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PART B

02.

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PO/CH/NL/725
Part. B

Chancellor's (Lawson) Papers:
Autumn Statement 1984.

ECONOMIC ASSUMPTIONS

3.19

cc CST
Sir T Burns
Mr Bailey
Mr Kemp
Mr Battishill
Mr H Evans
Mr Scholar
Ms Scammen
Mr J. Shields

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

16 October 1984

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Dear Andrew

The Prime Minister will wish to be aware of the economic assumptions which the Chancellor is proposing for public expenditure in the years 1985-86 to 1987-88. Most will be published in the Autumn Statement, the Government Actuary's November Report and the next Public Expenditure White Paper.

For the Autumn Statement the main assumptions are:-

	Unemployment (GB, narrow, millions)	Inflation (per cent rise in RPI, year to May)	Average Earnings (per cent rise, underlying year on year)
1984-85	3.0	-	7½*
1985-86	3.0	4¾	7*

(*These figures reflect "underlying" increases which take no account of the impact of the miners' dispute. The miners' dispute will probably reduce the 1984-85 figures to about 7 per cent and raise the 1985-86 figure to 7½ per cent.)

The figure for unemployment in the current financial year 1984-85 should not in itself cause much surprise. The total, on the definition used by the Government Actuary (GB, excluding school leavers and temporarily stopped), stood at nearly 3 million on a seasonally-adjusted basis in September. So the assumption implies, broadly, little change over the next few months. But it is of course higher than the figure of 2.85 million for 1984-85 which was published in the February 1984 PEWP and repeated in the July Report of the Government Actuary.

For 1985-86, projections are inevitably more uncertain. But it would seem unwise to base further expenditure projections on an assumption that unemployment will start falling soon. The proposed figure of 3.0 million for 1985-86 is consistent with little net movement through the year.

On inflation, the last published figure of 4½ per cent for the RPI increase up to the end of 1984 now looks a little optimistic. It is however likely to be much nearer to the eventual outcome (probably about 4¾ per cent) than commentators thought at Budget time. The likely overshoot is more than explained by the rise in mortgage interest rates. It is possible that the 12-month figure could rise again early next year to about 5 per cent, reflecting the path of the RPI through last year, but the underlying path should still be downward. The proposed assumption that the 12-month increase will be about 4¾ per cent next May would be consistent with these general trends.

There are some complex presentational issues connected with the assumptions about increases in average earnings. These are not of great importance to the public expenditure projections, but are needed by the Government Actuary to forecast income from National Insurance Contributions.

The earnings figures for 1984-85 will be heavily influenced by the effects of the miners' dispute. Even on the assumption that the strike is settled by the end of the year the simple loss of miners' earnings during the dispute will reduce the average increases for the financial year by about 2/3 per cent. Thus, an "underlying" increase of about 7½ per cent will reduce to just under 7 per cent. In 1985-86, we would get the opposite effect: taking a reduced 1984-85 level as "base" the recorded increase between the years would be raised by about 2/3 per cent. Although some reduction in "underlying" increases is to be expected between the years, the relevant figures would then look like an increase from 7 per cent to 7½ per cent.

To avoid this presentational difficulty without distorting the Government Actuary's calculations, the Chancellor proposes to ask him to give greater prominence in his explanation about the figures to an "underlying" reduction from about 7½ per cent to about 7 per cent than to the actual figures. In smaller print, qualitative mention will be made of the impact of the miners' dispute and of the figures of 7 per cent and 7½ per cent respectively which have actually gone into his forecasts.

Later years of the Survey

Assumptions are also needed for the later years in the Survey period. Those on unemployment and prices have in previous years not been published until the Public Expenditure White Paper. This year, they might be revealed earlier if total expenditure figures are to be provided. The proposed paths are as follows:

	Unemployment	Inflation	
		RPI	GDP Deflator
	(GB, narrow, millions)	(per cent rise in year to May)	(per cent rise)
1984-85	3.0	(5.1)	4¾
1985-86	3.0	4¾	4½
1986-87	3.0	4	4
1987-88	3.0	3½	3¼

The assumption of a flat path for unemployment after a recent rise is fairly conventional. The last set of published figures showed unemployment staying at 2.85 million for the years 1984-85 to 1986-87. Reflecting the increases that have actually taken place this year, the proposal is now to show a level of 3.0 million for all years.

On the RPI, and GDP deflators the figures are likely to cause no surprises. On the RPI no change is proposed for May 1986 from the figure of 4 per cent shown in the last PEWP. A further deceleration to 3½ per cent is assumed for the year to May 1987.

Yours ever

David

D L C PERETZ

3.54

SECRET

FROM: DAVID PERETZ

DATE: 17 October 1984

cc Chief Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Monck
Mr Burgner
Mr Scholar
Mr Wilson
Mr Pratt
Mr Ridley

MR BATTISHILL

TIMING OF AUTUMN STATEMENT

I should record, for posterity, that the minute attached to your note of 15 October (of which I attach a final revised version) was not in the event sent to the Prime Minister.

2. As you know, the Chancellor decided to speak to the Prime Minister on the evening of 15 October, instead of writing; and events have now moved on following the meeting on 16 October with Mr Pattie and others.

D L C PERETZ

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

PRIME MINISTER

THE AUTUMN STATEMENT

I have been giving further thought to the timing of the Autumn Statement in the light of our conversation before the Party Conference and the latest information from Kleinworts about arrangements for launching the BT sale. This has thrown up important issues which I must report to you.

2. I now think it would be better if I could announce our public expenditure decisions in the House, and publish the Autumn Statement, on Monday 12 November, a day earlier than we had been planning. This would be the penultimate day of the Queen's Speech debate. It would remove any cause for complaint the Opposition might have if we delayed the Autumn Statement until Tuesdau 13 November, when they are likely to want to debate the economy. It would also clear the way for BT privatisation. At present, the BT price is to be fixed on Thursday, 15th and announced on Friday 16 November ("Impact Day"). John Wakeham, with whom I discussed this briefly before the Party Conference, thought that a Statement on 12 November was far better than one on 13 November.

3. Publishing immediately after the weekend will allow as little time normally taken to produce the Autumn Statement after Cabinet. The printers will have to work over the weekend, and through Sunday night. Peter Rees and I will be dependent on colleagues' quick agreement after Cabinet to the detailed programme figures and to the text for the printed Statement.

But the operation looks feasible so long as public expenditure is firmly settled at Cabinet on Thursday 8 November.

4. This last requirement is a critical one. If, for any reason, we are unable to reach agreement on the spending figures (at least for 1985-86, if not for all three years) on the 8th, there is no way the Autumn Statement can be ready by the 12th. The Economic Debate on the 13th would have to proceed without the public spending figures or the published Autumn economic forecast. And I would have to make a separate statement when we had settled the figures.

5. But in that case we could be in real trouble over BT. We have always recognised that more time might be needed to reach satisfactory decisions on public expenditure this year, given the extreme difficulty of some of the issues involved. That is why we agreed to bring forward discussion in Cabinet to 4 October, so that colleagues could agree quickly to the setting up of MISC 106. So far as BT is concerned, we raised with Kleinworts some weeks ago the scope for setting back Impact Day by a week if slippage in the Autumn Statement made that necessary. Whilst not something we would wish, I had understood that this option would remain available to us at least until we could see how far MISC 106 succeeded in clsoing the spending gap.

6. But in the last few days Kleinworts have let us know that they are opposed to any delay and that they believe that a postponement left untiul the last minute could so imperil the sale that it might be necessary to pull back and defer the whole operation into 1985.

6a. We could not, however, let the public spending decisions, and the Autumn Statement, slip a week and still go ahead with BT on 16 November. On the one hand it is accepted on all sides that the Autumn Statement cannot be published in the interval between Impact Day on 16 November and the start of dealings in BT shares on 3 December. On the other hand, if they (and the Autumn forecast) were not announced, we could be held to be in breach of the usual disclosure rules (including those of propriety as well as strict law) in such cases - bearing in mind particularly the size and unique nature of the BT sale.

7. Against that background, I have reviewed the courses open to us. There are only three feasible options:

(a) to maintain the present timetable, accepting all the risk that implies;

(b) to leave BT Impact Day on 16 November but to decide now to postpone announcing our public expenditure decisions and publishing the Autumn Statement until the second week in December;

(c) to decide now to put back BT by one week to 23 November, leaving open the possibility of deciding later to postpone the Autumn Statement to 20 November.

8. I cannot pretend that any of these courses is free from difficulty, or from risk.

(a) Staying where we are

9. First there is the question of the risk that we might not be able to reach a satisfactory outcome on public spending in just over three weeks from today. I understand the Lord President is planning to complete the work of MISC 106 and report to you by Friday 2 November. His report could then be circulated after the weekend for Cabinet on the 8th. This allows precious little time for the task he has been set. MISC 106 would have little more than two weeks if you are to

have time to bring your own influence to bear in trilateral discussions of the most sensitive issues. There may be some scope for rearrangement, and my officials have consulted the Cabinet Secretariat about this. But I can see no way of being sufficiently sure that on this timetable we would get a satisfactory outcome. But if at that late stage we found we needed a second Cabinet to resolve outstanding issues, we would then be in great difficulty over BT, with no satisfactory fall-back position.

(b) Deciding now to postpone the Autumn Statement to December

10. Although I understand this is Kleinwort's preferred option, if we see any risk of slippage on the date of the Autumn Statement, I am not attracted by it at all. Though not totally unprecedented it would be later than before. But more importantly, it would be bound to slow the momentum in reaching public expenditure decisions and reduce rather than increase the prospect of a satisfactory outcome. And it is already known that MISC 106 has been set up to go into the BT sale before public spending has been settled and announced, and with a risk of damaging speculation about the difficulty of reaching decisions would, in my view, be most unwise. Kleinworts are inclined to play this down, but I think they are wrong.

(c) Postponing BT by one week

11. As I have said, Kleinworts are opposed to this. Although they are not legally committed to Impact Day on 16 November, they have raised a number of objections. These are partly matters of confidence and partly of logistics:

> (a) apparently, 16 November is already widely perceived as the chosen date - in the City, among regional brokers and the press. And Kleinworts fear that any postponement would be interpreted as implying that the sale had run into problems;

(b) there would, they say, be severe planning and logistical problems.

12. Even allowing for some overstatement in Kleinworts presentation, I accept that there are real difficulties. New advertising space could cost £8-10 million. Financial institutions will have arranged for funds to mature on a certain date. A decision to postpone by a week would undoubtedly involve disruption; and in addition to the measurable costs, there could be some risk to the price.

13. Nevertheless, if there is to be a postponement, Kleinworts would like the decision to be taken as quickly as possible. That must be right.

Conclusion

14. I am afraid there is no easy solution. If we could be sure of settling public expenditure by 8 November, and on satisfactory terms, the programme we have is the best possible. But it also carries the highest risk - that, in the event of slippage, we may not be able to go ahead with BT this year.

15. I feel that this risk is now too great for us to take. With the best will in the world, there must be a distinct chance that we shall not be in a position to secure satisfactory decisions by 8 November.

16. I would propose, therefore, that we take a decision now to set back the BT programme by one week. I do so with reluctance, but in the belief that this would be the safest course. There would be costs, but less than those of getting the wrong public spending decisions because we ran out of time.

17. If we do decide to postpone, I see no need to alter the MISC 106 timetable or at this stage to abandon the hope of getting public spending settled on 8 November. And I think we should, for the time being, keep the possibility of taking a further week to a very close circle indeed. If we could keep to the 8 November timetable, the Autumn Statement could still go ahead on Monday 12 November in time for the Economic Debate the following day. But by taking a decision on BT now, we would have created a week's cushion in case more time proves necessary.

18. I am sorry to trouble you with this issue at such short notice. The difficulties over the BT timetable have only just become apparent. I have not, of course, been able to discuss it yet with Norman Tebbit. But in view of the urgency I thought you should know of the problem at once.

19. Peter Rees and I are at your disposal if you would like to discuss this.

[N.L.]

Secret and Personal

[This paper returned - for the meeting with own annotations, upon the pessimism of financial paper below me]

FROM: T BURNS

DATE: 19 October 1984

CHANCELLOR

cc: Sir Peter Middleton

SIR T. BURNS 19/10 OCT 76 TSY EC FORECAST

OCTOBER 1984 TREASURY ECONOMIC FORECAST

I attach my note on the forecast. I have not given it any wider circulation at the moment. I intend to do that at the beginning of next week but you might like a word first.

Happy to see me

T.B.

T BURNS

C

(i) Terry is getting v. gloomy on Coal strike

(ii) I think things are a bit in the balance at present, making it v. hard to forecast. Industry may be going to invest more than expected: or firms may simply give their money away in higher wages. But difficult to see lower interest rates having a v. crucial role in that decision.

(iii) Terry seems to be saying, I think, that ∴ may be a case for a bigger PSBR. (& maybe faster monetary growth as well, to allow for faster real growth)

(iv) You may like to see the record of the PCC discussion (below)

OCTOBER 1984 TREASURY ECONOMIC FORECAST

You have seen the October forecast. The main elements show little difference between this and the forecast we published in the FSBR. The projected growth of GDP over the forecast period is virtually the same as presented at Budget time after allowing for the miners' strike effects. Inflation is projected to be a little higher (but less than 1/2 per cent) despite the exchange rate being about 5 per cent less than expected. The picture for monetary growth is if anything a little better than expected at the time of the Budget - partly of course because interest rates are higher. The PSBR for this year looks like being a bit worse but the fiscal adjustment is much the same or better for 1985/86 if we can get somewhere near our public expenditure targets.

2. The main differences, which are mainly for the worse, are that the forecast now shows a lower exchange rate profile; higher interest rates throughout by between 1 1/2 and 2 per cent; and a higher level of unemployment (about 200,000 by 1986). On the other hand the company sector's cash flow position seems even stronger than expected despite the very sharp upturn in fixed investment.

World Outlook

3. The problem of interpreting US development dominates the world outlook discussion and poses significant policy problems at home. The continuation of high US interest rates, a rising dollar and a deteriorating US trade position looks unsustainable but the timing and nature of its resolution is highly uncertain. From our point of view the best outcome is a deliberate attempt by the US authorities to reduce their deficit, slower domestic demand growth and continuing output growth at 2-3 per cent per annum, a falling dollar and lower US interest rate. Slower US demand growth may weaken our exports but lower real interest rates and more bouyant domestic demand growth in Europe would be even more welcome.

4. The forecast shows a limited move in this direction. But there are considerable uncertainties. There may be no great pressures on a re-elected administration to change behaviour quickly and there may be no response until something unpleasant occurs - for example a falling dollar, rising inflation or faltering growth. Then there is the danger of over reaction with a sharp US downturn before Europe has a time to respond to the opportunity of lower interest rates.

5. There have been signs of demand weakness this Summer, not only in the UK but elsewhere. This may be related to the upward pressure on interest rates in the first half of 1984 but might also be due to the influence of strikes in Germany and the UK combined with some falls in the growth of consumer spending in the US. There are no clear reasons why - outside the US - this demand weakness should continue and I remain reasonably optimistic about world growth in 1985.

The UK Outlook

6. But the UK is now entering what is often a difficult leg of the cycle. We are now well into the stage when we expect progress on unemployment. Maybe the forecast is too cautious. Underlying inflation could continue to fall against a background of weak world prices. And some combination of continued world trade growth and lower interest rates might mean output growing at 3 per cent or so underlying. But the labour cost background is less reassuring; and the possibiliity of the combination of tight fiscal policy at home; continued high real interest rates and a sluggish European demand growth means that we should remain cautious. If developments turned out to be as suggested in the forecast there might be reasonable satisfaction apart from the level of unemployment. Progress here probably requires faster growth than suggested in the forecast.

7. There are a number of problems that are thrown up by this forecast. The PCC discussion earlier this week concentrated on the policy mix; the continuing poor adjustment of the UK labour market; and the problem of meeting the public expenditure planning totals and the prospects for the fiscal adjustment. In discussing these problems we need to remember that the forecast assumes the miners' strike will be over by Christmas. The longer it goes on, the more difficult it becomes to see the underlying trends; and forecasts which assume any early end come to seem less relevant. Clearly - even if the broad thrust of the forecast is right - there could be some nasty bumps before we get back onto that path.

The Mix of Monetary and Fiscal Policy

8. The unexpected and continuing high level of interest rates is disturbing. The growth of the target monetary aggregates is, if anything, better than we expected at the time of the budget. The fiscal deficit is not too far from the intended path. And yet we are faced with the prospect of

continuing high real interest rates. Of course this cannot be divorced from the impact of the coal dispute. This combined with earlier worries about monetary control put some pressure on interest rates. But a large part of the interest rate problem is the impact of high world real interest rates and the strength of the dollar. It can be argued that because of the conduct of US policy we are not getting the full relief on interest rates that might have been expected from fiscal virtue. The same point can be made about Europe as a whole where determined efforts have been made to reduce budget deficits. The danger is that the overall growth of nominal demand might turnout to be less than intended in the MTFS. And as I argue later there is a case to be made that we have understated the growth of potential GDP.

9. One possible response is to continue to try to reduce interest rates at home despite world interest rate levels. This might create pressure for a lower exchange rate although that risk would be less if Europe as a whole were to adopt a similar approach. The integration of world capital markets limits the potential degree of de-coupling of interest rates other than to the extent that exchange rate and inflationary expectations differ. But if it was not for the miner strike there might be some room for a more aggressive attempt to get interest rates down despite world interest rates levels.

10. The alternative approach is to accept that there are limits to the extent to which real interest rates in the UK can differ from those of the US and that this limits the extent to which it is appropriate to continue to press down on the PSBR. But there are clear dangers with this approach. Interest rates may turn out to be even higher than we now face. And it is much easier to take expenditure or tax action to ease the fiscal stance, than it is to reverse it if the circumstances change. This is the case for a medium term approach to fiscal policy. But it does suggest that there may be less urgency in getting the PSBR down to 2 per cent of GDP than we had previously judged. Against that, however, higher asset sales and higher oil revenues (despite the last few days' events) are not a fully sustainable way of lowering the PSBR and/or reducing taxation.

Labour Market Adjustment

11. Labour market behaviour continues to be disappointing. In the past year there has been no further fall in the level of pay settlements. Real earnings have risen by almost 3 per cent a year for the past three years and the signs are that this year is turning out much the same. In part this is probably because inflation has consistently turned out to be below inflationary

expectations in part it probably reflects the impact from higher levels of productivity.

12. Employers appear to have used a weakening of trade union power to change working practices rather than to put pressure on pay settlements. Having been through the difficult procedure of labour shedding employers have chosen to be reasonably generous with pay. Where there have been an increased number of jobs they have gone net, largely to part time female employment. Some of this is a reversal of the withdrawal of women from the labour market during the recession.

13. It is possible that as the scope for improving productivity is diminished there may be more pressure on pay settlements. But there are no signs of it yet. The mood among many employers seems to be that there are pressures for "catching-up", particularly from those who have had below average increases in recent years. And I am not persuaded that there is much to be gained from further banging the wage moderation drum.

14. In the light of developments in the past two years it seems unlikely that there will be sufficient labour market adjustment in the period covered by the forecast to bring unemployment down sharply without a rather faster growth of output than we are currently expecting. This emphasises the approach of making changes that will improve the functioning of the labour market, even though any impact will be gradual. I was struck by the number of people in the US who gave some credit for their slow growth of labour costs to the scale of the de-regulation of product markets.

15. The US achievemnent has been to get large numbers of people into employment and to keep down the growth of real wages. There has been a rapid increase in output with little pressures for higher inflation or for labour costs to increase at a faster pace. Although there has been considerable leakage of US demand into higher imports and lower exports the division of nominal GDP growth of almost 12 per cent per annum (first half of 1984 over first half of 1983) between almost 8 per cent output growth and 4 per cent inflation has been very impressive.

16. It has been argued that the rapid growth of UK productivity and increased labour supply (through a higher female participation rate) are evidence of this faster growth potential. Certainly CBI figures for skilled labour vacancies show no problems. If we were persuaded by this assessment

one possible conclusion would be that we would need to be more ambitious in terms of the nominal framework. Instead of basing policy upon a reduced rate of nominal GDP growth from now on the path should be revised in response to the apparent faster growth of productive potential than we had previously expected.

17. The doubts about such an approach centre upon the risk to inflation. A falling exchange rate and an easing of pressures on margins could undo the disinflationary pressure. And the failure of wages to adjust so far suggests that there would be a danger of acceleration if domestic demand were to grow much faster. But this is an option that we will need to examine to judge the scale of the risks as we look at the budget arithmetic.

Public Expenditure

18. Although the forecast assumes less than full success on the expenditure side relative to the MTFS therre still appears to be scope for a fiscal adjustment in the budget. This is largely due to a projection of higher oil revenue because of both a higher volume of output and higher sterling oil prices.

19. If we did stick to the existing plans it would mean a large cost terms reduction, only some of which would be due to the miners strike. The PCC view clearly was that it is important that we end up with a realistic figure that can be held and not to divorce the decision making process from reality. If it is not possible to get the decisions that are necessary to deliver the objectives we should settle for publishing a higher figure and not engage in too much fudging.

20. There are many risks associated with the forecast of the fiscal adjustment, particularly on the oil revenue side. It would be tempting fate to publish a figure of £3 billion as a central estimate of the fiscal adjustment as the bulk of outside opinion seems to be that we are likely to understate the potential room for manoeuver at this stage in the year. This has been the experience of the past two years, although not by design. I would be happier to see a published figure of about half this with some margin built into the oil revenue forecast.

& $/£ xR

CONFIDENTIAL

Use 5% indexals 20.
Retain CT tax reckoner
otherwise content. N.

FROM: BRENDA HOLMAN
23 October 1984

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Battishill
Mr Evans
Mr Odling-Smee
Mr R I G Allen
Mr Griffiths
Mr Powell
Mr Pratt

PS/Inland Revenue
Mr Calder (IR)
PS/Customs & Excise
Mr Wilmott (C&E)

HOLMAN 23/10

23/10

1. MR MONGER

2. CHANCELLOR OF THE EXCHEQUER

AUTUMN STATEMENT: PART FOUR (THE REVENUE EFFECTS OF ILLUSTRATIVE TAX CHANGES)

As you know, previous Autumn Statements have contained sections showing the revenue effects of illustrative tax changes (a tax ready-reckoner). This has generally been received as a useful part of the Statement, and has been used to some extent as a 'DIY budget kit'.

2. A draft of a possible version for this year is attached. It has been discussed with the Revenue departments. The figures in it are still provisional but they are unlikely to alter greatly.

3. There have been few changes from last year's format, except that references to and ready-reckoners for investment income surcharge and National Insurance Surcharge (NIS) have been omitted following the abolition of these taxes in the 1984 Budget.

4. Currently the illustrative indexation assumption (representing the annual increase in the RPI to December 1984 which forms the basis for statutory indexation) is shown as 5 per cent, in line with the

preference you expressed last year for a 'whole number'. I understand the forecast in Part 1 is likely to suggest a slightly lower figure for the fourth quarter of 1984, probably $4\frac{3}{4}$ per cent. This alternative indexation assumption would alter the illustrative 1985-86 income tax allowances, and the costs of indexation, and illustrative figures on this basis are given in Annex A. The Annex also shows the effect of a $4\frac{3}{4}$ per cent revalorisation percentage for the indirect taxes. Other tables would be unchanged (except for tiny changes to CTT bands).

5. Table 4.5 gives ready-reckoners for corporation tax. There is some case for omitting these as redundant this year since the CT rates have been decided for several years ahead, and any change in them does not seem likely in practice. Omitting the ready-reckoners for CT could, however, be seen as a first step in tailoring the ready-reckoner to what might happen.

6. In order to keep to the timetable for the AS (which has this section going to the printers this week) your decision is needed as soon as possible please, on whether:

a. the illustrative indexation percentage should be 5 per cent or $4\frac{3}{4}$ per cent (para 4)

b. the corporation tax ready-reckoner should be retained (para 5) and whether you are otherwise content with the draft.

Brenda Holman

BRENDA HOLMAN
ECONOMICS OF TAXATION
DIVISION

4. THE REVENUE EFFECTS OF ILLUSTRATIVE TAX CHANGES

4.01 The tables below show various illustrative changes to the major taxes and estimates of their direct revenue effects at forecast 1985-86 price and income levels. Figures are given for full year effects and also the effect in the first year (1985-86) - that is, the part of the full year effect which would be expected to come through in tax receipts in that financial year. Neither of these is the same as the effect on the public sector borrowing requirement (PSBR) because of the second round effects of tax changes on the economy.

4.02 Estimates of the size of the direct effects of tax changes depend on economic variables, such as prices, earnings, consumer expenditure, etc, and thus may alter as the prospects change. The illustrative tables which follow are based on a view of the economy that is consistent with Part 1.

4.03 There are, in principle, a number of ways of measuring the direct effect on revenue of a tax change, depending on the assumptions made about changes in the tax base and whether revenue from other taxes is included. The definitions used here are explained in note (a) to Table 4.2 of the 1984-85 Financial Statement and Budget Report; and a fuller description for indirect taxes is given in an article in Economic Trends, March 1980.

4.04 Where appropriate the figures set out below show the effect of indexation by an illustrative 5 per cent. This is in line with the annual rate of increase in the RPI forecast for the fourth quarter of this year (Table 1.[ ])

Indexation of allowances, thresholds and bands for 1985-86

4.05 With indexation by 5 per cent, the 1984-85 levels of allowances, thresholds and bands would be as shown below. The rules for rounding up set out in the 1980 Finance Act (for income tax) and the 1982 Finance Act (for capital transfer tax and capital gains tax) have been followed. 1984-85 figures are shown for comparison:

Table 4.1 Income Tax

	1984-85	1985-86
Allowances	£	£
Single and wife's earned income allowance	2,005	2,115
Married allowance	3,155	3,315
Additional personal and widow's bereavement allowance	1,150	1,200
Single age allowance	2,490	2,620
Married age allowance	3,955	4,155
Aged income limit	8,100	8,600

Income tax rates	Bands of taxable income	
Per cent	1984-85	1985-86
30	0- 15,400	0- 16,200
40	15,401- 18,200	16,201- 19,200
45	18,201- 23,100	19,201- 24,400
50	23,101- 30,600	24,401- 32,300
55	30,601- 38,100	32,301- 40,200
60	over 38,100	over 40,200

Table 4.2 Capital Transfer Tax

Rate on death	Lifetime rate	Bands of chargeable value	
		1984-85	1985-86
Per cent	Per cent	£'000	£'000
Nil	Nil	0- 64	0- 68
30	15	64- 85	68- 90
35	17½	85- 116	90- 122
40	20	116- 148	122- 156
45	22½	148- 185	156- 195
50	25	185- 232	195- 244
55	27½	232- 285	244- 300
60	30	over 285	over 300

Table 4.3 Capital Gains Tax

	1984-85	1985-86
	£	£
Annual exempt amount		
Individuals	5,600	5,900
Trusts	2,800	2,950

Estimates of the costs of the changes shown above are as follows:

Table 4.4 Costs of Indexation

£ million at forecast 1985-86 prices, incomes and capital values

	First year cost	Full year cost
Indexation of income tax allowances and thresholds of which:	920	1,190
Increases in main personal allowances	830	1,035
Increase in the basic rate limit(1)	50	80
Increases in further higher rate thresholds(1)	40	75
Indexation of capital transfer tax thresholds and bands	15	45
Indexation of capital gains tax exempt amounts	Nil	10

(1) Additional costs after previous changes have been introduced.

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

4.06 Table 4.5 below gives estimates of the direct effects (at forecast levels of 1985-86 prices and incomes) of changes in the main personal allowances, thresholds and rates of income tax from the indexed levels of allowances and thresholds set out in table 4.1 above. For corporation tax the table shows the effects of a 1 percentage point change in the rate of tax and in the small companies' rate.

4.07 Table 4.5 shows the costs or yields resulting from individual allowance changes of £100 and of changes in all allowances by 1 per cent and 10 per cent of their 1984-85 values. These changes are applied to the indexed levels of table 4.1. The costs or yields are linear over a fairly broad range of changes. Reasonably accurate estimates can be obtained by pro-rating the ready reckoner figures for increases in allowances of less than about 20 per cent and for reductions of less than about 5 per cent from the indexed values. The estimated revenue effects of each allowance and threshold change are shown to the nearest £ million or £5 million (to avoid undue magnificiation of rounding errors when using the ready reckoner to consider larger changes). However, the figures should not be assumed to be accurate to this degree.

4.08 The income tax changes have been costed on the assumption that each is introduced in isolation. In practice there is little interaction between the personal allowances, so an estimate of the cost of more than one allowance change can be obtained by combining the individual costs or yields for each item. However, the effect of a change in the basic or higher rates of tax, or in the higher rate thresholds, would be smaller than the amounts shown in the table if those changes were introduced at the same time as an increase in one or more allowances (and larger if combined with a decrease in allowances).

Table 4.5 Direct effects of specimen changes in income tax

	£ million at forecast 1985-86 income levels	
	First year Cost/ Yield	**Full year Cost/ Yield**
Income Tax(1)		
Rates	[1050]	[1125]
Change basic rate by 1p(2)		
Change all higher rates by 1p	48	95
Personal Allowances		
Change single and wife's earned income allowance by £100	290	360
Change married allowance by £100	260	320
Change single age allowance by £100	24	32
Change married age allowance by £100	21	26
Change aged income limit by £200	3	5
Change all main personal allowances by 1 per cent	160	195
Change (raise-/+lower+) all main personal allowances by 10 per cent	-1540/+1600	-1915/+1995
Higher Rate Bands		
Change (raise-/lower+) all higher rate thresholds by 1 per cent	-15/+15	-27/+28
Change (raise-/lower+) all higher rate thresholds by 10 per cent	-135/+170	-245/+310
Allowances and thresholds		
Change all main personal allowances and higher rate thresholds by 1 per cent	170	225
Change (raise-/lower+) all main personal allowances and higher rate thresholds by 10 per cent	-1650/+1775	-2150/+2315
Corporation Tax(3)		
Change rate by 1 percentage point(4)	120	220
Change small companies' rate by 1 percentage point	13	25

(1) Changes are from the indexed levels of allowances and thresholds shown in table 4.1. Percentage changes are, however, of 1984-85 levels.

(2) Including the effect of the change on receipts of Advance Corporation Tax and on consequent liability to Mainstream Corporation Tax.

(3) Assessment to Corporation Tax normally relates to the preceding year. These are, therefore the changes to revenue that would occur if the changed rates were applied to forecast 1984-85 income levels.

(4) Assuming small companies' rate unchanged.

4.09 The additional cost of an increase in the higher rate thresholds tends to fall as the total increase rises, so estimates have been given for two different changes, 1 per cent and 10 per cent on top of indexation. Nor are the effects of changes in higher rate thresholds symmetrical between increases and decreases. The table indicates that decreases would yield rather more than corresponding increases would cost.

4.10 The effect of a package which changes all main personal allowances and higher rate thresholds by 1 per cent and 10 per cent are also shown. These changes have been calculated as percentages of the 1984-85 levels and the effects estimated on top of the 5 per cent illustrative indexation.

4.11 Estimates derived from this ready reckoner for a combination of more than one tax change should be taken only as a general guide to the revenue effect of the package, particularly where a number of interacting changes are included.

Indirect taxes

4.12 Figures for changes in the excise duties (table 4.6) are shown in two sections. The first shows the extra revenue from the individual duties if they were to be increased by exactly 5 per cent, together with the price increase that would result (after allowing for consequential VAT).

4.13 The second section shows for most duties the revenue yield from changing current levels of duty so that (after VAT) the price of a typical item is changed by exactly one penny. For VED, a £1 change for cars and light vans is shown. Table 4.7 shows the revenue effects of a 1 percentage point change in the rate of VAT.

4.14 The estimates are direct effects except that they do, however, allow for changes in the composition of consumers' expenditure within a fixed total, due to relative price changes.

4.15 Within limits the illustrative changes for specific duties shown here can be scaled up or down to give a reasonable guide to the revenue effects. For example, a unit change could be combined with a revalorisation change to show the effects of a different percentage movement in duty. However, with large changes the margins of uncertainty surrounding the effects on sales and hence on revenue become progressively larger, and scaled estimates will be less reliable.

Table 4.6 Revenue effects of indirect tax changes (£ million 1985–86 prices and income levels)

	5% Revalorisation(1)			Unit changes from present levels of duty		
	Current level of duty on typical item(2)	Price change inc. VAT (pence)	Full year yield(3) £m	Price change inc. VAT	Actual percentage Change in duty %	Full year(3) yield/cost £m
Indirect Taxes						
Beer (pint)	17.3p	1.0	90	1p	5.0	90
Wine (bottle of table wine 70 cl)	63.4p	3.6	25	1p	1.4	7½
Spirits (bottle)	£ 4.64	26.7	30	1p	0.2	1
Tobacco (20 kingsize cigarettes)(4)	76.2p	3.8	125	1p	1.3	35
Petrol (gallon)	78.0p	4.5	220	1p	1.1	50
Derv (gallon)	65.8p	3.8	55	1p	1.3	15
VED (cars and light vans)	£90.00	£4.50	85	£1	1.1	19

(1) An 'across the board' revalorisation by 5 per cent (including the minor duties not shown above) would yield about £650 million in a full year, and the impact on the RPI would be to raise it by less than ½ per cent.

(2) VAT is payable in addition to the duty except in the case of VED.

(3) Assuming for illustrative purposes implementation on 1 April, the first and full-year yield of changes in excise duties would be identical for petrol, derv and VED; for beer and tobacco the first-year would be approximately eleven twelfths of the full-year; and for wine and spirits it would be approximately twenty-three twenty-fourths.

