PO-CH/NL/725

PART D

PO/CH/NL/725
Part. D

Ends: November 1984.

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

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1984 AUTUMN STATEMENT: INDEX

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J. PUBLIC EXPENDITURE BY PROGRAMME/DEPARTMENT

1.	Defence	DM1	Mr Martin
2.	FCO including ODA	AEF1	Mr Legg
3.	EC Contribution	EC1	Mr Mortimer
4.	IBAP and Agriculture	IAE1	Mr Bonney
5.	DTI	IAE2	Mr Yeo
6.	Department of Energy	PE1	Dr Bird
7.	ECGD	AEF2	Mr Scott-Barrett
8.	Department of Employment	IAE3	Mr Mercer
9.	Department of Transport	HE1	Mrs Imber
10.	Housing	LG2	Mr Stredder
11.	PSA	LG2	Mr Allan
12.	DOE: other environmental services	LG2	Mr Pike
13.	Urban programme	LG2	Mr Stredder
14.	Home Office	HE1	Mr Smith
	and Lord Chancellor's Department	HE1	Mr Russell
15.	Education and Science	HE2	Mr Faulkner
16	Arts and Libraries	HE2	Mr Sargent
17.	Health and personal social services	ST2	Mr Denham
18.	Social Security	ST1	Miss Noble
19.	Civil Superannuation	S	Mr P L Dyer
20.	Scotland, Wales and Northern Ireland	ST3	Mr Davis
21.	Special sales of assets	PE2	Mr Sutton
22A.	Nationalised industries EFL's 1985-86	PE2	Mr Palmer
22B.	Water authorities	LG2	Mrs Spencer
K.	**Bank Notes and Coinage**	HF2	Mr L Watts
L.	**Role of Lord Young**	EU	Mr M Emmott

A SUMMARY AND KEY POINTS ON 1984 AUTUMN STATEMENT

1. SUMMARY

1.1 Autumn Statement brings together usual announcements on broad public expenditu re decisions and National Insurance contributions for coming year, together with autumn Industry Act Forecast (see briefs E2, D and B3 respectively). Autumn Statement document also contains usual "ready-reckoner" showing revenue effects of illustrate tax changes. (Brief H explains Statement content in more detail.)

1.2 1985-86 public expenditure planning total has been held to a total of £132 billion cash, same as figure provided in Cmnd 9143. (Brief E2 explains in more detail, including necessary adjustments made to particular Departments' programmes within the total.)

1.3 AS not the occasion for major review of macroeconomic policy. By convention, PSBR figure and monetary growth targets are assumed for forecasting purposes to be in line with illustrative projections in 1984 FSBR. 1985-86 PSBR is thus put at £7 billion, or about 2 per cent of GDP, which should be consistent with declining interest rates in real and nominal terms. Actual PSBR to be provided for in 1985-86 will be decided in Budget.

1.4 Annual review of National Insurance contributions has left main contribution rates unchanged. Lower and upper earnings limits revised, as statute requires, to reflect. November 1984 increase in single rate of National Insurance retirement pension. Overall 1985-86 NIS and NIC burden on employers barely changed (up £70m) in cash terms. Substantial reduction in real terms.

1.5 Industry Act Forecast takes account of decisions on public spending and NICs. With fiscal and monetary restraint maintained, the outlook is for continued growth of output and gradual decline in inflation. Forecast consistent with continued growth of employment. Main forecast figures are:

whole economy, per cent changes on previous year

	1983	1984
growth of GDP(A)	2½	3½
RPI inflation to fourth quarter	4¾	4½
consumer spending	2½	3
fixed investment	7	3
exports	5½	4½
imports	7½	4
current account balance (£bn)	0	2½
PSBR (£bn)	8½	7 (after fiscal adjustment of 1½)

Brief B5 explains the estimated impact of the coal strike, and its aftermath, on the forecasts.

1.6 Implications for 1985 Budget are that, with public expenditure held to plan and monetary restraint maintained, there should be scope for further reduction in taxes, worth up to £1½ billion for 1985-86. This "fiscal adjustment" is slightly below £2 billion projected in 1984 FSBR and, as usual in the autumn, subject to wide margin of error.

2. Main positive themes

2.1 Economy well on course as economy responds to opportunities provided by MTFS framework of fiscal and monetary restraint - in place for 4½ years now.

2.1.1 Growth forecasts/actuals have been:

(per cent increases on previous year)

	Budget 1984	AS 1984
1982	2	2
1983	3	3
1984	3	2½
1985	2½(year to H1)	3½

.. Now into fourth year of growth from trough in first half 1981. Long-lasting recovery by postwar standards.

.. Average annual growth 1981 to 1985 will be healthy 2¾ per cent.

.. recent UK growth and prospects compare well with Europe. GDP growth in 1984 likely to be in line with EC average despite miners' strike effects. And for 1985 UK likely to show fastest growth in Community. Even excluding 1 per cent point contribution from assumed end to miners' strike, UK growth likely to be well up with EC average.

[Figures are:

per cent growth on previous year	UK (Industry Act Forecast: bracketted figures refer to position excluding miner's strike)	EC (average) (expected to appear in December Annual Economic Report (preferably not to be quoted meanwhile)
1984	2½(3½)	2.2
1985	3½(2½)	3.3]

2.1.2 Key to durability of growth has been success of anti-inflation policy. In contrast to previous post-war recoveries, inflation has come down steadily and faster than sceptics suggested. [Simon and Coates: "Probably time to concede a moral victory to the Treasury on this year's inflation forecast."] In terms of GDP deflator, inflation down from, 12 per cent in 1981 to 5 per cent in 1983, with further fall in first half 1984. RPI inflation expected to decline gradually in 1985, to 4½ per cent by 1985Q4, compared with 4¾ per cent at Q4 1984, and 4¾ per cent assumption for Q2 1985 given to Government Actuary.

2.1.3 Interest rates affected by nervousness over strikes etc during summer. But now well below US rates, for first time since 1945. Currently short rates [ ] per cent below US, compared with [[ ] per cent above US in early 1979].

2.1.4 Fixed investment across whole economy poised to set post-war record in 1984 and to go yet higher in 1985. At 1980 prices, figures are:

1979 (previous peak)	1984 forecast	1985 forecast
£44bn	£45bn	£47bn

Generally growth has been well balanced, with investment and consumption having made equal contributins to growth over the year to 1984H1.

2.1.5. Employment has continued to rise, with the employed labour force estimated to have risen ¼ million in year to June 1985. Industry Act forecast consistent with continued rise in employment in 1985. Rate of increase, and picture for unemployment will clearly reflect developments on real wages.

2.2 1985 Budget outlook benefits because public spending aggregate plans for 1985-86 held to Cmnd 9143 level.

.. planning total held to previously planned level. So no fresh "cuts" overall. But painful adjustments to some programmes inevitable.

.. an essential step in maintaining successful strategy to restrain inflation without undue pressure on interest rates. Most of the summer's increase in interest rates has recently unwound, reflecting continued confidence in governments policies.

.. Forecast suggests confirms useful scope for tax cuts in 1985 Budget in light of public spending decisions. Holding public spending broadly level in a growing economy gives room for further progress in reducing tax burden from levels to which it was driven in recession.

.. £1½ billion positive "fiscal adjustment" for 1985-86 subject to revision in the light of developments before Budget. But clearly better to have positive rather than negative figure at this stage.

3. General line in reply to likely key criticisms

3.1 Poor outlook for public sector investment? (see also Brief E4)

[AS document Part 1 says "In 1985...public sector investment...may decline...". Implications of 1985-86 housing cuts etc. Precise figures for capital spending by programme will not in fact be available until PEWP in New Year.]

... Important thing is fixed investment in whole economy. This is expected to be a post war record in 1984 and to rise further in 1985. [At 1980 prices figurs are (£bn) pre-recession 1979 peak 44, 1984 forecast 45, 1985 forecast 47.]

.. Some change in split of total between public and private sectors to be expected over years as relative size of public sector cut back, consistently with privatisation etc.

.. Premature in advance of PEWP to jump to hard conclusions about gros spublic sector outlays on capital goods and the value of work given to the construction industry. Half the £600m reduction in net housing programme, for example, reflects forecast of extra receipts and will not affect amount of building work done.

.. No evidence that significant nationalised industry investment projects yielding a good return are being held back by lack of finance.

3.2 Poor outlook for investment across whole economy?

[AS document part 1 shows total fixed investment rising 7 per cent in 1984, but only 3 per cent in 1985]

.. No. Level of investment to set post-war records in both 1984 and 1985 [figures at 3.1 above]

.. Investment growth expected to continue in 1985, albeit at a more moderate pace than in 1984.

.. Local authority capital overspend and big rise in North Sea investment were particular factors for 1984 not likely to recur in 1985

.. Business investment has been growing strongly. For non-North Sea industrial and commercial companies, 1984 fixed investment mayu be up 10 per cent with further rise of perhaps 6 per cent in 1985.

3.3 Why not spend some of the buoyant oil revenues on public sector capital projects to help unemployment and raise investment, instead of rising them to "finance unemployment" or for cutting personal taxes in 1985 Budget?

.. No evidence money short for public projects with good return. CBI agrees that, as in private sector, investment must yield proper return.

.. essential to preserve "fiscal adjustment" for tax reductions so that burden of taxation can come down from the unacceptably high levels it reached in the recession [non-North Sea taxes and NICs as proportion of GDP: [ ]].

.. more spent on public sector capital at expense of higher borrowing or taxes means higher interest rates or blunted incentives. Either way, jobs will be lost elsewhere in the economy and net benefit to employment will be small over long run.

.. £ for £, special employment measures create more job opportunities than typical public sector capital projects.

3.4 Are 1985-86 public spending plans realistic following overspend in 1984-85? Pressures of local authorities, Trident programme etc? [See also brief E2]

Plans are realistic:

.. £3 billion Reserve (as provided for 1984-85 in 1983 AS)

.. 1985-86 provision for local authority current spending raised by £[950]m for realism.

.. improved forecasting techniques have led to similar "realism" increases on programme allocations for ECGD, social security, etc.

.. Trident pressures on defence programme to be kept in perspective. Costs will amount to only [ ] per cent of Defence Budget over next [ ] years. Premature to worry about dollar costs. Dollar can go down as well as up, as history shows. [See also Brief J1].

3.5 Why not something more imaginative on NICs - eg as Dr Owen suggests - if better trend on labour costs so important for employment/unemployment?

.. Employers will be benefiting enormously in 1985-86 from absence of NIS. Total NIS and NIC burden on them up only £[70]m in money terms compared with 1984-85. This is an increase of only [ ] per cent at a time when average earnings, including the effect of new pay settlements, are assumed to be rising at a rate of [7½] per cent. So a big cut in real terms.

.. Full economic effects of arbitrary changes in NIC LEL, contribution rates etc often not fully thought through. Big increase in LEL, for example, could easily be vitiated by bidding up of relative pay at bottom end of scale. This would offset the incentive to employ the groups concerned and harm skill differentials.

.. and easy to run up big "deadweight" losses by subsidising jobs that would arise anyway.

.. Wrong to see NICs as arbitrary payroll tax. They are contributions which buy employees rights to National Insurance benfits. Government examining many aspects of social security benefit system in depth, in Mr Fowler's reviews. Dangerous meanwhile to make arbitrary changes on contributions side which would wreck the contributory principle.

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B1 RECENT DEVELOPMENTS IN THE UK ECONOMY

Factual

(i) See also World developments (Brief B2), Monetary developments (C2), Coal strike effects (B5)

(ii) Inflation remains low. Retail price inflation [4.7 per cent September] is slightly above the average of the other major 6 OECD economies [4.3 September] but below the EC average [5.9 year to August].

(iii) Indications are that, across the whole economy, pay settlements remain in 5 to 6 per cent range.

UK: Year on year percentage changes

	1983	1984 Q1	1984 Q2	Latest month	
RPI	4.6	5.2	5.2	4.7	September
Producer output prices in manufacturing	5.5	5.9	6.3	[6.2	October]
Underlying whole economy average earnings	8.4	7¾	7¾	[7½	August]
Unit wage costs in manufacturing	2.1	4.7	3.5	[5.9	August]

(iv) Actual whole economy earnings (5.9 per cent August) are rising less rapidly than the underlying trend partly because of the coal strike and partly because of delayed settlements.

(v) Industrial and commercial company profits continue to rise and were up 22 per cent first half 1984 on first half 1983. This followed a rise of 24 per cent in the previous year. (For non-North Sea iccs the increases were [22] and [20] per cent.) Companies had a financial surplus of over £5 billion in first half 1984 in spite of a substantial rise in investment spending.

(vi) Output (GDP (A)) was reduced by ½ per cent in Q1 as a direct result of the coal strike and by 1¼ per cent in Q2. The average measure of GDP in the first half was nevertheless 3¼ per cent higher than in the first half of 1983.

(vii) Composition of recovery now broadening. Early stages dominated by end to rundown of stocks fall and rise in consumers expenditure. Investment now relatively more important (up 10 per cent [H1 84 on H1 83]. Output growing almost as fast as domestic demand now rest of the world has also recovered.

Percentage contributions to growth

	Consumer's Expenditure	+	Consumption	+	Investment	+	Stock building	+	Net Trade	=	GDP(E) growth
1981 H1 to 1983 H1	2.3		0.7		1.7		1.8		-2.3		4.2
1983 H1 to 1984 H1	1.5		0.2		1.7		-0.6		-0.5		2.4

(viii) Provisional estimate for 1984 Q3 consumer's expenditure only 1 per cent higher than a year earlier. Car sales had been abnormally high in 1983Q3, however, and the growth of spending other than on cars was 2¼ per cent over the year. Consumer spending in the first three quarters is provisionally estimated as 2 per cent higher then in the same period in 1983.

(viii) In the three months to September for manufacturing production, [comparison with previous 3 months to be inserted 9 November]. There were, however, large rises at the end of 1983 and so the latest three month average is [2] per cent higher than last year. Recent movements in the total production index have been distorted by the effects of the coal strike. The three months to September are [½] per cent below the same period last year but the strike has reduced the level by 3½ per cent. Construction output (not included in production index) estimated to have been over [5] per cent higher in [first six months] of 1984 than a year earlier.

(ix) The current account of the 1984 balance of payments was in deficit of £530 million in the 9 months to September. The figures are erratic and initial estimates - particularly for invisibles - are often revised upwards. The oil and coal balance to September was reduced by an estimated £1½ billion as a result of the coal strike.

(x) Unemployment Average monthly rise of 15,000 in the six months to October. Number in work (include self-employed) estimated to have risen by around a quarter of a million in year to June 1984. Unfilled vacancies, at 170,000, now the highest since March 1980. Productivity continues to improve but at a slower rate. Manufacturing productivity rose 5½ per cent in 1982, 6¾ per cent in 1983, and [3 per cent] in the latest three months compared with a year earlier.

(xi) CBI Survey (October) of manufacturing shows continuing optimism on export orders and, to a lesser extent, output. Figure for general optimism about the business situation, depressed, partly due to coal strike.

(xii) On partial data CSO longer and shorter leading indicator series have risen after falling since early this year. On basis of past timing relationships, longer leader indicates cyclical "peak" in early 1985. But effects of coal dispute make interpretaton particularly difficult.

Positive
[See also fuller note attached of statistical "bull points"]

(i) Combination of 3 per cent growth with inflation below 5 per cent not seen since 1960s.

(ii) GDP(A) grew 8 per cent between trough of recession in 1981 H1 and 1984 H1 and was then at highest ever level - 3½ per cent above 1979 pre-recession peak.

(iii) Total fixed investment 10 per cent higher in the first half of 1984 than a year earlier. For 1984 as a whole, expected to be postwar record. [IAF suggests figure of £45 bn at 1980 prices, compared with 1979 pre-recession peak of £44 bn.]

(iv) Number of people in work up nearly 300,000 since trough in March 1983.

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Defensive

(i) Recovery faltering. 'Precious few signs at the moment that we are heading for a downturn'. [Chancellor Mansion HO speech 18 October.] Miners strike depressing output but GDP average measure still up 3 per cent in the year to 1984 Q2.

(ii) Unemployment still rising. Number in work risen by ¼ million in year to June. In France and Germany numbers in work have continued to fall.

(iii) Inflation not falling and likely to rise after fall in sterling? Relationship between exchange rate and inflation depends on large number of factors. Prices of industrial commodities have been falling in recent months.

(iv) Government own indicators show peak in 1985? "Peak" implies moderation of growth, not necessarily any fall in output. Already into fourth year of recovery as long as any in post-War period. Interpretation of leading indicators subject to greater uncertainty than usual because of side-effects of coal dispute.

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B2 RECENT DEVELOPMENTS IN THE WORLD ECONOMY

Factual

(i) OECD output rose 5 per cent in year to H1 1984. European output over the same period rose by just 2 percent but this is distorted by strikes in Germany and the UK. US GNP more than 7 per cent up in first three quarters of 1984 over same period last year.

(ii) Recovery is forecast to continue in 1985 though at a slower rate. Industry Act Forecast projects GNP in the major seven countries to rise by 4 per cent in 1985 after 5 per cent this year. This is broadly in line with latest IMF forecasts. Total world imports expected to be up 10 per cent in 1984 and to grow strongly over the next two years.

(iii) Unemployment rate for OECD area has declined slightly since 1983 due mainly to large fall in US of two percentage points. It has risen further in Europe and to a lesser extent in Japan:

	UNEMPLOYMENT LEVELS (NATIONAL DEFINITIONS, MILLIONS)			UNEMPLOYMENT RATES (OECD STANDARDISED)	
	1983 H1	**1984 H1**	**Absolute change**	**1983 H1**	**1984 H1**
OECD Europe	17.6	18.5	0.9	10.3	10.9
US	11.4	8.7	-2.7	10.1	7.6
Japan	[ ]	[ ]	[ ]	[ ]	[ ]
OECD Total	32.8	31	-1.8	8.9	8.2

(iv) Consumer price inflation in the major countries has declined from 12 per cent in 1980 to about 4½ per cent in year to September. No further fall expected as slight rises in US offset further falls in Europe. Non-oil commodity prices have fallen back some way this year after rapid rise in 1983. Oil markets depressed due to a combination of weak demand in industrial countries and rising non-Opec production.

(v) Three-month interest rates in the US have fallen in recent weeks to under 10 per cent from their July peak of around 12 per cent. Long bond yields have also declined. Rates in Continental Europe have shown little movement.

(vi) The combined current account deficit of major industrialised countries has widened throughout the year as US position has deteriorated further. US trade deficit reached $96 billion in the 9 months to September.

(vii) Exchange rates remain volatile. The dollar has reached new peaks against all European currencies. Dollar effective rate rose 9 per cent above previous mid-January peak to new record of over 144 in mid-October but has since eased. Within EMS deutschemark particularly weak against dollar. Consequently EMS under little strain. Belgian franc remains firmly at the bottom.

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(viii) Monetary growth in the major countries is generally within target ranges. In the US the ceilings for M1 and M2 next year have been lowered by 1 and ½ points to 4-7 per cent and 6-8½ per cent respectively. French target also lowered for 1985.

(ix) General government financial deficit of the seven major economies rose from 1¾ per cent of GDP in 1979 to 4 per cent in 1983. OECD (July) expect it to fall to 3½ per cent in 1984 and 1985. After allowing for impact of the economic cycle, major countries apart from the US, have generally moved towards balancing their budgets. OECD estimate that the major countries, excluding the US, will reduce their structural deficits by ¾ per cent of GDP this year, and a further ¼ per cent next year.

Positive

(i) World activity, especially trade, has recovered unexpectedly rapidly this year. Investment particularly strong. Widespread agreement among forecasters that world recovery will continue next year although at a slightly reduced pace mainly reflecting the natural slowdown of the US economy. No major reacceleration of inflation is in prospect.

(ii) Major countries agreed at London Economic Summit (June 1984) and IMF/IBRD Annual Meetings September 1984 to continue existing counter-inflationary strategy to sustain recovery. Necessitates disinflationary monetary policy, further action to reduce budget deficits and action to remove/reduce structural rigidities, including protectionist measures.

(iii) Considerable progress made towards resolving debt problems. Some countries eg Mexico making determined efforts to adjust. Continuing effort required. Look forward to constructive dialogue on debt at next IMF/World Bank meetings in April.

Defensive

(i) US recovery result of running large budget deficit? Accept US deficit may have had temporary effect on US activity. But recovery primarily due to progress against inflation, effect of tax cuts on incentives and flexible working of markets, particularly labour market.

(ii) US budget deficit? Welcome downpayment package to cut deficit by $150 billion in FY 1985-87. Recognise further measures needed. Without them deficit likely to remain unacceptably large over next few years, over $200 bn in 1987 by latest Congress estimates, threatening interest rates prospects. President Reagan promises long-term plan to cut the deficit in budget for FY 1986 to be released January 1985.

(iii) Outlook for dollar? Markets determine exchange rates. Sharp change in sentiment could affect rate. Any sharp, destabilising fall in dollar would benefit no-one.

(iv) Interest rates? Interest rates have remained high during 1984 in major industrialised countries. Undoubtedly depressed some activity. Hope US government will take firm steps to cut budget deficit thereby reducing its claim on world savings and easing interest rate pressures.

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(v) US recovery slowing down? US economy has recovered faster than expected this year. Natural that pace of recovery should slow down to a more sustainable rate.

(vi) World inflation will accelerate as recovery continues? No clear signs of any resurgence. Important that major industrial nations, as agreed at London Summit stick to anti-inflation policies. Commodity prices remain weak. Monetary growth under control.

(vii) Outlook for unemployment? OECD forecast (July) unemployment in Europe to rise to almost 20 million in 1985. Key to solving unemployment is freer working of labour markets particular with respect to real wages. OECD unemployment fallen slightly but now levelling off at 8½ per cent. With increased labour supply, number of unemployed still rising.

(viii) More rapid European expansion urged by EC's Annual Economic Report? Report is work of Commission. Not yet considered by Council of Ministers. Accept Europe not yet fully shared in recovery. Agree structural impediments, especially in labour markets, to growth should be curbed. Fiscal expansion only dissipated in higher inflation.

(ix) International debt? Recent IMF/World Bank meetings endorsed London Summit strategy. In particular where debtor countries achieving successful adjustment readiness to consider more extended multi-year re-scheduling - as recently with Mexico. Important that developed countries pursue policies which permit lower real interest rates and secure sustainable growth.

(x) Dialogue on debt? Agreement at September IMF/World Bank Annual meetings to devote Interim and Development Committee meetings next April to discussing debt prospects and other international financial issues. Important to recognise no instant solutions to debt problem.

(xi) UK social security provision harsh compared to others? Benefits either reduced or increases delayed in US, Japan, Germany, Netherlands and elsewhere. Difficult to compare internationally but benefits for some, especially long term unemployed, probably more generous here than in US and France.

(xii) Insufficient social security explains fall in US unemployment? No doubt part of reason. But France also has no safety net, yet unemployment high and rising there.

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B3 INDUSTRY ACT FORECAST - SHORT TERM ECONOMIC PROSPECTS

Factual

(i) The Industry Act Forecast gives one year projections of GDP, manufacturing output, prices, public finances and the current account. It updates and rolls forward the FSBR Forecast. The attached table summarises the forecast.

(ii) Main features of forecast:

(a) Inflation expected to remain low, maybe showing a gradual decline. 4¾ per cent increase in year to 1984 Q4 and 4½ per cent to 1985 Q4. (4¾ per cent also the assumed annual increase to May 1985 for purposes of GAD Report.)

(b) Total output expected to grow 3½ per cent 1985 on 1984 following 2½ per cent growth between 1983 and 1984. The coal strike is assumed to reduce output this year by 1 per cent so "underlying" growth is 3½ per cent in 1984 and 2½ per cent in 1985.

(c) Manufacturing output forecast to rise by 2½ per cent in 1985.

(d) Company income growth to continue, albeit more slowly, and financial surplus likely to remain high.

(e) Export volume forecast to rise 4½ per cent in 1985 after 5½ per cent in 1984. Imports to rise 4 per cent after 7½ per cent this year. Coal strike increases import growth this year and lowers it in 1985. Current account surplus £2½ billion in 1985 after strike-affected bare balance this year.

(f) Consumer spending growth increases to 3½ per cent in 1985 as fiscal adjustment and end to coal strike boost income growth. Stockbuilding contribution (1 per cent) also high because of end of strike effect. Investment growth (3 per cent) more modest as public investment declines and investment growth in the North Sea moderates from very high recent rates.

(g) 1984-85 PSBR now expected to be around £8½ billion. 1985-86 PSBR assumed to be 2 per cent of GDP, as in 1984 MTFS (see brief C1).

(h) Monetary growth for 1985-86 assumed to be within the illustrative target ranges in MTFS (3 to 7 per cent for MO, 5 to 9 for £M3).

(i) World trade in manufactures (UK market - weighted) to rise 4½ per cent in 1985 after 8 per cent this year.

