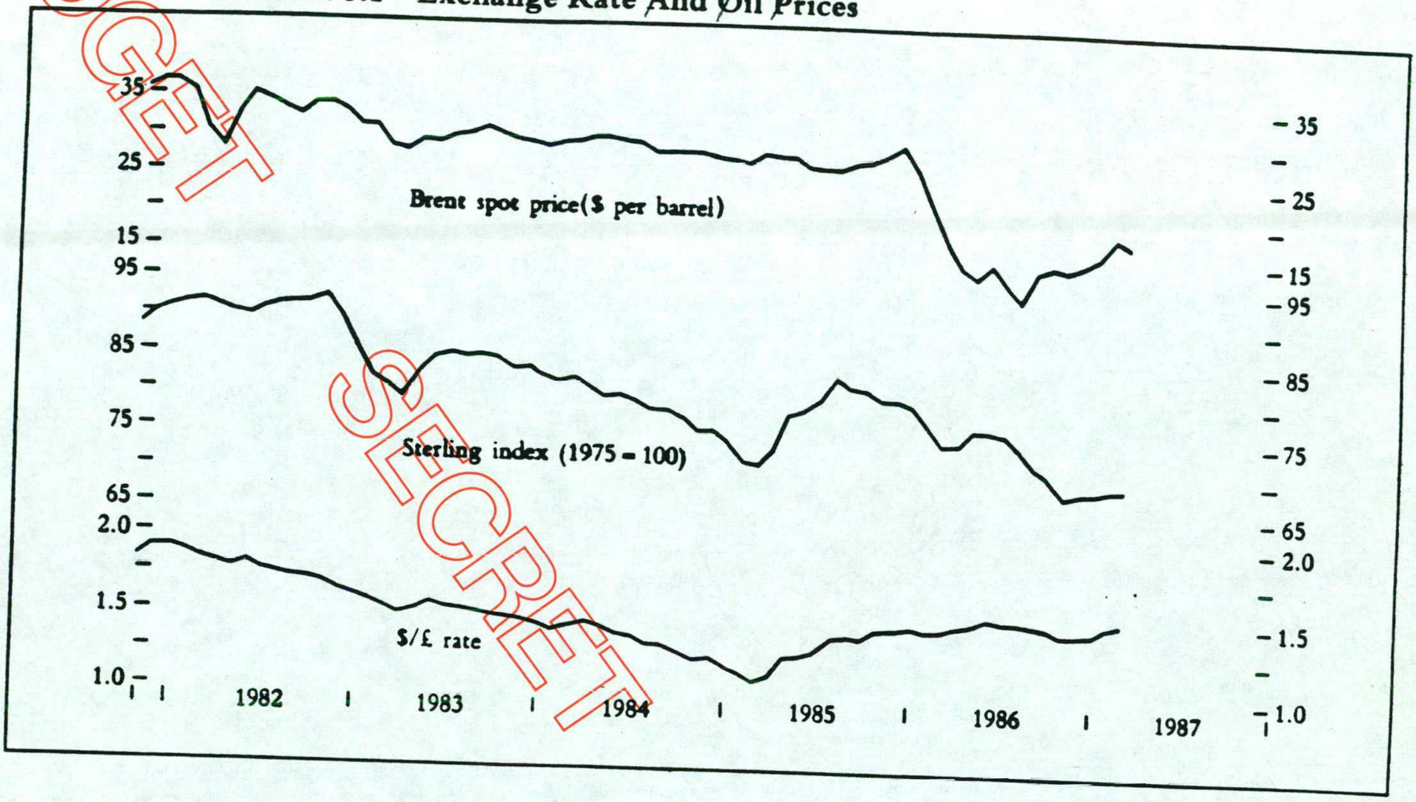
Chart 3.1 Exchange Rate And Oil Prices



Interest rates **3.08** Short-term interest rates in the UK, which rose to nearly 13 per cent in January 1986, fell last spring to around 10 per cent. But with sterling weakening in the summer and autumn and M0 also indicating an easing of monetary conditions they were raised to 11 per cent in October and ~~have~~ remained around that level until early March, since when they have ~~since, though inter-bank rates have recently~~ fallen ~~a little~~. Rates in several overseas countries have also been reduced in recent months. Longer-term rates in the UK followed the same broad profile as short-term rates during 1986, falling sharply in the spring and rising in the autumn. In recent weeks they have fallen again, to below 10 per cent.

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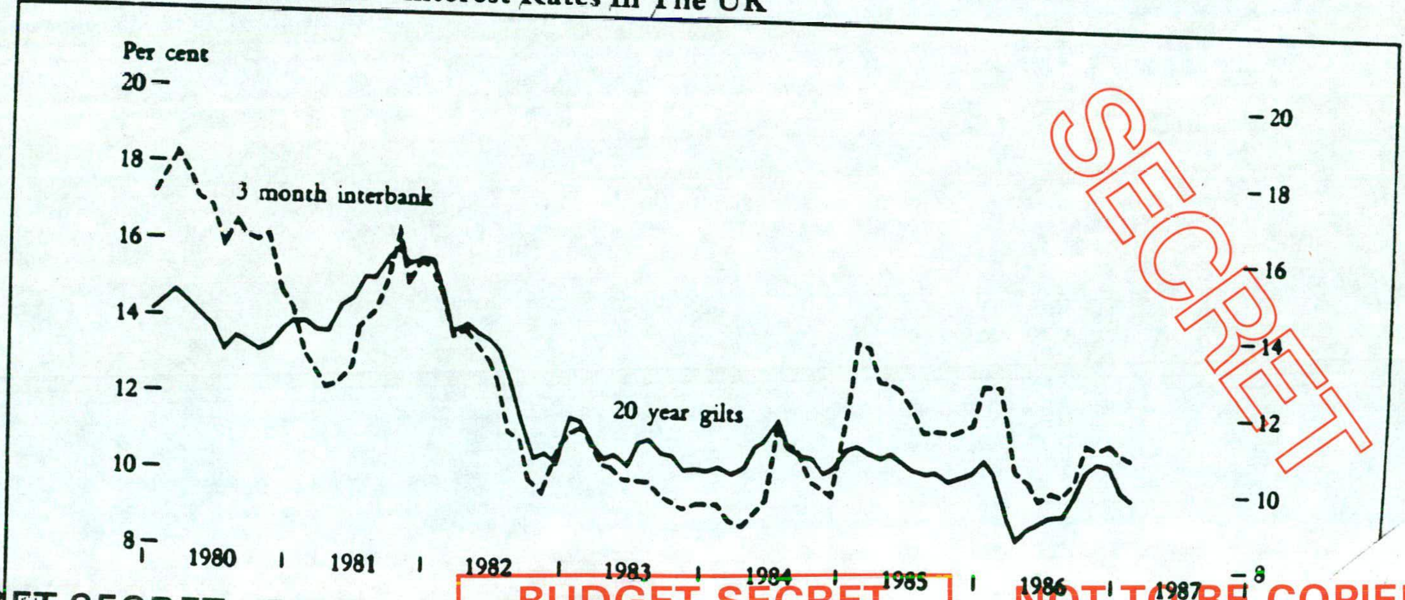
Chart 3.2 Interest Rates In The UK



, as shown in Chart 3.3.

Narrow money **3.09** M0 growth was below the centre of its 2–6 per cent target range in the early months of 1986–87. Its growth quickened from August onwards, reflecting both the falls in interest rates in the spring and the buoyant growth of personal incomes, and moved into the upper half of its target range. More recently with interest rates increased in the autumn and held there, until 9 March it has fallen back again to the middle of its target range,

Chart 3.3 **Growth Rates Of Monetary Aggregates**

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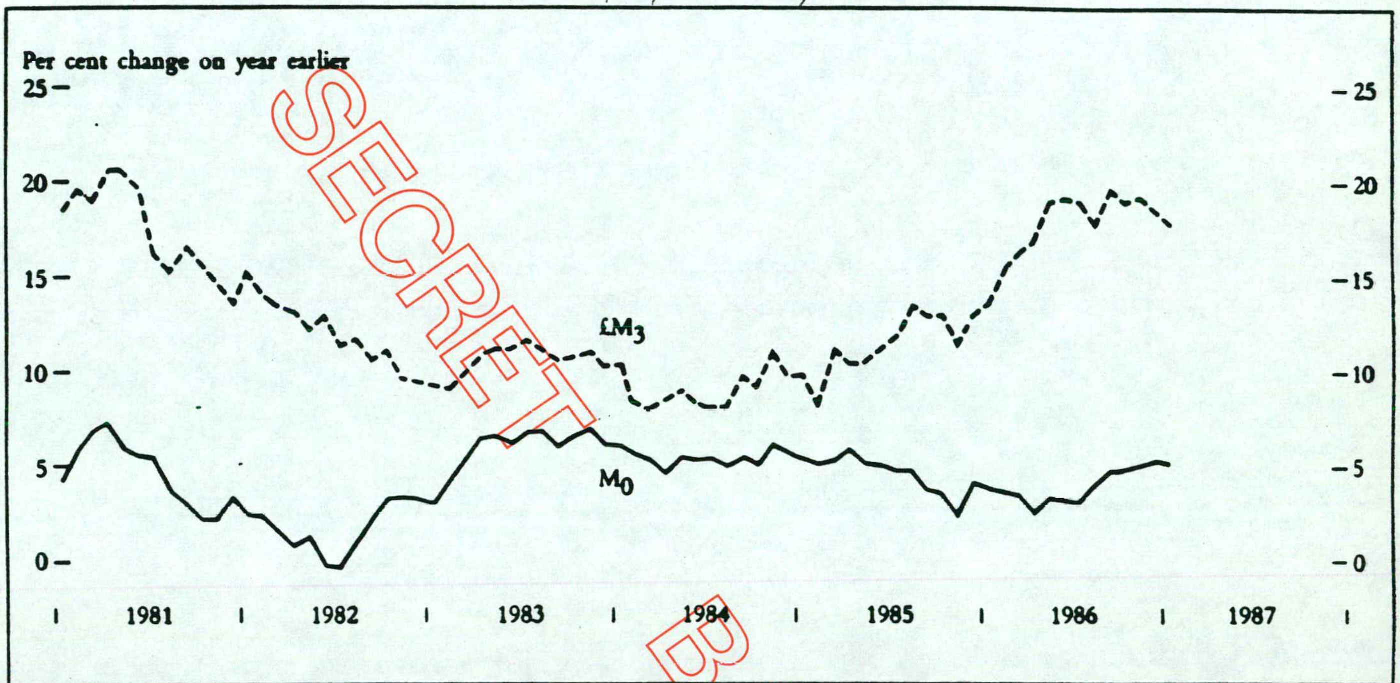

Broad money **3.10** The growth of £M3 rose to 18 per cent in the early months of 1986–87 and has since remained at about that level. This is some 3 points above the top of its target range, which in turn was set well above the growth of money GDP. Holdings of bank deposits by companies and financial institutions have grown particularly rapidly. The wider aggregates that include building societies' liabilities have grown more slowly, although also at a rate well in excess of the growth of money GDP: the year-on-year growth of PSL2 has been about 13–14 per cent in recent months. Credit has continued to grow strongly, reflecting at least partly the pace of financial innovation and liberalisation.

3.11 The growth of broad money must be seen in the context of the strong growth of private sector wealth and strongly positive real interest rates that have made financial assets attractive to hold. Increased competition in financial markets has narrowed the margins between borrowing and lending rates and this has led ~~to~~ persons and companies to build~~ing~~ up both their liquidity and their borrowing. The considerable increase in liquidity since 1980 appears to have been willingly held, and has been accompanied by lower inflation.

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World economy

Recent developments

3.12 The world economy has been strongly influenced by the fall in oil and other commodity prices, and by the substantial depreciation of the dollar. Lower import prices have helped to reduce inflation in the industrialised countries and stimulated faster growth in real domestic demand. But developing countries—and oil producers in particular—have suffered a sharp deterioration in their terms of trade.

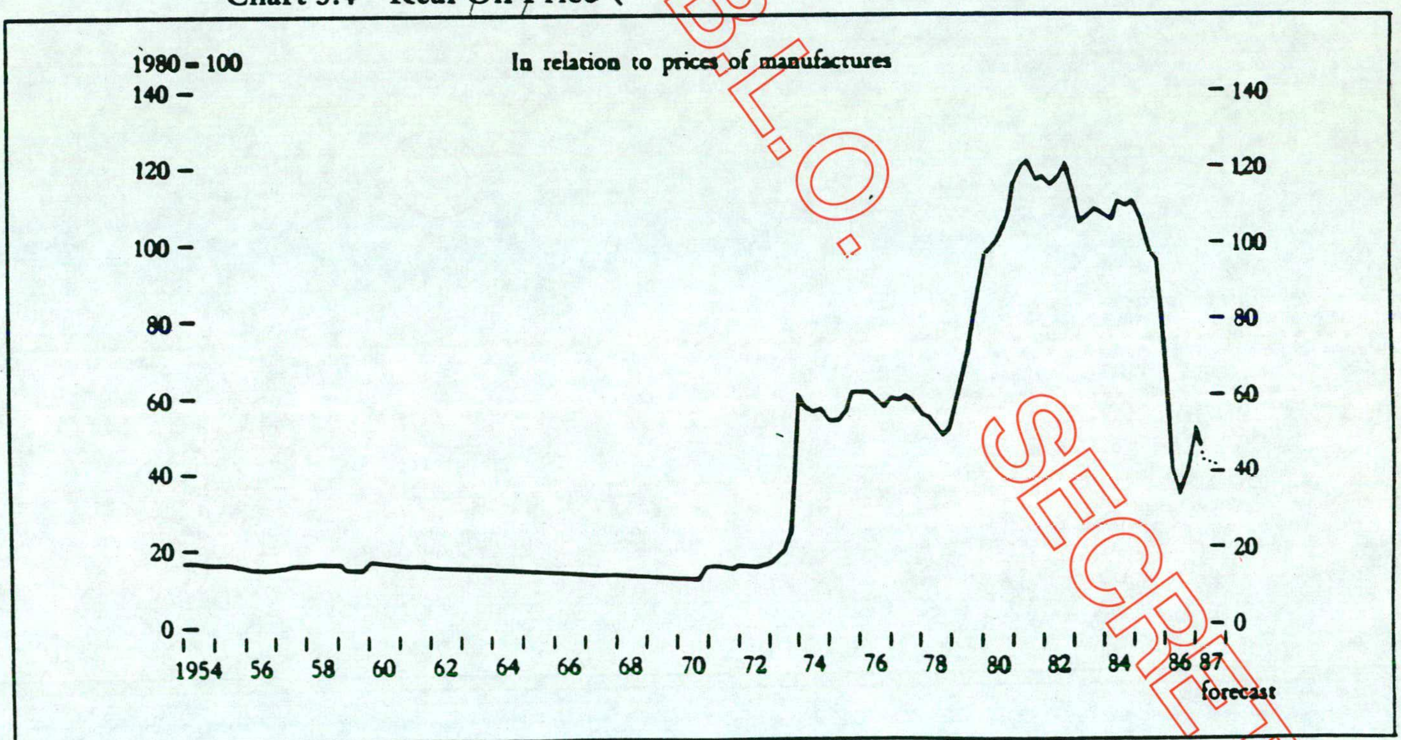
3.13 Real GNP in the seven largest OECD countries grew by about 2½ per cent in 1986. Domestic demand grew rather faster, at 3½–4 per cent, with large rises in household incomes and consumers' expenditure. Inflation fell further; and average consumer prices in the seven major countries increased by only 2 per cent in 1986.

3.14 Despite the buoyancy of domestic demand in these countries, industrial production has grown only slowly. This has been largely a result of weak export demand, particularly from developing countries, and relatively sluggish growth in investment.

3.15 The changes in exchange rates over the last two years are already beginning to have significant effects on trade volumes; but these have not yet been enough to overcome the terms of trade effects (the "J-curve"). As a result, the trade imbalances between the major countries remain large. The surpluses in Japan and Germany have continued to grow, though more slowly; and there has been little sign yet of any substantial reduction in the US current account deficit.

l.c. l.c.

Chart 3.4 Real Oil Price



3.16 Oil prices fell below $10 per barrel last summer, but rose in the second half of the year following the OPEC meeting in December. They have recently traded in a range of $15–$18 a barrel. Food and industrial materials

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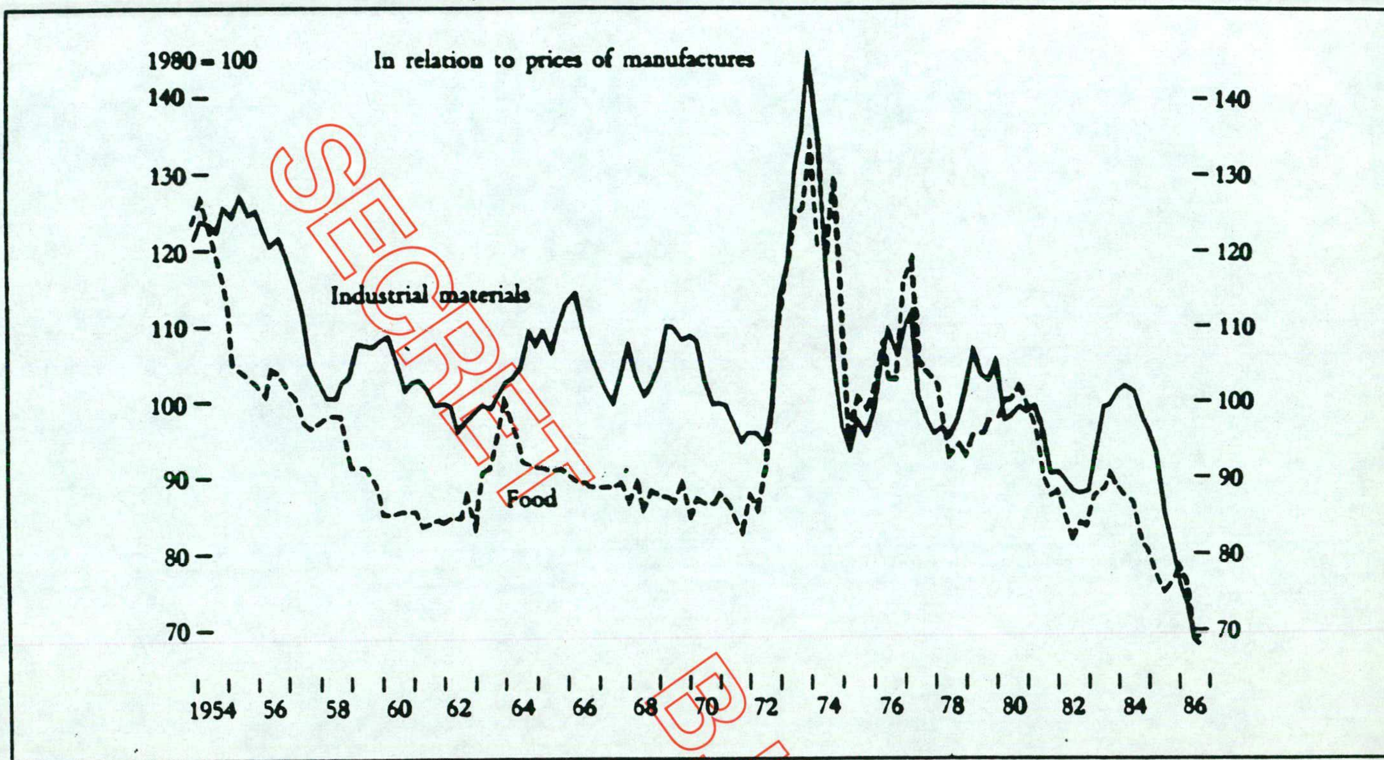
prices also fell sharply through most of last year, although they recovered slightly in the autumn. Charts 3.4 and 3.5 show past movements in real commodity prices, highlighting the extent of the recent falls.