(4) The duty on cigarettes has ad valorem and specific elements; the percentage change relates only to the specific element, but the price change includes the consequent increase in ad valorem duty and VAT.

Table 4.7 VAT

	First year(1) yield/cost	Full year yield/cost
1% point change in rate of VAT	625	840

(1) Assuming implementation on 1 April.

ANNEX A

Illustrative 4¾% indexation

	1985-86
	£
Allowances	
Single & wife's earned income allowance	2105
Married allowance	3305
Additional personal and widow's bereavement allowance	1200
Single age allowance	2615
Married age allowance	4145
Aged income limit	8500

Costs of Indexation

£ million at forecast 1985-86 prices, incomes and capital values

	First year cost	Full year cost
Indexation of income tax allowances and thresholds, of which:	860	1115
Increases in main personal allowances	770	960
Increases in basic rate limit (1)	50	80
Increases in further higher rate thresholds (1)	40	75
Indexation of capital transfer tax thresholds and band	15	45
Indexation of capital gains tax exempt amounts	Nil	10

(1) Additional costs after previous changes have been introduced.

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Indirect Taxes

	Current level of duty on typical item	Price change incl VAT (pence)	Full year yield £m
Beer (pint)	17.3p	0.9	85
Wine (bottle of table wine 70 cl)	63.4p	3.5	25
Spirits (bottle)	£4.64	25.4	30
Tobacco (20 kingsize cigarettes)	76.2p	3.6	115
Petrol (gallon)	78.0p	4.3	210
Derv (gallon)	65.8p	3.6	55
VED (cars and light vans)	£90	£4.27½	80

'Across the board' revalorisation by 4¾ per cent would yield about £625m in a full year.

A/S PART IV
ILL' TAX CHANGES

3.69

FROM: DAVID PERETZ

DATE: 24 October 1984

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Battishill
Mr Evans
Mr Monger
Mr Odling-Smee
Mr R I G Allen
Mr Griffiths
Mr Powell
Mr Pratt

PS/IR
Mr Calder - IR
PS/C&E
Mr Wilmott - C&E

MS HOLMAN

AUTUMN STATEMENT:
PART FOUR (THE REVENUE EFFECTS OF ILLUSTRATIVE TAX CHANGES)

The Chancellor is broadly content with the ~~drafts~~ draft attached to your minute of 23 October.

2. On the two specific questions you asked:-

(a) He thinks the illustrative indexation percentage should be 5 per cent.

(b) The corporation tax ready-reckoner should be retained.

D L C PERETZ

FISCAL PROJECTIONS FOR THE A/S

SECRET AND PERSONAL   COPY NO. 1/30

CHANCELLOR

FROM: C J RILEY
DATE: 25 October 1984
cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Cassell
Mr Kemp
Mr Monck
Mr Battishill
Mr Burgner
Mr Lankester
Mr Lavelle
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Watson
Mr Folger
Miss Peirson
Miss Seammen
Mr Williams
Mr Grice
Mr Ridley
Mr Lord
Mr Portillo

FISCAL PROJECTIONS FOR THE AUTUMN STATEMENT

We have completed fiscal projections up to 1987-88 based on the judgements in the October forecast, but using stylised assumptions about the economy after the period to be covered by the Industry Act forecast (IAF). Following the Likierman Report, you are considering whether to publish expenditure projections for three years in the Autumn Statement.

If the various practical difficulties can be overcome and you decide to go ahead, you will wish to decide whether at the same time to publish three year revenue projections. This paper discusses the stylised assumptions on which the revenue projections might be based and presents projections based on the proposed assumptions. It also discusses the implications of changes since the Budget for the appropriate PSBR path and how this affects the way in which the fiscal projections might be presented. Drafts of possible sections for inclusion in the Autumn Statement are provided.

Assumptions

2. Publication of revenue projections, if it were to go ahead, would be designed to enable the public expenditure plans to be considered alongside our latest view on revenues. It would involve updating the numbers in the MTFS in the light of the Industry Act forecast, without in any way reconsidering the stance of policy. This means:

(i) using the same PSBR path as in the MTFS*;

(ii) getting as close as possible to the MTFS paths of inflation and output growth from 1986 onwards.

3. After allowing for the effect of the miners' strike, the October forecast of output was reasonably close to the MTFS output path up to and including 1986-87. The inflation forecast was higher throughout, but the IAF is likely to show lower figures. The table below summarises the assumptions we propose (bracketed figures exclude the direct effect of the miners' strike).

---

* We propose to assume that the PSBR path from 1986-87 is as follows:

	1986-87	1987-88
£ billion	7.2	7.0
% of GDP	1.9	1.75

This enables us to round both the absolute and percentage figures as in the MTFS.

	GDP Growth (%)			Inflation (GDP deflator**)		
	MTFS path	October Forecast	Proposed Assumption	MTFS path	October Forecast	Proposed Assumption
1984-85	3	2 (3)	2 (3)	$4\frac{3}{4}$	5	$4\frac{3}{4}$
1985-86	$2\frac{1}{2}$	$3\frac{1}{4}$ $(2\frac{1}{4})$	$3\frac{1}{4}$ $(2\frac{1}{4})$	$4\frac{1}{4}$	$5\frac{1}{4}$	$4\frac{1}{2}$
1986-87	2	$2\frac{1}{4}$	$2\frac{1}{4}$	4	$4\frac{1}{4}$	4
1987-88	2	$\frac{3}{4}$	2	$3\frac{1}{2}$	5	$3\frac{1}{4}$
1988-89	2	-	(2)	3	-	(3)

4. We propose to stick with <u>output</u> as in the forecast up to 1986-87. This means $\frac{1}{4}$% lower underlying growth in 1985-86 than in the MTFS, offset by $\frac{1}{4}$% faster growth in 1986-87. If the IAF were to have a higher figure in 1985-86 we could revise the 1986-87 number down accordingly. The proposed path, including the 1988-89 figure which we do not really need for present purposes, means average GDP growth of $2\frac{1}{4}$% between 1983-84 and 1988-89, as in the MTFS. It should not pose any great presentational problems.

5. We propose to use the <u>inflation</u> path adopted for the economic assumptions for public expenditure. This is consistent with that underlying the MTFS, though somewhat lower than in the October forecast.

---

* Market prices.

6. The path of money GDP implied by the proposed output and inflation paths is set out below, alongside that in the MTFS.

	Money GDP assumptions (%growth)		
	MTFS	Actual Path	Adjusted for miners' strike
1984-85	7¾	7	8
1985-86	6¾	8	7
1986-87	6	6¾	6¾
1987-88	5¾	5½	5½
1988-89	5	(5¼)	(5¼)
1984-85 to 1988-89	35½	36½	36½

The Projections

7. The projections are described in detail in the attached annex by Mr Grice. Differences from the October forecast are much the same on both sides of the public sector's accounts, so that the fiscal adjustments are very similar. Both expenditure and receipts are lower throughout the period, but particularly in 1987-88, mainly reflecting lower inflation. The differences are set out in paragraph 15 of Mr Grice's annex.

8. Differences from the MTFS, on which public attention would focus, are greater. The broad picture is that higher public expenditure throughout the period is more than offset by higher revenues, particularly from the North Sea. Non-North Sea revenues are higher partly because the path of money incomes is slightly higher in the current projection, but partly also because of a slight upward revision to the share of taxes in GDP. As a consequence of these changes, the fiscal adjustments are higher than in the MTFS both in 1985-86 and cumulatively over the whole 3-year period. The main differences are set out below.

??

Differences from the MTFS

£billion	1984-85	1985-86	1986-87	1987-88
General Government expenditure	+ $2\frac{1}{2}$	+ $3\frac{1}{2}$	+ $3\frac{1}{2}$	+ 4
General Government receipts	+ $1\frac{1}{2}$	+ 4	+ 4	+ $4\frac{1}{2}$
Annual fiscal adjustment	-	+ $1\frac{1}{2}$	- $\frac{1}{2}$	-

9. The projections use the same PSBR path as in the MTFS. But as well as small differences in the underlying economic assumptions, described above, the composition of the PSBR is now rather different from that in the MTFS. In particular:

(i) Asset sales are now put £$\frac{1}{2}$ billion higher than in the MTFS in 1985-86.

(ii) North Sea revenues are now put £3 billion higher in 1985-86, £$1\frac{1}{2}$ billion higher in 1986-87 and £$\frac{1}{2}$ billion higher in 1987-88.

Self contradictory

Also, interest rates in both real and nominal terms are assumed to be higher throughout the period than was envisaged at Budget time. In principle all these changes should be taken into account in assessing whether the PSBR path in the MTFS is still appropriate.

Policy Issues

10. It can be argued that short term movements in both North Sea revenues and asset sales should be reflected largely in variations in the

PSBR, rather than offsetting changes in taxation or public expenditure. It was stated explicitly in the MTFS that we take these factors into account in setting the PSBR - see paragraph 2.17, reproduced below.

> "The appropriate path of the PSBR from year to year reflects many considerations, including the cyclical position of the economy. The composition of public sector receipts and expenditure also has to be taken into account. The profile of public sector asset sales is an important aspect of this, since they are unlikely to make a large contribution to reducing interest rates. The higher level of asset sales over the next five years than in recent years points to an initial downward shift in the PSBR path. The pattern of North Sea oil revenues is also relevant: the likelihood that they may be near their peak in 1984-85 is a further reason for seeking to make rapid progress this year in reducing the PSBR."

11. Taken to its logical conclusion, this view implies that the PSBR should be over £3 billion lower in 1985-86 than in the MTFS - ie under £4 billion - with smaller downward adjustments to the subsequent years. But an analysis based entirely on the composition of the PSBR is, of course, too simplistic. A more detailed assessment will underly the decisions finally taken in the Budget. Other factors may suggest some relaxation in the fiscal stance. A lower underlying level of GDP in 1985-86 could be used to justify a marginally higher PSBR, though the numbers involved are probably small. Perhaps more importantly, there is a danger that with higher than expected real interest rates in both the UK and the rest of the world, the growth of money GDP may turn out lower than envisaged in the MTFS. And recent events in the labour market may point to somewhat faster growth of potential output than we have been assuming. All these points suggest that it may well not be appropriate to go as far in the reducing the PSBR as the naive calculations based on oil revenues and asset sales suggest. But of course there is no need to come to a decision on this yet.

<u>Presentation</u>

12. There are a number of presentational problems if full three year fiscal projections are to be published. Most obviously the fiscal

adjustment calculated for 1985-86 using the PSBR in the MTFS may well give too sanguine an impression of the likely scope for tax cuts in the next Budget because of the compositional issue. The danger, which will be difficult to avoid if the present figure is published, is that expectations about the Budget might be raised unjustifiably when the fiscal adjustment is published, only to be dashed in a few months time. However, outside commentators will be aware of the compositional changes to the PSBR, and they can be expected to draw attention to the consequences outlined above. Indeed, Tim Congdon has already focussed on this issue - in his column in the Times on 24 October. Outside comment may lead to pressure being exerted on Ministers and officials, for example by the Treasury Committee, to give some indication before the Budget of any likely shifts in the PSBR figure. But of course, to the extent that this occurs, the danger of a high fiscal adjustment raising expectations unjustifiably is diminished.

13. If the public expenditure figures finally agreed by Cabinet are well below those in the October forecast, as they may be, the fiscal adjustments will be even higher than the present projections indicate, making the presentational problems more acute. Getting back to the "baseline" agreed at the 5 July Cabinet would yield the following figures:

Annual Fiscal Adjustments with alternative public expenditure paths

£ billion	1985-86	1986-87	1987-88	Cumulative
Using the judgements in the October forecast	3½	4	3½	11
Using the 5 July "baseline"	~~5~~ 4	~~4¾~~ 5	4¾	~~14½~~ 14

14. These difficulties would clearly have to be considered carefully if three-year projections were to be included in the AS. In fact, however, the main difficulties arise in 1985-86, and so cannot be avoided by publishing projections for one year only.

15. One possibility would be to publish a fiscal adjustment for 1985-86

some way below the figure given earlier. Even in this case, however, there would be a number of possible approaches to presenting the figures.

(i) Present the figures and the fiscal adjustments without comment.

(ii) Present them with a clear statement that, as usual, the fiscal adjustments do not in any way pre-judge the decisions you will take in the Budget.

(iii) Add a comment that the appropriate level of the PSBR will be reassessed at Budget time in the light of changed circumstances - including in particular North Sea Revenues, Asset Sales, and the state of the cycle.

(iv) Give some indication of the direction, if not the order of magnitude, of any revision to the PSBR indicated by the projections. This would have to be accompanied by a statement of the obvious point that the situation may well change between now and Budget time.

16. Something along the lines of (ii) is probably the minimum we could get away with, and would presumably cause no difficulties. Going as far as (iii) would be helpful and could help dampen down expectations. But Option (iv) runs into the objection that it comes perilously close to updating the MTFS. If we give directions of change we are bound to be pressed to give orders of magnitude. We have always argued that it is not appropriate to update a medium term strategy more than once a year.

17. Given that we have to deal with the problem of 1985-86, it is not obvious that adding projections for the two subsequent years would pose very great presentational difficulties over and above those endemic to these sort of calculations, though there clearly would be some. The main presentational arguments against going ahead are:

(i) that a precedent would be set which may cause difficulties in subsequent years.

(ii) that publication of sizeable fiscal adjustments for the years after 1985-86 would increase the pressure for significant tax cuts that might build up between now and the Budget.

(iii) that it is bound to add to pressure, from the TCSC for example, to update the MTFS.

18. It may help in reaching a view on whether to proceed with three-year projections to see drafts of how they might look in practice in the Autumn Statement. Two drafts are attached. Version A assumes that the projections are included in part I, essentially expanding the relevant section of Mr Evans' draft of 26 October. Version B is written on the assumption that the projections are included as a separate section. Both versions display alternative approaches to the presentatonal difficulties raised earlier in the paper.

Conclusions

19. It may well be that a final decision on whether to include three-year revenue projections in the Autumn Statement cannot be taken yet. You will obviously be taking into account the legal implications of the BT sale, the timetable, and other relevant considerations. And the numbers will change when the October forecast is updated. But it would be helpful to receive guidance on whether we should continue work on the projections as the Industry Act forecast takes shape, and proceed for the present on the basis that they will be published.

NO

20. If publication is a real possibility, we would be grateful for:

- approval of the assumptions on which the projections are based

- your views on the presentational issues raised in this note

- guidance on the location of the projections within the Autumn Statement

- comments on the drafts attached.

CJR

C.J. RILEY.

Ref: 108424

SECRET AND PERSONAL

ANNEX

FISCAL PROJECTIONS FOR THE AUTUMN STATEMENT

This note records our provisional three year fiscal projections for possible inclusion in the Autumn Statement.

2. The Assumptions. The projections are based on the stylised assumptions for GDP growth and inflation set out in the covering minute. The output path gives rounded GDP growth over the five years of $2\frac{1}{4}$% pa, exactly as in the MTFS. Inflation, measured by the GDP deflator, falls to the same rounded terminal level as in the MTFS.

3. For the two extra years covered by these projections, as compared to last years Autumn Statement, the PSBR is assumed to be as follows.

	1986-87	1987-88
£ billion	7.2	7.0
% of GDP	1.9	1.75

Both absolute and percentage figures thus round to those in the MTFS.

4. General Government Receipts. The tax forecasts have benefitted from detailed exercises by both Revenue departments, based on the assumptions given above. National Insurance and other contributions are derived by iteration from a starting point calculated by GAD at the beginning of the Autumn Forecast. Projected general government receipts then look as follows:

General Government Receipts (£ billion)

	1983-84	1984-85	1985-86	1986-87	1987-88
Taxes on Income, Expenditure and Capital	97½	105½	115	122½	129½
National Insurance and Other Contributions	21½	23	25	27	28½
Interest and Other Receipts	11½	10½	11	11½	12
Accruals Adjustments	-½	1	-½	-½	-½
TOTAL	129½	140	150½	160½	169
Of which, North Sea before ACT set-off	9	12	12½	11	10

5. In total, the path for receipts is significantly higher than that presented in the FSBR. The changes are recorded in the following table.

General Government Receipts: Changes from Those in the FSBR (£ billion)

	1983-84	1984-85	1985-86	1986-87	1987-88
Taxes on Income, Expenditure and Capital	+½	+½	+3½	+3	+3½
Non-NS		-1½	+½	+1½	+3
National Insurance and Other Contributions	+¼	-	+½	+1	+1
Interest and Other Receipts	+1	+½	-	+¼	-
Accruals Adjustments	-½	-	-	-¼	-
TOTAL	+1	+1½	+4	+4	+4½
Of which, North Sea before ACT set-off	-	+2	+3	+1½	+½

6. Most most of the increase in projected revenue stems from higher taxes. Three quarters of this upward revision for 1985-86 is due to higher projected receipts from the North Sea, given the forecast of greater production in that year and higher sterling oil prices. But the North Sea accounts for progressively less of the difference in subsequent years. Most of the increase after 1985-86 is accounted for by higher non-North Sea taxes.

7. Several factors contribute to the increase in non-North Sea revenues:

a) On the company side, non-North Sea profits are now expected to be more buoyant than when the Revenue last provided detailed input for the MTFS in March. Public corporations are also now expected to pay more corporation tax than we thought at the time of the Budget. This also applies to BT and British Airways, due to be privatised.

b) Personal direct taxes are also forecast to be higher than underlying the MTFS, mainly as a result of a higher wage and salary bill. On average, personal direct taxes account for a little less than a half and company taxes a little more than a half of the total increase.

c) Indirect taxes represent only a small part of the increase. Whilst personal disposable income is now forecast to be greater than at the time of the MTFS, this is partially offset on expenditure by a higher savings ratio. Moreover, receipts for some duties in 1984-85 to date have been disappointing and have led the Customs to take a less optimistic view of subsequent years.

d) The only other revision of any significance is to National Insurance contributions. Their revision owes entirely to the more buoyant wage and salary bill.

8. As compared to the MTFS most of the extra receipts now projected can be attributed to the higher path for money GDP. In the MTFS, nominal GDP was projected to rise by 29% between 1983-84 and 1987-88. Total receipts were projected to increase by 28% over the same period. In the current projections, the corresponding figures are for growth in GDP and receipts of 30½% But whilst most of the relative buoyancy in receipts is accounted for by higher GDP, a non-negligible part derives from their share having risen. This can be seen from the ratio of total receipts to GDP.

Ratio of Total Government Receipts to Money GDP: Per Cent

	1983-84	1984-85	1985-86	1986-87	1987-88
MTFS	42.3	42.2	41.8	42.1	41.9
Current Projection	42.3	42.7	42.4	42.3	42.3
Difference	-	0.5	0.6	0.2	0.4

9. Two features of this table stand out:

(a) by 1987-88 government receipts are projected to be some 0.4% points higher in relation to GDP than in the MTFS. About 1% of the rise in receipts is due purely to their share of money GDP having risen;

b) the difference between MTFS and current projections is greatest in 1984-85 and the next year. This largely reflects the upward revisions to expected North Sea revenue over that period.

10. General Government Expenditure. At this stage, the expenditure table is based on the October Forecast. The planning total, and hence total general government expenditure, will of course change as the PES procedures draw to a conclusion. Line (1) of the following table is thus the October Forecast planning total. Line (2) is the adjustment which is necessary given that the economic assumptions underlying the Autumn Statement projections differ from the October Forecast. In particular, the more rapid growth towards the end of the period causes a relative reduction in unemployment and thus a reduction in demand-led expenditures, and lower inflation also reduces the cash figures.

General Government Expenditure (£ billion)

	1983-84	1984-85	1985-86	1986-87	1987-88
October Forecast Planning Total	121	128	~~134~~ 133	139	145
Subsequent Changes, primarily due to Economic Assumptions	-	-	-½	-½	-1½
Public Corporations Transactions	-	-	1	½	-
Other National Accounts Adjustments	4	4½	5	5½	5½
Interest Payments	15	16	17	16½	16½
General Government Expenditure in NA Terms	139½	148½	155½	161	165½
Of which, Special Sales of Assets	1.0	2.3	2.5	2.0	2.0
MEMO: Planning Total underlying fiscal projections	121	128	132½ ~~133½~~	138½	143½

11. As compared to the MTFS, total expenditure shows a higher profile throughout. In national accounts terms, the rise is now approaching £1 billion in 1983-84, £2½ billion in 1984-85 and around £4 billion in later years:

a) In 1983-84 the upward revision reflects a classification change within "other National Accounts adjustments", which increases both expenditure and receipts by £½ billion with no effect on borrowing and a slightly higher outturn planning total.

b) In the later years the upward revision reflects higher debt interest payments of around £1 billion pa due to higher interest rates and higher borrowing in 1984-85, a higher planning total and the classification change mentioned above.

12. These upward revisions occur in spite of greater expected special sales of assets. As compared to the MTFS, special asset sales are now put some £300 million and £500 million higher in 1984-85 and 1985-86 respectively.

13. Public Borrowing. The table for public sector borrowing implied by the preceding projections emerges as here:

Public Sector Borrowing (£billion)

	1983-84	1984-85	1985-86	1986-87	1987-88
General Gvt. Expenditure	139½	148½	155½	161	165½
General Gvt. Receipts	129½	140	150½	160½	169
Fiscal Adjustment from previous year	-	-	-	3½	7½
Annual Fiscal Adjustment	-	-	3½	4	3½
CGBR	10	9	8½	8	7½
PSBR	9½	8½	7	7	7
As a Percentage of GDP	3.2	2.6	2.0	1.9	1.7
Money GDP, Market Prices	306	328	355	379	400

14. In general terms, the story is one of higher government receipts compared to those projected at the time of the MTFS partly -but only partly - offset by higher expected expenditures. The upward revisions to receipts reflect some revised judgements as well as upward revisions to the paths of prices and money GDP, and it is mainly for this reason that the net effect is an increase in the implied fiscal adjustment. By 1987-88 the cumulative fiscal adjustment is about £1 billion greater than that published in the MTFS:

Cumulative Fiscal Adjustment (£ billion)

	1985-86	1986-87	1987-88
MTFS	2	6½	10
Current Projections	3½	7½	11

15. Comparison with the October Forecast. Though the proposed projections are significantly different from those presented in the MTFS, on both sides of the account, there is little change from those implicit in the October Forecast. The table below shows the differences for the main elements of the borrowing table.

Proposed Fiscal Projections: Differences from October Forecast (£ billion)

	1985-86	1986-87	1987-88
General Government Expenditure	- 0.6	- 0.7	- 2.0
General Government Receipts	- 0.5	- 0.8	- 1.7
GGBR	-	- 0.4	- 0.1
PSBR	-	- 0.4	- 0.1
Implicit Cumulative Fiscal Adjustment	-	- 0.6	+ 0.2

16. Both general government receipts and general government expenditure are lower than in the October forecast but by broadly similar amounts.

In the case of receipts this stems from the lower relative inflation path causing reduced nominal incomes and thus lower tax receipts. This lower inflation path is also partly responsible for the reduced levels of public expenditure. But at least two other factors are also at work. First, as noted in paragraph 7 above, demand-led expenditures are attenuated by the more buoyant economy underlying the proposed projections compared to the Autumn Forecast. Second, there is also an effect from lower debt interest payments, given the lower inflation path and thus lower interest rates. This effect is quantitatively significant only in 1987-88, however. Given the PSBR path on which these projections are based, the implicit cumulative fiscal adjustment is the same as that in the Autumn Forecast for 1985-86. It is rather smaller - more than £½ billion -in 1986-87 but then marginally wider in the following year.

Ref: 108418

FISCAL PROJECTIONS TO 1987-88: VERSION A

1. The PSBR in 1983-84 was £9.7 billion*, as forecast in the Financial Statement and Budget Report. The EC rebate in respect of 1983 was not received during 1983-84, and this increased central government borrowing on own account. On the other hand public corporations' borrowing turned out a little lower than expected.

2. In the first six months of 1984-85, the PSBR was £7.2 billion, the same as the Budget forecast for the full year. It was always expected that the PSBR would be more than usually front-end loaded this year. Even so, there are reasons for expecting public borrowing this year to be above the Budget forecast, though lower than in 1983-84:

(i) Local authorities overspend on capital account in 1983-84 seems ~~likely~~ to be followed by further overspend in 1984-85.

(ii) Higher interest rates than expected at the time of the Budget have increased debt interest payments.

(iii) On the revenue side, however, extra receipts from North Sea oil are expected broadly to offset these two factors.

(iv) The miners' strike may add, over the year as a whole, getting on for £1½ billion to total borrowing.

3. As a result, the PSBR for 1984-85 as a whole is now projected some 1¼ billion higher, at [£8½] billion, than the Budget forecast. There is inevitably still a substantial margin of error surrounding this forecast (average errors in PSBR forecasts at this time of year exceed £2 billion).

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* New definition. On the old definition (including bank deposits) it was £10.0 billion.

4. For the next three financial years, the projections summarized in tables 1.7-1.9 assume further falls in the ratio of the PSBR to GDP. The projections after 1985-86 are illustrative. The assumptions underlying these projections are in line with those in the 1984 MTFS updated to take account of the new public expenditure plans described in Part 2 and the changed economic perspective outlined in the preceding sections of Part 1. As before, the PSBR is assumed to fall from 2 per cent of GDP in 1985-86 and 1986-87 to $1\frac{3}{4}$ per cent in 1987-88, equivalent in each year to about £7 billion. Real GDP (average measure) is projected to grow by [2 per cent] in 1984-85 and by [$3\frac{1}{4}$ per cent] in 1985-86: these estimates are affected by the miners' strike and the underlying increases are [3 per cent] and [$2\frac{1}{4}$ per cent]. GDP is assumed to grow by 2-$2\frac{1}{4}$ per cent after 1985-86, consistent with an average of $2\frac{1}{4}$% in the five years to 1988-89. Inflation, as measured by the GDP deflator, is put at $4\frac{3}{4}$ per cent in 1984-85 and $4\frac{1}{2}$ per cent in 1985-86. Thereafter the assumption is of a fall to $3\frac{1}{4}$ per cent in 1987-88. The effective exchange rate shows no major change from year to year.

<u>Public Expenditure</u>

5. General government expenditure in national accounts terms is forecast to rise, in cash, by around [$6\frac{1}{2}$] per cent in 1984-85 and [$4\frac{1}{2}$] per cent in 1985-86. The numbers are affected by the miners' strike: the underlying rates of increase are [$5\frac{1}{2}$] per cent for both years For 1986-87 and 1987-88, the corresponding growth rates are [$3\frac{1}{2}$] per cent and [$2\frac{3}{4}$] per cent respectively. Further details are given in Part 2.

Table 1.7 General Government Expenditure

£ billion, cash

	1983-84	1984-85	1985-86	1986-87	1987-88
General Government expenditure (1)	121	128	~~133½~~ 132½	138½	143½
National accounts adjustments (2)	4	4½	6	6	5½
Interest payments	15	16	17	16½	16½
Total expenditure in national account terms	139½	148½	155½	161	165½

(1) Expenditure on programmes by central government and local authorities plus the Reserve and special sales of assets, after making allowance for expected outturn.

(2) Adjustments to line 1 to the definitions used in National Accounts Statistics.

Revenue

6. ~~Revenue~~ estimates depend on incomes, spending and prices, as well as on policy decisions. Revenue is projected on conventional assumptions of revalorisation of the main direct tax allowances and thresholds, and of excise duties. For 1985-86 a figure of 4¾ per cent* is used for this adjustment. Estimates of oil revenues assume that North Sea oil prices do not change very much in sterling termsfrom the levels set [in early November]. National Insurance contribution rates are assumed to remain at the levels set out in Part 3.

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* Part 4 shows the direct revenue effects on an illustrative (and rounded) assumption of 5 per cent.

7. The revenue estimates are shown in table 1.8. On the above assumptions, general government receipts are projected to rise by about 31 per cent between 1983-84 and 1987-88, almost exactly in line with the rise in money GDP.

Table 1.8 General Government Receipts

£ billion, cash

	1983-84	1984-85	1985-86	1986-87	1987-88
Taxes on income, expenditure and capital	97½	105½	115	122½	129½
National Insurance and other contributions	21½	23	25	27	28½
Interest and other receipts	11½	10½	11	11½	12
Accruals adjustments	-½	1	-½	-½	-½
Total receipts	129½	140	150½	160½	169
of which North Sea tax revenues	9	12	12½	11	10

Borrowing

9. Table 1.9 provides projections of Government receipts, expenditure and borrowing. The estimates of the fiscal adjustment are extremely uncertain: they depend on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions. For the public sector as a whole, the flows on either side of the account approach £200 billion.

Table 1.9 Public Sector Borrowing*

£ billion

	1983-84	1984-85	1985-86	1986-87	1987-88
General Government expenditure	139½	148½	155½	161	165½
General Government receipts	129½	140	150½	160½	169
Fiscal adjustment from previous years	-	-	-	-3½	-7½
Annual fiscal adjustment	-	-	-3½	-4	-3½
General Government borrowing requirement	10	9	8½	8	7½
Public sector borrowing requirement	9½	8½	7	7	7
as percentage of GDP	3¼	2½	2	2	1¾
Money GDP at market prices	306	328	355	379	400

9. These projections are based mechanically on the policy assumptions - and in particular the PSBR path - set out in the MTFS. The implied fiscal adjustment in 1985-86 is put at [£3½billion], some [£1½billion] higher than in the MTFS. The fiscal adjustments in the succeeding two years are put at about [£4 billion], and the cumulative fiscal adjustment up to 1987-88 is much the same as in the MTFS.

10. Great caution is needed in interpreting these projections.

---

* Totals may not add due to rounding

Alternative 1: The figures should not be taken as an indication of possible changes in the 1985 Budget. As the MTFS noted, the appropriate path for the PSBR from year to year will depend upon several factors, including the cyclical position of the economy and the composition of public sector receipts and expenditure. It will be reviewed at Budget time.

Alternative 2: As the MTFS has emphasized, many factors bear on the appropriate path for the PSBR, not least the composition of public sector receipts and expenditure. As compared with the projections in the 1984 MTFS, both expenditure and revenues seem likely to be higher. In the case of revenue, this partly reflects higher North Sea oil revenues, as a result of higher sterling oil prices and production, especially in 1985-86 and 1986-87. Public sector asset sales are also expected to be higher in 1985-86 than in the MTFS. These factors suggest that, even on the assumptions here, the scope for tax reductions is likely to be less than the fiscal adjustments taken literally would indicate. These considerations will have to be weighed carefully nearer to the 1985 Budget.

Ref: 108429

VERSION B FISCAL PROJECTIONS TO 1987-88

SECRET AND PERSONAL

FISCAL PROJECTIONS TO 1987-88: VERSION B

1. The public expenditure plans to 1987-88, which are outlined in section 2, have been drawn up to be consistent with the government's declared objectives for expenditure, taxation and public borrowing. [These objectives were most recently set out in the 1984 Medium Term Financial Strategy and the Green Paper on Public Expenditure and Taxation into the 1990s.] Consideration of public expenditure alongside revenue is a key part of the process of fiscal planning. This section presents updated fiscal projections for the three year period covered by the expenditure plans.

Developments to the end of 1984-85 - as in Version A.

Assumptions

2. The assumptions underlying the projections are in line with those in the 1984 MTFS, updated to take into account the new public expenditure plans in part 2 and the economic forecast in part 1. As before, the PSBR is assumed to fall from 2% of GDP in 1985-86 and 1986-87 to $1\tfrac{3}{4}$% in 1987-88, equivalent in each year to about £7 billion. GDP is assumed to grow by 2-$2\tfrac{1}{4}$% after 1985-86, consistent with an average of $2\tfrac{1}{4}$% in the five years to 1988-89. Inflation, as measured by the GDP deflator, is assumed to fall from $4\tfrac{1}{2}$% in 1985-86 to $3\tfrac{1}{4}$% in 1987-88. The effective exchange rate shows no major change from year to year.

Public Expenditure

3. General government expenditure in national accounts terms is forecast to rise, in cash by [$4\tfrac{1}{2}$ per cent] in 1985-86. For 1986-87 and 1987-88, the corresponding growth rates are $3\tfrac{1}{2}$ per cent and $2\tfrac{3}{4}$ per cent respectively. Further details are given in Part 2.

Table [1.7] General Government Expenditure*

Revenue

4. Revenue estimates depend on incomes, spending and prices, as well as on policy decisions. Revenue is projected on conventional assumptions of revalorisation of the main direct tax allowances and thresholds, and of excise duties. Estimates of oil revenues assume that North Sea oil prices do not change very much in sterling terms from levels set [ational insurance the beginning of November]. National insurance contributions are assumed to remain at the levels set out in part 3.

5. The revenue estimates are shown in table [1.8]. On the above assumptions, general government receipts are projected to rise by about 31% between 1983-84 and 1987-88, almost exactly in line with the rise in money GDP.

Table [1.8] General Government Receipts*

Borrowing

6. Table [1.9] provides projections of Government receipts, expenditure and borrowing. [The estimates of the fiscal adjustment are extremely uncertain. They depend on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions. For the public sector as a whole, the flows on either side of the account approach £200 billion.]

Table 1.9 Public Sector Borrowing*

Conclusion

7. These projections are based mechanically on the policy assumptions - and in particular the PSBR path - set out in the 1984 MTFS. The implied fiscal adjustment in 1985-86 is put at [£3½ billion], some [£1½ billion]

higher than in the MTFS. The fiscal adjustments in the succeeding two years are put at about [£4 billion], and the cumulative fiscal adjustment up to 1987-88 is much the same as in the MTFS.

