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FILE TITLE

AUTUMN STATEMENT 1988

1/2

FILE NUMBER PO-CH/NL/0712 PART A

FOR DISPOSAL ADVICE SEE INSIDE COVER

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SECRET

pmp

FROM: MISS M O'MARA
DATE: 5 NOVEMBER 1986

PRINCIPAL PRIVATE SECRETARY

Spoken

cc Mr Scholar
Mr Culpin
Mr Pickering
B/10

AUTUMN STATEMENT BRIEFS: A1 AND B1

As you know, we are planning to put the key briefs to the Chancellor this evening. But in view of all the photocopying which has to be done in the special circumstances of this year, we have to run off the Autumn Statement Brief tonight, so we shall not be able to reflect any of the Chancellor's amendments in the version which is circulated widely tomorrow.

2. Senior officials have looked at the draft at various stage but, given the sensitivity in presentation, we thought that the Chancellor might like to glance at briefs A1 and B1 during the course of today, if he has time to do so. The drafts below are still in the process of being checked for details by divisions but it would be helpful to know if the Chancellor is content with the overall tone. (There is deliberately some overlap.) These drafts have benefited from comments by Mr Scholar and Mr Culpin.

~~3. In order to take the Chancellor's amendments on board, we would need his comments by 5.30pm.~~

MOM

MISS M O'MARA

Ch

Looks OK (& Robert has already had a go at earlier drafts). A couple of comments marked.

AA

A1 STRATEGY

Factual

(i) No change in strategy. 1986-87 PSBR in line with Budget forecast. Government's fiscal stance remains as set out in MTFS at Budget time. No relaxation.

(ii) Further healthy, balanced growth forecast with inflation remaining low. Current account moves into small deficit but prospects for fall in unemployment more promising.

(iii) General government expenditure (GGE) fallen as percentage of GDP in every year since 1982-83, including or excluding privatisation proceeds. Plans imply further fall in ratio in each of Survey years.

(iv) Planning totals increased to

- enable higher spending on priority services: health, education (including teachers' pay), housing, roads, law and order
- make provision for social security expenditure.

(v) New totals represent Cabinet's allocation of spending priorities within constraint of declining ratio of GGE to GDP.

(vi) How the sums add up:

Comparison with FSBR forecast for 1986-87 **£ billion**

Expenditure		**Receipts**	
Increase in GGE	+1	Increase in non-North Sea revenue	+2
Reduction in public corporations' market and overseas borrowing	- ½	Decrease in North Sea revenue (including APRT policy change)	-1 ½
Net change	+ ½	**Net change in revenue (including policy change)**	+ ½

So no change in PSBR, despite higher public expenditure, lower North Sea revenues and policy change in North Sea fiscal regime. Reflects buoyancy of non-North Sea revenues.

Positive

(i) Success of Government's economic strategy reflected in inflation at levels not seen for almost two decades, economic growth averaging nearly 3 per cent for 5 successive years and nearly 1 million more new jobs since 1983 election. Now forecasting growth of 3 per cent in 1987, with underlying inflation remaining broadly stable. Prospects for fall in unemployment more promising too.

(ii) Strategy on course. Prudent management of economy in past permits increase in priority services now: health, education (including teachers' pay), housing, roads, law and order. Yet no relaxation of fiscal stance.

(iii) Plans show continuing decline in GGE as proportion of GDP over Survey period, reducing burden of State on private sector. Profile similar, even excluding privatisation proceeds.

(iv) Credibility of public expenditure plans: Increased provision for LAs and social security. Large and rising Reserves of £[3.5] billion (1987-88) to £[7.5] billion (1989-90).

(v) PSBR on track: No change from FSBR forecast. Higher spending matched by higher receipts, despite lower North Sea revenues and policy change in North Sea taxation.

(vi) Adjustment to lower oil revenues: Autumn Statement demonstrates, as predicted in Budget, that public finances have accommodated reduction in oil revenues. Oil revenues in 1986-87 forecast down £6½ billion on 1985-86 but PSBR up by only £1¼ billion. Even excluding privatisation proceeds, PSBR up only £3½ billion - much less than oil revenue fall.

(vii) Government responding positively to concerns of offshore supplies industries etc. in Scotland and North East England, in wake of oil price fall. But no PSBR increase.

Defensive

(i) Policy U-turn: No. "The State takes too much of the nation's income; its share must be steadily reduced" (1979 Manifesto). Continued reduction in GGE as percentage of GDP throughout Survey period fully consistent with this aim.

(ii) Fiscal stance: Remains as set out in MTFS at Budget time. No relaxation.

(iii) No scope for future tax cuts: Wait for Budget. Any fiscal adjustment in 1987-88 will depend on spending and revenue. Extra spending clearly reduces scope for any tax cuts. No revenue projections or fiscal adjustment published with Autumn Statement. None published in 1985 either.

(iv) Fiscal policy too loose? No.

(a) For 1986-87 PSBR lower as percentage of GDP (1¾ per cent) than in any year since 1971-72 (also 1¾ per cent), barring 1985-86 (1½ per cent). Even excluding privatisation receipts (3 per cent), only 1985-86 (2¼ per cent) had lower PSBR/GDP ratio since 1971-72.

(b) Fiscal outlook for future years remains as set out in MTFS.

(v) Fiscal stance too tight? Present level of borrowing consistent with prudent management of nation's resources. Government not prepared to take risks with inflation.

(vi) Alteration in fiscal/monetary mix needed (Budget Speech referred to possibility of change in mix over short term): No. MTFS remains as set out at Budget time.

WPU

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(vii) Current account deficit in 1986-87: Emergence of small deficit (only ½ per cent of GDP) not surprising given deterioration in oil balance, sluggish world trade growth in 1986 and relatively high domestic demand. But volume of non-oil exports now growing again. Recovery set to continue in 1987, reflecting faster growth in UK markets and UK's improved competitiveness.

Takes time for full effects of existing exchange rate change to work through to improved trade balance And . . .

(viii) Further devaluation needed in view of forecast current deficit? No. Key to sustained improvement in competitiveness is lower pay settlements.

(ix) Inflation rising again. Rise in all items RPI 1986Q4 to 1987Q4 attributable to mortgage interest component. Excluding this, RPI inflation unlikely to be very different in 1987Q4 from what it is now.

(x) Price stability objective abandoned. No. Never suggested likely to be reached in next two years. Government inherited inflation in double figures in 1979. More than halved by end of last Parliament. Price stability realistic objective for next Parliament.

(xi) Chancellor's Party Conference rejection of "irresponsible spending spree" overturned. Nonsense. GGE continues to decline as percentage of GDP in every Survey year. Contrast irresponsibility of Opposition who, in own words, would increase PSBR by £6 billion in first year of office, let alone implications of full spending commitments.

(xii) What has happened to "revenue determines expenditure"? Expenditure plans still set in relation to what nation can afford to finance either by taxation or borrowing.

(xiii) How can Government afford to increase planning totals this autumn but not last, despite subsequent oil price fall? Need to look at overall fiscal stance, not just expenditure increase. Despite £1½ billion fall in North Sea revenue (including oil taxation change), receipts overall up by estimated £½ billion in 1986-87. So revenue buoyancy fully offsets increase in general government spending. this year [For future years, wait for Budget.]

?

X/o

(xiv) Revised plans not credible. Increases, including prudent Reserves, reflect determination to make plans which can be delivered.

(xv) Planning totals too low; increased public spending better for jobs than tax cuts. Those who justify such calls on basis of model simulations fundamentally misguided. No model fully captures incentive and other supply side effects of tax reductions - what really matter for jobs.

(xvi) Government favouring public spending above tax cuts. Government remains firmly committed to reducing tax burden when prudent to do so. But has never ruled out selective increases in spending in priority areas.

(xvii) Employment programme should have been increased. Government spending around £3 billion in 1986-87 on measures to promote enterprise, employment and vocational education and training, including £1.2 billion targeted on long term unemployed. Budget already added around £300 million to programme in 1987-88 and 1988-89. But key to more jobs lies primarily in better performance of economy and slower growth of pay; not in large and rapid increase in public spending.

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(xviii) Policies have not delivered falling unemployment in past. Nearly 1 million new jobs since June 1983. Not reflected in lower unemployment because labour force growing even more rapidly. Budget measures and pick-up in activity mean immediate prospects of reducing unemployment more favourable. Slower growth of labour force projected for rest of decade should improve chance of reduction over next few years. But pay developments remain critical.

(xix) If public expenditure under pressure in 1986-87, why give £300 million to oil industry? Rise in non-oil revenues sufficient to offset both higher spending and APRT repayment without increase in PSBR. Change in North Sea fiscal regime is simply phasing adjustment, in response to oil companies' reduced tax liability following oil price fall. Will reduce PSBR in later years.

Contact point: Miss C Evans (FP) 233 8737

B1 FISCAL POLICY 1986-87 TO 1989-90: REVENUE PROSPECTS 1986-87

[See also Public sector borrowing: historical statistics and international comparisons (Brief B2), Content, changes and timing compared with 1985 (D1), North Sea tax regime (E3), Public expenditure: 1986-87 (G1) and Public expenditure: 1987-88 to 1989-90 (G2)]

Factual

(i) PSBR for 1986-87 forecast at £7 billion, 1¾ per cent of GDP. No change from FSBR forecast.

(ii) PSBR excluding privatisation proceeds for 1986-87 forecast at £12 billion, 3 per cent of GDP.

(iii) Margin of error: Average absolute margin of error on current year PSBR forecast at time of Autumn Statement around ¾ per cent of GDP, equivalent to £3 billion at current level of GDP.

(iv) General government receipts in 1986-87: £½ billion higher than FSBR forecast overall. Following change announced in North Sea fiscal regime (see E3), North Sea revenues now forecast £1½ billion lower than in FSBR, but more than offset by higher non-oil receipts:

(a) North Sea receipts forecast lower

- lower dollar oil price and

- early repayment of Advance Petroleum Revenue Tax (APRT).

(b) Non-North Sea corporation tax receipts forecast up - in line with higher profits.

(c) VAT receipts forecast up. Experience to date suggests FSBR forecast for 1986-87 was underestimate.

(d) Stamp duty forecast up, reflecting buoyant stock market and higher asset prices.

(See also Autumn Statement Table 1.13.)

(v) General government expenditure (GGE) in 1986-87: £1 billion higher than FSBR forecast. (See also G1.)

(vi) Public corporations' market and overseas borrowing (PCMOB) in 1986-87: Around £½ billion lower than FSBR forecast. FSBR based on earlier expectations of demands of nationalised industries for external finance in 1986-87, subsequently revised.

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B1

(vii) Comparison of forecasts

	£ billion		
		1986-87	
	1985-86 Outturn	**FSBR Forecast**	**AS Forecast**
GGE	158.7	163.4	164 ½
General Govt receipts	151.9	155.9	156 ½
o/w North Sea revenues	11.3	6.1	4 ½
General Govt Borrowing Requirement	6.9	7.5	8
PCMOB	-1.0	-0.4	-1
PSBR	5.8	7.1	7
PSBR excluding privatisation proceeds	8.5	11.9	12

(viii) Changes to components of PSBR since Budget

	£ billion	
	1985-86	**1986-87**
Expenditure		
General Government	+1	+1
Public corporations' market and overseas borrowing	0	- ½
Net change	+1	+ ½
Receipts		
Non-North Sea receipts	+2	+2
North Sea revenues (including APRT policy change for 1986-87)	0	-1 ½
Net change (including APRT change in 1986-87)	+2	~~+1 ½~~ ½
PSBR	-1	0

Already on board MOM tells me.

WPU

(ix) No PSBR forecast for 1987-88: Government's fiscal stance remains as set out in MTFS at Budget time. No relaxation.

(x) MTFS path for PSBR published at Budget time:

Per cent of GDP

1987-88	**1988-89**	**1989-90**
1¾	1½	1½

Full MTFS will be produced with 1987 Budget, as usual.

(xi) Revenue projections: None in Autumn Statement beyond 1986-87 forecast.

(xii) Fiscal adjustment: None published. (See D1.)

FSBR projected fiscal adjustments of:

£ billion

1987-88	**1988-89**	**1989-90**
2	4	3

(xiii) MTFS remains in place, as set out at Budget time.

(xiv) Path for money GDP growth; GDP deflator

			per cent		
	1985-86	**1986-87**	**1987-88**	**1988-89**	**1989-90**
Money GDP					
FSBR	9½	6¾	6½	6	5½
Autumn Statement	9½	5½	7	not app	not app
GDP deflator					
FSBR	6	3¾	3¾	3½	3
Autumn Statement	6	3	3¾	not app	not app

(xv) Money demand pledge: MTFS "provides as firm a guarantee against inadequate money demand as it does against excessive money demand" (1986 Budget Speech).

(xvi) Key PSBR components: See Annex.

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Positive

(i) 1986-87 PSBR on track: No change from FSBR forecast, despite £1 billion increase in general government expenditure and £300 million PSBR cost of policy change in North Sea fiscal regime.

(ii) MTFS remains in place, as set out in Budget.

(iii) PSBR as percentage of GDP in 1985-86 lower (1½ per cent) than expected at Budget time (2 per cent) and lower than for any year since 1971-72. Also true of PSBR excluding privatisation proceeds (2¼ per cent of GDP). (See B2.)

(iv) PSBR as percentage of GDP in 1986-87 (1¾ per cent) lower than any year since 1971-72, barring 1985-86. Also true of PSBR excluding privatisation proceeds (3 per cent). Even excluding privatisation proceeds, under half the average for 1974-75 to 1978-79 (6¾ per cent). (See B2.)

(v) General government receipts for 1986-87 now forecast £½ billion higher than in FSBR, although forecast of oil revenues £1½ billion lower (including PSBR cost of bringing forward APRT repayments). Non-oil receipts therefore more buoyant than forecast in FSBR - indicative of healthy non-North Sea economy. (See also E3.)

(vi) If 1985-86 PSBR were set at same proportion of GDP as at 1975-76 peak under Labour Government, it would now amount to over £35 billion.

Defensive

(i) Fiscal stance: Government's fiscal stance remains as set out in MTFS at Budget time. No relaxation.

(ii) No scope for future tax cuts: Wait for Budget. Any fiscal adjustment in 1987-88 will depend on spending and tax revenues. Extra spending clearly reduces scope for any tax cuts. No revenue projections or fiscal adjustment published with Autumn Statement. None published in 1985 either.

(iii) Fiscal policy too loose? No.

(a) For 1986-87 PSBR lower as percentage of GDP (1¾ per cent) than in any year since 1971-72 (also 1¾ per cent), barring 1985-86 (1½ per cent). Even excluding privatisation receipts (3 per cent), only 1985-86 (2¼ per cent) had lower PSBR/GDP ratio since 1971-72.

(b) Fiscal outlook for future years remains as set out in MTFS.

(iv) PSBR misleading measure of fiscal stance? Alternative measures (eg PSBR excluding privatisation receipts) show substantial loosening of policy 1986-87 on 1985-86? No unique measure of fiscal stance. Increase in PSBR excluding privatisation proceeds (£3½ billion) much smaller than fall in oil revenues (£6½ billion).

(v) Forecast increase in PSBR in 1986-87 over 1985-86 (around £1¼ billion) fraction of forecast fall in oil revenues of £6½ billion over same period. Even excluding privatisation proceeds, increase in PSBR of £3½ billion well below oil revenue fall.

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(vi) PSBR rising again as percentage of GDP. PSBR in 1985-86 and 1986-87 expected to be lower than in any year since 1971-72 as percentage of GDP, with or without privatisation proceeds.

(vii) Forecast rise in money GDP growth means policy too expansionary. (Forecast to increase from 5½ per cent in 1986-87 to 7 per cent in 1987-88.) Money GDP growth in 1986-87 lower than envisaged at Budget time (6¾ per cent). Now expected to be higher in 1987-88 (7 per cent rather than 6½ per cent MTFS projection). Result is to bring level of money GDP in 1987-88 back to MTFS path. Money GDP figures in any case medium-term objectives, not short term targets. Policy on track.

(viii) Fiscal/monetary policy mix is wrong? High real interest rates indicative of loose fiscal, tight monetary policy? No. MTFS set at Budget time remains in place.

(ix) Why no forecast of revenues/fiscal adjustment for 1987-88 (and future years)? See D1.

(x) Fiscal adjustment unpublished because eliminated. No. See D1.

(xi) Why no PSBR forecast for 1987-88? No forecast published at time of Autumn Statement. But fiscal stance remains as set out in MTFS at Budget time.

(xii) Revision to MTFS necessary. No. Chancellor reaffirmed MTFS in Oral Statement.

(xiii) Government favouring public spending above tax cuts. ~~No.~~ Government remains firmly committed to reduction in tax burden when prudent to do so. But has never ruled out selective increases in spending in priority areas.

(xiv) Case for tax cuts weak even in principle. No. Those who pray in aid model simulations to support their case fundamentally misguided. No model fully captures incentive and other supply side effects of tax reductions. No coincidence that Japan and US, two most successful economies, have lowest level of tax as proportion of national income.

Contact point: A W Ritchie (PSF) 233 5507

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B1

ANNEX

Key PSBR components

£ billion[oo]

	1985-86			1986-87		
	FSBR	outturn	Change	FSBR	AS	Change
Planning total	133.9	133.6	-0.3	139.1	140½	+1¼
(O/w: privatisation proceeds)	(-2.6)	(-2.7)	(-0.1)	(-4.7)	(-4¾)	(-)
Interest payments	17.7	17.7	-	18.2	17½	-¾
Less PCMOB*	-1.3	-1.0	+0.2	-0.4	-1	-½
Other adjustments	5.0	6.3	+1.3[o]	5.7	5½	-
General govt. exp	157.7	158.6	+0.9	163.4	164½	+1
North Sea revenues	11.5	11.3	-0.2	6.1	4½	-1½
Non-NS taxes	101.6	103.3	+1.7	111.5	113½	+2
Nat. Ins. contributions	24.3	24.4	+0.1	26.2	26½	
Interest and other receipts	12.5	13.2	+0.7[o]	12.2	12	-
Accruals adjustments	-0.3	-0.5	-0.2	-0.1	-	-
General govt. receipts	149.6	151.7	+2.1	155.9	156½	+½
GGBR	8.1	6.9	-1.3	7.5	8	+½
Plus PCMOB*	-1.3	-1.0	+0.3	-0.4	-1	-½
PSBR	6.8	5.8	-1.0	7.1	7	-
PSBR as per cent of GDP	2	1½	-½	1¾	1¾	-

* Public corporations' market and overseas borrowing

o Includes classification change on central government VAT refunded, worth £0.3 billion. Of remainder, major differences are on accruals adjustments and central government temporary lending to public corporations.

oo All £ figures rounded to nearest £100 million for 1985-86 outturn and FSBR and to nearest £½ billion for Autumn Statement forecast. PSBR as percentage of GDP rounded to nearest ¼ per cent. Figures do not necessarily sum to totals, either down or across, because of rounding.

HOUSE OF COMMONS
LONDON SW1A 0AA

Pmg
[Ch has seen CST's]

CH/EXCHEQUER
REC. 06 SEP 1988
ACTION CST
COPIES TO

The Chancellor
11 Downing Street
London SW1

31 August 1988

Dear Chancellor,

PUBLIC SPENDING WHITE PAPER

I understand your office did not receive a copy of my submission on the above.

I enclose a further copy for your consideration.

Yours faithfully,

p.p.

Gordon Brown

PUBLIC EXPENDITURE WHITE PAPER

We were asked for our views on the new arrangements proposed for the Public Expenditure White Paper.

1. We agree that as much information as is available should be published at the time of the Autumn Statement. We suggest that this expanded Autumn Statement should include all the material at present published in Volume 1 of the White Paper and all the information about nationalised industries' finance (internal and external) and capital expenditure and about local authority spending now published in Volume 1 and Volume 2.

2. We oppose any delay in the publication of material now part of Volume 2. Instead we believe that there is a strong case for the publication in one volume of the departmental figures in Volume 2. We see no reason why these should not be published in January. This is in line with the important convention that information about policy decisions should be made available at the earliest opportunity. We therefore oppose the proposal that separate departmental should be delayed until the time of the Budget and that there should be no Treasury publication of the material now in Volume 2. We see noreason why additional material should not be published after by the departments themselves after January - on the lines of the detailed Scottish Office figures - but we believe it important to retain the requirement to make a full public spending report in January as soon as possible after the plans have been finalised.

3. We oppose the view that there should be only one Public Spending debate during the year. We believe there should be a debate on the Autumn Statement AND a debate on the Public Spending documents produced in January. We see no reason why there should not also be departmental debates on public spending estimates, but this should be in addition to these two major Treasury debates.

4. We believe there is an overwhelming case for the Autumn Statement to include updated estimates of tax and other government receipts for both the coming financial year and the two subsequent years of the planning period. These estimates should be based on the conventional assumption that rates of taxation and levels of allowances remain unchanged in real terms. They should be accompanied by a provisional statement of Government intentions regarding borrowing in the coming year and over the remainder of the Survey period. Without such information, it will remain impossible to assess government spending plans in terms of overall budgetary strategy and the availability of finance which must form the basis for them. It will continue to be difficult to consider tax and public spending issues together even though they are counterparts in a common budgetary decision-making process as the Government has been so eager to emphasize.

1. APS/A
2. Rep
Answer

HOUSE OF COMMONS
LONDON SW1A 0AA

The Chief Secretary
The Treasury
1 Parliament Square
London SW1P 3AG

Ch/CST wd like to discuss

MPW

31 August 1988

Dear Chief Secretary,

PUBLIC SPENDING WHITE PAPER

I understand your office did not receive a copy of my submission on the above.

I enclose a further copy for your consideration.

Yours faithfully,

p.p.

Gordon Brown

Mr Turnbull

We spoke and you agreed to provide a draft reply for the Chief Secretary to send to Mr Brown.

CEvans 2/9

cc Chancellor -2
Mr Anson
Mr Phillips
Mr Odling Smee
Mr MacAuslan
Mr Grieve
Ms Walker

PUBLIC EXPENDITURE WHITE PAPER

We were asked for our views on the new arrangements proposed for the Public Expenditure White Paper.

1. We agree that as much information as is available should be published at the time of the Autumn Statement. We suggest that this expanded Autumn Statement should include all the material at present published in Volume 1 of the White Paper and all the information about nationalised industries' finance (internal and external) and capital expenditure and about local authority spending now published in Volume 1 and Volume 2.

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PPS p1.

FROM: A TURNBULL
DATE: 13 SEPTEMBER 1988

CHIEF SECRETARY

cc Chancellor
Mr Anson
Mr Phillips
Mr Odling-Smee
Mr MacAuslan
Mr Gieve
Miss Walker

FINANCIAL REPORTING TO PARLIAMENT: LETTER TO DR GORDON BROWN

I understand you wish to clear your reply to Dr Brown with the Lord President and the Chief Whip in order to ensure that the line taken between Front Benches is the same as that "through the usual channels". I attach the necessary drafts. Dr Brown's letter will need to be copied to the Lord President and the Chief Whip.

AT

A TURNBULL

I have suggested one small (amendment) to the draft minute below.

TURNBULL TO CST 13 SEPT

DRAFT LETTER FOR THE CHIEF SECRETARY TO SEND TO

Dr Gordon Brown MP

Thank you for your letter of 31 August, to which was attached a statement of the Opposition's views on the Government's proposals, set out in Cm 375, for restructuring financial reporting to Parliament and for the way the documents are debated.

2. The views you put forward seem to me to represent in large measure a defence of the status quo. They do not adequately take into account either the changes that have already taken place in the structure of documents reporting public spending plans, ~~nor the debate that has been taking place between the Government,~~ or the views expressed by both the PAC and the Departmental Select Committees on the way financial reporting to Parliament should develop.

3. It is important to take into account the change which has already taken place in the Autumn Statement. Prior to 1985, the Autumn Statement announced figures for departmental programmes for only one year ahead. It now provides figures for three years ahead, both for the aggregate and for the distribution between programmes. Nearly all the important policy changes taken during the Public Expenditure Survey are announced either in the Autumn Statement itself or in separate departmental announcements (Ministerial Statements, PQs and Press Notices) which immediately follow it.

4. The result is that sufficient information is now made available in November to enable Parliament to debate both the Government's policy on public spending as a whole and the main decisions on priorities. The consequence of this has been a diminution in the role of the Public Expenditure White Paper as the vehicle for expressing the general lines of the Government's spending plans. When the PEWP appears in January it contains a great deal of detail about the management of departmental programmes but very little that is new about policy. This must call into question whether it is necessary to repeat the information on aggregate spending and ask Parliament to debate it again.

5. Your proposals also fail to take account of the growth in interest, expressed by both the PAC and Select Committees in departmental reports, providing an account of departmental objectives and targets and of departmental performance in meeting them. Your proposal is that we should retain one volume, along the lines of this year's Volume II, containing all the departmental material. But Volume II has already grown to be a massive document and I do not believe there remains scope within a single document, produced under Treasury editorship, to contain all the information which Select Committees are seeking on the departmental management of programmes.

6. The suggestion that departmental reports should be shortly before the Budget is partly in order to allow departments time to write up what will be a large body

of material, and partly to meet the concern of the PAC that there should be a better alignment between departmental spending plans, as they emerge from the Survey, and requests for Supply. Publication of departmental reports and Supply Estimates alongside each other in early March will facilitate that process.

7. I agree with you that it is an important convention that information about policy decisions should be made available at the earliest opportunity; but I do not believe the Government's proposals infringe this. Indeed, as I have indicated above, the Autumn Statement and the Ministerial announcements linked to it provide information on major policy changes within days of Cabinet's final decisions. As I have explained above, the role of departmental reports is not to announce policy changes, but to provide an account of a department's stewardship of its programmes.

8. In paragraph 3 of your memorandum, you request that the special analyses currently in Chapters 2-6 of Volume I of the PEWP should be produced in November. Paragraph 7(iii) of Cm 375 explained that much of this detailed statistical material could not, for logistical reasons, be produced with the Autumn Statement. In part this is because the detailed allocation to sub-programmes has still to take place, and partly because time is required to collate and analyse the detailed figures. For this reason this information will have to follow somewhat later, for example in a statistical

supplement to the Autumn Statement early in the New Year.

9. The PAC and a number of the Select Committees are still considering the Government's proposals, and the Treasury and Civil Service Committee has broadly supported them. For the reasons given above, I do not think the proposals you have put forward respond adequately to the pressures for improved financial reporting or take account of the exchange between the Government and Parliament which have informed the proposals set out in Cm 375.

10. If, as the Government proposes, the dual role of the current PEWP (setting out the broad lines of policy and reporting on departmental performance) is to be divided between an enlarged Autumn Statement and departmental reports, there need to be changes in the structure of debates. You have proposed that there should be no change in the three days currently allocated to public expenditure in general, ie the economic day of the Debate on the Address which has provided an occasion for first reactions to the Autumn Statement, the formal debate in December or January on the Autumn Statement and the TCSC's report on it, and the February debate on the PEWP.

11. The Government does not believe that a debate in February on a PEWP which provides no new policy information is worthwhile (in this it has the support of the TCSC). That is why the proposal has been put to you

that there should continue to be three days of debate in the period between the opening of Parliament and the Budget - one day as part of the Debate on the Address and a two-day debate immediately Parliament returns in January on the Autumn Statement and the TCSC report. There would be an understanding that one of these days would consider the economy generally and one public expenditure. In the Government's view this provides adequate time, which is better aligned with the timing of policy announcements.

12. The final issue you raised in your statement was whether the Government should publish an update of estimates for revenue for the following three years. This has, of course, been raised on a number of occasions in the past. The most recent was the recommendation of the TCSC in its response to Cm 375 in July "that Parliament should be provided with revenue forecasts in the autumn to set beside expenditure decisions". The Treasury will be responding to this in due course.

DRAFT LETTER FOR THE CHIEF SECRETARY TO SEND TO

Lord President cc Chief Whip

1. In its White Paper on Financial Reporting to Parliament (Cm 375) the Government put forward proposals to change the structure of its financial documents. As much as possible of the key material from Chapter 1 of the Public Expenditure White Paper (PEWP) would be incorporated into the Autumn Statement; and the departmental chapters of Volume II of the PEWP would become separate departmental reports to be published in March. In effect the PEWP would be wound up and its role in announcing the broad expenditure aggregates and the main decisions on priorities would be carried out by the Autumn Statement (as has largely happened already) and its role as an account of departmental performance in the management of programmes would be carried out by the departmental reports. In the process three occasions for expenditure announcements would be rationalised into two.

2. This change in the structure of documents has implications for the way they are debated by Parliament. Cm 375 did not put forward firm proposals for debates but said (paragraph 14) that the Government would consult further before taking a final view on the arrangements.

3. The TCSC had suggested that the day allocated to the old PEWP debate, which would become redundant under these proposals, should be used for a debate or debates on individual programmes, on the basis of reports of departmental Select Committees. When we consulted you earlier about this, you advised against this proposal as you felt it would not be possible to reduce the number of days for economic debate in the November/March period from three to two.

4. Instead it was agreed that we should consult on the proposal that there would still be three Government days in this period for debating the economy/public expenditure but these should be the economic day in the Debate on the Address and a two-day debate on the Autumn Statement (and the TCSC's report on it) immediately Parliament returns in January, with one day being devoted to economic policy and the other to public expenditure. The TCSC support the idea of a two-day debate though they hanker after a day later in the year on departmental reports as well.

5. Murdo Maclean has put this informally to the Opposition Treasury spokesman. In response Gordon Brown has sent me the attached memorandum setting out the Opposition views on the structuring both of documents and debates. I do not think his proposals are helpful, being largely a defence of the status quo which both the Government and the TCSC acknowledge to be unsatisfactory

(the latter's comments are contained in their response to Cm 375, HC 614).

6. I propose to reply to Gordon Brown along the lines of the attached draft but before I do so I would like to know that you are content.

[JM]

jc17

BUDGET SECRET - TASK FORCE LIST

COPY NO 1 OF 22

From: J ODLING-SMEE

4th March 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr S Davies
Mr Riley
Miss Sinclair
Mr Mowl
Mr Cropper
Mr Tyrie
Mr Call

Mr Calder)
Mr Eason) IR
Mr Weeden)

Many thanks. Re 1st question in para 14, option 3 (CGT only) looks the most sensible course. Re 2nd question, if pressed for an answer, it must be clear & consistent with answer to 1st question: the relevant forecasting basis is option 3, too. Finally, cost of package will need to take account not only of above Table 2 but also distribution assumption (on Eason's [illegible] of 4/3 refunds).

BEHAVIOURAL EFFECTS OF INLAND REVENUE TAX CHANGES

Sir Peter Middleton held a meeting yesterday to discuss what account to take of behavioural responses in estimating the direct effects of Inland Revenue tax changes for publication in Table 4.1 of the FSBR.

The options

2. Three possible options were identified:

- no behavioural effects would be taken into account

- behavioural effects would be taken into account for all tax changes, except perhaps where the effects were thought to be very small

- behavioural effects would be taken into account only where their impact on estimates of revenue cost was a fairly high proportion (eg above 50 per cent) of the estimated cost with no behavioural response.

3. The advantage of the first option (no behavioural effects) is that it would be very easy to explain what we were doing.

4. However, it would be a change of policy, and some might argue that it was retrogressive because we were giving less useful information. We have, of course, allowed for such effects selectively in the past (eg Stamp Duty in 1986). This option would show the highest figures for the cost of the package (see table).

5. The second option (all behavioural effects taken into account) has the advantage that the resulting estimates are likely to be more reliable indicators of the revenue change which actually results from the tax change. It produces the lowest cost of the package.

6. However, our estimates are mostly not very firmly based, and in the case of changes in the basic rate and personal allowances we have not made any estimates at all. The higher rates pose a special problem. The estimates in Mr Riley's paper of 4th March may satisfy nobody: some people will think that they assume too big a response and others that the response is much too small. But we should be able to say that we have put in a ball park estimate of behavioural effects for the two years in question and that the higher rate changes would have positive effects which, like all supply side measures, build up over time.

7. If the intermediate approach were adopted, capital gains tax is the obvious case for which to assume some behavioural response. The estimates in the table show that in the first year the behavioural response completely dominates the estimated revenue cost on the assumption of no response, and it is over 65 per cent of it in the second year. The behavioural response brings the cost of the CGT package in 1989-90 down from £650 million to £210 million. For the other taxes in the table except independent taxation, the estimated behavioural response never exceeds 25 per cent of the revenue cost assuming no response, although for the higher rates it is quite large in absolute terms and in relation to the overall cost of the package.

8. Another reason for distinguishing CGT from the others is that more effort has been devoted in recent months to estimating the behavioural effects, so that the figures are defensible if not necessarily more reliable. But it is inevitably somewhat arbitrary to include behavioural effects for some measures and not others.

9. If behavioural responses were taken into account for CGT alone, the cost of the package would be closer to the all behavioural responses case than to the no responses case.

<u>Post-Budget revenue forecasts</u>

10. If behavioural effects are taken into account in the costings in Table 4.1, they should also be taken into account in the post-Budget revenue forecasts in Chapters 2 and 6. At the moment only the behavioural effects associated with CGT and independent taxation are allowed for in the forecast. Should you choose the second option for Table 4.1, we would in principle have to raise the post-Budget revenue forecasts, mainly because of the higher revenues from higher rate taxpayers. But the forecasts have been constrained by the need to show particular paths for public expenditure and the PSBR.

11. In the case of the 1988-89 forecast in Chapter 6 the problem of adjusting the revenue forecast downwards would be exacerbated, but only to the extent of £50 million or so. The order of magnitude of the problem is greater in the later years, although there could be a case for raising both revenues and the fiscal adjustment (eg by £1 billion in 1991-92).

12. Even if behavioural effects are not taken into account for some or all taxes in Table 4.1, they should probably still be taken into account in the forecasts of revenues in Chapters 2 and 6. This would raise the same problem as above.

13. In any case the question arises whether, although the revenue forecasts are constrained, we should describe them in public as taking account of behavioural responses. Our recommendation here is that we should try to avoid situations in which we are asked, but if

pressed we should reply that in principle behavioural responses are taken into account. As with other details of the forecast, we would not be prepared to provide detailed numbers. A possible variant would be to say that we have done this for all the main changes except the basic rate and higher rate changes. The justification for omitting these two would be that behavioural effects have never been allowed for in the past.

Conclusion

14. We would be grateful for your views on:

- which option to adopt for estimating the revenue effects in Table 4.1

- whether to describe the revenue forecasts in Chapters 2 and 6 as taking account of (some or all) behavioural responses.

JOS

J ODLING-SMEE

BEHAVIOURAL RESPONSES AND THE COST OF THE PACKAGE

	Cost (-) or yield (+) in £ million	
	1988-89	1989-90
CGT		
No response effect	- 45	- 650
Behavioural response	+ 90	+ 440
Total effect	+ 45	- 210
Independent taxation		
No response effect	Nil	Nil
Behavioural response	Neg	- 20
Total effect	Neg	- 20
Car scales		
No response effect	+ 260	+ 310
Behavioural response	+ 30	+ 50
Total effect	+ 290	+ 360
Home improvement loans		
No response effect	+ 80	+ 200
Behavioural response	- 20	- 30
Total effect	+ 60	+ 170
Higher rates		
No response effect	- 995	-2,150
Behavioural response	+ 50	+ 275
Total effect	- 945	-1,875
Total behavioural effects	+ 150	+ 715
Effect of Package* assuming:		
No behavioural responses	-4,095	-6,665
All estimated responses	-3,945	-5,950
Responses for CGT only	-4,005	-6,225

Do these include no post 87 indexing A more differentials?

*Latest figures

53/2/LPD/3757/010

PDPB/88/16

COPY 1 OF 2.

BUDGET SECRET - TASK FORCE LIST

ECONOMIC SECRETARY TO THE TREASURY

FROM: P D P BARNES
DATE: 8 March 1988

PS/CHANCELLOR

BEHAVIOURAL EFFECTS OF THE INLAND REVENUE TAX CHANGES

The Economic Secretary has seen Mr Odling-Smee's submission to the Chancellor of 4 March.

2. The Economic Secretary wonders whether we could not choose a formula like, "behavioural effects are taken into account where they are i) substantial, ii) concentrated and iii) within a set time horizon".

3. By "concentrated" the Economic Secretary means not defused over the economy generally. He thinks it may be assumed that top rate cuts will have indirect effects defused over the whole economy, which may well be substantial but which will be picked up in the underlying growth rate.

4. The Economic Secretary thinks we do not want to say that the behavioural effects of top rates are excluded as non-substantial.

PB

P D P BARNES
Private Secretary

I would be reluctant to be more precise in answer to TCSC question; the behavioural effects (stabilization) taken into account for Excise Duty changes. In general not for IR tax changes, because offsetting generally; but Lawson has been done for CGT (as with Stamp Duty in 1986) static effects are direct ~~substitution~~ & growth actions.

A.

jc9

From: J ODLING-SMEE

5th October 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Byatt
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr S Davies
Mr Gilhooly
Mr Mowl
Mr Riley
Dr Courtney
Mr Wilson
Mr Ford
Mr Cropper
Mr Tyrie
Mr Call

PS/Inland Revenue
Mr Calder
Mr Eason
Mr Gonzalez
Mr Weeden
Mr Ko

PS/C&E
Mr P R H Allen
Mr Morris

REVENUE EFFECTS OF TAX CHANGES

You will recall that we had some discussions before the Budget about how to measure the revenue effects of tax changes in the FSBR and elsewhere. I have been looking at this systematically over the last few months with the revenue departments and others in the Treasury. The result is the attached note.

2. We are not recommending any major changes to current practice. Our main conclusions are:

a. The broad philosophy should be that behavioural responses should in principle be taken into account in estimates of direct revenue effects of tax changes (eg in FSBR Chapter 4, Budget Scorecard Table 1, and Autumn

Statement Chapter 4), but in practice explicit allowance would only be made where it would be misleading not to do so. In other cases behavioural effects would usually be ignored on de minimis grounds, in the interests of simplicity and intelligibility.

b. Income effects should be ignored in estimating direct effects of tax changes. This is already done for Inland Revenue taxes, but the Customs methodology effectively assumes that there are income effects.

c. The Customs methodology should therefore be revised so that direct revenue effects are estimated on the assumption that real consumption rather than nominal consumption is constant. We will continue to take account of substitution between goods when indirect taxes changed.

d. Apart from substitution between goods in the case of indirect taxes, the other cases where behavioural responses might be allowed for are, following the principle in a., where they could lead to a significant change in revenue (eg stamp duty changes, CGT changes such as those in this year's Budget).

e. We should not in general justify the absence of an allowance for behavioural responses by the argument that they are difficult to estimate because of a lack of empirical evidence.

? do we really need this & it will draw attention to issue

f. We should prepare a short note for the first issue of Economic Trends following the Autumn Statement to explain the principles that govern the estimation of direct revenue effects.

3. These conclusions are agreed by the Treasury and revenue departments. If you approve we shall go ahead with the changes in Customs methodology and preparation of the Economic Trends note.

OD-S

J ODLING-SMEE

REVENUE EFFECTS OF TAX CHANGES

There was considerable discussion before the 1988 Budget about whether to allow for behavioural responses in estimating the revenue effects of tax changes. It was apparent that there were no clear cut principles underlying what has in fact been done in the past, and in practice we may not have been wholly consistent (eg between Inland Revenue and Customs taxes).

2. Since the Budget a small group from the Treasury and the revenue departments have been considering what principles should be adopted to guide the measurement of the revenue effects of tax changes. This note summarises their conclusions.

Direct revenue effects

3. The note concentrates on measures of direct revenue effects of tax changes. Estimates of direct effects are shown in FSBR Chapter 4 (repeated in Table 1.1), Budget Scorecard Table 1, and Autumn Statement Chapter 4, and they are given in response to PQs about the revenue consequences of tax changes.

4. The word "direct" indicates that these estimates do not attempt to incorporate all the revenue consequences of tax changes. In particular, they do not include macro-economic effects, such as those resulting from consequential changes in interest rates, aggregate wages or the level of output; and they may not include all the likely behavioural responses at the micro level. Estimates which attempt to incorporate all indirect as well as direct effects are shown in Budget Scorecard Table 2, where they are called the PSBR effects of tax changes.

5. The FSBR also provides forecasts of future revenues in chapters 2 and 6 (repeated in Table 1.2). Although this note is not primarily concerned with forecasts, there is a brief discussion of how forecasts relate to direct revenue effects.

Principles and criteria for measures of direct revenue effects

6. One can imagine a range of alternative measures of direct revenue effects, each one taking account of more (or different) behavioural and indirect effects than the previous one. At one extreme, the simplest possible measure would be the change in tax rates applied to the existing tax base. At the other extreme would be the measure used in Budget Scorecard Table 2, although it would not be very accurate to continue to describe this as a measure of direct effects.

7. Within the whole range, apart from the extremes, there is no obvious, clearly-definable position which corresponds to a measure of direct effects alone and which could be applied to all taxes. It is therefore necessary to develop guidelines for deciding exactly how direct effects should be measured. It is proposed that the following three criteria should govern the choice of measures:

a. they should be straightforward to estimate and understand

b. they should not give a misleading impression of the order of magnitude of the total effects, within the time period under consideration, of the particular tax change on revenues

c. the measurement methodology should be consistent across all taxes, using a common macro-economic framework.

8. The first criterion points towards being at one end of the series and excluding behavioural and other responses. However, this could be misleading in cases where behavioural responses would lead to large changes in tax revenues, implying a violation of the second criterion. The first two criteria would be reconciled if we adopted the broad principle that behavioural responses should in principle be taken into account, but in practice explicit allowance need only be made where it would be misleading not to do so. In other cases behavioural effects would often be ignored on de minimis grounds. This principle lies behind the conclusions below.

9. A similar argument could be made about indirect macro-economic effects: they should be ignored unless they are quantitatively important. However, these are in general less easy to understand than micro-economic behavioural responses, and the measurement of them is contentious and complex. In the interests of simplicity it is recommended that, as now, they should not be included in measures of direct effects.

Income and substitution effects

10. In considering the arguments for and against taking account of various behavioural responses in estimating the direct revenue effects of tax changes it is helpful to distinguish between income and substitution effects.

11. Income effects may arise in a variety of contexts if tax changes alter private sector incomes. An obvious example is the increase in consumers' expenditure, and hence indirect tax revenue, when income tax is reduced. Income effects are defined on the assumption that relative prices (post-tax) are unchanged.

12. There are a number of different types of substitution that can take place if a tax change alters relative prices, including:

a. substitution between different goods and services within total consumption;

b. substitution between consumption and saving;

c. substitution between different savings media within total saving;

d. substitution between income and leisure (eg an increase in income tax causes people to increase their leisure and reduce their income, ie to work less hard);

e. substitution between labour and capital in the production process;

f. substitution by companies between different sources of finance.

13. When substitution occurs there may be second round effects on relative prices: the price of the thing towards which people substitute rises relative to the price of the thing they substitute away from. Among those which might be affected are goods prices (eg when indirect taxes are changed), real wages (eg when income tax or employee NICs are changed) and asset prices (eg when stamp duty or the taxation of saving is changed). These price changes, as well as the volume changes that are the direct result of substitution, alter tax revenues.

Conclusions about direct revenue effects

14. The first conclusion is that income effects should be ignored in estimating direct effects of tax changes. The main justification for this is simplicity. However it is also helpful to abstract from changes in the overall stance of fiscal policy in order to focus on the structural effects of changes in taxation. It is convenient when analysing structural effects to assume revenue neutrality, since arguments about the long-term effects, eg on incentives, of tax changes are then not obscured by arguments about short-term income effects. As a first approximation revenue neutrality implies that the income effects of the specific tax change will be roughly balanced by the opposite income effects of offsetting tax changes. This is strictly true only if the offsetting tax changes are very similar in nature (eg fall on the same groups) as the initial tax change.

15. The implication that there are offsetting tax changes is consistent with the approach of the MTFS. In this the PSBR path for the medium term is set out in advance and the budget-making process is primarily one of "using up" the fiscal adjustment (ie substituting specific tax cuts for the generalised tax cut implied by the fiscal adjustment) rather than financing tax cuts out of additional borrowing. But such an assumption does not imply that tax changes are never in reality reflected in changes to the PSBR. In situations of this sort, the implications of changes in the PSBR would be analysed separately.

16. The methodology currently used for estimating direct effects of Inland Revenue taxes does, in fact, assume no income effects. However, the methodology for Customs taxes assumes that the level of consumption changes in the opposite direction from a change in an indirect tax. The direct effects of changes in indirect taxes are measured on the assumption that total consumption at current market prices remains unchanged, and hence, since an increase in an indirect tax raises the market price value of any given volume of consumption, consumption at factor cost (ie the volume of consumption) must fall. The **second conclusion** is therefore that the methodology used for Customs taxes should be altered so that it is based on the assumption that consumption at factor cost rather than consumption at market prices is constant. Estimates of the direct effects calculated on this basis are compared with those on the current method and the simplest possible measure in the table below. The proposed estimates fall in between the other two: substitution away from the good whose tax is being increased leads to some loss of revenue, and the assumption (underlying the current methodology) that real consumption falls to the extent necessary to keep nominal consumption unchanged leads to a further loss of revenue.

Alternative measures of direct effects of indirect tax changes

(£ million, 1988-89)

	Fixed tax base: fixed real consumption without substitution effects	Present measure: fixed nominal consumption with substitution effects	Proposed measure: fixed real consumption with substitution effects
10% increase in duty on:			
Beer	240	185	215
Spirits	180	75	95
Wine	85	50	60
Tobacco	485	285	350
Petrol	745	570	645
1 point increase in rate of VAT (to 16%)	1,615	1,190	1,420

17. Turning to substitution effects, the **third conclusion** is that nearly all substitution effects can be ignored for changes in all the main taxes, with one clear exception. They can be ignored in most cases because empirical evidence suggests that the estimates of direct revenue effects would not change very much if they were taken into account. It is therefore generally not misleading to ignore them, and it makes the calculations much simpler.

18. The exception is substitution between goods and services within consumption in response to changes in indirect taxes. This can be quite important because of high elasticities of substitution between, for example, beer and spirits. It is already taken into account in the methodology used by Customs for estimating the direct revenue effects of changes in indirect taxes. This conclusion therefore implies that the methodology should remain unchanged in this respect.

19. Although quantitatively important substitution effects following generalised changes in the main taxes may be confined to substitution within consumption, significant substitution effects may arise when tax changes are targeted at specific areas or sectors. More generally, specific tax changes may sometimes be associated with relatively large behavioural responses. The **fourth conclusion** is therefore that we should be prepared to allow for any behavioural effects which are likely to have a quantitatively significant impact on estimates of direct revenue effects within a relevant time period. This justifies the estimates of behavioural responses we made for the stamp duty changes in 1984 and 1986 and the CGT changes in 1988. It might also have justified taking account of behavioural responses in estimating the direct revenue effects of the changes in higher income tax rates in 1988, although it would be for discussion whether Mr Riley's estimates of indirect effects in the first two years could be regarded as de minimis.

20. We shall have to use our judgement, together with the best estimates that are available, of the orders of magnitude of the revenue effects of behavioural responses in deciding whether they are quantitatively important enough to be taken into account in the final figures. We would need to look at them in relation to both

the particular tax change and the overall package. For this purpose, as well as to analyse the incidence of tax changes, we shall need to calculate revenue effects which include behavioural responses in a number of cases even though we do not end up reporting them in the FSBR.

21. Finally, the **fifth conclusion** is that we should not in general justify the absence of an allowance for behavioural responses by the argument that they are difficult to estimate because of a lack of satisfactory empirical evidence. Many numbers which we do provide in the FSBR are difficult to estimate and subject to wide margins of error, but that does not prevent us from publishing them. In some cases, such as the introduction of a new tax relief (eg BES on private renting), we have no option but to produce estimates of take-up, even though there may be little or no relevant empirical evidence on which to base them. Of course we should not eschew the use of the "difficult to estimate" argument for all time, as it may occasionally be helpful (eg in a situation like 1988 with the higher rate changes). It should, however, be used sparingly.

22. A corollary is that if we choose to include estimates of behavioural effects which are subject to a very wide margin of error, we should deliberately err on the side of caution. This will minimise the risk that such costings are more, rather than less, misleading than costings which make no allowance for behavioural effects. It may be noted that if this approach is adopted, it increases the chance that such effects will in practice be omitted on de minimis grounds.

Conclusions about forecasts

23. The forecasts of tax revenues published in the FSBR (chapters 2 and 6) are often constrained in various ways, so that it is unclear exactly what is being assumed about the effects of Budget tax changes on revenues. However, before the constraints are applied in the final weeks before the Budget, unconstrained forecasts of revenues are made. Both unconstrained and constrained forecasts are considered here.

24. The main conclusion about unconstrained forecasts of revenue is that we should continue to do what we have done in the past. In other words, we should continue to take account of all behavioural effects which are incorporated in the measures of direct revenue effects, together with the following additional effects:

a. income effects resulting from the fact that the impact on aggregate income or expenditure of each tax change is not in practice exactly offset by the impact of the fiscal adjustment which is assumed to finance it;

b. substitution effects (eg between consumption and saving, income and leisure, and labour and capital) which are small, and so ignored in estimates of direct effects so as to keep them simple, but can be taken into account without too much difficulty in forecasts;

c. macro-economic effects resulting from changes in aggregate wages, output, interest rates, the exchange rate etc, which are themselves the result of the tax change.

25. We are able to take these into account in forecasts because estimates of them are implicit in the Treasury model. But it is difficult to isolate the quantitative importance of each of the routes through which indirect revenue effects occur. It would be even more difficult to explain them in public. This is the reason why, given the criteria of simplicity and intelligibility discussed above, it is not proposed that we should use the information incorporated in the Treasury model in estimating direct revenue effects, even though we do use it in forecasts.

26. When it comes to the (constrained) published forecasts, we have to be prepared to say what has been taken into account, and what has not. But, given the nature of these forecasts, it is genuinely difficult to make an accurate statement about this. Constraints applied to the forecasts cannot readily be allocated to particular aspects of behaviour - either pre- or post-Budget.

27. In these circumstances the most defensible line would be to say that the forecast provides our best estimate of the likely outturn for the economy and Government revenue, taking into account all the various behavioural factors and responses which the government believes are likely to occur. We would be prepared to say, for example under TCSC questioning, that the forecast took account of such-and-such effects, without necessarily providing any quantification. This would be in line with our general policy of not giving quantitative breakdowns in public of how the economic forecast is built up. On occasions we might want to say that the forecast did not take account of a particular effect because it was impossible to estimate it.

Action required

28. As a result of the conclusions about direct revenue effects, action is required in three areas. First, Customs plan to amend their methodology so as to base it on unchanged consumption at factor cost rather than unchanged consumption at market prices. This will mean that the numbers will change. Secondly, we need to amend the introduction to the explanatory notes to Table 4.1 of the FSBR. Thirdly, if the proposals in this paper are accepted, it would be helpful to explain in public the principles that govern the estimation of direct revenue effects. The most suitable occasion would probably be the first issue of Economic Trends following the Autumn Statement. The article would refer to the tax ready reckoners published in the Autumn Statement and would be in place well before we came out with the FSBR containing the new notes to Table 4.1.

29. This review has thrown up a number of other areas where further research would be useful. We need to know more about the extent to which indirect tax changes, particularly the specific duties, are passed on into prices. This has very obvious implications for indirect tax revenue, both directly and through the scale of substitution effects. A start has been made on this at Customs.

30. We are currently reviewing our estimates of elasticities of substitution between goods for use in measuring direct revenue effects of changes in indirect taxes. Further research on the

latter is currently being undertaken by Professor Richard Blundell (UCL), financed in part by the Treasury and Customs, but is not yet complete. It is possible that desirable revisions with significant effects on the costings will emerge. But if we are not able to produce reasonably robust estimates within the next week or so, the changes will have to be postponed until next year's ready reckoners (to be published in the 1989 Autumn Statement).

31. More generally, information on substitution effects is rather scant in a number of areas - including savings and company financing. While we may expect that such effects will generally be sufficiently small that they can be ignored in costing tax changes, these are areas where further work would be desirable both as background information and in order to inform longer-term analyses of the structural effects of taxation.

gep1.ip/jm/scorecard2

pg

SCORECARD
COPY NO 3 OF 23

SECRET AND PERSONAL

FROM: J MACAUSLAN
DATE: 14 OCTOBER 1988

CHIEF SECRETARY +1

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

[looks like a reserve line of 3/7/11 & NRW]

SCORECARD: 14 OCTOBER 1988

Table 1 is our latest scorecard. It is based on the economic assumptions so far decided (see below). It shows additions to programmes of (£ million):

+ 3,650 + 6,400 +10,560

and, with Reserves of £3.5/7/10/5 billion, additions to the planning total of :

+ 150 + 2,900 + 7,060

<u>Main Changes</u>

2. Table 2 shows the main changes since the 12 October scorecard:

MACAUSLAN → CST 14/10

(i) defence* reflects you meeting with Mr Younger this morning.

(ii) EC contributions reflect the path in Mr Mortimer's submission of today.

(iii) minor changes have been made on IBAP, MAFF, DTI, DEn, DOE, legal departments and OAL, reflecting recent settlements and adjustments.

(iv) the figures for health have come down slightly reflecting latest estimates of the costs in the Survey years of clinical regrading.

(hmm...)

(v) the social security numbers have been altered, reflecting today's RPI announcement (which adds about £15 million a year) and ST's latest view of the likely outcome. ST assume that we will get the reduction in duration of UB, but not get the CB freeze.

Remaining variables

3. Table 3 shows the main outstanding variables.

4. The main scorecard incorporates the economic assumptions so far agreed. There will be a submission by EA early next week on the remaining economic assumptions:

The RPI and Rossi for September 1989 and September 1990.

The GDP deflator for 1988-89 through to 1991-92.

Interest rates over the whole period.

---

* Mr Younger has specifically requested that knowledge of a settlement should not be spread either publicly or within Whitehall until he has had a chance to debrief within MOD. For the time being the settlement should be described as "nearing settlement".

Unemployment over the period.

The Chancellor will hold a meeting on Wednesday to agree new assumptions on these. Table 3 shows the effects on expenditure of the guesses we have been using as to the outcome of that meeting; the Annex comments on these effects. They may add some £200 million in 1989-90 (less if defence does not have to be fully compensated for inflation); and some £500-750 million in the later years.

5. The table also shows the other main outstanding variables in the planning total: transport, CB/UB, territories, and the final payment from BAe for Rover, on which Mr Monck submitted yesterday. The figures for the territories assume that Mr Walker accepts a settlement near the extra £75 million you have offered him in 1989-90; and that Scotland gets a similar bonus, and Northern Ireland about £30 million. If Scotland settles without a bonus, there is a further £80 million reduction. The figures assume little or no bonus for any territory in the later years.

Sep folder behind

Planning totals

6. The possible eventual additions to the planning total in 1989-90 are in the range £0-500 million. If

(a) the economic assumptions turn out no worse than we have guessed,

(b) health and defence are not fully compensated for a higher GDP deflator,

(c) the territories settle at less than full compensation for English RTB receipts, and

(d) we score the BAe payment in 1989-90 on the DTI programme, we could be within about £100 million of baseline. This would be so even if we do not get the CB freeze, and even with a Reserve of £3.5 billion. There is some possibility of an outcome below baseline.

7. The additions to the planning total in 1990-91 are likely to be about £3-3.5 billion; and in the final year about £7-8 billion. This means an average real annual growth rate of the planning total from 1988-89 to 1991-92 of 3.5 per cent. The average real growth rate from 1987-88 is 2.6 per cent (see Table 4).

8. The economic forecast shows a planning total outturn in 1989-90 £1.5 billion higher than the new planning total we expect to emerge from this Survey; and an outturn for 1990-91 about £3 billion higher.

GGE/GDP ratios

9. The GGE/GDP ratios depend not only on the additions to the planning total, but also on money GDP, and on debt interest and other national accounts adjustments. The question what figures to adopt for debt interest is wrapped up with the presentation of the Industry Act Forecast, on which there will be a submission by EA for discussion at the Chancellor's meeting on Wednesday.

10. The ratio in 1988-89 looks likely to be around 40 per cent (see Table 4). In 1989-90, the ratio is likely to be 39½ per cent; it could get pushed down to 39¼ per cent, although that would make it harder to show a declining trend later; it is looking unlikely that it will be 39¾ per cent. For 1990-91, we are likely to show either 39½ per cent or 39¼ per cent, depending mainly on debt interest. For 1991-92, 39 per cent is not impossible though we may end up at 39¼ per cent; again the main variable is debt interest.

11. A run of 39½/39¼/39 per cent would be very satisfactory. 39 per cent could be the lowest ratio since 1966-67. But if we end up with 39¼ per cent in the last year, the choice will be between 39½/39½/39¼ per cent and 39½/39¼/39¼ per cent. The former may be better, since it

(a) can be explained by the rapid GDP growth depressing the 1989-90 figure,

(b) does not raise the spectre of a halt to the decline in the ratio, and

(c) leaves the 1989 survey better placed, as we would not in this Survey have pushed the level of GGE down to the minimum figures.

12. The forecast suggests that the outturn GGE ratios could be considerably lower than these numbers (see Table 4).

13. Table 4 also shows that the real average annual growth rate from 1987-88 to 1991-92 could be kept to 1¼ per cent. Again, much depends on debt interest.

Conclusion

14. The biggest outstanding variables are the economic assumptions and debt interest. There is little point in reaching too firm a view on the Reserve, or the desired path of the GGE ratio, until after the Chancellor's meeting on Wednesday. We will submit again alongside the submission on economic assumptions early next week, and towards the end of next week in the light of decisions taken on Wednesday. That later submission will invite decisions tying up the remaining figures.