(j) Major 6 other OECD economies to slow to 3½ per cent GDP growth in 1985 after 5 per cent this year. Inflation to fall from 4½ per cent to 4.

(k) Effective exchange rate for 1985 assumed to be little different from average in July-October 1984.

(l) No explicit forecasts of pay or unemployment provided. Assumptions on both, as supplied for Government Actuary's Department report, given in Part 3 of Autumn Statement document.

(m) British Telecom is included in private sector totals in 1985-6. The figure for business investment growth, however, excludes BT.

(n) IAF sees slower growth this year than Budget FSBR (3 per cent) but underlying growth is higher. Underlying 2½ per cent growth in 1985 is the same as shown in FSBR for 1985 H1. Inflation to the fourth quarter of this year fractionally higher than 4½ per cent FSBR; inflation to 1985 Q2 at 4¾ per cent instead of 4. Brief B4 contains information on outside forecasts.

Positive

(i) Forecast will imply average 2¾ per cent a year GDP growth over for the four years 1981-85.

(ii) Inflation to continue downward trend, below 5 per cent for third year in a row.

(iii) Aside from effects of miners' strike, outlook generally consistent with Treasury forecast given at Budget time. Gloom of some outside forecasters on 1984 inflation, in particular, shown to be unjustified.

(iv) On forecast assumptions, still good prospect of further tax reductions in 1985 Budget.

(v) Total fixed investment expected to set new records in both 1984 and 1985. [Figures (£ bn 1980 prices) are 44 pre-recession peak in 1979, 45 forecast 1985.]

Defensive

(i) Outlook for unemployment/employment?

Following recent practice of both Labour and Conservative governments, no unemployment forecast/employment is given. Working assumptions to 1985-86 are published in GAD report and for later years will be in PEWP.

Employment has been growing rapidly - there was a rise of a quarter of a million in those in work (including self-employed) to June 1984. Rise is expected to continue in the forecast period. The work-force has grown even faster and so unemployment has still risen. Employment has grown most rapidly in service industries, particularly part-time jobs, which have attracted women who were not previously claiming benefit and so were not included in the working population.

(ii) Underlying GDP growth to slow sharply from 3½ per cent 1984 to 2½ per cent 1985?

FSBR foreshadowed some moderation of growth in 1985. Not unexpected as contribution from expansion of North Sea output tails off. But forecast still implies healthy 2¾ per cent annual growth of GDP between 1981 and 1985.

(iii) 1984-85 PSBR higher than forecast in FSBR?

The forecast is £1¼ billion higher. Miners' strike (assumed impact of £1½ billion on 1984-85 PSBR) is key factor. (see also Brief C1).

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(iv) Investment growth only 3 per cent in 1985? There is some reduction in public investment from the high levels of 1983 and 1984 and slowing of the fast growth of investment in the North Sea. But, for whole economy, total fixed investment still expected to set new records in both 1984 and 1985.

Onshore business investment is forecast to increase 7 per cent after 10 per cent rise in 1984. Investment in service sector three quarters of total business investment already at record level.

(v) Investment to fall in 1984H2?
Coal strike has reduced investment in the mining industry. Imposition of VAT, and lower grants, may check the growth of home improvement work. Total investment expected to set new record in 1985.

(vi) Earnings growth to rise again?

Underlying earnings growth not expected to rise. Actual earnings growth for whole economy currently depressed by miners' dispute, naturally expected to pick up when strike ends.

(vii) Assumption about mortgage rates?

Some fall assumed at the beginning of 1985 with possible further fall later in the year.

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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	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	
		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 for 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 higher inflation and probably overstates the margin of error at low rates of inflation.

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B4 OUTSIDE FORECASTS

Factual

This brief reports on consensus of outside forecasters' views about the economy. Reflects forecasts by LBS, NIESR, Simon and Coates (S&C), Phillips and Drew (P&D), Henley, CBI, Cambridge Econometrics, and Liverpool.

World economy

(i) OECD output grows by 4½-5½ per cent in 1984, bolstered by strong GNP growth in the USA. For 1985 overall increase in output falls to around 3 per cent as a slowdown in US activity offsets higher growth of output in many European economies.

(ii) Trade expands by 7½-8½ per cent this year easing to 5-6 per cent next year.

(iii) Inflationary pressures remain subdued as a result of continuing downward pressures on oil and commodity prices. Consumer price inflation stays below 6 per cent this year and next.

UK economy

(i) The consensus expects GDP, on the output measure, to grow by 2¼ per cent 1984 and around 3 per cent 1985. Retail price inflation seen as rising from 5 per cent (1984 Q4) to 5¾ per cent (1985 Q4). See annex for further details.

(ii) Coal strike (assumed to finish by end 1984) transfers up to 1 per cent of GDP growth from 1984 into 1985; but underlying growth is slightly lower next year.

(iii) Recent forecasts such as LBS, P&D, S&C expect growth in consumers' expenditure to provide the main contribution to GDP growth in 1985 after strong contributions from GDFCF and exports this year. Increase in consumer spending put at 2½-3 per cent for 1985, underpinned by rising real incomes.

(iv) Total gross domestic fixed capital formation increases by 8-9 per cent in 1984 in response to rising company income and the 1984 Budget tax measures. Next year sees some slowdown to around 3-4 per cent.

(v) Exports of goods and services increase by 5½-6 per cent by volume in 1984 reflecting increased OECD activity and the advantages of a lower exchange rate. Next year only the LBS expect a higher rate of increase (6½ per cent). Others such as P&D, S&C, NIESR expect 3-4 per cent.

(vi) Forecasts for the increase in volume of imports this year vary from 6½ per cent (S&C, Henley) to 8½ per cent (NIESR, P &D) depending on the assumed trade effects of the coal strike. 1985 range is wider (2½-7½ per cent) but most recent forecasts expect a deceleration to 2½-3½ per cent.

(vii) Current account of balance of payments expected to show surplus of about £½ billion this year. Next year the range of forecasts is wider - from £-0.5 bn (NIESR) to nearly £+3 bn (S&C, Liverpool).

(viii) All outside forecasters have progressively revised down their forecasts of retail price inflation for 1984 Q4. S&C, P&D, Henley now expect an outturn between 4½-5 per cent. Over the coming year inflation is expected to be broadly stable though a slightly higher level of inflation is expected by some groups in 1985 Q4.

Rising wage settlements and labour costs are seen as offset by lower oil and commodity prices.

(ix) The consensus has unemployment still rising in 1985. The only groups expecting a fall are the CBI and Liverpool. The most pessimistic groups are NIESR and LBS, both expecting about 3.3 million by end 1985.

(x) Monetary and fiscal policies are assumed to stay broadly in line with MTFS guidelines. However the consensus expects a PSBR outturn of about £8 bn this year mainly as a result of higher government expenditure. £M3 grows at a rate near the top of the 6-10 per cent target range in 1984-85.

Positive

(i) **Outsiders more pessimistic about inflation than Treasury?**

No. All outside groups have steadily revised down their inflation forecasts for both 1984 and 1985. Simon & Coates, Phillips & Drew, Henley expect retail prices to increase by 4½-5 per cent by 1984 Q4. They have come into line with the Treasury, whose Budget time inflation forecast is now being confirmed by the actual figures.

(ii) **Outsiders gloomy about GDP growth?**

No. Consensus expects 2 per cent this year and 3 per cent next year.

Defensive

1. **But higher growth in 1985 is statistical illusion due to coal strike?**

End to strike would be one factor. But groups such as LBS, Simon & Coates, Phillips & Drew, also expect for example a stronger underlying consumers' expenditure growth in 1985.

2. **But they expect inflation to increase next year?**

Most groups expect inflation to be broadly stable (5-6 per cent).

3. **Nobody expects unemployment to come down?**

Most groups do expect unemployment to rise. But gloomy predictions from groups such as Cambridge Econometrics are based crudely on demographic factors (ie a rising labour force) and ignore importance of real wages as an adjustment mechanism.

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CONSENSUS AND RANGE OF OUTSIDE FORECASTS

B4 (Annex)

	CONSENSUS	RANGE				
GDP (Output) growth						
1984	2.0	1.8	(S&C)	-	2.3	(LBS)
1985	2.9	2.0	(Cambridge)	-	3.2	(P&D, S&C)

Note: On the expenditure measure Liverpool are at the top end of the range in 1985 with 4.4 per cent.

	CONSENSUS	RANGE				
RPI Inflation						
1984 Q4	5.0	4.6	(S&C)	-	5.7	(NIESR)
1985 Q4	5.8	4.9	(S&C)	-	6.5	(NIESR)

Note: Liverpool expect consumer price inflation to average 4.5 per cent in 1984 and 2.3 per cent in 1985 - the lowest of all outside inflation forecasts.

	CONSENSUS	RANGE				
Unemployment (UK, adults, s-adj, millions)						
1984 Q4	3.09	3.0	(CBI)	-	3.13	(S&C)
1985 Q4	3.14	2.9	(CBI)	-	3.26	(LBS)
PSBR (£ million)						
1984-85	7.9	7.1	(CBI)	-	10.3	(NIESR)
1985-86	7.4	3.8	(Liverpool)	-	10.7	(NIESR)
Current account (£ billion)						
1984	0.4	-0.2	(NIESR)	-	1.0	(Liverpool)
1985	1.1	-0.5	(NIESR)	-	2.9	(Liverpool)
Sterling Index (1975=100)						
1984 Q4	76.7	75.0	(S&C)	-	78.2	(Henley)
1985 Q4	77.7	76.0	(S&C)	-	81.0	(LBS)

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B5 COAL STRIKE: EFFECTS TO DATE AND IMPACT TO FORECASTS

Factual

(Forecast assumes strike finished end-December 1984.)

(i) Main effect on GDP level is from loss of coal output and estimated to be 1¼ per cent of GDP currently. Loss for 1984 estimated at 1 per cent [or around £3 bn]. In terms of the expenditure components GDP loss in 1984 mainly due to higher imports and destocking.

(ii) Because of strike forecast GDP growth this year now around 2½ per cent (1 per cent below forecast underlying increase of 3½ per cent). Growth of 3½ per cent expected in 1985 (1 per cent above underlying increase of 2½ per cent).

(iii) Industrial production loss currently 3½ per cent - mainly due to lost coal output. Effects outside coal industry small. But recorded net output in iron and steel and electricity supply industries affected by more costly mix of inputs (road transport of materials, etc). Overall manufacturing output level hardly affected - impact of perhaps ½ per cent.

(iv) Balance of trade adversely affected on both coal and oil accounts to tune of over £1½ billion in 9 months to September.

(v) PSBR cost of strike will be about £1½ billion for 1984-85, a main reason for expected PSBR overshoot to around £8½ billion compared with Budget estimate of £7¼ billion. Public expenditure cost on same assumptions also "about £1½ billion" (central estimate is about £1.3 billion but uncertainties large).

(vi) No estimates for strike's impact on profit and loss accounts of nationalised industries, which differ from PSBR/public spending cash effects.

(vii) Recent falls in sterling were chiefly due to dollar strength but coal dispute naturally had an effect on sentiment.

(viii) Coal strike has affected market confidence, therefore domestic interest rates higher.

(ix) Because of effects on interest rates and confidence strike adversely affecting employment throughout economy. In addition, short time working for some NCB suppliers, jobs threatened in retail trade in mining areas.

Positive

(i) Not cheaper to keep mines open than to close them as some studies say. Higher subsidies mean more taxation and borrowing. These would threaten jobs throughout the economy.

(ii) Miners' strike chief reason for expecting overspend of 1984-85 expenditure Reserve.

(iii) End-August coal stocks at power stations over 15 million tonnes and will see us through winter without power cuts.

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B5

Defensive

(i) Impact of strike on production, outside coal industry, has been small. [Loss of output in iron and steel industry and electricity supply is value added not gross production.] Manufacturing output hardly affected: 3 months to September up [ ] per cent on a year ago.

(ii) Obviously coal and dock strikes had an effect on confidence but CBI latest trend survey generally encouraging about manufacturing output growth, export prospects and output prices.

(iii) Higher PSBR forecast still below 1983-84 and - as proportion of GDP - smallest for more than a decade. Bulk has been funded. Still confidently expect to meet 1984-85 monetary targets.

(iv) Estimated £1½ bn 1984-85 PSBR cost takes account of post-strike effects in 1984-85 where these can be predicted with some certainty. Figure fully consistent with 1 August estimate of "up to around £400 million" which took account only of impact on PSBR to end July.

(v) Industry's book losses different from cash public expenditure effects The cash effects of an industrial dispute on any enterprise will usually be different from the effect on the profit and loss acount. For example, during 1983-84, the dispute increased NCB book losses by about £300 million, but they still kept within their cash EFL.

(vi) The Winter Supplementary for the NCB of £607 m in consistent with the estimated £1½ bn PSBR cost and relates to book losses.

(vii) NCB 1985-86 external financing limit unchanged since Cmnd 9143. Ministers will consider position again once strike ends.

(viii) Public spending effect of strike in 1984-85 likely to be about £1½ billion, as for PSBR. Latter likely to prove bigger than former after the event, but at this stage, cannot precisely forecast either.

(ix) Bulk of deterioration on balance of trade should be temporary.

(x) No decision taken on most appropriate method of meeting costs of strike, including extra costs incurred in maintaining electricity supplies.

(xi) PSBR costs and loss of GDP not the same. GDP loss reflects lost income across the economy; lost miners' earnings represent good part of this. PSBR cost measures cash effect on public purse.

(xii) Strike still a good investment? Hope it ends ~~quickly~~ fully. But even before it began taxpayer was covering deficit of around £1 billion a year by NCB. This would increase, if uneconomic pits not closed, to impose a an intolerable growing drain on national resources.

(xiii) Coal price increase just announced? Increase of around 4½ per cent is NCB's normal autumn price change and just below the inflation rate.

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B6 (EB Note on Mrs Lane's m/c)

B6: EMPLOYMENT AND UNEMPLOYMENT

Note: see Briefs J [ ] for Survey decisions on SEMs, L for role of Lord Young

Factual

(i) Adult unemployment (seasonally adjusted) rose on average 15 thousand per month in six months to October. Recent monthly path has been erratic - October increase only 3 thousand following rise of 26 thousand in September.

(ii) Employed labour force (including self employed) rose 250 thousand in year to June 1984: service sector employment rose 280 thousand while manufacturing fell 60 thousand (most of this fall was in 1983). Part time female employment up 165 thousand. Stock of notified vacancies is back on upward trend. October figure 6 thousand higher than in July and highest level since March 1980

(iii) Simultaneous rise in employment and unemployment over past year due to resumption of growth in labour supply. Many new jobs have gone to people not previously claiming benefit (eg women seeking part time work).

(iv) Miners' strike may have harmed employment - through confidence effect on interest rates and, more locally, through pressures on NCB suppliers and retailers in mining areas. But effects impossible to quantify.

(v) Survey of company executives conducted for CBI found balance of +5 per cent expecting higher employment in 12 months and +17 per cent expecting higher employment in 5 years. Fastest growth expected in services and among small and medium sized firms.

(vi) Continued rise in claimant unemployment possible: upward trend in labour force projected; more employment growth expected but many new jobs likely to be for part timers; further real wage growth expected. Most outside forecasters now expect small increases in unemployment through 1985.

(vii) Current unemployment assumption for public expenditure plans is 3.0 million (GB excluding school leavers) for 1984-85 and after. October 1984 figure was 2.98 million.

(viii) Public expenditure Survey identified significant savings on Special Employment Measures (SEMs) - £220m in 1985-86, mainly reflects reduced take up of YTS. Partly offset by agreed expansion of Enterprise Allowance from 50,000 places in 1984-85 to 62,500 in 1985-86 and subsequently. Net reduction of £168m in SEMs expenditure in 1985-86.

Positive

(i) More jobs being created - employment up ¼ million in year to June 1984.

(ii) New jobs going to most flexible and least unionised workers - part-timers for example. Self-employment up estimated 430 thousand since mid-1979.

(iii) Productivity in manufacturing at record level - up about 6 per cent in 1982 and 1983, though growth has slowed recently.

(iv) Revised provision for SEMs will broadly maintain the present impact of the programme on the unemployment register - reducing it by about 450,000. All the existing schemes are being continued and some are being expanded.

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Defensive

(i) Unemployment still rising - outlook bleak? Employment up ¾ million in year to June 1984 and growth expected to continue. But labour force also growing fast and many new jobs - especially part time jobs - going to women not previously claiming benefit. Faster progress on jobs will be helped by slower real wage growth, as demonstrated by US experience. Contrast UK where real wages have risen 3 per cent in each of the past 2 years.

(ii) Why cut Special Measures, given bleak outlook? Reductions due largely to savings from low take up. Some expansion of the measures (eg Enterprise Allowance) has been possible.

(iii) [If pressed] The reduction in SEMs provision cannot be translated into an effect on unemployment. The provision in the last White Paper is now seen to have been based on unrealistically high forecasts of take up.

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C1 PSBR AND FISCAL PROSPECTS 1984-85 AND 1985-86

(For note on 1983-84 see paragraph 2.1 below)

1. Introduction and Summary

Factual

(i) The Autumn Statement fiscal picture compares as follows with that shown in the FSBR:

Public Sector Borrowing (Table 2.6 and paragraph 2.18 of FSBR, table 1.9 of AS)

	1984-85			1985-86		£bn
	FSBR	AS	change	FSBR	AS	change
General Government expenditure	146	148 ½	+2 ½	152	154 ½	+2 ½
of which, debt interest	(15 ½)	(16)	(+ ½)	(15 ½)	(17)	(+1 ½)
General Government receipts	138 ½	140	+1 ½	146 ½	148 ½	+2
of which, tax receipts*	(104 ½)	(105 ½)	(+1)	(111 ½)	(113 ½)	(+2)
implied fiscal adjustment	-	-	-	2	1 ½	- ½
General Government Borrowing Requirement	8	9	+1	7 ½	7 ½	-
Public Sector Borrowing Requirement	7 ¼	8 ½	1 ¼	7	7	-
as percentage of GDP	2 ¼	2 ½	+ ¼	2	2	-
money GDP at market prices	328	327	-1	350	353	+3
* memo: accrued North Sea tax revenues	10	12	+2	9 ½	12	+2 ½

NB because of rounding, columns may not sum

(ii) Expenditure is expected to be higher than in the 1984 FSBR in all years. In part this reflects a change in the national accounts treatment of transactions in public sector pension funds, which has the effect of raising expenditure and revenue by about £ ½ billion in all years with no net effect on borrowing: this classification change is included in "national accounts adjustments" in table 1.7 and in "interest and other receipts" in table 1.8 of the AS. Expenditure is also higher in 1984-85 and 1985-86 because of higher debt interest (see Defensive (ii) below). 1984-85 is also affected by expected overspend on the planning total: see Brief E1.

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(iii) Revenue is also higher in all years, partly because of the classification change (see ii above) but also because North Sea oil tax receipts are expected to be higher (in 1984-85 and 1985-86, by £1½ bn and £2½ billion respectively).

(iv) The fiscal adjustment in 1985-86 is about £½ billion down, at £[1½] billion. But the margin of error is ± £5 billion.

1.2 **Positive**

(i) Changes are not great, considering margins of error. Accuracy of 1983-84 PSBR estimate in 1984 FSBR truly remarkable (see paragraph 2.1 below), since March information was not available and could have been very different from forecast.

1.3 **Defensive**

(i) Has expenditure planning total increased in 1984-85 by £2-3 bn apart from miners' strike? (Miners' strike adds about £1½ bn, but North Sea revenues increased by £2 billion, according to AS table 1.8; yet PSBR up by £1¼ bn. Press have also suggested that EC rebate and higher asset sales increase receipts.)

No:-

(a) AS tables 1.7 and 1.8 show 1984-85 expenditure and revenue up by about £2½ billion and £1½ billion respectively. But £½ billion of each increase is due to classification change - see above. Net increase in expenditure therefore a little over £2 billion, of which debt interest is a little over £ ½ billion (see below) and miners' strike £1½ billion. [Planning total overshoot is £1½ billion - see Brief E1.]

(b) Increase in oil receipts in 1984-85 not £2 billion. AS table 1.8 shows accrued oil revenues (as did FSBR table), ie before adjustment for ACT (Advance Corporation Tax) which oil companies have earlier set off against their tax liabilities. Difference in accrued revenues is nearly £2 billion but difference in receipts in 1984-85 is only £1½ billion.

(c) Part of extra oil revenues offset by reduction in expected income tax receipts. Higher interest rates cause increased mortgage tax relief, before tax on increased interest paid on building society deposits comes through.

(d) Local authority borrowing up in 1984-85 partly because of capital overspend in 1983-84. Some bills for expenditure in late March 1984 affected borrowing in early April.

(e) EC rebate for 1983 is extra, but on other hand rebate for 1984 not now likely before 1985-86.

(f) Asset sales forecast in Budget about £2 bn. Outturn dependent on market conditions. NB not all privatisation receipts (eg Jaguar) count as special sales of assets. See Brief J22.

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(ii) Why are debt interest payments so much higher in 1984-85 and 1985-86 than in the 1984 FSBR? (A little over £½ billion in 1984-85 and £1½ billion in 1985-86.) Mainly because of higher forecast borrowing in 1984-85 and higher interest rates in both years than in the FSBR.

1.4 The remaining sections of this brief commment in more detail on the figures for 1983-84, 1984-85 and 1985-86, and offer material for public use.

2. 1983-84

2.1 PSBR in 1983-84: was £9.7 billion or 3.2 per cent of GDP (on new definition, excluding bank deposits; it was £10.0 million on old definition), exactly as forecast in 1984 FSBR. EC rebate in respect of 1983 was not received during 1983-84 and this increased central government borrowing on own account. But public corporations' borrowing turned out a little lower than expected.

3. 1984-85

3.1 **Factual**

(i) PSBR in first 7 months 1984-85: outturn in first 7 months is likely to have been about £[ ] billion, close to latest estimate for year as a whole. (Estimated outturn for October PSBR, and for first 7 months, will be published 16 November.) It was always expected that PSBR in 1984-85 would be more than usually front-end-loaded, because of extra receipts in second half (BT sale and change in VAT on imports).

(ii) PSBR for 1984-85 as a whole: now expected to be about £8½ billion, 2½ per cent of GDP - some £1¼ billion higher than the 1984 FSBR forecast of £7¼ billion, but lower than in 1983-84. Estimate of £8½ billion was given by Chancellor in employment Debate on 30 October. But still large margin of error (± £2 billion) in forecast at this stage of year.

(iii) Estimates of both expenditure and revenue have increased since FSBR forecast; many factors involved, working in both directions. Main reasons for expecting borrowing to be above Budget forecast are:-

(a) local authorities' overspend on capital account in 1983-84 seems likely to be followed by further overspend in 1984-85;

(b) higher interest rates than expected at time of Budget have increased debt interest payments;

(c) extra receipts from North Sea oil (higher production and sterling prices than expected at time of Budget, despite recent cuts in dollar prices) are expected broadly to offset (a) and (b); but

(d) miners' strike, assuming ends in December, may add about £1½ billion to total borrowing (this estimate given by Chancellor in employment debate on 30 October).

(iv) Public expenditure planning total outturn for 1984-85 now expected to be nearly £128 billion, about £1½ billion higher than in FSBR, ie broadly cost of miners' strike. See Brief E1.

(v) Recent PSBR outturns as a proportion of GDP (average measure) have been:

1974-75 to 1978-79 (average)	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85 (forecast)
6.7	4.8	5.4	3.3	3.1	3.2	2½

3.2 **Positive**

(i) As proportion of GDP, estimated 1984-85 PSBR well below that in 1983-84 and comfortably the smallest for well over a decade.

(ii) Essential to continue progress in getting borrowing down within MTFS framework if interest rates to be reduced further.

3.3 **Defensive**

(i) 1984-85 PSBR out of control? No. Change in estimated outturn for 1984-85 since Budget is well within wide margins of error around PSBR forecasts (average error in past forecasts is £4-5 billion for year ahead at Budget time).

(ii) Why has 1984-85 PSBR increased so much since Budget? Change not that great. Revision to central estimate, particularly as % of GDP, is really very small. Chief reason for revision is effect of miners' dispute, which was unforeseen at Budget time. See also Defensive points at 1.3 above.

(iii) Cost of miners' strike? Estimated effect of dispute on PSBR is about £1½ billion in 1984-85, on assumption that dispute is over by end of 1984. Estimated effect on public expenditure is also about £ 1½ billion - PSBR effect is slightly greater because of net tax loss, but both estimates round to about £1½ billion. See Brief B5.

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4. **1985-86**

4.1 **Factual**

(i) Projection for PSBR in 1985-86 unchanged from MTFS path set out in 1984 FSBR, ie £7 billion (equivalent to 2 per cent of GDP).

(ii) Underlying forecasts and assumptions:-

(a) Real GDP (average measure) grows by 2 per cent in 1984-85 and [3½ per cent] in 1985-86. These estimates are affected by miners' strike: underlying increases are [3] per cent and [2½] per cent. See Brief B5.