Chart 3.5 Real Commodity Prices l.c. l.c.



3.17 World import volumes are thought to have grown by more than 5 per cent during 1986. This is somewhat faster than in 1985, largely because of a rise in oil trade as the major oil companies rebuilt their stocks. Developed countries' exports of manufactures rose by only 3 per cent as buoyant domestic demand in industrialised countries, was partially offset by cuts in developing countries' imports.

Prospects **3.18** The outlook for oil prices remains uncertain. The forecast below is based on ~~sticking to~~ the assumption that North Sea oil prices average $15 per barrel in 1987–88. Non-oil commodity prices may remain low, with food prices held down by the large surpluses of agricultural production. With rising activity in the major economies, industrial material prices may recover slightly from their current low levels.

3.19 Table 3.1 shows the forecasts for activity and inflation in the major seven industrialised countries, and for world trade. Inflation is expected to remain low, though it may rise a little from last year's level. In the US inflation may increase slightly as the effects of the fall in the dollar feed through, but the corresponding appreciation of the yen and deutschemark should mean that prices in Japan and Germany rise only very slowly, if at al'

Table 3.1 World economy

	Per cent changes on a year earlier			
		Estimates	Forecasts	
	1985	1986	1987	1988 H1
Major Seven countries[1]:				
Real GNP	3	2½	2½	3
Real domestic demand	3	3¾	3	3¼
Industrial production	3	1	2½	4½
Consumer prices	4	2	2¼	2¾
World trade, at constant prices				
Total imports	3½	5½	3½	4½
Trade in manufactures[2]	4	2½	3½	4

[1] *US, Japan, Germany, France, UK, Italy and Canada.*
[2] *Developed countries' exports weighted by UK markets.*

3.20 These changes in exchange rates and inflation will affect domestic demand and output. In Japan and Germany they are likely to strengthen domestic demand but weaken export demand; in the US, the opposite effects are likely. In aggregate, domestic demand in the major industrial countries is likely to grow less strongly than in 1986. But GNP growth should be much the same, and industrial production should grow rather faster, helped by a recovery in exports.

Imports by non-oil developing countries seem likely to rise more quickly in 1987, after little change in 1986: despite continuing debt problems for some of these countries, commodity prices and hence export earnings are expected not to be as weak as in 1986.

3.21 World trade in manufactures is forecast to grow rather more quickly in 1987 than in 1986, though the pattern may be uneven. Import demand in the US is likely to slow down considerably, and oil producers are likely to cut back their imports further. But imports by Japan and Germany are expected to increase rapidly. Growth in total world trade in 1987 is likely to be slower than in 1986, largely because the rebuilding of oil stocks is not expected to continue.

UK trade and the balance of payments

Relative costs and prices

3.22 The UK's competitiveness improved markedly during 1986. Productivity rose fast and the growth of unit labour costs was only a little above that of our main competitors. As a result, the lower exchange rate was almost entirely reflected in improved competitiveness. Much of The gain in competitiveness seems likely to be maintained over the year ahead.

(See Table 3.2)

Table 3.2 The exchange rate and competitiveness

	Sterling index (1975 = 100)	Relative unit labour costs* (1980 = 100)
1984 Q4	75	80
1985 Q4	80	86
1986 Q4	68	72

* *Ratio of UK manufacturing costs to those overseas.*

Trade prices and the terms of trade (excluding oil)

3.23 Prices of most imports rose during 1986, as the effects of the depreciation of sterling more than offset generally weak world prices. Export prices also rose, as exporters took advantage of sterling's decline to improve profit margins. Excluding oil, the terms of trade for goods worsened slightly between 1985 and 1986. Little further change seems likely in 1987.

The forecast for visible trade is summarised in Table 3.3.

Visible trade volumes (goods other than oil and erratics)

3.24 Exports of manufactures have been growing strongly in recent months. Growth had flattened in the final months of 1985 and exports fell briefly in early 1986, in common with those of other main manufacturing countries. But since then they have recovered strongly, and in the three months to January were 6½ per cent above their level a year earlier. With rising world trade and the continued benefits of improved competitiveness, manufactured exports should show further strong growth in 1987. Exports of non-manufactures rose rapidly last year, mainly as a result of exceptionally high grain exports ~~(the UK harvest was of poor quality and less suitable for domestic use); they~~ are unlikely to continue at these levels in 1987. Total exports should grow by about 6 per cent, compared with 2½ per cent in 1986.

(demand for UK grain exports was strong, partly reflecting drought in Southern Europe); grain exports

3.25 UK manufactured export volumes appear to have increased in line with developed countries' exports in 1986. This reinforces the previous evidence that the declining trend over the decades up to 1981 has ended.

illustrated in Chart 3.6,

3.26 Non-oil imports were flat in the early part of 1986, but then rose sharply in the second half of the year. More recently, the rate of growth has moderated. Imports are likely to continue to rise in 1987 as domestic activity expands, though improved competitiveness should slow the rate of growth. Non-manufactured imports rose rapidly in 1986, ~~again partly the result of the poor quality of the 1985 UK harvest~~; this effect is unlikely to continue in 1987. In total, imports of goods other than oil are forecast to rise by ~~5~~ 4½ per cent between the second halves of 1986 and 1987.

partly reflecting increased imports of foodstuffs

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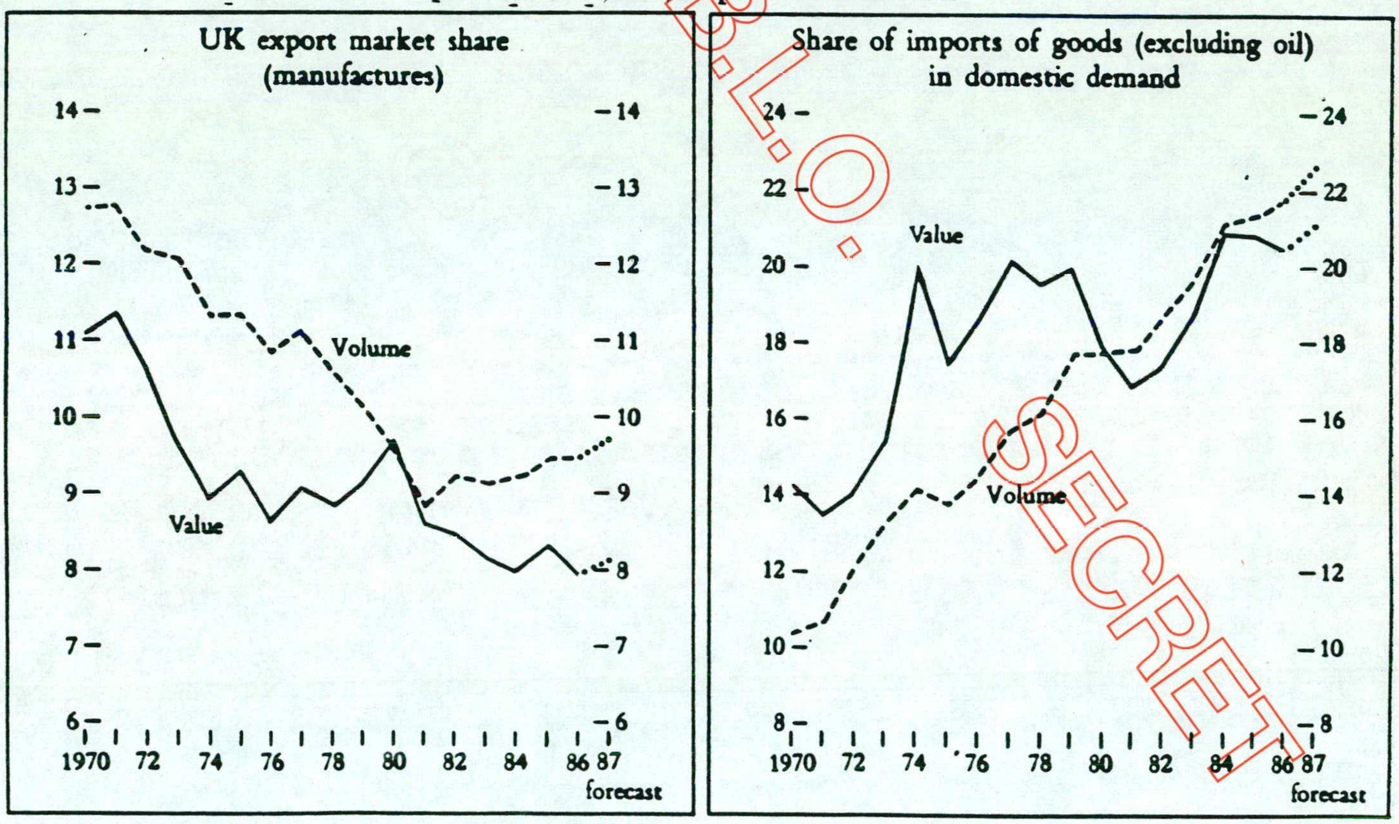
Chart 3.6 Export Shares And Import Penetration



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Oil trade **3.27** Britain's surplus on oil trade halved from £8 billion in 1985 to £4 billion in 1986, reflecting the sharp fall in world oil prices and some decline in the volume of net oil exports. A fall in North Sea companies' payments abroad, which was only partly matched by lower overseas earnings by UK oil companies, helped to offset the reduction in the oil visible trade surplus. North Sea production in 1987 is likely to be ~~a little~~ somewhat lower than in 1986 and the oil trade surplus slightly smaller.

Table 3.3 Visible trade

	Per cent changes on previous year					
	All goods			Goods less oil and erratic items		
	Export volume	Import volume	Terms of trade*	Export volume	Import volume	Terms of trade
1985	5½	3½	1½	7	4	1½
1986	4	6	−5½	2½	6	−1
1987 Forecast	~~3½~~ 4	7~~½~~	~~½~~ 0	6	8~~½~~	~~1~~ ½

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

3.28 The surplus on invisibles rose in 1986. Net receipts of interest, profits and dividends (IPD) rose particularly rapidly as a result of the lower payments abroad by North Sea companies and an increase in the surplus on other earnings. The surplus on services fell in 1986, largely due to lower net earnings from tourism. The deficit on transfers was abnormally low last year, reflecting the size and timing of government transactions with the European Community.

3.29 The surplus on invisibles is forecast to show a further rise in 1987 with the pound's depreciation during last year helping to increase the sterling value of the earnings on the UK's large stock of foreign assets. The surpluses on services should also benefit from the improvement in UK competitiveness. These higher earnings should more than offset an increase in the transfers deficit to a more normal level.

Current account **3.30** The current account recorded a £1 billion deficit in 1986 following a surplus of £3 billion in 1985. Lower net oil earnings and an increased deficit on trade in manufactures more than offset an improvement in invisibles. The forecast for 1987 is for a current account deficit of £2½ billion. Details are given in Table 3.4.

Table 3.4 Current account

	£ billion				
	Manufactures	Oil	Other goods	Invisibles	Current balance
1985	−3	8	−7½	5	3
1986	−5½	4	−7	7	−1
1987 Forecast	−8	4	−7	8½	−2½

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3.31 The UK's stock of net overseas assets is thought to have risen by the end of 1986 to about £[110] billion (equivalent to [28] per cent of GDP: its highest recorded level for over ~~30~~ 40 years) compared with £80 billion at the end of 1985. The increase in the sterling value of assets reflects both the strength of world stock markets and the depreciation of sterling last year.

Demand and activity

3.32 The UK economy continued its steady growth in 1986. But there are ~~considerable~~ uncertainties over the precise estimates of the rate of growth, given the ~~large~~ differences between the three separate estimates of GDP (based on measures of expenditure, income and output). The output figures—generally recognised as the most reliable short-term indication—show~~ed~~ non-oil growth of around 3 per cent between the end of 1985 and the end of 1986, following a brief pause in late 1985.

3.33 As in other industrial countries, consumers' expenditure in the UK grew strongly in 1986 as inflation fell and real incomes rose. UK exports were weak in the first half of the year, but recovered strongly in the second half. Imports had been depressed in the first half of the year but also rose sharply in the second half as the economy gained momentum, with particularly marked rises in imports of capital goods. Output growth in the service industries exceeded growth of manufacturing output for the year as a whole; but manufacturing output rose 2 per cent between the two halves of the year as exports recovered.

Personal sector expenditure

3.34 Real personal disposable income is estimated to have risen by about 4 per cent in 1986, and consumers' expenditure by ~~about 5~~ over 4½ per cent. This implies some further fall in the personal saving ratio which has been declining throughout most of the 1980s. One reason is that with lower inflation households have needed to make less provision for the erosion of their past savings. Another factor has been a decline in the growth of employers' contributions to pension funds as a result of the surpluses that many funds have been showing, reinforced by the provisions of the 1986 Finance Act: these contributions are treated in the national accounts as a part of personal income and saving. The buoyancy of consumers' spending may also owe something to the strength of the stock market. In spite of the fall in the saving ratio, higher asset prices and lower inflation have contributed to an increase of over 50 per cent in persons' net holdings of financial assets since the end of 1983.

3.35 Real personal disposable income is forecast to rise by ~~a little over 3~~ around 3½ per cent in 1987. This is rather less than in 1986 and reflects a narrowing of the gap between earnings growth and price inflation. Though there may be some further decline in the saving ratio, consumers' expenditure is expected to grow more slowly than in 1986, at ~~around 3½~~ a little under 4 per cent.

3.36 The housing market was buoyant in 1986, and private residential investment, both in new dwellings and in improvements to existing dwellings, grew strongly during the course of the year. Private housing

× starts were about ~~7~~ 8½ per cent higher than in 1985; in Greater London, where the largest increases in house prices have been recorded, private housing starts in the first three quarters of 1986 were about 60 per cent up on a year earlier. These higher starts should be reflected in completions and investment in new dwellings during 1987; private residential investment may rise by around 10 per cent in the year as a whole.

Company incomes and expenditure

gross trading

3.37 The rate of return earned by non-North Sea industrial and commercial companies (ICCs) continued to rise last year; profits earned in the North Sea fell by more than half. The outlook for companies is favourable, but further substantial rises in profitability will probably have to depend less on depressed world prices of inputs of materials and fuels, and more on firms containing the costs that are under their own control.

3.38 Company sector spending was relatively weak in 1986. North Sea investment has been falling in the face of sharply lower profits. Onshore business investment was affected by the bringing forward of capital spending into 1985 ahead of the final stage of the reduction in capital allowances announced in the 1984 Budget.

3.39 The prospects are for investment to grow rapidly this year. The DTI investment intentions survey published last December pointed to growth in non-North Sea business investment of about 6 per cent, continuing into 1988. The latest quarterly CBI survey of industrial trends indicated a pick up in investment in manufacturing industry, and the forecast assumes that the DTI's intentions survey projections will be broadly realised. Table 3.5 provides details of the forecast for total investment and its components.

Table 3.5 Gross fixed domestic capital formation

	£ billion at 1980 prices	Per cent changes on a year earlier		
				Forecast
	1985	1985	1986	1987
Business[1]	30·5	4	−3	4
Private dwellings[2]	9·3	−1	~~8~~ 9	8
General government	6·6	−4	~~6~~ 7	−1
Total fixed investment	**46·4**	**2**	~~0~~ ½	**4**

[1] Includes investment by public corporations

[2] Includes purchase less sales of land by persons, companies and public corporations, other than purchases of council houses.

3.40 The economy's stock/output ratio fell in 1986 for the sixth successive year. It appears that manufacturers ran down stocks and though distributors' stock levels rose, the increase was a small one in relation to the increase in the volume of sales. The latest quarterly CBI survey suggested that manufacturers may not now be intending to reduce their stocks of raw materials much further, possibly because of the firmer trend in raw material prices in recent months. An additional source of destocking in 1986 was the exceptionally high exports of grain which reduced the stocks held by the Intervention Board for Agricultural Produce (IBAP).