J MACAUSLAN

TABLE 1

SECRET
SUMMARY SCORECARD

Date of last update: 14/10/88

(£million)

	1989-90 BASELINE	1989-90 DEPT POSITION	1989-90 FORECAST OUTCOME	1989-90 HMT POSITION	1990-91 BASELINE	1990-91 DEPT POSITION	1990-91 FORECAST OUTCOME	1990-91 HMT POSITION	1991-92 BASELINE	1991-92 DEPT POSITION	1991-92 FORECAST OUTCOME	1991-92 HMT POSITION
Ministry of Defence	19,969.0	100.0	100.0	100.0	20,575.0	500.0	500.0	500.0	21,075.0	900.0	900.0	900.0
FCO - Diplomatic, Information, Culture	743.0	20.9	20.9	20.9	761.0	42.2	42.2	42.2	780.0	45.9	45.9	45.9
FCO - Overseas Development Administration	1,505.0	30.0	30.0	30.0	1,551.0	55.0	55.0	55.0	1,590.0	80.0	80.0	80.0
European Communities	1,470.0	500.0	500.0	500.0	1,320.0	630.0	630.0	630.0	1,353.0	230.0	230.0	230.0
Intervention Board for Agricultural Produce	1,690.0	-421.1	-421.1	-421.1	1,845.0	-395.8	-395.8	-395.8	1,891.0	-268.4	-268.4	-268.4
Ministry of Agriculture, Fisheries and Food	786.0	14.5	14.5	14.5	801.0	8.7	8.7	8.7	821.0	5.0	5.0	5.0
Forestry Commission	64.0	8.6	8.6	8.6	65.0	11.9	11.9	11.9	67.0	13.6	13.6	13.6
Department of Trade and Industry	1,282.0	63.8	63.8	63.8	1,222.0	79.2	79.2	79.2	1,225.0	-71.7	-71.7	-71.7
Export Credits Guarantee Department	128.6	6.8	6.8	6.8	95.9	3.6	3.6	3.6	97.5	-38.1	-38.1	-38.1
Department of Energy	309.0	35.6	35.6	35.6	316.0	4.7	4.7	4.7	323.0	-70.9	-70.9	-70.9
Department of Employment	4,185.0	-200.0	-200.0	-200.0	4,241.0	-300.0	-300.0	-300.0	4,347.0	-400.0	-400.0	-400.0
Department of Transport	2,244.0	530.2	278.0	228.8	2,299.0	565.6	331.9	252.3	2,357.0	734.3	338.1	272.4
DOE - Housing	2,378.0	-1,283.2	-1,283.2	-1,283.2	2,399.0	-991.5	-991.5	-991.5	2,459.0	-702.2	-702.2	-702.2
DOE - Other Environmental Services	904.0	75.0	75.0	75.0	935.0	-76.0	-76.0	-76.0	958.0	-67.0	-67.0	-67.0
Home Office	1,382.0	246.1	246.1	246.1	1,415.0	353.9	353.9	353.9	1,450.0	323.7	323.7	323.7
Legal departments	1,046.0	42.9	33.6	12.5	1,107.0	77.8	61.4	28.1	1,135.0	143.0	106.1	36.8
Department of Education and Science	5,156.0	359.1	359.1	359.1	5,293.0	399.6	399.6	399.6	5,425.0	364.3	364.3	364.3
Office of Arts and Libraries	454.0	4.1	4.1	4.1	471.0	1.6	1.6	1.6	483.0	25.4	20.4	13.4
Department of Health	18,559.0	1,176.0	1,176.0	1,176.0	19,445.0	1,397.0	1,397.0	1.397.0	19,931.0	1,816.0	1,816.0	1,816.0
Department of Social Security	50,889.0	199.8	191.4	-124.1	53,347.0	1,474.7	1,323.4	1,095.4	54,681.0	3,349.6	3,136.4	2,908.0
Scotland: negotiable	5,033.0	62.4	50.8	-248.6	5,206.0	66.8	55.8	-246.9	5,336.0	75.9	62.5	-248.9
Scotland: formula		192.1	219.2	52.8		443.9	262.6	37.3		575.1	314.0	-5.7
Wales: negotiable	2,101.0	71.7	63.6	63.6	2,169.0	73.1	66.7	66.7	2,223.0	62.2	58.5	58.5
Wales: formula		81.8	95.8	13.6		200.8	111.3	1.4		263.8	135.9	-18.8
Northern Ireland: negotiable	5,323.0	8.3	8.3	8.3	5,508.0	12.1	12.1	12.1	5,645.0	56.4	56.4	56.4
Northern Ireland: formula		109.3	110.1	57.8		193.4	133.5	60.9		234.1	150.3	54.4
Chancellor's Departments ?	4,019.0	53.6	65.2	38.2	4,162.0	128.4	130.3	115.3	4,268.0	243.5	245.3	212.3
Other Departments	397.0	29.0	24.9	13.9	415.0	40.5	34.6	19.3	425.0	82.7	73.6	59.7
DOE - Property Services Agency	-163.0	60.4	27.6	15.1	-162.0	90.3	16.1	-33.1	-166.0	70.4	-29.0	-73.8
Nationalised Industries	114.0	308.0	-170.5	-439.7	-274.0	329.1	-271.8	-697.3	-282.0	-110.2	-440.2	-946.7
Privatisation EFLS		166.8	166.8	166.8		188.9	259.4	193.1		536.7	1,813.9	1,813.9
Local Authority Relevant	33,520.0	1,653.0	1,653.0	1,653.0	34,517.0	1,984.0	1,984.0	1,984.0	35,380.0	2,211.0	2,211.0	2,211.0
Adjustment												
TOTAL ADDITIONS TO PROGRAMMES	165,126.0	4,378.9	3,654.0	2,293.9	170,692.0	7,721.4	6,385.4	4,697.1	174,918.0	10,857.1	10,563.4	8,659.3

TABLE 2

SECRET

14/10/88

SUMMARY OF CHANGES IN FORECAST OUTCOME
SINCE LAST SCORECARD

	1989-90 CHANGE IN FORECAST OUTCOME	1990-91 CHANGE IN FORECAST OUTCOME	1991-92 CHANGE IN FORECAST OUTCOME
Ministry of Defence	0.0	-100.0	-100.0
FCO - Diplomatic, Information, Culture	0.0	0.0	0.0
FCO - Overseas Development Administration	0.0	0.0	0.0
European Communities	-40.0	-20.0	-150.0
Intervention Board for Agricultural Produce	0.0	-3.0	1.0
Ministry of Agriculture, Fisheries and Food	-1.0	-1.3	0.9
Forestry Commission	0.0	0.0	0.0
Department of Trade and Industry	0.0	0.0	-0.4
Export Credits Guarantee Department	0.0	0.0	0.0
Department of Energy	-3.8	-3.9	-5.0
Department of Employment	0.0	0.0	0.0
Department of Transport	0.0	0.0	0.0
DOE - Housing	-0.2	-9.5	0.8
DOE - Other Environmental Services	1.0	11.0	1.0
Home Office	0.0	0.0	0.0
Legal departments	-0.9	-5.7	-4.8
Department of Education and Science	0.0	0.0	-2.0
Office of Arts and Libraries	0.0	0.0	1.0
Department of Health	-15.0	-12.0	-11.0
Department of Social Security	-31.3	-27.6	-8.8
Scotland: negotiable	-0.9	1.9	4.0
Scotland: formula	-3.1	-4.9	-1.9
Wales: negotiable	0.4	0.6	0.9
Wales: formula	-1.7	-2.3	-0.8
Northern Ireland:negotiable	0.0	0.0	0.0
Northern Ireland: formula	-0.9	-0.9	-0.5
Chancellor's Departments	0.0	0.0	0.0
Other Departments	0.0	-0.2	0.0
DOE - Property Services Agency	0.0	0.0	0.0
Nationalised Industries	0.0	0.0	0.0
Privatisation EFLs	0.0	0.0	0.0
Local Authority Relevant	0.0	0.0	0.0
Adjustment			
TOTAL ADDITIONS TO PROGRAMMES	-97.4	-177.8	-275.6

gep1.ip/tables/scorecard

SECRET

TABLE 3

POSSIBLE CHANGES TO SCORECARD OF 14 OCTOBER

1. Scorecard: additions to planning total	+ 150	+2900	[+7065]
2. Economic assumptions			
Rpi +1% 9/89	-	+ 450	+ 480
GDP deflator +½% 89-90			
DES/ODA/DSS	+ 60	+ 65	+ 70
DH/MOD	+ 200	+ 210	+ 220
Interest rates	+ 180	+ 190	+ 190
Unemployment 1.9m	- 230	- 240	- 240
	+ 210	+ 675	+ 720
3. Other programme changes			
Territories	- 100	- 200	- 200
DTp	+ 50	+ 50	+ 50
	- 50	- 150	- 150
TOTAL ADDITION TO PLANNING TOTAL	+ 310	+ 3425	[+7635]
4. Less likely programme changes			
CB/UB	- 180	- 60	- 20
BAe/Rover	- 150	-	-
	- 330	- 60	- 20

SECRET

TABLE 4

POSSIBLE SURVEY OUTCOME

	1988-89	1989-90	1990-91	1991-92
Planning total				
Additions (£m)		+ 250	+3,500	[+7,500]
Real growth over previous year (%)		3.3	3.7	3.4
Average annual real growth over 1987-88				2.6
1988-89				3.5
GGE				
As % of GDP: GEP	40	39½	39¼	39
: forecast	39½	38¾	38½	
Real growth over previous year (%)		0.9	2.1	2.1
Average annual real growth over 1987-88				1.3
1988-89				1.7

Notes

GGE figures exclude privatisation proceeds.

Other assumptions:

	Real GDP Growth	GDP deflator	Debt interest
1988-89	4.0%	6.0%	
1989-90	2.5%	5.0%	£17 bn
1990-91	2.5%	3.5%	£16 bn
1991-92	2.5%	3.0%	£15.5 bn

StChRemit

SECRET AND PERSONAL

ANNEX

MAIN EFFECTS OF REVISIONS TO ECONOMIC ASSUMPTIONS

The most important asumptions for public expenditure are those for inflation. The main programmes concerned are:

i. Health: Mr Clarke's bids for service growth, pay and FPS were pitched in relation to the July GDP assumptions. The elements sensitive to inflation cover the bulk of his programme and an increase of ½ per cent in the GDP deflator would cost around £100 million. We judge it would probably have to be largely conceded. We would expect to resist any claims for compensation for higher inflation this year on the grounds that this had been dealt with directly in the Review Body settlement and that health authorities seem in fact to be under less pressure than expected this year.

ii. Defence: we would resist any compensation for higher inflation in this year. For the plan years, your agreement this morning with Mr Younger does not require you to go back to him if the deflators are revised. And the concordat on the objectives for the settlement accepted that the figures would not be opened other than for a significant variation in inflation projections; and we would argue that ½ per cent is not significant. (Full compensation from a ½ per cent revision would come to around £100 million a year).

iii. Education: Mr Baker explicitly sought an assurance that if the GDP deflator were raised he could modify his settlement for student awards and clinical academics' pay. This would cost only £5-10 million. It would be important to prevent any reopening of the larger elements such as science and universities.

iv. ODA: the settlement was designed to allow ODA to show the Aid programme at 0.28 per cent of GNP in 1989 and, with the advantage of rounding, in 1990 as well. The higher money GDP figures now being considered for publication would probably mean that even the 1989 figure would recourse to rounding. However, your letter to Mr Patten stated explicitly that "the settlement relates to the cash figures and will not be reopened if any of the underlying economic assumptions prove to be incorrect". Thus you are not obliged to make any further concessions, but if you did the cost would be between £5-10 million a year.

v. Social Security: a higher RPI would feed automatically into benefits. An extra 1 per cent would add approximately £450 million in years 2 and 3. If it were assumed that rents rose in line with the GDP deflator, the extra HB costs would be £50 million a year for each 1 per cent increase in the price level.

vi. Local authority current expenditure: the 1989-90 RSG settlement was designed to leave provision broadly constant in real terms. Taking account of the provision for community charge start-up costs, Ministers working with a 4½ per cent deflator would estimate a 0.2 per cent real increase. With a 5 per cent deflator, this would be turned into a 0.3 per cent reduction. A similar thing happened last year and no adjustment was made. We would probably be able to avoid reopening this time. (The outside world, working with a 4 per cent deflator, would see the change as a 0.7 per cent real increase). If the revisions to the GDP deflator were any greater than ½ per cent this year and ½ per cent next, it might be impossible to hold the settlement, at least for the later years. Each 1 per cent would cost £300 million a year.

Thus, apart from the automatic additions to benefits, it is likely to be possible to hold additions to settlements to less than £250 million. We would expect the benefit of a lower unemployment assumption and the cost of higher interest rates broadly to cancel out.

ecl.vh/jamie/CST

CONFIDENTIAL

1. Diary - Paymaster to Cargo + Jamie Mortimer. He will deal.
2. PMP

FROM: J E MORTIMER
DATE: 14 October 1988

CHIEF SECRETARY

cc Chancellor
Paymaster General
Sir P Middleton
Mr Anson
Sir G Littler
Mr Lankester
Mr Turnbull
Mr RIG Allen
Mr Bonney
Mr MacAuslan
Mr Mercer
Evans
Mr Towers
Mr Addison

Not a brilliantly drafted letter - & the omission of any reference to the ~~[illegible]~~ problem this causes for the overall PX outcome must be rectified. SX

AUTUMN STATEMENT PROJECTION OF NET PAYMENTS TO COMMUNITY INSTITUTIONS

This note informs you about our latest projection of net payments to Community institutions. It seeks your agreement that these figures should be included in the Autumn Statement.

2. The figures are as follows:

				£ million
	1988/89	1989/90	1990/91	1991/92
Latest projection	950	1970	1950	1580
PES baseline (projection in last PEWP)	800	1470	1320	1350
Difference	+150	+500	+630	+230

The projection represents a complete reworking of the figures, and has been discussed with other departments.

3. Some of the main assumptions in the projection are as follows:

(i) the Commission will introduce a rectifying letter this year to amend the draft 1989 budget. Although the figures in it are not yet firm, we assume it will take account of an agricultural underspend of 1.3 becu (because of higher world food prices arising from the American drought), the carry-forward of a surplus of 1230 mecu from 1988, and higher customs duties in 1989;

(ii) the sterling/ecu exchange rate from now on will be £1 = 1.50 ecu (around 2 per cent weaker than today's rate);

(iii) from 1990 onwards, agricultural guarantee expenditure will be the maximum allowed within the new agricultural guideline agreed at the Brussels European Council;

(iv) structural fund commitments will grow to some 13 becu in 1992 (in 1988 prices), in line with the conclusions of the Brussels European Council;

(v) expenditure on the Integrated Mediterranean Programmes and R&D will grow in line with the existing framework programmes;

(vi) other expenditure will grow in line with the maximum rate provisions of the Treaty of Rome;

(vii) the own resources ceiling will rise from 1.15 per cent of Community GNP in 1988 to 1.20 per cent in 1992. The structure of own resources will be changed in line with what was agreed at the Brussels European Council. The VAT ceiling will continue to be 1.4 per cent. There will be a new fourth resource based on shares in GNP. The Fontainebleau abatement system will be modified to take account of the benefit to the UK of the new structure of own resources.

The changes

4. The main reasons for the sharp deterioration in the projection are:

(i) <u>the agreement on the future financing of the Community</u>. As you explained to the House in the PEWP debate last February (and as the Prime Minister had announced earlier), the Brussels package is likely to increase our net payments to the Community by some £200-300 million a year. This remains our estimate;

(ii) higher customs duties. The deterioration in our balance of payments has been associated with higher customs duty receipts, which have to be paid over to the Community. For example, customs duties in 1988-89 in the current projection (net of collection costs) are some £110 million higher than estimated in the baseline figures (agreed in September 1987) and £230 million higher for 1990-91. These extra payments do not give rise to any extra abatement;

(iii) a higher VAT base and higher GNP. Rapid growth in the economy and higher VAT receipts have led Customs and Excise and our own forecasters to revise up substantially the estimate of the UK's VAT base and GNP. The VAT base for 1988 in the current projection, for example, is £280 billion, some 6 per cent (around £14 billion) higher than the estimate contained in the baseline figures. The upwards revision to the VAT base means that we shall have to pay large VAT adjustments in both 1989 and 1990 (of about £240 million each year). The baseline figures assume no VAT adjustments in either year (in fact, we had assumed a VAT adjustment of around £100 million in 1989, but this was suppressed as part of a smoothing operation);

NB

(iv) lower receipts. The forecast share of UK receipts from the Community budget (around 9 per cent in all future years) is almost identical to that assumed in the last PEWP, although the exchange rate assumption on which the projection is based (£1 = 1.5 ecu) is about 5 per cent stronger than that in the PEWP, and we would normally expect a stronger exchange rate to lead to a higher share of receipts. Lower MAFF estimates of cereals yields and butter production, however, have led them to continue to forecast a very low share of agricultural receipts (6½ per cent) from 1990 onwards.

The profile of the projection

5. The year by year deterioration in the projection is uneven, with a relatively small worsening in 1988-89 and a much larger worsening in 1989-90 and 1990-91.

6. The worsening in 1988-89 would have been worse but for the effects of provisional twelfths in the first part of 1988. This increased our net payments in 1987-88 by some £240 million, and reduced them by a similar amount in 1988-89.

7. Much of the deterioration in 1989-90 arises because of the large VAT adjustment we now expect to pay during 1989. Although this will give rise to extra abatement, it will not do so until 1990 (or possibly 1991).

8. The large deterioration in 1990-91 reflects both a large VAT adjustment payable in 1990 and a sharp fall in our share of agricultural receipts (as forecast by MAFF). These two factors more than offset the extra abatement arising from the payment of the VAT adjustment in 1989.

Some uncertainties

9. As ever, the projection is extremely uncertain. Some of the more important uncertainties relate to whether or not the Budget Council will agree to a rectifying letter to amend the 1989 draft budget, the size of next year's agricultural underspend, the future course of world agricultural prices, the timing of corrections to our abatement, the effectiveness of the new budget discipline arrangements, our receipts from the new structural fund regimes and the course of sterling/ecu/dollar exchange rate. Relatively small changes to the timing of our payments to, or receipts from, the Community could affect the path of the projection substantially.

10. In view of these great uncertainties, we have smoothed the projection a little. We have assumed, in particular, as in the past, that the large VAT adjustments payable in 1989 .and 1990 will be reflected in higher abatements the following year. In practice, there is a good chance that we may have to wait an extra year for the corrections. But the effect of taking this extra year into account would be to increase our net payments in 1989-90 and 1990-91 and reduce them in 1991-92 and 1992-93, further skewing the profile of the projection. We have also assumed that we shall receive in 1990 an upwards correction to our abatement payable in respect of 1988 of 100 mecu.

11. This submission has been discussed with GE. They have asked us to leave open the possibility of making small changes to the projection at a later stage if this should be necessary in the light of the overall public spending position. We are happy to do this.

NB

12. We would be grateful to know whether you are content (subject to the possibility of some last minute fine-tuning as referred to above) for the projection set out in paragraph 2 to be included in the Autumn Statement.

13. The publication of this projection would obviously be politically sensitive. You might, therefore, care to warn the Prime Minister about it. I attach a draft minute for you to send. Mr Turnbull advises that it would be sensible for the minute to issue on Monday so that the Prime Minister receives it before she receives the more general public spending papers being prepared for Star Chamber.

J E MORTIMER

ecl.vh/jamie/DftMin

CONFIDENTIAL

DRAFT MINUTE FROM THE CHIEF SECRETARY TO THE PRIME MINISTER

cc Foreign Secretary
Min of Agriculture
SoS for Trade and Industry

AUTUMN STATEMENT: OUR NET PAYMENTS TO COMMUNITY INSTITUTIONS

You will wish to be aware of the projection of net payments to Community institutions which, subject to the possibility of some minor last minute refinements, I plan to include in the Autumn Statement public expenditure tables.

2. The projection is as follows:

				£ million
	1988/89	**1989/90**	**1990/91**	**1991/92**
Latest projection	950	1970	1950	1580
PES baseline (projection in last PEWP)	800	1470	1320	1350
Difference	+150	+500	+630	+230

You will see that the projection involves a substantial deterioration compared with the figures included in the 1988 Public Expenditure White Paper (PEWP). This deterioration may lead to some criticism when the figures are released, even though a substantial part of the worsening had been expected and publicly announced (see paragraph 3(i) below).

3. The new projection takes full account of the agreement on the future financing of the Community reached at Brussels in February, including the decision to increase the own resources

ceiling to 1.2 per cent of Community GNP by 1992. It also takes account of the latest estimate of the Community's agricultural underspend next year.

4. The main reasons for the deterioration compared with the PEWP are as follows:

(i) <u>the Brussels agreement</u>. In your statement to the House on 15 February, you said that the Brussels package would cost "a maximum of about £300 million a year" compared to what would happen with a continuation of the 1.4 per cent VAT ceiling (the assumption used in the PEWP projection). This remains our estimate of what the package will cost;

(ii) <u>higher customs duties</u>. Higher than expected imports have resulted in higher than expected customs duties, which have to be paid into the Community budget. This, of itself, increases our net payment by some £110 million in 1988-89 rising to £230 million in 1990-91. These extra payments do not give rise to any extra abatement;

(iii) <u>higher payments of VAT and GNP-related contributions</u>. The recent rapid growth of GNP and consumers' expenditure have led us to revise up the forecast of our VAT and GNP payments in future years. Although the additional payments should give rise to extra abatement, they are unlikely to do so until 1990 at the earliest (because of the lags in the abatement arrangements);

(iv) low receipts. Although the projection is based on a stronger £/ecu exchange rate than the PEWP, and we would normally expect this to lead to a higher share of receipts, we are now expecting our receipts share to remain unchanged at a disappointingly low 9 per cent.

5. You will be aware that the projection of our net payments is extremely uncertain, and that relatively small changes to the timing of our payments to, or receipts from, the budget could lead to significant changes in the profile of the net figures. I am not persuaded, however, that the projection is pessimistic, and believe that we may only store up troubles for ourselves in the future if we were to publish lower figures. I therefore think that, despite likely criticism, we should publish the figures contained in the table in paragraph 2 above. We would of course have to explain carefully why the deterioration has occurred. It is possible that, in working out the detailed figures, I may need to modify the published profile slightly.

6. I am copying this minute to Nigel Lawson, Geoffrey Howe, John MacGregor and David Young.

gep1.ip/jm/ps.chx

CONFIDENTIAL

PMP

FROM: J MACAUSLAN
DATE: 17 OCTOBER 1988

PS/CHANCELLOR

cc: PS/CST
PS/PMG
Sir P Middleton
Mr Anson
Sir G Littler
Mr Lankester
Mr Turnbull
Mr R I G Allen
Mr Bonney
Mr Mercer
Mr Mortimer
Mr Evans
Mr Towers
Miss Walker
Mr Addison

Ch.
OK – to include sq. bracketed passage?
AS 17/10

OK –

AUTUMN STATEMENT
PROJECTION OF NET PAYMENTS TO COMMUNITY INSTITUTIONS

You asked for a sentence for the draft minute to the Prime Minister, noting the effect of the new projections of net payments to the Community on the overall public expenditure arithmetic. I would suggest adding a new paragraph after the existing paragraph 5, reading as follows:

> "This deterioration is of course unhelpful for the overall Survey arithmetic. [While we have had no alternative but to take it into account in recent assessments of the overall position, it must inevitably mean greater restraint on other programmes if we are to achieve our aims]".

JM

J MACAUSLAN

PosRep

CONFIDENTIAL

FROM: M G RICHARDSON
DATE: 18 October 1988

(1) MR ~~ANSON~~

Copies attached for:
Chancellor of the Exchequer
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton*

(2) CHIEF SECRETARY

£400 million

This is a little lower than the figures for 1988-89 in the Economic Forecast, which showed a net claim on the Reserve of £0.6 billion. It reflects slightly later information than was available for the Forecast.

[have these been taken on board in scorecard?]

DA
18/10

? effect on later yrs?

cc

List A	List B*
Sir T Burns	Mr Phillips
Sir A Wilson	Mr Monck
Mr Scholar	Mr Spackman
Mr Odling-Smee	Mr Burgner
Mr Sedgwick	Mr A Edwards
Mr Robson	Mrs Case
Mr Culpin	Mr R I G Allen
Mr Pickford	Mr Mountfield
Mr Gieve	Mr Moore
Mr MacAuslan	Mr Turnbull
	Miss Peirson
	Mr L Watts
	Mr Mowl
	Mrs R J Butler
	Mr Pegler
	Mr I Taylor
	Mr Deaton
	Mr C Woolf
	Miss Adamson
	Miss Chalk
	Mr Kidgell - CSO

*Supplementary analysis attached

PLANNING TOTAL AND STATE OF THE RESERVE 1988-89

This submission provides details of GEP's October assessment of the Reserve and planning total for 1988-89.

2. This assessment indicates total claims on the 1988-89 Reserve of **£0.2 billion** and hence a planning total outturn of **£153.6 billion**. The estimated outturn is **£3.3 billion** below 1988 PEWP and FSBR plans, £2.0 billion lower than last month's assessment.

RICHARDSON
→
1. ANSON
2. CST
18/10

3. The main <u>decreases</u> since last month are:

i. £710 million on Social Security expenditure, excluding housing benefit, to reflect a revised assessment of take-up by ST and DSS in the light of several months of actual data under the new benefit regime, and lower assumptions about unemployment.

466

ii. £660 million on local authorities, composed of:

- a £600 million net reduction on capital mainly due to additional housing receipts offset by higher expenditure on other environmental services; these take account of partial first quarter outturn information.

- a net £70 million reduction on current expenditure mainly to reflect a reduction of £80 million in the forecast of housing benefit in the light of mid-year claims from local authorities.

iii. £230 million in the forecast of IBAP expenditure on export subsidies and stocks following the US drought and UK harvest.

iv. £120 million on New Towns reflecting a revised forecast of receipts.

v. £100 million on MOD procurement and accommodation services.

vi. £100 million extra privatisation proceeds.

vii. a £70 million net reduction on hospital and community health expenditure, despite making full allowance for nurses' pay, following the removal of a contingency item for general hospital services.

4. There have been no significant increases since last month.

5. Table 1 shows the main claims on the Reserve and changes since last month:

Table 1

	Total		Changes since last month	
			£billion	
Central govt cash limited	**1.15**		**0.20**	
of which: EYF carryforward		0.60		0.00
NHS pay review body		0.80		0.05
Cash limit shortfall		-1.00		-0.25
Central govt. non cash limited (incl NIF)	**-0.50**		**-0.95**	
of which: Soc Sec (excl HB)		-0.70		-0.70
Rover		0.55		0.00
NHS pay review body		0.05		0.00
IBAP gross		-0.40		-0.25
Central govt. Other	**0.35**		**0.00**	
of which: CFERs		-0.20		0.00
Net EC contributions		0.15		-0.05
NI (Shorts Brothers)		0.40		0.00
Local authorities	**0.60**		**-0.65**	
of which:				
Relevant current		1.25		0.00
Other current		-0.10		-0.05
Capital		-0.55		-0.60
Public corporations	**-0.40**		**-0.10**	
of which: Nat Ind EFLs		-0.30		0.05
List III PCs		-0.10		-0.10
Privatisation proceeds	**-1.00**		**-0.10**	
TOTAL (rounded)	**0.2**		**-2.00**	

6. The attached annex shows the latest estimate of outturn analysed by department compared with 1988 PEWP plans; the attached chart shows how our assessment of the planning total outturn has changed each month.

7. Claims on the Reserve totalling £2.2 billion have been formally agreed. Table 2 shows total claims charged and expected, discretionary and non-discretionary.

Table 2

£ billion

	Formally agreed	Expected	Total
Discretionary	2.4	0.3	2.6
Non-discretionary	-0.2	-2.3	-2.4
TOTAL	2.2	-2.0	0.2

8. The latest estimated outturn for running costs is £13,838 million, £105 million above initial running costs limits. This is unchanged from last month. On this month's estimates, running costs would account for just over 9 per cent of the planning total.

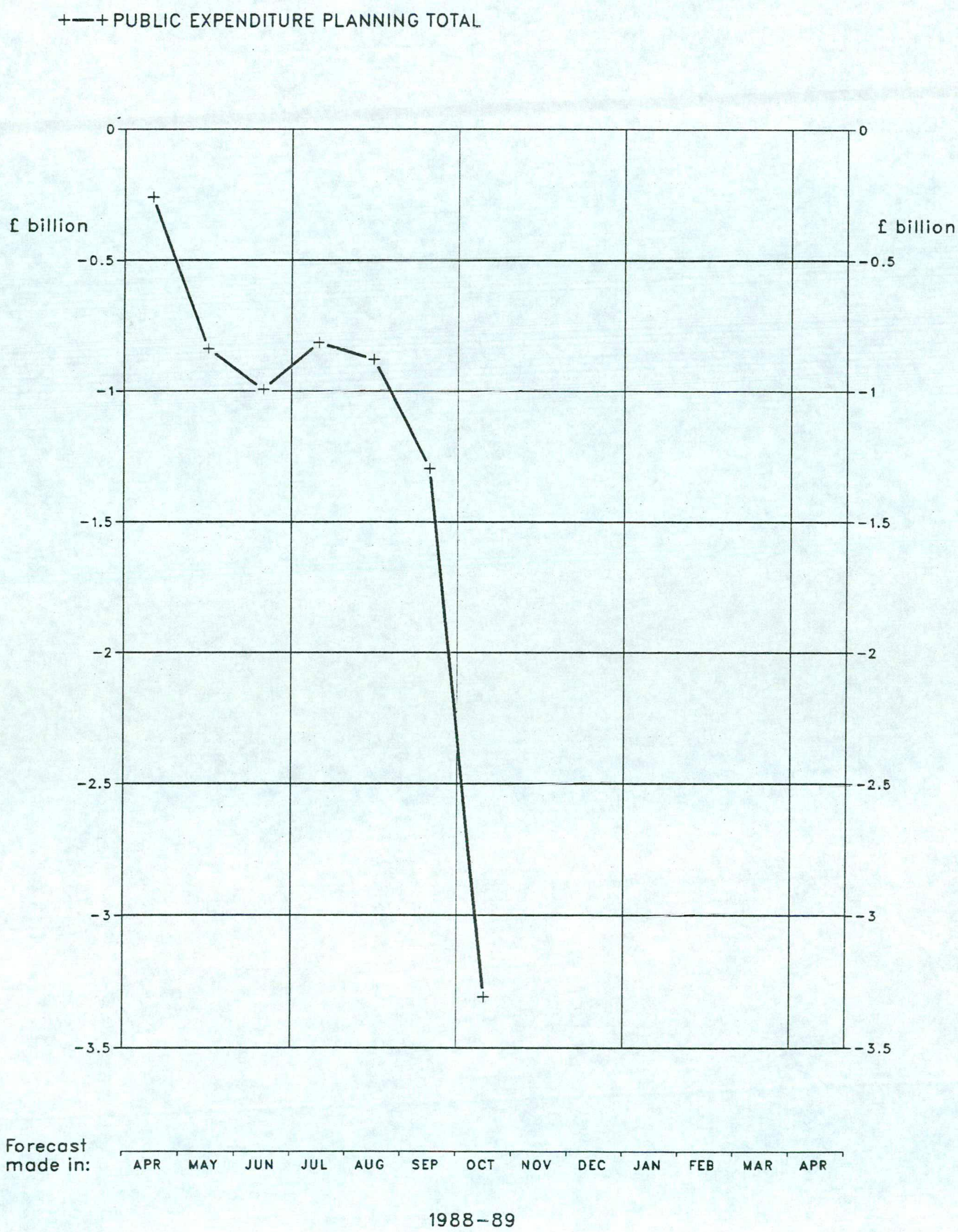
Conclusion

9. This month's assessment is that the 1988-89 Reserve will be underspent by £3.3 billion, but this is still subject to great uncertainty. We are now engaged in clearing with departments the figures for 1988-89 for publication in the Autumn Statement. In light of this we shall be advising you next week on the presentation of 1988-89 outturn in the Autumn Statement.

MG Richardson

M G RICHARDSON

PUBLIC EXPENDITURE PLANNING TOTAL:CHANGE FROM PLANS 1988-89



1988-89 TOTAL PUBLIC EXPENDITURE BY DEPARTMENT

£billion

1988-89	1988 PEWP Plans (1)	Sept est. (2)	Oct est. (3)	Change on Sept (4)	Change on Plans (5)
Ministry of Defence	19.22	19.38	19.28	-.10	.06
Foreign & Commonwealth Office - ODA	1.43	1.47	1.47	-	.04
Foreign & Commonwealth Office - other	.73	.75	.75	-.01	.02
European Community	.80	.98	.95	-.03	.15
Intervention Board for Agricultural Produce	1.35	1.19	.96	-.23	-.39
Agriculture	.80	.85	.84	-.02	.04
Forestry Commission	.06	.06	.06	-	*
Department of Trade & Industry	1.25	1.61	1.54	-.07	.29
Department of Energy	.12	.22	.20	-.02	.08
Export Credits Guarantee Department	.13	.08	.07	*	-.06
Department of Employment	4.24	4.14	4.13	-.01	-.11
Department of Transport	5.15	5.07	4.94	-.13	-.21
DOE - Housing	3.02	2.94	2.06	-.87	-.96
DOE - Property Services Agency	-.13	-.12	-.01	.11	.11
DOE - Other Environmental Services	3.86	4.06	4.37	.31	.51
Home Office	6.05	6.27	6.28	.01	.23
Legal Departments	.97	.95	.95	*	-.02
Department of Education and Science	17.97	18.39	18.47	.07	.49
Office of Arts and Libraries	91	.94	.97	.04	.06
DHSS Health & Personal Social Services	20.68	21.73	21.72	-.01	1.04
DHSS - Social Security	48.46	48.53	47.73	- 79	-.73
Civil Superannuation	1.34	1.24	1.24	-	-.10
Scotland	8.51	8.68	8.67	-.01	.16
Wales	3.45	3.60	3.59	-.02	.14
Northern Ireland	5.14	5.53	5.52	*	.38
Chancellors Departments	2.46	2.39	2.43	.04	-.03
Minor Departments	.38	.50	.38	-.13	-.01
Total expenditure on programmes	158.37	161.42	159.56	-1.86	1.19
Privatisation proceeds	-5.00	-5.90	-6.00	-.10	-1.00
Plans/Estimated outturn	153.37	155.52	153.56	-1.96	.19
Reserve not allocated above	3.50	-	-	-	
Planning Total	156.87	155.52	153.56	-1.96	
Implied overspend on plans	-	2.16	.19	-1.96	
Reserve available	-	3.50	3.50	-	
Implied overspend on planning total	-	-1.34	-3.31	-1.96	

(1) Cm 288 adjusted for the effects of classification changes.
(2) Consistent with PEPR(88) 7.
(3) Consistent with PEPR(88) 8.
(4) Column 4 = Column 3 - Column 2, calculated on unrounded figures and independently rounded.
(5) Column 5 = Column 3 - Column 1, calculated on unrounded figures and independently rounded.
* Indicates less than +/- £5 million.

CONFIDENTIAL

FROM: **P N SEDGWICK**
DATE: 18 OCTOBER 1988

CHANCELLOR

[A number of pts, passim.]

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Phillips
Mr Scholar
Mr C W Kelly
Mr Luce
Mr Odling-Smee
Ms Peirson
Mr Turnbull
Mr Gieve
Mr Hibberd
Mr MacAuslan
Mr Mowl
Mr O'Donnell
Mr Pickford
Ms Simpson

ECONOMIC PROSPECTS IN THE AS AND ECONOMIC ASSUMPTIONS FOR PUBLIC EXPENDITURE

Introduction

This note, which Jim Hibberd and I have put together with the help of a number of Treasury divisions, considers the main forecast numbers and economic assumptions for the Autumn Statement. The background against which decisions will have to be made is one in which the forecast could well attract even closer scrutiny and critical assessment than usual. Large errors in the FSBR forecast for 1988 have led to some loss of credibility. (David Owen's note to you of October 14 assessed the likely extent of the forecasting errors for 1988.) — in forecast strings.

2. There is an operational requirement to reach decisions on the economic assumptions for public expenditure at your meeting tomorrow, and it is sensible to consider at the same time the main figures for the Industry Act forecast. Clearly the public expenditure assumptions and the Industry Act Forecast in the Autumn Statement must be consistent with each other, eg on inflation and money GDP. Annex A brings together all the variables on which decisions are necessary and can act as the agenda for your meeting.

SEDGEWICK → CHEX 18/10

3. Information due between now and the Autumn Statement may have implications for the published Industry Act forecast, particularly the numbers we publish for this year. The decisions at your meeting tomorrow will in some cases, therefore, be provisional. Nevertheless we will go ahead and draft Chapter 2 of the Autumn Statement on the basis of the numbers decided at your meeting. The

first draft of the Industry Act Forecast is due to reach you on October 27.

Assumptions underlying the forecast

4. The Autumn Statement last year stated explicitly (paragraph 1.02) that the forecast for the year ahead assumed the same **PSBR** as forecast for the current financial year. It went on to say that the actual PSBR for the following year would as usual be set in the budget. We advise that the same procedure be followed this year to minimise speculation on the fiscal stance to be adopted in the budget.

depends on what we publish for PSBR in 88-89.

5. The October internal forecast has the average **North Sea oil price** rising from its present low level to $14 by 1989Q3. Recent practice in published forecasts has been to assume an oil price "close to recent levels". (In the FSBR we did not give a precise number for the assumed price.) We recommend the same approach in the IAF. This will probably imply a lower assumed average price in 1989 than in the October forecast.

Proposals for the published forecast and assumptions for public expenditure

6. Final decisions on the detailed forecast numbers in the Industry Act Forecast can be taken later, when you have seen a draft of Chapter 2 of the Autumn Statement. Decisions on the public expenditure assumptions, on the other hand, must be taken at your meeting tomorrow, and circulated immediately thereafter to a number of departments (in particular DSS: Annex B lists the other departments concerned). Decisions must also be taken on when to tell other departments about changes in the GDP deflator assumptions. The main departments concerned are DH, MOD, DES, and ODA. The Annex to Mr MacAuslan's submission of 14 October discusses the position with each of these departments.

7. The main variables we need to consider at this stage are:

- **real GDP (IAF only)**
- **the current account (IAF only)**
- **RPI (IAF and public expenditure assumptions)**
- **GDP deflator (IAF and public expenditure assumptions)**
- **Money GDP (IAF and public expenditure assumptions)**
- **PSBR (IAF only)**

We need also to consider, for public expenditure purposes only, medium term paths for

- unemployment,
- average earnings,
- interest rates.

The rest of this note considers these in turn, and notes the position on debt interest, on which decisions need not be taken at this stage.

Real GDP

8. Subject to your views on the outlook for GDP in the October forecast, I can see no reason for not publishing the same numbers in the IAF. Beyond 1989 we propose to extrapolate the MTFS path from the 1988 FSBR. (The assumption on GDP in the medium term is necessary for the money GDP assumption.)

(do we do 1/4%'s ?)
NO

(consider also in combination with GDP deft / money GDP)

GDP growth
(non-North Sea in brackets)

	FSBR	October Forecast	Proposed IAF	Proposed Medium Term Path
1988	3(3½)	4¼(4¾)	4½ 4¼(4¾)	
1989	2½(3)*	2¾(3)	2½ 2¾(3)	
1989-90	2½			2½
1990-91	2½			2½
1991-92	2½			2½

why is diff between oil & non-oil larger ? than in FSBR? (rebasing?)

*1989H1 on a year earlier

Current Account

9. By the time of the Autumn Statement we will have visible trade figures for nine months of 1988. (There will be data only for two quarters for invisibles. These are subject to possibly substantial revision.)

? £13bn as < 3% GDP
– or better to get all bad news out
, 3% GDP

10. We should publish our current best guess for 1988, £14bn, unless new information between now and publication of the Autumn Statement casts doubts on it. There is only one more set of

[wait for Sept imports figures]

monthly trade figures (for September) due between now and the Autumn Statement, though information on domestic demand will also be relevant.

11. For reasons set out in the forecast report, the current account deficit is not expected to fall in 1989. You have also noted publicly that the current account is likely to be the last variable to adjust following the recent rise in interest rates. There is a good case therefore for projecting a large current account deficit for 1989 also in the Autumn Statement. But the text could make it clear that there could be some fall through the year. In summary we propose:

??

No: much [illegible] £16bn

Current Account £bn.

	October Forecast	Proposed for AS		FSBR
1988	-14	-14	13 ?	-4
1989	-14	~~-14~~ -13 or -12	12 or 11	-4*

*1st half at an annual rate

The RPI

12. The FSBR inflation forecast for 1988Q4 is some way below the likely outturn, mainly because of a higher mortgage interest rate, but also due to an increase in underlying inflation. (Mr Owen's post-mortem note shows a variable track record on inflation forecasting. Our predictions were too high between 1981 and 1983 and too low between 1984 and 1987.) No new information will be available before the Autumn Statement, though we more or less know the effect that the rise in the mortgage rate in October will have on the RPI. I advise publishing our forecast of 6¼ per cent for 1988Q4.

13. For 1989Q4 it is convenient to consider the RPI forecast in two parts, the underlying inflation rate (ie less MIPs) and the mortgage rate effect. You will presumably wish to show inflation moderating in the second half of 1989, with a textual reference to further increases from the last recorded - October 1988 - inflation rate into the first half of next year and a slowdown thereafter.

14. The October forecast report identified a number of factors pointing to a rising underlying rate of inflation through next

year. The **RPI less MIPs** is expected to increase from 5 per cent in 1988Q4 to 5½ per cent in 1989Q4. The IAF could assume an RPI less MIPs inflation rate of 5 per cent at end-1989, ½ per cent less than the October forecast. We could adjust the published components of the RPI (except housing and nationalised industry prices) to achieve this.

OR

15. Turning to the **all items RPI** (ie including MIPs), it has been the practice in published forecasts in the 1980s to present forecasts for the RPI on the assumption that nominal interest rates remain at current levels. But we have not made the interest rate assumptions explicit in the text of the IAF, and have declined to reveal them to the TCSC or others. Maintaining that practice, total RPI inflation is forecast to fall between 1988Q4 and 1989Q4 as the effect of increased mortgage rates in the second half of 1988 drop out.

for the time

16. The forecast for the total RPI that is consistent with a judgement on the RPI less MIPs of 5 per cent, and with constant interest rates from now on, is 5½ per cent. Even with the effects of the rises in the mortgage rate during 1988 dropping out by 1989(4), the total RPI still grows more quickly than the RPI less MIPs because the average mortgage (to which the mortgage rate is applied) will still be rising rapidly, at 12 per cent, reflecting lagged house price increases.

17. The discussion so far has assumed that we continue to publish the RPI table in the same format as in recent published forecasts. This shows the total RPI together with the components for food, nationalised industries, total housing, and "other". One innovation would be to include the RPI less MIPs explicitly. To do so would be consistent with recent pressure on Mr Fowler to publish the series regularly. Against that, however, the assumption on the mortgage interest rate would be more readily deducible. Nonetheless we can if you wish, consider alternative presentations of the IAF RPI table.

Answer: probably not

? publish 5%, implicitly with a 1% cut in mortgage rates? ✓

RPI Forecasts

	Total RPI			RPI less MIPs not published	
	October Forecast	Proposed for AS	FSBR	October Forecast	Proposed underlying for AS
1988(4)	6¾	6¾	4	5	5
1989(4)	6	~~5½~~ 5	4*	5½	5

*forecast for 1989Q2

18. Assuming you are content with the above proposals, we need to consider what they imply for the RPI for September 1989 and September 1990 to use for calculating social security expenditure. Assumptions are needed for the total RPI and for the RPI excluding housing costs (the ROSSI index). The latter is used to uprate about one third of the social security programme. The September 1989 figure for the total RPI is likely to be higher than the figure for 1989Q4 because the latest (October 1988) rise in the mortgage rate will, by assumption, still be affecting the year on year change in September. The September figure for the total RPI consistent with a 1989Q4 increase of 5½ per cent is 6 per cent. The equivalent figure for the Rossi index in September 1989 is 5 per cent.

now 5½/5

19. The assumption on ROSSI will not be published at the time of the Autumn Statement. But we ought to work on the assumption that the figures might be provided if a PQ were put down asking for them, or if a Select Committee asked for them. It is difficult to think of any basis on which DSS (or we) could refuse to provide them. At the very least, we can expect DSS to have to reveal the actual ROSSI figure for the year to September 1988, which is being used to uprate the income-related benefits for 1989-90. Gordon Brown has already written to you on this point, urging that the full RPI be used to uprate these benefits instead of ROSSI.

& Sept 1990?

	Year to September 1988	Year to September 1989	Year to September 1990
Published 1988 PEWP assumptions	4½	3¼	
Unpublished July economic assumptions	5½	4½	4
October forecast	5.9	6½	5
Proposed Assumptions for Public Expenditure			
Total RPI	5.9	5½ ~~6~~ 5½ ?	4
RPI less housing (ROSSI) (not published)	4.7	5	4

The GDP Deflator

20. The GDP deflator is currently rising at a rapid rate. For 1988-89 it is probably best to publish 6½ per cent, close to the October forecast. As the forecast report notes, most of the factors generating the high GDP deflator in 1988-89 are to a considerable extent already recorded (terms of trade increases) or known to be in the pipeline (earnings increases in the public sector). For 1989-90 growth of the GDP deflator will need to appear consistent with other parts of the published forecast, for instance the RPI and the terms of trade. This points to a figure of 5½ per cent for 1989-90. Beyond 1989-90 we propose to follow past practice and assume that growth of the GDP deflator is as in the last MTFS.

prefer 5

21. The figures for growth in the GDP deflator have important implications for public expenditure. Certain departments will claim that they have based their bids on existing GDP deflator assumptions. GEP consider that the further proposed increase in the price level of 2 percentage points (ie 1 per cent this year and next) - when our proposal is compared with the latest circulated (July) assumptions - across the whole Survey period would greatly increase the risk of being required to reopen the defence, health, aid, and education settlements at a potential cost of up to about £500-750 million a year. The risk is substantially greater than if there were only a 1 percentage point increase on the July level. The proposed assumptions would also cast doubt on the RSG settlement reached in July, and on the provision for local authority relevant expenditure both in 1989-90 and in the later

but 1% of that has effectively already happened this year.

years. The Chief Secretary is currently seeking colleagues' agreement on the latter). Each 1 percentage point increase in the price level could mean up to £300 million a year extra on these figures. Finally, the increase proposed in the assumptions may make it very difficult to prevent a general reopening of settlements.

	1988-89	1989-90	1990-91	1991-92
FSBR/MTFS (published)	4½	4	3½	3
July PES assumption	5½	4½	3½	3
October forecast	6¾	6	5	
Proposed IAF forecast/ assumptions for public expenditure	6½	5½	3½	3
GEP's preference	6	5		

discuss (or perhaps 6¼)

22. The proposed GEP assumption of a 5 per cent increase for the GDP deflator in 1989-90 would not sit too comfortably with a total RPI increase of 5½ per cent for 1989(4). It would probably make necessary some shading down of RPI inflation in 1989(4).

(No bad thing)

Money GDP

23. The proposed IAF projection for **money GDP** to 1989-90 and the assumptions for the years to 1991-92 follow from the forecasts and assumptions on real growth and inflation. There is a sharp drop between 1988-89 and 1989-90.

(check implications for ratios)

6¼
4¼
10½

5
2¾
7¾

6¼
4½
10¾

5
2½
7½

MONEY GDP AND ITS COMPONENTS

	1987-88	1988-89	1989-90	1990-91	1991-92
Money GDP growth					
Published MTFS	9¾	7½	6½	6	5½
October forecast	10	11	8.7	7.3	
Proposed forecast/ assumptions for public expenditure	**10**	**10¾**	**8¼**	**6**	**5½**
Money GDP (£billion)					
Published MTFS	424.3	456.4	486.5	516.1	544.5
October forecast	424.4	471.4	512.2	549.8	
Proposed forecast/ assumptions for public expenditure	**424.4**	**470.0**	**508.8**	**539.3**	**569.0**

Cal 88 455 Cal 89 498

4/56 14 ~~[illegible]~~ 14

Constrained on calendar years, but 1989-90 still looks high.

The PSBR/PSDR

24. The Industry Act forecast in the Autumn Statement will include a forecast for the **PSBR/PSDR** for the current financial year only. There will be a certain amount of detail on revenues and expenditure in the conventional tables, and in the text as well.

25. The PSBR has been over-forecast since 1985 in public forecasts. I believe we should publish our best estimate of the outturn this year. However, we should leave the final decision on the precise number until a fairly late stage. The September figures for the LABR and PSBR were not available in time to influence the latest internal forecast. By the time of the AS we will have the PSDR for October and some information on central government transactions in the early part of November. In particular we will know how much corporation tax was received in October, the second most important CT month in the year, and the extent of the recovery in central government revenues following the postal strike.

? true of 8 Nov?

(surely should have a safety margin)

	PSDR £bn,		
	October Forecast	Proposed for AS	FSBR
1988-89	11¾	~~11¾~~ 10	3

(whole number: £1 bn = ¼ %)

Unemployment

26. An unemployment assumption for 1988-89 and the following financial year will appear in the Government Actuary's report in mid-November. The assumption for the whole of the Survey period will be published with the public expenditure plans in the Autumn Statement and again in the PEWP. The table below shows the last published assumption (which appeared both in the 1987 Autumn Statement and 1988 PEWP) together with the provisional unpublished assumptions issued to departments in September. Also shown is the forecasters' current view for 1988-89 and beyond.

	GB ADULT UNEMPLOYMENT (millions)			
	1988-89	1989-90	1990-91	1991-92
1988 PEWP	2.6	2.6	2.6	
September assumption	2.1	2.0	2.0	2.0
Forecasters' current view	2.1	1.8	1.8	1.7
OK **Proposed economic assumption**	**2.1**	**1.9**	**1.9**	**1.9**

27. In August GB adult unemployment stood at 2,154 thousand, having fallen by an average of 46 thousand a month over the most recent three months, compared to an average 37 thousand fall in the previous three months. Unemployment fell hardly at all in September, reflecting temporary, but substantial, over-recording of unemployment due to the effect of the postal strike. It does not alter our view that there is still a strong underlying downward trend in the figures, and Department of Employment expect to publish substantially revised September figures in November. The October GB unemployment figures to be published in mid-November will probably show unemployment at around 2.0 million, perhaps a touch over, continuing the pronounced downward trend of the last two years. For the current financial year as a whole the assumption of 2.1 million that we circulated to departments in September still represents our best view of the expected outturn.

28. However, we warned in September that the assumptions for later years (to be published in the Autumn Statement) would need to be

reconsidered in the light of later figures and short term prospects. It now seems likely that unemployment will continue falling at least for a little while.

29. The economic assumption for unemployment has always been a stylised path, not a forecast. On the other hand, keeping one eye on the outturn and what short term trends are likely to be at the time of publication of the PEWP in January, the September assumption of 2.0 million for 1989-90 and beyond looks high. We could easily justify an assumption of 1.9 million (a bit lower than the expected number for December 1988) for all subsequent years, or even 1.85 million.

(twiddle might help to secure exact planning total)

30. The proposed path for the Autumn Statement follows the pattern of the last two Autumn Statements, ie a lower level in the three forward years than in the current year. In the 1985 Autumn Statement, the assumption was 3.05 million in 1985-86 and 3 million in each of the subsequent years; and in the 1986 Autumn Statement the assumption was 3.1 million in 1986-87 and 3.05 million in each of the subsequent years. In the 1987 Autumn Statement the assumption was 2.7 million in 1987-88 and 2.6 million in 1988-89.

Average Earnings

31. The earnings assumptions has little impact on demand led expenditure. Average earnings assumptions for 1988-89 and 1989-90 are due to be published in the Government Actuary Department's Report in November and the PEWP in January. Revised (but unpublished) assumptions were circulated in July. They are compared below with the March assumptions (also unpublished) and the forecasters' current view.

WHOLE ECONOMY EARNINGS GROWTH

	1988-89	1989-90	1990-91	1991-92
1987 GAD Report/ 1989 PEWP	6½			
Unpublished March assumption	6½	5½	5	5
Unpublished July assumption	8½	7	6	5
October forecast	8¾	9	8¼	7¾
OK Proposed assumption	8¾	7½	6	5

32. Actual whole economy average earnings rose by 9¼ per cent in the year to August 1988; the corresponding increase in underlying earnings was 8 per cent. The forecast projects a further, though small, rise in 1989-90 and has earnings growth moderating slowly thereafter. For 1988-89 we propose an assumption of 8¾ per cent, in line with the forecast. For subsequent years we suggest something lower than the forecast.

Interest Rates

33. Interest rate assumptions are never published though they are circulated fairly widely among departments (see Annex B). Revised assumptions for short-term interest rates were issued in July (long-rates were unchanged from the March assumptions). They are compared with the current forecast in the table below.

34. Short-term interest rates are currently higher than we foresaw in June and the October forecast has them higher over the forecast period. We recommend revising the assumption in line with what we propose should underlie the Industry Act Forecast for 1988-89 (ie with no change in short rates assumed during 1989). For subsequent years we propose sticking to the July assumptions.

Pretty sound

INTEREST RATES

	(close 11 October)	1988-89	1989-90	1990-91	1991-92
3-month sterling interbank					
July assumption		10	10	9½	9
October forecast	11.8	10.8	11.8	11.0	11.0
Proposed		**10¾**	**11¾**	**9½**	**9**
20-year gilt rate					
July assumption		9½	9½	9½	9½
October forecast	9.2	9.6	9.8	9.8	9.8
Proposed		**9½**	**9½**	**9½**	**9½**
6-month dollar LIBOR					
July assumptions		9	10	9	9
October forecast	8.6	8.8	9.8	9.7	8.8
Proposed		**9**	**10**	**9**	**9**

Debt Interest

35. The Autumn Statement will include projections of gross debt interest to 1991-92. A proper projection would need to be based on assumptions about the PSDR path. On this occasion, however, it may be

??

better to include a stylised projection so as to avoid an explicit assumption that we might have to disclose on whether the PSDR does or does not return to zero. We are considering stylised paths and will make proposals at a later stage. The numbers for debt interest will have possibly important implications for GGE and the path of the GGE ratio. — critical surely

indeed

Effects of Revised PES Assumptions

36. The upward revisions to interest rates and inflation proposed in this submission would add to the totals for demand led expenditure. The unemployment assumption would reduce demand led spending. The net effect is summarised below. No allowance is made for any re-opening of agreements outside the area of demand led expenditure as a result of the higher GDP deflator assumptions.

EFFECTS OF PROPOSED ASSUMPTIONS (£bn.)

	1988-89	1989-90	1990-91	1991-92
RPI			630	870
GDP deflator		60	60	60
Short Interest Rates	82	195	12	1
Unemployment		-230	-230	-240
	82	25	472	691

Decisions

37. We need to agree:

(i) A reference to the PSBR in the Autumn Statement. Last year we assumed the same PSBR for the year ahead as forecast for the current year and noted that the annual PSBR for the following year (in this case 1989-90) would be set in the Budget. We propose the same this year.

SP — 17½ — 16½ - 16½ - 15½
17½ 16½ 17 16¾
17½ 16½ 16½ 16½

(ii) On the oil price we propose that no number should be given in the IAF, but that there should be a textual reference to the assumed oil price being "close to recent levels".

38. The other detailed decisions on numbers are set out in Annex A.

P.N.S

P N SEDGWICK

ANNEX A: SUMMARY: DECISIONS ON PUBLISHED IAF FORECAST AND ECONOMIC ASSUMPTIONS

	1988	1989	1990	1988-9	1989-90	1990-91	1991-92
1. GDP growth (non-N.Sea in brackets)							
FSBR/MTFS published	3 (3½)	2½(3)*	4	3 (3½)	2½(3)	2½(3)	2½(3)
October forecast	4¼(4¾)	2¾(3)					
Proposed published Autumn Statement	**4¼(4¾)**	**2¾(3)**		**2½(3)**	**2½(3)**	**2½(3)**	
* 1989H1 at annual rate							
2. Current Account (£bn)							
FSBR/MTFS published	- 4	- 4*					
October forecast	-14	-14					
Proposed published Autumn Statement	**-14**	**-14**					
* 1989H1 at annual rate.							
3. RPI (Q4 per cent change on year earlier)							
FSBR published	4	4(1989Q2)					
October forecast	6¼	6					
Proposed published Autumn Statement	**6¼**	**5½**					
4. Proposed economic assumptions (year to September)							
RPI							
July assumption	5½	4½	4				
Proposed assumption	**5.9**	**6**	**4**				
ROSSI							
July assumption	4¼	3½	3				
Proposed assumption	**4.7**	**5**	**4**				
5. GDP deflator (per cent change on year earlier)							
FSBR/MTFS published				4½	4	3½	3
October forecast				6¾	6	5	
Proposed Autumn Statement forecast/economic assumptions				**6½**	**5½**	**3½**	**3**
GEP preferred assumptions				**6**	**5**	**3½**	**3**

	1988-89	1989-90	1990-91	1991-92
6. Unemployment (millions)				
September assumption (unpublished)	2.1	2.0	2.0	2.0
October forecast	2.1	1.8	1.8	
Proposed published economic assumption	**2.1**	**1.9**	**1.9**	**1.9**
7. Average earnings				
July economic assumption (unpublished)	8½	7	6	5
October forecast	8¾	9	8¼	7¾
Proposed economic assumption	**8¾***	**7½***	**6**	**5**

* Published in GAD Report and PEWP

	1988-89	1989-90	1990-91	1991-92
8. Interest Rates				
3-month sterling interbank				
July unpublished assumption	10	10	9½	9
October forecast	10.8	11.8	11.0	11.0
Proposed unpublished assumption	**10¾**	**11**	**9½**	**9**
20- year gilt rate				
July unpublished assumption	9½	9½	9½	9½
October forecast	9.6	9.8	9.8	9.8
Proposed unpublished assumption assumption	**9½**	**9½**	**9½**	**9½**
6-month dollar LIBOR				
July unpublished assumption	9	10	9	9
October forecast	8.8	9.8	9.7	8.8
Proposed unpublished assumption assumption	**9**	**10**	**9**	**9**

ANNEX B **DEPARTMENTS RECEIVING ECONOMIC ASSUMPTIONS**

Unemployment	DHSS, DEmp, Northern Ireland Office (NIO), GAD.
RPI (including and (excluding housing costs)	DHSS, ECGD, NIO, GAD
GDP deflator	DHSS, GAD
Average earnings	DHSS, GAD
Interest Rates	DTI, ECGD, DOE, NIO, Scottish Office Welsh Office. (The last four receive these to compute housing subsidies.)

* Superannuation uprating assumptions go to departments paying public service pensions. Though described as superannuation uprating assumptions, the departments are well aware that they are actually the September to September all items increase.

CONFIDENTIAL

ANNEX C PUBLICATION OF ECONOMIC ASSUMPTIONS

AUTUMN STATEMENT (AS): GOVERNMENT ACTUARY'S ANNUAL REPORT (GAD): PUBLIC EXPENDITURE WHITE PAPER (PEWP)

DATE DUE	November AS	November GAD	January PEWP
UNEMPLOYMENT	Figures shown in PEWP are also given in Chapter 1 of AS.	Financial year averages for 1988-89 and 1989-90 shown as basis for estimates of expenditure on social security.	Financial year averages up to 1991-92 shown as basis for estimates of expenditure on social security.
RPI	Figures shown in PEWP are also given in Chapter 1 of AS. **The Industry Act forecast will also show annual percentage changes to 1988Q4 and 1989Q4.**	Percentage increase in year to September 1988 shown as basis for estimates of expenditure on social security.	Annual percentage increases up to September 1990 shown as basis for estimates of expenditure on social Secuity.
AVERAGE EARNINGS	Pubished in Chapter 3 of AS. Same figures as for GAD Annual Report. Internal forecast used to derive published estimates of government revenut.	Average growth rates to 1988-89 and 1989-90 shown, as basis for estimates of income from NI contributions.	<u>Not shown.</u> But used for calculating family income supplement and housing benefit.
INTEREST RATES	<u>Not shown</u>. But figures used as basis for estimating expenditure on various programmes (eg interest support costs, housing).	Not relevant.	<u>Not shown.</u> But figures up to 1991-92 used as basis for estimating expenditure on various programmes and debt interest payments.
GDP DEFLATOR	Shown in Chapter 1 of AS.	Not relevant.	Financial year percentage increases up to 1991-92 shown. They determine cost terms for public expenditure.

gep1.ip/jm/cst 18.10

SECRET AND PERSONAL

SCORECARD
COPY NO: 3 OF: 23

FROM: J MACAUSLAN
DATE: 18 OCTOBER 1988

CHIEF SECRETARY +1

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

Ch
What is clearly crucial is how far programmes are reopened. I'm pretty sure, for example, we should be able to hold LA settlement – surely Ridley wouldn't reopen it, & other spending ministers can be dealt with. I'm a bit suspicious about other programmes too.
AA

MACAUSLAN → CST 18/10

ECONOMIC ASSUMPTIONS AND SURVEY OUTTURN

This note shows the effect of the economic assumptions discussed in Mr Sedgwick's submission of today on the possible outcome of the Survey. It also notes an implication of any decisions to accelerate the Autumn Statement timetable.

2. My submission of 14 October – below – covered the latest scorecard. It also showed (Table 3) the possible effects of revised economic assumptions. Table 1 below updates that Table. It shows the effects of the economic assumptions proposed in Mr Sedqwick's submission, with a variant for a GDP deflator of 5 per cent for 1989-90 rather than the 5½ per cent proposed. A crucial question is how far settlements are reopened because of the revisions. I

assume health, aid, and student awards are reopened if the 1989-90 deflator is 5 per cent; and that defence and the RSG settlement must also be adjusted if we go for 6½ per cent in 1988-89 and 5½ per cent in 1989-90. I have assumed that the risk of wider reopening can be contained, even in the latter case.

3. The table also updates the assessment of the other possible changes to the scorecard.

4. Tables 2 and 3 update Table 4 in my 14 October submission (showing the implications of the possible Survey outcome). Assuming Reserves of £3.5/7/10.5 billion, Table 2 shows the implications of the economic asumptions proposed by EA, and Table 3 those of the variant with a lower GDP deflator.

5. All Tables assume that any expenditure implications of an agreement at E(EP) on 27 October on student loans will be handled in the 1989 Survey rather than this one; that Mr Clarke delivers the previously agreed savings on dental and eye testing; and that there is no need to increase provision in this Survey for launch aid to Rolls Royce.