(b) General rate of inflation, as measured by GDP deflator, is 4¾ per cent in 1984-85 and 4½ per cent in 1985-86.

(c) Main direct tax allowances and thresholds, and excise duties, are revalorised in 1985-86, using a figure of 4¾ per cent. See also Part 4 of AS.

(d) Dollar prices for North Sea oil do not change very much from the levels prevailing in early November.

(e) Sterling exchange rate index in 1985 is broadly similar to recent average level.

(iii) Public expenditure planning total in 1985-86. See Brief E2.

(iv) Debt interest in 1985-86. £1½ billion higher than Budget forecast, mainly because higher interest rates and higher borrowing in 1984-85.

(v) Revenue in 1985-86. On above assumptions, and before fiscal adjustment, increase in tax revenues in 1985-86 compared with 1984-85 is £8 billion, close to forecast rise in money GDP of 8 per cent. North Sea oil revenues forecast some £2½ billion higher than in 1984 FSBR, at [around £12 billion].

(vi) Fiscal adjustment in 1985-86. This shows extent to which, if policies are successful and if economy develops as projected, there would be room for lower taxes (in addition to revalorisation of personal allowances) or higher spending than assumed. Fiscal adjustment is , at £1½ billion, projected a little below 1984 FSBR figure of £2 billion. But margin of error at least ± £5 billion at this stage of forecast for next year. Will be reviewed, in light inter alia of new forecast, for 1985 Budget.

4.2 **Positive**

(i) Further fall in PSBR expected between 1984-85 and 1985-86 (even after fiscal adjustment), from £ 8½ billion to £7 billion.

(ii) Projections still on MTFS track. Should be consistent with interest rates declining in both nominal and real terms.

(iii) Now 4½ years since introduction of MTFS, during which time inflation reduced from almost 20 per cent to under 5 per cent.

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4.3 **Defensive**

(i) Public expenditure plans for 1985-86 overoptimistic? Reserve too low? No. Realistic. See Brief E.2.

(ii) North Sea taxes will decline in later years, but public expenditure will go on growing? Path for PSBR will be reconsidered in 1985 Budget in light of likely pattern of North Sea and other revenues and other factors. 1984 FSBR acknowledged that size of oil revenues was relevant to deciding appropriate level of PSBR. And high oil revenues was one reason for planned reduction in PSBR between 1983-84 and 1984-85 (and now again in 1985-86).

(iii) Effect of miners' strike on 1985-86 PSBR? Decisions have yet to be taken on policies following strike (eg rate of stock rebuilding, possible "Scargill surcharge" on electricity prices). Projections in AS assume some extra stock rebuilding, but no extra price increases. See Brief B5.

(iv) Reconsider PSBR path now? No. Inappropriate to review MTS more frequently than once a year at Budget time.

(v) PSBR for 1985-86 shoud be £ 3½-4 billion, not £ 7 billion, because of higher oil revenue and asset sales? (Tim Congdon, Times 24 October, suggested £3½ bn PSBR if oil revenues up £ 3½ billion. AS shows oil revenues £2½ billion higher and asset sales £½ bn higher.)

1984-85 FSBR acknowledged that size of oil revenues and asset sales relevant to deciding appropriate level of PSBR. But other factors have also changed since March: too early to say whether any changes in MTFS projections will be appropriate.

(vi) US budget deficit has boosted US output and employment? UK should copy? May be short run effects, but has caused high interest rates and present position ins unsustainable. Main factor underlying better US performance on jobs is freer operation of markets.

(vii) Both employment and wages have risen during US recovery, so discrediting argument that lower wages would lead to higher employment? No. Over the longer term the contrast between falling wage cost and rising employment in the US, and rising wage costs and falling employment in the UK and other European countries, is quite clear.

(viii) PSBR path not consistent with any fall in unemployment? Increase of 300 thousand in number of jobs since March 1983. Speed with which jobs created, and so timing of sustained fall in unemployment, depends crucially on realistic levels of pay. Last Budget's abolition of NIS and reform of corporation tax will encourage creation of soundly based new jobs, by removing tax discrimination against employment of labour.

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C2 MONETARY AND EXCHANGE RATE DEVELOPMENTS

Factual

Monetary Aggregates

(i) Provisional money figures for banking October show both target aggregates, £M3 and MO, on target.

Table 1

% change, seasonally adjusted (decimal actual in October shown in brackets)

	Banking October		annualised growth rates: Latest 6 months	Latest 12 months	Since start of 1984-85 target period (8 months)
MO	+¾	(0.8)	6¾	5½	6 (target 4-8)
£M3	+¼ to ½	(0.3)	8¾	8¼	9¼ (target 6-10)
M2*	+1 to 1¼	(1.2)	..	13¼	..
PSL2	+1	(1.1)	15	13½	15½

*not seasonally adjusted

(ii) Front-end-loaded PSBR has been more than fully funded (by about £1 billion) in the target period so far. High sterling lending in last two months may be due to special factors (see (iv) below), and to catching up after relatively low growth over the summer.

Interest rates

(iii) Clearing banks cut base rates by ½ per cent, to 10 per cent, on 6 November. This resulted from UK market rates following US rates down in the previous week, and a consequent ½ per cent reduction by the Bank in their dealing rate on 5 November.

(iv) Following banks' base rate reduction, Building Societies Association announced that a mortgage rate reduction was likely, but no decision will be taken until effect of BT sale on their deposit base is known ie cut cannot come into effect before 1 January. (Mortgage rates unchanged since July - see Annex table.)

(v) For key interest rate movements since 1978, see Annex.

(vi) Exchange Rate Policy. Unchanged, ie no explicit or implicit exchange target. As Chancellor said in Mansion House Speech (18 October), Government take rate into account "when its behaviour suggests that domestic monetary indicators are giving a false reading, which they are not." For recent exchange rate movements, see Annex.

Positive

(i) Monetary conditions are sound. MO is at mid-point of its target range. £M3 growth, at 9¼ per cent is within its target range with 6 and 12 month growth rates lower still. Confident that £M3 will for third successive year end up in target range for target period as a whole with the newly-targeted MO also on target.

(ii) With last week's base rate reduction, interest rates now recovered from sharp rise in July, and back on downward trend.

(iii) Market interest rates have remained relatively steady in October despite industrial situation and oil price worries. As Chancellor pointed out at Mansion House, this suggests that markets are taking a more balanced view of financial developments; in particular, they have come to recognise that monetary aggregates are critical to judging monetary conditions and determining interest rates.

Defensive

A **MONETARY POLICY**

(i) **Targets 1984-85?**

Will be set in Spring. MTFS indicates broad trend in monetary growth that we will be seeking to achieve. Unlikely to be any change in aggregates used for target purposes.

(ii) **Government pursuing policy of sustained overfunding?** [PSBR overfunded by £1.3 bn in banking October].

Governor's Kent lecture does not mark change in policy. Funding has always been seen as an instrument of monetary policy in short run. PSBR slightly underfunded over target period to mid-September.

B. **CURRENT MONETARY SITUATION**

(iii) **Monetary policy too tight**? No. Target aggregates in target range, no evidence that these aggregates are giving the wrong signals.

(iv) **Bank lending accelerating?**

It is the money figures that are important. But so far as lending is concerned, this month's figure should be seen in context of unusually small PSBR and high debt sales. High imports and retail sales in calendar September may also have contributed to high lending. May also be some catching up after relatively low growth over summer, but difficult to read much into two months figures. (September's figure was probably inflated by round-tripping.)

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(v) **Interest rates still too high?**

Base rates recovered from July increase. Scope for lower rates depends on maintaining sound monetary conditions, and on developments in domestic industrial situation and in US.

(vi) **High interest rates killing recovery?**

High interest rates, if they persist, are one potential brake on growth. Nevertheless, recovery continues to be broadly based, with strong growth in investment and further growth likely in both exports and personal consumption.

(vii) **PSBR impact of miners strike likely to affect interest rates?**

Most of additional borrowing has already occurred and had been funded. Important thing is to keep trend of borrowing coming down over a period of years.

(viii) **Fall in sterling require rise in interest rates?**

As Chancellor said in Mansion House Speech, monetary aggregates are of central relevance in determining interest rates. Sterling has now recovered from its fall in October when its behaviour reflected industrial worries and oil price falls, not loose monetary conditions.

C. **EXCHANGE RATE**

(ix) **Sterling still vulnerable?**

Pound now recovering on weaker dollar, absorbing well recent base rate cuts. Against DM, sterling little changed from Budget levels. With monetary conditions sound, market confidence in Government's economic strategy is high.

(x) **Sterling currently below rate assumed in Autumn Statement?**

[Autumn Statement assumes sterling index in 1985 not very different from level in July-October 1984 ie 77½].

Rate in Autumn Statement an assumption, not a forecast; and refers to a period average - allowing for short term fluctuations. In any case, present rate well within usual margins of error.

(xi) **Join EMS?**

Question of UK joining EMS exchange rate mechanism kept under review - but no early plans to join. Current uncertainty about dollar and oil prices not right conditions for UK participation. Membership gives no immunity from market pressures and could well substitute interest rate for exchange rate volatility.

(xii) **Effect of fall in £ on price inflation?**

Depends on large number of factors, including sterling's relative movement against different currencies, whether exchange rate movements are expected to be temporary or permanent, pressures on margins and cost, and stance of Government policy. Industrial commodity spot prices falling in recent months.

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Contact points:

Domestic monetary questions
M Neilson (HF3) 233-5871

Exchange rate, EMS etc
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174/2

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C2 ANNEX

Annex: Key interest rate movements

Bank base rates	%
May 10 1978	9
October 1 1981	16
November 4 1982	9
January 12 1983	11
October 4 1983	9
March 14 1984	8¼ to 8½
June 25-6 1984	9¼
July 6 1984	10
July 11 1984	12
August 9 1984	11½
August 10 1984	11
August 17 1984	10½
November [6] 1984	10

Mortgage rates		%
December 1	1978	11.75
November	1979	15
May	1981	13
October	1981	15
November	1982	10
June	1983	11.25
April	1984	10.25
July	1984	12.50

Market interest rates have moderated over recent weeks as the folowing table shows:

UK and US market interest rates

	UK 3 month interbank	3 month Eurodollar	UK 10 year Gilt	US long T-bond
14 March	$8^{13}/16$	$10^{3}/8$	10.28	12.29
25 June	$9^{7}/16$	$12^{3}/16$	11.93	13.55
11 July (UK base rate peak)	$11^{7}/8$	$11^{7}/8$	12.40	13.28
17 August/latest	10½	$11^{7}/8$	11.45	12.81
UK base rate fall)				
5 October	10½	$10^{7}/16$	11.29	12.44
19 October	10¾	10¼	11.6	12.00
6 November	[ ]	[ ]	[ ]	[ ]
9 November	[ ]	[ ]	[ ]	[ ]

Exchange rate: Recent movements

Lowest recorded index	=74.0 (19.10.84, noon)
9 November index	= [ ]
Record low against $	= 1.1830 (18.10.84)
Record low against DM	= 3.52½ (24.3.83)

From March average this year (ie month of Budget/latest $ low), sterling has fallen [12½] per cent against $, [1½] per cent against DM and [5½] per cent in index terms. Same period, dollar has risen around [12½] per cent against DM (recently touching 11½ year high) and reached record highs against most other European currencies.

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D NATIONAL INSURANCE

Factual

(i) Social Security Act 1975 requires Secretary of State for Social Services to review National Insurance contribution rates and limits annually. Main decisions for 1985-86 given in Chancellor's oral statement, repeated in Part 3 of Autumn Statement. Details to be given by Secretary of State in Written Answer on [ ] November, when necessary (affirmative) Orders laid along with report by the Government Actuary showing the effect of the changes on the National Insurance Fund. Details set out in DHSS Press Notice to be issued [ ] November.

(ii) Main announcements

(a) Class 1 rates for employed persons to remain unchanged at their 1984-85 level. (See table in Annex).

(b) Lower Earnings Limit (LEL) to increase from £34 a week to £35.50 in line with single rate retirement pension. (Difference between 4.4 per cent increase in LEL and 5.1 per cent increase in pension due to rounding rule set by statute).

(c) Upper Earnings Limit (UEL) to rise 6 per cent from £250 a week to £265 (just under 7½ times the LEL).

(d) Treasury Supplement down from 11 per cent of contributions to 9 per cent.

(e) Employers' to be relieved of cost of NICs on statutory sick pay. At present employers are liable to pay NICs on statutory sick pay (SSP), in the same way as on ordinary pay: they can recover the cost of the SSP payments themselves by deducting the amount from their gross NIC bill, but not the NICs they have paid on that SSP. (NB employees will still be liable to pay NICs on SSP). See also brief J20 for changes to SSP after April 1986.

(f) Directors' personal liability for their company's unpaid NICs ("Section 152(4) powers") to be abolished.

(iii) Benefit Uprating. See brief J20.

(iv) Government Actuary's Report

(a) economic assumptions - not forecasts - published in GAD report:

(i) numbers of unemployed (GB excluding school leavers etc) averages 3 million in 1984-85 and 1985-86;

(ii) underlying rate of increase in average earnings 7½ per cent in 1984-85 and 7 per cent in 1985-86; but these rates affected by lost earnings in coal industry. Accordingly, GAD report assumes average earnings in 1984-85 7 per cent higher than 1983-84, and average earnings in 1985-86 7½ per cent higher than 1984-85.

(iii) 4¾ per cent increase in RPI in 12 months to May 1985, period relevant for November 1985 benefit uprating.

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(b) Report shows projected annual surplus (ie excess of income over expenditure) in 1985-86 of £[million] taking cumulative balance to £[ ] million or [ ] per cent of annual benefit expenditure. Minimum balance recommended by GAD $^1/_6$th of benefit expenditure.

(v) Employers' burden. See table 3.1 of Autumn Statement. Because of part-year effect of abolition of National Insurance Surcharge (announced in 1984 Budget) total (NIC + NIS) burden on employers in 1985-86 expected to be only slightly higher in cash terms than in 1984-85. This is despite increase of £830 million because of increased earnings.

NB Table 3.1 relates to private and public sector employers. Increase in private sector employers burden [£50] million; NIS not abolished for LAs until 31 March 1985, so arithmetic of table 3.1 includes full year effect of NIS abolition for part of public sector.

(vi) Employees burden See table 3.1 of Autumn Statement. Changes mean maximum increase in employees' payments of £1.35 a week, (for those whose earnings put them at or above new UEL).

Positive

(i) No increase in Class 1 contribution rates. Second year this has been possible - rates held at level set in 1983-84 despite continuing increase in benefit expenditure.

(ii) Increase in upper earnings limit less than assumed increase in earnings. Most employees pay little or no more. Only those with earnings above £250 a week (well above average earnings) pay noticeably more and for them the maximum weekly increase is only £1.35.

(iii) As Table 3.1 of Autumn Statement shows, when full account is taken of abolition of NIS, total employers (NIC + NIS) bill in 1985-86 expected to be only slightly higher in cash terms than in 1984-85. This represents a substantial cut in real terms compared with assumed increases in prices of 4¾ per cent and earnings of over 7 per cent.

Defensive

(i) Why not cut contribution rates when Fund is running at such a surplus?

Fund is only in surplus because over £2 billion of general taxpayers' money - the Treasury Supplement - is being paid into it. See (viii) and (ix) below.

(ii) Cumulative balance well above level recommended by Government Actuary

$^1/_6$ of benefit expenditure was recommended by GA as prudential minimum, not a target or optimum level.

(iii) Employers rate should have been cut (like NIS) to help jobs

Government has already done considerable amount for employers. Staged abolition of NIS has been worth £3 billion to private sector employers. Effect of last stage of abolition only just being felt - took effect from 1 October, just a few weeks ago. As table 3.1 of Autumn Statement shows, taking account of NIS, total employers' bill in 1985-86 expected to be only slightly higher in cash terms than in 1984-85 - a substantial real reduction. Not clear yet how far employers

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have used benefit of NIS abolition to create jobs or dissipated it in excessive pay settlements.

(iv) LEL should be raised further to help jobs

LEL has been set at level required by existing legislation (Social Security Act 1975) ie equal to single rate retirement pension, rounded down. May be arguments for changing the legislation for the future. But musn't fall into trap of thinking of NICs a crude payroll tax like NIS. Contributions earn entitlement to benefit: raising LEL excludes low paid from State pension and other NI benefits. Also, at present, LEL and UEL are integral part of SERPS benefit calculation. Need to wait until Mr Fowler's pension review has completed work and we know where we are going on the benefit side before any radical changes could be made to earnings limits.

(v) LEL should be changed into threshold

Enormously expensive (ie several £ billions. If pressed: best estimate of order of £6 billion). Contribution record at minimum level enough to qualify for basic State pension and full range of other NI benefits. Only fair that minimum contributions should be reasonable amount (cf private sector minimum insurance premiums). See also (iv) above.

(vi) UEL should have been increased further, or abolished

UEL set at maximum permitted within existing legislation. See also (iv) above.

(vii) UEL should not have been increased

Would mean that better-off did not pay fair share of benefit expenditure. Increase is less than assumed rise in earnings.

(viii) Selective reductions/exemptions for NICs (by age, region or industry)

Lot of factors would need to be taken into account, including administrative complications for employers and implications for benefit entitlement. Would need to be very sure effect would be a substantial, well targeted impact on jobs before acting.

(ix) Why reduce Treasury Supplement instead of cutting rates?

Non-contributory (ie non-Fund) benefit expenditure increasing faster than Fund expenditure, so balance of financing social security spending tending to shift towards taxpayer. Progressive reductions in Treasury Supplement help to redress that balance. Even after proposed 2 per cent cut in Treasury Supplement, taxpayer will be financing [ ] per cent of total social security expenditure, compared with [ ] per cent in [ ].

Contact Point: Miss C Noble (ST1) 233-3169. Detailed Queries to DHSS.

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ANNEX D

D1 (Annex) MAIN CONTRIBUTION RATES AND LIMITS: 1984-85 AND 1985-86

Employed Persons (Class 1)

When earnings exceed the lower earnings limite (LEL), contributions are payable on total income, not just the excess over the LEL, up to the upper earnings limit (UEL). For those who are contracted into the State earnings-related pension scheme, the standard Class 1 rate is payable on all earnings up to the UEL; for those who are contracted out, the amount payable is the sum of the standard, contracted - in rate on earnings up to the LEL and the contracted-out rate on earnings between the LEL and the UEL.

	1984-85	1985-86
Class 1 standard, contracted-in rate		
Primary (ie employee)	9.0%	9.0%
Secondary (ie employer)	10.45% *	10.45%
Class 2 contracted out rate		
Primary (ie employee)	6.85%	6.85%
Secondary (ie employer)	6.35% *	6.35%
Class 1 reduced rate for married women		
optants (employee)	3.85%	3.85%
Class 1 Lower earnings limit (LEL) (per week)	£ 34.00	£ 35.50
Class 1 Upper earnings limit (UEL) (per week)	£250.00	£265.00

* Excludes National Insurance Surcharge, levied at 1 per cent.

Self Employed (Class 2 and 4)

The self employed pay a flat-rate weekly contribution, Class 2, unless they successfully claim that their earnings are below the small earnings exception; and an annual earnings (ie profit) related contribution, Class 4, collected after the end of the year. (Liability calculated from income tax return). Class 4 contribution are payable on the excess of profits above the lower profits limit, up to the upper profits limit.

Class 2 flat rate contribution	£ 4.60	£ 4.75
Class 2 small earnings exception (per annum)	£1,850	£1,925
Class 4 (annual) earnings-related contribution rate	6.3%	6.3%
Class 4 lower profits limit (per annum)	£ 3,950	£4,150
Class 4 upper profits limit (per annum)	£13,000	£13,780

Non-Employed, Voluntary contributions (Class 3)

People who, for various reasons, are not paying Class 1 or Class 2 contributions, and who would otherwise have an incomplete contribution record which would reduce, or eliminate, their entitlement to benefit, can choose to pay weekly flat rate Class 3 contributions.

Class 3 non-employed contributions (per week)	£4.50	£ 4.65

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E1 Public Expenditure 1984-85

Factual

(i) The present estimated outturn for the planning total in 1984-85 is "nearly £128 billion", or "about £1½ billion" up on the White Paper plans, which, after Budget and classification changes totalled £126.3 billion (see AS paragraph 1.58). At this stage of the year the estimated outturn is very uncertain.

(ii) The chief reason for expecting an overspend on the Reserve (the Reserve included in plans was £2¾ bn) is the impact of the miners' strike. Net impact of claims is to exhaust Reserve of £2¾ billion with strike likely to take expenditure about £1½ billion above plans.

(iii) Significant claims on the Reserve include local authorities' overspend on current and capital account. Other claims on the Reserve include sums previously announced in Summer Supplementaries, roll forward of last year's capital underspends (under end year flexibility scheme), part of costs of 1984 NHS pay awards, and a variety of other increases in Supply expenditure for which Winter Supplementaries will shortly be presented. These additions will be partially offset by some underspends and extra receipts that reduce net expenditure.

(iv) Winter Supplementaries (consistent with the estimated planning total outturn) will be presented shortly together with the FST's Note, which will show supply expenditure outturn against budget profile for the first half year.

(v) Supply services (which represent voted money, financing only part of public expenditure) totalled £43.8 billion in the first six months of 1984-85, 6½ per cent higher than for the same period last year compared with a budget forecast increase of 5¾ per cent for the whole of 1984-85. [Corresponding figures for first 7 months will be published on 16 November.]

(vi) Latest public expenditure plans by Department for 1984-85 are shown in Table 2.1 of AS incorporating Budget and classification changes. [NB. No breakdown is available of expected outturn by Department.]

(vii) General government expenditure in national accounts terms is forecast to rise by around £2½ billion (AS Table 1.7) compared with plans (more than outturn planning total because of debt interest and other adjustments - see brief C1).

(viii) Public expenditure as a percentage of GDP since 1979-80 is:

1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	
					plans	(estimated) (outturn)
39½	42	43½	43	42½	42½	43

(ix) The difference between the FSBR figure for the 1984-85 planning total (£126.2 billion) and the AS plan figure of £126.3 bn for 1984-85 is due to a number of classification and other small changes.

Positive

(i) Impact of the miners' strike clearly exceptional.

(ii) Excluding the effect of the strike, spending broadly on course, with unanticipated expenditure likely to be close to the Reserve.

(iii) Estimated outturn public expenditure as a percentage of GDP is still on a declining trend, particularly if strike-caused blip is ignored. (See factual (viii)). (For 1985-86 see brief E2.)

Defensive

(i) **Why no action, as during 1983-84, to cut public expenditure to meet planning total?**

Claims on the Reserve accepted only after thorough search for offsetting savings. Action taken in some areas (eg to restrain capital overspending by LAs). Costs of disruptive cuts at this late stage outweigh benefits. Rest of public expenditure programme cannot bear the cost of exceptional factors such as miners' strike.

(ii) **LA current overspending**

LA Budgets likely to exceed provision substantially (over £1 billion) this year. But should be less of a problem next year. 18 authorities -highest spenders - to the rate capped in 1985-86. Realistic and achievable targets for authorities spending below GRE ("low spenders"). Much more severe penalties already announced for overspending targets in England and Wales in 1985-86.

(iii) **LA capital overspending**

LAs have been under voluntary restraint since July to minimise overspending in 1984-85, and maximising receipts. LA capital control system under urgent review to improve control arrangements.

(iv) **Cost of the Miners' Strike**

The estimated public expenditure cost of the miners' strike for 1984-85, assuming dispute ends by Christmas is about £1½ billion, similar to PSBR cost. See brief B5.

(v) **Other major claims on Reserve**

Major claims already announced:

1. End-year flexibility £½ billion.
2. Health service pay awards £¼ billion.
3. Summer Supplementaries £¼ billion.

Other potential claims :

1. LA current (LA budgets expected to exceed provision by around £1.2 billion)

   [NOT FOR USE: Total LA current claim on the Reserve, including housing benefit and contribution to housing revenue account, is over £1½ billion; this excludes policing costs of strike.]

2. LA capital (uncertain, but significant overspending likely)
3. Impact of economic developments on demand-led programmes (Winter Supplementaries being taken as necessary.)

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Partially offset by underspend on some Votes and extra receipts that reduce public expenditure. NB Potential claims and offsets are very uncertain at this stage of the year. Margin of error about ± £1 billion.

(vi) **Access to Reserve for excess public service pay**?

Public expenditure plans for 1984-85 include allowance of 3 per cent for pay of central government etc employees. Recourse to Reserve has been used this year to finance part of NHS awards (announcements 31 July, 17 October). Otherwise presumption that costs of settlements in excess of 3 per cent will be absorbed in existing programmes.

(vii) **Cash limit breaches and planning total outturn 1983-84**

The provisional planning total outturn for 1983-84 is £120.3 billion, the same as estimated in the 1984 PEWP but against plan of £119.6 billion in 1983 PEWP. There were very few cash limit breaches last year (see Cash Limits 1983-84 Provisional Outturn, Cmnd 9823).

