PO-CH/NL/0714 PART 4

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FROM: M C SCHOLAR
DATE: 10 March 1986

CHANCELLOR OF THE EXCHEQUER

cc: Principal Private Secretary
Chief Secretary (2)
Financial Secretary (2)
Economic Secretary (2)
Minister of State (2)
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Sir Geoffrey Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr H P Evans
Mr Monger
Mr Odling-Smee
Mr Cropper
Mr H J Davies
Mr Lord

Sir Lawrence Airey - IR
Mr Battishill - IR
Mr Isaac - IR

Sir Angus Fraser - C&E
Mr Knox - C&E

Deputy Governor (B/E)

FINAL SCORECARD

Attached is scorecard number 8, compiled as usual with the help of FP, MP, IAE and the Revenue Departments. This will be the final scorecard in this year's Budget round.

M C SCHOLAR

BLO enclosure 14 pages

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Miss O'Mara	)
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FORECARD OF 10 MARCH 1986

TABLE 1

DIRECT EFFECTS OF BUDGET MEASURES

[All figures are net of the cost or yield of indexation or revalorisation included in the base forecast]

cost(-)/yield(+) (£m rounded to £5m)

Note	Proposal	1986-87 -	1986-87 +	1987-88 -	1987-88 +
1	VAT		Nil	Nil	
2	Excise duties - petrol/derv		135		145
	- VED	135		140	
	- tobacco		175		180
	- alcohol	175		190	
	- other		Nil		Nil
3	Income tax - basic rate	950		1305	
4	Income tax - higher rates		15		30
5	Corporation Tax	Neg		20	
6	Pension funds		25		125
7	Capital Gains Tax	Nil		Nil	
8	Capital Transfer Tax	35		55	
9	Stamp Duty		Neg		10
10	Car and car fuel benefits		Nil		15
11	Charitable giving a) Package of reliefs	Neg		60	
	b) Anti-abuse measures		Neg		20
12	Savings	Neg		25	
13	Business Expansion Scheme		Neg		10
14	Employee Share Schemes	Neg		Neg	
15	Lollipops a) VAT relief for charities	10		10	
	b) Extension of pension relief for Nazi victims	Neg		Neg	
	c) Exemption from income tax of July Social Security uprating	15		Neg	
16	Minor Starters a) VAT: motoring expenses		Nil		40
	b) Mines & oil wells allowances	Neg		45	
	c) Relief for overseas travel expenses	10		5	
	d) Other	Neg			30
17	Taxing non-resident entertainers and sportsmen		Nil		75
	Total (Tax Measures)	1330	350	1855	680
		-980		-1175	

expenditure increases(+)/decreases(-)

Expenditure Measures (Gross)	+	-	+	-
Loan Guarantee Scheme	Neg		5	
Enterprise allowance	5		30	
New Workers Scheme	25		50	
LTU Pilots - Jobstart & counselling	65		50	
Community Programme	55		115	
Staff and other running costs	40		30	
Northern Ireland consequentials	5		10	
Total expenditure measures (Gross)		+195		+290
Offsetting savings on social security benefits		-95		-125
Total Expenditure Measures (Net)[a]		+100		+165

NB. Consultative Document on profit sharing (Weitzman): See serial 18 in notes to Table 1.

(a) To be financed from the Reserve

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SCORECARD OF 10 MARCH 1986

TABLE 2

PSBR EFFECTS[(a)]

(All figures are net of the cost or yield of indexation or revalorisation included in the base forecast)

£m
(rounded to £5m)
reduction(-)/increase(+)

Proposal	1986-87 +	1986-87 -	1987-88 +	1987-88 -
VAT		Nil		Nil
Excise Duties	Nil		5	
Income tax - basic rate	975		1465	
Income tax - higher rates		15		30
Corporation Tax	Neg		20	
Pension funds		35		150
Capital Gains Tax	Nil		Nil	
Capital Transfer Tax	35		55	
Stamp Duty		Neg		10
Car and car fuel benefits		Nil		15
Charitable giving a) Package of reliefs	Neg		60	
b) Anti-abuse measures		Neg		20
Savings	Neg		25	
Business Expansion Scheme		Neg		10
Employee Share Scheme	Neg		Neg	
Lollipops	25		10	
Minor Starters	10			20
Taxing non-resident entertainers and sportsmen		Nil		75
	1045	50	1640	330
Total (Tax Measures)		+995		+1310
Expenditure Measures		Nil		Nil
TOTAL		+995		+1310

(a) The figures for PSBR cost given in this table are calculated in terms of the change in the fiscal adjustment implied by each measure listed. Adding the figures together shows how much of any fiscal adjustment indicated by the forecasts, assuming a given PSBR, would be used up.

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Notes to Table 1

1. VAT: Assumes no increase in the standard rate.

Revalorisation by 5.7% of the VAT threshold (the level of turnover at which businesses must register for VAT) would raise it to £20,500 (from £19,500). The revenue effects (which are negligible) are included in the forecast.

Various VAT lollipops are covered in item 15.

2. Excise Duties: Assumes a revenue neutral excise duty package in which the cost of a standstill on duty for alcohol, pipe tobacco and cigars is offset by overindexing cigarettes and hand rolling tobacco (**11.1p on a typical packet of 20 King Size**); a standstill on car VED is balanced by overindexing petrol (**up 7.5p a gallon**); unchanged lorry VED is offset by overindexing derv (**up 6.5p a gallon**); and the abolition of some, and a standstill on other, minor oil duties is balanced by an increase in the duty on gas oil (**up 1.5p a gallon**).

With this package the Budget as a whole has an RPI impact effect of +0.11% on top of indexation, including the 0.07% impact effect of a cut of 1p in income tax basic rate.

Details of the package are as follows:

Duties	Impact on typical pre-Budget prices[a]	Effect, compared with revalorisation in 1986-87	1987-88
	£m	£m	£m
Alcoholic drinks	0	-175	-190
Pipe tobacco/cigars	0	-5	-5
Cigarettes/HRT	11.1p	+180	+185
VED[b] (cars)	0	-110	-115
Petrol	7.5p	+110	+120
VED[b] (lorries)	0	-25	-25
Derv	6.5p	+30	+30
Bus fuel grants	-	-5	-5
Fuel oil	0	-5	-5
AVTUR, lubricating oils, other rebated oils	-	-20	-20
Gas oil	1.5p	+25	+25
TOTAL		0	-5

(a) Assumes entire price increase is passed on to the consumer
(b) Excludes balancing changes in minor VED rates as agreed at Overview 5.

3. Income tax - basic rate: Figures assume a basic rate cut of 1p combined with statutory price indexation (5.7%) of all allowances and thresholds. Since the cost of price indexation is included in the forecast, the cost shown in table 1 represents the cost of the basic rate cut.

The figures assume no change in the mortgage interest relief ceiling and that Life Assurance Premium Relief remains at 15%.

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4. Income tax - higher rates: The figures assume a basic rate cut of 1p and the following higher rate package (option M1B):

Tax Rate	Threshold (£)
29%	0-17,200
40%	17,201-20,200
45%	20,201-25,400
50%	25,401-33,300
55%	33,301-41,200
60%	over 41,200

5. Corporation Tax: The figures assume no change in the basic regime but small firms rate to be reduced in line with the 1p basic rate cut. The full year cost is £35m.

6. Pension funds: Assumes that where pension funds surpluses exceed 5% the funds are required to reduce surpluses to below 5% within 5 years. The method of reduction to be at the discretion of the funds. No fund will be forced to make a refund in the first year (1986-87). Where the reduction is achieved by a refund to the employer the refund will be subject to tax at a flat rate of 40% on the employer. The figures in Table 1 assume the tax will be paid as the refund is made. Funds to be allowed to provide an actuarial certificate (subject to a spotcheck) rather than a full return where the surplus does not exceed 5%.

7. Capital Gains Tax: Assumes no major change. (Indexation of the annual exempt amount is assumed in the forecast.) A concession on CGT on first sale of BES shares is covered at Item 13.

8. Capital Transfer Tax: (Forecast assumes indexation of the threshold.) Assumes abolition of charge on gifts between individuals during their lifetime, except for a charge introduced on a taper for gifts within 7 years of death. The taper is set at 100% of the death rate in the three years before death with charges at 80%, 60%, 40% and 20% in the preceding four years respectively. The exemption for gifts to spouses remains. The trust regime is kept unchanged so far as possible. The cost builds up over time and will be affected by behaviourial changes.

9. Stamp Duty: Assumed package includes a reduction from 1% to ½% from 27 October 1986 for all share transactions currently subject to stamp duty. No change in the duty on houses. No change in capital duty or unit trust duty. Cost of rate reduction to be financed by extension of stamp duty base. Figures in the table reflect discussions with the Bank.

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			cost(-)/yield(+) 1986-87	1987-88	Assumes introduction on
a)	Reduction in stamp duty on shares to ½%		-70	-110	(27 October 1986)
b)	Possible extension of stamp duty base through				
	(i) charge on ADRs	(5%)	+10	+10	(18 March 1986)
	(ii) intra account dealing	(½%)	+10	+20	(27 October 1986)
	(iii) takeovers incl. mergers	(½%)	+20	+20	(18 March 1986)
	(iv) loan stock	(½%)	+20	+20	(18 March 1986)
	(v) Renounceable letters	(½%)	+10	+15	(27 October 1986)
	(vi) Company purchases of own shares	(½%)	+1	+1	(27 October 1986)
Net cost/yield of a) and b)			+Neg	-24	
Additional tax on capital gains			Nil	+35	
TOTAL (rounded)			+Neg	+10	

The package now achieves broad revenue neutrality in 1987-88 as well as 1986-87.

10. Car and car fuel benefit scales: As from 1 April 1987, the engine size break points for these scales to be changed, on a revenue neutral basis, from 1300cc and 1800cc to 1400cc and 2000cc to align with the EC directive on exhaust emissions. Resulting scale charges for car benefits then to be increased by 10% for 1987-88. Car fuel scale to be decoupled from car scale and kept at broadly 1986-87 level, as adjusted on a revenue neutral basis for change in break points. From 1987-88 the car fuel scale will be used not only for income tax purposes but also as the basis for assessing the VAT chargeable on fuel used for private journeys in business cars (see item 16a in Table 1 and the equivalent reference in Table 5).

Scale charges for more expensive cars also to be increased by 10%, and cash break points to be frozen at the 1986-87 level. No change in present thresholds for high and low business mileage.

11. Charitable giving: Overall the package assumes

(a) abolition of the limit on higher rate relief for covenanted donations by individuals, and apportionment of covenanted donations by close companies, combined with measures to prevent increased abuse. Estimated overall cost is Neg in 1986-87 and £5m in 1987-88. In addition there is an estimated yield of neg in 1986-87 and £20m in 1987-88 from measures restricting present abuse, the yield from which is shown as a separate line in Table 1.

(b) tax relief for charitable donations made by individuals through payroll deduction schemes run by employers and paid through agencies. Employers not compelled to run a scheme; but no relief except through a scheme. Cost depends on take-up but assuming a £100 annual limit, 1½ million employees taking part, and an April 1987 start, estimated costs are nil in 1986-87 and £20m in 1987-88.

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(c) relief for single gifts by companies (quoted and USM but not close companies). Assumes restriction of relief for single gifts made by a company in a year to a maximum of 3% of the amount of dividends paid by the company in that year. On this basis the cost would be about £35m in 1987-88, though it would build up in later years.

12. Savings: Assumes a new scheme from 1987. New investment would be confined to cash. Quoted and USM shares only would qualify. Maximum investment of £2400pa. In order to qualify for relief investment would have to be committed to a yearly Plan for a minimum holding period (12-24 months) (although funds could be switched to new shares within that period if desired). Early withdrawals will be taxed in the normal way. Dividend income to be exempt from tax if re-invested (but not if withdrawn in cash). Costs in Table 1 comprise:

	1986-87	1987-88
Tax relief on dividends	Neg	-25
CGT exemption	Nil	Neg

The figures assume a take up by ½ million investors in the first year and that all dividends are reinvested.

The eventual cost could be very much higher depending on take up.

13. Business Expansion Scheme: Assumes extension of the scheme from 1 April 1987 (when current scheme is due to end). Table 1 shows, as will the FSBR, the net effect of the cost of extending the scheme and the yield from changes in its coverage. (The full year cost of the scheme at current levels of investment will be given in an FSBR footnote.) Table 1 includes the yield from excluding some asset based activities and the restriction to be placed on ownership of land and buildings. New (but not existing) BES shares to be exempt from CGT on first sale. Exemption from CGT has no effect on receipts in the next 5 years.

14. Employee Share Schemes: Assumes a package including admitting the use of shares subject to a restriction requiring disposal when employment ends (while at the same time closing loopholes in taxing provisions affecting unapproved employee share acquisitions); easing access to schemes for employee controlled companies; easing conditions on exercise of savings-related share options; and permitting access for registered worker co-operatives. The cost of each of these items is as follows:

	1986-87	1987-88	Full Year
Restricted share (net)	Nil	Nil	-5
Access for employee-controlled companies	Neg	Neg	Neg
Exercise of SAYE-related share options	Neg	Neg	Neg
Access for Co-operatives	Neg	Neg	Neg

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15. Lollipops: Assumes the following package:

Budget Starter	Proposal	£m Revenue costs (-) 1986-87	1987-88
22	VAT relief for installation of distress alarms and lifts for handicapped	-3	-3
115	Extension of relief under S.22(2)FA74 for pensions paid to Nazi victims	-1	-1
172	Exemption from income tax of July 1986 uprating of retirement pensions, widows benefits and invalid care allowance only	-15	Neg
-	VAT relief on newspaper advertising by charities	-1/-2	-1/-2
-	VAT relief for medicinal products supplied to charities	-2	-2
-	Extension of VAT relief for donated medical equipment	-3/-4	-3/-4
-	VAT relief for recording equipment for a blind charity	-1	-1
-	VAT relief for welfare vehicles	Neg	Neg
	Total (rounded)	-25	-10

There are no measurable consequences for the RPI impact effect.

16. Minor Starters: See Table 5.

17. Taxing non-resident entertainers and sportsmen: Assumes the introduction of withholding arrangements and other measures to counter tax avoidance and evasion by non-resident entertainers and sportsmen who derive income from the UK. (Estimated yield £100m in a full year.)

18. Profit Sharing - Weitzman: The aim is to promote labour market flexibility and increasing worker identification with his employer's business and its profitability. The proposal is for tax relief on 10% of total remuneration for employees who reach an agreement with their employers which links at least 20% of remuneration to profits. The proposal is to refer in the Budget Statement to a consultative document to be published later on.

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SCORECARD OF 10 MARCH 1986

TABLE 3

EMPLOYMENT AND ENTERPRISE MEASURES

Estimates exclude staff and running costs (except line 6)

Cash

Note	Proposal	1986-87 Gross Exp £m	1986-87 Net Exp £m	1986-87 Net Exch Cost* £m	1986-87 No. off Count 1/ 000	1987-88 Gross Exp £m	1987-88 Net Exp £m	1987-88 Net Exch Cost* £m	1987-88 No. off Count 1/ 000	1988-89 Gross Exp £m	1988-89 Net Exp £m	1988-89 Net Exch Cost* £m	1988-89 No. off Count 1/ 000
1.	Loan Guarantee Scheme	Neg	Neg	Neg	4	5	Neg	Neg	9	15	Neg	Neg	10
2.	Enterprise Allowance	5	Nil	Nil	2	30	20	10	7	40	25	15	7
3.	New Workers Scheme	25	15	10	18	50	30	20	21	50	30	20	21
4.	L.T.U. Pilots												
	- Jobstart	10	10	5	3	25	20	10	3	25	20	10	4
	- Counselling	55	Nil	-10	43	25	-5	-15	16	25	-5	-15	16
5.	Community Programme	55	35	25	23	115	75	55	23	120	75	55	23
6.	Staff and other running costs	40	40	40	Nil	30	25	25	Nil	35	30	30	Nil
7.	Northern Ireland consequentials	5	5	Neg	3	10	5	5	3	10	5	5	3
8.	Total (rounded)	195	100	70	96	290	165	110	82	320	180	120	84

* The net Exchequer cost takes account of the reduction in social security benefits, and increases in income tax revenue, as people leave the unemployment count and take up places on the schemes.

1/ End of financial year

Notes to Table 3

1. Loan Guarantee Scheme: Existing scheme due to close on 31 March 1986. Table 3 assumes new scheme starts from April 1986 with premium paid by borrowers of 3 per cent and proportion of loan guaranteed by Government 70 per cent. Net exchequer cost per person off the count is £700.

2. Enterprise Allowance Scheme: Present annual rate of entry is 64,500. Rate of entry is rising so that total entry will be 80,000 in 1986-87. Table 3 assumes an increase in the annualised rate of entry to 100,000 by January 1987. First year net exchequer cost per person off the count is £3000.

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3. New Workers Scheme: Table 3 assumes this new scheme provides for £15 a week for employers of 18-19 year olds earning less than £55 a week and of 20 year olds earning less than £65 a week. Coverage of 60,000 by April 1987. First year net exchequer cost per person off the count is £1300.

4. Pilots for long term unemployed: At present pilots exist in 9 areas - those unemployed for more than a year called for interview and directed towards job or employment and training measures; those taking a job paying less than £80 a week get a taxable allowance of £20 for 6 months (Jobstart). Table 3 assumes extension nationwide to all unemployed over one year. Net public expenditure and net exchequer cost estimates are nil or negative because they do not include running costs (which form the major part of expenditure on the counselling initiative). Social Security benefit savings and income tax flowback are greater than the non-running cost element of the estimates.

5. Community Programme: The present target is 230,000 places by June 1986. Table 3 assumes an expansion to 255,000 by September 1986, and an increase in the average wage limit to £67 a week from April 1986.

6. Staff and running costs: includes the staff and running costs of all the measures. Numbers off the count are a result of 300 extra staff in Department of Employment and DHSS to counter fraud.

7. Elsewhere figures in the table cover the effect on Department of Employment, covering GB. Extending the measures to Northern Ireland adds 2.75 per cent to the cost.

8. The Table shows the agreed package as described to Lord Young by the Chancellor on 10 March, following a meeting on Thursday 6 March.

The costs shown are within the amount assumed by the forecasters for employment and training measures when assessing the pressures on the Reserve in 1986-87. The measures do not therefore affect the fiscal arithmetic and are scored as nil in Table 2. The net public expenditure costs are shown in Table 1.

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TABLE 4

STAFFING EFFECTS

Proposal	Effect on manpower numbers at April 87		April 88	
	-	+	-	+
Customs and Excise				
VAT		Nil		Nil
Excise Duties		Nil		Nil
Minor Starters		Neg		Neg
Total Customs		Neg		Neg
Inland Revenue[a]				
Income tax - allowances and basic rate[b]		45		160
Income tax - unchanged mortgage interest relief ceiling (c)		Nil		Nil
Income tax - higher rates (ie option M1B)		Nil		Nil
Corporation Tax		Nil		Nil
Pension Funds		5		5
CGT (indexation of thresholds)		Neg		Neg
CTT: Statutory indexation[d]		30		50
Abolition of lifetime charge[e]	Nil		20	
Stamp Duty		20		20
Car and car fuel benefits[f]		Nil		Nil
Charitable giving[g]		25		50
Savings[h]		5		15
BES		Neg		Neg
Employee Share Schemes		15		10
Tax on non-resident entertainers and sportsmen		20		20
Lollipops[i]	185			Nil
Minor Starters		10		20
Revised P11DA (employers Benefits in Kind return) procedure (j)	100		50	
Total Inland Revenue		-110		+280
Department of Employment Group				
Loan Guarantee Scheme		Neg		Neg
Enterprise allowance		50		130
New Workers Scheme		120		120
Fraud Abuse		300		300
Jobstart		90		90
Counselling		1000		850
Community Programme		200		200
Total Department of Employment Group[k]		+1760		+1690
Total		+1650		+1970

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Notes to Table 4

(a) The figures show the effect of the proposals on the manpower baseline (which for April 1988 is 66,374). The manpower baseline is generally based on the assumption that workloads remain unchanged except where there has been a specific adjustment to the baseline in the Survey to take account of foreseeable changes to workload (see notes (c) and (j) below). COP is assumed to be implemented by April 1988 and the figures quoted take account of the estimated COP savings of 4000 included in the April 1988 target.

(b) The manpower effect reflects statutory price indexation of allowances and thresholds.

(c) MIRAS - large loans: The forecast growth in new loans over £30,000 during 1986-87 requires an extra 55 staff at 1.4.87 for which provision has already been made in the Survey. From April 1987 lenders are required to bring into MIRAS new loans above the limit, contributing to a reduction back to NIL extra staff by 1.4.88. Increasing the limit to £35,000 would require an extra 15 staff at 1.4.87 (a saving of 40 against the Survey provision) and achieve a saving of 60 at 1.4.88.

(d) On the basis of the latest estimates, statutory indexation of CTT will not be sufficient to avoid an increase in the 1986-87 workload. In addition, the workload now forecast for 1985-86 will be higher than was estimated before the 1985 Budget. The table shows the combined effect of these two increases. The reasons for both increases is that house and share prices have been rising more quickly than the RPI. The total staff cost will be 65 units (30 at 1 April 1987, 50 at 1 April 1988 and 65 at 1 April 1989).

(e) The manpower savings from abolition of CTT lifetime charge is inevitably somewhat speculative.

(f) The change in engine size breakpoints in the car benefit scales will require 45-75 man-year units to set up during 1986-87. These will not be required by April 1987.

(g) The continuing staff cost in later years is estimated to be 40 units though this figure depends crucially on the level of giving.

(h) The continuing staff cost in later years is estimated to be 35 units and will depend crucially on future take up.

(i) The saving reflects the combined effect of exempting the pension increase in July 1986 and recoding for the pension increase in April 1987. There will be further staff savings compared with Survey provision (not in the Scorecard) of 140 units at April 1988 arising from the change in the uprating date.

(j) Additional provision was made in the Survey for the growth in the P11D workload up to April 1987 that result from unchanged thresholds (at £8500). Figures in the table show the savings, against this baseline, that result from the revised procedure.

(k) The figures shown are the staff required for the employment measures shown in Table 3.

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SCORECARD OF 10 MARCH 1986

TABLE 5

MINOR STARTERS

(Items in Starters list which Ministers have agreed are now serious contenders, with revenue effect of £3m or more)

cost(-)/yield(+)

FB Starter Number	FB Category	Proposal	1986-87 -	1986-87 +	1987-88 -	1987-88 +
7	C	VAT: motoring expenses		Nil		40
8	C	VAT: avoidance by disaggregation		Neg		20
15	C	VAT: long-term lettings of accommodation		Nil		10
116	B1	Mines and oil wells allowances	Neg		45	
125	B2	Tax treatment of Enterprise Allowance (a)	Neg		5	
129	B2	PRT relief for exploration and appraisal expenditure in inshore waters (b)	Neg		Neg	
134	C	Relief for overseas travel expenses	10		5	
146	C	S.252 ICTA: sale of the losses of insolvent companies	Neg			5
173	C	CGT relief for part disposals of land	Nil		5	
410	C	Increased penalties for VED evasion		Neg		5 (c
		Total	-10		+20	

Notes to Table 5

(a) Now costed on Case VI treatment; complete exemption has been ruled out.

(b) Reflects the fact that because of the lower oil price forecast, Department of Energy forecast of exploration and appraisal expenditure has been significantly reduced (it is now expected to be £2.5m in both years). The cost to be shown as negligible in the FSBR.

(c) Estimate of yield from improved compliance offset by the effect of increasing the number of out of court settlements. Starter subject to agreement by Home Office which has not yet been obtained.

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276/008

COPY 1 NO OF 3

FROM: M C SCHOLAR
DATE: 12 March 1986

CHANCELLOR

cc: Sir P Middleton

BUDGET SUMMARY FOR THE QUEEN

I attach a draft summary of the Budget for your audience with the Queen on Monday.

2. This draft, I believe, could also serve as a guidance telegram to overseas Posts, for despatch on Budget Day.

3. I would be grateful for your comments, if possible in the course of tomorrow, so that we can put a final draft to you on Friday.

M C SCHOLAR

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BUDGET SUMMARY FOR THE QUEEN

This year's Budget comes at a time of great change in the world economy, with the dramatic and unprecedented fall in oil prices. But the Budget's main themes are those of its predecessors - the defeat of inflation, and the creation of an enterprise culture which will promote the growth of output and employment.

Economic Background

2. Output in the world economy has been rising since early 1983 and inflation has been coming down since 1980. The fall in the oil price will be of particular help to oil-importing countries, both in the developed and the developing world. A period of low inflation and good growth in output and trade is in prospect. ~~Many of the~~ There are worrying problems associated with payments imbalances and external indebtedness ~~will remain~~. But the benefits to trade, output and inflation from the fall in oil prices should prove substantial.

3. At home, inflation, after the upward movement last year, is now down to 5½ per cent and is set to fall to below 4 per cent in a few months. Output continues to grow strongly. In 1985, the economy grew by 3½ per cent, faster than any other country in the European Community, and the United States. The UK now about to enter its sixth year of growth at an average level of 3 per cent.

4. The pattern of growth remains broadly based. Manufacturing exporters have increased their share of world trade - and a further 5 per cent growth in manufactured exports is forecast in 1986. Investment is expected to grow by about 5 per cent this year. Personal incomes are also growing fast. On the balance of payments the forecast is for a current account surplus of £3½ billion.

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5. Employment has continued to rise - a total of 700,000 new jobs between March 1983 and September 1985 - but unemployment remains stubbornly and disappointingly high.

6. Because of the UK's position as a major oil producer, the oil price fall will help the major non-oil countries more than it will help us. But, despite the adverse effect on our terms of trade (because we lose slightly more from our export earnings than we gain from lower import prices), and on Government revenues, there is a valuable benefit for the non oil economy, especially for manufacturing, in terms of lower costs. And the increase in world trade which should follow lower oil prices will also provide an excellent opportunity for British exporters.

slightly beneficial for the on balance

Budget Strategy

7. The Government's Medium Term Financial Strategy (MTFS) is, as usual, extended forward in the Budget. It is designed steadily to reduce the growth of total spending power in the economy over a period of years, at a pace which will gradually squeeze inflation out of the system, while leaving room for further economic growth. Target ranges will again be published for the growth of broad and narrow money, and the Government will continue in operating policy to have regard to a range of evidence about monetary conditions - of which the most important is the exchange rate.

8. To support monetary policy the Government intends to keep public borrowing at a low level. The 1985-86 Public Sector Borrowing Requirement (PSBR) is expected to come out at around £7 billion or 2 per cent of GDP, the lowest level since 1971-72. This outcome was achieved in spite of the fall in oil revenues, because of restraint in public expenditure.

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9. Last year's MTFS indicated for 1986-87 oil revenues of £11½ billion, and scope for possible tax reductions of £3½ billion. Since then the outlook for the public finances has been substantially affected by the sharp fall in oil prices. Assuming an oil price averaging $15 a barrel for the financial year 1986-87, oil revenues are projected at £6 billion. But for the buoyancy in non oil revenues and the firm restraint on public spending, an increase in taxation would have been necessary in this year's Budget.

10. Last year's MTFS also indicated a PSBR for 1986-87 of £7½ billion, or 2 per cent of GDP. The Government have decided to stick broadly to this figure, but, given the uncertainties over the oil price, to go a little below it and provide for a PSBR of £7 billion, or 1¾ per cent of GDP. That figure accommodates the Budget measures, which provide for a reduction in the burden of taxation of a little under £1 billion.

Help for the unemployed

11. The continuing high level of pay settlements is continuing to inhibit the growth of employment. In the longer term greater wage flexibility is essential. This year, to add to the measures the Government has already taken to encourage such flexibility, and to encourage identification between employee and enterprise, the Government propose to issue a consultative document seeking views on an incentive scheme of temporary tax relief to encourage special profit sharing schemes, in which at least 20 per cent of income is directly related to the success of the enterprise.

12. For the more immediate future, the measures announced in last year's Budget are still to show most of their effect. The expansion of the Youth Training Scheme to cover all 16 and 17 year olds comes into effect next month. The increase in the size of the Community Programme (which provides work of community benefit, for the long term unemployed) is going ahead fast. This year the Government are raising the target for expansion from 230,000 places by June 1986, to 255,000 by the end of 1986.

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13. The long term unemployed will also benefit from the nationwide extension of the pilot schemes, which were originally announced by the Secretary of State for Employment last year. As a result of this extension all the long term unemployed will be called for a counselling interview and encouraged to find work. And those of the long term unemployed who take a job at less than £80 a week will receive a £20 a week grant for 6 months.

14. In addition, the Enterprise Allowance Scheme is being expanded to give more unemployed people help to start their own business; and a new scheme - the New Workers Scheme - will provide a cash incentive to employers to create jobs for young people aged 18-20 at realistic wages.

15. The public expenditure cost of these and other changes will be £195 million in 1986-87 and £290 million in 1987-88. After allowing for social security savings, the net public expenditure cost will be £100 million and £165 million respectively.

Taxes on Business and Enterprise

16. The Corporation Tax structure announced in 1984 comes fully into force this year with the main rate coming down to 35 per cent.

17. In addition, the Business Expansion Scheme which was due to come to an end in April 1987 will be extended indefinitely. It is already attracting substantial amounts of new equity capital into unquoted companies. A number of improvements to the Scheme are proposed, including measures to ensure that it is focussed on high risk investment. It will also be extended to certain forms of ship chartering.

18. Small businesses will also benefit by the extension of the Loan Guarantee Scheme, and the reduction in the premium charged for the Government guarantee from 5 per cent to 3 per cent. The abolition of the Capital Transfer Tax on gifts between individuals during

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their lifetime, will be a further help. What remains of this tax will be renamed the Inheritance Tax.

Savings and investment

19. The Budget includes a number of further measures to reform the taxation of savings and investment. The present rules relating to pension fund surpluses will be clarified. The rate of Stamp Duty on share transactions will be halved and the cost recouped by bringing into tax a range of transactions which are at present entirely free of Stamp Duty. Finally there is to be a radical new scheme for tax-free investment in equities, further to promote wider share ownership.

Charities

20. A number of specific concessions will be made, relieving charities from VAT in respect of certain purchases. But the major change proposed here is directed towards charitable giving rather than towards the charities themselves. By

- abolishing the upper limit on relief at higher rates of income for convenants
- allowing tax relief to companies for one-off gifts up to a maximum of 3 per cent of dividends
- providing relief to individuals for regular gifts of up to £100 to charity where these are deducted at source by their employers

the Budget should stimulate additional charitable giving of [£] million - at least twice the cost to the Exchequer of these measures.

Taxes on Spending

21. Overall, excise duties will be increased by about the same amount as would be required to keep pace with inflation. Petrol and derv duties will be increased by rather more than

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this - by 7½p a gallon and 6½p respectively. Given the recent increase in oil companies' profit margins these increases need not be passed on to the consumer. The real tax burden on the motorist will be kept unchanged, with no increase in Vehicle Excise duty on cars and lorries. In recognition of the dangers to health cigarettes and hand rolling tobacco will be increased by the equivalent of just over 11p a packet of 20 king size. Cigars and pipe tobacco duties will not be changed. There will be no increase in the duties on any alcoholic drinks. This should help with the difficulties currently faced by the Scotch whisky industry.

22. No changes are proposed in the rate or coverage of VAT (apart from the changes in relation to charities.)

Income Tax

23. As foreshadowed in the Budget Statement last year, the Government has published a Green Paper on personal taxation discussing options. In particular, it outlines a possible reform (made possible by computerisation) of the system of income tax personal allowances. Instead of treating a wife's income as that of her husband, there would be independent taxation, with allowances transferable between husband and wife. Everyone would have a tax allowance in his or her own right. A husband and wife would be taxed independently, but would be able to transfer unused allowances to each other. Married women would have privacy in their tax affairs; the tax penalties on marriage would be removed; and more tax relief would go to couples at the point when they are most likely to need it, when one of the partners is not in paid work.

24. The Government is making further reductions in income tax, in order to increase incentives. Since 1979, allowances have been increased by 20 per cent in real terms so that they are now higher, as a proportion of average earnings than, for example, in Germany or the United States. This year, basic allowances are increased in line with prices and the basic rate of income tax is reduced by 1 penny - improving incentives for the 95 per cent of

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employees, and for the 90 per cent of all self-employed people and unincorporated businesses, for whom the basic rate is also the marginal rate. The new basic rate will be 29p in the £. There will be a comparable change in the small firms Corporation Tax rate.

Summary

25. The Budget maintains the Government's strategy to defeat inflation and to create the conditions for the growth of output and inflation. The overall burden of taxation is being reduced. Specific measures will be taken to help the unemployed; to promote enterprise and initiative; and to increase savings, investment and charitable giving.

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COPY NO 1 OF 28 COPIES

FROM: D N WALTERS
DATE: 12 MARCH 1986

MLS 12/3

1. MR SCHOLAR

2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr Butler
Mr Cassell
Mr Monck
Mr Monger
Mr Turnbull
Mr Evans
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mr Pratt
Mr Haigh
Mr Romanski
Mr Porteous
Mr Fray
PS/IR
Mr Walker - IR
PS/C&E
Mr Wilmott - C&E

Cy
Answers to questions on para 9 please.
RL
12/3

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BUDGET DAY PRESS NOTICES

... I attach a list of the press notices which your Departments currently propose to issue on Budget day.

Separate submission, for your approval, in tonight's box.

2. For the Treasury there will be the customary notices on excise duties and VAT; and North Sea revenues. In addition, subject to your confirmation, there will be Treasury press notices on profit sharing and the Green Paper on Personal Taxation. On the former, Mr Monck is minuting you separately. On the latter, I understand that you have now decided that the text will be a reproduction of the introduction to the Green Paper but we are unclear whether the press notice should be released by the Treasury or the Inland Revenue.

tomorrow morning (to replace your redraft of Budget Speech)

PEM thinks it should be HMT. (see below)

3. Of the proposed Treasury press notices, Mr Culpin has queried whether we really need the one which simply summarises changes in excise duties and VAT since that will be covered in the Snapshot.

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4. Customs propose to issue their usual notices on duty changes. In addition, they will be issuing a number of others covering minor items referred to in the FSBR and which require Resolutions. The Minister of State has seen and approved the text of all proposed Customs' notices.

5. As last year, Inland Revenue have a long list of notices covering all their tax changes in the Budget. These are being submitted individually to Treasury Ministers for approval.

6. Neither the Bank nor the Department of National Savings are intending a Budget day press release.

7. As to other Departments, Transport plan to issue three press notices and, depending on decisions, will have a fourth. The three which are firm cover VED rates, the VED trade licensing system and shipping (BES). The terms of the two on VED have been cleared with the Minister of State. The possible fourth press notice would cover VED evasion. This has also been approved by the Minister of State but on a contingency basis.

8. Finally, the Department of Employment will be issuing one press notice on the employment package.

9. I would be grateful to know:

(i) whether you are content with the attached list of press notices;

(ii) whether the press notice on the Personal Tax Green Paper is to be issued by the Treasury or the Revenue; (? HMT)

(iii) whether you agree that the Treasury press notice on excise duties and VAT should be dropped. (yes)

D N Walb

D N WALTERS

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BUDGET DAY PRESS NOTICES

TREASURY

Excise duty and VAT
Government revenue from the North Sea
Profit sharing (1)
Green Paper: Reform of Personal Taxation (2)

CUSTOMS AND EXCISE

Hydrocarbon oils
Tobacco products
VAT: registration threshold
VAT: motoring expenses
VAT: charities
VAT: imports (transfer of relief) and exports (conditions to be satisfied)
VAT: hotel accommodation and holiday services
VAT: disaggregation
Changes in excise licences
Betting and gaming duties in Northern Ireland
Excise warehousing regulations

INLAND REVENUE

The Budget 1986: Income Tax (distributional tables)
Income tax and PAYE: changes for 1986-87
Car and car fuel benefits
Abolition of P11DA
Relief for overseas travel expenses
Approved employee share schemes
Share interests acquired by directors and employees
Benefits uprating exemption
Charities
Building Societies: minor consequentials
Pension scheme surpluses
Personal equity plan
Stamp duty
Capital gains tax
Capital allowances
Small companies' CT rate
Business Expansion Scheme
Company reconstructions: restriction of relief
Loans to participators in close companies
Taxation treatment of Enterprise Allowance
Accrued income scheme and consequentials
Market makers
Company migrations (Section 482 ICTA 1970)
Tax treatment of pensions paid to Nazi victims
Dividends paid to recognised clearers
Entertainers and sportsmen
Oil taxation measures
Mines and oil wells allowances
Deduction of tax (consequentials of basic rate change)
Mortgage interest relief
Capital Transfer Tax - Inheritance Tax
CTT: partly exempt estates
CTT: gifts with reservations on insurance policies
CTT and Inheritance Tax: thesholds and rate bands

(1) Mr Monck minuting separately

(2) Subject to decision as to whether this should be issued by the Treasury or the Inland Revenue

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COPY NO 1 OF 41

FROM: M C SCHOLAR
DATE: 12 March 1986

CHANCELLOR OF THE EXCHEQUER

cc: Principal Private Secretary
Chief Secretary (2)
Financial Secretary (2)
Economic Secretary (2)
Minister of State (2)
Sir P Middleton
Sir Terence Burns
Mr F E R Butler
Sir Geoffrey Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr H P Evans
Mr Monger
Mr Odling-Smee
Mr Turnbull
Mrs R Butler
Mr Culpin
Miss O'Mara
Miss Peirson
Mr Riley
Miss Sinclair
Mr Pratt
Mr Cropper
Mr H J Davies
Mr Lord

Sir Lawrence Airey-IR
Mr Battishill-IR
Mr Isaac-IR
Mr Calder-IR
Mr Johns-IR

Sir Angus Fraser-C&E
Mr Knox-C&E
Mr Wilmott-C&E

Deputy Governor B/E

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1986 FSBR

I attach the printer's proofs of the FSBR.

2. To give you a clear picture of how the FSBR will actually appear, your copy consists of the sheets from which the printer will finally make his plates for printing (although in one or two respects the printer has not yet got the style for the tables

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exactly right; we will be making the necessary changes for the next proof stage).

3. A small number of corrections have been made in manuscript to the attached proofs to bring them up to date where necessary. But to keep the copy fairly clean, we have kept these to a minimum. Not all of the numbers in the table are yet consistent. The proofs will be further corrected taking account of additional comments before being returned to the printer.

4. There are a number of points to note:

Chapter 1

5. Table 1.1 now appears facing the first page of Chapter 1 (the other solutions you suggested would break up the text in awkward places).

6. Paragraph 1.08 gives a figure for tax reductions of 'almost £1 billion', although it is not clear whether this is referring to direct or PSBR effects. The usual form is to show direct effects in the table but to give the overall PSBR effect of the Budget in the text. This would require deleting all of paragraph 1.08 after 'planning total' and inserting:

> "The public sector borrowing requirement for 1986-87 is set at some £7 billion, or 1¾ per cent of GDP - slightly below the level indicated in the MTFS published in last year's FSBR. The Budget measures are expected to contribute ~~just under~~ £1 billion to this figure, over and above the cost of indexing tax rates and allowances, and revalorising excise duties. Table 1.2 below summarises the sources of the receipts and the direction of expenditure."

Do you wish us to make this change?

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7. Mr Monck has suggested that the employment measures should appear in the following order in Table 1.1:

Jobstart counselling
Jobstart allowance
Community Programme
New Workers Scheme
Enterprise Allowance
Loan Guarantee Scheme
Northern Ireland consequentials

Do you agree?

Chapter 2

8. The annex to Chapter 2 shows the shortfall in the planning total as £½ billion (since the figures are rounded to £½ billion). The unrounded figure is £0.3 billion, and the shortfall is described as 'slight' in Chapter 5 - paragraph 5.02.

Chapter 3

9. We propose to put the extra chart, which you requested, immediately after Table 3.10. And a reference to the reduction in income tax will appear in paragraph 3.44. The average errors in Table 3.14 are now calculated over the period 1975-84.

Chapter 4

10. The Chapter takes in the new paragraph on ACT, and the link with income tax. Sir Peter Middleton's suggestion that each line of Table 4.1 be given a number to link it to the section of the annex has not yet been taken up (there is insufficient room on the attached proof). But we will put these numbers in, if you agree.

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11. The planning total outturn for 1985-86 is shown as £133.9 billion, in line with the Chief Secretary's decision.

Timing

12. We need to put these proofs back to the printer, having taken in your further comments, first thing on Friday morning in order to keep to the timetable. I should be grateful, therefore, if you would let us have your comments before close tomorrow (Thursday) evening.

MCS

M C SCHOLAR

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recent events in world oil markets make the projection of oil revenues particularly uncertain. On the expenditure side, the planning total for the final year has yet to be agreed.

2.29 Changes since the 1985 MTFS are discussed in the Annex to this Chapter.

Table 2.5 Public Sector Borrowing[1]

	£ billion, cash					
	1984–85	1985–86	1986–87	1987–88	1988–89	1989–90
General government expenditure	150·0	157	163	~~169~~ 170	175	180
General government receipts	140·~~8~~9	~~149~~ 150	156	164	174	182
Fiscal adjustment from previous years[2]	—	—	—	—	2	6
Annual fiscal adjustment[2]	—	—	—	2	4	3
GGBR	**9·1**	**8**	~~8~~ 7	**8**	**7**	**7**
Public corporations' market and overseas borrowing	1·0	−1	—	−1	~~−4~~ −	~~−4~~ −
PSBR	**10·1**	**7**	**7**	**7**	**7**	**7**
Money GDP at market prices	327	~~339~~ 356	380	405	~~430~~ 429	453
PSBR as per cent of GDP	**3·1**	**2**	**1¾**	**1¾**	**1½**	**1½**

[1] *Rounded to the nearest £1 billion from 1985–86 onwards. Further details for 1985–86 and 1986–87 are provided in Table 6.5.*
[2] *Means lower taxes or higher expenditure than assumed in lines 1 and 2.*

Conclusion

2.30 Events in the UK and elsewhere may necessitate revisions to the assumptions on which the projections have been based. But the Government is committed to maintaining the progress to lower inflation in the medium term, secured by appropriate financial policies. The MTFS provides the framework within which the Government will pursue its economic policy.

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FROM: ROBERT CULPIN
DATE: 12 MARCH 1986

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr H Evans
Mr Monger
Mr Odling-Smee
Mr Scholar
Miss O'Mara
Mr Pratt
Mr H Davies

BUDGET EPR

As Mr Scholar reported on 28 February, and as we discussed after the last overview, we have established that we could issue as an EPR Supplement, on Budget Day, a short, self-contained summary of the Budget. We could make it freely available on the Tuesday, including it in our Budget pack, and send it to everyone on the EPR mailing list within a day or two. It would not be possible, for security reasons, to make it a regular EPR, but this would come reasonably close. We could take credit with the TCSC and others for getting out something approximating to a "Budget in brief".

2. I attach a draft, which I have discussed with Mr Scholar. It follows the structure of Chapter 1 of the FSBR and, wherever possible, uses language from one or other of the existing Budget texts, to minimise different presentations. It is necessarily short, because we could not print anything much longer. It tries to put to wider use some of the charts from your Budget broadcast.

3. Do you want to go ahead with something on these lines? If so, could I please have comments as soon as possible?

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4. If we proceed, we shall of course have to carry through to the EPR Supplement any relevant changes to the other Budget texts.

ROBERT CULPIN

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DRAFT EPR SUPPLEMENT

THE BUDGET

For the last seven years, the Government's consistent objective has been to defeat inflation and establish a vigorous, enterprising, economy which will generate sustained growth and increased employment. Monetary and fiscal policy have been set to bring about lower inflation while providing for continued growth in output. Micro economic policies have been designed to enhance the prospect for output and employment by improving incentives, removing unnecessary controls, ensuring that markets work properly - and generally improving the adaptability of the economy. The measures in the Budget strengthen these policies and reduce the burden of taxation and the role of the State in the economy.

Medium Term Financial Strategy

2. The Budget follows the Medium Term Financial Strategy (MTFS) which the Government has pursued since 1980. The MTFS sets the framework of financial discipline within which economic policy decisions are taken. It has succeeded in bringing inflation down - Chart 1 - and facilitating a sustained period of uninterrupted growth - Chart 2.

3. It has done so by steadily reducing the annual rate of increase, in cash, of total spending power in the economy, as measured by the money value of our national output. Charts 3 and 4 show how this is squeezing inflation out of the system while real growth continues.

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4. Table 1 sets out the Government's broad objective for money GDP in the medium term, and the chosen money supply targets consistent with that. Table 2 illustrates the possible split of money GDP between real growth and inflation.

5. Table 3 gives a path for the Public Sector Borrowing Requirement (PSBR). For 1986-87, the Budget sets the PSBR slightly below the level indicated in the previous MTFS.

Oil

6. The Budget has had to be framed in the unprecedented context of a dramatic fall in the world oil price. Oil prices have halved, from about $30 a barrel in November to an average of about $15 over the last x weeks. They are now the lowest since 1979. As a result, the Government's oil revenues are expected to fall from about £11½ billion in 1985-86 to about £6 billion in 1986-87.

7. Consumers and industry will benefit from lower oil prices. And lower oil prices will encourage higher world trade and output, with lower world inflation. The overall effects on both output and inflation in the UK are expected to be broadly neutral - if anything, slightly beneficial.

Forecast

8. These effects are taken into account in the forecast published with the Budget - Table 4. Inflation is set to fall further - to [3½%] in 1986. Output is expected to continue to grow by around 3%, (with a faster growth) ~~Investment and exports are forecast to grow more rapidly~~. The balance of payments may be in surplus by £3½ billion in 1986 even though oil prices are low.

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Tax measures

9. The main income tax proposals in the Budget are:-

- A cut of 1p in the basic rate
- Indexation - by 5.7% - of personal tax allowances.

The Government believes that people should be left free to spend or save more of their own money. These changes will let people keep more of what they earn. They will benefit 14 million working taxpayers - 95% of the total - with the greatest proportionate benefit going to those on middle incomes. They will also reduce the marginal tax rate for the vast majority of unincorporated businesses and the self employed.

10. Chart 5 shows the income tax structure for 1986-87.

11. The Chancellor is publishing with the Budget a Green Paper on the longer term Reform of Personal Taxation. This discusses a range of options which will in due course be opened up by the computerisation of PAYE.

12. In particular, it outlines a possible reform of the present system of personal allowances. Instead of treating a wife's income as that of her husband, there would be independent taxation, with allowances transferable between husband and wife. Everyone would have a tax allowance in his or her own right. A husband and wife would be taxed independently, but would be able to transfer unused allowances to each other. Married women would have privacy in their tax affairs; the tax penalties on marriage would be removed; and more tax relief would go to couples at the point when they are most likely to need it, when one of the partners is not in paid work.

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13. The other main tax proposals in the Budget are:

- A new scheme for tax-free investment in equities - the Personal Equity Plan
- A halving of the stamp duty on share transactions, together with a broadening of the base of the tax
- Abolition of Capital Transfer Tax on lifetime gifts
- Clearer rules for dealing with excessive surpluses in pension funds
- Indefinite extension of the Business Expansion Scheme (described in the Economic Progress Report for November/December 1984)
- A substantial package of assistance to charitable giving.

These measures will help promote wider share ownership, help new and small businesses, and encourage charitable giving.

14. As a further measure of help for new and small businesses, the Loan Guarantee Scheme will be extended. This provides a Government guarantee for 70% of qualifying bank loans.

15. There is no change in the rate of VAT. Excise duties are being increased, in total, by about the amount required to keep pace with inflation. Within that, petrol and derv are increased by rather more; but the real tax burden on the motorist will be kept unchanged, with no increase in Vehicle Excise duty on cars and lorries. There is no increase in the duties on any alcoholic drinks.

Employment and unemployment

16. Despite the persistence of high unemployment, which is a major problem throughout Europe, Britain has created more jobs in the last 2 years than the rest of the Common Market put together. Chart 5 shows the record in the UK and in some of our major competitors.

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17. The Government believes that further progress on employment depends on two main things. The first is a sustained improvement in the performance of business and industry, and thus of the economy as a whole. The Budget is designed to assist this. The second is a level of pay which prices people into jobs instead of pricing them out of jobs.

18. One way to make pay arrangements more flexible, and more sensitive to market pressures, might be to move to a system in which a significant proportion of an employee's remuneration depends directly on the company's profitability per person employed. This would give the workforce a more direct personal interest in their company's success. The Government will therefore discuss with employers and others whether a scheme could be devised to give some tax incentive to the development of such profit sharing agreements.

19. To give more immediate help to the unemployed, the Budget includes a number of direct measures:-

- Everyone of the long-term unemployed throughout the country will be called to interviews to see if they can be helped in finding a job
- There will be a nationwide Jobstart Scheme, providing a grant of £20 a week for six months for those long-term unemployed who take a job at less than £80 a week
- A New Workers Scheme will help 18-20 year olds. It will provide for a payment of £15 a week for a year to any employer taking on an 18 or 19 year old at not more than £55 a week, or a 20 year old at not more than £65 a week.
- The rate of entry into the Enterprise Allowance Scheme will be increased from about 64 thousand a year to 100 thousand a year by April 1987. This Scheme makes payments of £40 a week for up to a year to assist unemployed men and women to set up in business on their own account.
- The Community Programme, which offers the long-term unemployed work for up to a year on projects of benefit to the community, will be expanded from about 200 thousand places to ~~250~~ 255 thousand by [date].

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20. These measures come on top of the decision, announced in the 1984 Budget, to launch a new 2-year Youth Training Scheme, leading to a recognised vocational qualification. The new and expanded YTS will come into operation in April.

21. All of these measures to help the unemployed will have a public expenditure cost. This will be met from the public expenditure Reserve, and so will not add to the planning total for public expenditure.

