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PART E

1986 BUDGET AUTUMN STATEMENT

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PART F

Autumn Statement
Budget 1986.
PART. ~~III~~

Start - 9 November 1986.
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THIS TRANSCRIPT WAS TYPED FROM A TELEDIPHONE RECORDING AND NOT COPIED FROM AN ORIGINAL SCRIPT: BECAUSE OF THE POSSIBILITY OF MIS-HEARING AND THE DIFFICULTY, IN SOME CASES, OF IDENTIFYING INDIVIDUAL SPEAKERS, THE BBC CANNOT VOUCH FOR ITS ACCURACY.

THIS WEEK/NEXT WEEK

RECORDED FROM TRANSMISSION: BBC-1 **DATE:** 9.11.86

MacCORMICK: Chancellor of the Exchequer , let me begin by picking up a couple of points made by your two Conservative colleagues in Vivi[redacted] White's report, Lord Bruce-Gardyne ([redacted]) saying you're taking some risks with inflation, Hugh Dyke's welcoming the policy as a return to normal Conservative policies. Don't both these remarks suggest that in effect you have done a U-turn?

NIGEL LAWSON, MP, CHANCELLOR OF THE EXCHEQUER: No, there's no U-turn at all. Let's, let's, you know I think that, if I may say so, commentators' vocabulary I find rather limited. And, you know, they have very few phrases that they can turn to, and U-turn is one of them and so they pluck that off the shelf. But let's look at the facts, what we're talking about is public expenditure, right? During the 10 years prior to our election in 78/79, that's the 10 years up to 78/79, public expenditure and this is indeed, this is total public expenditure to get the underlying trend, I strip away the privatisation proceeds altogether. Total public expenditure rose by 3% a year, in real terms. During our first parliament from 78/79 to 82/83, it rose at 2 1/4% a year, we got it down to that in real terms. During our second parliament from 82/83 now to this year, 86/87, the next four year period, it came down further to 1 3/4% in real terms. The figures that I gave the house on Thursday get it down further, to 1% a year in real terms. So will you tell me where and when the U-turn occurred?

MacCORMICK: Well, we used to hear ...

LAWSON: No, can you tell me?

MacCORMICK: Well, what, I'm trying to show a wider range of vocabulary than U-turn. We used to hear from the Government that public expenditure was virtually evil, that it was the old failed policies of throwing monies at things and would cause inflation, why is the increased public expenditure you've announced now not going to achieve these bad results?

LAWSON: NO, we've never said that. What we have said is that public expenditure needs to be got down as much as we can as a proportion of the total output and that the private sector take a larger and larger share of the total economy. And that is what we have achieved since 82/83 successfully and it's not just pie in the sky, we've achieved it ever since 82/83, and these plans would make it continue to do so. The argument for public expenditure has got nothing to do with the economy. Afterall, the vast amound of money we spend on Defence is because we consider it is important to have this country properly defended. When we spend money on hospitals it is because we need hospitals. But clearly when one is thinking of the economic performance of this country, one wants to get public expenditure declining as a share of the total economy. And therefore all we have to do and that's what I've sought to do, is strike a balance between the desire to get public expenditure a progressively smaller part of the total, while yet meeting these basic economic needs, non-economic needs for defence for the police, for health, the whole National Health service, and for Education.

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MacCORMICK: Now, let me just contrast something you yourself said a little while ago at the Conservative Party Conference, on this point, because you talked about not engaging in an irresponsible spending spree,

LAWSON: Quite right ....

MacCORMICK: And, and and never taking risks with inflation, and yet your former Treasury colleague, Lord Bruce Gardyne [redacted] has just been saying he thinks you are taking risks, and he says that you should cash in on what you've now decided to do as quickly as possible. That sounds as if he thinks you are on a pre-election spending spree.

LAWSON: No, he's always been of an apprehensive temperament, he was a very good Minister when he was a Minister, but he's always been of an apprehensive temperament. I don't believe, that, by any stretch of the imagination, when you have public expenditure continuing to decline, as a share of the total national output, you can call that an irresponsible spending spree. The problem was, that under previous Governments, we had public expenditure progressively going up as a share of total national output. And that caused many of the problems that we inherited when we came into office in 1979.

MacCORMICK: So if you're not doing very much really, is your colleague Hugh Dykes wrong to welcome, as a great improvement, what you announced last Thursday?

LAWSON: I'm very glad that the whole of the party from one end to the other, has supported and approved of what I announced, and I think that shows the unity of the Conservative Party which is something which I welcome.

MacCORMICK: What about Bryan Gould's comment on the film there, that you now have to explain to the electorate whenever that explanation has to be made, why in his words, you went haring off in the wrong direction for seven years before you changed your approach?

LAWSON: But as I explained we haven't changed our approach, that's the whole point. And therefore the premise is wrong and the conclusion doesn't follow.

MacCORMICK: Well at least the rhetoric used to be wrong then.

LAWSON: No, no, that's not true, nothing has changed. If you take the fiscal stance, which after all, it is the public expenditure is not important merely in terms of the share of G.D.P., that's certainly important, but it's also important in terms of where the fiscal stance is. The balance between public expenditure and taxation, how much you have to borrow. And I've made it absolutely clear that there is no way in which this will lead to a penny piece of additional borrowing. So there is no change in stance.

MacCORMICK: On the fiscal stance, you've made it clear since your speech in the House last Thursday, that you still want to see reductions in Income Tax, are these still on in your next budget?

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LAWSON: I've never said anything about the next Budget, nor shall I, nor would it be proper for me to do so, and you wouldn't expect me to do so Donald, but certainly that is our objective on the taxation front. When we shall attain it, I don't know, but we've already got it down from 33 pence in the pound to 29 pence in the pound, that's four pence off. And we've got another four pence to knock off. And when we shall do it, I don't know, but do it we shall.

MacCORMICK: Perhaps something you would like to comment on, and could comment on, would be the report in at least one Sunday newspaper this morning that you personally would like another two Budgets to go before the next election, so that you might make further progress towards the goal, the ambition of 25% standard rate of income tax.

LAWSON: I would be very happy with that, but, as you know, the question of the timing of the election is a matter for the Prime Minister. But I will say this. That I am absolutely certain, that there is no quick dash to the country in mind, and certainly, when I was putting forward my proposals, I had to put forward my proposals, which I did, on the basis that we were going the full term, and not merely that, that we will be continuing in office after the election.

MacCORMICK: In other words, in spite of what Lord Bruce Gardyne ([redacted]) says again, I know he's got an apprehensive nature, but you yourself see no need .....

LAWSON: I know him very well, we wrote a book together once, and so I know his nature very well, and then it is, and that came out in that little ....

MacCORMICK: And discounting his psychological problems you ....

LAWSON: They're not problems....

MacCORMICK: (LAUGHS). You yourself see no need whatever to go to the country in 1987, sooner or later in that year, no imperative?

LAWSON: No imperative at all, it's a matter for the Prime Minister, she has all the options open.

MacCORMICK: Thanks very much in the meantime. Let's bring in our guests here, Chancellor, just for a moment or two, first of all, Paul Ormerod, Economist and Forecaster. What's your reaction to the Chancellor's repeated insistence that nothing has changed, the policies continue as they always have been.

PAUL ORMEROD, DIRECTOR, HENLEY CENTRE FOR FORECASTING: Well I think if we look at two different aspects and widen discussion somewhat, we can see quite clearly there has been a U-turn. First of all on monetary targets, the Chancellor was the author of the medium term financial strategy, which called for rigorous monetary targets. And gradually during the course of this year, they've been all but abandoned. But I think, more worryingly, in terms of the consumer spending boom, which is taking place, we have in 86 and 87 consumer spending growing nearly twice as fast as the economy overall, a classic pre-election boom, which is simply unsustainable. Uh, and I think that's a way in which Government economic policy has changed. First of all on monetary targets, but more generally in allowing simply a pre-election boom to take place.

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McCORMICK: What about these points specifically?

LAWSON: No, it's not true, on monetary targets, um, ever since I've been Chancellor of the Exchequer, we've targeted narrow money and broad money. The narrow money target we are well within the target range and remain there all the time. The broad money has become harder and harder to interpret, for reasons the Governor of the Bank of England set out at great length and very cogently in a lecture he gave at Loughborough, very recently. This is something which has been clear long before this year, it's not something new, it's something which I have alluded to myself in the past, we're certainly concerned with, certainly watch broad money very carefully, and that is why I continued this year with a broad money target, but it does require skill in the interpretation of it, and you cannot just look at the figures and conclude that they mean exactly what they used to mean, they don't. So it's a more complicated business and this is an opportunity for this country. And indeed the Germans, who I think have a very very fine reputation in monetary policy, in getting inflation down, has indeed. And the proof of the pudding is in the eating, and we've got inflation down. But if you look at the Germans, for the first time since they started targeting, in I think 1975, their monetary growth, they targeted a thing called Central Bank Money, is well above their target ranges. And yet they're not worried about inflationary upsurges in Germany, and I think quite rightly so, and it is a more complicated, more liberated, financially liberated world in which we live in, in which a certain amound of skill is needed in the interpretation of some of these aggregates.

PAUL ORMEROD
DIRECTOR, HENLEY CENTRE FOR
FORECASTING: Well I think if Mr Lawson could deal with my second point really in terms of the unsustainable nature of the consumer boom which is taking place. THis year consumer spending is growing twice as rapidly as national output ; and that's a pre-election boom of the sort we saw in '63-64, '72-73. It simply is unsustainable.

MacCORMICK: Are you saying that's a departure from the straight and narrow of previous Conservative policy?

ORMEROD: Oh yes indeed, it takes policy outside the medium term framework. It's simply short-termism, something Mr Lawson's accused the city of, but I think he's got a dose of it himself.

MacCORMICK: On that point -

LAWSON: No, I don't quite understand, I don't understand that point. If you look at the recovery that we've had since the trough of the recession in the middle of '81 as a whole, you will find that investment has actually risen faster than consumer demand overall, during the whole of that period including this year. And that's something which hasn't happened in previous recoveries. Now, it is perfectly true whatPaul Ormerod says, that this particular year - 1986 - consumer demand has been rising much faster. But the forecast for 1987 shows a less rapid rise in consumer demand, with consumer demand going up four percent in real terms. And, indeed, non-oil exports going up at five and a half percent in real terms and investment going up perhaps a little over - that's non-oil investment because we all know what's happened to the oil industry recently - non-oil investment going up at perhaps just a little bit over three percent. So in fact what it shows is a very balanced picture in 1987. And I think just to pick out one particular year, when for reasons that's got nothing to do with the Government consumer demand happens to have been going faster than other parts of the economy, I don't think that proves anything at all.

MacCORMICK: Let me bring in Tim Congdon at this point because you have been, ever since 1979, a staunch defender of the Government's monetarist approach. DO you now think that the Government has abandoned that or relaxed it too much or what?

TIM CONGDON
CHIEF ECONOMIST
L.MESSEL AND CO,
STOCKBROKERS: Yes, in two ways. First of all I agree with a lot of what the Chancellor has said about monetary control; there are problems in interpreting the figures. But there's also been in the last year an increase in broad money eighteen percent, compared with a typical figure in the early eighties of about eleven or twelve percent. Now, whatever the excuse is, that's a big change and it isn't really justified. The second thing I'd say is that the GOvernment set itself some targets for public expenditure. THose targets have been exceeded by about four billion pounds; perhaps in the event they exceed even more than that.

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CONGDON (Continued): Well, there are some problems there and there's all sorts of pressures that the Treasurer has to cope with. But if the Chancellor really believes in sound finance on honest money, it seems to me he should say afterwards: 'spending's gone up, we have to pay for it and we certainly can't cut taxes'. But then, a day afterwards, or two days afterwards we hear that the eventual goal is to cut taxes. And I think that isn't consistent. Much better to say if the country wants this extra spending then the country has to pay for it.

MacCORMICK: You yourself, Mr Lawson, said last Thursday you can't spend the same pound twice.

LAWSON: That's right. It's exactly the same point that Tim Congdon was making. You can't spend the same pound twice and taxes will be reduced only to the extent, and when, it is prudent to do so. There will be, as I indicated a moment ago, there will be not a penny piece of additional borrowing as a result of the expenditure, public expenditure, increases that I announced. These will all have to be fully met by tax revenues, every penny out of them. And the question is whether - and time alone will tell, and as I indicated earlier I'm not saying anything about the next Budget - the question is whether, over a period of time then we will be able to reduce taxes as well. THat is our objective, and I believe ultimately we'll be able to do it, but when I don't know. As for the monetory targets, may I refer briefly?

MacCORMICK: Yes do.

LAWSON: I think that what Tim - this is I'm afraid a little bit technical that's why I didn't do it before - but since TIm raised it, if you look at PSL II which is the better broad money aggregate to get an overall view, because what happens is that because the banks are engaging in mortgage lending, whereas previously it was the building socities,that causes particular problems with the interpretation of sterling M III. If you replace L II that's going up at eleven percent at the moment, it's nothing like the eighteen percent which Tim Congdon referred to.

MacCORMICK: Yes, but in broad layman's terms, in spite of the difficulties of the various measurements and so forth, perhaps the point Tim Congdon was making was, and the point Paul Ormerod was making as well, is that you have simply allowed too much money to go sloshing around the economy.

LAWSON: No, that's not so. And indeed it is very inconsistent. Most of my, at least most of my critics are very inconsistent. Because most of my critics, at the same time as they are saying there's too much credit, too much money sloshing around the economy - I don't believe there is - say that interest rates are far too high. Well, they really can't have it both ways. And the fact is that the GOvernment has been courageous and has raised interest rates when it has been necessary to do so, as quite recently, in order to keep monetory conditions on track. But you know people really can't accuse us at one and the same time of having interest rates too high and allowing monetory conditions to be too easy.

McCORMICK: Well we come on to interest rates and other details of economic policy shortly, but I want first of all to ask Lord Kearton, who is also with us, what, from where you sit as a member of an important Lords' economic committee, where you sit on how the Chancellor has behaved in his Autumn statement last Thursday?

LORD KEARTON
SELECT COMMITTEE OVERSEAS TRADE
1984-85: Well, I think it's politically a brilliant budget, in every way. There's something for everyone and politically he has in fact stolen most of the Opposition's clothes. He's doing things which the Opposition Parties have advocated, he's doing things which the so-called Wet Wing of the Tory Party advocated; and I think, in fact, he showed himself to be an extremely clever politician. And I think the way he's put the whole thing together, the whole package, again is extraordinary well done. So, one can only compliment the Chancellor most warmly on a very clever piece of work. But I share the apprehension of Jock Bruce-Gardyne and looking ahead, twelve months, two years, three years, I think the country could be in trouble. But discussing immediate effects of the budget, the immediate effects of the budget I think to be entirely beneficial.

MacCORMICK: Was there no ambition on your part last Thursday, Mr Lawson, to pinch a few clothes lying around?

LAWSON: Not at all, because the clothes that the Opposition Parties are wearing are horrific! Because what they are calling for is a massive increase in public expenditure, way way in excess of anything that -

MacCORMICK: Over five years is their proposal.

LAWSON: No, no. They're saying in the very first year there should be an extra ten billion, and they say that the borrowing requirement should go up by six billion. I am not proposing a penny-piece of additional borrowing. The policies of the Opposition would be absolutely disasterous for for this country's economy; you would have run-away inflation and all the problems we had in the seventies. I'm certainly neither stealing their clothes, nor have any ambition to wear their appalling garments.

MacCORMICK: To people sitting at home, Mr Lawson, that may sound as though you are saying that Opposition spending is sinful, your spending is virtuous.

LAWSON: It's a question of the quantity; it's a question of what the country can afford. What I have done is something which is well within what the economy and the country can afford. As I said, public expenditure under these plans will rise less rapidly than it has in the past in real terms, and will continue to decline as a share of total national output. Under their policies it would rise much faster than national output, and we would be int he hands of, bankrupt, and in the hands of the IMF before you could say 'Denis Healey'.

(VT FOLLOWS)

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MacCORMICK: Mr. Chancellor to begin by going back to the beginning of that report by Will Hutton, Norman Strauss there, who used to be in Mrs. Thatcher's policy unit said that the strategy now as revealed in the autumn statement, will do nothing to revive and restore those parts of Britain which are not sharing in prosperity and where so many people are out of work. What do you say to that?

LAWSON MP: They are sharing in the prosperity but it's quite true that they are not sharing it to anything like the same extent, it is absolutely true that there is a North-South divide, it's something which concerns me very considerably, it's why we do continue to have a regional policy, and it's something, which of course, has been with us for a very long time. I made a statement in Reading the other day, you may recall suggesting that one way of helping this is if there were some regional differentiation of wage rates, which certainly would help the situation very considerably, after all, living costs, housing costs and so on are very much more expensive in the South and it would make the North of England a more attractive place. This, of course, was howled down by trade union leaders, who I am afraid didn't show the same concern for the problems of these areas that I was in a practical way showing, but it is a very difficult point. But let's be absolutely clear, although there are these differences, if we get the economy as a whole doing better, then everybody benefits, including the people in the North of England, in Soctland and in Wales.

MacCORMICK: did you mean anything more specific than that, the economy as a whole improving, when you said last Thursday that the prospects for some fall in unemployment are now more promising?

LAWSON MP: Yes, I was talking about the economy as a whole. I was talking about the economy as a whole and I believe that is the case, although, of course, as I went onto say, this could be jeopardised if excessive pay increases are continued to be agreed. This is a very important point, it is not so much the pay, although that is..it is taking pay and productivity together, what is happening to unit labour costs in this country, particularly compared with our competitors overseas, and it is a responsibility for industry, and industry accepts this, CBI is not in dispute with me over this, it is a responsibility of industry itself, management, to keep a better control of their unit labour costs.

MacCORMICK: Well, let's go to our other guests now for a moment as well, Lord Kearton before we had Will HUtton's report, you were saying, you were hinting darkly that you saw grim troubles for the economy coming up, what are these and to what extent are these influenced by Nigel Lawson's admitted concern about wages going up too fast?

LORD KEARTON: If I can go backwards just a little bit, the Chancellor made great play of the fact that he is not raising taxes to pay for all these goodies he is handing out, in extra for education, extra for transport and so on, it depends on the buoyancy of revenue, fundamentally, on a very active retail sector and as was pointed out in the commentary, this depends on the consumer boom, which in fact is fuelled by imports. The Chancellor is really looking forward to a continuation of consumer boom, and making lots of retail profits and so on, which he will then pull back in part by taxes and thereby increase his ...outgoings. This completely under estimates the colossal danger to our balance of payments and I have lived through twenty years where the balance of payments constraints was thing which really was a single overwhelming factor at the back of all governments minds. The best part of twenty years all the stop go, the balance of payments difficulties,...the Chancellor is forecasting a balance of payments deficit for next year, one and a half billion. It can only be an opinion, but I think that is much too low. Again, I think is one starts looking ahead to 1988, 1989 and so forth, the oil revenues will certainly decline. Our oil production will decline, 1986 is probably the peak of our oil production, even the Chancellor's own statement he forecasts, a modest reduction for next year, a further reduction the year after, unless some absolutely major finds, which is extremely unlikely now that exploration has been cut right back, then we shall be down on our oil production, down on our oil revenue, down on our oil taxes, and, if I may say so, even getting to the stage of oil imports, all at a time when we are in trouble.

MacCORMICK: Are you arguing in effect that the gradual sort of disappearance of oil from the economy, very gradual of course, is going to take us back to the days of twenty years ago.

KEARTON: Yes, it isn't going to be as gradual as the governments hopes, if one looks at the profile of the fields, they have all continued in production much better than people expected, but the total reserves haven't altered, so when they do start declining, the decline will be faster than is traditional inoil fields.

MacCORMICK: Tim Congdon, do you share this view of Lord Kearton's about the balance of payments and the disappearance of oil and the implications of all that?

CONGDON: I don't...I think Britain will remain an oil exporter for many years, what always happens with these things...the jobbers just say one thing and then what happens in practice is quite different. Britain is essentially an oil exporter. The price of oil has fallen.

MacCORMICK: Even with exploration being reduced as Lord Kearton said.

CONGDON: In five years time the oil price will be fifty dollars a barrel and there will be more exploration, more development, thi this is one area where I think the critics are wrong. We have got very large foreign assets, eighty billion pounds or so, we have had a sequence of surpluses, if there is a small deficit in 1987, you have quite a large deficit, this is not something to worry about, I am worried much more about government policy, about government borrowing and about money supply growth, my criticism would be that we have had with the medium term strategy, we had five stable years and there have now been the two key parts of that strategy, monetary stability and low borrowing are now being threatened, and on the monetary side certainly, they have been broken and I think we are going to get, a little boom, perhaps quite a big boom, and there will have to be a correction of getting back into cycles and that's quite contrary to what the government said it was trying to do.

MacCORMICK: Well, I don't want to lose sight of that point and let me ask Paul Ormerod first of all, in specific of balance of payments dangers, foreseen by Lord Kearton, if you agree with that?

ORMEROD: Yes indeed, I think it's potentially a major problem facing the British economy, earlier this year the Chancellor forecast, well his forecast has changed by three and a half billion pounds through the course of 1986, he forecast a surplus, he now forecasts the balance of payments will be in balance, so I think the odds will be the Treasury's prediction next year of a deficit of a billion and a half, could be a substantial understatement and many outside forecasters looking at four or five billion pounds deficit on the balance of payments in 1987, which must be very worrying for the longer term future to the British economy.

MacCORMICK: Is it possible you have been too optimistic on that particular point?

LAWSON MP: Well, all forecasts are inevitably uncertain in subject to a margin of error, that's true and Paul Ormerod's forecast, just as much is as true of Treasury forecasts, I think it is fair to say, and I think the Economist recently did a study, which showed this, that the Treasury forecasts have a much better track record than outside forecasts, and we have made, sincerely the best forecast we can, and time alone will show whether it's right or not, but I think it is not at all surprising that there should be after a period, incidently, when we have had a cumulative surplus on the balance of payments current account of some twenty one billion pounds since we have been in office, there should be a short period of deficit, when you reckoned that the oil price has halved and also world trade has, because of the effects of the oil price fall and the commodity price fall in general, commodity price fall on a number of countries, world trade has fallen very considerably this year. It will, I think, rise again in 1987, but we have still got much lower oil earnings, but no, I believe that on this point that Tim Congdon's analysis is basically right.

MacCORMICK: You don't think that oil is going to become a gradually, decreasingly important part of the economy, thus hastening us back to the days as Lord Kearton fears, where the balance of payments constraint was a bug bear to chancellors of both main parties.

LAWSON MP: The output of, NOrth Sea output oil output, will be declining very gradually, certainly. Lord Kearton is quite right, 1986 is likely to be the peak year, but the decline will be a very very gradual one, much more gradual than he was implying, we have had a sharp fall in the value, because of the sharp fall in the price of oil, but that has happened that is behind us, we have coped with that, and I said, it is quite remarkable the way in which we have succeeded in coping with that and the fact that there is....the fact that it is a gradually declining trend from now on, to the end of the forecast period and no doubt beyond, is something we have fully taken into account in the forecast and in the policy.

MacCORMICK: What about Tim Congdon's other point though, that we have had five stable years and that's now been thrown onto confusion and uncertainty.

LAWSON MP: There is no confusion or uncertainty, and there is no , we are continuing this stability. It is very important indeed, I mean, when we launched, and I had some part in the launching of it, when we launched the medium term financial strategy in 1980, the words medium terms were just as important as the words financial strategy, it was a desire to get away from these short-term expediency chopping and changing all of the time into a steady policy, which would continue in business and industry would know where it was and everybody would know where they were, and that's better for the economy, and, as I say, this is what we are continuing to do, the borrowing requirement continues to be under control, continues to be coming down as a proportion of GDP, far far lower incidently, even if you don't include the privatisation proceeds, far far lower than it was in the early Seventies and..

narrow money, that is going along very satisfactorily within the target range. There is a particular problem, which we discussed a moment ago, about broard money, but I am satisfied that the broard money is not showing any signs of an upsurge in inflation, there is going to be a temporary ...inflation, as indicated in the forecasts I have put out, and then after that it will continue to come down again.

THIS WEEK/NEXT WEEK
9 November 1986

MacCORMICK: Paul Ormerod, do you regard the inflation, the prospects for that, as being as good as the Chancellor says?

ORMEROD: Well I think almost all outside forecasters, outside the Treasury, believe inflation next year will be higher for a variety of reasons. The credit boom, wage pressure, falls in sterling; people are really looking at five and six percent at the end of next year rather than three and a half percent. But I think if we could come back to this question of the balance of payments and the short-term unsustainable nature of Government policy. In '86, in volume terms, imports rising at five percent, exports rising at one percent, that simply can't go on. I think that is really the fundamental question facing the Government, but obviously, as I said earlier, I think also inflation will be rising. But the balance of payments is really the worrying problem for '87.

MacCORMICK: In that worrying problem, Lord Kearton, how important is the plight, as was said in [redacted] Hutton's report of manufacturing industry?
WILL

LORD KEARTON: Well, I thought what was brought out in [redacted] WILL Hutton's report very clearly was the fact that we 've under-invested in industry for a great many years. And one of the drawbacks of the very high exchange rates of '80-81 and so on, was its absolute loss in manufacturing capacity of about twenty percent. A great deal of the manufacturing investment in recent years has been to make what we were making rather more efficiently. But there's been no net expansionof industrial production. Two years ago Mr Lawson made a very celebrated speech at Cambridge in which he rather played down the importance of the manufacturing industry. And I was one of the people who really took some exception to that. The impression I have of some of his recent statements, he's changed his views a little bit and looking through his whole statement he's looking for improved performance in manufacturing industry and improved exports to rescue him in almost every way. SO, I'm very pleased he's converted to the view that manufacturing industry is critically important. I think getting manufacturing industry back to where we want it has been a long haul, and I think many of the steps the Government's taken, particularly in view, if I may say so, on vocational training, and I think that steps should be taken especially in education in order to get the universities more directly involved with manufacturing industry. Speaking, one of my own interests, I think the business of making chancellors, a lot of chancellors appointed recently have come from industry rather than from a state of distinguished social service or academia and so forth; I think the country's moving in the right direction. My worry is it's not going to move anything like fast enough to save some very serious trouble at the end of this decade.

MacCORMICK: Have you changed your mind a bit on manufacturing and its importance?

LAWSON: No, I've always felt manufacturing is very important. I think the speech which Frank Kearton took exception to - I was rather reacting to the people who were talking as if the economy was solely composed of manufacturing industry. Manufacturing industry was the only thing that existed or mattered, whereas in fact it is only twenty-five percent of the total economy; very important, very important -

MacCORMICK: Fifty percent of exports?

LAWSON: Fifty percent of exports, although if you look at our invisible earnings, these are one of the most important [redacted] parts of our foreign exchange earnings. But manufacturing exports I think, are going to go up next year. It's very important. I mean, our forecast is - and I say it's the best forecast we canmake - we have no interest whatever in putting forward phoney forecasts.

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9 November 1986

LAWSON: (continued) Our track record is a good one. Our manufacturing output going up four percent in real terms in '87, and non-oil manufacturing exports going up five and a half percent. Now that is a forecast of good news for manufacturing industry. And it's interesting that the most recent CBI survey bears up the fact that manufacturers are far more optimistic about the future than they have been for some time.

LORD KEARTON: I take with respect then, I agree the exports will go up. I think the exchange rate changes will make them go up. But we no longer make many things which the consumer wants. As the consumer boom goes on, as is made clear in Mr Hutton's report, we shall suck in a great many more imports which we no longer manufacture ourselves. This is where the danger of balance of payments comes along. The exports will grow, but imports will grow even faster.

LAWSON: May I just say one thing on what Paul Ormerod said about inflation. Every year that I've been Chancellor, the outside forecast has been forecasting a much higher rate of inflation than the Treasury has and every single year it is the Treasury forecast that has been right. I have to say too, that even if you took his figure of five to six percent inflation, which I don't accept would lead you to that figure, that is a lower figure than the Labour Government achieved for the whole of their period of office; not in a single month did they give anything like as low as that. Our achievement on inflation, getting it down from what it was, twenty-seven percent or something, under Labour to three percent today is a remarkable achievement and we are determined not to throw that away.

MacCORMICK: But would you be afraid that sterling might come under pressure because of the admitted balance of payments deficit you're going to have next year?

LAWSON: No, the market is well aware, the foreign exchange market is well aware that prospects of the balance of payments and that's already taken into account. But certainly, I have no wish to see sterling go any lower. There had to be a fall in the exchange rate in order to adjust for the very sharp fall in the oil price,that inevitably had to occur and that was explicit in my Cambridge speech, which frankly referred to some three years ago, that was not some sudden after-thought, some sudden change of policy. But that has now happened, and I don't wish to see it go any further down.

MacCORMICK: What do you think, Tim COngdon about that particular point?

CONGDON: Well, I think the Chancellor is taking some risks with inflation, and it's not just a question of what's happening to broad money, eighteen percent growth; it's also what's happening to house prices; they're up by about fifteen percent on a year ago, and there's still plenty of mortgage credit coming into the economy. And also on the exchange rate. Now some of that may be because of the fall in the oil price. But the last stage of the fall, in terms of against the deutchmark from about three forty to two eighty in the summer, was a very large fall in a period when the oil price was, if anything, firming up. SO it seems to me that on both the house price side, a leading indicator for general inflation, and the exchange rate that the Chancellor is wrong to be complacent.

cont'd /

THIS WEEK/NEXTWEEK
9 November 1986

CONGDON (Continued): There is more inflation coming ahead and I think the treasury forecast is far too optimistic. I think that, looking ahead, one of the key things is how, I'm sure that sterling is going to weaken in '87. It's an election year and there's going to be some jitters on the foreign exchanges. What's going to be very difficult to judge, and I feel Mr Lawson has a very difficult job here, is how he should react to a weak sterling. SHould he put interest rates up and blame it on the Opposition because the foreign people don't like what's happening in Britain, or is the exchange rate weak because of our own domestic monetary policy. And I feel that there's an argument that it is because of what we're doing and we won't take corrective action soon enough and then there's inflation coming through in '88 and 89.

1.4120 } 67.6
2.8350

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

[illegible]

~~[illegible]~~

~~[illegible]~~

MacCORMICK: Are these dangerous and how are you going to deal with them?

LAWSON: I think Tim Congdon's put his finger on one problem, which we've already seen, how, whether this problem will get any greater, uh, or whether it will diminish will depend on what people's, among other things, on what people think of the chances, uh, the possibility of the Labour Government getting into power at the next election. It is certainly true that the, those who hold sterling, are scared stiff of the damage, of the great economic damage, which they know very well a Labour Government would do, if it ever got into office. And that is something which I have to contend with. And it is, it may require interest rates to rise. If so, so be it. I certainly, that is a problem which is inherent in the situation, and it's not something which is going to come, it's something which is already there at the present time, but of course as it looks more and more likely that Labour won't win the next election, then maybe that particular problem which I do have to grapple with, may diminish, we shall see.

MacCORMICK: But interest rates might have to go up?

LAWSON: As I say, if there is pressure on sterling then that is how we have responded in the past, as Tim Congdon mentioned, and that is how we would have to respond in the future.

MacCORMICK: Turning to the whole question of the competitiveness of the British economy, including manufacturing, which is essential if the whole thing, if the growth on which the Autumn statment was predicated is to happen, what's you key prescription and requirement Paul Ormerod, for a more competitive British economy?

ORMEROD: Well I think it's really, it's a longer term solution, it's not one which is amenable to short term measures. But it does essentially require a balance in the economy which gives much more weight to investment. Certainly much more than we've seen in the last six or seven years. The Chancellor referred earlier in the programme to the good investment record in Britain in the last few years, but you know that's choosing a very selective date to start from 1981. Certainly in any international comparison investment as a share of national output has been very low in Britain since 1979, and has actually shown a weaker trend compared to previous 20 or 30 years, and I think for a longer term that's a very worrying aspect about the current stance of policy.

MacCORMICK: Lord Keaton, do you agree with that?

LORD KEATON: I agree entirely with what Paul Ormerod said. I think we're lucky, if I may say so, to have Mr. Lawson as Chancellor, because I think he's got great courage, and I think he's got great panache in many ways. And I think he works on the good old phrase "Let boldness be my friend" and I think he's being very bold, but he's going to need every ounce of luck which he can muster both for himself and for the country, to pull us through the next two or three years.

MacCORMICK: Care to respond to that paeon of praise?

LAWSON: Oh, I'm most grateful to Lord Keaton all generals need luck, that's well known. But I'd like to say this, that it's not just the quantity of the investment that matters, it's also the quality of investment, which is a long term process, Paul Ormerod's quite right. But one of the reasons why I made a very, introduced a very radical reform of the corporation tax system, the way in which we tax the corporate sector, the company sector in this country, in 1984, which was phased in and came fully into effect for the first time this year, was to create a climate, and I'm glad to see incidentally, that reform's now been emulated by the United States, but it was to create a climate in which we will get a better quality of

cont/

LAWSON (CONT): investment, and I think that is what we are seeing coming through, a better quality of investment, because that's what matters. The return that you get as a country from each pound of investment that takes place. It's not just the quantity of hardware that matters, but the quality of it.

MacCORMICK: Finally ....

LAWSON: The research and development too, it's not just hardware. And that's very important as has been said earlier.

MacCORMICK: Finally, Chancellor, just another question, on the timing of the next election. Lord Keaton has said you'll need all the luck you can get, you said every general needs that, but isn't there a case for going sooner rather than later in order to cut down the margin for luck that you need?

LAWSON: No I see no worries here beyond the normal worries and problems which there always are in an uncertain world, when we're subject to a lot of events throughout the world, beyond our control, and I am quite content to go the whole way until 1988, indeed it would have the advantage of an extra Budget this Parliament, but it is, as I said earlier, a matter for the Prime Minister.

MacCORMICK: Chancellor of the Exchequer, Lord Keaton, Tim Congdon and Paul Ormerod, thanks all very much indeed for taking part in the discussion today. And that's all from THIS WEEK NEXT WEEK until next Sunday at the usual time, one o'clock, please join us once again then, 'till then, from all of us here, Good Afternoon to you.

PH4/59

cc PS/CST
PS/Sir P Middleton
Mr Scholar
Mr Turnbull
Mr Fox
Miss O'Mara
Mr Culpin
Mr Dyer
Mr Fray
Mr Cropper
Mr Tyrie
Mr Ross Goobey

pup

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

Steven Wood Esq
Private Secretary to
The Lord Privy Seal
Privy Council Office
Whitehall
LONDON SW1

10 November 1986

Dear Steven,

AUTUMN STATEMENT: BACKBENCHERS' BRIEF

.. I attach a note which describes the circumstances in which the Backbenchers' brief on the Autumn Statement was prepared and circulated.

The note does not cover the more general issue of the role of Special Advisers (as set out, for example, in the Government's response to the TCSC Report on the duties and responsibilities of civil servants and Ministers).

I am copying this letter to David Norgrove (No.10) and Trevor Woolley (Cabinet Office).

Yours
Alex

A C S ALLAN

MR 1/66

pwp

AUTUMN STATEMENT: BACKBENCHERS' BRIEF

(1) The brief was prepared in the Treasury by a Special Advisor. There was no prior consultation about the contents with Conservative Research Department (CRD).

(2) The cover sheet was provided by CRD. Because of the sensitivity of the information, the brief was reproduced in the Treasury, under arrangements whereby the cost was charged to CRD.

(3) Two Special Advisors deposited the copies in the Whip's office at 3.30 pm with instructions that they were not to be opened or released before the Chancellor had sat down after delivering his Statement.

(4) This procedure was followed, and copies were not made available to backbenchers until after 4.00 pm.

(5) The only advance distribution (outside the Government) of material connected of the Autumn Statement was that the usual copies of the Oral Statement plus press notices were given to the leaders of the Opposition parties, the Chairmen of the PAC and TCSC etc at 2.50 pm. Special arrangements were made to help the Shadow Chancellor, and a copy of the material was given to him at 2.00 pm.

(6) Copies of the backbenchers' brief were included in the material circulated to other Cabinet Ministers during the afternoon.

(7) The brief was marked 'confidential'. This is standard practice for CRD briefing given to backbenchers.

RC2.78

Fray

FROM: CATHY RYDING

DATE: 10 November 1986

MR WALTERS

cc Mr Scholar
Mr Sedgwick
Mr Turnbull
Miss O'Mara
Mr Culpin
Mr Gray
Mr Allum
Mrs Dunn
Mr Dyer
Miss Evans
Mr Pickering
Mr Porteous
Mr Woodall
Mr Rawlings
Mr Roges
Miss Wallace
Mr Fray
Miss Titmus
Mr Jiwani

LESSONS FROM THE AUTUMN STATEMENT

Thank you for your minute of 17 November. Generally, given the very tight timetable, the Autumn Statement seemed to go very well from this offices point of view. This was due in no small part to the tremendous effort from the Registry and the Secretarial Unit. There were, however, a number of areas where there were problems and these together with our suggestions for improvements are detailed below.

Other Department's Press Notices

2. For the most part the arrangements for handling other Departments' press notices worked well and we agree they should be retained, subject to the changes suggested below, for future Budget and Autumn Statement exercises. However, two of the press notices from other Departments were very late indeed - DoE and Customs. (This was for the second year running in the case of DoE.) When the

DoE press notice arrived, the original back page was in error and a new back page had to be stapled on. There was no apparent reason for the late arrival of this press notice. In future years, and perhaps even for next year's Budget, it might be worth sending a special letter to DoE. The letter might point out that it is in DoE's interests to see that their press notices arrive in this office in good time for inclusion in the packages we dispatch. The message they want to get across will have much less impact if their press notices are not widely available.

3. We understand that the Customs' press notice was very late because at the last minute the Chief Secretary objected to the draft. It would be helpful to have details of the clearance procedure this press notice went through in order to see whether problems of this sort could be avoided in future.

4. More generally, it might be worth considering whether those Departments whose spending plans are finalised early on in the round could be given a much earlier deadline - rather similar to the procedure we adopt in the Budget.

5. Also, the fact that some Departments were issuing more than one press notice caused confusion in preparing the packages. It would be helpful if in future years these press notices could be separately packaged ie one envelope for each individual set of press notices. Also, it might be worth asking Departments issuing more than one press notice to put some markings on the front to distinguish them from one another.

Backbench material

6. It would be useful to consider well in advance whether any backbench material should be included in the packages circulated by this office. This year copies of the backbenchers brief were included in the packages for other Cabinet Ministers very much as a last minute thought.

Parliamentary Section

7. There was also a last minute problem with the number of packages required by Parliamentary section - in particular for the House of Commons Library. Although the Aide Memoire correctly specified the number of packages required by Parliamentary Section, it would be helpful if it could detail exactly who the packages are for. This office has to address the envelopes for the packages and this is very difficult if the information is not readily available in the Aide Memoire. This is very much in line with Miss Evans' point in your minute that the distribution on arrangements in the Annexes to the Aide Memoire were not easy to follow.

Outside Distribution

8. There was some confusion over the distribution of packages to Neddy, CBI, etc. (listed in the Aide Memoire as being the responsibility of this office) where we and the press office gave different times for collection of the packages. It might be worth investigating whether in future the press notice should handle all external distribution.

CR

CATHY RYDING

010/1289

FROM: **CHIEF SECRETARY**
DATE: **10 November 1986**

MR F E R BUTLER

cc:
Principal Private Secretary
Sir Peter Middleton
Mr Anson
Mr Monck
HEGs
Mr Culpin
Miss O'Mara

PUBLIC EXPENDITURE SURVEY 1986

Now that the Public Expenditure Survey for 1986 is (almost) completed I want to convey my thanks to all those involved in the Treasury. I have, once again, been impressed not only by the quality of advice and briefing often produced at very short notice but also by the unfailing good humour displayed in often trying circumstances. While I realise it would be wrong to single out divisions or individuals, the greatest workload inevitably falls on the General Expenditure and Running Costs divisions and their role in co-ordinating the Survey so efficiently and effectively is greatly appreciated.

2 I would be grateful if this message could be passed right down the line. I realise that much essential work is done behind the scenes by people who do not come to meetings, and I would like to take this opportunity to acknowledge their contributions as well.

John MacGregor

JOHN MacGREGOR

From: R B SAUNDERS

Date: 10 November 1986

MISS C EVANS

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Monck
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr Gray
Mr Culpin
Miss O'Mara
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Hudson
Mr Dyer

AUTUMN STATEMENT: FINAL PROOF AND PUBLICATION ARRANGEMENTS

Sir Peter Middleton has seen your minute of 7 November. He is content with the proof copy of the Autumn Statement attached to it. But he wonders whether it is really necessary, as suggested in your paragraph 4, to circulate the document before publication, since there is after all very little, if anything, that is new in it.

R B SAUNDERS
Private Secretary

pwp

FROM: A C S ALLAN
DATE: 10 NOVEMBER 1986

MISS C EVANS

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Butler
Mr Anson
Mr Monck
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr Gray
Mr Culpin
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2. The Chancellor is content with the Press Notice, subject to the addition of "full, printed" before "Autumn Statement".

3. On Chapter 1, he feels there can be no changes to the Press Notice. In particular, Mr Sedgwick's insertion about the margin of error on the PSBR would lead commentators to believe we were retreating from the forecast in the oral statement.

4. One omission from Chapter 2 is any reference to the pledge on the PSBR and the fiscal stance. The Chancellor would be grateful if Mr Scholar could draft a new paragraph to be inserted after the

present 2.04.

5. The Chancellor feels that paragraph 2.01 should be redrafted, after the first two sentences, to read:

> "These plans should ensure a continued deceleration in the growth of public spending. In real terms, the average growth in general government expenditure, excluding privatisation proceeds in order to show the underlying trend, is expected to be 1 per cent a year over the next 3 years (1¼ per cent for the planning total). This compares with growth averaging almost 3 per cent in the decade up to 1978-79, around 2¼ per cent in the period 1978-79 to 1982-83 and around 1¾ per cent in the period 1982-83 to 1986-87. The plans also provide for public spending to decline as a proportion of GDP, as it has done over the last four years. Between 1982-83 and 1986-87 there was a decline of [2½] percentage points. With economic growth continuing at present rates, there will be a further decline of more than [2] percentage points, bringing the ratio back to the levels of the early seventies. These trends are set out in tables 2.1 and 2.2".

6. The Chancellor feels that the penultimate sentence of 2.03 should be amended to read:

> "This in part reflects the fact that last year no decisions were taken about appropriate levels of local authority current expenditure in 1987-88 and 1988-89, and provision was set at the same cash level as in 1986-87, with an adjustment for realism in the shape of larger reserves for those two years".

7. In table 2.3 the heading "increase over 1985/86" should be "change from 1985/86 outturn" - and this needs to be carried through to the other tables.

8. The first sentence of paragraph 2.20 should be amended to read "Provision for gross capital expenditure on housing has been increased by about £450 million in 1987-88" - as in the oral Statement.

9. In paragraph 2.21 words "amounting to about £100 million over the 3 years" should be deleted. It is very important not to sum over several years.

10. Paragraph 2.22 should start "The revised plans take account of some increase in rent payments, and additional expenditure on maintenance on ....".

11. Paragraph 2.23 should start "Provision in 1987/88 has been increased substantially. This will allow for ....". More generally, the Chancellor feels the tenses in Chapter 2 need to be tidied up; at present the draft has "is", "has been", and "will be". He feels that we should say "provision has been" and, where appropriate, "spending will be".

12. In paragraph 2.25 "teachers pay offer" should be replaced by "package on teachers' pay and conditions of service".

13. The Chancellor feels that the original paragraph 2.30 should be reinstated and the sentence at the end of the previous paragraph deleted. He feels that otherwise there will be jibes about our hiding increases in unemployment in the footnotes.

14. In paragraph 2.33 what are the "other adjustments"?

15. In paragraph 2.34 delete the second sentence.

16. In paragraph 2.36 change "estimated" in the third line to "forecast".

17. In 3.01 move the mention of the cut in the Treasury supplement from second place in the list to last place.

18. In 4.02 amend the middle sentence to read "The fall in the oil price means that some fields will not start to generate profits on a scale sufficient to generate PRT liabilities until much later than expected..".

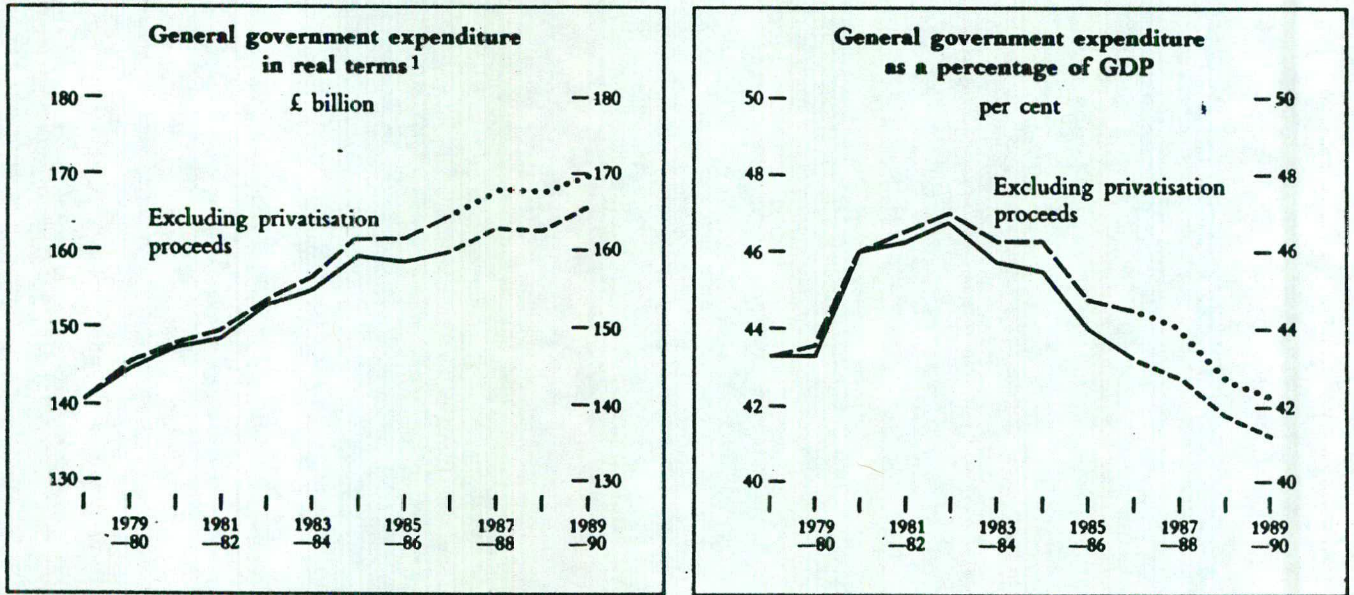
ACSA

A ~~C S~~ ALLAN

"Spot no U-turn"

As spoken

Public expenditure trends



1 Cash figures adjusted to 1985-86 price levels by excluding the effect of general inflation as measured by the GDP deflator.

AVERAGE GROWTH IN PLANNED PUBLIC SPENDING IN REAL TERMS COMPARED WITH PAST TRENDS

	1968-69 to 1978-79	1978-79 to 1982-83	1982-83 to 1986-87	1986-87 to 1989-90
GGE* excluding privatisation proceeds	2.9	2.2	1.7	1.0

* GGE (general government expenditure) is the combined expenditure of central and local government including net lending and debt interest.