<u>Acceleration of timetable</u>

6. If it is decided to accelerate the timetable for the Autumn Statement, we will need to ask divisions immediately to clear with those departments that have already settled the relevant figures and paragraphs for the Autumn Statement. If asked why the hurry, we would expect, subject to your views, and those of the Chancellor, to advise divisions to tell departments that there was a possibility - although nothing was yet decided - that the Autumn Statement might be in early rather than mid-November.

JM

J MACAUSLAN

gep1.ip/tables/scorecard1

SECRET

√ = as in Sedgwick note

TABLE 1

POSSIBLE CHANGES TO SCORECARD

	1989-90		1990-91		1991-92	
1 Scorecard: additions to planning total	+ 110		+ 2850		[+ 7030]	
2 Economic assumptions (in all three years) for demand led effect of GDP deflator, so difference is reopened programme						
GDP deflator	5½	5	5½	5	5½	5
DES/ODA/DSS (Sedgwick has +60)	+ 120	+ 70	+ 125	+ 75	+ 130	+ 80
DH/MOD	+ 400	+ 100	+ 420	+ 110	+ 440	+ 120
Local authorities	+ 300	-	+ 315	-	+ 330	-
Rpi +1½% 9/89 (lower with 5% GDP because has lower RPI too)	-		+ ~~620~~ 630	+ 450	+ ~~780~~ 870	+ 480
Interest rates	+ 195	+ 195	+ 12	+ 12	-	-
Unemployment 1.9m	- 230	- 230	- 240	- 240	- 240	- 240
	+ 785	+ 135	+ ~~1260~~ 1270	+ 405	+ ~~1440~~ 1530	+ 440
3 Other programme changes						
Territories	- 75	-75	- 40	-40	+ 25	+25
DTp	+ 50	+50	+ 50	+50	+ 50	+50
	- 25	-25	+ 10	+10	+ 75	+75
TOTAL ADDITION TO PLANNING TOTAL	+ 870	+ 220	+~~4,110~~ 4,120	+3,265	[+~~8,545~~ 8,635]	[+7,545]
4 Less likely programme changes						
CB/UB	- 195		- 75		- 35	
BAe/Rover	- 150		-		-	
	- 345		- 75		- 35	

(amended to agree with Sedgwick figures) ge½1.ip/tables/survey 2 3

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TABLE 2

SURVEY OUTCOME: MAIN CASE — ie using Sedgwick assumptions

	1988-89	1989-90	1990-91	1991-92
Planning total				
Additions (£bn) (before "Wholly programme changes")		0.9	4.1	8.5
Real growth (%) over previous year		3.2	3.7	3.6
over 1987-88				2.5
1988-89				3.5
GGE				
As % of GDP	39.9	39.2	39	39
Real growth (%) over previous year		0.7	2.1	2.2
over 1987-88				1.2
over 1988-89				1.7
Assumptions				
GDP deflator	6.5	5.5	3.5	3.0
Real growth	4	2.5	2.5	2.5
Debt interest	17.6	17	16	15.5
Reserves		3.5	7.0	10.5

based on what PSDR assum?

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SECRET

TABLE 3

Survey outcome: lower variant

	1988-89	1989-90	1990-91	1991-92
Planning total				
Additions (£bn)		0.2	3.25	7.5
Real growth				
Over previous year		3.3	3.6	3.6
over 1987-88				2.6
1988-89				3.5
GGE				
As % of GDP	40.1	39.4	39.2	39.1
Real growth				
Over previous year		0.9	2.0	2.2
over 1987-88				1.3
1988-89				1.7
Assumptions				
GDP deflator	6	5	3½	3
Real growth	4	2.5	2.5	2.5
Debt interest	17.6	17	16	15.5
Reserves		3.5	7.0	10.5

FROM : MISS J C SIMPSON
DATE : 18 OCTOBER 1988

CHANCELLOR OF THE EXCHEQUER

cc	Chief Secretary	Mr Scholar
	Financial Secretary	Mr Phillips
	Paymaster General	Mr Odling-Smee
	Economic Secretary	Mr Sedgwick
		Mr Turnbull
	Sir P Middleton	Miss Peirson
	Sir T Burns	Mr McIntyre
	Mr Anson	Mrs M E Brown
	Mr Byatt	Mr Hibberd
	Mr Monck	Mr MacAuslan

[See [illegible] minute for [illegible] on 27/10]

SIMPSON → CHEX 18/10

BRINGING FORWARD THE DATE OF THE AUTUMN STATEMENT

— below

1. Mr Turnbull's minute of 14 October on the state of the Survey indicated that there were only three programmes unresolved and that alternative channels for resolving them could be used. It raised the question whether, in those circumstances, it was worth Star Chamber meeting at all.

Present timetable

2. The present Autumn Statement timetable, aiming for 15 November, is based on the assumption that up to three weeks would be needed for Star Chamber. In the light of progress so far, and the probability that only one week at the most might be needed, you may wish to consider bringing the date of the Autumn Statement forward. This minute sets out the considerations involved. It has been discussed with Mr Odling-Smee and Mr Turnbull.

Options for accelerating the timetable

3. The advantages of bringing the date forward are twofold. First, it reduces the risk of the outcome of the Survey being released piecemeal by leaks, thus making it difficult to present it in the most favourable way and possibly unsettling the markets. Second, it also reduces the risk of Departments to whom we do not

give any revised economic assumptions discovering what they are and seeking to reopen their own programmes accordingly.

4. We have identified these options for accelerating the timetable:

i. Cabinet Wednesday 2 November, Oral Statement Tuesday 8 November, Printed Document 8 November;

ii. Cabinet 2 November, Oral Statement 2 November, Printed Document 8 November;

iii. Cabinet Thursday 10 November, Oral Statement 10 November, Printed Document 15 November.

5. Option (i) is simply the present schedule accelerated by one week. Subject to the caveats below, we believe this can be achieved. Its advantage is that Oral Statement and printed document come out together and there is adequate time after Cabinet to finalise the expenditure figures, get the printing done and briefing run off. (Indeed, there is a day longer than usual as Cabinet has to be on Wednesday 2 November because the Prime Minister is in Poland on Thursday.) Its disadvantage is that there is a risk that the survey outcome would leak during the long gap and that the element of (pleasant) surprise would be lost.

6. Option (ii) adopts the 1986 procedure, with the Oral Statement immediately after Cabinet with the printed document a few days later. Its advantage is that news is announced immediately decisions are taken. It would, however, require the preparation of typeset versions of the forecast and a summary table for public expenditure figures. To be feasible this option would require decisions on all programmes by the middle of next week so that numbers can be agreed and a report for Cabinet prepared for circulation on Monday, 31 October. There are, however, a number of disadvantages. First, there are risks in going for an announcement a few hours after Cabinet. If an unexpected issue affecting the figures came up, the presentation of the Oral Statement could be very awkward. Second, one would need a reason for the immediate announcement which did not commit

don't we have to do under option (i) also?

Early Cat.

us to doing the same every year. In 1986 our cover was that Parliament was not sitting in the following week. Our judgement is that only if all the programmes are clearly settled during next week, including any adjustments for inflation (which in turn presupposes these adjustments are limited) can this be attempted. And then it would be a tremendous scramble.

7. Option (iii) shares the advantage of (ii), but it allows much more time for the preparatory work eg drafting of the Oral Statement and the summary note, and preparation of briefing.

Concluding the Survey negotiations

8. Social security, which in any case needs to be decided early, can be handled in an ad hoc group. Negotiations on Transport are at an impasse, but further bilateral negotiations, assisted perhaps by an intermediary, could be undertaken. The most troublesome issue is the Welsh block (and the risk that it could cause the other territorial blocks to be reopened). It is arguable, however, that Mr Walker, like any experienced negotiator, will use up whatever time is available to him. The longer he has got, the longer he will take. Thus all three can probably be settled as well in two weeks as three. The scope for accelerating the timetable will also depend on being able to make any adjustments to programmes necessary to take account of revised economic assumptions quickly, if you decide on Wednesday to revise them. Provided the revision to the inflation assumptions is not too large, GEP would expect this to be manageable.

Social security and NICs

9. The benefit uprating statement is at present scheduled for some time in the week beginning 24 October. Meeting this timetable is dependent on decisions being reached on Child Benefit and on the effect of any revised economic assumptions. But these decisions are not on the critical path as they have to be taken earlier than required for Survey purposes.

10. National Insurance Contributions may be more of a problem. The Department of Social Security internal timetable has slipped back by a week, and ST are not now expecting a letter from the Secretary of State making his formal proposals until the week beginning 24 October. The loss of a week is not crucial for a 15 November Autumn Statement, especially as we do not expect the proposals themselves to cause any difficulty. It could, however, cause difficulties with a printed Autumn Statement on 8 November. The printing timetable for the Autumn Statement document is based on the assumption that the NICs and tax ready reckoner chapters can be got out of the way in advance of the two main chapters. Ideally, the printers would like first drafts by the end of this week (21 October) if we were going to publish the printed document on 8 November. This is clearly impracticable, but any slippage beyond about 25 October would make things very difficult for the printers. We could send the drafts over with our best guess at the figures before we heard from the Department so that the printers could set the chapter up. This could well mean, however, that more amendments than usual would be needed, thus increasing the pressure on the timetable in the later stages.

X Surely he can be pressed.

Forecast

11. The main forecast exercise has been completed and your meeting on 19 October is to discuss the figures that should be included in the IAF. It should therefore be possible to produce this for an Autumn Statement on 8 November, although this would have to be at the expense of some internal consideration. It should just be possible to produce the IAF in time for an Oral Statement on 2 November, although the timing would be extremely tight and there would be very little time to consider the issues in depth or work on the drafting.

Printers

12. The printers could cope with an Autumn Statement on 8 November provided we could get the public expenditure and IAF chapters to them by 28 October and the other two chapters sometime before then.

Industrial action

13. The Civil Service unions are at present balloting their members on a day of industrial action on 7 November in support of the GCHQ union rebels. The printers say that they are almost certain not to be affected even if the vote is in favour. HMSO distributors do most of their work on the day of the Autumn Statement itself and are confident that they could cope even if a few of their staff did stay away on 7 November. Industrial Relations Division say they do not as yet know what action may be taken in the Treasury, but they cannot rule out some staff in crucial areas, for example office services, being absent that day. They also feel that staff who might be prepared to work normally that day might not be prepared to work overtime. As the Autumn Statement brief is normally completed late in the Monday evening and run off overnight, this could be a serious constraint.

Do it earlier

Statistics

14. Moving the Autumn Statement to 2 November (Oral) or 8 November (Oral and written) would make almost no difference to the published statistics which would be available as the great bulk of them are published between 16 and 18 November. It would mean, however, that we would lose the internal estimate of the October PSBR that would otherwise be available.

15. The Bank of England Quarterly Bulletin is to be published on 10 November. Moving the date of the Autumn Statement from one side of it to the other would make little difference to any potential embarrassment that might arise from discrepancies between the two publications.

British Steel

16. The pathfinder prospectus for British Steel is due to be published on 28 October and impact day is set for 23 November. Having the Autumn Statement on 8 rather than 15 November should

not therefore cause any difficulty. An Oral Statement on 2 November would be rather close to the publication of the pathfinder, and PE would like to check with the lawyers that it would cause no problems if this were to be the preferred option.

Conclusion

17. Although the timetable is very tight, taking the Survey to Cabinet on 2 November whether for announcement that day or on 8 November, might be possible provided clear decisions are reached on all programmes during the course of next week. The main risks are that

Must wait

(a) the Department of Social Security will delay decisions on NICs until late next week, thus causing pressure on the printing timetable;

(b) the IAF will not receive as much consideration as usual and mistakes may creep in;

(c) a similar problem could arise with the public expenditure chapter of the published Autumn Statement and with the briefing; and

(d) industrial action may reduce the number of copies of the Autumn Statement available on 8 November.

The risks can, however, be minimised by deciding as early as possible, preferably tomorrow, whether to go for this accelerated timetable or not. The decision last year to advance the timetable by a week was taken at almost exactly the equivalent stage, and it is not really feasible to leave the decision much later, though that was a decision to accelerate with the Statement following a few days after Cabinet. Option (ii) is even more ambitious as it accelerates with an immediate announcement. Option (iii) has the advantage of combining adequate preparation time with the immediate announcement.

The best

JS

MISS J C SIMPSON

gep1.ip/jm/ec ass

SECRET AND PERSONAL

SCORECARD
COPY NO: 3 OF: 23

FROM: J MACAUSLAN
DATE: 19 OCTOBER 1988

CHIEF SECRETARY +1

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

CST bilateral

MACAUSLAN → CST 19/10

EFFECT OF AGREED REVISIONS TO ECONOMIC ASSUMPTIONS

Table 1 below is a revised version of the Table I sent up last night. It shows our best guess as to the effects of the economic assumptions agreed at the meeting held by the Chancellor this morning.

2. The economic assumptions are as in Table 2. I have assumed, for the moment, unemployment at 1.9 million.

3. The assumptions will go out to departments as soon as possible. In the case of DSS, that means as soon as the remaining issues are resolved. Departments will then calculate the expenditure implications. In the meantime, we have made what guesses we can using ready reckoners. There is, I am afraid, quite a margin of error around our guesses.

4. In the case of the GDP deflator, there is a margin of error around the estimate of the effect on Housing Benefit; but, more importantly, it is not yet clear to what extent we will reopen settlements already reached. DM, ST1, HE2, and AEF will be offering advice in the next day about how to handle MOD, DH, DES,

and ODA respectively. I assume that we will not need to give MOD any compensation. The £120 million for health in Table 1 implies only £100 million for DH, with the remaining £20 million being territorial consequences.

5. The figures for the territories in block 3 of Table 1 assume that you concede:

Territory	1989-90	1990-91	1991-92
Wales	85	72	65
Scotland	85	72	65
Northern Ireland	40	35	30

The figures in Annex B to Alan White's submission of yesterday are more optimistic by £25 million a year. The allowance of £50 million for DTp includes territorial consequences, and therefore implies a concession to DTp itself of only about £40 million a year. The social security offset assumes a concession on family credit.

6. There remains a small addition to the planning total in 1989-90. Even if all the settlements turned out exactly as in Table 1, there would still be a margin of error of a few 10s of million of £s around this figure. But there is scope to reduce it further if necessary. We might do better on the territories or on DTp. We could reduce the first year figure for our net contribution to the EC. Or we could cut £100 million by reducing the unemployment assumption to 1.85 million; or £150 million by declaring the Rover receipt from BAe.

7. The addition to the planning total in 1990-91 looks like being within £3.5 billion. The margin for error on this figure is of course even bigger.

8. Table 3 shows the implications of these figures for growth rates and the GGE ratios.

9. The Table shows a fall in the planning total and in GGE in real terms between 1987-88 and 1988-89. It also shows that the growth of GGE in real terms between 1987-88 and 1991-92 averages 1¾ per cent - the same figure as projected in the last White Paper for the period from 1986-87 to 1990-91. The real growth rate of the planning total over the Survey period is 3.7 per cent, well in excess of the growth of the economy. But the growth of GGE over the same period is 1.8 per cent.

17.6/17.1/16/15.8

10. The ratios show up the problems of success in holding the 1989-90 planning total. I have used debt interest figures derived by assuming a PSDR of £10 billion in 1988-89 and 1989-90, and zero thereafter. On these figures the ratios would round to 39¼/39¼/39 per cent, or even to 39¼ per cent in all years.

11. It would be nice to have a bigger fall over the Survey period. That means:

(a) it would be helpful if the 1989-90 figure rounded to 39½ per cent. That requires some combination of changes to the money GDP figure (eg "rounding" down to £504 billion) and of changes to the debt interest or other national accounts adjustments figures.

(b) we cannot afford to see a decline between 1989-90 and 1991-92 in the debt interest figures of less than about the £1.3 billion shown in this Table.

12. But a more thorough submission on the debt interest problem will come up in the next few days.

JM

J MACAUSLAN

SECRET

TABLE 1

POSSIBLE CHANGES TO SCORECARD

1 Scorecard: additions to planning total	+ 110	+ 2850	[+ 7030]
2 Economic assumptions			
GDP deflator	[yesterday quoted 70, 75, 80 for DES/ODA/DSS]		
DES	+ 5	+ 5	+ 5
ODA	–	+ 15	+ 15
DSS	+ 25	+ 25	+ 30
	= 30	= 45	= 50
DH (profile in earlier note was 100, 110, 120 so difference is territories)	+ 120	+ 130	+ 140
Rpi +1% 9/89	–	+ 550	+ 770
Rossi +1½% 9/89, +1% 9/90			
Interest rates	+ 120	+ 10	–
Unemployment 1.9m	– 220	– 230	– 240
	+ 50	+ 505	+ 720
3 Other programme changes	yesterday's profile was -75	-40	+25
Territories	– 70	– 70	– 35
DTp etc	+ 50	+ 50	+ 50
CB/UB	– 195	– 75	– 35
Soc Sec offset	+ 90	+ 95	+ 100
details in folder behind	– 125	–	+ 80
TOTAL ADDITION TO PLANNING TOTAL	+ 35	+3,355	[+7,830]
	∴ +20		
4 Other possible programme changes			
BAe/Rover	– 150		

Sh'd be +75 (acc to PS/CST nts)

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SECRET

TABLE 2

OCTOBER ECONOMIC ASSUMPTIONS

	9/88	9/89	9/90
Rpi	5.9	5½	4
Rossi	4.7	5	4

	1988-89	1989-90	1990-91	1991-92
GDP Deflator	6¼	5	3½	3
Money GDP	469	505	535	565
Unemployment	2.1	1.9	1.9	1.9
3 month interbank	10¾	11	9½	9
	0.21%	0.20%	0.19%	0.18%
	0.11%	0.10%	0.09%	0.09%

£1 bn

£½ bn

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SECRET

Now using correct 88-9 outturns?

TABLE 3

SURVEY OUTCOME: MAIN CASE

	1988-89	1989-90	1990-91	1991-92
Planning total				
Additions (£m)		40	3,355	7,830
Real growth (%)				
over previous year	- 0.6	3.5	3.8	3.7
over 1987-88				2.6
1988-89				3.7
GGE				
As % of GDP	39.87	39.3	39.2	39.13
rounding to	40/39¾	39¼	39¼	39¼/39
Real growth (%)				
over previous year	0.4	1.1	2.1	2.4
over 1987-88				1.3
over 1988-89				1.9
Assumptions				
(£ billion)				
Other national accounts adjustments	9.6	9.3	9.2	8.7
Debt interest	17.6	17.1	16	15.8
Reserves		3.5	7.0	10.5

jc7

MP

CONFIDENTIAL

ODLING-SMEE → PPS 19/10

From: J ODLING-SMEE
19th October 1988

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
Sir Peter Middleton
Mr Anson
Sir Terence Burns
Mr Phillips
Mr Scholar
Miss Peirson
Mr Sedgwick
Mr Turnbull
Mrs Brown
Mr Gieve
Mr Hibberd
Mr MacAuslan
Mr McIntyre
Miss Simpson

1/1
1/8 — US elections
10/10
10/15

BRINGING FORWARD THE DATE OF THE AUTUMN STATEMENT

— below

Miss Simpson is sending you a timetable consistent with the Public Expenditure Cabinet and the Oral Autumn Statement being on Tuesday, 1 November. As you will see, it is organisationally feasible.

2. On the public expenditure side, as well as two outstanding programmes there are still numerous other issues to be resolved, the implications of the changed economic assumptions to be worked through, and the detailed figures to be settled on a host of programmes. As long as all decisions are taken and the great bulk of the figures fixed by Tuesday, 25 October, it should be possible to meet the timetable for completing briefing and tables for 1 November. If not, we would have to switch to the slower option.

3. However, the risks of something going wrong on the 1 November timetable are much higher than on the original timetable when the Autumn Statement was to be on 15 November. With the chapters and the briefing going through fewer drafts, there is a greater risk that mistakes, inconsistencies, and gaps will not be spotted in time.

4. One other word of warning. The compressed timetable means that the Chancellor himself will have to respond quickly at various points. The two most difficult are likely to be 26 October when there will be about 36 hours to comment on the two main Autumn Statement chapters, and 31 October-1 November when, in addition to Cabinet and his Statement in the House, he will have to look at the only proofs of the two main chapters which we will see before the final book proofs.

J ODLING-SMEE

chex.rm/ah/11

CONFIDENTIAL

FROM: A P HUDSON
DATE: 20 October 1988

PMP

CHANCELLOR

cc Mr Gieve
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

GORDON BROWN MP ON THE BALANCED BUDGET

In looking around for material for next Tuesday, I came across the attached point from Gordon Brown's speech in the Budget Debate.

2. You might like to keep it up your sleeve for the Autumn Statement. Brown could defend what he said, on the grounds that he was talking about the figures in the FSBR. But if you use this in response to his response to the Autumn Statement itself, he will not get the chance, even if he remembers the point.

APH

A P HUDSON

[Mr. Gordon Brown]

exchange rate stability that he had achieved, but he was prevented from doing that by the Prime Minister. Instead he told us that we must judge the Budget and its success because he has balanced his books. I looked at what the Chancellor said last Tuesday:

"At one time, it was regarded as the hallmark of good government to maintain a balanced budget; to ensure that, in time of peace, Government spending was fully financed by revenues from taxation, with no need for Government borrowing."—*Official Report,* 15 March 1988; Vol. 129, c. 997.]

So on the Chancellor's own definition, current taxation revenues should exceed current spending. His problem is that, even on his own definition—that is that current taxation revenues without privatisation receipts should exceed current expenditure, he did not balance the Budget last year or this year, and he will not balance it in years to come. It would have been better if he had come to the House with modesty, and rather than triumphantly proclaiming that he had balanced the Budget, referred us to an article some years ago, when he——

The Chancellor of the Exchequer (Mr. Nigel Lawson): When was it written?

Mr. Brown: I shall come to that. In the article, he attacked what he called

that "school of economic commentators, who see mystical significance in an overall budget balance since this is a muddled amalgam of Gladstone and Keynes without the logical consistency of either".

The Chancellor rightly asked me when he wrote the article; I am happy to concede that he wrote it in 1962. I would not have mentioned it but for the fact that he has repeated the same views in the years since then. Did he say to the Treasury and Civil Service Select Committee in 1984 that his objective was a balanced Budget or that it was the crucial test of the health of the economy?

"There is no particular magic about a balanced budget. It may trip off the tongue rather well"—

indeed, it did, four or five times last Tuesday—

"but I do not think it necessary to have a balanced budget in order to achieve the objective of stable prices."

Our objection to the Chancellor's statement is that, although he may claim to have balanced the Budget, just about everything else in the economy and society was left unbalanced. There is an imbalance between investment and consumption, between the regions and the centre, between the rich and the poor and between private affluence and public squalor.

At the heart of the unbalanced Budget was the balance of payments problem, to which the right hon. Member for Old Bexley and Sidcup (Mr. Heath) referred. The balance of payments is bad and worsening, and it will be accentuated by the tax cuts, which will fuel imports. The problem will be made even more serious by the Prime Minister's determination to run high interest and exchange rates. The current account deficit is £1·5 billion this year and will be £4 billion next year. The manufacturing deficit is £6·5 billion this year and next year will be the worst in our 200-year history as an industrial nation — £8·5 billion. The Chancellor may think——

Mr. Redwood: Will the hon. Gentleman explain why we should believe his forecasts now when, in October 1986, he was reported in *The Guardian* as saying that Government policies had no chance of bringing down unemployment? If everything is so awful, why is unemployment falling more quickly here than anywhere else in western Europe, and why do we have the fastest growth rate?

Mr. Brown: If the hon. Gentleman would read my articles and repeat them accurately, I might be prepared to answer. The Chancellor said that a balance of payments deficit — a manufacturing deficit — of £6·5 billion was perfectly manageable, and that a manufacturing deficit of £8·5 billion, which is what it would be, would be neither here nor there.

Does the Prime Minister agree with him about this? I know that the Prime Minister and the Chancellor do not see eye to eye on everything, except for the fact that this might be the Chancellor's last Budget, but do they see eye to eye on the manufacturing trade deficit? I must ask the Chancellor, who thinks that the manufacturing trade deficit is neither here nor there, to consider the words of the Prime Minister. When she was aspiring to become Prime Minister, the right hon. Lady said:

"It is often said we must export or die. I would add: we must manufacture or die even more quickly."

That was not a Tory wet, a Labour Back Bencher or a member of a Select Committee in another place, but the then Leader of the Opposition. Does she and the Chancellor now say, with 30 per cent. of our manufacturing jobs lost, 50 per cent. of our cars, 50 per cent. of our washing machines, 50 per cent. of our fridges, 60 per cent. of many items of our furniture, 90 per cent. of our videos and 100 per cent. of our radios imported, with trade deficits in new industries far bigger than trade deficits ever were in the old ones, that we must manufacture or die even more quickly? Never, until this Government came to power did we import more manufactured goods than we exported and never did we send more money abroad than we invested in manufacturing in many of our regions. Never before have we had whole areas of the country where people are without regular work, either because they are unemployed, in part-time work or in training schemes and who outnumber those employed in manufacturing industry, whether new or old.

Mr. Steel: Will the hon. Member support the Amalgamated Engineering Union to get 1,000 jobs for Scotland?

Mr. Brown: The right hon. Gentleman knows perfectly well our determination to get those jobs for Scotland. *[Interruption.]* If Conservative Members would stop trying to make party political points out of this issue and started to fight for the contract for Britain, we would be far better off.

The Budget is not just a missed opportunity for investment in our future, exports and jobs. It gave to the very few what could have provided a lifeline for the National Health Service. The British Medical Association report, which was published only a few days ago, said that 31 per cent. of consultants have had to cancel operations because of financial restrictions, that 3,000 hospital beds have been lost this year and that the problems next year will be worse than the problems this year. What was the Government's response? Ruthlessly to exclude from expenditure in the Budget the one item on which the vast majority of the people agreed, and then to tell us that the Budget was about taxation and nothing to do with expenditure.

'jc17'

4439.

From: J ODLING-SMEE
21st October 1988

CHANCELLOR OF THE EXCHEQUER

cc Sir Peter Middleton
Mr Anson
Sir Terence Burns
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mrs Butler
Mr S Davies
Mr Hibberd
Mr Mowl
Ms Simpson
Ms Walker

Ch/ We have conducted a poll of your office on this (sample size 6).
Option c gets 5 votes
option b gets 1
MPW.

Thanks. Pse use version (c).

CHARTS IN AUTUMN STATEMENT AND FSBR

We have been giving some thought to the design of charts in the Autumn Statement and the FSBR, partly in order to standardise on the way in which the years are presented along the horizontal axis (at the moment the treatment varies from chart to chart), and partly to try to avoid the messiness associated with having minus signs and dashes representing units alongside each other (see, for example, the bottom right-hand corner of version a of the attached Chart 3.4 from the FSBR).

2. Although most of the changes we are making are minor, one is more obvious. This is the joining up of the dashes on both horizontal and vertical axes. The question then arises whether to retain the existing box around the whole chart, and thus have two boxes (as in the PEWP charts), or whether to abandon the outer box. Mock-ups of pages 19 and 23 of the FSBR on three different bases are attached:

a. as in the FSBR

b. with the dashes joined up and the outer box retained

c. with the dashes joined up and without the outer box.

3. Some of the chapter authors and others I have consulted prefer the second and some the third. My own preference is for the second. This would represent a move back to the presentation of the charts in FSBRs and Autumn Statements before the 1986 redesign. Part of the purpose of that redesign was to reduce the clutter of the charts and to use the width of the whole page. Reintroducing axes may seem to reintroduce some clutter, but it helps the clarity and we are proposing to retain the width of the whole page.

4. I would be grateful for your agreement to our moving to version b or c for the Autumn Statement charts, and for your preference between the two. We shall be sending the charts to the draftsmen today, and so I would be grateful for your views as soon as possible.

JO-S

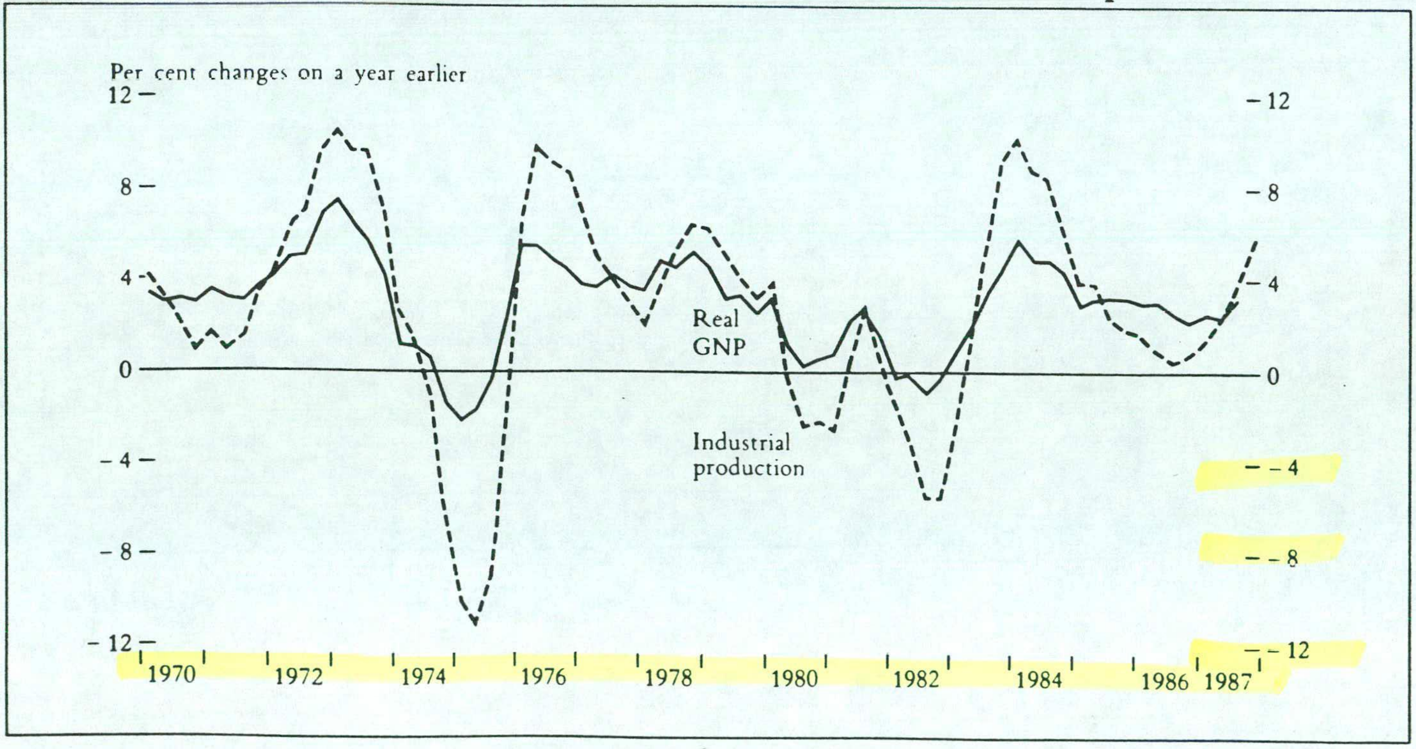
J ODLING-SMEE

VERSION a
(as in FSBR)

3.13 Substantial falls in import prices in 1986—notably for oil, but also for many other primary commodities—were partly reversed in 1987. Oil prices recovered from their low point of the summer of 1986, but have weakened in recent months. Prices of other industrial materials rose as world activity picked up. Nevertheless, consumer price inflation in the major economies has remained low. In Japan and Germany, the appreciation of their currencies meant that inflation was close to zero. But in the US, consumer price inflation rose to $4\frac{1}{2}$ per cent at the end of 1987.

3.14 The improved terms of trade for developing countries boosted the exports of the major industrialised countries and helped to strengthen business investment. This more than offset some slowdown in the growth of real personal incomes and consumer spending. As a result industrial production has been particularly buoyant; industrial output in the major seven OECD economies was over 5 per cent higher in December 1987 than a year earlier.

Chart 3.4 Major seven economies' real GNP and industrial production



3.15 Equity prices in the US and most other countries continued to rise in the first part of 1987, reaching an all-time high in a number of countries around mid-year. In large part, the subsequent fall in equity prices can be seen as a correction, even though the scale and sharpness of the fall in October were unprecedented. Prompt action by the monetary authorities in the major countries to reduce interest rates and provide sufficient liquidity helped to prevent a major collapse of confidence.

3.16 In the United States, domestic demand growth, which had averaged $5\frac{1}{2}$ per cent a year between 1983 and 1986, slowed to $2\frac{1}{2}$ per cent in 1987; as a

VERSION 6

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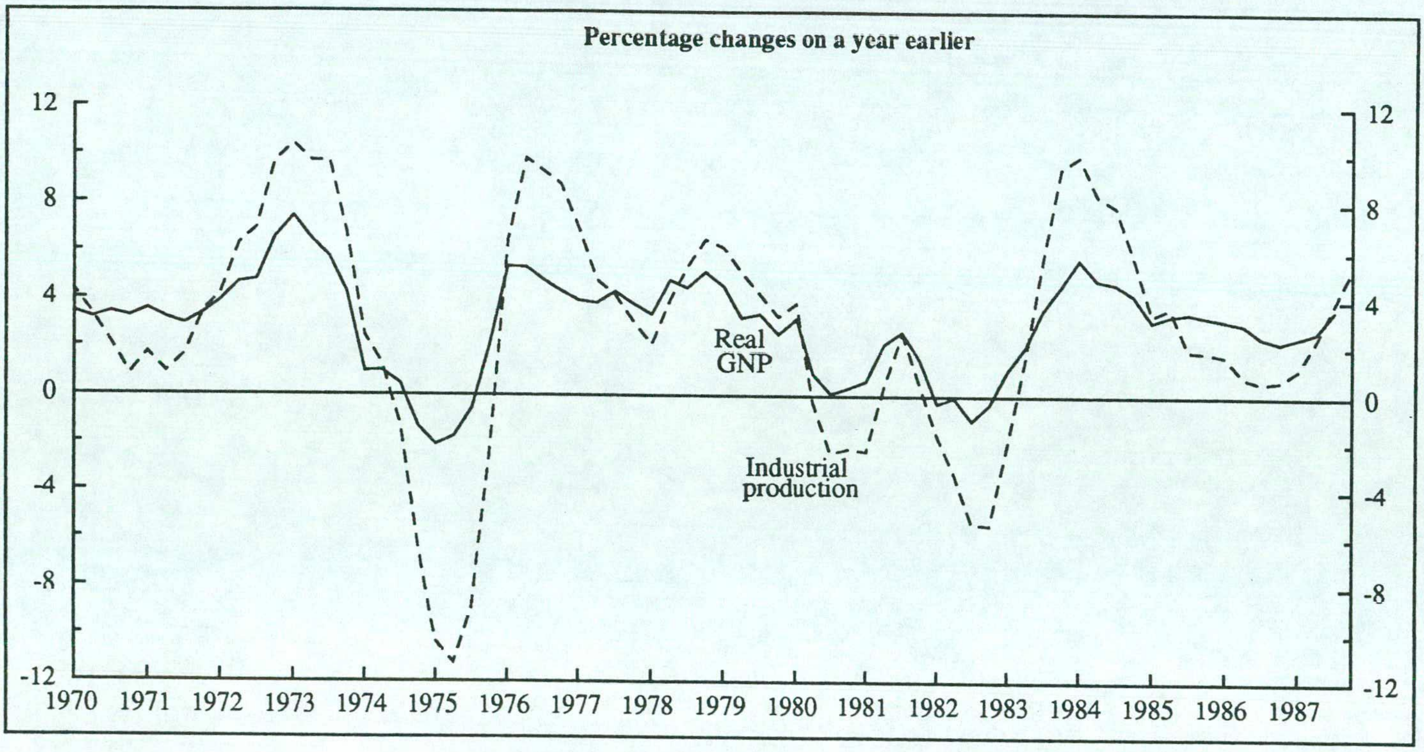

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VERSION C

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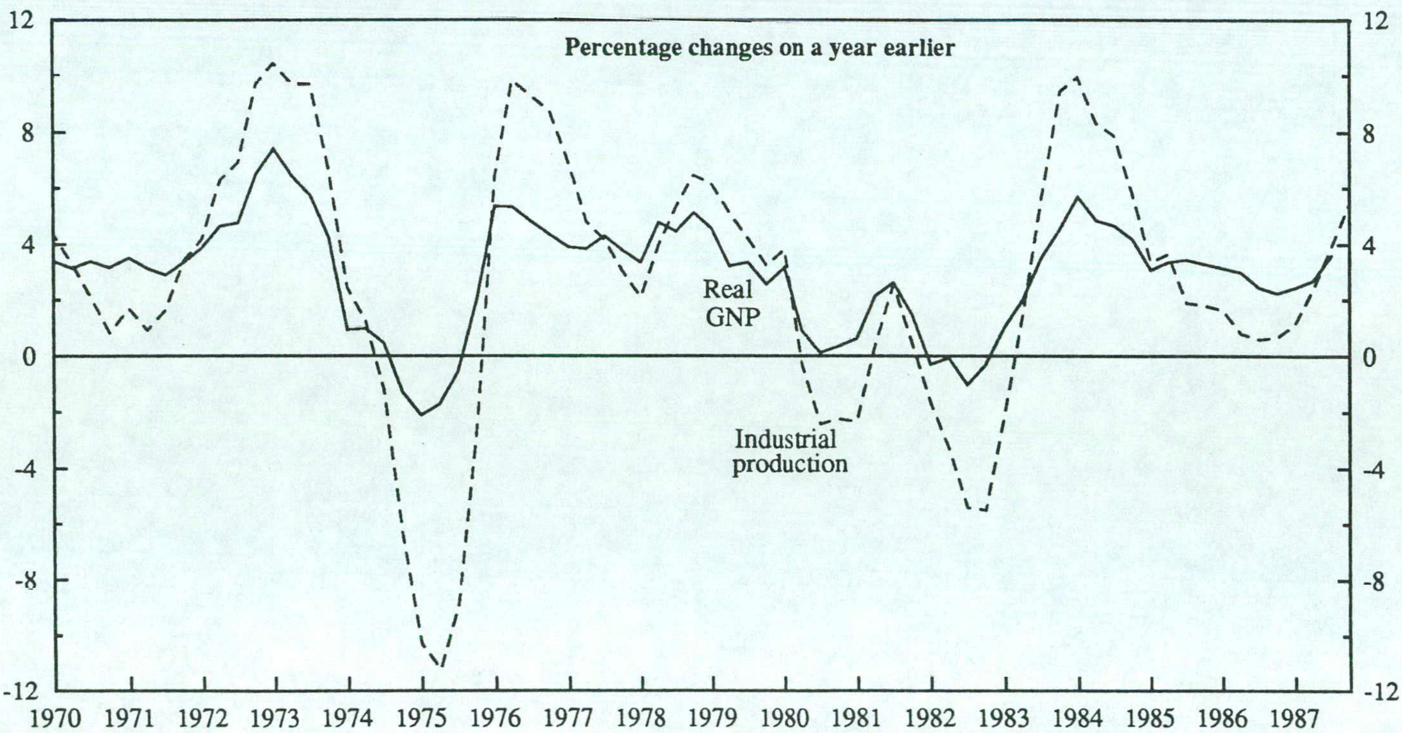

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VERSION a
(as in FSBR)

Table 3.4 Current account

£ billion

	Manufactures	Oil	Other goods	Invisibles	Current balance
1986	−5½	4	−7	8½	0
1987	−6½	4	−7½	8	−1½
1988 Forecast	−8½	2½	−6½	8½	−4

Demand and activity

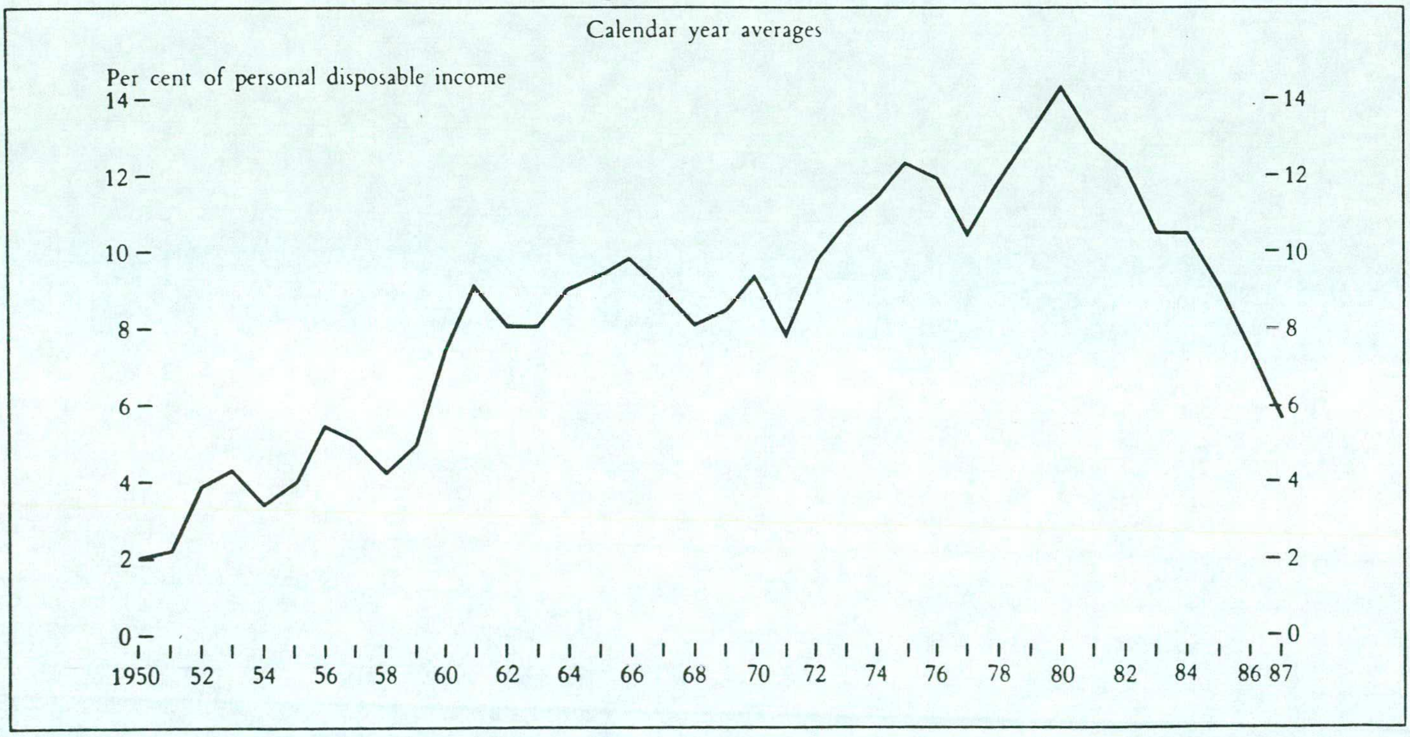
3.31 The UK economy grew by 4½ per cent in 1987. Growth was strong throughout the non-oil economy: manufacturing output rose by 5½ per cent, construction output by 8½ per cent and output of the service industries by 5½ per cent.

Personal sector expenditure

3.32 Consumers' expenditure is now estimated to have risen by 5 per cent in 1987, less than in 1986. This was faster than the 3½ per cent growth in real personal disposable income, and the savings ratio once again fell.

3.33 A number of factors could account for the decline in the savings ratio in recent years. Inflation has been at a low level not experienced since the 1960s. Recent increases in real house prices, and in equity prices to October 1987, may also have contributed. And many employers have taken so-called holidays on their contributions to employees' pension funds; these score as reduced personal saving.

Chart 3.6 Personal savings ratio



3.34 Personal borrowing rose further during 1987, in large part reflecting increased mortgage borrowing. But personal sector financial assets showed a larger increase, despite the October share price fall (Chart 3.7).

VERSION b

Table 3.4 Current account

£ billion

	Manufactures	Oil	Other goods	Invisibles	Current balance
1986	−5½	4	−7	8½	0
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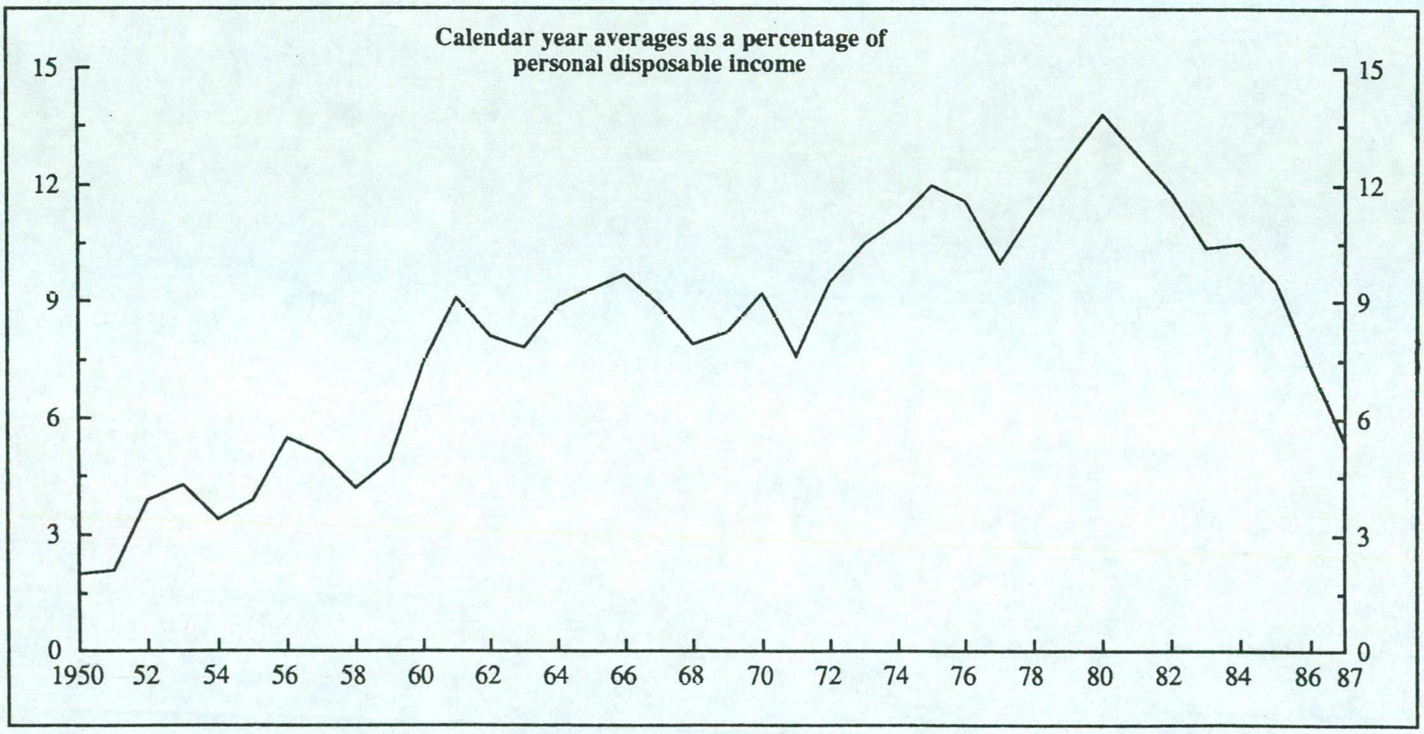

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VERSION C

Table 3.4 Current account

£ billion

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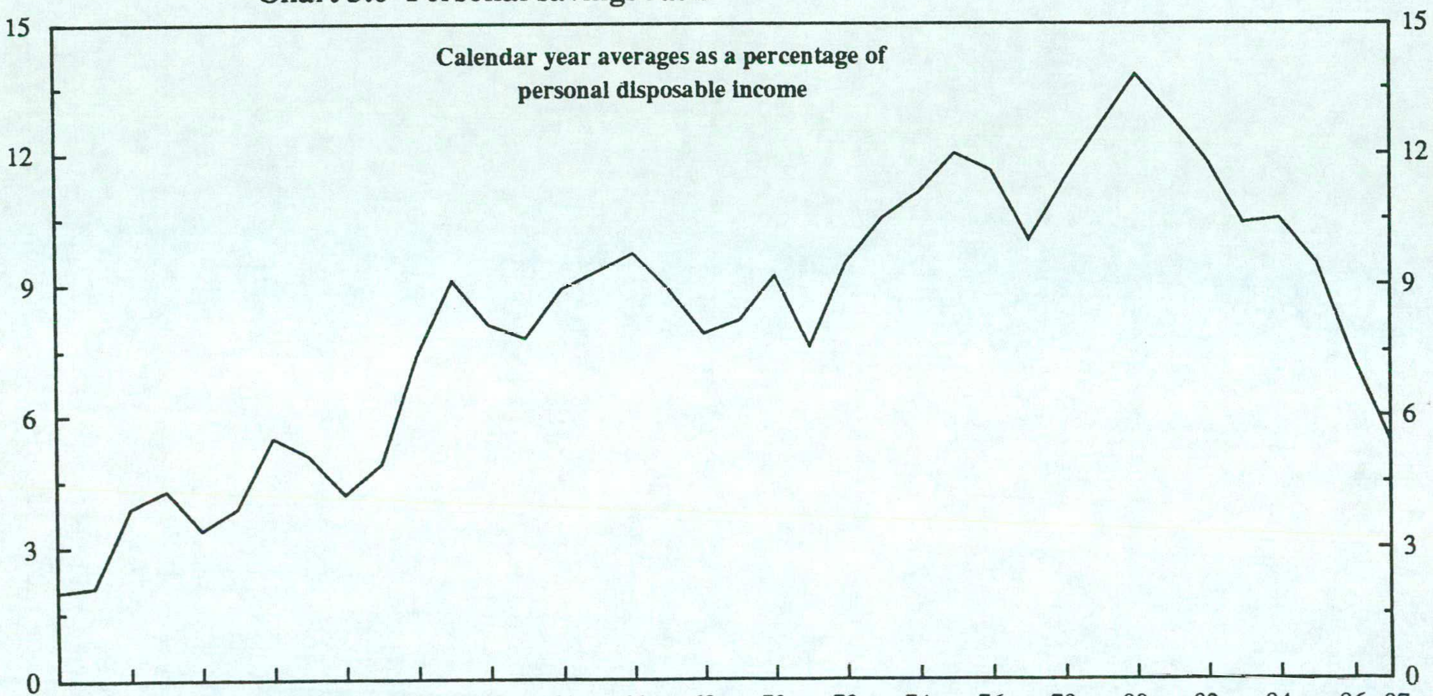

3.34 Personal borrowing rose further during 1987, in large part reflecting increased mortgage borrowing. But personal sector financial assets showed a larger increase, despite the October share price fall (Chart 3.7).

TimeAS

CONFIDENTIAL

FROM: A TURNBULL
DATE: 21 OCTOBER 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Phillips
Mr Odling-Smee
Mr Sedgwick
HEGs
Mr Gieve
Mrs Butler
Mr MacAuslan
Mr Richardson
Miss Walker
Miss Simpson

Ch/
PS letter to issue on Monday?

Ok as stated

TIMING OF AUTUMN STATEMENT

Now that the Chief Secretary has reached agreement on nearly all the major issues outstanding, the way is now clear to bring the outcome of the Survey to Cabinet on Tuesday 1 November and for you, provided there are no hitches at Cabinet, to make your Oral Statement that afternoon.

2. We need to inform departments of this, partly to ensure that they put preparation of their Press Notices in hand, and partly so that Expenditure Divisions have a justification for pressing for early clearance of figures and Autumn Statement texts. As time is very short we would like to do this as early as possible on Monday.

3. I attach a draft Private Secretary letter to No 10. Whereas the comparable letter of 1986 (copy attached for you and the Chief Secretary) was building on a decision that had been announced at the previous Cabinet meeting, there is this time no such decision. Although I understand the date of the Oral Statement has been agreed with the Prime Minister the letter is drafted as a proposal seeking approval.

4. As soon as we have word from No 10 confirming the proposals (which can be more or less instantaneous) I will send the letter to PFOs in order to ensure that it gets rapidly to working level.

5. In 1986, the Oral Statement coincided with Treasury questions on Supply Day on the Economy. There was thus no doubt that the Leader of the Opposition and the Opposition Treasury spokesman would be present. This year this cannot be guaranteed. You may want, through the Whips, to give some advance warning in order to avoid a Parliamentary row.

but when?

AG

A TURNBULL

CONFIDENTIAL

Paul Gray
10 Downing Street

Final to sign

~~DRAFT PRIVATE SECRETARY LETTER TO~~ No 10

AUTUMN STATEMENT

which I understand has been brought forward to Tuesday 1 November in view

The Chief Secretary has now been able to resolve most of the major issues on public expenditure programmes though there remains a good deal of work to finalise the detailed figuring. The Chancellor feels it is desirable to proceed with the announcement of the outcome of the Survey as soon as possible after the decisions have been reached. He therefore proposes that the outcome of the Survey should be considered by Cabinet next week, ~~In view~~ Because of the Prime Minister's departure for Poland ~~on Wednesday~~ this ~~would involve bringing the~~ Cabinet ~~meeting forward to Tuesday 1 November.~~ ~~has been brought forward to~~ the following day.

now fixed for 1 Nov whatever happens

2. In most previous years it has been the practice for the Autumn Statement to be delivered to the House ~~in~~ on? the ~~week~~ Tuesday following the Cabinet meeting, allowing the weekend for printing of the Autumn Statement document. With the advancement of the Cabinet meeting the gap, which is always ~~would be longer than usual.~~ uncomfortably long, would be even longer. The Chancellor therefore proposes, assuming all the necessary decisions are taken at Cabinet, to adopt the practice of 1986 when, as Parliament was not sitting at the start of the following week, he made his Oral Statement on the afternoon of the Cabinet. The printed Autumn Statement would be published on Tuesday 8 November.

3. The Chancellor recognises that this timetable will require a great deal of effort in departments to get all the supporting material prepared but feels that~~, if it can be done,~~ an early announcement is very much better than waiting until the next Cabinet meeting on 10 November.

4. The Chancellor proposes to accompany his Oral Statement with Press Notices containing the Industry Act Forecast and tables summarising the expenditure plans; these would be made available in the Vote Office. He hopes that departments will be ready as usual to issue press Notices on the same day, providing a positive presentation of the main features of their programmes. These should emphasise the outputs to be achieved as well as the money to be spent.

5. To ensure that the release of departments' Press Notices is properly co-ordinated with the announcements from the Treasury, the Chancellor would be grateful if departments could follow the arrangements set out in the attached Annex.

6. Although these plans are being made to allow for the Oral Statement to be made on 1 November, this cannot of course be taken for granted. It will depend on the settlement of any issues still outstanding and the Cabinet discussion itself. For the time being, therefore, no public statement of the likely date of the Statement should be made. I should be grateful if you

could ensure that knowledge of the arrangements is confined to those who need to know. If departments are asked about the date of the Statement, they should say that the public expenditure round has not yet been concluded and that the Autumn Statement will be made as soon as practicable after final agreement has been reached.

7. I would be grateful to know as soon as possible that the Prime Minister is content.

8. I am copying this letter to the Private Secretaries to all Cabinet Ministers, to ~~[ ]~~ Michael Saunders (Attorney General's Office), ~~[ ]~~ Eleanor Goodison (Office of the Minister for the Arts), ~~[ ]~~ Myles Wickstead (Office of the Minister for Overseas Development, ~~[ ]~~ Alan Maxwell (Lord Advocate's Office) and to Sir Robin Butler.

~~[ACSA]~~

A C S ALLAN

cst.ps/14ce24.10

CONFIDENTIAL

→ Andrew

PMP

CHIEF SECRETARY TO THE TREASURY

FROM: MISS C EVANS
DATE: 24 October 1988

PS/CHANCELLOR

cc: Sir Peter Middleton
Mr Anson
Sir Terence Burns
Mr Odling-Smee
Mr H Phillips
Mr Turnbull
Mr Robson
Mr Gieve
Mr MacAuslan
Mr Pickford
Miss Simpson
Mr Call
Mr Tyrie

Alex nb.

M.

AUTUMN STATEMENT PRESENTATION: DEFENCE

The Chief Secretary believes that the 3 year settlement on defence is a very important positive point to make in the presentation. It provides MOD with resources to meet defence commitments and enables them to plan within a firm framework. He hopes that we can agree with the MOD to mention this in the oral statement but suggests that we put this to them after the Prime Minister has approved the settlement.

Carys Evans

MISS C EVANS
Private Secretary

outturn

CONFIDENTIAL

FROM: M G RICHARDSON
DATE: 24 October 1988

1. MR ANSON

I agree. It will be important to avoid a fall below $39\frac{3}{4}$ %.

A
24/10

Copies attached for

Chancellor
Sir P Middleton

2. CHIEF SECRETARY

Ch
? case for showing round £1/2 bn longfall thus giving a bit of a safety margin?

AA

cc Sir T Burns
Mr Phillips
Mr Monck
Mr Scholar
Mr Turnbull
Mr Odling-Smee
Mr Sedgwick
Mr Mowl
Mr MacAuslan
Mrs Butler
Mr I Taylor
Mr Pegler

* Barry [illegible] is [illegible] with almost 1/2 the year still to go. I would prefer to round the longfall up to £1/2 bn, giving an estimated planning total outturn of £153.8 bn. N.

1988-89 OUTTURN: PRESENTATION IN THE AUTUMN STATEMENT

This minute seeks your agreement to proposals for the presentation of 1988-89 outturn in the Autumn Statement.

2. We recommend that the Autumn Statement should show an **estimated outturn of £153.6 billion**, an underspend of **£3.3 billion** on 1988 PEWP plans.

3. £153.6 billion is the same estimate as was reported in the GEP October Reserve assessment (my minute of 18 October). However within the constant total there have been a few offsetting changes in individual departments' figures:

a. a £135 million decrease on Social Security to reflect DSS's latest view of outturn.

b. a £130 million decrease on the British Rail EFL, reflecting the industry's latest view in the light of higher than forecast property sales, passenger revenues and ERDF grants.

c. a £155 million increase on the Post Office EFL to remove the assumed Giro bank sale proceeds.

813

d. a £90 million increase in the Electricity (England and Wales) EFL to reflect the net effect on 1988-89 of funding pension liabilities arising from privatisation.

4. A breakdown by department of what the Autumn Statement will show and how this differs from our latest assessment and from PEWP plans is at annex. The latest Treasury view is some £320 million higher than a simple aggregate of departmental estimates. We would therefore intend to show a positive Adjustment for longfall - probably of a rounded £300 million. Apart from some minor differences that largely offset each other, this is almost entirely attributable to provision for the reconstruction of Shorts' balance sheet, which for reasons of commercial confidentiality and sensitivity vis a vis the Commission, cannot be shown against the Northern Ireland line. The order of Adjustment proposal might not be significant enough to attract attention, but if it did, we would say that if reflected some differences in judgement. If we were further pressed, ST accept that we would have to say that part of the Adjustment reflected a potential payment which was commercially sensitive at this stage. To omit the Shorts provision altogether however would mean publishing an undersped of well over £3½ billion - higher than the original 1988-89 Reserve.

5. At this stage we can not be sure what a £153.6 planning total outturn would imply for the 1988-89 GGE/GDP ratio. If GDP were estimated at £471 billion this year (see Mr Owen's submission today on the Industry Act Forecast), then GGE excluding privatisation proceeds would have to be more than £1 billion higher for the number to round up to 40 per cent (assuming movements in quarters of percentage points), and we should need to watch carefully to prevent a fall below 39¾ per cent. But we see little scope for amending the planning total outturn in order to deliver a preferred GGE/GDP ratio without an awkwardly large Adjustment that would be likely to raise more questions than we could answer.

6. An estimated outturn of £153.6 billion and a underspend of £3.3 billion will inevitably attract some criticism, but we think

this should be manageable. Just over half the net underspend is accounted for by higher than expected receipts (privatisation proceeds, local authorities, and new towns); some of the remaining underspending will be eligible for carryforward under the EYF scheme. It is mainly on these grounds that we would maintain that the underspend did not warrant any relaxation of spending constraints. Any accusation that the Government had been covertly planning to underspend (for the second successive year) could be met by pointing to the unpredictable nature of the additional receipts, of the underspending on demand led programmes (Social Security and IBAP) and to the better than expected performance of Nationalised Industries.