Revenue and expenditure

21. Table 4 summarises the effect of both the tax and expenditure measures.

22. Chart 5 shows the sources and uses of public money in 1986-87.

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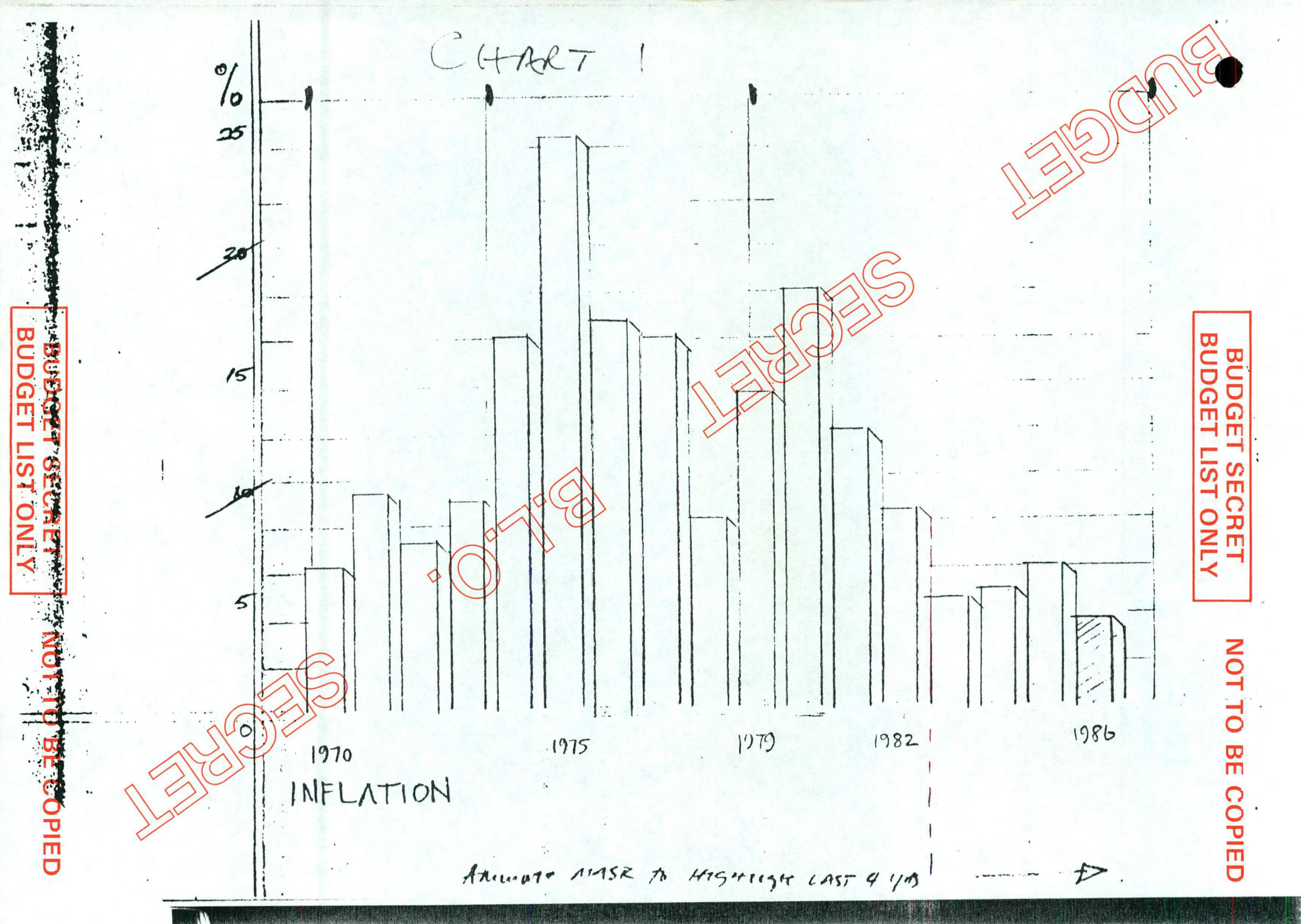
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1979
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INFLATION
ASSUMES MSR TO HIGHLIGHT CAST Q 1/79
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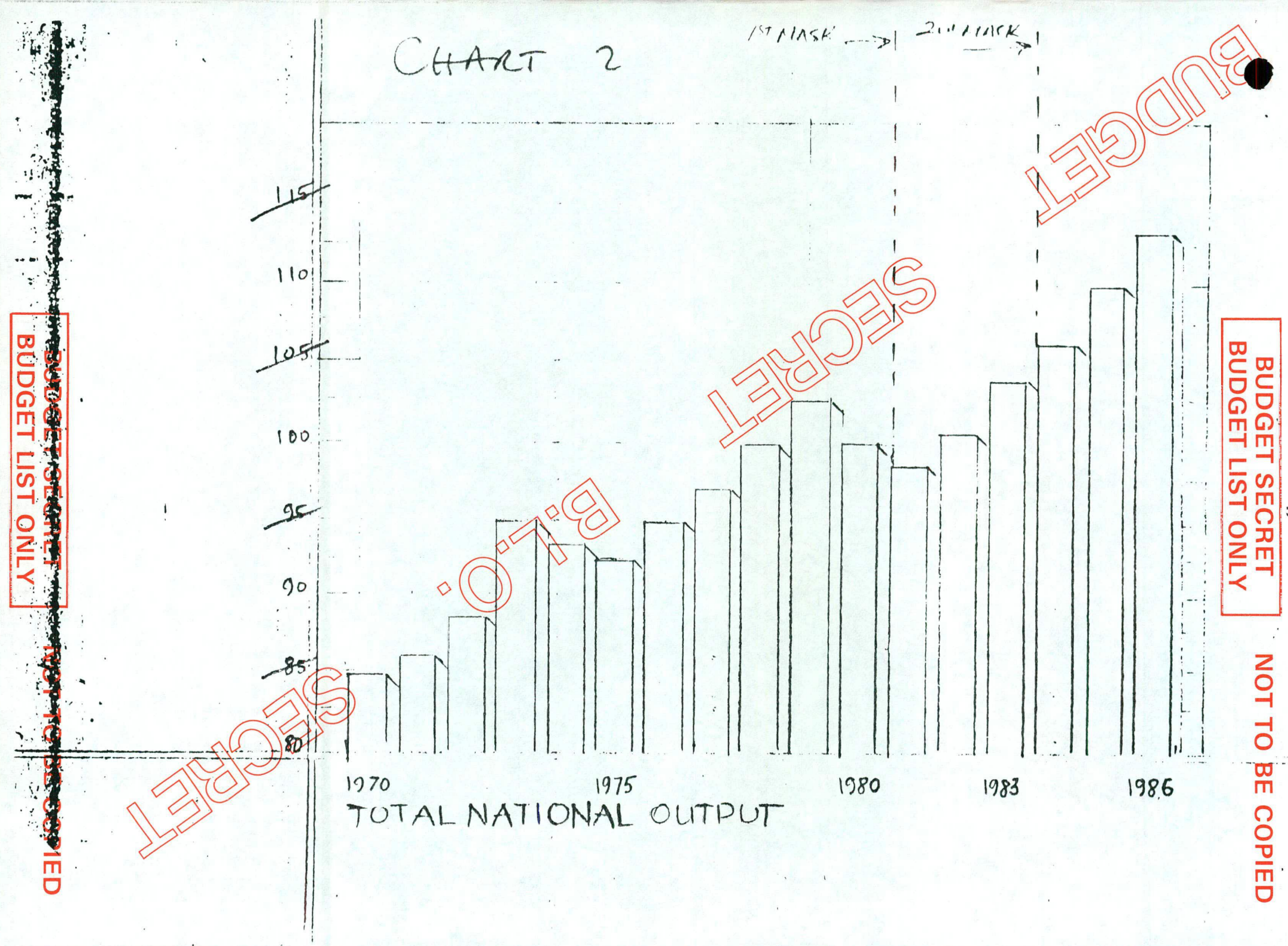

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Chart 3

Money GDP Growth and Inflation

(percentage change on same quarter of previous year)

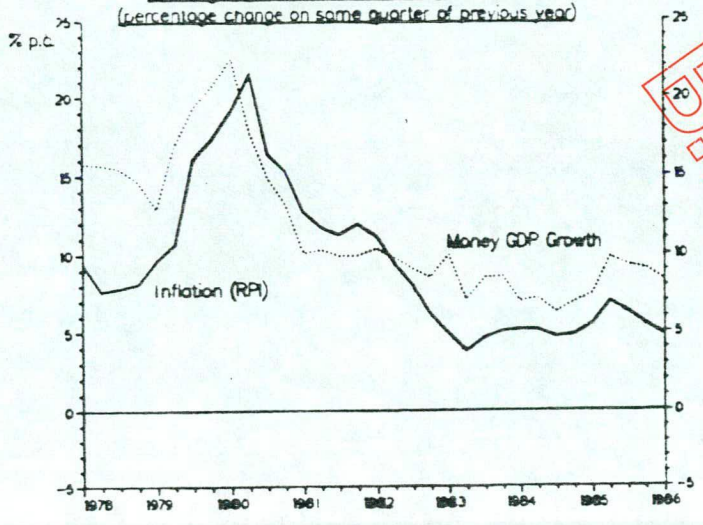

Chart 4

Money GDP and Output Growth

(percentage change on same quarter of previous year)

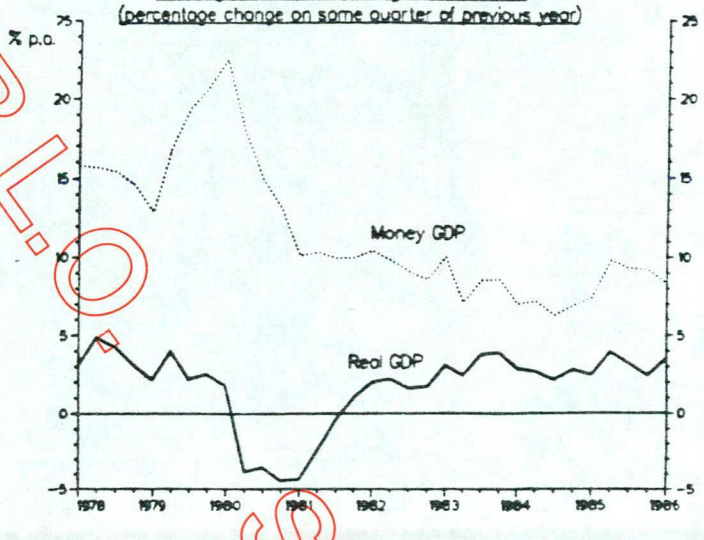

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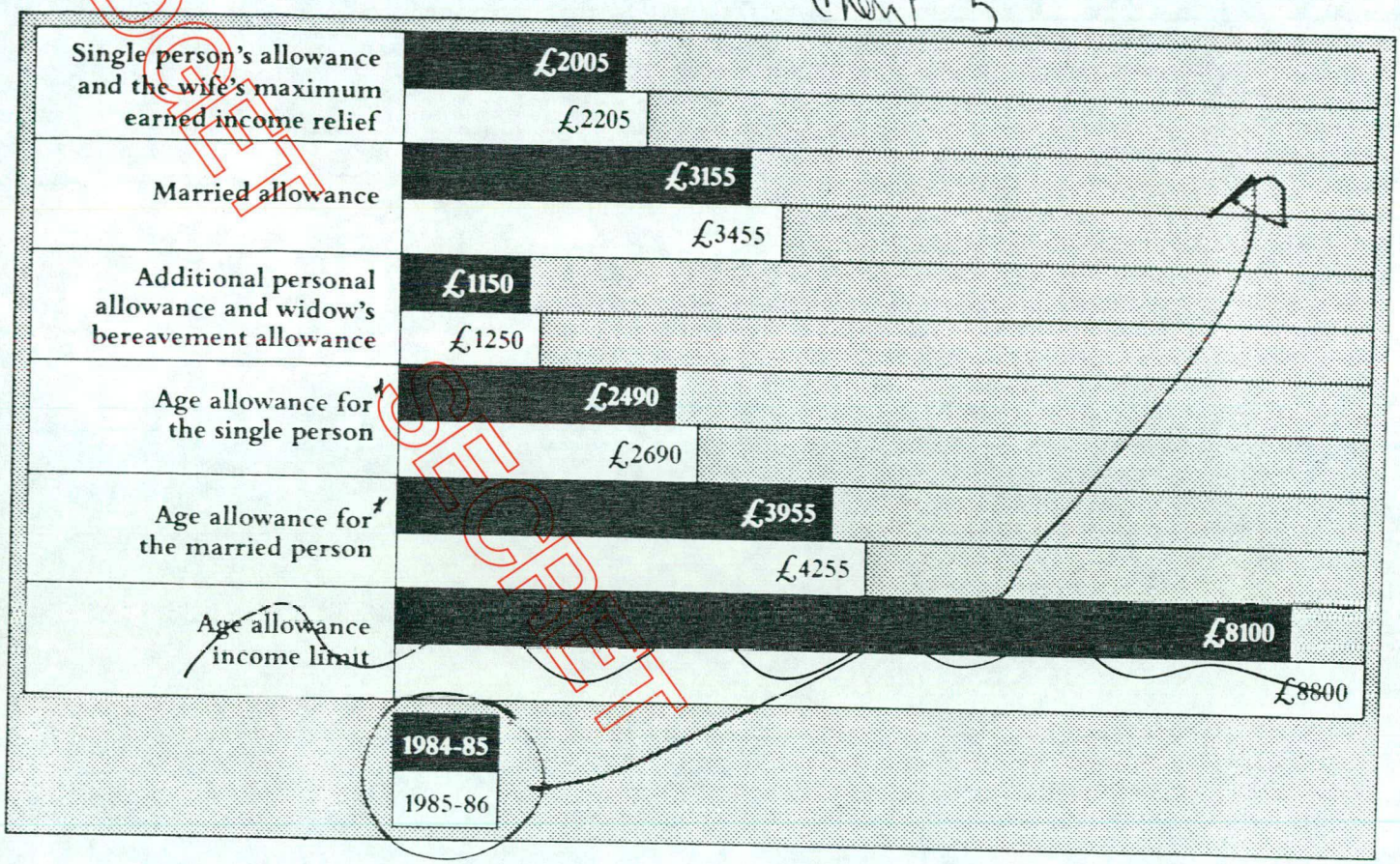
Chart 5



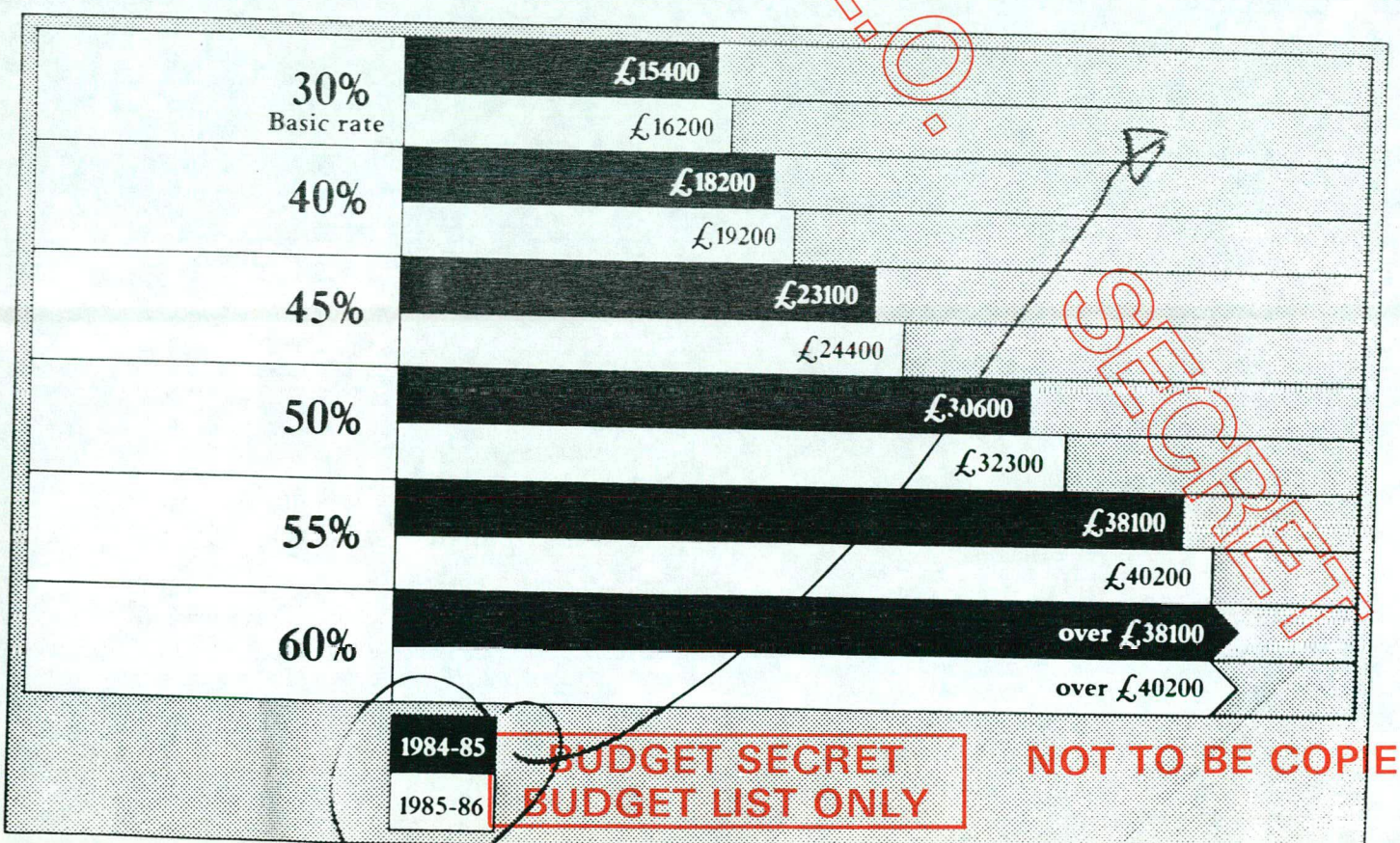


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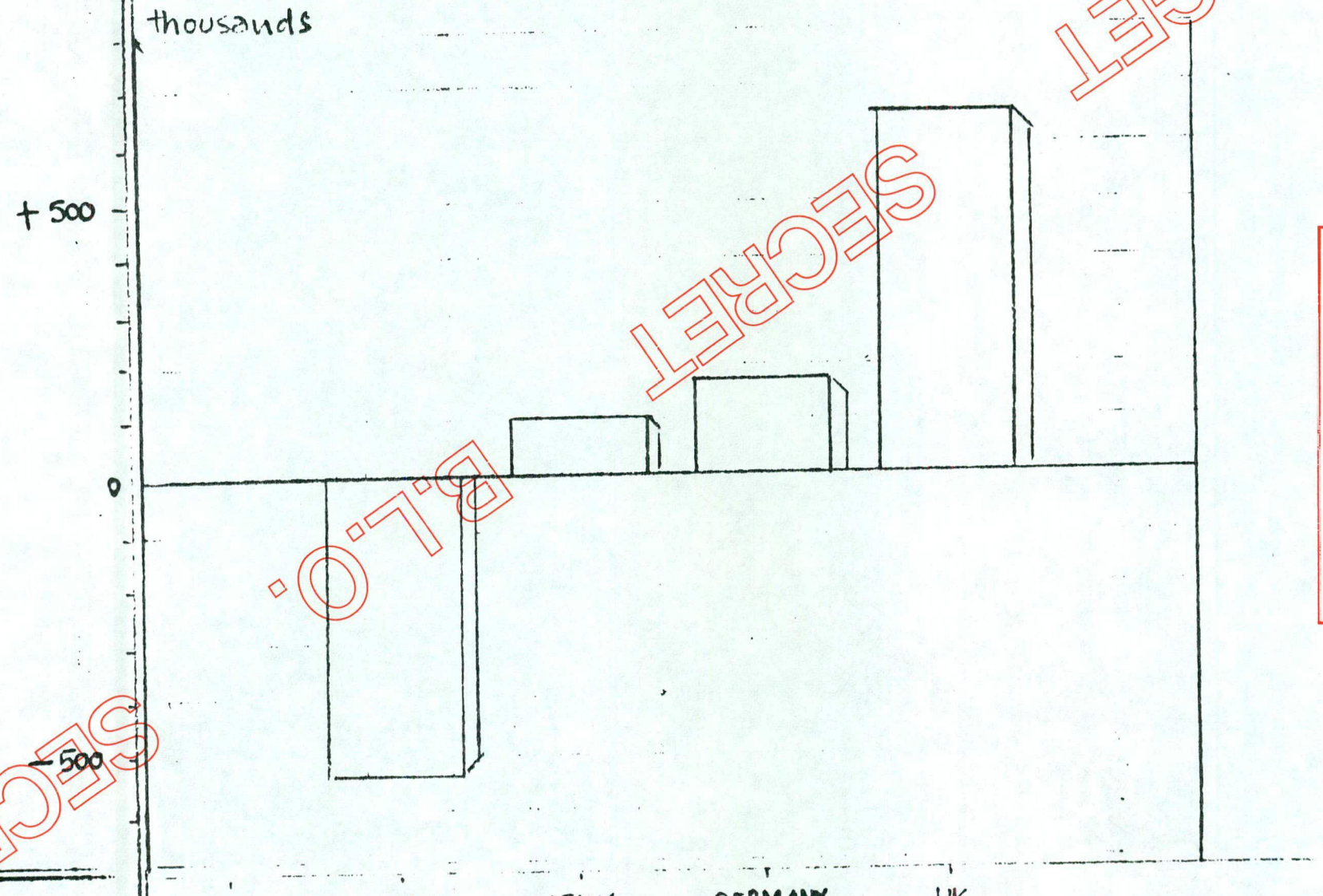
CHART 56



CHANGE IN EMPLOYMENT 1983-1985

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Table 3

CBI trends survey

(% balances)

	Jan 1984	Apr 1984	Jul 1984	Oct 1984	Jan 1985	Apr 1985
Optimism	+27	+26	− 3	− 5	+ 4	+18
Capital expenditure next 12 months	+20	+21	+14	+18	+11	+14
Numbers employed: next 4 months	−16	−12	−17	−15	−10	− 1
Volume of output: next 4 months	+20	+20	+16	+13	+19	+27
Average domestic prices next 4 months	+45	+36	+23	+34	+39	+30

Forward indicators

The April **CBI Industrial Trends Survey** indicated continued growth in manufacturing demand and output and an expected stabilisation of manufacturing employment. Business optimism rose significantly and recent movements are plotted in chart 7. Total order books stood at their best level since 1977. Recent results from the survey are summarised in table 3.

The monetary aggregates

Narrow money

'Narrow money' refers to money balances which are readily available to finance current spending, that is to say for 'transactions purposes'.

M0 (target aggregate)

Notes and coin held by the public and banks plus banks' holdings of cash (till money) plus banks' operational balances at the Bank of England (bankers' balances).

Broad money

'Broad money' refers to money held for transactions purposes and money held as a form of saving. It provides an indicator of the private sector's holdings of relatively liquid assets — assets which could be converted with relative ease and without capital loss into spending on goods and services.

Sterling M3 (£M3 — target aggregate)

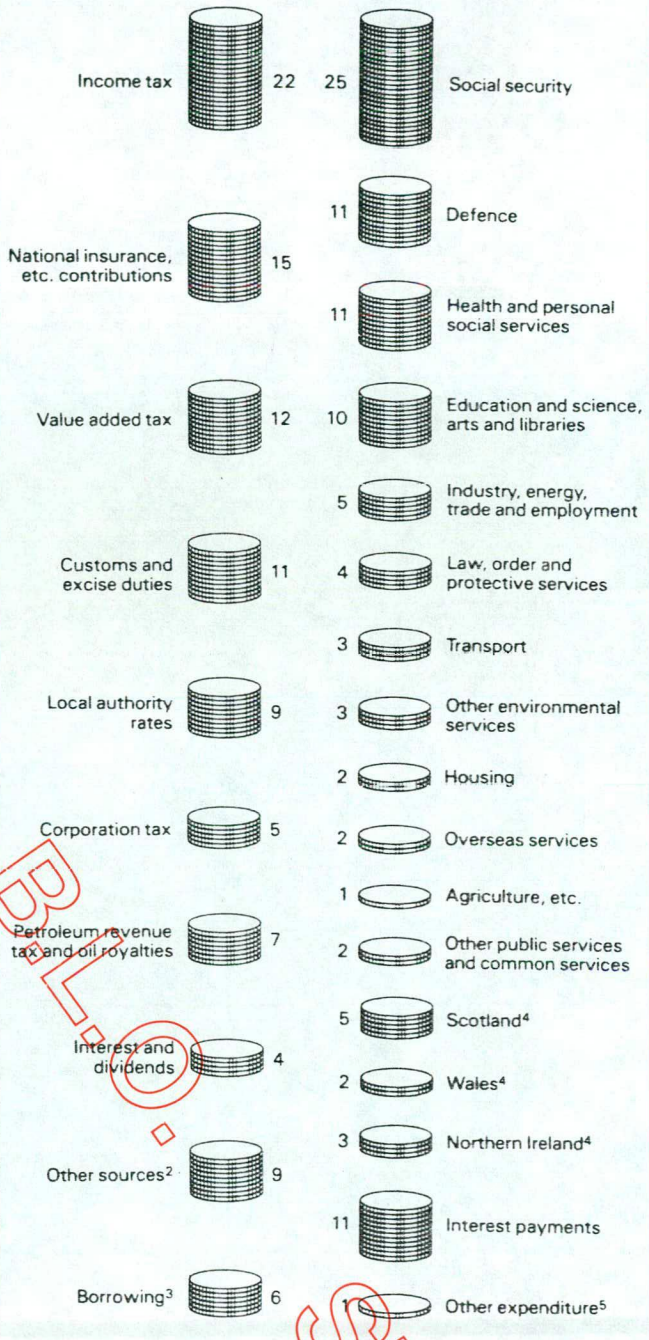
Notes and coin held by the public plus all private sterling deposits (sight and time) held by UK residents in UK banks.

See also the *Bank of England Quarterly Bulletin*, December 1982, page 530, March 1983, page 78 and March 1984, page 79. Monthly figures for these aggregates are given in the Central Statistical Office's *Financial Statistics* (obtainable from HMSO).

CHART 7

Public money 1984-85

Pence in every pound[1]



Cash totals of revenue and expenditure: £150 billion

[1] Rounded to the nearest penny. Because of rounding, expenditure items do not add to 100p.
[2] Including vehicle excise duty, taxes on capital, gross trading surplus and rent.
[3] By central and local government.
[4] Expenditure under the responsibility of the territorial Secretary of State.
[5] After deducting receipts from special sales of assets.

Source: Derived from *Financial Statement and Budget Report 1985-86*, table 5.4.

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TABLE 1.

Growth of the Money Supply and Money GDP

	1985–86	1986–87	1987–88	1988–89	1989–90
Money GDP[1]	9 (7¾)	6½	6¼	6	5½
M0[2]	3¼	2–6	2–6	1–5	1–5
£M3[2]	14¾	11–15			

[1] *Percentage change on previous financial year. See Table 2.2 for assumptions on output and inflation. The figure in brackets for 1985-86 is adjusted for the coal strike. The figure for 1986-87 is a forecast; and in subsequent years the figures describe the Government's broad medium term objective.*
[2] *1985–86: percentage change from mid-February to mid-February.*
1986–87: target ranges.
1987–88 onwards: illustrative ranges for M0.

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TABLE 2.

Output and Inflation Assumptions

Percentage change on previous financial year ⟶	1985–86	1986–87	1987–88	1988–89	1989–90
Real GDP					
Non-North Sea	3¾	3	2¾	2¾	2¾
Total	3½	2¼	2½	2½	2½
Inflation					
GDP deflator	5¾	3¾	3¾	3½	3

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TABLE 3

Public Sector Borrowing[1]

PSBR	10·1	7	7	7	7	7
PSBR as per cent of GDP	3·1	2	1¾	1¾	1½	1½

[1] *Rounded to the nearest £1 billion from 1985–86 onwards. Further details for 1985–86 and 1986–87 are provided in Table 6.5.*
[2] *Means lower taxes or higher expenditure than assumed in lines 1 and 2.*

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TABLE 4.

The prospects: summary

	Forecast	Average errors from past Forecasts[1]
A. Output and expenditure at constant 1980 prices	per cent changes 1985 to 1986	
Domestic demand	3½	1
of which:		
Consumers' expenditure	4	1
General Government consumption	1	1
Fixed investment	5	2½
Change in stockbuilding (as per cent of level of GDP)	0	¾
Exports of goods and services	5	2½
Imports of goods and services	6	2½
Gross domestic product: total	3	1
manufacturing	3	2½
B. Inflation		
Retail prices index	per cent changes	
1985Q4 to 1986Q4	3½	2
1986Q2 to 1987Q2	3½	3½
Deflator for GDP at market prices	per cent changes on a year earlier	
Financial year 1985–86	5½	1
Financial year 1986–87	3¾	2
C. Money GDP at market prices	per cent changes on a year earlier	
Financial year 1985–86	9	1½
Financial year 1986–87	7	1½
D. Balance of payments on current account	£ billion	
1986	3½	2½
1987 first half (at an annual rate)	1½	4
E. PSBR	£ billion[2]	
Financial year 1985–86	6¾ (1·9)	1 (¼)
Financial year 1986–87	[7] [(1·8)]	4½ (1½)

[1] *The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications and government forecasts (see Economic Progress Report June 1981). The calculations for the constant price variables [and the GDP deflator] are derived from forecasts made during the period between June 1965 and October 1983. For the current balance and the retail prices index, forecasts made between June 1970 and October 1983 are used. For the PSBR, Budget forecasts since 1967 are used. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.*

[2] *Per cent of GDP in market prices shown in brackets.*

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TABLE 5.

Budget Measures[1]

	£ million at current prices		
	1986–87 Changes from an indexed base	Changes from a non-indexed base	1987–88 Changes from a non-indexed base (yield(+)/cost(−))
Tax Proposals:			
Income tax basic rate	−950	−950	
Income tax allowances & thresholds	+15	−1 125	
Excise Duties—petrol/derv	+135	+475	
—VED	−135	+5	
—tobacco	+175	+315	
—alcohol	−175	Nil	
—gas oil	+25	+30	
—other minor oil duties	−25	−20	
Stamp duty—reduction in rate	−70	−70	
—extension of base	+70	+70	
Capital Transfer Tax	−35	−55	
Charities—package of reliefs	−10	−10	
—anti-abuse measures	Neg	Neg	
Pension Fund Surpluses	+25	+25	
Other tax changes	−25	−40	
Total tax measures	−980	−1 350	
Expenditure Measures:			
Loan Guarantee Scheme	Neg	Neg	+5
Enterprise Allowance Scheme	+5	+5	+35
New Workers Scheme	+25	+25	+50
Counselling Initiative	+85	+85	+45
Jobstart	+15	+15	+25
Community Programme	+60	+60	+120
Northern Ireland consequentials	+5	+5	+10
Total expenditure measures (gross)	+195	+195	+290
Offsetting reductions in social security benefits	−95	−95	−125
Net call on the Reserve	+100	+100	+165

[1] *These measures, and the basis of the costings shown, are described in detail in Chapters 4 and 5.*

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1986 paper

4. The Budget Tax and National Insurance Proposals

The Government's approach to taxation

4.01 The Government's aim is to reduce the burden of taxation as a proportion of Gross Domestic Product, within the overall financial framework of the Medium Term Financial Strategy. The Green Paper "The Next Ten Years: Public Expenditure and Taxation into the 1990s" (Cmnd 9189) outlined the framework within which the discussion of fiscal plans over the longer term could take place. The size and shape of tax changes in any year depend on many factors: they must above all ensure that the nation's finances are maintained on a sound footing. What is important is that annual changes should be part of a coherent approach to taxation over the longer term, designed to complement the Government's policies in other fields.

4.02 The Government has a number of objectives which influence its approach to taxation. These include stimulating enterprise and wealth creation; more freedom for individuals to decide how to spend money which they have earned; the encouragement of personal independence and of the voluntary sector; and the reform and rationalisation of the tax system.

Achievements

4.03 Considerable progress has already been made. Basic personal allowances have been increased by about 20 per cent in real terms since 1978-79. The top rate of income tax on earned income has been reduced from 83 per cent to 60 per cent; while the basic rate has been reduced from 33 to 30 per cent.

4.04 The Government initiated in 1984 a radical reform of business taxation. Corporation Tax was reduced from 52 per cent to 35 per cent for the financial year 1986. This is the lowest rate of any major industrialised country. The reform included the abolition of stock relief and phasing out of first year allowances for plant and machinery and initial allowances for industrial buildings. The burden of capital taxation has also been reduced.

4.05 Three taxes have been abolished: Investment Income Surcharge; Development Land Tax and National Insurance Surcharge.

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4.06 The need to adopt a cautious and prudent approach, in the light of lower oil prices and revenues, and uncertainty about the future, has limited the scope for overall tax reductions. Nevertheless, the tax proposals in this year's Budget represent a firm continuation of the Government's policies. The main changes in tax and national insurance contributions proposed in the Budget are summarised below. A full list of changes is given in the Annex to this Chapter.

Income Tax

4.07 Income tax personal allowances and higher rate thresholds will be increased by 5.7 per cent (the year on year increase in the RPI to December 1985, in line with the statutory indexation provisions). This will mean that

the single persons and wife's earned income allowances will rise from £2205 to £2335

the married allowance will rise from £3455 to £3655

the additional personal allowance and widow's bereavement allowance will rise from £1250 to £1320

the basic rate limit will rise from £16,200 to £17,200

National Insurance Contributions

4.08 From 5 October 1986, changes are proposed to national insurance contribution rates for certain low paid employees [and for the self employed]. Unless otherwise stated, the decisions announced on 12 November 1985 and taking effect on 6 April 1986 will continue to apply.

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- The existing reduced rates of Class 1 employees contributions of 5 per cent and 7 per cent will be cut by 1 percentage point to 4 per cent and 6 per cent respectively and a new reduced rate band of 8 per cent introduced for employees earning from £95 a week up to £140 a week. The full graduated structure of Class 1 rates will then be as follows:

Earnings £pw	Employer (no change) Rate payable on all earnings %	Employee Rate payable on all earnings %
38 to 59.99	5	4
60 to 94.99	7	6
95 to 139.99	9	8
140 to 285	10.45	9
285 and over	10.45	9% of 285

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- [The flat rate Class 2 contributions for the self employed will be reduced from £3.80 to £3.40 a week from 5 October 1986]

- [The Class 3 voluntary contributions will be reduced from £3.70 to £3.30 a week]

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Excise duties

4.09 The duties on cigarettes and hand rolling tobacco will rise by 13.6 per cent, equivalent to just over 11p on a packet of 20 cigarettes. Those on pipe tobacco and cigars will remain unchanged, as will all duties on alcoholic drinks.

4.10 Duties on road fuels will go up by a little more than 8 per cent or approximately 7.5p on a gallon of petrol and 6.5p on a gallon on derv.

Business Expansion Scheme

Encouragement of Enterprise

4.11 The Business Expansion Scheme has made a valuable contribution to the growth of risk investment and employment. It is therefore proposed to continue it after 1 April 1987 and to exempt new BES shares from CGT on first sale. Proposals to modify the scheme are being made to ensure that it provides effective encouragement to high risk investment. Some asset based activities are to be excluded.

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Capital Transfer Tax

4.12 In order to remove obstacles to outright giving, the lifetime CTT charge is to be abolished for gifts between individuals made on or after Budget Day. A charge will however be maintained on transfers involving trusts. Provision will be made to charge gifts in relation to which the donor may continue to enjoy a benefit. To reflect its new structure, the tax will be known as the Inheritance Tax.

4.13 Under the new arrangements, the yield from Inheritance Tax on deaths is to be protected by charging gifts within 7 years of death at taper rates. The exempt amount and rate bands of the tax will be increased by 5.7% under the statutory indexation provisions.

Encouragement of Wider Share Ownership

4.14 The Government propose to introduce a new tax scheme, as from 1 January 1987, specifically designed for individuals who invest directly in equities. Shares held in specially designated accounts will be free of any tax on both capital gains and dividend income, provided that such gains and income are reinvested within the account. Investment of up to £2,400 will be permitted each year and the shares will have to be held for a minimum period.

Stamp Duty

4.15 It is proposed that the rate of Stamp Duty should be reduced from 1 per cent to ½ per cent on share transactions. Since it is not proposed to reduce the overall amount of tax paid on financial transactions, the rate cut will be offset by widening the scope of duty to cover the following transactions (currently exempt):

	Rate %
American Depository Receipts (ADRs)	3
Intra-account dealing	½
Takeovers including mergers	½
Loan Stock	½
Renounceable letters	½
Company purchase of own shares	½

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Employee Share Schemes

4.16 To build on the progress already made in recent years, the following measures are proposed to encourage the spread of approved employee share schemes:

- the extension of the present tax relief to shares subject to a restriction requiring disposal when employment ends;

- easier access for employee controlled companies (and worker co-operatives);

- easier conditions on exercise of savings-related share options.

Pension Fund Surpluses

4.17 The Budget proposals tackle two problems relating to occupational pension schemes which have recently caused concern. It has been suggested that a number of pension schemes now have assets greatly exceeding the cost of their projected liabilities. But there is an undesirable degree of uncertainty about the options open to trustees of schemes when seeking to reduce such surpluses. It is proposed to clarify and reform the present rules as follows:

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- pension funds assets and liabilities will be valued, for these purposes only on standard assumptions provided by the Government Actuary;

- where such valuation shows an actuarial surplus of assets over liabilities of over 5%, the trustees will be required to reduce it to not more than 5%:

- the reduction can be made by (i) an increase in pension benefits (within existing limits), (ii) a contribution reduction or holiday by either employer or employee or (iii) a refund to the employer; or by any combination of these measures (but no refund will be permitted below 5 per cent);

- where a refund is made, it will be subject to a recovery charge in the employer's hands at a rate of 40%.

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Charitable giving

4.18 Four new types of tax relief are proposed:

- Companies - other than close companies - will for the first time be able to claim tax relief for single gifts to charity. The relief will be on single gifts up to a maximum equal to [2] per cent of the ordinary dividends paid by the company in an accounting period.

- To encourage charitable giving by other companies and individuals, the Government will remove the present annual limit of £10,000 on the amount of charitable giving through deeds of covenant for which an individual taxpayer may claim higher rate relief.

- There will be a new scheme to encourage individuals to make donations to charity through deductions from their wages and salaries. Employees whose employers participate in the scheme will be able to get tax relief on donations of up to £100 a year.

- VAT relief will be available on installation of distress alarms and lifts for the handicapped, most press advertising by charities, medicinal products, video and refrigeration equipment supplied to certain charities, recording equipment used by charities for the blind, and welfare vehicles used by charities to transport the deaf, blind or mentally handicapped.

4.19 Measures are also to be taken to prevent charitable status being abused by a minority of unscrupulous operators who are manipulating, for personal gain, the present rules for charitable relief.

Business taxation

4.20 The final stage in the business tax reforms introduced in 1984 will take effect on 1 April 1986 with the reduction in the main corporation tax rate to 35% and (with a few mainly transitional exceptions) the disappearance of first year and initial capital allowances. It is proposed to complete these reforms by updating the mines and oil wells capital allowances code, and adapting the system of allowances for agricultural buildings. In order to provide a full measure of tax depreciation for agricultural buildings and works with

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a short life, balancing adjustments will be available on their disposal or destruction if the taxpayer chooses.

Capital gains tax

4.21 To maintain its value, the CGT annual exempt amount is to be increased in accordance with the statutory indexation provisions by 5.7% from £5,900 to £6,300 in the case of individuals, and from £2,950 to £3,150 in the case of most trusts.

Oil taxation

4.22 No other changes are being proposed to oil taxation apart from technical changes to remove some anomalies.

Car and car fuel benefits

4.23 The scales which determine the cash equivalents of car and car fuel benefits received by directors and employees earning £8,500 or more are to be changed from 6 April 1987. The present 1300cc and 1800cc engine-size break points are to be aligned, on a revenue-neutral basis, with those - 1400cc-2000cc - for the EC Directive on exhaust emissions. The resulting scale charges for car benefits will be increased by 10 per cent. From April 1987 the same fuel benefit scales will be used both for income tax purposes and to assess the VAT chargeable on fuel used for private journeys in business cars.

Value Added Tax

4.24 From 19 March 1986 the registration limits will become £20,500 per annum and £7,000 per quarter.

Vehicle Excise Duty

4.25 The duty on most cars, light vans, lorries and motor cycles will remain unchanged. The duty rates on buses, coaches, taxis will rise by 5%.

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Table 4.2 Direct effects of changes in taxation measured against an indexed base.

£million

	Estimated effect on receipts in 1986-87 (a)	Estimated effect on receipts in 1987-88 (a)
INLAND REVENUE		
Income tax		
Increase in single allowance of £130 and married allowance of £200	Nil	Nil (b)
Increase in additional personal allowance and widow's bereavement allowance of £70	Nil	Nil (b)
Increase in age allowance of £180 (single) and £250 (married) and income limit of £600	Nil	Nil (b)
Increase in basic rate limit of £1000 to £17,200	Nil	Nil (b)
Increase in further higher rate thresholds	Nil	Nil (b)
Abolition of higher rate relief limit for charitable covenants	Negligible	-5
Relief for charitable donations through payroll deduction schemes	Nil	-20 (c)
Fringe benefits - car and car fuel scales	Nil	+15
Changes to relief for overseas travel expenses	-10	-5 (e)
Changes in taxation of employee share acquisitions	Negligible	Negligible (f)
Use of restricted shares in approved employee share schemes	Negligible	Negligible (g)
Use of shares providing employee control in approved employee share schemes	Negligible	Negligible
Exercise of options granted under approved savings-related share option schemes	Negligible	Negligible
[Co-operatives' use of redeemable shares in approved profit-sharing schemes	Negligible	Negligible]
[Change in basis of assessment of enterprise allowance	Negligible	-5]
Exemption of pensions paid to victims of Nazi persecution	Negligible	Negligible
Relief for dividends paid into recognised clearing systems	Nil	Nil
Extension of disclosure of information to local authorities	Nil	Nil
Income tax and capital gains tax		
Business Expansion Scheme- continuation beyond April 1987 and changes in coverage	Negligible	+10 (h)
Tax relief for equity savings scheme	Negligible	-25 (i)
Income tax and corporation tax		
Mines and oil wells capital allowances	Negligible	-45 (j)
Changes in agricultural buildings allowance rules	Negligible	Negligible (k)
Changes in capital allowance rules for leased assets	Negligible	Negligible
Changes in capital allowance rules for fixtures	Nil	Nil
VAT penalties, interest, surcharges and repayment supplement	Nil	Negligible (l)
[Relief for expenditure on research and development	?	?]
Income tax, corporation tax and capital gains tax		
Charities: anti-avoidance measures	Negligible	+20
Limiting scope of anti-bondwashing provisions	Negligible	Negligible
Amendments to Accrued Income Scheme	Negligible	Negligible

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Income tax, corporation tax, capital gains tax and capital transfer tax		
Changes in relation to securities	Negligible	Negligible
Income tax, corporation tax and recovery charge		
Refunds by occupational pension schemes	+20	+120 (a)
Corporation tax		
Relief for single donations to charity by companies	Negligible	-25 (n)
Loans by close companies	(o)	(o)
Transfer of losses on company reconstruction	Nil	+5 (p)
Definition of associated company for ring fence ACT set-off	Nil	Nil (q)
Corporation tax and capital gains tax		
Options and contracts for gilt-edged securities etc	Nil	Negligible
[Sale] part disposals of land	Nil	-5
Oil taxation		
Fields in common ownership, shared use of assets	Nil	Nil
[Disposal receipts in exempt gas fields	Negligible	Negligible]
Onshore/offshore boundary line	Negligible	Negligible [(r)]
Alternative gas valuation rules	Nil	Nil
Capital gains tax		
Indexation of annual exempt amount	Nil	Nil (b)
Restriction of holdover relief for dual resident trusts	Nil	+5
Capital transfer tax and inheritance tax		
Abolition of lifetime charge on transfers between individuals	-35	-35 (s)
Indexation of chargeable rate bands	Nil	Nil (b)
Partially exempt estates	Negligible	Negligible
[Extension of exemption for share transfers to employee trusts	Negligible	Negligible]
Stamp duties		
Reduction in rate on shares to 0.5 per cent from Autumn 1986	-70	-75 (t)
Extension of duty to takeovers etc	+20	+20
Withdrawal of exemption for loan stock and purchases of own shares	+20	+20
Duty on conversion to depositary receipts	[+10]	[+10]
Other changes	+20	+35
TOTAL INLAND REVENUE	[-25]	[-5]

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CUSTOMS AND EXCISE

Value added tax

Increase in registration limits	Nil	Nil
Revised treatment of motoring expenses	Nil	+40]
New rules on disaggregation of registrations	Negligible	+20
Long term lettings of accommodation	Nil	+10
Reliefs for charities and the handicapped	-10	-10

Excise duties

No change in rate of spirits duty	-45	-45 (c)
No change in rate of beer duty	-95	-105 (c)
No change in rate of duty on cider and perry	-5	-5 (c)
No changes in rates of wine and made wine duties	-30	-35 (c)
Increases in rates of duty on light oil etc	+110	+120 (c)
Increase in rate of duty on heavy oil for use in road vehicles	+30	+30 (c)
No change in rate of fuel oil duty	-5	-5 (c)
Abolition of duty on lubricating oils	-10	-10 (c)
Abolition of duty on AVTUR	-10	-10 (c)
Increase in rate of duty on gas oil	+25	+25 (c)
Increases in rates of tobacco products duties	+175	+180 (c)
TOTAL CUSTOMS AND EXCISE	+130	+200

Vehicle excise duty

No change in VED on cars and lorries	-135	-140]
Increased penalties for VED evasion	Neg	+10

Other

Bus fuel grants	-5	-5
TOTAL CHANGES IN TAXATION	[-35]	[+60]

National Insurance Contributions reduction in rate for earnings below £140 pw	-150	-400
Total changes in taxation in National Insurance contributions	-185	-340

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a. Estimates are rounded to the nearest £5million. 'Negligible' means less than £3million. Components may not sum to totals because of rounding. A detailed list of the proposals is contained in Annex [ ] with a description of the method of estimating the direct effects on revenue.

b. Taxes subject to statutory indexation. The table below shows the direct revenue effects of indexing the income tax main allowances and thresholds (which are shown as the first five lines in Table 4.2 above), the capital gains tax exempt amount and the capital transfer tax threshold and bands.
Indexation in 1986-87 is by reference to the increase in the general index of retail prices between December 1984 and December 1985 (5.7per cent), rounded in accordance with the statutory provisions. For 1987-88 further indexation of [3.6]per cent is assumed (in line with the MTFS).

Direct Revenue effects £million

	Indexation		Effect of proposed Budget 1986 changes compared with indexation		Total	
	1986-87	1987-88	1986-87	1987-88	1986-87	1987-88
Income tax						
Main allowances	-1020	-1995	Nil	Nil	-1020	-1995
Basic rate limit	-70	-205	Nil	Nil	-70	-205
Further higher rate thresholds	-50	-100	Nil	Nil	-50	-100
Total income tax	-1140	-2300	Nil	Nil	-1140	-2300
Capital gains tax						
Exempt amount	Nil	-5	Nil	Nil	Nil	-5
Capital transfer tax						
Thresholds and bands	-20	-60	Nil	Nil	-20	-60

c. The table below shows the direct revenue effects of indexing the excise duties by reference to the increase in the general index of retail prices between December 1984 and December 1985 (5.7 per cent) and the forecast increase between December 1985 and December 1986 ([3.6]per cent).

Direct Revenue effects £million

	Indexation		Effect of proposed Budget 1986 changes compared with indexation		Total	
	1986-87	1987-88	1986-87	1987-88	1986-87	1987-88
Commodity						
Beer, cider and perry	+100	+170	-100	-110	Nil	+60
Wine	+30	+55	-30	-35	Nil	+20
Spirits	+45	+75	-45	-45	Nil	+30
Tobacco	+140	+255	+175	+180	+315	+435
Petrol	+270	+470	+110	+120	+380	+590
Derv	+65	+120	+30	+30	+95	+150
VED	+140	+230	-135	-140	+5	+90
Minor duties	+10	+20	Nil	Nil	+10	+20
Bus fuel grants	-5	-10	-5	-5	-10	-15
Total	+795	+1385	Nil	-5	+795	+1380

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d. This estimate is highly uncertain and depends on take-up.
e. The higher first year cost arises from the proposal to apply these improvements with effect from 6 April 1984.
f. Full year yield at 1986-87 income levels, £5million. This estimate is highly uncertain.
g. Full year cost at 1986-87 income levels, £10million. This estimate is highly uncertain.
h. The scheme has a full year cost at current levels of investment of about £100million. The 1987-88 figure includes a small first year cost for continuing the scheme after April 1987.
i. The cost will build up over a period and will depend on take-up. This estimate is highly uncertain.
j. The cost will decline gradually in later years.
k. Cost will not exceed £5million in early 1990's. Long term cost not exceeding £20million.
l. The yield will build up over time to about [£40million] by 1991-92.
m. The figure for 1987-88 includes a yield of £[70]million in corporation tax and income tax reflecting changed levels of contributions to or benefits paid from pension funds. [The overall yield including recovery charge may be about £[250]million in each of the following three years. These estimates are highly uncertain.
n. Rising to about £70million, depending on take-up.
o. Without this measure the anomaly in the treatment of loans to participators in close companies could have led to widespread avoidance, costing tens of £millions.
p. Rising to an eventual yield of about £50million a year.
q. Without this measure it might be possible to breach the ring fence which could result in a loss of tax.
[r. These figures cannot be directly compared with those of the yield from the removal of immediate PRT exploration and appraisal relief for onshore fields given in the 1985-86 FSBR. In the light of revised forecasts of exploration and appraisal expenditure, the yield from withdrawing this relief from areas within the UK coastline is now estimated to be [£ million] in a full year.]
s. The estimated eventual effect attributable to transfers in 1986-87 is £70million. If increased lifetime giving reduces the amounts in the death estates of donors, the CTT yield from those death estates will be reduced. But the effects are long-term and uncertain.
t. Duty on additional transactions expected to follow from the reduction in the rate is taken into account. The estimate is subject to a wide margin of error. The figure for 1987-88 takes account of a yield of £35million capital gains tax arising on the additional transactions.

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Annex to Chapter 4

The Budget Proposals in Detail

Income tax

It is proposed -

to increase the single person's allowance and the wife's maximum earned income relief from £2,205 to £2,335 and the married allowance from £3,455 to £3,655

to increase the additional personal allowance and widow's bereavement allowance from £1,250 to £1,320

to increase the age allowance for the single person from £2,690 to £2,850, for the married from £4,255 to £4,505 and the age allowance income limit from £8,800 to £9,400

to increase the basic rate limit to £17,200

to increase the width of the 40 per cent band to £3,200, of the 45 per cent band to £5,500 and of the 50 per cent and 55 per cent bands to £8,400.

As a consequence of these changes, the structure of personal tax rates in operation in 1986-87 will be:

Bands of Taxable Income £	Per cent
0-17,200	30
17,201-20,400	40
20,401-25,900	45
25,901-34,300	50
34,301-42,700	55
over 42,700	60

It is also proposed -

to abolish the £10,000 limit on higher rate relief for covenanted donations to charities

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to introduce from April 1987 relief for charitable donations up to £100 a year made through payroll deduction schemes

to change on a revenue neutral basis, with effect from 1987-88, the present engine size breakpoints in the scales for taxing car and car fuel benefits in respect of company cars provided to directors and to employees whose remuneration is at a rate of £8,500 a year or more, and to increase the new scale for car benefits by 10 per cent

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to extend the relief for overseas travel expenses incurred by UK employees working abroad and by expatriates working in the UK, and to extend to UK self-employed persons with businesses wholly abroad all of the reliefs for overseas travel and subsistence that are available to UK employees working wholly abroad. Changes to apply from 1984-85

to amend the tax charging provisions relating to directors' and employees' acquisitions of shares and interests in shares in their companies

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to permit the use in approved employee share schemes of shares subject to restrictions on their retention by ex-directors and ex-employees

to permit the use in approved employee share schemes of shares of a class the majority of which is held by directors and employees and which gives them control of the company

to enable approved savings-related share option schemes to permit exercise of options within three years in certain circumstances

[to enable [registered bona fide co-peratives/worker co-operatives] to use redeemable shares in approved profit sharing schemes]

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[to change the basis of assessment of the enterprise allowance from Case I to Case VI of Schedule D.]

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to exempt certain pensions paid to victims of Nazi persecution

to exempt from the requirement to deduct tax certain dividends in respect of securities held in recognised clearing systems

to allow the Department of Employment to pass on to local authorities certain specified information supplied to that Department from the Inland Revenue Employers' Index.

Income tax and capital gains tax

It is proposed -

to extend indefinitely the duration of the Business Expansion Scheme, to introduce an exemption from capital gains tax on the first sale of qualifying shares and to make certain changes to the coverage of the scheme.

Income tax and corporation tax

It is proposed -

to amend the mines and oil wells capital allowances; in particular to change to percentage based writing down allowances on a reducing balance and incurred basis, instead of the existing output-related allowances

to amend the provision governing the agricultural buildings allowance

to amend the legislation relating to capital allowances on machinery or plant which is leased

to amend the capital allowance provisions in respect of fixtures to provide for loaned equipment

to disallow deductions for VAT penalties, interest and surcharges and to disregard VAT repayment supplement

[to provide immediate relief for expenditure incurred on research and development by a company which is not yet trading]

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Income tax, corporation tax and capital gains tax

It is proposed -

to introduce a new tax relief for individuals investing in equities

to introduce provisions to counter abuse of the tax reliefs for charities

to remove certain securities within the Accrued Income Scheme from the scope of the anti-bondwashing provisions

to make minor amendments to the Accrued Income Scheme

Income tax, corporation tax, capital gains tax and capital transfer tax

It is proposed -

to make changes in relation to securities replacing special rates for Stock Exchange jobbers by rules for market makers

Income tax, corporation tax and recovery charge

It is proposed -

to introduce a tax recovery charge on payments from over-funded occupational pension schemes to sponsoring employers

Corporation tax

It is proposed -

to introduce a relief from tax for single donations to charity by companies which are not close

to correct an anomaly in the taxation of loans to participators in close companies

to restrict the transfer of tax losses on a company reconstruction

to make a technical amendment to the definition of associated company for ring fence ACT set-off purposes

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Corporation tax and capital gains tax

It is proposed -

to exempt, with effect from 2 July 1986, gains on the disposal of any option or contract to acquire or dispose of gilt-edged securities or qualifying corporate bonds

[to amend the provisions dealing with small part disposals of land]

[to give exemption for onshore venture capital companies]

Oil taxation

It is proposed -

to clarify allocation of tariff charge in cases of fields in common ownership which received development consent on same day

[to exempt certain disposals in wholly exempt gas fields]

to ensure that the onshore/offshore boundary for oil tax purposes coincides with the UK coastline

to provide an alternative basis for determining the market value of methane and certain other light gas

Capital gains tax

It is proposed -

to increase the annual exempt amount in line with the increase in the retail prices index so that for 1986-87 an individual will be exempt on the first £6,300, and most trusts on the first £3,150, of capital gains

to amend the hold-over relief for gifts to dual resident trusts

Capital transfer tax and inheritance tax

It is proposed -

to abolish the charge on transfers between individuals made on or after 18 March 1986 and more than 7 years before the transferor's death, and to charge inheritance tax on other transfers on or after that date

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to charge transfers made on or after 18 March 1986 but within 7 years of the transferor's death as tapered amounts of tax due on the death rate scale

It is proposed, for events on or after 18 March 1986 -

to reduce from 10 to 7 years the period for cumulation of a transferor's or settlor's previous chargeable transfers for the purpose of the rate of tax on transfers into trust and on property held in trust.

