PO-CH/NL/0055

PART C

SECRET

(Circulate under cover and notify REGISTRY of movement)

PO -CH /NL/0055

PART C

1986 BUDGET AUTUMN STATEMENT

DD's 25years 2-2-95 N. Aziz.

PO -CH /NL/0055
PART C

STARTS :- 30-10-86

ENDS :- 4-11-86

351/52

CONFIDENTIAL

FROM: B O DYER
DATE: 30 October 1986

01-233 4749

pmp

MR M C SCHOLAR

cc Miss Peirson
Mr Sedgewick
Mr Turnbull
Mr Culpin
Miss Evans

AUTUMN STATEMENT

Your minute of yesterday's date records the Chancellor's preference to bring forward publication of the printed Autumn Statement to Wednesday 12 November; and seeks my views on the procedural implications for its formal presentation to Parliament.

2. I do not see any great problem. It makes not an hap'ath of difference to the House whether it is presented to Parliament in response to a 'Return to an Order of the House' or as a 'Command Paper'.

3. Clearly, if possible, it would be nicer to continue the customary practice of using an 'Unopposed Return'. Moreover, given that the Opposition are now using their last Allotted Day in the current Session for an economic debate (also on Thursday 6th November), it may prove impossible to keep the date of the Autumn Statement secret until the day of the Statement itself. Should this occur and an announcement is made, even as late as Wednesday 5th November, we can table the motion for an 'Unopposed Return' that night. It will then appear on the Order Paper on the day of the Statement, and taken formally at the commencement of Public Business. This remit to provide the House with copies of the printed statement can carry through the Sessional break,

and copies deposited in both Houses on the day the Queen opens Parliament (ie 12 November).

4. Alternatively, if we can keep the date of the Statement secret until the day itself, the printed Autumn Statement can be presented (as you suggest) as a Command Paper on 12 November.

5. I do not see either course causing the Printers insurmountable problems. At worst, it will mean printing two front pages to take account of the alternative wording.

B O DYER

pup

FROM: MISS G M NOBLE
DATE: 30 October 1986

MR SCHOLAR

cc Miss Peirson
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr Culpin
Mr Allan
Mr Short
Mr P Gray
Mrs Dunn
Mr Pickering
Mr Gibson
Miss C Evans

AUTUMN STATEMENT BRIEFING

Thank you for your minute of 29 October. I have asked DHSS to include the economic assumptions in the PQ which they will answer on the day of the oral statement giving all the detailed NIC contribution rates. They will include something very close to the wording we are proposing for part 3 of the Autumn Statement. That will cover the earnings assumption and unemployment in 1986-87 and 1987-88, but we need to think a bit further about the assumptions for the later years. It will look a bit odd to include in the NIC PQ because the GAD report only covers 1987-88.

2. Last year, the RPI assumptions were given in the Social Security text of the Autumn Statement and the unemployment assumptions in parenthesis in the NIC section. We do not give earnings assumptions beyond the year ahead. If DHSS issue a press notice on benefit expenditure we could ask them to include the RPI and unemployment assumptions in that; but I am far from certain that they will issue a press notice on benefits because * there are no new policy decisions. Moreover, including the assumptions in a press notice is not quite the same thing as giving them to Parliament. The best option may be to put them in an extra footnote in GEs public expenditure table.

3. Following our conversation, told the DHSS finance division about the split presentation and discussed how it affects the timing of operations at their end. I have asked them to deal on a strict "need-to-know" basis within DHSS.

MISS G M NOBLE

* I have just been told that No 10 have asked DHSS to produce a press notice

c Mr Kuczys

Mr Hudson AJK

Miss Evans

Suspect that action on this will end up with us. Pl will you establish with the Chancellor's office who is to do this, and if it is to be us commission material based on our Queen's Speech entry. MCS 31/10

Spoke Carys Evans, She will take this on. AHH 3.11.

10 DOWNING STREET

CH/EXCHEQUER
REC. 31 OCT 1986
ACTION MR FER BUTLER
COPIES TO CST
SIR P MIDDLETON
MR SCHOLAR
MR TURNBULL
MR CULPIN
MR P R C GRAY

From the Principal Private Secretary

30 October 1986

PWP

Dear Joan,

The Prime Minister wishes to maximise the presentational impact of the Autumn Statement and The Queen's Speech. She wishes the presentation to focus particularly on the Government's future initiatives and plans so as to make clear the Government's continuing programme of reform and innovation. She would therefore like special care to be taken with the presentation of the packages of material which are issued to journalists in connection with the Autumn Statement and The Queen's Speech so that they present the Government's programme to its best advantage.

The Treasury will shortly be in touch with Departments about the arrangements for the preparation and issue of Press Notices on their new spending plans as part of the Autumn Statement.

The Prime Minister wishes to have prepared for The Queen's Speech a tight summary, covering at the most three pages of double spaced text, of the most important and presentationally attractive elements of Departments' legislation and <u>other</u> initiatives which their Minister will be putting forward in the forthcoming session.

The No 10 Press Office already co-ordinates the compilation of briefing material on The Queen's Speech, and will be responsible for the preparation of the summary in this case. Accordingly I ask that you, and those to whom this letter is copied, should send to Bernard Ingham, Chief Press Secretary No 10, <u>two or three paragraphs</u> of appropriate material on their sections of The Queen's Speech. These paragraphs should highlight those particular elements in Departments' legislation and <u>other</u> initiatives for the forthcoming session so as to help No 10 pull together the most attractive parts of the Government's programme. This material should be sent to No 10 by noon on Thursday 6 November.

I am copying this letter to the Private Secretaries of Ministers in charge of Departments.

Yours sincerely

Nigel Wicks

N. L. WICKS

26/176/10

Miss Joan MacNaughton,
Lord President's Office

LD/01

CONFIDENTIAL

PU?P

FROM: A C S ALLAN
DATE: 31 OCTOBER 1986

MR SCHOLAR

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Sedgwick
Mr Turnbull
Mr Culpin
Miss Evans
Mr Dyer

AUTUMN STATEMENT

The Chancellor discussed with Ministers and Advisers at Prayers the date when the printed Autumn Statement should be pubslihed. There was a firm preference for Wednesday 12 November.

2. I understand that there are no logistical or Parliamentary difficulties which rule that out (it may have to be published as a Command paper rather than presented to Parliament in response to a "return to an order of the House"). The Chancellor would therefore wish to go firm on publishing on that date.

ACSA

A C S ALLAN

MR 1/57

CONFIDENTIAL

Pug

FROM: A C S ALLAN
DATE: 31 October 1986

MR SCHOLAR

cc: Miss Peirson
Mr Sedgwick
Mr Turnbull
Mr Culpin
Miss Evans
Mr Dyer

AUTUMN STATEMENT

I showed the Chancellor Mr Dyer's note of 30 October, as you suggested. He now wishes to go firm on publishing the printed Autumn Statement on Wednesday 12 November, if necessary as a Command paper.

ACSA

A C S ALLAN

2136/014

Foreign Off

CONFIDENTIAL

To go round straight after lunch.

DRAFT PRIVATE SECRETARY LETTER

AUTUMN STATEMENT

At this morning's meeting of Cabinet, the Prime Minister said she ~~hoped it would be possible for~~ intended that Cabinet ~~to~~ should discuss the outcome of the public expenditure Survey at its next meeting on 6 November. ~~It is possible, although it cannot be taken for granted, that the discussions will be completed on that day.~~

2. In previous years, the Autumn Statement has been made on the Monday or Tuesday following the Cabinet meeting. This year, Parliament will not be sitting ~~on that day~~ then. Rather than hold over the announcement until Thursday 13 November after Parliament has resumed, the Chancellor ~~will, if~~ plans, assuming all the necessary decisions have been taken, to make an Oral Statement on the afternoon of 6 November. The printed document would be presented to Parliament ~~on Thursday 13 November.~~ the following week.

3. ~~On this hypothesis,~~ ~~If the oral statement is made that day,~~ The Chancellor ~~will support~~ proposes to accompany his Oral Statement with issue Press Notices containing ~~his Oral Statement with~~ the Industry Act forecast and a summary table of the expenditure plans; ~~which will~~ these would also be made available in the Vote Office. ~~and issued as Press Notices~~ He hopes that Departments will be ready as usual to issue Press Notices on the same day giving the main features of their programmes, The Prime Minister has ~~emphasised~~ stressed the importance she attaches to a positive and forward-looking presentation of the

and wherever possible backing that up with appropriate material on output, rather than emphasising the money spent.

main features of the Autumn Statement.

4. ~~Since~~ ~~a~~ A Statement on 6 November would not leave the usual interval ~~of a few days~~ between the Cabinet discussion and the Autumn Statement, and it is therefore particularly important ~~on this hypothesis~~ that the texts of Press Notices should be agreed with the Treasury in advance to ensure both that the figuring is consistent and that the presentation is ~~consistent~~ in line with the way the Autumn Statement as a whole is put over.

5. To ensure that the release of departmental Press Notices is properly co-ordinated with the announcements from the Treasury, I would be grateful if each department could:

(i) notify the relevant Treasury division by Monday morning, whether ~~if, subject to there being a Statement on 6 November,~~ it intends to issue a Press Notice on the day of the Autumn Statement;

(ii) show the Treasury division concerned a draft by close on Monday;

(iii) provide ~~Mr~~ Doug Walters here (233-8652) ~~in the Treasury, (ext 8652)~~ with ~~a~~ the name and telephone number of someone in each Department who can be contacted about the arrangements for sending copies to the Treasury;

(iv) provide this ~~the Chancellor's~~ office ~~in the Treasury~~ with 100 copies of the Press Notice by 4.00 pm on Wednesday; so that we can circulate them if the oral Statement is made the following day.

(v) arrange for the contact to inform ~~Mr~~ Doug Walters by 2.00 pm at the latest on Thursday 6 November if there is to be any modification of the Press Notice following the Cabinet discussion.

6. Although these plans are being made to ~~facilitate a~~ allow for the oral Statement to be made on 6 November ~~announcement~~, this cannot of course be taken for granted. ~~This~~ It will depend on the ~~progress~~ settlement of any programmes still outstanding and on the Cabinet discussion itself. For the time being, therefore, no public statement of the likely date of the Statement should be made. I should be grateful ~~therefore,~~ if you could ensure that knowledge of the arrangements is confined to those who need to know. If Departments are asked about the date of the Statement, they should say that the public expenditure round has not yet been concluded and that the Autumn Statement ~~no final decision has been made and the date of the Statement will depend on the outcome of the Cabinet discussions.~~ will be made as soon as practicable after final agreement has been reached.

7 I am copying this letter to the Private Secretaries to all Cabinet Ministers and to David Norgrove (No10) ~~and to~~ ~~TO~~

A C S ALLAN

PRINCIPAL PRIVATE SECRETARY

SECRET.

FROM: A G TYRIE
DATE: 31 OCTOBER 1986

AP H

PWF

CHANCELLOR

cc Chief Secretary
Ms O'Mara
Mr Hudson
Mr Cropper
Mr Ross Goobey
Mr Scholar

AUTUMN STATEMENT BRIEF

I attach a first draft of the Backbench brief for the Autumn Statement.

2. Alex Allan has made some helpful suggestions for the initial few pages and EB have also given it a preliminary check. Some of the numbers are still liable to change.

3. The Chief Secretary wanted the brief to be comprehensive. My personal view is that it is rather long.

4. Having said that I should mention that I have omitted the following points or departments:

- defensive briefing about the absence of fiscal adjustment (this is the second year of the revised format; I doubt there will be a hallabalou)

- Trade and Industry

- Lord Chancellor's Department

- Nurses' pay omitted from the health section for brevity's sake.

- North Sea taxation.

5. The section "Strategy on public expenditure" has been placed early on to enable the first few pages to serve as a speaking note for Backbenchers. The tone of the key

points ~~in~~ and the Strategy sections are very dependent on the tone of the Autumn Statement itself. I have had a stab at the trade-off between words that would satisfy the markets and words that could provide political ammunition, I have erred on the side of the latter. I have omitted altogether any reference to revenue buoyancy or hints that we can confirm now that we will stick to the PSBR targets next March.

6. I will put thought to better opposition bashing material over the weekend and something on the Alliance. But I expect you would prefer that good knockabout was reserved for Ministerial speeches on the day!

AGT

A G TYRIE

FIRST DRAFT

BACKBENCH BRIEF FOR THE AUTUMN STATEMENT

<u>Key points</u>

1. The economy is strong. It is heading for its fifth year of balanced growth and low inflation.

2. The Government has reviewed its spending plans and decided on increases in priority areas: health, education, including teachers' pay, housing, roads, law and order. These increases can be afforded while keeping public expenditure falling as a precaution of national income.

<u>Alternative paragraph 2</u>

[Prudent management of the economy in past years now permits an increase in priority areas...].

3. Financial discipline is in place. The Chancellor has repeated his commitment to continuing with prudent fiscal and monetary policies. Within this framework some increases can be afforded. The Autumn Statement accords with the 1979 manifesto commitment to reduce the share the State takes of the nation's income.

[4. These plans are both generous and realistic. Generous provision for local authority and social security spending is matched by realistic reserves of £X billion for 1987-88 and £Y billion for 1989-90.]

SECRET

Strategy on Public Expenditure

[Prudent financial management over many areas now permits] [There has been] a significant increase in public expenditure for priority areas, including health, education, law and order and roads spending. The Government has also recognised the need for higher spending on local authorities and social securities. To make room for these the planning total for this year has been increased to X, a Y% increase. Planning totals for subsequent years have been increased to.....Increases for next year include: (three examples for Backbenchers to highlight in weekend speeches).

This has been achieved while implementing a policy of falling public expenditure as a percentage of GDP. By 198990, at X%, spending will be at its lowest level as a proportion of GDP since the early 1970s. The Steady decline ~~is reducing~~ cut in the burden of the State on the private sector, ~~is being maintained.~~

Provision has been increased ~~provision~~ in certain key areas. Substantial reserves have also been provided. These will be enough to ensure that future spending stays within our plans. The reserves for 1988-9 and 1989-90 are set at . [These are slightly smaller than for comparable years in the 1986 Public Expenditure White Paper. The annual increasing steps of £2 billion allow for a prudent margin and for the continuing reassessment of priorities which will take place in later surveys.]

Prudent financial management and flexible planning are the hallmarks of this year's settlement.

Value for money

Getting better value for money from a given level of expenditure has made its contribution. We now have 80,000 fewer civil servants, 500 fewer quangos and savings of many hundreds of millions of pounds from competitive tendering, efficiency scrutinies and cash released from NHS cost improvement programmes. There is more to come. More value for money savings have already been identified in the Civil Service, up to £800 million a year from defence procurement and over £1 billion a year pinpointed from Audit Commission reports on local authorities.

Privatisation. Planned proceeds from privatisation for 1987-88 and 1988-89 have been increased upwards slightly from £4.75 billion to £5 billion. The achievements of the privatisation programme are well known. One-fifth of the State-owned commercial sector inherited in 1979 has been transferred to the private sector. Further important sales are planned, notably British Gas and British Airways. The benefits of privatisation in increased efficiency, more freedom from political bureaucratic interference, and more incentives for management and employees alike, have been enormous.

Economic Prospects

<u>The winning combination sustained</u>. 1987 will be another year of healthy balanced growth with low inflation - the fifth in a row. This is a combination we have not seen for a generation. The growth forecast for next year is 3% compared with 2½% at Budget time. The unemployment outlook is more promising too.

Inflation in recent months has been at its lowest level for almost 20 years. It is now back to the average of the 1950s and 1960s. The forecast shows some rise in the RPI over the next year, but if volatile mortgage interest payments are excluded, inflation will remain broadly static.

<u>The economic upswing is broadly based</u>. The economy is providing balanced growth. Although consumer spending rose by 5% in the year to the third quarter of 1986 this spending is not sustaining the growth. Indeed growth in consumer spending is expected to fall slightly in 1987. The forecast pick-up in growth reflects improved prospects for exports together with an increase in stocks held by industry.

Company profitability is at the highest level for over 20 years. The net growth of new businesses between 1983 and

1985 averaged 550 a week. Last year new company registrations were up 7%, reaching a record level.

Manufacturing output has risen 10% since the June 1983 election. Over the past five years manufacturing held its market share and kept pace with world output better than at any period in recent history.

Balance of Payments. A small current account deficit is forecast for next year. This is the natural consequence of the sharp fall in the oil price.

Export volumes are now picking up after a flat period at the beginning of 1986, reflecting the weakness in world trade. In non-oil terms export volumes rose by 2½% in the third quarter of 1986 on the previous quarter - this is an all-time high. Exports are expected to rise again in 1987.

Net overseas assets stood at £80 billion at the end of last year giving an annual return of over £4 billion. [We are now reaping the benefits of the abolition of exchange control and prudent investment of North Sea oil revenue.]

Employment. Employment has been rising continuously since before the last election - the longest period of sustained employment growth for nearly 30 years. An even more rapid rise in the labour force has kept employment stubbornly high. But, with the labour force growth slowing and economic activity picking up, to say nothing of training and other measures to boost employment, the prospects for a fall in unemployment are more promising.

<u>Borrowing</u>. A firm financial framework is being maintained and public borrowing remains on track. The forecast PSBR of £7½ billion is up only a half billion on the Budget forecast, while the changes being made to the North Sea fiscal regime alone amount to a cost of £300 million this year. [Section needed PSBR and North Sea oil].

The Programmes - Summary Table of Main Changes Here

1. Health. The Government has increased NHS spending by over 24% in real terms between 1978-9 and 1986-7 - an average of about 2½% a year. The totals announced in the Autumn Statement will enable the Government to improve on this excellent record.

Spending on health in 1987-8 will be increased by over 6% on the current year, rising to over £19 billion. There are also further substantial rises for 1988-9, to £19.8 bllion and 1989-90, to over £20.7 billion.

Cost improvement programmes should release a further £150 million in 1986-7 for spending on services to patients.

Spending on NHS capital has risen by 28.5% in real terms between 1978-9 and 1985-6. Under Labour it fell by 30%. Over 100 new hospital schemes are planned to have been completed between 1979-80 and 1989-90. At the moment there are 380 major schemes under way in a £3 billion building programme.

2. Social Security. Total benefit expenditure has risen by 35% in real terms, to £11 billion since 1978-9. Spending on benefits for the long term sick and disabled is up 55% between 1978-9 and 1985-6. The commitment to protect pensioners against inflation has been more than maintained

despite an increase in 850,000 pensioners. Expenditure on retirement pension is up 17% in real terms between 1985-6 and 1978-9.

1987 benefit uprating is fully in line with inflation. The transition has now been completed to regular April upratings.

The estimated outturn for 1986-7 is £44.3 billion for 1986-7, rising to over £49 billion in 1989-90. Total programme amounted to £41 billion in 1985-86.

3. **Education.** Provision has been substantially increased over the 1986 White Paper. The provision for the DES is up 12% on last year. Furthermore £320 million has been made available as part of a package to end the long running teachers' dispute.

Spending for pupils in schools is at record levels; it has risen by 17% in real terms between 1978-9 and 1985-6. Education capital spending will remain broadly at present levels, despite fall in rolls. An additional £10 million in 1987-88 and 1988-89 for voluntary schools' capital represents a substantial increase on the 1986-87 provision.

The science budget has also been increased by £20 million in 1987-88 and 1988-89. The Government is spending £16 million more in 1989-90. There will be a substantial increase for Civil R & D (the Secretary of State for Trade and Industry will announce the precise amount in a few weeks). The <u>universities</u> provision has been increased by £65 million in 1987-88 and £72 million in 1988-89.

4. **Housing.** 1987-88 gross provision for housing is increased by £460 million over the last White Paper. £220 million of this is represented by receipts and the rest by an increase in the base line. In the following years provision will be further increased by £365 million, in 1988-9 and by £370 million, in 1989-90, made available from additional receipts.

Much of the addition is intended for renovation. By channelling the provision through the Urban Housing Renewal Unit (in the Department of Environment) resources will be more effectively used. Audit Commission reports have highlighted much wasteful spending by local authorities. Total capital spending on local authority renovation is already £1.3 billion a year. With current account maintenance and repair, total local authority renovation would be £2.56 billion.

5. **Employment.** The 1986 Budget measures included major increases in programmes for the unemployed, especially the young and the long-term unemployed. The 1986 Budget added nearly £200 million to Department of Employment spending in 1986-87, and nearly £300 million in 1987-8.

These measures are bringing results:

- YTS. About two-thirds of participants are in jobs, further education or training three months after leaving the scheme

- Job Clubs. Two-thirds of people leaving job clubs go directly into employment

- Community Programme. Participants are twice as likely to find work afterwards as the average long-term unemployed.

Total Department of Employment spending (including MSC) is up 96% in real terms between 1978-9 and 1986-7. It is planned to increase to 103% in real terms by 1987-8. Employment training and related measures will be £3 billion in 1987-8, rising to £3.3 billion in 1989-90.

6. Transport. Local authority capital road provision is up £60 million in both 1987-8 and 1988-9. This increase is entirely for local roads. National road provision is up £5 million in 1987-8 and £15 million in 1988-9.

Over 600 miles of motorways and trunk roads were completed between 1987 and mid-1986. The backlog of motorway and trunk road repairs is planned to be eliminated by 1981.

Because of unending privatisation, no separate provision is made for the National Bus Company's external finance in 1987-88. (BR).

7. Defence. Provision for 1987-8 and 1988-9 remains as

planned in the 1986 Public Expenditure White Paper. The provision for 1989-90 gives a cash increase of £490 million over 1988-9. The Falklands costs are now declining markedly, from £570 million (1985-6) to under £130 million (1989-90).

Defence expenditure is broadly stable following a real terms.

hold

8. <u>Law and Order</u>. Law and order spending has increased by 36% in real terms between 1978-79 and 1985-86. An increased provision for police will mean 300 extra officers for the Metropolitan Police and 500 for the provincial forces in 1987-8. An additional £61 million will be available to help the victims of crime in 1988-88 and '89-90 (and £61 million more in 1989-90 than 1988-89), ~~and~~ there will be increased funding for the fight against drugs and for a crime prevention campaign.

The prison building programme consists of sixteen prisons at a cost of £427 million, with four more at the design stage.

9. **Overseas Aid.** Increases in aid are planned to maintain the overseas aid programme to 1989-90 at the same real terms level as 1986-7. The UK aid programme is substantial, the sixth largest among Western donors and the third largest in the EEC.

Aid is important. Perhaps equally crucial in alleviating problems of developing countries is the private sector's direct investment. This rose from £980 million in 1983 to over £2½ billion in 1985.

10. **Energy.** Provision is down by £140 million made possible by the ending of the "coal buying scheme", which was encouraging industries to switch to coal-firing energy generation. The electricity ~~industries~~ industry is forecast to make a record profit in 1986-87. Electricity prices are down 10% in real terms since the 1983 election, contrasting with a real term increase of 27% during the last Labour

administration.

11. **Agriculture.** The substantial spending programme in 1987-88 and the two following years demonstrates the Government's full commitment to British agriculture. Provision will be increased for flood defences to help meet the costs urgently needed to strengthen the sea defences in East Anglia, and the rebuilding of the sea wall at Seaford.

12. **Arts and Libraries.** The provision for 1987-8 represents a 16% increase in real terms on 1978-79. This more than fulfills the Government's 1983 manifesto pledge to keep up the level of support. Even after the deduction of additional post-abolition central funding central Government provision will be 7% higher in real terms over the life time of this Parliament.

Radical and generous changes to charitable giving were announced in the last Budget. These will greatly benefit the arts world, as does the Business Sponsorship Incentive Scheme, which has generated £10.5 million since the Government launched it in 1984.

13. **Nationalised Industries.** Nationalised industry financing requirements are planned to decline progressively over the survey period. They have already declined from £3.2 billion in 1981-82 to £560 million in 1986-87.

14. **Local Authorities.** Grant in 1987-88 is £1.5 billion higher than in 1986-87. This recognises the growth in local

authority budgets, plus the addition for teachers' pay, and is between ½ and 1% above general inflation.

This generous provision should keep average rate rises low, between 2 and 4%, on average, if local authorities spend in line with plans.

Gross capital provision is being increased by £750 million in Great Britain in 1987-88. Extra receipts of around £350 million will also increase the room for gross spending in 1988-89. These plans fully allow for the expected use of spending power from capital receipts.

15. **European Community payments**. The Fontainebleau system is now working as planned and producing larger abatements. The 1986 abatement is £1,250 million, the largest ever received. The 1987 abatement in the draft Community Budget is £1,125 million, but the EC's Budget Council has recognised that this figure will have to be corrected upwards.

The Labour Party

What they did last time

In their first year of office Labour increased spending by X and borrowing by Y. The consequences are well known. Labour were forced into the hands of the IMF. In 1975-6 the ratio of the PSBR to GDP ~~(at 9¼%)~~ in 1975-6 would ~~imply the PSBR~~ translate into a PSBR for the current financial year of over £35 billion.

2. Profligacy on this scale forced the Labour Party into a savage reversal of their spending plans. Even by 1978-9 Labour had still not recovered from these cuts. The damage was particularly severe in capital spending, and contrasts sharply with the record of the Conservative Government.

Capital Spending

	Real Terms percentage increases (1984 85=100)	
	1978-79 over 1973-74	1985-86 over 1978-79
Total capital (gross)	-20	0
Health capital	-31	+28
Road (capital and current, central and local government)	-36	+10

This was the legacy of Labour's tenure, roads unbuilt, hospitals postponed.

What they say they will do

3. Labour spending spokesmen have committed the Labour Party to a spending spree rather more profligate than they implemented in their first years of office in the mid 1970s. The Chief Secretary costed these in February at £24 billion. By July the cost had risen to £28 billion, if a further £7 billion of pledges by Michael Meacher is excluded.

4. Since July the Labour have made a number of further pledges which add about another £8 billion to the £28 billion figure.

5. From time to time the Labour Party try to give the impression that they have learnt the lessons of the past. For instance Mr Kinnock has said:

> "We are not going to be able to say 'yes' to everything. It is no good there being a galaxy of promises which prevents us from being able to fulfill hardly any of them." (Guardian 20 March 1984).

By contrast writing in Tribune Roy Hattersley called for "a massive boost in demand" because "there has to be reflation in the sense that there is a shortage of demand." (Tribune, 10 May 1985).

6. Labour spokesmen have openly admitted that keeping track of the cost of pledges is not a high priority. For example John Smith said "I am not sure that it's important to cost everything in detail." (Tribune 8 November 1985). Since the Chief Secretary added up the cost of Labour's

policies Labour ~~they~~ have responded by implying that some of them may be deferred, but Labour spokesmen have fallen short of saying that they would not be implemented in the lifetime of a Parliament.

7. Clearly Labour hope to "buy votes" ~~on a massive scale~~ with these huge and unsustainable policies. ~~to a wide range of interest groups~~. This is particularly reprehensible on the social services field where vulnerable groups have false hopes held out to them.

8. Since Labour are committed not to increase the basic rate, increased spending would have to be financed out of higher income tax rates, indirect taxation and borrowing. For illustration, if £28 billion were raised from VAT alone, on ready reckoner arithmetic, this would imply a rate of at least 43%. If the basic rate were raised, this would imply an increase for the ordinary taxpayer to 53p in the pound.

Finance C 18:30 Thursday.

Macb staying in Chamber.

Note for meeting & brief in Office

? Whip going out.

015/71

CONFIDENTIAL

Sorry, but this simply won't do. Some of the bracketings — eg Diplomatic wing & aid — are infallible recipes for a massive parliamentary row wh. will completely destroy the reception of the AS. Pse. consult urgently with CST on an approach wh. is viable in Parly terms. (NB I can't imagine Depts, who have been used to put out their own press releases, will wear this degree of concealment anyway)

2. The table also needs to be changed as I have indicated @ X.

From: P R C GRAY

Date: 31 October 1986

CHANCELLOR

Ch

Column order is a bit odd

cc Chief Secretary
Sir P Middleton
PEX
HEGS
Mr Culpin
Mr Scholar
Miss O'Mara
HEDs
Mrs Dunn

ORAL AUTUMN STATEMENT: SUMMARY EXPENDITURE TABLE

I attach the format of the summary table of the revised expenditure plans that we propose you should lay before the House on the afternoon of 6 November.

2. It represents a somewhat simplified version of the full table 2.2 that will be given in the written statement. We do not think it would be prudent to plan to produce the full table on 6 November. Even if all programmes had been settled before 6 November, there is inevitably a degree of uncertainty about some of the component figures - particularly for the territorial departments - which on normal form take a couple of days to sort out. We therefore think it highly desirable to have some degree of flexibility to finalise these details between 6 November and publication of the Written Statement.

3. We propose to achieve this by grouping together in line 18 of the attached format all the territorial departments **and** a few of the other smaller departments who will be separately identified in the full table 2.2 - arts and libraries, PSA, Superannuation and Other Departments.

4. The format also includes some other groupings of departments which will be separately identified in the full table 2.2, namely:

(i) the FCO Diplomatic Wing and ODA are merged.

(ii) IBAP, Domestic Agriculture and Forestry are merged.

Otherwise, all the rows are as will appear in the full table 2.2.

5. Other points you may wish to note on the format are:

(i) figures for 1985-86, which this year we propose to include in the full table 2.2, are omitted.

(ii) underneath the main departmental breakdown, figures are given for a broad spending authority breakdown between nationalised industries, LA relevant current and other departmental spending. ("Other departmental spending" covers central government programmes, local authority non-relevant and capital spending, and those public corporations which are not nationalised industries.) This three way split corresponds to the totals to be shown in the more detailed tables 2.2A, 2.2B and 2.2C in the Written Statement. We propose including these totals in the 6 November table so that you will be able to draw attention to, for example, the figures for LA relevant current spending.

(iii) a memo line is included at the bottom of the table for general government expenditure. This reflects your wish for this aggregate to be given some degree of prominence. We envisage repeating this line in the full table 2.2.

6. We will let you have a version of this table with the near final figures as soon as possible next week. Meantime, it would be helpful to have your reactions to the proposed format.

PRCG.

P R C GRAY

PUBLIC EXPENDITURE PLANS (1)

DEPARTMENTS (Including local authority spending and nationalised industries external finance)	CMND 9702(2) PLANS	ESTIMATED OUTTURN 1986-87	CHANGES FROM PLANS	CMND 9702(2) PLANS 1987-88	1988-89	REVISED PLANS 1987-88	1988-89	1989-90	CHANGES BETWEEN CMND 9702 AND REVISED PLANS 1987-88	1988-89
1. DEFENCE										
2. FCO PROGRAMME including ODA										
3. EUROPEAN COMMUNITY										
4. AGRICULTURE including IBAP/FORESTRY										
5. TRADE AND INDUSTRY										
6. EXPORT CREDITS GUARANTEE DEPT										
7. DEPT OF ENERGY										
8. DEPT OF EMPLOYMENT(3)										
9. DEPT OF TRANSPORT										
10. HOUSING										
11. OTHER ENVIRONMENTAL SERVICES										
12. HOME OFFICE										
13. LORD CHANCELLOR'S DEPARTMENT										
14. EDUCATION & SCIENCE										
15. DHSS-HEALTH & PSS										
16. DHSS-SOCIAL SECURITY										
17. CHANCELLORS DEPARTMENTS										
18. TERRITORIAL & OTHER DEPARTMENTS										
19. PRIVATISATION PROCEEDS										
20. RESERVE										
21. ADJUSTMENTS(4) ALLOWANCE FOR SHORTFALL/LONGFALL										
PLANNING TOTAL										
COMPARISON OF CMND 9702(2) AND REVISED PLAN BY SPENDING AUTHORITY										
NATIONALISED INDUSTRIES										
LA EXPENDITURE RELEVANT FOR RSG										
OTHER DEPARTMENTAL SPENDING (5)										
MEMO ITEM:										
GENERAL GOVERNMENT EXPENDITURE (6)										

PLANS

Why not repeat these 3 columns for 87-88 & 88-89 with single column for 89-90 (new) plans

1] Except were specified otherwise, the rounding conventions used in this table are for figures to be rounded to the nearest £10 million, except for social security, the spending authority breakdown and the planning total which are rounded to the nearest £100 million. Differences have been calculated on unrounded figures and rounded in the same way as their equivalent total: figures may therefore not sum to totals or changes shown.

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

3] Compared with the last White Paper (Cmnd 9702) overall provision for the Department of Employment has been increased by £195 million in 1986-87, £290 million in 1987-88 and £329 million in 1988-89.

4] Double counting of agricultural spending in Scotland and Wales which is also included in the totals for Agriculture. The 1986-87 estimated outturn figure includes external finance of £400 million for nationalised industries to be privatised that year.

5] Includes local authority capital and non-relevant current expenditure.

6] Figures in "Cmnd 9702 plans" columns are as in the 1986 Financial Statement and Budget Report. The estimated outturn for 1986-87 is rounded to £0.1 billion and revised plans for future years are rounded to £0.5 billion.

The Association of
British Chambers of Commerce
Sovereign House, 212a Shaftesbury Avenue
London WC2H 8EW
Telephone: 01-240 5831/6 Telex: 265871 MONREF G CHA001 Fax: 01-379 6331
DIRECTOR-GENERAL: R.G. TAYLOR

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REC. 04 NOV 1986 4/11
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COPIES TO CST FST EST MST
SIR P MIDDLETON
SIR T BURNS
MR F E R BUTLER
MR MONCK
MR SCHOLAR
MR SEDGWICK
MR MOORE
MR PERETZ MR CULPIN
MR GILHOOLY MR CROPPER
MR TYRIE MR ROSS GOOBEY

Rt Hon Nigel Lawson MP
The Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1P 3AG

31 October 1986

Dear Chancellor

I thought it would be helpful if, in the period immediately before the Government's Autumn Statement, I drew to your attention certain important evidence from the Third Quarter Regional Business Survey conducted by the UK Chambers of Commerce, on which a full analysis has just been concluded.

The most disturbing conclusion to come from the Third Quarter Survey is that, while there has been a slight increase in the trend of orders during the quarter from the home market, orders from export markets have decreased yet again and the balance is now totally flat i.e. the number of firms reporting increases in export orders is completely cancelled out by the number of firms reporting decreases. I attach the balance figures (determined by subtracting the percentage of companies reporting decreases from the percentage reporting increases). This evidence prompts us to emphasise our concern at the extremely disturbing trend in the balance of payments, with their implication for UK industrial production and employment - a reversal of the current balance from a surplus of £3,602m in 1985 and a total surplus of £942m in the first half of 1986 to a deficit of £1,151m in the third quarter alone of 1986 (with a deterioration in the non-oil visible balance from a deficit of £2,345m in the second quarter of 1986 to one of £3,718m in the third quarter and in the manufacturing trade balances from a deficit of £612m in the second quarter to £1,951m, in the third quarter.)
As I said, these trade and production developments have implications for employment, and our survey shows overall a slight deterioration in the prospects for employment. Unfortunately the deterioration is most marked in regions which already have high unemployment: the West and East Midlands, Greater Manchester and Merseyside, the North East and Wales.

So far as policy options are concerned I must emphasise the following:-

1. The Third Quarter Survey shows interest rates being far and away the most important obstacle to expansion: and these surveys were taken before the recent 1% rise in interest rates.

2. Although in the past quarter there has been a considerable movement towards what Chambers would regard as a favourable exchange rate regime (a lower sterling exchange rate against the European - but not the Japanese - currencies which are most important for export trade and import competition, and a stable rate against the dollar in which imports and raw materials are priced), the latest surveys show concern that this situation, which augurs well for UK trade competitiveness in nine months time, may not

../..

last. We would again urge membership of the exchange rate mechanism of the EMS, which would help to ensure stability; otherwise, we urge an interest rate policy designed to avert sharp rises in the sterling exchange rate if, for example, the price of oil rose.

3. The Third Quarter Survey shows that concern about the level of pay settlements now ranks equal second (to the burden of local authority rates) as an obstacle to future expansion. The ABCC believe that you are right to continue emphasising the dangers to competitiveness and employment resulting from pay settlements averaging twice or three times the rate of inflation and well beyond any productivity gains, thus there is little cheer on the unit wage costs front. Chambers of Commerce do not negotiate pay settlements on behalf of their members, which are predominantly small and medium sized enterprises unable to dictate the outcome of industry-wide settlements. We believe that a policy initiative rather than simple exhortation is required and will be addressing the problem in our Representations for the 1987 Budget. Meanwhile, the business community will be carefully watching developments in the teachers' pay negotiations, because of what this may imply for the remainder of the public sector and the private sector in the forthcoming pay round. We support the clear statement by the Secretary of State for Education that pay concessions of the kind envisaged should be matched by realistic, visible and lasting improvements in efficiency, productivity and working practices.

4. Chambers would react strongly on behalf of their 50,000 members if there were to be increases beyond the rate of inflation in public utility charges - particularly electricity, gas and water. We support the objections expressed by the Chairman of the Thames Water Authority over the proposed rescheduling of debt repayments, which will have serious consequences for water charges. We should also be critical if the final rate support grant settlement (which should take account of the Government's proposals for teachers' pay) made sharp rate increases inevitable.

