PO-CH/NL/0712 PART A

2/2

CONFIDENTIAL

FROM : MISS J C SIMPSON
DATE : 28 OCTOBER 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Byatt
Mr Culpin
Mr Odling-Smee
Mr Gilhooly
Mr Riley
Mr A Wilson
Mr Tyrie
Mr Call

Table is v. messy: pref easier with 1988-89 → 1989-90 columns running straight vertically down the page. ✓

AUTUMN STATEMENT CHAPTER 4

I attach the proof of Chapter 4 of the printed Autumn Statement.

2. We have amended paragraph 4.04 as in Mr Allan's minute of 25 October. ETS felt, however, that the fact of the change to the basis of the figures ought to be recorded somewhere as it makes a significant difference to some of them. We are therefore proposing to insert a footnote in Table 4.6 (marked in red - top copy only). We should be grateful if you could confirm that you are content with this.

3. It would be helpful to have comments during the course of today. Please may I have them in any case by <u>10.00am on Monday, 31 October</u>.

JS

MISS J C SIMPSON

Ch
OK to X?
(one possible change marked)
AA

UK spoke: OK as amended by you.

Orange file

FROM: B O DYER
DATE: 28 October 1988

01-270 4520

If anyone making trouble, all they can do is delay the printed document, which will merely make them look foolish & in no way embarrass the Govt., since all the info will already have appeared in non-printed form on the 1st Nov.

NL.

CHANCELLOR

PRINTED AUTUMN STATEMENT : FORMAT

Having confirmed your wish to publish as a House of Commons paper, may I seek your permission to consult the Clerk of Journals (Bill McKay) - **in the strictest confidence, of course, and on a hypothetical basis with no dates mentioned** - to ensure there are no procedural or propriety problems that may have escaped me? I should like to tie this up completely watertight. We are breaking new ground and I would not wish any difficulty with the House Authorities to cause mischief at the eleventh hour, given the printing constraints.

Moreover, ~~in~~ in the highly unlikely event

B O DYER

B O DYER

Many thanks

I see no need to consult the Clerk of Journals. I suggest we simply proceed as outlined in paragraph 4 of your previous note (27/10): viz table the Motion for an Unopposed Return on Mon 7/11 and move it on Tues 8/11.

I do not see what problems this can possibly create, since we shall be producing the printed document on the earliest practicable date - and I will, of course, inform the House in my oral statement on 1/11 that the printed document will be published on 8/11.

psec.lb/bd.12

CONFIDENTIAL

PST follow the procedure @ X! This cannot possibly [illegible] as [illegible] now [illegible] [illegible] any [illegible]. N.

FROM: B O DYER
DATE: 27 October 1988

01-270 4520

CHANCELLOR

cc Mr Odling-Smee
Miss Simpson

PRINTED AUTUMN STATEMENT : FORMAT

I understand you are minded to publish the printed Autumn Statement as a House of Commons Paper. This is technically possible, but it could be messy, set a rather unique precedent and provoke criticism and points of order from Opposition Members seeking to embarrass you.

2. For the printed Autumn Statement to be published as a House of Commons paper it <u>must</u> be laid in compliance to a 'Return to an Order of the House'. There is no statutory or other means open to us. Given that we cannot table a Motion for such a Return until the day of the Autumn Statement (without pre-empting Cabinet approval), the earliest the Motion can be moved and the Order formally endorsed by the House is Wednesday 2nd November. As a consequence, the front page of the printed Autumn Statement would read:

AUTUMN STATEMENT
1988

Return to an Order of the House of Commons dated **2** November 1988: for

Copy of the Autumn Statement 1988
as <u>laid</u> before the House of Commons by
the Chancellor of the Exchequer on <u>2 November 1988</u>

Treasury Chambers)
2 November 1988)

Nigel Lawson

Ordered by the House of Commons to be printed **2** November 1988

3. This mode of publication would have two distinct disadvantages. First, it would, in effect, separate/divorce the printed Autumn Statement from your Oral Statement. Secondly, the 'Order of the House of Commons' to provide the House with the printed Autumn Statement (ie lay) would be dated 2nd November. Given the printing constraints, you could not comply with this order on the day ordered - except in 'dummy'.

4. As I understand it, the printed Autumn Statement will not be available for laying and publication until 8th November - a gap of 6 days between the Order of the House and your compliance; hence the reference to provoking criticism and points of order. The only alternative would be to delay tabling the Motion for an Unopposed Return until 7th November and move it on the 8th; thus enabling you to comply with the order of the House. But this would leave a sizeable gap between the date of the Oral Statement and the House ordering presentation and publication of the printed Autumn Statement which, in itself, could provoke questions. X

? why

5. Given the foregoing, I would recommend publishing the printed Autumn Statement as a Command Paper - as we did in 1986. It is neater and will avoid the potential for embarrassment that could attend publication as a House of Commons paper.

B O DYER

chex.rm/mw/28 CONFIDENTIAL

FROM: MISS M P WALLACE
DATE: 27 October 1988

MR ODLING-SMEE

cc **Chief Secretary**
Mr Anson
Mr Turnbull
Mr Sedgwick
Mr Gieve
Miss Simpson
Mr Dyer

PRINTED AUTUMN STATEMENT: FORMAT

The Chancellor was grateful for your minute of 26 October.

2. He is content for the printed Autumn Statement to use the same quality paper, and the same style of cover as in previous years, as you recommend.

3. However, he is not happy for the Autumn Statement to be published as a Command Paper: he comments that in 1986 we had to do this, because the House was not sitting, but that does not apply this year, and the normal HC paper treatment should be used.

[not sent out, pending Brian Dyer's comments etc]

MOIRA WALLACE

CONFIDENTIAL

(*i.e. was between sessions)

FROM : J ODLING-SMEE
26th October 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Mr Anson
Mr Turnbull
Mr Sedgwick
Mr Gieve
Miss Simpson
Mr Dyer

I am content with para 2, but not with the proposal in para 6. In 1986 we had to do this because the House was not sitting*; but this year the House does sit & the normal treatment applies. HC paper should be used.

PRINTED AUTUMN STATEMENT : FORMAT

The printers need us to confirm for them a number of details about the presentation of the printed Autumn Statement document.

2. We are proposing to use the same quality paper as in previous years and also to stick to the familiar grey and blue cover. Are you content with this?

Form of the document

3. The Autumn Statement is normally published as a House of Commons paper. In order to do this, we have to table a 'Notice of Motion for Unopposed Return'. Normally, this is tabled the day before the Oral Statement to enable the printed document to be presented immediately. Obviously we shall not do that. And once we have departed from the normal practice, we think that there would be advantages in following the example of 1986 and publishing the printed document as a Command Paper.

4. It would be possible to table the Motion at any time after the Oral Statement, but once we had done so we would be committed to producing the document within a reasonable time. Although we do not expect any difficulty about this, producing the document as a Command Paper would keep the operation entirely under our control.

5. This would mean only two modifications to the document. First, the front cover would have the Cm number printed on it. Second, the

front page would be substantially different. I attach copies of the 1986 and 1987 versions to show this, together with the front cover of the 1986 version.

6. Are you content that we should publish the Autumn Statement this year as a Command paper?

JOS

J ODLING-SMEE

Autumn Statement 1986

5/58

HM TREASURY
NOVEMBER, 1986

Cm 14

Autumn Statement 1986

Presented to Parliament by the Chancellor of the Exchequer by Command of Her Majesty November 1986

HER MAJESTY'S STATIONERY OFFICE LONDON

Cm 14 £4·80

Autumn Statement
1987

Return to an Order of the House of Commons dated 3 November 1987: for

Copy of the Autumn Statement 1987
as laid before the House of Commons by
the Chancellor of the Exchequer on 3 November 1987

Treasury Chambers 3 November 1987	}	Nigel Lawson

Ordered by the House of Commons to be printed 3 November 1987

HER MAJESTY'S STATIONERY OFFICE LONDON

£5·10

House of Commons No. 110

CONFIDENTIAL

FROM: J P MCINTYRE
DATE: 28 October 1988

CHIEF SECRETARY

cc Chancellor
Mr Anson
Mr Phillips
Miss Peirson
Mr Turnbull
Mr Gieve
Mr MacAuslan
Mr Pickford
Mr Ramsden
Mr Call

AUTUMN STATEMENT: DSS PRESS STATEMENT

DSS officials told us this afternoon that Mr Moore had changed his mind and decided that he would like to put out a short press statement on Autumn Statement day. The draft he has approved is attached.

2. As you will see, the main aim of the statement is to play up the extent to which the programme is increasing and thus address the presentational difficulty caused by the underspend of £0.9 billion in the current year and the reduction of £0.1 billion next year which the Autumn Statement figures will show.

[some scribbles from me too]

3. I have indicated some fairly minor amendments. One possibility, in the second indent, is to make the effect of the fall in unemployment rather clearer.

4. We would be grateful to know whether you are content with the draft and the suggested amendments.

J P MCINTYRE

Version 1

Press Notice

SOCIAL SECURITY SPENDING

John Moore, Secretary of State for Social Services, today commented on increases in planned expenditure on social security benefits announced in the Chancellor's Autumn Statement. He also announced, in answer to a Parliamentary Question, changes to National Insurance contributions ~~earnings bands~~ which will take effect in the week beginning 10 April 1989. Mr Moore said:

"Total spending on social security is planned to increase by £3.4 billion from £47.6 billion in the current year to £51 billion next year, increasing to almost £60 billion by the end of the survey period. The detailed plans will be published in the New Year in my Department's report. At this stage, I wish to make two key points:

* the plans imply ~~assume~~ a growth rate in spending on benefits of over 2% above the assumed increase ~~rate of~~ in prices ~~inflation~~. ~~Thus~~ £2.1 billion of the £3.4 billion increase is accounted for by the increase in ~~higher~~ benefit rates I announced on October 27. Most of the remaining £1.3 billion is due to [take-up of?] ? increased provision for people claiming benefits for long-term sickness and disability, where spending has increased by over 90% in real terms since we took office in 1979.

* the continuing fall in unemployment. This more than accounts for the £900m fall in expenditure this year, compared with previous plans. ~~and with a further £500m next year~~ is the main reason why my planning total for 1989-90 ~~that year~~ is broadly unchanged. And it has saved over £1½ billion in each of the next three years. This will ?

It is thanks to the growth in the economy and to the success of our economic policies that the country is able to afford the massive resources devoted to social security spending which are outlined in the Chancellor's statement."

jg111

SECRET AND PERSONAL

FROM: J GIEVE
DATE: 28 October 1988

PW

CHANCELLOR

cc Chief Secretary
Mr Turnbull
Mr Odling-Smee
Mr Tyrie

AUTUMN STATEMENT: ORAL STATEMENT

I would still prefer to restructure the oral statement this year. In both the last two years we have wished to start with the strength of the fiscal position in order to avoid undue reaction to an increase in the public expenditure planning total. This year we have unexpectedly good news on the Survey result with a 1989-90 planning total about £3 billion below most people's expectations. The impact of this announcement will be diminished if it is prefaced by an announcement that we are underspending by a similar amount in the current year. Moreover I think the message on the PSDR this year - which is certainly a bullpoint - would healthily strengthen the section on the forecast.

2. However, it would be perfectly possible to retain the 3-part structure and lead off with the new PSDR figure and include less on public expenditure in the first part. For example you might replace paras 5-9 with the following:

!

"In the Budget, I set a public sector debt replacement - PSDR - for 1988-89 of £3 billion, equivalent to three quarters of a percent of GDP.

Mainly as a result of the stronger economic growth, total Government revenues are likely to exceed the Budget forecast substantially with both income and tax and VAT particularly buoyant.

With the sharp fall in unemployment, the continuing success of our "right to buy" legislation, and our privatisation programme, we have also been spending less than we expected.

As a result, I now expect this year's PSDR to be £10 billion, equivalent to two and a quarter percent of GDP.

3. Whether or not you retain the 3-part structure, I would be inclined to start the public expenditure section with the 40 per cent figure on the following lines:

"I turn now to public expenditure.

Not so long ago, the share of national income spent by the State seemed to rise inexorably. [From 25 per cent in 1930, to 35 per cent in 1960, 40 per cent in 1970 and a breathtaking peak of nearly 50 per cent in 1975.] In the last 6 years we have decisively reversed that trend and achieved the largest and longest sustained fall since the war-time economy was unwound.

This year the share of gross domestic product going in public expenditure, excluding privatisation proceeds, will be below 40 per cent - the first time this has happened for over 20 years.

In July, Cabinet set itself the objectives.......(as at present)."

4. I have a few other comments:

Para 18 - I think it is worth adding at the end "and will result in an increase for the NHS next year of 5 per cent in real terms over the record level of spending this year."

Both done.

Science Capital

Paras 23 and 24 - I think these should be included since we will not be issuing any text with the tables on the public expenditure results and these are two points we do wish to get into the press. [They will not appear in other Departments' press releases.]

JL Gieve

JOHN GIEVE

Option (ii) in paragraph is perfectly viable. It would be consistent with the earlier decision.
P.N.
28.8

FROM: COLIN MOWL
DATE: 28 October 1988

1. MR SEDGWICK
2. CHANCELLOR OF THE EXCHEQUER

cc Sir P Middleton
Sir T Burns
Mr Scholar
Mr Odling-Smee
Mrs Todd
Mr Vernon

AUTUMN STATEMENT: PSDR IN 1988-89

Mr Sedgwick's minute of 25 October advised you that our latest best estimate of the PSDR in 1988-89 was a little over £11 billion (the October internal forecast was £11¾ billion) and that by implication publication of a forecast of £10.2 billion would provide a safety margin of around £1 billion.

2. With only two days to go we now have a reasonable idea of how central government finances have behaved during October. There are still one or two uncertainties, but it looks as though the net repayment in October could be about £¾ billion lower than in both the last monthly note on the PSBR and in the October internal economic forecast. This is mainly due to a shortfall on Inland Revenue receipts and national insurance contributions. The Inland Revenue shortfall is likely to be on income tax. It does not appear to be corporation tax.

Interesting

3. This potential underforecast of the CGBR(O) in October follows a small underforecast in September which at the time we attributed to the postal dispute. This interpretation now looks suspect. It is always difficult to know how much weight to give to the very latest information, but we would now put our central forecast of the PSDR in 1988-89 around £10½ billion, may be a little more. To maintain a safety margin in the Autumn Statement we now recommend publishing a figure below £10.2 billion. There are two options:

(i) stick to a rounded £10 billion but round up, say from £9.8 billion (shown in table 12 of the draft IAF);

At this stage, stick to a rounded £10 billion or go for (i)?

yes -

(ii) publish a rounded £9½ billion (say £9.7 billion unrounded); there is an AS precedent for £½ billions - the 1984 AS included a forecast of £8½ billion.

Both of these options imply that the PSDR would round to 2 per cent of money GDP, compared with 2¼ per cent for £10.2 billion.

4. Outside analysts may greet a forecast below £10 billion with some scepticism, but they do not have any information on October.

5. We should be grateful if you could let us know early this afternoon which of the options in paragraph 3 you prefer. Alternatively you could stick to £10.2 billion, recognising that this provides only a small safety margin.

Colin Mowl

COLIN MOWL

28.10.1

CONFIDENTIAL

MP

FROM: R B SAUNDERS

DATE: 28 October 1988

MR TURNBULL

* Note @ GW

cc Chancellor
Chief Secretary
Mr Anson
Mr Phillips
Miss Peirson
Mr Gieve
Mr MacAuslan
Mr Pickford
Mr A M White
Mr Griffiths
Mr Tyrie
Mr Call

Ch/ Most of this is already overtaken or incorporated in OS etc.
But you might like to note X in para 6, which (I think) is a sensible further pt to make. [Press release at back is none too good]
MPW

AUTUMN STATEMENT: HEALTH

This is to record what I have now agreed with Department of Health about presentation, and how we propose to take on board the Chancellor's comments recorded in Miss Wallace's minute of today.

2. At a meeting this morning, Mr Griffiths and I agreed with Department of Health to focus on the following numbers for England:

a. Increase in plan for 1989-90 - £1¾ billion. This includes reduced superannuation contributions, new cost improvement programmes and increased land sales.

b. Resources available to NHS (including reduced superannuation contributions, new cost improvement programmes and increased income generation receipts) increased in 1989-90 over 1988-89 by £1.8 billion - amounting to 9½% cash, 4½% real terms. Mr Clarke's press notice will headline the £1.8 billion.

c. Increase in resources available for HCHS current (same basis as b.) £1.3 billion, amounting to 10% cash, 5% real terms.

Income generation affects the year-on-year figures but not the 1989-90 plan-on-plan. Land sales receipts reflect the latter, but we have agreed with DoH not to include them in the year-on-year calculations since receipts this year are likely to turn out much closer to £290 million than the £190 million in the last White Paper.

3. Mr Griffiths and I have done some quick estimates of UK figures, which we are now trying to check out so far as possible. We think the NHS UK figures for the three survey years are something like £24.450/25.830/26.950 billion, representing increases of £1530 million in 1989-90 and £1830 million in 1990-91 over previous plans. We will incorporate rounded figures in the health brief. Adding in employers' superannuation etc (and making some heroic assumptions about cost improvement programmes in the territories and superannuation savings in Scotland and Northern Ireland) we reach total increases in resources of £2160 million and £2630 million respectively. We suggest rounding to £2.2 billion and £ 2.6 billion, although this may need to change if we are able to refine our calculations.

now improved + in O.S. by APH

4. These can be substituted for the £1¾/2 billion in the present drafts of the oral and written statements. I attach a revised version of the health paragraph for the oral statement, which also takes on board the points in your minute of yesterday.

5. As to the written statement, paragraph 1.46 would now conclude as follows:

X

> "... 7½% to 4%. Taking all these factors into account, the resources available to the NHS in England have been increased by £1¾ billion in 1989-90 and over £2 billion in 1990-91. The corresponding figures for the UK as a whole are estimated at £2.2 billion and £2.6 billion respectively."

over 2 over 2½

Paragraph 1.47 would begin:

> "For hospital and community health services in England, current resources amount to about 5% more in real terms in 1989-90 than in 1988-89. This increase will allow ..."

CONFIDENTIAL

6. Turning to the two points in paragraph 4 of Mr Gieve's minute of yesterday, we are clearing a new positive point for the briefing as follows:

[as you asked]

> "Resources available to health growing faster than for other public expenditure programmes and faster than economy as a whole."

On pay, we have added a new defensive point:

X

> "<u>What provision made for pay</u>? Adequate provision has been made for pay increases for Whitley staff and for review body groups assuming that the review bodies accept the Government's recommendation that there should only be a modest increase in pay next year."

In response to the Chancellor's point, we have added at the end of defensive (viii):

> "We have brought the review body process forward so that health authorities will be able to plan their annual budgets in full knowledge of what the pay increase will be."

7. Finally, we are including a line in the defensive briefing in response to the question "Doesn't this show that you've been underfunding the health service up to now?"

8. I also attach the latest version of Mr Clarke's draft press notice. This will change further. The main change that I have proposed is to switch the presentation of the first two paragraphs, so that it leads off with the £1.8 billion in the headline, rather than the £1.6 billion.

RBS

R B SAUNDERS

Re X, I cannot see how we can have a much greater degree of precision (rounds to the nearest £100m) for the UK than we have (rounds to the nearest £250m) for [illegible]. We must either have 50m to nearest £0.1 bn, or 50m to nearest £1/4 bn. Preferably the former.
N.

28.10.2

CONFIDENTIAL

DRAFT PARAGRAPH FOR ORAL STATEMENT

First health. An extra £1¼ billion is being provided for the National Health Service in England in 1989-90 and an extra £1½ billion in the following year. There will be corresponding increases in Scotland, Wales and Northern Ireland. On top of that health authorities will benefit from an extra £100 million a year from sales of surplus land. And continuing the rate of cost improvement savings achieved in recent years will produce an extra £150 million in 1989-90 and £300 million in 1990-91. In addition, the Government is accepting the recommendation of the Government Actuary, in a report which is published today, that employers' superannuation contributions in England and Wales should be reduced. This will save the Health Service a further £300m a year. In total the Health Service in the UK will have an extra £[2.2] billion in 1989-90 and £[2.6] billion in the following year. These are the largest increases ever. The increase in current resources available to the hospital and community health services amounts to 5% in real terms in 1989-90 over 1988-89.

OVERTAKEN.

S

CONFIDENTIAL

DRAFT PRESS NOTICE

GOVERNMENT BOOSTS HEALTH SERVICE BY £1.8 BILLION

"Next year, in England alone, we will make available an extra £[1.6] billion for our Health Service," said Kenneth Clarke, Secretary of State for Health, today.

On top of that, if health authorities do no more than they have achieved in recent years, there will be further cost improvements of £150 million, while an extra £25 million is forecast from income generation schemes. Taken together this means extra resources of £[1.8] billion, the equivalent of a cash increase of 9½ per cent or 4½ per cent extra after allowing for inflation. This is clearly a quite spectacular boost to health spending. It underlines yet again the continuing and growing priority that this Government has given to the NHS.

2

"The Chancellor has proved yet again that it is by encouraging an efficient society that this Government has been able to pay for a just one.

"But of course getting the health service to deliver the care that patients want is not merely a matter of more money. It is also a question of getting every best penny of value out of those collosal hmm sums we [have pumped] put into the NHS and of putting it all to use in the interests of patients. That's why we now have to concentrate on improving our health service and on bringing all parts of the service up to the standards of the best.

Mr Clarke continued:

"In 1989-90 spending on the NHS will increase to £19.7 billion. The Health Service will also benefit by nearly £300 million a year as a result of reductions in employers' superannuation contributions, recommended by the Govt Actuary and announced today.

["The £19.7 billion we are making available next year will be worth more in services to patients because of health authorities' continued success in improving their efficiency and the way they manage their resources. We will be expecting them to maintain their efforts to generate significant extra resources through the cost improvement programme, as well as to raise additional income from trading activities. Altogether these should add a further £175 million to health service revenue resources next year.]

Mr Clarke continued:

"The extra cash we are putting in, together with continued improvements in health service efficiency, should enable services to be expanded by significantly more than is necessary to take account of the growing numbers of elderly people, while enabling health authorities to plan to bring their income and expenditure into balance. The increase announced today also means:

*more money for hospital building. Net capital ~~Government~~ ~~provision~~ provision will be 10 per cent higher next year. And we expect income from land and property sales to increase. So the health capital programme - for building new hospitals and for maintaining the existing stock - is expected to increase to £1.2 billion next year.

* an extra £68 million next year for prevention, care, and treatment of AIDS;

* extra cash - £12 million next year - for nurses' training. This means we can get on with implementing Project 2000. More training place will be provided for ~~We will also be looking at the training needs~~ of specialist nurses;

* primary care will continue to develop and expand

"In addition to this increase in health service spending we are providing new specific grants for the Personal Social Services - to support local authority spending on the training of social services staff working with children, and on social services for people with AIDS.

"This increase in our spending plans provides a sound basis for moving forward into the 1990s and should enable the Health Service to face up with confidence to the challenges of the future."

NOTES TO EDITORS

1. Total Spending on health and personal social services (HPSS) in England is planned to ~~will~~ increase from £21.7 ~~£19.4~~ billion in 1988-89 of which NHS is 18.4, (including the additional sums made available in-year for Review Body awards) to £23.2 ~~£19.8~~ billion in 1989-90 (of which £19.7 billion relates to the NHS). The figures

agreed in this year's public expenditure survey for 1990-91 and 1991-92 are £~~20.9~~ 24.4 billion and £~~21.8~~ 25.4 billion respectively.

2. Changes to employers' contributions to the NHS superannuation scheme, on the recommendation of the Government Actuary, have been announced today. The Government Actuary's report recommended a reduction in the employers' contribution from 7 per cent to $4^1/_2$ per cent. This change will not affect NHS staff's pension rights in any way, but will mean that extra money will be available to spend on services. The amounts involved in 1989-90 are £237 million for Hospital and Community Services (HCHS) and £40 million for Family Practitioner Services (FPS).

3. The effects of the increases in expenditure on individual programmes are as follows:

HCHS Revenue

Expenditure 1988-89 (estimated outturn) £12.6 billion. Expenditure provision 1989-90 £13.5 billion. Plus savings from employers' superannuation reductions; £237 billion in 1989-90. ~~(Equivalent to cash increase of over $8^1/_2$ per cent, $3^1/_2$ per cent in real terms, compared with 1988-89.)~~ Other resources available from income generation schemes (an increase of £25 million expected over 1988-89) and from cash-releasing cost improvement programmes (about £150 million more next year). Total equivalent to increase of £1.3bn (10 per cent cash, 2½ per cent real terms).

HCHS capital

Net provision in 1988-89 £832 million; increases to £912 million in 1989-90. Plus increased income from land sales - expected to be £290 million in 1989-90. Gross expenditure therefore expected to be around £1200 million.

Health authorities' capital programmes include some 500 major building schemes (each costing over £1 million) of which around 140 are already under construction and expected to be completed over the next 3 years.

Family Practitioner Services (FPS)

Planned spending on FPS in 1989-90 expected to be £4 1/2 billion, an increase of £280 million over 1988-89. Plus £40 million reduction in costs from employers' superannuation contributions - so equivalent to a total increase of £320 million.

Personal Social Services (PSS)

Capital expenditure by local authorities on personal social services expected to be £124 million in 1989-90, an increase of £9 million over the planned level for 1988-89. But ~~local authorities~~ there will be ~~able to spend~~ increased capital receipts; ~~this~~ these will be taken into account in allocations.

The Government is still consulting on the Rate Support Grant Settlement for 1989-90, but present proposals for personal social services represent an increase of over 10 per cent above the amount included in the settlement for 1988-89.

Two new specific grants are to be introduced in 1989-90. One is to support local authority expenditure on training social services staff working with children. The other is to support spending on social services provided for people with AIDS and HIV-related conditions undertaken by those authorities under the greatest pressure to provide these services.

pmp

FROM: GUS O'DONNELL

DATE: 31 OCTOBER 1988

MR GIEVE

cc: PS/Chancellor
Sir T Burns
Mr Sedgwick
Mr Pickford
Mr Bush
Ms Turk
Mr Curwen

AUTUMN STATEMENT: DOMESTIC DEMAND AND GDP

1. Mr Odling-Smee asked me to reply to your minute of 28 October and Alex Allan's minute of 31 October on the same subject.

2. Sarah Hogg and Chris Huhne have probably picked up this point as a result of the extensive work carried out at Brookings some time ago on the gap between domestic demand and GNP growth needed to reduce the trade imbalances between the US, Germany and Japan. Economists at the Fed have also used their world models to answer questions such as 'how much of a gap between GDP and domestic demand growth is needed to reduce current account imbalances by x percent over y years'.

3. GDP(E) consists approximately of domestic demand plus net exports. In the forecast GDP grows a little more rapidly than domestic demand as a result of the improvement in net exports. In the Autumn Statement tables the growth rates of domestic demand and GDP have been rounded to 3 per cent.

Table 1: GDP(E) and its Components

(1980 Markets Prices)

	Domestic Demand	**Net Exports of goods and services**	**GDP(E)**
Growth rate (a)	3.09	3.25	3.24
1988 Weight (b)	100.4	-0.4	100
Contribution to growth	+3.10	+0.13	3.24

4. The balance on transfers and IPD - which does not of course count as part of GDP - also improves in the forecast. This explains around £0.7 billion of the current account improvement. The remainder is due to the improvement in net exports, which can be split into a

volume effect and a terms of trade effect. The total improvement in the current account is £1.8 billion.

5. Mr Allan's minute noted the uneven path of the improvement through the year. However, if we are asked to explain how the current account can improve from £13 billion to £11 billion (ie the year on year change) when domestic demand and GDP grow at the same rate (again, year on year) we cannot use arguments about the uneven pattern through the year. It is true that there are lags in the system but the accounting identity that GDP growth equals domestic demand growth plus the change in net exports, appropriately weighted, must hold in each period. The same analysis as applied above for year on year growth could be used, for example, to explain the change between 1988H2 and 1989H2.

Line to take

Q. How can the current account improve when domestic demand and GDP are expected to grow at the same rate?

A. GDP is projected to grow a little faster than domestic demand, although this is not apparent in the tables because of rounding. The small turnround in the current account deficit also reflects an improvement in the terms of trade and the balance on interest, profits and dividends.

Gus O'Donnell

A O'DONNELL

jg110 CONFIDENTIAL Blue / Pink

FROM: J GIEVE
DATE: 28 October 1988

MR ODLING-SMEE

Ch
Good point
AA

cc PS/Chancellor
Sir T Burns
Mr Sedgwick
Mr O'Donnell
Mr Pickford
Mr Bush

AUTUMN STATEMENT: DOMESTIC DEMAND AND GDP

As I explained to you this morning, both Sarah Hogg and Chris Huhne have attempted recently to estimate what deceleration of domestic demand (and consumption in particular) would be necessary to produce an improvement in the current account. They have toyed with figures of, for example, a 1 per cent slower growth of domestic demand than GDP. They have also pointed out that, given the growth in monthly deficits over this year, merely holding the position on the current account would produce a larger deficit in 1989 than in 1988 (although the September figure has been helpful in blurring the trends). They will undoubtedly look very carefully, therefore, at this aspect of the industry act forecast.

2. The last draft I have seen shows the same growth rate for domestic demand and GDP (although exports are forecast to grow faster than imports). However, we are showing a smaller deficit in 1989 than 1988. It will be important, therefore, for the briefing to explain how these figures are consistent. Is it just a matter of rounding? Are there other flows involved eg IPD - and if so why are we forecasting that they will be more favourable in 1989 than in 1988 (the fact that our interest rates are higher than most and that there will be a net inflow of capital from abroad would suggest that any change should be unfavourable)?

J.C. Gieve

JOHN GIEVE

Surely this is simply our old friend, the difference between year-on-year growth & in-year growth. In-year growth of domestic demand will be appreciably less than in-year growth of GDP; but because of the exceptionally rapid in-year growth of domestic demand in 1988, the year-on-year growth comes out the same. Nevertheless, if this is not clear to outsiders or to J. Gieve, this clearly means that the AS briefing on this is defective, & needs strengthening & improving in this respect.

typg/ln/pej/aef1/4.31.10.1p

CONFIDENTIAL

Py

FROM: J C MAY

31 October 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir Peter Middleton
Mr Anson
Mr Turnbull
Mr Mountfield
Mr Davis
Mr Pickford
Miss Simpson

AUTUMN STATEMENT: WAR SERVICE CREDIT FOR COLONIAL PENSIONERS

You asked for a short note on this issue in case it is raised by Ivor Stanbrook MP during tomorrow's Autumn Statement.

BACKGROUND

2. The Foreign Secretary will provide, from his PES agreement, for war service credit for ex-colonial servants. This will resolve a long-standing issue whereby former members of the Colonial Service, unlike other public service pensioners, did not receive credit for war service in their pensions calculations. There has been strong pressure for change, both by the Overseas Service Pensioners Association and by Ivor Stanbrook MP in the House. A recent Early Day Motion attracted over 350 signatures.

3. Up to 6,000 pensioners may benefit, at an estimated cost of £6 million annually, this to be borne on the ODA Superannuation Vote and not the aid programme as such. The changes will come into effect from 1 April 1989. ODA are to release a separate press notice to coincide with your Autumn Statement.

4. The Foreign Secretary will attempt to have a word with Mr Stanbrook before your Statement. Mr Stanbrook may try to catch the Speaker's eye in order to raise the issue. If he does, I suggest you respond along the following lines:

> "I am pleased to say that provision has been made to provide for war service credit in the calculation of pensions of ex-colonial servants. This will come from ODA's Superannuation Vote. Up to 6,000 pensioners should benefit. I recognise the determined work carried out by my Honourable Friend on this issue, and the interest shown by many Honourable and Rt Honourable members."

J C MAY

cst.pas/mc/min31.10

FROM: MARK CALL
DATE: 31 OCTOBER 1988

CHIEF SECRETARY

cc PS/Chancellor
Mr Turnbull
Mr Gieve
Miss Simpson
Mrs Chaplin
Mr Tyrie

AUTUMN STATEMENT: BACKBENCH BRIEF

I attach a copy of the revised draft of the main brief incorporating comments from you and others.

I am getting final revisions of numbers for the detailed Annex, and will submit this shortly.

Thanks. OK as amended by you. I have made one or two further changes.

MC

MARK CALL

2. I don't think it matters too much which order Economy & PX are in, but clearly there must be consistency.

Ch

I have redrafted introduction. I have retained order & suggested that main body be re-ordered to line up with that. Alternatively, could do public spending before economy in both intro & main body.

cst.pas/mc/31.10.88

SECRET AND PERSONAL

AUTUMN STATEMENT

A. KEY POINTS

The Economy

see redraft attached

Prospects for 1989 are good. Inflation is expected to turn down by the end of the year. Growth should slow down slightly but still reach a healthy [is anticipated to return to trend at] 3%. There should be further falls in unemployment. Investment is forecast to grow further, following record levels this year.

A

The Government's finances are sounder than ~~for a generation~~ at any time since records began in early 1950s. The Government expects debt repayment of £10 billion for 1988-89, reducing the burden borne in the decades ahead. The Government would be a substantial net repayer of debt even without any privatisation proceeds.

Public Expenditure

see redraft attached

The public expenditure planning total for next year is unchanged. Thanks to the strength of the economy and the continuing search for greater efficiency, the Government has succeeded in combining firm control of total public spending with increases for priority programmes: these include the highest ever increase for health, and substantial increases for law and order, transport, science and defence.

These have been made possible by savings in other areas, that reflect the success of economic policy over recent years. These include a large reduction in unemployment; the success of the Government's Right to Buy policy which has increased capital receipts; the reduced burden of nationalised industries on the Exchequer; and lower CAP spending resulting from the greater financial discipline for which the Government has been pressing. These savings have been supplemented by more effective targeting on policy priorities and increasing value for money on public spending.

The share of national income taken by public spending this year will be below 40%, the lowest level for over 20 years. Over the Survey period public spending as a proportion of national income is planned to fall further. This will be the longest sustained fall in public spending as a proportion of national income since the wartime economy was unwound.

