PO-CH/NL/0120
PART G

**SECRET**

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PART G

BUDGET 1988 SCORECARD AND OVERVIEW

DD's 25 years N. Agis 1/12/95.

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PART G

31-12-88

# CABINET OFFICE PAPER

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**SCORECARD**
**NO.** 24 **OF** 25 **COPIES**

FROM: A P HUDSON
DATE: 31 October 1988

**PS/CHIEF SECRETARY**

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Phillips
Mr Odling-Smee
Mr ~~Luce~~ Mr Sedgwick *
Mr Turnbull
Mr MacAuslan
Mr Gieve
Mr Pickford
Miss J C Simpson
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Footman (Bank)
Mr Gray (No. 10) *

* with first half

**AUTUMN STATEMENT: ORAL STATEMENT: CHANCELLOR'S DRAFT, SECOND HALF**

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

2. Please could I have comments as soon as humanly possible. We cannot guarantee to take in comments received after ~~3 pm~~ 7.30 pm.

APH

**A P HUDSON**

27. I turn next to National Insurance Contributions.

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

29. The lower earnings limit will be increased next April to £43 a week, in line with the single person's pension, and the upper earnings limit will be raised to £325 a week. The upper limits for the 5 per cent and 7 per cent reduced rate bands will also be increased, to £75 a week and £115 a week respectively. The upper limit for the 9 per cent rate for employers will be raised to £165 a week.

30. Over recent years, we have steadily reduced the Treasury Supplement, the taxpayer's contribution to the National Insurance Fund. From 18 per cent in 1979, it now stands at 5 per cent. My RHF and I now propose to carry this policy to its logical conclusion and to abolish the Supplement altogether. The necessary legislation will be introduced early in the new Session.

31. However, because of the healthy state of the National Insurance Fund, this decision will not require

any increase in contribution rates. Thus, the main Class I contribution rates will remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

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

33. Growth this year looks to be turning out at $4\frac{1}{2}$ per cent, compared with the 3 per cent growth I forecast at the time of the Budget. Investment is particularly strong, growing twice as fast as consumption, with manufacturing investment exepcted to show the biggest rise of all, at 18 per cent. Indeed, it is striking that investment has grown twice as fast as consumption over the whole of the past five years.

34. The continuing vigour of the British economy is testimony to the transformation that has taken place in the supply side of the economy; a transformation which has enabled the seven years to 1988 to record a combination of strong and steady growth unmatched since the War.

35. As a result, unemployment has been falling rapidly. Since the middle of 1986, it has fallen by very nearly one million - the fastest fall on record, and faster than in any other major country.

36. Inflation, as measured by the retail price index, is likely to be a little over 6 per cent in the fourth

quarter of this year. Part of the rise in recorded inflation reflects the impact on mortgage payments of the higher interest rates needed to tighten monetary policy and thus get inflation firmly back on a downward trend. Excluding mortgage interest payments, the RPI in the fourth quarter is likely to be around 5 per cent, compared with the 4 per cent forecast at the time of the Budget.

37. Exports have continued to perform well, with manufactured exports up 7½ per cent over the past year. Over the past seven years, the UK's share of world trade in manufactur~~ing~~ed goods has remained steady after decades of decline - and indeed has risen slightly over the past two years. However, with investment booming, and consumer spending increasing fast, imports have grown even faster than exports, rising by 13 per cent in the year to the third quarter. This has led to a substantially greater current account deficit than I forecast at the time of the Budget. For 1988 as a whole, this now looks like turning out at some £13 billion, equivalent to 2¾ per cent of GDP.

38. The stronger than expected economic growth this year means that total tax revenues are likely to exceed the Budget forecast by £3½ billion. Both income tax and VAT have been particularly buoyant.

39. In the Budget, I set a Public Sector Debt Repayment - or PSDR - for 1988-89 of £3 billion, equivalent to around ¾ per cent of GDP. With higher than expected Government revenues and lower than expected public expenditure, this year's PSDR now looks likely to turn out at some £10 billion, equivalent to over 2 per cent of GDP.

40. This will be the second successive year of debt repayment, something that has not been achieved since records began in the early 1950s. Moreover, this year, the Budget would still be in surplus, by some £4 billion, even if there were no privatisation proceeds at all. No other major economy has such sound public finances.

41. Looking ahead to 1989, the economy is forecast to grow by a further 3 per cent, with domestic demand also up by 3 per cent. Once again, investment is expected to grow considerably faster than consumption, and once again unemployment is expected to fall.

42. The slower growth forecast for 1989 inevitably implies a marked deceleration during the course of the year, particularly so far as domestic demand is concerned. Thus, comparing the second half of next year with the second half for this year, overall growth is forecast at 2½ per cent, and growth in domestic demand at only 1½ per cent.

43. The current account deficit is likely to remain high, at some £11 billion or 2¼ per cent of GDP, but is forecast to be on a pronounced downward trend by the end of the year.

44. And inflation, while it will inevitably continue to edge up for some months to come, is forecast to peak at some point in the middle of next year before falling back again to 5 per cent by the fourth quarter.

45. In short, after two years of unexpectedly rapid expansion, growth next year is forecast to return to a sustainable level, and one which compares well with the economic performance of the '70s; while inflation will resume its downward path. The public finances are in substantial surplus and will remain so, with public spending on priority programmes continuing to increase, while overall public spending continues to fall as a share of GDP, to a level not seen for a quarter of a century.

46. The satisfactory prospect that lies before us is yet further testimony to the success of the policies we have been pursuing these past 9½ years, and to the economic transformation those policies have wrought.

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**CONFIDENTIAL**

**CABINET: DEFENSIVE BRIEFING** **BRIEF 1**

**Outcome restrictive, no need for painful measures**

Cabinet agreed in July objective of keeping as close as possible to existing planning totals. That is what we have done. Additions of £3.3 billion and £7.7 billion to baseline in later two years. Real growth of public expenditure from 87-88 to 91-92 exactly same as projected last year for 86-87 to 90-91. Massive increases for priority services: in many cases record increases. Would have been quite wrong to allow all of reductions from lower unemployment, lower CAP spending, and Right to Buy sales to feed through into higher public spending; would have been damaging to market confidence.

**Difficulty of Survey exaggerated by Treasury eg £2-3 billion increases to planning total in recent press stories**

No. Press stories were speculation, not inspired by Treasury. No false pretences: we did start with massive commitments (about £3-3.5 billion in first year); reductions on social security and agricultural spending, and RTB receipts, not declared by colleagues until recently.

**With inflation higher, can and must compensate through higher programmes**

| [ | 1988-89 | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|---|
| GDP deflators (%) | | | | |
| PEWP | 4½ | 3½ | 3 | - |
| FSBR | 4½ | 4 | 3½ | 3 |
| July | 5½ | 4½ | 3½ | 3 |
| Autumn Statement | 6¼ | 5 | 3½ | 3 |
| Increase FSBR to AS | 1¾ | 1 | - | - |
| Ditto cumulative | 1¾ | 2¾ | 2¾ | 2¾] |

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SCORECARD
NO. 24 OF 27 COPIES

FROM: A P HUDSON
DATE: 31 October 1988

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Phillips
Mr Odling-Smee
Mr Luce
[redacted]
Mr Turnbull
Mr MacAuslan
Mr Gieve
Mr Pickford
Miss J C Simpson
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Footman (Bank, by fax)

**AUTUMN STATEMENT: ORAL STATEMENT:**
**CHANCELLOR'S DRAFT, FIRST HALF**

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

2. Please could I have comments as soon as humanly possible. We cannot guarantee to take in comments received after 6.00 pm.

APH

A P HUDSON

**AUTUMN STATEMENT 1988: ORAL STATEMENT:**

**CHANCELLOR'S DRAFT**

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

2. Cabinet today agreed the Government's public expenditure plans for the next three years. I can therefore set out for the House this afternoon the public expenditure plans for the next three years, and the expected outturn for this year; proposals for national insurance contributions; and the forecast of economic prospects for 1989 required by the 1975 Industry Act.

3. The main public expenditure figures, together with the full text of 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, which will be published next Tuesday.

Public expenditure

4. I turn first to public expenditure.

5. For the current financial year, 1988-89, the public expenditure planning total now looks likely to amount to £154½ billion, or some £3¼ billion less than was allowed for in the last Public Expenditure White Paper. In other words, only around £¼ billion of the £3½ billion reserve I provided for is in fact likely to be needed.

6. The main reasons for this shortfall are an extra £1 billion in privatisation proceeds, benefit payments down by almost £1 billion as a direct result of a sharper than expected fall in unemployment, and some £$\frac{3}{4}$ billion of extra housing receipts under the right-to-buy programme. Taken together with the strong growth in the economy this year, and the containment of debt interest now that the Budget is in surplus, this means that total public spending this year, even excluding privatisation proceeds, will be less than 40 per cent of national income - the first time this has happened for over 20 years.

7. Not so long ago, the share of national income spent by the State seemed to rise inexorably. Over the past six years, that trend has been decisively reversed.

8. Since 1982-83, public expenditure, excluding privatisation proceeds, expressed as a share of national income has fallen by 7 percentage points - the largest and longest sustained fall since the wartime economy was unwound.

9. Over the whole decade since this Government first took office, from 1978-79 to 1988-89, public expenditure has grown by under 1$\frac{1}{2}$ per cent a year in real terms. This is exactly half the rate at which it grew over the whole of the immediately preceding decade.

10. Looking ahead, Cabinet agreed in July that public spending over the next three years should keep as close as possible to the existing planning totals, and should continue to fall as a share of national income. The plans I am about to announce meet both those objectives.

11. For 1989-90, the planning total published in the last Public Expenditure White Paper was £167 billion. It will remain at £167 billion. This important outcome has been made possible, despite the many claims for increased public spending, by a continuation of two of the factors that have contributed to this year's shortfall: benefit savings from lower unemployment and increased receipts from council house sales.

12. For 1990-91, however, while these two factors persist, the planning total has been set at £179½ billion, some £3¼ billion more than the previously published figure. For 1991-92, the planning total has been set at £191½ billion.

13. These totals include the same level of reserves as in last year's plans; that is to say £3½ billion in the first year, £7 billion in the second year, and £10½ billion in the third. They also incorporate an unchanged estimate of privatisation proceeds of £5 billion a year.

14. Over the three survey years as a whole, the new planning totals imply a real growth in spending on programmes of over 3 per cent a year. But thanks to a fall in the burden of debt interest as a result of the dramatic improvement in the Government's finances from Budget deficit to Budget surplus, overall public spending, excluding privatisation proceeds, will rise by less than 2 per cent a year, well within the prospective growth of the economy as a whole. In other words, total public spending, excluding privatisation proceeds, will continue to decline as a proportion of national income.

15. But, at the same time, substantial additional funds have been made available for the Government's most important public expenditure priorities. The figures I am about to give all represent increases over the plans in the last Public Expenditure White Paper.

16. First, health. An extra £1¼ billion is being provided for the National Health Service in England in 1989-90, and an extra £1½ billion in the following year. There will, of course, be corresponding increases in Scotland, Wales, and Northern Ireland. On top of that, health authorities are expected to receive an extra £100 million a year from sales of surplus land. Continuing the rate of cost improvement savings achieved in recent years will produce an extra £150 million in 1989-90 and an extra £300 million the following year. In addition, the Government is accepting the recommendation

of the Government Actuary, in a report published today, that NHS employers' superannuation contributions in England and Wales should be reduced, which will save the Health Service in England alone almost £300 million a year.

17. In total, the increases for the Health Service in the UK as a whole will be over £2 billion in 1989-90, which represents a real increase of 4½ per cent on this year's outturn, and over £2½ billion in the following year. These are [by far] the largest increases the Health Service has ever received, not just in cash terms, but in real terms, too.

18. Second, roads. An extra £220 million is being provided next year for building and repairing motorways and trunk roads, and for strengthening bridges, with a further £250 million the following year.

19. Third, housing. Gross provision for public sector housing investment is being increased by over £400 million a year. But thanks to the success of the Government's right to buy policy, this is more than financed by extra receipts.

20. Fourth, law and order. An extra £290 million has been made available in 1989-90 and £430 million in 1990-91, principally for a further expansion in the prison building programme. This will provide a further

3,000 places by 1991-92. Provision for local authority spending on the police has been increased by £240 million.

21. Defence spending is to be increased by £150 million in 1989-90 and £600 million in 1990-91. These significant increases are designed to provide a firm framework for the next three years within which our defence programme can be planned with confidence.

22. So far as the massive social security budget is concerned, lower unemployment has saved more than £1½ billion in both 1989-90 and 1990-91. But substantial increases in planned spending on other benefits, particularly for the disabled, mean that the social security programme will be only marginally reduced in 1989-90, and some £1.7 billion higher than previously planned in 1990-91.

23. On science and technology, we have altered the balance of public support within an increased total. In particular, provision for spending by the Department of Education and Science has been increased by £120 million a year, with the science budget up by 11 per cent in real terms in 1989-90. This reflects the importance the Government attaches to basic and strategic research.

24. The new plans imply an overall increase of £2½ billion in public sector capital spending in 1989-90.

This includes extra investment in hospitals, housing, prisons, and roads. There is provision for higher investment by the nationalised industries, including further anti-pollution measures by the Water Authorities. We have also provided in full for all the new safety measures identified by London Regional Transport following the King's Cross disaster.

25. That the Government has been able to strengthen its priority programmes within an unchanged planning total for 1989-90 is, in large measure, a reflection of the success of its policies. The improved performance of the economy has eased pressures on a number of programmes, giving the Government more scope than ever before to shift resources where its own priorities, rather than circumstances, dictate.

26. The details of these and other changes are provided in the material in the Vote Office. More details will be published in the printed Autumn Statement next week.

gep1.ip/jm/scorecard9

SECRET AND PERSONAL

SCORECARD
COPY NO: 3 OF: 24

FROM: J MACAUSLAN
DATE: 31 OCTOBER 1988

CHIEF SECRETARY +1

cc: Chancellor +1
Sir P Middleton
Mr Anson
Sir T Burns
Mr Monck
Mr Phillips
Mr Luce
Mr Odling-Smee
Mr Sedgwick
Mr Turnbull
Mrs Butler
Mr Gieve
Mr Mowl
Mr Pickford
Mr Richardson
Miss Simpson
Miss Walker
Mr Call
Mr Tyrie

**BRIEFING FOR PUBLIC EXPENDITURE CABINET**

I attached revised versions of some of the briefing:

(a) the tables which the Chancellor might hand round at Cabinet (corrected as in Alex Allan's note of today).

(b) Brief 1 (incorporating the Chancellor's comments in Alex Allan's note of today).

(c) Brief 2, correcting a misprint.

(d) Brief 6, revised on the assumption that you will want to follow the approach recommended in Andrew Turnbull's note of today on capital: ie that we claim an increase over the White Paper provision of £2¼ billion, with the £¼ billion increase for VAT on new construction coming on top of that, rather than claiming the full £2½ billion.

ni separate blue folder

(e) the last page of Brief 30 (the last page of the whole package) correcting a misprint.

JM

J MACAUSLAN

**TABLE 1: SURVEY OUTCOME**

| | | | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|---|---|
| 1. | | Baseline | | | |
| | (a) | Departmental programmes | 165.1 | 170.6 | 174.8* |
| less | (b) | Privatisation proceeds | - 5.0 | - 5.0 | - 5.0 |
| plus | (c) | Reserves | +7.0 | +10.5 | - |
| equals | (d) | Planning Total | 167.1 | 176.1 | - |
| 2. | | Additions to programmes | 3.5 | 6.8 | 11.3 |
| less | | Scope to draw down Reserve | -3.5 | -3.5 | |
| equals | | Increase in Planning Total | 0.0 | 3.3 | |
| 3. | | Reserve for new final year | | | 10.5 |
| 4. | | New planning totals (1+2+3) | 167.1 | 179.4 | 191.6 |
| Memo: | | New Reserves | 3.5 | 7.0 | 10.5 |

* For 1991-92 there was an unpublished baseline for programmes, but no figures for Reserves or the planning total have been formally agreed. Only new levels for these will be published.

**TABLE 2: PUBLIC EXPENDITURE TRENDS**

£ billion

| | 1987-88 | 1988-89 | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|---|---|
| **Planning total** | **145.7** | **153.6** | **167.1** | **179.4** | **191.6** |
| Add back privatisation proceeds | 5.2 | 6.0 | 5.0 | 5.0 | 5.0 |
| Add debt interest | 17.5 | 17.7 | 17.2 | 16.2 | 15.6 |
| Add national accounts adjustments | 8.2 | 9.6 | 9.4 | 9.4 | 8.8 |
| **equals General govt expenditure (excl priv proceeds)** | **176.7** | **186.9** | **198.7** | **210.0** | **221.0** |
| Planning total % change real terms | - 0.6 | - 0.8 | 3.6 | 3.8 | 3.7 |
| GGE (excl priv proceeds) % change real terms | - 0.6 | - 0.4 | 1.3 | 2.2 | 2.2 |
| GGE (excl priv proceeds) % of GDP | 41½ | 39¾ | 39¼ | 39 | 38¾ |
| cf last PEWP | (42½) | (42) | (42¾) | (41¼) | (-) |

1

**CONFIDENTIAL**

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**Outcome restrictive, no need for painful measures**

Cabinet agreed in July objective of keeping as close as possible to existing planning totals. That is what we have done. Additions of £3.3 billion and £7.7 billion to baseline in later two years. Real growth of public expenditure from 87-88 to 91-92 exactly same as projected last year for 86-87 to 90-91. Massive increases for priority services: in many cases record increases. Would have been quite wrong to allow all of reductions from lower unemployment, lower CAP spending, and Right to Buy sales to feed through into higher public spending; would have been damaging to market confidence.

**Difficulty of Survey exaggerated by Treasury eg £2-3 billion increases to planning total in recent press stories**

No. Press stories were speculation, not inspired by Treasury. No false pretences: we did start with massive commitments (about £3-3.5 billion in first year); reductions on social security and agricultural spending, and RTB receipts, not declared by colleagues until recently.

**With inflation higher, can and must compensate through higher programmes**

| [ | 1988-89 | 1989-90 | 1990-91 | 1991-92 |
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| GDP deflators (%) | | | | |
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| July | 5½ | 4½ | 3½ | 3 |
| Autumn Statement | 6¼ | 5 | 3½ | 3 |
| Increase FSBR to AS | 1¾ | 1 | - | - |
| Ditto cumulative | 1¾ | 2¾ | 2¾ | 2¾] |

With Autumn Statement showing higher inflation and further large current account deficit next year, more than ever essential to restrain expenditure if market confidence is to be retained. Expenditure planning is in cash, not volume. Colleagues have been able to negotiate against an emerging picture on inflation: reported higher assumptions in July. Final settlements reached in knowledge of many of factors leading to higher inflation assumptions. A large part due to investment prices - eg in construction industry: again, a reason for restraint to avoid fuelling overheating.

**<u>If Minister x seeks to hold up agreement until given adjustment to his programme</u>**

Expenditure plans are in cash, not volume. Control totals are there to be held to. Cannot reopen plans at this stage. Essential that we present to public the plans outlined. Consequences of not agreeing today very serious indeed.

[If pressed: Cannot give any commitment to agreeing claims on Reserve but if any colleague finds his programme in serious political difficulty, naturally prepared to re-examine position].

(See also brief 7 on Defence).

**<u>Kenneth Baker gets an inflation adjustment for student awards, why should not we?</u>**

[Mr Baker's letter of 17 October to Mr Ridley, copied to territorial ministers, said "I have ... settled provision for student awards with John Major on the basis that ... will be uprated in line with the GDP deflator".]

