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**Financial Statement  
and  
Budget Report  
1993-94**

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**HM TREASURY  
MARCH, 1993**



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# Financial Statement and Budget Report 1993-94

Return to an Order of the House of Commons dated 16 March 1993: for

*Copy of Financial Statement and Budget Report 1993-94  
as laid before the House of Commons by  
the Chancellor of the Exchequer when opening the Budget*

Treasury Chambers  
16 March 1993

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Stephen Dorrell

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# Contents

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Chapter 1	The Budget	5
Chapter 2	The Medium Term Financial Strategy	9
	Annex A: M0's monitoring range	17
	Annex B: Details of the fiscal projections	19
	Annex C: Changes since the 1992 MTFS	21
Chapter 3	The economy: recent developments and prospects	23
	Annex A: The Panel of Independent Forecasters	50
Chapter 4	The Budget measures	55
	Annex A: How revenue effects are calculated	67
	Annex B: Tax changes announced before the Budget	70
Chapter 5	Public expenditure	73
Chapter 6	The public sector finances	79
	Annex: Conventions used in presenting the public finances	92



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# 1 The Budget

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**1.01** The Financial Statement and Budget Report (FSBR) supplements the Chancellor's Budget Statement. It presents the Medium Term Financial Strategy (MTFS); describes developments in the economy over the past year and provides economic forecasts to mid-1994; sets out the Budget proposals; summarises the Government's spending plans; and gives forecasts for the public finances for the year ahead.

**The Medium Term  
Financial Strategy**

**1.02** Chapter 2 describes the framework of the Government's economic policy. The Government has set a target range for underlying inflation of 1 to 4 per cent, and aims to bring it down to the lower part of this range by the end of the present Parliament. Macroeconomic policy is directed to achieving this, while the purpose of microeconomic policy is to improve supply performance. The Government has set a monitoring range of 0 to 4 per cent for the growth of narrow money (M0), which will apply throughout the medium term. The monitoring range for broad money (M4) in the medium term will be 3 to 9 per cent. The Government's fiscal objective is to bring the public sector borrowing requirement (PSBR) back towards balance over the medium term. Tight control over public expenditure and the fiscal measures announced in the Budget will reinforce the natural tendency of the PSBR to fall as the economy recovers.

**The economy**

**1.03** Chapter 3 describes recent developments in the economy and the prospect to mid-1994. GDP changed very little during 1992, but for the year as a whole it was  $\frac{1}{2}$  per cent down on 1991. The Treasury forecast is for GDP growth of  $1\frac{1}{4}$  per cent in 1993, very similar to the average of forecasts by the Panel of Independent Forecasters, rising to 3 per cent ( $2\frac{1}{4}$  per cent non-oil) in the first half of 1994. Underlying inflation has continued to come down sharply, but may rise a little during the course of 1993. The Treasury forecast for both the fourth quarter of 1993 and mid-1994 is  $3\frac{3}{4}$  per cent, within the Government's 1 to 4 per cent target range.

**Budget measures**

**1.04** Chapter 4 sets out the tax and national insurance proposals in the Budget, and the expenditure measures are described in Chapter 5. The direct effect of these measures on the public finances is broadly neutral in 1993–94, but there are net increases in revenue of  $\pounds 6\frac{1}{2}$  billion in 1994–95 and  $\pounds 10\frac{1}{2}$  billion in 1995–96. The main measures are set out opposite Table 1.1, which shows their effect on government revenues.

**Public expenditure**

**1.05** Chapter 5 sets out the Government's spending plans to 1995–96, and an estimate of the outturn for public expenditure in 1992–93.

**Public sector finances**

**1.06** Chapter 6 presents the complete financial picture for the public sector. A PSBR of  $\pounds 35$  billion is forecast for 1992–93,  $\pounds 2$  billion lower than the forecast in the 1992 Autumn Statement. The PSBR for 1993–94 is forecast at  $\pounds 50$  billion, after taking account of the Budget measures. Table 1.2 shows the main components of general government receipts and expenditure.

Table 1.1 The Budget measures<sup>1</sup>

	£ million		yield(+)/cost(-)	
	Changes from a non-indexed base	Changes from an indexed base		
		1993-94	1993-94	1994-95
<b>Income tax</b>				
allowances and basic rate limit frozen	0	660	920	960
married couple's allowance restricted to 20 per cent	—	—	910	1 170
20p band widened	-370	-300	-710	-850
mortgage interest relief reduced to 20 per cent	—	—	820	870
company cars, fuel and vans	200	200	345	390
relocation relief restricted	—	—	200	200
<b>Stamp duty</b>				
land and property threshold doubled	-220	-220	-270	-265
<b>Business taxes</b>				
ACT rate reduced and dividend taxation reformed	-100	-100	100	900
petroleum revenue tax reformed	—	—	300	400
measures against avoidance	70	70	460	450
<b>Business rates</b>	-370	-370	-260	...
<b>Capital gains tax</b>				
new relief for entrepreneurs	*	*	-20	-30
<b>Value added tax</b>				
VAT on domestic fuel and power	—	—	950	2 300
reform of VAT penalties	-50	-50	-75	-75
VAT relief on bad debts	-150	-150	—	—
<b>Excise duties</b>				
alcohol	125	30	50	55
road fuels	485	195	640	1 020
tobacco	385	245	295	310
VED	385	300	310	320
<b>National insurance contributions</b>				
employees	—	—	1 750	2 100
self-employed	—	—	40	110
<b>Other tax changes</b>	-25	-20	-30	-30
<b>Public spending measures<sup>2</sup></b>	...	...	...	...
<b>Total effect of Budget changes<sup>3</sup></b>	<b>365</b>	<b>490</b>	<b>6 725</b>	<b>10 305</b>

<sup>1</sup> The tax and national insurance measures and the revenue effects are set out in more detail in Chapter 4.

<sup>2</sup> See Chapter 5. Net public expenditure costs totalling £240 million between 1993-94 and 1995-96 will be met within the control total, and will not add to planned spending.

<sup>3</sup> The revenue effects of the tax and national insurance measures announced before the Budget are set out in Annex B to Chapter 4.

— = Nil

\* = Negligible

... = Not applicable



### The main measures

#### **Further help for business and the unemployed in the early stages of recovery, building on the measures announced in the Autumn Statement**

The Chancellor has announced a package of measures to provide new opportunities for the long term unemployed. There will be no real increase in business rates for 1993–94. The housing market will be helped by doubling the threshold for stamp duty on property to £60 000. VAT relief will be given earlier on bad debts. Smaller businesses will also be helped by improvements to the Loan Guarantee Scheme and a new capital gains tax relief to encourage entrepreneurs to reinvest in new businesses. The rate of advance corporation tax (ACT) will be reduced to 20 per cent, boosting businesses' cash flow, and the Government will consult on a new scheme to relieve surplus ACT on dividends paid from foreign income. More help will be given to exporters through increased export credit cover and lower premiums.

#### **A programme for raising revenue in the medium term, to reduce the budget deficit and thereby help to ensure that the recovery is sustainable**

**In 1993–94 there is little net change in taxes.** The 20p income tax band is widened by £500, and there is help for business and the housing market; this is paid for by leaving income tax allowances unchanged, raising scale charges for company cars and fuel, and increasing excise duties by 5 per cent for alcohol other than spirits, 6½ per cent for tobacco, and 10 per cent for fuel. The tax credit on dividends will be reduced to 20 per cent. The income tax charge on dividends will be reduced from the basic rate of 25 per cent to the lower rate of 20 per cent.

**In subsequent years the Budget raises additional revenue.** From April 1994 national insurance contributions will rise by 1 per cent for employees and the self-employed; the rate of relief on mortgage interest will be reduced to 20 per cent; the value of the married couple's allowance will be restricted to 20 per cent; VAT will be charged on domestic fuel and power at 8 per cent from April 1994, rising to the full standard rate from April 1995; and road fuel duties will rise by at least 3 per cent a year on average in real terms in future Budgets. There are a number of provisions to block tax avoidance schemes. And the reform of petroleum revenue tax will increase the yield from North Sea taxes. Some of the proceeds of these tax increases will be used to widen the 20p income tax band by a further £500.