PMP

From: R B SAUNDERS

Date: 10 November 1986

MISS C EVANS

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Monck
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr Gray
Mr Culpin
Miss O'Mara
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Hudson
Mr Dyer

c Miss Evans

Mr Allan

My instinct is to circulate. But we will do what you say,

MCS 10/11

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RBS

R B SAUNDERS
Private Secretary

31/2/4/1

1196/10

FROM: A C S ALLAN
DATE: 10 NOVEMBER 1986

MISS C EVANS

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Butler
Mr Anson
Mr Monck
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ACSA

A ~~C S~~ ALLAN

Bfwt advice

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CH/EXCHEQUER
REC. 11 NOV 1986 11/11
ACTION MR TURNBULL
COPIES TO CST FST EST MST
SIR P MIDDLETON
SIR T BURNS
MR F E R BUTLER
MR ANSON
MR SCHOLAR
MISS PEIRSON
MR NORTON
MR CROPPER

Alex Allan Esq
Private Secretary to the Chancellor
of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

10 November 1986

Dear Alex

Was sh accept x i

AUTUMN STATEMENT

My Secretary of State feels the Chancellor should be aware of the unnecessary embarrassment for the Treasury caused by the way in which territorial departments' expenditure was presented following his oral statement on 6 November.

He understands that the figures were aggregated in a line for "Territorial and Other Departments" to allow for any last-minute adjustments to territorial departments' figures as a result of changes in formula consequentials before the Autumn Statement is published. Such adjustments do affect the underlying figures right up until publication of the White Paper but Scottish Office officials had agreed with Treasury officials on 5 November the figures for the Scotland programme to appear in the Autumn statement so there should have been no difficult about revealing them with those of every other Department. I am afraid the result of the Treasury's aggregation has been to create mystery and confusion where there need have been none. This has enabled Opposition spokesmen to make mischief in a way which reflects embarrassingly upon the Treasury.

Mr Rifkind agrees with the Chancellor that the figures should not now be released until the Autumn Statement is published but in case this combination of circumstances whereby a table has to be published in advance should ever occur again, he wishes it to be clear that he would ask for the territorial departments' figures to be shown separately at the same time as everyone elses. x

I am copying this letter to Colin Williams (Welsh Office) and David Watkins (Northern Ireland Office).

Yours
Andy Running

for ROBERT GORDON
Private Secretary

JSS31403

PWP

FROM: A G TYRIE
DATE: 11 NOVEMBER 1986

CHANCELLOR

Discussed.

cc Chief Secretary
Minister of State
Financial Secretary
Economic Secretary
Mr Cropper
Mr Ross Goobey
Mr Culpin

AUTUMN STATEMENT BRIEFING

The attached note went out to the full circulation list for the weekly members' brief, Conservative members, candidates etc. as a special mailing last Thursday. In view of this I think it would be difficult to persuade the Party Chairman to give us a full side or more in next week's Members' Brief, the more so since they will have the Queen's Speech to cover.

2. Nonetheless I have asked for space; we should probably be able to get a section referring to the earlier brief, and making some of the points from your 'This Week, Next Week' interview. I have sent Judith Chaplin the transcript and she is preparing a draft.

A Tyrie

pp A G TYRIE

Conservative Research Department BRIEFING NOTE

THE AUTUMN STATEMENT

Public Spending Since 1982-83, public spending has been declining as a proportion of national output whether privatisation proceeds are included or excluded. It is set to fall again this year. The Statement reflects the Government's determination to ensure this trend continues. Within this constraint, the Government has announced increases in the planning total for 1987-88 and 1988-89, encompassing more spending in key priority areas such as education, health, housing, law and order and roads.

Strategy By 1989-90, public spending will be at its lowest level as a proportion of GDP since the early 1970s - 41½%. This will reduce the burden of the State on the private sector. Spending has been increased by £4¾ billion for 1987-88 and £5½ billion for 1988-89 within this overall constraint.

The economy is in its sixth year of steady growth while inflation stays at its lowest level since the 1960s. Growth should be faster next year than this, with manufacturing output increasing by 4%. In this upswing, fixed investment has risen at an annual average rate of 4½% whereas consumption has risen by 2¾%; by contrast, in Labour's upswing, investment increased by 1½% and consumption by 3% per annum.

Fiscal policy The Government's overall fiscal stance was clearly set out in the Medium-Term Financial Strategy published at the time of the Budget earlier this year. There will be no relaxation of that stance.

Labour's plans The profligacy of Labour's commitments which, when in full swing, would amount to a further £28 billion, would mean higher taxes, higher interest rates and probably lead to a repetition of IMF-imposed drastic cuts in capital spending. The last Labour Government cut road building by 36% and health service capital spending by 30%.

<u>Programmes</u>

<u>Local authority</u> spending current provision for 1987-88 has increased by £4 billion. The Aggregate Exchequer Grant, the contribution taxpayers make to local government spending, is up almost £1½ billion, about 10%, next year on this year's settlement. This generous provision should keep rate rises low, between 2% and 4% on average, if local authorities spend in line with plans.

<u>Education</u> provision for the DES in 1987-88 (including LA relevant expenditure) is up 15% on 1986-87 plans. There is an extra £60 million in 1987-88 and £70 million in 1988-89 for universities.

<u>Health</u> expenditure will again rise by 2½% in real terms in 1987-88; capital spending is up by 31% between 1979-80 and 1985-86. Under Labour it fell 30%.

<u>Roads</u> Provision for roads investment is up £65 million in 1987-88, and £75 million in 1988-89, mostly for local authority roads.

<u>Social security</u> Total benefit expenditure has risen 35% in real terms since 1978-79, and on the long term sick and disabled by 55% in real terms.

<u>Employment</u> The 1986 Budget measures added £290 million to Department of Employment spending in 1987-88.

<u>Housing</u> Gross capital provision up £450 million in 1987-88 and £350 million in 1988-89.

<u>Law and Order</u> An increased provision will mean 300 extra Metropolitan officers and 500 more officers in provincial forces in 1987-88.

Defence provision for 1987-88 and 1988-89 remains as planned in the 1986 Public Expenditure White Paper.

Privatisation proceeds have been increased slightly from £4¾ billion to £5 billion for 1987-88 and 1988-89.

Public Spending Outturn in 1986-87 is likely, for the planning total, to be about £1¾ billion more than the 1986 White Paper figure. Other expenditure items, such as debt interest, outside the planning total, are likely to fall short of Budget forecasts reducing the total overrun on the expenditure side to about £½ billion. North Sea oil revenues will be about £1 billion lower than estimated, but this will be more than offset by higher non-oil revenues, particularly VAT and Corporation Tax. Total non-oil revenues are now expected to exceed the Budget forecast by £2 billion. This means that net revenues are expected to be £1 billion higher. This will be reduced to £½ billion, the same as the projected expenditure overrun, by the change in oil taxation announced on 6 November which brings forward certain repayments in Advanced Petroleum Revenue Tax. The forecast PSBR for 1986-87 is therefore unchanged at £7 billion.

The Economic Forecast The Industry Act Forecast foresees growth rising to 3% in 1987 from 2½% in 1986. The balance of payments is forecast to move into a current account deficit of about £1½ billion in 1987 before the full benefits of higher non-oil exports take effect. This follows a cumulative surplus of £21 billion over the past six years (1980-85). Inflation is forecast to stay low showing a small rise to 3¾% for the RPI in the fourth quarter of 1987; but with the underlying level remaining broadly stable. The Government's commitment to squeeze out inflation by a policy of sound money remains undiminished. With economic activity picking up next year and the growth in the labour force slowing down, the prospects for a fall in unemployment are more promising. Employment has been rising continuously for the longest period for almost 30 years. Manufacturing output, which has already risen 10%

since the 1983 election, is forecast to rise a further 4% in 1987. Over the past 5 years, manufacturing exports have held their market share better than at any period in recent history.

<u>Conclusion</u> The Government's policies are bringing results. The economy is now enjoying sustained growth with low inflation and steadily rising living standards, a combination that has eluded successive governments for a generation.

6th November 1986

Printed and published by Conservative Research Department, 32 Smith Square, London SW1P 3HH.

RA7.40

FROM: THE CHANCELLOR
DATE: 11 NOVEMBER 1986

MISS M O'MARA

AUTUMN STATEMENT

I should like to say a particular word of thanks to you and the rest of EB for the immensely long hours you put in painstakingly preparing all the briefing for the Autumn Statement. It is a great comfort to know that all the relevant material is there, and in a readily accessible form, so that all queries are answered quickly and accurately.

NL

NIGEL LAWSON

Mr Scholar

Many thanks. I should have spotted this earlier myself.

N

Chancellor

Reference ....

from Michael Scholar

Autumn Statement Table 2.3

It would have been better if we'd given these figures, to stand GGE up, as you said:

	1986-87	1987-88	1988-89	1989-90
				£m
Gross debt interest	17,462	18,149	18,111	18,709
PCMOB	937	1,128	1,220	1,250
National Accounts adjustments	5,641	5,791	6,110	6,335
Total	24,040	25,068	25,441	26,294

But I'm afraid that, by the time we spoke, HMSO were well into their print run, and had sent home the people who would have been needed to change the plate (we had told them that they would have it all in good time this year, so there was no need to work overnight).

If asked, we can give these figures, and say that all this will be set out in the White Paper. People may notice that the debt interest figures for 1985-86 and 1986-87 are down £½b compared with the FSBR figures (Table 1.10 of the Autumn Statement compared with Table 2.3 of the FSBR)

CODE 18-77

Reference ....

; and that for the later years they are down by a bit more than £3/4 b in the first two years and £1/4 b in the last.

If questioned about that – as we sometimes are – we can only waffle about the debt maturity structure, re-estimation etc, as usual – although I suppose we can also point this time to a lower total of outstanding debt than assumed in the FSBR, given the PSBR shortfall in 1985-86.

MCS 11 November 1986

LA/49

FROM: A C S ALLAN
DATE: 12 NOVEMBER 1986

pwp

MR SCHOLAR

cc Miss O'Mara

AUTUMN STATEMENT TABLE 2.3

The Chancellor was most grateful for your (manuscript) note of 11 November. He felt he should have spotted the point earlier himself. He would be grateful if the numbers could be covered in the briefing for the TCSC hearing.

ACSA

A C S ALLAN

4-3 Mr Allan

For insertion after existing para 2.04

" 2.04A When he announced these changes to the public expenditure plans in the House of Commons on 6 November 1986 the Chancellor of the Exchequer reaffirmed the Government's commitment to the fiscal stance set out in the medium term financial strategy published at the time of the 1986 Budget. The Chancellor said that there would be no relaxation of that stance, and that the PSBR in 1987-88 would be held to 1¾ per cent of GDP. "

Will this do?

MCS 10/11

Ch

OK?

AA

OK

Thanks

PUP

Printed A.S.

H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-233 3415
Telex: 262405

PWP

12 November /86

AUTUMN STATEMENT

As foreshadowed in the Chancellor of the Exchequer's Oral Statement to the House of Commons on 6 November, the Treasury today published the Autumn Statement.

full, printed CX.

PRESS OFFICE
HM TREASURY
PARLIAMENT STREET
LONDON SW1P 3AG
01 233 3415

Autumn Statement
1986

Presented to Parliament by the Chancellor of the Exchequer by Command of Her Majesty November 1986

HER MAJESTY'S STATIONERY OFFICE LONDON

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Contents

Can we make the letters bigger + spread further down the page please

Cx.

→ new para on PSBR pledge after 2.04

→ no to PS addition.

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Economic prospects for 1987

Summary

1.01 GDP is forecast to grow by 3 per cent in 1987, following growth of 2½ per cent this year. Inflation should remain low: the recent rise in mortgage interest payments will add about half a per cent to RPI inflation for the next year taking it to 3¾ per cent in the fourth quarter of 1987.

Assumptions

1.02 The forecast for the UK assumes that fiscal and monetary policies will be as in the Medium Term Financial Strategy (MTFS) in the 1986 Financial Statement and Budget Report (FSBR).

envisaged at time of the

around

1.03 Total Government borrowing (the PSBR) for 1986–87 is expected to be £7 billion, ~~no higher than at~~ Budget ~~time~~ even after taking account of the proposed change in oil taxation. For 1987–88, the forecast assumes, as in the 1986 MTFS, that the PSBR will be 1¾ per cent of GDP. The sterling index is assumed to stay at broadly its present level.

described in chapter 4.

1.04 It is assumed that North Sea oil prices average $15 a barrel over the next year.

World economy

1.05 GNP in the major industrial countries has been rising by 2½–3 per cent a year since 1984. Domestic demand has been rising quite strongly over the last year, but a fall in exports to countries outside the OECD area, including OPEC, has held back overall GNP growth and ~~caused~~ a larger fall in the growth of industrial output. Low inflation seems likely to contribute to the strong growth in domestic demand in most major economies through 1987, while exports to countries outside the OECD area should fall less than this year. ~~Markets~~ for UK manufactures are forecast to grow by about 4½ per cent in 1987, compared to a likely 2 per cent in 1986.

contributed to/

Industrial growth in particular should pick up. Export markets

Demand and activity

1.06 UK domestic demand has grown strongly in the last year, but for most of the year sluggish world demand has restrained exports. In 1987 domestic spending is expected to increase at a similar rate to this year and exports to continue their recent recovery. GDP is likely to rise by close to 3 per cent with manufacturing output increasing by almost 4 per cent.

Labour market

1.07 Employment has continued to rise with around 200,000 extra jobs in the year to June 1986. Unemployment appears to have stopped rising during the last six months. Prospects for some fall in unemployment are promising as activity picks up and growth in the labour force slows.

more/

Inflation

1.08 Inflation has fallen this year with the retail prices index (RPI) rising by 3 per cent in the year to September compared to 5½ per cent in the year to the fourth quarter of 1985. The low rate of inflation is likely to lead to some reduction in pay settlements. At the end of 1987, RPI inflation is forecast at 3¾ per cent, but excluding mortgage interest payments inflation should be much the same as it is now.

Trade and the current account

1.09 The decline in oil prices, coupled with a pause earlier this year in the growth of world trade, means that the current account is likely to be close to balance in 1986. The volume of UK non-oil exports has been growing again, and this should continue in 1987 at a pace reflecting the faster growth in UK markets and the UK's improved competitiveness. At the same time the volume of imports is likely to continue to rise as domestic activity expands. The current account may show a deficit of some £1½ billion next year.

World economy

Recent developments

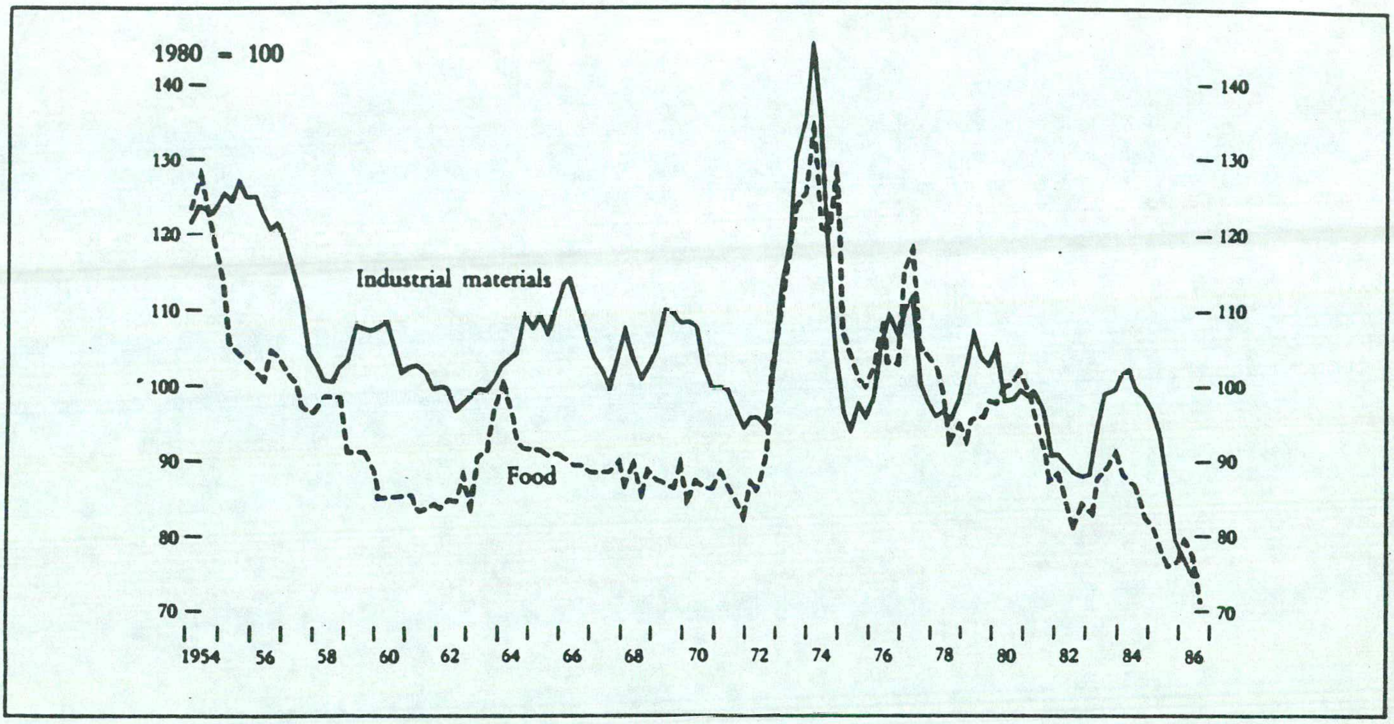
1.10 Real GNP in the major seven OECD ~~countries~~ economies has been growing at 2½–3 per cent a year since the end of 1984. Industrial production in 1986 has grown slowly, reflecting the weakness in exports to OPEC and other developing countries.

1.11 In the second quarter of 1986 domestic demand in the seven major countries was about 4 per cent higher than a year earlier. But exports have been weak, while imports have grown rapidly. Both these developments are in part the result of the fall in primary commodity prices and the collapse in oil prices. The producers of oil and other primary commodities have had to reduce their imports while consumers in the industrial countries, enjoying lower inflation and large increases in real incomes, have now started to spend more. Consumer prices in the major economies are now only 1½–2 per cent higher on average than a year ago; in Japan and Germany they are lower.

1.12 In the US, lower inflation and interest rates have given a further fillip to demand, after one of the longest post-war periods of expansion. Only in recent months has there been any sign of improvement in the trade deficit despite the dollar's decline since March 1985. A number of reasons have been suggested. The strong growth in consumers' expenditure has sucked in imports from abroad. Oil imports have risen to replace high cost domestic production. The dollar has not depreciated significantly against the currencies of some important trading competitors (e.g. Taiwan and Korea). Finally the US has probably been experiencing some of the normal "J-curve" effects of currency movements, which have been exacerbated by the size of the initial trade imbalance—the value of US merchandise imports is half as large again as that of its exports.

1.13 Japan and Germany are both experiencing a contraction in the net external demand for their products as a result of the strength of their currencies and the weaknesses in the developing world. In Germany the growth of consumption has risen, which, together with an investment recovery, has helped to raise the growth of domestic demand and counter the external slowdown. In Japan, however, investment has weakened and real GNP growth has fallen well short of potential. Largely as a result of sharply reduced oil import bills and the initial J-curve effects of their exchange rate appreciations, both countries are seeing large increases in their current account surpluses this year.

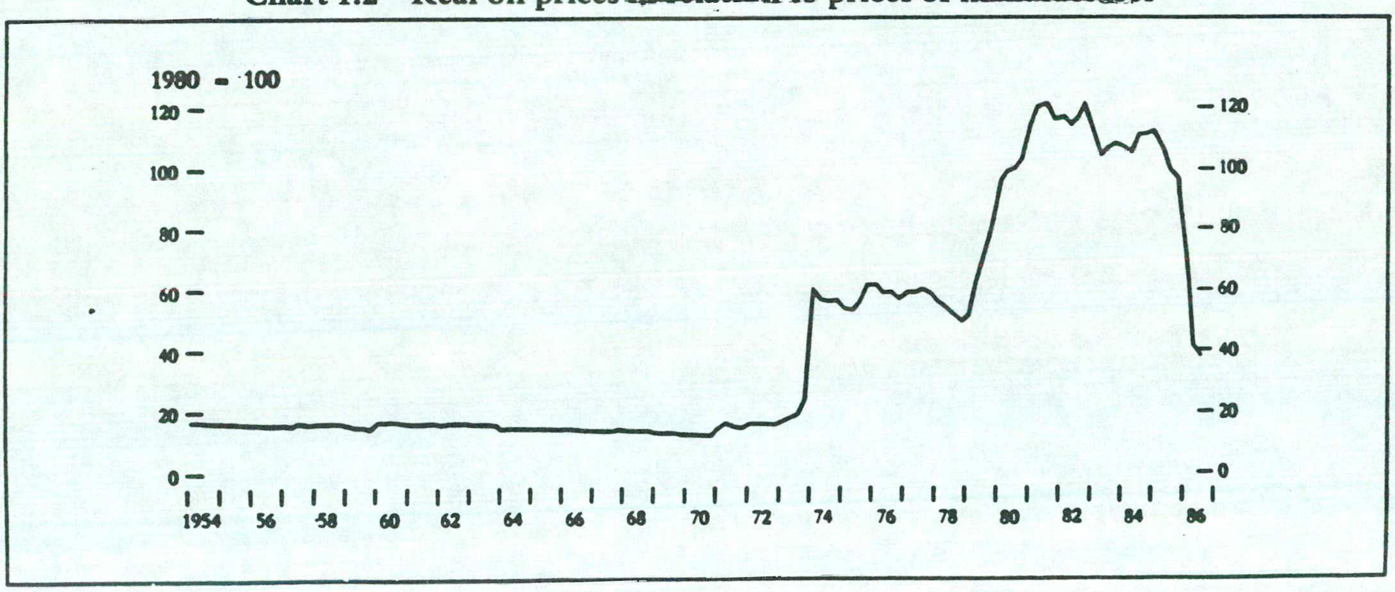
Chart 1.1 Real commodity prices ~~in relation to prices of manufactures~~



1.14 Oil prices fluctuated in the \$8–\$15 per barrel range over the summer months, moving towards the top end of the range when OPEC announced a short-term production agreement for September and October—now extended to December. Non-oil commodity prices, particularly food prices, fell during the first half of this year industrial materials prices reached post-war lows in real terms in mid-1986. Since August the prices of industrial materials have risen slightly. Charts 1.1 and 1.2 show past developments in real non-oil and oil commodity prices.

1.15 World import volumes seem likely to rise by about 4½ per cent in 1986, partly as a result of increased trade in oil. The growth of world trade in manufactures has probably been below the growth of total world imports in 1986.

Chart 1.2 Real oil prices ~~in relation to prices of manufactures~~



Prospects **1.16** World oil demand may have increased this year, following the decline during the past five years. Further increases are likely in the next few years partly in response to the lower real oil price. At the same time, low oil prices may lead to lower production in non-OPEC countries and cutbacks in development activity. There should be scope for OPEC to increase production in line with increased demand and any cutbacks in non-OPEC production. The forecast assumes that North Sea oil prices average $15 a barrel next year—a small premium over world prices.

1.17 Food prices are unlikely to strengthen significantly, as rising subsidies to farmers will bolster supply over the next few years. But there is likely to be some rise in industrial materials prices in real terms as industrial production recovers in the major countries.

Table 1.1 **World economy**

	Per cent changes on a year earlier		
		Forecasts	
	1985	1986	1987
Major Seven countries[1]:			
Real GNP	3	2½	3
Industrial production	3	1	4
Exports of goods (volume)	4	2	3
Consumer prices	4	2	2
World trade, at constant prices			
Total imports	3	4½	4
~~UK export markets~~[2] Trade in manufactures	4	2	4½

[1] *US, Japan, Germany, France, UK, Italy and Canada.* [2] ~~For manufactures.~~ UK weighted

1.18 Table 1.1 shows the forecast for world activity and trade, and for consumer price inflation. Low inflation should continue to sustain domestic demand in the major economies. However in the US the combination of a fall in the dollar and an end to the once-and-for-all effects of lower oil prices may lead to a modest rise in inflation. This could contribute to some slowdown in the growth of domestic demand. The effect of a lower growth in domestic demand on real GNP may be offset by improved trade performance following the dollar's depreciation.

1.19 The economic recovery in Europe seems set to continue; indeed, in many countries, including Germany, output may grow faster next year. Japanese growth, however, may be relatively modest next year as its traditionally strong export performance suffers from the yen's appreciation and domestic demand does not grow sufficiently to offset this.

1.20 The major seven industrial countries are expected to grow on average by 3 per cent in 1987. Domestic demand growth is likely to be a little faster and, together with the prospect of some recovery in commodity prices, should lead to some improvement in the financial position of many non-oil developing countries. As a result their imports should start to rise again. The oil producing countries, on the other hand, may have to cut their imports further.

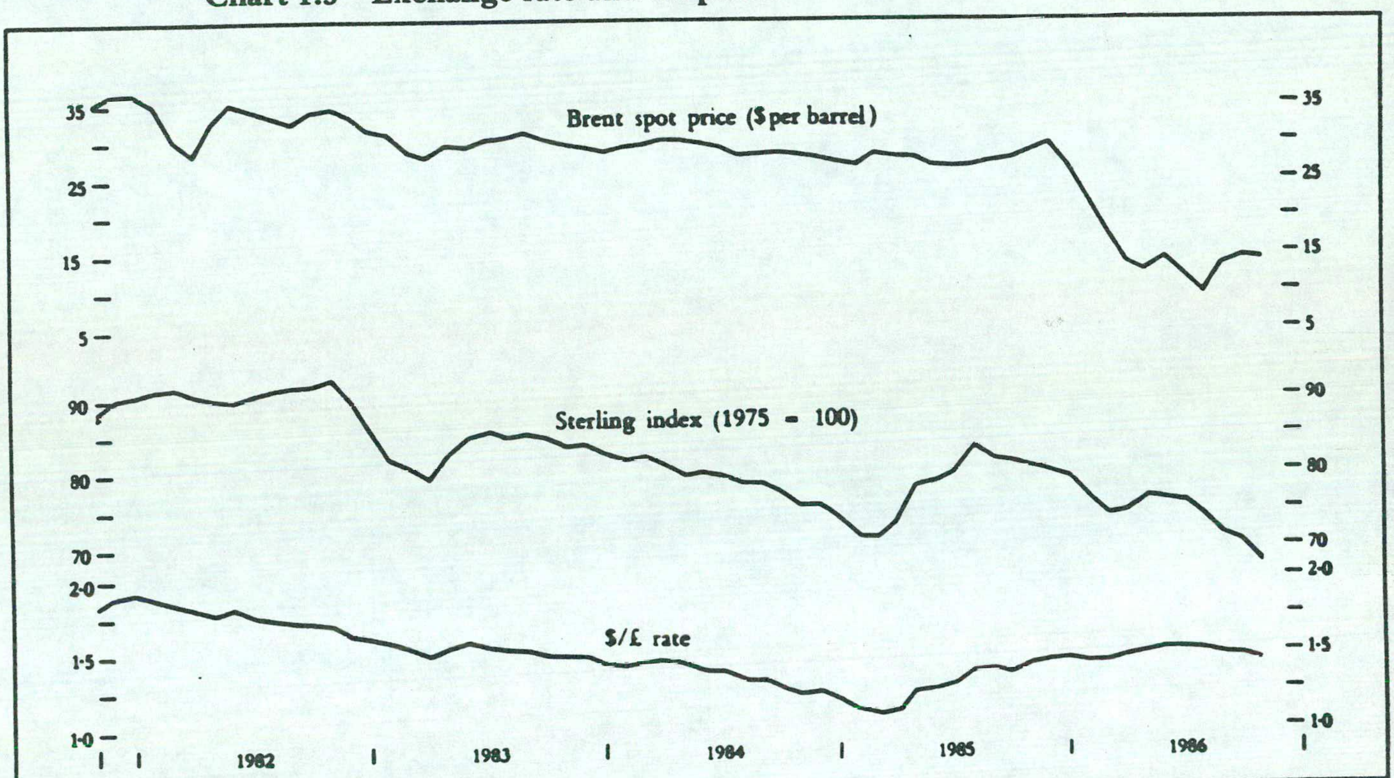
1.21 Growth of total world trade in 1987 may be slightly less than this year. Imports into non-oil developing countries and countries whose exchange rates have appreciated are forecast to grow quickly. By contrast there may be some slowing in US import growth, while further large cutbacks in OPEC imports are expected. Trade in manufactures, however, may grow rather faster than in 1986. As Table 1.1 shows, world trade in manufactures is estimated to have grown rather more slowly than total world imports in 1986, but is forecast to grow at a similar rate to world imports in 1987, at a little over 4 per cent.

Trade and the balance of payments

Exchange rates

1.22 The dollar has declined during most of 1985 and 1986, and compared with its peak in February 1985 is now almost 40 per cent lower against both the Deutschemark and the Yen. The sterling index rose by about 7 per cent between the two halves of 1985, but has declined by about 13 per cent since oil prices began to fall at the end of 1985. During 1986 sterling has remained broadly unchanged against the dollar, but has fallen against the other major currencies. The forecast assumes that sterling remains close to its present level in both dollar and effective terms.

Chart 1.3 Exchange rate and oil prices



Relative costs and prices

1.23 There has been a marked improvement in the UK's cost and price competitiveness since the second half of 1985 as the depreciation of sterling following the fall in oil prices has more than offset the extent to which labour costs have been rising faster in the UK than in most other major countries.

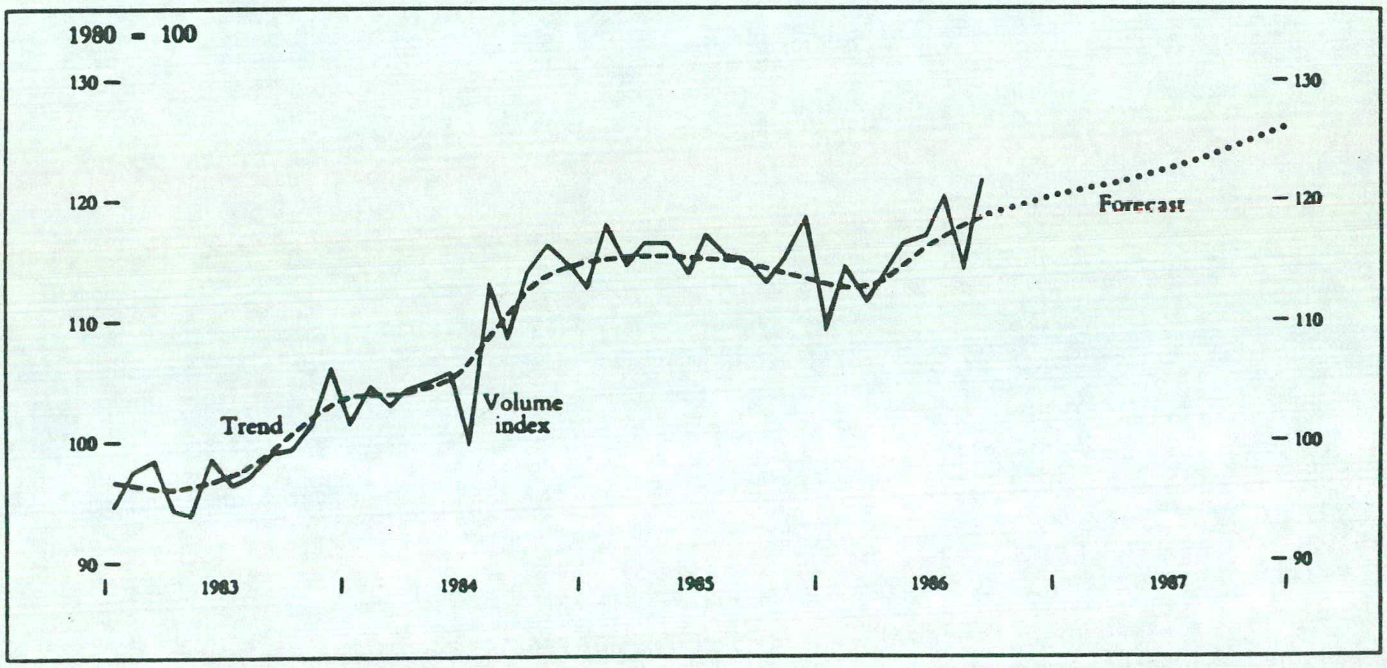
Trade prices and the terms of trade (excluding oil)

1.24 Prices of exports of goods have been rising during 1986, following a small fall at the end of last year. In the third quarter of 1986 export prices of manufactures were some 4 per cent higher than a year ago. Import prices were weak until very recently since lower world prices for many commodities offset the effects of sterling's depreciation. The non-oil terms of trade, therefore, have remained relatively steady. They may worsen slightly over the next year as a result of rises in some commodity prices and the recent depreciation of sterling.

Trade volumes (goods other than oil and erratics)

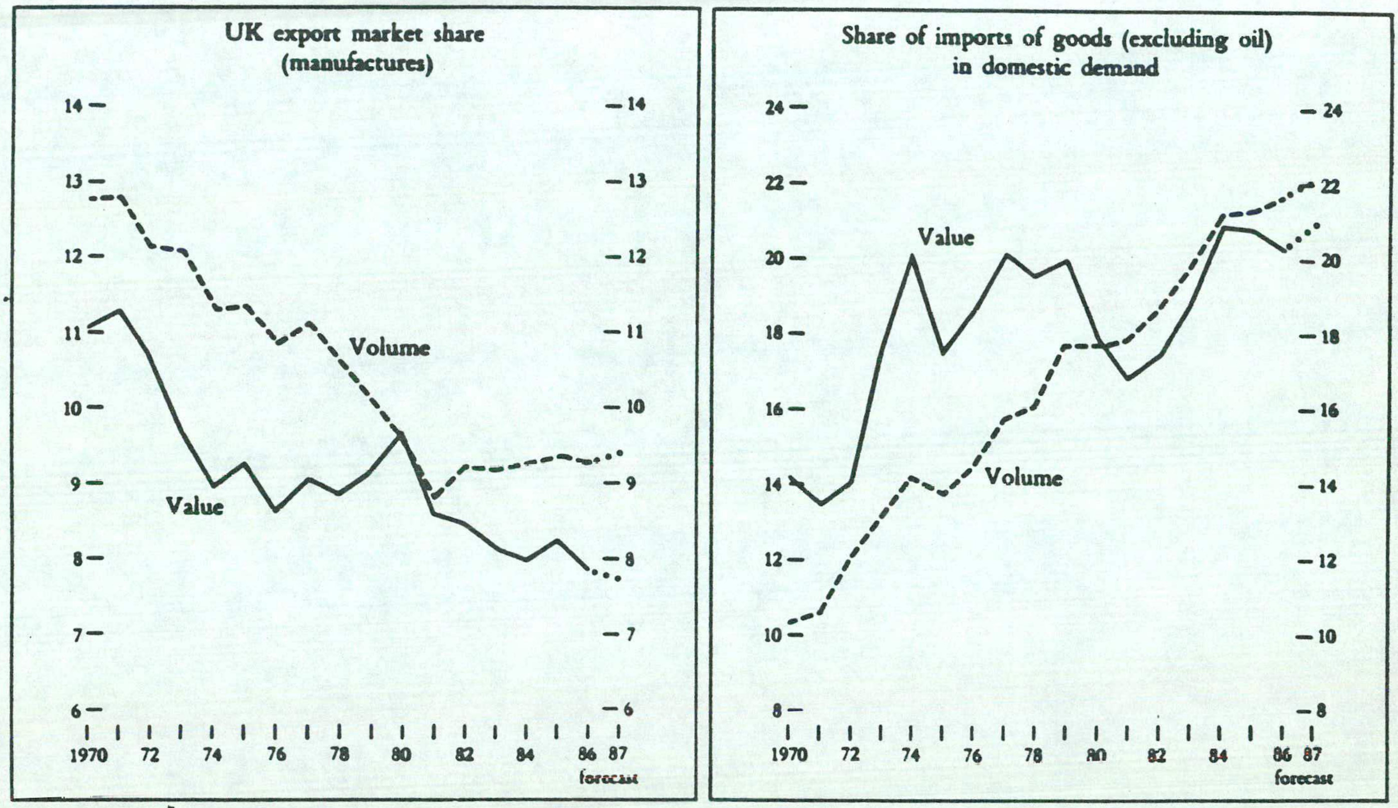
1.25 As Chart 1.5 shows, the share of UK manufactured exports in the volume of world trade has been broadly steady since 1980—following the decline of earlier years. Non-oil export volumes fell in the early months of 1986 when world trade growth was sluggish but have risen again in recent months. In the third quarter of 1986 exports of manufactures were some 3 per cent higher than in the first half of this year. World markets for UK manufactures are expected to grow more rapidly in 1987. This, together with the lagged benefits from this year's gain in competitiveness, suggests that exports should continue to grow steadily. As can be seen from Chart ~~As~~ 1.4 a rising trend in UK non-oil exports has been evident since the second quarter of 1986 when world trade began to recover from its slowdown during the winter. The forecast is that a continuation of this trend will bring growth of $5\frac{1}{2}$ per cent between 1986 and 1987—a sharp rise over the 1 per cent growth between 1985 and 1986.

Chart 1.4 Export volumes (excluding oil and erratic items)



1.26 Non-oil imports grew relatively slowly in the first half of this year, but have tended to rise more rapidly in recent months. The volume of imports has risen rather more rapidly than domestic demand, although the increase in import penetration has been less rapid than during some previous periods with similar growth of domestic demand. Manufactured imports rose particularly fast: some $8\frac{1}{2}$ per cent up in the third quarter over the first half of the year. Imports of food have also been unusually high this year as a result of the poor quality of last year's harvest. Imports seem likely to continue to rise strongly in 1987 as domestic activity expands, ~~in~~ although the lower exchange rate together with a return to more normal levels of food imports will tend to slow the rate of growth. Imports of goods are forecast to rise by 6½ per cent in 1987 compared to 5 per cent in 1986.

Chart 1.5 Export share and import penetration



Oil trade 1.27 Net oil exports are likely to be some £4 billion lower in 1986 than in 1985 as a result of lower world oil prices. About half of this effect on the current account will be offset by lower payments of interest, profits and dividends to foreign companies from the North Sea. Production from the North Sea in 1987, which is likely to be close to the centre of the range of 110–130 million tonnes published in the Department of Energy's 1986 Brown Book, is likely to be lower than in 1986. At the same time domestic demand for oil may grow modestly in response to both lower oil prices and rising activity. The oil trade surplus may therefore decline by a further £½ billion or so in 1987.

Total **Trade in goods** and erratics

1.28 Table 1.2 shows the main movements in the terms of trade and trade volumes for both total visible trade and trade excluding oil. The UK's terms of trade in visible trade have declined in 1986, as a result of lower oil prices, and are forecast to show little overall change next year. The volume of visible exports, which has been recovering in recent months, is forecast to rise further in 1987 although the overall growth will be held ~~down~~ back by a lower volume of oil exports. The volume of visible imports, which was almost 5 per cent higher in the first three quarters of 1986 than a year earlier, is forecast to show ~~a~~ similar growth in 1987.

Table 1.2 Trade in goods

	Per cent changes on previous year					
	All goods			Goods less oil and erratic items		
	Export volume	Import volume	Terms of trade*	Export volume	Import volume	Terms of trade*
1985	5½	3	1½	7	4	1½
1986 Partly forecast	2	5	−6	1	5	1
1987 Forecast	3	5	½	5½	6½	−½

** The ratio of UK export average values to import average values.*

Invisibles **1.29** The surplus on invisibles is likely to rise significantly in 1986 as higher earnings from ~~interest profits and dividends~~ (IPD) more than offset a lower surplus on services. The decline in the surplus on services in the first half of this year was partly due to a fall in net tourism earnings, some of which was attributable to fears in the US about terrorism in Europe. The transfers balance, which depends largely on the size and timing of government transactions with the EC, has been in smaller deficit this year although there has been a tendency for other transfer payments abroad to rise.

1.30 The surplus on IPD rose in the first half of 1986. This reflects not only lower payments from the North Sea but also the effect of sterling's depreciation on UK earnings overseas. The surplus on IPD seems likely to increase further in 1987 as the full-year effects of sterling's depreciation are reflected in earnings in sterling terms.

Current account

Table 1.3 Current account

	£ billion				
	Manufactures	Oil	Other goods	Invisibles	Current balance
1985	−3	8	−7½	5½	3½
1986 Partly forecast	−5½	4	−7	8½	0
1987 forecast	−7½	3½	−6½	9	−1½

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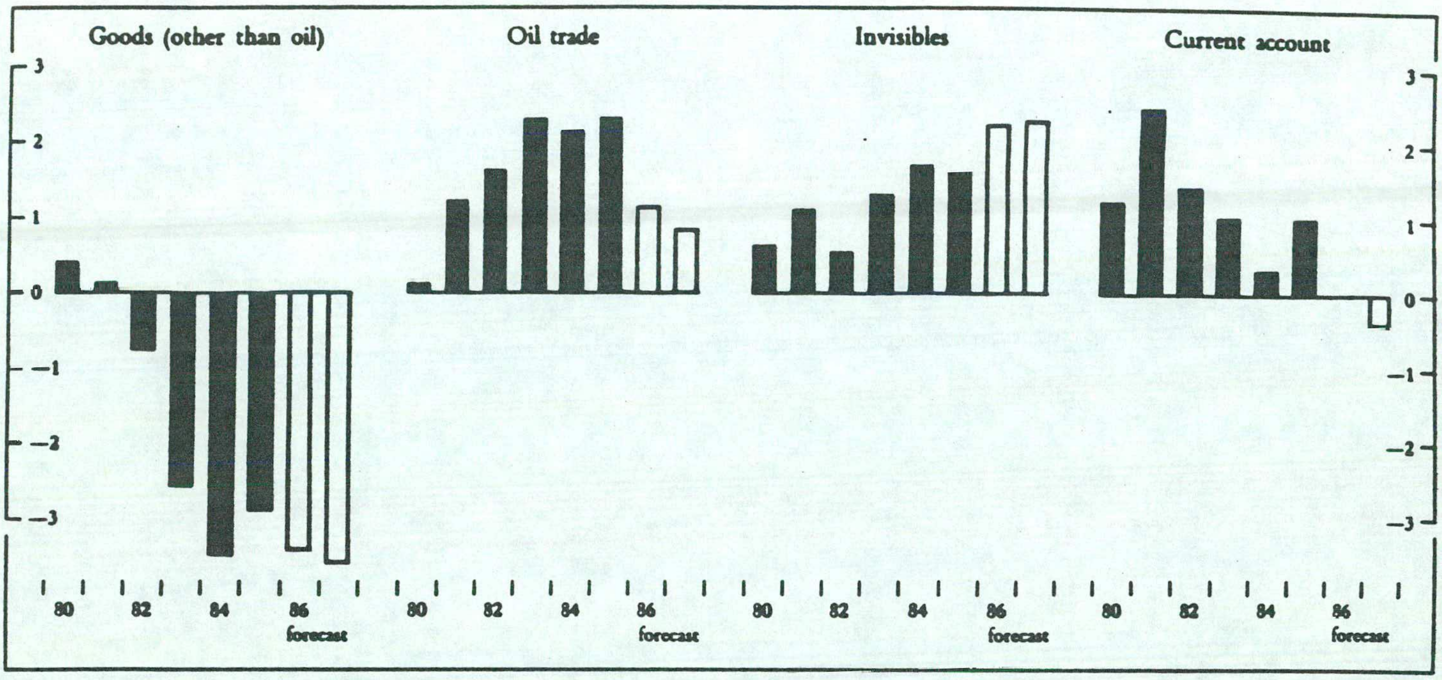
align

1.31 The current balance of payments recorded a deficit in the third quarter of 1986, following a surplus of about £1 billion in the first half of the year; for the year as a whole the forecast is for broad balance. In 1987 the current account is forecast to be in deficit by around £1½ billion. The main factors behind the changes between 1985 and 1986 have been described in paragraphs 1.22–1.30 above. Between 1985 and 1986 the fall in the net oil surplus and the increase in the deficit on manufactures more than offset a rise in invisibles. The forecast for 1987 is that with rising world trade and the benefits of improved competitiveness the current account may show no further deterioration from the second half of 1986.

Chart 1.6 The current account of the balance of payments (surpluses and deficits as a per cent of GDP)



Overseas assets 1.32 The large current account surpluses of the early 1980s, when the value of oil production was at its peak, have enabled the UK to build a large stock of net overseas assets. This stock was about £80 billion, equivalent to 22 per cent of GDP, at the end of 1985. It has probably risen further this year.

Demand and activity

1.33 Over the five years since the end of the 1979–81 recession, GDP growth has averaged 2¾ per cent a year. After adjusting for the coal strike, ~~economic growth averaged almost~~ 4 per cent in ~~1983 and~~ 1984, but slowed down during 1985 as exports weakened. GDP in the first half of 1986 is estimated to have been around 2 per cent higher than in the first half of 1985, and about 1¼ per cent higher after excluding the direct effects of the recovery from the coal strike. Economic activity has started to rise more quickly again, at an annual rate of about 2½ per cent over the two most recent quarters.

GDP grew by 3½ per cent in 1983 and by about

1.34 Spending by the personal sector has been strong this year. In the first three quarters of 1986 consumers' expenditure was almost 5 per cent higher than a year earlier, and the buoyancy of demand in the housing market has started to show up in higher private residential investment.

1.35 Output of the service industries (accounting for 56 per cent of the economy's total output in 1985) continues to expand quite rapidly: the estimated 3½ per cent growth over the year to the second quarter of 1986 is only a little less than the growth rate recorded over the previous two years. Manufacturing output is estimated to have fallen by about 1 per cent over the year to the second quarter of 1986, after a two year period in which output in manufacturing had been expanding faster than the rest of the economy. In recent months the trend in manufacturing output has been upwards again. For 1986 as a whole, manufacturing output is expected to remain at about the same level as last year.

Personal sector expenditure

with/ rising/

1.36 Real personal disposable income has probably grown by some 4 per cent in 1986, ~~and~~ real consumers' spending by almost 5 per cent. The saving ratio has fallen again this year in line with falling inflation. Both earnings and the consumers' expenditure deflator are forecast to rise less in 1987 than this year: the saving ratio is assumed not to change much from its current level. Consumers' expenditure may rise by about 4 per cent next year, with spending on durables rising rather more.