Simply reflects one effect of settlement reached with Secretary of State on an element of programme where relationship with inflation particularly close; does not represent any shift away from cash planning.
[If pressed: was this year crucial to show that awards are broadly maintaining real value, since we are <u>not</u> specifically reimbursing cost of community charge. Plans are in cash [see answer above]

**Growth in GDP means we should be spending more, and can do within ratios**

Cabinet agreed to keep as close as possible to cash planning totals. That's what markets will focus on. Exceptional growth this year means large step down in ratio in 1988-89. Settlements consistent with Cabinet remit of continued decline - although only just. Any higher spending would have meant failure to meet Cabinet remit. Economically wrong to expand public spending further at present time. Would jeopardise economic success, and make it harder to meet priority needs as handsomely as we have this year.

**Current year outturn means lower Reserves needed?**
[See also brief number 3]

No. Current year benefits from

- social security undershoot: reflects in part unanticipated fall in unemployment, not likely to be repeated next year;
- higher capital receipts (RTB and New Towns): already taken into account in Survey for future years; and
- capital underspending eligible for end year flexibility

Severe risks next year: of overspend on local authority current and capital; EYF liability; EC contributions. Essential to maintain prudent Reserves. Chancellor has proposed maintaining at same level as in last Survey.

**Current year outturn means room to spend more this year?**

Extra privatisation proceeds and capital receipts (accounting for about half this year's undershoot) no reason for spending spree. Control of public expenditure must continue to be and seen to be firm. Much of rest of this year's undershoot due to lower unemployment. When unemployment rose, forced to concede overshoots. So reasonable that when it falls, part of benefit taken in lower spending.

[But willing to consider bringing expenditure forward to 1988-89 where offset by reductions in later years.]

**[illegible]w Planning Total means smaller Reserve needed in Survey period?**

Still operating with existing planning total, so must show Reserves which commentators will see as credible in that framework.

**Sticking to planning total in 1989-90 a fake: simply due to capital receipts?**

Receipts are very substantial benefit to planning total. Reflect success of Government's RTB policy. Quite proper to score in planning total: counterpart to investment - which also scores - in housing. Benefit is another reflection of Government policy bearing fruit. In any case trend growth rate over Survey period not significantly affected if one took out receipts.

**Freezing child benefit an unnecessary political risk. Could have produced a satisfactory outcome without it**

[See also brief 23]

Switch from child benefit to targeted measures justified on merits. Would have been difficult to get to baseline in first year without the £130 million net saving.

SECRET AND PERSONAL

BRIEF 2

**FACTSHEET**

| | | 1988-89 | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|---|---|
| | | | | | (£ billion) |
| **Planning total** | | | | | |
| White Paper plans | | 156.9 | 167.1 | 176.1 | - |
| Proposed changes | | -3.3 | - | +3.3 | |
| New plans | | 153.6 | 167.1 | 179.4 | 191.6 |
| (increase in programmes) | | | 3.5 | 6.8 | 11.3 |
| | | | | | (%) |
| Real growth | | | | | |
| over previous year | | -0.8 | 3.6 | 3.8 | 3.7 |
| average from 1987-88 | | | | | 3.3 |
| 1988-89 | | | | | 3.7 |
| **GGE (ex priv proc)** | | | | | |
| As % of GDP | | 39¾ | 39¼ | 39 | 38¾ |
| (White Paper | | 42 | 42¾ | 41¼ | - |
| FSBR | | 41¼ | 40¾ | 40 | - ) |
| Real growth | | | | | |
| over previous year | | -0.4 | 1.3 | 2.2 | 2.2 |
| average from 1987-88 | | | | | 1¾ |
| 1988-89 | | | | | 1.9 |
| **Economic assumptions** | | | | | |
| GDP deflator - | PEWP | 4½ | 3½ | 3 | - |
| | FSBR | 4½ | 4 | 3½ | 3 |
| | July | 5½ | 4½ | 3½ | 3 |
| | AS | 6¼ | 5 | 3½ | 3 |
| AS/FSBR change | | +1¾ | +1 | - | - |
| ditto cumulative | | +1¾ | +2¾ | +2¾ | +2¾ |
| Unemployment | PEWP | 2.6 | 2.6 | 2.6 | - |
| (GB narrow, millions) | July | 2.25 | 2.25 | 2.25 | 2.25 |
| | AS | 2.1 | 1.9 | 1.9 | 1.9 |
| Interest rates | July | 10 | 10 | 9½ | 9 |
| (3 month interbank) | AS | 10¾ | 11 | 9½ | 9 |
| | | 1988 | 1989 | 1990 | |
| Rpi to September | PEWP | 4½ | 3¼ | - | |
| | July | 5½ | 4½ | 4 | |
| | AS | 5.9 | 5½ | 4 | |

BRIEF 6

## CAPITAL AND INFRASTRUCTURE SPENDING

£ million

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Additions to plans | 2,500* | * | * |
| - of which due to VAT on new construction | 250* | * | * |

* Estimates. Current/capital split still being worked out and details will be given in 1989 PEWP. Comparable figures for 1990-91 and 1991-92 not available as investment programmes of water and electricity industries will have dropped out on privatisation.

Main Changes (excluding additions for VAT)

Prisons capital: 124/174/96 and agreement to 3,150 extra places by 1993. Also 19/22/21 for court building. Plans imply 160 per cent real increase in capital spending on prisons between 1987-88 and 1991-92. Aim is to provide 58,130 places by 1993.

DOE Housing (gross): 441/339/415 of which LA spending 395/150/-59. Within these totals, LA renovation 185/5/-81, LA new housing provision 144/114/39, Housing Corporation 40/186/457. Plans imply that gross investment in housing over next three years will be about £3.7 billion a year.

NHS capital: 168/188/178 Biggest building programme in NHS history: over 500 major schemes underway in England with total value of £4 billion. NHS capital already up 40 per cent in real terms since 1978-79; plans imply further real growth.

National roads: 111/151/154 on new road construction, 66/70/70 on structural maintenance and 43/30/27 on bridges. 35/47/33 increase in LA capital for local roads, Manchester LRT. Also extra provision for local airports. Plans imply further 20 per cent real increase in capital spending between 1987-88 and 1991-92.

Schools capital: 95/95/103 additions to LA gross education spending. Plans allow continuation of £250 million programme to LA and voluntary schools to reduce backlog of improvement needs identified by school buildings survey.

Nationalised industries: including 195/204/350 British Rail, 138/[illegible]1/134 LRT, and £250 million in 1989-90 for water. Plans allow £3 billion BR and £1½ billion LRT investment programme over next 3 years. Have provided fully for all new safety measures identified by LRT following Kings Cross disaster. Additions to water investment programme virtually all for environmental measures: cleaning up sewage discharges and improving drinking water.

Sensitive policy points

**Massive reduction in net provision for housing?** Reflects success of Government's right-to-buy policy. Important point is that gross spending - better measure of new assets created - is up. Plans provide for nearly £12 billion gross spending over 3 Survey years.

Points for Cabinet discussion

**Not enough spending on capital/infrastructure?**

Gross public sector capital spending in 1987-88 broadly same in real terms as in 1978-79, despite deliberate policy of reducing state's role in providing new housing. In other areas, eg national roads, railway investment, prisons and NHS capital, very substantial real increases.

Survey builds on that record. Already spending nearly £25 billion a year. Extra £2.5 billion next year (~~excluding~~ including addition for VAT on new construction) in Survey will ensure public capital spending remains higher in real terms than in both 1978-79 and 1987-88.

**Public sector capital spending falling as share of GDP?**

Yes, but so is total public spending. Frees private sector for greater role.

**Capital spending to decline in real terms despite additions?**

No. Spending next year planned as high in real terms as in both 1978-79 and 1988-89.

23.6 23.4 23.1
87-

**LA CAPITAL**

£m

| Provision (GB) | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Bids | +1327 | +1174 | +1225 |
| Outcome | -1397 | -1524 | -1608 |
| of which - gross | + 573 | + 66 | - 191 |
| - receipts | -1969 | -1589 | -1417 |

| Allocations | Housing | Transport* | Education | PSS | Other Services | Total |
|---|---|---|---|---|---|---|
| 1989-90 | 1110 | 625 | 152 | 67 | 340 | 496 |
| as % 1988-89 (before EYF) | 86% | 99% | 95% | 95% | 130% | 95% |

*excludes transfer from British Rail (1988-89 £5m, 1989-90 £1m).

**Main Changes**

(i) Large increases in projected receipts over baseline. Small reductions in capital allocations compared with 1988-89.

(ii) Other Services allocations up on 1988-89 level by 30 per cent include £135 million for the costs of implementing the Community Charge.

**Sensitive Policy Points**

(i) Fall in allocations for all services (except Other Services, but increase only due to CCh element). But £2 billion extra receipts to LAs available. Proposals for new control system published on 7 July 1988, for inclusion in next session's Housing and Local Government Bill, will better match resources to needs.

**Points for Cabinet Discussion**

(i) 1988-89 underspend. DOE officials still considering how best to present the forecast underspend on DOE/LA1 to LAs. Not proposed to issue any extra allocations to reduce underspend.

(ii) Officials will be recommending abolition of DOE/LA1 and WO/LA1 (main English and Welsh LA capital cash limits) for 1988-89 and 1989-90 so that EYF additions to expenditure will not be available. Propose to reintroduce cash limit on credit approvals and capital grants under new control system.

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until after Oral Statement
then UNCLASSIFIED

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## A1 STRATEGY

**Factual**

(i) Objectives of Government's economic policy unchanged:

- to defeat inflation;
- to encourage enterprise and initiative, which will continue to generate sustained economic growth and increased employment;

(ii) No change in conduct of policy. Fiscal stance set once a year in the Budget - within year interest rate changed to keep monetary conditions on track.

(iii) Prospects for growth:

- 4½ per cent growth in 1988 (5 per cent non-oil), but more sustainable growth of 3 per cent in 1989;
- continuing boom in business investment, growing at 13 per cent in 1988 and 7 per cent in 1989. ~~- still very respectable by historical standards;~~ forecast to grow by
- consumers' expenditure expected to slow down from 5½ per cent in 1988 to 3½ per cent in 1989;
- good prospects for further fall in unemployment over next year, though more slowly than ½ million fall in last 12 months.

(iv) Policy already tightened to ensure inflation resumes downward trend and growth in domestic demand slows down. ~~sustainable rate~~ ~~current account deficit declines.~~ Interest rates ~~raised by 4½ points since June;~~ at 12 per cent and Chancellor has made clear they will stay high for as long as necessary

- inflation forecast at 6¼ per cent in 1988Q4; ~~and to~~ be on firm ~~downward trend~~ in second half, ~~of 1989~~, to reach 5 per cent by 1989Q4; ~~May rise a bit further in early 1989, but should~~ likely to edge up further in first half of 1989 before turning down again
- current account deficit likely to be slowest indicator to respond to tightening. Deficit forecast at £13 billion in 1988 (~~3~~ 2¾ per cent of GDP), and £~~12~~ 11 billion in 1989. ~~though declining through the year.~~

(v) Revised assessment of fiscal position in 1988-89:

- PSDR of £10 billion (~~2½~~ 2¼ per cent of GDP), £7 billion higher than forecast at Budget time. Even excluding privatisation proceeds, a PSDR of £4 billion.
- General government receipts likely to exceed Budget forecast by £4 billion, primarily result of higher than forecast economic growth.
- Planning total in 1988-89 about £3 billion lower than in 1988 PEWP, reflecting both higher privatisation and right-to-buy receipts and lower spending on programmes because of falling unemployment.

(vi) Planning total unchanged in 1989-90 from 1988 PEWP, £3½ billion higher in 1990-91. Within those totals significant shift. Priority programmes increased:

- health )
- law and order )
- housing ) [Illustrative numbers for
- ~~transport~~ roads ) each to follow]
- defence )
- science )
- ~~improving environment~~ ) ? what on

Increases made possible because resources released through success of Government's policies:

- falling unemployment
- further right-to-buy receipts
- ~~greater financial discipline for CAP~~ ? EC payment ↑ This is world weather.
- improved nationalised industry performance
- public sector debt repayment, leading to lower debt interest payments

(vii) Real growth of GGE (excluding privatisation proceeds) averaging 1¼ per cent a year in 1987-88 to 1991-92. Compares with nearly 3 per cent in decade before 1978-79, and 1.6 per cent in 1978-79 to 1987-88.

lowest since 196[illegible];

Declining ratio of GGE to GDP: below 40 per cent (excluding privatisation proceeds) in 1988-89; ~~and~~ lowest since 1966-67; projected to fall to under 39 per cent by 1991-92.

**Positive**

(i) Public expenditure objectives achieved - held planning total in 1989-90; share of public spending in national income declines ~~steadily~~ gradually over Survey period.

(ii) Public finances sound and strong - PSDR of £10 billion (~~2½~~ 2¼ per cent of GDP) in 1988-89. A surplus even excluding privatisation proceeds, for only the second time since the beginning of the 1950s.

(iii) Good prospects for sustained growth and falling unemployment reflecting success of Government's policies to encourage enterprise and initiative:

- well into eighth successive year of growth: seven years to 1988 longest period of sustained growth averaging around 3 per cent since war;

- unemployment fallen in last 12 months by ½ million.

(iv) Defeating inflation remains prime Government objective:

- policies already tightened in response to upturn in inflation;

- inflation expected to resume downward trend in 1989;

reduces burden of debt interest → thus

A1

(v) Success of Government's policies directly responsible for:

- higher public sector debt repayment, which permits increased spending on programmes within overall public expenditure total;
- increased public spending in priority areas;
- overall public spending held within 1988 PEWP plans this year and next.

(vi) Firm control of public spending in past has produced current successful economy. Now allowing higher public spending in priority areas, within unchanged planning total for 1989-90. Tight control ensures that public spending grows more slowly than whole economy. Continuing firm control essential to maintain progress.

(vii) Declining ratio of GGE to GDP (excluding privatisation proceeds):

- now on lower path than implied in 1988 PEWP; growth in expenditure well within prospective growth of economy as a whole;
- ratio this year below 40 per cent for first time in over ~~2 decades;~~ 20 years;
- ratio fallen nearly 7 percentage points since 1982-83, longest and largest sustained fall since [ ];

(viii) Capital spending planned to increase by [£3 billion] (gross) in both 1989-90 and 1990-91: hospitals, housing, prisons, roads, safety measures for London Transport, anti-pollution measures by Water Authorities.

**Defensive**

Path heavily affected by past changes in mortgage rates; excluding mortgage interest payments, path much smoother

X (i) Inflation rising? RPI inflation ~~(whether including or excluding mortgage interest payments)~~ forecast to peak in 1989 before turning down again. Expected to be around 5 per cent by end-1989. Firm action already taken to keep inflation under control. Government will not hesitate to take whatever further action is necessary.

(ii) Balance of payments crisis now upon us? No.

- Balance of payments slowest indicator to respond to recent tightening. Current account deficit forecast at 3 per cent in 1988 and 2½ per cent in 1989.

repetitive

- ~~Deficit entirely private sector phenomenon. Reflects rapid rise in investment and increased individual wealth combined with confidence to spend it.~~
- Present deficit financing high investment spending by private sector, contrary to period of 1960s and 1970s when current account deficit financed public sector deficit. Private investment adding to productive capacity which will boost exports and displace imports in future.



2¾ CHECK

Consumer spending growing at much the same rate in 1988 as in 1986 and 1987.

- Government has taken appropriate action and deficit will correct itself in time. No cause for concern provided firm financial framework in place, as it is.

- UK creditworthiness high: general strength of economy and high level of overseas assets mean no problems in financing deficit.

(iii) Growth based on consumer boom? No, But on top of that ~~Temporary period of excessive growth in consumer demand, but~~ fixed investment this year growing twice as fast. Reflecting improved profitability and confidence of British industry. ~~In 1988 investment forecast to grow by 12 per cent as against consumption growth of 5½ per cent.~~ Consumption forecast to slow down (from 5½ pc to 3½ per cent in 1989.

(iv) Growth forecast to slow sharply in 1989?

- Growth in 1988 well above trend, so want to see return to more sustainable rate. Policy already tightened in order to achieve that.

- Forecast shows growth decelerating from 4½ per cent in 1988 to 3 per cent in 1989. ~~- still perfectly respectable growth rate and same as average for last eight years.~~

(v) Interest rate rises too little, too late? Government acted promptly to tighten policy. Full effects will take some time to come through. Lower mortgage commitments figures in August and September now feeding through into lower mortgage lending.

(vi) Interest rate rises crippling industry, home buyers?

- Need to control inflation paramount.

- Industry performing very well and will continue to do so. Investment intentions remain strong. Far more to fear from resurgence of inflation. 1 per cent increase in interest rates, even if sustained for whole year, increases costs by far less than 1 per cent increase in wage settlements.

- Aware mortgage increases cause problems for number of people and regret that. But in long term, keeping inflation under control far more important to public than fluctuations in mortgage rate.

– Higher interest rates boon to savers, including large number of pensioners

(vii) No longer aiming at either PSDR/GDP ratio of 1 per cent or balanced budget? Balanced budget shown for future years in 1988 MTFS but acknowledged may be fluctuations in short term. MTFS not reviewed in autumn. Medium term PSDR path will be published in 1989 MTFS as usual.

(viii) Buoyant revenue indicates more tax cuts on the way? Much too early to say. Wait for Budget. Government committed to reducing tax, but only when prudent to do so. Chancellor already said intends substantial surplus in 1989-90.

(ix) Fiscal stance too loose/Budget tax cuts irresponsible? No.

- Budget boosted supply, not demand - supply-side benefits will improve output and trade performance in long term.

- Fiscal policy ~~still~~ very? tight; PSDR of £10 billion forecast - £7 billion higher than in Budget.

- And Government has kept public spending under control. GGE ~~fallen as percentage of GDP from peak in 1982-83 and set to continue falling through survey period.~~ [~~Hardly an irresponsible stimulus to demand.~~] In 1988-89 will be ~~[illegible]~~ lower than in 1987-88 in real terms.

(x) Why increase planning total in 1990-91? Strength of economy and public finances have made possible some additions to expenditure, especially for priority programmes. But increase in planning total still gives lower GGE/GDP ratio than implied by 1988 PEWP plans, and real growth rate over survey period unchanged.

(xi) Pattern of spending plans to fit in with next election? Plans simply reflect what needs to be spent in each year. ~~Good reasons for increase in~~ 1991-92 ~~(eg~~ electricity and water negative EFLs drop out of plans. ~~[other examples?]).~~

(xii) Underspend in 1988-89/higher tax revenues/falling ratio of GGE to GDP should mean more money available for programmes?

figures deflect fact than

- Higher spending on priority areas, made possible by success of Government's policies (see Factual vi).

- No intention of letting up ~~and~~ on prudent fiscal policy and firm control of expenditure which have brought about current strength of economy.

- No question of spending up to level implied by any particular ratio. ~~or using up all available revenues.~~

(xiii) Expenditure falling in real terms in 1988-89? Real cuts in plans for 1989-90?

- Result of success of Government's policies: lower growth in social security payments because unemployment falling; ~~lower IBAP payments because CAP finances under better control;~~ higher privatisation and right-to-buy receipts; improved nationalised industry performance.

- Nevertheless been able to increase spending on priority programmes (see Factual vi).

(xiv) Real cuts in benefits to finance tax cuts for rich? Nonsense.

- Spending on social security up 40 per cent in real terms since Government took office and planned to increase further 10 per cent in real terms by 1991-92.

- Families on income-related benefits (fully indexed) ~~protected from child benefit freeze and~~ get 50p a week more per child than if child benefit had been uprated: 3 million children benefit.

Wrong: CB freeze doesn't harm them @ all.

Economic performance



- Lower tax rates improve incentives and so boost ~~wealth~~ and job creation to benefit of all. Consistent theme of policy since 1979. Has contributed to far higher increase in real take-home pay at <u>all</u> earnings levels than under last labour government.