#### **Measures to improve the environment by encouraging more efficient use of fuel**

The increases in road fuel duties in this Budget and future Budgets, the extension of VAT to domestic fuel and power, and energy saving measures already announced, will all help to reduce emissions of CO<sub>2</sub> in line with the UN Climate Change Convention.

#### **A programme of tax reform, simplification and deregulation**

Restricting the married couple's allowance, mortgage interest relief and the tax credit on dividends to 20 per cent will broaden the tax base. The option of self-assessment will be given to all who pay tax by assessment from 1996–97; and tax for the self-employed will be greatly simplified. Company cars will be valued for tax purposes as a proportion of list prices from April 1994. Petroleum revenue tax is abolished for new fields, and cut to 50 per cent for existing fields. Taxation of foreign exchange gains and losses will be reformed. The VAT penalty regime is eased and thresholds for VAT registration and cash accounting are raised. Relocation expenses qualifying for tax relief will be limited to £8 000.

Table 1.2 The finances of the public sector<sup>1,2</sup>

	£ billion				£ billion		
	1992-93		1993-94		1992-93		1993-94
	1992 Budget	Latest estimate	Forecast		1992 Budget <sup>6</sup>	Latest estimate	Forecast
<b>RECEIPTS</b>				<b>EXPENDITURE<sup>6</sup></b>			
Inland Revenue:				<b>Central government expenditure</b>			
Income tax	59.6	56.5	57.5	<b>156.1</b>	<b>158.1</b>	<b>166.4</b>	
Corporation tax <sup>3</sup>	16.8	15.7	14.6	of which:			
Petroleum revenue tax	0.1	0.0	0.6	Social Security	55.3	56.5	
Capital gains tax	1.1	1.0	1.0	Health and OPCS	27.6	28.1	
Inheritance tax	1.3	1.2	1.3	Defence	24.0	23.7	
Stamp duties	1.5	1.3	1.7	Scotland	6.4	6.5	
<b>Total Inland Revenue</b>	<b>80.4</b>	<b>75.7</b>	<b>76.7</b>	Wales	3.0	3.0	
Customs and Excise:				Northern Ireland	6.5	6.6	
Value added tax	40.0	37.4	39.9	Other departments	33.3	33.8	
Hydrocarbon oil duties	11.8	11.3	12.7	<b>Central government support for local authorities</b>	<b>58.4</b>	<b>59.2</b>	
Tobacco duties	6.6	6.1	6.6	<b>Local authority self-financed expenditure</b>	<b>9.5</b>	<b>10.0</b>	
Alcohol duties	5.3	5.1	5.1	<b>Financing requirements of nationalised industries</b>	<b>3.4</b>	<b>3.5</b>	
Betting and gaming duties	1.1	1.0	1.1	<b>Reserve</b>	<b>4.0</b>	<b>—</b>	
Car tax	0.7	0.5	0.0	<b>New control total</b>	<b>231.4</b>	<b>230.9</b>	
Customs duties	1.9	1.8	1.9				
Agricultural levies	0.0	0.2	0.2	<b>Cyclical social security</b>	<b>11.5</b>	<b>13.3</b>	
<b>Total Customs and Excise</b>	<b>67.4</b>	<b>63.4</b>	<b>67.5</b>	<b>Central government debt interest</b>	<b>17.6</b>	<b>17.5</b>	
Vehicle excise duties	3.2	3.2	3.7	<b>Privatisation proceeds</b>	<b>- 8.0</b>	<b>- 8.1</b>	
Oil royalties	0.5	0.5	0.7	<b>Accounting adjustments</b>	<b>6.0</b>	<b>6.2</b>	
Rates <sup>4</sup>	14.1	13.8	13.3				
Other taxes and royalties	4.1	4.2	4.6				
<b>Total taxes and royalty receipts</b>	<b>169.8</b>	<b>160.8</b>	<b>166.5</b>				
Social security receipts	38.7	37.4	39.1				
Community charge and council tax	8.0	8.7	8.2				
Interest and dividends	5.5	5.2	4.8				
Gross trading surpluses and rent	3.7	4.1	4.1				
Other receipts <sup>5</sup>	4.0	7.7	6.4				
<b>General government receipts</b>	<b>229.8</b>	<b>223.9</b>	<b>229.2</b>	<b>General government expenditure</b>	<b>258.5</b>	<b>259.9</b>	
						<b>280.3</b>	

## Expenditure, receipts and borrowing

	£ billion		
	1992-93		1993-94
	1992 Budget	Latest estimate	Forecast
General government expenditure	258.5	259.9	280.3
General government receipts	229.8	223.9	229.2
General government borrowing requirement	28.7	36.0	51.1
Public corporations' market and overseas borrowing	- 0.6	- 1.0	- 1.0
<b>Public sector borrowing requirement</b>	<b>28.1</b>	<b>35.1</b>	<b>50.1</b>

<sup>1</sup> In this and other tables, constituent items may not sum to totals because of rounding.<sup>2</sup> On a cash basis. See Annex to Chapter 6.<sup>3</sup> Includes advance corporation tax (net of repayments); (also includes North Sea corporation tax after ACT set-off, and corporation tax on gains).<sup>4</sup> National non-domestic rates and local authority rates.<sup>5</sup> Includes accruals adjustments to index-linked gilts.<sup>6</sup> On current definitions.

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# 2 The Medium Term Financial Strategy

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**2.01** The Medium Term Financial Strategy sets out the framework for achieving sustainable growth based on permanently low inflation.

**2.02** Last autumn, following the suspension of sterling's membership of the ERM, the Government put in place a new policy framework for its counter-inflation strategy. At the centre of this framework is a quantified target—to keep underlying inflation (as measured by the RPI excluding mortgage interest payments) in the range 1 to 4 per cent, and to bring it down to the lower part of this range by the end of the present Parliament.

**2.03** This target implies a path for the growth of money GDP—total spending in the economy in cash terms—averaging about 6 per cent a year over the next three years, and falling gradually thereafter. It is the role of macroeconomic policy to deliver this. The purpose of microeconomic policy is to improve the efficiency of markets and strengthen the supply performance of the economy, so as to raise the growth rate of output compatible with a given inflation path.

## **Monetary policy**

**2.04** The conduct of monetary policy involves a judgement on inflationary trends in the economy and whether the Government's objective is likely to be achieved. While sterling remains outside the ERM, decisions about interest rates are based on a continuing assessment of monetary conditions, measured principally by the growth of narrow and broad money, and movements in the exchange rate and asset prices. Developments in these and other relevant indicators are now set out in the Monthly Monetary Report, which has been published by the Treasury since last December.

**2.05** For both narrow and broad money the Government has set monitoring ranges which are judged to be consistent with the medium term path for money GDP and hence inflation. There is no similar range for the exchange rate, but this remains an important indicator which directly influences domestic costs and prices and reflects market perceptions of the stance and future direction of policy. Movements in asset prices have in the past been valuable leading indicators of inflation.