(viii) **How does state of Reserve compare with earlier years?**

Not possible to make comparisons because new style Reserve includes demand led expenditure which was not charged to the Reserve in earlier years.

(ix) **End year flexibility scheme costly**?

Scheme has meant claim on Reserve of £¾ billion (in roll forward of last year's capital underspend), but has helped planning of capital expenditure.

(x) **Higher asset sales**?

1984-85 asset sales forecast is £1900 m. We are well on course to achieve this. NB. Not all privatisation receipts (eg Jaguar, Sealink) score as special sales of assets. (See brief J22).

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E2 PUBLIC EXPENDITURE 1985-86
[NB Detailed questions on programmes should be addressed to Departments concerned.]

Factual

(i) Plans for 1985-86 have been held to £132.1 billion, the same as in last Public Expenditure White Paper (Cmnd 9143)

(ii) The Reserve for 1985-86 is £3 billion. This is the same as for the equivalent year (1984-85) in last year's Autumn Statement.

(iii) Major increases in plans compared with the White Paper are:

Local authority current	[£980m]
Social security	[£510m]
Export Credits Guarantee Department	[£300m]
Intervention Board for Agricultural Produce	[£130m]

(iv) Major decreases are:

Housing	[ ]
Employment	[-£120m]
Transport	[-£100m]
Civil Superannuation	[-£60m]

(v) Sums add up because of:

Changes to Reserve	[-£150m]
and Asset sales	[-£500m]

(vi) As percentage GDP, plans for 1985-86 represent a fall in the ratio of public expenditure to GDP from [42½ per cent] in 1984-85 to [41 per cent] in 1985-86.

(vii) Allowing for inflation, planning total broadly constant if strike-related blip in 1984-85 ignored, as it should be:

£ billion 1983-84 cost terms

1983-84 est. outturn	1984-85 plan	1984-85 (est out-turn)	1983-86 plan
120.3	120.5	(122.1)*	120.7

* not quoted explicity but derivable from cash figures given in Part 1 of AS document

Figures for earlier years are given in table 2.2.

(viii) Plans announced are now firm. Precise figures may change slightly between White Paper as result of more detailed calcualtions (eg territorial consequences) and raised forecasts (eg social security, IBAP). Reserve will also be reviewed before the White Paper is finalised.

(ix) White Paper will be published in the early part of 1984 - probably by end January. Will contain figures for 1986-87 and 1987-88.

Positive

(i) Outcome of the annual review of expenditure plans has been to hold planning total at the level announced in previous plans. Repeats Government's similar achievement in 1982 and 1983.

(ii) The fall of [ ] percentage point in the GDP ratio continues Government's progress in reducing public expenditure as ratio to GDP. Now [ ] points below level of 1982-83. (See Brief E1 for historical figures)

(iii) Expenditure constant after allowing for inflation (real cost terms). So benefits of economic growth available to private sector.

(iv) Success in keeping expenditure down will help Chancellor when he considers scope for tax reductions in next Budget.

Defensive

(i) **Is Reserve adequate, bearing in mind 1984-85 over-run**? Yes. Have increased LA current provision by [£950 million] for realism. Have taken steps to improve forecasting of demand led expenditure - plans include large increases on IBAP. ECGD and Social Security for that reason. And have kept substantial Reserve for unforeseen expenditure.

(ii) **Why has NIS claw-back been conveniently forgotten**?

[FSBR said expenditure programmes (excluding local authorities) would be reduced to take account of NIS abolition (paragraph 4.24). And Table 5.5 of FSBR accordingly showed planning totals lower than the White Paper (1985-86 £131.6 billion FSBR, £132.1 billion PEWP)]

Treasury made sure NIS reductions were fully taken into account when plans were revised. But Budget also contained tax changes on corporation tax and VAT which increased public expenditure. On the balance satisfied to have kept to PEWP plans.

(ii) **What have you assumed about the miners strike**?

Provision for NCB has not been reviewed and is same as the White Paper. To be considered after strike is over.

(iii) **Have you assumed any exceptional energy price increases**?

Nationalised industry prices for decision by industries. But overall are expected to be broadly in line with movements in RPI.

(iv) **Special Sales of Assets increased to pay for higher expenditure**

Have not changed plans to raise extra cash but have updated forecast of existing plans. Increase results from a number of changes. Not our practice to disclose details of its composition because price information commercially sensitive. But clearly British Telecom a significant component.

(v) **Government cutting education/transport/employment?**

Decision to contain expenditure has inevitably meant reductions in some programmes to compensate for increases in others. Overall public expenditure held stable.

(vi) **What are the economic assumptions**?

Used realistic assumptions. Working assumption on unemployment given to GAD in Part 3 of AS (3.0 m GB excluding school leavers etc - see Brief D) GDP deflator in Part 1 4½ per cent 1985-86]. Interest rate assumptions market sensitive.

(vii) **Figures for later years**

Final details to be settled, will publish results in PEWP early next year. Results likely to be broadly in line with last PEWP for 1986-87 with expenditure broadly flat in real terms through to 1987-88.

(viii) **Why no increase in public expenditure**?

Need to create room for tax cuts, to reduce burden on private sector and improve incentives.

(ix) **Does Government care about social effects of cuts**?

Yes. Also cares about tax burden. Government first decides what can be afforded. Then how that total should be divided between programmes. Effects considered as each decision taken.

(x) **Capital/current split**? [See also Brief E4]

Too early to give figures. No figures for nationalised industries' investment yet available. The need to consider capital expenditure was in Ministers' minds throughout the public expenditure discussions. NB cuts in Housing much less than appears. About £300 million of the apparent reduction is additional receipts from the sale of council houses, which are negative public expenditure, but leave gross spending unaffected.

(xi) **Administrative costs**

Special attention given to ensure departmental running costs under control. Results in increases of around 3.5 per cent. Details will appear when Estimates presented (and possibly in public expenditure White Paper).

(xii) **Effects on industry**

Main effect will be through staying within expenditure plans. Public sector will not be adding to burdens on private sector either through higher taxes or higher interest rates.

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(xiii) **Effects of spending cuts on employment**?

Not sensible to estimate such figures as if in a vaccum. Holding public spending total to previously planned level brings benefits in interest rates and opens way for lower taxes. This helps creation of real jobs and Industry Act forecast consistent with continued growth of employment in 1985.

(xiv) **Effect on inflation**

Industry Act Forecast takes account of expected public sector price rises and shows further gradual decline in inflation - to 4½ per cent by end 1985. Impact of spending decisions themselves on RPI small. Broadly speaking, EFLs do not imply nationalised industry price rises out of line with movements in RPI.

(xv) **Local authority current expenditure**

Government obliged to recognise excessive levels of past and present spending in formulating realistic plans for future. But cannot condone overspending. Plans for relevant current expenditure in 1985-86 make provision which is realistic in relation to levels of overspending in 1984-85.

(xvi) **Local authority capital**

Following overspending of 1983-84 cash limit by £ m planned expenditure for 1985-86 has been similarly reduced. Total for year depends on decisions Ministers still have to take about allocation of their programmes.

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E3 PAY ASSUMPTION

Factual

(i) Public expenditure programme figures for 1985-86 reflect an assumption that Central Government rates of pay and allowances will increase on average by 3 per cent from settlement dates. Assumption applies to increases in pay rates and allowances deriving from any settlements affecting 1985-86 which have not yet been concluded, ie any settlements for settlement dates between now and 31 March 1986.

(ii) Coverage: public expenditure plans for those groups for which the Government is directly responsible: ie Civil Service, Armed Forces, NHS employees and certain other groups. Thus it does not apply to local authorities and nationalised industries.

(iii) Costs and numbers

		Pay Bill in 1985-86	nos in 1985-86
		£ billion	000s
Civil Service	(GB)	5 ½	600
Armed Forces	(UK)	3 ½	330
NHS*	(GB)	9	1000
Universities	(GB)	1	100
Other		1 ½	70
	Total	20 ½	2100

* NHS figures exclude Family Practitioner Service

Each 1 per cent on the pay bill for these groups costs about £200 million.

(iv) Previous assumptions and settlements for main groups (per cent approx)

	Assumption	Settlements: Civil Service (non-industrial)	Settlements: Armed Forces	Settlements: NHS
1980-81	14	16.8	16.8	31.1
1981-82 (1)	6	7.5	10.3	7
1982-83	4	5.9	6.1	6-7.5 (2)(3)
1983-84	3.5	4.86	7.2 (2)	7 (4)
1984-85	3	4.55	4.92 (2)	4.5 (Ancillaries) 4.63 (DDRB Groups)(2) 7.5 (Nurses and Midwives)

Notes
(1) First year of cash planning.
(2) First year cost only.
(3) Nurses' award was 12.3 per cent from August 1982, but covered both the 1982 and 1983 settlements.
(4) and restitution for DDRB groups from 1 January 1984 of 1981 abatement of 2.7 per cent.

Positive

(i) Pay assumption one of several working assumptions made in deciding public expenditure plans. Any prudent employer must make assumption of this kind.

(ii) It is not a pay norm nor an objective. Nor will it predetermine individual pay settlements. It relates to the allowance for pay in public expenditure plans, not particular settlements. Each settlement will be dealt with individually. Settlements higher (or lower) than 3 per cent are not ruled out (NB but see defensive (vi): the presumption is that the additional cost of settlements above 3 per cent will have to be found from within Departments' planned provisions).

Defensive

(i) Pay assumption the same as for 1984-85: Is the Government letting up on pay? No. Continue to look for falling trend over long-term in pay settlements throughout the economy. Only way to achieve lasting fall in unemployment

(ii) Does the Government expect 3 per cent settlements when average earnings likely to increase by 7 per cent or more next year? The pay assumption is not intended as a norm or objective. Negotiations on 1985 pay settlements have not yet started. But the Government is seeking realistic settlements throughout the economy. Long-term inflation trend remains downwards. Gap of this order between average earnings increase in economy as a whole and pay assumptions is nothing new. Nevertheless public expenditure totals have held.

(iii) The Government is attempting to hold down public sector pay? Pay Negotiators must take account of affordability and the assumption indicates what the Government thinks can be afforded for pay compared with other expenditure within overall provisions.

(iv) 3 per cent will mean a squeeze on programme expenditure? That depends on the outcome of the 1985 pay negotiations. If settlements were greater than 3 per cent, the impact on programmes will depend on the extent to which Departments etc can offset the excess by efficiency or other savings.

(v) How will additional costs of previous staged settlements be met? They are being absorbed within the public expenditure totals announced today.

(vi) A pay assumption precludes genuine negotiations? (See previous points) Genuine negotiations cannot take place without regard to cost: no employer can afford to do that. Worth recalling that eg Civil Service settlements have in each year since 1980-81 been higher than the pay assumption.

(vii) Access to Reserve for any excess? Presumption against recourse to the Reserve and that settlements will be met from within cash plans. Cannot be ruled out absolutely; but will depend on circumstances of the time. Pay no different from other prices in this respect. (Note: Civil Service pay settlements have been consistently higher than the pay assumption in recent years by around 2 percentage points, but have generally been absorbed within cash limits; exceptions have been made for Health Service.)

(viii) Review Body groups an exception? Same considerations apply. If, say, NHS pay awards exceed allowance in plans, efficiency or other savings must be found if health service is not to suffer. (If pressed on access to Reserve for Health pay awards: in the circumstances of 1984-85, it was recognised that Health Review

Bodies' awards could not be met in full from programme. But NHS expected to meet costs of all pay increases in 1985-86 from within resources now available.

(ix) Public service unions launching campaign against continued use of pay assumptions No evidence that use of assumption in past has determined outcome of settlements; nor that the settlements in the public services have been unreasonable in the light of recruitment/retention experience (NB recent arbitrators' awards - Civil Service in 1982, teachers in 1984 - only slightly higher than employers' final offer.).

(x) Local authorities and nationalised industries? In these cases the need for a planning assumption does not arise because the Government has no direct responsibility for spending on pay, and the constraints on spending are different: the RSG settlement and EFLs. Moderation needed in pay settlements in these areas. No intention of adjusting RSG or EFLs in light of pay settlements.

(xi) Why change in practice (this year no formal announcement prior to the Autumn Statement)? Now routine part of public expenditure planning and no separate and formal announcement necessary.

(xii) Why no consultation with the Civil Service Unions/other unions who might be affected? Matter of internal public expenditure planning and elaborate consultation not therefore necessary. However, matter was raised at Chancellor's 2 October meeting with Civil Service Unions, before final decisions had been taken. Health Service unions also had opportunity to make views known to Ministers before final decisions taken.

(xiii) Nationalised industries pay and EFLs Achieving nationalised industries' plans depends on the industries keeping current costs including wage costs under control in the way that private sector companies have to do. Failure to do this is likely to mean either higher prices or less investment. EFLs are not automatically increased to meet increases in current costs.

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E4 CAPITAL/CURRENT AND INFRASTRUCTURE

Factual

(i) Autumn Statement only provides outline of expenditure plans for 1985-86; no details yet of capital/current split for future years. Must wait for outline decisions to be translated into detailed programme figures in 1985 PEWP.

(ii) Last year's PEWP (Table 1.13) showed aggregate capital spending by public sector broadly maintained in real terms at 1978-79 level.(£24 bn in 1984-85 or about one fifth of planning total).

(iii) Repair and maintenance expenditure is increasing in importance - DOE estimate that in 1982 R & M contracts represented additional expenditure by the public sector to the value of about 50 per cent of capital contracts, or at least £5 billion.

Positive

(i) Important thing is investment in the economy as a whole - particularly now that major enterprises such as BT have been/are being privatised. Across the whole economy, fixed investment in 1985 expected to be post-war record, as is 1984 figure. [IAF figures are £47 bn and £45 bn respectively compared with 1979 peak of £44 bn at 1980 prices.] NB

(ii) No "target" or "right" level of public capital expenditure. Each proposal must be considered on its merits in context of priorities for public expenditure as a whole. In some areas proper to cut back public sector investment to make room for private sector (eg, privatised corporations). In other areas Government recognises importance of public sector provision of infrastructure; and its decisions take proper account of relevant economic and social benefits.

(iii) Government policies aimed at reducing PSBR and inflation, to provide framework for sustained growth. Jeopardising this objective (by higher expenditure; or wasting resources with non-cost effective expenditure) would be more damaging in long run.

(iv) Private sector investment helped by lower interest rates (cuts in base rates earlier this month) and discipline on spending essential for this.

Defensive

(i) Cuts in 1985-86 capital expenditure on housing?

£300 million of the housing cut is in fact extra receipts. The Government's policy is to transfer, where possible, new provision for housing to private sector. This policy is now beginning to bear fruit: the number of private sector housing starts in 1983 was the highest since 1974. In their latest (October) State of Trade Enquiry, the House-Builders Federation say that starts in 1984, although lower than in 1983 will remain at a high level compared with recent years. (They also say 44 per cent of respondents expect to employ more site labour in the coming year while 22 per cent expect to employ less.) (See Brief J12 for more details).

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(ii) Outlook for construction industry?

Construction industry output for first half 1984 encouraging - up 5¼ per cent on same period of 1983; private industrial activity strong. Industry will benefit from marked rise in investment now taking place. Health of construction industry tied to condition of economy, particularly interest rates.

(iii) Cut in local authority capital spending in 1984-85?

No moratorium or cut in plan. LAs been asked to restrain spending and maximise receipts, to get closer to plans. (See Brief F1 for more details)

(iv) Cuts in LA Capital expenditure in 1985-86

After allowing for shift of LRT to public corporations sector, and offset to overspending in 1983-84, plans for 1985-86 are broadly in line in cash terms with plans for 1984-85.

(v) Capital cuts in transport programme?

Despite necessary constraint on programme as whole motorway and trunk road capital spending has been preserved and will show increase over 1984-85. Since 1979 over £350 million spent on M25 alone - substantial programme of road building. (See Brief J11 for more details).

(vi) What are new capital figures?

Too early to know. Detailed programme figures have to be processed before tables can be produced for next PEWP in early 1985.

(vii) State of Infrastructure

Much alarmist talk. Consider cost-effectiveness of expenditure. Need may be for current not capital (eg, repair and maintenance) or better management (eg, more intensive use of education facilities). Decline in public sector capital stock in certain sectors not unexpected as society's needs change.

(viii) Role as pump primer/seedcorn

No objection to capital expenditure where it is cost effective. Accept that it can have role in bringing down industrial costs. But way forward is to reduce unit labour costs and remove obstacles to free functioning of markets. Non-cost effective expenditure would waste resources, harm employment and growth in longer-run.

(ix) Encourage private sector capital projects (eg, with guarantees)

No genuinely viable project should need guarantees. They would only serve to undermine market disciplines. Such schemes often tantamount to higher public expenditure; with same potentially damaging impact on wider objectives, and private sector.

(x) Capital/infrastructure spending generates employment?

Main trust of policies must be to keep inflation down and secure downward trend in interest rates. Initial impact on employment of increased public investment likely to be shortlived because of resulting increase in interest rates/inflation.

(xi) Increase employment by spending more on infrastructure within total expenditure

If objective is to maximise the short-term employment impact of public expenditure, not clear that switch towrds infrastructure would be sensible. Employment and training measures have a bigger and more direct impact per £ of expenditure. Spending on these measures has been steadily growing as a proportion of total public expenditure. [But, here again, there is a limit to what can be spent without imposing costs on the private sector and damaging long-term employment prospects.]

Contact Point: P W McDonald (GEP2) 233-4607

E5 VALUE FOR MONEY

Factual

(i) Government took office with specific aim of improving efficiency in public services.

(ii) Action to get better value for money summarised in successive White Papers eg from 1981 ("Efficiency in the Civil Service", Cmnd 8293) to 1984 ("Progress in Financial Management in Government Departments", Cmnd 9297).

(iii) Government pursuing better value for money in various ways throughout public services - in central government, quangos, local authorities, and NHS.

Positive Points

(i) Government's plans are not only to control public spending but to secure good value for the taxpayer's money by deciding precisely what needs to be done and then doing it efficiently.

(ii) In the Civil Service major drive to make the whole management of government policies more professional and business-like. Progress evident from reduction of over 100,000 in size of Civil Service since 1979.

(iii) Over 700 quangos have been abolished, rationalised or cut substantially saving nearly £120 million a year.

(iv) In the NHS the implementation of the Griffiths Report is helping to define objectives, pinpoint responsibility for achieving them and monitor progress.

(v) The work of the Audit Commission is helping local authorities get better value from their resources.

(vi) Privatisation and competitive tendering are opening up more of public sector activity to the market pressures which act as a spur to better value for money.

Defensive Points

(i) Investment in better financial management is producing more than just systems and jargon: it is money well spent to save on administrative costs and deliver government policies more efficiently.

(ii) There is still lots of room for improving efficiency but that is why the Government intends to stick to the task it has set.

(iii) The conflict between pressures for public services and shortage of cash to pay for them makes it vital to get better value for money. But so too does the fact that the taxpayer and ratepayer always deserves good value for his pound, irrespective of the policy or programme.

Contact point: R Willis (FM) 233 5278

F LOCAL AUTHORITY SPENDING AND GRANTS

1. CURRENT EXPENDITURE

1984-84 overspend

1.1 Factual

1984-85 local authorities in Great Britain budgeting to overspend White Paper provision by around £1.2 bn. Indicates need, on realism grounds, for increased provision for 1985-86 (provisional targets and guidelines already announced) of £960m over adjusted baselines (to take account of NIS abolition, transfer of LRT to central government, transfer of financial responsibility for some non-advanced further education to central government).

Targets and Grant for 1985-86

Provisional 1985-86 settlements announced in July and August. Provisional targets allow maximum 4¼ per cent increase over 1984-85 effective budgets, require maximum 1½ per cent cut. 18 authorities in England to be rate capped.

AEG in England around £11.7 bn, £1915 million in Scotland, £1013 million in Wales.

Much more severe penalties already announced for overspending targets in England and Wales in 1985-86.

Rate Support Grant Reports will be presented to Parliament in December.

1.2 Positive

(i) 18 authorities - highest spenders - to be rate capped in 1985-6. Will be of direct benefit to their ratepayers.

(i) Has allowed setting of realistic and achievable targets for authorities spending below GRE ("low spenders").

1.3 Defensive

(i) Addition to provision shows White Paper plans were meaningless?

No. Had to be revised up because of overspending in 1984-5.

(ii) Cut in grant percentage will force rates up?

Lower expenditure is the real key to low rate increases. Taxpayer cannot be expected to pick up bill for excessive local authority spending. If authorities spend in line with targets, rate increases should be lower next year than this. Harsher penalties needed to bring home to authorities the need to stick to Government's plans.

(iv) Baker review shows that policies are a failure?

Far from it. Rate capping will curb excesses of highest spenders in 1985-6. But all would agree that system should be kept under review.

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(v) No savings from abolition?

Savings will materialise from removal of layer of unnecessary and unproductive bureaucracy. Government will take powers to ensure that major services are run efficiently and effectively. Further savings depend on decisions of lower tier authorities.

2. CAPITAL EXPENDITURE

2.1 Factual

(i) The following table shows the net aggregate national provision for LA capital, resulting from Survey decisions on programmes:

£bn	1984-85 (provision)	1985-86
England	2.7	[ ]
Wales	.2	[ ]
Scotland	.7	[ ]
GB	3.7	[ ]

(ii) 1985-86 provision is a reduction on plan for 1984-85 of about £[ ] million. This is largely accounted for by the transfer of LRT from the LA sector to public corporation sector (£200m), and by reductions to take account of the 1983-84 overspends of about £400 million. But another substantial overspend is expected in 1984-85, so the reduction from expected 1984-85 outturn to 1985-86 provision will be greater.

(iii) LAs have been under voluntary restraint since July to minimise overspending in 1984-85, and maximising receipts. LA capital control system under urgent review because of overspending problems. [Changes in the system for 1985-86 to be announced shortly, to keep spending within cash limits in future.]

2.2 Positive

(i) Net provision broadly maintained: allowing for LRT transfer, reductions of 1985-86 over 1984-85 provision only compensate, under normal cash limit rules for earlier overspending.

(ii) Gross spending will be much greater than net provision: £[ ] million in 1985-86. Could be more if LAs increase their receipts above expected levels.

2.3 Defensive

(i) Why make cuts to compensate for overspend, when in ealier years there was large underspends which LAs were not allowed to carry forward?

The normal cash limit discipline requires later year reductions to maintain overall public expenditure plans. And we have now agreed to a [2] per cent carry-forward facility be carried forward on the national cash limit, to allow underspent resources to be carried forward.

(ii) Effect on construction industry?

With the 1983-84 overspend, and the possible excess in 1984-85 Industry has had more than our plans provided for. Reductions in 1985-86 do little more than restore plans.

(iii) Further cuts to take account of 1984-85 overspending?

Authorities are in general heeding the call for voluntary restraint, and generating extra receipts. We do not know what the outturn for 1984-85 will be - wide range of forecast from £75 million underspend to £750 million overspend. Consider action when know position more clearly.

Contact point: Current Expenditure and Rate Support Grant
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Capital Expenditure
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G TAX READY RECKONER

Factual:

(i) Part 4 of Autumn Statement contains a 'ready reckoner' for changes in income-tax, corporation tax and indirect taxes at 1985-86 price and income levels. It is very similar in format to the ready-reckoners given in the 1984 Autumn Statement.

(ii) It also gives the 1985-86 levels of allowances, thresholds and bands following indexation by an illustrative 4¾ per cent, the revenue 'cost' of this indexation and the revenue gains from revalorisation of excise duties by 4¾ per cent.

Limitations and Pitfalls

(i) Changes to income tax are over and above the indexed levels of allowances etc; those for excise duties are from the current (unrevalorised) level of duties.

(ii) The income tax changes are costed in isolation, and this should be recognised in estimating the costs or yields of interacting changes and packages. For example, revenue effect of a change in an income tax rate depends on the level of allowances, thresholds etc assumed.

(iii) Revenue effects of income tax changes are generally linear over a range and can be pro-rated.

(iv) Within limits, revenue effects of changes to indirect taxes can also be scaled up or down. Large increases, though, may result in the last unit of duty raising less than previous ones.

Positive

(i) This ready-reckoner gives estimates for the direct effect on revenue in the next financial year, (prior to Autumn Statements estimates were given for current year only).

(ii) Helpful to those making budget representations, or who wish to cost tax packages.

Defensive

(i) Why no PSBR costs given? The total effect of a tax change on the PSBR will depend on how the economy responds - which is highly uncertain and on what is assumed about monetary policy. Direct revenue effects do not require such assumptions. [If pressed: PSBR costs in 1985-86 would generally be close to first year costs (usually a bit lower).]

(ii) Why are some increases in allowances etc more than 4¾ per cent? Because the rules for rounding up in 1980 and 1982 Finance Acts (which have been applied here) mean that some increases are rounded up by quite large amounts.

(iii) Why are first-year revenues less than full-year revenue for some taxes? This happens when duties are deferred (beer, tobacco). It also applies to VAT which is collected in arrears. There are also lags in collecting income taxes, especially higher rate tax.