8. Great caution is needed in interpreting these projections.

<u>Alternative 1:</u> The figures should not be taken as a firm indication of possible changes in the 1985 Budget. As the 1984 MTFS noted, the appropriate path for the PSBR from year to year depends upon several factors, including the cyclical position of the economy and the composition of public sector receipts and expenditure. It will be reviewed at Budget time.

<u>Alternative 2:</u> As the MTFS has emphasized, many factors bear on the appropriate path for the PSBR, not least the composition of public sector receipts and expenditure. As compared with the projections in the 1984 MTFS, both expenditure and revenues seem likely to be higher. In the case of revenue, this partly reflects higher North Sea oil revenues, as a result of higher sterling oil prices and production, especially in 1985-86 and 1986-87. Public sector asset sales are also expected to be higher in 1985-86 than in the MTFS. These factors suggest that, even on the assumptions here, the scope for tax reductions is likely to be less than the fiscal adjustments taken literally would indicate. These considerations will have to be weighed carefully at Budget time.

Ref: 108428

b/f 31/10

SECRET and PERSONAL

FROM: T BURNS

DATE: 25 October 1984

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State

Sir P Middleton

PCC
Mr Evans
Mr Odling-Smee

Mr Ridley
Mr Lord
Mr Portillo

This version has only some small changes from the earlier one, which was not circulated.

(Sir PEM votes for a fiscal adjustment of 1 Sir TB is still on 1½)

Thanks. What is the deadline for decision between these two options?

Not until the week after next. But T.B. suggests a meeting towards the end of next week. OK?

OK

OCTOBER 1984 TREASURY ECONOMIC FORECAST

I attach my note on the foreecast.

T BURNS

Sir PEM suggests we may need a general wrap up meeting on AS, including this.

BURNS → Ch/Ex 25/10

OCTOBER 1984 TREASURY ECONOMIC FORECAST

You have seen the October forecast. The main elements show little difference between this and the forecast we published in the FSBR. The projected growth of GDP over the forecast period is virtually the same as presented at Budget time after allowing for the miners strike effects. Inflation is projected to be a little higher (but less than 1/2 per cent) despite the exchange rate being about 5 per cent less than expected. The picture for monetary growth is if anything a little better than expected at the time of the Budget -partly of course because interest rates are higher. The PSBR for this year looks like being a bit worse but the fiscal adjustment is much the same or better for 1985/86 if we can get somewhere near our public expenditure targets.

2. The main differences, which are mainly for the worse, are that the forecast now shows a lower exchange rate profile; higher interest rates throughout by between 1 1/2 and 2 per cent; and a higher level of unemployment (about 200,000 by 1986). On the other hand the company sector's cash flow position seems even stronger than expected despite the very sharp upturn in fixed investment.

World Outlook

3. The problem of interpreting US developments dominates the world outlook discussion and poses significant policy problems at home. The continuation of high US interest rates, a rising dollar and a deteriorating US trade position looks unsustainable but the timing and nature of its resolution is highly uncertain. From our point of view the best outcome is a deliberate attempt by the US authorities to reduce their deficit, slower domestic demand growth and continuing output growth at 2-3 per cent per annum, a falling dollar and lower US interest rates. Slower US demand growth may weaken our exports but lower real interest rates and more bouyant domestic demand growth in Europe would be even more welcome.

4. The forecast shows a limited move in this direction. But there are considerable uncertainties. There may be no great pressures on a re-elected Administration to change behaviour quickly and there may be no response until something unpleasant occurs - for example a falling dollar, rising inflation or faltering growth. Then there is the danger of over reaction with a sharp US downturn before Europe has a time to respond to the opportunity of lower interest rates.

5. There have been signs of demand weakness this Summer, not only in the UK but elsewhere. This may be related to the upward pressure on US interest rates in the first half of 1984 but might also be due to the influence of strikes in Germany and the UK combined with some falls in the growth of consumer spending in the US. There are no clear reasons why - outside the US - this demand weakness should continue and I remain reasonably optimistic about world growth in 1985.

The UK Outlook

6. But the UK is now entering what is often a difficult leg of the cycle. We are now well into the stage when we expect progress on unemployment. Maybe the forecast is too cautious. Underlying inflation could continue to fall against a background of weak world prices. And some combination of continued world trade growth and lower interest rates might mean output growing at 3 per cent or so underlying. But the labour cost background is less reassuring; and the possibility of the combination of tight fiscal policy at home; continued high real interest rates and a sluggish European demand growth means that we should remain cautious. If developments turned out to be as suggested in the forecast there might be reasonable satisfaction apart from the level of unemployment. Progress here probably requires faster growth than suggested in the forecast.

7. There are a number of problems that are thrown up by this forecast. The PCC discussion concentrated on the policy mix; the continuing poor adjustment of the UK labour market; and the problem of meeting the public expenditure planning totals and the prospects for the fiscal adjustment. In discussing these problems we need to remember that the forecast assumes the miners' strike will be over by Christmas. The longer it goes on, the more difficult it becomes to see the underlying trends; and forecasts which assume any early end come to seem less relevant. Clearly -even if the broad thrust of the forecast is right - there could be some nasty bumps before we get back onto that path.

The Mix of Monetary and Fiscal Policy

8. The unexpected and continuing high level of interest rates is disturbing. The growth of the main monetary aggregates is, as we expected at the time of the budget, close to or within target. The fiscal deficit is not too far from the intended path. And yet we are faced with the prospect of continuing high real interest rates. Of course this cannot be divorced from

Exchange rate?

the impact of the coal dispute. This combined with earlier worries about monetary control put some pressure on interest rates. But a large part of the interest rate problem is the impact of high world real interest rates and the strength of the dollar. It can be argued that because of the conduct of US policy we are not getting the full relief on interest rates that might have been expected from fiscal virtue. The same point can be made about Europe as a whole where determined efforts have been made to reduce budget deficits. The danger is that the overall growth of nominal demand might turnout to be less than intended in the MTFS. And as I argue later there is a case to be made that we have understated the growth of potential GDP.

9. One possible response is to continue to try to reduce interest rates at home despite world interest rate levels. This might create pressure for a lower exchange rate although that risk would be less if Europe as a whole were to adopt a similar approach. The integration of world capital markets limits the potential degree of de-coupling of interest rates other than to the extent that exchange rate and inflationary expectat\ions differ. But if it was not for the miner's strike there might be some room for a more aggressive attempt to get interest rates down despite the level of world rates.

10. The alternative approach is to accept that there are limits to the extent to which real interest rates in the UK can differ from those of the US and that this limits the extent to which it is appropriate to continue to press down on the PSBR. But there are clear dangers with this approach. Interest rates may turn out to be even higher than we now face. And it is much easier to take expenditure or tax action to ease the fiscal stance, than it is to reverse it if the circumstances change. This is the case for a medium term approach to fiscal policy. But it does suggest that there may be less urgency in getting the PSBR down to 2 per cent of GDP than we had previously judged. Against that, however, higher asset sales and higher oil revenues (despite the last few days' events) are not a fully sustainable way of lowering the PSBR and/or reducing taxation.

Labour Market Adjustment

11. Labour market behaviour continues to be disappointing. In the past year there has been no further fall in the level of pay settlements. Real earnings have risen by almost 3 per cent a year for the past two years and the signs are that the current pay round is turning out much the same. In part this

is probably because inflation has consistently turned out to be below inflationary expectations; in part it probably reflects the impact from higher levels of productivity.

12. Employers appear to have used a weakening of trade union power to change working practices rather than to put pressure on (real) pay settlements. Having been through the difficult procedure of labour shedding employers have chosen to be reasonably generous with pay. The increased employment opportunities in the service sector have been met largely by part time women. Some of this is a reversal of the withdrawal of women from the labour market during the recession.

13. It is possible that as the scope for improving productivity is diminished there may be more downward pressure on pay settlements. But there are no signs of it yet. The mood among many employers and unions seems to be that there are pressures for "catching-up", particularly from those who have had below average increases in recent years. And I am not persuaded that there is much to be gained from further banging the wage moderation drum.

14. In the light of developments in the past two years it seems unlikely that there will be sufficient labour market adjustment in the period covered by the forecast to bring unemployment down sharply without a rather faster growth of output than we are currently expecting. This emphasises the approach of making changes that will improve the functioning of the labour market, even though any impact will be gradual. I was struck by the number of people in the US who gave some credit for their slow growth of labour costs to the scale of the de-regulation of product markets.

15. The US achievement has been to get large numbers of people into employment, partly by keeping down the growth of real wages. There has been a rapid increase in output with little pressures for higher inflation or for labour costs to increase at a faster pace. Although there has been considerable leakage of US demand into higher imports and lower exports the division of nominal GDP growth of almost 12 per cent per annum (first half of 1984 over first half of 1983) between almost 8 per cent output growth and 4 per cent inflation has been very impressive.

16. It has been argued that the rapid growth of UK productivity and increased labour supply (through a higher female participation rate) are evidence of this faster growth potential. Certainly CBI indicators of skilled labour vacancies show no problems. If we were persuaded by this assessment one possible conclusion would be that we should take it into account when designing the nominal framework. The path of nominal GDP growth from now on should be revised up a little in response to the apparently faster growth of productive potential experienced in recent years.

17. The doubts about such an approach centre upon the risk to inflation. A falling exchange rate and an easing of pressures on margins could undo the disinflationary pressure. And the failure of wages to adjust so far suggests that there would be a danger of acceleration if domestic demand were to grow much faster. But this is an option that we will need to examine to judge the scale of the risks as we look at the budget arithmetic.

Public Expenditure

18. Although the forecast assumes less than full success on the expenditure side relative to the MTFS there still appears to be scope for a fiscal adjustment in the Budget. This is largely due to a restraint on expenditure and a projection of higher oil revenue because of both a higher volume of output and higher sterling oil prices.

19. If we did stick to the existing expenditure plans it would mean a significant cost terms reduction, only some of which would be due to the miners strike. The PCC view clearly was that it is important that we end up with a realistic planning total that can be held and not divorce the decision making process from reality. If it is not possible to get the decisions that are necessary to deliver the objectives, we should settle for publishing a higher figure and not engage in too much fudging.

20. There are many risks associated with the forecast of the fiscal adjustment, particularly on the oil revenue side. We will have further information before we publish, that may cause us to revise our best estimates. It would be tempting fate to publish a figure of £3 billion as a central estimate of the fiscal adjustment: the bulk of outside opinion seems to expect us to adopt a cautious approach at this stage in the year. Depending on the

outcome of the public expenditure discussion I would be happier to see a published figure of about half this amount with some contingency margin built into the forecast for eg oil revenues.

~~950 b/f Oct + 8½ wks @ 750m a wk = 425 = total 1375~~

SECRET AND PERSONAL

FROM: HUW EVANS

26 October 1984

CHANCELLOR

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Cassell
Mr Kemp
Mr Monck
Mr Battishill
Mr Burgner
Mr Lankester
Mr Lavelle
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Folger
Mr Mowl
Miss Peirson
Mr Riley
Mr Robson
Ms Seammen
Mr Horton
Mr Ridley
Mr Lord
Mr Portillo

See comments passim. N.

P.S. There will be considerable advance comment on X, which I find somewhat surprising myself. (See also 1.39) N.

AUTUMN STATEMENT, PART 1: THE ECONOMIC FORECAST

EVANS → Ch/Ex 26/10

I attach a draft of part 1, on economic prospects for 1985. We have taken into account the changes in economic assumptions (notably on inflation) recently agreed; otherwise the numbers and text are consistent with the forecast report circulated on October 12. We have not yet updated the forecast for the latest developments in the economy or for subsequent policy decisions.

2. Some of the more important numbers eg the PSBR this year and the fiscal adjustment next year depend on decisions yet to be taken on public expenditure and on assumptions (eg on oil prices and exchange rates) yet to be finalised. But unless there are major departures from what has been assumed, most of the text and tables should not be subject to major change. Some of the less sensitive sections - trade, and domestic activity in particular - we propose to discuss with the CSO and DTI.

3. It would be very helpful to have general reactions to the text, tables and charts, so that we could get this section to the printers next week. It is difficult to make last-minute changes to the charts (we are checking them particularly carefully this year): they cover the past only and so are not sensitive to changes in the forecast. I have not included at this stage the large table (table 1.11 in last year's Autumn Statement): it contains few numbers of interest that are not in the main text and tables. Fiscal projections to 1987-88, to be considered for possible inclusion in the Autumn Statement, will be sent to you separately by Mr Riley.

4. In general, the coverage of the forecast in the draft is much as in last year's Autumn Statement. The details of the forecast were set out in my October 12 report. I draw attention to the following areas:

i) The miners' dispute

The forecast is based on, and must make explicit, an assumption about when it ends. An assumption on the terms of the settlement is implicit in the forecast but need not be spelt out. The main quantitative references to the dispute in the draft are as follows: the duration of

Summary, paragraph 1.02: "It is necessary, for the purposes of this forecast, to make an assumption about the miners' dispute: it is assumed to be over by the end of the year".

Summary, paragraph 1.04: "... 1 per cent [growth in 1985] represents, by assumption, recovery from the miners' dispute".

Balance of payments, pararaph 1.17: "By comparison with the Budget forecast the miners' dispute is worsening this year's oil balance by some £2 billion...".

Demand and activity, paragraph 1.32: "The miners' dispute is estimated to be reducing the level of total output in the economy by rather over 1 per cent".

Table 1.5: shows the growth in GDP in 1984 and 1985 including and excluding the effects of the miners' dispute.

(2 weeks) £8

We cannot have £1bn as the bottom of the range, since we are going to see that it is £1bn by end-October. Nor can we have such a large range when there are only two months to go (a £½ billion range over 2 months is a range of 750m a wk!)

£1¼-1½ (or "getting on for £1½bn")

Fiscal projections, paragraph 1.52: "the miners' dispute may add over the year as a whole some £[1-1½] billion to total borrowing". No estimate is given of the forecast effect on 1985-86.

ii) Fiscal projections

On the the current financial year, there will be a little more information (especially the October CGBR) before final decisions are needed, though if your speech next Tuesday referred (as in a recent draft) to latest estimates for the current year "perhaps in the range £8-8½ billion" this would close some options. 1985-86 is more difficult. A certain caution about the size of the prospective tax cut in 1985-86 is understandable. But the arithmetic we have done since our October 12 reports does not, despite what is happening to oil prices, suggest a smaller fiscal adjustment. Indeed, success on the public expenditure front in getting closer to the 1985-86 target - helped by the changes in economic assumptions - could imply a larger fiscal adjustment. Given that Part 1 of the Autumn Statement cannot take a different (ie higher) view of public expenditure from the plans in Part 2, a low fiscal adjustment in 1985-86 could imply an implausibly low revenue forecast (precisely the position that the LBS forecast coming out on Monday finds itself in). There is a good case for looking at revised estimates for 1985-86, in the light of public expenditure discussions, before coming to a view on what to publish for the fiscal adjustment. The figures in tables 1.7-1.9 should be regarded as illustrative, particularly for 1985-86.

iii) Employment and unemployment

The main references in the text are in the summary, paragraph 1.04: "The rise in employment, over 1 per cent in the year to mid 1984, is expected to continue" and paragraphs 1.45 to 1.48 in the section on productivity and the labour market. The implication of paragraph 1.48, broadly consistent with the flat assumption chosen for public expenditure purposes, is that no great change in unemployment is likely over the forecast period, with both employment and the labour force rising at unspecified rates.

iv) Exchange rate.

The usual formula is to make an assumption of no change, because of the difficulties (for both policy and forecasting) of being seen to make a forecast. But the assumed ending of the miners' strike provides one reason for expecting - as in the forecast - the rate to recover: were we to assume a rate constant at recent levels of 74-75, the inflation forecast would edge up or lose some credibility. We propose therefore, paragraph 1.14, to say that "the assumption on sterling is that the level in 1985 will not be very different from the average of the period July-October 1984". The average level July-October was $77\frac{1}{2}$, thus implying - but not spelling out - that the forecast implies a rise, without specifying precisely how much.

v) Current account

Before we saw the September trade figures our forecast for the current account in 1984 as a whole was £$1\frac{1}{4}$ billion. Now that the cumulative deficit to end September is put at £-$\frac{1}{2}$ billion, that judgment looks a little optimistic. Nevertheless for reasons spelt out in paragraph 1.24 we expect the outturn to be better than the indications so far. This time last year we published a forecast for 1983 of a £$\frac{1}{2}$ billion surplus: the outturn is now estimated at a £3 billion surplus. There was a similar story in 1982. We will consider this further over the next week or so.

? £1 bn

HPE

H P EVANS

ENC

SECRET AND PERSONAL

SUMMARY

1.01 1984 looks like being the best year since 1976 for growth in world output and trade. Price rises, particularly in commodities but also in industrial products, are low. Next year will see slower growth in the United States, only partly offset by somewhat faster growth in parts of Europe. With world interest rates likely to remain high in real terms, and with major debt problems easing only very slowly, many developing countries will have to make further internal adjustments.

(the duration of

1.02 It is necessary, for the purposes of this forecast, to make an assumption about the miners' dispute: it is assumed to be over by the end of the year. The forecast is based on the usual assumption that fiscal and monetary policies in 1985-86 will be as indicated in 1984 Medium Term Financial Strategy.

1.03 In the first half of 1984 total output in the UK was over 3 per cent up on a year earlier despite the losses caused by the miners' strike. With rising real incomes benefiting both the personal and company sectors, and with companies having successfully restored their financial positions, domestic demand should grow substantially again in 1985. With further growth in prospect for UK markets overseas, exports should record another rise.

1.04 Total output in the UK is forecast to rise by $3\frac{1}{2}$ per cent in 1985 (of which 1 per cent represents~~, by assumption,~~ recovery from the miners' strike). The rise in employment, over 1 per cent in the year to mid 1984, is expected to continue.

1.05 Price rises and wage settlements have been fairly steady since early 1983. Inflation this year has been much as expected in the Budget forecast despite a lower exchange rate. Although no major change is foreseen for 1985, there may be a gradual decline in inflation.

DRAFT OF PCI.

1.06 Britain's external accounts were in substantial surplus in the period 1980-83, contributing to the rapid build up of overseas assets. In 1984 extra oil imports have led to a position of near balance so far; with the ending of the miners' strike, a return to surplus is forecast. North Sea oil production in 1985 may be close to its maximum.

1.07 For the 1984-85 financial year as a whole, the extra costs of the miners' dispute, and higher expenditure elsewhere, may more than offset higher oil revenues. Although the outturn is still very uncertain, the result is forecast to be a PSBR somewhat above the Budget forecast, but below the outturn for 1983-84. For next year, 1985-86, latest forecasts suggest that there would probably be scope for tax cuts if the PSBR was to be £7 billion, or 2 per cent of GDP, as assumed in the last MTFS.

THE WORLD ECONOMY

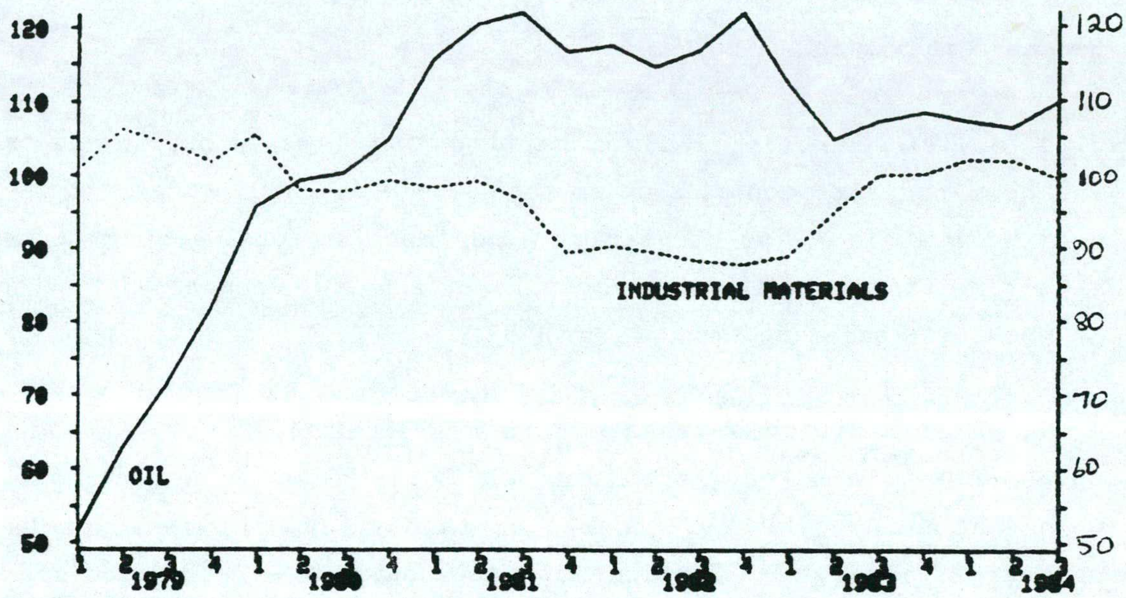
Recent developments

1.08 1984 is likely to show a rapid growth in world output and trade. GNP in the major six economies other than the UK is likely to grow by about 5 per cent with an increase of nearly 10 per cent in total world imports. At the same time, inflationary pressures have been low: consumer prices are rising at about $4\frac{1}{2}$ per cent, much as in 1983.

1.09 These developments have been heavily influenced by movements in the US economy. This year, total output in the US may be 7 per cent or more by volume above 1983 levels, domestic demand 9 per cent up and total imports up over 25 per cent. Coupled with the continued large budget deficit in the US, the expansion has contributed to the general rise in the level of world interest rates, a major factor offsetting the effect of the growth in US imports on activity in Europe and many developing countries.

1.10 Commodity prices picked up sharply in the course of 1983 as expectations of recovery were finally confirmed, but more recently spot prices have fallen back some way: perhaps because many producers are under financial pressures to maximise revenues and output, and because in the industrial countries restocking has been modest. Oil prices, set in terms of the strengthening dollar, rose 5 per cent in real terms between mid 1983 and late 1984, but the resulting imbalance in the market compounded by higher production and weak demand may now be bringing about some adjustment. Chart 1.1 shows commodity prices, for oil and industrial materials, expressed in real terms.

CHART 1.1 COMMODITY PRICES*, 1980 = 100



*in relation to prices of manufactured exports

Prospects

1.11 The US economy seems set for slower growth, already foreshadowed in the leading indicators. As the economy gets nearer to full employment and high rates of capacity utilisation, slower growth is likely, particularly in interest-sensitive areas of domestic demand such as stockbuilding, housing investment and consumer durables. Assuming only slow progress in reducing the fiscal deficit, and a slow pick up in inflation, we expect US interest rates to stay high next year. We have assumed that US residents and foreigners continue to fund the deficits, without any major break in confidence. Although the US policy imbalance ~~if~~ is not sustainable indefinitely, its resolution could well take several years.

1.12 In Europe the recovery has not yet gone very far and a growth rate of 3 per cent or so could well be sustained in 1985. In the developing countries, faced with the prospect of continuing high interest rates, a strong dollar and weak terms of trade, growth of domestic demand and imports may again be subdued, with major adjustment problems remaining; and OPEC markets are also liable to be weak.

1.13 Overall, the slowdown in the US will probably not be fully offset by higher growth elsewhere and the fall in unemployment over the past year may not be repeated. Nevertheless 1985 could well be another year of reasonable growth and low inflation:

Table 1.1 World economy

percentage changes on a year earlier

	1983	1984	1985
World GNP*	2½	5	3½
Consumer prices*	4½	4½	4
World trade in manufactures (UK-weighted)	1½	7	4½

*Major 6: US, Canada, Japan, France, Germany, Italy

THE EXCHANGE RATE AND THE BALANCE OF PAYMENTS

1.14 The budget forecast assumed that the sterling index would be close to its average level last year of 83. In the event, the effective exchange rate has been weaker than this, perhaps partly because of the unexpected strength of the dollar, and partly because of industrial disputes and more recently weaknesses in oil prices (see chart 1.2). The assumption on sterling for this forecast is that the level in 1985 will not be very different from the average of the period July-October 1984 [when it was $77\frac{1}{2}$].

CHART 1.2

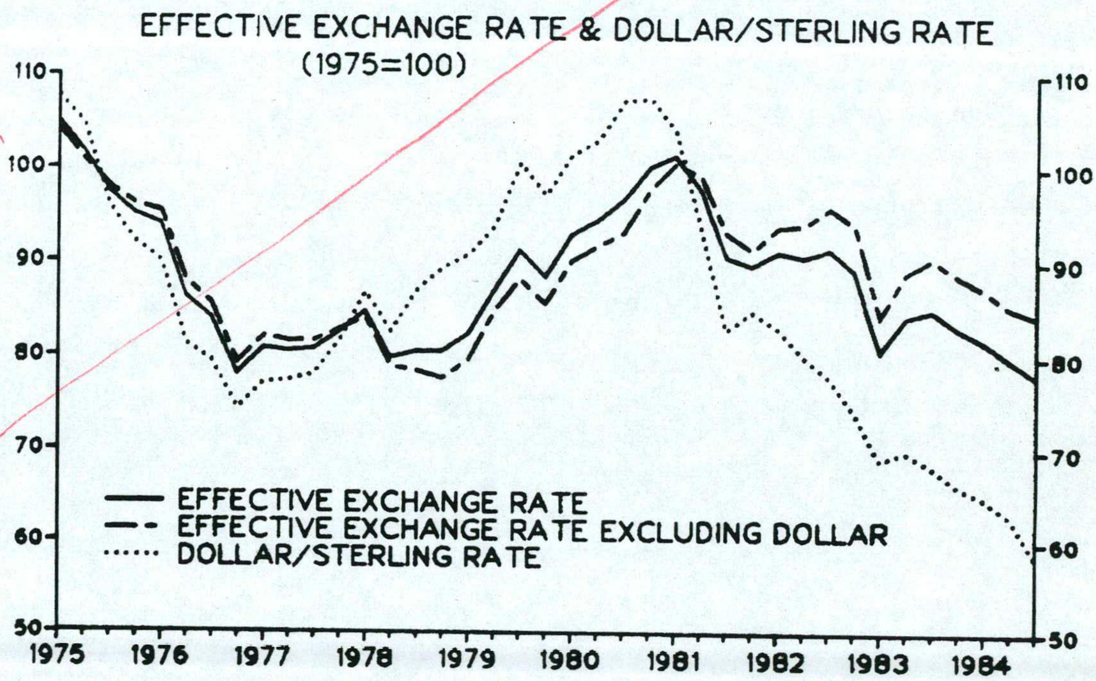


Chart appears to end @ Q2 1984: should get Q3 1984 or even Oct 1984 (88…

1.15 With UK unit labour costs in manufacturing expected to continue to grow a little faster than the average of our major competitors there may not be any further gains in cost (and price) competitiveness in 1985. After reaching 10 per cent this year import price inflation is likely to fall, perhaps to an annual rate of some 5 per cent for manufacturing in the year to 1985 Q4, broadly in line with world inflation.

1.16 This slowdown in import price inflation, on the assumption of stability in the sterling index, plays a role in keeping domestic inflation low over the next year, and in maintaining the terms of trade close to current levels.

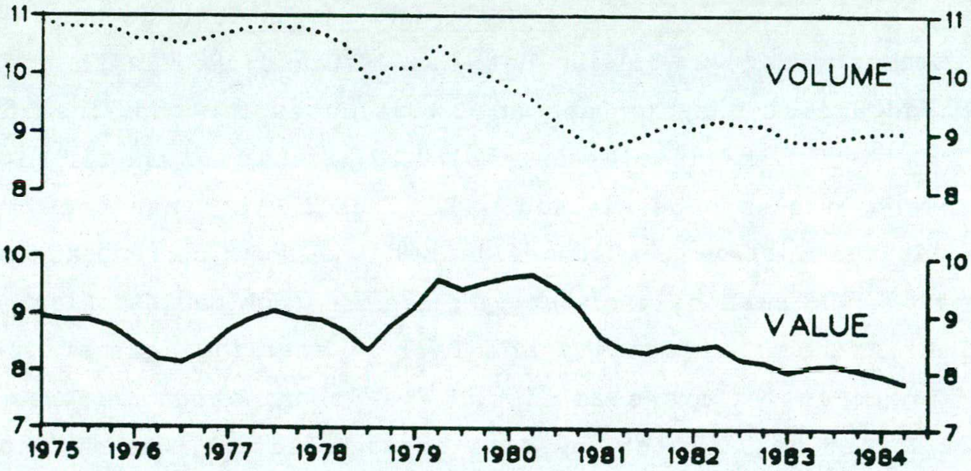
1.17 Despite the effect of the miners' strike in raising oil importsthis year, the outturn for the balance of trade in oil is likely to exceed last year's surplus of £7 billion. By comparison with the Budget forecast,the miners' strike is worsening this year's oil balance by some £2 billion, but this is being roughly offset by a higher level of sterling oil prices and a higher level of North Sea oil production.

1.18 Trade statistics have been distorted by the dock strikes but the underlying trends have shown a slower growth in volumes of both exports and imports than at the turn of the year. Nonetheless it is likely that the volume of exports of goods will be 7 per cent higher this year than in 1983, the best performance since 1977. Imports, above all of manufactures, have also been growing strongly this year as a result of the continuing recovery in domestic demand.

1.19 Chart 1.3 shows the trends in UK manufacturing exports as a share of main manufacturing countries' trade measured in both value and volume terms.

CHART 1.3

SHARE OF U.K EXPORTS IN MAIN MANUFACTURING COUNTRIES EXPORTS OF MANUFACTURES
(PERCENT, THREE QUARTER MOVING A VERAGE)



1.20 In the absence of major changes in cost competitiveness or other aspects of trade performance, prospects for growth of UK exports will depend mainly on expansion of UK markets. With world trade in manufactures forecast to rise by 4-5 per cent next year, exports might well grow by 3-4 per cent in volume terms in 1985. This would be consistent with recent survey evidence from the CBI, showing small positive balances on the exports optimism indicator, and a fairly stable position on export order books.

1.21 Increases in import penetration in manufactures in both volume and value terms have been broadly offset, for the economy as a whole, by falls in imports as North Sea production has risen. These trends are expected to continue next year, as domestic demand for manufactures - noticeably more cyclical than total domestic demand - continues to grow strongly. Imports of goods other than oil could rise 7½ per cent in 1985, much the same as in 1984. With oil imports assumed to fall after the end of the miners' dispute, total imports of goods may rise 4½ per cent.

1.22 The balance on <u>services,</u> as a percentage of GDP,reached a low point in 1982, as the effects of the loss of competitiveness were felt, and the decline in the UK merchant fleet reduced the balance on sea transport by nearly £1 billion between 1980 and 1983. Some of this loss of competitiveness has now been regained and the balance has started to recover: with a slower decline in the UK fleet and a fairly buoyant world economy, we expect a continued improvement in the services balance next year.

1.23 The balance on <u>interest,profits and dividends</u> (IPD) has risen from zero to an estimated £1½-2 billion between 1980 and 1983, with the build up of the UK's net asset position abroad. (Estimates for the first half of 1984, which put the IPD balance at only £1.2 billion at an annual rate, are provisional and liable to be revised up). This in turn has been made possible by the capital outflows, which reflected the large current account surpluses of the 1980-1983 period, assisted by rises in stock market prices and currency revaluations, and especially the fall in sterling against the dollar (in which 50 per cent of overseas assets are denominated). If, as is assumed, the fall in the dollar/sterling rate comes to an end, the ratio of net assets to GDP may grow more slowly. But the assets will continue to provide a stream of income in future years, when North Sea oil production may be lower than at present.