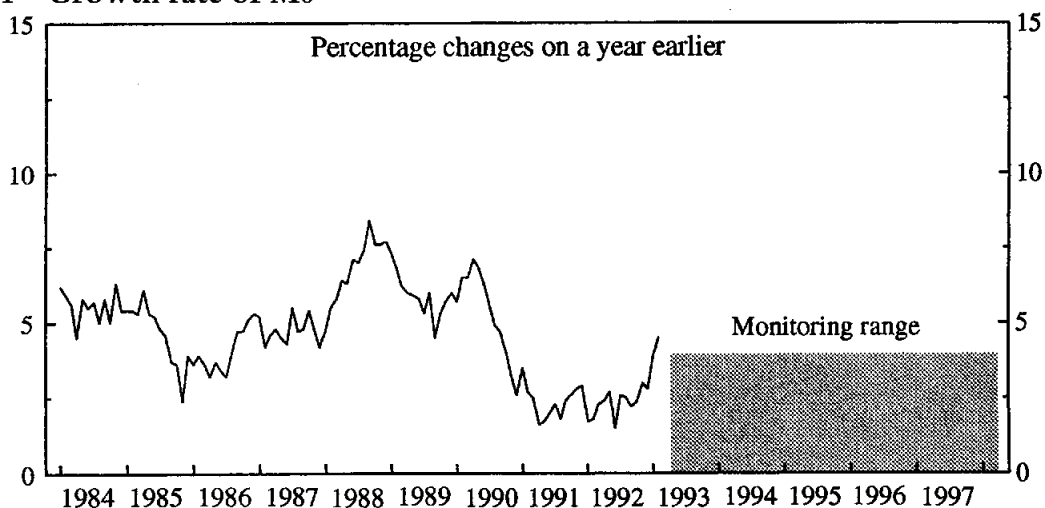
**2.06** If narrow or broad money moves outside its monitoring range, or there is a sharp movement in the exchange rate or asset prices, this is likely to be a cause for concern; but the evidence from any one indicator has to be weighed against the message from the others in judging the outlook for inflation.

**Narrow money** **2.07** Last year's MTFS set a target of 0 to 4 per cent for M0 growth in 1992–93, and this target was reaffirmed in the autumn. M0's twelve month growth rate fell below the centre of the target range in June, but rose in the second half of 1992 and was above the top of the target range in February.

**2.08** Interpretation of M0 has been complicated by recent developments in the relationship between its growth and that of money GDP. Over the last two decades the average growth of M0 was about 4 per cent a year lower than that of money GDP and the velocity of M0 rose accordingly. But in the last few years there have been signs that M0's velocity trend has slowed down. These developments are discussed in Annex A.

**2.09** For the time being the Government considers it prudent to retain a range of 0 to 4 per cent for M0. This will apply for the whole period covered by this year's MTFS. It will be treated as a monitoring range rather than a target, because the Government now has a target for the inflation rate itself. Following the recent sharp fall in interest rates, M0 growth may be above this range in the short term; but with policy set to deliver the Government's inflation objective it should fall back in the medium term.

**Chart 2.1 Growth rate of M0<sup>1</sup>**



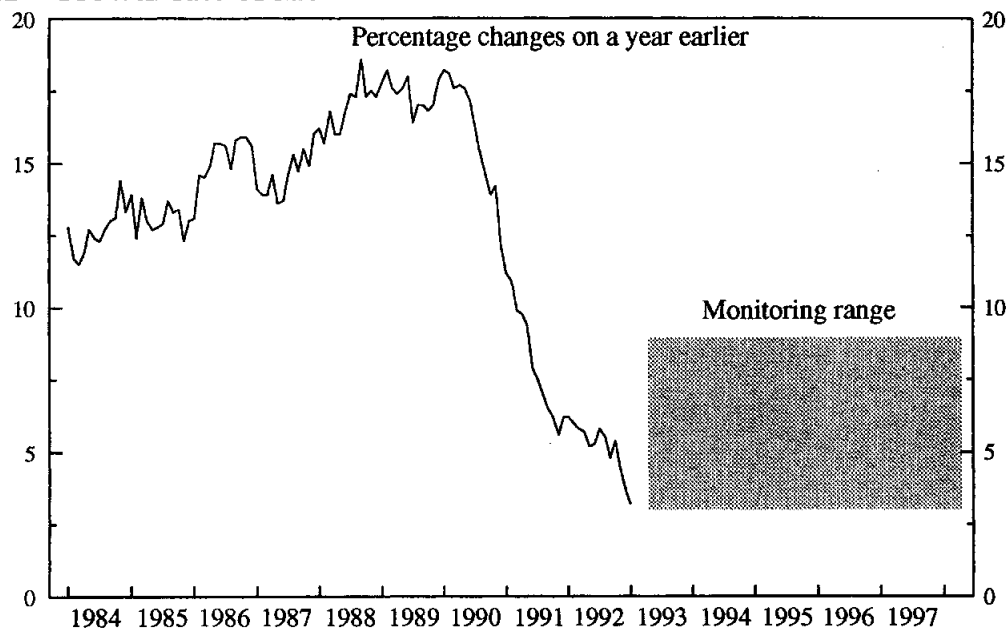
<sup>1</sup> 12 month growth rate, seasonally adjusted.

**Broad money and credit**

**2.10** No ranges were set for broad money between 1986 and 1992; however, M4 was still taken into account in assessing monetary conditions. It was decided last autumn to publish a monitoring range for M4, to show what growth rates would or would not be regarded as a cause for concern. The monitoring range in the second half of 1992–93, announced in the Autumn Statement, is 4 to 8 per cent. M4 growth has fallen since the monitoring range was set, reflecting in particular very low growth in lending to the personal sector in the fourth quarter, and has been below the range since the start of 1993.

**2.11** The Government is setting a monitoring range for M4 of 3 to 9 per cent for the whole period covered by the MTFS. The mid point of the monitoring range is unchanged at 6 per cent; but the width has been increased to 6 percentage points because it now applies to a longer period.

Chart 2.2 Growth rate of M4<sup>1</sup>



<sup>1</sup> 12 month growth rate, not seasonally adjusted.

### The full fund policy

1. The Government's full fund policy helps to ensure that its borrowing is financed in a non-inflationary way and provides markets and investors with an indication of the scale of funding the authorities are likely to undertake year by year. Under the present definition the net total of maturing debt, the PSBR and any underlying increase in the foreign exchange reserves has been met by sales of debt to purchasers other than banks and building societies. Some detailed changes have been made in the past; for example since 1989 Treasury bill sales have not counted as funding, whichever sector buys them.
2. Under the present definition, if banks and building societies seek to increase their own liquidity by buying gilts, the Government has to sell more debt. This is not appropriate when demand for credit is weak and the growth of the private sector's liquidity is subdued. Moreover, this process drains cash from the money markets, increasing the need for the authorities to provide money market assistance and for the banks and building societies to part with the liquid assets that are acquired in those official operations. As a result, the ability of banks and building societies to increase their total liquidity is constrained; and the task of managing the provision of money market assistance is made more complicated.
3. The Government intends to continue the full fund policy but from now on to allow sales of debt to banks and building societies to count as funding, in the same way as sales of debt to other sectors. As before, sales of Treasury bills will not count as funding, and no change is envisaged in the practice whereby current coupon gilts below 3 years' maturity are not issued other than in exceptional circumstances, reflecting the unchanged objectives of the policy.
4. The policy will be operated in a symmetrical way. When banks and building societies are net buyers of government debt, total debt sales will be lower than under the present specification. But when banks and building societies are net sellers, total debt sales will be higher. Over a period of years this will not change the total amount of debt sales, except to the extent that there is a long term trend in bank and building society holdings.
5. This change will take effect from 1993-94. Purchases of gilts by banks and building societies in 1992-93 (estimated at some £5½ billion to the end of February) will be taken into account in implementing funding policy over the next 2 to 3 years.

### Fiscal policy

**2.12** Fiscal policy will be set to maintain sound public finances, which are essential for a sustainable economic recovery. The Government's objective is to bring the PSBR back towards balance over the medium term.

**2.13** A large part of the present PSBR is attributable to the effects of the economic cycle. But it is impossible to determine with any precision how much of it will be reversed as the economy recovers. Whatever the underlying position, the actual level of the PSBR is important in itself because it adds to the amount of public sector debt outstanding and thereby raises debt servicing costs. A run of large budget deficits, even if largely cyclical in origin, would lead to a weakening in the underlying fiscal position.