It is proposed -

to tax gifts with reservation of benefit made on or after 18 March 1986 in connection with the donor's death as if the whole of the gifted asset had remained in his estate until the reservation was finally given up

to increase the bands of chargeable value for transfers on deaths occurring on or after 18 March 1986, in line with the increase in the retail prices index as follows:

Band of chargeable value £000	Rate on death per cent
0- 71	0
71- 95	30
95-129	35
129-164	40
164-206	45
206-257	50
257-317	55
Over 317	60

to charge at half the death rates transfers (other than between individuals) not within 7 years of the transferor's death

to amend the rules concerning the interaction of partially exempt transfers and business and agricultural reliefs

[to extend the exemption for transfers of shares in a company to an employee trust]

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Stamp duties

It is proposed with effect from 19 March 1986 -

to charge duty at a rate of 0.5 per cent on takeovers and certain other company reorganisations

to introduce a new exemption for company reconstructions

to withdraw exemptions from sale duty for certain categories of loan stock and purchases by a company of its own shares

to withdraw the exemption from bearer instrument duty for bearer letters of allotment

to charge duty at 3 per cent on the conversion of shares into depository receipts

It is proposed with effect from a date in the autumn:

to reduce the rate of duty on transfers of shares to 0.5 per cent

to impose a tax on certain share transactions which do not at present pay stamp duty

to withdraw the exemption from sale duty for letters of allotment

to change the rate of duty on bearer instruments

Value Added Tax

It is proposed -

to increase the registration limit to £20,500 per annum and £2,000 per quarter

to make VAT relief available for charities on installation of distress alarms and lifts for the handicapped, most press advertising by charities, medicinal products, video and refrigeration equipment supplied to certain charities, recording equipment used by charities for the blind, and welfare vehicles used by charities to transport the deaf, blind or mentally handicapped

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to define the VAT treatment of accommodation in a hotel more closely, and in particular to restrict provision relating to long stays to stays by individuals (to take effect from 1 November 1986)

to change the law to counter tax avoidance by artificial disaggregation of businesses

Excise duties

It is proposed -

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to increase the duties on cigarettes and hand rolling tobacco by [11.2p] per packet of 20 cigarettes

to increase the duties on road fuels by [7.5p] a gallon and on derv by [6.5p] a gallon

to abolish the duties on aviation kerosene and lubricating oils

to increase the duty on gas oil by [1.5p] per gallon

Vehicle Excise Duties

It is proposed -

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to increase from 19 March 1986 the rate of duty for hackney carriages of up to 20 seats to £52.50, and the additional payment for each additional seat to £1.05. The concessionary rates of duty for farmers' heavy goods vehicles over 7.5 tonnes, will be increased by varying amounts as a second stage in the process of bringing them into line with the proportion of average mileage covered by these vehicles on public roads

to increase from 1 January 1987 the rate of duty for trade licences to £70 for cars and £14 for motorcycles. The increase in trade licence rates will be part of a package of measures reforming trade licence arrangements, including widened availability and changes in the duration for which they are available to 6 months and 12 months. A new type of probationary trade licence is also to be introduced for new businesses and for businesses where there is a doubt whether there is sufficient business to justify a full licence.

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ANNEX 6.A: Relationship between Tables in Chapter 6

6A.1 Table 6.7 is based on the definitions used to compile the national accounts. In order to show the financial deficit (which is often used in international comparisons), lending and other financial transactions are separated from the analysis of receipts and expenditure in lines [1-23] and shown in lines [25-29]. These lines show the relationship between the financial deficit and the borrowing requirement.

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6A.2 Table 6.6 is a summary version of Table 6.7, showing the public sector only, but separating current and capital expenditure in order to show the current surplus. Also, in order to give a clearer picture, capital spending in Table 6.6 includes defence capital and excludes asset sales, as in Table 1.14 of the Public Expenditure White Paper. (However, unlike the White Paper table, capital spending in both Tables 6.6 and 6.7 also includes expenditure by nationalised industries prior to privatisation, changes in the level of stocks, and certain national accounts adjustments.) Taxes on capital are included in current receipts in Table 6.6.

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6A.3 Tables 6.3-6.5 are summary versions of the sectoral columns of Table 6.7. The information in Table 6.7 is rearranged so that, for example, central government grants to local authorities (which appear as negative expenditure in the local authorities column of Table 6.7, lines 17 and 22) appear as receipts in Table 6.4. Also, interest paid by local authorities to central government (which appears as negative receipts in the local authorities column of Table 6.7, line 8) appears as expenditure in Table 6.4. Finally, lending and other financial transactions (lines 25-29 of Table 6.7) are included in the receipts and expenditure of Tables 6.3-6.5.

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6A.4 Table 6.1 uses the same information as Table 6.7, but again rearranges it. To derive general government expenditure, it starts by giving a functional breakdown of the public expenditure planning total: that includes not only general government expenditure in the third column of Table 6.7 (including some of the "financial transactions" in lines 25-29), but also borrowing or capital

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expenditure by public corporations in the fourth column. General government expenditure as shown in Table 6.1 is then obtained by adding general government debt interest from the third column of Table 6.7 and the national accounts adjustments already included in Table 6.7, and deducting public corporations' borrowing from the market and overseas.

6A.5 Alternatively, general government expenditure in Table 6.1 (and table [2.4]) can be obtained as the sum of lines 23, 25 and 26 (third column) in Table 6.7 and on-lending to public corporations in Table 6.5.

6A.6 To derive general government receipts, Table 6.1 takes the receipts shown in the third column of Table 6.7 (lines 12, 27, 28 and 29) and rearranges them according to the type of activity which gives rise to them. For example, oil revenues comprise North Sea corporation tax and petroleum revenue tax (included in "taxes on income" in Table 6.7) plus oil royalties. The sub-total "total taxes and royalties" is the same as the first line of Table [2.3] in Chapter 2.

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Table 6.B.1 Summary of Central Government Transactions

£ billion

	1985-86 Latest estimate	1986-87 Forecast
Consolidated Fund		
Revenue (Table 6.B.3)	106.1	109.8
Expenditure (Table 6.B.2)	-110.2	-114.5
Deficit met from National Loans Fund	4.2	4.7
National Loans Fund		
Receipts (Table 6.B.4)	14.3	15.4
Payments (Table 6.B.4)	-19.2	-19.1
Consolidated Fund deficit (as above)	-4.2	-4.7
Total net borrowing by the National Loans fund	**-9.1**	**-8.4**
Other funds and accounts (net)	**-1.0**	**-0.7**
Central Government Borrowing Requirement (including borrowing for on-lending to local authorities and public corporations)	**-10.2**	**-9.1**

Table 6.B.2 Consolidated Fund Expenditure

£ million

	1985-86 Latest estimate	1986-87 Forecast
Supply Issues[1]	**98200**[2]	**101100**
Standing Services		
Payment to the National Loans Fund in respect of Service of the National Debt	7600	8500
Northern Ireland-share of taxes etc.	1800	1900
Payments to the European communities	2600[2]	2800
Other	60	50
Total Standing Services	12100	13300
Total Consolidated Fund expenditure	**110200**	**114500**

[1]Supply Issues are monies paid from the Consolidated Fund to Departments' cash accounts with the Paymaster General for spending on Supply. Supply Expenditure (see Table 5.) equates closely to total Supply Issues in most years, although there may sometimes be slight timing differences between the two.
[2] £970 million was paid to the European Communities from Supply Issues instead of Standing Services.

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Table 6.B.3 Consolidated Fund Revenue

£ million

	1985-86		1986-87
	Budget forecast	Latest estimate	Forecast
Inland Revenue-			
Income tax	35200	35100	39300
Corporation tax[1][2]	10100	10800	11900
Petroleum revenue tax[3]	8200	6630	2460
Capital gains tax	790	900	1000
Development land tax	55	60	35
Capital transfer tax[4]	760	880	920
Stamp duties	1100	1230	1400
Recovery charge	-	-	25
Total Inland Revenue	*56200*	*55600*	*57040*
Customs and Excise-			
Value added tax	18300	19300	20700
Petrol, derv etc. duties	6500	6500	7300
Cigarettes and tobacco	4300	4300	4800
Spirits, beer, wine, cider and perry	4200	4200	4400
Betting and gaming	700	740	800
Car tax	760	880	980
Other excise duties	20	20	20
EC own resources[5]			
Customs duties, etc.	1400	1200	1300
Agricultural levies	100	160	160
Total Customs and Excise	*36300*	*37300*	*40500*
Vehicle excise duties[6]	2500	2400	2500
National Insurance surcharge	30	30	-
Oil royalties	2500	2000	950
Gas Levy	520	520	500
Broadcasting receiving licences	790	980	1000
Interest and dividends	870	990	840
Other[7]	6700	6400	6500
Total Consolidated Fund revenue	**106500**	**106100**	**109800**

[1] Includes advance corporation tax (net of repayments) 3600 3900 4400

[2] North Sea corporation tax 2800 3030 2600
of which satisfied by setting off ACT 1200 1180 1100
Liability to corporation tax arising in respect of North Sea production may be satisfied by setting off ACT arising on dividends paid in previous periods in respect of both onshore and offshore activities. Dividends and ACT associated with North Sea activities alone cannot be identified.

[3] Includes advance payments of petroleum revenue tax.

[4] Includes estate duty 4 6 5

[5] Customs duties and agricultural levies are accountable to the European Communities as 'own resources' actual payments to the Communities are recorded in Table 6.B.2.

[6] Includes driving licence receipts.

[7] Includes the 10 per cent of 'own resources' refunded by the European Communities to meet the costs of collection, other receipts from the European Communities and central privatisation proceeds.

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Table 6.B.4 National Loans Fund Receipts and Payments

£ million

	1985-86	1986-87
	Latest estimate	Forecast
Receipts		
Interest on loans, profits of the Issue Department of the Bank of England, etc.	6700	6900
Service of the National Debt–balance met from the Consolidated Fund	7600	8500
Total	**14300**	**15400**
Payments		
Service of the National Debt		
Interest	14100	15300
Management and expenses	170	170
Total Service of the National Debt	14300	15400
Loans to:		
Nationalised industries	180	-680
Other public corporations	260	210
Local authorities	4400	4000
Private sector and within central government	100	140
Total National Loans Fund lending[1]	5000	3700
Total	**19200**	**19100**

[1]On-lending to local authorities and public corporations in Tables 6.4 and 6.5 includes, in addition to National Loans Fund lending, net lending from other funds and accounts (mainly Supply Issues in table 6.B.2).

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FROM: R PRATT
DATE: 14 MARCH 1986

CHANCELLOR OF THE EXCHEQUER

FSBR

... I attach a photocopy of the FSBR as it was returned to the printer this afternoon.

Richard Pratt

RICHARD PRATT

Thanks.

I suggest Chancellor

Table 1.2 to M Pearce cc (1) debt li as sho

l.c.

Table 1.1 Budget Measures[1]

	£ million ~~at current prices~~		
	1986–87 Changes from an indexed base	Changes from a non-indexed base	1987–88 Changes from a non-indexed base (yield(+)/cost(−
Tax Proposals:			
Income tax basic rate [2]	−950	−950	−1305
Income tax allowances & thresholds	+15	−1125	−1470
Excise Duties—petrol/derv	+135	+~~475~~465	+695
—VED	−135	+5	+10
—tobacco	+175	+315	+335
—alcohol	−175	Nil	Nil
—gas oil	+25	+30	+30
—other minor oil duties	−25	−20	−20
Stamp duties—reduction in rate	−70	−70	−75
—extension of base	+70	+70	+85
Capital Transfer Tax (Inheritance tax)	−35	−55	−100
Charities—package of reliefs	−10	−10	−70
—anti-abuse measures	Neg	Neg	+20
Pension ~~Fund Surpluses~~ ~~scheme refunds~~ fund surpluss rules	+~~25~~20	+~~25~~20	+120
Other tax changes	−~~25~~25	−~~40~~25	+60
Total tax measures	−~~980~~5	−1350	−~~1885~~
Expenditure Measures:			(cost(+)/saving(−))
(5) Loan Guarantee Scheme	Neg	Neg	+5
(4) Enterprise Allowance Scheme	+5	+5	+35
(3) New Workers Scheme	+25	+25	+50
(1) ~~Counselling Initiative~~ ~~Jobstart allowances~~	~~+85~~ +100	~~+85~~ +100	~~+45~~
~~Jobstart allowances~~	~~+15~~	~~+15~~	~~+25~~
(2) Community Programme	+60	+60	+120
~~Northern Ireland consequentials~~	~~+5~~	~~+5~~	~~+10~~
Total expenditure measures (gross)[3]	+195	+195	+290
Offsetting ~~reductions~~ in social security benefits	−95	−95	−125
Net call on the Reserve	+100	+100	+165

[1] *These measures, and the basis of the costings shown, are described in detail in Chapters 4 and 5.*

[2] Figures include the change in the consequential change in the rate of NIC

[3] Including Northern Ireland consequentials

Counselling initiative and Jobstart allowance

Regular stub, as shown, but do not print number

In this and other tables in this Financial Statement and Budget Report, the components may not add to the totals because of rounding.

1 The Budget

1.01 The objective of the Government's economic policy is to defeat inflation and establish a vigorous, enterprising, economy which will generate sustained growth and increased employment.

1.02 The Financial Statement and Budget Report supplements the Chancellor's Budget Statement. It describes the Medium Term Financial Strategy (MTFS); outlines developments in the economy over the past year; provides forecasts to mid–1987; details the government's tax proposals; summarises the public expenditure elements in the Budget; and brings together the financial position of the public sector.

The medium term financial strategy

1.03 Chapter 2 describes the MTFS, which provides the framework for all economic policy decisions. Monetary and fiscal policy is set to bring about lower inflation while providing for continued growth in output. Micro–economic policies are designed to ~~enhance~~ the prospect for output and employment by improving incentives, removing unnecessary controls, ensuring that markets work properly—and generally improving the adaptability of the economy.

1.04 The measures in the Budget are designed to strengthen these policies and to reduce the burden of taxation and the role of the state in the economy. ~~Both tax and expenditure are on a declining path as a proportion of GDP.~~ and expenditure are on a declining path as a proportion of GDP

Forecast

1.05 Chapter 3 describes the main developments in the economy and the prospect for the next 18 months. The sharp fall in oil prices will sustain growth and reduce inflation in the world economy, and will help industry, ~~in this country~~. Inflation in the United Kingdom is set to fall further—to 4 per cent in 1986. Output is expected to continue to grow by around 3 per cent. Investment and exports are forecast to grow more rapidly. The balance of payments may be in surplus by £4 billion in 1986 even though oil prices are low.

Tax measures

1.06 Chapter 4 sets out the tax proposals in the Budget. They include a cut of 1p in the basic rate of income tax; a new scheme for tax–free investment in equities; the abolition of Capital Transfer Tax on lifetime gifts; and a substantial package of assistance to charitable giving. Table 1.1 below summarises the effect of all these measures.

Public expenditure

1.07 Chapter 5 describes the public expenditure measures announced in the Budget designed to help the unemployed. The new pilot schemes for the long term unemployed (counselling and the Jobstart Scheme) are to be ~~extended nationwide~~. The rate of entry into the Enterprise Allowance Scheme will ~~also~~ be increased. A new scheme—the New Workers

Scheme—will be introduced, providing for payments to employers of 18–20 year olds where the wages are below specified limits. The Community Programme will be ~~expanded by~~ raised to 255000 places this year.

Borrowing

1.08 Chapter 6 brings together the complete financial picture for the public sector. The public expenditure measures will be financed from the Reserve and thus do not add to the public expenditure planning total. ~~Taxes are reduced by almost £1 billion. The public sector borrowing requirement is set at some £7 billion—1¾ per cent of GDP. This is slightly below the level indicated in the MTFS published in last year's FSBR.~~ Table 1.2 ~~below~~ summarises the sources of the receipts and the direction of expenditure.

The public sector borrowing requirement is set at some £7 billion, or 1¾ per cent of GDP – slightly below the level indicated in the MTFS published in last year's FSBP. The Budget measures are expected to contribute £1 billion to this figure, over and above the cost of indexing tax rates and allowances and revalorising excise duties.

Table 1.2 The public sector's finances analysed by function

	£ billion		
	1985–86		1986–87
	1985 Budget[1]	Latest estimate	Forecast
RECEIPTS			
Income taxes[2]	35·3	35·6	35·7
Corporation tax[1,2] excluding North Sea	8·2	8·4	9·4
Capital taxes	1·9	2·5	2·8
Expenditure taxes:			
Value added tax	18·3	19·3	20·7
Local authority rates	13·6	13·7	15·6
Petrol, derv, etc., duties	6·5	6·5	7·3
Spirits, beer, wine, etc.	4·2	4·2	4·4
Cigarettes and other tobacco	4·3	4·3	4·7
Other	8·8	8·6	9·3
Total expenditure taxes	55·8	56·6	61·9
North Sea revenues:			
North Sea corporation tax[3]	2·8	3·0	2·7
Petroleum revenue tax	8·2	6·4	2·4
Oil royalties	2·5	2·1	1·0
Total North Sea	13·5	11·5	6·1
Other[3,4]	−1·2	−1·6	−1·2
Total taxes and royalties	**113·4**	**113·1**	**117·6**
National Insurance and other contributions	24·6	24·3	26·2
Interest and dividend receipts	6·4	6·4	6·4
Gross trading surpluses and rent	3·1	2·9	2·7
Other	2·8	2·9	3·0
General government receipts	**150·4**	**149·6**	**155·9**

	£ billion		
	1985–86		1986–87
	1985 Budget[1]	Latest estimate	Forecast
EXPENDITURE			
DHSS—Social security	40·0	41·3	42·9
Defence	18·0	18·0	18·5
DHSS—Health and personal social services	16·5	16·7	17·7
Scotland, Wales and Northern Ireland	14·2	14·5	15·0
Education and science	13·6	14·3	14·3
Other departments	29·3	31·7	31·2
Privatisation proceeds	−2·5	−2·6	−4·8
Reserve	5·0	—	4·5
Adjustments	—	—	−0·4
Public expenditure planning total	**134·2**	**133·9**	**139·1**
General government debt interest	17·8	17·7	18·2
less public corporations' market and overseas borrowing	−2·3	−1·3	−0·5
Other national accounts adjustments	5·5	5·0	5·7
General government expenditure	**159·8**	**157·7**	**163·4**

DIFFERENCE BETWEEN EXPENDITURE AND REVENUE FINANCED BY BORROWING:

	1985–86		1986–87
	1985 Budget	Latest estimate	Forecast
General government expenditure	*159·8*	*157·7*	*163·4*
General government receipts	*150·4*	*149·6*	*155·9*
General government borrowing requirement	9·4	8·1	7·5
Public corporations market and overseas borrowing	−2·3	−1·3	−0·4
Public sector borrowing requirement	**7·1**	**6·8**	**7·1**

[1] *On current definitions.*
[2] *Excluding advance corporation tax and corporation tax on capital gains.*
[4] *Adjustments for advance corporation tax set off against North Sea corporation tax plus accruals adjustments.*

3 Before advance corporation tax set off

2 Medium Term Financial Strategy

2.01 The Medium Term Financial Strategy (MTFS) provides the framework for economic policy, as it has since 1980. It is intended to bring inflation down further over a period of years, and ultimately to achieve price stability. It is complemented by policies which encourage enterprise, efficiency and flexibility, thus promoting the growth of output and the creation of jobs.

2.02 Economic policy is set in a nominal framework in which public expenditure is controlled in cash terms and money GDP growth is gradually reduced by monetary and fiscal policy. As the growth of money GDP declines, inflation is squeezed out, and the division of money GDP between output growth and inflation is improved.

2.03 Over the past six years, money GDP growth has declined from nearly 20 per cent to around 9 per cent. Inflation has come down to around 5 per cent and is set to fall further. And the economy is about to embark on its sixth successive year of growth. For the first time since the 1960s steady growth is now being combined with low inflation.

Chart 2.1

Objectives and the Framework of Policy

The money GDP path

2.04 Policy will be directed at maintaining monetary conditions that will bring about a gradual reduction in the growth of money GDP over the medium term, broadly in line with the path shown in Table 2.1 While the

figures are not targets, and fluctuations will inevitably occur, the aim will be avoid substantial departures in either direction in the medium term. This is consistent with both a further reduction in inflation and continued growth in real output at a sustainable rate.

Table 2.1 Growth of the Money Supply and Money GDP

	1985–86	1986–87	1987–88	1988–89	1989–90
Money GDP[1]	9½ (7¾) (4½)	6¾	6½	6	5½
M0[2]	3½	2–6	2–6	1–5	1–5
£M3[2]	14¾	11–15			

[1] *Percentage change on previous financial year. See Table 2.2 for assumptions on output and inflation. The figure in brackets for 1985-86 is adjusted for the coal strike. The figure for 1986-87 is a forecast; and in subsequent years the figures describe the Government's broad medium term objective.*
[2] *1985–86: percentage change from mid-February to mid-February.*
1986–87: target ranges.
1987–88 onwards: illustrative ranges for M0.

2.05 The growth of money GDP is expected to be ~~the same in 1986-87 as~~ assumed last year. ~~But~~ Partly as a consequence of the sharp fall in oil prices, ~~this is made up of higher~~ output growth and lower inflation. In the later years money GDP growth declines further.

Instruments of Policy

2.06 While firm monetary policies must be supported by low public sect borrowing in the medium term, there is some scope for varying the balan between fiscal and monetary policy, especially in the short term. In practice, the Budget provides the main opportunity to review fiscal policy, while short term interest rates can be varied more frequently to keep monetary conditions on track.

2.07 Until recently the authorities also sought to control the growth of broad money and liquidity by overfunding, ie selling more debt than needed to fund the ~~public sector borrowing requirement~~. This was generally seen as a distortion of financial markets, and it was reflected in t rising stock of commercial bills held by the Bank of England.

2.08 On the view that systematic overfunding was neither a sustainable nor an effective medium term means of affecting monetary conditions, the Chancellor announced in October 1985 that sales of debt outside the banking system in any one financial year would be limited to amount needed to fund the PSBR; and that policy action within the year to influence monetary conditions would take the form of changing short term interest rates.

Monetary Policy

2.09 Monetary conditions are assessed in the light of movements in broad and narrow money and the behaviour of other financial indicators, in particular the exchange rate.

Chart 2.2 Monetary Growth

Narrow Money

2.10 Ideally, the target aggregate for narrow money should reflect those (principally non–interest bearing) assets that are directly used for making transactions; should respond unambiguously, but not be over sensitive, to interest rate changes; and should have a stable relationship with money GDP. In practice, however, there is no single measure of narrow money that meets all these criteria. As in the US, M1 has been inflated by a rapid growth of interest bearing sight deposits, previously held in the form of term deposits. The same developments have distorted non–interest bearing M1 which continues to be affected by short term variations in the boundary between interest bearing and non-interest bearing accounts.

2.11 M0 covers only a narrow range of transactions balances. It has however demonstrated a relatively stable velocity trend over a long period and responds in an unambiguous manner to changes in interest rates. Its velocity has risen as institutional change and technological developments have led to a progressive reduction in the use of cash, but this has been occurring at a fairly steady and predictable pace. M0 has proved a good indicator of monetary conditions in recent years and remains the best choice of narrow aggregate for target purposes.

Broad Money

2.12 Measures of broad money have persistently grown faster than money GDP over the last six years, in contrast with the experience in the 1970s. High real interest rates have increased the relative attractiveness of financial assets; and financial liberalisation and increased competition between banks and building societies have led to a rapid build up of both liquidity and debt. Yet this has proved consistent with declines in both inflation and money GDP growth. At the same time the high proportion of interest bearing deposits within broad money has meant that the immediate response of broad liquidity aggregates to changes in short term interest rates is highly uncertain.

l.cash.

Chart 2.3 Velocity of the Monetary Aggregates

l.c.

Monetary Targets

2.13 As in the past two years, the Government is setting targets for the year ahead, 1986–87, for M0 as a measure of narrow money, and for £M3 as a measure of broad money. The ranges are shown in Table 2.1

2.14 For M0 the target range of 2–6 per cent is the same as indicated in last year's MTFS. Illustrative ranges are also given for M0 in later years, consistent with the declining path of money GDP growth

2.15 For £M3, the target range has been raised to 11–15 per cent reflecting the rapid fall in velocity observed in recent years. Illustrative rang for future years are not given for £M3 because the uncertainties surrounding its velocity trend are at present too great.

l.c

Interpretation of Monetary Conditions

2.16 In implementing policy and in making decisions about short term interest rates, the Government has to make a careful assessment of the behaviour of the monetary aggregates in relation to their targets, together with other relevant evidence, especially the exchange rate.

2.17 There is no mechanical formula for taking the exchange rate into account in assessing monetary conditions; a balance must be struck between the exchange rate and domestic monetary growth consistent with the Government's aims for money GDP and inflation.

2.18 If the underlying growth of M0 or £M3 were to move significantly outside their target ranges, the Government would take action on interest rates unless other indicators suggested clearly that monetary conditions remained satisfactory. Experience has shown that a change in short term rates is unlikely to alter the growth of £M3 significantly within the target period. But such action clearly affects the tightness of monetary conditions, and this would be likely to show up

which is what matters

in the behaviour of M0 and the exchange rate. ~~Provided the behaviour of other indicators was satisfactory, continued growth of £M3 outside its range in these circumstances would not be a cause for concern~~.

Fiscal Policy

2.19 The PSBR in 1985–86 is expected to be about 2 per cent of GDP, in line with last year's projection. This follows four years when the PSBR remained at about 3¼ per cent of GDP. The sharp reduction this year would have taken place in 1984–85 but for the coal strike. It is the second significant downward step since the MTFS began in 1980. The figure of 2 per cent is the lowest recorded since 1971–72. This would still have been the case even if there had been no proceeds from privatisation.

Chart 2.4 Public Sector Borrowing Requirement.

The PSBR Path

2.20 ~~The profile of the PSBR in the fiscal projections is set out~~ in Table 2.5. ~~It~~ is much as suggested last year. As usual, account has been taken of the composition of receipts and expenditure.

2.21 The PSBR for 1986–87 is ~~forecast to be~~ £7 billion, or 1¾ per cent of GDP—slightly below the level indicated in last year's MTFS. North Sea revenues are projected to decline steeply in 1986–87 to about £6 billion, half their level in 1985–86. The proceeds from the Government's privatisation programme are expected to rise from £2½ billion in 1985–86 to £4¾ billion in 1986–87, as set out in the Autumn Statement.

2.22 ~~The fiscal projections show~~ A further slight reduction in the PSBR to 1½ per cent of GDP ~~in~~ 1988–89 and 1989–90. The figures after 1986–87 are illustrative, and decisions about the appropriate PSBR in particular years will be taken nearer the time.

Assumptions

2.23 For the period to 1988–89, the expenditure projections in Table 2.3 incorporates the public expenditure plans set out in the Public Expenditure White Paper (Cmnd. 9702). It is assumed that the planning total for 1989–90 will remain broadly flat in real terms. The revenue projections in Table 2.4 are based on the conventional assumptions of constant 1986–87 tax and National Insurance contribution rates, and allowances and thresholds indexed from the proposed 1986–87 levels. All changes proposed in the Budget are taken into account.

2.24 The assumptions about output growth and inflation that underlie the revenue projections are shown in Table 2.2. They are consistent with the figures for money GDP growth in Table 2.1. ~~The~~ Oil prices ~~is~~ are assumed to average $15 a barrel ~~in both 1986 and 1987 and thereafter~~ to ~~rise in line with the world price of manufactured exports~~. It is assumed that there is no major change in either the sterling exchange rate index or the sterling/ dollar exchange rate from year to year.

Table 2.2 Output and inflation assumptions

Percentage change on previous financial year	1985–86	1986–87	1987–88	1988–89	1989–90
Real GDP					
Non-North Sea	3¾	~~3¾~~	2¾	2¾	2¾
Total	3½	~~2¾~~ 3	2½	2½	2½
Inflation					
GDP deflator	~~5¾~~ 6	3¾	3¾	3½	3

Public Expenditure

2.25 Continued restraint in public spending plays a vital role in the Government's economic strategy. The cash planning totals set by the Government in the White Paper are designed to hold total spending broadly level in real terms. The projection given in Table 2.3 extends to 1989–90, one year longer than the plans. The assumption for the final year implies that the planning total remains broadly flat in real terms over the whole MTFS period.

2.26 As a proportion of GDP, general government expenditure has already fallen significantly from its peak of over 46 per cent in 1982–83. Given the assumed growth of output, it is projected to decline further from 44 per cent in 1985–86 to less than 40 per cent in 1989–90. This will enable a continued low level of borrowing to be combined with reductions in the burden of taxation, so improving motivation, efficiency and employment. The plans for public expenditure are set out ~~discussed~~ more fully in Chapter 5.

Table 2.3 General Government Expenditure

£ billion, cash

	1984–85	1985–86	1986–87	1987–88	1988–89	1989–90
Public expenditure planning total[1]	129·6	134	139	144	149	153
Interest ~~payments~~	16·1	18	18	19	19	19
Other adjustments[2]	4·3	6	6	7	7	7
General government expenditure[3]	**150·0**	**158**	**163**	**~~169~~ 170**	**175**	**180**
of which						
Privatisation proceeds[4]	2·1	2½	4¾	4¾	4¾	4¾

[1] *For 1984–85 to 1988–89, the figures are equivalent to those in Table 5.1. Assumed to be the same in real terms in 1989–90 as in 1988–89.*
[2] *See paragraph 5.04. The adjustments convert the planning total plus gross debt interest into general government expenditure. One adjustment removes most public corporations' market and overseas borrowing, shown in Table 2.5, which can fluctuate considerably from year to year.*
[3] *General government expenditure, and its components, are rounded to the nearest £1 billion from 1985–86 onwards.*
[4] *See the Public Expenditure White Paper (Cmnd. 9702), Table 1.4. Assumed to be the same in cash terms in 1989–90 as in 1988–89.*

Revenue

2.27 The growth in Government revenues in cash terms over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. On the unchanged policy assumptions set out above, general government receipts are expected to increase somewhat less than money GDP. Government revenues from the North Sea are projected to fall sharply in 1986–87 from the peak levels of 1984–85 and 1985–86 mainly because of the drop in oil prices. But the decline in revenues from this source is offset by buoyant non–North Sea revenues, ~~which are projected to rise marginally as a share of non–North Sea GDP from the level in 1985–86 over the period~~ slightly.

Table 2.4 General Government Receipts

£ billion, cash

	1984–85	1985–86	1986–87	1987–88	1988–89	1989–90
Taxes on incomes, expenditure and capital	105·34	113	118	128	132	139
National Insurance and other contributions	22·9	24	26	28	29	31
Interest and dividends	5·0	6	6	6	6	6
Other receipts	6·34	6	6	6	7	7
Accruals adjustment	1·31	—	—	—	—	−1
General government receipts[1]	**140·89**	**~~149~~ 150**	**156**	**164**	**174**	**182**
of which: North Sea tax[2]	12·0	~~12~~ 11½	6	4	4	4

[1] *Rounded to the nearest £1 billion from 1985–86 onwards.*
[2] *Royalties, petroleum revenue tax (including advance payments), and corporation tax from North Sea oil and gas production (before advance corporation tax set-off). This does not correspond exactly to tax receipts in the same financial year in respect of North Sea production. See footnote 2 to Table 6B3.*

Public Sector Borrowing

2.28 The projections of Government expenditure and receipts are brought together in Table 2.5 to provide projections of the general government borrowing requirement (GGBR) and the PSBR. The size of the fiscal adjustment depends upon the estimates of revenues and expenditure. As always, these are subject to major uncertainties. Apart from the general difficulty of projecting the yield from a given set of tax rates,

recent events in world oil markets make the projection of oil revenues particularly uncertain. On the expenditure side, the planning total for the final year has yet to be agreed.

2.29 Changes since the 1985 MTFS are discussed in the Annex to this Chapter.

Table 2.5 Public Sector Borrowing[1]

£ billion, cash

	1984–85	1985–86	1986–87	1987–88	1988–89	1989–90
General government expenditure	150·0	158	163	~~169~~ 170	175	180
General government receipts	140·9	~~149~~ 150	156	164	174	182
Fiscal adjustment from previous years[2]	—	—	—	—	2	6
Annual fiscal adjustment[2]	—	—	—	2	4	3
GGBR	**9·1**	**8**	~~8~~ 7	**8**	**7**	**7**
Public corporations' market and overseas borrowing	1·0	−1	—	−1	~~−1~~ —	—
PSBR	**10·1**	**7**	**7**	**7**	**7**	**7**
Money GDP at market prices	327	358	382	407	~~430~~ 431	455
PSBR as per cent of GDP	**3·1**	**2**	**1¾**	**1¾**	**1½**	**1½**

[1] *Rounded to the nearest £1 billion from 1985–86 onwards. Further details for 1985–86 and 1986–87 are provided in Table 2.5.*
[2] *Means lower taxes or higher expenditure than assumed in lines 1 and 2.*

Conclusion

2.30 Events ~~in the UK and elsewhere may necessitate revisions to~~ the assumptions on which the projections have been based. But the Government is committed to maintaining the progress to lower inflation in the medium term, secured by appropriate financial policies. The MTFS provides the framework within which the Government will pursue its economic policy.

Annex to Chapter 2

Changes since the 1985 FSBR

Money GDP **2A.1** The level of money GDP in 1985–86 is now expected to be higher than was projected in last year's MTFS, reflecting both higher output and a higher deflator. Th level from 1986–87 onwards is also higher. The decline in the growth rate of money GDP from 1985–86 to 1988–89 is similar to that assumed last year. Non-North Sea output growth is assumed to be slightly faster, and oil production is projected to decline more slowly. The GDP deflator is projected to grow more slowly in 1986–87, but very slightly faster in the subsequent years than assumed last year.

Table 2.6 Level of Money GDP

per cent changes from 1985 MTFS projections

1985–86	1986–87	1987–88	1988–89
+1	+1 1/4	+2	+2 3/4

Monetary Aggregates **2A.2** The growth of M0 is towards the bottom half of its target range in 1985–86. The target range for 1986–87 is the same as the illustrative range given last year. The illustrative ranges for subsequent years decline less rapidly.

2A.3 The growth of £M3 in 1985–86 is well above the target range originally set last year, and the range set for 1986–87 is considerably higher than the illustrativ range in last year's MTFS.

Table 2.7 Monetary Aggregates

	per cent change 1985–86	1986–87	1987–88	1988–89
M0				
1986 MTFS	3½	2–6	2–6	1–5
1985 MTFS	3–7	2–6	2–5	0–4
£M3				
1986 MTFS	14½	11–15		
1985 MTFS	5–9	4–8	3–7	2–6

Fiscal Projections **2A.4** Table 2.8 shows changes in the fiscal projections since the 1985 FSBR, after allowance for classification changes.

Changes in Expenditure **2A.5** The expected underspend in the planning total in 1985–86 is referred to in Chapter 5. The planning totals for 1986–87 onwards are as in Cmnd 9702, which incorporates a slightly higher figure in 1988–89 than assumed last year. General government expenditure is lower in 1985–86 than projected last year, mainly because of the lower planning total and because of changes in the pattern of public corporations' borrowing. They borrowed less from general government and more from the market and overseas, and this pattern is projected to continue in 1986–87. In 1988–89, the changes in the planning total and public corporations' borrowing both add to general government expenditure. There are no chan to the path of debt interest.

Receipts **2A.6** The reductions in North Sea revenues are due to lower sterling oil prices. Other taxes are higher throughout the period, mainly because of the higher level of money GDP. National Insurance contributions are higher towards the end of the period for much the same reason.

Table 2.7 Revenue and expenditure[1]

	Changes from 1985 MTFS projections £ billion				
	1984–85	1985–86	1986–87	1987–88	1988–89
Expenditure					
1. Planning total	–	– ½	—	—	+ ½
2. Other[2]	+0·3	–2	– 1	+ ½	+1
3. General government expenditure	+0·3	–2½	– 1	+ ½	+1½
Receipts[3]					
4. North Sea taxes	—	–2	–5	–5½	–4
5. Other	+0·7	+1½	+2½	+3	+4
6. General government receipts	+0·8	–1	–3	–4	–2
7. Implied cumulative fiscal adjustment[4]	0	0	–3½	–4½	–3½
8. Public corporations' market and overseas borrowing[5]	+0·1	+1	+ 1	—	– ½
9. PSBR	–0·4	–	– ½	—	– ½

[1] *Classification changes since the 1985 FSBR add the following amounts to both expenditure and receipts:*

£ billion				
+0·2	+0·3	+0·2	+0·2	+0·2

The main changes are in respect of the treatment of transactions in certain public sector pension funds and of National Savings Bank management expenses.

[3] *The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set-off. See footnote [2] to Table 6B.3.*

[4] *Line 6 = lines 1 – 6 – 3 + 7*

[5] *Public corporations' market and overseas borrowing is included in the planning total and in the PSBR, but not in general government expenditure. Changes in it are therefore deducted in line 2 and added back in line 9.*

2. Other +0·1 –½ –½ –1

2. Includes changes in debt interest and other items

3 The Economy: Recent Developments and Prospects to Mid~~A~~1987

Summary

Demand and activity

3.01 There were further sizeable increases in both exports and business investment in 1985. For the forecast period substantial growth is likely not only in most areas of domestic spending but also in exports. Total domestic production and manufacturing output are both expected to record further growth ~~in the range 2-3~~ per cent.

Labour market

3.02 Employment has continued to rise, with over 200 000 extra jobs in the year to September 1985. In spite of this there has been some further rise in unemployed claimants over the last year. However, the labour force is now expected to grow less rapidly, and prospects for unemployment are better than for some years.

Inflation

3.03 After rising in the early months of 1985, inflation has been on a downward path since June and in January 1986 the RPI increase over the previous year was 5½ per cent. The inflation rate is forecast to be ~~below~~ 3½ per cent.

Assumptions

3.04 The UK forecast is based on the assumption that fiscal and monetary policies are set within the framework of the MTFS. ~~North Sea oil prices~~ are assumed to average $15 per barrel ~~in 1986-87~~. Neither the sterling index nor the sterling/dollar exchange rate is assumed to change much.

World economy

3.05 Output in the world economy has now been rising since early 1983, and inflation has been coming down since 1980. ~~The recent large fall in oil prices will be of particular help to oil importing countries both in the developed and developing world~~. Assisted by further moves to lower interest rates, a period of low inflation and good growth in output and trade is in prospect. Many of the problems arising from payments imbalances and debt repayments will remain. But the benefits to trade, output and inflation from the fall in oil prices should prove substantial.

Trade and the current account

3.06 Exports have grown strongly over the last two years. The current account of the balance of payments is expected to remain in sizeable surplus despite the big fall in oil prices. Offsets include higher export earnings on other goods, lower profits earned by foreign oil companies in the North Sea, ~~and~~ higher earnings from the UK's stock of overseas assets.

World economy

Recent developments

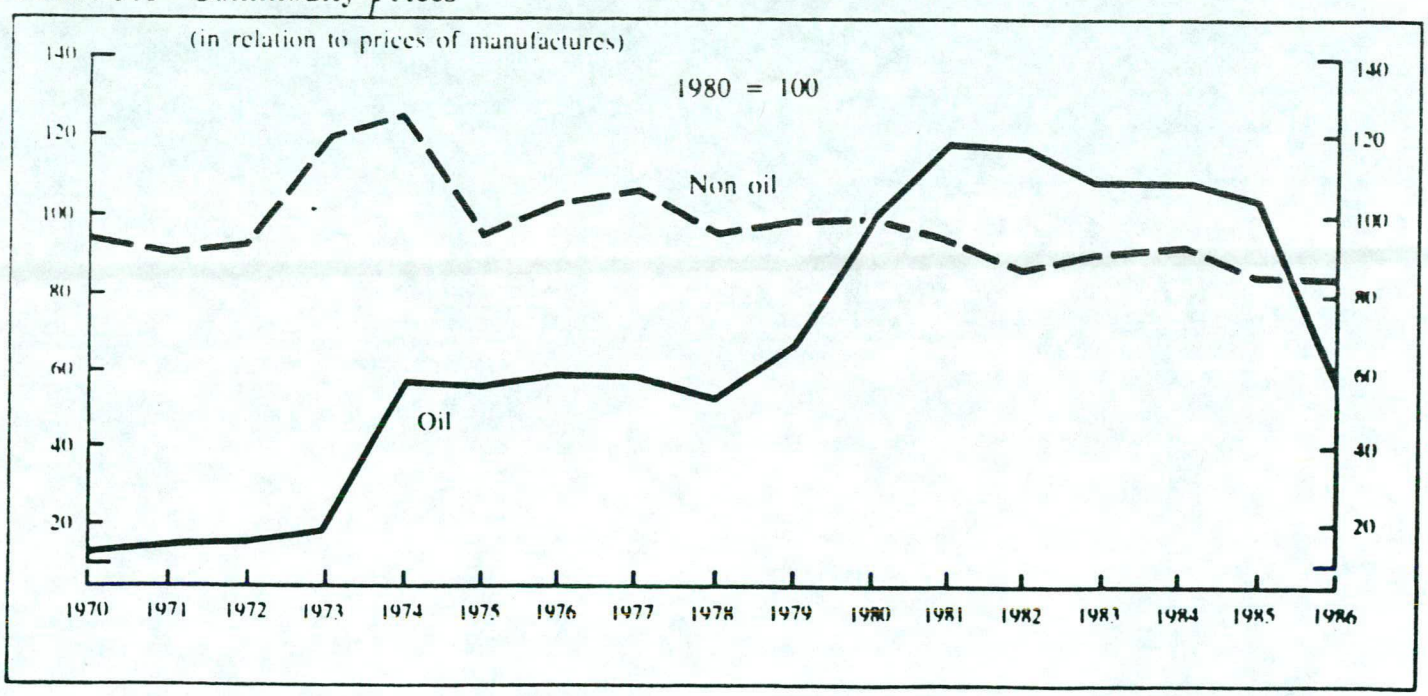
3.07 After a spurt in 1983 and the first half of 1984, US economic growth has slowed down sharply. By the final quarter of 1985 real GNP was 2½ per cent higher than a year earlier. The performance of the US economy has strongly influenced the pattern of economic growth in other major industrialised countries. In Japan and Germany, in particular, output grew significantly faster than domestic demand in both 1984 and 1985, thanks to the substantial external contribution to demand, stemming in large part from the US. More recently the recovery in Europe has strengthened and growth has become less dependent on exports to the US. In Japan growth has shown some signs of slackening, although remaining high by European standards.

3.08 Domestic demand is now growing at similar rates in the US and other major industrialised countries. But the effect of much faster growth between 1982 and 1984 in the US, together with the effects of the rise—still only partially reversed—in the dollar, are seen in the pattern of current account balances: a large deficit in the US and large surpluses in Germany and Japan. There have, though, been a number of helpful steps towards reducing these imbalances over the past year. Slower growth in the US has not only reduced the increase in US imports, but also contributed to lower interest rates and a fall in the dollar. The latter was helped by the Plaza Agreement of 22 September 1985 between the Finance Ministers of the Group of Five.

Inflation

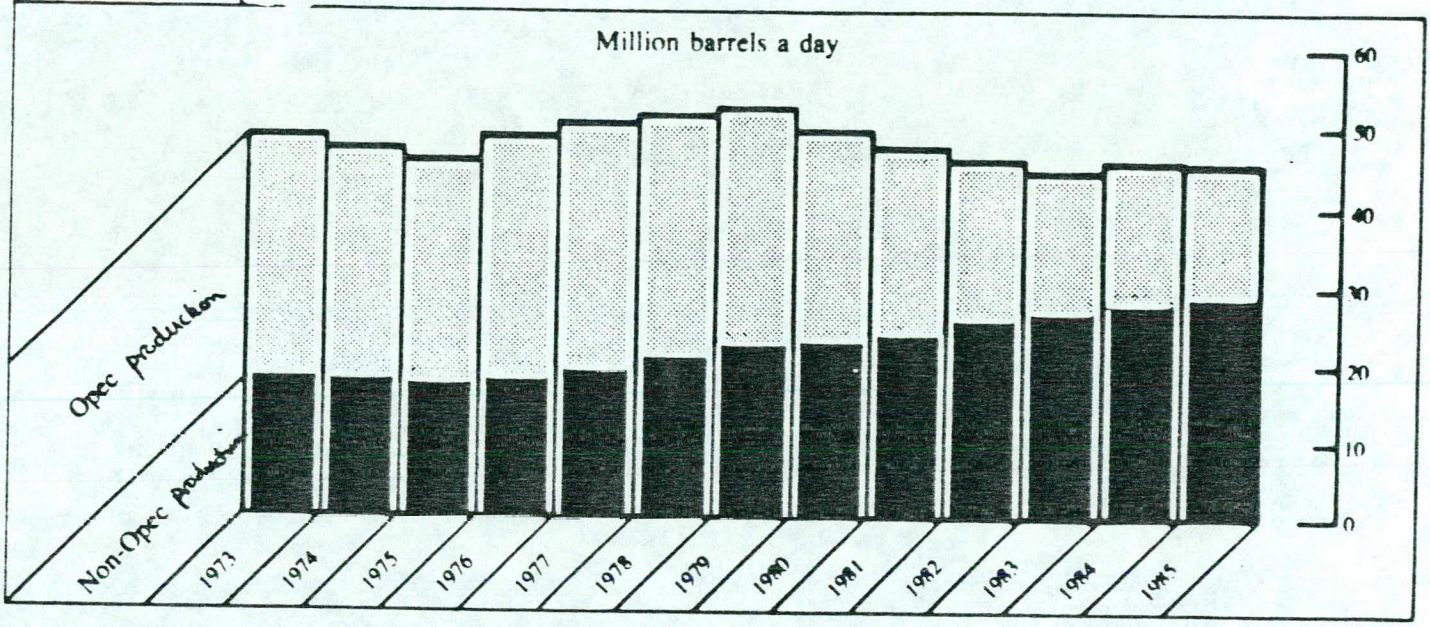
3.09 The rate of world inflation fell further in 1985: consumer prices in the major industrialised countries increased on average by about 4 per cent, compared with over 4½ per cent in 1984. This has been associated with a continuing weakness in primary product prices (see Chart 3.1).

Chart 3.1 Commodity Prices



3.10 Since November 1985, oil prices have fallen sharply. Before the first oil price shock the non-communist world demand for oil was around 48 million barrels per day, and about 30 mbd of this was produced by OPEC members. Despite the 1973–74 increase in oil prices OPEC managed to maintain roughly this level of production throughout the 1970s. After falling in 1974 and 1975 total demand for oil rose again during the rest of the decade, while non-OPEC supply grew by roughly the same amount in absolute terms. Chart 3.2 shows total oil production: this is the sum of OPEC and non-OPEC production (the latter defined to include net exports of oil from the communist bloc) and is equal to non-communist world consumption plus stockbuilding.

Chart 3.2 Oil production



3.11 Experience since the second sharp increase in oil prices in 1979 has been very different. Demand for oil has fallen and non-OPEC supplies have continued to rise steadily. OPEC's pricing policy made it effectively the residual source of supply, and demand for OPEC oil nearly halved: from about 31½ mbd in 1979 to less than 17½ mbd on average in 1985. Saudi Arabia's production fell particularly sharply.

3.12 Towards the end of 1985 Saudi Arabia indicated that it was no longer prepared to hold its own production at very low levels in order to maintain the existing level of prices. The resulting increase in supply, combined with no sign that other producers were prepared to make offsetting cuts in their production, has produced a sharp fall in prices.

Prospects

3.13 Total demand and supply for oil may respond only gradually even to the large fall in price, and so excess capacity is likely to be present for some time. This forecast assumes that prices will average $15 per barrel for the rest of 1986 and 1987 ~~over the next year~~ —rather below, in real terms, the level between 1974 and 1979.

BUDGET SECRET—BUDGET LIST ONLY

3.14 The prices of most other primary products are also unlikely to strengthen significantly over the next year or so, since with some exceptions (for example a temporary shortfall in the coffee crop), supplies are abundant and stocks relatively high. The industrial countries can therefore expect further improvements in their terms of trade, raising real incomes and enabling inflation to fall further (see Table 3.1).

Table 3.1 World economy

	Per cent changes on a year earlier			
		Estimates	Forecasts	
	1984	1985	1986	1987 H1
Major Seven countries[1]:				
Real GNP	4½	2½	3½	4
Consumer prices	4½	4	2½	1½
World trade, at constant prices				
Total imports	10	3	5½	5½
UK export markets[2]	8½	4½	5	5

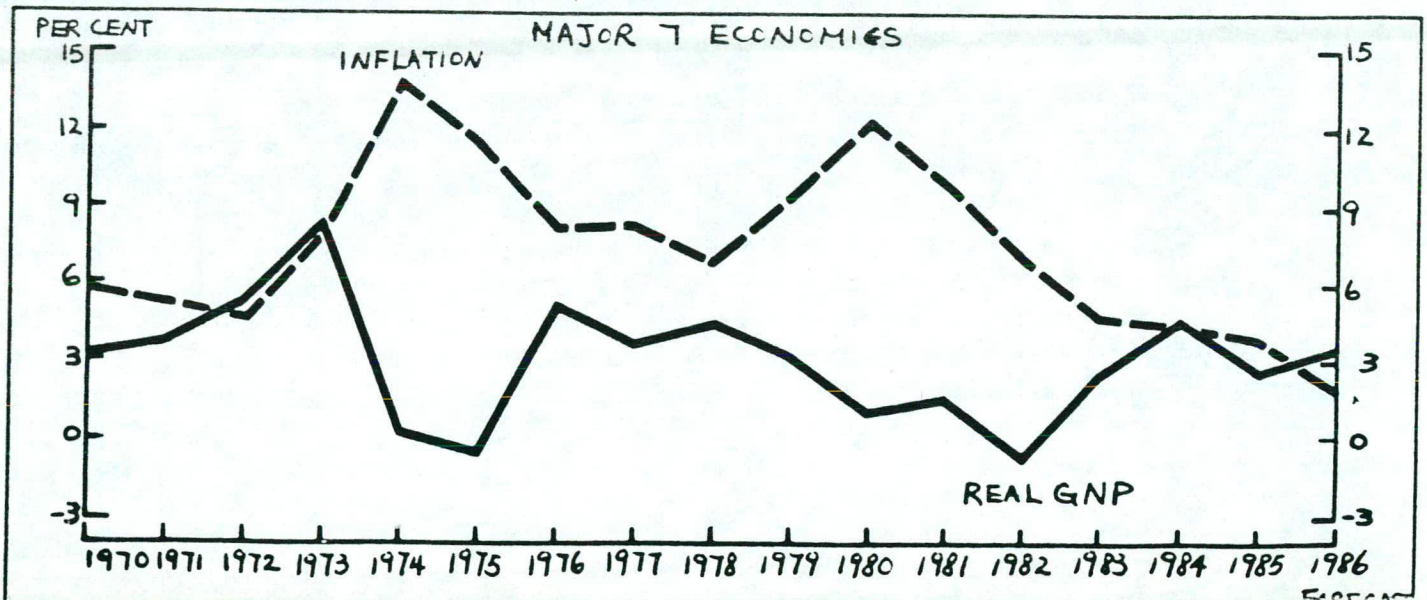
[1] *US, Japan, Germany, France, UK, Italy and Canada.* [2] *Manufactures.*

Growth **3.15** The growth of real GNP in the **US** should pick up in 1986, benefiting from lower oil prices and from the effect of the lower dollar on trade. Consumers' expenditure, while growing more slowly than in recent years, should be helped by the lagged effects of lower interest rates and rises in asset prices.

3.16 Growth in **Japan** may be weaker than usual in 1986 as the expansion of domestic demand may not be sufficient to compensate for a slowdown in the growth of exports. In most **European** countries the economic recovery should strengthen in 1986, with the rate of growth increasing, particularly in Germany.

3.17 As shown in Chart 3.3, the major industrialised countries may grow by about 3½–4 per cent over the next year. Together with lower inflation and interest rates in the major countries and the reduced cost of oil imports, this should provide a better prospect for the non-oil developing countries, despite weak commodity prices. Oil exporting countries, on the other hand, particularly those already heavily indebted, face severe difficulties and will have to cut their imports further.