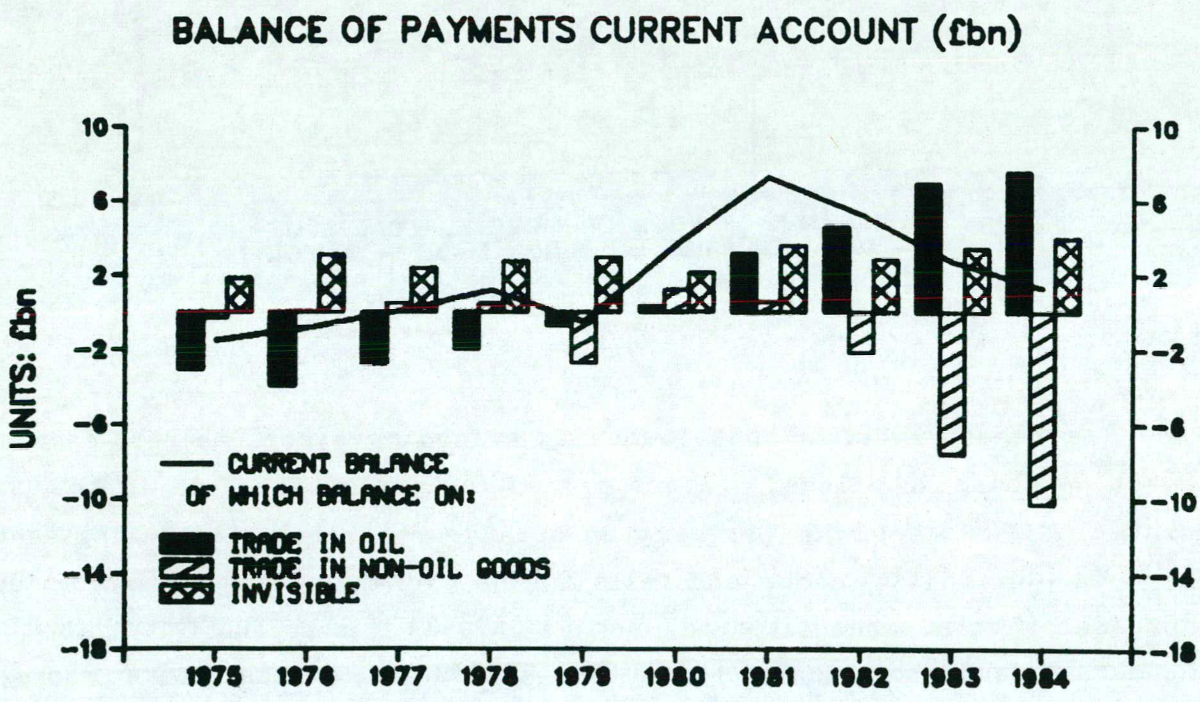
Table 1.2

Net UK External Assets, end year

	£ billion	per cent of GDP
1979	15	$7\frac{1}{2}$
1983	56	$18\frac{1}{2}$
1984 (estimate)	70	21

1.24 Our estimate of a current account surplus of £[1] billion in 1984 compares with a CSO estimate of a deficit of £$\frac{1}{2}$ billion for the first nine months. We have allowed for: the receipt of EC funds and a rise in exports in the fourth quarter; and a better outcome on invisibles than indicated by recent data and CSO projections. An improvement in the surplus forecast for the current account in 1985 reflects in particular lower oil imports after the assumed ending of the miners' strike, low commodity prices, and a rising surplus on invisibles. The sectoral composition of the current account in recent years has been as follows:

CHART 1.4

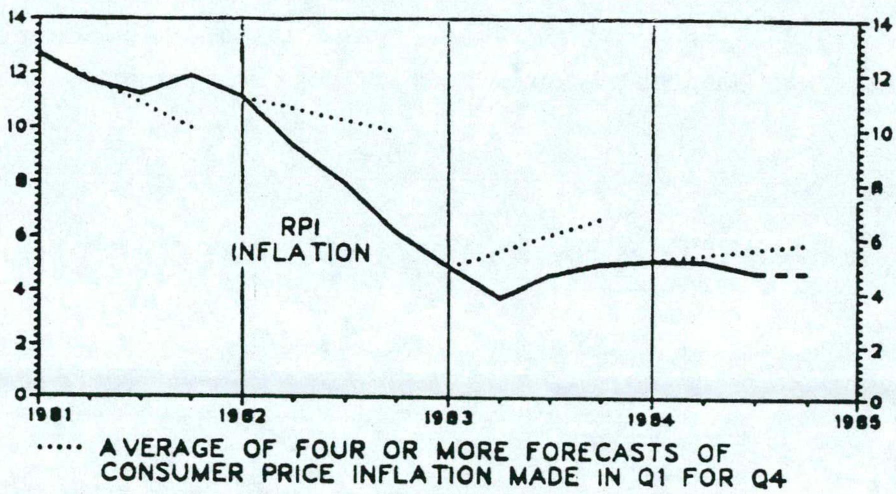


INFLATION

1.25 Inflation abroad has been generally low. In the UK,inflationary pressures have remained very moderate, despite further falls in the exchange rate. The higher inflation rate indicated by the RPI in the second half of 1983 and early 1984 is, as expected, proving temporary. As measured by the GDP deflator at market prices, inflation has fallen from 10 per cent in 1981 to 5 per cent in 1983 and to about [4½] per cent in the first half of 1984.

1.25 The general tendency among forecasters to overestimate price rises can be seen in the chart below (the dotted lines show outside forecasts, made early in the year, of inflation at the end of the year):

CHART 1.5 ERRORS IN PRICE FORECASTS



Costs

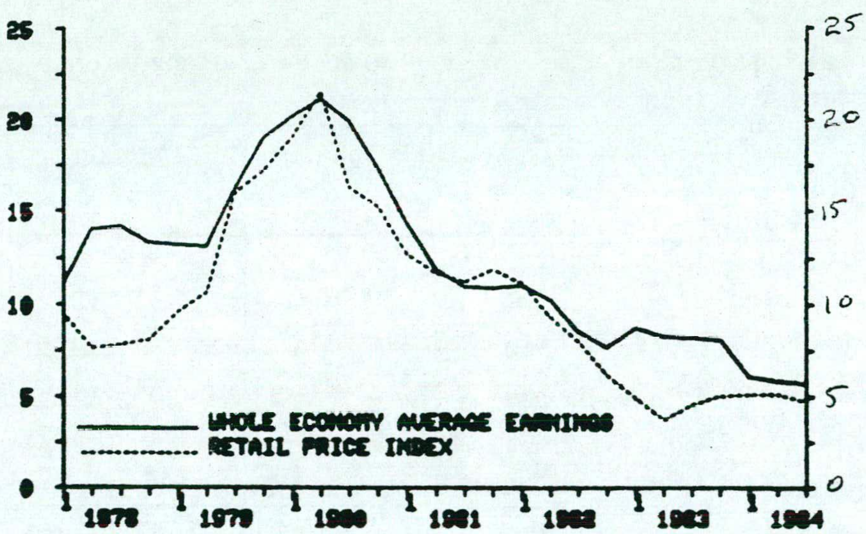
1.26 The recent falls in spot commodity prices have not, as yet, made much impact on domestic prices. Import prices for basic materials in the third quarter of 1984 were 15 per cent up on a year earlier, reflecting earlier rises in commodity prices and falls in the exchange rate. Domestic cost increases have not benefited as much as in 1983 from productivity gains, but the cuts in and abolition of the National Insurance Surcharge are helping to limit cost increases this year. Unit labour costs in the first half of 1984 were 4 per cent higher than a year earlier. Despite a 10 per cent rise in the prices of imported manufactures in the course of 1984, competitive pressures helped to limit the rise in prices at the wholesale stage (excluding food, drink and tobacco) to around $5\frac{1}{2}$ per cent, much as in 1983 and close to the rise in costs.

Pay

1.27 Pay settlements in the 1983-84 pay round were generally around $5\frac{1}{2}$ per cent, very similar to those in the 1982-83 pay round. Earnings in the economy as a whole have been reduced by the miners' strike and by delays in some public sector settlements. The underlying rate of increase, about $7\frac{1}{2}$ per cent, reflects, in addition to nationally negotiated wage settlements: productivity deals, bonus payments, changes in hours worked, and compositional changes.

1.28 With earnings rises, on an underlying basis, well above price rises, real earnings for those in employment have been on an increasing trend since mid 1982, as shown in chart 1.6

CHART 1.6 **EARNINGS AND PRICES**
PERCENTAGE CHANGES ON A YEAR EARLIER



Text talks abt underlying earnings, however, graph does not. Shd it not? (relevant to 1984)

Prospects

1.29 While no major change in the rate of price inflation is expected in 1985, there may be some gradual decline, in the absence of the fall in the exchange rate and as the effects of recent falls in commodity prices come through. In a generally weak labour market, there have been substantial rises in real take-home pay over the past two years; and further increases in real take home pay would be consistent with a flat or slowly falling trend in wage settlements. Labour costs, taking account of the abolition of the NIS from October 1984, may rise by about 4 per cent in 1985.

1.30 The recovery in domestic demand and output since 1981 has been reflected in, and encouraged by, a recovery in profit margins on home sales. With sterling assumed to be steadier, costs and domestic prices may move more nearly in line in 1985.

1.31 The annual increase in the RPI may stay near to its present level of 4¾ per cent through the first half of 1985 before falling in the fourth quarter. The housing component is strongly affected by changes in the mortgage interest rate: by the fourth quarter of 1985, the annual increase in the RPI will no longer be influenced by the sharp rise in mortgage rates in the summer of 1984. Table 1.3 shows changes in the main components of the RPI. Wholesale price inflation should also decline slowly in the course of 1985.

Table 1.3 Retail Prices — Per cent changes on a year earlier

	Weight	1983 Q4	1984 Q4 Forecast*	1985 Q4 Forecast
Food	20	6	3 (3)	4½
Nationalised industries**	10	1½	3½ (3½)	5
Housing	14	6½	10½ (7)	4
Other	56	5	4 (4½)	4½
Total	100	5	4¾ (4½)	4½

* 1984 FSBR forecast in parenthesis

** Includes BT and London Transport; excludes water

Will be affected by outcome of current PESC round

SECRET AND PERSONAL

DEMAND AND ACTIVITY

1.32 Activity rose by over 3 per cent in 1983. In the first half of 1984, the average measure of GDP again showed a rise of over 3 per cent on a year earlier; had it not been for the miners' strike, the increase would have been about 4 per cent. Since the early part of the year, there is evidence from both goods and labour markets of a somewhat slower rate of growth in activity. The miners' strike is estimated to be reducing the level of total output in the economy by rather over 1 per cent.

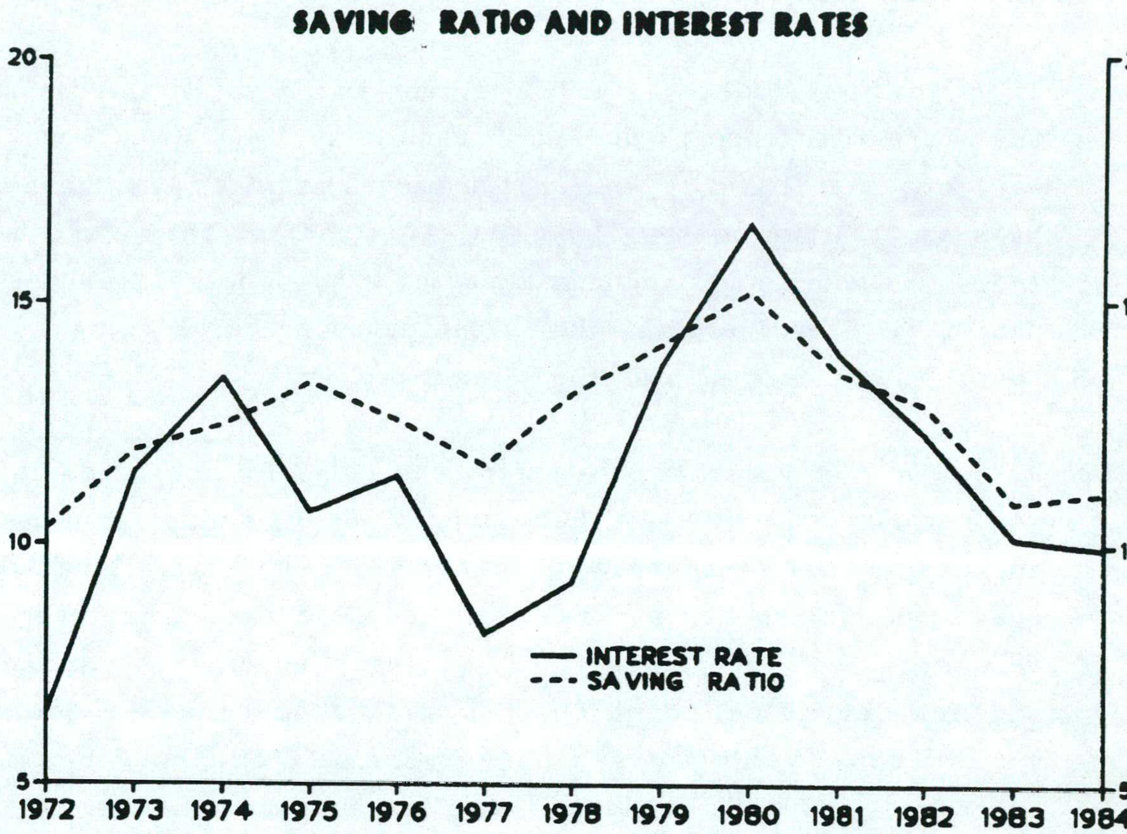
1.33 For the first two years of the upturn which began in 1981 domestic demand grew more quickly than output. By 1983, there had been a widespread increase in all components of domestic demand, with a large rise in consumer spending. This year the growth of domestic demand has been slower, partly as a result of the effect of the miners' dispute on stockbuilding, and the balance has as expected shifted away from consumer spending towards investment. But overseas markets have grown more rapidly and so the increases in GDP and domestic demand are much more in line.

Personal sector income and expenditure

1.34 In 1983 real personal disposable income recovered to its 1980 level. But in order to finance higher spending, consumers reduced their rate of saving by $4\frac{1}{2}$ percentage points. Between 1982 and 1983 the increase in consumer spending was almost $4\frac{1}{2}$ per cent, helped by renewed growth in personal income.

1.35 The fall in saving was encouraged by the fall in inflation (which had been steadily eroding the real value of existing assets), by the drop in interest rates and by easier access to credit. Chart 1.7 compares the saving ratio with nominal interest rates: both the saving ratio and nominal interest rates reflect, to a major extent, the rate of inflation. The high growth in spending in 1983 included a large increase in expenditure on durables, particularly on motor cars where expenditure rose by over 20 per cent, in part no doubt delayed replacement of the existing stock.

CHART 1.7

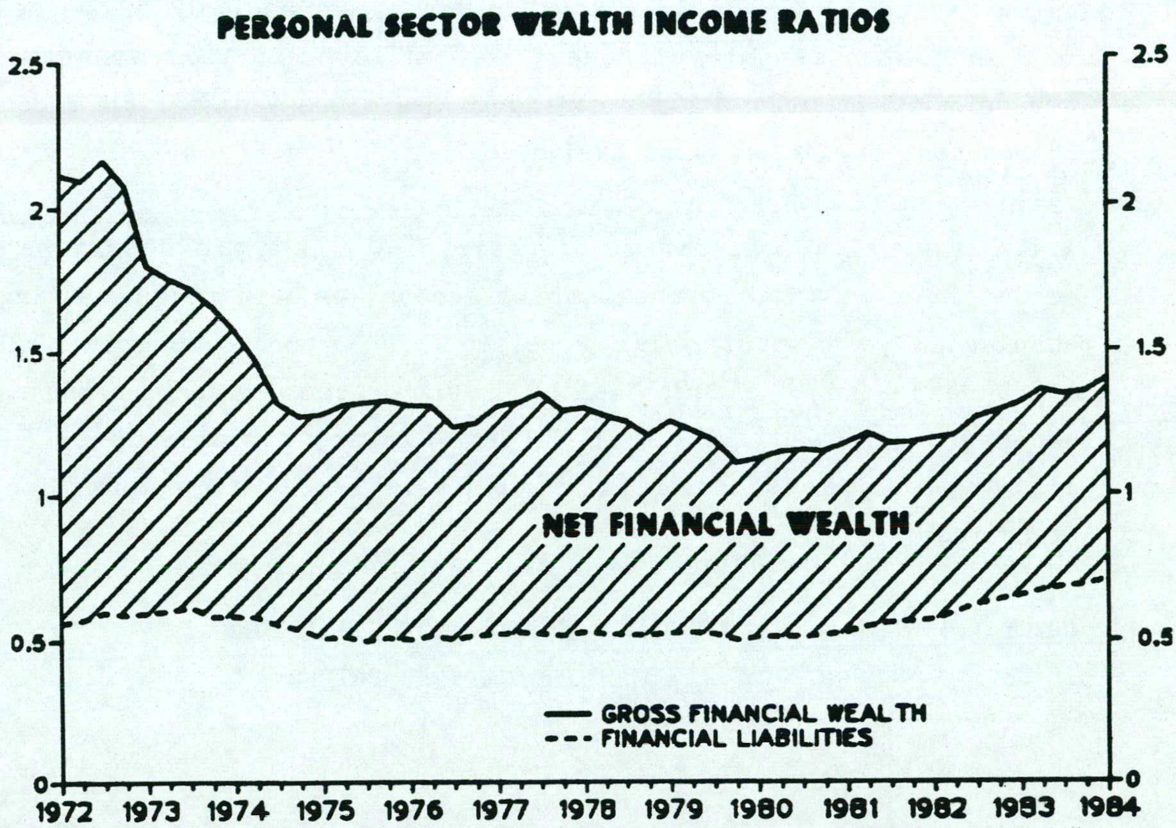


1.36 In 1984 personal income growth has continued in spite of the effects of the miners' strike, and spending on non-durables seems likely to record another sizeable rise. Durables consumption seems likely to stay near last year's high level with a rise in total consumer spending of perhaps $2^{1}{}_{2}$ per cent, rather less than in 1985.

1.37 The assumption that the £[ ] billion fiscal adjustment next financial year is used to cut personal taxes raises real personal disposable income in 1985 by [$^{1}{}_{2}$] per cent. This, combined with an assumed recovery in miners' earnings, and increases in employment and most other sources of income, produces a forecast of a rise in RPDI of over 4 per cent. As would be normal at times of rapid income growth the savings ratio is expected to rise slightly and personal consumption may grow by $3^{1}{}_{2}$ per cent.

1.38 The personal sector has more than trebled its borrowing since 1979, the major part of the increase being attributed to loans for house purchase from banks and building societies. Not all the lending, however, has directly financed spending: personal liquidity has been built up. Chart 1.8 shows that net financial wealth has increased in relation to income, partly as a result of valuation changes in the gilt and stock markets, but, with increased borrowing, gross financial wealth has increased faster.

CHART 1.8



1.39 Personal investment in housing has now been redefined to include improvement work, which grew rapidly to mid 1984. 1982 and 1983 saw a substantial recovery, now slowing down, in new housing investment. The ending of some grant-aided improvement schemes and the imposition of VAT are likely to check~~, perhaps sharply,~~ the growth of improvement work from mid 1984 and the level of housing investment in both 1984 and 1985 may remain close to the 1983 outturn.

(?)

I'm surprised Treasury expected the housing [illegible]

SECRET AND PERSONAL

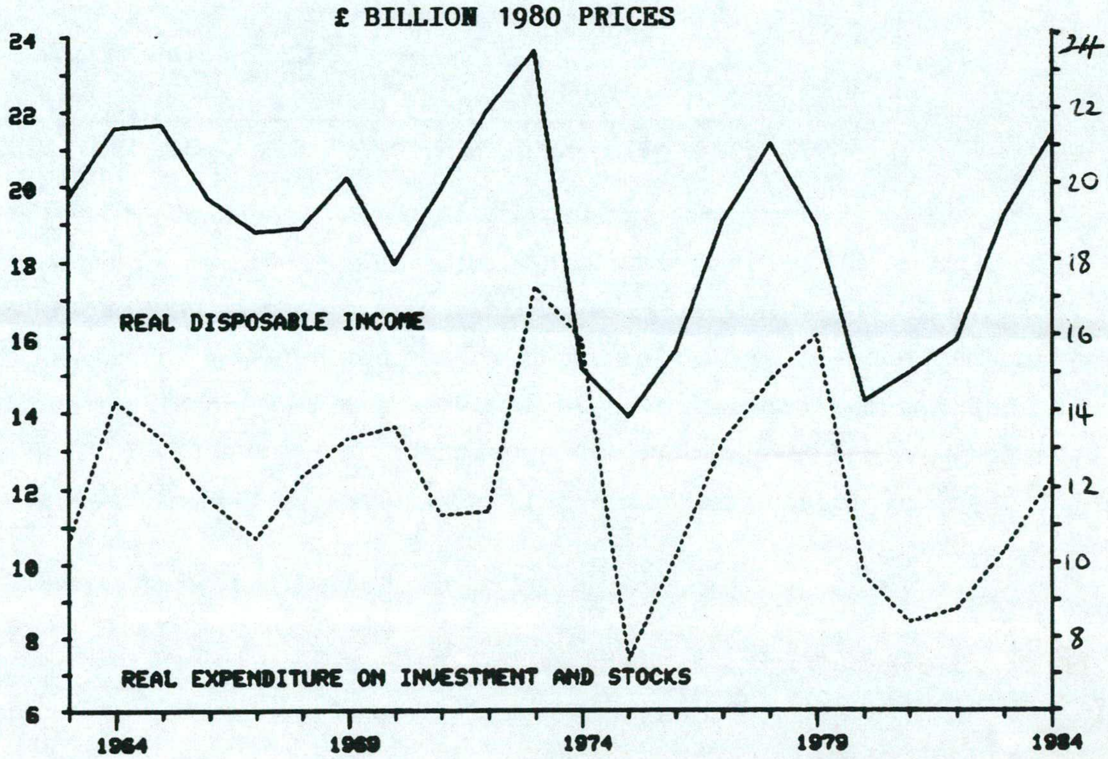
COMPANY INCOME AND EXPENDITURE

1.40 The last eighteen months have seen a major recovery in company incomes as sales and profit margins have improved, particularly in overseas markets. This increase has not yet been fully reflected in tax payments, and in the twelve months to June 1984, non-North Sea company disposable incomes were up 28 per cent on the previous twelve months.

1.41 As usual at this stage of the cycle, company expenditure has lagged behind incomes so that the company sector has been running a large financial surplus, with a substantial improvement in corporate liquidity. This surplus can be expected to diminish as the growth in company incomes moderates and as expenditure rises. But in the absence of any sizeable stock rebuild, the company sector's financial surplus is likely to remain high by past standards.

CHART 1.9 COMPANY* INCOME AND EXPENDITURE

£ BILLION 1980 PRICES



*Industrial and commercial companies (excluding those operating in the North Sea)

SECRET AND PERSONAL

Investment

1.42 Business investment is now growing strongly: in the first half of 1984 it was up 13 per cent in real terms on the first half of 1983. The recovery in manufacturing investment this year has been particularly marked. For 1984 as a whole, fixed investment by non-North Sea industrial and commercial companies may be 10 per cent up on 1983, with further growth in 1985. With North Sea expenditure recovering from the low level seen in 1983 and some further increase in housing investment, 1984 seems likely to record a substantial increase in total private fixed investment. In 1985, North Sea investment may not rise so much; housing investment is unlikely to increase further, and public investment may decline, so the growth in total fixed investment in 1985 may be modest.

how much?

cf 1.39

X

What is non North Sea business investment expected to do in 1985?

Stockbuilding

1.43 In contrast to fixed investment, company expenditure on stocks has shown little tendency towards the recovery usual at this stage of the cycle: real interest rates are high, and the tax changes in the Budget reduced the incentive to hold stocks. Manufacturers' and distributors' stocks fell during the first half of 1984, reversing the rise seen over the previous six months. Recent surveys do not suggest much desire to change stock levels, and the forecast sees no more than a weak resumption of stockbuilding in 1985 as the growth in output and sales continues.

Total demand and activity

1.43A With real incomes of both persons and companies rising, domestic demand is expected to continue to grow during the forecast period. The effects of the miners' strike seem likely to make the increase in demand and output larger than in 1984. The continuing recovery in world markets is allowing exports to grow more in line with imports; and GDP in line with domestic demand. Export growth is expected to slow next year as world markets grow less rapidly and import growth falls because less oil is required for electricity production.

Table 1.4 Domestic demand and GDP

per cent changes

	1983	1984	1985
Domestic demand	4½	2½	3½
Exports of goods and services	1	6	4
Imports of goods and services	5½	7	4
Domestic production: GDP	3	2½	3½

1.44 The share of manufacturing industry in total output has been falling since the early 1970s. For 1985 as a whole, with substantial growth continuing in the demand for manufactures, output in the manufacturing sector should rise further, but perhaps a little more slowly than output in total. Increases of about 10 per cent in the output of the North Sea oil sector in 1983 and 1984 accounted for about ½ per cent of GDP growth in each year; no further sizeable increases in oil output are expected.

Table 1.5 GDP and manufacturing output

per cent changes

	1983	1984	1985
Gross domestic product, average measure	3	2½	3½
(the figures in brackets exclude the effects of the miners' dispute)		(3½)	(2½)
Manufacturing	2½	2	2½

PRODUCTIVITY AND THE LABOUR MARKET

1.45 As the economic recovery became firmly established during 1983 total employment began to rise. By June 1984 the employed labour force is estimated to have been almost 300 thousand higher than at the trough in March 1983. Most of the increase was in the services sector: many of the new jobs were part-time and filled by women. In the manufacturing sector, which accounted for much of the labour shedding of the previous three years, employment continued to fall though at a much reduced rate. The rise in productivity in manufacturing - up about 20 per cent over the past three years - has gone beyond the usual cyclical recovery.

1.46 Underlying trends in productivity are hard to identify because of the strong cyclical influences. In part the strong recovery in output per head in recent years reflects normal adjustment following the large fall between 1979 and 1981. During 1983 manufacturers may have been a little more cautious than usual, preferring initially to meet the increased demand for output with substantial increases in overtime working rather than by taking on new workers. Table 1.6 shows average annual growth rates of output per head, for manufacturing and non-manufacturing, over longer periods of time.

Table 1.6 Output per head

annual averages, per cent

	1964-73	1973-79	1979-83
Manufacturing	4	$\frac{3}{4}$	3
Non-manufacturing	$3\frac{1}{2}$	$\frac{1}{4}$	1

Even over complete cycles the path of actual output per head can be significantly influenced by the relative strength of booms and recessions. Thus the apparent slowdown in productivity between 1973 and 1979 may in part reflect the (unsustainable) strength of the 1973 peak in activity, to which firms did not fully adjust their labour force, and the relative weakness of the 1979 peak. The slowdown in the 1973-79 period may also reflect a tendency, subsequently reversed, for potential productivity gains arising from eg higher investment not to be fully realised.

1.47 Nevertheless it seems clear there has been some pick up in underlying productivity growth since the late 1970s. This may have been a response to the more rapid growth of real labour costs both in real terms and in relation to other business costs. Changes in working practices and attitudes to innovation may be having a permanent effect on the rate of growth of productivity, though the evidence is not conclusive. The forecast assumes that underlying productivity growth in manufacturing and non-manufacturing will continue at a faster rate than in the 1973-79 period but rather slower than recorded in the last four years. Taken together with the forecast of output this is consistent with continued growth in total employment.

1.48 Despite the recovery in employment, unemployment levelled out only briefly during the second half of 1983 and since the beginning of this year it has increased on average by ~~17 thousand~~ 17,000 per month. The figures imply a very substantial increase in the working population over the past year, considerably larger than the growth in the labour force that had been expected on the basis of demographic changes. It seems that, while continued falls in manufacturing employment resulted in more full-time workers joining the unemployment count, the growth in part-time jobs in service industries attracted women who were not previously claiming benefit. Probably many of these women were returning to work after a period outside the labour force. Although the figures are very uncertain, further growth in the labour force is forecast and the trend towards more part-time working, which was evident throughout the seventies, may continue.

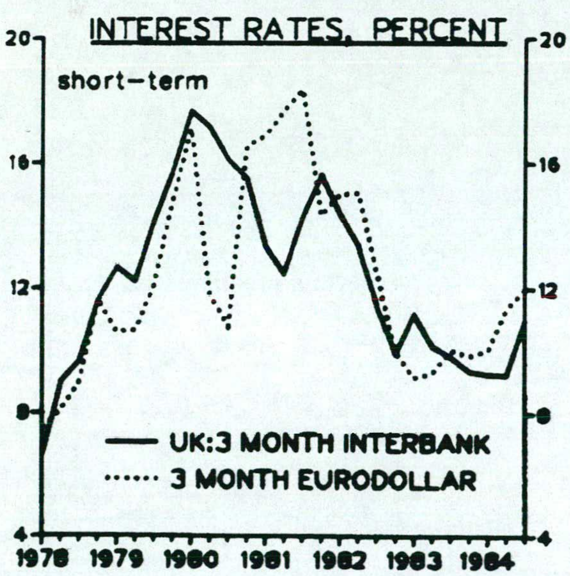
SECRET AND PERSONAL

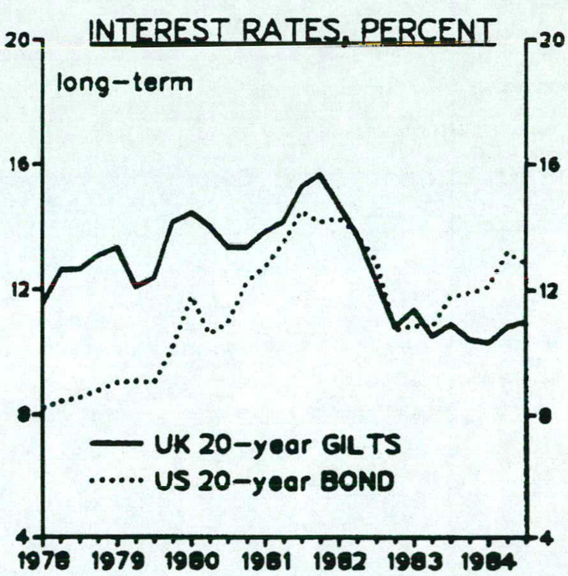
INTEREST RATE AND MONETARY GROWTH

Interest Rates

1.49 In the USA the continuing rise in economic activity together with expectations of both a high Federal deficit and restrictions on monetary growth, led to further upward pressure on interest rates in the first half of the year. There was subsequently some easing in rates, but they are still well above the level prevailing at the beginning of the year. By contrast interest rates in the other major OECD economies, apart from Canda, have changed very little. In the UK there was some further easing in short-term interest rates in the early months of the year, but strong upward pressure emerged in the money markets in July, associated with a weakening of the sterling/dollar exchange rate and market worries about industrial disputes and certain aspects of domestic monetary conditions. With the subsequent easing of the latter worries, rates have fallen back, but not by the full extent of the July increase.

CHART 1.10





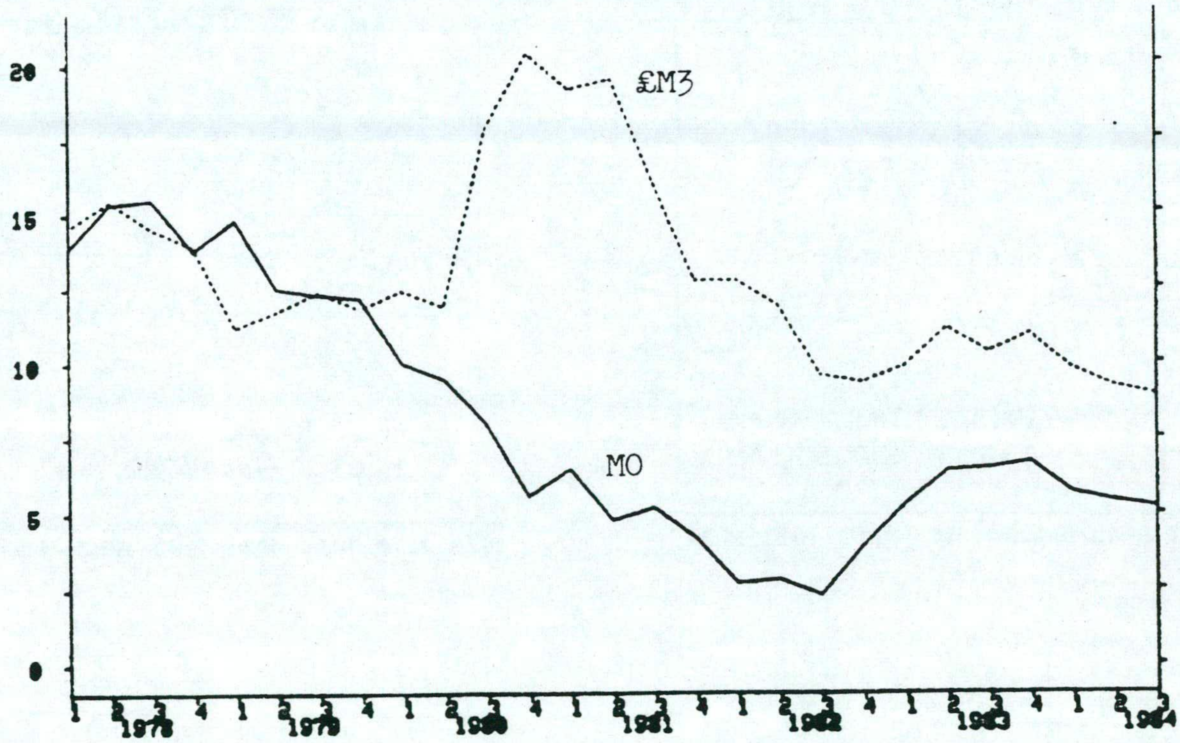
USE target period to mid - October

Money Supply

1.50 Growth of MO in the current target period to mid-September was well within its 4-8 per cent target range. Growth of £M3 over the same period was a little above its 6-10 per cent target range, but growth over the 12 months to mid-September was within the target range. Our limited experience with M2 still makes it difficult to interpret, as does the reclassification of certain building society accounts from outside to within M2. PSL2 has been growing faster than £M3, mainly as a result of the relatively rapid growth of building society deposits. The forecast assumes that the 1985-86 target ranges for MO and £M3 will be the same as the illustrative ranges in this year's Medium Term Financial Strategy, 3-7 per cent for MO and 5-9 per cent for £M3.

CHART 1.11

Chart: monetary growth, percentage changes on a year earlier
for banking months March, June, September and December



SECRET AND PERSONAL

FISCAL PROJECTIONS

1.51 The PSBR in 1983-84 was £9.7 billion*, as forecast in the Financial Statement and Budget Report. The EC rebate in respect of 1983 was not received during 1983-84, and this increased central government borrowing on own account. On the other hand public corporations' borrowing turned out a little lower than expected.

1.52 In the first six months of 1984-85, the PSBR was £7.2 billion, the same as the Budget forecast for the full year. It was always expected that the PSBR would be more than usually front-end-loaded this year. Even so, there are reasons for expecting public borrowing this year to be above the Budget forecast, though lower than in 1983-84:

(i) Local authorities' overspend on capital account in 1983-84 seems likely to be followed by further overspend in 1984-85.