7. In short we see very little room for manoeuvre in the presentation of 1988-89 outturn in the Autumn Statement - mainly because of the impracticability of adding to the Adjustment line. We think any adverse criticism of a £3¾ billion or so underspend could be coped with. Indeed the size of the underspend could well be exploited to good effect - for example in demonstrating that public expenditure is under firm control. I should therefore be grateful for your agreement that the estimated planning total outturn for 1988-89 be shown in the Autumn Statement as £153.6 billion.

M G Richardson

M G RICHARDSON

1988 Autumn Statement - Total departmental expenditure

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£ million

1988-89	PEWP	Oct PEPT	Latest HMT view	AUTUMN STATEMENT	AUTUMN S. -HMT view	AUTUMN S. - PEWP
Ministry of Defence	19,220	19,280	19,280	19,300	20	80
Foreign and Commonwealth-Dip Wing	720	750	750	750	10	30
Foreign and Commonwealth-ODA	1,430	1,470	1,470	1,490	20	60
European Communities	800	950	950	950	0	150
Ministry of Agriculture Fisheries and Food	2,210	1,860	1,860	1,860	0	-350
Department of Trade and Industry	1,250	1,540	1,690	1,710	10	460
Export Credits Guarantee Department	130	70	90	90	0	-40
Department of Energy	120	200	290	220	-70	100
Department of Employment	4,240	4,130	4,130	4,130	-10	-120
Department of Transport	5,150	4,940	4,810	4,810	0	-330
Department of Environment - Housing	3,020	2,060	2,060	2,050	-10	-970
Department of Environment - Other environmental services	3,860	4,370	4,370	4,390	20	530
Home Office	6,050	6,280	6,280	6,280	0	230
Legal Departments	970	950	960	960	0	-20
Department of Education and Science	17,970	18,470	18,470	18,440	-30	470
Office of Arts and Libraries	910	970	970	980	10	70
Department of Health	20,680	21,720	21,730	21,740	10	1,060
Department of Social security	48,460	47,700	47,600	47,600	0	-900
Scotland	8,510	8,670	8,670	8,720	50	210
Wales	3,450	3,590	3,590	3,600	10	150
Northern Ireland	5,140	5,520	5,520	5,170	-360	20
Chancellor of the Exchequer's Departments	3,800	3,670	3,670	3,670	0	-130
Other Departments	260	360	360	360	0	100
Total Departments	158,370	159,600	159,600	159,200	-320	900
Privatisation proceeds	-5,000	-6,000	-6,000	-6,000	0	-1,000
Reserve	3,500	0	0	0	0	-3,500
Adjustments(longfall on Dept est)	0		0	320	320	320
PLANNING TOTAL	156,870	153,600	153,600	153,600	0	-3,300

117/10

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CH/EXCHEQUER

REC. 24 OCT 1988

ACTION Mr Turnbull

COPIES TO CST, Sir P Middleton, Mr Anson, Mr Phillips, Mr Odling-Smee, Mr Sedgwick, Mr Grieve, Mr MacAuslan Miss Simpson Miss Walker

24/10

PJ

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

24 October 1988

Dear Alex,

AUTUMN STATEMENT

Thank you for your letter of today's date. I should be grateful if you and copy recipients would ensure this letter is shown only to those with a need to know.

The Prime Minister is content for the outcome of the Survey to be considered by Cabinet on 1 November and, subject to the necessary decisions having been taken, for the Chancellor to make plans to deliver his Oral Statement on the same afternoon. She agrees that departments should put in hand arrangements positively to present the main features and outputs of their programmes on the same day. The Prime Minister also agrees that, for the time being, no public statement of the likely date of the Statement should be made.

I am copying this letter to the Private Secretaries to all Cabinet Ministers, Michael Saunders (Law Officers' Department), Eleanor Goodison (Office of the Minister for the Arts), Myles Wickstead (Office of the Minister for Overseas Development), Alan Maxwell (Lord Advocate's Office), Trevor Woolley (Cabinet Office) and Murdo Maclean (Chief Whip's Office).

Yours,

Paul.

PAUL GRAY

Alex Allan, Esq.,
H.M. Treasury.

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cst.ps/10ce24.10

SECRET AND PERSONAL

000449

FROM: MISS C EVANS
DATE: 24 October 1988

PS/CHANCELLOR

cc: Sir Peter Middleton
Mr Anson
Sir Terence Burns
Mr Odling-Smee
Mr Monck
Mr H Phillips
Mr Luce
Mr Sedgwick
Mr Turnbull
Mr Gieve
Mr MacAuslan
Mr Pickford
Miss Simpson
Mr Call
Mr Tyrie

The Chief Secretary has the following comments on Mr Odling-Smee's draft of 21 October. In general he thinks the statement should bring out strongly two key points:

(a) that the improved performance of the economy has released substantial resources for priority programmes <u>and</u> enabled greater prioritisation than ever before;

(b) to emphasise the increase in total capital investment and bring out where this is to be spent i.e. on water prisons, roads etc. A suggested paragraph is attached at Annex.

His drafting amendments and suggestions are as follows:

<u>Para 9, 2nd sentence</u>

As phrased this invites Parliamentary uproar at the end of the first sentence and the beginning of the second. The Chief Secretary would turn it round thus. 'The very high levels of tax receipts ... show how ill-informed is the comment that the tax reductions announced in the Budget were too great.'

Para 12, first sentence

'Objective' to read 'objectives'.

Last sentence: after 'secure' insert 'both of'.

Para 13,

First sentence to read: 'The planning total for 1989-90 will be unchanged at £[167 billion].

Para 15 second sentence

Before '1¼ per cent', insert: 'only'.

Para 16

Redraft first sentence and add new second and third sentences as follows:

See A7 redraft.

'Despite holding total spending for next year within the previously announced totals, these new plans enable us to provide substantial additional resources to implement the Government's most important priorities. The improved performance of the economy has opened up the possibility of a substantial shift in resources to meet our policy objectives. Overall, this represents a greater prioritisation within public expenditure than ever before.'

ugh!

Para 17 last sentence

After 'represent' insert 'by far'.

<u>Para 22</u>

The Chief Secretary wonders whether we need this paragraph given that the Autumn Statement comes after Mr Moore's uprating statement. In particular he wonders whether there is any need to mention Child Benefit. He would either delete the paragraph or simply say:

'As My Right Honourable Friend the Secretary of State for Social Services said last week, large increases are expected in spending on benefits, particularly for the disabled, and special assistance for poorer families is again being significantly improved. These increases are partly offset by the fall in unemployment, leaving the social security programme broadly unchanged in 1989-90 but around [£1.2 billion] higher than planned in 1990-91.

<u>Para 25</u>

Redraft first sentence as follows:

'These plans mean that the Government has been able both to strengthen its priority programmes and hold overall spending to baseline in the first year. This achievement illustrates the success of our policies. The large reduction in unemployment has enabled savings to be realised on .....'

Last sentence, rephrase as follows: 'All this has made room for additional spending on other priority programmes.'

<u>Para 26</u>

The Chief Secretary suggests deleting all but the first two sentences of this paragraph. He suggests that this material could go in a press release to accompany the printed Autumn Statement document.

Para 34, 2nd sentence

Delete ' has been artifically increased by', insert 'is largely due to'

Para 36

The Chief Secretary suggests deleting the last sentence and redrafting the first as follows:

'Current circumstances make it even more difficult than usual to foresee how the economy will develop next year.'

Para 38 first sentence

After 'beneficial' insert 'and long term.'

Para 40 second sentence

Redraft as follows: 'My forecast is for a declining deficit but one that may remain as high as £12 billion in 1989'.

Para 41

Delete 'slower', insert 'more sustainable.'

Para 42 last sentence

Delete 'keep them', insert 'ensure they remain'.

Carys Evans

MISS C EVANS
Private Secretary

ANNEX

New paragraph on capital

The new plans contain an increase of [£] in capital spending. This includes extra investment especially on hospitals, housing, prisons and roads. And the nationalised industries' improved performance has also made possible for higher investment on key projects such as anti pollution measures by the water authorities. We have also provided fully for [all the all necessary investment on new] safety measures identified by London R Transport following [the inquiry into] the King's Cross fire. disaster.

SECRET AND PERSONAL
SCORECARD

COPY NO 1 OF 5

FROM: C F WOOLF
DATE: 24 October 1988

MISS WALLACE

cc Mr Turnbull
Mrs Butler
Mr MacAuslan

1988 AUTUMN STATEMENT: BACKGROUND BRIEFING

Miss Walker (GEP1) has asked me to let you have a table showing the planning total (in real terms), general government expenditure (GGE) excluding privatisation proceeds (in real terms) and GGE excluding privatisation proceeds as a percentage of GDP for the years since 1963-64. These figures are highlighted in the attached table. They give the current position and may be subject to some revisions, particularly in the case of GDP and GDP deflator figures, before they are finalised for the Autumn Statement. The GDP figures on which the percentages for 1988-89 to 1991-92 are based are those given in Mr MacAuslan's submission of 21 October and should not yet be quoted.

Many thanks.
(Folder retained)

C F WOOLF
GEP3
x 5639

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Ch
I agree with Robert. Otherwise OK? AA

From: A A B WILSON
Date: 24 October 1988

1. MR CULPIN

2. CHANCELLOR

cc: PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Byatt
Mr Odling-Smee
Mr Riley
Miss Simpson
Mr Ko - IR
Mr Morris - C&E

I wd omit x, but Mr Odling-Smee wd leave it in.

Otherwise no problems.

OK, with the 2½ deletions. This can be left to the FSBR.

24/10

AUTUMN STATEMENT: CHAPTER 4

I attach a draft of Chapter 4, entitled Tax Revenue Ready Reckoner. This is very similar to last year's version with the dates and figures changed, although the introduction of independent taxation of husband and wife and the linking of capital gains tax to income tax rates has led to a few changes where appropriate. The figures are provisional at this stage, but they should give a reasonably close estimate of the revenue effects of the various illustrative changes.

2. A minor change in the methodology used to calculate the direct effects of tax changes has been made since last year following the meetings of ROCCIT* which was set up to consider how these should be calculated. (Mr Odling-Smee's submission to you of 5 October 1988 refers.) It is intended that the Annex to Chapter 4 of the FSBR will contain the main explanation of the methodology, but a brief explanation of the change is made in paragraph 4.04 of the draft.

3. With your approval, we plan to send Chapter 4 to the printers on Tuesday 25 October.

Alan Wilson

Alan Wilson

* Review of costing changes in taxation

459/20

4 TAX REVENUE READY RECKONER

4.01 The tables below show the effects of various illustrative tax changes on tax receipts in 1989-90 and 1990-91. Where appropriate, they allow for the introduction in 1990-91 of independent taxation of husband and wife.

4.02 The effects of tax changes depend on economic variables, such as prices, earnings and consumers' expenditure. The estimates shown are consistent with the economic forecast given in Chapter 2.

4.03 An illustrative rate of inflation of 6¼ per cent has been used to show the effects of indexation and revalorisation in 1989-90. This is in line with the annual rate of increase in the RPI forecast for the fourth quarter of 1988.

4.04 The tables show estimates of the direct effects of tax changes. In practice, tax changes will themselves affect economic variables, which in turn will have further effects on tax yields and on the PSBR. The estimated direct effects are not, therefore, the same as the effects on the PSBR. [~~The precise definition of direct effects is explained in the Annex to Chapter 4 of the Financial Statement and Budget Report. However, whereas in the past the direct effects of changes in Customs and Excise taxes and duties assumed that total consumers' expenditure at market prices did not change, the estimates below assume that total consumers' expenditure at factor cost does not change.~~] x

Indexation of allowances, thresholds and bands for 1989-90

4.05 Tables 4.1 to 4.3 show tax allowances, thresholds, and bands for 1989-90 after 6¼ per cent indexation. For income tax, rounding follows the rules laid down in the 1980 Finance Act; for inheritance tax and capital gains tax those laid down in the 1982 Finance Act. Estimates of the revenue effects of these changes are shown in Table 4.4.

Table 4.1 Income tax

	1988-89	1989-90
Allowances:		
Single and wife's earned income allowance	2605	2775
Married allowance	4095	4355
Additional personal and widow's bereavement allowance	1490	1580
Single age allowance (age 65-79)	3180	3380
Married age allowance (age 65-79)	5035	5355
Single age allowance (age 80 and over)	3310	3520
Married age allowance (age 80 and over)	5205	5535
Aged income limit	10600	11300

Income tax rates	Bands of taxable income	
	£	
Per cent	1988-89	1989-90
25	0-19300	0-20600
40	over 19300	over 20600

Table 4.2 Inheritance tax

Rate on death	Bands of chargeable value	
	£000	
Per cent	1988-89	1989-90
Nil	0-110	0-117
40	over 110	over 117

Table 4.3 Capital gains tax

	£	
	1988-89	1989-90
Annual exempt amount:		
Individuals	5000	5400
Trusts	2500	2700

Table 4.4 Costs of indexation for 1989-90

	£ million	
	1989-90	1990-91
Indexation of income tax allowances and basic rate limit[1]	1370	1505
Of which:		
Increases in main personal allowances	1200	1270
Increase in the basic rate limit[2]	170	235
Indexation of inheritance tax threshold	35	100
Indexation of capital gains exempt amounts	-	10

1 Cost includes the consequential effects on capital gains tax.

2 Additional cost after previous change has been introduced.

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

4.06 Table 4.5 shows estimates of the direct revenue effects of illustrative changes in income tax and corporation tax. For income tax allowances and the basic rate limit these are changes from an indexed base.

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

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

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Table 4.5 direct effects of illustrative changes in income tax and corporation tax[1]

	£ million 1989-90 cost/yield	1990-91 cost/yield
Income tax		
Rates		
Change basic rate by 1p[2]	1400	1725
Change higher rate by 1p	100	205
Personal allowances[3]		
Change single and wife's earned income allowance by £100	275	325
Change married allowance by £100	225	285
Change single age[4] allowance by £100	22	32
Change married age allowance[4] by £100	18	19
Change aged income limit by £200	3	3
Change all main personal allowances by 1 per cent[5]	180	235
Change all main personal allowances by 10 per cent:[5]		
increase (cost)	1800	2325
decrease (yield)	1875	2400
Basic rate limit		
Change basic rate limit by 1 per cent[5]	23	36
Change basic rate limit by 10 per cent:[5]		
increase (cost)	215	340
decrease (yield)	270	420
Allowances[3] and basic rate limit		
Change all main personal allowances and basic rate limit by 1 per cent:[5]	205	270
Change all main personal allowances and basic rate limit by 10 per cent:[5]		
increase (cost)	2000	2650
decrease (yield)	2150	2825
Corporation tax[6]		
Change full rate by 1 percentage point	420	650
Change small companies' rate by 1 percentage point[7]	30	50

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

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

[3] Estimated effects in 1990-91 assume equivalent changes in the corresponding allowances under Independent Taxation. (For details see page 39 of the FSBR 1988-89).

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

[5] Percentage changes are calculated with reference to 1988-89 levels.

[6] Assessment to corporation tax normally relates to the preceding year. These estimates are, therefore, the changes to revenue that would occur if the changed rates were applied to incomes from 1 April 1988.

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

Indirect Taxes

4.09 Table 4.6 shows estimates of the effects of changes in excise duties. The first part shows the extra revenue from the individual duties if they were to be increased by 6¼ per cent, together with the price increase that would result (after allowing for consequential VAT). The second part shows the revenue yield from changing current levels of duty so that (after VAT) the price of a typical item is changed by the amount shown.

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

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

tax revenue

Table 4.6 **Revenue effects of indirect tax changes**

	Current level of duty on typical items	6¼% Revalorisation[1] Price change inc VAT[2]	£m yield in[3] 1989-90	1990-91	Changes from present levels of duty Price change inc VAT[2]	Actual percentage change	£m cost/yield[3] 1989-90	1990-91
Beer (pint)	19.4p	1.4p	125	135	1p	4.5	90	100
Wine (70cl bottle of table wine)[4]	71.7p	5.2p	45	50	5p	6.1	45	50
Spirits (bottle)	£4.73	34.0p	60	65	10p	1.8	20	20
Cigarettes[5] (~~10~~ 20 kingsize)	96.7p	6.0p	215	235	1p	1.0	35	40
Petrol (gallon)	92.9p	6.7p	400	435	1p	0.9	55	70
Derv (gallon)	78.6p	5.6p	90	100	1p	1.1	15	20
VED (cars and light vans)	£100.00	£6.25	145	155	£1.00	1.0	25	25

Rc

[1] An 'across the board' revalorisation by 6¼ per cent (including the minor duties not shown above) would yield about £1130m in 1989-90 and £1245m in 1990-91 and the impact on the RPI would be to raise it by 0.4 per cent.

[2] VAT is payable in addition to the duty except in the case of VED

[3] Assuming implementation on 1 April 1989

[4] Revenue effects include all wines

[5] The duty on cigarettes has ad vaolorem and specific elements; the percentage change relates only to the specific element, but the price change includes the subsequent increase in ad valorem duty and VAT.

Table 4.7 VAT

	£m cost/yield in 1989-90	1990-91
1% change in rate of VAT[1]	1300	1830

[1] Assuming implementation of 1 April 1989

(Last year's)

4 Tax revenue ready reckoner

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

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

4.03 An illustrative rate of inflation of 4 per cent has been used to show the effects of indexation and revalorisation in 1988–89. This is in line with the annual rate of increase in the RPI forecast for the fourth quarter of 1987.

4.04 The tables show estimates of the direct effects of tax changes. In practice, tax changes will themselves affect economic variables, which in turn will have further effects on tax yields and on the PSBR. The estimated direct effects are not, therefore, the same as the effects on the PSBR. The approach used here is explained in the Annex to Chapter 4 of the Financial Statement and Budget Report published in March 1987.

Indexation of allowances, thresholds and bands for 1988–89

4.05 Tables 4.1 to 4.3 show tax allowances, thresholds, and bands for 1988–89 after 4 per cent indexation. For income tax, rounding follows the rules laid down in the 1980 Finance Act; for inheritance tax and capital gains tax those laid down in the 1982 Finance Act. Estimates of the revenue effects of these changes are shown in Table 4.4.

Table 4.1 Income tax

	£ 1987–88	£ 1988–89
Allowances:		
Single and wife's earned income allowance	2 425	2 525
Married allowance	3 795	3 955
Additional personal and widow's bereavement allowance	1 370	1 430
Single age allowance (age 65–79)	2 960	3 080
Married age allowance (age 65–79)	4 675	4 865
Single age allowance (age 80 and over)	3 070	3 200
Married age allowance (age 80 and over)	4 845	5 045
Aged income limit	9 800	10 200

Income tax rates	Bands of taxable income £	
Per cent	1987–88	1988–89
27	0–17 900	0–18 700
40	17 901–20 400	18 701–21 300
45	20 401–25 400	21 301–26 500
50	25 401–33 300	26 501–34 800
55	33 301–41 200	34 801–43 100
60	Over 41 200	Over 43 100

Table 4.2 Inheritance tax

Rate on death	Bands of chargeable value £'000	
Per cent	1987–88	1988–89
Nil	0–90	0–94
30	90–140	94–146
40	140–220	146–229
50	220–330	229–344
60	Over 330	Over 344

Table 4.3 Capital gains tax

	£ 1987–88	£ 1988–89
Annual exempt amount:		
Individuals	6 600	6 900
Trusts	3 300	3 450

Table 4.4 **Costs of indexation for 1988–89**

	£ million	
	1988–89	1989–90
Indexation of income tax allowances and thresholds	940	1 420
Of which:		
Increases in main personal allowances	770	1 120
Increase in the basic rate limit*	110	170
Increases in further higher rate thresholds*	60	130
Indexation of inheritance tax thresholds and bands	25	60
Indexation of capital gains exempt amounts	—	10

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

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

4.06 Table 4.5 shows estimates of the direct revenue effects of illustrative changes in income tax and corporation tax. For income tax allowances and thresholds, these are changes from an indexed base.

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

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

Table 4.5 Direct effects of illustrative changes in income tax and corporation tax[1]

	£ million	
	1988–89 cost/yield	1989–90 cost/yield
Income tax		
Rates		
Change basic rate by 1p[2]	1 250	1 600
Change all higher rates by 1p	85	165
Personal allowances[3]		
Change single and wife's earned income allowance by £100	295	380
Change married allowance by £100	240	310
Change single age allowance[4] by £100	23	30
Change married age allowance[4] by £100	22	26
Change aged income limit by £200	4	5
Change all main personal allowances by 1 per cent	180	235
Change all main personal allowances by 10 per cent:		
increase (cost)	1 775	2 325
decrease (yield)	1 825	2 400
Higher rate thresholds[3]		
Change all higher rate thresholds by 1 per cent: increase (cost)	31	55
decrease (yield)	32	60
Change all higher rate thresholds by 10 per cent:		
increase (cost)	280	520
decrease (yield)	365	650
Allowances and thresholds[3]		
Change all main personal allowances and higher rate thresholds by 1 per cent	215	295
Change all main personal allowances and higher rate thresholds by 10 per cent:		
increase (cost)	2 050	2 825
decrease (yield)	2 250	3 075
Corporation tax[5]		
Change full rate by 1 percentage point	360	560
Change small companies' rate by 1 percentage point[6]	25	45

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

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

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

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

[5] *Assessment to corporation tax normally relates to the preceding year. These estimates are, therefore, the changes to revenue that would occur if the changed rates were applied to incomes from 1 April 1987.*

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

Indirect taxes **4.09** Table 4.6 shows estimates of the effects of changes in excise duties. The first part shows the extra revenue from the individual duties if they were to be increased by exactly 4 per cent, together with the price increase that would result (after allowing for consequential VAT). The second part shows the revenue yield from changing current levels of duty so that (after VAT) the price of a typical item is changed by the amount shown.

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

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

Table 4.6 Revenue effects of indirect tax changes

	Current level of duty on typical items	4% Revalorisation[1] Price change inc. VAT[2]	£m yield in[3] 1988–89	1989–90	Changes from present levels of duty Price change inc. VAT[2]	Actual percentage change in duty	£m cost/yield in[3] 1988–89	1989–90
Beer (pint)	18·6p	0·9p	65	70	1p	4·7	75	85
Wine (70 cl bottle of table wine)[4]	68·6p	3·2p	20	20	5p	6·3	30	35
Spirits (bottle)	£4·73	21·8p	25	30	10p	1·8	15	15
Cigarettes (20 kingsize)[5]	93·4p	3·7p	95	110	1p	1·1	25	30
Petrol (gallon)	88·1p	4·1p	210	240	1p	1·0	55	60
Derv (gallon)[6]	74·5p	3·4p	50	55	1p	1·2	15	15
VED (cars and light vans)	£100·00	£4·00	85	90	£1·00	1·0	20	25

[1] *An 'across the board' revalorisation by 4 per cent (including the minor duties not shown above) would yield about £590m in 1988–89 and £655m in 1989–90, and the impact on the RPI would be to raise it by 0·3 per cent.*

[2] *VAT is payable in addition to the duty except in the case of VED.*

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

[4] *Revenue effects include all wines.*

[5] *The duty on cigarettes has ad valorem and specific elements; the percentage change relates only to the specific element, but the price change includes the subsequent increase in ad valorem duty and VAT.*

[6] *Revenue effects allow for offsetting increase in bus fuel grants.*

Table 4.7 VAT

	£m cost/yield in 1988–89	1989–90
1% change in rate of VAT[1]	940	1 310

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

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CONFIDENTIAL

FROM: J C J RAMSDEN
DATE: 24 October 1988

1. MR MCINTYRE JM 24/10.

2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Scholar
Mr Culpin
Miss Peirson
Mr Odling Smee
Mr Gilhooly
Mr Riley
Mr Speedy
Mr Tyrie
Mr Call
Mr Mace (IR)

Ch/ Looks OK?

OK

NATIONAL INSURANCE CONTRIBUTIONS: CHAPTER 3 OF AUTUMN STATEMENT

I attach a draft of Chapter 3 of the Autumn Statement, dealing with National Insurance Contributions. This is on the lines foreshadowed in Mr McIntyre's submission of 20 October. It is little changed from last year's chapter, except for the proposal to abolish the Treasury Supplement.

- The reduced earnings brackets can be finalised when you have reached a view on the proposals in Mr Moore's letter of 22 October. Mr McIntyre is submitting separately today on this. Mr Moore has put forward one of the two compromise options which you have indicated you would be prepared to consider (Miss Wallace's minute of 21 October). The attached draft assumes you are broadly content but leaves open the question of whether the step at £105 should go up by £5 or £10 (Mr Moore proposes £10).

- The figures in table 3.1 are being recalculated by the Government Actuary in the light of the revised assumptions which he was given at the end of last week. The figures can be added in later. I attach a copy of last year's chapter. As you will see, the figures to be supplied show income from contributions but not outgo on benefits, so no conclusions can be drawn from them on the likely size of the National

Insurance Fund (NIF) surplus. This will emerge when the GAD report is published. DSS Ministers have not yet decided when that should be. This year it was not till February but it would normally be earlier, possibly even before the Christmas break.

1. I would be grateful to know if you are content with the draft. I will submit a version including all the missing figures as soon as they are available. In the meantime the text needs to go to the printers by close on Tuesday 25 October.

J C J Ramsden

J C J RAMSDEN

octst1.20

written answer? Yes, but OK

~~(and of course, your OS)~~

3. NATIONAL INSURANCE CONTRIBUTIONS

3.01 The Secretary of State for Social Security has conducted his annual review of national insurance contributions, as required by the provisions of the Social Security Act 1975. Full details were set out in a statement by the Secretary of State on [-] November 1988. The main proposals are as follows:

- The Class 1 insurance rates for employees and employers should remain unchanged for 1989-90.

- The lower earnings limit should be increased from April 1989 from the present level of £41 a week to £43 a week in line with the single person's rate of retirement pension.

- The upper earnings limit should be increased from £305 a week to £325 a week.

- The earnings limit for the reduced rate brackets should also be increased from £70, £105 and £155 a week to £75, [£115], and £165 a week.

- ~~Abolition of~~ The Treasury Supplement, subject to Parliamentary approval of the necessary legislative changes, should be abolished. The Supplement is currently equivalent to 5 per cent of contributions.

This would give the following structure of national insurance contributions:

Weekly earnings	Percentage NIC rate on all earnings: Employees	Percentage NIC rate on all earnings: Employers
Below £43	(No NICs payable)	
£43 to £74.99	5	5
£75 to [£114.99]	7	7
[£115] to £164.99	9	9
£165 to £325	9	10.45
Above £325	9 on £325	10.45

3.02 The necessary orders will be laid shortly with a report by the Government Actuary on the likely effect of the changes on the National Insurance Fund. In accordance with normal practice, the

Government Actuary has been provided with working assumptions for use in preparing his report. These assumptions, which are not forecasts or predictions, will be summarised in his report and include the following:

- the number of unemployed (GB, excluding school leavers etc) averages 2.1 million in 1988-89 and 1.9 million in 1989-90.

- the increase in average earnings is expected to decline from about 8.8 per cent between financial years 1987-88 and 1988-89 to about 7.5 per cent between financial years 1988-89 and 1989-90. Figures for settlements are of course lower than these earnings figures in both years.

The report will also allow for an uprating of benefits in April 1989 on the basis of the 5.9 per cent increase in the RPI over the year ending in September 1988 as announced by the Secretary of State on 27 October 1988.

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

Table 3.1 Estimated total payments by employers and employees of national insurance contributions in 1988-89 and 1989-90.(1)

Great Britain (£million)

	Employers	**Employees**	**Total**
National insurance contributions:			
1988-89			
1989-90			
Total change			
of which:			
Change in contributions from increased earnings, etc[2]			
Change in contributions from increase in earnings limits			

[1] Figures are rounded to the nearest £10 million. Detailed figures for national insurance contributions will be included in the Government Actuary's report on the draft of the Social Security (Contributions, Re-rating) (No.2) Order 1988. As in previous years, figures in this table are on a receipts basis excluding self-employed and voluntary contributions. Figures include NHS Allocation contributions. Employers' contributions are net of deductions in respect of statutory sick pay and statutory maternity pay.

[2] Including population and employment changes.

3 National insurance contributions

3.01 The Secretary of State for Social Services has conducted his annual review of national insurance contributions, as required by the provisions of the Social Security Act 1975. Full details were set out in a statement by the Secretary of State on 3 November 1987. The main proposals are as follows:

—the Class 1 insurance rates for employers and employees should remain unchanged for 1988–89.

—the lower earnings limit should be increased from April 1988 from the present level of £39 a week to £41 a week in line with the single rate retirement pension.

—the upper earnings limit should be increased from £295 a week to £305 a week.

—the earnings limit for the reduced rate brackets should also be increased from £65, £100 and £150 a week to £70, £105 and £155 a week.

—the Treasury supplement should be cut from 7 per cent of contributions to 5 per cent.

This would give the following structure of national insurance contributions:

Weekly earnings	Percentage NIC rate on all earnings	
	Employees	Employers
Below £41	(No NICs payable)	
£41 to £69·99	5	5
£70 to £104·99	7	7
£105 to £154·99	9	9
£155 to £305	9	10·45
Above £305	9 on £305	10·45

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

—the number of unemployed (GB, excluding school leavers etc) averages 2·7 million in 1987–88 and 2·6 million in 1988–89.

—the increase in average earnings is expected to decline from about $7\frac{1}{2}$ per cent between tax years 1986–87 and 1987–88 to about $6\frac{1}{2}$ per cent between tax years 1987–88 and 1988–89. Figures for settlements are of course lower than these earnings figures in both years.

The report will also allow for an uprating of benefits in April 1988 on the basis of the 4·2 per cent increase in the RPI over the year ending in September 1987, as announced by the Secretary of State on 27 October 1987.

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

Table 3.1 Estimated total payments by employers and employees of national insurance contributions in 1987–88 and 1988–89[1]

	Great Britain (£ million)		
	Employers	Employees	Total
National insurance contributions:			
1987–88	13 510	12 540	26 050
1988–89	14 800	13 550	28 350
Total change	+1 290	+1 010	+2 300
of which:			
Change in contributions from increased earnings, etc[2]	+1 180	+860	+2 040
Change in contributions from lower contracted-out rebate[3]	+220	+110	+330
Change in contributions from increase in earnings limits	−110	+40	−70

[1] *Figures are rounded to the nearest £10 million. Detailed figures for national insurance contributions will be included in the Government Actuary's report on the draft of the Social Security (Contributions, Re-rating) (No. 2) Order 1987. As in previous years, figures in this table are on a receipts basis excluding self-employed and voluntary contributions. Figures include NHS and Employment Protection Allocation contributions. Employers' contributions are net of deductions in respect of statutory sick pay and statutory maternity pay.*
[2] *Including population and employment changes.*
[3] *As announced by Secretary of State for Social Services on 16 March 1987.*

ea.eh/owen/Ind.Act
docs.pns-24.10

CONFIDENTIAL

FROM: D W OWEN

DATE: 24 OCTOBER 1988

1. MR SEDGWICK P.N.S 24.X

2. CHANCELLOR

cc Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Odling Smee
Mr Turnbull
Mr Hibberd
Mr MacAuslan
Mr Mowl
Mr O'Donnell
Ms Simpson
Mr Coulton

Ch/ Points for decision at para 10. 24/10

Annex @ end.

INDUSTRY ACT FORECAST: SUMMARY TABLES

This note discusses the design of the two final tables in the Industry Act forecast (IAF). (The versions included in the 1987 Autumn Statement are attached as Annex A.) It also considers which measure of GDP should be used, in the summary tables and throughout the text of the IAF, given our concern that the expenditure measure and, by implication, the average measure are currently understating growth.

2. A decision to use a measure of GDP other than the conventional average measure has important implications for the presentation of the Autumn Statement (AS). In order to incorporate any necessary changes in the drafts of Chapters 1 and 2 which are due to be sent to you tomorrow evening, we would like to have your reactions to the options discussed in this note by noon tomorrow, if that is possible.

Main summary table

3. A proposed alternative version of the main economic prospects summary table (Table 1.12 in last year's AS) is attached. It is based on some proposals made by Mr Odling-Smee just before the Budget, which you did not want pursued then because of lack of time. The main presentational improvements in this table compared with the previous published version are:

- for each variable the time periods run from left to right across the table. In the previous version the time periods ran across the page for some variables and down the page for others.

- the latest outturn year is included

- the time periods to which the forecasts relate are shown within the table above each set of figures. An alternative would be to put these in brackets after the variable definitions (eg Retail price index (Q4 on Q4)).

4. The revised table also incorporates some changes in the information provided:

- the margins of error relating to forecasts for the current year are omitted (except for the PSBR - see below). In the 1987 AS - but not in previous Autumn Statements - margins of error for the current year were included for inflation, money GDP, and the current account only. These are unlikely to be of much interest, except perhaps the margin of error for the current account, which we could put in the text instead

- the PSDR is included for 1987-88 and 1988-89 only, along with the margin of error for 1988-89. The PSDR has never before been shown in the Autumn Statement summary table, although it is shown in the corresponding FSBR table and is the only important forecast variable which is not shown in the summary. In the past its inclusion has been ruled out because we did not wish to draw attention to the fact that we were not giving an explicit forecast for the next financial year.

Preferred measure of GDP

5. The final table in the IAF (Table 1.13 in last year's AS) shows the levels of GDP and the main expenditure components, annually and half yearly. At least since the early 1980s the measure of GDP shown in this table has been the average of the expenditure, output and income measures. In earlier years we

published "compromise" estimates which were weighted averages of the three measures, reflecting the degree of confidence we had in the individual measures. However as far as we can tell from examining past publications, we did not reveal the precise weighting used to construct the compromise measure.

6. In present circumstances we need to consider how to present our best view of the rate of economic growth. There are two main options:

(i) use the **conventional average measure** but make it clear in the text of the IAF and in the footnotes that we think the expenditure measure and, consequently, the average measure are currently understating growth. There is a precedent for this approach in last year's AS (footnote to table 1.13 - see Annex A), though, given the greater scale of the problem this year, we would need to give more prominence to our doubts about the official estimates of growth.

(ii) use a **weighted average** of the three measures. Sir T Burns has suggested giving weights of ½ to GDP(E), 1 to GDP(I) and 1½ to GDP(O). This gives a reduced weighting to the expenditure measure and an increased weighting to the output measure, which the CSO admits publicly is the most reliable indicator of short term movements.

7. Two versions of the final table are attached based on these options. The main difference is that, with the weighted measure of GDP, real growth is ½ per cent faster in both 1987 and 1988. The projected growth of 5 per cent in 1988 on this measure is probably closer to the likely outturn, after upward revisions to expenditure, than the 4½ per cent growth in the conventional average measure.

8. There are problems with either approach. If we base our growth estimate on the average measure we will have to qualify it by references to doubts about the statistics. On the other hand

if we use a weighted measure it will be a break with the practice of the past few years. We would need to explain and justify the weighting system we use and we could be open to the charge of constructing data in an arbitrary way. The faster growth of real and money GDP which would result from choosing the weighted measure might also cause problems in the presentation of public expenditure plans. The ratio of general government expenditure to money GDP would fall more rapidly in 1988-89, which could be compared unfavourably with the relatively slow fall projected for later years. A GE submission on Wednesday will discuss this in more detail.

Layout of the final table

9. Both the attached versions of the final table are very similar in layout to previous published versions. The only change we propose is to include, in the bottom panel of the table, the changes in stockbuilding and the statistical adjustment as a percentage of GDP. This brings out very clearly the large contribution of the statistical adjustment - the difference between the preferred measure of GDP and the expenditure measure - to growth this year.

Summary

10. It is possible that we will need to revise some of the numbers later in the week. However it would be helpful at this stage to have your reactions on the following points:

(i) are you content with the proposed main summary table? In particular - is there any objection to dropping the margins of error for 1988? Would you prefer to follow previous practice and omit the PSDR?

(ii) which measure of GDP should we use?

Re (i): Yes, subject to three changes: (a) since ct a/c deficit for 1988 has been revised down from £14 bn to £13 bn, forecast for 1989 should be similarly revised down from £12 bn to £11 bn; (b) PSDR estimate for 1988-89 should be £10 bn (not £11 bn), as indicated @ my mtg; (c) for RPI presentation use the alternative @ X above (Q4 on Q4). No objection to dropping margins of error for 1988 and content to include PSDR.

(ii) the conventional one (option (i)) but with a more stringent health warning in the footnote than last year. We can, and should, increase this for the 1989 FSBR, however.

David Owen

D W OWEN

EA1 DIVISION

tables/tb12-prosp

Economic Prospects: summary

Percent changes on a year earlier unless otherwise stated

	1987	Forecast 1988	Forecast 1989	Average errors from past forecasts[1]
GDP and domestic demand at constant prices				
Domestic demand	4½	6	3	1
of which:				
Consumers' expenditure	5	6	3½	1¼
General government consumption	1	½	- 1	¾
Fixed investment	5½	12	5½	2
Change in stockbuilding (as a percentage of GDP)	0	0	0	¾
Exports of goods and services	5½	1½	5	2¼
Imports of goods and services	7½	11½	4½	2¾
Gross domestic product	4	4½	3	¾
Manufacturing output	6	6½	3½	2
Balance of payments current account (£ billion)	- 2½	-13	~~-12~~ -11	4¼
Inflation	1987~~Q4~~	1988~~Q4~~	1989~~Q4~~	
Retail price index (Q4 on Q4)	4	6¼	5	1¾
	1987-88	1988-89	1989-90	
GDP deflator at market prices	5¼	6¼	5	1¾
Money GDP at market prices	10	11	8	1½
£ billion	424	471	510	
PSDR (£ billion)	3½	~~11~~ 10		3
as a percent of GDP	¾	2¼		½

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

Option (i) (using average measure of GDP)

TABLE : GROSS DOMESTIC PRODUCT AND ITS COMPONENTS

£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 statistical adjustment	GDP at factor cost (average measure[1])	GDP index (average measure) 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	215.3	74.0	60.3	102.8	0.6	452.9	99.2	49.5	0.5	304.7	100.0
1986	226.8	75.4	60.8	106.6	0.6	470.3	105.6	51.8	1.1	314.0	103.0
1987	238.5	76.0	64.2	112.5	0.6	491.8	113.3	54.5	3.1	327.1	107.4
1988	252.2	76.2	71.9	114.4	1.0	515.8	126.5	56.9	8.9	341.4	112.0
1989	260.7	75.5	75.8	120.3	0.8	533.2	131.9	59.2	9.7	351.8	115.4
1987H1	117.0	37.8	31.2	55.5	-0.2	241.4	53.9	26.7	0.9	161.6	106.1
H2	121.4	38.3	32.9	57.1	0.7	250.4	59.4	27.8	2.3	165.5	108.7
1988H1	124.2	38.0	34.2	56.0	0.5	253.0	60.9	27.8	4.1	168.5	110.6
H2	128.0	38.2	37.6	58.3	0.5	262.8	65.6	29.2	4.8	172.9	113.5
1989H1	129.7	37.5	37.7	59.5	0.4	264.8	65.4	29.4	4.7	174.6	114.6
H2	131.1	38.1	38.1	60.7	0.4	268.5	66.4	29.8	5.0	177.2	116.3
Per cent changes[2]											
1986 to 1987	5	1	5½	5½	0	4½	7½	5	½	4	4
1987 to 1988	6	½	12	1½	0	5	11½	4½	2	4½	4½
1988 to 1989	3½	-1	5½	5	0	3½	4½	4	0	3	3

[1] The average GDP figures are averages of constant price output expenditure and income estimates of GDP. Percentage changes are calculated from unrounded levels and then rounded to the nearest half per cent. Figures for 1988H2 and beyond are forecasts.

2. Changes as a percentage of GDP for stocks and statistical adjustment.

Option (ii) (using weighted average of 3 measures of GDP)

TABLE : GROSS DOMESTIC PRODUCT AND ITS COMPONENTS

£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 statistical adjustment	GDP at factor cost (compromise measure[1])	GDP index (compromise measure) 1985=100
1984	207.9	74.0	58.1	97.1	1.1	438.1	96.7	48.7	1.0	293.7	96.4
1985	215.3	74.0	60.3	102.8	0.6	452.9	99.2	49.5	0.5	304.7	100.0
1986	226.8	75.4	60.8	106.6	0.6	470.3	105.6	51.8	1.2	314.1	103.1
1987	238.5	76.0	64.2	112.5	0.6	491.8	113.3	54.5	3.9	327.9	107.6
1988	252.2	76.2	71.9	114.4	1.0	515.8	126.5	56.9	11.5	344.0	112.9
1989	260.7	75.5	75.8	120.3	0.8	533.2	131.9	59.2	12.5	354.7	116.4
1987H1	117.0	37.8	31.2	55.5	-0.2	241.4	53.9	26.7	0.9	161.6	106.1
H2	121.4	38.3	32.9	57.1	0.7	250.4	59.4	27.8	2.9	166.2	109.1
1988H1	124.2	38.0	34.2	56.0	0.5	253.0	60.9	27.8	5.3	169.7	111.4
H2	128.0	38.2	37.6	58.3	0.5	262.8	65.6	29.2	6.2	174.3	114.4
1989H1	129.7	37.5	37.7	59.5	0.4	264.8	65.4	29.4	6.1	176.0	115.5
H2	131.1	38.1	38.1	60.7	0.4	268.5	66.4	29.8	6.5	178.7	117.3
Per cent changes[2]											
1986 to 1987	5	1	5½	5½	0	4½	7½	5	1	4½	4½
1987 to 1988	6	½	12	1½	0	5	11½	4½	2½	5	5
1988 to 1989	3½	-1	5½	5	0	3½	4½	4	½	3	3

[1] The compromise GDP figures are weighted averages of constant price output expenditure and income estimates of GDP. Percentage changes are calculated from unrounded levels and then rounded to the nearest half per cent. Figures for 1988H2 and beyond are forecasts.

[2] Changes as a percentage of GDP for stocks and statistical adjustment

ANNEX A

TABLES FROM 1987 AUTUMN STATEMENT

Table 1.12 Economic prospects: summary

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

[1] *The errors relate to the average differences (on either side of the central figure) between forecast and outturn; the errors given for constant price output and expenditure are relevant to the forecast for next calendar or financial year. The method of calculating these errors has been explained in earlier publications and Government forecasts (see Economic Progress Report June 1981). The calculations of average errors are based on forecasts made between 1975 and 1985.*

[2] *Per cent change on previous financial year in brackets; average error shown relates to the forecast of the percentage change.*

Table 1.13 Constant price forecasts of expenditure, imports and gross domestic product

£ billion at 1980 prices, seasonally adjusted

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

[1] *The average measure of gross domestic product—the preferred measure of economic activity—grew by some 3¾ per cent between the first halves of 1986 and 1987. The output-based measure, the most reliable indicator of short period GDP movements, similarly suggests growth of around 4 per cent.*

Timing and other measurement difficulties in the national accounts make it difficult to relate directly the three measures of GDP; it seems appropriate to discount the lower growth rate currently shown by the expenditure measure of GDP.

NOTE OF A MEETING HELD IN THE CHANCELLOR'S ROOM, HM TREASURY AT 10.30AM ON WEDNESDAY 19 OCTOBER

Present: Chancellor
Chief Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Phillips
Mr Luce
Mr Odling-Smee
Miss Peirson
Mr Sedgwick
Mr Turnbull
Mrs Butler
Mr Gieve
Mr Hibberd
Mr MacAuslan
Mr Pickford
Miss Simpson
Miss Walker
Mr Call

AUTUMN STATEMENT: INDUSTRY ACT FORECAST, ECONOMIC ASSUMPTIONS FOR PUBLIC EXPENDITURE, AND TIMING

The meeting first discussed the key figures for the Industry and Forecast, and the public expenditure assumptions for the Autumn Statement, on the basis of Mr Sedgwick's minute of 18 October.

Assumptions underlying the forecast

2. The Chancellor said that he was content for the Autumn Statement to state explicitly that the forecast for the year ahead assumed the same PSBR as forecast for the current financial year. He was also content for the IAF to assume an oil price "close to recent levels", in line with practice in previous published forecasts.

Real GDP

3. The Chancellor said that he was not keen to break precedent and publish figures for real GDP growth rounded to the nearest quarter. He thought this had an air of spurious accuracy. He also queried the apparent narrowing of the differential between oil and non-oil growth: he would be interested to know what the unrounded figures were, and if there was a significant change what the explanation was. The question then arose of which way rounding to one-half would tip the numbers. Sir T Burns said that he would wish to look again at the unrounded figures, and at the profile of half yearly figures, which we would also publish in the Autumn Statement. He would also want to consider what account needed to be taken of likely discrepancies between different measures of GDP. The Chancellor wondered whether, if we discounted the likely under-recording of GDP(E), a figure of 4½ per cent for the whole economy in 1988 would be more appropriate. It was noted that likely under-recording of GDP(E) had been explicitly taken into account in the figures published in last year's Autumn Statement: in principle it was agreed that a similar footnote should be included in this year version. Sir T Burns would provide further advice on the options.

Current Account

4. In discussion of the proposed current account path, it was noted that a deficit of £14 billion for 1988 was towards the top of the range of market expectations; as far as 1989 was concerned, the markets would be expecting some downward sloping stylised path, and a flat path would arouse suspicion that in fact we expected some deterioration in 1989. The margin of error on the forecast for 1989 was huge. Provisionally, it was agreed that the IAF should show a deficit of £14 billion for 1988, and £12 billion for 1989, but we would want to consider the September trade figures before finalising the 1989 figure.

The RPI

5. It was agreed that the IAF should assume an RPI less MIPs inflation rate of 5 per cent at end-1989, but that it should show the all items RPI coming back to 5 per cent by 1989Q4. This implied some falling back of interest rates by end-1989, but this was plausible, and consistent with what outside forecasters would be expecting.

6. The Chancellor said he was not attracted by the idea of including in the Autumn Statement a series of figures for the RPI excluding MIPs for future years. But he was attracted to Mr Sedgwick's suggestion that we should publish a chart showing the path of both RPI and RPI excluding MIPs for past years: it was for consideration whether this should cover the future as well as past figures.

7. In line with the assumptions for calendar year RPI, it was agreed that the assumption for the RPI to September 1989 should be 5½ per cent; the equivalent assumption for RPI less housing (Rossi) should remain at 5 for September 1989.

GDP Deflator

8. There were differences of view between GDP and the forecasters about the proposed assumptions for the GDP deflator. After discussion, a compromise of 6¼ in 1988-89 and 5 in 1989-90 was agreed.

Money GDP

9. It was noted that the money GDP projection would need to be revised in line with decisions on real growth and inflation.

PSBR/PSDR

10. The Chancellor said he thought it right to publish a number rounded to the nearest £1 billion, with some safety margin; the choice lay between £10 and £11 billion. He was inclined to the lower figure, and this was provisionally agreed, unless there were any surprises in the next CGBR figures, which caused us to revise our internal forecasts.

Unemployment

11. It was agreed that 1.9 million was provisionally the preferred assumption. This should be given to relevant departments when appropriate. However, we should hold open the prospect, internally, that the assumption might be trimmed to 1.85 million.

Average Earnings

12. The proposed path of $8^3/_4$ /7½/6/5 was agreed.

Interest Rates

13. It was agreed that the assumption for three month sterling interbank in 1989-90 should be revised down for consistency with the new RPI assumptions. The choice would probably be between 11 and 11¼ per cent. Initially departments should be asked to rework their figures using 11 per cent.

Debt Interest

14. Mr Sedgwick noted that there were a number of possible approaches to the figures of debt interest in future years. Either it could be calculated on the basis of assumptions about interest rates and the PSDR, eg. that it returns to zero as in the

MTFS, or on the basis of a stylised path for debt interest which did not involve assumptions about the path of the PSDR. On any of these approaches, we would be pressed about the assumptions we had made. It was agreed that a further submission was required, setting out possible paths for debt interest, how the assumptions used could be defended, and their effect on the survey figuring.

Timing of the Autumn Statement

15. The Chancellor and the Chief Secretary were agreed that, if the latest view of progress in the survey was correct, it would not make sense to stick to the original Autumn Statement timetable with a public expenditure cabinet on 10 November. The choice was therefore between options (i) and (ii) in Miss Simpson's minute of 18 October. The Chief Secretary said that if we went to Cabinet on 2 November but delayed the Oral Statement until 8 November it seemed very likely that news would leak out, and presentational advantage would be lost: he therefore favoured planning to do the Oral Statement on the afternoon of 2 November. There were risks in this strategy, in particular the danger that some Ministers would seek to reopen settlements at Cabinet. The Chancellor said he very much hoped it would be possible to limit the number of programmes reopened because of revised deflators. The Chief Secretary agreed that we should attempt to limit this as far as possible, although he saw difficulties on health, student awards, and overseas aid.

16. The Chancellor also commented that given the likelihood that the timetable would be accelerated, it was essential that DSS be told to produce their NIC proposals without delay. It was not acceptable that this should be allowed to jeopardise the whole timetable. Miss Peirson agreed to take this forward. The other next steps were for the Chancellor to discuss timing with the Prime Minister, and for officials to consider how much departments should be told, and when. It would be necessary to look back at

the handling of the 1986 operation. However, in the meantime the working assumption internally should be that the Public Expenditure Cabinet would be on Wednesday 2 November with an Oral Statement that afternoon. Informing Departments on whether the Oral Statement would be immediately after Cabinet could be deferred, but a final decision would be required by Tuesday 25 October, if departments were to have enough time to prepare press notices and clear them with the Treasury.

MOIRA WALLACE
19 October 1988

__Distribution__

Those present

ea.eh/sedgwick/25.10.1

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FROM: P N SEDGWICK

DATE: 25 OCTOBER 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Phillips
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr S J Davies
Mr Gieve
Mr Grice
Mr Hibberd
Mr MacAuslan
Mr Mowl
Mr O'Donnell
Mr Owen
Ms Turk
Ms Simpson
Mr Vernon
Ms Walker
Ms Chaplin
Mr Tyrie
Mr Call

Ch
Needs work, but I don't see any need for an ad hoc meeting?
AA

See changes passim. (I agree with all yr (AA's) changes except where indicated.)

DRAFT CHAPTER 2 OF THE AUTUMN STATEMENT: THE INDUSTRY ACT FORECAST

I attach a draft of the Industry Act Forecast for the Autumn Statement. The draft has benefited from a number of suggestions - notably by Sir P Middleton and Sir T Burns - but it has had far less scrutiny than is customary. In addition there is much less time than usual between your seeing the first draft and publication. There will in effect be one more draft, that will incorporate your comments on this one, which will reach you on Thursday evening.

The rest of this note discuses the main problems raised by this draft.

The order of sections

It is essential that the IAF has material on the discrepancies in the national and sectoral accounts, which pose a major problem for assessment of recent trends and for forecasting. Sensible discussion of growth, the balance of payments, and the financial position of the personal sector is not possible unless the problems with the statistics are set out. Without such a discussion early on each section will need to have some material on the inadequacies of its statistics, and the chapter as a whole would become repetitive.

If a separate section on the statistics is in the main body of the text - as in the attached draft - it makes sense for it to come before detailed discussion of the domestic economy, ie between the sections on the world economy and trade and the balance of payments.

I wd prefer this

Another possibility, which Sir P Middleton has suggested, would be to include this material as annex (as we have, for instance, with chapter 2 of the FSBR). This could still involve some problems of repetition because the main text might have to refer forward in a number of places to the annex on the statistics.

X

Assumptions

The forecast assumes for 1989 an average North Sea oil price of $13 and a sterling index of 76. These numbers are close to the averages since September 1. They are not disclosed in the draft IAF.

The numbers

Some of the detailed figures still require checking and are liable to change. This applies to the charts as well as the tables.

(a) You have already indicated your preference for the treatment of GDP in the final table, which retains the simple average of the expenditure, output ,and income measures. Real GDP growth in 1988 is 4½ per cent and money GDP growth in 1988-89 is 11 per cent. Non-oil GDP growth is now half a per cent higher than total GDP growth in both 1988 and 1989. We will agree the precise number for the level of money GDP for 1989-90 with GEP in the course of tomorrow.

(b) The forecast has a current account of £13 billion for 1988 and £11 billion for 1989. (see separate Note)

(c) At your meeting on 19 October it was agreed that the PSDR for 1988-89 should be £10 or 11 billion, somewhat below our internal forecast of £11¾ billion completed earlier this month. Since then the expected outturn for public expenditure has been revised down (Mr Richardson's minute to the Chief Secretary of yesterday). We also had a lower than expected LABR for September. On the other hand central government receipts in October -an important month for tax payments - have so far been less than envisaged in the recent internal forecast, which had a PSDR for 1988-89 of £11¾ billion. Our best central forecast for the 1988-89 PSDR is now a little over £11 billion. We think that the IAF PSDR should be £10 billion. (It is £10.2 billion in table 2.11). To achieve this PSDR there is a fall in the share of taxes in GDP of half a percentage point between 1987-88 and 1988-89. The FSBR had no change. (The tax shares are not shown explicitly in the IAF, but can be worked out.)

(d) The forecast for the nationalised industry component of the RPI (see table 2.6) is for an increase of 6¼ per cent in the year to 1989Q4. With total RPI inflation at 5 per cent, this implies a rise in real NI prices identical to that shown in table 2.6 for 1988Q4. The forecasts for individual prices have been revised slightly since our internal forecast and agreed with PE. (An annex table shows them.) Until the electricity price increase is announced only about a third of the increase in the NI RPI component in the year to 1989Q4 will be public knowledge. After the electricity increase is announced the proportion rises to about 80 per cent. (Mr Monck's note of today to the Chief Secretary discusses the handling of NI price increases.) (blue folder below)

(e) North Sea taxes for 1988-89 (table 2.10) are a little higher than the FSBR forecast of £3.3 billion, even though the Piper-Alpha disaster has led to a loss of production and the oil price has been lower than expected. (We might revise this figure on Inland Revenue advice.) In part this is the result of the underlying, pre Piper-Alpha, level of production being greater than expected at budget time. In addition the forecast assumes that the Piper-Alpha insurance receipts - due before the end of the calendar year - will be subject to tax. We will need to prepare a careful briefing line with Department of Energy and Inland revenue on North Sea aspects of the forecast.

Charts and Tables

An annex to this note lists the charts in the draft IAF and shows the charts in the last Autumn Statement that we have dropped. In order to complete them on time we need final decisions now on which charts to include in the IAF.

The forecasts for growth in the world economy table (2.1) have been rounded for the first time to the nearest half per cent. The convention was to round to the nearest quarter of a per cent, but it seemed odd not to adopt the same convention as for the UK.

P.N.S

P N SEDGWICK

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ANNEX : Nationalised Industry Price Increases 1988Q4-1989Q4, nominal per cent

	Expected Outcome	RPI weight (per 1000)	Contribution to Price Increase	Announcement of Price Increase
Post Office	0.0	2.0	0.0	-
Rail	9.4	5.6	1.1	Announcement this Friday by BR
LRT Tube	12.5	1.4	0.4	)Already public knowledge,
LRT Buses	12.25	1.1	0.3	)although not formally)announced
Electricity	5.88	26.0	3.2	No ministerial statement planned. Announcement by by industry some time after AS
Coal/Coke	0.0	5.0	0.0	-
Water	9.8	7.0	1.4	Expected to become public knowledge shortly after Christmas. No formal ministerial announcement
Total Nationalised Industries		**48.1**	**6.3***	

* Memo:
28% of increase in public domain before Autumn Statement.

ANNEX: **Charts in first draft**	**Charts omitted relative to 1987 AS**
(* Signifies same charts included in 1987 AS.)	
World Economy	
2.1* Major 7 Real GNP and Industrial Production	Real oil price (now displayed in 2.2)
2.2* Real Commodity Prices	
National and Sectoral Accounts	
2.3 Growth in different GDP measures	
2.4 Balancing Items in Sectoral Accounts	
Trade and Balance of Payments	
2.5* Exchange Rates (£/DM, £/$, ERI)	Current Account (Surpluses/deficits as share of GDP.)
2.6* Export Volumes (Goods less oil)	
2.7* Export Share	
2.8* Imports: Share of total Domestic Demand	
Domestic Demand and Activity	
2.9* Personal sector Savings Ratio	Stockbuilding
2.10 Personal sector wealth	
2.11* Net Rate of Return-ICCs	
Inflation	
2.12 RPI & RPI less MIPs	
2.13* Unit Labour Costs in manufacturing	
Labour Market	
2.14 Labour productivity	
Financial	
2.15* Growth rate of monetary aggregates	
2.16* Interest Rates	
Fiscal	
2.17 PSBR/PSDR	

CHARTS OMITTED RELATIVE TO 1987 AUTUMN STATEMENT

Chart 1.2 Real oil price

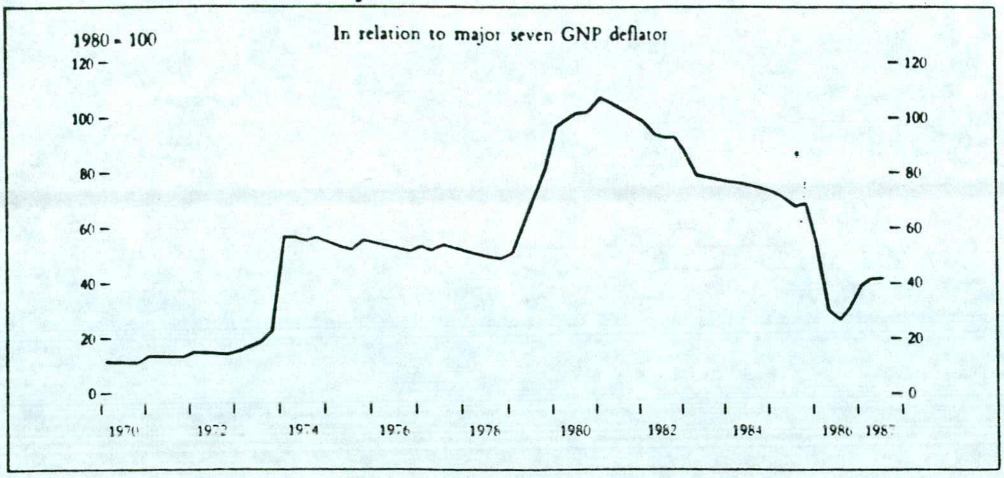


Chart 1.7 The current account of the balance of payments (surpluses and deficits as a percentage of GDP)

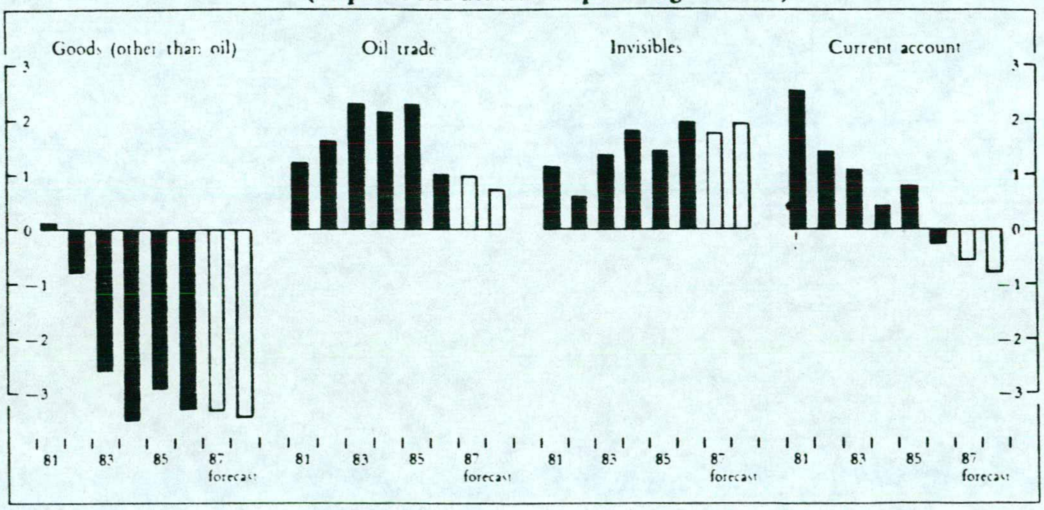
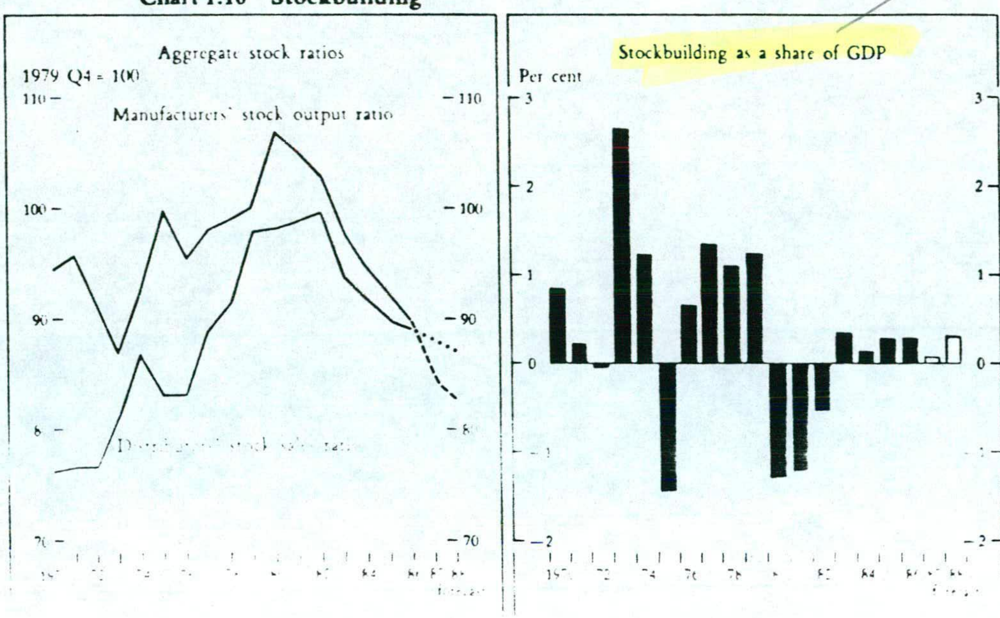


Chart 1.10 Stockbuilding



this is good to show "abolition" of stock cycle, but perhaps no great loss — & Terry is worried that residual error conceals some stockbuilding

2 : ECONOMIC PROSPECTS FOR 1989

Summary

2.1 GDP is ~~expected~~ forecast to grow by following growth of 4½ per cent ~~in 1988 and~~ this year. 3 per cent in 1989. ~~Growth is likely to slow down through next year.~~ Inflation is expected to peak in mid-1989, and fall back by the end of the year.