**2.14** Tight public expenditure ceilings were announced in the Autumn Statement. The discretionary increases in tax revenues announced in the Budget will build up over time, and together with the public expenditure plans will thus ensure a steady improvement in the underlying fiscal position. The direct effects of the Budget measures on revenues are summarised in Table 2.1.

**Table 2.1 Direct effects of Budget measures**

Per cent of GDP				
1993-94	1994-95	1995-96	1996-97	1997-98
0.1	1.0	1.4	1.6	1.7

**2.15** The speed with which the PSBR declines will depend on the rate of growth of the economy over the medium term.

### The economy in the medium term

**2.16** At the trough of a recession it is very difficult to assess future growth prospects. The illustrative projections shown in Table 2.2 assume that the recovery continues to gather pace in 1994, and that output then grows somewhat faster than its trend rate for a number of years. These growth assumptions are very similar to the average of the projections made by the Panel of Independent Forecasters (nearly 3 per cent a year); and slightly lower than in last year's MTFS.

**Table 2.2 Money GDP growth, output growth and inflation<sup>1</sup>**

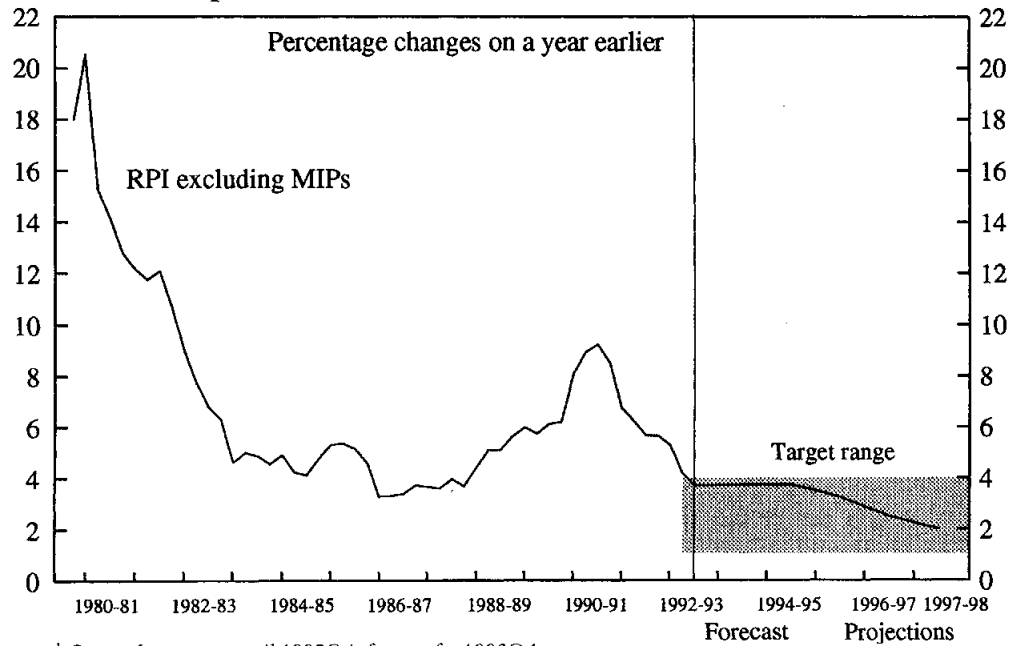
	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
<b>Money GDP</b>	$3\frac{3}{4}$	$4\frac{3}{4}$	<b>7</b>	$6\frac{1}{2}$	$5\frac{1}{2}$	$4\frac{3}{4}$
Real GDP:						
Non-North Sea	$-\frac{1}{4}$	$1\frac{1}{2}$	$2\frac{1}{4}$	$2\frac{3}{4}$	3	3
Total	—	2	$2\frac{1}{2}$	$2\frac{3}{4}$	$2\frac{3}{4}$	$2\frac{3}{4}$
Inflation:						
RPI excluding MIPs <sup>2</sup>	$3\frac{3}{4}$	$3\frac{3}{4}$	$3\frac{3}{4}$	$3\frac{1}{4}$	$2\frac{1}{2}$	2
GDP deflator	$3\frac{1}{2}$	$2\frac{3}{4}$	$4\frac{1}{4}$	$3\frac{3}{4}$	$2\frac{1}{2}$	2

<sup>1</sup> Percentage changes on previous financial year; forecasts for 1993-94 and assumptions thereafter.

<sup>2</sup> Percentage change in year to 1992Q4 and 1993Q4; percentage change on previous financial year thereafter.

2.17 With a degree of spare capacity likely to remain for some years yet, inflation is assumed to fall further in the medium term. But there may be little progress over the next two years if the current level of the exchange rate continues.

Chart 2.3 Consumer price inflation<sup>1</sup>



<sup>1</sup> Quarterly outturns until 1992Q4; forecast for 1993Q4; MTFS projections (financial year averages) thereafter.

2.18 These assumptions for output and inflation imply a path of money GDP growth which averages about 6 per cent a year over the next three years, before declining in subsequent years. Because of timing effects associated with the fall in the exchange rate, both the GDP deflator and money GDP will understate underlying movements in 1993–94, and overstate them in 1994–95.

**Fiscal projections**

2.19 The assumptions in Table 2.2 underlie the projections for the public finances shown in Table 2.3. Details of the revenue and expenditure projections are set out in Annex B. After rising in 1993–94, the PSBR falls significantly as a proportion of GDP, so that by 1997–98 it is down to 3 $\frac{3}{4}$  per cent.

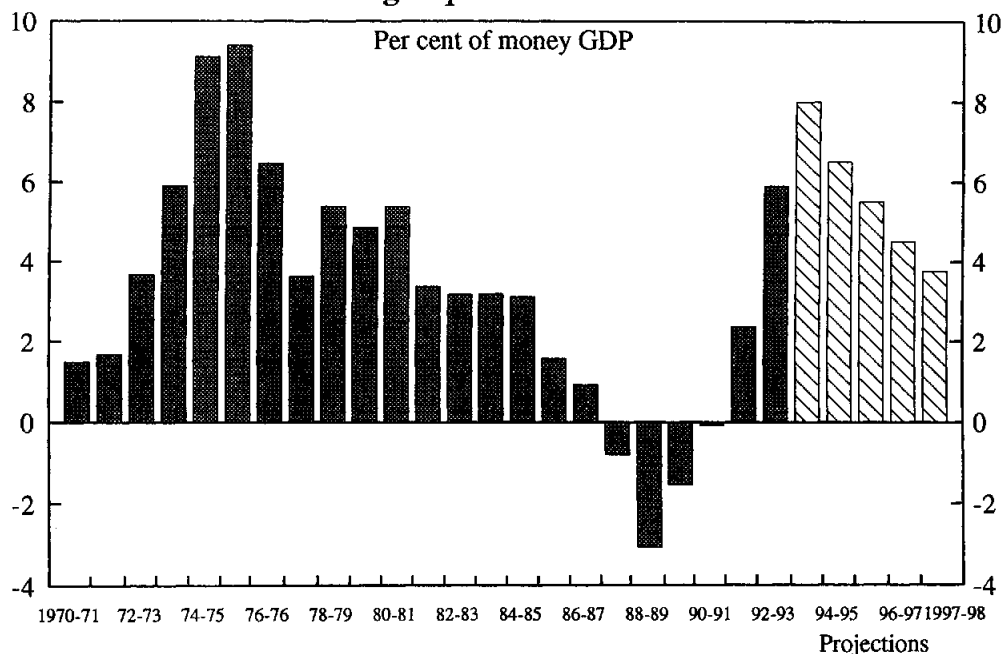
**Table 2.3 Fiscal projections<sup>1</sup>**