(ii) Higher interest rates than expected at the time of the Budget have increased debt interest payments.

(iii) On the revenue side, however, extra receipts from North Sea oil are expected broadly to offset these two factors.

£1¼-1½ billion

(iv) The miners' strike may add, over the year as a whole, some [£1-1½ billion] to total borrowing.

or "getting on for £1½ billion"

£1¼

1.53 As a result, the PSBR for 1984-85 as a whole is now projected some [£1-1¼] billion higher, at [£8½] billion, than the Budget forecast. There is inevitably still a substantial margin of error surrounding this forecast (average errors in PSBR forecasts at this time of year exceed £2 billion).

---

*New definition. On the old definition (including bank deposits) it was £10.0 billion.

(since 8½ - 7¼ = 1¼)

1.54 The projections in tables 1.7-1.9 take account of the Government's spending plans shown in Part 2. The assumption is made that tax thresholds, allowances and specific duties are indexed in 1985-86 by $4\frac{3}{4}$ per cent. The forecast also takes the same assumption as in the MTFS about the PSBR in 1985-86: 2 per cent of GDP, equivalent to £7 billion. On the basis of the current projections of expenditure and revenue, this would leave room for a fiscal adjustment, perhaps of the order of [£ billion]. (The forecast assumes, conventionally, that the fiscal adjustment takes the form of a reduction in income tax, which is then incorporated in the projections of personal income and spending etc). Although the fiscal adjustment for 1985-86 is not very much changed since the Budget projection, both expenditure and revenues seem likely to be higher. In the case of revenue, this mainly reflects higher North Sea oil revenues, as a result of higher sterling prices and production. But this assessment of fiscal prospects should not be taken as a firm indication of the likely scale of changes in the 1985 Budget. It will be necessary to review nearer the time the appropriate level for the PSBR in 1985-86.

plus, 1/2 of contr., new forecast

1.55 Any estimate of the extent of the fiscal adjustment for 1985-86 is extremely uncertain: it depends on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions. For the public sector as a whole, the flows on either side of the account approach £200 billion.

Expenditure

1.56 General government expenditure in national accounts terms is forecast to rise, in cash, by around [$6\frac{1}{2}$ per cent] in 1984-85 and [$4\frac{1}{2}$ per cent] in 1985-86. Table 1.7 shows the basis of these figures. They are affected by the miners' strike: the underlying rates of increase are ~~both~~ [$5\frac{1}{2}$ per cent. Details of expenditure programmes in 1985-86 are provided in Part 2.

X

for both years.

SECRET AND PERSONAL

Table 1.7 General Government Expenditure+

£ billion

	1983-84	**1984-85**	**1985-86**
General government expenditure (1)	121	128	134
National accounts adjustments(2)	4	$4\frac{1}{2}$	5
Interest payments	15	16	17
Total expenditure in national account terms	$139\frac{1}{2}$	$148\frac{1}{2}$	156

(1) Expenditure on programmes by central government and local authorities plus the reserve and special sales of assets, after making allowance for expected outturn.

(2) Adjustments to line 1 to the definitions used in National Accounts Statistics.

+constituent items in this and in tables 1.8 and 1.9 may not sum to totals because of rounding to nearest £$\frac{1}{2}$ billion.

Revenue

1.57 Revenue estimates depend on incomes, spending and prices, as well as on policy decisions. Revenue in 1985-86 is projected on conventional assumptions of revalorisation of the main direct tax allowances and thresholds, and of excise duties, using a figure of $4\frac{3}{4}$ per cent*. Estimates of oil revenues assume that sterling prices for North Sea oil do not change very much from the levels set [in early November].

1.58 The revenue projections are shown in table 1.8. Real GDP (average measure) is forecast to grow by 2 per cent in 1984-85 and by $3\frac{1}{4}$ per cent in 1985-86: these estimates are affected by the miners' strike, and the underlying increases are 3 per cent and $2\frac{1}{4}$ per cent. The general rate of inflation, as measured by the GDP deflator, is put at $4\frac{3}{4}$ per cent in 1984-85 and $4\frac{1}{2}$ per cent in 1985-86. The increase in revenue - before fiscal adjustment - in 1985-86 is close to the forecast rise in money GDP of $8\frac{1}{2}$ per cent.

15a Quek(?)

*Part 4 shows the additional direct revenue cost of yields on an illustrative and rounded assumption of 5 per cent.

Chi?

Table 1.8 General Government Receipts+

£ billion

	1983-84	1984-85	1985-86
Taxes on income, expenditure and capital	97½	105½	115½
National Insurance and other contributions	21½	23	25
Interest and other receipts	11½	11	11
Accruals adjustments	-½	1	-½
Total Receipts	129	140	151
of which North Sea tax revenues	9	12	12½

Borrowing

1.59 Table 1.9 provides projections of Government receipts, expenditure and borrowing.

Table 1.9 Public Sector Borrowing+

£ billion

	1983-84	1984-85	1985-86
General government expenditure	139½	148½	[156]
General government receipts	129½	140	[151]
Implied fiscal adjustment(1)	-	-	[ ]
General Government Borrowing Requirement	10	9	8½
Public Sector Borrowing Requirement	9¾	8½	7
as percentage of GDP	3¼	2½	2
Money GDP at market prices	306	328	357

(1) On the same assumption as in the 1984 MTFS about the PSBR as a proportion of GDP in 1985-86

This is a v. awkward fig. Can we have a breakdown between housing & business investment?

The Prospects: summary

Table 1.10 presents a summary of the economic prospects.

Table 1.10 Economic Prospects(1)

		1983 to 1984	1984 to 1985	Average errors(2) from past forecasts
A	Output and expenditure at constant 1980 prices			
	Gross domestic product (at factor cost)	2½	3½	1
	Consumers' expenditure	2½	3½	1½
	General government current expenditure	1½	½	1½
	Fixed investment	7	2	2½
	Exports of goods and services	6	4	3
	Change in rate of stock-building as a percentage of the level of GDP	-½	1	1
	Imports of goods and services	7	4	3
		1984	**1985**	
B	Balance of payments on current account (£ billion)	1	3	3½
C	Retail prices index (4th quarter)	4¾	4½	3(3)

(1) The forecast includes the effect of the fiscal adjustment in 1985-86.

(2) 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 on Government forecasts, notably in the Economic Progress Report, June 1981. The errors are after adjustment for the effects of major changes in fiscal policy, where excluded from the forecast.

(3) The average error for inflation was calculated from a period of much inflation and probably overstates the margin of error at low rates of inflation.

316.57

SECRET AND PERSONAL

MP

FROM: DAVID PERETZ
DATE: 29 October 1984

MR EVANS

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Cassell
Mr Kemp
Mr Monck
Mr Battishill
Mr Burgner
Mr Lankester
Mr Lavelle
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Folger
Mr Mowl
Miss Pierson
Mr Riley
Mr Robson
Ms Seammen
Mr Horton
Mr Ridley
Mr Lord
Mr Portillo

AUTUMN STATEMENT, PART I: THE ECONOMIC FORECAST

The Chancellor had the following drafting and other comments on the text attached to your minute of 26 October:-

<u>Paragraph 1.02:</u> first sentence insert "the duration of" after "about";

<u>Paragraph 1.04:</u> delete "by assumption" in the first sentence;

<u>Paragraph 1.11:</u> there are two typographical errors - insert "we" before "expect ~~us~~ US" in the third sentence; and "is" for "if" in the last sentence;

<u>Paragraph 1.14:</u> the exchange rate chart appears to end at Q2 1984; surely it should go to Q3, or even to October 1984 to make sense of the text;

Chart 1.6: the text in paragraphs 1.27 and 1.28 talks about underlying rises in prices and earnings; the graph does not seem to match the text;

Table 1.3: the Chancellor noted that the nationalised industries figure may be affected by the outcome of the PES round;

Paragraph 1.39: delete "perhaps sharply" in the last sentence. The Chancellor is also surprised that housing investment is not expected to to be higher (and how does this tie up with the penultimate sentence in paragraph 1.42?)

Paragraph 1.48: third line, 17,000 for "17 thousand";

Paragraph 1.50: the final version should use figures for growth of MO and £M3 during the target period to mid-October;

Paragraph 1.52: the Chancellor thinks the facts will justify words in (iv) something like "getting on for £1½ billion";

Paragraph 1.53: presumably the figure here should be £1¼ billion;

Paragraph 1.54: last sentence, this should probably also mention that, of course, there will be a new forecast by the time of the 1985 Budget;

Paragraph 1.56: penultimate sentence, last few words to read "are [5½ per cent] for both years";

<u>Paragraph 1.57:</u> something seems to have gone wrong with the footnote to this paragraph.

2. One more general point. °The Chancellor thinks the figure for growth in fixed investment in 1985 (end of paragraph 1.42, and table 1.10) could give rise to considerable adverse comment; and he finds the figure somewhat surprising himself. Could you supply a figure for forecast non-North Sea business investment in 1985?

DLCP

D L C PERETZ

73/249

SECRET & PERSONAL

FROM: H C GOODMAN
DATE: 29 October 1984

FINANCIAL SECRETARY TO THE TREASURY

PS/CHANCELLOR

cc PS/CST
PS/EST
PS/MST
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Cassell
Mr Kemp
Mr Monck
Mr Battishill
Mr Burgner
Mr Lankester
Mr Lovell
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Folger
Mr Mole
Miss Pierson
Mr Riley
Mr Robson
Ms Seammen
Mr Houghton
Mr Ridley
Mr Lord
Mr Portillo
Mr Evans

PS/FST → PERETZ 29/10

AUTUMN STATEMENT PART I: THE ECONOMIC FORECAST

The Financial Secretary has read Mr Evans' minute of 26 October and the attached draft of Part I.

2. He believes that paragraph 1.02 of the summary concerning the miners' strike should be recast to read:

> "For forecast purposes only, it is necessary to make an assumption about the miners' dispute: in that context it is assumed to be over by the end of the year".

3. The Financial Secretary has a number of other points, but presumably there will be an opportunity to discuss these at a meeting?

H C GOODMAN

MJ

SECRET AND PERSONAL

FROM: M W Norgrove

DATE: 29 October 1984

MR H EVANS

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Mr Bailey
Sir Terence Burns
Mr Cassell
Mr Kemp
Mr Monck
Mr Battishill
Mr Burgner
Mr Lankester
Mr Lavelle
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Folger
Mr Mowl
Miss Peirson
Mr Riley
Mr Robson
Ms Seammen
Mr Horton
Mr Ridley
Mr Lord
Mr Portillo

PS/MST → EVANS 29/10

AUTUMN STATEMENT, PART 1: THE ECONOMIC FORECAST

The Minister of State has seen your note of 26 October. On paragraph 1.39 he has asked "do we need 'perhaps sharply'? - it will be used against us by the construction industry".

MWN

M W NOGROVE
Private Secretary

SECRET AND PERSONAL

COPY No. /

SECRET

FROM: T U BURGNER
30 October 1984

CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Financial Secretary
Sir Peter Middleton
Mr Bailey
Sir Terence Burns
Mr Monck
Mr Cassell
Mr Battishill
Mr Scholar
Mr RH Wilson
Mr Hosker - T.Sol.

AUTUMN STATEMENT: BT ASPECTS

This submission reports the present position and discusses the options in relation to the BT sale if it seemed unlikely that Cabinet can reach agreement on public expenditure by 8 November with the AS published on 12 November (the ground covered is broadly that in Q8-Q10 of the annotated agenda attached to Mr Battishill's minute). From the point of view of achieving a successful BT sale, an 8 November Cabinet which reaches agreement on public expenditure with the Autumn Statement following on 12 November remains the best option by a very wide margin.

Burgner 30/10

Postpone BT Sale by a Week?

2. You discussed this with Martin Jacomb at your meeting on 16 October. He gave his view that flexibility over the timing of the sale had now virtually disappeared. The prospective date (Impact Day 16 November) was widely known and market confidence would be severely jolted. The complicated planning and logistical arrangements simply could not be rearranged at this stage. You accepted that you had to give considerable weight to Jacomb's advice although you did not altogether close the option of a BT postponement. For his part Jacomb confirmed that while postponement was "already virtually impossible" it would not be more difficult to take a decision nearer the date of the sale.

3. There is not much that can be added to this picture. The BT operation is proceeding satisfactorily according to the time-table and the Press and market reception is at present most encouraging. The key dates, including 16 November Impact Day, are all in the Pathfinder prospectus which was published last Friday. Postponement

would undoubtedly involve disrupting both in the UK and overseas a carefully planned and complex operation. Perhaps worse still would be the impact on the markets, particularly on the underwriters who have been carefully nursed by Kleinworts towards a huge commitment for 15 November. The effect of freezing the operation for a week at the Government's behest is unpredictable. Although this option is theoretically still open, it looks (as expected) even less attractive the closer we get to the sale.

<u>15 or 22 November Cabinet?</u>

4. At your meeting, Jacomb expressed himself in favour of a two-week postponement rather than one (assuming postponement was necessary) in order to ensure that Cabinet would not be taking its key public expenditure decisions on the day (15 November) that the issue was being priced. There is no doubt something in this point - although to the extent that the AS is regarded as material to the BT sale, we still face a problem with a 22 November Cabinet. But the position would be particularly awkward if key decisions were taken immediately before the underwriting agreement was signed. This argues in favour of planning for a 22 November Cabinet.

5. Against that there are two considerations in favour of 15 November:

- a successful outcome on the 15th would ensure that there were no Press stories about Government disagreement to unsettle the markets in the Offer period
- leaving the AS as late as 26/27th (on the basis of a 22 November Cabinet) means that the general public as well as the underwriters will have submitted applications before the AS is published. Again the importance of this depends upon the materiality of the AS.

6. You may think it worthwhile to have a final consultation with Jacomb before taking a final decision. There seems no need to decide as between a 15th or 22nd Cabinet (assuming that 8 November is ruled out) before early next week.

7. A decision to postpone would allow more time for the remaining public expenditure issues to be settled in an orderly manner. The

x Bragher P.

programme of meetings on outstanding issues (all of which are likely to involve the Prime Minister) would need to be scheduled accordingly. The Treasury would have to do whatever possible to ensure that the longer time-table (particularly if aiming for 22nd) did not lead to a damaging loss of momentum.

Disclosure Problems

8. As agreed, we are considering in conjunction with Peter Peddie, Treasury Solicitor and DTI what problems arise if the AS is put back one or two weeks after Impact Day. The research and discussion of its implications are continuing. So far we have not found any single issue which would suggest that this fallback raises insuperable legal difficulties.

9. The main areas considered are these:

1984-85

Pathfinder Prospectus & 1984-85 Profit Forecast. Mr Wilson's minute of 24 October reported that the macro-economic assumptions used by BT for the 1984-85 profit forecast were close to the Treasury's present forecasts; and that the sensitivities of the forecast to changes in those assumptions did not create any need to disclose information to BT about our views.

PSBR Outturn. You have already given details to Parliament during the Debate today. The question of disclosure of the planning total in the Autumn Statement is covered in Mr Williams' submission. From BT's point of view the arguments point in favour of disclosure.

1985-86

Questions of materiality are less clear-cut after 1984-85. Points to note are:

(a) Treasury Solicitor's advice is that BT will have relied upon Coopers & Lybrand long form report which includes a profit forecast to end-March 1986 in supporting statements in the Prospectus about the good future prospects for the business and the adequacy of working capital. We are therefore arranging to engage in a similar exercise to disclose the assumptions used for 1985-86 as for 1984-85.

(b) AS: we have sought to identify those areas where decisions might be material to BT. Two possible ones are:

- regional policy - we have been looking at the assumptions made by BT for future regional development grants and assistance received under the European Regional Development Fund. On the latter the results are not wholly clear but the amounts at stake appear small and may not be material.
- NICs (BT is a labour-intensive industry). So long as the decision is for minimal change, there should be no problem.

(c) Market impact of the AS. Peddie has drawn attention to the distinction between the overall market effect of the AS and its individual components. In principle this is clearly right. Jacomb earlier gave you a view that it was the fiscal adjustment that mattered to the markets rather than public expenditure totals but it was a "personal and preliminary" view. We will need to get up-to-date market advice both from him and perhaps from the Bank (but best taken once we are clearer about the likely content of the AS).

Later Years

10. The risks of materiality diminish the further in time from the point of sale, although the lawyers will not go so far as to say categorically that information or forecasts about later years are not material. We think the reasonable line to take is that information for later years is not material unless it is very significantly out of line with market expectations. We will have to leave a final judgment until later in the public expenditure round - although our hope must be that the public expenditure results are sufficiently on track not to cause problems.

TB

T U BURGNER

COPY NO 1

30 OCT 1984

The agenda for your meeting tomorrow

FROM: A M W BATTISHILL
DATE: 30 October 1984

1. SIR PETER MIDDLETON

2. CHANCELLOR OF THE EXCHEQUER 30/10.

cc Chief Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Cassell
Mr Monck
Mr Burgner
Mr Odling-Smee
Mr Scholar
Mr Pratt
Mr Ridley
Mr Lord

BATTISHILL → MIDDLETON 30/10

AUTUMN STATEMENT, PUBLIC EXPENDITURE AND BT

We are pressing ahead in the hope that Cabinet will still be able to settle the outstanding public expenditure issues on 8 November so that the Autumn Statement can be published on 12 November as planned. You have already seen drafts of Parts 1 and 4; and a draft of Part 3 should be with you shortly.

2. As Mr Bailey's minute of 29 October to the Chief Secretary recognises, a decision whether or not to go for Cabinet on the 8th will be needed before the Prime Minister departs for Bonn on Friday morning.

3. If she decides the risks of disagreement are too great, and the final decisions must be put back, we shall need to take immediate stock of the consequences, particularly for BT. Ministers will have urgently to decide between setting back BT Impact Day and the Autumn Statement by one week in the hope of resolving public expenditure at Cabinet on Thursday 15 November - or proceeding with BT and deferring the Autumn Statement until after Impact Day. In the latter event the choice would be between putting public expenditure back on the agenda for Cabinet on the 15th or the 22nd of November.

4. Because of the Bonn Summit on Friday time for consideration this week is very short. You will, therefore, be receiving tonight advice from a number of quarters relating to this complex of issues. From:

(a) Mr Burgner on the BT options, including the latest position on legal advice;

(b) Mr Williams on the handling of this year's forecast outturn for the planning total and on the Winter Supplementaries;

(c) Mr Riley on possible revenue projections for the Autumn Statement.

5. In addition, we thought you might find it helpful to have the attached summary note of the various issues (large and small) which arise on the Autumn Statement (aside from the unresolved public expenditure issues) and which need to be decided over the next days. This could serve, if you wished, as an agenda for a meeting before you and the Chief Secretary see the Prime Minister tomorrow evening.

AMWB

A M W BATTISHILL

SECRET

LIST OF ISSUES

AUTUMN STATEMENT, PUBLIC EXPENDITURE AND BT

List of Issues

Q1 Is public expenditure likely to go to Cabinet on 8 November or not?

If the answer is yes, questions 2 to 5 should be resolved this week. If the answer is no, questions 6 to 11 need to be addressed.

Q2 Star Chamber report to Cabinet has to be cleared so that it can be circulated on Friday 2 November. Chief Secretary's paper must be circulated on 5 November. [Mr Bailey's submission of 29 October]

Q3 Cabinet has not had a full economic discussion so far this Autumn. Though there has sometimes in the past been an Autumn economic paper by the Chancellor, for the past 2 years Cabinet has had only a short oral report (by Sir Geoffrey Howe in 1982 and yourself in 1983). Assuming that you do not wish to write an economic paper, the choices are: (i) another oral presentation; (ii) to circulate the draft Industry Act Forecast (from the Autumn Statement) or (iii) a summary of it. How do you wish to proceed?

Oral 8/11

Q4 We need to settle some outstanding points on the contents of the Autumn Statement:

(a) Do you wish to give public expenditure figures for three forward years or only one?

One

(b) If only one year, no particular Autumn Statement points arise. But if we have to give three years figures then:

- Are you content to settle for three years' aggregate figures for Nationalised Industries EFLs leaving for later decision whether they should be broken down in the PEWP?

- at present three columns of figures for the coming year are given in Table 2.1 (attached) of the Autumn Statement - the White Paper figures; Budget and other changes; and the revised plans. Three columns for each of three years would be dreadfully unwieldy. Do you agree that (in addition to 1984-85 plans) we should give 2 columns for 1985-86 (the White Paper figures in one column and the revised plans in the other) and 1 column for each of 1986-87 and 1987-88 (the latest plans)?

- Should we also include three years' manpower figures? [Paragraph 15 of Mr Battishill's submission of 27 September]

- Do you wish to give revenue projections for three years? And if so (i) do you agree that the revenue projections should be put in a new section in the Autumn Statement to follow Part 2 (on public expenditure)?; (ii) do you agree with the proposed presentation of the revenue projections; and (iii) do you agree with the proposed growth and inflation deflators for the three years? [Mr Riley's submission of 30 October]

(c) We also need to decide how we are to deal with the 1984-85 planning total [Mr Williams' submission of 30 October]:

- Should we publish the prospective outturn for the 1984-85 planning total in the Autumn Statement [see also Mr Burgner's submission of 30 October]

(5)

- If so, what figure for the planning total should we give?

- Where should the information, and the explanation, be given - in Part I of the Autumn Statement or Part 2?

(d) Should we include a footnote to Table 2.1 of the Autumn Statement to give the pay assumption? [Paragraph 19 of Mr Battishill's submission of 27 September]

(e) Should we round all figures in Table 2.1 of the Autumn Statement to the nearest £10 million, and the total to the nearest £100 million? [Paragraph 18(i) of Mr Battishill's submission of 27 September]

(f) Can we - this year at least - dispense with the idea of giving a detailed 1983-84 outturn in the Autumn Statement? [Miss Peirson's submission of 30 October]

Q5 Do you agree that we should publish Winter Supplementaries a week after the Autumn Statement, with proof copies being sent, in confidence, in advance to Select Committees on the same day as the Autumn Statement is delivered? [Mr Williams' submission of 30 October]

If the answer to Question 1 is that public expenditure is <u>not</u> going to Cabinet on 8 November, the following issues need to be addressed

Q6 Do public expenditure decisions go back at least one week until Cabinet on 15 November? Or is there any likelihood of a special Cabinet between the 8th and 15th?

Q7 If the <u>latter</u>, (eg Cabinet on Tuesday 13th) there would not be time for a full printed version of the Autumn Statement to be published after such a Cabinet and before Impact Day. We would then need to consider what <u>has</u> to be published before Impact Day, and how.

SECRET

Q8 If the <u>former</u>. Ministers will need to address the choice between (i) putting back both Impact Day and Autumn Statement together; or (ii) putting back the Autumn Statement but keeping Impact Day on 16 November

Q9 If Impact Day and Autumn Statement are put back (8(i) above) how best to proceed?

Q10 If only the Autumn Statement is put back (until <u>after</u> Impact Day) (8(ii) above) then:

(a) Are final decisions to be taken on 15 November or 22 November Cabinet (with the Autumn Statement on 19/20 November or 26/27 November)? [Mr Burgner's submission of 30 October]

(b) What are the consequences for further work on public expenditure? [Mr Burgner's submission of 30 October]

(c) What further information must be disclosed before Impact Day assuming Cabinet settles public expenditure on (i) 15th or (ii) 22nd November (in each case with the Autumn Statement a few days later). In particular on:

- PSBR and planning total outturn for 1984-85?
- The forecast or the fiscal proposals for next year?
- Anything else? [Mr Burgner's submission of 30 October]

Q11 Can the announcement of NICs wait for the delayed Autumn Statement (presumably yes if the changes do not require legislation)?

SECRET

Q12 Do you agree that if the Autumn Statement is delayed, the Winter Supplementaries should be published before the Autumn Statement? [Mr Williams' submission of 30 October]

Q13 With this later timetable, the detailed Questions 3 and 4 above still need to be addressed; but they become less urgent.

Central Unit

Table 2.1 Public Expenditure Plans

£ million

	1983–84	1984–85		
	White Paper (Cmnd 8789) with Budget and other pre-survey changes(1)	White Paper (Cmnd 8789)	White Paper (Cmnd 8789) with Budget and other pre-survey changes	Revised plans(2)
Departments (excluding nationalised industries' external finance)(3)				
Ministry of Defence	15 716	17 288	17 270	17 010
Foreign & Commonwealth Office (including Overseas Development Administration)	1 683	1 801	1 806	1 807
European Community	380	450	450	450
Intervention Board for Agricultural Produce	1 274	835	825	1 247
Agriculture	992	998	994	1 009
Forestry Commission	59	60	60	56
Department of Trade and Industry	1 488	1 370	1 411	1 351
Department of Energy	470	457	457	543
Export Credits Guarantee Department	55	164	164	166
Department of Employment	2 981	3 317	3 376	3 308
Department of Transport	3 366	3 466	3 546	3 537
DOE—Housing	2 709	2 988	2 993	2 496
DOE—Property Services Agency	−145	−115	−116	−92
DOE—Other Environmental Services	3 186	3 227	3 210	3 209
Home Office	4 041	4 253	4 241	4 333
Lord Chancellor's Department	449	509	509	501
Department of Education & Science	12 583	12 912	12 877	13 052
Office of Arts & Libraries	560	584	585	595
DHSS—Health and Personal Social Services	14 478	15 382	15 328	15 414
DHSS—Social Security	34 783	35 939	36 687	36 850
Civil Superannuation	937	1 017	1 036	1 053
Scotland(4)	6 160	6 339	6 339	6 318
Wales(4)	2 397	2 486	2 480	2 459
Northern Ireland	3 796	4 019	4 031	4 020
Other Departments	1 967	2 058	2 069	2 116
Adjustment for refund of VAT on certain services contracted out by Government departments	—	—	—	−30
Nationalised industries	2 748	2 615	2 548	1 882
Local authority current expenditure not allocated to departments	904	455	455	625
Special sales of assets	−1 250	−1 500	−1 500	−1 900
Reserve	1 040	3 000	3 000	3 000
PLANNING TOTAL	**119 807**	**126 374**	**127 131**	**126 385**

Note:

(1) Including measures announced on 7 July 1983 and changes of classification.

(2) Some figures may be subject to detailed technical amendment before publication of the 1984 Public Expenditure White Paper.

(3) Provision for pay in these programmes reflects the pay factor of 3 per cent announced on 15 September 1983.

(4) Excluding agricultural expenditure, which is included in the agricultural line.

TABLE 2.1 PUBLIC EXPENDITURE PLANS

FROM: M L WILLIAMS
DATE: 30 OCTOBER 1984

1. MR ~~BAILEY~~ AMD 31/10
2. CHANCELLOR

cc Sir T Burns
Mr Anson
Mr Cassell
Mr H Evans
Mr Scholar
Mr Battishill
Mr Burgner
Miss Peirson
Mr Culpin
Mr Stibbard
Mr Ridley

Copies attached for:

Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton

AUTUMN STATEMENT: EXPENDITURE IN 1984-85

This note discusses the presentation in the Autumn Statement (AS) of the prospective overspend on the planning total for 1984-85. No final decision needs to be taken at this stage, but it would be helpful to know provisionally, both for the preparation of briefing and of Part 2 of the AS (which reports the outcome of the survey), whether and how you wish to refer to the prospective overspend. The note assumes that, even if you indicate before the AS (eg in this afternoon's speech) the extent of overspend on the planning total, no precise figure will be published before then.

Only PSBR

WILLIAMS
→ BAILEY
30/10

Should a figure be published?

2. In the last 2 years, the planning total estimated outturn has not been given in the AS, but we have been prepared to give it to anyone who asked a specific question; thus it was given to the TCSC in 1982. It would be open to us to adopt the same approach this year. But we strongly recommend publication of the figures in the AS. This approach allows us to take into account from the outset the prospective outturn in the presentation of the AS and the associated briefing. We cannot expect that the figure will not be requested, and a later announcement would risk either the accusation that we were trying to hide the poor position or souring somewhat the immediate impact of the Statement; and either could have a damaging impact on the BT flotation.

322

3. There is moreover, one reason why not publishing the figure with the AS Statement could make the position look worse than it is. Part 1 of the AS gives an expected outturn for general government expenditure (see Table 1.7 of the draft in an earlier box attached to Mr Evans' submission of 26 October). An educated guess can then be made of the overspend on the planning total. The steps involved are set out in annex A; however there may be a tendency to focus on the bottom line of the table only which might suggest an increase in the planning total of £2½ billion.

4. It will also be helpful in relation to Winter Supplementaries to have had the figure published. The Supplementaries are normally presented in mid November. We suggest that, for an AS on 12 November, they should be given in confidence to the relevant departmental Select Committees on that day, and then formally presented a week or so later with the Financial Secretary's note. The supplementaries are expected to total more than £2½ billion (which is consistent with the expected overspend on the planning total of £1.7 billion). The Financial Secretary's note will help to moderate any adverse impact by indicating that supply expenditure as a whole has not been running ahead of the budget profile. But it would also help to be able to assert that the Supplementaries contained no new information, in the sense that the aggregate was consistent with the planning total outturn in the AS.

5. The handling of Winter Supplementaries could be more difficult if the AS were delayed into December or beyond. To avoid the risk of the Contingencies Fund being exhausted it is essential to secure the Consolidated Fund Act before Christmas, ie we would have to present the Winter Supplementaries by early in December. If the planning total outturn had been published in another context, there would be no difficulty but, if not, the handling of the Suppelementaries could be awkward as well as possibly being thought to represent new information in relation to BT. Advice will be submitted separately if this problem looks like materialising.

What figure should be published?

6. The current assessment of the expected outturn for the planning total is £127.9 billion, ie £1.7 billion above the last published plans. This excess exceeds the predicted costs of the miners' strike, Thus an accurate indication of the outturn will make clear that, notwithstanding the strike, the planning total is likely to be exceeded. Moreover, the revised arrangements for the Reserve which for the first time covers overspends on all programmes, mean that the excess will also imply that the Reserve is likely to be exceeded Indeed this is the first time (at least in recent years) that the Reserve has been exceeded, although it would have been exceeded in the past had it been defined as it now is.

7. The final outturn for the planning total is highly uncertain (perhaps ± £1 billion), and you may feel that it would be creating unnecessary difficulties were you to reveal the full extent of the of the overspend at this stage of the year. Thus you might feel justified in shading the excess to "about £1½ billion". This figure is not out of line with the costs of the strike so the implication could be left ~~and encouraged~~ in briefing that the strike alone accounted for the overspend. An alternative would be to give a range for the outturn of £127½-£128 billion, but this would sit oddly with a point estimate of the PSBR.

8. On the other hand, this approach would arguably be deliberately misleading, which is perhaps especially dangerous in the BT context. If the TCSC or others asked the pertinent questions it might be difficult to continue to fudge the figure, again with the risk of souring the impact of the Statement. I therefore recommend that a more precise indication be given, eg "nearly £128 billion" and an excess of "a little more than £1½ billion". The uncertainty surrounding the figure can still be emphasised.

How should the figure be presented?

9. There are a number of ways in which the figure might be presented. I do not suggest that much detail should be published of the overspend, other than the impact of the strike. There is nothing among the potential claims on the Reserve that is equally exceptional; many are unexpected and were unforeseeable, but the Reserve is meant to cope with such increases. Mention of local authority capital (as in Part 1 para 1.52) has the advantage that it and the strike just about account for the overspend, and LA capital is certainly unpredictable. Moreover, unlike LA current expenditure, which we indicated in the FSBR might exceed plans, it was not until some time after the budget that we were aware of the LA capital overspend. But reliance on any particular factor as an explanation would expose us to questions about failure to take either general or specific action to offset the overspend. We are still left free to point to the main factors involved, many of which are in the public domain, when briefing on the Statement.

10. In the view of the expenditure side of the Treasury, reference to the outturn would best be included in Part 1 of the Statement which discusses current developments and the forecast. That would leave Part 2 to focus, as in previous years, entirely on expenditure plans. Our suggestion is to include a sentence in para 1.56 of Mr Evans' draft along the following lines:

> "The additional claims on expenditure in 1984-85 mean that the prospective outturn for the planning total at nearly £128 billion, is expected to exceed plans (shown in Table 2.1) by a little more than £1½ billion".

At annex B, I show where the sentence might be included.

11. This preferred presentation is matter-of-fact and deliberately avoids surrounding the figure with more explanation. A different approach, if you wished to add a little more defensive commentary and a link with the future, would be to limit the reference in Part 1 to a footnote in Table 1.7 indicating the outturn, and instead include a self-standing paragraph in Part 2 along the lines:

> "The prospective outturn for the planning total is nearly £128 bn, which compares with the total for the original White Paper plans, as modified by the budget, of £126.2 billion (see table 2.1). At this stage of the year, the estimated outturn is very uncertain, but some of the exceptional reasons for expecting an overspend were indicated in Part 1; in particular the impact of the miners' strike and to a lesser extent, local authorities' overspend on capital account. Other significant influences include local authority current expenditure."

<u>Conclusion</u>

12. I strongly recommend (para 2 above) that a figure for the planning total outturn should be published in the AS. Among other advantages, this would avoid difficulties that might otherwise arise on presentation of Winter Supplementaries.

13. I also recommend (para 8) that a more precise indication be given of the outturn, notwithstanding both the uncertainty and the fact that the excess cannot readily be accounted for by the miners' strike alone.

14. On the presentation of this figure, the expenditure side of the Treasury recommends that the presentation suggested in para 10 and Annex B. However a rather more explicit alternative (para 11) is also put forward for you to consider.