Assumptions

2.2 The forecast assumes that fiscal and monetary policies are operated within the framework of the Medium Term Financial Strategy (MTFS). It assumes that both sterling and North Sea oil prices remain close to their recent levels. The Public Sector Debt Repayment (PSDR) is expected to be about £10 billion, equivalent to 2¼ per cent of GDP, in the current financial year, considerably greater than the figure expected at Budget time. The forecast assumes the same PSDR for 1988-89; the actual PSDR for that year will, as usual, be set in the Budget.

Do we need to spell out still? yes

World Economy

2.3 GNP in the major industrialised countries has grown faster than expected, and ~~It~~ is forecast to rise by 4 per cent in 1988; ~~and by~~ 3 per cent in 1989. World trade in manufactures has also picked up sharply and should ~~rise~~ grow by 9 per cent in 1988. Inflation in the major industrialised countries is expected to remain low.

growth is forecast to slow down slightly, to

UK trade and current account

2.4 The UK current account is ~~likely~~ forecast to be in deficit by £13 billion in 1988. This is ~~greater~~ considerably larger than ~~expected~~ forecast at Budget time due mainly to stronger ~~than expected~~ growth in ~~domestic demand.~~ The current account deficit ~~should begin to improve~~ to show some reduction? during 1989.

both investment and consumption

~~is forecast to narrow~~

Demand and Activity

2.5 The economy has grown strongly over the past year, though major inconsistencies in the official statistics make it difficult to assess the precise extent of growth. The output measure of GDP (the most reliable indicator of activity over short periods) is likely to grow by about 5½ per cent in 1988, with manufacturing output rising by 6½ per cent. Non-oil export volumes recovered strongly after falling in early 1988. Domestic demand growth, which has risen sharply over the past year, as investment has boomed and consumers' expenditure has continued to grow relatively rapidly, is expected to moderate in 1989 ~~and to grow no faster than GDP.~~

Inflation

2.6 Retail price inflation is expected to be 6¼ per cent in the fourth quarter of 1988. It ~~could~~ is likely to rise further in the first half of 1989 before falling to 5 per cent in the fourth quarter of 1989. Unit labour costs have risen slowly over the past year. Wage settlements need to moderate to keep growth of unit labour costs in check as output growth slows down.

Labour market

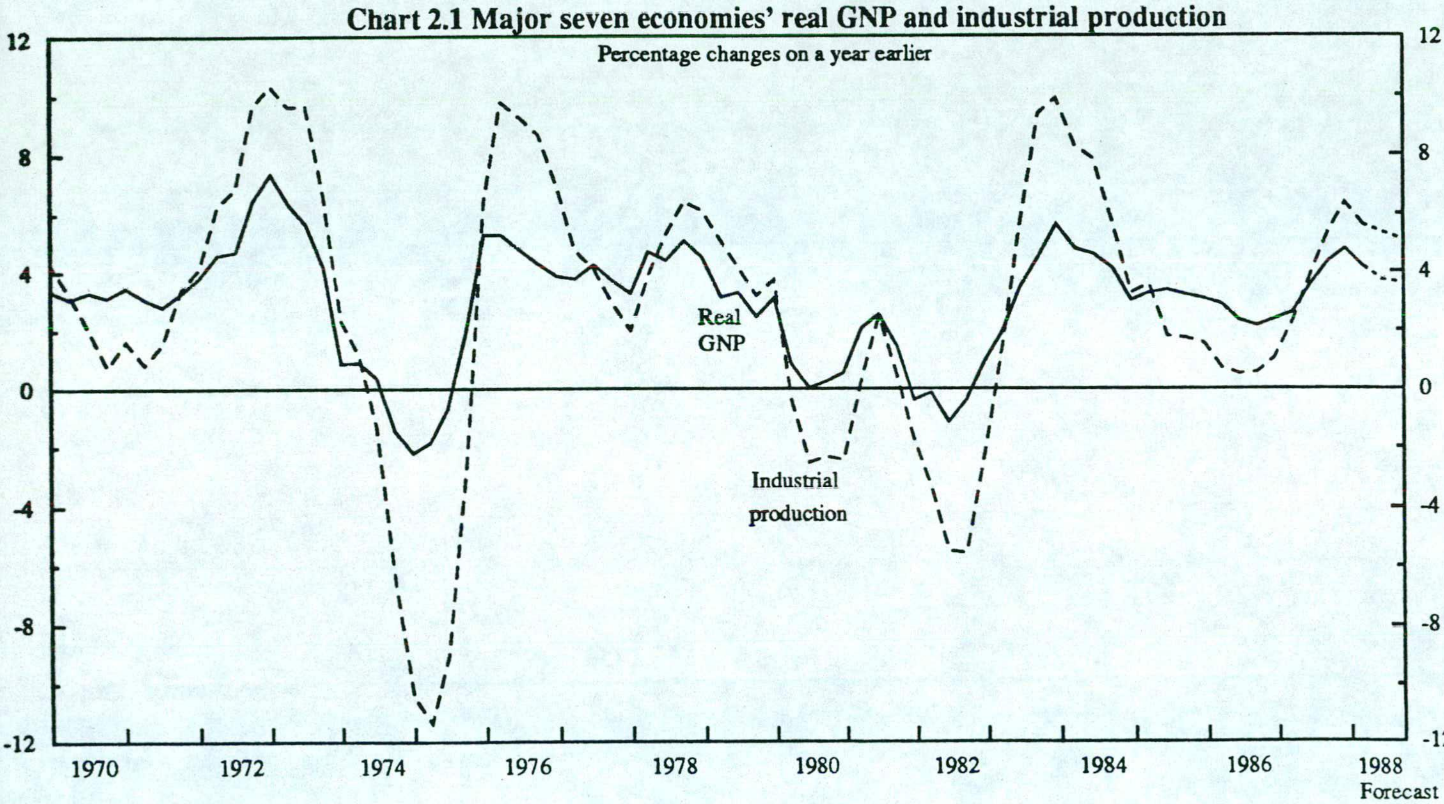
2.7 Employment has increased rapidly over the past year. Unemployment fell by 500,000 in the year to September - the largest annual decline since the war. since Productivity has continued to grow at a very fast rate, especially in manufacturing. Unemployment should continue to fall over the next year though probably at a slower rate than recently.

World Economy

Recent developments

2.8 Since the recession in 1982 the major seven OECD countries have experienced six years of steady growth ~~expansion~~, with real GNP growing at an average rate of 3½ per cent a year and the unemployment rate falling by 2½ percent.

Chart 2.1 Major seven economies' real GNP and industrial production



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2.9 Growth in these countries ~~Real GNP in the major seven economies~~ is estimated to have increased ~~by~~ to over 4 per cent ~~in~~ over the ~~last~~ past year ~~to the second half of 1987 and first half of 1988.~~ ~~Industrialised countries'~~ exports have grown strongly ~~strengthened~~, especially to those developing countries ~~whose import capacity was enhanced by a strong recovery~~ which benefitted from the rise in real commodity prices in 1987 and the first half of 1988. Greater ~~certainty about~~ exchange rate~~s~~ stability, following the Louvre Accord and rising capacity utilisation have strengthened business confidence and contributed to a resurgence of investment.

2.10 In contrast to 1984, when the strength of activity in the major seven mainly reflected developments in the United States, the latest [spurt] in activity has been worldwide. This is reflected in the pick up in total trade and in world trade in manufactures, both of which are rising at around 9 per cent a year. ~~And~~ , however,

Pretty long. Could omit 2.11 & 2.12

Current

2.11 ~~Although~~ All the major seven OECD countries are experiencing an investment boom, ~~there are important differences between developments in the three largest economies.~~ In the United States domestic demand growth, which averaged 5 per cent a year between 1983 and 1986, slowed to around 3 per cent a year in 1987 and the first half of 1988. But growth was sustained by a remarkable surge [recovery] in export volumes, which increased by 30 per cent between the first half of 1987 and the first half of 1988. As a result, the trade deficit [has narrowed].

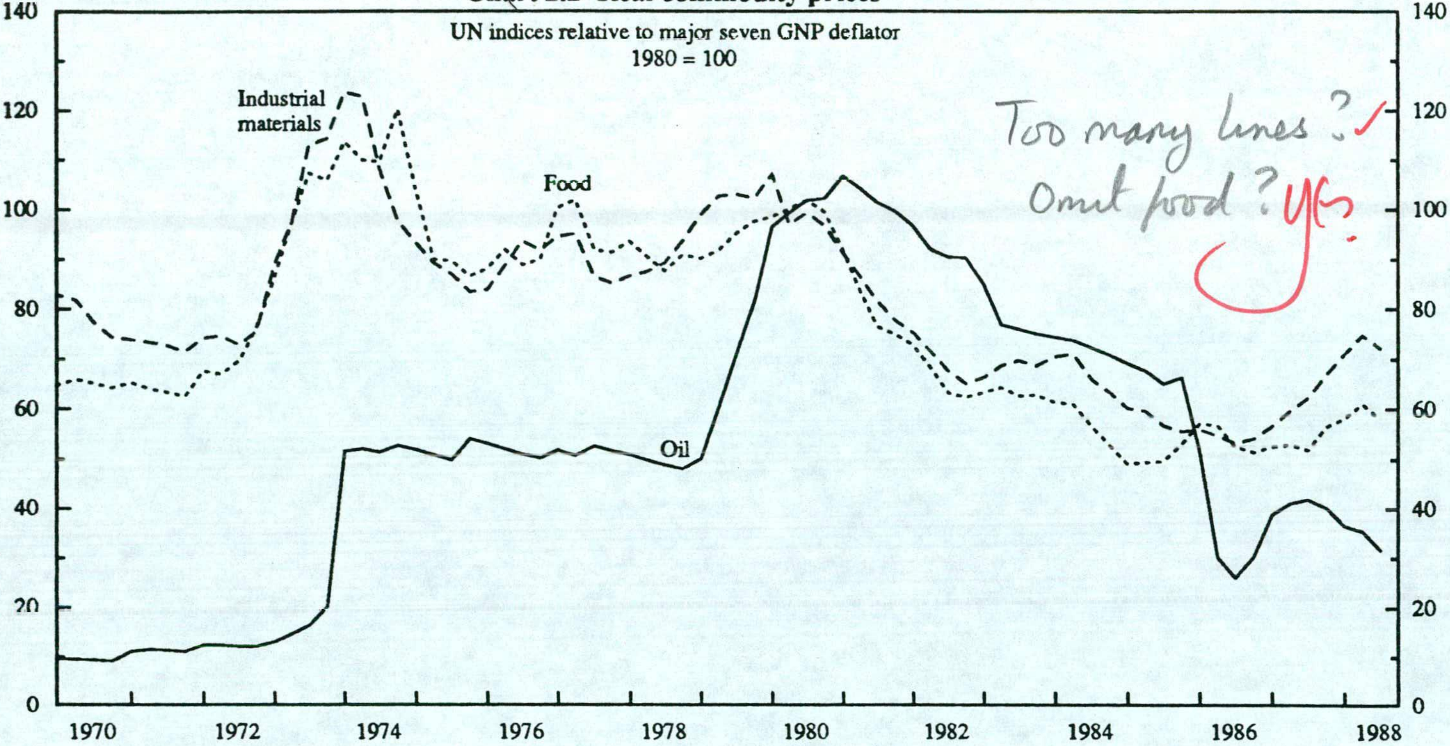
2.12 In Japan, [domestic demand has increased by almost 8 per cent over the last year. Even with strong import growth real GNP grew by 5½ per cent]. In Germany, [the pick up in growth reflects both a strengthening of domestic demand and a recovery of export volumes]. there has been a pick up both domestic demand and in exports, with little change in the trade surplus.

GNP grew by 5½ per cent last year, but domestic demand growth was even stronger at 8 per cent. As a result the trade surplus [narrowed]

2.13 Although non-oil commodity prices rose ~~have risen~~ by around 20 per cent in real terms over the last year, oil prices ~~have fallen~~ fell by rather more. The net effect on aggregate costs in industrial countries is ~~probably close to zero~~ likely to be small. Consumer price inflation in the major seven ~~OECD~~ countries has remained around 3 per cent.

~~Nonetheless, there were some concerns in the summer that the strength of demand would lead to rising inflation, and the authorities in most of the major industrial have countries responded by raising interest rates.~~

Chart 2.2 Real commodity prices



Forecast 2.14 Table 2.1 shows the forecasts for activity and inflation in the major seven ~~OECD~~ countries and for world trade. Real GNP in the major seven countries is expected to grow a little less strongly in 1989 than in 1988, ~~as higher interest rates reduce the growth of consumer spending and investment - particularly residential investment~~, with some slow-down in consumer spending.

Table 2.1 World economy

Percentage changes on a year earlier

		Forecasts	
	1987	1988	1989
Major seven countries[1]:			
Real GNP	3¼	4	3
Real domestic demand	3¾	4	3
Industrial production	3¼	5½	4½
Consumer prices	3¼	3	4
World trade, at constant prices			
Total imports	5	9	6½
Trade in manufactures	5½	8½	7½

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

2.15 Growth in world trade may also slow a little ~~down~~ in 1989, but probably by less than activity in the major seven ~~OECD~~ countries, ~~because~~ since the imports of some developing countries are expected to remain buoyant. ~~Because there is a relatively high share of manufactured goods in these countries' imports, total trade in manufactures is forecast to slow down rather less than total world trade.~~

2.16 Spot prices of non-oil commodities have weakened recently, but the continued strength of industrial activity ~~is expected to prevent any further fall in real commodity prices~~. ~~Capacity constraints in several major OECD countries and the continued strength of demand is expected to lead to~~ There is likely to be a modest rise in consumer price inflation in 1989.

makes a further fall ~~unlikely~~ doubtful

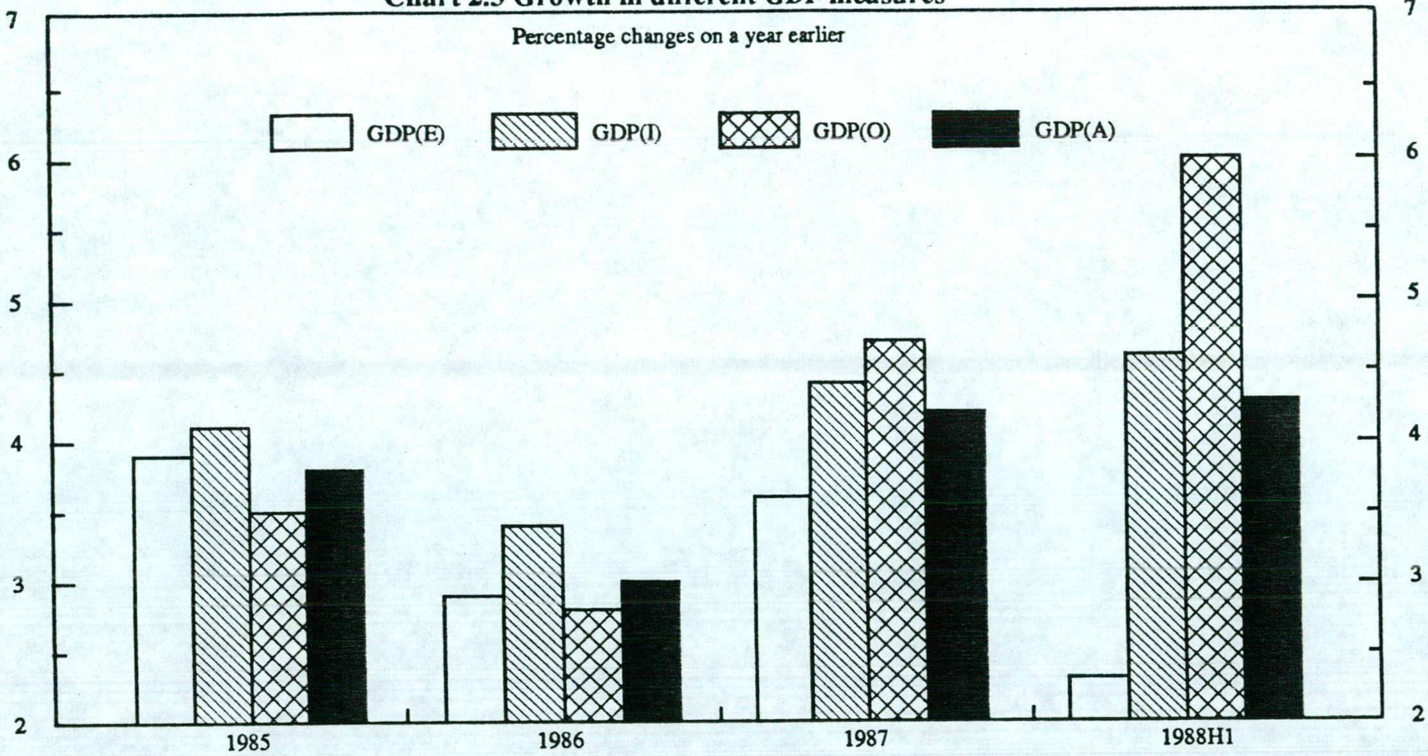
Use Middleton draft (see X on cover note)

UK National and sectoral accounts

2.17 It is difficult to assess just how strongly the UK economy has grown over the past two years because of the considerable disparity between the various measures of real GDP. The disparity is particularly marked for the first half of 1988. Chart 2.3 illustrates the discrepancy between the different measures since 1985. The output measure which is the most reliable short-term indicator of activity over periods up to a year. It grew by 6 per cent in the year to the first half of 1988. The income measure of GDP has also shown strong growth.

2.18 By contrast, the expenditure measure of GDP, which until recently has tended to grow faster than the other measures, has grown by ~~shows~~ only 2½ per cent growth in the year to the first half of 1988H1. Recorded Growth in consumer spending was particularly sluggish between the first and second quarters of this year. It seems likely that aggregate expenditure has been under-recorded over the past two years, and maybe over a longer period. As a result, the statistical adjustment - the difference between the average and expenditure measures of GDP - has contributed 2 per cent to the recorded 4½ per cent growth of average GDP.

Chart 2.3 Growth in different GDP measures

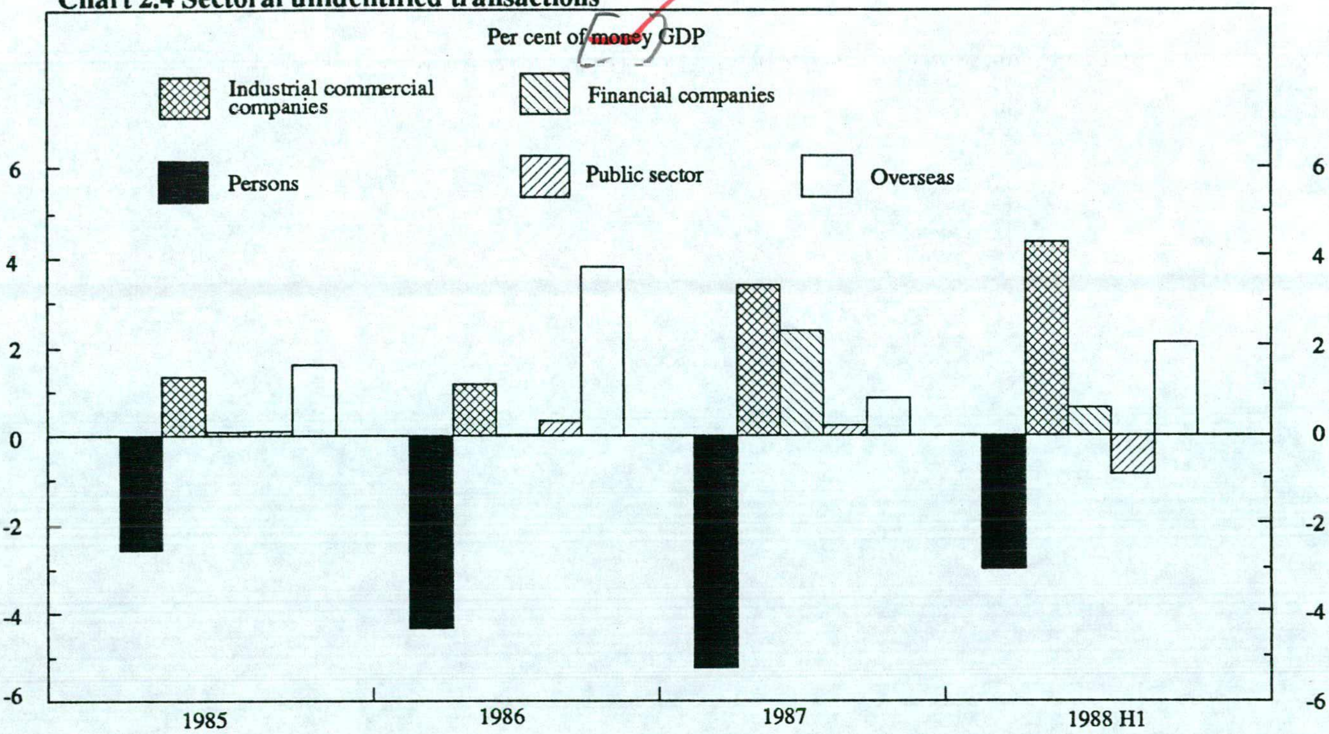


2.19 There are analogous problems with the current price national accounts figures, reflected in a rising residual error (the difference between the current price income and expenditure measures of GDP), especially in the first half of 1988.

2.20 Chart 2.4 shows that the large residual error is also associated with large balancing items in the sectoral financial accounts. (The balancing item is the difference between net acquisitions of financial assets as measured from financial data and as measured from national income and expenditure data. The sum of the balancing items is equal to the residual error.)

Ok if relegated to Annex

Chart 2.4 Sectoral unidentified transactions



2.21 In 1987, ~~In the 1988 Blue Book~~ the personal sector balancing item (including life assurance and pension funds) ~~was estimated at~~ almost 8 per cent of personal disposable income ~~in 1987~~. This suggests that the personal sector acquired far more financial assets than the national income and expenditure estimates imply. ~~It seems likely that there has~~ there may also have been some under-recording of personal sector income. ~~in the national income and expenditure accounts, though it is most unlikely that all the balancing item is unrecorded income.~~

2.22 The large balancing item in the overseas sector in the first half of 1988 (about £7 billion) indicates that there were either unrecorded credits on the current account ~~and~~/or unrecorded net capital inflows — or, most likely, both. To the extent that it reflects unrecorded net exports or IPD the true current account deficit was lower than the recorded figure. ~~The balancing item in the industrial and commercial companies sector may imply some under-recording of real spending on investment and stocks and/ or unrecorded trade credit extended to other sectors.~~

Spell out

the current account deficit was smaller

If, as these balancing items suggest, ~~net trade~~ and company sector spending ~~were~~ was higher, ~~it~~ would go some way to explain the sluggish behaviour of the expenditure measure of GDP relative to the other measures.

than the recorded figures indicate, that

Trade and the balance of payments

~~remained more stable recently~~. The dollar/Deutschemark rate remains close to where it was at the time of the Louvre accord,

Exchange Rates

2.23 Exchange rates between the major currencies have ~~been fairly stable over the past eight months, although they have been more volatile than in the period immediately after the Louvre accord. The Deutschemark has had periods of weakness against sterling and the dollar.~~ The forecast assumes that sterling remains close to recent levels.

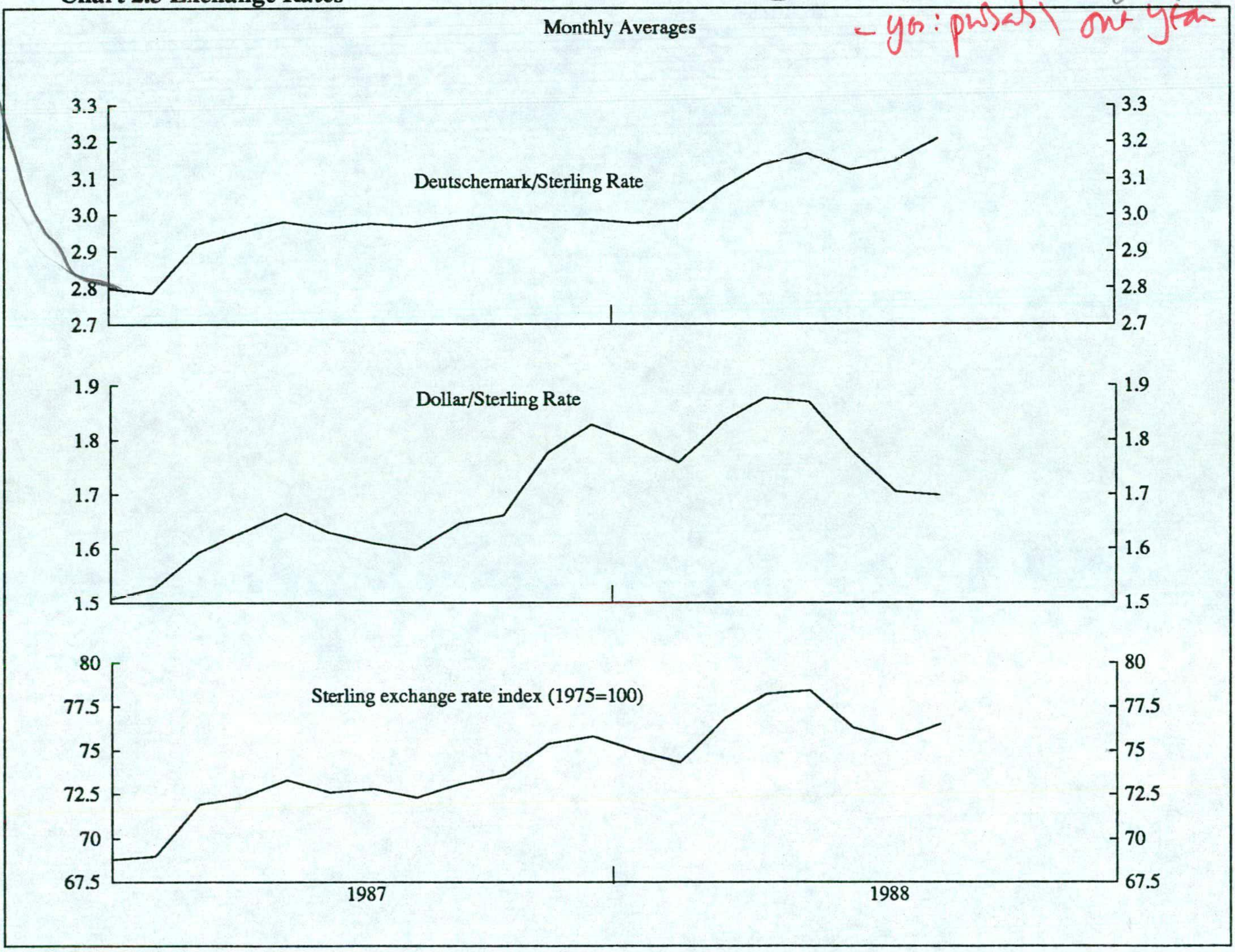
8ct

CHECK

need a longer period

- yes: probably one year more

Chart 2.5 Exchange Rates



This is not the agreed format for charts (see next chart)

Relative costs and prices

2.24 Manufacturing unit labour costs in the UK have risen only slightly over the past year, but still marginally faster than the average of other major industrial countries. [The increase in relative unit labour costs, combined with the rise in the exchange rate, may have caused a slight loss of labour cost competitiveness.] Nonetheless, most of the large gain in labour cost competitiveness in 1986 has been maintained! (if true!)

2.25 But it is the rapid increase in domestic demand that explains most of the deterioration in the current account. Recent CBI Surveys suggest that some industries have been facing capacity constraints and part of the unexpected domestic demand has been satisfied by imports. Some potential exports may also have been diverted to the domestic market. These capacity effects should unwind as domestic demand slows down and extra capacity becomes available following the investment boom.

Trade volumes (goods other than oil)

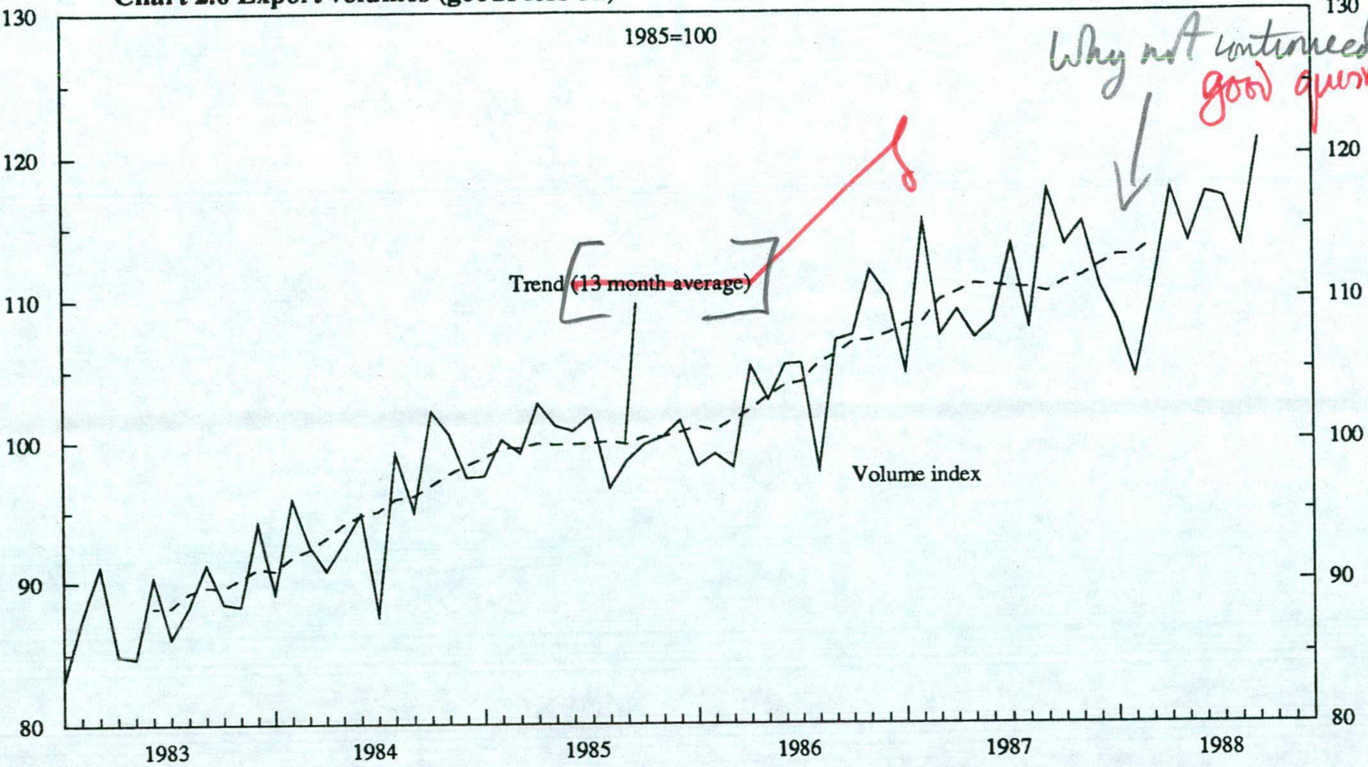
2.26 After erratically low figures in early 1988 (a phenomenon apparent in a number of EC countries), the volume of UK manufactured exports has since risen as world trade has continued to expand. In the third quarter of 1988 the volume of exports of manufactures was over 7½ per cent higher than a year earlier. After decades of decline, the UK's volume share of world trade in manufactures has changed little since 1981. Indeed, over the past two years, exports of manufactures have ~~, in fact,~~ grown a little faster than world trade and UK share has risen slightly. (~~so there Mr Gould!~~)

Table 2.2: Visible trade

	Percent changes on previous year					
	All goods			Goods less oil		
	Export volume	Import volume	Terms of trade*	Export volume	Import volume	Terms of trade*
1987	5	7	1	6½	8	1
1988	1½	12	½	4	13	2
1989	6	5	½	8	5	- ½

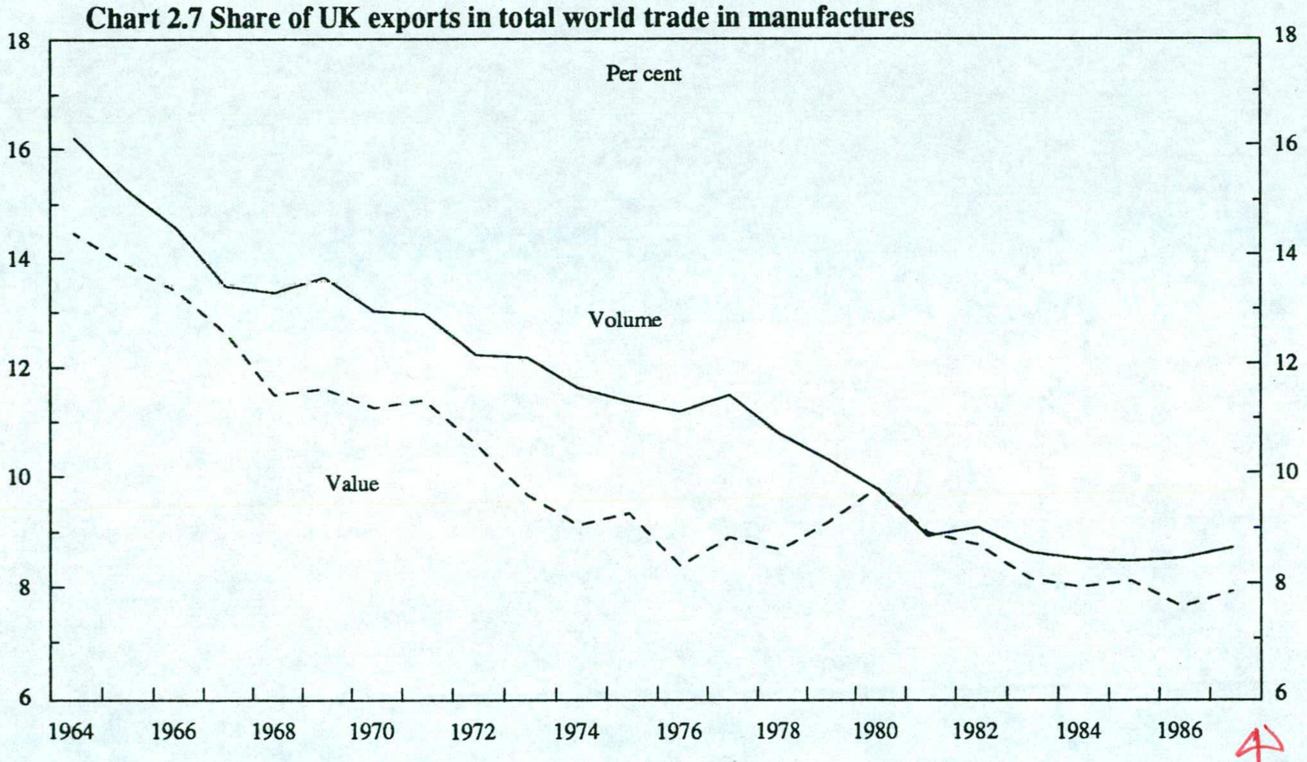
* The ratio of UK export average values to import average values

Chart 2.6 Export volumes (goods less oil)



2.27 ~~Following the recent strong recovery in~~ Manufactured export volumes ~~they~~ are forecast to rise by just under 8 per cent in 1989, ~~This would imply a UK share of world trade in manufactures close to the average level maintained since the early 1980s.~~ in line with the projected growth of world trade.

Chart 2.7 Share of UK exports in total world trade in manufactures

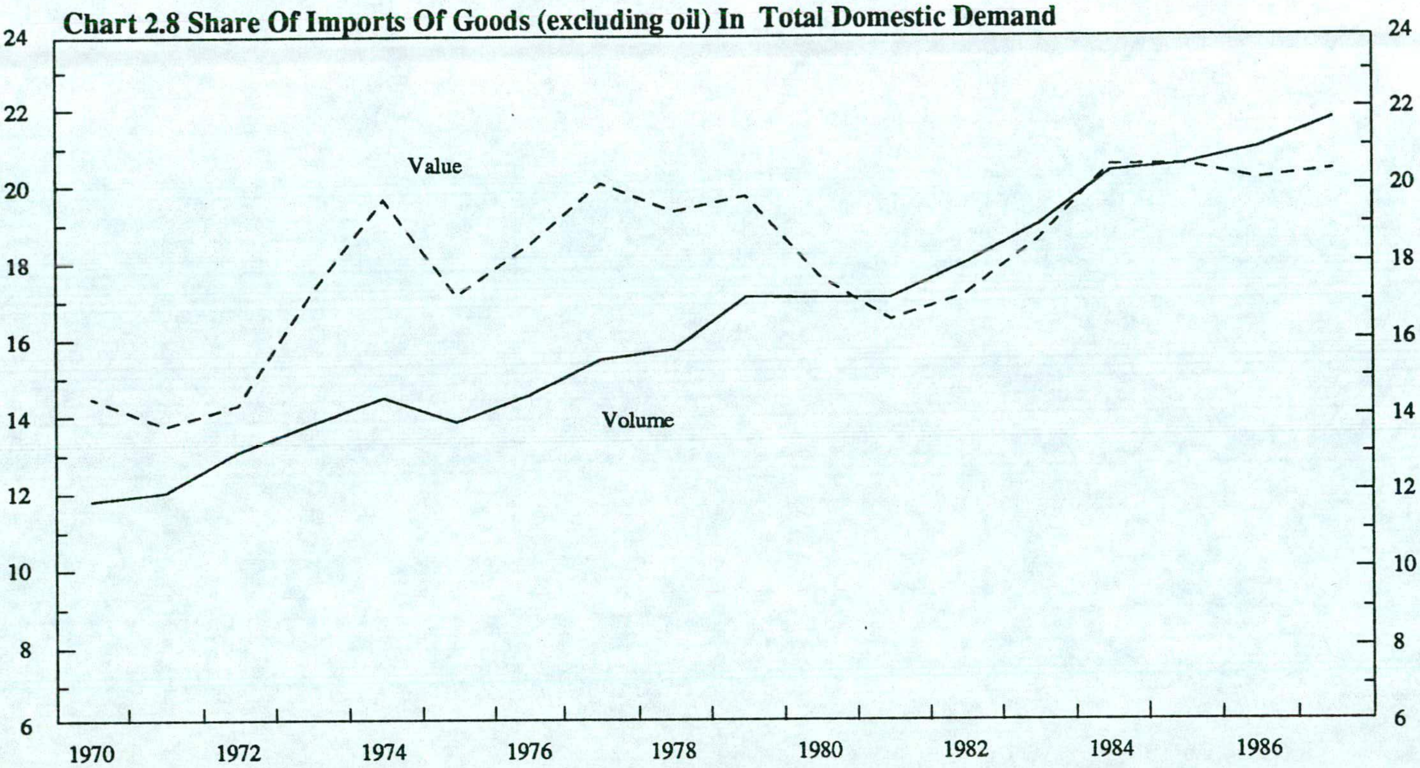


Insert 1988*

~~1988~~ *even if to-date,

2.28 Non-oil imports have risen very rapidly this year reflecting the strength of domestic demand, ~~a slight worsening in competitiveness,~~ and ~~perhaps~~ capacity shortages in some industries. Non-oil imports are expected to grow by 13½ per cent in 1988. But import growth should slow significantly in 1989, to 5 per cent, as domestic demand decelerates and as extra capacity becomes available following the investment boom.

Chart 2.8 Share Of Imports Of Goods (excluding oil) In Total Domestic Demand



Oil trade

2.29 The oil trade surplus is expected to fall by almost £2 billion in 1988, to around £2¼ billion. This is is the result of lower sterling oil prices, a decline in production (mainly due to the Piper Alpha disaster), and increased domestic demand for oil. Oil production is likely to fall again in 1989~~, but is still expected to remain above the centre of the range published in the Department of Energy's 1988 Brown Book (even allowing for the effect of the Piper Alpha disaster)~~. Declining production and a further rise in domestic demand for oil imply a further fall of about £½ billion in the oil surplus in 1989.

Trade prices and the terms of trade

2.30 The terms of trade have improved slightly over the past year, with the higher exchange rate more than offsetting the effects of falling oil prices. The terms of trade are expected to be unchanged between 1988 and 1989.

Invisibles and overseas assets

2.31 The surplus on invisibles for 1988 is likely to be around £2 billion lower than in 1987. This is largely due to a fall in the balance on services. UK tourists have been spending more abroad and the surplus on financial services has also come down due to lower net premiums on insurance.

2.32 Net earnings from interest, profits and dividends are expected to be largely unchanged from last year. ~~During 1987 the value of the stock of UK net overseas assets fell by £24 billion to £90 billion, largely due to revaluations following the fall in the US dollar. The effects of this fall in net overseas assets should be offset by an improved oil surplus as declining production reduces payments abroad by North Sea companies.~~ The deficit on transfers is expected to be unchanged in 1988 with lower payments to the European Community offset by higher bilateral aid.

2.33 The invisibles surplus should rise in 1989 as the balance on services recovers and payments abroad by North Sea companies continue to fall. These improvements will be partially offset, however, by increased payments to the European Community.

Current account

2.34 The current account is estimated to have been in deficit by just under £10 billion in the first 9 months of 1988 (though the large overseas balancing item suggests this may overstate the actual deficit). The forecast for the year as a whole is for a deficit of £13 billion (about 3 per cent of GDP), ~~compared to a deficit of £2½ billion, (½ per cent of GDP) in 1987.~~

is for

2.35 The forecast for 1989 ~~shows only~~ a slightly smaller current account deficit, ~~despite an~~ The expected slowdown in domestic demand growth~~. The slow turnaround in the current account is mainly due to~~ the smaller oil surplus and the fact that world trade growth is also projected to be somewhat slower in 1989.

will help reduce the current account deficit but this will be partially offset by

Table 2.3 Current account

	£ billion				
	Manufactures	Other	Oil	Invisibles	Current blance
1987	- 7½	-7	4	7½	- 2½
1988 Partly forecast	-14	-7½	2½	5½	~~-14~~ -13
1989 Forecast	-14½	-7½	2	6	~~-14~~ -11

adjust to match totals

Hurray! Well done

Demand and Activity

Personal sector expenditure

2.36 Consumer spending is estimated to have risen by 5½ per cent in 1986 and by 5 per cent in 1987. This is considerably faster than personal disposable income, and the recorded savings ratio fell from an estimated 9½ per cent in 1985 to 5½ per cent in 1987. ~~First estimates of consumer spending in 1988 show slow growth between the first and second quarters. But preliminary figures for consumer spending in the third quarter suggest a strong recovery, and the savings ratio has probably continued to fall.~~

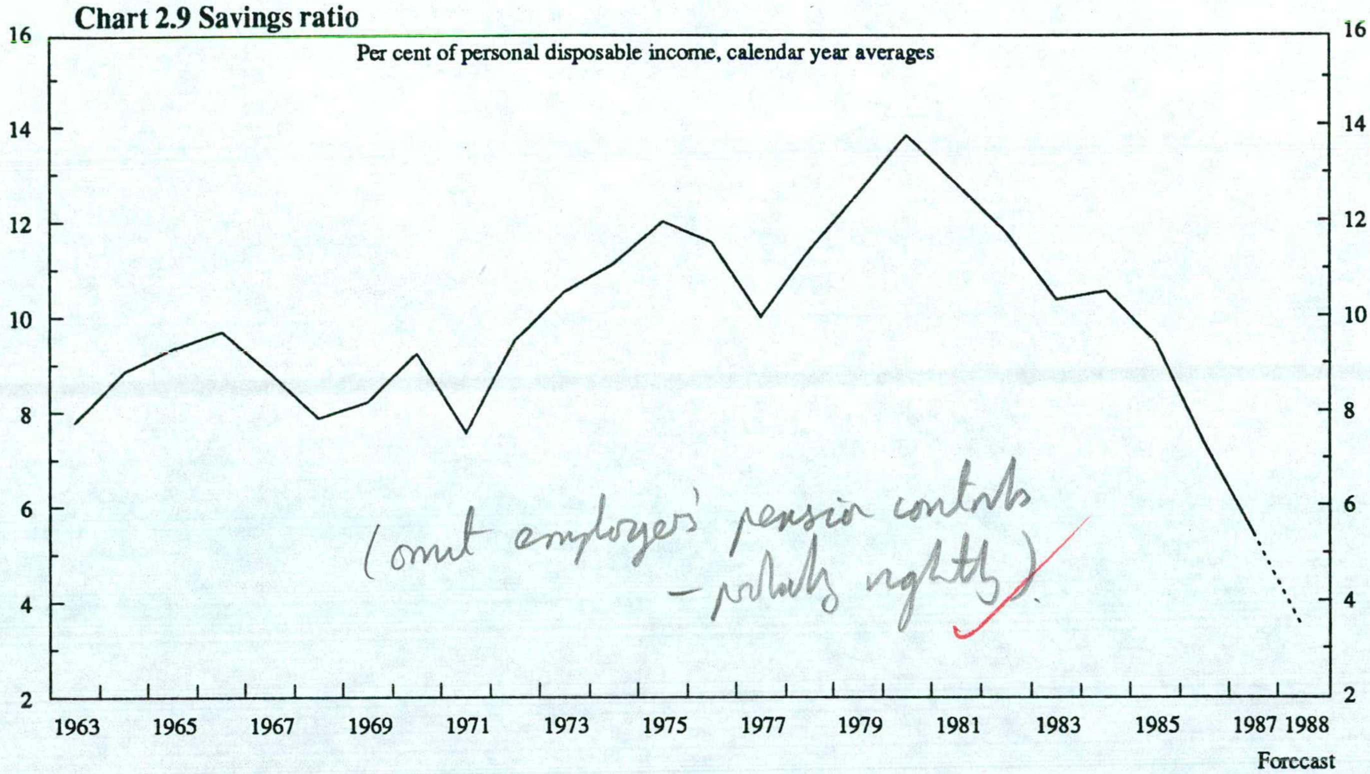
In 1988, consumer spending is likely to increase by about 5½ per cent, a similar rate to that in 1986 and 1987. The savings ratio is likely ~~to fall~~ have fallen further to about 3½ per cent.

It is likely to have fallen further in 1988.

2.37 ~~The savings ratio has now been on a downward trend since the peak of 1980. This would be true even if allowance was made for some under-recording of personal income in the national accounts, as suggested by the large personal sector balancing item. Lower inflation expectations, increased wealth (especially recent increases in housing wealth), and greater confidence about future economic developments may have temporarily reduced the perceived need for saving relative to income.~~ ~~Moreover,~~ employers' contributions to pension funds have been falling ~~relative to personal disposable income~~ in recent years as companies have reacted to the surpluses that many funds have been running; ~~These contributions are measured in personal disposable income in national accounts, and are likely to show up as a fall in the savings ratio.~~ this scores ~~as~~ The official statistics as lower savings. phrase

There are several reasons which may explain the substantial fall in the savings ratio since 1980. Most important has probably been ~~the~~ greater confidence in the future, with people having lower inflation expectations and greater wealth (especially following the large rises in house prices). In addition,

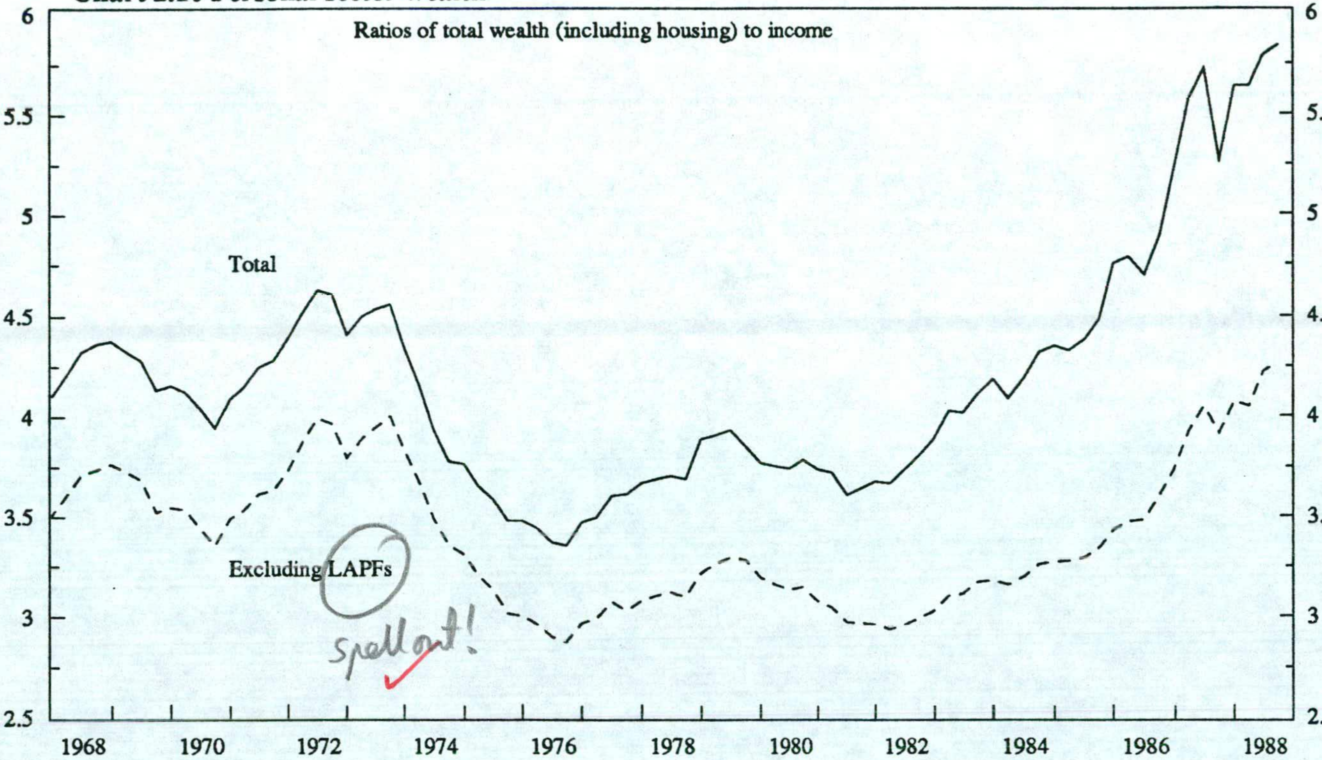
Chart 2.9 Savings ratio



2.38 [For 1988 as a whole, consumer spending is expected to rise by almost 5½ per cent, faster than the rise in real personal disposable income. The savings ratio could fall to an average 3½ per cent for 1988. Much of the recent increase in consumption has been financed by borrowing, mainly by withdrawing equity from increased housing wealth.] But householders will not wish to go on accumulating debt at the same rate as recently: Levels of borrowing are already high relative to income. Moreover, households are now substantial net payers of interest, and higher interest rates are therefore particularly likely to reduce consumer spending. This should be reinforced by a sharp slowdown in the growth of house prices and, hence, housing wealth. [~~Overall~~] Consumer spending is expected to rise by 3½ per cent in 1989 with a marked deceleration through the year. The savings ratio should recover slowly during 1989.

The fall in the savings ratio has ~~been~~ taken the form of ~~primarily by~~ an increase in borrowing — particular mortgage borrowing — following the ending of mortgage rationing and other restrictions.

Chart 2.10 Personal sector wealth



2.39 The housing market has been particularly buoyant over the past year, though the fall in building society mortgage commitments in August and September suggests that the pressure of demand is easing. Nonetheless, for 1988 as a whole private sector investment in dwellings and improvements is likely to increase by 16 per cent compared to 5½ per cent in 1987. Housing investment is ~~unlikely to rise significantly~~ further ~~in 1989~~. likely to remain at its 1988 level in 1989.

Stet

Company incomes and expenditure

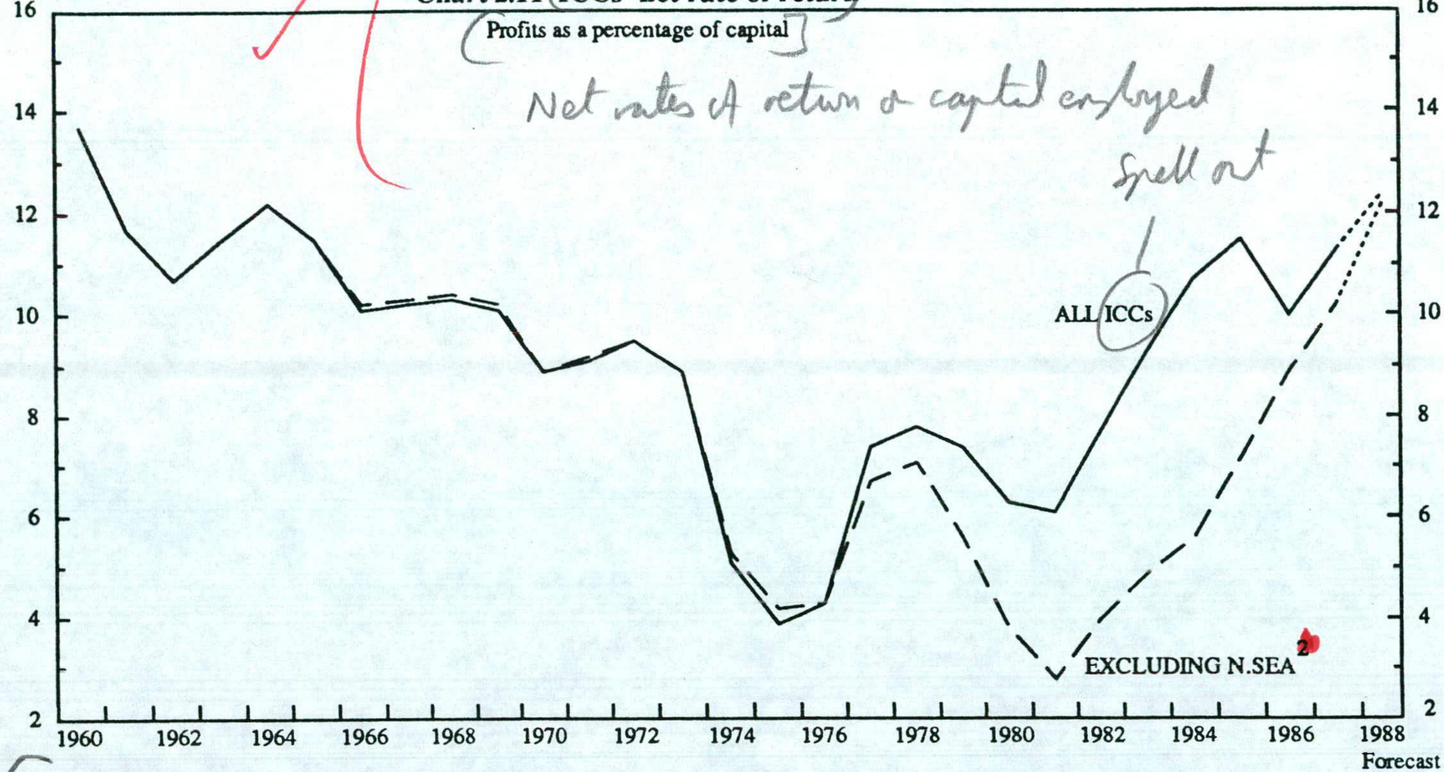
2.40 The net rate of return of non-North Sea industrial and commercial companies (ICCs) rose for the sixth successive year in 1987, back to levels not seen since the late 1960s. ~~The recovery in oil prices in 1987 boosted North Sea company profitability so that the rate of return of all ICCs also recovered.~~ The net rate of return of manufacturing companies rose to 9.2 per cent in 1987, again the highest level since the late 1960s. With continued strong profit growth likely in 1988, ~~the~~ net rates of return ~~of both non-North Sea and all ICCs is~~ are expected to improve further.

Companies' real rates of return

Chart 2.11 ICCs' net rate of return[1]

Profits as a percentage of capital

Net rates of return on capital employed



~~1. Basis of estimates~~
~~(i)Profits : net operating surplus on UK operations~~
~~(ii)Capital : net capital stock plus book value of stocks in UK~~
~~2. North Sea exploration and production activities~~

2.41 Developments so far in 1988 confirm the investment boom predicted by recent CBI and DTI Investment Intentions Surveys. Manufacturing investment (including leased assets) rose 13 per cent higher in the year to the first half of 1988, while private non-manufacturing investment rose 15 per cent. Business investment is expected to rise a little faster in 1988 than the June DTI Intentions Survey suggested. Further growth in business investment is expected in 1989. Stockbuilding is expected to continue on only a moderate scale in 1988 and 1989

Worth a table on investment growth?

Yes, if we can have 1988 figs (Hamilton)

Prospects for demand and activity

2.42 Growth of the average measure of GDP is expected to be around 4½ per cent in 1988. It could turn out to be even higher if, as seems likely, the expenditure measure is subsequently revised up. ~~The forecast for 1989 presented in table 2.13 makes some allowance for a further small rise in the average estimate of GDP relative to the expenditure measure though much less than in 1988.~~ As a result of ~~this and~~ the slowdown in domestic demand, GDP is expected to rise more slowly in 1989. ~~(There is obviously a very wide margin of error around any projection of the divergence between different measures of GDP.)~~

do we need [illegible]

Too complicated?

2.43 North Sea output fell by some 3 per cent between the first hal~~ves~~ f of 1987 and the first half 1988, and is expected to decline further in 1988. In 1989 declining output in the North Sea may reduce GDP growth by ½ percentage point. Manufacturing output is forecast to rise faster than total non-North Sea GDP in both 1988 and 1989.