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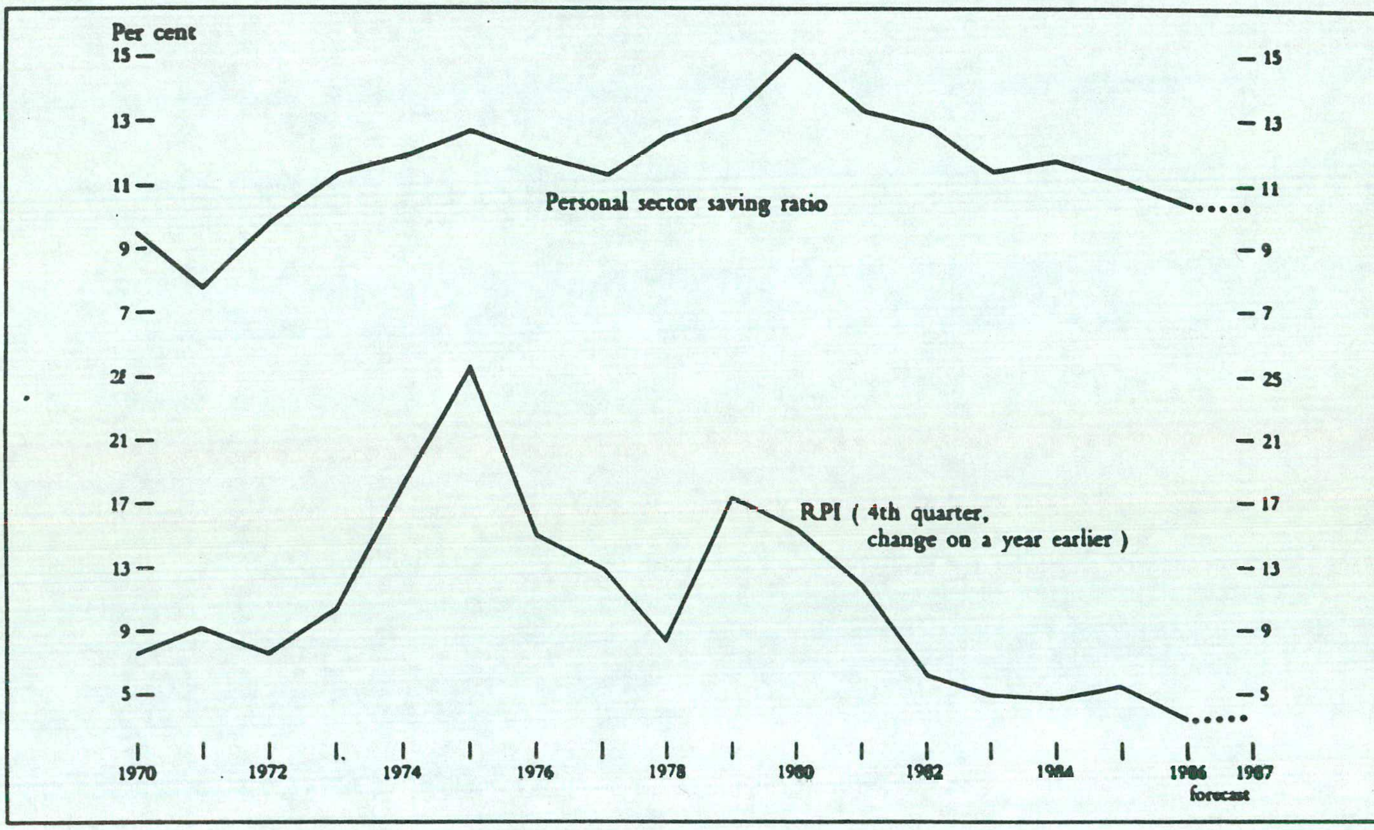
Chart 1.7 RPI and personal saving ~~rates~~ ratio



1.37 Increased demand for housing has led to a pick up in house prices over the last year and housebuilding has risen as a result. Private housing starts were about 10 per cent higher in the first three quarters of 1986 than in the same period of 1985. The rise in starts since early 1985 is beginning to show up in the number of houses completed. Spending on improvements to dwellings should continue to reflect the general buoyancy of personal sector demand, so that total private investment in dwellings should show growth of more than 5 per cent both this year and next.

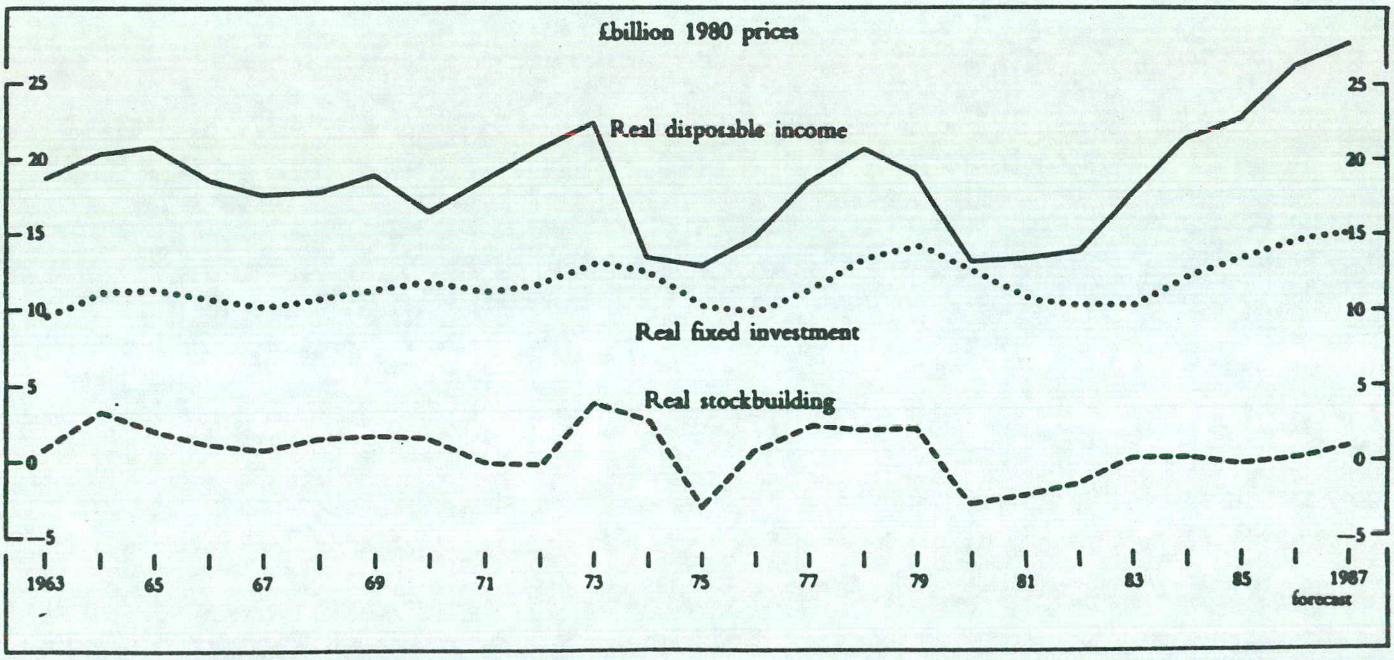
Company incomes and expenditure

1.38 The net real rate of return earned by industrial and commercial companies (ICCs) in 1985 was 11·9 per cent, the highest since 1964. The rates of return earned by non-North Sea ICCs and by manufacturing companies were the highest since 1973 and more than double those earned in 1981. In the first half of 1986 non-North Sea ICCs' profits net of stock appreciation were some 17 per cent higher than in the corresponding period of 1985. North Sea companies' profits fell by 54 per cent, however, reflecting the fall in the oil price.

1.39 Company spending has been relatively subdued in 1986. As expected, the advance warning of the reduction in capital allowances given in the 1984 Budget caused some capital spending to be brought forward into 1985 from 1986. Non-oil business investment nevertheless seems likely to rise this year by almost 3 per cent, compared with 6 per cent last year. North Sea investment ~~has responded much more quickly than was expected at Budget time to the fall in oil prices and~~ now seems likely to record a ~~substantial~~ fall this year.

1.40 Companies' expenditure on stocks has been running at a low level this year: stocks in manufacturing industry fell in real terms in the first half of 1986, as they had done during 1985. Again, reactions to the 1984 Budget corporate tax changes will have been an influence. Chart 1.8 shows the relation between non-North Sea ICCs' disposable income, ~~and expenditure.~~ fixed investment, and stockbuilding.

Chart 1.8 **Company income and expenditure (non-North Sea industrial and commercial companies)**



Note: Figures are approximate, adjusted for estimated effects of privatisation and do not take account of certain transactions between North Sea oil companies and other industrial and commercial companies.

1.41 In 1987 non-oil business investment is expected to grow at a similar rate to, or slightly faster than, this year reflecting the current high level of profitability and the recovery in demand in domestic and foreign markets.

x

A further sizeable fall in North Sea investment is expected: without this, growth in total investment next year would be about half a percentage point higher.

? not/

1.42 Stock ratios have been falling since 1980, and surveys ~~do not~~ suggest that stocks have yet reached desired levels in relation to output or sales. Stock ratios are expected to fall further over the next year; but less steeply than in recent years as most of the adjustment to higher costs of stockholding may now have taken place. Higher stockbuilding next year than this is likely to make a positive contribution to growth.

Prospects for demand and activity

1.43 The strength of consumer spending evident in European economies in recent months suggests that the benefits of the oil price cut are starting to come through, so that UK exporters should face a more favourable world environment next year. At home stronger growth in investment should offset an expected slowdown in consumer spending, so that domestic demand in total is expected to grow next year at much the same rate as this year. The prospects overall are for balanced growth, at a rate very slightly above the average experienced over the last five years (see Table 1.4).

Table 1.4 Domestic demand and GDP

	Per cent changes on a year earlier		
		Forecasts	
	1985	1986	1987
Domestic demand	3	3½	3½
Exports of goods and services	6	1	3
Imports of goods and services	3	5	4½
Domestic production: GDP*	3½	2½	3

** Average measure*

1.44 North Sea output will probably be slightly higher on average this year than in 1985, but is expected to fall in 1987, as envisaged in the 1986 Brown Book. Thus the increase in non-oil exports and growth of the non-oil economy are rather higher than the increase in total exports and GDP. The forecast for manufacturing exports implies a recovery in manufacturing output; the manufacturing sector is expected to grow faster than the rest of the economy next year (see Table 1.5).

Table 1.5 Real GDP and manufacturing output

	Per cent changes on a year earlier		
		Forecasts	
	1985	1986	1987
GDP (average measure)	3½	2½	3
GDP, adjusted for coal strike*	3	2	3
GDP, adjusted for coal strike and excluding oil output*	3	2	3½
Manufacturing output	3	0	4

** Adjustments are approximate*

Inflation

x

1.45 The ~~retail prices index (~~RPI~~)~~ rose by 3 per cent in the year to September, compared with a rise of 5½ per cent in the year to the fourth quarter of 1985. Falls in mortgage interest rates earlier in the year have contributed to lower RPI inflation: retail prices excluding mortgage payments rose by 3¾ per cent in the year to the third quarter of 1986.

1.46 Other price indices have also recorded substantial falls in inflation this year. The deflator of GDP at market prices is expected to rise by only 3 per cent in the present financial year, compared with a 6 per cent rise in financial year 1985–86; and in September producer output prices (for manufactures, excluding food, drink and tobacco) were ~~less than~~ 4 per cent higher than a year earlier, compared with an increase of 6 per cent in the year to the fourth quarter of 1985.

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1.47 Between the spring of 1985 and August this year the prices of materials and fuels purchased by manufacturing industry fell almost continuously. The recent falls in sterling and a modest recovery in some non-food primary commodity prices mean this decline in industry's input costs may have come to an end.

that/

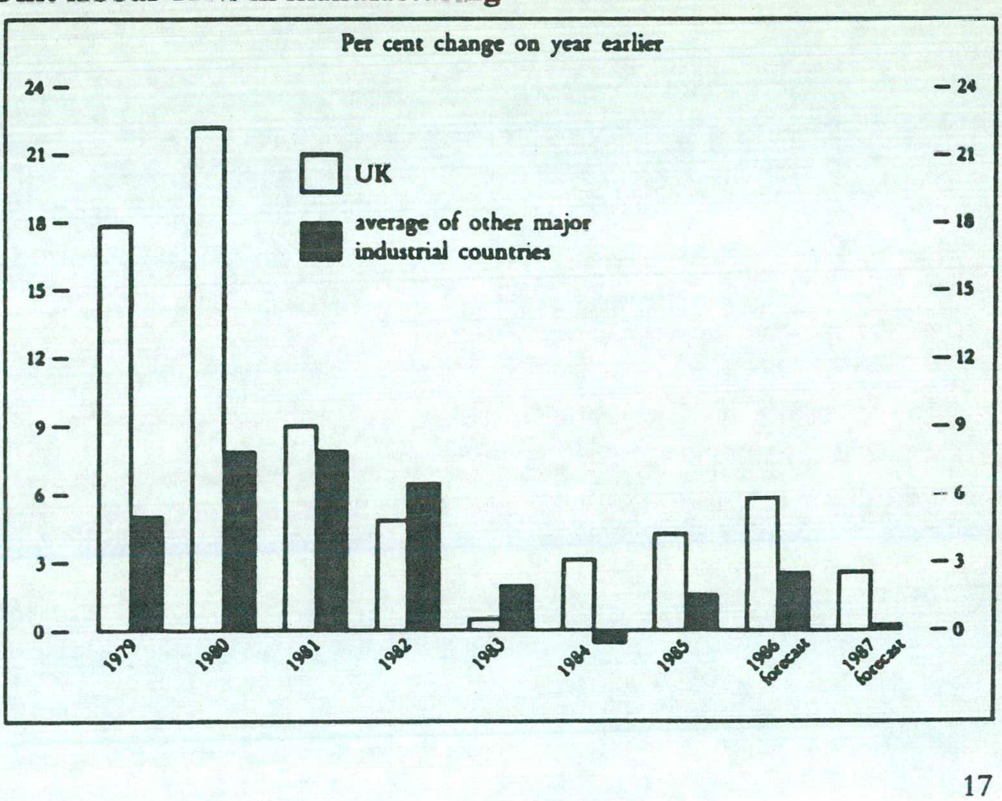
published figures for

1.48 In spite of the fall in price inflation there has been no decline so far in the underlying rate of growth in average earnings. Underlying growth of real pre tax earnings is likely to be above 4 per cent in 1986.

The/ ic

1.49 Even though employers' other labour costs (in particular their contributions to pension funds) have been growing more slowly than average earnings, unit labour costs in both the non-oil economy as a whole and manufacturing will probably have risen by around 5½ to 6 per cent in 1986, much faster than in most other major industrial countries (see Chart 1.9).

Chart 1.9 Unit labour costs in manufacturing



Prospects **1.50** With RPI inflation 3 percentage points lower than it was at the start of the last pay round, pay settlements are expected to be a little lower than last year: indeed, there have already been signs of a move towards lower settlements in the private sector in recent months. Despite an increase in overtime working, growth in average earnings is expected to fall somewhat in the present pay round. Productivity growth should pick up as compared with this year: actual unit labour costs for the non-oil private sector may rise by around 4 per cent next year, and manufacturing unit labour costs by rather less.

Table 1.6 Costs in manufacturing

unit/

	Per cent changes on a year earlier Unit labour costs	Cost of materials and fuel[1]	Estimated total unit costs[2]	Output prices[1]
1984	3	8½	5	5½
1985	4	4	4½	6½
1986 Partly forecast	6	−11½	½	4
1987 Forecast	2½	2	3½	3½

[1] *Producer prices excluding food, drink and tobacco.*
[2] *Including costs of bought in services.*

1.51 The increase in retail prices excluding mortgage interest ~~costs~~ payments over the next year is not likely to be very different from what it has been over the last year. However, the increase in mortgage rates in the second half of October will add just over ½ point to RPI inflation. Nationalised industry prices in aggregate continue to reflect lower energy costs, and food prices the general weakness of world prices. The pattern of price increases this year and that expected next year means that the annual rate of inflation may rise slightly in the middle of next year before resuming its downward path towards the end of the year.

Table 1.7 Retail prices index

Per cent changes on a year earlier → move heading across

	Weight in 1986	1985 Q4	Forecasts 1986 Q4	1987 Q4
Food	18½	3¼	4	2½
Nationalised industries[1]	6	5½	3½	1¾
Housing	14½	9¼	6½	10¼
Other	61	5¼	2¼	3
Total	**100**	5½	3¼ (3½)[2]	3¾ ← bd

[2] *FSBR forecast in brackets.* ← reverse order.

[1] *Includes water: gas is included in "other" prices.*

1.52 The GDP deflator measures the price of domestic value added—principally unit labour costs and profits per unit of output—and excludes import prices. It is sensitive to movements in North Sea profits, which may fall by 50–60 per cent in the current financial year: this is part of the reason why the deflator for GDP at market prices may rise by only 3 per cent in the current financial year. In 1987–88 the assumption of a stable oil price, and hence little further change in North Sea profits, implies a slightly higher increase in the GDP deflator than this year, at about 3¾ per cent, the same as was assumed in the MTFS.

1.53 Money GDP is forecast to grow by 5½ per cent in 1986–87, less than was expected at Budget time. Both inflation and, to a lesser extent, output growth have been revised down since the Budget. Money GDP is forecast to grow by 7 per cent in 1987–88, as output growth picks up and the growth of the GDP deflator reverts to its underlying path following the temporary effect of falling North Sea profits in 1986–87.

Productivity and the labour market

1.54 The results from the 1985 Labour Force Survey have led to an upward revision of the estimated growth in employment since 1983. Total employment in Great Britain is estimated to have grown by about 1,050,000 between March 1983 and June 1986. Almost half of this increase is accounted for by growth in self-employment. Estimates of the number of employees are subject to revision when the results of the 1984 Census of Employment become available.

1.55 Over the last year growth in employment has slowed down, reflecting the weakness of output during 1985. In the year to June 1986, the employed labour force grew by around 200,000 (see Table 1.8). Employment growth in the service industries remains very strong: the number of employees in the service industries increased by almost 250,000 in the year to June. However, the number of employees in manufacturing industries fell by 90,000 while almost 50,000 jobs were lost in the energy and water supply industries.

Table 1.8 Employment

Thousands, change in GB seasonally adjusted

	Employees in employment			Self-employed	HM Forces	Employed labour force
	Male	Female full-time	Female part-time			
une 1983 to une 1984	−37	+ 5	+221	+275	+4	+468
une 1984 to une 1985	+46	+ 3	+174	+108	0	+332 stet
une 1985 to une 1986	−59	−30	+172	+122*	−4	+~~199~~ stet

* Figure for self-employment over the last year is a projection based on self-employment growth over the previous four years.

1.56 Productivity growth has fallen back during the last year, as is normal during a period of slower output growth. The average annual growth in manufacturing productivity over the period from 1979 is estimated to be 3 per cent, close to the rate in the sixties (see Table 1.9), and much faster than that achieved in the seventies. Growth in output per man hour in non-manufacturing has been rising at about 2 per cent ~~per annum~~ since 1979. However, the large rise in part-time employment has brought down the growth in output per head in non-manufacturing to around 1¼ per cent a year.

a year/

Table 1.9 Output per head of the employed labour force

	Annual averages, per cent changes		
	1964–73	1973–79	1979–86
Manufacturing	3¾	¾	3
Non-manufacturing*	3	½	1¼

** Includes private sector and nationalised industries other than in manufacturing and oil.*

Unemployment

1.57 The increase in unemployment has slowed down over the past year, and seasonally adjusted adult unemployment was at the same level in September 1986 as it had been in March.

1.58 The impact of the employment measures announced in the Budget, including the Restart scheme to help the long term unemployed, and the pick up in ~~the~~ economic growth now underway, mean that the immediate prospects of reducing unemployment are more favourable. The slower growth in the labour force projected for the rest of the decade should improve the chance of a reduction in unemployment over the next few years. The extent of any reduction will, however, depend crucially on what happens to pay.

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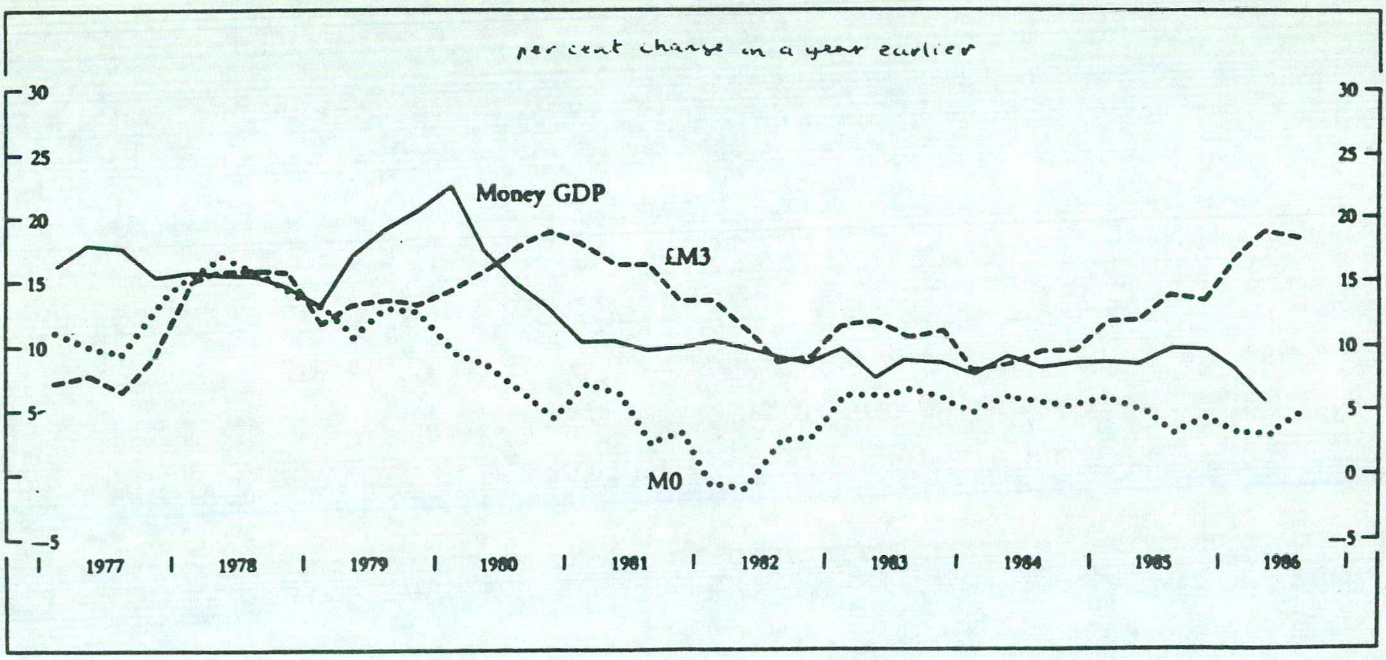
Financial conditions

1.59 Market short term interest rates, which fell by nearly 2 percentage points after the Budget, have risen by about 1 percentage point since the end of August. Real short term rates remain high. Long term interest rates fell sharply in the spring, dropping below 9 per cent in April, but in the last two months the weakening in world bond markets and the rise in UK short term rates have caused them to move back above 10½ per cent. The forecast assumes that short term interest rates will be set to maintain monetary conditions that are consistent with the counter-inflationary aims of the MTFS.

Chart 1.10 Monetary aggregates and money GDP



1.60 The year-on-year growth in M0 moved slightly above the midpoint of its target range of 2–6 per cent over the last few months mainly reflecting earlier falls in nominal interest rates and strong growth in personal incomes and expenditure. Following the recent rise in interest rates M0 is expected to grow more slowly.

1.61 Throughout the current financial year growth in £M3 has been above the target range in the MTFS, with growth in excess of 18 per cent in the year to mid-September. In part this has reflected the increased attractiveness of interest-bearing bank deposits relative to other retail deposits. PSL2, which includes most of these other deposits, rose by 14 per cent during the year to mid-September. For the past six years, high rates of growth of broad money—largely the result of financial innovation and liberalisation—have been consistent with appropriately tight monetary conditions and thus a substantial fall in inflation.

Fiscal developments

3/

1.62 Tables 1.10 to 1.12 show details of general government expenditure and receipts and of public sector borrowing for 1985–86 and 1986–87, together with changes from the FSBR estimates. The PSBR in 1985–86 was £5·8 billion, just over £1 billion lower than the estimate in the 1986 FSBR. Lower central government borrowing accounts for the major part of this downward revision. In the first six months of 1986–87 the PSBR was £6 billion, in line with expectations at Budget time. Taking into account the proposed change in oil taxation, the PSBR forecast for the year as a whole is unchanged at £7 billion. ~~There is still a substantial margin of error surrounding this forecast — average errors in PSBR forecasts at this time of year have been around 3 per cent of GDP, equivalent to £ billion.~~

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around/

delete CX.

1.63 Table 1.10 shows the relationship between the planning total and general government expenditure in national accounts terms. The estimated outturn for the cash planning total in 1986–87 is £1¼ billion more than ~~anticipated~~ at Budget time, implying a rise between 1985–86 and 1986–87 of 5 per cent. The projected increase in general government expenditure is smaller, at under 4 per cent. The difference between general government expenditure and the planning total is little changed from the FSBR forecast.

expected/ X

Table 1.10 General government expenditure

	£ billion	
	1985–86	1986–87
Public expenditure planning total	133½	140½
Interest payments	17½	17½
Less public corporations' market and overseas borrowing	−1	−1
Other adjustments	6½	5½
General government expenditure in national accounts terms	**158½**	**164½**

X

described in chapter 4

1.64 The estimates in Table 1.11 of taxes on income, expenditure, and capital depend on the estimated growth in money incomes as well as tax rates and allowances. The projected fall in North Sea revenues of just under £7 billion to £4½ billion in 1986–87 means that the forecast increase in general government receipts for 1986–87, at 3 per cent, is significantly below the 5½ per cent rise forecast for money GDP. North Sea revenues in 1986–87 are now expected to be £1½ billion lower than forecast at Budget time. Part of this downward revision is the result of change in the arrangements for the repayment of APRT ~~announced today~~ which reduces revenue in 1986–87 by £0·3 billion. Most of the rest of the shortfall is accounted for by a lower dollar oil price ~~in the first half of the~~ year than assumed at Budget time. Non-North Sea taxes and national insurance contributions are forecast to increase by ~~nearly~~ 9½ per cent in 1986–87—3½ per cent ~~higher~~ than the increase in money GDP. The forecast of non-oil receipts in 1986–87 has been revised upwards by nearly £2 billion since the 1986 FSBR, largely as a result of buoyant VAT and corporation tax receipts.

of/ of/ of/ stet the/ Advance Petroleum Revenue Tax (/ so far this/ over/ 7/ more/

Table 1.11 General government receipts

	£ billion 1985–86	1986–87
Taxes on income, expenditure and capital	114½	118
National insurance and other contributions	24½	26½
Interest and other receipts	13	12
Accruals adjustments	−½	—
Total receipts	**151½**	**156½**
of which North Sea revenues (including allowance for the change in ~~Advance~~ PRT in 1986–87)	11½	4½

7 A/

1.65 Table 1.12 shows revised estimates of government receipts, expenditure and borrowing in 1985–86 and 1986–87.

Table 1.12 Public sector borrowing

	£ billion 1985–86	1986–87
General government expenditure	158½	164½
General government receipts	151½	156½
General government borrowing requirement	7	8
Public corporations' market and overseas borrowing	−1	−1
Public sector borrowing requirement	6	7
as percentage of GDP	1½	1¾
Money GDP at market prices	360	380

1.66 Table 1.13 summarises the changes since the 1986 FSBR.

Table 1.13 Changes to the estimates of public sector receipts, expenditure and borrowing

	£ billion	
	1985–86	1986–87
Expenditure		
General government	+1	+1
Public corporations' market and ~~other~~ overseas borrowing	—	−½
Total	+1	+½
Receipts		
Non-North Sea receipts	+2	+2
North Sea revenues (excluding effect of policy change for 1986–87)	—	−1½
Total receipts ~~(excluding effect of North Sea policy change in 1986–87)~~	+2	+~~1~~½
PSBR	−1	—

Table 1.14 Economic prospects

	Forecast 1985 to 1986	Forecast 1986 to 1987	Average errors from past forecasts[1]
	per cent changes		
A. Output and expenditure at constant 1980 prices			
Domestic demand	3½	3½	1
of which:			
Consumers' expenditure	5	4	1¼
General government consumption	1½	1½	1
Fixed investment	2	2½	2¼
Change in stockbuilding (as per cent of level of GDP)	0	½	¾
Exports of goods and services	1	3	2½
Imports of goods and services	5	4½	3
Gross domestic product: total	2½	3	¾
: manufacturing	0	4	2½
	£ billion		
B. Balance of payments—current account	0	−1½	3
C. Inflation	per cent changes Q4 to Q4		
Retail prices index	3¼	3¾	2¼
	per cent changes on previous financial year		
	1986–87	1987–88	
Deflator for GDP at market prices	3	3¾	2
	per cent changes on previous financial year		
D. Money GDP at market prices	5½	7	1¾

[1] *The errors relate to the average differences (on either side of the central figure) between forecast and outturn; they are relevant to the forecast for next calendar or financial year. The method of calculating these errors has been explained in earlier publications and Government forecasts (see Economic Progress Report June 1981). The calculations of average errors are based on forecasts made between 1975 and 1984. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.*

Table 1.15 Constant price forecasts of expenditure, imports and gross domestic product

£ billion at 1980 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	**Total final expenditure**	*Less* Imports of goods and services	*Less* Adjustment to factor cost	*Plus* Statistical adjustment	**Gross domestic product at factor cost**	GDP index 1980=100
1981	136·9	49·0	37·8	62·7	−2·5	**284·0**	56·4	30·1	−0·5	**197·0**	98·7
1982	138·2	49·6	39·4	63·3	−1·1	**289·3**	59·5	30·4	0·7	**200·1**	100·3
1983	143·8	50·5	41·7	64·7	0·7	**301·3**	62·8	31·5	−0·1	**207·0**	103·8
1984	146·9	50·9	45·5	69·0	−0·1	**312·2**	68·5	32·7	1·8	**212·8**	106·6
1985	152·0	51·1	46·3	73·3	0·6	**323·4**	70·6	33·8	1·5	**220·4**	110·5
1986	159·3	52·0	47·~~2~~3	74·1	0·7	**333·4**	74·1	35·0	1·2	**225·5**	113·0
1987	165·~~7~~6	52·8	48·4	76·5	1·4	**344·~~8~~7**	77·5	36·2	1·2	**232·2**	116·4
1985 H1	75·1	25·6	23·4	36·8	0·5	**161·3**	35·2	16·8	0·5	**109·9**	110·2
H2	76·9	25·5	22·9	36·5	0·2	**162·1**	35·4	17·1	1·0	**110·5**	110·8
1986 H1	78·5	25·7	23·4	36·5	0·4	**164·5**	35·9	17·3	0·6	**111·9**	112·2
H2	80·8	26·3	23·9	37·6	0·3	**168·~~9~~8**	38·3	17·7	0·6	**113·5**	113·8
1987 H1	81·6	26·4	23·9	38·0	0·7	**170·5**	38·~~4~~3	17·9	0·6	**114·9**	115·2
H2	84·0	26·4	24·~~5~~4	38·5	0·8	**174·2**	39·2	18·3	0·6	**117·3**	117·6
	Per cent changes										
1984 to 1985	3½	½	2	6	—	3½	3	3½	—	3½	3½
1985 to 1986	5	1½	2	1	—	3	5	3½	—	2½	2½
1986 to 1987	4	1½	2½	3	—	3½	4½	3½	—	3	3

Mr [illegible]

2 Outline public expenditure plans for 1987–88 to 1989–90

2.01 The public expenditure planning totals for 1987–88 and 1988–89 are £[148·7] billion and £[154·2] billion respectively, compared with £143·9 billion and £148·7 billion in the FSBR. The planning total for 1989–90 is set at £[161·5] billion. ~~In real terms, average growth in public~~ general government expenditure ~~(measured by both the planning total and general government expenditure)~~ compared with the forecast outturn for 1986–87 is expected to be [1½] per cent a year (1¼ per cent for the planning total). This compares with ~~annual growth rates averaging around [1¼] per cent in the eight years since 1978–79, and around [3] per cent in the decade before that. With economic growth continuing at present rates over this period, public expenditure is expected to continue to account for a steadily declining proportion of GDP. By 1989–90, it should be back to the levels of the early seventies. These trends are set out in Tables 2.1 and 2.2.~~ nearly 1978–79, around 2¼ per cent in the four years to 1982–83, and about 1¾ per cent in the four years to 1986–87.

These plans * ← insert CX para

1986–87: outturn

2.02 The estimated outturn of the planning total for 1986–87 is [£140·4 billion], around 1 per cent above the plans set out in the Financial Statement and Budget Report (FSBR). The main increases in expenditure compared with those plans are in local authority expenditure and in demand-led programmes, notably social security. Details are given in Table 2.3.

~~2.03 Against a background of steady economic growth since the early 1980s,~~ With economic growth continuing at present rates over this period the declining trend of public ~~expenditure~~ spending as a percentage of GDP over the last four years will continue. Between 1982–83 and 1986–87 there was a decline as a percentage of GDP of [3½] percentage points ~~by 1989–90, it is expected to be a further [2½] percentage points lower.~~ ; back to the levels of the early seventies. These trends are set out in Tables 2.1 and 2.2.

Future years: main changes

2.04 3 Compared to the plans published in Cmnd 9702 there have been increases in planned expenditure on services to which the Government attaches high priority, such as health, education and law and order. Extra provision has also been made for capital expenditure, approaching £1 billion in 1987–88, in particular on housing, schools and roads. In addition provision has been made to cover substantial growth in demand-led areas, the most significant of which is social security. The plans envisage a substantial uplift in provision for local authority current expenditure. This in part reflects the fact that no decisions were taken about appropriate levels of expenditure in 1987–88 and 1988–89 ~~beyond those provided for in 1986–87. This was reflected in the higher level of Reserves for those two years in last year's plans.~~ [There are also increases in the external financ~~ing limits~~ for some nationalised industries in 1987–88 and 1988–89, particularly the energy industries.]

CX and provision was set at the same cash level as in 1986-87, with an adjustment for realism in the shape of larger Reserves for those two years.

~~Limit the 1985 Public Expenditure Survey~~

cx a current

CX last year ~~no decision~~

Table 2.1 Public expenditure trends

£ billion

	Planning total[1]		General government expenditure[2]		
	Cash	Real terms[3]	Cash	Real terms[3]	Per cent of GDP
1978–79	65·7	124·0	74·6	140·7	43¼
1979–80	77·6	125·2	89·7	144·7	43¼
1980–81	92·6	126·1	108·3	147·4	46
1981–82	103·9	128·7	120·1	148·8	46¼
1982–83	113·4	131·0	132·6	153·1	46¾
1983–84	120·3	132·9	140·2	155·0	45¾
1984–85	129·8	137·6	150·1	159·1	45½
1985–86	133·6	133·6	158·6	158·6	44
1986–87	140·4	136·5	164·4	159·9	43¼
1987–88	148·6	139·3	173·7	162·8	42¾
1988–89	154·2	139·6	179·6	162·7	41¾
1989–90	161·5	142·1	187·8	165·2	41¼

(Estimated)
[1] Outturn ~~up to~~ for 1986–87; plans for 1987–88 onwards.
[2] General government expenditure as defined in the National Accounts and in the Medium Term Financial Strategy (MTFS).
[3] Cash figures adjusted to 1985–86 price levels by excluding the effect of general inflation as measured by the GDP deflator at market prices. The GDP deflator is assumed to increase by some 3 per cent in 1986–87, and by 3¾, 3½ and 3 per cent respectively in the years 1987–88 to 1989–90.

Table 2.2 Public expenditure trends excluding privatisation proceeds

£ billion

	Planning total[1]		General government expenditure[2]		
	Cash	Real terms[3]	Cash	Real terms[3]	Per cent of GDP
1978–79	65·7	124·0	74·6	140·7	43¼
1979–80	77·9	125·8	90·0	145·3	43½
1980–81	93·0	126·6	108·7	147·9	46
1981–82	104·4	129·3	120·6	149·4	46½
1982–83	113·9	131·6	133·1	153·7	47
1983–84	121·4	134·2	141·4	156·3	46¼
1984–85	131·9	139·8	152·1	161·3	46¼
1985–86	136·3	136·3	161·3	161·3	44¾
1986–87	145·2	141·1	169·2	164·5	44½
1987–88	153·6	144·0	178·7	167·5	44
1988–89	159·2	144·2	184·6	167·2	42¾
1989–90	166·5	146·5	192·8	169·6	42¼

(Estimated)
[1] Outturn ~~up to~~ for 1986–87; plans for 1987–88 onwards.
[2] General government expenditure as defined in the National Accounts and in the Medium Term Financial Strategy (MTFS).
[3] Cash figures adjusted to 1985–86 price levels by excluding the effect of general inflation as measured by the GDP deflator at market prices. The GDP deflator is assumed to increase by some 3 per cent in 1986–87, and by 3¾, 3½ and 3 per cent respectively in the years 1987–88 to 1989–90.

, for example

of the cost of interest support for fixed rate export finance

2.0~~5~~4 These increases are in part offset by reductions in planned expenditure in respect of the latest estimates of the United Kingdom's net contribution to the European Communities and ~~departmental spending~~ by the Department ~~of Energy~~. The expected level of receipts from the Government's privatisation programme has been increased from £4¾ billion to £5 billion in each year.

CX → insert new para on PSBR pledge

Reserves

2.0~~6~~5 The plans include Reserves of £[3·5] billion in 1987–88, £[5·5] billion in 1988–89 and £[7·5] billion in 1989–90. The Reserves will be available to meet contingencies not covered elsewhere in the plans, including estimating changes.

Public expenditure White Paper

2.0~~7~~6 Full details of spending plans, including detailed information on the outputs expected to be achieved from individual programmes, together with information on running costs and manpower, will be published in the forthcoming 1987 public expenditure White Paper.

Departments

2.0~~8~~7 Table 2.3 sets out spending plans by department including local authority spending and nationalised industry external finance. ~~The breakdown into departments will be carried through into separate chapters for the Public Expenditure White Paper and into the classes for Estimates, thereby making it easier to make comparisons between the various documents.~~ Tables 2.3A to 2.3C show separately the elements within the departmental totals—nationalised industries' external finance, local authority relevant current spending, and other departmental spending. The following paragraphs indicate, in brief, the main changes to departmental programmes.

Defence 2.0~~9~~8 The estimated outturn for 1986–87 reflects an increase in provision as a result of carry-forward of capital underspend from 1985–86. This increase has been met from the Reserve. For 1987–88 and 1988–89 the provision remains as planned in the last public expenditure White Paper (Cmnd 9702) after allowing for the net effect of minor changes, including a reduction in estimated Falklands costs. These costs fall markedly over the period and will in future be subsumed in the defence budget. Provision for 1989–90 represents an increase of £4~~8~~90 million over the previous year.

Overseas development administration 2.~~10~~09 The net overseas aid programme is being maintained in real terms at its 1986–87 level throughout the three years.

CX

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Table 2.3 Public expenditure plans[1, 2] £ million

changes from out-turn

Departments (including local authority spending and nationalised industries external finance)	Outturn 1985–86	Cmnd 9702 plans[3] 1986–87	Estimated outturn 1986–87	~~Increase over 1985–86~~ 1986–87	Changes from plans 1986–87
Ministry of Defence	17 972	18 530	18 600	630	70
FCO—Diplomatic wing	605	640	670	60	30
FCO ~~(including ODA)~~ – ODA	1 245	1 320	1 320	70	+0
European Community	831	650	1 090	260	440
IBAP and other CAP expenditure	1 857	1 540	1 5~~60~~20	−330	−20
Domestic agriculture, fisheries and food	912	840	920	10	80
Forestry Commission	51	50	50	—	—
Department of Trade and Industry	1 524	1 300	1 370	−160	60
Export Credits Guarantee Department	319	300	250	−70	−50
Department of Energy	677	120	170	−510	50
× Department of Employment [4]	3 342	3 920	3 970	630	40
Department of Transport	4 572	4 790	4 920	350	130
DOE—Housing	2 861	2 760	2 850	−10	90
DOE—Other environmental services	3 910	3 660	4 070	160	420
DOE—Property Services Agency	−97	−90	−90	10	+0
Home Office	4 728	4 960	5 260	530	300
Lord Chancellor's Department	525	590	620	100	30
Department of Education and Science	14 480	14 320	15 950	1 470	1 630
Office of Arts and Libraries	721	730	800	80	70
DHSS—Health and personal social services	16 640	17 720	17 960	1 320	230
DHSS—Social security [5]	41 466	42 800	44 500	3 000	1 600
Civil superannuation	1 017	1 190	1 140	120	−60
Scotland	7 221	7 570	7 810	590	240
Wales	2 780	2 900	3 060	280	150
Northern Ireland	4 262	4 520	4 530	270	10
Chancellor's departments	1 819	2 010	2 070	250	60
Other departments	334	430	450	110	20
Privatisation proceeds	−2 702	−4 750	−4 750	−2 050	—
Reserve	—	4 400	—	—	−4 400
Adjustments[6]	−290	−670	−700	−410	−30
Planning total	**133 580**	**139 100**	**140 400**	**6 800**	**1 300**
General government expenditure	**158 ~~600~~** 551	**163 400**	**164 400**	+5,900	**1 000**

[1] In this and Tables 2.3A to 2.3C some figures may be subject to detailed technical amendment before publication of the 1987 public expenditure White Paper.

[2] The rounding and other conventions used in this table and 2.3A to 2.3C are as follows: planned figures are rounded to the nearest £10 million, except for social security and the planning and spending authority totals and general government expenditure *which are rounded to the nearest £100 million. Outturn figures for 1986–87 have also been rounded to reflect their provisional nature. Differences have been calculated on unrounded figures and rounded in the same way as their equivalent total: figures may therefore not sum to totals or changes shown.*

In the case of general government expenditure, this does not imply accuracy to this degree.

[3] Plans as set out in the last public expenditure White Paper (Cmnd. 9702) adjusted for Budget measures and other minor changes of classification and allocation.

Removal of 6 *Double counting of agricultural spending in Scotland and Wales which is also included in the total for domestic agriculture, fisheries and food and IBAP and other CAP expenditure* in all years. *The 1986–87 plans and estimated outturn figure include external finance of −£400 million for nationalised industries to be privatised that year,* and an allowance for shortfall.

4. Compared with the last White Paper shown under columns headed Cmnd 9702 plans overall provision for the Department of Employment has been increased by £180 million in 1986-87, £240 million in 1987-88 and £2[illegible] in 1988-89 mainly [illegible]

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Table 2.3 Public expenditure plans[1, 2]—continued

Cmnd 9702 plans[3]		New Plans			Changes between Cmnd 9702 and ~~revised~~ new plans		Departments (including local authority spending and nationalised industries external finance)
1987–88	1988–89	1987–88	1988–89	1989–90	1987–88	1988–89	
18 820	18 990	18 790	18 980	19 470	−20	−10	Ministry of Defence
660	690	700	730	750	40	40	FCO—Diplomatic wing
1 350	1 390	1 360	1 400	1 440	10	10	FCO—ODA ~~(including ODA)~~
1 150	950	870	440	1 060	−280	−510	European Community
1 630	1 660	1 660	1 780	1 880	40	120	IBAP and other CAP expenditure
830	840	880	900	900	50	60	Domestic agriculture, fisheries and food
50	60	50	50	60	0	0	Forestry Commission
1 090	940	1 110	960	950	20	20	Department of Trade and Industry
220	130	160	110	50	−60	−20	Export Credits Guarantee Department
−550	−280	−~~100~~ 90	−50	−250	450	230	Department of Energy
4 030	4 220	4 050	4 240	4 340	20	20	Department of Employment
4 840	4 810	5 140	5 080	5 140	300	270	Department of Transport
2 840	2 890	3 200	3 020	3 090	360	130	DOE—Housing
3 560	3 580	3 850	3 890	3 930	290	310	DOE—Other environmental services
−130	−130	−90	−90	−90	40	40	DOE—Property Services Agency
5 010	5 050	5 540	5 700	5 870	530	650	Home Office
610	650	670	720	770	60	70	Lord Chancellor's Department
14 400	14 470	16 600	17 350	17 840	2 200	2 880	Department of Education and Science
740	760	810	830	860	60	80	Office of Arts and Libraries
18 460	19 140	19 100	19 840	20 720	630	700	DHSS—Health and personal social services
44 300	45 800	46 000	47 500	49 300	1 700	1 700	DHSS—Social security
1 310	1 400	1 270	1 360	1 430	−40	−40	Civil superannuation
7 410	7 430	7950	8100	8220	540	670	Scotland
2 940	3 000	3190	3300	3370	250	300	Wales
4 690	4 820	4870	4980	5150	120	160	Northern Ireland
2 050	2 070	2 230	2 320	2 420	180	250	Chancellor's departments
490	510	570	600	620	70	90	Other departments
−4 750	−4 750	−5 000	−5 000	−5 000	−250	−250	Privatisation proceeds
6 080	7 870	3 500	5 500	7 500	−2 580	−2 320	Reserve
−260	−270	−260	−270	−280	—	—	Adjustments[6]
143 900	**148 700**	**148 600**	**154 200**	**161 500**	**4 700**	**5 500**	**Planning total**
169 500	**174 700**	**173 700**	**179 600**	**187 800**	**4 200**	**4 900**	**General government expenditure**

5. The number of unemployed (GB, excluding school leavers etc) is assumed to average 3.1 million in 1986-87 and 3.05 million in 1987-88, 1988-89 and 1989-90. The RPI is assumed to rise by 3.75 per cent in the year to September 1987 (for the upratings in April 1988) and by 3.5 per cent in the year to September 1988 (for the upratings in April 1989).

Printer – note renumbering of footnotes.

Foreign and Commonwealth Office (diplomatic wing)

2.1~~1~~0 Changes include extra provision for security works to protect diplomatic staff and property overseas, and for the introduction of the visa regime announced on 1 September and reported to the House of Commons on 21 October by the Home Secretary. The costs of the new visa regime are expected to be largely recovered from fees.

European Communities

2.1~~2~~1 The estimate of outturn in 1986–87 includes subscriptions to the European Investment Bank of £48 million, of which £33 million is to maintain the ecu value of paid in capital. The changes since Cmnd 9702 represent the effects of the latest projection of the United Kingdom's net payments to European Community (EC) institutions. The profile implies a drop in payments in 1988–89, followed by an increase in 1989–90. This mainly reflects the assumption that the United Kingdom will benefit from a large correction to its 1987 abatement during 1988.

Intervention Board for Agricultur~~e~~al Produce and other CAP expenditure

2.1~~3~~2 Provision is made to meet the cost of operating the Common Agricultural Policy in the UK. Most of market support expenditure is ultimately financed from EC Budget receipts which are reflected in the UK's net contribution to the EC.

Domestic agriculture, fisheries and food

2.1~~4~~3 Small additions to provision have been made in a number of areas, in particular on flood defences.

Forestry Commission

2.1~~5~~4 The reduction shown reflects increased estimates of receipts from harvesting of timber.

Trade and industry

2.1~~6~~5 Allowance is made for increased spending on industrial support measures including research and development.

Export Credits Guarantee Department

2.1~~7~~6 The net reductions reflect latest estimates of the cost of interest support for fixed rate export finance.

Energy

2.1~~8~~7 The increases in provision relate mainly to the external finance of British Coal and Electricity (England and Wales), partly offset by reduced expenditure on mineworkers redundancy costs.

Employment

2.1~~9~~8 Major new enterprise and employment measures since last year's Autumn Statement were announced in the 1986 Budget and these are now reflected in existing plans. Additional expenditure since then on central government programmes (notably on the Technical and Vocational Education Initiative, on an increase in the number of Job Clubs, and on payments from the Redundancy Fund) is offset by savings elsewhere.

Transport

2.~~20~~19 Additional provision has been made for capital expenditure on roads. Provision for local authorities current expenditure is also increased. External finance for transport nationalised industries has been reduced ~~in later years.~~ over the Survey period.

 spending will be

CX — it has been increased by about £450 million in 1987-88.