Re-order

SPENDING PROGRAMMES

E ~~B~~.**INCREASED SPENDING ON PRIORITIES** (for further details see Annex).

The success of Government policies, together with sound financial management, have meant that it has been possible to increase spending on priority services. make substantial savings which can be used to finance extra spending on priority programmes

- Successful economic policies have brought growth which has reduced unemployment and released resources for other key areas.

- The large budget surplus has reduced Interest payments on the needed just to service national debt.

- Privatisation and the Right to Buy have brought significant capital receipts.

- Government efforts to bring greater financial discipline to the CAP have brought savings.

- Nationalised industries are performing better, so reducing their call on the Exchequer.

- The Value for Money drive has achieved greater output from money spent, as well as releasing resources for deployment elsewhere.

The Government has therefore been able to increase spending in the following key areas:

<u>National Health Service.</u> The NHS will receive the largest increase in resources ever - ~~£1¾~~ over £2 billion ~~in England alone~~ in 1989-90, and over £2½ billion in 1990-91. ~~There are further sums for Scotland [of], Wales [of] and Northern Ireland~~ [of].

<u>Low Income Families.</u> Next year poorer families will receive an additional £70 million over and above the prices uprating of the child allowances in Income Support, Family Credit and Housing Benefit. These families would not have been helped by an increase in Child Benefit as it would have been offset automatically against other benefits. A general Child Benefit increase would have helped only those families not in receipt of other benefits.

<u>Law and Order.</u> An extra £285 million in 1989-90, and £310 million in 1990-91.

<u>Transport.</u> A record increase of an extra £225 million for construction and maintenance of roads and bridges. Extra investment by London Transport and CAA to improve safety, and by British Rail to improve the quality of service.

<u>Defence.</u> An extra £150 million in 1989-90, and £600 million in 1990-91. [Agreed efficiency targets will release at least an extra £800 million over the next 3 years to improve Defence capability.] [CHECK]

<u>Science and Technology.</u> A 16% increase in spending on basic science over the next year as part of an increase in Department of Education and Science spending on science and technology of more than £120 million in 1989-90.

<u>The Environment.</u> The Water Authorities will receive an extra £250 million in 1989-90, most of it for anti-pollution measures. Over the next 4 years, they plan to spend £1.2 billion on improvements to sewerage disposal. More will

be spent on improving drinking water standards, and the cleanliness of our bathing beaches. The electricity industry will invest £1.5 billion on reducing Sulphur emissions from power stations.

Capital Investment. Increases total an extra £2½ billion in 1989-90 for roads, housing, hospitals, prisons and nationalised industries.

D ~~C~~. **PUBLIC EXPENDITURE POLICY AND PLANS**

Objectives Achieved. The settlement has met the objectives set by Cabinet in July:

- to keep as close as possible to the existing planning totals;

- to ensure that the proportion of national income accounted for by public expenditure continues to decline.

New Planning Total and Reserves. The planning total for 1989-90 will be £167 billion, unchanged from previous plans. In 1990-91 the planning total will be £179½ billion, an increase of £3½ billion on plans announced last year. In 1991-92 the planning total will be £191½ billion.

These totals include the same prudent Reserves over the next 3 years as in previous plans: £3½ billion/£7 billion/£10½ billion.

The planning totals also assume privatisation proceeds of £5 billion, unchanged from the last White Paper.

Out-turn for 1988-89. The outturn for spending in 1988-89 now looks likely to amount to £154 billion, or about £3 billion less than was allowed for in last year's Public Expenditure White Paper. This is even after allowing an extra £1 billion in health expenditure during the year. This is due to firm control of public spending; allied to:

- higher receipts from the privatisation programme and Right to Buy and New Town sales; and

- lower programme spending, especially on social security, due to the sharp and welcome fall in unemployment.

Ratio of Public Expenditure to GDP. In 1988-89 the proportion of economic activity accounted for by State spending will have dropped below 40% for the first time in over 20 years. That is excluding privatisation proceeds. The Government's policies have brought the ratio down from nearly 47% in 1982-83. This is the largest and longest sustained fall since the War-time economy was unwound. Further reductions over the Survey period are planned.

C ~~D~~. STRENGTH OF THE PUBLIC FINANCES

The public finances are stronger than they have been for a generation. This is the second year in succession that the Government has repaid debt. Debt repayment of £10 billion (2¼% of GDP) is now expected, this year. Under Labour the income and expenditure deficit rose to 9¼% of GDP, equivalent in today's terms to about £40 billion.

Supply-side reforms have played a critically important part in the recent growth in the economy and the restoration of the health of the public finances.

Government Revenues. Government revenues will exceed the Budget forecast by almost £4 billion. This is due to faster than expected growth, which in turn has yielded higher than expected tax receipts.

Even when the effects of privatisation proceeds are removed, there would still be a substantial surplus. In 1987-88 £4 billion of public sector debt was repaid.

B

~~E.~~ **ECONOMIC OUTLOOK**

Growth

Growth is expected to turn out at 4½% this year. Economic performance is well ahead of that expected earlier this year and far more vigorous than could have been expected at the time of the stock market crash last October. The combination of strong and steady growth which Britain has enjoyed in the seven years to 1988 has not been matched since the War. The vigour of the British economy, particularly over the past two years, is a testimony to the transformation of the supply side of the economy.

After ~~2~~ two years of rapid expansion, growth in 1989 is expected to be back in line with the trend of recent years, at 3%. ~~This slower rate was achieved only twice in the 1970s.~~

~~compares well with the economic performance of~~

X

Unemployment

Since the middle of 1986 unemployment has fallen by almost one million, the fastest fall on record, and faster than in any other major country. Unemployment is expected to continue to fall in 1989.

Investment

— as it has over the whole of the past five years.

Investment has been very strong, growing twice as fast as consumption. Manufacturing investment has shown the biggest rise of all, at 18%. ~~Over the past five years investment has risen faster than in any five year period for a quarter of a century.~~ Business investment is likely to continue to grow strongly in 1989, at 7%.

Inflation

Inflation is expected to be a little over 6% in the fourth quarter of this year. Interest rates have been raised to bring downward pressure on inflation, to curb excessive growth in domestic spending, and make it more attractive to save. Part of the rise in the RPI is attributable to higher mortgage rates. Excluding mortgage interest payments, the RPI in the fourth quarter will be around 5%.

There is likely to be some further rise in inflation between now and the first half of 1989 but by the second half of next year it is expected to be on a downward trend, reaching 5% by the fourth quarter. The defeat of inflation will remain the top priority of economic policy.

The Balance of Payments

Exports have continued to perform well. Manufactured exports are up 7½% over the past year. The UK's volume share of world trade has risen slightly over the past two years and held steady over the 1980s, after decades of decline.

However, with investment booming and consumer spending increasing fast, imports have risen rapidly, by 13% in the year to the third quarter, contributing to a rise in the current account deficit. This is expected to be £13 billion this year, 2¾% of GDP.

The current account deficit is expected to be around £11 billion in 1989 and on a downward trend by the end of the year.

F. NATIONAL INSURANCE CONTRIBUTIONS

Limits Revised. As a result of the Autumn Review:

- The Lower Earnings Limit will go up to £43 a week from next April

- The Upper Earnings Limit will go up to £315 a week

- The reduced rate band limits will be raised to £75 a week and £110 a week

- The upper limit for the 9% rate for employers will be raised to £160 a week.

<u>Treasury Supplement to be Abolished.</u> The Government has pursued a policy of steadily reducing the taxpayer's contribution to the National Insurance Fund, and it now stands at 5%. The Government now proposes to take this policy to its logical conclusion, and, subject to the approval of Parliament, to abolish the Treasury Supplement.

<u>No Increase in Class I Contributions.</u> Because of the healthy state of the National Insurance Fund, the abolition of the Treasury Supplement will not lead to an increase in Class I rates. These will stay at 9% for employees, and 10.45% for employers.

G. CAPITAL SPENDING: THE RECORDS COMPARED

As a result of the Government's policies private investment in industry has soared - growing at over four times the EC average since 1981. Public sector capital spending is now running at nearly £25 billion a year. This is broadly level with 1978-79 despite a deliberate policy of reducing th State's role in providing new housing. Under Labour capital spending <u>fell</u> 23% in real terms. Labour choose to ignore private investment, and consider only public expenditure. But even there their record is poor.

This shd go at end of PX section (ie @ end of new E)

Public Sector Capital Spending (changes in real terms);

	Under Last Labour Government	Since 1979
Roads	public spending fell 40%	Increased by 30%
Railways	Unchanged	Up 15%
Hospitals	Cut by nearly a 1/3	Increased by over 40%
Prisons	Down by almost 2/3	Nearly doubled
Overall	fell 23%	Broadly level

ANNEX: THE PROGRAMMES

over £2

HEALTH AND PERSONAL SOCIAL SERVICES ~~An extra £1¾~~ billion will be available to the Health Service ~~in England alone~~ in 1989-90 and over £2½ billion in the following year, representing the largest ever increase in resources. As a result spending on the NHS will be up by [40%] in real terms between 1978-79 and 1989-90. ~~Extra money is also being made available for the Health Service in Scotland, Wales and Northern Ireland.~~

The resources being made available to the Health Service will allow:

- full funding of the cost of the Nurses Grading Review and of the 1988 pay awards
- health authorities to expand services significantly
- Project 2000 training for nurses to be phased in from 1989-90
- more training places for nurses in paediatric and intensive care units
- extra money for exceptional costs imposed on certain regions by AIDS cases.

The NHS is working better than ever before, and a record number of patients are being treated. In 1986 (latest available figures) as compared with 1978 there were

- over 1 million (19%) extra in-patient cases
- 490,000 (87%) more day cases
- 3.75 million (11%) more out-patients attendances.

The number of staff providing direct patient care has increased from 444,000 in 1978 to 523,000 in 1988.

Capital Spending on the Hospital and Community Health Service is up by 43% in real terms between 1978-79 and 1988-89. During Labour's term of office it fell by nearly 30%. The biggest building programme in the history of the NHS is now under way, with over 500 major schemes and a total value of £4 billion.

SOCIAL SECURITY Full uprating of all benefits except Child Benefit, which has been maintained at £7.25 per child per week. This enables an extra £70 million to be directed to poorer families on Income Supplement and Family Credit There is also an extra £6.5 million for the cold weather scheme which has been improved and rationalised.

[Higher take-up is expected to lead to increased expenditure on disability benefits. The cost of the upratings and the other increases in provision will be partly offset by savings resulting from the fall in unemployment and the decision not to uprate Child Benefit in April 1989, and as a result the programme will be broadly unchanged in 1989-90, but provision will be about £1,700 million higher in 1990-91.]

Provision is included for the extra cost of special assistance to low income families; changes to Housing Benefit; and help for Income Support claimants towards the average 20% payments of rates and the Community Charge.

The benefit rates announced by the Secretary of State are the higher of those calculated directly from the published increase of the RPI for the year to September 1988 (5.9%), and those derived from a recalculation to take account of the RPI error discovered in November 1987. In addition the plans provide for further upratings of benefits in April 1990 and April 1991.

Entitlement to Mobility Allowance worth £x per week has been extended from age 75 to 80 to enable many elderly disabled people to retain the use of a car.

TRANSPORT Increases of over £100 million in 1989-90 and £140 million in 1990-91 have been allocated to build new trunk roads and motorways. Starts on 137 miles of new road are planned for 1988-89, including 19 by-passes. Over 40 schemes which would add more than 200 miles of new road are planned to start in 1989-90.

Total spending on trunk roads and **motorways** in England is planned to be 24% more in 1989-90 than in the previous year in cash terms. Between 1978-79 and 1989-90 capital spending on trunk roads and motorways in England alone will have increased by over 50% in real terms. This contrasts with a fall of over 40% from 1973-74 to 1978-79 under the Labour government.

£66 million more will be provided for trunk **road maintenance** in 1989-90 and £70 million in 1990-91. Nearly £50 million extra has been provided for **bridge strengthening** in 1989-90.

British Rail is undertaking a massive investment programme - over £2.5 billion over the next 3 years - including improvements to quality of service on Network South East and preparations for Channel Tunnel services. Substantial investment will be made in **London Underground.** This includes a project to enhance the Central Line at a cost of over £700 million up to 1996. Full provision has been made for all safety measures identified by LRT following the King's Cross fire.

Plans for the **Civil Aviation Authority** reflect the acceleration of investment to enhance capacity of air traffic control and to improve passenger safety.

OVERSEAS DEVELOPMENT ADMINISTRATION The net Aid Programme in 1989-90 is now set at £1.43 billion. Further increases represent growth of almost 18% by 1991-92 over previously published plans for 1988-89. [The increased provision will cover:

- full costs of UK's interest subsidy contribution to the IMF's **Enhanced Structural Adjustment Facility**

- expected costs of the Chancellor's **sub-Saharan debt initiative**

- increase in **bilateral programmes**

- provision for War Service Credit to former Colonial servants.

The high quality of UK aid is recognised internationally, with 81% of UK bilateral aid going to low income countries. Almost all new bilateral commitments are made as grants.

The UK is in the forefront of the sub-Saharan debt initiative. The UK has already written off loans to 14 African countries at a cost of almost £300 million. The UK is the first country to subscribe in full to the World Bank's General Capital Increase.

FOREIGN AND COMMONWEALTH OFFICE Spending on the Foreign Office will be increased by £30 million in 1989-90 taking the Departmental total to £770 million a year. The increase reflects the Government's commitment to represent effectively British interest abroad.

Extra resources will be provided to expand programmes such as The British Council, FCO scholarships, and sponsored visitors. Spending on these programmes will be increased by £13 million in 1989-90 and £15 million in 1990-91.

DEFENCE Spending on the defence programme will be increased by £150 million in 1989-90, and by £600 million in 1990-91. These increases in provision reflect the fact that the Government attaches the highest priority to defence and the maintenance of freedom. Since 1978-79 spending on defence has increased in real terms by about a fifth, reflecting commitment to NATO's 3% real growth target in the period up to and including 1985-86. At the same time efficiency and value for money have been improved. The use of competition in defence equipment procurement is up from 30% of contracts by value in 1979-80 to 50% in 1987-88.

HOME OFFICE Provision for local authority expenditure, largely for the police, has been substantially increased - by £350 million in 1989-90. In addition an extra £260 million has been provided principally for a further expansion of the prison building programme, with a further £370 million in 1990-91. As a result between 1988-89 and 1991-92 an extra 3,000 places in 5 new prisons, as well as extra accommodation at existing prisons, will be provided.

Following these increases expenditure on law and order will have risen 72% in real terms between 1978-79 and 1991-92. This has allowed an increase in police manpower of 20,000 since 1979, of which 13,000 are extra officers.

EMPLOYMENT The substantial and welcome fall in unemployment has allowed significant reduction in planned expenditure. The new plans still include provision of £1.4 billion a year for the new Employment Training Scheme, and around £1 billion a year for the Youth Training Scheme. New measures will achieve better targetting of help for the unemployed.

EDUCATION AND SCIENCE Total spending of about £19.6 billion is planned for 1989-90, most of it by local authorities. Since the beginning of the decade, the level of expenditure per school pupil has risen by some 30% in real terms. The Government's education reforms will ensure that full value is obtained for this expenditure, and that standards will continue to rise. Participation in higher education will increase. The number of First Degrees awarded is now expected to be around 135,000 a year by 1990, more than 25% up on a decade earlier.

Provision is made for an increase of 16% in the science budget.

ARTS AND LIBRARIES The Government's policy of encouraging greater private sector sponsorship of the arts has achieved substantial results. To enable subsidised arts bodies to plan with confidence, and to encourage them to become more self-reliant for development and growth, a three year programme for the arts was announced last year. This covered most central government spending, and provided for a 17% increase by 1990-91. This year provision has been increased by a further £25 million (6%) between 1990-91 and 1991-92 to roll the programme forward into a new third year.

The total provision in 1989-90 represents a 25% increase in real terms since 1978-79.

<u>**ENERGY**</u> The plans for 1989-90 and 1990-91 reflect net reductions in the Energy nationalised industries' external finance requirement. The increase in 1991-92, reflects the privatisation of the electricity industry, which will result in the loss of substantial net repayments of external finance. The cash contribution lost will be over £1 billion.

<u>**TRADE AND INDUSTRY**</u> The Enterprise Initiative is projected to build up over time, expenditure reaching £160 million by 1991-92. The Department's plans also reflect the privatisation of British Steel and further privatisation of shipbuilding.

<u>**HOUSING**</u> As a deliberate result of Government policy, most investment in housing is undertaken by the private sector. Even so, provision for **capital investment** by the public sector has been set at over £4 billion a year - an increase of £450 million on previous plans for 1989-90 and nearly £350 million for 1990-91. These plans include increased spending on new homes for rent by the Housing Corporation and on renovation by local authorities of their own stock through Estate Action.

£190 million has been allocated for **Housing Action Trusts** (HATs) over the three survey years. HATs will improve rundown estates attracting private sector investment and diversifying the ownership and management of the estates.

[1987 was the best year for house building since 1973. Total housing starts in the first half of 1988 were up 16% on the same period last year, with private sector starts up 21% over the same period.]

The 1988 Budget changes to the Business Expansion Scheme will encourage the development of the private rented sector.

<u>**EUROPEAN COMMUNITIES**</u> [The projection of the UK's net payments to Community institutions has been increased by £500 million in 1989-90 as a result of, the buoyancy of imports (which has led to an upwards revision of customs' duties payable to the Community), higher VAT payments as well as the Brussels Agreement on the future financing of the Community.

The Fontainebleau mechanism, which has worked well, producing large abatements for the UK. The abatement being made in 1988 is £1,600 million, and by the end of 1988 the UK will have received abatements of around £4½ billion.

<u>**EXPORT CREDIT GUARANTEE DEPARTMENT**</u> The Department supports UK exports by providing credit insurance facilities. The changes to the public expenditure plans reflect the latest estimates of the cost of interest support and tender to contract cover.

<u>**LEGAL DEPARTMENTS**</u> An increase in spending of £30 million in 1989-90 taking the Departmental total to £840 million a year, will cover increased spending on Legal Aid, Court building, and handling of Court business. An additional 65 courtrooms will be built by 1991-92 in order to reduce waiting times.

<u>**MAFF**</u> Spending on agriculture is largely determined by the Common Agricultural Policy. The Government has sought to bring sense and financial discipline to the CAP, and has succeeded in securing savings through reform.

SCOTLAND, WALES AND NORTHERN IRELAND The net changes in these programmes mainly reflect the changes in comparable programmes in England, through the block mechanism. The Secretaries of State will allocate this expenditure based on previous patterns of expenditure and taking account of local factors.

Scotland and Wales have done well under public expenditure arrangements for a great many years. On the latest figures (1987-88) Scots received £2,676 of public spending per capita compared with a UK average of £2,162.

CHANCELLOR'S DEPARTMENTS Inland Revenue provision has been increased to allow for the introduction of Independent Taxation, and for continued development of computer systems, to improve efficiency and customer service. The increase in Customs and Excise provision of £16 billion is to meet higher forecast workload, including work to prevent drug trafficking, and subsumes cumulative efficiency savings of about 2½% a year.

LOCAL AUTHORITIES Aggregate Exchequer Grant to local authorities for 1989-90 has been set at £17.4 billion. The plans for local authorities' current expenditure show increases of around £2 billion a year over previous plans, largely as a result of authorities overspending in 1988-89 which is rolled forward into the later year's figures. These also plans reflect estimates of the costs of Housing Benefit, and take into account the proposed changes in benefit entitlement.

Local authority gross capital spending in GB is forecast to be £8.1 billion in 1988-89. After allowing for capital receipts, mainly from Right to Buy sales, the net cost of programmes is forecast to be £4.7 billion. Allocations of £135 million have been made to allow for the costs of implementing the Community Charge.

NATIONALISED INDUSTRIES Estimated outturn for nationalised industries external finance requirements for 1988-89 is £400 million, £290 million lower than the plans in the White Paper. This reflects better than expected performance by British Rail and British Steel. This is a massive reduction in the burden placed on the taxpayer by the nationalised industries, down from nearly £3 billion in 1978-79. These impressive improvements in performance are expected to continue, and in 1989-90 it is expected that the nationalised industries will generate a cash surplus. The forthcoming privatisation of British Steel, the water industry, and the electricity supply industry acknowledge the improvement in performance. As a result of the loss of the cash contribution of the electricity industry, total provision for external finance increases in 1991-92 to £1.3 billion.

The nationalised industries will undertake massive spending to improve the condition of the environment. The Water Authorities will receive an extra £250 million in 1989-90, virtually all of which will be spent on anti-pollution measures. Over the next 4 years, they will spend £1.2 billion on improvements to sewage discharge. In addition, money is provided for improvements to the quality of our drinking water and the cleanliness of our beaches. The electricity industry has embarked on a £1.5 billion programme to reduce the emission of sulphur by power stations.

It will remain the Government's policy to strengthen the nationalised industries as businesses earning an adequate rate of return for the taxpayer.

pay

FROM : MISS J C SIMPSON
DATE : 31 OCTOBER 1988

CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Sedgwick
Mr Odling-Smee
Mr Turnbull
Mr Gieve
Mr Hibberd
Mr MacAuslan
Mr Pickford

PRINTED AUTUMN STATEMENT : CHAPTER 2

I attach the printers' proof of Chapter 2 of the printed Autumn Statement - the Industry Act forecast. The amendments necessary to bring it into line with the Treasury press notice have already been marked.

2. Please may I have any comments on layout etc by noon on Wednesday, 2 November. The proofs must be returned to the printers that afternoon.

Ch
Change to para 2.37 essential

JS

MISS J C SIMPSON

AA

2.4 & 2.6

2.11, 2.12

2 Economic prospects for 1989

Summary

2.01 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

2.02 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 ans d 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 in 1988–89; the actual PSDR for that year will, as usual, be set in the Budget. ×

lower case

World economy

2.03 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 ~~sharply~~ and should grow by 8½ per cent in 1988. Inflation in the major industrialised countries is expected to remain low.

strongly

Demand and activity

2.04 The economy has grown strongly over the past year, though major inconsistencies in the official statistics (discussed in the a ~~A~~nnex) make it difficult to assess the precise extent of growth. The average measure of GDP 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. is expected to moderate in 1989. × ×

forecast

, which may understate the true position,

It

UK trade and current account

2.05 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.

Inflation

2.06 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. l.c. 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~~.

Manufacturing

×

Labour market

2.07 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.

Half a million

It

World economy

Recent developments

2.08 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 per cent.

2.09 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 benefited from the rise in real commodity prices in 1987 and the first half of 1988. Greater exchange rate stability following the Louvre ~~Accord~~ accord (l.c.) and rising capacity utilisation have strengthened business confidence and contributed to a resurgence of investment.

Chart 2.1 **Major seven economies' real GNP and industrial production**

(explain)
in all these countries

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. All the major ~~seven~~ countries are currently experiencing an investment boom.

2.11 Although non–oil commodity prices rose by ~~around~~ nearly 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 2.2 Real commodity prices

Forecast

2.12 Table 2.1 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 2.1 World economy

	Per cent 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.*

will stet still

2.13 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.

remain high

2.14 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

2.15 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 2.3 Exchange rates

Relative costs and prices

2.16 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.

2.17 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)

7½

2.18 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~~ 7½ per cent higher than a year earlier. Manufactured export volumes are forecast to rise by ~~nearly~~ over ~~9~~ 8 per cent in 1989, ~~in line with~~ close to the projected growth of world trade.

Chart 2.4 Unit labour costs in manufacturing

Chart 2.5 Export volumes (goods less oil)

2.19 Chart 2.6 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.~~ X X X

2.20 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.

Chart 2.6 Share of UK exports in total world trade in manufactures

Charts 2.4
2.6

Oil trade

2.21 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

2.22 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 to remain broadly unchanged ~~between~~ during the rest of 1988 and in 1989.

Chart 2.7 Share of imports of goods (excluding oil) in total domestic demand

Table 2.2 Visible trade

	Per cent changes on previous year					
	All goods			Goods less oil		
	Export volume	Import volume	Terms of trade[1]	Export volume	Import volume	Terms of trade[1]
1987	5	7	1	6½	8	1
× 1988 Partly forecast	2	12½	~~2~~ 1½	5	13½	2½
××× 1989 Forecast	~~6½~~ 7	5	1½	8½	5	1½

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

Invisibles and overseas assets

2.23 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~~ insurance premiums ~~on insurance~~ net of claims.

2.24 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.

2.25 The invisibles surplus should rise a little in 1989 because ~~as the balance on services recovers and~~ payments abroad by North Sea companies continue in part to fall. ~~These improvements will be partially offset, however, by increased payments to the European Community.~~

the fall in the sterling value of UK assets in North America

During

2.26 ~~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~~ largely due to ~~revaluations~~ following the fall in the US dollar.

Current account **2.27** The current account is estimated to have been in deficit by just under £10 billion in the first nine months of 1988 (though the large 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).

benefit non-oil trade,

2.28 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 ~~partly~~ fully offset by the smaller oil surplus ~~and the fact that world trade growth is projected to be somewhat slower~~.

Table 2.3 **Current account**

	£ billion Manufactures	Other	Oil	Invisibles	Current balance
1987	− 7½	−7	4	7½	− 2½
1988 Partly forecast	−13½	−~~7½~~ 8	2½	5½	−13
1989 Forecast	−~~12~~ 11½	−7½	2	6	−11

Demand and activity

the growth in

Personal sector expenditure **2.29** 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~~ fall~~en~~ ~~further~~ to about 3½ per cent.

2.30 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.

for the first time

and

2.31 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. 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, a 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.

Personal
i.e.

Chart 2.8 ~~S~~savings ratio

It is likely to rise much more slowly in 1989.

2.32 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~~ in 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~~ substantially. ~~Housing investment is unlikely to rise significantly further in 1989.~~

Company incomes and expenditure

for almost twenty years.

2.33 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 almost twenty years.

surveys

2.34 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~~ modest scale in 1988 and 1989.

Manufacturing investment, including leased assets, is likely to rise by 18 per cent and total non-oil business investment by 13 per cent.

Chart 2.9 Companies' net rates of return

Table 1.4 Gross fixed domestic capital formation

	£billion at 1985 prices 1987	Per cent changes on a previous year 1987	Forecast 1988	1988
Business[1]	41·1	6½	13½	7½
of which: non-oil business	39·2	8½	13½	~~6½~~ 7
manufacturing	10·1	5	18	10
Private dwelling[2]	~~16·5~~ 15·2	7	13	2½ 2
XX Central government	~~6·7~~ 8·1	−~~1~~½	~~1½~~ ½	2 ~~6~~½
Total fixed investment	**64·2**	**5½**	**12**	**5½**

[1] *Includes investment by public corporations.*

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

Prospects for demand and activity

2.35 Growth of the average measure of GDP is ~~expected~~ forecast 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~~ With the forecast slowdown in domestic demand, GDP is expected to rise more slowly in 1989.

2.36 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 the second half of 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 2.5: Domestic demand and GDP

	Per cent changes on a year earlier		
		Forecast	
	1987	1988	1989
Domestic demand	4½	6 4	3 6½
Exports of goods and services[1]	5½ (6½)	1½ (~~3½~~)	5½ (~~7~~)
Imports of goods and services[1]	7½ (8)	12 (13)	4½ (~~4½~~) 5
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

in part

2.37 The annual rate of RPI inflation has risen since early 1988, ~~mainly~~ as a result of the rise in mortgage interest rates. Chart 2.10 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.

Chart 2.10 RPI inflation ~~Total and total excluding mortgage interest payments~~

2.38 ~~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.

X

Pay settlements have edged up, as labour markets conditions have tightened, but high overtime

2.39 The underlying increase in average earnings has risen from ~~7¼~~ 8½ per cent ~~in August 1987~~ at the start of the year 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.

2.40 Despite high earnings increases, growth in manufacturing unit labour costs ~~have~~ has been kept down by the rapid growth in productivity, and they are expected to rise by just ~~over~~ under 1 per cent in 1988.

Prospects **2.41** 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 slowdown in demand and activity may mean that profit margins will show less growth in 1989 and that ~~But~~ slightly faster growth in unit labour costs will grow more rapidly (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 2.6 Costs in manufacturing

	Per cent changes on previous year			
	Unit labour costs	Cost of materials and fuel[1]	Estimated total unit costs[2]	Output prices[1]
1986	5	−10½	2¼	4
1987	¼	5	1½	4¼
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.*

2.42 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 2.7 Retail prices index

	Weight in 1988	Per cent changes on a year earlier	Forecasts	
		1987 Q4	1988 Q4	1989 Q4
Food	16¼	3½	3¼	3¼
Nationalised industries	5½	2¼	7¼	6¼
Housing	15¼	7	16¼	7
Other	63	3¾	~~5¼~~ 4½	4¾
Total	**100**	**4**	**6¼**	**5**

2.43 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 198~~8–89~~ 9–90.

Productivity and the labour market

2.44 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. Since 1983, there has been an increase of over ~~1½~~ 2 million in the ~~number of jobs~~ workforce in employment. X

Table 2.8 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.*

2.45 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 2¼ per cent a year since 1983.

Table 2.9 Output per head of the employed labour force

(Annual average, per cent 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

2.46 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. The main threat to achieving this would be excessive pay settlements. X X

Financial developments

varied by less than 3 per cent from its present level (1)

2.47 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 $5 billion, net of official borrowing.

Narrow money

2.48 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

2.49 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 2.11 **Growth rates of monetary aggregates**

2.50 Chart 2.12 shows the recent path of interest rates. Monetary conditions have tightened considerably during this year.

Chart 2.12 Interest rates in the UK

Fiscal developments

2.51 Tables 2.10 to 2.12 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.

2.52 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 6½ 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.

Table 2.10 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~~** 9
of which			
Privatisation proceeds	−5·2	−5·0	−6·0

because of higher interest rates and inflation (which raises the cost of servicing debt

Higher than expected debt repayment reduces interest payments, but most of this effect will be in future years.

2.53 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.

general government expenditure

2.54 The ~~Budget~~ forecast for general government receipts has been revised up by ~~£4~~ over £3½ 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 £~~1½~~ 3/4 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)~~, each of which are £½ billion higher. The ~~latter~~ higher stamp duty mainly reflects the buoyancy of the housing market earlier this year. ~~Total taxes and national insurance contributions are expected to be somewhat lower in 1988–89 than in 1987–88 as a percentage of money GDP.~~

2.55 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~~ Shares in British Petroleum, and interest receipts £¾ billion higher. General government receipts in total are now forecast to increase by ~~9~~ 8½ per cent in 1988–89, much the same rate of increase as in 1987–88.

Table 2.11 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~~ 143·8
National insurance and other contributions	~~28·9~~ 29·1	31·6	32·~~4~~2
Interest and dividends	6·0	5·6	6·4
Other receipts	5·~~9~~8	6·~~4~~5	6·~~2~~3
Total receipts	**176·6**	**184·9**	~~**189·3**~~ 188·6
of which			
North Sea revenues	4·7	3·3	3·3

2.56 Table 2.12 shows the ~~old~~ Budget and ~~new~~ latest 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.

Table 2.12 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~~6	184·9	~~189·0~~ 188·1
General government debt repayment	2·0	2·0	~~8·2~~ 7·8
Public corporations' market and overseas debt repayment	1·6	1·2	2·0
PSDR	**3·6**	**3·2**	**~~10·2~~** 9·8
PSDR as per cent of GDP	← ¾	← ¾	← 2¼
PSDR excluding privatisation proceeds As per cent of GDP	← −¼	← −½	← ~~1~~ 3/4

Chart 2.13 Public Sector borrowing requirement[1]

Table 2.13 Economic prospects: summary

Per cent changes in 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 per cent 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	~~1¼~~ 3/4
Manufacturing output	6	7	4½	2
Balance of payments current account (£billion)	**−2½**	**−13**	**−11**	**4¼**
Inflation				
Retail prices index (Q4 on Q4)	4	6¼	5	1~~¼~~ 3/4
GDP deflator at market prices (financial year)	**5¼**	**6¼**	**5**	**1~~¼~~** 3/4
Money GDP at market prices (financial year)	**10**	**11**	**8**	**1~~¼~~** 3/4
£ billion	424	471	508	
PSDR (financial year) £ billion	3½	10		3
as a per cent of GDP	~~¼~~ 3/4	2~~¼~~		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 2.14 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 (average[1] 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~~4~~** STET.	107·4
1988	251·9	76·4	72·0	114·~~3~~4	1·0	**515·8**	126·8	~~57·0~~ 56·7	~~9·1~~ 8·9	**341·~~1~~2**	112·0
1989	261·1	75·9	76·0	120·~~7~~8	0·6	**534·4**	132·~~5~~8	59·4	9·~~7~~9	**352·~~2~~1**	115·6
1987 H1	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~~6
1988 H1	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~~0	~~5·0~~ 4·8	**172·~~6~~7**	113·4
1989 H1	129·8	37·9	37·9	59·8 ✓	0·3	**265·7**	65·~~6~~9	29·5	4·~~7~~9	**175·~~4~~2**	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~~1
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	4½ L	~~0~~ ½	**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 measure both understate recent growth.*

BOLD

[2] *Changes as a percentage of GDP for stockbuilding and statistical adjustment.*

Annex to Chapter 2

UK national and sectoral accounts

It is difficult to assess

2A.1 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. This disparity is particularly marked for the first half of 1988. Chart 2A.1 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.

2A.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 2A.1 **Growth in different GDP measures**

2A.3 There are ~~analogous~~ related 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 2A.2 Residual error as a proportion of GDP(E)

Chart 2A.3 Sectoral unidentified transactions

At the same time

have emerged

2A.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.)~~ difference between the income and expenditure measures of GDP.

Sectoral ~~balancing items are the~~ differences

are

2A.5 In 1987 the balancing item for the personal sector was about 8 per cent of personal disposable income. This ~~suggests~~ indicate 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 and, hence, saving.