Table 2.4 Domestic demand and GDP

Percentage changes on a year earlier

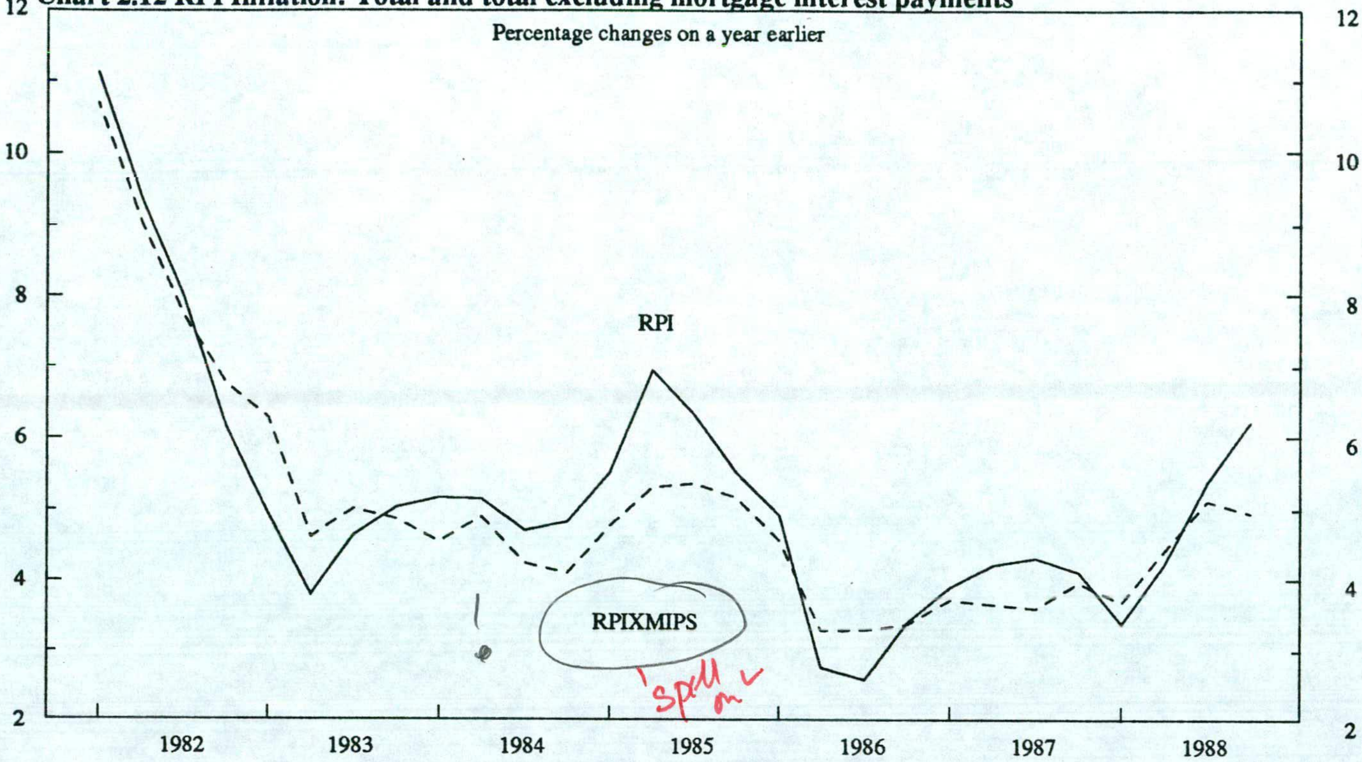
	1987	Forecasts 1988	Forecasts 1989
Domestic demand	4½	6	3
Exports of goods and services[1]	5½(6½)	1½(3½)	5½(7)
Imports of goods and services[1]	7½(8)	12(13)	4½(4½)
Domestic production: GDP[1,2]	4 (4½)	4½(5)	3 (3½)
Manufacturing	6	7	4½

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

Inflation

2.44 The annual rate of RPI inflation has risen since early-1988, mainly as a result of the rise in mortgage interest rates. Chart 2.12 shows that, excluding mortgage interest payments (MIPs), the increase has been less pronounced, though ~~still on an upward trend since~~ it has risen from the low levels of 1986 and 1987 (associated with the oil price fall).

Chart 2.12 RPI Inflation: Total and total excluding mortgage interest payments

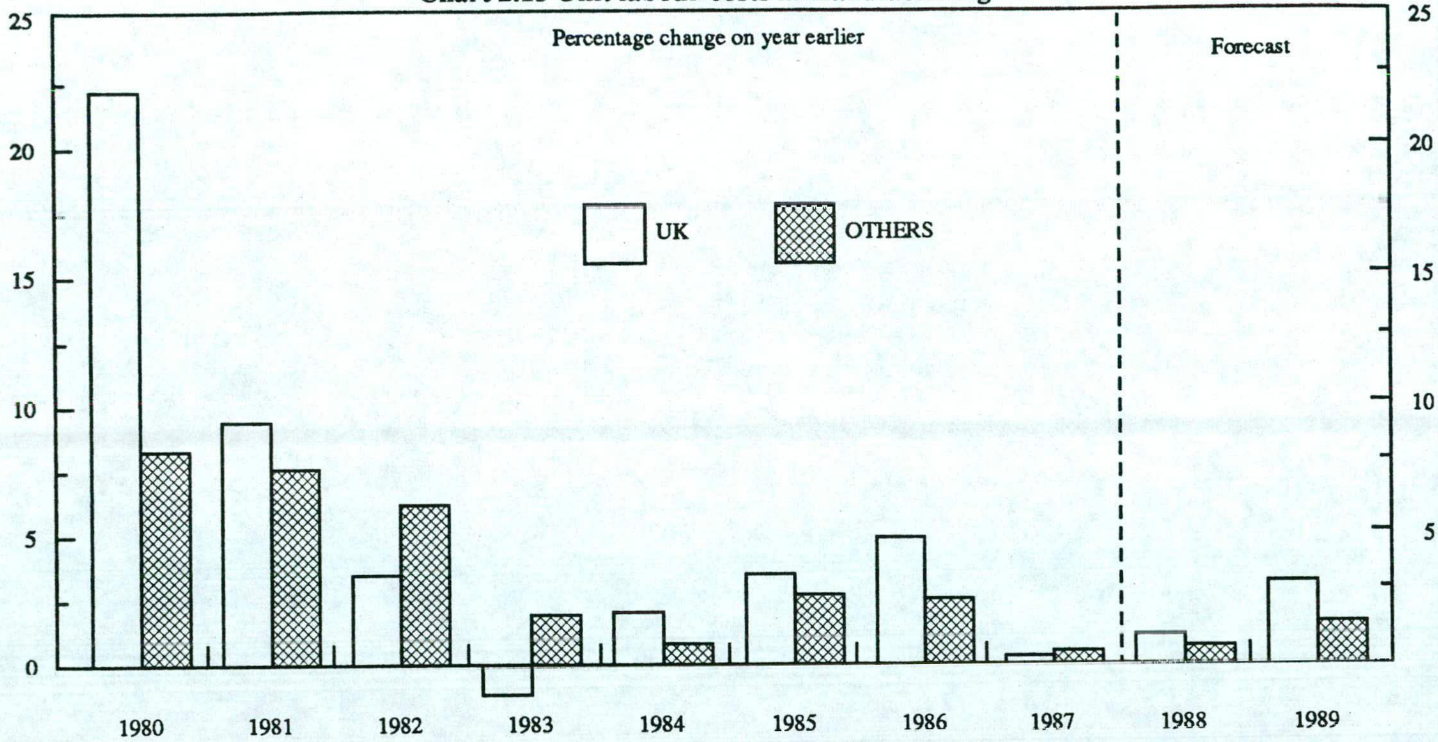


2.45 Total RPI inflation is likely to average 6¼ per cent in the fourth quarter of 1988; excluding mortgage interest payments (MIPs) the figure is expected to be 5 per cent. Producer price inflation has also ~~crept~~ edged up ~~through~~ during 1988. Though higher than expected at Budget time, the rate of underlying increase in prices has been much lower than in periods of comparably fast demand and output growth in the 1970s.

2.46 The underlying increase in average earnings has risen from 8½ per cent at the start of the year to 9¼ in August. The rise is mainly accounted for by continued high overtime payments and performance related bonuses. But pay settlements have also edged up as labour market conditions have tightened.

2.47 Despite high earnings increases, growth in unit labour costs have been kept down by the rapid growth in productivity, ~~Even so, they are likely to rise by a little more than the average of competitors' this year.~~
and they are expected to rise by just over 1 per cent in 1988.

Chart 2.13 Unit labour costs in manufacturing



Prospects

2.48 The low growth in costs over the last two years has not been fully reflected in producer output prices. With fast growth in demand, UK manufacturing industry has ~~experienced large~~ increases ~~in~~ profit margins substantially. ~~(A difference between the growth of total costs and of prices in table 2.5 indicates a change in profit margins.)~~ The projected slow down in demand and activity may mean that bigger margins will show little growth in 1989. But slightly faster ~~rising~~ growth in unit labour costs (because of a ~~normal~~ weak cyclical slowdown in productivity growth) and increased costs of materials and fuels could, together, imply that producer output price inflation may rise by only a little less in 1989 than in 1988.

Table 2.5 Costs in manufacturing

	Percent changes on year earlier			
	Unit labour costs	Costs of materials and fuel1	Estimated total unit costs2	Output prices1
1986	5	-10½	2¼	4
1987	¼	5	1½	4½
1988 Partly forecast	1½	4½	1½	4¾
1989 Forecast	3½	3	4	4½

1 Producer prices excluding food, drink and tobacco industries.

? xx

2 Including costs of bought-in services.

to 5 per cent by the fourth quarter,

2.49 Retail price inflation could rise further during the first half of 1989 before moderating ~~[thereafter]~~ ~~[as the effects of the mortgage interest rate increases in the second half of 1988 drop out of the calculation.~~ RPI ~~inflation (less~~ excluding ~~MIPs) is also likely to go on rising into early~~ 1989, [perhaps to a peak of ~~5½ per cent by the spring~~,] before ~~falling back in the second half of the year.~~]

The fluctuations in the RPI are chiefly the result of past changes in mortgage rates; excluding mortgage interest payments, the inflation path is likely to be much smoother,

Table 2.6 Retail prices index

		Percentage changes on a year earlier		
			Forecasts	
	Weight in 1988	**1987 Q4**	**1988 Q4**	**1989 Q4**
Food	16¼	3½	3¼	3¼
Nationalised industries	5½	2¼	7½	6½
Housing	15¼	7	16¼	8
Other	63	3¾	5½	4½
Total	100	4	6¼	5

2.50 The GDP deflator, which measures the price of domestic value added (principally unit labour costs and profits per unit of output), is forecast to rise by 6¼ per cent in 1988-89 and by 5 per cent in 1988-89.

Productivity and the labour market

2.51 The workforce in employment in Great Britain has continued to rise strongly over the last year; in the twelve months to June 1988 it is estimated to have risen by [~~439 thousand~~]. Since 1983, there has been an increase of over 2 million in the number of jobs.

440,000

400

Table 2.6 Changes in Employment

	Thousands, change in GB seasonally adjusted					
	Employees in employment Male	Female	Self-employed	HM Forces	Work related Government Training Programmes	Workforce in employment
June 1985 to June 1986	-68	+152	+ 16	-4	+50	+145
June 1986 to June 1987	- 6	+242	+234	-3	+85	+552
June 1987 to June 1988	+60	+222	+124*	-3	+35	+438

* Figures for self-employment over the last year are a projection based on self-employment growth over the previous five years.

Stet 2.52 Productivity has been growing strongly, with manufacturing productivity now estimated to have risen by 4½ per cent a year on average since 1979. ~~Underlying growth in labour productivity in manufacturing industry now appears to be higher than the rate experienced in the 1960s.~~ Output per head in the non-manufacturing sector has risen by about 1¾ per cent a year since 1979, and by about 2½ per cent a year since 1983.

Table 2.7 Output per head of the employed labour force

(Annual average, percentage changes)

	1964-73	1973-79	1979-88[2]
Manufacturing	3¾	3¾	4½
Non-manufacturing[1]	3	½	1¾
Whole economy	2¾	1	2¼
Non-North Sea economy	2¾	½	2

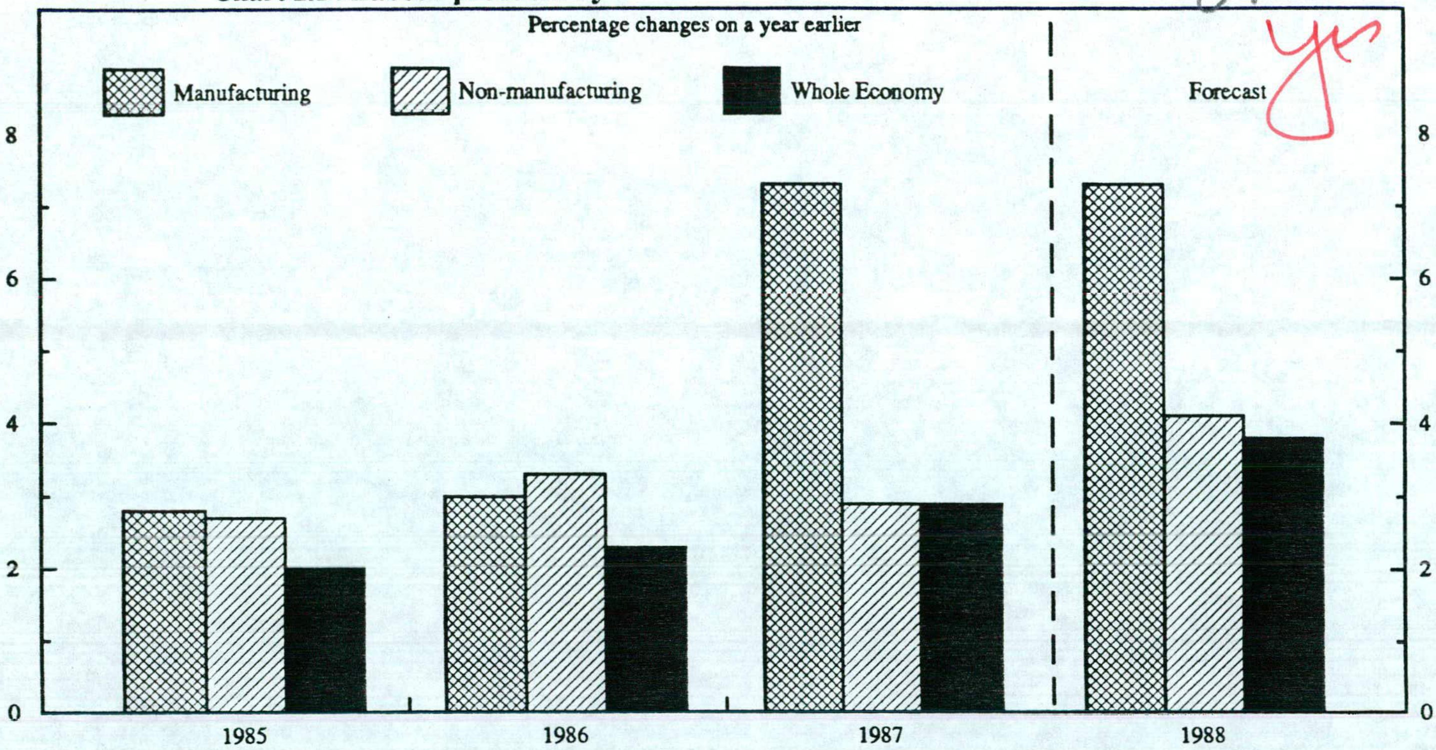
1 Excludes public services and North Sea oil and gas extraction.

2 Includes estimate for calendar year 1988

Horrible chart! Omit?

Yes

Chart 2.14 Labour productivity



Unemployment

2.53 By September 1988, seasonally adjusted adult unemployment in the UK had fallen for 26 successive months, and by some 940,000 in total. The fall in unemployment over the past year is mainly attributable to the strong growth of output and employment. A further, though slower, fall in unemployment is likely over the year ahead.

Financial developments

2.54 Over the past year, with the exception of a short-lived upsurge in April & ~~except for a single day in~~ May, the ~~closing~~ sterling index has not ~~never once diverged by more than 3 index points from 76.~~ varied by less than 3 per cent from its present level. ~~Sterling appreciated slightly on average during the first half of 1988-89, although there were periods of both upward and downward pressure on the exchange rate. During this period there were net underlying inflows to the reserves of some \$3 billion.~~ Over the ~~last year~~, the reserves have increased by \$x billion, net of official borrowing.

Same again

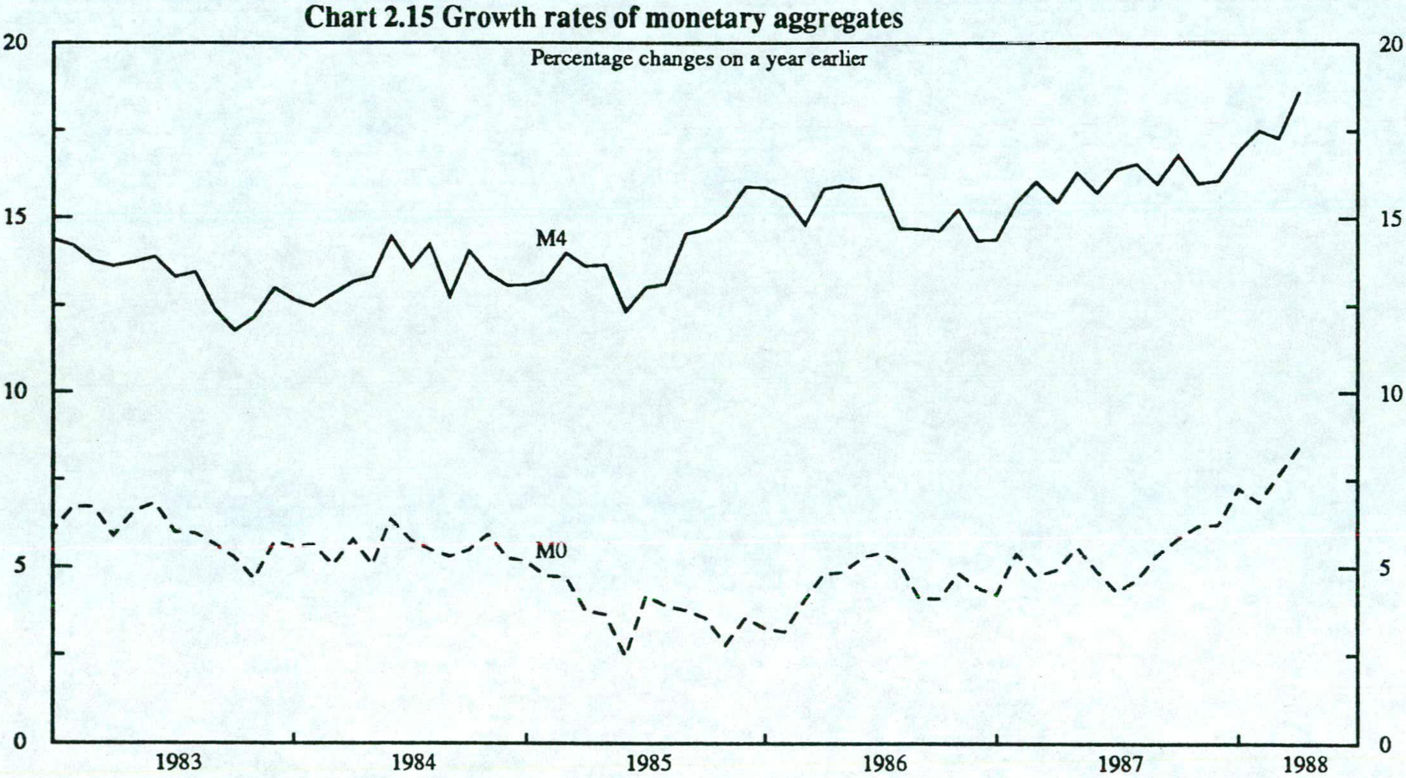
Narrow Money

2.55 The year on year growth of M0 has remained ~~been persistently~~ above the ~~upper bound~~ top of ~~the~~ its 1-5 per cent target range, ~~since January (when the 1987-88 target range of 2-6 per cent was in operation). This has been accompanied by greater than projected growth in consumers' expenditure.~~ Increases in interest rates since the summer are expected to slow the growth of M0 considerably over the next six months, although it may not return within its target range by the end of the financial year.

Broad Money

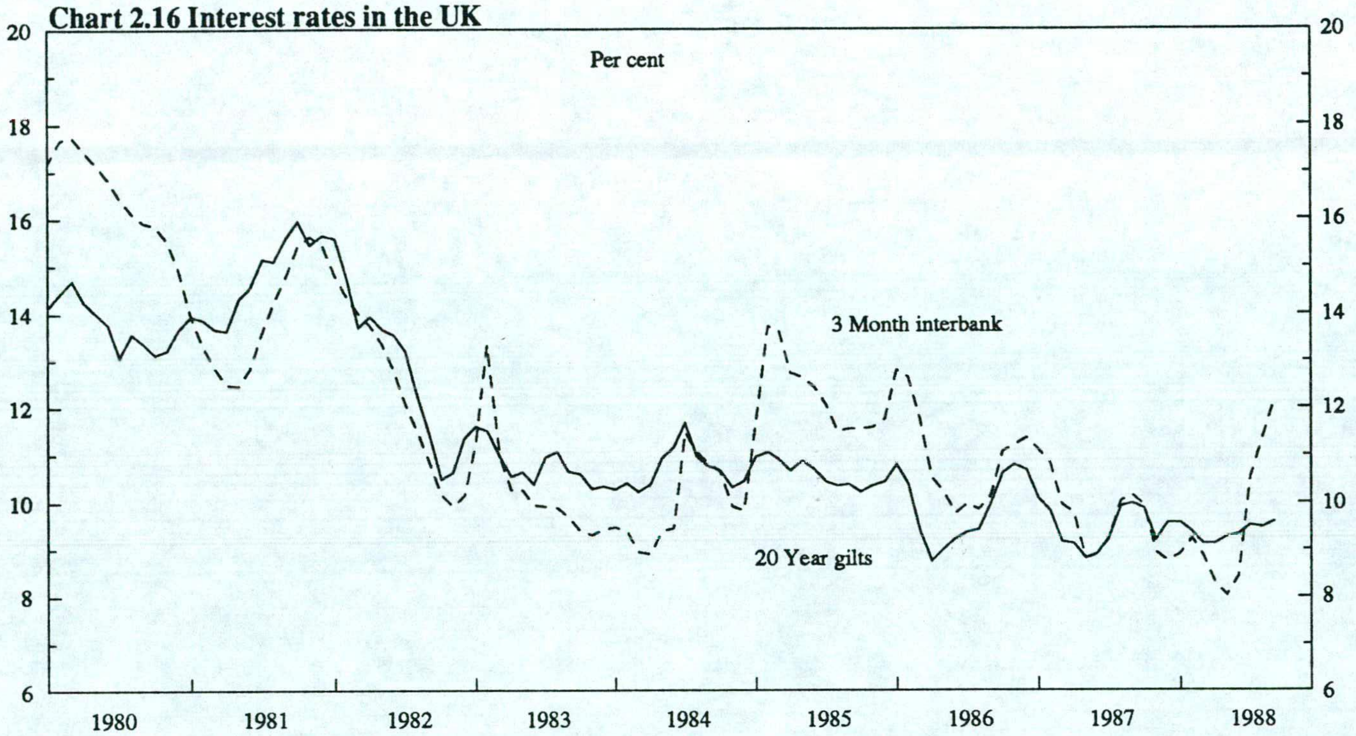
2.56 Broad money has continued to grow rapidly. There has been a marked increase in personal and financial sector deposits, as the stock market crash led to a move away from new investment in equities and unit trusts. Financial innovation and liberalisation continues to contribute to the growth of broad money.

Chart 2.15 Growth rates of monetary aggregates



2.57 Chart 2.16 shows the recent path of interest rates. Monetary conditions have tightened considerably during this year. ~~and are now consistent with the fall in inflation projected for the second half of 1989.~~

Chart 2.16 Interest rates in the UK



Fiscal developments

show both the Budget projections and latest forecasts for

2.58 Tables 2.9 to 2.11 general government expenditure and receipts and the public sector debt repayment (PSDR). The PSDR in 1987-88 was £3¾ billion, slightly higher than estimated in the 1988 FSBR.

2.59 In the first half of 1988-89 there was debt repayment of £3¾ billion, compared with public sector borrowing of about £2 billion in the first half of 1987-88. The revised forecast for 1988-89 as a whole is a PSDR of about £10 billion, £7 billion higher than forecast in the FSBR. This is due, in roughly equal amounts, to higher than expected receipts and lower than expected expenditure. Apart from higher privatisation proceeds, these revisions largely reflect the higher than expected growth of activity and prices.

stet

~~(implicitly in money terms)~~

Table 2.9 General government expenditure

	£ billion		
	1987-88	1988-89	
	Outturn	Budget Forecast	Latest Forecast
Public expenditure planning total	145.7	156.8	153.6
Interest payments	17.5	17.5	17.7
Other adjustments	8.3	8.6	9.5
General government expenditure	**171.5**	**182.9**	**180.8**
of which			
Privatisation proceeds	- 5.2	- 5.0	- 6.0

smaller
and higher

2.60 Chapter 1 gives the latest estimate for the public expenditure planning totals in 1988-89. Gross debt interest payments in 1988-89 are a little higher than forecast at Budget time ~~and~~ than in 1987-88. The move from borrowing to net debt repayment has not yet affected interest payments fully. Moreover, against the background of the rise in the foreign exchange reserves the reduction in net interest payments resulting from net debt repayment by general government has come through initially as higher interest receipts rather than lower payments. The upward revision to the forecast of other adjustments largely reflects a change in the composition of public corporations' net financing which increases GGE but does not affect the PSDR.

interesting
but could do
with shortening

2.61 The forecast for general government receipts has been revised up by £4 billion since the Budget, most of which is accounted for by higher taxes and national insurance contributions. Income tax and VAT receipts are expected to be £1 billion and £1¼ billion higher respectively than in the Budget forecast. Other significant increases come from national insurance contributions (up £¾ billion), and stamp duty (up nearly £½ billion). The latter mainly reflects the buoyancy of the housing market. Total taxes and national insurance contributions are expected to be somewhat lower in 1988-89 as a percentage of money GDP, than in 1987-88.

2.62 Gross interest and dividend receipts are forecast to be £¼ billion higher in 1988-89 than in 1987-88. Within this, dividends are about £¼ billion lower due to the sale of the government's remaining BP shares, and interest receipts £½ billion higher. General government receipts in total are now forecast to increase by just under 9 per cent in 1988-89, much the same rate of increase as in 1987-88.

Table 2.10 General government receipts

	£ billion		
	1987-88	1988-89	
	Outturn	Budget Forecast	Latest Forecast
Taxes on income, expenditure and capital	132.7	141.2	144.0
National insurance and other contributions	28.9	31.6	32.4
Interest and dividends	6.0	5.6	6.3
Other receipts	5.9	6.4	6.3
Total receipts	**173.6**	**184.9**	**189.0**
of which North Sea revenues	4.7	3.3	3.4

2.63 Table 2.11 shows the old and new forecasts for the PSDR. The forecast is still subject to a ~~great degree of uncertainty.~~ wide margin of error: the average error on PSDR forecasts for the current financial year made in the autumn is ½ per cent of GDP, or nearly £3 billion. On the basis of this forecast, the budget surplus in 1988-89 will be larger as a proportion of money GDP than in any year since the beginning of the 1950s~~, when the present series began~~.

?

figures were first collected on this basis

Table 2.11 Public sector debt repayment

	£ billion		
	1987-88	1988-89	
	Outturn	Budget Forecast	Latest Forecast
General government expenditure	171.5	182.9	180.8
General government receipts	173.6	184.9	189.0
General government debt repayment	2.1	2.0	8.2
Public corporations' market and overseas debt repayment	1.6	1.2	2.0
PSDR	**3.7**	**3.2**	**10.2**
PSDR as per cent of GDP	**¾**	**¾**	**2¼**
PSDR excluding privatisation proceeds as per cent of GDP	- ¼	- ½	1

Chart 2.17 Public sector borrowing requirement

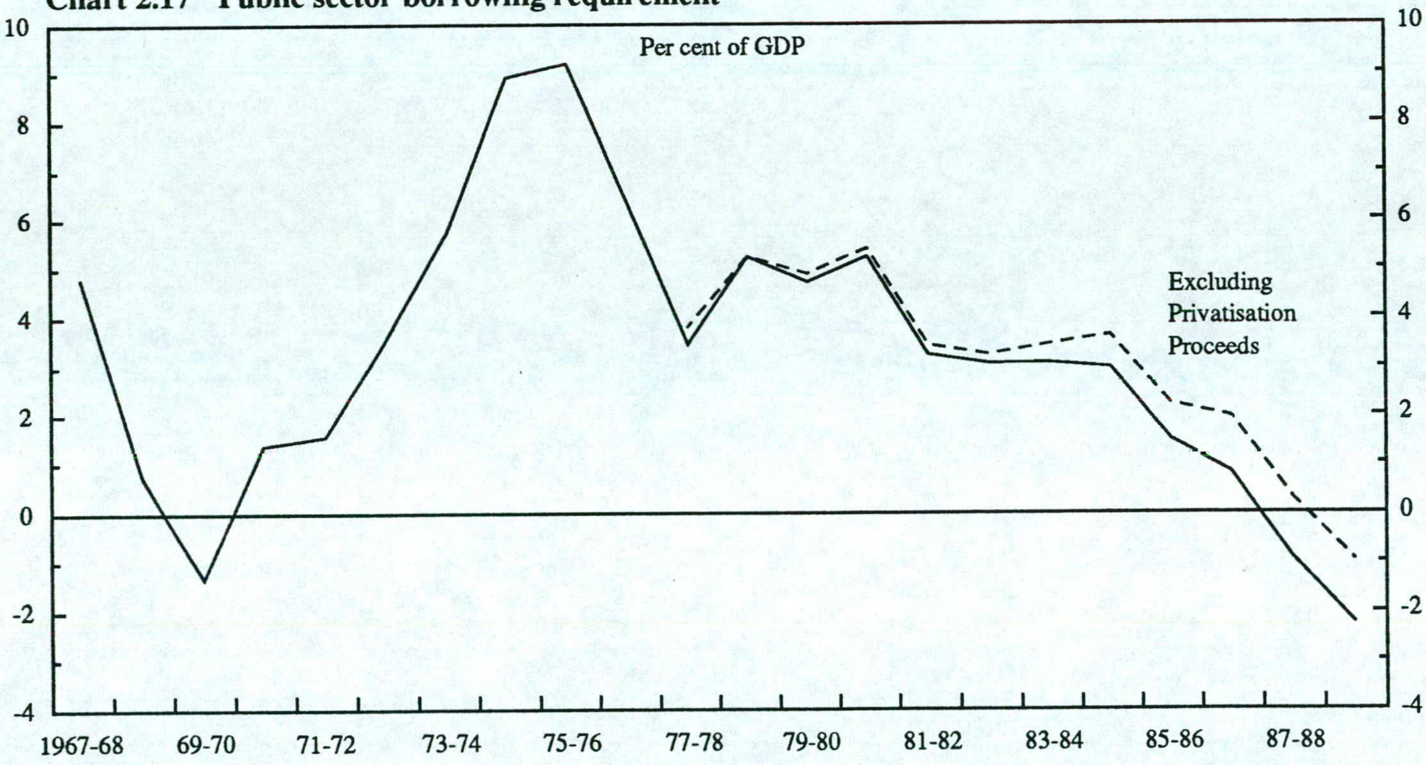


Table 2.12

Economic Prospects: summary

Percent changes on a year earlier unless otherwise stated

	1987	Forecast 1988	1989	Average errors from past forecasts[1]
GDP and domestic demand at constant prices				
Domestic demand	4½	6	3	1
of which:				
Consumers' expenditure	5	5½	3½	1¼
General government consumption	1	½	- ½	¾
Fixed investment	5½	12	5½	2¼
Change in stockbuilding (as a percentage of GDP)	0	0	0	¾
Exports of goods and services	5½	1½	5½	2¼
Imports of goods and services	7½	12	4½	2¾
Gross domestic product	4	4½	3	¾
Manufacturing output	6	7	4½	2
Balance of payments current account (£ billion)	- 2½	-13	-11	4¼
Inflation				
Retail price index (Q4 on Q4)	4	6¼	5	1¾
GDP deflator at market prices (financial year)	5¼	6¼	5	1¾
Money GDP at market prices (financial year)	10	11	8	1¾
£ billion	424	471	510	
PSDR (financial year) £ billion	3½	10		3
as a percent of GDP	¾	2¼		½

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

TABLE : 2.13 GROSS DOMESTIC PRODUCT AND ITS COMPONENTS

£billion at 1985 prices, seasonally adjusted

	Consumers' expendi- ture	General Government consumption	Total fixed investment	Exports of goods and services	Change in stocks	**Total final expenditure**	Less imports of goods and services	Less adjustment to factor cost	Plus statistical adjustment	**GDP at factor cost (average measure)**	GDP index (average measure) 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	215.3	74.0	60.3	102.8	0.6	452.9	99.2	49.5	0.5	304.7	100.0
1986	226.8	75.4	60.8	106.6	0.6	470.3	105.6	51.8	1.1	314.0	103.0
1987	238.5	76.0	64.2	112.5	0.6	491.8	113.3	54.5	3.1	327.1	107.4
1988	251.9	76.4	72.0	114.3	1.0	515.9	126.8	57.0	9.1	341.2	112.0
1989	260.9	75.9	76.0	120.8	0.6	534.4	132.4	59.3	9.7	352.3	115.6
1987H1	117.0	37.8	31.2	55.5	-0.2	241.4	53.9	26.7	0.9	161.6	106.1
H2	121.4	38.3	32.9	57.1	0.7	250.4	59.4	27.8	2.3	165.5	108.7
1988H1	124.2	38.0	34.2	56.0	0.5	253.0	60.9	27.8	4.1	168.5	110.6
H2	127.8	38.4	37.8	58.3	0.5	262.9	65.9	29.2	5.0	172.7	113.4
1989H1	129.7	37.9	37.8	59.8	0.3	265.6	65.5	29.5	4.7	175.3	115.0
H2	131.2	38.1	38.2	61.0	0.3	268.8	66.9	29.8	5.0	177.0	116.2
Per cent changes 2											
1986 to 1987	5	1	5½	5½	0	4½	7½	5	½	4	4
1987 to 1988	5½	½	12	1½	0	5	12	4½	2	4½	4½
1988 to 1989	3½	- ½	5½	5½	0	3½	4½	4	0	3	3

1 The average GDP figures are averages of constant price output, expenditure and income estimates of GDP. In the year to 1988H1, the expenditure measure grew by 2½ per cent compared with 4½ per cent growth for the income measure and 6 per cent for the output measure. It is likely that the expenditure measure and, consequently, the average both understate recent growth. Percentage changes are calculated from unrounded levels and then rounded to the nearest half per cent. Figures for 1988H2 and beyond are forecasts.

2 Changes as a percentage of GDP for stockbuilding and statistical adjustment

gus.5 25.10

-yes-

SECRET AND PERSONAL

OK £13/11?

AA

On grounds of caution I would be tempted to go for £13½ bn but £13 bn is certainly realistic in the light of the Sept figures.

TB

FROM: GUS O'DONNELL

DATE: 25 OCTOBER 1988

1. SIR T BURNS

2. CHANCELLOR

cc Chief Secretary
Sir P Middleton
Mr P Sedgwick
Mr Hibberd
Ms Turk

CURRENT ACCOUNT FORECAST IN THE AUTUMN STATEMENT

You might want to consult the numbers shown below when considering the forecast for the current account deficit in 1988. (These calculations include the September trade figures, so this note is not being circulated to all recipients of the draft chapter 2 of the Autumn Statement.)

2. The current account deficit in the first three quarters of the year has amounted to £9.78 billion (although the invisibles data are subject to considerable revisions). The tables below show, respectively, the monthly rate required in the fourth quarter to achieve various annual totals and the average monthly deficits over recent periods.

Table 1: **<u>Monthly Rate Required to Achieve 1988 total of</u>:**

(£billion)

Annual Total:	13.0	13.5	14.0
Required monthly rate in Q4	1.07	1.24	1.41

Table 2: **<u>Average Monthly deficits over last</u>:**

(£billion)

	3 months	6 months	9 months	12 months
Monthly Average	1.34	1.16	1.09	0.97

505/10/88

3. We revised our 1988 forecast down from £14 billion to £13 billion after obtaining the September figures. Our original forecast was constructed as follows: the deficit to August was £9.2 billion and we assumed a monthly average deficit of £1.15 billion for the next four months, taking the total for the year to £13.8 billion, which was rounded up to £14 billion. Now we know that the deficit to September is £9.8 billion. If we kept our previous assumption of £1.15 billion per month we would obtain a deficit of £13.2 billion which we would round down to £13 billion. In the light of the September figures we are inclined to lower slightly our forecast of the monthly average for the remaining three months and £13.0 billion is now our central forecast.

Gus O'Donnell

A O'DONNELL

CONFIDENTIAL

FROM: J GIEVE
DATE: 25 October 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Turnbull
Mr Sedgwick
Mr Pickford
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Bush
Mr Dyer

a
(discuss with CST?)

For CST
5/2

AA

AUTUMN STATEMENT: PRESS AND BROADCASTS

Although we cannot firm up the arrangements until after Cabinet on Tuesday, we need to make a provisional plan for press briefings and interviews. In general, I think we should try to field Ministers for as many TV and radio programmes as we can. As usual this will make Tuesday afternoon a bit of a scramble but if we can avoid Ten minute Rule Bills and PNQs the schedule should be possible.

Ten minute Rule Bill

2. I understand that John Brown(e?) MP has a Ten minute Rule Bill scheduled for Tuesday. This concerns an amendment to the Trades Description Act. I understand from Parliamentary Branch that if he were to withdraw the Bill in the last 24 hours (ie after 3.30pm on Monday) it would be too late for an alternative to be tabled. Given the very tight time constraints, I think it would be helpful if he could be persuaded to withdraw.

(Word @ Prayers?)

3. If Mr Brown does agree to withdraw, and there are no PNQs or other major disasters which require a statement by the Prime Minister or the Foreign Secretary, you should start your Oral Statement at 3.30pm. It seems unwise to rely on your sitting down until 4.30pm (or close to 5pm if the Ten minute Rule Bill goes ahead).

Schedule for Tuesday

4. I suggest that you should record interviews for the TV channels and the Chief Secretary should cover Newsnight and the radio. As in previous years, I think it would be sensible for the economic correspondents to have a briefing from Sir T Burns and Mr Anson (supported by Mr Sedgwick and Mr Turnbull). I take it that you will also wish to see the Lobby and the Conservative Backbenchers. This would give the following timetable:

	3.30 - 4.30	Oral statement
e	4.30 - 5.00	Chancellor interviews with BBC TV news and ITN/ Channel 4.
		Chief Secretary interviews with Radio 4 and IRN.
		Sir T Burns, Mr Anson, Mr Sedgwick, Mr Turnbull, Mr Gieve background briefing for economic correspondents (HMT).
	5.30	Chancellor & CST to Lobby
f	6.15	Chancellor and Chief Secretary to see Conservative Backbenchers.
	Evening	Chief Secretary to Newsnight.

We will try to ensure that your interviews are done face-to-face rather than down the line. I would welcome the Chief Secretary's views on the format for the Newsnight interview. Would he prefer a separate interview at the end of the contributions from Gordon Brown (and possibly the Democrats), or would he prefer a three-cornered discussion. It seems likely that the interviews or discussion will follow a piece by Daniel Jeffreys and we can only hope that it is less tendentious than some Newsnight pieces in the past.

5. In addition to these interviews and briefings, we will discuss with the BBC and IRN the possibility of broadcasting the oral statement itself, we will distribute copies of the press releases and the oral statement to journalists and we will try to arrange with the wire services a page by page release of the typescript (so as to ensure that they get the words right on their stories). In addition, we plan to use the Treasury pages on Reuters and Telerate to put out a simple summary of the main points from your statement. I attach an illustration of what this would look like based on last year's Autumn Statement. The function of this is to reach quickly the City and ensure that their initial comments are based on our selection of main points.

Wednesday

6. I suggest the following programme:

	7.00 - 9.00 ? 8.00	Chancellor in radio cars in Downing Street	Today programme IRN breakfast programme
		Chief Secretary	BBC Breakfast Time
		Financial Secretary or Economic Secratary	TV AM
9	11.00am (approx)	Chancellor	Jimmy Young programme
		Mr Gieve & Mr Bush	Briefing for Foreign Financial journalists group
	12.00 (approx)	Economic Secretary	Business Daily (ITV)
??	other	Chancellor	Phone calls to editors of Economist and Spectator

? is this likely to be worth it

Other Briefing

7. Depending on the reaction to the Statement (and the number of articles on the Wednesday morning), it may be worth your or the Chief Secretary speaking to some political columnists on Wednesday and Thursday. This may be particularly valuable for the Sunday papers - eg Bruce Anderson and Michael Jones. It may also be worth having a word with, say, Peter Jenkins. I will try to have a word with Christopher Monckton on Tuesday evening to influence the Evening Standard editorial.

8. Looking at the media, you have agreed to do Panorama which will now appear live on Monday, 7 November. We may also get bids from the City Programme (Thames Television, Thursday evening), the Business Programme, the Money Programme, and On the Record (all Sunday). While we do not want major interviews for any of these, it may be sensible for the Financial Secretary or the Economic Secretary to appear in shorter pieces in order to ensure that the Government view is expressed. Finally, we may get bids from the satellite and cable services from Europe. We can deal with these as they arise.

9. In the past you have done a major interview with the Financial Times after the Autumn Statement. No doubt other papers would also welcome an interview. My inclination is to wait and see who asks and to think in terms of an article after Panorama. We may also able to place a signed article by you in one of the Sunday papers perhaps the Sunday Express or Mail on Sunday.

S. Exp.

10. I would welcome your comments.

JGL Gieve

JOHN GIEVE

aut st

MAIN POINTS FROM CHANCELLOR'S STATEMENT

Outturn for 1987-88

Public expenditure planning total forecast to be £147½ billion, £1 billion less than in last public expenditure White Paper, mainly due to higher capital receipts by local authorities and new towns.

Total tax revenues likely to exceed Budget forecast by almost £2½ billion. Reflects economic growth, profitability, and oil price above forecast.

PSBR to be only £1 billion - ¼ per cent of GDP. Even excluding privatisation proceeds, lowest PSBR for 17 years.

Public expenditure 1989-90 - 1991-92

Since 1982-83 longest sustained fall in public expenditure as a proportion of national income since the early 1950s.

New planning totals have been set at £156 3/4 billion for 1988-89 and £167 billion for 1989-90 - increases of £2½ billion and £5½ billion respectively over totals previously published.

For 1990-91 the planning total has been set at £176 billion. Prudent to set aside larger reserves within the planning totals than previously: £3½ billion in 1988-89; £7 billion in 1989-90; £10½ billion.

Privatisation proceeds planned to be £5 billion per year.

Excluding privatisation proceeds public spending's share of national income has fallen from nearly 47 per cent in 1982-83, to around 42½ per cent in 1987-88. By 1990-91 it will be down to 41¼ per cent, the lowest since 1972-73.

Real growth of public spending planned to be around 1¼ per cent a year, well within the prospective growth of the economy as a whole.

Steady economic growth and reduced burden of debt interest enable provision of additional resources for priority services: health, law and order, and education.

National insurance contributions: minor changes to earnings bands. In addition, Treasury supplement (taxpayers' contributions) reduced from 7 per cent to 5 per cent. Does not require any change in contribution rates which once again remain unchanged.

Industry Act forecast

Growth this year likely to be 4 per cent, compared with the 3 per cent growth forecast at Budget time. Strong growth in domestic demand more than matched by the rapid rise in exports. Manufacturing industry doing particularly well.

Inflation in 1987 Q4 likely to be 4 per cent. No need to amend current account deficit of some £2½ billion.

Forecast takes into account the likely implications of the recent falls in world stock markets. Economic forecasting more than usually hazardous. Strength of British economy and of public finances puts us in the best possible position to weather any storm.

Economy forecast to grow next year by around 2½ per cent. 3 per cent growth for the non-North sea economy as a whole. Business investment likely to be particularly strong, rising by 5½ per cent.

Further small increase in the current account deficit, to about £3½ billion, or 3/4 per cent of GDP.

Inflation may rise a little next year, reaching 4½ per cent in the fourth quarter. Defeat of inflation remains at the heart of the Government's economic strategy.

Unemployment should continue to fall.

Pup

FROM : MISS J C SIMPSON
DATE : 26 OCTOBER 1988

PS/CHANCELLOR

Ch
OK?
AA

OK as ...

cc PS/CST
PS/FST
PS/PMG
Mr Turnbull
Mr Sedgwick
Mr Odling-Smee
Mr Gieve
Mr Dyer

DATE OF THE AUTUMN STATEMENT : LINE TO TAKE FOR PRIME MINISTER AND LORD PRESIDENT

It was agreed at the Chancellor's meeting on Monday that we should provide a line to take for the Prime Minister and the Lord President to use in response to the question "When is the Autumn Statement".

2. The Chancellor will be answering the first question on the order paper for Oral Questions with the reply "I will, as usual, be publishing a new forecast in the Autumn Statement next month" (copy attached). We propose that both the Prime Minister and the Lord President, if after this they are still asked, should simply refer back to the Chancellor's reply.

3. I attach a line to take on this basis.

JS.

MISS J C SIMPSON

Please type this & note below

DATE OF THE AUTUMN STATEMENT

It is possible that the Prime Minister may be asked during Questions on 27 October when the Autumn Statement is likely to be. The Chancellor will be answering Oral Questions that day and there are a number of questions which ask him for his latest forecast of various economic variables. In response, he will make a reference to "publishing a new forecast in the Autumn Statement next month".

Line to take

If, after this, the Prime Minister is still asked the question, we suggest she should reply

> "As my RHF the Chancellor has just made clear, the Autumn Statement will be ~~sometime~~ next month."
>
> ~~in the first half of November~~

published

DATE OF THE AUTUMN STATEMENT

It is possible that the Lord President may be asked during Business Questions on 27 October when the Autumn Statement is likely to be. The Chancellor will be answering Oral Questions that day and there are a number of questions which ask him for his latest forecast of various economic variables. In response, he will make a reference to "publishing a new forecast in the Autumn Statement next month".

<u>Line to take</u>

If, after this, the Lord President is still asked the question, we suggest he should reply

> "As my RHF the Chancellor has just made clear, the Autumn Statement will be [~~sometime~~ next month]."

~~in the first half of November.~~

Published

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ORAL

THURSDAY 27 OCTOBER 1988

TREASURY

La - Cardiff South and Penarth

* **MR ALUN MICHAEL :** To ask Mr Chancellor of the Exchequer, what is his latest estimate of the outturn of the balance of payments position at the end of the current financial year.

MR NIGEL LAWSON

I will, as usual, be publishing a new forecast in the Autumn Statement next month.

CONFIDENTIAL

FROM: A TURNBULL
DATE: 26 OCTOBER 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Phillips
Mr Odling-Smee
Mr Sedgwick
Mr Gieve
Mr Pickford
Mr MacAuslan
Mrs Butler
Mr Richardson
Miss Walker
Miss Simpson
Mr Woolf

[Mr Gieve rings to say he is very pro publishing as many tables as possible on OS day - MPW]

a OK? AA

OK except for no 2 tables @ X, wh. sh'd be held back as offering the TCSC.

AUTUMN STATEMENT: PUBLIC EXPENDITURE PRESS NOTICE

When you last presented your Oral Statement on the day of Cabinet, the Treasury issued two Press Notices. One provided more or less the full text of the Industry Act Forecast, the other on expenditure gave just two tables - the main table showing levels and changes by department plus the nationalised industry EFLs. We were very conscious that we had very little time after Cabinet and that if any changes had to be made to the figures we wanted to minimise the material to be revised to a minimum. We also wanted to keep the volume of material to be copied and distributed.

2. Having handled the situation in 1986 successfully we feel a bit more confident that we could cope with a larger Press Notice. Not only will this get more information into the public domain and aid the presentation effort but it will also reduce the extent to which the printed document has anything new so that it can be published in an entirely routine way.

3. We therefore suggest publishing the following material:

i. Public expenditure by department - levels and changes. This is the main table in Chapter 1.

ii. The three supporting tables showing expenditure by

- central government
- local authorities
- public corporations.

iii. The 1989-90 EFLs for the nationalised industries.

iv. The 'triangle tables" comparing plans and outturns for

- GGE/GDP ratios
- planning total

v. A time series going back to 1963-64 for GGE, money GDP and the GDP deflator. This will enable us to substantiate the claim of the "lowest ratio for 20 years".

vi. Public spending by department in cash and real terms.

vii. A chart showing the GGE/GDP ratios back to 1963-64.

Examples of the material, **with near but not absolutely final figures**, are attached.

4. We do not see the need for any text summarising the main points as all the relevant information will be in the text of the Oral Statement which will be "published" at the same time. As suggested by the Chief Secretary, we propose including a paragraph on the changes in the presentation of public spending plans so that readers know what sort of Autumn Statement to expect when it appears.

5. If disaster were to strike, and significant reworking of the figures were required after the Cabinet discussion, it might not be possible to see the changes through to all the above tables. We could then fall back on the main table, (i) above, and the nationalised industry EFLs, (iii) above, as was done in 1986.

6. We would be grateful to know if you are content with these proposals.

AT

A TURNBULL

PressNot

1 November 1988

AUTUMN STATEMENT

PUBLIC EXPENDITURE PLANS

This Press Notice provides details of the Government's public expenditure plans announced by the Chancellor of the Exchequer to the House of Commons today. The information in the attached tables and chart will appear in the printed Autumn Statement which will be published on Tuesday 8 November.

As indicated in the White Paper on "Financial Reporting to Parliament" (Cm 375) the section on public spending in the printed Autumn Statement will be expanded so that it includes nearly all the information ~~on the general picture~~ previously found in Chapter 1 of the Public Expenditure White Paper. The role of the White Paper, which will appear early in the New Year, will be principally to spell out the details of individual departmental programmes. The individual chapters will be bound separately rather than published as one large volume covering all departments. This will ~~not only~~ provide a stepping stone to the eventual production of departmental reports to replace the White paper, a development which a number of Select Committees have promoted; ~~but~~ it will also enable those whose interest is confined to a particular department to obtain only that chapter.

Press Office
HM Treasury
Parliament Street
London SW1P 3AG

01-270 5238

omit table nos?

Table 1.1 General government expenditure, excluding privatisation proceeds, as a percentage of GDP; plans and outturn

per cent

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
March 1984 FSBR (1)	46	45	44	43					
March 1985 FSBR (1)	46	46¼	45¾	44	43				
January 1986 PEWP (Cmnd 9702)	46¼	46¼	45	44	43	42¼			
January 1987 PEWP (Cm 56)	46¼	46¼	44¾	44½	44	42¾	42¼		
January 1988 PEWP (Cm 288)	46	46¼	44½	44	42½	42	41¾	41¼	
This Autumn Statement	45¾	46¼	44½	43¾	41½	39½	39	38¾	38¾

Key: ------ plans; ______ outturn and estimated outturn

(1) Financial Statement and Budget Report.

OMIT

Table 1.3 Public expenditure planning total(1); plans and outturn

---------- plans

——— outturn and estimated outturn

	£ billion								
	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
March 1982 White Paper (Cmnd 8494) (2)	120.8	127.8							
February 1983 White Paper (Cmnd 8789)	119.7	126.6	132.4						
February 1984 White Paper (Cmnd 9143)	120.5	126.6	132.2	136.8					
January 1985 White Paper (Cmnd 9428)	120.4	128.3	132.2	136.9	141.7				
January 1986 White Paper (Cmnd 9702) (2)	120.4	129.7	134.3	139.2	144.0	148.8			
January 1987 White Paper (Cm 56)	120.4	129.9	133.7	140.5	148.7	154.3	161.5		
Jan 1988 White Paper (Cm 288)	120.4	129.9	133.8	139.3	147.4	156.9	167.1	176.1	
This Autumn Statement	120.4	129.9	133.8	139.3	145.7	153.6	167.1	179.5	191.7

(1) Public expenditure planning total on current definitions.
(2) Including changes announced in the March Budget Statement.

TABLE 1.4: PUBLIC EXPENDITURE (1)

£ million

	Latest estimates of outturn			New plans			Changes from January 1988 White Paper (2)		
	1987-88 OUTTURN	1988-89 ESTIMATED OUTTURN	CHANGE 1987-88 TO 1988-89	1989-90 PLANS	1990-91 PLANS	1991-92 PLANS	1988-89	1989-90	1990-91
Ministry of Defence	18,862.2	19,300.0	437.8	20,098.2	21,138.8	22,042.8	79.0	129.8	564.2
FCO - Diplomatic wing	659.8	751.0	91.2	767.6	808.0	849.5	27.0	26.0	48.1
FCO - Overseas Development Administration	1,303.2	1,490.0	186.8	1,538.4	1,626.7	1,691.4	58.0	33.4	75.5
European Communities	1,663.8	950.0	-713.8	1,969.7	1,949.7	1,582.6	150.0	500.0	630.0
Ministry of Agriculture, Fisheries and Food (3)	1,976.2	1,863.0	-113.2	1,946.7	2,156.4	2,352.1	-349.0	-381.3	-340.7
Department of Trade and Industry	728.0	1,705.0	977.0	1,363.8	1,341.6	1,169.0	455.0	164.3	195.3
Export Credits Guarantee Department	150.8	90.0	-60.8	135.4	99.6	59.5	-41.0	6.8	3.6
Department of Energy	218.3	215.0	-3.3	-245.5	-511.8	624.4	95.0	-63.2	-99.4
Department of Employment	3,914.7	4,125.0	210.3	4,093.1	4,053.2	4,061.9	-117.0	-198.0	-297.0
Department of Transport	4,586.1	4,813.0	226.9	5,357.6	5,540.2	5,656.2	-334.0	242.7	328.5
DOE - Housing	2,697.1	2,053.0	-644.1	1,685.7	2,026.7	2,382.1	-968.0	-1,319.7	-1,018.8
DOE - other environmental services	3,640.0	4,385.0	745.0	4,475.8	4,541.9	4,680.9	525.0	478.4	438.4
Home Office	5,701.9	6,279.0	577.1	6,876.5	7,199.2	7,366.7	227.0	588.1	730.9
Legal departments (4)	793.3	955.0	161.7	1,079.0	1,168.6	1,240.7	-19.0	33.5	61.3
Department of Education and Science	17,081.1	18,440.0	1,358.9	19,570.5	20,239.2	20,773.9	469.0	866.4	998.0
Office of Arts and Libraries	888.8	981.0	92.2	976.0	1,008.4	1,054.7	68.0	27.1	27.6
Department of Health	19,715.7	21,738.0	2,022.3	23,155.0	24,378.6	25,387.6	1,055.0	1,455.0	1,699.0
Department of Social Security	46,249.3	47,601.0	1,351.7	50,970.0	55,241.8	58,645.5	-859.0	-120.9	1,687.5
Scotland	8,087.0	8,720.0	633.0	8,994.5	9,192.5	9,725.4	214.0	381.5	414.5
Wales	3,330.3	3,596.0	265.7	3,803.6	3,921.7	4,047.9	145.0	252.8	260.0
Northern Ireland	4,925.9	5,165.0	239.1	5,455.6	5,659.2	5,858.1	21.0	132.6	151.4
Chancellor's departments	3,431.5	3,668.0	236.5	4,084.0	4,284.3	4,493.0	-128.0	34.8	90.3
Other departments	295.8	362.0	66.2	301.0	325.2	329.1	104.0	68.2	73.9
Reserve		0.0	0.0	3,500.0	7,000.0	10,500.0	-3,500.0	-3,500.0	-3,500.0
Privatisation proceeds	-5,160.5	-6,000.0	-839.5	-5,000.0	-5,000.0	-5,000.0	-1,000.0	0.0	0.0
Adjustment (5)		321.0	321.0	0.0	0.0	0.0	321.0		
PLANNING TOTAL	145,740.3	153,566.0	7,825.7	166,952.2	179,389.7	191,575.0	-3,302.0	-161.7	3,222.1
General government gross debt interest		17,600.0		17,100.0	16,000.0	15,800.0			
Other national accounts adjustments		9,400.0	1,100.0	9,300.0	9,200.0	8,700.0	1,300.0		
GENERAL GOVERNMENT EXPENDITURE				193,352.2	204,589.7	216,075.0			

(1) The rounding and other conventions used in this table and Tables 1.7, 1.8 and 1.9 are as follows: plan figures are rounded to the nearest £10 million except for social security (in this table and Table 1.7), the planning and spending authority totals (except public corporations) and general government expenditure which are rounded to the nearest £100 million. In the case of general government expenditure, this does not imply accuracy to this degree. Debt interest and other national accounts adjustments are rounded to the nearest £500 million. Outturn figures for 1988-89 have also been rounded to reflect their provisional nature. The changes and totals are based on the unrounded figures, and may therefore differ from the changes and sums of the rounded figures. In this and Tables 1.7, 1.8 and 1.9 some figures may be subject to detailed technical amendment before the publication of the 1989 public expenditure White Paper.

(2) Plans as set out in the last public expenditure White Paper (Cm 288) adjusted for minor changes of classification and allocation.

(3) Includes Intervention Board for Agricultural Produce and Forestry Commission.

(4) Legal departments comprise: the Lord Chancellor's Department, the Northern Ireland Court Service, the Crown Prosecution Service, the Serious Fraud Office and the Crown Office.

(5) An adjustment for the difference between the assessment of the likeikely outturn for 1988-89 and the sum of the other items shown.

CONFIDENTIAL

Table 1.5

EXTERNAL FINANCING LIMITS FOR THE NATIONALISED INDUSTRIES 1989-90

	£million[1]
British Coal	560
British Railways Board	440
British Shipbuilders	-1
British Waterways Board	48
Civil Aviation Authority	47
Electricity (England and Wales)	-1300
Electricity (Scotland)[2]	-60
London Regional Transport	287
Post Office	-91
Scottish Transport Group	-5
Water (England and Wales)[3]	40
TOTAL	-34

1 Figures are shown rounded to the nearest £1 million.

2 From April 1989, the Scottish Electricity Boards will enter a revised trading relationship in preparation for privatisation. Separate EFLs for the two Boards will be determined when the new arrangements are established.

3 Allowance for external financing for the Regional Water Authorities. Figures will depend on the actual timing of the establishment of the National Rivers Authority (see paragraph 1.36) and privatisation during 1989-90.