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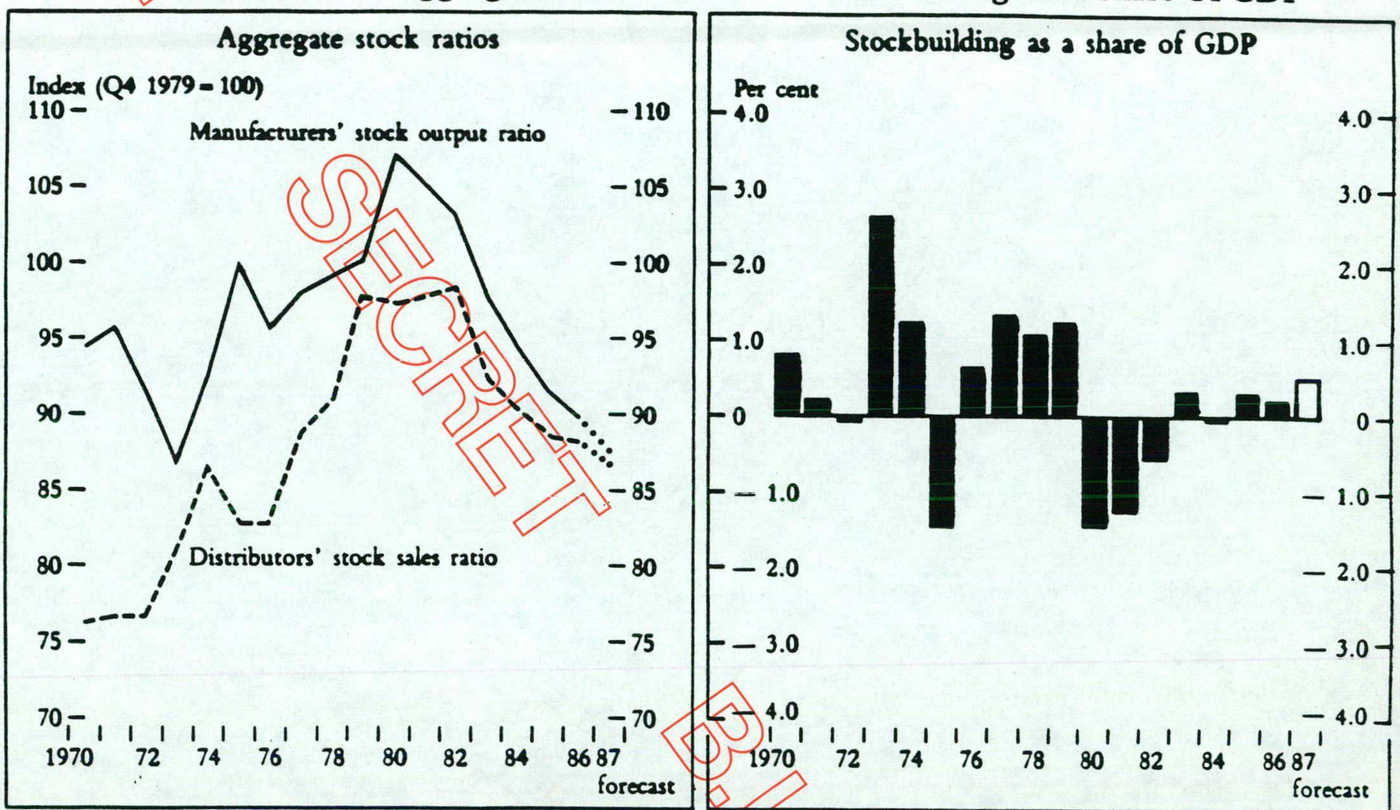
3.41 Stockbuilding is ~~thus~~ likely to make a positive contribution to growth in 1987, although the forecast is for only a small rise in stocks by the standards of most years in the 1970s (see Chart 3.7), and there is likely to be a further fall in the stock output ratio for the whole economy.

Chart 3.7 Stockbuilding ~~**Aggregate Stock Ratios**~~ ~~**Stockbuilding As A Share Of GDP**~~



Prospects for demand and activity

3.42 The forecast is for a further year of steady growth in 1987. GDP is expected to grow by 3 per cent, around the rate at which it was growing in the latter part of 1986. Exports and investment are forecast to grow strongly, offsetting some slowing down in consumer spending. The prospects for demand and activity are summarised in Table 3.6.

Table 3.6 Domestic demand and GDP

	Per cent changes on a year earlier (constant prices)		
		Forecasts	
	1986	1987	1988 H1
Domestic demand	3½	3½	2½
Exports of goods and services	2½	4	1½
Imports of goods and services	5½	6½	2½
Domestic production: GDP*	2½	3	2½

* *Average measure.*

(See Table 3.7)

3.43 The recovery in manufacturing output seen in the second half of 1986 is forecast to ~~continue, helped by rising exports~~. Construction output also rose sharply during 1986, and should benefit further from the expected strength of private investment in buildings during 1987.

Table 3.7 Real output

	Per cent changes on a year earlier		
		Forecasts	
	1986	1987	1988 H1
GDP	2½	3	2½
Non-North Sea output	2½	3½	3
Manufacturing output	½	4	3

Inflation

(See Chart 3.8)

3.44 Both retail and producer output price inflation remain close to the lowest levels experienced since the 1960s. The RPI rose by 3½ per cent in 1986, compared to a rise of 6 per cent in 1985. The annual inflation rate reached a low point of 2·4 per cent in July and August: most of its subsequent rise has reflected a higher contribution from the mortgage interest payments component of the RPI.

3.45 The rate of increase of producer output prices has also fallen significantly since the start of 1986, although it has started to edge up again recently, reflecting in part the fall in sterling that took place during the summer and early autumn.

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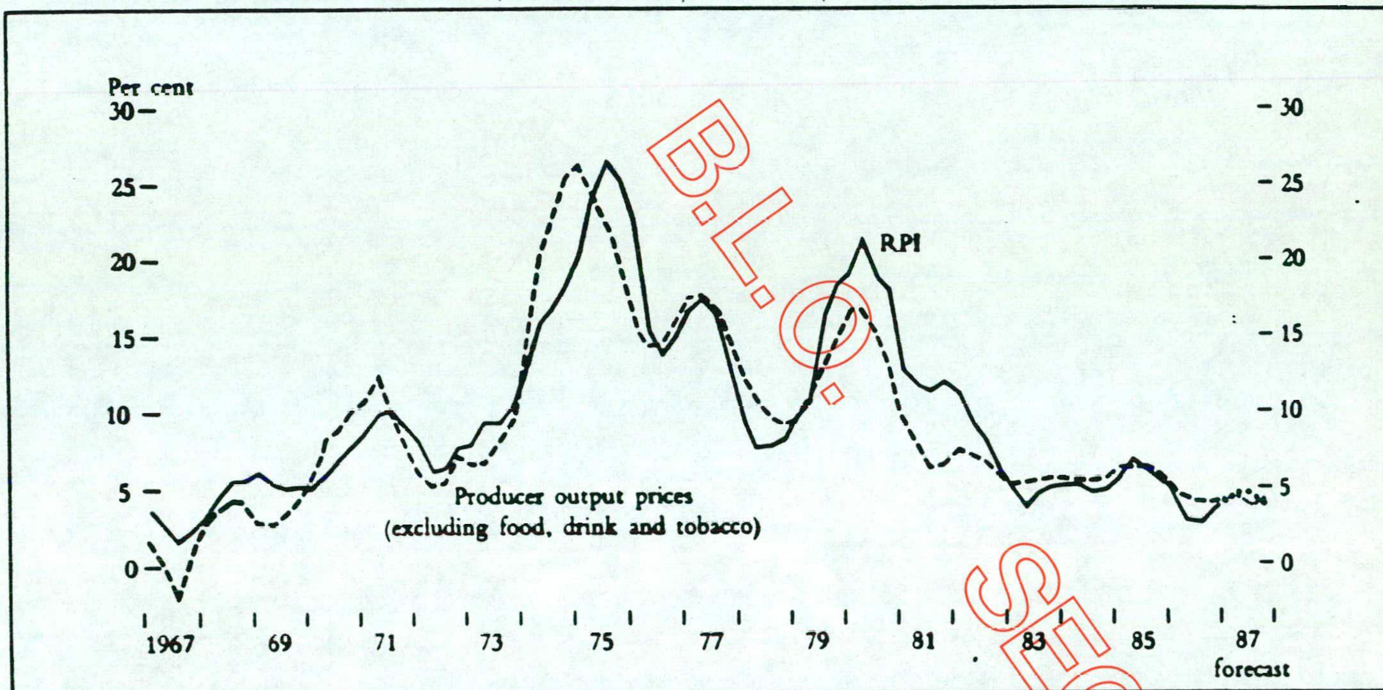
Chart 3.8 Annual Increases In Producer Prices And The RPI



3.46 Pay increases in the private sector have fallen slightly in recent months. Settlements in manufacturing industry recorded by the CBI have shown a fall of about 1½ per cent since 1985, although settlements in the private sector as a whole, including those outside manufacturing, may have fallen by less than this. This decline in pay settlements has not yet been reflected in lower recorded growth in average earnings. The current annual rate of growth of earnings reflects settlements made over the whole of the last year (the majority of them still dating from the period when settlements were running at a higher rate than they now are), and is also affected by overtime working, which has risen since the second quarter of 1986.

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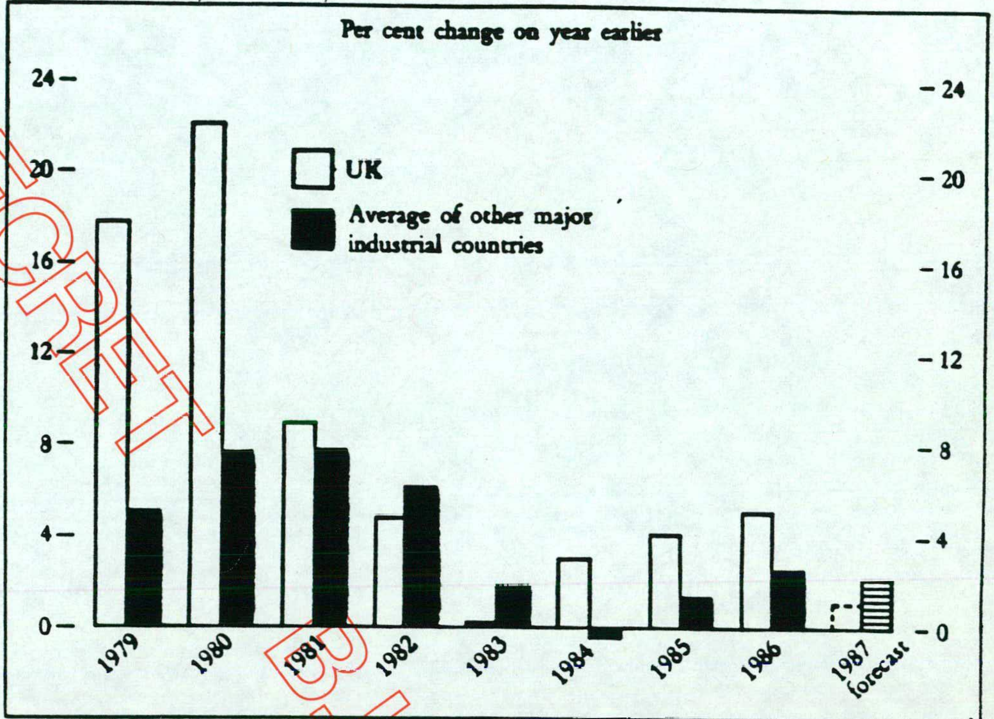
3.47 In spite of the continuing relatively fast growth of earnings, unit labour costs in manufacturing have probably changed only a little since the first quarter of 1986 as productivity has risen sharply. Between 1985 and 1986 unit labour costs in manufacturing rose by about 5 per cent. Chart 3.9 shows recent and forecast movements in UK labour costs in relation to those of other major industrial countries.

Chart 3.9 Unit Labour Costs in Manufacturing



Prospects 3.48 The lower pay settlements recorded in recent months should lead to a lower recorded growth of earnings. Nevertheless employees will enjoy a further substantial rise in real earnings in 1987. The high rate of productivity growth currently being recorded should contain the growth in unit labour costs to below 4 per cent for the non-oil private sector as a whole, and to around 1½ per cent for manufacturing industry.

Table 3.8 Costs in manufacturing

	Per cent changes on a year earlier			
	Unit labour costs	Cost of materials and fuels[1]	Estimated total costs[2]	Output prices[1]
1984	3	8½	~~4½~~ 5	5½
1985	4	4½	4½	6½
1986	5	−10½	0	4½
1987 Forecast	1½	3	2	4

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

3.49 The figures in Table 3.8 suggest that profit margins in manufacturing have widened markedly in recent years; it seems likely that industry will hold on to the gains it made last year with the help of falling input costs, and

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profit margins may widen further during 1987 given the forecast low growth in unit labour costs. In the longer run the higher level of profitability should lead to more investment, greater capacity, higher productivity, and hence lower inflationary pressure.

(for details, see Table 3.4)

3.50 The year-on-year rate of inflation is likely to continue to edge up over the next few months, perhaps rising temporarily to over 4½ per cent. This will mainly reflect the relative movements in 1986 and 1987 of petrol prices (which fell during the first half of 1986 to a low point in July and early August) and mortgage interest rates. But inflation should then fall back in the second half of the year, to around 4 per cent in the fourth quarter. The tax and price index (TPI) is expected to show a much smaller increase than the RPI during 1987, peaking at around 3 per cent during the summer, and probably falling to around 2 per cent by the fourth quarter.

Table 3.9 Retail prices index

		Per cent changes on a year earlier		
			Forecasts	
	Weight in 1986	1986 Q4	1987 Q4	1988 Q2
Food	18½	3¼	~~2¾~~ 2½	3½
Nationalised industries*	6	3¼	2	5
Housing	14½	7	9	~~6¼~~ 7½
Other	61	2½	3½	~~3¾~~ 3½
Total	**100**	**3½**	**[4]**	**[4]**

** Includes water.*

3.51 The GDP deflator measures the price of domestic value added—principally unit labour costs and profits per unit of output—and excludes import prices. It is sensitive to movements in North Sea profits, which may have fallen by more than half in the current financial year: as a result the deflator for GDP at market prices may have risen by only 3 per cent in 1986–87. Given the assumption of a $15 oil price from now on, and with the further rise in non-North Sea profits now foreseen, the GDP deflator may rise rather faster in 1987–88 than in the previous year, perhaps by around 4½ per cent.

Productivity and the labour market

3.52 Results from the 1984 Census of Employment became available in December. These showed that the change in the number of employees since the last Census in 1981 had been very close to provisional estimates based on the results of successive Labour Force Surveys. Results from the 1986 Labour Force Survey have led to minor upward revisions to figures for employees, and to a downward revision to the figure for growth in self-employment between mid 1985 and mid 1986. Growth since March 1983 in the employed labour force in Great Britain is now estimated at 1,040,000. Table 3.10 shows changes in employment over the last three years for which figures are available.

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Table 3.10 Employment

Thousands, change in GB seasonally adjusted

	Employees in employment		Self-employed	HM Forces	Total in employment
	Male	Female			
September 1983 to September 1984	−23	+19~~1~~0	+23~~3~~5	+3	+406
September 1984 to September 1985	+47	+196	+90	−2	+330
September 1985 to September 1986	−25	+126	+38*	−3	+136

** Figure for self-employment growth since June 1986 is a projection based on self-employment growth over the previous five years.*

3.53 Growth in employment averaged only about 20,000 a quarter in the first half of 1986, reflecting the period of sluggish output growth at the end of 1985 and in early 1986. The third quarter saw employment growing at almost three times this rate as the economy quickened again. Recent monthly figures for manufacturing employment point to a further pick up in total employment growth in the fourth quarter.

3.54 While confirming earlier figures for the total number of employees the Census results show some differences from the previous figures in the composition of changes in employment. Full-time female employment has risen by much more, and part-time female employment by much less than previously estimated; employment outside manufacturing has risen more than previously thought while manufacturing employment has shown a corresponding greater decline. The estimate of productivity growth in manufacturing since the 1979 cyclical peak has been raised by about ½ per cent a year on average. Underlying growth in manufacturing productivity now seems to be back to the rate experienced in the 1960s.

