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FROM: A P HUDSON

DATE: 31 October 1988

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Phillips
Mr Odling-Smee
Mr ~~Luce~~ Mr Sedgwick*
Mr Turnbull
Mr MacAuslan
Mr Gieve
Mr Pickford
Miss J C Simpson
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Footman (Bank)
Mr Gray (No. 10)*

* with first half

**AUTUMN STATEMENT: ORAL STATEMENT:**

**CHANCELLOR'S DRAFT, SECOND HALF**

... I attach the second half of the Chancellor's own draft of the Oral Statement.

2. Please could I have comments as soon as humanly possible. We cannot guarantee to take in comments received after ~~7 pm~~ 7.30 pm.

AH

A P HUDSON

**AUTUMN STATEMENT 1988: ORAL STATEMENT:**

**CHANCELLOR'S DRAFT**

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

2. Cabinet today agreed the Government's public expenditure plans for the next three years. I can therefore set out for the House this afternoon the public expenditure plans for the next three years, and the expected outturn for this year; proposals for national insurance contributions; and the forecast of economic prospects for 1989 required by the 1975 Industry Act.

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

<u>Public expenditure</u>

4. I turn first to public expenditure.

5. For the current financial year, 1988-89, the public expenditure planning total now looks likely to amount to £154½ billion, or some £3¼ billion less than was allowed for in the last Public Expenditure White Paper. In other words, only around £¼ billion of the £3½ billion reserve I provided for is in fact likely to be needed.

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

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

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

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

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

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

12. For 1990-91, however, while these two factors persist, the planning total has been set at £179½ billion, some £3¼ billion more than the previously published figure. For 1991-92, the planning total has been set at £191½ billion.

13. These totals include the same level of reserves as in last year's plans; that is to say £3½ billion in the first year, £7 billion in the second year, and £10½ billion in the third. They also incorporate an unchanged estimate of privatisation proceeds of £5 billion a year.

14. Over the three survey years as a whole, the new planning totals imply a real growth in spending on programmes of over 3 per cent a year. But thanks to a fall in the burden of debt interest as a result of the dramatic improvement in the Government's finances from Budget deficit to Budget surplus, overall public spending, excluding privatisation proceeds, will rise by less than 2 per cent a year, well within the prospective growth of the economy as a whole. In other words, total public spending, excluding privatisation proceeds, will continue to decline as a proportion of national income.

15. But, at the same time, substantial additional funds have been made available for the Government's most important public expenditure priorities. The figures I am about to give all represent increases over the plans in the last Public Expenditure White Paper.

16. First, health. An extra £1¼ billion is being provided for the National Health Service in England in 1989-90, and an extra £1½ billion in the following year. There will, of course, be corresponding increases in Scotland, Wales, and Northern Ireland. On top of that, health authorities are expected to receive an extra £100 million a year from sales of surplus land. Continuing the rate of cost improvement savings achieved in recent years will produce an extra £150 million in 1989-90 and an extra £300 million the following year. In addition, the Government is accepting the recommendation

of the Government Actuary, in a report published today, that NHS employers' superannuation contributions in England and Wales should be reduced, which will save the Health Service in England alone almost £300 million a year.

17. In total, the increases for the Health Service in the UK as a whole will be over £2 billion in 1989-90, which represents a real increase of 4½ per cent on this year's outturn, and over £2½ billion in the following year. These are [by far] the largest increases the Health Service has ever received, not just in cash terms, but in real terms, too.

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

19. Third, housing. Gross provision for public sector housing investment is being increased by over £400 million a year. But thanks to the success of the Government's right to buy policy, this is more than financed by extra receipts.

20. Fourth, law and order. An extra £290 million has been made available in 1989-90 and £430 million in 1990-91, principally for a further expansion in the prison building programme. This will provide a further

3,000 places by 1991-92. Provision for local authority spending on the police has been increased by £240 million.