Environment—~~housing~~ Housing

2.~~21~~20 ~~In 1987–88~~ Provision for gross capital expenditure on housing ~~will be higher by about £225 million than 1986–87 forecast outturn~~. The Government is fully meeting its commitment to local authorities that initial allocations in 1987–88 would be no less than 80 per cent of the 1985–86 level. Extra resources are being provided for the renovation of the local authorities' housing stock through the Urban Housing Renewal Unit. The Housing Corporation will also have additional funds and will be able to embark on privately financed housing association schemes. The success of the Government's Right to Buy policy is reflected in the higher level of capital receipts ~~(some £950 million more than previously forecast)~~ over the Survey period.

Environment—~~other~~ Other

2.~~22~~21 There will be an increase of £50 million in the provision for capital spending on local environmental services in 1987–88. In each of the three years there is provision for £40 million more to be spent on urban renewal, and there will be increased resources for rural employment and environmental protection. These increases in gross expenditure are partly the results of the extra capital receipts~~, amounting to about £100 million over the three years,~~ which are expected from the sale of new town assets. Increased provision is also made for local authority current expenditure.

CX

Environment—PSA

CX some ... on

2.~~23~~22 The revised plans take account of ~~unavoidable~~ increases in rent payments, and ~~some~~ additional expenditure on maintenance, ~~for~~ on "spend to save" estate rationalisation projects which have the highest rate of return and ~~for~~ on some major new works projects for which PSA retains financial responsibility.

CX on

Home Office

CX provision in 1987-88 has been increased substantially

2.~~24~~23 ~~Additional provision (partly offset by savings and additional receipts) is made to~~ allow for increases in police establishments, ~~and~~ for the design ~~of~~ work on further new prisons, bringing the number of prisons in the building programme to twenty, and for other law and order initiatives. Provision is increased for fire service capital. Additional provision is made to cover the increasing demands on the Criminal Injuries Compensation Scheme.

CX This will

Li these increases are partly offset by savings and additional receipts.

Lord Chancellor's Department

2.~~25~~24 Allowance is made for extra staff to meet the expanding workloads of both criminal and civil courts (partly offset by fees) and for the cost of legal aid.

Department of Education and Science

CX package on teachers' pay and conditions of service

2.~~26~~25 Provision has been increased for both current and capital expenditure on schools. The enhancement includes the extra provision needed to cover the costs of the ~~teachers' pay offer~~ announced by the Secretary of State. New funds have been made available for the initiative on City ~~Technologically~~ Technology Colleges. Funding for the universities has been increased, on the basis ~~offered by the Government~~ of a commitment to greater selectivity, rationalisation, better financial management and improved teaching standards. Additional provision has been made for science.

Office of Arts and Libraries

2.~~27~~26 Additional provision is made for local authority expenditure on museums, galleries and libraries; and there is also an increase in Government grants-in-aid to national institutions. The arts will also benefit from the measures on charitable donations in the last Budget.

Health and personal social services

2.28 Additional provision has been made to allow for demographic pressure and service improvements in the Hospital and Community Health Service. In addition health authorities will have available extra cash released by their continuing cost improvement programmes (expected to yield a further £150 million in 1986–87 on top of the ~~£400~~ £390 million cumulative savings achieved prior to that). Planned provision for the Family Practitioner Services allows for higher forecast demand. Provision for personal social services has also been increased.

Social security

[has been increased in the light of this year's experience and
[Most of the increase represents higher expected expenditure on existing means tested benefits. The provision

2.29 The provision reflects the latest estimates of benefit expenditure over the Survey period. ~~It~~ takes account of the upratings and other changes to benefits announced by the Secretary of State for ~~Health and~~ Social ~~Security~~ Services on 22 October 1986 and allows for further upratings of benefits in April 1988 and April 1989 on the basis of the assumed rise in prices over the relevant periods. ~~The relevant assumptions about unemployment and prices are set out at the foot of Table 2.3~~

STET
Cx.

2.30 [For the purpose of these estimates, it has been assumed that the RPI will rise by 3·75 per cent between September 1986 and September 1987 (the basis of the April 1988 upratings) and by 3·5 per cent in the year to September 1988 (the basis of the April 1989 upratings). The actual upratings of individual benefits will be announced when the relevant RPI figures are known.]

Scotland, Wales and Northern Ireland

2.31 The net changes in these programmes mainly reflect the effects of changes in comparable programmes in England. [The Secretaries of State have discretion to allocate this expenditure taking account of local factors.]

Chancellor's departments

2.32 Allowance is made for additional staff in the revenue departments required to deal with increases in work load and to strengthen controls against drug smuggling. Around one third of the overall increases reflect the changes in the estimates of the cost of providing tax relief on Life Assurance Premiums and Mortgage interest to non-taxpayers.

lc lc

Other departments

2.33 Most of the additional provision is for revised estimates of the cost of the new Crown Prosecution Service. Allowance has also been made for increases for Parliament and the cost of the new Serious Fraud Office.

Nationalised industries

2.34 External Financing Limits (EFLs) for nationalised industries in 1987–88 are listed in Table 2.4. In total, there is an increase from provision in Cmnd 9702 of £680 million. This reflects a number of changes but is primarily the result of additional provision for ~~the~~ Electricity ~~Supply Industry~~ (England and Wales), the South of Scotland Electricity Board, and for British Coal (formerly the National Coal Board). Table 2.3A shows the total provision for nationalised industries' external finance in each of the three years and how this is allocated between departments. A progressive reduction in the external financing requirements of the industries from the level in 1987–88 is expected in 1988–89 and 1989–90.

Table 2.4 External financin~~g~~e limits for the nationalised industries 1987–88

	£ million[1]
~~National Coal Board~~ British Coal	727
Electricity (England and Wales)	−1305
North of Scotland Hydro-electric Board	−1
South of Scotland Electricity Board	84
British Steel Corporation	66
Post Office	−57
National Girobank	−3
British Railways Board	751
British Waterways Board	45
Scottish Transport Group	1
British Shipbuilders	49
Civil Aviation Authority	15
Water (England and Wales)	35
London Regional Transport	275
Other industries[2]	10
Total	**690**

pk (formerly the
[British Airports Authorities)
[National Bus Company

[1] *Figures are shown rounded to the nearest £1 million.*
[2] *Allowance for BAA which is expected to be privatised in 1987-88 and for NBC, where external financing requirements will depend on the progress and timing of the industry's disposals programme.*

Local authorities

Current

[Estimated outturn – as shown in Table 2.3.B – is £2.7 billion over plans; this includes sums for teachers' pay and (other adjustments).
? / what are they CX.

2.3~~5~~3 In 1986–87, local authorities in Great Britain have budgeted to exceed Cmnd 9702 provision for local authority current expenditure relevant for rate support grant by around £2·2 billion. No decision was taken last year on provision for 1987–88 and 1988–89 and the figures in Cmnd 9702 were set at the same cash levels as for 1986–87. This was taken into account in setting the level of the Reserves for those years.

2.3~~6~~4 Provision for the three forward years has now been set at levels which show annual increases on the estimated outturn for 1986–87 of 4½ per cent, 4 per cent and 2¾ per cent. ~~After excluding the exceptional effects of additional provision for teachers' pay in all years, the increases are 3¾ per cent, 3 per cent and 2½ per cent.~~ CX.

2.3~~7~~5 For 1987–88, Aggregate Exchequer Grant to local authorities has been set at £16·4 billion, £1·4 billion above the level for 1986–87. The Government also proposes to abolish grant recycling in England and Wales—the process whereby ~~grant forfeited by overspenders is distributed~~ to all ~~other~~ authorities. ~~In order to~~ this will give authorities greater certainty ~~about~~ their grant entitlements and ~~to act as a disincentive to the highest spending authorities.~~ Guidelines and grant penalties for exceeding them will continue in Scotland.

[grant underclaimed as authorities increase spending is redistributed
[will provide a tougher regime for high spenders.

Capital

forecast
CX.

2.~~38~~36 Local authority gross capital spending in Great Britain in 1986–87 is forecast to be £6·5 billion. After allowing for capital receipts, net spending is ~~estimated~~ to be £4·1 billion, £0·5 billion higher than provided for in Cmnd 9702. These figures remain subject to some uncertainty.

2.~~39~~37 Gross provision for spending in 1987–88, has been increased by £0·7 billion to £6·6 billion. Provision of £6·~~2~~4 billion and £6·5 billion is made for 1988–89 and 1989–90 respectively. Within this provision the amount which is issued as allocations will take account of the expected use by local authorities of the spending power available to them from other sources, notably capital receipts.

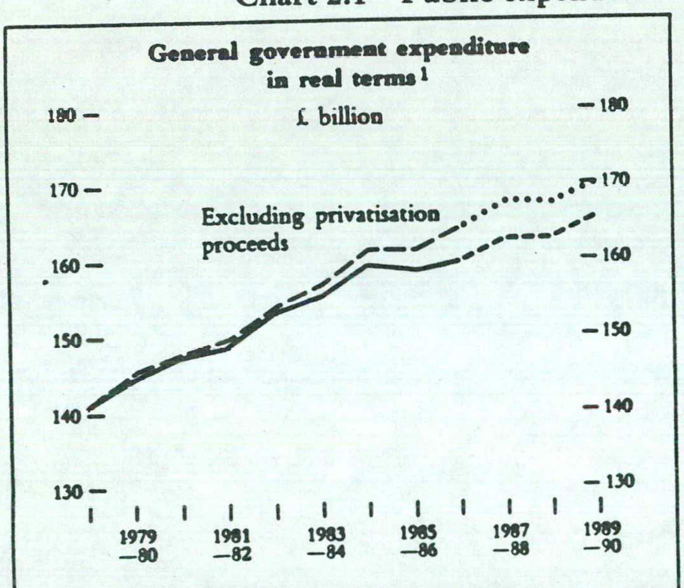
2.~~40~~38 On the main local authority capital cash limit in England—DoE/LAI—allocations of over £2·6 billion will be issued in 1987–88. The reduction from the £2·7 billion issued in 1986–87 will be more than offset by the growing spending power from capital receipts—estimated to be £2·8 billion in 1987–88, £0·2 billion higher than in 1986–87.

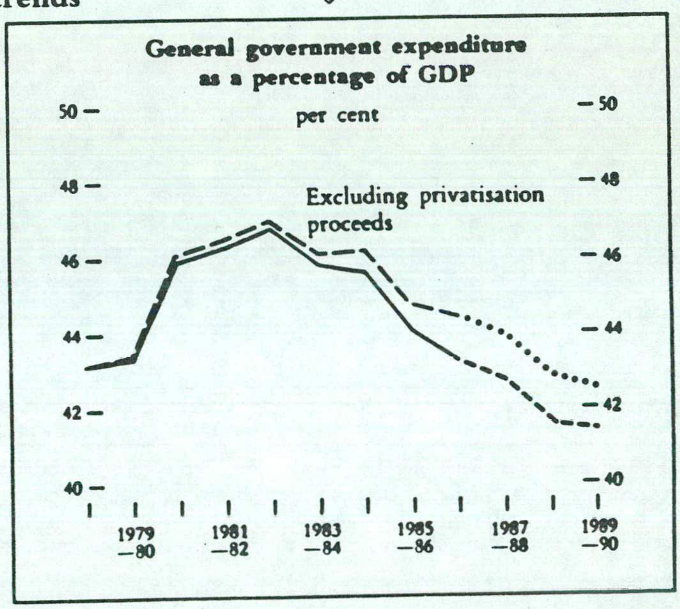
Privatisation

2.~~41~~39 The estimate of net proceeds from privatisation in Cmnd 9702 has been increased to £5 billion in each of the three years. The effects of excluding privatisation proceeds from the public expenditure figures are shown in Table 2.2

to be redrawn on basis of revised figures

Chart 2.1 Public expenditure trends





1 Cash figures adjusted to 1985-86 price levels by excluding the effect of general inflation as measured by the GDP deflator.

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Table 2.3.A Nationalised industries' external financing by department £ million

	~~Outturn~~	Cmnd 9702 Plans	Estimated outturn	~~Increase over 1985–86~~ changes from 1985–86 outturn	Changes from plans	Cmnd 9702 Plans		Plans New			Changes between Cmnd 9702 and new plans	
	1985–86	1986–87	1986–87	1986–87	1986–87	1987–88	1988–89	1987–88	1988–89	1989–90	1987–88	1988–89
Ministry of Defence	−2	~~0~~ —	~~0~~ —	~~0~~ —	~~0~~ —	~~0~~ —	~~0~~ —	~~0~~ —	~~0~~ —	~~0~~ —	~~0~~ -	~~0~~ —
Ministry of ~~Domestic~~ Agriculture, Fisheries and Food*	16	10	20	0	10	10	10	20	20	20	10	10
Department of Trade and Industry	388	120	90	−300	−30	~~60~~ 70	−70	60	−100	−100	−10	−30
Department of Energy	−197	−690	−690	−490	0	−1 140	−880	−580	−510	−660	560	370
Department of Transport* i	1 033	1 090	1 110	80	20	1 020	990	1 050	910	860	30	−80
DOE—Other environmental services	214	140	120	−90	−20	30	30	50	40	−10	10	0
Scotland* 2	233	240	240	10	0	0	−120	90	−20	−170	90	100
Wales* 3	28	20	20	−10	0	10	10	10	10	10	0	0
Total* 4	**1 712**	**530**	**510**	**−1 200**	**−20**	**10**	**−30**	**690**	**350**	**−60**	**680**	**380**

~~* All Ministry of Agriculture, Fisheries and Food.~~

i * *The figures for 1985–86 include public expenditure which is both local authority relevant current spending and nationalised industries' external finance. The sum involved is £115 million. In 1986–87 and subsequent years the public expenditure figures count this money as local authority relevant only.*

2 * *As for footnote* ~~*~~ i*; the sum involved is £40 million.*

3 * *As for footnote* ~~*~~ i*; the sum involved is £7 million.*

4 * *Totals include an allowance of − £~~2~~400 million 1986–87 in respect of ~~BGC~~ and ~~BAB~~ which are due to be privatised in that year; similarly, allowances are included for ~~NBC~~ and BAA in 1987–88 and for ~~NBC~~ in 1988–89.*

British Gas Corporation British Airways Board

National Bus Company plc (formerly British Airports Authority

National Bus Company.

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Changes from

Table 2.3.B Local authority expenditure relevant for RSG by department £ million

Local authority expenditure relevant for RSG	Outturn	Cmnd 9702 Plans	Estimated outturn	~~Increase over~~ 1985–86 out-turn	Changes from plans	Cmnd 9702 Plans		Plans Now			Changes between Cmnd 9702 and ~~revised~~ new plans	
	1985–86	1986–87	1986–87	1986–87	1986–87	1987–88	1988–89	1987–88	1988–89	1989–90	1987–88	1988–89
Domestic agriculture, fisheries and food	105	100	130	20	30	100	100	120	120	130	20	30
Department of Trade and Industry	71	70	80	10	10	70	70	80	80	80	10	20
Department of Employment	92	80	100	10	20	80	80	100	100	110	20	20
Department of Transport[1]	1 785	1 750	1 830	90	130	1 750	1 750	1 950	2 010	2 060	200	260
DOE—Housing	155	~~150~~ 140	130	−30	−20	140	140	140	140	140	−10	−10
DOE—Housing: rate fund contributions to housing revenue accounts	522	~~330~~ 320	450	−60	140	330	330	440	450	460	110	120
DOE—Other environmental services	2 683	2 640	2 760	80	120	2 640	2 640	2 850	2 940	3 010	210	290
Home Office	3 742	3 860	4 150	410	290	3 860	3 860	4 330	4 460	4 580	470	600
Department of Education and Science	10 987	10 820	12 280	1 300	1 470	10 820	10 820	12 850	13 500	13 880	2 030	2 690
Office of Arts and Libraries	408	400	430	30	40	400	400	450	470	480	60	70
DHSS—Health and personal social services	2 406	2 520	2 680	270	150	2 520	2 520	2 850	2 940	3 010	320	410
DHSS—Social security	162	140	~~180~~ 170	~~20~~ 10	40	140	140	210	190	200	70	60
Scotland[1]	2 870	2 970	3 150	280	180	2 970	2 970	3 310	3 440	3 530	330	460
Wales[1]	1 126	1 160	1 230	100	60	1 160	1 160	1 300	1 350	1 390	130 ~~90~~	~~140~~ 190
Wales—Rate fund contributions to housing revenue accounts	~~0~~ 4	0	0	0	0	0	0	0	0	0	0	0
Total local authority expenditure relevant for RSG	**27 117**	**27 000**	**29 600**	**2 500**	**2 700**	**27 000**	**27 000**	**31 000**	**32 200**	**33 000**	4,000	5,200

[1] *For 1985–86 includes nationalised industries' external finance described in footnotes [2,3] and [4] to Table 2.3.A.*

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changes from

X

Table 2.3.C Other departmental spending £ million

Departments (excluding local authority spending relevant for RSG and nationalised industries' external finance)	Outturn	Cmnd 9702 Plans	Estimated outturn	Increase ~~over~~ 1985–86 outturn	Changes from plans	Cmnd 9702 Plans		Plans New			Changes between Cmnd 9702 and new ~~revised~~ plans	
	1985–86	1986–87	1986–87	1986–87	1986–87	1987–88	1988–89	1987–88	1988–89	1989–90	1987–88	1988–89
Ministry of Defence	17 975	18 520 3	18 600	620 3	70	18 820	18 990	18 790	18 980	19 460 7	−20	−10
FCO—Diplomatic wing	605	640	670	60	30	660	690	700	730	750	40	40
FCO (including ODA)	1 245	1 320	1 320	70	0	1 350	1 390	1 350	1 400	1 440	0	10
European Community	831	650	1 090	260	440	1 150	950	870	440	1 060	−280	−510
IBAP and other CAP expenditure	1 857	1 540	1 560 20	−330	20	1 630	1 660	1 660	1 780	1 880	40	120
Domestic agriculture, fisheries and food	791	730	770	−20	40	720	740	740	760	760	20	20
Forestry Commission	51	50	50	0 –	0	50	60	50	50	60	0	0
Department of Trade and Industry	1 045	1 120	1 200	160	80	960	940	970	970	970	10	30
ECGD	319	300	250	−70	−50	220	130	160	110	50	−60	−20
Department of Energy	874	800	850	−20	50	590	600	480	460	410	−110	−140
Department of Employment	3 251	3 840	3 870	620	30	3 950	4 130	3 950	4 130	4 240	0	0
Department of Transport	1 870	1 960	1 940	70	−20	2 070	2 080	2 140	2 170	2 210	80	90
DOE—Housing	2 184	2 290	2 260	80	−30	2 370	2 410	2 630	2 430	2 490	260	10
DOE—Other environmental services	1 014	870	1 190	170	310	880	910	950	920	930	70	10
DOE—Property Services Agency	−97	−90	−90	10	0	−130	−130	−90	−90	−90	40	40
Home Office	986	1 100	1 110	120	0	1 150	1 190	1 210	1 230	1 290	60	50
Lord Chancellor's Department	525	590	620	100	30	610	650	670	720	770	60	70
Department of Education and Science	3 493	3 500	3 670	180	170	3 590	3 660	3 750	3 840	3 960	160	190
Office of Arts and Libraries	313	340	370	60	30	350	360	360	370	380	10	10
DHSS—Health and personal social services	14 234	15 200	15 280	1 050	80	15 940	16 620	16 250	16 910	17 720	310	290
DHSS—Social security	41 308	42 700	44 300	3 000	1 600	44 200	45 600	45 800	47 300	49 100	1 600	1 700
Civil superannuation	1 017	1 190	1 140	120	−60	1 310	1 400	1 270	1 360	1 430	−40	−40
Scotland	4 158	4 360	4 420	260	50	4 440	4 580	4560	4680	4860	120	100
Wales	1 629	1 720	1 810	180	90	1 760	1 820	1880	1930	1990	120	110
Northern Ireland	4 262	4 520	4 530	270	10	4 690	4 820	4810	4980	5150	120	160
Chancellor's departments	1 834	2 010	2 070	230	60	2 050	2 070	2 230	2 320	2 420	180	250
Other departments	334	430	450	110	20	490	510	570	600	620	70	90
Adjustments[1]	−290	−270	−300	−10	−30	−260	−270	−260	−270	−280		
Total	**107 615**	**112 000**	**115 000**	**7 400**	**3 000**	**115 600**	**118 600**					

Removal of [1]Double counting of agricultural spending in Scotland and Wales which is also included in the totals for domestic agriculture, fisheries and food and IBAP and other CAP expenditure.

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 were set out in a statement by the Secretary of State on 6 November 1986. The main proposals are as follows:

The Class 1 insurance rates for employers and employees should remain unchanged for 1987–88.

The Treasury Supplement should be cut from 9 per cent of contributions to 7 per cent.

The lower earnings limit should be increased from April 1987 from the present level of £38 a week to £39 a week in line with the single rate retirement pension.

The upper earnings limit should be increased from £285 a week to £295 a week.

The earnings limit for the reduced rate brackets should also be increased from £60, £95 and £140 a week to £65, £100 and £150 a week.

This would give the following structure of national insurance contributions:

Weekly earnings	Percentage NIC rate on all earnings	
	Employees	Employers
Below £39	(No NICs payable)	
£39 to £64·99	5	5
£65 to £99·99	7	7
£100 to £149·99	9	9
£150 to £295	9	10·45
Above £295	9 on £295	10·45

3.02 The necessary orders will be laid shortly with a report by the Government Actuary on the likely effect of the changes on the National Insurance Fund. In accordance with normal practice, the Government Actuary has been provided with working assumptions for use in preparing his report. These assumptions, which are not forecasts or predictions, will be summarised in his report and include the following:

The number of unemployed (GB, excluding school leavers etc) averages 3·1 million in 1986–87 and 3·05 million in 1987–88. (3·05 million has also been assumed for 1988–89 and 1989–90 in the estimates of social security spending shown in Chapter 2.)

a/ic

Figures for settlements are of course lower than these earnings figures in both years. The earnings figures for 1987-88 reflect the decline in settlements which has already taken place, and the further decline now expected.

lc The increase in average earnings is expected to decline from about 7½ per cent between tax years 1985–86 and 1986–87 to about 6½ per cent between tax years 1986–87 and 1987–88. ~~[This is consistent with settlements averaging 4 per cent in 1987–88.]~~

The report will also allow for an uprating of benefits in April 1987 on the basis of the 2·1 per cent increase in the RPI over the eight months ending in September 1986, as announced by the Secretary of State on 22 October 1986.

3.03 The estimated effects of the proposed changes are shown in Table 3.1.

Table 3.1 Estimated total payments by employers and employees of national insurance contributions in 1986–87 and 1987–88[1]

	Great Britain (£ million)		
	Employers	Employees	Total
National insurance contributions:			
1986–87	12 320	11 580	23 900
1987–88	13 160	12 460	25 620
Total change	+840	+880	+ ~~1 720~~ 1680
of which:			
Change in contributions from increased earnings, etc[2]	+970	+870	+1 840
Change in contributions from increase in earnings limits	−130	+10	−120

X

[1] *Figures are rounded to the nearest £10 million. Detailed figures for national insurance contributions will be included in the Government Actuary's report on the draft of the Social Security (Contributions, Re-rating) (No 2) Order 1986. 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 and, for 1987–88, statutory maternity pay.*

[2] *Including population and employment changes.*

CONFIDENTIAL

4 Oil taxation and revenue ready reckoner

Repayment of Advance Petroleum Revenue Tax (APRT)

4.01 ~~The Government is reviewing the North Sea tax regime in the light o[f the] recent oil price fall and will be announcing its conclusions in the 1987 Budget. In the interim, given the current difficulties of the offshore supplie[s] industry in Scotland and the North East of England,~~ The Government announced on 6 November its intention to introduce a Bill early in the nev[w] Session of Parliament. ~~The purpose of this would be~~ to bring forward ~~to th[e] current financial year~~ certain repayments of APRT due to the oil compani[es] which under the present law would have been spread over the next three financial years.

lc

CX

profits on a scale sufficient to generate

4.02 APRT advances the payment of Petroleum Revenue Tax (PRT) int[o] the early years of an oil field's production. These advance payments may b[e] set against future PRT. Under the provisions of the 1983 Finance Act, thes[e] payments were, in any event, coming to an end: the last period for which APRT is payable ends on 31 December 1986. The fall in the oil price mea[ns] that some fields will not start to generate ~~profits and therefore~~ PRT liabilities until much later than expected (if at all) and so will not be able to utilise their APRT credits. Under current law, APRT would not be repai[d] until 1988 or later. The proposed measure would bring forward to March ~~the current financial year~~ repayments of APRT credits on fields that had n[ot] reached payback by 30 June 1986, up to a limit of £15 million per compa[ny] per field.

4.03 This measure would have a revenue cost in 1986–87 of ~~will increase the public sector borrowing requirement (PSBR) in 1986–87 by~~ up to £310 million, which would ~~but there will be a corresponding reduction in the PSBR of~~ (£130 million in 1987–88, £120 million in 1988–89 and £60 million in 1989–90)

fully recouped over the next three years

Revenue ready reckoner

4.04 The tables below show the effects of various illustrative tax changes o[n] receipts of tax in 1987–88 and 1988–89.

4.05 The effects of tax changes depend on economic variables, such as prices, earnings and consumer expenditure. The estimates shown are consistent with the ~~economi~~c forecast given in Chapter 1.

4.06 An illustrative rate of inflation of 3¼ per cent has been used to show t[he] effects of indexation and revalorisation in 1987–88. This is in line with the annual rate of increase in the RPI forecast for the fourth quarter of 1986.

4.07 The tables show estimates of the direct effects of tax changes. In practice, tax changes will themselves affect economic variables, which in turn will have further effects on tax yields and on the PSBR. The estimate direct effects are not, therefore, the same as the effects on the PSBR. The approach used here is explained in the Annex to Chapter 4 of the Financial Statement and Budget Report published in March 1986.

4.08 The estimates of the effects in 1988–89 assume that the levels of allowances, rates of duty etc set for 1987–88 continue to apply in 1988–89.

Indexation of allowances, thresholds and bands for 1987–88

4.09 Tables 4.1 to 4.3 show tax allowances, thresholds, and bands for 1987–88 after 3¾ per cent indexation. For income tax, Rounding follows the rules laid down in the 1980 Finance Act ~~for income tax and the 1982 Finance Act for inheritance tax and capital gains tax~~; for inheritance tax and capital gains tax those laid down in the 1982 Finance Acts. Estimates of the revenue effects of these changes are shown in Table 4.4.

Table 4.1 Income tax

	~~£ million~~	
	1986–87	1987–88
Allowances:		
Single and wife's earned income allowance	2 335	2 415
Married allowance	3 655	3 775
Additional personal and widow's bereavement allowance	1 320	1 360
Single age allowance	2 850	2 950
Married age allowance	4 505	4 655
Aged income limit	9 400	9 800

Income tax rates	Bands of taxable income	
Per cent	~~£ million~~	
	1986–87	1987–88
29	0 17 200	0–17 800
40	17 201–20 200	17 801–20 900
45	20 201–25 400	20 901–26 300
50	25 401–33 300	26 301–34 500
55	33 301–41 200	34 501–42 700
60	Over 41 200	Over 42 700

Table 4.2 Inheritance tax

£'000

Rate on death	Bands of chargeable value	
Per cent	~~£ million~~	
	1986–87	1987–88
Nil	0–71	0–74
30	71–95	74–99
35	95–129	99–134
40	129–164	134–170
45	164–206	170–213
50	206–257	213–266
55	257–317	266–328
60	Over 317	Over 328

Table 4.3 Capital gains tax

	£ ~~million~~	
	1986–87	1987–88
Annual exempt amount:		
Individuals	6 300	6 600
Trusts	3 150	3 300

Table 4.4 Costs of indexation in 1987–88

	£ million	
	1987–88	1988–89
Indexation of income tax allowances and thresholds	710	950
Of which:		
Increases in main personal allowances	600	760
Increase in the basic rate limit*	70	110
Increases in further higher rate thresholds*	40	80
Indexation of inheritance tax thresholds and bands	18	40
Indexation of capital gains exempt amounts	—	5

* *Additional costs after previous changes have been introduced.*

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

4.10 Table 4.5 shows estimates of the direct revenue effects of illustrative changes in income tax and corporation tax. For income tax allowances and thresholds, these are from the indexed levels for 1987–88.

4.11 The effects of the illustrative changes can be scaled up or down over a reasonably wide range. However, the extra cost of increasing allowances and, in particular, higher rate thresholds tends to fall as the allowances or thresholds rise. For this reason, effects are given for different percentage changes.

4.12 The total cost of a group of income tax allowance changes can be broadly assessed by adding together the revenue effects of each change. However, if allowances are increased substantially and combined with a reduction in basic or higher rates, the effects of the rate reductions will be reduced. In such cases, the cost or yield obtained by adding components from the ready reckoner should be considered only as a general guide.

lc lc lc lc lc

Table 4.5 Direct Effects of Illustrative Changes in Income Tax and lc → Corporation Tax[1]

lc

	£ million	
	1987–88 cost/yield	1988–89 cost/yield
Income tax		
itals → **Rates**		
Change basic rate by 1p[2]	1 100	1 450
Change all higher rates by 1p	65	150
itals **Personal allowances**[3]		
Change single and wife's earned income allowance by £100	290	380
Change married allowance by £100	235	300
Change single age allowance by £100	24	32
Change married age allowance by £100	23	30
Change aged income limit by £200	4	6
Change all main personal allowances by 1 per cent	175	225
Change all main personal allowances by 10 per cent:		
increase (cost)	1 725	2 200 stet
decrease (yield)	1 800	2 275
itals **Higher rate thresholds**[3]		
Change all higher rate thresholds by 1 per cent: increase (cost)	25	50
decrease (yield)	25	50
Change all higher rate thresholds by 10 per cent:		
increase (cost)	215	450
decrease (yield)	290	575
itals **Allowances and thresholds**[3]		
Change all main personal allowances and higher rate thresholds by 1 per cent	200	275
Change all main personal allowances and higher rate thresholds by 10 per cent:		
increase (cost)	1 925	2 650
decrease (yield)	2 100	2 900
Corporation tax[4]		
Change full rate by 1 percentage point	210	390
Change small companies' rate by 1 percentage point[5]	20	40

[1] *The estimated revenue effects of changes in the basic rate of income tax and in the main personal allowances of 10 per cent are rounded to the nearest £25m; other effects over £50m are rounded to the nearest £5m; effects of less than £50m are rounded to the nearest £1m.*

[2] *Including the effect of the change on receipts of advance corporation tax and on consequent liability to mainstream corporation tax.*

[3] *For simplicity, percentage changes are calculated with reference to 1986–87 levels.*

[4] *Assessment to corporation tax normally relates to the preceding year. These estimates are, therefore, the changes to revenue that would occur if the changed rates were applied ~~from 1987–88~~.*

[5] *These figures ignore any possible associated changes in the imputation system.*

to incomes from 1 April 1986

Indirect taxes

4.13 Table 4.6 shows estimates of the effects of changes in excise duties. The first part shows the extra revenue from the individual duties if they were to be increased by exactly 3¼ per cent, together with the price increase that would result (after allowing for consequential VAT). The second part shows the revenue yield from changing current levels of duty so that (after VAT) the price of a typical item is changed by the amount shown.

4.14 Table 4.7 shows the revenue effects of a 1 percentage point change in the rate of VAT.

4.15 Within limits the illustrative changes for specific duties can be scaled up or down to give a reasonable guide to the revenue effects. 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

		3¼% Revalorisation[1]			Changes from present levels of duty			
			£m Yield/~~Cost~~ in[3]				£m Yield/Cost in[3]	
	Current level of duty on typical items	Price change inc. VAT[2]	1987–88 £m	1988–89 £m	Price change inc. VAT[2]	Actual percentage change in duty	1987–88 £m	1988–89 £m
~~Indirect taxes~~								
Beer (pint)	18·6p	0·7p	55	60	1p	4·7	75	90
Wine (70 cl bottle of table wine)[4]	68·6p	2·6p	20	20	5p	6·3	35	40
Spirits (bottle)	£4·73	17·7p	25	30	10p	1·8	15	15
Cigarettes (20 kingsize)[5]	92·7p	3·0p	75	85	1p	1·1	25	30
Petrol (gallon)	88·1p	3·3p	165	185	1p	1·0	50	55
Derv (gallon)	74·5p	2·8p	40	45	1p	1·2	15	15
VED (cars and light vans)	£100·00	£3·25	65	65	£1·00	1·0	20	20

[1] *An 'across the board' revalorisation by 3¼ per cent (including the minor duties not shown above) would yield about £475m in 1987–88 and £525m in 1988–89, and the impact on the RPI would be to raise it by 0·3 per cent.*
[2] *VAT is payable in addition to the duty except in the case of VED.*
[3] *Assuming implementation on 1 April 1987.*
[4] *Revenue effects include all wines.*
[5] *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 subsequent increase in ad valorem duty and VAT.*

Table 4.7 VAT

	£m Yield/Cost in	
	1987–88	1988–89
1% change in rate of VAT[1]	800	1 130

[1] *Assuming implementation on 1 April 1987.*

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2136/038

FROM: A Turnbull
DATE: 12 November 1986

PRINCIPAL PRIVATE SECRETARY

cc PS/CST
Mr F E R Butler
Miss Peirson
Mr Gray
Mr Norton

AUTUMN STATEMENT: TERRITORIES

I attach a draft reply to send to Mr Rifkind's Private Secretary.

AT

A TURNBULL

Ch

I have shortened and made a bit more positive. If you're content I will circulate back to officials before sending it out.

AA

I mean wish to shorten further, but pse leave your version typed up first.

DRAFT LETTER FOR MR A C S ALLAN TO SEND TO

Robert Gordon Esq
PS/Mr Rifkind

AUTUMN STATEMENT

Thank you for your letter of 10 November. You refer to "the unnecessary embarrassment for the Treasury" caused by the decision to incorporate the figures for all three territories in a catch-all line, together with other departments and civil superannuation. In fact we took this course to avoid embarrassment, though of a different kind. Could I explain the background.

Cabinet's discussion

2. The circumstances surrounding this year's Autumn Statement were exceptional. The Parliamentary timetable made it impossible to follow the normal pattern of a Statement on the following Tuesday. The Chancellor therefore decided to make an announcement was therefore made on the very same afternoon, of the Cabinet meeting. This left only a couple of hours after the end of the meeting to finalise, print and distribute the Statement and the accompanying table.

3. In previous years the last figures to be settled for the Autumn Statement have been the territories; indeed last year the figures to go in the printed document were still being argued over discussed on the Friday after the Cabinet meeting. This year we wanted to avoid the embarrassment of issuing one set of figures

on Thursday of one week and being forced to issue different ones the following Wednesday. We therefore took the precaution this year of aggregating the territories and some other non-controversial programmes in order to give us more scope to exploit the roundings should flexibility if any late variations have had come up. It was our understanding that your officials were aware of our proposals and had not raised objection to them.

either this is a fact or it isn't.

4. In the event there was no change to the figures as a result of at Cabinet and the figures as at 5 November have remained unchanged. the ones you want to publish. With hindsight we probably could have published the figures for all three territories on 6 November. Nevertheless, we remain of the view that we were justified, in the light of previous experience, in taking the precaution we did, especially since we would not want to create a precedent which we might not be able to follow on any similar occasion in the future.

If similar circumstances arise in the future we will do our best to ensure that separate figures for all three territories are published at the same time as those for other Departments. And

5. These circumstances were unusual, but they could recur as a result of a similar pressure of Parliamentary business and other events. If they did we might again wish to take a cautious approach to the figures to be published immediately after Cabinet, though we would of course discuss the matter with you beforehand.

6. I am copying this letter to Colin Williams (Welsh Office) and David Watkins (Northern Ireland Office).

Alex
pmp

COMMITTEE OFFICE
HOUSE OF COMMONS
LONDON SW1A OAA
01-219 5766 (Direct Line)
01-219 3000 (Switchboard)

TREASURY AND CIVIL SERVICE COMMITTEE

PRESS NOTICE

The Autumn Statement

As part of its programme of public evidence sessions on the Chancellor's Autumn Statement the Treasury and Civil Service Committee will take evidence on Monday 17 November at 4.45 pm in Room 8 from HM Treasury officials.

D F HARRISON
Clerk

12 November 1986

cc Sir Terence Burns
Mr Cassell
Mr Scholar
Mr Turnbull
Mr Sedgwick
Mr Allan - 12/2
Miss Rutter
Mr Saunders

from Rt Hon Terence L Higgins MP 20/11

Debbie

HOUSE OF COMMONS
LONDON SW1A 0AA

12 November 1986

Dear Chancellor.

Following informal contacts about the Committee's consideration of the Autumn Statement, may I now formally invite you to give evidence on Thursday 20 November at 4.45 pm in Room 8.

A ever
Terence

RT HON TERENCE L HIGGINS
Chairman of the Treasury and Civil Service Committee

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
SW1P 3AG

CH/EXCHEQUER

REC.	13 NOV 1986 ✓13/11
ACTION	MR SCHOLAR
COPIES TO	CST SIR P MIDDLETON SIR T BURNS MR F E R BUTLER MR ANSON MR CASSELL MR TURNBULL MISS C EVANS MRS LESTER

Ch

As already fixed.

Do you need to reply personally on lines "Thank you for your letter of 12 November. I confirm that I shall be ready to give evidence to the Committee on Thursday 20 November at 4.45pm." ? Or shall I just ring Clerk?

AA

That'll do, I think.

✓ done
AA
13/11.

002

FROM: MISS J C SIMPSON

DATE: 13 November 1986

1. MR MORTIMER Am 13/11

2. PS/CHANCELLOR

cc PS/MST
Mr Lavelle
Mr Edwards
Mr Cropper

AUTUMN STATEMENT: HOUSE OF LORDS EXCHANGES - LETTER FROM PS/LORD TREFGARNE

I attach a draft letter about EC budget abatements for Lord Trefgarne to send to Lord Bruce of Donnington in response to his undertakings during the House of Lords discussions of the Chancellor's Autumn Statement.

JS

MISS J C SIMPSON

LA/63

FROM: A C S ALLAN
DATE: 13 NOVEMBER 1986

pmf

MR TURNBULL

cc PS/Chief Secretary
Mr F E R Butler
Miss Peirson 18/2
Mr Gray
Mr Norton

AUTUMN STATEMENT: TERRITORIES

The Chancellor would prefer the reply to the Scottish Office to be slightly more positive than in the draft attached to your note of 12 November, on the lines of the amended version attached. I should be grateful for any quick comments. One point on which he would be grateful for further advice was whether or not Scottish Office officials were aware of what we were planning. The draft leaves this somewhat ambiguous.

ACSA

A C S ALLAN

Mr Allan cc PS/CST
Mr FER Butler
Mr Turnbull
Mr Gray
Mr Norton

Mr Norton has confirmed (with the Scottish Office) that SO officials were aware.

I am not happy about making the promise in paragraph 4. In similar circumstances in future I would want to urge similar caution: indeed, the territories themselves might urge it, to avoid the possibility of different figures coming out 6 days later. I suggest a redraft as shown.

MSP 14.11

AJ 1.8

DRAFT LETTER FOR MR A C S ALLAN TO SEND TO

Robert Gordon Esq
PS/Mr Rifkind

AUTUMN STATEMENT

Thank you for your letter of 10 November.

2. The circumstances surrounding this year's Autumn Statement were exceptional. The Parliamentary timetable made it impossible to follow the normal pattern of a Statement on the Tuesday following Cabinet's discussion. The announcement was therefore made on the same afternoon. This left only a couple of hours after the end of the meeting to finalise, print and distribute the Statement and the accompanying table.

3. In previous years the last figures to be settled for the Autumn Statement have been the territories; indeed last year the figures to go in the printed document were still being discussed on the Friday after the Cabinet meeting. We therefore took the precaution this year of aggregating the territories and some other programmes in order to give us more flexibility if any late variations had come up. [It was our understanding that] your officials were aware of our proposals and had not raised objection to them.

4. In the event there were no alterations to the figures as a result of discussions at Cabinet and the figures as at 5 November have remained unchanged. With hindsight we could have published the figures for all three territories on 6 November. ~~If similar~~ However, in the unlikely event of similar timetable pressures ~~circumstances~~ arising in the future, we ~~will do our best to ensure that separate figures for all three territories are published at the same time as those for other Departments.~~ might well wish to take a similarly cautious approach, in case there were last minute alterations to the figures; we would of course discuss the matter beforehand with your Department.

5. I am copying this letter to Colin Williams (Welsh Office) and David Watkins (Northern Ireland Office).

LA/63

FROM: A C S ALLAN
DATE: 13 NOVEMBER 1986

MR TURNBULL

cc PS/Chief Secretary
Mr F E R Butler
Miss Peirson
Mr Gray
Mr Norton

AUTUMN STATEMENT: TERRITORIES

The Chancellor would prefer the reply to the Scottish Office to be slightly more positive than in the draft attached to your note of 12 November, on the lines of the amended version attached. I should be grateful for any quick comments. One point on which he would be grateful for further advice was whether or not Scottish Office officials were aware of what we were planning. The draft leaves this somewhat ambiguous.

ACSA

A C S ALLAN

Mr Allan

(i) I am content with a shorter, slightly more positive version but

(ii) Mr Butler Miss Peirson and I all feel the promise at the end should be a bit more conditional - I have suggested some words

(iii) I can confirm Scottish Office officials did ~~not~~ know of our plans. The phrase in square brackets can be taken out.

AT 14/11

Ch

I much prefer Mr Turnbull's line to Miss Peirson's v cautious one (below). I suggest a slight reformulation

ACSA

Use AT version as amended by you

[illegible]

268/11
10

AJ 1.8

Please type

~~DRAFT LETTER FOR MR A C S ALLAN TO SEND TO~~

Robert Gordon Esq
PS/~~Mr Rifkind~~ Secretary of State for Scotland
Scottish Office

AUTUMN STATEMENT

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3. In previous years the last figures to be settled for the Autumn Statement have been the territories; indeed last year the figures to go in the printed document were still being discussed on the Friday after the Cabinet meeting. We therefore took the precaution this year of aggregating the territories and some other programmes in order to give us more flexibility if any late variations had come up. ~~[It was our understanding that]~~ Your officials were aware of our proposals and had not raised objection to them.

4. In the event there were no alterations to the figures as a result of discussions at Cabinet and the figures as at 5 November have remained unchanged. With hindsight we could have published the figures for all three territories on 6 November. If similar circumstances arise in the future we will do our best to ensure that separate figures for all three territories are published at the same time as those for other Departments, [~~though to do this it will be necessary for figures to be agreed for the summary table which the Treasury and Departments are prepared to see reproduced in the written printed document.~~]

5. I am copying this letter to Colin Williams (Welsh Office) and David Watkins (Northern Ireland Office).

This will depend on all the consequentials for the territories being settled quickly, so that the figures in the summary table are the same as those subsequently published in the printed document.

Phillips & Drew
ECONOMICS UNIT

RW

THE 1986 AUTUMN STATEMENT

An assessment for the House of Commons Select
Committee on the Treasury and Civil Service
submitted by
Bill Martin, Specialist Adviser to the Committee
on 13 November 1986

The paper expresses the personal views of the
author and not those of Phillips & Drew.

THE 1986 AUTUMN STATEMENT

An assessment for the House of Commons Select Committee
on the Treasury and Civil Service
by Bill Martin, Specialist Adviser to the Committee

The Autumn Statement forecast is based on one key proposition. Fiscal policy, relaxed in the last Budget, is to remain lax, but interest rates are to remain high. The aim is to stabilise sterling while generating a pre-election boomlet. The short term risks are obvious. Another sterling crisis and a further hike in interest rates. But the longer term risks are of greater concern. The sustainability of policy is now in doubt, adding to uncertainty - something the Medium Term Financial Strategy was supposed to avoid. Meanwhile, the imbalance between booming consumption and weak investment growth is damaging the economy's productive potential. Despite the attempt to cheer us up, the Autumn Statement is a depressing read.

Public spending

The planning total has been raised by £4 3/4bn in 1987/88, following a £1 1/4bn upward revision to the estimated outturn for this financial year. £5 1/2bn has been added to the old 1988/89 plans. The planned cash increase is worth nearly 6% in 1987, falling to less than 4% in 1988. A further 4 1/2% rise is pencilled in for 1989. The increments to the old plans are fairly fiddle-free. £1/4bn each year has been added to planned privatisation receipts - now £5bn pa from 1987 - and a similar amount has been added to projected receipts from council house sales. Both items are treated best as financing items rather than as negative public expenditure.

If met, the new plans would have the effect of restoring expenditure back to its previous inexorable growth trend in 'real terms', that is, cash spend excluding the effects of economy-wide inflation. On the Chancellor's inflation forecast, spending on the planning total measure will rise by 2% this year and next, substantial upward revisions on the previous plans (Table 1 and first graph).

Table 1 : Public spending planning totals#

		% growth pa, real terms**		
	Est outturn	-------------plans-------------		
FY	1979-85	1986	1987	1988
(a) Unadjusted	1.1	2.2(0.5)	2.1(-0.3)	0.2(-0.2)
(b)(a) ex asset sales*/ coal strike	1.3	4.3(2.5)	1.8(-0.5)	0.0(-0.4)

* Privatisation proceeds and council house sales.

\# 1986 White Paper/Budget plans in parentheses.

** Cash spend relative to official projected increase in economy-wide inflation as measured by the GDP deflator: currently 3% in 1986/87 and 3 3/4% in 1987/88. The Budget projection of 3 1/2% inflation is taken for 1988/89.

The underlying increase this year is a great deal more. Spending in 1985/86 was bloated by the once-off costs of the coal strike - worth about £1 1/4bn - while asset sales will be some £2bn higher in 1986 than last year. Together these factors add 2% to underlying growth in expenditure, giving over 4% in all. This surge probably reflects the reaction of budget managers to their unhappy experience in 1985 when real spending was squeezed out by the operation of cash limits and an unexpected pick up in inflation (the Treasury forecast 5%, the outcome was 6%).

At first sight then, the new spending targets appear to accommodate the normal kind of upward pressure on real spending with a further allowance for catch up this year. Such apparently generous targets should be hittable. But doubts arise on several counts:

* The reserve for 1987 (£3 1/2bn) is below this year's allowance (£4 1/2bn) which has proved inadequate.

* Although real spending is set to rise by an average 1 1/4% pa, as the Chancellor said, the profile is heavily front-loaded. For 1988, planned real growth is only 1/4%, well below trend.

* Prices for public sector goods and services are likely to be rising faster than inflation economy-wide (as measured by the GDP deflator).

* The Treasury's forecast that economy-wide inflation will stay below 4% may well prove too optimistic.

On our estimates, the relative price of public provision will be rising at around double its trend rate of increase (of 3/4% pa) over the next two years (second graph). Public sector pay, around a third of total spending, will probably rise by 7 1/2-8% pa allowing for the cost of the likely teachers' settlement. Relative prices will get a further boost from the prospective increase in import prices which are excluded as a matter of definition from the GDP deflator. Meanwhile, inflation economy-wide looks set to bounce along in a 4 1/2-5 1/2% band, thanks to the strong underlying trend in unit wage costs. The result is that the average price of all public provision may well be advancing at 6% or more over the next two years.