Table 3.11 Output per head of the employed labour force

Per cent changes

	Annual averages			1983 Q4 to 1984 Q4[1]	1984 Q4[1] to 1985 Q4	1985 Q4 to 1986 Q4
	1964–73	1973–79	1979–86			
Manufacturing	3¾	¾	3½	3¼	2¼	4¼
Non-manufacturing[2]	3	½	1¼	1¾	1~~¼~~½	2 ~~1½~~
Whole economy	2¾	1¼	2	2	1	2 ~~1¼~~
Non-North Sea economy	2¾	½	1¾	~~1¾~~ 2	1~~½~~¼	2½

[1]*Figures for 1984 Q4 are adjusted for the estimated effect of the coal strike.*

[2]Excludes public services and North Sea oil and ~~Includes private sector and nationalised industries other than manufacturing and oil~~ gas extraction

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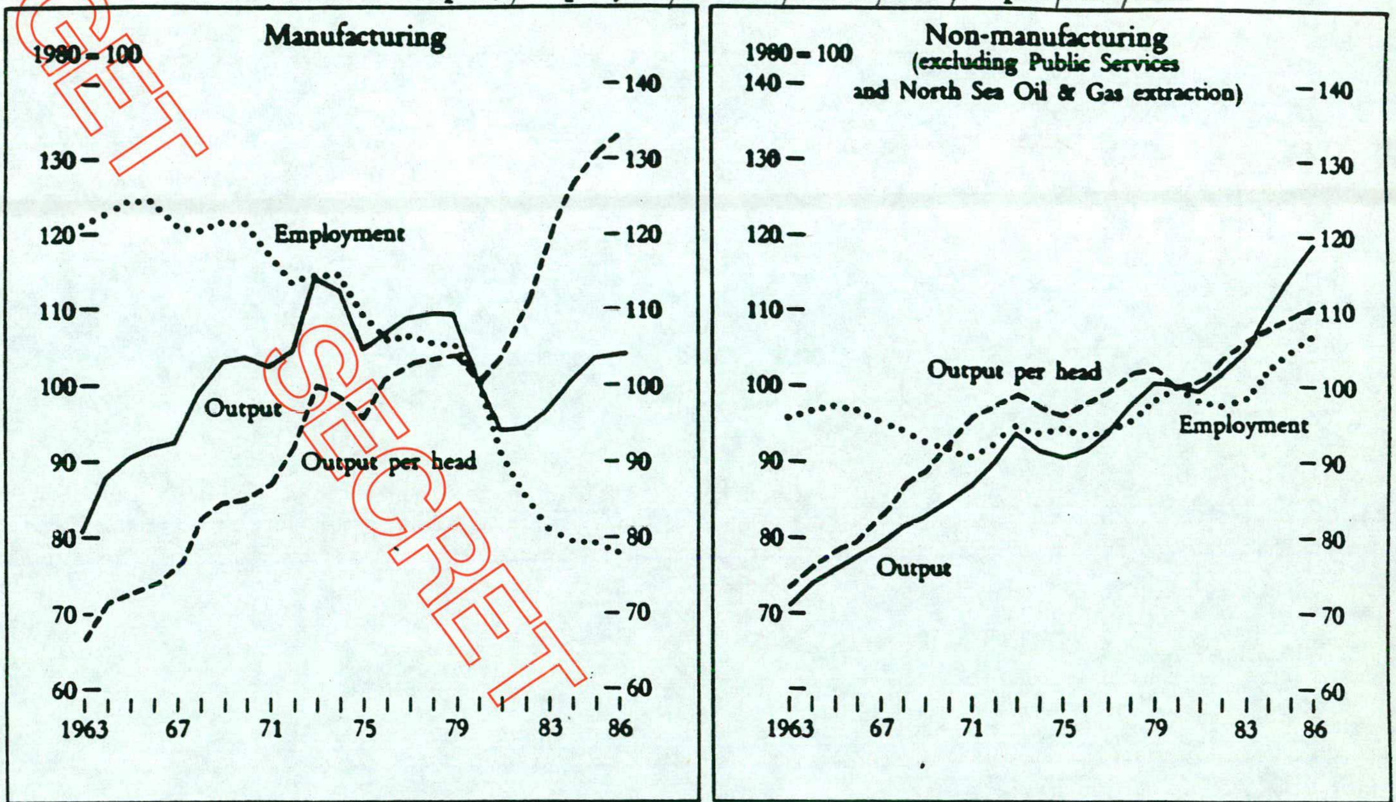
Chart 3.10 Output, Employed Labour Force And Output Per Head



space **Unemployment** **3.55** Seasonally adjusted adult unemployment in the United Kingdom fell by over 100,000 in the six months to January, the largest six month fall since 1973. The continued strength of the UK economy means that employment growth is likely to pick up further during the next year, and the outlook for a continuation of the decline in unemployment is promising. The training and counselling measures announced and implemented over the past year are helping the long term unemployed in particular. A sustained major reduction in unemployment will continue to depend on moderation in pay settlements.

Forecast and outturn

3.56 The table below compares the main elements of the forecast published in the 1986 FSBR with the outturn or latest estimate:

Table 3.12 Forecast and outturn

	1986 FSBR forecast	Latest estimate/ forecast	Average errors from past forecasts
Total gross domestic product; per cent change between 1985 and 1986	3	2½	¾
RPI: per cent increase between the fourth quarters of 1985 and 1986	3½	3½*	1½
Money GDP, per cent change between 1985–86 and 1986–87	6¾	6	1¼
Current account of the balance of payments in 1986, £ billion	3½	−1*	3
PSBR, financial year 1986–87, £ billion	7	[~~5~~] 4.3	[~~4~~] 5

* *Outturn*

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3.57 Inflation in the fourth quarter of 1986 was in line with the forecast made a year ago. GDP growth has probably been a little below forecast, although the data on which latest estimates for 1986 are based is still very uncertain. Non-oil tax revenues have grown faster than forecast, and the PSBR in 1986–87 is likely to turn out almost ~~about~~ £~~2~~ 3 billion below last year's forecast. The largest error made last year was on the current account; the main factors here were that growth in UK export markets turned out well below what had been expected a year ago while the terms of trade worsened more than forecast.

3.58 This year's forecast is summarised in Table 3.13.

Risks and uncertainties

3.59 No forecast is complete without an indication of error margins. Table 3.13 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide an indication of possible errors in the current forecast. Those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR, including the revenues of the public corporations, are about £200 billion; and for the current account of the balance of payments exceed £150 billion.

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Table 3.13 The prospects: summary

	Forecast	Average errors from past forecasts[1]
Output and expenditure at constant 1980 prices	per cent changes 1986 to 1987	percentage points
Domestic demand	3½	¾
of which:		
Consumers' expenditure	~~3½~~ 4	1
General government consumption	~~2~~ 1½	1
Fixed investment	4	2¼
Change in stockbuilding (as per cent of level of GDP)	½	¾
Exports of goods and services	4	2½
Imports of goods and services	6¼	2½
Gross domestic product: total	3	¾
: manufacturing	4	2
Inflation		
Retail prices index	per cent changes	
1986Q4 to 1987Q4	4	1½
1987Q2 to 1988Q2	4	2¼
Deflator for GDP at market prices	per cent changes on a year earlier	
Financial year 1986–87	3	¾
Financial year 1987–88	4½	1¾
Money GDP at market prices	per cent changes on a year earlier	
Financial year 1986–87	6	1¼
Financial year 1987–88	7½	1½
Balance of payments on current account	£billion	
1987	−2½	3
1988 first half (at an annual rate)	−2	3½
PSBR	£billion[2]	
Financial year 1986–87	4.3 [~~5~~ (1¼%)]	[1¼ (¼%)]
Financial year 1987–88	[[illegible] (1%)] 4.1	[¼ (1½%)] 5 4

[1] *The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications and government forecasts (see Economic Progress Report June 1981). The calculations of average errors are based on forecasts made between 1975 and 1985. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.*

[2] *Per cent of GDP at market prices shown in brackets.*

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Table 3.14 Constant price forecasts of expenditure, imports and gross domestic product*

£ billion at 1980 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	**Total final expenditure**	*Less* imports of goods and services	*Less* adjustment to factor cost	*Plus* statistical adjustment	**Gross domestic product at factor cost**	GDP index (average estimate) 1980 = 100
1982	138·~~2~~ 3	49·6	39·~~5~~ 4	63·3	−1·1	**289·~~3~~** 5	59·5	30·4	0·~~1~~ 3	**~~200·1~~** 199.9	100·~~3~~ 2
1983	143·6	50·~~5~~ 6	41·7	64·7	0·7	**301·~~2~~** 3	62·8	31·5	−0·~~0~~ 3	**~~207·0~~** 6.7	103·~~8~~ 6
1984	146·~~6~~ 7	~~50·9~~ 1.0	45·5	69·1	−0·1	**312·~~0~~** 2	68·6	32·6	~~2·0~~ 1.7	**212·~~8~~** 7	106·~~7~~ 6
1985	152·0	~~50·9~~ 1.0	46·~~4~~ 3	73·1	0·~~7~~ 6	**323·~~1~~** 0	70·7	~~33·7~~ 4.0	1·~~5~~ 4	**~~220·1~~** 19.8	110·~~3~~ 1
1986	159·~~4~~ 2	51·~~9~~ 6	46·~~3~~ 6	75·3	0·~~6~~ 5	**333·~~6~~** 1	74·8	35·0	2·~~0~~ 2	**225·~~7~~** 6	113·~~1~~ 0
1987	165·~~3~~ 2	~~51·1~~ 2.3	48·~~7~~ 5	78·4	1·~~5~~ 3	**~~346·5~~** 5.7	79·~~5~~ 4	36·3	2·~~1~~ 5	**232·~~7~~** 5	116·~~6~~ 5
1985 H1	75·~~1~~ 0	25·5	23·~~4~~ 3	36·7	0·~~5~~ 4	**161·~~2~~** 0	35·2	16·7	0·5	**109·~~8~~** 5	~~110·1~~ 109.8
H2	~~77·1~~ 6.9	25·~~1~~ 5	23·0	36·4	0·2	**~~161·9~~** 2.0	35·5	17·~~0~~ 2	~~1·0~~ 0.9	**110·~~3~~** 2	110·~~6~~ 5
1986 H1	78·6	25·~~8~~ 5	23·~~2~~ 3	36·7	0·~~5~~ 4	**164·~~8~~** 5	35·9	17·2	0·~~5~~ 6	**112·~~2~~** 0	112·~~4~~ 2
H2	80·~~8~~ 6	26·~~1~~ 0	23·~~2~~ 3	38·7	0·1	**168·~~8~~** 7	39·0	17·8	1·~~5~~ 6	**113·6**	113·8
1987 H1	stet 81·1	~~26·5~~ 6.0	~~23·4~~ 4.1	39·~~0~~ 1	0·8	**~~172·1~~** 1.9	39·~~3~~ 2	18·0	~~0·8~~ 1.2	**~~115·6~~** 6.0	~~115·9~~ 6.2
H2	83·4	26·~~6~~ 3	24·~~3~~ 4	39·3	0·~~7~~ 4	**~~174·3~~** 3.8	40·~~2~~ 1	18·3	1·2	**~~117·1~~** 6.6	~~117·4~~ 6.9
1988 H1	84·9	26·~~5~~ 4	24·4	39·~~6~~ 7	0·~~8~~ 5	**~~176·3~~** 5.9	40·~~7~~ 0	18·5	1·~~0~~ 2	**118·~~4~~** 7	118·~~8~~ 9
Per cent changes											
1984 to 1985	3½	0	2	6	—	**3½**	3	3½	—	**3½**	3½
1985 to 1986	~~3~~ 4½	~~2~~ 1	~~1~~ ½	3	—	**3**	6	~~1~~ 2½	—	**2½**	2½
1986 to 1987	~~3½~~ 4	~~2~~ 1½	4	4	—	**4**	6½	3½	—	**3**	3
1987 H1 to 1988 H1	3½	0	~~2~~ 1	1½	—	**2½**	2½	~~3~~ 2½	—	**2½**	2½

* GDP figures in the table are based on "compromise" estimates of gross domestic product, reflecting, for the past, average movements in constant price expenditure, output and income estimates of GDP. Percentage changes are calculated from unrounded levels and then rounded to half per cent. Figures for 1987 H1 and beyond are forecasts. Figures for periods up to the end of 1986 are based mainly on the national accounts published earlier (covering periods up to 1986 Q3) and incorporate some revised and later data and forecasts. A full set of national accounts, to end 1986, will be published by the CSO on 21 March.

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4 The Budget tax proposals

4.01 The main tax changes proposed in the Budget are summarised below. A full list of changes is given in Table 4.1

Income tax

4.02 The basic rate of income tax will be reduced to 27 per cent.

4.03 The main income tax personal allowances will be increased in line with the statutory indexation provisions (based on the increase of 3·7 per cent in the RPI in the year to December 1986). This will mean that:

the single person's and wife's earned income allowances will rise from £2 335 to £2 425.

the married allowance will rise from £3 655 to £3 795.

the age allowance will rise from £2 850 to £2 960 (single) and from £4 505 to £4 675 (married) and the income limit from £9 400 to £9 800.

the additional personal allowance and widow's bereavement allowance will rise from £1 320 to £1 370.

4.04 For those aged 80 and over the age allowance will be further increased to £3 070 (single) and £4 845 (married)

~~basic rate limit will be increased from £17 200 to £17 900 and the~~

4.05 The allowance for the blind will be increased from £360 to £540.

4.06 The higher rates of income tax will be charged as follows:

~~Tax rate~~ Rate of tax per cent	Taxable Income £
40	17 901–20 400
45	20 401–25 400
50	25 401–33 300
55	33 301–41 200
60	over 41 200

4.07 Car benefit scale charges will be increased by 10 per cent from 6 April 1988.

Profit related pay

7,

4.08 An income tax relief will be introduced for employees in profit-related pay (PRP) schemes which meet certain conditions and which have been registered with the Inland Revenue. The maximum amount of PRP eligible for relief will be £3 000, or 20 per cent of total PAYE pay, whichever is lower. Relief will be given on half the eligible amount.

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Excise duties **4.09** The duty on petrol will be reduced by the equivalent of about 5p a gallon (including VAT) in respect of unleaded petrol only.

4.10 Duty will no longer be levied on on-course betting.

4.11 The rates of duty on gaming machine licences will be increased by between 25 and 28 per cent.

Vehicle excise duty **4.12** The rates of duty on farmers' heavy goods vehicles over 7·5 tonnes will be increased by between 5 and 34 per cent. The rates of duty for trade licences will be increased to £85 for cars and £17 for motor cycles. A new taxation class will be created for recovery vehicles. The duty rate will be £50.

Inheritance tax **4.13** From Budget day the threshold will be increased from £71 000 to £90 000 and the number of chargeable bands reduced from seven to four. The new scale will be as follows:

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Rate of tax per cent	Band of chargeable value £000
0	0– 90
30	90–140
40	140–220
50	220–330
60	Over 330

4.14 Lifetime gifts of "interests in possession" in settled property will be exempt from inheritance tax (IHT) if the donor survives for seven years. Measures against abuse will be incorporated.

4.15 Trust property in which there is an interest in possession will not be taxed on the death of a life tenant if the property is put into a heritage maintenance fund not later than two years after the death.

4.16 Property accepted in lieu of tax may be valued at the date of the offer, and interest will cease to accrue on that date, at the option of the offeror.

4.17 From Budget day, the rate of business relief on transfers of holdings of more than 25 per cent (other than control holdings) in unquoted companies will be increased from 30 to 50 per cent. Companies dealt in on the Unlisted Securities Market (USM) will from Budget day be treated for IHT purposes in the same way as companies with a full listing on the Stock Exchange.

Corporate sector
~~**Corporation tax**~~ **4.18** The main rate of corporation tax for the financial year 1987 will be 35 per cent. The small companies' rate of corporation tax will be reduced to 27 per cent. The rate of advance corporation tax (ACT) will go down automatically to 27/73rds as a consequence of the reduction in the basic rate of income tax.

4.19 All companies, building societies and other bodies chargeable to corporation tax will become liable, after a phasing-in period, to pay the tax nine months after the end of the accounting period for which tax is due.

4.20 From Budget day there will be changes in the tax treatment of companies' capital gains. They will be taxed without adjustment, other than the indexation that applies to post-1982 gains, at the rates of corporation tax applying to other profits (including, where appropriate, the small companies' rate) and credit for payment of ACT will be allowed against liability to tax on them.

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4.21 From 1 April 1987, credit for any foreign withholding tax actually paid or deemed to be paid on interest received by banks on any new loan made by them to a non-resident will be allowed only against corporation tax due on the profit from that loan. This rule will apply to existing loans with effect from 1 April 1988.

4.22 From 1 April 1987 dual resident companies will not be allowed a double deduction for interest payments. This change will not apply to trading companies.

4.23 Legislation will be introduced for a new scheme, known as Pay and File, to streamline the assessment and collection of corporation tax. The scheme will be implemented when the necessary computerisation is complete.

Oil taxation

4.24 Two relaxations to the expenditure relief rules are proposed:

to allow a proportion of the costs up to payback of developing certain new fields against petroleum revenue tax (PRT) liabilities in another field; and

to allow certain research expenditure which is not specifically for the purpose of any determined oil field to be set against PRT liabilities in any field after three years.

A minor technical change is also proposed to the rules for allocating oil allowance.

Provision will be made ~~Provisions will be introduced~~ ~~and~~ to prevent the carrying back of ACT giving rise to repayment of ACT under certain repealed provisions.

7[[**4.25** ~~It is proposed to mitigate~~ There will be mitigation of the effects of Section 16 of the Oil Taxation Act 1975, which restricts set-off of ACT against ring fence profits, by allowing limited carryback of surrendered ACT and by allowing surrender of ACT to a ring fence company by a 50/50 joint venture owning that

7] company.]

7[ ] **4.26** It is [also] proposed to restrict the set-off against ring fence profits of ACT paid by an oil extraction company in respect of certain dividends on preference shares where the capital raised has not been used for oil extraction purposes.

Business Expansion Scheme

4.27 Two amendments will be made to the Business Expansion Scheme:

for investments made in the first half of the tax year, the investor will be able to opt for part of the relief to be given for the previous year; and

the rules governing the special relief for film production will be relaxed.

Pensions 4.28 *Personal pensions; In* the light of the reform of Social Security, a new tax regime for personal pensions (ie pensions taken out by an individual independently of his employer) will be introduced, to replace and extend at present, broadly similar, legislation for retirement annuities. The new regime will come into effect next year. The main features will be:

benefits based on the actual return from invested contributions ("money purchase");

no limits on pension benefits;

a tax-free lump sum, subject to a limit;

annual contributions limited to 17·5 per cent of earnings (more for people over 50) with employers free to contribute within the limit; and

tax relief for contributions, tax exemption for fund income and gains.

4.29 Employees will be able to "contract-out" of the State Earnings Related Pension Scheme (SERPS) by joining a personal pension scheme, to which the DHSS will pay a "minimum contribution".

4.30 *"No frills" occupational schemes:* Employers will be able to establish simplified ~~"no frills"~~ occupational schemes which may be "final salary" or "defined contribution". Under the new social security rules, the latter may be "contracted out money purchase" schemes.

4.31 There will be greater transferability between different types of pension arrangements.

4.32 *Additional voluntary contributions (AVCs):* Members of occupational pension schemes will be able to pay AVCs—on which tax relief will be available—to arrangements outside their employer's scheme. As with in-scheme AVCs, contributions will be subject to existing limits on contributions and benefits.

4.33 *Exploitation of tax reliefs:* A number of changes in current pensions law and practice will be made, to counter certain types of exploitation, particularly by high earners. These include:

a limit on lump sums of £150 000;

changes in the rules on "final salary" for pension purposes; and

changes in the rules relating to accelerated accrual of benefits.

Employee share schemes 4.34 The rules for the 1980 and 1984 employee share option schemes will be changed to make it possible, in the event of a takeover, for participants to exchange their existing share options for options over shares in the acquiring company.

Capital gains tax 4.35 The capital gains tax annual exempt amount is to be increased in accordance with the statutory indexation provisions from £6 300 to £6 600 in the case of individuals, and from £3 150 to £3 300 in the case of most trusts.