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* Last published ready-reckoner was in Treasury Supplement to Economic Progress Report, July 1984

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(iv) Indexation percentage likely to be wrong (as last year)? 4¾ per cent is consistent with the annual rise in the RPI towards the end of the year. The actual RPI increase relevant to the income tax allowance indexation provisions of the 1980 and 1982 Finance Acts will be that in the year to December.

(v) Why has the effect of a 1 per cent change in the Corporation Tax rate increased so much? Pre-tax profits are now forecast to be higher. The 1984 Finance Act has also widened the tax-base by restructuring capital allowances and abolishing stock relief.

(vi) Corporation Tax rates already announced right through to 1986: why include CT in the ready-reckoner at all? Government has no plans to alter CT rates set out in 1984 Budget. But ready-reckoner is intended as an aid to public debate. Others may regard changes in CT rate as option worth discussion.

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H AUTUMN STATEMENT CONTENTS

Factual

(i) The Statement brings together the announcements generally made in the Autumn. It includes:

(a) an economic forecast, which provides the information required by the 1975 Industry Act and sets out the fiscal position with expenditure, revenue and borrowing figures for 1984-85 and 1985-86;

(b) the agreed public expenditure plans for 1985-86;

(c) the proposed changes in National Insurance contributions from April 1985.

The printed document also has a section giving ready reckoners of the direct revenue effects of illustrative changes in the major taxes.

(ii) The 1985 Statement differs in only one significant way from its predecessor. It quantifies (paragraph 1.58) the expected public expenditure outturn in the current year (see Brief E1).

(iii) The Treasury and Civil Service Committee (TCSC) were critical of a number of points arising from last year's Autumn Statement. They argued that the PSBR figures should be struck without reckoning receipts from asset sales, so as to produce figures which are "undistorted by random fluctuations" in receipts from sales. They also argued that the Government should update the MTFS in the Autumn Statement and that the impact on the Reserve of estimating and discretionary changes should be separately itemised to provide more information to Parliament. In their Reply the Government made it clear that they did not accept the Committee's recommendations on this point.

(iv) The recently published report "Structure and Form of Government Expenditure Reports", submitted to the TCSC by Messrs Likierman and Vass, recommended, inter alia, that the Autumn Statement should include public expenditure figures for three forward years, not one as hitherto. This point was pursued by the TCSC in examining Treasury officials on 22 October.

(v) There will be no mention of Civil Service manpower in The Autumn Statement nor a parallel announcement of Civil Service manpower numbers with the Statement. Departmental manpower targets for the three years to 1988 have still to be finally selected with some departments (eg MOD) in the light of the 1984 Survey, and will be announced later. The expenditure plans for 1985-86, detailed in this year's Autumn Statement, reflect the latest estimate of departmental manpower levels in that year. They also take account of the 3 per cent pay assumption. The difference between the estimated departmental manpower requirement in 1985-86 and the targets to be announced later are not likely to be significant in expenditure terms.

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Positive

(i) This is the third successive Autumn Statement. It covers the same material as before, but with minor improvements.

(ii) Published even more quickly than usual, after Cabinet had settled public expenditure plans.

(iii) AS provides figures for public finances both this year and next, and a detailed ready reckoner of the effects of tax changes. Sets out background in indicating kind of choices Chancellor may face in preparing the 1985 Budget. Position may, of course, change before the Spring.

Defensive

(i) Why no expenditure figures for later years? Government has published AS as soon as possible, so as to provide Parliament and public with information about next year without delay. Figures for later years will be published as usual in Public Expenditure White Paper.

(ii) Why no revisions to the MTFS? MTFS is updated annually each Budget. As its name implies, it provides a framework for economic policy over a period of years ahead. Not consistent with this to revise it every few months.

(iii) Should have more information about changes impacting on the Reserve? Reserve is part of the mechanism for controlling public spending. The public expenditure planning total is the control total and unavoidable fluctuations in programmes during the year have to be absorbed by the Reserve (in the first instance). The Reserve must therefore be managed as a whole. Separately published figures for discretionary and estimating changes on demand-led programmes would weaken its control value, eg by inhibiting search for discretionary savings to offset non-discretionary increases.

(iv) PSBR figures should exclude asset sales receipts? Present treatment in line with accounting systems recommended by international organisations for economic and government accounting. In nearly all cases, acquisition of assets now being sold increased government spending and borrowing: entirely logical that receipts should reduce spending and borrowing now they are being sold. Composition of PSBR taken into account when assessing PSBR to be provided for in Budget.

(v) Why no Civil Service manpower details with this year's Statement?

The position was very different last year; when, in parallel with the Autumn Statement, the Government announced its plans for Civil service manpower up to 1988 in a Parliamentary Question. The 1984 Survey simply reviewed those plans: to ensure departmental targets were being adhered to or improved on wherever possible.

Contact point: K F Murphy (CU) 233 8652

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J1 DEFENCE (Detailed questions to MOD)

Factual

(i) The provision for defence in 1985-86 is £18,060 million, which is the same figure as in the 1984 Public Expenditure White Paper (Cmnd 9143).

(ii) The provision for 1985-86 meets the Government's commitment to plan to implement up to that year the NATO aim of real increases in defence spending in the region of 3 per cent per annum with an addition for Falklands costs. Falklands provision in 1985-86 is £552 million, compared with £684 million in 1984-85.

(iii) The provision for later years will be announced in the 1985 PEWP.

(iv) Under the end-year flexibility arrangements announced in 1983, £251 million of defence expenditure has been carried forward from 1983-84 to 1984-85. The increase in the defence cash limit for 1984-85, which is met from the Reserve, was announced on 31 July (Hansard, written answers columns 189-192) and a Winter Supplementary will be presented shortly. (Note: this switch of provision between years will distort the pattern of real growth in 1983-84, 1984-85 and 1985-86.)

Positive

(i) Despite continuing pressures on public expenditure, the Government has maintained the commitment to meet in 1985-86 the NATO aim of real annual increases in the region of 3 per cent.

(ii) Defence expenditure has increased in real terms every year since 1978-79. The 1985-86 provision is the seventh successive year of real growth. This achievement is unique in post-war period.

(iii) In 1985-86 defence expenditure will be more than £10,000 million higher in cash terms than in 1978-79 (£7,497 million).

(iv) In absolute terms, the level of UK defence expenditure is highest in Western Europe. As a proportion of GDP and per capita, UK defence budget is second only to US amongst major NATO allies.

Defensive

(i) NATO aim of 3 per cent real growth per annum? Meeting this in 1985-86.

(ii) What about later years? Figures for defence expenditure in later years will be published in the 1985 PEWP. [If pressed: 1984 PEWP (Cmnd 9143) indicated that commitment to NATO aim of annual 3 per cent growth not extended beyond 1985-86. Should be recalled tht UK growth of defence spending since 1978-79 second only to US, and far superior to that of major European allies. Real growth since 1978-79 has greatly increased the level of UK defence spending; within this defence capabilities can be maintained and improved by increased efficiency. It is defence capability and output which counts, not cash inputs.

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(iii) "Increased" Trident costs must mean reduction in conventional capabilities? Not necessarily:

(a) Expenditure on Trident project spread over some 20 years. Over that period, it will represent only 3 per cent of the defence budget; forward planning designed to accommodate this.

(b) Premature to assume adverse exchange rate affects. Dollar expenditure spread over some 20 years; peaks in the late 1980s and early 1990s. It is the dollar/sterling rate at the time of the expenditure which is the relevant point, not today's rate. Rate can change in favour of sterling as well as against.

(iv) Why no cuts in defence, given pressure on public expenditure? Resources allocated to defence reflect priority UK attaches to maintaining national security through contribution to Western defence.

(v) Why not faster decline in Falklands expenditure? This will occur after 1985-86, as capital works completed and spending on equipment replacement tails off.

(vi) Why is provision for 1985-86 unchanged when there is now a 3 per cent pay assumption? Provision has been reduced to reflect the pay assumption. But there have been other adjustments to the figures, including an addition to reflect the latest inflation forecast for non-pay provision (4½ per cent GDP deflator rather than original 4 per cent cash factor).

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J2 FOREIGN AND COMMONWEALTH OFFICE (INCLUDING OVERSEAS DEVELOPMENT ADMINISTRATION)

Factual

(i) The agreed provision for the FCO Aid and other programmes for 1985-86 is £1867 million. (Rounded to £1870 m in the Autumn Statement document.)

(ii) This differs from the 1984 Public Expenditure White Paper as follows:-

		Change £m
(a)	Additional provision*	+6.2
(b)	Surrender of receipts from sale of surplus property in Kuala Lumpur	-4.4

(iii) The Foreign Secretary will not be making decisions on the allocation of resources between his programmes until the weekend (10/11 November) so any detailed questions arising in the Debate will have to be referred to him.

Positive

(i) Allocation for 1985-86 maintains the plans announced in the 1984 White Paper.

Defensive

(i) The precise allocation of resources between the programmes has not yet been decided. The Foreign Secretary will answer on specific points.

(ii) IF PRESSED on the Government's commitment to the UN target of 0.7 per cent ratio of official development aid to GNP: The Government accepts this target but is not committed to a timetable for achieving it.

Contact point: C J E Legg (AEF1) 233-4956

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*This stems from agreement to carry over underspent [aid] money from 1983-84, but FCO has yet to decide whether aid programme should benefit from this.

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J3: EC CONTRIBUTION

Factual

Net payments to Community institutions are projected as follows:

	£m 1985-86
Autumn Statement	750
Cmnd 9143	550
increase	200

It is assumed that the Fontainebleau agreement is implemented. In particular:

- the UK receives an abatement for 1984 of 1000 mecu payable in 1985;
- thereafter, the UK receives an abatement equal to 66 per cent of our VAT/expenditure gap in the previous year;
- the VAT ceiling is increased to 1.4 per cent on 1 January 1986;
- budget discipline applies.

Positive

(i) As a very rough order of magnitude, our net payments to the Community in future years are likely to be around half of what they would have been had there been no agreement at Fontainebleau, no abatements and the continuation of the 1 per cent VAT ceiling.

(ii) The reason why the UK will be better off as a result of Fontainebleau is that, after abatement, our VAT rate is likely to remain below 1 per cent, although the VAT rate of other member states is likely to be in excess of 1 per cent.

(iii) The Fontainebleau agreement represents a successful culmination of the Government's long and persistent effort to correct the budget inequity and to put the UK's refunds on a lasting basis. In respect of 1985 and later years, UK abatements will be paid automatically on the revenue side. This should avoid the haggles with other member states and the European Parliament that have occurred in recent years. This represents a far more satisfactory arrangement than anything the Opposition were able to achieve. The system they negotiated at the 1975 Dublic Summit did not produce one ecu of refunds.

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(iv) The Fontainebleau Council agreed important guidelines on budgetary discipline and these have been taken into account in the projection. Agricultural expenditure is assumed to grow from 1985 onwards at less than the growth rate of the own resources base. Other types of expenditure are assumed to grow no faster than the "maximum rate".

Defensive

(i) The figures in the Autumn Statement cannot be directly compared with those in the White Paper. The White Paper figures were constructed using a stylised assumption about budget refunds. It was assumed that refunds would equal two-thirds of our net contribution to the allocated budget, and that the bulk of future refunds would be received in the first quarter of the year following that to which they relate. It was clearly stated that this assumption was not a forecast nor a negotiating objective. For the AS, a completely new projection was made of all elements of our gross payments and receipts. The assumption about VAT abatements took account of the Fontainebleau settlement. From 1985 onwards, the UK abatement is set at 66 per cent of our VAT/expenditure gap in the previous year.

(ii) Our refunds over the period 1980 to 1983, expressed as a proportion of our net contribution, were on a declining trend. They were also becoming increasingly difficult to negotiate. Had there been no agreement at Fontainebleau, we would have had difficulty obtaining payment of our 1983 refunds. We would have had little or no propect of getting a refund for 1984. And refunds for subsequent years would have been impossible to obtain.

(iii)) The European Parliament has suggested that refunds should be paid on the expenditure side, and that new system should only last four years. The Government is confident these suggestions will be rejected.

Contact point: T Lennon (EC1) 233 4731

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J4: AGRICULTURE AND IBAP (Detailed questions to MAFF)

Factual

(i) The **"Agriculture"** totals include agriculture, fisheries and food expenditure in UK. A territorial allocation will be given in the PEWP. The 1985-86 provision is £935 m (rounded to £930 m in the Autumn Statement document) compared with £1021 million in Cmnd 9143. The decrease of £86 million amounts to about 8 per cent of which some £58m relates to pre-funded CAP schemes. Details of adjustments within the total will be announced by Minister of Agriculture in an arranged written PQ on day of Autumn Statement.

(ii) The **"IBAP"** programme represents expenditure by the Intervention Board for Agricultural Produce on agricultural support under the CAP. The 1985-86 provision is increased by £190 million (17 per cent) to £1310 million. This is largely due to a forecast increase in intervention buying of cereals following the record 1984 harvest. These costs fall initially on the Exchequer but are recouped from the market and by Community reimbursement for losses when intervention stocks are sold.

Defensive

(i) The overall net decrease in "Agriculture" includes revised estimates of 100 per cent EC funded expenditure (annual ewe premium) and policy adjustments to capital grants schemes. Provision is also made for the enhancement to the suckler cow premium and the milk outgoers scheme which were announced earlier this year.

(ii) Increase for IBAP reflects latest estimates of costs of implementing CAP. Forecasts are highly uncertain and dependent on weather, harvests, market conditions, etc.

(iii) 1984-85 Winter Supplementaries required on several Agriculture Votes to cover inter alia an increase in the beef suckler cow subsidy (announced in April), payments under the new milk outgoers scheme (announced in May), estimating increases in capital grants and for an increase in IBAP's administration costs offset by savings within MAFF's programme.

Contact point: R J Bonney (IAE1) 233-4536

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J5: DEPARTMENT OF TRADE AND INDUSTRY (other) (Detailed questions to the DTI)

Factual

(i) The agreed provision for the Department of Trade and Industry in 1985-86 (excluding nationalised industries' external finance) is £1359 million.

(ii) The figure represents an increase of less than 1 per cent on spending in the current year.

(iii) Provision for 1985-86 onwards for regional policy expenditure for the three operating departments (DTI, Scottish and Welsh Offices) takes into account the forthcoming changes to the regional development grant scheme and to the assisted areas map which are expected to be announced at the end of November by the Secretary of State for Trade and Industry.

(iv) The figure is the agreed total for the current year, but DTI are still allocating it between their many sub-programmes.

Positive

(i) Within the new total there are sizeable increases to finance launch aid already agreed and for shipbuilding.

(ii) Key changes related to regional assistance (already trailed in the White Paper on Regional Industrial Development - Cmnd 9111 - published December 1983) are:

- changes to make grant scheme more cost-effective
- more emphasis on job creation
- more emphasis on selectivity
- more support for the service sector
- updating of assisted areas map.

Defensive

(i) Details of regional policy changes to be announced soon by Secretary of State for Trade and Industry.

(ii) Details of expenditure effects of policy changes will be set out in Public Expenditure White Paper.

Contact points: E A Yeo (IAE 2) 233 4051

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J6: DEPARTMENT OF ENERGY

Factual

(i) The 1985-86 provision for energy is £683 m. This is £128 million more than provision in 1984-85 and £122 million more than the Cmnd 9143 provision of £571 m.

(ii) These changes are due to higher expenditure on the Redundant Mineworkers Payments Scheme (RMPS) resulting from improved terms and more redundancies, offset by reductions in other areas.

(iii) The offsetting reductions are mainly in respect of nuclear research and development. The balance reflects reduced requirements.

Postive

(i) The higher expenditure on RMPS will enable the NCB to make more rapid progress towards eliminating uneconomic colliery capacity. In the long run the financial benefits to the NCB will exceed the cost of redundancies.

Defensive

(i) The findings of a review of the UKAEA was summarised in a Press Release by DEnergy on 3 October. Decisions on the review recommendations will be announced in due course with their implication for the financing of the nuclear R & D programmes shown in the 1984 PEWP.

(ii) The various reductions in expenditure will not prevent Department of Energy pursuing any priority projects. The reduction will be achieved by adjustments in a number of areas, including the rephasing of expenditure. Detailed allocations have yet to be decided.

Contact point: Dr Bird (PE1) 233-8719

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J7: EXPORT CREDITS GUARANTEE DEPARTMENT (Detailed questions to ECGD)

Factual

(i) The agreed provision for ECGD in 1985-86 is £323 million [(rounded to £320 m in the printed statement)] which is an increase of £293 million on the provision in the 1984 Public Expenditure White Paper.

(ii) This increase mainly reflects higher estimates of interest support costs for fixed rate export credit.

(iii) There has also been a substantial increase, for the same reason, in ECGD's 1984-85 provision in the Winter Supplementary Estimates, with a revised provision for the public expenditure programmes of £439 million, an increase of £199 million on the Main Estimate. This Vote (Class IV, 10) is not cash-limited.

Positive Points

(i) The increased cost of interest support reflects the effect of higher interest rate assumptions on existing business. The cost of interest support for new business should be reduced by the OECD agreement to link the fixed rate charged to borrowers more closely to market rates.

Defensive Point

(i) ECGD's provision does not cover its trading activities. Although the cost of claims has exceeded income from premium and recoveries over the last three years, it is believed that the bulk of the claims payments will be recovered, and that there will be no overall loss. ECGD's trading activities are therefore not scored as public expenditure.

Contact point N H Scott-Barrett (AEF2) 233-4724

J8: EMPLOYMENT

Factual

(i) Agreed provision for the Department of Employment Group in 1985-86 is £3182 million, 2 per cent lower than in the 1984 PE White Paper figure of £3250. (The printed Autumn Statement gives a rounded 1985-86 figure of £3180 m.)

(ii) Savings resulting from revised forecasts of demand for some special measures (notably YTS) have been partly offset by expansion of the Enterprise Allowance scheme, higher redundancy payments and the transfer from local authorities to the MSC of some of the provision for work related non-advanced further education.

(iii) Higher level of redundancy payments is partly offset by a reduction (worth £37 million) in the rebate paid to employers from the Redundancy Fund from 41 to 35 per cent of their statutory payments.

(iv) The new provision represents an increase of 2 per cent over planned spending for this year.

(v) Changes will be announced in three separate Press Releases (on special measures, training loans, and Redundancy Fund rebate) issued by DEm on 12 November.

Positive

(i) The plans allow for the continuation of all special measures and the expansion of some (Enterprise Allowance, Part-Time Job Release and Job-Splitting).

(ii) Because of improved cost-effectiveness, broadly unchanged provision for occupational training will support a substantial increase in trainee numbers.

(iii) Provision is being made to expand the Technical and Vocational Education Initiative and to introduce a pilot scheme of training loans.

Defensive

(i) Savings have been possible because of revised forecasts of demand for some special measures; in part this reflects demographic factors and an improvement in employment prospects.

(ii) Higher spending on special measures would require some mix of lower spending in other areas, higher taxation or higher borrowing. Each carries a penalty which would fall on jobs.

(iii) Reduction in employers' rebate from the Redundancy Fund is very small in relation to total redundancy costs. And it will be reflected over time in lower NI contributions than would otherwise have been the case.

Contact point: M C Mercer (IAE3) 233 3690

J9 DEPARTMENT OF TRANSPORT (excluding nationalised industries)

Department of Transport will be issuing a Ministerial statement about the reclassification of Public Trust Ports from the public to the private sector. [When?]

Factual

	£m 1985-86
Cmnd 9143 figure	3,661
Autumn Statement plans	3,290

Positive Points

(i) Provision for spending by Central Government on road building and structural maintenance will show an increase over 1984-85 provision of £27.5 millions (3.4 per cent). End-year flexibility added £1.4 millions to the programme in 1984-85 in excess of the published figures.

(ii) Local authority current spending substantially increased. Taking into account the greater income from car parks this allows for increased spending on road maintenance. IF PRESSED It also allows for a more realistic figure for bus subsidies [SENSITIVE].

(iii) Savings will be achieved by

(a) transferring public trust ports to the private sector

(b) increased income from licensing and testing schemes

(c) lower local authority capital expenditure, reflecting recent trends in outturn

Defensive Points

(i) Despite necessary constraint on programme as a whole, motorway and trunk road capital expenditure has been preserved and will show an increase over provision for 1984-85.

(ii) Cuts in provision for capital expenditure on local roads and ports reflect the low priority that local authorities appear to attach to the expenditure, given that provision has been consistently underspent in past years.

(iii) £329 m has been transferred out of the programme in respect of the establishment of LRT.

Contact Point: Mrs V Imber (HE1) 233-8410.

J10 HOUSING (Detailed questions to DoE)

Factual

(See Brief EA for additional material on prospects for construction industry, including housebuilding.)

(i) The housing figures grows and net are ad follows. Note that, of the £630m reduction in 1985-86 compared with Cmnd 9143, £330 m simply reflects a higher forecast of receipts.

Cmnd 9143 £ bn	1984-85	1985-86
capital	3245	3090
current	850	820
receipts	-1595	-1300
net	2500	2610

AS £ bn	1984-85	1985-86
capital	3245	2740
current	850	870
receipts	-1595	-1630
net	2500	1980

(ii) Capital provision covers local authority new build, council house renovation and home improvement grants plus Housing corporation and New Towns housing.

(iii) Reductions in capital likely to fall partly on Housing Corporation but mainly on local authorities. For them to decide what to reduce but will probably cut new building and improvement grants.

Defensive

(i) Effect on council housing. Slows growth in the council built stock. Does not halt or reverse it.

(ii) Homelessness. Local authorities will continue to meet their obligation to house the statutorily homeless.

(iii) Condition of council stock. Provision allows for some increase in spending on renovation.

(iv) Improvement grants. Provision assumes spending will fall back to the level before the recent surge. Sufficient to meet priority needs.

(v) Construction industry. Cannot predict effect on industry or employment. Depends what other area of public expenditure would have been cut if housing had not been.

(vi) Overspending. Local authorities overspent by some £170 million on housing capital in 1983-84. Not yet clear whether or by how much will overspend in 1984-85. But clearly, the more local authorities spend in one year, the less they need to spend subsequently.

(vii) Not a swingeing cut in Housing expenditure. An extra £[330] m of receipts which offset the gross expenditure exaggerate the effect on the net total (down [ ] per cent). Gross expenditure is down 7.7 per cent from the Cmnd 9143 plans.

Positive

(i) Reductions reflect Government's determination to keep public expenditure under control. This helps private sector - not least private sector provision of housing - through lower inflation and lower interest rates.

Contact point: P J S Stredder (LG2) (233 5343)

J11 PSA (Detailed questions to PSA)

Factual

(i) The agreed provision for PSA in 1985-86 is minus £90m. This represents an increase of £10m (11 per cent) on the sum in the 1984 PEWP due to an increase for major new works, "spend to save" projects and maintenance of civil estate.

(ii) PSA do not envisage any announcement.

Positive

(i) The increased provision provides for the construction of a new building (Matheson House at Telford) for the COP programme. It will also allow some highly cost-effective "spend to save" schemes to go ahead.

Defensive

(i) The Treasury are aware of PSA's concern about the current condition of the civil estate (PSA estimate the backlog of maintenance work to be about £90m). It is recognised that the provision as agreed will only allow for the more urgent maintenance jobs to be undertaken next year. Decisions on future years spending will need to be taken in the light of what needs to be done (PSA are drawing up a detailed forward plan) and balanced against competing claims in other areas.

Contact point: C C Allan (LG2) 233-5015

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J12: DOE: OTHER ENVIRONMENTAL SERVICES (Detailed questions to DOE)

Factual

(i) Other environmental services covers capital and current expenditure by local authorities on environmental services such as refuse collection, by DOE on programmes such as derelict land reclamation and the heritage, and by sponsored bodies eg the Nature Conservancy Council and the Sports Council; and the Urban Programme (see J13 below).

(ii) The agreed provision for England in 1985-86 is £3240 m, which is a net decrease of £30 m ([ ] per cent) on the figure in the 1984 Public Expenditure White Paper.

(iii) [Within this total, provision for local authority net capital expenditure in 1985-86 is being cut by £[28] m to £[ ] m to offset the local authority capital overspend in 1983-84.]

(iv) For 1984-85 a Winter Supplementary Estimate is to be presented proposing an increase of £10 m in the provision for the Urban Development Corporations for high priority projects. The extra resources are being made available from a reduction in provision for Urban Development Grant. There are no cash limit implications as both items of expenditure form part of DOE's urban aid cash block.

(v) [DOE plan to issue a press release about the outcome of the Survey on [ ] November.]

Positive

(i) Gross local authority capital expenditure on this programme will be much greater than net provision: £[ ]m in 1985-86. Could be more if LAs increase their receipts above expected levels.

(ii) Provision for the Nature Conservancy Council and the Countryside Commission is being increased to enable them to safeguard Sites of Special Scientific Interest and to conserve landscapes.