	Per cent of GDP					
	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
General government expenditure excluding privatisation proceeds	44 $\frac{3}{4}$	45 $\frac{1}{2}$	45	44	43 $\frac{3}{4}$	43 $\frac{1}{4}$
Privatisation proceeds	1 $\frac{1}{4}$	1	$\frac{3}{4}$	$\frac{1}{4}$	$\frac{1}{4}$	$\frac{1}{4}$
General government expenditure	43 $\frac{1}{2}$	44 $\frac{3}{4}$	44	44	43 $\frac{1}{2}$	43 $\frac{1}{4}$
General government receipts	37 $\frac{1}{2}$	36 $\frac{1}{2}$	37 $\frac{1}{4}$	38 $\frac{1}{4}$	38 $\frac{3}{4}$	39 $\frac{1}{4}$
Public corporations' market and overseas borrowing	- $\frac{1}{4}$	- $\frac{1}{4}$	- $\frac{1}{4}$	- $\frac{1}{4}$	- $\frac{1}{4}$	- $\frac{1}{4}$
<b>PSBR</b>	<b>5<math>\frac{3}{4}</math></b>	<b>8</b>	<b>6<math>\frac{1}{2}</math></b>	<b>5<math>\frac{1}{2}</math></b>	<b>4<math>\frac{1}{2}</math></b>	<b>3<math>\frac{3}{4}</math></b>
Money GDP at market prices (£ billion) <sup>2</sup>	599	628	671	716	756	792

<sup>1</sup> Rounded to nearest  $\frac{1}{4}$  per cent of GDP.

<sup>2</sup> Rounded to nearest £1 billion.

**Chart 2.4 Public sector borrowing requirement<sup>1</sup>**



<sup>1</sup> Negative values indicate a public sector debt repayment.

**Revenue 2.20** The revenue projections are based on the conventional assumption of constant tax and national insurance rates from 1993-94, except where future changes have already been announced. All proposed Budget changes are taken into account. Allowances, thresholds and specific duties are assumed to be indexed in subsequent Budgets from the levels proposed in the March 1993 Budget; the precise assumptions made are set out in more detail in Chapter 4.

**2.21** The ratio of general government receipts to GDP falls in 1993-94; the delayed effects of broadly unchanged levels of economic activity in 1992-93, outweigh the effects of the Budget measures. Thereafter the ratio rises as the economy recovers and the wedge of tax increases announced in the Budget



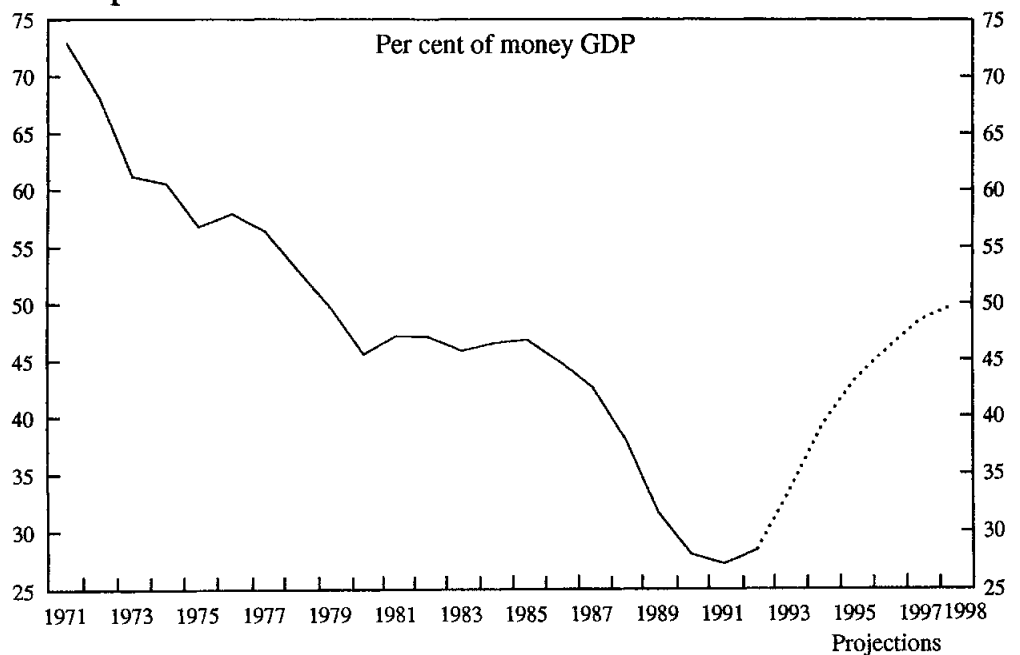
builds up. Projections for the non-North Sea tax burden and the components of general government receipts consistent with Table 2.3 are given in Tables 2B.2 and 2B.4 respectively in Annex B.

**Public expenditure** 2.22 The Government's public expenditure plans are set out in detail in Chapter 5. The objective continues to be that public spending should take a declining share of national income over time, while value for money is constantly improved. The ratio of general government expenditure (GGE) excluding privatisation proceeds to GDP was on a downward trend for much of the 1980s, though in recent years the impact of the recession has caused the ratio to rise. It should resume its downward trend as the economy recovers, and as the PSBR and thus the growth of debt interest begin to fall.

2.23 The projections of general government expenditure in Table 2.3 (and Table 2B.3 in Annex B) incorporate the control totals published in the 1992 Autumn Statement (Cm 2096) for the period to 1995–96. Detailed plans for the new control total will be settled in future Surveys. The projections for cyclical social security take account of higher levels of unemployment since the Autumn Statement. Those for gross debt interest payments reflect the PSBR projections in Table 2.3.

**Public sector debt** 2.24 The effect of the recession on the PSBR has led to a rise in the net public sector debt ratio, and this ratio will continue to rise in the next few years. As the PSBR comes down, the rate of increase will slow. How quickly it does so, and the level at which the ratio peaks, will depend on the medium-term economic growth rate.

Chart 2.5 Net public sector debt ratio<sup>1</sup>



<sup>1</sup> Net public sector debt at end-March as a percent of money GDP in four quarters centred on end-March.

**Alternative projections** 2.25 There is inevitably some uncertainty about medium term prospects. The economy is operating well below capacity at the moment, and output is likely to return towards trend over the medium term. But trend output—the level consistent with stable inflation—is not directly observable, and has to be inferred from other economic data. How quickly output will return to trend is also uncertain.

2.26 Economic growth is most unlikely to follow the precise path set out in the main projection. On the one hand, growth could be stronger, given the present degree of spare capacity: for example, if businesses control their costs tightly and respond strongly to the recent gain in cost competitiveness, UK trade performance could be further improved. But equally, the pick-up in growth could be more sluggish: high levels of private sector indebtedness could continue to hold back the recovery in domestic demand, in both the UK and other countries, and the growth in world trade could be weaker than currently expected.

2.27 Table 2.4 shows two variants which are used to illustrate the sensitivity of the fiscal prospect to the rate of growth. The growth rates differ from the main case by  $\frac{1}{2}$  per cent in either direction from 1994–95.

**Table 2.4 Variant growth assumptions**

	1994–95	1995–96	1996–97	1997–98
Non-oil GDP: high	$2\frac{3}{4}$	$3\frac{1}{4}$	$3\frac{1}{2}$	$3\frac{1}{2}$
low	$1\frac{3}{4}$	$2\frac{1}{4}$	$2\frac{1}{2}$	$2\frac{1}{2}$
<i>Memorandum item:</i>				
Average of the projections of Panel of Independent Forecasters <sup>1</sup>	3.0	3.0	2.8	n.a.

<sup>1</sup> Whole economy, calendar year.

2.28 In the absence of discretionary action, the path of the PSBR is significantly affected by the growth rate. Table 2.5 illustrates this using the assumptions in Table 2.4. In the stronger growth case the PSBR falls to  $2\frac{1}{4}$  per cent of GDP by 1997–98. And even if economic developments are less favourable, the wedge of tax increases announced in the Budget should ensure a substantial reduction in the PSBR over the medium term. Whatever the outturn for growth, the Government will take whatever action is necessary to ensure a sound and sustainable fiscal position.

