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PART. D

1989 BUDGET FINANCIAL
SECTOR BORROWING
REQUIREMENTS

11-3-89

mp.pc/Riley/098

COPY NO. 1 OF 13 COPIES

FROM: C J RILEY
DATE: 8 March 1989

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Peretz
Mr Sedgwick
Mr S Davies
Mr Mowl
Miss Simpson

MINUTE ON THE MTFS FOR THE PRIME MINISTER

X I attach a draft of your minute for the Prime Minister. The fiscal numbers are provisional; they will need to be checked when we have the PSDR figure for February (due tomorrow) and your final decisions on the figures to be published.

Thanks.
A few minor changes.
I note X, which may also affect Y.

CJR.

C J RILEY

a
OK?
AA

mp.pc/Riley/093

Please re-do as fitter draft

DRAFT MINUTE TO PRIME MINISTER ON MTFS

With PSDR figures now available for the first 11 months of the year - the last figures we shall have before the Budget - I am in a position to let you have ~~the~~ my usual note on the ~~1989 MTFS which I promised in my minute of 7 March~~ Medium Term Financial Strategy.

2. This will be the tenth occasion on which we have set out the MTFS in the Red Book. I propose to use this opportunity to highlight the ~~major economic improvements which have occurred as a result of~~ transformation of the economy that has followed our pursuit of sound financial policies coupled with supply-side reforms. I will stress that, although the details of the MTFS have changed over the last decade as the economy has evolved, the essence of the strategy has remained unchanged.

and not to accommodate inflationary complexes.

3. At the centre of the MTFS, as always, is the over-riding requirement to bring down the rate of inflation. ~~This means not postponing the achievement of our medium term inflation objectives when money GDP growth exceeds the rate we have been aiming for, as it has done in the last two years.~~ We have taken firm action since the summer to bring the economy back onto track, and the decline in money GDP growth which I propose to aim for over the medium term should bring about a decisive reduction in inflation.

Over the past two years, money GDP growth has exceeded the rate we have been aiming for. In part this reflects a better supply performance in the economy; but it also reflects stronger inflationary pressures.

Fiscal policy

4. [~~It looks as though~~] the PSDR in 1988-89 will turn out significantly [~~rather~~] higher than (the £10 billion I) forecast at the time of the Autumn Statement. We have a surplus of [£16 billion] with one month to go, though with the usual "surge" of ~~borrowing~~ spending in the final month the figure for the year as a whole is likely to turn out [~~slightly~~] somewhat lower. I intend to publish a figure of [£14 billion], which as usual is slightly on the cautious side.

5. Last Year I set out the principle of a balanced budget as the norm for fiscal policy, and I intend to reaffirm it this year. [I do not believe that we should aim for the maximum possible repayment of debt, because that would ~~simply~~ unnecessarily delay the reductions in taxation ~~which are necessary if we are~~ needed to build on the supply side improvements already achieved.] But given the size of the present surplus, and the need to maintain a prudent and cautious approach, I am sure we should only aim to return to balance gradually, over a period of years.

6. The tax and national insurance package we have agreed will enable me to budget for a PSDR of [£12 billion] in 1989-90, [the same as in 1988-89 after allowing for the fall in privatisation proceeds] from £7 billion to £5 billion. effectively This implies no change in the overall tax burden between the two years; the package merely offsets the fiscal drag in the system. Thereafter I propose to show a gradual return towards budget balance, and thus a number of further years of debt repayment. [~~If~~] Provided we continue to ~~we succeed in~~ restrain[~~ing~~] the growth of public expenditure, this should enable us to bring down the tax burden over the medium term.

Monetary policy

7. The MTFS will once again emphasise that the task of exerting downward pressure on inflation falls to monetary policy. It will also make it clear again that short-term interest rates are the essential instrument of monetary policy; that interest rate decisions are made on the basis of a comprehensive assessment of monetary conditions, with particular weight given to the behaviour of MO in relation to its target range and to exchange rate; and that the Government is not prepared to accommodate increases in domestic costs by exchange rate depreciation.

8. I intend to set a target range for MO growth in 1989-90 of 1 to 5%, as foreshadowed in last year's MTFS; ~~it~~ this is the same as the range for 1988-89. Although the 12 month growth rate of MO is likely to start the year above the target range, the tightening of monetary policy since the summer should bring it back within the range ~~in the next few months.~~ before too long. We have already seen a sharp ~~a~~ deceleration, with the annualised six month growth rate now well within the range.

9. For subsequent years I propose to show a declining path for monetary growth in line with that shown in last year's MTFS. The range -1 to 3% for the final year (1992-93) should be consistent with money GDP growth of around 5%, and hence a decisive fall in inflation from the average rate of the last five years.

Capital market liberalisation

10. I shall also be announcing on Budget day a substantial liberalisation of the London sterling capital market. I am abolishing the queue for bond and equity issues which has been operated by the Bank of England since 1946, opening up the market for sterling paper and at the same time simplifying its regulatory regime. I am also making some consequential changes in the taxation of deep discount and other bonds. Taken together all these changes will give greater flexibility to those who issue capital in London; and wider choice to those who invest here.

NL

COPY NO. 1 OF 33 COPIES

FROM: C J RILEY
DATE: 8 March 1989

CHANCELLOR

cc
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Sedgwick
Mrs Butler
Mr S Davies
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Sir Anthony Battishill) IR
Mr Beighton)
Mr Isaac)
Mr Painter)
Mr Calder)

Mr Unwin) C&E
Mr Jefferson Smith)
Mr Allen)

Thanks.

Ch
A few comments
AA

& afterwards.

FSBR CHAPTER 1

I attach amended proofs of Chapter 1, taking on board your earlier comments.

2. There are some small changes to the numbers in table 1.1. In addition, Mr Culpin has suggested a neater and simpler version of the section on excise duties, amalgamating all the unchanged duties into one line and specifying which VED rates are being changed. Which version do you prefer?

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3. Table 1.2 does not take account of the latest revisions to the forecast, and will anyway have to be amended in the light of your decisions on the PSDR. I will show you the revision numbers as soon as possible. Note that I have reinserted footnote 2 which you had earlier deleted; classification changes have changed the GGE figures by more than a £100 million in 1988-89, and so we would prefer to retain this standard footnote.

4. The proofs must go back to the printers by noon tomorrow (Thursday), so I would be grateful for comments by 11 am.

CJR

C J RILEY

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 0993

Table 1.1 The Budget measures[1]

	£ million		yield(+)/cost(−)
	1989–90		1990–91
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
National insurance			
✓ employee contributions reformed and reduced	−980	−980	−2 80~~5~~ 0
Income tax			
personal allowances and basic rate limit indexed	−1 465	—	—
car benefit scales increased	+160	+160	+200
Excise duties			
petrol, derv etc	—	−545	−580
duty on unleaded petrol reduced, duty increased for 2 and 3 star petrol	−40	−40	−100
vehicle excise duty	+40	−150	−170
tobacco	—	−235	−250
alcohol	—	−255	−280
× Value ~~A~~ a dded ~~T~~ t ax			
× non-domestic construction etc	+315	+315	+5~~40~~ 35
Life assurance tax regime reformed	−20	−20	+45
Corporation tax			
small companies' profits limits increased	*	*	−35
× Other tax changes	−1/60	−1/25	−55
Pensioners' earnings limit abolished[2]	…	…	…
Total	**−2 150**	**−1 875**	**−3 490**

~~I think I prefer 'thresholds'!~~ or

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

* = *Negligible.*

λ … = Not applicable

[2] *Public expenditure cost of £190 million in 1989–90 and £375 million in 1990–91 will be met from the Reserve. See Chapter 5.*

— = *Nil.*

also SFA (next page)

If there are really −160 cs −125, perhaps ought to disaggregate Sch E after all

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Culpin version

Table 1.1 The Budget measures[1]

	£ million 1989–90		yield(+)/cost(−) 1990–91
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
National insurance			
employee contributions reformed and reduced	− 980	− 980	− 2 80~~8~~0
Income tax			
personal allowances and basic rate limit indexed	− 1 465	—	—
car benefit scales increased	+ 160	+ 160	+ 200
Excise duties			
most duties unchanged	–	− 1225	− 1320
duty on unleaded petrol reduced, duty increased for 2 and 3 star petrol	− 40	− 40	− 100
vehicle excise duty rates for taxis, buses and some lorries increased	+40	+40	+ 40
Value added tax			
non-domestic construction etc	+ 315	+ 315	+ 5~~[illegible]~~ 35
Life assurance tax regime reformed	− 20	− 20	+ 45
Corporation tax			
small companies' profits limits increased	⋆	⋆	− 35
Other tax changes	− 160	− 125	− 55
Pensioners' earnings limit abolished[2]	…	…	…
Total	− 2 150	− 1 875	− 3 490

[1] *These measures, and the basis of the costings shown, are described in detail in Chapter 4.*
⋆ = *Negligible.*
… = Not applicable

[2] *Public expenditure cost of £190 million in 1989–90 and £375 million in 1990–91 will be met from the Reserve. See Chapter 5.*
— = *Nil.*

Or could do: duty on unleaded . . .
VED . . .
Other duties unchanged

Good idea: do this

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1 The Budget

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

1.02 The Financial Statement and Budget Report (FSBR) supplements the Chancellor's Budget Statement. It presents the Medium Term Financial Strategy (MTFS); describes developments in the economy over the past year; provides forecasts to mid-1990; sets out the tax and national insurance proposals in the Budget; summarises the Government's spending plans; and gives forecasts for the public finances for the year ahead.

The Medium Term Financial Strategy

1.03 Chapter 2 describes the MTFS, which provides the framework for the Government's economic policy. The objectives of the MTFS and the central role of monetary policy have remained unchanged throughout the 1980s, a period of substantial economic progress. Monetary policy is designed to reduce money GDP growth and thus inflation over the medium term, with the ultimate objective of achieving stable prices; in this year's MTFS money GDP growth falls to around 5½ per cent over the next four years. Monetary policy is buttressed by a sound fiscal policy, with a substantial budget surplus in both 1988–89 and 1989–90; a gradual return to a balanced budget is projected over the medium term, with both taxes and public expenditure declining as a share of GDP. The MTFS is complemented by policies designed to improve the working of markets and the supply performance of the economy.

The economy

1.04 Chapter 3 describes the main developments in the economy in 1988 and the prospect until mid-1990. ~~In recent years economic trends have become increasingly difficult to interpret because of inconsistencies within the national and sectoral accounts; adjusted figures that reduce (but do not eliminate) these inconsistencies are used throughout the FSBR~~. The economy grew strongly again in 1988, by 4½ per cent, with the largest fall in unemployment since the war. GDP is forecast to grow by a further 2½ per cent in 1989. ~~on the basis of growth through the year lower than this.~~ Inflation is forecast to be on a downward trend in the second half of 1989.

Tax and national insurance measures

1.05 Chapter 4 sets out the tax and national insurance proposals in the Budget. They include reform and reduction of employee national insurance contributions, indexation of the main income tax thresholds, improvements to personal equity plans and employee share schemes, ~~reform of~~ the taxation of life assurance, pensions, and unit trusts, measures to promote unleaded petrol, and abolition of the earnings rule for pensioners. The measures are summarised in Table 1.1. /stet

changes in ?

changes to the taxation of

Public expenditure

1.06 Chapter 5 summarises the Government's spending plans, as set out in the public expenditure White Paper. This chapter also provides the latest estimate of the outturn for the public expenditure planning total in 1988–89.

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Public sector finances

1.07 Chapter 6 presents the complete financial picture for the public sector. The public sector debt repayment is forecast to be [£14 billion] in 1988–89. A further debt repayment of [£12 billion] is forecast for 1989–90, equivalent to £7 billion net of privatisation proceeds, the same as in 1988–89. The forecast takes account of the measures in the Budget which are expected to reduce taxation and national insurance contributions by £1·9 billion, after adjusting for the net cost of indexing direct and indirect tax rates and allowances. Table 1.2 shows the main components of general government receipts and expenditures.

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Table 1.2 The finances of the public sector[1]

	£ billion		
	1988–89		1989–90
	1988 Budget[2]	Latest estimate	Forecast
RECEIPTS			
Inland Revenue:			
Income tax	42·1	43·5	47·1
Corporation tax[3]	19·8	18·8	22·0
Petroleum revenue tax	1·2	1·3	1·3
Capital gains tax	2·0	2·4	2·1
Inheritance tax	1·0	1·1	1·1
Stamp duties	2·0	2·3	2·6
Total Inland Revenue	**68·0**	**69·4**	**76·1**
Customs and Excise:			
Value added tax	26·2	27·5	29·8
Petrol, derv duties etc.	8·4	8·7	8·7
Tobacco duties	5·0	5·1	5·1
Alcohol duties	4·5	4·6	4·7
Betting and gaming duties	0·9	0·9	0·9
Car tax	1·3	1·4	1·4
Customs duties	1·6	1·7	1·8
Agricultural levies	0·1	0·2	0·1
Total Customs and Excise	**47·9**	**49·9**	**52·5**
Vehicle excise duties	2·8	2·8	2·9
Oil royalties	0·6	0·6	0·6
Gas levy	0·4	0·4	0·4
Local authority rates[4]	19·0	18·9	20·4
Other taxes and royalties	2·5	2·7	2·8
Total taxes and royalties	**141·2**	**144·8**	**155·7**
National insurance and other contributions	31·6	32·8	34·6
Interest and dividends	5·6	6·6	6·7
Gross trading surpluses and rent	3·5	3·3	3·5
Other receipts	2·9	3·3	3·4
General government receipts	**184·9**	**190·8**	**203·8**

	£ billion		
	1988–89		1989–90
	1988 Budget[2]	Latest estimate	Forecast
EXPENDITURE			
Department			
Social security	48·5	47·4	51·0
Health	20·7	21·8	23·2
Defence	19·2	19·0	20·1
Education and science	18·0	18·4	19·6
Home office and legal departments	7·0	7·2	8·0
Transport	5·1	4·8	5·4
Scotland	8·5	8·7	9·0
Wales	3·5	3·6	3·8
Northern Ireland	5·1	5·6	5·5
Other departments	22·8	21·7	23·1
Privatisation proceeds	−5·0	−7·0	−5·0
Reserve	3·5	—	3·5
Public expenditure planning total	**156·9**	**151·1**	**167·1**
General government gross debt interest	17·5	18·2	16·6
Other adjustments	8·6	9·2	9·5
General government expenditure	**183·0**	**178·5**	**193·2**

Receipts, expenditure and debt repayment

	£ billion		
	1988–89		1989–90
	1988 Budget[2]	Latest estimate	Forecast
General government receipts	184·9	190·8	203·8
General government expenditure	183·0	178·5	193·2
General government debt repayment	2·0	12·3	10·6
Public corporations' market and overseas debt repayment	1·2	1·7	1·5
Public sector debt repayment	**3·2**	**14·0**	**12·1**

New figs

h

[1] *In this and other tables constituent items may not add up to totals because of rounding.*
[2] *On current definitions.*
[3] *Includes advance corporation tax (net of repayments):* 5·3 6·0 6·4
— also includes North Sea Corporation tax after ACT set off and corporation tax on gains.
[4] *In this and other tables community charge receipts in Scotland are included with local authority rates.*

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FROM: S J DAVIES
DATE: 8th March 1989

COPY NO. 1 OF 27

CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Monck
Mr Scholar
Mrs Lomax
Mr Peretz
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Grice
Miss O'Mara
Mrs R Butler
Mr Mowl
Mr Barrie
Mr Savage
Miss Simpson
Mrs Chaplin
Mr Call
Mr Tyrie

A few points (layout not v good)

1989 FSBR CHAPTER 2

I attach the proofs of Chapter 2 as they have returned from the printer, with a few additional amendments marked.

2. There is a choice to be made in paragraph 2.13, over whether the private sector's financial position should be described as "likely to move back towards surplus" or as "likely to move closer to balance". The second version is the one that has been in recent drafts. But we expect in the longer term (though not necessarily in the MTFS period) that the private sector financial position will move right back into surplus. "Back ~~towards~~ into surplus" may thus be more accurate than "closer to balance".

OK?

OK

Sorry I misread 'more' for 'under'.

3. I was asked (in a comment on paragraphs 2.10 to 2.11) why 1991-92 growth of money GDP is ½ per cent under that in 1988 MTFS. In fact it is ½ per cent higher than in the 1988 MTFS, which is consistent with what is said in those paragraphs. So doesn't answer (revised) question

4. The latest forecast/data revisions have left us with the following nominal/real GDP and inflation paths (still subject to further change):

		1988-89	1989-90	1990-91	1991-92	1992-93
	was	10¾	8			
Money GDP		**11**	**7¾**	**6**	**6**	**5½**
Real GDP:	non-North Sea	4½	2¼	2	3	3
	total	3½	2¼	2	2¾	2¾
Inflation:	GDP deflator	7	5½	4	3	2½

5. The proofs have to be returned to the printers at noon tomorrow (Thursday) and this is the last opportunity for substantive amendment so I would be grateful for any further comments you may have by early tomorrow.

SJD

S J DAVIES

2 The Medium Term Financial Strategy

Development of the MTFS

2.01 This is the tenth occasion on which the Government has set out its Medium Term Financial Strategy (MTFS).

2.02 Since its inception in 1980 the MTFS has provided a nominal framework within which the Government pursues its objective of bringing down the rate of inflation. The MTFS has been complemented by policies designed to improve the working of markets and the supply performance of the economy. The objectives of the MTFS and the central role of monetary policy in reducing inflation have remained unchanged throughout the 1980s; but the precise form in which the nominal framework has been expressed and the indicators used in the assessment of monetary conditions have changed as the economy has itself evolved.

2.03 The original version of the MTFS specified the nominal framework in terms of broad money—the aggregate known at the time as £M3 and now simply as M3—which had shown a stable relationship with money GDP in the second half of the 1970s. M3 initially had two roles: it was used to describe the Government's strategic objective for growth of nominal magnitudes in the medium term; and to act as a target in the short term, and thus as a guide to setting interest rates. However, following the abolition of exchange controls and other measures of financial liberalisation the earlier relationship between broad money and money GDP changed. It became necessary to give more attention to money GDP itself and to take account of other monetary indicators in setting interest rates.

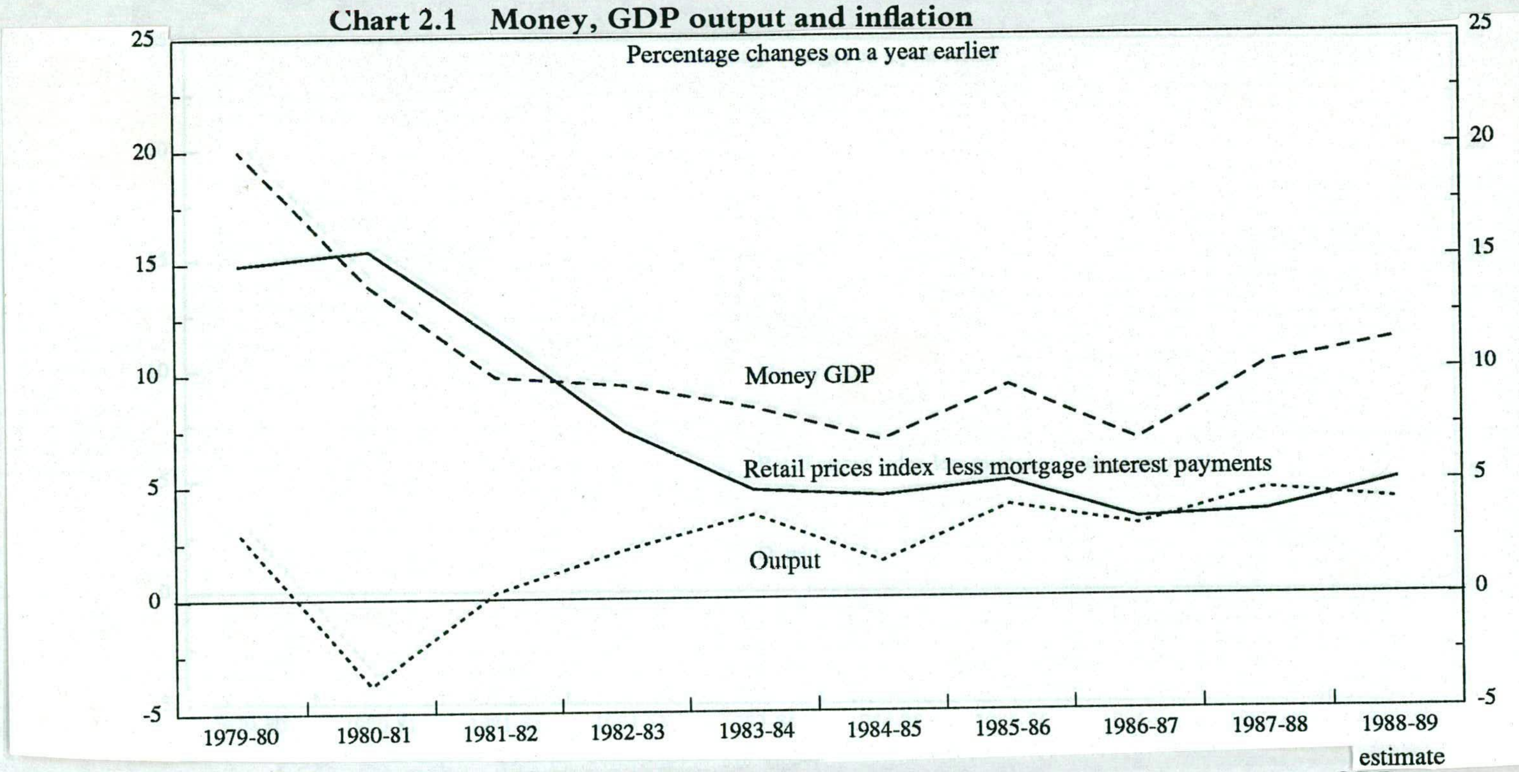
2.04 The nominal framework has been expressed in essentially its present form for the past six years. A medium term path for money GDP has been shown in all versions of the MTFS since 1982. M0 was introduced as a target aggregate in 1984, initially alongside M3, and since 1987 has been the only monetary aggregate for which a target range is given. The importance of the exchange rate in the assessment of monetary conditions was discussed in the 1982 MTFS, and restated regularly in subsequent versions.

2.05 Since the introduction of the MTFS, objectives for fiscal policy have been described in terms of the public sector borrowing requirement (which has now become a public sector debt repayment). With the PSBR at almost 5 per cent of GDP in 1979–80, a major reduction in the deficit was an essential component of the strategy in the early years of the MTFS. Since then, the public finances have been transformed and are now in substantial surplus; this has allowed the Government to move from a medium term objective of deficit reduction to a long term objective of a balanced budget.

Economic performance since 1980

2.06 As a result of sound financial policies coupled with supply side reforms, substantial economic progress has been made during the 1980s. Inflation in recent years has been brought back to levels not experienced since the 1960s. The increase in the RPI excluding mortgage interest payments is likely to have averaged about 5 per cent in 1988–89, compared with over 15 per cent in the first year of the MTFS. The growth of GDP has averaged around 3 per cent a year since 1980–81, while productivity performance has improved sharply compared both with the UK's record in the second half of the 1970s and with the performance of other industrial countries. Latest figures put the workforce in employment (Big change) [almost ~~700 000~~ 1½ million] above its 1980–81 level and at an all time high. Industrial profitability has recovered to levels not seen for almost 20 years. The UK has acquired one of the largest stocks of net overseas assets of any country.

Chart 2.1 Money, GDP output and inflation



2.07 The early years of the MTFS saw a sharp decline in money GDP growth. Output fell in the first year but started to recover in 1981; as output accelerated money GDP growth settled down between about 7 and 9½ per cent a year. Since 1986, the growth of money GDP has risen somewhat, with higher output growth matched by an upward movement in inflation.

2.08 As in other industrial countries, recent growth of demand in the UK has been much stronger than expected; here this has occurred in the face of high real interest rates and a substantial tightening of fiscal policy. Private x x sector investment has surged—growing by ~~over~~ about 25 30 per cent over the past two years. And several years of rising asset prices and increased consumer borrowing have helped to stimulate household expenditure. The collapse of stock market prices in October 1987 did not dampen demand in the way that had been widely expected.

Objective for money GDP

2.09 The Government's intention remains to bring down inflation further over a period of years and ultimately to achieve price stability. To this end, it plans to reduce the rate of growth of money GDP over the medium term; monetary policy will be directed to achieving this. Money GDP growth in 1988–89 is estimated to have overshot the path published in last year's MTFS by ~~over 3~~ 3½ percentage points; but current prospects, discussed in Chapter 3, are for a substantial slowdown in demand in 1989 and the first half of 1990, in part the result of the tightening of policy during 1988. Money GDP growth in 1989–90 is forecast to be ~~about~~ just over 1~~½~~ percentage point~~s~~ higher than envisaged in last year's MTFS.

2.10 It is the Government's policy not to accommodate inflationary impulses. To the extent that faster money GDP growth reflects supply side improvements it is sensible to raise the money GDP objective to accommodate the faster potential growth; but to the extent that faster growth of money GDP reflects only higher demand with no supply side improvement, the Government will take action designed to return to its planned path for money GDP growth over the medium term.

2.11 As compared with last year the Government has revised its view of the likely real growth rate over the medium term, taking account of a slower projected decline in oil output. The medium term trend in output growth consistent with declining inflation is now put at 2¾ per cent, compared with 2½ per cent assumed last year; the medium term trend in non-North Sea output growth consistent with declining inflation is put at 3 per cent.

Table 2.1 Money GDP growth, output and inflation[1]

		1988–89	1989–90	1990–91	1991–92	1992–93
Money GDP		~~10¾~~ 11	~~8~~ 7¾	**6**	**6**	**5½**
Real GDP:	non-North Sea	~~5~~ 4½	2~~½~~ ¼	2~~¼~~	3	3
	total	~~4~~ 3½	2~~½~~ ¼	2	2¾	2¾
Inflation:	GDP deflator	~~6½~~ 7	5½ ¼	4	3	2½

[1] *Percentage changes on previous financial year. The figures for 1989–90 are forecasts; the figures for subsequent years show the Government's medium term objectives for money GDP and consistent assumptions for output and inflation. The projections in the table make no allowance for any effect of the replacement of local authority domestic rates by the Community Charge on recorded growth in money GDP or the GDP deflator.*

2.12 Table 2.1 sets out the Government's revised objectives for money GDP. The aim is to get back by 1991–92 onto the path implied by last year's money GDP objectives, after allowing for the higher trend output growth now assumed. The new path is intended to be consistent with reducing inflation to 3 per cent by 1991–92, as envisaged in last year's MTFS. There will inevitably be some fluctuation around the path for money GDP. Moreover, the split between output and inflation implied by it is subject to unavoidable uncertainty; illustrative assumptions are shown in Table 2.1. Following two years of rapid growth, output is likely to grow somewhat less than trend in the next two years.

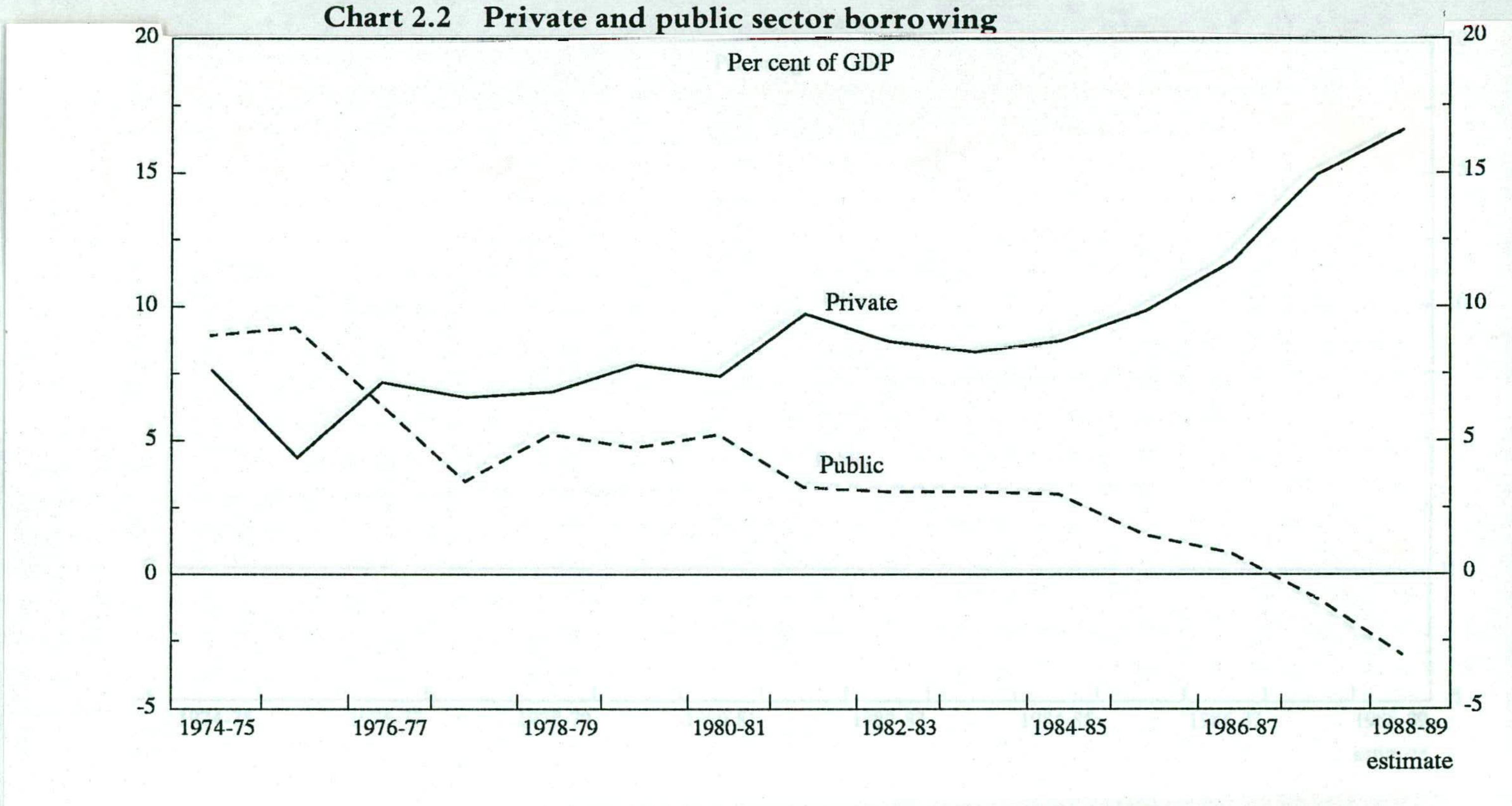
Ruto

the annex to

2.13 The flows of saving and investment in the economy over the medium term are also uncertain; and these inherent uncertainties are compounded at present by the discrepancies in the macroeconomic statistics discussed more fully in the annex to Chapter 3. In recent years the private sector as a whole appears to have moved from large surplus into substantial deficit, and this has led to the balance of payments current account moving into deficit despite the public sector's move into surplus. It seems likely that these trends will reverse themselves over the medium term, and the private sector's financial position is likely to move [back ~~towards~~ surplus/ ~~closer to balance~~]. In particular, the personal debt/income ratio, which has been rising fast, should tend to stabilise, as borrowers and lenders become more cautious about allowing further increases: this will imply higher net personal saving.

(See cover note)

Chart 2.2 Private and public sector borrowing



Monetary policy

2.14 The task of exerting downward pressure on inflation falls to monetary policy, conducted within a sound fiscal framework. Experience in the UK and elsewhere has shown that direct quantitative controls, once thought to be a possible instrument of monetary control, are not only inefficient and distortionary, and so undesirable, but also ineffective in today's sophisticated financial markets. Even a decade ago, markets were learning quickly how to circumvent such controls; their proficiency in doing so would be much greater now. The further liberalisation announced today, including the abolition of the Control of Borrowing Order (see box), removes one of the last vestiges of post-war controls on capital markets.

Further Measures Liberalising the Financial Markets

The removal of controls in financial markets since 1979 has contributed to greater competition and efficiency in the allocation of capital. Further liberalisation was announced in the Budget. The Control of Borrowing Order (COBO), which, with its antecedents, goes back to the immediate post-War period, is to be revoked and its parent legislation repealed. A General Consent has been issued by the Treasury, which means that it will no longer be necessary for [new] borrowers ~~issues~~ (other than local authorities) to obtain the Bank of England's consent to the timing of [their] new issues. The Bank will no longer operate a new issues queue in the equity and bond markets. COBO itself will remain in place, solely for local authorities, only until new controls on their borrowing, contained in the Local Government and Housing Bill, come into force. The regulatory regime for sterling commercial paper and short-term corporate bonds is also to be significantly liberalised, creating a single regime for sterling paper with an initial maturity of up to 5 years. In addition, the restrictions preventing certain borrowers, including foreign sovereigns and private companies, from making sterling issues in this maturity range will be removed.

issuers

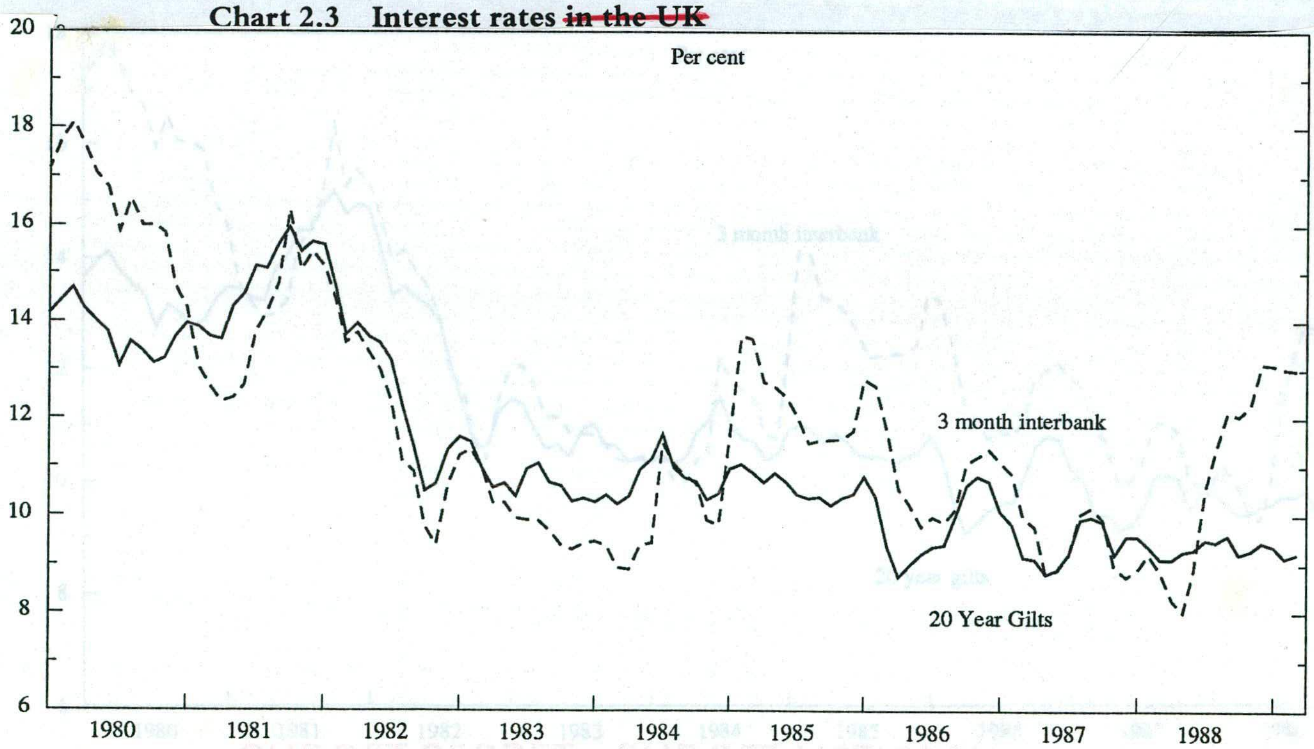
Better left as is: applies to ~~equity~~ issues, not just – or even mainly – borrowing (despite name of Order!)