4.36 The ceiling for retirement relief will be raised from £100 000 to £125 000.

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Lloyd's: reinsurance to close

4.37 Legislation is proposed to bring the tax treatment of members of Lloyd's into line with the normal tax treatment of provisions for outstanding liabilities made by ordinary insurance companies and of similar provisions made by other financial traders. These proposals would affect the tax treatment of Lloyd's reinsurance to close and will first apply to premiums payable in respect of the 1985 Lloyd's account closing at 31 December 1987.

PAYE and subcontractor schemes

4.38 Changes will be made to the PAYE and subcontractor deduction schemes, including the charging of interest where formal assessments have had to be made of tax deducted under these schemes. This follows recommendations of the Keith Committee.

VAT

4.39 From 18 March 1987 the registration limits will become £21 300 per annum and £7 250 per quarter.

4.40 Subject to the Government's obtaining the necessary derogation from the European Community, businesses with annual turnover below £250 000 are to be given the option of accounting for VAT on the basis of payments received and made. This optional system of cash accounting is intended to come into effect on 1 October 1987.

4.41 An optional system of annual accounting for VAT is to be introduced with advance payments based normally on the previous year's tax so that businesses with annual turnover below £250 000 would need to send only one return to Customs each year.

4.42 The period within which businesses must notify and be registered for VAT will be extended to 30 days.

4.43 The simpler VAT schemes for retailers will be made available for use by many more small and medium-sized businesses.

4.44 The rules on VAT input tax deduction by partly exempt traders are to be revised so as to curb tax avoidance and to prevent distortion of competition.

4.45 VAT relief for charities will be extended to certain welfare vehicles used by hospices to transport the terminally ill; to specialised location and identification equipment used by rescue and first aid services; to goods donated for export by a charity for relief of distress or animal welfare; to installing or adapting bathroom, washroom or lavatory facilities for the handicapped in charity residential homes; and to drugs and chemicals directly used by a charity in medical care or research.

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Table 4.1 Direct effects of changes in taxation

See Annex 4 paragraph numbers	£ million Estimated effect on receipts in: 1987–88 Changes from a non-indexed base	1987–88 Changes from an indexed base	1988–89 Changes from an indexed base
INLAND REVENUE			
Income tax			
1 Reduction of 2p in basic rate	−1 910	−1 910	−2 690
2 Increase in single allowance of £90 and married allowance of £140	−610	—	—
3 Increase in additional personal allowance and widow's bereavement allowance of £50	−5	—	—
4 Increase in age allowance of £110 (single) and £170 (married) and income limit of £400	−80	—	—
5 Further increase in age allowance of £110 (single) and £170 (married) for those aged 80 and over	−10	−10	−10
6 Increase in blind allowance of £180	*	*	*
7 Increase in basic rate limit of £700 to £17 900	−60	—	—
8 Changes to further higher rate thresholds	−5	+40	+80
9 Profit Related Pay	*	*	~~−35~~ 50
10 Fringe benefits—car scale	—	—	+30
~~11 [Fringe benefits—official rate of interest~~	~~—~~	~~—~~	~~*~~]
~~12~~ 1 Income support paid to the unemployed and to strikers	—	—	*
~~13~~ 2 Approved employee share schemes—takeovers	*	*	*
~~14~~ 3 Payroll giving to charities—increase in donation limit to £120 a year	*	*	*
7† ~~15~~ 4 Legislation on Lloyd's reinsurance to close†	—	—	†
~~16~~ 5 Apportionment of income etc of close companies	*	*	*
~~17~~ 6 Foreign partnerships—removal of possible anomaly	*	*	*
Income tax and capital gains tax			
~~18~~ 7 Business Expansion Scheme changes	−5	−5	−5
~~19~~ 8 Amendment to offshore fund rules	*	*	*
Income tax and corporation tax			
19 ~~20~~ Personal pensions	~~—~~	~~—~~	−25
~~21~~ 0 other ~~Changes~~ in pensions ~~law and practice~~ changes	~~—~~	~~—~~	−40
~~22~~ 1 Friendly societies	*	*	*
~~23~~ 2 Keith Committee—PAYE and subcontractors	+5	+5	+45
~~24~~ 3 Interest payments between related companies	*	*	*
~~25~~ 4 Increase in exemption limits for trade union provident funds	*	*	*
~~26~~ 5 Capital allowances—extension of assured tenancies relief	*	*	*
~~27~~ 6 Relief for the costs of training	*	*	*
Income tax, corporation tax and capital gains tax			
~~28~~ 7 Securities—Financial Services Act consequentials	—	—	—
Income tax, corporation tax, capital gains tax, inheritance tax and stamp duties			
~~29~~ 8 Unit trusts—Financial Services Act consequentials	—	—	—
Corporation tax			
29 ~~30~~ Reduction in rate of ACT to 27/73 rds of the amount of the distribution	−290	−290	−130
~~31~~ 0 Reduction in small companies' rate to 27 per cent	*	*	−45
~~32~~ 1 Harmonisation of payment dates for corporation tax	*	*	+100
~~33~~ 2 Taxation of indexed gains in full at normal corporation tax rates	*	*	+80
~~34~~ 3 ACT set-off against tax on companies' gains	*	*	−20
~~35~~ 4 Dual resident companies—non-allowance of double deduction	*	*	+125
~~36~~ 5 Foreign withholding tax on interest received by banks	*	*	+20
~~37~~ 6 Relaxation of set-off of surrendered ACT against ring fence profits	−20	−20	−20
~~38~~ 7 ACT set-off against ring fence profits (certain preference share dividends)	—	—	+15
~~39~~ 8 Building societies—groups of companies and capital gains	*	*	*
39 ~~40~~ Pay and file	—	—	—
~~41~~ 0 Amendment to controlled foreign companies legislation	+10	+10	+10
Corporation tax and capital gains tax			
~~42~~ 1 Financial futures and traded options	—	—	*

* = Negligible — = Nil † Details of measure subject to consultation, so no estimate possible at present.

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Table 4.1 Direct effects of changes in taxation—*continued*

	£ million Estimated effect on receipts in: 1987–88		1988–89
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
Oil taxation			
~~43~~42 40 per cent cross field allowance	−5	−5	−15
~~44~~43 Petroleum revenue tax relief for certain research expenditure	—	—	—
~~45~~44 Oil allowance—final adjustments	*	*	*
Capital gains tax			
~~46~~45 Indexation of annual exempt amount	—	—	—
~~47~~46 Retirement relief	—	—	*
Inheritance tax			
~~48~~47 Changes to rates and bands	−90	−75	−170
~~49~~48 Business relief and Unlisted Securities Market	*	*	*
49 ~~50~~ Abolition of lifetime charge on interest in possession trust property	*	*	*
~~51~~50 Heritage maintenance funds	*	*	*
~~52~~51 Property accepted in lieu of tax	*	*	*
Stamp duties			
~~53~~52 Changes to stamp duties and the reserve tax	*	*	*
TOTAL INLAND REVENUE	**−3 080**	**−2 265**	**−2 ~~705~~** 20 −2720
CUSTOMS AND EXCISE			
Value added tax			
53 ~~54~~ Revised treatment of tour operators' margins	—	—	+20
54 ~~55~~ New rules on deduction of input tax by partly exempt traders	+300	+300	+400
55 ~~56~~ Cash accounting for small businesses	−100	−100	−10
56 ~~57~~ Increase in registration limits	*	*	—
57 ~~58~~ Revised registration requirements	−15	−15	−25
58 ~~59~~ Annual accounting for small businesses	—	—	−25
59 ~~60~~ Simplified retail schemes	—	—	—
60 ~~61~~ Removal of loophole on imported services	*	*	+5
1 61 ~~62~~ Reliefs for charities	−5	−5	−5
x **Excise duties**			
62 ~~63~~ No change in rate of spirits duty	—	−25	~~−25~~ −30
63 ~~64~~ No change in rate of beer duty	—	−60	~~−65~~ −70
64 ~~65~~ No change in rate of duty on cider and perry	—	*	*
65 ~~66~~ No change in rates of wine and made-wine duties	—	−20	−20
66 ~~67~~ No change in rates of duty on petrol etc	—	−190	−210
67 ~~68~~ No change in rate of duty on derv	—	−50	~~−50~~ −55
68 ~~69~~ No change in rate of minor oil duties	—	−5	−5
1 70 70 Duty differential in favour of unleaded petrol	*	*	*
69 ~~71~~ No change in rate of tobacco products duties	—	−105	−110
71 ~~72~~ Abolition of on-course betting duty	−20	−20	−20
72 ~~73~~ Increase in rates of gaming machine licence duties y	+20	+20	+20
TOTAL CUSTOMS AND EXCISE	**+180**	**−275**	~~**−125**~~ −140
Vehicle excise duty			
73 ~~74~~ No change in VED on car, light van and main lorry rates	—	−95	−100
74 ~~75~~ Increases in other VED rates	+5	+5	+5
75 ~~76~~ Recovery vehicles	*	*	*
1 76 ~~77~~ VED ~~back orders~~ enforcement measures.	*	*	+5
Other			
77 ~~78~~ Bus fuel grants	—	+5	+5
TOTAL VED AND OTHER	**+5**	**−85**	**−85**
TOTAL CHANGES IN TAXATION	**−2 895**	**−2 625**	~~**−2 915**~~ ~~−2930~~ −2945

* = Negligible — = Nil

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Annex to Chapter 4

How the figures in Table 4.1 have been calculated

Table 4.1 gives the direct effects of changes in taxation. Estimates are rounded to the nearest £5 million. "Negligible" means less than £3 million.

The direct effect of a tax change is the difference between the yield of the tax which would arise on the basis of the rates of tax, allowances, etc prevailing before the Budget (the pre-Budget regime) and the yield after the changes proposed in the Budget (the post-Budget regime).

For Inland Revenue taxes (and VED) the difference in yield for each tax is generally calculated by applying the pre- and post-Budget tax regimes to the same tax base. This base is the post-Budget base—that is the levels of income, profits etc forecast for future years on the assumption that all the measures proposed in the Budget take effect. In certain cases, however, the difference in yield also takes account of changes in taxpayers' behaviour arising from the tax change where these behavioural changes can be directly attributed to the change in tax.

For Customs and Excise taxes and duties, the calculation takes into account, where possible, the effect of the tax change on the pattern of consumers' expenditure and the resulting impact on other expenditure taxes but makes no allowance for secondary effects: in particular, it is assumed that total consumers' expenditure does not change. A fuller description of the methodology is in Economic Trends, March 1980.

Table 4.1 shows the expected change in receipts of tax resulting from the Budget proposals. Additional information is provided in the commentary below for those proposals where the effect on tax liabilities in the first complete year to which the change applies (full year effect) is substantially different from the effect on receipts in either 1987–88 or 1988–89; or where the impact of the proposal is expected to build up over a period of years.

The figures in the first column of Table 4.1 show the direct effect of the Budget proposals on receipts in 1987–88. Budget proposals are compared with a non-indexed base—that is, with the pre-Budget regime of allowances, thresholds and rates of duty at 1986–87 money levels.

The figures in the second column show the direct effect of the Budget proposals on receipts in 1987–88, measured against an indexed base. The indexed base for 1987–88 is obtained by increasing 1986–87 allowances, thresholds and rates of duty by 3·7 per cent, the increase in the RPI over the year to December 1986.

~~[illegible]~~

[check table number]

The figures in the third column show the direct effect on receipts in 1988–89, also measured against an indexed base. For this comparison, both the Budget proposals and the indexed base for 1987–88 have been further indexed by the forecast movement in the RPI between the fourth quarters of 1986 and 1987 (shown in Table ~~3.[illegible]~~ 3.13)

The estimates shown in Table 4.1 do not reflect changes in the tax base arising from changes in money incomes and in the general level of prices and other economic variables ~~which may result from the~~ proposed ~~tax change. These secondary~~ effects

are, of course, taken into account in estimating the impact of the tax change on the PSBR. The base for the post-Budget forecast of each tax (given in Table 6.B.3) takes account of the effects, direct and secondary, of all the measures announced in the Budget.

Table 4.1 does not include certain measures announced and implemented before Budget day. These are the amendment of the material interest test for approved employee share schemes and other purposes, tax relief for the cost of seconding employees to educational bodies, the tax treatment of invalid care allowance paid to married women, and changes in the pricing and valuation rules for petroleum revenue tax. These measures are reflected in the baseline for costing the effect of tax changes in the Budget.

The remainder of this annex provides a commentary on the Budget proposals in Table 4.1. The paragraph numbers refer to the lines in this table.

Income tax

1 The basic rate will be reduced from 29 per cent to 27 per cent. The cost figures in the table for this item assume that the changes in items 2–7 have been made first. They include the saving in public expenditure on mortgage interest relief to those below the tax threshold. The effect of the consequential change in the rate of advance corporation tax (ACT) is shown in line ~~[30]~~ 29 of Table 4.1.

x 7[30] £29

2 The single person's allowance and the wife's maximum earned income relief will be increased from £2 335 to £2 425 and the married allowance from £3 655 to £3 795.

3 The additional personal allowance and widow's bereavement allowance will be increased from £1 320 to £1 370.

4 The age allowance will be increased for the single person from £2 850 to £2 960 and for the married from £4 505 to £4 675; the age allowance income limit will be increased from £9 400 to £9 800.

5 There will be a new, higher level of age allowance for those aged 80 or over. The allowance will be £3 070 for the single person and £4 845 for the married.

6 The blind allowance will be increased from £360 to £540. This will cost about £2 million per year.

7 The basic rate limit will be increased to £17 900.

8 The threshold for the 45 per cent higher rate will be raised by £200 to £20 400. The thresholds for the 50 per cent, 55 per cent and 60 per cent rates will remain at £25 400, £33 300 and £41 200 respectively.

9 One half of profit related pay (PRP) paid to an employee under a registered scheme will be relieved from income tax, subject to the lower of two annual limits: where the total PRP exceeds 20 per cent of total PAYE pay, PRP will be regarded for tax relief purposes as limited to that amount, and the maximum annual amount of PRP which may be taken into account will be £3 000. ~~Cost will depend on take-up. In 1988-89, costs will still be low, but could be £50 million. They will build up in later years, when they could be measured in hundreds of millions of pounds.~~

The cost will depend on take-up. It will build up substantially in later years as tax relief becomes payable on ~~new~~ more schemes, ~~more schemes are registered~~ and PRP becomes a higher proportion of total pay.

10 For 1988–89, the scale for taxing car benefits in respect of company cars provided for directors, and for employees whose remuneration is at a rate of £8 500 a year or more, will be increased by 10 per cent. No change is proposed for 1988–89 to the scale charges for car fuel benefit, also—from 6 April 1987—used for VAT purposes.

~~11 [With effect from 6 April 1987 the official rate of interest for taxing cheap or interest-free loans provided for directors, and for employees whose remuneration is at a rate of £8 500 a year or more will follow more closely movements in banks' base rates.]~~

~~12~~ 1 Legislation providing for the taxation of supplementary benefit paid to the unemployed and to strikers will be amended to reflect the replacement in 1988 of supplementary benefit by income support.

~~13~~ 2 Approved savings-related or discretionary share option schemes will be permitted to enable directors and employees, when their company is taken over, to exchange their existing options for options over shares in the acquiring company.

~~14~~ 3 The limit on charitable donations qualifying for relief under payroll deduction schemes will be increased to £120 from April 1987.

~~15~~ 4 The tax treatment of Lloyd's reinsurance to close will be made consistent with the treatment of provisions for outstanding liabilities made by insurance companies and similar provisions made by other financial traders. The legislation will first take effect for the Lloyd's 1985 Account which closes at the end of 1987. This is assessable for the year 1985–86, the tax for which does not become payable until 1 January and 1 July 1989. The estimate of receipts depends on the details of the new arrangements, which are still to be established.

~~16~~ 5 The Inland Revenue's powers to apportion the income and annual payments of a close company to its participators will be made obligatory (a recent Court case held that they were discretionary).

~~17~~ 6 A possible anomaly in the law relating to the taxation of foreign partnerships will be removed to prevent substantial potential revenue loss.

Income tax and capital gains tax

~~18~~ 7 Relief under the Business Expansion Scheme for investments made in the first half of the tax year will, in part, be able to be claimed against the income of the previous tax year. The special relief for film production, which requires the company to be producing films throughout the three year qualifying period, will be relaxed so that the requirement can be satisfied by the distribution of films produced in this period.

~~19~~ 8 The Revenue will be given a limited discretion in certifying offshore funds as distributing funds.

Income tax and corporation tax

~~20~~ 19 A new tax regime for personal pensions will be introduced to replace and extend the present, broadly similar, legislation for retirement annuities. The estimated cost assumes an initial take-up of 200 000 rising to 400 000 by April 1989.

7 " "

~~21~~ 0 The changes proposed for pensions include some tightening up to guard against exploitation of the tax reliefs and some relaxations, in particular to allow members of occupational schemes to pay additional voluntary contributions to pension plans outside their employer's scheme ("freestanding AVCs"). The estimated overall cost of the package assumes an initial take-up of "freestanding AVCs" of 250 000 and includes a modest yield from the tightening up measures.

~~22~~ 1 A change is proposed in the limit applicable to tax exempt life or endowment business carried on by friendly societies. The present limit of £750 gross sum assured will be changed to £100 annual premium.

from April 1988

~~23~~ 2 The PAYE and subcontractor deduction schemes will be slightly amended. In particular, there will be an interest charge where PAYE tax, or an amount that should have been paid under deduction by a contractor, has to be formally determined. The yields shown result largely from earlier payments of tax due.

~~24~~ 23 Where certain interest is paid between companies which are members of a group or under common control, it will be treated in all cases as being paid and received on the same day. Without this measure there could have been widespread avoidance.

~~25~~ 24 The exemption limits for trade union provident funds will be increased from £2 400 to £3 000 (for lump sums) and from £500 to £625 (for annuities).