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## B1 INDUSTRY ACT FORECAST OF UK ECONOMY

Other relevant briefs:
- BB1 UK economy: recent developments
- BB2 World economy and international comparisons
- BB3 Balance of payments, oil and competitiveness
- BB4 Manufacturing and Industry
- C1 Fiscal policy
- C2 Revenue prospects
- C3 Monetary policy
- CC3 Interest and exchange rates

**Factual**

(i) Short term forecast to end 1989 in Chapter 2 of Autumn Statement (AS) meets Industry Act 1975 requirement that Government publish two economic forecasts a year.

(ii) - For main points of AS forecasts, see table 1 at Annex.

- For comparisons with recent official forecasts, see table 2 at Annex.

(iii) Activity

**percentage changes on year earlier**

| (a) Output: | **Outturn 1987** | **Forecast 1988** | **Forecast 1989** |
|---|---|---|---|
| GDP (average measure) | 4 | 4½ | 3 |
| GDP (A) excluding oil | 4½ | 5 | 3½ |
| Manufacturing output | 6 | 7 | 4½ |

NB: Rounded to nearest ½ per cent

| (b) Expenditure components: | | | |
|---|---|---|---|
| Consumers' expenditure | 5 | 5½ | 3½ |
| General government consumption | 1 | ½ | -½ |
| Total fixed investment | 5½ | 12 | 5½ |
| **Total domestic demand** | **4½** | **6** | **3** |
| Exports of goods and services* | 5½ (6½) | 1½ (3½) | 5½ (7) |
| Imports of goods and services* | 7½ (8) | 12 (13) | 4½ (4½) |

* Figures for non-oil goods and services in brackets

NB: Rounded to nearest ½ per cent.

(iv) Inconsistencies in national accounts: In year to first half of 1988 expenditure measure of GDP rose 2½ per cent, compared with 4½ per cent for income measure and 6 per cent for output measure. Output measure most reliable for periods up to a year. Expenditure and, consequently, average measure probably understating growth. ~~[Forecast makes allowance for further rise in average relative to expenditure measure in 1989, though much less than in 1988.]~~



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(v) Forecast implies following percentage increases in real GDP (average annual increases in brackets)

| | 1988 | 1989 |
|---|---|---|
| From 1979H1 peak | [20 (2)] | [23 (2)] |
| From 1981H1 trough | [24 (3)] | [27 (3)] |
| From 1983H1 | [18 (3½)] | [21½ (3½)] |

(vi) Fixed investment

| | £ billion at 1985 prices | percentage change on year earlier 1988 | 1989 |
|---|---|---|---|
| Business investment[1] | 41.1 | 13½ | 7 |
| of which: (i) non-oil business | 39.2 | 13½ | 6½ |
| (ii) manufacturing | 10.1 | 18 | 10 |
| Private dwellings[2] | 16.5 | 13 | 2 |
| General government | 6.7 | -1½ | 6½ |
| **Total fixed investment** | **64.2** | **12** | **5½** |

(1) Includes investment by public corporations.
(2) Includes net purchase of land and existing buildings by persons,companies and public corporations, other than purchases of council houses.

(vii) RPI inflation

| | percentage changes on year earlier | | | |
|---|---|---|---|---|
| | **Weight in 1988** | **Outturn 1987Q4** | **Forecast 1988Q4** | **Forecast 1989Q4** |
| Food | 16¼ | 3½ | 3¼ | 4 |
| Nationalised industries | 5½ | 2¼ | 7½ | 6½ |
| Housing | 15¼ | 7 | 16 | 8 |
| Other | 63 | 3¾ | 5½ | 4¼ |
| **Total** | **100** | **4** | **6¼** | **5** |

NB: Rounded to nearest ¼ per cent.

(viii) Earnings: Underlying increase up from 8½ percent at start of year to 9¼ per cent in August.

(ix) Manufacturing unit labour costs growth kept down by rapid growth of productivity. But forecast to rise in 1988, just under 1 per cent.

(x) Unemployment should continue to fall over next year, though probably at slower rate than recently.

(xi) Balance of payments: Current account deficit of £13 billion forecast in 1988 (3 per cent of GDP), falling to £11 billion in 1989, following deficit of £2½ billion in 1987. Deficit greater than expected at Budget time mainly due to stronger than expected growth in domestic demand.

(xii) North Sea oil prices and exchange rate assumed to remain close to recent levels.

(xiii) World economy: GNP growth in major industrialised economies likely to ease slightly to 3 per cent in 1989, after 4 per cent growth in 1988. World trade in manufactures likely to grow by about 8½ per cent in 1988 and by 7½ per cent in 1989. (See also BB2.)

(xiv) PSBR: See C1.

(xv) Comparison with independent forecasts:

| percentage increase on year earlier | Autumn Statement | | Average of independent forecasts (October) | |
|---|---|---|---|---|
| | 1988 | 1989 | 1988 | 1989 |
| GDP | 4½ | 3 | 3.7 | 2.4 |
| Consumers' expenditure | 5½ | 3½ | 5.4 | 3.0 |
| Fixed investment | 12 | 5½ | 9.7 | 4.3 |
| Exports of goods and services | 1½ | 5½ | 1.7 | 4.6 |
| Imports of goods and services | 12 | 4½ | 9.8 | 5.6 |
| RPI inflation (Q4) | 6¼ | 5 | 5.6 | 5.1 |
| Current account (£ billion) | -13 | -11 | -10.7 | -10.6 |
| PSDR (£ billion, financial years) | 10 | not published | 6.7 | 6.0* |

* PSDR figures for 1989-90 published by independent forecasters reflect various assumptions about tax changes in the Budget.

**Positive**

X (i) ~~Forecast~~ Average annual growth (likely to turn out at ~~of~~ 3 per cent in 8 years to 1989 ~~if forecast correct~~, compared with 2 per cent annual growth in 1970s. Six years to 1987 already longest period of steady growth at satisfactory 3 per cent rate since War.

(ii) GDP growth likely to moderate to around 3 per cent in 1989, ~~close to~~ the average rate between 1981 and 1987.

(iii) Non-oil economy forecast to grow by 5 per cent in 1988 and 3½ per cent in 1989. As in 1987, faster growth in manufacturing output (up 7 percent in 1988 and 4½ per cent in 1989) than non-oil GDP.

(iv) Growth well balanced: 1989 forecast to be year ~~of balanced growth with consumer spending,~~ on which both exports and fixed investment ~~all expected to increase by 3 per cent or more.~~ grow faster than consumption.

(v) 1988 and 1989 forecast to see substantial increases in fixed investment:

? ? ?



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Smaller



(vi) Forecast shows contribution to growth from stockbuilding remaining modest. Contribution much less volatile than in 1960s and 1970s.

(vii) Non-oil exports of goods forecast to rise 8½ per cent in 1989 in line with projected growth of world trade.

(viii) Healthy growth of manufacturing productivity is limiting unit labour cost increases in 1988.

(ix) Unemployment should continue to fall over year ahead.

**Defensive**

(i) FSBR forecast seriously wrong

foresee

- Why is this forecast any better?

- Treasury did not ~~anticipate~~ exceptional strength of economy this year but nor did other forecasters.

- misleading statistics, which initially suggested slowdown in 1988Q1, made forecasting more than usually difficult.

- all forecasts uncertain; we always publish margins of error.

- as always, this is our best forecast.

- economic policy set in medium term context and not based on short-term f'casts.

(ii) Forecast error led to Budget misjudgement - tax cuts were a mistake. No. Purpose of tax reforming Budget was to achieve further lasting improvement in supply side performance. Fiscal policy is unequivocally tight, with PSDR likely to be £10 billion in 1988-89.

(iii) Forecast errors the result of disarray in statistics. Inconsistencies in statistics clearly make forecasting difficult. But no reason to suppose this explains failure of all forecasters to anticipate strength of economy this year. Government has set up review of economic statistics. CSO Blue Book press notice (9 September) announced exercise to produce balanced set of accounts, to be completed within six months. Hoped that these would inform debate but no intention that they replace existing accounts.

(iv) Economy overheating? Growth clearly temporarily above trend in 1987 and 1988, but forecast to moderate in 1989.

- Supply-side improvements since 1970s allow firms to operate more efficiently at higher levels of capacity utilisation.

- CBI's latest quarterly Survey (October) found little evidence of widespread overheating.

- Foundations for continued supply flexibility reinforced by strong growth in fixed investment. Business investment set to rise by 12 per cent in 1988.

(v) Sharp slowdown in activity through 1989? Growth during 1988 above trend. Thus not surprising if some moderation in 1989. But despite this non-oil economy forecast to grow 3½ per cent in 1989, though slowing down in year.

(vi) Deceleration in manufacturing output growth: But manufacturing forecast to see eighth successive year of expansion in 1989; record not seen since before first oil price shock. Manufacturing output expected to rise faster than non-oil GDP in 1988 and 1989, as it did in 1987.

(vii) Projected slowdown in consumption growth unlikely. Already clear signs of housing market cooling down, especially in London and South East. This, and high levels of debt-income ratio, should discourage further rapid accumulation of debt by households. Also, households now substantial net payers of interest, so rise in interest rates should reduce personal disposable income directly.

(See also BB1.)

(viii) Growth based on consumer boom financed by tax cuts. No. Forecast shows fixed 80% investment growing twice as fast as consumer spending in 1988. Balanced growth forecast for 1989, with ~~consumer spending,~~ investment and exports ~~all~~ expected to rise ~~by 3 per cent or more.~~ faster than consumer spending. Reflects improved profitability of British industry, together with success of exporters in taking advantage of expanding world markets.

(ix) Why does general government consumption fall in 1989?

- Growth temporarily depressed by special factors (eg transfer of polytechnics from LA sector and winding down of Community Programme) which reduce GG consumption from 1988H2 onwards. Adjusting forecast for these special factors, GG consumption would rise by ½ per cent in 1989, a little below average rate of 3 years to 1987.

(x) Current balance deficits in 1988 and 1989: See BB3.

(xi) Unemployment forecast: Not practice of this or previous Governments to give precise forecast for unemployment. Unemployment should continue to fall over next year, though more slowly than over past year. Excessive pay settlements could threaten further progress.

X

(xii) Forecast shows deteriorating labour cost competitiveness in 1988 and 1989. ~~Only goes to highlight danger of excessive pay settlements.~~ Even so, ~~n~~ N on-oil exports of goods forecast to rise 8½ per cent in 1989, in line with projected growth of world trade.

(xiii) Inflation on upward trend. Total RPI inflation As in A1 ~~and inflation excluding mortgage interest payments~~ likely to peak in early to mid 1989 before falling back to around 5 per cent by end 1989. Reflects firm action already taken to ensure inflationary pressures remain under control.

(xiv) Why are nationalised industry prices forecast to rise faster in 1989 than RPI? as a whole

A number of these industries have substantial investment programmes to finance, or lack of [illegible] return on capital employed. Employers to have firm control of costs.

- ~~Average figure for NI price increases in year to 1989Q4 reflects mixture of information ranging from assumptions about outcome of decisions not yet taken to increases already announced (eg LRT and Network South-East fares).~~



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Most important indicator of UK's competitiveness is share of world trade, which has stabilised in the 80s after decades of decline. Indeed, over the past two years share has risen slightly. But clearly essential for

- ~~Increases will help to finance necessary investment and new capacity (eg London Underground).~~

  (See also RR23).

(xv) <u>Oil price assumption</u>: Considerable uncertainty about oil prices. But assumption that price remains close to recent levels ~~realistic and prudent~~. (See also (BB3).

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TABLE 1

ECONOMIC PROSPECTS: SUMMARY

Per cent changes on a year earlier unless otherwise stated

| | 1987 | Forecast 1988 | 1989 | Average errors from past forecasts[1] |
|---|---|---|---|---|
| **GDP and domestic demand at constant prices** | | | | |
| Domestic demand of which: | 4½ | 6 | 3 | 1 |
| Consumers' expenditure | 5 | 5½ | 3½ | 1¼ |
| General government consumption | 1 | ½ | -½ | ¾ |
| Fixed investment | 5½ | 12 | 5½ | 2¼ |
| Change in stockbuilding (as a percentage of GDP) | 0 | 0 | 0 | ¾ |
| Exports of goods and services | 5½ | 1½ | 5½ | 2¼ |
| Imports of goods and services | 7½ | 12 | 4½ | 2¾ |
| Gross domestic product | 4 | 4½ | 3 | ¾ |
| Manufacturing output | 6 | 7 | 4½ | 2 |
| **Balance of payments current account (£ billion)** | -2½ | -13 | -11 | 4¼ |
| **Inflation** | | | | |
| Retail price index (Q4 on Q4) | 4 | 6¼ | 5 | 1¾ |
| GDP deflator at market prices (financial year) | 5¼ | 6¼ | 5 | 1¾ |
| **Money GDP at market prices (financial year)** | 10 | 11 | 8 | 1¾ |
| £ billion | 424 | 471 | 508 | |
| **PSDR (financial year)** | | | | |
| £ billion | 3½ | 10 | | 3 |
| as a per cent of GDP | ¾ | 2¼ | | ½ |

1 The errors relate to the average differences (on either side of the central figure) between Autumn Industry Act forecasts and outturn over the last ten years and apply to the forecasts for 1989, except for the PSDR where they apply to the forecasts for 1988-89.

Source: Autumn Statement, table 2.12.

TABLE 2

Comparisons of official forecasts

(a) Output (Non-oil in brackets)

| | per cent change on year earlier 1987 | 1988 | 1989 |
|---|---|---|---|
| **GDP** | | | |
| - 1987 Autumn Statement | 4 (4½) | 2½ (3) | not app |
| - 1988 FSBR | 4½ (5) | 3 (3½) | 2½ (3)* |
| - 1988 Autumn Statement | 4 (4½) | 4½ (5) | 3 (3½) |
| **Manufacturing output** | **1987** | **1988** | **1989** |
| - 1987 Autumn Statement | 5 | 3½ | not app |
| - 1988 FSBR | 5½ | 5 | 3½* |
| - 1988 Autumn Statement | 6 | 7 | 4½ |

* 1989H1 only

(b) **Inflation** per cent change on year earlier

| **RPI** | **1987Q4** | **1988Q4** | **1989Q2** | **1989Q4** |
|---|---|---|---|---|
| - 1987 Autumn Statement | 4 | 4½ | not app | not app |
| - 1988 FSBR | 4 | 4 | 4 | not app |
| - 1988 Autumn Statement | 4 | 6¼ | not app | 5 |
| **GDP deflator** | **1987-88** | **1988-89** | **1989-90** | **1990-91** |
| - 1987 Autumn Statement | 4¼ | 4½ | 3½* | 3* |
| - 1988 FSBR | 5 | 4½ | 4* | 3½* |
| - 1988 Autumn Statement | 5¼ | 6¼ | 5 | 3½* |

* assumption

## C1 FISCAL POLICY

Other relevant briefs: C2 Revenue prospects
C3 Monetary policy
CC1 Public sector borrowing: historical statistics and international comparisons

**Factual**

(i) PSDR for 1988-89 forecast around £10 billion, 2¼ per cent of GDP, compared with of £3.2 billion in FSBR. ~~[No other revision of PSDR/PSBR forecast on this scale between FSBR and Autumn Statement during 1980s.]~~ defensive point ?

(ii) PSDR excluding privatisation proceeds for 1988-89 forecast at around £4 billion, almost 1 per cent of GDP.

(iii) Margin of error: Average absolute error on current year PSDR forecast made in autumn over last 12 years around 0.6 per cent of GDP, equivalent to about £3 billion at current level of GDP.

(iv) General government receipts in 1988-89: Almost £4 billion higher than FSBR forecast. (See C2.)

(v) General government expenditure (GGE) in 1988-89: Over £2 billion lower than FSBR forecast; £1 billion of this reduction due to higher privatisation proceeds. (See E1.)

(vi) Comparison of forecasts

| | | £ billion | |
|---|---|---|---|
| | 1987-88 | 1988-89 | |
| | Outturn | FSBR forecast | AS forecast |
| General government expenditure | 171.6 | 182.9 | 180.6 |
| General government receipts | 173.6 | 184.9 | 188.7 |
| of which: | | | |
| North Sea revenues | 4.7 | 3.3 | 3.4 |
| General government debt repayment | 2.1 | 2.0 | 8.1 |
| PCMOD** | 1.6 | 1.2 | 2.0 |
| PSDR | 3.7(¾)* | 3.2(¾)* | 10.2(2¼)* |
| PSDR excluding privatisation proceeds | -1.3(-¼)* | -1.8(-½)* | 4.2(1)* |

Figures do not necessarily sum to totals because of rounding.

* Figures in brackets are as percentage of GDP.
** Public corporations' market and overseas debt repayment.

(vii) PSDR outturn in first 6 months of financial year

| | | £ billion |
|---|---|---|
| | 1987-88 | 1988-89 |
| PSDR | -1.9 | 3.7 |
| PSDR excluding privatisation proceeds | -5.8 | -1.2 |

standard practice.

(viii) No PSDR forecast for 1989-90: Forecast of economic prospects for 1989 in Chapter 1 of Autumn Statement constructed on assumption that PSDR in 1989-90 will be same as forecast outturn for 1988-89. MTFS path for PSDR will be reviewed at time of 1989 Budget in normal way.

(ix) Chancellor indicated in Mansion House speech (20 October) that he intended to see a "substantial surplus" in 1989-90.

(x) Fiscal projections: Full fiscal projections only published at Budget time. Autumn Statement contains public expenditure plans to 1991-92, but no revenue or PSDR projections beyond 1988-89, and hence no projections for fiscal adjustment.

(xi) GGE projections to 1991-92. See E2.

(xii) Path for money GDP growth, real GDP growth and inflation

| | percentage growth over previous financial year | | | | |
|---|---|---|---|---|---|
| | 1987-88 | 1988-89 | 1989-90 | 1990-91 | 1991-92 |
| **Money GDP** | | | | | |
| FSBR | 9¾ | 7½ | 6½ | 6 | 5½ |
| Autumn Statement | 10 | 10¾ | 8 | 6* | 5½* |
| **Real GDP** | | | | | |
| FSBR | 4½ | 3 | 2½ | 2½ | 2½ |
| Autumn Statement | 4½ | 4** | 2½** | 2½* | 2½* |
| **GDP Deflator** | | | | | |
| FSBR | 5 | 4½ | 4 | 3½ | 3 |
| Autumn Statement | 5¼ | 6¼ | 5 | 3½* | 3* |

* Money GDP growth path (and real GDP growth and GDP deflator components) for 1990-91 and 1991-92 remain as set out in MTFS at Budget time.

** Financial year real GDP figures not published but can be inferred approximately from money GDP and GDP deflator figures.

(xiii) Key PSDR components: See Annex.

**Positive**

(i) Government finances very strong. 1988-89 PSDR forecast to be about £10 billion (2¼ per cent of GDP), almost £7½ billion higher than forecast at Budget time. Never repaid debt on this scale in any year since beginning of 1950s.

(ii) 1988-89 only third year with budget surplus since early 1950s: (other years were 1987-88 and 1969-70). (See also CC1.)

(iii) 1988-89 PSDR excluding privatisation proceeds forecast to be 1 per cent of GDP. Only other year since beginning of 1950s with budget surplus after excluding privatisation proceeds was 1969-70 (PSDR of 1¼ per cent of GDP).

(iv) For first 6 months of 1988-89, PSDR excluding privatisation proceeds £4½ billion higher than for corresponding period in 1987-88.

(v) International comparisons: Treasury forecast suggests UK general government financial surplus in 1988. All other major industrial (G7) countries still running fiscal deficits, with possible exception of Japan which is close to balance. (See also CC1).