This has got rather crowded. Might be better to move last para of previous page to top of this page and graph to next page etc?

(I) made less crowded by making box full width (like charts) but looks better, I think.

2.15 Here, as in other countries, monetary policy is implemented by changing the level of short-term interest rates. The process of financial liberalisation has increased the power of interest rates as a policy instrument. They can now fulfil their function as the price of money and credit unhampered by quantitative controls. At the same time, the rise in borrowing and holdings of liquidity, which followed liberalisation, means that interest rates now act on a wider base.

Chart 2.3 Interest rates ~~in the UK~~

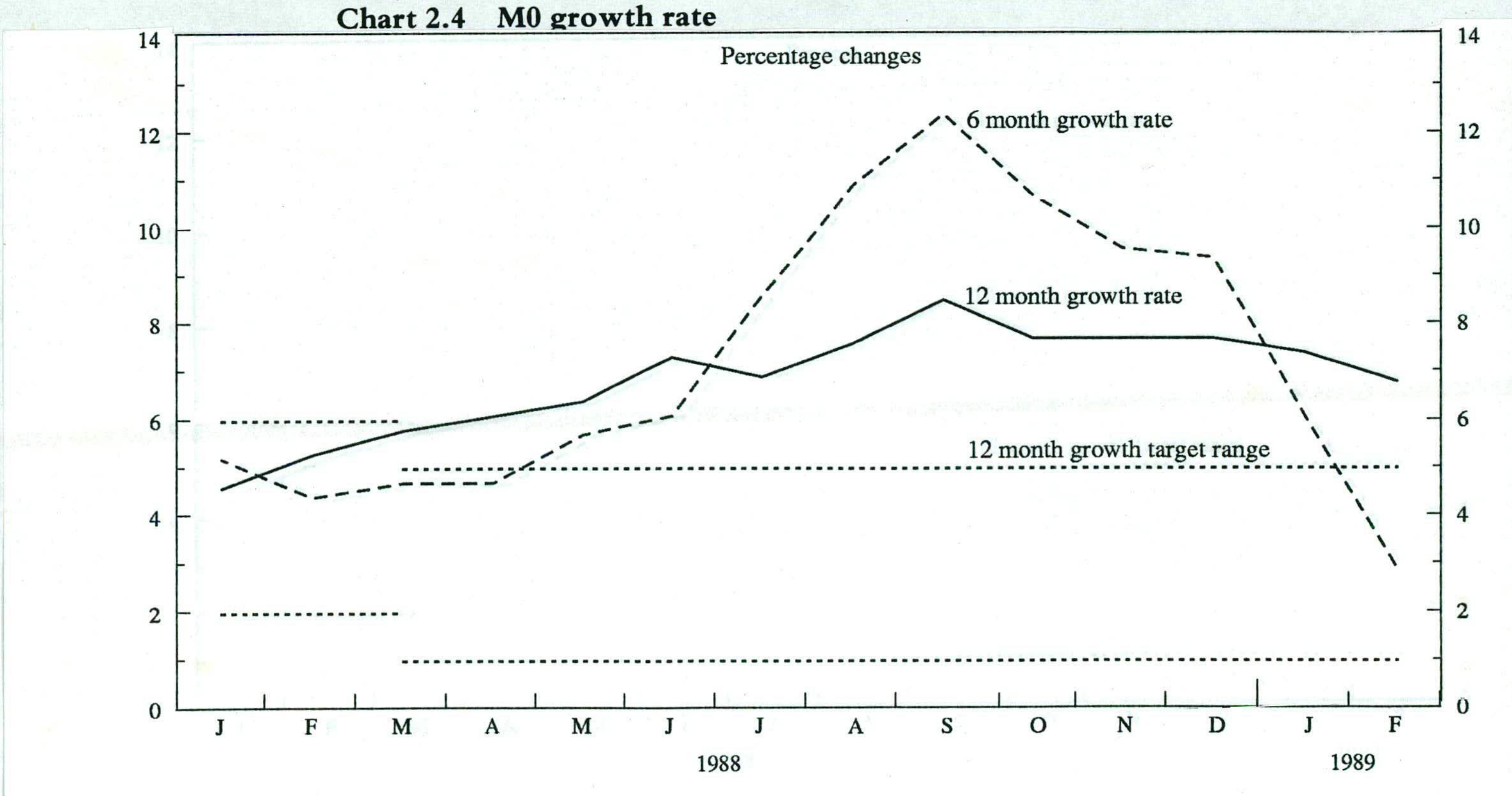


2.16 Decisions about interest rates are made on the basis of a comprehensive assessment of monetary conditions. The evidence of a range of indicators has to be appraised and balanced. But the assessment gives particular weight to the behaviour of narrow money in relation to its target range and to the exchange rate. Attention is also paid to the behaviour of broad money or liquidity. Short-term interest rates fell from 9 per cent in early 1988 to touch 7½ per cent for a fortnight in May. Thereafter, they were raised steadily to reach 13 per cent by the end of November, where they have remained.

2.17 Longer term interest rates have been stable despite the rise in short rates. 20 year gilts yields have fluctuated between around 9 and 9½ per cent throughout the ~~last~~ past year, and currently stand near the middle of this range. This relative stability has been a feature of recent years. Since the sharp decline in 1982, the trend in long rates has been gently downwards, with only minor fluctuations.

2.18 Narrow money, as measured by M0, has continued to have a reliable and predictable relationship with money GDP. Reflecting the higher growth of money GDP, the 12 month growth rate of M0 has been above the target range throughout 1988–89. M0 grew particularly rapidly between March and September last year, but has slowed sharply since the autumn in response to the higher interest rates in the second half of 1988. Its estimated annualised growth over the last six months seasonally adjusted is ~~(~~under 3 per cent~~)~~, the lowest since the middle of 1987.

Chart 2.4 M0 growth rate



poor layout again

2.19 For 1989–90, a target range for M0 of 1–5 per cent has been set, the same as the illustrative range for that year in last year's MTFS. Measured by the 12 month growth rate, it is likely to begin the year above the target

range. But as the deceleration over recent months continues, it will come back within it. The ranges given in Table 2.2 for later years are illustrative and show a steady fall consistent with the declining path for money GDP growth.

Table 2.2 Growth of M0[1]

1988–89	1989–90	1990–91	1991–92	1992–93
$7\frac{1}{2}$	1 to 5	0 to 4	0 to 4	−1 to 3

[1] 1988–89: forecast per cent change on previous financial year;
1989–90: target range for 12 month growth rate; 1990–91 onwards: illustrative ranges.

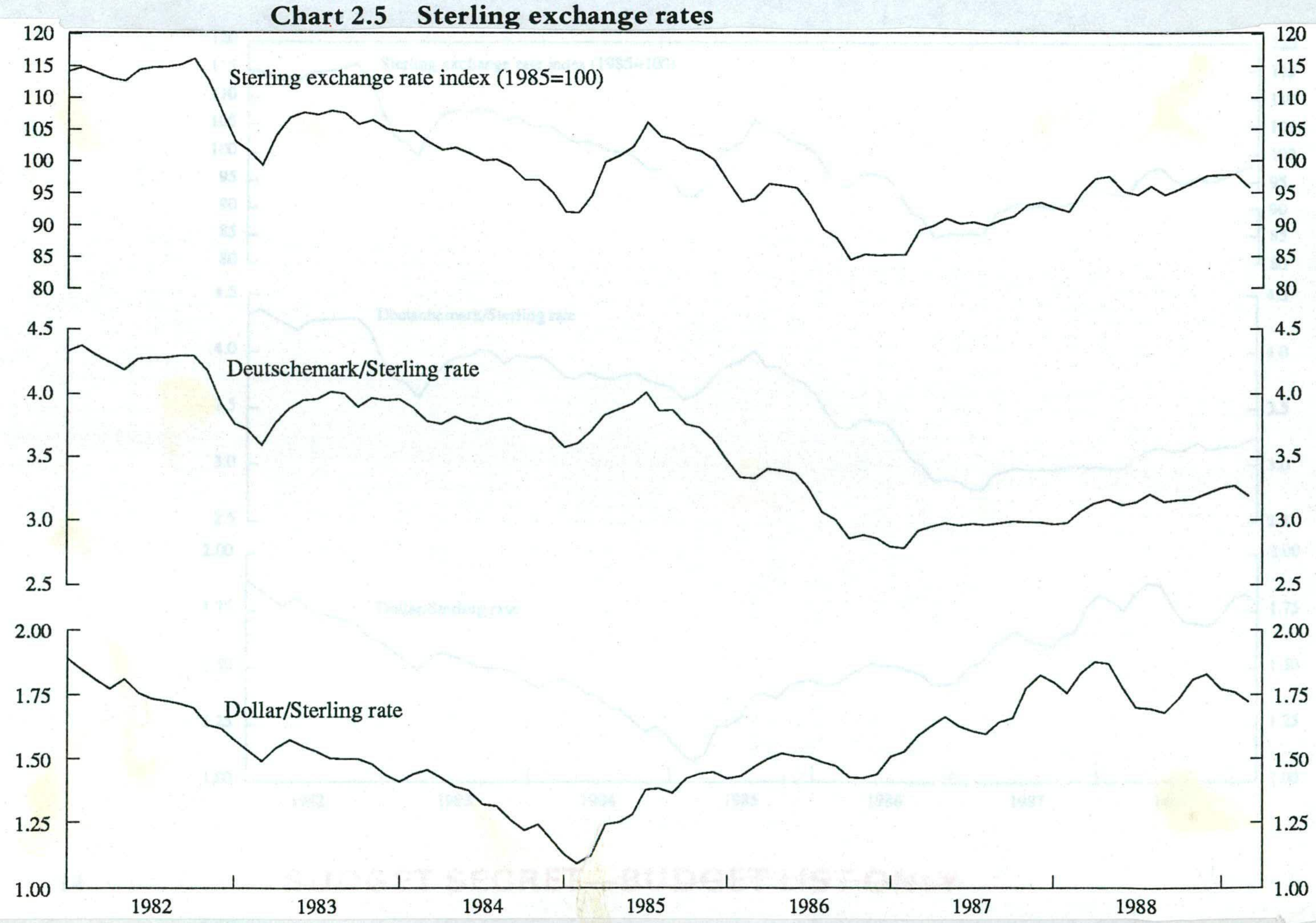
2.20 The exchange rate is a key influence upon, and a key indicator of, monetary conditions. It has to be considered together with all the evidence of domestic indicators in making monetary policy decisions. Monetary policy has the overriding task of defeating inflation: the Government is accordingly not prepared to accommodate increases in domestic costs by exchange rate depreciation. [Sterling has risen slightly against the deutschemark over the past year. The dollar has also risen against the deutschemark, though it has shown little change against the yen.]

(It is very staccato)

not necessary?

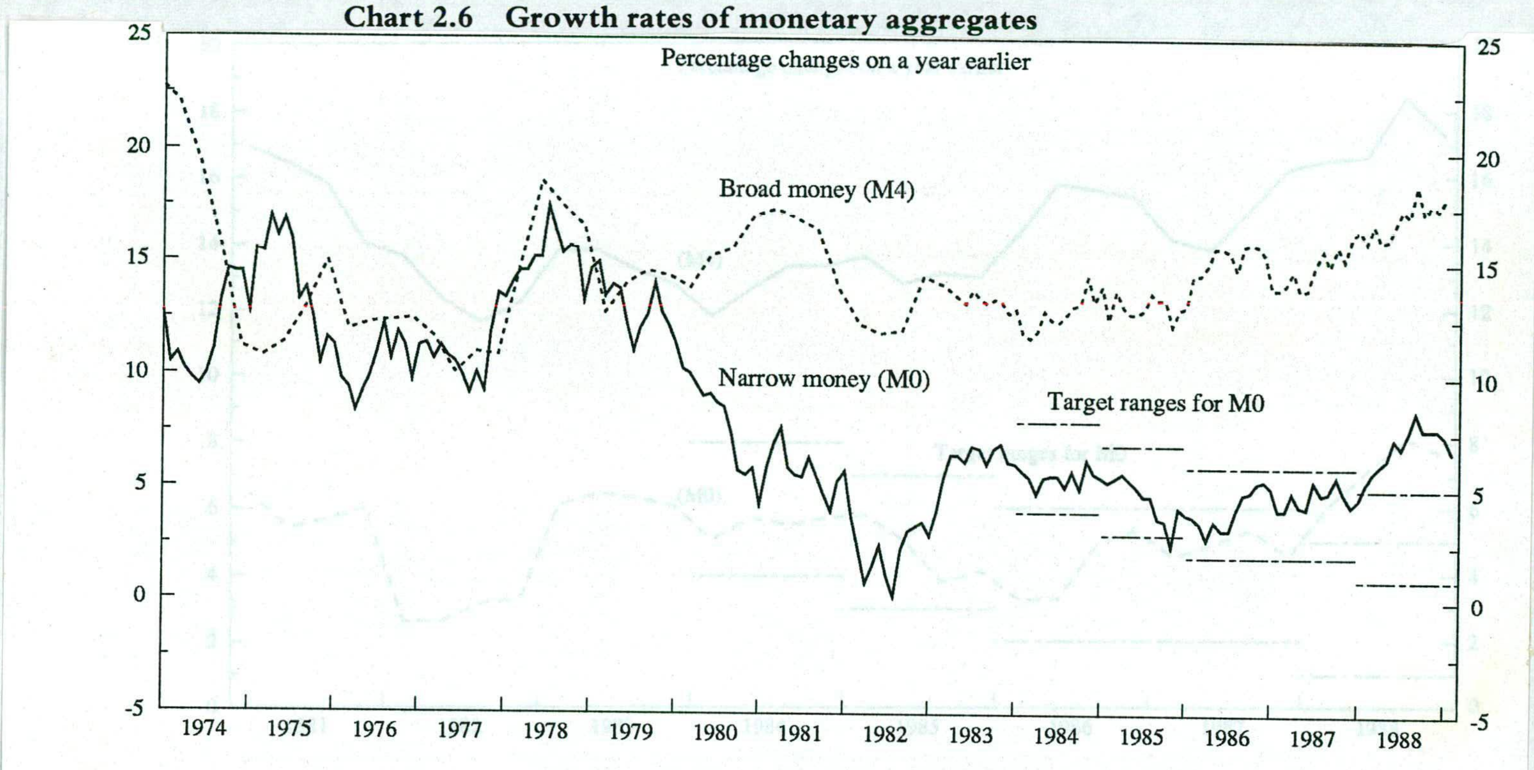
2.21 Exchange rates are also important in international economic relationships. The improved co-operation between the G7 countries, who share a common counter-inflationary objective, has been clearly beneficial to the international community.

Chart 2.5 Sterling exchange rates



2.22 In assessing monetary conditions, the interpretation of broad money, or liquidity, requires considerable judgment. There have been significant changes in the relationship between broad money and spending over the years. Because it is used as a store of value as well as for transactions purposes, what matters, so far as subsequent inflationary pressure is concerned, is not its growth rate alone but the extent to which people are prepared to hold interest-bearing money balances rather than to spend them.

Chart 2.6 Growth rates of monetary aggregates



Funding policy

2.23 The Government will continue to conduct its own financial affairs so as to have a broadly neutral impact on liquidity. That is embodied in the policy of funding the net total of maturing debt, the PSBR, and any underlying increase in the foreign exchange reserves, by sales of debt outside the banking and building society sectors. Should this total be negative, then 'unfunding' will be required; that is, the authorities will make purchases of debt. Gilts bought in by the Bank of England are normally held in its Issue Department. The Government is taking powers in this year's Finance Bill to enable the National Loans Fund to acquire these gilts for cancellation.

2.24 Now that the public sector is repaying the debt it is possible to devote more attention to the structure of the remaining debt, both to secure lower expected servicing costs and to improve the quality of debt by reducing reliance on borrowing in the form of liquid instruments. Attention will also be paid to smoothing the profile of redemptions. The reverse auction conducted in January 1989, the first of its kind, enabled the authorities to make substantial purchases of gilts maturing in 1989–90, a year when maturities will be particularly heavy.

(see also the Peretz note)

2.25 In general, however, the Government decides what types and maturity of debt to repurchase or issue, depending on current relativities and expected future yields. In 1988–89, the Government took the view that, on this criterion, its longer term debt looked relatively expensive borrowing.

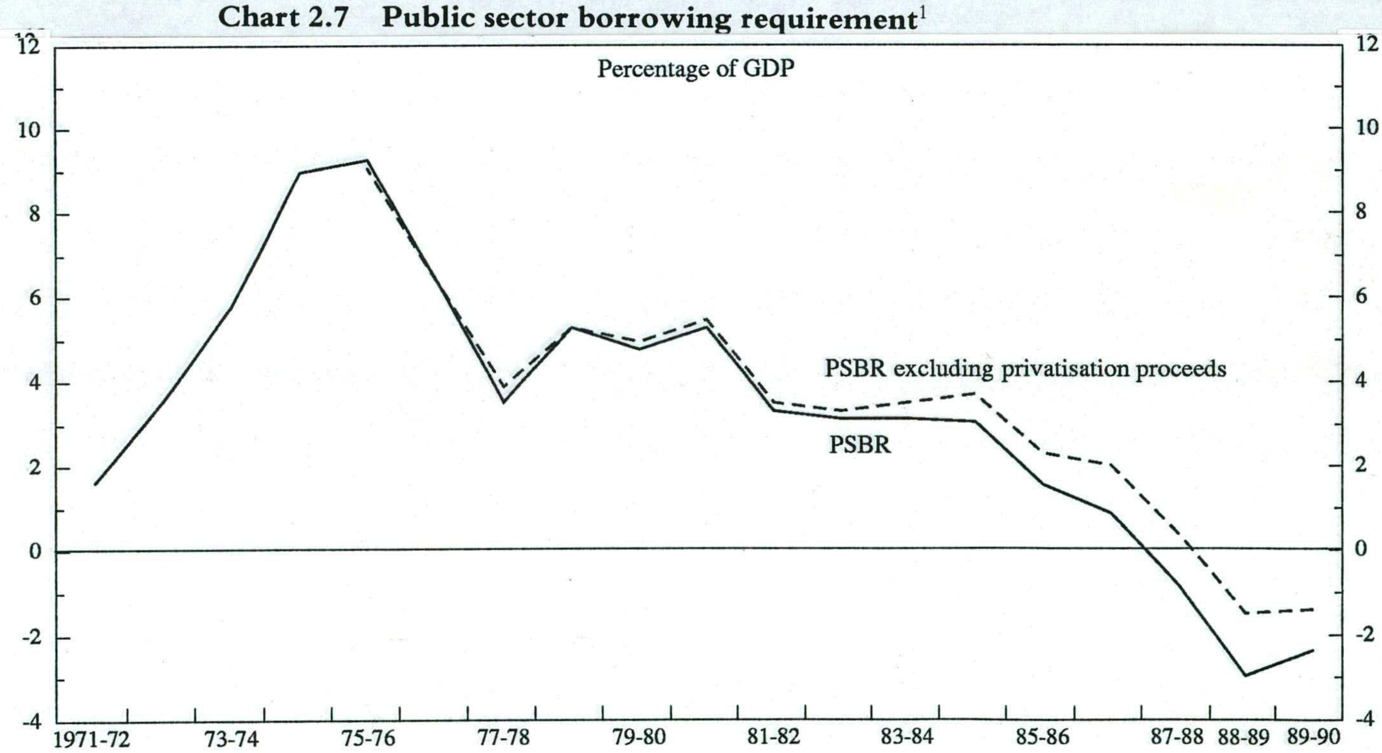
Accordingly, much of the buying-in of conventional gilts required by the full fund policy was of longer maturity issues, so as to secure greater future debt interest savings. The fact that the Government has been a net repurchaser of long term debt and the emergence of a downward sloping yield curve have created favourable conditions for longer term borrowing by the private sector. The increasing volume of fixed rate sterling borrowing by companies has been a welcome development.

2.26 Indexed debt has the advantage of reducing uncertainty, to both the Government and investors, about future real yields. In circumstances when the Government believes it will reduce inflation in a way that is not yet fully reflected in market yields, index-linked borrowing becomes particularly attractive to the Government as compared with conventional gilts. Net sales of indexed gilts continued in 1988–89, despite the reduction in total gilts outstanding, and about one eighth of all gilts outstanding are now in indexed form.

Fiscal policy

2.27 It is now expected that the net repayment of debt in 1988–89 will total about £[14] billion ([3] per cent of GDP), compared with a forecast in last year's Budget of £3 billion. Even allowing for the fact that privatisation proceeds are now expected to be some £2 billion higher than forecast a year ago, this means that the fiscal stance has been considerably tighter than planned, reflecting in large part the strength of economic activity which has both boosted tax revenues and depressed public expenditure.

Chart 2.7 Public sector borrowing requirement[1]



[1] *Negative values indicate a public sector debt repayment.*

clear

2.28 The long term objective of fiscal policy remains a balanced budget. This provides a ~~clean~~ and simple rule, with a good historical pedigree. It constitutes a firm buttress for monetary policy in the struggle against inflation, while enabling the burden of public debt, and with it debt interest, steadily to diminish as a proportion of the economy as a whole. And it means that as public expenditure declines as a share of GDP, so too can the burden of taxation.

2.29 The Government intends to move from the present surplus towards a balanced budget gradually over the medium term. The PSDR for 1989–90 has been set at £12 billion; this is equivalent to £7 billion net of privatisation proceeds, the same as in 1988–89. The projected PSDR path thereafter is shown in Table 2.7. As usual, the PSDR to be set in future Budgets will be reviewed in the light of circumstances at the time; [as tax rates are set on the basis of medium to longer term objectives the PSDR will tend to be increased by GDP growth above trend, and to be reduced by below trend GDP growth.]

Do we want/need this?

Public expenditure

2.30 The Government's objective for expenditure is to maintain a downward trend over the medium term in the ratio of general government expenditure to GDP. Firm control of public expenditure, coupled with the strength of economic activity has caused the ratio of GGE excluding privatisation proceeds to GDP to fall by 7 percentage points since 1982–83. This is the largest and most sustained fall since the immediate post-war period and it has brought the ratio back to levels not experienced since the mid 1960s. The Government is determined to build on this achievement.

X

Table 2.3 General government expenditure (excluding privatisation proceeds) as a per cent of money GDP[1]

1963–64	36¼	1973–74	42¾	1983–84	45¾
1964–65	35¾	1974–75	48¼	1984–85	46¼
1965–66	37¼	1975–76	48½	1985–86	44½
1966–67	38¾	1976–77	46	1986–87	43¾
1967–68	42¼	1977–78	42¾	1987–88	41½
1968–69	40¾	1978–79	43¼	1988–89	39½
1969–70	40¼	1979–80	43½	*1989–90*	*39¼*
1970–71	40¾	1980–81	46	*1990–91*	*39*
1971–72	41	1981–82	46½	*1991–92*	*38¾*
1972–73	41	1982–83	46¾	*1992–93*	*38*

better

[1] *1988–89: latest estimate; 1989–90: forecast; 1990-91 onwards: MTFS projections.*

Do you think italics work? (I don't)

I do!

2.31 Projections of government expenditure are shown in Table 2.4. For the period to 1991–92, they incorporate the public expenditure plans shown in the public expenditure White Paper (Cm 601–621); the projections of gross debt interest payments and other adjustments are consistent with the latest economic projections and assumptions. It is provisionally assumed that general government expenditure will grow by 1 per cent in real terms in 1992–93; decisions will be taken in the 1989 Survey.

Table 2.4 General government expenditure[1]

	£ billion, cash					
	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
Public expenditure planning total	145·7	150·6	167	179	192	200
Gross debt interest	17·7	18·~~3~~ 2	16½	15	14½	14
Other adjustments	8·3	10·~~0~~ 1	10	10½	9½	9½
General government expenditure[2]	**171·7**	**178·8**	**194**	**205**	**216**	**223**
Privatisation proceeds	5·1	7·0	5	5	5	5
General government expenditure excluding privatisation proceeds	**176·9**	**185·8**	**199**	**210**	**221**	**228**

[1] *For 1987–88 to 1991–92, the figures are taken from Table 5.1.*

[2] *General government expenditure, and its components, are rounded to the nearest £1 billion from 1989–90 onwards; except for debt interest and other adjustments which are rounded to the nearest £½ billion, as in Chapter 5. General government expenditure is assumed to grow by 1% in real terms in 1992–93.*

Revenue

2.32 The Government's objectives for taxation are to reduce tax rates and bring down the tax burden. Much progress has been made in reducing rates and reforming the structure of the tax system; and the tax burden has fallen from the peak of 1981–82. But the Government's success in bringing down the share of public expenditure has so far been reflected mainly in the emergence of a budget surplus. l.c. Moving back towards a balanced budget over the medium term should also enable continued public expenditure restraint to be reflected in a gradual fall in the tax burden.

also

Table 2.5 Non-oil taxes and national insurance contributions as a per cent of non-oil money GDP[1]

1963–64	29	1973–74	33¼	1983–84	37¾
1964–65	29½	1974–75	35¾	1984–85	37¾
1965–66	31¼	1975–76	35¼	1985–86	37
1966–67	32	1976–77	36	1986–87	37½
1967–68	33¼	1977–78	35	1987–88	37½
1968–69	35¼	1978–79	34¼	1988–89	37½
1969–70	36¾	1979–80	35½	*1989–90*	*37½*
1970–71	36¼	1980–81	36¼	*1990–91*	37 ~~*36½*~~
1971–72	34¾	1981–82	38¾	*1991–92*	*36½*
1972–73	32½	1982–83	38¼	*1992–93*	*35½*

(Ditto)

[1] *1988–89: latest estimate; 1989–90: forecast; 1990-91 MTFS onwards: MTFS projections.*

2.33 The growth in government revenues over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. Government revenues from the North Sea are projected to decline relative to money GDP as oil output falls. After taking account of the tax reductions announced in the Budget, non-North Sea revenues are also projected to grow at a little under the rate of growth of non-oil money GDP.

Table 2.6 General government receipts

	£ billion, cash					
	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
Taxes on incomes, expenditure and capital	133·2	144·~~8~~4	15~~6~~7	16~~5~~7	17~~3~~5	~~177~~ 181
National insurance and other contributions	29·0	32·~~8~~9	34	3~~6~~5	3~~8~~7	~~40~~ 39
Interest and dividends	6·1	6·~~9~~7	7	~~7~~·6	6	6
Other receipts	5·6	~~5·7~~ 6.5	~~7~~6	6	~~7~~6	~~7~~6
General government receipts [1]	**173·9**	**190·~~9~~5**	**204**	**214**	**224**	**23~~0~~2**
of which North Sea tax[2]	4·7	~~2·7~~ 3.2	3	~~2~~3	3	3

[1] *General government receipts, and its components, are rounded to the nearest £1 billion from 1989–90 onwards.*

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

Public sector borrowing

2.34 The projections of government expenditure receipts are brought together in Table 2.7 to provide projections of the general government borrowing requirement (GGBR), the PSBR and the fiscal adjustment.

2.35 Changes since the 1988 MTFS are discussed in the annex to this chapter.

Table 2.7 Public sector debt repayment[1]

	£ billion, cash					
	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
General government receipts	173·9	190·9	204	214	224	23~~0~~2
General government expenditure	171·8	178·8	194	205	216	223
Fiscal adjustment from previous years[2]	—	—	—	—	1	2
Annual fiscal adjustment[2]	—	—	—	1	1	~~2~~4
GGDR	**2·1**	**12**	**10**	**8**	**6**	**3**
Public corporations' market and overseas debt repayment	1·6	2	2	1	0	0
PSDR	**3·7**	**14**	**12**	**9**	**6**	**3**
Money GDP at market prices	426	47~~2~~5	5~~07~~11	54~~0~~2	57~~1~~3	60~~2~~3
PSDR as per cent of GDP	**0·9**	**3**	**2½**	**1¾**	**1**	½

[1] *Rounded to the nearest £1 billion from 1989–90 onwards. Further details for 1988–89 and 1989–90 are provided in Tables 1.2 and 6.9*

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

Conclusion

2.36 This tenth issue of the MTFS has reviewed the greatly improved economic record of the 1980s. It has reaffirmed the Government's commitment to reducing inflation and to the policy of lower taxes and lower public spending as a share of GDP. The MTFS provides the financial framework within which the policies to achieve the Government's objectives are set.

Annex to Chapter 2

Changes since the 1988 MTFS

Money GDP X

2A.1 The growth rate of money GDP is expected to be higher in both 1988–89 and 1989–90 than envisaged in last year's MTFS, with growth in the GDP deflator 2½ percentage points higher in 1988–89 and 1½ points higher in 1989–90. Inflation is projected to get back to last year's path by 1991–92. The projected trend in output growth over the medium term in the whole economy is ¼ percentage point higher than in last year's MTFS, reflecting a slower decline in oil output.

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

x x

Differences from 1988 MTFS projections, percentage points

1988–89	1989–90	1990–91	1991–92
+3~~¼~~ 1/2	+1~~½~~ 1/4	0	+½

Monetary aggregates

2A.2 M0 has moved above its target range during 1988–89 but it has been growing more slowly since the autumn. The target range for 1989–90 is the same as the illustrative range given last year. The illustrative ranges for subsequent years are also the same.

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

	Per cent changes on a year earlier			
	1988–89	1989–90	1990–91	1991–92
1989 MTFS	7½	1–5	0–4	0–4
1988 MTFS	1–5	1–5	0–4	0–4

Fiscal projections

2A.3 Table 2A.3 shows changes in the fiscal projections since the 1988 FSBR. Additional information on 1988–89 is given in Chapter 6.

Expenditure

2A.4 The undershoot on the planning total in 1988–89 is described in Chapter 5. The planning total for 1989–90 onwards is as in the public expenditure White Paper (Cm 601–621), which incorporates higher figures for 1990–91 and 1991–92 than assumed last year. The general government expenditure figures for the future have also been revised up since last year; but to a lesser extent in 1990–91 and 1991–92 than the planning total, as the path for PSDR now assumed implies lower debt interest payments.

Receipts

2A.5 Revenues in 1988–89 have been much higher than forecast, in large part reflecting higher money GDP growth in both 1987–88 and 1988–89. Because of some lag between the accruals and payments of taxes, the buoyancy of the economy over the last year will still be contributing to the growth of revenues in 1989–90. In spite of the effect of the Piper Alpha and other accidents on oil output, North Sea revenues in 1988–89 were almost exactly as forecast. The projections of North Sea revenues for later years are little changed from the 1988 MTFS.

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

	Changes from 1989 MTFS projections, £ billion				
	1987–88	1988–89	1989–90	1990–91	1991–92
Expenditure					
1 Planning total	−½	−6	0	+3½	+~~8~~7½
2 Other[2,5]	+½	+2	+~~1~~1½	0	−2
3 General government expenditure	**0**	**−4**	**+~~1~~1½**	**+3½**	**+~~6~~5½**
Receipts[3]					
4 North Sea taxes	0	0	0	0	0
5 Other taxes and contributions	+1	+~~5~~4½	+7½	+~~7~~8	+8½
6 Other[2]	−1	+1½	+1~~½~~	+1½	+1
7 General government receipts	**0**	**+6**	**+9** 8½	**+8** 9½	**+9**½
8 Implied cumulative fiscal adjustment[4]	—	—	−~~+~~3	−~~+1~~3	~~+2~~−1
9 Public corporations' market and overseas debt repayment[5]	+½	+1	+1	0	+1
10 PSDR	**+½**	**+11**	**+12**	**+9**	**+6**

[1] Rounded to the nearest £½ billion. Classification changes since the 1988 FSBR are included but their effects on both expenditure and receipts is small.
[2] Includes changes in debt interest and other items.
[3] The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set off.
[4] Line 8 = lines 9 − 10 − 3 + 7.
[5] Public corporations' market and overseas debt repayment is deducted from the planning total, and included in the PSDR, but not in general government expenditure. Changes in it are therefore added to line 2 and subtracted in line 9.

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Table 2.6 General government receipts

	£ billion, cash					
	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
Taxes on incomes, expenditure and capital	133·2	144·~~8~~4	15~~6~~7	16~~3~~7	17~~6~~5	1~~77~~81
National insurance and other contributions	29·0	32·~~8~~9	34	3~~6~~5	3~~8~~7	~~40~~ 39
Interest and dividends	6·1	6·~~9~~7	7	~~7~~·6	6	6
Other receipts	5·6	~~5·7~~ 6.5	~~7~~6	6	~~7~~6	~~7~~6
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of which North Sea tax[2]	4·7	~~2·7~~ 3.2	3	~~2~~3	3	3

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Annex to Chapter 2

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

Differences from 1988 MTFS projections, percentage points

1988–89	1989–90	1990–91	1991–92
+3½	+1¼	0	+½

Monetary aggregates

2A.2 M0 has moved above its target range during 1988–89 but it has been growing more slowly since the autumn. The target range for 1989–90 is the same as the illustrative range given last year. The illustrative ranges for subsequent years are also the same.

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

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Fiscal projections

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Expenditure

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Expenditure					
1 Planning total	−½	−6	0	+3½	+~~8~~7½
2 Other[2,5]	+½	+2	+~~1~~½	0	−2
3 General government expenditure	**0**	**−4**	+~~1~~½	+3½	+~~6~~5½
Receipts[3]					
4 North Sea taxes	0	0	0	0	0
5 Other taxes and contributions	+1	+~~5~~4½	+7½	+~~7~~8	+8½
6 Other[2]	−1	+1½	+1~~½~~	+1½	+1
7 General government receipts	**0**	**+6**	+~~9~~8½	+~~8~~9½	+9½
8 Implied cumulative fiscal adjustment[4]	—	—	−~~1~~3	−~~+1~~3	~~+2~~−1
9 Public corporations' market and overseas debt repayment[5]	+½	+1	+1	0	+1
10 PSDR	**+½**	**+11**	**+12**	**+9**	**+6**

[1] *Rounded to the nearest £½ billion. Classification changes since the 1988 FSBR are included but their effects on both expenditure and receipts is small.*
[2] *Includes changes in debt interest and other items.*
[3] *The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set off.*
[4] *Line 8 = lines 9 − 10 − 3 + 7.*
[5] *Public corporations' market and overseas debt repayment is deducted from the planning total, and included in the PSDR, but not in general government expenditure. Changes in it are therefore added to line 2 and subtracted in line 9.*

rjb/506

RESTRICTED
Covering BUDGET SECRET

COPY 1 OF 18 COPIES
FROM: MRS R J BUTLER
DATE: 8 March 1989

CHANCELLOR OF THE EXCHEQUER

cc PS/CST
PS/FST
PS/PMG
PS/EST
Sir P Middleton
Sir T Burns
Mr Anson
Mr Phillips
Mr Scholar
Mr Peretz
Mr Culpin
Mr Riley
Mr Sedgwick
Mrs Lomax
Mr S Davies
Miss Simpson

Cl
Looks OK.
AA

Ok.
Thanks.