**Table 2.5 Variant PSBR projections**

	Per cent of GDP			
	1994–95	1995–96	1996–97	1997–98
High growth	$6\frac{1}{4}$	$4\frac{3}{4}$	$3\frac{1}{2}$	$2\frac{1}{4}$
Low growth	$6\frac{3}{4}$	6	$5\frac{3}{4}$	$5\frac{1}{4}$

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# Annex A to Chapter 2:

## M0's monitoring range

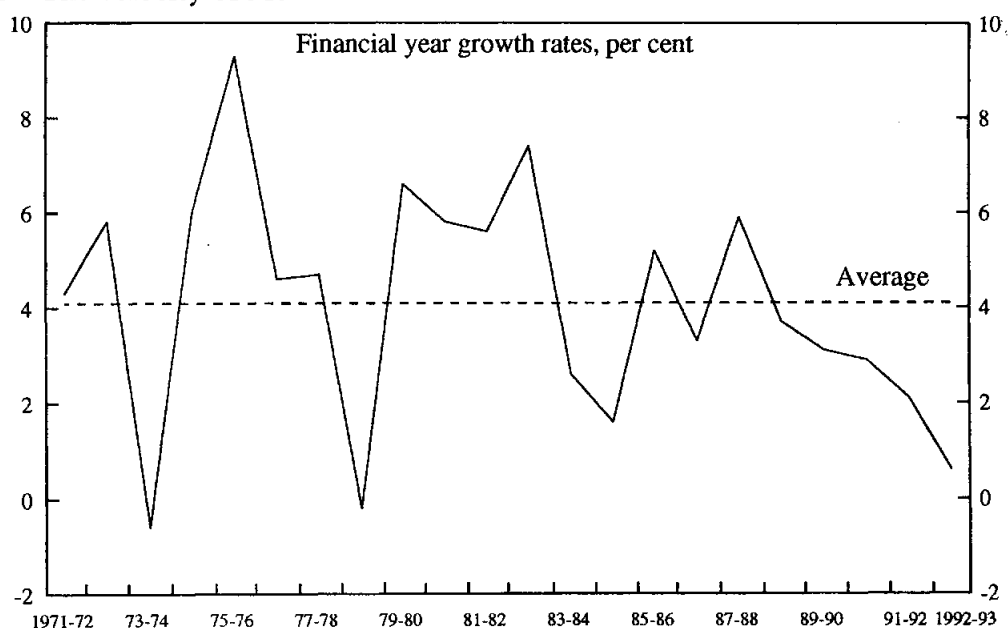
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**2A.1** The Government has set a target range for M0 in every year since 1984. M0 has proved a reliable indicator, although its use is primarily to signal current trends in the economy, rather than to warn of future changes. The target range set for M0 has come down from 4 to 8 per cent in 1984–85 to 0 to 4 per cent in 1991–92 and 1992–93. M0 growth has been within the ranges set for most of this period, the main exception being the period from early 1988 to mid 1990, when the overheating of the economy and rise in inflation was reflected in M0 growth well above its target range.

**Velocity of M0** **2A.2** Over the whole period since the war, M0 has grown much less quickly than money GDP; in other words, its velocity of circulation has increased. In the 1950s and 1960s M0 grew about 2 per cent a year on average less than money GDP, and since then the gap has averaged about 4 per cent a year. The target ranges for M0 set in previous years have generally assumed a continuation of the velocity trend at around 4 per cent.

**2A.3** This rise in M0's velocity reflects both the growing use of means of payment other than cash and probably also a reduction in average cash holdings relative to the amount of cash transactions. Interest rates probably affect both the use of cash as a means of payment and the average amount of cash people hold for a given level of cash transactions. High interest rates have in the past given banks an incentive to introduce innovations which encourage people to keep money in their current accounts rather than in cash; and correspondingly give banks' and building societies' depositors an incentive to hold money in interest bearing accounts rather than cash. Changes in the composition of spending and the structure of employment may also have had an effect on M0's velocity.

**Chart 2A.1** The velocity of M0<sup>1</sup>



<sup>1</sup> Based on money GDP figures adjusted for distortion arising from the abolition of domestic rates.

**Recent developments**

**2A.4** As Chart 2A.1 shows, during the last two decades, changes in velocity have fluctuated quite widely from year to year. But since the 1980s there have been two developments: the fluctuations have become smaller and so has the average annual increase in velocity. In 1992–93, M0's velocity is estimated to have risen only marginally. It is difficult at this stage to decide whether we are witnessing a temporary effect or a more long-lasting change in the trend.

**2A.5** The recent fall in interest rates may have had two effects. It may have encouraged individuals to increase their holdings of cash relative to their transactions and it may have reduced the incentive for financial institutions to find further innovations which discourage the use of cash. The first effect would cause a temporary slowdown in the growth of velocity; the second would tend to cause a permanent slowdown.

**2A.6** If the latter effect is significant, the experience of permanently lower inflation and interest rates will lead to a lower trend increase in M0 velocity in the 1990s than in the previous two decades; this would mean a higher rate of growth of M0 would be consistent with low inflation. If M0's velocity trend were to fall back to the 2 per cent or so average annual increase recorded in the 1950s and 1960s, M0 growth could remain at, or above, the top of a 0 to 4 per cent range as long as inflation remains in the upper half of its 1 to 4 per cent target range; especially when real GDP is growing faster than trend and the once-for-all effects of recent cuts in interest rates continue to come through.

**2A.7** The Government has decided to retain a 0 to 4 range for M0 for the present. But the possibility that there has been a change in the velocity trend will have to be borne in mind in assessing M0's performance in relation to this range over the year ahead. The M0 range will be treated as a monitoring range rather than a target, because the Government now has a target for the inflation rate itself.

# Annex B to Chapter 2:

## Details of the fiscal projections

**Table 2B.1 General government expenditure (excluding privatisation proceeds) as a percent of money GDP<sup>1,2</sup>**

1963–64	36 $\frac{3}{4}$	1975–76	49 $\frac{1}{4}$	1987–88	41 $\frac{3}{4}$
1964–65	36 $\frac{1}{2}$	1976–77	46 $\frac{3}{4}$	1988–89	39 $\frac{1}{4}$
1965–66	37 $\frac{3}{4}$	1977–78	43 $\frac{1}{4}$	1989–90	39 $\frac{3}{4}$
1966–67	39 $\frac{1}{2}$	1978–79	44	1990–91	40 $\frac{1}{4}$
1967–68	43 $\frac{1}{4}$	1979–80	44	1991–92	42
1968–69	41 $\frac{1}{2}$	1980–81	46 $\frac{1}{2}$	1992–93	44 $\frac{3}{4}$
1969–70	41	1981–82	47 $\frac{1}{4}$		
1970–71	41 $\frac{1}{4}$	1982–83	47 $\frac{1}{2}$	1993–94	45 $\frac{1}{2}$
1971–72	41 $\frac{3}{4}$	1983–84	46 $\frac{1}{2}$	1994–95	45
1972–73	41 $\frac{1}{2}$	1984–85	47	1995–96	44
1973–74	43 $\frac{1}{2}$	1985–86	45	1996–97	43 $\frac{3}{4}$
1974–75	48 $\frac{3}{4}$	1986–87	44	1997–98	43 $\frac{1}{4}$

<sup>1</sup> 1992–93: latest estimate; 1993–94: forecast; 1994–95 onwards: MTFS projections.

<sup>2</sup> Based on money GDP figures adjusted for the years before 1990–91 to remove the distortion caused by the abolition of domestic rates.