5. Finally, I would reiterate once again our powerful arguments (put to you in the letter of 15 July from our Chairman of Council, Tommy Macpherson, and developed in our paper "Invest Now, Save Later" published earlier this year) for a substantial programme of capital investment in infrastructure projects, notably, housing repairs and improvement particulary in inner cities; improvement of the water and sewage system; and continuing development of the UK road and railway system (on which we must acknowledge the progress that has already been made). We believe that such spending would be cost effective in terms of contribution to industrial efficiency and to diminishing unemployment and we should be wary indeed of public spending increases in the next financial year which are simply designed to be absorbed in public service pay increases.

I am sending copies of this letter to the other Ministers concerned: the Secretaries of State for Trade and Industry, Employment, Environment, Education and Science, Transport, Social Services and the Chief Secretary to the Treasury.

Yours sincerely

Roger Burman

R S Burman

Chairman of the Economic and Industrial Committee

EXPORT ORDERS (BALANCES) 1986

REGION	1ST QUARTER	2ND QUARTER	3RD QUARTER
London & South East	+23	+1	+10
East Anglia	+20	0	+3
East Midlands	+18	-3	-20
West Midlands	+10	-1	-8
Greater Manchester	+16	-22	0
Merseyside	+10	+8	-6
Yorkshire & Humberside	+6	+1	+2
North East	+6	+3	+5
South West	+15	+22	+16
Bristol and West	+23	0	+6
Scotland	+21	+17	0
Wales	+12	+9	+7
TOTAL SURVEY	+14	+1	0

RC2.69

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1. ~~Tony~~ rex
2 PWP

FROM: CATHY RYDING
DATE: 3 November 1986

MR SCHOLAR

cc Sir P Middleton
Sir T Burns
Mr F E R Butler
Miss Peirson
Mr Sedgwick
Mr Turnbull
Mr Culpin

AUTUMN STATEMENT: PRESENTATION ON 6 NOVEMBER

The Chancellor has seen your minute of 3 November.

x| 2. He is content with the APRT presentation you suggest. His preferred colour for the Treasury document folder is blue.

C.R

CATHY RYDING

CE30

CONFIDENTIAL

FROM: M C SCHOLAR
DATE: 3 NOVEMBER 1986

CHANCELLOR OF THE EXCHEQUER

c/ content with APRT presentation suggested in Para 3? OK
Which colour would you prefer for the Treasury documents folder? - unfortunately grey isn't available. Blue
CR 3/11

cc Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Miss Peirson
Mr Sedgwick
Mr Turnbull
Mr Culpin

AUTUMN STATEMENT: PRESENTATION ON 6 NOVEMBER

Assuming Cabinet reaches agreement on Thursday we shall be issuing four documents as you sit down after making your oral statement

(a) copy of your oral statement
(b) the Industry Act Forecast press notice
(c) the Public expenditure table press notice
(d) Revenue Ready Reckoner (ie what will be Chapter 4 of the printed document)

These will provide virtually all the information to be included in Chapters 1, 2 and 4 of the printed document. The rest will be in press notices issued by other departments - eg, in the DHSS PQ and press notice, which will provide all the significant information later to go into in Chapter 3.

2. We propose to release the four Treasury documents under cover of a folder overprinted with the attached standard Autumn Statement cover layout. There is a choice of three colours, cream, blue or white (samples attached) - we would be grateful to know which you prefer. We think this is the simplest and quickest means of packaging the documents (it avoids the need for stapling or tagging) in the short time available after Cabinet.

3. The Inland Revenue will be issuing a press notice on the APRT change. To make life bearable after 1.00pm on Thursday we are trying to cut down the number of documents which will go into the Treasury

folder. We suggest, therefore, that the Inland Revenue press notice should not be included in our folder; and that we cover the APRT change by adding a separate section to (d) above - as we will have to do in any event in the printed document. Chapter 4 should be renamed (perhaps "Oil taxation and revenue ready-reckoner" instead of the present "The Revenue effects of Illustrative Tax Changes")

4. Are you content with this presentation please and may we know your preferred colour for the press notices folder?

MCS

M C SCHOLAR

Autumn Statement 1986

HM TREASURY
NOVEMBER, 1986

SM2/77

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2355

1985 AS: 2100
1984 AS: 1828
1983 AS: 1170.

FROM: A P HUDSON
DATE: 3 NOVEMBER 1986

PS/CHIEF SECRETARY

cc Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Scholar
Mr Turnbull
Mr Sedgwick
Miss O'Mara
Mr Culpin
Mr Gray
Miss Noble
Mr Pickering
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Ch

This is wordcount 2355 (abt 17 min) – a bit longer than previous yrs, as expected given that the written doc will not be available.

AH

AUTUMN STATEMENT

I attach the Chancellor's own draft of the Oral Statement.

2. The sections on detailed public expenditure measures are pending the Chief Secretary's views.

3. Please could I have comments and additional contributions by close tonight?

AH

A P HUDSON

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

Cabinet today agreed the Government's public expenditure plans for the next three years.

In the normal course of events that would be followed by the publication of the printed Autumn Statement, accompanied by an Oral Statement to the House, next Tuesday.

For obvious reasons that is not possible this year.

So while the Autumn Statement will be printed in the normal way and laid before the House as soon as it reassembles next Wednesday, I thought it would be for the convenience of the House if I made my Oral Statement today.

This will cover all three of the key elements in the printed Statement: the Government's outline public expenditure plans for each of the next three years and the expected outturn for this year, proposals for next year's national insurance contributions, and the forecast of the economic prospects for 1987 required by the 1975 Industry Act.

Summary tables for both public expenditure and the economic forecast will be available from the Vote Office as soon as I have sat down. // P I turn first to the outturn

for the current financial year, 1986-87.

The public expenditure planning total now looks likely to amount to some £140½bn // £1½bn, or a little over 1 per cent, more than was allowed for in this year's Public Expenditure White Paper. The main reason~~s~~ for this excess is an 8 per cent rise in the current spending of local authorities - far more than was provided for. However, two major items of public expenditure which lie outside the planning total, debt interest and the overseas borrowings of the nationalised industries, are likely to fall £1bn short of what was forecast at the time of the Budget, which reduces the overall expenditure overrun to about £½bn.

On the revenue side, the North Sea tax take is likely to be even lower, by about £1bn, than I envisaged at the time of the Budget, largely because for a long period the oil price has been below the $15 a barrel level on which the Budget arithmetic was explicitly based.

This shortfall, however, is more than offset by the continuing buoyancy of non-oil revenues, in particular VAT and Corporation Tax, which now look likely to exceed the Budget forecast by £1½bn. This would imply an overall revenue overrun of about £½bn, the same as the projected expenditure overrun.

At the same time I have one tax change to announce.

The collapse of the oil price has led to a sharp cutback

SECRET

in investment activity in the North Sea, with inevitable consequences for the UK offshore supplies industry both in Scotland and the North of England.

Against this background the Government is conducting a review of the North Sea fiscal regime, and I shall be announcing my conclusions in the light of that review in the Budget.

But given the current difficulties of the offshore supplies industry, there is one change I believe it right to make without further delay.

I propose, on a carefully targeted basis, to accelerate the arrangements for the repayment to the oil companies of Advance Petroleum Revenue Tax due to them.

The details of this change, which will require legislation early in the new Session of Parliament, are set out in a Press Notice the Inland Revenue will be issuing as soon as I have sat down.

The new arrangements will result in a loss of revenue this financial year of some £300m, which will of course be fully recouped over the next three years.

Taking this into account, the Public Sector Borrowing Requirement for the current year is now forecast to be about £7½bn, slightly above the £7bn figure which I set in the Budget. // I turn now to the public expenditure plans for the next three years. This year, for the

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fourth successive year, public spending is set to decline as a proportion of national output.

And this remains true even before deducting the proceeds of privatisation.

The Government is determined to ensure that this trend continues: to see to it that total public spending, even without taking account of privatisation proceeds, continues to decline as a percentage of GDP. The plans I am about to announce secure that objective. But within this overall constraint the Government has felt it right, in the context of its policy priorities, to allow an increase in the previously announced planning totals for 1987-88 and 1988-89.

The new totals have been set at £148½bn for 1987-88 and £154½bn in 1988-89, an increase of £4½bn and £5½bn respectively.

For 1989-90 the planning total has been set at £XYZbn.

//P Compared with the forecast outturn for 19~~9~~86-87, these totals suggest an average growth of public spending of a shade over 1 per cent a year in real terms, well within the prospective growth of the economy as a whole.

As usual, these totals incorporate estimates for the proceeds of privatisation. Last year I increased the estimate of these proceeds very substantially to £4¾bn in each of the three Survey years, a figure which I expect

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SECRET

to be duly achieved this year.

Although the privatisation programme is now moving ahead more strongly than ever before, I have decided to make only a modest further addition to this estimate, bringing it to £5bn in each of the next three years.

The new planning totals also contain substantial reserves, rising from £3½bn in 1987-88 to £7½bn in 1989-90.

[These are larger than in any previous survey with the exception of last year's, when, exceptionally, local authority provision was artificially set at the same cash figure for all three years and special allowance had to be made for this in setting the reserves.]

The public expenditure increases I have announced allow us to make realistic provision both for local authority current expenditure, over which the Government has no direct control, and for demand-led programmes such as social security, while still leaving scope for increased spending on services to which the Government attaches particular priority.

But before referring to some of the more important changes, let me make one thing absolutely clear.

There can be no question of allowing the projected increases in public expenditure over the next three years

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to undermine the prudence of the Government's overall fiscal stance, either next year or subsequently.

The Government's fiscal stance will remain as set out in the medium-term financial strategy published at the time of this year's Budget.

Pending CST's news

[The largest increase comes on local authority current spending, where provision for 1987-88 and 1988-89 had previously been set at the same cash level as in 1986-87, pending further decisions. Full account has now been taken of likely future levels of spending, and this has meant an increase of £4bn in provision for 1987-88. Over half of this increase is for education, including the new proposals on pay and conditions of service for teachers announced last week. A further major portion of the increase is for the police. In subsequent years provision has been set so as to grow [broadly in line with] inflation.

In addition to the increased provision for the cost of education in schools contained within local authority current spending, there will be additional provision for universities of £60m in 1987-88 and £70m in 1988-89.

Spending on the health service will be increased by £310m in 1987-88 with further increases in subsequent years. Combined with the resources increasingly being generated

SECRET

by greater efficiency, this will not only meet the growing demands on the health service but will allow it to improve services.

In addition to enjoying the benefits of substantially higher receipts from council house sales - nearly £1bn over the three years - housing investment will be increased by £225m in 1987-88. This will sustain the rising trend of spending on renovation and improvements and provide extra resources for the housing associations.

In the light of this year's experience, £1¼bn has been added to next year's provision for social security, most of which represents greater take-up of existing means-tested benefits.

For defence, the provision remains as planned in the last White Paper after allowing for minor changes, including a reduction in the estimated cost of the Falklands deployment. The defence programme will continue to benefit from the substantial real growth in previous years and the wide-ranging action to improve efficiency and value for money.]

A summary table setting out the figures for each programme will be available in the Vote Office as soon as I have sat down, and further details of these and other changes will be contained in the printed Autumn Statement which will be published as soon as the House returns next

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week. In addition, full details, together with information on running costs and manpower, will be given in the public expenditure White Paper early in the New Year.

I now turn to National Insurance contributions. The Government have conducted the usual Autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the national insurance fund, and taking account of the benefit uprating which my Rt Hon Friend the Secretary of State for Social Services announced on 22 October.

The lower earnings limit will be increased next April to £39 a week, in line with the single person's pension, and the upper earnings limit will be similarly raised to £295 a week. The limits for the reduced rate bands which I announced in last year's Budget will also be increased again in April, but by proportionately larger amounts. Thus the upper limit for the 5 per cent and 7 per cent bands will be raised to £65 a week and £100 a week respectively, and the upper limit for the 9 per cent rate for employers will be raised to £150 a week. The taxpayer's contribution to the National Insurance Fund - the so-called Treasury Supplement - will be reduced by 2 per cent to 7 per cent, but this will not require any change in contribution rates. Thus the main Class I contribution rates will once again remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

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Finally, I turn to the Industry Act Forecast.

Both growth and inflation have turned out to be slightly lower this year than I envisaged at the time of the Budget.

Growth now looks like turning out at 2½ per cent, against a Budget forecast of 3 per cent, and inflation in the

x Fourth Quarter of this year now looks likely to be 3¼ per cent, against the Budget forecast of 3½ per cent. The principal reason for this slower growth has been the disappointing performance of exports, which were hard hit by the cutback in spending by OPEC and other primary producers affected by the sharp fall in commodity prices in general and the oil price in particular. These are export markets of particular importance to the UK.

Combined with a halving in the value of our own oil exports, this has meant a significant deterioration in the current account of the balance of payments, a surplus of from £Xbn in 1985 - and a cumulative surplus of £YZbn over the six years from 1980 to 1985 inclusive - to a forecast of broad balance for 1986.

Looking ahead to 1987 the prospects are generally encouraging. While the inescapable adjustment of the exchange rate to the oil price collapse has now taken place, it will inevitably take time before the full benefits come through in higher non-oil exports and

reduced import penetration at home.

This means we can expect the current account of the balance of payments to go into deficit next year, for the first time since 1979, to the tune of some £1½bn.

Even so, exports are forecast to rise next year by 3 per cent, compared with an increase of only 1 per cent this year, with manufacturing output, in consequence, up by 4 per cent. And with domestic demand continuing to expand at the same rate as this year, the economy overall is likely to grow by a further 3 per cent next year - the sixth successive year of growth at 3 per cent or thereabouts, and into the seventh.

Recorded inflation is likely to edge up a little, to 3¾ per cent in the Fourth Quarter of 1987.

This is [entirely/almost entirely] due to the effect on the RPI of the timing of mortgage rate changes, and the Government's commitment to a monetary policy that will squeeze out inflation remains unabated.

Meanwhile the likelihood of faster growth next year, coming at a time when unemployment already appears to have stopped rising, suggests that the prospects for some fall in unemployment are now more promising than at any previous time this decade.

But this promise could still be frustrated by

SECRET

11

excessive pay settlements. // The full text of the Autumn forecast is to be published today and is now available in the Vote Office.

It will, of course, also be included in the printed Autumn Statement next week.

Mr Speaker, the strategy we have followed since 1979 has brought inflation down to the lowest level for two decades, combined with sustained growth and steadily rising living standards.

This is a combination that has eluded successive Governments for a generation. We have brought it about by the determined pursuit of free markets and sound money.

And that is what we will stick to.

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pup

Table 1: Changes to Planning Total

		1987-88	1988-89	1989-90
1.	Opening Reserves (after Budget measures)	6.1	7.9	9.6
2.	Total additions to programmes (see C(86)22)	7.5	8.1	10.6
3.	Excess over Reserves	1.4	0.2	1.0
4.	less increase in privatisation proceeds	-0.2	-0.2	-0.2
5.	New Reserves required	3.5	5.5	7.5
6.	Increase in planning total (3-4+5)	4.7	5.5	8.3
7.	Baseline	143.9	148.7	153.2
8.	New planning totals	148.6	154.2	161.5

SECRET (until after Autumn Statement)

Table 2: Public Expenditure Trends

		1985-86	1986-87	1987-88	1988-89	1989-90
(i)	Planning total (cash)	133.6	140.4	148.6	154.2	161.5
(ii)	Planning total (real terms 1985-86 prices)	133.6	136.5	139.3	139.6	142.1
	Percentage change	-2.9	2.2	2.0	0.2	1.7
	Average over Survey					1.3

		1978-79	1982-83	1986-87	1987-88	1988-89	1989-90
(iii)	General government expenditure as a proportion of GDP						
	Including privatisation proceeds	43¼	46¾	43¼	42¾	41¾	41¼
	Excluding privatisation proceeds	43¼	47	44½	44	42¾	42¼

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until after Oral Statement
then UNCLASSIFIED

TABLE 3

Prospects: summary

	Outturn 1985	Forecast 1986	Forecast 1987	Average errors from past forecasts*
A. Output and expenditure at constant 1980 prices (percentage change on year earlier):				
Domestic demand	3	3½	3½	1
of which:				
Consumers' expenditure	3½	5	4	1¼
General Government consumption	½	1½	1½	1
Fixed investment	2	2	2½	2¼
Change in stockbuilding (as per cent of level of GDP)	½	0	½	¾
Exports of goods and services	6	1	3	2½
Imports of goods and services	3	5	4½	3
Gross domestic product: total	3½	2½	3	¾
manufacturing	3	0	4	2½
B. Balance of payments:				
Current account (£ billion)	3½	0	-1½	3
C. Inflation:				
Retail prices index (percentage change Q4 on Q4)	5½	3¼	3¾	2¼
	1985-86	**1986-87**	**1987-88**	
Deflator for GDP at market prices (percentage change on year earlier)	6	3	3¾	2
D. Money GDP at market prices (percentage change on year earlier):	9½	5½	7	1¾

Source: Forecasts for 1986 and 1987 and average errors on past forecast published in Autumn Statement Table 1.14.

* Errors relate to average differences (on either side of central figure) between forecast and outturn: relevant to forecast for next calendar or financial year. For method of calculating these errors, see 'Economic Progress Report' June 1981. Margins of error based on forecasts made in ten years 1975-1984. Errors after adjustment for effects of major changes in fiscal policy where excluded from forecasts.

WPU

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SECRET

Pwp.

FROM: MISS C EVANS
DATE: 3 NOVEMBER 1986

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Scholar
Mr Sedgwick
Mr Turnbull
Miss Noble (Chapter 3 only)
Mr M Williams (Chapter 4 only)

CL
A few comments on chapter?

AA

(not as urgent as other stuff).

PRINTED AUTUMN STATEMENT: FIRST PROOF

... I attach a proof copy of the printed Autumn Statement which will be published on 12 November. The document is printed in Treasury House Style ie following this year's FSBR. The two page table (this year Table 2.3) detailing public expenditure plans will, as last year, include colour.

2. We would be grateful for your comments on the attached ~~draft~~ Chapters. A revised proof will be submitted at the end of the week.

Front cover and title page

3. Publication on Wednesday 12 November means that the document will need to be in the form of a Command Paper. The front cover will have a Command Number in the bottom right-hand corner and the title page will be on the lines of the public expenditure White Paper.

Chapter 1: Economic Prospects for 1987

4. The attached text has been amended to take account of the comments you made on the draft submitted by Mr Sedgwick on Friday. EA have submitted a clean typed version this evening to Sir Terence Burns of which Mr Allan has a copy.

See separate folder

Chapter 2: Outline Public Expenditure Plans for 1987-88 to 1989-90

Attached

5. You commented on an earlier version of this chapter (Mr Allan's minute of 29 October to Mrs Dunn) and the attached has been

extensively redrafted to take account of your comments and those of the Chief Secretary. The paragraphs dealing with individual departments are still in the process of being cleared with them. The figures are also still being refined. We have included two tables for public expenditure trends on the lines you suggested. The graphic designers have also drawn up charts showing general government expenditure in real terms and as a percentage of GDP.

Almost nil this included

6. You suggested that the text on the various specific programmes should include information on output. This is difficult to do within the confines of the Autumn Statement where there is only space to describe the main changes to the programmes at fairly aggregate levels. Your Private Secretary's letter to departments did however urge them to cover outputs as well as the changes in provision. In addition, we suggest a more prominent reference to the fact that this information will be included in the White Paper.

Attached (not shown to you at the time)

7. You also asked about the classification change affecting ECGD. Mrs R J Butler's submission to the Chief Secretary on 25 March (copied to your Private Secretary) sought permission to make a number of non-controversial classification changes at the start of the Survey when the baselines were being settled. The purpose of the ECGD change was to move their figures from an accruals to a cash basis, to bring them into line with all other elements of the planning total. Miss Rutter's minute of 11 April gave the Chief Secretary's approval for certain of these changes including ECGD. Other changes made at the same time include switching the Covent Garden Market Authority to List I from List II public corporations.

8. At the time of Mrs Butler's submission it was thought that the change in ECGD would add £28 million to the planning total in 1987-88. In the event, when ECGD submitted the data to amend the data base it was realised that due to further previously unsuspected difficulties, £47 million would need to be added. But by this stage, it would not have been feasible to reverse the process.

Chapter 3: National Insurance Contributions

9. This Chapter is in the same form as last year. The sentence in square brackets at the end of the second indent of paragraph 3.02 will need to be amended to ensure consistency with the GAD report. The figures in Table 3.1 are still provisional.

Chapter 4: Oil Taxation and Revenue Ready-Reckoner

10. As foreshadowed in Mr Scholar's minute of today we have changed the title of this Chapter to include the APRT change. You will wish to focus on the text of paragraphs 4.01-4.03 describing the APRT measure. This is a Revenue draft as amended by Mr Scholar. Mr Williams is content.

11. The remainder of Chapter 4 follows the content and layout of earlier years with one exception. Last year, the ready reckoner showed the effects of tax changes on taxpayers' liabilities (full year effects) and on receipts of tax in the first year. This year the Chapter shows the effects on receipts in both the first year (1987-88) and the second year (1988-89): this change mirrors a similar change introduced in this year's FSBR.

Carys Evans

MISS C EVANS

Autumn Statement 1986

HM TREASURY
NOVEMBER, 1986

Autumn Statement 1986

Return to an Order of the House of Commons dated 13 November 1986: for

Copy of Autumn Statement 1986
as laid before the House of Commons by
the Chancellor of the Exchequer on 13 November 1986

Treasury Chambers
13 November 1986 } Nigel Lawson

Ordered by the House of Commons to be printed 13 November 1986

HER MAJESTY'S STATIONERY OFFICE LONDON

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Contents

CHAPTER 1

1 Economic prospects for 1987

Ch Ignore this chapter see P Sedgwick note with re-draft.
AA

Summary

Inflation should remain low: the recent rise in mortgage interest payments will add about half a per cent to RPI inflation over the next year taking it to 3¾ per cent in the fourth quarter of 1987

1.01 GDP is forecast to grow by 3 per cent in 1987, following growth of 2½ per cent this year. ~~Excluding mortgage interest costs, retail price inflation should remain close to its present level, rising by 3¼ per cent in the year to the fourth quarter of 1987.~~

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

1.03 For 1986–87, total Government borrowing (the PSBR) is forecast ~~at~~ a £7½ billion, £½ billion higher than at Budget time as a result of changes ~~to~~ in oil taxation. For 1987–88, the forecast assumes ~~that sterling's effective exchange rate remains at broadly its present level and that interest rates are appropriate to achieve the aims of the MTFS.~~

, as in the 1986 MTFS, that the PSBR will be 1 3/4 per cent of GDP. The sterling index is assumed to stay at broadly its present level

1.04 ~~The forecast assumes~~ It is assumed that North Sea oil prices average $15 a barrel over the next year. ~~and that sterling's effective exchange rate remains at broadly its present level.~~

World economy **1.05** GNP in the major industrial countries has been rising by 2½–3 per cent a year since 1984. Domestic demand has been rising quite strongly over the last year, but a fall in exports to countries outside the OECD area, including OPEC, has held back overall GNP growth and caused a larger fall in the growth of industrial output. Low inflation ~~and interest rates~~ seems likely to contribute to the strong growth in domestic demand in most major economies through 1987, while exports to countries outside the OECD area should fall less than this year. Markets for UK manufactures are forecast to grow by about 4½ per cent in 1987 compared to a likely 2 per cent in 1986.

xx

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

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

Inflation **1.08** Inflation has fallen this year with the retail prices index rising by 3 per cent in the year to September compared to 5½ per cent in the year to the fourth quarter of 1985. ~~This~~ The low rate of inflation is likely to lead to some reduction in pay settlements~~, over the pay round just starting~~. At the end of 1987, RPI inflation is forecast at 3¾ per cent , but excluding the effect of mortgage interest rates should be much the same as it is now.

Trade and the current account

1.09 The decline in oil prices, coupled with a pause earlier this year in the growth of the volume of world trade, ~~has led to a deficit on the UK's current account in recent months~~ means that the current account is likely to be close to balance in 1986. The volume of UK non-oil exports has been growing again, and this ~~recovery~~ should continue in 1987 at a pace reflecting the faster growth in UK ~~export~~ markets and the UK's improved competitiveness. At the same time ~~T~~the volume of imports is likely to continue to rise as domestic activity expands. The current account may show a deficit of some £1½ billion next year.

World economy

Recent developments

1.10 Real GNP in the major seven countries has been growing at a rate of 2½–3 per cent a year since the end of 1984. Industrial production in 1986 has grown slowly ~~as a result of the~~ : reflecting the weakness in exports to OPEC and other developing countries~~, and falls in energy-related activity~~.

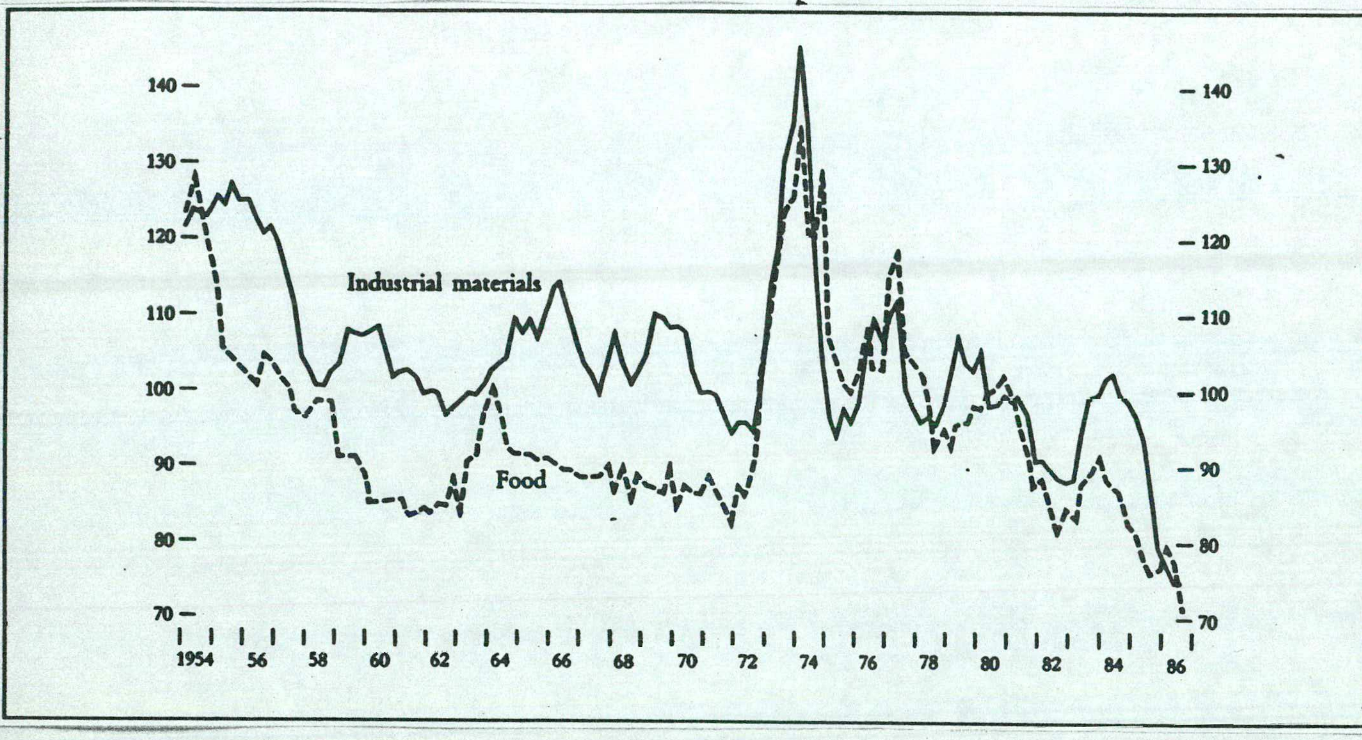
1.11 In the second quarter of 1986 domestic demand in the seven major countries was about 4 per cent higher than a year earlier. But exports have been weak, while imports have grown rapidly. Both these developments are in part the result of ~~reflect~~ the fall in primary commodity prices and~~, more recently,~~ the collapse in oil prices. The producers of oil and other primary commodities have had to reduce their imports while consumers in the industrial countries, enjoying lower inflation and large increases in real incomes, have now started to spend more. Consumer prices in the major economies are now only 1½–2 per cent higher on average than a year ago; in Japan and Germany they are lower.

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

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

Real

Chart 1.1 Commodity prices



1.14 Oil prices fluctuated in the \$8–\$15 per barrel range over the summer months, moving towards the top end of the range when OPEC announced a short-term production agreement for September and October—now extended to December. Non-oil commodity prices, particularly food prices, ~~have remained weak,~~ Industrial materials prices reached a post-war low in real terms in mid-1986, ~~but~~ have recovered slightly. ~~since August.~~ Charts 1.1 and 1.2 show past developments in ~~oil and~~ non-oil commodity prices.

fell during the first half of this year

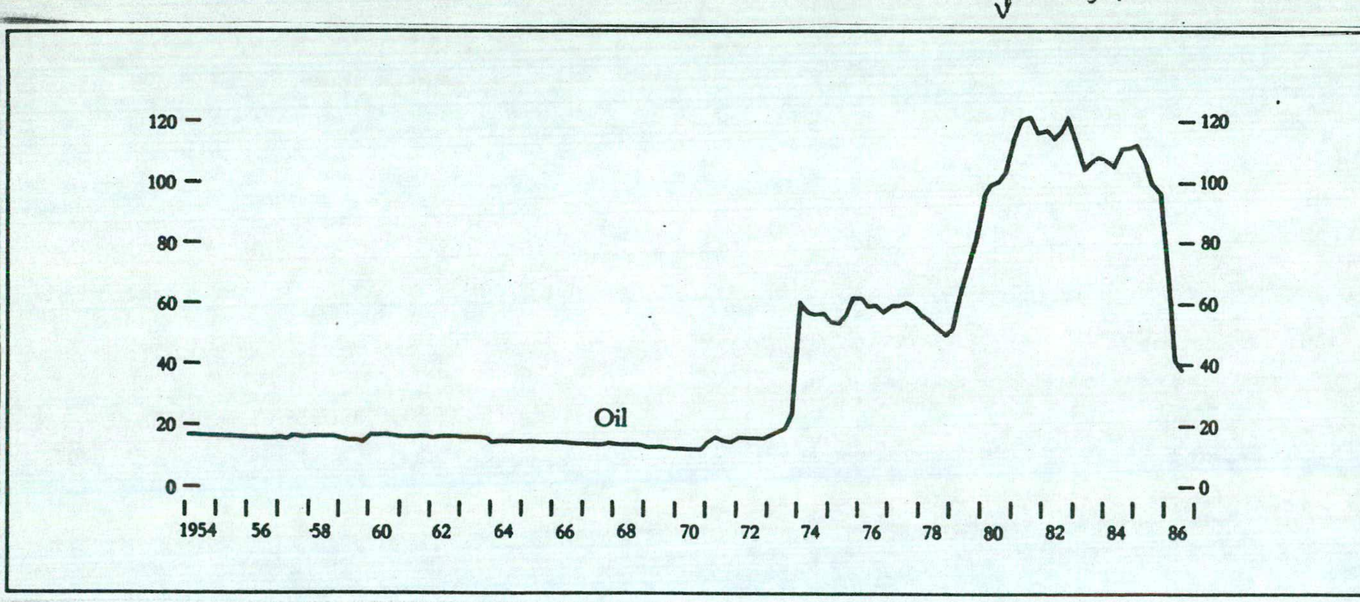
Since August the prices of industrial materials

and oil

Real

Chart 1.2 Oil prices

printer close gap.



1.15 World import volumes seem likely to rise by about 4½ per cent in 1986, partly as a result of increased trade in oil. However, weak trade in manufactures at the start of the year and depressed demand in oil producing countries have led to UK export markets for manufactures growing more slowly than world imports in 1986.

Prospects

1.1~~5~~6 World oil demand may have increased this year, following the decline~~s~~ ~~in~~ during ~~most of~~ the past five years. Further increases are likely in the next few years partly in response to the lower real oil price. At the same time, low oil prices may lead to lower production in non-OPEC countries and cutbacks in development activity. ~~As OPEC oil is effectively the residual source of supply, there should be scope for higher levels of production. This should help to stabilise oil prices.~~ There should be scope for OPEC to increase production in line with increased demand and any cutbacks in non-oil production. The forecast assumes that North Sea oil prices average $15 a barrel next year—~~including~~ a small premium over world prices.

1.1~~6~~7 Food prices are unlikely to strengthen significantly, as rising subsidies to farmers will bolster ~~mean little prospective reductions in~~ supply over the next few years. But there is likely to be some rise in industrial materials prices in real terms as industrial production recovers in the major countries.

Table 1 shows the forecast for world activity and trade, and for consumer price inflation.

1.1~~7~~8 ~~The combination of~~ low inflation ~~and interest rates~~ should continue to sustain ~~provide a considerable stimulus to~~ domestic demand in the major economies. However, in the US, the fall in the dollar and an end to the once-and-for-all effects of lower oil prices may lead to a modest rise in inflation. This, ~~together with some rise in interest rates,~~ could contribute to some slowdown in ~~slow~~ the growth of domestic demand. The effect of a lower growth in domestic demand on real GNP may be offset by improved trade performance following the dollar's depreciation.

Table 1.1 World economy

	Per cent changes on a year earlier		
		Forecasts	
	1985	1986	1987
Major Seven countries[1]:			
Real GNP	3	2½	3
Industrial production	3	1	1
Exports of goods (volume)	4	2	3
Consumers' expenditure deflator	4	2	2
World trade, at constant prices			
Total imports	3	4½	4
UK export markets[2]	4½	2	4½

roman not italic

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

[2] For *~~M~~manufactures.*

1.1~~8~~9 The ~~steady~~ economic recovery in Europe seems set to continue; indeed, in many countries including Germany, output may grow faster next year. Japanese growth, however, may be relatively modest ~~fall some way short of its potential~~ next year as its traditionally strong export performance suffers from the yen's appreciation, and domestic demand does not grow sufficiently to offset this.

1.~~19~~20 The major seven industrial countries are expected to grow on average by 3 per cent in 1987. Domestic demand growth is likely to be a little faster and, together with the prospect of some recovery in commodity prices, ~~and~~ should lead to some improvement in the financial position of many non-oil developing countries. As a result their imports should start to rise again. The oil producing countries, on the other hand, may have to cut their imports further.

1.2~~0~~1 Growth of ~~T~~total world trade growth in 1987 ~~is expected to~~ may be slightly less than this year. Imports into non-oil developing countries and countries whose exchange rates have appreciated are forecast to grow quickly. By contrast there may be some slowing in US import growth, while further large cutbacks in OPEC imports are expected. Trade in manufactures, however, may grow rather faster than in 1986. ~~This is the main reason for the forecast recovery in UK export markets.~~

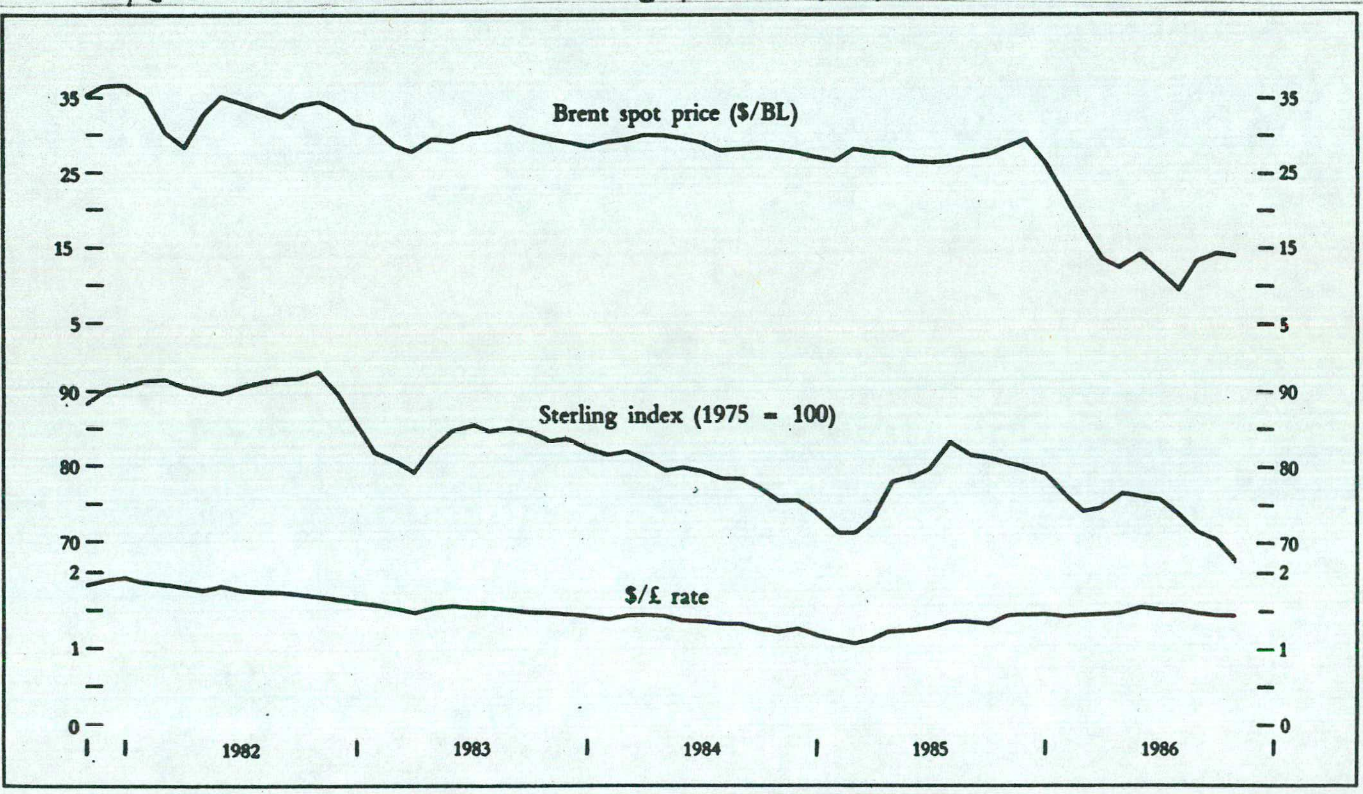
Trade and the balance of payments

Exchange rates

1.2~~1~~2 The dollar has declined during most of 1985 and 1986 and compared with its peak in February 1985 ~~is almost 30 per cent lower (against the IMF basket of 17 major currencies) than at its peak in early 1985. Over the same period the Deutschemark has appreciated by about 20 per cent in effective terms and the Yen by more than 40 per cent. The sterling index rose by about 8 per cent between the two halves of 1985, but since oil prices began to fall at the beginning of 1986 it has declined by about 15 per cent (Chart 1.3)~~. During 1986 sterling has remained broadly unchanged against the dollar, but has fallen against most other currencies. The forecast assumes that sterling remains close to its present level in both dollar and effective terms.

is just over 37 per cent lower against the Deutschemark and the Yen. The sterling index rose by about 7 per cent between the two halves of 1985, but has declined by about 13½ per cent since oil prices began to fall at the end of 1985.