**Defensive**

(i) Budget tax cuts adding to domestic demand and irresponsible? Budget boosted supply, not demand. ~~Despite longer term commitment, Government did not plan in Budget for reduced tax burden (ratio of tax receipts to GDP) for 1988-89.~~ Nonsense to argue fiscal policy too loose.: debt repayment as percentage of GDP now forecast to be even higher than expected at Budget time.

X
dangerous given (ii)

(ii) Tax burden now shown as falling, so Budget did after all contribute to stimulating domestic demand? Latest revenue and GDP forecasts imply small fall ([¼] percentage point) in non oil tax burden in 1988-89; but an even bigger downward revision to the GGE/GDP ratio forecast. So argument that Budget not stimulative holds even more strongly.

(iii) Excessive reliance on monetary policy - need for fiscal tightening now? Task of fiscal policy is to buttress monetary policy, with expenditure and tax decisions taken in medium term context. Fiscal policy already tight by any standards. Notion that fiscal policy could or should be used to fine-tune demand is to hark back to failures of 1960s and 1970s. Chancellor reiterated (interview, Radio 4, "World at One", 25 August) intention to stick to rule of having one budget a year in Spring. Job of ensuring monetary conditions remain on track must fall to short term interest rates. (See also [C3].)

(iv) Money GDP path higher than in MTFS: FSBR forecast, like other forecasts made at the time, understated buoyancy of demand and consequent inflationary pressures. Hence upward revision to money GDP growth figures for 1988-89 and 1989-90. MTFS path for money GDP growth in later years not reviewed in Autumn.

(v) Money GDP growth and PSDR forecasts imply change to MTFS and fiscal stance?

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

- MTFS designed to bring inflation down further over period of years. Always allowed for short term fluctuations. No change in primary objective of price stability.

- By raising interest rates Government already taken resolute action to bring monetary conditions back on track. Will take whatever further action proves necessary. Forecast shows inflation coming down in 1989-90.

- Fiscal stance over medium term set in accordance with MTFS and hence reviewed only at Budget time. PSDR path for medium term will be published in 1989 MTFS as usual, and PSDR for 1989-90 will be set in 1989 Budget in light of prevailing circumstances.

While public spending under firm control;

(vi) Why such big increase in 1988-89 PSDR forecast? To large extent, PSDR forecast higher because economy growing faster ~~and inflation higher~~ than expected at Budget time, so tax revenues higher and expenditure lower. Also privatisation proceeds higher. world conjuncture

That is our best present forecast

(vii) PSDR forecast for 1988-89 still too low: Substantial upward revision (over £7 billion) to 1988 FSBR forecast. Of course, outturn could be higher - or lower. Average error estimated on past experience at ±£3 billion for current forecast.

[(viii) Government deliberately published pessimistic forecast for 1988-89 PSDR at Budget time. No. Budget forecast was best estimate at time. In event, economy been growing faster than expected and inflation higher, leading to higher tax revenues and lower expenditure.]

(ix) Forecast implies large PSDR for 1989-90 compared with balanced budget in MTFS? Hence scope for tax cuts?

- PSDR for 1989-90 will be set at Budget time in accordance with 1989 MTFS.

- But assumption always required to construct Industry Act forecast for following year.

- Assuming same PSDR in 1989-90 as in 1988-89 is same convention as ~~before~~. last year.

- Chancellor has indicated that he intends to see substantial surplus in 1989-90.

(x) Higher revenues would permit higher expenditure growth.

- Continued restraint in public spending vital element of economic success.

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

- Control of public expenditure and sound fiscal policies allow substantial additions to priority programmes.

(xi) Why no fiscal adjustment published? Haven't done for last (x) years. Autumn Statement about expenditure, not tax. Contains outline of future spending plans and conditional forecast of economic prospects. Not intended as restatement of MTFS which is reviewed only at Budget time.

(xii) Why is tax burden forecast for 1988-89 lower than at Budget time? Mainly because money GDP growing faster than expected, while some of extra tax revenue generated will not be paid until later financial years (eg corporation tax).

Contact point: C M Kelly (MP1) 270 5508

**KEY PSDR COMPONENTS***

**ANNEX**

| | 1987-88 | | | 1988-89 | | |
|---|---|---|---|---|---|---|
| | **FSBR** | **outturn** | **change** | **FSBR** | **AS** | **change** |
| | | | | | £ billion | |
| Planning total | 146.0 | 145.7 | -0.3 | 156.8 | 153½ | -3 |
| (o/w: privatisation proceeds) | ( ) | ( ) | ( ) | ( ) | ( ) | ( ) |
| Interest payments | 16.3 | 16.0 | -0.4 | 16.3 | 15½ | -½ |
| Plus PCMOD** | 1.2 | 1.6 | +0.4 | 1.2 | 2 | +1 |
| Other adjustments | 8.3 | 8.3 | 0 | 8.6 | 9½ | +½ |
| General govt. exp | 171.8 | 171.6 | -0.2 | 182.9 | 180½ | -2½ |
| North Sea revenues | 4.7 | 4.7 | 0 | 3.3 | 3½ | 0 |
| Non-NS taxes | 127.6 | 128.0 | +0.4 | 138.5 | 141½ | +2½ |
| Nat. Ins. Contributions | 28.7 | 28.9 | +0.2 | 31.6 | 32½ | +1 |
| Interest and other receipts | 12.7 | 12.0 | -0.7 | 12.0 | 12½ | +½ |
| General govt. receipts | 173.7 | 173.6 | -0.1 | 184.9 | 188½ | +4 |
| GGDR | 1.9 | 2.0 | +0.1 | 2.0 | 8 | +6 |
| Plus PCMOD** | 1.2 | 1.6 | +0.4 | 1.2 | 2 | +1 |
| PSDR | 3.1 | 3.7 | +0.6 | 3.2 | 10 | +7 |
| PSDR as per cent of GDP | ¾ | 1 | +¼ | ¾ | 2¼ | +1½ |

* All £ figures rounded to nearest £100 million for 1987-88 outturn and FSBR and to nearest £½ billion for Autumn Statement forecast. PSDR as percentage of GDP rounded to nearest ¼ per cent. Figures do not necessarily sum to totals, either down or across, because of rounding.

** Public corporations' market and overseas debt repayment.



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## C3 MONETARY POLICY (INCLUDING ROLE OF INTEREST AND EXCHANGE RATES)

Other relevant briefs: C1 Fiscal Policy 1988-89 to 1991-92.
BB3 Balance of payments, oil and competitiveness
CC3 Interest and exchange rate developments.

**Factual**

(i) Monetary policy: Object of monetary policy to maintain conditions that keep downward pressure on money GDP growth and hence inflation.

(ii) Policy instruments: Short-term interest rates are the essential instrument of monetary policy.

(iii) Assessing monetary conditions: Conditions assessed in light of movements in narrow and broad money and behaviour of other financial indicators, in particular, exchange rate.

(iv) Latest money supply figures

[Full figures for September published 31 October].

**Monetary aggregates: growth to end September**
**per cent - unadjusted**

| | 1 month | 12 month |
|---|---|---|
| M0 | 0.4 | 8.1 |
| M3 | 3.1 | 22.6 |
| M4 | 2.2 | 18.6 |
| M5 | 2.2 | 17.9 |

(v) September M0 figures affected by postal dispute.

(vi) Monetary target 1988-89: 1988 FSBR set target range for M0 growth in 1988-89 and illustrative range for 1989-90 onwards.

| | 1988-89 | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|---|
| 1988 MTFS | 1-5(1) | 1-5 | 0-4 | 0-4 |

(1) per cent change on previous financial year.



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(vii) Bank and building society lending

[Full figures for September published 31 October]

(a) One month changes

| | Bank and building society lending | | | | Bank lending | | | |
|---|---|---|---|---|---|---|---|---|
| | £ billion | | % | | £ billion | | % | |
| July | +9.1 | (+9.2) | +2.4 | (+2.5) | +6.2 | (+6.5) | +2.6 | (+2.7) |
| August | +4.5 | (+5.9) | +1.2 | (+1.5) | +1.6 | (+3.1) | +0.7 | (+1.3) |
| September | +9.0 | (+7.6) | +2.1 | (+2.1) | +7.2 | (+5.9) | +2.9 | (+2.4) |

(Figures in brackets seasonally adjusted)

(b) 12 month growth rates

| | Bank and building society % | Bank % |
|---|---|---|
| April | +21.9 | +26.9 |
| May | +22.2 | +26.8 |
| June | +22.7 | +27.5 |
| July | +23.6 | +27.8 |
| August | +24.0 | +27.7 |
| September | +24.2 | +27.9 |

(viii) Total personal sector borrowing outstanding

Amounts outstanding at end 1988 for

| | £ billion | % of total |
|---|---|---|
| Consumer credit | 37 | 15 |
| House purchase | 184 | 75 |
| Other | 23 | 9 |
| Total | 244 | 100 |

NB Figures may not sum because of rounding.

Total borrowing outstanding not published, as borrowing outstanding in form of trade credits etc not known. But will be greater than £244 billion shown above.

Source: CSO

(ix) Mortgage repossessions and arrears:

- Repossessions down 19 per cent in first half of 1988 as against previous six month period and at lowest level for 3 years

- Borrowers in arrears for 6 months or more only 0.6 per cent of all building society mortgage lending

| | 1987 July-December | 1988 Jan-June | Per cent Change |
|---|---|---|---|
| Repossessions | 11,280 | 9,180 | -19 |
| Loans in arrears more than 6 months | 61,440 | 59,440 | -3 |
| Number of loans at end of period | 7,229,000 | 7,300,000 | |

(x) Funding policy: Aim in general to fund total of maturing debt, PSBR and any net foreign exchange market intervention over financial year as a whole. Does not necessarily mean required funding will be fully completed within financial year.

~~(xi)~~ Chancellor announced on 13 October launch of new taxable National Savings product, Capital Bond.

(xii) UK membership of EMS Exchange Rate Mechanism (ERM): No change in Government's position. Matter kept under continual review. Will join when Government considers time is right.

**Positive**

(i) Commitment: Need to control inflation paramount. Government will not hesitate to take whatever action is necessary to achieve this, however unpopular, as shown by recent interest rate increases.

(ii) Firm monetary policy has brought and kept inflation down well below crippling levels of 1970s, while economy has enjoyed longest period of sustained economic growth for half a century.

(iii) High interest rates good news for savers, including many pensioners.

(iv) Government wishes to encourage long term saving and improve quality of Government borrowing. Hence Chancellor announced on 13 October launch of Capital Bond; and limit for reinvestment of matured savings certificates into current issue has been doubled to £10,000.

**Defensive**

(i) Interest rate increases consequence of irresponsible Budget? No. Purpose of tax reforming Budget was to achieve further lasting improvement in supply side performance. Fiscal policy unequivocally tight. ~~Budget did not aim to reduce taxation as proportion of national income; and~~ surplus now forecast to be £[10½] billion.

(ii) Adjusting fiscal policy only once a year places excessive reliance on monetary policy? Notion that fiscal policy could or should be used to fine tune demand harks back to failures of 1960s and 1970s. Task of fiscal

C3

policy is to buttress monetary policy with expenditure and tax decisions taken in medium term context to deliver prudent sustainable fiscal position.

(iii) Controls on lending? Wrong in principle and ineffective in practice. In financial markets, as elsewhere, best way to improve performance is by deregulation and removing artificial controls. With increasing sophistication of financial sector and absence of exchange controls, measures could not be made to work effectively.

(iv) Mistake to loosen policy post-crash? Infinitely preferable to doing nothing at time of fragile confidence, even though may have stored up some problems for later on.

(v) Mistake to cut interest rates to 7½ per cent? Purely temporary measure lasting only two weeks, in response to exceptional upward foreign exchange market pressures which tightened monetary policy. Those who claim detrimental effect on Government's anti-inflationary stance are often very same people who claim recent increases in interest rates ineffective.

(vi) Consumer credit boom? Three-quarters of personal borrowing is for mortgages. Consumer credit only 15 per cent of personal debt. Less than 5 per cent of personal debt in form of credit card lending. Some credit card payments simply convenient alternative to cash and cheque payments: around 40 per cent of credit card users settle within interest free period.

(vii) Higher mortgage rates hurting home owners? Aware mortgage increases cause problems for number of people and regret that. But in long term, keeping inflation under control far more important to public than fluctuations in mortgage rate.

(viii) Higher mortgage rates will lead to more repossessions? Repossession not in interest of lenders. Most will make arrangements to cover temporary problems.

[As A1: defensive (vi)]

Investment intentions remain strong

(ix) Higher interest rates damage industry? Industry performing very well and will continue to do so. Far more to fear from resurgence of inflation. 1 per cent increase in interest rates, even if sustained for whole year, increases costs by far less than 1 per cent increase in wage settlements.

(x) UK short term nominal rates highest in G7? Reflects number of factors including higher UK inflation. Reductions in interest rates only made when justified by monetary conditions.

above G7 average: this reflects

?(interesting, but not v good point here)

(xi) UK currently real interest rates out of line with competitors? Short term real rates ~~bound to move higher when base rates have increased 4½ per cent since beginning of June. Reflects Government's determination to keep on top~~ of inflation. ~~Long term rates lowest in G7, relative to inflation.~~ Long rates have scarcely risen @ all.

(xii) Strength of sterling damages competitiveness? Repeatedly made clear that Government will not accommodate inflation by exchange rate depreciation. Holding down unit costs - which is in industry's own hands - key to competitiveness.

(xiii) Budget tax cuts cancelled out by mortgage rate increases? Misleading to compare just two elements in standard of living when over



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Outturns 88r



lifetime of Government, living standards have improved so much. In any case, tax changes permanent and will bring long term benefit. Interest rates vary from time to time to ensure monetary conditions continue to bear down on inflation.

(xiv) Higher interest rates will increase inflation? In short term RPI will increase since UK, unlike most other major countries, includes mortgage interest payments in its price index. But measures now taken will ensure that in due course inflation comes down again.

(xv) Interest rate increases failing to have an effect? Early days yet; policy has tightened considerably, and full effects will take some time to come through. Lower mortgage commitments figures in August and September now feeding through into lower mortgage lending.

(xvi) More encouragement for savings? Higher interest rates good for savers. New National Savings Capital Bond and doubled reinvestment limit for matured savings certificates should encourage saving as well as improving quality of Government's funding.

(xvii) Use National Savings to absorb liquidity as alternative to increasing interest rates? National Savings inflows over financial year to date less than £140 million a month as against average of nearly £3 billion into bank and building society interest-bearing deposits. Moreover, banks and building societies could easily make up any Government-induced shortfall in wholesale markets. That said, Government still keen to encourage saving and improve quality of funding.

(xviii) High PSDR changes funding policy? No, as Mansion House speech made clear, policy unchanged. Full fund which neutralises impact of public sector on monetary system - no more, no less. ~~See factual (x).~~

spell out what policy is

(xix) Required unfunding not necessarily to be fully completed within course of financial year? Statement in 1988 Mansion House Speech simply obverse of Chancellor's statement in last year's speech that funding would not necessarily take place within financial year.

(xx) Exchange rate policy? Part of total economic policy. Degree of exchange rate stability assists in battle against inflation and also in promoting satisfactory economic performance.

(xxi) Sterling one-way bet if interest rates remain high? No. Nothing in financial markets ever one-way bet. Government stated repeatedly that it will always take whatever action needed on interest rates whenever it is necessary.

(xxii) Conflict between interest rate and exchange rate policy? In theory, could be conflict between requirements of anti-inflationary policy and exchange rate stability. But if purely short-term conflict, intervention can be used on short time scale, as earlier this year.

(xxiii) Membership of ERM would have prevented recent fluctuations in sterling and avoided need for higher interest rates? ~~No.~~ Joining ERM not a soft option. Countries within ERM ~~frequently experience currency realignments and~~ frequently change interest rates.

Oh yes? - none for nearly 2 years!



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(xxiv) Join ERM by 1992? No fixed timetable. Will join when Government considers time is right.

(xxv) Proposals for European Central Bank and Common European Currency? Community should focus on immediate and practical requirements eg free movement of capital, free market in financial services and developing use of private ecu. Proposals for common currency/Central Bank presuppose readiness to surrender national control over monetary policy and that all Member states pursuing same economic policy. Not in prospect.

Contact points: N P Williams (MG1) 270 5561 (Exchange rates)
M H Wheatley (MG1) 270 4614 (Interest rates, funding etc)

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E1 **PUBLIC EXPENDITURE 1988-89**

Detailed questions on programmes to individual Departments

Other relevant briefs:
- C1 Fiscal policy 1988-89 to 1991-92
- E2 Public expenditure 1989-90 to 1991-92
- E3 Public expenditure: historical statistics, plans and international comparisons
- EE29 Debt interest and other national accounts adjustments

**Factual**

(i) Prospective outturn for 1988-89 planning total

- £153.6 billion (although estimate still uncertain). Includes implications of winter Supplementaries and claims expected later.

- Represents underspend of £3.3 billion on 1988 PEWP plans of £156.9 billion (adjusted for classification changes).

(ii) Main reasons for underspend

- increased privatisation proceeds £1.0 billion

- lower Social Security payments due to fall in unemployment £0.9 billion

- higher net receipts from local authorities and New Towns £0.7 billion

- revised expenditure forecast for Intervention Board for Agricultural Produce £0.3 billion

- improved nationalised industry performance £0.3 billion.

(iii) Comparison of 1988-89 planning total outturn with 1988 PEWP plans

[see table 1.2 of Autumn Statement]

Main increases

- DoH (mainly reflecting NHS pay settlement) (£1.1 billion);

- DES (£0.4 billion) and DOE Other Environmental Services (£0.5 billion) reflecting LA overspending;

- DTI (largely payment to Rover) (£0.5 billion);

Main decreases

- Intervention Board for Agricultural Produce (reflecting effects of US drought and UK harvest) (£0.3 billion);

- LA capital (net) (reflecting higher gross spending offset by even higher receipts) (£0.6 billion);

- Privatisation proceeds (£1.0 billion);

- DSS (reflecting lower unemployment) (£0.9 billion);

(iv) Reserve

- Reserve in 1988 PEWP plans £3.5 billion

- Agreed claims amount to over £2.0 billion. Offset by higher receipts than forecast and underspending elsewhere

(v) Main agreed and potential claims on Reserve

| | £ million |
|---|---|
| End-year flexibility | 770 |
| Local authority relevant | 1200 |
| Local authority capital (gross) | 1140 |
| NHS and FPS pay review | 890 |
| Assistance to Rover Group | 550 |

(vi) Main agreed and potential benefits to the Reserve

| | £ million |
|---|---|
| Privatisation proceeds | 1000 |
| Extra capital receipts: | |
| LA capital receipts | 1720 |
| New Towns capital receipts | 120 |
| Net improvement in nationalised industries (mainly Steel and Rail) | 290 |

Reserve will also benefit from forecast underspending (eg on social security £860 million and IBAP £340 million.)

(vii) General government expenditure (GGE) excluding privatisation proceeds.

| (£ billion) | 1987-88 | 1988-89 PEWP (as published) | 1988-89 AS |
|---|---|---|---|
| Planning total (excl pp) | 150.9 | 161.8 | 159.6 |
| Debt interest | 17.5 | 18.0 | 17.7 |
| Other adjustments | 8.2 | 8.0 | 9.6 |
| **Total GGE (excl pp)** | **176.7** | **188.0** | **186.9** |

(viii) GGE (excluding privatisation proceeds) as percentage of GDP estimated 39¾ per cent in 1988-89. Compares 42 per cent forecast in PEWP; 41½ per cent in 1987-88. and



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until [    ] November 1988
then UNCLASSIFIED

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## Positive

(i) Public expenditure firmly under control.

(ii) Prospective outturn for planning total is £153.6 billion, £3.3 billion less than plans (adjusted for classification changes).