(iii) Extra resources are also being made available for [to be completed]

Contact point: K J Pike (LG2) 233-4611

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J13: URBAN PROGRAMME (UP)
(Detailed questions to DoE)

Factual

(i) UP is one element of "other environmental services" programme (see J12). It covers certain local authority spending in England on programmes of Departments of Environment, Health & Social Security, Education & Science and Transport.

(ii) This spending is aimed at assisting Local Authorities to deal with the special concentrations of social need associated with the decline of the inner-city areas. UP spending in 1984-85 is £348 million.

(iii) Total UP provision in 1985-86 is £336 million 8 per cent down on Cmnd 9143 provision of £366 million.

(iv) Bulk of UP spending is on DoE programmes. Plans fall from £256 million in 1984-85 to £241 million in 1985-86.

(v) Urban Programme and Policy Review (UPPR) was completed by officials in May. Ministers are still considering its implications for policy. These decision on resources reflect its conclusions.

Defensive

(i) No swingeing cut in UP expenditure. UPPR has identified how to get better value for slightly less money.

(ii) Reductions will be made in lower priority parts of the UP (eg Traditional Urban Programme) and lower priority geographical areas.

(iii) High priority areas (eg partnership authorities) will be protected.

Positive

(i) Government remains committed to giving substantial help ($^1/_3$ of a billion a year) to inner cities.

Contact point: P J S Stredder (LG2) 233 5343

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J14: HOME OFFICE AND LORD CHANCELLOR'S DEPARTMENT

A. HOME OFFICE

Factual

(i) The 1985-86 provision for the Home Office programme is £4590 million. About three-quarters is spent on the police and fire and other local authority services and one-quarter on central government activities of which the largest is the prison service.

(ii) The net increase of £70 million over the Cmnd 9143 figure for 1985-86 includes £[50] million for police and £[30] million for the fire service. There is also provision for additional expenditure on control of immigration and citizenship, non-custodial measures and aftercare, and the initial stages of computerising the Passport Office.

(iii) Home Office Press Office will be provided with detailed briefing.

(iv) For Class IX, 6 (Police and various other grants) a Winter Supplementary Estimate of £154.7 million is being presented. This is required mainly to meet the Home Office share of the cost of policing the miners' strike up to October 1984. The Vote is not subject to a cash limit.

Positive

(i) Programme provides for slight increase in police establishment and for continued recruitment up to establishment totals. Increase of 7.8 per cent in police numbers since June 1979 fundamental to Government's law and order policy.

(ii) The prison provision covers a further part of the cost of the prison building programme designed to eliminate overcrowding by the end of the decade.

(iii) The increases in expenditure for immigration and citizenship will strengthen entry controls and cover the opening of the new terminal at Heathrow Airport.

(iv) Total increase in provision continues to reflect the Government's commitment to law and order.

Defensive

(i) Any sensible Government must bear in mind the balance between providing resources for priority areas and the results that will produce. It is right therefore to continue to look at methods for achieving value for money without endangering the rule of law.

(ii) The prisons provision reflects Government's commitment to a greater number of inmate places. In a civilised society the Government cannot ignore the need to provide humane conditions for offenders.

(iii) IF PRESSED The Government continues to believe that the police should receive fair and proper remuneration for the job they do. Police pay has been increased for most ranks by 5.13 per cent from September 1984 consistent with the principles of the Edmund Davies Report.]

Contact point: B P Smith (HE1) 233 7160

B. LORD CHANCELLOR'S DEPARTMENT

Factual

(i) The 1985-86 provision is £536 m, £11 m (2 per cent) reduction on the Cmnd 9143 figure.

(ii) The provision has been rounded to £540 m in the printed Statement.

(iii) A reduction of £10 million in planned provision for courts building takes account of more realistic forecasts of the work likely to be achieved.

Defensive

The reduced provision still allows for adequate growth in court rooms to cope with increasing volume of work.

Contact point: P Russell (HE1) 233 8379

J15: EDUCATION AND SCIENCE (Detailed questions to DES)

Factual

(i) The agreed provision for DES in 1985-86 is an increase (rounded) of £280 million (2 per cent) over the 1984 White Paper figure, as adjusted.

(ii) Sir Keith Joseph will be making a written statement, to be issued as a press release, on the afternoon of 12 November. As far as possible all questions should be directed to him. The student award position is particularly sensitive.

Positive Points

(i) Local authority current provision has been substantially increased. If overall costs are restrained and economies made possible by falling school rolls are secured there should be scope to continue development of policies for the school curriculum and to respond to the growing demand for non-advanced further education.

(ii) The Science Budget has been significantly enhanced. This will provide for a restructuring programme in the research councils and allow, subject to Advisory Board for the Research Councils advice, for assistance with special cost increases and for an increase in the proportion of top quality research applications the Research Councils can fund.

(iii) Increased provision on a selective basis for unversities' equipment to strengthen the research base.

(iv) Increased provision for existing commitments to student awards and the Assisted Places Scheme.

Defensive Points

(i) Modest reduction in local authority capital to compensate for 1983-84 overspend.

(ii) Student award savings are targeted on those families most able to pay. Our student support system is still amongst the most generous in the world.

Contact Point M J C Faulkner (HE2) 233 8481

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J16 ARTS AND LIBRARIES (Detailed questions to OAL)

Factual

(i) The agreed provision for OAL in 1985-86 is £636 m, an increase of £12 m (2 per cent) over the Cmnd 9143 figure. The rounded figures in the printed statement show provision of £640 m, an increase of £20 m (3 per cent).

(ii) Lord Gowrie is currently considering the allocation of the Arts and Libraries programme for 1985-86, and an announcement will be made before Christmas. No details of this allocation can be provided in the meantime, and all questions should be directed to Lord Gowrie.

Positive

(i) Provision has been increased for both the central government and local authority elements of the Arts and Libraries programme. The Government remains committed to keeping up the level of support for the arts.

(ii) Work will continue on the current phase of the new British Library building at St Pancras.

Defensive

(i) The increased provision recognises the funding requirement of the arts and libraries, but these have to be balanced with the pressing requirements of other areas (eg NHS), and the need to restrain total public expenditure.

(ii) The Government is actively seeking to promote private sponsorship of the arts to supplement government funding.

Contact Point: Mr S D H Sargent (HE2) 233 8494.

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J17: HEALTH AND PERSONAL SOCIAL SERVICES (Detailed questions to DHSS)

DHSS will issue a press notice and their Secretary of State will answer an arranged written PQ on the afternoon on which the Autumn Statement is delivered.

Factual

(i) The overall figures for this heading are:

	£m
	1985-86
Cmnd 9143	16,250
Autumn Statement	16,480
difference	230

(ii) The provision for health in England in 1985-86 is £14,040m, which is an increase of £180m (1.3 per cent) on the figure in the 1984 Public Expenditure White Paper.

(iii) The new plan represents an increase of almost 5 per cent on spending this year.

(iv) Spending in 1984-85 is being increased in the Winter Supplementaries by nearly £300m over the 1984 Public Expenditure White Paper figure. Of this £240m is for the excess costs of the NHS pay awards and £60m for volume growth and price increases in the Family Practitioner Services.

(v) Planned provision for the personal social services in England in 1985-86 is £2,420m, (£30m above the figure in the White Paper). The Autumn Statement total provision for health and personal social services includes £20m of classification changes since the White Paper was published.

Positive

(i) The outcome honours the election and other pledges on the NHS: total health spending in Great Britain is planned to increase by £700m over this year's level, just as the Prime Minister said in her election speech in Edinburgh.

(ii) Provision is being made for cost of demographic change - 1 per cent more resources than inflation.

(iii) Full provision is being made for the Family Practitioner Services to avoid the risks of an overrun.

(iv) The NHS is expected to make further improvements in services and reductions in waiting lists through substantial cost improvement savings. Appointing general managers in the health service as recommended by the Griffiths report will give greater impetus to achieving these savings.

(v) The sharply increasing drugs bill is to be tackled by taking measures to secure more cost effective prescribing with greater emphasis on generic drugs.

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Defensive

(i) Exemptions from charges will remain but no responsible government could rule out increases in charges to patients. IF PRESSED: the level of charges is a matter for my Rt Hon Friend the Social Services Secretary [SENSITIVE].

(ii) The cost of NHS pay settlements in 1985-86 will have a direct effect on the resources available to improve services to patients. However, the government expects these costs and those which may arise from advances in medical science and demographic change to be met from within this year's allocation of resources, supplemented through improved efficiency and by cost improvement savings.

(iii) Planned NHS capital spending is to be broadly maintained in real terms. The published (net) figures do not present the full picture, as part of the cash increase needed to match forecast inflation is to be raised through higher receipts from NHS land and property sales.

Contact point: J M G Denham (ST2) 233-5166

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J18: SOCIAL SECURITY

Factual

(i) Social Security programme for 1985-86 rises by £480 m compared with Cmnd 9143.

(ii) Figures reflect latest estimate of benefit expenditure allowing for effect of revised economic assumptions. Main estimating changes are result of higher assumptions on unemployment, and increased take-up of housing benefit and invalidity benefit.

(iii) Main policy changes to be announced in Autumn Statement are:

(a) changes in payments made to supplementary benefit claimants for board and lodging and residential care, to take effect in 1985-86;

(b) changes in the rules affecting invalidity benefit (IVB) which will permit the restoration, from November 1985, of the 5 per cent abatement of invalidity pension introduced in 1980 in lieu of taxation. (Government has always promised to restore abatement when benefit brought into tax.)

(c) Secretary of State for Social Services also to introduce legislation to extend duration of statutory sick pay to 28 weeks with effect from April 1986.

(iv) Details will be given in DHSS Press Notice on [ ] November. Legislation on (b) and (c) to be included in Bill, mainly about occupational pensions, to be published on [ ] November.

(v) Benefit uprating As Secretary of State announced on 18 June, benefits due to go up on 26 November this year. Uprating on "historic method", in line with increase in prices in 12 months to May 1984. Pensions up in line with 5.1 per cent increase in RPI, Supplementary benefit scale rate up in line with 4.7 per cent increase in RPI less housing, Housing Benefit up in line with housing costs. Plans for 1985-86 include provision for full uprating of benefits in November 1985 based on 4¾ per cent assumed increase in RPI in 12 months to May 1985. Actual uprating of individual benefits will be announced in June 1985, when May RPI known.

Positive

(i) Increasing disquiet over present rules for board and lodging, especially for young people. General tightening up of rules should be welcome.

(ii) Has proved possible to restore 5 per cent abatement of invalidity pension although not yet possible for operational reasons to bring IVB into tax. Government still believes principle of taxing IVB right.

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Defensive

(i) Social Security programme accounts for about 1/3 of public expenditure. Impossible to exempt it from search for economies. Social Security benefits more generous than some other countries.

(ii) Savings announced do not pre-empt or pre-judge the Social Security Reviews. But Secretary of State has already made it clear that he can give no guarantee that he will not look for savings on benefits under review (eg Housing Benefit, Child Benefit, Supplementary Benefit etc) in future.

(iii) Reviews not due to conclude their business until end of year. No decisions on Housing Benefit means-testing or taxing Child Benefit etc have been, or will be, taken until reviews have reported.

(iv) Taxation of IVB. Government still believes it right to bring into tax benefits which replace taxable income. Therefore principle of taxing IVB not in dispute. However, since still not possible, for operational reasons, to impose taxation, Government has felt it right to restore the abatement in the meantime. [IF PRESSED: Taxation will not be imposed during 1985. Timing will be decided in context of general taxation policy and in light of staffing and operational considerations.]

(v) Extension of SSP just a fiddle to make figures add up? No. Doesn't take effect until April 1986, so hasn't influenced figures for 1985-86 at all. True that no net PSBR savings, but fully justified on merits. Reduces duplication of state and private provision, amounts to contracting out, saves staff in DHSS, consistent with policy of bringing into tax benefits which replace taxable earnings.

Contract point: Miss G Noble (ST1) 233-3169

J19 CIVIL SUPERANNUATION

Factual

(i) Figures are:

	£m 1985-86
Cmnd 9143	1130
Autumn Statement	1070
reduction	60

Note that the Autumn Statement figure is rounded to the nearest £10 million. A figure to the nearest £1 million will be given in Part II of the PEWP.

(ii) Provision is mainly to pay civil service pensions awarded in earlier years, or for lump sums to those retiring in the years covered.

(iii) No substantial changes in the rules of the scheme or in the pensions increase arrangements have occurred or are assumed for the future.

(iv) Manifesto declared that public sector pensions would continue to be index-linked on basis of realistic contributions. No decisions yet taken on possible move to a contributory scheme.

Positive Points

(i) Although scheme is mainly non-contributory, pensions have been taken into account in settling pay. Scott Report (1981) gave effective employee contribution of 8 per cent which is higher than private sector average.

(ii) Reductions in size of Civil Service will eventually reduce superannuation liabilities. Meanwhile must pay pensions which have accrued in the past.

Defensive Points

(i) Sensible to defer decision on contributory scheme while Fowler Inquiry is sitting.

(ii) Large transfer payments consequent on privatisation (eg for Royal Ordnance Factories) are a bringing forward of payment for liabilities already incurred, and should not be regarded as an extra cost of privatisation.

Contact point: P L Dyer (Superannuation) 233 3507

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J20: SCOTLAND, WALES, NORTHERN IRELAND

Factual

(i) 1985-86 figures in the Statement compare as follows with the Cmnd 9143 provisions:

	£m Cmnd 9143	AS
Scotland	6700	6780
Wales	2640	2650
Northern Ireland	4210	4240

(ii) 1985-86 provisions for individual services within these territories cannot be finalised until the Secretaries of State have made their reallocations taking account of local factors.

(iii) For 1984-85 Winter Supplementary Estimates relating to industrial support in Wales (non-cash limited) will add £5.5 million to Cmnd 9143 for the territorial programmes.

Positive

(i) Any points will be made by the Secretaries of State when they make their separate statements probably before the Christmas recess.

Defensive

(i) IF PRESSED: The allocation of resources within the agreed expenditure totals is a matter for the respective Secretaries of State, who will be making their own statements in due course.

Contact point: A J Davis (ST3) 233-8045 Wales and Scotland
L J Woodman (ST3) 233-7893 Northern Ireland.

J21: SPECIAL SALES OF ASSETS

Factual

(i) Net proceeds from special sales of assets (1985-86) are shown as increasing from £2000 million to £2500 million (or by 25 per cent).

Positive

(i) Figure reflects fact that momentum of privatisation programme being maintained.

Defensive

(i) **Main objectives of the privatisation programme** are to improve efficiency and promote competition, although the sale receipts are clearly beneficial.

(ii) **Why has 1985-86 figure increased?**

The new forecast reflects revised estimates of individual sales' likely receipts and timing rather than any deliberate acceleration of the programme which is continuing on course. Always genuine uncertainty about level of likely receipts. Dependent on market conditions at time of sale and on decisions yet to be taken, for example about phasing of receipts.

(iii) **What about British Airways - now to slip into 1985-86?**

[ ].

(iv) **How is £500 million increase in 1985-86 made up?**

Asset sales programme always has a number of components (eg nine sales 1983-84, and 1982-83, thirteen sales in 1981-82). Because details and timing of sales are commercially sensitive, not our practice to break down target figures into detailed components. (Plans for this Parliament include British Shipbuilders (Warships), ROFs, National Bus Company, Rolls Royce, Short Bros, parts of British Steel and British Leyland, and as many as possible of Britain's airports).

(v) **Receipts from asset sales should not score as offsets to public expenditure figures?**

Sales of physical and financial assets have always been treated as negative public expenditure (eg sales of BP shares in 1977-78). In nearly all cases*, acquisition of assets increased public expenditure (and PSBR); symmetrical and logical these aggregates should be reduced when assets are disposed. This treatment is in line with international guidelines for national and government accounting. (See also brief C1).

(vi) **Government overloading market with new issues? (see also (~~viii~~ ix) below)**

No. UK company capital issues in 1983 50 per cent more than ever. Investors are prepared to adjust their portfolios to accommodate privatisation issues. And sales reduce the Government's demands on the gilts market.

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* [Nationalisation achieved by swapping gilts for shares is an exception.]

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(vii) **1984-85 position?**

The 1984-85 asset sales forecast is £1900 million. We are well on course to achieve this. Receipts to date are approximately £500 million, (mainly Enterprise Oil and AB Ports residual shareholding). **NB** Not all privatisation receipts (eg Jaguar, Sealink) score as special sales of assets.

(**Not to be used:** It is estimated that receipts for the current year will be around £2.3 billion. Because of the sensitivity of the estimates of individual components of this total this estimate should not be revealed.)

(viii) **When will 1983-84 outturn be published?**

Outturn in 1983-84 was £1142 million, below the target of £1250 million due to the slippage of Enterprise Oil into 1984-85. Detailed outturn figures will be published in the PEWP.

(ix) **Impact of Autumn Statement on BT sale?**

[No material impact]

(x) **Any other question about BT sale?**

Legal advice is that nothing should be said which could be interpreted as an inducement to buy shares. Questions should be answered by reference to the pathfinder prospectus published on 26 October.

Contact:

Individual privatisations	Relevant Sponsor Departments
Overall programme	T J Sutton (PE2) 233-5540
BT sale	J Williams (PE3) 233-3522

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319
63
256

J22A

J22A NATIONALISED INDUSTRIES EXTERNAL FINANCING LIMITS 1985-86 GENERAL ASPECTS

Factual

(i) Nationalised industry expected external finance increases from £[~~1063~~] 1140 million to £[1318] million. In the printed Statement the figure is rounded to £[ ] m.

(ii) The difference of £[ ] million (rounded) between earlier plans and 1985-86 EFLs is constituted as follows:

	£ million
reclassification of London Regional Transport to nationalised industry sector	+323
reductions (mainly Electricity (England and Wales), British Shipbuilders, British Rail, Water (England and Wales)	-347
increases (mainly British Steel and British Gas)	+279

(iii) The National Coal Board's figures are unchanged. Ministers will consider the position on the NCB when the strike is over. [For coal strike effects, See B5].

(iv) Nationalised industries are one part of the public sector where rate of return on investment can be measured. Overall, aggregate real rate of return has fluctuated around zero for several years: much less than the 5 per cent target and well below rates in the private sector.

(v) British Telecom and British Airways are excluded from all 1985-86 figures in view of their impending privatisation.

Positive

(i) Excluding effect of reclassification of London Regional Transport, nationalised industry financing requirements show a small decrease in 1985-86 over earlier plans. Decrease shows that Government attempts to encourage industries to reduce current costs and increase efficiency are proving successful.

(ii) 1985-86 aggregate EFLs also show a marked reduction over 1984-85. This declining requirement for external finance is cause for congratulation not concern. Shows progressive improvement in nationalised industry finances in recent years is being sustained to the benefit of the taxpayer and nation as a whole.

(iii) Nationalised industry price rises in 1985-86 are still to be settled but overall price increases are expected to be broadly in line with movements in the RPI.

(iv) Gas and electricity profits are large in £ million. But these are huge industries. Capital invested is some £32 billion in electricity and £14 billion in gas. The return on the assets is not high. Few private sector companies would be satisfied with these returns.

(v) Nationalised industry investment, adjusted for privatisation and certain changes in accounting treatment has been broadly maintained in real terms since 1979-80. Investment in 1983-84 is currently estimated to have increased by 10 per cent over 1982-83, to £[ ] bn cash after allowing for privatisations.

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CBI paper "Fabric of Nation" did not contain any evidence of substantial nationalised industry projects with an adequate rate of return which have been frustrated.

Defensive

(i) Reason for BSC EFL increase - British Steel Corporation EFL represents latest estimate of the Corporation's cash requirements. BSC are currently reappraising their strategy and will present options to the Government in due course. [Refer any further questions to DTI].

(ii) Reason for BGC EFL increase - reflects in part increased tax liability arising from Wytch Farm disposal [Refer any further questions to the Department of Energy].

(iii) BS EFL - British Shipbuilders EFL is shown on composite basis for Merchant and Warshipbuilding Divisions in view of impending privatisations of Warshipbuilding Yards - see footnote 4 to Table 2.3. [Refer any further questions to DTI].

(iv) Financing increases in NCB's EFL - position on EFL to be considered. Any increase could be financed by savings elsewhere, or from the expenditure reserve.

(v) Aren't the figures wishful thinking? - The annual Investment and Financing Review considers each nationalised industry in depth on the basis of figures supplied by the industries themselves. No reason to think that the outcome is not well-founded. [NB industries undershot original (1982 Autumn Statement) EFLs in 1983-84 by over £800 million and were on course to keep within 1984-85 EFLs had it not been for damaging effects of miners' strike].

(vi) Will investment fall in 1985-86? - industries' investment plans have still to be finalised in light of EFLs. But there will be marked drop in nationalised industry investment as a result of privatisation of British Telecom and British Airways. Their investment will, of course, then be included in private sector statistics.

(vii) Achievement of EFLs - Achieving plans depends on the nationalised industries keeping current costs, including wage costs, under control just as private sector companies have to. Failure to do this is likely to mean either higher prices or less investment. EFLs are not automatically increased to meet increases in current costs.

Contact Points Individual Industries: Relevant Sponsor Departments
Overall programme: C A Palmer (PE2) 233-5561

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J22B WATER AUTHORITIES (ENGLAND AND WALES)

NB (Detailed questions, including on individual RWAs to DOE, or on Welsh WA to Welsh Office. Land drainage questions to MAFF. Scottish water services are provided by local authorities - refer to Scottish Office)

Factual

(i) EFL and investment totals for the industry have been agreed as follows (£ million):

	1984-85 Cmnd 9143 with EFL NIS adjustment)	1985-86
EFL	284	202
investment	778	846

(ii) Financial targets for the industry (per cent real return on assets) have now been set on a 3 year policy as follows (these are averages - targets for individual authorities will differ):

1985-86	1986-87	1987-88
1.4	1.7	1.9

(iii) Charges are a matter for individual authorities. But increases in 1985-86 are expected to be above RPI.

Positive

(i) Water investment is being increased by about 9 per cent to eg meet need for repair and maintenance work on underground systems (including sewers) and respond to pressure to improve the environment (implementation of Control of Pollution Act). Investment planned to run at about £846 m in 1985-86.

(ii) The Government has set financial targets for 3 years to help the industry plan ahead. The return on the industry's £30 billion assets is still not high compared to what is normal in the private sector and, even, some nationalised industries.

(iii) Charges will be increasing but will still fall short of economic levels.

(iv) Most water authorities are achieving an efficiency aim set by the Government which reduces operating costs by about 1 per cent a year. If they can do better this will help keep charges increases down.

Defensive

(i) Higher charges a tax on water users as charges based on rateable value (RV) - water charges are a charge for water and not a tax. Present system for domestic users based on RV but anyone can have meter installed if they prefer volume based charge. About 40 per cent of usage is metered, including industry.

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J22B

(ii) Putting up water rates out of line with rate capping? - Great majority of Water services are provided and charged for by the water authorities in England and Wales - a nationalised industry. Increasing water charges toward more economic levels, has nothing to do with controlling the spending of profligate local authorities.

(iii) Effect of increased charges on the poor - water charges taken into account in social security benefits.

(iv) Effect on inflation, industrial costs etc - water is a very small element of the RPI and of most industries' costs, so not a significant problem. Each 1 per cent change in average level of water charges would raise RPI by only 0.01 per cent.

Contact Point Ms Z Spencer (LG1) 233-5535

Brief K not available at present.

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L ROLE OF LORD YOUNG

Factual

(i) Lord Young's role as Minister Without Portfolio is to promote policies for the growth of enterprise and job creation.

(ii) He will tackle 4 areas initially:

- (a) The 14-18 age group
- (b) Small firms policy
- (c) Competition
- (d) Liberalisation

The first two areas have immediate priority and working groups consisting of Ministers and officials from relevant Departments have been set up.

(iii) The groups will report conclusions and recommendations to appropriate Cabinet Committees, by whom decisions will be taken.

Positive

(i) A number of important initiatives to stimulate enterprise and employment have been taken in recent years. The various groups will seek to identify the obstacles which remain and to ensure the maximum integration of policies and programmes across a range of Departments.

Defensive

(i) Wrong to see this development as signalling a change in the Government's view about the appropriate level of public expenditure on relevant programmes. It is more a question of whether existing resources can be deployed more effectively.

Contact point: M Emmott (Enterprise Unit) 233 3035

1984
AUTUMN
STATEMENT

Autumn Statement 1984

HM TREASURY
NOVEMBER, 1984

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

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Contents

1. Economic Prospects for 1985

Summary

World economy

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.

Assumptions

1.02 This 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 Financial Statement and Budget Report. It is also based on the formal assumption that the coal strike will be over by the end of 1984.

Demand and output

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 coal 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 recovery from the coal strike). The rise in employment, over 1 per cent in the year to mid 1984, is expected to continue.

Inflation

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. Inflation in 1985 is expected to decline gradually.

External accounts

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 contributed to a position of near balance so far; with the ending of the coal strike, a return to surplus is forecast. North Sea oil production in 1985 may be close to its maximum.