Chart 1.3 Exchange Rate and Oil Prices



Relative costs and prices

1.2~~2~~3 There has been a marked improvement in the UK's cost and price competitiveness since the second half of 1985 as the depreciation of sterling following the fall in oil prices has more than offset the extent to which labour costs have been rising faster in the UK than in most other major countries.

Trade prices and the terms of trade (excluding oil)

1.2~~3~~4 Prices of exports of goods have been rising again in recent months. In the third quarter of 1986 export prices of manufactures were some 4 per cent higher than a year ago. Import prices were weak until very recently ~~as~~ since lower world prices for many commodities offset the effects of sterling's depreciation. The non-oil terms of trade, therefore, have remained relatively steady. They may worsen slightly over the next year as a result of rises in some commodity prices and the recent depreciation of sterling.

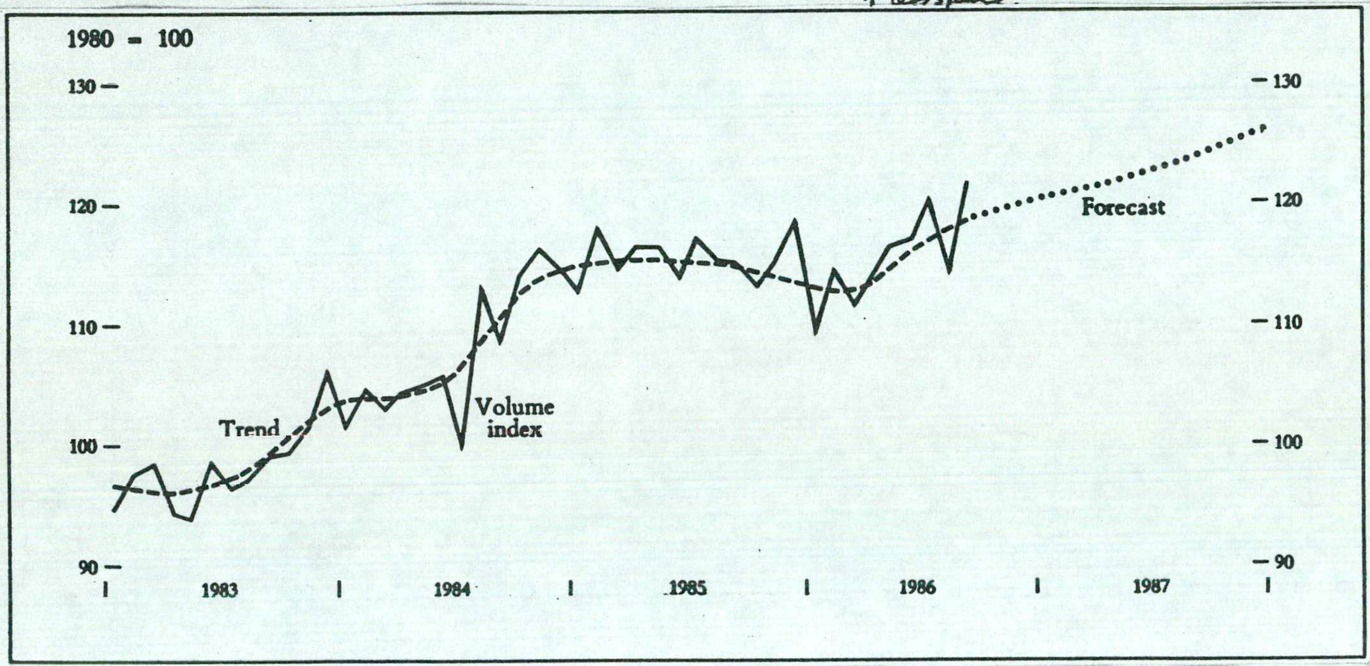
Trade volumes (goods other than oil and erratics)

5 As Chart 1.5 shows, t

1.2~~4~~ ~~T~~he share of UK manufactured exports in the volume of world trade has been broadly steady since 1980—following the decline of earlier years. Non-oil export volumes fell in the early months of 1986 when world trade growth was sluggish but have risen again in recent months. In the third quarter of 1986 exports of manufactures were some 3 per cent higher than in the first half of this year. World markets for UK manufactures are expected to grow more rapidly in 1987. This, together with the lagged benefits from this year's gain in competitiveness, suggests that exports should continue to grow steadily. A ~~The forecast is that a continuation of the~~ rising trend in UK non-oil exports has been evident since the second quarter of 1986 when world trade began to recover from its slowdown during the winter. The forecast is that a continuation of this trend will bring about growth of 5½ per cent between 1986 and 1987—a sharp rise over the 1 per cent growth between 1985 and 1986.

Chart 1.4 Export Volumes (excluding oil and erratic items)

less space



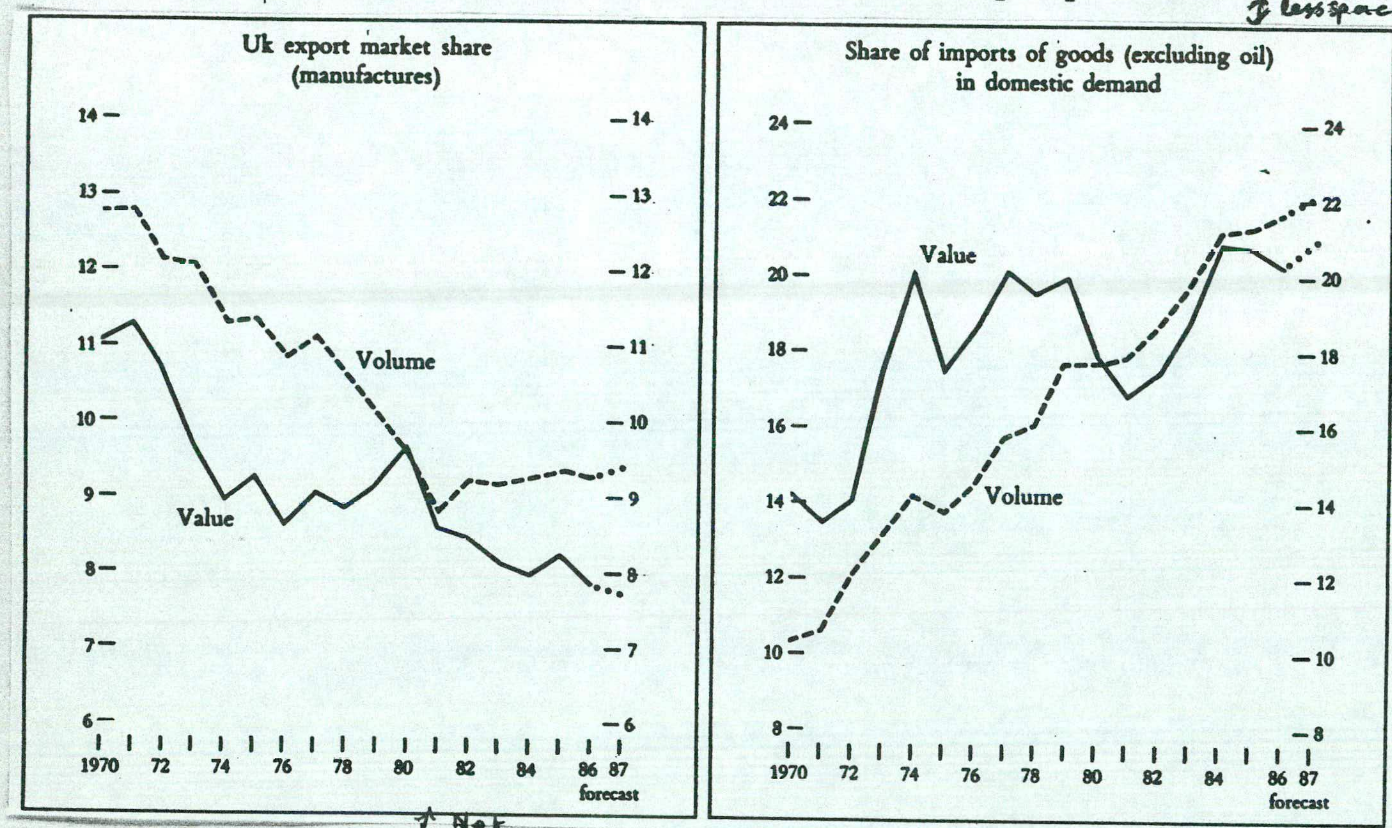
6

1.2~~5~~ Non-oil imports grew relatively slowly in the first half of this year but have tended to rise more rapidly in recent months. The volume of imports appears to have risen rather more rapidly than domestic demand, although the increase in import penetration has been less rapid than during ~~at~~ some previous periods with similar ~~of strong~~ domestic expenditure ~~expansion~~. Manufactured imports rose particularly fast: some 8½ per cent up in the third quarter over the first half of the year. Imports of food have also been unusually high this year as a result of the poor quality of last year's harvest. Imports seem likely to continue to rise ~~relatively~~ strongly in 1987 as domestic activity expands—although the lower exchange rate together with a return to more normal levels of food imports will tend to slow the rate of growth. Imports of goods are forecast to rise by 6 per cent in 1987 compared to 5 per cent in 1986.

x

Chart 1.5 Export share and import ~~performance~~ penetration

less space



Oil trade 1.26 ~~Non~~ Net oil exports are likely to be some £4 billion lower in 1986 than in 1985 as a result of lower world oil prices. About half of this effect on the current account will be offset by lower payments of interest, profits and dividends to foreign companies from the North Sea. Production from the North Sea, which is likely to ~~decline gradually in 1987 while at the same time~~ be close to the centre of the range of 110-130 million tonnes published in the Department of Energy's 1986 Brown Book, is likely to be lower than in 1986. At the same time domestic demand for oil may grow modestly in response to both lower oil prices and rising activity. The ~~contribution of~~ oil ~~to the current account~~ trade surplus may therefore decline by a further £½ billion or so in 1987.

Trade in goods 1.27 Table 1.2 shows the main movements in the terms of trade and trade volumes for both total visible trade and trade excluding oil. The UK's terms of trade in visible trade ~~in the first three quarters of 1986 were some 5 per cent below the level of a year ago reflecting the decline in oil prices. The terms of trade~~ have declined in 1986, as a result of lower oil prices, and are forecast to show little overall change next year. The volume ~~of total goods~~ visible exports, ~~which~~ has been recovering in recent months ~~from its low level in the first half of 1986~~, is forecast to rise further in 1987, although the overall growth will be held down by a lower volume of oil exports. The volume of ~~total goods~~ visible imports, which was almost 5 per cent higher in the first three quarters of 1986 than a year earlier, is forecast to show a similar growth in 1987.

Table 1.2 Trade in goods

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

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

not bold

Invisibles 1.2~~8~~9 The surplus on invisibles is likely to rise significantly in 1986 as higher earnings from interest profits and dividends (IPD) more than offset a lower surplus on services. The decline in the surplus on services in the first half of this year was partly due to a fall in net tourism earnings, some of which was attributable to fears in the US about terrorism in Europe. The transfers balance, which depends largely on the size and timing of government transactions with the EC, has been in smaller deficit this year although there has been a tendency for other transfer payments abroad to rise.

~~1.29~~ 30 The surplus on ~~interest, profits and dividends (IPD)~~ IPD, rose in the first half of 1986. This reflects not only lower payments from the North Sea but also the effect of sterling's depreciation on UK credits from earnings overseas. The surplus on IPD seems likely to increase further in 1987 as the full-year effects of sterling's depreciation are reflected in earnings in sterling terms.

Current Account

Table 1.~~5~~3 Current account

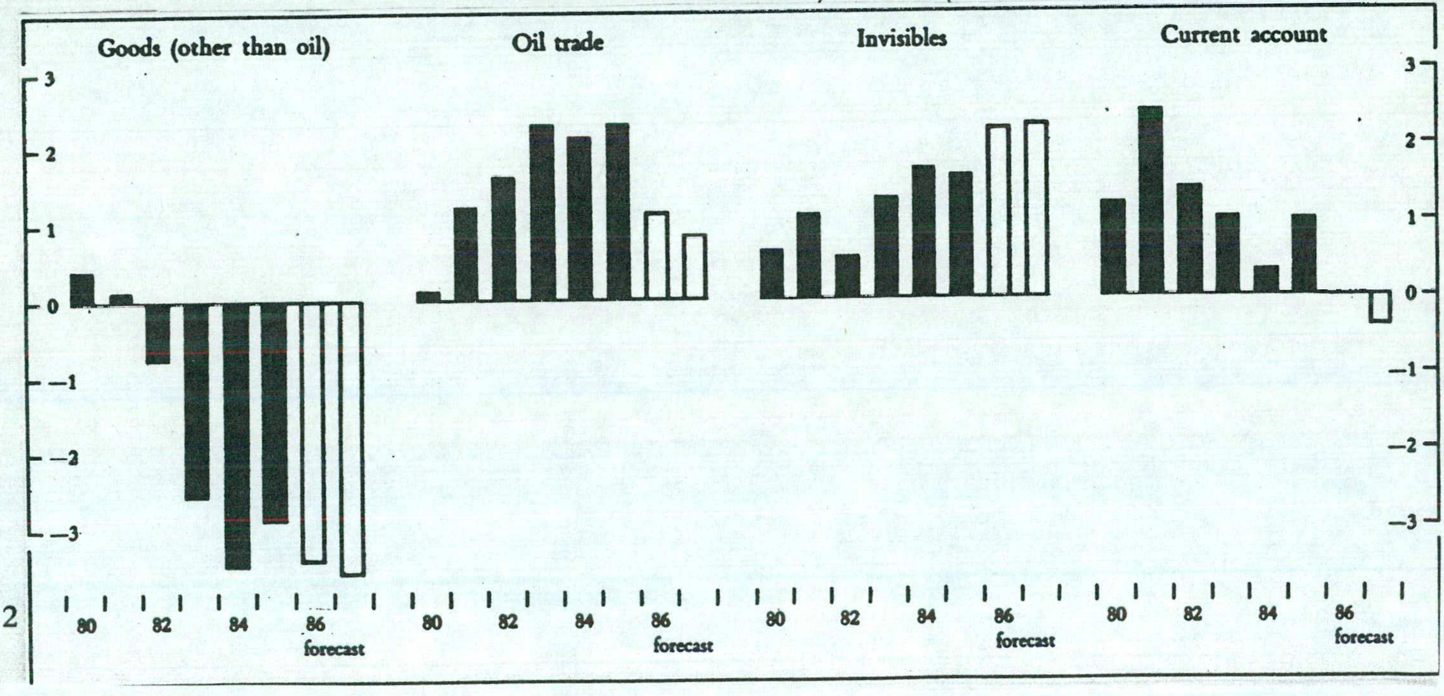
£ billion	Manufactures	Oil	Other goods	Invisibles	Current balance
1985	−3	8	−7½	5½	3½
1986 Partly forecast	−5½	4	−7	8½	0
1987 forecast	−7½	3½	−6½	9	−1½

1.3~~0~~1 The current balance of payments recorded a deficit in the third quarter of 1986, following a surplus of about £1 billion in the first half of the year; ~~F~~for the year as a whole the forecast is for broad balance. The main factors behind the changes between 1985 and 1986 have been ~~the fall in the net oil surplus coupled with an increase in the deficit on manufactures trade. These together have more than offset a rise in the invisibles surplus~~. The forecast for 1987 is that with rising world trade and the benefits of improved competitiveness the current account may show no further deterioration from the second half of 1986. ~~The deficit for 1987 is forecast to be £1½ billion.~~

In 1987 the current account is forecast to be in deficit by around £1½ billion

described in paragraphs 1.23–1.30 above. Between 1985 and 1986 the fall in the net oil surplus and the increase in the deficit in manufactures more than offset a rise in invisibles

Chart 1.6 Current Account Balance of Payments



Overseas assets

1.3~~1~~2 The large current account surpluses of the early 1980s, when the value of oil production was at its peak, have enabled the UK to build a large stock of net overseas assets. This stock was about £80 billion, equivalent to 22 per cent of GDP, at the end of 1985. It has probably risen further this year.

Demand and activity

1.3~~2~~3 Over the 5 years since the end of the 1979–81 recession, GDP growth has averaged $2\frac{3}{4}$ per cent a year. After adjusting for the coal strike, economic growth averaged almost 4 per cent in 1983 and 1984, but slowed down during 1985 as exports weakened. GDP in the first half of 1986 is estimated to have been around 2 per cent higher than in the first half of 1985; and ~~only~~ about $1\frac{1}{4}$ per cent higher after excluding the direct effects of the recovery from the coal strike. Economic activity has started to rise more quickly again, at an annual rate of about $2\frac{1}{2}$ per cent over the two most recent quarters.

1.3~~3~~4 Spending by the personal sector has been ~~very~~ strong this year. In the first three quarters of 1986 consumers' expenditure was almost 5 per cent higher than a year earlier, and the buoyancy of demand in the housing market has started to show up in higher private residential investment. ~~By contrast exports will be little higher this year than last.~~

1.3~~4~~5 Output of the service industries (accounting for 56 per cent of the economy's total output in 1985) continues to expand quite rapidly: the estimated $3\frac{1}{2}$ per cent growth over the year to the second quarter of 1986 is only a little less than the growth rate recorded over the previous two years. Manufacturing output is estimated to have fallen by about 1 per cent over the year to the second quarter of 1986, after a two year period in which output in manufacturing had been expanding faster than the rest of the economy. In recent months the trend in manufacturing output has been upwards again. For 1986 as a whole, manufacturing output is expected to remain at about the same level as last year.

Personal sector expenditure

1.3~~5~~6 Real personal disposable income has probably grown by some 4 per cent in 1986, and real consumers' spending by almost 5 per cent. The saving ratio has fallen again this year ~~and is now back to levels last seen in the early 1970s, before the first oil price shock~~. Both earnings and the consumers' expenditure deflator are forecast to rise less in 1987 than this year: the saving ratio is assumed not to change much from its current level. Consumers' expenditure may rise by about 4 per cent next year, with spending on durables rising rather more ~~than this~~.

in line with falling inflation

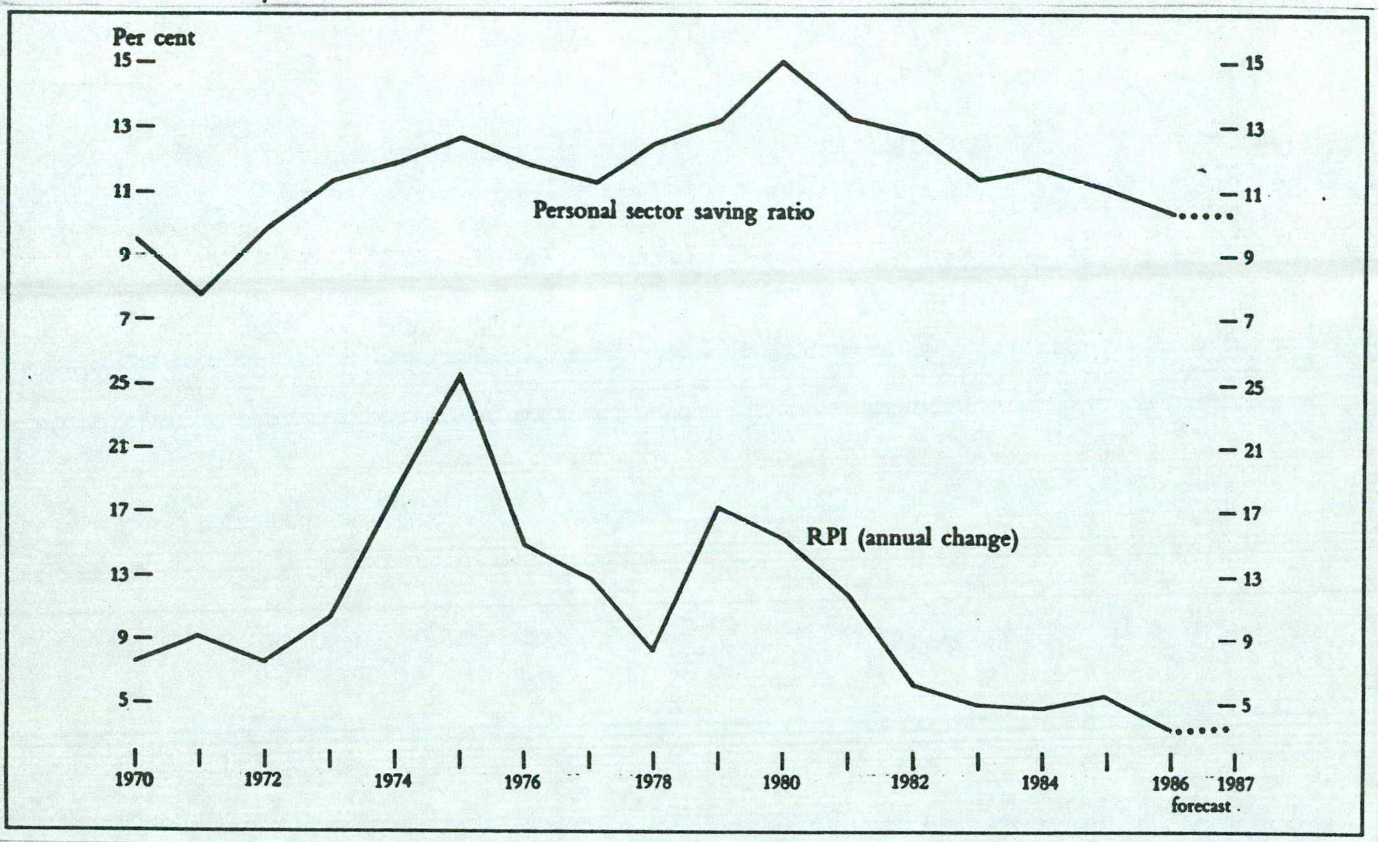
x

1.3~~6~~7 Increased demand for housing has led to a pick up in house prices over the past year and housebuilding has risen as a result. Private housing starts were about 10 per cent higher in the first ~~half~~ of 1986 than in the same period of 1985. The rise in starts since early 1985 is beginning to show up in the number of houses completed. Spending on improvements to dwellings should continue to reflect the general buoyancy of personal sector demand, so that total private investment in dwellings should show growth of more than 5 per cent both this year and next.

three quarters

lc

Chart 1.7 RPI and Personal Savings ratio



Company incomes and expenditure

1.37 8 The net real rate of return earned by industrial and commercial companies (ICCs) in 1985 was 11·9 per cent, the highest since 1964. The rates of return earned by non-North Sea ICCs and by manufacturing companies were the highest since 1973 and more than double those earned in 1981. In the first half of 1986 non-North Sea ICCs profits net of stock appreciation were some further 17 per cent higher than in the corresponding period of 1985. North Sea companies' profits fell by 54 per cent, however, reflecting the fall in the oil price.

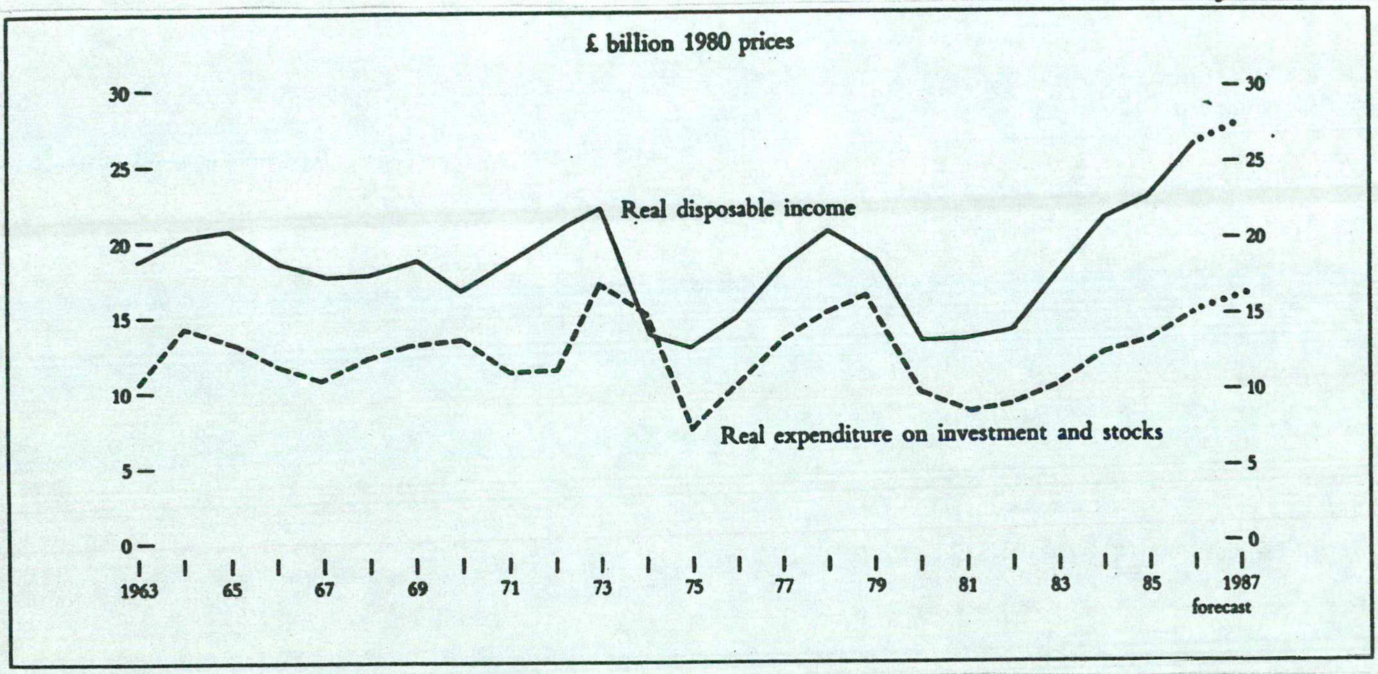
1.38 9 Company spending has been relatively subdued in 1986. As expected, It The advance warning of the reduction in capital allowances given in the 1984 Budget ~~is likely to have~~ caused some capital spending to ~~have been~~ be brought forward into 1985 from 1986. Non-oil business investment nevertheless seems likely to rise this year, by about 3 per cent, compared with 6 per cent last year. North Sea investment has responded much more quickly than was expected at Budget time to the fall in oil prices and now seems likely to fall by 15–20 per cent this year.

1.39 40 Companies' expenditure on stocks has been running at a low level this year: stocks in manufacturing industry fell in real terms in the first half of 1986, as they had done during 1985. Again, reactions to the 1984 Budget corporate tax changes will have been an influence. Chart 1.7 8 shows the relation between non-North Sea ICCs disposable income and expenditure.

V

Chart 1.8 Company Income and Expenditure

close up



1.~~40~~1 In 1987 non-oil business investment is expected to grow at a similar rate to, or slightly faster than, this year reflecting the current high level of profitability and the recovery in demand in domestic and foreign markets. A further sizeable fall in North Sea investment is expected: without this growth in total investment next year would be about half a percentage point higher.

1.~~41~~2 Stock ratios have been falling since 1980, and surveys do not suggest that stocks have yet reached desired levels in relation to output or sales. Stock ratios are expected to fall further over the next year; but less steeply than t~~hey have been falling~~ in recent years as most of the adjustment to higher costs of stockholding may now have taken place. Higher stockbuilding next year than this is likely to make a positive contribution to growth. ~~Taking stockbuilding and fixed investment together, growth in non-North Sea companies' expenditure should exceed growth of their disposable income next year.~~

Prospects for demand and activity

1.~~42~~3 The strength of consumer spending evident in European economies in recent months suggests that the benefits of the oil price cut are starting to come through, so that UK exporters should face a more favourable world environment next year. At home stronger growth in investment should offset an expected slowdown in consumer spending, so that domestic demand in total is expected to grow next year at much the same rate as this year. The prospects overall are for balanced growth, at a rate ~~a little~~ very slightly above the average experienced over the last five years (see Table 1.4).

Table 1.4 Domestic demand and GDP

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

** Average measure*

1.4~~3~~4 North Sea output will probably be slightly higher on average this year than in 1985, but is expected to fall in 1987, ~~perhaps by as much as 5 per cent.~~ as envisaged in the 1986 Brown Book. Thus the increase in non-oil exports and growth of the non-oil economy are rather higher than the increase in total exports and GDP. The forecast for manufacturing exports implies a recovery in manufacturing output; the manufacturing sector is expected to grow faster than the rest of the economy next year (see Table 1.5).

Table 1.5 Real GDP and manufacturing output

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

** Adjustments are approximate*

Inflation

1.4~~4~~5 The retail prices index (RPI) rose by 3 per cent in the year to September, compared with a rise of 5½ per cent in the year to the fourth quarter of 1985. Falls in mortgage interest rates earlier in the year have contributed to lower RPI inflation: retail prices excluding mortgage costs have risen by 3¼ per cent in the year to the third quarter of 1986.

1.4~~5~~6 Other price indices have also recorded substantial falls in inflation this year. The deflator of GDP at market prices is expected to rise by only 3 per cent ~~in the present financial year, compared with a 6 per cent rise in financial year 1985–86~~; and in September producer output prices (for manufactures, excluding food~~s~~, drink and tobacco) were less than 4 per cent higher than a year earlier, compared with an increase of 6 per cent in the year to the fourth quarter of 1985.

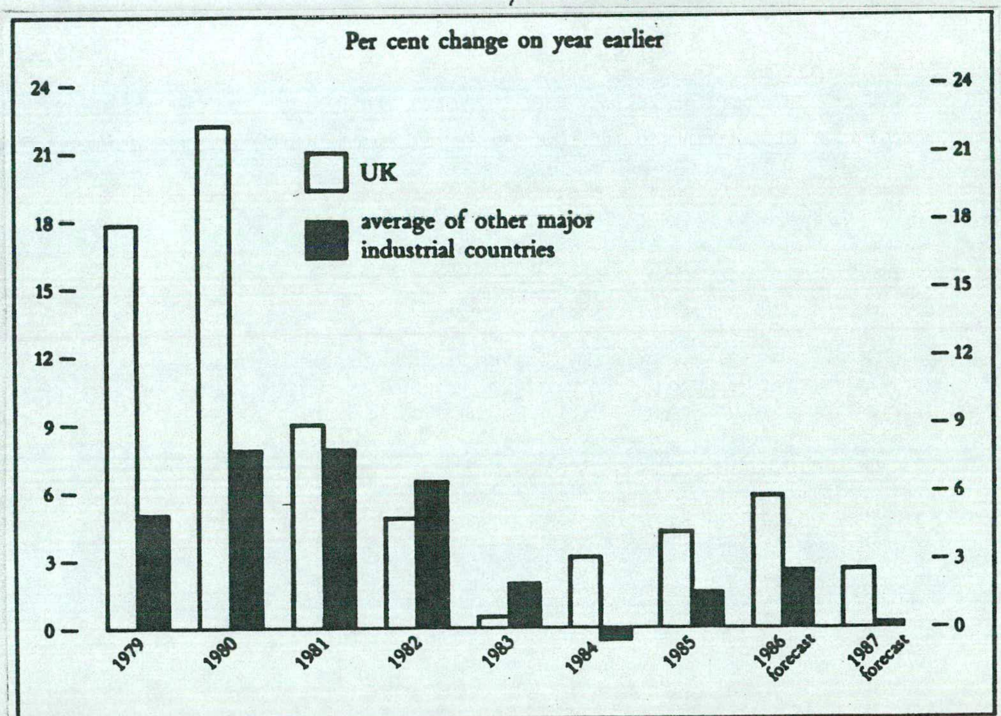
+

1.4~~6~~7 Between the spring of 1985 and August this year the prices of materials and fuels purchased by manufacturing industry fell almost continuously. The recent falls in sterling and a modest recovery in some non-food primary commodity prices mean this decline in industry's input costs may have come to an end.

//1.48 In spite of the fall in price inflation there has been no decline so far in the underlying rate of growth in average earnings. Underlying growth of real pre tax earnings is likely to turn out above 4 per cent in 1986.

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

Chart 1.9 Unit Labour Costs



Prospects 1.48 With RPI inflation 3 percentage points lower than it was at the start of the last pay round, pay settlements are expected to be a little lower than last year: indeed, there have already been signs of a ~~trend~~ towards lower settlements in the private sector in recent months. Despite an increase in overtime working, growth in average earnings is expected to fall somewhat in the present pay round. Productivity growth should pick up as compared with this year: actual unit labour costs for the non-oil private sector may rise by around 4 per cent next year, and manufacturing unit labour costs by rather less.

move

Table 1.6 Costs in manufacturing

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

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

1.~~49~~ 51 The increase in retail prices excluding mortgage interest costs over the next year is not likely to be very different from what it has been over the last year. However, the increase in mortgage rates in the second half of October will add just over ½ point to RPI inflation. Nationalised industry prices in aggregate continue to reflect lower energy costs, and food prices the general weakness of world prices. The pattern of price increases this year and that expected next year means that the annual rate of inflation may rise slightly in the middle of next year before resuming its downward path towards the end of the year.

Table 1.7 Retail prices index

	Per cent changes on a year earlier			
			Forecasts	
	Weight in 1986	1985 Q4	1986 Q4[1]	1987 Q4
Food	18½	3¼	4 (3)	2½
Nationalised industries[2]	6	5½	3½ (4)	1¾
Housing	14½	9¼	6½ (7½)	10¼
Other	61	5¼	2¼ (3)	3
Total	**100**	**5½**	**3¼ (3½)**	**3¾**

bold [1] *FSBR forecast in brackets.*

[2] *Includes water: gas is included in " other " prices.*

1.5~~0~~2 The GDP deflator measures the price of domestic value added—principally unit labour costs and profits per unit of output—and excludes import prices. It is sensitive to movements in North Sea profits, which may fall by 50–60 per cent in the current financial year: ~~as a result,~~ the deflator for GDP at market prices may rise by only 3 per cent in the current financial year~~, as compared with 6 per cent in 1984–85~~. In 1987–88 the assumption of a stable oil price, and hence little further change in North Sea profits, implies a somewhat higher increase in the GDP deflator than this year~~; the increase in the deflator of GDP at market prices next year is therefore likely to be~~ at about 3¾ per cent, the same as was assumed in the MTFS.

this is part of the reason why

1.5~~1~~3 Money GDP is forecast to grow by 5½ per cent in 1986–87, less ~~considerably more slowly~~ than was expected at Budget time. Both inflation and, to a lesser extent, output growth have been revised down since the Budget. Money GDP is forecast to grow by 7 per cent in 1987–88, as output growth picks up and the growth of the GDP deflator reverts to its underlying path following the temporary effect of falling North Sea profits in 1986–87.

Productivity and the labour market

1.5~~2~~4 The results from the 1985 Labour Force Survey have led to an upward revision of the estimated growth in employment since 1983. Total employment in Great Britain is estimated to have grown by about 1,050,000 between March 1983 and June 1986. Almost half of this increase is accounted for by growth in self-employment. Estimates of the number of employees are subject to revision when the results of the 1984 Census of Employment become available.

1.5~~3~~5 Over the ~~past~~ last year growth in employment has slowed down, reflecting the weakness of output ~~in~~ during 1985. In the year to June 1986, the employed labour force grew by around 200,000 (see Table 1.8). Employment growth in the service industries remains very strong: the number of employees in the service industries increased by almost 250,000 in the year to June. However, the number of employees in manufacturing industries fell by 90,000 while almost 50,000 jobs were lost in the oil and coal mining industries.