1989 FSBR: CHAPTER 5

I attach a copy of the amended proofs of Chapter 5 of the FSBR which, pending final decisions, uses the estimated outturn figures for 1988-89 recommended to the Chief Secretary in Mr Richardson's minute of 6 March.

2. The text of paragraph 5.06 has been modified slightly in the light of the latest figures and comments from Departments on the descriptions for their programmes.

3. There will be further changes to the figures for GGE, GDP and the GDP deflator in the next day or so which will affect the last few lines of Table 5.01. The final figures will be incorporated into the proofs on Saturday.

4. The proofs have to be returned to the printers at noon tomorrow (Thursday) and this is the last opportunity for substantive amendment so I would be grateful for any further comments you may have by 10am tomorrow.

RJ Butler

MRS R J BUTLER

5 Public expenditure

5.01. The Government's expenditure plans for the next three years were set out in the 1988 Autumn Statement (HC 695) and in detail in the 1989 public expenditure White Paper (Cm 601–621). They are summarised in Table 5.1.

Changes since previous Budget

5.02. The planning total for 1989–90 remains unchanged from the level shown in the last FSBR; the planning total for 1990–91 has been increased by £3·3 billion. In both years, extra resources have been provided to meet the Government's priorities, including substantial additional sums for health, law and order, defence and roads. Provision for local authority current spending and the UK's net contribution to the European Communities is also higher.

Table 5.1 Public expenditure

	£ billion				
	1987–88 Outturn	1988–89 Estimated outturn	1989–90 Plans	1990–91 Plans	1991–92 Plans
Department					
Social security	46·3	47·4	51·0	55·3	58·7
Health	19·7	21·7	23·2	24·4	25·4
Defence	18·9	19·0	20·1	21·2	22·1
Education and science	17·1	18·4	19·6	20·2	20·8
Home Office and legal departments	6·5	7·2	8·0	8·4	8·6
Transport	4·6	4·8	5·4	5·5	5·7
Scotland	8·1	8·7	9·0	9·1	9·7
Wales	3·3	3·6	3·8	3·9	4·0
Northern Ireland	4·9	5·6	5·5	5·7	5·9
Other departments	21·~~4~~6	21·2	23·1	23·7	25·~~2~~3
Privatisation proceeds	−5·1	−7·0	−5·0	−5·0	−5·0
Reserve			3·5	7·0	10·5
Public expenditure planning total	**145·7**	**150·6**	**167·1**	**179·4**	**191·6**
General government gross debt interest[1]	17·7	18·~~3~~2	16·5	15	14½
Other adjustments[1]	8·3	~~9·9~~ 10·1	~~9·9~~ 10·1	10½	9½
General government expenditure	**171·7**	**178·8**	**193·5**	**205**	**216**
General government expenditure excluding privatisation proceeds:					
in real terms (base year 1987–88)[2]	176·9	173·5	176·3	179·6	183·2
as a percentage of GDP	**41½**	**39~~¼~~** ½	**39** ¼	**39**	**38~~½~~** ¾

[1] *1990–91 and 1991–92 figures rounded to nearest £½ billion.*

[2] *Using GDP deflator and money GDP on the same basis as in Table 2.1.*

looks OK.

BUDGET SECRET—BUDGET LIST ONLY

Public spending trends ½

5.03. General government spending, excluding privatisation proceeds, has fallen from $46\frac{3}{4}$ per cent of GDP in 1982–83 to [39] per cent in 1988–89. The expenditure plans to 1991–92 are consistent with the Government's policy of reducing the share of national income taken by total government spending. The move to Budget surplus has reduced the burden of debt interest, and the fall in unemployment has made savings possible in the social security, employment and training programmes. These savings, together with higher housing receipts and reduced agricultural market support have made room for increases in priority programmes within the declining trend of total expenditure relative to national income.

Budget consequences

5.04. The public expenditure cost of abolishing the earnings rule for state retirement pensioners (£190 million in 1989–90 and £375 million in 1990–91) will be charged to the Reserve, and will not add to planning totals. The public expenditure cost of extending VAT to non-residential construction and property development was incorporated in the plans set out in the 1988 public expenditure White Paper.

1988–89 outturn

5.05. The latest estimates for the outturn for the planning total in 1988–89, which are still subject to some uncertainty, suggest that it is likely to be £150·6 billion, £6·3 billion below the plans shown in the 1988 public expenditure White Paper and the 1988 Budget (of which £2 billion represents increased privatisation proceeds) and £2·8 billion below the outturn figure shown in the 1989 public expenditure White Paper. A breakdown is shown in Table 5.2.

Table 5.2 Comparison of plans and estimated outturn for 1988–89

	1988–89 £ billion		
	Plans[1]	Estimated outturn	Outturn minus plans
Central government[2]	114·3	114·4	+0·1
Local authority[2]	42·6	42·9	+0·3
of which:			
relevant expenditure	33·2	34·5	+1·2
other current	5·4	5·3	−0·1
capital	4·0	3·1	−0·9
Nationalised industries and other public corporations	1·4	0·3	−1·1
Privatisation proceeds	−5·0	−7·0	−2·0
Reserve	3·5		−3·5
Public expenditure planning total	**156·9**	**150·6**	**−6·3**

[1] *Plans from The Government's Expenditure Plans 1988–89 to 1990–91 (Cm 288), adjusted for classification changes.*

[2] *Excluding finance for nationalised industries and other public corporations.*

BUDGET SECRET—~~BUDGET LIST ONLY~~
0767

5.06. The major changes in 1988–89 between programme plans in the 1988 White Paper and the estimated outturn are:

central government: increases arising from ~~NHS~~ pay settlements for NHS Review Body groups (£0·9 billion), a capital grant of £0·~~4~~5 billion associated with the sale of Rover to BAe and finance for ~~the~~ an initial recapitalisation of Shorts Brothers prior to privatisation (£0·4 billion), are largely offset by reductions in social security expenditure (£1·0 billion) due ~~mainly~~ to the fall in unemployment; lower payments by the Intervention Board for Agricultural Produce (£0·4 billion) and lower expenditure on employment programmes (£0·4 billion);

local authorities: an overspend of £1·2 billion on planned current expenditure and a net underspend of £0·9 billion on capital expenditure, reflecting higher gross spending (£1·2 billion) offset by higher receipts (£2·1 billion);

nationalised industries and other public corporations: an underspend of £1·1 billion mainly by the electricity supply industry (£0·6 billion, reflecting latest information on timing of tax payments), British Steel (£0·3 billion due to higher profitability prior to privatisation) and British Rail (£0·3 billion, mainly due to buoyant passenger income).

Table 5.3 Public expenditure by spending authority

	£ billion 1987–88 Outturn	1988–89 Estimated outturn	1989–90 Plans	1990–91 Plans	1991–92 Plans
Central government[1]	109·4	114·4	123·7	131·2	136·9
of which:					
Voted in Estimates	76·9	80·9	86·9	92·2	96·4
other	32·5	33·5	36·8	39·0	40·5
Local authorities[1]	40·7	42·9	44·0	45·5	47·1
of which:					
relevant expenditure	32·0	34·5	35·2	36·5	37·5
other current	5·1	5·3	6·2	6·7	7·1
capital	3·6	3·1	2·6	2·4	2·5
Nationalised industries	0·3	−0·1	—	−0·4	1·0[2]
Other public corporations	0·5	0·5	0·9	1·0	1·1
Privatisation proceeds	−5·1	−7·0	−5·0	−5·0	−5·0
Reserve			3·5	7·0	10·5
Public expenditure planning total	**145·7**	**150·6**	**167·1**	**179·4**	**191·6**

[1] *Excluding finance for nationalised industries and other public corporations.*

[2] *The increase in 1991–92 refleacts the disappearance from the public expenditure figures, following privatisation, of the substantial negative external finance of the electricity industry.*

Public expenditure by spending authority

5.07. Central government spending makes up about three quarters of the planning total. About 70 per cent of this is voted by Parliament through the annual Supply Estimates and covers the expenditure of government departments for their own activities as well as their funding of other bodies such as the National Health Service. Most of the remainder consists of social security payments paid out of the National Insurance Fund. Spending by

BUDGET SECRET—~~BUDGET LIST ONLY~~

BUDGET SECRET—BUDGET LIST ONLY

local authorities accounts for about one quarter of public expenditure. Nationalised industries and other public corporations account for the remainder of the total. Table 5.3 gives outturn figures for the last two years and the plans as published in the public expenditure White Paper.

Supply Estimates **5.08**. For 1989–90, the plans set out in the public expenditure White Paper have now been translated, where appropriate, into detailed control totals in Supply Estimates. The total Estimates provision for 1989–90 for which the Government is seeking Parliamentary approval is shown in Table 5.4. The main Estimates for 1989–90 are published in a series of booklets on 14 March 1989 with a Summary and Guide (Cm 633) which summarises the Estimates and explains how they relate to the public expenditure planning total. It also describes the Supply procedure.

5.09. Of the £116·5 billion included in the Supply Estimates, £90·2 billion is direct public expenditure. The remaining £26·3 billion does not feature directly as public expenditure because it consists of grants to local authorities and finance for other bodies whose spending is counted as public expenditure. About 60 per cent ~~two thirds~~ of the money voted in Estimates is subject to cash limits, which provide the Government with greater control over its cash expenditure during the financial year.

Table 5.4 Supply expenditure

	£ billion			
	1987–88		1988–89	1989–90
	Expected outturn in 1987 Budget	Final outturn	Expected outturn	Provision
Main Supply Estimates	104·5	104·5	108·3	116·5
Supplementaries and net underspending	0·9	1·0	2·4	
Total Supply expenditure	**105·3**	**105·5**	**110·7**	
Public expenditure element	79·5	79·6	85·0	

chex.rm/aa1/54 **BUDGET CONFIDENTIAL**

FROM: A C S ALLAN
DATE: 2 March 1989

PS

MRS R BUTLER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Riley
Mr Sedgwick
Mr S J Davies
Mr McIntyre
Miss Simpson

1989 FSBR: CHAPTER 5

The Chancellor was grateful for your minute of 1 March. He had the following comments on the amended proofs of Chapter 5:

(i) He agreed with Mr Anson that the last sentence of paragraph 5.01 should be deleted.

(ii) He also agreed with Mr Anson that "(£x million in 1989-90)" should be added after "state retirement pensioners" in paragraph 5.04.

(iii) The manuscript addition to paragraph 5.06 should refer to "the electricity supply industry" rather than "electricity".

ACSA

A C S ALLAN

COPY NO 32 OF 34 COPIES

FROM: A C S ALLAN
DATE: 9 March 1989

MR RILEY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middlcton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Sedgwick
Mrs Butler
Mr S Davies
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Beighton - IR
Mr Isaac - IR
Mr Painter - IR
Mr Calder - IR

Mr Unwin - C&E
Mr Jefferson Smith - C&E
Mr P R H Allen - C&E

FSBR CHAPTER 1

The Chancellor was grateful for your minute of 8 March. He had the following comments.

(i) On excise duties, he would prefer the order in Table 1.1 to be

- Duty on unleaded petrol ...
- Vehicle Excise Duty rates ...
- Other duties unchanged.

He accepts that this will mean an increase in the figures for the cost of the unleaded petrol changes measured from an indexed base, and a reduction in the figure for the yield from the VED changes.

(ii) Given that the "other tax changes" had got as large as -£160 million in 1989-90, he wondered whether we ought to disaggregate Schedule E after all; but after further advice he accepted that the existing treatment can stand.

(iii) Amend paragraph 1.05 to read "...improvements to personal equity plans and employee share schemes, reform of the taxation of life assurance, changes to the taxation of pensions and unit trusts...".

A C S ALLAN

chex.rm/AA1/69 **RESTRICTED**

FROM: A C S ALLAN
DATE: 9 March 1989

PV

MR MOWL

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Sedgwick
Mr Riley
Mr Culpin
Mrs Lomax
Mr S J Davies
Mr Hibberd
Mrs R Butler
Mr Pickford
Mr Gieve
Mr Patterson
Mrs Wright
Mrs Todd
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Calder - IR
Mr Vernon - C&E

FSBR CHAPTER 6

The Chancellor was most grateful for your minute of 8 March. He has no further comments on the text. He would be interested in due course for any explanation you have about why the estimate of the level of non-North Sea profits in 1987 has been revised down so much.

ACSA

A C S ALLAN

fp.nh/docs/9.3.macp BUDGET SECRET COPY NO 1 of 7

FROM: N I MACPHERSON
DATE: 9 March 1989

Ch/ Chancellor yield from LA ind = £800-900m — so "£¼bn" means c. 30% incr. (H'ever, the %age might be a bit lower by the time the changes are mature ∴ the base will have increased.)

1. MR GILHOOLY
2. PS/CHANCELLOR

cc PS/Financial Secretary
Mr Culpin

Mr Calder - IR

FSBR: CHAPTER 4

The Chancellor raised a number of questions on the latest draft.

2. **Paragraph 4.02** and **notes 1 to 5** of the Annex. It is 'the higher **level of** age allowance' because 'higher age allowance' could be interpreted as the married couple's age allowance.

3. **Paragraph 4.11** the Revenue want 'in practice' inserted, since most employees are taxed on a receipts basis not by statute but simply because their accrued earnings are **in practice** equal to their receipts.

4. In Table 4.1, FSBR theology prevents stamp duty being added to the 'Income tax and corporation tax' category. For stamp duty to be allowed in, the LAPD measure would need to affect directly not only stamp duty but also income tax and corporation tax.

5. All the Chancellor's other comments have been taken on board.

6. The Chancellor may want to know that the long term yield by 'Life assurance - pension measures' has been changed from around £250 million to around £¼ billion. The Revenue felt the former implied too great a degree of accuracy.

Mick Macpherson

N I MACPHERSON

COPY NO 34 OF 34 COPIES

FROM: A C S ALLAN
DATE: 9 March 1989

Pg

MR RILEY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Sedgwick
Mrs Butler
Mr S Davies
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Beighton - IR
Mr Isaac - IR
Mr Painter - IR
Mr Calder - IR

Mr Unwin - C&E
Mr Jefferson Smith - C&E
Mr P R H Allen - C&E

FSBR CHAPTER 1

The Chancellor was grateful for your minute of 8 March. He had the following comments.

(i) On excise duties, he would prefer the order in Table 1.1 to be
- Duty on unleaded petrol ...
- Vehicle Excise Duty rates ...
- Other duties unchanged.

He accepts that this will mean an increase in the figures for the cost of the unleaded petrol changes measured from an indexed base, and a reduction in the figure for the yield from the VED changes.

(ii) Given that the "other tax changes" had got as large as -£160 million in 1989-90, he wondered whether we ought to disaggregate Schedule E after all; but after further advice he accepted that the existing treatment can stand.

(iii) Amend paragraph 1.05 to read "...improvements to personal equity plans and employee share schemes, reform of the taxation of life assurance, changes to the taxation of pensions and unit trusts...".

ACSA

A C S ALLAN

1.8c.x

CONFIDENTIAL

FROM: P N SEDGWICK
DATE: 9 MARCH 1989

CHANCELLOR

cc Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Monck
Mr Scholar
Mrs Lomax
Mr Peretz
Mr Riley
Mr S Davies
Mr Gieve
Mr Hibberd
Mr Melliss
Mr Mowl
Mr O'Donnell
Mr Pickford
Mr Bush
Mr Owen
Ms Simpson

Thanks: SH various ~~xxx~~ comments to be passed

FSBR CHAPTER 3 : IAF

I attach the latest printers' proof of chapter 3 of the FSBR. The latest numbers are shown in manuscript. (Versions of the charts that use the latest numbers have been superimposed on the printers' versions.)

2. A corrected version of the chapter has to reach the printers today. This is the last opportunity to make changes to the layout of the chapter - design and location of tables, charts, etc. I would be grateful for your comments as soon as possible.

The recorded numbers

3. Following the CSO's major revisions to the recorded data we no longer have adjusted national and sectoral accounts. The "box" has been transformed into a conventional FSBR annex - rather like the one in the Autumn Statement - that sets out the latest CSO data (which will not have been published by budget day) and how we are interpreting it.

4. Because there are still considerable inconsistencies in the CSO's numbers this version still has some features not in recent IAFs that we want to keep;

- the box with the health warning about the data, at the bottom of the summary page;

- a different format for certain tables, notably table 3.5 on the current account (which shows the balancing item - though see paragraph 8 below) and table 3.6 on investment;

SH my comment

- "compromise" GDP is the unweighted average of the three measures until 1987, and calculated by using the growth in GDP(O) in 1988.

5. As far as the third of these is concerned, the practice in past Treasury published forecasts (though not in the 1980s) has been not to use the unweighted average of the three measures on occasions when these have been of unequal reliability. Growth of the expenditure measure of GDP in 1988 still looks implausibly low, notwithstanding the large upward revisions that the CSO have found. The low growth of GDP(E) drags down the unweighted average of the three measures. Many outside forecasters have been using GDP(O) for 1988.

Charts and tables

6. The attached draft has the table with the exchange rate and cost competitiveness (table 3.2) as well as the long standing labour cost chart (chart 3.10).

Use version A (as amended)

7. I attach as well some charts showing RPI inflation (less MIPs) and consumer price inflation in the rest of the G7. Of these I prefer version A (which goes to 1989Q1 - the figure for which is only partly forecast - and which uses monthly data). There is, however, no obvious slot for such a chart in chapter 3.

Stick to existing chart (in text)

– RPI

8. I attach alternative versions of chart 3.9 starting in 1979 or 1980. Would you prefer either of these to the one beginning in 1982 (the starting date used for this chart in the Autumn Statement)? An earlier starting date with high rates of inflation shows the latest observation for total RPI inflation in a more favourable light. , but, because scale smaller, doesn't make cum & exc MIPs point as clearly.

~~Stick to one in text~~

9. We could revert to a more traditional form of table 3.5 (version attached), with all the components of the current account that we have shown in published forecasts as well as the balancing item for past years. More detail on the current account could make it a little easier to explain our forecast. OK, use ~~at~~ version ~~for~~ @ end

10. Which version of the productivity table would you like? I attach a copy of Jim Hibberd's minute of yesterday.

already decided

Money GDP and the GDP deflator

11. Now that we have final versions of the figures that we shall publish for 1988 it has been possible to finalise money GDP and the GDP deflator for financial years. The table below compares these with the Autumn Statement numbers.

	Money GDP		GDP deflator	
	AS	FSBR	AS	FSBR
1988-89	11	11	6¼	7¼
1989-90	8	8 (7¾)	5	5½

The very high growth of the GDP deflator in 1988-89 is in large part the effect of the fall in NS production which changes the composition of the total GDP deflator. We are paying the price this year for using a deflator rather than a fixed weight price index. As the CSO has "recorded" the GDP deflator for three of the four quarters of 1988-89 there is no way that we can avoid the high growth for the year as a whole.

The oil price

12. Because spot prices have been persistently high this year we are now using an average North Sea oil price of $16 rather than the $15½ we had been assuming. It was not possible to describe the latter as "close to recent levels". Many commentators will assume from this form of words that we have used an even higher price.. The effect on the published numbers is negligible.

P.N.S

P N SEDGWICK

3 The economy: recent developments and prospects to mid-1990

Revision OK

Summary

3.01 GDP is forecast to grow by around 2 1/2 per cent in 1989; this is below the average of recent years and comes after two years of above average growth. RPI inflation should fall to 5½ per cent by the end of the year.

Demand and activity

3.02 GDP is estimated to have risen by 4½ per cent; recorded domestic demand rose by 6½ per cent ~~in 1988~~, with investment rising by 12 per cent and consumption by 6½ per cent. Business investment is forecast to continue to grow strongly this year, and consumer spending to slow sharply. For 1989 as a whole total domestic demand is forecast to rise by 2½ per cent. GDP growth in 1989 is forecast at 2 1/2 per cent (~~2½~~ 3 per cent for non-oil GDP), ~~with a similar growth rate through the year.~~ with growth through the year at 2 per cent.

in 1988

Inflation

3.03 Retail prices rose by 6½ per cent in the year to the fourth quarter of 1988. RPI inflation is forecast to fall to 5½ per cent by the fourth quarter of this year and to 4½ per cent by the middle of 1990.

Labour market

3.04 Employment has risen sharply over the past year to an all time high, and unemployment fell by 530,000 in the year to January. Unemployment is most unlikely to continue ~~to fall~~ falling at the same rapid rate in 1989.

World economy

3.05 GNP growth in the main industrial economies was about 4 per cent last year; it is forecast to ease to 3 per cent in 1989. World trade in manufactures rose by 10 per cent in 1988, and is forecast to rise a further 8 per cent this year.

UK trade and current account

3.06 After a sluggish start in early 1988 export volumes of manufactures picked up quickly; in the second half of 1988 they were 5 per cent higher than a year earlier. Import volumes rose even more rapidly, boosted by strong domestic demand, especially business investment. The current account moved into large deficit in 1988; it is forecast to show a similar deficit in 1989 as in 1988, and to fall thereafter.

Assumptions

3.07 The forecast assumes that fiscal and monetary policy are operated within the framework of the Medium Term Financial Strategy. It assumes that North Sea oil prices and the exchange rate remain close to recent levels.

There have been major inconsistencies in the recorded national and sectoral accounts. For its assessment of recent developments the Treasury has used the latest CSO data, which incorporates some substantial revisions to previous published estimates. The annex to this chapter assesses the latest data. The CSO will publish a full set of national accounts on March 17.

3 The economy: recent developments and prospects to mid-1990

Summary

3.01 GDP is forecast to grow by around 2 per cent in 1989; this is below the average of recent years and comes after two years of above average growth. RPI inflation should fall to 5½ per cent by the end of the year.

in 1988

The latest CSO figures show

or omit altogether

– yes: governed by box @ graphs p.

Demand and activity **3.02** GDP is estimated to have risen by 4½ per cent; ~~recorded~~ domestic demand rose by 6½ per cent ~~in 1988,~~ with investment rising by 12 per cent and consumption by 6½ per cent. Business investment is forecast to continue to grow strongly this year, and consumer spending to slow sharply. For 1989 as a whole total domestic demand is forecast to rise by 2½ per cent. GDP growth in 1989 is forecast at 2 per cent (2½ per cent for non-oil GDP), with a similar growth rate through the year.

Inflation **3.03** Retail prices rose by 6½ per cent in the year to the fourth quarter of 1988. RPI inflation is forecast to fall to 5½ per cent by the fourth quarter of this year and to 4½ per cent by the middle of 1990.

but

Labour market **3.04** Employment has risen sharply over the past year to an all time high. ~~and~~ unemployment fell by 530,000 in the year to January, ~~Unemployment~~ is most unlikely to continue ~~to fall~~ at the same rapid rate in 1989.

falling

World economy **3.05** GNP growth in the main industrial economies was about 4 per cent last year; it is forecast to ease to 3 per cent in 1989. World trade in manufactures rose by 10 per cent in 1988, and is forecast to rise a further 8 per cent this year.

UK trade and current account **3.06** After a sluggish start in early 1988 export volumes of manufactures picked up quickly; in the second half of 1988 they were 5 per cent higher than a year earlier. Import volumes rose even more rapidly, boosted by strong domestic demand, especially business investment. The current account moved into large deficit in 1988; it is forecast to show a ~~similar~~ deficit ~~in~~ 1989 ~~as~~ in 1988, and to fall thereafter.

Similar to that

Assumptions **3.07** The forecast assumes that fiscal and monetary policy are operated within the framework of the Medium Term Financial Strategy. It assumes that North Sea oil prices and the exchange rate remain close to recent levels.

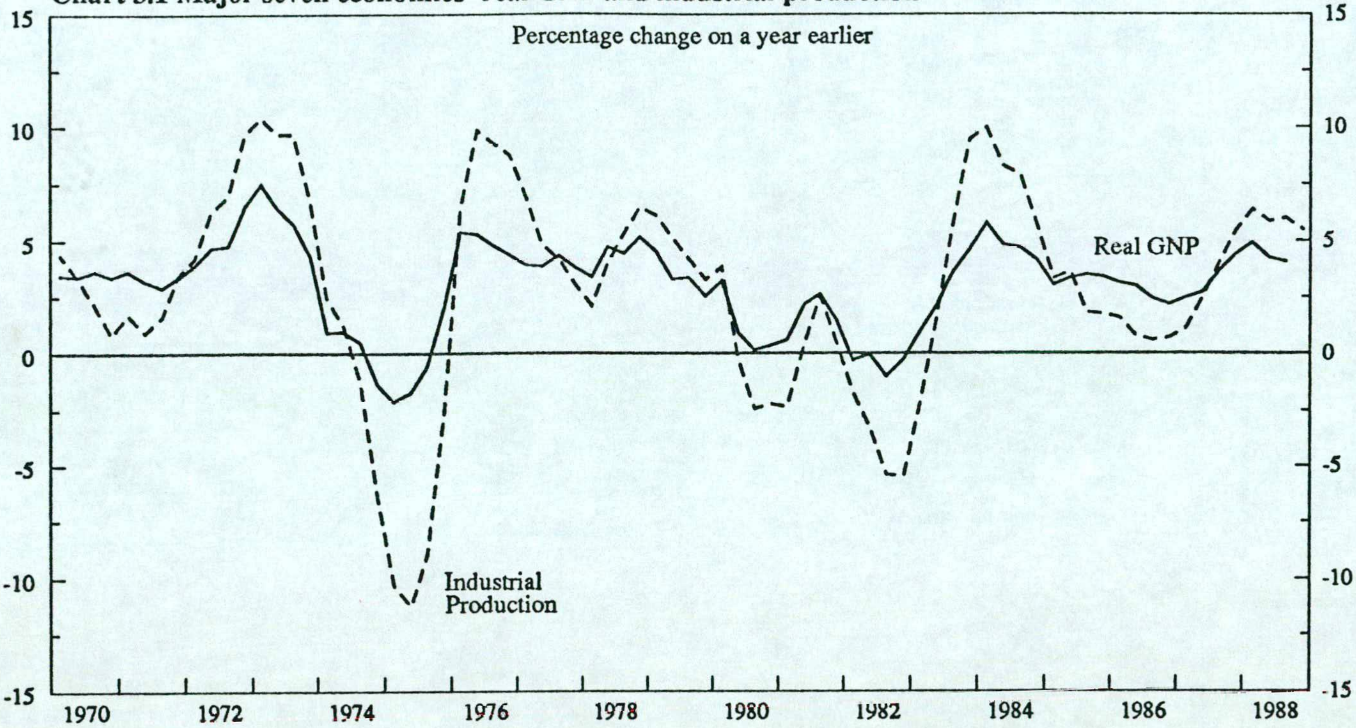
> *There have been major inconsistencies in the recorded national and sectoral accounts. For its assessment of recent developments the Treasury has used the latest CSO data, which incorporate some substantial revisions to previous published estimates. The annex to this chapter assesses the latest data. The CSO will publish a full set of national accounts on March 17.*

World economy

Recent developments

3.08 Real GNP in the major seven economies is estimated to have grown by 4¼ per cent in 1988, compared with 3¼ per cent in the previous year and an average growth of 3½ per cent a year from 1982 to 1987. Domestic demand grew at about the same rate as GNP in 1988. Growth was particularly strong in Japan and the US in the first half of the year.

Chart 3.1 Major seven economies' real GNP and industrial production



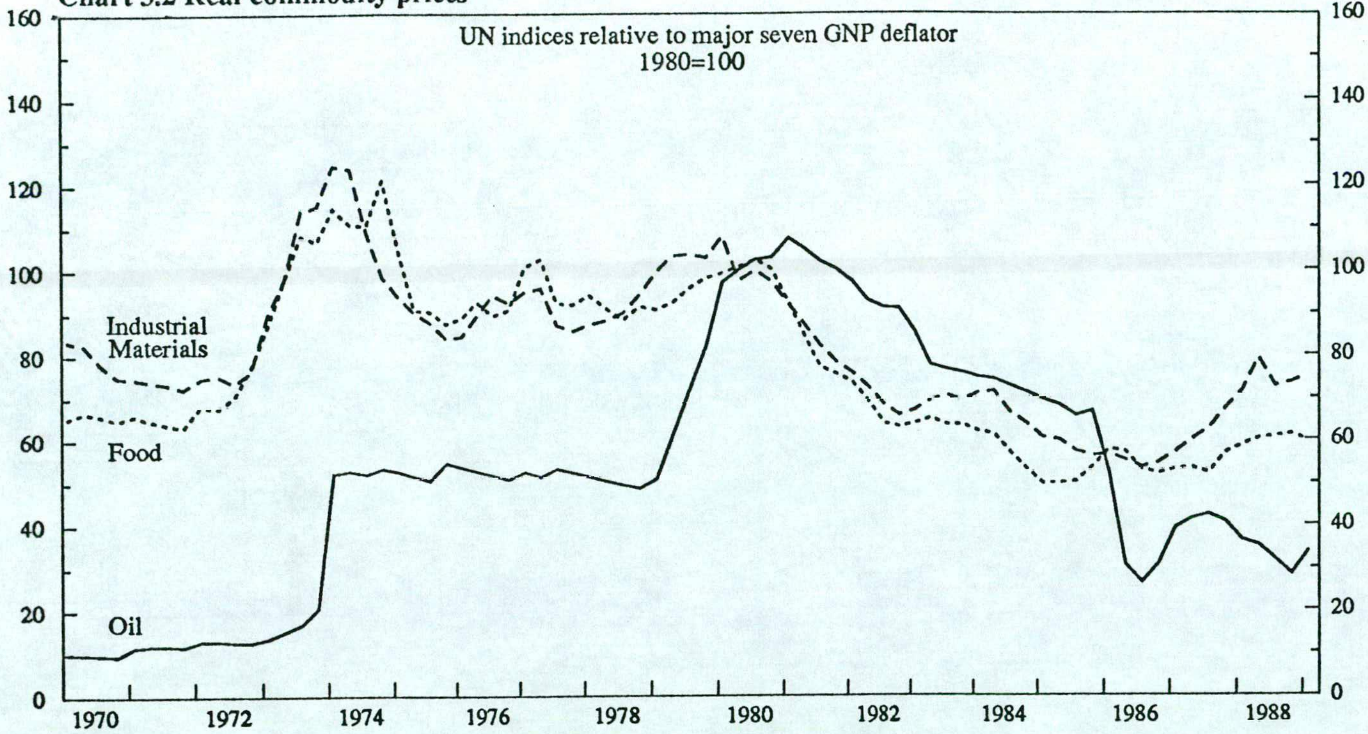
3.09 Business investment grew rapidly in all the major seven countries in 1988 (averaging almost 12 per cent); and export growth was also strong (~~almost 10~~ over 9 per cent). Investment was boosted by rising profitability, increased capacity utilisation and high levels of business confidence. Growth in private consumption was about 3½ per cent, little changed on 1987.

3.10 World trade in manufactures was boosted by high investment, and probably grew by around 10 per cent, the fastest annual growth rate since 1984.

3.11 Capacity utilisation in manufacturing rose strongly in 1988, to levels at or above the previous peaks reached in 1979 and 1980. Unemployment fell significantly in North America and the UK.

3.12 Non-oil commodity prices, particularly of industrial materials and metals, rose sharply in the first half of 1988. After significant falls from the mid-year peak they have risen again in recent months. Oil prices drifted downward for much of 1988, but have firmed since November.

Chart 3.2 Real commodity prices



3.13 In the fourth quarter of 1988 consumer price inflation averaged 3½ per cent in the major industrial countries, only ¼ per cent higher than a year earlier. But there have been some recent indications of increased inflationary pressures. Interest rates have risen in all major seven economies except Japan since the spring of last year. For major countries as a whole the average increase was about 2 percentage points.

3.14 Continued progress in reducing current account imbalances was made in early 1988, with significant reductions in both the US deficit and Japanese surplus. But little or no further progress was made in the second half of the year.

Forecast

3.15 Table 3.1 shows the forecast for activity and inflation in the major seven countries, and for world trade.

Table 3.1 World economy

	Percentage changes on previous year			
	Forecasts			
	1987	1988	1989	1990 H1
Major seven countries[1]				
Real GNP	3¼	4¼	3	2½
Real domestic demand	3¾	4½	3¼	2½
Industrial production	3¼	6	4~~½~~¼	2½
Consumer prices	3	3¼	4~~¼~~	3~~½~~¾
World trade, at constant prices				
Total imports	5½	8½	6~~¼~~	5
Trade in manufactures	7¾	10	8	5¾

Footnote to Table 3.1
1 US, Japan, Germany, France, UK, Italy and Canada

3.16 GNP growth is expected to slow through 1989 as the investment cycle passes its peak and as the effects of tighter monetary policy work through. The forecast growth of 3 per cent is close to estimates of productive potential. The slowdown is expected to be more marked in North America than in Continental Europe.

3.17 Growth of world trade in manufactures is expected to slow to about 5¾ per cent by mid 1990, still above the trend rate for the period 1973 to 1987.

3.18 The forecast slowdown in world economic growth suggests that recent commodity price inflation should abate; commodity prices are forecast to remain constant in real terms. With world demand slowing, consumer price inflation in the major seven economies is forecast to fall back to about 3~~½~~ per cent by mid-1990. 3/4

3.19 Little further progress is expected in reducing the current account imbalances in nominal terms in 1989.

UK trade and the balance of payments

Relative costs and prices

3.20 UK manufacturing unit labour costs rose slightly faster in 1988 than in 1987; productivity growth did not fully offset a continuing high level of pay increases. Unit labour costs in the other major countries grew on average at a similar rate to the UK, although sterling's appreciation resulted in a rise in the UK's relative unit labour costs. But cost competitiveness still remains more favourable than in 1985, before the fall in world oil prices. The maintenance of competitiveness in the year ahead will depend on success in ~~continuing to~~ restrain ing unit cost increases.

Table 3.2 The exchange rate and cost competitiveness

	Sterling index (1985 = 100)	Relative unit labour costs (1985 = 100)
1985 Q4	101·4	104·0
1986 Q4	85·1	83·2
1987 Q4	92·7	93·~~5~~6
1988 Q4	96·7	98·4

Trade volumes (goods other than oil)

3.21 After erratically low figures in the first quarter of 1988, the volume of UK manufactured exports has since risen strongly as world trade has continued to expand. In the second half of 1988 the volume of exports of manufactures was 5 per cent higher than a year earlier. Manufactured export volumes are forecast to rise by 7½ per cent in 1989, close to the projected growth of world trade. A slightly faster rate of growth is forecast for non-manufactured exports.

Table 3.3 Visible trade

	Percentage ~~Per cent~~ changes on previous year					
	All goods			Goods less oil		
	Export volume	Import volume	Terms of trade[1]	Export volume	Import volume	Terms of trade[1]
1987	5	7	1	6½	8	1
1988	-½	13	2	3	14½	2½
1989 Forecast	5½	5½	1½	7½	~~5~~ 4½	-½

[1] *Ratio of export average values to import average values.*

3.22 Non-oil imports rose much faster than exports, by 14½ per cent in 1988, reflecting the strength of domestic demand and capacity shortages in some industries. Imports of capital and intermediate goods rose fastest; the increase ~~on~~ in the growth of imports of consumer goods in 1988 was entirely attributable to passenger cars. Further high investment (which is import intensive) is likely to sustain continued high levels of capital goods imports in 1989. Nonetheless the slow-down in overall domestic demand and the extra capacity available from the current investment boom means that import growth may slow significantly in 1989, to 5 per cent.