TABLE 1.7: CENTRAL GOVERNMENT SPENDING (1)

	Latest estimates of outturn			New plans			Change from January 1988 White Paper(1)		
	1987-88 OUTTURN	1988-89 ESTIMATED OUTTURN	CHANGE 1987-88 TO 1988-89	1989-90 PLANS	1990-91 PLANS	1991-92 PLANS	1988-89	1989-90	1990-91
Ministry of Defence	18,862.2	19,300.0	437.8	20,098.2	21,138.8	22,042.8	79.0	129.8	564.2
FCO - Diplomatic wing	659.8	751.0	91.2	767.6	808.0	849.5	27.0	26.0	48.1
FCO - Overseas Development Administration	1,303.8	1,447.0	143.2	1,509.7	1,599.2	1,663.2	45.0	33.4	75.5
European Communities	1,663.8	950.0	-713.8	1,969.7	1,949.7	1,582.6	150.0	500.0	630.0
Ministry of Agriculture, Fisheries and Food	1,795.3	1,654.0	-141.3	1,707.0	1,909.7	2,093.3	-339.0	-397.9	-359.1
Department of Trade and Industry	899.6	1,821.0	921.4	1,333.9	1,281.9	1,133.4	557.0	73.5	81.2
Export Credits Guarantee Department	150.8	90.0	-61.0	135.4	99.6	59.5	-41.0	6.8	3.6
Department of Energy	565.0	527.0	-38.0	493.4	412.3	357.7	15.0	31.8	-22.4
Department of Employment	3,782.9	3,986.0	203.1	3,953.6	3,908.9	3,914.1	-125.0	-200.0	-300.0
Department of Transport	1,373.3	1,430.0	56.7	1,781.9	1,884.7	1,944.6	-27.0	289.2	350.9
DOE - Housing	1,301.1	1,385.0	83.9	1,381.0	1,624.2	1,919.2	65.0	-1.7	156.2
DOE - other environmental services	467.5	506.0	38.5	646.0	667.5	670.1	18.0	188.5	196.3
Home Office	991.9	1,148.0	156.1	1,434.0	1,568.4	1,562.6	32.0	257.6	366.3
Legal departments	793.3	955.0	161.7	1,079.0	1,168.6	1,240.7	-19.0	33.5	61.3
Department of Education and Science	2,693.7	2,970.0	276.3	4,279.1	4,399.8	4,463.1	31.0	268.7	282.0
Office of Arts and Libraries	368.9	420.0	51.1	438.9	452.9	482.9	3.0	4.1	1.6
Department of Health	16,653.8	18,385.0	1,731.2	19,721.3	20,825.8	21,728.7	836.0	1,247.0	1,468.0
Department of Social Security	42,522.2	43,628.0	1,105.8	46,335.3	50,164.0	53,180.9	-824.0	-508.6	1,098.9
Scotland (2)	3,458.6	3,805.0	346.4	3,826.0	4,053.3	4,209.9	111.0	100.1	185.0
Wales (2)	1,538.7	1,714.0	175.3	1,858.4	1,928.9	1,991.0	49.0	141.0	150.2
Northern Ireland (2)	3,799.4	4,061.0	261.6	4,282.3	4,461.0	4,626.0	63.0	106.3	119.8
Chancellor's departments	3,438.4	3,673.0	234.6	4,090.9	4,290.2	4,498.9	-130.0	34.8	90.3
Other departments	295.8	362.0	66.2	301.0	325.2	329.1	105.0	68.2	73.9
TOTAL	109,379.8	114,968.0	5,588.0	123,423.6	130,922.6	136,543.8	681.0	2,432.1	5,321.8

(1) See footnotes to Table 1.4. Figures exclude finance for public corporations.

(2) The breakdown of the Scottish, Welsh and Northern Irish figures between central government, local authorities and public corporations is based on previous patterns of expenditure and may be varied, except in the case of local authority relevant expenditure in 1989-90, where the provision for Scotland and Wales is as announced in July in the RSG settlement for that year.

£ million

TABLE 1.8: LOCAL AUTHORITY SPENDING (1)

	Latest estimates of outturn			New plans			Change from January 1988 White Paper		
	1987-88 OUTTURN	1988-89 ESTIMATED OUTTURN	CHANGE 1987-88 TO 1988-89	1989-90 PLANS	1990-91 PLANS	1991-92 PLANS	1988-89	1989-90	1990-91
Ministry of Agriculture, Fisheries and Food	179.1	189.0	9.9	220.8	226.2	233.2	-11.0	15.1	15.8
Department of Trade and Industry	86.3	96.0	9.7	104.8	107.3	109.7	5.0	10.0	10.0
Department of Employment	126.7	138.0	11.3	138.8	143.6	147.2	7.0	2.0	3.0
Department of Transport	2,530.3	2,558.0	27.7	2,750.5	2,819.2	2,904.1	-91.0	27.0	22.0
DOE - Housing	1,406.3	732.0	-674.3	313.7	381.5	393.1	-955.0	-1,226.0	-1,083.0
DOE - Other environmental services	3,229.8	3,872.0	642.2	3,746.3	3,664.5	3,776.6	500.0	285.0	119.7
Home Office	4,709.7	5,131.0	421.3	5,442.9	5,630.8	5,804.1	197.0	330.5	364.6
Department of Education and Science	14,387.4	15,470.0	1,082.6	15,291.5	15,839.4	16,310.9	438.0	597.7	716.0
Office of Arts and Libraries	519.9	561.0	41.1	537.1	555.5	571.8	64.0	23.0	26.0
Department of Health	3,049.5	3,343.0	293.5	3,433.7	3,552.8	3,658.9	219.0	208.0	231.0
Department of Social Security	3,727.1	3,973.0	245.9	4,634.7	5,077.8	5,464.6	-34.0	387.7	588.6
Scotland (2)	4,253.2	4,575.0	321.8	4,822.5	4,915.9	5,069.9	166.0	264.6	238.8
Wales (2)	1,714.0	1,780.0	66.0	1,834.8	1,892.4	1,953.6	97.0	108.4	118.5
Northern Ireland (2)	781.6	824.0	42.4	863.1	892.7	917.9	1.0	18.9	22.7
TOTAL	40,700.9	43,242.0	2,541.1	44,135.2	45,699.6	47,315.6	603.0	1,051.9	1,393.7
of which:-									
Relevant expenditure (3)	31,985.3	34,448.0	2,462.7	35,256.4	36,494.5	37,586.4	1,207.0	1,736.4	1,977.5
Other current	5,070.6	5,369.0	298.4	6,103.2	6,594.1	7,056.0	-39.0	430.2	649.1
Capital	3,644.7	3,425.0	-219.7	2,774.3	2,610.1	2,673.5	-566.0	-1,114.7	-1,232.9

(1) See footnotes to Table 1.4. Figures exclude finance to public corporations.

(2) See ~~paragraph~~ footnote 2 to table [1.7].

(3) Public expenditure relevant for Aggregate Exchequer Grant.

£ million

TABLE 1.9: PUBLIC CORPORATIONS (1) (2)

	Latest estimates of outturn			New plans			Changes from January 1988 White Paper		
	1987-88 OUTTURN	1988-89 ESTIMATED OUTTURN	CHANGE 1987-88 TO 1988-89	1989-90 PLANS	1990-91 PLANS	1991-92 PLANS	1988-89	1989-90	1990-91
				0.0	0.0	0.0			
FCO - Overseas Development Administration	-0.5	43.0	43.5	28.7	27.4	28.1	13.0	0.0	0.0
Ministry of Agriculture, Fisheries and Food	1.8	20.0	18.2	19.0	20.5	25.5	0.0	1.5	2.6
Department of Trade and Industry	-257.8	-212.0	45.8	-74.9	-47.6	-74.1	-106.0	80.8	104.1
Department of Energy	-346.8	-312.0	34.8	-738.8	-924.1	266.8	80.0	-95.0	-77.0
Department of Employment	5.2	1.0	-4.2	0.6	0.6	0.6	0.0	0.0	0.0
Department of Transport	682.5	825.0	142.5	825.2	836.3	807.5	-216.0	-73.5	-44.4
DOE - Housing	-10.4	-64.0	-53.6	-9.0	21.0	69.8	-77.0	-92.0	-92.0
DOE - Other environmental services	-57.3	7.0	64.3	83.5	209.9	234.2	7.0	4.9	122.4
Department of Health	12.4	10.0	-2.4	0.0	0.0	0.0	0.0	0.0	0.0
Scotland (3)	375.3	340.0	-35.3	346.0	223.4	445.6	-63.0	16.8	-9.3
Wales (3)	77.7	102.0	24.3	110.4	100.4	103.2	-1.0	3.4	-8.7
Northern Ireland (3)	344.9	280.0	-64.9	310.6	305.5	314.2	-43.0	7.4	8.9
Chancellor's departments	-6.9	-5.0	1.9	-6.9	-5.9	-5.9	2.0	0.0	0.0
				0.0	0.0	0.0		0.0	0.0
TOTAL (4)	820.1	1,035.0	214.9	894.4	767.4	2,215.5	-404.0	-145.7	6.6
of which:-									
Nationalised industries	267.9	396.0	128.1	-33.5	-396.1	983.8	-291.0	-0.5	-9.9
Other public corporations	552.5	639.0	86.5	927.9	1,163.7	1,231.8	-113.0	-145.2	16.5

(1) See footnotes to table 1.4.

(2) For nationalised industries and most public corporations the planning total includes their external finance. For natioralised industries' external financing limits for 1989-90, see Table 1.5.

(3) See ~~paragraph 1.~~ footnote 2 to Table 1.7

(4) For nationalised industries to be privatised, provision is included as follows: British Steel until 1988-89; Water (England and Wales) until 19 Electricity (England, Wales and Scotland) until 1990-91. Precise external financing requirements will depend on the timing of reorganisation and privatisations. Excluding these industries throughout, figures for the remaining industries are:

1,660.0	1,660.0	0.0	1,290.0	1,130.0	980.0	-30.0	-160.0	-240.0

Table 1.10 Public expenditure by department, 1978-79 to 1991-92(1)

£ billion

	1978-79 outturn	1982-83 outturn	1983-84 outturn	1984-85 outturn	1985-86 outturn	1986-87 outturn	1987-88 outturn	1988-89 estimated outturn	1989-90 plans	1990-91 plans	1991-92 plans
Ministry of Defence	7.5	14.4	15.5	17.2	18.0	18.2	18.9	19.3	20.1	21.1	22.0
FCO - Diplomatic wing	0.3	0.5	0.5	0.6	0.6	0.6	0.7	0.8	0.8	0.8	0.8
FCO - Overseas Development Administration	0.8	1.0	1.2	1.2	1.2	1.3	1.3	1.5	1.5	1.6	1.7
European Communities	0.8	0.6	0.8	1.0	0.8	1.1	1.7	1.0	2.0	1.9	1.6
Ministry of Agriculture, Fisheries and Food(2)	0.8	1.8	2.0	2.0	2.4	1.8	2.0	1.9	1.9	2.2	2.4
Department of Trade and Industry	1.8	1.9	1.5	1.6	1.5	2.1	0.7	1.7	1.4	1.3	1.2
Export Credits Guarantee Department	0.4	0.3	0.3	0.5	0.3	0.3	0.2	0.1	0.1	0.1	0.1
Department of Energy	0.6	0.9	1.1	2.6	0.7	-0.2	0.2	0.2	-0.2	-0.5	0.6
Department of Employment	1.1	2.4	2.9	3.1	3.4	3.9	3.9	4.1	4.1	4.1	4.1
Department of Transport	2.6	4.3	4.3	4.6	4.6	4.7	4.6	4.8	5.4	5.5	5.7
DOE - Housing	3.6	2.7	3.2	3.3	3.0	2.8	2.7	2.1	1.7	2.0	2.4
DOE - Other environmental services	2.3	3.6	3.8	4.0	3.9	4.0	3.6	4.4	4.5	4.5	4.7
Home Office	1.9	3.8	4.1	4.7	4.7	5.1	5.7	6.3	6.9	7.2	7.4
Legal departments(3)	0.2	0.4	0.4	0.5	0.6	0.7	0.8	1.0	1.1	1.2	1.3
Department of Education and Science	7.7	12.7	13.4	13.9	14.4	15.7	17.1	18.4	19.6	20.2	20.8
Office of Arts and Libraries	0.3	0.6	0.6	0.7	0.7	0.8	0.9	1.0	1.0	1.0	1.1
Department of Health	7.4	13.9	14.7	15.8	15.6	17.9	19.7	21.7	23.2	24.4	25.4
Department of Social Security	16.4	32.5	35.2	38.1	41.5	44.4	46.2	47.6	51.0	55.2	58.5
Scotland	3.9	6.5	6.8	7.1	7.2	7.7	8.1	8.7	9.0	9.2	9.3
Wales	1.6	2.5	2.7	2.7	2.8	3.1	3.3	3.6	3.8	3.9	4.0
Northern Ireland	2.2	3.6	3.8	4.1	4.4	4.6	4.9	5.2	5.5	5.7	5.9
Chancellor's departments	1.4	2.6	1.6	2.6	2.8	3.2	3.4	3.7	4.1	4.3	4.5
Other departments	0.4	0.6	0.9	0.2	0.2	0.2	0.3	0.4	0.3	0.3	0.3
Reserve									3.5	7.0	10.5
Privatisation proceeds		-0.5	-1.1	-2.2	-2.7	-4.5	-5.2	-6.0	-5.0	-5.0	-5.0
Adjustment(4)								0.3			
Planning total	65.7	113.6	120.4	129.9	133.8	139.3	145.7	153.6	167.1	179.5	191.7
General government gross debt interest	7.4	13.9	14.5	16.1	17.7	17.6	17.5	17.7	17.0	16.0	16 0
Other national accounts adjustments	1.8	5.2	5.5	4.7	6.7	7.5	8.2	9.4	9.0	9.0	9 0
General government expenditure	75.0	132.6	140.4	150.6	158.2	164.4	171.5	180.6	193.5	204.7	216 2
General government expenditure (excluding privatisation proceeds)	75.0	133.1	141.6	152.8	160.9	168.9	176.7	186.6	198.5	209.7	221.2
- as a percentage of GDP	43¼	46¾	45¾	46¼	44½	43¾	41½	39½	39	38¾	38¾
Money GDP	173.0	284.7	308.6	330.5	361.1	385.7	424.5	471	509	540	559

(1) See footnote (2) to Table 1.4.
(2) See footnote (4) to Table 1.4.
(3) See footnote (5) to Table 1.4.
(4) See footnote (7) to Table 1.4.

Table 1.11 Public expenditure in real terms(1) by department, 1978-79 to 1991-92(2)

	£ billion (base year 1987-88)										
	1978-79 outturn	1982-83 outturn	1983-84 outturn	1984-85 outturn	1985-86 outturn	1986-87 outturn	1987-88 outturn	1988-89 estimated outturn	1989-90 plans	1990-91 plans	199.-92 p.ans
Ministry of Defence	15.4	18.1	18.7	19.7	19.5	19.1	18.9	18.2	18.0	18.3	18.5
FCO - Diplomatic wing	0.6	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
FCO - Overseas Development Administration	1.6	1.3	1.4	1.4	1.4	1.4	1.3	1.4	1.4	1.4	1.4
European Communities	1.5	0.7	1.0	1.1	0.9	1.1	1.7	0.9	1.8	1.7	1.3
Ministry of Agriculture, Fisheries and Food(3)	1.6	2.3	2.4	2.3	2.6	1.9	2.0	1.8	1.7	1.9	2.0
Department of Trade and Industry	3.7	2.4	1.8	1.8	1.7	2.2	0.7	1.6	1.2	1.2	1.0
Export Credits Guarantee Department	0.7	0.4	0.3	0.6	0.4	0.3	0.2	0.1	0.1	0.1	0.1
Department of Energy	1.1	1.1	1.3	3.0	0.7	-0.2	0.2	0.2	-0.2	-0.4	0.5
Department of Employment	2.2	3.0	3.5	3.6	3.7	4.1	3.9	3.9	3.7	3.5	3.4
Department of Transport	5.4	5.5	5.2	5.3	5.0	4.9	4.6	4.5	4.8	4.8	4.8
DOE - Housing	7.3	3.4	3.8	3.7	3.2	3.0	2.7	1.9	1.5	1.8	2.0
DOE - Other environmental services	4.6	4.5	4.6	4.5	4.3	4.2	3.6	4.1	4.0	3.9	3.9
Home Office	3.8	4.7	5.0	5.3	5.2	5.4	5.7	5.9	6.2	6.2	6.2
Legal departments(4)	0.3	0.5	0.5	0.6	0.6	0.7	0.8	0.9	1.0	1.0	1.0
Department of Education and Science	15.9	16.0	16.2	16.0	15.7	16.5	17.1	17.4	17.5	17.5	17.5
Office of Arts and Libraries	0.7	0.8	0.8	0.8	0.8	0.9	0.9	0.9	0.9	0.9	0.9
Department of Health	15.2	17.5	17.7	18.1	18.1	18.9	19.7	20.5	20.8	21.1	21.3
Department of Social Security	33.7	40.9	42.4	43.7	45.1	46.8	46.2	44.8	45.7	47.8	49.3
Scotland	8.0	8.2	8.2	8.2	7.9	8.1	8.1	8.2	8.1	8.0	8.2
Wales	3.2	3.2	3.2	3.1	3.0	3.2	3.3	3.4	3.4	3.4	3.4
Northern Ireland	4.4	4.5	4.6	4.7	4.8	4.8	4.9	4.9	4.9	4.9	4.9
Chancellor's departments	3.0	3.3	1.9	3.0	3.1	3.3	3.4	3.5	3.7	3.7	3.8
Other departments	0.8	0.8	1.1	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Reserve									3.1	6.1	8.8
Privatisation proceeds		-0.6	-1.4	-2.5	-2.9	-4.7	-5.2	-5.6	-4.5	-4.3	-4.2
Adjustment(5)								0.3			
Planning total	134.9	143.0	145.0	148.9	145.6	146.7	145.7	144.5	149.8	155.5	151.2
General government expenditure	153.8	167.0	169.2	172.7	172.1	173.1	171.5	170.0	173.4	177.3	181.8
General government expenditure (excluding privatisation proceeds)	153.8	167.6	170.5	175.2	175.0	177.8	176.7	175.7	177.9	181.6	186.0
GDP deflator (% increase on previous year)		7.1	4.6	5.1	5.4	3.3	5.3	6¼	5	3½	3

(1) Cash figures adjusted to 1987-88 price levels by excluding the effect of general inflation as measured by the GDP deflator.
(2) See footnote (2) to Table 1.4.
(3) See footnote (4) to Table 1.4.
(4) See footnote (5) to Table 1.4.
(5) See footnote (7) to Table 1.4.

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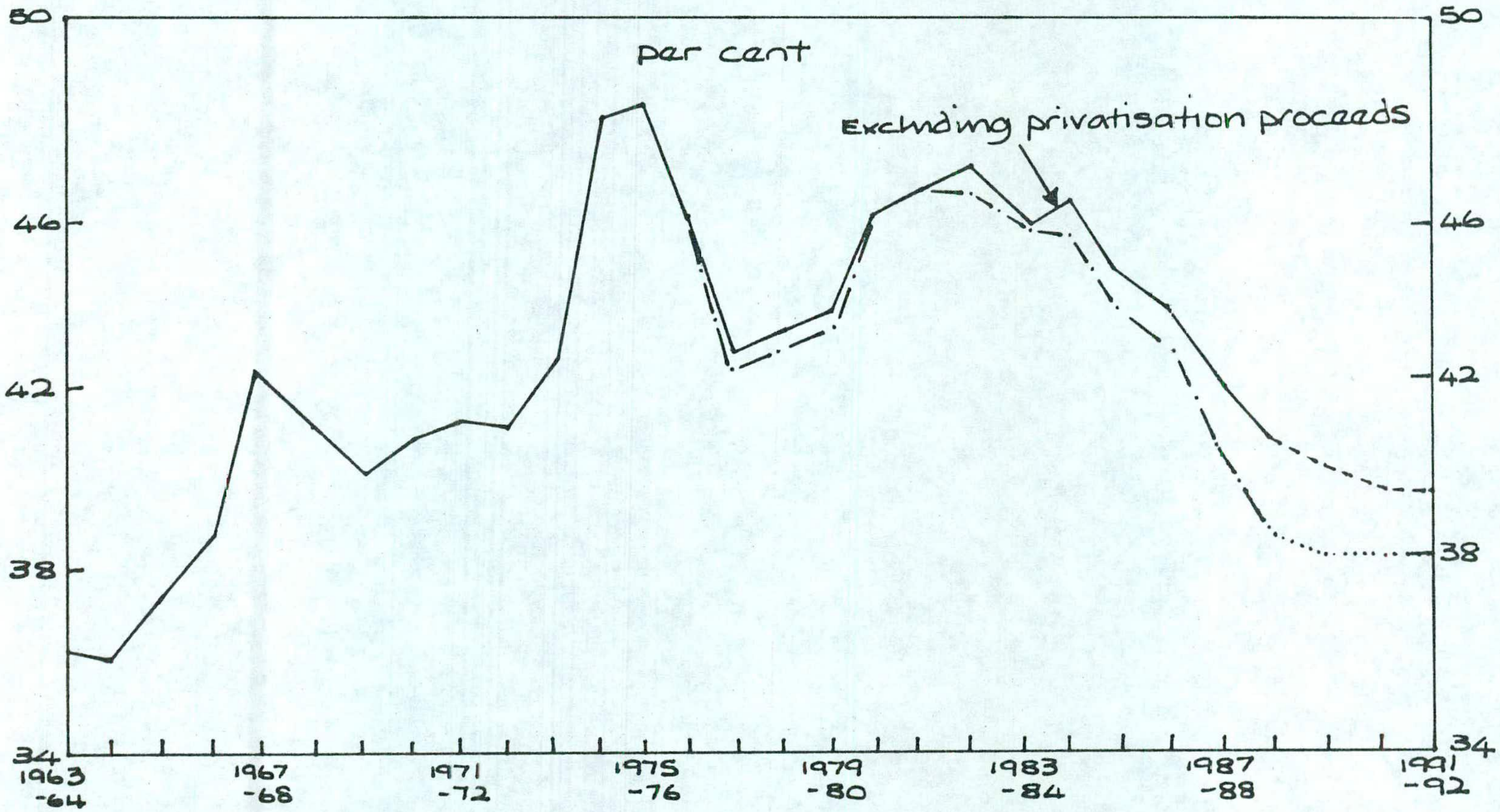
TRENDS IN PUBLIC SPENDING

	General government expenditure (excluding privatisation proceeds)				
	Cash (£ billion)	Real terms(1) (£ billion)	As a % of GDP	Money GDP (£ billion)	GDP Deflator (1987-88=100)
1963-64	11.3	92.3	36¼	31.4	12.3
1964-65	12.3	95.3	36	34.1	12.9
1965-66	13.6	96.8	37¼	36.6	14.1
1966-67	15.1	102.8	38~~¼~~¾	38.8	14.6
1967-68	17.5	115.5	42¼	41.2	15.1
1968-69	18.2	115.2	41	44.6	15.8
1969-70	19.3	115.6	40¼	48.0	16.7
1970-71	21.6	119.8	40¾	53.1	18.0
1971-72	24.4	123.3	41¼	59.2	19.8
1972-73	27.6	129.9	41	67.5	21.3
1973-74	32.0	140.5	42¾	74.8	22.8
1974-75	42.9	157.6	48¼	89.1	27.2
1975-76	53.8	157.5	48½	110.8	34.2
1976-77	59.6	154.1	46	129.4	38.7
1977-78	64.4	146.3	42¾	150.8	44.0
1978-79	75.0	153.8	43¼	173.0	48.7
1979-80	90.3	158.6	43½	207.7	57.0
1980-81	109.0	161.5	46	236.6	67.5
1981-82	121.0	163.3	46½	259.8	74.1
1982-83	133.1	167.6	46¾	284.7	79.4
1983-84	141.6	170.5	45¾	308.6	83.0
1984-85	152.8	175.2	46¼	330.5	87.2
1985-86	160.9	175.0	44½	361.1	91.9
1986-87	168.9	177.8	43¾	385.7	95.0
1987-88	176.7	176.7	41½	424.5	100.0
1988-89	186.6	175.7	~~39½~~ 39¾	471	106.2
1989-90	198.5	177.9	~~39~~ 39¼	509	111.6
1990-91	209.7	181.6	~~38¾~~ 39	540	115.5
1991-92	221.2	186.0	38¾	569	118.9

(1) Cash figures adjusted to 1987-88 price levels by excluding the effect of general inflation as measured by the GDP deflator.

Source: Figures for 1963-64 to 1987-88 from CSO data
Figures for 1988-89 to 1991-92, Hm Treasury

Chart 1.1 General government expenditure as a percentage of GDP



jg109

CONFIDENTIAL

FROM: J GIEVE
DATE: 27 October 1988

MR D GRIFFITHS

cc Chancellor
Chief Secretary
Mr Anson
Mr Phillips
Mr Turnbull
Miss Peirson
Mr Saunders
Mr MacAuslan
Mr Pickford
Mr A M White
Mr Tyrie
Mr Call

pl cc Alex
Andrew
+ return to MPN.

AUTUMN STATEMENT: HEALTH

We spoke about the health briefing and passages for the oral statement. One of the main positive points of our presentation will be the extra resources for health so it is vital to get the figures straight and ensure that we, Department of Health, and the Prime Minister all sing the same tune.

2. The first point, I think, is that we should focus on resources for the NHS and not the Health and Personal Social Services programme as a whole. If possible it would be best to use UK figures but if that is impossible, because the territories have not yet made their dispositions, we need NHS figures for England.

3. You will be producing a table of figures showing additions to plan and year on year increases for various health totals both gross and net of receipts, efficiency improvements, and changes in pension contributions. We need to decide which of these figures to focus on. My suggestion is that we should focus on:

(a) the increase over previous plan for 1989-90 for the NHS as a whole gross of reduced pension contributions and extra receipts; I understand the figure is £1¾ billion;

(b) the real rate of growth in resources available for the HCHS between 1988-89 and 1989-90 gross of pension contributions, receipts, and efficiency improvements; I take it that is the figure of 5 per cent.

4. We need also to have answers to the following questions:

(i) What does this include for pay? As I understand it we are allowing only for the GDP deflator for review body groups. Since that is bound to come out I suggest we volunteer it and say that if necessary the provision will be reviewed in the Spring in the light of the review body awards (since that was the declared purpose of bringing forward the review body report); and

(not quite — didn't we focus rather on letting HAs feed RB numbers into their budgets in good time

(ii) What will this do to spending on health as a proportion of national output? In the absence of the territories figures we can't give a clear answer but we can compare the growth rate of HCHS resources (or NHS resources) with the growth rate projected for GDP; it seems likely that on both counts there will be an increase in health spending as a proportion of GDP.

(but we do not want to highlight this too much in presentation when we are always saying no particular right % of GDP)

J.G. Gieve

JOHN GIEVE

* Wot really must try & get real possible figure for the NHS for the UK as a whole. MP.

CONFIDENTIAL

FROM: MISS M E PEIRSON
DATE: 27 October 1988

MR SAUNDERS

cc Chancellor
Chief Secretary
Mr Anson
Mr Phillips
Mr Turnbull
Mr Gieve
Mr MacAuslan
Mr Pickford
Mr A M White
Mr Griffiths
Mr Tyrie
Mr Call

(See also my note a page below)

Ch/ This is all, I feel, unnecessarily complicated. Must be sorted out. Any preferences you wish us to feed in? For what its worth, I think we must have something to say on UK increase for health, hedged with caveats if necessary, but the numbers are too good to waste. I cannot believe

AUTUMN STATEMENT: HEALTH

I have agreed with Mr James, DH, subject of course to any further thoughts anyone may have, that we should all focus on the following figures, for England only (actual figures given below are still to be confirmed):-

i) increase plan-on-plan for 1989-90 for NHS as a whole, gross of reduced pension contributions and increased land sales and cost improvement programme proceeds (cips), ie [£1 3/4 bn];

ii) increase year-on-year for 1989-90 (new plan) on 1988-89 (estimated outturn) for NHS, gross of reduced pension contributions, as an absolute figure, ie [£1.7 bn];

iii) increase year-on-year for 1989-90 on 1988-89 for NHS, gross of reduced pension contributions AND increased cips and income generation proceeds, as a real growth rate, ie [5-5½%];

iv) as for (ii), but for HCHS current, ie [£1.1 bn];

v) as for (iii), but for HCHS current, ie[5 %].

2. It does not seem possible to reduce the number of foci: (i) is necessary for the Chancellor's oral statement; (ii) and (iii) are what DH want for Mr Clarke's press statement; and there is usually considerable interest in (iv) and (v).

3. It will also be necessary to explain in our press briefing why none of these figures is the same as the figure in the main table circulated by the Treasury (because the latter is for HPSS, ie including LA current expenditure on personal social services). There are of course secondary tables showing the split between CG and LA expenditure. This difficulty is one reason for not giving UK figures; another is that territorial dispositions have not been decided.

4. I should explain that income generation does not appear in (i) because any increase in plan is tiny; land sales do not appear in (ii) or (iii) because DH do not think they will increase year-on-year; and cips and income generation do not appear in (ii) and (iv) because DH want to stick to resources provided by the Government. As regards the last point, it seemed worth conceding since DH were willing to go along with our treatment in (i), (iii) and (v): of course it suits them too (bigger figures), but they have tended to refuse in previous years.

MEP

MISS M E PEIRSON

> territorial Mins wd disagree. On John G's minute behind, are you happy with proposed line on pay? [I don't think it gives a v. good signal to Review Bodies]

MPW.

CONFIDENTIAL

OK subject to a number of pts passim

FROM: P N SEDGWICK
DATE: 27 OCTOBER 1988

CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Phillips
Mr Scholar
Mr C W Kelly
Mr Odling-Smee
Mr Turnbull
Mr S J Davies
Mr Gieve
Mr Grice
Mr Hibberd
Mr MacAuslan
Mr Mowl
Mr O'Donnell
Mr Owen
Ms Turk
Ms Simpson
Mr Vernon
Ms Walker
Ms Chaplin
Mr Tyrie
Mr Call

Ch
OK? Some comments made
AA

THE INDUSTRY ACT FORECAST

I attach a revised draft of the Industry Act Forecast, which Mr Hibberd has put together. It incorporates your comments on the previous draft. We are due to receive final comments from you by lunchtime tomorrow.

2. This is the version that will be issued as a press notice on Tuesday. (A draft version of the Press Notice itself - copied from the 1986 version - is attached.) The presentation of the printed version, to be included in the AS grey book, will differ in a number of minor respects, but the words and numbers will be identical.

3. There are a few points that you might like to note.

(i) <u>Inconsistencies in the national and sectoral accounts</u>
The material on this now forms an annex. We have kept references in the main text to a minimum. We have put a chart of the residual error chart into the Annex; without it the recent rise in the residual error is not recorded anywhere.

(ii) <u>Relative unit labour costs</u>
There were two separate references to the growth of unit labour costs at home and abroad plus a chart that appeared with the second reference. In this draft there is one

reference (in paragraph 16), and the chart 4 comes immediately after it.

(iii) **Exchange rates**

The $/DM rate is now close to the Louvre level, though it has not always been so since the Accord. We have altered your wording slightly (paragraph 15).

When?

Sterling (the ERI) has varied over the past year in months other than April and May by more than 3 per cent from its present level. The drafting in paragraph 47 reflects this.

eh?? Must get this straightened out.

(iv) **Consumers' expenditure**

After discussion among ourselves and with Sir T Burns we have omitted the chart showing the personal sector net wealth/income ratio, and the single sentence on it (that would have come in paragraph 31). This sentence did not fit easily into the surrounding argument. The choice was between explaining more fully the behaviour and significance of net wealth and dropping the chart and reference. For this draft we chose the latter. If you wanted us to reinstate the chart and augment the text we could do so tomorrow.

Not worth it?

(v) **Inflation**

We have changed the components of tables 6 and 7 for the forecast period (including 1988) since the last draft.

You might like to be aware that for 1989 we have used the forecast increase in the average rate poundage in England and Wales (7 per cent) as the indicator for the rates component of the RPI for England and Wales plus Scotland. No other procedure seems feasible until there is a decision on the consequences of the reform of local authority finance for the construction of the RPI. None of this is given in the text or tables, but we could disclose the nature of our working assumption on Scotland if asked what it was. We would on past precedent not give the assumed increase in the average rate poundage.

Paragraph 39 (on earnings) has been redrafted. (Following past practice we have shown the proposed passages on recent developments in the labour market to DE.) It now puts more emphasis on pay settlements, particularly in the public sector.

(vi) **Net foreign assets**

You deleted a passage on IPD that included the only reference to the UK's net foreign assets. We have recently always provided an estimate of the value of net foreign assets at the end of the preceding year (eg in the paragraph 1.29 in the 1987 AS). To omit a reference this time might look as if we were concealing the recorded drop in 1987 (though this was given in the FSBR). We have added a sentence with the figure (paragraph 26).

P.N.

P N SEDGWICK

H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-270 5238
Facsimile: 270 5244
Telex: 9413704

1 NOVEMBER 1988

ECONOMIC PROSPECTS FOR 1988

The Industry Act (1975) requires the Government to publish economic forecasts twice a year. This forecast reviews economic developments so far this year and outlines the prospects for 1989. The main details of the forecast were given to the House of Commons this afternoon by the Chancellor of the Exchequer.

PRESS OFFICE
HM TREASURY
PARLIAMENT STREET
LONDON SW1P 3AG
01-270 5238

ECONOMIC PROSPECTS FOR 1989

Summary

GDP is forecast to grow by 3 per cent in 1989, following growth of 4½ per cent this year. Inflation is expected to peak in mid-1989, and fall back by the end of the year.

Assumptions

2. The forecast assumes that fiscal and monetary policies are operated within the framework of the Medium Term Financial Strategy (MTFS). It assumes that both North Sea oil prices and sterling remain close to their recent levels. The Public Sector Debt Repayment (PSDR) is expected to be about £10 billion in the current financial year, equivalent to 2¼ per cent of GDP. The forecast assumes a similar PSDR in 1989-90 ~~as~~ to that in 1988-89; the actual PSDR for that year will, as usual, be set in the Budget.

World economy

3. GNP in the major industrialised countries has grown faster than expected, and is forecast to rise by 4 per cent in 1988; growth is forecast to slow down slightly, to 3 per cent, in 1989. World trade in manufactures has also picked up strongly and should grow by 8½ per cent in 1988. Inflation in the major industrialised countries is expected to remain low.

Demand and activity

4. The economy has grown strongly over the past year, though major inconsistencies in the official statistics (discussed in the Annex) make it difficult to assess the precise extent of growth. The average measure of GDP, which may understate the true position, is likely to grow by about 4½ per cent in 1988, with manufacturing output rising by 7 per cent. Non-oil export volumes have recovered strongly after falling in early 1988. Domestic demand ~~growth, which~~ has risen sharply over the past year as investment has boomed and consumers' expenditure has continued to grow rapidly; it is expected to moderate in 1989.

TB wd prefer "forecast".

UK trade and current account

5. The UK current account is forecast to be in deficit by £13 billion in 1988. This is considerably larger than forecast at Budget time, due mainly to stronger growth in both investment and consumption. The current account deficit should show ~~some~~ reduction during 1989.

a slight

Inflation

6. Retail price inflation is expected to be 6¼ per cent in the fourth quarter of 1988. It is likely to rise further in the first half of 1989 before falling to 5 per cent in the fourth quarter of 1989. Unit labour costs have risen slowly over the past year, since productivity has continued to grow at a very fast rate, especially in manufacturing. Wage settlements need to moderate to keep growth of unit labour costs in check as output growth slows down.

Labour market

7. Employment has increased rapidly over the past year. Unemployment fell by 500,000 in the year to September. Unemployment should continue to fall over the next year, though probably at a slower rate than recently.

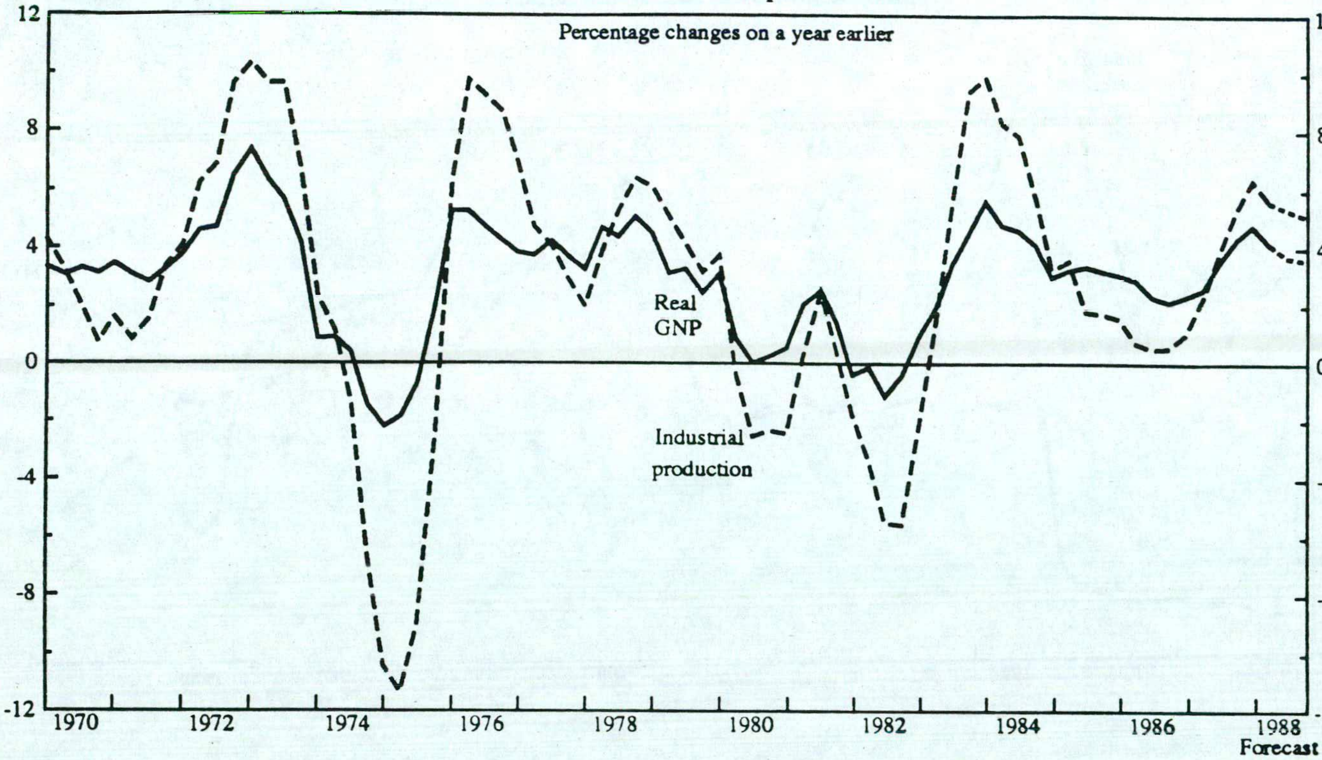
World economy

Recent developments

8. Since the recession in 1982 the major seven OECD countries have experienced six years of steady growth, with real GNP growing at an average rate of 3½ per cent a year and the unemployment rate falling by 2½ percent.

9. Growth in these countries is estimated to have increased to over 4 per cent over the past year. Exports have grown strongly, especially to those developing countries which benefitted from the rise in real commodity prices in 1987 and the first half of 1988. Greater exchange rate stability following the Louvre Accord and rising capacity utilisation have strengthened business confidence and contributed to a resurgence of investment.

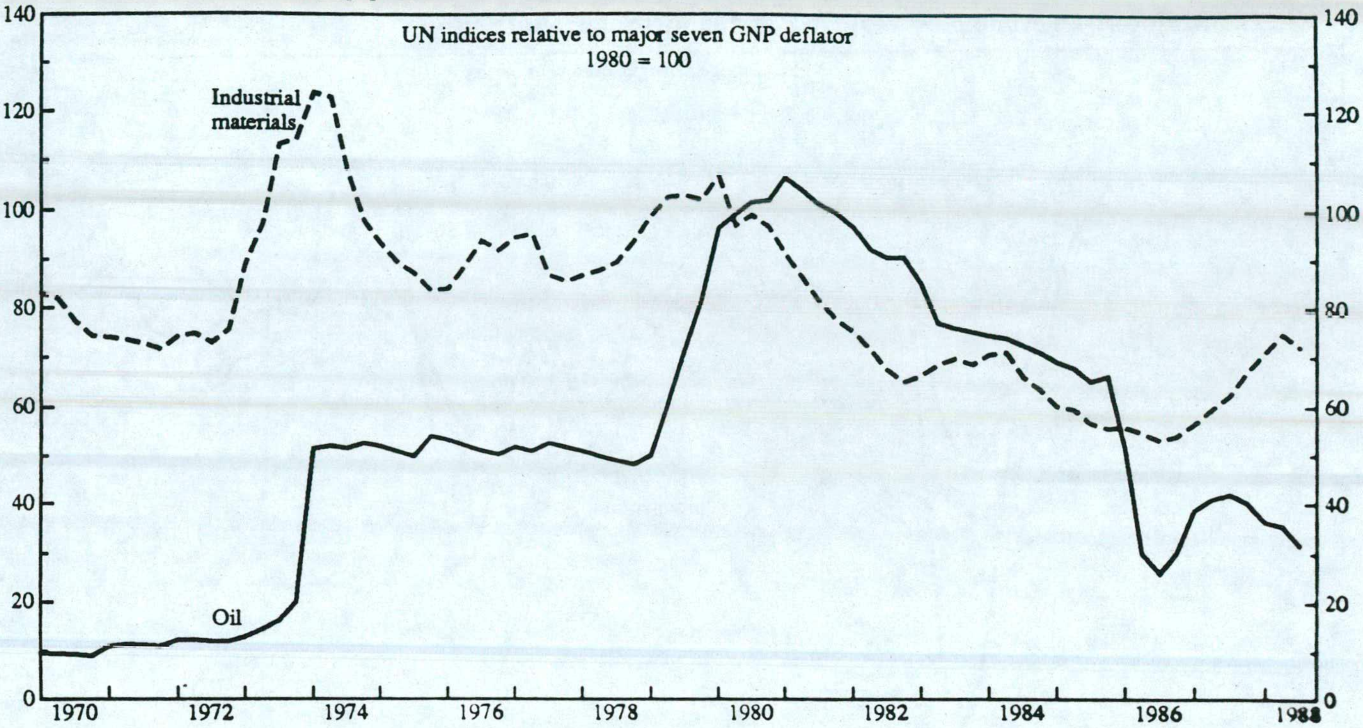
Chart 1 Major seven economies' real GNP and industrial production



10. In contrast to 1984, when the strength of activity in the major seven mainly reflected developments in the United States, the latest spurt in activity has been worldwide. This is reflected in the pick up in total trade and in world trade in manufactures, both of which are rising at around 9 per cent a year. All the major ~~seven~~ countries are currently experiencing an investment boom.

11. Although non-oil commodity prices rose by around 20 per cent in real terms over the last year, oil prices fell by rather more. The net effect on aggregate costs in industrial countries is likely to be small. Consumer price inflation in the major seven countries has remained around 3 per cent.

Chart 2 Real commodity prices



Forecast 12. Table 1 shows the forecasts for world trade, ~~and~~ activity and inflation in the major seven countries. Real GNP ~~in the major seven countries~~ is expected to grow a little less strongly in 1989 than in 1988, with some slow-down in consumer spending.

Table 1 World economy

	Percentage changes on a year earlier		
		Forecasts	
	1987	1988	1989
Major seven countries[1]:			
Real GNP	3½	4	3
Real domestic demand	3½	4	3
Industrial production	3½	5½	4½
Consumer prices	3½	3	4
World trade, at constant prices			
Total imports	5	9	6½
Trade in manufactures	5½	8½	7½

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

13. Growth in world trade may also slow a little in 1989, but probably by less than activity in the major seven countries, since the imports of some developing countries are expected to remain buoyant.

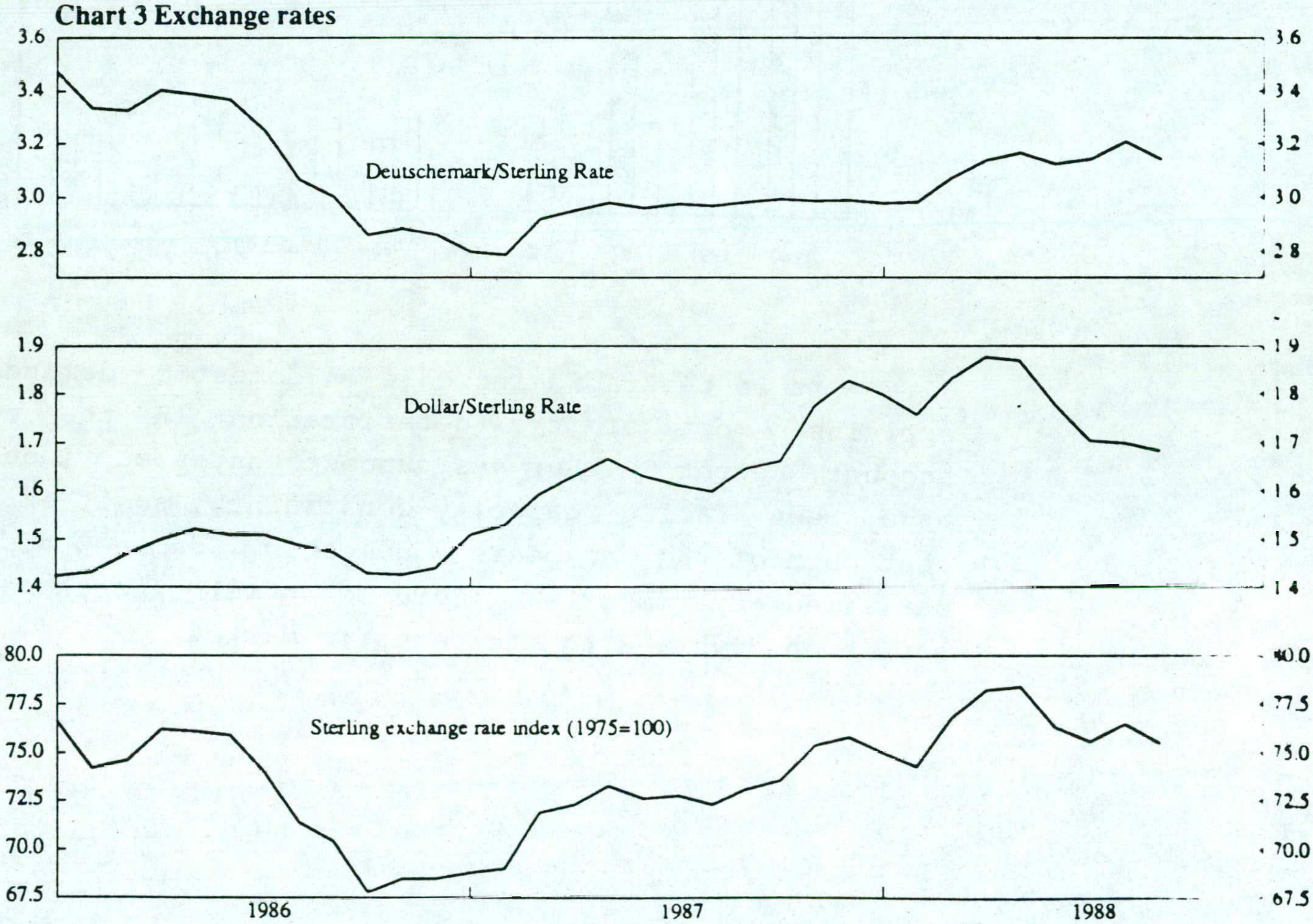
14. Spot prices of non-oil commodities have weakened recently, but the continued strength of industrial activity makes a further fall doubtful. There is likely to be a modest rise in consumer price inflation in 1989.

Trade and the balance of payments

Exchange Rates

15. Exchange rates between the major currencies have been fairly stable over the past eight months. The dollar/Deutschemark rate is close to its level at the time of the Louvre Accord. The forecast assumes that sterling remains close to recent levels.

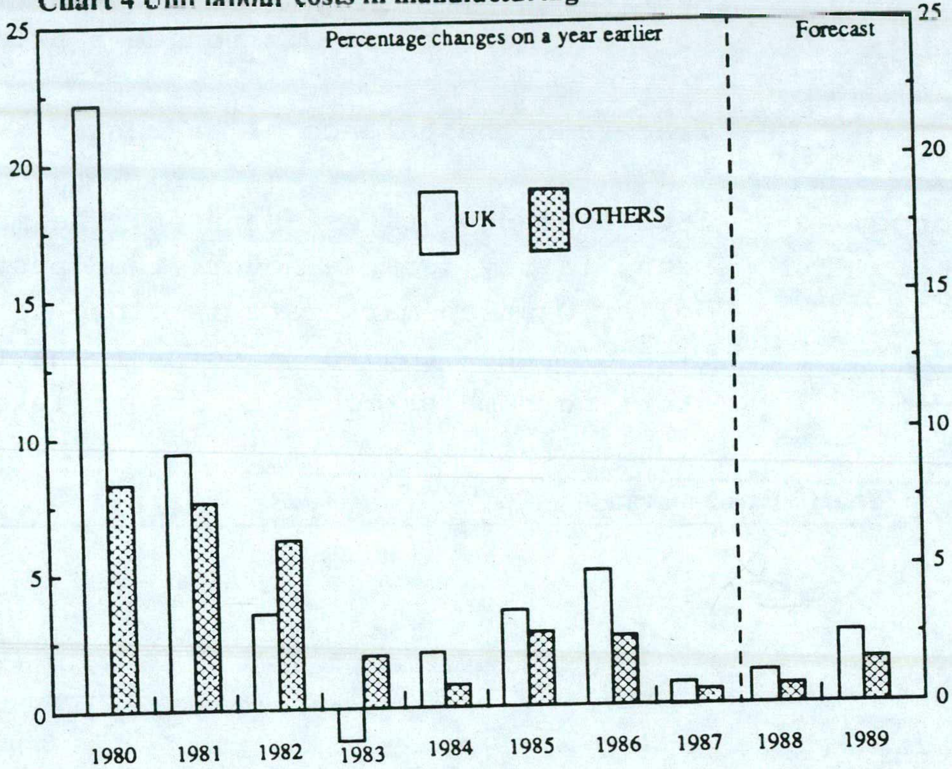
Chart 3 Exchange rates



Relative costs and prices

16. Manufacturing unit labour costs in the UK have risen only slightly over the past year, but still marginally faster than the average of other major industrial countries. Nonetheless, most of the large gains in labour cost competitiveness in 1986 has been maintained.

Chart 4 Unit labour costs in manufacturing

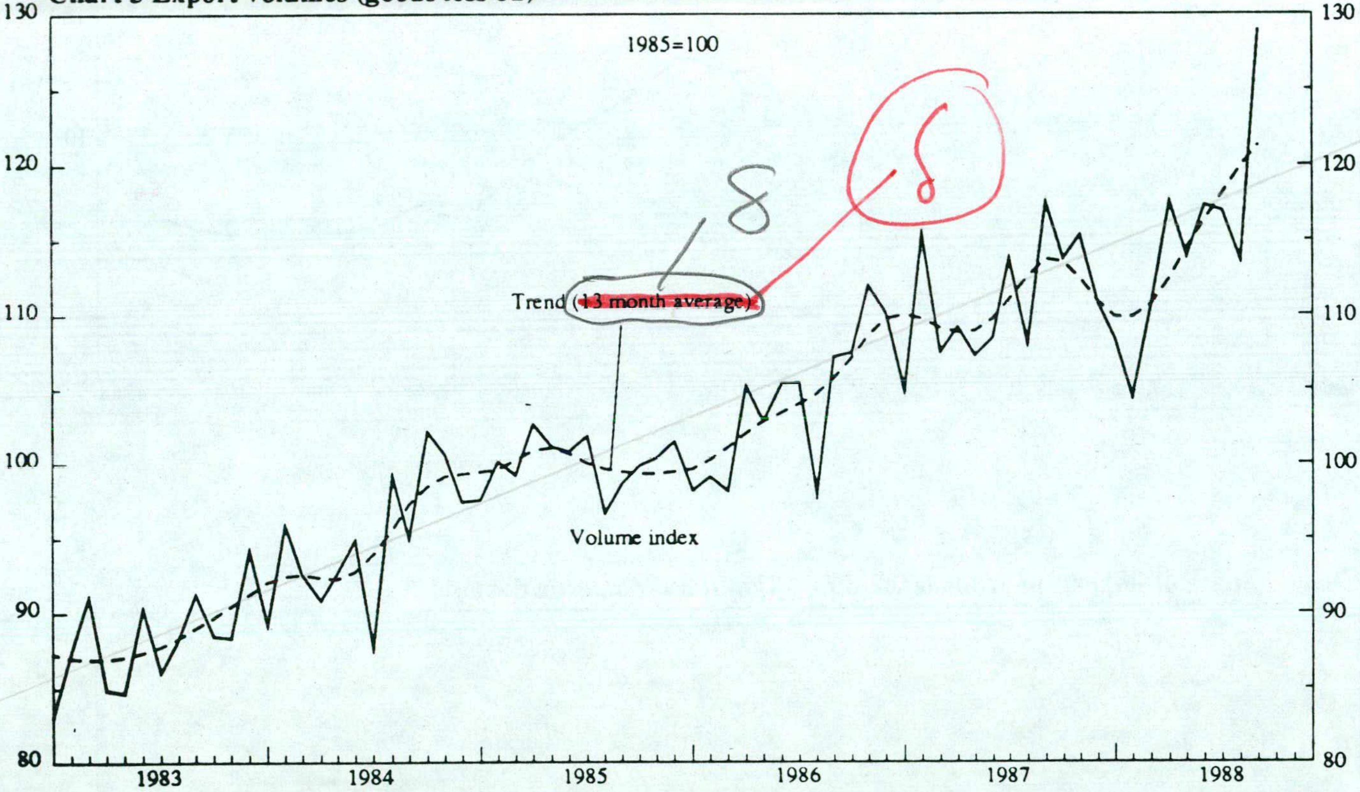


17. It is the rapid increase in domestic demand that explains most of the deterioration in the current account. Recent CBI Surveys suggest that some industries have been facing capacity constraints, so it is likely that part of the unexpected domestic demand has been satisfied by imports. Some potential exports may also have been diverted to the domestic market.

Trade volumes (goods other than oil)

18. After erratically low figures in early 1988, the volume of UK manufactured exports has since risen as world trade has continued to expand. In the third quarter of 1988 the volume of exports of manufactures was around 8½ per cent higher than a year earlier. Manufactured export volumes, are forecast to rise by nearly 9 per cent in 1989, in line with the projected growth of world trade.

Chart 5 Export volumes (goods less oil)



19. Chart 6 shows how, after decades of decline, the UK's volume share of world trade in manufactures has changed little since 1981. Indeed, over the past two years, exports of manufactures have grown a little faster than world trade and the UK's share has risen slightly.

Chart 6 appears to show a decline in 1988. Pse check

Chart 6 Share of UK exports in total world trade in manufactures

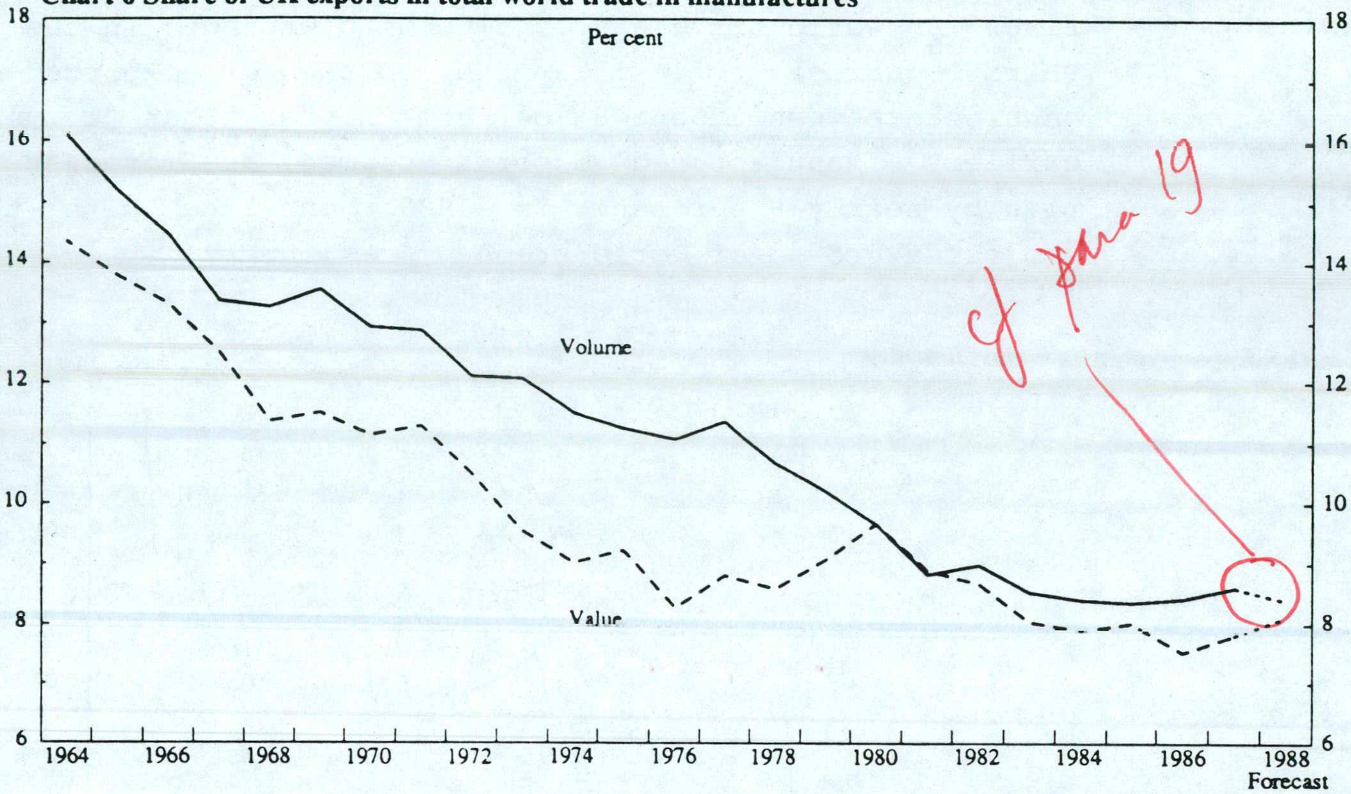
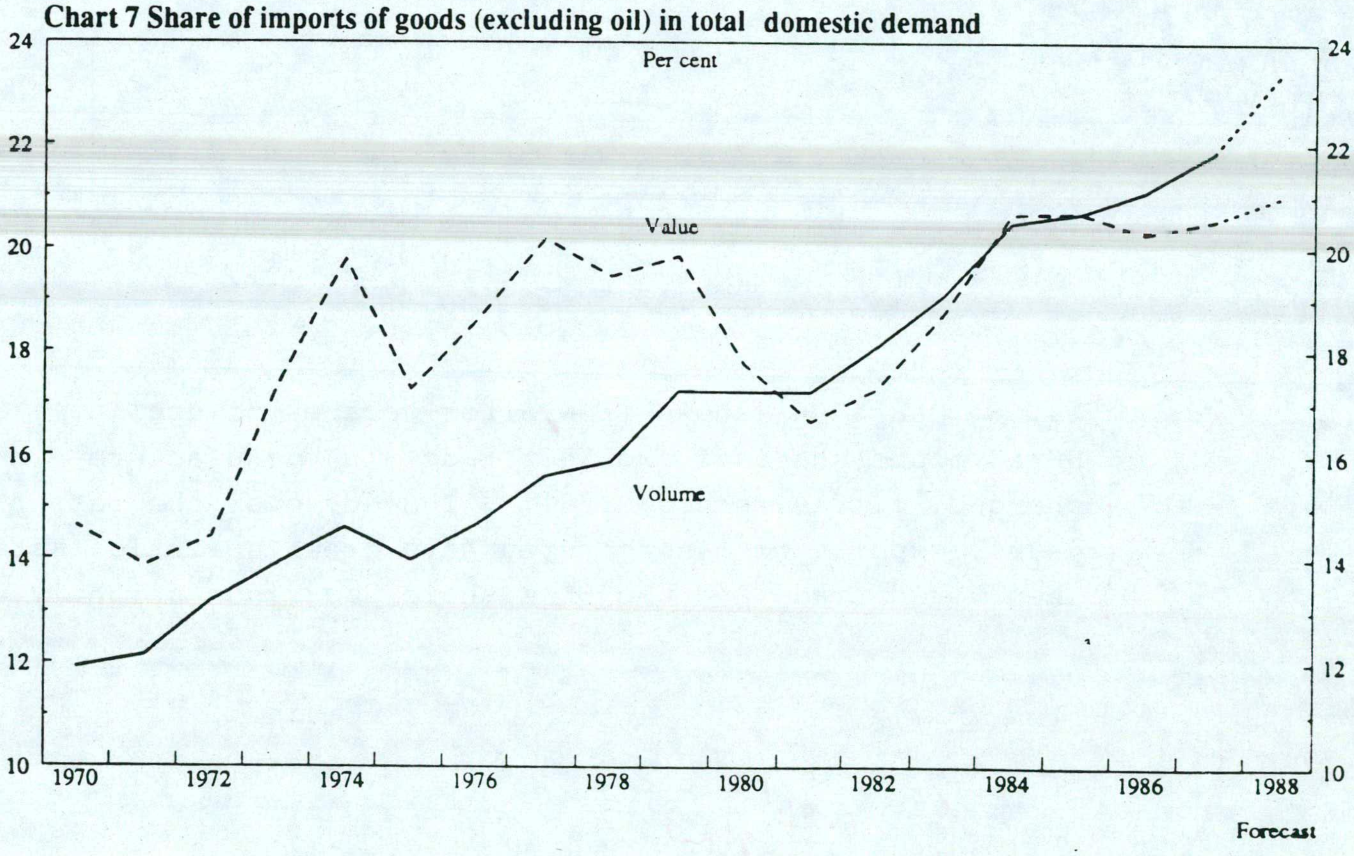


Chart 7 Share of imports of goods (excluding oil) in total domestic demand



20. Non-oil imports have risen very rapidly this year reflecting the strength of domestic demand and capacity shortages in some industries. Non-oil imports are expected to grow by 13½ per cent in 1988. But import growth should slow significantly in 1989, to 5 per cent, as domestic demand decelerates and as extra capacity becomes available following the investment boom.