Table 1.8 Employment

Thousands, change in GB seasonally adjusted

	Employees in employment: Male	Employees in employment: Female full-time	Employees in employment: Female part-time	Self-employed	HM Forces	Employed labour force
June 1983 to June 1984	−37	+ 5	+221	+275	+4	+468
June 1984 to June 1985	+46	+ 3	+174	+108	0	+332
June 1985 to June 1986	−59	−30	+172	+122*	−4	+199

** Figure for self-employment over the last year is a projection based on self-employment growth over the previous 4 years.*

1.5~~4~~6 Productivity growth has fallen back during the last year, as is normal during a period of slower output growth. The average annual growth in manufacturing productivity over the period since 1979 is estimated to be 3 per cent, close to the rate achieved in the sixties (see Table 1.9), and much faster than that achieved in the seventies. Growth in output per man hour in non-manufacturing has been rising at about 2 per cent per annum since 1979. However, the large rise in part-time employment has brought down the growth in output per head in non-manufacturing to around 1¼ per cent a year.

Table 1.9 Output per head of the employed labour force

Annual averages, per cent changes

	1964–73	1973–79	1979–86
Manufacturing	3¾	¾	3
Non-manufacturing*	3	½	1¼

* ~~Excludes public services and oil, includes nationalised industries except steel.~~ Includes private sector and nationalised industries other than those in manufacturing and oil.

Unemployment

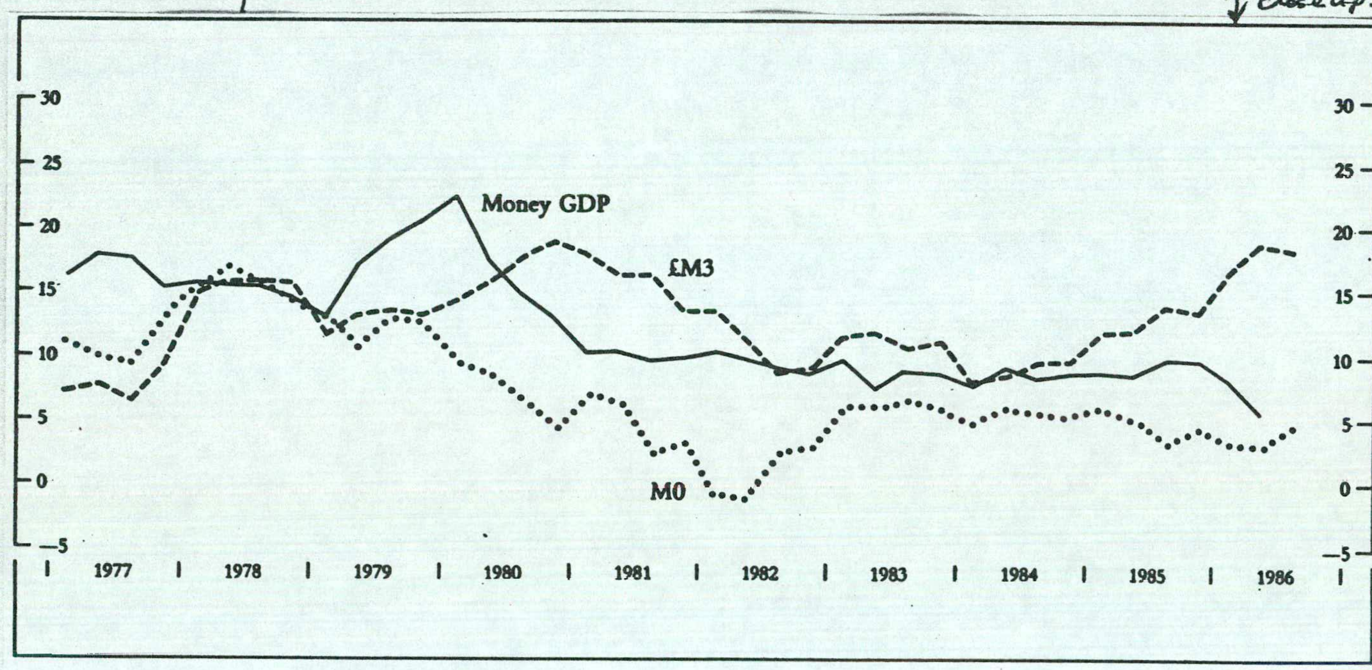
1.5~~5~~7 The increase in unemployment has slowed down over the ~~last~~ past year, and seasonally adjusted adult unemployment was at the same level in September 1986 as it had been in March.

1.5~~6~~8 The impact of the employment measures announced in the Budget, including the Restart scheme to help the long term unemployed, and the pick up in the economic growth now underway, mean that the immediate prospects of reducing unemployment are favourable. The slower growth in the labour force projected for the rest of the decade should make it relatively easier to secure a reduction in unemployment over the next few years. The extent of any reduction will, however, depend crucially on what happens to pay.

Financial conditions

1.5~~7~~9 Market short term interest rates, which fell by nearly 2 percentage points after the budget, have risen by about 1 percentage point since the end of August. Real short term rates remain high. Long term interest rates, ~~too,~~ fell sharply in the spring, dropping below 9 per cent in April, ~~although~~ but in the last two months the weakening in world bond markets and the rise in UK short term rates have caused them to move back above 10½ per cent. The forecast assumes that short-term interest rates will be set to maintain monetary conditions that are consistent with the counter-inflationary aims of the MTFS.

Chart 1.10 Money aggregates and money GDP close up.



1.~~58~~60 The year-on-year growth in M0 moved slightly above the midpoint of its target range of 2–6 per cent over the last few months mainly reflecting earlier falls in nominal interest rates and strong growth in personal incomes and expenditure. Following the recent rise in interest rates M0 is expected to grow more slowly.

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

together with changes from the FSBR estimates.

Fiscal developments

1.60 Tables 1.10 to 1.12 show details of general government expenditure and receipts and of public sector borrowing for 1985–86 and 1986–87. The PSBR in 1985–86 was £5·8 billion, just over £1 billion lower than the estimate in the 1986 FSBR. Lower central government borrowing accounts for the major part of this downward revision. In the first six months of 1986–87 the PSBR was £6 billion, in line with expectations at budget time. ~~The~~ forecast for the year as a whole has been raised from £7 billion to £7½ billion ~~as a result of the changes to oil taxation~~.

Taking into account the proposed change in oil taxation, the

1.61 Table 1.10 shows the relationship between the planning total and general government expenditure in national accounts terms. The ~~forecast rise in~~ the cash planning total between in ~~1985–86 and~~ 1986–87 is ~~5¼ per cent, implying a planning total for 1986–87~~ £1¼ billion ~~higher than~~ at Budget time. The projected increase in general government expenditure is smaller, at under 4 per cent. The difference between general government expenditure and the planning total is~~, at £24 billion, a little below~~ the FSBR forecast. ~~with lower debt interest payments the main explanatory factor.~~

estimated outturn for

more than anticipated

implying a rise between 1985-86 and 1986-87 of 5 per cent

little changed from

Table 1.1~~2~~0 General government expenditure

	£ billion	
	1985–86	1986–87
Public expenditure planning total	133½	140½
Interest payments	17½	17½
Less public market and overseas borrowing	−1	−1
Other adjustments	6½	6
General government expenditure in national accounts terms	**158½**	**164½**

1.62 The estimates in Table 1.11 of taxes on income, expenditure, and capital, depend on the estimated growth in money incomes as well as tax rates and allowances. The projected fall in North Sea revenues ~~from £11 billion~~ in 1985–86, to £4½ billion in 1986–87, means that the forecast increase in general government receipts, for 1986–87, at 3 per cent, is significantly below the 5½ per cent rise forecast for money GDP. North Sea revenues in 1986–87 are now expected to be £1½ billion lower than forecast at Budget time. The ~~recently announced~~ repayment of APRT reduces revenue in 1986–87 by £0·3 billion. Most of the rest of the shortfall is accounted for by a lower dollar oil prices in the first half of the year than assumed at Budget time. Non-North Sea taxes and national insurance contributions are forecast to increase by 9 per cent in 1986–87—3½ per cent higher than in the increase in money GDP. The forecast of non-oil taxes in 1986–87 has been revised upwards by £1½ billion since the 1986 FSBR, ~~partly~~ as a result of buoyant VAT and Corporation Tax receipts.

of just under £7 billion

changes in the arrangements for the

announced today

largely

Table 1.11 General government receipts

	£ billion	
	1985–86	1986–87
Taxes on income, expenditure and capital	114½	117½
National insurance and other contributions	24½	26½
Interest and other receipts	13½	12
Accruals adjustments	−½	—
Total receipts	**151½**	**156**
bold → of which North Sea tax revenues*	11½	4½

* includes allowance for the change in advance PRT in 1986-87

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

Table 1.12 Public sector borrowing

	£ billion	
	1985–86	1986–87
General government expenditure	158½	164½
General government receipts	151½	156
General government borrowing requirement	7	8½
Public corporations market and overseas borrowing	−1	−1
bold → Public sector borrowing requirement	6	7½
as percentage of GDP	1½	2
Money GDP at market prices	360	380

1.64 Table 1.13 summarises the changes since the 1986 FSBR.

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

	£ billion	
	1985-86	1986-87
Expenditure		
General Government	+1	+1
Public Corporations' market and other borrowing	-	-½
Total	+1	+½
Receipts		
Non North Sea receipts		
North Sea revenues (excluding effect of policy change for 1986-87)	+2	+1½
Total receipts (excluding effect of North Sea policy change in 1986-87)	0	-1
	+2	+½
Change in Advance PRT in 1986-87	-	-½
PSBR	-1	+½

NB Table to be restyled along the lines of 3.14 of the FSBR.

Table 1.14 Economic prospects

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

[1] *The errors relate to the average differences (on either side of the central figure) between forecast and outturn; they are relevant to the forecast for next calendar or financial year, except in the case of the PSBR error which is relevant to the forecast for the current financial year. The method of calculating these errors has been explained in earlier publications and government forecasts (see Economic Progress Report June 1981). The calculations of average errors are based on forecasts made between 1975 and 1984. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.*

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

£ billion at 1980 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	**Total final expenditure**	*Less* Imports of goods and services	*Less* Adjustment to factor cost	*Plus* Statistical adjustment	**Gross domestic product at factor cost**	GDP index 1980 = 100
1981	136·9	49·0	37·8	62·7	−2·5	**284·0**	56·4	30·1	−0·5	**197·0**	98·7
1982	138·2	49·6	39·4	63·3	−1·1	**289·3**	59·5	30·4	0·7	**200·1**	100·3
1983	143·8	50·5	41·7	64·7	0·7	**301·3**	62·8	31·5	−0·1	**207·0**	103·8
1984	146·9	50·9	45·5	69·0	−0·1	**312·2**	68·5	32·7	1·8	**212·8**	106·6
1985	152·0	51·1	46·3	73·3	0·6	**323·4**	70·6	33·8	1·5	**220·4**	110·5
1986	159·3	52·0	47·2	74·1	0·7	**333·4**	74·1	35·0	1·2	**225·5**	113·0
1987	165·4	52·8	48·3	76·5	1·4	**344·5**	77·5	36·2	1·2	**232·1**	116·3
1985 H1	75·1	25·6	23·4	36·8	−0·5	**161·3**	35·2	16·8	0·5	**109·9**	110·2
H2	76·9	25·5	22·9	36·5	0·2	**162·1**	35·4	17·1	1·0	**110·5**	110·8
1986 H1	78·5	25·7	23·4	36·5	0·4	**164·5**	35·9	17·3	0·6	**111·9**	112·2
H2	80·8	26·4	23·9	37·6	0·3	**168·9**	38·3	17·7	0·6	**113·5**	113·8
1987 H1	81·6	26·4	23·9	38·0	0·7	**170·5**	38·3	17·9	0·6	**114·9**	115·2
H2	83·9	26·4	24·4	38·5	0·7	**174·0**	39·1	18·3	0·6	**117·2**	117·5
Per cent changes											
1984 to 1985	3½	½	2	6	—	3½	3	3½	—	3½	3½
1985 to 1986	5	1½	2	1	—	3	5	3½	—	2½	2½
1986 to 1987	4	1½	2½	3	—	3½	4½	3½	—	3	3

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

λ measured by both the planning total and general government expenditure)
λ averaging around
λ around

This is the same as the average annual growth rate

compares with average annual growth of public expenditure

2.01 The public expenditure planning totals for 1987–88 and 1988–89 are £[148·6] billion and £[154·1] billion respectively, compared with £143·9 billion and £148·7 billion in the FSBR. The planning total for 1989–90 is set at £[161·7] billion. In real terms, average growth in public expenditure compared with the forecast outturn for 1986–87 is expected to be [1¼] per cent a year. ~~This compares with average annual growth rates of [1¼] per cent~~ in the eight years since 1978–79, and [3] per cent in the decade before that. With economic growth continuing at present rates over this period, public expenditure is expected to continue to account for a steadily declining proportion of GDP. By 1989–90, it should be back to the levels of the early seventies.

1986–87: outturn

2.02 The estimated outturn of the planning total for 1986–87 is [£140·5 billion], around 1 per cent above the plans set out in the Financial Statement and Budget Report (FSBR). The main increases in expenditure compared with those plans are in local authority expenditure and in demand-led programmes, notably social security. Details are given in Table 2.3.

Either omit, or – better – merge the numbers in with end of 2.01

2.03 Against a background of steady economic growth since the early 1980s, the declining trend of public expenditure as a percentage of GDP over the last four years will continue. Between 1982–83 and 1986–87 there was a decline as a percentage of GDP of [3½] percentage points; by 1989–90, it is expected to be a further [2½] percentage points lower.

Future years: main changes

This para is too compressed — and as a result the flow is v muddled

λ approaching £1 billion in 1987–88

particularly

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

Table 2.1 Public expenditure trends

£ billion

	Planning total[1]		General government expenditure[2]		
	Cash	Real terms[3]	Cash	Real terms[3]	Per cent of GDP
1978–79	65·7	124·0	74·6	140·7	43¼
1979–80	77·6	125·2	89·7	144·7	43¼
1980–81	92·6	126·1	108·3	147·4	46
1981–82	103·9	128·7	120·1	148·8	46¼
1982–83	113·4	131·0	132·6	153·1	46¾
1983–84	120·3	132·9	140·2	155·0	45¾
1984–85	129·8	137·6	150·1	159·1	45½
1985–86	133·6	133·6	158·6	158·6	44
1986–87	140·4	136·5	164·4	159·9	43¼
1987–88	148·7	139·4	173·8	162·9	42¾
1988–89	154·2	139·6	179·~~8~~6	162·~~8~~7	41¾
1989–90	161·5	142·1	~~188·6~~ 187.8	165·~~9~~2	41~~½~~ ¼

[1] *Outturn up to 1986–87; plans for 1987–88 onwards.*
[2] *General government expenditure as defined in the National Accounts and in the Medium Term Financial Strategy (MTFS).*
[3] *Cash figures adjusted to 1985–86 price levels by excluding the effect of general inflation as measured by the GDP deflator at market prices. The GDP deflator is assumed to increase by some 3 per cent in 1986–87, and by 3¾, 3½ and 3 per cent respectively in the years 1987–88 to 1989–90.*

Table 2.2 Public expenditure trends excluding privatisation proceeds

£ billion

	Planning total[1]		General government expenditure[2]		
	Cash	Real terms[3]	Cash	Real terms[3]	Per cent of GDP
1978–79	65·7	124·0	74·6	140·7	43¼
1979–80	77·9	125·8	90·0	145·3	43½
1980–81	93·0	126·6	108·7	147·9	46
1981–82	104·4	129·3	120·6	149·4	46½
1982–83	113·9	131·6	133·1	153·7	47
1983–84	121·4	134·2	141·4	156·3	46¼
1984–85	131·9	139·8	152·1	161·3	46¼
1985–86	136·3	136·3	161·3	161·3	44¾
1986–87	145·2	141·1	169·2	164·5	44½
1987–88	153·7	144·1	178·8	167·6	44
1988–89	159·2	144·2	184·~~8~~6	167·~~7~~2	42¾
1989–90	166·5	146·5	~~193·6~~ 192.8	~~170·3~~ 169.6	42~~½~~ ¼

[1] *Outturn up to 1986–87; plans for 1987–88 onwards.*
[2] *General government expenditure as defined in the National Accounts and in the Medium Term Financial Strategy (MTFS).*
[3] *Cash figures adjusted to 1985–86 price levels by excluding the effect of general inflation as measured by the GDP deflator at market prices. The GDP deflator is assumed to increase by some 3 per cent in 1986–87, and by 3¾, 3½ and 3 per cent respectively in the years 1987–88 to 1989–90.*

2.05 These increases are in part offset by reductions in planned expenditure in respect of the latest estimates of the United Kingdom's net contribution to the European Communities and departmental spending by the Department of Energy. The expected level of receipts from the Government's privatisation programme has been increased from £4¾ billion to £5 billion in each year.

Reserves

2.06 The plans include Reserves of £[3·5] billion in 1987–88, £[5·5] billion in 1988–89 and £[7·5] billion in 1989–90. The Reserves will be available to meet contingencies not covered elsewhere in the plans, including estimating changes.

Public expenditure White Paper

2.07 Full details of spending plans, together with information on running costs and manpower, will be published in the forthcoming public expenditure White Paper.

including detailed information on the outputs expected to be achieved from individual programmes,

Departments

2.08 Table 2.~~1~~3 sets out spending plans by department including local authority spending and nationalised industry external finance. The breakdown into departments will be carried through into separate chapters for the Public Expenditure White Paper and into the classes for Estimates, thereby making it easier to make comparisons between the various documents. Tables 2.~~2~~3A to 2.~~2~~3C show separately the elements within the departmental totals—nationalised industries' external finance, local authority relevant current spending, and other departmental spending. The following paragraphs indicate, [in brief,] the main changes to departmental programmes.

X

Defence

2.09 The estimated outturn for 1986–87 reflects an increase in provision as a result of carry-forward of capital underspend from 1985–86. This increase has been met from the Reserve. For 1987–88 and 1988–89 the provision remains as planned in the last Public Expenditure White Paper (Cmnd 9702) after allowing for the net effect of minor changes, including a reduction in estimated Falklands costs. These costs fall markedly over the period and will in future be subsumed in the defence budget. Provision for 1989–90 represents an increase of £4~~9~~50 million over the previous year.

Is it credible to single out one element as met from the Reserve when the Reserve as a whole is lost?

Overseas development administration

2.10 The overseas aid programme is being maintained in real terms at its 1986–87 level throughout the three years.

Foreign and Commonwealth Office (diplomatic wing)

2.11 Changes include extra provision for security works to protect diplomatic staff and property overseas, and for the introduction of the visa regime announced on 1 September and reported to the House of Commons on 21 October by the Home Secretary. The costs of the new visa regime are expected to be largely recovered from fees.

European Communities

2.12 The estimate of outturn in 1986–87 includes subscriptions to the European Investment Bank of £48 million, of which £33 million is to maintain the ecu value of paid in capital. The changes since Cmnd 9702 represent the effects of the latest projection of the United Kingdom's net payments to European Community institutions. The profile implies a ~~very sharp~~ drop in payments in 1988–89, This ~~partly~~ mainly reflects the assumption that the United Kingdom will benefit from a large correction to its 1987 abatement during 1988.

, followed by an increase in 1989-90

Table 2.3 Public expenditure plans[1, 2]

Departments (including local authority spending and nationalised industries external finance)	Outturn	Plans[3] Cmnd 9702	Estimated outturn	Changes from plans	~~Existing~~ plans[3] Cmnd 9702	
	1985–86	1986–87	1986–87	1986–87	1987–88	1988–89
Ministry of Defence	17 972	18 5~~00~~30	18 600	~~100~~ 70	18 820	18 990
FCO—~~Other/~~ Diplomatic wing	605	640	670	30	660	690
FCO (including ODA)	1 245	1 320	1 320	—	1 350	1 390
European Community	831	650	1 090	440	1 150	950
IBAP and other CAP expenditure	1 857	1 540	1 560	20	1 630	1 660
Domestic agriculture, fisheries and food	912	840	920	80	830	840
Forestry Commission	51	50	50	—	50	60
Department of Trade and Industry	1 524	1 300	1 370	60	1 090	940
Export Credits Guarantee Department	319	300	250	−50	220	130
Department of Energy	677	120	170	50	−550	−280
Department of Employment	3 342	3 920	3 970	40	4 030	4 220
Department of Transport	4 572	4 790	4 920	130	4 840	4 810
DOE—Housing	2 861	2 760	2 850	90	2 840	2 890
DOE—Property Services Agency	−97	−90	−90	—	−130	−130
DOE—Other environmental services	3 910	3 660	4 070	420	3 560	3 580
Home Office	4 728	4 960	5 260	300	5 010	5 050
Lord Chancellor's Department	525	590	620	30	610	650
Department of Education and Science	14 480	14 3~~00~~20	~~16 000~~ 15 950	1 6~~00~~30	14 400	14 ~~500~~ 470
Office of Arts and Libraries	721	730	800	70	740	760
DHSS—Health and personal social services	16 640	17 7~~00~~20	~~18 000~~ 17 960	2~~00~~30	18 ~~500~~ 460	19 1~~00~~40
DHSS—Social security	41 466	42 800	44 500	1 600	44 300	45 800
Civil superannuation	1 017	1 190	1 140	−60	1 310	1 400
Scotland	7 221	7 570	7 810	240	7 420	7 440
Wales	2 780	2 900	3 060	150	2 980	3 040
Northern Ireland	4 262	4 520	4 530	10	4 690	4 820
Chancellor's departments	1 819	2 010	2 070	60	2 050	2 070
Other departments	334	430	450	20	490	510
Privatisation proceeds	−2 702	−4 750	−4 750	—	−4 750	−4 750
Reserve	—	4 400	—	−4 400	6 080	7 820
Adjustments ~~and shortfall/longfall~~[4] good!	−290	−670	−700	−30	−260	−270
Planning total	**133 580**	**139 100**	**140 400**	**1 300**	**144 000**	**148 700**
bold General government expenditure	000 000	000 000	000 000	0 000	000 000	000 000

bold

[1] *In this and Tables 2.3A to 2.3C some figures may be subject to detailed technical amendment before publication of the 1987 ~~P~~ublic ~~E~~xpenditure White Paper.* p e

[2] *The rounding and other conventions used in this table and 2.3A to 2.3C are as follows: planned figures ~~up to £10 billion~~ are rounded to the nearest £10 million, except for social security and the planning and spending authority totals which are rounded to the nearest £100 million. Outturn figures for 1986–87 have also been rounded to reflect their provisional nature. Differences have been calculated on unrounded figures and rounded in the same way as their equivalent total: figures may therefore not sum to totals or changes shown.*

[3] *Plans as set out in the last* p e *~~P~~ublic ~~E~~xpenditure White Paper (Cmnd. 9702) adjusted for Budget measures and other minor changes of classification and allocation.*

[4] *Double counting of agricultural spending in Scotland and Wales which is also included in the total for domestic agriculture, fisheries and food and IBAP and other CAP expenditure. The 1986–87 plans and estimated outturn figure includes external finance of −£400 million for nationalised industries to be privatised that year.*

Table 2.3 Public expenditure plans[1, 2]—continued

Revised plans 1987–88	1988–89	1989–90	Changes between ~~existing~~ Cmnd 9702 and revised plans 1987–88	1988–89	Departments (including local authority spending and nationalised industries external finance)
18 790	18 980	19 4~~60~~70	−20	−10	Ministry of Defence
700	730	750	40	40	FCO—~~Other~~ Diplomatic wing
1 3~~50~~60	1 400	1 440	~~0~~ 10	10	FCO (including ODA)
870	440	1 060	−280	−510	European Community
1 660	1 780	1 880	40	120	IBAP and other CAP expenditure
880	900	900	50	60	Domestic agriculture, fisheries and food
50	50	60	0	0	Forestry Commission
~~1 100~~ 1110	~~940~~ 960	~~940~~ 950	~~—~~ 20	~~—~~ 20	Department of Trade and Industry
160	110	50	−60	−20	Export Credits Guarantee Department
−~~100~~ 90	−50	~~50~~ −250	450	230	Department of Energy
4 0~~40~~ 50	4 2~~30~~40	4 340	~~10~~ 20	20	Department of Employment
5 140	5 080	5 140	300	270	Department of Transport
3 200	3 020	3 090	~~361~~ 360	130	DOE—Housing ✓
−90	−90	−90	40	40	DOE—Property Services Agency
3 8~~00~~ 50	3 8~~60~~ 90	3 9~~40~~30	2~~40~~90	~~270~~ 310	DOE—Other environmental services
~~5 730~~ 5,540	~~5 470~~ 5 700	~~5 640~~ 5 870	~~320~~ 530	~~430~~ 650	Home Office
670	720	770	60	70	Lord Chancellor's Department
16 600	17 350	17 840	2 200	2 880	Department of Education and Science
810	8~~40~~30	860	60	80	Office of Arts and Libraries
19 100	19 8~~00~~ 40	20 7~~00~~ 20	6~~00~~30	700	DHSS—Health and personal social services
46 000	47 500	49 300	1 700	1 700	DHSS—Social security
1 270	1 360	1 430	−40	−40	Civil superannuation
—	—	—	—	—	Scotland
—	—	—	—	—	Wales
—	—	—	—	—	Northern Ireland
2 2~~40~~ 30	2 3~~30~~ 20	2 4~~30~~20	~~190~~ 180	~~260~~ 250	Chancellor's departments
~~520~~ 570	~~540~~ 600	~~560~~ 620	~~30~~ 70	~~40~~ 90	Other departments
−5 000	−5 000	−5 000	−250	−250	Privatisation proceeds
3 500	5 500	7 500	−2 580	−2 320	Reserve
~~—~~ −260	~~—~~ −270	~~—~~ −280	~~260~~	~~270~~	Adjustments ~~and shortfall/longfall~~[4]
—	—	—	—	—	**Planning total**
000 000	000 000	000 000	0 000	0 000	General government expenditure bold

bold

Intervention Board for Agriculture Produce and other CAP expenditure

2.13 Provision is made to meet the cost of operating the Common Agricultural Policy in the UK. ~~Such of the expenditure as is recouped eventually from EC budget receipts arising from sales will be reflected in the forecast net contribution to the EC.~~ Most of market support expenditure is ultimately financed from EC Budget receipts which are reflected in the UK's net contribution to the EC

Domestic agriculture

2.14 Small additions to provision have been made in a number of areas, in particular on flood defences.

Forestry Commission

2.15 The reduction shown reflects increased estimates of receipts from harvesting of timber.

Trade and industry

2.16 Allowance is made for increased spending on industrial ~~research~~ support measures. ~~[Additional provision is made for the external financing limit for British Shipbuilders.]~~ including research and development.

Export Credits Guarantee Department

2.17 The net reductions reflect latest estimates of the cost of interest support for fixed rate export finance.

Energy

2.18 The increases in provision relate mainly to the external finance of British Coal and Electricity (England and Wales) partly offset by reduced expenditure on mineworkers redundancy costs.

Employment

2.19 Major new enterprise and employment measures since last year's Autumn Statement were announced in the 1986 Budget and these are now reflected in existing plans. Additional expenditure since then (notably on the Technical and Vocational Education Initiative, on an increase in the number of Job Clubs, and on payments from the Redundancy Fund) is offset by savings elsewhere.

Provision for local authority current expenditure is also increased.

Transport

2.20 Additional provision has been made for capital expenditure on roads. External finance for transport nationalised industries has been reduced in later years.

Environment—housing

forecast outturn.
initial
local authority
able
(some £350 million more than previously

2.21 In 1987–88 provision for gross capital expenditure on housing will be higher by about £225 million than ~~in~~ 1986–87. The Government is ~~thus~~ fully meeting its commitment to local authorities that allocations in 1987–88 would be no less than 80 per cent of the 1985–86 level. Extra resources are being provided for the renovation of the housing stock through the Urban Housing Renewal Unit. The Housing Corporation will also have additional funds and will be ~~allowed~~ to embark on privately financed housing association schemes. The success of the Government's Right to Buy policy is reflected in the higher level of capital receipts forecast) over the ~~three years.~~ Survey Period

Environment—other

2.22 There will be an increase of £50 million in the provision for capital spending on local environmental services in 1987–88. In each of the three years there is provision for £40 million more to be spent on urban renewal, and there will be increased resources for rural employment and environmental protection. These increases in gross expenditure are partly the results of the extra capital receipts, amounting to about £100 million over the three years, which are expected from the sale of new town assets. Increased provision is also made for local authority current expenditure.

Environment—PSA 2.23 The revised plans take account of unavoidable increases in rent payments, some additional expenditure on maintenance, for "spend to save" estate rationalisation projects which have the highest rate of return and for some major new works projects for which PSA retains financial responsibility.

Home Office 2.24 Additional provision (partly offset by savings and additional receipts) is made to allow for increases in police establishments and for the design of work on further new prisons bringing the number of prisons in the building programme to twenty and for other law and order initiatives. Provision is increased for Fire Service capital. Additional provision is made to cover the increasing demands on the Criminal Injuries Compensation Scheme.

Lord Chancellor's Department 2.25 Allowance is made for extra staff to meet the expanding workloads of both criminal and civil courts (partly offset by fees) and for the cost of legal aid.

Department of Education and Science 2.26 [Provision has been increased for both current and capital expenditure on schools. The enhancement ~~reflects~~ includes the extra provision needed to cover the costs of the teachers' pay offer announced by the Secretary of State. New funds have been made available for the initiative on City Technological Colleges. Funding for the universities has been increased, ~~as the Government offered in return for a move by the universities to greater security and rationalisation.~~] on the basis offered by the Government of a committee to greater selectivity, rationalisation, better financial management and improved teaching standards

New proposals on teachers' pay and conditions of service

Office of Arts and Libraries 2.27 [Provision for expenditure on the arts and museums has been increased in each of the three years.]

Health and personal social services 2.28 Additional provision has been made to allow for ~~increased~~ demographic pressure and service improvements in the Hospital and Community Health Service. In addition health authorities will have available extra cash released by their cost improvement programmes (expected to yield a further £150 million in 1986–87 on top of the £400 million cumulative savings achieved prior to that). Planned provision for the Family Practitioner Services allows for higher forecast demand. Provision for personal social services has also been increased substantially.

Social security 2.29 The provision reflects the latest estimates of benefit expenditure over the Survey period. It takes account of the upratings and changes to benefits announced by the Secretary of State for Health and Social Security on 22 October 1986 and allows for further upratings of benefits in April 1988 and April 1989 on the basis of the assumed rise in prices over the relevant periods.

2.30 [For the purpose of these estimates, it has been assumed that the RPI will rise by 3·75 per cent between September 1986 and September 1987 (the basis of the April 1988 upratings) and by 3·5 per cent in the year to September 1988 (the basis of the April 1989 upratings). The actual upratings of individual benefits will be announced when the relevant RPI figures are known.]

Scotland, Wales and Northern Ireland 2.31 The net changes in these programmes mainly reflect the effects of changes in comparable programmes in England. [The Secretaries of State have discretion to allocate this expenditure taking account of local factors.]

Chancellor's departments 2.32 Allowance is made for additional staff in the revenue departments required to deal with increases in work load and to strengthen controls against drug smuggling. [Around one third of the overall increases reflect the changes in the estimates of the cost of providing tax relief on Life Assurance Premiums and Mortgage interest to non-taxpayers.]

Other departments 2.33 Most of the additional provision is for revised estimates of the cost of the new Crown Prosecution Service, and the cost of the new Serious Fraud Office.

Allowance has also been made for increases for Parliament

Nationalised Industries

2.34 External Financing Limits (EFLs) for nationalised industries in 1987–88 are listed in Table 2.4. In total, there is an increase from provision in Cmnd 9702 of £[ ] million. This reflects a number of changes but is primarily the result of additional provision for the Electricity Supply Industry, the South of Scotland Electricity Board, and for British Coal (formerly the National Coal Board). [There have been reductions in the external financing requirements of London Regional Transport, the [water authorities] [ ], [ ].] Table 2.2A shows the total provision for nationalised industries' external finance in each of the three years and how this is allocated between departments. A progressive reduction in the external financing requirements of the industries from the level in 1987–88 is expected in 1988–89 and 1989–90.

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

	£ million[1]
National Coal Board	680
Electricity (England and Wales)	−1305
North of Scotland Hydro-electric Board	−1
South of Scotland Electricity Board	84
British Steel Corporation	66
Post Office	−55
National Girobank	−6
British Railways Board	751
British Waterways Board	45
Scottish Transport Group	1
British Shipbuilders	50
Civil Aviation Authority	15
Water (England and Wales)	35
London Regional Transport	275
Other industries[2]	10
Total	**645**

[1] *Figures are shown rounded to the nearest £1 million.*
[2] *Allowance for BAA, which is expected to be privatised in 1987-88 and for NBC, where external financing requirements will depend on the progress and timing of the industry's disposals programme.*

Local authorities

Current **2.35** In 1986–87, local authorities in Great Britain have budgeted to exceed Cmnd 9702 provision for current expenditure by around £2·5 billion. No decision was taken last year on provision for 1987–88 and 1988–89 and the figures in Cmnd 9702 were set at the same cash levels as for 1986–87. This was taken into account in setting the level of the Reserves for those years.

2.36 Provision for the three forward years has now been set at levels which
on the estimated outturn for 1986-87 of
show annual increases ~~of~~ [4½ per cent], [4 per cent] and [2¾ per cent] after taking account of the additional provision for teachers' pay in all years

2.37 For 1987–88, Aggregate Exchequer Grant to local authorities has been set at [£16·4 billion, £1·5 billion] above the level for 1986–87. The Government also proposes to abolish grant recycling in England and Wales—the process whereby grant forfeited by overspenders is distributed to all other authorities—in order to give authorities greater certainty about their grant entitlements and to act as a disincentive to the highest spending authorities. Guidelines and grant penalties for exceeding them will continue in Scotland.

Capital **2.38** Local authority gross capital spending in Great Britain in 1986–87 is forecast to be £6·~~6~~5 billion. After allowing for capital receipts, net spending is estimated to be £4·1 billion—£0·5 billion higher than provided for in Cmnd 9702. These figures remain subject to some uncertainty.

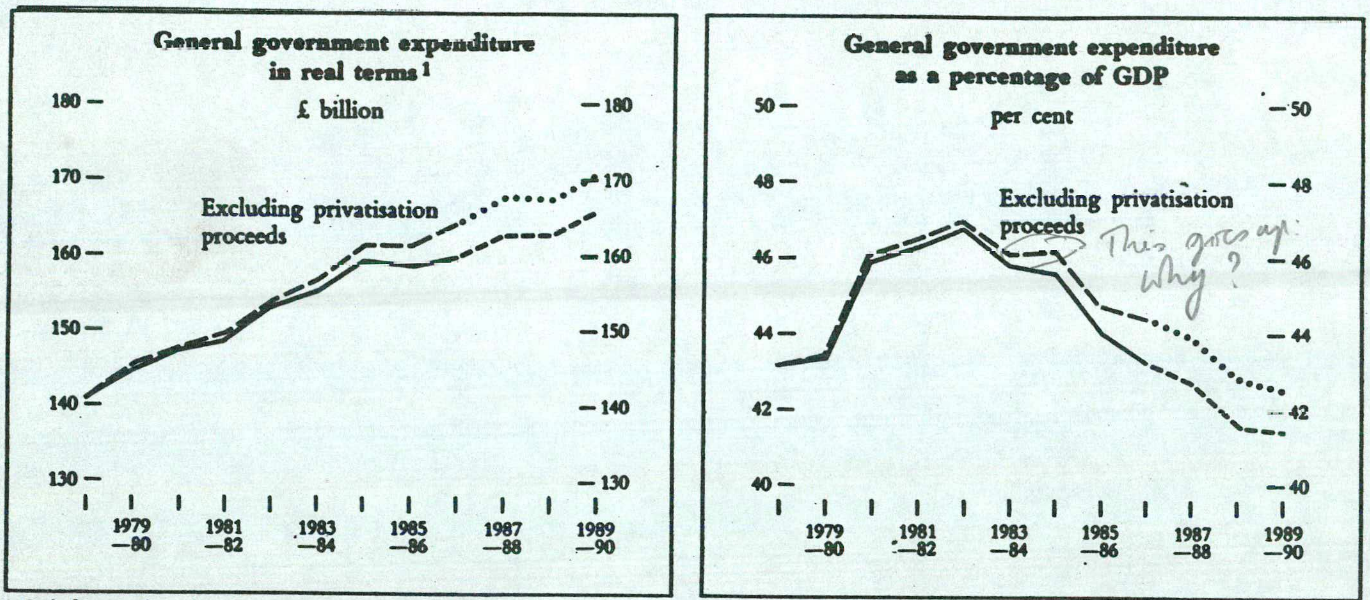
2.39 Gross provision for spending in 1987–88 has been increased by £0·7 billion to £6·6 billion. Provision of £6·~~3~~2 billion and £6·5 billion is made for 1988–89 and 1989–90 respectively. Within this provision the amount which is issued as allocations will take account of the expected use by local authorities of the spending power available to them from other sources, notably capital receipts.

2.40 On the main local authority capital cash limit in England—DoE/LAI—allocations of over £2·6 billion will be issued in 1987–88. The reduction from the £2·7 billion issued in 1986–87 will be more than offset by the growing spending power from capital receipts—estimated to be £2·8 billion in 1987–88, £0·2 billion higher than in 1986–87.

