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PRIME MINISTER

AUTUMN STATEMENT: FORECAST FISCAL ADJUSTMENT

We have on several occasions discussed the problems which arise from publishing in the Autumn Statement a forecast of the size of the fiscal adjustment - ie the scope for the tax cuts or expenditure increases - which may be available in the next year's Budget.

We first published a fiscal adjustment forecast with the new Autumn Statement in 1982. These forecasts are, inevitably, always highly uncertain. They are based on revenue and expenditure estimates, all of which are subject to major uncertainties; the revenue forecasts are themselves based on conventional assumptions of revalorisation and unchanged tax rates; and the fiscal adjustment forecasts rest, too, on an assumption for the PSBR - normally that shown in the previous Budget's MTFs. We have stressed these uncertainties on every possible occasion, and have drawn attention to the large differences in earlier years between the fiscal adjustment actually made in the Budget, and that which had been forecast in the preceding autumn.

But many commentators including market analysts have chosen to ignore all this. Last year, you will recall, attention focussed heavily on the forecast fiscal adjustment, which was invested with a quite unjustified significance. There was even speculation that the true figure might be considerably larger than the £1½ billion we published. This speculation unsettled the markets - where there were fears that we might be relaxing our determination to maintain downward pressure on inflation. This contributed to sterling's difficulties in the early part of this year which you will remember very clearly.



I do not believe that we should run these risks again, and I have gone out of my way to say so - to the TCSC and more widely. So I suggest that we take a final decision to revert to earlier practice and publish no forecast of the fiscal adjustment. This, in turn, will mean publishing no revised revenue forecasts - since commentators would otherwise themselves be able to derive a 'government' fiscal adjustment forecast from our other published figures.

There will certainly be some criticism of this, probably led by the Treasury and Civil Service Committee, with accusations that we are being needlessly secretive, going into reverse on the reforms introduced by Geoffrey Howe, and so on. In handling this we will be much helped if we publish in the Autumn Statement - for the first time and as requested by the TCSC - three years' expenditure figures rather than only one. I hope colleagues will agree to a proposal to this effect at the next Cabinet discussion of public expenditure.

I have consulted John Wakeham about all this. John agrees that we need to activate sympathetic backbenchers (of whom there are quite a few) to speak out and not leave the floor to the TCSC and other critics. I intend, too, to write to Terence Higgins as Chairman of the TCSC, informing him of our decision, stressing the uncertainties and dangers of the fiscal adjustment forecast, and suggesting that, because it is a forecast of no operational significance and on which no decisions are based, its disappearance is no real loss. I hope at the same time to be able to tell him that we will be improving the information we give the House by publishing three years' expenditure figures in the Autumn Statement.

You may find it helpful to have the attached copy of the briefing material we have prepared, to assist the presentation of this decision.

A handwritten signature in dark ink, appearing to be 'N.L.' with a flourish.

N.L.

28 October 1985

DRAFT AUTUMN STATEMENT BRIEF

FORECAST FISCAL ADJUSTMENT

Factual

1. The Autumn Statement this year gives 3 years' expenditure plans.
2. There are no forecasts of revenue in the Autumn Statement in any of the 3 years.
3. And it does not therefore subtract the one from the other to give a fiscal adjustment. The practice of calculating the fiscal adjustment for the year ahead has been discontinued.

Positive

1. Providing expenditure plans for 3 years ahead is a new step. It gives Parliament more information than in the past. It responds to a request from the Treasury and Civil Service Select Committee.
2. The fiscal adjustment calculation for the year ahead which has been dropped was pure arithmetic. It imparted no genuine new information. It was the difference between decisions and a forecast based on conventional assumptions.
3. The fiscal adjustment calculation, first introduced in 1982, has been increasingly misinterpreted as giving a guide to the Government's intentions in the forthcoming Budget. Notwithstanding repeated health warnings, it has caused damaging speculation at home and ferment in the financial markets. It played a large part in the sterling slide in the winter of 1985. The Government has accordingly decided to drop it.

4. The proper time to give this information is in the Budget. The MTFs figures are reviewed then. And the revenue forecasts will inevitably be different from those based on present information which is incomplete and out of date by the time of the Budget.

Defensive

1. Removing fiscal adjustment a retrograde step? Government something to hide. No. Old fiscal adjustment figure no more than arithmetic. Based on difference between Government's decision on expenditure plans and forecast revenue (on which no decisions were made), and on PSBR as shown in the last year's MTFs. In the past Autumn Statement forecasts of fiscal adjustment made in subsequent Budget were subject to a margin of error of $+\pounds 1\frac{1}{2}$ billion. New revenue forecast prepared and MTFs itself further reviewed before the Budget. Fiscal adjustment figure published in Autumn Statement therefore very uncertain (but commentators frequently overlooked this).

2. No fiscal adjustment means commentators cannot use Autumn Statement to produce their own Budget representations - defeats purpose of Autumn Statement. Fiscal adjustment forecast never intended to be basis for Budget representations. Subject to a margin of error; gave little useful information; and no operational decisions could or should have been based on it. It is partly because commentators interpreted it as basis for Budget representations, that Government has now decided to discontinue publishing forecast fiscal adjustment.

3. Withholding Information from Parliament. Fiscal adjustment figure included for first time when Autumn Statement introduced in 1982. Always expected that Autumn Statement would evolve over time. Experience shows fiscal adjustment not helpful and can be damaging, so now dropped. Autumn Statement, however, further developed to include 3 years' expenditure plans.