Oil trade

21. The oil trade surplus is expected to fall by over £1½ billion in 1988 to around £2½ billion. This is the result of lower sterling oil prices, a decline in production (mainly due to the Piper Alpha disaster), and increased domestic demand for oil. Oil production is likely to fall again in 1989. Declining production and a further rise in domestic demand for oil imply another fall of about £½ billion in the oil surplus in 1989.

Trade prices and the terms of trade

22. 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. The terms of trade are ~~expected~~ assumed to remain unchanged between 1988 and 1989.

Table 2: Visible trade

	Percent 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 Partly forecast	2	12½	2	5	13½	2½
1989 Forecast	6½	5	1½	8½	5	½

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

Invisibles and overseas assets

23. The surplus on invisibles for 1988 is likely to be around £2 billion lower than in 1987. This is largely due to a fall in the balance on services. UK tourists have been spending more abroad and the surplus on financial services has come down due to lower net premiums on insurance.

24. Net earnings from interest, profits and dividends are expected to be unchanged from last year. The deficit on transfers is also expected to be unchanged in 1988 with lower payments to the European Community offset by higher bilateral aid.

25. The invisibles surplus should rise in 1989 as the balance on services recovers and payments abroad by North Sea companies continue to fall. These improvements will be partially offset, however, by increased payments to the European Community.

See cover this note

26. In 1987 the value of the stock of UK net overseas assets fell by £24 billion to £90 billion by the end of the year, mainly due to revaluations following the fall in the US dollar.

Current account 27. The current account is estimated to have been in deficit by just under £10 billion in the first 9 months of 1988 (though the large positive ~~overseas~~ balancing item suggests that this may overstate the actual deficit). The forecast for the year as a whole is for a deficit of £13 billion (about 2¾ per cent of GDP).

28. The forecast for 1989 is for a slightly smaller current account deficit. The expected slowdown in domestic demand growth will help reduce the current account deficit, but this will be partially offset by the smaller oil surplus and the fact that world trade growth is projected to be somewhat slower.

Table 3: Current account

	£ billion				
	Manufactures	**Other**	**Oil**	**Invisibles**	**Current balance**
1987	- 7½	-7	4	7½	- 2½
1988 Partly forecast	-13½	-7½	2½	5½	-13
1989 Forecast	-12	-7	2	6	-11

Demand and activity

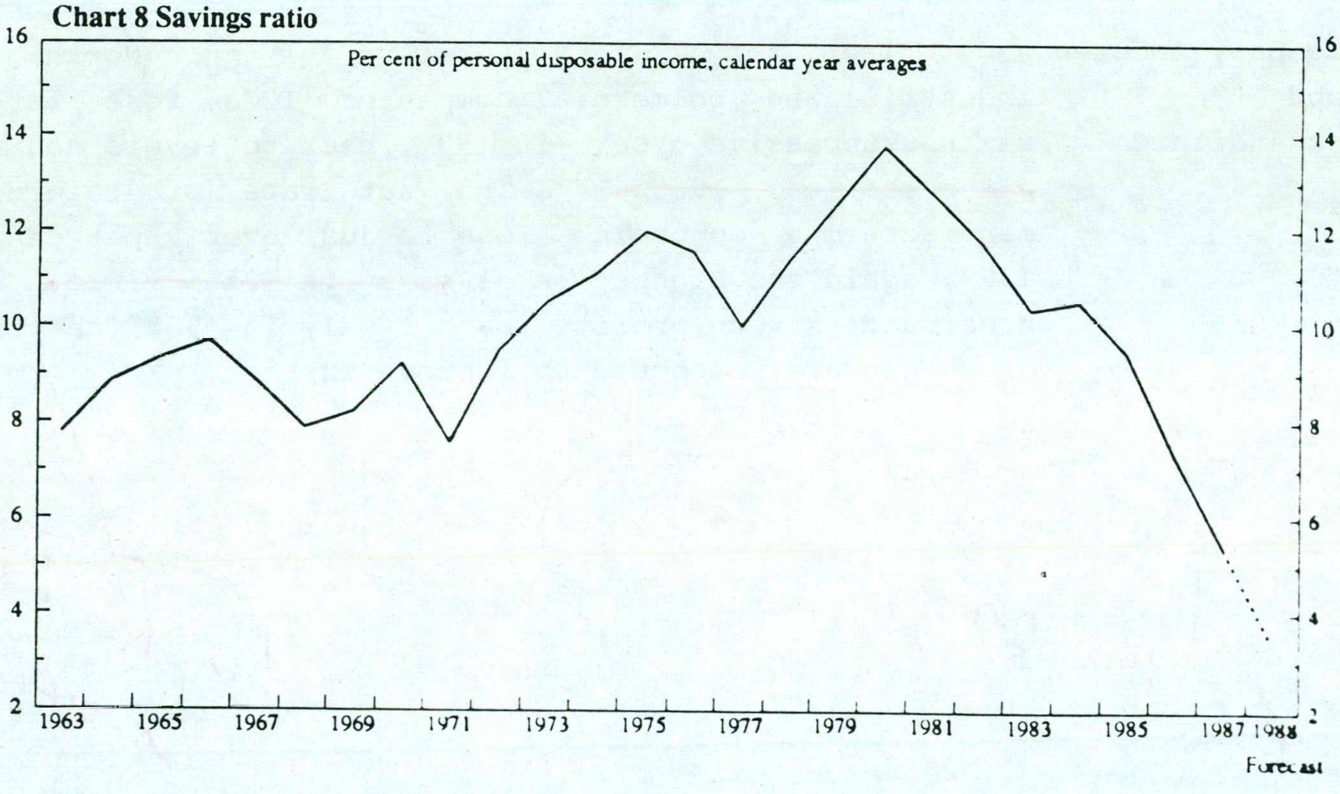
the growth in

Personal sector expenditure

29. Consumer spending is estimated to have risen by 5½ per cent in 1986 and by 5 per cent in 1987. This is considerably faster than real personal disposable income, and the recorded savings ratio fell from an estimated 9½ per cent in 1985 to 5½ per cent in 1987. In 1988 consumer spending is likely to increase by about 5½ per cent, a similar rate to that in 1986 and 1987. The savings ratio is likely to have fallen further, to about 3½ per cent.

30. Several factors may explain the substantial fall in the savings ratio since 1980. Most important has been greater confidence in the future, with people having lower inflation expectations and greater wealth, (especially following the large rise in house prices). In addition, employers' contributions to pension funds have been falling ~~[relative to personal disposable income]~~ in recent years as companies have reacted to the surpluses that many funds have been running; this scores in the official statistics as lower personal ~~income and~~ savings.

Chart 8 Savings ratio



for the first time

31. The fall in the savings ratio has been associated with an increase in borrowing - particularly mortgage borrowing - following the ending of mortgage rationing and other restrictions. But householders will not wish to go on accumulating debt at the same rate as recently. Levels of borrowing are already high relative to income. Moreover, households are now substantial net payers of interest, and Higher interest rates are therefore particularly likely to reduce consumer spending. This should be reinforced by a slowdown in the growth of house prices and, hence, housing wealth. Consumer spending is expected to rise by 3½ per cent in 1989 with a marked deceleration through the year. The savings ratio should recover slowly during 1989.

What is official

32. The housing market has been particularly buoyant over the past year, though the fall in building society mortgage commitments in August and September suggests that the pressure of demand is easing. Nonetheless, for 1988 as a whole private sector investment in dwellings and improvements is likely to increase by 16 per cent compared to 5½ per cent in 1987. Housing investment is unlikely to rise significantly further in 1989.

Company incomes and expenditure

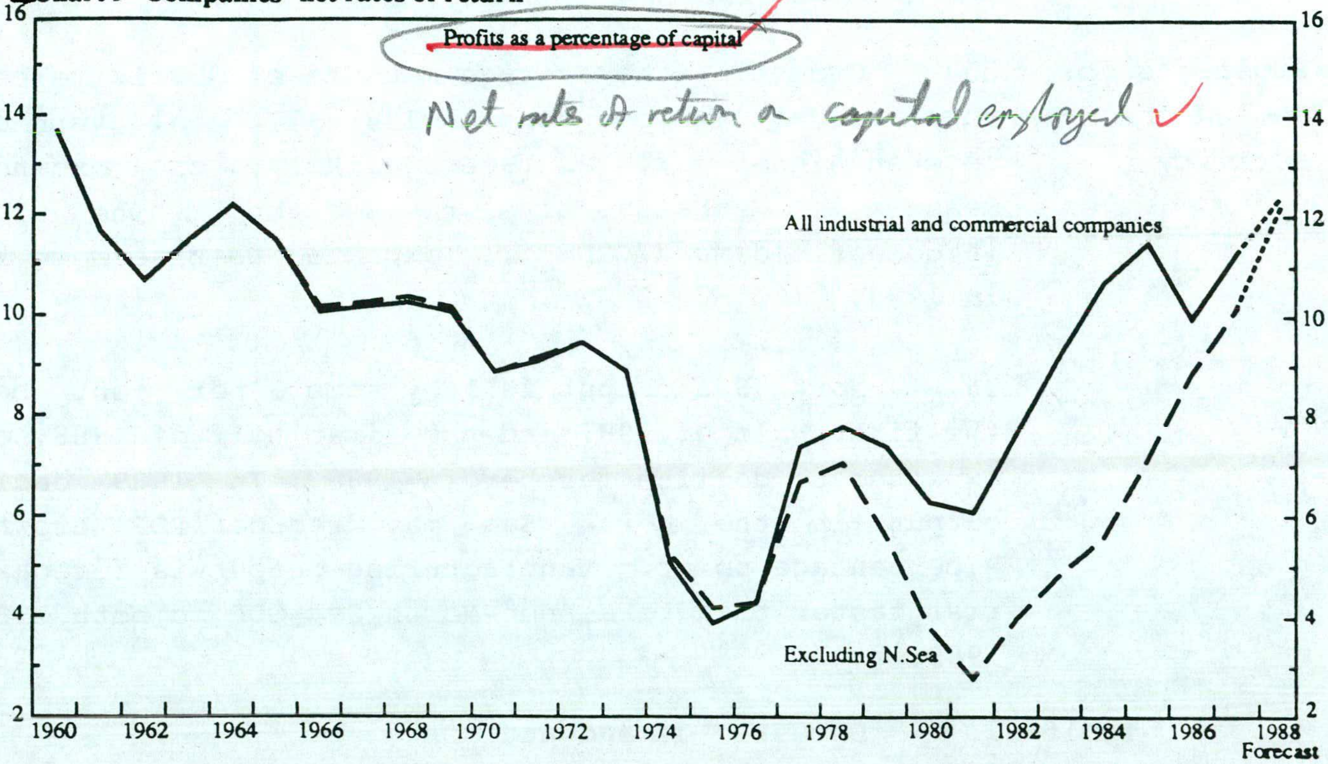
33. The net rate of return of non-North Sea industrial and commercial companies (ICCs) rose for the sixth successive year in 1987, back to levels not seen ~~since the late 1960s~~. The net rate of return of manufacturing companies rose to just over 9 per cent in 1987, again the highest level ~~since the late 1960s~~. With continued strong profit growth likely in 1988 net rates of return are expected to improve further.

for over 20 years.

for more than 20 years.

[From Chart 9 looks like highest since mid-1960s]

Chart 9 Companies' net rates of return



34. Developments so far in 1988 confirm the investment boom predicted by recent CBI and DTI Investment Intentions Surveys. Manufacturing investment (including leased assets) rose 13 per cent higher in the year to the first half of 1988, while private non-manufacturing investment rose 15 per cent. Business investment is expected to rise a little faster in 1988 than the June DTI Intentions Survey suggested. Further growth in business investment is expected in 1989. Recorded stockbuilding is expected to continue on only a moderate scale in 1988 and 1989.

NEW TABLE

Could do just business investment — or private sector + public corporations

Table 4: Gross fixed domestic capital formation

	£billion at 1985 prices	Percentage changes on previous year		
			Forecast	
	1987	1987	1988	~~1988~~ 1989
Business[1]	41.1	6½	13½	7½
of which: non-oil business	39.2	8½	13½	6½
manufacturing	10.1	5	18	10
Private dwellings[2]	16.5	7	13	2
General government	6.7	-3½	- 1½	6½
Total fixed investment	**64.2**	**5½**	**12**	**5½**

OWN GOAL TO INCLUDE THIS LINE

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

OK, I think

Prospects for demand and activity

35. Growth of the average measure of GDP is expected to be around 4½ per cent in 1988. It could turn out to be even higher if, as seems likely, the expenditure measure is subsequently revised up. As a result of The slowdown in domestic demand, GDP is expected to rise more slowly in 1989.

36. North Sea output fell by some 3 per cent between the first half of 1987 and the first half of 1988, and is expected to decline further in 1988. In 1989 declining output in the North Sea may reduce GDP growth by ½ percentage point. Manufacturing output is forecast to rise faster than total non-North Sea GDP in both 1988 and 1989.

Table 5: Domestic demand and GDP

Percentage changes on a year earlier

		Forecast	
	1987	**1988**	**1989**
Domestic demand	4½	6	3
Exports of goods and services[1]	5½(6½)	1½(3½)	5½(7)
Imports of goods and services[1]	7½(8)	12(13)	4½(4½)
Gross Domestic Product[1,2]	4 (4½)	4½(5)	3 (3½)
Manufacturing Output	6	7	4½

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

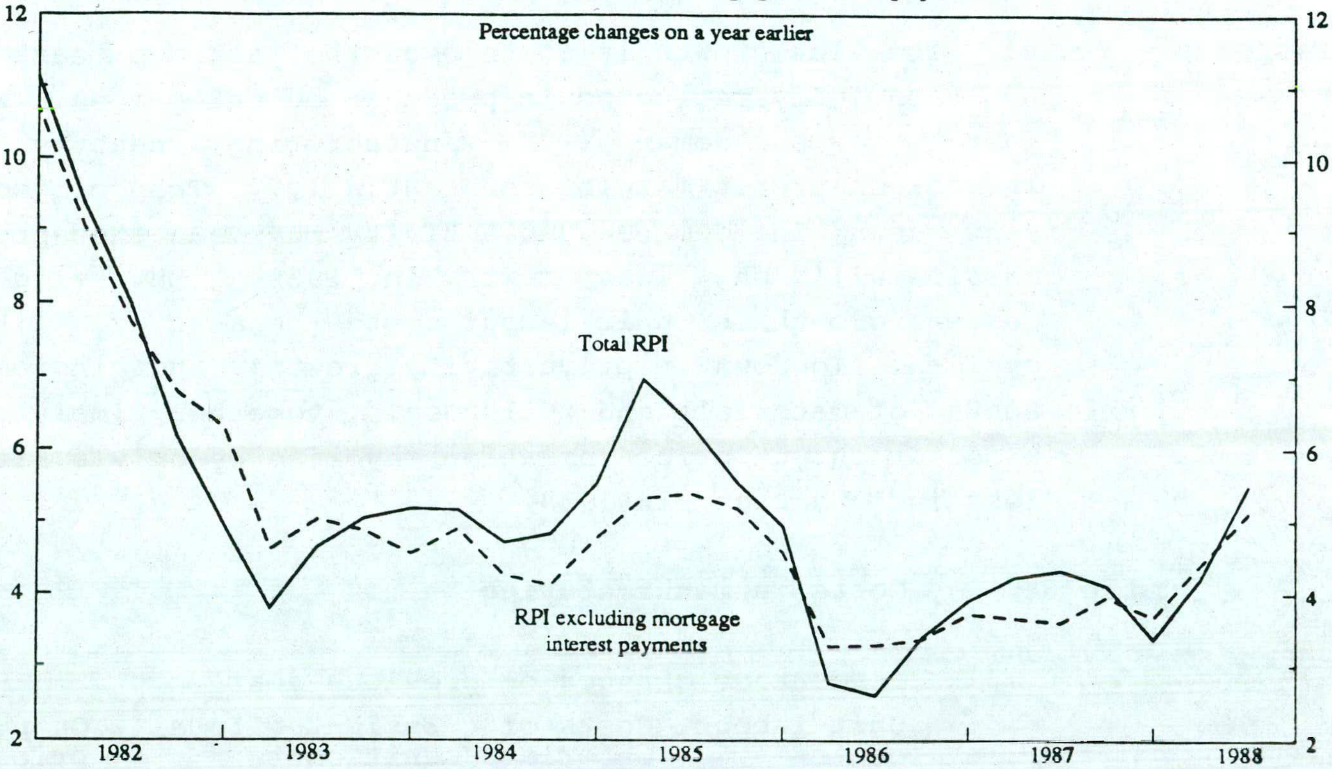
Inflation

37. The annual rate of RPI inflation has risen since early 1988, mainly as a result of the rise in mortgage interest rates. Chart 10 shows that, excluding mortgage interest payments (MIPs), the increase has been less pronounced, though it has risen from the low levels of 1986 and 1987 which were associated with the oil price fall.

Somewhat

CONFIDENTIAL

Chart 10 RPI inflation: Total and total excluding mortgage interest payments



38. Total RPI inflation is likely to average 6¼ per cent in the fourth quarter of 1988; excluding mortgage interest payments (MIPs) the figure is expected to be 5 per cent. Producer price inflation has also edged up during 1988. Though higher than expected at Budget time, the underlying rate of increase in prices has been much lower than in periods of comparably fast demand and output growth in the 1970s.

39. The underlying increase in average earnings has risen from ~~7¼ per cent in August 1987~~ to 9¼ per cent in August 1988. ~~The rise is mainly accounted for by higher settlements (especially in the public sector).~~ But high overtime payments and performance related bonuses have also played an important part.

Earlier version was better! (was it untrue)

Check

40. Despite high earnings increases, growth in manufacturing unit labour costs ~~have~~ has been kept down by the rapid growth in productivity. ~~and they~~ Unit labour costs in manufacturing are expected to rise by just over 1 per cent in 1988.

Prospects

3 variants use (for the noun)
① slow down
② slow-down
③ slowdown
standardise on ② ?
Yes

41. The low growth in costs over the last two years has not been fully reflected in producer output prices. With fast growth demand, UK manufacturing industry has increased profit margins substantially. The projected slow-down in demand and activity may mean that profit margins will show less growth in 1989. But slightly faster growth in unit labour costs (because of a likely cyclical slowdown in productivity growth) and increased costs of materials and fuels could, together, imply that producer output price inflation may rise by only a little less in 1989 than in 1988.

Table 6: Costs in manufacturing

	Percentage changes on previous year			
	Unit labour costs	Costs of materials and fuel [1]	Estimated total unit costs [2]	Output prices [1]
1986	5	-10½	2¼	4
1987	¼	5	1½	4½
1988 Partly forecast	¾	4	1¼	4¾
1989 Forecast	2½	1½	3¼	4¼

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

42. Retail price inflation could rise further during the first half of 1989 before moderating to 5 per cent by the fourth quarter. The fluctuations in the RPI are chiefly the result of past changes in mortgage rates; excluding mortgage interest payments, the inflation path is likely to be much smoother.

Table 7: Retail prices index

	Weight in 1988	Percentage changes on a year earlier: 1987 Q4	Forecasts: 1988 Q4	Forecasts: 1989 Q4
Food	16¼	3½	3¼	3¼
Nationalised industries	5½	2¼	7¼	6¼
Housing	15¼	7	16¼	7
Other	63	3¾	5¼	4¾
Total	100	4	6¼	5

43. The GDP deflator which measures the price of domestic value added (principally unit labour costs and profits per unit of output) is forecast to rise by 6¼ per cent in 1988-89 and by 5 per cent in 1988-89.

Productivity and the labour market

44. The workforce in employment in Great Britain has continued to rise strongly over the last year: in the twelve months to June 1988 it is estimated to have risen by 440,000 thousand. Since 1983, there has been an increase of over 1¾ million in the number of jobs.

Table 8: Changes in Employment

Thousands, GB seasonally adjusted

	Employees in employment: Male	Employees in employment: Female	Self-employed	HM forces	Work related government training programmes	Workforce in employment
June 1985 to June 1986	-68	+152	+ 16	-4	+50	+145
June 1986 to June 1987	- 6	+242	+234	-3	+85	+552
June 1987 to June 1988	+60	+222	+124[1]	-3	+35	+438

[1] Figures for self-employment over the last year are a projection based on self-employment growth over the previous five years.

45. Productivity has been growing strongly, with manufacturing productivity now estimated to have risen by 4½ per cent a year on average since 1979. Underlying growth in labour productivity in manufacturing industry now appears to be higher than the rate experienced in the 1960s. Output per head in the non-manufacturing sector has risen by about 1¾ per cent a year since 1979, and by about 2½ per cent a year since 1983.

Table 9: Output per head of the employed labour force

(Annual average, percentage changes)

	1964-73	1973-79	1979-88[2]
Manufacturing	3¾	¾	4½
Non-manufacturing[1]	3	½	1¾
Whole economy	2¾	1	2¼
Non-North Sea economy	2¾	½	2

[1] Excludes public services and North Sea oil and gas extraction.

[2] Includes estimate for calendar year 1988

Unemployment

46. By September 1988, seasonally adjusted adult unemployment in the UK had fallen for 26 successive months, and by some 940,000 in total. The fall in unemployment over the past year is mainly attributable to the strong growth of output and employment. A further, though slower, fall in unemployment is likely over the year ahead.

Financial developments

See cover note

47. Over the past year, with the exception of a short-lived upsurge in April and May, the sterling index has been in the range 73-79. In the year to September, the reserves have increased by an underlying $5billion, net of official borrowing.

I don't like this formulation. Unless the Chan can demonstrate to the that it is accurate, the version I used in debate on Tues.

October figure not published till next day

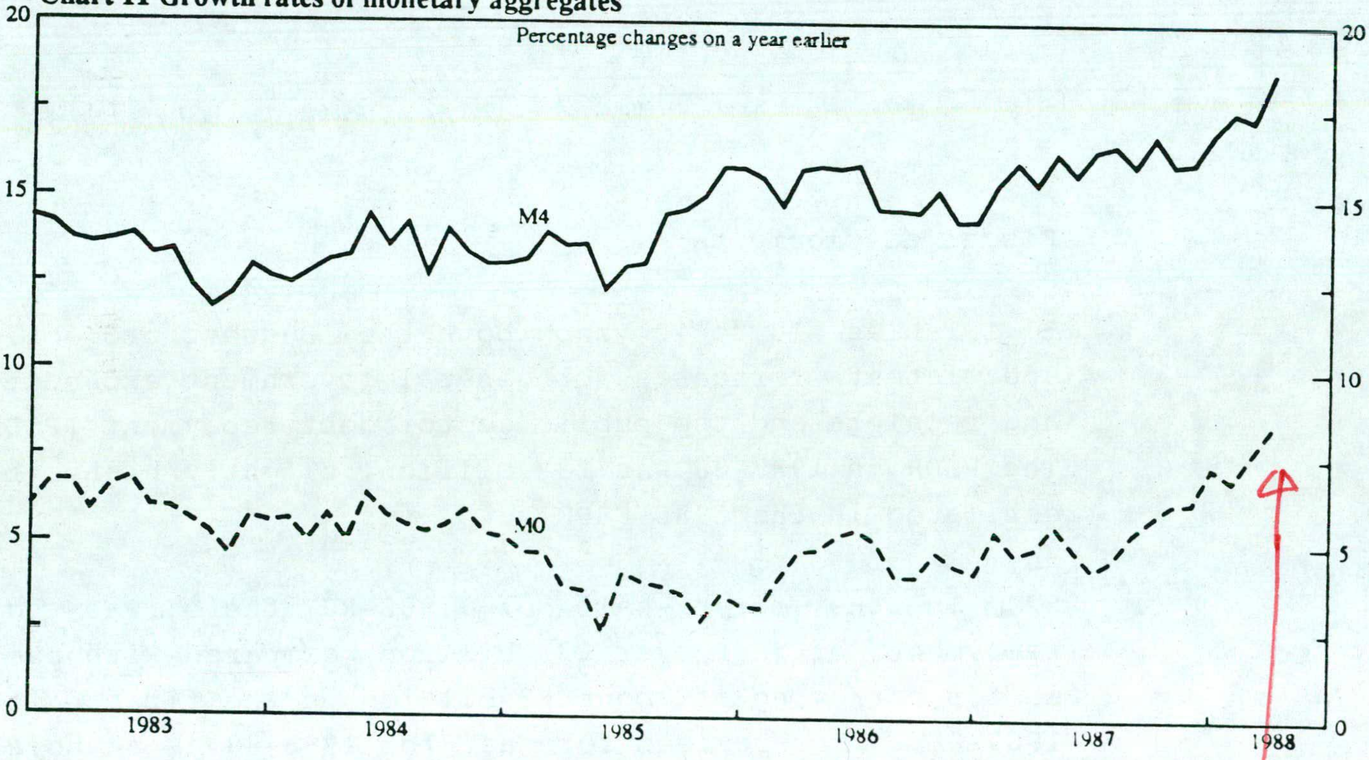
Narrow Money

48. The year on year growth of M0 has remained above the top of its 1-5 per cent target range. Increases in interest rates since the summer are expected to slow the growth of M0 considerably over the next six months, although it may not return within its target range by the end of the financial year.

Broad Money

49. Broad money has continued to grow rapidly. There has been a marked increase in personal and financial sector deposits, as the stock market crash led to a move away from new investment in equities and unit trusts. Financial innovation and liberalisation continues to contribute to the growth of broad money. [Growth in liquidity from these sources does not of itself represent inflationary pressure.]

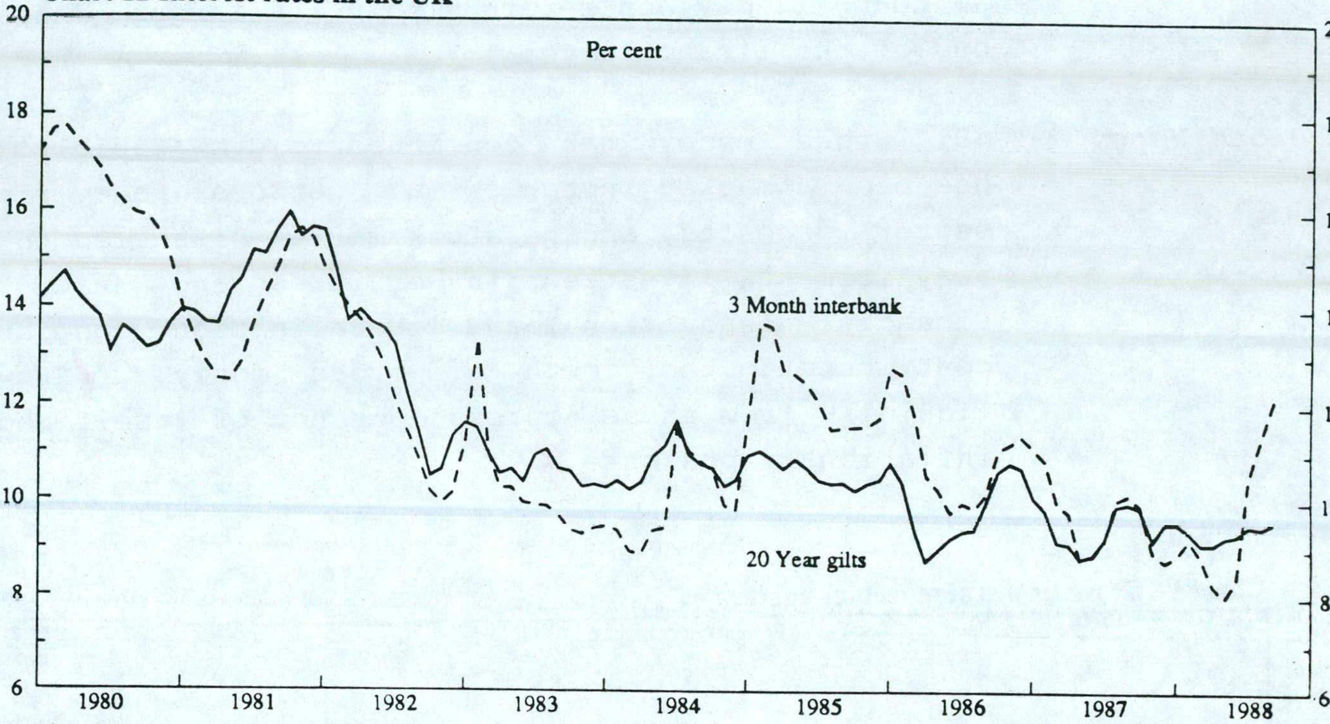
Chart 11 Growth rates of monetary aggregates



Insert October M0 fig, wh was much lower.

50. Chart 12 shows the recent path of interest rates. Monetary conditions have tightened considerably during this year.

Chart 12 Interest rates in the UK



Fiscal developments

51. Tables 10 to 12 show both the Budget projections and latest forecasts for general government expenditure and receipts and the public sector debt repayment (PSDR). The PSDR in 1987-88 was £3½ billion, slightly higher than estimated in the 1988 FSBR.

52. In the first half of 1988-89 there was debt repayment of just over £3½ billion, compared with public sector borrowing of about £2 billion in the first half of 1987-88. The revised forecast for 1988-89 as a whole is a PSDR of £10 billion, £7 billion higher than forecast in the FSBR. This is due in roughly equal amounts to higher than expected receipts and lower than expected expenditure. The revisions on the receipts side largely reflect the higher than expected growth of money GDP.

was "activity & prices"

Table 10: General government expenditure

	£ billion		
	1987-88	1988-89	
	Outturn	Budget Forecast	Latest Forecast
Public expenditure planning total	145.7	156.8	153.6
Interest payments	17.5	17.5	17.7
Other adjustments	8.2	8.6	9.6
General government expenditure	**171.5**	**182.9**	**180.8**
of which			
Privatisation proceeds	- 5.2	- 5.0	- 6.0

(Last sentence says Ch 2 gives latest estimates of planning total)

53. Gross debt interest payments in 1988-89 are a little higher than in 1987-88, and than forecast at Budget time. The upward revision to the forecast of other adjustments largely reflects a change in the composition of public corporations' net financing which increases GGE but does not affect the PSDR.

Must (briefly) give reason why: people might be surprised they are higher, given much higher PSBR than forecast

54. The ~~Budget~~ forecast for general government receipts in 1988-89 has been revised up by £4 billion since the Budget, most of which is accounted for by higher taxes and national insurance contributions. Income tax and VAT are expected to be £1 billion and £1¼ billion higher respectively than in the Budget forecast. Other significant increases come from national insurance contributions (up £¾ billion), and stamp duty (up nearly £½ billion). The latter mainly reflects the buoyancy of the housing market earlier this year. Total taxes and national insurance contributions are expected to be ~~somewhat~~ slightly lower in 1988-89 than in 1987-88 as a percentage of money GDP.

55. Total interest and dividend receipts are forecast to be £½ billion higher in 1988-89 than in 1987-88. Within this, dividends are about £¼ billion lower due to the sale of the government's remaining BP shares, and interest receipts £¾ billion higher. General government receipts in total are now forecast to increase by 9 per cent in 1988-89, much the same rate of increase as in 1987-88.

Table 11 General government receipts

	£ billion		
	1987-88	1988-89	
	Outturn	Budget Forecast	Latest Forecast
Taxes on income, expenditure and capital	132.7	141.2	144.0
National insurance and other contributions	28.9	31.6	32.4
Interest and dividends	6.0	5.6	6.4
Other receipts	5.9	6.4	6.2
Total receipts	**173.6**	**184.9**	**189.3**
of which North Sea revenues	4.7	3.3	3.3

56. Table 12 shows the old and new forecasts for the PSDR. The forecast is still subject to a wide margin of error; the average error on PSDR forecasts for the current financial year made in the autumn is ½ per cent of GDP, or nearly £3 billion. On the basis of this forecast, the budget surplus in 1988-89 will be larger as a proportion of money GDP than in any year since the beginning of the 1950s, the earliest date for which figures on this basis are available.

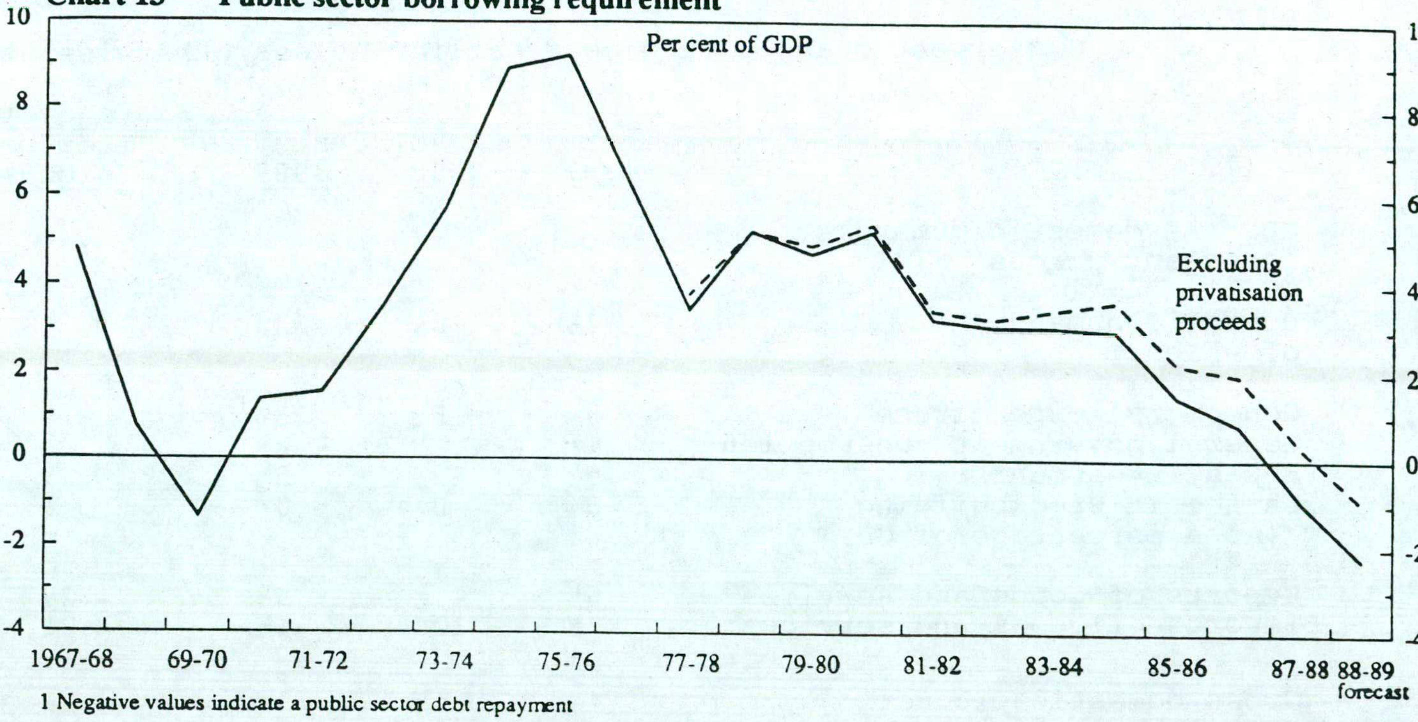
X

slight redraft.

Table 12: Public sector debt repayment

	£ billion		
	1987-88	1988-89	
	Outturn	Budget Forecast	Latest Forecast
General government expenditure	171.5	182.9	180.9
General government receipts	173.5	184.9	189.0
General government debt repayment	2.0	2.0	8.2
Public corporations' market and overseas debt repayment	1.6	1.2	2.0
PSDR	**3.6**	**3.2**	**10.2**
PSDR as per cent of GDP	**¾**	**¾**	**2¼**
PSDR excluding privatisation proceeds as per cent of GDP	- ¼	- ½	1

Chart 13 Public sector borrowing requirement[1]



1 Negative values indicate a public sector debt repayment

Table 13: Economic prospects: summary

Percent changes on a year earlier unless otherwise stated

	1987	Forecast 1988	Forecast 1989	Average errors from past forecasts[1]
GDP and domestic demand at constant prices				
Domestic demand	4½	6	3	1
of which:				
Consumers' expenditure	5	5½	3½	1¼
General government consumption	1	½	- ½	¾
Fixed investment	5½	12	5½	2¼
Change in stockbuilding (as a percentage of GDP)	0	0	0	¾
Exports of goods and services	5½	1½	5½	2¼
Imports of goods and services	7½	12	4½	2¾
Gross domestic product	4	4½	3	¾
Manufacturing output	6	7	4½	2
Balance of payments current account (£ billion)	- 2½	-13	-11	4¼
Inflation				
Retail price index (Q4 on Q4)	4	6¼	5	1¾
GDP deflator at market prices (financial year)	5¼	6¼	5	1¼
Money GDP at market prices (financial year)	10	11	8	1¼
£ billion	424	471	508	
PSDR (financial year) £ billion	3½	10		3
as a percent of GDP	¼	2¼		[illegible]

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

TABLE : 14 GROSS DOMESTIC PRODUCT AND ITS COMPONENTS

£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 statistical adjustment	**GDP at factor cost[1] (average measure)**	GDP index (average measure) 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	215.3	74.0	60.3	102.8	0.6	**452.9**	99.2	49.5	0.5	**304.7**	100.0
1986	226.8	75.4	60.8	106.6	0.6	**470.3**	105.6	51.8	1.1	**314.0**	103.0
1987	238.5	76.0	64.2	112.5	0.6	**491.8**	113.3	54.5	3.1	**327.1**	107.4
1988	251.9	76.4	72.0	114.3	1.0	**515.8**	126.8	57.0	9.1	**341.1**	112.0
1989	261.1	75.9	76.0	120.7	0.6	**534.4**	132.5	59.4	9.7	**352.2**	115.6
1987H1	117.0	37.8	31.2	55.5	-0.2	**241.4**	53.9	26.7	0.9	**161.6**	106.1
H2	121.4	38.3	32.9	57.1	0.7	**250.4**	59.4	27.8	2.3	**165.5**	108.7
1988H1	124.2	38.0	34.2	56.0	0.5	**253.0**	60.9	27.8	4.1	**168.5**	110.6
H2	127.8	38.4	37.8	58.3	0.5	**262.8**	65.9	29.2	5.0	**172.6**	113.4
1989H1	129.8	37.9	37.9	59.8	0.3	**265.7**	65.6	29.5	4.7	**175.4**	115.0
H2	131.3	38.1	38.1	60.9	0.3	**268.7**	66.9	29.9	5.0	**176.9**	116.2
Per cent changes 2											
1986 to 1987	5	1	5½	5½	0	**4½**	7½	5	½	**4**	4
1987 to 1988	5½	½	12	1½	0	5	12	4½	2	**4½**	4½
1988 to 1989	3½	- ½	5½	5½	0	3½	4½	4	0	3	3

1 The GDP figures are averages of constant price output, expenditure and income estimates of GDP. Percentage changes are calculated from unrounded levels and then rounded to the nearest half per cent. Figures for 1988H2 and beyond are forecasts. In the year to 1988H1, the expenditure measure grew by 2½ per cent compared with 4½ per cent growth for the income measure and 6 per cent for the output measure. It is likely that the expenditure measure and, consequently, the average both understate recent growth.

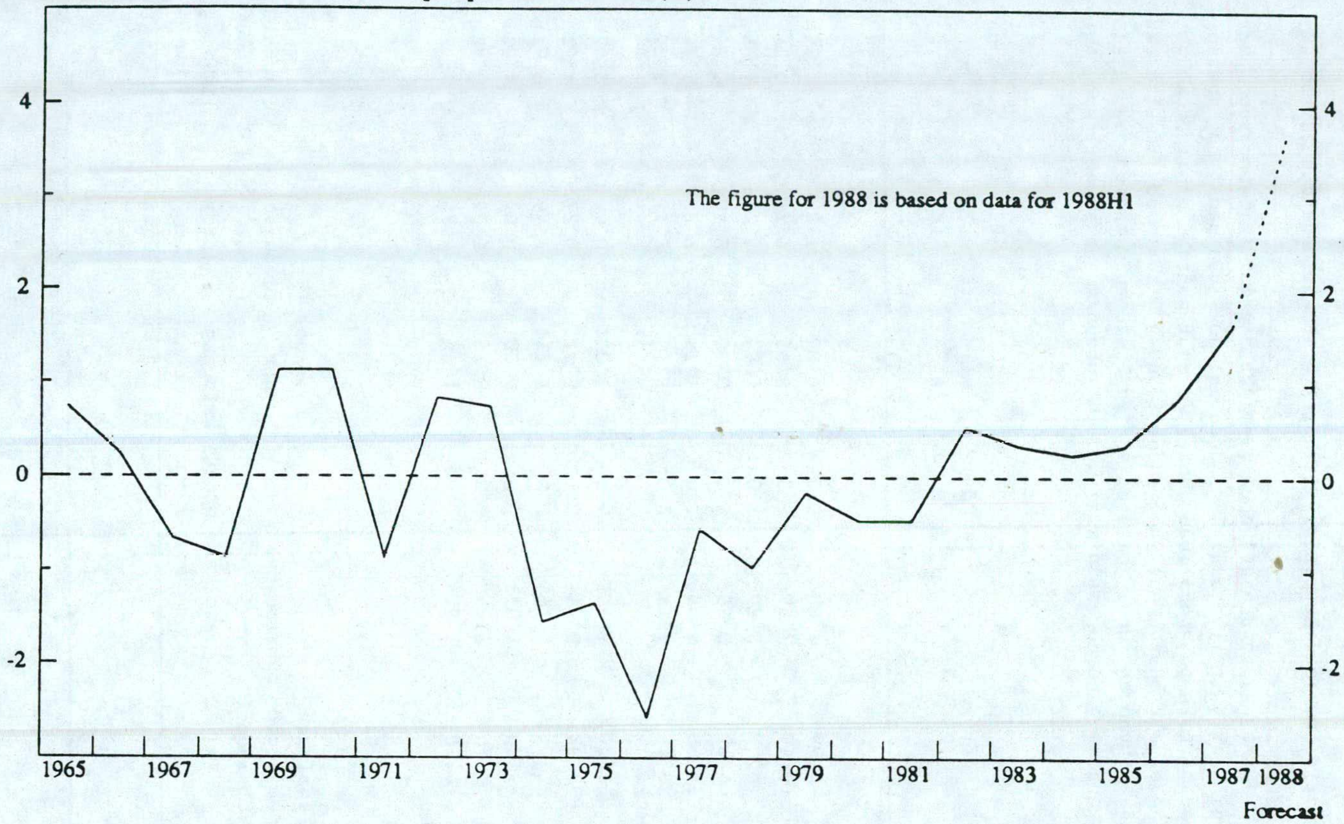
Str ~ bold type

2 Changes as a percentage of GDP for stockbuilding and statistical adjustment

(see facing page first)

A.3. There are analogous problems with the current price national accounts figures, reflected in a rising residual error (the difference between the current price income and expenditure measures of GDP), especially in the first half of 1988.

Chart A.2 Residual error as a proportion of GDP(E)



A.4. The large residual error is associated with large balancing items in the sectoral financial accounts. (The balancing item is the difference between net acquisitions of financial assets as measured from financial data and as measured from national income and expenditure data. The sum of the balancing items is equal to the residual error.)

ANNEX

UK national and sectoral accounts

A.1. It is difficult to assess just How strongly the UK economy has grown over the past two years ~~is unclear~~ because of the considerable disparity between the various measures of real GDP. The disparity is particularly marked for the first half of 1988. Chart A1 illustrates the differences between the separate measures since 1985. The output measure, which is the most reliable short-term indicator, grew by 6 per cent in the year to the first half of 1988. The income measure has also shown strong growth

this is incomprehensible to the lay reader: make it much clearer

A.2. By contrast, the expenditure measure of GDP grew by only 2½ per cent over the same period. It seems likely that aggregate expenditure has been under-recorded over the past two years, and maybe over a longer period. As a result, the statistical adjustment - the difference between the average and expenditure measures of GDP - has contributed 2 per cent to the recorded 4½ per cent growth of average GDP over the year to the first half of 1988.

Chart A.1 Growth in different GDP measures

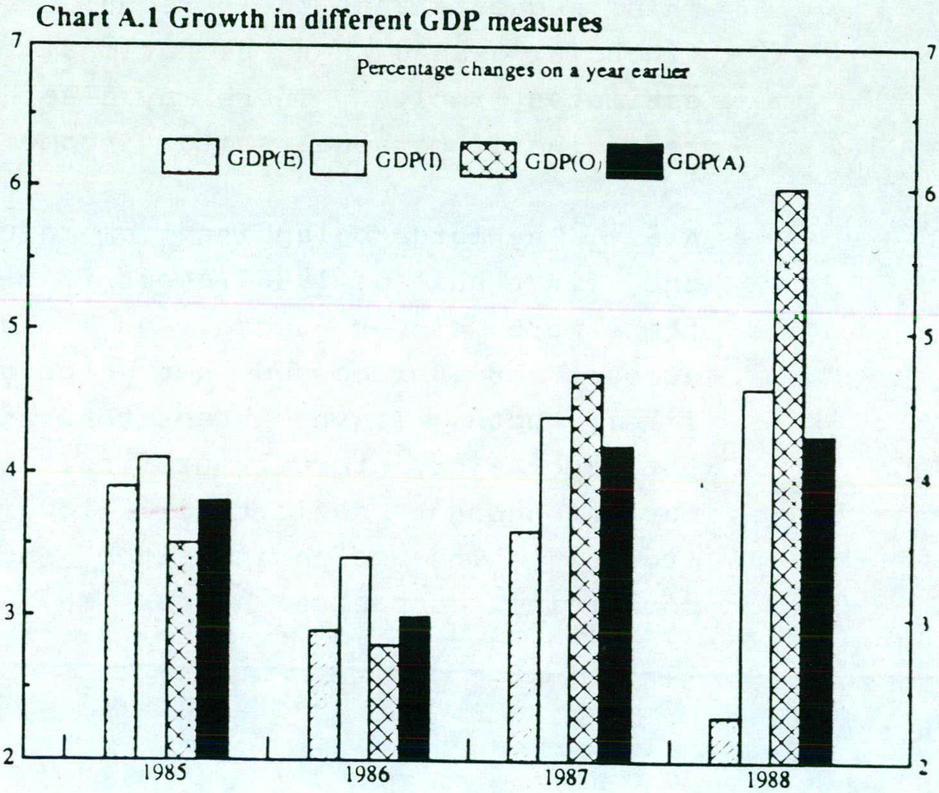
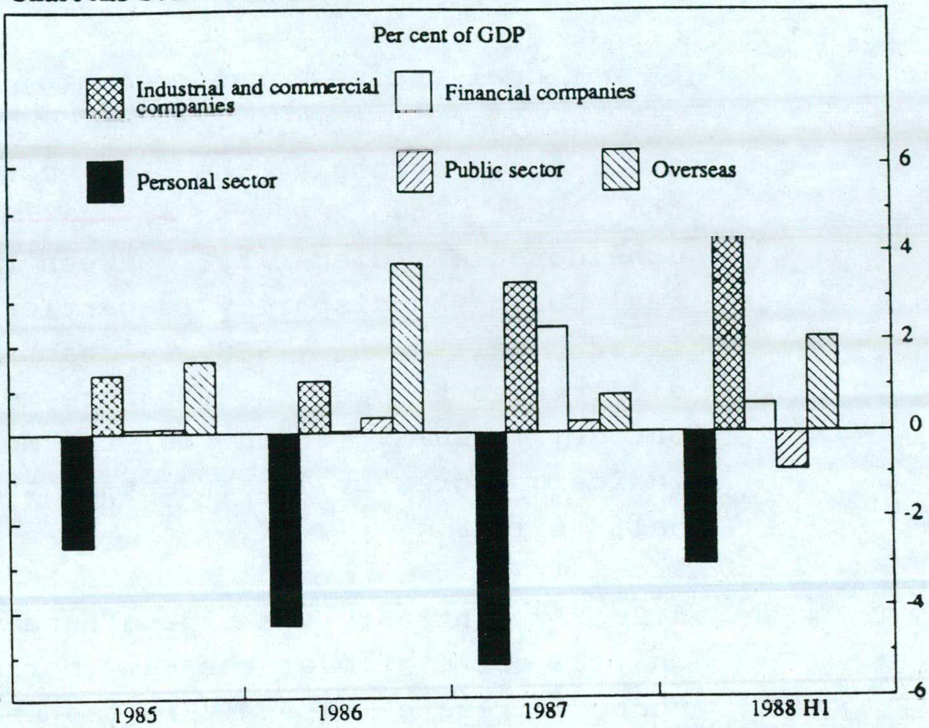


Chart A.3 Sectoral unidentified transactions



A.5. In 1987, the balancing item for the personal sector was about 8 per cent of personal disposable income. This suggests that the personal sector acquired far more financial assets than the national income and expenditure estimates imply. There may also have been some under-recording of personal sector income.

A.6. The large balancing item in the overseas sector in the first half of 1988 (about £7 billion) indicates that there were either unrecorded credits on the current account or unrecorded net capital inflows - or, most likely, both. To the extent that it reflects unrecorded net exports or interest, profits, and dividends, the true current account deficit ~~was~~ is lower than the recorded figure. The balancing item in the industrial and commercial companies sector may imply some under-recording of real spending on investment and stocks or unrecorded trade credit extended to other sectors. If, as these balancing items suggest, the current account deficit was small^er^ and company sector spending was higher than the recorded figures indicate, that would go some way to explain the sluggish behaviour of the expenditure measure of GDP relative to the other measures.

A.7 The forecast for 1989 presented in table 13 of the main text makes some allowance for a further rise in the average estimate of GDP, relative to the expenditure measure, though much less than in 1988.

They can't really mean this: the exp. measure shouldn't really have behaved sluggishly @ all, ~~[illegible]~~ since GDP(E) ≡ GDP(I); & there can be no explanation for [illegible] that didn't really happen. PBB rephrase.

CHANCELLOR OF THE EXCHEQUER

Ch

I only saw the final version of the IAF press notice this evening. Two points:

① Para 37 says "in part as a result of the rise in mortgage interest rates", whereas John Anson had suggested leaving this whole phrase out (when it began "mainly as a result of..").

② Para 39 says "labour markets have tightened" instead of

over

I did not agree - or even discuss - either of these pts. But, as you say, can only change ② in the print version, & anyway who will bother abt that.

my manuscript (or earlier version) which said "labour market conditions have tightened".

Did you agree these 2 points with Sedgwick?

AA

[We could take both points on board in printed AS, but to delete ① would probably raise too many questions if people spotted diff with typescript AS]

CONFIDENTIAL

Dnoby [illegible] 29/10.

FROM: P N SEDGWICK
DATE: 28 OCTOBER 1988

PS/CHANCELLOR

Ch
P Sedgwick will be in the office from about 10-30 tomorrow (Saturday). Grateful if you could phone your views to him (01-270-4459 or Jim Hibberd on 4590). If you have any difficulties getting him, ring me in Hampshire
AA

cc Sir P Middleton
Sir T Burns
Mr Anson
Mr Odling-Smee
Mr Hibberd
Mr Mowl
Mr O'Donnell
Mr Owen

AS : INDUSTRY ACT FORECAST

There are a few final points on which we need the Chancellor's agreement this afternoon. They follow from discussions we have had with Sir T Burns and Mr Odling-Smee.

Wage settlements

2. There is one reference only in the latest draft - in paragraph 6 - to the need for moderate wage settlements. On reflection we do not think that it is phrased in the best way. In the past we have emphasised the adverse effects of high wage increases on unemployment; not on labour costs and inflation as in the present draft. The alternatives to the present sentence at the end of paragraph 6 (which should be deleted) are

either to rephrase the last sentence of paragraph 7 to read

"Unemployment should continue to fall over the next year, though probably at a slower rate than recently, provided wage settlements moderate."

or to rephrase the last sentence of paragraph 46 to read

X "A further, though slower, fall in unemployment is likely over the year ahead provided wage settlements moderate." The main threat to achieving this would be excessive pay settlements.

We do not favour having a reference to wage moderation in more than one place, and there is of course the option of having no such reference.

Ch
I would favour either X (as amended), or simply moving the existing sentence in para 6 to the end of para 7.
AA

[illegible]

CONFIDENTIAL

see my comments on draft attached

3. The Chancellor preferred the original draft of paragraph 39 (which discusses the rise in underlying average earnings). As he suspected it was not correct and we have to stick with the current version.

Inflation ✓ already agreed.

4. Mr Anson's criticism of the existing draft (his minute to the Chancellor of today) is correct. We have deleted the phrase "mainly as a result of the rise in mortgage interest rates".

5. I have discussed the final sentence of paragraph 38 with Sir T Burns and Mr Odling-Smee. We would like to omit it. There was only one period of very fast demand growth in the 1970s, and the inflation that ensued was augmented by colossal rises in world commodity prices. If you wanted to retain the sentence the latter part of it could be redrafted to read

OK ✓

ie omit "comparably" OK?

> "....the underlying rate of increase in prices has been lower than in periods of fast demand and output growth in the 1970s". ✓

This reformulation can just about be interpreted to refer to the late 1970s as well as the 1972-75 period.

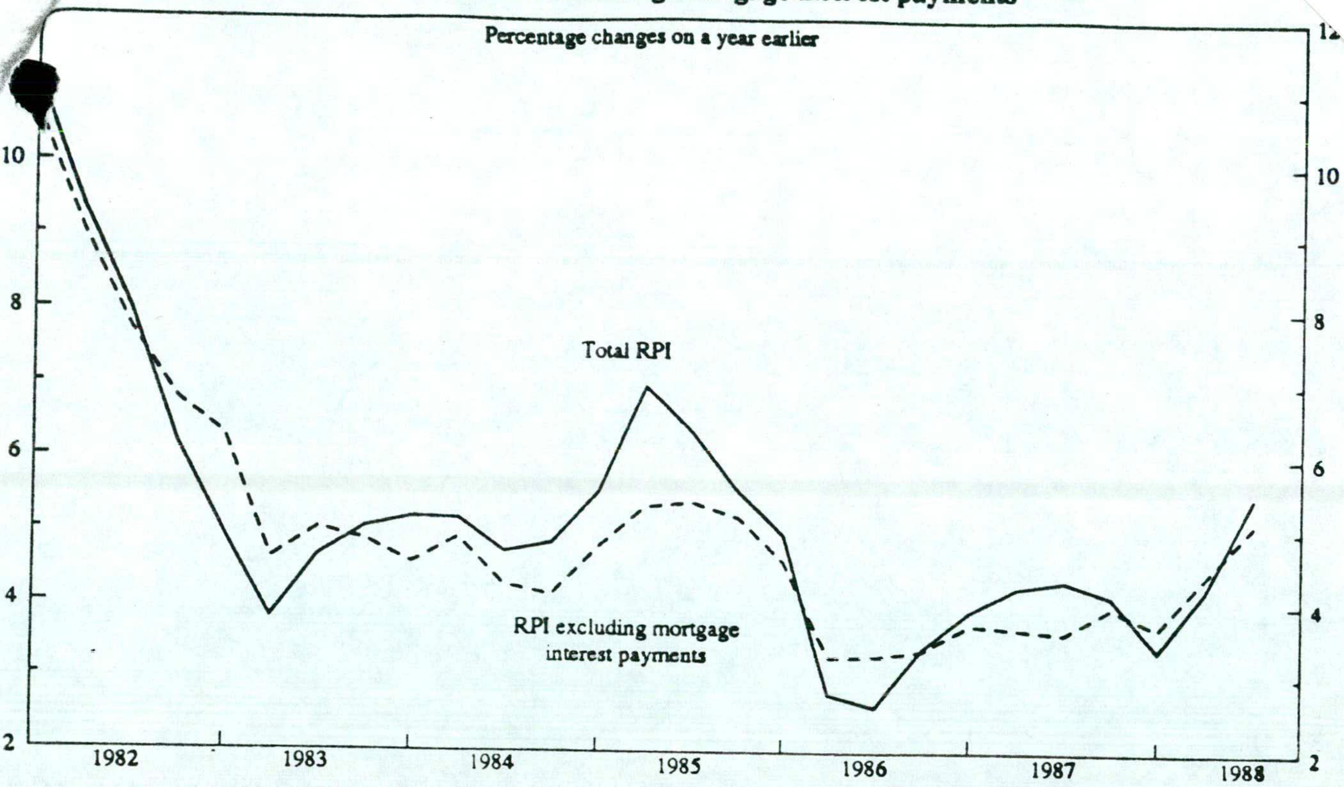
6. Still on inflation we would like to delete the final sentence of paragraph 49 (which refers to growth in liquidity as a result of innovation and liberalisation not of itself representing inflationary pressure). Read carefully it is unobjectionable, but it does have a hollow ring when only a few paragraphs earlier the draft records how the growth of earnings and various measures of prices has been edging up. ✓

Not crucial. Omit? ✓

P.N.S

P N SEDGWICK

Chart 10 RPI inflation: Total and total excluding mortgage interest payments



38. Total RPI inflation is likely to average 6¼ per cent in the fourth quarter of 1988; excluding mortgage interest payments (MIPs) the figure is expected to be 5 per cent. Producer price inflation has also edged up during 1988. Though higher than expected at Budget time, the underlying rate of increase in prices has been much lower than in periods of comparably fast demand and output growth in the 1970s.

8½ per cent at the start of the year

Earlier version was better! (was it untrue)

39. The underlying increase in average earnings has risen from 7¼ per cent in August 1987 to 9¼ per cent in August 1988. The rise is mainly accounted for by higher settlements (especially in the public sector). But high overtime payments and performance related bonuses have also played an important part.

has

40. Despite high earnings increases, growth in manufacturing unit labour costs ~~have~~ been kept down by the rapid growth in productivity. ~~and they~~ are expected to rise by just over 1 per cent in 1988.

Check

Pay settlements have edged up as labour market conditions have tightened, ~~but~~

Unit labour costs in manufacturing

CONFIDENTIAL

FROM J ANSON
DATE 28 OCTOBER 1988

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr Sedgwick
Mr Odling Smee
Mr Turnbull
Mr Hibbard
Mr Gieve

Ch
Any preference?
Little (a) seems OK to me.
AA

OK - [Told Sedgwick]

INDUSTRY ACT FORECAST

Could I offer one comment on Mr Sedgwick's draft of 27 October.

2. I think someone coming fresh to it would feel that the second half of the first sentence of paragraph 37 was not borne out by Chart 10. Chart 10 gives the impression that about one-third of the increase in the inflation rate since the beginning of 1988 has been due to MIPS, and the rest to other causes. This is not consistent with the word "mainly" in paragraph 37.

3. The general point is one which you will no doubt want to make in the oral statement, and Mr Odling-Smee's draft of that (of 26 October) was not open to the same objection. It would be a pity if that were to be confused by a wrangle about whether the point had been exaggerated in the text of the IAF. Possible alternatives might be:-

(a) To delete "mainly...rates" and rely on the second sentence.

(b) To put a full stop at "1988", and substitute something like "An important element in this has been the rise in mortgage interest rates".

JA

J ANSON

002 mg