Privatisation

2.41 The estimate of net proceeds from privatisation in Cmnd 9702 has been increased to £5 billion in each of the three years. The effects of excluding privatisation proceeds from the public expenditure figures are shown in Table 2.~~1~~12

Chart 2.1 Public expenditure trends



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

Table 2.3.A Nationalised industries' external financing by department

	Outturn	Cmnd 9702 Plans	Estimated outturn	Changes from plans	Cmnd 9702 Plans		Revised plans			Changes between Cmnd 9702 and revised plans	
	1985–86	1986–87	1986–87	1986–87	1987–88	1988–89	1987–88	1988–89	1989–90	1987–88	1988–89
Ministry of Defence	−2	0	0	0	0	0	0	0	0	0	0
Domestic agriculture, fisheries and food[1]	16	10	20	10	10	10	20	20	20	10	10
Department of Trade and Industry	388	120	90	−30	~~70~~ 60	−70	60	−100	−100	−10	−30
Department of Energy	−197	−690	−690	0	−1 140	−880	−580	−510	−660	560	370
Department of Transport[2]	1 033	1 090	1 110	20	1 020	990	1 050	910	860	30	−80
DOE—Other environmental services	214	140	120	−20	30	30	50	40	−10	10	0
Scotland[3]	233	240	240	0	0	−120	90	−20	−170	90	100
Wales[4]	28	20	20	0	10	10	10	10	10	0	0
Total[5]	**1 712**	**530**	**510**	**−20**	**10**	**−30**	**690**	**350**	**−60**	**680**	**380**

[1] *All Ministry of Agriculture, Fisheries and Food.*

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

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

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

[5] *Totals include an allowance in plans and estimated outturn in 1986–87 in respect of BGC and BAB which are due to be privatised in that year; similarly, allowances are included for NBC and BAA in ~~1987–88 and 1988–89 respectively.~~* the later years.

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

Local authority expenditure relevant for RSG	Outturn	Cmnd 9702 Plans	Estimated outturn	Changes from plans	Cmnd 9702 Plans		Revised plans			Changes between Cmnd 9702 and revised plans	
	1985–86	1986–87	1986–87	1986–87	1987–88	1988–89	1987–88	1988–89	1989–90	1987–88	1988–89
Domestic agriculture, fisheries and food	105	100	130	30	100	100	120	120	130	20	30
Department of Trade and Industry	71	70	80	10	70	70	80	80	80	10	20
Department of Employment	92	80	100	20	80	80	100	100	110	~~10~~ 20	20
Department of Transport[1]	1 785	1 750	1 880	130	1 750	1 750	1 950	2 010	2 060	200	260
DOE—Housing	155	150	130	−20	140	140	140	140	140	−10	~~0~~ −10
DOE—Housing rate fund contributions to housing revenue account	522	330	460	140	330	330	440	450	460	110	120
DOE—Other environmental services	2 683	2 640	2 760	120	2 640	2 640	2 850	2 940	3 010	210	290
Home Office	3 742	3 860	4 150	290	3 860	3 860	4 330	4 460	4 580	470	600
Department of Education and Science	10 987	10 8~~00~~20	12 ~~300~~ 280	~~1 500~~ 1470	10 820	10 820	12 850	13 500	13 880	2 030	2 690
Office of Arts and Libraries	408	400	430	40	400	400	450	470	480	60	70
DHSS—Health and personal social services	2 406	2 520	2 680	150	2 520	2 520	2 850	2 940	3 010	320	410
DHSS—Social security	162	140	180	40	140	140	210	~~200~~ 190	200	70	60
Scotland[1]	2 870	2 970	3 150	180	2 980	2 980	3 310	3 440	3 5~~20~~30	330	460
Wales[1]	1 126	1 160	1 230	60	1 210	1 210	1 300	1 350	1 390	90	140
Wales—rate fund contributions to house revenue accounts	0	0	0	0	0	0	0	0	0	0	0
Total local authority expenditure relevant for RSG	**27 117**	**27 000**	**29 500**	**2 700**	**27 000**	**27 000**	**31 000**	**32 200**	**33 000**		

[1] *For 1985–86 includes nationalised industries' external finance described in footnotes 2, 3 and 4 to Table 2.3.A.*

Table 2.3.C Other departmental spending

Departments (excluding local authority spending relevant for RSG and nationalised industries' external finance)	Outturn	Cmnd 9702 Plans	Estimated outturn	Changes from plans	Cmnd 9702 plans		Revised plans			Changes between Cmnd 9702 and revised plans	
	1985–86	1986–87	1986–87	1986–87	1987–88	1988–89	1987–88	1988–89	1989–90	1987–88	1988–89
Ministry of Defence	17 975	18 5~~00~~ 20	18 600	~~100~~ 70	18 820	18 990	18 790	18 980	19 460	−20	−10
FCO—~~Other~~ Diplomatic wing	605	640	670	30	660	690	700	730	750	40	40
FCO (including ODA)	1 245	1 320	1 320	0	1 350	1 390	1 350	1 400	1 440	0	10
European Community	831	650	1 090	440	1 150	950	870	440	1 060	−280	−510
IBAP and other CAP expenditure	1 857	1 540	1 560	20	1 630	1 660	1 660	1 780	1 880	40	120
Domestic agriculture, fisheries and food	791	730	770	40	720	740	740	760	760	20	20
Forestry Commission	51	50	50	0	50	60	50	50	60	0	0
Department of Trade and Industry	1 045	1 120	1 200	80	960	940	970	970	970	10	30
ECGD	319	300	250	−50	220	130	160	110	50	−60	−20
Department of Energy	874	800	850	50	590	600	~~520~~ 480	~~530~~ 460	~~490~~ 410	~~−60~~ −110	~~−70~~ −140
Department of Employment	3 251	3 840	3 870	30	3 950	4 130	3 950	4 130	4 240	0	0
Department of Transport	1 870	1 960	1 940	−20	2 070	2 080	2 140	2 170	2 210	80	90
DOE—Housing	2 184	2 290	2 260	−30	2 370	2 410	2 630	2 430	2 490	260	10
DOE—Property Services Agency	−97	−90	−90	0	−130	−130	−90	−90	−90	40	40
DOE—Other environmental services	1 014	870	1 190	310	880	910	950	920	930	70	10
Home Office	986	1 100	1 110	0	1 150	1 190	1 210	1 230	1 290	60	50
Lord Chancellor's Department	525	590	620	30	610	650	670	720	770	60	70
Department of Education and Science	3 493	3 500	3 670	170	3 590	3 660	3 750	3 840	3 960	160	190
Office of Arts and Libraries	313	340	370	30	350	360	~~350~~ 360	370	380	10	10
DHSS—Health and personal social services	14 234	15 200	15 280 ~~15 300~~	~~100~~ 80	15 940	16 620	16 250	16 910	17 720	310	290
DHSS—Social security	41 308	42 700	44 300	1 600	44 200	45 600	45 800	47 300	49 100	1 600	1 700
Civil superannuation	1 017	1 190	1 140	−60	1 310	1 400	1 270	1 360	1 430	−40	−40
Scotland	4 158	4 360	4 420	50	4 440	4 580					
Wales	1 629	1 720	1 810	90	1 760	1 820					
Northern Ireland	4 262	4 520	4 530	10	4 690	4 820					
Chancellor's departments	1 834	2 010	2 070	60	2 050	2 070	~~2230~~ ~~2240~~	~~2320~~ ~~2330~~	2420 ~~2430~~	~~190~~ 180	~~260~~ 250
Other departments	334	430	450	20	490	510	~~520~~ 570	~~540~~ 600	~~560~~ 620	~~30~~ 70	~~40~~ 90
Adjustments[1]	−290	−270	−300	−30	−260	−270	−260	−270	−280	~~260~~	~~270~~
~~Planning~~ Total	**107 615**	**112 000**	**115 000**	**3 000**	**115 600**	**118 600**					

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

CHAPTER 3

3 National insurance contributions

3.01 The Secretary of State for Social Services has conducted his annual review of national insurance contributions, as required by the provisions of the Social Security Act 1975. Full details were set out in a statement by the Secretary of State on 6 November 1986. The main proposals are as follows:

—The Class 1 insurance rates for employers and employees should remain unchanged for 1987–88.

—The Treasury Supplement should be cut from 9 per cent of contributions to 7 per cent.

—The lower earnings limit should be increased from April 1987 from the present level of £38 a week to £39 a week in line with the single rate retirement pension.

—The upper earnings limit should be ~~correspondingly~~ increased from £285 a week to £295 a week.

—The earnings limit for the reduced rate brackets should also be increased from £60, £95 and £140 a week to £65, £100 and £150 a week.

This would give the following structure of national insurance contributions:

Weekly earnings	Percentage NIC rate on all earnings	
	Employees	Employers
Below £39	(No NICs payable)	
£39 to £64·99	5	5
£65 to £99·99	7	7
£100 to £149·99	9	9
£150 to £295	9	10·45
Above £295	9 on £295	10·45

Should be centred, since it applies to employees & employers, & brackets otiose

3.02 The necessary orders will be laid shortly with a report by the Government Actuary on the likely effect of the changes on the National Insurance Fund. In accordance with normal practice, the Government Actuary has been provided with working assumptions for use in preparing his report. These assumptions, which are not forecasts or predictions, will be summarised in his report and include the following:

—The number of unemployed (GB, excluding school leavers etc) averages 3·1 million in 1986–87 and 3·05 million in 1987–88. (3·05 million has also been assumed for 1988–89 and 1989–90 in the estimates of social security spending shown in ~~Part~~ Chapter 2.)

We now have a new wording for this

—The increase in average earnings is expected to decline from about 7½ per cent between tax years 1985–86 and 1986–87 to about 6½ per cent between tax years 1986–87 and 1987–88. [This is consistant with settlements averaging 4 per cent in 1987–88.]

e/

The report will also allow for an uprating of benefits in April 1987 on the basis of the 2·1 per cent increase in the RPI over the eight months ending in September 1986, as announced by the Secretary of State on 22 October 1986.

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

Table 3.1 Estimated total payments by employers and employees of national insurance contributions in 1986–87 and 1987–88[1]

	Great Britain (£ million)		
	Employers	Employees	Total
National insurance contributions:			
1986–87	12 320	11 580	23 900
1987–88	13 160	12 460	25 620
Total change	+840	+880	+1 720
of which:			
Change in contributions from increased earnings, etc[2]	+970	+870	+1 840
Change in contributions from increase in earnings limits	−130	+10	−120

[1] *Figures are rounded to the nearest £10 million. Detailed figures for national insurance contributions ~~are~~ will be included in the Government Actuary's report on the draft of the Social Security (Contributions, Re-rating) Order 1986. As in previous years, figures in this table are on a receipts basis excluding self employed and voluntary contributions. Figures include NHS and Employment Protection Allocation contributions. Employers' contributions are net of deductions in respect of statutory sick pay and, for 1987–88, statutory maternity pay.*
[2] *Including population and employment changes.*

CHAPTER 4

Oil taxation

4 ~~Tax changes~~ and revenue ready reckoner

bold →

Repayment of Advance Petroleum Revenue Tax (APRT)

— Blast

Watch this word

4.01 The Government is reviewing the North Sea tax regime in the light of recent oil price fall and will be announcing its conclusions in the 1987 Budget. In the interim, given the current difficulties of the offshore supplies industry in Scotland and the North of England, the Chancellor of the Exchequer announced on 6 November the Government's intention to introduce a Bill early in the new Session of Parliament. The purpose of this would be to bring forward to the current financial year certain repayments of APRT due to the oil companies which under the present law would have been spread over the next three financial years.

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

4.03 This measure would increase the PSBR in 1986-87 by up to £310 million, but there will be a corresponding reduction in the PSBR of £130 million in 1987-88, £120 million in 1988-89 and £60 million in 1989-90.

bold →

Revenue ready reckoner

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

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

4.06 An illustrative rate of inflation of 3¼ per cent has been used to show the effects of indexation and revalorisation in 1987–88. This is in line with the annual rate of increase in the RPI forecast for the fourth quarter of 1986.

4.07 The tables show estimates of the direct effects of tax changes. In practice, tax changes will themselves affect economic variables, which in turn will have further effects on tax yields and on the PSBR. The estimated direct effects are not, therefore, the same as the effects on the PSBR. The approach used here is explained in the Annex to Chapter 4 of the Financial Statement and Budget Report published in March 1986.

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

side heading

Indexation of allowances, thresholds and bands for 1987–88

4.09 Tables 4.1 to 4.3 show tax allowances, thresholds, and bands for 1987–88 after 3¼ per cent indexation. Rounding follows the rules laid down in the 1980 Finance Act for income tax and the 1982 Finance Act for inheritance tax and capital gains tax. Estimates of the revenue effects of these changes are shown in Table 4.4.

Table 4.1 Income tax

	1986–87 £	1987–88 £
Allowances:		
Single and wife's earned income allowance	2 335	2 415
Married allowance	3 655	3 775
Additional personal and widow's bereavement allowance	1 320	1 360
Single age allowance	2 850	2 950
Married age allowance	4 505	4 655
Aged income limit	9 400	9 800

Income tax rates Per cent	Bands of taxable income 1986–87 £	 1987–88 £
29	0–17 200	0–17 800
40	17 201–20 200	17 801–20 900
45	20 201–25 400	20 901–26 300
50	25 401–33 300	26 301–34 500
55	33 301–41 200	34 501–42 700
60	Over 41 200	Over 42 700

Table 4.2 Inheritance tax

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

bold

Table 4.3 Capital gains tax

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

bold

Table 4.4 Costs of indexation in 1987–88

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

** Additional costs after previous changes have been introduced.*

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

side heading

4.10 Table 4.5 shows estimates of the direct revenue effects of illustrative changes in income tax and corporation tax. For income tax allowances and thresholds, these are from the indexed levels for 1987–88.

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

4.12 The total cost of a group of income tax allowance changes can be broadly assessed by adding together the revenue effects of each change. However, if allowances are increased substantially and combined with a reduction in basic or higher rates, the effects of the rate reductions will be reduced. In such cases, the cost or yield obtained by adding components from the ready reckoner should be considered only as a general guide.

Table 4.5 Direct Effects of Illustrative Changes in Income Tax and Corporation Tax[1]

	£ million	
	1987–88 cost/yield	1988–89 cost/yield
Income tax		
Rates		
Change basic rate by 1p[2]	1 100	1 475
Change all higher rates by 1p	65	150
Personal allowances[3]		
Change single and wife's earned income allowance by £100	290	380
Change married allowance by £100	235	300
Change single age allowance by £100	24	32
Change married age allowance by £100	23	30
Change aged income limit by £200	4	6
Change all main personal allowances by 1 per cent	175	225
Change all main personal allowances by 10 per cent:		
increase (cost)	1 725	2 200
decrease (yield)	1 800	2 275
Higher rate thresholds[3]		
Change all higher rate thresholds by 1 per cent:		
increase (cost)	25	50
decrease (yield)	25	50
Change all higher rate thresholds by 10 per cent:		
increase (cost)	215	450
decrease (yield)	290	575
Allowances and thresholds[3]		
Change all main personal allowances and higher rate thresholds by 1 per cent	200	275
Change all main personal allowances and higher rate thresholds by 10 per cent:		
increase (cost)	1 925	2 650
decrease (yield)	2 100	2 900
Corporation tax[4]		
Change full rate by 1 percentage point	210	390
Change small companies' rate by 1 percentage point[5]	20	40

bold → bold → bold → bold bold → X

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

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

[3] *For simplicity, percentage changes are calculated with reference to 1986–87 levels.*

[4] *Assessment to corporation tax normally relates to the preceding year. These estimates are, therefore, the changes to revenue that would occur if the changed rates were applied from ~~financial year~~ 1987–88.*

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

Indirect taxes

(D side heading

3¼

4.13 Table 4.6 shows estimates of the effects of changes in excise duties. The first part shows the extra revenue from the individual duties if they were to be increased by exactly ~~2¼~~ per cent, together with the price increase that would result (after allowing for consequential VAT). The second part shows the revenue yield from changing current levels of duty so that (after VAT) the price of a typical item is changed by the amount shown.

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

4.15 Within limits the illustrative changes for specific duties can be scaled up or down to give a reasonable guide to the revenue effects. However, with large changes the margins of uncertainty surrounding the effects on sales and hence on revenue become progressively larger, and scaled estimates will be less reliable.

Table 4.6 Revenue effects of indirect tax changes

		3¼% Revalorisation[1]			Changes from present levels of duty			
			Yield/Cost in[3]				Yield/Cost in[3]	
	Current level of duty on typical items	Price change inc. VAT[2]	1987–88 £m	1988–89 £m	Price change inc. VAT[2]	Actual percentage change in duty	1987–88 £m	1988–89 £m
Indirect taxes								
Beer (pint)	18·6p	0·7p	55	60 ~~50~~	1p	4·7	75	90
Wine (70 cl bottle of table wine)[4]	68·6p	2·6p	20	20	5p	6·3	35	40
Spirits (bottle)	£4·73	17·~~1~~p 7	25	30 ~~25~~	10p	1·8	15	15
Cigarettes (20 kingsize)[5]	92·7p	3·0p	75	85 ~~70~~	1p	1·1	25	30
Petrol (gallon)	88·1p	3·3p	165	185 ~~150~~	1p	1·0	50	55
Derv (gallon)	74·5p	2·8p	40	45 ~~40~~	1p	1·2	15	15
VED (cars and light vans)	£100·00	£3·25	65	65 ~~55~~	£1·00	1·0	20	20

[1] *An 'across the board' revalorisation by 3¼ per cent (including the minor duties not shown above) would yield about £475m in 1987–88 and £525m in 1988–89, and the impact on the RPI would be to raise it by 0·3 per cent.*
[2] *VAT is payable in addition to the duty except in the case of VED.*
[3] *Assuming implementation on 1 April 1987.*
[4] *Revenue effects include all wines.*
[5] *The duty on cigarettes has ad valorem and specific elements; the percentage change relates only to the specific element, biut the price change includes the subsequent increase in ad valorem duty and VAT.*

Table 4.7 VAT

	Yield/Cost in	
	1987–88 £m	1988–89 £m
1% change in rate of VAT[1]	800	1 130

[1] *Assuming implementation on 1 April 1987.*

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SECRET

PWP (but if there's another copy, destroy)

FROM: A P HUDSON
DATE: 3 NOVEMBER 1986

PS/CHIEF SECRETARY

cc Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Scholar
Mr Turnbull
Mr Sedgwick
Miss O'Mara
Mr Culpin
Mr Gray
Miss Noble
Mr Pickering
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Master (With amendments & comments marked in blue)

AUTUMN STATEMENT

I attach the Chancellor's own draft of the Oral Statement.

2. The sections on detailed public expenditure measures are pending the Chief Secretary's views.

3. Please could I have comments and additional contributions by close tonight?

APH

A P HUDSON

Notes attached by:
Middleton
Turnbull (x2)
Pearson
FER Butler
Ross-Goobey
(Comments attributed to Scholar, Sedgwick and Norgrove phoned through).

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

Cabinet today agreed the Government's public expenditure plans for the next three years.

In the normal course of events that would be followed by the publication of the printed Autumn Statement, accompanied by an Oral Statement to the House, next Tuesday.

For obvious reasons that is not possible this year.

(second formulation needed if it is a Command Paper)

So while the Autumn Statement will be printed in the normal way and [laid before the House / presented to Parliament] as soon as it reassembles next Wednesday, I thought it would be for the convenience of the House if I made my Oral Statement today.

Scholar

This will cover all three of the key elements in the printed Statement: the Government's outline public expenditure plans for each of the next three years and the expected outturn for this year, proposals for next year's national insurance contributions, and the forecast of the economic prospects for 1987 required by the 1975 Industry Act.

All Scholar

The full text of the economic forecast together with ~~Summary~~ tables for ~~both~~ public expenditure and the ~~outturn~~ rest of the information customarily published with this statement ~~economic forecast~~ will be available from the Vote Office as soon as I have sat down; they will be included in the printed Autumn Statement published next week.

I turn first to the outturn

for the current financial year, 1986-87.

FERB and Turnbull

The public expenditure planning total now looks likely to amount to [~~some~~] just under £140½bn // £1¼bn ~~£1½bn~~, or a little [~~over~~] less than 1 per cent, [more than] above what was allowed for in this year's Public Expenditure White Paper. The main reason~~s~~ for this excess is an 8 per cent rise in the current spending of local authorities - far more than was provided for. However, [~~two major~~] other items [~~of public~~] on the expenditure side which lie outside the planning total, the largest of which is debt interest, [~~and the overseas borrowings of the nationalised industries,~~] are likely to fall [~~£1bn~~] short of what was forecast at the time of the Budget, [~~which~~] thus reduc~~es~~ing the [~~overall expenditure~~] total overrun on the expenditure side to about £½bn.

Turnbull

On the [~~revenue~~] receipts side, the North Sea tax take is likely to be even lower, by about £1bn, than I envisaged at the time of the Budget, largely because for a long period the oil price has been below the $15 a barrel level on which the Budget arithmetic was explicitly based.

Scholar

This shortfall, however, is more than offset by the continuing buoyancy of non-oil revenues, in particular VAT and Corporation Tax, [~~which~~] Non-oil revenues now look likely to exceed the Budget forecast by £1½bn. This would imply an [~~overall revenue~~] overrun on the receipts side of about £½bn, the same as [~~the projected~~] on the expenditure side. [~~overrun~~].

Turnbull

Norgrove (less mini-Budget)

At the same time I have one [tax] change [in the North Sea fiscal regime] to announce. on the revenue side ← might meet his point.

The collapse of the oil price has led to a sharp cutback

in investment activity in the North Sea, with inevitable consequences for the UK offshore supplies industry both in Scotland and the North East of England.

Hill IR

Against this background the Government is conducting a review of the North Sea fiscal regime, and I shall be announcing my conclusions in the light of that review in the Budget.

But given the current difficulties of the offshore supplies industry, there is one change I believe it right to make without further delay.

I propose, on a carefully targeted basis, to accelerate the arrangements for the repayment to the oil companies of Advance Petroleum Revenue Tax due to them.

The details of this change, which will require legislation early in the new Session of Parliament, are set out in a Press Notice the Inland Revenue will be issuing as soon as I have sat down.

Hill IR

The new arrangements will have a revenue cost [~~result in a loss of revenue~~] this financial year of some £300m, which will [of course] be fully recouped over the next three years.

Taking this into account, the Public Sector Borrowing Requirement for the current year is now forecast to be about £7½bn, slightly above the £7bn figure which I set in the Budget.

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

SECRET

4

fourth successive year, public spending is set to decline as a proportion of national output, both before and after deducting the proceeds of privatisation.

APH ?

FERB

[And this remains true even before deducting the proceeds of privatisation.]

APH:

~~as part of the~~ in accordance with Medium Term Financial Strategy

Ross Goobey

over the current planning period

FERB

The Government is determined to ensure that this trend continues: to see to it that total public spending, even without taking account of privatisation proceeds, continues to decline as a percentage of GDP. The plans I am about to announce secure that objective. But within this overall constraint the Government has felt it right, in the context of its policy priorities, to allow an increase in the previously announced planning totals [~~for 1987-88 and 1988-89~~.] of £144 billion for 1987-88 and £149 billion for 1988-89.

Square brackets on numbers are Turnbull, pending final roundings

Square brackets on clause are FERB

I would not take FERB's comment here

Nor me.

The new totals have been set at [£148½bn] for 1987-88 and [£154½bn] in 1988-89, [an increase of [£4½bn] and [£5½bn] respectively.]

For 1989-90 the planning total has been set at ~~£XYZbn~~ [£161½bn].

FERB + Turnbull

¶ Compared with the forecast outturn for 1986-87, these totals [~~suggest~~] indicate an average growth of public spending of [~~a shade over~~] about 1¼ per cent a year in real terms, well within the prospective growth of the economy as a whole.

As usual, these totals incorporate estimates for the proceeds of privatisation. Last year I increased the estimate of these proceeds very substantially to £4¾bn in each of the three Survey years, a figure which I expect

to be duly achieved this year.

Although the privatisation programme is now moving ahead more strongly than ever before, I have decided to make only a modest further addition to this estimate, bringing it to £5bn in each of the next three years.

The new planning totals also contain substantial reserves, rising from £3½bn in 1987-88 to £7½bn in 1989-90.

FERB, Turnbull, Scholar

These are larger than in any previous survey with the exception of last year's, when, exceptionally, local authority provision was artificially set at the same cash figure for all three years and special allowance had to be made for this in setting the reserves.

The public expenditure increases I have announced allow us to make realistic provision both for local authority current expenditure, over which the Government has no direct control, and for demand-led programmes such as social security, while still leaving scope for increased spending on services to which the Government attaches particular priority.

But before referring to some of the more important changes, let me make one thing absolutely clear.

There can be no question of allowing the projected increases in public expenditure over the next three years

to undermine the prudence of the Government's overall fiscal stance, either next year or subsequently.

See separate note with comment.

The Government's fiscal stance will remain as set out in the medium-term financial strategy published at the time of this year's Budget.

Turnbull/CST amendment to detailed progs

~~Pending~~ CST's ~~news~~

[The largest increase [~~comes on~~ is for] local authorit~~y~~ies whose current spending ~~[where provision for 1987-88 and 1988-89 had previously been set at]~~ is now put next year at £4 billion above previous provision. This in part reflects the fact that the previous plans simply carried forward the same ~~cash~~ level of cash spending as in 1986-87. ~~[pending further decisions. Full account has now been taken of likely future levels of spending, and this has meant an increase of £4bn in provision for 1987-88.] [Over half of this increase is for]~~ But it also demonstrates the priority we are giving to education, which, including the new proposals on pay and conditions of service for teachers announced last week, account for about half the increase. A further major portion of the increase is for the police. ~~[In subsequent years provision has been set so as to grow [broadly in line with] inflation.]~~

In addition to the increased provision for the cost of education in schools contained within local authority current spending, there will be additional provision for universities of £60m in 1987-88 and £70m in 1988-89.

Peirson

Spending on the health and personal social services will be substantially increased. ~~[by £310m in 1987-88 with further increases in subsequent years.]~~ For the health service alone, the increases in England [are] will be about £300 million a year. Combined with the resources increasingly being generated by greater efficiency, this will provide both for ~~not only meet the growing demands on the health service but will allow it to~~ improved services and for the growing number of patients. I prefer original: "demands" is much wider than "growing number of patients"; it covers primary care too.

I don't like either much.

In addition to enjoying the benefits of substantially higher receipts from council house sales [- nearly £1bn over the three years -] housing investment will be increased by £225m in 1987-88. This will sustain the rising trend of spending on renovation and improvements and provide extra resources for the housing associations.

PEM suggests omitting because of worries that it might get added to privatisation proceeds.

Peirson

[~~In the light of this year's experience,~~] £1¾bn has been added to next year's provision for social security, most of which represents greater take-up of existing means-tested benefits.

CST/Turnbull suggests redraft: "The effects on the plans of the rise in demand-led expenditure is shown particularly in next year's increased provision of £1¾ bn for social security.

I prefer Peirson

I don't.

For defence, the provision remains as planned in the last White Paper after allowing for minor changes, including a reduction in the estimated cost of the Falklands deployment. The plans thus provide Continued stability for defence expenditure ~~plans has thus been provided~~, with the ~~defence~~ programme ~~will continue to~~ benefiting from the substantial real growth in previous years and the wide-ranging action to improve efficiency and value for money.

Within these plans, overall has been increased by nearly

? [Additional] capital spending A [will be approaching] £1 billion in 1987-88, of which about two-thirds is accounted for by local authorities

[A summary table setting out the figures for each programme will be available in the Vote Office as soon as I have sat down, and] further details of these and other changes will be contained in the printed Autumn Statement which will be published as soon as the House returns next

already of p1.

CST/Turnbull

Spending on roads is being increased by £65 million next year and £75 million the year after, mostly for local authority roads.

week. In addition, full details, together with information on running costs and manpower, will be given in the public expenditure White Paper early in the New Year.

I now turn to National Insurance contributions. The Government have conducted the usual Autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the national insurance fund, and taking account of the benefit uprating which my Rt Hon Friend the Secretary of State for Social Services announced on 22 October.

The lower earnings limit will be increased next April to £39 a week, in line with the single person's pension, and the upper earnings limit will be similarly raised to £295 a week. The limits for the reduced rate bands which I announced in last year's Budget will also be increased again in April, but by proportionately larger amounts. [Thus] the upper limit for the 5 per cent and 7 per cent bands will be raised to £65 a week and £100 a week respectively, and the upper limit for the 9 per cent rate for employers will be raised to £150 a week. The taxpayer's contribution to the National Insurance Fund - the so-called Treasury Supplement - will be reduced by 2 per cent to 7 per cent, but this will not require any change in contribution rates. Thus the main Class I contribution rates will once again remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

Says what the rates are before announcing they're unchanged.

SECRET

9.

Finally, I turn to the Industry Act Forecast.

Both growth and inflation have turned out to be slightly lower this year than I envisaged at the time of the Budget.

Growth now looks like turning out at 2½ per cent, against a Budget forecast of 3 per cent, and inflation in the x fourth Quarter of this year [~~now looks~~ is] likely to be 3¾ per cent, against the Budget forecast of 3½ per cent. The principal reason for this slower growth has been the disappointing performance of exports, which were hard hit by the cutback in spending by OPEC and other primary producers affected by the sharp fall in commodity prices in general and the oil price in particular. [These are export markets of particular importance to the UK.]

Sedgwick says not true ? ? I will check

Combined with a halving in the value of our own oil exports, this has meant a significant deterioration in the current account of the balance of payments, from a surplus of [~~from £Xbn~~ just over £3½ bn] in 1985 - and a cumulative surplus of [~~£YZbn~~] £21 bn over the six years from 1980 to 1985 inclusive - to a forecast of broad balance for 1986.

Looking ahead to 1987 the prospects are generally encouraging. While the [~~inescapable~~ necessary] adjustment of the exchange rate to the oil price collapse has now taken place, it will inevitably take time before the full benefits come through in higher non-oil exports and

Sedgwick

reduced import penetration at home.

This means we can expect the current account of the balance of payments to go into deficit next year[, for the first time since 1979,] to the tune of some £1½bn.

I'd keep in.

Sedgwick

Even so, visible exports are forecast to rise next year by 3 per cent, compared with an increase of only ~~1~~ 2 per cent this year, with manufacturing output, in consequence, up by 4 per cent. And with domestic demand continuing to expand at the same rate as this year, and fixed investment growing by about 2½ per cent next year, the economy overall is [likely to grow by a further 3 per cent next year] on course for a year of balanced growth - the sixth successive year of growth at 3 per cent or thereabouts, and into the seventh.

Ch Better comparison is excluding oil & countries, which goes 1½/5½% AA

Done in speech.

Michael's additions are perhaps overdoing it

Scholar

Scholar

Recorded inflation is likely to edge up a little, to 3¾ per cent in the Fourth Quarter of 1987.

Sedgwick + CST (PEM suggest omitting both). I agree CST.

This is [~~entirely~~/almost entirely] due to the effect on the RPI of the timing of mortgage rate changes; [and] the Government's commitment to a monetary policy that will squeeze out inflation remains unabated.

Norgrove says PM nervous about unemployment forecasts.

Meanwhile the likelihood of faster growth next year, coming at a time when unemployment already appears to have stopped rising, suggests that the prospects for some fall in unemployment are now more promising [than at any previous time this decade.]

PEM feels this is out of place

[But this promise could still be frustrated by

SECRET

11

excessive pay settlements. The full text of the Autumn forecast is to be published today and is now available in the Vote Office.

Scholar (in line with amendment on p1)

It will, of course, also be included in the printed Autumn Statement next week.

Mr Speaker, the strategy we have followed since 1979 has brought inflation down to the lowest level for two decades, combined with sustained growth and steadily rising living standards.

This is a combination that has eluded successive Governments for a generation. We have brought it about by the determined pursuit of free markets and sound money.

And that is what we will stick to.

31

PPS in ?

PWP

CONFIDENTIAL

From: R B SAUNDERS

Date: 3 November 1986

Overtaken

PRINCIPAL PRIVATE SECRETARY

cc Chief Secretary
Financial Secretary
Mr Cassell
Mr Monck
Mr Scholar
Miss Sinclair
Mr M L Williams
Miss C Evans
Ms Leahy

PS/IR
Mr Pitts - IR

AUTUMN STATEMENT: APRT

Sir Peter Middleton has seen Mr Williams' minute of 31 October. He would be inclined to redraft the paragraph as follows:

> "The fall in oil prices ... the North East. I am therefore proposing an adjustment ... Advance Petroleum Revenue Tax. With lower oil prices ... expected, and in some cases not at all. This change ... Inland Revenue. These new arrangements ... £300 million. There will ... later years."

2. Sir Peter Middleton would also prefer to drop the first two sentences, and make the whole thing contingent on the "forced loan" effects of the fall in the oil price. But he recognises that this may not be right politically.

RBS

R B SAUNDERS
Private Secretary

RA7.24

? move 3/3½ 1986/87 / 1¼ ? ½

FROM: A C S ALLAN
DATE: 3 November 1986

CHANCELLOR

ORAL AUTUMN STATEMENT

Not surprisingly, the passage which has attracted most attention is the one at the top of page 6 on fiscal policy and the MTFS. The various comments are as follows:

(i) Sir P Middleton and Sir T Burns say "fiscal stance is not an FSBR concept. And we don't want to get hooked on a row of PSBR numbers at this stage; that is a matter for the Budget". They therefore propose that the sentence should say "The Government's fiscal stance will be set out in the MTFS published at the time of next year's Budget".

(ii) Michael Scholar prefers the earlier Peter Middleton formulation. He suggests deleting the sentence Peter and Terry amend and adding a new sentence at the end of the previous paragraph to say "These increases are bound to mean that there will be less scope in next year's Budget for cuts in taxes than there would otherwise have been".

(iii) Alastair Ross Goobey would like you to be more explicit and replace the paragraph with "... fiscal policy is determined at Budget time and depends on revenues as well as expenditure. I can assure you today that the fiscal stance published at that time will follow the existing planned path".

(iv) David Norgrove reported to me that the Prime Minister would favour a more explicit reference to the PSBR path underlying your formulation.

(v) Robert Culpin was content with your formulation, provided he could say "yes" if asked if this did mean you were saying you were sticking to the PSBR path in the MTFS.

2. The other points are worth noting.

(i) Andrew Turnbull wriggles around with your presentation of GGE + PCMOB etc (page 2). But I think his redraft is broadly acceptable.

(ii) Robin Butler has the odd suggestion of leaving out the references to the £4½ billion/£5½ billion increases as being too stark (and leaving people to work this out for themselves).

3. Otherwise the points are mainly small drafting comments - marked up on the master attached.

AA

A C S ALLAN

MASTER

SECRET

FROM: A P HUDSON
DATE: 3 NOVEMBER 1986

PS/CHIEF SECRETARY

Master
(With amendments & comments marked in blue)

cc Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Scholar
Mr Turnbull
Mr Sedgwick
Miss O'Mara
Mr Culpin
Mr Gray
Miss Noble
Mr Pickering
Mr Cropper
Mr Tyrie
Mr Ross Goobey

AUTUMN STATEMENT

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Pearson
FER Butler
Ross-Goobey
(Comments attributed to Scholar, Sedgwick and Norgrove phoned through).

APH

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SECRET

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(second formulation needed if it is a Command Paper)

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Scholar

This will cover all three of the key elements in the printed Statement: the Government's outline public expenditure plans for each of the next three years and the expected outturn for this year, proposals for next year's national insurance contributions, and the forecast of the economic prospects for 1987 required by the 1975 Industry Act.

All Scholar

The full text of the economic forecast together with ~~Summary~~ tables for ~~both~~ public expenditure and the rest of the information customarily published with this statement ~~economic forecast~~ will be available from the Vote Office as soon as I have sat down; they will be included in the printed Autumn Statement published next week // P I turn first to the outturn

for the current financial year, 1986-87.

FERB and Turnbull

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Turnbull

On the ~~revenue~~ receipts side, the North Sea tax take is likely to be even lower, by about £1bn, than I envisaged at the time of the Budget, largely because for a long period the oil price has been below the $15 a barrel level on which the Budget arithmetic was explicitly based.

Scholar

This shortfall, however, is more than offset by the continuing buoyancy of non-oil revenues, in particular VAT and Corporation Tax. ~~which~~ Non-oil revenues now look likely to exceed the Budget forecast by £1½bn. This would imply an ~~overall revenue~~ overrun on the receipts side of about £½bn, the same as ~~the projected~~ that on the expenditure side ~~overrun~~.

Turnbull

Norgrove (less mini-Budget)

At the same time I have one [tax] change {in the North Sea fiscal regime} on the revenue side to announce.

The collapse of the oil price has led to a sharp cutback

SECRET

in investment activity in the North Sea, with inevitable consequences for the UK offshore supplies industry both in Scotland and the North East of England.

Hill IR

Against this background the Government is conducting a review of the North Sea fiscal regime, and I shall be announcing my conclusions in the light of that review in the Budget.

But given the current difficulties of the offshore supplies industry, there is one change I believe it right to make without further delay.

I propose, on a carefully targeted basis, to accelerate the arrangements for the repayment to the oil companies of Advance Petroleum Revenue Tax due to them.

The details of this change, which will require legislation early in the new Session of Parliament, are set out in a Press Notice the Inland Revenue will be issuing as soon as I have sat down.

Hill IR

The new arrangements will have a revenue cost [~~result in a loss of revenue~~] this financial year of some £300m, which will [~~of course~~] be fully recouped over the next three years.