M L WILLIAMS

General Government Expenditure

	Published in FSBR [1]	Table 1.7 of Draft AS	Apparent Difference	Actual Difference
Planning total	126.4 [2]		[1½]	+1.7 [3]
Public corporations transactions	0.4			-0.2
General Government expenditure	[126½]	128	+1½	+1.5
National accounts and other adjustments	4	4½	+½	+0.2
Interest payments	15½	16	+½	+0.7
Total General Government expenditure in national accounts terms	146	148½	+2½	+2.5

Notes:

1) Tables 2.4 and 5.3
2) before NIS abolition, incorporated in other national accounts adjustments
3) ie on the same convention as in the first column; the figure of £1.7 is as in the latest position report.

ANNEX A

ANNEX B

1.56 General government expenditure in national accounts terms is forecast to rise, in cash, by around [$6\frac{1}{2}$ per cent] in 1984-85 and [$4\frac{1}{2}$ per cent] in 1985-86. Table 1.7 shows the basis of these figures. They are affected by the miners' strike: the underlying rates of increase are both [$5\frac{1}{2}$ per cent] for both years. Details of expenditure programmes in 1985-86 are provided in Part 2.

The additional claims on expenditure in 1984-85 mean that the prospective outturn for the planning total at nearly £128 billion is expected to exceed plans (shown in Table 2.1) by a little more than £1½ billion.

Table 1.7 General Government Expenditure+

£ billion

	1983-84	1984-85	1985-86
General government expenditure (1)	121	128	134
National accounts adjustments(2)	4	$4\frac{1}{2}$	5
Interest payments	15	16	17
Total expenditure in national account terms	$139\frac{1}{2}$	$148\frac{1}{2}$	156

(1) Expenditure on programmes by central government and local authorities plus the reserve and special sales of assets, after making allowance for expected outturn.

(2) Adjustments to line 1 to the definitions used in National Accounts Statistics.

+constituent items in this and in tables 1.8 and 1.9 may not sum to totals b...

ANNEX B

FROM: D R H BOARD
DATE: 30 October 1984

MR H EVANS

cc PPS
Sir T Burns
Mr Cassell
Mr Battishill
Mr Lavelle
Mr Odling-Smee
Mr Mowl
Miss Peirson
Mr Riley
Mr Horton

PS/PEM → EVANS 30/10

AUTUMN STATEMENT, PART 1: THE ECONOMIC FORECAST

Sir Peter Middleton has the following comments on the draft attached to your submission of 26 October:-

(a) para 1.01, line 4 - delete "only";

(b) para 1.02, line 2 - delete ":", substitute "which";
line 5 - give a reference;

(c) para 1.13, line 3 delete "reasonable", substitute "fair";

(d) para 1.15, line 4 - avoid the term "import price inflation";

(e) chart 1.7 - Sir Peter thought this might be taken to imply that interest rates are set to rise;

(f) para 1.47, line 1 - delete "some", substitute "a".

2. He also wondered, on the section "exchange rate and the balance of payments", what the effect of assuming a continuation of the current sterling index would be.

Douglas Board

D R H BOARD
Private Secretary

David C 31/10/84.

Thanks. You asked about the pattern of meetings last year. Ohs

CHANCELLOR OF THE EXCHEQUER

David,

Thanks

SEQUENCE OF A/S MTGS LAST YEAR.

Nov 3 Draft of Pt I discussed.

11 Text of full published A/S discussed.

(16 Proof of A/S and draft Oral Statement sent to No 10)

16 Briefing meeting.

17 A/S published.

David

CHANCELLOR OF THE EXCHEQUER

David B

Can you look on the last yr's sequence of meetings on X?

DLW

C

I don't think we do need a meeting just on this, FST isn't pressing for one, & will be sending in his detailed comments.

See also PEM's comments below.

DLW

We could of course hold a mtg on the Entire PS - when PS is @ 1st proof stage, perhaps (what was last yr's timing?)

N.

1-34

SECRET

David
~~Your copy for 11-45~~
[illegible]

AUTUMN STATEMENT, PUBLIC EXPENDITURE AND BT

List of Issues

31/10/84.

Q1 Is public expenditure likely to go to Cabinet on 8 November or not?

If the answer is yes, questions 2 to 5 should be resolved this week. If the answer is no, questions 6 to 11 need to be addressed.

Q2 Star Chamber report to Cabinet has to be cleared so that it can be circulated on Friday 2 November. Chief Secretary's paper must be circulated on 5 November. [Mr Bailey's submission of 29 October]

No prob

Q3 Cabinet has not had a full economic discussion so far this Autumn. Though there has sometimes in the past been an Autumn economic paper by the Chancellor, for the past 2 years Cabinet has had only a short oral report (by Sir Geoffrey Howe in 1982 and yourself in 1983). Assuming that you do not wish to write an economic paper, the choices are: (i) another oral presentation; (ii) to circulate the draft Industry Act Forecast (from the Autumn Statement) or (iii) a summary of it. How do you wish to proceed?

Oral presi

Q4 We need to settle some outstanding points on the contents of the Autumn Statement:

(a) Do you wish to give public expenditure figures for three forward years or only one?

one year only

(b) If only one year, no particular Autumn Statement points arise. But if we have to give three years figures then:

SECRET

- Are you content to settle for three years' aggregate figures for Nationalised Industries EFLs leaving for later decision whether they should be broken down in the PEWP?

- at present three columns of figures for the coming year are given in Table 2.1 (attached) of the Autumn Statement - the White Paper figures; Budget and other changes; and the revised plans. Three columns for each of three years would be dreadfully unwieldy. Do you agree that (in addition to 1984-85 plans) we should give 2 columns for 1985-86 (the White Paper figures in one column and the revised plans in the other) and 1 column for each of 1986-87 and 1987-88 (the latest plans)?

- Should we also include three years' manpower figures? [Paragraph 15 of Mr Battishill's submission of 27 September]

- Do you wish to give revenue projections for three years? And if so (i) do you agree that the revenue projections should be put in a new section in the Autumn Statement to follow Part 2 (on public expenditure)?; (ii) do you agree with the proposed presentation of the revenue projections; and (iii) do you agree with the proposed growth and inflation deflators for the three years? [Mr Riley's submission of 30 October]

(c) We also need to decide how we are to deal with the 1984-85 planning total [Mr Williams' submission of 30 October]:

- Should we publish the prospective outturn for the 1984-85 planning total in the Autumn Statement [see also Mr Burgner's submission of 30 October]

- If so, what figure for the planning total should we give?

- Where should the information, and the explanation, be given - in Part I of the Autumn Statement or Part 2?

(d) Should we include a footnote to Table 2.1 of the Autumn Statement to give the pay assumption? [Paragraph 19 of Mr Battishill's submission of 27 September]

Yes

(e) Should we round all figures in Table 2.1 of the Autumn Statement to the nearest £10 million, and the total to the nearest £100 million? [Paragraph 18(i) of Mr Battishill's submission of 27 September]

Yes

(f) Can we - this year at least - dispense with the idea of giving a detailed 1983-84 outturn in the Autumn Statement? [Miss Peirson's submission of 30 October]

Q5 Do you agree that we should publish Winter Supplementaries a week after the Autumn Statement, with proof copies being sent, in confidence, in advance to Select Committees on the same day as the Autumn Statement is delivered? [Mr Williams' submission of 30 October]

If the answer to Question 1 is that public expenditure is <u>not</u> going to Cabinet on 8 November, the following issues need to be addressed

Q6 Do public expenditure decisions go back at least one week until Cabinet on 15 November? Or is there any likelihood of a special Cabinet between the 8th and 15th?

Q7 If the <u>latter</u>, (eg Cabinet on Tuesday 13th) there would not be time for a full printed version of the Autumn Statement to be published after such a Cabinet and before Impact Day. We would then need to consider what <u>has</u> to be published before Impact Day, and how.

Q8 If the <u>former</u>, Ministers will need to address the choice between (i) putting back both Impact Day and Autumn Statement together; or (ii) putting back the Autumn Statement but keeping Impact Day on 16 November

Q9 If Impact Day and Autumn Statement are put back (8(i) above) how best to proceed?

Q10 If only the Autumn Statement is put back (until <u>after</u> Impact Day) (8(ii) above) then:

(a) Are final decisions to be taken on 15 November or 22 November Cabinet (with the Autumn Statement on 19/20 November or 26/27 November)? [Mr Burgner's submission of 30 October]

(b) What are the consequences for further work on public expenditure? [Mr Burgner's submission of 30 October]

(c) What further information must be disclosed before Impact Day assuming Cabinet settles public expenditure on (i) 15th or (ii) 22nd November (in each case with the Autumn Statement a few days later). In particular on:

- PSBR and planning total outturn for 1984-85?
- The forecast or the fiscal proposals for next year?
- Anything else? [Mr Burgner's submission of 30 October]

Q11 Can the announcement of NICs wait for the delayed Autumn Statement (presumably yes if the changes do not require legislation)?

Q12 Do you agree that if the Autumn Statement is delayed, the Winter Supplementaries should be published before the Autumn Statement? [Mr Williams' submission of 30 October]

Q13 With this later timetable, the detailed Questions 3 and 4 above still need to be addressed; but they become less urgent.

Central Unit

Table 2.1 Public Expenditure Plans

£ million

	1983–84	1984–85		
	White Paper (Cmnd 8789) with Budget and other pre-survey changes(1)	White Paper (Cmnd 8789)	White Paper (Cmnd 8789) with Budget and other pre-survey changes	Revised plans(2)
Departments (excluding nationalised industries' external finance)(3)				
Ministry of Defence	15 716	17 288	17 270	17 010
Foreign & Commonwealth Office (including Overseas Development Administration)	1 683	1 801	1 806	1 807
European Community	380	450	450	450
Intervention Board for Agricultural Produce	1 274	835	825	1 247
Agriculture	992	998	994	1 009
Forestry Commission	59	60	60	56
Department of Trade and Industry	1 488	1 370	1 411	1 351
Department of Energy	470	457	457	543
Export Credits Guarantee Department	55	164	164	166
Department of Employment	2 981	3 317	3 376	3 308
Department of Transport	3 366	3 466	3 546	3 537
DOE—Housing	2 709	2 988	2 993	2 496
DOE—Property Services Agency	−145	−115	−116	−92
DOE—Other Environmental Services	3 186	3 227	3 210	3 209
Home Office	4 041	4 253	4 241	4 333
Lord Chancellor's Department	449	509	509	501
Department of Education & Science	12 583	12 912	12 877	13 052
Office of Arts & Libraries	560	584	585	595
DHSS—Health and Personal Social Services	14 478	15 382	15 328	15 414
DHSS—Social Security	34 783	35 939	36 687	36 850
Civil Superannuation	937	1 017	1 036	1 053
Scotland(4)	6 160	6 339	6 339	6 318
Wales(4)	2 397	2 486	2 480	2 459
Northern Ireland	3 796	4 019	4 031	4 020
Other Departments	1 967	2 058	2 069	2 116
Adjustment for refund of VAT on certain services contracted out by Government departments	—	—	—	−30
Nationalised industries	2 748	2 615	2 548	1 882
Local authority current expenditure not allocated to departments	904	455	455	625
Special sales of assets	−1 250	−1 500	−1 500	−1 900
Reserve	1 040	3 000	3 000	3 000
PLANNING TOTAL	**119 807**	**126 374**	**127 131**	**126 385**

Note:

(1) Including measures announced on 7 July 1983 and changes of classification.

(2) Some figures may be subject to detailed technical amendment before publication of the 1984 Public Expenditure White Paper.

(3) Provision for pay in these programmes reflects the pay factor of 3 per cent announced on 15 September 1983.

(4) Excluding agricultural expenditure, which is included in the agricultural line.

Pl. amend M

SECRET AND PERSONAL COPY NO.

CHANCELLOR /

FROM: C J RILEY

DATE: 31 October 1984

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Cassell
Mr Kemp
Mr Monck
Mr Battishill
Mr Burgner
Mr Lankester
Mr Lavelle
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Watson
Mr Folger
Miss Peirson
Mr Williams
Mr Grice
Mr Ridley
Mr Lord
Mr Portillo

FISCAL PROJECTIONS FOR THE AUTUMN STATEMENT

Please note the attached corrections to figures in my submission circulated on 30 October (incorrectly dated 25 October).

pp. C J RILEY

Corrections

Covering minute:

Table in para 13, page 7. The bottom line should read:

1985-86	1986-87	1987-88	Cumulative
4	5	$4\frac{3}{4}$	14

Annex:

Table in para 10, page 5. The 1985-86 figures should be amended as follows.

October forecast planning total (top line)	133
Planning total underlying fiscal projections (bottom line)	$132\frac{1}{2}$

Para 11(a), page 6. The figure in the third line should be £$\frac{1}{2}$ billion.

Fiscal projections Version A:

In table 1.7, page 3, the 1985-86 figure for General Government Expenditure should be $132\frac{1}{2}$.

Ref: 108431

(17)

FROM: MISS M O'MARA
DATE: 31 October 1984

cc PS/Financial Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Cassell
Mr Monck
Mr Battishill
Mr Burgner
Mr Odling-Smee
Mr Scholar
Mr Gray
Miss Peirson
Mr Riley
Mr M L Williams
Mr Ridley
Mr Lord

PS/CHIEF SECRETARY

AUTUMN STATEMENT, PUBLIC EXPENDITURE AND BT

The Chancellor, Chief Secretary and Financial Secretary discussed the Chief Secretary's minute of 30 October and Mr Battishill's minute of the same date with officials this morning.

2. It was noted that it should be possible to settle the size of all Departmental programmes other than Mr Jenkin's outside Cabinet. On this basis, Cabinet should be able to discuss public expenditure and reach final decisions on 8 November, as planned. However, Cabinet might also have to discuss the totals for local authority relevant current expenditure and it might not be possible to take both these issues on the same day. The position could not be assessed until the Lord President had held his meeting on the local authorities but the Chancellor expressed a strong preference for avoiding two separate Cabinet discussions of public expenditure.

3. The Chief Secretary said that Mr Walker had this morning offered MISC 106 reductions of £1,900 million over the three year period. Mr Gray noted that in presenting these figures, Mr Walker had said that they ignored any CT effect. Although the natural interpretation of this statement was that the CT effect would be netted off before EFLs were struck, Mr Walker had explicitly said that the whole £1,900 million would be carried through into EFLs. However, it could not be assumed that he could be held to an offer made on this basis. The Chief Secretary noted that on prices Mr Walker had suggested an implied annual 4½ per cent increase for electricity over the three year period and increases of 6 per cent, 7 per cent and 8 per cent on gas. The Lord President was likely to recommend the Prime Minister to accept the package Mr Walker had put forward. It was agreed that the Chief Secretary should minute the Prime Minister, reluctantly accepting Mr Walker's offer on prices but indicating that he believed there was scope for securing further cost savings from the energy industries, thereby encouraging the Prime Minister to chair a meeting with Mr Walker herself. It would be necessary to ensure that she was very carefully briefed for this. There would also be an advantage in the Prime Minister holding a preliminary meeting with Mr Jenkin, although he was bound to appeal to Cabinet.

4. On the overall arithmetic, Mr Gray noted that if there were no further additions for LA current expenditure, the FCO could be held to baseline, if both MOD and DOE eventually accepted the MISC 106 proposals and if D/Energy offered savings of £1900 million for the three year period, with MISC 106 accepting MAFF's revised offer, public expenditure would be about £350 million above target in 1985-86, £200 million above in 1986-87 and £1050 million above in 1987-88, assuming reserves of £3 billion, £4 billion and £5 billion in the respective years. It was pointed out that the 1987-88 figure could be reduced by £350 million through allowing a growth of 3¼ per cent in the planning total for that year. The Chancellor commented that attention was bound to be focussed on the first two years of the Survey. He suggested the best way to present these figures was to argue that they remained within the 1984 White Paper totals, when no account was taken of the NIS deductions. If this approach were questioned, it should be pointed out that no account had been taken of CT either, where the sums involved were much larger. It should also be possible to claim that the planning total remained "broadly stable" over the full Survey period, even if growth of more than 3¼ per cent had to be accepted in 1987-88.

5. It was stressed that the public expenditure outcome could be considerably worse if concessions had to be made on the DOE programme. It was agreed that in this case, there would be no benefit in attempting to secure further savings from those who had already

settled, whether across the board or selectively. This made it all the more important to secure additional savings on the energy industries. It was important that the Prime Minister should realise the importance of not exceeding the 1984 White Paper figures and that she should be given a clear explanation of the way in which the abolition of NIS could be used in the presentation of the totals.

6. The meeting then turned to the annotated agenda attached to Mr Battishill's minute of 30 October.

7. It was agreed that there should be no difficulty in clearing the Star Chamber report or in circulating the Chief Secretary's paper. The Chancellor would make an oral presentation to Cabinet on 8 November.

8. On the form of the Autumn Statement itself, it was agreed that:

(i) public expenditure figures should be given for only one year ahead. The Chancellor concurred with the market advice he had already received from Kleinworts that the expenditure figures for 1986-87 and 1987-88 were not material to the BT sale. However, it was suggested that it would be prudent to encourage the TCSC not to take evidence on the Autumn Statement until after 3 December. The Chancellor said he would raise this point with Mr Higgins when he met him later in the day.

(ii) The reference to the prospective outturn for the 1984-85 planning total should be included in Part 1 of the Autumn Statement, where it should be indicated that the planning total was expected to exceed plans by about £1½ billion. The Chancellor noted that given the great uncertainties about the final figure, he would like commentators to draw the inference that had it not been for the coal strike, public expenditure in 1984-85 would have been on target.

(iii) The pay assumption should be included in a footnote to Table 2.1 and all figures in that table should be rounded as Mr Battishill had suggested.

(iv) A detailed 1983-84 outturn should not be given this year but the Chancellor undertook to tell Mr Lilley that the Treasury would give his proposal further thought.

(v) Winter Supplementaries should be published a week after the Autumn Statement with proof copies sent in advance to Select Committees.

MOM

MISS M O'MARA

A/S PART I: ECONOMIC FORECAST

47/249

SECRET AND PERSONAL

(pmp)

PS/FST → EVANS 31/10

FROM: H C GOODMAN
DATE: 31 October 1984

MR EVANS

cc PS/Chancellor

AUTUMN STATEMENT PART I: ECONOMIC FORECAST

As the Chancellor's Office told me that it is unlikely that there will be a meeting to discuss your minute of 26 October and the draft IAF I am sending you direct the Financial Secretary's detailed points.

2. My earlier minute recorded his view that the assumption about the length of the miners' dispute should be redrafted.

3. Paragraph 1.11 final line - the Financial Secretary thinks that the Statement "Although the US policy on balance is not sustainable indefinitely, its resolution could well take several years." should be redrafted, as it suggests that the UK Government is content for the US Government to carry on as they are. More pressure needs to be put on them.

3. Paragraph 1.23. The sentence beginning Estimates (should be redrafted) The Financial Secretary thinks that since the figures are provisional and liable to be revised they might as well be excluded.

4. The Financial Secretary also queried the nationalised industry figures set out in table 1.3. We spoke about this.

5. Paragraph 1.39 - the Financial Secretary thinks that the final sentence should be dropped if further extensions to the VAT base are to be considered. It is not helpful to suggest that VAT inhibits economic activity.

HG.

H C GOODMAN

Pps pl

233/43

SECRET

FROM: **A M ELLIS**
DATE: 31 October 1984

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Anson
Mr Cassell
Mr H Evans
Mr Scholar
Mr Battishill
Mr Burgner
Miss Peirson
Mr Culpin
Mr Stibbard
Mr Williams
Mr Ridley

I entirely agree with the FST. LST was saying "about £1½ bn" & equate it to the cost of remaining strike. N.

AUTUMN STATEMENT: EXPENDITURE IN 1984-85

was on the agenda for yr 31/10 meeting

The Economic Secretary has seen Mr Williams' submission of 30 October. Mr Williams discussed (paragraph 6-8) how precise an indication ought to be given ~~at~~ the planning total overspend. The Economic Secretary disagrees that "about £1½ billion" is so imprecise as to be misleading and to prejudice, in any way, the BT launch. The markets will not in his view be expecting the high degree of precision assumed by Mr Williams some four months before the end of the financial year, particularly given the well known difficulties in forecasting the outturn.

AE

A M ELLIS

1/11/84.

1. Economic Prospects for 1985

Summary 10053

1·01 1984 looks like being the best year since 1976 for growth in world output and trade. Price rises, particularly in commodities but also in industrial products, are low. Next year will see slower growth in the United States, partly offset by somewhat faster growth in parts of Europe. With world interest rates likely to remain high in real terms, and with major debt problems easing only very slowly, many developing countries will have to make further adjustments.

1·02 It is necessary, for the purposes of this forecast, to make an assumption about the duration of the miners' dispute: it is assumed to be over by the end of the year. The forecast is based on the usual assumption that fiscal and monetary policies in 1985–86 will be as indicated in the 1984 Medium Term Financial Strategy in the FSBR.

1·03 In the first half of 1984 total output in the UK was over 3 per cent up on a year earlier despite the losses caused by the miners' strike. With rising real incomes benefiting both the personal and company sectors, and with companies having successfully restored their financial positions, domestic demand should grow substantially again in 1985. With further growth in prospect for UK markets overseas, exports should record another rise.

1·04 Total output in the UK is forecast to rise by 3½ per cent in 1985 (of which 1 per cent represents recovery from the miners' strike). The rise in employment, over 1 per cent in the year to mid 1984, is expected to continue

1·05 Price rises and wage settlements have been fairly steady since early 1983. Inflation this year has been much as expected in the Budget forecast despite a lower exchange rate. Although no major change is foreseen for inflation in 1985, there may be a gradual decline.

1·06 Britain's external accounts were in substantial surplus in the period 1980–83, contributing to the rapid build up of overseas assets. In 1984 extra oil imports have led to a position of near balance so far; with the ending of the miners' strike, a return to surplus is forecast. North Sea oil production in 1985 may be close to its maximum.

is likely to

1·07 For the 1984–85 financial year as a whole, the extra costs of the miners' dispute, ~~and~~ on top of higher expenditure elsewhere, ~~may~~ more than offset higher oil revenues. Although the outturn is still very uncertain, the result is forecast to be a PSBR somewhat above the Budget forecast, but below the outturn for 1983–84. For next year, 1985–86, latest forecasts suggest that there would probably be scope for tax cuts if the PSBR ~~was~~ to be £7 billion, or 2 per cent of GDP, ~~as~~ assumed in the last MTFS.

were the

The world economy

disaggregate

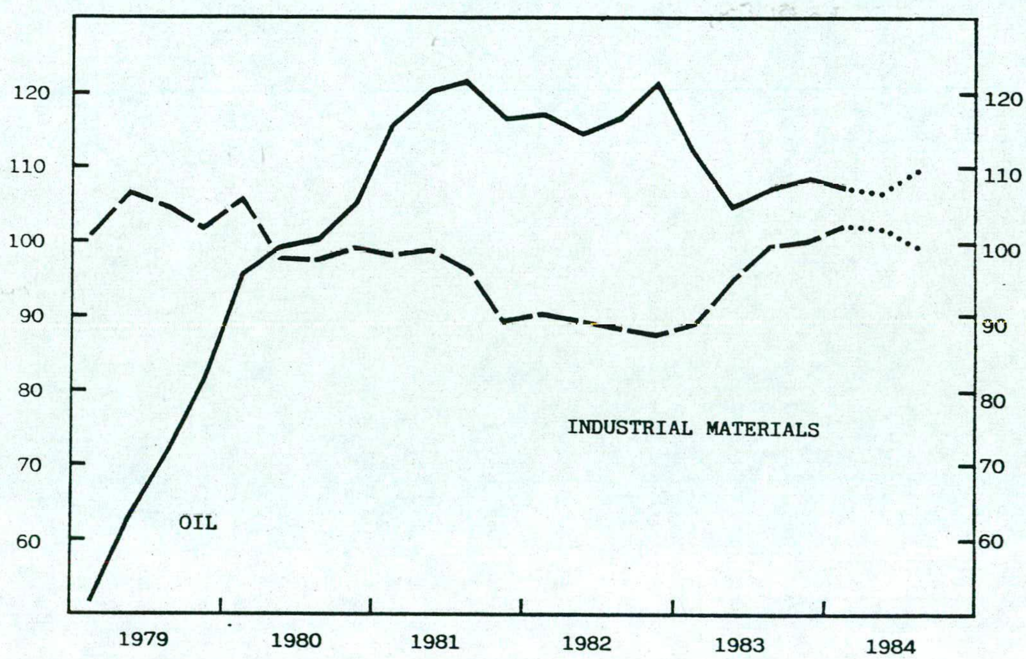
Recent developments

1·08 1984 is showing a rapid growth in world output and trade. GNP in the major six economies other than the UK is likely to grow by about 5 per cent with an increase of nearly 10 per cent in total world imports. At the same time, inflationary pressures have been low: consumer prices are rising at about 4½ per cent, much as in 1983.

1·09 These developments have been heavily influenced by movements in the US economy. This year, total output in the US may be 7 per cent or more by volume above 1983 levels, domestic demand 9 per cent up and total imports up over 25 per cent. Coupled with the continued large budget deficit in the US, the expansion has contributed to the general rise in the level of world interest rates—a major factor constraining activity in Europe and many developing countries, and offsetting in part the effect of the growth in US imports. ?

1·10 Commodity prices picked up sharply in the course of 1983 as expectations of recovery were finally confirmed, but more recently spot prices have fallen back some way: perhaps because many producers are under financial pressures to maximise revenues and output, and because in the industrial countries restocking has been modest. Oil prices, set in terms of the strengthening dollar, rose 5 per cent in real terms between mid 1983 and late 1984, but the resulting imbalance in the market compounded by higher production and weak demand may now be bringing about some adjustment. Chart 1.1 shows commodity prices, for oil and industrial materials, expressed in real terms.

CHART 1.1 Commodity prices, 1980 = 100*



* In relation to prices of manufactured exports.

Prospects

1·11 The US economy seems set for slower growth, already foreshadowed in the leading indicators. As the economy gets nearer to full employment and high rates of capacity utilisation, slower growth is likely, particularly in interest-sensitive areas of domestic demand such as stockbuilding, housing investment and consumer durables. Assuming only slow progress in reducing the fiscal deficit and a slow pick up in inflation, US interest rates may stay high next year. We have assumed that US residents and foreigners continue to fund the deficits, without any major break in confidence. Although the US policy imbalance is not sustainable indefinitely, its resolution could well take several years. ??

1·12 In Europe the recovery has not yet gone very far and a growth rate of 3 per cent or so could well be sustained in 1985. In the developing countries, faced with the prospect of continuing high interest rates, a strong dollar and weak terms of trade, growth of domestic demand and imports may again be subdued, with major adjustment problems remaining; and OPEC markets are also liable to be weak.

When?

1·13 Overall, the slowdown in the US will probably not be fully offset by higher growth elsewhere and the fall in unemployment over the past year may not be repeated. Nevertheless 1985 could well be another year of fair growth and low inflation:

Table 1.1 World Economy

Why exclude UK?

	Percentage changes on a year earlier		
	1983	1984	1985
World GNP*	$2\frac{1}{2}$	5	4
Consumer prices*	$4\frac{1}{2}$	$4\frac{1}{2}$	4
World trade in manufactures (UK-weighted)	$1\frac{1}{2}$	7	$4\frac{1}{2}$

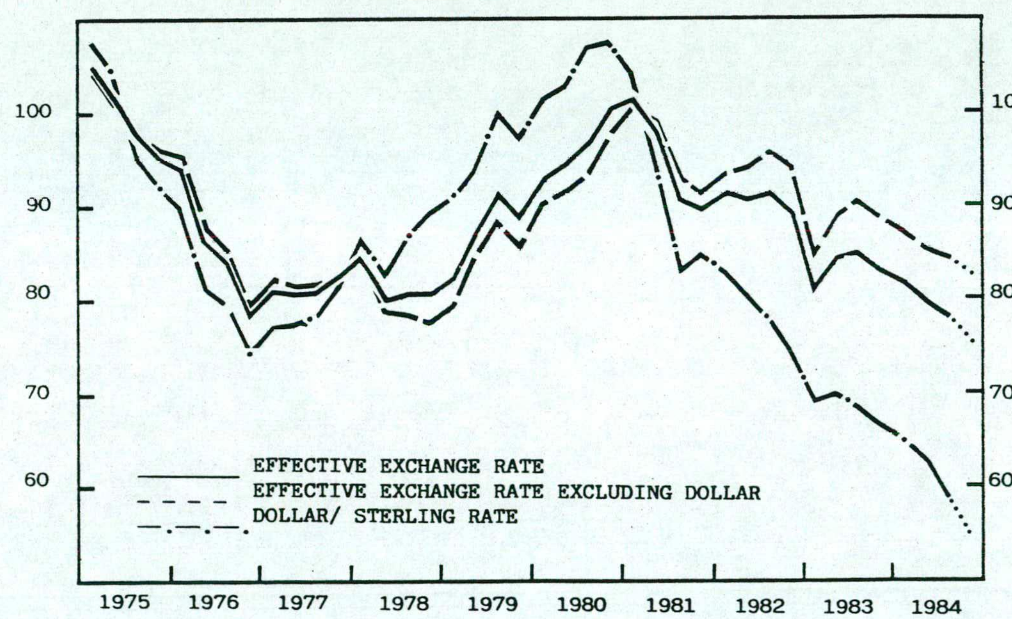
* Major 6: US, Canada, Japan, France, Germany, Italy.

longer

The Exchange Rate and The Balance of Payments

1·14 The budget forecast assumed that the sterling index would be close to its average level last year of 83. In the event, the effective exchange rate has been weaker than this, partly because of the unexpected strength of the dollar, and partly because of industrial disputes and more recently weaknesses in oil prices (see chart 1.2). The assumption on sterling for this forecast is that the level in 1985 will not be very different from the average of the period July–October 1984 [$77\frac{1}{2}$].

CHART 1.2 Effective exchange rate and dollar/sterling exchange rate, 1975 = 100



1.15 With UK unit labour costs in manufacturing expected to continue to grow a little faster than the average of our major competitors there may not be any further gains in cost ~~(or price)~~ competitiveness in 1985. After reaching 11 per cent this year the rise in import prices is likely to decline, perhaps to an annual rate of some 5 per cent for manufactures by the second half of 1985, broadly in line with world inflation.

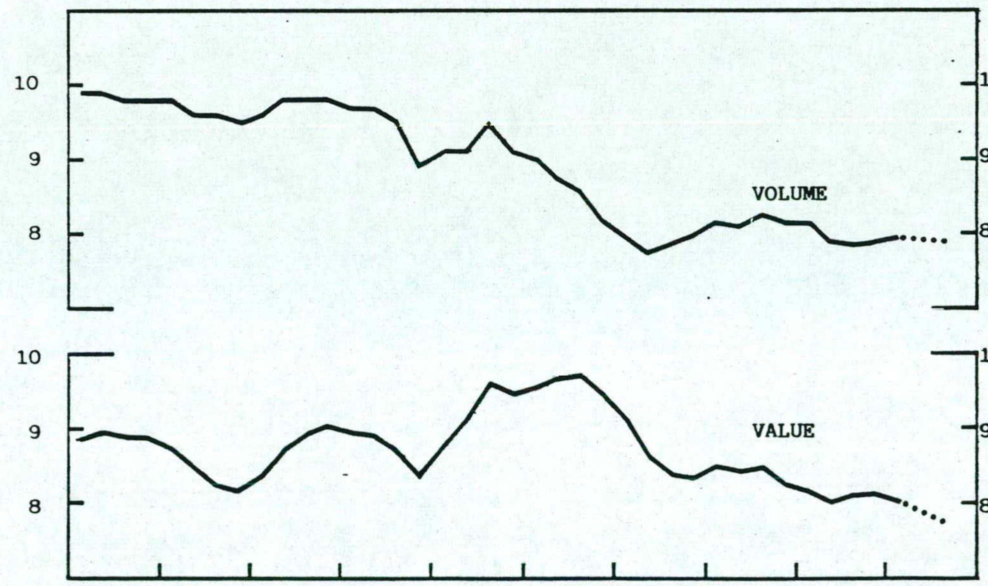
1.16 This slower growth of import prices, on the assumption of stability in the sterling index, plays a role in keeping domestic inflation low over the next year, and in maintaining the terms of trade close to current levels.

1.17 Despite the effect of the miners' strike in raising oil imports this year, the outturn for the balance of trade in oil may exceed last year's surplus of £7 billion. By comparison with the Budget forecast, the miners' strike is worsening this year's c.b. balance by some £2 billion. On the other hand, higher sterling oil prices and higher North Sea oil production are adding a similar amount to the forecast of the oil balance.

1.18 Trade statistics have been distorted by the dock strikes but the underlying trends have shown a slower growth in volumes of both exports and imports than at the turn of the year. Nonetheless it is likely that the volume of exports of goods will be 7 per cent higher this year than in 1983, the best performance since 1977. Imports, of manufactures, have been growing strongly this year as a result of the continuing recovery in domestic demand.

1.19 Chart 1.3 shows the trends in UK manufacturing exports as a share of main manufacturing countries' trade measured in both value and volume terms.