CHART 3.3 GROWTH AND INFLATION



ITALICS

Table 3.2 World import volumes, annual growth rates

	US	Japan	Europe*	OPEC	Developing countries	Other	Total
Weights in 1984	19	8	31	7	14	21	100
	Per cent changes on a year earlier						
1984	24	11	6	−10	8	11	10
1985 Estimates	3	1	5	−8	1	6	3
1986 Forecasts	7	9	8	−16	7	6	5

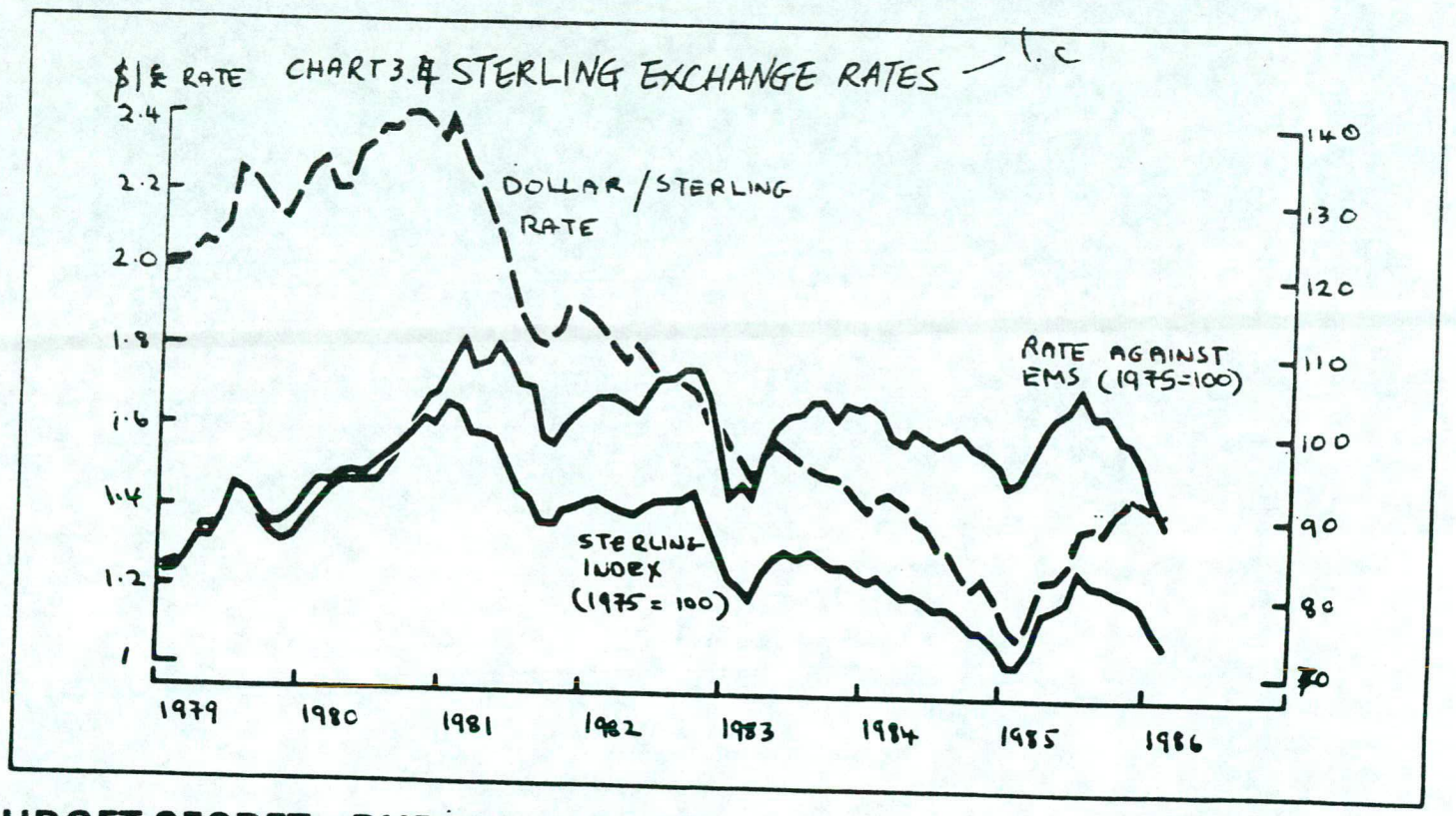
* *Germany, France, UK, Italy, Netherlands and Belgium.*

3.18 This picture of world activity is reflected in the pattern of world trade growth. Import growth is likely to be strongest in oil-importing countries and ~~in those in~~ where exchange rates have appreciated most over the past year. This points to rapid growth of imports into Europe, Japan and many developing countries, but to large falls in oil producers' imports. Overall import growth in 1986 should be well above that of 1985.

Financial conditions

Exchange rates

3.19 The **dollar** has declined substantially (by over 20 per cent against a basket of other currencies) since its peak in early 1985. In 1985 as a whole the **sterling** index was little different from 1984. There were however some sizeable swings during the course of the year. The index rose from a lowpoint of 70½ in January to a high of 84½ in July before declining to 78 in December. The index declined further in the opening months of this year, as oil prices fell. Over the past year sterling has risen by about 30 per cent against the dollar, but fallen against most other currencies. The forecast assumes that sterling will not change much ~~from its present level~~, either in dollar or effective terms.



BUDGET SECRET--~~BUDGET LIST ONLY~~

Interest rates

3.20 Short-term interest rates fell during much of 1985 from the peak levels reached in February and March. They rose again in January this year as sterling weakened but in 1986 so far they have been a little below levels a year earlier. However on average in 1985–86 short rates, at 12 per cent, have been a point or so above the levels of 1984–85 and several points above levels in the US, and most other industrialised countries. Long rates have been much more stable. Yields on 20 year gilts have been within the 10–11 per cent range for almost all of the last three years, but they have recently fallen below 10 per cent for the first time since 1973. Real yields on index-linked gilts have also been relatively stable.

Chart 3.5 Interest rates in the UK

Narrow money

3.21 **M0** was near the centre of its target range in the early months of 1985–86, but growth slowed during the course of the year, mainly in response to the increase in interest rates last winter. In recent months M0 growth has generally been just above the bottom of its target range. The annual increase in M0 velocity has been relatively stable for many years now, and is expected to remain so.

3.22 Growth in the non-interest bearing component of M1, 3 per cent over the last year, has also slowed. This has been in response to higher interest rates and the increased availability of high interest cheque accounts which are in M1, contributing to an acceleration in M1 in total.

Broad money

3.23 The rate of growth of £M3 has risen during the course of 1985–86 and has been well above both the target range set in the 1985 MTFS and the growth of money GDP. With the funding objective now set at the level needed to cover the PSBR, £M3 growth (at 14–15 per cent on a year earlier in recent months) has reflected a continued strong expansion of bank credit. Other broad aggregates have grown at much the same rate.

3.24 The rapid expansion of broad money and credit reflects to a large extent the pace of financial innovation and liberalisation. Since over two-thirds of £M3 bears interest and is now an attractive means of holding financial wealth, the high level of real interest rates may have contributed to higher bank deposits. The higher levels of broad money and debt in relation to incomes probably reflect a permanent and continuing shift in the private sector's portfolio which is not likely to be reversed through higher spending. They are thus consistent with the slower growth of nominal incomes and fall in inflation contained in this forecast.

Trade and the balance of payments

Relative costs and prices

3.25 The last two to three years as a whole have exhibited relatively little change in most measures of cost and price competitiveness, although there have been large short-term swings associated with movements in the nominal exchange rate. As Table 3.3 shows, the effects of a lower nominal exchange rate have been broadly offset by unit labour cost increases at home above those in the UK's main overseas competitors, despite a good UK productivity performance. Assuming change in the exchange rate, the UK's cost and price competitiveness may be little different from the average of the last three years.

Table 3.3 The exchange rate and competitiveness*

	Sterling Index	Relative unit labour costs	Relative export prices	Import Price Competitiveness
	(1975 = 100)	(1980 = 100)	(1980 = 100)	(1980 = 100)
1983	83½	85	89	94½
1984	78½	83½	87½	92
1985 Estimates	78	86½	~~89½~~ 90	91½

* *Ratio of costs/prices in UK manufacturing to those overseas.*

Trade prices

3.26 Prices of most categories of imports fell during the course of 1985. The exchange rate appreciated during the course of the year, inflation in the developed world was low and commodity prices were weak. By the final quarter of 1985 import prices of all goods and services were 5½ per cent lower than a year earlier. About half of the fall seems likely to be reversed by the end of 1986.

Terms of trade

3.27 For 1985 as a whole, the terms of trade for goods were 1½ per cent above those of 1984 because of the weakness of commodity prices. But the terms of trade are likely to be worse in 1986 because the price of oil has fallen relative to other goods and services. As oil has a greater share in UK exports than in imports, a fall in its price reduces export prices relative to import prices. The fall in oil prices on its own worsens the terms of trade in goods by ¾ per cent.

Table 3.4 Trade in goods

	Per cent changes on a year earlier		
	Export Volume	Import Volume	Terms of Trade*
1983	2	8	1 (1)
1984	8½	11	−2½ (−1½)
1985	5½	3	1 (1½)
1986 Forecasts	6	5½	−3 (2)

*The ratio of UK export to import prices (average values), the figures in brackets exclude oil.

Trade volumes (goods other than oil)

3.28 As shown in Chart 3.6 UK exporters of manufactures improved their share ~~of world trade~~ in volume terms ~~in 1984 and may also have done so in 1985. The value share was broadly unchanged in 1984 when UK export prices fell relative to those of our competitors, but probably rose in 1985.~~ The forecast of exports of manufactures ~~(excluding erratics)~~ in volume terms is for further growth of 6 per cent in 1986, ~~close to the same as the rise in world trade~~ a little faster than the growth of UK export markets.

Chart 3.6 Export share and import penetration

3.29 Between 1982 and 1985 the growth in demand for manufactures (5½ per cent at an annual rate) has been shared by importers and domestic producers, with importers continuing to increase their share. Domestic demand for manufactures is expected to grow in 1986, because of further growth in investment and expenditure on consumer durables in particular. Growth in imports of manufactures in 1986 is forecast to be over 7 per cent, twice as fast as domestic demand growth, a relationship similar to that between 1982 and 1985.

Trade in oil

3.30 The prospect is for a substantial fall in the surplus on trade in oil in 1986 as a result of lower oil prices, partly offset in the current account as a whole by reduced invisible earnings of foreign owned companies operating in the

North Sea. Little change in oil production is expected and domestic demand for oil will be below the 1985 level which was boosted by the coal strike.

Invisibles **3.31** The surplus on trade in **services** has more than doubled since 1982. 1985 was an exceptionally good year, with large gains in earnings from financial services, tourism and travel. With imports of services, particularly tourism, likely to grow faster, the balance on services may show only a modest gain in 1986.

3.32 The profile of the **transfers** balance is affected by the timing of official transactions with the European Community. As the bulk of the UK's rebate on its 1984 contribution was delayed into 1986, the transfers balance was unusually low in 1985, by about £½ billion. A correspondingly high figure is projected for 1986.

3.33 On provisional estimates, the surplus on **interest, profits and dividends** (IPD) fell in 1985. Earnings on UK investment overseas were depressed by a once-for-all write off of losses on BP's Sohio subsidiary and UK banks' net earnings on their foreign currency business fell. In 1986 the surplus on IPD is expected to rise sharply. Lower oil prices will reduce the profits of foreign oil companies operating in the North Sea more than they reduce the profits of UK oil companies' overseas operations and there should be a net rise in the other components of IPD as a result of a projected further increase in the UK's net overseas assets.

Table 3.5: Current account of the balance of payments ~~£ billion~~

£ billion

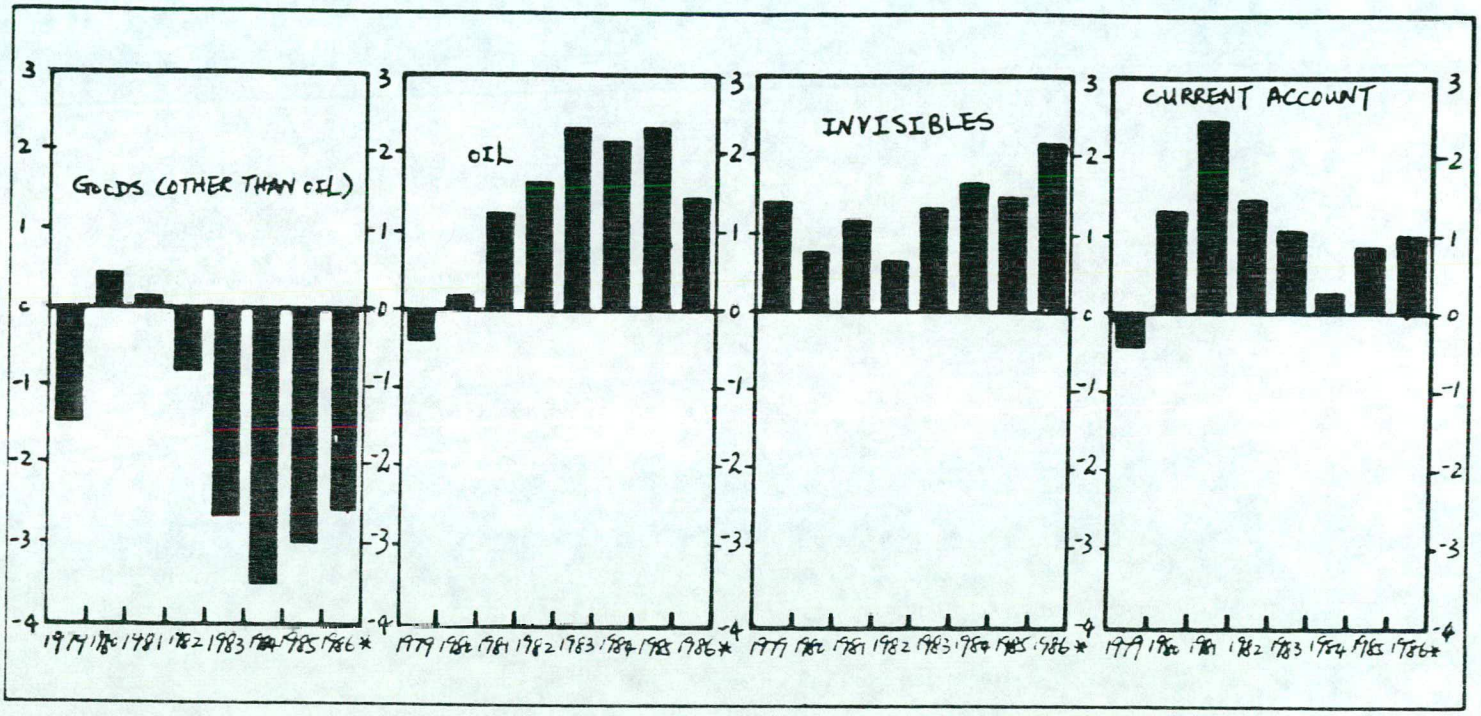
	Oil*	Manufactures	Other goods	Invisibles	Total*
1983	7(4)	-2½	-5½	4	3 (3)
1984	7(4)	-4	-7½	5½	1 (½) 3½
1985	8(4½)	-3	-7	5	3 (4½)
~~1986 (forecast)~~ 1986 Forecasts	5(3)	-3	-6½	8	3½(3)

~~4~~ Figures in ~~brackets~~ ~~subtract~~ North Sea profits due ~~abroad~~ ~~from the visible~~ balance on oil ~~less North Sea profits due abroad~~

* Figures in brackets are after adjustment for the effects of the coal strike and the timing of EC rebates

3.34 Table 3.5 summarises the current account and its main components. Allowing for the effects of the coal strike the current account was in sizeable surplus in each of the last three years and a substantial surplus is again forecast for 1986. On an underlying basis, the surplus in 1986 is expected to be lower than in 1985, as a result of the big fall in oil prices. The contribution of North Sea oil to the current account ~~is the balance of trade in~~ oil less ~~foreign companies'~~ North Sea profits is forecast to fall from ~~a strike adjusted £6½~~ billion in 1985 to £3½ billion in 1986. Chart 3.7 shows the components of the account over a longer period, relative to GDP.

THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS
(SURPLUSES AND DEFICITS AS A PER CENT OF GDP)



* FORECAST

Overseas assets

3.35 The UK's stock of net overseas assets is estimated to have been 25 per cent of GDP (almost £90 billion) at the end of 1985, compared with 6 per cent of GDP (£12 billion) in 1979.

Inflation

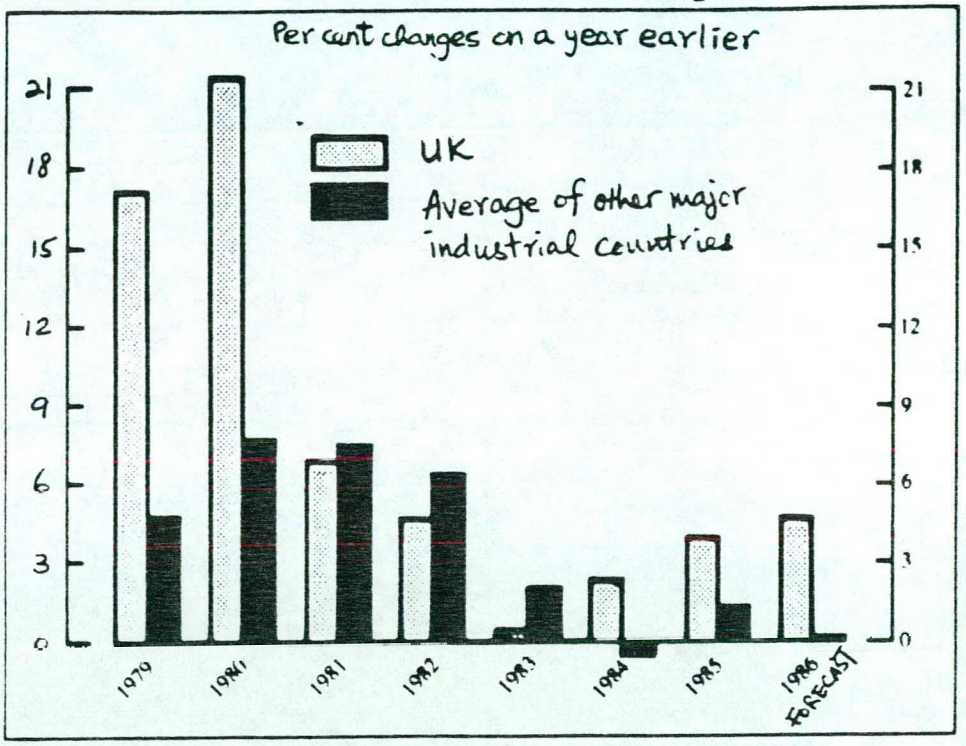
Inflation and costs in 1985

3.36 In the year to the fourth quarter of 1985 the RPI increased by 5½ per cent, a little more than forecast in last year's FSBR. In the middle of the year retail price inflation touched 7 per cent reflecting in particular increases in mortgage interest rates in February and April 1985 and the weakness of sterling in late 1984 and early 1985. Between May and January retail prices rose by only 1·1 per cent in total, helped by a fall in mortgage rates, by lower petrol prices, and a general easing of cost pressures.

3.37 Import prices declined during 1985 and in the final quarter were about 5 per cent lower than a year earlier. Prices of the manufacturing sector's materials and fuel inputs fell rapidly from their peak in February and by the end of the year were 6 per cent below their December 1984 level. The rate of increase in manufacturing output prices started to slow down in the second half of 1985.

3.38 The underlying growth of **average earnings** (that is, abstracting from the effects of strikes, delayed settlements and other temporary factors) continued at about 7½ per cent in 1985 — little changed from 1984. With output per head growing at about 2 per cent (after allowing for the effects of the coal strike) the growth in unit wage costs was about 5½ per cent in 1985. Unit labour costs rose by about 1 per cent less mainly because of the abolition of the National Insurance Surcharge in October 1984. In the manufacturing sector, average earnings increased by 8½–9 per cent and unit labour costs by 4 per cent. This was much faster than in most other major industrial countries (see Chart 3.8). Pre-tax real earnings of employees increased by an average of 2–2½ per cent a year between 1982 and 1985.

Chart 3.8 Unit labour costs in manufacturing



Prospects **3.39** So far the current pay round is showing little sign of any significant change in the level of pay settlements or in the underlying rate of growth of average earnings in the private sector. Unit labour costs for the economy as a whole may rise by around 5 per cent in 1986. World commodity prices are likely to remain weak in 1986. With oil prices in sterling terms falling by almost a half between 1985 and 1986, the overall cost of manufacturers' material and fuel inputs should fall quite sharply between the two years. The prospects are for little change in manufacturers' total costs and a further widening of profit margins on domestic sales, as shown in Table 3.6.

Table 3.6 Costs in manufacturing

	Per cent changes on a year earlier			
	Unit Labour Costs	Cost of Materials and Fuel*	Estimated Total Costs	~~Producer~~ Output Prices*
1983	½	8	3	5½
1984	2½	8½	4½	5½
1985	4	4	4	6½
1986 Forecasts	4½	−11	0	4

* *Excluding food, drink and tobacco.*

3.40 The fall in import prices since the spring of 1985 has contributed to the recent low monthly growth in retail prices; it will continue to contribute to low increases in prices over the coming months, so that the annual rate of inflation will fall quite sharply. In the last quarter of the year inflation may be about 3½ per cent, with little change likely in the first half of 1987. The fall in oil prices is expected to work its way fully through to petrol prices in the course of 1986. The forecast increase in the housing component of the RPI (which covers mortgage payments, rents, rates, and other housing costs) includes the effect of a substantial rise in local authority rates in 1986–87.

Table 3.7 Retail prices index

Per cent changes on a year earlier

	Weights in 1985	1984 Q4	1985 Q4	Forecasts 1986 Q4	1987 Q2
Food	19	3½	3	3	3½
Nationalised Industries*	9	4	5½	4	3
Housing	14	10½	9½	7½	5½
Other	58	4	5½	3	3½
Total	**100**	**5**	**5½**	**3½**	**3½**

* *Including water.*

3.41 The **GDP deflator** measures the price of domestic value added—principally unit labour costs and profits per unit of output—and excludes imports altogether. The GDP deflator covers all sectors of the economy, including oil output in the North Sea, and so is sensitive to the fall in world oil prices. This contributes to a marked slowdown in the growth of GDP deflator over the coming year. The deflator for GDP at market prices is estimated to have increased by 5 per cent in 1985–86, about one per cent faster than in 1984–85. In 1986–87, inflation on this measure is expected to fall to about 3¾ per cent.

Demand and activity

3.42 Latest estimates suggest that **GDP** rose by about 3½ per cent in 1985, or 2½ per cent after making allowance for the effect of the recovery from the coal strike. Over the year to the first quarter of 1985, GDP is estimated to have risen by almost 4 per cent in strike adjusted terms; since then the path of GDP has been flatter. The rise in GDP between the first and third quarters of the year was more than accounted for by recovery from the coal strike, but growth seems to have picked up again in the fourth quarter: the preliminary estimate of the output measure of GDP showed growth at annual rate of 2½ per cent between the third and fourth quarters of the year. The flattening out of strike adjusted GDP during the middle of 1985 reflected in part the high level of business investment and North Sea output in the first quarter of the year. Output in most sectors of the economy, including manufacturing, continued on an upward trend throughout 1985.

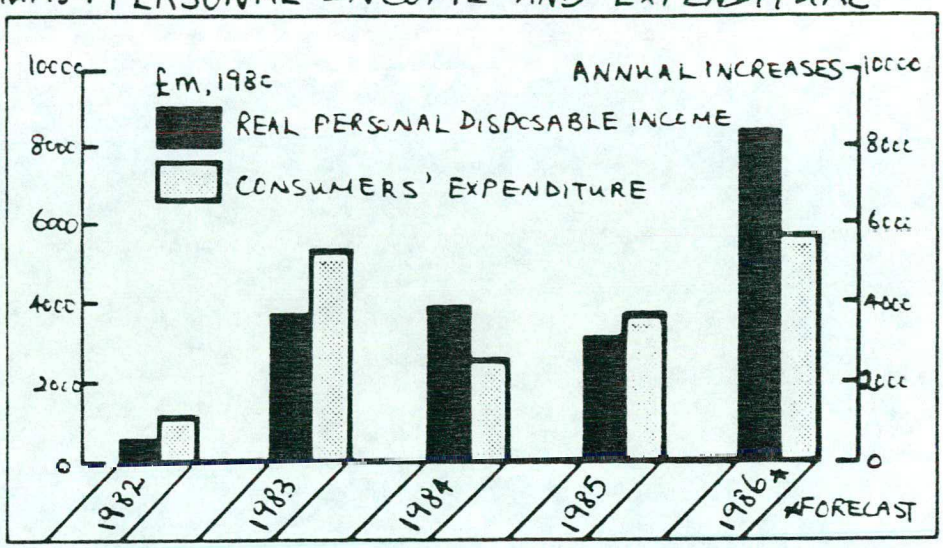
Personal sector expenditure

3.43 Between 1980 and 1983 the inflation rate fell by about three-quarters and the personal saving ratio fell by almost a quarter. In 1984, with the uncertainties caused by the long coal strike, consumers were more cautious and saving rose. During 1985 spending picked up again, particularly spending on durables which was some 7 to 8 per cent higher in the second half of 1985 than in the second half of 1984.

3.44 The combination of lower price inflation and little change in earnings growth, together with higher dividend income reflecting

the buoyant profitability of the company sector, is expected to lead to substantial growth of **real personal disposable income** of about 5 per cent in 1986. There may be some increase in the saving ratio, as consumers adjust to higher levels of income; but most of the rise in incomes should be reflected in higher spending, with continuing strength in purchases of durables. Chart 3.9 shows recent and forecast changes in personal income and consumer spending.

CHART 3.9 PERSONAL INCOME AND EXPENDITURE



3.45 Investment in dwellings by the personal sector fell between 1984 and 1985, but a resumption in growth is expected for 1986. Investment in housing improvements started to recover during 1985, and is expected to show further growth in 1986 as personal incomes rise. In spite of the increases in mortgage interest rates early in 1985, house prices remained firm; private housing starts which had fallen during 1984 were rising throughout 1985, and the total for the year was well above the number of completions. This trend in starts should show up in investment in new houses during 1986.

3.46 The demand for housing (as reflected in house prices) and spending on consumer durables have both been resilient in the last year or so, in spite of the high level of real interest rates. The personal sector has been responding to the financial liberalisation of recent years and the greater availability of credit as well as to changes in interest rates. Borrowing from banks and building societies by the personal sector increased by about 18 per cent in 1985, and by 20 per cent a year on average between 1980 and 1985. This borrowing has not only helped to finance current consumption and spending on tangible assets, but has also been accompanied by substantial acquisition of financial assets: in fact the growth in the personal sector's financial assets has in recent years more than matched the growth in its liabilities, partly because of capital gains on holdings of equities and gilts.

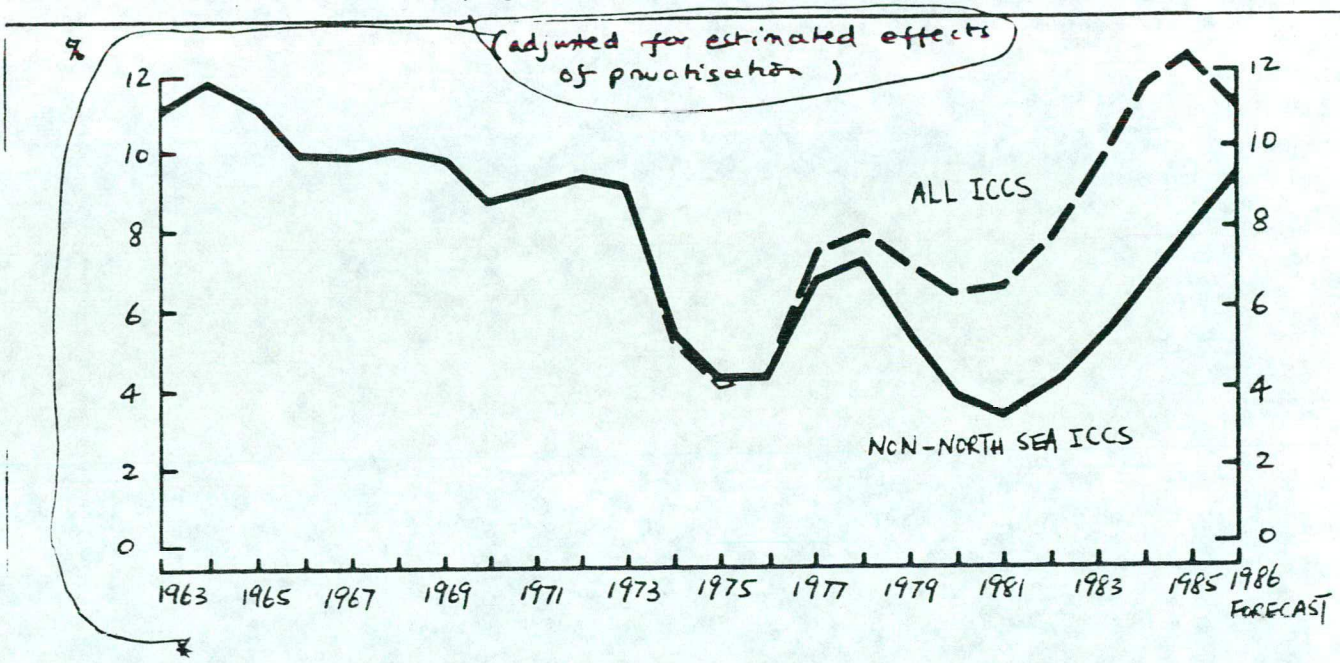
Company income and expenditure

Profitability

3.47 Company profitability has continued the recovery that began in 1981. The net real rate of return for all industrial and commercial companies (ICCs) for 1985 is estimated to have been the highest since 1960. For non-North Sea ICCs, profitability in 1985 was higher than any time since 1973

3.48 The recent sharp fall in oil prices will mean a substantial reduction in North Sea profits in 1986, and the overall return earned by ICCs may fall. However, non-North Sea ICCs will be prime beneficiaries of the fall in oil prices, as they have been of the weakness of other commodity prices during 1985; their profitability is expected to increase further in 1986 (see Chart 3.10).

Chart 3.10 REAL RATE OF RETURN — i.e. INDUSTRIAL AND COMMERCIAL COMPANIES*



Fixed investment

3.49 Total business investment, including North Sea investment and investment by public corporations, grew by about 1½ per cent in 1985. Within this total manufacturing investment increased by ¾ per cent, after taking into account the increase in assets leased by manufacturing companies. This was a somewhat smaller increase than intentions surveys had earlier suggested was likely. The path of investment during 1985 was greatly influenced by the reduction in capital allowances which became effective at the end of the first quarter of the year. Leasing business was particularly buoyant in the first quarter and fell back heavily thereafter.

3.50 1986 is likely to see a similar quarterly pattern. The level of business investment in 1986 as a whole will be affected by the transition to the reformed system of company taxation announced in the 1984 Budget: this gave firms an incentive to bring investment forward that would otherwise have taken place during 1986. The fundamental prospects for business investment remain very favourable. Profitability has been rising strongly: one indication of the past and prospective recovery in profits is the buoyancy of the stock market. In addition, there is evidence from CBI surveys that an expansion of capacity will be needed in a number of industries.

3.51 The DTI survey published last December indicated an increase in manufacturing and service industries investment of about 1 per cent, within which total manufacturing investment is expected to fall by about 2 per cent. By contrast the CBI interpret their most recent survey as implying a 5 per cent rise in manufacturing investment in the first three quarters of 1986 compared with the corresponding period of 198

With the additional boost to profits of most companies from lower oil prices, a rise in business investment in 1986 of 5 per cent is forecast, rather more than suggested by the DTI survey.

3.52 Table 3.8 provides details of the forecast for total investment and its major components. North Sea investment is expected to recover this year to a similar level to that in 1984, ~~mainly~~ reflecting ~~increases in expenditures on oil fields already under development and on gas fields due for development~~. Overall ~~in~~ 1986, ~~fixed investment~~ is expected to ~~show~~ a ~~further~~ year of good growth in fixed investment.

the development of new fields approved in 1985 and early 1986

Table 3.8 Gross fixed domestic capital formation

	£ billion at 1980 prices 1984	Per cent changes on a year earlier 1984	1985	Forecast 1986
Business[1]	29·2	10	2	5
Private dwellings[2]	9·5	4	0	5
General government	6·8	4	-5	2
Total fixed investment	45·5	8	1	5

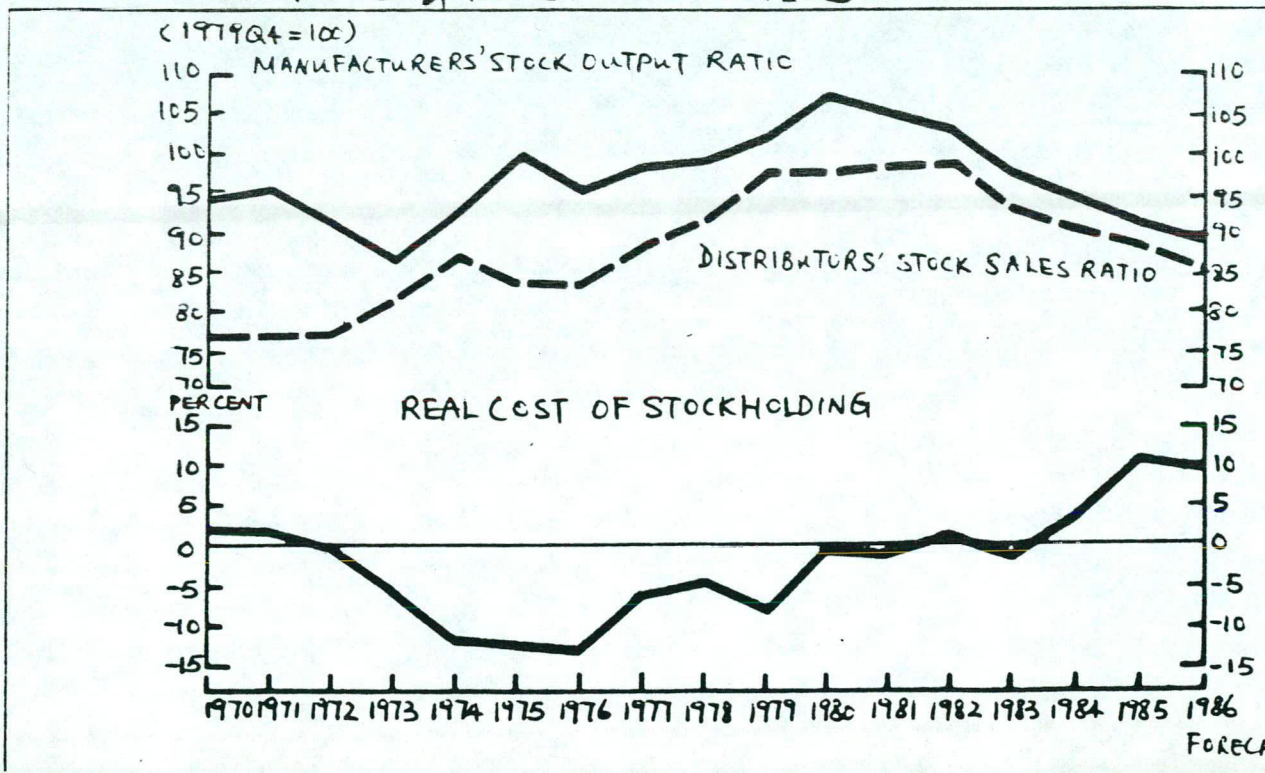
[1] *Including investment by public corporations*

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

ITALICS BOLD

Stockbuilding **3.53** Survey evidence suggests that despite the low expenditure on **stock building** in 1985, most companies still regard their current stock levels as more than adequate in relation to output and sales. The fall in stock ratios in recent years may reflect in part cautious behaviour by companies after the last recession. Another factor has been the high cost of holding stocks as a result of the high level of real interest rates and the abolition of stock relief in the 1984 Budget. Stock ratios and the estimated real cost of holding stocks are illustrated in Chart 3.11.

CHART 3.11 STOCK RATIOS



Prospects for demand and activity

3.54 Strong growth in exports has made an important contribution to GDP growth over the last two years. In 1985 the increase in manufactured exports was ~~almost twice~~ the estimated increase in ~~world trade in manufactures~~, while UK imports of manufactures grew less than usual in relation to the growth in demand.

3.55 The fall in oil prices has improved the prospects for world trade, and the adjustment of the exchange rate to lower oil prices has made British manufactures more competitive. As in most other industrial countries, higher domestic demand (stimulated by lower inflation) is expected to make an important contribution to growth in 1986, but exports should also show substantial growth (see Table 3.9). The slowdown forecast for export growth in the first half of 1987 reflects the path of North Sea oil output and hence oil exports.

Table 3.9 Domestic demand and trade

	Per cent changes on a year earlier (at constant prices)		
		Forecasts	
	1985	1986	1987 H1
Domestic demand	2½	3¼	3
Exports of goods and services	6	5	3
Imports of goods and services	3	6	5

3.56 Total domestic production is expected to increase by 3 per cent in 1986, following 3½ per cent growth in 1985. After allowance for the coal strike, growth is close to 2½ per cent in both years as shown in Table 3.10. The average level of oil production in 1986 is likely to be close to the level in 1985 and 1984, but the fall forecast for oil output between the first half of 1986 and the first half of 1987 may cut total GDP growth by ~~over~~ ½ per cent. Output growth in the non-oil economy in 1986 and the first half of 1987 is expected to be comparable to that seen in 1985. Manufacturing output has grown slightly faster than GDP since 1983. The composition of demand growth in the forecast suggests that growth in manufacturing output may continue at around the underlying rate of growth of GDP.

Table 3.10 Real GDP and manufacturing output

	Per cent changes on year earlier		
		Forecasts	
	1985	1986	1987 H1
GDP (average measure)	3½	3	2½
GDP, adjusted for coal strike *	2½	2½	2½
GDP, adjusted for coal strike and excluding oil output *	2½	2½	3
Manufacturing output	3	3	2½

* Adjustments are approximate

Prob 3.2

Productivity and the labour market

3.57 Total employment in Great Britain is estimated to have grown by about 220 000 over the year ending September 1985, giving a total increase since March 1983 of over 700 000.

3.58 The published figures show an increase of 12 000 in the number of employees in employment during the first nine months of 1985: a further rise in the number of employees in the service industries was largely offset by falls in the production and construction industries. Self employment is assumed to have risen by about 31 000 a quarter since the middle of 1984, the same as the estimated quarterly increase over the previous three years. This compares with an increase of about 68 000 a quarter recorded between the middle of 1983 and the middle of 1984. The estimates of growth in employment over the recent past shown in Table 3.11 are subject to revision when the Census of Employment for 1984 and the Labour Force Survey for 1985 become available.

Table 3.11 Employment

thousands, change in GB, seasonally adjusted

	Employees in employment			Self employed	HM Forces	Employed labour force
	Male	Female full-time	Female part-time			
September 1983 to September 1984	− 84	+ 19	+ 174	+ 236	+ 3	+ 348
September 1984 to September 1985	− 105	+ 20	+ 181	+ 125	− 2	+ 219

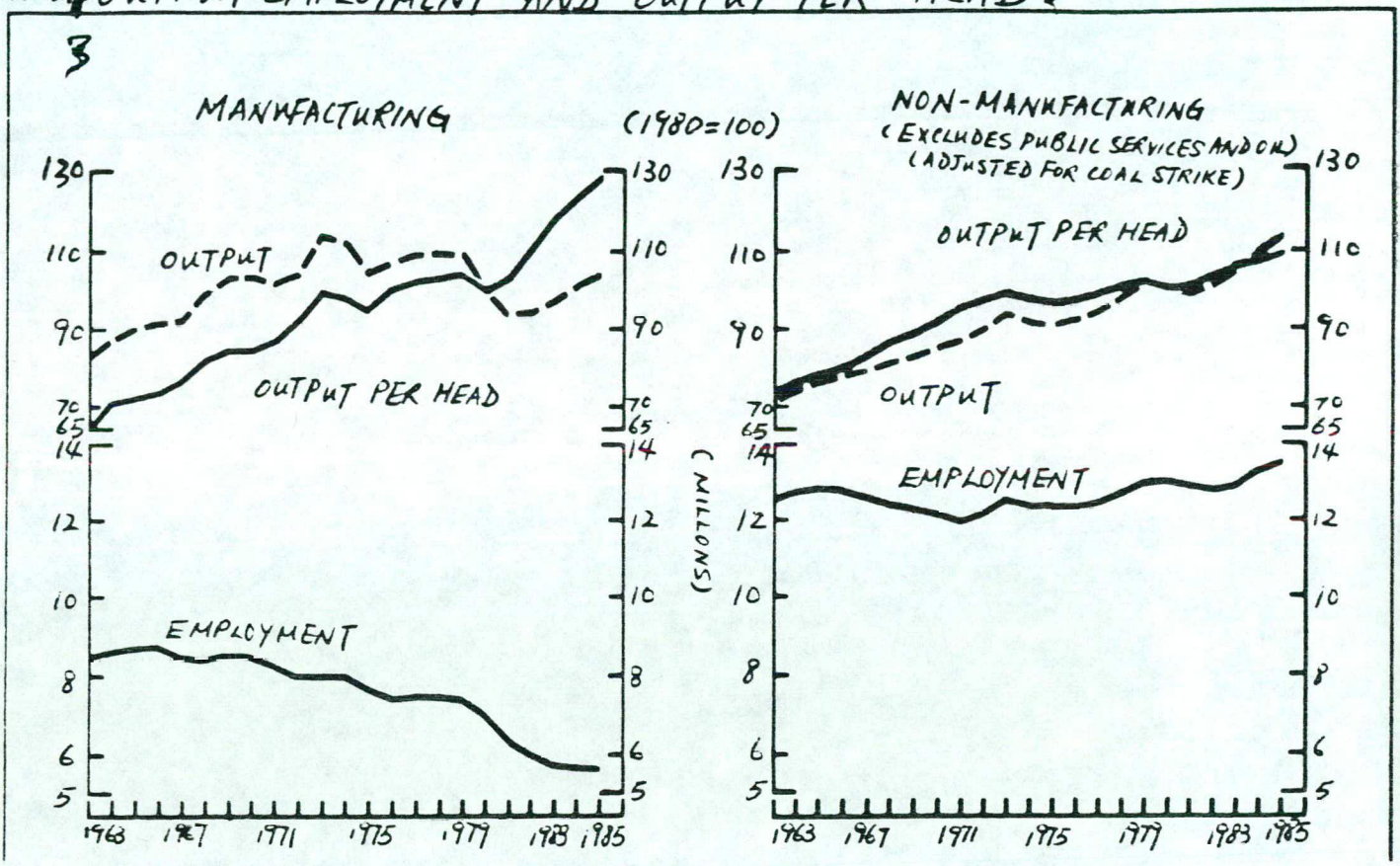
3.59 Following upward revisions to the output estimates, output per head in manufacturing now appears to have risen by about 3¾ per cent in 1985, ~~in line with~~ the annual average of 3½ per cent for the period 1979–85. This marks a major improvement on the productivity performance recorded between 1973 and 1979: the trend growth in productivity in manufacturing now appears to be close to the rate achieved during the sixties (see Table 3.12). Non-manufacturing productivity has also been rising faster of late than in the 1973 to 1979 period. Growth in output per man hour has been rising at about 2 per cent per annum since 1979. However, the rise in part-time employment is currently bringing down growth in output per head in non-manufacturing, to about 1 per cent a year.

Table 3.12 Output per head

	Employed labour force (millions)	Per cent changes in output per head (annual averages)		
	1984	1964–73	1973–79	1979–85
Manufacturing	5½	3¾	¾	3½
Non-manufacturing*	13½	3	½	1

* *Excludes public services and oil, and includes nationalised industries except steel.*

CHART 3.1 OUTPUT EMPLOYMENT AND OUTPUT PER HEAD



Unemployment

3.60 The increase in employment since 1983 has not so far prevented a continuing rise in **unemployment,** as growth in the labour force has been exceptionally large. However, the rise in unemployment has slowed down over the last year: the average increase in adult unemployment was about 5 000 a month over the twelve months to February.

3.61 Pay increases have generally been well above price rises and well above the rise in pay in most other industrialised countries (see Chart 3.8), thus contributing to the rise in unemployment in recent years. With output and employment continuing to grow, and growth in the labour force ~~starting~~ slowing ~~to slow~~ down, the prospects for unemployment are better than they have been for some years.

Forecast and outturn

3.62 The table below compares the main elements of the forecast published in the 1985 FSBR with outturn or latest estimate:

Table 3.13 Forecast and outturn

	Forecast	Latest estimate/ forecast	Average errors from past forecasts
Total output: per cent change between 1984 and 1985	3½	3½	¾
RPI: per cent increase between the fourth quarters of 1984 and 1985	5	5½*	1½
Money GDP, per cent change between 1984–85 and 1985–86	8½	9½	1½
Current account of the balance of payments in 1985, £ billion	3	3	2½
PSBR, financial year 1985–86 £ billion	7	7	5

* Outturn.

Because of the new chart, this table should go on the next page, with para 3.64 coming here

3.63 Inflation in the fourth quarter of 1985 turned out a little higher than forecast a year ago. The forecasts made at the time of the last Budget for output growth and the current balance in 1985, and for the PSBR in 1985–86, are all very close to the latest estimates for these variables. In each case such error as there appears to have been is considerably smaller than the average error from past forecasts.

Table 3.14 The prospects: summary

	Forecast	Average errors from past Forecasts[1]
A. Output and expenditure at constant 1980 prices	per cent changes 1985 to 1986	
Domestic demand	3½	1
of which:		
Consumers' expenditure	4	1
General Government consumption	1	1
Fixed investment	5	2
Change in stockbuilding (as per cent of level of GDP)	0	¾
Exports of goods and services	5	2½
Imports of goods and services	6	2½
Gross domestic product: total	3	3/4
: manufacturing	3	2
B. Inflation		
Retail prices index	per cent changes	
1985Q4 to 1986Q4	3½	1½
1986Q2 to 1987Q2	3½	2½
Deflator for GDP at market prices	per cent changes on a year earlier	
Financial year 1985–86	6	1
Financial year 1986–87	3¾	2
C. Money GDP at market prices	per cent changes on a year earlier	
Financial year 1985–86	9½	1¼
Financial year 1986–87	6¾	1½
D. Balance of payments on current account	£billion	
1986	3½	2½
1987 first half (at an annual rate)	1½	3
E. PSBR	£ billion[2]	
Financial year 1985–86	(2)	1 (¼)
Financial year 1986–87		(1¾)

[1] *The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications and government forecasts (see Economic Progress Report June 1981). The calculations for the constant price variables [and the GDP deflator] are derived from forecasts made during the period between June 1965 and October 1983. For the current balance and the retail prices index, forecasts made between June 1970 and October 1983 are used. For the PSBR, Budget forecasts since 1967 are used. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.*

[2] *Per cent of GDP in market prices shown in brackets.*

The calculations of average errors are based on forecasts made between 1975 and 1984.

Risks and uncertainties

3.64 No forecast is complete without an indication of error margins. Table 3.14 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide an indication of possible errors in the current forecast. Those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR, including the revenues of the public corporations, are about £200 billion; and for the current account of the balance of payments exceed £150 billion.

3.65 While the size of errors will change over time as the economy fluctuates, and as forecasting techniques change, in many cases the averages have not shifted very much since 1976. For the RPI, however, average errors are derived from a period of high and fluctuating inflation, averaging 12 per cent, and overstate likely errors at current rates of inflation. The average error in the last three Budget forecasts looking ahead to the end of the year was ½ per cent.

BUDGET SECRET—BUDGET LIST ONLY

Table 3.15 Constant price forecasts of expenditure, imports and gross domestic product*

£ billion at 1980 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	Total final expenditure	*Less* Imports of goods and services	*Less* Adjustment to factor cost	*Plus* Statistical adjustment	Gross domestic product at factor cost	GDP index 1980 = 100
1981	136·5	48·9	37·9	62·0	−2·5	282·9	55·9	30·2	−0·5	196·3	98·6
1982	137·6	49·4	40·1	62·8	−1·1	288·7	58·7	30·6	0·7	200·1	100·4
1983	142·9	50·2	42·2	64·4	0·7	300·4	62·1	31·5	0·1	206·7	103·7
1984	145·6	50·9	45·5	69·1	−0·1	310·9	68·0	32·7	2·0	212·1	106·4
1985	149·6	51·2	45·9	73·2	0·9	320·9	70·1	33·6	1·8	219·0	109·9
1986	155·4	51·6	48·2	76·8	0·8	332·9	74·1	34·5·0	1·9	225·7	113·2
1984 H1	72·6	25·2	22·7	33·7	−0·3	153·9	32·9	16·3	0·6	105·3	105·6
H2	73·0	25·7	22·8	35·4	0·1	157·0	35·1	16·4	1·4	106·9	107·3
1985 H1	74·0	25·5	23·2	36·8	0·2	159·7	35·0	16·6	1·0	109·1	109·4
H2	75·7	25·7	22·7	36·4	0·7	160·5 1·2	35·1	17·0	0·9	110·0	110·4
1986 H1	76·9	25·7	24·2	38·1	0·2	164·5·2	36·5	17·3	0·8	112·2	112·6
H2	78·5	25·8	24·4	38·7	0·6	167·6	37·6	17·6	1·1	113·5	113·9
1987 H1	79·9	25·8	24·2	39·3	0·7	169·7 170.0	38·2	17·9	1·0	114·9	115·3
	Per cent changes										
1983 to 1984	2	1½	8	7	—	3½	9½	3½	—	2½	2½
1984 to 1985	3	½	1	6	—	3	3	3	—	3½	3½
1985 to 1986	4	1	5	5	—	3½	6	3½	—	3	3
1986 H1 to 1987 H1	4	½	0	3	—	3	5	3	—	2½	2½

** GDP figures in the table are based on "compromise" estimates of gross domestic product, reflecting for the past average movements in constant price expenditure, output and income estimates of GDP. Percentage changes are calculated from unrounded levels and then rounded to half per cent. Totals in £ billion may not add due to rounding. Figures for 1986 H1 and beyond are forecasts. Figures for periods up to the end of 1985 are based mainly on the national accounts published earlier this year (covering periods up to 1985 Q3) and incorporate some revised and later data and forecasts. A full set of national accounts, to end 1985, will be published by CSO on 21 March.*

BUDGET SECRET—BUDGET LIST ONLY

4 The Budget Tax Proposals

4.01 The main tax changes proposed in the Budget are summarised below. A full list of changes is given in ~~the Annex to this Chapter~~. Table 4.1

Income Tax

4.02 The basic rate of income tax will be reduced to 29 per cent.

4.03 Income tax personal allowances will be increased ~~by~~ 5·7 per cent ~~(the increase~~ in the RPI in the year to December 1985~~) as provided for by statute)~~ This will mean that

- the single person's and wife's earned income allowances will rise from £2 205 to £2 335
- the married allowance will rise from £3 455 to £3 655
- the additional personal allowance and widow's bereavement allowance will rise from £1 250 to £1 320

4.04 Thresholds for the higher rates of income tax will be as follows:

Tax rate Per cent	£
29	0–17 200
40	17 201–20 200
45	20 201–25 400
50	25 401–33 300
55	33 301–41 200
60	over 41 200

Social Security uprating

4.05 The uprating date for Social Security benefits is being changed from November to April. As part of the transitional arrangements there will be an ~~interim~~ uprating in July 1986. Exceptionally, the Government has decided to exempt from income tax the amount of the increase payable in 1986–87 on retirement pensions~~es~~ and linked long term benefits.

~~Non-resident~~ Visiting entertainers and sportsmen

4.06 UK practice on the taxation of visiting entertainers and sportsmen will be brought into line with that in most other OECD countries by the introduction of deduction of tax at source, and other measures. The new arrangements will not come into effect until 1987–88.

Excise duties

4.07 The ~~duties~~ specific duties on cigarettes and hand rolling tobacco will rise by about 13½ per cent, equivalent to just over 11p on a packet of 20 cigarettes. Those on pipe tobacco and cigars will remain unchanged.

4.08 Duties on alcoholic drinks will remain unchanged.

4.09 Duties on road fuels will go up by a little more than 8 per cent or the equivalent of approximately 7½p on a gallon of petrol and 6½p on a gallon of derv.

Vehicle Excise Duty **4.10** The duty on cars, light vans, motor cycles and most lorries will remain unchanged. The duty rates on buses, coaches and taxis will rise by 5 per cent.

Business Expansion Scheme **4.11** The Business Expansion Scheme ~~was due to come to an end on 1 April 1987.~~ It is proposed to continue it indefinitely and to exempt new BES shares from ~~CGT~~ on first sale. Certain low-~~rate~~ activities including those with high-asset-backing are to be excluded. ~~Certain forms of ship chartering are~~ to be included. ~~Chartering~~ Ships is to be included.

Capital Transfer Tax **4.12** The lifetime ~~CTT~~ charge is to be abolished for all gifts between individuals made on or after Budget Day. There will, however, remain a tax on transfers made on death. Gifts made within seven years of death will be charged ~~at a tapered rate~~ but with taper relief. To reflect its new structure, the tax will be known as the Inheritance Tax.

4.13 Under the new arrangements, ~~and also to protect the lifetime charge~~, there will continue to be a charge on transfers involving trusts. Provision will be made to charge gifts in relation to which the donor may continue to enjoy a benefit. The exempt amount and rate bands of the tax will be increased from Budget Day, as follows:

Bands of chargeable value £000	Rate on death per cent
0–71	0
71–95	30
95–129	35
129–164	40
164–206	45
206–257	50
257–317	55
Over 317	60

Personal Equity Plans **4.14** A new scheme known as Personal Equity Plans will be introduced to encourage individuals to invest directly in equities. Shares held in such plans will be free of any tax on both capital gains and dividend income. Investment of up to £2 400 will be permitted each year and the shares will have to be held for a minimum period of not more than two years.