Taking this into account, the Public Sector Borrowing Requirement for the current year is now forecast to be about £7½bn, slightly above the £7bn figure which I set in the Budget. // I turn now to the public expenditure plans for the next three years. This year, for the fourth successive year, public spending is set to decline as a proportion of national output, both before and after deducting the proceeds of privatisation.

FERB

[And this remains true even before deducting the proceeds of privatisation.]

The Government is determined to ensure that this trend continues: to see to it that total public spending, even without taking account of privatisation proceeds, continues to decline as a percentage of GDP ~~as part of the Medium Term Financial Strategy~~ ~~Ross Goodey~~. The plans I am about to announce secure that objective over the ~~current planning period~~ next 3 yrs. But within this overall constraint the Government has felt it right, in the context of its policy priorities, to allow an increase in the previously announced planning totals [~~for 1987-88 and 1988-89.~~] of £144 billion for 1987-88 and £149 billion for 1988-89.

FERB

Square brackets on numbers are Turnbull, pending final roundings

Square brackets on clause are FERB

The new totals have been set at [£148½bn] for 1987-88 and [£154½bn] in 1988-89, [an increase of [~~£4½bn~~ 4¾] and [£5½bn] respectively.]

I would not take FERB's comments here NO

For 1989-90 the planning total has been set at ~~£XYZbn~~ [£161½bn].

¶ Compared with the forecast outturn for 19~~9~~86-87, these totals [~~suggest~~ indicate] an average growth of public spending of [~~a shade over~~] about 1¼ per cent a year in real terms, well within the prospective growth of the economy as a whole.

FERB + Turnbull

As usual, these totals incorporate estimates for the proceeds of privatisation. Last year I increased the estimate of these proceeds very substantially to £4¾bn in each of the three Survey years, a figure which I expect

SECRET

to be duly achieved this year.

Although the privatisation programme is now moving ahead more strongly than ever before, I have decided to make only a modest further addition to this estimate, bringing it to £5bn in each of the next three years.

The new planning totals also contain substantial reserves, rising from £3½bn in 1987-88 to £7½bn in 1989-90.

FERB, Turnbull, Scholar

~~These are larger than in any previous survey with the exception of last year's, when, exceptionally, local authority provision was artificially set at the same cash figure for all three years and special allowance had to be made for this in setting the reserves.~~ 1987/88

The public expenditure increases I have announced allow us to make realistic provision both for local authority current expenditure, over which the Government has no direct control, and for demand-led programmes such as social security, while still leaving scope for increased spending on services to which the Government attaches particular priority.

But before referring to some of the more important changes, let me make one thing absolutely clear.

There can be no question of allowing the projected increases in public expenditure over the next three years

to undermine the prudence of the Government's overall fiscal stance, [either next year or subsequently.]

See separate note with comments.

The Government's fiscal stance will remain as set out in the medium-term financial strategy published at the time of this year's Budget.

Turnbull/CST amendment to detailed progs

~~Pending CST's views~~

[The largest increase is for ~~comes on~~ local authorities whose current spending ~~where provision for 1987-88 and 1988-89 had previously been set at~~ is now put next year at £4 billion above previous provision. This in part reflects the fact that the previous plans simply carried forward the same ~~cash~~ level of cash spending as in 1986-87. ~~pending further decisions. Full account has now been taken of likely future levels of spending, and this has meant an increase of £4bn in provision for 1987-88. Over half of this increase is for~~ But it also demonstrates the priority we are giving to education, which including the new proposals on pay and conditions of service for teachers announced last week, accounts for about half the increase. A further major portion of the increase is for the police. ~~In subsequent years provision has been set so as to grow [broadly in line with] inflation.~~

XRSG

In addition to the increased provision for the cost of education in schools contained within local authority current spending, there will be additional provision for universities of £60m in 1987-88 and £70m in 1988-89.

Spending on the health and personal social services will be substantially increased. ~~by £310m in 1987-88 with further increases in subsequent years.~~

Peirson

For the health service alone, the increases in England [are] will be about £300 million a year.

Combined with the additional resources increasingly being generated

? [illegible]

by greater efficiency, this will provide both for ~~not only meet the growing demands on the health service but will allow it to~~ improved services and for the growing number of patients.

I prefer original: "demands" is much wider than "growing number of patients", which carries funny overtones.

In addition to enjoying the benefits of substantially higher receipts from council house sales ~~- nearly £1bn over the three years -~~ housing investment will be increased by £225m in 1987-88. This will sustain the rising trend of spending on renovation and improvements and provide extra resources for the housing associations.

PEM suggests omitting because of worries that it might get added to privatisation proceeds.

Peirson

stet

~~In the light of this year's experience,~~ £1¾bn has been added to next year's provision for social security, most of which represents a greater expected take-up of existing means-tested benefits.

I prefer Peirson.

CST/Turnbull suggests redraft: ~~"The effects on the plans of the rise in demand-led expenditure is shown particularly in next year's increased provision of £1¾ bn for social security.~~

For defence, the provision remains as planned in the last White Paper after allowing for minor changes, including a reduction in the estimated cost of the Falklands deployment. ~~Continued stability for defence expenditure plans has thus been provided, with~~ The defence programme will continue to benefiting from the substantial real growth in previous years and the wide-ranging action to improve efficiency and value for money.

Within these plans,

~~Additional~~ capital spending has been increased by nearly ~~will be approaching~~ £1 billion in 1987-88, of which about two-thirds is accounted for by local authorities

stet/

~~A summary table setting out the figures for each programme will be available in the Vote Office as soon as I have sat down, and~~ further details of these and other changes will be contained in the printed Autumn Statement which will be published as soon as the House returns next

ahead of p1.

CST/Turnbull

Spending on roads is being increased by £65 million next year and £75 million the year after, mostly for local authority roads.

week. In addition, full details, together with information on running costs and manpower, will be given in the public expenditure White Paper early in the New Year.

I now turn to National Insurance contributions. The Government have conducted the usual Autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the national insurance fund, and taking account of the benefit uprating which my Rt Hon Friend the Secretary of State for Social Services announced on 22 October.

The lower earnings limit will be increased next April to £39 a week, in line with the single person's pension, and the upper earnings limit will be similarly raised to £295 a week. The limits for the reduced rate bands which I announced in last year's Budget will also be increased again in April, but by proportionately larger amounts. [~~Thus~~] The upper limit for the 5 per cent and 7 per cent bands will be raised to £65 a week and £100 a week respectively, and the upper limit for the 9 per cent rate for employers will be raised to £150 a week. The taxpayer's contribution to the National Insurance Fund - the so-called Treasury Supplement - will be reduced by 2 per cent to 7 per cent, but this will not require any change in contribution rates. Thus the main Class I contribution rates will once again remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

SECRET

Finally, I turn to the Industry Act Forecast.

Both growth and inflation have turned out to be slightly lower this year than I envisaged at the time of the Budget.

Growth now looks like turning out at 2½ per cent, against a Budget forecast of 3 per cent, and inflation in the ~~Fourth Quarter~~ fourth quarter of this year is ~~now looks~~ likely to be 3¾ per cent, against the Budget forecast of 3½ per cent. The principal reason for this slower growth has been the disappointing performance of exports, which were hard hit by the cutback in spending by OPEC and other primary producers affected by the sharp fall in commodity prices in general and the oil price in particular. ~~These are export markets of particular importance to the UK.~~

Sedgwick says not true ?? I will check

Combined with a halving in the value of our own oil exports, this has meant a significant deterioration in the current account of the balance of payments, from a surplus of just over £3½ bn ~~from £Xbn~~ in 1985 - and a cumulative surplus of £21 bn ~~£Yzbn~~ over the six years from 1980 to 1985 inclusive - to a forecast of broad balance for 1986.

Looking ahead to 1987 the prospects are generally encouraging. While the necessary ~~inescapable~~ adjustment of the exchange rate to the oil price collapse has now taken place, it will inevitably take time before the full benefits come through in higher non-oil exports and

Sedgwick

reduced import penetration at home.

This means we can expect the current account of the balance of payments to go into deficit next year[, for the first time since 1979,] to the tune of some £1½bn.

Sedgwick

Ch

Better comparison is excluding oil & erratics, which goes 1½/5½%

AA

Even so, [~~visible~~ non-oil] exports are forecast to rise next year by 3 per cent, compared with an increase of only ~~1~~ 2 per cent this year, with manufacturing output, in consequence, up by 4 per cent. And with domestic demand continuing to expand at the same rate as this year, ~~and fixed investment growing by about 2½ per cent next year,~~ the economy overall is [likely to grow by a further 3 per cent next year] ~~on course for a year of balanced growth~~ - the sixth successive year of growth at 3 per cent or thereabouts~~, and into the seventh~~.

Scholar

Michael's additions are perhaps overdoing it

Scholar

Record~~ed~~ inflation is likely to edge up a little, to 3¾ per cent in the Fourth Quarter of 1987.

Sedgwick + CST (PEM suggest omitting both).

This is [~~entirely~~/almost entirely] due to the effect on the RPI of the timing of mortgage rate changes; [~~and~~] the Government's commitment to a monetary policy that will squeeze out inflation remains unabated.

Meanwhile the likelihood of faster growth next year, coming at a time when unemployment already appears to have stopped rising, suggests that the prospects for some fall in unemployment are now more promising ~~[than at any previous time this decade.]~~

Norgrove says PM nervous about unemployment forecasts.

PEM feels this is out of place

[But this promise could still be frustrated by

excessive pay settlements. ~~The full text of the Autumn forecast is to be published today and is now available in the Vote Office.~~

Scholar (in line with amendment on p1)

~~It will, of course, also be included in the printed Autumn Statement next week.~~

Mr Speaker, the strategy we have followed since 1979 has brought inflation down to the lowest level for two decades, combined with sustained growth and steadily rising living standards.

This is a combination that has eluded successive Governments for a generation. We have brought it about by the determined pursuit of free markets and sound money.

And that is what we will stick to.

Jonathan on spot

Chancellor wants to get the point in the previous paragraph could be extended by the words "...... proportion of national output, both before and after deducting the proceeds of privatisation".

Perhaps because I am so appalled by them, I find that the figures of £4½ billion and £5½ billion for the increases in the planning total half-way down that page come in very starkly. I would suggest deleting the words "an increase of £4½ billion and £5½ billion respectively" and allowing people to do their own arithmetic by extending the end of the previous paragraph to read ".... to allow an increase in the previously announced planning totals of £144 billion for 1987-88 and £149 billion in 1988-89". Even so, I would have felt happier with a slower build-up to this announcement.

In the penultimate paragraph on that page I suggest redrafting "...... these totals indicate an average growth of public spending of about 1¼ per cent a year in real terms ......".

Page 5: I favour including the square bracketed paragraph in the middle of the page.

F.E.R.B.

F. E. R. BUTLER

TURNBULL

2136/036

SECRET & PERSONAL

FROM: A Turnbull
DATE: 3 November 1986

MR HUDSON

cc PS/Chancellor
PS/CST
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Monck
Mr Scholar
Mr Sedgwick
Mr Mowl

Mr Gray
Miss O'Mara
Mrs Dunn
Mr Tyrie

AUTUMN STATEMENT: ORAL

I am minuting you separately about the references to departmental programmes.

2. I have a number of comments to make on the rest:

(i) Page 2, line 3. The outturn for the current year is now put at £140.4 billion, £1.3 billion over the plan. While £140½ billion is still the right figure to use for the total, the change could be expressed as £1¼ billion, though this change would need to be carried through into the text of the Industry Act.

(ii) Elsewhere on <u>page 2</u>. The Chancellor has adopted the presentation which shows the overrun on the PSBR as broadly the same magnitude as the policy change. But in one or two places he is creating a new expenditure aggregate, the disadvantages of which I set out in my minute of 31 October. Also there is a logical error in the way he has set out the argument. He has gone from the planning total to the total of the changes on the expenditure side, highlighting PCMOB. But PCMOB plays no part in this difference

Planning total
+ Debt interest
+ PCMOB
+ National accounts adjustments
= GGE
- PCMOB
= Total of changes on the expenditure side.

COMMENTS:
FERB

SECRET

FROM: F. E. R. BUTLER
3rd November, 1986.

MR. HUDSON

c.c. Chief Secretary
Sir P. Middleton
Sir T. Burns
Mr. Scholar
Mr. Turnbull
Mr. Sedgwick
Miss O'Mara
Mr. Culpin
Mr. Gray
Miss Noble
Mr. Pickering
Mr. Cropper
Mr. Tyrie
Mr. Ross Goobey

AUTUMN STATEMENT

I offer these comments on the draft attached to your minute of 3rd November. I have concentrated on the public expenditure passage, excluding the paragraphs on individual programmes on which a revised draft incorporating the Chief Secretary's comments is being circulated.

Page 2, first main paragraph - on the basis of the latest figures for the current year the first two lines could read:-

> "Public expenditure planning total now looks likely to amount to just under £140½ billion - £1¼ billion, or a little less than 1 per cent, more than was allowed for in this year's public expenditure white paper".

Mr. Turnbull is providing a revised version of the latter part of that paragraph.

Page 4: I suggest leaving out the single sentence, first main paragraph: since it is so marginally true, it seems best not to make a feature of it. If the

But the two PCMOB changes cancel out so the difference between the planning total and the total of changes on the expenditure side is explained by the debt interest and the other adjustments.

I suggest the following drafting changes which should give everyone what they want. It gives the Chancellor the presentation he is after, it sidesteps the PCMOB problem, and avoids the creation of a new aggregate:

- in line 8: "However, other items on the expenditure side which lie outside the planning total, the largest of which is debt interest, are likely to fall short of what was forecast at the time of the Budget, reducing the overrun on the expenditure side to about £½ billion."

Line 13 "On the receipts side". Receipts and Expenditure then mirror the terminology of the headings of table 1.2 of the PSBR.

Line 22 (paragraph numbers please in next edition) "This would imply an overrun on the receipts side of about £½ billion, the same as on the expenditure side".

(iii) Page 4, lines 14 and 15. The planning totals quoted here will have to reflect the precise arithmetic and the way it can be rounded. For the moment, these figures are close to the final outcome but should be put in square brackets. (It looks as if the increase in 1987-88 will be around £4.7 billion and that in 1988-89 £5.5 billion, so the rounding in the first year is a bit suspect. GEP will be making a submission tomorrow on how to close the books).

(iv) Page 4, line 17. Put in £161½ billion in square brackets.

(v) Line 20. "... of around 1¼ per cent". The increase on the precise definition varies.

	Annual average 1986-87 to 1989-90
PT with priv proceeds	1.35
PT without priv proceeds	1.26
GGE with priv proceeds	1.24
GGE without priv proceeds	1.16

Referring to 1¼ per cent is sound for all definitions.

AT

A TURNBULL

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GGE without priv proceeds	1.16

Referring to 1¼ per cent is sound for all definitions.

AT

A TURNBULL

TURNBULL: DEPARTMENTAL PROGRAMMES

2136/036

SECRET

FROM: A Turnbull
DATE: 3 November 1986

MR HUDSON

cc PS/Chancellor
PS/CST
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Monck
Mr Scholar
HEGs
Mr Gray
Miss O'Mara
Mrs Dunn
Mr Tyrie

AUTUMN STATEMENT: ORAL

I attach a passage on the departmental programmes which embodies the comments of the Chief Secretary. These references have not yet been cleared with departments. I would be grateful if divisions could now do this and let me have any suggested changes by midday tomorrow, 4 November, please.

AT

A TURNBULL

Reverse order

12. Spending on the health service will be increased by about £300 million in 1987-88 and 1988-89. Combined with the resources increasingly being generated by greater efficiency this will allow the health service to respond to new and growing demands with improved services.

13. The largest single increase is for local authorities whose current spending is now put next year at £4 billion above the previous provision. This in part reflects the fact that the previous plans simply carried forward the same level of cash spending as in 1986-87. But it also demonstrates the priority we are giving to education which, including the new proposals on pay and conditions of service for teachers announced last week, accounts for about half the increase. A further major portion of the increase is for the police. In addition to the increased provision for the cost of education in schools contained within the local authority current spending, there will be additional provision for universities of £60 million in 1987-88 and £70 million in 1988-89.

14. In addition to enjoying the benefits of substantially higher receipts from council house sales - nearly £1 billion over three years - housing investment will be increased by £225 million in 1987-88. This will sustain the rising trend of spending on renovation and improvements and provide extra resources for the housing associations.

15. The effects on the plans of the rise in demand-led expenditure is shown particularly in next year's increased provision of £1¾ billion for social security.

16. Spending on roads is being increased by £65 million next year and £75 million the year after, mostly for local authority roads.

17. For defence, the provision remains as planned in the last White Paper after allowing for minor changes, including a reduction in the estimated costs of the Falklands deployment. Continued stability for defence expenditure plans has thus been provided,

with the programme benefiting from the substantial real in previous years and the wide-ranging action to improve efficiency and value for money.

18. Additional capital spending will be approaching £1 billion in 1987-88, of which about two-thirds is accounted for by local authorities.

PEIRSON

3.11.03

SECRET

FROM: MISS M E PEIRSON
DATE: 3 November 1986

MR A P HUDSON

cc PS/Chief Secretary
Mr F E R Butler
Mr Turnbull
Ms Boys
Mr Culpin
Mr Gray
Miss O'Mara
Miss Noble
Mr Pickering
Mr Cropper
Mr Tyrie
Mr Ross Gooby

AUTUMN STATEMENT: ORAL

1. I have the following suggestions ~~o~~on the draft paragraphs on health and social security, on which I am now consulting the DHSS. I may have further suggestions to make when I have their comments.

2. On health (bottom of page 6) it seems necessary to start with a reference to health and personal social services, since the summary table will not show health alone, and the increase in health and personal social services is more than twice the increase in health. It is also necessary to refer to England, since there will be substantial corresponding increases in Scotland, Wales and Northern Ireland. Also, I have already consulted the DHSS about the second sentence, and the following reflects their views.

> "Spending on the health and personal social services will be substantially increased. For the health service alone, the increases in England are about £300 million a year. Combined with the resources being generated by greater efficiency, this will provide both for improved services and for the growing number of patients."

3. For social security (middle of page 7), I have two comments:-

SECRET

(i) It is not possible to begin "In the light of this year's experience" now that nothing is being said about the contribution of social security to the overrun in the current year, earlier in the statement. So delete that phrase.

(ii) I am still battling with DHSS over the last phrase ("greater take-up of existing means-tested benefits"). They would prefer "increased numbers of beneficiaries". I shall let you know the outcome.

MEP

MISS M E PEIRSON

MIDDLETON

SM2/77

SECRET

FROM: A P HUDSON
DATE: 3 NOVEMBER 1986

PS/CHIEF SECRETARY

cc Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Scholar
Mr Turnbull
Mr Sedgwick
Miss O'Mara
Mr Culpin
Mr Gray
Miss Noble
Mr Pickering
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Allan,

An important change on P6. And a minor on on p10. And a comment on p10.

BM 3/11

AUTUMN STATEMENT

I attach the Chancellor's own draft of the Oral Statement.

2. The sections on detailed public expenditure measures are pending the Chief Secretary's views.

3. Please could I have comments and additional contributions by close tonight?

A P HUDSON

SM/AS

SECRET

1

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

Cabinet today agreed the Government's public expenditure plans for the next three years.

In the normal course of events that would be followed by the publication of the printed Autumn Statement, accompanied by an Oral Statement to the House, next Tuesday.

For obvious reasons that is not possible this year.

So while the Autumn Statement will be printed in the normal way and laid before the House as soon as it reassembles next Wednesday, I thought it would be for the convenience of the House if I made my Oral Statement today.

This will cover all three of the key elements in the printed Statement: the Government's outline public expenditure plans for each of the next three years and the expected outturn for this year, proposals for next year's national insurance contributions, and the forecast of the economic prospects for 1987 required by the 1975 Industry Act.

Summary tables for both public expenditure and the economic forecast will be available from the Vote Office as soon as I have sat down. // P I turn first to the outturn

for the current financial year, 1986-87.

The public expenditure planning total now looks likely to amount to some £140½bn // £1½bn, or a little over 1 per cent, more than was allowed for in this year's Public Expenditure White Paper. The main reason~~s~~ for this excess is an 8 per cent rise in the current spending of local authorities - far more than was provided for. However, two major items of public expenditure which lie outside the planning total, debt interest and the overseas borrowings of the nationalised industries, are likely to fall £1bn short of what was forecast at the time of the Budget, which reduces the overall expenditure overrun to about £½bn.

On the revenue side, the North Sea tax take is likely to be even lower, by about £1bn, than I envisaged at the time of the Budget, largely because for a long period the oil price has been below the $15 a barrel level on which the Budget arithmetic was explicitly based.

This shortfall, however, is more than offset by the continuing buoyancy of non-oil revenues, in particular VAT and Corporation Tax, which now look likely to exceed the Budget forecast by £1½bn. This would imply an overall revenue overrun of about £½bn, the same as the projected expenditure overrun.

At the same time I have one tax change to announce.

The collapse of the oil price has led to a sharp cutback

SECRET

3

in investment activity in the North Sea, with inevitable consequences for the UK offshore supplies industry both in Scotland and the North of England.

Against this background the Government is conducting a review of the North Sea fiscal regime, and I shall be announcing my conclusions in the light of that review in the Budget.

But given the current difficulties of the offshore supplies industry, there is one change I believe it right to make without further delay.

I propose, on a carefully targeted basis, to accelerate the arrangements for the repayment to the oil companies of Advance Petroleum Revenue Tax due to them.

The details of this change, which will require legislation early in the new Session of Parliament, are set out in a Press Notice the Inland Revenue will be issuing as soon as I have sat down.

The new arrangements will result in a loss of revenue this financial year of some £300m, which will of course be fully recouped over the next three years.

Taking this into account, the Public Sector Borrowing Requirement for the current year is now forecast to be about £7½bn, slightly above the £7bn figure which I set in the Budget. // I turn now to the public expenditure plans for the next three years. This year, for the fourth successive year, public spending is set to decline as a proportion of national output.

And this remains true even before deducting the proceeds of privatisation.

The Government is determined to ensure that this trend continues: to see to it that total public spending, even without taking account of privatisation proceeds, continues to decline as a percentage of GDP. The plans I am about to announce secure that objective. But within this overall constraint the Government has felt it right, in the context of its policy priorities, to allow an increase in the previously announced planning totals for 1987-88 and 1988-89.

The new totals have been set at £148½bn for 1987-88 and £154½bn in 1988-89, an increase of £4½bn and £5½bn respectively.

For 1989-90 the planning total has been set at £XYZbn.

// Compared with the forecast outturn for 1986-87, these totals suggest an average growth of public spending of a shade over 1 per cent a year in real terms, well within the prospective growth of the economy as a whole.

As usual, these totals incorporate estimates for the proceeds of privatisation. Last year I increased the estimate of these proceeds very substantially to £4¾bn in each of the three Survey years, a figure which I expect

to be duly achieved this year.

Although the privatisation programme is now moving ahead more strongly than ever before, I have decided to make only a modest further addition to this estimate, bringing it to £5bn in each of the next three years.

The new planning totals also contain substantial reserves, rising from £3½bn in 1987-88 to £7½bn in 1989-90.

[These are larger than in any previous survey with the exception of last year's, when, exceptionally, local authority provision was artificially set at the same cash figure for all three years and special allowance had to be made for this in setting the reserves.]

The public expenditure increases I have announced allow us to make realistic provision both for local authority current expenditure, over which the Government has no direct control, and for demand-led programmes such as social security, while still leaving scope for increased spending on services to which the Government attaches particular priority.

again!

But before referring to some of the more important changes, let me make one thing absolutely clear.

There can be no question of allowing the projected increases in public expenditure over the next three years

to undermine the prudence of the Government's overall fiscal stance, either next year or subsequently.

[The Government's fiscal stance will ~~remain as~~ be set out in the medium-term financial strategy published at the time of ~~this~~ next year's Budget.]

Fiscal stance is not an PSBR concept. Awkward to get drawn into a row however on PSBR numbers at this stage; that is a matter for the Budget. Hence the suggested amendment. TB agrees. 3/11

Pending CST's news

[The largest increase comes on local authority current spending, where provision for 1987-88 and 1988-89 had previously been set at the same cash level as in 1986-87, pending further decisions. Full account has now been taken of likely future levels of spending, and this has meant an increase of £4bn in provision for 1987-88. Over half of this increase is for education, including the new proposals on pay and conditions of service for teachers announced last week. A further major portion of the increase is for the police. In subsequent years provision has been set so as to grow [broadly in line with] inflation.

In addition to the increased provision for the cost of education in schools contained within local authority current spending, there will be additional provision for universities of £60m in 1987-88 and £70m in 1988-89.

Spending on the health service will be increased by £310m in 1987-88 with further increases in subsequent years. Combined with the resources increasingly being generated by greater efficiency, this will not only meet the growing demands on the health service but will allow it to improve services.

In addition to enjoying the benefits of substantially higher receipts from council house sales - (nearly £1bn over the three years) - housing investment will be increased by £225m in 1987-88. This will sustain the rising trend of spending on renovation and improvements and provide extra resources for the housing associations.

Is this wise. It might get added into asset sales.

In the light of this year's experience, £1¾bn has been added to next year's provision for social security, most of which represents greater take-up of existing means-tested benefits.

For defence, the provision remains as planned in the last White Paper after allowing for minor changes, including a reduction in the estimated cost of the Falklands deployment. The defence programme will continue to benefit from the substantial real growth in previous years and the wide-ranging action to improve efficiency and value for money.]

A summary table setting out the figures for each programme will be available in the Vote Office as soon as I have sat down, and further details of these and other changes will be contained in the printed Autumn Statement which will be published as soon as the House returns next

week. In addition, full details, together with information on running costs and manpower, will be given in the public expenditure White Paper early in the New Year.

I now turn to National Insurance contributions. The Government have conducted the usual Autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the national insurance fund, and taking account of the benefit uprating which my Rt Hon Friend the Secretary of State for Social Services announced on 22 October.

The lower earnings limit will be increased next April to £39 a week, in line with the single person's pension, and the upper earnings limit will be similarly raised to £295 a week. The limits for the reduced rate bands which I announced in last year's Budget will also be increased again in April, but by proportionately larger amounts. Thus the upper limit for the 5 per cent and 7 per cent bands will be raised to £65 a week and £100 a week respectively, and the upper limit for the 9 per cent rate for employers will be raised to £150 a week. The taxpayer's contribution to the National Insurance Fund - the so-called Treasury Supplement - will be reduced by 2 per cent to 7 per cent, but this will not require any change in contribution rates. Thus the main Class I contribution rates will once again remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

Finally, I turn to the Industry Act Forecast.

Both growth and inflation have turned out to be slightly lower this year than I envisaged at the time of the Budget.

Growth now looks like turning out at $2\frac{1}{2}$ per cent, against a Budget forecast of 3 per cent, and inflation in the

x Fourth Quarter of this year now looks likely to be $3\frac{1}{4}$ per cent, against the Budget forecast of $3\frac{1}{2}$ per cent. The principal reason for this slower growth has been the disappointing performance of exports, which were hard hit by the cutback in spending by OPEC and other primary producers affected by the sharp fall in commodity prices in general and the oil price in particular. These are export markets of particular importance to the UK.

Combined with a halving in the value of our own oil exports, this has meant a significant deterioration in the current account of the balance of payments, a surplus of from £Xbn in 1985 - and a cumulative surplus of £YZbn over the six years from 1980 to 1985 inclusive - to a forecast of broad balance for 1986.

Looking ahead to 1987 the prospects are generally encouraging. While the inescapable adjustment of the exchange rate to the oil price collapse has now taken place, it will inevitably take time before the full benefits come through in higher non-oil exports and

reduced import penetration at home.

This means we can expect the current account of the balance of payments to go into deficit next year, for the first time since 1979, to the tune of some £1½bn.

?

Even so, exports are forecast to rise next year by 3 per cent, compared with an increase of only 1 per cent this year, with manufacturing output, in consequence, up by 4 per cent. And with domestic demand continuing to expand at the same rate as this year, the economy overall is likely to grow by a further 3 per cent next year - the sixth successive year of growth at 3 per cent or thereabouts, and into the seventh.

Doesn't AS say 2¾%

Recorded inflation is likely to edge up a little, to 3¾ per cent in the Fourth Quarter of 1987.

This is [~~entirely/almost entirely~~] due to the effect on the RPI of the timing of mortgage rate changes, and the Government's commitment to a monetary policy that will squeeze out inflation remains unabated.

?

Meanwhile the likelihood of faster growth next year, coming at a time when unemployment already appears to have stopped rising, suggests that the prospects for some fall in unemployment are now more promising than at any previous time this decade.

Would delete this as out of place.

[But this promise could still be frustrated by

SECRET

11

excessive pay settlements. // The full text of the Autumn forecast is to be published today and is now available in the Vote Office.

It will, of course, also be included in the printed Autumn Statement next week.

Mr Speaker, the strategy we have followed since 1979 has brought inflation down to the lowest level for two decades, combined with sustained growth and steadily rising living standards.

This is a combination that has eluded successive Governments for a generation. We have brought it about by the determined pursuit of free markets and sound money.

And that is what we will stick to.

Ross Goobey

1250/55

SECRET

FROM: A ROSS GOOBEY
DATE: 3 NOVEMBER 1986

MR HUDSON

cc CST
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Scholar
Mr Turnbull
Mr Sedgwick
Miss O'Mara
Mr Culpin
Mr Gray
Miss Noble
Mr Pickering
Mr Cropper
Mr Tyrie

AUTUMN STATEMENT

I have seen the drafts of the Chancellor's Statement.

2. Although the paragraphs at the bottom of page 5/top of page 6 make unequivocal statement about fiscal policy, I think that there will be adverse comment on the following two points.

3. First, that after four successive years of decline public expenditure (as measured by the planning total) will, at best, remain constant as a proportion of national output in 1987/88. Is there a case for inserting on page 4, para 2, line 4 after "percentage of GDP", "as part of the Medium Term Financial Strategy", and in line 5, after "objective" insert "over the current planning period"? To ignore the fact will make it seem that it is being hidden.

4. Secondly, despite natural reluctance to refer to the PSFD, comment is bound to be made on the potential effect on this item (as well as on PSBR under both measurements). The optimistic and/or sympathetic analyst will take forward the £1½ billion of non-oil revenue and assume the £1 billion shortfall on oil does not recur which brings the PSFD to £12.4 billion and leaves the PSBR at £7 billion for 1987/88 with no fiscal adjustment.

The less sympathetic will simply add the "overrun" and warn of a PSFD of £16½ billion and PSBR of £11½ billion. there is a case therefore to be made for being even more explicit on page 6, para 1, about the fiscal stance. I would insert a replacement paragraph:

> "To those who would interpret these additions to expenditure as a loosening of the fiscal targets which were published in the Medium Term Financial Strategy at the time of this year's Budget, I say that is an incorrect interpretation. Fiscal policy is determined at Budget time and depends on revenues as well as expenditure. I can assure you today that the fiscal stance published at that time will follow the existing planned path."

ARG

A ROSS GOOBEY

3119/005

SECRET

PWP

FROM: A G TYRIE
DATE: 3 NOVEMBER 1986

CHANCELLOR

cc Chief Secretary
Mr Hudson
Mr Cropper
Mr Ross Goobey

AUTUMN STATEMENT BACKBENCH BRIEF

I attach a second draft of the Backbench brief for the Autumn Statement, incorporating comments from this morning's meeting. The section on Labour can be added later. I have not yet tackled the section on spending in individual areas which will be added in an Annex.

2. Other points:

- The conclusion will need an extra few lines.

Doubt it. - Do you want anything on NICs? No

- You may want point 4 of key points to be expanded. X

AGT

A G TYRIE

Ch
Some comment marked
(Andrew shares with Terry
(a) poor proof-reading
(b) failure to know difference
between anticipate & expect!)

AA

3119/001

SECRET

SECOND DRAFT

Key points

Public spending

1. Public spending is set to decline as a proportion of national output for the fourth successive year. This is the case even when privatisation proceeds are excluded. The Autumn Statement reflects the Government's determination to ensure that this trend continues, and that public spending continues to decline as a percentage of GDP.

? (from oral AS, but sounds grudging out of context)

2. Within this overall constraint, the Government has felt it right to [allow an] increase [in] the previously announced planning totals for 1987-88 and 1988-89; enabling more to be spent on priority areas, including education, health, housing, law and order,and roads.

The economy

3. The economy is in its sixth year of steady growth and heading for its seventh, while inflation stays at the lowest level since the 1960s. ~~Grants~~ Growth should be faster next year than this, with manufacturing output increasing by 4%.

X

4. In this upswing consumption and investment have kept pace with one another, a sharp contrast with the weaker

upswing under Labour in which increases in investment lagged well behind consumption.

Fiscal policy

5. The Government's fiscal stance will remain as set out in the MTFS published in the Budget. There can be no question of permitting [projected] increases in public expenditure to undermine the prudence of the Government's overall fiscal stance.

X

Labour's plans

6. The Government's financial prudence contrasts with the profligacy of Labour's [spending] plans to increase spending by at least £28 billion. Such financial recklessness would probably force a repetition of their humiliating rescue by the IMF followed by drastic cuts in capital spending. The last Labour Government cut road building by 36% and hospital building by 31% during their five years in office.

X

New page

Strategy on public expenditure

7. The Autumn Statement sets out the Government's plans for ensuring that public spending continues to decline as a percentage of GDP. By 1989-90[, the third year of the survey,] [at X%] spending will be at its lowest level as a proportion of GDP since the early 1970s — X%. This steady decline will further reduce the burden of the State on the private sector.

8. Within this constraint the Government has felt it right to permit an increase in the previously announced planning

totals for 1987-88 of £X billion, and for 1988-89 of £Y billion.

9. Public spending has been increased in priority areas. Education will benefit from the increased provision contained within local authority current spending — and this includes additional provision for the new proposals on teachers' pay & conditions of service. There will also be an extra £60 million for universities in 1987-88 and £70 million in 1988-89.

10. Health service provision will be increased by £310 million in 1987-88 with further increases in subsequent years. The Health Service has already benefited from resources made available from greater efficiency. The combination of increased efficiency and increased provision will enable the Health Service to meet [ongoing] additional demands and to improve services.

11. Housing will also benefit. [Local authority] Housing investment will be increased by £225 million in 1987-88, in addition to the benefits from substantially higher receipts from Council house sales. These funds will sustain the rising level of spending on renovation and improvement; [and also provide] there will also be more funds for housing associations.

Value for money

12. Getting better value for money from a given level of expenditure has made its contribution. We now have 80,000 fewer civil servants, 500 fewer quangos and savings of many hundreds of millions of pounds from competitive tendering,

efficieny scrutinies, and cash released from NHS cost improvement programmes. There is more to come. More value for money savings have already been identified in the Civil Service, up to £800 million a year from defence procurement and over £1 billion a year pinpointed from the [all] Audit Commission reports on local authorities.

Privatisation

12. Planned proceeds from privatisation for 1987-88 and 1988-89 have been increased slightly from £4.75 billion to £5 billion. The achievements of the privatisation programme are well known. One fifth of the State owned commercial sector inherited in 1979 has been transferred to the private sector. Further important sales are planned, notably British Gas and British Airways. The benfits of privatisation and increased efficiency, more freedom from political and bureaucratic interference, and more incentives for management and employees alike, have been enormous.

The planning total for 1986-7

13. [The Chancellor anticipates that] The planning total for 1986-87 (will) is likely to be about £1¼ billion, (a little under over 1%) more than the White Paper figure. This is mainly because local authority current spending is up 8%, far more than provided for. However the overall expenditure overrun is likely to be reduced by two items outside the planning total - debt interest and the overseas borrowings of nationalised

amend in line with oral AS

industries. These are likely to fall £1 billion short of forecast.

North Sea oil, revenues and the PSBR

15. North Sea oil revenues will be £1 billion lower than envisaged at the time of the Budget but this will be more than offset by the buoyancy of non-oil revenues, in particular VAT and Corporation Tax, which are likely to exceed the Budget forecast by £1½ billion, leaving an overall revenue overrun of about £½ billion. This is the same as the projected expenditure overrun.

16. Public borrowing remains on track within a firm financial framework. The forecast PSBR of £7½ billion is up £½ billion on the Budget forecast. The small increase is a consequence of a change in the arrangements for repayment to the oil companies of advanced petroleum revenue tax. Given the current difficulties of the offshore supply industry the Government has decided to accelerate these repayments, at a cost of about £300 million, carefully targetted to independent companies ~~which have~~ whose cash flow has been badly affected.

16. The PSBR is staying virtually ~~unchanged~~ on track despite a massive drop in oil revenues, from £11 bn in 1985-86 to forecast £4½ bn in 1986-87. £6½ billion It is a remarkable achievement that this massive drop has been absorbed with so little difficulty. ~~Last year oil revenues were £11 billion. This year they are anticipated expected to be $4.5 billion. (Check)~~ £

Growth

17. Growth is likely to be 2½% this year, compared with

the Budget forecast of 3%, the main reason being the cut-back in spending by OPEC and other primary producers affected by the sharp fall in commodity quality prices. Next year the economy is likely to grow faster, at about 3%, taking Britain into its seventh consecutive year of growth at about this rate.

Balance of payments

19. 1985 saw a surplus in the balance of payments of £X billion making a cumulative surplus for the past six years of £X billion. For 1986 the current account is forecast to be in broad balance.