4. Treasury must have produced, internally, revised revenue forecasts for 1986-87. How can you justify not giving them? Many more forecasts produced internally than are published. No

Presumption that they should all be published, particularly when no operational decisions based on them. Indeed, presumption is of no unnecessary publication of information where it is market-sensitive (eg interest rates). Publishing revenue forecasts could lead commentators to derive implied Government fiscal adjustment forecast. Experience shows such speculation, when apparently based on Government figures, (which inevitably have special status) can unsettle the markets. Plenty of outside forecasts available.

5. Autumn Statement unbalanced - three years' expenditure figures but not revenue. Not comparing like with like. Expenditure plans are outcome of Government's decisions on programmes. Revenue figures published in Autumn Statement are forecast with no policy commitments. Revenue and expenditure brought together in the MTFs at Budget time. Government has never undertaken to update MTFs in the Autumn Statement.

6. What about 'revenue determines expenditure'? Revenue does indeed determine expenditure. As Chancellor told TCSC in April, the 1985 "Green Paper sets out very clearly the taxation objective in the medium term which determines what public expenditure we think we can afford" - eg that it should remain flat in real terms. MTFs reviewed each year at Budget time against this background; revenue and expenditure totals then determined. Autumn Statement gives departmental breakdown of these totals and is not itself an update of MTFs.

7. Government could publish fiscal adjustment and give adequate warning about uncertainties. Experience shows warnings are not heeded. Extensive "health warnings" in 1984 - eg in Chancellor's oral statement on 12 November and in printed Autumn Statement:

"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."

Warnings repeated by the Chancellor in his Sunday Times article, "A Budget for Jobs", Sunday, 30 December.

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"(And may add that I wish I were as confident as the press appear to be that I will have even half the scope for tax cuts that they write about)".

Background

Forecasts of the economic prospects for the year ahead have been published twice a year, as required by the Industry Act 1976. The Act gives considerable discretion over what to publish, and there is no requirement to publish forecasts of the revenue, the PSBR or the implied fiscal adjustment.

Until 1982, the IAF did not include revenue forecasts. It included expenditure forecasts and some indication of the unconstrained PSBR - ie the difference between expenditure and revenue (the latter forecasts being prepared within the Treasury, based on conventional assumptions about indexation and revalorisation, but not themselves published).

In the 1980s pressure began to build up in favour of a 'Green Budget'. (It took the form of the Armstrong Report on Budgetary Reform in 1980, and the TCSC Report on Budgetary Reform in 1982.) This would involve publication, about 3-4 months before the Budget, of a Green Budget - ie the Government's 'whole economic and fiscal strategy' in provisional form. It would give revenue projections based on a revised MTFs, the Government's view of the fiscal adjustment and alternative packages for using that fiscal adjustment.

The Government responded in October 1982, saying that an early update of the MTFs, or making early proposals for tax decisions, would mean taking decisions earlier than necessary; relying on incomplete economic information; and running the risk of requiring a change of direction in mid year. But, in their response to the TCSC Report, the Government agreed to publish an Autumn Statement which would include estimates of revenue, expenditure and borrowing in an expanded Industry Act forecast. The Government added, in its response, that it expected the contents of the Autumn Statement to evolve over time.

No commitment was made to publish a fiscal adjustment, but, in practice, each of the 3 Autumn Statements beginning in 1982 has

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included a quantified but heavily qualified assessment of what fiscal adjustment was implied by the expenditure, revenue and borrowing figures (the latter figure being that set out in the previous MTFS). Chancellors have not themselves emphasised the significance of the fiscal adjustment, except in 1983, when the Chancellor spent some time during the Autumn Statement debate discussing why the Autumn Statement showed a negative fiscal adjustment (ie an increase in taxes) for 1984-85. In the 1982 and 1984 Autumn Statements there was a small positive fiscal adjustment (£1 billion and £1½ billion respectively); the table attached compares the fiscal adjustment in the Autumn Statement with the actual adjustment made in the following Budget.

In April 1985, the Chancellor told the TCSC:

"I must say I have increasingly, during the time that I have been Chancellor, come to feel that the practice in the Autumn of giving a fiscal adjustment and an implicit forecast for the PSBR for the year ahead does far more harm than good. It conveys no useful information really, because no Budget judgement has been taken at that time and, as for the forecast of the PSBR, it is subject to an enormous margin of error and all it does is create misapprehensions of one kind and another and then one has to spend a lot of time trying to correct those misapprehensions. I must say, and I say it to you, Mr Chairman, I think in the light of experience this is not really a very helpful practice, and it might well be sensible to discontinue it.

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AUTUMN STATEMENT

PREDICTION OF FISCAL ADJUSTMENT

Date of Autumn Statement	Forecast for	PSBR		Fiscal adjustment*			£ billion
		Autumn Statement forecast	FSBR forecast	Forecast in Autumn Statement	Made in FSBR	Difference ^o (4) - (3) - (2) + (1)	Error ^o as a proportion of original forecast
		(1)	(2)	(3)	(4)	(5)	
1982	1983-84	8	8.2	+1	+1.7	+ $\frac{1}{2}$	50
1983	1984-85	8	7.2	- $\frac{1}{2}$	-	+1 $\frac{1}{4}$	250
1984	1985-86	7	7.1	+1 $\frac{1}{2}$	+0.7	- $\frac{3}{4}$	50

* + = lower taxes

^o adjusted for difference in PSBR forecast;
+ = higher adjustment in FSBR