CHART 1.3 Share of UK exports in main manufacturing countries exports of manufactures (%, three quarter moving average)



PART 1—GALLEY 3

export

1.20 In the absence of major changes in cost competitiveness or other aspects of trade performance, prospects for growth of UK exports will depend mainly on expansion of UK markets. With world trade in manufactures forecast to rise by 4–5 per cent next year, exports might well grow by 3 ½ per cent in volume terms in 1985. This would be consistent with recent survey evidence from the CBI, showing positive balances on the exports optimism indicator, and on expectations of export orders and deliveries. **10057**

1.21 Increases in import penetration in manufactures in both volume and value terms have been broadly offset, for the economy as a whole, by falls in imports of oil as North Sea production has risen. These trends are expected to continue next year, as domestic demand for manufactures—noticeably more cyclical than total domestic demand—continues to grow strongly. Imports of goods other than oil could rise 7½ per cent in 1985, much the same as in 1984. With oil imports assumed to fall after the end of the miners' dispute, total imports of goods may rise 4 per cent.

1.22 The balance on *services*, as a percentage of GDP, reached a low point in 1982, as the effects of the loss of competitiveness were felt, and the decline in the UK merchant fleet reduced the balance on sea transport by nearly £1 billion between 1980 and 1983. Some of this loss of competitiveness has now been regained and the balance has started to recover: with a slower decline in the UK fleet and a fairly buoyant world economy, we expect a continued improvement in the services balance next year.

following the abolition of exchange control.

1.23 The balance on *interest, profits and dividends* (IPD) has risen from zero in 1980 to nearly £2 billion in 1983, with the build up of the UK's net asset position abroad. (Estimates for the first half of 1984, which put the IPD balance at only £1¼ billion at an annual rate, are provisional and liable to be revised up). This in turn has been made possible by the capital outflows, which reflected the large current account surpluses of the 1980–1983 period, assisted by rises in stock market prices and currency revaluations, especially the fall in sterling against the dollar (in which some 50 per cent of overseas assets are denominated). If, as is assumed, the fall in the dollar/sterling rate comes to an end, the ratio of net assets to GDP may grow more slowly. But the assets will continue to provide a stream of income in future years, when North Sea oil production may be lower than at present.

Table 1.2

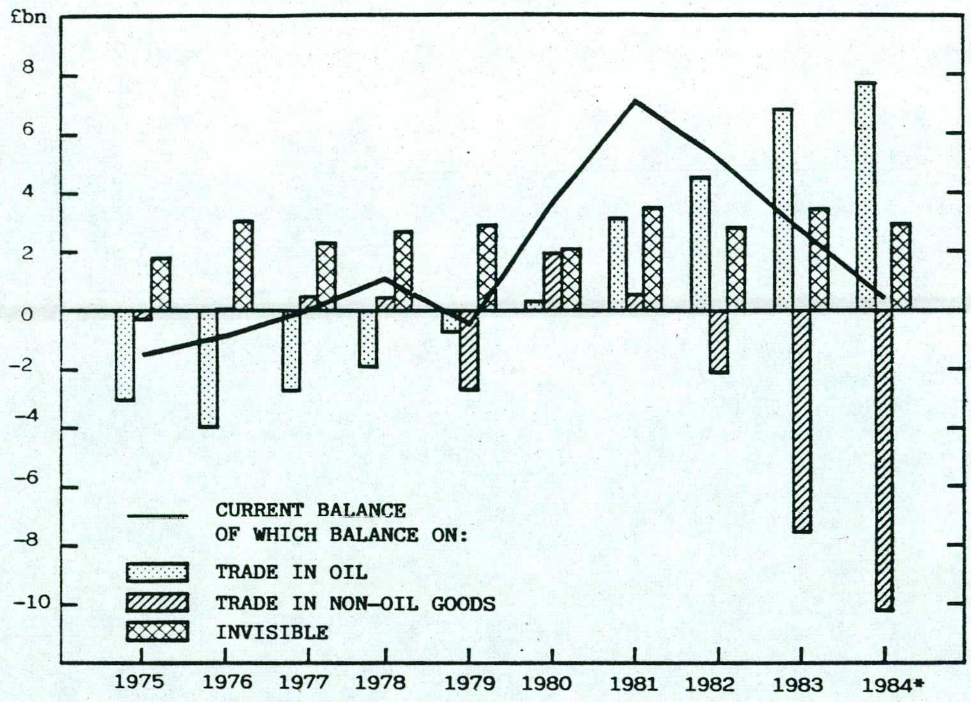
Net UK External Assets, end year

	£ billion	per cent of GDP
1979	13	7½
1983	56	18½
1984 (forecast)	70	21

1.24 Our estimate of current account balance in 1984 compares with a CSO estimate of a deficit of £½ billion for the first nine months. We have allowed for: the receipt of EC funds and a rise in exports in the fourth quarter; and a better outcome on invisibles than indicated by recent data and CSO projections.* An improvement in the surplus forecast for the current account in 1985 reflects in particular lower oil imports after the assumed ending of the miners' strike, low commodity prices, and a rising surplus on invisibles. The sectoral composition of the current account in recent years ~~has been as follows:~~ is shown in Chart 1.4

* in addition, the forecast allows for an upward revision to imports on a balance of payments basis, from 1980 onwards, currently worth nearly £½ billion at an annual rate. Details will be published with the October trade figures.

CHART 1.4 Balance of payments current account (£ billion)



* FIRST HALF YEAR ANNUALISED

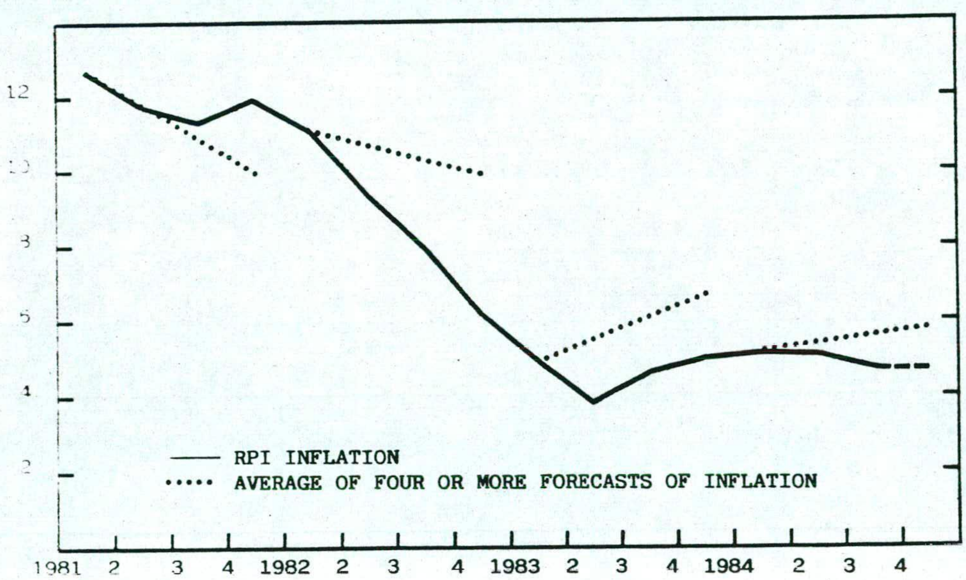
Inflation

1.25 Inflation abroad has been generally low. In the UK, inflationary pressures have remained very moderate, despite further falls in the exchange rate. The higher inflation rate indicated by the RPI in the second half of 1983 and early 1984 is, as expected, proving temporary. As measured by the GDP deflator at market prices, inflation has fallen from 12 per cent in 1981 to 5 per cent in 1983 with a further fall in the first half of 1984.

1.26 The general tendency among forecasters to overestimate price rises can be seen in the chart below (the dotted lines show forecasts, made early in the year, of inflation at the end of the year):

CHART 1.5 **Inflation: RPI path and recent predictions**

drop 1981



Costs

1.27 The recent falls in spot commodity prices have not, as yet, made much impact on domestic prices. Import prices for basic materials in the third quarter of 1984 were 15 per cent up on a year earlier, reflecting earlier rises in commodity prices and falls in the exchange rate. Domestic cost increases have not benefited as much as in 1983 from productivity gains, but the cuts in and abolition of the National Insurance Surcharge are helping to limit cost increases this year.

Despite a 10 per cent rise in the prices of imported manufactures in the course of 1984, competitive pressures helped to limit the rise in prices at the wholesale stage (excluding food, drink and tobacco) to 5½–6 per cent, much as in 1983 and close to the rise in costs.

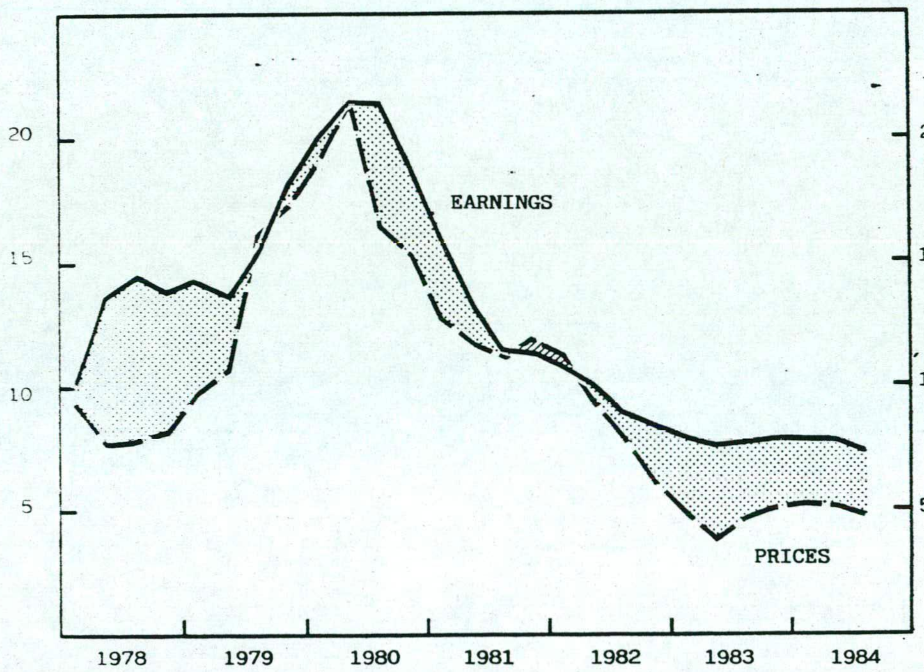
Pay

1.28 Pay settlements in the 1983–84 pay round were generally around 5½ per cent, very similar to those in the 1982–83 pay round. Earnings in the economy as a whole have been reduced by the miners' strike and by delays in some public sector settlements. The underlying rate of increase, about 7½ per cent, reflects, in addition to nationally negotiated wage settlements: productivity deals, bonus payments, changes in hours worked, and compositional changes.

10059

1.29 With earnings rises, on an underlying basis, well above price rises, real earnings for those in employment have been on an increasing trend since mid 1982, as shown in chart 1.6.

CHART 1.6 Earnings (underlying) and prices
Percentage changes on a year earlier



Prospect

1.30 While no major change in the rate of price inflation is expected in 1985, there may be some gradual decline, in the absence of a fall in the exchange rate and as the effects of recent falls in commodity prices come through. In a generally weak labour market, there have been substantial rises in real take-home pay over the past two years; and further increases in real take-home pay would be consistent with a flat or slowly falling trend in wage settlements. Labour costs, taking account of the abolition of the NIS from October 1984, may rise by about 4 per cent in 1985.

1.31 The recovery in domestic demand and output since 1981 has been reflected in, and encouraged by, a recovery in profit margins on home sales. With sterling assumed to be steadier, costs and domestic prices may move more nearly in line in 1985.

1.32 The annual increase in the RPI may stay near to its present level of 4¾ per cent through the first half of 1985 before falling in the fourth quarter. The housing component is strongly affected by changes in the mortgage interest rate: by the fourth quarter of 1985, the annual increase in the RPI will no longer be influenced by the sharp rise in mortgage rates in the summer of 1984. Table 1.3 shows changes in the main components of the RPI. Wholesale price inflation should also decline slowly in the course of 1985.

Table 1.3 Retail Prices

	Weight	Per cent changes on a year earlier			
		1983 Q4	1984 Q4 Forecast*		1985 Q4 Forecast
MFood	20	6	3	(3)	4
MNationalised industries**	10	1½	3½	(3½)	4½
MHousing	14	6½	10½	(7)	4
MOther	56	5	4	(4½)	4½
MTotal	100	5	4¾	(4½)	4½

* 1984 FSBR forecast in parenthesis.
** Includes BT and London Transport; excludes water. — Why? better include water

Demand and Activity

10060

1.33 Activity rose by over 3 per cent in 1983. In the first half of 1984, the average measure of GDP again showed a rise of over 3 per cent on a year earlier; had it not been for the miners' strike, the increase would have been about 4 per cent. Since the early part of the year, there is evidence from both goods and labour markets of a somewhat slower rate of growth in activity. The miners' strike is estimated to be reducing the level of total output in the economy by rather over 1 per cent.

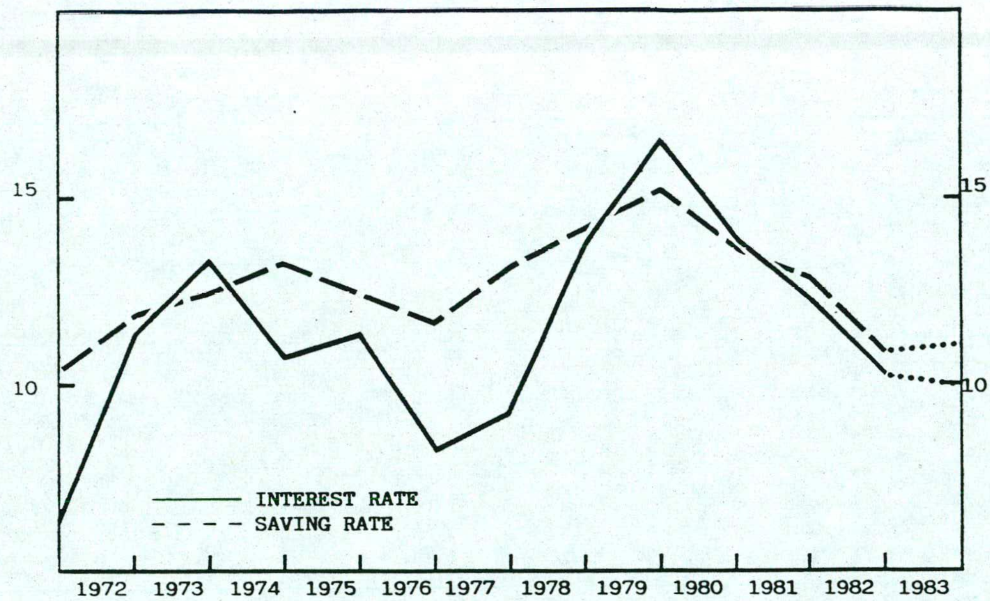
1.34 For the first two years of the upturn which began in 1981 domestic demand grew more quickly than output. By 1983, there had been a widespread increase in all components of domestic demand, with a large rise in consumer spending. This year the growth of domestic demand has been slower, partly as a result of the effect of the miners' dispute on stockbuilding, and the balance has as expected shifted away from consumer spending towards investment. But overseas markets have grown more rapidly and so the increases in GDP and domestic demand are much more in line.

Personal sector income and expenditure

1.35 In 1983 real personal disposable income recovered to its 1980 level. But in order to finance higher spending, consumers reduced their rate of saving by 4½ percentage points. Between 1982 and 1983 the increase in consumer spending was almost 4½ per cent, helped by renewed growth in personal income.

1.36 The fall in saving was encouraged by the fall in inflation (which had been steadily eroding the real value of existing assets), by the drop in interest rates, and by easier access to credit. Chart 1.7 compares the saving ratio with nominal interest rates: both the saving ratio and nominal interest rates reflect, to a major extent, the rate of inflation. The high growth in spending in 1983 included a large increase in expenditure on durables, particularly on motor cars where expenditure rose by over 20 per cent, in part no doubt delayed replacement of the existing stock.

CHART 1.7 Savings ratio and interest rate (percent).



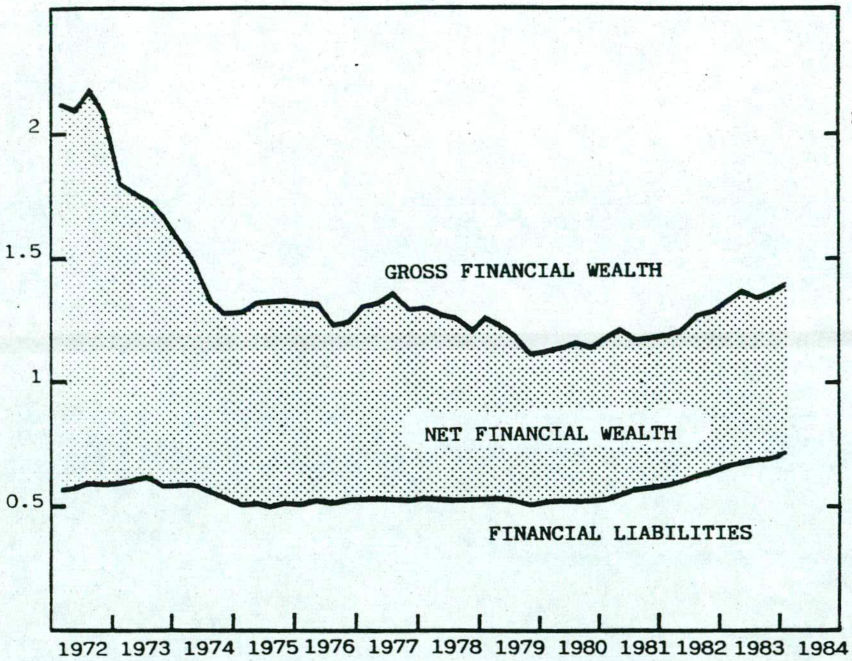
1.37 In 1984 personal income growth has continued in spite of the effects of the miners' strike, and spending on non-durables seems likely to record another sizeable rise. Durables consumption seems likely to stay near last year's high level with a rise in total consumer spending of perhaps 2 per cent, rather less than in 1983

* 1.38 The assumption that the £[ ] billion fiscal adjustment next financial year is used to cut personal taxes raises real personal disposable income in 1985 by [½] per cent. This, combined with an assumed recovery in miners' earnings, and increases in employment and most other sources of income, produces a forecast of rise in RPDI of 4 per cent. As would be normal at times of rapid income growth the savings ratio is expected to rise slightly and personal consumption may grow by 3½ per cent.

10061

1.39 The personal sector has more than trebled its borrowing since 1979, the major part of the increase being attributed to loans for house purchase from banks and building societies. Not all the lending, however, has directly financed spending: personal liquidity has been built up. Chart 1.8 shows that net financial wealth has increased in relation to income, partly as a result of valuation changes in the gilt and stock markets, but, with increased borrowing, gross financial wealth has increased faster.

CHART 1.8 Personal sector wealth income ratios



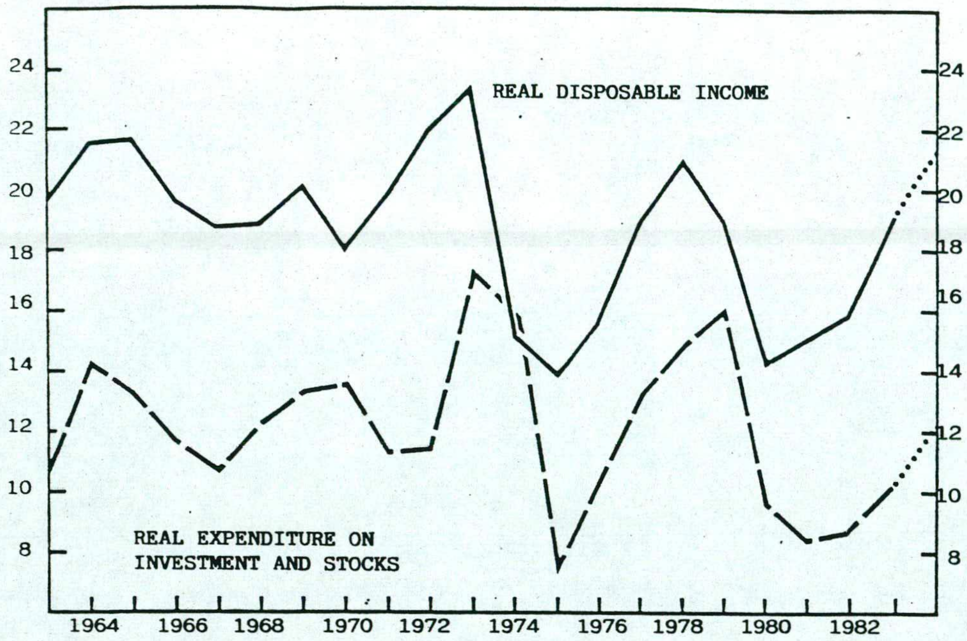
1.40 Personal investment in housing has now been redefined to include improvement work, which grew rapidly to mid 1984. 1982 and 1983 saw a substantial recovery, now slowing down, in new housing investment. The ending of some grant-aided improvement schemes and the imposition of VAT are likely to check the growth of improvement work from mid 1984 and the level of housing investment in both 1984 and 1985 may remain close to the 1983 outturn.

Company income and expenditure

1.41 The last eighteen months have seen a major recovery in company incomes as sales and profit margins have improved, particularly in overseas markets. This increase has not yet been fully reflected in tax payments, and in the twelve months to June 1984, non-North Sea company disposable incomes were up 28 per cent on the previous twelve months.

1.42 As usual at this stage of the cycle, company expenditure has lagged behind incomes so that the company sector has been running a large financial surplus, with a substantial improvement in corporate liquidity. This surplus can be expected to diminish as the growth in company incomes moderates and as expenditure rises. But in the absence of any sizeable stock rebuild, the company sector's financial surplus is likely to remain high by past standards.

CHART 1.9 **Company* income and expenditure**
£ billion 1980 prices



* Industrial and commercial companies (excluding those operating in the North Sea).

10062

Investment

1.43 Business investment is now growing strongly: in the first half of 1984 it was up 13 per cent in real terms on the first half of 1983. The recovery in manufacturing investment this year has been particularly marked. For 1984 as a whole, fixed investment by non-North Sea industrial and commercial companies may be 10 per cent up on 1983, with further growth of perhaps 6 per cent in 1985. With North Sea expenditure recovering from the low level seen in 1983, 1984 seems likely to record a substantial increase in total private fixed investment. In 1985, North Sea investment may not rise so much; housing investment is unlikely to increase further, and public investment [particularly by local authorities] is expected to decline [following the overspend in 1983–84 and 1984–85]. Thus the growth in fixed investment for the economy as a whole in 1985 may be modest.

* discuss

Stockbuilding

1.44 In contrast to fixed investment, company expenditure on stocks has shown little tendency towards the recovery usual at this stage of the cycle: real interest rates are high, and the tax changes in the Budget reduced the incentive to hold stocks. Manufacturers' and distributors' stocks fell during the first half of 1984, reversing the rise seen over the previous six months. Recent surveys do not suggest much desire to change stock levels, and the forecast sees no more than a weak resumption of stockbuilding in 1985 as the growth in output and sales continues.

Total demand and activity

1.45 With real incomes of both persons and companies rising, domestic demand is expected to continue to grow during the forecast period. The effects of the miners' strike seem likely to make the increase in demand and output larger than in 1984. The continuing recovery in world markets is allowing exports to grow more in line with imports; and GDP in line with domestic demand. Export growth is expected to slow next year as world markets grow less rapidly and import growth falls because less oil is required for electricity production.

10063

Table 1.4 Domestic demand and GDP

	Percentage changes on a year earlier		
	1983	1984	1985
Domestic demand	4½	2½	3½
Exports of goods and services	1	5½	4½
Imports of goods and services	5½	7½	4
Domestic production: GDP	3	2½	3½

1.46 The share of manufacturing industry in total output has been falling since the early 1970s. For 1985 as a whole, with substantial growth continuing in the demand for manufactures, output in the manufacturing sector should rise further, but perhaps a little more slowly than output in total. Increases of about 10 per cent in the output of the North Sea oil sector in 1983 and 1984 accounted for about ½ per cent of GDP growth in each year; no further sizeable increases in oil output are expected.

Table 1.5 GDP and manufacturing output

	Percentage changes on a year earlier		
	1983	1984	1985
Gross domestic product, average measure (the figures in brackets exclude the effects of the miners' dispute)	3	2½ (3½)	3½ (2½)
Manufacturing	2½	2	2½

footnote

Productivity and the labour market

1.47 As the economic recovery became firmly established during 1983 total employment began to rise. By June 1984 the employed labour force is estimated to have been almost 300 thousand higher than at the trough in March 1983. Most of the increase was in the services sector: many of the new jobs were part-time and filled by women. In the manufacturing sector, which accounted for much of the labour shedding of the previous three years, employment continued to fall though at a much reduced rate. The rise in productivity in manufacturing—up nearly 20 per cent over the past three years—has gone beyond the usual cyclical recovery.

1.48 Underlying trends in productivity are hard to identify because of the strong cyclical influences. In part the strong recovery in output per head in recent years reflects normal adjustment following the large fall between 1979 and 1981. During 1983 manufacturers may have been a little more cautious than usual, preferring initially to meet the increased demand for output with substantial increases in overtime working rather than by taking on new workers. Table 1.6 shows average annual growth rates of output per head, for manufacturing and non-manufacturing, over longer periods of time.

10064

Table 1.6 Output per head

	Annual averages, per cent		
	1964–73	1973–79	1979–83
Manufacturing	4	¾	3
Non-manufacturing	3½	¼	1

Even over complete cycles the path of actual output per head can be significantly influenced by the relative strength of booms and recessions. Thus the apparent slowdown in productivity between 1973 and 1979 may in part reflect the (unsustainable) strength of the 1973 peak in activity, to which firms did not fully adjust their labour force, and the relative weakness of the 1979 peak. The slowdown in the 1973–79 period may also reflect a tendency, subsequently reversed, for potential productivity gains arising from higher investment not to be fully realised. 8

1.49 Nevertheless it seems clear there has been a pick up in underlying productivity growth since the late 1970s. This may have been a response to the more rapid growth of labour costs both in real terms and in relation to other business costs. Changes in working practices and attitudes to innovation may be having a permanent effect on the rate of growth of productivity, though the evidence is not conclusive. The forecast assumes that underlying productivity growth in manufacturing and non-manufacturing will continue at a faster rate than in the 1973–79 period but rather slower than recorded in the last four years. Taken together with the forecast of output this is consistent with continued growth in total employment.

1.50 Despite the recovery in employment, unemployment levelled out only briefly during the second half of 1983 and since the beginning of this year it has increased on average by 17,000 per month. The figures imply a very substantial increase in the working population over the past year, considerably larger than the growth in the labour force that had been expected on the basis of demographic changes. It seems that, while continued falls in manufacturing employment resulted in more full-time workers joining the unemployment count, the growth in part-time jobs in service industries attracted women who were not previously claiming benefit. Probably many of these women were returning to work after a period outside the labour force. Although the figures are very uncertain, further growth in the labour force is forecast and the trend towards more part-time working, which was evident in the seventies, may continue.

Evidence?

10065

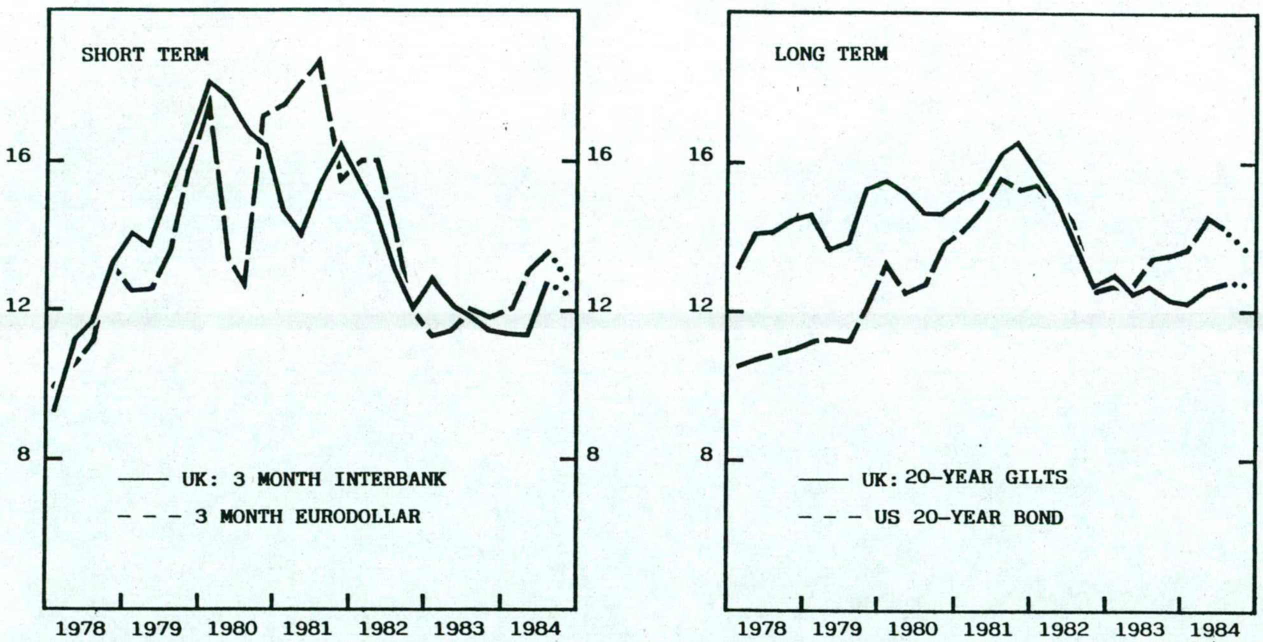
Interest rate and monetary growth

Interest rates

1.51 In the US the continuing rise in economic activity together with expectations of both a high Federal deficit and restrictions on monetary growth led to further upward pressure on interest rates in the first half of the year. There has subsequently been some easing in rates, but they are still above the level prevailing at the beginning of the year. By contrast interest rates in most other major OECD economies have changed very little. In the UK there was some further easing in short-term interest rates in the early months of the year, but strong upward pressure emerged in the money markets in July, associated with a weakening of the sterling/dollar exchange rate and market worries about industrial disputes and certain aspects of domestic monetary conditions. With the subsequent easing of the latter worries, rates have fallen back, but not by the full extent of the July increase.

Yes

CHART 1.10 **Interest rates** (percent)

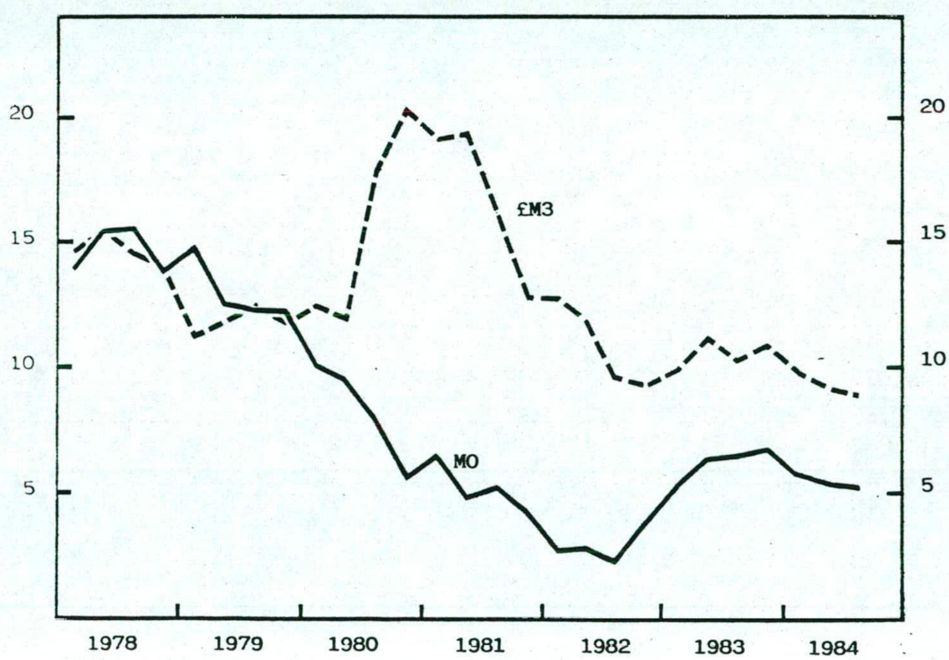


Money supply

1.52 Growth of M0 in the current target period to mid-October was [well within] its 4–8 per cent target range. Growth of £M3 over the same period was ~~[a little above]~~ its 6–10 per cent target range~~, but growth over the 12 months to mid-October was [within the target range]~~. Our limited experience with M2 still makes it difficult to interpret, as does the reclassification of certain building society accounts from outside to within M2. PSL2 has been growing faster than £M3, mainly as a result of the relatively rapid growth of building society deposits. The forecast assumes that the 1985–86 target ranges for M0 and £M3 will be the same as the illustrative ranges in this year's Medium Term Financial Strategy, 3–7 per cent for M0 and 5–9 per cent for £M3.

within

CHART 1.11 **Monetary growth,** percentage changes on a year earlier for banking months March, June, September and December



Fiscal projections

1.53 The PSBR in 1983–84 was £9·7 billion*, as forecast in the Financial Statement and Budget Report. The EC rebate in respect of 1983 was not received during 1983–84, and this increased central government borrowing on own account. On the other hand public corporations' borrowing turned out a little lower than expected.

1.54 In the first six months of 1984–85, the PSBR was £7·2 billion, the same as the Budget forecast for the full year. It was always expected that the PSBR would be more than usually front-end-loaded this year. Even so, there are reasons for expecting public borrowing this year to be above the Budget forecast, though lower than in 1983–84:

(i) Local authorities' overspend on capital account in 1983–84 seems likely to be followed by further overspend in 1984–85.