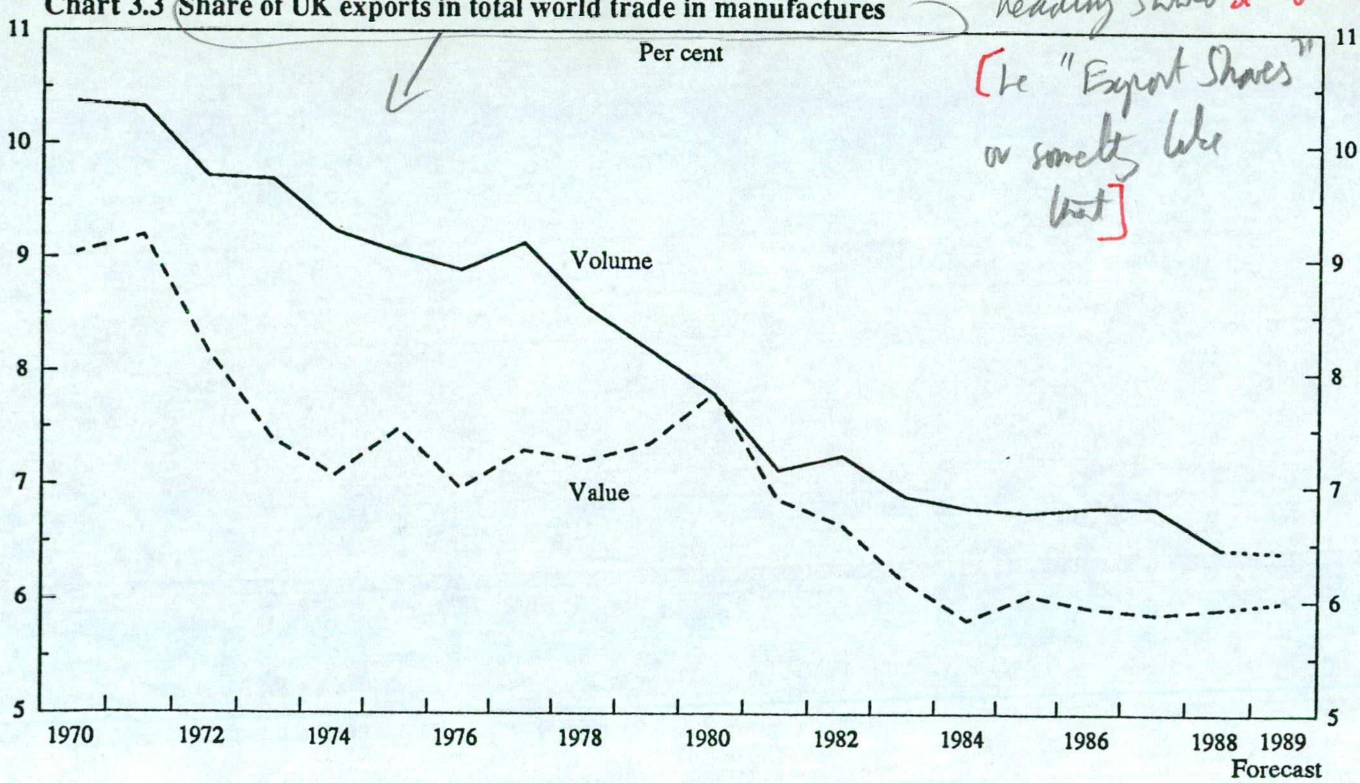
Table 3.4 ~~Percentage~~ Growth of import volumes by category of manufactured goods

Style as per previous table (3.3)

Percentage changes	1986	1987	1988
Consumer goods	9	7	17
Capital goods	−1	10½	22
Intermediate goods	9	13	23
Semi-manufactured goods	6	10	12

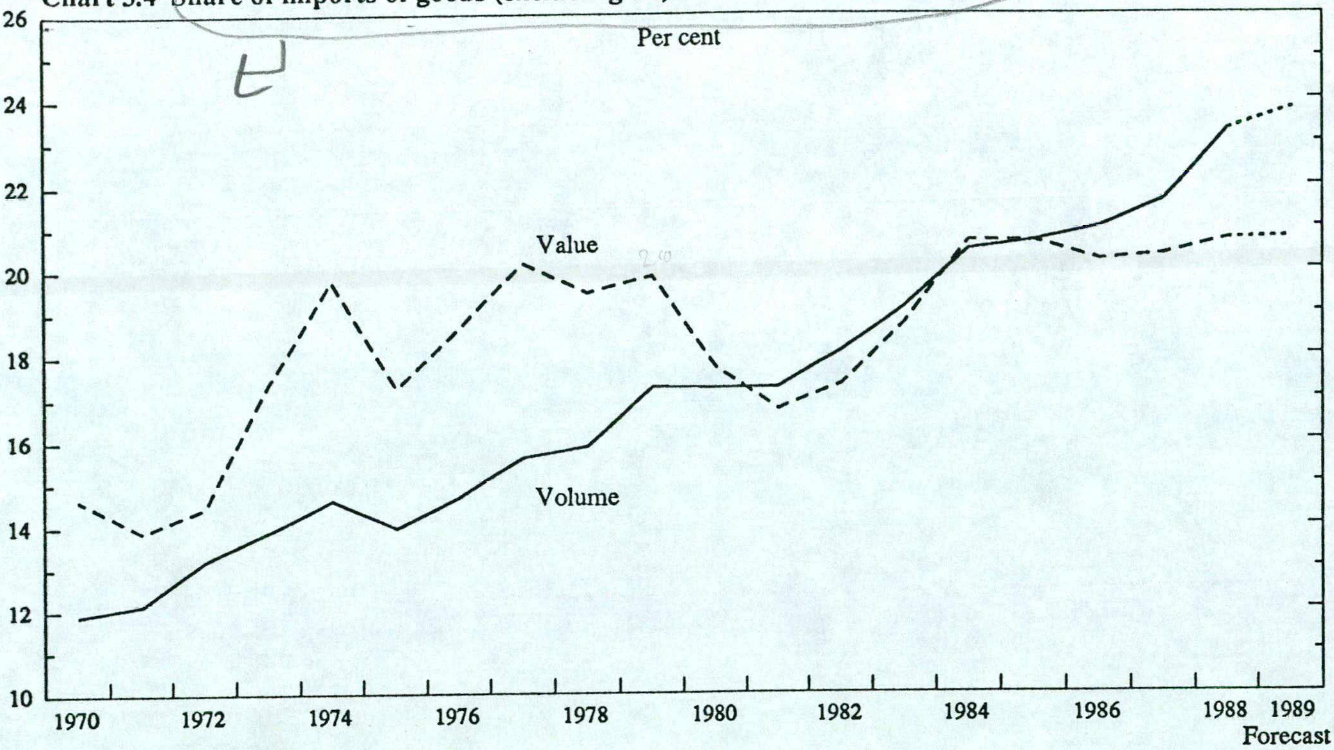
Chart 3.3 Share of UK exports in total world trade in manufactures

heading should be "UK share of trade" [i.e "Export Shares" or something like that]



"Import penetration"

Chart 3.4 Share of imports of goods (excluding oil) in total domestic demand



Oil trade 3.23 The oil trade surplus fell by just under £2 billion in 1988 to £2½ billion. This was a result of lower sterling oil prices, a decline in production (mainly due to the Piper Alpha disaster) and increased domestic demand for oil. The temporary shutdowns in the Brent and Fulmar fields are expected to contribute to a further fall in production in 1989. Production is forecast to rise a little from mid-1989 as output recovers from the effects of the accidents. The oil trade surplus is forecast to fall again in 1989 to £2 billion, mainly as a result of the fall in production in the first half of the year.

higher net receipts of interest, profits and dividends.

Trade prices and the terms of trade 3.24 The terms of trade have improved somewhat over the past year, with the higher exchange rate more than offsetting the effects of falling oil prices. No significant change is forecast in the non-oil terms of trade this year, although the oil terms of trade may improve considerably, since the temporary shortage of North Sea quality crude, following the various accidents, is likely to raise its premium over other crudes.

[Statistics never say what the balancing item is.]

Invisibles 3.25 The surplus on invisibles is provisionally estimated to have fallen by £1½ billion to £6 billion in 1988. This was mainly due to a decline in the surplus ~~in~~ on services, offset in part by ~~a lower IPD balance~~ higher. The invisibles surplus is forecast to be £7½ billion in 1989 as improvements in the services and IPD balances are projected to be only partially offset by increased net transfers overseas, largely the result of higher net contributions to the European Community Budget.

OR SOME SUCH — may be ~~exaggerated~~ artificially inflated to some extent,

Current account 3.26 The current account is estimated to have been in deficit by £14½ billion in 1988. However, the estimate ~~of the current account deficit in 1988 are~~ is ~~subject to unusually wide margins of error~~ given the ~~unprecedented size~~ magnitude of the balancing item. The deterioration relative to the forecast in last year's FSBR was mainly due to the unexpected strength of domestic demand, particularly investment demand, combined with very high levels of capacity utilisation in some industries.

(is it? it's not so big in previous 2 years as well)

(This table OK?) Alternative version better

Table 3.5 Current account

£ billion

	Visibles	Invisibles	Current balance	Balancing item
1987	−10	7½	−3	12½
1988	−20½	6	14½	15
1989 forecast	−21½	7	−14½	

Need to make clear that the ~~understatement~~ exaggeration of the 1988 ct balance is projected forward, in the work, to 1989. (i.e. ~~that~~ our low forecast −14½ so much the same as 1988)

3.27 Though the current account deficit is expected in due course to fall from recent levels with the slow-down in growth of domestic demand, the projected deficit for 1989 as a whole is forecast to be unchanged.

Demand and Activity

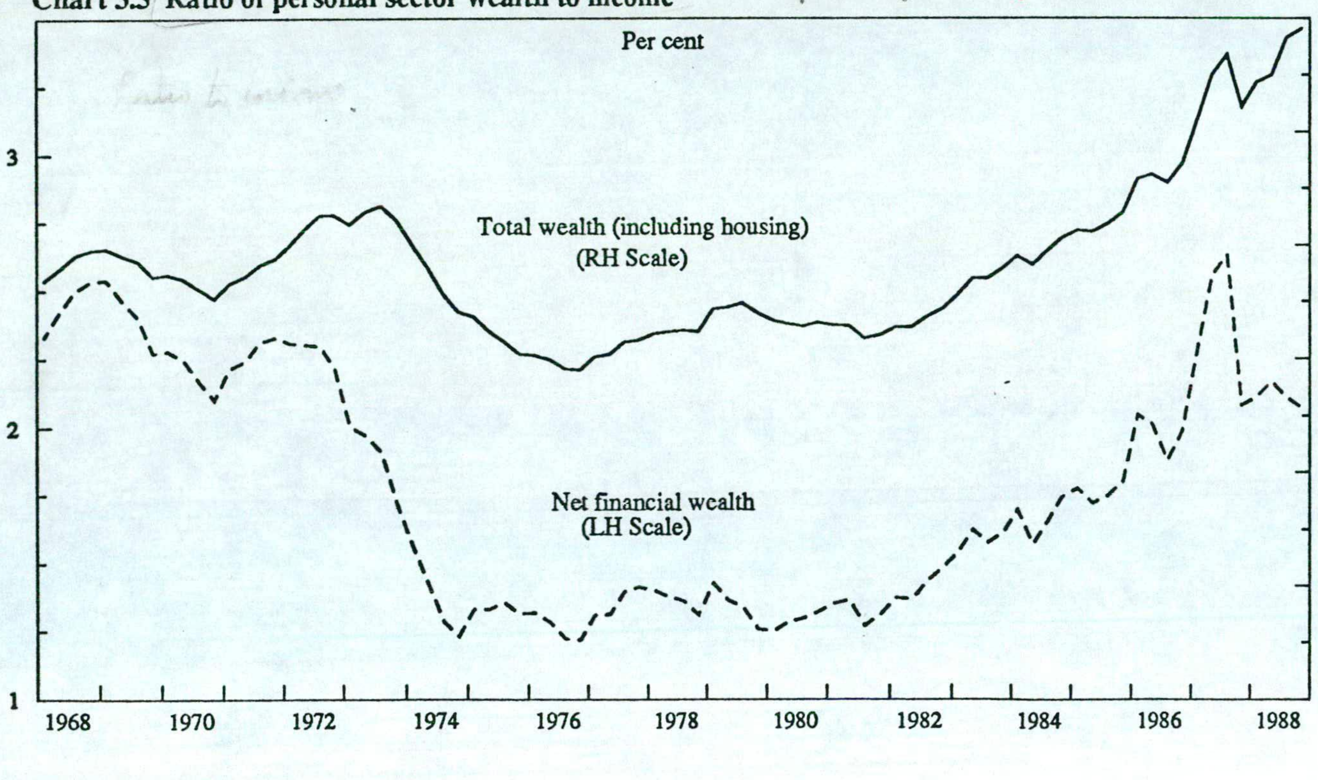
CSOs probably OK here?

3.28 The economy probably grew by 4½ per cent in 1988. Growth was strong throughout the non-oil economy; manufacturing output rose by 7 per cent, construction output by 8 per cent and output of the service industries by 5 per cent. Problems with recent estimates of the expenditure measure of GDP mean that recorded growth in domestic demand in 1988 may, at 6½ per cent, be ~~understated~~ an underestimate.

Personal sector expenditure

3.29 Consumer spending is estimated to have risen by 6½ per cent in 1988, a little faster than in 1987. With growth in real personal disposable income at 4 per cent in 1988, the personal saving ratio once again fell. The fall in the personal sector saving ratio in recent years is due to a number of factors. First, there has undoubtedly been greater consumer confidence as a result of sustained growth, falling unemployment and rising wealth. Second, greater wealth itself (especially housing wealth) has led to a perceived need for lower savings relative to income. Finally, financial deregulation and innovation has led to greater competition in credit markets, enabling people to borrow more relative to income.

Chart 3.5 Ratio of personal sector wealth to income ← probably OK.



3.30 Consumer spending is forecast to rise much more slowly this year than last, growing by 2 per cent between the second half of 1988 and the second half of 1989. The slowdown in retail spending growth at the end of 1988 and the fall in retail sales volumes in January indicate that personal spending is already moderating. The personal sector is now a net payer of interest. Higher interest rates are therefore likely to reduce new borrowing and increase savings. The personal sector savings ratio is forecast to recover slowly.

3.31 The housing market was particularly buoyant in the first half of 1988. But there are now clear signs that it is easing. Building society mortgage lending commitments have fallen markedly from the high levels of last summer, and there is increasing evidence that house prices in the South East have stopped rising ~~(and may be even falling in some areas)~~. House price inflation is likely to be very low through 1989, and total private housing investment is expected to decline.

Company expenditure and incomes

3.32 Business investment rose sharply in 1988, by ~~12~~ 14½ per cent. A strong surge in investment is consistent with expectations outlined in CBI Surveys and DTI Investment Intentions Surveys. The same surveys point to further strong growth in 1989. Over the past [5] years total business investment has grown over twice as fast as total consumption. X

Table 3.6 **Gross fixed domestic capital formation**

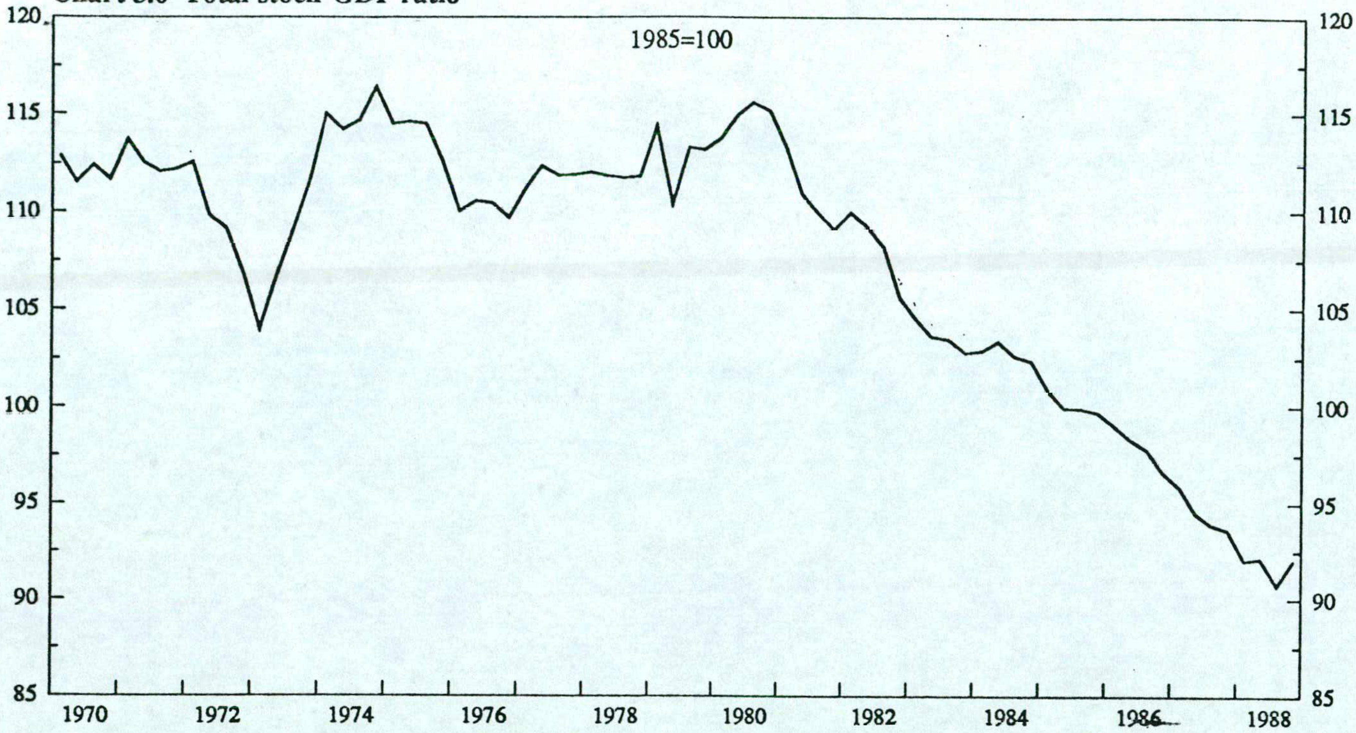
	Weights in 1987	Percentage changes on previous year 1988	Forecast 1989	
Business[1,3]	6~~5~~6	14~~1~~½	~~9~~8	xxx
Private dwellings etc[2]	2~~7~~1	~~[13]~~ 11	~~[−9]~~ −5½	
General government[3]	13	~~3~~ 1	~~[−4]~~ 3	
Total fixed investment	**100**	**12¼**	~~5~~ 4½	

[1]*includes investment by public corporations;*
[2]*including total transfer costs of land and existing buildings;*
[3]*excludes purchases less sales of land and existing buildings.*

(or 'higher')

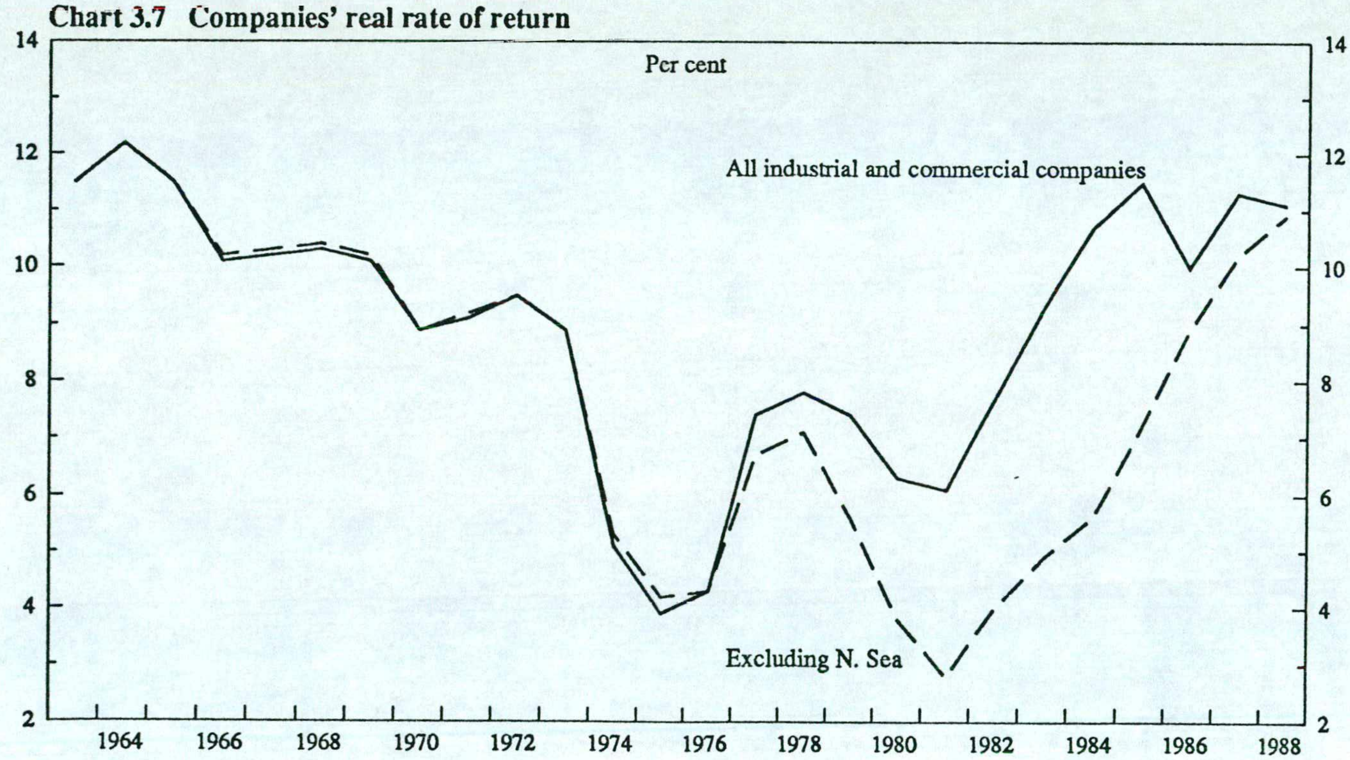
3.33 Stockbuilding is estimated to have been ~~more buoyant~~ greater in the second half of 1988 than in the first half. But it is likely to be lower in 1989, with some destocking in the second half, as the growth of domestic demand slows down. [The long run downward trend in the total stocks–GDP ratio is expected to continue.]

Chart 3.6 Total stock-GDP ratio



3.34 Non-North Sea industrial and commercial company sector profits are estimated to have risen by about 20 per cent in 1988; since 1984 profits (net of stock appreciation) have risen on average by 22 per cent a year. Manufacturing profit margins rose particularly strongly. In 1988, the rate of return of non-North Sea industrial and commercial companies rose for the seventh successive year.

Chart 3.7 Companies' real rate of return



Saving~~s~~ and investment

3.35 Table 3.7 shows that, as a share of GDP, total saving~~s~~ ~~have~~ has remained unchanged since 1986, with rising company and public sector saving~~s~~ offsetting falling personal sector saving~~s~~.

ought to be 1st yr of table

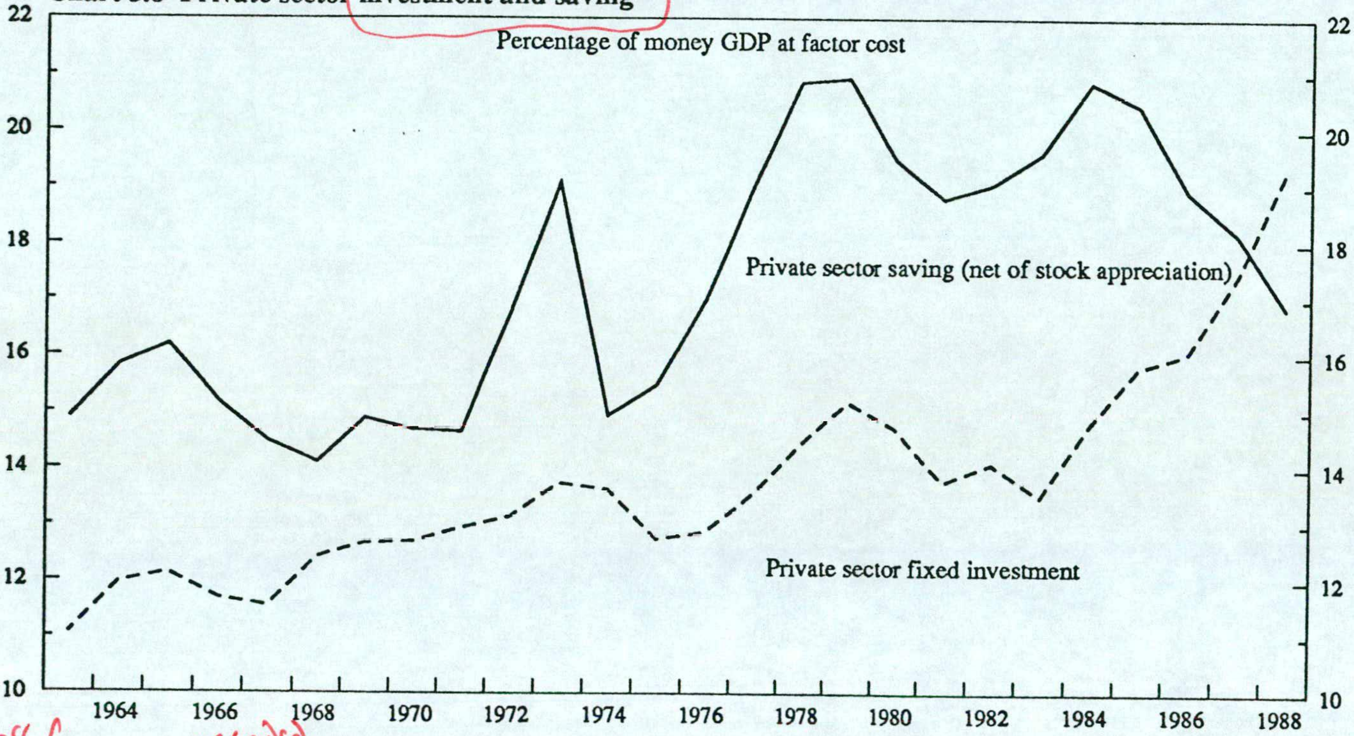
Table 3.7 Saving

~~(~~per cent~~age~~ of GDP at factor cost~~)~~

	Personal sector	Company sector	Total private	Public sector	Total national
1985	7·5	~~13·0~~ 12·9	20·4	1·0	21·4
1986	~~6·1~~ 5·6	~~13·0~~ 13·7	~~19·1~~ 19·3	~~1·2~~ 1·3	~~20·3~~ 20·6
1987	~~4·1~~ 3·6	~~14·5~~ 15·1	~~18·6~~ 18·8	~~1·6~~ 1·7	~~20·2~~ 20·4
1988	~~2·5~~ 1·6	~~14·4~~ 15·3	16·9	~~3·5~~ 3·6	~~20·4~~ 20·5

3.36 The fall in private sector saving~~s~~ since 1984 has come at the same time as a steep rise in private sector investment. The result has been an increased call on overseas savings and hence a current account deficit.

Chart 3.8 Private sector investment and saving



Prospects for demand and activity

cf 3.28

3.37 Growth of domestic demand is forecast to fall sharply from a~~n~~ ~~estimated~~ $6\frac{1}{2}$ per cent in 1988 to $2\frac{1}{2}$ per cent in 1989, because of the slowdown in consumption ~~and investment growth~~ and ~~lower stockbuilding~~ some destocking. xx
Domestic demand is forecast to rise by only 1½ per cent between the second halves of 1988 and 1989, with GDP rising by 2 per cent in 1989, and 2 per cent between the second half of 1988 and the second half of 1989. Declining North Sea production and the temporary effects of recent accidents may reduce GDP growth by $\frac{1}{2}$ per cent in 1989, but the recovery from these accidents is forecast to produce higher growth of total GDP than non-North Sea GDP in the year to the first half of 1990. Manufacturing output is forecast to grow slightly less ~~fast~~ than non-oil GDP through 1989, following ~~(~~two years~~)~~ of very rapid growth in ~~(~~1987 and 1988~~)~~. xxxx

Table 3.8 Domestic demand and GDP

	Percentage changes on a year earlier		
		Forecast	
	1988	1989	1990 H1
Domestic demand	6½	2½	1½
Exports of goods and services[1]	−1 (1½)	4½ (6)	7 ~~6½ (6½)~~ 7
Imports of goods and services[1]	12 (13)	4½ (3½)	3 ~~2½ (2½)~~ 3
GDP[1,2]	4½ (5)	2 (2½)	2½ (2)
Manufacturing production	7	3½	1½

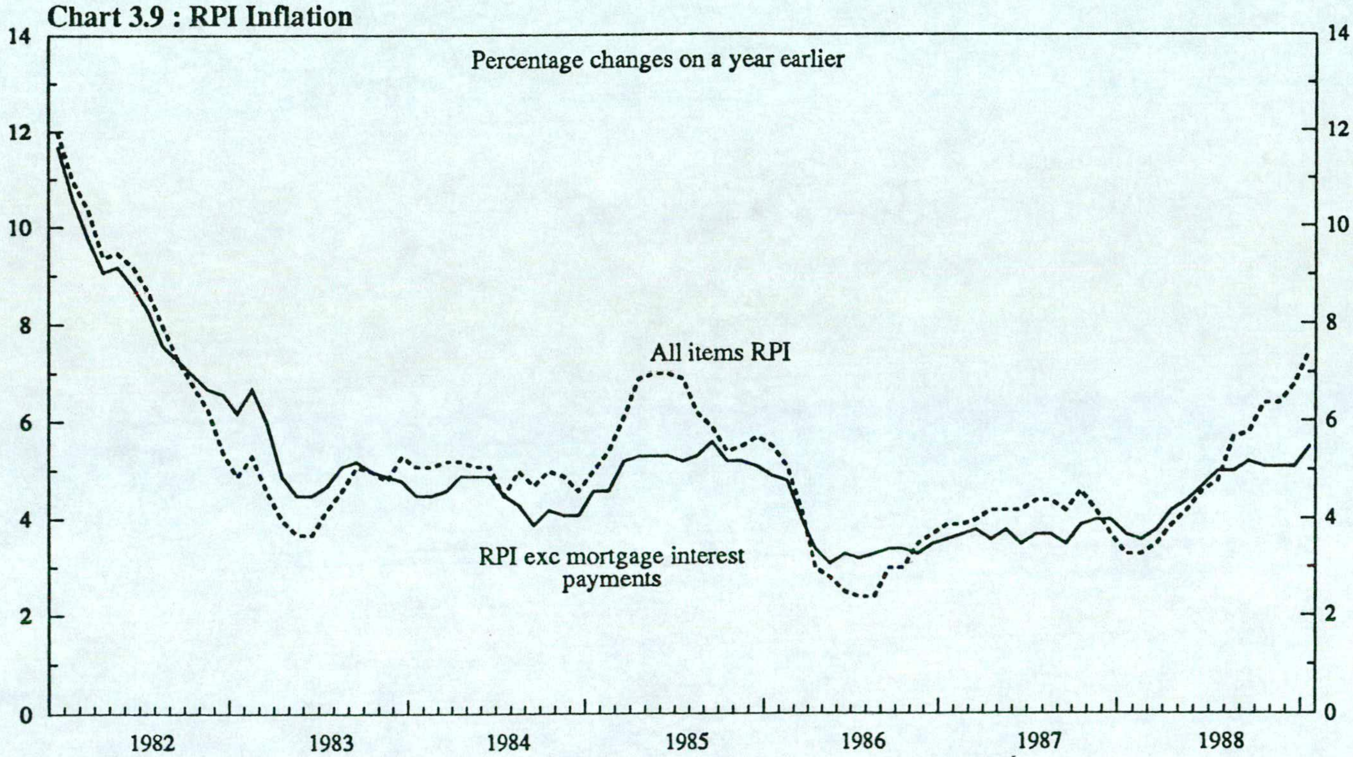
[1] *Non-oil shown in brackets.*
[2] *Average measures.*

? compromise

Inflation

3.38 The annual rate of retail price inflation was 6½ per cent in 1988Q4, a little higher than forecast in the Autumn Statement. Excluding mortgage interest payments, RPI inflation was 5·1 per cent.

Chart 3.9 : RPI Inflation



3.39 According to CBI data, pay settlements in manufacturing rose to just under 7 per cent in 1988Q4, about 1 per cent higher than a year earlier, with service sector settlements slightly higher. Average earnings rose by 8¾ per cent in the year to December, with earnings in manufacturing boosted by continued high overtime. Labour costs in manufacturing rose [2½] per cent in 1988.

Chart 3.10 : Unit labour costs in manufacturing

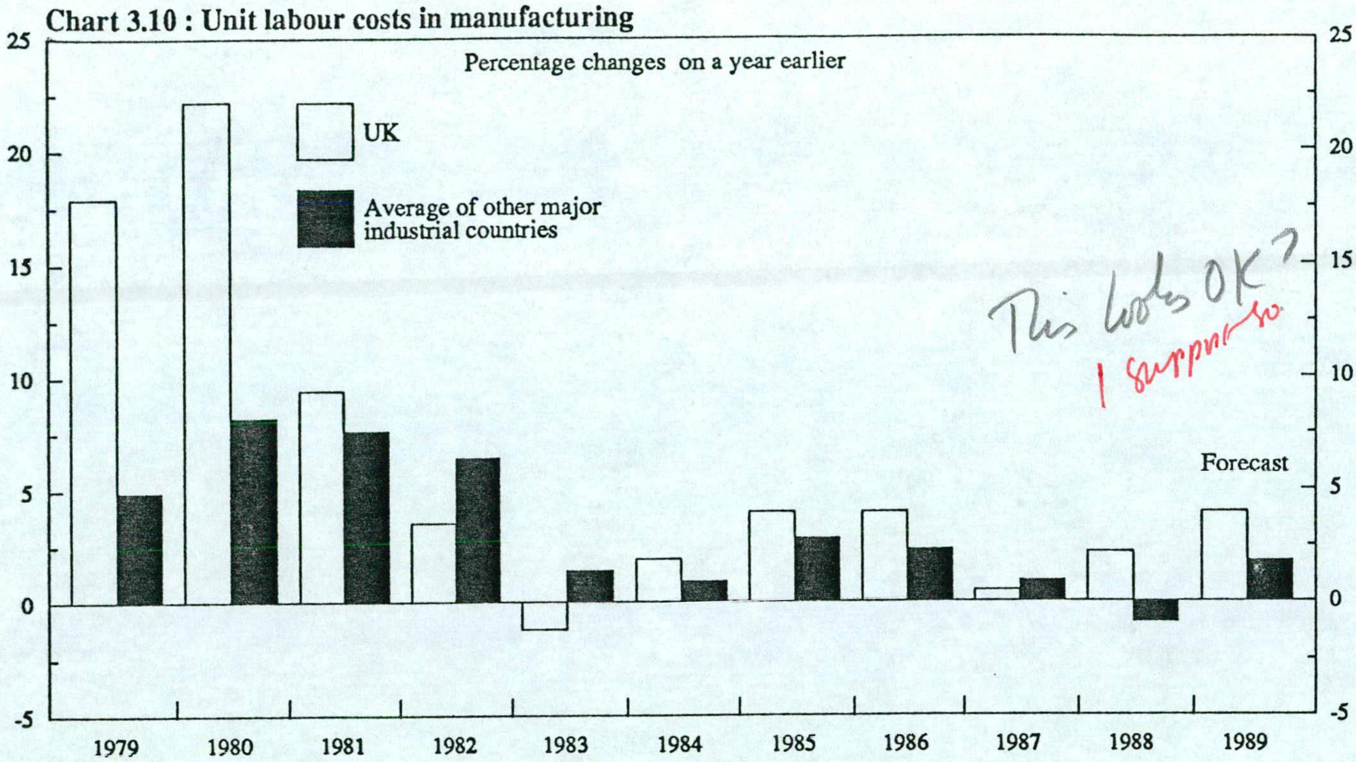


table looks like UK margins in 1989. Explain pse.