**Table 2B.2 Non-North Sea taxes and social security contributions as a percent of non-North Sea money GDP<sup>1,2,3</sup>**

1963–64	29 $\frac{1}{2}$	1975–76	36 $\frac{3}{4}$	1987–88	38
1964–65	30	1976–77	36 $\frac{1}{2}$	1988–89	37 $\frac{1}{4}$
1965–66	31 $\frac{3}{4}$	1977–78	35 $\frac{1}{2}$	1989–90	37 $\frac{1}{4}$
1966–67	32 $\frac{1}{2}$	1978–79	34 $\frac{3}{4}$	1990–91	36 $\frac{3}{4}$
1967–68	34	1979–80	35 $\frac{1}{2}$	1991–92	36 $\frac{1}{2}$
1968–69	35 $\frac{3}{4}$	1980–81	36 $\frac{3}{4}$	1992–93	34 $\frac{3}{4}$
1969–70	37 $\frac{1}{2}$	1981–82	39 $\frac{1}{4}$		
1970–71	37	1982–83	38 $\frac{3}{4}$	1993–94	34 $\frac{1}{2}$
1971–72	35 $\frac{1}{4}$	1983–84	38 $\frac{1}{4}$	1994–95	35 $\frac{1}{4}$
1972–73	33	1984–85	38 $\frac{1}{4}$	1995–96	36 $\frac{1}{4}$
1973–74	33 $\frac{3}{4}$	1985–86	37 $\frac{1}{2}$	1996–97	36 $\frac{3}{4}$
1974–75	36 $\frac{1}{4}$	1986–87	37 $\frac{3}{4}$	1997–98	37

<sup>1</sup> 1992–93: latest estimate; 1993–94: forecast; 1994–95 onwards: MTFS projections.

<sup>2</sup> Based on non-North Sea money GDP figures adjusted for the years before 1990–91 to remove the distortion caused by the abolition of domestic rates.

<sup>3</sup> Including the community charge and from 1993–94 the council tax.

**Table 2B.3 General government expenditure<sup>1</sup>**

	£ billion						
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
New control total	211.4	231	244	254	263	274	284
Cyclical social security	10.9	13½	15	16	17	18	18½
Central government debt interest	16.3	17½	19½	23½	26	28	29½
Accounting adjustments	5.5	6	7½	8½	9½	10	10½
<b>Total general government expenditure<sup>2,3</sup> excluding privatisation proceeds</b>	<b>244.1</b>	<b>268</b>	<b>286</b>	<b>302</b>	<b>315</b>	<b>330</b>	<b>343</b>
Privatisation proceeds	7.9	8	5½	5½	1	1	1
<b>Total general government expenditure</b>	<b>236.1</b>	<b>260</b>	<b>280</b>	<b>296</b>	<b>314</b>	<b>329</b>	<b>342</b>

<sup>1</sup> For 1991-92 to 1995-96 the figures are taken from Chapter 5.

<sup>2</sup> From 1992-93 onwards general government expenditure (including and excluding privatisation proceeds) and the new control total are rounded to the nearest £1 billion; cyclical social security, debt interest, accounting adjustments and privatisation proceeds are rounded to the nearest £½ billion. The new control total is assumed to grow by 1½ per cent a year in real terms in 1996-97 and 1997-98.

<sup>3</sup> General government expenditure includes debt interest payments to other sectors as follows (£ billion):

1991-92	17.0	1995-96	26
1992-93	18	1996-97	28
1993-94	20	1997-98	30
1994-95	23½		

**Table 2B.4 General government receipts<sup>1</sup>**

	£ billion						
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
Taxes on income, expenditure and capital <sup>2</sup>	172.3	169	176	192	212	227	241
Social security contributions	37.0	37	39	44	47	50	53
Interest and dividends	6.0	5	5	5	6	6	6
Other receipts	6.9	13	9	10	10	10	11
<b>General government receipts<sup>3,4</sup></b>	<b>222.2</b>	<b>224</b>	<b>229</b>	<b>251</b>	<b>275</b>	<b>293</b>	<b>311</b>

<sup>1</sup> Taxes and social security contributions are measured on an accruals basis. Accruals adjustments are included in other receipts. Thus total government receipts are measured on a cash basis.

<sup>2</sup> Includes the community charge/council tax.

<sup>3</sup> General government receipts, and its components, are rounded to the nearest £1 billion from 1992-93 onwards.

<sup>4</sup> Including North Sea revenues as follows (£ billion):

1991-92	1.0	1995-96	3
1992-93	1	1996-97	4
1993-94	2	1997-98	4
1994-95	3		

**Table 2B.5 Public sector borrowing requirement<sup>1</sup>**

	£ billion						
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
General government expenditure	236.1	260	280	296	314	329	342
General government receipts	222.2	224	229	251	275	293	311
General government borrowing requirement	14.0	36	51	45	40	36	31
Public corporations' market and overseas borrowing	-0.2	-1	-1	-1	-1	-1	-1
<b>PSBR</b>	<b>13.8</b>	<b>35</b>	<b>50</b>	<b>44</b>	<b>39</b>	<b>35</b>	<b>30</b>
Money GDP	580.4	599	628	671	716	756	792
<b>PSBR as per cent of money GDP</b>	<b>2.4</b>	<b>5¾</b>	<b>8</b>	<b>6½</b>	<b>5½</b>	<b>4½</b>	<b>3¾</b>

<sup>1</sup> Rounded to the nearest £1 billion from 1992-93 onwards. Further details for 1993-94 are provided in Tables 1.2 and 6.9.

# Annex C to Chapter 2:

## Changes since the 1992 MTFS

**2C.1** Sterling's membership of the ERM was suspended in September, necessitating some changes to the framework of the Government's counter-inflation policies. The Government announced a new quantified target for inflation—to keep underlying inflation (as measured by the RPI excluding mortgage interest payments) in the range 1 to 4 per cent, and to reduce it to the lower part of this range by the end of the present Parliament.

**Inflation** **2C.2** Underlying inflation came down within the target range in September 1992, and has since fallen further.

**Narrow money** **2C.3** The growth rate of M0 was above the top of its target range in February 1993.

**Broad money and credit** **2C.4** A monitoring range of 4 to 8 per cent for the growth of M4 over the previous 12 months was announced in the 1992 Autumn Statement. M4 growth has been below the range since the start of 1993.

**Money GDP, output and inflation** **2C.5** The growth of money GDP, prices and output are all expected to be substantially lower in 1992–93 than was envisaged in last year's MTFS. Disinflationary pressures remain strong, but the depreciation in sterling and the Budget measures mean that the fall in inflation over the medium term is more gradual. Output growth is assumed in the main case to be a bit below that in the 1992 MTFS, so that the level of output is significantly lower throughout the period to 1996–97.

**Table 2C.1 Money GDP growth, output growth and inflation**

	Percentage differences from 1992 MTFS projections				
	1992–93	1993–94	1994–95	1995–96	1996–97
Money GDP growth	$-3\frac{1}{4}$	-2	---	$+\frac{1}{2}$	$+\frac{1}{4}$
Real GDP growth:					
Non-North Sea	-2	$-1\frac{1}{2}$	$-1\frac{1}{4}$	$-\frac{3}{4}$	$-\frac{1}{2}$
Total	-2	$-1\frac{1}{4}$	$-1\frac{1}{4}$	$-\frac{3}{4}$	$-\frac{1}{4}$
Inflation:					
GDP deflator	-1	$-\frac{1}{2}$	$+1\frac{1}{4}$	$+1\frac{1}{4}$	$+\frac{1}{2}$

**Fiscal projections** **2C.6** Table 2C.2 shows changes in the fiscal projections since the 1992 FSBP. Additional information on 1992–93 is given in Table 1.2 in Chapter 1 and in Chapter 6.

**Expenditure** 2C.7 The outturn in 1992–93 is discussed in Chapter 5.

**Receipts** 2C.8 Revenues in 1992–93 are expected to be lower than forecast in the 1992 FSBR, almost entirely as a result of lower than forecast economic activity: details are given in Chapter 6. Projections for future years are likewise affected by the lower levels of output shown in Table 2C.1. Estimates of the effects of the Budget measures are shown in Table 2.1.