Stamp Duties **4.15** The rate of Stamp Duty on share transactions is to be reduced in the Autumn from 1 per cent to ½ per cent. The scope of the duty will be widened to cover the following transactions (currently exempt):

Takeovers including mergers (but excluding company reconstructions) – from 19 March

Certain Loan Stock – from 19 March

Letters of allotment – partly from 19 March and partly from the Autumn

Intra account dealing – from the Autumn

Company purchase of own shares – from the Autumn

A 5 per cent duty is being imposed where shares are converted into Depositary Receipts, from 19 March.

Employee Share Schemes

4.16 The following measures will be taken to encourage further the spread of approved employee share schemes:

—the extension of the present tax reliefs to shares which ~~have been granted to employees with the condition that they be sold, returned to the employer, or otherwise disposed of~~ must be disposed of when the employment ends.

—changes to enable employee controlled companies and worker co-operatives to take advantage more easily of existing schemes.

—more liberal regime for savings-related share options.

Pension Funds Surpluses

4.17 The present rules relating to pension fund surpluses will be clarified and revised as follows:

—pension funds' assets and liabilities will be valued, for tax purposes only, on standard assumptions ~~provided~~ advised by the Government Actuary;

—where such valuation shows an actuarial surplus of assets over liabilities of more than 5 per cent, the trustees shall be required to reduce it to not more than 5 per cent by ~~either~~ (i) an increase in pension benefits (within existing limits), or (ii) a contribution reduction or holiday by either employer or employee, or (iii) a refund to the employer, or (iv) by any combination of these measures, the choice of method being for the trustees to decide;

—where a refund is made to the employer, it will be subject to ~~a tax~~ tax charge in the ~~company's~~ employer's hands at a rate of 40 per cent.

—no refund will be permitted which would reduce the surplus to less than 5 per cent.

Charitable giving

4.18 Four new types of tax relief will be introduced:

—Companies ~~in~~ other than close companies ~~are~~ will for the first time be able to claim tax relief for single gifts to charity. The relief will be on single gifts up to a maximum equal to 3 per cent of the ordinary dividends paid by the company in the accounting period.

—The present annual limit of £10 000 on the amount of charitable giving through deeds of covenant for which an individual taxpayer may claim higher rate relief will be abolished; restrictions will remain only where the measures against abuse apply.

—There will be a new scheme from April 1987 to encourage individuals to make donations to charity through deductions from their wages and salaries. Employees whose employers participate in the scheme will be able to get tax relief on donations of up to £100 a year.

—VAT relief will be available on distress alarms and lifts for the handicapped and their charities, non-classified press advertising by charities, medicinal products supplied to charities, video and refrigeration equipment used in medical applications by certain eligible bodies including charities, welfare vehicles used by such bodies to transport the deaf, blind and mentally handicapped, and recording equipment used by charities for the blind.

4.19 Measures are also to be taken to prevent abuse of the tax relief for charities.

Business taxation

4.20 The final stage in the business tax reforms introduced in 1984 will take effect on 1 April 1986 with the reduction in the main corporation tax rate to 35 per cent and (with a few mainly transitional exceptions) the full implementation of the ~~standard reducing balance~~ new system of capital allowances. These reforms will be completed by updating the mines and oil wells capital allowances code, and adapting the system of allowances for agricultural buildings. In order to provide a full measure of tax depreciation for agricultural buildings and works with a short life, ~~the~~ taxpayers may choose to make balancing adjustments on their disposal or destruction.

Oil taxation

4.22 ~~The small companies' corporation tax rate will be reduced to 29 per cent. Unincorporated businesses will benefit from the reductions in basic rat to 29 per cent.~~ Except for the updating of the mines and oil wells capital allowances code, no other changes are being proposed to oil taxation apart from technical changes to remove some anomalies.

Capital gains tax

4.23 The ~~CGT~~ capital gains tax annual exempt amount is to be increased in accordance with the statutory indexation provisions ~~by 5.7 per cent~~ from £5 900 to £6 30 in the case of individuals, and from £2 950 to £3 150 in the case of most trusts.

~~Car and car fuel benefits~~

4.24 The scales which determine the taxable cash equivalents of car and car fuel benefits in respect of company cars provided for directors and for employees earning £8 500 a year or more are to be changed from 6 April 1987. The present (1300cc and 1800cc) engine-size break points are to be aligned, on a revenue-neutral basis, with those (1400cc and 2000cc) ~~set out~~ in the proposed European Community Directive on car exhaust emissions. The resulting scale charges for car benefits (but not car fuel benefits) will be increased by 10 per cent for 1987–88. From April 1987 the c fuel benefit scale is to be used both for income tax purposes and to assess th VAT chargeable on fuel used for private journeys in business cars.

Value Added Tax

4.25 From 19 March 1986 the registration limits will become £20 500 per annum and £7 000 per quarter.

4.20 The small companies' rate of Corporation Tax will be reduced to 29%. As a consequence of the reduction in the basic rate of income tax, the rate of ACT will be reduced to 29/71sts of the distribution. To reinforce this link between the rates, the Finance Bill will contain a provision for the ACT rate to be adjusted automatically in line with future changes in the basic rate of income tax.

Table 4.1 Direct effects of changes in taxation

£ million

		Estimated effect on receipts in 1986–87 measured against:		Second year effect
		Indexed base	Non-indexed base	
	INLAND REVENUE			
	Income tax			
1	Reduction of 1p in basic rate	−830	−830	
2	Increase in single allowance of £130 and married allowance of £200	Nil	−895	
3	Increase in additional personal allowance and widow's bereavement allowance of £70	Nil	−10	
4	Increase in age allowance of £160 (single) and £250 (married) and income limit of £600	Nil	−115	
5	Increase in basic rate limit of £1 000 to £17 200	Nil	−70	
6	Changes to higher rate thresholds	+15	−35	
7	Abolition of higher rate relief limit for charitable covenants	Negligible *	Negligible *	−5
8	Relief for charitable donations through payroll deduction schemes	Nil	Nil	−20
9	Changes in rules for the tax treatment of non-resident entertainers and sportsmen	Nil	Nil	+75
10	Fringe benefits—car and car fuel scales	Nil	Nil	+15
11	Changes to relief for overseas travel expenses	−10	−10	−5
12	Exemption for 1986–87 of July increase in retirement pensions and linked long term benefits	−15	−15	Negligible
13	Changes in taxation of employee share acquisitions	Negligible *	Negligible *	Negligible
14	Use of restricted shares in approved employee share schemes	Negligible *	Negligible *	Negligible
15	Use of shares providing employee control in approved employee share schemes	Negligible *	Negligible *	Negligible
16	Worker co-operatives' use of redeemable shares in approved profit-sharing schemes	Negligible *	Negligible *	Negligible
17	Exercise of options granted under approved savings-related share option schemes	Negligible *	Negligible *	Negligible
18	Change in basis of assessment of enterprise allowance	Negligible *	Negligible *	−5
19	Exemption of pensions paid to victims of Nazi persecution	Negligible *	Negligible *	Negligible
	Income tax and capital gains tax			
20	Tax relief for Personal Equity Plan	Negligible *	Negligible *	−25
21	Business Expansion Scheme—continuation beyond April 1987 and changes in coverage	Negligible *	Negligible *	+10
	Income tax and corporation tax			
22	Refunds by occupational pension schemes to employers	+20	+20	+120
23	Mines and oil wells capital allowances	Negligible *	Negligible *	−45
24	Changes in agricultural buildings allowance rules	Negligible *	Negligible *	Negligible
25	Changes in capital allowance rules for leased assets	Negligible *	Negligible *	Negligible
26	VAT penalties, interest, surcharges and repayment supplement *	Nil	Nil *	Negligible
	Income tax, corporation tax and capital gains tax			
27	Charities: anti-avoidance measures	Negligible *	Negligible *	+20
28	Limiting scope of anti-bondwashing provisions	Negligible *	Negligible *	Negligible
29	Amendments to Accrued Income Scheme	Negligible *	Negligible *	Negligible
	Income tax, corporation tax, capital gains tax and capital transfer tax			
30	Changes in relation to securities	Negligible *	Negligible *	Negligible

* = Negligible
— = Nil

Table 4.1 Direct effects of changes in taxation—*continued*

£ million

	Estimated effect on receipts in 1986-87 Indexed base	Non-indexed base	Second year effects 1987-88
Corporation tax			
31 Reduction in rate of ACT to 29/71 times the amount of the dividend	−120	−120	−60
32 Reduction in small companies rate to 29 per cent	Negligible	Negligible	−20
33 Relief for single donations to charity by companies	Negligible	Negligible	−35
34 Loans by close companies	Negligible	Negligible	Negligible
35 Transfer of losses on company reconstruction	Negligible	Negligible	+5
Corporation tax and capital gains tax			
36 Small part disposals of land	Nil	Nil	−5
Oil taxation			
37 Technical changes to remove anomalies	Negligible	Negligible	Negligible
Capital gains tax			
38 Indexation of annual exempt amount	Nil	Nil	−5
Reduction of period for cumulation of transfers to 7 years			
Taxation of gifts with reservation of benefits			
39 Restriction of holdover relief for dual resident trusts	Nil	Nil	+5
Capital transfer tax (inheritance tax)			
40 Abolition of lifetime charge on transfers between individuals & consequential changes	−35	−35	−55
41 Indexation of chargeable rate bands	Nil	−20	−45
Exemption for share transfers to employee trusts	Negligible	Negligible	Negligible
Stamp duties			
43 Ther Changes from 19 March 1986	+50	+50	+50
42 Reduction in rate on shares to ½ per cent from Autumn 1986	−70	−70	−75
44 Other changes from Autumn 1986	+20	+20	+35
TOTAL INLAND REVENUE	−975 ~~−985~~	−2135 ~~−2145~~	−279
CUSTOMS AND EXCISE			
Value added tax			
45 Increase in registration limits	Nil	Negligible	Negligible
46 Revised treatment of motoring expenses	Nil	Nil	+40
47 New rules on disaggregation of registrations	Negligible	Negligible	+20
48 Revised treatment of hotels and tourism	Nil	Nil	+10
49 Reliefs for charities and the handicapped	−10	−10	−10
50 Direct exports	Nil	Nil	Nil
51 Transfer of import relief	Nil	Nil	Nil
Excise duties			
52 No change in rate of spirits duty	−45	Nil	Nil
53 No change in rate of beer duty	−95	Nil	Nil
54 No change in rate of duty on cider and perry	−5	Nil	Nil
55 No changes in rates of wine and made wine duties	−30	Nil	Nil
56 Increases in rates of duty on ~~light oil~~ petrol etc	+110	+380	+400
57 Increase in rate of duty on ~~heavy oil for use in road vehicles~~ derv	+30	+95	+105
58 No change in rate of fuel oil duty	−5	Nil	Nil
59 Abolition of duty on lubricating oils	−10	−10	−10
60 Abolition of duty on AVTUR	−10	−10	−10

Table 4.1 Direct effects of changes in taxation—*continued*

	£ million		
	Estimated effect on receipts in 1986–87 [a]		Second year effects
	Indexed base	Non-indexed base	
61 Increase in rate of duty on gas oil	+25	+30	+30
62 Increases in rates of tobacco products duties	+175	+315	+335
63 Abolition of certain excise licences	Negligible	Negligible	Negligible
64 Northern Ireland betting and gaming	Negligible	Negligible	Negligible
TOTAL CUSTOMS AND EXCISE	**+130**	**+790**	**+910**
Vehicle excise duty			
66 No change in VED on car, light van and main lorry rates	−135	Nil	Nil
67 Increase in other VED rates	Nil	+5	+5
~~Increased penalties for VED evasion~~	~~Negligible~~	~~Negligible~~	~~£5~~
Other			
Bus fuel grants	−5	−10	−10
68 **TOTAL CHANGES IN TAXATION**	−995 985	−1360 1350	−1885 −1885
69 Changes in trade licensing arrangements	*	*	*
65 Excise warehousing regulations	Nil	Nil	Nil

insert on this spreadsheet

Annex to Chapter 4

How the figures in Table 4.1 have been calculated

~~Table 4.1~~

Table 4.1 gives the direct effects of changes in taxation. Estimates are rounded to the nearest £5 million. "Negligible" means less than £3 million. Components may not sum to totals because of rounding.

The **direct** effect of a tax change is the difference between the yield of the tax which would arise on the basis of the rates of tax, allowances, etc prevailing before th Budget (the pre-Budget regime) and the yield after the changes proposed in the Budget (the post-Budget regime).

For **Inland Revenue** taxes (and VED) the difference in yield for each tax is generally calculated by applying the pre- and post-Budget tax regimes to the same ta base. This base is the post-Budget base—that is the levels of income, profits etc forecast for future years on the assumption that all the measures proposed in the Budget take effect. In certain cases, however, the difference in yield also takes account of changes in taxpayers' behaviour arising from the tax change where thes behavioural changes can be directly attributed to the change in tax. For example, the estimate of the direct cost of the cut in stamp duty rates allows for the expecte increase in chargeable transactions, ~~as well as for the expected increase in capital gains tax~~.

For **Customs and Excise** taxes and duties, the calculation takes into account, where possible, the effect of the tax change on the pattern of consumers' expenditu and the resulting impact on other expenditure taxes but makes no allowance for secondary effects: in particular, it is assumed that total consumers' expenditure does not change. A fuller description of the methodology is in Economic Trends, March 1980.

Table 4.1 shows the expected change in **receipts** of tax resulting from the Budget proposals. Additional information is provided below for those proposals where the effect on tax **liabilities** in the first complete year to which the change applies (full year effect) is substantially different from the effect on **receipts** in either 1986–87 [or 1987–88]; or where the impact of the proposal is expected to build up over a period of years.

The direct effects shown in the third column of Table 4.1 assume that the levels of allowances, rates of duty etc proposed in the Budget for 1986–87 continue to apply for 1987–88 and compare the effect on receipts in that year with allowances and rates of duty unchanged from their money levels in 1985–86 (the unindexed base).

The estimates shown in Table 4.1 do not reflect changes in the tax base arising from changes in money incomes and in the general level of prices and other economic variables which may result from the proposed tax change. These secondary effects are, of course, taken into account in estimating the impact the tax change on the PSBR. The base for the post-Budget forecast of each tax (given in Table 4.3) takes account of the effects, direct and secondary, of all the measures announced in the Budget.

The remainder of this annex provides a commentary on the ~~entries to~~ Table 4.1.

Please print these numbers in bold as in the text like para numbers. - but as shown, not underlined etc.

Income tax

(1) The basic rate will be reduced from 30 per cent to 29 per cent. ~~Apart from the revenue loss shown, there will be a saving in public expenditure in mortgage tax relief for the tax fresh~~ (2) The single person's allowance and the wife's maximum earned income relief will be increased from £2 205 to £2 335 and the married allowance from £3 455 to £3 655.

The cost figures in the table include the saving in public expenditure on mortgage interest relief. But they do not include ACT shown on line (31) of Table 4.1

(3) The additional personal allowance and widow's bereavement allowance will be increased from £1 250 to £1 320.

(4) The age allowance will be increased for the single person from £2 690 to £2 850, and for the married from £4 255 to £4 505; the age allowance income limit will be increased from £8 800 to £9 400.

(5) The basic rate limit will be increased to £17 200.

(6) The width of the 40 per cent higher rate band will be maintained at £3 000; the 45 per cent band ~~increased to~~ at £5 500 and the 50 per cent and 55 per cent bands ~~increased to £8 400~~. at £7 500

(7) The £10 000 limit on higher rate relief for covenanted donations to charities will be abolished.

(8) From April 1987 relief will be introduced for charitable donations of up to £100 a year made through payroll deduction schemes. The cost estimate depends on take up.

(9) New rules will be introduced for the tax treatment of visiting ~~non-resident~~ entertainers and sportsmen who derive income from the UK. In later years, the yield from this measure is expected to be in excess of £100 million a year ~~p.a.~~

(10)(a) With effect from 1987–88, the present engine size breakpoints in the scales for taxing car and car fuel benefits in respect of company cars provided for directors and employees whose remuneration is at a rate of £8 500 a year or more, will be changed on a revenue neutral basis and the new scale for car benefits will be increased by 10 per cent.

The scale charges for expensive cars and for cars without an engine rated in cc's will also be increased by 10 per cent, and the market-value breakpoints for these cars are to remain unchanged.

comparable to those

(11) The relief for certain overseas travel expenses incurred by UK resident employees working abroad and by expatriates working in the UK will be extended from 1984–85. ~~All of the reliefs for overseas travel and subsistence that are~~ available to UK resident employees working wholly abroad ~~will be extended to UK resident self employed persons with businesses wholly abroad.~~ The higher ~~cost~~ first year cost arises from the proposal to apply these improvements with effect from 6 April 1984.

UK resident self-employed persons working wholly abroad ... comparable to those

(12) For 1986–87 the increase in retirement pensions and linked long term benefits payable from July 1986 will be exempted from income tax.

(13) The tax charging provisions relating to directors' and employees' acquisitions of shares and interests in shares in their companies will be amended.

(14) The use of shares subject to restrictions on their retention by ex-directors and ex-employees will be permitted in approved employee share schemes.

(15) The use of shares of a class, the majority of which is held by directors and employees and which gives them control of the company, will be permitted in approved employee share schemes.

(16) Registered worker co-operatives will be able to use redeemable shares in approved profit sharing schemes.

(17) Approved savings-related share option schemes will be enabled to permit exercise of options within three years in certain circumstances.

(b) The return employers have to make of those (directors & employees whose remuneration is at a rate of £8,500 a year or more) not in receipt of benefits or expenses payments, will be simplified.

(18) The basis of assessment of the enterprise allowance will be changed from Case I or Case II to Case VI of Schedule D.

(19) Certain pensions paid to victims of Nazi persecution will be exempted from income tax.

Income tax and capital gains tax

(20) A new tax relief will be introduced for individuals investing in equities. The cost will build up over a number of years and will depend on take up.

(21) The duration of the Business Expansion Scheme will be extended indefinitely; an exemption from capital gains tax will be introduced on the first sale of new qualifying shares and certain changes will be made to the coverage of the scheme. The scheme has a full year cost at current levels of investment of about £10 million. The 1987–88 figure includes a small first year cost for continuing the scheme after April 1987.

Income tax and corporation tax

(22) The ~~arrangements~~ rules relating to occupational pension fund surpluses will be clarified and refunds from overfunded schemes to sponsoring employers will be charged to tax at 40 per cent. The figure for 1987–88 includes a yield of £70 million in Corporation Tax and income ~~related~~ tax reflecting changed levels of contributions to or benefits paid from pension funds. The overall yield, including the charge on refunds may be about £250 million in each of the following three years.

(23) The mines and oil wells capital allowances rate will be amended; in particular to change to percentage based writing down allowances on a reducing balance and incurred basis, instead of the existing output-related allowances. The cost will decline gradually in later years.

(24) The provisions governing the agricultural buildings allowance will be amended. The cost will be up to £5 million in the early 1990s and up to £20 million in the longer term.

(25) The legislation relating to capital allowances on machinery or plant which is leased and on certain vehicles ~~which are leased~~ will be amended.

This will increase subsequent liability to mainstream corporation tax. The full year cost is £10 million

(26) Deductions for VAT penalties, interest and surcharges will be disallowed and VAT repayment supplement will be disregarded. The yield will build up over time to about £40 million by 1991–92.

Income tax, corporation tax and capital gains tax

(27) Provisions to counter abuse of the tax reliefs for charities will be introduced.

Income tax, corporation tax, capital gains tax and capital transfer tax

(30) Changes will be made in relation to securities including replacing special rules for Stock Exchange jobbers by rules for market makers.

(28) Certain securities within the Accrued Income Scheme will be removed from the scope of the anti-bondwashing provisions.

(29) Changes will be made to the Accrued Income Scheme.

Corporation tax

(30) The rate at which advance corporation tax for 1986–87 will be payable will be fixed at 29/71sts of the amount of the distribution.

(32) The small companies rate of Corporation Tax for the financial year 1986–87 will be reduced to 29 per cent.

(33) A relief from tax will be introduced for single donations to charity by companies which are not close. The cost may rise to about £70 million depending on take up. £100

(34) An anomaly in the taxation of loans to participators in close companies will be corrected. Without this measure there could have been widespread avoidance, costing tens of £ millions.

(35) The transfer of tax losses on a company reconstruction will be restricted. The yield will rise eventually to about £50 million a year.

Corporation tax and capital gains tax

(36) The provisions dealing with small part disposals of land will be amended.

(37)(a) The allocation of tariff charge in cases of fields in common ownership which received development consent on the same day will be clarified.

Oil taxation

(b) The onshore/offshore boundary for oil tax purposes will be defined to coincide with the UK coastline.

(c) An alternative basis for determining the market value of ~~methane and~~ certain ~~other~~ light gases will be provided.

Capital gains tax

(38) The annual exempt amount will be increased in line with the increase of ~~the~~ per ~~cent~~ in the retail prices index during 1985 so that for 1986–87 an individual will be exempt on the first £6 300, and most trusts on the first £3 150, of capital gains.

(39) The hold-over relief for gifts to dual resident trusts will be amended.

Capital transfer tax and (inheritance tax)

(40) The charge on transfers between individuals made on or after 18 March 1986 and more than seven years before the transferor's death will be abolished. Inheritance tax will be charged on other transfers on or after that date. The estimated eventual effect attributable to transfers in 1986–87 is £70 million. If increased lifetime givings reduce the amounts in the death estate of donors, the CTT yield from those death estates will be reduced.

Transfers made on or after 18 March 1986 but within seven years of the transferor's death will be charged according to the scale for transfers on death; the charge will be reduced in the case of transfers more than three years before death.

For events on or after 18 March 1986 the period for cumulation of a transferor's or settlor's previous chargeable transfers for the purpose of the rate of tax on transfers into trust and on property held in trust will be reduced from ten to seven years.

Gifts with reservation of benefit made on or after 18 March 1986 in connection with the donor's death will be taxed as if the whole of the gifted asset had remained in his estate until the reservation was finally given up.

? lowercase or bold.

(41) The tax will in future be known as ~~renamed~~ the Inheritance Tax. The bands of chargeable value for transfers on death occurring on or after 18 March 1986 will be increased ~~by 5·7 per cent~~ broadly in line with the increase of 5·7 per cent in the retail prices index in the year to December 1985. ~~The proposed rate structure will be as follows:~~

Bands of chargeable value £000	Rate on death per cent
0–71	0
71–95	30
95–129	35
129–164	40
164–206	45
206–257	50
257–317	55
Over 317	60

Transfers (other than between individuals) not within seven years of the transferor's death will be charged at half the death rates.

Stamp duties

(42) ~~With effect from 19 March 1986~~ The rate of duty on shares will be reduced from 1% to ½% with effect from the future. ~~Duty will be charged at a rate of ½ per cent on takeovers and certain other company reorganisations.~~ The duty on additional transactions expected to follow from the reduction in the rate is taken into account in the costing. The figure for 1987–88 takes account of the increased yield in ~~Capital Gains Tax~~ capital gains tax arising on the additional transactions.

(43) ~~SA~~ SDLT effect from 19 March 1986.
Duty will be charged at a rate of ½ percent on takeovers of certain other company reorganisations.
A new exemption for company reconstructions will be introduced.

Exemptions from sale duty for certain categories of loan stock will be withdrawn.

The exemption from bearer instrument duty for bearer letters of allotment will be withdrawn.

Duty will be charged at 5 per cent on the conversion of shares into depositary receipts and on the transfer of shares to certain clearing houses.

(44) With effect from a date in the autumn:

The rate of duty on transfers of shares will be reduced to ½ per cent.

A charge will be imposed on ~~certain~~ intra-account and other share transactions which do not at present pay stamp duty.

The exemption from sale duty for letters of allotment and for purchases by a company of its own shares will be withdrawn.

There will be an exemption for market makers.

Value Added Tax

(45) The registration limit will be increased to £20 500 per annum and £7 000 per quarter.

(46) The Inland Revenue fuel benefit scale will be used to assess VAT chargeable on fuel used for private journeys in business cars from 6 April 1987

(47) The law will be changed to counter tax avoidance by artificial disaggregation of businesses.

(48) The VAT provision relating to long stays in hotels by individuals will be restricted, with effect from 1 November 1986.

(49) VAT relief will be made available for distress alarms and lifts for the handicapped and their charities; non-classified press advertising by charities and medicinal products supplied to charities; video and refrigeration equipment used in medical applications by certain eligible bodies, including charities; welfare vehicles used by such bodies to transport the deaf, blind or mentally handicapped; and recording equipment used by charities for the blind.

(50) The law will be amended to enable regulations to be made specifying conditions to be satisfied for the zero rating of certain exports.

(51) The law will be amended to allow for the transfer of VAT import relief and its obligations to a person other than the original importer.

Excise duties

(56) The duty on petrol will be increased by 7½p a gallon ~~and on derv by 6½p a gallon~~ ~~(including £ in each case of consequential VAT.)~~

(59) The duty on aviation kerosene ~~and most lubricating oils~~ will be abolished.

(60) The duty on most ~~lubricating~~ oils will be abolished.

(61) The duty on gas oil will be increased by 1½p per gallon.

(62) The duties on cigarettes and hand rolling tobacco will be increased by 11·1p per packet of 20 cigarettes ~~[illegible]~~ inclusive of consequential VAT.

(63) The duties on excise licences under the Alcoholic Liquor Duties Act 1979 and the Matches and Mechanical Lighters Duties Act 1979 will be abolished.

(64) The provisions of the Betting and Gaming Duties Act 1981 relative to general betting duty, pool betting duty and bingo duty will be extended to Northern Ireland.

(65) Powers will be taken to make certain amendments to regulations relating to goods in warehouses or travelling to or from them.

(52-55) There will be no changes in the ~~rates~~ duties on alcoholic drinks

(57) The duty on derv will be increased by 6½p a gallon, inclusive of consequential VAT.

(58) There will be no change in the duty on fuel oil

(66) There will be no change in the duties on cars, light vans and most lorries.

I.C

Vehicle Excise Duties

(67) From 19 March 1986 the rate of duty for hackney carriages of up to 20 seats will be increased to £52·50, and the additional payment for each additional seat to £1·05. The concessionary rates of duty for farmers' heavy goods vehicles over 7·5 tonnes, will be increased by varying amounts as a second stage in the process of bringing them into line with the proportion of average mileage covered by these vehicles on public roads.

(68) From 1 January 1987 the rate of duty for trade licences will be increased to £70 for cars and £14 for motorcycles. The increase in trade licence rates will be part of a package of measures reforming trade licence arrangements, including widened availability and changes in the duration for which they are available to six months and 12 months. A new type of probationary trade licence is also to be introduced for new businesses and for businesses where there is a doubt whether there is sufficient business to justify a full licence.

A provision will be introduced requiring a person convicted of using an unlicensed vehicle to pay twice the level of back duty owing in addition to any fine.

Bus fuel grants

(69) Bus fuel grants to certain bus service operators will automatically be increased to compensate them for the increase in duty on derv.

5 Public Expenditure

Public spending trends

5.01 The public expenditure planning total is the measure on which the Government's spending controls are based. Table 5.1 and Chart 5.1 show the path of the planning total in cash and in real terms ie after adjusting for the rate of inflation as measured by the GDP deflator. (The updated GDP deflator assumptions and money GDP figures are given in Chapter 2.)

Table 5.1 Public expenditure

£ billion

	1984–85	1985–86	1986–87	1987–88	1988–89
Department					
DHSS – Social security	38·1	41·3	42·9	44·4	45·9
Defence	17·2	18·0	18·5	18·8	19·0
DHSS – Health and personal social services	15·8	16·7	17·7	18·3	19·1
Scotland, Wales and Northern Ireland	13·7	14·5	15·0	15·0	15·2
Education and science	14·0	14·3	14·3	14·4	14·5
Other	33·0	31·7	31·2	31·2	31·6
Privatisation proceeds	−2·1	−2·6	−4·7	−4·7	−4·7
Reserve			4·5	6·3	8·0
Adjustments			−0·4[1]		
Public expenditure planning total	**129·6**	**133·7**[2]	**139·1**	**143·9**	**148·7**
General government gross debt interest	16·1	17·7	18·2	19	19
Other adjustments	4·3	6·2	6·1	7	7
General government expenditure	150·0	157·7	163·4	170	175
Planning total in real terms (base year 1984–85)	129·6	127·4	126·9	126·2	126·0
General government expenditure as percentage of GDP	46	44	42½	41½	40½

[1] *Includes external finance of − £400 million for nationalised industries to be privatised in 1986–87.*

[2] *The Treasury's latest estimate of outturn.*

5.02 The latest estimates suggest that the planning total outturn in 1985–86 is likely to be £0.5 billion below the figure set at the time of the 1985 Budget. Even after allowing for the effects of the miners' strike, spending in real terms in 1985–86 should be below the level of 1984–85, the first time since 1977–78 that there has been no increase in real terms. For the three following years the expenditure plans in cash terms are as set out in the 1986 Public Expenditure White Paper (Cmnd. 9702). In real terms the planning total is expected to fall slightly in 1986–87, and then to remain broadly constant over the period to 1988–89.

5.03 Table 5.1 and Chart 5.1 also show that general government expenditure as a percentage of GDP is projected to continue the downward trend established since 1982–83, with a substantial further fall over the next three years. By 1988–89 the percentage is expected to be the lowest since 1972–73. This would be the case even without any proceeds from privatisation.

Chart 5.1 Trends in public expenditure 1978–79 to 1988–89

5.04 General government expenditure covers spending by central government and local authorities. It is the definition of government spending used in the national accounts, the forecasts and the MTFS. The main difference between general government expenditure and the planning total is general government gross debt interest, amounting to some £18 billion in 1986–87. There are also a number of other definitional differences and adjustments which are described in Part 7 of the 1986 Public Expenditure White Paper, paragraph 42. In 1986–87, these adjustments account for a further £6 billion.

Employment measures

5.05 The Budget speech included public expenditure measures to assist further enterprise and employment. The gross cost of these measures for the UK as a whole will be £195 million in 1986–87, £290 million in 1987–88 and £320 million in 1988–89. The net public expenditure cost after allowing for reduced expenditure on social security benefits will be £100 million in 1986–87, £165 million in 1987–88 and £180 million in 1988–89. These net costs will be charged against the Reserve provided in the White Paper, and thereby met within unchanged planning totals. Summer Supplementary Estimates will be presented to Parliament in due course for the extra resources required by the Department of Employment, the Manpower Services Commission, ~~and Northern Ireland Departments~~ in 1986–87.

5.06 The ~~counselling~~ counselling scheme for the long term unemployed, and the Job ~~Start~~ scheme, also for the long term unemployed, both of which

were introduced in January 1986 on a pilot basis, are to be extended nationwide as soon as possible. The costs of this extension will be £100 million in 1986–87 and £70 million in 1987–88.

5.07 The number of places on the Community Programme, which is also targeted at long term unemployed adults, is being raised to 255 000 from the existing level of nearly 200 000 places. Extra provision for this and for an increase in the average wage limit to £67 will be £60 million in 1986–87 and £120 million in 1987–88.

5.08 The Enterprise Allowance Scheme for those unemployed who set up in business on their own account is to be expanded to an annual rate of 100 000 entrants by April 1987, as against the current rate of 65 000. The cost of this will be about £5 million in 1986–87 and about £35 million in 1987–88.

5.09 A new scheme has been announced to help 18–20 year olds to find jobs. This scheme, the New Workers Scheme, will provide for an allowance of £15 per week for employers taking on 18 to 19 year olds on earnings of £55 per week or less and 20 year olds on earnings of £65 per week or less. The cost of this scheme is expected to be £25 million in 1986–87 and £50 million in 1987–88.

Loan Guarantee Scheme

5.10 The loan guarantee scheme, under which the Government guarantees 70 per cent of qualifying loans to small businesses, is being extended for a further three years, with revised rules. The premium is being halved to 2½ per cent, and there are ceilings on the portfolio of loans covered of £90 million in 1986–87 and £130 million in the two subsequent years. The cost will be about £5 million in 1987–88.

Supply Estimates

5.11 For 1986–87, the plans set out in the Public Expenditure White Paper have now been translated into detailed control totals. The Supply Estimates set out the sums that the Government asks Parliament to vote for most expenditure by Government departments and certain other bodies. The main Estimates for 1986–87 are published on 18 March 1986 with a Summary and Guide (Cmnd. 9742) which summarises the Estimates and explains how they relate to the public expenditure planning total. Of the £99·1 billion included in the Supply Estimates, £74·6 billion is direct public expenditure in line with the plans published in the White Paper for public expenditure to be voted in Estimates. Nearly 60 per cent of the money voted in Estimates is subject to cash limits, which provide the Government with greater control over its cash expenditure during the financial year.

Table 5.2 Supply expenditure

	£ billion			
	1984–85		1985–86	1986–87
	Expected outturn in 1985 Budget	Final outturn	Expected outturn	Provision
Main Supply Estimates	90·4[1]	90·4[1]	96·0	99·1
Supplementaries and net under-spending	3·4	3·2	2·0	
Total Supply Expenditure	**93·8**	**93·6**	**98·1**	
(public expenditure element)	(70·6)	(70·6)	(74·9)	

[1] *Adjusted for abolition of NIS.*

cc(2)

as sent to printer 14/7

6 Public Sector Transactions

6.01 The tables in Chapter 6 provide further information on transactions of the public sector in 1985–86 and 1986–87. They elaborate the more rounded and summary figures shown in ~~Chapters 2, 3 and 5.~~ The forecasts for 1986–87 incorporate the effects of the Budget measures. The basis of the tables and the relationship between them is outlined in Annex ~~A~~ to this Chapter.

~~The Public Sector Borrowing Requirement, 1985–86 estimates~~

6.02 The forecast a year ago for the PSBR in 1985–86 was £7·1 billion. Borrowing in the 11 months to February totalled £~~7·1~~ billion, but the scale of borrowing in March is always high, with high expenditure and in some cases low income (for example, local authorities have low rate income in that month), and is expected to be higher than usual because of low oil revenues. The latest estimate of the outturn for the year is £6·8 billion or 2 per cent of GDP, but there remains substantial uncertainty surrounding the estimates both of the PSBR itself* and of its components (expenditure and revenue). Table 6.1 shows the sectoral composition of the PBSR.

Table 6.1 Public sector borrowing requirement

	£ billion 1985–86 Latest estimate
1. Central government on own account	4·9
2. Local authority borrowing from central government	4·8
3. Local authority borrowing from market and overseas	−2·7
4. Total local authority borrowing	2·1
5. Public corporations' borrowing from central government	1·1
6. Public corporations' borrowing from market and overseas	−1·3
7. Total public corporations' borrowing	−0·2
8. Public sector borrowing requirement	6·8
Memorandum item:— Central government borrowing requirement (lines 1 + 2 + 5)	10·7

6.03 Although there is little net change in the estimated PSBR in 1985–86 since the forecast made a year ago, there are some sizeable changes in its components:

(i) A reduction of about £2 billion in **oil revenues** (as forecast in the Autumn Statement), to £11½ billion, mainly because the

* The average errors on PSBR forecasts made at this time of year, over the last 10 years, are ± £1 billion for the current year and ± £1½ billion for the year ahead. See Table 3.8. (Over the last 5 years, the error for the year ahead has averaged nearer 1% of GDP, equivalent to ± £4 billion in 1986–87.)

dollar/sterling exchange rate has turned out higher than assumed in the 1985 Budget. (The sharp drop in the dollar oil price since December has had little effect on revenues in 1985–86, because of the lags in payments.)

(ii) An increase in **other revenues** of around £1½ billion. **VAT receipts** are expected to be some £1 billion higher, mainly reflecting some increase in the proportion of consumers' spending on goods subject to VAT; **capital tax** receipts some £½ billion higher, because of higher capital gains ~~tax receipts~~ and a greater number of estates subject to capital transfer tax; and **corporation tax** receipts (excluding North Sea tax receipts) some £¼ billion higher, because of increased dividend payments.

(iii) A shortfall ~~of around [£½ billion]~~ in the **planning total** outturn.

1986–87 projections

6.04 The PSBR in 1986–87 is forecast to be £7·1 billion*, or 1¾ per cent of GDP, slightly below the projection for 1986–87 in the 1985 MTFS. Again there are sizeable changes in the components, both since the 1985 MTFS projections (see Annex to Chapter 2) and between 1985–86 and 1986–87:

(i) **Oil revenues** are now forecast at around £6½ billion in 1986–87, compared with £11½ billion estimated in 1985–86. The reason is mainly the drop in the dollar oil price. (The forecast assumes that the price of North Sea crude averages $15 per barrel for the rest of 1986†, and that the dollar/sterling exchange rate does not change much.)

(ii) **Non-oil revenues** are forecast to rise by 9 per cent between 1985–86 and 1986–87, ~~about the same as the~~ a little under the 9 per cent rise in non-oil ~~incomes~~ money GDP. Within the overall increase there is:

—a rise of 1½ per cent in **corporation tax receipts** (excluding North Sea tax receipts), reflecting the estimated rise of around 20 per cent in non–North Sea company incomes between 1984 and 1985;

—a rise of ~~10~~ 8½ per cent in **income tax receipts** (the buoyancy from the expected real growth in ~~earnings~~ incomes is ~~only partly~~ more than offset by the ~~Budget~~ reflecting ~~measures~~ in the basic rate); ~~and~~

—a rise of 9 per cent in **expenditure tax receipts**, reflecting further real growth in consumers' expenditure; and

(iii) **Expenditure**, on the other hand, is little changed from the 1985 FSBR projections. In particular, the **planning total** remains the same, and represents only a 4 per cent increase in cash terms on the estimated outturn for 1985-86.

a rise of 12 per cent in capital tax receipts, mainly in capital gains.

Government transactions by sector

6.05 Tables 6.2 to 6.4 show forecasts of receipts and expenditure for central government, local authorities and public corporations respectively, in both 1985–86 and 1986–87. Expenditure in 1986–87 is understated since the expenditure Reserve has not been allocated.

* See footnote ~~X~~ on page 1.

† If prices were $1 per barrel lower on average in 1986, but other things—including the exchange rate—were unchanged, North Sea revenues would be around £½ billion lower in 1986–87.

Table 6.2 Central government transactions

	£ billion	
	1985–86 Latest estimate	1986–87 Forecast
Receipts		
Taxes and royalties	99.54	102.0
National Insurance contributions	24.3	26.2
Other	9.89	10.42
Total receipts	**133.6**	**138.4**
Expenditure		
Current expenditure on goods and services	46.4	49.1
Current grants and subsidies	71.36	74.43
Interest	16.1	17.0
Net lending and capital expenditure, excluding on-lending to local authorities and public corporations	4.4	2.3
Total expenditure	**138.5**	**142.7**[1]

[1] *Excluding any allocation from the expenditure Reserve*

Central government **6.06** Central government spending includes grants and subsidies to local authorities and public corporations (including nationalised industries), which are included in the receipts of those sectors, shown in Tables 6.3 and 6.4.

Table 6.3 Local authority transactions

	£ billion	
	1985–86 Latest estimate	1986–87 Forecast
Receipts		
Rates (net of rate rebates)[1]	13.7	15.6
Rate support grant	11.2	11.79
Other grants from central government	9.6	10.6
Other	5.1	5.1
Total receipts	**39.56**	**43.0**
Expenditure		
Current expenditure on goods and services	28.82	28.5
Current grants and subsidies	5.23	5.1
Interest	4.2	4.5
Net lending and capital expenditure	4.0	3.8
Total expenditure	**41.47**	**41.9**
[1] *Memo: Rate rebates*	*1.7*	*1.9*

[2] *Excluding any allocation from the expenditure Reserve*

Local authorities

6.07 Local authority **receipts** consist primarily of rate income plus grant from central government. The increase forecast in net rate income between 1985–86 and 1986–87 is based on recent information about rate decisions by individual local authorities.

6.08 The latest estimate of local authority **borrowing** in 1985–86 is based on the Borrowing Intentions Survey of a sample of authorities. However, borrowing in the last month of the financial year is always very high and the margin of error is correspondingly great. The source of their borrowing still more uncertain: in 1985–86 they are expected to have borrowed much more from central government than forecast in the 1985 Budget, and to have repaid correspondingly more to the market, but in 1984–85 it was the other way round.

Table 6.4 Public corporations' borrowing requirement

	£ billion	
	1985–86 Latest estimate	1986–87 Forecast
Receipts		
Gross trading surplus (including subsidies)	7·45	7·7
Other	3·21	2·87
Total receipts	**10·67**	**10·4**[1]
Expenditure		
Interest, dividends and taxes on income	4·1	3·67
Net lending and capital expenditure	6·54	6·05
Total expenditure	**10·45**	**9·6**[1]

[1] *Excluding any allocation from the expenditure Reserve*

Public corporations

6.09 The public corporations' **receipts** include subsidies and capital grants from central and local government. For the nationalised industries (and the majority of other public corporations), their net **external finance**, ie their **borrowing** plus those subsidies and grants, is included in the planning total. The effects of the coal strike have continued in 1985–86, adding abou £1 billion to the industries' financing needs, eg for coal stock rebuilding by t Electricity Supply Industry.

Table 6.5 Public Sector transactions by sub-sector and economic category

£ billion[1]

1985–86 Latest estimate

	Line[2]	General government: Central government	General government: Local authorities	General government: Total	Public corporations	Public sector
Current and capital receipts						
Taxes on income, and oil royalties	1		—		−0·3	
Taxes on expenditure	2	42·9	13·7	56·6	—	56
Taxes on capital	3	2·5	—	2·5	—	2
~~North Sea oil royalties~~	~~4~~	~~2·0~~	~~—~~	~~2·0~~	~~—~~	~~2~~
National Insurance and other contributions	4 5	24·3	—	24·3	—	24
Gross trading surplus	5 6	−0·3	0·3	−0·1	7·5	7
Rent and miscellaneous current transfers	6 7	0·3	2·9	3·2	0·5	3
Interest and dividends from private sector and abroad	7 8	2·9	0·6	3·5	1·1	4
Interest and dividends within public sector	8 9	5·5	−2·6	2·9	−2·9	
Imputed charge for non-trading capital consumption	9 10	0·9	1·4	2·3	—	
Capital transfers from private sector	10 11	—	—	—	0·2	
Total	11 12	**133·0**	**16·3**	**149·2**	**6·2**	**155**
Current and capital expenditure						
Current expenditure on goods and services	12 13	−46·4	−28·2	−74·6	—	−74
Subsidies	13 14	−5·6	−1·2	−6·8	—	−6
Current grants to personal sector	14 15	−43·2	−4·1	−47·2	—	−47
Current grants paid abroad	15 16	−2·6	—	−2·6	—	−2
Current grants within public sector	16 17	−20·2	20·2	—	—	
Debt interest	17 18	−16·1	−1·5	−17·7	−0·6	−18
Gross domestic fixed capital formation	18 19	−3·1	−3·5	−6·6	−6·0	−12
Increase in stocks	19 20	−0·5	—	−0·5	−0·1	−6
Capital grants to private sector	20 21	−2·1	−0·7	−2·9	−0·1	−3
Capital grants within public sector	21 22	−1·2	0·7	−0·6	0·6	
Total	22 23	**−141·8**	**−18·4**	**−159·4**	**−6·2**	**−165**
Unallocated Reserve	23 24	—	—	—	—	
Financial surplus/deficit	24 25	**−8·8**	**−2·1**	**−10·2**	—	**−10**
Financial transactions						
Net lending to private sector and abroad	25 26	−0·1	0·2	0·1	−0·2	
Cash expenditure on company securities (net) (including privatisation proceeds)	26 27	2·7	—	2·7	—	
Transactions concerning certain public sector pension schemes	27 28	0·4	—	0·4	—	
Accruals adjustments	28 29	−0·4	0·1	−0·3	0·4	
Miscellaneous financial transactions	29 30	0·5	−0·3	0·3	−0·1	
Borrowing requirement	30 31	**4·9**	**2·1**	**7·0**	**−0·2**	

[1] *Sign convention: receipts positive, payments negative.*

[2] *Relationship between lines:* (25) = (11) + (21) + (24) = − (26) to (30) *inclusive.*

6 Public Sector Transactions

Line[2]	£ billion[1] 1986–87 Forecast — General government: Central government	General government: Local authorities	General government: Total	Public corporations	Public sector	
						Current and capital receipts
1	52·89	—	52·89	−0·2	52·8	Taxes on income, and oil royalties
2	46·3	15·6	61·9	—	61·9	Taxes on expenditure
3	2·8	—	2·8	—	2·8	Taxes on capital
~~4~~	~~1·0~~	~~—~~	~~1·0~~	~~—~~	~~1·0~~	~~North Sea oil royalties~~
5	26·2	—	26·2	—	26·2	National Insurance and other contributions
6	−0·6	0·3	−0·3	7·7	7·4	Gross trading surplus
7	0·3	2·9	3·3	0·5	3·8	Rent and miscellaneous current transfers
8	3·2	0·6	3·8	1·0	4·8	Interest and dividends from private sector and abroad
9	5·7	−3·1	2·6	−2·6	—	Interest and dividends within public sector
10	1·0	1·4	2·4	—	2·4	Imputed charge for non-trading capital consumption
11	—	—	—	0·2	0·2	Capital transfers from private sector
11	**137·8**	**17·8**	**155·6**	**6·7**	**162·2**	**Total**
						Current and capital expenditure
12	−49·1	−28·5	−77·6	—	−77·6	Current expenditure on goods and services
13	−5·8	−0·9	−6·7	—	−6·7	Subsidies
14	−44·9	4·2	−49·1	—	−49·1	Current grants to personal sector
15	−2·5	—	−2·5	—	−2·5	Current grants paid abroad
16	−21·1	21·1	—	—	—	Current grants within public sector
17	−17·0	−1·2	−18·2	−0·6	−18·7	Debt interest
18	−3·3	−3·4	−6·7	−5·6	−12·2	Gross domestic fixed capital formation
19	−0·2	—	−0·2	—	−0·2	Increase in stocks
20	−2·1	−0·6	−2·7	−0·1	−2·8	Capital grants to private sector
21	−1·4	0·7	−0·6	0·6	—	Capital grants within public sector
22	−147·3	**−17·0**	**−164·3**	**−5·6**	−169·9	**Total**
23	~~—~~	~~—~~	~~—~~	~~—~~	**−4·5**	**Unallocated Reserve** ← Not bold
24	~~—~~	~~—~~	~~—~~	~~—~~	**−12·2**	**Financial surplus/deficit**
						Financial transactions
25	−0·2	0·3	—	−0·1	—	Net lending to private sector and abroad
26	4·8	—	4·8	—	4·8	Cash expenditure on company securities (net) (including privatisation proceeds)
27	0·6	—	0·6	—	0·6	Transactions concerning certain public sector pension schemes
28	−0·1	—	−0·1	—	−0·1	Accruals adjustments
29	0·2	−0·4	−0·2	−0·1	−0·3	Miscellaneous financial transactions
30	~~—~~	~~—~~	~~—~~	~~—~~	**7·1**	**Borrowing requirement**

Not bold

N.B. The entries in columns 1–4 of lines (new) 23, 24 & 30 must be left blank. They are not zero (−).

Annex to Chapter 6

Part A: Relationship between tables in Chapter 6, and with Table 1.2; and outturn data

Relationship between tables

6A.1 Table 6.5 is based on the definitions used to compile the national accounts. In order to show the financial deficit (which is often used in international comparisons), lending and other financial transactions are separated from the analysis of receipts and expenditure in lines 1–24 and shown in lines 28–30. These lines show the relationship between the financial deficit (line 28) and the borrowing requirement (line 31).

6A.2 Tables 6.2–6.4 are summary versions of the sectoral columns of Table 6.5. The information in Table 6.5 is rearranged so that, for example, central government grants to local authorities (which appear as negative expenditure in the local authorities column of Table 6.5, lines 17 and 23) appear as receipts in Table 6.3. Interest paid by local authorities to central government (which appears as negative receipts in the local authorities column of Table 6.5, line 8) appears as expenditure in Table 6.3. Finally, lending and other financial transactions (lines 25–30 of Table 6.5) are included in the receipts and expenditure of Tables 6.2–6.4.

6A.3 Table 1.2 in Chapter 1 uses the same information as Table 6.5, but again rearranges it. To derive general government expenditure, it starts by giving a functional breakdown of the public expenditure planning total: that includes not only general government expenditure in the third column of Table 6.5 (including the "financial transactions" in lines 26–27), but also borrowing or capital expenditure by public corporations in the fourth column. General government expenditure as shown in Table 1.2 is then obtained by adding general government debt interest from the third column of Table 6.5 and the national accounts adjustments already included in Table 6.5, and deducting public corporations' borrowing from the market and overseas.

6A.4 Alternatively, general government expenditure in Table 1.2 (and Table 2.3) can be obtained as the sum of lines 25, 26, 27 and 29 (third column) in Table 6.5 and on–lending to public corporations in Table 6.1.

6A.5 To derive general government receipts, Table 1.2 takes the receipts shown in the third column of Table 6.5 (lines 1, 20, 21 and 22) and rearranges them according to the type of activity which gives rise to them. For example, oil revenues comprise North Sea corporation tax and petroleum revenue tax (included in "taxes on income" in Table 6.5) plus oil royalties. The sub–total "total taxes and royalties" is the same as the first line of Table 2.4 in Chapter 2.

Outturn data

6A.6 Outturns for the PSBR and the statutory central government accounts (as in Tables 6.B.1–4 in Part B of the Annex) are compiled monthly and published by press notice 12 working days after the end of the month and then in more detail in Tables 2.5 and 3.12 to 3.16 of the following issue of Financial Statistics. Outturn fo the details of the PSBR on national accounts definitions, as in Table 6.5, are compiled quarterly and published in sections 2 to 5 of Financial Statistics three months after the end of the quarter.

6A.7 The first outturn for the PSBR in 1985–86 will accordingly be published on April 16. The first national accounts outturns for 1985–86 will appear in the June issue of Financial Statistics, including Supplementary Table 13 which is based on Table 6.5.

Part B: Central Government Transactions

Table 6.B.1 Summary of Central Government Transactions

	£ billion 1985–86 Latest estimate
Consolidated Fund	
Revenue (Table 6.B.3)	105·8
Expenditure (Table 6.B.2)	−110·2
Deficit met from National Loans Fund	4·5
National Loans Fund (Table 6.B.4)	
Receipts	14·3
Payments	−23·9
Total net borrowing by the National Loans Fund	**−9·6**
Other funds and accounts (net)	**−1·1**
Central Government Borrowing Requirement (including borrowing for on-lending to local authorities and public corporations)	**−10·7**

Table 6.B.2 Consolidated Fund expenditure

	£ million 1985–86 Latest estimate
Supply issues[1]	**98 100**[2]
Standing services	
Payment to the National Loans Fund in respect of service of the national debt	7 700
Northern Ireland—share of taxes etc.	1 800
Payments to the European Communities	2 600[2]
Other services	60
Total standing services	12 200
Total Consolidated Fund expenditure	**110 200**

[1] *Supply Issues are monies paid from the Consolidated Fund to Departments' cash accounts with the Paymaster General for spending on Supply. Supply Expenditure (see Table 5.2) equates closely to total Supply Issues in most years, although there may sometimes be slight timing differences between the two.*

[2] *£960 million was paid to the European Communities from Supply Issues instead of Standing Services.*

Table 6.B.3 Consolidated fund revenue

	£ million		
	1985–86		1986–87
	Budget forecast	Latest estimate	Forecast
Inland Revenue			
Income tax	35 200	35 100	38 500
Corporation tax[1] [2]	10 100	10 700	11 700
Petroleum revenue tax[3]	8 200	6 400	2 400
Capital gains tax	790	930	1 050
Development land tax	55	60	35
Capital transfer tax [redacted] (inheritance tax[4])	760	890	910
Stamp duties [redacted]	1 100	1 230	1 430
Total Inland Revenue	**56 200**	**55 300**	**56 000**
Customs and Excise			
Value added tax	18 300	19 300	20 700
Petrol, derv etc. duties	6 500	6 500	7 300
Cigarettes and other tobacco	4 300	4 300	4 700
Spirits, beer, wine, cider and perry	4 200	4 200	4 400
Betting and gaming	700	730	800
Car tax	760	880	980
Other excise duties	20	20	20
EC own resources[5]			
Customs duties, etc.	1 400	1 200	1 300
Agricultural levies	100	160	160
Total Customs and Excise	**36 300**	**37 300**	**40 400**
Vehicle excise duties[6]	2 500	2 400	2 500
National Insurance surcharge	30	30	—
[redacted]	[redacted]	[redacted]	[redacted]
Gas Levy	520	520	500
Broadcasting receiving licences	790	990	1 000
Interest and dividends	870	910	840
Other[7]	9200 ~~6 700~~	8400 [redacted]	7400 ~~6 400~~
Total consolidated fund revenue	**106 500**	**105 800**	[redacted]

[1] *Includes advance corporation tax (net of repayments)* — 3 600 | 3 800 | 4100 [redacted]

[2] *North Sea corporation tax of which satisfied by setting off ACT* — 2 800 | 3 000 | 2 700; 1 200 | 1 200 | 1 200

Liability to corporation tax arising in respect of North Sea production may be satisfied by setting off ACT arising on dividends paid in previous periods in respect of both onshore and offshore activities. Dividends and ACT associated with North Sea activities alone cannot be identified.