Borrowing

1.07 For the 1984–85 financial year as a whole, higher oil revenues are likely to be more than offset by higher expenditure including the extra costs of the coal strike. Although the outturn is still uncertain, the result is forecast to be a PSBR of £$8\frac{1}{2}$ billion, some £$1\frac{1}{4}$ billion above the Budget forecast. For next year, 1985–86, latest forecasts suggest that there would be scope for tax cuts of about £$1\frac{1}{2}$ billion if the PSBR were to be the £7 billion, or 2 per cent of GDP, assumed in the last MTFS.

The world economy

Recent developments

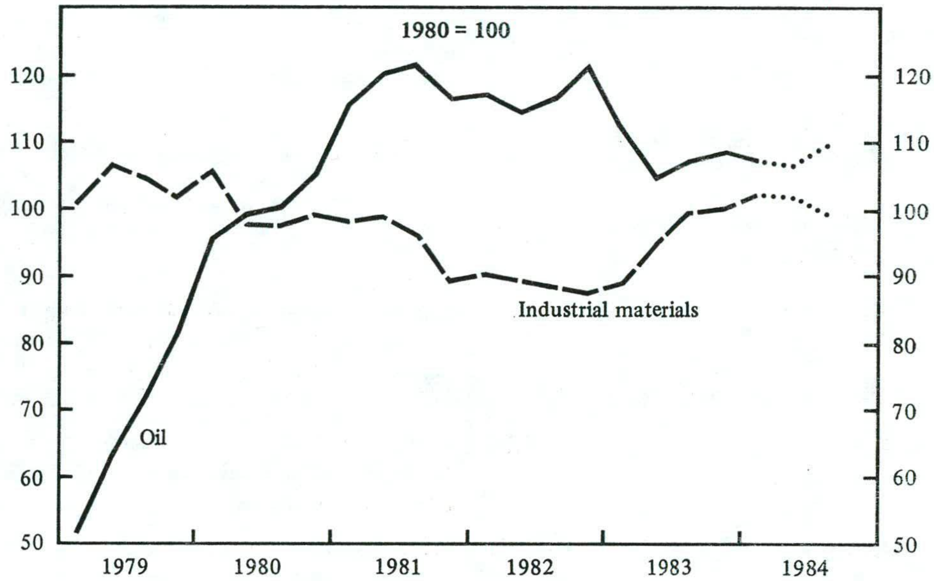
1.08 1984 is showing a rapid growth in world output and trade. The combined GNP of the major six economies other than the UK is likely to grow by about 5 per cent with an increase of nearly 10 per cent in total world imports. At the same time, inflationary pressures have been low: consumer prices are 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 constraining 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 only very limited recovery in 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
(in relation to prices of manufactured exports)



Prospects

1.11 The US economy seems set for slower growth. 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. Interest rates have recently fallen from the levels reached in the middle of 1984. But next year, lack of progress in reducing the fiscal deficit would tend to keep interest rates high. It is assumed that the deficits continue to be funded without any major break in confidence. Although the US policy imbalance is unsustainable, it is difficult to foresee when or how it will be resolved.

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 in the US 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

	Percentage changes on a year earlier		
	1983	1984	1985
World GNP*	2½	5	4
Consumer prices*	4½	4½	4
World trade in manufactures (UK-weighted)	1½	7	4½

* US, Canada, Japan, France, Germany, Italy.

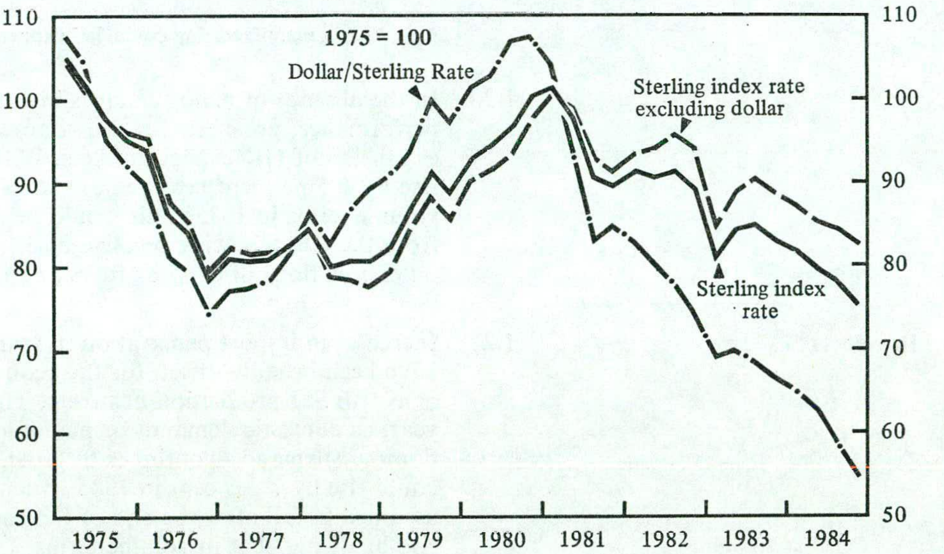
The Exchange Rate and The Balance of Payments

Sterling

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 sterling index has been weaker than this, to a considerable extent because of the unexpected strength of the dollar, but also because of industrial disputes. For this forecast it is assumed that the level of the sterling index in 1985 will not change much from the current level.

CHART 1.2

Sterling Index and Dollar/Sterling Rate



Relative costs and prices

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 competitiveness in 1985. After reaching 10 per cent this year the rise in import prices for manufactures is likely to decline, perhaps to an annual rate of some 5 per cent 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, should play a role in keeping domestic inflation low over the next year, and in maintaining the terms of trade close to current levels.

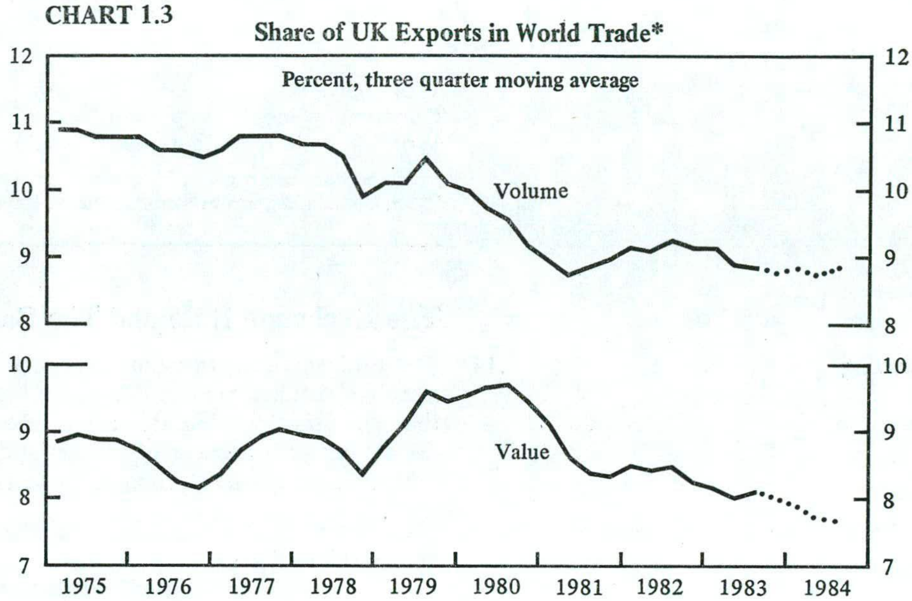
Trade in goods

1.17 Despite the effect of the coal strike in raising oil imports this year by some £2 billion, the outturn for the balance of trade in oil may exceed last year's surplus of £7 billion, helped by higher sterling oil prices and higher 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 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



*Main manufacturing countries' exports of manufactures

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 export 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 positive balances on the exports optimism indicator, and on expectations of export orders and deliveries.

Prospects

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 by 7 per cent in 1985, much the same as in 1984. With oil imports assumed to fall after the end of the coal strike, total imports of goods may rise by 4½ per cent in volume terms.

Invisibles

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

1.23 The balance on interest, profits and dividends (IPD) has risen from zero in 1980 to an estimated £1½–2 billion in 1983, with the build up of the UK's net assets overseas following the abolition of exchange controls: see table 1.2. (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 upwards.) 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 roughly half of the UK's 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

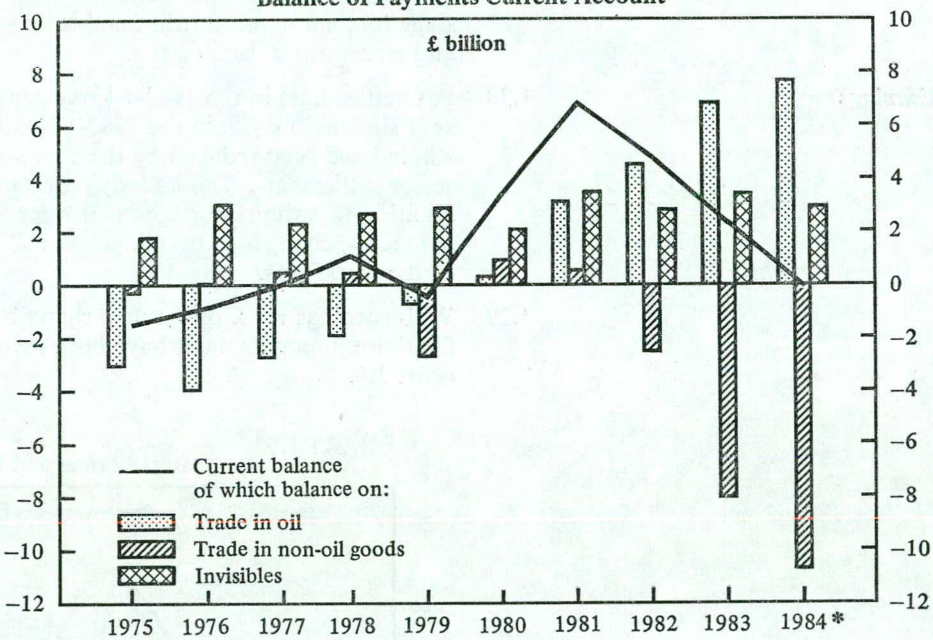
	Net UK External Assets, end year	
	£ billion	per cent of GDP
1979	15	7½
1983	56	18½
1984 (estimate)	70	22

Current account

1.24 The estimate of a current account balance in 1984 compares with a CSO estimate of a deficit of £½ billion for the first nine months. The forecast allows for the receipt of EC refunds 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 coal strike, low commodity prices, and a rising surplus on invisibles. The sectoral composition of the current account in recent years is shown in chart 1.4.

CHART 1.4

Balance of Payments Current Account



*First half year at an annual rate

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. 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.

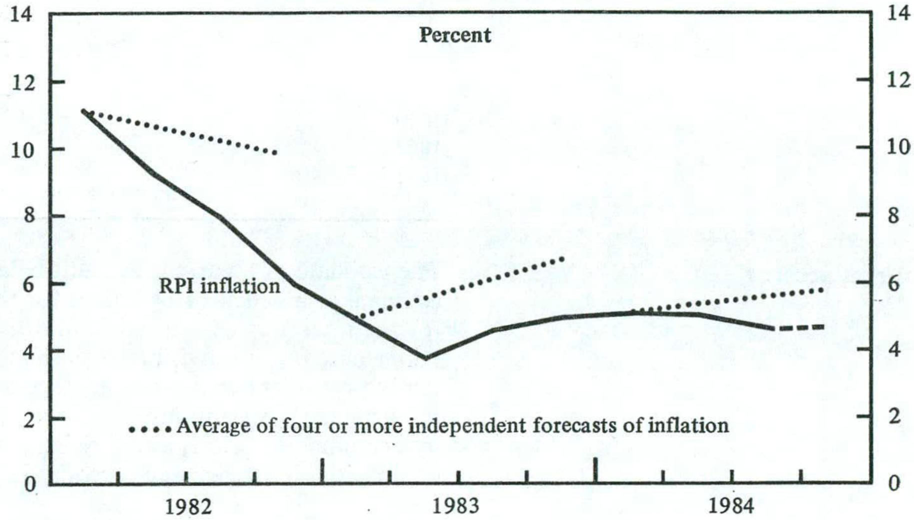
1.26 The recent tendency among forecasters to overestimate price rises can be seen in chart 1.5 (the dotted lines show forecasts, made early in the year, of inflation at the end of the year).

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 costs have not benefited as much as in 1983 from productivity gains, but the cuts in and subsequent 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

CHART 1.5

Inflation: RPI Path and Recent Predictions



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.

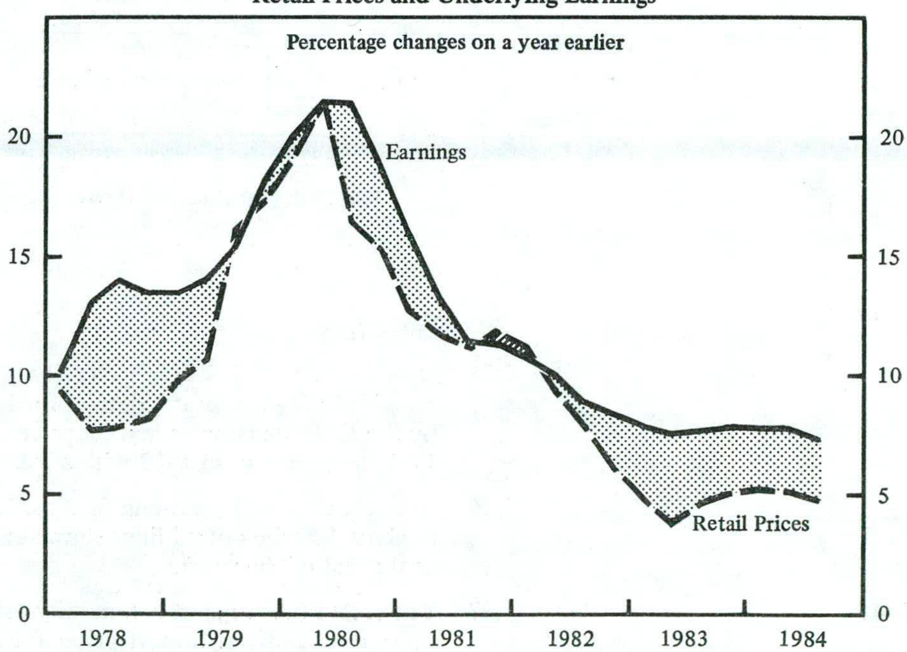
Earnings

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 coal 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 overtime and short time, and changes in the composition of the workforce.

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

CHART 1.6

Retail Prices and Underlying Earnings



Prospects

1.30 While no major change in the rate of price inflation is expected in 1985, there is likely to 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. Unit labour costs, taking account of the abolition of the national insurance surcharge 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 recent rate of around 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	3½	(3)	4
Nationalised industries**	10	1½	3½	(3½)	4½
Housing	14	6½	10½	(7)	4
Other	56	5	4	(4½)	4½
Total	100	5	4¾	(4½)	4½

* 1984 FSBR forecast in brackets.
** Includes BT and London Regional Transport; excludes water.

Demand and Activity

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 coal 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 coal strike is estimated to be reducing the current level of total output in the economy by 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 because the coal strike has led to lower stocks, and the balance has as expected shifted away from consumer spending towards investment, while overseas markets have grown more rapidly. The increases in GDP and domestic demand are now much more in line.

Personal income and expenditure

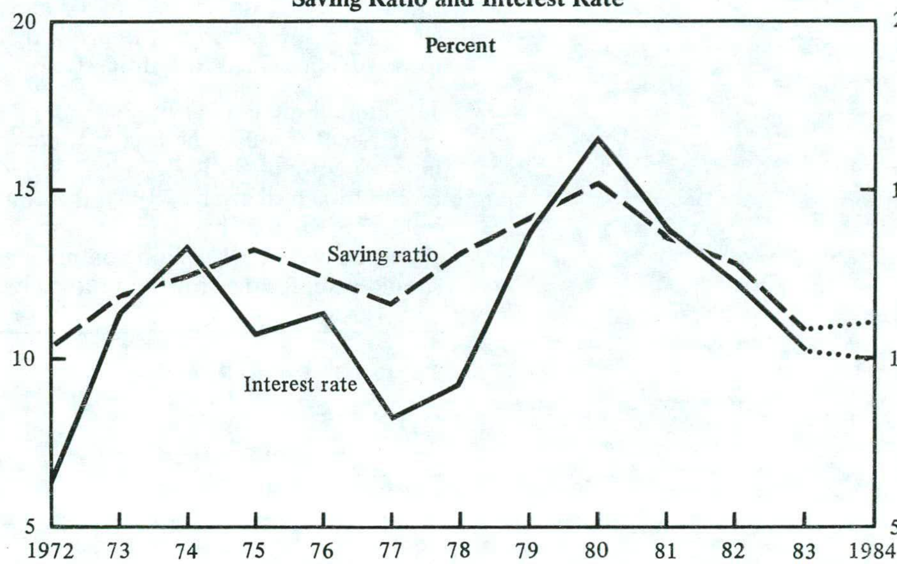
1.35 In 1983 real personal disposable income recovered to its 1980 level. But in order to finance higher spending, consumers reduced their rate of saving by 4½ percentage points. Between 1982 and 1983 the increase in consumer spending was almost 4½ per cent, helped by renewed growth in personal income.

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 a nominal interest rate: both the saving ratio and interest rates reflect, amongst other things, the rate of inflation. The high growth in spending in 1983 included a large increase in expenditure on durables, particularly on motor cars, in part, no doubt, a delayed replacement of the existing stock.

1.37 In 1984 personal income growth has continued in spite of the effects of the coal 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.

CHART 1.7

Saving Ratio and Interest Rate

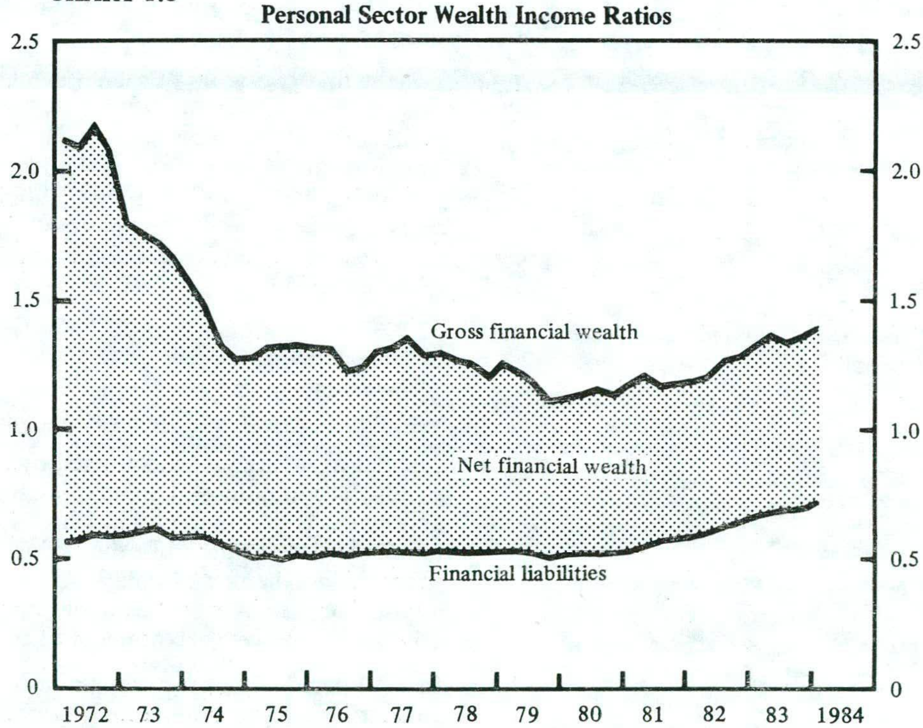


1.38 Paragraph 1.56 below indicates that there might be scope for a fiscal adjustment in 1985–86 of some £1½ billion. The assumption that this is used to cut income tax raises real personal disposable income in 1985 by nearly ½ per cent. This, combined with increases in employment and most other sources of income, suggests a forecast rise of RPDI of 4 per cent. As usual when income grows strongly the saving ratio is expected to rise and personal consumption may grow by 3 per cent.

1.39 The personal sector has more than doubled 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 since 1980 net financial wealth has increased in relation to income, partly as a result of the strength of the gilt and stock markets, but, with increased borrowing, gross financial wealth has increased a little faster.

CHART 1.8

Personal Sector Wealth Income Ratios



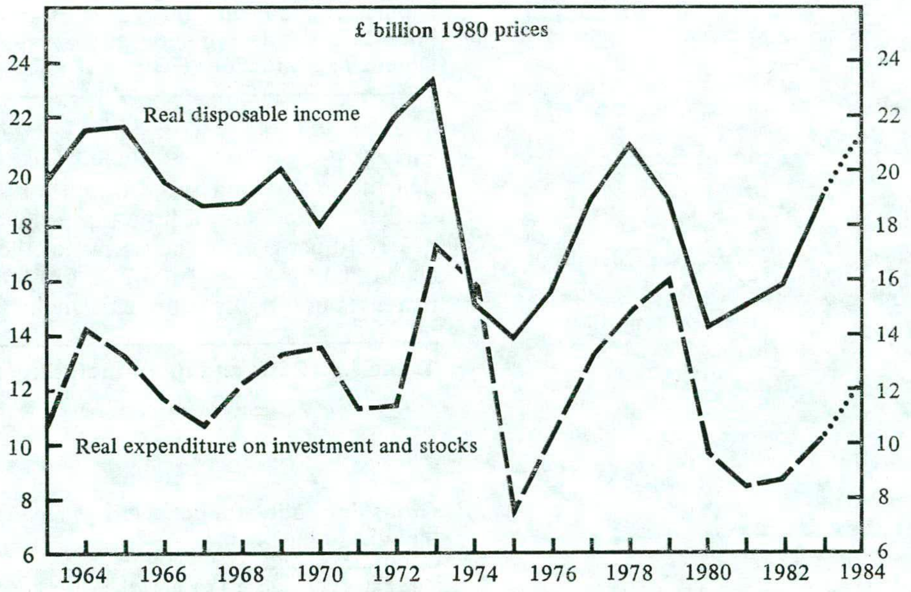
Company income and expenditure

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



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

Fixed 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 11 per cent up on 1983. With North Sea expenditure increasing rapidly from the low level seen in 1983, 1984 seems likely to record a substantial increase in total private fixed investment. A further good year for private fixed investment is expected in 1985. North Sea investment is likely to increase further although not by as much as this year; and investment by non-North Sea industrial and commercial companies may grow by 7 per cent.

1.43 This rapid growth of private investment is likely to be offset in part by lower public investment, particularly by local authorities following the likely overspend in 1984–85. Personal investment in housing—now redefined by the CSO to include improvement work—grew rapidly to mid 1984. 1982 and 1983 saw a substantial recovery, now slowing down, in new housing investment. There may be a check to the growth of improvement work. But the level of total personal housing investment in 1985 is likely to be a little higher than in 1984. For the economy as a whole, investment growth is expected to continue in 1985 at a rate close to the overall growth of output.

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 modest resumption of stockbuilding in 1985 as the growth in output and sales continues.

Domestic 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 assumed recovery from the coal 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 a little 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

Percentage changes on a year earlier

	1983	1984	1985
Domestic demand	$4\frac{1}{2}$	$2\frac{1}{2}$	$3\frac{1}{2}$
Exports of goods and services	1	$5\frac{1}{2}$	$4\frac{1}{2}$
Imports of goods and services	$5\frac{1}{2}$	$7\frac{1}{2}$	4
Domestic production: GDP	3	$2\frac{1}{2}$	$3\frac{1}{2}$

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 averaging nearly 10 per cent in the output of the North Sea oil sector in 1983 and 1984 accounted for about $\frac{1}{2}$ 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	3	$2\frac{1}{2}(3\frac{1}{2})$	$3\frac{1}{2}(2\frac{1}{2})$
Manufacturing	$2\frac{1}{2}$	2	$2\frac{1}{2}$

The figures in brackets exclude the effects of the coal strike.

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 300,000 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 over 20 per cent since the end of 1980—has gone beyond that usually expected in 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.

Table 1.6 Output per head

Annual averages, percentage changes

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

* Excluding public services and oil.

1.49 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. 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.

Unemployment

1.50 Despite the recovery in employment, unemployment (seasonally adjusted) levelled out only briefly during the second half of 1983 and since the beginning of this year it has increased on average by 15,000 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. 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 1970s, may continue.