By excluding these price rises from cash plans, we derive the implications for the 'volume' of public expenditure. The implications do not make joyful reading. For 1987, we find a fall of 1/4% in public spending volume, followed by a remarkable 3% decline in 1988, if the plans are met. Is that credible? We have argued that spending this year is inflated to an extent, reflecting a catching up process after the unaccustomed belt tightening of 1985. For this reason, we give the Chancellor the benefit of doubt on 1987 plans. We withdraw support in 1988, however. Usual pressures for volume increases indicate the likelihood of a massive spending overrun, perhaps up to £6bn, that year in the absence of a sharp shift in policy. This is our first worry.

Budget arithmetic

The burgeoning bill for public spending is being paid for out of buoyant non-oil tax receipts. As a result, the Treasury's conventional budget arithmetic probably shows that the Chancellor could still deliver tax cuts and stick to his £7bn PSBR figure next year and thereafter. Apparently, he can spend extra billions but claim to be fiscally prudent. It's all done with mirrors, of course. Budget arithmetic is a wholly inadequate way of assessing the prudence or otherwise of the 'Government's overall fiscal stance'. This is our second worry.

We start with the usual sums.

Table 2 shows our guesstimates of the Treasury's internal forecasts for non-oil taxes (including national insurance) on income, expenditure and capital. This component of tax take can be related to projections of non-oil money GDP built up from the few clues scattered through the Autumn and Budget Statements.

Table 2 : Guesstimated Treasury revenue forecast - £bn unless stated

FY	1985	1986	1987	1988
Money GDP	360.5	380	406.5	431
Oil value added	17	8	7	7
Non-oil money GDP	343.5	372	399.5	424
Non-oil tax take	127.5	140	151	161
(% of non-oil GDP)	(37)	(37.5)	(38)	(38)
Oil revenue	11.5	4.5	4	4
Other receipts	12.5	12	12	13
General Govt receipts	151.5	156.5	167	178

Figures rounded to nearest £1/2bn.

This year the Treasury has discovered an extra £2bn of non-oil revenue compared with the Budget forecast, despite a probably modest downward revision of estimated non-oil money GDP. Revenue forecasts for 1986 have been boosted by the upward revision to tax take in 1985. That raised the base level for future projections. But revenues are also rising faster than incomes, thanks in part to the progressive nature of the tax system. On this basis, the Treasury have probably increased its Budget forecasts for non-oil tax take by £3bn in 1987 and by £4bn in 1988. We reckon these revisions carry straight through to overall government receipts with oil prices steady at $15 a barrel.

Table 3 gives our reconstruction of the Treasury's familiar PSBR table. On these tentative numbers the net effect of extra spending and extra tax take is to reduce the scope for tax cuts in 1987 from £2bn, projected in the Budget, to £1bn. Such parsimony pays off in 1988, however, assuming public spending stays on target. Here we see a bountiful £4 1/2bn 'fiscal adjustment' - higher even than in the Budget projections.

Table 3 : Guesstimated Treasury PSBR forecast £bn, unless stated

FY	1987		1988	
	Before	Now	Before	Now
General Government:				
expenditure	170	173.5	175	179.5
receipts	164	167	174	178
Fiscal adjust previous	-		2	1
annual	2	1	4	4.5
GG borrowing	8	7.5	7	7
Public corps borrowing	-1	-0.5	-	-
PSBR	7	7	7	7
(as % money GDP)	(1.75)	(1.75)	(1.5)	(1.5)
Money GDP	407	406.5	431	431

Figures rounded to nearest £1/2bn. "Before" = 1986 Budget projections.

Prospects and policy

Our concern is that this kind of figuring will be used as justification for tax cuts. In truth there is no such justification. The Chancellor's borrowing plans were laid down before he or the Treasury realised the full enormity of Britain's looming balance of payments problem. The Treasury has had to scale down its March Budget forecast from a £3 1/2bn surplus on current account to a nil balance in 1986. Next year, where it once anticipated surplus (£1 1/2bn at an annual rate in 1987H1), it now sees deficit (£1 1/2bn). Plans for borrowing set on the basis of the Budget computer prints cannot be right in the Autumn Statement printouts. The right plans must be based on a realistic assessment of Britain's economic problems.

The economy is now beset by a number of the difficulties which we predicted in our evidence to the Committee in March. The key concerns are:

* Evidence of emerging supply constraints. Spare capacity in manufacturing industry is low, despite poor growth. In the labour market, the ratio of vacancies to unemployment is rising strongly, earnings increases show little sign of moderation and skill shortages abound.

* Investment expenditure has been weak relative to consumption and is forecast by the Treasury to remain so.

* The non-oil trade deficit is widening sharply at a time of dwindling oil surpluses.

* The trend rise in unit wage costs appears to be stuck at around 5% pa. Coupled with the turnaround in import prices and high profits growth, it implies an escalation in inflation from now on.

The Treasury forecast plays down these unhappy developments. Although it sees a larger non-oil trade deficit - £14bn in 1987 as compared with £10 1/2bn in 1985 - the overall current account deficit is contained by a remarkable increase in the projected invisibles surplus.

The officially estimated surplus on invisibles in the first nine months of this year is £5.8bn and includes the once-off benefit of the delayed rebate on UK contributions to the European Community's Budget worth nearly £1/2bn. The official projection on invisibles is now £600m a month indicating a figure for the full year of under £8bn. The Treasury forecasts £8 1/2bn this year rising to £9bn in 1987. This looks particularly optimistic on the basis of current estimates.

We have similar reservations about the export forecast. It is not unreasonable that non-oil export volumes should grow a little faster than world trade - though the Treasury have on previous occasions downplayed the importance of competitiveness changes. What is questionable is whether manufacturers have capacity of the right quantity and quality to take advantage of sterling's decline to the extent the Treasury now appears to assume. Overall, we expect a current account deficit in excess of £3bn next year, getting bigger.

The Treasury is similarly over-optimistic on inflation. Wage settlements are assumed to fall despite the pull of strong profits growth and tighter labour markets. It forecasts also a very sharp fall in unit labour costs in manufacturing industry. However, much of that fall is attributable to the cyclical pick up in output and, as a result, should not be a significant influence on manufacturers' pricing behaviour. We would expect to see a rising profit margin in relation to unit wage costs, not a fall in prices. Buoyant margins are being encouraged in any event by sterling weakness and robust demand. We expect inflation over 4 1/2% by end 1987.

Tough Budget required

In these circumstances, the Chancellor's policy settings implicit in the Autumn Statement are plainly wrong. Resources have to be redirected into improving the balance of payments and boosting investment but without re-igniting inflation. <u>The first requirement is a reduction in real interest rates and a further fall in sterling.</u> (Sterling has probably fallen by enough to compensate for the oil price drop but not for other factors which are undermining the current account.) However, at a time of near-full capacity, falling sterling has to be accompanied by a cut back in domestic expenditure. Falling sterling combined with surging domestic demand is simply a recipe for inflation. <u>The second requirement, therefore, is a tough fiscal stance.</u>

Table 4 gives the Committee some idea of how tough. It shows two model simulations producing, over three years, roughly equal improvements on the current account. The scale of that improvement - a cumulative £4bn - is probably not out of line with UK needs over the next few years. Indeed, it may understate them. In (A) sterling falls 10% each year - cumulating to over a 30% fall against the baseline level. That does the trick, but only at the cost of accelerating inflation - 4 1/2 points up by year 3.

<u>Table 4 : How to right the current account</u>

	Yr 1	Yr 2	Yr 3
(A) Large depreciation			
Current account (£bn)	Nil	1	3.25
GDP growth (% pts)	0.5	1	0.75
Inflation (% pts)	1	2.5	4.5
(B) Depreciation & tough Budget			
Current account £bn	0.5	0.5	3
GDP growth (% pts)	0.25	Nil	Nil
Inflation (% pts)	Nil	0.5	Nil

(A) Steady depreciation of 10% a year.

(B) Depreciation of 3% in years 1 and 2 only, plus tax increases.

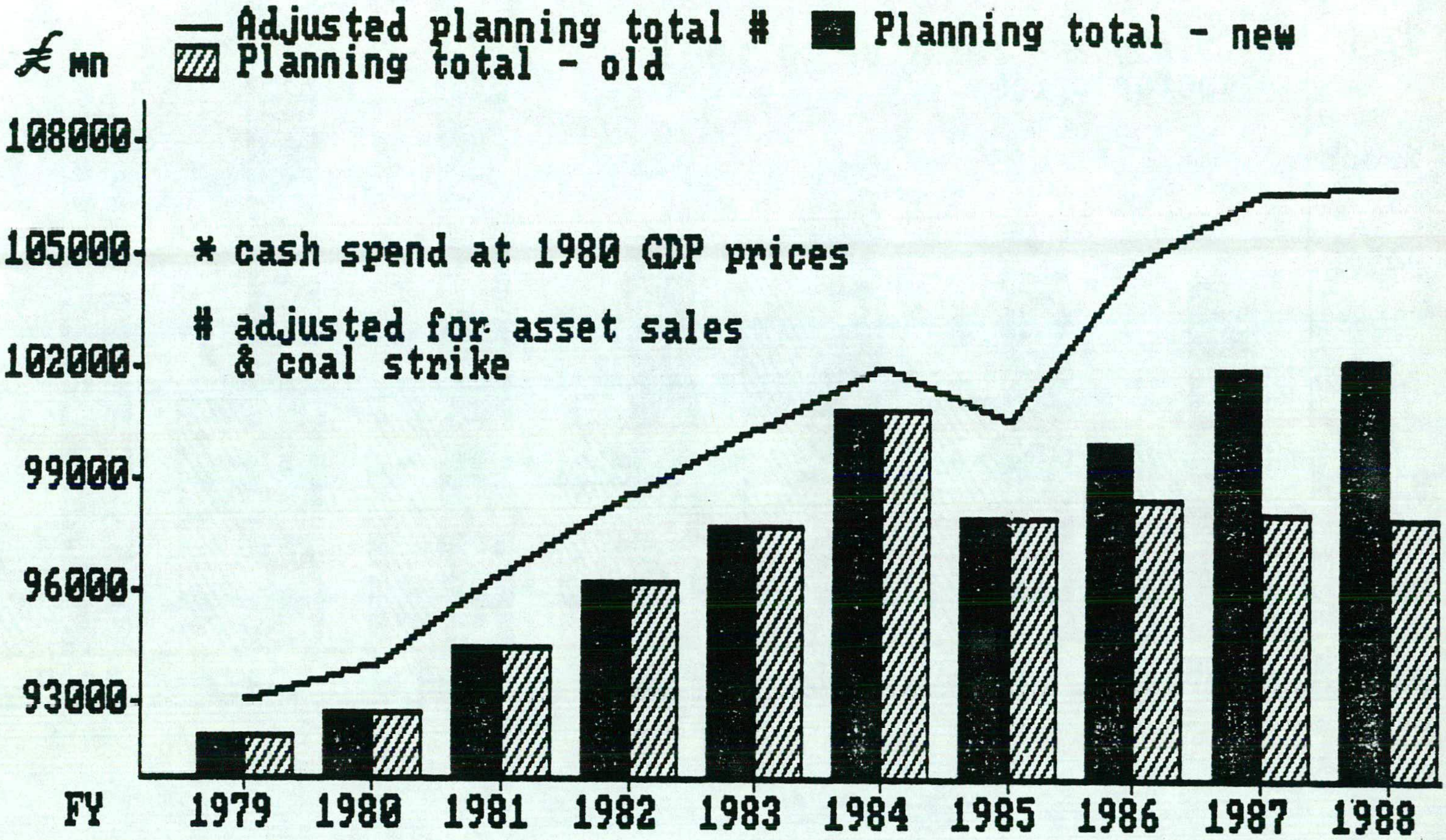
Figures, rounded to nearest 0.25, show differences from a baseline forecast, eg in year 2, simulation (A) shows the current account is £1bn better than it would otherwise have been.

The simulations were conducted on Phillips & Drews macro-model of the economy by my colleague Mr. Chris Johns.

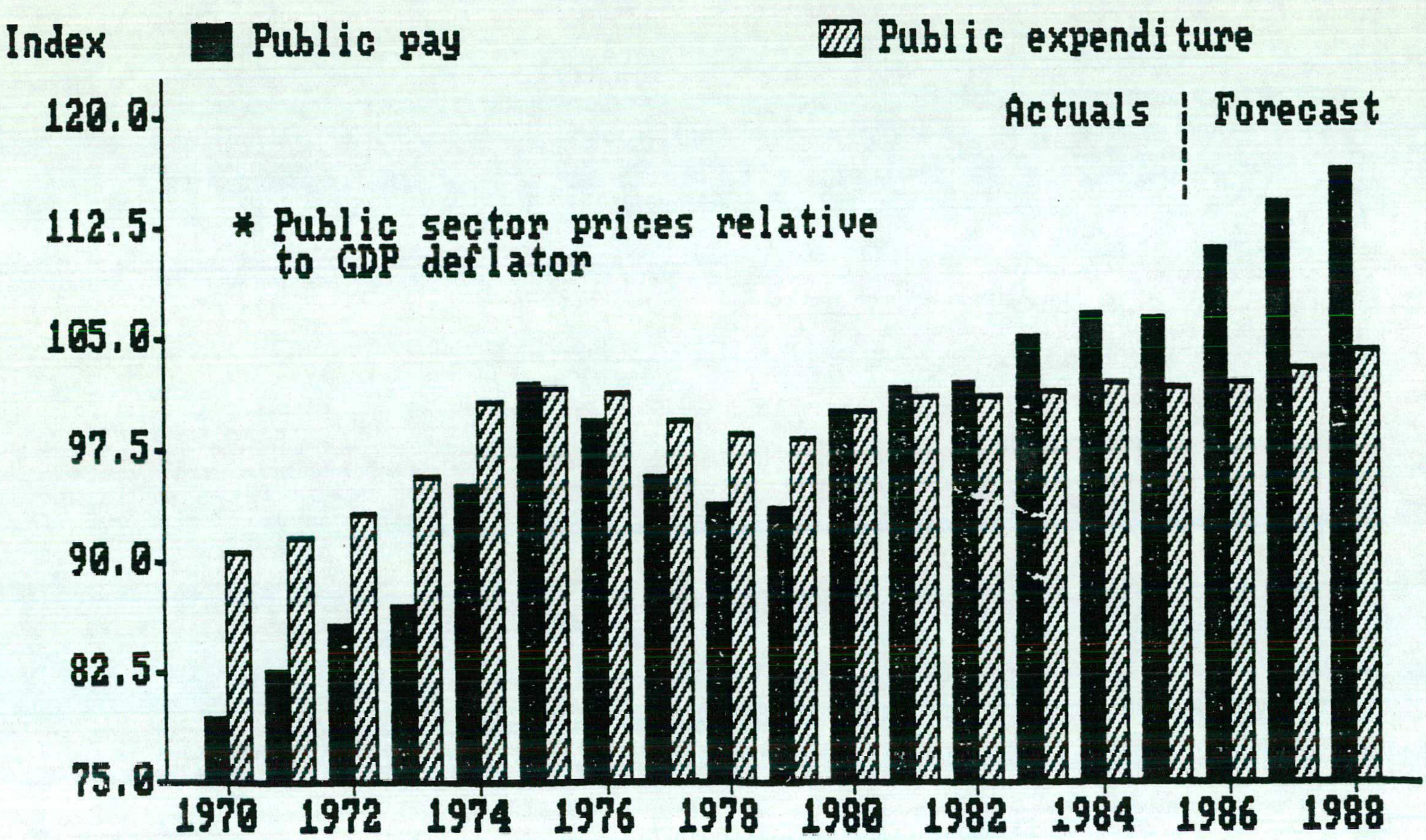
So in B, depreciation is combined with a tough budgetary stance involving (purely for the purposes of example) higher personal taxation. The reduction in consumption of itself helps to right the balance of payments, so the required cumulative fall in sterling is only 6% over 2 years. Inflation barely moves. And despite the tax increases output is not depressed - because of the rise in net exports. The bad news for the chancellor is that simulation (B) involves a cumulative rise in the standard rate of income tax of 7p in the pound!

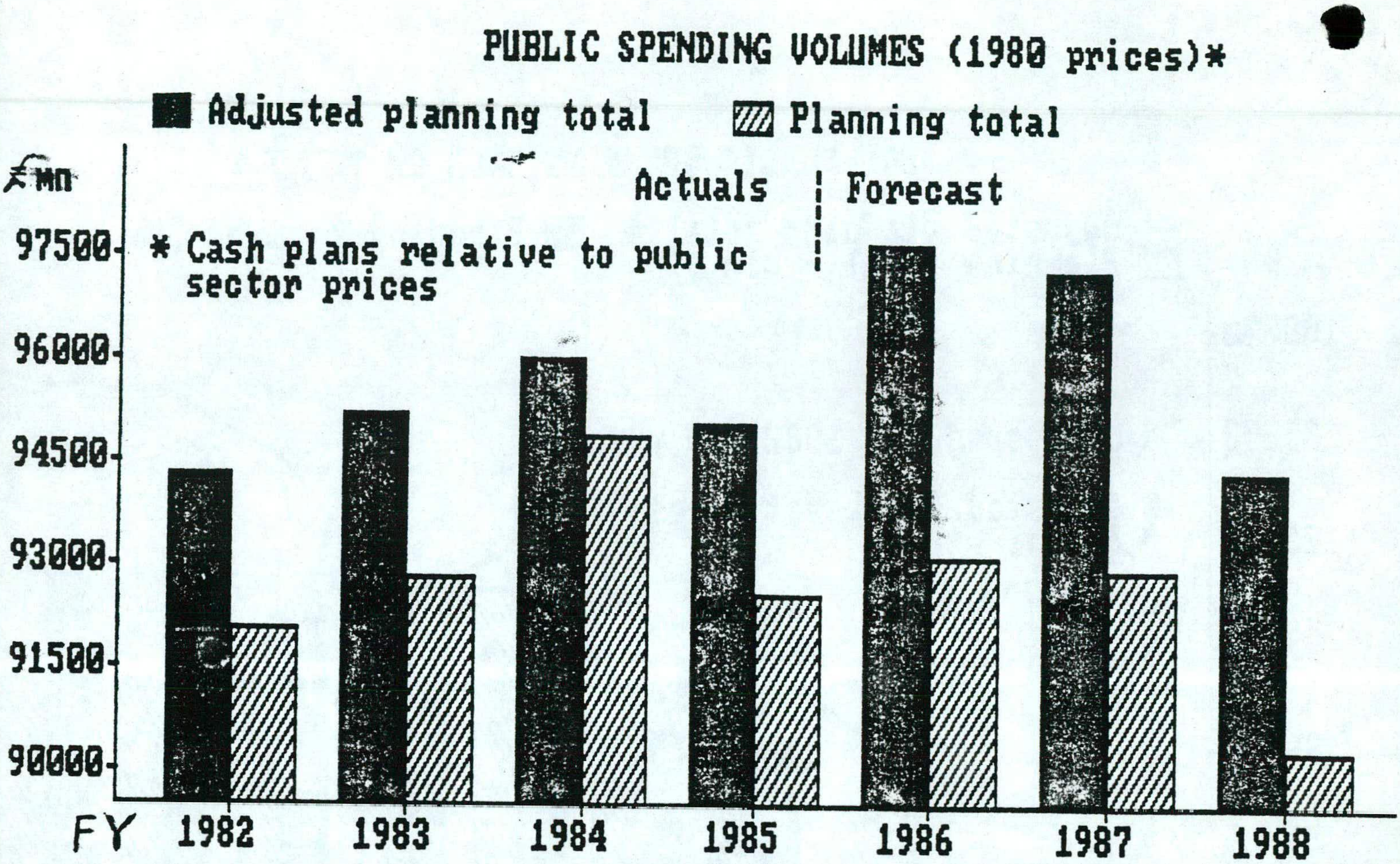
Political pressures could, conceivably, deflect the present Chancellor from adopting this route. <u>But tough budgets will come sooner or later in our view.</u> It would be far better that they came as a result of a cool appraisal of the true needs of the economy. Regrettably it is far more likely that the belt tightening will start after another massive flight from sterling. That's our final worry. It all seems a world away from the original vision of the MTFS.

REAL PUBLIC SPENDING BACK ON TREND *



RELATIVE PRICES RISING (Index,1980=100)*




PUBLIC SPENDING VOLUMES (1980 prices)*
Adjusted planning total
Planning total
£mn
Actuals
Forecast
* Cash plans relative to public sector prices
97500
96000
94500
93000
91500
90000
FY
1982
1983
1984
1985
1986
1987
1988

LA/63

pmp

FROM: A C S ALLAN
DATE: 13 NOVEMBER 1986

MR TURNBULL

cc PS/Chief Secretary
Mr F E R Butler
Miss Peirson 18/2
Mr Gray
Mr Norton

Mr Allan

I don't think this line is sustainable. What there surely must be is a presumption that the territorial figures will be published, but make clear to Scots/Welsh/NI etc. that this will necessitate them agreeing rapidly on consequentials. If they can't accept that, then we will have to revert to this formulation

AUTUMN STATEMENT: TERRITORIES

The Chancellor would prefer the reply to the Scottish Office to be slightly more positive than in the draft attached to your note of 12 November, on the lines of the amended version attached. I should be grateful for any quick comments. One point on which he would be grateful for further advice was whether or not Scottish Office officials were aware of what we were planning. The draft leaves this somewhat ambiguous.

Jill Rutter 14/11

ACSA

A C S ALLAN

Mr Allan cc PS/CST
Mr FER Butler
Mr Turnbull
Mr Gray
Mr Norton

Mr Norton has confirmed (with the Scottish Office) that SO officials were aware.

I am not happy about making the promise in paragraph 4. In similar circumstances in future I would want to urge similar caution: indeed, the territories themselves might urge it, to avoid the possibility of different figures coming out 6 days later. I suggest a redraft as shown.

MSP 14.11

AJ 1.8

DRAFT LETTER FOR MR A C S ALLAN TO SEND TO

Robert Gordon Esq
PS/Mr Rifkind

AUTUMN STATEMENT

Thank you for your letter of 10 November.

2. The circumstances surrounding this year's Autumn Statement were exceptional. The Parliamentary timetable made it impossible to follow the normal pattern of a Statement on the Tuesday following Cabinet's discussion. The announcement was therefore made on the same afternoon. This left only a couple of hours after the end of the meeting to finalise, print and distribute the Statement and the accompanying table.

3. In previous years the last figures to be settled for the Autumn Statement have been the territories; indeed last year the figures to go in the printed document were still being discussed on the Friday after the Cabinet meeting. We therefore took the precaution this year of aggregating the territories and some other programmes in order to give us more flexibility if any late variations had come up. [It was our understanding that] your officials were aware of our proposals and had not raised objection to them.

4. In the event there were no alterations to the figures as a result of discussions at Cabinet and the figures as at 5 November have remained unchanged. With hindsight we could have published the figures for all three territories on 6 November. However, in the unlikely event of similar timetable pressures ~~If similar circumstances~~ arise in the future, we might well wish to take a similarly cautious approach, in case there were last minute alterations to the figures; we would of course discuss the matter beforehand with your Department. ~~will do our best to ensure that separate figures for all three territories are published at the same time as those for other Departments.~~

5. I am copying this letter to Colin Williams (Welsh Office) and David Watkins (Northern Ireland Office).

CE6

Alex

FROM: MISS C EVANS
DATE: 13 NOVEMBER 1986

MCS 13/11

1. **MR SCHOLAR**

2. **CHANCELLOR OF THE EXCHEQUER**

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Butler
Mr Cassell
Mr Anson
Mr Turnbull
Mr Sedgwick
Miss O'Mara
Mr Culpin

Ch
OK? (see also separate papers below)
AA

OK

TCSC: OFFICIALS' EVIDENCE ON THE AUTUMN STATEMENT

May we have your agreement please that the following team should represent the Treasury at the TCSC hearing on Monday 17 November:

Sir Terence Burns
Mr Cassell
Mr Scholar
Mr Sedgwick
Mr Turnbull.

Carys Evans
MISS C EVANS

MR 1/74

pmp

FROM: A C S ALLAN
DATE: 14 NOVEMBER 1986

MISS C EVANS

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Butler
Mr Cassell
Mr Anson
Mr Scholar
Mr Turnbull
Mr Sedgwick
Miss O'Mara
Mr Culpin

TCSC: OFFICIALS' EVIDENCE ON THE AUTUMN STATEMENT

The Chancellor was content with the team proposed for the TCSC hearing on Monday 17 November.

ACSA

A C S ALLAN

1784.28

The line taken is the same as the Chancellor's in the recent Economic Policy debate.

14/xi

FROM: P H BROOK

DATE: 14 November 1986

1. MR RICHARDSON
2. PS/CHANCELLOR

cc: PS/CST
PS/FST
PS/EST
PS/MST
Sir Peter Middleton
Sir Terence Burns
Sir G Littler
Mr F E R Butler
Mr Cassell
Mr Peretz
Mr Kelly
Mr Cropper

REPEAT OF AUTUMN STATEMENT: LORD DIAMOND

I attach a draft letter from Lord Trefgarne to Lord Diamond for you to forward. This deals with the point made by Lord Diamond about real interest rates during the repeat of the Autumn Statement.

P. Brook

P H BROOK

DRAFT LETTER FROM LORD TREFGARNE TO LORD DIAMOND

During the repeat of the Autumn Financial Statement on 6 November I undertook to write to you about interest rates.

Short term interest rates are the essential instrument of monetary policy, and will be held at whatever levels are necessary to maintain monetary conditions that place steady downward pressure on inflation. The success of this strategy is clearly demonstrated by the fact that inflation is now around 3 per cent, the lowest level for twenty years.

[Actual figures for real interest rates are difficult to derive, since real interest rates measure the cost of borrowing (or the return on investment) after allowance has been made for expectations of future price inflation (which are impossible to gauge).]

Real interest rates are difficult to measure, since they depend on expectations about future inflation. But

[As you pointed out, however,] it does seem that they are at present [real interest rates in the UK are] historically high[; this is also the case] in the UK and throughout the industrialised world. [The additional factors that account for] the] One reason for the high level of UK real interest rates [include the high level of pay settlements in this country and the premium needed to cover the market's fear of a Labour Government.] is that UK unit labour costs are still rising faster than those of our major competitors.

DRAFT LETTER FROM PS/CHANCELLOR

TO: PS/LORD TREFGARNE

AUTUMN STATEMENT

You asked for a draft of a suitable letter for Lord Trefgarne to send to Lord Renton about local authority spending, following the repeat in the House of Lords of the Chancellor's Autumn Statement. I suggest the following, which has been cleared with the Department of the Environment.

DRAFT LETTER FROM LORD TREFGARNE TO LORD RENTON

NOT INDENTED

"On 6 November you asked, following the Autumn Statement, ~~on the question of local government expenditure,~~ about the actual and estimated effects of the changes in local government which ~~have been~~ were made by ~~the~~ legislation ~~in 1984~~ the year before last. ~~No doubt~~ I presume you were referring to the provisions for rate limitation in the Rates Act 1984 — but if you had some other point in mind do let me know.

~~I am pleased to be able to tell you that~~ Rate capping has forced local authorities to keep their spending lower - both to avoid selection for the scheme and as a result of it. In nearly all areas which were subject to rate limitation in 1985-86 and in 1986-87 ratepayers have ~~actually~~ seen a cash cut in their rate bills. And in all cases rate demands ~~were~~ have undoubtedly been lower than they would have been if authorities ~~were~~ had been allowed to spend as they wished. It is difficult to put any hard figures on the saving achieved because we do not know what local authorities would have decided to spend if they had had a free rei~~g~~n. But the savings ~~is~~ are likely to run into hundreds of millions of pounds."

1. MR PIRIE ✓ 14/11

2. PS/CHANCELLOR

FROM: R FELLGETT

Date: 14 November 1986

LORD RENTON'S QUESTION ABOUT LOCAL AUTHORITY SPENDING

I attach a draft reply for you to send to Lord Trefgarne's office, with a form of words about the savings from rate capping. (I infer from Lord Renton's question and the preceding question that his enquiry was about rate capping, although he did not actually explicitly say so. I have been unable to clarify that this was his intention; the telephone in his chambers in Lincolns Inn has been unanswered all week.)

2. The proposed form of words for Lord Trefgarne's reply to Lord Renton has been largely provided by the Department of the Environment, and closely follows previous public statements by their Ministers.

Robin Fellgett

R FELLGETT

Ch

All 3 draft replies now in. If you are content I will combine into a single letter to Lord Trefgarne.

AA

yes pse

CE8

BF for TCSC
Wdw or Thursday

FROM: MISS C EVANS
DATE: 14 NOVEMBER 1986

MR SCHOLAR

cc Chancellor of the Exchequer
Chief Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Cassell Mr Kemp
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr S Davies
Mr Gray
Mr Mathews
Mr Mowl
Miss O'Mara
Mr C Allan

TCSC: OFFICIALS' HEARING ON MONDAY 17 NOVEMBER

I attach questions received from the Committee on the fiscal stance, public expenditure, wages and the fiscal adjustment.

Carys Evans

MISS C EVANS

Ch

Terry may ring you on Sunday to discuss these.

AA

CE8

FISCAL STANCE

no. Only difference is exports & BOP. Domestic demand etc much as foreseen @ Budget time.

1. The outlook for the economy is very different now from what it was in the Budget forecast and yet the fiscal stance remains the same (Budget PSBR forecast £7 billion, Budget forecast for current account 1986-87 £3½ billion, 1987-88 £1½ billion, latest forecast current account in balance this year, deficit next year). Doesn't the PSBR target carry different significance against the revised balance of payments forecast and would not a smaller PSBR be justified now? Ch has made position clear. MTFS is about medium-term & about stability in policy. BOP deficit small.

2. If the Treasury is saying that the scope for tax cuts depends on the buoyancy of revenues, doesn't that imply that your fiscal policy is pro-cyclical? MTFS again.

3. Doesn't the public expenditure overrun in 1986-87 represent a significant set back to the objective of cutting income tax to 25p in the £? Long-term objective. But £ extra spending is £ less for tax cuts.

4. What are the reasons for the overrun on the planning total in 1986-87, with particular reference to social security and education?

5. The 1986 FSBR objective was to hold spending level in real terms. The Autumn Statement policy is to reduce expenditure as a percentage of GDP. Is this a deliberate policy change or an admission that the Government is unable to control local authority spending? Providing for continued deceleration, (3/2¼/1¾/1). And reform of LG finance to improve accountability

6. Is the Reserve for 1987-88 large enough? LA/SocSec points.

7. Does the extra expenditure on education reflect higher priority for this service or is it simply the result of teachers' salaries catching up? Higher salaries in return for improvements in conditions of service & salary structure.

8. Expenditure is planned to increase in real terms by 2 per cent in 1987-88, but only a ½ per cent in the following year. Is this realistic? Although deflating the proposed planning totals by the inflation forecast produces some real increases, isn't there likely to be an adverse relative price effect which means that volume spending may not go up very much? Is this going to make plans more difficult to achieve?

EC contributions etc.

9. Last year's Autumn Statement gave no figures for local authority spending in future years, on the basis that there had been no agreement with local authorities. Does the fact that the Statement this year includes planned figures for local authority spending reflect agreement with local authorities about spending levels or are these simply Treasury objectives?

Government ~~plans~~. Estimates

WAGES

1. The forecast expresses the hope that wage settlements may fall over the next 12 months: what is the evidence for this? How confident is the Treasury of this forecast?

some recent figures.

2. The recent Treasury Working Paper on Wage Bargaining says that lower import costs feeding through into higher profits is a factor leading to higher pay settlements. Would the converse apply?

MANPOWER

1. What is the state of progress on the Rayner scrutinies?
2. What are the manpower implications of future spending plans for the NHS, education service, law and order?

FISCAL ADJUSTMENT

1. Is it reasonable to expect outsiders to interpret the forecast without spelling out the assumed fiscal adjustment?

As last year.

Yes, but also (Better than last yr: since they have ~~[illegible]~~ not only the spending figs but – exceptionally – the PSBR, they have an implicit forecast for revenue after fiscal adjustment (if any)).

cc PPS. / CHANCELLOR

==

HOUSE OF COMMONS

MINUTES OF EVIDENCE

TAKEN BEFORE

TREASURY & CIVIL SERVICE COMMITTEE

MONDAY 17 NOVEMBER 1986

SIR TERENCE BURNS, MR F. CASSEL, MR M.C. SCHOLAR, MR A. TURNBULL and MR P. SEDGWICK

Evidence heard in Public   Questions 1 - 81

USE OF THE TRANSCRIPT

1. Members and prospective witnesses to whom the transcript is sent in strict confidence, under the authority of Mr Speaker and the Committee, are asked to note that the text is unpublished and that its use should be governed by the guidelines in the following paragraphs.

2. Members receive copies for the purpose of correcting questions addressed by them to witnesses, and are asked to send any corrections to the Committee Clerk as soon as possible.

3. Prospective witnesses receive copies in preparation for any evidence they may subsequently give.

4. This is an uncorrected and unpublished transcript of evidence taken in public and reported to the House.

5. No public use should be made of the text.

MONDAY 17 NOVEMBER 1986

Members present:

Mr T.L. Higgins, in the Chair
Mr John Browne
Mr Ralph Howell
Mr Austin Mitchell
Mr John Townend
Mr Richard Wainwright
Mr John Watts

SIR TERENCE BURNS, Chief Economic Adviser, MR F. CASSEL, Deputy Secretary, Public Finance, MR M.C. SCHOLAR, Under Secretary, Central Unit, MR A. TURNBULL, Under Secretary, General Expenditure Policy Group and MR P. SEDGWICK, Under Secretary, Forecasting and Analysis Group, HM Treasury, called in and examined.

Chairman

1. We are most grateful to you and your colleagues for coming along this afternoon to give evidence on the Autumn Statement and, as you know, we shall be taking evidence on Thursday from the Chancellor of the Exchequer. We are not, in fact, in our usual room - it may look the same from your point of view but there are several more rows which we hope will give rather more room. We will be asking questions on various aspects of the Autumn Statement. If you have any preliminary remarks you would like to make then we will be glad to hear them.

(Sir Terence Burns) I have no introductory comments to make.

Chairman: We can start, I think, with Mr Watts who has the first set of questions.

Mr Watts

2. Would you agree that the stance on monetary policy in the Autumn Statement amounts to an exchange rate target?

(Sir Terence Burns) No, I would not. The stance on monetary policy in the Autumn Statement is as set out in the MTFS last March and by the Chancellor in his Lombard speech in April.

3. I recall in his evidence to us in our post Budget Inquiry the Chancellor was laying much greater emphasis on the matter of the exchange rate, particularly as a restraint on inflationary pressures on the economy and we have seen, in the Autumn Statement, a very substantial downgrading of the weight placed on other monetary targets.

(Sir Terence Burns) I do not agree with the last part of that statement. There is no doubt that the exchange rate does have an important part to play in the assessment of monetary conditions and the Chancellor has repeatedly made that clear but also made clear that monetary targets also have an important role to play. Indeed, in the Mansion House speech he pointed out that one of the reasons for the last increase in exchange rates was because the growth of MO, the narrow measure of money, had picked up quite sharply.

4. We have no explicit monetary targets in this statement at all?

(Sir Terence Burns) Indeed not. That has been the position in all previous Autumn Statements that I can recall. Indeed, we frequently have exchanges at this time of year along these lines. The Chairman often puts to me the question: "Why is there not a greater treatment of monetary policy in the Autumn Statement?" I point out that is not the role of the Autumn Statement. The Autumn Statement presents forecasts of the economy, it presents the figures for public expenditure. Of course, the Chancellor has made a statement about monetary policy in the

Mansion House which is also customary at this time of the year. The Autumn Statement is not the occasion for a re-statement of monetary policy.

5. If I can pursue the exchange rate point: how confident is the Treasury that the assumption made in the forecast that the effective exchange rate will remain at about its present level is a realistic one?

(Sir Terence Burns) I emphasise, of course, that this is not a forecast, it is specifically suggested to be an assumption. I would not dream of attempting to forecast the exchange rate. I have watched too many people for too many years get their fingers burnt at this game. I cannot for that reason make any particularly strong statements about what is going to happen to the exchange rate, as we have so often seen in the past, it can move quite sharply in either direction in ways which catch people by surprise. I think this is a realistic assumption and also I should point out an assumption which we usually make in these forecasts.

6. It is no more than an assumption and we would not necessarily expect to see any measures to damp down significant deviations either up or down?

(Sir Terence Burns) It certainly is only an assumption. I do not think the second statement that you make follows from that. As I agreed earlier, the Chancellor has frequently said the exchange rate is an important indicator that is taken into account in the assessment of monetary conditions and sharp movements of the exchange rate would clearly have indications of policy on that basis. The fact it is an assumption for the purposes of this forecast does not invalidate the general statement about the role of the exchange rate in the assessment of monetary policy.

7. So there is an implicit target but not an explicit one?

(Sir Terence Burns) There is neither an implicit target nor an explicit target and that is also something which I have had cause to state in this room or, as the Chairman points out, another room, on several occasions in the past. This game of hunt the exchange rate target is an old and familiar friend and we constantly point out that there is not an exchange rate target.

8. Finally, if the pound were to fall in effective terms, how would this affect the forecasts for inflation exports in the current account?

(Sir Terence Burns) If the exchange rate were to be lowered then in time we would expect prices to be higher, we would expect the volume of exports to be higher and again, in time, we would expect the current account to improve. Although, as we know, for some time there may be adverse movements because of the familiar characteristics of the J-Curve.

9. What reasons would you have to expect beneficial effects on exports in the absence of any certainty about the future course of exchange rates? Because, I find in talking to businessmen that uncertainty about the future level of exchange rates is one of the factors that seems to deter businesses from taking advantage of what might turn out to be a short-term improvement in international competitiveness?

(Sir Terence Burns) I accept the fact there is inevitable uncertainty about the exchange rate. It is a characteristic of the exchange rate system that the world has. I think that fact inevitably means a change in exchange rates will have a smaller?

similar impact on exporters' decisions because, obviously, they must take into account the extent to which it is going to persist. However, despite that, I think the evidence is clear that changes in the exchange rate do have an impact upon export performance, possibly that impact is not as great as was once thought to be the case and again this is a subject on which we have had exchanges in this Committee. I would accept that the fact that there are fluctuations in the exchange rate is possibly one reason why factors in the exchange rate are not as great as they have been before. I do not think that invalidates the general proposition that it will in time - I stress in time - have an effect on export performance.

Chairman

10. Could I just pursue two points raised by Mr Watts. Are we wrong in thinking the Chancellor has recently gone on record saying that he would not wish to see the exchange rate any lower than it is at present?

(Sir Terence Burns) That is correct, he said that in an interview on BBC Radio last Sunday. I cannot recall the exact words but they were a statement along those lines.

11. That would seem to imply an exchange rate target at any rate in a downward or upward direction depending which way you are looking at it?

(Sir Terence Burns) I cannot explain any more than what was contained in what the Chancellor said. If you wish to explore that further you will have to wait until Thursday.

will certainly be pressed on this

12. Perhaps we might do that. Can I pursue the other point that Mr Watts raised which is the extent to which there are monetary policy statements in the Autumn Statement. I think we regarded the public sector borrowing requirement as a monetary policy within the medium term financial strategy, but would I be right in thinking that this is the first time in an Autumn Statement that a view has been extended about PSBR?

(Sir Terence Burns) Yes. The position on the PSBR in this Autumn Statement is not quite the same as it was last year. We have, of course, always presented a forecast on the assumption that the PSBR was in the previous year's MTFS, to take the PSBR that would operate for the next financial year, and of course there has been a very strong presumption that come the time of the Budget that, indeed, would be the PSBR for the following year. Indeed, I think if you look at the last three or four years you will find in each case the PSBR in the Budget has been set either at or just below the level that was given in the previous year's MTFS, nevertheless it was a presumption. This year the Chancellor has gone further than that and he has said that the PSBR next year will be held to that figure. He has done that because there was some question as to whether or not people would interpret the changes to the planning total as implying the fiscal stance would be relaxed next year. In order to make quite clear that that would not be the case he felt it was necessary on this occasion to go a little bit further in terms of statements of fiscal policy.

13. To that extent there is this year a statement about monetary policy in the Autumn Statement whereas there has not been recently?

(Sir Terence Burns) A statement about fiscal policy.

14. Yes, but a relationship between the two?

(Sir Terence Burns) There is indeed that extra dimension this year to the Autumn Statement.

15. And the medium term financial strategy has clearly been placed in the context of the PSBR as well as the monetary indicator?

(Sir Terence Burns) It has but it is specifically the fiscal side that I think the Chancellor was addressing here because it was specifically that side that might have been called into question as a result of the increases to the planning total.

Chairman: I think Mr Browne has a couple of quick questions relating to what Mr Watts was talking about.

Mr Browne

16. Further to the Chairman's question before last when the Chancellor said that he did not wish to see sterling go any

lower, to which indicator do you think he was referring, was it sterling against the deutschemark, sterling against the US dollar, or sterling against the trade-weighted index, or another?

(Sir Terence Burns) I do not think he was actually specific about it but my guess would be he had in mind the sterling index. That is the measure that most of our statements about the exchange rate refer to.

17. Thank you, that is very interesting. It implied, although he did not give a figure, that there was a sort of psychological floor possibly on the trade-weighted index basis, do you feel there is also a psychological ceiling or lid to sterling the Chancellor would have in mind?

(Sir Terence Burns) I do not think that follows. I think you have to interpret his comments about the exchange rate in the context of the kind of movement we have seen recently. On previous visits to this Committee the Chancellor has stressed as far as the exchange rate was concerned he neither wanted to see excessive movement in the exchange rate, but he also wanted to keep a relatively bracing exchange rate, and above all he stressed that he did not approve of an exchange rate that may have to accommodate differential movements in inflation or cost pressure. However, because of the oil price reduction this year it has been inevitable that there would be some reduction of the exchange rate. As he has said that correction has now taken place and I think he wants to emphasise that that period of exchange rate depreciation is now behind us and we are back to the same principles that were in place previously.

18. Thank you very much.

(Sir Terence Burns) And, therefore, that I think is the reason that lies behind the emphasis of the statement.

Mr Townend

19. Sir Terence, what is the real underlying increase in the departmental expenditure now for 1986/87 in percentage terms over 1985/86?

(Sir Terence Burns) I will pass that to Mr Turnbull.

(Mr Turnbull) In real terms?

20. No, I mean the real departmental expenditure excluding asset sales and excluding the change in the cost of interest?

(Mr Turnbull) The increase in the planning total from one year to the next in terms of outturn is from 133.6 to 140.4, that is on the basis of outturns, and in one case the asset sale is four and three-quarters and in the other it is two and three-quarters.

21. Is not the underlying increase bigger because were not the 1985/86 figures bloated by the effects of the coal strike, by some one point something billion? If you get down to the real departmental spending is it not increasing by something like four per cent?

(Mr Turnbull) I am not sure in the event that the increase in the coal strike in 1985/86 was necessarily as large as that. It is very difficult to disentangle the finances of the NCB, as it then was, towards the end of the year when it enjoyed a very rapid improvement. That was certainly a difficulty. I think one billion was the figure we estimated at the time.

22. This Committee was given a figure of about one and a quarter billion.

(Mr Turnbull) Yes.

23. If you take that into account are we not up to four or five per cent and that actually is greater than the estimated

increase in the growth of the domestic product in the Autumn Statement which is three and a bit per cent?

(Mr Turnbull) You started by saying you wanted to get to an underlying figure, I am not sure by taking any one year movement to any other year, particularly when you have the difficulty of making corrections for a specific factor, that that is necessarily a way to do it.

24. As far as the public are concerned they are interested in departmental expenditure. We have had this argument about asset sales before, but accepting you exclude asset sales and you allow for the distorting effect of the miners' strike in 1985/86 it would be true, would it not, that departmental spending is increasing in 1986/87 faster than the increase in GDP?

(Mr Turnbull) I would have thought there is not a lot of difference between them. I am not sure there is an enormous difference between them. In 1985/86 we had a very sharp fall in real terms followed by, in 1986/87, a rise in real terms. You are trying to ascribe the rise in 1986/87 in real terms as in some sense a measure of the underlying change, I am not sure it is necessarily wise to do that.

25. What I have said is correct, is it not, whether you think it is wise or not? If you make the adjustments that I suggested to you in actual fact the departmental spending is rising at a higher percentage term in 1986/87 than GDP?

(Mr Turnbull) Excluding the planning total itself, in 1986 we have a rising by 2.2,excluding privatisation by 3.6, which in that year is, as you say, higher than the real growth of GDP.

26. Particularly if you add one and a quarter billion for the coal strike and the change in the interest rate. Can I proceed? You say this year's Autumn Statement indicates there has been a significant change in the Government public spending policy?

(Mr Turnbull) Some people try to describe it as that but the underlying objective, which has been an objective for a number of years, has been to reduce the share of spending as a proportion of national income. That is an objective one finds expressed back in 1979 before the present Government came to power. You find it appearing again in the longterm Green Paper issued in 1984 and it has been there as a constant theme all through the various times there have been statements about the speed with which that objective is going to be achieved. It is clear that you are going to make less progress or slower progress towards reducing that if expenditure is rising at 1 to 1½ percent in real terms than if you had it constant in real terms. I would see it as less a change of objective but more a change of the speed at which that objective is being achieved.

27. You did state in the 1986 FSBR that the aim was to hold total public spending broadly level in real terms. Now that is a statement that has not been repeated this year. It does seem we have moved away from that now and, instead of trying to help public spending in real terms, we are trying to reduce the total of public spending to a percentage of GDP, which is slightly different.

(Mr Turnbull) That statement was also there in the FSBR, the first statement.

28. To that extent there has been a change in direction or change in emphasis?

(Mr Turnbull) A change in degree, yes, within this broad framework of trying to bring the share down. But that statement of bringing the share down was in the FSBR in the previous White Paper as well. It has been around for a very long time.

29. Could you tell me what assumption has been made in producing these figures of public sector pay in the next finance year 1987-88?

(Mr Turnbull) There is not necessarily any assumption about public sector pay, except in some very special circumstances such as teachers. In the case of departmental cash limits what is agreed is the cash amount and that does not involve the assumption of a particular level of pay. In the case of local authorities, provision is made and GREs are set and the outcome will vary according to the increase in pay. The degree of pressure that people are under will vary according to the increase in pay. The survey is not put together by taking an assumption about pay, as it used to be two years ago.

30. When departments are doing their budget, they must in their own minds take account to some extent of the sort of figures they will include if pay increases are going to average 3 percent which is very different from pay increases averaging 8 or 9 percent. I know you set the departmental budget. You said that departments have cash limits.

(Mr Turnbull) The essence is that the departments have that view; what they agree with the Treasury are the cash limits or the running cost limit.

31. The Government has been preaching to private industry that pay increases are too great and they should get them down to roughly the level of inflation. We would hope the Government would set an example but clearly, if pay rates go up much faster, you are going to be digging into the reserves. In the next financial year the reserves are at a lower figure than in the current year. When one considers that this Autumn Statement shows an overrun of expenditure - a considerable overrun of expenditure, when one considers pressure on wages, are you confident that the figure you have in the next financial reserve will be adequate?

(Mr Turnbull) The reserve for 1987-88 is higher in absolute terms and in planning terms than any previous year except the year we are now in, when there were particular circumstances of local authority decisions on how to provide for local authorities in the survey. What had happened was that the provision for 1986-87 set only a very small half percent rise above the 1985-86 outturn and at the same cash level thereafter. Given that we now have local authority spending projected to rise at 4½ percent next year, that implies a very different size of reserve. We have gone back to reserves that are lower than last year but still higher than previous years. Moreover, the rise steps between the reserves in each year are larger than they have been before.