[3] *Includes advance payments of petroleum revenue tax.*

[4] *Includes estate duty.*

[5] *Customs duties and agricultural levies are accountable to the European Communities as 'own resources', actual payments to the Communities are recorded in Table* [redacted] 6.B.2.

[6] *Includes driving licence receipts.*

[7] *Includes the 10 per cent of 'own resources' refunded by the European Communities to meet the costs of collection, other receipts from the European Communities,* [redacted] *privatisation proceeds and oil royalties (see Table 1.2).*

Table 6.B.4 National Loans Fund receipts and payments

	£ million 1985–86 Latest estimate
Receipts	
Interest on loans, profits of the Issue Department of the Bank of England, etc.	6 600
Service of the National Debt—balance met from the Consolidated Fund	7 700
Total receipts	**14 300**
Payments	
Service of the National Debt	
Interest	14 100
Management and expenses	170
Total Service of the National Debt	*14 300*
Loans to:	
Nationalised industries	90
Other public corporations	260
Local authorities	4 800
Private sector and within central government	90
Total National Loans Fund lending[1]	5 200
Consolidated Fund deficit	4 500
Total payments	**23 900**

[1] *On-Lending to local authorities and public corporations in Table 6.1 includes, in addition to National Loans Fund lending, net lending from other funds and accounts (mainly Supply Issues in Table 6.B.2).*

(A.)

Such are projects to rise as a share of non-Natural GDP marginally (from the level in 1985-86

		1985/86 Est.
CGBR (O)		4.9
LABR from CG	4.4	
LABR other	-2.5	
Total LABR		1.9
PCBR from CG	1.1	
PCBR other	-1.2	
Total PCBR		-0.1
PSBR		6.7

Memorandum item:
CGBR (Items 1+2+5) 10.4

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FROM: M C SCHOLAR
DATE: 6 March 1986

CHANCELLOR

cc: Principal Private Secretary
Chief Secretary (2)
Financial Secretary (2)
Economic Secretary (2)
Minister of State (2)
Sir P Middleton
Sir T Burns
Mr Pratt (2)

REVISED SCORECARD

As you requested, I attach an up-to-date version of the scorecard.

2. I am not circulating this more widely at this stage (it can go round on the usual scorecard circulation early next week).

3. Table 1 - the basis of the table in Chapter 1 of the FSBR - now totals £985 million. Table 2 - not published in the FSBR - is unavoidably a little above this; but, given the uncertainty of this figuring, we probably ought to say, whether the table totals £1 billion or just above or just below that figure, that the PSBR effect is "about £1 billion".

M C S

M C SCHOLAR

BLO enclosure 12 pages

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TABLE 1

DIRECT EFFECTS OF BUDGET MEASURES

[All figures are net of the cost or yield of indexation or revalorisation included in the base forecast]

cost(-)/yield(+) (£m rounded to £5m)

Note	Proposal	1986-87 -	1986-87 +	1987-88 -	1987-88 +
1	VAT		Nil	Nil	
2	Excise duties - petrol/derv		135		145
	- VED	135		140	
	- tobacco		175		180
	- alcohol	175		190	
	- other		Nil		Nil
3	Income tax - basic rate	950		1305	
4	Income tax - higher rates		15		30
5	Corporation Tax	Neg		20	
6	Pension funds		25		125
7	Capital Gains Tax	Nil		Nil	
8	Capital Transfer Tax	35		55	
9	Stamp Duty		Neg		10
10	Car and car fuel benefits		Nil		15
11	Charitable giving a) Package of reliefs	Neg		60	
	b) Anti-abuse measures		Neg		20
12	Savings	Neg		25	
13	Business Expansion Scheme		Neg		10
14	Employee Share Schemes	Neg		Neg	
15	Lollipops a) VAT relief for charities	10		10	
	b) Extension of pension relief for Nazi victims	Neg		Neg	
	c) Exemption from income tax of July Social Security uprating	20		Neg	
16	Minor Starters a) VAT: motoring expenses		Nil		40
	b) Mines & oil wells allowances	Neg		45	
	c) Relief for overseas travel expenses	10		5	
	d) Other	Neg			30
17	Taxing non-resident entertainers and sportsmen		Nil		75
		1335	350	1855	680
	Total (Tax Measures)		-985		-1175

expenditure increases(+)/decreases(-)

	Expenditure Measures (Gross)	+	-	+	-
	Enterprise allowance	10		80	
	Loan Guarantee Scheme	Neg		10	
	New Workers Scheme	25		50	
	LTU Pilots - Jobstart & interviews	75		75	
	Community Programme	45		90	
	Staff and other running costs	45		40	
	Northern Ireland	5		5	
	Offsetting savings on social security benefits		90		140
	Total Expenditure Measures (Net)		+115		+210

NB. Consultative Document on profit sharing (Weitzman): See serial 18 in notes to Table 1.

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TABLE 2

PSBR EFFECTS[(a)]

(All figures are net of the cost or yield of indexation or revalorisation included in the base forecast)

£m
(rounded to £5m)
reduction(-)/increase(+)

Proposal	1986-87 +	1986-87 -	1987-88 +	1987-88 -
VAT		Nil		Nil
Excise Duties	Nil		5	
Income tax - basic rate	975		1465	
Income tax - higher rates		15		30
Corporation Tax	Neg		20	
Pension funds		35		150
Capital Gains Tax	Nil		Nil	
Capital Transfer Tax	35		55	
Stamp Duty		Neg		10
Car and car fuel benefits		Nil		15
Charitable giving a) Package of reliefs	Neg		60	
b) Anti-abuse measures		Neg		20
Savings	Neg		25	
Business Expansion Scheme		Neg		10
Employee Share Scheme	Neg		Neg	
Lollipops	30		10	
Minor Starters	10			20
Taxing non-resident entertainers and sportsmen		Nil		75
	1050	50	1640	330
Total (Tax Measures)	+1000		+1310	
Expenditure Measures	Nil		Nil	
TOTAL	+1000		+1310	

(a) The figures for PSBR cost given in this table are calculated in terms of the change in the fiscal adjustment implied by each measure listed. Adding the figures together shows how much of any fiscal adjustment indicated by the forecasts, assuming a given PSBR, would be used up.

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Notes to Table 1

1. VAT: Assumes no increase in the standard rate.

Revalorisation by 5.7% of the VAT threshold (the level of turnover at which businesses must register for VAT) would raise it to £20,500 (from £19,500). The revenue effects (which are negligible) are included in the forecast.

Various VAT lollipops are covered in item 15.

2. Excise Duties: Assumes a revenue neutral excise duty package in which the cost of a standstill on duty for alcohol, pipe tobacco and cigars is offset by overindexing cigarettes and hand rolling tobacco (**11.1p on a typical packet of 20 King Size**); a standstill on car VED is balanced by overindexing petrol (**up 7.5p a gallon**); unchanged lorry VED is offset by overindexing derv (**up 6.5p a gallon**); and the abolition of some, and a standstill on other, minor oil duties is balanced by an increase in the duty on gas oil (**up 1.5p a gallon**).

With this package the Budget as a whole has an RPI impact effect of +0.11% on top of indexation, including the 0.07% impact effect of a cut of 1p in income tax basic rate.

Details of the package are as follows:

Duties	Impact on typical pre-Budget prices[a]	Effect, compared with revalorisation in 1986-87	1987-88
	£m	£m	£m
Alcoholic drinks	0	-175	-190
Pipe tobacco/cigars	0	-5	-5
Cigarettes/HRT	11.1p	+180	+185
VED[b] (cars)	0	-110	-115
Petrol	7.5p	+110	+120
VED[b] (lorries)	0	-25	-25
Derv	6.5p	+30	+30
Bus fuel grants	-	-5	-5
Fuel oil	0	-5	-5
AVTUR, lubricating oils, other rebated oils	-	-20	-20
Gas oil	1.5p	+25	+25
TOTAL		0	-5

(a) Assumes entire price increase is passed on to the consumer
(b) Excludes balancing changes in minor VED rates as agreed at Overview 5.

3. Income tax - basic rate: Figures assume a basic rate cut of 1p combined with statutory price indexation (5.7%) of all allowances and thresholds. Since the cost of price indexation is included in the forecast, the cost shown in table 1 represents the cost of the basic rate cut.

The figures assume no change in the mortgage interest relief ceiling and that Life Assurance Premium Relief remains at 15%.

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4. Income tax - higher rates: The figures assume a basic rate cut of 1p and the following higher rate package (option M1B):

Tax Rate	Threshold (£)
29%	0-17,200
40%	17,201-20,200
45%	20,201-25,400
50%	25,401-33,300
55%	33,301-41,200
60%	over 41,200

5. Corporation Tax: The figures assume no change in the basic regime but small firms rate to be reduced in line with the 1p basic rate cut. The full year cost is £35m.

6. Pension funds: Assumes that where pension funds surpluses exceed 5% the funds are required to reduce surpluses to below 5% within 5 years. The method of reduction to be at the discretion of the funds. No fund will be forced to make a refund in the first year (1986-87). Where the reduction is achieved by a refund to the employer the refund will be subject to tax at a flat rate of 40% on the employer. The figures in Table 1 assume the tax will be paid as the refund is made. Funds to be allowed to provide an actuarial certificate (subject to a spotcheck) rather than a full return where the surplus does not exceed 5%.

7. Capital Gains Tax: Assumes no major change. (Indexation of the annual exempt amount is assumed in the forecast.) A concession on CGT on first sale of BES shares is covered at Item 13.

8. Capital Transfer Tax: (Forecast assumes indexation of the threshold.) Assumes abolition of charge on gifts between individuals during their lifetime, except for a charge introduced on a taper for gifts within 7 years of death. The taper is set at 100% of the death rate in the three years before death with charges at 80%, 60%, 40% and 20% in the preceding four years respectively. The exemption for gifts to spouses remains. The trust regime is kept unchanged so far as possible. The cost builds up over time and will be affected by behaviourial changes.

9. Stamp Duty: Assumed package includes a reduction from 1% to ½% from 27 October 1986 for all share transactions currently subject to stamp duty. No change in the duty on houses. No change in capital duty or unit trust duty. Cost of rate reduction to be financed by extension of stamp duty base. Figures in the table reflect discussions with the Bank.

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			cost(-)/yield(+) 1986-87	1987-88	Assumes introduction on
a)	Reduction in stamp duty on shares to ½%		-70	-110	(27 October 1986)
b)	Possible extension of stamp duty base through				
	(i) charge on ADRs	(5%)	+10	+10	(18 March 1986)
	(ii) intra account dealing	(½%)	+10	+20	(27 October 1986)
	(iii) takeovers incl. mergers	(½%)	+20	+20	(18 March 1986)
	(iv) loan stock	(½%)	+20	+20	(18 March 1986)
	(v) Renounceable letters	(½%)	+10	+15	(27 October 1986)
	(vi) Company purchases of own shares	(½%)	+1	+1	(18 March 1986)
Net cost/yield of a) and b)			+Neg	-24	
Additional tax on capital gains			Nil	+35	
TOTAL (rounded)			+Neg	+10	

The package now achieves broad revenue neutrality in 1987-88 as well as 1986-87.

The Economic Secretary is considering measures to prevent forestalling on ADRs.

10. Car and car fuel benefit scales: As from 1 April 1987, the engine size break points for these scales to be changed, on a revenue neutral basis, from 1300cc and 1800cc to 1400cc and 2000cc to align with the EC directive on exhaust emissions. Resulting scale charges for car benefits then to be increased by 10% for 1987-88. Car fuel scale to be decoupled from car scale and kept at broadly 1986-87 level, as adjusted on a revenue neutral basis for change in break points. From 1987-88 the car fuel scale will be used not only for income tax purposes but also as the basis for assessing the VAT chargeable on fuel used for private journeys in business cars (see item 16a in Table 1 and the equivalent reference in Table 5).

Scale charges for more expensive cars also to be increased by 10%, and cash break points to be frozen at the 1986-87 level. No change in present thresholds for high and low business mileage.

11. Charitable giving: Overall the package assumes

(a) abolition of the limit on higher rate relief for covenanted donations by individuals, and apportionment of covenanted donations by close companies, combined with measures to prevent increased abuse. Estimated overall cost is Neg in 1986-87 and £5m in 1987-88. In addition there is an estimated yield of neg in 1986-87 and £20m in 1987-88 from measures restricting present abuse, the yield from which is shown as a separate line in Table 1.

(b) tax relief for charitable donations made by individuals through payroll deduction schemes run by employers and paid through agencies. Employers not compelled to run a scheme; but no relief except through a scheme. Cost depends on take-up but assuming a £100 annual limit, 1½ million employees taking part, and an April 1987 start, estimated costs are nil in 1986-87 and £20m in 1987-88.

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(c) relief for single gifts by companies (quoted and USM but not close companies). Assumes restriction of relief for single gifts made by a company in a year to a maximum of 3% of the amount of dividends paid by the company in that year. On this basis the cost would be about £35m in 1987-88, though it would build up in later years.

12. Savings: Assumes a new scheme from 1987. New investment would be confined to cash. Quoted and USM shares only would qualify. Maximum investment of £2400pa. In order to qualify for relief investment would have to be committed to a yearly Plan for a minimum holding period (12-24 months) (although funds could be switched to new shares within that period if desired). Early withdrawals will be taxed in the normal way. Dividend income to be exempt from tax if re-invested (but not if withdrawn in cash). Costs in Table 1 comprise:

	1986-87	1987-88
Tax relief on dividends	Neg	-25
CGT exemption	Nil	Neg

The figures assume a take up by ½ million investors in the first year and that all dividends are reinvested.

The eventual cost could be very much higher depending on take up.

13. Business Expansion Scheme: Assumes extension of the scheme from 1 April 1987 (when current scheme is due to end). Table 1 shows, as will the FSBR, the net effect of the cost of extending the scheme and the yield from changes in its coverage. (The full year cost of the scheme at current levels of investment will be given in an FSBR footnote.) Table 1 includes the yield from excluding some asset based activities and the restriction to be placed on ownership of land and buildings. New (but not existing) BES shares to be exempt from CGT on first sale. Exemption from CGT has no effect on receipts in the next 5 years.

14. Employee Share Schemes: Assumes a package including admitting the use of shares subject to a restriction requiring disposal when employment ends (while at the same time closing loopholes in taxing provisions affecting unapproved employee share acquisitions); easing access to schemes for employee controlled companies; easing conditions on exercise of savings-related share options; and permitting access for registered worker co-operatives. The cost of each of these items is as follows:

	1986-87	1987-88	Full Year
Restricted share (net)	Nil	Nil	-5
Access for employee-controlled companies	Neg	Neg	Neg
Exercise of SAYE-related share options	Neg	Neg	Neg
Access for Co-operatives	Neg	Neg	Neg

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15. Lollipops: Assumes the following package:

Budget Starter	Proposal	£m Revenue costs (-) 1986-87	1987-88
22	VAT relief for installation of distress alarms and lifts for handicapped	-3	-3
115	Extension of relief under S.22(2)FA74 for pensions paid to Nazi victims	-1	-1
172	Exemption from income tax of July 1986 Social Security uprating	-20	Neg
-	VAT relief on newspaper advertising by charities	-1/-2	-1/-2
-	VAT relief for medicinal products supplied to charities	-2	-2
-	Extension of VAT relief for donated medical equipment	-3/-4	-3/-4
-	VAT relief for recording equipment for a blind charity	-1	-1
-	VAT relief for welfare vehicles	Neg	Neg
	Total (rounded)	-30	-10

There are no measurable consequences for the RPI impact effect.

16. Minor Starters: See Table 5.

17. Taxing non-resident entertainers and sportsmen: Assumes the introduction of withholding arrangements and other measures to counter tax avoidance and evasion by non-resident entertainers and sportsmen who derive income from the UK. (Estimated yield £100m in a full year.)

18. Profit Sharing - Weitzman: The aim is to promote labour market flexibility and increasing worker identification with his employer's business and its profitability. The proposal is for tax relief on 10% of total remuneration for employees who reach an agreement with their employers which links at least 20% of remuneration to profits. The proposal is to refer in the Budget Statement to a consultative document to be published later on.

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TABLE 3

EMPLOYMENT AND ENTERPRISE MEASURES

Estimates exclude staff and running costs (except line 6)

Cash

ote	Proposal	1986-87 Gross Exp £m	1986-87 Net Exp £m	1986-87 Net Exch Cost* £m	1986-87 No. off Count† 000	1987-88 Gross Exp £m	1987-88 Net Exp £m	1987-88 Net Exch Cost* £m	1987-88 No. off Count† 000	1988-89 Gross Exp £m	1988-89 Net Exp £m	1988-89 Net Exch Cost* £m	1988-89 No. off Count† 000
1.	Enterprise Allowance	10	5	Nil	7	80	45	35	16	100	65	40	16
2.	Loan Guarantee Scheme	Neg	Neg	Neg	4	10	Neg	Neg	9	15	Neg	Neg	10
3.	New Workers Scheme	25	15	10	18	50	30	20	21	50	30	20	21
4.	L.T.U. Pilots												
	- Jobstart	20	15	10	8	50	35	25	8	50	35	25	8
	- Counselling	55	Nil	-10	43	25	-5	-15	16	25	-5	-15	16
5.	Community Programme	45	30	20	20	90	60	45	20	95	60	45	20
6.	Staff and other running costs	45	45	45	4	40	40	40	5	40	40	40	6
7.	Northern Ireland	5	5	Neg	5	5	5	5	5	10	5	5	5
8.	Total	205	115	75	109	350	210	155	100	385	230	160	102

* The net Exchequer cost takes account of the reduction in social security benefits, and increases in income tax revenue, as people leave the unemployment count and take up places on the schemes.

† End of financial year

Notes to Table 3

1. Enterprise Allowance Scheme: Present annual rate of entry is 64,500. Rate of entry is rising so that total entry will be 80,000 in 1986-87. Table 3 assumes an increase in the annualised rate of entry to 130,000 by January 1987. First year net exchequer cost per person off the count is £3000.

2. Loan Guarantee Scheme: Existing scheme due to close on 31 March 1986. Table 3 assumes new scheme starts from April 1986 with premium paid by borrowers of 3 per cent and proportion of loan guaranteed by Government 70 per cent. Net exchequer cost per person off the count is £700.

3. New Workers Scheme: Table 3 assumes this new scheme provides for £15 a week for employers of 18-19 year olds earning less than £55 a week and of 20 year olds earning less than £65 a week. Coverage of 60,000 by April 1987. First year net exchequer cost per person off the count is £1300.

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4. Pilots for long term unemployed: At present pilots exist in 9 areas - those unemployed for more than a year called for interview and directed towards job or employment and training measures; those taking a job paying less than £80 a week get a taxable allowance of £20 for 6 months (Jobstart). Table 3 assumes extension nationwide to all unemployed over one year. Net public expenditure and net exchequer cost estimates are nil or negative because they do not include running costs (which form the major part of expenditure on the counselling initiative). Social Security benefit savings and income tax flowback are greater than the non-running cost element of the estimates.

5. Community Programme: The present target is 230,000 places by June 1986. Table 3 assumes an expansion to 250,000 by September 1986. This figure would be increased if offsetting savings were found in Department of Employment's programmes.

6. Staff and running costs: includes the staff and running costs of all the measures. Numbers off the count are a result of 300 extra staff in Department of Employment and DHSS to counter fraud.

7. Elsewhere figures in the table cover the effect on Department of Employment, covering GB. Extending the measures to Northern Ireland adds 2.75 per cent to the cost.

8. The table shows the Treasury's desired outcome - accepting Lord Young's proposals on items 1-5, with a modest expansion of the Community Programme bringing the total net public expenditure cost to £115m in 1986-87 and £210m in 1987-88. The precise mix of measures may vary and the gross cost could be higher than the figure shown (as a result of a bigger expansion of the Community Programme) if offsetting savings are found.

The costs shown are within the amount assumed by the forecasters for employment and training measures when assessing the pressures on the Reserve in 1986-87. The measures do not therefore affect the fiscal arithmetic and are scored as nil in Table 2. The net public expenditure costs are shown in Table 1.

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TABLE 4

STAFFING EFFECTS

Proposal	Effect on manpower numbers at April 87		April 88	
	-	+	-	+
Customs and Excise				
VAT		Nil		Nil
Excise Duties		Nil		Nil
Minor Starters		Neg		Neg
Total Customs	Neg		Neg	
Inland Revenue[a]				
Income tax - allowances and basic rate[b]		45		160
Income tax - unchanged mortgage interest relief ceiling (c)		Nil		Nil
Income tax - higher rates (ie option M1B)		Nil		Nil
Corporation Tax		Nil		Nil
Pension Funds		5		5
CGT (indexation of thresholds)		Neg		Neg
CTT: Statutory indexation[d]		30		50
Abolition of lifetime charge[e]	Nil		20	
Stamp Duty		20		20
Car and car fuel benefits[f]		Nil		Nil
Charitable giving[g]		25		50
Savings[h]		5		15
BES		Neg		Neg
Employee Share Schemes		15		10
Tax on non-resident entertainers and sportsmen		20		20
Lollipops[i]	185			Nil
Minor Starters		10		20
Revised P11DA (employers Benefits in Kind return) procedure (j)	100		50	
Total Inland Revenue	-110		+280	
Department of Employment Group				
Enterprise allowance		275		310
Loan Guarantee Scheme		Neg		Neg
New Workers Scheme		120		120
Fraud Abuse		300		300
Jobstart		170		170
Counselling		1500		1000
Community Programme		200		200
Total Department of Employment Group[k]	+2565		+2100	
Total	+2455		+2380	

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Notes to Table 4

(a) The figures show the effect of the proposals on the manpower baseline (which for April 1988 is 66,374). The manpower baseline is generally based on the assumption that workloads remain unchanged except where there has been a specific adjustment to the baseline in the Survey to take account of foreseeable changes to workload (see notes (c) and (j) below). COP is assumed to be implemented by April 1988 and the figures quoted take account of the estimated COP savings of 4000 included in the April 1988 target.

(b) The manpower effect reflects statutory price indexation of allowances and thresholds.

(c) MIRAS - large loans: The forecast growth in new loans over £30,000 during 1986-87 requires an extra 55 staff at 1.4.87 for which provision has already been made in the Survey. From April 1987 lenders are required to bring into MIRAS new loans above the limit, contributing to a reduction back to NIL extra staff by 1.4.88. Increasing the limit to £35,000 would require an extra 15 staff at 1.4.87 (a saving of 40 against the Survey provision) and achieve a saving of 60 at 1.4.88.

(d) On the basis of the latest estimates, statutory indexation of CTT will not be sufficient to avoid an increase in the 1986-87 workload. In addition, the workload now forecast for 1985-86 will be higher than was estimated before the 1985 Budget. The table shows the combined effect of these two increases. The reasons for both increases is that house and share prices have been rising more quickly than the RPI. The total staff cost will be 65 units (30 at 1 April 1987, 50 at 1 April 1988 and 65 at 1 April 1989).

(e) The manpower savings from abolition of CTT lifetime charge is inevitably somewhat speculative.

(f) The change in engine size breakpoints in the car benefit scales will require 45-75 man-year units to set up during 1986-87. These will not be required by April 1987.

(g) The continuing staff cost in later years is estimated to be 40 units though this figure depends crucially on the level of giving.

(h) The continuing staff cost in later years is estimated to be 35 units and will depend crucially on future take up.

(i) The saving reflects the combined effect of exempting the pension increase in July 1986 and recoding for the pension increase in April 1987. There will be further staff savings compared with Survey provision (not in the Scorecard) of 140 units at April 1988 arising from the change in the uprating date.

(j) Additional provision was made in the Survey for the growth in the P11D workload up to April 1987 that result from unchanged thresholds (at £8500). Figures in the table show the savings, against this baseline, that result from the revised procedure.

(k) The figures shown are the staff required for the employment measures shown in Table 3.

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TABLE 5

MINOR STARTERS

(Items in Starters list which Ministers have agreed are now serious contenders, with revenue effect of £3m or more)

cost(-)/yield(+)

FB Starter Number	FB Category	Proposal	1986-87 -	1986-87 +	1987-88 -	1987-88 +
7	C	VAT: motoring expenses		Nil		40
8	C	VAT: avoidance by disaggregation		Neg		20
15	C	VAT: long-term lettings of accommodation		Nil		10
116	B1	Mines and oil wells allowances	Neg		45	
125	B2	Tax treatment of Enterprise Allowance[(a)]	Neg		5	
129	B2	PRT relief for exploration and appraisal expenditure in inshore waters (b)	Neg		Neg	
134	C	Relief for overseas travel expenses	10		5	
146	C	S.252 ICTA: sale of the losses of insolvent companies	Neg			5
173	C	CGT relief for part disposals of land	Nil		5	
410	C	Increased penalties for VED evasion		Neg		5[(c)]
		Total	-10		+20	

Notes to Table 5

(a) Now costed on Case VI treatment; complete exemption has been ruled out.

(b) Reflects the fact that because of the lower oil price forecast, Department of Energy forecast of exploration and appraisal expenditure has been significantly reduced (it is now expected to be £2.5m in both years). The cost to be shown as negligible in the FSBR.

(c) Estimate of yield from improved compliance offset by the effect of increasing the number of out of court settlements. Starter subject to agreement by Home Office which has not yet been obtained.

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COPY NO 1 OF 39

FROM: M C SCHOLAR
DATE: 10 MARCH 1986

CHANCELLOR OF THE EXCHEQUER

cc Principal Private Secretary
Chief Secretary (2)
Financial Secretary (2)
Economic Secretary (2)
Minister of State (2)
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Sir Geoffrey Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr H P Evans
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Miss Peirson
Mr Riley
Mr Pratt
Mr Cropper
Mr H J Davies
Mr Lord

Mr Lawrence Airey - IR
Mr Battishill - IR
Mr Isaac - IR
Mr Calder - IR
Mr Johns - IR

Sir Angus Fraser - C&E
Mr Knox - C&E
Mr Wilmott - C&E

1986 FSBR: SECOND DRAFT

I attach Chapters 1, 2 and 6 of the FSBR, revised in accordance with the comments made at meetings last week. We need to return these drafts to the printer soon tomorrow and I would be grateful if Mrs Lomax could let me have your comments as soon as possible tomorrow morning.

2. As you have said, these Chapters, and Chapter 4, need to be checked carefully against the wording of the Budget Speech. We have tried to reflect in the attached drafts the version of the Budget Speech you prepared over the weekend.

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3. Both tables in Chapter 1 are at present incomplete or not up-to-date. (In particular, figures for 1987-88 will need to be recalculated following your decisions this afternoon on the basis of calculation.) We hope to get them right tomorrow or on Wednesday; but to get a better feel for the Chapter, you will wish to see them in their present state. You will see that the presentation of the employment measures in Table 1.1 has been amended: the separate line for running costs has been removed and a running cost element included in the figures for each individual measure. (In this respect the Table differs from the scorecard - although the overall totals remain the same.)

4. In Chapter 2 we offer two versions of the first chart. We generally prefer Version B, but would be grateful to know your preference. If you go for Version A we will have to decide whether it should be elongated (to be consistent with most of the Chart-sizes; but flattening out the peaks and troughs).

MCS

M C SCHOLAR

This seems to have come from N Monck/Adam - I recall your decision this is much. But I can provide with Nick in the meeting if you are unhappy.

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1.01 The objective of the Government's economic policy is to defeat inflation and establish a vigorous, enterprising, economy which will generate sustained growth and increased employment.

1.02 The Financial Statement and Budget Report supplements the Chancellor's Budget Statement. It describes the Medium Term Financial Strategy (MTFS); outlines developments in the economy over the past year; provides forecasts to mid-1987; details the government's tax proposals; summarises the public expenditure elements in the Budget; and brings together the financial position of the public sector.

1.03 Chapter 2 describes the MTFS, which provides the framework for all economic policy decisions. Monetary and fiscal policy is set to bring about lower inflation while providing for continued growth in output. Micro-economic policies are designed to enhance the prospect for output and employment by improving incentives, removing unnecessary controls, ensuring that markets work properly - and generally improving the adaptability of the economy.

1.04 The measures in the Budget are designed to strengthen these policies and to reduce the burden of taxation and the role of the state in the economy. Both tax and expenditure are on a declining path as a proportion of GDP.

1.05 Chapter 3 describes the main developments in the economy and the prospect for the next eighteen months. The sharp fall in oil prices will sustain growth and reduce inflation in the world economy, and will help industry in this country. Inflation in the United Kingdom is set to fall further - to 4 per cent in 1986. Output is expected to continue to grow by around 3 per cent. Investment and exports are forecast to grow rapidly. The balance of payments may be in surplus by £4 billion in 1986 even though oil prices are low.

1.06 Chapter 4 sets out the tax proposals in the Budget. They include a cut of 1p in the basic rate of income tax; a new scheme for tax-free investment in equities; the abolition of Capital Transfer Tax on lifetime gifts; and a substantial package of assistance to

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1.07 Chapter 5 describes the public expenditure ~~consequences of the~~ measures ~~to help the unemployed shown in Table 1.1~~. The new pilot schemes for the long term unemployed (counselling and the Jobstart scheme) are to be extended nationwide. The rate of entry into the Enterprise Allowance Scheme will also be increased. A new scheme - the New Workers Scheme - will be introduced, providing for payments to employers of 17-20 year olds where the wages are below specified limits. The Community Programme will be expanded by [25,000] places.

1.08 Chapter 6 brings together the complete financial picture for the public sector. The public expenditure measures will be financed from the Reserve and thus do not add to public expenditure. Taxes ~~have been~~ are reduced by ~~about~~ almost £1 billion. ~~This leaves a public sector borrowing requirement of~~ £7 billion - 1¾ per cent of GDP. This is ~~rather~~ below the level indicated in the MTFS published in last year's FSBR. Table 1.2 below summarises the sources of the receipts and the direction of expenditure

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charitable giving. Table 1.1 below summarises the effect of all these measures.

Table 1.1

Budget Measures[1]

£ million at current prices

	1986-87		1987-88
	Changes from an indexed base	Changes from a non-indexed base	Changes from a non-indexed base (yield(+)/cost(-))
Tax Proposals:			
Income tax basic rate	-950	-950	
Income tax allowances & thresholds	+15	-1125	
Excise duties - petrol/derv	+135	+475	
- VED	-135	+5	
- tobacco	+175	+315	
- alcohol	-175	Nil	
- gas oil	+25	+30	
- other minor oil duties	-25	-20	
Stamp duty - cut in rate	-70	-70	
- extension of base	+70	+70	
Capital Transfer Tax	-35	-55	
Charities - package of reliefs	-10	-10	
- anti-abuse measures	Neg	Neg	
Pension Fund Surpluses	+25	+25	
Other tax changes	-25	-40	
Total tax measures	-980	-1350	
Expenditure Measures:			
Loan Guarantee Scheme	Neg	Neg	+5
Enterprise Allowance	+5	+5	+35
New Workers Scheme	+25	+25	+50
Counselling Initiative	+85	+85	+45
Jobstart	+15	+15	+25
Community Programme	+60	+60	+120
Northern Ireland consequentials	+5	+5	+10
Total expenditure measures (gross)	+195	+195	+290
Offsetting reductions in social security benefits	-95	-95	-125
Net call on the Reserve	+100	+100	+165

(1) These measures, and the basis of the costings shown, are described in detail in Chapters 4 and 5.

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Table C1.1-2 The public sector's finances analysed by function

£ billion

	1985-86		1986-87
	1985 Budget	Latest estimate	Forecast
Receipts			
Corporation tax excluding North Sea[1]	8.2	8.3	9.5
Other taxes on income	35.3	35.6	38.5
Taxes on capital	1.9	2.5	2.7
Expenditure taxes:			
Value added tax	18.3	19.3	20.7
Local authorities rates	13.6	13.7	15.6
Petrol, derv etc. duties	6.5	6.5	7.3
Cigarettes and tobacco	4.3	4.4	4.8
Spirits, beer, wine, etc.	4.2	4.2	4.4
Other	8.6	8.5	9.0
Total expenditure taxes	55.5	56.5	61.6
North Sea revenues:			
North Sea corporation tax	2.8	3.0	2.7
Petroleum revenue tax	8.2	6.4	2.4
Oil royalties	2.5	2.1	1.0
Total North Sea	13.5	11.5	6.1
Other[2]	-0.9	-1.1	-1.0
Total taxes and royalties	**113.5**	**113.2**	**117.5**
National Insurance and other contributions	24.6	24.3	26.2
Interest and dividend receipts	6.4	6.4	6.4
Other			
Gross trading surpluses and rent	3.1	2.8	2.7
Miscellaneous	2.1	3.1	3.2
Accruals adjustments	0.2	-0.3	-
General government receipts	**150.1**	**149.5**	~~155.9~~ 155.4

	1985-86		1986-87
	1985 Budget	Latest estimate	Forecast
Expenditure			
DHSS - Social security	40.0	41.3	42.9
Defence	18.0	18.0	18.5
DHSS - Health and personal social services	16.5	16.7	17.7
Scotland, Wales and Northern Ireland	14.2	14.5	15.0
Education and science	13.6	14.3	14.3
Other	29.3	31.5	31.2
Central privatisation proceeds	-2.5	-2.6	-4.8
Reserve	5.0	-	4.5
Adjustments	-	-	-0.4
Public expenditure planning total	**134.2**	**133.7**	**139.1**
General government debt interest	18.0	17.7	18.2
less public corporations' net market and overseas borrowing	-2.3	-1.2	-0.5
Other national accounts adjustments	5.0	4.9	5.7
General government expenditure	**159.5**	**157.6**	**163.4**

Difference between expenditure and revenue financed by borrowing:-

General government expenditure	159.5	157.6	163.4
General government receipts	150.1	149.5	~~155.9~~ 155.8
General government borrowing requirement	9.4	8.1	~~7.5~~ 7.6
Public corporations market and overseas borrowing	-2.3	-1.2	-0.5
Public sector borrowing requirement	**7.1**	**6.8**	~~7.0~~ 7.1

(1) Excluding corporation tax on capital gains

(2) Adjustments for advanced corporation tax set off against North Sea corporation tax plus accruals adjustments

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MEDIUM-TERM FINANCIAL STRATEGY

2.01 The Medium Term Financial Strategy (MTFS) provides the framework for economic policy, as it has since 1980. It is intended to bring inflation down further over a period of years, and ultimately to achieve price stability. It is complemented by policies which encourage enterprise, efficency and flexibility, thus promoting ~~enhancing~~ the growth of output and the creation of jobs.

2.02 Economic policy is set in a nominal framework in which public expenditure is controlled in cash terms and money GDP growth is gradually reduced by monetary and fiscal policy. As the growth of money GDP declines inflation is squeezed out, and the division of money GDP between output growth and inflation is improved.

2.04 Over the past six years, money GDP growth has declined from nearly 20% to around 9%. Inflation has come down to around 5% and is set to fall further. And the economy is about to embark on its sixth successive year of growth. For the first time since the 1960s, steady growth is now being combined with low inflation.

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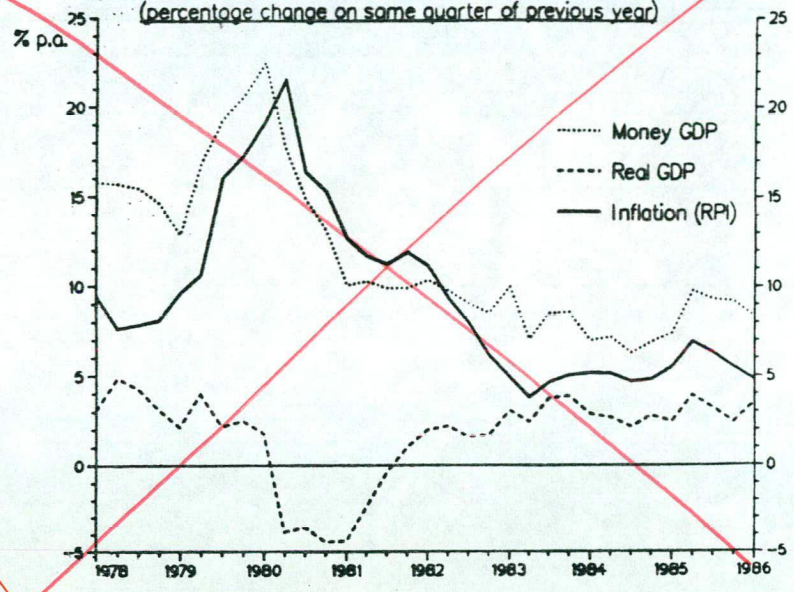
Money GDP Growth, Inflation and Output Growth

(percentage change on same quarter of previous year)



Objectives and the Framework of Policy

The money GDP path

2.06 Policy will be directed at maintaining monetary conditions consistent with a gradual reduction in the growth of money GDP over the medium term, broadly in line with the path shown in table 2.1. While the figures are not targets, and fluctuations will inevitably occur, the aim will be to avoid substantial departures in either direction in the medium term. This should be consistent with both a further reduction in inflation and continued growth in real output at a sustainable rate.

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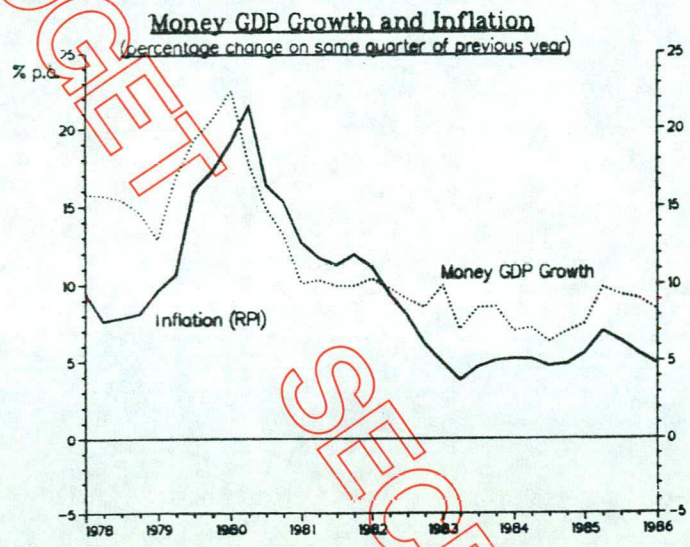
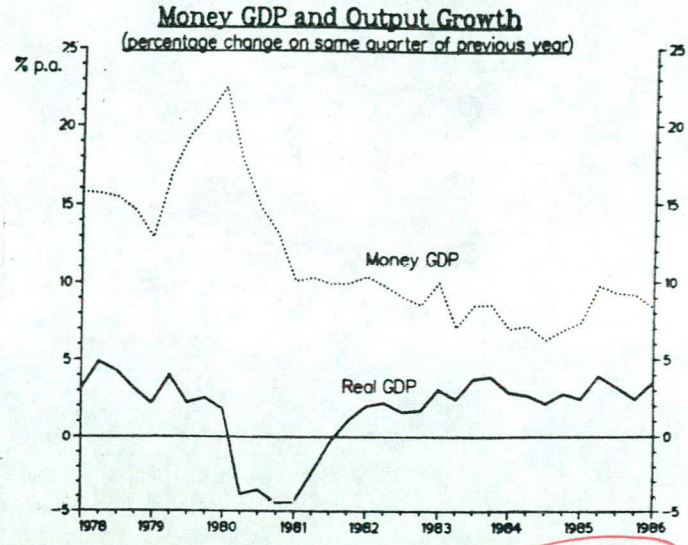
Revised charts ✓





Real GDP growth slow

Objectives and the Framework of Policy

The money GDP path

2.06 Policy will be directed at maintaining monetary conditions ~~consistent with~~ a gradual reduction in the growth of money GDP over the medium term, broadly in line with the path shown in table 2.1. While the figures are not targets, and fluctuations will inevitably occur, the aim will be to avoid substantial departures in either direction in the medium term. This ~~should be~~ is consistent with both a further reduction in inflation and continued growth in real output at a sustainable rate.

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Table 2.1 Growth of the Money Supply and Money GDP

	1985-86	1986-87	1987-88	1988-89	1989-90
Money GDP (1)(2)	9($7\frac{3}{4}$)	$6\frac{1}{2}$	$6\frac{1}{4}$	6	$5\frac{1}{2}$
M0 (3)	$3\frac{1}{2}$	2-6	2-6	1-5	1-5
£M3 (3)	$14\frac{3}{4}$	11-15			

(1) The money GDP figure for 1986-87 is a forecast; and in subsequent years the figures describe the government's broad medium term objective.

(2) Percentage change on previous financial year. See Table 2.4 for further detail. The figure in brackets for 1985-86 is adjusted for the coal strike.

(3) 1985-86: percentage change from mid-February to mid-February.
1986-87: target ranges.
1987-88 onwards: illustrative ranges for M0.

2.07 The growth of money GDP is expected to be the same in 1986-87 as assumed last year. But partly as a consequence of the sharp fall in oil prices, this is made up of higher output growth and lower inflation. In the later years money GDP growth declines further.

Instruments of Policy

2.08 It is necessary to support monetary policy by an appropriate fiscal policy. There is some scope for varying the balance between them, especially in the short term. In practice, the budget provides the main opportunity to review fiscal policy, while short term interest rates can be varied more frequently to keep monetary conditions on track.

2.09 Until recently the authorities also sought to a considerable extent to control the growth of broad money and liquidity by overfunding, i.e.

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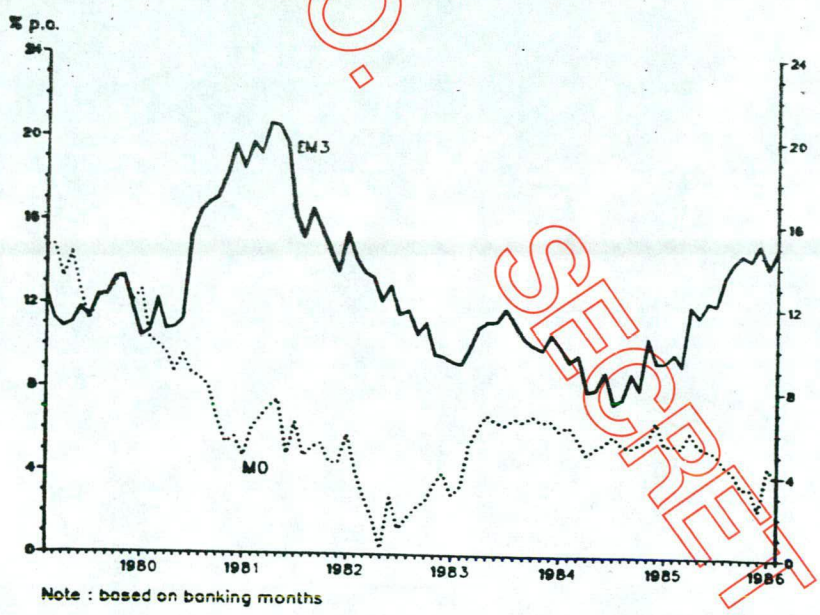
selling more debt than needed to fund the public sector borrowing requirement. This was generally seen as a distortion of financial markets, and it was reflected in the rising stock of commercial bills held by the Bank of England.

2.10 On the view that systematic overfunding was neither a sustainable nor an effective medium term means of affecting monetary conditions, the Chancellor announced in October 1985 that sales of debt outside the banking system in any one financial year would be limited to the amount needed to fund the PSBR; and that policy action within the year to influence monetary conditions would take the form of changing short term interest rates.

Monetary Policy

2.11 Monetary conditions are assessed in the light of movements in broad and narrow money and the behaviour of other financial indicators, in particular the exchange rate.

Monetary Growth



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Narrow Money

2.12 Ideally, the target aggregate for narrow money should reflect those assets that are directly used for making transactions; should respond unambiguously, but not be over sensitive, to interest rate changes; and should have a stable relationship with money GDP. As in the United States, M1 has been inflated by a rapid growth of interest bearing sight deposits, previously held in the form of term deposits. Non-interest bearing M1 continues to be affected by short-term variations in the boundary between interest bearing and non interest bearing accounts; ~~and it has been very sensitive to changes in interest rates.~~

2.13 M0 only covers a narrow range of transactions balances but it has demonstrated a relatively stable velocity trend over a long period. ~~It~~ responds in an unambiguous manner to changes in interest rates, ~~but not excessively~~. Its velocity has risen as institutional change and technological developments have led to a progressive reduction in the use of cash, but ~~these changes have taken place~~ at a fairly steady pace. It has proved a good indicator of monetary conditions in recent years and remains the best choice of narrow aggregate for target purposes.

Broad Money

2.14 Measures of broad money have persistently grown faster than money GDP over the last six years, unlike the experience of the 1970s. High real interest rates have increased the relative attractiveness of financial assets; and financial liberalisation and increased competition between banks and building societies have led to a rapid build up of both liquidity and debt. Yet this has proved ~~wholly~~ consistent

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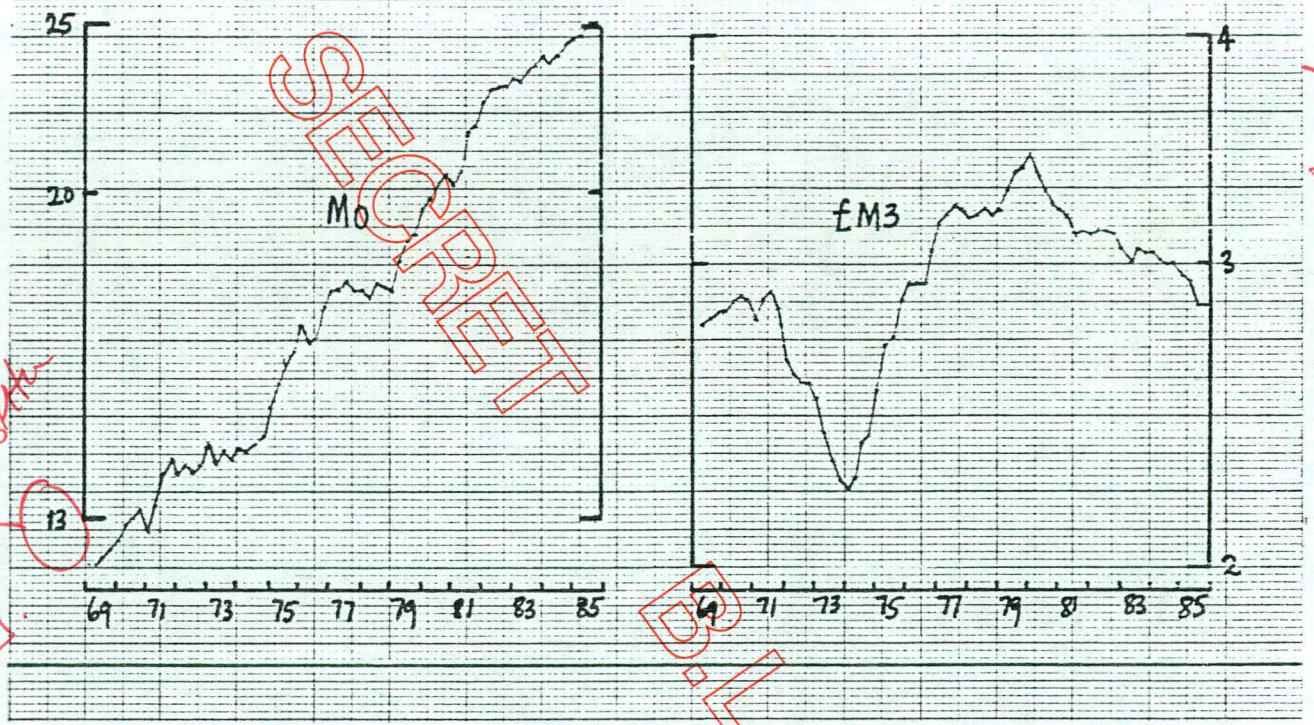
with declines in both inflation and money GDP growth. At the same time the high proportion of interest bearing deposits within broad money has meant that the immediate response of broad liquidity aggregates to changes in short term interest rates is highly uncertain.

Chart 2. Velocity of the Monetary Aggregates



Monetary targets

2.15 The government is setting targets in 1986-87, as in the last two years, for M0 as a measure of narrow money, and £M3 as a measure of broad money. The ranges are shown in Table 2.1.

2.16 For M0 the target range of 2-6% is the same as indicated in last year's MTFS. Illustrative ranges are also given for M0 in later years.

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2.17 For £M3, the target range has been raised to 11-15% reflecting the rapid fall in velocity observed in recent years. Illustrative ranges for future years are not given for £M3 because the uncertainties surrounding its velocity trend are at present too great.

Interpretation of Monetary Conditions

2.18 In implementing policy and making decisions about interest rates, the Government has to make a careful assessment of the behaviour of the monetary aggregates in relation to their targets, and other relevant evidence, especially the exchange rate.

2.19 There is no mechanical formula for taking the exchange rate into account in assessing monetary conditions; a balance must be struck between the exchange rate and domestic monetary growth consistent with the Government's aims for money GDP and inflation. Exchange rate changes have to be interpreted in the light of world developments, such as changes in oil prices. For example the immediate effect of a fall in oil prices is to reduce inflation, and this has to be considered alongside any movement in the exchange rate which may occur.

2.20 If the underlying growth of M0 or £M3 were to move significantly outside their target ranges, the government would take action on interest rates unless other indicators suggested clearly that monetary conditions remained satisfactory. If action is triggered by £M3 moving outside its target range this is unlikely to bring £M3 back inside the range within the target period. But such action clearly affects the tightness of monetary conditions, and this would be likely to show up in the behaviour of M0 and

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the exchange rate. Provided the behaviour of other indicators was satisfactory, continued growth of £M3 outside its range would not be a cause for concern.

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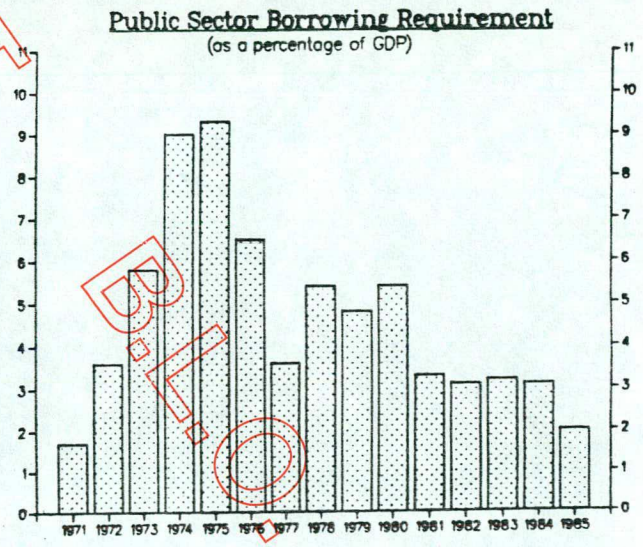
2.21 The PSBR in 1985-86 is expected to be about 2% of GDP, in line with last year's projection. This follows four years when the PSBR remained at about $3\frac{1}{4}$% per cent of GDP. The sharp reduction this year would have taken place in 1984-85 but for the coal strike. It is the second significant downward step since the MTFS began in 1980. The figure of 2% is the lowest recorded since 1971-72. This would still have been the case even if there had been no proceeds from privatistion.



The PSBR Path

2.22 The profile of the PSBR in table 2.5 is much as suggested last year. As usual, account has been taken of the composition of receipts and expenditure.

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2.23 The PSBR for 1986-87 is forecast to be £7 billion, or $1\frac{3}{4}$ per cent of GDP. North Sea revenues are projected to decline steeply in 1986-87 to about £6 billion, ~~which is only~~ half their level in 1985-86. The proceeds from the Government's privatisation programme are expected to rise from £$2\frac{1}{2}$ billion in 1985-86 to £$4\frac{3}{4}$ billion in 1986-87, as set out in the Autumn Statement.

2.24 The fiscal projections summarised in table 2.5 show a further ~~small~~ steady reduction in the PSBR to $1\frac{1}{2}$% of GDP in 1988-89 and 1989-90. The figures after 1986-87 are illustrative, and decisions about the appropriate PSBR in particular years will be taken nearer the time.

Assumptions

2.25 For the period to 1988-89, the expenditure projection in Table 2.3 incorporates the public expenditure plans set out in the Public Expenditure White Paper (Cmnd 9702). It is assumed that the planning total for 1989-90 will remain broadly flat in real terms. The revenue projections in Table 2.4 are based on the conventional assumptions of constant 1986-87 tax and contribution rates, and allowances and thresholds indexed from the proposed 1986-87 levels. All changes proposed in the Budget are taken into account.

2.26 The assumptions about output growth and inflation that underlie the revenue projections are shown in Table 2.2. They are consistent with the figures for money GDP growth in Table 2.1. The oil price is assumed to average $15 a barrel in both 1986 and 1987 and thereafter to rise in line with the world price of manufactured exports. It is assumed that

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there is no major change in the sterling exchange rate index from year to year.