3.40 UK manufacturing industry's profit margins increased significantly again in 1988, for the sixth year running. The forecast deceleration in domestic demand and activity in 1989 is expected to lead to some fall in margins though from record high levels.

Table 3.9 Costs in manufacturing

Percentage ~~Per cent~~ changes on previous year

	Unit labour costs	Cost of materials and fuel[1]	Estimated total unit costs[2]	Output prices[1]
1987	1	5	1¾	4½
1988	2½	4¾	2½	4¾
1989 Forecast	4	4¾	4	5½

not italics

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

[2] *Including costs of bought-in goods services.*

was 4¾ was 6 was 4½

3.41 Retail price inflation is likely to moderate to 5½ per cent by the final quarter of 1989 as the effects of past increases in mortgage interest rates start to drop out and as retailers' profit margins are squeezed following the deceleration in consumer demand.

Table 3.10 Retail Prices Index

	Weight in 1988	Percentage changes on previous year 1988Q4	Forecasts 1989Q4	1990Q2
Food	16¼	4	4¼	4
Nationalised industries	5½	7	6 from 7	4¾
Housing	15¼	16¼	10	4
Other	63	4¾	4½	4½
Total	**100**	**6½**	**5½**	**4½**

3.42 The GDP deflator, which measures the price of domestic value added (principally unit labour costs and profits per unit of output), is forecast to have risen by 7 per cent in 1988–89 and to rise by 5½ per cent in 1989–90.

Productivity and the labour market

3.43 Recent revisions to data suggest that the workforce including those on training programmes rose by 1·5 million in the two years to September 1988 and 2·8 million since March 1983. Excluding those on training programmes, the increase was 1·4 million in the two years to September 1988 and 2·4 million since March 1983.

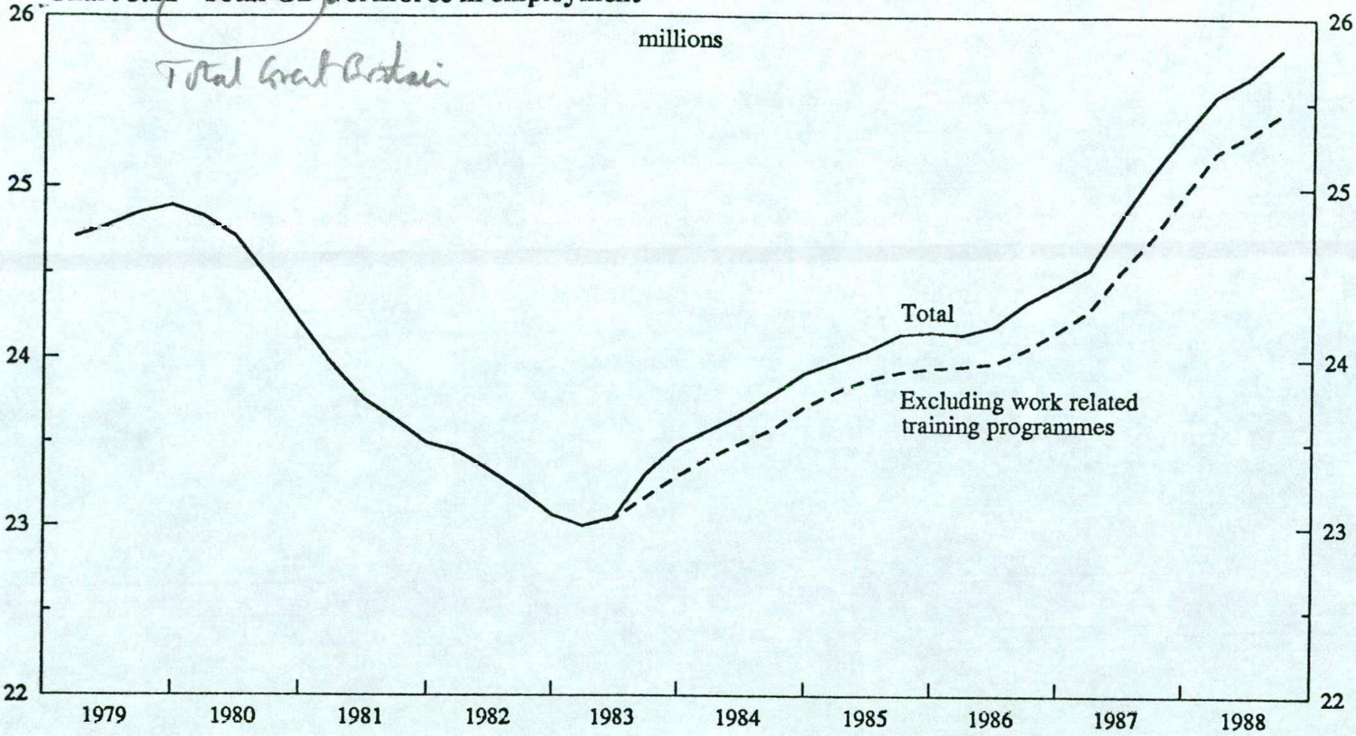
Table 3.11 Changes in employment

	Thousands, seasonally adjusted, GB Employees in employment: Male	Employees in employment: Female	Self-employed	HM forces	Work-related government training programmes	Workforce in employment
September 1985 to September 1986	−82	+148	+71	−3	+55	+188
September 1986 to September 1987	+145	+307	+207	−4	+98	+754
September 1987 to September 1988	+245	+362	+125[1]	−4	+3	+731

[1] *Figures for self-employment after June 1988 are projections based on self-employment growth since 1981.*

Chart 3.11 ~~Total GB~~ workforce in employment

Total Great Britain



3.44 Productivity also continued to rise strongly in 1988. Manufacturing productivity has risen by an average 4¼ per cent a year since 1979, higher than at any time since the 1960s, [and faster since 1980 than any other major industrialised country.] Output per head in the non-manufacturing sector has risen by about 1¼ per cent a year since 1979. Output per head in manufacturing industry has risen faster in the 1980s than in any other major industrialised economy and whole economy productivity growth has been second only to Japan's.

60's 70's & 80's RIGHT

Table 3.12 Output per head of the employed labour force

	Annual average percentage changes		
	1964–73	1973–79	1979–88
Manufacturing	3¾	¾	4¼
Non-manufacturing	3	½	1¼
Whole economy	2¾	1	2
Non-North Sea economy	2¾	½	1¾

Unemployment

3.45 By January 1988, seasonally adjusted unemployment in the UK had fallen for 30 successive months, by over a million in total. This is the longest and largest sustained fall in unemployment since the war. The fall in unemployment over the past year is mainly attributable to the strong growth of output and employment. [Excessive pay settlements are the main threat to further falls in unemployment.]

Forecast and Outturn

3.46 Table 3.13 compares the main elements of the forecast published in the 1988 FSBR with the outturn or latest estimate.

Table 3.13 Forecast and outturn

	1988 FSBR forecast	Outturn or latest estimate	Average errors from past forecasts
GDP (~~per cent~~ percentage change between 1987 and 1988)	3	4½*	1
RPI (~~per cent~~ change between the fourth quarters of 1987 and 1988)	4	6½	1
Money GDP (~~per cent~~ change between 1987–88 and 1988–89)	7½	11	1½
Current account of the balance of payments (1988, £ billion)	−4	−14¼	3
PSDR (1988–89, £ billion)	3	[ ]	4

* *Output measuring GDP.*

'measure of'? ✓

3.47 Recorded inflation in the fourth quarter of 1988 was higher than forecast a year ago mainly because of increases in interest rates in the second half of the year. Real and money GDP growth were both stronger than forecast. The current account deficit was also larger than forecast, mainly because of the continued buoyancy of domestic demand, especially business investment, and associated capacity constraints in some sectors. The PSDR is likely to turn out substantially higher than forecast a year ago, reflecting lower government expenditure than projected and greater buoyancy of tax revenues ~~in the face of high demand and employment.~~

arising from faster growth than expected.

3.48 This year's forecast is summarised in Table 3.14.

In view of J.P. pr & all Ral's shortcomings for disaggregates on run-on (see Table 3.3)

Table 3.14 Economic prospects: summary

	Percentage changes on previous year unless otherwise stated			
	Forecast 1988	1989	1990 H1	Average errors from past forecasts[1]
GDP and domestic demand at constant prices				down from 5
Domestic demand	6½	2½	1½	1
of which:				
Consumers' expenditure	6½	3½	2	1¼
General government consumption	½	1/2	~~1½~~ 1	1
Fixed investment	12	~~8~~ 4 1/2	~~2~~ 3	3¼
Change in stockbuilding (as per cent of GDP)	½	−½	−½	½
Exports of goods and services	was +1/2 −1	4½	~~6½~~ 7	2
Imports of goods and services	12	4½	~~2½~~ 3	2½
Gross domestic product	4½	2	2½	1
Manufacturing output	7	3½	1½	2½
Balance of payments current account (£ billion) ~~1990H1 at annual rate)~~	−14½	−14½	[13] 3	3¼ Discuss
Inflation				
Retail price index (Q4 on Q4)	6½	5½	4½ [2]	1
GDP deflator at market prices (financial year)	~~6½~~ 7 1/4	5½		¾
Money GDP at market prices (financial year)	11	~~7½~~ 7 3/4		1½
£ billion	47~~3~~ 2	~~511~~ 509		
PSDR (financial year)				
£ billion	14	14		4¼
as a per cent of GDP	3	2 3/4		¾

[1] *The errors relate to the average differences (on either side of the central figure) between FSBR forecasts and outturn over the last ten years, and apply to the forecasts for 1989.*
[2] *Q2 on Q2.*
3 At an annual rate.

Table 3.15 Gross domestic product and its components[1]

£ billion at 1985 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	**Total final expenditure**	*Less* imports of goods and services	*Less* adjustment to factor cost	*Plus* compromise ~~statistical~~ adjustment	**GDP at factor cost** (compromise measure)	GDP index 1985 = 100
1984	207·9	74·0	58·1	97·1	1·1	438·1	96·7	48·7	0·8	293·5	96·3
1985	215·5	74·0	60·3	102·8	0·6	453·1	99·2	49·5	0·5	304·9	100·0
1986	227·8	75·4	61·3	106·6	0·7	471·~~6~~7	105·5	51·~~7~~9	−0·4	~~313·9~~ 314.0	103·0
1987	240·1	76·2	66·4	112·~~5~~4	0·9	495·~~8~~9	113·4	54·~~7~~8	0·~~8~~2	328·~~5~~0	107·~~7~~6
1988	255·6	76·7	74·~~5~~2	111·2	~~2·0~~ 1.9	~~520·0~~ 519.7	126·9	56·~~7~~4	~~6·4~~ 5.8	342·~~9~~1	112·~~4~~2
1989	264·~~3~~1	~~76·6~~ 77.1	~~78·1~~ 77.6	~~115·9~~ 116.3	~~0·0~~ −0.2	534·9	132·~~5~~8	58·~~6~~1	~~6·4~~ 5.8	~~350·3~~ 349.8	114·~~9~~7
1987 H1	117·6	37·7	32·~~4~~1	55·7	0·0	243·~~4~~2	54·5	26·8	0·~~1~~0	~~162·1~~ 161.8	106·~~3~~1
H2	122·5	38·5	34·~~0~~2	56·7	0·9	252·~~5~~8	58·8	28·0	0·~~8~~2	166·~~4~~2	109·~~1~~0
1988 H1	125·9	38·2	36·~~5~~6	55·9	0·7	257·~~2~~3	61·2	27·9	~~2·3~~ 1.4	~~170·5~~ 169.7	111·~~8~~3
H2	129·~~8~~7	38·5	~~38·0~~ 37.6	55·~~4~~3	1·3	262·~~8~~4	65·7	28·~~1~~5	4·~~1~~3	172·~~4~~5	113·1
1989 H1	131·~~8~~6	38·~~1~~5	38·~~8~~3	57·~~0~~1	0·~~4~~2	~~266·0~~ 265.8	65·~~9~~8	~~29·2~~ 28.9	~~3·2~~ 2.9	~~174·1~~ 173.9	114·~~3~~1
H2	132·~~6~~5	38·~~5~~6	39·~~3~~2	59·~~0~~2	−0·4	~~268·9~~ 269.2	~~66·6~~ 67.0	29·~~4~~2	~~3·2~~ 2.9	~~176·1~~ 175.9	115·~~8~~4
1990 H1	~~134·6~~ 133.9	38·~~7~~8	39·~~5~~4	~~60·7~~ 61.0	−0·6	272·~~9~~6	67·~~6~~8	29·~~9~~5	~~3·2~~ 2.9	178·~~7~~1	~~117·2~~ 116.8
Per cent changes											
1986 to 1987	5½	1	8½	5½	0	5	7½	~~6~~ 5½	+0	4½	4½
1987 to 1988	6½	½	12	−1	~~1½~~	5	12	3~~½~~	+1½	4½	4½
1988 to 1989	3½	~~0~~ ½	~~5~~ 4½	4½	−½	3	4½	3~~½~~	+0	2	2
1989 H1 to 1990 H1	2	1~~½~~	~~2~~ 3	~~6½~~ 7	−½	2½	~~2½~~ 3	2~~½~~	+0	2½	2½

[1] The compromise GDP figures up to 1987 are averages of constant price expenditure, output and income estimates of GDP. Percentage changes are calculated from unrounded levels and then rounded to the nearest half per cent. The annex to this chapter assesses the recorded data.

Growth in 1988 is based on the output measure

Annex to Chapter 3

explained that, because of problems with the statistics,

National and sectoral accounts

3A.1 ~~It was explained in~~ the Autumn Statement ~~that~~ it has become increasingly difficult to assess the development of the economy in the recent past. The alternative measures of GDP show different growth rates between years and different paths within years. There are very ~~big~~ large balancing items in the sectoral accounts. And the data are subject to large revisions.

x

3A.2 The figures for the past in this chapter are the CSO's latest estimates; there may be further small changes before the full set of national accounts ~~are~~ is published on 17 March.

3A.3 Revisions to the figures for 1986, 1987 and 1988 have reduced the difference between the various measures of GDP.

Table 3A.1 **Gross Domestic Product: 1985 prices, seasonally adjusted**

	1985 = 100			
	GDP Expenditure	GDP Output	GDP Income	Compromise GDP*
1987	~~108·1~~ 107.7	107·~~9~~8	107·~~3~~2	107·~~7~~6
1988	~~111·0~~ 110.5	112·~~6~~4	~~111·8~~ 112.0	112·~~4~~2
1987 H1	106·~~9~~3	106·~~3~~2	105·9	106·~~3~~1
H2	109·~~3~~1	109·~~6~~4	108·6	109·~~1~~0
1988 H1	~~[ ]~~ 110.5	111·~~7~~5	~~112·0~~ 111.9	111·~~8~~3
H2	~~[ ]~~ 110.4	113·~~5~~4	~~111·6~~ 112.3	113·~~1~~2
Growth rates percentage change on a year earlier				
1987	4·~~6~~3	4·~~9~~7	4·~~3~~4	4·~~6~~5
1988	~~[2·7]~~ 2.6	4·3	4·~~2~~5	4·3
1988 H1	[4.0]	5·~~1~~0	5·~~9~~7	5·~~1~~0
H2	[ ] 1.2	3·7	3·~~8~~4	3·~~6~~9

x Compromise

* ~~Adjusted~~ GDP is the ~~same as~~ unweighted average of the three measures to the end of 1987, and uses the growth of GDP(0) for 1988.

Spending.

3A.4 Compared with earlier published estimates there have been unusually large upward revisions to some components of GDP(E), particularly company ~~expenditure~~. Fixed investment has been revised up in both 1987 and 1988, and is now estimated to have grown by 8½ per cent in 1987 and 12 per cent in 1988. Following these revisions the path of investment is more consistent with the high level of imports of capital and intermediate goods.

3A.5 But despite the revisions, there are still problems ~~in interpreting~~ with the statistics in 1988. The expenditure measure of GDP ~~still grows~~ is still estimated to have grown significantly less rapidly than the output or income measures—especially in the second half of the year. In this forecast ~~the~~ a compromise measure of GDP is used, and is estimated to have grown by 4½ per cent in 1988, in line with the output measure.

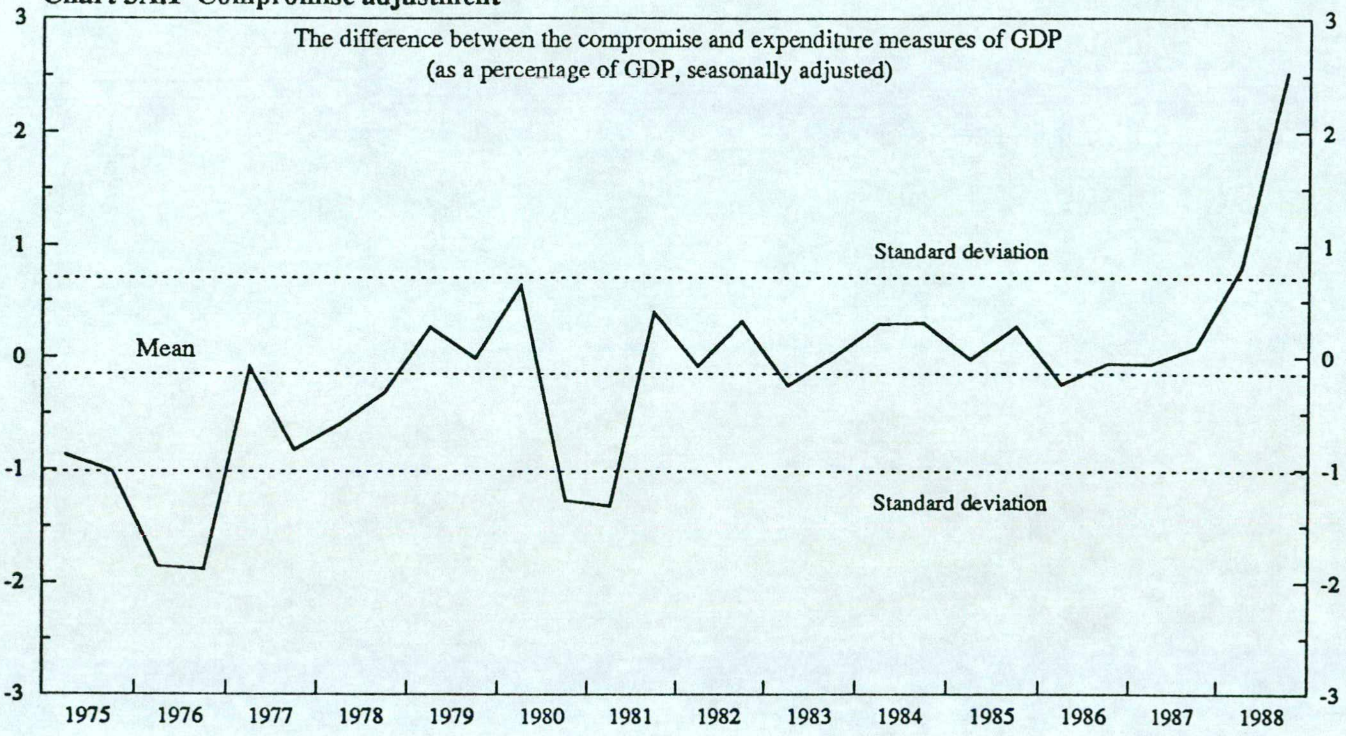
This judgement is based on the widely accepted view that the output measure of GDP is the most reliable measure of recent activity, and is consistent with the other indicators of activity including CBI surveys.

3A.6 The income measure of GDP grew by a similar amount in 1988, although its path through the year was more erratic. In contrast, the expenditure measure of GDP is estimated to have grown by only 2~~½~~ ¾ per cent.

Table says 2.66 (ie 2½%)

3A.7 The difference between the estimated growth of the compromise measure of GDP and the expenditure measure is shown as the ~~statistical~~ compromise adjustment in Table 3.14. Chart 3.A1 shows the difference between the expenditure measure of GDP and compromise GDP. The difference for 1988 is still at an unusually high level.

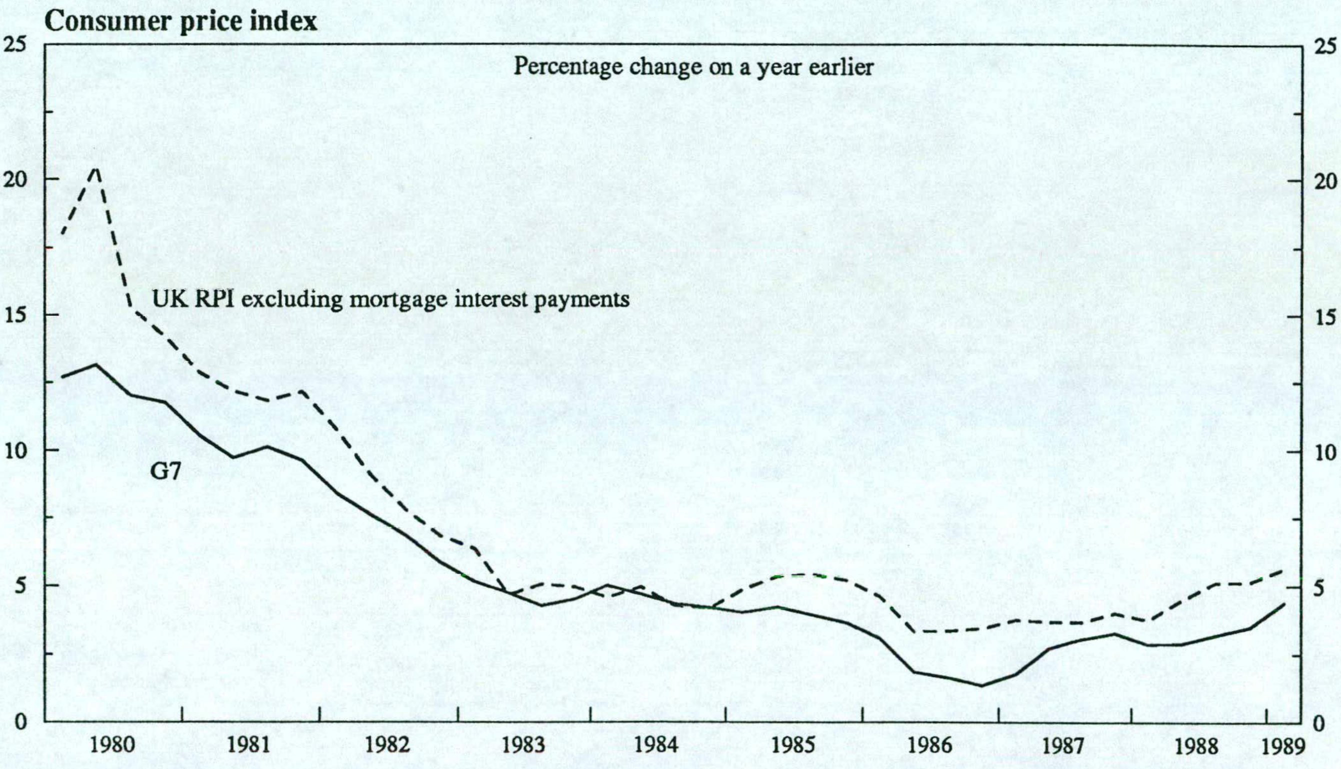
Chart 3A.1 Compromise adjustment



X) Sectoral accounts & balances items

[cf AS. The sectoral panels (plus a table to go with them) re most important part of the Annex.]

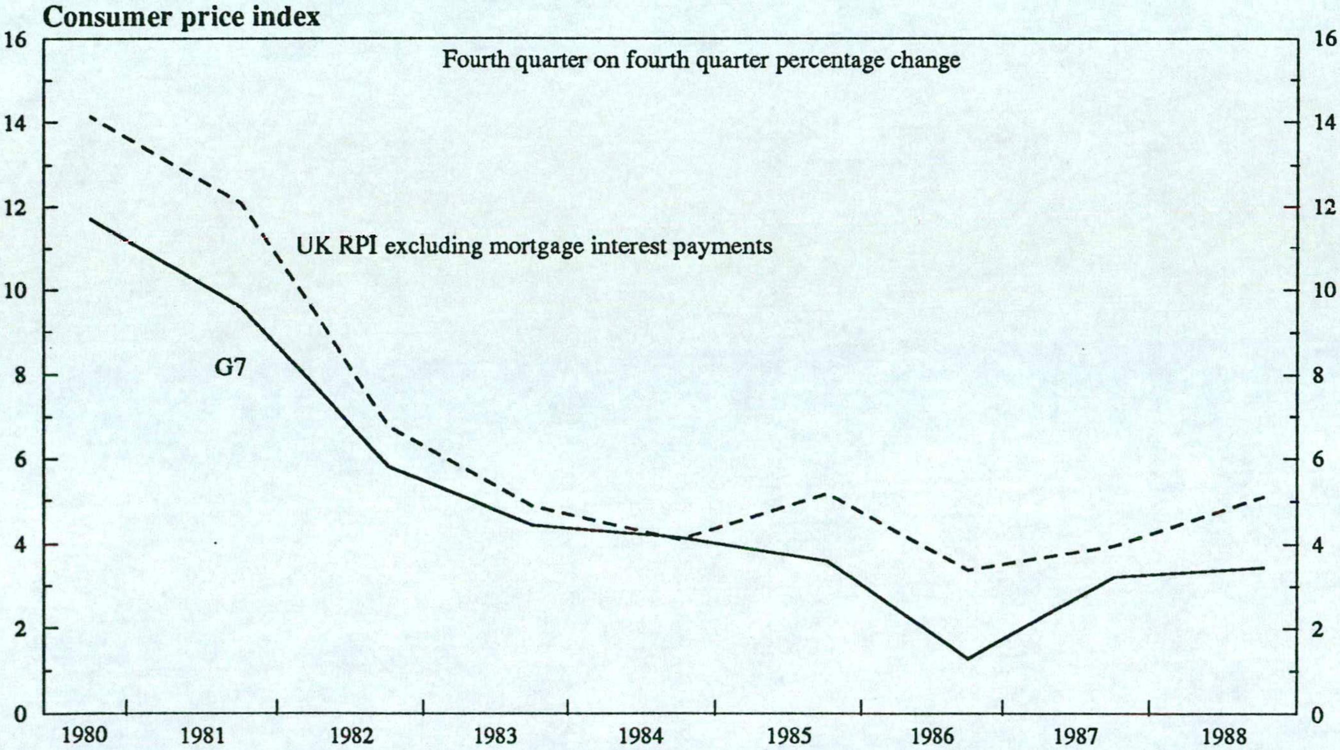
VERSION A



Consumer price index
Percentage change on a year earlier
UK RPI excluding mortgage interest payments
G7
25
20
15
10
5
0
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989

VERSION B

Consumer price index



VERSION C

Consumer price index

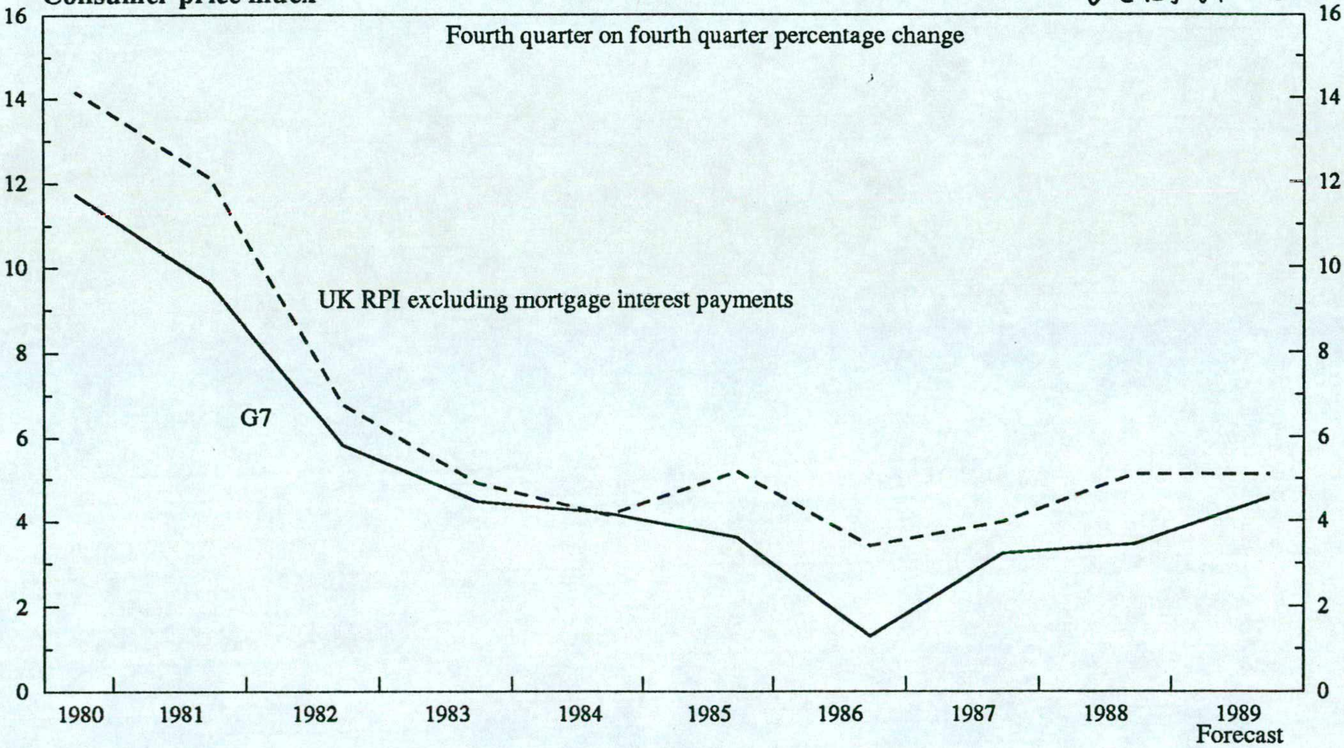


Chart 3.9 : RPI Inflation

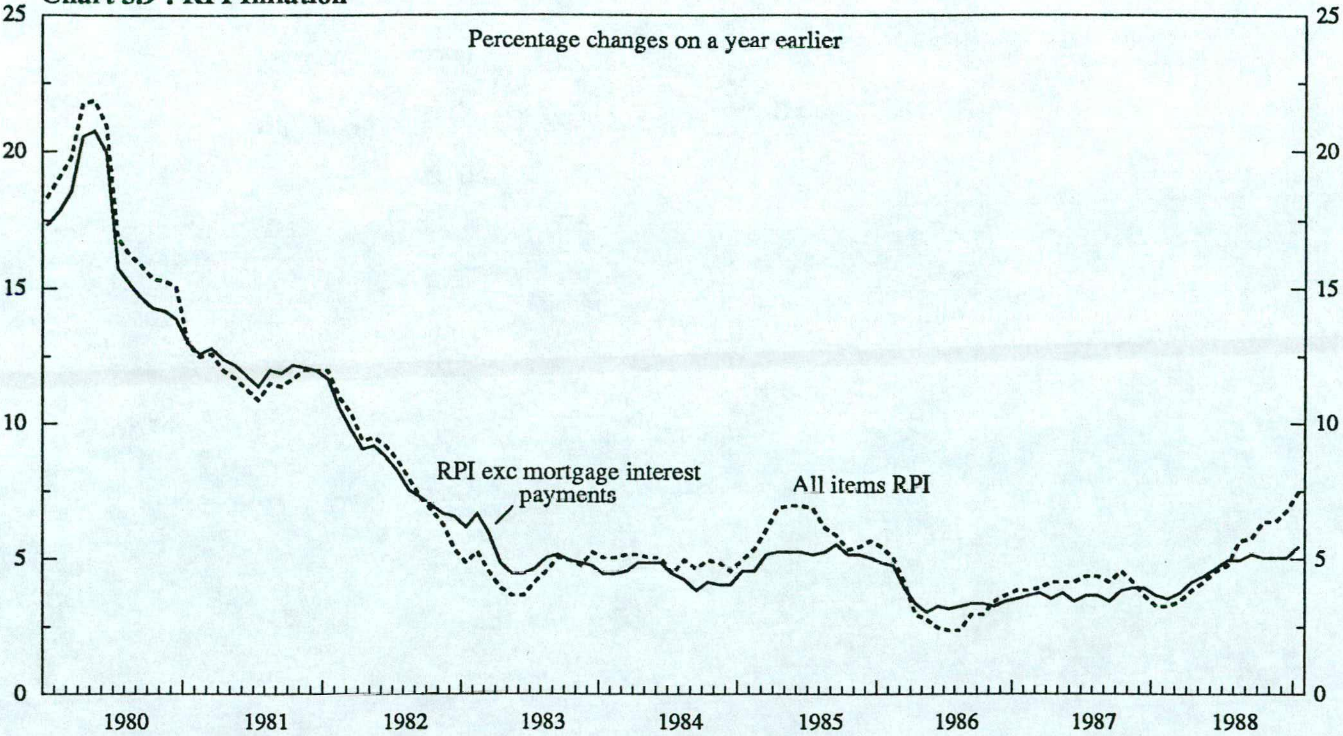
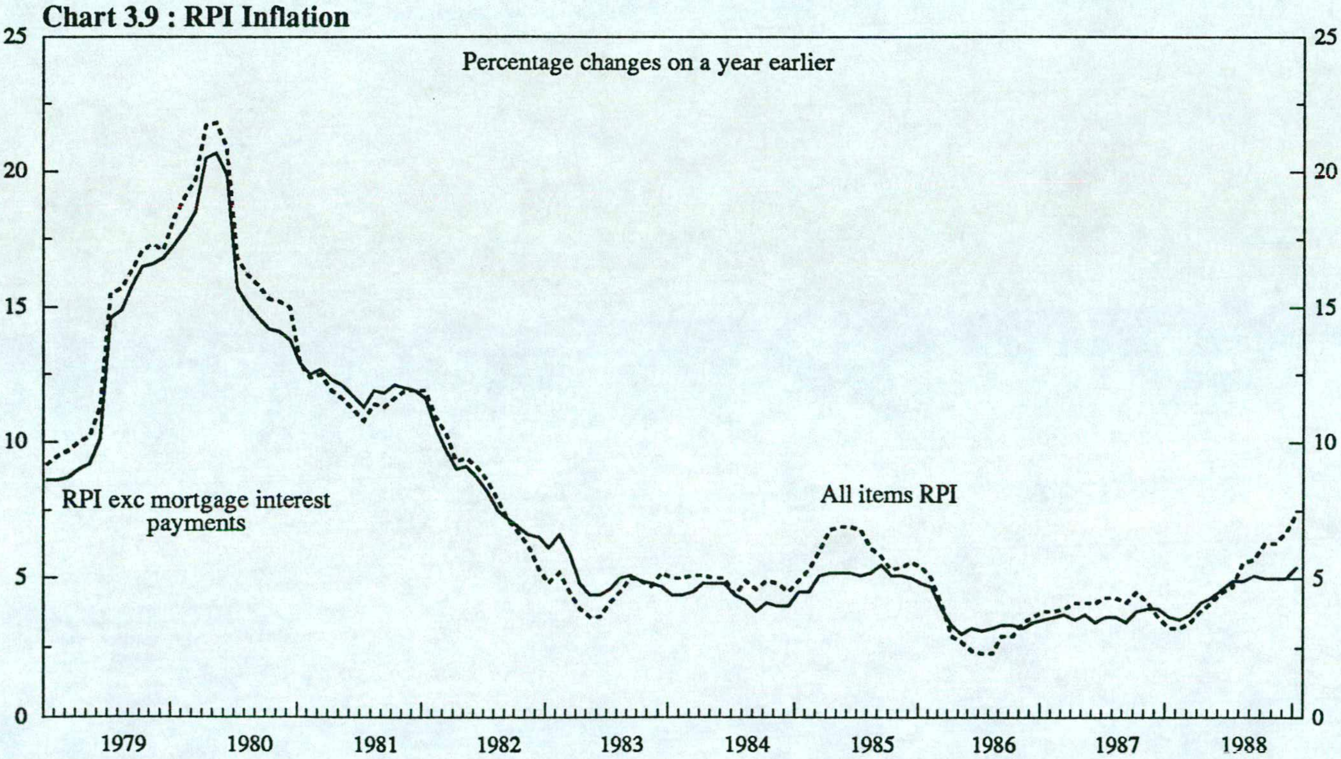


Chart 3.9 : RPI Inflation



FROM: J S HIBBERD
DATE: 8 MARCH 1989

PS/CHANCELLOR OF THE EXCHEQUER

cc : Sir Peter Middleton
Sir Terence Burns
Mr Sedgwick
Mr Riley

FSBR CHAPTER 3: THE INDUSTRY ACT FORECAST

Your minute of 8 March regarding output per head.