2A.6 The large balancing item in the overseas ~~sector~~ in the first half of 1988 (about £7 billion) indicates that there were either unrecorded net 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,~~ credits (ie net visible exports or invisibles) the true current account deficit was lower than the recorded figure. The balancing item ~~in~~ for 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 and company sector spending was~~ net exports and ~~capital~~ company sector capital spending were higher than the recorded figures indicate, that would go some way to ~~explain~~ correct the sluggish behaviour of the expenditure measure of GDP relative to the other measures.

NP

2A.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.

2A.5 There is little information on the nature or size of the errors in the income and expenditure or the financial accounts that give rise to these large balancing items.

chex.ps/mw/17 CONFIDENTIAL

FROM: MISS M P WALLACE

DATE: 31 October 1988

MP

MISS J C SIMPSON

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Scholar
Mr Culpin
Miss Peirson
Mr Odling-Smee
Mr Gilhooly
Mr Riley
Mr McIntyre
Mr J Ramsden
Mr Tyrie
Mr Call

Mr Mace - IR

AUTUMN STATEMENT CHAPTER 3

The Chancellor was grateful for your minute of 28 October and Mr Ramsden's of the same date.

2. As I mentioned to you, he had a few minor amendments to the table in paragraph 3.01, which are indicated in manuscript on the copy behind.

...

MOIRA WALLACE

CONFIDENTIAL

FROM : MISS J C SIMPSON
DATE : 28 OCTOBER 1988

CHANCELLOR OF THE EXCHEQUER

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 McIntyre
Mr J Ramsden
Mr Tyrie
Mr Call
Mr Mace (IR)

Ch/ This looks fine to me, subject to eliminating the blobs, and filling in the blank. Do you have any comments?

MPW.

AUTUMN STATEMENT CHAPTER 3

I attach the proof of Chapter 3 of the printed Autumn Statement.

2. As proposed in Mr Ramsden's minute of 24 October, the layout is identical to last year's. We should have the figures to complete Table 3.1 during the course of this afternoon.

Now behind

3. It would be helpful to have comments during the course of today. Please may I have them in any case by 10.00am on Monday, 31 October.

See my comment

Thanks. A minor improvement of presentation of Table in 3.01, pse.

JS.

MISS J C SIMPSON

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: 1?

—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.

—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	Employers
Below £43	0 ~~(No NICs payable)~~	0
£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.*

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[2] *Including population and employment changes.*

octst1.32

FROM: J C J RAMSDEN

DATE: 28 October 1988

CHANCELLOR OF THE EXCHEQUER

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 McIntyre
Mr Tyrie
Mr Call
Mr Mace (IR)

Thanks. Presumably date in 3.01 will be 1 November 1988. NL

AUTUMN STATEMENT CHAPTER 3

Miss Simpson sent you the proof of Chapter 3 of the printed Autumn Statement with her submission of 28 October. The Government Actuary's Department have now given us the figures for table 3.1. They are shown in manuscript on the attached copy of the proof.

2. As you will see, the effect of increasing the earnings limits is to reduce the amount paid by employers (-£220m) and increase the amount paid by employees (+£130m). In the case of employees, raising the upper earnings limit (UEL) means that everyone with earnings above the limit pays more NICs (£1.80pw). This more than offsets a reduction in NICs for those employees who gain from the changes to the lower-rate bands. Employers also gain from the lower-rate bands but do not lose from the increase in the UEL, which only applies to employees.

J C J Ramsden

J C J RAMSDEN

3 National insurance contributions

1/11 ?

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 [redacted] 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.

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—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	15,280	13,900	29,180
1989–90	16,410	14,580	30,990
Total change	1,130	680	1,810
of which:			
Change in contributions from increased earnings, etc[2]	1,350	550	1,900
Change in contributions from increase in earnings limits	-220	+130	-90

[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.*

H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-270 5238
Facsimile: 270 5244
Telex: 9413704

mp

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. A fuller account of the new plans will appear in the printed Autumn Statement which will be published on Tuesday 8 November.

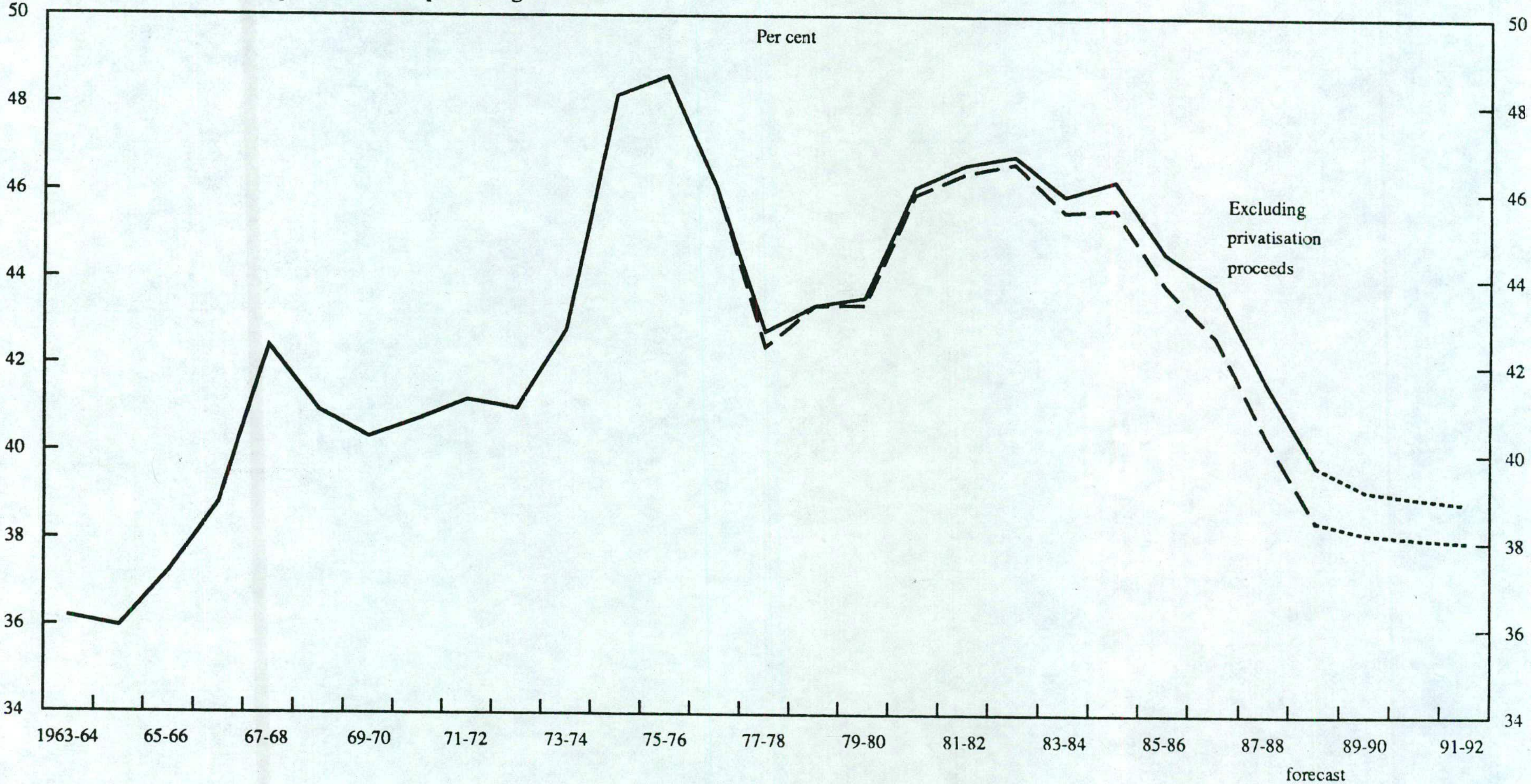
As indicated in the White Paper on "Financial Reporting to Parliament" (Cm 375) the section on public spending in the printed Autumn Statement will be expanded so that it includes nearly all the information previously found in Chapter 1 of the Public Expenditure White Paper. The role of the White Paper, 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 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; and 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

93/88

General government expenditure as a percentage of GDP



Trends ratios

Table 1 Trends in public spending

	General government expenditure (excluding privatisation proceeds)		Money GDP (£ billion)	General government expenditure (excluding privatisation proceeds) as a percentage of GDP
	Cash (£ billion)	Real terms (1) (£ billion)		
1963-64	11.3	87.9	31.4	36¼
1964-65	12.3	91.7	34.1	36
1965-66	13.6	96.8	36.6	37¼
1966-67	15.1	102.8	38.8	38¾
1967-68	17.5	115.5	41.2	42¼
1968-69	18.2	115.2	44.6	41
1969-70	19.3	115.6	48.0	40¼
1970-71	21.6	119.8	53.1	40¾
1971-72	24.4	123.3	59.2	41
1972-73	27.6	129.9	67.5	41
1973-74	32.0	140.5	74.8	42¾
1974-75	42.9	157.6	89.1	48¼
1975-76	53.8	157.5	110.8	48½
1976-77	59.6	154.1	129.4	46
1977-78	64.4	146.3	150.8	42¾
1978-79	75.0	153.8	173.1	43¼
1979-80	90.3	158.6	207.6	43½
1980-81	109.0	161.5	236.6	46
1981-82	121.0	163.3	259.9	46½
1982-83	133.1	167.6	284.6	46¾
1983-84	141.6	170.5	308.6	45¾
1984-85	152.8	175.2	330.5	46¼
1985-86	160.9	175.0	361.1	44½
1986-87	168.9	177.8	385.7	43¾
1987-88	176.7	176.7	424.5	41½
1988-89	186.9	175.9	471	39¾
1989-90	198.7	178.1	508	39¼
1990-91	210.0	181.9	539	39
1991-92	221.0	185.8	569	38¾

(1) Cash figures adjusted to 1987-88 price levels by excluding the effect of general inflation as measured by the GDP deflator at market prices. The GDP deflator is assumed to increase by some 6¼ per cent in 1988-89, and by 5, 3½ and 3 per cent respectively in the years 1989-90 to 1991-92.

TOTAL P/EX

TABLE 2: 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	18,853	19,300	450	20,120	21,180	22,090	80	150	600
FCO - Diplomatic wing	660	750	90	770	810	850	30	30	50
FCO - Overseas Development Administration	1,303	1,480	180	1,540	1,630	1,690	50	30	80
European Communities	1,664	950	-710	1,970	1,950	1,580	150	500	630
Ministry of Agriculture, Fisheries and Food (3)	1,976	1,860	-110	1,950	2,160	2,350	-350	-380	-340
Department of Trade and Industry	728	1,700	980	1,360	1,340	1,160	460	160	190
Export Credits Guarantee Department	151	110	-40	180	120	60	-20	60	30
Department of Energy	228	220	-10	-250	-510	620	100	-60	-100
Department of Employment (4)	3,915	4,120	210	4,020	3,960	3,960	-120	-250	-370
Department of Transport	4,586	4,810	230	5,360	5,540	5,660	-330	240	330
DOE - Housing	2,697	2,050	-640	1,710	2,040	2,380	-970	-1,290	-1,010
DOE - other environmental services (5)	3,640	4,380	740	4,480	4,560	4,700	520	480	460
Home Office	5,702	6,280	580	6,900	7,220	7,390	230	610	760
Legal departments (6)	793	960	160	1,080	1,170	1,240	-20	30	60
Department of Education and Science	17,081	18,440	1,360	19,570	20,240	20,770	470	870	1,000
Office of Arts and Libraries	889	980	90	980	1,010	1,050	70	30	30
Department of Health	19,716	21,740	2,020	23,160	24,380	25,390	1,060	1,460	1,700
Department of Social Security (4)	46,249	47,600	1,400	51,000	55,300	58,700	-900	-100	1,700
Scotland	8,087	8,720	630	8,970	9,140	9,680	210	410	410
Wales	3,330	3,600	270	3,790	3,900	4,010	140	240	230
Northern Ireland	4,926	5,160	240	5,470	5,690	5,910	20	140	180
Chancellor's departments	3,432	3,670	240	4,080	4,280	4,490	-130	40	90
Other departments	296	360	70	320	340	350	100	70	70
Reserve	0	0	0	3,500	7,000	10,500	-3,500	-3,500	-3,500
Privatisation proceeds	-5,161	-6,000	-840	-5,000	-5,000	-5,000	-1,000	0	0
Adjustment (7)	0	330	330	0	0	0	330	0	0
PLANNING TOTAL	145,740	153,600	7,800	167,100	179,400	191,600	-3,300	0	3,300
General government gross debt interest	17,526	17,700	200	17,000	16,000	15,500	-500	-700	-1,300
Other national accounts adjustments	8,230	9,600	1,400	9,500	9,500	9,000	1,600	1,300	900
GENERAL GOVERNMENT EXPENDITURE	171,496	180,900	9,400	193,700	205,000	216,000	-2,200	600	2,900

NOTES

(1) The rounding and other conventions used in this table and Tables 3, 4 and 5 are as follows: plan figures are rounded to the nearest £10 million, except for social security (in this table and Table 3), the planning and spending authority totals (except for 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 for future years 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 table and Tables 3, 4 and 5 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 changes of classification and allocation.

(3) Includes Intervention Board for Agricultural Produce and Forestry Commission.

(4) Changes include a transfer from the Department of Employment to the Department of Social Security of £50 million in 1989-90 and £80 million in 1990-91 to cover certain increased expenditure on administering benefits for the unemployed.

(5) Includes Water Services Office.

(6) 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.

(7) An adjustment for the difference between the assessment of the likely outturn for 1988-89 and the sum of the other items shown.

CG

TABLE 3: CENTRAL GOVERNMENT SPENDING (1)

£ million

	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	18,853	19,300	450	20,120	21,180	22,090	80	150	600
FCO - Diplomatic wing	660	750	90	770	810	850	30	30	50
FCO - Overseas Development Administration	1,304	1,450	150	1,510	1,600	1,660	50	30	80
European Communities	1,664	950	-710	1,970	1,950	1,580	150	500	630
Ministry of Agriculture, Fisheries and Food	1,795	1,650	-140	1,710	1,930	2,120	-340	-400	-340
Department of Trade and Industry	900	1,820	920	1,330	1,280	1,130	560	70	80
Export Credits Guarantee Department	151	110	-40	180	120	60	-20	60	30
Department of Energy	575	530	-50	490	410	360	20	30	-20
Department of Employment	3,783	3,990	200	3,880	3,810	3,810	-120	-250	-380
Department of Transport	1,373	1,430	60	1,780	1,880	1,940	-30	290	350
DOE - Housing	1,301	1,380	80	1,410	1,630	1,920	60	20	160
DOE - other environmental services	468	510	40	650	670	670	20	190	200
Home Office	992	1,150	160	1,430	1,570	1,560	30	260	370
Legal departments	793	960	160	1,080	1,170	1,240	-20	30	60
Department of Education and Science	2,694	2,970	280	4,280	4,400	4,460	30	270	280
Office of Arts and Libraries	369	420	50	440	450	480	0	0	0
Department of Health	16,654	18,380	1,730	19,720	20,830	21,730	840	1,250	1,470
Department of Social Security	42,522	43,600	1,100	46,300	50,200	53,200	-800	-500	1,100
Scotland (2)	3,459	3,800	350	3,850	4,060	4,220	110	130	190
Wales (2)	1,539	1,710	180	1,860	1,920	1,980	50	140	140
Northern Ireland (2)	3,799	4,060	260	4,290	4,480	4,650	60	110	140
Chancellor's departments	3,438	3,670	230	4,090	4,290	4,500	-130	40	90
Other departments	296	360	70	320	340	350	100	70	70
TOTAL	109,380	115,000	5,600	123,500	131,000	136,600	700	2,500	5,400

(1) See footnotes to Table 2. Figures exclude finance for public corporations.

(2) The breakdown of the Scottish, Welsh and Northern Irish additions 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.

LA3

TABLE 4: LOCAL AUTHORITY SPENDING (1)

£ million

	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	190	10	220	230	230	-10	20	20
Department of Trade and Industry	86	100	10	100	100	110	0	0	10
Department of Employment	127	140	10	140	150	150	10	0	0
Department of Transport	2,530	2,560	30	2,750	2,820	2,900	-90	30	20
DOE - Housing	1,406	730	-670	310	380	390	-960	-1,230	-1,080
DOE - Other environmental services	3,230	3,870	640	3,750	3,660	3,780	500	280	120
Home Office	4,710	5,130	420	5,470	5,660	5,830	200	350	390
Department of Education and Science	14,387	15,470	1,080	15,290	15,840	16,310	440	600	720
Office of Arts and Libraries	520	560	40	540	560	570	60	20	30
Department of Health	3,050	3,340	290	3,430	3,550	3,660	220	210	230
Department of Social Security	3,727	3,970	250	4,640	5,080	5,470	-30	390	590
Scotland (2)	4,253	4,580	320	4,760	4,860	5,010	170	260	230
Wales (2)	1,714	1,780	70	1,820	1,870	1,930	100	90	100
Northern Ireland (2)	782	820	40	870	900	940	0	20	30
TOTAL	40,701	43,200	2,500	44,100	45,700	47,300	600	1,100	1,400
of which:-									
Relevant expenditure (3)	31,985	34,400	2,500	35,200	36,500	37,500	1,200	1,700	2,000
Other current	5,071	5,400	300	6,100	6,600	7,000	0	400	600
Capital	3,645	3,400	-200	2,800	2,600	2,700	-600	-1,100	-1,200

(1) See footnotes to Table 2. Figures exclude finance to public corporations.

(2) See footnote (2) to Table 3.

(3) Public expenditure relevant for Aggregate Exchequer Grant.

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TABLE 5: PUBLIC CORPORATIONS (1) (2)

£ million

	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
FCO - Overseas Development Administration	0	30	30	30	30	30	0	0	0
Ministry of Agriculture, Fisheries and Food	2	20	20	20	0	0	0	0	-20
Department of Trade and Industry	-258	-210	50	-70	-50	-70	-110	80	100
Department of Energy	-347	-310	30	-740	-920	270	80	-100	-80
Department of Employment	5	0	0	0	0	0	0	0	0
Department of Transport	682	820	140	830	840	810	-220	-70	-40
DOE - Housing	-10	-60	-50	-10	20	70	-80	-90	-90
DOE - Other environmental services	-57	10	60	80	230	250	10	0	140
Department of Health	12	10	0	0	0	0	0	0	0
Scotland (3)	375	340	-40	350	220	450	-60	20	-10
Wales (3)	78	100	20	110	100	100	0	10	-10
Northern Ireland (3)	345	280	-60	310	310	320	-40	10	10
Chancellor's departments	-7	0	0	-10	-10	-10	0	0	0
TOTAL (4)	820	1,020	200	900	770	2,220	-420	-140	10
of which:-									
Nationalised industries	268	400	130	-30	-400	980	-290	0	-10
Other public corporations	552	630	70	930	1,170	1,240	-130	-140	20

(1) See footnotes to Table 2.

(2) For nationalised industries and most public corporations the planning total includes their external finance. For nationalised industries' external financing limits for 1989-90, see Table 6.

(3) See footnote (2) to Table 3.

(4) For nationalised industries to be privatised, provision is included in plans as follows: Water (England and Wales) up to and including 1989-90 and Electricity (England, Wales and Scotland) up to and including 1990-91. Precise external financing requirements will depend on the timing of reorganisation and privatisations. Excluding these industries, figures for the remaining industries are: 1989-90 £1280 million, 1990-91 £1120 million and 1991-92 £980 million.

TABLE 6

EXTERNAL FINANCING LIMITS FOR THE NATIONALISED INDUSTRIES 1989-90

	£million[1]
British Coal	560
British Railways Board	439
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	-35

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 and privatisation during 1989-90.

TABLE 7: 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	21.2	22.1
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(1)	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	0.2	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	4.0	4.0	4.0
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(1)	2.3	3.6	3.8	4.0	3.9	4.0	3.6	4.4	4.5	4.6	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(1)	0.2	0.4	0.4	0.5	0.6	0.7	0.8	1.0	1.1	1.2	1.2
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	16.6	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	55.3	58.7
Scotland	3.9	6.5	6.8	7.1	7.2	7.7	8.1	8.7	9.0	9.1	9.7
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	2.5	2.6	2.8	3.2	3.4	3.7	4.1	4.3	4.5
Other departments	0.4	0.6	0.1	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(1)								0.3			
Planning total	65.7	113.6	120.4	129.9	133.8	139.3	145.7	153.6	167.1	179.4	191.6
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	15.5
Other national accounts adjustments	1.8	5.2	5.5	4.7	6.7	7.5	8.2	9.6	9.5	9.5	9.0
General government expenditure	75.0	132.6	140.4	150.6	158.2	164.4	171.5	180.9	193.7	205.0	216.0
General government expenditure (excluding privatisation proceeds)	75.0	133.1	141.6	152.8	160.9	168.9	176.7	186.9	198.7	210.0	221.0

(1) See footnotes to Table 2.

TABLE 8: PUBLIC EXPENDITURE IN REAL TERMS(1) BY DEPARTMENT, 1978-79 TO 1991-92 £ 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	1991-92 plans
Ministry of Defence	15.4	18.1	18.6	19.7	19.5	19.1	18.9	18.2	18.0	18.3	18.6
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(2)	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	0.2	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	3.6	3.4	3.3
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(2)	4.6	4.5	4.6	4.5	4.3	4.2	3.6	4.1	4.0	3.9	4.0
Home Office	3.8	4.7	5.0	5.3	5.2	5.4	5.7	5.9	6.2	6.3	6.2
Legal departments(2)	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	47.9	49.3
Scotland	8.0	8.2	8.2	8.2	7.9	8.1	8.1	8.2	8.0	7.9	8.1
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	5.0
Chancellor's departments	3.0	3.3	3.0	3.0	3.1	3.3	3.4	3.5	3.7	3.7	3.8
Other departments	0.8	0.8	0.1	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(2)								0.3			
Planning total	134.9	143.0	145.0	148.9	145.6	146.7	145.7	144.6	149.7	155.4	161.1
General government expenditure	153.8	167.0	169.2	172.7	172.1	173.1	171.5	170.2	173.6	177.5	181.6
General government expenditure (excluding privatisation proceeds)	153.8	167.6	170.5	175.2	175.0	177.8	176.7	175.9	178.1	181.9	185.8
GDP deflator (% increase on previous year)		7.1	4.6	5.1	5.4	3.3	5.3	6 ¼	5	3 ½	3
(1987-88=100)	48.7	79.4	83.0	87.2	91.9	95.0	100.0	106.2	111.6	115.5	118.9

(1) Cash figures adjusted to 1987-88 price levels by excluding the effect of general inflation as measured by the GDP deflator.
(2) See footnotes to Table 2.

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PMP

1 NOVEMBER 1988

IAF

ECONOMIC PROSPECTS FOR 1989

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.

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94/88

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. 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 2 per cent of GDP. The forecast assumes a similar PSDR in 1989-90 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 forecast 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 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.

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 a slight reduction during 1989.

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. Manufacturing unit labour costs have risen slowly over the past year, since productivity has continued to grow at a very fast rate.

Labour market

7. Employment has increased rapidly over the past year. Unemployment fell by half a million in the year to September. It should continue to fall over the next year, though probably at a slower rate than recently.

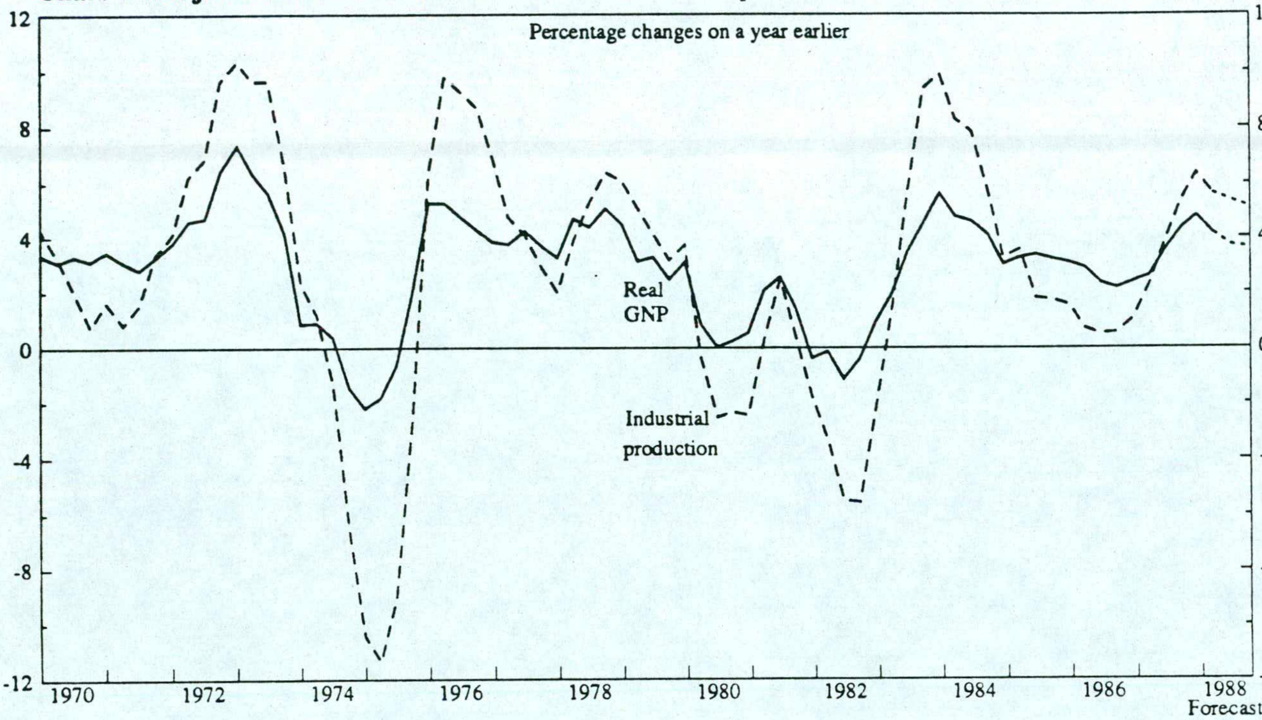
World economy

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 per cent.

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 benefited 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.

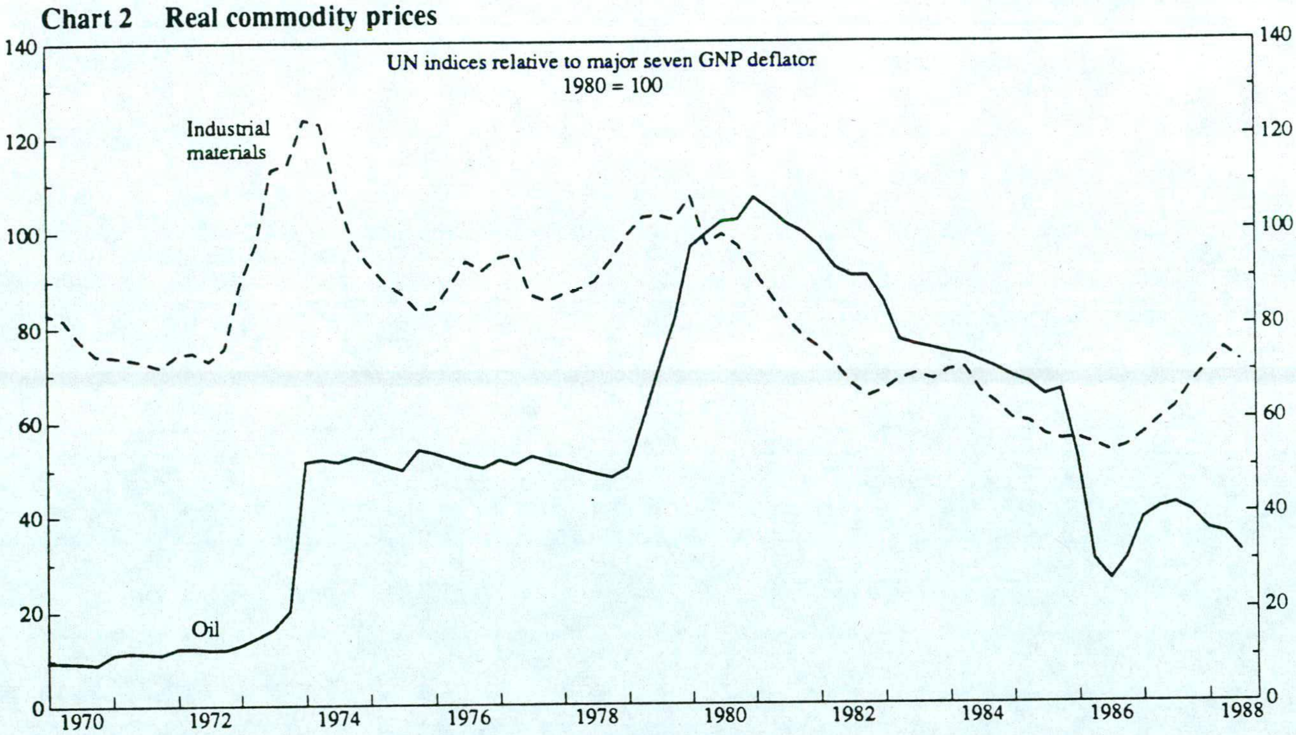
Chart 1 Major seven economies' real GNP and industrial production



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 experienced in all these countries. 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 countries are currently experiencing an investment boom.

11. Although non-oil commodity prices rose by nearly 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, activity and inflation in the major seven countries. Real GNP 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 previous year		
		Forecasts	
	1987	1988	1989
Major seven countries[1]:			
Real GNP	3½	4	3
Real domestic demand	3½	4	3
Industrial production	3	5½	4½
Consumer prices	3	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 will probably still remain high since the imports of some developing countries are expected to remain buoyant.

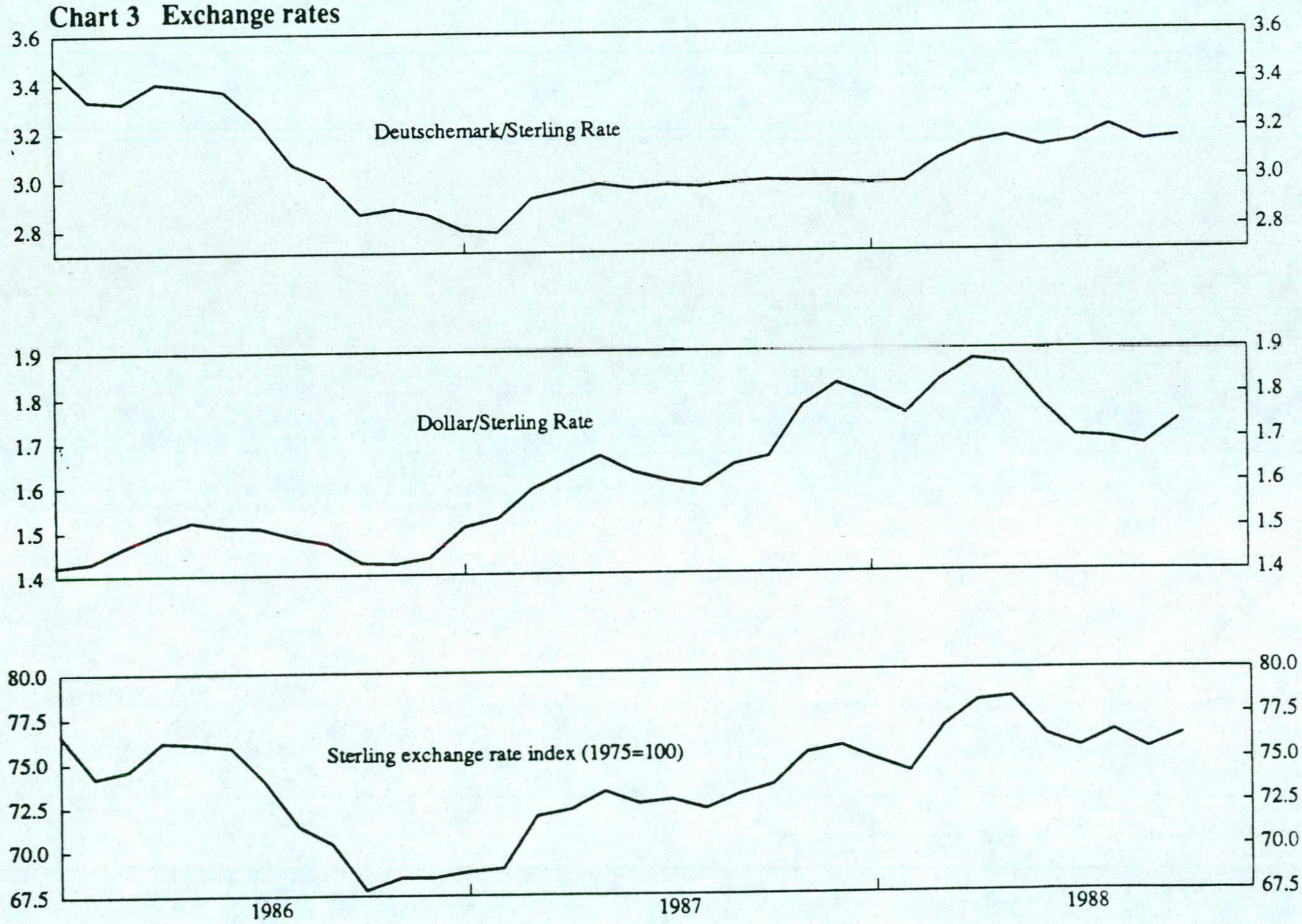
14. Spot prices of non-oil commodities have weakened recently, but the continued strength of industrial activity makes a further fall doubtful. There is likely to be a modest rise in consumer price inflation in 1989.

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.