(iii) GGE (excluding privatisation proceeds) as percentage of GDP at lowest level for over twenty years. Estimated 39¾ per cent in 1988-89. Fallen from ~~45¾~~ 46¾ per cent in ~~1983-84~~ 1982-83 and 41½ per cent in 1987-88.

(iv) Real terms decrease in planning total and GGE (1988-89 over 1987-88): GGE (excluding privatisation proceeds) 0.4 per cent lower than 1987-88; planning total 0.8 per cent lower.

(v) Underspend helped by continued strength of the economy. Lower unemployment £1.1 billion; £0.7 billion from higher net capital receipts of local authorities and New Towns; £0.3 billion from better results of nationalised industries. (Also £1 billion from more successful privatisation proceeds).

## Defensive

(i) Details of Departmental spending (estimated outturn and Reserve claims): Refer to Departments.

(ii) If underspending, why, not spend more elsewhere? Tight control of expenditure cornerstone of economic policy. ~~No relaxation now. Outturn still uncertain. Undershoot on planning total substantially result of increased receipts. Some underspending eligible for end year flexibility.~~

(iii) What is "Adjustment" in Autumn Statement Table 1.3? "Adjustment" £300 million shows difference between assessment of likely outturn for 1988-89 and sum of other items shown. Adjustment regularly included in AS and PEWP tables.

(iv) Implications for PSBR/PSDR? See [C1]

(v) Winter Supplementaries: To be presented to Parliament this month, as usual. Planning total outturn allows for expected claims on Reserve.

(vi) Government unnecessarily miserly with expenditure this year? Over £2 billion of Reserve claims agreed, including extra £0.9 billion for NHS and FPS pay. Offset by higher receipts (privatisation proceeds, LA capital, New Towns) and effects of economic success (lower unemployment, better performance of nationalised industries).

(vii) Underspend looks implausible?

Best estimate at present. Naturally still uncertain.

No presumption that reserve must be fully spent.



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(viii) Why not allocate more to programmes instead of Reserve?

Reserve needed for unforeseen contingencies. Essential part of prudent expenditure control. Agreed claims on Reserve in 1988-89 already exceed £2 billion.

(ix) Always overspend on same programmes?

Not true. Underspending this year on social security and NI EFLs. NHS addition reflects continuing priority for health. Problem with local authorities addressed in Government's plans for local authority finance.

(x) Government covertly planning for real falls in GGE?

No. Over £2 billion added to programmes in both 1987-88 and 1988-89. Offset by higher than anticipated receipts, underspending, and lower debt interest.

(xi) Why plans (£156.9 billion) different from PEWP (£156.8 billion)?
Standard practice to update plans to reflect classification changes.

(xii) Underspend on plans entirely result of higher capital receipts?
No. See Factual (ii) above.

**Contact point:** P Pegler (GEP2) 270 5531



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**E2 PUBLIC EXPENDITURE: 1989-90 TO 1991-92**

Detailed questions on programmes to individual Departments.

Other relevant briefs:
- C1 Fiscal policy 1988-89 to 1991-92
- E1 Public expenditure: 1988-89
- E3 Public expenditure: Industrial statistics, plans and international comparisons
- EE Briefs.

**Factual**

(i) Planning totals

| | £ billion 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| 1988 PEWP | 167.1 | 176.1 | not app |
| Survey changes | Nil | +3.3 | not app |
| **Revised planning total** | 167.1 | 179.4 | 191.6 |

Notes: (1) Government sets planning totals for purpose of planning and controlling public expenditure; by holding to planning totals Government seeks to achieve wider objective of reducing general government expenditure (GGE) as a proportion of GDP.

(2) New plans, especially for 1991-92, reflect loss of negative EFLs of industries being privatised (see EE24), notably electricity and water.

(ii) Growth in public spending: longer term trends

| | Average annual percentage change in real terms 1968-69 to 1978-79 | 1978-79 to 1987-88 | 1987-88 to 1991-92 |
|---|---|---|---|
| **GGE (excluding privatisation proceeds)** | **+2.9** | **+1.6** | **+1¼** |
| GGE (including privatisation proceeds) | +2.9 | +1.2 | +1.5 |
| Planning total (including privatisation proceeds) | +2.9 | +0.9 | +2.5 |

Note: GGE (excluding privatisation proceeds) provides best measure of underlying trend of public spending and is measure to use when quoting real terms growth rate and ratios to GDP (because includes debt interest which is also financed from taxation but excludes privatisation proceeds).



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(iii) Growth in public spending: 1987-88 to 1991-92

| | Per cent change in real terms on year earlier | | | | Average 1987-88 to |
|---|---|---|---|---|---|
| | 1988-89 | 1989-90 | 1990-91 | 1991-92 | 1991-92 |
| GGE (excluding privatisation proceeds) | -0.4 | +1.0 | +2.3 | +2.2 | +1¼ |
| GGE (including privatisation proceeds) | -0.7 | +1.7 | +2.5 | +2.3 | +1.5 |
| Planning total (including privatisation proceeds) | -0.8 | +3.6 | +3.8 | +3.7 | +2.5 |

(iv) GGE (excluding privatisation proceeds) as percentage of GDP

| | | |
|---|---|---|
| 1966-67 | 38½ | |
| 1969-70 | 40 | |
| 1975-76 | 48½ | (post-war peak) |
| 1978-79 | 43¼ | |
| 1982-83 | 46¾ | (peak under this Government) |
| 1986-87 | 44 | |
| 1987-88 | 41½ | |

| | PEWP 1988 | FSBR 1988 | AS 1988 |
|---|---|---|---|
| 1988-89 | 42 | 41¼ | 39¾ |
| 1989-90 | 41¾ | 40¾ | 39¼ |
| 1990-91 | 41¼ | 40 | 39 |
| 1991-92 | not app | not app | 38¾ |

(See also E3.)

(v) Reserves

| | £ billion |
|---|---|
| 1989-90 | 3.5 |
| 1990-91 | 7.0 |
| 1991-92 | 10.5 |

(For details of Reserves in previous plans, see Annex 2.)

(vi) Main changes to Departments' cash plans since 1988 PEWP

| | £ million, cash terms | | |
|---|---|---|---|
| | 1989-90 | 1990-91 | |
| **Increases** | | | |
| Central government: | | | |
| Health* | +1,170 | +1,390 | Service improvement, pay and capital spending |
| Defence | +160 | +610 | |
| Transport* | +250 | +290 | Road building programme |
| Home Office* | +260 | +370 | Increased prison building |
| Education* | +260 | +280 | Polytechnics, universities and basic science |
| Local authorities: | | | |
| Relevant | +1,700 | +1,000 | |
| **Decreases** | | | |
| IBAP | -420 | -400 | Lower cost of CAP market support |
| Employment | -200 | -300 | Lower unemployment |
| DOE Housing* | -1,285 | -1,000 | Higher capital receipts |

Note: Additions to programmes marked with an asterisk in general relate to England only. A breakdown of the additions to the territorial programmes will be given in the 1989 PEWP.

(See Annex 1 and individual briefs in section EE for further details.)

(vii) Economic assumptions: Inflation assumptions higher, unemployment assumptions lower. See Annex 3.

(viii) Debt interest: See EE29.

**Positive**

(i) Firm control of public expenditure in past has helped produce present successful economy. Autumn Statement shows Government will maintain that control in future; plans allow real growth of about 1¼ per cent a year.

(ii) Planning total for 1989-90 unchanged First time for four years that planning total for year ahead has been held at level published in previous PEWP. Demonstrates Government's firm control of expenditure.

(iii) Ratio of public spending to GDP reduced

- Ratio has fallen by about 7 percentage points since 1982-83.

- Now planned to follow lower path than in 1988 PEWP or FSBR. Ratios for all three years lower.

- ratio in 1988-89 (39¾ per cent) will be below 40 per cent for first in over two decades.

- 38¾ per cent ratio in 1991-92 will be lowest since 1966-67.

- Continuing decline reduces burden of public sector on taxpayer.

(iv) <u>Real growth in GGE (excluding privatisation proceeds) decelerating</u> - to average 1¼ per cent a year in four years 1987-88 to 1991-92, compared with 1.6 per cent from 1978-79 to 1987-88 and almost 3 per cent a year over decade to 1978-79.

(v) <u>Increased spending on priority programmes</u>. Compared with plans in last PEWP, extra resources allocated to health, education, science, law and order, defence, roads and improving environment. Also more for social security in later years.

(vi) <u>Increased provision for public sector capital spending</u> by about £3 billion a year in 1989-90 and 1990-91 including large increases for nationalised industries, housing, education, health capital, roads and prisons (see EE28).

(vii) <u>Offsetting reductions in public expenditure plans reflect success of policy in other areas</u>

- Sound financial policy has led to reduced burden of debt interest

? omit

- Progress in reforming CAP has contributed to lower agricultural support

- Falling unemployment has meant savings on social security and employment programmes

- Nationalised industries' improved performance has reduced demands on taxpayer

- Value for money improvements produce large savings, eg NHS (England) cost improvement programmes expected to yield £700 million by end of current financial year.

- Success of council house sales under Government's right-to-buy policy has helped pay for more capital spending on housing by local authorities.

(viii) <u>Intergovernment comparisons</u>

- Public spending increased in 1974-75 at unsustainable rate and led to subsequent cuts.

- Between 1973-74 and 1978-79 total capital spending <u>down</u> over 20 per cent in real terms; NHS capital <u>down</u> 30 per cent; motorways and trunk roads capital <u>down</u> 40 per cent. Since 1978-79 NHS capital up by x% in real terms and motorways & trunk roads capital up by y%.



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- In recent years, increases in public spending have been brought down to rate economy can afford.

- Result is that increases have been steady and sustained: GGE (excluding privatisation proceeds) in 1991-92 planned to be 20 per cent higher in real terms than in 1978-79.

- Capital spending broadly maintained in real terms (see EE28).

(ix) Changes to Autumn Statement and PEWP. As indicated in White Paper "Financial Reporting to Parliament" (Cm 375), section on public spending in Autumn Statement has been expanded to include much general information on public spending previously in Chapter 1 of PEWP. PEWP will be published in separate departmental chapters in New Year and will elaborate on individual programmes.

**Defensive**

(i) Why increase in 1990-91 planning total? Strength of economy and public finances have made possible some additions to expenditure, especially for priority programmes. Increase in planning total consistent with lower ratio of public spending to GDP than implied by 1988 PEWP plans. Real growth rate over whole survey period same as projected at end of last Survey.

(ii) Should spend more on vital public services - room within growing GDP?

- Higher spending on priority areas possible because of success of Government's policies (see p(vii) above).

- But prudent fiscal policy and firm control of expenditure have brought about current strength of economy.

- No question of spending up to level implied by any particular ratio.

(iii) Public spending has been cut in real terms compared to levels in 1988 PEWP? Demonstrates Government's grip over public expenditure. Have nevertheless been able to increase spending on priority programmes because success of Government policies has permitted offsetting reductions elsewhere, eg debt interest, unemployment benefit, ~~agricultural support,~~ council house sales.

~~success of Government's weather policies?!~~

(iv) Extra spending possible given buoyant tax revenues? Quite wrong to adjust spending to use up whatever revenues happen to arise in any particular year. Would be disruptive to programmes and harmful to economy since spending planned over medium term.

(v) Concentration on GGE/GDP ratio implies accommodating higher inflation or boosting spending when economy buoyant? No.

- Ratio reduced below 1988 PEWP path. Implies spending in real terms up by less than real GDP.



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- No automatic adjustment for inflation.

(vi) Government prefers tax cuts to increased spending? No conflict between cutting tax rates and increasing spending, as record shows: Reducing tax rates encourages enterprise and initiative, in turn improving growth and hence resources available for priority services. Over time, lower tax rates mean more revenue, not less.

Government has done both.

(vii) Rise in money GDP has enabled Government to relax spending control? No.

- Have stuck to 1989-90 planning total.

- Public finances now sufficiently strong to permit some increase in spending where merited. But public spending must still account for declining share of national income.

- Government maintaining firm control over total public spending. Has necessitated difficult decisions.

(viii) Principle of cash planning clearly abandoned? No.

- Public expenditure still planned in cash. Survey conducted in cash terms and cash plans for first year become cash limits. Procedure still strictly enforced.

- No Department entitled to increase in overall provision for its programme because of inflation. All additions must be argued for.

(ix) Emphasis on GGE deliberate attempt to divert attention from faster growing planning total? Emphasis on GGE not new. MTFS focuses on GGE, since includes debt interest which also has to be financed by taxation. Sensible to concentrate on same measure in public expenditure context too.

(x) Why is growth in planning total so much higher than for GGE? Higher figures for later years reflect prudent Reserves in face of uncertainties. But Government will, as usual, review totals in next Survey in light of position then. Debt interest (in GGE but not planning total) falling due to sound financial policies. Loss of negative EFLs of electricity and water increases planning total in last year; if all industries to be privatised are excluded, growth of planning total averages x per cent in real terms between 1987-88 and 1991-92.

(xi) Planning total in 1989-90 only maintained thanks to higher capital receipts? Receipts largely reflect success of Government's right-to-buy policy. Quite proper to score in planning total: counterpart to investment - which also scores - in housing. Benefit simply reflects Government policy bearing fruit. [IF PRESSED: Even if capital receipts excluded, GGE (excluding privatisation proceeds) would show steady downward trend as share of GDP and planned growth 1987-88 to 1991-92 remains about 1¼ per cent.]

(xii) Only tiny fall in GGE/GDP ratio after 1989-90? All ratios well below PEWP plans, Ratio in 1991-92 projected to be over 2½ percentage points below that of last outturn year (1987-88).



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What is the fig?

and at levels not seen for over 20 years.

(xiii) Plans always unrealistic compared to outturn? No. Outturn on planning total below final plan figure in 1979-80, 1981-82, 1982-83 and 1987-88 and forecast to be below in 1988-89 (see E1). So counting this year, 5 undershoots and 5 overshoots in past decade.

(xiv) What happened to revenue determines expenditure? Never meant to mean spending increases to use up whatever revenue available. Revenue "determines" in sense of "constrains" over medium term.

(xv) Did Star Chamber meet? Was set up as usual and considered report from Chief Secretary on his bilateral discussions. But in event, did not prove necessary to refer any programmes to it.

(xvi) Government cutting benefits to poor and child benefit to pay for tax cuts for rich? Nonsense.

- Spending on social security up 40 per cent in real terms since Government took office and planned to increase further 10 per cent in real terms by 1991-92. (See EE17.)

- Families on income-related benefits (fully uprated) ~~protected from child benefit freeze and~~ get 50p a week more per child than had child benefit been uprated. 3 million children benefit.

- Lower tax rates improve incentives and so boost wealth and job creation to benefit of all. Consistent theme of policy since 1979, has contributed to far higher increase in real take-home pay at all earnings levels than under last labour government.

(xvii) Level of Reserves: Set at same level as last year. Experience suggests large Reserves prudent to meet unforeseen requirements. Government criticised in past for setting reserve too low. [IF PRESSED: No implication that Treasury expects Departments to overspend or inflation to exceed assumptions.]

(xviii) Not enough spent on capital and infrastructure? See EE28.

**Contact point**: Miss S P B Walker (GEP1) 270 5522.

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ANNEX 1

**PUBLIC EXPENDITURE PLANS: CHANGES FROM 1988 PEWP AND SINCE 1978-79 ANALYSED BY DEPARTMENT AND BY SPENDING AUTHORITY**

| | 1989-90 cash change from 1988 PEWP (£ million) | 1990-91 cash change from 1988 PEWP (£ million) | Real terms percentage change 1978-79 to 1987-88 | Real terms percentage change 1987-88 to 1991-92 (1) |
|---|---|---|---|---|
| <u>Department</u> | | | | |
| Defence | | | | |
| FCO-Diplomatic Wing | | | | |
| FCO-ODA | | | | |
| European Communities | | | | |
| MAFF | | | | |
| DTI | | | | (3) |
| ECGD | | | | |
| Energy | | | | (3) |
| Employment | | | | |
| Transport | | | | |
| DOE-Housing | | | | |
| DOE-Other | | | | (3) |
| Home Office | | | | |
| Legal Departments | | | | |
| Education and Science | | | | |
| Arts and Libraries | | | | |
| Health | | | | |
| Social Security | | | | |
| Scotland (2) | | | | |
| Wales (2) | | | | |
| Northern Ireland (2) | | | | |
| Chancellor's Depts | | | | |
| Other Departments | | | | |
| <u>Spending authority</u> | | | | |
| Central government | | | | |
| LA relevant | | | | |
| LA total | | | | |
| Nationalised Industries | | | | (3) |

<u>Notes</u>

(1) In final column the 1987-88 figures include allocation to programmes of that year's Reserve, whereas 1991-92 figures are before allocation of Reserve of £10.5 billion.

(2) Changes to territorial programmes mainly reflect changes in comparable programmes in England. A breakdown of territorial programmes by function will be given in the 1989 PEWP.

(3) Figure affected by loss of negative EFLs due to privatisations. Excluding industries to be privatised, real terms percentage change from 1987-88 to 1991-92 would be: DTI x percent, Energy x percent, DOE Other x percent, Nationalised industries x per cent.



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ANNEX 1 (cont)

**PUBLIC EXPENDITURE PLANS: NEW PLANS ANALYSED BY DEPARTMENT**

| | Percentage cash change on previous year | | |
|---|---|---|---|
| | 1989-90[1] | 1990-91 | 1991-92 |
| Defence | | | |
| FCO-Diplomatic Wing | | | |
| FCO-ODA | | | |
| European Communities | | | |
| MAFF | | | |
| DTI[2] | | | |
| ECGD | | | |
| Energy[2] | | | |
| Employment | | | |
| Transport | | | |
| DOE-Housing | | | |
| DOE-Other[2] | | | |
| Home Office | | | |
| Legal Departments | | | |
| Education and Science | | | |
| Arts and Libraries | | | |
| Health | | | |
| Social Security | | | |
| Scotland | | | |
| Wales | | | |
| Northern Ireland | | | |
| Chancellor's Departments | | | |
| Other Departments | | | |
| Total Departmental programmes[2] | | | |
| (Projected rise in GDP deflator) | | | |

<u>Notes</u>

(1) Implied 1988-89 figures are current expected outturn including allocation to programmes of Reserves. 1989-90 and subsequent figures are <u>before</u> allocation of Reserves of £3.5 billion, £7 billion and £10.5 billion respectively.

(2) See note 3 to previous table. Excluding industries to be privatised, percentage cash changes would be:

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| DTI | | | |
| Energy | | | |
| DOE Other | | | |
| Total | | | |



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**RESERVES**

£ billion

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| 1988 Autumn Statement | 3.5 | 7 | 10.5 |
| Per cent of planning total | | | |
| Compares with | Year 1 | Year 2 | Year 3 |
| 1988 PEWP | 3.5 | 7.0 | 10.5 |
| 1987 PEWP | 3.5 | 5.5 | 7.5 |
| 1986 PEWP | 4.5 | 6.25 | 8.0 |
| 1985 PEWP | 3.0 | 4.0 | 5.0 |
| 1984 PEWP | 2.75 | 3.75 | 4.75 |

(NB Reserves in 1986 PEWP high to reflect exceptional decision to project LA current spending at constant cash levels.)

ANNEX 3

ECONOMIC ASSUMPTIONS

| | 1988-89 | | | 1989-90 | | | 1990-91 | | | 1991-92 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **1988 PEWP** | **1988 FSBR** | **1988 AS** | **1988 PEWP** | **1988 FSBR** | **1988 AS** | **1988 PEWP** | **1988 FSBR** | **1988 AS** | **1988 PEWP** | **1988 FSBR** | **1988 AS** |
| Unemployment (GB narrow, millions) | 2.6 | not app | 2.1 | 2.6 | not app | 1.9 | 2.6 | not app | 1.9 | not app | not app | 1.9 |
| GDP deflator (per cent) | 4½ | 4½ | 6¼ | 3½ | 4 | 5 | 3 | 3½ | 3½ | not app | 3 | 3 |

| | September 1988 to September 1989 | | September 1989 to September 1990 | |
|---|---|---|---|---|
| | 1988 PEWP | 1988 AS | 1988 PEWP | 1988 AS |
| RPI (per cent) | 3¼ | 5½ | not app | 4 |

(See also D1, EE17.)