2. The problem we have in providing the productivity numbers the Chancellor wanted to insert in Table 3.11 relates to the non-manufacturing component. The definition of this sector is a Treasury concept. It comprises the private non-manufacturing sector of the economy ie excluding the output and employment of the non-trading public sector, the manufacturing sector and the North Sea sector. The data are specially constructed for us and have not hitherto been available before 1963. It could, in time, be constructed and we can set it in hand. But we need to liaise with DEmp and CSO for the relevant series and it is most unlikely we could have it in time for closing the Red Book this week. The main problem would be in getting consistent estimates of non-trading public sector employment and output before 1963.

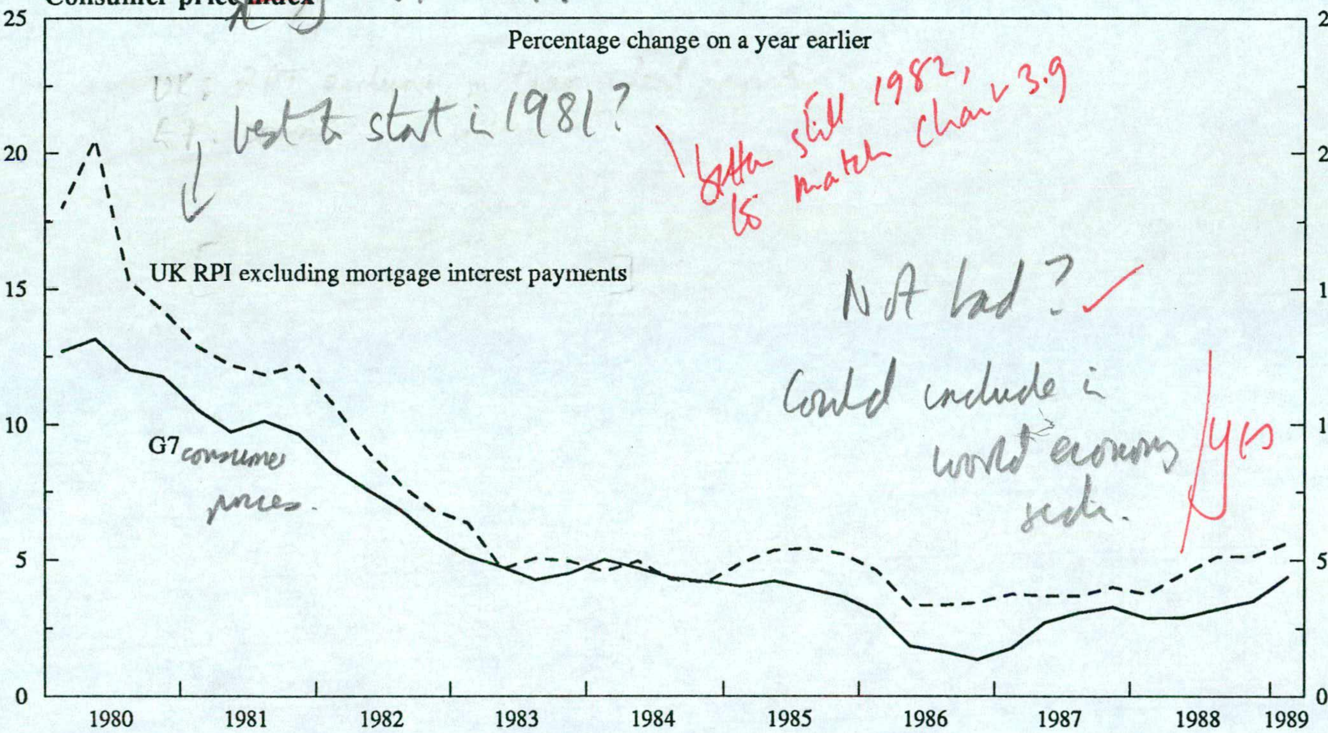
3. There is no conflict between this and the usual international comparisons we make over the 1960s, 1970s and 1980s. These are only at the whole economy and manufacturing levels, data for which <u>are</u> available back to 1960. There is nothing immutable about the current formulation of Table 3.11 and it could easily be recast along the attached lines if the Chancellor wishes, ie excluding non-manufacturing.

Jim Hibberd

J S HIBBERD

VERSION A

Consumer price ~~index~~ in UK & G7.



best to start in 1981?

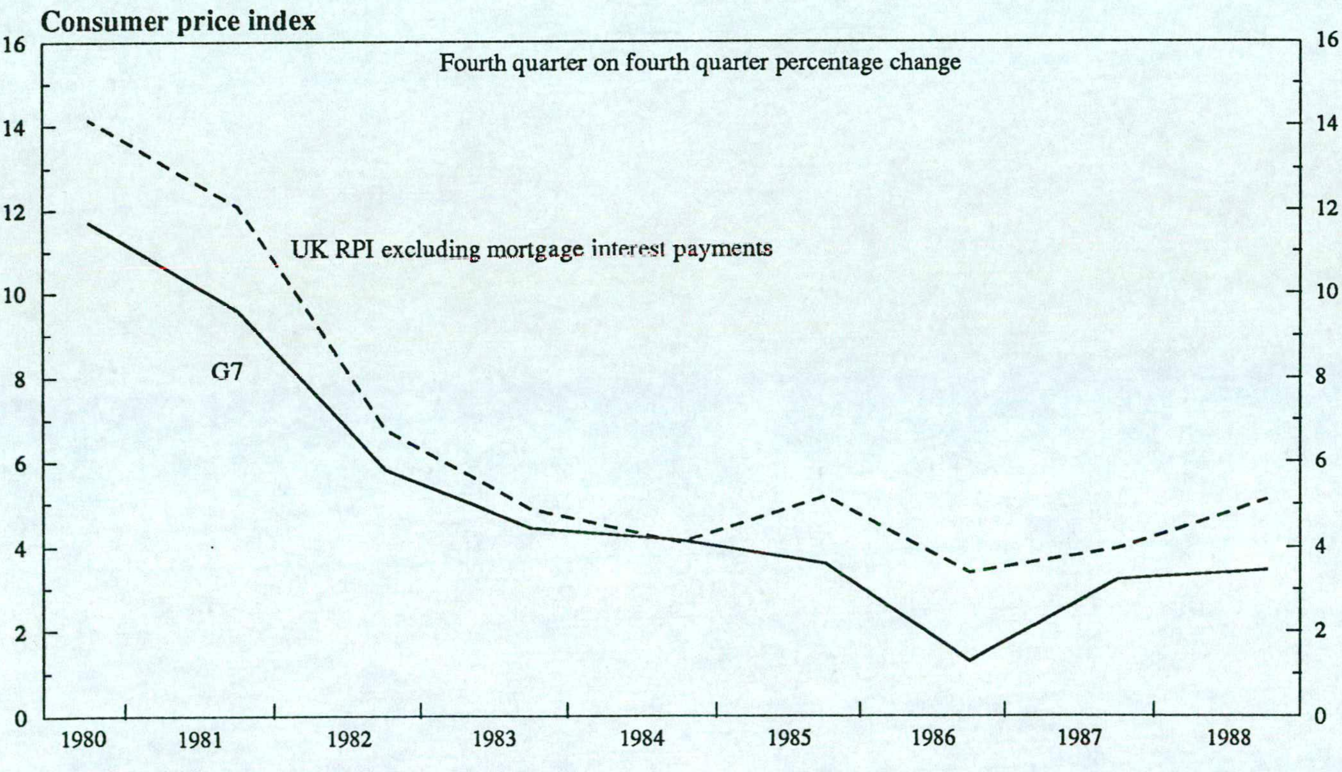
better still 1982, to match chart 3.9

Not bad?

Could include in world economy section.

yes

VERSION B


Consumer price index
Fourth quarter on fourth quarter percentage change
UK RPI excluding mortgage interest payments
G7
16
14
12
10
8
6
4
2
0
1980
1981
1982
1983
1984
1985
1986
1987
1988

VERSION C

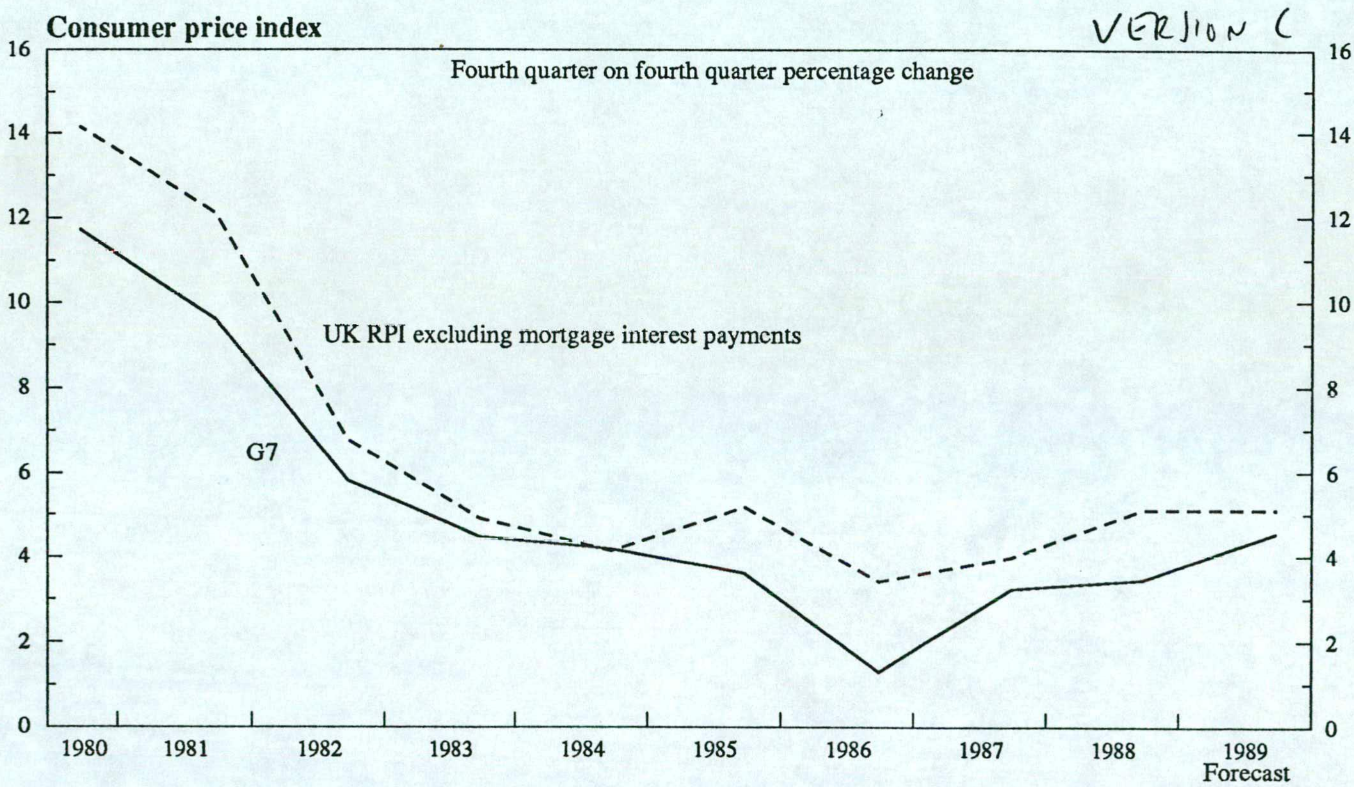

Consumer price index
Fourth quarter on fourth quarter percentage change
UK RPI excluding mortgage interest payments
G7
0
2
4
6
8
10
12
14
16
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
Forecast

Chart 3.9 : RPI Inflation

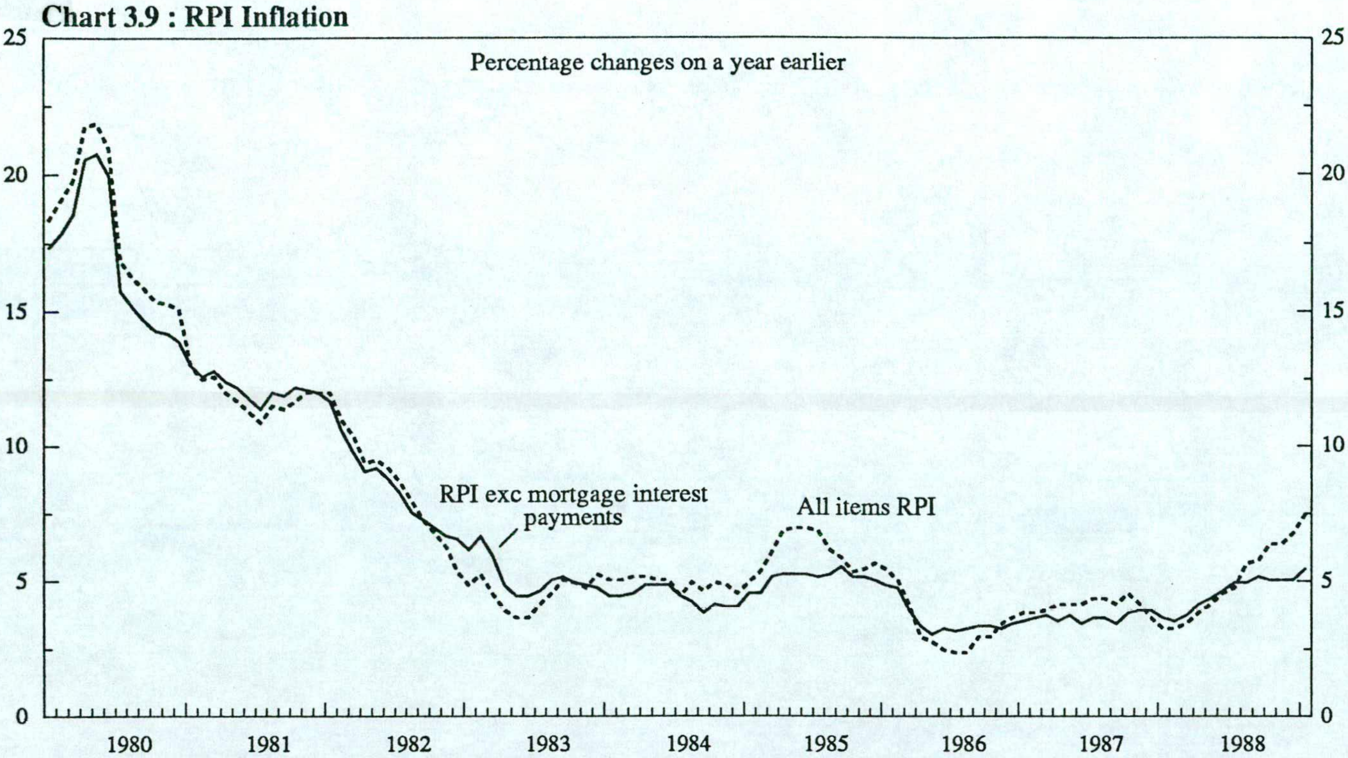


Chart 3.9 : RPI Inflation

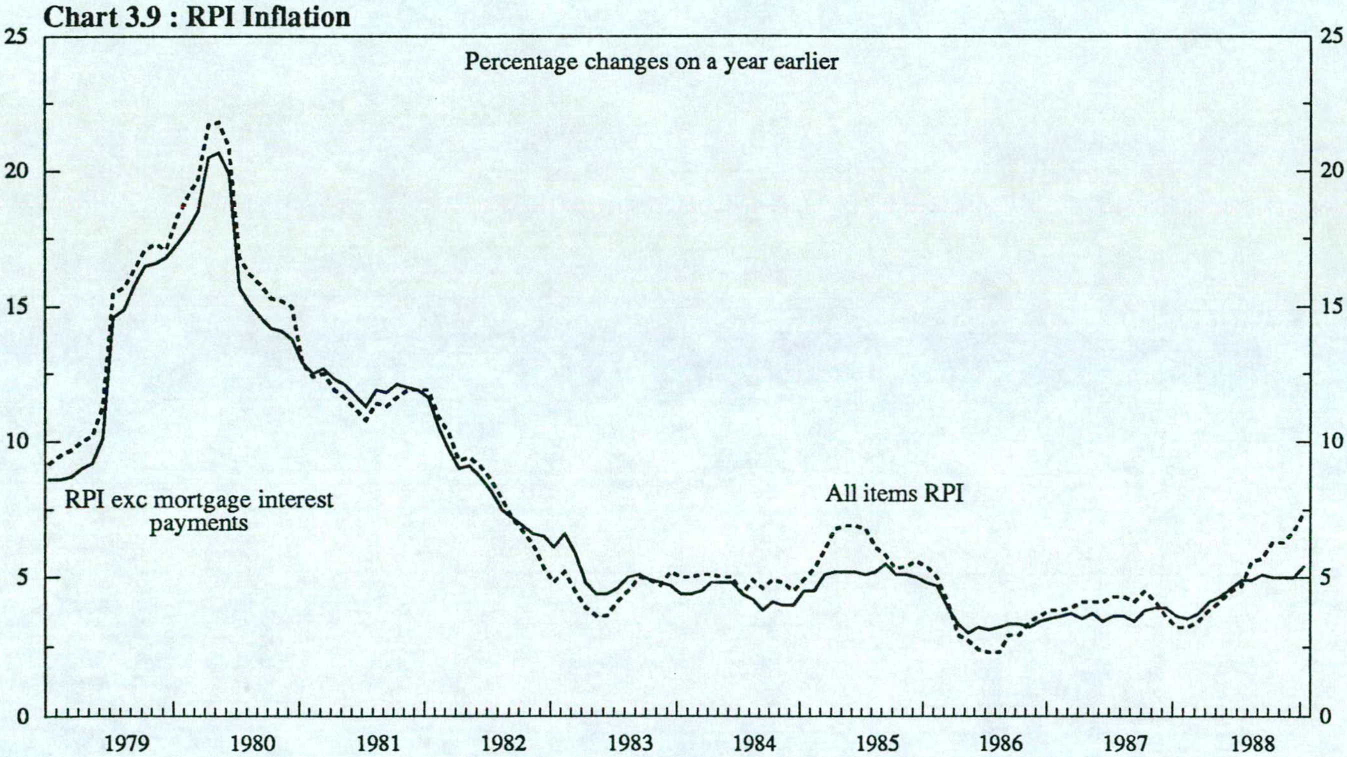


Table 3.5 : Current account

£ billion

	Manufactures	Other	Oil	Invisibles	Current Balance	Balancing Item
1987	-7½	-7	4	7½	-3	12½
1988	-14½	-8½	2½	6	-14½	15
1989 forecast	-15½	-7½	2	7	-14½	-

COPY NO 24 OF 24 COPIES

FROM: A C S ALLAN
DATE: 9 March 1989

PJ

MR MACPHERSON

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Gilhooly
Mr Matthews
Miss Simpson
Miss Wallace

Sir A Battishill - IR
Mr Calder - IR

Mr Unwin - C&E
Mr P R H Allen - C&E

FSBR CHAPTER 4

The Chancellor was grateful for your minute of 8 March. He had the following points:

(i) He would move up Schedule E to the income tax part of the narrative section.

(ii) Should the penultimate indent of paragraph 4.02 refer to "age allowances" rather than "age allowance"?

(iii) In the text on Schedule E, why do we need the addition of "in practice" ("not already in practice taxed on a receipts basis").

CHANCELLOR OF THE EXCHEQUER

(iv) The beginning of paragraph 4.12 should be amended to read: "A number of changes will be made to the taxation of pensions. In the case of occupational pensions:".

(v) Chart 4.1 is much too big, and should be reduced to half its present size.

(vi) The Chancellor feels it might be worth changing the second grouping in table 4.1 to "income tax, corporation tax and stamp duty", so that the abolition of life assurance policy duty can be brought together with the other two lines on life assurance companies. But this is not essential if it causes great problems.

(vii) The Chancellor would prefer to have a line at the end of table 4.1 showing "total Budget changes", as in table 1.1.

(viii) Why do we need the addition of the words "level of" in the notes to lines 1-5?

(ix) Amend the new note to line 22 to read "...in particular, to spread over 7 years the relief for the costs of acquiring new business (other than pension and general annuity business), subject to transitional arrangements in the first 4 years; and to reduce the corporation tax rate ..."

ACSA

A C S ALLAN

chex.rm/aal/72 **BUDGET SECRET**

COPY NO 14 OF 14 COPIES

FROM: A C S ALLAN
DATE: 9 March 1989

PL

MR RILEY

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Peretz
Mr Sedgwick
Mr S Davies
Mr Mowl
Miss Simpson

MINUTE ON THE MTFS FOR THE PRIME MINISTER

The Chancellor was grateful for your minute of 8 March and the attached draft. I attach a copy incorporating the Chancellor's comments: we shall update it to take account of the final decisions on the PSDR.

ACSA

A C S ALLAN

Ch

OK as amended slightly to reflect PSDR decisions? Yes, as further (slightly) amended.

One question, do you want, for the Prime Minister, to point out that PSDR in 1989-90 ex pp is higher than 1990-91? Yes i.e.

AA

^ COPY NO OF

Please type for signature

PRIME MINISTER

With PSDR figures now available for the first 11 months of the year - the last figures we shall have before the Budget - I am in a position to let you have my usual note on the Medium Term Financial Strategy.

This will be the tenth occasion on which we have set out the MTFS in the Red Book. I propose to use this opportunity to highlight the transformation of the economy that has followed our pursuit of sound financial policies coupled with supply-side reforms. I will stress that, although the details of the MTFS have changed over the last decade as the economy has evolved, the essence of the strategy has remained unchanged.

At the centre of the MTFS, as always, is the over-riding requirement to bring down the rate of inflation and not to accommodate inflationary impulses. Over the past two years, money GDP growth has exceeded the rate we have been aiming for. In part this reflects a better supply performance in the economy; but it also reflects stronger inflationary pressures. We have taken firm action since the summer to bring the economy back onto track, and the decline in money GDP growth which I propose to aim for over the medium term should bring about a decisive reduction in inflation.

Fiscal policy

The PSDR in 1988-89 will turn out significantly higher than the £10 billion I forecast at the time of the Autumn Statement. So far ~~We~~ we have a surplus of [£16 billion] with one month to go, though with the usual surge of spending in the final month the figure for the year as a whole is likely to turn out somewhat lower. I intend to publish a figure of [£14 billion] as our best guess~~, which as usual is slightly on the cautious side~~.

Last year I set out the principle of a balanced budget as the norm for fiscal policy, and I intend to reaffirm it this year. I do not believe that we should aim for the maximum possible repayment of debt, because that would unnecessarily delay the reductions in taxation needed to build on the supply side improvements already achieved. But given the size of the present surplus, and the need to maintain a prudent and cautious approach, I am sure we should only aim to return to balance gradually over a period of years.

The tax and national insurance package we have agreed will enable me to budget for a PSDR of almost [£1~~2~~4 billion] in 1989-90, [~~effectively~~] the same as in 1988-89. [~~after allowing for the fall in privatisation proceeds from £7 billion to £5 billion.~~] This implies no change in the overall tax burden between the two years: the package merely offsets the fiscal drag in the system. Thereafter I propose to show a gradual return towards budget balance, and thus a number of further years of debt repayment. Provided we continue to restrain the growth of public expenditure, this should enable us to bring down the tax burden over the medium term.

Monetary policy

The MTFS will once again emphasise that the task of exerting downward pressure on inflation falls to monetary policy. It will also make it clear again that short-term interest rates are the

(optional) (It also means that) ~~Excluding~~ privatisation proceeds, which will total £7 billion in 1988-89 but are planned to return to ~~is~~ £5 billion in 1989-90, I am budgeting for a rise in almost the PSDR, from £7 billion to £9 billion.)

essential instrument of monetary policy; that interest rate decisions are made on the basis of a comprehensive assessment of monetary conditions, with particular weight given to the behaviour of MO in relation to its target range and to exchange rate; and that the Government is not prepared to accommodate increases in domestic costs by exchange rate depreciation.

I intend to set a target range for MO growth in 1989-90 of 1 to 5%, as foreshadowed in last year's MTFS; this is the same as the range for 1988-89. Although the 12 month growth rate of MO is likely to start the year above the target range, the tightening of monetary policy since the summer should bring it back within the range before too long. We have already seen a sharp deceleration, with the annualised six month growth rate now well within the range.

For subsequent years I propose to show a declining path for monetary growth in line with that shown in last year's MTFS. The range -1 to 3% for the final year (1992-93) should be consistent with money GDP growth of around 5%, and hence a decisive fall in inflation from the average rate of the last five years.

<u>Capital market liberalisation</u>

I shall also be announcing on Budget day a substantial liberalisation of the London sterling capital market. I am abolishing the queue for bond and equity issues which has been operated by the Bank of England since 1946, opening up the market for sterling paper and at the same time simplifying its regulatory regime. I am also making some consequential changes in the taxation of deep discount and other bonds. Taken together all these changes will give greater flexibility to those who issue capital in London; and wider choice to those who invest here.

[NL]

10 ~~9~~ March 1989

chex.rm/aa1/68 RESTRICTED

FROM: A C S ALLAN
DATE: 9 March 1989

PG

MRS R J BUTLER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Phillips
Mr Scholar
Mr Peretz
Mr Culpin
Mr Riley
Mr Sedgwick
Mrs Lomax
Mr S Davies
Miss Simpson

FSBR CHAPTER 5

The Chancellor was grateful for your minute of 8 March. He had no further comments on Chapter 5.

ACSA

A C S ALLAN

COPY NO 28 OF 29 COPIES

FROM: A C S ALLAN
DATE: 9 March 1989

PG

MR S J DAVIES

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Monck
Mr Scholar
Mrs Lomax
Mr Peretz
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Grice
Miss O'Mara
Mrs R Butler
Mr Mowl
Mr Barrie
Mr Savage
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

FSBR CHAPTER 2

The Chancellor was grateful for your minute of 8 March. He had the following comments.

(i) In paragraph 2.13, he prefers "back into surplus".

(ii) I am afraid I misread the Chancellor's handwriting in transcribing his comment on paragraph 2.10. He did indeed ask "why, then, is the 1991-92 growth of money GDP ½ per cent more than in the 1988 MTFS?" He feels this is not consistent with the point in paragraph 2.10 that "to the extent that faster growth of money GDP reflects only higher demand with no supply side improvement, the Government will take action to return to its planed path for money GDP growth over the medium term". How do we reconcile this?

(iii) The Chancellor thought the layout of the page with the box on capital market liberalisation would look better if the box was full width, like the chart; this would make the page less crowded.

ACSA

A C S ALLAN

est.ld/james/9 Mar/PS CHX

CONFIDENTIAL

Papers please.

FROM: S M A JAMES
DATE: 9 March 1989

PS/CHANCELLOR

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Sir P Middleton
Sir T Burns
Mr Wicks
Mr Scholar
Mr Peretz
Mr Riley
Mr Sedgwick
Mr Davies
Mr Grice
Miss O'Mara
Mr Mowl
Mr Barrie
Mr Savage
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

'basis' ok

FSBR CHAPTER 2

The Economic Secretary has seen Mr Davies' latest draft circulated yesterday.

2. He has reviewed the paragraphs on funding policy (2.23-2.26). In paragraph 2.25 he would suggest either replacing "criterion" with "basis" or deleting the words "on this criterion" entirely.

SMAJ

S M A JAMES
PRIVATE SECRETARY

mp.pc/Riley/102

PW

BUDGET SECRET

COPY NO. 2 OF 14 COPIES

FROM: C J RILEY
DATE: 10 March 1989

SIR P MIDDLETON

cc Mr A C S Allan
Sir T Burns
Mr Anson
Mr Scholar
Mrs Lomax
Mr Sedgwick
Mrs Butler
Mr S Davies
Mr MacAuslan
Mr Mowl
Mr Savage

MEDIUM TERM FISCAL PROJECTIONS IN THE FSBR

I attach copies of the main fiscal tables covering the medium term with the numbers we expect to appear in the FSBR. I think we have managed to meet the various constraints required.

Circulated to show you the numbers, not the layout.

C J RILEY

Very many thanks.

P.S. Extraordinary statistics of tax burden during first [illegible] on Ch.

Table 2.1 Money GDP growth, output and inflation[1]

		1988-89	1989-90	1990-91	1991-92	1992-93
Money GDP		**11**	**7¾**	**6**	**6**	**5½**
Real GDP:	non-oil	4½	2¼	2	3	3
	total	3½	2¼	2	2¾	2¾
Inflation:	GDP deflator	7¼	5½	4	3	2½

[1] Percentage changes on previous financial year. The figures for 1989-90 are forecasts; the figures for subsequent years show the Government's medium term objectives for money GDP and consistent assumptions for output and inflation. The projections in the table make no allowance for any effect of the replacement of local authority domestic rates by the Community Charge on recorded growth in money GDP or the GDP deflator.

Table 2.3: General government expenditure (excluding privatisation proceeds) as a percentage of GDP[1]

1963-64	36¼	1973-74	42¾	1983-84	45¾
1964-65	~~36~~ 35¾	1974-75	~~48¾~~ 48	1984-85	46¼
1965-66	37¼	1975-76	48½ PEAK	1985-86	44½
1966-67	38¾	1976-77	46	1986-87	43¾
1967-68	~~42¾~~ 42¼	1977-78	42¾	1987-88	41½
1968-69	40¾	1978-79	43¼	1988-89	39½
1969-70	40¼	1979-80	43½	1989-90	39¼
1970-71	40¾	1980-81	46	1990-91	39
1971-72	41	1981-82	~~46¼~~ 46½	1991-92	38¾
1972-73	41	1982-83	~~45¾~~ 46¾	1992-93	38

[1] 1988-89: latest estimate, 1989-90: forecast; 1990-91 onwards: MTFS projections.

Table 2.4 General government expenditure[1]

	£ billion, cash					
	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93
Public expenditure planning total[2]	145.7	150.6	167	179	192	200
Gross debt interest	17.8	18.3	17	15½	14½	14
Other adjustments	8.4	10.2	10	10½	9½	9½
General government expenditure[3]	171.9	179.1	194	205	216	224
Privatisation proceeds	5.1	7.0	5	5	5	5
General government expenditure excluding privatisation proceeds	177.0	186.1	199	210	221	229

1 For 1987-88 to 1991-92, the figures are taken from Table 5.1

2 Existing definition: as proposed in Cm 441, a new definition of the planning total will be introduced in the 1989 Survey.

3 General government expenditure, and its components, are rounded to the nearest £1 billion from 1989-90 onwards; except for debt interest and other adjustments which are rounded to the nearest £½ billion, as in Chapter 5. General government expenditure is assumed to grow by 1 per cent in real terms in 1992-93.

Table 2.5: Non-oil taxes and national insurance contributions as a percentage of non-oil money GDP[1]

1963-64	29	1973-74	33¼	1983-84	37¾
1964-65	29½	1974-75	35¾	1984-85	37¾
1965-66	31	1975-76	36¼	1985-86	37¼
1966-67	32	1976-77	36	1986-87	37¾
1967-68	33¼	1977-78	35	1987-88	37¾
1968-69	35¼	1978-79	34¼	1988-89	37½
1969-70	36¼	1979-80	35½	1989-90	37½
1970-71	36¼	1980-81	36¼	1990-91	36¾
1971-72	34¾	1981-82	38¾	1991-92	36
1972-73	32½	1982-83	38¼	1992-93	35

OK though 36¼ & 35¼ wd have been ~~[illegible]~~ nicer

1 1988-89: latest estimate; 1989-90: forecast; 1990-91 onwards: MTFS projections (after fiscal adjustment).

Table 2.6 General government receipts

	£ billion, cash					
	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93
Taxes on incomes, expenditure and capital	133.2	144.6	157	165	172	179
National insurance and other contributions	29.0	32.8	34	35	38	39
Interest and dividends	6.1	6.6	7	7	7	6
Other receipts	5.6	6.9	8	8	9	9
General government receipts[1]	173.9	190.9	206	214	225	233
Of which North Sea tax[2]	4.7	3.2	3	3	3	3

1 General government receipts, and its components, are rounded to the nearest £1 billion from 1989-90 onwards.

2 Royalties, petroleum revenue tax (including advance payments) and corporation tax from North Sea oil and gas production (before advance corporation tax set off). This does not correspond exactly to tax receipts in the same financial year in respect of North Sea production.

Table 2.7 **Public sector debt repayment**[1]

	£ billion, cash					
	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93
General government receipts	173.9	190.9	206	214	225	233
General government expenditure	171.9	179.1	194	205	216	224
Fiscal adjustment from previous years[2]	-	-	-	-	1	3
Annual fiscal adjustment[2]	-	-	-	1	2	3
GGDR	2.1	12	12	8	6	3
Public corporations' market and overseas debt repayment	1.6	2	2	2	0	0
PSDR	3.7	14	14	10	6	3
Money GDP at market prices	426	472	509	539	571	603
PSDR as per cent of GDP	0.9	3	2¾	1¾	1	½

1 Rounded to the nearest £1 billion from 1989-90 onwards. Further details for 1988-89 and 1989-90 are provided in Tables 1.2 and 6.9

2 Means lower taxes or higher expenditure than assumed in lines 1 and 2.

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

Differences from 1988 MTFS projections, percentage points

1988-89	1989-90	1990-91	1991-92
+3½	+1¼	0	+½

Table 2A.3 Revenue and expenditure[1]

	Changes from 1988 MTFS projections, £ billion				
	1987-88	1988-89	1989-90	1990-91	1991-92
Expenditure					
1. Planning total	-½	-6	0	+3½	+7½
2. Other[2,5]	+½	+2½	+1½	0	-1
3. General government expenditure	0	-3½	+1½	+3½	+6½
Receipts[3]					
4. North Sea taxes	0	0	0	0	+½
5. Other taxes and contributions	+1	+4½	+7½	+8½	+6½
6. Other[2]	-1	+1½	+3	+½	+3½
7. General government receipts	0	+6	+11	+9	+10
8. Implied cumulative fiscal adjustment[4]	-	-	-3½	-3½	-2½
9. Public corporations' market and overseas debt repayment[5]	+½	+1	+½	+1	+½
10 PSDR	+½	+11	+14	+10	+6

1 Rounded to the nearest £½ billion. The above changes include the effect of classification changes made since the 1988 FSBR. Within expenditure they are largely offsetting. In 1987-88 classification changes reduce receipts by £0.2 billion.