32. So you are quite happy that the reserves in the statement are adequate?

(Mr Turnbull) We have obviously thought about the size of reserve required. The size of reserve that the Treasury settles upon has to reflect the nature of the decision contingency it has to cover.

33. My last question: would you agree that, if the Government had kept to its forecast and its plans as set out in the previous Autumn Statement, it would have been considerably easier for the Chancellor to achieve his aim of bringing the standard rate down?

(Mr Turnbull) I think the Chancelllor has acknowledged that himself in his statement about not spending the same pound twice.

Mr Wainwright

34. Sir Terence, my questions are about the balance of payments on the current accounts. First of all, there is a very substantial difference between the 1986 forecast of total current balance in the Bduget Statement this year and the same forecast, the same heading of forecast, in your Autumn Statement this year, dropping from 3½ million surplus ot nil. The biggest single discrepancy between those two balance figures is cccounted for in manufactures. Could you give us some breakdown of the factors which have led you to revise this forecast, specially with manufactures, so substantially?

(Sir Terence Burns) I take it you are asking about the factors which lie behind the changed performance?

35. Indeed.

(Sir Terence Burns) I think by far the main factor was the extent to which world trade growth did not turn out as anticipated - I should emphasise world trade in manufactures. It has been a very difficult year obviously for forecasters as far as balance of payments is concerned, we have had some very big changes in oil prices, big changes in exchange rates, big changes in commodity prices, and assessing the impact of those changes upon world markets, I accept, has proved difficult. Above all, what has happened during the course of 1986 is that the growth of world trade in manufactures has not been as buoyant as we anticipated, in particular, tracing it back to do with the speed with which the non-OECD countries cut their import levels, in fact, the growth of imports if the ~~non-~~OECD countries stet had been relatively buoyant through 1986, reflecting the relatively rapid growth of domestic demand. But those countries whose exports have suffered, both the oil producers and the other commodity producers, have been forced, or have felt it necessary, to cut their level of imports. This explains, of course, why it is that across the main industrial countries growth in industrial production has done rather worse than has the growth of output as a whole. Basically what has happened in the industrial countries is that domestic demand has risen rapidly, as anticipated, but exports across the board have been relatively weak, and we think it reflects the extent to which the markets have been weak although it will be some time before we get all the information in.

36. Those very powerful factors being as you describe, are you not really very optimistic in your 1987 forecast of the total balance of payments outcome of a deficit of only $1\frac{1}{2}$ billion, in view of the trends which you have just been elaborating?

(Sir Terence Burns) Again there have been some sharp movements recently and if you examine the balance of payments forecasts which have been made by the various people who engage in this business, obviously there have been some quite sharp revisions in recent months, largely reflecting the actual outcome in the last three to four months. I think it is still early days to be sure to just what extent those pressures will continue. After quite a period when imports grew relatively slowly compared to the growth of domestic demand or final demand, we have suddenly seen quite a sharp increase in the summer months; a lot of the forecasts of the current account have changed as a result of that. We think this is not necessarily an optimistic forecast, although I would stress and fully accept that the standard error around balance of payments forecasts is huge. The other thing I could point out in defence is by and large we have not had a record of being excessively optimistic about the balance of payments. It is true that that is the way it has turned out in 1986, but if you go back and look at the record over the last five or six years, I think you will find by and large the errors have been in the other direction. I never like to be forced into the position of saying, "Absolutely, this forecast is the only one there could possibly be", just as I do not want to resist any suggestion from your side of the table that we are inevitably unduly pessimistic or optimistic on any item. I accept with all the humility that all forecasters should express that forecasts can turn out to be wrong.

37. While acknowledging the Treasury's successes in forecasts in past years, in saying a lot of things have changed in this year's

Autumn Statement, it occurs to us the forecasting system may be one of them.

(Sir Terence Burns) That is an incorrect assumption; there has been no change to the forecasting system. There may have been change in some of the people engaged in the forecasting system, as I said earlier, but there has been no change in the forecasting system.

38. In trying to explain your forecast for 1987 exports, in paragraph 1.25 of the Autumn Statement you speak about world markets expecting to grow more rapidly, and then, "This, together with the lagged benefits from this year's gain in competitiveness, suggests that exports should continue to grow steadily." However, in the Autumn Statement of last year, 1985, you said, and again I quote, "The experience of the past five years suggests that export volumes have not been very responsive to price and cost changes."

(Sir Terence Burns) There is no inconsistency in those statements. The statement last year was a relative statement, it was suggesting how responsive it was compared to some other views which had been expressed. It did not say exports were totally unresponsive, and if you recall we had an exchange about this particular subject, and indeed we had a further exchange when I came with the Chancellor, and again you expressed some dismay at my statement, if I remember - or certainly Mr Mitchell expressed those thoughts.

39. It was both of us.

(Sir Terence Burns) We have not changed our view about that, and indeed in the forecasting system which has been operated it is exactly the same impact of changes in competitiveness on imports as last year. There has been a significant change in competitiveness over the past year and even with the relatively small impact of those changes upon exports you would expect to see this shown up in our export performance. I repeat, I do not regard those statements as inconsistent. I never said at any stage there was no impact of changes of competitiveness upon exports, what I said was, we had over the course of the 1980s revised down the size of that impact, but nevertheless it still left a significant effect, and that is what is essential here to produce this slightly faster growth of UK exports than world trade.

40. The words which were actually used were those I quoted from last year's Autumn Statement.

(Sir Terence Burns) But they are not inconsistent with what I have just said, I am sure.

41. We can pursue this on Thursday, but I would like to move to invisibles, because here again I would like to ask why you are able to produce a relatively optimistic forecast for the future of the balance of invisibles and put it for this current year, 1986, to 8½ billion whereas in the Budget it was only 5 billion? That is a very steep increase after only 8 months. I would like to put these figures to you: the official estimated surplus of invisibles for the first nine months of this present year is stated to be 5.8 billion, and that includes nearly half a billion of the delayed rebate from the EEC. The Department of Trade and Industry in its customary press notice about the balance of payments puts in the invisible balance for the final three months of this year, following the nine months I have just mentioned, an invisible balance surplus of 600 million a month. These figures together do not add up to what in the Statement is the optimistic total outcome of 8½ billion for invisibles.

(Sir Terence Burns) Could I check an earlier statement you made? Did you say our Budget forecast had the invisible surplus at 5½ billion, because according to the document I have here it is 8?

42. You are quite right. I am sorry.

(Sir Terence Burns) So there really is very little difference between the forecast we make now and the forecast we made at Budget time.

43. Nevertheless, you are expecting something which the figures do not appear to validate.

(Sir Terence Burns) Let me make some general comments and then Mr Sedgwick will make some more specific comments. Essentially what happens to invisibles during the course of the year is always very difficult and, if anything, there is a tendency for the figures eventually to be revised upwards; whenever information appears there appears to be an under statement, particularly, on the IPD account. From memory the second quarter figure, where we have detailed information, is showing a surplus of 2 billion, so at that rate I do not think we are far away from it. The underlying change is the movement of the IPD account which reflects two factors, one is the reduced debits on the North Sea account, because with lower oil revenues there is less accruing to overseas oil companies, and with the high level of net overseas assets we have quite a good return in any case on non-oil IPD.

(Mr Sedgwick) I think the fact that the figures are as high as they are in the first half of the year might make anyone suspect we might be correct in assuming there would be a much larger overall invisible surplus than last year. The figure for last year has been revised up from 5 billion, which it was at the time of the Budget this year, to 5.8 billion, so there is evidence of that tendency now to revise the figures upwards.

Apart from the effects this year of depreciation of our earnings with foreign assets, which Sir Terence has just referred to, there are, of course, lower payments from North Sea profits earned on the part of foreign companies which automatically are recorded as debits in the accounts because those earnings are much lower with lower oil prices. There is one other effect that is worth mentioning, we think that the figures for credits on tourism have probably been affected, to some extent, in the earlier part of this year by the fears in America, in particular, because of the terrorism scare but we think any such effect could have been a few hundred million pounds worse and should wear off over time.

44. Can I ask whether in the trade forecasting and policy forecasting you really feel you have allowed sufficient for the fact our unit wage costs appear to be stuck at a figure of approximately growing at 5 per cent per annum overall, there is no indication they are dropping. Manufacturers, by and large, are enjoying rising profits which makes it very difficult for them to resist pay and earnings rate increases. You have only to look at the daily newspapers to see the evidence of increasing skill shortages, exporting employers competing for skilled people in the labour market and doubts that too we are not getting very near to capacity as far as effective modern competitive plant use is concerned. Do you not think those factors should engender some caution that our exports will increase to the level you have indicated?

(Sir Terence Burns) I think we have been cautious in our judgment about the pattern of exports. On the unit labour costs which you mentioned, in fact I think the most recent figure we have is 3½ per cent up on the previous year. The figures that appeared over the winter months very much reflected the weakness of manufacturing output and as manufacturing output has picked up and with it the growth of productivity, then the computed figures for unit labour costs and manufacturing have declined.

Chairman

45. Over what period?

(Sir Terence Burns) That is the last figure published, the figure for September, the twelve month change to September. I also suspect that some of the figures for unit labour costs in the main G5 competitors are rising faster than we had previously estimated, also reflecting their low growth of manufacturing output and continued growth of earning. I would not dispute our's are still rising faster than the average main competitors but of course we had this quite substantial exchange rate change which has affected competitiveness and I think the other things you mentioned were mainly to do with skill shortages, capacity etc., it is rather more difficult to read vacancy figures have risen very sharply in recent months but they are still not at the very high level that one has sometimes seen when there were pressures upon capacity. I noticed the answer to the CBI question about skilled shortages, although it has risen it is still not in the kind of territory which would have previously suggested great pressures. They have two other questions, one about what capacities manufacturers are working at and what are the constraints upon output which point in slightly different directions. I do not see a great threat from that side. Without a shadow of doubt, capacity utilisation has picked up. I think we are some way from the kind of pattern of events which one would customarily think of as where there are real supply constraints upon export performance. If I can emphasise, I do not want to be dogamatic about this or any other forecast but I think it is quite a sensible forecast under the circumstances. It does not give as much weight possibly to the last two or three months' figures as some forecasters have given but I think it would be a mistake to do that at this stage until we have some more months' information.

Chairman: A very single supplementary from Mr Browne.

Mr Browne

46. Sir Terence, would you accept that just as in the field of corporate finance, also in the case of Government finance, it is not just the level of borrowing in itself that is a critical issue alone but also the use of proceeds. Therefore when you see in the United States that the standard rate of tax will be quite dramatic with effect from 1st January 1987, in an economy where there is still increasing of public expenditure this time financed by borrowing, would you feel this Government would be prepared in future to increase borrowing if the use of proceeds, the use to which this money were put, were considered good for the economy, i.e. to finance a massive reduction in standard rate of tax within the United Kingdom, or is the present rise in public expenditure an overwhelming set back to any prospect of a significant rate of reduction in United Kingdom income tax?

(Sir Terence Browne) I can only tempt myself to interpret policy as I see it and I think that clearly this Government has not set about reducing income tax on the basis of a higher borrowing requirement in the hope that the lower tax rates would generate the sort of revenues which people have talked about in the United States as following from those lower taxes.

47. Do you think it would in the future?

(Sir Terence Burns) I think that that is very much a question which you should put to the Chancellor. So far the overall fiscal stance has been a matter of considerable importance to this Government and they have been prepared to increase tax, as they did in 1981, if it was necessary, in order to maintain a credible fiscal stance. I do not see any signs of that overall approach changing.

Mr Mitchell

48. Can I just express my joy that our exchanges on the exchange rate had such a marvellous effective effect on Treasury thinking?

(Sir Terence Burns) I am sorry to disappoint you Mr Mitchell.

49. It does seem a very substantial change from last year.

(Sir Terence Burns) What is the substantial change?

50. You are making the best of a bad job. The exchange rate has gone down, therefore you have to find virtue in that process: what you said would not happen last year will happen because exports will have to increase. You need them to fill the figures in and therefore they will because of depreciation.

(Sir Terence Burns) I appreciate your desire to debate this subject, I really do not think that is fair. The Chancellor made quite clear in his speech some years ago at Cambridge in the face of sharply changing oil revenue there would have to be some real exchange rate change as part of the correcting mechanism. He has continued during the course of the last few months to accept that what we have seen in the way of exchange rate change has been that behaviour in practice. I repeat we have not changed our views about the impact of exchange rate changes or of changes in cost competitiveness upon exports, maybe we should but we have not and in time you will see what the scale of the effect will be.

Mr Mitchell:Not to continue on rhetorical questions: in 1981 when the pound was at its height we were told it was not really all that bad for industry after all and it was making them leaner and fitter and last year we were told competitiveness was not all that important and this year because there is a gap to be filled we are told that depreciation will give certain advantage to which you will allow exports to increase to fill it. Can I move on because I do want to turn on to ---

Chairman

51. A process of mutual education.

(Sir Terence Burns) Chairman, I enjoy this experience where one is fighting for the final word but, out of deference to Mr Mitchell, I will cease to question him.

Mr Mitchell

52. To move on to something there is agreement on: the fact that industry and the economy are being crucified on the cross of high interest rates which are higher than our competitors which means putting up the cost of living higher than it should be and yet you seem to be assuming, as I read the statement, they will continue at this daft level. Is that correct, are you assuming interest rates will continue at this level, maybe even increase?

(Sir Terence Burns) I do not publish forecasts on interest rates, never have done and I am not going to.

53. The housing element in the RPI is put at 10¼% so that assumes interest rates will be as high as now. In the Summary paragraph 1.01 says: "...the recent rise in mortgage interest payments will add about half a per cent to RPI inflation for the next year" which assumes they come in a bit further because they do not come in until November.

(Sir Terence Burns) I think one thing you must bear in mind in looking at the figure for the contribution of housing and the RPI excluding mortgage rate, is even if there is no change in the mortgage rate the total RPI tends to grow faster than the RPI excluding mortgage rate because of the way in which it is computed based on a lagged growth of house prices which have been growing at 10% per annum which is rather faster than the rest of the index. You cannot then look at that component and say the excess of that over general inflation is bound to increases in mortgage rates which would tend to grow faster anyway reflecting the way that component is computed.

54. Are you assuming that interest rates will stay at this level?

(Sir Terence Burns) I do not wish to be drawn on the subject of what we have assumed on the interest rates. It has been a practice that we do not get into the business of making forecasts on the interest rates. We have, it is true, of course, presented information for the RPI which contains some clues but I do not want to go beyond that.

55. If the exchange rate is assumed to stay broadly flat at about this level and we take it that interest rates are being set in forecasts to devalidate(sic) that assumption, in other words they are being used to support that assumption -----

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(Sir Terence Burns) The interest rates used are those we judge to be necessary to reflect in broad terms the monetary conditions that are consistent with the MTFS. The exchange rate is one part of that.

56. Since there is a worsening current account position does that not imply a further rise in interest rates to offset the effect on sterling of the worsening current account?

(Sir Terence Burns) Not necessarily. I think we would suggest that by and large the movements on capital account are possibly more important than the movements on current account as far as the exchange rate determination is concerned. There is already a significant differential between our interest rates and elsewhere, as you yourself pointed out, and I do not think you can conclude from that what would be necessary to deliver this exchange. That is a matter of judgment. We have a long practice of not commenting upon assumptions about interest rates, we make an assumption about the exchange rate and we publish it but I do not wish to be drawn on that.

Mr Mitchell: Thank you. Let me come to the exchange rate assumption because you said ----

Chairman

57. Could I interrupt for just a moment?

(Sir Terence Burns) I do not want to be too tedious about this, Chairman.

58. I understand, of course, the traditional position but I was just going to say on the figure in Table 1.7 for housing where we are given a 10¼% increase for that component of the RPI in the fourth quarter of 1987 could you let us have a breakdown of that figure between interest rates and housing prices, if necessary lagged?

(Sir Terence Burns) I am not sure that I can do that, Chairman, because you are then asking for the interest rate assumption.

59. But it is there, is it not?

(Sir Terence Burns) It is implicit in those figures, that is true. May I take that away? I will, of course, take your request away and discuss it with the Chancellor.

Mr Mitchell

60. Could I just pursue Mr Wainwright's point about unit labour costs which are rising substantially, more rapidly than our competitors. I personally see little basis for the assumption that they will not continue to rise at this rate and at a higher level than our competitors. I think the Incomes Data Services figures indicated there has been no fall in settlements, the Government has no policy for incomes apart from prayer, and profits seem to be high and they are not going into investment in the same degree that they are being paid into wages creating a climate in which unit labour cost inflation can go on. If it does remain high at that level does it not require further depreciation of sterling to sustain an improvement in competitiveness?

(Sir Terence Burns) I would make two comments on that. There are signs in the CBI settlements, as I understand it, that there has been some small reduction in the rate of settlements and our own monitoring of these figures would support that. I think that we would claim there are some signs that a low inflation rate is being translated into low settlements, but I agree by no means enough and the growth of labour costs continues to be disturbing. On other hand we do think we will be seeing lower rates of increase in the overheads, we see a figure of 2½% for 1987 reflecting in part the low rate of settlements and the faster growth of productivity as output grows faster in 1987. That will produce proportions which are, I suspect, reasonably close to the average that will be brought in from the other major countries but still possibly a bit above them. However, the Chancellor has made clear, as I mentioned earlier, he is not prepared simply to follow a policy of exchange rate depreciation to validate higher levels of earnings in this country relative to those in our competitor countries.

61. If that figure is not accurate of depreciation that would be necessary and would also be desirable to draw investment and input emerging into exports that depreciation will be resisted?

(Sir Terence Burns) Yes, and the gain in competitiveness we have experienced will be to some degree eroded. As the Chancellor has debated with you on several occasions about that, he sees it as once you give in to this process of simply following high labour costs with currency depreciation you are in a vicious circle which can only get worse.

62. I will ask that of him as well but it might not have the same devastating effect that it has had on you.

(Sir Terence Burns) If you have no more effect on the Chancellor than you have had on me it will take a long while.

63. That implies depreciation will be resisted. How will it be resisted, will it be resisted by rising interest rates or the use of reserves? Have we learned any lessons from attempts to stop the fall in the recent period?

(Sir Terence Burns) I do not think one would imagine trying to use reserves over a long period of time in order to compensate for higher rates of labour costs in this country. It would have to be resisted by a general tightening of policy and ensuring the faster rates of growth of earnings did not show up in faster inflation andexchange rate depreciation.

64. One final question: it has been regarded as a political Autumn Statement because spending money looks incredible for a Government that has been saying it has been impossible to do that, and suddenly all of this develop before an election is likely. You may have seen the cover of Private Eye this week with the Prime Minister holding out five pound notes saying: "Here are some of my new policies". A good job has been done in the Autumn Statement providing figures to make this look feasible and look as though it is responsible, there is not going to be a Nemesis, but that figuring looks at its most incredible to me for the balance of payments.

In other words, we seem to be running a risk of a substantial balance of payments problem with consequent threat to sterling. The calculation seems shakiest there, the calculation on the increase in invisibles, the calculation on the increase in exports for manufacturing industry which has been very hard hit, which has skill shortages and faces rising interest rates, which has not invested at the level of its competitors. The forecasts on that are slowing of imports which again looks slightly incredible. Would it be true to say that the risks are greatest on the balance of payments and the figures are most likely to be invalidated in that area?

(Sir Terence Burns) I suggested earlier that balance of payments pictures inherently have a large standard error. I do not see the risk in this direction as any greater than normal error that surrounds forecasting of this particularly difficult magnitude.

Chairman

65. I thought you were saying earlier it was a particularly difficult year for forecasting in this area, forecasting the balance of payments.

(Sir Terence Burns) 1986, I think, has been a particularly difficult year. But there have been very difficult years in the past from which we compute the averages that we set out here to be the range we would expect it to be within. I do not see those risks as being any greater than that. I think that a lot of the response that you are suggesting is not surprising in the circumstances of the times, put it this way, but I do not think the scale of current changes warrants the scale of cover by Private Eye.

Mr Mitchell

66. You were saying there was a big fall off in imports in 1987. Why should that occur? They will not be increasing the way they have been doing.

(Sir Terence Burns) We have not assumed it was a great fall off. What has happened in recent years is that, taking between the second half of 1984 and the first half of 1986, there was relatively slow growth of imports considering the growth of domestic demand. What we then have seen into the second half of 1986 has been a very big increase in level of imports. What is not clear is what lies behind that. What we are assuming, if one takes year on year, is that imports of goods and services in 1987 grow by 4½ percent compared with 5 percent growth in 1986. That cannot be described as a great rate of change.

Mr Howell

67. Sir Terence, could I ask a few questions on public sector manpower and the implications in the Statement. What progress has been made with the Rayner reviews regarding efficiency of investment in the public sector?

(Mr Turnbull) That is probably for me to answer. These scrutinies are now called efficiency unit scrutinies rather than Rayner scrutinies, they are still continuing and our estimate is that since 1979 they have led to savings of 300 million a year and to the saving of around 22,000 posts.

68. Are you satisfied that these savings make overall savings because, for instance, on the question of the saving of a few million in staff in employment offices, many hundreds of millions have been spent because people no longer have to register and it is much easier to carry on being unemployed. Do you get the point I am making?

(Mr Turnbull) Since 1979 something like 130,000 posts have been saved in the Civil Service and there are various reasons for that. Some of those have come about because of pure efficiency savings, some through contracting out, some through privatisation, some through hiving off. But the example you have given can be looked at in one of two ways, maybe as a streamlining of procedures or cutting out of a function. It is a separate argument as to whether cutting out that function turned out in retrospect to be a good thing. But there are numerous ways in which these manpower savings in the Civil Service have been made.

69. Could I turn to the question of local government? It must be a great disappointment that local government is still spending 9 percent more than it should be spending and the bulk of this, I think everybody accepts, is in manpower itself. Do you think, Sir Terence, the manpower watch is having any real effect?

(Mr Turnbull) Certainly what is happening in those local authority fields is that, manpower having fallen for a number of years, it is now rising with in 1985-86 an increase of about three-quarters of 1 percent. That is not a large increase but it is still a small increase in contrast with the movement in the Civil Service as a whole. But, as has been explained on a number of occasions to this Committee, the Government does not control local authority manpower directly, it sets a financial regime and does not even control spending directly. It sets a regime of grant, of GREs, the taper at which the grant is removed, a series of incentives and disincentives for spending, but the ultimate decision on manpower is for local authorities to make, and with regard to what you refer to as manpower watch, we obviously watch manpower but we do not in central government control it and are not the employers for that manpower.

70. This is a terrible weakness in the whole of our system, is it not?

(Mr Turnbull) I am not sure - well, it is called local government. (laughter) — so I was told.

71. Yes, but is there no prospect of doing anything more? The Government made attempts to control local government but it has not been successful, has it?

(Mr Turnbull) The Government has set this financial regime for the high spending councils and also the rate capping regime . It has established the Audit Commission whose job is to identify savings and it has no statutory power to enforce things but must act by publicity and example. It tries to encourage councils to follow the practice of the best. That is as far as central government is able to go while local government is still a separate decision-making entity.

72. But all these schemes have failed. What prospect is there that they are going to do other than fail in the future?

(Mr Turnbull) Well, a Green Paper has just been issued - it was issued last spring - and the process of consultation on that has, I think, just been completed and the Government is considering the replies. One of the themes of that Green Paper which is anticipated in the Bill on Scotland is to increase lcoal accountability, increase transparency, so that local electors can see how it is that expenditure rises and local taxation rises. There are changes proposed in the grant regime which will help make that possible.

73. Could I just turn to one point on wages? Do you think that,since we insist on fully indexed linking benefits, the Government is actually forcing up wages? Since the benefits are index-linked and tax-free, it is necessary for wage-earners at the lower end of the scale to acquire higher wages than they otherwise would. Do you not see that, Sir Terence, as the Government itself acting against its real intention of holding wages steady?

(Sir Terence Burns) I understand the method which you were describing, but if wages were also no more than index linked we would be somewhat more content than we are at the moment. The influence which is coming from that direction, first of all, I would have thought is diminishing relative to levels of earnings, and of course one has to take into account the more general social objectives at the same time. In that sense there are conflicting pressures at work.

74. You accept there are conflicting pressures in this area?

(Sir Terence Burns) I am not sure. Speaking personally I have never been persuaded there is a huge impact all the way up the scale in terms of earnings growth from these pressures, but I fully accept that there are points in the earnings distribution where it does exercise an influence.

75. Thank you. I wonder if I could ask a question on table 1.8 on employment. I cannot quite make the arithmetic add up there, but it seems we are talking of the employment labour force rising whereas in actual fact whole time jobs are being exchanged for part-time jobs. Do you think there is any real value in this table at all?

(Sir Terence Burns) Yes, otherwise we would not present it! It is on this basis the figures are collected and that we also make projections. Obviously they are described as part-time, it is not as if we were dressing part-time jobs up as something else.

76. But when we are talking about manpower in the civil service we are talking about whole time equivalents, and there seems to be some inconsistency in totting up all the part-time jobs and implying they are full time.

(Sir Terence Burns) If you yourself were the employer, it is rather easier to work out what the full-time equivalent is than if you are simply monitoring what is going on in the economy at large.

As far as I am aware we do not have information to make an accurate assessment of full-time equivalents.

Mr Browne

77. What evidence does the Treasury have that wage settlements are likely to moderate in the face of, first of all, high corporate profits, and, secondly, indications of serious skill shortages in the very business areas where the high profit margins are made?

(Sir Terence Burns) There are a number of factors which we think have influence upon the rate of growth of earnings, although one cannot define that with any great precision. The main one is the previous growth of prices, in other words what the inflation rate has been in the period before. On that basis we have seen quite a substantial slow down in the rate of inflation and you would expect that to show up in terms of a huge growth in earnings. If you look historically, you can see this happen fairly clearly. Company profitability also possibly has some effect, but we are not looking for any great change between this year and next year in the contribution from that direction. I think we have to accept there is a certain inflexibility about the rate of growth of earnings. The whole concept of a going rate and pay round means one does not get sharp changes in the rate of growth of earnings which the Chancellor likes to see given the rate of change in inflation. As far as pressures in the labour market are concerned, I referred to this earlier and clearly the labour market is looking a bit tighter than it was, and we can see this by looking at the figures for vacancies and by looking at the figures for the skilled labour shortages, which you can see in the CBI answers. I would not myself have said it was yet at the level which would have been sufficient to compensate for the down pressure one would be expecting to see upon earnings growth coming from a declining inflation rate whichwe can see.

78. Could I ask you to summarise briefly what you feel the Government have learnt in balancing intervention in the foreign exchange market with interest rates and doing what they wish to do with sterling, whether it is up, down or whatever and not asking for target levels? How do you feel the experience of past years has distilled out in getting that balance?

(Sir Terence Burns) I would say that we see a short-term role for intervention, but that intervention is not something that can be used to bring about precise changes to exchange rates. Therefore intervention is essentially tactical. If one wants to have a rather longer lasting impact upon exchange rates then it is a question of interest rate policy and a question of the whole pressure which is coming from the monetary policy as a whole.

Mr Browne: Thank you.

Chairman: I think we should bring our proceedings to a close now but Mr Mitchell has a quick question for you.

Mr Mitchell

79. You indicated that the wage costs earlier this year were boosted by the impact on productivity of a slow down in output which takes place?

(Sir Terence Burns) Yes.

80. Could we take it then that the underlying rise in unit costs was less than the actual figure for the early part of the year?

(Sir Terence Burns) Yes.

81. In that case there is an underlying rise in unit costs in the forecast, stripping out the fact of a cyclical improvement in productivity?

(Sir Terence Burns) I do not want to be too precise about this but if we take 1986-87 together, then the growth of unit labour costs overstates what the underlying rate has been. I think the figure for 1987 probably understates it alittle. The 4 per cent growth in manufacturing output which is anticipated in the forecast for 1987 we would expect to lead to a faster rate of growth of productivity in manufacturing than you would get on average.

Chairman: We are very grateful to you, Sir Terence, and your colleagues for your help in setting the scene and clarifying a number of issues before we take evidence from the Chancellor on Thursday. We are most grateful to you all for coming.

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cc PS/CST
PS/FST
PS/EST
PS/MST
Sir P Middleton
Sir T Burns
Sir G Littler
Mr F E R Butler
Mr Cassell
Mr Peretz
Mr Kelly
Mr Richardson
Mr Brook
Mr Cropper

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

17 November 1986

Simon Routh Esq
Assistant Private Secretary
Minister of State for Defence Procurement
Ministry of Defence
Whitehall
London

pmg

Dear Simon

AUTUMN STATEMENT: FOLLOW-UP REPLIES

You asked for suitable draft letters for Lord Trefgarne to send in response to the questions raised following his report of the Autumn Statement in the House of Lords.

... I attach drafts of three letters: to Lord Bruce of Donington about EC payments; to Lord Renton about Local Authority Spending; and to Lord Diamond about interest rates.

Yours
Alex

A C S ALLAN
Principal Private Secretary

DRAFT LETTER FROM LORD TREFGARNE TO LORD BRUCE OF DONNINGTON

During our exchanges on the Autumn Statement on 6 November, you asked me whether the figures the Chancellor announced took any account of a forecast overspend on CAP expenditure, and whether the existance of that overspend would have any effect on our EC abatement entitlement for the current year. I explained to you the position on our 1986 abatement and the present situation on the 1987 Budget, and undertook to write to you about the calculation of our 1987 abatement.

The 1987 draft budget includes provision for our abatement next year of 1633 million ecus, or about £1,125 million. The Council has now agreed to the payment of that sum, and the Autumn Statement figures take due account of this. In fact, we already know that this figure is an underestimate of our true entitlement. After the Commission calculated it and published it in their preliminary draft budget, the UK made on 1 August a large additional VAT payment, called a 'VAT adjustment' to correct underpayments of VAT in previous years. Because of the way the abatement system works, the effect of this payment is to increase our abatement entitlement. The agreed methodology for calculating and correcting our abatement, however, makes no provision for any correction before September next year. Even then, a correction is only optional; we cannot insist on mandatory correction until September 1988.

The Council recognised that it would not be fair to ask the UK to wait that long and has therefore agreed that to the extent it is not possible to make any correction in 1987, they will include the provision in the 1988 draft budget. The Autumn

Statement figures for 1986-87, 1987-88 and 1988-89 assume that this is what in fact happens. Any overrun on the CAP in 1987 would not affect our 1987 abatement entitlement.

DRAFT LETTER FROM LORD TREFGARNE TO LORD RENTON

On 6 November you asked, following the Autumn Statement, about the actual and estimated effects of the changes in local government which were made by legislation the year before last. I presume you were referring to the provisions for rate limitation in the Rates Act 1984 - but if you had some other point in mind do let me know.

Rate capping has forced local authorities to keep their spending lower - both to avoid selection for the scheme and as a result of it. In nearly all areas which were subject to rate limitation in 1985-86 and in 1986-87 ratepayers have seen a cash cut in their rate bills. And in all cases rate demands have undoubtedly been lower than they would have been if authorities had been allowed to spend as they wished. It is difficult to put any hard figures on the saving achieved because we do not know what local authorities would have decided to spend if they had had a free rein. But the savings are likely to run into hundreds of millions of pounds.

DRAFT LETTER FROM LORD TREFGARNE TO LORD DIAMOND

During the repeat of the Autumn Financial Statement on 6 November I undertook to write to you about interest rates.

Short term interest rates are the essential instrument of monetary policy, and will be held at whatever levels are necessary to maintain monetary conditions that place steady downward pressure on inflation. The success of this strategy is clearly demonstrated by the fact that inflaion is now around 3 per cent, the lowest level for twenty years.

Real interest rates are difficult to measure, since they depend on expectations about future inflation. But it does seem that they are at present historically high in the UK and throughout the industrialised world. One reason for the high level of the UK real interest rates is that UK unit labour costs are still rising faster than those of our major competitors.

cc: PS/Chief Secretary
Mr F E R Butler
Mr Turnbull
Miss Peirson
Mr Gray
Mr Norton

pwp

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

17 November 1986

Robert Gordon Esq
Secretary of State for Scotland
Scottish Office

Dear Robert,

AUTUMN STATEMENT

Thank you for your letter of 10 November.

The circumstances surrounding this year's Autumn Statement were exceptional. The Parliamentary timetable made it impossible to follow the normal pattern of a Statement on the Tuesday following Cabinet's discussion. The announcement was therefore made on the same afternoon. This left only a couple of hours after the end of the meeting to finalise, print and distribute the Statement and the accompanying table.

In previous years the last figures to be settled for the Autumn Statement have been the territories; indeed last year the figures to go in the printed document were still being discussed on the Friday after the Cabinet meeting. We therefore took the precaution this year of aggregating the territories and some other programmes in order to give us more flexibility if any late variations had come up. Your officials were aware of our proposals and had not raised objection to them.

In the event there were no alterations to the figures as a result of discussions at Cabinet and the figures as at 5 November have remained unchanged. With hindsight we could have published the figures for all three territories on 6 November. If similar circumstances arise in the future we will do our best to ensure that separate figures for all three territories are published at the same time as those for other Departments. This will depend on all the consequentials for the territories being settled quickly, so that the figures in the summary table are the same as those subsequently published in the printed document.

I am copying this letter to Colin Williams (Welsh Office) and David Watkins (Northern Ireland Office).

Yours
Alex

A C S ALLAN
Principal Private Secretary

Covering CONFIDENTIAL

FROM: MISS M O'MARA
DATE: 18 NOVEMBER 1986

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Odling-Smee
Miss Peirson
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr Bottrill
Mr Culpin
Mr S J Davies
Mr Gray
Mr Grice
Mr C W Kelly
Mr Mowl
Miss Noble
Mr Pickering
B/10

Ch
Mainly for officials supporting you – I told Margaret much more useful to have figures rather than pages of unnecessary lines to take.
AA

TCSC APPEARANCE: 20 NOVEMBER

As requested, I attach facts and figures on some of the points which could come up at your appearance on Thursday.

2. The general public expenditure section contains a table showing changes by Department (including LA current and nationalised industries). For every departmental group identified in the Autumn Statement the table provides, for each year from 1986-87 to 1989-90:

(1) the new plan totals in cash
(2) the cash increase in absolute levels over previous plans for that year
(3) the percentage increase in cash terms over the previous year
(4) the percentage increase in real terms over the previous year.

3. We understand you also asked at Prayers on 14 November for the real increases by programme in 1987-88 over 1986-87 after allocating the Reserve pro rata to programmes. A further table sets out these calculations. Since the 1987-88 Reserve is some 2.3 per cent of programme expenditure, the effect of the calculations is to add 2.3 per cent to each of the departmental real growth figures at (4).

4. GEP would, however, advise strongly against quoting these higher figures. Inevitably calls on the Reserve will not arise pro rata to the size of programmes; some will be more and others less. In general, the hope would be to keep to a minimum calls for cash-limited programmes. And it would, for example, be unfortunate to quote a figure which implied that the Defence budget might reasonably be assumed to benefit from access to the Reserve of £437 million. GEP's advice, therefore is that the only real term figures you should quote for Departments are those at (4) in the first table; you could, however, also make the point in general terms that, in making any departmental comparisons between 1986-87 and 1987-88, allowance has to be made for the fact that the former year includes the assumed calls on the Reserve and the latter year excludes them.

5. GEP will be providing separately new estimates of the coal strike effect on public expenditure (a point which came up when officials appared before the Committee yesterday).

6. The Autumn Statement brief, from which most of the material below was drawn, contains, of course, considerably more detail. In particular, it covers each of the departmental programmes individually. In the notes below, we have simply given a few facts and figures on social security, Scotland and local authorities.

7. You will be receiving separate briefing this evening on the provisional money figures and briefing on developments in the domestic and foreign exchange markets, as usual, for Cabinet. Your office may like to discover the latest position from MG1 before you leave for the Committee on Thursday afternoon.

8. Perhaps Mr Allan could let us know in the course of tomorrow if there are any other points you would like us to cover.

MOM

MISS M O'MARA

INDUSTRY ACT FORECAST

Prospects: summary

	Outturn 1985	Forecast 1986	Forecast 1987	Average errors from past forecasts*
A. Output and expenditure at constant 1980 prices (percentage change on year earlier):				
Domestic demand	3	3½	3½	1
of which:				
Consumers' expenditure	3½	5	4	1¼
General Government consumption	½	1½	1½	1
Fixed investment	2	2	2½	2¼
Change in stockbuilding (as per cent of level of GDP)	½	0	½	¾
Exports of goods and services	6	1	3	2½
Imports of goods and services	3	5	4½	3
Gross domestic product: total	3½	2½	3	¾
manufacturing	3	0	4	2½
B. Balance of payments:				
Current account (£ billion)	3½	0	-1½	3
C. Inflation:				
Retail prices index (percentage change Q4 on Q4)	5½	3¼	3¾	2¼
	1985-86	**1986-87**	**1987-88**	
Deflator for GDP at market prices (percentage change on year earlier)	6	3	3¼	2
D. Money GDP at market prices (percentage change on year earlier):	9½	5½	7	1¾

Source: Forecasts for 1986 and 1987 and average errors on past forecast published in Autumn Statement Table 1.14.

* Errors relate to average differences (on either side of central figure) between forecast and outturn: relevant to forecast for next calendar or financial year. For method of calculating these errors, see 'Economic Progress Report' June 1981. Margins of error based on forecasts made in ten years 1975-1984. Errors after adjustment for effects of major changes in fiscal policy where excluded from forecasts.

IAF

Comparisons of official forecasts

A. **Output**

GDP (per cent change on year earlier)	**1985**	**1986**	**1987**
- 1985 Autumn Statement IAF	3 ½	3	not app
- 1986 Budget IAF	3 ½	3	2 ½ ≠
- 1986 Autumn Statement IAF	3 ½	2 ½	3

Manufacturing output (per cent change on year earlier)	**1985**	**1986**	**1987**
- 1985 Autumn Statement IAF	2 ½	2 ½	not app
- 1986 Budget IAF	3	3	2 ½ ≠
- 1986 Autumn Statement IAF	3	0	4

B. **Inflation**

RPI (per cent change on year earlier)	**1986Q4**	**1987Q2**	**1987Q4**
- 1985 Autumn Statement IAF	3 ¾	not app	not app
- 1986 Budget IAF	3 ½	3 ½	not app
- 1986 Autumn Statement IAF	3 ¼	not app	3 ¾

GDP deflator (per cent change on year earlier)	**1985-86**	**1986-87**	**1987-88**	**1988-89**	**1989-90**
- 1985 Autumn Statement IAF	5	4 ½	3 ½*	3*	not app
- 1986 Budget IAF	6	3 ¾	3 ¾*	3 ½*	3*
- 1986 Autumn Statement IAF	6	3	3 ¾	3 ½*	3*

* assumption

≠ 1987H1 on 1986H1

WPU

Forecast assumes

- sterling remains close to its present level in both dollar and effective terms.
- North Sea oil prices average $15 per barrel until end of 1987.

"Pause" in world economic growth

		Industrial production growth (per cent) Latest 3 months compared with previous 3 months at annual rate
US	(Sep)	+2½
Japan	(Sep)	-3
Germany	(Sep)	+1
France	(Aug)	+9
UK	(Aug)	-1
Italy	(Aug)	-10
Canada	(May)	-5
Major 7	(Aug)*	+1

* estimate

Non-oil economy forecast to grow 3½ per cent in 1987.

Non-oil business investment expected to grow in 1987 at similar rate to, or slightly faster than, 1986 (nearly 3 per cent).

Current account: trends and prospects

Annual averages

£billion

	1974-79	1980-84	1985	1986*	1987*
Oil	-2.6	+4.4	+8.2	4	3½
Manufactures	+4.0	+1.3	-3.0	-5½	-7½
Other goods	-4.8	-5.3	-7.3	-7	-6½
Invisibles	+2.4	+3.1	+5.7	8½	9
Current account	-1.0	+3.5	+3.6	0	-1½
Percentage of GDP (average over period)	-1.0	+1.3	+1.0	0	-½

* Industry Act forecast.

WPU

Difference between Autumn Statement and FSBR current account forecasts for 1986:

	£ billion
Oil	-1
Manufactures	-2 ½
Other goods	- ½
Invisibles	+ ½
Total	-3 ½

Visible oil trade balance

£ billion						Forecast	
1980	1981	1982	1983	1984	1985	1986	1987
0.3	3.1	4.6	7.0	6.9 (9.2)	8.2 (9.3)	4	3 ½

Figures in brackets adjusted for coal strike.

- Substantial fall in oil trade surplus expected in 1986 as result of lower prices.

- Net oil exports 8 per cent of total exports of goods and services in 1985 (15½ per cent gross). Projected to be 4 per cent in 1986. Further fall forecast in 1987 reflecting gradually falling production and rising domestic consumption. Partly offset in current account by reduced North Sea invisible earnings of foreign companies.

Export and import volumes (excluding oil and erratics)

	Annual average percentage change				
	1974H1 to 1979H1	1979H1 to 1986Q3	1983Q2 to 1986Q3	1985 to 1986*	1986 to 1987*
Exports	+2 ½	+2 ½	+6 ½	+1	+5½
Imports	+5	+5 ½	+8 ½	+5	+6 ½

* Industry Act forecast

(a) After little growth in 1986, exports (excluding oil and erratics) forecast to rise by 5½ per cent in 1987, as world trade picks up and lagged effects of competitiveness gain come through.

(b) Imports (excluding oil and erratics) forecast to grow by 5 per cent in 1986 and by 6½ per cent in 1987. Reflects domestic demand growth.

Share of UK manufactures in UK export markets and import penetration

Per cent

	Exports		Imports*	
	Value	**Volume**	**Value**	**Volume**
1973	9.7	12.1	17.5	13.3
1979	9.2	10.1	20.0	17.7
1980	9.7	9.7	17.9	17.8
1981	8.6	8.8	16.8	17.8
1983	8.1	9.1	18.8	19.7
1985	8.2	9.4	20.8	21.3

* share of imports of goods (excluding oil) in domestic demand.

(a) Since 1980, UK volume share of UK export markets levelled off, halting long-term decline. Forecast implies export volumes rise roughly in line with growth in markets.

(b) Import volumes have risen faster than domestic demand and trend projected to continue. Import penetration in value terms has risen after fall in early 1980s.

Exchange rate and relative costs:

1975 = 100

	Sterling effective exchange rate	Relative manufacturing unit labour costs*	Relative GDP deflators*
1974	108.0	103.1	93.4
1979	87.4	108.8	106.8
1983	83.4	120.7	113.4
1984	78.7	118.2	107.7
1985	78.3	120.8	109.2
1986Q3	71.9	109.0**	99.2**

* Ratio of UK costs/prices to those overseas
** estimates

(a) Costs and prices risen faster in UK than in other major economies measured in domestic currencies.

(b) Between 1979 and 1985 UK relative manufacturing unit labour costs much higher than in 1970s.

(c) Depreciation of sterling since 1985H2 accompanied by marked improvement in UK's cost and price competitiveness.

Unemployment

- Immediate prospects more favourable as result of Budget employment measures (including Restart) and pick-up in economic growth.

- Over next few years chances of reduction improved by slower growth in labour force projected for rest of decade.

Retail Prices Index

	1985Q4	1986Q4	1987Q4
Food	3 ¼	4	2 ½
Nationalised Industries*	5 ½	3 ½	1 ¾
Housing	9 ¼	6 ½	10 ¼
Other	5 ¼	2 ¼	3
Total	5 ½	3 ¼ (3 ½)**	3 ¾

* Includes water; gas included in "Other" throughout.

** FSBR forecast in brackets.

Growth forecast based on consumption boom? No. Forecast shows balanced growth; pick-up in economic activity reflects improved export prospects and forecast increase in company spending on stocks and capital goods, in turn reflecting healthy financial position of company sector.

Economy overheating in 1987? No evidence that economy overheating. Unemployment remains high, overtime working relatively low and manufacturers cite lack of demand, not plant capacity, as factor likely to limit output.

UK growth in 1987 unbalanced compared with other economies No. Private consumption in most major OECD countries expected to grow by 3-4 per cent a year and GDP growth expected to be in same range. Little different from UK.

PERSONAL AND CONFIDENTIAL UNTIL 11.30 AM ON 13 NOVEMBER 1986 B2a

International Comparisons of Unemployment

Although other countries have been experiencing significant increases in unemployment, the unemployment rate in the United Kingdom is higher than in most other countries. The following table gives the latest figures on national definitions, which are not strictly comparable owing to national differences in coverage and concepts of unemployment, together with the available OECD standardised rates which are recommended for comparing levels of unemployment.

	UNEMPLOYMENT, NATIONAL DEFINITIONS					RECOMMENDED OECD STANDARDISED RATES	
	Unadjusted			Seasonally adjusted		Seasonally adjusted	
	Latest month	Number (000s)	% rate	Number (000s)	% rate	Latest month	% rate
Spain	September	2,710	21.5	2,727*	21.6	Jun	21.0
Ireland	September	232	17.9	238	18.3	..	..
United Kingdom	October	3,237	11.7	3,168	11.5	May	13.3
Belgium	September	428	15.6	433	15.7	Aug	12.1
Netherlands	August	711	14.6	696	14.3	Aug	12.1
Italy	August	3,085[a]	13.5	2,698***	11.4	Apr	11.3
France	September	2,519	10.8	2,474	10.6	Aug	10.5
Canada	September	1,127	8.8	1,221	9.5	Aug	9.7
Denmark	August	198	7.3	214	7.9	..	..
Germany	October	2,026	8.1	2,172	8.7	Aug	8.3
Portugal	August	361	8.4	..	..	..	..
Australia	September	632	8.3	634	8.4	July	8.2
Finland	July	190	6.8	200	7.2	Aug	6.9
United States	August	7,955	6.6	8,027	6.7	Aug	6.7
Greece	August	76	4.3	96e	5.4e	..	..
Austria	August	113	3.9	151e	5.2e	Mar	3.5
Japan	July	1,670	2.8	1,770	2.9	July	2.9
Sweden	August	125	2.9	131**	2.8	July	2.5
Norway	August	38	2.1	36	2.0	May	1.9
Luxembourg[a]	September	2	1.4	..	..	..	..
Switzerland	August	20	0.7	..	..	July	0.9
EEC[b]						May	12.1
OECD - Selected countries only[c]						May	8.1

e estimated

a SOEC figures

b Includes Belgium, France, Germany, Italy, Netherlands and UK

c Includes all countries with Standardised rates

* August figure

** December figure

*** April Figure

Sources:- OECD "Main Economic Indicators" supplemented by Labour Attache reports etc

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MAIN ECONOMIC STATISTICS PUBLISHED SINCE 6 NOVEMBER

Output and Demand

1. GDP(O) (published 19 November) in 1986Q3 1 per cent up on 1986Q2, 3 per cent up on 1985Q3.

   GDP(O), excluding oil, in 1986Q3 ½ per cent up on 1986Q2, 2¾ per cent up on 1985Q3.

2. Industrial production in 1986Q3 1½ per cent up on 1986Q2, 2 per cent up on 1985Q3.

3. Manufacturing output in 1986Q3 1¼ per cent up on 1986Q2, 1 per cent up on 1985Q3.

4. Industrial investment in 1986Q3 virtually same as in preceding quarter but 2 per cent lower than year earlier. Manufacturing investment 5 per cent lower than in previous quarter and 6½ per cent lower than in 1985Q3.