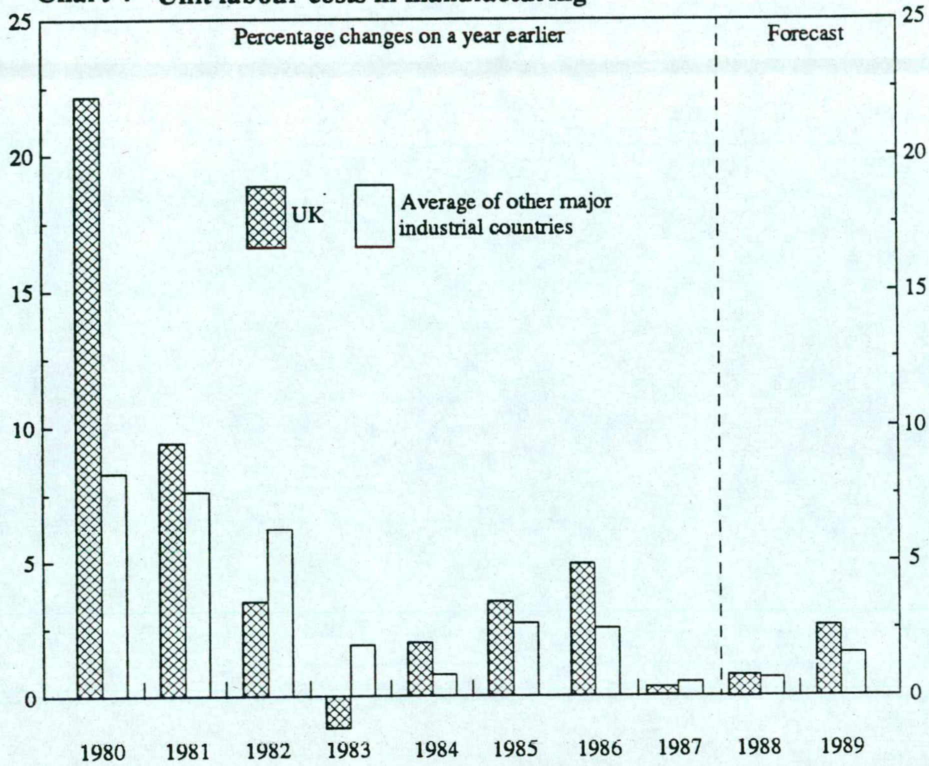
Chart 3 Exchange rates



Relative costs and prices

16. Manufacturing unit labour costs in the UK have risen only slightly over the past year. Most of the large gain in labour cost competitiveness in 1986 has been maintained.

Chart 4 Unit labour costs in manufacturing

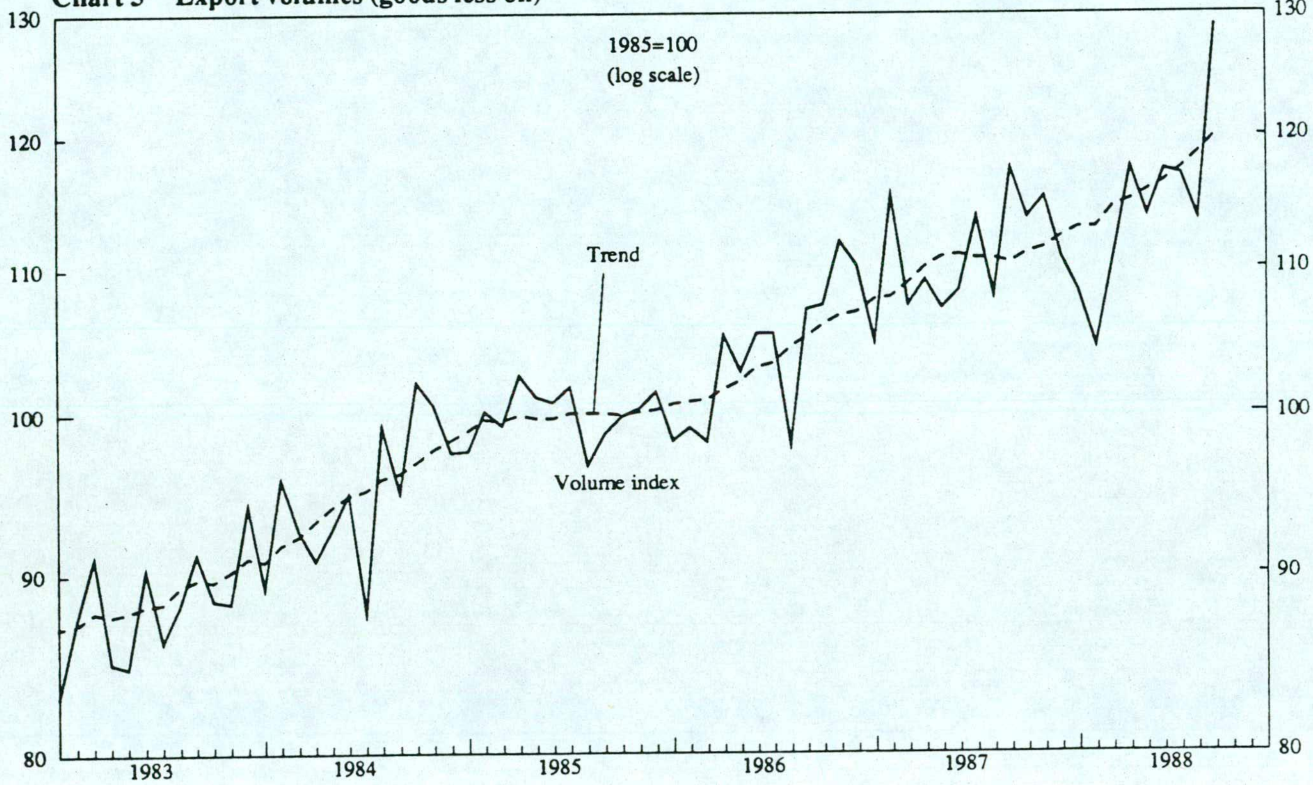


17. It is the rapid increase in domestic demand that explains most of the deterioration in the current account. Recent CBI surveys suggest that some industries have been facing capacity constraints, so it is likely that part of the unexpected domestic demand has been satisfied by imports. Some potential 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 7½ per cent higher than a year earlier. Manufactured export volumes are forecast to rise by over 8 per cent in 1989, close to 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.

Chart 6 Share of UK exports in total world trade in manufactures

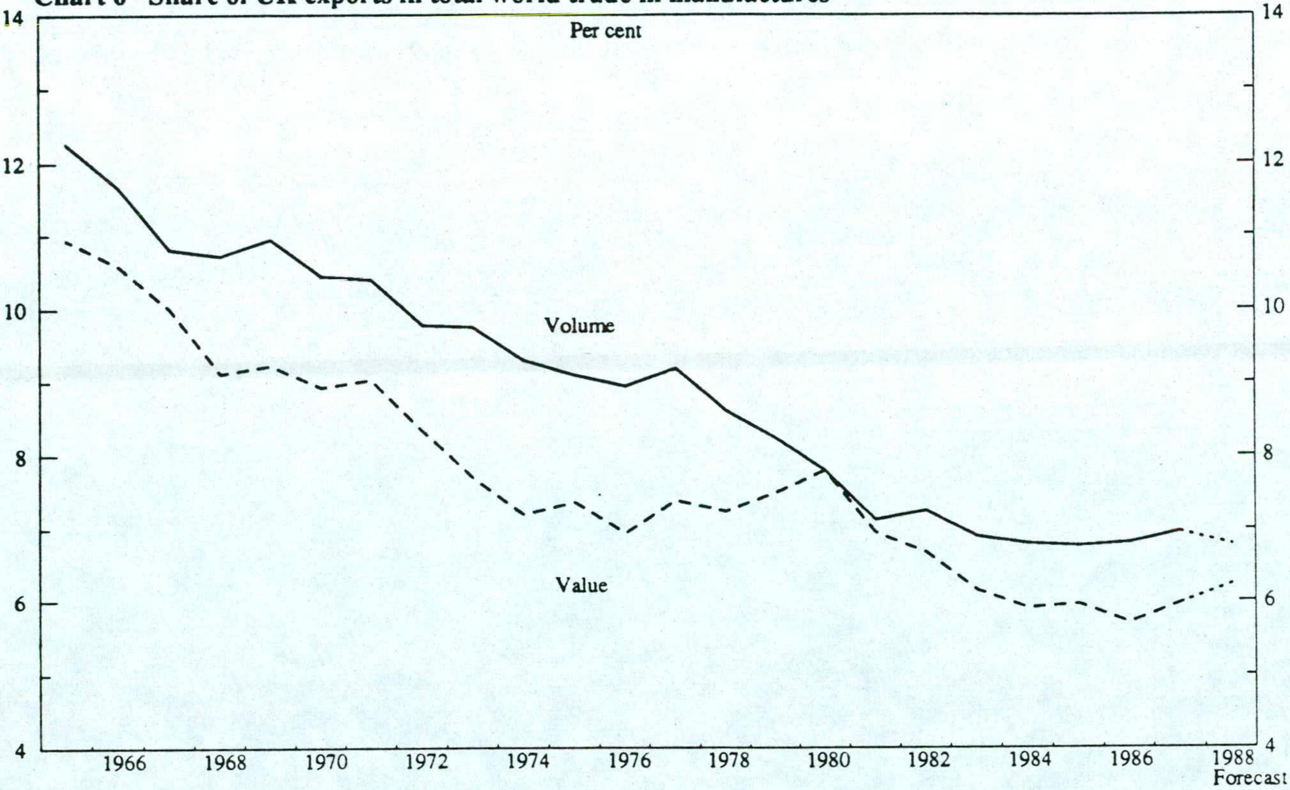
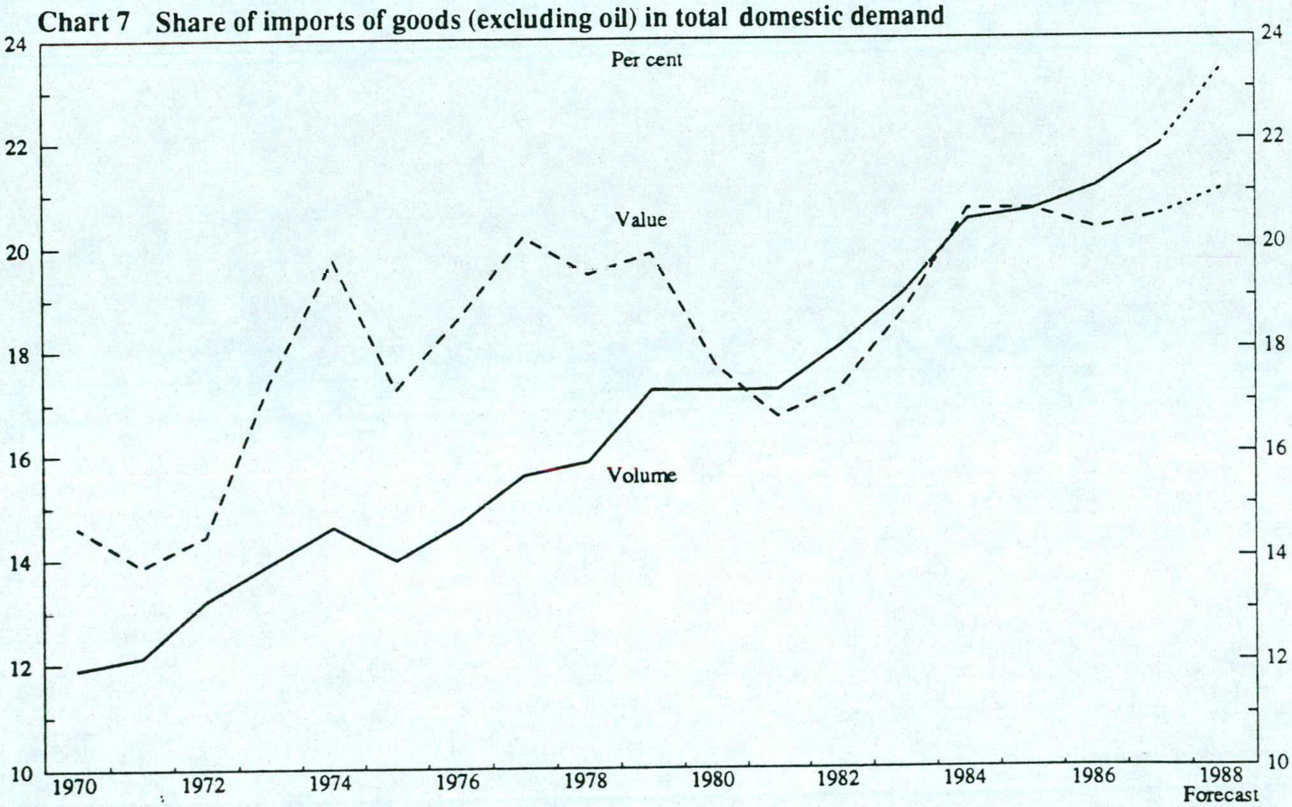


Chart 7 Share of imports of goods (excluding oil) in total domestic demand



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 assumed to remain broadly unchanged during the rest of 1988 and in 1989.

Table 2 **Visible trade**

	Percentage 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	1½	5	13½	2
1989 Forecast	7	5	1	8½	5	1

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

Invisibles and overseas assets

23. The surplus on invisibles in 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 insurance premiums net of claims.

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 a little in 1989 in part because payments abroad by North Sea companies continue to fall.

26. During 1987 the value of the stock of UK net overseas assets fell by £24 billion, to £90 billion, largely due to the fall in the sterling value of UK assets in North America 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 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 benefit non-oil trade, but this will be partly offset by the smaller oil surplus.

Table 3 Current account

	£ billion				
	Manufactures	**Other**	**Oil**	**Invisibles**	**Current balance**
1987	- 7½	-7	4	7½	- 2½
1988 Partly forecast	-13	-8	2½	5½	-13
1989 Forecast	-11½	-7½	2	6	-11

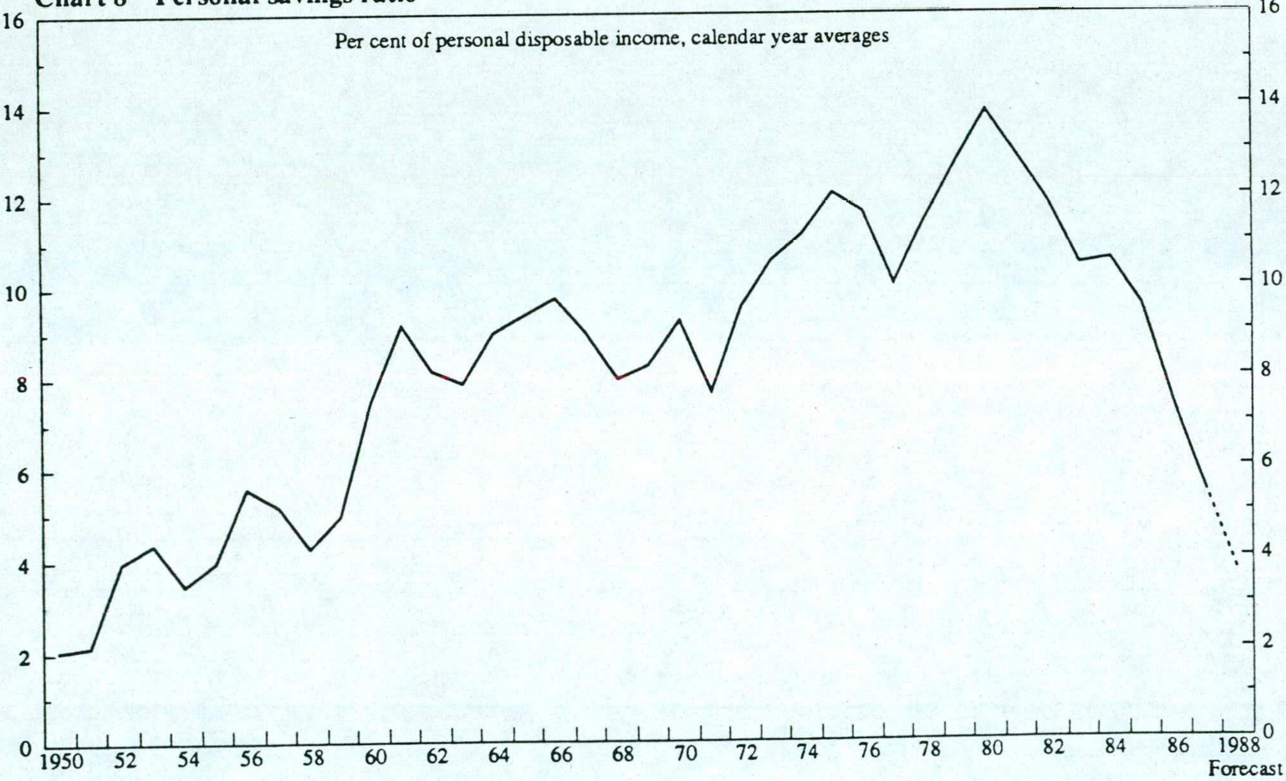
Demand and activity

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 the growth in 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 fall 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 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 saving.

Chart 8 Personal savings ratio



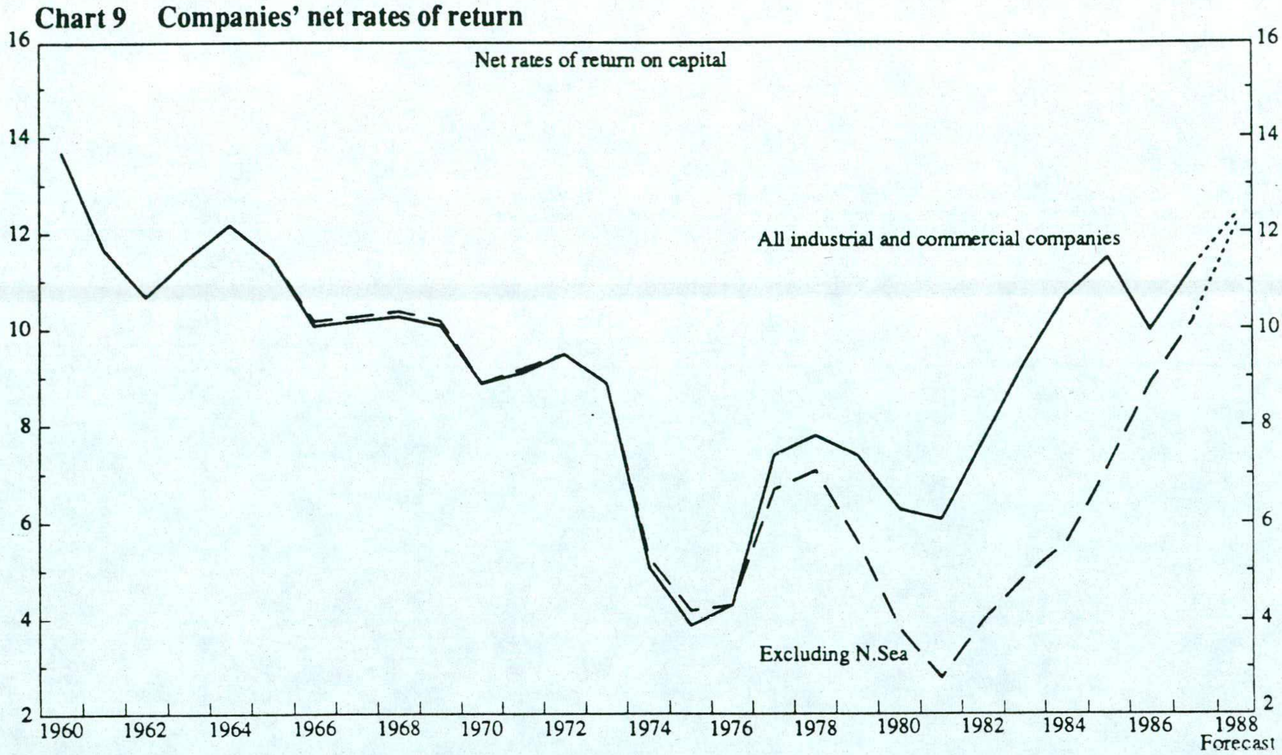
31. The fall in the savings ratio has been associated with an increase in borrowing - particularly mortgage borrowing - following the ending of mortgage rationing and other restrictions. But householders will not wish to go on accumulating debt at the same rate as recently: levels of borrowing are already high relative to income. Moreover, households are now, for the first time, substantial net payers of interest, and higher interest rates are therefore particularly likely to reduce consumer spending. This should be reinforced by a slow-down in the growth of house prices and hence of housing wealth. Consumer spending is expected to rise by 3½ per cent in 1989 with a deceleration through the year. The savings ratio should recover slowly during 1989.

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, private sector investment in dwellings and improvements is likely to increase substantially in 1988 as a whole. It is likely to rise much more slowly 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 for almost twenty years. The net rate of return of manufacturing companies rose to just over 9 per cent in 1987, again the highest level for almost twenty years. With continued strong profit growth likely in 1988 net rates of return are expected to improve further.

Chart 9 Companies' net rates of return



34. Developments so far in 1988 confirm the investment boom predicted by recent CBI surveys and DTI Investment Intentions Surveys. Business investment is expected to rise a little faster in 1988 than the June DTI Intentions Survey suggested. Manufacturing investment, including leased assets, is likely to rise by 18 per cent and total non-oil business investment by over 13 per cent. Further growth in business investment is likely in 1989. Recorded stockbuilding is expected to continue on only a moderate scale in 1988 and 1989.

Table 4 Gross domestic fixed capital formation

	£billion at 1985 prices	Percentage changes on previous year	Forecasts	
	1987	1987	1988	1989
Business[1]	41.1	6½	13½	7½
of which: non-oil business	39.2	8½	13½	7
manufacturing	10.1	5	18	10
Private dwellings[2]	15.2	7	13	2½
General government	8.1	- ½	½	2½
Total fixed investment	**64.2**	**5½**	**12**	**5½**

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

Prospects for demand and activity

35. Growth of the average measure of GDP is forecast 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. With the forecast slow-down 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 the second half of 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

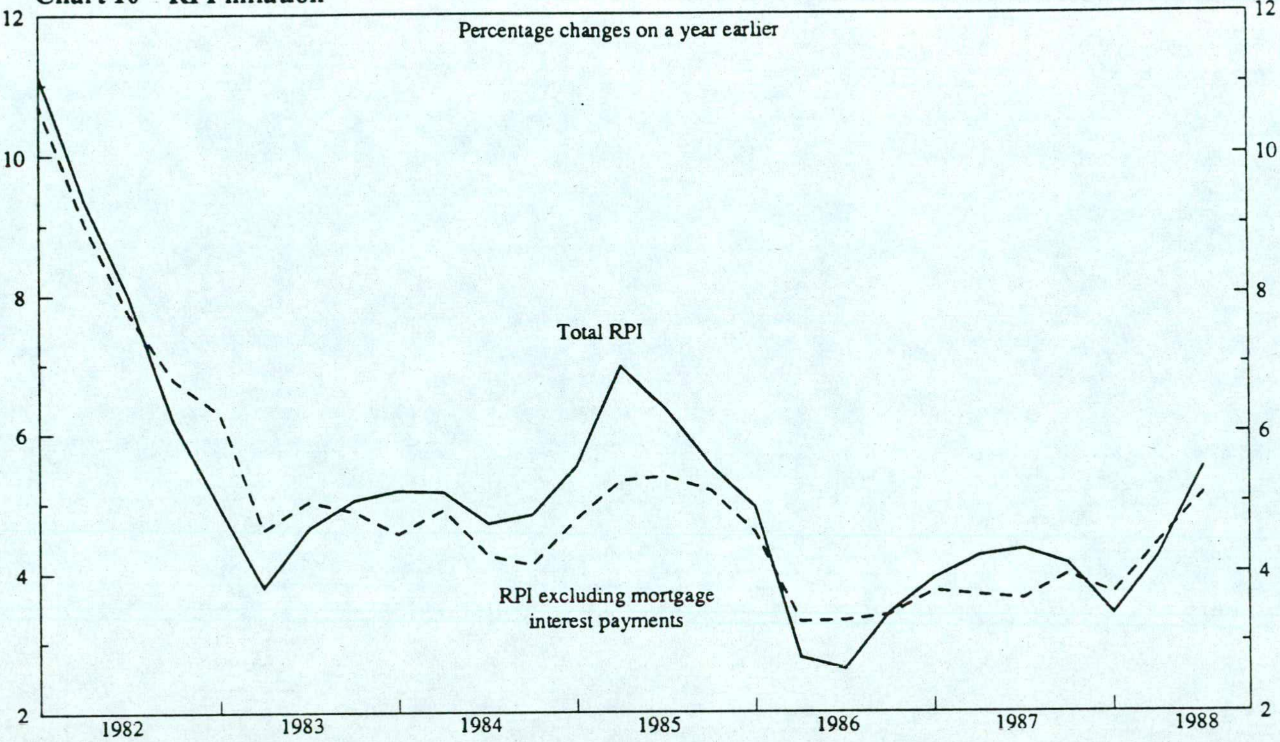
	Percentage changes on a year earlier	Forecasts	
	1987	1988	1989
Domestic demand	4½	6	3
Exports of goods and services[1]	5½(6½)	1½(4)	5½(6½)
Imports of goods and services[1]	7½(8)	12(13)	4½(5)
Gross Domestic Product[1,2]	4 (4½)	4½(5)	3 (3½)
Manufacturing Output	6	7	4½

1 Non-oil shown in brackets. 2 Average measure.

Inflation

37. The annual rate of RPI inflation has risen since early 1988, in part as a result of the rise in mortgage interest rates. Chart 10 shows that, excluding mortgage interest payments, 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.

Chart 10 RPI inflation



38. RPI inflation is likely to average 6¼ per cent in the fourth quarter of 1988; excluding mortgage interest payments 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 lower than in periods of fast demand and output growth in the 1970s.

39. The underlying increase in average earnings has risen from 8½ per cent at the start of the year to 9¼ per cent in August 1988. Pay settlements have edged up as labour markets have tightened, but high overtime payments and performance related bonuses have also played an important part.

40. Despite high earnings increases, growth in manufacturing unit labour costs has been kept down by the rapid growth in productivity. Unit labour costs in manufacturing are expected to rise by just under 1 per cent in 1988.

Prospects

41. 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 increased profit margins substantially. The projected slow-down in demand and activity may mean that profit margins will show less growth in 1989, and that unit labour costs will grow more rapidly (because of a likely cyclical slow-down in productivity growth). Producer output price inflation may be only a little less in 1989 than in 1988.

Table 6 Costs in manufacturing

	Percentage changes on previous year			
	Unit labour costs	Cost of materials and fuel	Estimated total unit costs[2]	Output prices[1]
1986	5	-10½	2¼	4
1987	¼	5	1½	4¼
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

	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	7¼	6¼
Housing	15¼	7	16¼	7
Other	63	3¾	4½	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 1989-90.

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 2 million in the workforce in employment.

Table 8 Changes in Employment

	Thousands, GB seasonally adjusted					
	Employees in employment		Self-employed	HM forces	Work related government training programmes	Workforce in employment
	Male	Female				
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 six 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 1988.

Unemployment

46. By September 1988, seasonally adjusted adult unemployment in the UK had fallen for 26 successive months, 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. The main threat to achieving this would be excessive pay settlements.

Financial developments

47. Over the past year, with the exception of a short-lived upsurge in April and May, the sterling index has varied by less than 3 per cent from its present level. In the nine months to September, the reserves increased by an underlying $5 billion, net of official borrowing.

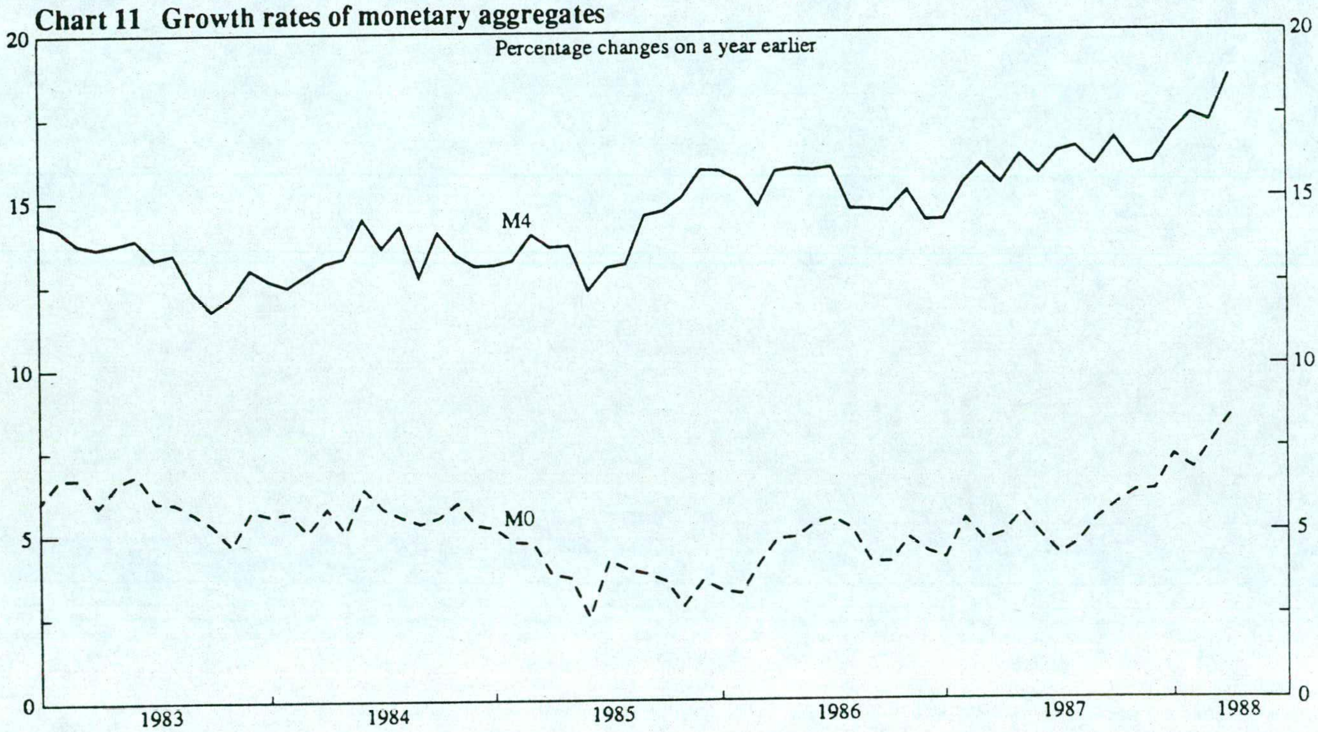
Narrow money

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

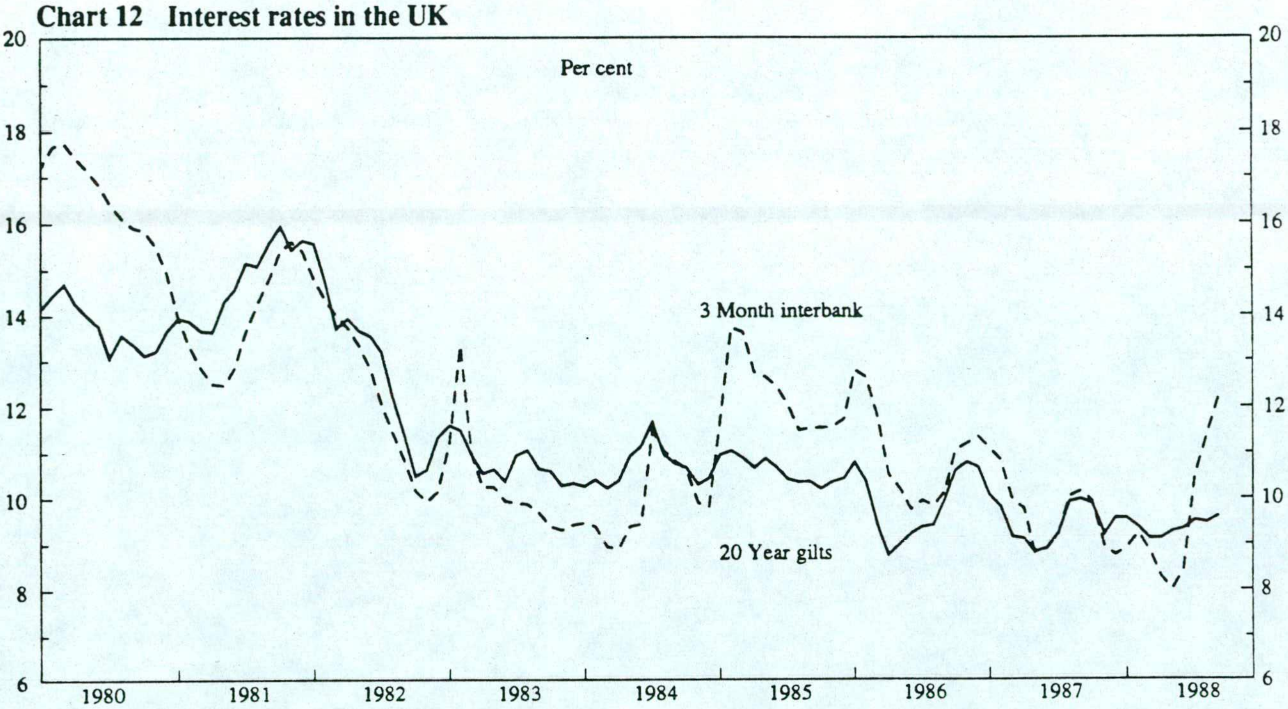
49. Broad money has continued to grow rapidly. There has been a marked increase in personal and financial sector deposits, as the stock market crash led to a move away from new investment in equities and unit trusts. Financial innovation and liberalisation continue to contribute to the growth of broad money.

Chart 11 Growth rates of monetary aggregates



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. 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, £6½ 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.

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**	**180.9**
of which Privatisation proceeds	- 5.2	- 5.0	- 6.0

53. Gross debt interest payments in 1988-89 are a little higher than forecast at Budget time because of higher interest rates and inflation (which raises the cost of servicing indexed debt). Higher than expected debt repayment reduces interest payments, but most of this effect will be in future years. The upward revision to the forecast of other adjustments largely reflects a change in the composition of public corporations' net financing which increases general government expenditure, but does not affect the PSDR.

54. The forecast for general government receipts has been revised up by over £3½ billion since the Budget, most of which is accounted for by higher taxes and national insurance contributions. VAT and income tax are expected to be £1 billion and £¾ billion higher respectively than in the Budget forecast. Other significant increases come from national insurance contributions and stamp duty, each of which are £½ billion higher. The higher stamp duty mainly reflects the buoyancy of the housing market earlier this year.