~~26~~ 25 Capital allowances for construction costs of properties provided for letting on assured tenancy terms by "approved bodies" were introduced in 1982 for a period of five years ending 31 March 1987. That period will be extended by a further five years ending 31 March 1992.

~~27~~ 26 With effect from 6 April 1987, training costs borne by an employer to equip with new work skills a worker who is to leave his present employment will normally no longer be treated as a taxable benefit received by the employee and the circumstances in which such costs will be allowed in computing the employer's taxable profits will be correspondingly widened.

Income tax, corporation tax and capital gains tax

~~28~~ 27 Legislation will enable securities quoted on new Recognised Investment Exchanges to be treated in the same way as comparable securities quoted on the Stock Exchange.

Income tax, corporation tax, capital gains tax, inheritance tax and stamp duties.

~~29~~ 28 Changes in the tax rules for unit trusts are necessary to cater for the definitional and regulatory changes relating to unit trusts introduced in the Financial Services Act.

Corporation tax

~~30~~ 29 As a consequence of the reduction in the basic rate, the rate of advance corporation tax (ACT) for 1987–88 will be 27/73rds of the amount of the distribution. This reduction in ACT will be balanced by an increase in the subsequent liability to mainstream corporation tax.

~~31~~ 30 The small companies' rate of corporation tax for the financial year 1987 will be reduced to 27 per cent.

~~32~~ 31 All companies, building societies and other bodies chargeable to corporation tax will be liable to pay the tax nine months after the end of each accounting period. For individual companies etc. the change will be phased in over a period of up to three years. The yield in 1988-89 represents a bringing forward of payment dates from 1989-90.

~~33~~ 32 Under present law capital gains by companies are reduced by one-seventh before being charged to corporation tax at 35 per cent. Gains realised from Budget day will cease to be reduced. Instead they will be taxed in full (with indexation allowance) at normal corporation tax rates. For small companies, the small companies' rate will apply to gains. The yield represents the difference between receipts at the level of capital gains before the change and receipts at the level of capital gains expected as a result of the change.

~~34~~ 33 Credit for the payment of ACT will be allowed against liability for tax on gains realised from Budget day. The cost shown against this measure is extremely tentative.

~~35~~ 34 Dual resident companies are companies which are simultaneously resident in two countries. It is proposed that, unless they are trading companies, they should no longer enjoy a deduction in both countries for the interest which they pay.

~~36~~ 35 The rules for calculating banks' taxable income from making a loan to a non-resident will be changed so that any tax credit for foreign withholding tax paid or deemed to be paid on the interest they receive may be offset only against UK tax due on the turn on that loan. The yield will build up over time to about £60 million by 1990–91.

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~~37~~ 36 Effects of Section 16 of the Oil Taxation Act 1975 will be mitigated by allowing limited carry back of ACT surrendered to a ring fence subsidiary by its parent (initially restricted by a monetary ceiling of £10 million per company), or, in the case of a company owned by a consortium which is a 50/50 joint venture, by allowing surrender of ACT to the ring fence consortium company.

7]

~~38~~ 37 ACT in respect of dividends paid on or after Budget day on certain preference shares where the capital raised has not been used for ring fence purposes will no longer be available for set-off against corporation tax on ring fence profits. Provision will also be made to prevent the carrying back of ACT giving rise to repayment of ACT under certain repealed provisions. Without this measure, there could have been widespread avoidance of the ring fence provisions, possibly costing tens of £million.

~~39~~ 38 The capital gains provisions for groups of companies will be amended to include building societies.

~~40~~ 39 Under Pay and File companies will estimate and pay their corporation tax on the normal due date without the need for the Inland Revenue to make estimated assessments. Interest will run from the normal due date on tax paid late by the company and on tax repaid to the company. Returns will be due twelve months after the accounting period with automatic penalties for delay. This measure will not be implemented before 1992.

7[

~~41~~ 40 The legislation affecting controlled foreign companies is to be amended to prevent avoidance of a UK tax charge on dividends. Without this provision, there could be a significant loss of tax.

7]

Corporation tax and capital gains tax

~~42~~ 41 The provisions ~~concerning~~ concerned with financial futures dealt in on recognised futures exchanges and with traded options will be amended.

7 concerning
L concerned with

Oil taxation

~~43~~ 42 Up to 10 per cent of expenditure incurred in developing certain new oil fields will be allowed against a participator's PRT liability in another field. The cost could build up to £40 million in 1989–90, and to £80 million in 1990–91.

~~44~~ 43 Research expenditure will be allowed against a participator's PRT liability in any field if, three years after it is incurred, it has not yet become allowable for any field. No cost therefore arises until 1990–91, when it will amount to about £30 million, and £25 million thereafter (taking account of CT clawback).

~~45~~ 44 The scope for redistributing oil allowance amongst participators, in order to correct imbalances, will be extended. The cumulative total of oil allowance will be unchanged.

Capital gains tax

~~46~~ 45 The capital gains tax annual exempt amount is to be increased in accordance with the statutory indexation provisions from £6 300 to £6 600 in the case of individuals, and from £3 150 to £3 300 in the case of most trusts.

~~47~~ 46 The limit for retirement relief will be increased from £100 000 to £125 000.

7[ ] 4.13

Inheritance tax

~~48~~ 47 The estimated full year cost for the proposed rate structure in paragraph 4.1~~1~~3 attributable to transfers in 1987–88 is £220 million, measured against the indexed base.

~~49~~ 48 The rate of relief on transfers of holdings of more than 25 per cent and up to 50 per cent in unquoted companies is to be increased from 30 to 50 per cent from Budget day. Minority holdings in USM companies will no longer qualify for business relief, but shares in such companies will be treated for all IHT purposes like shares in companies with a full listing. The revenue effect of these changes is likely to be broadly neutral.

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~~50~~ 49 **(a)** The charge on transfers made by individuals to interest in possession trusts on or after 17 March 1987 and more than seven years before the death of the transferor will be abolished.

(b) The charge on termination of an interest in possession in settled property in favour of another individual on or after 17 March 1987 and more than seven years before the death of the person beneficially entitled to the interest will be abolished.

(c) An alternative basis will be provided for determining the rate of charge on the termination of an interest in possession in settled property in favour of a discretionary trust on or after 17 March 1987.

~~51~~ 50 **(a)** IHT will not be payable in respect of settled property on the death on or after 17 March 1987 of a person beneficially entitled to an interest in possession in that property if the property becomes subject to the trusts of a qualifying heritage maintenance fund within two years (or if a Court Order is needed, within three years) after the death.

(b) The charge where property formerly subject to an interest in possession leaves a heritage maintenance fund will be altered: if the tax given up when the property entered the maintenance fund was tax on the termination of an interest in possession, the exit charge will be based on the cumulated chargeable transfers of the person whose interest was terminated.

~~52~~ 51 **(a)** The tax satisfied by acceptance of pre-eminent heritage property in lieu of IHT may be calculated, at the option of the offeror, by reference to the value of the property at the date of the offer instead of the value at the date of acceptance.

(b) Where this option is selected, the tax will be regarded as having been paid on the date of the offer and so will not bear interest after that date.

Stamp duties

~~53~~ 52 Certain technical changes are proposed to the legislation governing stamp duties and the reserve tax.

Value Added Tax

~~54~~ 53 The gross margins earned by tour operators on sales of tours within the European Community will be brought within the scope of VAT with effect from 1 April 1988.

~~55~~ 54 The law will be changed to strengthen the rules relating to the deduction of input tax by partly exempt traders; and to exempt the underwriting of, and making of arrangements for, capital issues.

~~56~~ 55 Businesses with annual turnover below £250 000 will have the option of accounting for VAT on the basis of payments made and received. It is intended that this system should be introduced on 1 October 1987.

~~57~~ 56 The registration limit will be increased to £21 300 per annum and £7 250 per quarter.

~~58~~ 57 The time allowed to notify for registration will be extended to 30 days, and it will be made easier to deregister.

~~59~~ 58 Businesses with annual turnover below £250 000 will have the option of making a single VAT return each year (instead of the present four) with nine advance payments based normally on the VAT paid in the previous year. This system will be introduced in the second half of 1988. Certain recommendations of the Keith Committee which were due to be implemented in 1988 will, as a result, be deferred until 1989. The cost of deferral will be £25 million in 1988–89 and some £50 million to £75 million in 1989–90.

~~60~~ 59 The special schemes for retailers are to be improved and changed in a number of ways.

60 ~~61~~ The law will be changed to prevent the avoidance of tax on imported services by exempt businesses.

61 ~~62~~ VAT relief for charities will be extended to certain welfare vehicles used by hospices to transport the terminally ill; to specialised location and identification equipment used by rescue and first aid services; to goods donated for export by a charity for relief of distress or animal welfare; to installing or adapting bathroom, washroom or lavatory facilities for the handicapped in charity residential homes; and to drugs and chemicals directly used by a charity in medical care or research.

Excise duties

62 – 69 ~~63–70~~ There will be no changes in the duties on alcoholic drinks, tobacco products and most hydrocarbon oils.

70 ~~71~~ The duty on unleaded petrol will be reduced by 5p a gallon (inclusive of consequential VAT).

71 ~~72~~ The duty on bets placed on-course at horse and greyhound racetracks will be abolished.

72 ~~73~~ The rate of gaming machine licence duty will be increased as follows:

- for 5p "amusement with prizes" machines by £30
- for 10p "amusement with prizes" machines by £75
- for 5p jackpot machines by £75
- for 10p jackpot machines by £210

The amount of refund on surrender of a licence will be increased and the arrangements for collecting the duty will be changed.

Vehicle excise duties

73 ~~74~~ There will be no change in the duties on cars, light vans, taxis, buses, coaches, motor cycles and most lorries.

74 ~~75~~ The concessionary rates of duty for farmers' heavy goods vehicles over 7·5 tonnes will be increased by varying amounts as the final stage in the process of bringing them into line with the proportion of average mileage covered by these vehicles on public roads. From 1 January 1988 the rate of duty for trade licences will be increased to £85 for cars and £17 for motor cycles, as the second stage in the process of increasing these rates to the rates for ordinary licences for cars and motor cycles between 150 and 250cc, respectively.

cc/

75 ~~76~~ From 1 January 1988 a new taxation class will be created for recovery vehicles. The rate of duty will be set at £50.

76 ~~77~~ The law will be amended so that, on conviction for VED evasion, the courts will be required to order payment of all back duty due from that offender from the expiry of the last licence or date of acquisition of the vehicle, without regard for any non-use of the vehicle during the period. The maximum penalty for failure to return a licence, issued against a cheque that is subsequently dishonoured, will be increased.

bold → **Other**

77 ~~78~~ There will be no change in bus fuel grant.

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5 Public expenditure

Public spending plans **5.01** The 1987 public expenditure White Paper (Cm 56) set out plans for public spending for the next three years and provided the basis for the more detailed Supply Estimates, cash limits and other spending controls for 1987–88. These plans are summarised in Table 5.1. The Budget makes no change to them.

Changes since previous Budget **5.02** Since the last FSBR, extra funds have been allocated to priority services including education, health and law and order. The estimated costs of some demand-led programmes, such as social security, have also risen.

Table 5.1 **Public expenditure**

	£ billion				
	1985–86 Outturn	1986–87 Estimated outturn	1987–88 Plans	1988–89 Plans	1989–90 Plans
Department					
DHSS – Social security	41·5	44·6	46·0	47·5	49·3
Defence	18·0	18·2	18·8	19·0	19·5
DHSS – Health and personal social services	16·6	18·0	19·1	19·9	20·8
Education and science	14·5	15·7	16·6	17·4	17·8
Home Office (and Lord Chancellor's department)	5·3	5·8	6·2	6·4	6·6
Employment	3·4	3·8 ~~7~~	4·0	4·2	4·3
Other departments	37·1	38·3 ~~7~~	39·4	39·4	40·7
Privatisation proceeds	−2·7	−4·4	−5·0	−5·0	−5·0
Reserve			3·5	5·5	7·5
Bold Public expenditure planning total	133·6	140·0	148·6	154·2	161·5
General government gross debt interest[1]	17·~~7~~6	[17·5]	[~~18·0~~] 17·8	[18]	[19]
Other adjustments*	7·~~2~~6	[7·~~3~~] 4	[7·0]	[8]	[8]
General government expenditure*	**158·~~5~~8**	**[164·~~8~~] 9**	**[173·5]**	**[180]**	**[188]**
Planning total in real terms (base year 1985–86)	133·6	[135·7] ~~[136·0]~~	[138·~~0~~] 1	[137·~~7~~] 8	[139·~~2~~] 4
bold **General government expenditure as a percentage of GDP**	**44**	**[43~~¼~~]**	**[42¼]**	**[41¼]**	**[40~~½~~]** ¾

1988–89 and 1989–90 figures rounded to nearest £1 billion.

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Public spending trends **5.03** The plans show a further fall in general government spending as a percentage of GDP in each of the next three years (see Table 5.1); this would still be the case even without any proceeds from privatisation. By 1989–90,

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the percentage should be back to the level of the early seventies. This reflects the Government's continued objective of reducing steadily the state's share of the nation's income.

5.04 General government expenditure covers spending by central government and local authorities. It is the key public ~~expenditure~~ spending aggregate used in the Medium Term Financial Strategy. The main difference between general government expenditure and the planning total is the inclusion in the former of gross debt interest, amounting to some [£18] billion in 1987–88. There are also a number of other definitional differences and adjustments, which are described in the Annex to Part 2 of the 1987 public expenditure White Paper. In 1987–88, these adjustments account for a further £7 billion.

1986–87 outturn

5.05 The latest estimates, which still remain subject to some uncertainty, suggest that the planning total outturn in 1986–87 is likely to be about £140·0 billion, £0·9 billion above the plans shown in the 1986 public expenditure White Paper and the 1986 Budget. ~~[This is very close to the estimated outturn figure shown in the Autumn Statement and this year's White Paper.]~~ The details are shown in Table 5.2.

Table 5.2 Comparison of plans and estimated outturn for 1986–87

	£ billion 1986–87 Plans*	Estimated outturn	Outturn minus plans
Central government	102·6	105·0	+2·4
Local authority	35·2	38·1	+3·0
of which			
relevant expenditure	27·0	29·4	+2·5
other current	4·5	4·8	+0·3
capital	3·7	3·8	+0·2
Nationalised industries and other public corporations	1·6	1·3	−0·3
Privatisation proceeds	−4·8	−4·4	+0·4
Reserve	4·5		−4·5
Public expenditure planning total	**139·1**	**140·0**	**+0·9**

*Plans from The Government's Expenditure Plans 1986–87 to 1988–89, Cmnd 9702, adjusted for classification changes.

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5.06 The major changes between plans and estimated outturn are:—

i. an increase of £3·0 billion in local authority expenditure including an overrun of £2·5 billion on expenditure relevant for Aggregate Exchequer Grant (relevant expenditure);

ii. an increase in social security expenditure of £1·7 billion;

iii. additional equity of £680 million in Rover Group to meet debt and restructuring costs associated with disposal of their trucks and bus businesses.

The additions to programmes amount to some £5.0 billion and, together with a shortfall of 0·4 billion ~~£400m~~ on privatisation proceeds, exceed the Reserve of £4·5 billion. The consequent overrun on the planning total amounts to about £0·9 billion.

Printer please put stubs in same format as Table 5.2

Table 5.3 Public expenditure by spending authority

£ billion	1985–86 Outturn	1986–87 Estimated outturn	1987–88 Plans	1988–89 Plans	1989–90 Plans
Central government*	98·5	105·0	108·3	111·2	115·7
of which Voted in Estimates	71·3	74·5	76·3	78·7	81·1
Other	27·1	30·5	32·0	32·5	34·6
Local authorities*	35·2	38·1	40·2	41·1	42·4
of which Relevant expenditure	26·9	29·4	31·0	32·2	33·1
Other current	4·5	4·8	4·9	4·9	5·2
Capital	3·9	3·8	4·3	4·0	4·1
Nationalised industries	1·7	0·5	0·7	0·3	−0·1
Other public corporations	0·9	0·~~8~~ 9	1·0	1·0	1·1
Privatisation proceeds	−2·7	−4·4	−5·0	−5·0	−5·0
Reserve			3·5	5·5	7·5
Public expenditure planning total	**133·6**	**140·0**	**148·6**	**154·2**	**161·5**

*Excluding finance for public corporations ~~(including~~ nationalised industries and other

Public expenditure by spending authority

5.07 Central government spending makes up about three quarters of the planning total. About 70 per cent of this is voted by Parliament through the annual Supply Estimates and covers the expenditure of government departments for their own activities as well as their funding of other bodies such as the National Health Service. Most of the remainder consists of social security payments paid out of the National Insurance Fund. Spending by local authorities accounts for about one quarter of public expenditure. Nationalised industries and other public corporations account for the remainder of the total. Table 5.3 gives outturn figures for the last two years and the plans as published in the public expenditure White Paper.

Supply Estimates

5.08 For 1987–88, the plans set out in the public expenditure White Paper have now been translated, where appropriate, into detailed control totals in Supply Estimates. The total Estimates provision for 1987–88 for which the Government is seeking Parliamentary approval is shown in Table 5.4. The main Estimates for 1987–88 are published in a series of booklets on 17 March 1987 with a Summary and Guide (Cm 94) which explains the Supply procedure and summarises the Estimates. It also explains how they relate to the public expenditure planning total.

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5.09 Of the £104·5 billion included in the Supply Estimates, £78·8 billion is direct public expenditure. The remaining £25·6 ~~m~~ billion does not feature directly as public expenditure because it consists of grants to local authorities and finance for other bodies whose spending is counted as public

expenditure. Just over 60 per cent of the money voted in Estimates is subject to cash limits, which provide the Government with greater control over its cash expenditure during the financial year.