Table 2.2 Output and Inflation Assumptions

	Percentage change on previous financial year				
	1985-86	1986-87	1987-88	1988-89	1989-90
Real GDP					
Non-North Sea	3¾	3	2¾	2¾	2¾
Total	3½	2¾	2½	2½	2½
Inflation					
GDP deflator	5¾	3¾	3¾	3½	3

Public Expenditure

2.27 Continued restraint in public spending plays a vital role in the Government's economic strategy. The cash planning totals set by the Government in the White Paper are designed to hold total spending broadly level in real terms. The projection given in Table 2.3 extends to 1989-90, one year longer than the plans. The assumption for the final year means that the planning total remains broadly flat in real terms over the whole MTFS period.

2.28 As a proportion of GDP, general government expenditure has already fallen significantly from its peak of over 46 per cent in 1982-83. Given the assumed growth of output, it is projected to decline further from over 44 per cent in 1985-86 to less than 40 per cent in 1989-90. This will enable a continued low level of borrowing to be combined with reductions in the burden of taxation, so improving motivation, efficiency and

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employment. The existing plans for public expenditure are discussed more fully in Chapter 5.

Table 2.3 General Government Expenditure

£billion, cash

	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
Public expenditure planning total (1)	129.6	134	139	144	149	153
Gross debt Interest	16.1	18	18	19	19	19
Other adjustments (2)	4.3	6	6	7	7	7
General government expenditure(3)	**150.0**	**158**	**163**	**169**	**175**	**180**
of which Privatisation proceeds(4)	2.1	$2\frac{1}{2}$	$4\frac{3}{4}$	$4\frac{3}{4}$	$4\frac{3}{4}$	$4\frac{3}{4}$

(1) For 1984-85 to 1988-89, the figures are equivalent to those in Table 5.1. Assumed to be the same in real terms in 1989-90 as in 1988-89.

(2) See paragraph 5.04. The adjustments convert the planning total plus gross debt interest into general government expenditure. One adjustment removes most public corporations' market and overseas borrowing, shown in Table 2.5, which can fluctuate considerably from year to year.

(3) General Government Expenditure, and its components, are rounded to the nearest £1 billion from 1985-86 onwards.

(4) See the Public Expenditure White Paper (Cmnd 9702), Table 1.4. Assumed to be the same in cash terms in 1989-90 as in 1988-89

Revenue

2.29 The growth in Government revenues in cash terms over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. On the unchanged policy assumptions set out above, general government receipts are expected to increase somewhat less

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than money GDP. Government revenues from the North Sea are projected to fall sharply in 1986-87 from the peak levels of 1984-85 and 1985-86 mainly because of the drop in real oil prices. But the decline in revenues from this source is partially offset by buoyant non-North Sea revenues.

[I comment on growth of non-NSea taxes cut & many a/c? Try a Spring + let me see it]

Table 2.4 General Government Receipts(1)

£billion, cash

	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
Taxes on incomes, expenditure and capital	105.5	113	118	125	132	139
National Insurance and other contributions	22.9	24	26	28	29	31
Interest and dividends	5.0	6	6	6	6	6
Other receipts	6.3	5	5	5	6	7
Accruals adjustment	1.3	-	-	-	-	-1
General government receipts	**140.8**	**149**	**156**	**164**	**174**	**182**
North Sea tax(2)	12.0	12	6	4	4	4

(1) Rounded to the nearest £1 billion from 1985-86 onwards.

(2) Royalties, petroleum revenue tax (including advance payments), and corporation tax from North Sea oil and gas production (before advance corporation tax set-off). This does not correspond exactly to tax receipts in the same financial year in respect of North Sea production. See footnote 2 to Table 6B.3.

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Public Sector Borrowing

2.30 The projections of Government expenditure and receipts are brought together in Table 2.4 to provide projections of the general government borrowing requirement (GGBR) and of the PSBR. The size of the fiscal adjustment depends upon

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the estimates of revenues and expenditure. As always, these are subject to major uncertainties. Apart from the general difficulty of projecting the yield from a given set of tax rates, recent events in world oil markets make the projection of oil revenues particularly uncertain. On the expenditure side, the planning total for the final year has yet to be agreed.

2.31 Changes since the 1985 MTFS are discussed in the Annex.

Table 2.5 Public Sector Borrowing (1)

£billion, cash

	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
General government expenditure	150.0	158	163	169	175	180
General government receipts	140.8	149	156	164	174	182
Fiscal adjustment from previous years (2)	-	-	-	-	2	6
Annual Fiscal adjustment (2)	-	-	-	2	4	3
GGBR	**9.1**	**8**	**8**	**8**	**7**	**7**
Public corporations' market and overseas borrowing	1.0	-1	-	-1	-1	-1
PSBR	**10.1**	**7**	**7**	**7**	**7**	**7**
Money GDP at market prices	327	357	381	405	430	453
PSBR as % of GDP	**3.1**	**2**	**1¾**	**1¾**	**1½**	**1½**

(1) Rounded to the nearest £1 billion from 1985-86 onwards. Further details for 1985-86 and 1986-87 are provided in Table 6.5.

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

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Conclusion

2.32 Events in the UK and elsewhere may necessitate revisions to the assumptions on which the projections have been based. But the Government is committed to maintaining the progress to lower inflation in the medium term, secured by appropriate financial policies. The MTFS provides the framework within which the Government will pursue its economic policy.

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ANNEX

Changes since the 1985 FSBR

Money GDP

2A.1 The level of money GDP in 1985-86 is now expected to be higher than was projected in last year's MTFS, reflecting both higher output and a higher deflator. The level from 1986-87 onwards is also higher. The decline in the growth rate of money GDP from 1985-86 to 1988-89 is similar to that assumed last year. Non-North Sea output growth is assumed to be slightly faster, and oil production is projected to decline more slowly. The GDP deflator is projected to grow more slowly in 1986-87, but very slightly faster in the subsequent years than assumed last year.

Table 2.6 Level of Money GDP

per cent changes from 1985 MTFS projections

1985-86	1986-87	1987-88	1988-89
$+\frac{3}{4}$	+1	$+1\frac{1}{2}$	$+2\frac{1}{2}$

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Monetary Aggregates

2A.2 The growth of M0 is expected to be in the lower half of its target range for 1985-86. The target range for 1986-87 is the same as the illustrative range given last year. The illustrative ranges for subsequent years decline less rapidly.

2A.3 The growth of £M3 in 1985-86 is well above the target range originally set last year, and the range set for 1986-87 is higher than the illustrative range in last year's MTFS.

Table 2.7 Monetary Aggregates

Per cent change	1985-86	1986-87	1987-88	1988-89
M0				
1986 MTFS	$3\frac{1}{2}$	2-6	2-6	1-5
1985 MTFS	3-7	2-6	1-5	0-4
£M3				
1986 MTFS	$14\frac{3}{4}$	11-15		
1985 MTFS	5-9	4-8	3-7	2-6

2A.4 Table 2.8 shows changes in the fiscal projections since the 1985 FSBR, after allowance for classification changes.

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Table 2.8 Revenue and expenditure

£billion, cash

	Changes from 1985 MTFS projections				
	1984-85	1985-86	1986-87	1987-88	1988-89
Expenditure					
1. Planning total	-0.1	- ½	-	-	+ ½
2. Other[4]	+0.4	-2	- ½	-	+1
3. General government expenditure	+0.3	-2½	- ½	-	+1½
Receipts[2]					
4. North sea taxes	-	-2	-5	-5½	-4
5. Other taxes and contributions	+0.7	+1½	+2½	+3	+4
6. Other receipts	+0.1	- ½	- ½	-1½	-1½
7. General government receipts	+0.8	-1	-3½	-4	-2
8. Implied cumulative fiscal adjustment[3]	0	0	-3½	-4½	-3½
9. Public Corporations' market and overseas borrowing[4]	+0.1	+1	+ ½	-	- ½
10. PSBR	-0.4	- ½	-	-	- ½

1 The classification changes add the following amounts to both expenditure and receipts:

£billion				
+0.2	+0.3	+0.2	+0.2	+0.2

The main changes are in respect of the treatment of transactions in certain public sector pension funds and of National Savings Bank management expenses.

2 The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set-off. See footnote 2 to Table 6B.3

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

4 Public corporations' market and overseas borrowing is included in the planning total and in the PSBR, but not in general government expenditure. Changes in it are therefore deducted in line 2 and added back in line 9.

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Changes in expenditure

2A.5 The expected underspend in the planning total in 1985-86 is ~~discussed~~ in Chapter 5. The planning totals for 1986-87 onwards are as in Cmnd 9702 which implies a slightly higher figure in 1988-89 than assumed last year. General government expenditure is lower in 1985-86 than projected last year, both because of the lower planning total and because of changes in the pattern of public corporations' borrowing. They borrowed less from general government and more from the market and overseas, and this pattern is projected to continue in 1986-87. In 1988-89, the changes in the planning total and public corporations' borrowing are in the opposite direction.

Changes in receipts

2A.6 The reductions in North Sea revenues are due to lower sterling oil prices. Other taxes are higher throughout the period, mainly because of the higher level of money incomes. National Insurance contributions are higher towards the end of the period for much the same reason.

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3 The Economy: Recent Developments and Prospects to Mid-1987

Summary

Demand and activity **3.01** 1985 saw further sizeable increases in both exports and business investment. For the forecast period substantial growth is likely not only in mo areas of domestic spending but also in exports. Total domestic production and manufacturing output are both expected to record further growth in th range 2–3 per cent.

Labour market **3.02** Employment has continued to rise, with over 200 000 extra jobs in the year to September 1985. In spite of this there has been some further rise in unemployment over the last year. However, with labour force growth now likely to fall, prospects for unemployment are somewhat better than for some years.

Inflation **3.03** After rising in the early months of 1985, inflation has been on a downward path since June and in January 1986 the RPI increase was 5½ per cent. The inflation rate is expected to be at or below 4 per cent for most of the forecast period.

Assumption **3.04** The UK forecast is based on the assumption that fiscal and monetary policies are set within the framework of the MTFS. North Sea oil prices are assumed to average $15 in 1986–87. Neither the sterling index nor the sterling/dollar exchange rate is assumed to change much.

World economy **3.05** Output in the world economy has now been rising since early 1983, and inflation has been coming down since 1980. The recent large fall in oil prices will be of particular help to oil importing countries both in the developed and developing world. Assisted by further moves to lower interest rates, a period of low inflation and good growth in output and trade is in prospect. Many of the problems arising from payments imbalanc and debt repayments will remain. But the benefits to trade, output and inflation from the fall in oil prices should prove substantial.

Trade and the current account **3.06** Exports have grown strongly over the last two years. The current account of the balance of payments is expected to remain in sizeable surplus despite the big fall in oil prices. Offsets include higher export earnings on other goods, with most overseas markets benefiting from the fall in oil prices, lower profits earned by foreign oil companies in the North Sea, and higher earnings from the UK's stock of overseas assets.

World economy

Recent developments **3.07** After a spurt in 1983 and the first half of 1984, US economic growth has slowed down sharply. By the final quarter of 1985 real GNP was 2½ per cent higher than a year earlier. The performance of the US economy has strongly influenced the pattern of economic growth in other major industrialised countries. In Japan and Germany, in particular, output grew significantly faster than domestic demand in both 1984 and 1985, thanks to the substantial external contribution to demand, stemming in

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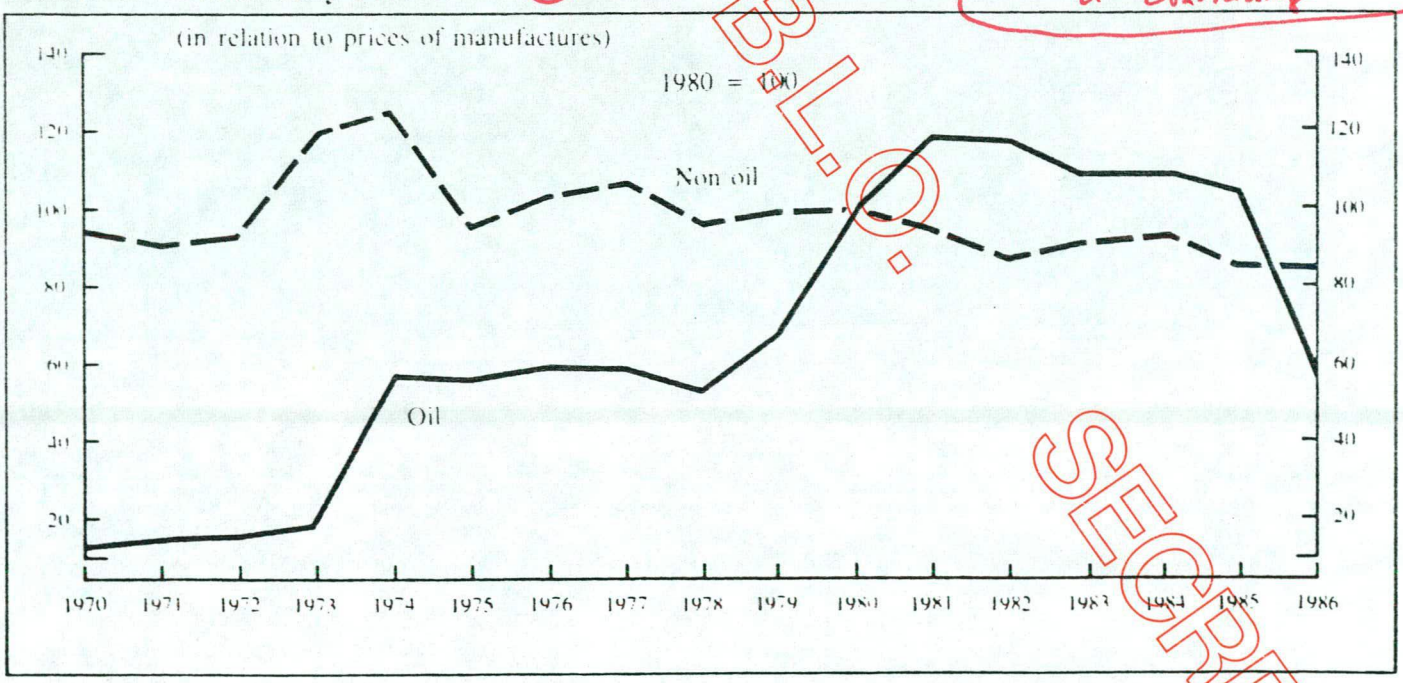
large part from the US. More recently the recovery in Europe has strengthened and growth has become less dependent on exports to the US. In Japan growth has shown some signs of slackening, although remaining high by European standards.

3.08 Domestic demand is now growing at similar rates in the US and other major industrialised countries. But the effect of much faster growth between 1982 and 1984 in the US, together with the effects of the rise—still only partially reversed—in the dollar, are seen in the pattern of current account balances: a large deficit in the US and large surpluses in Germany and Japan. There have, though, been a number of helpful steps towards reducing these imbalances over the past year. Slower growth in the US has not only reduced the increase in US imports, but also contributed to lower interest rates and a fall in the dollar. The latter was helped by the Plaza Agreement of 22 September between the Finance Ministers of the Group of Five. Nevertheless, a period in which US domestic demand growth is significantly slower than that in Europe and Japan is likely to prove necessary if current account surpluses and deficits are to be reduced.

3.09 The rate of inflation fell further in 1985: consumer prices in the major industrialised countries increased on average by about 4 per cent, compared with over 4½ per cent in 1984. This partly reflects the weakness of primary product prices (see Chart 3.1).

Chart 3.1 Commodity Prices



3.10 Since December 1985, oil prices have fallen sharply. The background to these oil price developments is set out in Chart 3.2. Before the first oil price shock the non-communist world demand for oil was around 48 million barrels per day, and about 30 mbd of this was produced by OPEC members. Despite the 1973–74 increase in oil prices OPEC managed to

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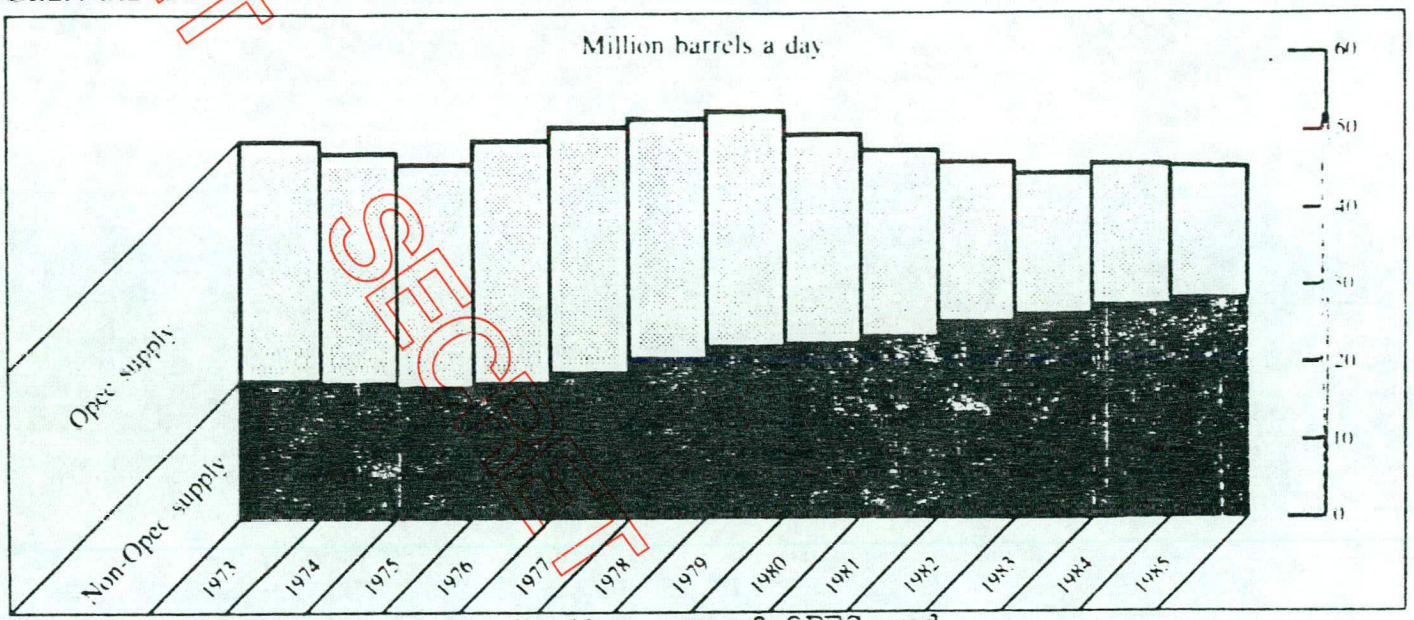
maintain roughly this level of production throughout the 1970s. After falling in 1974 and 1975 total demand for oil rose again during the rest of the decade, while non-OPEC supply grew by roughly the same amoun in absolute terms.

Chart 3.2 Oil Production



(1) Total oil production is the sum of OPEC and non-OPEC(2) production and is equal to non-communist world consumption plus stockbuilding.

(2) Non-OPEC production includes net exports of oil from centrally planned economies.

the communist bloc.

3.11 Experience since the second sharp increase in oil prices in 1979 has been very different. Demand for oil has fallen and non-OPEC supplies have continued to rise sharply. OPEC's pricing policy made it effectively the residual source of supply and demand for OPEC oil nearly halved: from about 30 mbd in 1979 to less than 17½ mbd on average in 1985. A large share of the production cuts fell on Saudi Arabia.

restrict

3.12 Towards the end of 1985 Saudi Arabia indicated that it was no longer prepared to maintain its own production at very low levels in order to maintain the existing level of prices. The resulting increase in supply, combined with no sign that other producers were prepared to make offsetting cuts in their production, has produced a sharp fall in prices.

Prospects

3.13 Total demand and supply for oil may well respond only slowly even to the large fall in price, and so excess capacity is likely to be present for some time. This forecast assumes that prices will settle at around $15 per barrel—rather below, in real terms, the level between 1974 and 1979.

average $15 ?

average $15 a barrel

3.14 The prices of most other primary products are also unlikely to strengthen significantly over the next year or so, since with some exceptions (for example a temporary shortfall in the coffee crop), supplies are abundant and stocks relatively high. The industrial countries can therefo expect further improvements in their terms of trade, raising real incomes and enabling inflation to fall further (see Table 3.1).

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Table 3.1: World economy

	percentage change on a year earlier			
	1984	1985	1986	1987 first half
Major Seven countries*:				
Real GNP	4½	2½	3½	4
Consumer prices	4½	4	2½	1½
World trade, at constant prices				
Total imports	10	3	6	5½
Trade in manufactures (UK weighted)	8½	4	5	5

* USA, Japan, Germany, France, UK, Canada and Italy.

3.15 The growth of real GNP in the US should pick up in 1986, benefiting from lower oil prices and from the effect of the lower dollar on trade. Consumers' expenditure, while growing more slowly than in recent years, should be helped by the lagged effects of lower interest rates and rises in asset prices.

3.16 Growth in Japan may be weaker than usual in 1986 as the expansion of domestic demand may not be sufficient to compensate for a slowdown in the growth of exports. In most European countries the economic recovery should strengthen in 1986, with the rate of growth increasing, particularly in Germany.

3.17 Overall the major industrialised countries may grow by about 3½–4 per cent over the next year. Together with lower inflation and interest rates in the major countries and the reduced cost of their oil imports, this should provide a better prospect for the non-oil developing countries, despite weak commodity prices. Oil producing countries, on the other hand, particularly those already heavily indebted, face severe difficulties and will have to cut their imports further.

Chart 3.3

GROWTH AND INFLATION

MAJOR 7 ECONOMIES

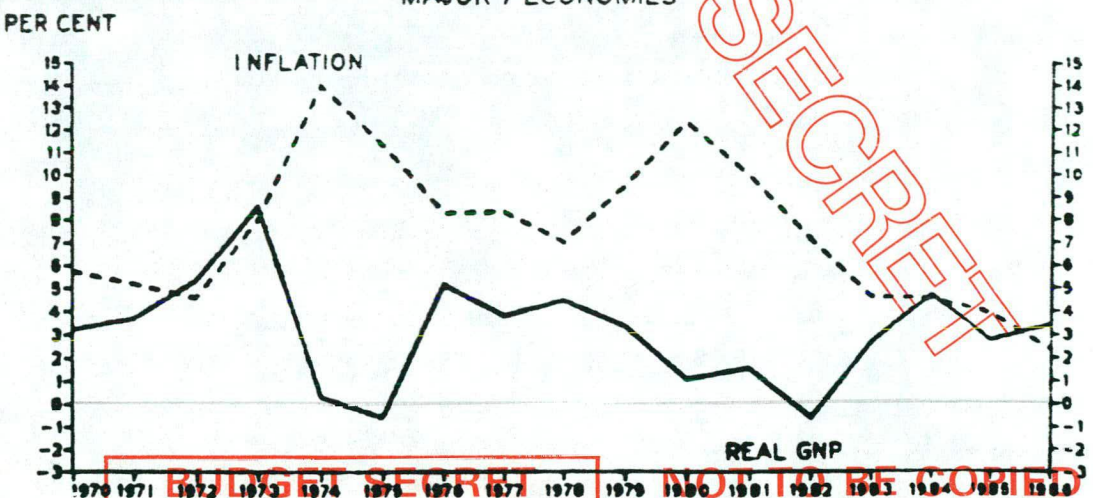

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Table 3.2: World import volumes, annual growth rates

	USA	Japan	Europe*	OPEC	Developing countries	Other	Total
Weights in 1984	19	8	31	7	14	21	100
1984	24	11	6	- 10	8	10	10
1985	3	1	5	- 8	1	6	3
1986 (forecast)	9	8	7	- 16	7	5	6

* Germany, France, UK, Italy, Netherlands and Belgium

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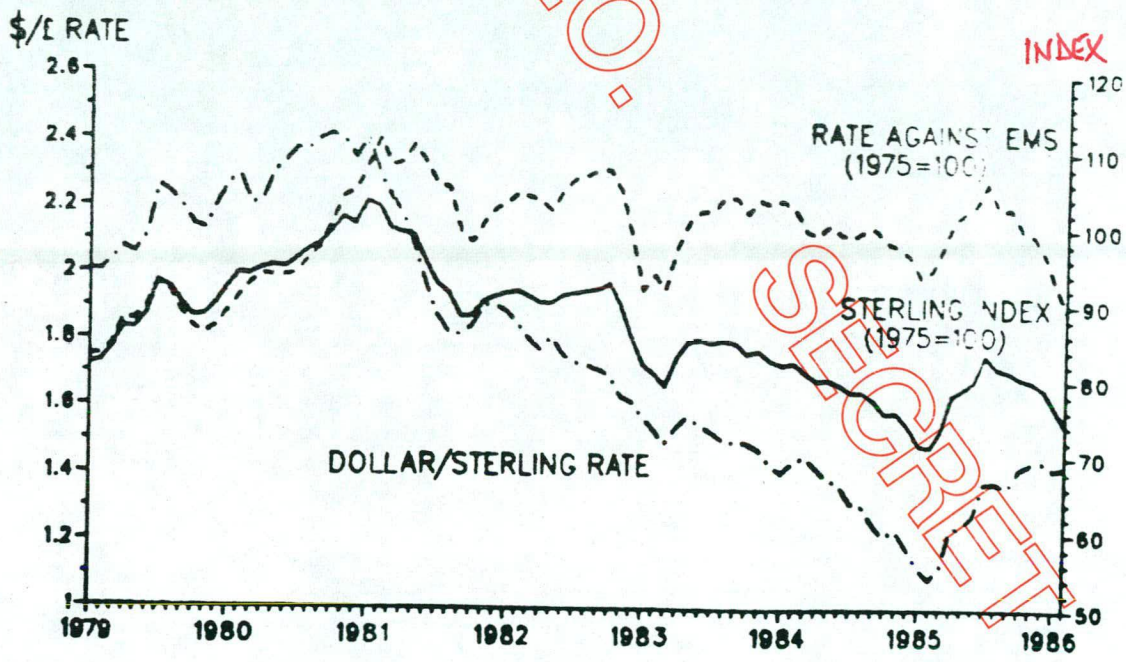
3.18 This picture of world activity is reflected in the pattern of world trade growth. Import growth is likely to be strongest in oil-importing countries and in those whose exchange rates have appreciated most over the past year. This points to rapid growth of imports into Europe, Japan and many developing countries, but to large falls in oil producers' imports. Overall import growth in 1986 should be well above that of 1985.

Financial conditions

Exchange rates

3.19 The **dollar** has declined substantially (by over 20 per cent against a basket of other currencies) since its peak in early 1985. In 1985 as a whole the **sterling** index was little different from 1984. There were however some sizeable swings during the course of the year. The index rose from a low point of 70½ in January to a high of 84½ in July, when UK interest rates fell, before declining to 78 in December. The index has fallen a little further this year as a result of the fall in oil prices. Over the past year sterling has risen by about 30 per cent against the dollar, but fallen against most other currencies.

Chart 3.4 STERLING EXCHANGE RATES



3.20 The forecast assumes that sterling will not change much from its present level, either in dollar or effective terms.

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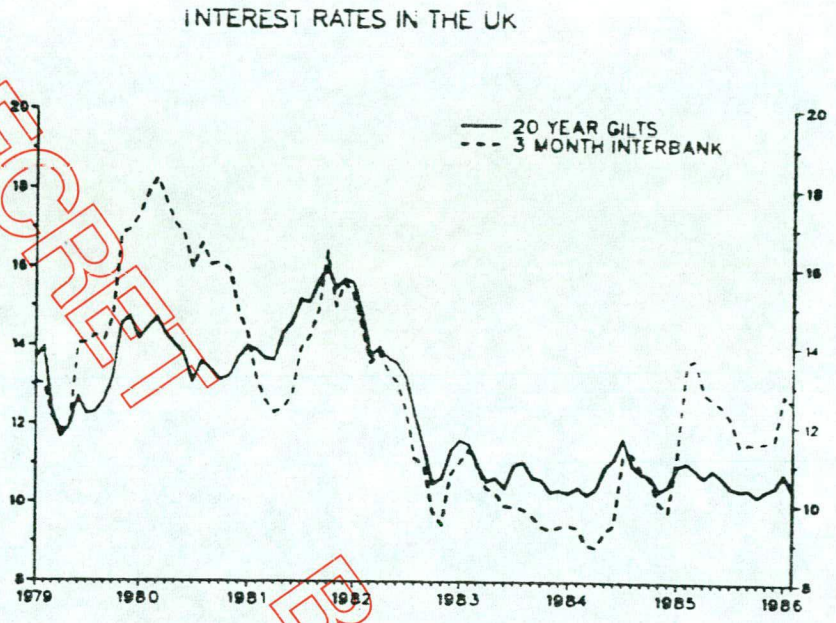
Interest rates

3.21 Short-term interest rates fell during much of 1985 from the peak levels reached in February and March. They rose again in January this year as sterling weakened but in 1986 so far they have been a little below levels a year earlier. However on average in 1985–86 short rates, at 12 per cent, have been a point or so above the levels of 1984–85 and several points above levels in the US, and most other industrialised countries. Long rates have been much more stable. Yields on 20 year gilts have been within the 10–11 per cent range for almost all of the last three years. Real yields on index-linked gilts have also been relatively stable.

Chart 3.5



Narrow money

3.22 M0 was near the centre of its target range in the early months of 1985–86, but growth slowed during the course of the year, in response to the increase in interest rates last winter. In recent months M0 growth has generally been just above the bottom of its target range. The annual increase in M0 velocity has been stable for many years now, and is expected to remain so.

3.23 Growth in the non-interest bearing component of M1, 3 per cent over the last year, has also slowed. This has been in response to higher interest rates and the increased availability of high interest cheque accounts which are in M1, contributing to an acceleration in M1 in total.

Broad money

3.24 The rate of growth of £M3 has risen during the course of 1985–86 and has been well above both the target range set in the 1985 MTFS and the growth of money GDP. With the funding objective now set at the level needed to cover the PSBR, £M3 growth (at 14–15 per cent on a year earlier in recent months) has reflected a continued strong expansion of bank credit. Other broad aggregates have grown at much the same rate.

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3.25 The rapid expansion of broad money and credit reflects to a large extent the pace of financial innovation and liberalisation. In addition, since over two-thirds of £M3 bears interest and is now an attractive means of holding financial wealth, the high level of real interest rates may have contributed to higher bank deposits. The higher levels of broad money and debt in relation to incomes probably reflect a permanent and continuing shift in the private sector's portfolio which is not likely to be reversed through higher spending. They do not therefore pose a threat to the slower growth of nominal incomes and the fall in inflation in this forecast.

Trade and the balance of payments

Relative costs and prices

3.26 The last two to three years as a whole have exhibited relatively little change in most measures of cost and price competitiveness, although there have been large short-term swings associated with movements in the nominal exchange rate. As Table 3.3 shows, the effects of a lower nominal exchange rate have been broadly offset by unit labour cost increases at home above those in the UK's main overseas competitors, despite a good UK productivity performance. Assuming an unchanged exchange rate, the UK's cost and price competitiveness may be little different from the average of the last three years.

Table 3.3: The nominal exchange rate and relative costs and prices in manufacturing.*

	Sterling Index (1975=100)	Relative actual unit labour costs	Relative export prices (1980=100)	Import Price Competitiveness
1983	83½	85	89	94½
1984	78½	83½	87½	92
1985 (Estimate)	78	86	89½	91½

* Ratio of UK to overseas costs/prices

Trade prices

3.27 Prices of most categories of imports fell during the course of 1985. The exchange rate appreciated during the course of the year, inflation in the developed world was low and commodity prices were weak. By the final quarter of 1985 import prices of all goods and services were 5 per cent lower than a year earlier.

Terms of trade

3.28 For 1985 as a whole, the terms of trade were 1 per cent above those of 1984 because of the weakness of commodity prices. But the terms of trade are likely to be worse in 1986 because the price of oil has fallen relative to other goods and services. As oil has a greater share in UK exports than in imports, a fall in its prices reduces export prices relative to import prices. On its own, the fall in oil prices worsens the terms of trade in goods by 3 per cent, producing a fall in real national disposable income of 1 per cent.

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Table 3.4: Trade in goods – balance of payments basis

per cent changes on a year earlier

All goods

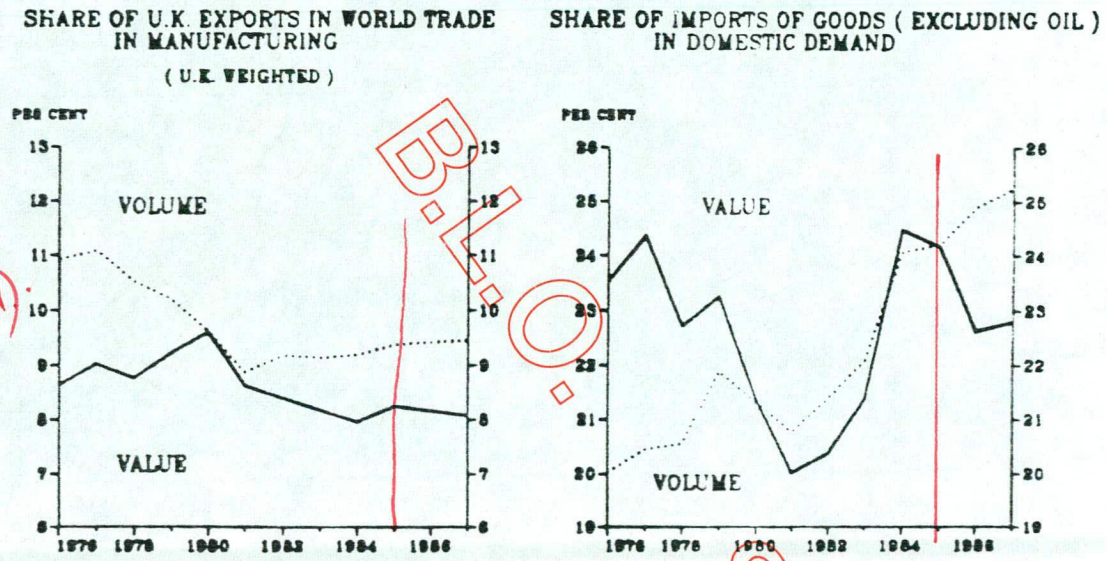
	Export Volume	Import Volume	Terms of Trade*
1983	2	8	- ½ (-1)
1984	8½	11	- 1½ (-1)
1985	5½	3	2½ (3½)
1986(Forecast)	5½	6½	- 4 (1)

Trade volumes (goods other than oil)

3.29 As shown in Chart 3.6 UK exporters of manufactures improved their share of world trade in volume terms in 1984 and may also have done so in 1985. The value share was broadly unchanged in 1984 when UK export prices fell relative to those of our competitors, but probably rose in 1985. The forecast of exports of manufactures (excluding erratics) in volume terms is for further growth of 5 per cent in 1986. This is the same as the rise in world trade, but less than in 1985.

Chart 3.6

EXPORT SHARES AND IMPORT PENETRATION



3.30 Between 1982 and 1985 the growth in demand for manufactures (5½ per cent at an annual rate) has been shared by importers and domestic producers, with importers continuing to increase their share. Domestic demand for manufactures is expected to grow in 1986, because of further growth in investment and expenditure on consumer durables in particular. Growth in imports of manufactures in 1986 is forecast to be around 7 per cent, twice as fast as domestic demand growth, a relationship similar to that between 1982 and 1985.

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	Oil	Non-oil	mfg	other goods	services	Total *
83	7	-4	-2½	-5½	4	3 (3)
84	7	-6	-4	-7	5	1 (4)
85	8	-5	-3	-7	5	3 (4½)
86 (F)	5½	-1½	-3½	-6½	8½	4 (3½)

* figs in brackets are after adjustment for the effect of the coal strike & the timing of ITC rebates

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Trade in oil **3.31** The prospect is for a substantial fall in the surplus on trade in oil in 1986 as a result of lower oil prices, partly offset in the current account as a whole by reduced earnings of foreign owned companies operating in the North Sea. Little change in oil production is expected and domestic demand for oil will be below the 1985 level which was boosted by the coal strike.

Invisibles **3.32** The surplus on trade in **services** has more than doubled since 1982. 1985 was an exceptionally good year, with large gains in earnings from financial services, tourism and travel. With imports of services, particularly tourism, likely to grow faster, the balance on services may show only a modest gain in 1986.

3.33 The profile of the **transfers** balance is affected by the timing of official transactions with the European Community. As the bulk of the UK's rebate on its 1984 contribution was delayed into 1986 the transfers balance was unusually low in 1985, by about £½ billion. A correspondingly high figure is projected for 1986.

3.34 On provisional estimates, the surplus on **interest, profits and dividends** (IPD) fell in 1985. Earnings on UK investment overseas were depressed by a once-for-all write off of losses on BP's Sohio subsidiary and UK banks' net earnings on their foreign currency business fell. In 1986 the surplus on IPD is expected to increase. Lower oil prices will reduce the profits of foreign oil companies operating in the North Sea more than they reduce the profits of UK oil companies' overseas operations. There should be a net rise in the other components of the IPD balance as a result of a projected further increase in the UK's net overseas assets.

Table 3.5: Current account of the balance of payments, £billion

	Oil	Other Goods**	Invisibles	Total	
				Actual and forecast	After allowing for special factors*
1983	7	- 8 (-2½)	4	3	3
1984	7	- 11 (-4)	5	1	4
1985	8	- 10 (-3)	5	3	4½
1986 (Forecast)	5½	- 10 (-3½)	8½	4	3½

* The timing of EC rebates and the effect of the coal strike.

** The balance on manufactures is in brackets.

3.35 Table 3.5 summarises the current account and its main components. Allowing for the effects of the coal strike the current account was in sizeable surplus in each of the last three years and a substantial surplus is again forecast for 1986. On an underlying basis, the surplus in 1986 is expected to be lower than in 1985, as a result of the big fall in oil prices. The contribution of North Sea oil to the current account—ie the balance of trade in oil less foreign companies' North Sea profits—is forecast to fall from a strike-adjusted £6½ billion in 1985 to £3½ billion in 1986. Chart 3.7 shows the components of the account over a longer period, relative to GDP.

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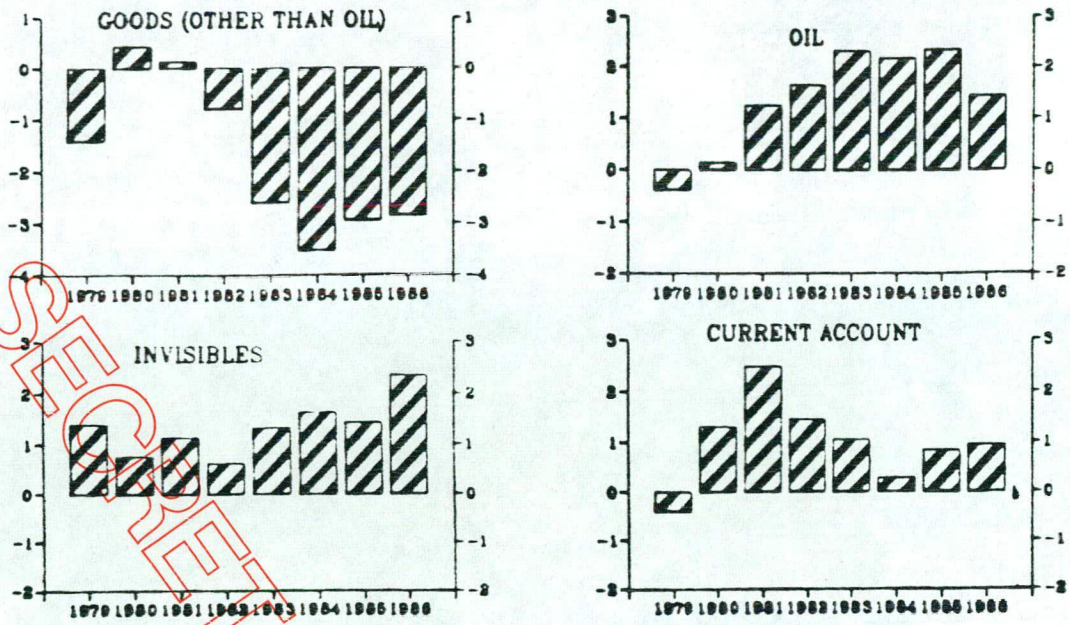
Chart 3.7 THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS
(SURPLUSES AND DEFICITS AS A PER CENT OF GDP)



Overseas assets

3.36 The UK's stock of net overseas assets is estimated to have been 24 per cent of GDP (£85 billion) at the end of 1985, compared with 6 per cent of GDP in 1979.

Inflation

Inflation and costs in 1985

3.37 In the year to 1985Q4 the RPI increased by 5½ per cent, a little more than forecast in last year's FSBR. In the middle of the year retail price inflation touched 7 per cent reflecting in particular increases in mortgage interest rates in February and April 1985 and the weakness of sterling in late 1984 and early 1985. Between May and January retail prices rose by only 1·1 per cent in total, helped by a fall in mortgage rates, by lower petrol prices, and a general easing of cost pressures.

3.38 Import prices declined during 1985 and in the final quarter were about 5 per cent lower than in 1984Q4; the prices of imported fuels fell 14 per cent over the same period. Prices of the manufacturing sector's imported inputs fell rapidly from their peak in February and by the end of the year were 6 per cent below their December 1984 level. The rate of increase in manufacturing output prices started to slow down in the second half of 1985.

3.39 The underlying growth of average earnings (that is, abstracting from the effects of strikes, delayed settlements and other temporary factors) continued at about 7½ per cent in 1985 — little changed from 1984. With output per head growing at about 2 per cent (after allowing for the effects of the coal strike) the growth in unit wage costs was about 5½ per cent in 1985. Unit labour costs rose by about 1 per cent less mainly because of the abolition of NIS in October 1984. In the manufacturing sector, average earnings increased by 8½–9 per cent and unit labour costs by 4 per cent. This was much faster than in most other major industrial

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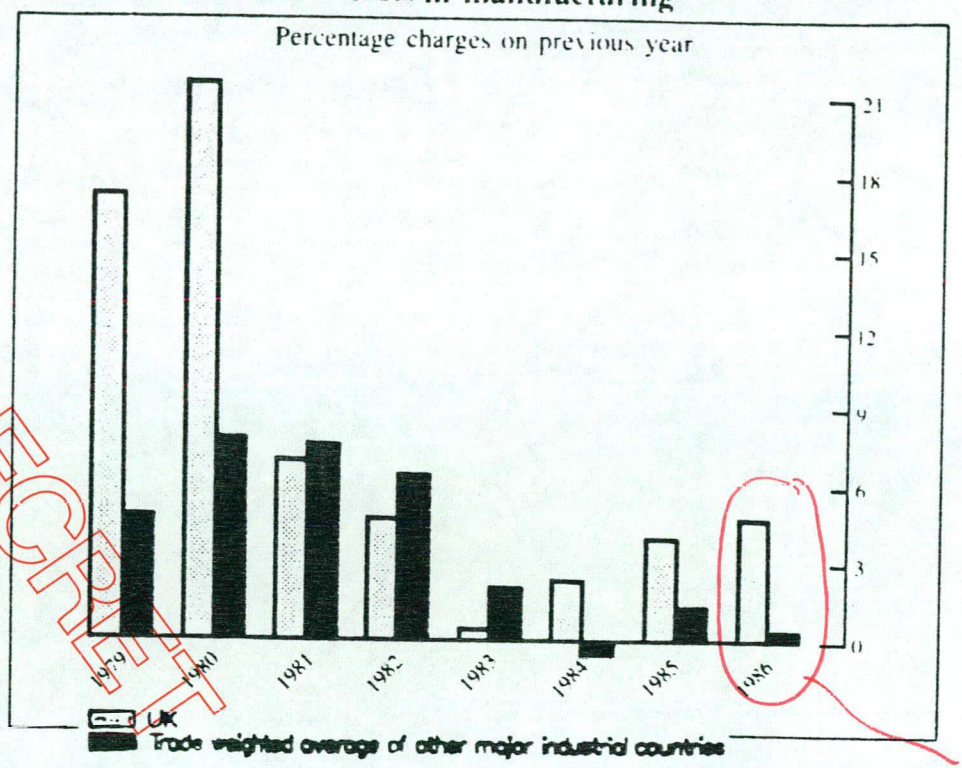
countries (see Chart 3.8). Pre-tax real earnings of employees increased by an average of almost 2½ per cent a year between 1982 and 1985.

Chart 3.8 Unit labour costs in manufacturing



Prospects **3.40** So far the current pay round is showing little sign of any significant change in the level of pay settlements or in the underlying rate of growth of average earnings in the private sector. Unit labour costs for the economy as a whole may rise by 5 per cent in 1986, and unit labour costs in manufacturing may rise slightly less than this. World commodity prices are likely to remain weak in 1986. With oil prices in sterling terms falling by almost a half between 1985 and 1986, the overall cost of manufacturers' material and fuel inputs should fall quite sharply between the two years. The prospects are for very modest growth in manufacturers' total costs and a widening of profit margins.

Table 3.6: Costs in manufacturing (percentage changes on a year earlier)

	Unit Labour Costs in Manufacturing	Materials and fuels purchased by manufacturing industry(1)	Estimated Total Costs	Output Prices(1)
1983	½	8	2½	5½
1984	2½	8½	4½	5½
1985	4	4	4	6½
1986 (forecast)	4½	-11	½	4½

(1) Excluding food, drink and tobacco

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of the year. The flattening out of strike adjusted GDP during the middle of 1985 reflected in part the high level of business investment and North Sea output in the first quarter of the year. Output in most sectors of the economy, including manufacturing, continued on an upward trend throughout 1985.

Personal sector expenditure

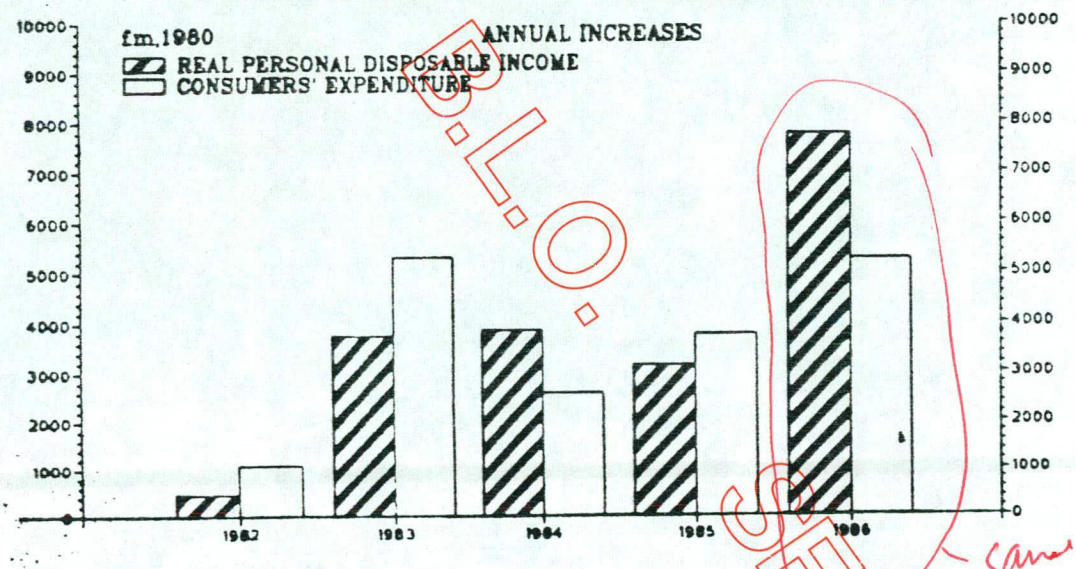
3.45 Between 1980 and 1983 the inflation rate fell by about three-quarters and the personal saving ratio fell by almost a quarter. In 1984, with the uncertainties caused by the long coal strike, consumers were more cautious and saving rose. During 1985 spending has picked up again, particularly spending on durables which was some 7 to 8 per cent higher in the second half of 1985 than in the second half of 1984.

3.46 The combination of lower price inflation and little change in earnings growth, together with higher dividend income reflecting the buoyant profitability of the company sector, is expected to lead to substantial growth of real personal disposable income of about 4 per cent in 1986. There may be some increase in the saving ratio, as consumers adjust to higher levels of income; but most of the rise in incomes should be reflected in higher spending, with continuing strength in purchases of durables. Chart 3.9 shows recent and forecast changes in personal income and consumer spending.

? savings

Chart 3.9

PERSONAL INCOME AND EXPENDITURE



same figure!

3.47 Investment in dwellings by the personal sector fell between 1984 and 1985, but a resumption in growth is expected for 1986. Investment in housing improvements, which fell in the second half of 1984, started to recover during 1985, and is expected to show further growth in 1986 as personal incomes rise. In spite of the increases in mortgage interest rates early in 1985, house prices remained firm; private housing starts which had fallen during 1984 were rising

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3.41 The fall in import prices since the spring of 1985 has contributed to the recent low monthly growth in retail prices, and will continue to contribute to low increases in prices over the coming months. The annual rate of inflation will fall quite sharply in the months after January 1986. In the last quarter of the year RPI inflation may be about 4 per cent, with little change likely in the first half of 1987. The fall in oil prices is expected to work its way fully through to petrol prices in the course of 1986. The forecast increase in the housing component of the RPI (which cove mortgage payments, rents, rates, and other housing costs) mainly reflects the prospects for local authority rates in 1986–87.

Table 3.7:

Retail prices index

Per cent changes on a year earlier

				Forecast	
	Weights in 1985	1984 Q4	1985 Q4	1986 Q4	1987 Q2
Food	19	3½	3	3	3½
Nationalised Industries (including water)	9	4	5½	4½	3
Housing	15	10½	9½	9½	3½
Other*	57	4	5½	3	4
Total	100	5	5½	4	3¾

3.42 Other price indices sometimes move differently from the RPI because of differences in coverage. In particular they vary in the degree to which they are affected by movements in import prices, and the housing component of the RPI includes a direct effect from interest rate changes which is absent from other price indices.

3.43 The GDP deflator measures the price of domestic value added—principally unit labour costs and profits per unit of output—and excludes imports altogether. The GDP deflator covers all sectors of the economy, including oil output in the North Sea, and so is highly sensitive to the fall in world oil prices. This contributes to a marked slowdown in the growth of GDP deflator over the coming year. The deflator for GDP at market prices is estimated to have increased by 5¼ per cent in 1985–86, about one per cent faster than in 1984–85. In 1986–87, inflation on this measure is expected to fall back to about 3¾ per cent. With no further benefit from lower oil prices assumed after 1986, the GDP deflator is not expected to show any further decline in 1987–88.

Demand and activity

3.44 Latest estimates suggest that GDP rose by about 3½ per cent in 1985, or 2½ per cent after making allowance for the effect of the recovery from the coal strike. Over the year to the first quarter of 1985, GDP is estimated to have risen by almost 4 per cent in strike adjusted terms; since then the path of GDP has been flatter. The rise in GDP between the first and third quarters of the year was more than accounted for by recovery from the coal strike, but growth seems to have picked up again in the fourth quarter: the preliminary estimate of the output measure of GDP showed growth at annual rate of 2½ per cent between the third and fourth quarters

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throughout 1985, and the total for the year was well above the number of completions. This trend in starts should show up in investment in new houses during 1986.

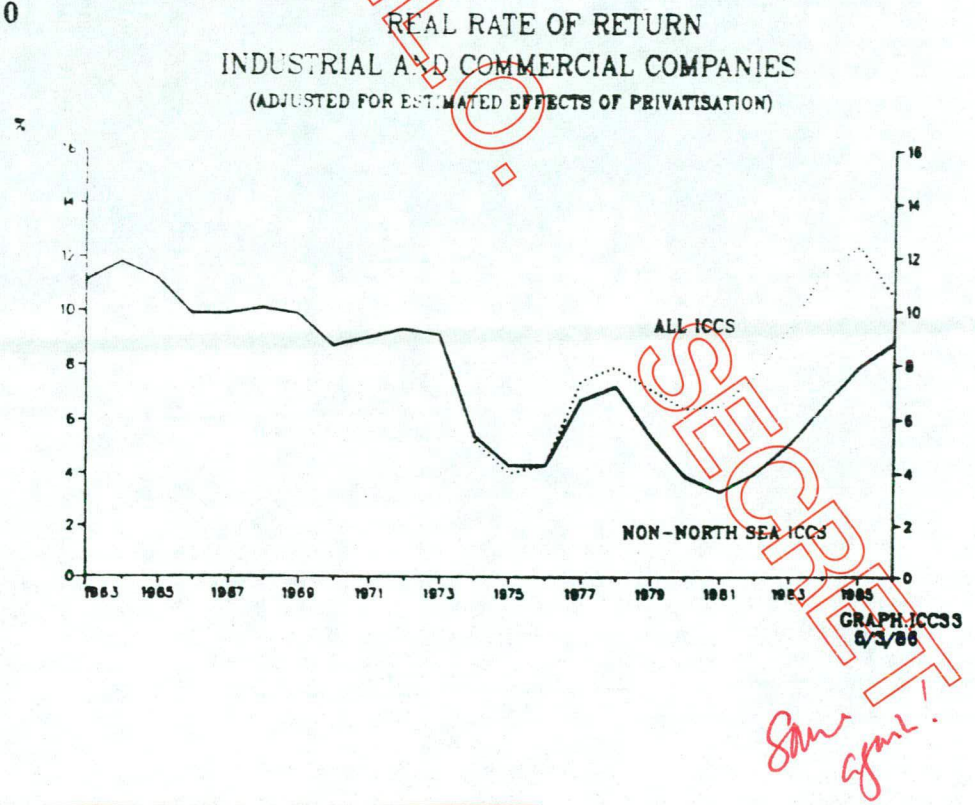
3.48 The demand for housing (as reflected in house prices) and spending on consumer durables have both been resilient in the last year or so, in spite of the high level of real interest rates. The personal sector has been responding to the financial liberalisation of recent years and the greater availability of credit as well as to the changes in interest rates. Borrowing from banks and building societies by the personal sector increased by about 18 per cent in 1985, and by 20 per cent a year on average between 1980 and 1985. This borrowing has not only helped to finance current consumption and spending on tangible assets, but has also been accompanied by substantial acquisition of financial assets: in fact the growth in the personal sector's financial assets has recently more than matched the growth in their liabilities, partly because of capital gains on holdings of equities and gilts.