5. Retail sales in 3 months to October 2 per cent higher than in previous three months; 6 per cent higher than in same period a year earlier.

Inflation

1. RPI inflation 3.0 per cent in October (3.4 per cent excluding mortgage interest rate).

2. Producer price inflation 4.3 per cent in October. Input prices fell 5.3 per cent in year to October.

3. Tax and price index rose 1.5 per cent in year to October.

Labour Market

1. Adult unemployment (seasonally adjusted) fell sharply again by 25,000 in October. Level 3,168,000, 11.5 per cent of working population. Headline total fell by 96,000 to 3,237,000, 11.7 per cent of working population.

2. Stock of vacancies increased by further 6,000 in September to reach 213,000.

3. Manufacturing employment fell by 20,000 in 1986Q3; was little changed between August and September.

4. Manufacturing productivity in 1986Q3 2.7 per cent up on 1985Q3.

5. Manufacturing wage costs in 1986Q3 4.4 per cent up on 1985Q3.

PSBR

In first seven months of 1986-87 PSBR £5.7 billion (compared with £5.3 billion in same period of 1985-86).

Money Supply

Provisional money figures published 11.30am Thursday 20 November. Separate briefing being provided.

HA/04

FORECASTS FOR THE UK ECONOMY

A comparison of independent forecasts

Compiled by
EB Division
HM Treasury

November 1986 No. 2

As well as incorporating the latest Industry Act forecast published in the Autumn Statement, this issue includes new forecasts that have been received from: Alexanders Laing & Cruickshank; Cambridge Econometrics; Capel-Cure Myers; Henley Centre for Forecasting; James Capel & Co; London Business School; Oxford Economic Forecasting; Phillips & Drew; Scrimgeour Vickers & Co; and Wood Mackenzie & Co.

2.The average independent forecast is for GDP growth of 2.2 per cent in 1986 increasing to 2.6 per cent in 1987.

3. The average independent forecast is for an inflation rate of 3.3 per cent 1986Q4 rising to 4.6 per cent by 1987Q4.

4. The average independent forecast for unemployment is 3.20 million in 1986Q4 falling to 3.10 million by 1987Q4.

5. The average independent forecast for the current account is for a surplus of £0.2 billion in 1986 and a deficit of £2.7 billion in 1987.

6. The average independent forecast for the PSBR in 1986-87 is £7.8 billion rising to £9.9 billion in 1987-88.

Please note that this comparison is a summary of published material reflecting the views of the forecasting organisations themselves and does not in any way provide new information on the Treasury's own views. The comparison contains only a selection of forecasters which is kept continually under review. No significance should be attached to the inclusion or exclusion of any particular forecasting organisation. HM Treasury accepts no responsibility for the accuracy of the material published in this comparison.

Subscription enquiries should be addressed to Committee Section, HM Treasury, Parliament Street, London SW1P 3AG (01-233-4917). An invoice for the annual subscription fee of £50 will be sent on receipt of application. Distribution enquiries to Nigel Dawson (01-233-3276). All other enquiries to Ross Kerley (01-233-4489).

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COMPARISON OF FORECASTS   SUMMARY TABLES

FORECASTS FOR 1986/1986-87   * New forecast

Except where specified figures are percentage changes on previous year   (GDP components in constant 1980 prices)

Date of Forecast	IAFo * Nov '86	NIESR August '86	LBS * Oct '86	Phillips & Drew * Nov '86	Goldman Sachs Oct '86	Henley * Nov '86	C'bridge Econ (z) * Nov '86	L'pool Sept '86	CBI Sept '86	OECD May '86	Oxford * Nov '86	EC Oct '86	INDEPENDENT AVERAGE	INDEPENDENT RANGE		CITY AVERAGE
Forecasts for calendar year 1986																
GDP	2 1/2 (A)	1.8 (O)	2.1 (O)	2.2 (A)	2.1 (A)	2.2 (A)	2.0 (O)	2.7 (E)	2.2 (A)	3.0 (A)	2.1 (A)	2.3 (E)	2.2	1.8 (NIESR)	3.0 (OECD)	2.1
Consumers' Expenditure	5	3.8	4.7	4.4	4.3	4.2	3.4	3.1c	4.8	3.75	4.6	4.3	4.2	3.4 (CAM)	4.8 (CBI)	4.3
General Govt Consumption	1 1/2	1.1	0.5	0.7	1.0	0.9	0.8	0.0d	1.8	0.75	0.7	0.6	0.9	0.5 (LBS)	1.8 (CBI)	1.0
Gross Fixed Investment	2	1.8	0.6	2.5	1.8	0.6	3.3	4.7e	1.0	4.5	1.7	1.9	2.0	0.6 (LBS,HENLEY)	4.5 (OECD)	1.8
-public	-	0.2	-1.7r	3.1	-	2.0	-	-	-5.5	1.75	2.0	10.2v	0.6	-5.5 (CBI)	3.1 (P&D)	2.5
-private	-	2.2	1.2r	2.4	-	0.2	-	-	2.8	5.25g	1.7	0.8	1.7	0.2 (HENLEY)	2.8 (CBI)	1.6
Stockbuilding (bn pounds)	0.7	1.4	0.9	0.3	0.8	1.1	1.1	-	0.9	0.0n	1.0	1.0	0.9	0.3 (P&D)	1.4 (NIESR)	0.9
Exports (goods & services)	1	0.9	0.7	0.9	1.4	2.1	2.2	-	1.7	4.25	0.8	1.1	1.6	0.7 (LBS)	4.25 (OECD)	1.2
Imports (goods & services)	5	3.9	4.0	3.9	4.2	4.7	4.3	-	5.3	5.0	4.5	4.4	4.4	3.9 (P&D,NIESR)	5.3 (CBI)	4.2
RPI (CPI) - 4th Qtr	3 1/4	3.3	3.4	3.8	2.8	3.1	(3.2)k	(3.7)k	3.0	(4.0)k	3.4	(4.0)k	3.3	2.8 (GS)	3.8 (P&D)	3.3
Average Earnings &	-	7.3	7.8	7.8	7.7	7.7	6.7	7.0	8.6	-	7.8	7.5	7.6	6.7 (CAM)	8.6 (CBI)	7.7
RPDI	-	4.1	4.2	3.6	3.3	4.0	-	-	2.3	-	4.4	3.9	3.7	2.3 (CBI)	4.4 (OXF)	3.7
Employment Growth	-	0.8s	0.7	1.0	0.5	0.8	-	-	0.5	0.5	-0.2s	0.8	0.7	0.5 (GS)	1.0 (P&D)	0.9
Unemployment (UK adults million - 4th Qtr)	-	3.15	3.17	3.20	3.29	3.20	3.2k	3.16k	3.19	-	3.19	3.31kw	3.20	3.15 (NIESR)	3.29 (GS)	3.20
Industrial Production	-	-	1.3	1.2	1.4	1.4	1.5	-	-	2.25	-	1.2	1.5	1.2 (P&D,EC)	2.25 (OECD)	1.3
Manufacturing Output	0	0.3	0.0	0.1	0.1	0.3	1.5	-	-0.5	-	0.4	0.1	0.3	-0.5 (CBI)	1.5 (CAM)	0.0
World trade &	2	3.5	3.1	3.9	3.5	3.2	-	5.9	2.9	3.50	4.6	3.8	3.8	2.9 (CBI)	5.9 (LIVERPOOL)	3.1
Current Account (bn pounds)	0	-0.7	-0.4	0.1	-0.8	-0.3	0.2	3.5	1.7	-	-1.0	-0.2	0.2	-1.0 (OXF)	3.5 (GS,OECD)	-0.2
Sterling Index(1975=100) Q4	-	74.3k	68.0	70.2	69.0	68.6	74.3k	74.9k	-	-	68.0	-	68.8	68.0 (LBS,OXF)	70.2 (P&D)	69.1
Short term interest rate - 4th Qtr &	-	-	11.0	11.9	11.0	11.0	-	9.7k	9.5	-	1.0	9.5	10.7	9.5 (CBI)	11.9 (P&D)	10.9
Oil Price ($ per barrel)&	15f	12.0	16.0	14.8	14.0	15.0	-	15.0	-	-	4.0	14.4	14.4	12.0 (NIESR)	16.0 (LBS)	14.7
Forecasts for financial year 1986-1987																
M0 growth	2-6 y	-	4.2	3.7k	4.3u	4.9	-	4.5k	-	-	-	3.8u	-	-	-	4.7
Sterling M3 growth	11-15 y	-	15.2	17.6k	12.4u	17.2	-	-	-	-	12.8q	15.4u	-	-	-	16.9
PSBR (billion pounds)	7	8.6	7.4	7.8	7.5	7.7	9.2	6.4	7.2	-	8.8	7.6	7.8	6.4 (LIV)	9.2 (CAM)	7.2

NOTES:

(A) average measure
(O) output measure
(E) expenditure measure

& for definition see individual forecasts
o Industry Act forecast

(c) non durable consumption
(d) current and capital including stockbuilding
(e) private sector investment, stockbuilding and durable consumption
(f) from November

(g) non-residential
(j) 1980 = 100
(k) calendar year 1986
(n) change in stockbuilding as a $ of GDP in previous period

(q) 1987Q2 on 1986Q2
(r) LBS assume all asset sales represent transfer of ownership
(s) employees in employment
(u) end 1986

(v) general government only
(w) including school leavers
(y) target range set in 1986 FSBR
(z) Cambridge Econometrics forecast taken from longer term disaggregate forecast

'Average' is defined as an unweighted average of comparable independent forecasts

'City Average' is an unweighted average of nine City forecasts. See City summary tables for details

COMPARISON OF FORECASTS SUMMARY TABLES

FORECASTS FOR 1987/1987-88 * New forecast

Except where specified figures are percentage changes on previous year (GDP components in constant 1980 prices)

	IAFo *	NIESR	LBS *	Phillips & Drew *	Goldman Sachs	Henley *	C'bridge Econ (z) *	L'pool	CBI	OECD	Oxford *	EC	INDEPENDENT AVERAGE	INDEPENDENT RANGE		CITY AVERAGE
Date of Forecast	Nov '86	August '86	Oct '86	Nov '86	Oct '86	Nov '86	Nov '86	Sept '86	Sept '86	May '86	Nov '86	Oct '86				
Forecasts for calender year 1987																
GDP	3 (A)	1.8 (O)	3.0 (O)	2.4 (A)	3.1 (A)	2.8 (A)	2.3 (O)	3.1 (E)	2.5 (A)	2.25 (A)	2.4 (A)	2.7	2.6	1.8 (NIESR)	3.1 (LIV)	2.7
Consumers' Expenditure	4	3.5	4.1	3.9	3.5	2.9	3.0	3.2c	4.2	3.5	3.1	3.7	3.5	2.9 (HENLEY)	4.2 (CBI)	3.7
General Govt Consumption	1 1/2	1.5	1.0	1.0	1.3	1.8	1.1	1.4d	0.9	0.5	1.4	0.7	1.1	0.5 (OECD)	1.8 (HENLEY)	1.3
Gross Fixed Investment	2 1/2	1.1	2.4	3.6	4.3	3.7	2.7	8.1e	4.4	2.75	3.6	3.5	3.2	1.1 (NIESR)	4.4 (CBI)	3.4
-public	-	-4.2	-11.6r	0.3	-	1.4	-	-	0.4	2.25	0.4	-0.8v	0.1	-4.2 (NIESR)	2.25 (OECD)	1.6
-private	-	2.6	6.2r	4.5	-	4.4	-	-	5.4	2.5g	4.5	4.1	4.3	2.6 (NIESR)	5.4 (CBI)	4.1
Stockbuilding (bn pounds)	1.4	2.0	0.7	0.5	2.4	0.8	1.9	-	0.7	0.5n	0.5	1.2	1.2	0.5 (P&D)	2.4 (GS)	1.0
Exports (goods & services)	3	3.2	4.8	0.9	3.6	4.6	4.2	-	3.0	2.0	4.2	3.7	3.4	0.9 (P&D)	4.8 (LBS)	3.8
Imports (goods & services)	4 1/2	6.3	4.7	4.3	5.6	4.2	5.5	-	4.1	5.25	4.8	5.6	5.0	4.1 (CBI)	6.3 (NIESR)	5.3
RPI (CPI) - 4th Qtr	3 3/4	5.5	3.5	4.4	4.2	4.3	(5.3)k	(3.4)k	4.9	(3.75)k	5.3	(3.9)k	4.6	3.5 (LBS)	5.5 (NIESR)	4.4
Average Earnings &	-	7.0	5.8	7.3	7.1	6.1	6.2	5.6	6.2	-	7.1	6.6	6.5	5.6 (LIV)	7.3 (P&D)	7.0
RPDI	-	3.4	3.2	3.3	3.5	3.0	-	-	2.2	-	2.0	3.3	3.0	2.0 (OXF)	3.5 (GS)	3.7
Employment Growth	-	1.2s	1.3	1.1	0.5	0.9	-	-	1.1	1.0	-0.2s	0.8	0.8	0.5 (GS)	1.3 (LBS)	1.0
Unemployment (UK adults million - 4th Qtr)	-	3.06	3.14	3.15	3.16	3.06	3.2k	3.18k	3.06	-	3.08	3.32kw	3.10	3.06 (CBI,NIESR,HEN)	3.16 (GS)	3.15
Industrial Production	-	-	2.0	0.9	0.9	2.1	0.6	-	-	2.5	-	2.2	1.6	0.6 (CAM)	2.5 (OECD)	1.7
Manufacturing Output	4	2.2	3.7	3.1	3.4	3.2	1.8	-	1.7	-	2.8	2.2	2.7	1.7 (CBI)	3.7 (LBS)	3.3
World trade &	4 1/2	4.5	6.2	4.0	4.25	4.7	-	6.9	3.4	4.0	7.1	4.4	4.9	3.4 (CBI)	7.1 (OXF)	4.1
Current Account (bn pounds)	- 1 1/2	-5.8	-2.4	-3.2	-2.8	-1.1	-5.5	-0.1	-1.7	-	-2.2	-2.3	-2.7	-5.8 (NIESR)	-0.1 (LIVERPOOL)	-1.5
Sterling Index(1975=100) Q4	-	70.2k	64.0	67.4	70.0	66.2	69.5k	75.3k	-	-	64.0	-	66.3	64.0 (OXF)	70.0 (GS)	67.9
Short term interest rate - 4th Qtr &	-	-	9.5	10.0	10.0	10.0	-	8.3k	8.5	-	9.5	9.5	9.6	8.5 (CBI)	10.0 (GS,HENLEY,P&D)	9.8
Oil Price ($ per barrel)&	15	12.0	15.0	16.0	14.0	14.9	-	15.0	-	-	14.0	12.5	14.2	12.0 (NIESR)	16.0 (P&D)	14.9
Forecasts for financial year 1987-1988																
M0 growth	2-6 y	-	6.0	4.2k	4.1u	5.9	-	5.0k	-	-	-	4.0u	-	-	-	4.0
Sterling M3 growth	-	-	9.9	16.8k	17.8u	16.1	-	-	-	-	10.5q	8.0u	-	-	-	15.0
PSBR (billion pounds)	(m)	11.1	7.8	9.0	10.0	10.2	11.4	6.2	7.9	-	8.8	7.0	9.9	6.2 (L'pool)	11.4 (CAM)	8.7
scope for fiscal change (billion pounds)●	-	0.0	2.0	3.0	2.5	2.5	-	2.6	—	-	2.0	2.0	2.1	0.0 (NIESR)	3.00 (P&D)	2.0

NOTES:

(A) average measure
(O) output measure
(E) expenditure measure

& for definition see individual forecasts
o Industry Act forecast
● interpreted variously by forecasters as either residual or as target

(a) first half 1987 at annual rate
(c) non durable consumption
(d) current and capital including stockbuilding
(e) private sector investment, stockbuilding and durable

(g) non-residential
(h) first half 1987 on first half 1986
(j) 1980 = 100
(k) calendar year 1987
(m) 1 3/4 per cent of GDP as reaffirmed by Chancellor on 6 November

(q) 1988Q2 on 1987Q2
(r) LBS assume all asset sales represent transfer of ownership
(s) employees in employment
(u) end 1987

(v) general government only
(w) including school leavers
(y) target range set in 1986 FSBR
(z) Cambridge Econometrics forecast taken from longer term disaggregate forecast

COMPARISON OF FORECASTS - SUMMARY TABLES

CITY FORECASTS FOR 1986/1986-87 * New forecast

Except where specified figures are percentage changes on previous year (GDP components in constant 1980 prices)

	IAFo *	Phillips & Drew *	Goldman Sachs	Hoare Govett	Wood Mack *	James Capel *	Alex Laing Cr *	Scrimgeour *	Capel-Cure *	Midland Bank	CITY AVERAGE
Date of Forecast	Nov '86	Nov '86	Oct '86	Oct '86	Nov '86	Nov '86	Nov '86	Nov '86	Oct '86	Sept '86	
					Forecasts for calendar year 1986						
GDP	2 1/2 (A)	2.2 (A)	2.1 (A)	2.8 (E)	2.1 (A)	2.0 (A)	2.2 (A)	2.0 (A)	1.9 (A)	2.0 (O)	2.1
Consumers' Expenditure	5	4.4	4.3	3.9	4.8	4.0	4.5	4.6	4.6	3.5	4.3
General Govt Consumption	1 1/2	0.7	1.0	1.3	0.4	1.4	0.8	0.7	1.2	1.3	1.0
Gross Fixed Investment	2	2.5	1.8	2.4	1.1	1.7	1.0	1.2	-	2.3	1.8
-public	-	3.1	-	1.6	4.7	1.0h	-	3.4	-0.4	-	2.5
-private	-	2.4	-	2.7	0.1	1.9h	-	0.6	2.1	-	1.6
Stockbuilding (bn pounds)	0.7	0.3	0.8	1.2	0.9	1.0	1.2	0.7	0.7	1.0	0.9
Exports (goods & services)	1	0.9	1.4	2.0	1.8	0.3	1.1	1.1	0.3	2.1	1.2
Imports (goods & services)	5	3.9	4.2	3.5	5.1	3.7	4.6	4.7	4.8	3.6	4.2
RPI (CPI) - 4th Qtr	3 1/4	3.8	2.8	2.8	3.6	3.4	3.4	3.4	3.1z	2.9	3.3
Average Earnings &	-	7.8	7.7	7.5	8.0	7.5	8.0	8.1	7.9	7.2	7.7
RPDI	-	3.6	3.3	3.5	3.9	-	3.8	-	4.2	-	3.7
Employment Growth	-	1.0	0.5	1.7	0.4	-0.2s	0.7	0.2s	-	-	0.9
Unemployment (UK adults million - 4th Qtr)	-	3.20	3.29	3.23	3.2	3.21z	3.20	3.20	3.2u	3.10	3.20
Industrial Production	-	1.2	1.4	-	1.4	-	1.2	-	-	-	1.3
Manufacturing Output	0	0.1	0.1	-	0.0	-	0.1	-0.1	0.0	-	.0
World trade &	2	3.9	3.5	-	2.2	3.5	2.5	2.4	4.0	-	3.1
Current Account (bn pounds)	0	0.1	-0.8	0.9	-0.7	-1.1	-0.7	-0.8	-0.5	2.0	-0.2
Sterling Index(1975=100)Q4	-	70.2	69.0	-	68.7	67.5	67.3	67.7	67.0u	73.2	69.1
Short term interest rate - 4th Qtr &	-	11.9	11.0	8.5y	10.7	11.3	11.2	11.0	11.0u	9.4	10.9
Oil Price($ per barrel)	15p	14.8	14.0	-	15.0	14.5	14.8	15.0	15.0	-	14.7
					Forecasts for financial year 1986-1987						
M0 growth	2-6 x	3.7k	4.3u	4.9	6.0	3.25	-	-	-	-	4.7
Sterling M3 growth	11-15 x	17.6k	12.4u	16.5	16.5	17.0	15.7	19.5	16.0	-	16.9
PSBR (billion pounds)	7	7.8	7.5	8.0	7.1	7.7	7.0	6.5	6.5	7.0	7.2

NOTES:

- (A) average measure
- (O) output measure
- (E) expenditure measure
- o Industry Act forecast
- & for definition see individual forecasts
- (h) distorted by asset transfers
- (k) calendar year 1986
- (p) November onwards
- (s) employees in employment
- (u) end 1986
- (x) target range set in 1986 FSBR
- (y) end financial year 1986-87
- (z) 1986H2

'City Average' is defined as an unweighted average of comparable City forecasts

COMPARISON OF FORECASTS - SUMMARY TABLES

CITY FORECASTS FOR 1987/1987-88 * New forecast

Except where specified figures are percentage changes on previous year (GDP components in constant 1980 prices)

	IAFo	Phillips & Drew	Goldman Sachs	Hoare Govett	Wood Mack	James Capel	Alex Laing Cr	Scrim- geour	Capel- Cure	Midland Bank	CITY AVERAGE
	*	*			*	*	*	*	*		
Date of Forecast	Nov '86	Nov '86	Oct '86	Oct '86	Nov '86	Nov '86	Nov '86	Nov '86	Oct '86	Sept '86	
Forecasts for calendar year 1987											
GDP	3 (A)	2.4 (A)	3.1 (A)	3.2 (E)	3.1 (A)	1.9 (A)	3.0 (A)	2.3 (A)	2.5 (A)	3.2 (O)	2.7
Consumers' Expenditure	4	3.9	3.5	4.5	4.0	3.7	3.8	3.0	3.5	3.4	3.7
General Govt Consumption	1 1/2	1.0	1.3	1.2	0.9	2.0	1.6	1.2	1.7	0.7	1.3
Gross Fixed Investment	2 1/2	3.6	4.3	4.3	3.7	2.1	2.1	3.0	-	4.0	3.4
-public	-	0.3	-	1.5	3.5	-5.7h	-	0.9	2.0	-	1.6
-private	-	4.5	-	5.1	3.8	4.3h	-	3.6	3.3	-	4.1
Stockbuilding (bn pounds)	1.4	0.5	2.4	0.9	1.0	0.3	1.7	0.4	0.6	0.8	1.0
Exports (goods & services)	3	0.9	3.6	4.9	4.9	2.5	5.3	3.7	4.8	3.8	3.8
Imports (goods & services)	4 1/2	4.3	5.6	6.9	5.3	5.5	6.0	4.7	5.9	3.4	5.3
RPI (CPI) - 4th Qtr	3 3/4	4.4	4.2	4.2	4.0	4.7	5.4	5.0	4.0z	2.9	4.4
Average Earnings &	-	7.3	7.1	7.0	7.2	6.7	7.4	7.7	6.8	6.0	7.0
RPDI	-	3.3	3.5	4.5	3.8	-	3.6	-	3.6	-	3.7
Employment Growth	-	1.1	0.5	2.3	0.3	-0.1s	0.6	-0.3s	-	-	1.0
Unemployment (UK adults million - 4th Qtr)	-	3.15	3.16	3.19	3.1	3.18z	3.18	3.27	3.2u	3.00	3.15
Industrial Production	-	0.9	0.9	-	3.0	-	2.0	-	-	-	1.7
Manufacturing Output	4	3.1	3.4	-	3.5	-	3.7	2.4	3.7	-	3.3
World trade &	4 1/2	4.0	4.25	-	3.0	3.3	4.5	5.5	4.0	-	4.1
Current Account (bn pounds)	- 1 1/2	-3.2	-2.8	1.0	-3.2	-3.4	-0.5	-2.2	-1.5	2.0	-1.5
Sterling Index(1975=100)Q4	-	67.4	70.0	-	65.6	64.1	66.5	66.5	64.0u	75.0	67.9
Short term interest rate - 4th Qtr &	-	10.0	10.0	-	9.0	12.3	10.5	9.0	10.0u	7.5	9.8
Oil Price($ per barrel)	15	16.0	14.0	-	15.0	14.0	15.0	15.0	15.0	-	14.9
Forecasts for financial year 1987-1988											
MO growth	2-6 x	4.2k	4.1u	-	5.5	3.25	-	-	-	-	4.0
Sterling M3 growth	-	16.8k	17.8u	-	14.0	13.75	-	17.2	15.0	-	15.0
PSBR (billion pounds)	(m)	9.0	10.0	-	8.2	10.0	-	8.9	8.0	7.0	8.7
scope for fiscal change (billion pounds)©	-	3.0	2.5	-	1.5	1.2	-	2.0	-	-	2.0

NOTES:

- (A) average measure
- (O) output measure
- (E) expenditure measure
- (I) Industry Act forecast
- & for definition see individual forecasts
- © interpreted variously by forecasters as either residual or target
- (h) distorted by asset transfers
- (k) calendar year 1987
- (m) 1 3/4 per cent of GDP as reaffirmed by Chancellor on 6 November
- (s) employees in employment
- (u) end 1987
- (x) target range set in 1986 FSBR
- (y) end financial year 1987-88
- (z) 1987H2

'City Average' is defined as an unweighted average of comparable City forecasts

Independent forecasting organisations covered in this comparison

Alexanders Laing & Cruickshank (Alex Laing Cr)
Cambridge Econometrics (C'bridge Econ)
Capel-Cure Myers (Capel-Cure)
Commission of the European Communities (EC)
Confederation of British Industry (CBI)
Goldman Sachs (GS)
Henley Centre for Forecasting (Henley)
Hoare Govett
James Capel & Co
Liverpool Research Group in Macroeconomics (Liverpool)
London Business School (LBS)
Midland Bank plc
National Institute for Economic and Social Research (NIESR)
Organisation for Economic Cooperation and Development (OECD)
Oxford Economic Forecasting (Oxford)
Phillips and Drew (P&D)
Scrimgeour Vickers & Co (Scrimgeour)
Wood Mackenzie & Co (Wood Mack)

FISCAL POLICY

PSBR

PSBR

	PSBR			PSBR excluding privatisation proceeds		PSFD[1]	
	Cash (£ billion)	Real terms (1985-86 prices) (£ billion)	Ratio to GDP (per cent)	Cash (£ billion)	Ratio to GDP (per cent)	Cash (£ billion)	Ratio to GDP (per cent)
1970-71	0.8	4.0	1½	0.8	1½	-0.2	-½
1971-72	1.0	4.5	1¾	1.0	1¾	0.7	1
1972-73	2.4	10.5	3½	2.4	3½	2.0	3
1973-74	4.3	17.5	5¾	4.3	5¾	3.5	4¾
1974-75	8.0	27.0	9	8.0	9	6.0	6¾
1975-76	10.3	27.6	9¼	10.3	9¼	8.1	7¼
1976-77	8.3	19.7	6½	8.3	6½	7.4	5¾
1977-78	5.4	11.2	3½	5.9	4	6.6	4½
1978-79	9.2	17.4	5¼	9.2	5¼	8.5	5
Average 1974-75 to 1978-79	8.2	20.6	6¾	8.3	6¾	7.3	5¾
1979-80	10.0	16.1	4¾	10.4	5	8.2	4
1980-81	12.7	17.2	5½	13.1	5½	11.9	5
1981-82	8.6	10.7	3¼	9.1	3½	5.7	2¼
1982-83	8.9	10.2	3¼	9.3	3¼	8.4	3
1983-84	9.8	10.8	3¼	10.9	3½	12.1	4
1984-85[2]	10.2	10.8	3	12.3	3¾	13.8	4¼
1985-86[2]	5.8	5.8	1½	8.5	2¼	7.8	2¼
Average 1979-80 to 1985-86	9.4	11.7	3½	10.5	3¾	9.7	3½
1986-87 (AS forecast)	7	6¾	1¾	11¾	3	12.7[3]	3¼[3]

(1) Public Sector Financial Deficit.

(2) If adjusted for coal strike, PSBR and PSFD ratios to GDP roughly 0.9 per cent lower in 1984-85 and 0.3 per cent lower in 1985-86.

(3) Unpublished.

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DEBT INTEREST

Published forecasts of general government gross debt interest payments:

DEBT INTEREST

£ billion

	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
1985 AS		18.0	-	-	-	-
1986 PEWP		18.0	18.5	18.5	19.0	-
1986 FSBR+		17.7	18.2	19	19	19
1986 AS*+	16.1	17½	17½	[18]	[18]	[19]
Changes between 1986 FSBR and 1986 AS+		0	-¾	[-½]	[-1]	[-½]

* figures in square brackets not published but implicit in Autumn Statement GGE figures.

\+ FSBR and AS rounded to nearest £ billion. Changes calculated from unrounded numbers and rounded to nearest £½ billion.

General

Forecasting debt interest payments is complex matter. The debt comes in many different forms.

When forecasting necessary to make number of simplifications of the complex structure of debt and this inevitably introduces element of error. Forecasts dependent on many, often very uncertain, assumptions: levels and paths of interest rates, inflation, new borrowing and the structure of the new borrowing. Forecasts subject to wide margins of error. Hence published forecasts heavily rounded.

Debt interest payments in 1986-87

Payments expected to be £¾ billion lower than forecast at Budget time.

About half of downward revision reflects lower than expected interest rates and inflation (reduces accrued interest on indexed securities).

Rest of revision due to variety of factors including changes in composition, and profile and amount of GG borrowing, (GGBR lower in 1985-86 than assumed in FSBR reduces debt interest payments this year).

Key PSBR components

£ billion oo

	1985-86			1986-87		
	FSBR	outturn	Change	FSBR	AS	Change
Planning total (O/w: privatisation proceeds)	133.9 (-2.6)	133.6 (-2.7)	-0.3 (-0.1)	139.1 (-4.7)	140 ½ (-4 ¾)	+1 ¼ (-)
Interest payments	17.7	17.7	-	18.2	17 ½	- ¾
Less PCMOB*	-1.3	-1.0	+0.2	-0.4	-1	- ½
Other adjustments	5.0	6.3	+1.3 o	5.7	5 ½	-
General govt. exp	157.7	158.6	+0.9	163.4	164 ½	+1
North Sea revenues	11.5	11.3	-0.2	6.1	4 ½	-1 ½
Non-NS taxes	101.6	103.3	+1.7	111.5	113 ½	+2
Nat. Ins. contributions	24.3	24.4	+0.1	26.2	26 ½	
Interest and other receipts	12.5	13.2	+0.7 o	12.2	12	-
Accruals adjustments	-0.3	-0.5	0.2	-0.1	-	-
General govt. receipts	149.6	151.7	+2.1	155.9	156 ½	+ ½
GGBR	8.1	6.9	-1.3	7.5	8	+ ½
Plus PCMOB*	-1.3	-1.0	+0.3	-0.4	-1	- ½
PSBR	6.8	5.8	-1.0	7.1	7	-
PSBR as per cent of GDP	2	1 ½	- ½	1 ¾	1 ¾	-

* Public corporations' market and overseas borrowing

o Includes classification change on central government VAT refunded, worth £0.3 billion. Of remainder, major differences are on accruals adjustments and central government temporary lending to public corporations.

oo All £ figures rounded to nearest £100 million for 1985-86 outturn and FSBR and to nearest £½ billion for Autumn Statement forecast. PSBR as percentage of GDP rounded to nearest ¼ per cent. Figures do not necessarily sum to totals, either down or across, because of rounding.

WPU

General government financial balances as percentage of GDP (deficit minus)

	1976	1979	average 1980-1984	1985	1986(1)	1987(1)
United States(2)	-2.1	0.6	-2.5	-3.5	-3.4	-2.5
Japan(2)	-3.7	-4.8	-3.6	-1.3	-0.8	-0.4
West Germany(2)	-3.4	-2.6	-2.9	-1.1	-0.8	-0.4
France	-0.5	-0.7	-2.1	-2.6	-2.6	-2.5
Italy	-9.0	-9.5	-11.4	-14.0	-12.9	-12.8
Canada(2)	-1.7	-1.8	-4.4	-6.1	-5.0	-4.6
United Kingdom	**-4.9**	**-3.5**	**-3.2**	**-3.1**	**-3.2**	**-3.1**
Total of above countries (G7)	-2.9	-1.7	-3.3	-3.5	-3.2	-2.6
EC(3)	-3.9	-3.6	-4.8	-4.7	-4.4	-4.1
Total OECD(4)	-2.7	-1.8	-3.4	-3.6	-3.3	-2.8

Source: OECD 'Economic Outlook,' May 1986 and OECD 'Economic Studies' Autumn 1984

(1) OECD forecasts

(2) As percentage of GNP. NB general government ratio for US is lower than often quoted Federal deficit (5¼ per cent in fiscal 1986) because of state government surpluses. Ratio for Japan also understates central government deficit because of surplus of social security funds.

(3) Excludes Luxembourg and Portugal.

(4) Covers 18 of 24 members.

Comparison of forecasts

	£ billion		
		1986-87	
	1985-86 Outturn	FSBR Forecast	AS Forecast
GGE	158.7	163.4	164½
General Govt receipts	151.9	155.9	156½
o/w North Sea revenues	11.3	6.1	4½
General Govt Borrowing Requirement	6.9	7.5	8
PCMOB	-1.0	-0.4	-1
PSBR	5.8	7.1	7
PSBR excluding privatisation proceeds	8.5	11.9	12

Changes to components of PSBR since Budget

	£ billion	
	1985-86	1986-87
Expenditure		
General Government	+1	+1
Public corporations' market and overseas borrowing	0	- ½
Net change	+1	+ ½
Receipts		
Non-North Sea receipts	+2	+2
North Sea revenues (including APRT policy change for 1986-87)	0	-1 ½
Net change (including APRT change in 1986-87)	+2	+ ½
PSBR	-1	0

General government receipts in 1986-87: £½ billion higher than FSBR forecast overall. Following change announced in North Sea fiscal regime, North Sea revenues now forecast £1½ billion lower than in FSBR, but more than offset by higher non-oil receipts:

(a) North Sea receipts forecast lower

- lower dollar oil price and
- early repayment of Advance Petroleum Revenue Tax (APRT).

(b) Non-North Sea corporation tax receipts forecast up - in line with higher profits.

(c) VAT receipts forecast up. Experience to date suggests FSBR forecast for 1986-87 was underestimate.

(d) Stamp duty forecast up, reflecting buoyant stock market and higher asset prices.

North Sea revenues

(a) Tax revenues

	1984-85	1985-86	1986-87	1987-88
1986 FSBR	12	11½	6	4
Autumn Statement	12	11½	4½	not app
Outside average	not app	not app	5½	4

Revenues in 1986-87 now expected to be £1½ billion lower than forecast at Budget time. Largely due to lower sterling oil price in first 3 quarters of 1986 than then assumed, together with £0.3 billion reduction due to decision to repay some Advance Petroleum Revenue Tax in March 1987.

(b) Share of North Sea revenues in total tax and NIC receipts 8 per cent in 1985-86. Expected to fall to 3½ per cent in 1986-87.

(c) Ready reckoner:

- $1 barrel difference in oil price (assuming other things including exchange rate unchanged) changes North Sea revenues by about £½ billion in full year.

- 1 million tonne per year difference in oil production would change revenues by £60 million in full year.

Total non-North Sea taxation and NICs as percentage of non-North Sea GDP

1970-71	36.2
1974-75	35.7
1978-79	34.1
1979-80	35.1
1980-81	36.1
1981-82	39.4
1982-83	39.2
1983-84	37.9
1984-85	38 2
1985-86 (est)	37.5
1986-87 (est)	37.7

MTFS path for PSBR published in 1986 FSBR:

	Per cent of GDP	
1987-88	1988-89	1989-90
1 3/4	1 1/2	1 1/2

1986 FSBR projected fiscal adjustments of:

	£ billion	
1987-88	1988-89	1989-90
2	4	3

Money GDP path and GDP deflator:

					per cent
	1985-86	1986-87	1987-88	1988-89	1989-90
Money GDP					
FSBR	9 1/2	6 3/4	6 1/2	6	5 1/2
Autumn Statement	9 1/2	5 1/2	7	not app	not app
GDP deflator					
FSBR	6	3 3/4	3 3/4	3 1/2	3
Autumn Statement	6	3	3 3/4	not app	not app

Debt interest payments in Survey years

Projections subject to wide margin of uncertainty.

Projections revised down since Budget broadly in line with revision to 1986-87 - ie £½-£1 billion a year.

Debt interest receipts in 1986-87

Figures for 1986-87 not shown separately in Autumn Statement but grouped with other receipts in table 1.11. No figures at all for later years.

Interest receipts largely subject to same influences as payments. Thus interest receipts down in 1986-87 compared with FSBR but offset by higher 'other receipts' (eg. higher trading surpluses of LA bodies).

MEASURES OF MONETARY GROWTH

	1970-71	1971-72	1972-73	1973-74	1974-75	1985-76	1976-77	1977-78	1978-79
Growth on previous year									
Money GDP	10.7	11.4	13.9	10.8	18.8	24.2	16.8	16.6	14.6
Growth through financial year (calendar Q1 on year earlier)									
MO	10.2	7.0	12.5	10.5	15.8	8.8	11.3	15.4	13.2
PSL2	11.5	15.3	20.2	17.0	9.1	10.8	8.3	15.7	13.4
£M3	13.4	17.9	25.7	23.5	8.1	6.2	7.6	14.9	12.1

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87
Growth on previous year								
Money GDP	19.9	13.8	10.0	9.2	8.1	7.3	9.6	(5.6)
Growth through financial year (calendar Q1 on year earlier)								
MO	9.7	7.1	4.2	6.1	4.9	6.0	3.2	(4.1)
PSL2	12.4	13.7	12.1	11.1	10.8	14.4	13.3	(12.1)
£M3	14.4	17.8	14.2	10.9	8.1	11.5	16.3	(15.4)

Figures in brackets indicate forecast.

PUBLIC EXPENDITURE

Planning totals

	1987-88	1988-89	1989-90
			£ billion
Previous plans*	143.9	148.7	153
Revised plans	148.6	154.2	161.5
Change	+4.7	+5.5	(+8.5)

* 1987-88 and 1988-89 plans as in 1986 PEWP; 1989-90 illustrative figure published in FSBR.

Reserves

Cash provision in £ billion (% of planning total in brackets)

	1987-88	1988-89	1989-90
1986 AS	3.5 (2.4)	5.5 (3.6)	7.5 (4.6)
Compared with:	Year 1	Year 2	Year 3
1984 PEWP	2.75 (2.2)	3.75 (2.8)	4.75 (3.5)
1985 PEWP	3 (2.3)	4 (2.9)	5 (3.5)
1986 PEWP	4.5 (3.2)	6.25 (4.3)	8 (5.4)

Very high Reserves in 1986 PEWP reflect decision to project LA current spending at constant cash levels. Reserves as percentage of planning total larger than in 1984 and 1985 PEWPs.

PUBLIC EXPENDITURE

GENERAL

WPU

	GGE as percentage of GDP		GGE (real terms*) £ billion	
	Including privatisation proceeds	Excluding privatisation proceeds	Including privatisation proceeds	Excluding privatisation proceeds
1978-79	43 ¼	43 ¼	140.7	140.7
1979-80	43 ¼	43 ½	144.7	145.3
1980-81	46	46	147.4	147.9
1981-82	46 ¼	46 ½	148.8	149.4
1982-83	46 ¾	47	153.1	153.7
1983-84	45 ¾	46 ¼	155.0	156.3
1984-85	45 ½	46 ¼	159.1	161.3
1985-86	44	44 ¾	158.6	161.3
1986-87	43 ¼	44 ½	159.9	164.5
1987-88	42 ¾	44	162.8	167.5
1988-89	41 ¾	42 ¾	162.7	167.2
1989-90	41 ¼	42 ¼	165.2	169.6

* Cash figures adjusted to 1985-86 price levels by excluding effect of general inflation as measured by GDP deflator.

per cent of GDP

	1968-69 to 1978-79	**1978-79 to 1982-83**	**1982-83 to 1986-87**	**1986-87 to 1989-90**
GGE excluding privatisation proceeds	**2.9**	**2.2**	**1.7**	**1.0**
GGE including privatisation proceeds	2.9	2.1	1.1	1.1
Planning total including privatisation proceeds	2.9	1.4	1.0	1.3
Planning total excluding privatisation proceeds	2.9	1.5	1.8	1.3

WPU

	General government expenditure			Planning total[1]	
	As percentage of GDP	Cash (£ billion)	Real terms[2] (£ billion)	Cash (£ billion)	Real terms[2] (£ billion)
1968-69	40½	18.2	105.8	16.1	93.6
1969-70	40	19.3	106.6	17.0	93.9
1970-71	40½	21.6	110.0	19.1	97.2
1971-72	41	24.3	113.5	21.4	100.1
1972-73	40¾	27.6	119.3	24.8	107.2
1973-74	42½	31.9	128.8	29.3	118.1
1974-75	48	42.8	144.6	39.3	133.1
1975-76	48½	53.7	144.6	48.8	131.4
1976-77	46	59.4	141.4	54.4	129.5
1977-78	42¼	63.7	132.9	56.8	118 6
1978-79	43¼	74.6	140.7	65.7	124.0
1979-80	43¼	89.7	144.7	77.6	125.2
1980-81	46	108.3	147.4	92.6	126.1
1981-82	46¼	120.1	148.8	103.9	128.7
1982-83	46¾	132.6	153.1	113.4	131.0
1983-84	45¾	140.2	155.0	120.3	132.9
1984-85	45½	150.1	159.1	129.8	137.6
1985-86	44	158.6	158.6	133.6	133.6
1986-87[3]	43¼	164.4	159.9	140.4	136.5
1987-88[4]	42¾	173.7	162.8	148.6	139.3
1988-89[4]	41¾	179.6	162.7	154.2	139.6
1989-90[4]	41¼	187.8	165.2	161.5	142.1

Source: HM Treasury using CSO data for historical figures on general government expenditure (GGE) and GDP.

(1) Figures from 1973-74 are on current definition of public expenditure. Figures up to and including 1972-73 do not include market and overseas borrowing by public corporations (including nationalised industries).

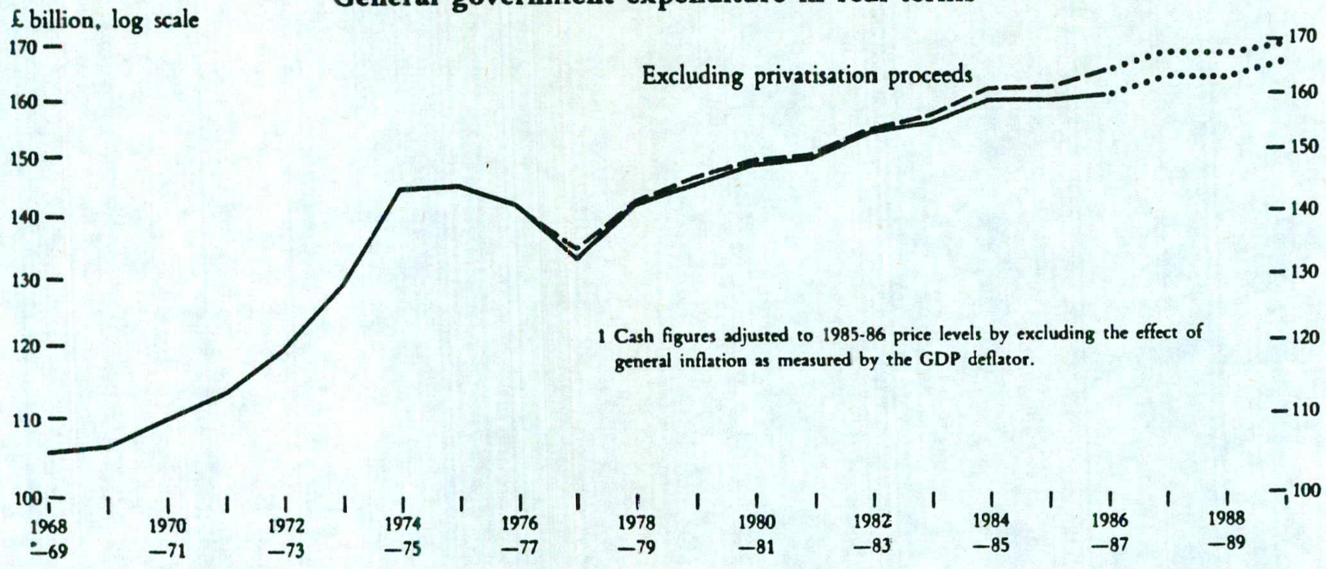
(2) Cash figures adjusted to 1985-86 price levels by excluding effect of general inflation as measured by GDP deflator.

(3) Estimated outturn.

(4) Planning total and GGE in cash as in Autumn Statement; GDP figures are those underlying Autumn Statement. GGE rounded to nearest £0.1 billion, although this does not imply accuracy to this degree.

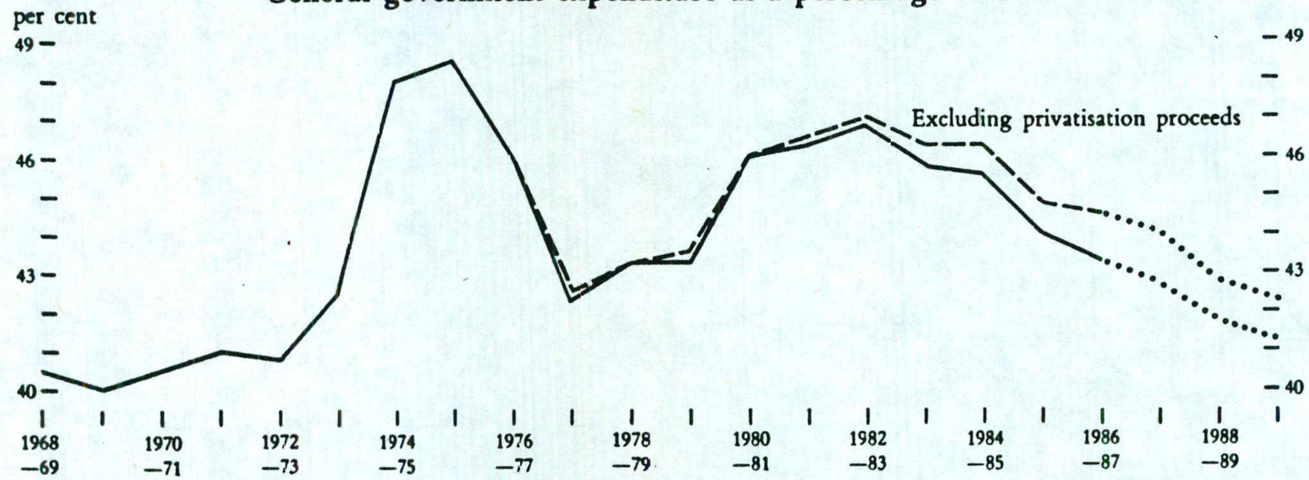
WPU

General government expenditure in real terms[1]



1 Cash figures adjusted to 1985-86 price levels by excluding the effect of general inflation as measured by the GDP deflator.

General government expenditure as a percentage of GDP



MY

Difference between planning total and GGE*

£ billion

Autumn Statement**	1986-87	1987-88	1988-89	1989-90
Gross debt interest	17½	18	18	19
PCMOB	1	1	1	1
National accounts adjustment	5½	6	6	6
Total difference between planning total and GGE	24	25	25	26

Changes from FSBR

(a) Unrounded (not for use in public)

Gross debt interest	-0.7	-0.5	-0.9	-0.6
PCMOB	0.6	0.3	0.7	0.8
National accounts adjustments	-0.1	-0.4	-0.4	-0.5
Total difference between planning total and GGE	-0.2	-0.5	-0.5	-0.3

(b) Rounded***

Gross debt interest	-¾	-½	-1	- ½
PCMOB	½	½	½	1
National accounts adjustments	-	-½	- ½	- ½
Total difference between planning total and GGE	-¼	-½	- ½	- ½

* Numbers may not sum owing to rounding.