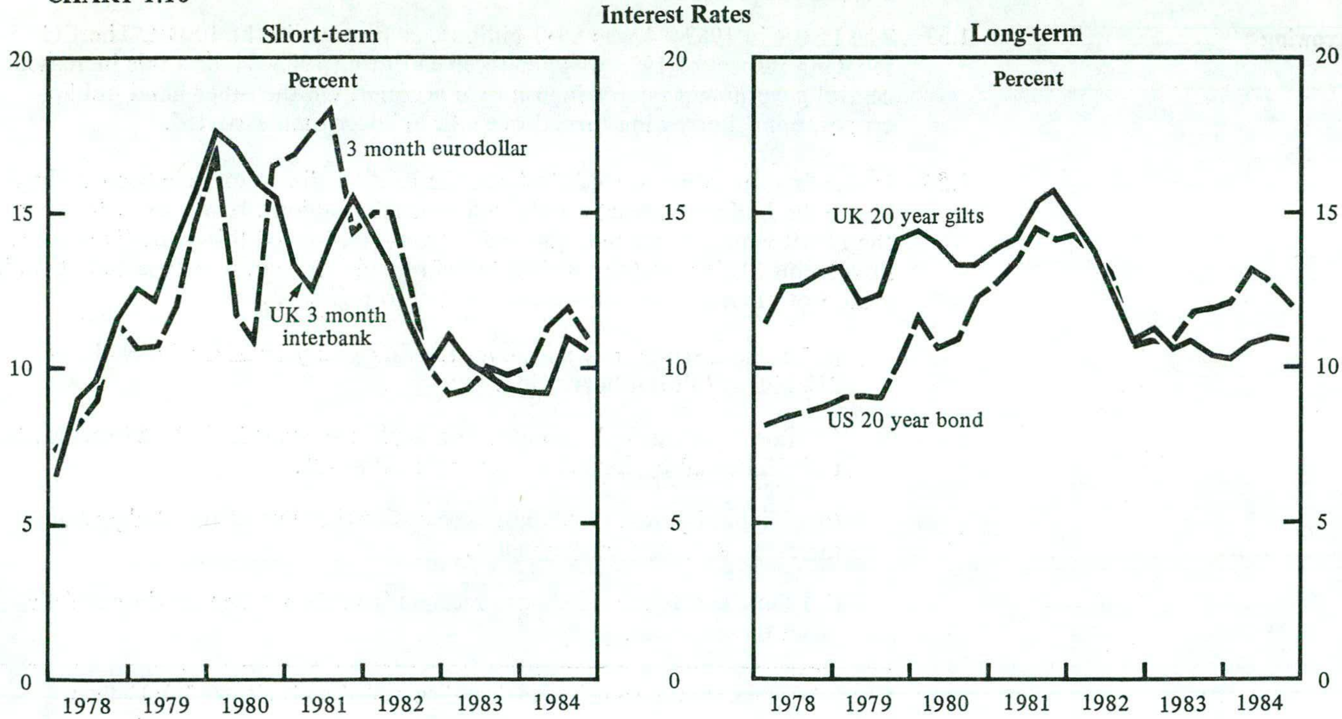
Interest rates and monetary growth

Interest rates

1.51 In the US the continuing rise in economic activity together with a continuing high Federal deficit and restrictions on monetary growth led to further upward pressure on interest rates in the first half of the year. Rates have subsequently fallen back, though generally not to the levels 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 the pace of monetary growth. With the subsequent easing of the latter worries, rates have fallen back, reversing most of the July increase.

CHART 1.10

Interest Rates

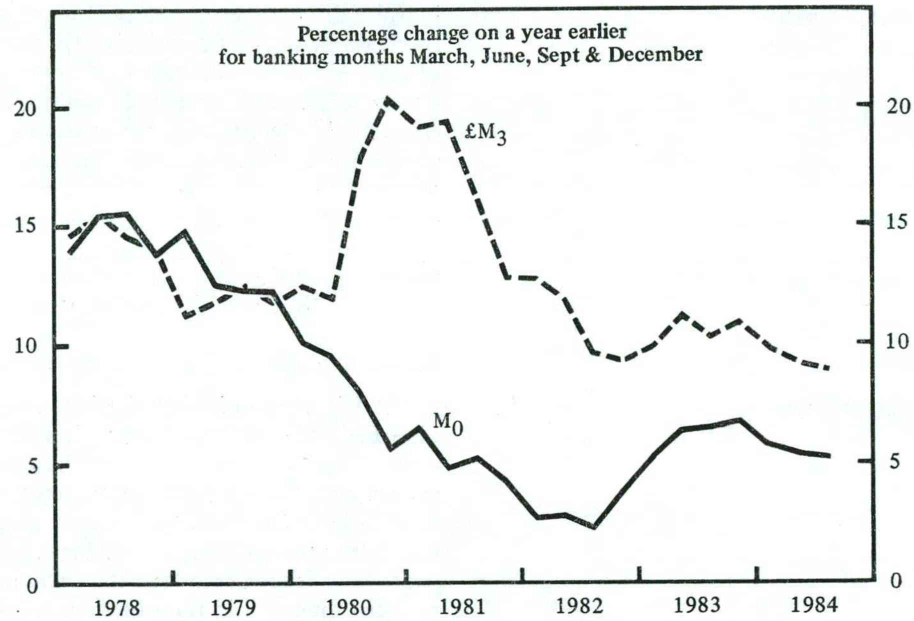


Monetary growth

1.52 Growth in both M0 and £M3 was within the target ranges over the first eight months of the current target period (to mid-October). M0 growth has been in the lower half of the 4–8 per cent range, while £M3 growth has fluctuated more widely, remaining generally in the upper half of the 6–10 per cent range. PSL2 has been growing faster than £M3, mainly as a result of the relatively rapid growth of building society deposits. Limited experience with M2 still makes it difficult to interpret, as does the reclassification of certain building society accounts from outside to within M2. 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.

CHART 1.11

Monetary Growth



Fiscal projections

Borrowing

1.53 The PSBR in 1983–84 was £9·7 billion*, as forecast in the FSBR. 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 seven months of 1984–85, the PSBR is likely to have been slightly above the Budget forecast for the full year (£7¼ billion). It was expected that the PSBR would be more than usually front-end-loaded this year. Even so, it now seems likely that the year's total will be higher than was expected at Budget time. Four major factors have contributed to this change:

(i) The coal strike may add, over the financial year as a whole, about £1½ billion to total borrowing.

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

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

(iv) On the revenue side, extra receipts from North Sea oil do not fully offset these factors.

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

1.55 As a result, the PSBR for 1984–85 as a whole is now projected at £8½ billion, some £1¼ billion higher than the Budget forecast. There is, as always, 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 usual assumption is made that tax thresholds, allowances and specific duties are indexed in 1985–86. The forecast also makes 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 £1½ 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. 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.

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, shown in table 1.7, is forecast to rise, in cash, by around 6½ per cent in 1984–85 and 3½ per cent in 1985–86. These figures are affected by the coal strike: the underlying rates of increase are around 5 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.

Table 1.7 General Government Expenditure

£ billion

	1983–84	1984–85	1985–86
General government expenditure(1)	120	128	132
National accounts adjustments(2)	4½	4½	5½
Interest payments	15	16	16½
General government expenditure in national accounts terms	**139½**	**148½**	**154**

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

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 specific 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 their current levels.

* Part 4 shows direct revenue effects arising from these assumptions.

1.60 The revenue projections are shown in table 1.8. Real GDP (average measure) is forecast to grow by 2¼ per cent in 1984–85 and by 3¼ per cent in 1985–86; these estimates are affected by the coal 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 tax revenues—before fiscal adjustment—in 1985–86 is close to the forecast rise in money GDP of 8 per cent.

Table 1.8 General Government Receipts(1)

£ billion

	1983–84	1984–85	1985–86
Taxes on income, expenditure and capital	97½	105½	113½
National insurance and other contributions	21½	23	25
Interest and other receipts	11½	10½	10½
Accruals adjustments	−½	1	−½
Total Receipts	**129½**	**140**	**148½**
of which North Sea tax revenues(2)	9	12	12

(1) Constituent items may not sum to totals because of rounding to the nearest £½ billion.
(2) Before Advance Corporation Tax set off.

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

Table 1.9 Public Sector Borrowing(1)

£ billion

	1983–84	1984–85	1985–86
General government expenditure(2)	139½	148½	154
General government receipts	129½	140	148½
Implied fiscal adjustment(3)	—	—	1½
General Government Borrowing Requirement	10	9	7
Public Sector Borrowing Requirement	9¾	8½	7
as percentage of GDP	3¼	2½	2
Money GDP at market prices	306	327	353

(1) Constituent items may not sum to totals because of rounding to the nearest £½ billion.
(2) In national accounts terms—see bottom line of table 1.7.
(3) On the same assumption as in the 1984 MTFS about the PSBR as a proportion of GDP in 1985–86.

The Prospects: summary

1.62 Table 1.10 presents a summary of the economic prospects.

Table 1.10 Economic Prospects(1)

	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)	$2\frac{1}{2}$	$3\frac{1}{2}$	1
Consumers' expenditure	2	3	$1\frac{1}{2}$
General government current expenditure	$1\frac{1}{2}$	1	$1\frac{1}{2}$
Fixed investment	$7\frac{1}{2}$	3	$2\frac{1}{2}$
Exports of goods and services	$5\frac{1}{2}$	$4\frac{1}{2}$	3
Change in rate of stock-building as a percentage of the level of GDP	$-\frac{1}{2}$	1	1
Imports of goods and services	$7\frac{1}{2}$	4	3
	1984	1985	
B **Balance of payments on current account (£ billion)**	0	$2\frac{1}{2}$	$3\frac{1}{2}$
C **Retail prices index (4th quarter)**	$4\frac{3}{4}$	$4\frac{1}{2}$	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 higher inflation and probably overstates the margin of error at low rates of inflation.

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	30·0	−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	32·5	0·1	207·2	104·1
1984	147·0	51·4	45·6	67·0	−1·0	310·0	65·5	32·7	0·4	212·2	106·6
1985	151·8	51·9	47·0	69·9	1·0	321·5	68·1	33·9	0	219·5	110·3
1983 H1	71·1	25·2	20·9	31·5	−0·1	148·6	29·8	16·2	0	102·6	103·1
H2	72·9	25·3	21·4	31·8	0·3	151·8	31·0	16·2	0·1	104·7	105·2
1984 H1	72·9	25·5	23·0	33·3	−0·8	153·8	32·2	16·1	0·4	105·9	106·4
H2	74·1	25·9	22·7	33·7	−0·2	156·1	33·3	16·5	0	106·4	106·9
1985 H1	75·1	25·9	23·4	34·7	0·5	159·5	33·6	16·8	0	109·1	109·6
H2	76·7	26·0	23·6	35·3	0·5	162·0	34·5	17·1	0	110·4	110·9
% changes:											
1982 to 1983	4½	2½	4	1		4	5½	3		3	3
1983 to 1984	2	1½	7½	5½		3	7½	½		2½	2½
1984 to 1985	3	1	3	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.

2. Outline Public Expenditure Plans for 1985-86

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 expenditure plans as now decided and for purposes of comparison the 1984–85 and 1985–86 plans. All figures are in cash.

The planning total

2.02 The outcome of the review is to set the public expenditure planning total for 1985–86 at £132·0 billion, slightly below the figure in the 1984 White Paper. After allowing for inflation, public expenditure will be broadly the same in real terms as planned for this year, 1984–85. 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 43½ per cent in 1981–82 to 41 per cent in 1985–86.

Changes in plans

2.03 Within the total for 1985–86 there are increases in social security, health, export credit and the UK's contributions to the European Communities. These are offset by reductions in other programmes including housing, employment services and the urban programme, together with 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 is unchanged from Cmnd 9143 and allows for annual growth of some 3 per cent in real terms, with an addition for Falklands costs.

FCO (including Overseas Development Administration)

2.05 The provision remains as planned.

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 bought into intervention following the large 1984 cereals harvest.

Agriculture	2.08	The net decrease reflects savings on market support measures and capital grants. Provision is included for the milk outgoers scheme and the enhanced rates of suckler cow subsidy announced earlier this year.
Forestry Commission	2.09	The reduction will be achieved mainly 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 is partly offset by reductions in other areas including nuclear research and development.
Export Credits Guarantee Department	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 £260 million is made to finance the expansion of some employment and training measures, including the Enterprise Allowance Scheme; 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 £330 million from revised estimates of demand for special measures, including the Youth Training Scheme, and a reduction in the rebate to employers from the Redundancy Fund.
Transport	2.14	The £370 million lower total reflects transfers out of the programme. Trust ports will be transferred to the private sector; and, on the establishment of London Regional Transport, planned expenditure on transport in London has been transferred to the Nationalised Industries sector. After taking account of these changes there is virtually no net change in provision.
Environment—Housing	2.15	Net housing provision is £310 million lower than provided for in Cmnd 9143, mainly as a result of a higher estimate of capital receipts, partly offset by increased subsidies to local authority housing. The reduction in gross capital provision is £65 million.
Environment—PSA	2.16	Additional provision has been made for new works and maintenance of the civil estate.
Environment—Other Environmental Services	2.17	There is a reduction in the Urban Programme and some other minor adjustments.
Home Office	2.18	The net increase is mainly for local authority expenditure on police, fire, probation and magistrates courts. Various changes within provision for central government expenditure include an increase for control of immigration.
Lord Chancellor's Department	2.19	The provision has been adjusted to reflect underspending on the court building programme.
Education and Science	2.20	The 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 plans: 1 per cent more than forecast inflation. 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. Some charges will be increased. 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 personal social services has also been increased.

Social Security

2.23 The provision reflects the latest estimate of benefit expenditure in 1985–86 including an allowance for an up-rating in November 1985 based on the assumed rise in prices in the twelve months to next May. The actual up-rating of individual benefits will be announced in June when the May RPI is known. The main policy changes affecting 1985–86 will be in the payments made to supplementary benefit claimants for board and lodging and for residential care, and in the rules affecting invalidity benefit, including restoration from November 1985 of the 5 per cent abatement of invalidity pension which has applied since 1980. The Secretary of State for Social Services will also be introducing legislation to extend the duration of statutory sick pay to 28 weeks with effect from April 1986.

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. It also takes account of savings that will result from the decision to cease to issue the £1 note.

Nationalised Industries

Nationalised Industries

2.26 External Financing Limits (EFLs) for nationalised industries in 1985–86 are set out in table 2.3. Overall there is an increase of £180 million in expected external financing requirements. This reflects a number of changes including the reclassification of London Regional Transport as a nationalised industry; decreased requirements for Electricity (England and Wales), British Shipbuilders, British Railways Board, and Water (England and Wales); and increases for the British Steel Corporation and British Gas Corporation.

Local Authorities

Current Expenditure

2.27 Local authority expenditure, except for the unallocated margin, is subsumed in the departmental totals shown in table 2.1. In 1984–85 local authorities are budgeting to exceed Cmnd 9143 provision for current expenditure relevant for Rate Support Grant by around £1·2 billion. For 1985–86 the Government has increased provision (adjusted for changes in the responsibilities of local authorities) by around £950 million to £25·5 billion. This implies in aggregate a reduction of about 3 per cent in real terms below 1984–85 budgets.

2.28 Local authorities have again been given provisional expenditure targets in England and Wales and guidelines in Scotland. Grant before holdback for 1985–86 will be about the same in cash (after adjustments) as the corresponding cash figure for 1984–85. Penalties for exceeding target or guidelines will be more severe than in 1984–85.

Capital Expenditure

2.29 The outlook for local authority 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. Net provision for Great Britain in 1985–86 is about £3·1 billion. This is a reduction from Cmnd 9143 of about £600 million, to take account of the 1983–84 overspend and of increased receipts.

Special Sales of Assets

Special Sales of Assets

2.30 Net proceeds from special sales of assets are estimated to increase by £500 million to £2½ billion, reflecting revised forecasts of receipts. There are considerable uncertainties attached to this figure which is dependent on market conditions at the time of sales.

Reserve

Reserve

2.31 The plans include a Reserve of £3 billion for 1985–86, £¼ billion higher than that included in Cmnd 9143 for 1984–85. The Reserve will be available to meet all contingencies and unavoidable increases, 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(1)(2)(3)

£ million

	1984–85	1985–86			
	White Paper (Cmnd 9143) with Budget changes	White Paper (Cmnd 9143)	White Paper (Cmnd 9143) with Budget changes	Revised plans	*Changes between Cmnd 9143 and revised plans*
Departments (excluding nationalised industries' external finance)(4)					
Ministry of Defence	17 000	18 060	18 010	18 060	*0*
Foreign and Commonwealth Office (including ODA)	1 800	1 870	1 870	1 870	*0*
European Community	380	550	550	750	*+200*
Intervention Board for Agricultural Produce	1 250	1 130	1 120	1 310	*+180*
Agriculture	1 000	1 020	1 020	930	*−90*
Forestry Commission	60	60	60	50	*−10*
Department of Trade and Industry	1 350	1 290	1 290	1 360	*+70*
Department of Energy	560	570	590	680	*+110*
Export Credits Guarantee Department	160	30	30	190	*+160*
Department of Employment	3 130	3 250	3 240	3 180	*−70*
Department of Transport	3 540	3 660	3 650	3 290	*−370*
DOE—Housing	2 500	2 610	2 600	2 300	*−310*
DOE—Property Services Agency	−90	−100	−100	−90	*+10*
DOE—Other Environmental Services	3 170	3 270	3 260	3 250	*−20*
Home Office	4 360	4 540	4 510	4 590	*+50*
Lord Chancellor's Department	500	550	550	540	*−10*
Department of Education & Science	13 050	13 450	13 380	13 590	*+140*
Office of Arts and Libraries	600	620	620	640	*+20*
DHSS—Health & Personal Social Services	15 420	16 270	16 200	16 480	*+210*
DHSS—Social Security	37 200	39 520	39 510	39 990	*+470*
Civil Superannuation	1 050	1 130	1 130	1 070	*−60*
Scotland	6 550	6 720	6 700	6 810	*+90*
Wales	2 560	2 650	2 640	2 660	*+10*
Northern Ireland	4 030	4 220	4 210	4 240	*+20*
Other Departments	2 070	2 160	2 150	2 130	*−30*
Nationalised Industries	1 830	1 140	1 060	1 320	*+180*
Local authority current expenditure not allocated to departments	660	400	400	600	*+200*
Special sales of assets	−1 900	−2 000	−2 000	−2 500	*−500*
Reserve	2 750	3 750	3 750	3 000	*−750*
PLANNING TOTAL(5)	**126 300**	**132 100**	**131 700**	**132 000**	*−100*

Notes

(1) Some figures may be subject to detailed technical amendment before publication of the 1985 Public Expenditure White Paper.

(2) Departments' figures shown are rounded to the nearest £10 million; the planning total is rounded to £100 million.

(3) All columns include minor classification changes since Cmnd 9143. The revised plans column also includes a transfer of provision for London Regional Transport of some £330 million from Department of Transport to Nationalised Industries; and a transfer for work-related non-advanced further education of some £60 million from Department of Education and Science to Department of Employment (see paragraphs 2.13, 2.14 and 2.26).

(4) Provision in these programmes reflects an assumption that central government rates of pay and allowances will increase on average by 3 per cent from due settlement dates.

(5) Excludes double counting of £290 million of agricultural spending in Scotland and Wales which is also included in the Agriculture total.

Public spending 1979–80 to 1985–86

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

	Planning total £ billion		
	Cash([1])	Cost terms([1,2]) base year 1983–84	Public([3]) expenditure as % of GDP
1979–80([4])	76·9	111·7	39½
1980–81([4])	92·7	113·5	42
1981–82([4])	104·7	116·5	43½
1982–83([4])	113·4	118·4	43
1983–84([4])	120·3	120·3	42½
1984–85([5])	126·3	120·6	42
1985–86([6])	132·0	120·6	41

([1]) Figures are rounded to the nearest £0·1 billion.

([2]) Cash figures adjusted for general inflation as measured by the GDP deflator at market prices. The GDP deflator is forecast to increase by some 4¾ per cent in 1984–85 and 4½ per cent in 1985–86 as shown in para 1.60.

([3]) Planning total plus net debt interest, refunded payments of VAT by local authorities and central government and an allowance for non-trading government capital consumption, expressed as a percentage of GDP at market prices.

([4]) Outturn/estimated outturn.

([5]) Plans in Financial Statement and Budget Report 1984–85, table 5.5, adjusted for subsequent classification changes. For estimated outturn, see paragraph 1.58.

([6]) Plans as in Table 2.1.

External Financing Limits

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

	£ million([1])
National Coal Board([2])	723
Electricity (England and Wales)	−1 128
North of Scotland Hydro-Electric Board	9
South of Scotland Electricity Board	191
British Gas Corporation	−352
British Steel Corporation	360
Post Office	−70
National Girobank	−3
British Airports Authority	−21
British Railways Board	918
British Waterways Board	45
National Bus Company	48
Scottish Transport Group	13
British National Oil Corporation([3])	−3
British Shipbuilders([4])	36
Civil Aviation Authority	27
Water (England and Wales)	203
London Regional Transport	323
Total	**1 319**

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

([2]) Provisional. To be reviewed at the end of the current industrial dispute.

([3]) 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.

([4]) This single figure for British Shipbuilders includes an allowance for some receipts from the privatisation of warshipbuilding yards.

3. National Insurance Contributions

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

—that the full 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;

—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 gross contributions to 9 per cent.

—that employers should be relieved of the cost of the national insurance contributions they make on payments under the statutory sick pay scheme.

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, are 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;

—that the underlying rate of increase in earnings will decline from about 7½ per cent between 1983–84 and 1984–85 to about 7 per cent between 1984–85 and 1985–86;

—that as a result of lost earnings in the coal industry, actual earnings in 1984–85 are 7 per cent higher than in 1983–84, and consequently average earnings in 1985–86 are assumed to be 7½ per cent higher than in 1984–85;

—that the movement in prices between May 1984 and May 1985, which is the relevant period for the November 1985 benefit uprating, will be 4¾ per cent.

3.03 The estimated effects of the proposed changes are shown in the table opposite. The table includes the effects of the abolition of the national insurance surcharge announced in the 1984 Budget.

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	880	—	880
National Insurance Contributions	10 730	10 120	20 850
Total	**11 610**	**10 120**	**21 730**
1985–86			
National Insurance Surcharge	30	—	30
National Insurance Contributions	11 650	11 040	22 690
Total	**11 680**	**11 040**	**22 720**
Analysis of change			
Change from abolition of NIS([2])	−850	—	−850
Change in NI contributions from increased earnings etc([3])	+860	+820	+1 680
Change in NI contributions from increase in earnings limits	+100	+100	+200
Change from rebate of employers NI contributions on statutory sick pay	−40	—	−40
Total change	**+ 70**	**+920**	**+990**

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

([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.

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 for 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.

4.04 Where appropriate the figures set out below show the effect of indexation by an illustrative $4\frac{3}{4}$ per cent. This is in line with the annual rate of increase in the RPI forecast for the fourth quarter of this year (table 1.10).

Indexation of allowances, thresholds and bands for 1985-86

4.05 With indexation by $4\frac{3}{4}$ per cent, the 1985–86 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

Allowances	1984–85 £	1985–86 £
Single and wife's earned income allowance	2005	2105
Married allowance	3155	3305
Additional personal and widow's bereavement allowance	1150	1200
Single age allowance	2490	2610
Married age allowance	3955	4145
Aged income limit	8100	8500

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

Indexation: Capital Taxes

Table 4.2 Capital Transfer Tax

Rate on death	Lifetime rate	Bands of chargeable value	
per cent	per cent	1984–85 £'000	1985–86 £'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	156–194
50	25	185–232	194–244
55	27½	232–285	244–299
60	30	over 285	over 299

Table 4.3 Capital Gains Tax

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

Indexation: Costs

4.06 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:	860		1115	
Increases in main personal allowances		770		960
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

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. The table also illustrates the effects of changing both the main personal allowances *and* higher rate thresholds by 1 per cent and 10 per cent of their 1984–85 values. All the cost and yield figures assume that the 1984–85 levels are first indexed and are therefore in addition to the costs arising from indexation as set out in table 4.4. 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 the nearest £1 million or £5 million, 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 pro-rating 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, particularly where a number of interacting changes are included.

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

£ million at forecast 1985–86 income levels

Ready Reckoner: Income Tax

	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 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 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.

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 $4\frac{3}{4}$ 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.

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)

	$4\frac{3}{4}$% 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	0·9	85	1p	5·0	90
Wine (bottle of table wine 70 cl)	63·4p	3·5	25	1p	1·4	$7\frac{1}{2}$
Spirits (bottle)	£4·64	25·4	30	1p	0·2	1
Tobacco (20 kingsize cigarettes)(4)	76·2p	3·6	115	1p	1·3	35
Petrol (gallon)	78·0p	4·3	210	1p	1·1	50
Derv (gallon)	65·8p	3·6	55	1p	1·3	15
VED (cars and light vans)	£90·00	£4·27$\frac{1}{2}$	80	£1	1·1	19

(1) An 'across the board' revalorisation by $4\frac{3}{4}$ per cent (including the minor duties not shown above) would yield about £625 million in a full year, and the impact on the RPI would be to raise it by less than $\frac{1}{2}$ 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.

Printed in the UK by Her Majesty's Stationery Office
3159456 Dd 502012 C55 11/84
ISBN 0 10 201285 7

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