Company income and expenditure

3.49 Company profitability has continued the recovery that began in 1981. The net real rate of return for all industrial and commercial companies (ICCs) for 1985 is estimated to have been the highest since 1960. For non-North Sea ICCs, profitability in 1985 was higher than any time since 1973.

3.50 The recent sharp fall in oil prices will mean a substantial reduction in North Sea profits in 1986, and the overall return earned by ICCs may fall. However, non-North Sea ICCs will be prime beneficiaries of the fall in oil prices, as they have been of the weakness of other commodity prices during 1985; their profitability is expected to increase further in 1986 (see Chart 3.10).

Chart 3.10



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Fixed investment

3.51 Total business investment, including North Sea investment and investment by public corporations, grew by about 4 per cent in 1985. Within this total manufacturing investment increased by 5 per cent, after taking into account the increase in assets leased by manufacturing companies. This was a somewhat smaller increase than Intentions surveys had earlier suggested was likely. The path of investment during 1985 was greatly influenced by the reduction in capital allowances which became effective at the end of the first quarter of the year. Leasing business was particularly buoyant in the first quarter and fell back heavily thereafter.

3.52 1986 is likely to see a similar quarterly pattern. The level of business investment in 1986 as a whole will be affected by the transition to the reformed system of company taxation announced in the 1984 Budget: this gave firms an incentive to bring investment forward that would otherwise have taken place during 1986. The fundamental prospects for business investment remain very favourable. Profitability has been rising strongly: one indication of the past and prospective recovery in profits is the buoyancy of the stock market. In addition, there is evidence from CBI surveys that an expansion of capacity will be needed in a number of industries. The DTI survey published last December indicated an increase in manufacturing and service industries investment of about 1 per cent, within which total manufacturing investment is expected to fall by about 2 per cent. By contrast the CBI interpret their most recent survey as implying a 5 per cent rise in manufacturing investment in the first three quarters of 1986 compared with the corresponding period of 1985.

3.53 With the additional boost to profits of most companies from lower oil prices, a rise in business investment in 1986 of 5 per cent, rather more than suggested by the DTI survey, is expected.

3.54 Table 3.8 provides details of the forecast for total investment and its major components. Overall in 1986, fixed investment is expected to show a further year of good growth. North Sea investment is expected to recover this year to a similar level to that in 1984, mainly reflecting increases in expenditures on oil fields already under development and on gas fields due for development.

Table 3.8: Gross Fixed Domestic Capital Formation

(at constant prices)

	1984 £ billion at 1980 prices	Per cent change on previous year		
		1984	1985	1986 Forecasts
Business(1)	29.0	11	4	5
Private dwellings(4)	9.5	4	- 1	4
General government	6.9	4	- 5	0
Total fixed investment	45.4	8	1	4½

(1) Including investment by public corporations

(2) Figures for manufacturing include assets leased from finance lessors, figures for other industries exclude these assets.

(3) Figures are for industry class 13 (1980 SIC)

(4) Includes purchases less sales of land and existing buildings by persons, companies and public corporations, other than purchases of council houses.

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Stockbuilding **3.55** Survey evidence suggests that despite the low expenditure on stock building in 1985, most companies still regard their current stock levels as more than adequate in relation to output and sales. The fall in stock ratios in recent years may reflect in part cautious behaviour by companies after the last recession. Another factor has been the high cost of holding stocks as

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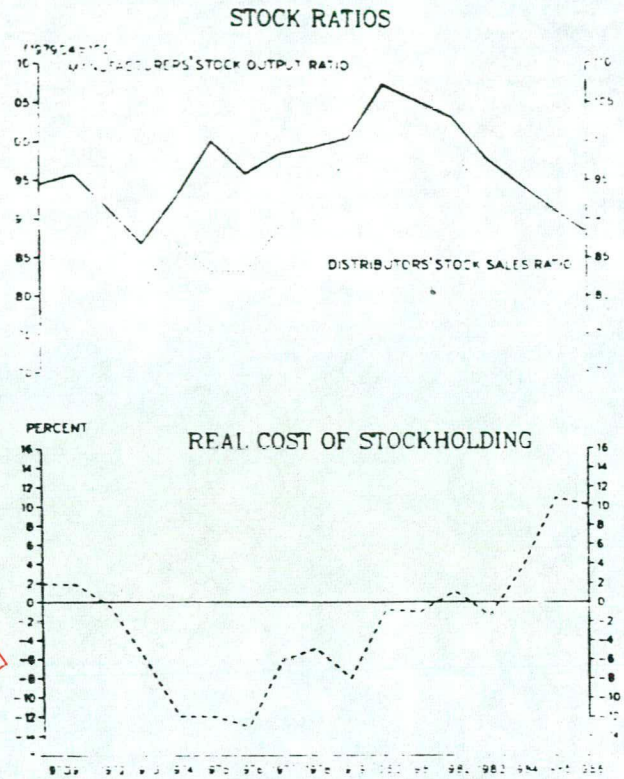
a result of the high level of real interest rates and the abolition of stock relief in the 1984 Budget. Stock ratios and the estimated real cost of holding stocks are illustrated in Chart 3.11.

Chart 3.11



Prospects for demand and activity

3.56 Strong growth in exports has made an important contribution to GDP growth over the last two years. In 1985 the increase in manufactured exports was twice the estimated increase in world trade in manufactures, while UK imports of manufactures grew less in relation to the growth in demand than has normally been the case in recent years.

3.57 The fall in oil prices has improved the prospects for world trade, and the adjustment of the exchange rate to lower oil prices has made British manufactures more competitive. As in most other industrial countries, higher domestic demand (stimulated by lower inflation) is expected to make an important contribution to growth in 1986, but exports should also show substantial growth. The slowdown forecast for export growth in the first half of 1987 reflects the path of North Sea oil output and hence oil exports.

Table 3.9: Domestic Demand and Trade at constant prices

per cent changes on a year earlier

	1985	1986	1987 First half
Domestic demand	2	3½	2½
Exports of goods and services	6½	5	3
Imports of goods and services	3½	6	4½

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3.58 Total domestic production is expected to increase by 3 per cent in 1986, following 3½ per cent growth in 1985. After allowance for the coal strike, growth is close to 2½ per cent in both years as shown in Table 3.10. The average level of oil production in 1986 is likely to be close to its level in 1985 and 1984, but the fall forecast for oil output between the first half of 1986 and the first half of 1987 may cut total GDP growth by over ½ per cent. Output growth in the non-oil economy in 1986 and the first half of 1987 is expected to be comparable to that seen in 1985. Manufacturing output has grown slightly faster than GDP since 1983. The composition of demand growth in the forecast suggests that growth in manufacturing output may continue at around the underlying rate of growth of GDP.

Table 3.10: GDP and Manufacturing Output

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

Productivity and the labour market

3.59 Total employment in Great Britain is estimated to have grown by about 220 000 over the year ending September 1985, giving a total increase since March 1983 of over 700 000.

3.60 The published figures show an increase of 12 000 in the number of employees in employment during the first nine months of 1985: a further rise in the number of employees in the service industries was largely offset by falls in the production and construction industries. Self employment is assumed to have risen by about 31 000 a quarter since the middle of 1984, the same as the estimated quarterly increase over the previous three years. This compares with an increase of about 68 000 a quarter recorded between the middle of 1983 and the middle of 1984. The estimates of growth in employment over the recent past shown in Table 3.11 are subject to revision when the Census of Employment for 1984 and the Labour Force Survey for 1985 become available.

Table 3.11: Employment (GB, seasonally adjusted)

	Employees in Employment			Self employed	HM Forces	Employed labour force
	Male	Female full-time	Female part-time			
September 1983 to September 1984	- 84	+ 19	+ 174	+ 237	+ 3	+ 349
September 1984 to September 1985	- 105	+ 20	+ 181	+ 125	- 2	+ 219

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3.61 Following upward revisions to the estimates of manufacturing output, output per head in manufacturing now appears to have risen by about 3¾ per cent in 1985, in line with the annual average of 3½ per cent for the period 1979–85. This marks a major improvement on the productivity performance recorded between 1973 and 1979: the trend growth in productivity in manufacturing now appears to be close to the rate achieved during the sixties (see Table 3.12). Non-manufacturing productivity has also been rising faster of late than in the 1973 to 1979 period. Growth in output per man hour has been rising at about 2 per cent per annum since 1979. However, the rise in part-time employment, is currently bringing down growth in output per head in non-manufacturing, to about 1 per cent a year.

Chart 3.12 OUTPUT EMPLOYMENT AND OUTPUT PER HEAD

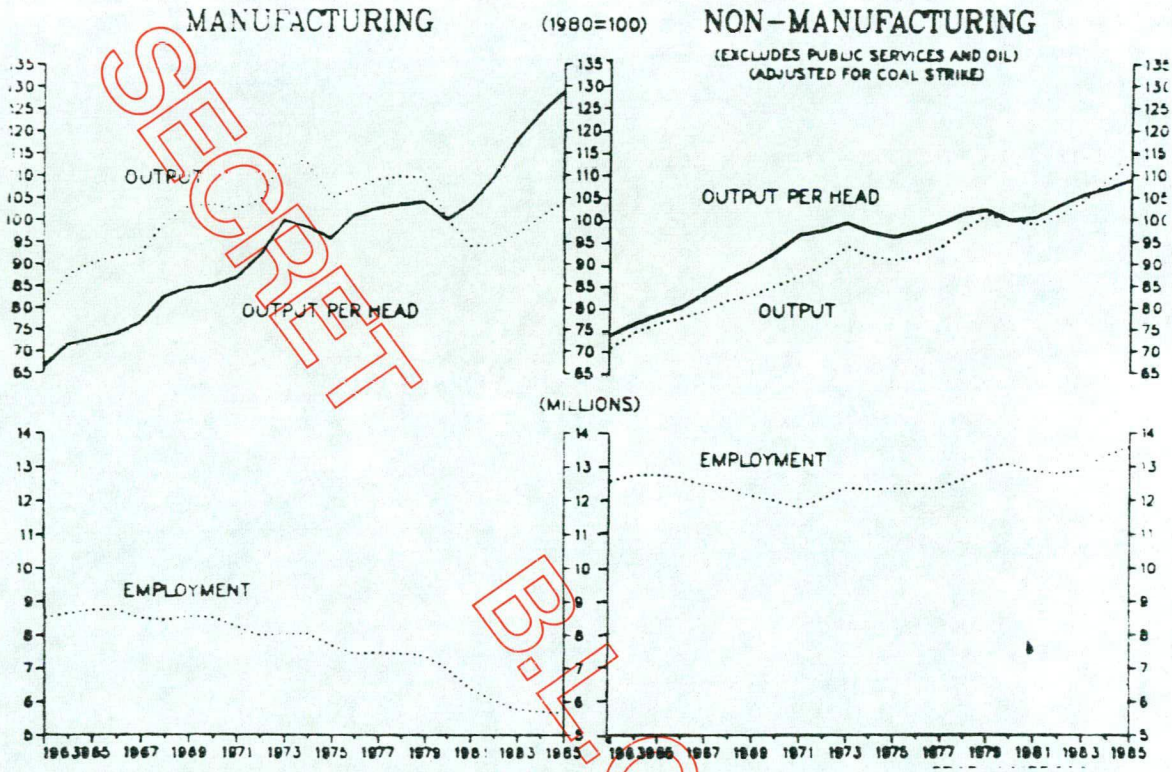

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Table 3.12: Output per head of the employed labour force

	Employed Labour Force in 1984 (millions)	Percentage change in output per head (annual averages)		
		1964–73	1973–79	1979–85
Manufacturing	5½	3¾	¾	3½
Non-manufacturing*	13½	3	½	1

* Excludes public services and oil, and includes nationalised industries except steel.

Unemployment **3.62** The rise in unemployment has slowed down over the last year: the average increase in adult unemployment was 5½ thousand a month over the twelve months to February. With output and employment continuing to grow quite strongly, and growth in the labour force starting to slow down, the prospects for unemployment are better than they have been for some years.

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Forecast and outturn

3.63 The table below compares the main elements of the forecast published in the 1985 FSBR with outturn or latest estimate:

Table 3.13: Forecast and Outturn

	Forecast	Outturn	Average error from past forecasts
RPI: per cent increase between the fourth quarters of 1984 and 1985	5	5½.	2

	Forecast	Latest estimate/ forecast	Average errors from past forecasts
Total output: per cent change between 1984 and 1985	3½	3½	1
Current account of the balance of payments in 1985, £ billion	3	3	2½
PSBR, financial year 1985-1986 £ billion	7	6¼	4½
Money GDP, per cent change between 1984-85 and 1985-86.	8½	9	2

3.64 Inflation in the fourth quarter of 1985 turned out a little higher than forecast a year ago. The forecasts made at the time of the last Budget for output growth and the current balance in 1985, and for the PSBR in 1985–86, are all very close to the latest estimates for these variables. In each case such error as there appears to have been is considerably smaller than the average error from past forecasts.

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Table 3.14: The Prospects: Summary

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	Forecast	Average errors from past forecasts*
A. Output and expenditure at constant 1980 prices; per cent changes between 1985 and 1986.		
Domestic demand	3½	[ ]
of which:		
Consumers' expenditure	3½	[1]
General Government consumption	1	[1½]
Fixed investment	4½	[2]
Change in stockbuilding (as per cent of level of GDP)	0	[¾]
Exports of goods and services	5	[2½]
Imports of goods and services	6	[2½]
Gross domestic product: total	3	[1]
manufacturing	2½	[3¼]
B. Inflation		
Retail prices index, per cent change on a year earlier		
1985Q4 to 1986Q4	4	[2]
1986Q2 to 1987Q2	3¾	[3½]
Deflator for GDP at market prices, per cent change on previous year		
Financial year 1985-86	5½	[ ]
Financial year 1986-87	3½	[ ]
C. Balance of payments on current account £billion:		
1986	4	[2½]
1987 first half (at an annual rate)	2	[4]

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D. Money GDP at market prices, per cent change

Financial year 1985-86	9	[ ]
Financial year 1986-87	6½	[ ]

E. PSBR

£billion (in brackets, per cent of GDP at market prices):

Financial year 1985-86	~~6½~~ 6¾ (1¾)	[1 (¼)]
Financial year 1986-87	7 (1¾)	[4½ (1½)]

---

* The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications and government forecasts (see Economic Progress Report June 1981). The calculations for the constant price variables [and the GDP deflator] are derived from forecasts made during the period between June 1965 and October 1983. For the current balance and the retail prices index, forecasts made between June 1970 and October 1983 are used. For the PSBR, Budget forecasts since 1967 are used. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.

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Risks and uncertainties

3.65 No forecast is complete without an indication of error margins. Table 3.14 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide an indication of possible errors in the current forecast. Those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR approach £200 billion; and for the current account of the balance of payments exceed £150 billion.

3.66 While the size of errors will change over time as the economy fluctuates, and as forecasting techniques change, in many cases the averages have not shifted very much since 1976. For the RPI, however, average errors are derived from a period of high and fluctuating inflation, averaging 12 per cent, and overstate likely errors at current rates of inflation. The average error in the last three Budget forecasts looking ahead to the end of the year was ½ per cent.

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Table 3.15 Constant price forecasts of expenditure, imports and gross domestic product*

£ billion at 1980 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	Total final expenditure	Less imports of goods and services	Less adjustment to factor cost	Plus statistical adjustment	Gross domestic product at factor cost	GDP index 1980=100
1981	136.5	48.9	37.7	62.0	-2.5	282.7	55.9	30.2	-0.3	196.3	98.5
1982	137.6	49.4	40.1	62.8	-1.1	288.7	58.7	30.6	0.7	200.1	100.4
1983	142.9	50.2	41.9	64.4	0.7	300.1	62.1	31.6	0.2	206.7	103.7
1984	145.5	50.9	45.4	69.0	-0.1	310.6	67.9	32.9	1.9	211.7	106.2
1985	149.3	51.0	46.0	73.4	0.5	320.2	70.3	33.0	1.9	218.8	109.8
1986	154.7	51.4	48.0	77.0	0.8	331.8	74.5	34.3	2.0	225.0	112.9
1984 H1	72.5	25.2	22.5	33.8	-0.4	153.7	33.0	16.3	0.5	105.0	105.3
H2	72.9	25.7	22.8	35.2	0.2	156.8	34.9	16.5	1.3	106.7	107.1
1985 H1	73.9	25.6	23.2	37.0	0.1	159.8	35.4	16.2	0.8	109.0	109.4
H2	75.4	25.4	22.8	36.4	0.4	160.4	34.9	16.8	1.2	109.9	110.3
1986 H1	76.6	25.6	24.2	38.2	0.2	164.8	36.9	17.0	0.9	111.9	112.3
H2	78.0	25.7	23.8	38.8	0.6	166.9	37.7	17.2	1.1	113.1	113.5
1987 H1	79.4	25.7	24.5	39.4	0.5	169.5	38.6	17.5	1.0	114.4	114.8
% change											
1983 to 1984	2	1½	8	7	-	3½	9½	4	-	-	2½
1984 to 1985	2½	½	1½	6½	-	3	3½	½	-	-	3½
1985 to 1986	3½	½	4½	5	-	3½	6	3½	-	-	3
1986H1-1987H1	3½	0	1	3	-	3	4½	3	-	-	2

* GDP figures in the table are based on "compromise" estimates of gross domestic product, reflecting for the past average movements in constant price expenditure, output and income estimates of GDP. Percentage changes are calculated from unrounded levels and then rounded to half per cent. Totals in £ billion may not add due to rounding. Figures for 1986H1 and beyond are forecasts. Figures for periods up to the end of 1985 are based mainly on the national accounts published earlier this year (covering periods up to 1985 Q3) and incorporate some revised and later data and forecasts. A full set of national accounts, to end 1985, will be published by CSO on 21 March.

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needs checking against Speech.

4. The Budget Tax Proposals

4.01 The main tax changes proposed in the Budget are summarised below. A full list of changes is given in the Annex to this Chapter.

Income Tax

4.02 The basic rate of income tax will be reduced to 29 per cent.

4.03 Income tax personal allowances will be increased by statutory indexation (based on the 5.7 per cent increase in the RPI in the year to December 1985). This will mean that

the single persons and wife's earned income allowances will rise from £2205 to £2335

the married allowance will rise from £3455 to £3655

the additional personal allowance and widow's bereavement allowance will rise from £1250 to £1320

4.04 Thresholds for the higher rates of income tax will be as follows:

Tax Rate	£
29%	0-17,200
40%	17,201-20,200
45%	20,201-25,400
50%	25,401-33,300
55%	33,301-41,200
60%	over 41,200

Social Security uprating

4.05 The uprating date for Social Security benefits is being changed from November to April. As part of the transitional arrangements there will be an uprating in July 1986 which will apply for a part year only. ~~The amounts of tax payable on the increased benefits, mainly by retired pensioners, would be small and in these special circumstances~~, the Government has decided to exempt from income tax the amount of the increase payable in 1986-87 to retirement pensioners and widows.

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E ...se duties

4.06 The duties on cigarettes and hand rolling tobacco will rise by about 13½ per cent, equivalent to just over 11p on a packet of 20 cigarettes. Those on pipe tobacco and cigars will remain unchanged.

4.07 Duties on alcoholic drinks will remain unchanged.

4.08 Duties on road fuels will go up by a little more than 8 per cent or approximately 7.5p on a gallon of petrol and 6.5p on a gallon of derv.

Vehicle Excise Duty

4.09 The duty on most cars, light vans, lorries and motor cycles will remain unchanged. The duty rates on buses, coaches, taxies will rise by 5%.

Encouragement of Enterprise

Business Expansion Scheme

4.10 The Business Expansion Scheme has made a valuable contribution to the growth of risk investment and employment. It is therefore proposed to continue it after 1 April 1987 and to exempt new BES shares from CGT on first sale. Proposals to modify the scheme are being made to ensure that it provides effective encouragement to high risk investment. Some asset based activities are to be excluded.

Capital Transfer Tax

4.11 In order to remove obstacles to outright giving, the lifetime CTT charge is to be abolished for gifts between individuals made on or after Budget Day. A charge will however be maintained on transfers involving trusts. Provision will be made to charge gifts in relation to which the donor may continue to enjoy a benefit. To reflect its new structure, the tax will be known as the Inheritance Tax.

4.12 Under the new arrangements, the yield from Inheritance Tax on deaths is to be protected by charging gifts within 7 years of death at tapered rates. The exempt amount and rate bands of the tax will be increased by 5.7% under the statutory indexation provisions.

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Encouragement of Wider Share Ownership

4.13 The Government propose to introduce a new initiative, as from 1 January 1987, specifically designed for individuals who invest directly in equities. Shares held in specially designated accounts will be free of any tax on both capital gains and reinvested dividend income. Investment of up to £2,400 will be permitted each year and the shares will have to be held for a minimum period of not more than two years.

Stamp Duty

4.14 It is proposed that the rate of Stamp Duty should be reduced from 1 per cent to ½ per cent on share transactions. The scope of the duty will be widened to cover the following transactions (currently exempt):

- Intra-account dealing
- Takeovers including mergers
- Loan Stock
- Renounceable letters
- Company purchase of own shares

A 5 per cent duty is being imposed where shares are converted into Depository Receipts.

Employee Share Schemes

4.15 To build on the progress already made in recent years, the following measures are proposed to encourage the spread of approved employee share schemes:

- the extension of the present tax relief to shares subject to a restriction requiring disposal when employment ends;
- easier access for employee controlled companies and worker co-operatives;
- easier conditions on exercise of savings-related share options.

Pension Fund Surpluses

4.16 It is proposed to clarify and revise the present rules relating to pension fund surpluses as follows:

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- pension funds' assets and liabilities will be valued, for the purposes of the new regime only, on standard assumptions provided by the Government Actuary;

- where such valuation shows an actuarial surplus of assets over liabilities of over 5%, the trustees shall reduce it to not more than 5% by (i) an increase in pension benefits (within existing limits), (ii) a contribution reduction or holiday by either employer or employee or (iii) a refund to the employer; (provided the surplus does not fall below 5%) or by any combination of these measures;

- where a refund is made, it will be subject to tax in the employer's hands at a rate of 40%.

Charitable giving

4.17 Four new types of tax relief are proposed:

- Companies - other than close companies - will for the first time be able to claim tax relief for single gifts to charity. The relief will be on single gifts up to a maximum equal to 3 per cent of the ordinary dividends paid by the company in an accounting period.

- The Government will remove the present annual limit of £10,000 on the amount of charitable giving through deeds of covenant for which an individual taxpayer may claim higher rate relief.

- There will be a new scheme from April 1987 to encourage individuals to make donations to charity through deductions from their wages and salaries. Employees whose employers participate in the scheme will be able to get tax relief on donations of up to £100 a year.

- VAT relief will be available on distress alarms and lifts for the handicapped and their charities, non-classified advertising and medicinal products supplied to charities, video

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and refrigeration equipment used in medical applications by certain eligible bodies including charities, welfare vehicles used by such bodies to transport the deaf, blind and mentally handicapped, and recording equipment used by charities for the blind.

4.18 Measures are also to be taken to prevent abuse of the tax relief for charities.

Business taxation

4.19 The final stage in the business tax reforms introduced in 1984 will take effect on 1 April 1986 with the reduction in the main corporation tax rate to 35% and (with a few mainly transitional exceptions) the disappearance of first year and initial capital allowances. It is proposed to complete these reforms by updating the mines and oil wells capital allowances code, and adapting the system of allowances for agricultural buildings. In order to provide a full measure of tax depreciation for agricultural buildings and works with a short life, balancing adjustments will be available on their disposal or destruction if the taxpayer chooses.

Oil taxation

4.20 No other changes are being proposed to oil taxation apart from technical changes to remove some anomalies.

Capital gains tax

4.21 To maintain its value, the CGT annual exempt amount is to be increased in accordance with the statutory indexation provisions by 5.7% from £5,900 to £6,300 in the case of individuals, and from £2,950 to £3,150 in the case of most trusts.

Car and car fuel benefits

4.22 The scales which determine the taxable cash equivalents of car and car fuel benefits in respect of company cars provided for directors and employees earning £8,500 a year or more are to be changed from 6 April 1987. The present 1300cc and 1800cc engine-size break points are to be aligned, on a revenue- neutral basis, with those 1400cc and 2000cc for the European Community Directive on car exhaust emissions. The resulting scale charges for car benefits will be increased by 10 per cent for 1987-88. From April 1987 the car fuel benefit scale is to be used both for income tax purposes and to assess the VAT chargeable on fuel used for private journeys in business cars.

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Value Added Tax

4.23 From 19 March 1986 the registration limits will become £20,500 per annum and £7,000 per quarter.

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5 Public Expenditure

Public spending trends

5.01 The public expenditure planning total is the measure on which the Government's spending controls are based. Table 5.1 and Chart 5.1 show the path of the planning total in cash and in real terms ie after adjusting for the rate of inflation as measured by the GDP deflator. (The updated GDP deflator assumptions and money GDP figures are given in Part 2.)

Table 5.1 The public expenditure planning total and general government expenditure

£ billion

	1984-85	1985-86	1986-87	1987-88	1988-87
Department					
DHSS - Social security	38.1	41.3	42.9	44.4	45.9
Defence	17.2	18.1	18.5	18.8	19.0
DHSS - Health and personal social services	15.8	16.7	17.7	18.5	19.1
Scotland, Wales and Northern Ireland	13.7	14.5	15.0	15.0	15.2
Education and science	14.0	14.1	14.3	14.4	14.5
Other	33.0	31.6	31.2	31.3	31.7
Privatisation proceeds	-2.1	-2.6	-4.8	-4.8	-4.8
Reserve			4.5	6.3	8.0
Adjustments			-0.4 [1]		
Public expenditure planning total	129.6	133.6 [2]	139.1	143.9	148.7
General government gross debt interest	16.1	17.7	18.2	18½	19
Other adjustments	4.3	6.2	6.2	6.4	6.6
General government expenditure	150.0	157.5	163.5	168.9	174.3
Planning total in real terms (base year 1984-85)	129.6	127.8	126.7	126.7	127.1
General government expenditure as percentage of GDP	46	44	43	42	40½

[1] Includes external finance of -£400m for nationalised industries to be privatised in 1986-87

[2] The Treasury's latest estimate of outturn

5.02 The latest estimates suggest that the planning total outturn in 1985-86 is likely to be £0.5 billion below the figure set at the time of the 1985 Budget. Of this £0.4 billion is accounted for by teachers' back pay which, as a result of the delay in ratifying the pay settlement, will slip from 1985-86 to 1986-87. After allowing for this and the effects of the miners' strike spending in real terms in 1985-86 should

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be below the level of 1984–85, the first time since 1977–78 there has been no increase in real terms. For the three following years the expenditure plans in cash terms are as set out in Cmnd. 9702. In real terms the planning total is expected to fall slightly in 1986–87, and then to remain broadly constant over the period to 1988–89.

5.03 Table 5.1 and Chart 5.1 also show that general government expenditure as a percentage of GDP is projected to continue the downward trend established since 1982–83, with a substantial further fall over the next three years. By 1988–89 the percentage is expected to be the lowest since 1972–73. ~~[These trends remain valid however one treats privatisation proceeds.] This will free an increasing share of the nation's resources to the private sector, and provide the basis for further reductions in the tax burden~~.

Chart 5.1 Trends in Public expenditure 1978–79 to 1988–89

This would be no cash even with all proceeds from privatisation.

~~Enterprise and~~ employment measures

5.05 Included in the announcements in the Budget speech was provision for further enterprise and employment measures. The gross cost of these measures will be £195 million in 1986–87 and £290 million in 1987–88. The net public expenditure cost after allowing for reduced

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expenditure on unemployment and supplementary benefit will be £100 million in 1986–87 and £165 million in 1987–88 as shown in Table 1.1. The net cost to public expenditure of these measures will be charged against the Reserves provided in Cmnd. 9702, and thereby met within unchanged planning totals. Summer Supplementary Estimates will be presented to Parliament in due course for the extra resources required by the Department of Employment and the Manpower Services Commission in 1986–87.

5.06 Two pilot schemes to help the long term unemployed were introduced in January 1986. The aim of the counselling scheme has been to help the long term unemployed through an in-depth interview. Interviewees may for instance be submitted for jobs, offered places on employment or training schemes or in a Jobclub, offered a specially designed Restart training course, as appropriate. The Job Start scheme provides an allowance of £20 per week to long term unemployed people who take a full-time job earning less than £80 per week. The schemes will be extended nationwide as soon as possible. [An intensive programme of counselling, offering interviews to a significant proportion of the long term unemployed, will be carried out in 1986–87.] The costs of this extension will be £95 million in 1986–87 [and £70 million in 1987–88].

5.07 The number of places on the Community Programme, which is also targeted at long term unemployed adults, is being increased to 250 000 from the existing level of nearly 200 000 places. The cost of this will be £60 million in 1986–87 and £120 million in 1987–88. The programme offers jobs to the long term unemployed for up to a year on projects of benefit to the community. When the expansion is complete, the scheme will be helping over 330 000 of the long term unemployed every year.

5.08 The Enterprise Allowance Scheme is to be expanded to allow for 100 000 entrants a year [by April 1987], as against 65 000 previously provided for. This scheme is intended to encourage enterprise and self-employment amongst those previously unemployed. Another scheme to help small business and enterprise is The Loan Guarantee Scheme, under which the Government guarantees 70 per cent of qualifying loans to small businesses, is to be extended for a further three years. The rules of the scheme will be revised, with the premium reduced from 5 per cent to 3 per cent, and a ceiling on the portfolio of loans covered of £90 million in 1986–87 and £130 million in the two subsequent years. These two measures together will cost about £10 million in 1986–87 and £45 million in 1987–88.

5.09 A new scheme has been announced to help 18–20 year olds to find jobs. This scheme, the New Workers Scheme, will provide for an allowance of £15 per week for employers taking on 18 to 19 year olds on earnings of £55 per week or less and 20 year olds on earnings of £65 per week or less. The cost of this scheme, [minor changes to Department of Employment programmes [including any offsetting savings]] is expected to be £25 million in 1986–87 and £50 million in 1987–88.

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Supply Estimates ~~5.10~~ For 1986–87, plans have now been translated into detailed control totals. The Supply Estimates set out the sums that the Government asks Parliament to vote for most expenditure by Government departments and certain other bodies. The main Estimates for 1986–87, are published on 18 March 1986 with a Summary and Guide (Cmnd. 9742) which summarises the Estimates and explains how they relate to the public expenditure planning total. Of the £99 billion included in the Supply Estimates, £74·6 billion is direct public expenditure in line with the plans published in Cmnd. 9702 for public expenditure to be voted in Estimates. Nearly [60] per cent of the money voted in Estimates is subject to cash limits which provide the Government with greater control over its cash expenditure during the financial year.

Table 5.2 Supply expenditure

£ billion	1984–85 Expected outturn in 1985 Budget	1984–85 Final outturn	1985–86 Expected outturn	1986–87 Provision
Main Supply Estimates	90.4[1]	90.4[1]	96.0	99.1
Supplementaries and net under-spending	3.4	3.2	2.0	-
Total Supply Expenditure	93.8	93.6	98.1	
(public expenditure element)	(70.6)	(70.6)	(74.9)	

[1] Adjusted for abolition of NIS

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6. Public Sector Transactions

6.01 The tables in Chapter 6 provide further information on transactions of the public sector in 1985-86 and 1986-87. They elaborate the more rounded and summary figures shown in Chapters 2, 3 and 5. The forecasts for 1986-87 incorporate the effects of the Budget measures. The basis of the tables and the relationship between them is outlined in Annex 6.A.

The Public Sector Borrowing Requirement

6.02 Table 6.1 shows the PSBR in 1985-86 and 1986-87. ~~The sectoral composition of the PSBR is shown for 1985-86 but not for 1986-87. The expenditure Reserve in 1986-87 has not been allocated among sectors and so the expenditure side of the forecast of the sectoral borrowing requirements is incomplete.~~

Table 6.1 Public Sector Borrowing Requirement

£ billion

	1985-86 Latest estimate	1986-87 Forecast
Central government on own account(*)	4.9	
Local authorities	1.9	
Public corporations	-0.2	
Public sector borrowing requirement	6.7	7.0

(*) Central government borrowing less on-lending to local authorities and public corporations.

1985-86 estimates

6.03 The forecast a year ago for the PSBR in 1985-86 was £7.1 billion. The latest estimate of the outturn is [£] billion or [ ]% of GDP, but the scale of borrowing in March is always high and difficult to predict(1), with high expenditure and in some cases low income (eg the local authorities, which have low rate income in that month).

(1) The average errors on PSBR forecasts made at this time are ±£1 billion for the current year and ±£5 billion for the year ahead. See Table [3.8]. (Over the last 6 years the error for the year ahead has been closer to 1% of GDP, equivalent to ±£4 billion in 1986-87.)

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6.04 Although there is thus little net change in the estimated PSBR, there are some sizeable changes in its components:

(i) A reduction of about [£2 bn] in oil revenues (as forecast in the Autumn Statement), to [£11½ bn], mainly because the $/£ exchange rate has turned out higher than assumed in the 1985 Budget. (The sharp drop in the $ oil price since December has had little effect on revenues in 1985-86, because of the lags in payments.)

(ii) An increase in other revenues of around [£1 bn]. VAT receipts are expected to be some £[1] bn higher, mainly reflecting some increase in the proportion of consumers' spending on goods subject to VAT; capital tax receipts some £[½] bn higher, because of a greater number of estates subject to capital transfer tax, and higher capital gains tax receipts; and ~~[national insurance contributions] and [gross trading surpluses] a little lower.~~

(iii) A ~~reduction~~ of around [£½ bn] in the planning total outturn, ~~[mainly] because of the delay in ratification of the teachers' pay settlement for 1985, which reduces local authorities' cash spending in 1985-86 by around [£400 million].~~

1986-87 projections

6.05 The PSBR in 1986-87 is forecast to be [£7 billion[1]], or ~~[2%]~~ of GDP, ~~[about the same as] the expected outturn in 1985-86, [but rather lower than]~~ the projection for 1986-87 in the 1985 MTFS. Again there are sizeable changes in the components, both since the 1985 MTFS projections [(see Annex to Chapter 2)] and between 1985-86 and 1986-87:

(i) Oil revenues are now forecast at around £[6] bn in 1986-87, compared with £11½ bn estimated in 1985-86. The reason is mainly the drop in the $ oil price, ~~but partly the higher $/£ exchange rate.~~ (The forecast assumes that the price of North Sea crude is $[15] per barrel for the rest of 1986[2], and that the $/£ exchange rate does not change much.)

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(1) See footnote (1) on page [ ]

(2) If prices were $1 per barrel lower on average in 1986, but other things - including the exchange rate - were unchanged, North Sea revenues would be around £½ billion lower in 1986-87.

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(ii) Non-oil revenues are forecast to rise by [9½]% between 1985-86 and 1986-87, [about the same as the] rise in non-oil incomes. Within the overall increase there are:

- a rise of [14]% in corporation tax receipts (excluding North Sea tax receipts), reflecting the estimated rise of around 18% in non-North-Sea company incomes between 1984 and 1985;

- a rise of [9%] in income tax receipts: the expected real growth in earnings, and the uprating of tax allowances in line with prices only (not earnings), are only partly offset by the Budget measures;

- a rise of [9½]% in expenditure tax receipts, partly because of continuing growth in consumers' expenditure.

(iii) Expenditure, on the other hand, is little changed from the 1985 FSBR projections. In particular, the planning total remains the same, and represents only a [4]% increase in cash terms on the estimated outturn for 1985-86.

Sectoral split of PSBR

6.06 Tables 6.2 to 6.4 show the forecasts of the receipts and expenditure of central government, local authorities and public corporations respectively, which produce the PSBR projections in Table 6.1. The forecasts for 1986-87 are incomplete because the expenditure Reserve has not been allocated (see paragraph 6.02 above).

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Table 6.2 Central Government transactions

£ billion

	1985-86 Latest estimate	1986-87 Forecast
Receipts		
Taxes and royalties	99.5	102.1
National Insurance and other contributions	24.3	26.2
Other	9.7	10.0
Total	**133.5**	**138.3**
Expenditure		
Current expenditure on goods and services	46.4	49.1
Current grants and subsidies	71.5	74.4
Interest	16.1	17.0
Net lending and capital expenditure, excluding on-lending to local authorities and public corporations	4.4	2.3
Total	**138.5**	**142.8**(1)
Central Government Borrowing		
Requirement on own account	4.9	
On-lending to local authorities and public corporations	5.4	
Central government borrowing requirement	**10.4**	

(1) Excluding any allocation from the expenditure Reserve

6.07 Central government spending includes grants and subsidies to local authorities and public corporations (including nationalised industries), which are included in the receipts of those sectors, shown in Tables 6.3 and 6.4. Table 6.2 also shows central government onlending to local authorities and public corporations, giving the whole CGBR, but the forecasts of onlending are particularly uncertain (since the local authorities and public corporations may instead choose to borrow more from, or repay less to, the market and overseas).

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Table 6.3 Local authorities' transactions

£ billion

	1985-86 Latest estimate	1986-87 Forecast
Receipts		
Rates (net of rate rebates)[1]	13.7	15.6
Rate support grant	11.2	11.8
Other grants from central government	9.6	10.6
Other	4.9	5.1
Total	**39.5**	**43.1**
Expenditure		
Current expenditure on goods and services	28.0	28.5
Current grants and subsidies	5.2	5.1
Interest	4.2	4.5
Net lending and capital expenditure	3.9	3.8
Total	**41.4**	**41.9**[2]
Local Authority Borrowing Requirement	**1.9**	
of which:		
Borrowing from central government	4.4	
Other borrowing	-2.5	
[1] Memo: Rate rebates	1.7	1.9

[2] Excluding any allocation from the expenditure Reserve

6.08 Local authority receipts consist primarily of rate income plus grant from central government. The increase forecast in net rate income between 1985-86 and 1986-87 is based on recent information about rate decisions by individual local authorities. The main change in local authority expenditure since the Public Expenditure White Paper is the delay in ratification of the teachers' pay settlement, referred to above.

6.09 The latest estimate of local authority borrowing in 1985-86 is based on the Borrowing Intentions Survey of a sample of authorities. However, borrowing in the last month of the financial year is always very high and the margin of error is correspondingly great. The source of their borrowing is still more uncertain: in 1985-86 they are

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expected to have borrowed [much more] from central government than forecast in the 1985 Budget, and to have repaid correspondingly more to the market, but in 1984-85 it was the other way round.

Public corporations

Table 6.4 Public Corporations' transactions

£ billion

	1985-86 Latest estimate	1986-87 Forecast
Receipts		
Gross trading surplus (including subsidies)	7.4	7.7
Other	3.2	2.8
Total	**10.6**	**10.4**[1]
Expenditure		
Interest, dividends and taxes on income	4.1	3.6
Net lending and capital expenditure	6.3	6.0
Total	**10.4**	**9.6**[1]
Public Corporations' Borrowing Requirement	**-0.2**	
of which:		
Borrowing from central government	1.1	
Other borrowing	-1.2	

[1] Excluding any allocation from the expenditure Reserve

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6.10 The public corporations' receipts include subsidies from central government. For the nationalised industries (and the majority of other public corporations), their net external finance, ie their borrowing plus those subsidies, is included in the planning total. The effects of the coal strike have continued in 1985-86, adding about £1 bn to the industries' financing needs, eg for coal stock rebuilding by the Electricity Supply Industry.

Table 6.5 Public sector transactions by sub-sector and economic category

£ billion[1]

	Line[2]	1985-86 Latest estimate				
		General government			Public corporations	Public sector
		Central government	Local authorities	Total		
Current and capital receipts						
Taxes on income	1	52.1	-	52.1	-0.3	51.9
Taxes on expenditure	2	42.9	13.7	56.6	-	56.6
Taxes on capital	3	2.4	-	2.4	-	2.4
North Sea oil royalties	4	2.0	-	2.0	-	2.0
National Insurance and other contributions	5	24.3	-	24.3	-	24.3
Gross trading surplus	6	-0.3	0.3	-0.1	7.4	7.4
Rent and miscellaneous current transfers	7	0.3	2.8	3.1	0.5	3.6
Interest and dividends from private sector and abroad	8	2.9	0.6	3.5	1.1	4.7
Interest and dividends within public sector	9	5.5	-2.6	2.9	-2.9	-
Imputed charge for non-trading capital consumption	10	0.9	1.4	2.3	-	2.3
Capital transfers from private sector	11	-	-	-	0.2	0.2
Total	12	**133.0**	**16.2**	**149.3**	**6.1**	**155.4**
Current and capital expenditure						
Current expenditure on goods and services	13	-46.4	-28.0	-74.4	-	-74.4
Subsidies	14	-5.6	-1.2	-6.8	-	-6.8
Current grants to personal sector	15	-43.1	-4.1	-47.2	-	-47.2
Current grants paid abroad	16	-2.6	-	-2.6	-	-2.6
Current grants within public sector	17	-20.2	20.2	-	-	-
Debt interest	18	-16.1	-1.5	-17.7	-0.6	-18.2
Gross domestic fixed capital formation	19	-3.1	-3.4	-6.5	-6.0	-12.5
Increase in stocks	20	-0.5	-	-0.5	-0.1	-0.6
Capital grants to private sector	21	-2.1	-0.7	-2.9	-0.1	-3.0
Capital grants within public sector	22	-1.2	0.7	-0.6	0.6	-
Total	23	**-141.0**	**-18.0**	**-159.1**	**-6.2**	**-165.2**
Unallocated Reserve	24	-	-	-	-	-
Financial surplus/deficit	25	**-8.0**	**-1.8**	**-9.8**	-	~~-9.8~~ -9.9
Financial transactions						
Net lending to private sector and abroad	26	-0.1	0.2	0.1	-0.2	-
Cash expenditure on company securities (net) (including privatisation proceeds)	27	2.7	-	2.7	-	2.7
Transactions concerning certain public sector pension schemes	28	0.4	-	0.4	-	0.4
Accruals adjustments	29	-0.4	0.1	-0.4	0.4	0.1
Miscellaneous financial transactions	30	0.5	-0.4	0.1	-0.1	-
Borrowing requirement	31	**4.9**	**1.9**	**6.8**	**-0.2**	~~6.7~~ 6.8

(1) Sign convention : receipts positive, payments negative.
(2) Relationship between lines : (25) = (12) + (23) + (24) = - {(26) to (31)}

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Table 6.5 continued

£ billion[1]

	Line[2]	1986–87 Forecast: General government: Central government	General government: Local authorities	General government: Total	Public corporations	Public sector
Current and capital receipts						
Taxes on income	1	52.0	–	52.0	–0.2	51.8
Taxes on expenditure	2	46.3	15.6	61.9	–	61.9
Taxes on capital	3	2.8	–	2.8	–	2.8
North Sea oil royalties	4	1.0	–	1.0	–	1.0
National Insurance and other contributions	5	26.2	–	26.2	–	26.2
Gross trading surplus	6	–0.6	0.3	–0.3	7.7	7.4
Rent and miscellaneous current transfers	7	0.3	2.9	3.3	0.5	3.8
Interest and dividends from private sector and abroad	8	3.2	0.6	3.8	1.0	4.8
Interest and dividends within public sector	9	5.7	–3.1	2.6	–2.6	–
Imputed charge for non-trading capital consumption	10	1.0	1.4	2.4	–	2.4
Capital transfers from private sector	11	–	–	–	0.2	0.2
Total	12	**137.8**	**17.8**	**155.6**	**6.7**	**162.3**
Current and capital expenditure						
Current expenditure on goods and services	13	–49.1	–28.5	–77.6	–	–77.6
Subsidies	14	–5.9	–0.9	–6.7	–	–6.7
Current grants to personal sector	15	–44.9	–4.2	–49.1	–	–49.1
Current grants paid abroad	16	–2.5	–	–2.5	–	–2.5
Current grants within public sector	17	–21.1	21.1	–	–	–
Debt interest	18	–17.0	–1.2	–18.2	–0.6	–18.7
Gross domestic fixed capital formation	19	–3.3	–3.4	–6.7	–5.6	–12.2
Increase in stocks	20	–0.2	–	–0.2	–	–0.2
Capital grants to private sector	21	–2.1	–0.6	–2.7	–0.1	–2.8
Capital grants within public sector	22	–1.4	0.7	–0.6	0.6	–
Total	23	**–149.3**	**–17.0**	**–164.3**	**–5.6**	**–169.9**
Unallocated Reserve	24					**–4.5**
Financial surplus/deficit	25					**–12.2**
Financial transactions						
Net lending to private sector and abroad	26	–0.2	0.3	–	–0.1	–
Cash expenditure on company securities (net) (including privatisation proceeds)	27	4.8	–	4.8	–	4.8
Transactions concerning certain public sector pension schemes	28	0.6	–	0.6	–	0.6
Accruals adjustments	29	–0.2	–	–0.2	–	–0.1
Miscellaneous financial transactions	30	0.1	–0.4	–0.2	–	–0.2
Borrowing requirement	31					**7.0**

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ANNEX 6.A: Relationship between Tables in Chapter 6, and with Table 1.2; and Outturn Data

Relationship between tables

6A.1 Table 6.5 is based on the definitions used to compile the national accounts. In order to show the financial deficit (which is often used in international comparisons), lending and other financial transactions are separated from the analysis of receipts and expenditure in lines [1-23] and shown in lines [25-29]. These lines show the relationship between the financial deficit and the borrowing requirement.

6A.2 Tables 6.2-6.4 are summary versions of the sectoral columns of Table 6.5. The information in Table 6.5 is rearranged so that, for example, central government grants to local authorities (which appear as negative expenditure in the local authorities column of Table 6.5, lines 17 and 22) appear as receipts in Table 6.3. Also, interest paid by local authorities to central government (which appears as negative receipts in the local authorities column of Table 6.5, line 8) appears as expenditure in Table 6.3. Finally, lending and other financial transactions (lines [25-29] of Table 6.5) are included in the receipts and expenditure of Tables 6.2-6.4.

6A.3 Table 1.2 in Chapter 1 uses the same information as Table 6.5, but again rearranges it. To derive general government expenditure, it starts by giving a functional breakdown of the public expenditure planning total: that includes not only general government expenditure in the third column of Table 6.5 (including some of the "financial transactions" in lines [25-29]), but also borrowing or capital expenditure by public corporations in the fourth column. General government expenditure as shown in Table 1.2 is then obtained by adding general government debt interest from the third column of Table 6.5 and the national accounts adjustments already included in Table 6.5, and deducting public corporations' borrowing from the market and overseas.

6A.4 Alternatively, general government expenditure in Table 1.2 (and Table [2.4]) can be obtained as the sum of lines [23, 25 and 26] (third column) in Table 6.5 and on-lending to public corporations in Table 6.4.

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6A.5 To derive general government receipts, Table 1.2 takes the receipts shown in the third column of Table 6.5 (lines [12, 27, 28 and 29]) and rearranges them according to the type of activity which gives rise to them. For example, oil revenues comprise North Sea corporation tax and petroleum revenue tax (included in "taxes on income" in Table 6.5) plus oil royalties. The sub-total "total taxes and royalties" is the same as the first line of Table [2.5] in Chapter 2.

Outturn data

6A.6 Outturns for the PSBR are compiled monthly and published by press notice 12 working days after the end of the month and then in more detail in tables [2.5 and 3.12 to 3.16] of the following issue of Financial Statistics. Outturn for the details of the PSBR on national accounts definitions, as in Table 6.5, are compiled quarterly and published in sections 2 to 5 of Financial Statistics three months after the end of the quarter.

6A.7 The first outturn for the PSBR in 1985-86 will accordingly be published on April 16. The first national accounts outturns for 1985-86 will appear in the June issue of Financial Statistics, including Supplementary Table 13 which is based on Table 6.5.

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Table 6.B.1 Summary of Central Government Transactions

£ billion

	1985-86 Latest estimate
Consolidated Fund	
Revenue (Table 6.B.3)	106.1
Expenditure (Table 6.B.2)	-110.2
Deficit met from National Loans Fund	4.1
National Loans Fund	
Receipts (Table 6.B.4)	14.3
Payments (Table 6.B.4)	-19.2
Consolidated Fund deficit (as above)	-4.1
Total net borrowing by the National Loans fund	**-9.0**
Other funds and accounts (net)	**-1.0**
Central Government Borrowing Requirement (including borrowing for on-lending to local authorities and public corporations)	**-10.2**

(1) No forecast for 1986-87 is given here (nor in Tables 6.B.2 and 6.B.4) because the expenditure reserve has not been allocated. See paragraph 6.02.

Table 6.B.2 Consolidated Fund Expenditure

£ million

	1985-86 Latest estimate
Supply Issues[1]	98200[2]
Standing Services	
Payment to the National Loans Fund in respect of Service of the National Debt	7600
Northern Ireland-share of taxes etc.	1800
Payments to the European communities	2600[2]
Other	60
Total Standing Services	12100
Total Consolidated Fund expenditure	**110200**

[1] Supply Issues are monies paid from the Consolidated Fund to Departments' cash accounts with the Paymaster General for spending on Supply. Supply Expenditure (see Table 5.) equates closely to total Supply Issues in most years, although there may sometimes be slight timing differences between the two.
[2] £970 million was paid to the European Communities from Supply Issues instead of Standing Services.

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Table 6.B.3 Consolidated Fund Revenue

£ million

	1985-86		1986-87
	Budget forecast	Latest estimate	Forecast
Inland Revenue-			
Income tax	35200	35100	38500
Corporation tax[1][2]	10100	10700	11700
Petroleum revenue tax[3]	8200	6430	7370
Capital gains tax	790	930	1050
Development land tax	55	60	35
Capital transfer tax[4]	760	890	910
Stamp duties	1100	1230	1430
Total Inland Revenue	*56200*	*55300*	*56000*
Customs and Excise-			
Value added tax	18300	19300	20700
Petrol, derv etc. duties	6500	6500	7300
Cigarettes and other tobacco	4300	4300	4700
Spirits, beer, wine, cider and perry	4200	4200	4400
Betting and gaming	700	430	800
Car tax	760	880	980
Other excise duties	20	20	20
EC own resources[5]			
Customs duties, etc.	1400	1200	1300
Agricultural levies	100	160	160
Total Customs and Excise	*36300*	*37300*	*40400*
Vehicle excise duties[6]	2500	2400	2500
National Insurance surcharge	30	30	-
Oil royalties	2500	2000	950
Gas Levy	520	520	500
Broadcasting receiving licences	790	980	1000
Interest and dividends	870	990	840
Other[7]	6700	6400	6500
Total Consolidated Fund revenue	**106500**	**106100**	**109800**
[1] Includes advance corporation tax net of repayments	3600	3800	4100
[2] North Sea corporation tax	2800	3030	2600
of which satisfied by setting off ACT	1200	1180	1100

Liability to corporation tax arising in respect of North Sea production may be satisfied by setting off ACT arising on dividends paid in previous periods in respect of both onshore and offshore activities. Payments and ACT associated with North Sea activities alone cannot be identified.

[3] Includes advance payments of petroleum revenue tax.

[4] Includes estate duty 4 6 5

[5] Customs duties and agricultural levies are accountable to the European Communities as 'own resources' actual payments to the Communities are recorded in Table 6.B.2.

[6] Includes driving licence receipts.

[7] Includes the 10 per cent of 'own resources' refunded by the European Communities to meet the costs of collection, other receipts from the European Communities and central privatisation proceeds.

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Table 6.B.4 National Loans Fund Receipts and Payments

£ million

	1985-86 Latest estimate
Receipts	
Interest on loans, profits of the Issue Department of the Bank of England, etc.	6700
Service of the National Debt-balance met from the Consolidated Fund	7600
Total	**14300**
Payments	
Service of the National Debt	
Interest	14100
Management and expenses	170
Total Service of the National Debt	14300
Loans to:	
Nationalised industries	180
Other public corporations	260
Local authorities	4400
Private sector and within central government	100
Total National Loans Fund lending[1]	5000
Total	**19200**

[1] On-lending to local authorities and public corporations in Tables 6.4 and 6.5 includes, in addition to National Loans Fund lending, net lending from other funds and accounts (mainly Supply Issues in Table 6.B.2).

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