**To nearest £½ billion for 1986-87; to nearest £ billion for future years.

***To nearest £¼ billion for 1986-87; to nearest £½ billion for future years.

Public expenditure (1) plans and outturns

£ billion

	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
larch 1980 White Paper (Cmnd 7841) (2)	91.2	101.0	106.4	112.4						
larch 1981 White Paper (Cmnd 8175) (2)(3)	92.8	104.4	109.9	113.6						
larch 1982 White Paper (Cmnd 8494) (3)	93.0	105.7	114.7	120.7	127.7					
'eb 1983 White Paper (Cmnd 8789)	92.7	104.6	113.1	119.6	126.5	132.3				
'eb 1984 White Paper (Cmnd 9143)	92.7	104.7	113.4	120.4	126.5	132.1	136.8			
Jan 1985 White Paper (Cmnd 9428)	92.7	104.6	113.5	120.3	128.2	132.1	136.8	141.6		
larch 1985 Budget (FSBR)	92.7	104.6	113.5	120.3	129.7	134.2	139.2	144.0		
Jan 1986 White Paper (Cmnd 9702)	92.6	103.9	113.4	120.3	129.6	134.2	139.1	143.9	148.7	
larch 1986 Budget (FSBR)	92.6	103.9	113.4	120.3	129.6	133.9	139.1	143.9	148.7	
1986 Autumn Statement	92.6	103.9	113.4	120.3	129.8	133.6	140.4	148.6	154.2	161.5

Outturns and estimated Outturns | Plans

(1) Public expenditure planning total as defined in the 1986 Autumn Statement.
(2) Converted into cash as explained on page 103 of Cmnd 8494 vol.2.
(3) Including changes announced in the March Budget Statement.

Economic assumptions

	1985-86	1986-87		1987-88		1988-89		1989-90	
	1986 PEWP	AS	1986 PEWP	AS	1986 PEWP	AS	1986 PEWP	AS	1986 PEWP
Unemployment (GB narrow) (1) **(million)**	3.05	3.1	3.0	3.05	3.0	3.05	3.0	3.05	not app
		AS	1986 FSBR	AS	1986 FSBR	AS	1986 FSBR	AS	1986 FSBR
GDP deflators(2) (financial year on financial year) **(per cent)**		$3\frac{3}{4}$	$3\frac{3}{4}$	$3\frac{3}{4}$	$3\frac{3}{4}$	$3\frac{1}{2}$	$3\frac{1}{2}$	3	3

RPI(1)	**September 1987 on September 1986**		**September 1988 on September 1987**	
	AS	**1986 PEWP**	**AS**	**1986 PEWP**
	3.75	3.25	3.5	not app

(1) See footnote to summary expenditure table published on 6 November.
(2) As in 1986 FSBR.

004/72

1986 AUTUMN STATEMENT: PUBLIC EXPENDITURE PLANS

Departments (incl LA current and nat inds)		1985-86	1986-87	1987-88	1988-89	1989-90
Defence - revised cash plans	(1)	17972	18600	18790	18980	19470
- cash increase from previous plans £m	(2)		+70	-20	-10	n/a
- cash increase from previous year %	(3)		+3.5	+1.0	+1.0	+2.6
- real increase from previous year	(4)		+0.5	-2.6	-2.4	-0.4
FCO - Diplomatic wing	(1)	605	670	700	730	750
	(2)		+30	+40	+40	n/a
	(3)		+10.7	+4.5	+4.3	+2.7
	(4)		+7.5	+0.7	+0.8	-0.3
FCO - Aid	(1)	1245	1320	1360	1400	1440
	(2)		0	+10	+10	n/a
	(3)		+6.0	+3.0	+2.9	+2.9
	(4)		+2.9	-0.7	-0.5	-0.1
EC Contributions	(1)	831	1090	870	440	1060
	(2)		+440	-280	-510	n/a
	(3)		n/a	n/a	n/a	n/a
	(4)		n/a	n/a	n/a	n/a
IBAP etc	(1)	1857	1520	1660	1780	1880
	(2)		-20	+40	+120	n/a
	(3)		-19.5	+9.2	+7.2	+5.6
	(4)		-21.5	+5.3	+3.6	+2.5
Domestic Agriculture	(1)	912	920	880	900	900
	(2)		+80	+50	+60	n/a
	(3)		+0.9	-4.5	+2.3	0
	(4)		-2.1	-7.8	-1.2	-2.9
Forestry	(1)	51	50	50	50	60
	(2)		0	0	0	n/a
	(3)		-2.0	0	0	+20.0
	(4)		-4.8	-3.6	-3.4	+16.5

		1985-86	1986-87	1987-88	1988-89	1989-90
DTI	(1)	1524	1370	1110	960	950
	(2)		+60	+20	+20	n/a
	(3)		-10.1	-19.0	-13.5	-1.0
	(4)		-12.8	-21.9	-16.4	-3.9
ECGD	(1)	319	250	160	110	50
	(2)		-50	-60	-20	n/a
	(3)		-22.6	-36.0	-31.2	-54.5
	(4)		-23.9	-38.3	-33.6	-55.9
Energy	(1)	677	170	-90	-50	-250
	(2)		+50	+460	+230	n/a
	(3)		n/a	n/a	n/a	n/a
	(4)		n/a	n/a	n/a	n/a
Employment	(1)	3342	3970	4050	4240	4340
	(2)		+40	+20	+20	n/a
	(3)		+18.8	+2.0	+4.7	+2.4
	(4)		+15.3	-1.7	+1.2	-0.6
Transport	(1)	4572	4920	5140	5080	5140
	(2)		+130	+300	+270	n/a
	(3)		+7.6	+4.5	-1.2	+1.2
	(4)		+4.5	+0.7	-4.5	-1.8
Housing	(1)	2861	2850	3200	3020	3090
	(2)		+90	+360	+130	n/a
	(3)		-0.4	+12.3	-5.6	+2.3
	(4)		-3.3	+8.2	-8.8	-0.7
DOE Other	(1)	3910	4070	3850	3890	3930
	(2)		+420	+290	+310	n/a
	(3)		+4.1	-5.4	+1.0	+1.0
	(4)		+1.1	-8.8	-2.4	-1.9
PSA	(1)	-97	-90	-90	-90	-90
	(2)		0	+40	+40	n/a
	(3)		+7.2	0	0	0
	(4)		+4.1	-3.6	-3.4	-2.9
Home Office	(1)	4728	5260	5540	5700	5870
	(2)		+300	+530	+650	n/a
	(3)		+11.3	+5.3	+2.9	+3.0
	(4)		+8.0	+1.5	-0.6	0

		1985-86	1986-87	1987-88	1988-89	1989-90
LCD	(1)	525	620	670	720	770
	(2)		+30	+60	+70	n/a
	(3)		+18.1	+8.1	+7.5	+6.9
	(4)		+14.7	+4.2	+3.8	+3.8
DES	(1)	14480	15950	16600	17350	17840
	(2)		+1630	+2200	+2870	n/a
	(3)		+10.2	+4.1	+4.5	+2.8
	(4)		+6.9	+0.3	+1.0	-0.2
OAL	(1)	721	800	810	830	860
	(2)		+70	+60	+80	n/a
	(3)		+11.0	+1.3	+2.5	+3.6
	(4)		+7.7	-2.4	-1.0	+0.6
Health	(1)	16640	17960	19100	19840	20720
	(2)		+230	+630	+700	n/a
	(3)		+7.9	+6.3	+3.9	+4.4
	(4)		+4.8	+2.5	+0.4	+1.4
Social Security	(1)	41466	44500	46000	47400	49300
	(2)		+1600	+1700	+1700	n/a
	(3)		+7.3	+3.4	+3.0	+4.0
	(4)		+4.2	-0.4	-0.4	+1.0
Superannuation	(1)	1017	1140	1240	1330	1410
	(2)		-60	-70	-70	n/a
	(3)		+12.1	+8.8	+7.3	+6.0
	(4)		+8.8	+4.8	+3.6	+2.9
Scotland	(1)	7221	7810	7950	8100	8220
	(2)		+240	+540	+670	n/a
	(3)		+8.2	+1.8	+1.9	+1.5
	(4)		+5.0	-1.9	-1.6	-1.5
Wales	(1)	2780	3060	3190	3300	3390
	(2)		+150	+250	+300	n/a
	(3)		+10.1	+4.2	+3.4	+2.7
	(4)		+6.9	+0.5	0	-0.3
Northern Ireland	(1)	4262	4530	4810	4980	5150
	(2)		+10	+120	+160	n/a
	(3)		+6.3	+6.2	+3.5	+3.4
	(4)		+3.2	+2.3	0	+0.4

		1985-86	1986-87	1987-88	1988-89	1989-90
Chancellor's Departments	(1)	1819	2070	2230	2320	2420
	(2)		+60	+180	+250	n/a
	(3)		+13.8	+7.7	+4.0	+4.3
	(4)		+10.5	+3.8	+0.5	+1.3
Other Departments	(1)	334	450	570	600	620
	(2)		+20	+70	+90	n/a
	(3)		+34.7	+26.7	+5.3	+3.3
	(4)		+30.8	+22.1	+1.7	+0.3

NB All percentages calculated using rounded figures.

PRO-RATA ALLOCATION OF 1987-88 RESERVE

DEPARTMENTS (including local authority current and nationalised industries)

	1987-88 plan (£m)	Pro-rata allocation of Reserve (£m)	Adjusted 1987-88 plan (£m)	increase in real terms from 1986-87 estimated outturn
Defence	18790	+437	19227	-0.4
FCO Diplomatic	700	+16	716	+3.0
FCO Aid	1360	+31	+1391	+1.6
EC Contributions	870	+20	890	-21.3
IBAP etc	1660	+38	1698	+7.7
Domestic Agriculture	880	+20	900	-5.7
Forestry	50	+1	51	-1.7
DTI	1110	+25	1135	-20.1
ECGD	160	+3	163	-37.2
Energy	-90	-2	-92	n/a
Employment	4050	+94	4144	+0.6
Transport	5140	+119	5259	+3.0
Housing	3200	+74	3274	+10.7
DOE Other	3850	+89	3939	-6.7
PSA	-90	-2	-92	-6.1
Home Office	5540	+129	5669	+3.9
LCD	670	+15	685	+6.5
DES	16600	+386	16986	+2.6
OAL	810	+19	829	-0.1
Health	19100	+444	19544	+4.9
Social Security	46000	+1071	47071	+2.0
Superannuation	1240	+29	1269	+7.3
Scotland	7950	+185	8135	+0.4
Wales	3190	+74	3264	+2.8
Northern Ireland	4810	+120	4930	+4.9
Chancellor's Departments	2230	+52	2282	+6.3
Other Departments	570	+13	583	+24.9
Privatisation	-5000			
Reserve	+3500			
Adjustments	-260			
Planning Total	148600	3500		+2.0

Likierman/Bloomfield Report (Published by Institute of Cost and Management Accountants)

Line to take

(i) Report does not anywhere use words "totally inadequate".

(ii) These words come from ICMA Press Notice which was issued before full Autumn Statement was published, ie author had not read it before issuing his blanket condemnation.

(iii) Report does not propose that analysis of variances should be a matter for Autumn Statement anyway - so again author of Press Notice has not understood the report.

(iv) At last year's hearings the Chairman said:

> "First of all, may I express, I am sure on behalf of the entire Committee, our pleasure at the improvements in the presentation you have carried out in response to the recommendations we made earlier."

Apart from absence of fiscal adjustment, Committee seemed satisfied with Autumn Statement. Document more or less identical this year.

(v) Four questions:

Does analysis suggested by Likierman/Bloomfield need to be done?
Need to be done by Treasury?
Need to be published?
Need to be published centrally or by departments?

Treasury will be examining the report to see what changes it or departments should make.

Background

Report recommends publication of:

- information on variance between plan and outturn to be included in PEWP following the end of the relevant financial year;

- identification of reasons for change;

- "triangle" tables for individual departments not just planning total - see table attached.

Latter requires departments to carry classification changes back not only to outturn and plans but also all previous plans. A great deal of work. Who apart from Likierman/Bloomfield wants this.

- ATTENTION : Michael Gunton

icma news release

The Institute of Cost and Management Accountants
Incorporated by Royal Charter

63 Portland Place London WIN 4AB
Telephone: 01-637 2311

38 : 86
10 November 1986

Embargoed until 00.01 hours Wednesday 12 November 1986

Presentation of todays Autumn Statement attacked

The presentation of the full Autumn Statement, a summary of which was published last Thursday, is totally inadequate. This is one of the conclusions in a report published today by the Institute of Cost and Management Accountants*. The report shows that it is currently impossible for non-experts to find the amounts by which government department's public spending plans have changed or the reasons for differences from plan. Authors Andrew Likierman and Susan Bloomfield** of the London Business School explain the difficulties of analysing public expenditure trends or variations from plan in the major financial documents presented to Parliament and set out ways of remedying them.

The report is complimentary about recent improvements in the presentation of some aspects of the major financial documents. But the authors stress the difficulties experienced by non-specialists in comparing departments' actual expenditure with what was planned and analysing trends. "For most organisations" they point out "this is a normal feature of financial planning and control". Yet in the case of the figures published for government departments, the variances from plan include the results of several quite different elements. These include the effects of both controllable and uncontrollable events, policy changes and the impact of budget measures on spending plans. "Because of this" the authors maintain, "it is not possible to measure the changes in the accuracy of departmental forecasts or changes in the ability of departments to keep within their budgets".

- On trend information, the authors point to the problems in analysing the figures as a result of the large number of technical and other changes. These take place each year and as a result users "need to be aware of the dangers of drawing incorrect conclusions".

Likierman and Bloomfield give a number of suggestions to overcome these difficulties. Among them are

* Information on the variance between plan and outturn for each government department in the Public Expenditure White Paper. This would eliminate the need to consult more than one document.
* An extension of the analysis showing the difference between two successive plans to identify the reasons for the variance between plan and outturn.
* Adjustment of past figures for departmental spending to enable trends and variances to be clear for those who want them.

The report also sets out the mechanism by which public spending plans are formulated and uses tables from recent documents to illustrate the problems.

* Establishing variances and trends in public expenditure by Andrew Likierman and Susan Bloomfield, published by the Institute of Cost and Management Accountants, 1986.

** Andrew Likierman is Director of the Institute of Public Sector Management at the London Business School and a member of the ICMA's Council. Susan Bloomfield is a Research Assistant at the London Business School.

Commenting on the Autumn Statement document, Andrew Likierman, one of the authors, said "It shows prime examples of the problems which we highlight in our report. It is not possible for anyone without a very good head for figures and a lot of experience to reconcile back to the plans produced last January. It just isn't reasonable to ask everyone to have such expertise."

Contact : Giles Collingridge - ICMA - 01 637 2311 or
Andrew Likierman - London Business School - 01 262 5050

6.11.01

17
18/11

CONFIDENTIAL

FROM: MISS M E PEIRSON
DATE: 6 November 1986

MR F E R BUTLER

cc PPS
PS/Chief Secretary
Mr Anson
Mr Scholar
Mr Turnbull
Mr Culpin
Miss O'Mara
Mr Gray
Miss Noble
Mr Gibson
Mr Cropper
Mr Ross Gooby
Mr Tyrie

UNEMPLOYMENT ASSUMPTIONS

1. There is one gloss I should like to add to Miss Noble's briefing. As you know, the apparent change in the unemployment assumption is from 3 million to 3.1 million in 1986-87 and from 3 million to 3.05 million in 1987-88 onwards. Miss Noble's brief points out that the latter 50,000 increase would cost only an extra £100 million of social security according to the DHSS ready reckoner.

SOCIAL SECURITY

2. However, the 3 million assumption published in the PEWP was on an old method of counting, which was changed as from last March. In the Department of Employment Gazette of October this year, it was stated that the change in the method of counting was estimated to have reduced the total by about 50,000. Therefore anyone who has read that Gazette might point out that the underlying increase in the unemployment assumption is 150,000 in 1986-87 and 100,000 in 1987-88. Clearly, using the ready reckoner would then produce an effect of £200 million a year in 1987-88 onwards.

CONFIDENTIAL

3. More generally, however, the line to take remains that the effect of the increase in unemployment numbers is a relatively insignificant factor, although there has been a significant rise in take-up of benefits by the existing unemployed (and higher average payments to them).

MEP

MISS M E PEIRSON

FROM: MISS G M NOBLE
DATE: 5 November 1986

MISS RUTTER

cc PPS
Mr F E R Butler
Mr Anson
Mr Scholar
Mr Turnbull
Miss Peirson
Mr Culpin
Miss O'Mara
Mr Gray
Mr Gibson
Miss C Evans
Mr Cropper
Mr Ross Goobey
Mr Tyrie

AUTUMN STATEMENT: DEFENSIVE SPEAKING NOTES

1. I attach some defensive material and positive points to make on the programme, as you requested for tomorrows debate. The material has been cleared with DHSS. There is more material in the main EB brief.

2. The defensive material on the £1.7 billion is basically a smoke screen. I think it is best to avoid trying to give any sort of quantitative analysis, and DHSS are certainly not ready to give a convincing enough breakdown. It would raise as many questions as it answered. The safest line, (as it happens, the truth) and the main answer to the point in your minute about why there is such a large increase in social security spending with no real increase in benefits (ie when the uprating was so small), is that the changes largely reflect the carry through of spending in 1986-87, where we are seeing a higher number of claimants and an increase in the average amounts of benefits being paid. If pressed for further details we can answer that the higher levels of spending in 1986-87 will be reflected in the winter supplementary estimates which will be released next week and which the House will have a chance to look at in detail.

3. I have included defensive material on whether the increase is solely due to higher unemployment. Quite genuinely, only a very small proportion of the extra spending is due to the 50,000 increase in the assumption - the DHSS ready reckoner published in

the PEWP would suggest £100million. But as Mr Fowler made clear in his papers for Star Chamber, spending on the unemployed has increased for other reasons - more of the unemployed are claiming means tested benefits, and the average amount paid to claimants is increasing (for example, because fewer now have working wives) and there seem to be second round effects like more people staying longer on invalidity benefit, more of the unemployed claiming disability benefits for their families etc. DHSS propose to use the line that unemployment is part of the story but by no means all of it, and that the usual full analysis of the programme by benefit and by type of claimant will be provided in the PEWP.

G M Noble

MISS G M NOBLE

DEFENSIVE MATERIAL ON SOCIAL SECURITY

(i) On the increase in provision

- The increase of £1,700 million in the provision for social security for 1987-88 and 1988-89 mainly reflects the carry through of the higher levels of spending in 1986-87.

- There is no single reason for this increase. It is the combination of a number of factors. But the most significant ones are the continuing rise in the number of people claiming means tested benefits and an increase in the average amounts of benefit paid. The slight increase in the assumed level of unemployment compared with the last Public Expenditure White Paper is not the major factor. There is an increase in take-up of means tested benefits among the long term sick and disabled and single parents. Average amounts paid in housing benefit to people both in an out of work are also increasing, as are the numbers claiming. And spending on family benefits has increased, reflecting, among other things, a higher birth rate and more children staying on at school after 16. There is also a continuing increase in the level of take up of benefits among the existing unemployed.

(ii) On the effect of unemployment

- Only a small proportion of the £1,700 million increase in the plans for 1987-88 and 1988-89 is due to higher assumptions about unemployment. The unemployment assumptions for those two years have been increased from 3 million to 3,050,000. That implies some reduction from the 3,100,000 assumed for 1986-87.

- If hon Members look at last year's White Paper they will see that the DHSS estimated that an extra 50,000 unemployed would add just over £100 million to their estimates of benefit expenditure in 1987-88. If pressed: the figures also allow for an increase in the average amounts of benefit being claimed by unemployed people. The usual full analysis of expenditure by benefit and type of claimant will be published in the public expenditure White Paper.

- It is worth remembering that most of the social security budget is actually spent on the elderly, the sick and disabled and on families. Only about one sixth of the social security programme is spent on benefits for unemployed people.

(iii) On the realism of the figures and the history of under-forecasting

- The figures are much more soundly based than in the past. The estimates of spending in 1986-87 on which the revised projections for the later years are based are the results of new monitoring and forecasting techniques which DHSS have just introduced. These are designed to pick up the underlying trends on expenditure at a far earlier stage in the year, and allow us to take proper account of them in the published plans for the later years.

- The figures are still of course subject to fluctuation. Even a small variation on such a large programme is a lot of money. A forecasting error of just ½ per cent is equivalent to £¼ billion.

Positive material on the programme as a whole

- The social security programme has increased by 35 per cent in real terms since the Government took office, and two thirds of that is due to higher spending on the elderly, the long term sick and disabled and families.

- Since 1978-79, the number of retirement pensioners has increased by nearly 1 million and yet pensions have increased in real terms. Expenditure on the elderly has grown by 25 percent in real terms equivalent to £4 billion between 1978-79 and 1985-86, of which £2½ billion was due to real increases in the amount of benefits paid.

- Spending on benefits for the long term sick and disabled has increased by over £1.75 billion in real terms or well over 50 per cent, due in part to higher numbers claiming, but also to real improvements and benefits. The most recent example of improvements in this area was the extension of invalid care allowance to married women which my Rt Hon friend the Secretary of State for social services announced in June.

Q1 Why is the year-on-year percentage growth for Scottish programmes. as in the Autumn Statement, so much less than those for the other two territories [see Annex], and/or than for GDP deflator?

A1 The low rate of growth has much to do with the fact that the Scottish Electricity Boards are entering on a period of heavy debt repayment. If you remove that distorting factor, Scottish programmes grow by 3.8%, 3.3%, 3.3%, in the three years - pretty close to the GDP deflator.

Q2 Have the normal workings of the comparability formula been interfered with, in Scotland's case?

A2 There has been no change to the formula used to calculate the proportion of changes in English (or English and Welsh) programmes that should be added to the Scottish block total. However, the Secretary of State decided not to take up his full entitlement of formula consequences on local authority current expenditure: to have done so would have encouraged higher spending by local authorities and thus a heavier burden on Scottish ratepayers. Apart from this adjustment, the Scottish block has received its full formula share of all changes to every one of the comparable English programmes.

Q3 Can you offer further explanation of the figures, which suggest a very substantial shortfall in Scotland's block entitlement however you look at it?

SCOTLAND

A3 I understand the Secretary of State will, in accordance with his normal practice, be making a statement before the Christmas Recess about the detailed allocation of resources within his programme totals already announced, and I cannot anticipate what he will be saying then.

Q4 Can you say any more about the figures for Wales and Northern Ireland, which on any calculation look more generous than Scotland's?

A4 The normal workings of comparability have given all three territories very substantial increases in their provision for the years 1987-88 to 1989-90. Comparisons between them can be misleading because their functional coverage varies in each case.

ANNEX

AUTUMN STATEMENT: YEAR-ON-YEAR PERCENTAGE INCREASES FOR EACH TERRITORY

per cent

	1986-87	1987-88	1988-89	1989-90
Scotland	7.5	1.8	1.9	1.5
Wales	10.1	4.2	3.4	3.0
N Ireland	6.3	6.1	3.6	3.4

Local authorities

Relevant current (including rate fund contributions to Housing Revenue Accounts)

							£ million	
	1986-87 est outturn		**1987-88 plan**		**1988-89 plan**		**1989-90 plan**	
GB	29,600	(+9.2)	31,000	(+4.6)	32,200	(+4.0)	33,000	(+2.6)

Percentage increase over previous plans in brackets.

Plans increased from 1986 PEWP so that provision over Survey period at broadly same level in real terms as LA budgets in 1986-87.

Figures include extra resources available for teachers' pay:

						£ million
	expenditure	**grant**	**expenditure**	**grant**	**expenditure**	**expenditure**
England	111	51	460	183	732	787
Wales	7	5	30	17	94	101
Scotland	14	8	60	30	47	50
Total	132	64	550	230	873	938

Pay bill: As percentage of all LA relevant current spending

- pay and pensions etc about 80 per cent;
- pay about 65 per cent;
- pay, excluding school teachers, about 45 per cent.

(All percentages approximate.)

Capital

				£ billion
	1986-87 est outturn	**1987-88 plan**	**1988-89 plan**	**1989-90 plan**
Gross provision (GB)	6.5	6.6	6.4	6.5

Increased to permit Government fully to meet commitment to LAs that allocations for Housing and Other Environmental Services would be no less than 80 per cent of 1985-86 level.

LAs

NATIONAL INSURANCE CONTRIBUTION RATES 1987-88

Summary of proposals

	Present 1986-87	Proposed 1987-88	Change
Employer's Class 1 (contracted-in)	10.45%	10.45%	-
Employer's Class 1 (contracted-in)	9%	9%	-
Opted-out married women	3.85%	3.85%	-
Lower Earnings Limit (Class 1)	£ 38	£ 39	+£ 1
Upper Earnings Limit (Class 1)	£285	£295	+£10
Low-paid earnings brackets	(£ 60 (£ 95 (£140	(£ 65 (£100 (£150	(+£ 5 (+£ 5 (+£10
Rates payable within low-paid brackets	(5% (7% (9%	(5% (7% (9%	- - -
Class 2 (self-employed)	£ 3.75	£3.85	+10p
Small earnings exception	£ 2,075	£2,125	+£50
Class 3 (voluntary)	£ 3.65	£3.75	+10p
Class 4 (self-employed, profits-related)	6.3 %	6.3%	-
Lower profits limit (Class 4)	£ 4,450	£4,590	+£140
Upper profits limit (Class 4)	£ 14,820	£15,340	+£520

Note: Contracting-out rebates not due for change until end of 1983-88 quinquennium; therefore remain at 4.1 per cent employer, 2.15 per cent employee (ie 6.25 per cent joint).

WPU

NICs

LEL up 2.6 per cent, compared with 2.1 per cent pension increase.

UEL up 3.5 per cent - maximum permissible within statutory rule that UEL must not exceed 7½ times pension.

Treasury Supplement cut from 9 per cent to 7 per cent. Worth £600 million.

~~(NB As proportion of total benefit expenditure, spending on means tested and non-contributory benefits will increase by 1 per cent between 1986-87 and 1987-88.)~~
(see * below)

Employment Protection Allocation, currently 0.25 per cent for employees and 0.20 per cent for employers, reduced to 0.07 per cent and 0.06 per cent respectively.

National Health Service Allocation, currently 0.75 per cent for employees and 0.60 per cent for employers, increased to 0.85 per cent and 0.70 per cent respectively.

Unemployment assumption: 3.1 million 1986-87; 3.05 million 1987-88.

Earnings assumption: About 7½ per cent between financial years 1985-86 and 1986-87; about 6½ per cent between financial years 1986-87 and 1987-88.

(NB Reduced rate bands up by 11-18 per cent since October 1985.)

Burdens

- For those earning between £39 and £285 a week (former UEL) no increase for either employee or employer for contracted-in; only 6p maximum combined increase for contracted-out.

  Some lower paid employees and their employers will pay less (up to £1.98 a week for employee and £2.16 a week for employer).

- For those earning above £285 a week, maximum possible increase is 90p a week. No change for employers.

- Income from employers' contributions expected to be just over £800 million (6.6 per cent) higher than in 1986-87. Due solely to higher earnings and employment. Uprating of earnings limits reduces burden by £150 million.

* In this context it is relevant that since 1981-82 expenditure on contributory benefits as a share of total social security expenditure has fallen from 61% to 54% by 1986-7. The share of social security expenditure devoted to income related benefits has increased from 19% to 26% over the same period.

- Income from employees' contributions expected to be about £870 million (7.5 per cent) higher than in 1986-87. Due almost entirely to higher earnings and employment. Uprating of earnings limits adds just £20 million (net) to employees' burden.

Changing LEL to threshold would cost some £6½ billion.

1251/1

FROM: A ROSS GOOBEY
DATE: 18 NOVEMBER 1986

Ch
Full transcript now attached
AA

CHANCELLOR

cc Mr Cropper
Mr Tyrie

TCSC - 17 NOVEMBER

You will be receiving a full note of the meeting from Miss Evans.

2. There were several items to which it was intimated the Committee will revert on Thursday.

Q11 3. Your statement on "This Week, Next Week", that you wish to see the pound no lower, was interpreted as putting a base under an unannounced exchange rate target range. Sir T Burns encouraged them to ask you exactly what was meant by the statement.

Q38-41 4. The contrast between the 1985 Autumn Statement that "export volumes have not been very responsive to price and cost changes" and the 1986 Statement that "with the lagged benefits from this year's gain in competitiveness ..... exports should continue to grow steadily" was drawn out by Wainwright and Mitchell. There is clearly a danger in imputing too much of the export volume growth to the lower sterling rate since this gives the "devaluers" ammunition.

Q46-47 5. Mr Browne was referred to you after asking whether the Government could not go for a supply-side tax cut in the expectation of higher revenues.

Q58-59 6. As Sir T Burns will no doubt report, he was pressed very hard to give a breakdown of the housing element of the RPI estimate for 1987, revealing the interest rate assumption. My own view is that such a precedent might be unfortunate although, again, it could be emphasised that, like the exchange rate, it is only a working assumption.

7. In general, the Committee was not very hostile, although they did seem keen to elicit a confession of change. John Townend was taking the line that, if you take back the excess costs of the miners' strike from the 1985-86 numbers, growth in 1986-87 of programmes is 4% real.

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ARG

A ROSS GOOBEY

CE17

FROM: MISS C EVANS
DATE: 18 NOVEMBER 1986

MES 18/11

1. MR SCHOLAR

2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr Gray
Miss O'Mara
Mr Culpin
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Hudson

TCSC: EVIDENCE FROM THE CHANCELLOR THURSDAY 20 NOVEMBER

I attach the Committee's questions to the Chancellor which I have received by telephone.

CE

MISS C EVANS

Ch

Points on which more briefing is needed

(a) funny definition of public expenditure in PE, Qn 2

(b) reasons for lumpy profile in future PES plans

(c) housing component of RPI

(d) the 4 2 pt (ARG para 7)

AA

Covered briefly in Turnbull note.

Rgtd. PSF [illegible]

CE11a

pup

FROM: MISS C EVANS
DATE: 18 NOVEMBER 1986

MR ALLAN

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr Gray
Miss O'Mara
Mr Culpin
Mr Cropper
Mr Ross Goobey
Mr Tyrie

Non-accommodation

TCSC: TREASURY OFFICIALS' HEARING

... I attach a record of yesterday's hearing. I will forward a copy of the official transcript as soon as we receive it.

CE

MISS C EVANS

TCSC: TRANSCRIPT OF TREASURY OFFICIALS' APPEARANCE 17 NOVEMBER 1986

Mr Watts Does the Autumn Statement stance on monetary policy amount to an exchange rate target?

Sir T Burns The Government's monetary stance remains as set out in the MTFS and in the Chancellor's Lombard speech.

Mr Watts But the Budget placed greater emphasis on the exchange rate as a restraint on inflation, does this imply downgrading of the weight on other targets?

Sir T Burns We have always said that the exchange rate is important as an indicator of monetary conditions but the Chancellor has made clear that the monetary aggregates are also important. For example, the last rise in interest rates was influenced by the increase in M0.

Mr Watts Why are there no monetary targets in the Autumn Statement?

Sir T Burns This is the same as previous years. The Autumn Statement deals with the Government's spending plans and provides the Industry Act Forecast, but it is not an occasion for restating monetary policy.

Mr Watts How confident is the Treasury of the assumption that the effective exchange rate will stay at present levels?

Sir T Burns The statement about the exchange rate is an assumption and not a forecast. The volatility of the exchange rate makes it very risky to make forecasts or strong statements about it. I hope that the assumption is realistic.

Mr Watts Can we expect measures to damp down deviations in the exchange rate from the Autumn Statement assumptions?

Sir T Burns The exchange rate is an important indicator, so sharp movements would certainly have implications for policy.

Mr Watts Does this mean that you have an implicit target for the exchange rate?

Sir T Burns We do not have an implicit or explicit target.

Mr Watts If the £ were to fall in effective terms how would this affect the forecast for inflation and the current account?

Sir T Burns We would expect prices to be higher, and the current account to improve over time but in the short term the J-curve effect would worsen the balance of payments.

Mr Watts Why do you assume that the lower exchange rate will have a beneficial effect on exports since it is clear that the uncertainty about future rates inhibits businessmen from taking advantage of them?

Sir T Burns It is inevitable that the impact of change will be limited by uncertainty about the future but it is clear that changes in the exchange rate do affect performance but possibly not as much as some commentators previously thought.

Mr Higgins Am I right in saying that the Chancellor has recently gone on record as saying that he does not want the exchange rate to go any lower than it is at present?

Sir T Burns I believe that is correct.

Mr Higgins Does that not imply a target for the exchange rate?

Sir T Burns No it does not. For an explanation of the Chancellor's statement you might ask him on Thursday.

Mr Higgins You said that there are no monetary targets in the Autumn Statement but surely the PSBR is a monetary target. Is this the first time for a PSBR target to appear in the Autumn Statement?

Sir T Burns We have always presented in the Statement an assumption that the MTFS PSBR target would continue, and there was a presumption that this would be the case. In the last few years, the PSBR has in fact been set at or slightly below the level of the previous Budget assumption. This year the Chancellor went a bit further than simply stating this as an assumption because of worries that people would see the revised expenditure plans as a signal of a loosening of fiscal policy.

Mr Higgins So this is a new departure restating monetary policy in the Autumn Statement?

Sir T Burns No. The Chancellor was simply addressing the fiscal policy point.

Mr Browne When the Chancellor said that he didn't want the £ to fall further, what indicator was he referring to?

Sir T Burns I would guess that he meant the sterling trade-weighted index.

Mr Browne Does the Chancellor have in mind that there is a psychological lid to sterling?

Sir T Burns I think you need to interpret the Chancellor's comments against the kind of movements in the exchange rate which we have seen recently. The

Chancellor has emphasised that he would prefer not to see too much movement, he thinks the exchange rate should be quite testing and should not move to accommodate higher costs including pay costs. It was inevitable that the £ would adjust to the fall in oil prices. But this adjustment has now taken place and rapid depreciation is behind us so we go back to the same principles as before.

Mr Townend What is the underlying increase in the Government's public expenditure plans from 1985-86 to 1986-87 after removing the effect of the miners' strike and privatisation proceeds?

Mr Turnbull The planning total has increased from £133.6 billion to £140.4 billion. In 1985-86 privatisation proceeds were £2¾ billion and in 1986-87 £4¾ billion.

Mr Townend Isn't the real underlying increase in programme expenditure in the two years around 4 per cent which is above the rate of growth of the economy as a whole?

Mr Turnbull The estimate of the impact of the coal strike is uncertain. It is doubtful if in 1985-86 it turned out as large as we had expected. I am not sure that it is useful to take the year on year growth in any two years as the measure of the underlying trend. In 1985-86 there was a sharp fall in real terms and in 1986-87 you had an increase in real terms. In 1986-87 the planning total went up by 2.2 per cent and excluding privatisation proceeds the increase was 3.6 per cent which is higher than the increase in GDP.

Mr Townend Has there been a change in public spending policy, from a policy of holding public spending constant in real terms to one of reducing public expenditure as a proportion of GDP?

Mr Turnbull There has always been a long term objective, since 1979, of reducing spending as a share of national income. This has been a constant theme but there have been various statements about the speed of achieving this objective. I would say that it was not a change of objective but a change in degree - a change in the speed of achieving the objective.

Mr Townend What assumption have you made about pay in the public sector?

Mr Turnbull There is no assumption about public sector pay except for special cases such as teachers. The individual departments have running costs limits and have to adjust their plans in the light of pay settlements but the Survey is not put together by starting with a pay assumption as in earlier years. In essence, it is up to departments to make provision for pay within their running costs limit.

Mr Townend Is the Government going to set an example on pay? If pay goes up, presumably it will be necessary to dig into the Reserve. The Reserve for 1987-88 is lower than this year: are you confident that this will be sufficient?

Mr Turnbull The Reserve provided in these plans are higher both absolutely and as a proportion of the planning total than in any previous White Paper except the last. The Reserves set in the 1986 PEWP reflected the fact that provision for local authority expenditure in 1986-87 was set only slightly above the 1985-86 out-turn and for the later years kept at the same cash level. In the Autumn Statement local authority expenditure is planned to rise and this implies lower Reserves.

Mr Townend Would you agree that if the Government had stuck to its previous plan it would have been easier to provide tax cuts in the 1987 Budget?

Mr Turnbull The Chancellor has already acknowledged this in his statement that you can't spend the same £ twice.

Mr Wainwright What are the factors underlying the difference between the Budget and Autumn Statement current account forecasts, with particular reference to the discrepancy in manufactures?

Sir T Burns The main factor underlying the revised forecast is the extent to which world trade in manufactures did not turn out as expected. There have been big changes in oil prices, the exchange rate and commodity prices which were very difficult to forecast. As the results of these relative price changes, the non-OPEC countries felt it necessary to cut the level of their imports so the growth of exports from the major industrial countries has been weak.

Mr Wainwright Are you not optimistic in forecasting a current account deficit of only £1½ billion next year?

Sir T Burns I accept that the standard error on the current account is enormous. There have been sharp movements recently. But it is not necessarily optimistic. Our record is not one of optimism on current account forecasts, in fact we have tended to bias in the opposite direction.

Mr Wainwright You said that a lot of things have changed in the past year. Has the forecasting system changed?

Sir T Burns There has been no change in the forecasting system.

Mr Wainwright The forecast suggests that exports will grow steadily as a result of the increase in competitiveness of British goods. How do you reconcile that with what you were saying last year that in the light of experience exports are not particularly price sensitive?

Sir T Burns There is no inconsistency. Last year we didn't say that exports were unresponsive: we were making a relative statement about how responsive they are. We haven't changed our view but the fall in the exchange rate this year is so significant that we expect there will be an impact on exports. In other words, we have revised down our view of the scale of the impact of the exchange rate on export volumes but we believe that the improvement in competitiveness which has taken place will be sufficient to have some effect.

Mr Higgins We shall want to pursue this question on Thursday.

Mr Wainwright The Autumn Statement is very optimistic about the future balance of invisibles at £8½ billion which compares with a forecast of £5½ billion in the Budget. The official estimates put the surplus in the first nine months at £5.8 billion including the delayed rebate from the EC, and DTI are forecasting an invisible balance in the last 3 months in surplus of about £600 million a month: that doesn't add up to £8½ billion.

Sir T Burns Actually the Budget forecast was £8 billion so there hasn't been a great change.

Mr Wainwright I accept that but I am still concerned that the figure looks optimistic.

Sir T Burns Estimating is very difficult in this area. Figures tend to be revised upwards at the end of the year and there is a tendency within year to understate the likely outcome. You have to take account of movements on the IPD account, and the reduced debit on oil revenues, the higher level of net overseas assets, and the good return on overseas assets.

Mr Sedgwick The figures so far this year tend to support our forecast. It is worth mentioning that last year's figure has now been revised upwards. There is one other effect which is also worth mentioning. Credits on tourism were probably affected by the terrorists' scare earlier this year, probably to the tune of a few hundred million: this is likely to wear off over time.

Mr Wainwright Have you allowed for growth in unit wage costs? If these continue to grow at 5 per cent a year, with manufacturers enjoying rising profits and therefore finding it hard to resist pay rises, and with skill shortages, are we getting near to capacity which points to caution in exports forecasts?

Sir T Burns We have been cautious but there are signs that manufacturing output has picked up. The latest figures to September show productivity picking up as well. I wouldn't dispute that unit costs are still rising faster than we would hope. Capacity is very hard to read, on skill shortages it is true that vacancies are up but they are not as high as they have been. I don't think this is a great threat, capacity utilisation has picked up but I don't see a really strong supply side constraint on exports.

Mr Browne Will this Government be prepared to increase borrowing to finance a reduction in the standard rate of taxes or does the increase in spending plans now rule this out?

Sir T Burns This Government has not set about reducing taxes by borrowing in anticipation of extra revenue.

Mr Browne Will the Government do it in future?

Sir T Burns In the past, the Government has placed great emphasis on restraining the PSBR.

Mr Mitchell I am glad to see that there has been a substantial change in policy on the exchange rate. Are you making a virtue of necessity ie you have to increase exports in order to produce a respectable balance of payments forecast and so you assume that the lower exchange rate will have this effect.

Sir T Burns It is not fair to say that there has been a major change of view. As the Chancellor said in his Cambridge speech, it was inevitable that there would be a depreciation of the real exchange rate in response to a fall in oil revenues. That has happened. I repeat we have not changed our views on the impact of competitiveness on the level of exports.

Mr Mitchell But you said last year that competitiveness was not that important a determinant of export levels. What assumption are you making about interest rates? Are you assuming that they will continue at the present levels which are highly damaging to industry and the economy and that they may in fact even increase?

Sir T Burns We don't publish an interest rate forecast.

Mr Mitchell But you are assuming that higher mortgage interest rates be responsible for the increase in the RPI inflation rate next year. So surely this means that you are expecting interest rates to increase?

Sir T Burns Even if there is no change in the mortgage rate, the RPI index including housing costs increases more quickly than if it is excluded because of the way that component is computed.

Mr Mitchell Are you therefore assuming that interest rates will stay at present levels?

Sir T Burns As I said it is not our practice to forecast interest rates.

Mr Mitchell If the exchange rate is assumed to stay broadly flat, what level of interest rates will be necessary to achieve that?

Sir T Burns We are assuming that interest rates will be set at the level needed to deliver the MTFS objectives.

Mr Mitchell Presumably that means that with a worsening current account higher interest rates will be needed to offset inflationary pressures?

Sir T Burns Not necessarily. Capital account movements are also very important. Our interest rates are already high by international standards but as I have said it is our practice not to comment on interest rate assumptions.

Mr Higgins Table 1.7 shows a 10¼ per cent increase in housing costs in 1987-88 over 1986-87. Can we have a breakdown of the interest rate and house prices components of that figure?

Sir T Burns I am afraid that I don't think I can do that. That would be the same as giving an interest rate forecast. May I take the question away and seek the Chancellor's views?

Mr Mitchell Unit labour costs are rising substantially, and the assumption is that they will continue to rise with no fall in pay settlements. Since the Government has no policy for dealing with this, and profits are not going into investment but into wage inflation, doesn't that require further depreciation of the £ to maintain our competitiveness?

Sir T Burns There are signs of some small moderation in pay settlements as a result of low inflation. Settlements are not coming down as we would hope but we think they will be lower in 1987. But the Chancellor has said that he is not prepared to validate higher earnings by further depreciation.

Mr Mitchell So you will resist further depreciation?

Sir T Burns Yes. The Chancellor has said that he will resist the vicious circle of high wage settlements followed by depreciation, fuelling higher rates of inflation.

Mr Mitchell How will you resist pressure for further depreciation? Will you use interest rates or will you run down the Reserves?

Sir T Burns We do not think it is viable to use the Reserves as a long term measure, there would have to be a general tightening of policy to resist the inflationary pressures.

Mr Mitchell You will have seen the Private Eye cover which suggests that what we are seeing is a pre-Election spending spree. The Autumn Statement tries to show the increase in spending is feasible and not irresponsible, but it is least credible on the balance of payments calculation and in particular the export assumption. Is it true to say that the risks are greatest on the balance of payments?

Sir T Burns As I said there is a very large standard error around this forecast but I am not sure that the risks are any greater than they always are in this area.

Mr Higgins But you said earlier that 1986 was particularly difficult for forecasting the balance of payments.

Sir T Burns Yes, but there have been uncertainties in earlier years too.

Mr Mitchell What is the basis for your assumed fall-off in imports?

Sir T Burns We are not assuming a great fall-off. There has been relatively slow growth in imports in the first half of 1986 with a faster increase in the second half. We are assuming that imports of goods and services will grow at 4½ per cent in 1987 which is a little below the 5 per cent increase in 1986.

Mr Howell What progress is being made in reducing public sector manpower, in particular through the Rayner Reviews?

Mr Turnbull The Rayner Reviews, or efficiency scrutinies as they are now called, have produced savings of £300 million a year with the reduction of some 22,000 posts a year.

Mr Howell Are you satisfied that these are genuine savings? Presumably some savings for example in the Department of Employment field have been achieved because people don't have to register for unemployment every week.

Mr Turnbull Civil Service numbers have fallen by 130,000 since 1979. This has been achieved by a combination of efficiency savings, contracting-out, streamlining, cutting out functions.

Mr Howell But what about local government manpower? Is the manpower watch working?

Mr Turnbull Local authority manpower grew by ¾ per cent between 1985 and 1986. This contrasts with the reduction in the Civil Service as a whole. The Government doesn't control local authority manpower directly. It sets a financial regime for local government but decisions on manpower are taken by individual local authorities.

Mr Howell But isn't this a terrible weakness in the system if you can't control local authority manpower?

Mr Turnbull That is because local authorities are separate decision-making entities. Central government sets a framework and tries to exert downward pressure in a number of ways, through the financial regime and through rate-capping. The Audit Commission tries to encourage greater efficiency by ensuring that councils follow best practice. One of the main themes in the Green Paper on the financing of local government has been the objective of increasing local accountability and transparency in the costing of local government services so that electors can exert pressure for efficiency.

Mr Howell Is the Government not fuelling wage pressures by index linking benefits?

Sir T Burns If wages in general did no more than follow the index linking of benefits, we would less worried about pay settlements than we are. Personally I have never been convinced that benefits have a huge impact on pay generally but I agree that the level of benefits can be a factor at some points in the earnings distribution.

Mr Howell The forecast mentions the increase in employment but a major element in this is the increase in part-time jobs. Isn't this a false comparison? Do you think there is any value at all in this table?

Sir T Burns Yes I do otherwise we wouldn't present it. Its made clear that they are part-time jobs: we are not trying to disguise the fact.

Mr Howell	In describing manpower changes in the public sector you convert part-timers into full time equivalents. Would it not be more consistent to do the same in presenting employment figures in the economy as a whole?
Sir T Burns	It is much easier for the employer to convert part-time into full time equivalents but I believe that that we don't have the information to make this conversion for the private sector.
Mr Browne	What evidence do you see pointing to greater moderation in wage settlements next year given the continuing high profits of companies and skill shortages?
Sir T Burns	We think that there are a number of influences which can't be defined precisely. The main influence is the lower inflation rate. Company profitability has some effect but we don't anticipate a large change here. There is an inflexibility due to the the going rate and I agree that the pressures in the labour markets suggest that the supply of the skills is tighter than it was but I don't think this is yet at a level sufficient to offset the downward pressure on wages from lower inflation.
Mr Browne	What has the Government learned from recent experience about the best way of intervening in the foreign exchange markets between direct intervention and interest rate changes?
Sir T Burns	We regard intervention as short term and tactical but to have an impact in the longer term you have to consider the implications for monetary policy as a whole.
Mr Mitchell	What is the underlying trend in unit costs?
Sir T Burns	I think the figure for 1986 overstates the underlying trend and that of 1987 understates it. That is because the forecast rate of growth in manufacturing output (and hence in productivity) for 1987 is 4 per cent which is above the longer term trend.

1251/1

FROM: A ROSS GOOBEY
DATE: 18 NOVEMBER 1986

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cc Mr Cropper
Mr Tyrie

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