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 shares in British Petroleum, and interest receipts £¾ billion higher. General government receipts in total are now forecast to increase by 8½ per cent in 1988-89, much the same rate of increase as in 1987-88.

Table 11 General government receipts

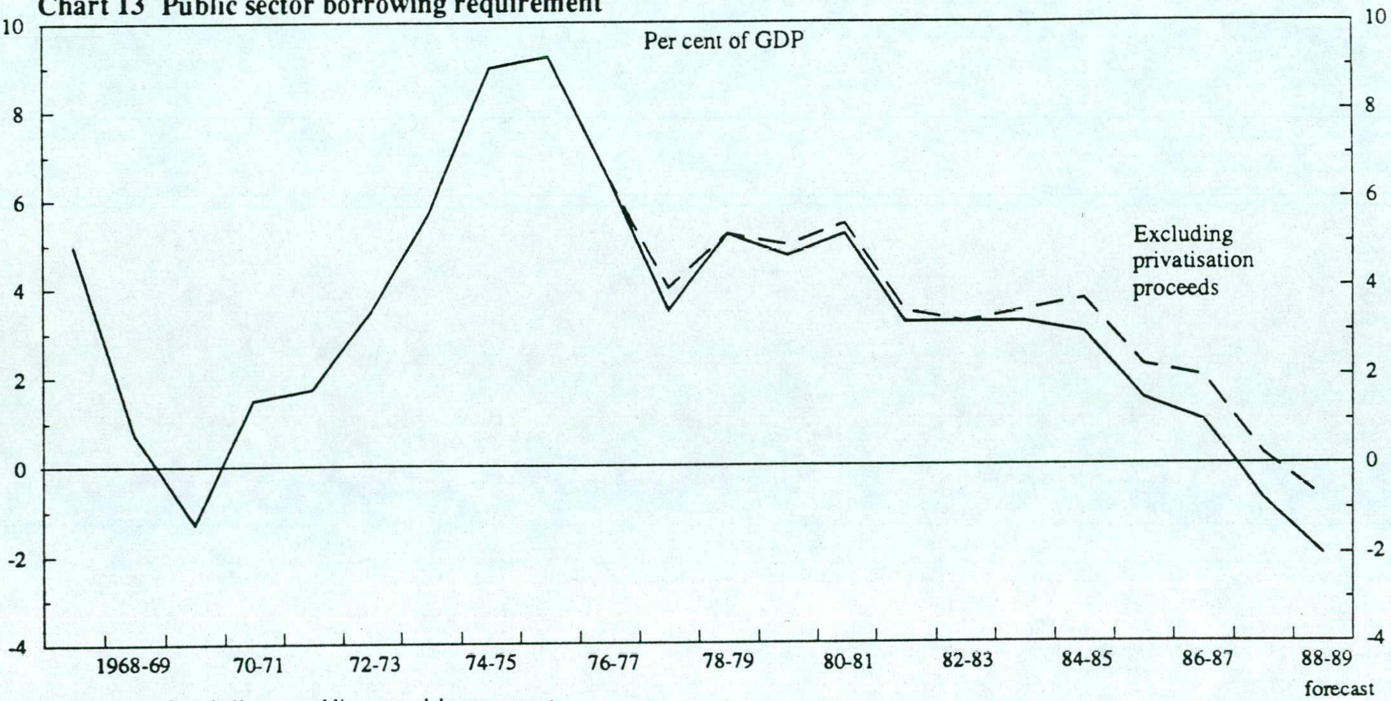
	£ billion		
	1987-88	**1988-89**	
	Outturn	**Budget forecast**	**Latest forecast**
Taxes on income, expenditure and capital	132.7	141.2	143.8
National insurance and other contributions	29.1	31.6	32.2
Interest and dividends	6.0	5.6	6.4
Other receipts	5.8	6.5	6.3
Total receipts	**173.6**	**184.9**	**188.6**
of which North Sea revenues	4.7	3.3	3.3

56. Table 12 shows the Budget and latest 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.

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	173.6	184.9	188.6
General government debt repayment	2.0	2.0	7.8
Public corporations' market and overseas debt repayment	1.6	1.2	2.0
PSDR	3.6	3.2	9.8
PSDR as per cent of GDP	¾	¾	2
PSDR excluding privatisation proceeds as per cent of GDP	- ¼	- ½	¾

Chart 13 Public sector borrowing requirement[1]



1 Negative values indicate a public sector debt repayment

Table 13: Economic prospects: summary

Percentage changes on previous year 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	508	
PSDR (financial year)				
£ billion	3½	10		3
as a percent of GDP	¾	2		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 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	114.4	1.0	**515.8**	126.8	56.7	8.9	**341.2**	112.0
1989	261.1	75.9	76.0	120.8	0.6	**534.4**	132.8	59.4	9.9	**352.1**	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**	108.6
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	29.0	4.8	**172.7**	113.4
1989H1	129.8	37.9	37.9	59.8	0.3	**265.7**	65.9	29.5	4.9	**175.2**	115.0
H2	131.3	38.1	38.1	60.9	0.3	**268.7**	66.9	29.9	5.0	**176.9**	116.1
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	4	2	**4½**	4½
1988 to 1989	3½	- ½	5½	5½	0	**3½**	4½	4½	½	**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 measure both understate recent growth.**

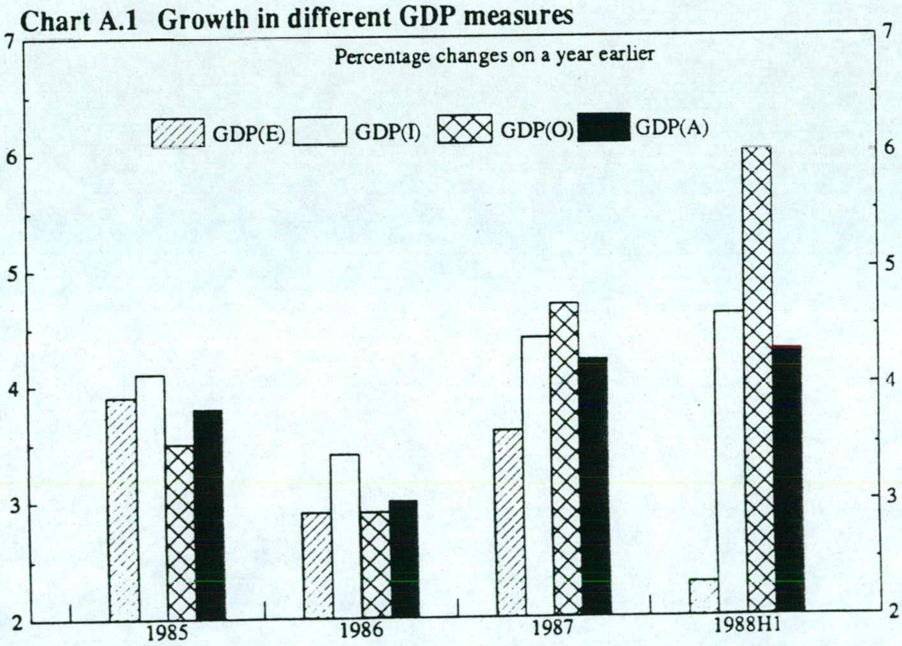
2 Changes as a percentage of GDP for stockbuilding and statistical adjustment

National and sectoral accounts

A.1. It is difficult to assess how strongly the UK economy has grown over the past two years because of the considerable disparity between the growth rates of the various measures of real GDP. The disparity was particularly marked for the first half of 1988. Chart A.1 illustrates the differences between the separate measures since 1985.

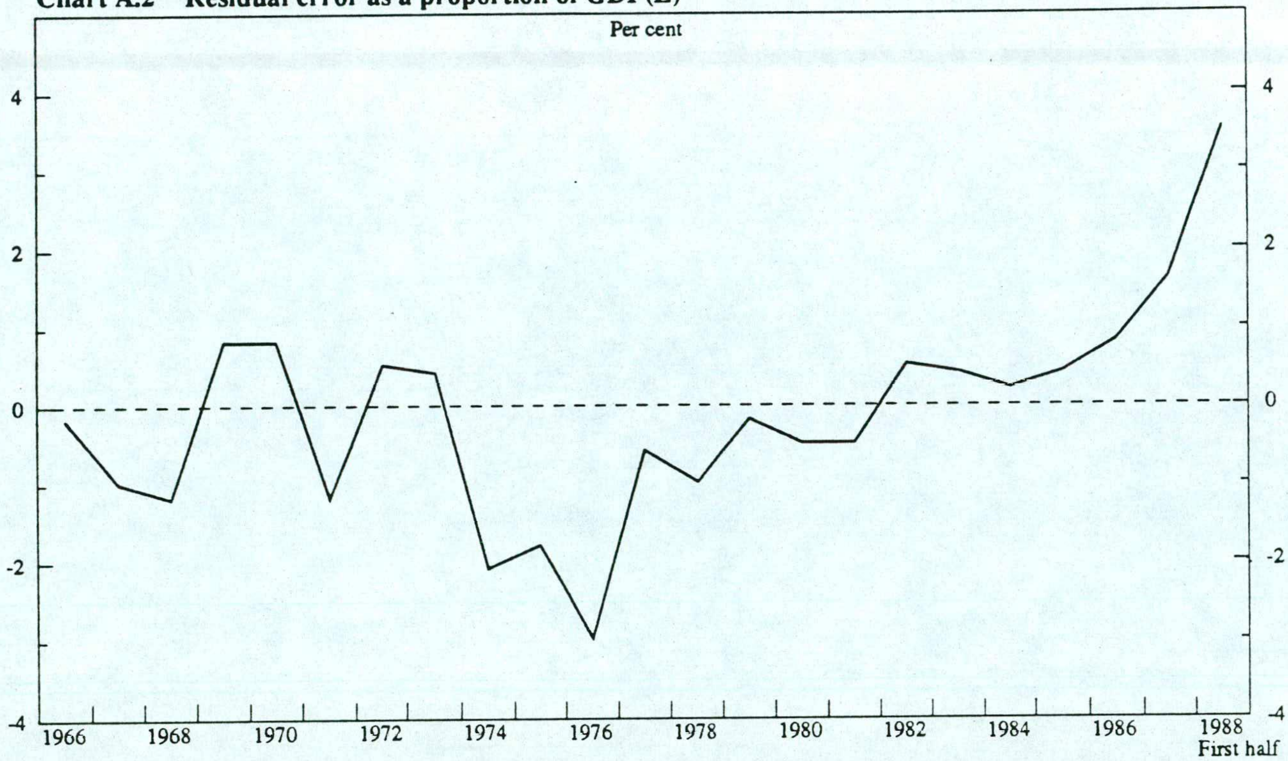
A.2. The output estimate of GDP, which is generally considered the most reliable short-term indicator, grew by 6 per cent in the year to the first half of 1988. The income measure has also shown strong growth. By contrast, the expenditure estimate of GDP grew by only 2½ per cent over the same period. It seems likely that growth in aggregate expenditure has been under-recorded over the past two years, and maybe over a longer period.

Chart A.1 Growth in different GDP measures



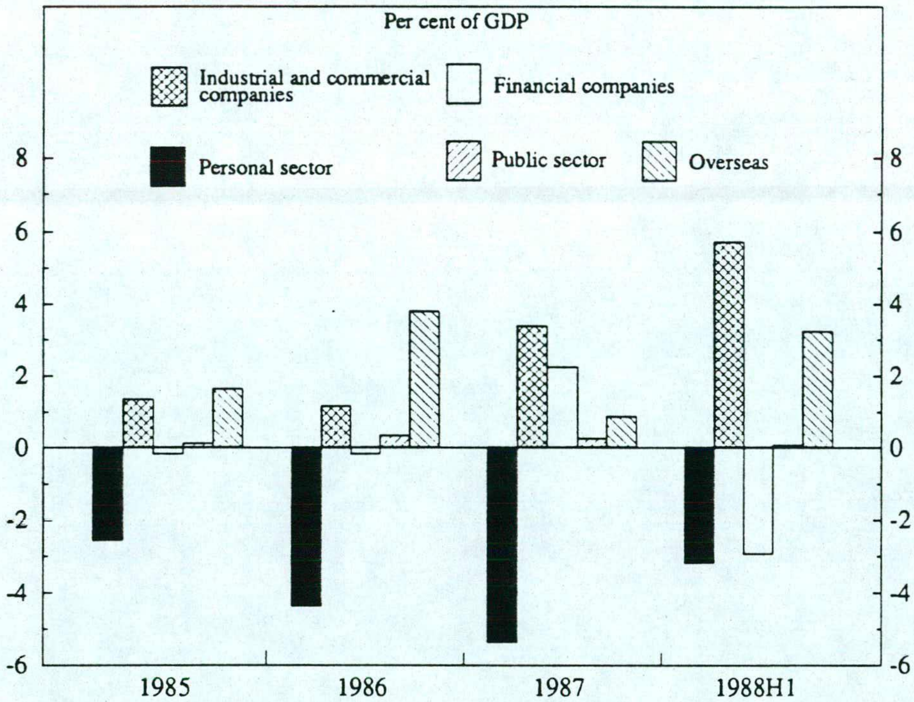
A.3. There are related problems with the current price national accounts figures, reflected in a rising residual error (the difference between the current price income and expenditure measures of GDP), especially in the first half of 1988.

Chart A.2 Residual error as a proportion of GDP(E)



A.4. At the same time large balancing items have emerged in the sectoral financial accounts. Sectoral balancing items are the differences 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 difference between the income and expenditure measures of GDP.

Chart A.3 Sectoral unidentified transactions



A.5. There is little information on the nature or size of the errors in the income and expenditure or the financial accounts that give rise to these large balancing items.

A.6. In 1987, the balancing item for the personal sector was equal to about 8 per cent of personal disposable income. This indicates that the personal sector may have acquired far more financial assets than the national income and expenditure estimates imply. It is also consistent with some under-recording of personal sector income and, hence, savings.

A.7. The large overseas balancing item in the first half of 1988 (about £7 billion) indicates that there were either unrecorded net credits on the current account or unrecorded net capital inflows or, most likely, both. To the extent that it reflects unrecorded net credits (ie net visible exports or invisibles) the true current account deficit would be lower than the recorded figure.

A.8. The balancing item for the industrial and commercial companies sector may imply some under-recording of spending on investment and stocks or unrecorded trade credit extended to other sectors. If net exports and company sector capital spending were higher than the recorded figures indicate, that would go some way to correct the sluggish behaviour of the recorded expenditure measure of GDP relative to the other measures.

A.9. The forecast for 1989 makes some allowance for a further rise in the average estimate of GDP, relative to the expenditure measure, though much less than in 1988.

PMP
Ayd OE

CHANCELLOR

FROM: A P HUDSON
DATE: 1 November 1988

AUTUMN STATEMENT: QUESTIONS

1. Moira and I have given a bit of thought to what Gordon Brown will say when he replies to the Autumn Statement.

2. He will presumably repeat a lot of the points he made last week.

- The Budget forecast was all wrong.
- The Budget judgement was all wrong and is the cause of the economic problems.
- The Budget surplus is down to privatisation, council house sales, and cheating pensioners.
- There is still a chronic shortage of investment.
- For most people, tax cuts have been wiped out by higher mortgage payments.

3. Specific points on the Statement could include the following.

- Why with an undershoot this year was there all the fuss about funding the nurses' pay award in full? Why couldn't you have taken the opportunity to finance a few more worthwhile projects, within your own planning total?
- Why not let councils spend their own housing receipts?
- You happily raised the planning totals before the last Election; now you have an undershoot, and you stick to the total for next year, in spite of higher inflation, which means you are really planning a real terms cut; but you then plan further real increases in the run-up to the next Election.

CHANCELLOR OF THE EXCHEQUER

- With all this money, and tax cuts, you still won't pay for sight tests, dental checks, child benefit, etc.
- What do the totals for the later years assume for child benefit (see note flagged.)? Or prescription charges?
- Do the health figures include any money for the outcome of the review? If so, how much and what? If not, isn't the review a sham? (Answer:no final decisions taken; Government will bring forward proposals in due course.)
- Won't most of your increases be wiped out by higher inflation?(See attached.)
- For example, most of the increase in health plans will go on nurses' pay. (Answer:less than half additional resources are for pay.)
- Why no mention of education? Training? Scotland? The regions? What's happening to them?
- The current account is awful and set to stay that way, and the manufacturing deficit the worst in our history. (The manufacturing deficit is the biggest ever; the current account deficit is well short of 1974 as a share of GDP, which was close to 4 per cent.)
- Tax cuts combined with public expenditure restraint not just socially wrong, but economically wrong - sucks in imports etc.
- With growth slowing, and spending on employment and training cut, what hope for the unemployed?

4. From your own backbenchers, I suppose some might raise the question John Odling-Smee was worried about: with growth at 3 per cent, how can you get inflation and the current account deficit down? Doesn't this show that policy isn't tight enough?

CHANCELLOR OF THE EXCHEQUER

5. This is a Culpinesque minute with mostly questions rather than answers! I doubt if any of these will give you any difficulty, but let me know if you want any more facts and figures.

APH

A P HUDSON

ljc8

From: J ODLING-SMEE
2nd November 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir Peter Middleton
Mr Anson
Sir Terence Burns
Mr Sedgwick
Mr Turnbull
Mrs Butler
Miss Simpson
Miss Walker
Mr Tyrie
Mr Call

Noted

Ch
Sorry - this had arrived by the time I got back. See also Rosemary Butler's note below
AA

PRINTED AUTUMN STATEMENT: CHAPTER 1

You asked for all the years to be marked on the horizontal scale and for faint horizontal lines to be drawn on Charts 1.1 and 1.2. May I make a few points to try to persuade you to remain with the existing presentation (shown in attached charts labelled PREFERRED)?

2. As I see it, the purpose of these charts is to give a general impression of what has been happening . If readers want to know the precise numbers and/or turning points they can consult Table 1.1 which contains the numbers underlying the charts. It is not necessary to present the charts in such a way that precise numbers can be read off them.

3. The inclusion of every year along the horizontal scale would clutter it up, or require rather small print, as the attached sample (labelled ALTERNATIVE) shows. For many years we have been showing only alternate years in charts with long time series which did not allow room for individual years. A number of charts in Chapter 2 show only alternate years, and it would be consistent to do the same in Chapter 1.

4. We do not show horizontal lines in any charts, except zero lines where appropriate, nor have we done so in the FSBR or the Autumn Statement for many years. (The PEWP shows horizontal lines,

(only of Chart 1.2)

but they are white lines against a pale coloured background and therefore not intrusive.) It would alter the unified appearance of the Autumn Statement to introduce horizontal lines in some charts.

5. The "ticks" on the vertical scales of the version of Chart 1.2 which you saw were inadvertently omitted, and will be present in the final version.

6. I therefore hope that we can stick with the existing style.

OD-S

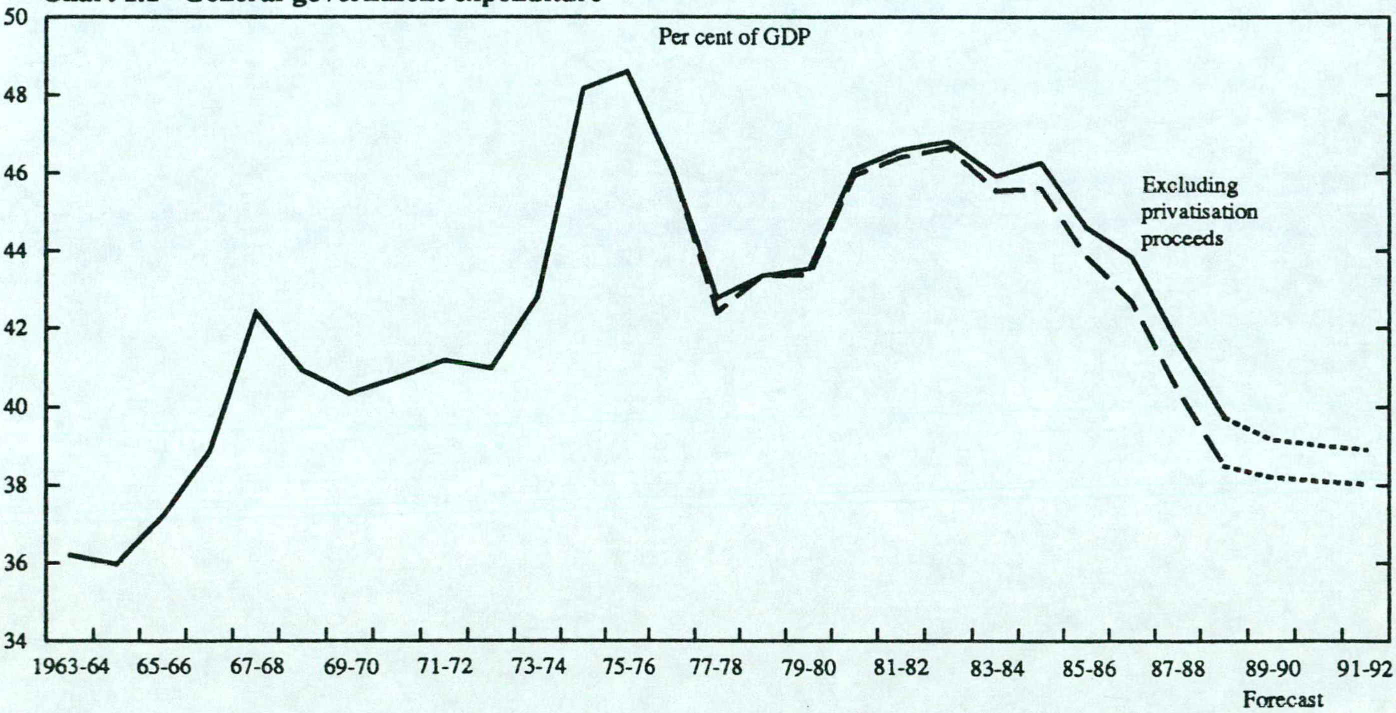
J ODLING-SMEE

I am unpersuaded. Ch 1 of the AS is in a real sense a replacement for pt 1 of the FSBR — which, as Mr O-S points out (see para 4) horizontal lines are quite rightly shown. The answer is to make the lines fainter & fainter (& therefore less intrusive) than in the alternatives to 1.2 shown here. Moreover where there are lines, there is no need for ticks. The latter of the alternative version of 1.2 are perfectly acceptable.

Needless to say, the same feature is req'd for Chart 1.1, tho' the only horizontal lines necessary are @ 40% → 45%, as per FCSA's note of 2/11. The charts need to give more than a 'general' impression: eg, you shd be able to see at a glance when we were last below 40% in

PREFERRED

Chart 1.1 General government expenditure

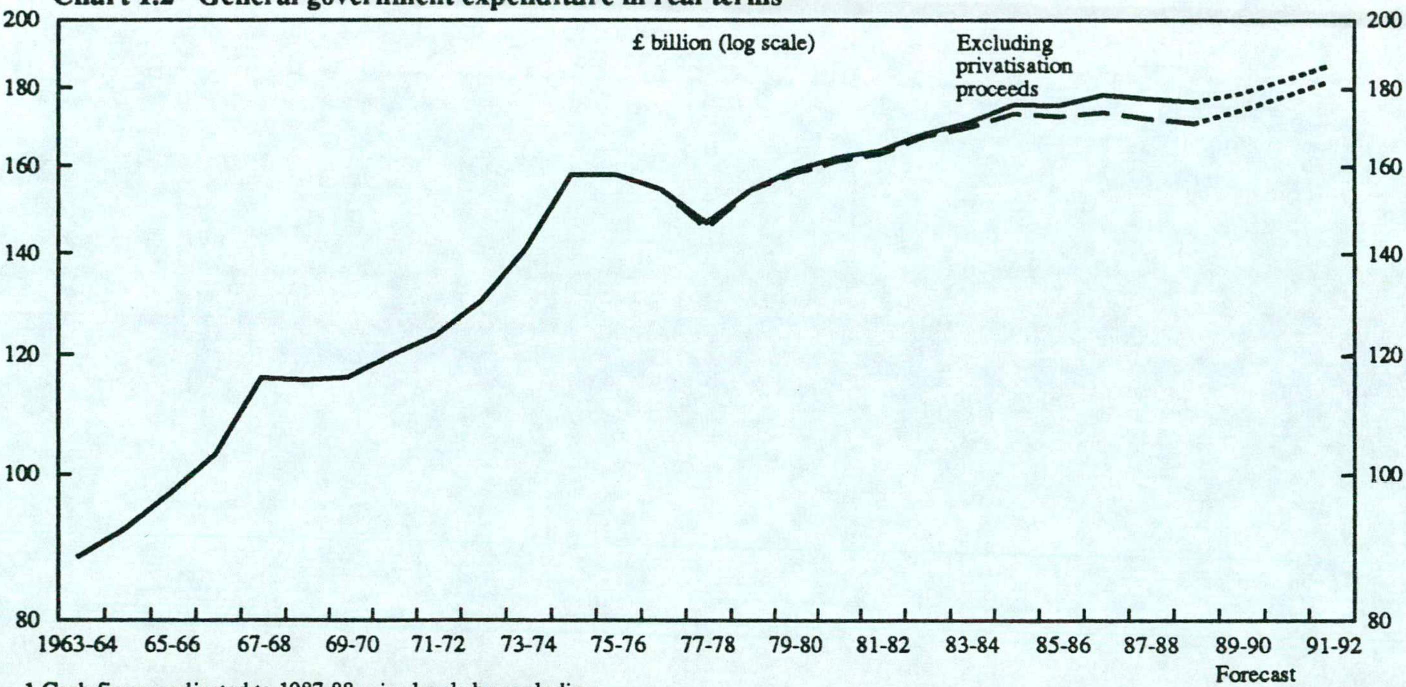


John says he can easily
move base to 35 not 34.

[What about odd numbered %s?]

PREFERRED

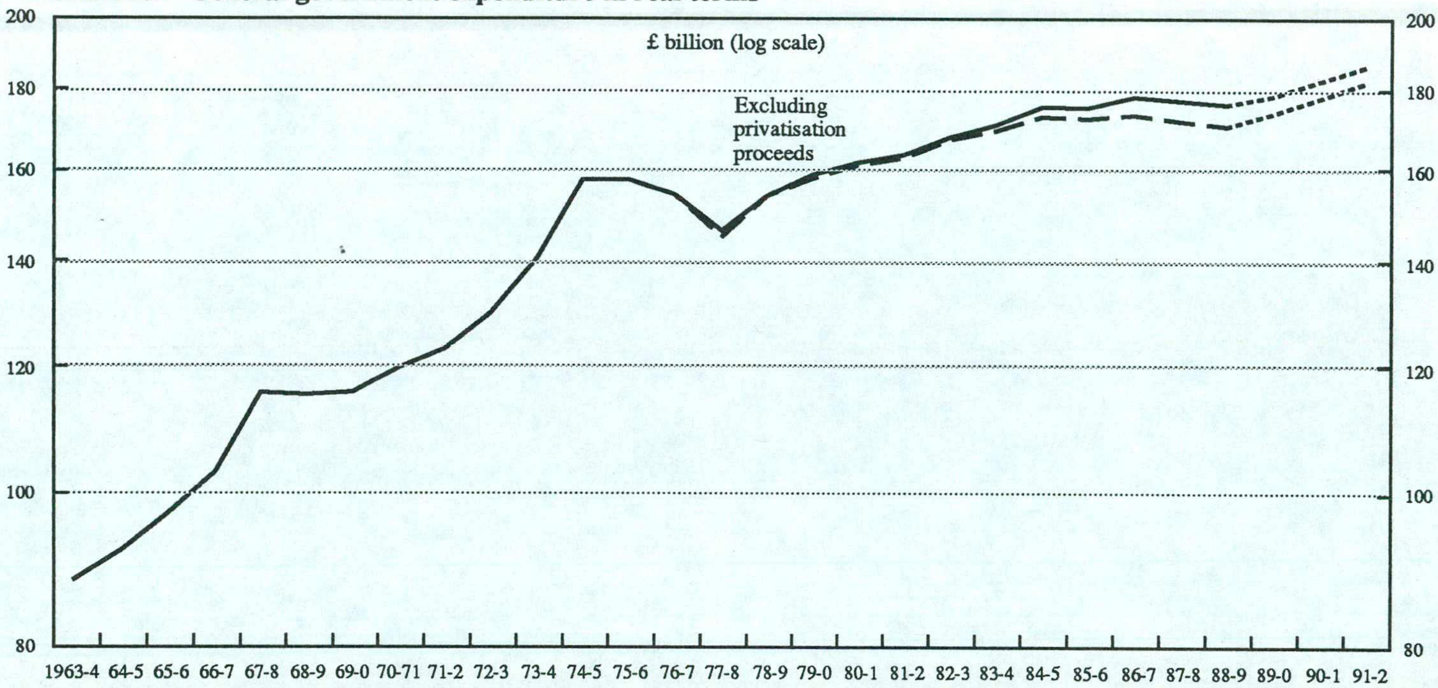
Chart 1.2 General government expenditure in real terms[1]



1 Cash figures adjusted to 1987-88 price levels by excluding the effect of general inflation as measured by the GDP deflator

ALTERNATIVE

Chart 1.2 General government expenditure in real terms[1]

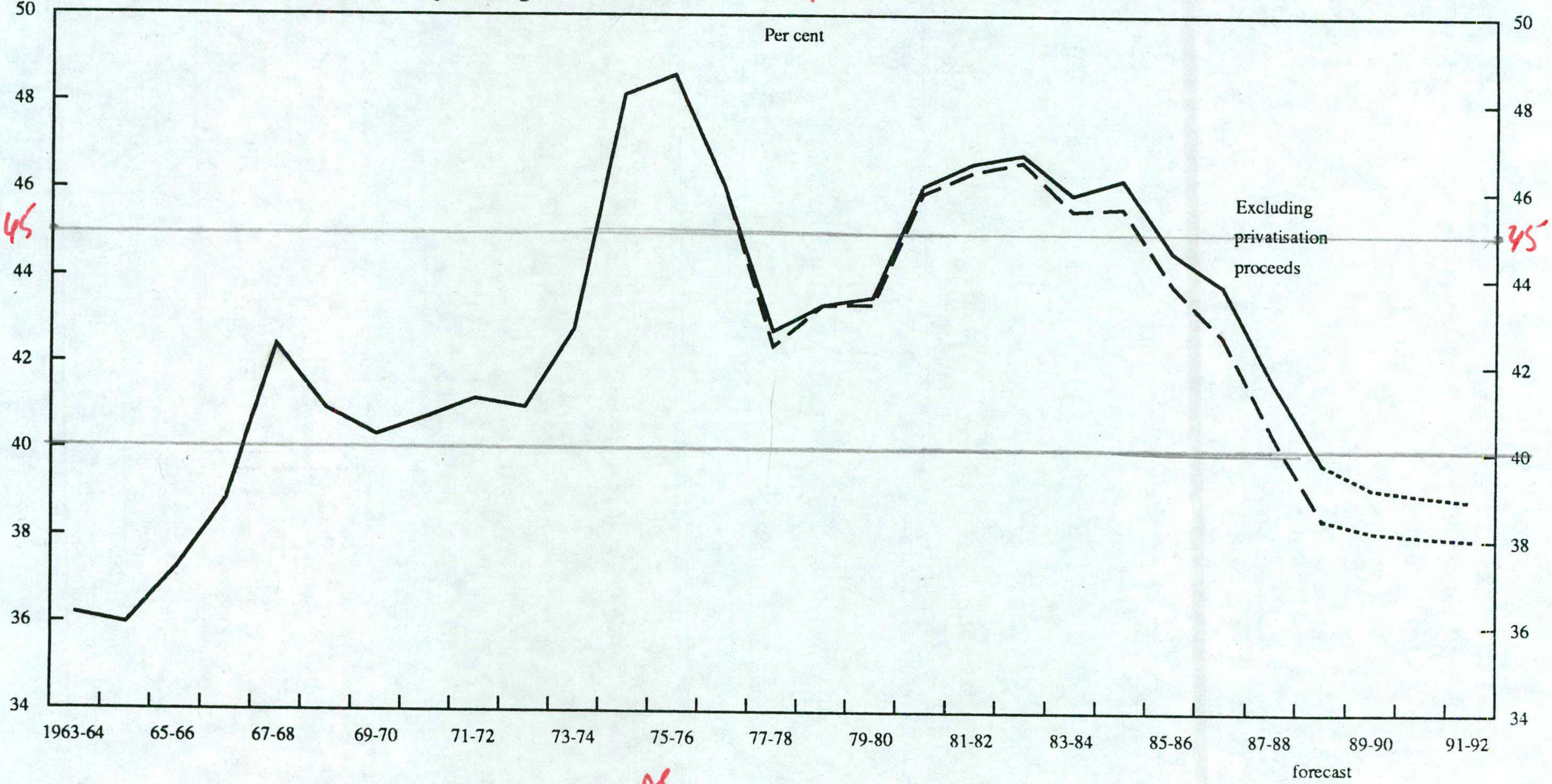


1 Cash figures adjusted to 1987-88 price levels by excluding the effect of general inflation as measured by the GDP deflator

*Please get redrawn, ~~[illegible]~~ (a) to start @ 35 & not 34, (b) to have all %'s marked on the scale (& not just even numbers), (c) to have 40% and 45% lines drawn in (faintly, but visibly), & (d) to have all years marked, & not just every other year (achieve this with the help of further abbreviation: eg 87-8 (or 87/8) & not 87-88).

M.

General government expenditure as a percentage of GDP



AA

P.S. there may be other pictures & graphs that would be more intelligible if ~~[illegible]~~ one or two lines were drawn. Perhaps you have a look.