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**BRIEFING FOR CABINET ON 1 NOVEMBER** **INDEX**

| Brief Number | Subject |
|---|---|
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| 3 | 1988-89 outturn |
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**CABINET: DEFENSIVE BRIEFING** **BRIEF 1**

**Outcome restrictive, no need for painful measures**

Cabinet agreed in July objective of keeping as close as possible to existing planning totals. That is what we have done. Additions of £3.3 billion and £7.7 billion to baseline in later two years. Real growth of public expenditure from 87-88 to 91-92 exactly same as projected last year for 86-87 to 90-91. Massive increases for priority services: in many cases record increases. Would have been quite wrong to allow all of reductions from lower unemployment, lower CAP spending, and Right to Buy sales to feed through into higher public spending; would have been damaging to market confidence.

**Difficulty of Survey exaggerated by Treasury eg £2-3 billion increases to planning total in recent press stories**

No. Press stories were speculation, not inspired by Treasury. No false pretences: we did start with massive commitments (about £3-3.5 billion in first year); reductions on social security and agricultural spending, and RTB receipts, not declared by colleagues until recently.

**With inflation higher, can and must compensate through higher programmes**

| [ | 1988-89 | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|---|
| GDP deflators (%) | | | | |
| PEWP | 4½ | 3½ | 3 | - |
| FSBR | 4½ | 4 | 3½ | 3 |
| July | 5½ | 4½ | 3½ | 3 |
| Autumn Statement | 6¼ | 5 | 3½ | 3 |
| | | | | |
| Increase FSBR to AS | 1¾ | 1 | - | - |
| Ditto cumulative | 1¾ | 2¾ | 2¾ | 2¾] |

With Autumn Statement showing higher inflation and further large current account deficit next year, more than ever essential to restrain expenditure if market confidence is to be retained. Expenditure planning is in cash, not volume. Colleagues have been able to negotiate against an emerging picture on inflation: reported higher assumptions in July. Final settlements reached in knowledge of many of factors leading to higher inflation assumptions. A large part due to investment prices - eg in construction industry: again, a reason for restraint to avoid fuelling overheating.

**<u>If Minister x seeks to hold up agreement until given adjustment to his programme</u>**

Expenditure plans are in cash, not volume. Control totals are there to be held to. Cannot reopen plans at this stage. Essential that we present to public the plans outlined. Consequences of not agreeing today very serious indeed.

[If pressed: Cannot give any commitment to agreeing claims on Reserve but if any colleague finds his programme in serious political difficulty, naturally prepared to re-examine position].

(See also brief 7 on Defence).

**<u>Kenneth Baker gets an inflation adjustment for student awards, why should not we?</u>**

[Mr Baker's letter of 17 October to Mr Ridley, copied to territorial ministers, said "I have ... settled provision for student awards with John Major on the basis that ... will be uprated in line with the GDP deflator".]

Simply reflects one effect of settlement reached with Secretary of State on an element of programme where relationship with inflation particularly close; does not represent any shift away from cash planning.
[If pressed: was this year crucial to show that awards are broadly maintaining real value, since we are <u>not</u> specifically reimbursing cost of community charge. Plans are in cash [see answer above]

**Growth in GDP means we should be spending more, and can do within ratios**

Cabinet agreed to keep as close as possible to cash planning totals. That's what markets will focus on. Exceptional growth this year means large step down in ratio in 1988-89. Settlements consistent with Cabinet remit of continued decline - although only just. Any higher spending would have meant failure to meet Cabinet remit. Economically wrong to expand public spending further at present time. Would jeopardise economic success, and make it harder to meet priority needs as handsomely as we have this year.

**Current year outturn means lower Reserves needed?**
[See also brief number 3]

No. Current year benefits from
- social security undershoot: reflects in part unanticipated fall in unemployment, not likely to be repeated next year;
- higher capital receipts (RTB and New Towns): already taken into account in Survey for future years; and
- capital underspending eligible for end year flexibility

Severe risks next year: of overspend on local authority current and capital; EYF liability; EC contributions. Essential to maintain prudent Reserves. Chancellor has proposed maintaining at same level as in last Survey.

**Current year outturn means room to spend more this year?**

Extra privatisation proceeds and capital receipts (accounting for about half this year's undershoot) no reason for spending spree. Control of public expenditure must continue to be and seen to be firm. Much of rest of this year's undershoot due to lower unemployment. When unemployment rose, forced to concede overshoots. So reasonable that when it falls, part of benefit taken in lower spending.

[But willing to consider bringing expenditure forward to 1988-89 where offset by reductions in later years.]

New Planning Total means smaller Reserve needed in Survey period?

Still operating with existing planning total, so must show Reserves which commentators will see as credible in that framework.

Sticking to planning total in 1989-90 a fake: simply due to capital receipts?

Receipts are very substantial benefit to planning total. Reflect success of Government's RTB policy. Quite proper to score in planning total: counterpart to investment - which also scores - in housing. Benefit is another reflection of Government policy bearing fruit. In any case trend growth rate over Survey period not significantly affected if one took out receipts.

Freezing child benefit an unnecessary political risk. Could have produced a satisfactory outcome without it

[See also brief 23]

Switch from child benefit to targeted measures justified on merits. Would have been difficult to get to baseline in first year without the £130 million net saving.

**FACTSHEET**

| | | 1988-89 | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|---|---|
| | | | | | (£ billion) |
| **Planning total** | | | | | |
| White Paper plans | | 156.9 | 167.1 | 176.1 | - |
| Proposed changes | | -3.3 | - | +3.3 | |
| New plans | | 153.6 | 167.1 | 179.4 | 191.6 |
| (increase in programmes) | | | 3.5 | 6.8 | 11.3 |
| | | | | | (%) |
| Real growth | | | | | |
| over previous year | | -0.8 | 3.6 | 3.8 | 3.7 |
| average from 1987-88 | | | | | 3.3 |
| 1988-89 | | | | | 3.7 |
| **GGE (ex priv proc)** | | | | | |
| As % of GDP | | 39¾ | 39¼ | 39 | 38¾ |
| (White Paper | | 42 | 42¾ | 41¼ | - |
| FSBR | | 41¼ | 40¾ | 40 | - ) |
| Real growth | | | | | |
| over previous year | | -0.4 | 1.3 | 2.2 | 2.2 |
| average from 1987-88 | | | | | 1¾ |
| 1988-89 | | | | | 1.9 |
| **Economic assumptions** | | | | | |
| GDP deflator - | PEWP | 4½ | 3½ | 3 | - |
| | FSBR | 4½ | 4 | 3½ | 3 |
| | July | 5½ | 4½ | 3½ | 3 |
| | AS | 6¼ | 5 | 3½ | 3 |
| AS/FSBR change | | +1¾ | +1 | - | - |
| ditto cumulative | | +1¾ | +2¾ | +2¾ | +2¾ |
| Unemployment | PEWP | 2.6 | 2.6 | 2.6 | - |
| (GB narrow, millions) | July | 2.25 | 2.25 | 2.25 | 2.25 |
| | AS | 2.1 | 1.9 | 1.9 | 1.9 |
| Interest rates | July | 10 | 10 | 9½ | 9 |
| (3 month interbank) | AS | 10¾ | 11 | 9½ | 9 |

| | | 1988 | 1989 | 1990 |
|---|---|---|---|---|
| Rpi to September | PEWP | 4½ | 3¼ | - |
| | July | 5½ | 4½ | 4 |
| | AS | 5.9 | 5½ | 4 |

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**PUBLIC EXPENDITURE 1988-89** **BRIEF 3**

**Factual**

(i) Prospective outturn for 1988-89 planning total

- £153.6 billion (although estimate still uncertain). Includes implications of Winter Supplementaries and claims expected later.

- Represents underspend of £3.3 billion on PEWP and FSBR plans of £156.9 billion (adjusted for classification changes).

(ii) Main reasons for underspend

- Increased privatisation proceeds £1.0 billion;

- Lower Social Security payments due to fall in unemployment £0.9 billion;

- Higher net receipts from local authorities and New Towns £0.7 billion;

- Revised expenditure forecasts for Intervention Board for Agricultural Produce £0.3 billion;

- Net improvement in nationalised industries performance £0.3 billion.

(iii) Reserve

- Reserve in 1988 PEWP plans £3.5 billion.

- Agreed claims amount to over £2.0 billion. Offset by higher capital receipts than forecast and underspending elsewhere.

(iv) Main claims on Reserve

| | £ million |
|---|---|
| End-year flexibility | 770 |
| Local authority relevant | 1200 |
| Local authority capital (gross) | 1140 |
| NHS and FPS pay review | 890 |
| Assistance to Rover Group | 550 |

700

(v) Main benefits to the Reserve

| | £ million |
|---|---|
| Privatisation proceeds | 1,000 |
| Extra capital receipts: | |
| LA capital receipts | 1720 |
| New Towns capital receipts | 120 |
| Net improvement in Nationalised industries (mainly Steel and Rail) | 290 |

1840

Reserve will also benefit from forecast underspending (eg social security £900 million and IBAP £340 million)

(vi) General government expenditure (GGE) excluding privatisation proceeds.

| £ billion | 1987-88 | 1988-89 PEWP (as published) | 1988-89 AS |
|---|---|---|---|
| Planning total (excl pp) | 150.9 | 161.8 | 159.6 |
| Debt interest | 17.5 | 18.0 | 17.7 |
| Other adjustments | 8.2 | 8.0 | 9.6 |
| **Total GGE (excl pp)** | **176.7** | **188.0** | **186.9** |

(vii) GGE (excluding privatisation proceeds) as percentage of GDP estimated 39¾ per cent in 1988-89. Compares with forecast 42 per cent in PEWP; 41½ per cent in 1987-88.

Positive

(i) GGE (excluding privatisation proceeds) as percentage of GDP at lowest level for over 20 years. Estimated 39¾ per cent in 1988-89. Fallen from 46¾ per cent in 1982-83 and 41½ per cent in 1987-88.

(ii) Underspend helped by continued strength of the economy. Lower unemployment £1.1 billion; £0.7 billion from higher net capital receipts of local authorities and new towns; £0.3 billion net from better results of nationalised industries. (Also £1 billion extra from privatisation proceeds.)

Defensive

(i) If underspending why not spend more elsewhere? Tight control of expenditure cornerstone of economic policy. No relaxation now. Outturn still uncertain. Undershoot on planning total substantially result of increased receipts. Some underspending eligible for end year flexibility.

(ii) Government unnecessarily miserly with expenditure this year? Over £2 billion of Reserve claims agreed, including extra £0.9 billion for NHS and FPS pay. Offset by higher receipts (privatisation proceeds, LA capital, New Towns) and effects of economic success (lower unemployment, better performance of nationalised industries).

(iii) Why not allocate more to programmes instead of Reserve? Reserve needed for unforeseen contingencies. Essential part of prudent expenditure control. Agreed claims on Reserve in 1988-89 already exceed £2 billion.

(iv) Government covertly planning for real falls in GGE? No. Over £2 billion added to programmes in both 1987-88 and 1988-89. Offset by higher than anticipated receipts, underspending and lower debt interest.

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4

RUNNING COSTS SUPPLEMENTARIES

New Baseline

1. Current baseline (after classification changes) and provisional outcome (with percentage increases over previous year) are:-

£m

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Baseline* | 13,454 (1.8) | 13,847 (2.9) | 14,192 (2.5) |
| Provisional Outcome | 14,227 (7.6) | 14,882 (4.6) | 15,503 (4.2) |

* later years held down artificially low in 1987 Survey

Rate of Increase 1989-90 over 1988-89

2. Now likely to be some 7.6% - ie 2.5% in real terms. Higher increase than in recent years (figures of 4.5% and 5.7% were quoted in the 1987 and 1988 White Paper respectively). At July Cabinet several colleagues expressed anxieties about running cost pressures. Settlements aim to maintain pressure for improved efficiency whilst enabling Ministers to deliver essential policies. Specific factors influencing totals include:-

a. significant increases in accommodation costs
b. more realistic departmental pay assumptions [mainly around 6-6.5%, but unwise to give any figure in Cabinet]
c increase in planned manpower levels in first two years of some 3,000
d. modest extra provision for some departments either offset in PES terms by extra receipts or for assistance with relocation expenditure.

**Consistency with Planning Total Growth**

3. The planning total figures are (rate of growth in brackets):

£m

| 1988-89 | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| 153,600 | 167,100 (8.8%) | 179,400 (7.4%) | 191,600 (6.8%) |

Provisional running costs growth is well within planning total growth (thereby meeting unpublished objective). Ratio of running costs to the planning total reduces from some 8.5% in 1988-89 to 8.1% by 1991-92, although bids in later Surveys may reduce this descrease.

**Three-Year Settlements**

4. Three year settlements reached with 30 departments (the majority). These should be held, barring significant and essential new developments. Of major departments only MOD, Health, DOE and PSA held to one year settlement. Later years' figures more realistic than even before.

**Extra Receipts Generation/Relocation Assistance**

5. 6 departments have opted for increases to their gross running costs totalling some £2.0 million on the promise of generating at least that much in extra receipts under the scheme approved by July Cabinet. In addition some departments have been granted modest assistance over the initial costs of relocation promising substantial benefits in later years. [The Paymaster General will report more fully on departments' relocation plans and progress in the early part of the next year].

**What is implied for Civil Service Pay?**

6. Departments have made own assumptions about likely paybill increases.

**Implications of the new IPCS settlement?**

7. First settlement involving levels survey under long term agreement. Basic across-the-board increase is 3½% (more for some key staff). Departments most concerned (MOD, PSA, DOE, DTI, HO, MAFF, DES) were consulted during negotiations, and confirm affordability.

**Large Settlements for individual departments?**

8. As usual, the large manpower-intensive departments - MOD, Employment, HO, Social Security, Inland Revenue - take the lion's share of extra cash.

**Chancellor's Departments**

9. Rate of increase for year 1 averages at 7.79%, boosted by 8.58% average increase for C&E and IR (see separate brief).

**Below-average Settlements**

10. Amongst major departments, only Scottish Office have settled (at 5.38%) significantly below average, thanks to well-constructed management plan.

**Manpower**

11. Current baseline and provisional outcome are:

| | 1988-89 | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|---|
| Baseline | 591,400 | 587,300 | 587,700 | 587,900 |
| Provisional Outcome | 577,000* | 590,900 | 591,000 | 589,000 |

*Staff in post 1 July

12. Several reductions, but offset by larger increases in Prisons and Land Registry.

SCIENCE AND TECHNOLOGY **BRIEF 5**

£ million

| Changes | 1988-89 | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|---|
| Agriculture | | +1 | -4 | -11 |
| Trade and Industry | | -15 | -18 | -99 |
| Energy* | | +15 | -25 | -53 |
| Other departments | | +8 | +7 | +8 |
| Education and Science | | | | |
| Science budget | | +108 | +107 | +105 |
| UGC funded science | | +13 | +25 | +15 |
| TOTAL Civil S&T* | | +131 | +92 | +15 |

*includes £0/-22/-22m for charging for nuclear safety work not in report to E(ST)

**New provision**

| | 1988-89 | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|---|
| Total civil S&T | 2,801 | 2,975 | 2,942 | 2,890 |
| Total excl launch aid | 2,689 | 2,844 | 2,869 | 2,911 |
| DES science budget | 719 | 837 | 838 | 855 |

**Main Changes**

Increase for basic science offset by savings on launch aid (£101 million in 1991-92), rundown of fast reactor and nuclear fusion programmes, charging more for agricultural advice and reducing near market research.

Note: "Basic science" plus national commitments (AIDS, CERN, BGS etc) equals "DES science budget" plus science in universities equals "DES science and technology".

Positive

(i) Revised plans allow 20 per cent increase in provision for basic science between 1988-89 and 1989-90. Handsomely meets E(ST) conclusion that we should reallocate money to basic science. The DES Science budget as a whole grows 16 per cent over the same period.

(ii) Extra £14 million now agreed for Science equipment in 1988-89.

Defensive

(i) Increase in S&T envelope too small? Increase for DES allows maintenance of national scientific commitment, continued reshaping of the science base, selective re-equipment, and important new research. Not possible to offset all of this in this Survey from savings in low priority areas. We shall need to secure further savings from DTI and Agriculture next year (as stated in Prime Minister's minute of 18 October). Represents substantial increase in DES science budget.

[If pressed: E(ST) agreed we should reallocate sums from low priority to high priority areas, keeping within sums in baseline for S and T. Cannot go any further beyond that decision].

(ii) Total civil science falling by end of Survey period. Excluding Launch Aid, the total rises each year. Right to exclude Launch Aid which distorts the profile of the totals: not a continuing programme and contractual payments end in 1990-91.

(iii) UK public spending on civil science remains lower than major European countries. Total public spending on R&D (including defence) now accounts for a higher proportion of GDP than in most of our competitors. And research spending by UK industry is increasing - up by 13 per cent in real terms since 1981.

(iv) Increases for science include redundancy costs. Outturn figures for past years also include redundancy costs. Excluding these costs does not alter the fact that spending on science is planned to increase substantially.

(v) Cuts in agricultural research sensitive. Plans still include £200 million a year spending on agriculture R&D. Encouraging farmers to pay for advice and near market research will help establish whether this research is economic.

(vi) Reduction in energy R&D. Reductions result principally from nuclear area, in particular the rundown of fast reactor and fusion programmes.

(vii) Reduction in launch aid. Savings reflect rundown of existing commitments for aerospace projects. Discussions with British Aerospace and Rolls Royce continue and if new programmes are agreed, new provision will be needed.

**BRIEF 6**

**CAPITAL AND INFRASTRUCTURE SPENDING**

£ million

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Additions to plans | 2,500* | * | * |
| - of which due to VAT on new construction | 250* | * | * |

* Estimates. Current/capital split still being worked out and details will be given in 1989 PEWP. Comparable figures for 1990-91 and 1991-92 not available as investment programmes of water and electricity industries will have dropped out on privatisation.

Main Changes (excluding additions for VAT)

Prisons capital: 124/174/96 and agreement to 3,150 extra places by 1993. Also 19/22/21 for court building. Plans imply 160 per cent real increase in capital spending on prisons between 1987-88 and 1991-92. Aim is to provide 58,130 places by 1993.

DOE Housing (gross): 441/339/415 of which LA spending 395/150/-59. Within these totals, LA renovation 185/5/-81, LA new housing provision 144/114/39, Housing Corporation 40/186/457. Plans imply that gross investment in housing over next three years will be about £3.7 billion a year.

NHS capital: 168/188/178 Biggest building programme in NHS history: over 500 major schemes underway in England with total value of £4 billion. NHS capital already up 40 per cent in real terms since 1978-79; plans imply further real growth.

National roads: 111/151/154 on new road construction, 66/70/70 on structural maintenance and 43/30/27 on bridges. 35/47/33 increase in LA capital for local roads, Manchester LRT. Also extra provision for local airports. Plans imply further 20 per cent real increase in capital spending between 1987-88 and 1991-92.

Schools capital: 95/95/103 additions to LA gross education spending. Plans allow continuation of £250 million programme to LA and voluntary schools to reduce backlog of improvement needs identified by school buildings survey.

Nationalised industries: including 195/204/350 British Rail, 138/221/134 LRT, and £250 million in 1989-90 for water. Plans allow £3 billion BR and £1½ billion LRT investment programme over next 3 years. Have provided fully for all new safety measures identified by LRT following Kings Cross disaster. Additions to water investment programme virtually all for environmental measures: cleaning up sewage discharges and improving drinking water.