20. However, the spending cut-back by OPEC, combined with the halving in the value of Britain's oil exports, has led to a deterioration in the current account of balance of payments. It will inevitably take time for the benefits in higher non oil exports and reduced import penetration to be fully reflected in the current account. This means we can expect the current account to go into deficit next year [for the first time since 1979,] by about £1½ billion.

21. Meanwhile, export volumes are picking up after a flat period at the beginning of 1986. In non oil terms export volumes rose by 2½% in the third quarter of 1986 on the previous quarter - this is an all time high. Exports are expected to rise again in 1987. give figures (non-oil non-erratics).

22. Net overseas assets stood at £80 billion at the end of last year, giving an annual return of over £4 billion. We are now reaping the benefits of the abolition of exchange

controls and prudent investment of North Sea oil revenues.

Inflation

23. Inflation in recent months has been at its lowest level for almost 20 years. It is now back to the average of the [1950s and] 1960s. The forecast shows a small rise in recorded inflation, to 3¾% in the fourth quarter of 1987. This is largely due to the effect on the RPI of the timing of recent mortgage rate change~~s~~. The Government's commitment to squeeze out inflation by a policy of sound money remains undiminished.

Employment

24. The prospect of faster growth for next year comes at a time when unemployment already appears to have stopped rising. With economic activity picking up and the growth in the labour force slowing the prospects for a fall in unemployment are more promising than at any previous time this decade. At the same time employment has been rising continuously since before the last election - the longest period of sustained employment growth for nearly 30 years. Only an even more rapid rise in the labour force has kept unemployment stubbornly high.

Prospects for industry

25. The prosects for industry are also good. Manufacturing output is forecast to grow particularly well in 1987, at 4%, the biggest rise since X. Manufacturing output has now risen 10% since the June 1983 election. Over the past 5 years manufacturing has held its market share and kept

pace with world output better than at any period in recent history.

26. Company profitability is at the highest level for over 20 years. The net growth of new businesses between 1983 and 1985 averaged 550 a week. Last year new company registrations were up 7%, reaching a record level.

27. The Government's policies are bringing results. The British economy is now enjoying sustained growth with low inflation and steadily rising living standards, the combination that has eluded successive governments for a generation.

PRAYERS

SECRET

Note
Annotated copy of draft brief sent to Andrew Tyrie. AA

FROM: A G TYRIE
DATE: 31 OCTOBER 1986

CHANCELLOR

cc Chief Secretary
Ms O'Mara
Mr Hudson
Mr Cropper
Mr Ross Goobey
Mr Scholar

Ch
I had tried to get Andrew to do the first 4 paras as "radio" piece. I will get them re-instated. I will also get Andrew Hudson to cast a close eye over re-draft of the rest
AA

AUTUMN STATEMENT BRIEF

I attach a first draft of the Backbench brief for the Autumn Statement.

2. Alex Allan has made (Ratto selectively taken!) some helpful suggestions for the initial few pages and EB have also given it a preliminary check. Some of the numbers are still liable to change.

3. The Chief Secretary wanted the brief to be comprehensive. My personal view is that it is rather long. RIGHT. THERE NEEDS AT LEAST TO BE A MAIN PTS OF PX, EVEN IF THERE ARE DETAILED ANNEXES.

4. Having said that I should mention that I have omitted the following points or departments:

- defensive briefing about the absence of fiscal adjustment (this is the second year of the revised format; I doubt there will be a hallabalou) v. good!

- Trade and Industry

- Lord Chancellor's Department

- Nurses' pay omitted from the health section for brevity's sake.

- North Sea taxation. APRT?? Needs bit on (a) because of APRT (b) because of remarkable way we have coped with £6½ billion (check) loss of revenue (86/7 cf 85/6)

5. The section "Strategy on public expenditure" has been placed early on to enable the first few pages to serve as a speaking note for Backbenchers. The tone of the key

points in the Strategy section are very dependent on the tone of the Autumn Statement itself. I have had a stab at the trade-off between words that would satisfy the markets and words that could provide political ammunition, I have erred on the side of the latter. I have omitted altogether any reference to revenue buoyancy or hints that we can confirm now that we will stick to the PSBR targets next March.

need to check carefully with AS

6. I will put thought to better opposition bashing material over the weekend and something on the Alliance. But I expect you would prefer that good knockabout was reserved for Ministerial speeches on the day!

yes

AGT

A G TYRIE

CONFIDENTIAL

pmp

FROM: A C S ALLAN

DATE: 3 NOVEMBER 1986

MR GRAY

cc: PS/Chief Secretary
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Scholar
Mr Turnbull
Mr Culpin
Miss O'Mara
Mrs Dunn

ORAL AUTUMN STATEMENT: SUMMARY EXPENDITURE TABLE

The Chancellor has seen the format of the summary table attached to your minute of 31 October. He feels that some of the bracketing - for example, the FCO Diplomatic wing and ODA - are infallible recipes for a major Parliamentary row which would destroy the reception of the Autumn Statement. He would be grateful if you could consult the Chief Secretary urgently on an approach which would be viable in Parliamentary terms. Departments will be putting out their own press notices, and will be most unlikely to accept the degree of concealment implied by the bracketings.

2. He also feels the table needs to be changed so that the heading "Revised Plans" does not extend to 1989-90. There would then be a new vertical line separating off the revised plans for 1987-88 and 1988-89 with the new plans for 1989-90.

ACSA

A C S ALLAN

FROM: ROBERT CULPIN
DATE: 3 NOVEMBER 1986

puf

MR GRAY

cc Principal Private Secretary
PS/Chief Secretary
Sir Peter Middleton
Mr F E R Butler
Mr Turnbull
Mr Scholar
Miss O'Mara
Mrs Dunn

ORAL AUTUMN STATEMENT: SUMMARY EXPENDITURE TABLE

In general, I like the blank table you sent the Chancellor on Friday. But may I make three suggestions?

First and most important, I think it would help the presentation if the "changes" columns could compare:

i. the revised plans for 1987/88 with the estimated outturn for 1986/87, and

ii. the revised plans for 1988/89 with the revised plans for 1987/88.

This would give the percentage changes between years <u>which we are now planning</u>.

The trouble with the present draft - which, I know, follows past convention - is that the "changes" columns compare only what we are planning now with what we planned a year ago. That is bound to throw up a lot of pluses, which can give an exaggerated impression of the actual increases in expenditure.

I do not suggest we suppress changes from baselines, but simply add changes between years. One possibility would be to put these on to a separate table. Another would be to give them instead of the "Command 9702 Plans" in your third and fourth columns: if we give revised plans and changes from old plans, we do not really need old plans as well.

done

Second, after the row two years ago, I am not mad keen on lumping the ODA into the FCO. Will the split be given in an FCO Press Notice? And if not, do we give it if asked?

Third and least important, if footnote 3 is a reference to Budget measures, I should be inclined to say so.

RC

ROBERT CUPLIN

SM2/77

SECRET

PSt have retyped, & let me have 2 copies ASAP

Pmp

FROM: A P HUDSON
DATE: 3 NOVEMBER 1986

PS/CHIEF SECRETARY

cc Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Scholar
Mr Turnbull
Mr Sedgwick
Miss O'Mara
Mr Culpin
Mr Gray
Miss Noble
Mr Pickering
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Ch
Spare copy (unmarked)

AA

PSR make each sentence a separate para.*

AUTUMN STATEMENT

I attach the Chancellor's own draft of the Oral Statement.

2. The sections on detailed public expenditure measures are pending the Chief Secretary's views.

3. Please could I have comments and additional contributions by close tonight?

A P HUDSON

* I will then indicate on the 2nd copy how the sentences are to go together in paras.

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

Cabinet today agreed the Government's public expenditure plans for the next three years.

In the normal course of events that would be followed by the publication of the printed Autumn Statement, accompanied by an Oral Statement to the House, next Tuesday.

For obvious reasons that is not possible this year.

So while the Autumn Statement will be printed in the normal way and ~~laid before the House~~ presented to Parliament as soon as ~~it~~ the House reassembles next Wednesday, I thought it would be for the convenience of the House if I made my Oral Statement today.

This will cover all three of the key elements in the printed Statement: the Government's outline public expenditure plans for each of the next three years and the expected outturn for this year, proposals for next year's national insurance contributions, and the forecast of the economic prospects for 1987 required by the 1975 Industry Act.

The full text of the economic forecast, together with the public expenditure figures and the rest of the information customarily published with this Statement ~~Summary tables for both public expenditure and the economic forecast~~ will be available from the Vote Office as soon as I have sat down. (They will also appear in the printed Autumn Statement to be published next week.) // P I turn first to the outturn

for the current financial year, 1986-87.

The public expenditure planning total now looks likely to amount to ~~some £140½bn £1½bn~~, almost £140½ billion – £1¼ billion, or a little ~~over~~ less than 1 per cent, ~~more than~~ about what was allowed for in this year's Public Expenditure White Paper. The main reason~~s~~ for this excess is an 8 per cent rise in the current spending of local authorities - far more than was provided for. However, ~~two major~~ other items ~~of public~~ on the expenditure side which lie outside the planning total, the largest of which is debt interest, ~~and the overseas borrowings of the nationalised industries~~, are likely to fall ~~£1bn~~ short of what was forecast at the time of the Budget, ~~which reduces~~ thus reducing the total overrun on the ~~overall expenditure overrun~~ expenditure side to about £½bn.

On the ~~revenue~~ receipts side, the North Sea tax take is likely to be even lower, by about £1bn, than I envisaged at the time of the Budget, largely because for a long period the oil price has been below the $15 a barrel level on which the Budget arithmetic was explicitly based.

This shortfall, however, is more than offset by the continuing buoyancy of non-oil tax revenues, in particular VAT and Corporation Tax. ~~which~~ Non-oil revenues now look likely to exceed the Budget forecast by ~~£1½bn~~ £2 billion. This would imply ~~an~~ a ~~overall revenue~~ net overrun on the receipts side of about ~~£½bn, the same as the projected~~ £1 billion, rather more than that on the expenditure ~~overrun.~~ side.

At the same time I have ~~one tax~~ one change on the North Sea fiscal regime to announce.

The collapse of the oil price has led to a sharp cutback

SECRET

in investment activity in the North Sea, with inevitable consequences for the UK offshore supplies industry both in Scotland and the North -East of England.

Against this background the Government is conducting a review of the North Sea fiscal regime, and I shall be announcing my conclusions in the light of that review in the Budget.

But given the current difficulties of the offshore supplies industry, there is one change I believe it right to make without further delay.

I propose, on a carefully targeted basis, to accelerate the arrangements for the repayment to the oil companies of Advance Petroleum Revenue Tax due to them.

The details of this change, which will require legislation early in the new Session of Parliament, are set out in a Press Notice the Inland Revenue will be issuing as soon as I have sat down.

The new arrangements will ~~result in a loss of~~ have a revenue cost this financial year of some £300m, which will ~~of course~~ be fully recouped over the next three years.

Taking this into account, the Public Sector Borrowing Requirement for the current year is ~~now~~ still forecast to be about ~~£7½bn, slightly above the £7bn~~ £7 billion, the figure ~~which~~ I set in the Budget.

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

SECRET

fourth successive year, public spending, both before and after deducting the proceeds of privatisation, is set to decline as a proportion of national output. ~~both by~~

~~And this remains true even before deducting the proceeds of privatisation.~~

Indeed, by the end of the period the ratio is planned to be back to the level of the early 1970s.

The Government is determined to ensure that this trend continues: to see to it that total public spending, even without taking account of privatisation proceeds, continues to decline as a percentage of GDP.

New para

The plans I for the next three years am about to announce secure that objective. ~~over the next three years.~~ But within this overall constraint ~~, the Government has felt it right,~~ and the Government has felt it right in the context of its policy priorities, to allow an increase in the previously announced planning totals for 1987-88 and 1988-89.

Compared with the prospective outturn for the current year, we are now planning for

The new planning totals have thus been set at £148½bn for 1987-88 and £154½bn in 1988-89, an increase of ~~£4½bn~~ £4¾ billion and £5½bn respectively.

For 1989-90 the planning total has been set at ~~£XYZbn~~ £161½ billion.

~~Compared with the forecast outturn for 1986-87, these totals suggest~~ an average growth of public spending of about 1¼ ~~a shade over 1~~ per cent a year in real terms, well within the prospective growth of the economy as a whole.

As usual, these totals incorporate estimates for the proceeds of privatisation.

Last year I increased the estimate of these proceeds very substantially to £4¾bn in each of the three Survey years, a figure which I expect

to be duly achieved this year.

Although the privatisation programme is now moving ahead more strongly than ever before, I have decided to make only a modest further addition to this estimate, bringing it to £5bn in each of the next three years.

The new planning totals also contain substantial reserves, rising from £3½bn in 1987-88 to £7½bn in 1989-90.

~~[These are larger than in any previous survey with the exception of last year's, when, exceptionally, local authority provision was artificially set at the same cash figure for all three years and special allowance had to be made for this in setting the reserves.]~~

The public expenditure increases I have announced allow us to make realistic provision both for local authority current expenditure, over which the Government has no direct control, and for demand-led programmes such as social security, while still leaving scope for increased spending on services to which the Government attaches particular priority.

But before referring to some of the more important changes, let me make one thing absolutely clear.

There can be no question of allowing the projected increases in public expenditure over the next ~~three~~ two years to undermine the prudence of the Government's overall fiscal stance~~, either next year or subsequently~~.

The Government's fiscal stance ~~will remain as~~ has been set out in the medium-term financial strategy published at the time of this year's Budget. There will be no relaxation of that stance.

Pending CST's news

Within the totality of public expenditure, [The largest increase ~~comes on~~ is for local ~~authority~~ authorities, whose current ~~spending, where provision for 1987-88 and 1988-89 had previously been set at the same cash level as in 1986-87,~~ spending next year is now put at £4 billion above the previous provision. This in part reflects the fact that the previous plans simply carried forward the same cash level as in 1986-87 of cash spending. ~~pending further decisions. Full account has now been taken of likely future levels of spending, and this has meant an increase of £4bn in provision for 1987-88. Over half of this increase is for~~ These substantial sums demonstrate the priority the Government is giving to education, which, including the new proposals on pay and conditions of service for teachers announced last week, accounts for about half the increase in provision. A further major portion of the increase is for the police. ~~In subsequent years provision has been set so as to grow [broadly in line with] inflation.~~ ~~[RSG/AEG statement(s) to be added]~~

~~In addition~~ On top of ~~to~~ the increased provision for the cost of education in schools, which is contained within local authority current spending, there will be additional provision for the universities of £60m in 1987-88 and £70m in 1988-89.

Spending on ~~the~~ health and personal social services will be substantially increased ~~by £310m in 1987-88 with further increases in subsequent years.~~ For the National Health Service alone, the increase in England amounts to some £300 million a year. Combined with the additional resources increasingly being generated

INSERT ~~STAR~~

~~As a contribution to the totality of~~ At the same time, we are increasing next year's Aggregate Exchequer Grant – the contribution that taxpayers make to local government spending – by 9 per cent over this year's settlement, a rise of almost £1½ billion by greater efficiency, this will ~~not only meet the growing demands on the health service~~ not only enable the health service to cope with a growing number of patients but will allow it to improve services.

~~In addition to enjoying the benefits of substantially higher receipts from council house sales - nearly £1bn over the three years -~~ Housing investment will be increased by £225m in 1987-88 over the expected outturn for 1986-87.

This will sustain the rising trend of spending on local authority renovation and improvements and provide ~~extra~~ additional resources for the housing associations.

In the light of this year's experience, £1¾bn has been added to next year's provision for social security, most of which represents a greater expected take-up of existing means-tested benefits.

Provision for ~~spending on~~ roads is being increased by £65 million next year and £75 million the year after, mostly for local authority roads.

For defence, the provision remains as planned in the last White Paper after allowing for minor changes, including a reduction in the estimated cost of the Falklands deployment.

The defence programme will continue to benefit from the substantial real growth in previous years and the wide-ranging action to improve efficiency and value for money.

Taking all programmes together, capital expenditure has been increased by almost £1 billion in 1987-88, of which about two-thirds is local authority spending.

~~A summary table setting out the figures for each programme will be available in the Vote Office as soon as I have sat down, and~~ Further details of these and other changes will be contained in the printed Autumn Statement which will be published as soon as the House returns next

week. In addition, full details, together with information on running costs and manpower, will be given in the public expenditure White Paper early in the New Year.

I now turn to National Insurance contributions. The Government have conducted the usual Autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the national insurance fund, and taking account of the benefit uprating which my Rt Hon Friend the Secretary of State for Social Services announced on 22 October.

The lower earnings limit will be increased next April to £39 a week, in line with the single person's pension, and the upper earnings limit will be similarly raised to £295 a week. The limits for the reduced rate bands which I announced in last year's Budget will also be increased again in April, but by proportionately larger amounts. ~~Thus~~ The upper limit for the 5 per cent and 7 per cent bands will be raised to £65 a week and £100 a week respectively, and the upper limit for the 9 per cent rate for employers will be raised to £150 a week. The taxpayer's contribution to the National Insurance Fund - the so-called Treasury Supplement - will be reduced by 2 per cent to 7 per cent, but this will not require any change in contribution rates. Thus the main Class I contribution rates will once again remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

Finally, I turn to the Industry Act Forecast.

Both growth and inflation have turned out to be slightly lower this year than I envisaged at the time of the Budget.

Growth now looks like turning out at 2½ per cent, against a Budget forecast of 3 per cent, and inflation in the Fourth Quarter of this year ~~now looks~~ is likely to be 3¼ per cent, against the Budget forecast of 3½ per cent. The principal reason for this slower growth has been the disappointing performance of exports, which were hard hit by the cutback in spending by OPEC and other primary producers affected by the sharp fall in commodity prices in general and the oil price in particular. ~~These are export markets of particular importance to the UK.~~

Combined with a halving in the value of our own oil exports, this has meant a significant deterioration in the current account of the balance of payments, from a surplus of ~~from £Xbn~~ some £3½ billion in 1985 - and a cumulative surplus of ~~£YZbn~~ £21 billion over the six years from 1980 to 1985 inclusive - to a forecast of broad balance for 1986.

Looking ahead to 1987 the prospects are generally encouraging. While the ~~inescapable~~ necessary adjustment of the exchange rate to the oil price collapse has now taken place, it will inevitably take time before the full benefits come through in higher non-oil exports and

reduced import penetration at home.

This means we can expect the current account of the balance of payments to go into deficit next year, for the first time since 1979, to the tune of some £1½bn.

Even so, non-oil exports are forecast to rise next year by ~~3~~ 5½ per cent, compared with an increase of only 1 per cent this year, with manufacturing output, in consequence, up by 4 per cent. And with domestic demand continuing to expand at the same rate as this year, the economy overall is likely to grow by a further 3 per cent next year - the sixth successive year of growth at 3 per cent or thereabouts. ~~and into the seventh.~~

Recorded inflation is likely to edge up a little, to 3¾ per cent in the Fourth Quarter of 1987.

This is [~~entirely~~/almost entirely] due to the effect on the RPI of the timing of mortgage rate changes. ~~and~~ The Government's commitment to a monetary policy that will squeeze out inflation remains unabated.

Meanwhile the likelihood of faster growth next year, coming at a time when unemployment already appears to have stopped rising, suggests that the prospects for some fall in unemployment are now more promising. ~~than at any previous time this decade.~~

But this promise could still be frustrated by

SECRET

11

excessive pay settlements. ~~The full text of the Autumn forecast is to be published today and is now available in the Vote Office.~~

~~It will, of course, also be included in the printed Autumn Statement next week.~~

Mr Speaker, the strategy we have followed since 1979 has brought inflation down to the lowest level for two decades, combined with sustained growth and steadily rising living standards.

This is a combination that has eluded successive Governments for a generation. We have brought it about by the determined pursuit of free markets and sound money.

And that is what we will stick to.

SECRET

FIRST DRAFT

BACKBENCH BRIEF FOR THE AUTUMN STATEMENT

Rewrite (1) completely, & lead with (2)

don't like this expression: (a) 'balanced growth' unclear, (b) 'fifth year', argument.

Key points

1. The economy is strong. It is heading for its fifth year of balanced growth and low inflation.

2. The Government has reviewed its spending plans and decided on increases in priority areas: health, education, [including teachers' pay,] housing, roads, law and order. These increases can be afforded while keeping total public expenditure falling as a ~~precaution~~ proportion of national income.

!!

Alternative paragraph 2

I don't like this at all

Defensive

~~[Prudent management of the economy in past years now permits an increase in priority areas...].~~

This does not mark any let-up in

or in the resolve to squeeze out inflation.

3. Financial discipline [is in place]. The Chancellor has repeated his commitment to continuing with prudent fiscal and monetary policies. [Within this framework some increases can be afforded.] [The Autumn Statement accords with the 1979 manifesto commitment to reduce the share the State takes of the nation's income.] Add exact PSBR commitment!

Omit

~~[4. These plans are both generous and realistic. Generous~~

~~provision for local authority and social security spending is matched by realistic reserves of £X billion for 1987-88 and £Y billion for 1989-90.]~~

For some reason Andrew has removed from Lee a rather good paragraph knocking Labour's plans — and contrasting them with prudence etc.

[illegible]

Chancellor and 1st 2 paras. Now to start with PX falling as % of GDP, then with that overall discipline, increase in PX concentrate on priorities

Strategy on Public Expenditure

The Government has decided to increase

[Prudent financial management over many areas now permits] a significant increase in public expenditure for on priority areas, including health, education, law and order and roads spending. ~~The Government has also recognised the need for higher spending on local authorities and social securities.~~ To make room for these the planning total for this year has been increased to X, a Y% increase. Planning totals for subsequent years have been increased to.....Increases for next year include: (three examples for Backbenchers to highlight in weekend speeches).

3rd yr is not an necessary pattern — not before

This has been achieved ~~while implementing a policy~~ within the ~~continuing~~ constraint of falling reducing public expenditure as a percentage of GDP. By 198990, at X%, spending will be at its lowest level as a proportion of GDP since the early 1970s. Steady decline is reducing the burden of the State on the private sector [is being maintained.]

~~Provision has been increased provision in certain key areas. Substantial reserves have also been provided. These will be enough to ensure that future spending stays within our plans. The reserves for 1988-9 and 1989-90 are set at . [These are slightly smaller than for comparable years in the 1986 Public Expenditure White Paper. The annual increasing steps of £2 billion allow for a prudent margin~~

~~and for the continuing reassessment of priorities which will take place in later surveys.]~~

~~Prudent financial management and flexible planning are the hallmarks of this year's settlement.~~

Value for money

Getting better value for money from a given level of expenditure has made its contribution. We now have 80,000 fewer civil servants, 500 fewer quangos and savings of many hundreds of millions of pounds from competitive tendering, efficiency scrutinies and cash released from NHS cost improvement programmes. There is more to come. More value for money savings have already been identified in the Civil Service, up to £800 million a year from defence procurement and over £1 billion a year pinpointed from Audit Commission reports on local authorities.

Privatisation. Planned proceeds from privatisation for 1987-88 and 1988-89 have been increased upwards slightly from £4.75 billion to £5 billion. The achievements of the privatisation programme are well known. One-fifth of the State-owned commercial sector inherited in 1979 has been transferred to the private sector. Further important sales are planned, notably British Gas and British Airways. The benefits of privatisation in increased efficiency, more freedom from political bureaucratic interference, and more incentives for management and employees alike, have been enormous.

Ch
Clearly v important to get PM firmly on side this afternoon - but if she still has worries, sensible to do contingency planning in case APRT change lost?

AA

APRT OK

Reference ....

Chancellor

Your talk with the Prime Minister this afternoon

We have now settled everything for the Autumn Statement - public expenditure, the forecast (except the PSBR), NICs - except oil taxation. We are approaching the point when everything has to be finalised (the Forecast Press Notice needs to be reproduced - 1300 or so copies - in the course of tomorrow).

We cannot cope with a change to the Forecast after tomorrow. I am therefore wondering whether, for the sake of absolute safety, Peter Sedgwick and I should concoct a forecast with no APRT change, or any other change in oil taxation, and a PSBR at whatever level you decide today (I guess £7 billion) ~~so~~ I would have the copies run off and stacked in my room - just in case this - the only element in the package not yet finally sewn up - came unstuck at Cabinet or before.

It would help me, to know whether it's worth going to that trouble, if you would let me know, after you have discussed with the Prime Minister this afternoon, what your assessment of this risk is.

MCS 4/11

CODE 18-77

SECRET

Economic Prospects

The winning combination sustained. 1987 will be another year of healthy balanced growth with low inflation - the fifth in a row. This is a combination we have not seen for a generation. The growth forecast for next year is 3% compared with 2½% at Budget time. The unemployment outlook is more promising too.

Inflation in recent months has been at its lowest level for almost 20 years. It is now back to the average of the 1950s and 1960s. The forecast shows some rise in the RPI over the next year, but if volatile mortgage interest payments are excluded, inflation will remain broadly static.

The economic upswing is broadly based. The economy is providing balanced growth. Although consumer spending rose by 5% in the year to the third quarter of 1986 this spending is not sustaining the growth. Indeed growth in consumer spending is expected to fall slightly in 1987. The forecast pick-up in growth reflects improved prospects for exports together with an increase in stocks held by industry.

needs redrafts but message right place.

Much too defensive

Check

Company profitability is at the highest level for over 20 years. The net growth of new businesses between 1983 and

1985 averaged 550 a week. Last year new company registrations were up 7%, reaching a record level.

Manufacturing output has risen 10% since the June 1983 election. Over the past five years manufacturing held its market share and kept pace with world output better than at any period in recent history.

Maybe put in 4% growth in mfg forecast for '87

<u>Balance of Payments</u>. A small current account deficit is forecast for next year. This is the natural consequence of the sharp fall in the oil price. too confusing

Export volumes are now picking up after a flat period at the beginning of 1986, reflecting the weakness in world trade. In non-oil terms export volumes rose by 2½% in the third quarter of 1986 on the previous quarter - this is an all-time high. Exports are expected to rise again in 1987.

Net overseas assets stood at £80 billion at the end of last year giving an annual return of over £4 billion. [We are now reaping the benefits of the abolition of exchange control and prudent investment of North Sea oil revenue.]

<u>Employment</u>. Employment has been rising continuously since

before the last election - the longest period of sustained employment growth for nearly 30 years. An even more rapid rise in the labour force has kept employment stubbornly high. But, with the labour force growth slowing and economic activity picking up, to say nothing of training and other measures to boost employment, the prospects for a fall in unemployment are more promising.

Borrowing. A firm financial framework is being maintained and public borrowing remains on track. The forecast PSBR of £7½ billion is up ~~only a~~ half a billion on the Budget forecast~~, while the changes being made to the North Sea fiscal regime alone amount to a cost of £300 million this year. [Section needed PSBR and North Sea oil].~~ ✓

as a result of the APRT changes, the [illegible] world [illegible] of [illegible] on [illegible] needs to be much (more output-oriented)

The Programmes - Summary Table of Main Changes Here

1. **Health.** The Government has increased NHS spending by over 24% in real terms between 1978-9 and 1986-7 - an average of about 2½% a year. The totals announced in the Autumn Statement will enable the Government to improve on this excellent record.

Spending on health in 1987-8 will be increased by over 6% on the current year, rising to over £19 billion. There are also further substantial rises for 1988-9, to £19.8 bllion and 1989-90, to over £20.7 billion.

Cost improvement programmes should release a further £150 million in 1986-7 for spending on services to patients.

Spending on NHS capital has risen by 28.5% in real terms between 1978-9 and 1985-6. Under Labour it fell by 30%. Over 100 new hospital schemes are planned to have been completed between 1979-80 and 1989-90. At the moment there are 380 major schemes under way in a £3 billion building programme.

2. **Social Security.** Total benefit expenditure has risen by 35% in real terms, to £11 billion since 1978-9. Spending on benefits for the long term sick and disabled is up 55% between 1978-9 and 1985-6. The commitment to protect pensioners against inflation has been more than maintained

despite an increase in 850,000 pensioners. Expenditure on retirement pension is up 17% in real terms between 1985-6 and 1978-9.

1987 benefit uprating is fully in line with inflation. The transition has now been completed to regular April upratings.

The estimated outturn for 1986-7 is £44.3 billion for 1986-7, rising to over £49 billion in 1989-90. Total programme amounted to £41 billion in 1985-86.

Put first.

3. **Education.** Provision has been substantially increased over the 1986 White Paper. The provision for the DES is up 12% on last year. Furthermore £320 million has been made available as part of a package to end the long running teachers' dispute.

Spending for pupils in schools is at record levels; it has risen by 17% in real terms between 1978-9 and 1985-6. Education capital spending will remain broadly at present levels, despite fall in rolls. An additional £10 million in 1987-88 and 1988-89 for voluntary schools' capital represents a substantial increase on the 1986-87 provision.

The science budget has also been increased by £20 million in 1987-88 and 1988-89. The Government is spending £16 million more in 1989-90. There will be a substantial increase for Civil R & D (the Secretary of State for Trade and Industry will announce the precise amount in a few weeks). The universities provision has been increased by £65 million in 1987-88 and £72 million in 1988-89.

4. **Housing.** 1987-88 gross provision for housing is increased by £460 million over the last White Paper. £220 million of this is represented by receipts and the rest by an increase in the base line. In the following years provision will be further increased by £365 million, in 1988-9 and by £370 million, in 1989-90, made available from additional receipts.

Much of the addition is intended for renovation. By channelling the provision through the Urban Housing Renewal Unit (in the Department of Environment) resources will be more effectively used. Audit Commission reports have highlighted much wasteful spending by local authorities. Total capital spending on local authority renovation is already £1.3 billion a year. With current account maintenance and repair, total local authority renovation would be £2.56 billion.

5. **Employment.** The 1986 Budget measures included major increases in programmes for the unemployed, especially the young and the long-term unemployed. The 1986 Budget added nearly £200 million to Department of Employment spending in 1986-87, and nearly £300 million in 1987-8.

These measures are bringing results:

- YTS. About two-thirds of participants are in jobs, further education or training three months after leaving the scheme

- Job Clubs. Two-thirds of people leaving job clubs go directly into employment

- Community Programme. Participants are twice as likely to find work afterwards as the average long-term unemployed.

Total Department of Employment spending (including MSC) is up 96% in real terms between 1978-9 and 1986-7. It is planned to increase to 103% in real terms by 1987-8. Employment training and related measures will be £3 billion in 1987-8, rising to £3.3 billion in 1989-90.

6. **Transport.** Local authority capital road provision is up £60 million in both 1987-8 and 1988-9. This increase is entirely for local roads. National road provision is up £5 million in 1987-8 and £15 million in 1988-9.

Over 600 miles of motorways and trunk roads were completed between 1987 and mid-1986. The backlog of motorway and trunk road repairs is planned to be eliminated by 1981.

Because of unending privatisation, no separate provision is made for the National Bus Company's external finance in 1987-88. (BR).

7. **Defence.** Provision for 1987-8 and 1988-9 remains as

planned in the 1986 Public Expenditure White Paper. The provision for 1989-90 gives a cash increase of £490 million over 1988-9. The Falklands costs are now declining markedly, from £570 million (1985-6) to under £130 million (1989-90).

Defence expenditure is broadly stable following a real terms.

bold

8. Law and Order. Law and order spending has increased by 36% in real terms between 1978-~~9~~7 and 1985-~~6~~8. An increased provision for police will mean 300 extra officers for the Metropolitan Police and 500 for the provincial forces in 1987-8. An additional £61 million will be available to help the victims of crime in 1988-89 and '89-90 (and £41 million more in 1989-90 than 1988-89). ~~, and there~~ There will be increased funding for the fight against drugs and for a crime prevention campaign.

The prison building programme consists of sixteen prisons at a cost of £427 million, with four more at the design stage.

9. **Overseas Aid.** Increases in aid are planned to maintain the overseas aid programme to 1989-90 at the same real terms level as 1986-7. The UK aid programme is substantial, the sixth largest among Western donors and the third largest in the EEC.

Aid is important. Perhaps equally crucial in alleviating problems of developing countries is the private sector's direct investment. This rose from £980 million in 1983 to over £2½ billion in 1985.

10. **Energy.** Provision is down by £140 million made possible by the ending of the "coal buying scheme", which was encouraging industries to switch to coal-firing energy generation. The electricity ~~industries~~ industry is forecast to make a record profit in 1986-~~7~~8. Electricity prices are down 10% in real terms since the 1983 election, contrasting with a real term increase of 27% during the last Labour

administration.

11. **Agriculture.** The substantial spending programme in 1987-88 and the two following years demonstrates the Government's full commitment to British agriculture. Provision will be increased for flood defences to help meet the costs urgently needed to strengthen the sea defences in East Anglia, and the rebuilding of the sea wall at Seaford.

12. **Arts and Libraries.** The provision for 1987-8 represents a 16% increase in real terms on 1978-79. This more than fulfills the Government's 1983 manifesto pledge to keep up the level of support. Even after the deduction of additional post-abolition central funding central Government provision will be 7% higher in real terms over the life time of this Parliament.

Radical and generous changes to charitable giving were announced in the last Budget. These will greatly benefit the arts world, as does the Business Sponsorship Incentive Scheme, which has generated £10.5 million since the Government launched it in 1984.

13. **Nationalised Industries.** Nationalised industry financing requirements are planned to decline progressively over the survey period. They have already declined from £3.2 billion in 1981-82 to £560 million in 1986-87.

14. **Local Authorities.** Grant in 1987-88 is £1.5 billion higher than in 1986-87. This recognises the growth in local

authority budgets, plus the addition for teachers' pay, and is between ½ and 1% above general inflation.

This generous provision should keep average rate rises low, between 2 and 4%, on average, if local authorities spend in line with plans.

Gross capital provision is being increased by £750 million in Great Britain in 1987-88. Extra receipts of around £350 million will also increase the room for gross spending in 1988-89. These plans fully allow for the expected use of spending power from capital receipts.

15. **European Community payments.** The Fontainebleau system is now working as planned and producing larger abatements. The 1986 abatement is £1,250 million, the largest ever received. The 1987 abatement in the draft Community Budget is £1,125 million, but the EC's Budget Council has recognised that this figure will have to be corrected upwards.

The Labour Party

What they did last time

In their first year of office Labour increased spending by X and borrowing by Y. The consequences are well known. Labour were forced into the hands of the IMF. In 1975-6 the ratio of the PSBR to GDP ~~(at 9¼%)~~ in 1975-6 would ~~imply the PSBR~~ translate into a PSBR for the current financial year of over £35 billion.

2. Profligacy on this scale forced the Labour Party into a savage reversal of their spending plans. Even by 1978-9 Labour had still not recovered from these cuts. The damage was particularly severe in capital spending, and contrasts sharply with the record of the Conservative Government. ~~whereas Labour cut capital spending the~~

wh ✓ helpful

Capital Spending

	Real Terms percentage increases (1984-85=100) 1978-79 over 1973-74	1985-86 over 1978-79
Total capital (gross)	-20	0
Health capital	-31	+28
Road (capital and current, central and local government)	-36	+10

This was the legacy of Labour's tenure, roads unbuilt, hospitals postponed.

What they say they will do

3. Labour spending spokesmen have committed the Labour Party to a spending spree rather more profligate than they implemented in their first years of office in the mid 1970s. The Chief Secretary costed these in February at £24 billion. By July the cost had risen to £28 billion, if a further £7 billion of pledges by Michael Meacher is excluded.

4. Since July the Labour have made a number of further pledges which add about another £8 billion to the £28 billion figure.

5. From time to time the Labour Party try to give the impression that they have learnt the lessons of the past. For instance Mr Kinnock has said:

> "We are not going to be able to say 'yes' to everything. It is no good there being a galaxy of promises which prevents us from being able to fulfill hardly any of them." (Guardian 20 March 1984). By contrast writing in Tribune Roy Hattersley called for "a massive boost in demand" because "there has to be reflation in the sense that there is a shortage of demand." (Tribune,

10 May 1985).

6. Labour spokesmen have openly admitted that keeping track of the cost of pledges is not a high priority. For example John Smith said "I am not sure that it's important to cost everything in detail." (Tribune 8 November 1985). Since the Chief Secretary added up the cost of Labour's

policies ~~they~~ Labour have responded by implying that some of them may be deferred, but Labour spokesmen have fallen short of saying that they would not be implemented in the lifetime of a Parliament.

7. Clearly Labour hope to "buy votes" ~~on a massive scale~~ with these huge and unsustainable policies, ~~to a wide range of interest groups~~. This is particularly reprehensible on the social services field where vulnerable groups have false hopes held out to them.

8. Since Labour are committed not to increase the basic rate, increased spending would have to be financed out of higher income tax rates, indirect taxation and borrowing. For illustration, if £28 billion were raised from VAT alone, on ready reckoner arithmetic, this would imply a rate of at least 43%. If the basic rate were raised, this would imply an increase for the ordinary taxpayer to 53p in the pound.

12.71

SECRET

PhP

FROM: A P HUDSON

DATE: 4 November 1986

PS/CHIEF SECRETARY

cc Mr Culpin
Miss O'Mara
Mr Cropper
Mr Tyrie
Mr Ross Goobey

AUTUMN STATEMENT: BACKBENCH BRIEF

The Chancellor has seen the draft attached to Mr Tyrie's 3 November minute.