Put with papers

BE 7/11

dti

the department for Enterprise

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Secretary of State for Trade and Industry

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Our ref PS4BLC
Your ref
Date 3 November 1988

Dear Jonathan

AUTUMN STATEMENT

You may be aware that during exchanges in the Lords on the Autumn statement, Lord Young undertook to write to Lord Peston to clarify the expenditure figures for the National Health Service (col 107 attached). I agreed with John MacAuslan that he would prepare such a letter for Lord Young's signature, presumably for submission through your office.

I also enclose a letter Lord Young subsequently received from Lord Sefton about the contribution of catering staff to measured GDP. I should be grateful if your officials could prepare a short reply explaining why a waiter's hire is as worthy as a production line worker's.

It would be helpful to have these by, say, next Tuesday, 8 November.

Yours ever,

Neil Thornton

NEIL THORNTON
Private Secretary

CH/EXCHEQUER 4/11
REC. - 4 NOV 1988
MR MacAuslan
CST
SIR T. Burns
MR Anson, MR Phillips
MR Sedgwick, Miss Peirson
MR Turnbull MR Gieve
MR Ackford MR A.M White
MR Griffiths MR G. O'Donnell
MR Tyrie MR Call

SECRETARY OF STATE FOR TRADE AND INDUSTRY'S OFFICE
-2 NOV 1988

HOUSE OF LORDS

[illegible] 1/11/88

Dear Lord Young.

'In a reply during the Autumn statement you implied that a waiter was "a productive person".

Does this mean that his efforts are included in GDP? And if so what proportion as it seems to me that the materials he serves has already been included as products.

[illegible]

Sefton of Garston

Autumn Statement

3.50 p.m.

The Secretary of State for Trade and Industry (Lord Young of Graffham): My Lords, with the leave of the House, I shall now repeat the Autumn Statement which is now being made in another place by my right honourable friend the Chancellor of the Exchequer. The Statement is as follows:

"Cabinet today agreed the Government's public expenditure plans for the next three years. I am therefore taking the earliest opportunity of informing the House of the contents of the Autumn Statement: that is, the public expenditure plans for the next three years, and the expected outturn for this year; proposals for national insurance contributions for 1989–90; and the forecast of economic prospects for 1989 required by the 1975 Industry Act.

"The main public expenditure figures, together with the full text of the economic forecast, will be available from the Vote Office as soon as I have sat down. They will also appear in the printed Autumn Statement, which will be published next Tuesday.

"I turn first to public expenditure. For the current financial year, 1988–89, the public expenditure planning total now looks likely to amount to some £$153\frac{1}{2}$ billion, or some £$3\frac{1}{4}$ billion less than was allowed for in the last public expenditure White Paper. In other words, only around £$\frac{1}{4}$ billion of the £$3\frac{1}{2}$ billion reserve I provided for is in fact likely to be needed.

"The main reasons for this shortfall are an extra £1 billion in privatisation proceeds, a reduction in social security spending of almost £1 billion as a direct result of the sharper than expected fall in unemployment, and a saving of some £$\frac{3}{4}$ billion, largely due to extra housing receipts under the right-to-buy programme. Taken together with the strong growth in the economy this year, and the containment of debt interest now that the Budget is in surplus, this means that total public spending this year, even excluding privatisation proceeds, will be less than 40 per cent. of national income—the first time this has happened for over 20 years. Not so long ago, the share of national income spent by the state seemed to rise inexorably. Over the past six years, that trend has been decisively reversed.

"Since 1982–83, public expenditure, excluding privatisation proceeds, expressed as a share of national income has fallen by seven percentage points—the largest and longest sustained fall since the wartime economy was unwound. Over the whole decade since this Government first took office, from 1978–79 to 1988–89, public expenditure has grown by under $1\frac{1}{2}$ per cent. a year in real terms. This is exactly half the rate at which it grew over the whole of the immediately preceding decade.

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

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

"For 1990–91, however, though these two factors will persist, the planning total has been set at £$179\frac{1}{2}$ billion, some £$3\frac{1}{4}$ billion more than the previously published figure. For 1991–92, the planning total has been set at £$191\frac{1}{2}$ billion. These totals include the same level of reserves as in last year's plans; that is to say, £$3\frac{1}{2}$ billion in the first year, £7 billion in the second year and £$10\frac{1}{2}$ billion in the third. They also incorporate an unchanged estimate of privatisation proceeds of £5 billion a year.

"Over the three survey years as a whole, the real growth in spending on programmes will be over 3 per cent. a year. This can be afforded only because of the fall in the burden of debt interest brought about by the dramatic improvement in the Government's finances from Budget deficit to Budget surplus. As a result, overall public spending, excluding privatisation proceeds, will rise by less than 2 per cent. a year, well within the prospective growth of the economy as a whole. In other words, total public spending, excluding privatisation proceeds, will continue to decline as a proportion of national income. But, at the same time, substantial additional funds have been made available for the Government's most important public expenditure priorities. The figures I am about to give all represent increases over the plans in the last public expenditure White Paper.

"First, health. An extra £$1\frac{1}{4}$ billion is being provided for the National Health Service in England in 1989-90, and an extra £$1\frac{1}{2}$ billion in the following year. There will be corresponding increases in Scotland, Wales and Northern Ireland. On top of that, health authorities are expected to receive an extra £100 million a year from sales of surplus land. Continuing the rate of cost improvement savings acheived in recent years will produce an extra £150 million in 1989-90 and an extra £300 million the following year. In addition, the Government are accepting the recommendation of the Government Actuary, in a report published today, that NHS employers' superannuation contributions in England and Wales should be reduced, which will save the Health Service a further £300 million a year.

"In total, the increases for the health service in the UK as a whole will be over £2 billion in 1989-90 and over £$2\frac{1}{2}$ billion in 1990-91. These are by far the largest increases the health service has ever received. Comparing next year with this year, the increase in real resources for the NHS should amount to some $4\frac{1}{2}$ per cent.

[LORD YOUNG OF GRAFFHAM.]

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

"Thirdly, housing. Gross provision for public sector housing investment is being increased by around £440 million in 1989-90 and £340 million the following year. But thanks to the success of the Government's right-to-buy policy, this is more than financed by extra receipts.

"Fourthly, law and order. An extra £290 million has been made available in 1989-90 and £430 million in 1990-91, principally for a further expansion in the prison building programme. This will provide a further 3,000 places by 1991-92. Provision for local authority spending on the police has been increased by £240 million.

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

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

"On science and technology, we have altered the balance of public support within an increased total. In particular, provision for spending by the Department of Education and Science has been increased by £120 million a year, with the science budget up by 16 per cent. in 1989-90. This reflects the importance the Government attach to basic and strategic research.

"The new plans imply an overall increase of £2¼ billion in public sector capital spending in 1989-90. This includes extra investment in hospitals, housing, prisons and roads. There is provision for higher investment by the nationalised industries including further anti-pollution investment by the water authorities.

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

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

"I turn next to national insurance contributions. The Government have conducted the usual autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the National Insurance Fund, and taking account of the statement on benefits which my right honourable friend the Secretary of State for Social Security made on 27th October. The lower earnings limit will be increased next April to £43 a week, in line with the single person's pension, and the upper earnings limit will be raised to £325 a week. The upper limits for the 5 per cent. and 7 per cent. reduced rate bands will also be increased, to £75 a week and £115 a week respectively. The upper limit for the 9 per cent. rate for employers will be raised to £165 a week.

"Over recent years, we have steadily reduced the Treasury supplement; the taxpayer's contribution to the National Insurance Fund. From 18 per cent. in 1979, it now stands at 5 per cent. My right honourable friend and I now propose to carry this policy to its logical conclusion and to abolish the supplement altogether. The necessary legislation will be introduced early in the new Session. However, because of the healthy state of the National Insurance Fund, this discretion will not require any increase in contribution rates. Thus, the main Class 1 contribution rates will remain unchanged at 9 per cent. for employees and 10·45 per cent. for employers.

"Finally, I turn to the Industry Act forecast. Growth this year looks to be turning out at 4½ per cent., compared with the 3 per cent. growth I forecast at the time of the Budget. Investment is particularly strong, growing twice as fast as consumption, with manufacturing investment expected to show the biggest rise of all, at 18 per cent. Indeed, it is striking that total investment has grown almost twice as fast as total consumption over the whole of the past five years.

"The continuing vigour of the British economy is testimony to the transformation that has taken place in the supply side of the economy; a transformation which has enabled the seven years to 1988 to record a combination of strong and steady growth unmatched since the war. As a result, unemployment has been falling rapidly. Since the middle of 1986 it has fallen by very nearly 1 million—the largest fall on record. Over the past year, unemployment has fallen faster in the UK than in any other major country.

"Inflation, as measured by the retail price index, is likely to be a little over 6 per cent, in the fourth quarter of this year. Part of the rise in recorded inflation reflects the impact on mortgage payments of the higher interest rates needed to tighten monetary policy and thus get inflation firmly back on a downward trend. Excluding mortgage interest payments, the retail prices index in the fourth quarter is likely to be around 5 per cent. compared with the 4 per cent. rise in the RPI forecast at the time of the Budget.

"Exports have continued to perform well, with manufactured exports up 7½ per cent. over the past year. Over the past seven years, the UK's share of world trade in manufactured goods has remained steady after decades of decline. However, with investment booming, and consumer spending increasing fast, total imports have grown even faster than exports, rising by 13 per cent. in the year to the third quarter. This has led to a substantially greater current account deficit that I forecast at the time of the Budget. For 1988 as a whole, this now looks like turning out at some £13 billion, equivalent to $2\frac{3}{4}$ per cent. of GDP.

"The stronger than expected economic growth this year means that total tax revenues are likely to exceed the Budget forecast by £$3\frac{1}{2}$ billion. Both income tax and VAT have been particularly buoyant. In the Budget, I set a public sector debt repayment—or PSDR—for 1988–89 of £3 billion, equivalent to around $\frac{3}{4}$ per cent. of GDP. With higher than expected Government revenues and lower than expected public expenditure, this year's PSDR now looks likely to turn out at some £10 billion, equivalent to over 2 per cent. of GDP.

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

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

"The slower growth forecast for 1989 inevitably implies a marked deceleration during the course of the year, particularly so far as domestic demand is concerned. Thus, comparing the second half of next year with the second half for this year, overall growth is forecast at $2\frac{1}{2}$ per cent., and growth in domestic demand at only $1\frac{1}{2}$ per cent. The current account deficit is likely to fall only slightly, to some £11 billion, or $2\frac{1}{4}$ per cent. of GDP.

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

"In short, after two years of unexpectedly rapid expansion, growth next year is forecast to return to a sustainable level, and one which compares well with the economic performance of the '70s; while inflation will resume its downward path. The public finances are in substantial surplus and will remain so, with public spending on priority programmes continuing to increase, while overall public spending continues to fall as a share of GDP to a level in 1991–92 not seen for a quarter of a century. The prospect that lies before us is yet further testimony to the success of the policies we have been pursuing these past $9\frac{1}{2}$ years and will continue to pursue, and to the economic transformation those policies have wrought."

My Lords, that concludes the Statement.

4.7 p.m.

Lord Bruce of Donington: My Lords, the House is indebted to the noble Lord, Lord Young of Graffham, for repeating the Statement made in another place. I must say that in the 10 years that I have had the honour of being in your Lordships' House I have never heard a more remarkable Statement.

One of the most agreeable characteristics of the noble Viscount, Lord Whitelaw, when he was the Leader of your Lordships' House, was his ability to own up to error. Time and again when your Lordships' House has been in some unfortunate impasse, perhaps some misunderstanding between the Front Benches, the noble Viscount came to the House and said in his most disarming manner, "My Lords, I may have made a mistake. In fact, I very often make mistakes". He always sat down to the plaudits of the House and its general approval of his unfailing honesty of expression in that regard.

The noble Lord, Lord Young of Graffham, if he will forgive me, does not suffer from a surfeit of modesty. The noble Lord was, of course, in part tied by the fact that he was reading a Statement made in another place. Perhaps if it had been left to him he would be making some amends for some of the most incredible forecasts made by the Chancellor at the time of his Budget.

The Statement begins with a long recital of proposal expenditue plans, with which I will deal briefly before I sit down. I refer to an incredible omission that makes the Statement most remarkable. It is the complete lack of any Treasury admission of gross error in the forecast that it made at the time of the Budget. We were then told that the current balance of trade would be in deficit for the year in the sum of £4 billion. Some of us took a sharp intake of breath at that. I can well remember the time when the prospect of a deficit on current account of some £300 million filled people with dismay. Even so £4,000 million was the forecast. We now have a Statement which says quite cheerfully and without explanation: "Oh no, it is not going to be £4 billion. It is going to be £13 billion and £11 billion the following year".

Before any reliance is placed on the forecasts that are made most optimistically in the concluding paragraphs of the Statement, read with such relish by the noble Lord, surely the House is entitled to ask on what basis these current forecasts are made. Using the Treasury model with the information available at that time, it is quite inconceivable that the Chancellor of the Exchequer did not know that the forecast of the current account deficit was at the time of the Budget being grossly understated. It is quite inconceivable.

Many of us have computers: I have one myself. There is a saying, "Rubbish in, rubbish out". Quite clearly, at the time of the Budget the noble Lord or his servants must have caused some rubbish to be put in. Perhaps it was a different statement of the unemployment figures that was fed into the model. These have varied from time to time with no distinction being made between those actually unemployed and those claiming benefit. There have been 21 alterations in the figures. Even with a

[LORD BRUCE OF DONINGTON.]

variation of that feed-in, there can be no excuse for a crass error of that kind. As your Lordships will recall, it was made at a time when an unparalleled sum of £2 billion to £3 billion was made available to the top income earners—or top income receivers, I should say—in this country. That probably was the purpose of it.

It will be imposssible for your Lordships to overlook the consequences of the Chancellor's forecast of a £13 billion deficit on current account. The endeavour is made to shrug off as a matter of no consequence. Statements have been made at one time or another that this deficit is easily covered by overseas assets, though one should bear in mind that these have depreciated by some £29 billion since the Stock Exchange crash of October 1987. It presupposes that the owners of those private investments overseas are willing for a charge to be created by the Government in order for them to cover the current account deficit. The noble Lord knows as well as anyone else that these charges are not available.

The question to which the country should address itself, and the question upon which even these expenditure plans announced this afternoon depend, is how long a country can continue to sustain a current account deficit on these lines. I have been waiting for some time and I expect the noble Lord, Lord Aldington, has also, for an apology to be made to him and to his committee for its report having been stigmatised as Marxist. It has proved very much nearer the mark than any forecast that the Chancellor has made. The position remains one of the utmost gravity.

I invite the noble Lord to contemplate what may happen as a result of the American election, whichever candidate is returned, whether it is Mr. Bush or Mr. Dukakis. If the new President of the United States, with his advisers, decides to take the advice offered to him some four monhts ago by the Chancellor of the Exchequer and to reduce the trade deficit, where then will be the prospects of the United Kingdom? The fact of the matter is that this country cannot go on sustaining such deficit.

The noble Lord always has the alibi which has been hinted at again in the Statement this afternoon of overheating: the country is doing so well because the economy is overheating. The imports into this country and the importers' industry are white hot at the present time, with manufactures coming into the country very largely as a result of the Budget earlier in the year. These manufactures are coming in as a result of the concessions to the higher taxpayers. This situation cannot be sustained.

In the meantime the inference is that the overheating, as it is called, applies to the country as a whole. We know perfectly well that it does not. Unemployment in the northern region as a percentage of the workforce (which has recently been enlarged by the noble Lord to include those employed in the Armed Forces) is 12 per cent., whereas in the South-East unemployment is 5·3 per cent. Unemployed claimants per vacancy in the northern region are 14 people unemployed for every vacancy. In the South-East the figure is five. The growth in average male earnings in the northern region is 8·6 per cent. and in the South-East it is 11 per cent. These are some of the figures that go to the root of the whole philosophy behind this Statement.

As regards the expenditure plans, we shall have to examine those in detail. I have had them for only 10 minutes or so and I am quite unable to pass any detailed observations. One thing can be said for certain. In the current age it is an idle boast to claim that the reduction of public expenditure is of itself a good thing, particularly at a time when the infrastructure of this country is in such a shocking state. There is much deprivation among our people. I believe that when the House has had an opportunity to digest this Statement and to analyse it further when the details are available from the Vote Office, it will treat it with the contempt that it deserves.

4.15 p.m.

Lord Banks: My Lords, I join in thanking the noble Lord for repeating the Statement made in another place by the Chancellor of the Exchequer. It seems that government policy is based upon a combination of high interest rates and the restraint of public expenditure. As the Statement explains, public expenditure is continuing to decline as a percentage of national income. It is expected to be less than 40 per cent. in the current year. One of the prongs of this two-pronged policy is in the main high interest rates designed to rein in private expenditure.

I believe it is agreed that the effect of these interest rates is long term to some extent. The other prong is designed to rein in public expenditure.

Is this strategy working and will it work in the future? Is this strategy sufficient to cope with a very high deficit in the balance of payments and at the same time with the rising inflation that we have at the moment? I have some doubts about it when I consider other factors that are involved. There is, for example, the impact of interest rates on rises in pay settlements, there is the credit boom and there are the proceeds of the recent tax cuts, all of which tend to increase private expenditure. If one takes all these factors together, they seem to constitute a recipe for private affluence amid public squalor, to quote Galbraith's phrase.

I wonder too whether the pound can sustain for two or three years a balance of payments deficit as high as it is at present. Exchange rates, as we know, are very important. I imagine the noble Lord will agree that we ought to be seeking stability in those. We are not yet a fully fledged member of the European monetary system. I should like to ask again whether we can be given any indication of when that is likely to occur. We understand that it is the Government's policy that it should occur at some time.

Perhaps I may briefly mention three of the individual items of expenditure referred to in the Statement. First, we welcome the additional expenditure on the health service although we doubt very much whether it will be enough to offset the chronic underfunding that we believe the health service has suffered in recent years. Next, there is the spending on prisons. We believe that to be essential, and we welcome it. We regret that no intention is expressed to abolish the upper limit in regard to employees' contributions to national insurance. We oppose the abolition of the Treasury supplement because it has always seemed to us that in effect if not technically it makes contributors pay for non-contributory benefit.

Finally, I wish to ask the noble Lord how far public expenditure is to decline as a percentage of national income. The Statement says it is intended that it should continue. Are any reasons advanced for this continued reduction? Is there any long-term strategy behind it?

Lord Young of Graffham: My Lords, I am grateful to the noble Lord, Lord Bruce of Donington, for his remarks on the Statement that I have just repeated to your Lordships' House. Perhaps I may say how much I agree with him on two matters. The first concerns the compliments that he paid to my noble friend Lord Whitelaw. I agree with every word that he said about my noble friend. The second concerns the way in which he said that this was an agreeable Statement. Surely no Statement that has been made to your Lordships' House could be more agreeable than the simple fact that £10 billion will now be paid off the national debt. Public expenditure after 22 years comes below 40 per cent. to 39·75 per cent. and over the next four years will decline gradually to 38·75 per cent.

I hope that the noble Lord, Lord Bruce of Donington, was slightly careless with his choice of words. I am sure he did not really mean to say that my right honourable friend the Chancellor of the Exchequer was aware at the time he made the Budget forecast that there were any figures that would imply other than a forecast of £4 billion on balance of payments. I am sure that he did not. Forecasts are simply forecasts, and circumstances can change very rapidly.

One of the other forecasts for which the noble Lord, Lord Bruce of Donington, failed to blame my right honourable friend the Chancellor of the Exchequer was his original supposition that the economy would grow by 3 per cent., instead of which it grew by 4·5 per cent. It was that excessive growth that was the cause of the difficulties that my right honourable friend recently adjusted.

The noble Lord should reread the Statement. He referred to the fact that the Chancellor somehow had given billions back to people at the time of the last Budget. I ask the noble Lord to look at the figures, which are now available. They will show that, instead of receiving total receipts from taxes of £184.9 billion, we are now estimating that there will be £188.6 billion, so that the Chancellor will take £3.7 billion more from the taxpayer than he estimated at the time of the Budget.

The noble Lord spoke also of a reduction in public expenditure. The figures over the planning period go from £167 billion to £191.5 billion. That is no reduction. Indeed, the noble Lord, Lord Banks—I am grateful for his comments—referred to that ill-used phrase "private affluence and public squalor". He was critical of the way in which the Government were not spending money on part of the public sector.

In 1988–89 the health service will receive over £2 billion more and in 1991–92 £1.5 billion more. If one compares next year with this year, the increase in real terms should amount to some 4.5 per cent., the greatest increase ever given. On roads it is £220 million, going to £250 million the following year; on housing it is £340 million, going to £440 million the following year; on law and order it is £290 million, going to £430 million the following year, and on defence it is £150 million. Wherever one looks there is additional expenditure. The great magic of the situation is that the Government have been able to afford extra public expenditure, at the same time reducing it as a percentage of GDP.

The noble Lord, Lord Banks, asked in conclusion how far that process should go. We have yet to get back to those halcyon days when public expenditure was at the point where the noble Lord, Lord Wilson of Rievaulx, took it on in 1964. I for one would like to see it back to that level.

Lord Boyd-Carpenter: My Lords, is my noble friend aware that the noble Lord, Lord Bruce of Donington, was quite right when he said that he had never heard a Statement like this, because he has never heard as good a Statement as this or as encouraging a Statement for the British public as a whole? Is he aware that the Statement makes it clear that Her Majesty's Government, while providing additional funds where they are really needed, have kept an effective grip on public expenditure, a fact that reflects great credit on the Government as a whole and on the Chief Secretary to the Treasury in particular? Is he aware also that many people will be very reassured to see this steady management of public expenditure?

Perhaps my noble friend can add one thing. The Chancellor of the Exchequer recently confirmed, I think, that it remains the policy of the Government to reduce the levels of taxation, particularly direct taxation. In view of the fact that those admirable citizens who have mortgage payments to pay are very much in need of further reductions in their tax demands, can my noble friend indicate without anticipating next year's Budget that it remains the policy of the Government to accept that taxation is still too high and should be reduced by stages?

4.30 p.m.

Lord Young of Graffham: My Lords, I am grateful to my noble friend. I have to confess that my right honourable friend the Chancellor of the Exchequer has not yet confided his Budget secrets to me and nor do I expect him to. However, he has recently confirmed that it remains his intention to reduce personal and direct taxation as and when it is prudent to do so. Inflation must remain the first priority, but happily today we have expenditure totals that enable progress to be made in the reduction of taxation.

Lord Diamond: My Lords, we on these Benches would also like to thank the Secretary of State for repeating the Statement. Its contents are mixed. The

[LORD DIAMOND.]
main conclusions that I draw from it are, first, that the Government have again shown ample evidence of their inability to guide the economy; and, secondly, that we are faced with a potentially dangerous situation, which no Member of your Lordships' House would wish to exaggerate—the forthcoming rise in the balance of payments deficit. It is one which is at least three times as large as was forecast as recently as six months ago. For that to have happened in that short period is, if I may say this to the noble Lord who spoke for the Labour Party, no evidence of a lack of good faith on the part of the Chancellor or any of his advisers. It is far from that. It is direct evidence that the Government are totally out of control of the economy. When they gave the figure of a balance of payments deficit of £4 billion, they sincerely believed that that would turn out to be the case. It would be highly dangerous at budget time to forecast a balance of payments deficit of £12 billion as a result of Budget policies. We know that. We have all been through it. We know the dangers. I repeat, I do not want to exaggerate the dangers.

I read the statement with a note of caution. I gather that most of the Statement has been written to try to satisfy confidence in the City and abroad. It is addressed to that audience and not, in particular, to members of the other place.

My other reason for saying that the Government are shown to be unable to guide the economy is the well known one of what happened to unemployment. Did Conservative candidates in the 1979 election say on platform after platform, "You vote for me and I guarantee that we will put unemployment to a figure that has never been thought of in this country's history"? I do not believe that they did. It is far fairer to the Government to say that the rise in unemployment was unintentional. The rise in the balance of payments deficit is unintentional. The rise in the other figures shown here is unintentional. The Government are totally out of control.

The public expenditure figures make it clear that everything we have been told about resources not being available for those issues about which your Lordships' House feels keenly and upon which it has made its decisions in Divisions is a lot of twaddle. The figures show it. The Chancellor is saying it. He is saying that for the coming year he has some £3·25 billion in hand above what was provided for and approved by the other place at the time of the Budget. He now proposes to continue the path of reducing public expenditure as a percentage of national income and, as we can read on every line, the Government are patting themselves happily on the back.

Why do a Conservative government wish continually to reduce public expenditure? The answer is as plain as a pikestaff. They have reduced taxation for the well-to do. They have improved my situation every year I have been sitting on these Benches. I have not asked for that. They have done it. They have done it for hundreds of thousands of people much more prosperous than myself. Why have they done that? Because is helps the well-to-do. Public expenditure helps the not so well-to-do. It is biased in favour of those at the bottom of the scale. All the social services benefit them. So what do the Government do! They reduce taxation to benefit their well-to-do friends. They say that due to that reduction they have no money to help those at the bottom of the scale. That is what I read into this sorry story.

Lord Young of Graffham: My Lords, I am grateful to the noble Lord, Lord Diamond. It occurs to me that his definition of an economy that is out of control may well be accurate when seen from his Benches. That may well be so, because I am not an authority on what the view is like from the noble Lord's Benches. If one goes around the nation or, even better, overseas, and asks other people whether the economy is one that is out of control, then one will receive a different view. Today when we go overseas we can indeed walk tall, because country after country, government after government and company after company recognise that we have had years of firm public expenditure discipline and we are now reaping the benefit.

The noble Lord was a distinguished Chief Secretary in his day. In that day we saw public expenditure rise as a percentage of GDP from 36 per cent. to 42·5 per cent. those were the days when far from benefiting more, became worse off. One only has to go back to the sorry 1960s and 1970s to realise what our standing in the world was and whether that benefited the less fortunate in our society.

The noble Lord says that now we have this surplus and are paying back the national debt we should afford more money. I say that it is only because we are prudent that we can do both. We can reduce the national debt and substantially increase expenditure. If we were not prudent, we might be back in that sorry time 12 years ago when, in today's figures the Government of the day had to go out and find £44 billion from countries around the world in order to keep afloat. From having to borrow £44 billion to paying back £10 billion, is an enormous difference. Thanks to that, and that only, around the country and in other countries, we are not regarded as out of control.

Lord Peston: My Lords, having listened to my noble friend Lord Bruce and the noble Lord, Lord Diamond, it seems that the Treasury has a choice. It has to accept that it is either meretricious or incompetent. It is up to it to decide which it would rather be.

It is hard to comment upon the document because, for reasons which seem to be increasingly absurd, we received it late. I can see no national security reason why such a Statement could not be available to your Lordships in the morning so that we could discuss it with full knowledge in the afternoon. I hope that the Secretary of State will therefore bear with me if I do not show a full knowledge of it.

I should like to ask the Secretary of State about Table 8 which is important. It is the public expenditure in real terms table. The noble Lord has talked about how bouyant everything is. My reading of the DES figure is that it rises from £17.4 billion to £17.5 billion and then stays constant in real terms.

That is not my idea of growth. I should like some explanation of that. The health figures are more interesting. I should like an explanation of them, because the 1988–89 outturn is put at £20.5 billion and the 1989–90 outturn is £20.8 billion. That is 0.3 over 20.5 which with my simple ability for doing sums is an increase of approximately 1.5 per cent. That 1.5 per cent. does not seem to me to be a very large real increase. To all people who know about health, 1.5 per cent. will not be a remotely sufficient increase to fund the demands placed on the health service in just that one year. If we then proceed with £21.1 billion and £21.3 billion, we get similar figures of a very low order of magnitude. I find it extraordinarily hard to make the Government's own figures in this document on health correspond at all to the rather optimistic Statement that has just been made. It seems to me that the Government are not finding the real resources to fund the health service in terms of its own stated requirements.

Perhaps I may ask the noble Lord for further clarification. Such real figures are simply the money figures divided by the projected GDP deflator. If the Government are as incompetent on predicting inflation as they have been about everything else, the GDP deflator upturn will be larger as well. In that case, if the Government stick to their proclaimed cash limits, the health service, education and so on will do rather worse.

I apologise to the noble Lord for asking him such detailed questions so rapidly. However, these are the only figures I have and this is the only way in which I can do it. I must ask him whether he can explain how he can say that everything is so good when the actual figures seem to be much less attractive.

Lord Young of Graffham: My Lords, the noble Lord, Lord Peston, will doubtless recall that the number of school leavers will drop substantially over the next few years. I think the number will drop by 30 per cent. by the early 1990s. Therefore the important matter is the expenditure per capita. As we have a declining school population, one would hope that we would spend less money.

Within this budget, the provision for spending by the Department of Education and Science has been increased by £120 million a year, with the science budget up by some 16 per cent. in 1989–90. The Treasury figures are often an arcane art form, if not a science. The survey changes over the period for the National Health Service in England alone show the departmental total going up from £21.7 million in 1988–89 to £23.1 million in 1989–90 and £24.3 million in 1990–91. I accept that these figures are different and there is an explanation for them. What I shall do is write to the noble Lord and put a copy of that letter in the Library.

Lord Mason of Barnsley: My Lords, from the Chancellor's point of view I suppose that was a very good Statement that he made to the House. But what of the views of the Secretary of State for Trade and Industry? First, he has admitted that there are bound to be higher interest rates and there is no telling what the limits will be. Secondly, there is bound to be a rise in inflation, I guess beyond mid-1989. Wages and salaries are very much outstripping productivity and it looks as though that will continue. Both those factors are bound to have an adverse effect on investment and manufacturing industry, especially the expansion of manufacturing industry as we lead up to 1992.

The Minister knows quite well as regards jobs that there has been an increase in service jobs but not in manufacturing jobs. We are getting plenty of waiters but not many productive workers. When we take into consideration the balance of payments deficit and the frightening figure of £13 billion that we shall face, we wonder how long this can go on. Is this not the weakness of the Government's case? The Secretary of State is responsible for our trade and the expansion of industry, especially manufacturing industry. Is he not disturbed by some of these trends?

4.45 p.m.

Lord Young of Graffham: My Lords, I am grateful to the noble Lord, Lord Mason. I am sure he would be the first to admit that a waiter is a productive worker. I think that the noble Lord did not mean to imply otherwise. He was concentrating on a specific sector of the wealth creation processes of this country; namely, manufacturing industry. Investment is particularly strong. Over the past five years, investment has been growing twice as fast as consumption. However, manufacturing investment is expected to show the biggest rise of all—18 per cent. That is the strength of these figures.

Far from high interest rates affecting investment, it has been shown over the years that it is inflation that affects them. Because manufacturing companies and industrial companies of all sorts do not know the outturn costs of their investments, that slows them down more than anything else.

The noble Lord also mentioned a deficit in the balance of payments. Nobody will underemphasise the importance of that; it is important. However, at the same time I must point out, without making too much of it, that there is a large overseas balancing item in the first half of 1988 which amounts to some £7 billion. That indicates that there were either unrecorded net credits on the current account or unrecorded net capital inflows, or most likely both. To the extent that it reflects unrecorded net credits—that is, net visible exports or invisible ones—the true current account deficit will be lower than the recorded figure.

It is the nature of these figures that they take some time to refine. I am not placing too much emphasis on this. We must see that we get the current account into balance. But we must point out that at a time when our exports continue to go up, month after month after month, when our share of world trade has stabilised after decades of decline, British industry is competitive again. As Secretary of State for Trade and Industry I believe this is a good Statement.

Earl Russell: My Lords, the noble Lord, Lord Young of Graffham, is perhaps aware that one cannot have something for nothing. He may therefore be prepared to consider the possibility that the restraint in public spending on which he has so

[EARL RUSSELL.]
much prided himself has not been achieved without a very heavy price from our public services and those who use them.

I should like the noble Lord to consider a view which is quite widespread among those in receipt of public spending, among whom I must declare an interest. These restraints have been achieved by the use of the terms "level funding" and "real terms" in ways which appear to many to be, in the literal and pre-Churchillian sense of that phrase, terminological inexactitudes. The noble Lord may perhaps be aware that the point has been made that many of our public services have survived up until now only by the process of spending reserves, accumulating debts, asset-stripping and deferred maintenance. This is a policy with a limited life expectancy.

I am not simply offering a plea for higher public spending. I am asking the noble Lord to consider the point of view that the level of our spending is incompatible with the level of our commitments. I should like the noble Lord to consider—if he should be convinced by that view—which of those is going to change. Will he decide that the public spending figure is absolute and that therefore some of our services must go? Or will he decide that spending commitments stand and that therefore this spending figure which he is putting before us is incompatible with our commitments? I think he must do one or the other.

Lord Young of Graffham: My Lords, I am grateful to the noble Earl, Lord Russell. However, I fear that I fail to recognise his description of the public services. When I come to your Lordships' House to repeat a Statement which shows that public expenditure will rise from £167 billion to £191½ billion, I wonder where this cutback in public expenditure is. Is it in the health service? During the lifetime of this Government that has seen expenditure rise from £7 billion to £24 billion. Is it in education? Is it in a whole series of areas? I should be grateful if the noble Earl would identify to me precisely those areas of public expenditure which he believes are in terminal decline because of government spending.

Earl Russell: My Lords, is the noble Lord——

The Lord Privy Seal (Lord Belstead): My Lords, for those of us who have not taken part, this debate is very interesting. If I may say so, the exchanges on each side have been fair and free. My noble friend Lord Young of Graffham does not need anybody to stand between him and those whom he is answering. However, I must remind the House for the second time in two weeks that we have agreed as a House that after a Statement is made—and I know that it was a long one today—a maximum of 20 minutes shall be set aside for the resulting deliberations.

It is a matter for your Lordships' House to decide whether or not we keep to that. I know that the noble Lord, Lord Jay, wishes to contribute. Perhaps I may suggest that we take the noble Lord's intervention and my noble friend's reply and then pass on to the next business.

Lord Jay: My Lords, is the noble Lord aware that at the rate of balance of payments deficit which he announced and forecast today, unless we borrow from overseas our official reserve will last only about three years?