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

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

23. On science and technology, we have altered the balance of public support within an increased total. In particular, provision for spending by the Department of Education and Science has been increased by £120 million a year, with the science budget up by 11 per cent in real terms in 1989-90. This reflects the importance the Government attaches to basic and strategic research.

24. The new plans imply an overall increase of £2½ billion in public sector capital spending in 1989-90.

This includes extra investment in hospitals, housing, prisons, and roads. There is provision for higher investment by the nationalised industries, including further anti-pollution measures by the Water Authorities. We have also provided in full for all the new safety measures identified by London Regional Transport following the King's Cross disaster.

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

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

27. I turn next to National Insurance Contributions.

28. The Government have conducted the usual autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the National Insurance Fund, and taking account of the statement on benefits which my Rt. Hon. Friend the Secretary of State for Social Security made on 27 October.

29. The lower earnings limit will be increased next April to £43 a week, in line with the single person's pension, and the upper earnings limit will be raised to £325 a week. The upper limits for the 5 per cent and 7 per cent reduced rate bands will also be increased, to £75 a week and £115 a week respectively. The upper limit for the 9 per cent rate for employers will be raised to £165 a week.

30. Over recent years, we have steadily reduced the Treasury Supplement, the taxpayer's contribution to the National Insurance Fund. From 18 per cent in 1979, it now stands at 5 per cent. My RHF and I now propose to carry this policy to its logical conclusion and to abolish the Supplement altogether. The necessary legislation will be introduced early in the new Session.

31. However, because of the healthy state of the National Insurance Fund, this decision will not require

any increase in contribution rates. Thus, the main Class I contribution rates will remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

32. Finally, I turn to the Industry Act Forecast.

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

34. The continuing vigour of the British economy is testimony to the transformation that has taken place in the supply side of the economy; a transformation which has enabled the seven years to 1988 to record a combination of strong and steady growth unmatched since the War.

35. As a result, unemployment has been falling rapidly. Since the middle of 1986, it has fallen by very nearly one million - the fastest fall on record, and faster than in any other major country.

36. Inflation, as measured by the retail price index, is likely to be a little over 6 per cent in the fourth

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

37. Exports have continued to perform well, with manufactured exports up 7½ per cent over the past year. Over the past seven years, the UK's share of world trade in manufactur~~ing~~ed goods has remained steady after decades of decline - and indeed has risen slightly over the past two years. However, with investment booming, and consumer spending increasing fast, imports have grown even faster than exports, rising by 13 per cent in the year to the third quarter. This has led to a substantially greater current account deficit than I forecast at the time of the Budget. For 1988 as a whole, this now looks like turning out at some £13 billion, equivalent to 2¾ per cent of GDP.

38. The stronger than expected economic growth this year means that total tax revenues are likely to exceed the Budget forecast by £3½ billion. Both income tax and VAT have been particularly buoyant.

39. In the Budget, I set a Public Sector Debt Repayment - or PSDR - for 1988-89 of £3 billion, equivalent to around ¾ per cent of GDP. With higher than expected Government revenues and lower than expected public expenditure, this year's PSDR now looks likely to turn out at some £10 billion, equivalent to over 2 per cent of GDP.

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

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

42. The slower growth forecast for 1989 inevitably implies a marked deceleration during the course of the year, particularly so far as domestic demand is concerned. Thus, comparing the second half of next year with the second half for this year, overall growth is forecast at 2½ per cent, and growth in domestic demand at only 1½ per cent.

43. The current account deficit is likely to remain high, at some £11 billion or 2¼ per cent of GDP, but is forecast to be on a pronounced downward trend by the end of the year.

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

45. In short, after two years of unexpectedly rapid expansion, growth next year is forecast to return to a sustainable level, and one which compares well with the economic performance of the '70s; while inflation will resume its downward path. The public finances are in substantial surplus and will remain so, with public spending on priority programmes continuing to increase, while overall public spending continues to fall as a share of GDP, to a level not seen for a quarter of a century.

46. The satisfactory prospect that lies before us is yet further testimony to the success of the policies we have been pursuing these past 9½ years, and to the economic transformation those policies have wrought.