2. He would be grateful if the Chief Secretary could go over the brief in detail.

3. The Chancellor does not think a section on NICs is needed. However, given the row about the RSG, the brief should point out the size of the increase in aggregate exchequer grant, both in absolute and percentage terms (using GB figures). He thinks it is the biggest increase since the Government took office.

4. He agrees that paragraph 4 of the key points should be expanded, with figures. I attach a table supplied by EB for the Chancellor's speech in the Economic Debate.

5. The Chancellor has some drafting comments, which I have marked on the attached copy.

APH

A P HUDSON

MR DENNIS CANAVAN

SUPPLEMENTARIES

FACTUAL

(i) Growth: Governments compared

	1973 to 1979	1979 to 1986H1
GDP(A)	1¼	1½
GDP(A), excluding oil	½	1¼

(ii) Growth: recoveries compared

GDP and components (1980 prices)

annualised percentage increases

	Recoveries	
	1975H2 to 1979H1	1981H1 to 1986H1
Consumers' expenditure	3	2¾
General government expenditure	1	1
Fixed investment	1¼	4¼
Exports of goods and services	5¼	3½
Imports of goods and services	4¾	6¼
Contribution of North Sea oil to GDP growth	1¼	¼
GDP(A)	3	2¾

3119/005

SECRET

FROM: A G TYRIE
DATE: 3 NOVEMBER 1986

CHANCELLOR

cc Chief Secretary
Mr Hudson
Mr Cropper
Mr Ross Goobey

AUTUMN STATEMENT BACKBENCH BRIEF

I attach a second draft of the Backbench brief for the Autumn Statement, incorporating comments from this morning's meeting. The section on Labour can be added later. I have not yet tackled the section on spending in individual areas which will be added in an Annex.

2. Other points:

- The conclusion will need an extra few lines.

- Do you want anything on NICs?

- You may want point 4 of key points to be expanded.

AGT

A G TYRIE

3119/001

SECRET

SECOND DRAFT

Key points

Public spending

1. Public spending is set to decline as a proportion of national output for the fourth successive year. This is the case even when privatisation proceeds are excluded. The Autumn Statement reflects the Government's determination to ensure that this trend continues, and that public spending continues to decline as a percentage of GDP.

2. Within this overall constraint, the Government has felt it right to ~~allow an~~ increase ~~in~~ the previously announced planning totals for 1987-88 and 1988-89; enabling more to be spent on priority areas, including education, health, housing, law and order,and roads.

The economy

3. The economy is in its sixth year of steady growth and heading for its seventh, while inflation stays at the lowest level since the 1960s. Growth ~~Grants~~ should be faster next year than this, with manufacturing output increasing by 4%.

4. In this upswing consumption and investment have kept pace with one another, a sharp contrast with the weaker

upswing under Labour in which increases in investment lagged well behind consumption.

Fiscal policy

5. The Government's fiscal stance will remain as set out in the MTFS published in the Budget. There can be no question of permitting ~~projected~~ increases in public expenditure to undermine the prudence of the Government's overall fiscal stance.

Labour's plans

6. The Government's financial prudence contrasts with the profligacy of Labour's ~~spending~~ plans to increase spending by at least £28 billion. Such financial recklessness would probably force a repetition of their humiliating rescue by the IMF followed by drastic cuts in capital spending. The last Labour Government cut road building by 36% and hospital building by 31% during their five years in office.

NEW PAGE

Strategy on public expenditure

7. The Autumn Statement sets out the Government's plans for ensuring that public spending continues to decline as a percentage of GDP. By 1989-90, ~~the third year of the survey, at X%~~ spending will be at its lowest level as a proportion of GDP since the early 1970s - X%. This steady decline will further reduce the burden of the State on the private sector.

8. Within this constraint the Government has felt it right to permit an increase in the previously announced planning

totals for 1987-88 of £X billion, and for 1988-89 of £Y billion.

9. Public spending has been increased in priority areas. Education will benefit from the increased provision contained within local authority current spending — and this includes additional provision for the new proposals on teachers' pay and conditions of service. There will also be an extra £60 million for universities in 1987-88 and £70 million in 1988-89.

10. Health service provision will be increased by £310 million in 1987-88 with further increases in subsequent years. The Health Service has already benefited from resources made available from greater efficiency. The combination of increased efficiency and increased provision will enable the Health Service to meet ~~ongoing~~ additional demands and to improve services.

11. Housing will also benefit. [Local authority] ~~H~~housing investment will be increased by £225 million in 1987-88, in addition to the benefits from substantially higher receipts from Council house sales. These funds will sustain the rising level of spending on renovation and improvement; ~~and also provide~~ there will also be more funds for housing associations.

Value for money

12. Getting better value for money from a given level of expenditure has made its contribution. We now have 80,000 fewer civil servants, 500 fewer quangos and savings of many hundreds of millions of pounds from competitive tendering,

efficieny scrutinies, and cash released from NHS cost improvement programmes. There is more to come. More value for money savings have already been identified in the Civil Service, up to £800 million a year from defence procurement and over £1 billion a year pinpointed from ~~all~~ the Audit Commission reports on local authorities.

<u>Privatisation</u>

12. Planned proceeds from privatisation for 1987-88 and 1988-89 have been increased slightly from £4.75 billion to £5 billion. The achievements of the privatisation programme are well known. One fifth of the State owned commercial sector inherited in 1979 has been transferred to the private sector. Further important sales are planned, notably British Gas and British Airways. The benfits of privatisation and increased efficiency, more freedom from political and bureaucratic interference, and more incentives for management and employees alike, have been enormous.

<u>The planning total for 1986-7</u>

13. ~~The Chancellor anticipates that~~ The planning total for 1986-87 is likely to be about ~~will be~~ £1¼ billion, (a little ~~over~~ under 1%), more than the White Paper figure. This is mainly because local authority current spending is up 8%, far more than provided for. However ~~the overall expenditure overrun is likely to be reduced by two items outside the planning total - debt interest and the overseas borrowings of nationalised~~ other items on the expenditure side which lie outside the planning total, the largest of which is debt interest, are likely to fall short of what was forecast at the time of the Budget, thus reducing the total overrun on the expenditure side to about £½ bn.

[In line with Mr Turnbull's redraft of the Oral Statement.]

~~industries. These are likely to fall £1 billion short of forecast.~~

North Sea oil, revenues and the PSBR

15. North Sea oil revenues will be £1 billion lower than envisaged at the time of the Budget but this will be more than offset by the buoyancy of non oil revenues, in particular VAT and Corporation Tax, which are likely to exceed the Budget forecast by £1½ billion, leaving an overall revenue overrun of about £½ billion. This is the same as the projected expenditure overrun.

16. Public borrowing remains on track ~~within a firm financial framework~~. The forecast PSBR of £7½ billion is up £½ billion on the Budget forecast. The small increase is a consequence of a change in the arrangements for repayment to the oil companies of advanced petroleum revenue tax. Given the current difficulties of the offshore supply industry the Government has decided to accelerate these repayments, at a cost of about £300 million, carefully targetted to independent companies ~~which have~~ whose cash flow has been badly affected.

16. The PSBR is staying virtually ~~unchanged~~ on track despite a massive £6½ billion drop in oil revenues, from £11 bn in 1985-86 to a forecast £4½ billion in 1986-87. It is a remarkable achievement that this ~~massive drop~~ has been absorbed with so little difficulty. ~~Last year oil revenues were £11 billion. This year they are anticipated to be $4.5 billion. (Check)~~

Growth

17. Growth is likely to be 2½% this year, compared with

the Budget forecast of 3%, the main reason being the cut-back in spending by OPEC and other primary producers affected by the sharp fall in ~~quality~~ commodity prices. Next year the economy is likely to grow faster, at about 3%, taking Britain into its seventh consecutive year of growth at about this rate.

Balance of payments

18. 1985 saw a surplus in the balance of payments of £X billion making a cumulative surplus for the past six years of £X billion. For 1986 the current account is forecast to be in broad balance.

20. However, the spending cut-back by OPEC, combined with the halving in the value of Britain's oil exports, has led to a deterioration in the current account of balance of payments. It will inevitably take time for the benefits in higher non oil exports and reduced import penetration to be fully reflected in the current account. This means we can expect the current account to go into deficit next year ~~for the first time since 1979,~~ by about £1½ billion.

21. Meanwhile, export volumes are picking up after a flat period at the beginning of 1986. In non oil terms export volumes rose by 2½% in the third quarter of 1986 on the previous quarter - this is an all time high. Exports are expected to rise again in 1987 [figures].

22. Net overseas assets stood at £80 billion at the end of last year, giving an annual return of over £4 billion. We are now reaping the benefits of the abolition of exchange

controls and prudent investment of North Sea oil revenues.

Inflation

23. Inflation in recent months has been at its lowest level for almost 20 years. It is now back to the average of the [1950s and] 1960s. The forecast shows a small rise in recorded inflation, to 3¾% in the fourth quarter of 1987. This is largely due to the effect on the RPI of the recent ~~timing of~~ mortgage rate change~~s~~. The Government's commitment to squeeze out inflation by a policy of sound money remains undiminished.

Employment

24. The prospect of faster growth for next year comes at a time when unemployment already appears to have stopped rising. With economic activity picking up and the growth in the labour force slowing the prospects for a fall in unemployment are more promising than at any previous time this decade. At the same time employment has been rising continuously since before the last election - the longest period of sustained employment growth for nearly 30 years. Only an even more rapid rise in the labour force has kept unemployment stubbornly high.

Prospects for industry

25. The prosects for industry are also good. Manufacturing output is forecast to grow particularly well in 1987, at 4%, the biggest rise since X. Manufacturing output has now risen 10% since the June 1983 election. Over the past 5 years manufacturing has held its market share and kept

pace with world output better than at any period in recent history.

26. Company profitability is at the highest level for over 20 years. The net growth of new businesses between 1983 and 1985 averaged 550 a week. Last year new company registrations were up 7%, reaching a record level.

27. The Government's policies are bringing results. The British economy is now enjoying sustained growth with low inflation and steadily rising living standards, the combination that has eluded successive governments for a generation.

MR DENNIS CANAVAN

SUPPLEMENTARIES

FACTUAL

(i) Growth: Governments compared

	1973 to 1979	1979 to 1986H1
GDP(A)	1¼	1½
GDP(A), excluding oil	½	1¼

(ii) Growth: recoveries compared

GDP and components (1980 prices)

annualised percentage increases

	Recoveries	
	1975H2 to 1979H1	1981H1 to 1986H1
Consumers' expenditure	3	2¾
General government expenditure	1	1
Fixed investment	1¼	4¼
Exports of goods and services	5¼	3½
Imports of goods and services	4¾	6¼
Contribution of North Sea oil to GDP growth	1¼	¼
GDP(A)	3	2¾

3119/005

SECRET

FROM: A G TYRIE
DATE: 3 NOVEMBER 1986

CHANCELLOR

cc Chief Secretary
Mr Hudson
Mr Cropper
Mr Ross Goobey

AUTUMN STATEMENT BACKBENCH BRIEF

I attach a second draft of the Backbench brief for the Autumn Statement, incorporating comments from this morning's meeting. The section on Labour can be added later. I have not yet tackled the section on spending in individual areas which will be added in an Annex.

2. Other points:

- The conclusion will need an extra few lines.

- Do you want anything on NICs?

- You may want point 4 of key points to be expanded.

AGT

A G TYRIE

3119/001

SECRET

SECOND DRAFT

Key points

Public spending

1. Public spending is set to decline as a proportion of national output for the fourth successive year. This is the case even when privatisation proceeds are excluded. The Autumn Statement reflects the Government's determination to ensure that this trend continues, and that public spending continues to decline as a percentage of GDP.

2. Within this overall constraint, the Government has felt it right to ~~allow an~~ increase ~~in~~ the previously announced planning totals for 1987-88 and 1988-89; enabling more to be spent on priority areas, including education, health, housing, law and order,and roads.

The economy

3. The economy is in its sixth year of steady growth and heading for its seventh, while inflation stays at the lowest level since the 1960s. Growth ~~Grants~~ should be faster next year than this, with manufacturing output increasing by 4%.

4. In this upswing consumption and investment have kept pace with one another, a sharp contrast with the weaker

upswing under Labour in which increases in investment lagged well behind consumption.

Fiscal policy

5. The Government's fiscal stance will remain as set out in the MTFS published in the Budget. There can be no question of permitting ~~projected~~ increases in public expenditure to undermine the prudence of the Government's overall fiscal stance.

Labour's plans

6. The Government's financial prudence contrasts with the profligacy of Labour's ~~spending~~ plans to increase spending by at least £28 billion. Such financial recklessness would probably force a repetition of their humiliating rescue by the IMF followed by drastic cuts in capital spending. The last Labour Government cut road building by 36% and hospital building by 31% during their five years in office.

NEW PAGE

Strategy on public expenditure

7. The Autumn Statement sets out the Government's plans for ensuring that public spending continues to decline as a percentage of GDP. By 1989-90, ~~the third year of the survey, at X%~~ spending will be at its lowest level as a proportion of GDP since the early 1970s - X%. This steady decline will further reduce the burden of the State on the private sector.

8. Within this constraint the Government has felt it right to permit an increase in the previously announced planning

totals for 1987-88 of £X billion, and for 1988-89 of £Y billion.

9. Public spending has been increased in priority areas. Education will benefit from the increased provision contained within local authority current spending — and this includes additional provision for the new proposals on teachers' pay and conditions of service. There will also be an extra £60 million for universities in 1987-88 and £70 million in 1988-89.

10. Health service provision will be increased by £310 million in 1987-88 with further increases in subsequent years. The Health Service has already benefited from resources made available from greater efficiency. The combination of increased efficiency and increased provision will enable the Health Service to meet ~~ongoing~~ additional demands and to improve services.

11. Housing will also benefit. [Local authority] housing investment will be increased by £225 million in 1987-88, in addition to the benefits from substantially higher receipts from Council house sales. These funds will sustain the rising level of spending on renovation and improvement; ~~and also provide~~ there will also be more funds for housing associations.

Value for money

12. Getting better value for money from a given level of expenditure has made its contribution. We now have 80,000 fewer civil servants, 500 fewer quangos and savings of many hundreds of millions of pounds from competitive tendering,

efficieny scrutinies, and cash released from NHS cost improvement programmes. There is more to come. More value for money savings have already been identified in the Civil Service, up to £800 million a year from defence procurement and over £1 billion a year pinpointed from ~~all~~ the Audit Commission reports on local authorities.

Privatisation

12. Planned proceeds from privatisation for 1987-88 and 1988-89 have been increased slightly from £4.75 billion to £5 billion. The achievements of the privatisation programme are well known. One fifth of the State owned commercial sector inherited in 1979 has been transferred to the private sector. Further important sales are planned, notably British Gas and British Airways. The benfits of privatisation and increased efficiency, more freedom from political and bureaucratic interference, and more incentives for management and employees alike, have been enormous.

The planning total for 1986-7

13. ~~The Chancellor anticipates that~~ The planning total for 1986-87, ~~will be~~ is likely to be about £1¼ billion, (a little ~~over~~ under 1%), more than the White Paper figure. This is mainly because local authority current spending is up 8%, far more than provided for. However ~~the overall expenditure overrun is likely to be reduced by two items outside the planning total - debt interest and the overseas borrowings of nationalised~~ other items on the expenditure side which lie outside the planning total, the largest of which is debt interest, are likely to fall short of what was forecast at the time of the Budget, thus reducing the total overrun on the expenditure side to about £½ bn.

[In line with Mr Turnbull's redraft of the Oral Statement.]

~~industries. These are likely to fall £1 billion short of forecast.~~

North Sea oil, revenues and the PSBR

15. North Sea oil revenues will be £1 billion lower than envisaged at the time of the Budget but this will be more than offset by the buoyancy of non oil revenues, in particular VAT and Corporation Tax, which are likely to exceed the Budget forecast by £1½ billion, leaving an overall revenue overrun of about £½ billion. This is the same as the projected expenditure overrun.

16. Public borrowing remains on track ~~within a firm financial framework~~. The forecast PSBR of £7½ billion is up £½ billion on the Budget forecast. The small increase is a consequence of a change in the arrangements for repayment to the oil companies of advanced petroleum revenue tax. Given the current difficulties of the offshore supply industry the Government has decided to accelerate these repayments, at a cost of about £300 million, carefully targetted to independent companies ~~which have~~ whose cash flow has ~~to~~ been badly affected.

16. The PSBR is staying virtually ~~unchanged~~ on track despite a massive £6½ billion drop in oil revenues, from £11 bn in 1985-86 to a forecast £4½ billion in 1986-87. It is a remarkable achievement that this ~~massive drop~~ has been absorbed with so little difficulty. ~~Last year oil revenues were £11 billion. This year they are anticipated to be \$4.5 billion. (Check)~~

Growth

17. Growth is likely to be 2½% this year, compared with

the Budget forecast of 3%, the main reason being the cut-back in spending by OPEC and other primary producers affected by the sharp fall in ~~quality~~ commodity prices. Next year the economy is likely to grow faster, at about 3%, taking Britain into its seventh consecutive year of growth at about this rate.

Balance of payments

19. 1985 saw a surplus in the balance of payments of £X billion making a cumulative surplus for the past six years of £X billion. For 1986 the current account is forecast to be in broad balance.

20. However, the spending cut-back by OPEC, combined with the halving in the value of Britain's oil exports, has led to a deterioration in the current account of balance of payments. It will inevitably take time for the benefits in higher non oil exports and reduced import penetration to be fully reflected in the current account. This means we can expect the current account to go into deficit next year ~~for the first time since 1979,~~ by about £1½ billion.

21. Meanwhile, export volumes are picking up after a flat period at the beginning of 1986. In non oil terms export volumes rose by 2½% in the third quarter of 1986 on the previous quarter - this is an all time high. Exports are expected to rise again in 1987 [figures].

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24. The prospect of faster growth for next year comes at a time when unemployment already appears to have stopped rising. With economic activity picking up and the growth in the labour force slowing the prospects for a fall in unemployment are more promising than at any previous time this decade. At the same time employment has been rising continuously since before the last election - the longest period of sustained employment growth for nearly 30 years. Only an even more rapid rise in the labour force has kept unemployment stubbornly high.

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SECRET

FROM: A ROSS GOOBEY
DATE: 4 NOVEMBER 1986

MR TYRIE

cc PS/Chancellor
PS/CST
Mr Hudson
Mr Cropper

PWP

AUTUMN STATEMENT: BACKBENCH BRIEF

I have seen your second draft.

2. You will no doubt be taking into account some of the comments made at this morning's meeting, viz

para 3, delete "And heading for its seventh"?

para 15, instead of the "consequence of a change ..." reference to APRT, the sentence might now read "This takes into account the change in the arrangements ..."

para 24, delete "At any previous time this decade"

3. In **para 25, line 4,** the "now" risen seems a little ambiguous. Is it "already"?

4. Also in **para 25, line 5,** should it not read "manufacturing exports have held their market share ..."?

5. **Para 3, line 3,** for "grants" read "growth".

6. **Para 9** will have to await the final draft of the Statement.

ARG

A ROSS GOOBEY

CONFIDENTIAL

FROM: F. E. R. BUTLER
4th November, 1986.

MR. GRAY

c.c. Principal Private Secretary
PS/Chief Secretary
Sir Peter Middleton
Mr. Turnbull
Mr. Scholar
Mr. Culpin
Miss O'Mara
Mrs. Dunn

Ch
Cash changes between years 85-86 and 86-87 marked in manuscript on computer print-out below. Not sure they're very much better than % (or they highlight some secrets @ £3bn) AA

ORAL AUTUMN STATEMENT: SUMMARY EXPENDITURE TABLE

I see the point of the suggestion in Mr. Culpin's minute of 3rd November that we should show percentage changes between years. But this would not only be an innovation - which I am rather reluctant to provide since we are subjecting people to unusual procedures in other ways: it would also raise some awkward questions.

2. In cash terms, I imagine that the only significant reduction in 1987-88 would be the trade and industry programme: there would also be a reduction in the net housing programme in 1988-89 and a small one in transport.

3. In real terms, the figures are given in brief G2 and these will also raise some awkward questions - reductions not only in the defence and trade and industry programmes but also in home office and employment in 1987-88. In 1988-89 there are real reductions in trade and industry, defence, transport, home office and net housing.

4. On either basis, these figures raise awkward questions and I do not think it is worth raising them in order to show some minus figures in the overall table.

They are a great help. One or two commentators use them

F.E.R.B.

F. E. R. BUTLER

SM1/83

SECRET

pwp

RECORD OF A MEETING IN THE CHANCELLOR'S ROOM, HM TREASURY

AT 9.00 AM ON TUESDAY, 4 NOVEMBER 1986

Present: Chancellor
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr Culpin
Miss O'Mara
Miss Evans
Mr Ross Goobey
Mr Tyrie

ORAL AUTUMN STATEMENT

The Chancellor said the main issue for discussion was the paragraph in the draft which said that the Government's fiscal stance would remain as set out in the MTFS published with this year's Budget. He felt that the markets would almost certainly draw alarmist conclusions from the increases in the planning totals and would in particular predict a large PSBR increase next year. It was therefore vital to provide a firm re-statement of the Government's policy. He had come to the conclusion that simply to say that the Government would continue to follow a prudent course would not be sufficient; something firmer was needed. Hence the paragraph under discussion. People would no doubt ask exactly what was meant, and in that case we should confirm that it meant that the intention was to hold the PSBR at $1\frac{3}{4}$ per cent of GDP in next year's Budget.

2. Sir P Middleton said he was extremely concerned about the draft paragraph. We had maintained a consistent line of saying

that fiscal policy should be set in the Budget, and there was no case for departing from that now. The forecast raised issues of whether a further tightening of fiscal policy might be appropriate in the Budget, and it would not be right to pre-empt discussion of that by fixing the PSBR now.

3. Sir T Burns said that much of the problems arose because at Budget time we had decided to present figures for expenditure which were consistent with the planning totals, and had therefore had to shade down revenue projections. There was thus much more revenue buoyancy than the markets realised. This would be difficult to put across. Another point was that we had successfully fought off proposals for making the Autumn Statement a Green Budget, and that whole issue would be thrown open again if we now fixed the PSBR - including the issue of why we were not presenting revenue figures alongside the expenditure numbers. He also thought there were difficulties over equating the fiscal stance with the PSBR.

4. The Chancellor felt that these points did not take account of the special circumstances of this year. We were making major additions to the planning totals and it was necessary to make it clear that this would not lead to an increase in borrowing. He thought alternative formulations such as pointing to buoyant revenues or saying that the extra expenditure reduced the scope for tax cuts could both have disastrous market effects: they would be taken as confirming market worries that the Government was set on a pre-election spree.

5. Sir P Middleton said he remained concerned that the formulation would tie the Government's hands if it decided that a tighter fiscal policy was needed. The Chancellor thought that in those circumstances there would be no market problems in setting the PSBR below the MTFS numbers. What the market now feared was a higher PSBR. He thought it was essential to give some anchor to policy: problems over pegging the exchange rate were well known;

so were the problems over making a commitment to reduce broad money growth; commitments about M0 did not seem to satisfy the market; we were therefore driven ineluctably to a PSBR commitment.

6. Sir T Burns was also concerned that there might be circumstances in which we would want for valid reasons to increase the PSBR - for example if the oil price collapsed again. The Chancellor thought this could be handled perfectly readily if circumstances changed to that extent.

7. The Chancellor said he would reflect further on two possible formulations: the first as in the existing draft; the second on the lines that the Government's fiscal stance had been set out in the MTFS and "there would be no relaxation of that stance". He would also want to consider removing the reference to "either next year or subsequently" in the paragraph before.

8. The meeting also discussed various other points:

(i) The Chancellor asked what the latest view on the PSBR was. Could it now be put at £7bn after the APRT change? Mr Sedgwick said he thought the latest information becoming available might well justify this. He would investigate further.

(ii) The Chancellor wondered whether there might be advantage in going back to reserves of 3/5½/8; this would make the increase in the planning total in 1987-88 £4bn not £4½bn. Mr Butler did not think this would help - and £3 billion in 1987-88 would be regarded as inadequate and £8 billion in 1989-90 would increase the rate of growth of public expenditure over the period as a whole. The Chancellor agreed that we should stick with reserves of 3½/5½/7½.

(iii) After some discussion it was agreed to take out the reference to the reserves being larger than in any previous survey with the exception of last year's.

(iv) The Chancellor asked for a sentence to be added on the increase in grant to local authorities.

(v) The Chancellor noted that the sentence on the special importance of OPEC markets to the UK had been drawn from the Industry Act Forecast. If it was not justified, the thought needed to be removed from both places.

(vi) There was some discussion about how many years of steady growth at about 3 per cent we could claim. It was agreed that the formulation should be changed to "the sixth successive year of steady growth at an average of nearly 3 per cent".

9. The Chancellor said he would be circulating a revised draft later that day.

ACSA

A C S ALLAN
10 November 1986

Distribution

Those present
Mr Cropper

(note: not distributed until 10 November) g.163

CONFIDENTIAL

FROM: MISS G M NOBLE
DATE: 4 November 1986

MR A P HUDSON

Mr Allan pp

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Scholar
Mr Turnbull
Miss Peirson
Mr Sedgwick
Miss O'Mara
Mr Culpin
Mr Gray
Mr Pickering
Mr Cropper
Mr Tyrie
Mr Ross Goobey

AUTUMN STATEMENT

With reference paragraph 4 of Miss Rutter's note of 3 November, the decisions about the EPA/NHS allocation (ie the attribution of national insurance contribution income between the redundancy fund, the national health service and the national insurance fund) will be included in a written PQ which Mr Fowler will answer on 6 November. The PQ will give the usual further details of the national insurance changes.

G Noble

MISS G M NOBLE

SM2/77

SECRET

Spoal

FROM: A C S ALLAN
DATE: 4 NOVEMBER 1986

PS/CHIEF SECRETARY

cc Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Scholar
Mr Turnbull
Mr Sedgwick
Miss O'Mara
Mr Culpin
Mr Gray
Miss Noble
Mr Pickering
Mr Cropper
Mr Tyrie
Mr Ross Goobey

AUTUMN STATEMENT

I attach the revised draft of the Oral Statement.

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

ACSA

A C S ALLAN

SM/AS

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

Cabinet today agreed the Government's public expenditure plans for the next three years.

In the normal course of events that would be followed by the publication of the printed Autumn Statement, accompanied by an Oral Statement to the House, next Tuesday.

For obvious reasons that is not possible this year.

So while the Autumn Statement will be printed in the normal way and presented to Parliament as soon as the House reassembles next Wednesday, I thought it would be for the convenience of the House if I made my Oral Statement today.

This will cover all three of the key elements in the printed Statement: the Government's outline public expenditure plans for each of the next three years and the expected outturn for this year; proposals for next year's national insurance contributions; and the forecast of the economic prospects for 1987 required by the 1975 Industry Act.

The full text of the economic forecast, together with the public expenditure figures and the rest of the information customarily published with this Statement will be available from the Vote Office as soon as I have sat down.

They will also appear on the printed Autumn Statement to be published next week.

I turn first to the outturn for the current financial year, 1986-87.

The public expenditure planning total now looks likely to amount to almost £140½bn - £1¼bn, or a little less than 1 per cent, abo~~ut~~ve what was allowed for in this year's Public Expenditure White Paper.

The main reason for this excess is an 8 per cent rise in the current spending of local authorities - far more than was provided for.

However, other items on the expenditure side which lie outside the planning total, the largest of which is debt interest, are likely to fall short of what was forecast at the time of the Budget, thus reducing the total overrun on the expenditure side to about £½bn.

On the receipts side, the North Sea tax take is likely to be even lower, by about £1bn, than I envisaged at the time of the Budget, largely because for a long period the oil price has been below the $15 a barrel level on which the Budget arithmetic was explicitly based.

This shortfall, however, is more than offset by the continuing buoyancy of non-oil tax revenues, in particular VAT and Corporation Tax.

Non-oil revenues now look likely to exceed the Budget forecast by £2bn.

This would imply a net overrun on the receipts side of about £1bn, rather more than that on the expenditure side.

At the same time I have one change on the North Sea fiscal regime to announce.

The collapse of the oil price has led to a sharp cutback in investment activity in the North Sea, with inevitable consequences for the UK offshore supplies industry both in Scotland and the North East of England.

Against this background the Government is conducting a review of the North Sea fiscal regime, and I shall be announcing my conclusions in the light of that review in the Budget.

But given the current difficulties of the offshore supplies industry, there is one change I believe it right to make without further delay.

I propose, on a carefully targeted basis, to accelerate the arrangements for the repayment to the oil companies of Advance Petroleum Revenue Tax due to them.

The details of this change, which will require legislation early in the new Session of Parliament, are set out in a Press Notice the Inland Revenue will be issuing as soon as I have sat down.

The new arrangements will have a revenue cost this financial year of some £300m, which will be fully recouped over the next three years.

Taking this into account, the Public Sector Borrowing Requirement for the current year is still forecast to be about £7bn, the figure I set in the Budget.

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

This year, for the fourth successive year, public spending, both before and after deducting the proceeds of privatisation, is set to decline as a proportion of national output.

The Government is determined to ensure that this trend continues: to see to it that total public spending, even without taking account of privatisation proceeds, continues to decline as a percentage of GDP.

The plans I am about to announce for the next three years secure that objective.

Indeed, by the end of the period the ratio is planned to be back to the level of the early seventies.

But within this overall constraint, and in the context of its policy priorities, the Government has felt it right to allow an increase in the previously announced planning totals for 1987-88 and 1988-89.

Compared with the prospective outturn for the current year, we are now planning for an average growth of public spending of about 1¼ per cent a year in real terms, well within the prospective growth of the economy as a whole.

The new planning totals have thus been set at £148½bn for 1987-88 and £154½bn in 1988-89, an increase of £4¾bn and £5½bn respectively.

For 1989-90 the planning total has been set at £161½bn.

As usual, these totals incorporate estimates for the proceeds of privatisation.

Last year I increased the estimate of these proceeds very substantially to £4¾bn in each of the three Survey years, a figure which I expect to be duly achieved this year.

Although the privatisation programme is now moving ahead more strongly than ever before, I have decided to make only a modest further addition to this estimate, bringing it to £5bn in each of the next three years.

The new planning totals also contain substantial reserves, rising from £3½bn in 1987-88 to £7½bn in 1989-90.

The public expenditure increases I have announced allow us to make realistic provision both for local authority current expenditure, over which the Government has no direct control, and for demand-led programmes such as social security, while still leaving scope for increased spending on services to which the Government attaches particular priority.

But before referring to some of the more important changes, let me make one thing absolutely clear.

There can be no question of allowing the projected increases in public expenditure over the next two years to undermine the prudence of the Government's overall fiscal stance.

X The Government's fiscal stance has been set out in the medium-term financial strategy published at the time of this year's Budget.

There will be no relaxation of that stance.

Within the totality of public expenditure, the largest increase is for the local authorities, whose current spending next year is now put at £4bn above the previous provision.

This in part reflects the fact that the previous plans simply carried forward the same level of cash spending as in 1986-87.

At the same time, we are increasing next year's Aggregate Exchequer Grant - the contribution that taxpayers make to local government spending - by 9 per cent over this year's Settlement; a rise of almost £1½bn.

These substantial sums demonstrate the priority the Government is giving to education, which, including the new proposals on pay and conditions of service for teachers announced last week, accounts for about half the increase in provision.

A further major portion of the increase is for the police.

On top of the increased provision for the cost of education in schools, which is contained within local authority current spending, there will be additional provision for the universities of £60m in 1987-88 and £70m in 1988-89.

Spending on the health and personal social services will be substantially increased.

For the National Health Service alone, the increases in

England amount to some £300m a year.

Combined with the additional resources increasingly being generated by greater efficiency, this will not only enable the Health Service to cope with a growing number of patients but will allow it to improve services.

Housing investment will be increased by £225m in 1987-88 over the expected outturn for 1986-87.

This will sustain the rising trend of spending on local authority renovation and improvements and provide additional resources for the housing associations.

In the light of this year's experience, £1¾bn has been added to next year's provision for social security, most of which represents a greater expected take-up of existing means-tested benefits.

Provision for roads is being increased by £65m next year and £75m the year after, mostly for local authority roads.

For defence, the provision remains as planned in the last White Paper after allowing for minor changes, including a reduction in the estimated cost of the Falklands deployment.

The defence programme will continue to benefit from the substantial real growth in previous years and the wide-ranging action to improve efficiency and value for money.

Taking all programmes together, capital expenditure has been increased by almost £1bn in 1987-88, of which about two-thirds is local authority spending.

Further details of these and other changes will be contained in the printed Autumn Statement which will be published as soon as the House returns next week.

In addition, full details, together with information on running costs and manpower, will be given in the public expenditure White Paper early in the New Year.

I now turn to National Insurance contributions.

The Government have conducted the usual Autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the national insurance fund, and taking account of the benefit uprating which my Rt Hon Friend the Secretary of State for Social Services announced on 22 October.

The lower earnings limit will be increased next April to £39 a week, in line with the single person's pension, and the upper earnings limit will be similarly raised to £295 a week.

The limits for the reduced rate bands which I announced in last year's Budget will also be increased again in

April, but by proportionately larger amounts.

The upper limit for the 5 per cent and 7 per cent bands will be raised to £65 a week and £100 a week respectively, and the upper limit for the 9 per cent rate for employers will be raised to £150 a week.

The taxpayer's contribution to the National Insurance Fund - the so-called Treasury Supplement - will be reduced by 2 per cent to 7 per cent, but this will not require any change in contribution rates.

Thus the main Class I contribution rates will once again remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

Finally, I turn to the Industry Act Forecast.

Both growth and inflation have turned out to be slightly lower this year than I envisaged at the time of the Budget.

Growth now looks like turning out at 2½ per cent, against a Budget forecast of 3 per cent, and inflation in the fourth quarter of this year is likely to be 3¼ per cent, against the Budget forecast of 3½ per cent.

The principal reason for this slower growth has been the disappointing performance of exports, which were hard hit by the cutback in spending by OPEC and other primary producers affected by the sharp fall in commodity prices in general and the oil price in particular.

Combined with a halving in the value of our own oil exports, this has meant a significant deterioration in the current account of the balance of payments, from a surplus of some £3½bn in 1985 - and a cumulative surplus of £21bn over the six years from 1980 to 1985 inclusive - to a forecast of broad balance for 1986.

Looking ahead to 1987 the prospects are generally encouraging.

While the necessary adjustment of the exchange rate to the oil price collapse has now taken place, it will inevitably take time before the full benefits come through in higher non-oil exports and reduced import penetration at home.

This means we can expect the current account of the balance of payments to go into deficit next year, for the first time since 1979, to the tune of some £1½bn.

Even so, non-oil exports are forecast to rise next year by 5½ per cent, compared with an increase of only 1 per cent this year, with manufacturing output, in consequence, up by 4 per cent.

And with domestic demand continuing to expand at the same rate as this year, the economy overall is likely to grow by a further 3 per cent next year - the sixth successive year of growth at 3 per cent or thereabouts.

Recorded inflation is likely to edge up a little, to $3\frac{3}{4}$ per cent in the Fourth Quarter of 1987.

This is almost entirely due to the effect on the RPI of the timing of mortgage rate changes.

The Government's commitment to a monetary policy that will squeeze out inflation remains unabated.

Meanwhile the likelihood of faster growth next year, coming at a time when unemployment already appears to have stopped rising, suggests that the prospects for some fall in unemployment are now more promising.

But this promise could still be frustrated by excessive pay settlements.

Mr Speaker, the strategy we have followed since 1979 has brought inflation down to the lowest level for two decades, combined with sustained growth and steadily rising living standards.

This is a combination that has eluded successive Governments for a generation.

We have brought it about by the determined pursuit of free markets and sound money.

And that is what we will stick to.

351/53

CONFIDENTIAL

FROM: B O DYER
DATE: 4 November 1986

01-233 4749

CHANCELLOR

cc Mr Scholar

AUTUMN STATEMENT

Ministers of the Crown neither require the permission of the Speaker nor the leave of the House to make a Statement. But prior notice of a Statement must be given to the Speaker. Courtesy and convention dictate that this is forthcoming by 12 noon, for the Speaker's daily conference with the Clerks at the Table.

2. To observe the proprieties, I propose, if you agree, to simply warn the Speaker's secretary at 11.55am on 6 November that we may have a Statement that day; and undertake to confirm one way or the other, together with its nature, at 1pm (ie after Cabinet)?

3. At the same time, may I also alert the Deliverer of the Vote, on a personal and confidential basis, that the Treasury **might** be depositing papers later in the day that could be of interest to Members participating in the Opposition inspired 'Economic' debate?

Ch
OK? (we may have some report out of Cabinet by 12.00).
AA

OK

B O DYER

3663/026

CONFIDENTIAL

pup

FROM: **B T GILMORE**
DATE: 4 November 1986

MR TURNBULL

cc Mr Burr
Mr Gray
Mr Revolta
Mr ~~Hudson~~ Mr Allan
Mr Russell
Mr Sutton
Mr A Williams

AUTUMN STATEMENT: ORAL

In the version attached to your minute of 3 November to Mr Hudson, the phrase "Spending on roads" should be changed to "Provision for roads" for the usual LA capital reasons.

2. With this change, I have cleared that version, including the layout of the accompanying table, with the Home Office, Transport and (for good measure) LCD and CPS. Mr Burr is dealing with DES and OAL.

BTG

B T GILMORE