Lord Young of Graffham: My Lords, I should like to see what happens. I could just as well say that on the basis of the present figures, as outlined today, in a matter of 15 years or so there will be no national debt. None of these things proceeds on a straight line. What the Chancellor has said is that he expects the balance of payments figure at £13 billion to be £11 billion the following year. I have litttle doubt that we shall see it decline, and decline sharply, thereafter.

This is a complex matter. It is complex because no one is totally certain about the method of recording these figures, and it gets confused with capital transfers too. But I hope very much that we shall not find ourselves running out of reserves as we did once upon a time. I hope those days are well and truly behind us.

Lord Molloy: My Lords, I wish to ask the noble Lord the Leader of the House if I may make two very brief points. I have been trying all afternoon to make those points.

Lord Belstead: My Lords, this is a matter for the House. I made a suggestion to your Lordships and I explained why I made that suggestion. May I repeat that I think perhaps the moment has come, with a long day ahead of us, to go on to the next business.

School Boards (Scotland) Bill

4.51 p.m.

Clause 6 [*Proceeding*]:

Lord Sanderson of Bowden moved Amendment No. 3:

Page 5, line 8, at end insert—

(", except where the matter which is the subject of the vote relates to the appointment—

(a) of a co-opted member, or

(b) to any particular office or committee,

in which case the decision shall be by lot.").

The noble Lord said: My Lords, in Committee we discussed the issue of whether or not a board chairman should use his casting vote when the subject of the vote relates to the co-option of a person to the board or the appointment of a board member to any particular office, or to the membership of a committee of the board.

Noble Lords opposite, and the noble Lord, Lord Carmichael of Kelvingrove, in particular, felt that, in those circumstances and where there was an equality of votes, the decision should be taken by lot. My noble friend Lord Dundee undertook to consider the arguments put forward by noble Lords. This we have now done.

I read the extracts of the debate from the *Official Report* with great interest, particularly the points made about seeking to avoid placing the chairman of

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AUTUMN STATEMENT: High interest, high sterling, high risk.

- The figures for public expenditure in 1988-89 and 1989-90 were much better than expected. These confirm the view that the PSBR surplus will be running at least £10 billion a year over this period and provide strong technical support for the long end of the gilt market.

- These figures have both been reduced by higher asset sales and strong economic growth. Departmental bids for extra expenditure next year have been accommodated within an unchanged planning total,reflecting the very large £7 billion reserve built into last year's plans.

- Plans for the early 1990s show substantial increases. The underlying growth rate of public expenditure (particularly capital spending) has increased significantly since Budget time. The Government is relying on improved economic performance to support this, despite the shaky performance this year.

- The Chancellor sees a return to sustainable, low-inflationary growth next year. We agree that growth should hold up as home demand slows. But it is difficult to see how the underlying rate of inflation can fall on this scenario.

- The Treasury's RPI forecast suggests that short term interest rates will be close to current levels this time next year. The risk is that imports, output and inflation again come in higher than forecast, forcing another rise in base rates to slow the economy and protect sterling.

Public Expenditure in 1988-89 and 1989-90

The Chancellor's Speech naturally highlights the better than expected figures for public expenditure in 1988-89 and 1989-90. These confirm the view that the PSBR surplus will be running at least £10 billion a year over this period and provide strong technical support for the long end of the gilt market.

However these figures have both been reduced by increased asset sales and strong economic growth. Departmental bids for extra expenditure next year have been accommodated within an unchanged planning total. But in part this reflects the very large £7 billion reserve built into last year's plans as part of the move towards "realism" in public expenditure.

This year's undershoot of £3.3b., was much larger than expected. It arises from a £1b. saving on unemployment and other social security benefits, £¾b. more receipts from council house sales to the public and £1b. of additional privatisation proceeds from the British Steel floatation. The last two of these items should be thought of as non-recurring.

Large increases in *departmental* expenditure over previous plans for 1989-90 are concealed within a constant planning total of £167b. as shown in the table below. The contingency reserve is cut by half to £3.5b. and an extra £1b. of council house sales is assumed. The funds are distributed to the National Health Service (£1.5b.), Education (£0.9b.), Home Office (£0.6b.), EEC (£0.5b.), Environment (0.4b.). Capital spending is favoured in the planned changes. Hospitals, prisons, roads and public sector housing all receive a cash boost; £2½b. in all will be added to the capital expenditure planning total, an increase of nearly a quarter. This marks an end to the trend towards lower capital expenditure seen since 1977.

Revisions to Expenditure Plans for 1989-90

	1987 plan	1988 plan	Increase
Departmental Spending	165	168½	+3½
plus:			
The reserve	7	3½	-3½
less:			
Privatisation proceeds	-5	-5	-
equals:			
Planning Total	167	167.0	-
plus:			
Debt interest (etc.)	26	27	+1
equals:			
General Government Expenditure	193.0	194.0	+1
(As % of GDP	(40¾)	(39¼)	(-1½)

No forecast is provided for the PSBR in 1989-90, in keeping with tradition, but the Chancellor indicated that he is aiming to deliver a debt repayment in the region of £10b., as in 1988-89. We assume that this allows for £2b. to be handed back to the private sector in the 1989 Budget, probably in the form of a 1p reduction in the standard rate of income tax. Our forecast of next year's fiscal arithmetic is displayed in the next table.

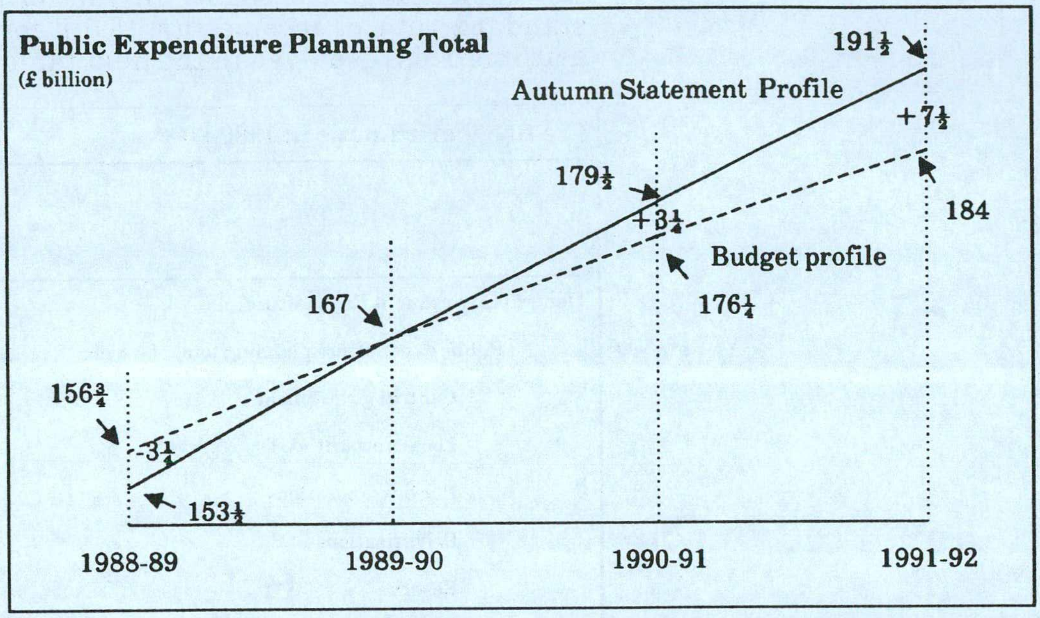
The fiscal arithmetic in 1989-90

	March Budget £b.	Autumn Statement £b.	SLH forecast £b.
General Government Expenditure	193	194	195
Public expenditure planning total of which:	167	167	168
Central government	120	123½	124
Local authorities	44	44	44½
Public corporations	1	1	1
Privatisations	-5	-5	-5
Reserve	7	3½	3½
Gross debt interest	17	17	17
Other adjustments	9	9½	9½
less			
Total Receipts	195	-	207
Taxes on incomes, expenditure, capital	150	-	158
National insurance etc.	34	-	36
Interest and dividends	5	-	6
Other	7	-	7
add			
Public corporations borrowing	-1	-	-1
less			
Provision for Budget tax cuts	3	-	2
equals			
Public Sector Borrowing Requirement	0	-	-12

Mr. Lawson's decision to hold the planning total in 1988-89 is probably the best news in the Autumn Statement. It implies that the prospect of further "buying-in" of government stock is intact for another 12 months. Beyond 1989-90 the position is more difficult to interpret.

Into the 1990s

The plans for 1990-91 and 1991-92 are substantially higher than the figures used at Budget time. With the figures for the late 1980s lower, the underlying growth rate of public expenditure has increased:



These increases partly reflect the higher rate of price inflation seen since the Budget. But the real growth rate has increased, as the following table demonstrates:

General Government Expenditure in Real Terms*

(% increase on previous year)

	1988 Budget	1988 Autumn Statement
1990-91	1.4	2.1
1991-92	1.0	2.3

*Cash figures, excluding privatisation proceeds and excluding the effect of general inflation as measured by the GDP deflator.

These growth rates are a lot higher than those allowed for in public expenditure plans earlier this decade. They are also a lot higher than the actual growth rates achieved in recent years, typically one per cent or less. It is possible that they will be undershot. But with the programme of council house sales drawing to a close and unemployment falling more slowly, this seems unlikely.

Moreover, this year's increase in capital spending could be a sign of things to come. The squeeze on capital spending has been a major factor in the control of public spending since 1976. Another has been the subdued growth in public sector pay. Which in many cases has been linked to the RPI and not private sector earnings. These policies are now extremely tight and there is a strong case for relaxation. It could well be that the next decade sees public expenditure growth in line with output, or even at a higher rate.

With the economy slowing down in 1989 and 1990, tax revenues will also be much less buoyant. The likelihood of continued budget surpluses during the 1990s is substantially reduced by these expenditure increases and this balances the good news for 1989-90.

Spending departments: Winners and losers
(in the three year period 1988/89 to 1990/91)

	Cumulative real gain, 1988/89 to 1990/91	
	%	£b., 1987/88 prices
Health	+3.0	+1.75
Education and Science	+2.2	+1.0
Home Office	+8.0	+1.0
Scotland	-1.1	-0.25
Defence	-1.0	-0.9
Social Security	+0.3	-2.55

The Autumn Statement Forecast

The Treasury forecast is summarised alongside our own forecast in the table below. Our detailed forecast will be published next week. Both forecasts are based on the assumption that sterling remains strong.

Economic prospects: summary
Percentage changes on previous year unless otherwise stated

	1988	1989 Autumn Statement forecast	1989 SLH forecast
GDP and domestic demand at constant prices			
Domestic demand, of which:	6	3	$2\frac{3}{4}$
Consumers' expenditure	$5\frac{1}{2}$	$3\frac{1}{2}$	$2\frac{1}{2}$
General government consumption	$\frac{1}{2}$	$-\frac{1}{2}$	1
Fixed investment	12	$5\frac{1}{2}$	$6\frac{1}{2}$
Change in stockbuilding (as a percentage of GDP)	0	0	$\frac{1}{2}$
Exports of goods and services	$1\frac{1}{2}$	$5\frac{1}{2}$	6
Imports of goods and services	12	$4\frac{1}{2}$	5
Gross domestic product	$4\frac{1}{2}$	3	$3\frac{3}{4}$
Manufacturing output	7	$4\frac{1}{2}$	$4\frac{3}{4}$
Balance of payments current account (£ billion)	-13	-11	-10
Inflation			
Retail price index (Q4 on Q4)	$6\frac{1}{4}$	5	6
GDP deflator at market prices (financial year)	$6\frac{1}{4}$	5	7
Money GDP at market prices (financial year)	11	8	10
£ billion	471	508	518
PSDR (financial year)			
£ billion	10		12
as a percentage of GDP	2		2

Output and Trade

The Treasury's export and output growth projections may appear optimistic, especially on a strong sterling scenario. But our analysis, which stresses the current profitability of UK production, supports these estimates.

Last year, the rate of return on capital reached $11\frac{1}{2}$%, and was higher than at any time since 1964. According to the Bank of England's calculations, published in the August Bulletin, trading profits reached a staggering 42 per cent of value added, well up on the 31 per cent recorded at the peak of the cycle in 1973, before the oil price rise. On this measure, UK profit margins are currently higher than in any other G7 country except Canada.

Profit margins in G7 countries
(Trading profits as share of valued added)

	1973	1979	1987
USA	30.2	31.9	35.6
Japan	46.7	41.8	40.8
W.Germany	32.7	32.5	35.4
France	35.1	32.9	35.3
Italy	34.1	36.7	42.1
Canada	37.9	41.0	46.5
UK	31.2	31.5	42.5

Profit margins have continued to increase this year as output price inflation has remained well ahead of cost inflation. This is clearly demonstrated by a table based on the Treasury forecast:

Cost and profit margins in Manufacturing

Per centage change on previous year

	Unit labour costs	Materials and fuel	Total costs	Output prices	Increase in margin*
1986	5	-10½	2¼	4	1¾
1987	¼	5	1½	4¼	2¾
1988	¾	4	1¼	4¾	3½
1989**	3½	2	4¼	5	¾
	(2½)	(1½)	(3¼)	(4¼)	(1)

* in percentage points. ** SLH forecast with HMT forecast in brackets

It seems unlikely that UK industrialists will let output growth fall back next year when it is as profitable as this. They will keep the production lines working at full stretch, helping to keep costs down. They will switch production from the home market to overseas markets and if necessary they will cut their margins to help penetrate these markets. There is plenty of scope for that: the profitability of exports relative to the home market has been rising throughout the 1980s.

What has happened is that manufacturers have been so hard pressed to meet domestic demand, that they have neglected export markets, allowing the fall in the pound since 1980 to increase profitability. There is plenty of scope for reversing this trend, now that UK demand is slowing. This adjustment will be helped by changes that are currently taking place in the international economy. Firstly, demand in Continental Europe is moving ahead strongly now, after years of slow growth. Secondly, the composition of world demand, like that in the UK, is switching from consumption to investment.

The Worldwide Investment Surge

Annual percentage change

	1987	1988 (1st half)
USA	4.9	13.7
Japan	10.1	15.4
West Germany	1.8	7.9
France	3.4	6.8
Italy	5.2	6.6
Canada	9.6	14.7
UK	3.9	11.0
G7 average	4.6	10.5

That is relevant, because the UK is much better at producing capital goods than consumer goods. It has already been reflected in strong UK output and exports of capital goods, both up over 10 per cent over the last three months.

The Treasury's import forecast looks too optimistic however. Excluding erratic items, import were up 12 per cent between the fourth quarter of last year and the third quarter of this year. Even if they were to level off at the third quarter rate, the 1989 on 1988 growth rate would still be 4½%, in line with the Treasury forecast.

We think that the volume of imports could grow very slowly during 1989, but that is because our consumption forecast is also fairly flat. This reflects our view that the consumer and in particular the home owner is exceptionally exposed to high interest rates at the moment. We have also assumed that real incomes grow more slowly, as consumer price inflation rises relative to earnings inflation. A relatively tight budget (with £2 billion of tax cuts) gives a growth in real earnings of just 3 per cent.

Fiscal Policy

The Treasury say that the saving ratio should recover slowly during 1989: implying that growth in real disposable income is greater than the growth in consumption of 3½ percent. This would seem to imply a growth in real incomes of almost 4 per cent.

This is worrying because it could imply a bigger Budget give away than we have assumed. For example, the Treasury may have assumed that earnings rise by 7½ per cent next year, in line with the assumption given to the Government Actuary. Excluding housing costs, their RPI forecast would suggest a rise in the consumer price index, used to deflate consumption and income, of about 5½ per cent. That would imply an increase in real earnings before tax of just 3 per cent. The remaining one per cent increase in real disposable incomes could be due to a rapid growth of dividends and other income. But with social security and other grants static, that seems unlikely. The only other explanation is that this reflects a Budget give away, worth about £3 billion.

To set against this evidence of a fiscal relaxation, the abolition of the Treasury Supplement to the National Insurance Fund can be seen as a fiscal tightening. National insurance contribution rates were increased in order to balance the fund during the early 1980s as unemployment rose. Now that it is coming down, contribution rates should fall. However, the Government Actuary has frozen them, allowing the growth in earnings and fall in unemployment to be reflected in a smaller Treasury Supplement. This has fallen back from 14½ per cent of contributions (£2.9 billion) in 1981 to 5 per cent (£1.6 billion) this year, and is now to be abolished.

Inflation

The most serious worry about this forecast is the Treasury supposition that a high interest rate - strong sterling policy will be a sufficient discipline on employers to prevent wage settlements form escalating further. The risk is that high profit levels will allow employers to accommodate demands for higher wages in line with the RPI. If wage settlements continue to escalate over the winter then the 'temporary blip' in the RPI will become entrenched.

The Treasury's earnings assumption is not disclosed, but the 7½ per cent figure given to the Government Actuary is probably indicative. With productivity falling back, the forecast of a 2½% rise in unit labour costs in manufacturing allows for very little, if any, increase in earnings inflation from present levels. This rise in labour costs is offset by a slower growth in profit margins. Even so, excluding food, nationalised industry prices and housing, the Treasury forecast shows a steady rise in the core rate of RPI inflation: from 3¾% in 1987 Q4 to 4½% in 1988 Q4 and 4¾% in 1989 Q4.

The housing component of the RPI suggests little change in short term interest rates from the present level. The risk is that output, imports and inflation will again come in higher than the Treasury forecast, forcing a rise in base rates, to slow activity and protect sterling.

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FROM : MISS J C SIMPSON
DATE : 4 NOVEMBER 1988

PS/CHANCELLOR

Mr Allan:-

cc PS/CST
Mr Odling-Smee
Mr Hibberd
Mr MacAuslan
Mr Ramsden
Mr A Wilson

PRINTED AUTUMN STATEMENT : BOOK PROOFS

I attach a copy of the book proofs of the printed Autumn Statement. They have not yet been corrected.

2. Please may I have any further comments on layout etc by noon today, Friday 4 November. The proofs must be returned to the printers by 5.00pm.

3. One point to note is that the blank right-hand page before Chapter 3 is unavoidable if we are to have the most sensible arrangement of text and tables/charts in Chapter 2 and put Chapter 3 on its traditional single opening. It seems, on balance, the least of the three evils facing us.

I agree. –

JS

MISS J C SIMPSON

Ch/ what do you think?

FROM : MISS J C SIMPSON
DATE : 4 NOVEMBER 1988

PS/CHANCELLOR

OK

MPW.

cc PS/CST
PS/Sir P Middleton
Mr Odling-Smee
Mr Dyer
Mr P Bennett

1988 AUTUMN STATEMENT : COVER PRICE

Now that they have seen the likely overall size of the Autumn Statement, the printers have been able to consider the cover price they would like to charge.

2. Last year's cover price was £5.10 for a document of 44 pages. This year, the document will run to 60 pages. A straight pro rata uplift would mean a cover price of £7.00, but that makes no allowance for inflation. Adding a further 5 per cent for inflation would take it to £7.30 as they do not deal in 5ps over £7.00.

3. The printers' opening bid is therefore £7.30.

JS

MISS J C SIMPSON

Room 12/2

MP

FROM: D P GRIFFITHS
DATE: 10 November 1988

PS/CHANCELLOR
(MISS WALLACE)

cc PS/Chief Secretary
Mr Anson
Mr Phillips
Miss Peirson
Mr Turnbull
Mr Saunders
Mr MacAuslan
Mr Gieve
Mr Call

AUTUMN STATEMENT

In exchanges in the Lords on the Autumn Statement Lord Young undertook to write to Lord Peston to clarify the position on expenditure plans on the NHS. I attach a draft reply which has been cleared with GE and the Department of Health. We are also taking the opportunity to answer Lord Peston's point about the timing of the availability of the Autumn Statement.

2. Lord Young's office also asked for a reply to the letter from Lord Sefton on the contribution of waiters to GDP. I understand that Mr Darlington has already sent this direct to you.

D P GRIFFITHS

Ch/
OK to send to Lord Y?

OK.

MP.

gep1.ip/docs/peston1

pl type final.

DRAFT LETTER FROM PS CHANCELLOR TO :-

Neil Thornton Esq
Principal Private Secretary to the Secretary of State for Trade and Industry
1 - 19 Victoria Street
London SW1

AUTUMN STATEMENT

Thank you for your letter of 3 November.

I attach a draft reply for your Secretary of State to send to Lord Peston clarifying the position on the Government's expenditure plans for the NHS. We also suggest that Lord Young takes the opportunity to answer the point Lord Peston raised about the timing of the availability of the Autumn Statement.

You also asked for advice on Lord Sefton's query about the scoring of waiters' services in GDP. ~~[From Mr Darlington's note].~~ (~~behind~~) I attach a contribution on this point

I am sending a copy of this letter to Andy McKeon (Department of Health).

MOIRA WALLACE

FROM:KEVIN DARLINGTON
DATE:7 NOVEMBER 1988

MS WALLACE

cc Mr Hibberd
Mr MacAuslan
Mr Saunders
Mr Owen

REPLY TO LORD SEFTON

1. Mr MacAuslan requested that I supply a few lines explaining why a waiter is a "productive person" for use in replying to Lord Sefton's query to Lord Young (copy attached).

"~~2~~. The services of a waiter are ,indeed, recorded as a contribution to Gross Domestic Product. GDP comprises all goods and services which result from economic activity. In the case of a meal served in a restauraunt, its value to the consumer is greater than that of the food alone. The waiter's skill and effort in taking the order,serving the meal and generally seeing to the diner's wishes constitute an integral part of the final product. This concept of value added applies equally to a waiter as it does to a production line worker in a a car factory whose endeavours result in a product the value of which is far greater than the sum of its component parts prior to their assembly.

3. Furthermore, there is no double-counting of the food served as part of the production of both the agricultural and catering industries. The expenditure approach to measuring GDP records only the expenditure on final goods and services. Hence the ingredients of a restaurant meal are only recorded when the final product leaves the production process which , in this case, is at the point of it being served by the waiter."

Kevin Darlington
KEVIN DARLINGTON

pl type paras 2 and 3 on plain paper with title at top:
" Waiters' services: contribution to reply to Lord Sefton "

2 ... 1988

HOUSE OF LORDS

1/11/88

Dear Lord Young.

'In a reply during the Autumn statement you implied that a waiter was "a productive person".

Does this mean that his efforts are included in GDP? and if so what proportion as it seems to me that the materials he serves has already been included as products.

Y.

Sefton of Garston

chex.ps/aa/42

FROM: A C S ALLAN
DATE: 1 December 1988

PS

I agree. This needs unscrambling. PS to fix a mtg with the Chief Whip. The CST should also be present.* L

CHANCELLOR

ALLAN → CHEX 1/12

DEBATE ON THE AUTUMN STATEMENT

Alan Howarth has been relaying to Murdo and the Chief Whip the discussions at Prayers. The ball is really in the Whips' court, but Murdo rang me today to pass on a proposal from Terence Higgins: this is that there should be a one-day debate on economic issues as early as possible in January, and a separate one-day debate on public expenditure in late January. This is not really very different from having a one-day debate on the Autumn Statement and a one-day debate on the PEWP: it would mean that the public expenditure debate was a bit earlier, and thus further away from the Budget; but it would mean, rather perversely, that the debate was held just <u>before</u> the publication of the PEWP, due on 31 January. I can't see any reason to go for it in preference to the two-day debate.

2. I have provisionally booked with Murdo a two-day debate on 11 and 12 January. But I am a bit concerned about all this dragging on: the Whips seem to be waiting for some sort of reply from the Opposition, when it is perfectly clear that they are likely to be obstructive and unhelpful - assuming the Opposition whips agree with the line Gordon Brown is running. There may well be a case for you having a word with the Chief Whip yourself next week - or would you prefer the Chief Secretary to do this?

*also Mr Wakeham, I think. L

AA

A C S ALLAN

3. AUTUMN STATEMENT DEBATE

The Whips were aiming for a 2-day debate when the House returned on the Autumn Statement and the Treasury Select Committee Report on it. Although the Chief Secretary had had no replies to his letters, Gordon Brown clearly wanted two bites. The Chancellor's strong preference was for a two-day debate on the Autumn Statement, and no debate on the PEWP. If absolutely necessary the Whips could concede one day on the Autumn Statement and one day on the PEWP, but should certainly not concede the addition of a third day. This matter should be settled between the Chief Whips.

4. CONSULTATION PAPER ON TAXATION OF FOREIGNERS IN THE UK

While Americans, and other foreign nationals, based in the UK were clearly much exercised at the possible removal of the current favourable treatment, it was not appropriate for Tom Sackville as a whip to be lobbying on their behalf.

5. TREASURY QUESTIONS

It was disappointing that Labour succeeded in securing the first ten questions and seventeen out of the first twenty.

6. EURO-MANIFESTO PLEDGES

With some modifications, the proposed pledges laid out in Mr Tyrie's minute of 18 November would be forwarded to the Manifesto Committee. While the pledges on VRA's may not survive the Manifesto Committee, it would be useful to put further pressure on the DTI. Sir Geoffrey Howe would be consulted on the commitments before the DTI were approached.

MC

MARK CALL

chex.pj/jc/16.12.2

FROM: MRS JUDITH CHAPLIN
16th December 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Hudson
Mr Tyrie
Mr Call

You asked me to prepare an end of term Backbenchers' Brief. Attached is a draft brief for your comments.

2. I have endeavoured to cover the points which you and other Ministers perceived to be worrying Backbenchers at the time of the Debate on the Address, and on which they are still likely to be questioned. Therefore, apart from the key points at the beginning, I have not covered more general points on the economy.

JC

JUDITH CHAPLIN

C.

V. largely culled from your ~~of~~ speech in the Debate on the Address. I've asked EB to check the figures, + have scribbled some comments of my own.

AH

(Chief Sec for PS debate?)

I have amended. But not for use as an end-of-term Backbenchers' brief, which we don't need, but on the anxieties of the Backbenchers' we would need for the PS debate.

Draft Brief on **THE ECONOMY**

A. Key Points

* Output ~~measure of GDP~~ has risen by 5 per cent in the year to 1988Q3. The UK is now in its eighth successive year of strong and steady growth - a period unmatched since the War. Since 1980 the UK has grown faster than any other European country.

* Total investment is expected to grow by ~~13~~ 12 per cent in 1988 - more than twice as fast as consumption - and has grown almost twice as fast as consumption over ~~as it has over the whole of~~ the last five years as a whole. Private investment as a proportion of GDP is at its highest level since records began in 1955.

[Not "more than twice" over past 5 yrs.]

* Manufacturing output is at its highest ever level, and Mfg ~~Output in the~~ third quarter of ~~three months to September 1988 was 9 per cent up on the figure for the first half of 1979.~~ (only just. Under Labour, mfg output fell.

* Manufacturing productivity has risen faster in the UK since 1980 than in all other major industrialised countries. For the whole economy, productivity has risen by 2¾ per cent a year - a growth rate similar to Japan's and faster than all the other major industrialised countries.

* Profitability (net real rate of return) for non-North Sea industrial and commercial companies is estimated to have risen to over 10 per cent in 1987, and this year is expected to be at its highest level since 1960.

* Unemployment (seasonally adjusted) has fallen for 28 months in a row, by over 1 million in total, and is now at its lowest level since the Spring of 1981. The UK unemployment rate is ~~now~~ below the EC average. Employment has risen by 2 million since 1983 and the increase in the last five years has been the best for forty years: there are now more people in work in the UK than at any time in our history.

* Business Start-ups, on the basis of VAT registrations, and net of failures, are running at a record rate of ~~exceeded stops by nearly 900 a week during 1987 and this year have averaged~~ over 1,000 a week.

* UK's volume share of world trade in manufacturing has remained steady over the past seven years after decades of decline. In the three months to October exports were 4½ per cent up on the same period last year.

* Living standards are at record levels. The real take-home pay of a married man with two children on average earnings has risen by 29 per cent since 1978-79.

B. Controlling Inflation

Firm control of inflation lies at the heart of the Government's economic policy. As inflationary pressures have re-emerged in the economy, the Chancellor has raised short-term interest rates over the last six months to 13 per cent and, as he has frequently ~~repeated~~ made clear, they will "remain as high as it takes for as long as it takes to get on top of inflation" (Hansard, 25th October 1988, col. 184).

h ex-MIPo

Increasing interest rates is a successful way of controlling inflation. In 1985 the rate of inflation rose to ~~5½~~ 7 per cent, but a sharp rise in interest rates brought it down again. Inflation is a monetary phenomenon and has to be curbed by monetary policy.

cum MIPo

* Higher interest rates raise the cost of borrowing, thereby reducing the incentive to make purchases on credit or to take out larger mortgages.

* They reduce the disposable incomes of borrowers through increasing loan and mortgage payments, so that consumer spending tends to fall.

* High interest rates provide an incentive to save, encouraging a switch from spending.

Well targeted. Because, for the first time ever, consumers are now net borrowers, higher interest rates will have their main effect precisely where they are needed - on consumer spending. It is because the higher interest rates do affect consumer spending that they will not be popular with many home owners - but far worse would be a return to ~~the~~ rampant inflation ~~of the 1970s.~~

There are already clear signs that higher interest rates are reducing demand in the economy:

- mortgage lending - which constitutes over 75 per cent of all personal lending - is falling. The Halifax Building Society announced a sharp fall in loans for first time buyers in November, down more than a third on November 1987, and clearing bank figures for October show the lowest bank lending for mortgages ~~since May 1988.~~ for several months.

- the growth in house prices has slowed down. The Royal Institute of Chartered Surveyors' October survey showed the slow down in house prices continuing to spread, with the number of estate agents reporting static prices doubling since the September survey.

- the CBI's Distributive Trades Survey, published on 8th December, reported that following the strong growth of recent months, retail sales are likely to increase far more slowly as higher interest rates begin to affect consumer spending.

Credit controls. Credit controls would not be a well targeted method of reducing borrowing. Only 15 per cent of all personal sector debt is in the form of consumer credit, of which only about $2\frac{1}{2}$ per cent is credit card borrowing. There would be no point therefore in controlling credit lending only; to have a serious impact any control would have to cover mortgage lending. That would lead to mortgage rationing and would freeze first time buyers out of the market. Additionally, without the re-introduction of exchange controls, any form of credit control could easily be circumvented by borrowing offshore. The price mechanism is the right mechanism for influencing the total quantity of savings and borrowing; and that means interest rates, as other Western industrial countries recognise.

C. Business and Interest Rates

It is on consumer spending, not corporate spending, that interest rates will have their principal effect. In contrast to the early 1980s, when many British companies were highly geared (ie had high levels of debt relative to their equity value), firms have reduced their reliance on borrowing. British companies' UK bank borrowing has fallen from 45 per cent of the market value of their equity in 1980, to 28 per cent at the end of 1987.

Top of p.2 says 1988 profitability highest since 1960. Both are true. But to avoid poss. confusion, best omit here?

Profitability for non-North Sea industrial and commercial companies is estimated to have risen to over 10 per cent in 1987, [~~its highest level since 1969,~~] so that firms have record profits ~~cash~~ available with which to finance expansion. As a result, they are far less sensitive to interest rate rises than they were.

[Better use AS Forecasts?]

Investment. The figures for private sector investment show that business expansion is continuing. Private investment this year is at an all time record as a proportion of national output. ~~The DTI investment intentions surveys projected a 16 per cent rise in~~ Manufacturing investment is set to rise by 18 per cent in the current year, with a further increase of ~~11~~ 10 per cent next year.

Total investment in the UK is estimated ~~expected~~ to be up ~~grow~~ by 12 ~~13~~ per cent in 1988, more than twice as fast as consumption. ~~In each of the last seven years, investment has outpaced consumption, except for ~~from~~ 1986 when the changes to the capital allowances rules in the 1984 Budget meant some projects had been ~~were~~ brought forward.~~

Although the increase in short-term interest rates will adversely affect some businesses, particularly small business, industry as a whole has far more to fear from the resurgence of inflation. A 1 per cent increase in interest rates, even if sustained for a whole year, raises costs by far less than a 1 per cent increase in pay settlements.

D. Inflation

The rise in the rate of inflation, although unwelcome, should be kept in perspective. In the UK, unlike almost all other major countries, mortgage interest payments are included in the RPI. If they are excluded, the rate of inflation, having risen steadily in the first half of the year to reach 5 per cent in July, has barely changed since to reach 5.1 per cent in ~~October~~ November.

Because ~~increases in~~ mortgage interest ~~rates~~ payments are included in the RPI, an increase in interest rates, designed to bring inflation down, has the ~~initial~~ perverse effect of increasing recorded inflation initially. The Autumn Statement forecasts that inflation, as measured by the RPI, will peak in mid-1989, before falling to 5 per cent by the end of the year.

Labour - the Party of Inflation. The ~~lowest~~ underlying figure (ie excluding mortgage interest payments) achieved by the last Labour Government was 7.7 per cent. The average annual increase ~~annually~~ in the RPI under the last Labour Government was 15½ per cent, whereas over the last five years, a period of equivalent length, the average annual increase has been 4¾ per cent.

Labour spokesmen constantly urge the Government to ~~lower~~ reduce interest rates and increase spending, which inevitably would lead to a weaker pound and runaway inflation. They are, as the Chancellor has said, at best indifferent to inflation and, as was seen when the Labour Party was last in Office, the Party of inflation.

E. **Balance of Payments**

The combination of high levels of investment and high consumer spending financed by borrowing has led to a current account deficit which is forecast to be some £13 billion in 1988. The figure is substantially higher than that estimated at the time of the Budget, due mainly to an under-estimate of the growth of investment. Total investment was forecast to grow by 6½ per cent this year, whereas it has risen by at least 12 per cent.

The current account deficit is an inevitable result of an excess of domestic investment over domestic saving with capital inflows from the rest of the world filling the gap. The gap has been caused not because private sector savings have fallen, but because private sector investment has risen – it is up – to some 16 per cent of GDP, the highest figure ever. Personal savings have fallen, but corporate savings have risen by roughly the equivalent amount.

Unlike the United Kingdom in the 1960s and 1970s, the present current account deficit is not the counterpart of ~~a capital inflow to finance~~ excessive Government borrowing and spending. On the contrary, the Government's finances are sounder than at any time since records began in the early 1950s. The Government expects a public sector debt repayment of £10 billion for 1988-89, and the budget is in healthy surplus even excluding privatisation proceeds.