Sensitive policy points

**Massive reduction in net provision for housing?** Reflects success of Government's right-to-buy policy. Important point is that gross spending - better measure of new assets created - is up. Plans provide for nearly £12 billion gross spending over 3 Survey years.

Points for Cabinet discussion

**Not enough spending on capital/infrastructure?**

Gross public sector capital spending in 1987-88 broadly same in real terms as in 1978-79, despite deliberate policy of reducing state's role in providing new housing. In other areas, eg national roads, railway investment, prisons and NHS capital, very substantial real increases.

Survey builds on that record. Already spending nearly £25 billion a year. Extra £2.5 billion next year (~~ex~~including addition for VAT on new construction) in Survey will ensure public capital spending remains higher in real terms than in both 1978-79 and 1987-88.

**Public sector capital spending falling as share of GDP?**

Yes, but so is total public spending. Frees private sector for greater role.

**Capital spending to decline in real terms despite additions?**

No. Spending next year planned as high in real terms as in both 1978-79 and 1988-89.

## CABINET BRIEF : MINISTRY OF DEFENCE

| | 1989-90 | 1990-91 | £ million 1991-92 |
|---|---|---|---|
| Bids (original, inc VAT) | 333 | 989 | 1440 |
| Outcome | 161 | 610 | 1024 |

Main Changes

MOD's 2½% pa programme of efficiency improvements has made a major contribution to bridging the gap between bid and outcome (although the Treasury does not know precisely how MOD intend to bridge it). On the new GDP deflator, the outcome represents a real increase of 2.3% between 1988-89 and 1991-92; the equivalent comparison in the 1988 PEWP showed a real decrease of 2.1%. The above figures do not reflect an anticipated £450 million carry forward of underspending from 1988-89 to 1989-90.

Sensitive Policy Points

The increase in the GDP deflator has reduced the real increase from 2.8% to 2.3%; even so there is an important turnround from the 1988 PEWP. On the Autumn Statement forecasts, defence expenditure as a % of GDP rounds to 4.0% in 1990-91 and to 3.9% in 1991-92; by comparison the old baseline (for 1990-91) represents 4% of GDP as forecast in the March FSBR. The change reflects the forecast faster growth of money GDP. We still compare favourably with our major European allies on defence expenditure in absolute terms and as a GDP %. The key issue, however, is the money needed to deliver the Government's defence policy and commitments, not the GPD %.

Points for Cabinet

Avoid any discussion. Defensive points :

(1) Cuts in equipment - outcome will finance defence policy. Will be decisions on priorities but this is nothing new.

(2) GDP deflator - no case for reopening settlement. Made clear at Brighton meeting and since that an upward revision was probable. Settlement reached in light of that. This is agreed to be a long term settlement which will only be opened in specified circumstances, including a "significant increase" in inflationary expectations. ½% on the deflator in 1989-90 is not significant for these purposes.

(3) As a % of GDP - 4% in 1989-90 and 1990-91 and 3.9% in 1991-92. Fall reflects fast growth of economy as a whole, including 4% this year. Cannot inflate defence spending simply because economy growing extraordinarily quickly.

# FOREIGN AND COMMONWEALTH OFFICE (DIPLOMATIC WING) 8

£million

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Bids | 36.5 | 56.4 | 60.3 |
| Outcome | 26.0 | 48.1 | 70.6 |

**Main Changes**

The agreement with the Foreign Secretary was in two main parts: £6.6/14.9/7.6 million for specifically agreed bids plus £37.0/50.0/61.0 million within which he had flexibility to allocate to individual items in his bids. The precise final allocations have not yet been made, nor has the running costs element been settled. Those figures are before adjustments to take account of overseas prices movements which are likely to amount to a reduction of £21.2 million in each year. The largest element in the increase is £16.9/29.3/34.4 million on running costs to meet existing commitments. Amongst the increased programme expenditure there are increases (subject to final allocation) of £10.8/12.91/13.31 million for British Council and FCO Scholarships (Manifesto commitment) and sponsored visitors, together, plus £9.67/10.04/10.91 million for improved accommodation and personnel and security measures. For the BBC External Services a capital project (Orfordness) in the audibility programme is reinstated with provision of £4.19/12.47/5.67 million following a provisional reduction last year whilst a reappraisal was made. [**NOT FOR USE:** Outcome (but not Bids) includes £3.6/4.4/23.2 million for GCHQ, over and above settlement with Foreign Secretary.]

**Sensitive Policy Point**

The agreement allows for an FCO contribution (£1.0/2.5/2.5 million) towards the financing of UK participation in the Seville EXPO 92. Lord Young will be taking the lead on that project and these sums will be transferred to DTI programmes for that purpose in 1989-90.

**Points for Cabinet Discussion**

The only point likely to arise at Cabinet is that the Foreign Secretary may say that there are a number of possible calls on his budget just over the horizon which he could not accommodate within the settlement. Many of these depend upon the prospects of peace in certain areas, such as Namibia and the Western Sahara. The expenditure consequences of such eventualities will need to be assessed if and when they arise.

OVERSEAS DEVELOPMENT ADMINISTRATION

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Bids | 58.4 | 100.5 | 150.4 |
| Outcome | 33.4 | 75.5 | 101.4 |

**Main Changes**

Aid programme provision increases to £1,430 million, £1,513 million and £1,574 million. The increases provide for the estimated costs of the sub-Saharan debt initiative, and the costs of the UK contribution to the IMF Enhanced Structural Adjustment Facility (ESAF). The settlement mainly provides for increases in bilateral aid, including ATP soft loans. On superannuation, provision is made for war service credit for former colonial servants, and a general uprating in pensions resulting from revised economic assumptions. Running cost increases provide, in part, for changes in administration to improve vfm.

**Sensitive Policy Points**

The agreement includes a commitment to review the soft loans facility early in 1989 to ensure Ministers are in a position to take decisions on any possible extension well before the next Survey. If this comes up, it can be presented positively to Lord Young - who is unaware of this commitment - and other colleagues, even though Treasury interests are to limit any extension. For example, the settlement allows for full funding of the soft loans facility up to the agreed ceiling, while the bilateral programme should benefit most from the overall increases agreed.

**Points for Cabinet Discussion**

The Foreign Secretary may wish to draw colleagues attention to the fact that the increases in the aid programme will only maintain the existing proportion of aid as a percentage of GNP - they will not increase what is a low figure internationally at a time of increasing economic prosperity. In reply, you might say: that the settlement provides for substantial real terms growth - of 5% over the Survey period, 4% in the first two years - in a programme which is not demand led; and (if you judge it necessary) that the increases should (just) maintain our current percentage share to 1990, and figures are necessarily speculative thereafter (the estimates are 0.28, 0.28, 0.27 per cent rounded: 0.0276, 0.0275, 0.0272 unrounded, based on 27 October revised GNP figures).

**EC NET PAYMENTS**

| | 1989-90 | 1990-91 | £million 1991-92 |
|---|---|---|---|
| Latest projection | +500 | +630 | +230 |

**Main changes**

The sharp increase in our net payments in 1989-90 and 1990-91 is a result of the Brussels agreement on the future financing of the Community, the buoyancy of imports (which has led to an upwards revision in the forecast of customs duties payable to the Community), more recent forecasts of consumers' expenditure and GNP (resulting in higher VAT and GNP-linked payments), and a very low forecast share of receipts from the Community budget.

**Sensitive policy points**

2. Increases in the projection of this order may well cause political embarrassment, and will need to be explained carefully. Some may argue that the large increases cast doubt on the Government's claim following the Brussels European Council in February that the agreement reached there on the future financing of the Community would cost up to a maximum of £300 million a year. In fact, our estimate of the cost of the future financing package remains unchanged, but other elements in the forecast have worsened as well, resulting in the very large increases in our net payments in 1989-90 and 1990-91.

**Points for Cabinet discussion**

3. It might be argued that, since the projection is very uncertain, we should publish lower figures in the Autumn Statement. While agreeing about the uncertainty, you should argue that it is by no means certain that this is a pessimistic projection, and that to publish lower figures would only store up problems for public expenditure control in later years.

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**IBAP and other CAP**

| | | | £ million |
|---|---|---|---|
| | **1989-90** | **1990-91** | **1991-92** |
| Bids | -302.2 | -287.9 | -192.8 |
| Outcome | -421 | -396 | -268 |

Main Changes

Large savings on CAP market support are slightly offset by a small addition for IBAP's administrative costs. The reductions are mainly due to:

(a) a revised estimate of the impact of CAP reform measures including the stabilisers package agreed in the European Council in February;

(b) a lower forecast of the UK cereals harvests for 1988 and future years; and

(c) in 1989-90 the effects of the drought in North America on world agricultural prices.

The forecasts include provision for devaluations of the green pound in line with the Agriculture Council's decision to remove monetary gaps by 1992. The increased provision for administration is largely to allow IBAP to introduce a new computer system to process export refunds.

Sensitive Policy Points/Points for Cabinet Discussion

Minister of Agriculture may claim credit for large savings from his policies on CAP Reform.

Line to take

Welcome reductions in CAP market support but still some way to go in achieving Government's objective of worldwide reduction in level of support for agriculture. In real terms UK spending on agriculture still planned to be 70% above level in 1979.

**DOMESTIC AGRICULTURE FISHERIES AND FOOD**

£ million

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Bids | 34.8 | 47.5 | 70.5 |
| Outcome | 14.4 | 8.4 | 5.1 |

**Main Changes**

The main increases agreed with Agriculture Ministers are for flood defence (£6.5 : 10.3 : 17.1 million) and for MAFF's running costs (£14.3 : 25.3 : 32.5 million). The increases have been partly offset by policy and estimating savings on capital grants (- £12.0 : 13.0 : 29.4 million) and by increased industry funding of Agricultural Advisory Services (- £1.2 : 4.9 : 8.7 million) and R and D (£ + 0.2 : - 2.6 : - 8.2 million).

**Sensitive Policy Points**

Agriculture Ministers have agreed that measures will be taken as soon as practicable to cash limit capital grants. For chargeable Agricultural Advisory Services the reductions agreed represent moves towards a target of 50 per cent full economic cost recovery in 1993-94; the agreed ultimate objective is 100 per cent cost recovery. The changes agreed for R and D include an increase in strategic environmental research within overall reductions to the programme equivalent to £30 million in full economic cost terms in 1991-92. Provision for R and D will be considered again in 1989 after the review commissioned by E(ST) has been completed.

**Points for Cabinet discussion**

The reductions in provision for advisory services and R and D may lead to redundancies in Agriculture Departments and the AFRC. The Chief Secretary has agreed to consider bids to take account of this in the 1989 Survey, and (if necessary) in the Main Estimates for 1989-90. The reductions agreed are modest in relation to the size of the programme and the overall level of support for agriculture (20 times more than other industry in relation to its share of GDP in 1987).

ia[illegible]st/Gr/101

**FORESTRY COMMISSION**

£ millions

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Bids | 10.4 | 13.2 | 14.4 |
| Outcome | 8.6 | 11.9 | 13.6 |

**Main changes**

The main changes covers the cost of higher planting grants for traditional forestry under the Woodland Grants Scheme, which replaced the pre-budget regime of tax concessions plus lower grants, and under the Farm Woodlands Scheme. They also cover the cost of replanting grants and supplements for the replacement of trees lost in the October 1987 Storm. In addition to the figures shown above there have been changes amounting to +£0.5 million, -£2.8 million and -£7.5 million in the Forestry Commission Disposals Programme.

**Sensitive Policy Points**

The agreement reflects the 1988 Budget decision whereby encouragement of Forestry by a combination of planting grants and tax concessions was replaced by a system of broadly comparable value of grants alone at higher rates. It remains to be seen whether the new grants will be sufficient to achieve the Government's planting target of 33,000 hectares a year. The Forestry Commission disposals programme is to be reviewed.

**Points for Cabinet Discussion**

None.

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**DEPARTMENT OF TRADE AND INDUSTRY** 12

| | 1989-90 | 1990-91 | £ million<br>1991-92 |
|---|---|---|---|
| Bids | 125 | 112 | - 24 |
| Outcome | 72 | 79 | - 72 |

**Main Changes**

The agreed bids include estimating changes on Regional Development Grants (£13.0/41.6/-13.8m) resulting from a surge in applications prior to the closure of the scheme, increased Shipbuilding Intervention Fund support (mainly for Govan) and additional provision for running costs and major works largely resulting from relocation plans. These increases are partly offset by savings on support for innovation and a substantial reduced requirement in 1991-92 on launch aid (£-0.1/-2.1/-101.3m) reflecting the running down of existing commitments.

**Sensitive Policy Points**

The only potentially sensitive issue is the reductions agreed with Lord Young on his S and T expenditure. Leaving aside the reduced requirement on launch aid these amount to £-14.6/-15.8/+2.8m. They are mainly on support for innovation, but also include small reductions on Research Establishments and Aeroengine R and D. The Cabinet paper includes a marker that further significant savings will have to be found in the 1989 Survey in the DTI programme. [See separate briefing on S and T.]

DEPARTMENT OF ENERGY
(INCLUDING AEA)

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| | | | £million |
| BIDS | +44 | +13 | -62 |
| OUTCOME | +34 | -16 | -93 |

Main Changes

These result from decisions on nuclear R&D programmes, notably those taken collectively in July to rundown the fast reactor and fusion programmes, which generate redundancy and restructuring costs as well as savings. Some of these feed through to the Atomic Energy Authority EFL. The departmental programme reflects increases in safety work by AEA on decommissioning and nuclear waste management and the first year cost of the move to the new HQ. Savings are being made in other areas of nuclear R&D, Energy Efficiency, the Offshore Supply Office, from the abolition of OPA, and estimating changes on the redundant mine workers payment scheme. In the two later years the reductions reflect also the transfer of nuclear safety research to HSC/HSE.

Points of sensitivity

Medium term savings on nuclear research can only be achieved at the cost of higher expenditure in the short run . These decisions have been criticised as shortsighted by the nuclear lobby. Responsibility for the increase cost of moving to Buckingham Gate is denied both by the Department of Energy and the PSA.

Points for Cabinet discussion

Mr Parkinson will no doubt claim great success on his part. There may be some criticism from others of the short term increases in expenditure on the nuclear programmes. But, they were agreed collectively by E(A) in July. Mr Parkinson may say that the increased costs of his HQ move are the fault of PSA, which Mr Ridley will deny. You should take the line that whatever happened in the past, they should both ensure that all is done to keep within the new agreed cash sum.

**DEPARTMENT OF EMPLOYMENT**

14

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| | | | £million |
| Bids | 186.4 | 231.6 | 241.6 |
| Outcome | -205.0 | -305.0 | -405.0 |

**Main changes**

The main reductions are on the Employment Training and Youth Training Schemes, with further savings from the Enterprise Allowance Scheme and the Redundancy Fund. The savings reflect the fall in unemployment and the declining number of school leavers. There is a substantial increase in running costs provision, mainly for pay and prices, but also including provision for the Stricter Benefit Regime.

**Sensitive policy points**

The reduced provision for ET and YTS will still enable the Government to meet its guarantees to the long-term unemployed and to school leavers. The savings on ET nevertheless have some sensitivity given that it is a new scheme which has been heavily promoted on the basis that it would absorb £1.4 billion a year and train 600,000 people a year. By adopting a broad definition of ET expenditure, it will still be possible to present the reduced provision for ET as a £1.4 billion programme. But the number trained each year is now likely to be around 540,000 rather than the 625,000 (presented as 600,000) originally planned. It has however been agreed that no new figure for target numbers will be put into circulation at this stage. If questions are asked, DE will take the line that the scheme is still at an early stage and that it is too early to make any new prediction of throughput.

Mr Fowler has insisted that no breakdown of the reductions should be announced until the Public Expenditure White Paper. Only a qualitative indication of main reductions will be given, although there will be no reference to reductions in ET.

**Points for Cabinet discussion**

Now that the question of public presentation has been resolved, we have no reason to expect Mr Fowler to raise any points; and we would not expect any from other Ministers.

DEPARTMENT OF TRANSPORT

15

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| | | | £ million |
| Bids | 548 | 588 | 759 |
| Outcome | 324 | 398 | 406 |

**Main Changes**

Increased provision for national roads new construction (111/151/154), maintenance (66/70/70) and bridges (48/39/36), together with corresponding provision for VAT on new construction (65/95/111), with an offsetting reduction from extra Severn Bridge toll receipts. Smaller increases (35/47/33) for local authority capital, comprising local roads, airports and the Manchester Light Rapid Transit scheme. A small running costs increase (4.2/4.9/10.5) on the basis of a 3 year settlement.

**Sensitive Policy Points**

Mr Channon will be presenting the results of the Review of the Road Programme to E(A) shortly with the intention of getting agreement to an expanded programme. You have made no commitments about additional resources for this programme (though you indicated informally that you might be willing to agree to a small increase in running costs for highways staff).

**Points for Cabinet Discussion**

Mr Channon might say that the settlement only allows him to continue with his existing road programme, and that extra resources will be required for an expanded programme. You will wish to say merely that this is a matter for future decision.

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DOE HOUSING

| | 1989-90 | 1990-91 | £m 1991-92 |
|---|---|---|---|
| Bids | - 895 | - 668 | -166 |
| Outcome | -1284 | -1001 | -734 |

Main Changes

i. Receipts increased by 1724/1318/1118 allowing substantial increases in gross spending within net reductions given above. Increased receipts also main reason for reduction in bids from original of 550/628/962.

ii. Gross capital spending up by 441/339/415 of which local authority spending change 395/150/-59.

iii. Local authority renovation (including Estate Action) change 185/5/-81. Local authority new provision (including support for Housing Associations) change 144/114/39.

iv. Housing Corporation gross capital increase of 40/186/457 mainly for new provision including mixed private/public funding schemes.

Sensitive Policy Points (no need to explain at Cabinet)

i. Massive reduction in net provision of nearly £1 billion a year will cause criticism when plans published. But this is due to success of Government's RTB policy - important point is gross spending is up.

ii. Continuing shift in gross capital provision from local authorities to Housing Corporation, including part privately funded schemes.

iii. Cost of transfers of local authority estates to Housing Action Trusts not to be made public until mid-year to avoid prejudicing transfer negotiations. Transfer payment and receipts to local authorities have nearly neutral impact on plans (small in-year claim on Reserve likely).

iv. Figures above reflect transfer out of provision for current expenditure to DoSS to cover benefit costs of assumed local authority rent increases. Assumptions for continued real increases in rents are sensitive.

Points for Cabinet discussion

No points likely to be raised.

**DEPARTMENT OF THE ENVIRONMENT: OTHER ENVIRONMENTAL SERVICES INCLUDING NEW TOWNS**

£ million

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Bids | 461 | 415 | 407 |
| Outcome (Net) | 75 | -71 | -64 |

**Main Changes**

Additions to Local Authority, Local Environmental Services Capital in the first year to meet local authority set-up costs for implementation of the Community Charge, (£m135/0/0).

Additions to cover the cost of the National Rivers Authority which will be established when the Regional Water Authorities (RWAs) become plcs. NRA will undertake river management, monitor pollution and water quality, deal with land drainage and flood defence work previously the role of the RWAs (£m43/77/71).

Increases declared in New Towns receipts (£m-135/-10/39) and in local authority receipts (£m-203/-293/-279).

Other increases within the programme include increases in provision for countryside, recreation and environmental protection and heritage (£m18/19/17) and increases in DOE running costs required inter alia to meet the demands of the water privatisation work and the continuing increase in planning appeals, (£m18/14/13).

Urban Group increased by (£m36/51/39) mostly for Urban Development Corporations, but City Grant also increased largely within existing Group provision through reductions in Urban Programme Capital and Derelict Land Reclamation.