Table 5.4 Supply expenditure

	£ billion 1985–86 Expected outturn in 1986 Budget	Final outturn	1986–87 Expected outturn	1987–88 Provision
Main Supply Estimates	96·0	96·0	99·~~0~~ 1	104·5
Supplementaries and net under-spending	2·0	2·1	2·8	
Total Supply expenditure	**98·1**	**98·1**	**101·9**	
(public expenditure element)	(74·9)	(75·0)	(77·3)	

6 The public sector's finances

The scope of this chapter

6.01 This chapter brings together revenue (discussed in Chapter 4) and spending (in Chapter 5), and provides an analysis and forecast of the public sector's finances in 1987–88, together with new estimates of outturn in 1986–87. It also comments on the main features of the public sector's finances in those two years, including the most important changes that have taken place since last year's projections. Table 6.1 is a summary.

Table 6.1 Public expenditure, receipts and borrowing

	£ billion			
	1985–86	1986–87		1987–88
	Outturn	1986 Budget	Latest estimate	Forecast
General government expenditure	158·~~5~~ 8	163·4	~~165·1~~ 164.9	173·5
General government receipts	151·~~0~~ 9	155·9	~~158·7~~ 159.0	168·~~7~~ 6
General government borrowing requirement	6·9	7·5	~~6·4~~ 5.9	4·~~8~~ 9
Public corporations' market and overseas borrowing	−1·1	−0·4	−1·~~5~~ 6	−0·8
Public sector borrowing requirement	**5·8**	**7·1**	**4·~~9~~** 3	**4·~~0~~** 1

6.02 The PSBR is now estimated to be ~~just under~~ £~~5~~ 4¼ billion in 1986–87, compared with the forecast of £7 billion made a year ago. The PSBR is forecast to be about £4 billion in 1987–88.

Public sector's finances: three-fold analysis

6.03 The public sector's finances can be analysed in a number of different ways:

by type or activity, showing on the one hand the different types of receipts (income taxes, corporation taxes, capital taxes, expenditure taxes, North Sea revenues, and so on); and on the other hand the spending (on social security, defence, health, education and so on) financed by those receipts and by borrowing;

by sector, showing the authority which undertakes the financing or spending: central government, local authorities or public corporations;

by economic category, showing, for example, whether the receipts and spending are current or capital transactions and whether current spending is on goods and services or transfer payments.

6.04 This three-fold analysis of the public sector's finances is analogous to the three-fold presentation of public spending that has become an established feature of the public expenditure White Paper (see paragraph 13 of Cm 56–I). The rest of this chapter sets out these three analyses in detail.

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Public sector finances : analysis by type or activity

~~Analysis by type or activity~~

6.05 Table 1.2 analyses the public sector's finances by type or activity. The main receipts of general government (ie central plus local government) are grouped according to the kind of activity which gives rise to them, while spending is shown, by department, as in Chapter 5 and in the public expenditure White Paper. Its bottom line, the public sector borrowing requirement (PSBR), is derived from those two totals. This derivation is repeated in Table 6.1.

Receipts

6.06 The Autumn Statement said that general government receipts in 1986–87 were likely to be higher than forecast in the 1986 Budget. The size of the overshoot now appears to be greater than envisaged then. Total general government receipts are now estimated to be over £~~2¾~~ 3 billion higher than the 1986 Budget forecast, despite a shortfall of £1¼ billion in oil receipts. As Table 1.2 shows non-North Sea corporation tax (£1¾ billion) and VAT (£¾ billion) account for most of the additional receipts. Stamp duty ~~duty, included in "other" expenditure taxes in Table 1.2~~, accounts for nearly a further £½ billion.

6.07 The shortfall in oil revenues mainly reflects lower than assumed oil prices in 1986 and the £0·3 billion repayment of advanced petroleum revenue tax announced in the Autumn Statement. Oil revenues are now estimated to have fallen from £11½ billion in 1985–86 to £4¾ billion in 1986–87. They are forecast to fall to £4 billion in 1987–88. This reduction is more than accounted for by lower receipts of North Sea corporation tax. This reflects the fall in oil prices in 1986, as corporation tax is paid with a lag. The sterling oil price is assumed to be somewhat higher in 1987 than in 1986 and oil production is forecast to fall slightly.

6.08 The 1986 Budget expected total non-oil receipts to rise a little less than the projected rise in non-oil money GDP. They are now estimated to have risen slightly more, by 9¾ per cent, compared with an estimated 9 per cent rise in non-oil money GDP. Corporation tax receipts in 1986–87 largely depend on profits and other income earned in calendar year 1985. On currently recorded data non-North Sea company incomes rose strongly in 1985. The rise, however, is insufficient to explain the whole of the increase in corporation tax receipts. One possibility is that the recorded data understate the full rise in company income. Another possibility is that the distribution of total income growth among individual companies was such that less use was made of capital allowances and other tax offsets than the forecast implied. The greater than expected buoyancy of VAT is partly attributable to total consumer spending rising a little faster than forecast, but also reflects a change in the composition of consumption towards spending on goods and services subject to VAT.

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nearly

6.09 In 1987–88 both total and non-oil money GDP are forecast to increase at much the same rate, about 7½ per cent. Non-oil receipts are forecast to rise by 7 per cent, after taking account of the Budget proposals. As Table 1.2 shows there is within this overall increase:

a further rise, of 21 per cent, in receipts of corporation tax (excluding North Sea mainstream corporation tax). This reflects continued growth of company incomes in 1986.

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a 4 per cent increase in receipts from income taxes—lower than the increase in personal incomes, reflecting the income tax reductions announced in the Budget.

8½
an ~~8~~ per cent increase in VAT receipts, following an 11 per cent increase in 1986–87. The rate of increase in consumer spending on goods and services subject to VAT is forecast to be lower in 1987–88 than in 1986–87.

an 8½ ~~a 9½~~ per cent increase in net local authority rate income, a smaller increase than in 1986–87.

3½ a ~~2½~~ per cent increase in revenue from excise duties.

6.10 Table 6.2 shows taxes (including rates) and national insurance contributions as a percentage of GDP. While, overall, the percentage is estimated to have fallen in 1986–87 and is forecast to fall a little further in 1987–88, non-oil taxes are estimated to have risen in 1986–87 as a percentage of non-oil GDP, and are likely to increase marginally ~~stay much the same~~ in 1987–88.

Table 6.2 Taxes and National Insurance Contributions (NICs) as a percentage of GDP

	1981–82	1982–83	1983–84	1984–85	1985–86	1986–87 Estimated outturn	1987–88 Forecast
Total taxes and NICs as a share of total money GDP	39·4	39·2	38·6	39·1	38·6	38·~~3~~ 1	38·~~1~~ 0
bold — Non-oil taxes and NICs as a share of non-oil money GDP	38·8	38·4	37·9	37·8	37·1	37·~~8~~ 6	37·8

Expenditure

6.11 Total general government expenditure is expected to have been £165 billion in 1986–87, a little higher than in the Autumn Statement and public expenditure White Paper, and 1½ ~~£1¼~~ billion higher than in the 1986 Budget forecast. There are two main reasons for the overspend compared with the Budget forecast. First, as explained in Chapter 5, the planning total is expected to be ~~£1¼~~ billion higher than planned. Secondly within public corporations' external financing requirement, a component of the planning total, public corporations have met a higher proportion by government borrowing and a smaller proportion by market and overseas borrowing. Partially offsetting these factors is an estimated £¾ billion reduction in the forecast of general government debt interest payments.

6.12 General government expenditure is expected to rise by 5 per cent in 1987–88, to £173½ billion. The planning total, at £148·6 billion, is the same as in the public expenditure White Paper. General government gross debt interest payments are forecast to rise a little ~~from £17½ billion in 1986–87 to nearly £18 billion~~ in 1987–88.

Borrowing

6.13 The difference between general government receipts and expenditure is the general government borrowing requirement (GGBR), as shown in Table 6.1. As general government lending to public corporations is included in general government expenditure, the GGBR together with public corporations' market and overseas borrowing, gives the PSBR.

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6.14 A year ago the PSBR in 1986–87 was forecast at £7·1 billion. Borrowing in the eleven months to February is provisionally estimated to have been £~~[1·5]~~ billion. Borrowing in March is always relatively high. Central government expenditure is likely to be unusually high this March as a result of transactions related to the Rover Group, while revenue is expected to be less than last year, with lower receipts from the North Sea, as a result of the fall in oil prices. Local authority borrowing is always high in the closing weeks of the financial year. The latest estimate of the outturn for the PSBR in 1986–87 as a whole is £4·~~9~~3 billion, or ~~1·3~~ 1¼ per cent of money GDP.

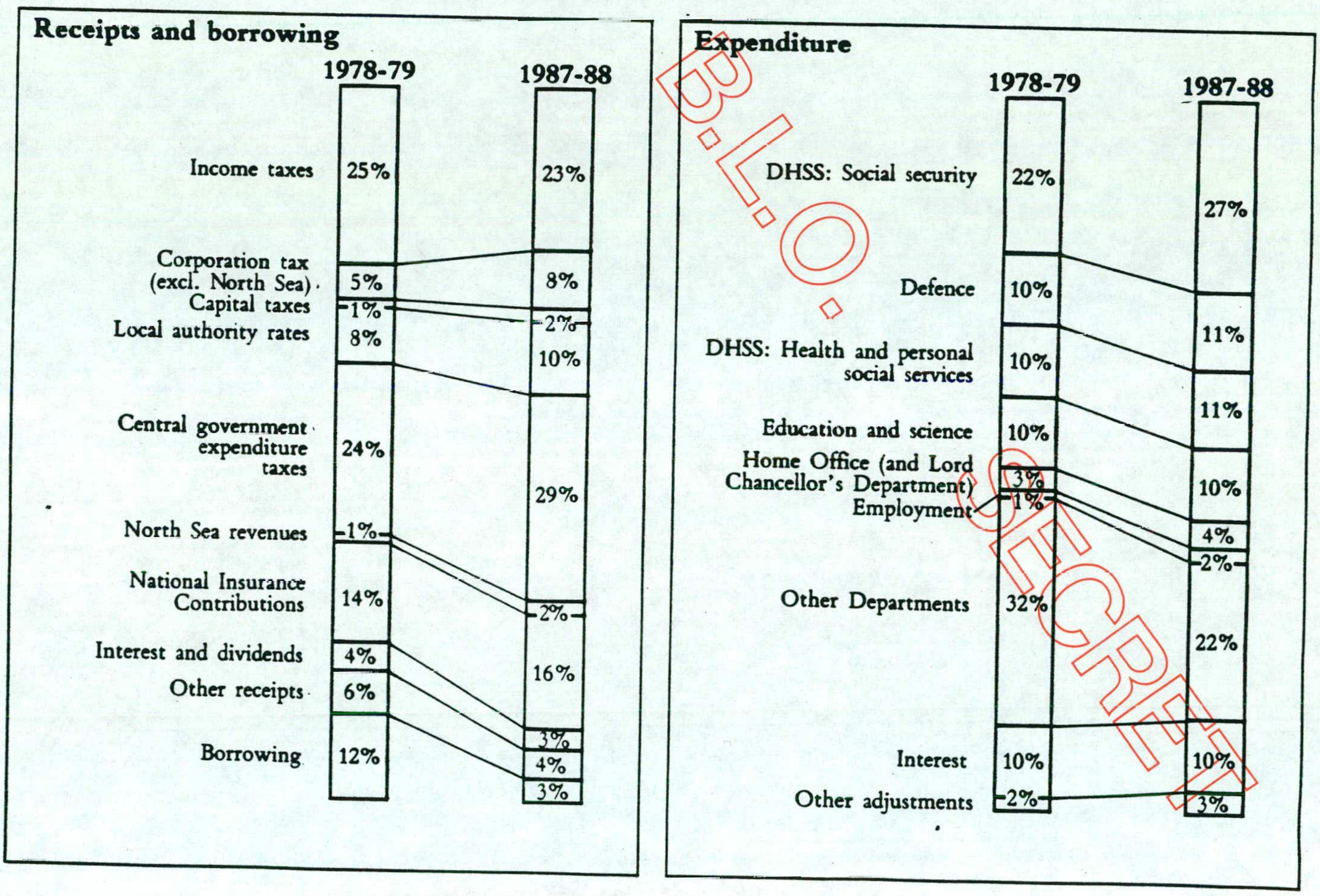
λ 0.1

6.15 The PSBR in 1987–88 is forecast to be about £4 billion, or 1 per cent of money GDP.

6.16 Both general government expenditure and receipts are estimated to have fallen as a proportion of money GDP in 1986–87, the latter because of the fall in oil revenues. In 1987–88 expenditure is projected to fall again as a proportion of money GDP, as it has done since 1982–83~~, while~~. General government receipts are also forecast to ~~be [the same as]~~ fall a proportion of money GDP ~~as in~~ 198~~6~~7–8~~7~~8.

6.17 Chart 6.1 shows the significant changes in the structure of receipts and expenditure which have taken place since 1978–79.

Chart 6.1 The structure of receipts and expenditure



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Public sector finances: analysis by sector

~~Analysis by sector~~

6.18 The PSBR may also be analysed by the authority or sector which will be undertaking (or repaying) the borrowing: central government, local authorities and public corporations. Table 6.3 shows the sectoral composition of the PSBR in 1986–87, in summary form.

Table 6.3 Public sector borrowing requirement

	£ billion			
	1985–86 Outturn		1986–87 Latest estimate	
1 Central government borrowing on own account	**4·1**		**5·~~4~~** 2	
2 Local authority borrowing from central government		5·7		4·~~9~~ 8
3 Local authority borrowing from market and overseas		−4·1	5	−4·~~1~~ 3
4 Total local authority borrowing	**1·7**		**0·~~8~~**	
5 Public corporations' borrowing from central government		1·1		0·2
6 Public corporations' borrowing from market and overseas		−1·1		−1·~~5~~6
7 Total public corporations' borrowing	**0·0**		**−1·~~3~~** 4	
8 Public sector borrowing requirement	**5·8**		**4·~~9~~** 3	
Memorandum item:— Central government borrowing requirement (lines 1+2+5)	10·9		10·~~5~~ 2	

6.19 Tables 6.4 to 6.6 show estimated outturns and forecasts of receipts and expenditure in 1986–87 and 1987–88 for each of the three sectors. These tables include some of the analysis by economic category in paragraph 6.2~~7~~ 6 and Table 6.7. Expenditure in 1987–88 does not include the Reserve, which has not been allocated. The forecast of the PSBR assumes however that the Reserve is fully spent.

6.20 Central government spending includes grants and subsidies to local authorities and public corporations (including nationalised industries), which are included in the receipts of those sectors, shown in Tables 6.5 and 6.6.

Table 6.4 Central government transactions

	£ billion		
	1985–86 Outturn	1986–87 Latest estimate	1987–88 Forecast
Receipts			
Taxes and royalties	100·6	~~104·5~~ 103.9	111·~~4~~ 0
National insurance and other contributions	24·7	26·~~4~~ 5	28·6
Other	10·5	10·~~3~~ 5	~~9·7~~ 10.
Total receipts	**135·8**	**~~141·0~~** 140.9	**149·~~7~~** 8
Expenditure			
Current expenditure on goods and services	46·6	49·~~2~~ 4	52·~~1~~ 2
Current grants and subsidies	72·2	~~76·9~~ 77.2	79·4
Interest	16·1	16·~~6~~ 5	17·~~3~~ 2
Net lending and capital expenditure, excluding on-lending to local authorities and public corporations	4·2	3·~~5~~ 0	2·~~3~~ 7
Total expenditure	**139·1**	**146·~~2~~** 1	**151·~~1~~*** 5

*Excluding any allocation from the Reserve

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6.21 Local authority receipts consist primarily of ~~the~~ rate income plus grants from central government. The forecast increase in net rate income between 1986–87 and 1987–88 takes account of available information about rate decisions by local authorities and additions to rateable value.

6.22 The local authority borrowing requirement (LABR) in the first eleven months of 1986–87 is provisionally estimated to have been a ~~surplus~~ net repayment of £~~[0·4]~~ 0.7 billion. The estimated outturn for the year as a whole is borrowing of £0·~~8~~ 5 billion. This estimate takes account of the usual high level of borrowing in March. If the estimated outturn is correct, and the margin of error surrounding the forecast is inevitably very large, the LABR in 1986–87 will be ~~nearly~~ over £1 billion lower than in 1985–86. This fall in borrowing appears to have been the result of current receipts rising more than current expenditure and a small fall in net capital spending. In 1986–87, as in 1985–86, local authorities replaced substantial amounts of market and overseas borrowing by borrowing from the central government,

Table 6.5 Local authority transactions

	£ billion		
	1985–86 Outturn	1986–87 Latest estimate	1987–88 Forecast
Receipts			
Rates (net of rate rebates)[1]	13·8	15·5	~~17·0~~ 16.9
Rate support grant	11·3	11·8	~~13·0~~ 12.[illegible]
Other grants from central government	10·0	11·4	~~11·8~~ 12.[illegible]
Other	5·6	~~5·6~~ 6.1	5·~~8~~ 9
Total receipts	**40·7**	**44·~~3~~ 8**	**47·3**
Expenditure			
Current expenditure on goods and services	28·5	31·~~5~~ 3	33·~~3~~ 1
Current grants and subsidies	5·3	5·8	5.6
Interest	3·7	4·4	4·~~6~~ 5
Net lending and capital expenditure	4·2	3·~~8~~ 9	4·0
Total expenditure	**41·7**	**45·~~2~~ 3**	**47·~~5~~[2] 2**

[1] *Memo: Rate rebates* 1·6 1·7 1·9
[2] *Excluding any allocation from the Reserve*

6.23 Table 6.6 shows public corporations' transactions. The public corporations' receipts include subsidies and capital grants from central and local government. For the nationalised industries (and the majority of other public corporations) their net external finance, ie their borrowing plus subsidies and grants, is included in the planning total. Changes from one year to another are affected by privatisations. During the course of 1986–87 British Gas and British Airways were privatised and ceased to be classified as public corporations.