This is v. compressed. Drop altogether? Yes

~~[It is nonsense to talk of the Government having "only one weapon".] Fiscal policy is an important~~ buttress to monetary policy in the fight against inflation. But ~~but~~ ~~it is not suitable for fine-tuning the economy because lags in the system mean tax changes take longer to have an effect on activity than interest rates do.~~

The current tight fiscal policy makes nonsense of the Labour Party's demand that the Government should reverse the tax cuts of the Budget. As the Chancellor has made clear, the cuts in tax rates in this year's Budget, within a very prudent fiscal stance, were designed to improve further the supply side of the economy. Improving ~~Increasing~~ the supply side of the economy ~~is part of~~ helps the defeat of inflation.

OK? Not a line we use v. often but I think it stands up. (Supply side constraints can lead to inflationary pressures wch have to be neutralised by higher interest rates.)

Capital inflows are financing high investment spending by the private sector, which will add to productive capacity thus boosting exports and displacing imports in the future. Meanwhile, the deficit is readily financeable due to the recognition of the strength of the economy and the high level of UK net overseas assets, which are second only to those of Japan. Unlike the situation under the last Labour government, there is no sterling crisis and, as the Government wins the battle against inflation, the balance of payments deficit will gradually right itself.

chex.md/ah/93 **UNCLASSIFIED**

FROM: A P HUDSON
DATE: 20 December 1988

Jacks

CHANCELLOR

cc Sir P Middleton*
Sir T Burns*
Mr Gieve
Mr A C S Allan
Mr Pickford
Miss Wallace
Mrs Chaplin
Mr Tyrie o/r
Mr Call
Mr N Forman MP

(* for information)

One or 2 starters ✓

World outlook / US GP (? OECD)

Role of fiscal policy

Domestic demand (RS Lothian)

Govt. stabiliser (TCSC)

AUTUMN STATEMENT DEBATE, 12 JANUARY

We are meeting tomorrow afternoon for a preliminary run over the ground for your speech in the Autumn Statement Debate on 12 January.

2. You open the debate, moving a motion to approve the Autumn Statement. We shall have to draft this in the New Year. (Copy of ... last year's attached.)

3. Three specific points:

✓ (a) I assume you will take this opportunity to announce the date of the Budget, as usual;

✓ (b) last year, you split the material with the Chief Secretary, so that you concentrated on the economy, and he dealt with public expenditure. Do you want to do the same again?

(c) you will have to mention the TCSC report, though I doubt if it will be sufficiently interesting to build a speech round, as we did in 1986!

3. As to the speech generally, it is hard to say, this far away, how things will look. However, there will not be very many new figures between now and then: we get the current account on Friday; and in early January, we get the reserves, producer prices, the final November retail sales figures, and possibly some more building society data. But all the key indicators come out the week after the debate.

4. Mortgage payments are likely to be going up again, and some of those whose mortgages only change once a year will see a steep increase in their payments early in the New Year. So commentators may have switched from wondering whether we have done enough, to wondering whether the tightening has been overdone.

5. I imagine you will definitely want to cover the following points:

- determination to get inflation down;
- economy slowing down, as intended;
- this will show up in different indicators at different stages, so the RPI will rise further, and the current account will be among the last to turn round;
- economic success, especially investment, and the balance of investment and consumption;
- sustainable growth rate now higher than before, thanks to supply-side reform;

- strength of the public finances, enabling excellent public expenditure record.

6. Other things you might mention are:

- any message on the exchange rate, presumably at least a repetition of the TCSC message;

- any indication of the likely stance in the Budget - determination to keep a substantial surplus, or whatever;

- something on the world economy: perhaps that growth is strong everywhere, that investment is strong, and that the new US administration understands the need to reduce the Budget deficit.

7. The Special Advisers may have ideas for Opposition bashing. Two points that occur to me are 'supply-side socialism - a contradiction in terms', and reminding them that a year ago, they were telling you to reflate the economy.

... 8. Moira and I have prepared the attached outline, stringing some of these points together.

APH

A P HUDSON

Autumn Statement

4.14 pm

The Chancellor of the Exchequer (Mr. Nigel Lawson): I beg to move,

That this House approves the Autumn Statement presented by Mr. Chancellor of the Exchequer on 3rd November 1987; welcomes the prospect of continuing low inflation and steady growth as the basis for maintaining the trend of rising employment; and congratulates Her Majesty's Government on the continuing reduction in the share of national income pre-empted by public expenditure.

Mr. Speaker: I must tell the House that a large number of right hon. and hon. Members wish to take part—no fewer than eight Privy Councillors. I do not subscribe wholly to the way in which the hon. Member for Cambridgeshire, South-West (Sir A. Grant) put his question to the Leader of the House today, but I would say to the House, and to Privy Councillors, that short speeches should be the order of the day if we are to ensure that more Back Benchers can be called. The Chair has—as yet—no authority to limit speeches to 10 minutes, but if speeches take about that time most of those on the list will be called.

I announce to the House that I have selected the amendment in the name of the Leader of the Opposition.

Mr. Lawson: The Autumn Statement debate this year is a little later than it has been in previous years. Part of the reason was to allow the Treasury and Civil Service Select Committee, which was established only on 24 November, to prepare its report. I believe that that delay was also for the convenience of the Opposition. I sympathise with the Committee's frustration that it was not constituted sooner and I congratulate my right hon. Friend the Member for Worthing (Mr. Higgins) and his colleagues on producing their report as promptly as they did.

Mr. John Smith (Monklands, East): The right hon. Gentleman referred to the convenience of the Opposition. In case such ideas gain some currency, let me make it quite clear that we were asked whether we thought it would be a good idea for the Select Committee to report. We assented to that. That is the only way in which it was convenient to us and in that respect it was convenient to the Government and everyone else, so what is the Chancellor's point?

Mr. Lawson: I am glad to see that the right hon. and learned Gentleman agrees with what I said.

In my Budget statement last March I warned that:

"the biggest risk to the excellent prospect I have outlined is that of a downturn in the world economy as a whole. There are still serious imbalances afflicting the three major economies—the United States, on the one hand, and Japan and Germany on the other — which, if not handled properly, could lead to a simultaneous downturn in all three. And this in turn could be exaggerated by renewed turmoil in the foreign exchange markets, whose tendency to overshoot is as notorious as it is damaging."—[*Official Report*, 17 March 1987, Vol. 112, c. 817.]

Recent events have brought those concerns very much to the fore, and I therefore propose to devote most of my remarks today to the prospects for the world economy —not least because this may be my last opportunity to do so before this year's Budget statement, which, I can now tell the House, will be on 15 March. The important issue of public expenditure will, therefore, be dealt with by my right hon. Friend the Chief Secretary, when he comes to wind up this debate, if he is fortunate, Mr. Speaker, to catch your eye.

Mr. David Winnick (Walsall, North): Before the Chancellor departs from the subject of public expenditure, which apparently is to be dealt with by his colleague, does the Chancellor take on board the sort of feelings that have been expressed up and down the country in the past few months and certainly in the past few weeks, which is that, given the cash crisis in the National Health Service, if there is a choice between more money for the NHS and other essential services or continuing tax cuts, it should be the former that has priority? Does the Chancellor recognise the strength of feeling, even among Conservative voters, on that issue?

Mr. Lawson: When I appeared before the Select Committee on the Treasury and Civil Service—of which the hon. Gentleman is a member—I recall that he and I had a discussion on that matter. I do not propose to go into that matter any further today because I want to talk directly about the world economy. My right hon. Friend the Chief Secretary will deal with public expenditure and, in particular, I am sure that he will deal with the NHS in the course of his speech.

Mr. Nicholas Bennett (Pembroke): Does my right hon. Friend agree that although the Government have cut income tax, tax yields have risen?

Mr. Lawson: That is quite correct.

Mr. Gerald Bermingham (St. Helens, South) *rose*——

Mr. Lawson: I cannot give way again. I recall that, a few moments ago, Mr. Speaker pointed out that a large number of right hon. and hon. Members wish to take part in the debate. I do not believe that it is fair on them if I prolong my remarks by giving way more than a limited amount of times.

I presented my Autumn Statement to the House a bare two weeks after the collapse of the world's stock markets that has come to be known as Black Monday. Apprehension about the prospects for the world economy at that time was at its most acute. It was widely predicted that the equity market collapse would inevitably lead to a major world recession this year.

Two months on, it is easier to put the sharp fall in the stock market in October into some perspective. Although the scale and suddenness of the fall were unprecedented, it has increasingly been seen as in large measure a correction, following the rapid rise in the early part of 1987. In the three main markets—London, New York, and Tokyo—following the sharp falls in October, share prices have not fallen any further since the end of that month, and are at much the same levels as a year ago. The impact on consumer spending — the so-called "wealth effect"—should therefore be limited.

But a shock such as the stock market collapse can readily damage business confidence quite severely. Most of the major countries therefore acted promptly to reduce interest rates, both to deal with the immediate risk of a lack of liquidity and to sustain business confidence. I am sure that, in the circumstances of that time, that was right.

A further reason why business confidence has remained pretty well intact is that all the economic evidence published since October, so far from implying that world recession is imminent, suggests that the world economy

OUTLINE FOR CHANCELLOR'S SPEECH IN AUTUMN STATEMENT DEBATE, 12 JANUARY 1989

1. Year to the day since the last Autumn Statement debate.

2. Then, a lot of pessimism about the outlook for the world economy, and the UK economy. Events have turned out very different.

3. 1988 in fact a year of very strong growth, and high investment, worldwide, and especially in the UK.

4. So as we enter 1989, issue not coping with recession, as many predicted, especially Party opposite, but dealing with inflation.

5. Explained in last economic debate how we are tackling that. Interest rates the instrument; worked before.

6. Now clear signs that the economy is slowing down as intended. [Quote some of the evidence.]

7. Always made clear that current account would be one of the last indicators to reflect tightening of policy; so it is proving. But that will happen in due course, and meanwhile it is readily financeable.

8. Unrealistic to expect economy to continue growing at this year's rate, and must slow down. But clear that sustainable growth rate is now significantly higher than before thanks to supply-side reforms: productivity; industrial relations; and investment. Indeed investment growth, well ahead of consumption, is key feature of recent economic development.

vs domestic demand (statistics)

9. Economy now much more buoyant. Only real threat to continued economic success would be failure to act

sufficiently to nip inflationary pressures in the bud. So ready to take whatever steps necessary. Monetary policy backed by sound fiscal stance, which will be maintained.

10. Prospects for 1989 therefore good; in particular, investment growth set to continue.

11. Meanwhile, all the Opposition have to offer is the contradiction in terms of "supply-side socialism".

cst.ps/15jm3.1/mins

RESTRICTED

AWP

[w also Katue 8/1]

FROM: CHIEF SECRETARY
DATE: 3 January 1989

CHANCELLOR

cc: Sir Peter Middleton
Sir T Burns
Mr Gieve
Mr A C S Allan
Mr Pickford
Mr Hudson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call
Mr N Forman MP

C.
I gather CST mentioned this to you this a.m. (I didn't see it until today.) I've done a v. first draft of this speech, taking account of these points. I shall, of course, take in the points you gave Alex this morning, & want to show it to him, Robert, & others this week, so as to give you a fairly well honed draft for the weekend.

AH

AUTUMN STATEMENT DEBATE, 12 JANUARY

I have seen Andrew Hudson's note of the meeting to discuss your speech in the Autumn Statement debate. The following random suggestions occur to me.

2. I think the main theme should be that we are prepared to take whatever steps are needed in the short term to ensure that the long-term health of the economy is secure. We need a strong anti-inflation passage to make clear the dangers we are facing and to remind the House of the relatively low inflation rates of our competitors.

3. With this long-term perspective we can look back (briefly) to the growth of the economy since 1979 and the improvements in living standards and employment which have resulted. The speech could emphasise that the long term prospects are excellent as a result of strong investment growth and the transformation of the supply side, but that in the short-term we face the problem of excess demand which will be painful to resolve. We need to explain the source of this demand and why interest rates are an effective and well targeted response. We also need to explode the myth that interest rates are our only means of managing the economy. We should emphasise we have a very tough fiscal policy and a complementary supply side strategy, but interest rates remain the appropriate short-term response to excess demand.

4. In the section on the world economy I would concentrate on the US economy (where there are genuine concerns not least on our own backbenches) and not too much on debt and protectionism.

5. In concluding along the lines Andrew suggests with the three awkward questions on Labour's economic policy you might ask also what has happened to the much vaunted policy review.

6. I would not refer to Labour's refrain of bad times just around the corner, since this will prompt jibes that "these have arrived". Similarly I am afraid that the Capital Bond reminder might seem rather trivial.

7. I agree that we should take the opportunity to trail the projected increase in the RPI (and reprise the likely slow down in growth, too?). In referring to the investment boom we would make the point that while short-term interest rates may deter some investment, the real spur to investment is confidence and potential profitability. To maintain this confidence in the long term we must be willing to take tough decisions where necessary. Industry's confidence in our record in this respect is the background to the current investment boom and the strongest reason for confidence that investment will continue.

CEvans

pp JOHN MAJOR

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CONFIDENTIAL

RMP

CHANCELLOR

FROM: CHIEF SECRETARY
DATE: 5 January 1989

cc: Sir Peter Middleton
Sir T Burns
Mr Gieve
Mr Pickford
Mr Mowl
Mr Hudson
Mrs Chaplin
Mr Tyrie
Mr Call
Mr N Forman MP
Miss Simpson

AUTUMN STATEMENT DEBATE, 12 JANUARY

A further thought occurs about your speech. Last year (£3½ billion) and this (circa £10 billion) there has been a substantial repayment of capital debt with

(a) the prospect of more to come and

(b) the policy of a balanced budget and a small national debt proportionate to GDP.

2 This is a bull point, particularly as it coincides with tax rate reductions and increases in spending on programmes, and yet it has not got across to colleagues. I think you might make a feature of it. It appeals to the Puritan instinct.

3 The headline points are:-

(a) This is 8 per cent (broadly) of net outstanding Government debt on the latest figures, repaid in only 2 years, with a projected annual interest saving of £2 billion by 1990-91 (1988 AS compared with 1987 AS).

(b) We are the first tax paying generation this century (i) to stop the seemingly inexorable rise of debt; (ii) <u>to begin to repay it in large sums</u> and (iii) to minimise the burden on future taxpayers.

4 People approve of repaying debt. We should make a virtue of doing so. Not only do we have sound finances now, we are using them to ensure we have similarly sound finance for the future.

John.

JOHN MAJOR

chex.pj/jc/6.1.2

FROM: MRS JUDITH CHAPLIN
6th January 1989

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Hudson
Mr Tyrie
Mr Call

DRAFT BRIEF FOR THE AUTUMN STATEMENT DEBATE 12 JANUARY 1989

Attached is a draft of the brief for the Autumn Statement Debate for your comments.

2. Would it be a good idea to attach the charts and text prepared for NEDC to reinforce the points on investment?

Jc

JUDITH CHAPLIN

Bit risky, I think, in case the Opposition found out that charts drawn by civil servants, for a NEDC meeting were attached to a CCO brief.

Thanks. Broadly fine: I have made a few changes.

2. I don't think we can simply reproduce the NEDC charts for this; but we can certainly redraw them: I would like to redraw the 2nd one (on the lines of the new chart we used in the brief) by companies, & alongside it a new chart showing savings, thus:

V. similar to prev. (pre-Xmas) draft.

(I would then write a new short text to accompany these 2 charts; we won't reproduce the NEDC text)

~~AAH~~

Draft Brief on THE ECONOMY

A. Key Points

* Output has risen by 5 per cent in the year to 1988Q3. The UK is now in its eighth successive year of strong and steady growth - a period unmatched since the War. Since 1980 the UK has grown faster than any other major European country.

* Total investment is expected to ~~grow~~ have grown by at least 12 per cent in 1988 - more than twice as fast as consumption - and has grown almost twice as fast as consumption over the last five years as a whole. Private investment as a proportion of GDP is at its highest level since records began in 1955.

* Manufacturing output is at its highest ever level, and rising fast. Under Labour, manufacturing output fell.

* Manufacturing productivity has risen faster in the UK since 1980 than in all other major industrialised countries. For the whole economy, productivity has risen by 2¾ per cent a year - a growth rate similar to Japan's and faster than all the other major industrialised countries.

* Profitability (net real rate of return) for non-North Sea industrial and commercial companies is

~~estimated to have risen~~ rose to over 10 per cent in 1987, and ~~this~~ last year is expected to ~~be at~~ have reached its highest level since 1960.

* Unemployment (seasonally adjusted) has fallen for 28 months in a row, by over 1 million in total, and is now at its lowest level since the Spring of 1981. The UK unemployment rate is below the EC average. Employment has risen by 2 million since 1983 and the increase in the last five years has been the best for forty years: there are now more people in work in the UK than at any time in our history.

* Business Start-ups, on the basis of VAT registrations, and net of failures, are running at a record rate of over 1,000 a week.

Share of world trade down on stand after 70s. Better than in export growth: last x months to Nov @ all-time high, up Y% on same period a yr ago.

* UK's volume share of world trade in manufacturing has remained steady over the past seven years after decades of decline. In the three months to October exports were 4½ per cent up on the same period last year.

* Living standards are at record levels. The real take-home pay of a married man with two children on average earnings has risen by 29 per cent since 1978-79.

B. <u>Economic Policy</u>

Firm control of inflation lies at the heart of the Government's economic policy. As inflationary pressures have re-emerged in the economy, the Chancellor has raised short-term interest rates to 13 per cent and, as he has frequently made clear, they will "remain as high as it takes for as long as it takes to get on top of inflation" (Hansard, 25th October 1988, col. 184).

Monetary policy, which operates through the level of interest rates, remains, as it always has been, the key to controlling inflation. ~~Increasing interest rates works as a way of controlling inflation.~~ In 1985 the rate of inflation rose to 7 per cent, but a sharp rise in interest rates brought it down again. <u>Inflation is a monetary phenomenon and has to be curbed by monetary policy</u>.

* Higher interest rates raise the cost of borrowing, thereby reducing the incentive to make purchases on credit or to take out larger mortgages.

* They reduce the disposable incomes of borrowers through increasing loan and mortgage payments, so that consumer spending tends to fall.

* High interest rates provide an incentive to save encouraging a switch from spending.

<u>Well targeted</u>. Because, for the first time ever, consumers are now net borrowers, higher interest rates will have their main effect precisely where they are needed - on consumer spending. It is because the higher interest rates do affect consumer spending that they will not be popular with many home owners - but far worse would be a return to rampant inflation.

<u>Lower Borrowing</u>. There are already clear signs that higher interest rates are reducing demand in the economy:

- mortgage lending - which constitutes over 75 per cent of all personal lending - is falling. The Halifax Building Society announced a sharp fall in loans for first time buyers in November, down more than a third on November 1987 and clearing bank figures for October show the lowest bank lending for mortgages for some months.

- the growth in house prices has slowed down. The Royal Institute of Chartered Surveyors' October survey showed the slow down in house prices continuing to spread, with the number of estate agents reporting static prices doubling since the September survey.

- There are indications that retail sales are slowing down.

<u>Inflation</u>. The rise in the rate of inflation, although unwelcome, should be kept in perspective. In

the UK, unlike almost all other ~~major~~ countries, mortgage interest payments are included in the RPI. If they are excluded, the rate of inflation, having risen steadily in the first half of 1988 to reach 5 per cent in July, has since barely changed, reaching 5.1 per cent in November.

Because increases in mortgage interest payments are included in the RPI, an increase in interest rates, needed ~~designed~~ to bring inflation down, has the perverse effect of increasing recorded inflation initially. Recent mortgage interest rate rises will initially increase the RPI in 1989. The Autumn Statement forecasts that inflation, as measured by the RPI, will peak in mid-1989, before falling to 5 per cent by the end of the year.

Labour - the Party of Inflation. Labour spokesmen constantly urge the Government to reduce interest rates and increase spending, which inevitably would lead to a weaker pound and runaway inflation. They are, as the Chancellor has said, at best indifferent to inflation as their record showed when last in Office.

The average annual increase in the RPI under the last Labour Government was 15½ per cent, whereas over the last five years, a period of equivalent length, (but of substantially faster economic growth, the average annual increase has been 4¾ per cent.

Credit controls. Credit controls, advocated by the Labour Party, would not work as a method of reducing borrowing. Only 15 per cent of all personal sector debt is in the form of consumer credit, of which only about 2½ per cent is credit card borrowing, so to have a serious impact any control would have to cover mortgage lending. Even if workable, this ~~That~~ would imply severe ~~lead to~~ mortgage rationing and would freeze first time buyers out of the market.

Moreover, ~~Additionally~~, without the reintroduction of exchange controls, any form of credit control could easily be circumvented by borrowing offshore. Other major industrialised countries - US, Japan, France, Germany - have all abandoned quantitative credit control recognising, like the UK, the only effective ~~right~~ mechanism for influencing the total quantity of savings and borrowing is the price mechanism and that means interest rates.

C. **Business and Interest Rates**

Interest rates will have their principal effect on consumer spending, not corporate spending. In contrast to the early 1980s, when many British companies were highly geared (ie had high levels of debt relative to their equity value), firms have reduced their reliance on borrowing. British companies' UK bank borrowing has fallen from 45 per cent of the market value of their equity in 1980, to 28 per cent at the end of 1987.

Profitability for non-North Sea industrial and commercial companies ~~is estimated to have risen~~ rose to over 10 per cent in 1987, the highest level since 1969, so that firms have retained profits available with which to finance expansion. As a result, they are far less sensitive to interest rate rises than they were.

Investment. Business expansion is continuing. Total investment in the UK is estimated to be up by at least 12 per cent in 1988, ~~growing~~ having grown twice as fast as consumption. In the last five years as a whole, total investment has grown almost twice as fast as consumption.

Private investment ~~this~~ last year ~~is~~ was at an all time record as a proportion of national output. Manufacturing investment is ~~set to rise by~~ reckoned to have risen by some 18 per cent ~~in the current~~ last year, with a further increase of 11 per cent ~~next~~ expected this year.

Although the increase in short-term interest rates will adversely affect some businesses, particularly small business, industry as a whole has far more to fear from the resurgence of inflation. A 1 per cent increase in interest rates, even if sustained for a whole year, raises costs by far less than a 1 per cent increase in pay settlements.

Public Sector Investment. Labour choose to ignore private investment, and consider only public sector spending when urging additional investment. Even there their record compares poorly.

Public sector capital spending is now running at around £25 billion a year. An additional £2¼ billion in

1989-90 will mean that total capital spending will be higher in real terms than in 1978-79, despite a deliberate policy of reducing the State's role in providing new housing. Under Labour capital spending fell 23 per cent in real terms.

Public Sector Capital Spending (changes in real terms)

	Under Last Labour Government	Since 1979
Roads	public spending fell 40%	increased by 30%
Railways	unchanged	up 15%
Hospitals	cut by nearly a third	increased by over 40%
Prisons	down by almost two thirds	nearly doubled
Overall	fell 23%	broadly level

D. **Balance of Payments**

The combination of high levels of investment and high consumer spending financed by borrowing has led to a current account deficit which ~~is~~ was forecast (last November) to be some £13 billion in 1988. The figure is substantially higher than that estimated at the time of the Budget~~, due mainly to an under-estimate of the growth of investment~~. The current account deficit ~~is an inevitable result of~~ reflects an excess of domestic investment (which has risen sharply) over domestic saving ~~with~~, (which has remained broadly unchanged), with capital inflows from the rest of the world filling the gap.

Capital inflows are financing high investment spending by the private sector, which will add to productive capacity thus boosting exports and displacing imports in the future. Meanwhile, the deficit is readily financeable due to the recognition of the strength of the economy, the high level of UK net overseas assets - second only to those of Japan - and reserves at record levels.

E. **Public Spending**

Debt Repayment. Unlike the 1960s and 1970s, the present current account deficit is not the counterpart of excessive Government borrowing and spending. The Government expects a public sector debt repayment of £10 billion for 1988-89 (2 per cent of GDP), and the budget is in healthy surplus even excluding privatisation proceeds.

Under Labour the PSBR rose to over 9 per cent of GDP, equivalent in today's terms of over £40 billion.

The current tight fiscal policy makes nonsense of the Labour Party's demand that the Government should reverse the tax cuts of the Budget. As the Chancellor has made clear, the cuts in tax rates in this year's Budget, within a very prudent fiscal stance, were designed to improve further the (long-term performance) ~~supply side~~ of the economy.

Firm control of total spending. The Government has decisively reversed the seemingly inexorable rise in the share of national income spent by the State. Since 1982-83, public expenditure, excluding privatisation proceeds, expressed as a share of national income has fallen by 7 percentage points - the largest and longest sustained fall since the wartime economy was unwound.

It is now under 40 per cent of national income - the first time this has happened for over 20 years. Over the whole decade from 1978-79 to 1988-89, public expenditure has grown by under 1½ per cent a year in real terms, half the rate at which is grew over the whole of the preceding decade.

In the Autumn Statement, the Chancellor announced that the public expenditure planning total for 1989-90 will be held at £167 billion. This has been achieved by a rigorous reassessment of priorities, coupled with a continuation of benefit savings from lower unemployment and increased receipts from council house sales, as well as reduced burden of nationalised industries, savings from CAP reform, and continued pressure for greater efficiency.

For 1990-91, the planning total is set at £179½ billion - some £3¼ billion more than the previously published figure - and at £191½ billion for 1991-92. Real growth in spending on programmes is over 3 per cent a year. This can be afforded only because of fall in burden of debt interest, so that overall public spending, excluding privatisation proceeds, will rise by less than 2 per cent a year, and will continue to decline slightly as a proportion of national income.

More for priority programmes. The success of the Government's economic policy has enabled more to be spent on priority programmes.

- More for health: total increases for the Health Service in the UK as a whole over £2 billion in 1989-90 (a real increase of 4½ per cent on this year's outturn) and over £2½ billion in the following year. By far the largest increases the Health Service has ever received.

- More for roads: an extra £220 million next year, and £250 million the year after.

- More for housing: gross spending up by over £400 million a year.

- More for law and order: an extra £290 million next year and £430 million the year after.

- More for defence: an extra £150 million next year and £600 million the year after.

- More capital spending: a total of £2¼ billion more in 1989-90, with substantial extra investment in hospitals, housing, prisons and roads.

(Further details of spending on individual programmes are given in the Appendix.)

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CONFIDENTIAL

FROM: MARK CALL
DATE: 10 JANUARY 1989

CHANCELLOR

C.
Sorry for delay on this. Most comments already picked up, I think.

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr Gieve
Mr Pickford
Mr Hudson
Mrs Chaplin
Mr Tyrie
Mr N Forman, MP

AUTUMN STATEMENT DEBATE

The point made in paragraph 2 of Judith's minute of 9 January is key. People re-elect this Government because it is not a government of quick-fixes. Instead it has been prepared to take action which is unpopular in the short-term, but essential to long-term success. The appropriate stance for you is one of 'steady under fire'.

Long-term/short-term policy

2. The speech should therefore distinguish between the achievement of long-term policy objectives (more responsive supplyside, lower inflation, reducing unemployment, public finances under control) and the short-term difficulties which are part and parcel of the business of governing. Something like:

> "It is important to distinguish between policies which are bringing permanent improvements to the British economy over a number of years, and the policy action needed to counteract short-term events and pressures in order to keep on course. The country recognises that - that's why they re-elected us twice. The markets recognise that - that is why there is stability in the markets, and why long-term interest rates are low. Only the opposition are so blinded by nearly a decade in the wilderness that they cannot see the transformation that has taken place in the British economy.

That transformation has taken place because, while we have had a clear set of long-term policy objectives, we have not shirked the unpopular short-term measures needed from time to time. So raising interest rates is the right policy, but I recognise it is not popular. It is not popular with people with mortgages - although they knew the spiral of house prices could not go on forever. It is not popular with the media and the press who seek sensation where there is none. Finally, it is not popular with the Party opposite because they know it will work. In the absence of any policies of their own they pray for economic disaster to sweep them back to office. They will need great patience."

?

??

Interest rates appropriate tool

3. You may like to stress that interest rates are the appropriate tool, along the following lines:

"Labour understand neither the nature of the problem, nor the solution. That's why they complain simultaneously of rising inflation and higher interest rates. Around the world, governments of all hues know that interest rates are the right tool to get inflation down. That is why short-term interest rates are rising around the world, not just here in the UK."

4. To reinforce the notion of the inflationary blip (although you may not choose to use the word) it would be worth stressing the analogy with 1985. In the absence of this some will be tempted to draw analogies with earlier periods.

Savings

5. Although paragraph 20 makes the point obliquely, I think it is worth explaining clearly that the savings ratio is a net concept, and that it is borrowing which has surged ahead, and not saving which has slumped. Given the early press speculation about a 'Budget for Savings', it might be worth alleviating some anxiety on the level of savings and putting the thing in perspective.

International section

6. While there clearly needs to be reference to the global economic context, there is currently too much. The trade paragraphs (36-38) seem out of place in this speech.

Media bids

7. I agree with Andrew Tyrie that if you were to appear on TV, there is a risk of 'Chancellor breaks Budget purdah to defend his economic policy'. They wouldn't run that headline for the Chief Secretary, however, and it may make sense for him to accept.

MC

MARK CALL

ps4/54H

Final Version of CX's O/S
1/11/88

CHANCELLOR OF THE EXCHEQUER'S AUTUMN STATEMENT, 1 NOVEMBER 1988

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

Cabinet today agreed the Government's public expenditure plans for the next three years. I am therefore taking the earliest opportunity of informing the House of the contents of the Autumn Statement: that is, the public expenditure plans for the next three years, and the expected outturn for this year; proposals for national insurance contributions for 1989-90; and the forecast of economic prospects for 1989 required by the 1975 Industry Act.

The main public expenditure figures, together with the full text of the economic forecast, will be available from the Vote Office as soon as I have sat down. They will also appear in the printed Autumn Statement, which will be published next Tuesday.

I turn first to public expenditure.

For the current financial year, 1988-89, the public expenditure planning total now looks likely to amount to some £153½ billion, or some £3½ billion less than was allowed for in the last Public Expenditure White Paper. In other words, only around £¼ billion of the £3½ billion reserve I provided for is in fact likely to be needed.

The main reasons for this shortfall are an extra £1 billion in privatisation proceeds, a reduction in social security spending of almost £1 billion as a direct result of the sharper than expected fall in unemployment, and a saving of some £¾ billion, largely due to extra housing receipts under the right-to-buy programme. Taken together with the strong growth in the economy this year, and the containment of debt interest now that the Budget is in surplus, this means that total public spending this year, even excluding privatisation proceeds, will be less than 40 per cent of national income - the first time this has happened for over 20 years.

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

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

Over the whole decade since this Government first took office, from 1978-79 to 1988-89, public expenditure has grown by under 1½ per cent a year in real terms. This is exactly half the rate at which it grew over the whole of the immediately preceding decade.

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

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

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

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

Over the three survey years as a whole, the real growth in spending on programmes will be over 3 per cent a year. This can be afforded only because of the fall in the burden of debt interest brought about by the dramatic improvement in the Government's finances from Budget deficit to Budget surplus. As a result, overall public spending, excluding privatisation proceeds will rise by less than 2 per cent a year, well within the prospective growth of the economy as a whole. In other words, total public spending, excluding privatisation proceeds, will continue to decline as a proportion of national income.

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

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

In total, the increases for the Health Service in the UK as a whole will be over £2 billion in 1989-90 and over £2½ billion in 1990-91. These are by far the largest increases the Health Service has ever received. Comparing next year with this year, the increase in real resources for the NHS should amount to some 4½ per cent.

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

Third, housing. Gross provision for public sector housing investment is being increased by around £440 million in 1989-90 and £340 million the following year. But thanks to the success of the Government's right-to-buy policy, this is more than financed by extra receipts.

Fourth, law and order. An extra £290 million has been made available in 1989-90 and £430 million in 1990-91, principally for a further expansion in the prison building programme. This will provide a further 3,000 places by 1991-92. Provision for local authority spending on the police has been increased by £240 million.

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

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

On science and technology, we have altered the balance of public support within an increased total. In particular, provision for spending by the Department of Education and Science has been increased by £120 million a year, with the science budget up by 16 per cent in 1989-90. This reflects the importance the Government attaches to basic and strategic research.

The new plans imply an overall increase of £2¼ billion in public sector capital spending in 1989-90. This includes extra investment in hospitals, housing, prisons, and roads. There is provision for higher investment by the nationalised industries, including further anti-pollution investment by the Water Authorities.

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

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

I turn next to National Insurance Contributions.

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

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

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

However, because of the healthy state of the National Insurance Fund, this decision will not require any increase in contribution rates. Thus, the main Class I contribution rates will remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

Finally, I turn to the Industry Act Forecast.

Growth this year looks to be turning out at 4½ per cent, compared with the 3 per cent growth I forecast at the time of the Budget. Investment is particularly strong, growing twice as fast as consumption, with manufacturing investment expected to show the biggest rise of all, at 18 per cent. Indeed, it is striking that total investment has grown almost twice as fast as total consumption over the whole of the past five years.

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

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

Inflation, as measured by the retail price index, is likely to be a little over 6 per cent in the fourth quarter of this year. Part of the rise in recorded inflation reflects the impact on mortgage payments of the higher interest rates needed to tighten monetary policy and thus get inflation firmly back on a downward trend. Excluding mortgage interest payments, the RPI in the fourth quarter is likely to be around 5 per cent, compared with the 4 per cent rise in the RPI forecast at the time of the Budget.

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

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

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

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

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

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

The current account deficit is likely to fall only slightly, to some £11 billion, or 2¼ per cent of GDP.

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

In short, after two years of unexpectedly rapid expansion, growth next year is forecast to return to a sustainable level, and one which compares well with the economic performance of the '70s; while inflation will resume its downward path. The public finances are in substantial surplus and will remain so, with public spending on priority programmes continuing to increase, while overall public spending continues to fall as a share of GDP, to a level in 1991-92 not seen for a quarter of a century.

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