**Sensitive Policy Points**

The agreement reached provides support for the set-up costs falling to Local Authorities to enable them to implement the community charge legislation.

Reductions in Urban Programme and Derelict Land Reclamation potentially contentious. But reductions only made to switch provision to City Grant where spending non-cost effective. Overall increase in Urban spending demonstrate commitment to inner cities.

**Points for Cabinet Discussion.**

None.

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HOME OFFICE

18

£ million

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Net bids | 426 | 571 | 569 |
| Outcome | 246 | 354 | 324 |

Main Changes

Prisons capital: (156, 215, 130) and agreement to 3,150 extra places by 1993.

Prisons manpower: (72, 111, 163) to man additional accommodation.

Non-prisons: (10, -1, -8) covering a range of small bids and offsets.

Sensitive policy points

None

Points for Cabinet discussion (defensive; unlikely to be raised)

Bids from LCD, CPS and SFO for video satellite links in courts were rejected: this is a Home Office policy where the costs fall entirely elsewhere; roughly £1 million a year across the board. Home Office officials are not reconciled to this, though the LCD, CPS and SFO are content to leave matters for another year.

It seems most unlikely that Mr Hurd would raise such a detailed point, but the line to take is that if Home Office think the policy is a high priority, the Departments in question should be able to absorb the cost, if necessary with a PES transfer from Home Office.

19

**LORD CHANCELLOR'S DEPARTMENT**
(excluding other legal depts)

| | £ million | | |
|---|---|---|---|
| | 1988-89 | 1990-91 | 1991-92 |
| Bids | 37 | 59 | 115 |
| Outcome | 29 | 44 | 80 |

(Settled in correspondence, without need for bilateral)

**Main Changes**

Increased provision for:

(i) Running Costs (£9/11/25 million): workloads of Crown Courts rising by an average of 6 per cent and of County Courts by 3 per cent; increases also for accommodation costs and effect of Local Pay Additions.

(ii) Legal Aid (£7/15/37 million) for increased volume and unit cost forecasts, and agreed new policies (including tape recording of police interviews and mutual legal assistance). LCD have argued that the reduced bids present a high risk strategy in a demand led programme, and that the bids may need to be reinstated in a future PES round. We have given no commitment on this.

(iii) Court Building (£25/30/30 million): in effect restores in cash terms much of the bids surrendered last year; includes full provision to meet cost of the EC VAT Infraction decision.

**Sensitive Policy Points**

None

**Points for Cabinet Discussion**

None

DEPARTMENT OF EDUCATION AND SCIENCE

| | 1989-90 | 1990-91 | £ million 1991-92 |
|---|---|---|---|
| Bids | 706 | 920 | 1060 |
| Outcome | 363 | 405 | 370 |

**Main Changes**

The agreed bids for Science (£104/106/105 million) allow for a 20 per cent increase in basic science and restructuring between 1988-89 and 1989-90 and you have reported this to E(ST). The polytechnics and colleges funding council (PCFC) receive sufficient funds to enable them to meet a 4 per cent pay settlement and price increases, to purchase the administrative equipment they need for their new functions and replace teaching and research equipment within 9 years (£96/87/70 million). Extra provision is made to increase student awards in line with inflation. Provision for local authority education spending is increased to maintain capital allocations at more or less the 1988-89 level (so the switch of polytechnics etc to central government should allow local authorities to spend more on schools' capital).

**Sensitive Policy Points**

Future problems may arise on polytechnic lecturers' pay (4 per cent settlement in 1989-90 budgetted for) and academics' pay (5 per cent settlement in 1989-90, after no settlement this year).

**Points for Cabinet Discussion**

Student awards will increase in line with the higher 5 per cent GDP deflator for 1989-90. But there will be no specific increase in student awards to reflect the Community Charges that students will have to pay.

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**OFFICE OF ARTS AND LIBRARIES**

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| | | | £ million |
| Bids | 5.7 | 7.1 | 58.2 |
| Outcome | 4.1 | 1.6 | 20.4 |

**Main changes**

£15 million in 1991-92 to roll forward the three-year programme agreed in the 1987 Survey into the new third year. Also increase for British Library, St Pancras project.

Increases in 1989-90 and 1990-91 purely to compensate for liability to VAT on new construction.

**Sensitive policy points**

Essence of three-year programme agreed in 1987 Survey that figures were not intended to be reviewed in intermediate years. Purpose of programme is to provide firm base for planning by subsidised arts bodies, and to encourage them to become more self-reliant for development and growth.

**DEPARTMENT OF HEALTH**

£ million

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Bids | 2,128 | 2,905 | 3,855 |
| Outcome | 1,256 | 1,477 | 1,896 |

**Main Changes**

Agreement was reached on all the individual sub-programmes. The great bulk of the increase is for HCHS Current (£963/1135/1302 million) reflecting knock-on costs of 1988 Review Body awards and providing for significant growth in services including increasing cost of AIDS. Substantial additional provision for HCHS capital expenditure on maintenance and equipment and for Family Practitioner Services to meet increased demand. There are offsetting savings from new cost improvement programmes and from a reduction in NHS employers' superannuation contributions from 7½% to 4 % (as recommended by the Government Actuary).

**Sensitive Policy Points**

FPS settlement allows for full range of savings agreed in 1987 Survey from introduction of dental examination and sight test charges. Clauses giving effect to these changes need to be reinstated in the Health and Medicines Bill following defeats in House of Lords in July. Mr Clarke has undertaken to do so but, as the charges are controversial, some Ministers might oppose this or argue for significant concessions (eg exemption of pensioners).

**Points for Cabinet Discussion**

Should the question of the charges arise, you should support the reinstatement of the Clauses and oppose the offering of significant concessions (or make clear that equivalent savings will have to be found from elsewhere within the programme). Charges are modest but will raise significant resources for improvements elsewhere in primary care sector. Government proposals exempt those whose circumstances are such that they cannot afford to pay.

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DEPARTMENT OF SOCIAL SECURITY

23

£million

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Bids | 907 | 2123 | 3912 |
| Outcome | -158 | 1626 | 3685 |
| **MAIN CHANGES** | | | |
| Economic | -1122 | -143 | 845 |
| of which: | | | |
| Lower unemployment | (-1643) | (-1710) | (-1772) |
| Higher inflation | (418) | (1437) | (2350) |
| RPI error | (88) | (92) | (95) |
| Higher rents | (139) | (200) | (359) |
| Higher earnings/tax cuts | (-124) | (-162) | (-187) |
| Estimating | 606 | 1,362 | 2,494 |
| of which: | | | |
| Disability | (550) | (820) | (1,400) |
| Other | | | |
| Community charge compensation | 119 | 124 | 128 |
| ETP:reduced estimate of benefit savings | 68 | 74 | 76 |
| Housing Benefit package | 105 | 94 | 87 |
| FC/IS: 50p | 70 | 70 | 70 |
| Other benefit increases | 9 | 12 | 17 |
| Administration | 198 | 273 | 227 |
| Child Benefit | - 158 | - 158 | - 158 |
| Tort recoveries | - | - 19 | - 38 |
| Other reductions | -52 | - 63 | - 63 |
| Net change | -158 | 1626 | 3685 |

Note: Changes shown in Autumn Statement will be slightly different mainly because they will include sums to be transferred to DE for running UBOs. As a result, the rounded change shown in the Autumn Statement for Year 1 will be -£100 million. The change in Year 2 will be shown as +£1,700 million.

**Possible points for Cabinet discussion**

1. Child Benefit freeze. Total savings, £202m a year, of which £44m already in baseline.

2. Tort. Support Mr Moore. Unlikely to be raised, as we understand DSS have now met Lord Chancellor's objections. But Mr Rifkind has intervened to argue for more time in consulting Scottish legal profession. Answer is that DSS issued consultation paper in July, so plenty of time for affected parties to comment. And government was criticised in PAC report Nov 1987: moving in new SS Bill would mean implementation in 1990-91 - very hard to defend longer delay. Vast majority of damage awards settled without involving courts. (Only 1% of awards made by courts, only 15% involve courts at all). DTI are worried about extra insurance costs for employers: right that employers should pay the cost of ensuring for safety at work: incentive to improve on safety.

3. Below baseline in Year 1 Justified by fall in unemployment - assumed to be 2.6 million in last PEWP, now 1.9 million. Saves DSS over £1½ billion a year throughout Survey period. Nearly all of these savings are offset in Year 1 by increases, notably those resulting from higher inflation than was assumed in the last plans and from the large rise in the estimated cost of disability benefit. (And remember that £1,400 million was added to baseline for 1989-90 in last year's Survey.) In later years, savings from lower unemployment are much more than offset, resulting in substantial net additions to programme.

**SCOTLAND**

| | 1989-90 | 1990-91 | £million 1991-92 |
|---|---|---|---|
| Bids | | | |
| Block | 46 | 43 | 49 |
| Non-block | 28 | 27 | 25 |
| Outcome* | 171 | 254 | 348 |

**Main Changes**

The main increases are formula consequentials of 58/83/177; an adjustment of 82/61/54 because of the increase in local authority housing receipts in England. In addition there is an addition of 25/28/30 to take account of the EC ruling on VAT. (There are also significant changes in LA provision - see brief 30).

**Sensitive Policy Points**

None that need be mentioned at Cabinet although Mr Rifkind will have his usual presentational problem of explaining the switch from Central Government to LAs which will be made more difficult this year by his failure to get as good a deal as Mr Walker and Mr King to compensate for the impact of buoyant LA current receipts in England.

**Points for Cabinet discussion**

There are unlikely to be any.

* In respect of total expenditure within the Secretary of State's responsibility.

**WALES**

| | 1989-90 | 1990-91 | £million 1991-92 |
|---|---|---|---|
| **Bids** | | | |
| Block | 22 | 25 | 26 |
| Non-block | 58 | 56 | 53 |
| **Outcome*** | 177 | 180 | 202 |

**Main Changes**

The main increases are block formula consequentials of 35/56/93; an adjustment of 82/61/54 because of the increase in local authority housing receipts in England; an addition of 18/22/21 to take account of the EC ruling on VAT; an addition to housing subsidies 2/1/2; and non-block changes of 41/41/31.

**Sensitive Policy Points**

There are no sensitive points for Wales.

**Points for Cabinet discussion**

Welsh Office office officials do not expect Mr Walker to raise any points (including points on industry).

* In respect of total expenditure within the Secretary of State's responsibility.

**NORTHERN IRELAND**

| | | | £million |
|---|---|---|---|
| | **1989-90** | **1990-91** | **1991-92** |
| **Bids** | | | |
| Block | 18 | 36 | 77 |
| Non-block | 4 | -2 | -6 |
| Outcome* | 136 | 185 | 270 |

**Main Changes**

LA formula consequentials of 46/54/60 and other formula consequentials of 35/43/66; plus 9/53/113 for ring-fenced Social Security Benefit expenditure in the wake of revised economic assumptions; an adjustment of 38/29/25 because of the increase in local authority housing receipts in England; and an addition of 14/14/14 to take account of the EC ruling on VAT. There are also miscellaneous reductions of -7/-9/-11.

Mr King allowed to use excess assets of NI Consolidated Fund to increase his spending power by about £50m in each year. This does not increase public expenditure.

**Sensitive Policy Points**

There are no sensitive points for Northern Ireland

**Points for Cabinet discussion**

Mr King is unlikely to mention any particular points.

* In respect of total expenditure within the Secretary of State's responsibility.

HM CUSTOMS AND EXCISE

£ million

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Bids | 22.4 | 42.1 | 79.9 |
| Outcome | 15.7 | 28.9 | 59.2 |

**Main Changes**

Growth in current expenditure due to forecast increases of workload on VAT registrations; and for passenger traffic and freight entries which are forecast to rise sharply. Subsumes cumulative efficiency savings of about 2½ per cent a year.

Capital expenditure provision increases in 1990-91 and 1991-92 mainly for the CHIEF (Customs handling of import and export freight) computer project.

**Sensitive Policy Points**

Drugs effort. Resources remain unchanged at levels enhanced during last year's Survey. Plans provides for 375 additional staff and 29 per cent increase in provision for this activity over the three year PES period.

**Points for Cabinet discussion**

See note on Inland Revenue entry which gives defensive briefing to charge that 2 of the Chancellor's Departments have again been given significant increases.

INLAND REVENUE

| | | | £ million |
|---|---|---|---|
| | 1989-90 | 1990-91 | 1991-92 |
| Bids | 21.5* | 79.4 | 88.8 |
| Outcome | 48.4* | 60.9 | 65.9 |

*includes £40m net effect of changes in LAPR/MIRAS savings due to different interest rate assumptions.

## Main Changes

Increase mainly accounted for by preparatory and live running costs of Independent Taxation (£33/22/30 million), and adjustments to last year's interim settlement following receipt of an acceptable 3 year management plan on running costs (£14/35/45 million). Additional capital provision has been agreed for replacement of computer equipment for the introduction of GDN, and cover against computer disaster (eg by allowing work to be switched, in the event of a complete breakdown, to another regional processing centres). These increases are partially offset by reductions in the forecast costs of life assurance premium relief and mortgage interest relief to non-taxpayers (£-23/-45/-49 million).

## Sensitive Policy Points

None.

## Points for Cabinet discussion

Other Ministers might ask why 2 of the Chancellor's Departments (Inland Revenue and Customs and Excise) have again been given significant increases. Most of increase for Revenue is to provide for the introduction of Independent Taxation - without that Revenue's running cost increase would have been well below average. Important to allow sufficient funds for such an important new initiative, and also, to enable the continuation of the development of the Revenue's computer systems which generate substantial efficiency savings. The growth in the Customs' provision covers the growth in the drugs effort agreed last year and in forecast workload in all Customs main activities, but it subsumes cumulative efficiency savings of about 2½ per cent a year.

**PSA**

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Bids | +60 | +90 | +70 |
| Outcome | +28 | +16 | -29 |

**Main Changes**

The agreement with Mr Ridley reflects significant increases over the period in outgoings on rents and in expenditure to meet requirements for major works and for the costs of implementing major changes in the structure and working practices of PSA as the Agency moves toward payment and untying in 1990 and Trading Fund status in 1993. Increased expenditure is offset by higher receipts from disposals and from PRS rents.

**Sensitive policy points**

2. (i) The agreement reflects no significant increase in expenditure on maintenance on the grounds that the baseline provision was the result of a significant increase in the 1987 Survey, and should be sufficient to enable PSA to reduce the backlog.

(ii) The agreement does not include specific provision for freehold purchases although Treasury remains willing to consider ad hoc cases that offer good value for money.

(iii) The increases in rent outgoings reflect greater buoyancy than expected last year in office rentals.

**Points for Cabinet discussion**

3. Unlikely to be any.

**NATIONALISED INDUSTRIES** 20

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Bids of on-going industries | + 307 | + 329 | - 110 |
| EFL's of privatised industries | 167 | 259 | 1814 |
| Outcome | - 4 | - 13 | + 1373 |

Main Changes Settlement fulfils Cabinet's remit to keep total provision to baseline or less in 1989-90 and 1990-91. Substantial improvement in British Steel performance, offset by increased investment in London Regional Transport and water industry (in 1989-90) and loss of British Steel's negative EFL. EFL increase in 1991-92 entirely due to electricity privatisation in 1990-91. EFL excluding industries to be privatised still shows steady decrease.

Sensitive Policy Points

Settlement provides for increased capital investment in water industry to meet EC and domestic requirements, partially offset by price increases of 9.8 per cent. Large increase in London Regional Transport (LRT) investment more than offset by 12 per cent increase in LRT fares and reductions from baseline in other transport industries. BR prices rise average 9.4 per cent. Electricity prices will rise nearly 6 per cent in 1989-90 (substantially less than last year; Electricity supply industry's financial target is unchanged). Civil Aviation Authority increases reflect accelerations of investment programme to deal with constraints in capacity of air traffic control. Some reduction in British Coal's investment programme. NI prices will increase by slightly more than forecast RPI, on average.

Points for Cabinet discussion

Cabinet should note main price rises (LRT, Water, BR, Electricity) but you will not want to invite discussion.

(IF ASKED - all price increases associated with higher investment plans. LRT's, prices still below cost of providing service. Water charges increase less than would be needed to cover additional investment fully).

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**LOCAL AUTHORITY RELEVANT**

| | 1989-90 | 1990-91 | 1991-92 |
|---|---|---|---|
| Agreed changes on baseline (£m) | +1715 | +1968 | +2196 |

**Main Points**

1. For 1989-90 consistent with provision for relevant current expenditure announced in July as part of RSG settlements for England, Scotland and Wales.

2. Grant of £17.4 billion announced at same time. Up £0.8 billion on grant available in 1988-89 and up £1.3 billion on grant being paid in 1988-89 after holdback. RSG Bill for England and Wales provides for fixed amount of grant to be paid in 1989-90, ie no holdback but no repayment of holdback for earlier years either.

3. Provision for 1990-91 and 1991-92 broadly makes conventional assumption of spending flat in real terms. Includes addition of £95 million in England and Wales as Community Charge implementation costs replace preparation costs. Scottish and Welsh figures calculated by normal block comparability rules. Figures will be superseded by plans for grants under the new planning total.

**Defensive**

1. Revised GDP deflator means plans for 1989-90 show real cuts. Provision up 8.5% on 1988-89 provision. Up 4.7% on LAs own 1988-89 budgets - still broadly level in real terms. Provision announced in July has subsequently been found to imply similar real cuts in previous years; but for 1989-90 LAs spending relative to the plans will not affect their grant entitlements. No question of reopening provision or grant totals.

2. Pointless to publish plans for LAs for 1990-91 and 1991-92, which will not be used under new planning total. Figures make conventional assumption of flat real spending for each Department (apart from increase for CC costs and reductions in Scotland and Wales under comparability formulae). Necessary to present AS tables as credible outcome of existing planning process. Figures also necessary to prepare Public Expenditure White Paper. Will be superseded by plans for grants and National Non-Domestic Rates payments in 1989 AS following first Survey under the new system.

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**LA CAPITAL**

| | | | £m |
|---|---|---|---|
| **Provision (GB)** | **1989-90** | **1990-91** | **1991-92** |
| Bids | +1327 | +1174 | +1225 |
| Outcome | -1397 | -1524 | -1608 |
| of which - gross | + 573 | + 66 | - 191 |
| - receipts | -1969 | -1589 | -1417 |

| **Allocations** | **Housing** | **Transport*** | **Education** | **PSS** | **Other Services** | **Total** |
|---|---|---|---|---|---|---|
| 1989-90 | 1110 | 625 | 152 | 67 | 340 | 496 |
| as % 1988-89 (before EYF) | 86% | 99% | 95% | 95% | 130% | 95% |

*excludes transfer from British Rail (1988-89 £5m, 1989-90 £1m).

**Main Changes**

(i) Large increases in projected receipts over baseline. Small reductions in capital allocations compared with 1988-89.

(ii) Other Services allocations up on 1988-89 level by 30 per cent include £135 million for the costs of implementing the Community Charge.

**Sensitive Policy Points**

(i) Fall in allocations for all services (except Other Services, but increase only due to CCh element). But £2 billion extra receipts to LAs available. Proposals for new control system published on 7 July 1988, for inclusion in next session's Housing and Local Government Bill, will better match resources to needs.

**Points for Cabinet Discussion**

(i) 1988-89 underspend. DOE officials still considering how best to present the forecast underspend on DOE/LA1 to LAs. Not proposed to issue any extra allocations to reduce underspend.

(ii) Officials will be recommending abolition of DOE/LA1 and WO/LA1 (main English and Welsh LA capital cash limits) for 1988-89 and 1989-90 so that EYF additions to expenditure will not be available. Propose to reintroduce cash limit on credit approvals and capital grants under new control system.