2 Includes changes in debt interest and other items.

3 The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set off.

4 Line 8= lines 9-10-3+7.

5 Public corporations' market and overseas debt repayment is deducted from the planning total, and included in the PSDR but not in general government expenditure. Changes in it are therefore added to line 2 and subtracted in line 9.

5 Public expenditure

5.01. The Government's expenditure plans for the next three years were set out in the 1988 Autumn Statement (HC 695) and in detail in the 1989 public expenditure White Paper (Cm 601–621). They are summarised in Table 5.1.

Changes since previous Budget

5.02. The planning total for 1989–90 remains unchanged from the level shown in the last FSBR; the planning total for 1990–91 has been increased by £3·3 billion. In both years, extra resources have been provided to meet the Government's priorities, including substantial additional sums for health, law and order, defence and roads. Provision for local authority current spending and the UK's net contribution to the European Communities is also higher.

Table 5.1 Public expenditure

	£ billion				
	1987–88 Outturn	1988–89 Estimated outturn	1989–90 Plans	1990–91 Plans	1991–92 Plans
Department					
Social security	46·3	47·4	51·0	55·3	58·7
Health	19·7	21·7	23·2	24·4	25·4
Defence	18·9	19·0	20·1	21·2	22·1
Education and science	17·1	18·4	19·6	20·2	20·8
Home Office and legal departments	6·5	7·2	8·0	8·4	8·6
Transport	4·6	4·8	5·4	5·5	5·7
Scotland	8·1	8·7	9·0	9·1	9·7
Wales	3·3	3·6	3·8	3·9	4·0
Northern Ireland	4·9	5·6	5·5	5·7	5·9
Other departments	21·6	21·2	23·1	23·7	25·3
Privatisation proceeds	−5·1	−7·0	−5·0	−5·0	−5·0
Reserve			3·5	7·0	10·5
Public expenditure planning total	**145·7**	**150·6**	**167·1**	**179·4**	**191·6**
General government gross debt interest[1]	17·7	18·3	17·1	15½	14½
Other adjustments[1]	8·4	10·2	10·1	10½	9½
General government expenditure	**171·9**	**179·1**	**194·3**	**205**	**216**
General government expenditure excluding privatisation proceeds:					
in real terms (base year 1987–88)[2]	177·0	173·5	176·4	179	182
as a percentage of GDP	**41½**	**39½**	**39¼**	**39**	**38¾**

[1] *1990–91 and 1991–92 figures rounded to nearest £½ billion.*

[2] *Using GDP deflator and money GDP on the same basis as in Table 2.1.*

D633 **CONFIDENTIAL**

FROM: S J DAVIES
DATE: 10th March 1989

CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Monck
Mr Scholar
Mrs Lomax
Mr Peretz
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Grice
Miss O'Mara
Mrs R Butler
Mr Mowl
Mr Barrie
Mr Savage
Mr Conaty
Miss Simpson
Mr Call
Mrs Chaplin
Mr Tyrie

a
3 points: two in this note & one by EST below

I accept the first of these points, but not the second: 'the medium term' is not synonymous with 'the MTFS period', or 'the next 4 yrs'; it is much less precise. When we mean the MTFS period let's say so. (see [illegible] EST's note)

FSBR CHAPTER 2

Mr Allan's minute of 9 March draws attention to the ½ percentage point increase in 1991-92 money GDP growth in the 1989 MTFS compared with the 1988 MTFS, and asks whether this change is consistent with paragraph 2.10 of the MTFS which says that:

> "to the extent that faster growth of money GDP reflects only higher demand with no supply side improvement, the Government will take action to return to its planned path for money GDP growth of the medium term".

The reason we have raised money GDP growth in 1991-92 is that we expect a slower fall in oil output over the medium term than we expected last year (see paragraph 2.11): this is a supply side change that would warrant a change in money GDP growth in terms of the principles described in paragraph 2.10. I do not think therefore that there is any inconsistency in the change that has been made.

This is worth ¼%. Other ¼% is roundings (Chris Riley tells me).

2. Can I also raise a point on paragraph 2.13. In the latest version returned to the printers, the second and third sentences read, at your request:

> "In recent years the private sector as a whole appears to have moved from large surplus into substantial deficit, and this has led to the balance of payments current account moving into deficit despite the public sector's move into surplus. It seems likely that these trends will reverse themselves over the medium term, and the private sector's financial position is likely to move back into surplus."

3. I think it would be better not to commit ourselves to the view that the private sector will actually get back into surplus before the end of the MTFS period. We cannot be sure how quickly the private sector financial position will return to a more normal state. It would be natural to read the second of the two sentences above to mean that we do forecast a return to surplus over the MTFS; although the drafting is not completely unambiguous. I think it would be better to be less definite; and to substitute "back towards surplus" for "back into surplus".

SJD

S J DAVIES

chex.rm/aal/74 CONFIDENTIAL

FROM: A C S ALLAN
DATE: 10 March 1989

Pp

MR S J DAVIES

cc PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Riley
Mr Sedgwick
Mr Gieve
Miss Simpson
Mrs Chaplin

FSBR CHAPTER 2

The Chancellor was grateful for your minute of 10 March.

2. He accepts the first of your points, that the change in 1991-92 money GDP growth is not inconsistent with what it said in the text.

3. He does not, however, see any need to change the text of paragraph 2.13. "The Medium Term" is not synonymous with "the MTFS period" or "the next four years"; it is much less precise. When we mean the MTFS period, we say so.

4. He has seen PS/Economic Secretary's minute of 9 March and agrees with the Economic Secretary that "criterion" in paragraph 2.25 should be replaced with "basis".

ACSA

A C S ALLAN

FROM : MISS J C SIMPSON
DATE : 11 MARCH 1989

CHANCELLOR

BOOK PROOFS OF THE FSBR

I enclose a copy of the book proofs of the FSBR as they have been returned to the printers, together with an uncorrected copy and a set of the charts we have also sent the printers this evening. (They already had the chart of Chapter 4 and the rest of those for Chapter 3.) We are aware that some further corrections need to be made to the contents page.

2. Mr Riley would be grateful if you could confirm if you are still happy with the sentence in paragraph 1.03 which states that

> "a gradual return <u>to</u> a balanced budget is projected over the medium term."

The projection in Chapter 2 does not show a return all the way to a balanced budget, while paragraph 2.29 states that

> "The Government intends to move gradually ... <u>towards</u> a balanced budget over the medium term."

Mr Riley has suggested that alternative drafts for paragraph 1.03 might be

> "a gradual <u>move back towards</u> a balanced budget is projected over the medium term"; OR

> "a gradual return to a balanced budget is <u>intended</u> over the medium term".

The printers have not been told to change the present text, but if you wished to do so - as MP would prefer - a change could be fed in at the 'read at press' on Monday morning.

3. Mr Riley thought your attention should also be drawn to paragraph 6.03, which now notes explicitly that the PSDR excluding privatisation proceeds is £2 billion higher in 1989-90 than in 1988-89. The sentence could be removed on Monday at the 'read at press' if you wished.

4. Mr Riley would be happy to discuss these points and any other queries you might have. His telephone number is 720 6263.

JS.

MISS J C SIMPSON

Mine, should you be unable to get him, is 800-3930.

Chart 2.1 Money GDP, output and inflation

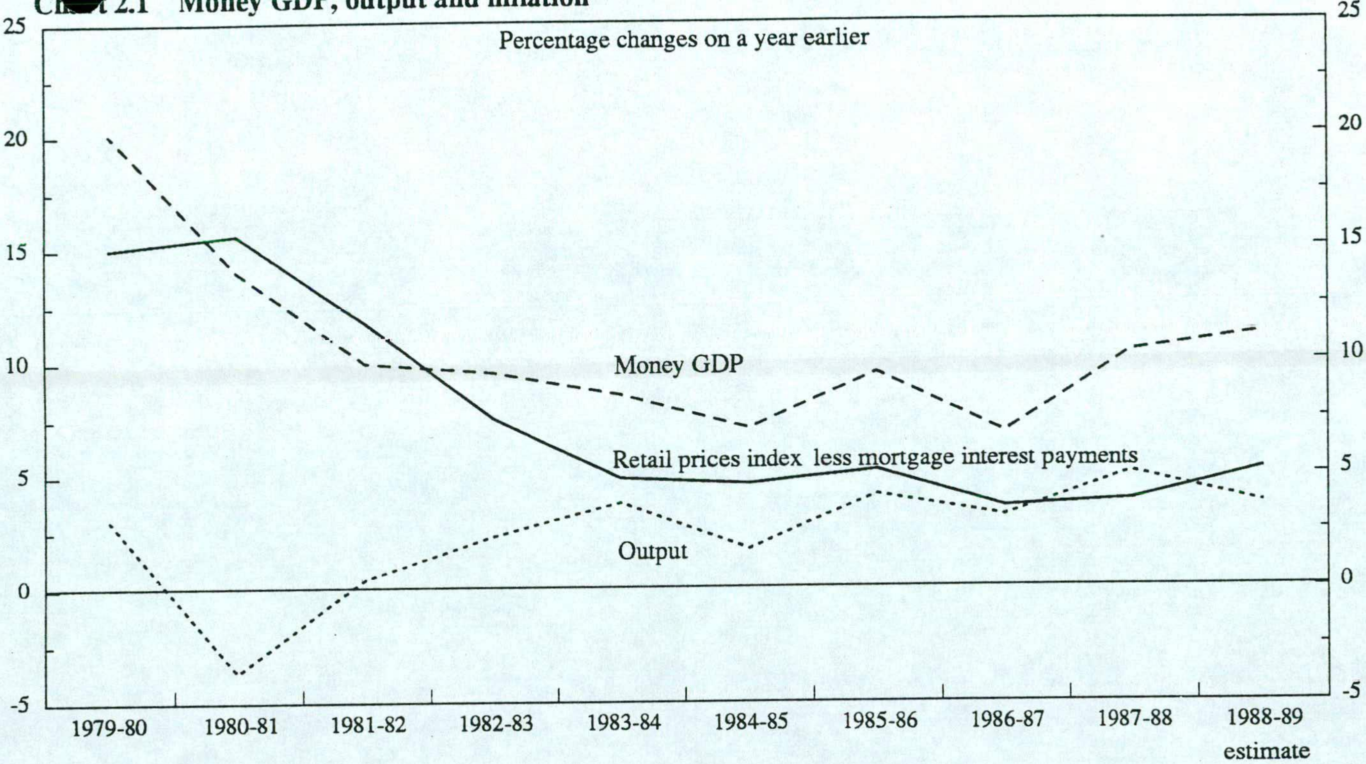


Chart 2.2 Private and public sector borrowing

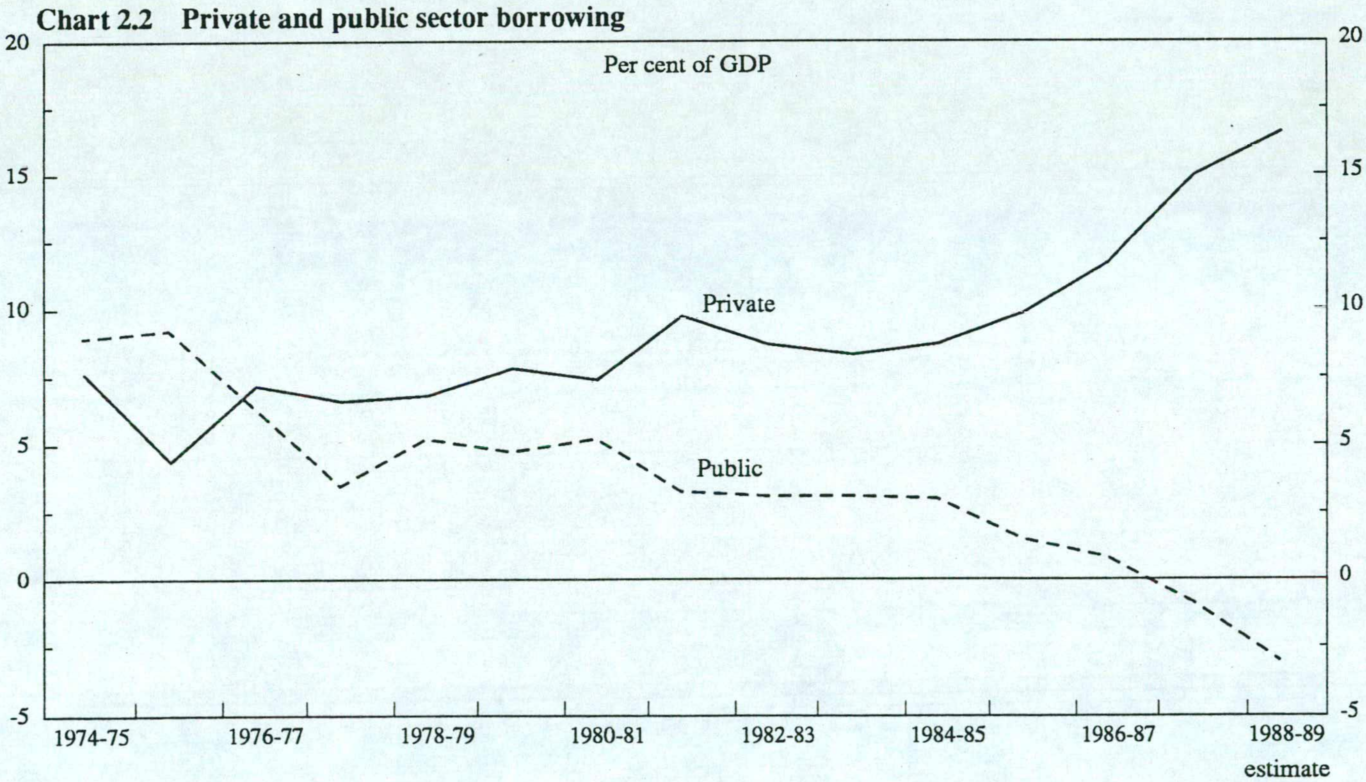


Chart 2.3 Interest rates in the UK

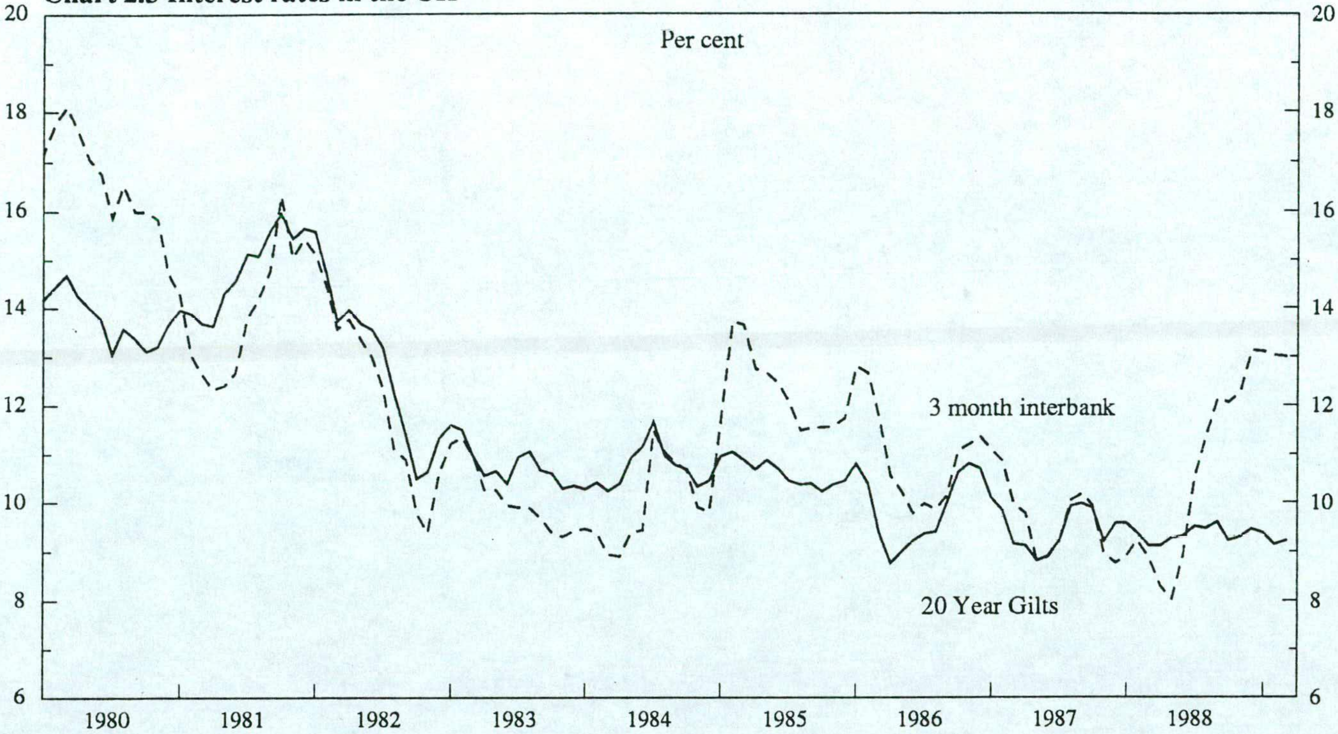
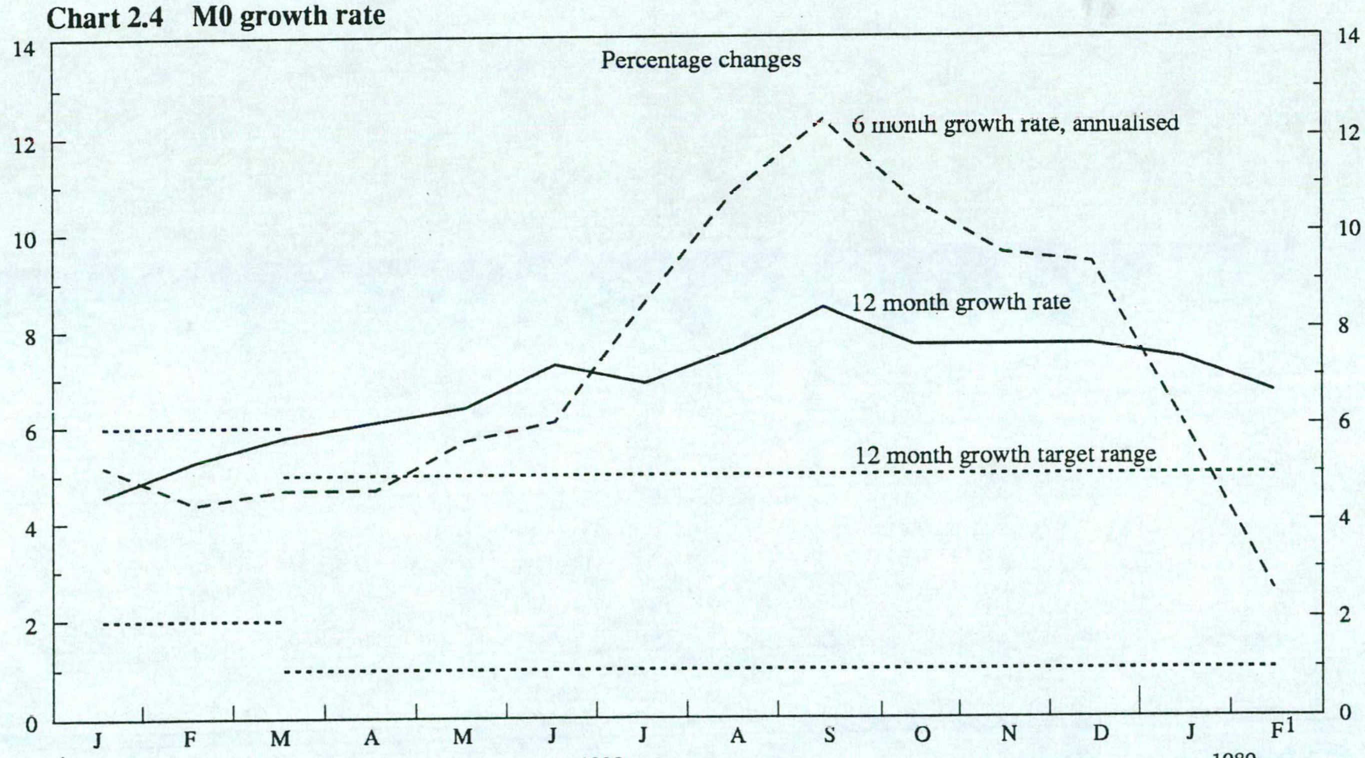


Chart 2.4 M0 growth rate



1 *estimate*

Chart 2.5 Sterling exchange rates

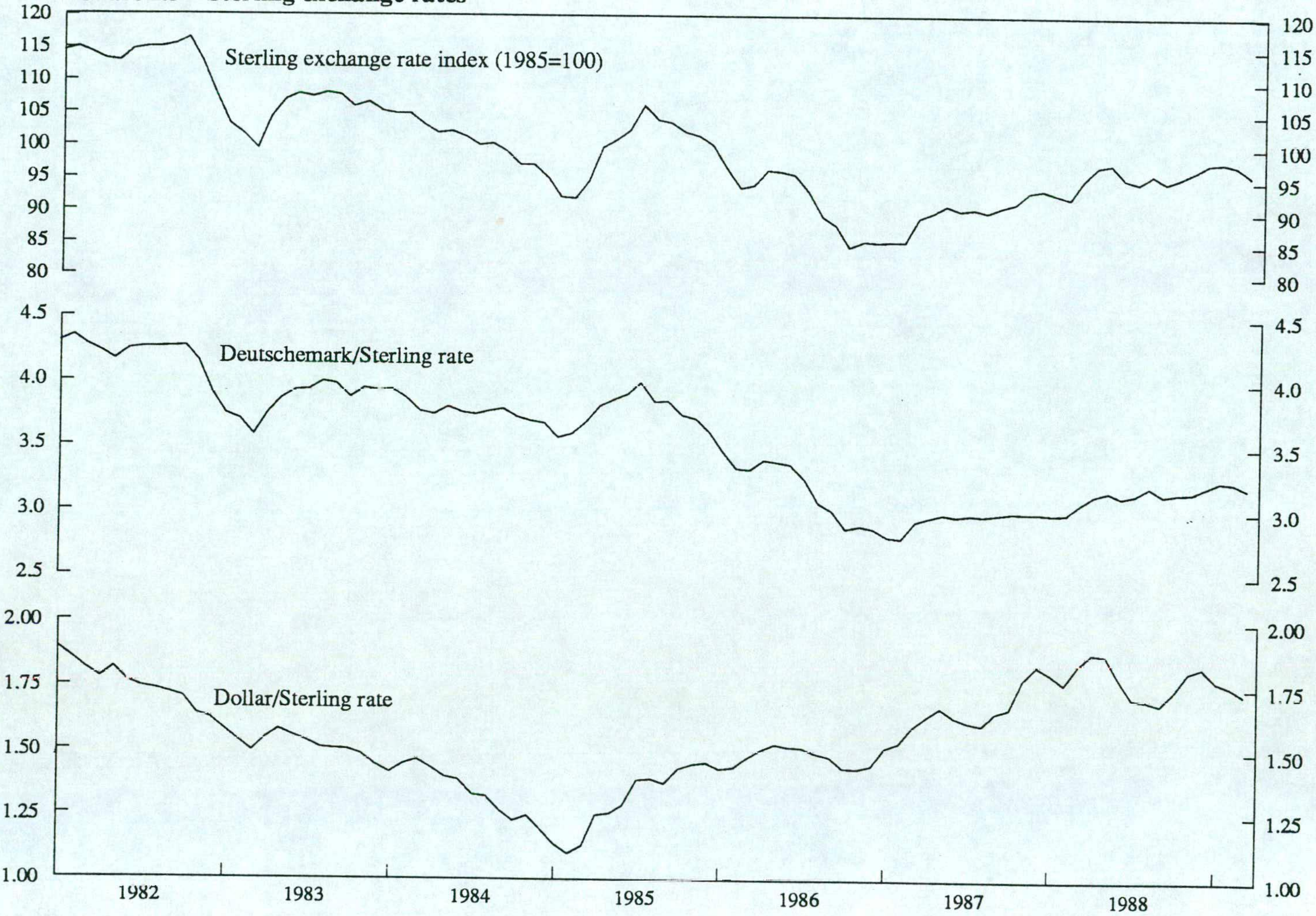


Chart 2 Growth rates of monetary aggregates

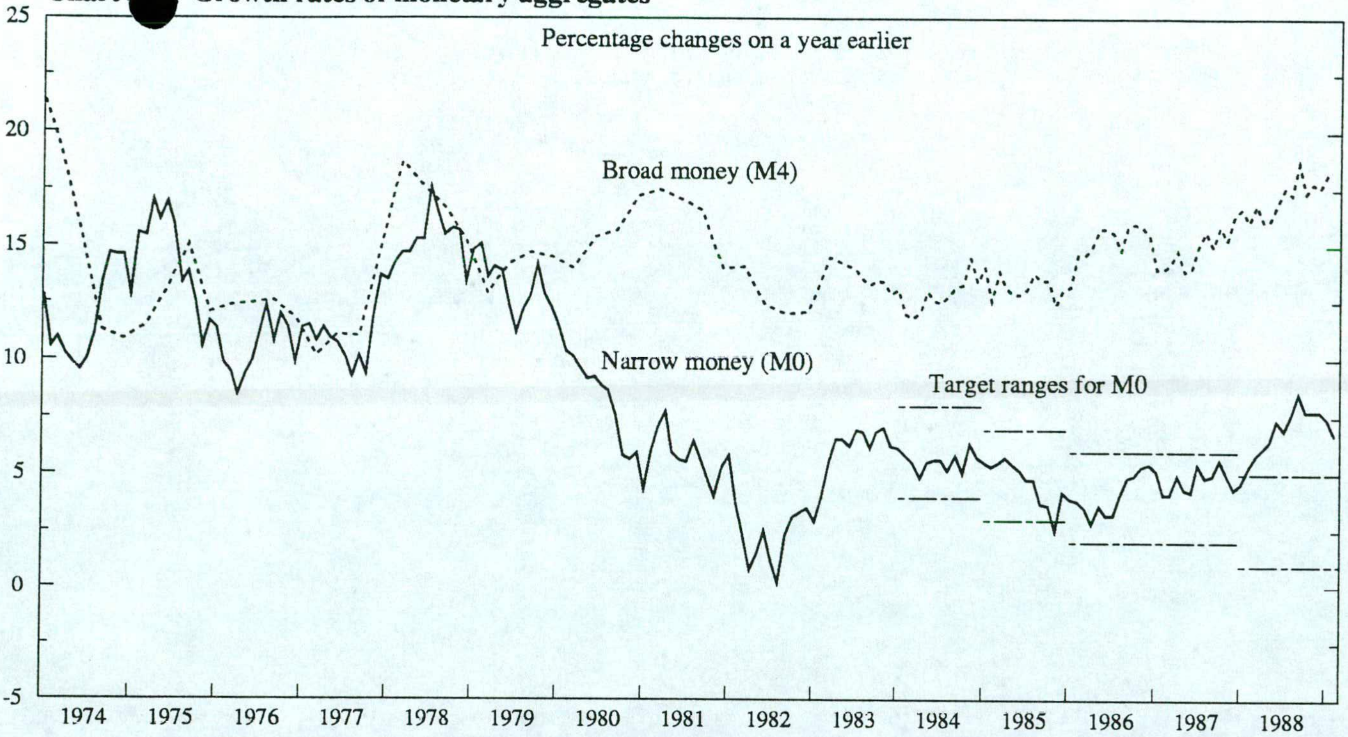
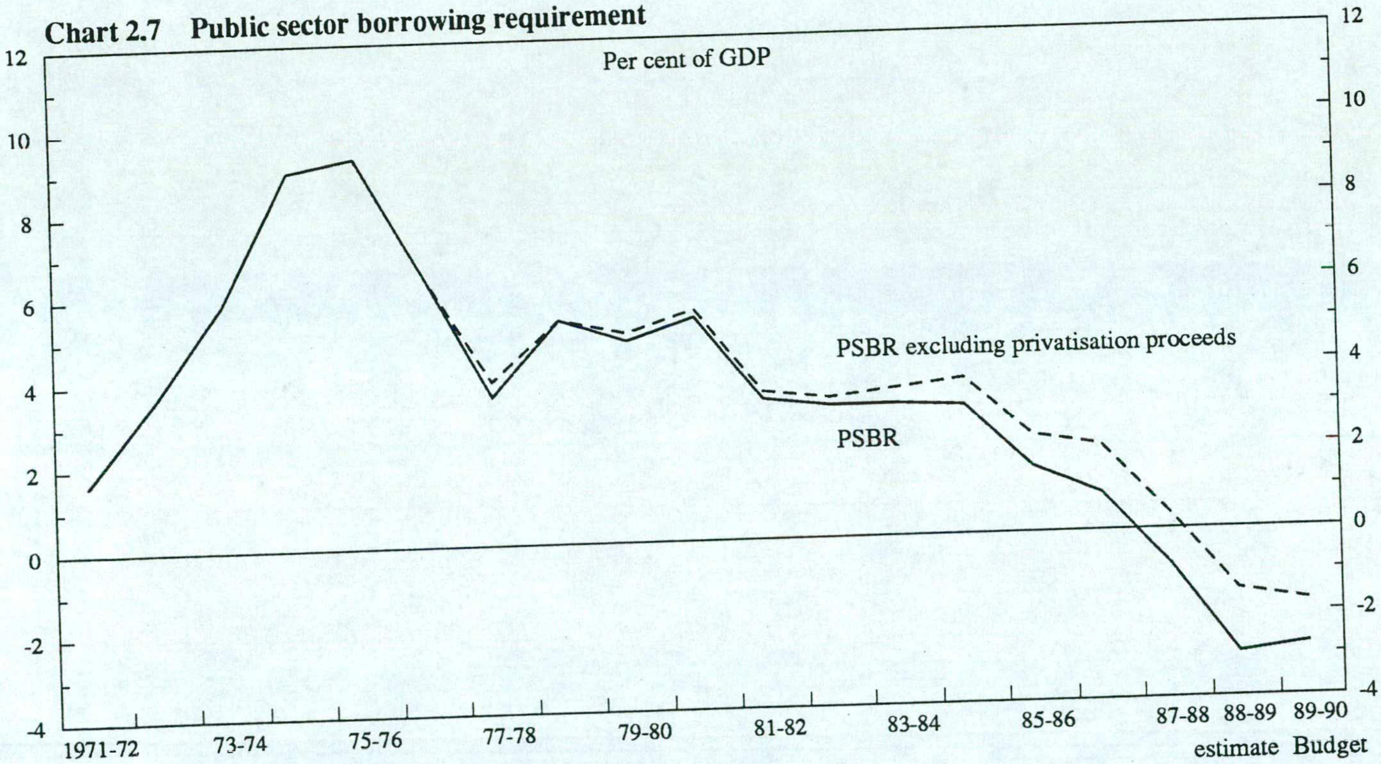