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Table 6.6 Public corporations' transactions

	£ billion		
	1985–86 Outturn	1986–87 Latest estimate	1987–88 Forecast
Receipts			
Gross trading surplus (including subsidies)	8·1	7·0	7·0
Other	1·8	3·~~6~~ √	2·4
Total receipts	**9·9**	**10·~~6~~** √	**9·4**
Expenditure			
Interest, dividends and taxes on income	4·3	3·~~7~~ 8	3·5
Net lending and capital expenditure	5·6	5·~~6~~ √	5·0
Total expenditure	**9·9**	**9·~~3~~** 1	**8·5***

** Excluding any allocation from the Reserve*

There is no single explanation for this reduction in aggregate borrowing, but major factors include reduced energy costs, lower interest payments and a favourable effect on cash flow of certain financial transactions. The transfer from the public corporations sector of those corporations privatised during 1986-87 is the main reason for the fall in gross trading surplus between 1985-86 and 1986-87.

6.24 Public corporations' borrowing requirement in the first eleven months of 1986–87 is provisionally estimated at a net repayment of £~~[1·1]~~ 1.4 billion. The estimated outturn for the year as a whole is ~~a~~ also net repayment of £1·~~3~~ 4 billion, compared with a nil borrowing requirement in 1985–86. ~~The reduction in borrowing appears to have been due to a number of factors including rising output, further improvements in productivity, the effect on profit margins of the decline in sterling and higher in net receipts of trade credit.~~

Public sector finances: analysis by economic category

Analysis by economic category

6.25 The transactions leading up to the PSBR may also be analysed by economic category (some details of which are given in Tables 6.4 to 6.6 above). This analysis is shown in Table 6.7, with a breakdown between central government, local authorities and public corporations. This analysis, which distinguishes between current and capital transactions (and within the latter between physical and financial investment) shows the derivation of the public sector financial deficit. The financial deficit, unlike the PSBR, is not wholly a measure of cash transactions because certain taxes included in lines 1 and 2 of Table 6.7 are measured on an accruals basis. An accruals adjustment is accordingly made in line 28.

6.26 The unallocated Reserve is assumed to be used up by spending on current items or physical capital formation ~~-~~ ie in transactions that fall above the financial surplus/deficit line. In practice allocations from the Reserve can affect financial transactions (lines 25 to 29). For example expenditure in 1986–87 associated with Rover Group is classified as cash expenditure on company securities and appears in line 26.

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Table 6.7 Public sector transactions by sub-sector and economic category

		£ billion[1]				
		1986–87 Latest estimate				
		General government			Public corporations	Public sector
	Line[2]	Central government	Local authorities	Total		
Current and capital receipts						
Taxes on income, and oil royalties	*1*	53·~~4~~ 2	—	53·~~4~~ 2	−0·1	53·~~3~~ 1
Taxes on expenditure	*2*	48·~~1~~ 0	15·5	63·~~6~~ 5	—	63·~~6~~
Taxes on capital	*3*	2·7	—	2·7	—	2·7
National insurance and other contributions	*4*	26·~~4~~ 5	—	26·5	—	26·5
Gross trading surplus	*5*	−0·3	0·4	0·1	7·0	7·1
Rent and miscellaneous current transfers	*6*	0·2	3·1	3·3	0·5	3·8
Interest and dividends from private sector and abroad	*7*	2·7	0·7	3·3	0·~~9~~ 8	4·~~2~~ 1
Interest and dividends within public sector	*8*	5·7	−3·3	2·4	−2·~~4~~ 3	~~—~~ 0
Imputed charge for non-trading capital consumption	*9*	1·0	1·4	2·4	—	2·4
Capital transfers from private sector	*10*	—	—	—	0·2	0·2
Total receipts	*11*	**~~140·0~~** 139.7	**17·8**	**157·~~8~~** 5	**6·0**	**163·~~8~~**
Current and capital expenditure						
Current expenditure on goods and services	*12*	−49·~~5~~ 4	−31·~~5~~ 3	~~−81·0~~ −80.7	—	~~−81·0~~ −80.
Subsidies	*13*	−5·1	−1·3	−6·4	—	−6·4
Current grants to personal sector	*14*	−46·~~2~~ 6	−4·5	~~−50·8~~ −51.2	—	−51.2 ~~−50·8~~
Current grants paid abroad	*15*	−3·~~2~~ 1	—	−3·~~2~~ 1	—	−3·~~2~~ 1
Current grants within public sector	*16*	−22·3	22·3	—	—	—
Debt interest	*17*	−16·5	−0·9	−17·5	−0·8	−18·3
Gross domestic fixed capital formation	*18*	−3·~~4~~ 3	−3·~~7~~ 6	~~−7·1~~ −6.9	−5·3	−12·~~4~~
Increase in stocks	*19*	0·1	—	0·1	0·1	0·1
Capital grants to private sector	*20*	−2·~~2~~ 3	−0·6	−2·~~8~~ 9	−0·1	−3.0 ~~−2·9~~
Capital grants within public sector	*21*	−1·~~6~~ 4	0·9	−0·~~7~~ 5	0·~~7~~ 6	0.1
Total expenditure	*22*	**~~−150·0~~** 149.9	**−19·~~3~~** 0	**~~−169·3~~** −168.9	**−5·~~5~~** 6	**−174·~~8~~**
Unallocated Reserve	*23*	—	—	—	—	—
Financial surplus/deficit	*24*	**−10·~~0~~** 2	**−1·~~5~~** 2	**−11·~~5~~** 4	**0·5**	−10.9 **~~−11·0~~**
Financial transactions						
Net lending to private sector and abroad	*25*	−0·2	0·~~5~~ 4	0·~~3~~ 2	−0·2	—
Cash expenditure on company securities (net) (including privatisation proceeds)	*26*	~~3·9~~ 4.0	—	~~3·9~~ 4.0	—	4.0 ~~3·9~~
Transactions concerning certain public sector pension schemes	*27*	0·8	—	0·8	—	0·8
Accruals adjustments	*28*	~~0·1~~	—	0.1	—	0·
Miscellaneous financial transactions	*29*	0·~~2~~ 3	0·~~2~~ 3	0·~~4~~ 6	1·~~0~~ 1	1·~~4~~
Borrowing requirement	*30*	**5·~~4~~** 2	**0·~~8~~** 5	**~~6·2~~** 5.7	**−1·~~3~~** 4	**4·~~6~~**

[1] *Sign convention: receipts positive, payments negative.*

[2] *Relationship between lines: (24) = (11) + (22) + (23)*
(30) = −(24 to 29)

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£ billion[1]

1987–88 Forecasts

Line[2]	General government: Central government	General government: Local authorities	General government: Total	Public corporations	Public sector	
						Current and capital receipts
1	~~57·4~~ 56.8	—	~~57·4~~ 56.8	−0·1	~~57·3~~ 56.7	Taxes on income and oil royalties
2	~~51·5~~ 50.9	~~17·0~~ 16.9	~~68·5~~ 67.8	—	~~68·5~~ 67.8	Taxes on expenditure
3	3·~~2~~ 3	—	3·~~2~~ 3	—	3·~~2~~ 3	Taxes on capital
4	28·6	—	28·6	—	28·6	National insurance and other contributions
5	−0·3	0·5	0·2	7·0	7·~~1~~ 2	Gross trading surplus
6	0·3	3·1	3·4	0·5	3·9	Rent and miscellaneous current transfers
7	2·~~8~~ 9	0·7	3·~~5~~ 6	0·7	4·~~2~~ 3	Interest and dividends from private sector and abroad
8	5·9	−3·7	2·2	−2·2	—	Interest and dividends within public sector
9	1·~~0~~ 1	1·5	2·~~5~~ 6	—	2·~~5~~ 6	Imputed charge for non-trading capital consumption
10	—	—	—	0·3	0·3	Capital transfers from private sector
11	**~~150·4~~** 149.3	**~~19·0~~** 18.9	**~~169·4~~** 168.2	**6·1**	**~~175·4~~** 174.3	**Total**
						Current and capital expenditure
12	−52·~~1~~ 0	−33·~~3~~ 1	−85·~~4~~ 1	—	−85·~~4~~ 1	Current expenditure on goods and services
13	−5·1	−1·0	−6·1	—	−6·1	Subsidies
14	−47·8	−4·6	−52·4	—	−52·4	Current grants to personal sector
15	−2·9	—	−2·9	—	−2·9	Current grants paid abroad
16	−23·6	23·6	—	—	—	Current grants within public sector
17	−17·~~3~~ 2	−0·7	~~−18·0~~ −17.9	−0·9	−18·~~9~~ 8	Debt interest
18	−3·5	−3·6	−7·0	−4·6	−11·6	Gross domestic fixed capital formation
19	−0·~~2~~ 4	—	−0·~~2~~ 4	−0·1	−0·~~3~~ 5	Increase in stocks
20	−2·~~0~~ 1	−0·7	−2·~~7~~ 8	−0·1	−2·~~8~~ 9	Capital grants to private sector
21	−1·~~8~~ 7	1·1	−0·~~7~~ 6	0·~~7~~ 6	—	Capital grants within public sector
22	**−156·~~2~~ 3**	**−19·~~2~~ 0**	**−175·~~5~~ 3**	**−5·~~0~~ 1**	**−180·~~5~~ 4**	**Total**
23					−3·5	Unallocated Reserve
24					**~~−8·5~~** −9.6	**Financial surplus/deficit**
						Financial transactions
25	−0·2	0·~~4~~ 2	~~0·2~~ –	−0·2	~~4~~ −0.2	Net lending to private sector and abroad
26	5·~~0~~ stet	—	5·0	—	5·0	Cash expenditure on company securities (net) (including privatisation proceeds)
27	0·5	—	0·5	—	0·5	Transactions concerning certain public sector pension schemes
28	−0·~~3~~ 1	0·1	~~−0·2~~ –	—	~~−0·2~~ –	Accruals adjustments
29	~~−0·6~~ 0.1	~~−0·1~~ –	~~−0·8~~ 0.1	+ 0.1	0·~~8~~ 2	Miscellaneous financial transactions
30					**4·~~0~~ 1**	**Borrowing requirement**

Annex to Chapter 6

Part A: relationship between tables in Chapter 6, and with Table 1.2; and outturn data

Relationship between tables

6A.1 Table 6.7 is based on the definitions used to compile the national accounts. In order to show the financial deficit for each sector, lending and other financial transactions are separated from the analysis of receipts and expenditure in lines 1–23 and shown in lines 25–29. These lines show the relationship between the financial deficit (line 24) and the borrowing requirement for each sector (line 30).

6A.2 Tables 6.4–6.6 are summary versions of the sectoral columns of Table 6.7. The information in Table 6.7 is rearranged so that, for example, central government grants to local authorities (which appear as negative expenditure in the local authorities column of Table 6.7, lines 16 and 21) appear as receipts in Table 6.5. Interest paid by local authorities to central government (which appears as negative receipts in the local authorities column of Table 6.7, line 8) appears as expenditure in Table 6.5. Finally, lending and other financial transactions (lines 25–29 of Table 6.7) are included in the receipts and expenditure of Tables 6.4–6.6.

6A.3 Table 1.2 in Chapter 1 uses the same information as Table 6.7, but again rearranges it. To derive general government expenditure, it starts by giving a departmental ~~functional~~ breakdown of the public expenditure planning total: that includes not only general government expenditure items in the third column of Table 6.7 (including the "financial transactions" in lines 25–26), but also borrowing or capital expenditure by public corporations in the fourth column. General government expenditure as shown in Table 1.2 is then obtained by adding general government debt interest from the third column of Table 6.7 and the national accounts adjustments already included in Table 6.7, and deducting public corporations' borrowing from the market and from overseas.

6A.4 Alternatively, general government expenditure in Table 1.2 (and Table [2.4]) can be obtained as the sum of lines 22, 23, 25 and 26 (third column) in Table 6.7 and on-lending to public corporations in Table 6.3.

6A.5 To derive general government receipts, Table 1.2 takes the receipts shown in the third column of Table 6.7 (lines 11, 27, 28 and 29) and rearranges them according to the type of activity which gives rise to them. For example, oil revenues comprise North Sea corporation tax and petroleum revenue tax (included in "taxes on income" in Table 6.7) plus oil royalties. The sub total "total taxes and royalties" is the same as the first line of Table [2.5] in Chapter 2.

Outturn data

6A.6 Outturns for the PSBR and the statutory central government accounts (as in Tables 6.B.1–4 in Part B of the Annex) are compiled monthly and published by press notice 12 working days after the end of the month and then in more detail in Tables 2.5 and 3.12 to 3.16 of the following issue of Financial Statistics. Details of the PSBR on national accounts definitions, as in Table 6.6, are compiled quarterly and published in sections 2 to 5 of Financial Statistics three months after the end of the quarter.

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6A.7 The first outturn for the PSBR in 1986–87 will accordingly be published on April 16. The first national accounts outturns for 1986–87 will appear in the June issue of Financial Statistics, including supplementary Table 13 which is based on Table 6.6.

Part B: central government transactions

Commentary on the tables

6B.1 The tables in Part B of this Annex are confined to central government transactions only, and are based on the statutory funds and accounts. Their relationship to the accounts of central government on a national accounts basis (as in Table 6.3) is described in the Financial Statistics Explanatory Handbook (1987 edition, p38). The receipts and payments in the Part B tables are all shown on a cash basis, not accrued. Table 1.2, however, shows the main categories of taxes on an accrued basis as in the national accounts: for instance the item "income taxes" in Table 1.2 differs slightly from "income tax" in Table 6.B.3.

Table 6.B.1 Summary of central government transactions

	£ billion 1986–87 latest estimate
Consolidated Fund	
Revenue (Table 6.B.3)	111·~~4~~ 1
Expenditure (Table 6.B.2)	−116·2
Deficit met from National Loans Fund	−5.1 ~~−4·8~~
National Loans Fund (Table 6.B.4)	
Receipts	15·6
Payments	−25·~~7~~ 4
Total net borrowing by the National Loans Fund	−9·~~6~~ 8
Other funds and accounts (net)	−0·~~9~~ 4
Central government borrowing requirement[1] * **(Table 6.3)**	−10·~~4~~ 2

*Including borrowing for on-lending to local authorities and public corporations.

Table 6.B.2 Consolidated Fund expenditure

	£ million 1986–87 latest estimate
Supply issues[1]	**101 900**
Standing services	
Payment to the National Loans Fund in respect of service of the national debt	8 900
Northern Ireland—share of taxes etc.	2 000
Payments to the European Communities[2]	3 300
Other services	110
Total standing services	14 300
Total Consolidated Fund expenditure	**116 200**

[1] *Supply Issues are monies paid from the Consolidated Fund to Departments' cash accounts with the Paymaster General for spending on Supply. Supply Expenditure (see Table 5.4) equates closely to total Supply Issues in most years, although there may sometimes be slight timing differences between the two.*
[2] *£500 million was paid to the European Communities from Supply Issues instead of Standing Services.*

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Table 6.B.3 Consolidated Fund revenue

	£ million		
	1986–87		1987–88
	Budget	Latest estimate	Forecast
Inland Revenue			
Income tax[1]	38 500	38 300	39 900
Corporation tax[2 3]	11 700	13 400	15 000
Petroleum revenue tax[4]	2 400	~~1 290~~ 1 260	~~1 690~~ 1 680
Capital gains tax	1 050	1 050	~~1 250~~ 1 230
Development land tax	35	55	20
Inheritance tax[5]	910	990	1100 ~~1 060~~
Stamp duties	1 430	1 840	~~2 000~~ 2 100
Bold Total Inland Revenue	56 000	56 900	61100 ~~60 900~~
Customs and Excise			
Value added tax	20 700	21 500	~~23 200~~ 23 300
Petrol, derv etc.	7 300	7 500	7 800
Cigarettes and other tobacco	4 700	4800 ~~5 000~~	4900 ~~5 000~~
Spirits, beer, wine, cider and perry	4 400	4 200	4 300
Betting and gaming	800	760	800
Car tax	980	980	~~1 110~~ 1 100
Other excise duties	20	20 ~~5~~	20
EC own resources[6]			
Customs duties, etc.	1 300	1 290	~~1 310~~ 1 350
Agricultural levies	160	220	230
Bold Total Customs and Excise	40 400	~~41 400~~ 41 200	~~43 900~~ 43 800
Vehicle excise duties[7]	2 500	2 500	2 600
Gas levy	500	520	490
Broadcasting receiving licences	1 000	1 010	1 030
Interest and dividends	840	~~880~~ 870	1 020
Other[8]	7 400	8 100	7 600
Bold Total Consolidated Fund revenue	108 600	~~111 400~~ 111 100	117 500

[1] See paragraph 6.B.1.

[2] Includes advance corporation tax (net of repayments)	4 100	4 400	~~4 [illegible]00~~ 4 700
[3] North Sea corporation tax	2 700	~~2 670~~ 2700	1 410
of which satisfied by setting off ACT	1 200	1 100	800

Liability to corporation tax arising in respect of North Sea production may be satisfied by setting off ACT arising on dividends paid in previous periods in respect of both onshore and offshore activities. Dividends and ACT associated with North Sea activities alone cannot be identified.

[4] Includes advance payments of petroleum revenue tax.

[5] Includes estate duty and capital transfer tax.

[6] Customs duties and agricultural levies are accountable to the European Communities as 'own resources'; actual payments to the Communities are recorded in Table 6.B.2.

[7] Includes driving licence receipts.

[8] Includes the 10 per cent of 'own resources' refunded by the European Communities to meet the costs of collection, privatisation proceeds and oil royalties (see Table 1.2).

Table 6.B.4 National Loans Fund receipts and payments

	£ million 1986–87 Latest estimate
Receipts	
Interest on loans, profits of the Issue Department of the Bank of England, etc.	6 700
Service of the National Debt—balance met from the Consolidated Fund	8 900
Total receipts	**15 600**
Payments	
Service of the National Debt	
Interest	15 400
Management and expenses	170
Total Service of the National Debt	15 600
Loans to:	
Nationalised industries	−390
Other public corporations	170
Local authorities	4 900
Private sector and within central government	100
Total National Loans Fund lending*	4 700
Consolidated Fund deficit	5100 ~~4 800~~
Total payments	**25 ~~2~~4 00**

**On-lending to local authorities and public corporations in Table 6.3 includes, in addition to National Loans Fund lending, net lending from other funds and accounts (mainly Supply Issues in Table 6.B.2).*

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