(ii) Higher interest rates than expected at the time of the Budget have increased debt interest payments.

(iii) On the revenue side, however, extra receipts from North Sea oil are expected broadly to offset these two factors. 10066

(iv) The miners' strike may add, over the year as a whole, approaching £1½ billion to total borrowing.

1.55 **As a result, the PSBR for 1984–85 as a whole is now projected some £1¼ billion higher, at £8½ billion, than the Budget forecast. There is inevitably still a substantial margin of error surrounding this forecast (average errors in PSBR forecasts at this time of year exceed £2 billion).**

1.56 The projections in tables 1.7–1.9 take account of the Government's spending plans shown in Part 2. The assumption is made that tax thresholds, allowances and specific duties are indexed in 1985–86 by 4¾ per cent. The forecast also takes the same assumption as in the MTFS about the PSBR in 1985–86: 2 per cent of GDP, equivalent to £7 billion. On the basis of the current projections of expenditure and revenue, this would leave room for a fiscal adjustment, perhaps
* of the order of £[[illegible]] billion. (The forecast assumes, conventionally, that the fiscal adjustment takes the form of a reduction in income tax, which is then incorporated in the projections of personal income and spending etc.) Although
NB the fiscal adjustment for 1985–86 is not very much changed since the Budget projection, both expenditure and revenues seem likely to be higher. In the case of revenue, this mainly reflects higher North Sea oil revenues, as a result of higher sterling prices and production. But this assessment of fiscal prospects should not be taken as a firm indication of the likely scale of changes in the 1985 Budget. It will be necessary to review nearer the time and in the light of updated forecasts the appropriate level for the PSBR in 1985–86. 10067

check standard wording from last year

1.57 Any estimate of the extent of the fiscal adjustment for 1985–86 is extremely uncertain: it depends on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions. For the public sector as a whole, the flows on either side of the account approach £200 billion.

Expenditure

1.58 General government expenditure in national accounts terms is forecast to rise, in cash, by around [6½ per cent] in 1984–85 and [4 per cent] in 1985–86. Table 1.7 shows the basis of these figures. They are affected by the miners' strike: the underlying rates of increase are 5-5½ per cent for both years. Details of expenditure programmes in 1985–86 are provided in Part 2. The additional claims on expenditure in 1984–85 mean that the prospective outturn for the planning total, at nearly £128 billion, may exceed plans (shown in table 2.1) by about £1½ billion.

*** New definition. On the old definition (including bank deposits) it was £10·0 billion.**

public sector

Table 1.7 General Government Expenditure*

£ billion

	1983–84	1984–85	1985–86
General government expenditure(1)	120½	128	133
National accounts adjustments(2)	4	4½	5
Interest payments	15	16	16½
Total expenditure in national account terms	**139½**	**148½**	**155**

(1) Expenditure on programmes by central government and local authorities plus the reserve and special sales of assets, after making allowances for expected outturn.
(2) Adjustments to line 1 to the definitions used in National Accounts Statistics.

plus/less

* Constituent items in this table and in tables 1.8 and 1.9 may not sum to totals because of rounding to nearest £½ billion.

Revenue

1.59 Revenue estimates depend on incomes, spending and prices, as well as on policy decisions. Revenue in 1985–86 is projected on conventional assumptions of revalorisation of the main direct tax allowances and thresholds, and of excise duties, using a figure of 4¾ per cent*. Estimates of oil revenues assume that dollar prices for North Sea oil do not change very much from the levels set [in early November]. their present

1.60 The revenue projections are shown in table 1.8. Real GDP (average measure) is forecast to grow by 2 per cent in 1984–85 and by 3¼ per cent in 1985–86; these estimates are affected by the miners' strike, and the underlying increases are 3 per cent and 2¼ per cent. The general rate of inflation, as measured by the GDP deflator, is put at 4¾ per cent in 1984–85 and 4½ per cent in 1985–86. The increase in revenue—before fiscal adjustment—in 1985–86 is a little below the forecast rise in money GDP of 8 per cent. ?

Table 1.8 General Government Receipts

£ billion

	1983–84	1984–85	1985–86
Taxes on income, expenditure and capital	97½	105½	114½
National Insurance and other contributions	21½	23	25
Interest and other receipts	11½	10½	11
Accruals adjustments	−½	1	−½
Total Receipts	**129½**	**140**	**150**
Memo: accrued North Sea tax revenues	9	12	12½

Borrowing

1.61 Table 1.9 provides projections of Government receipts, expenditure and borrowing.

Table 1.9 Public Sector Borrowing

£ billion

	1983–84	1984–85	1985–86
General government expenditure	139½	148½	155
General government receipts	129½	140	150
Implied fiscal adjustment(1)	—	—	[2½]
General Government Borrowing Requirement	10	9	7½
Public Sector Borrowing Requirement	9¾	8½	7
as percentage of GDP	3¼	2½	2
Money GDP at market prices	306	327	353

No! OK

(1) On the same assumption as in the 1984 MTFS about the PSBR as a proportion of GDP in 1985–86.

* Part 4 shows direct revenue effects on an illustrative (and rounded) assumption of 5 per cent.

The Prospects: summary

1.62 Table 1.10 presents a summary of the economic prospects.

Table 1.10 Economic Prospects(1)

Discuss

(? sep GG & other?)

or below GG ct & cap

		Percentage changes		
		1983 to 1984	1984 to 1985	Average errors(2) from past forecasts
A	Output and expenditure at constant 1980 prices			
	Gross domestic product (at factor cost)	2½	3½	1
	Consumers' expenditure	2	3½	1½
	General government current expenditure	1½	1	1½
	Fixed investment	7	2	2½
	Exports of goods and services	5½	4½	3
	Change in rate of stock-building as a percentage of the level of GDP	−½	1	1
	Imports of goods and services	7	4	3
		1984	1985	
B	Balance of payments on current account (£ billion)	0	2½	3½
C	Retail prices index (4th quarter)	4¾	4½	3(3)

(1) The forecast includes the effect of the fiscal adjustment in 1985–86.

(2) 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 on Government forecasts, notably in the Economic Progress Report, June 1981. The errors are after adjustment for the effects of major changes in fiscal policy, where excluded from the forecast.

(3) The average error for inflation was calculated from a period of much lower inflation and probably overstates the margin of error at low rates of inflation.

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Table 1.11 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
1979	137·3	48·1	43·9	63·4	2·5	295·1	59·9	32·2	0·7	203·8	102·4
1980	136·8	48·8	41·6	63·3	−2·9	287·6	57·4	30·9	−0·3	199·0	100·0
1981	136·7	48·8	38·1	62·1	−2·7	283·0	55·4	30·1	−0·9	196·6	98·8
1982	138·1	49·2	40·6	62·7	−1·2	289·5	57·6	31·6	0·4	200·7	100·9
1983	144·0	50·5	42·3	63·3	0·2	300·4	60·8	32·4	0·1	207·2	104·1
1984	147·0	51·4	45·3	67·0	−0·9	309·7	65·3	32·7	0·4	212·1	106·6
1985	152·1	51·8	46·0	69·9	1·0	320·8	67·9	33·9	0	219·0	110·0
1983 H1	71·1	25·2	20·9	31·5	−0·1	148·6	29·8	16·2	−21	102·6	103·1
H2	72·9	25·3	21·4	31·8	0·3	151·8	31·0	16·2	85	104·7	105·2
1984 H1	72·9	25·5	23·0	33·3	−0·8	153·8	32·2	16·1	364	105·9	106·4
H2	74·0	25·9	22·3	33·7	−0·1	155·8	33·1	16·5	41	106·2	106·7
1985 H1	75·1	25·9	22·9	34·7	0·4	159·0	33·5	16·8	0	108·7	109·3
H2	77·0	25·9	23·1	35·3	0·5	161·8	34·5	17·1	0	110·3	110·8
% changes:											
1982 to 1983	4½	2½	4	1		4	5½	3		3	3
1983 to 1984	2	1½	7	5½		3	7½	½		2½	2½
1984 to 1985	3½	1	2	4½		3½	4	3½		3½	3½

* 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 beyond 1984 H1 are forecasts.

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1/12/84

Autumn Statement 1984

RETURN to an Order of the House of Commons dated 12 November 1984: for

COPY of the AUTUMN STATEMENT 1984 as laid before the House by the CHANCELLOR OF THE EXCHEQUER on 12 November 1984

Treasury Chambers, 12 November 1984 } NIGEL LAWSON

Ordered by The House of Commons *to be printed*
12 November 1984

LONDON
HER MAJESTY'S STATIONERY OFFICE

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PART ① REMOVED AND PASSED

TO MR. H. P. EVANS , 39 4/3

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[10053 - 10070]

? 3yrs

DRAFT AUTUMN STATEMENT PART 2

2. Outline Public Expenditure Plans for 1985-86-1987-88

2.01 The Government has reviewed the public expenditure plans for 1985-86 published in the 1984 Public Expenditure White Paper (Cmnd 9143). Table 2.1 shows the public plans as now decided and for purposes of comparison the ~~1984-85 and~~ 1985-86 plans as published in the last White Paper. All figures are in cash unless otherwise stated.

The planning total

2.02 The outcome of the review is to keep the planning total for 1985-86 at [£132 billion], the figure in the 1984 White Paper. [As a result public expenditure broadly remains constant after allowing for inflation.] Table 2.2 shows the planning totals 1979-80 to 1985-86 in cash and cost terms; and public expenditure expressed as a ratio to GDP. The plans imply the ratio falling from [44 per cent] in 1981-82 to [ ] in 1985-86.

Changes in plans

2.03 Within the unchanged planning total for 1985-86 there are increases in social security, health, export credit and defence spending. These are partly offset by savings in other programmes including housing, employment and transport, and an increase in estimated receipts from special sales of assets. Full Details of the plans will be given in the forthcoming Public Expenditure White Paper.

PROGRAMMES

Defence

2.04 The provision for 1985-86 allows for annual growth of some 3 per cent in real terms, with an addition for Falklands costs.

Foreign and Commonwealth Office (including overseas Development Administration)

2.05 The provision reflects the transfer to the Home Office of responsibility for the Passport Office.

European Community

2.06 The estimated net contribution in 1985/86 takes account of the Fontainebleau agreement on budget abatements and new own resources. The figures in Cmnd 9143 were based on a stylised assumption about budget refunds, and no increase in the 1 per cent VAT ceiling. As a rough order of magnitude, in future years the UK's adjusted net contribution might be around half what it would have been if there had been no agreement, no abatements and the 1 per cent VAT ceiling had been maintained.

Intervention Board for Agricultural Produce

2.07 Extra provision has been made to take account of the grain stocks expected to be sold into intervention following the large 1984 cereals harvest.

Agriculture

2.08 The net reduction in planned ~~D~~domestic support for agriculture reflects savings being made on capital grants and land drainage partly offset by some additional provision is made for the milk outgoers scheme and the suckler cow subsidy.

Forestry Commission

2.09 The reduction of £4 million will be mainly achieved by improvements in efficiency and trading performance.

Trade and Industry

2.10 Additional provision is made for launch aid and for shipbuilding.

Energy

2.11 Higher expenditure on the Redundant Mineworkers Payment Scheme more than offsets reductions in nuclear research and development, resulting from changes in the financing and organisation of the United Kingdom Atomic Energy Authority.

Export Credits Guarantee Development

2.12 The increase in the cost of this programme mainly reflects higher estimates of interest support costs for fixed rate export credit.

Employment

2.13 Additional provision of £256 million is made in 1985-86 to finance an expansion of the Enterprise Allowance, a higher level of redundancy payments and the transfer, from local authorities to the MSC, of part of the provision for work related non advanced further education. The cost is more than offset by savings of £324 million which arise mainly from revised estimates of demand for special measures, notably the Youth Training Scheme.

Transport

2.14 The plans have been reduced by £300 million in 1985-86. This includes a transfer of £197 million to London Regional Transport EFLs, a reduction of £48 million arising from the transfer of public trust ports to the private sector, and savings on local authority capital spending. ?

Environment - Housing

2.15 Current expenditure is expected to rise by some £110 million in 1985-86 compared with the previous year. Gross capital expenditure is expected to fall between the same periods by £480 million while capital receipts remain broadly constant. The fall in gross capital expenditure will be composed partly of a reduction in the Housing Corporation's provision but mainly of lower local authority capital allocations reflecting the end of the temporary surge in home improvement grant spending and the Government's intention to shift the balance of new provision further to the private sector.

?

Environment - PSA

2.16 Additional provision has been made for major new works.

175/3

Environment - Other

Environmental Services

2.17 About three quarters of this expenditure is local authority current expenditure. There are some reductions in the remainder of the programme including the urban programme.

Home Office

2.18 Provision has been made for additional spending on police and the fire service up £ m and £ m respectively between 1984-85 and 1985-86. Extra provision is also made for control on immigration and citizenship and on non-custodial measures and after care.

Lord Chancellor's Department

2.19 The provision has been adjusted to reflect underspending on the court buildings programme and the continuing rise in the cost of legal aid.

Education and Science

2.20 Main changes are increased provision for local authority current expenditure (four-fifths of the total), for science and, on a selective basis, for equipment in universities, with some reduction in student awards and local authority capital expenditure. !

Office of Arts and Libraries

2.21 Additional provision has been made for public expenditure on the arts, museums and libraries.

Health and Personal Social Services

2.22 Provision for the Hospital and Community Health Service in 1985-86 represents a 5.5 per cent cash increase over 1984-85 spending: 1 per cent more than forecast inflation [in recognition of the demands arising from growing numbers of old people] ? Cost-improvement programmes building on those achieved this year should release substantial additional resources to enable health authorities further to develop services and improve patient care. Planned provision for the Family Practitioner Services allows for estimated demand (and takes account of measures to curb the sharply rising drugs bill.) Provision for the Personal Social Services has also been increased.

Social Security

2.23 The provison reflects the latest estimates of benefit expenditure in 1985-86 including an allowance for an uprating in November 1985 based on the rise in prices in the twelve months to May 1985. The actual uprating of individual benefit will be announced June when the May RPI is known. Changes are planned in the payments made to supplementary benefit claimants for board and lodging, and for invalidity benefit, including the restoration of the 5 per cent abatement made in November 1980.

Scotland, Wales, Northern Ireland

2.24 The net changes in these programmes mainly reflect changes in comparable programmes in England. The Secretaries of State have discretion to make allocations of this expenditure which take account of local factors.

Other Departments

2.25 The provision covers the costs of small departments including the initial cost of setting up the Independent Prosecution Service. Offsetting savings arise from the decision to stop printing the £1 note.

Nationalised Industries

2.26 External Financing Limits (EFLs) for nationalised industries in 1985-86 are set out in Table 2.3. Overall, there is a decrease of [£362] million in expected external financing requirements despite a marked increase in the requirements the British Steel Corporation. [Energy Industries]

LOCAL AUTHORITIES

Current Expenditure

2.27 In 1984-85 local authorities are budgeting to exceed White Paper provision for current expenditure relevant for Rate Support Grant by around £1.2 bn. The Government has therefore ~~had to~~ increased provision (adjusted for changes in the responsibilities of local authorities ~~between the two years~~), For 1985-86 by just over [£950 m] to £25.5 bn. This implies - broadly - a 3 per cent ~~cost~~ real terms ~~cut~~ saving over 1984-85 budget.

2.28 Local authorities have again been given provisional expenditure targets in England and Wales and guidelines in Scotland. Grant before holdback will be just over £14.6 bn: about the same, in cash, after adjustments, as the corresponding figure for 1984-85. Penalties for exceeding target or guidance will be ~~much~~ more severe than in 1984-85.

Capital Expenditure

2.29 The outlook for LA capital spending in 1984-85 is uncertain. Early returns suggested a large overspend on cash limits in England and Wales, and local authorities were asked to restrain spending, and to generate extra receipts. Provision for 1985-86 has been reduced to take account of the 1983-84 overspends of about £400 m and the 1983-84 cash limit adjustments made for Wales and Scotland. The transfer of London Regional Transport out of the Local Government sector has also required an adjustment of about £200 m. Taking account of these changes plans for 1985-86 are broadly in line in cash terms with the plans for 1984-85, with net GB provision at about £ bn.

Special Sales of Assets

2.30 The target for net proceeds from special sales of assets in 1985-86 has been increased by £500 million to £2½ billion reflecting revised assumptions of receipts. There are considerable uncertainties attached to this figure which is dependent on market conditions at the time of sales.

Reserve

2.31 The plans include a Reserve of £3 billion for 1985-86. The Reserve will be available to meet all contingencies including estimating changes. At this stage, the estimates of expenditure in 1985-86 on some demand - led services are inevitably still uncertain.

Table 2.1 Public Expenditure Plans

SECRET

1 year Autumn Statement

	1985-86	
	White Paper (Cmnd 9143)	Revised plans
Departments (excluding nationalised industries external finance)		
Ministry of Defence	18,050	18,055
Foreign and Commonwealth Office (including Overseas Development Administration)	1,866	1,865
European Community	550	750
Intervention Board for Agriculture Produce	1,125	1,135
Agriculture	1,022	950
Forestry Commission	57	53
Department of Trade and Industry	1,288	1,204
Department of Energy	591	687
Export Credits Guarantee Department	30	323
Department of Employment	3,245	3,178
Department of Transport	3,661	3,288
Department of the Environment (DOE) - Housing	2,607	
DOE - Property Services Agency	-99	-95
DOE - Other Enviromental Services	3,271	3,296
Home Office	4,540	4,767
Lord Chancellor's Department	547	536
Department of Education & Science	13,449	13,585
Office of Arts and Libraries	624	636
DHSS - Health & Personal Social Services	16,273	16,484
DHSS - Social Security	39,515	40,024
Civil Superannuation	1,131	1,075
Scotland (3)	6,528	6,951
Wales (3)	2,553	2,729
Northern Ireland	4,217	4,253
Other Departments	2,159	2,122
Nationalised Industres	1,145	
Local authority current expenditure not allocated to departments	400	595
Special sales of assets	-2,000	-2,500
Reserve	3,750	3,000
PLANNING TOTAL (5)	132,100	

Notes

(1) Some figures may be subject to detailed technical amendment before publication of the 1985 Public Expenditure Paper
(2) Departments pay provision reflects a pay factor of 3 per cent
(3) Excluding agricultural expenditure, which is included in the agricultural line
(4) Figures shown are rounded to nearest £10m
(5) Excludes double counting of £134m LA grants to NBC and BR

Public spending 1978-79 to 1984-85

Table 2.2 Public Expenditure Planning Totals 1979-80 to 1985-86

	Planning total £ million		
		Cost Terms[1, 2] base year 1982-83	Public[3] expenditure as % of GDP
	Cash[1]		
1978-79[4]	65,800	106,900	40 ½
1979-80[4]	76,900	107,000	40 ½
1980-81[4]	92,700	108,600	42 ½
1981-82[4]	104,700	111,600	44
1982-83[4]	113,400	113,400	43 ½
1983-84[5]	120,300	114,600	42 ½
1984-85[5]	126,500	[ ]	42
1985-86	132,100	[ ]	

(1) Figures are rounded to the nearest £100 million.

(2) Cash plans adjusted for general inflation as measured by the GDP deflator at market prices. The GDP deflator is forecast to increase by some 4½ per cent in 1984-85 and 4½ percent in 1985-86 as shown in para [1.00].

(3) Includes planning total plus net debt interest, payments of VAT by local authorities and non-trading government capital consumption.

(4) Outturn/estimated outturn.

(5) Plans in Financial Statement and Budget Report 1984-85, table 5.5.

External Financing Limits

Table 2.3 External Financing Limits for the Nationalised Industries (1985-86)

	£ million[1]
National Coal Board	
Electricity (England and Wales)	
North of Scotland Hydro-Electric Board	
South of Scotland Electricity Board	
British Gas Corporation	
British Steel Corporation	
British Telecom	
Post Office	
National Girobank	
British Airways Board	
British Airports Authority	
British Railways Board	
British Waterways Board	
National Bus Company	
Scottish Transport Group	
British National Oil Corporation[2]	
British Shipbuilders[3]	
Civil Aviation Authority	
Water (England and Wales)	
Total	

(1) Figures are shown rounded to the nearest £10 million.

(2) The figure for BNOC is not a limit. BNOC's trading results are likely to fluctuate from year to year given the uncertainties of oil trading.

(3) The British Shipbuilders EFL is provisional pending decisions on the industry's corporate plan.

3. Proposed changes to National Insurance Contributions

3.01 The Secretary of State for Social Services has conducted his annual review of national insurance contributions, as required by the provisions of the Social Security Act 1975. Full details are set out in the statement made by the Secretary of State in connection with the necessary re-rating orders laid on 12 November 1984 with an accompanying report by the Government Actuary. The main proposals are:

—that the Class 1 national insurance rates should remain unchanged for 1985–86 at their present level of 9 per cent for employees and 10·45 per cent for employers;

—that the lower earnings limit should be uprated, from April 1985, from the present level of £34 a week to £35·50 a week in line with the single rate retirement pension;

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—that the upper earnings limit should be increased from £250 a week to £265 a week;

—that the Treasury Supplement should be reduced in 1985–86 from its present level of 11 per cent of contributions (before taking account of the rebate for contracted out contributions) to 9 per cent.

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

—that the number of unemployed (GB excluding school leavers etc.) averages 3 million in 1984–85 and in 1985–86;

NB

—that the underlying increase in earnings between 1983–84 and 1984–85 is $7\frac{1}{2}$ per cent, and between 1984–85 and 1985–86 will be 7 per cent;

—that in 1984–85 the absolute level of earnings has been depressed by $\frac{2}{3}$ per cent by lost earnings in the coal industry and by other distortions;

—that the movement in prices between May 1984 and May 1985, which is the relevant period for the November 1985 benefit uprating, will be $4\frac{3}{4}$ per cent.

3.03 The estimated effect of the proposed changes are shown in the table opposite. The table includes the effects of the abolition of national insurance surcharge announced in the 1984 Budget, and allowing for that, employers' total payments are expected to increase between 1984–85 and 1985–86 by [no more than 1 per cent in cash terms].

much less

substantially less ... [illegible]

Table 3.1 Estimated total payments by employers and employees of National Insurance Contributions and National Insurance Surcharge in 1984–85 and 1985–86(1)

Great Britain (£ million)

	Employers	Employees	Total
1984–85			
National Insurance Surcharge	890	—	890
National Insurance Contributions	10 680	10 110	20 790
Total	**11 570**	**10 110**	**21 680**
1985–86			
National Insurance Surcharge	Why? 30	—	30
National Insurance Contributions	11 560	11 000	22 560
Total	**11 590**	**11 000**	**22 590**
Analysis of change			
Change from abolition of NIS(2)	−860	—	−860
Change in NI contributions from increased earnings(3)	+830	+810	+1 640
Change in NI contributions from increase in earnings limits and SSP changes	+50	+80	+130
Total change	**+20**	**+890**	**+910**

(1) Figures are rounded to the nearest £10 million and may not sum. Detailed figures for National Insurance Contributions are included in the Government Actuary's report on the draft of the Social Security (Contributions Re-rating) Order 1984.

(2) NIS was abolished as from 1 October 1984 for all employers except local authorities and related bodies, who will continue to pay NIS until the end of this tax year. Receipts of NIS in 1985–86 will be entirely in respect of liabilities which accrued before the end of this tax year.

(3) Including population and employment changes.

Note: As in previous years, figures in this table are on a receipts basis excluding self-employed and voluntary contributions. Figures include NHS and Employment Protection Allocation contributions. Employers' contributions are net of deductions in respect of statutory sick pay.

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4. The Revenue Effects of Illustrative Tax Changes

4.01 The tables below show various illustrative changes to the major taxes and estimates of their direct revenue effects at forecast 1985–86 price and income levels. Figures are given for full year effects and also the effect in the first year (1985–86)—that is, the part of the full year effect which would be expected to come through in tax receipts in that financial year. Neither of these is the same as the effect on the public sector borrowing requirement (PSBR) because of the second round effects of tax changes on the economy.

4.02 Estimates of the size of the direct effects of tax changes depend on economic variables, such as prices, earnings, consumer expenditure, etc, and thus may alter as the prospects change. The illustrative tables which follow are based on a view of the economy that is consistent with Part 1.

4.03 There are, in principle, a number of ways of measuring the direct effects on revenue of a tax change, depending on the assumptions made about changes in the tax base and whether revenue from other taxes is included. The definitions used here are explained in note (*a*) to Table 4.2 of the 1984–85 Financial Statement and Budget Report; and a fuller description for indirect taxes is given in an article in Economic Trends, March 1980. **10073**

4¾%

4.04 Where appropriate the figures set out below show the effect of indexation by an illustrative 5 per cent. This is broadly in line with the annual rate of increase in the RPI forecast for the fourth quarter of this year table 1.[ ]).

Indexation of allowances, thresholds and bands for 1985-86

4.05 With indexation by 5 per cent, the 1984–85 levels of allowances, thresholds and bands would be as shown below. The rules for rounding up set out in the 1980 Finance Act (for income tax) and the 1982 Finance Act (for capital transfer tax and capital gains tax) have been followed. 1984–85 figures are shown for comparison:

Indexation: Income Tax

Table 4.1 Income Tax

	1984–85	1985–86
Allowances	£	£
Single and wife's earned income allowance	2005	2115
Married allowance	3155	3315
Additional personal and widow's bereavement allowance	1150	1200
Single age allowance	2490	2620
Married age allowance	3955	4155
Age income limit	8100	8600

Income tax rates	Bands of taxable income	
Per cent	1984–85	1985–86
	£	£
30	0–15 400	0–16 200
40	15 401–18 200	16 201–19 200
45	18 201–23 100	19 201–24 400
50	23 101–30 600	24 401–32 300
55	30 601–38 100	22 301–40 200
60	over 38 100	over 40 200

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Indexation: Capital Taxes

Table 4.2 Capital Transfer Tax

Rate of death	Lifetime rate	Bands of chargeable value	
		1984–85	1985–86
per cent	per cent	£'000	£'000
Nil	Nil	0– 64	0– 68
30	15	64– 85	68– 90
35	17½	85–116	90–122
40	20	116–148	122–156
45	22½	148–185	156–195
50	25	185–232	195–244
55	27½	232–285	244–300
60	30	over 285	over 300

Table 4.3 Capital Gains Tax

	1984–85	1985–86
	£	£
Annual exempt amount		
Individuals	5600	5900
Trusts	2800	2950

4.06 Estimates of the costs of the changes shown above are as follows:

Indexation: Costs

Table 4.4. Costs of Indexation

	£ million at forecast 1985–86 prices, incomes and capital values First year cost	Full year cost
Indexation of income tax allowances and thresholds of which:	920	1190
Increases in main personal allowances	830	1035
Increase in the basic rate limit(1)	50	80
Increases in further higher rate thresholds(1)	40	75
Indexation of capital transfer tax thresholds and bands	15	45
Indexation of capital gains exempt amounts	Nil	10

(1) Additional costs after previous changes have been introduced.

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

Revenue Effects: Income tax

4.07 Table 4.5 gives estimates of the direct costs and yields (at forecast levels of 1985-86 prices and incomes) of changes in the main personal allowances, thresholds and rates of income tax. It shows the costs and yields resulting from individual allowance changes of £100 and of changes in all allowances and higher rate thresholds by 1 per cent and 10 per cent of their 1984-85 values over indexed levels. The table also illustrates the effects of packages which change both the main personal allowances and higher rate thresholds by 1 per cent and 10 per cent from their 1984-85 levels. All the cost and yield figures are in addition to the costs arising from indexation as set ou in Table 4.1. For corporation tax the table shows the effects of a 1 percentage point change in the rate of tax and in the small companies' rate.

4.08 The estimated revenue effects of each allowance and threshold change are shown to nearest £million or £5million, to avoid undue magnification of rounding errors when using the ready reckoner to calculate larger changes. The figures should not, however, be assumed to be accurate to this degree.

4.09 Costs and yields are linear over a fairly broad range of changes. Reasonably accurate estimates can be obtained by prorating the ready reckoner figures for increases in personal allowances of less than about 20 per cent and for reductions of less than about 5 per cent from the indexed values. The additional cost of an increase in the higher rate threshold, however, tends to fall as the total increase rises, so estimates have been provided for two different changes, 1 per cent and 10 per cent on top of indexation. The effects of changes in higher rate thresholds are not symmetrical between increases and decreases. The table indicates that decreases would yield rather more than corresponding increases would cost.

4.10 The income tax changes have been costed on the assumption that each is introduced in isolation. In practice, there is little interaction between the personal allowances, so an estimate of the revenue effect of more than one allowance change can be obtained by combining the individual costs or yields for each item. The effect of a change in the basic or higher rates of tax, or in the higher rate thresholds, however, would be smaller than the amount shown in the table, if those changes were introduced at the same time as an increase in one or more allowances (and larger if combined with a decrease in allowances). Estimates derived from this ready reckoner for a combination of more than one tax change should, therefore, be taken only as a general guide to the revenue effect of the package, particularly where a number of interacting changes are included.

Ready Reckoner:

Income Tax

Table 4.5 Direct effects of specimen changes in income tax and corporation tax

£ million at forecast 1985–86 income levels

	First year Cost/Yield	Full year Cost/Yield
Income Tax(1)		
Rates		
Change basic rate by 1p(2)	1050	1125
Change all higher rates by 1p	48	95
Personal Allowances		
Change single wife's earned income allowance by £100	290	360
Change married allowance by £100	260	320
Change single age allowance by £100	24	32
Change married age allowance by £100	21	26
Change aged income limit by £200	3	5
Change all main personal allowances by 1 per cent	160	195
Change (raise−/lower+) all main personal allowances by 10 per cent	−1540/+1600	−1915/+1995
Higher Rate Thresholds		
Change (raise−/lower+) all higher rate thresholds by 1 per cent	−15/+15	−27/+28
Change (raise−/lower+) all higher rate thresholds by 10 per cent	−135/+170	−245/+310
Allowances and Thresholds		
Change all main personal allowances and higher rate thresholds by 1 per cent	170	225
Change (raise−/lower+) all main personal allowances and higher rate thresholds by 10 per cent	−1650/+1775	−2150/+2315
Corporation Tax(3)		
Change rate by 1 percentage point(4)	140	240
Change small companies' rate by 1 percentage point	14	25

Ready Reckoner:

Corporation Tax

(1) Changes are from the indexed levels of allowances and thresholds shown in table 4.1. Percentage changes are, however, of 1984–85 levels.

(2) Including the effect of the change on receipts of Advance Corporation Tax and on consequent liability to Mainstream Corporation Tax.

(3) Assessment to Corporation Tax normally relates to the preceding year. These are, therefore the changes to revenue that would occur if the changed rates were applied to forecast 1984–85 income levels.

(4) Assuming small companies' rate unchanged.

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Indirect Taxes

4.11 Figures for changes in the excise duties (table 4.6) are shown in two sections. The first shows the extra revenue from the individual duties if they were to be increased by exactly 5 per cent, together with the price increase that would result (after allowing for consequential VAT).

4.12 The second section shows for most duties the revenue yield from changing current levels of duty so that (after VAT) the price of a typical item is changed by exactly one penny. For VED, a £1 change for cars and light vans is shown. Table 4.7 shows the revenue effects of a 1 percentage point change in the rate of VAT.

4.13 The estimates are direct effects. They do, however, allow for alterations, due to relative price changes, in the composition of consumers' expenditure within a fixed total.

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4.14 Within limits the illustrative changes for specific duties shown here can be scaled up or down to give a reasonable guide to the revenue effects. For example, a unit change could be combined with a revalorisation change to show the effects of a different percentage movement in duty. However, with large changes the margins of uncertainty surrounding the effects on sales and hence on revenue become progressively larger, and scaled estimates will be less reliable.

Table 4.6 Revenue effects of indirect tax changes (£ million 1985–86 prices and income levels)

	5% Revalorisation(1)			Unit changes from present levels of duty		
	Current level of duty on typical item(2)	Price change inc. VAT (pence)	Full year yield(3) £m	Price change inc. VAT	Actual percentage change in duty %	Full year(3) yield/cost £m
Beer (pint)	17·3p	1·0	90	1p	5·0	90
Wine (bottle of table wine 70 cl)	63·4p	3·6	25	1p	1·4	7½
Spirits (bottle)	£4·64	26·7	30	1p	0·2	1
Tobacco (20 kingsize cigarettes(4)	76·2p	3·8	125	1p	1·3	35
Petrol (gallon)	78·0p	4·5	220	1p	1·1	50
Derv (gallon)	65·8p	3·8	55	1p	1·3	15
VED (cars and light vans)	£90·00	£4·50	85	£1	1·1	19

(1) An 'across the board' revalorisation by 5 per cent (including the minor duties not shown above) would yield about £650 million in a full year, and the impact on the RPI would be to raise it by less than ½ per cent.

(2) VAT is payable in addition to the duty except in the case of VED.

(3) Assuming for illustrative purposes implementation on 1 April, the first and full-year yield of changes in excess duties would be identical for petrol, derv and VED; for beer and tobacco the first-year would be approximately eleven twelfths of the full-year; and for wine and spirits it would be approximately twenty-three twenty-fourths.

(4) The duty on cigarettes has *ad valorem* and specific elements; the percentage change relates only to the specific element, but the price change includes the consequent increase in *ad valorem* duty and VAT.

Table 4·7 VAT

	First year(1) yield/cost	Full year yield/cost
1% point change in rate of VAT	625	840

(1) Assuming implementation on 1 April.

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