Chart 2.7 Public sector borrowing requirement



1 *Negative values indicate a public sector debt repayment.*

Chart 3.1 Major seven economies' real GNP and industrial production

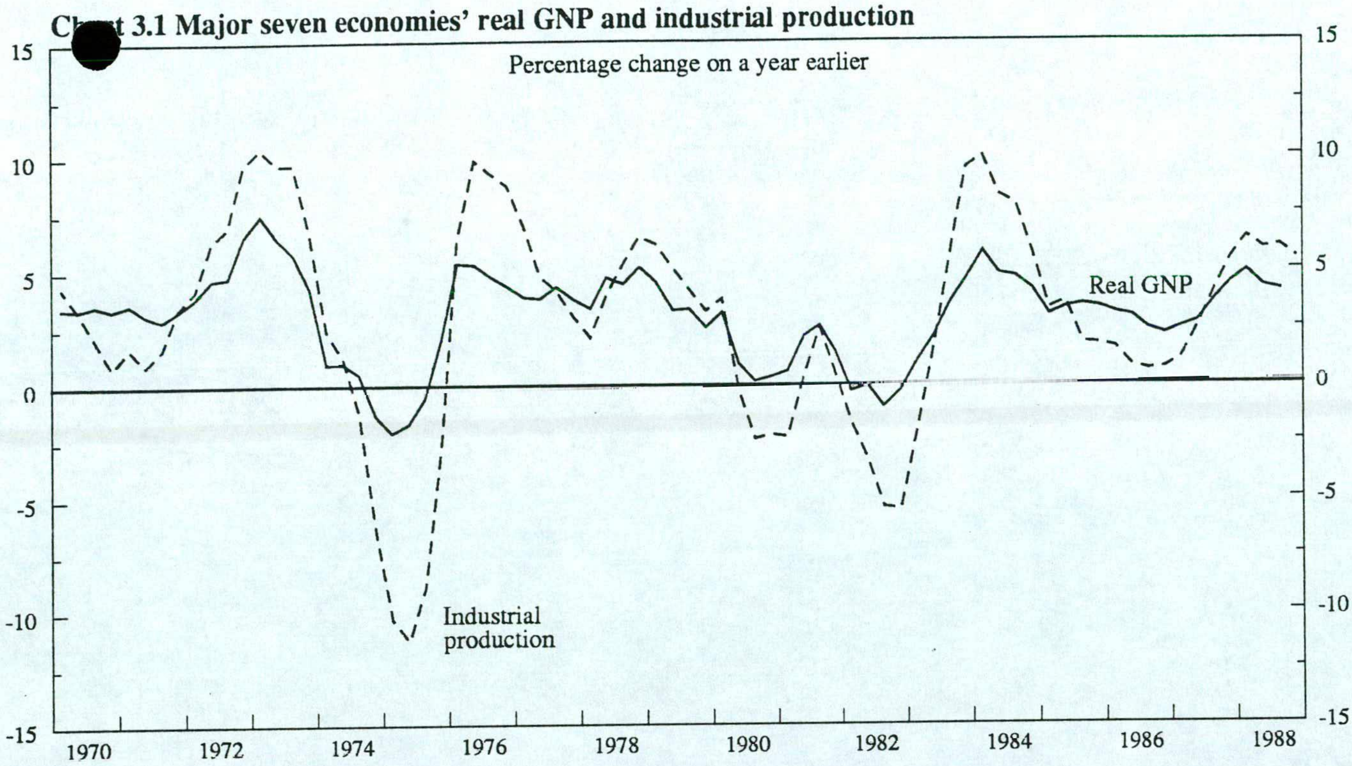


Chart 3.2 Real commodity prices

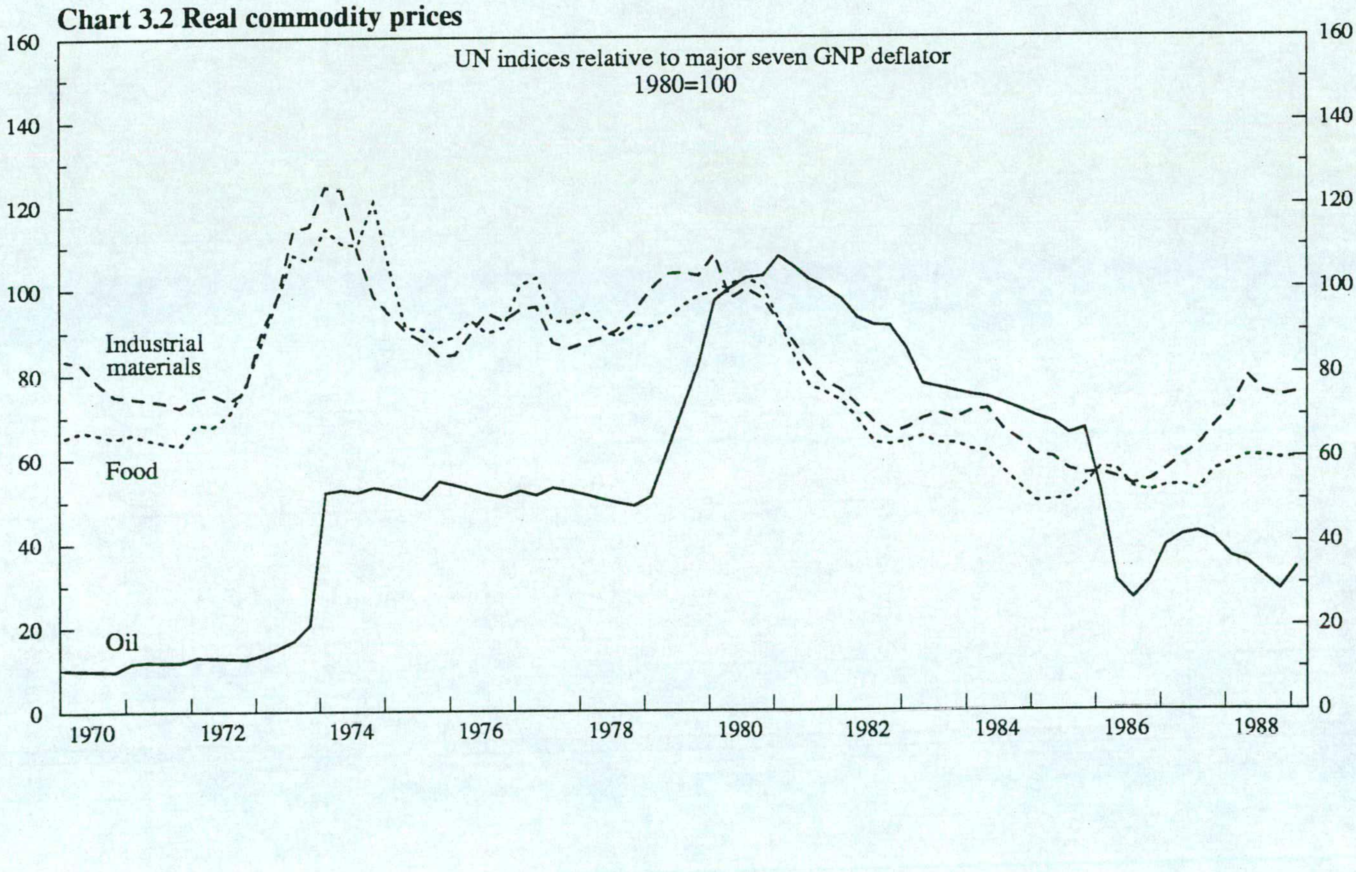


Chart 3.3 UK Share of trade

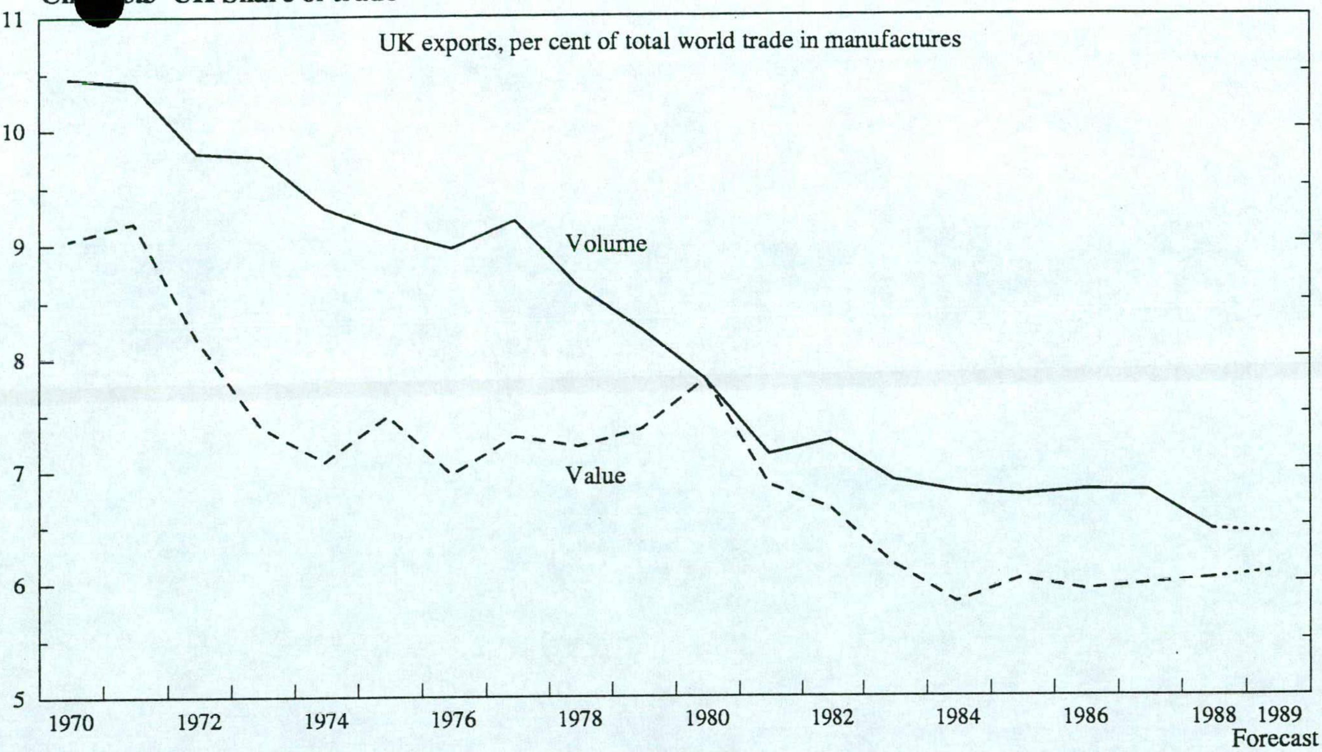


Chart 3.3 UK Share of trade

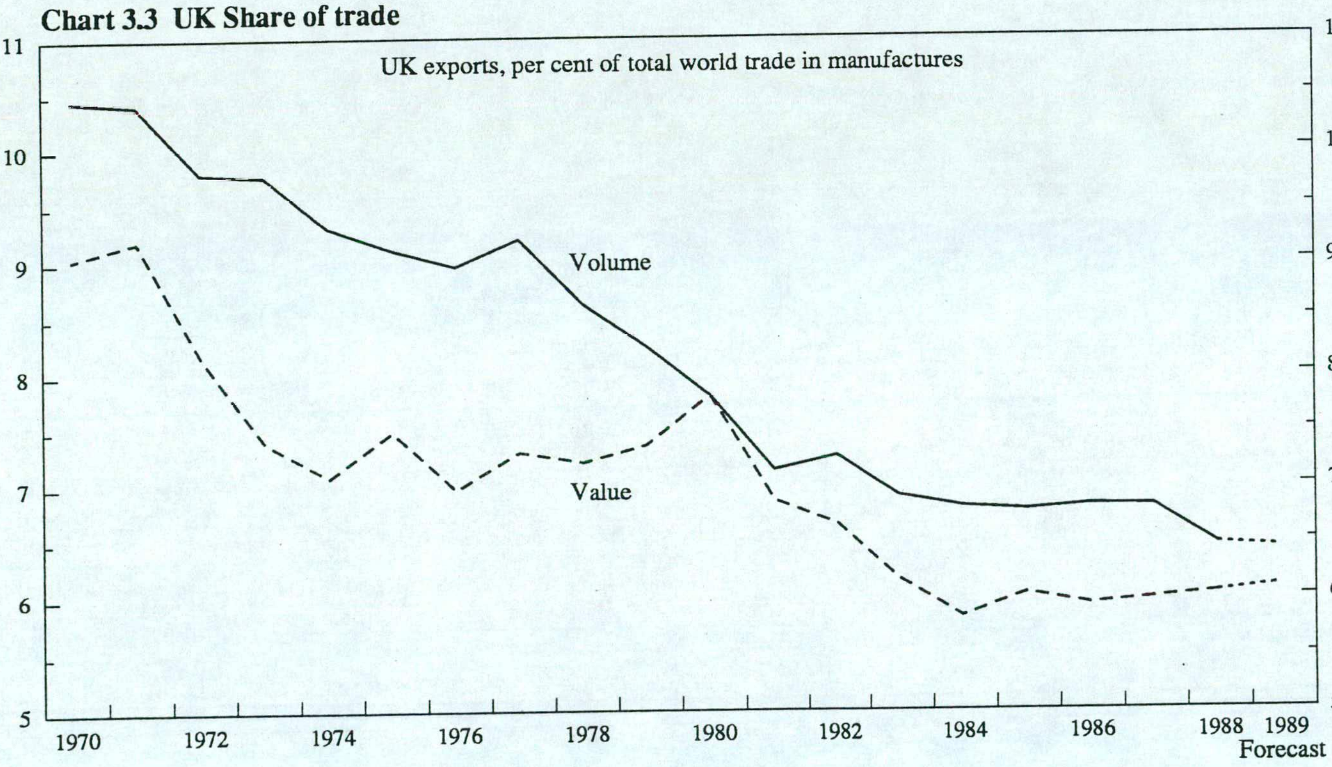


Chart 3.8 Private sector saving and investment

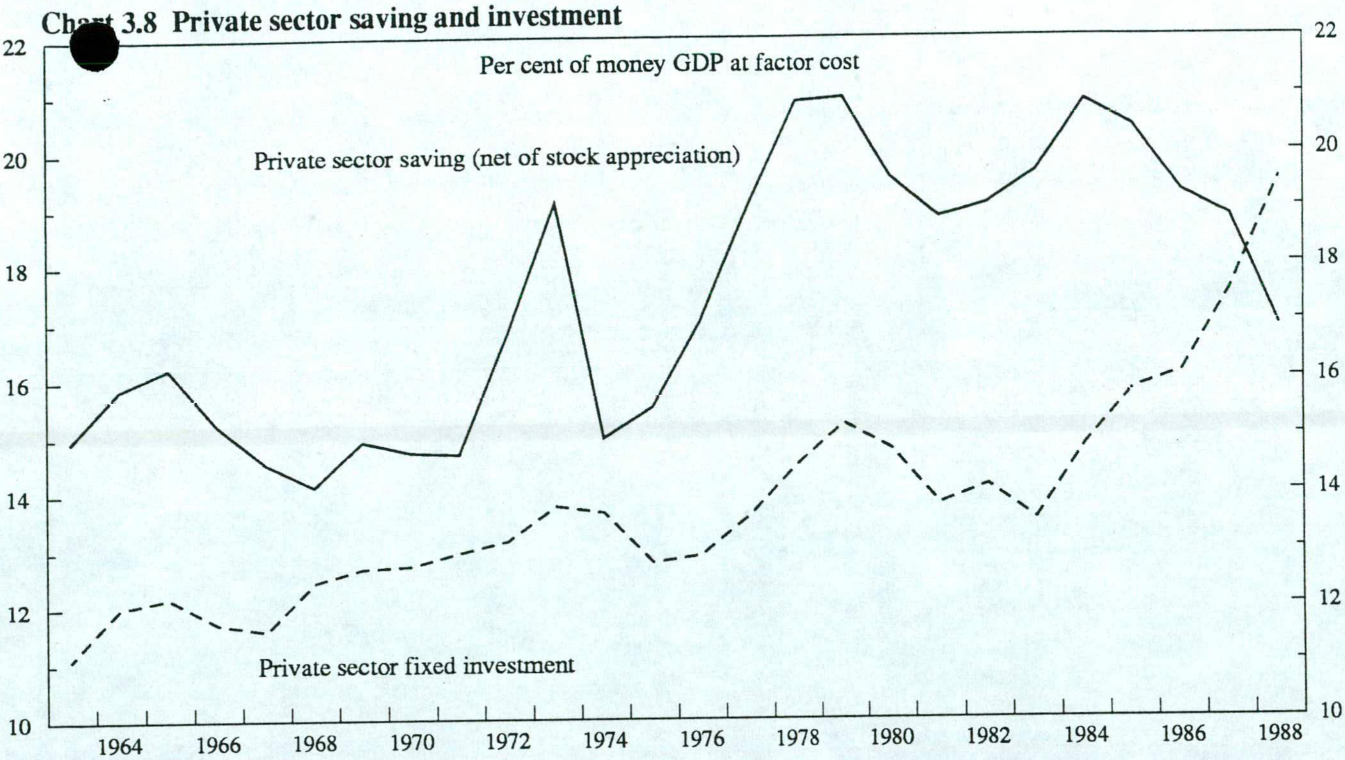


Chart 3.9 : RPI inflation

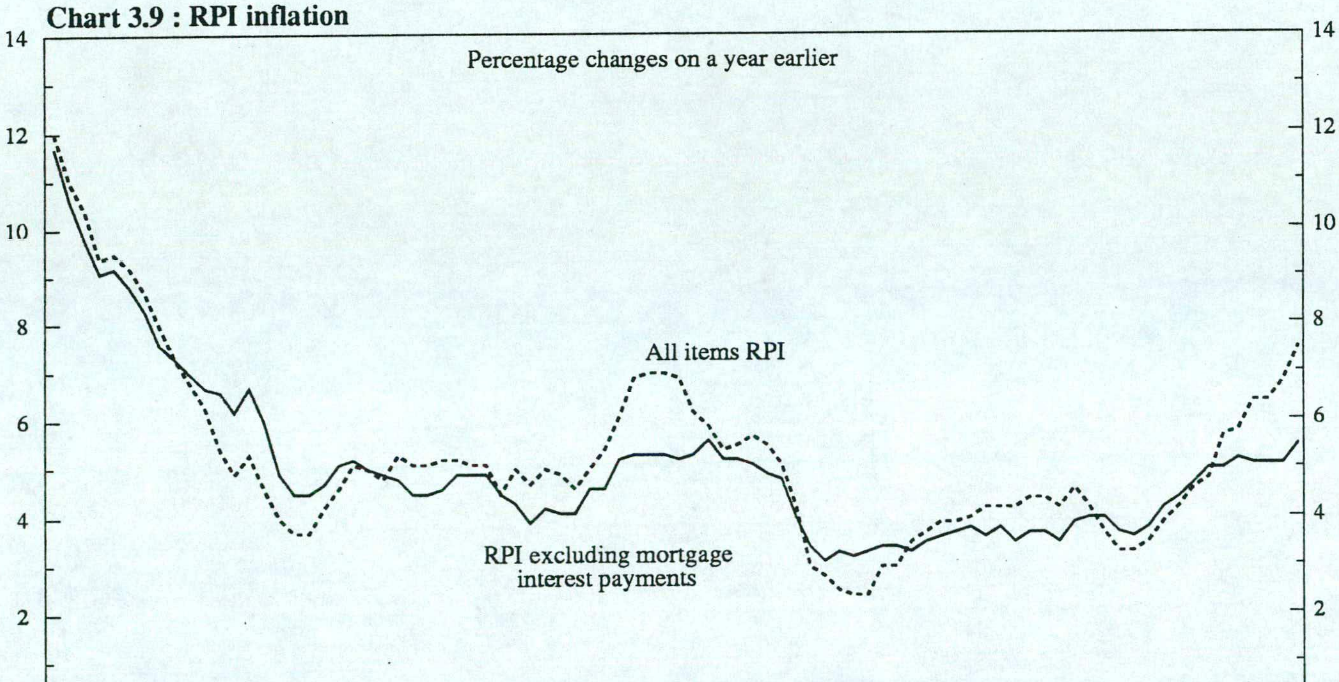


Chart 3.10 : Unit labour costs in manufacturing

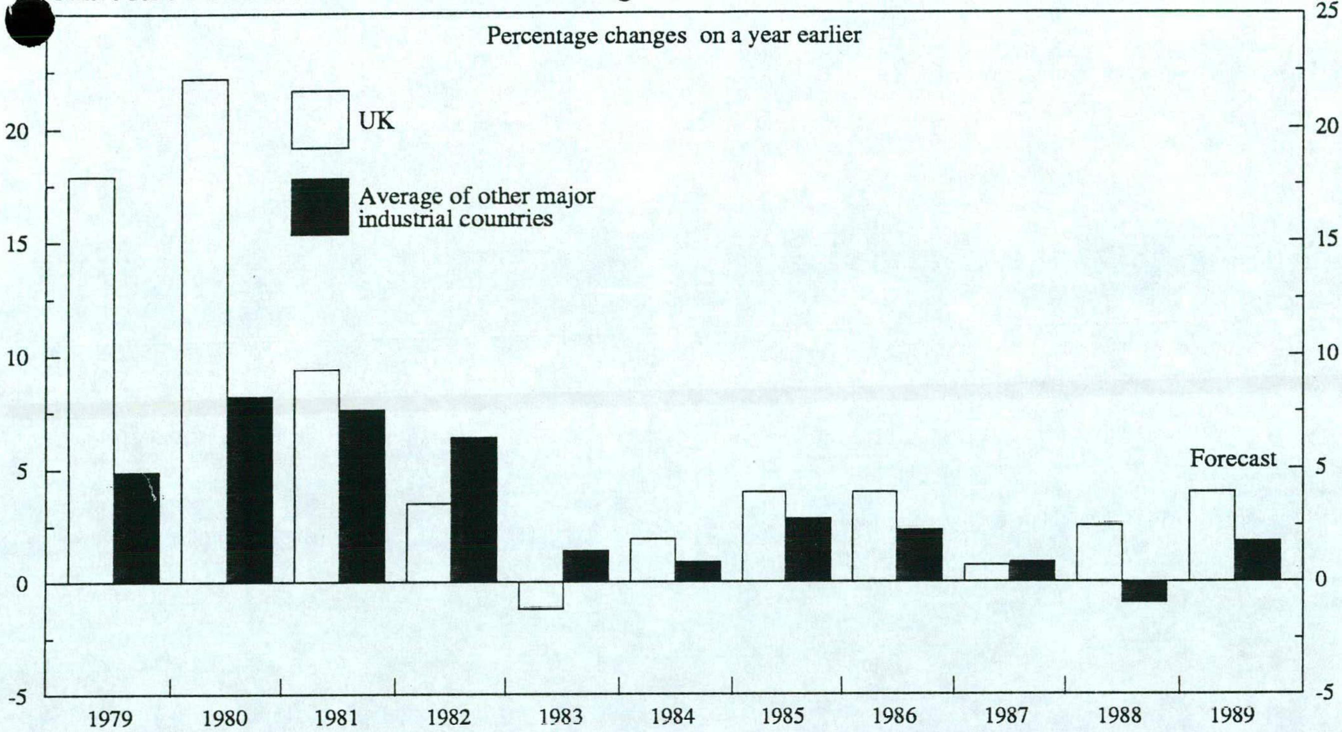


Chart 3A.1 Compromise adjustment

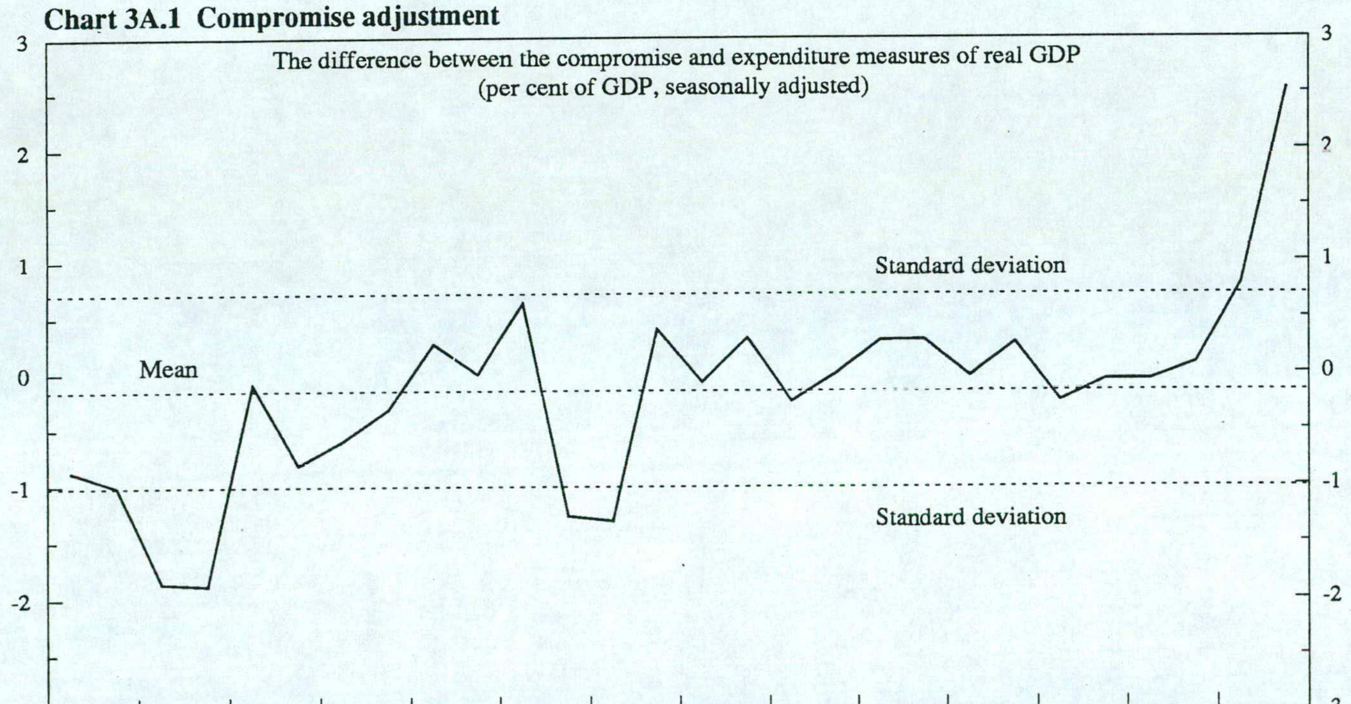


Chart 6.1 Taxes and national insurance contributions

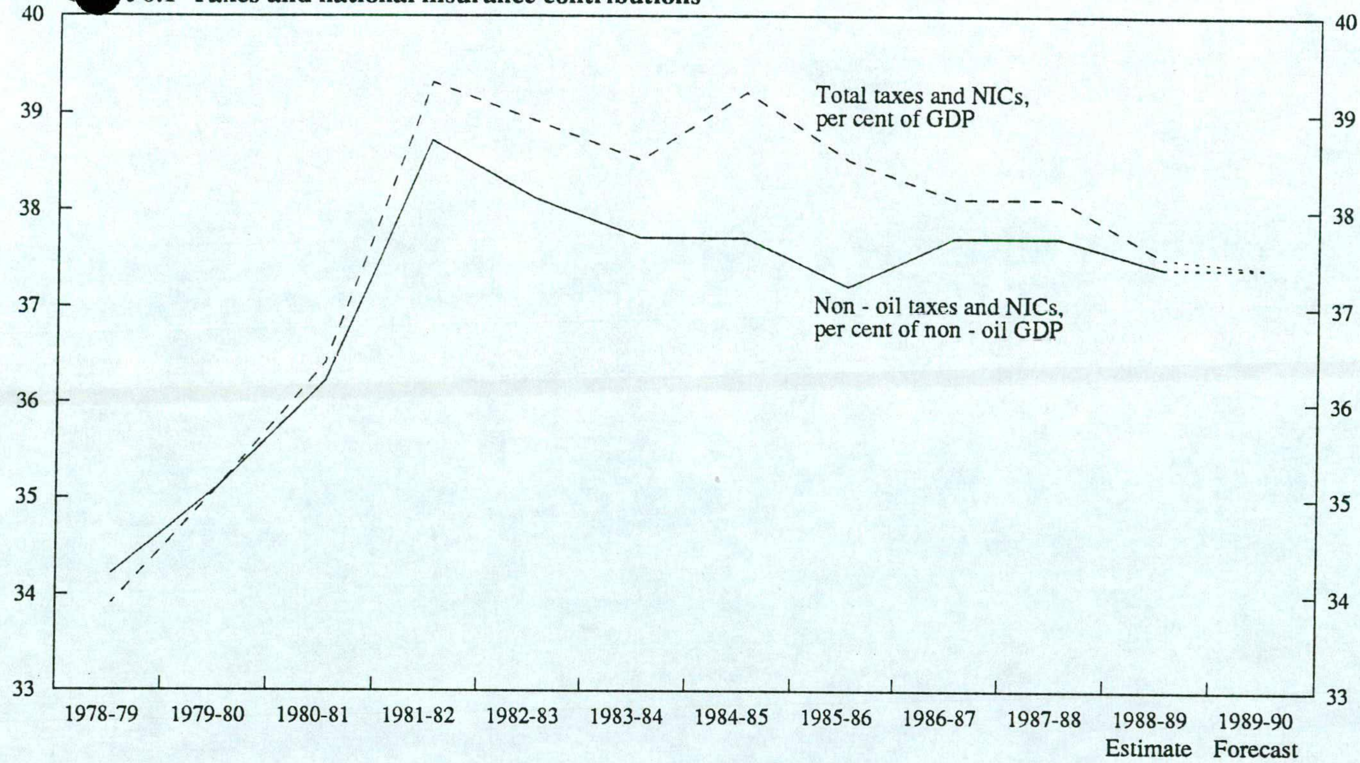


Chart 6.2 General government expenditure

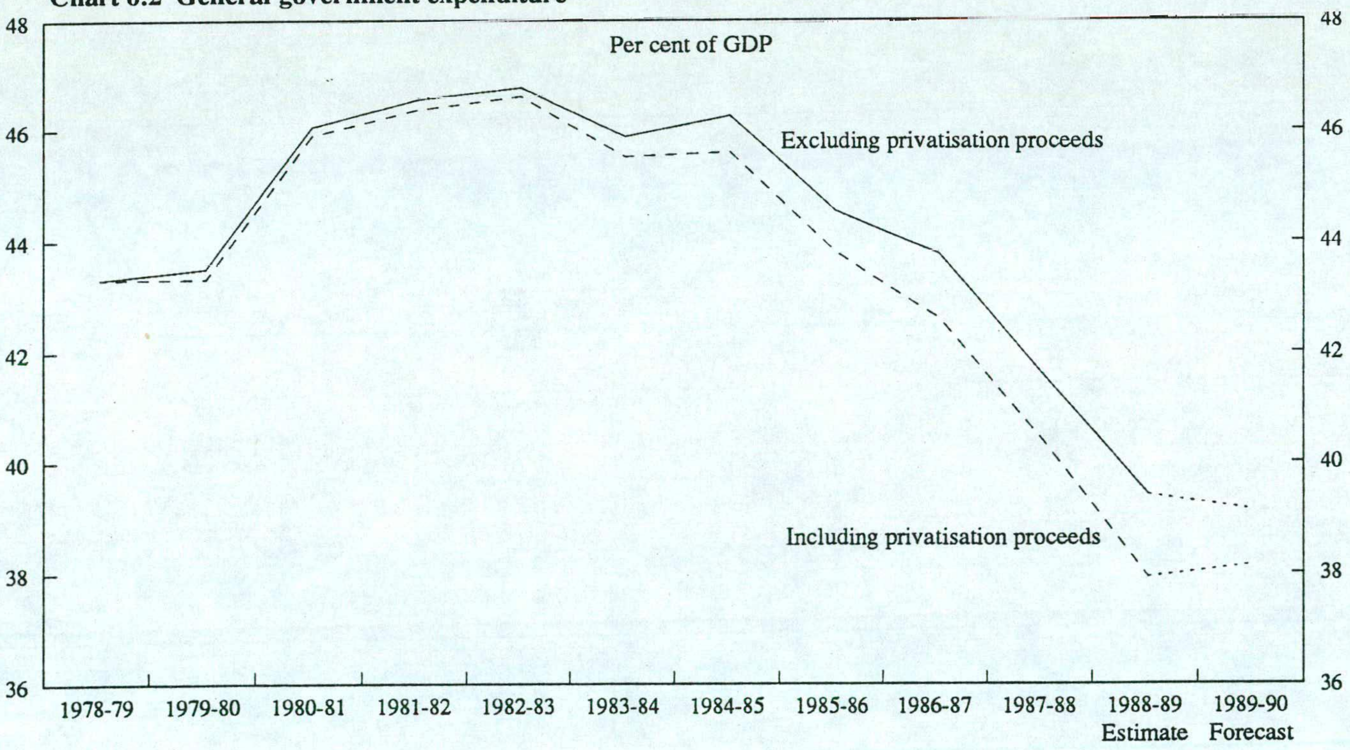


Chart 6.3 General government debt interest payments

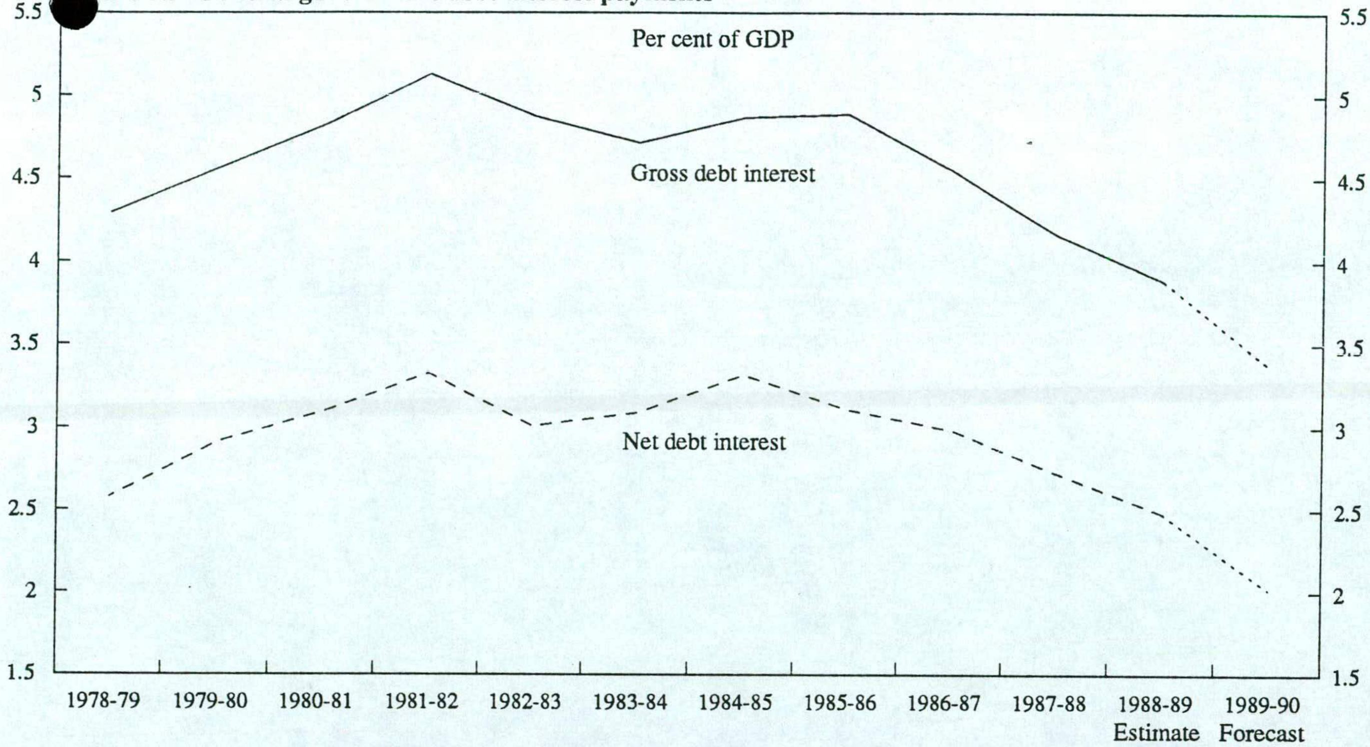


Chart 6.4 The structure of general government receipts and expenditure

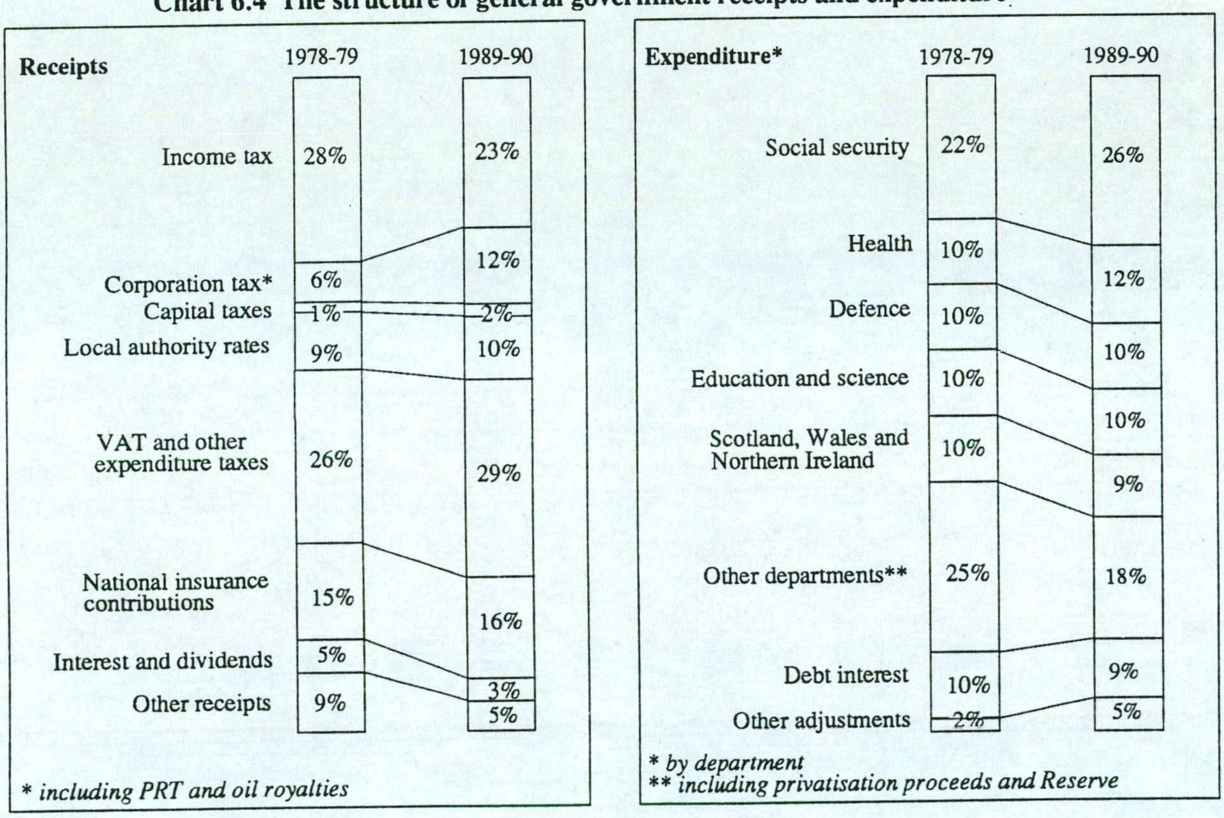


Chart 6.5 Public sector debt repayment by sector