**Table 2C.2 Revenue and expenditure<sup>1</sup>**

	Changes from 1992 MTFS projections, £ billion				
	1992–93	1993–94	1994–95	1995–96	1996–97
<b>1 General government expenditure</b>	<b>+1½</b>	<b>+1</b>	<b>+1</b>	<b>+5½</b>	<b>+12</b>
<i>Receipts<sup>2</sup></i>					
2 Taxes and contributions <sup>3</sup>	-14	-22½	-24	-21½	-26
3 Other <sup>4</sup>	+8½	+4	+5	+6½	+9
<b>4 General government receipts</b>	<b>-6</b>	<b>-18</b>	<b>-19</b>	<b>-15</b>	<b>-17</b>
5 Public corporations' market and overseas borrowing	-½	-½	-½	-½	-½
<b>6 PSBR</b>	<b>+7</b>	<b>+18½</b>	<b>+19½</b>	<b>+19½</b>	<b>+28½</b>

<sup>1</sup> Rounded to the nearest £½ billion. There have been no significant classification changes affecting the items in this table since the last FSBR.

<sup>2</sup> Using the same measurement conventions as Table 2B.4: see footnote 1 to that table.

<sup>3</sup> Includes social security contributions and the community charge/council tax.

<sup>4</sup> Includes debt interest and other items (including cumulative fiscal adjustment from last year's MTFS).



# 3 The economy: recent developments and prospects

## Summary

**World economy** **3.01** Since last summer, activity has fallen sharply in continental Europe and Japan, but there has been a stronger than expected recovery in the USA. GDP in the major seven (G7) economies is estimated to have increased by  $1\frac{1}{2}$  per cent in 1992. Activity in Europe and Japan is likely to remain weak, and G7 GDP growth may be no more than  $1\frac{1}{2}$  per cent again in 1993. With plenty of spare capacity, G7 inflation is forecast to remain below 3 per cent.

**UK activity** **3.02** GDP was somewhat stronger in the second half of 1992 than anticipated in the Autumn Statement, rising by  $\frac{1}{4}$  per cent on the first half. While non-oil GDP fell by  $\frac{1}{2}$  per cent in 1992 as a whole, it was broadly flat over the year to the fourth quarter. There remain considerable uncertainties and a wide range of views about the prospects for 1993. The forecasts from the Panel of Independent Forecasters range from growth of  $\frac{1}{4}$  to 2 per cent with an average of a little above 1 per cent. The Treasury forecast is very similar, at  $1\frac{1}{4}$  per cent,  $\frac{1}{4}$  percentage point more than in the Autumn Statement reflecting the higher than expected level of GDP in the second half of 1992. Growth is projected to pick up through the year, reaching 3 per cent in the year to the first half of 1994 ( $2\frac{1}{4}$  per cent non-oil).

**Table 3.1 Economic prospects: summary**

	Percentage changes on a year earlier unless otherwise stated				
	1992	Forecasts			1994 H1 Treasury
		Treasury	1993		
			Independent Panel <sup>1</sup>		
	Average	Range			
Gross domestic product	$-\frac{1}{2}$	$1\frac{1}{4}$	1	$\frac{1}{4}$ to 2	3
Domestic demand	$\frac{1}{2}$	$1\frac{1}{4}$	$\frac{3}{4}$	-1 to $1\frac{3}{4}$	3
Net trade <sup>2</sup>	$-1\frac{1}{4}$	0	$\frac{1}{2}$	0 to $1\frac{1}{4}$	0
RPI excluding mortgage interest payments (fourth quarter)	$3\frac{3}{4}$	$3\frac{3}{4}$	4	3 to $4\frac{3}{4}$	$3\frac{3}{4}$ <sup>3</sup>
Current account (£ billion)	-12	$-17\frac{1}{2}$	$-15\frac{1}{2}$	-20 to $-7\frac{1}{2}$	$-18\frac{1}{2}$ <sup>4</sup>
PSBR (financial year, £ billion)	35	50	47	40 to 55	

<sup>1</sup> Panel of Independent Forecasters; see Annex for further details.

<sup>2</sup> Contribution to GDP growth, percentage points.

<sup>3</sup> Q2.

<sup>4</sup> At an annual rate.

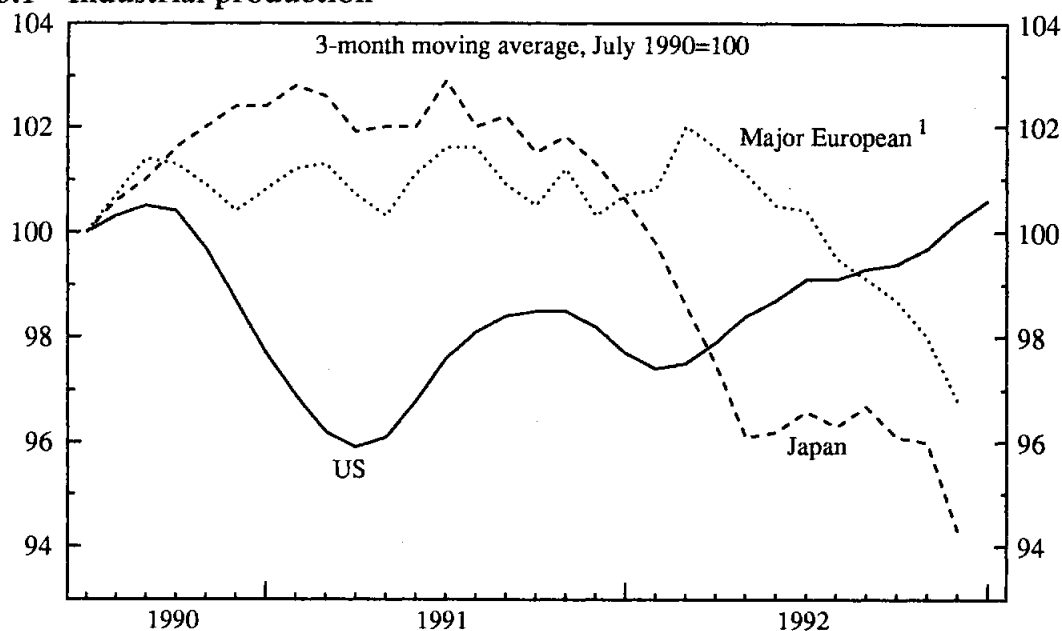
**Demand** **3.03** In the Treasury forecast the recovery is expected to come both from an increase in domestic demand, principally consumer spending, and exports. Trade performance improves significantly on 1992, although net trade makes virtually no contribution to GDP growth because imports rise as domestic demand increases.

- Inflation** 3.04 Further progress has been made on inflation, with underlying RPI inflation down to  $3\frac{1}{4}$  per cent in January. There remain powerful underlying disinflationary pressures and, apart from petrol prices, there is as yet little evidence of any effect on retail prices from the lower exchange rate. The forecasts of underlying RPI inflation in the fourth quarter of 1993 from the Independent Panel range from 3 to  $4\frac{3}{4}$  per cent, with an average of around 4 per cent. The Treasury forecast, after taking account of the Budget measures, is  $3\frac{3}{4}$  per cent for both the fourth quarter of 1993 and the second quarter of 1994.
- Labour market** 3.05 Underlying earnings growth fell to  $4\frac{3}{4}$  per cent in December and should fall further in 1993 as the effect of recent low settlements feeds through. Employment fell sharply and unemployment continued to rise in the second half of 1992. These trends are forecast to moderate in 1993, but with unemployment a lagging indicator it may be some time before it begins to fall back.
- Current account** 3.06 The current account deficit rose to £12 billion in 1992 from £ $6\frac{1}{2}$  billion in the previous year, with the visibles deficit rising and the invisibles surplus falling. The visibles deficit is forecast to increase further in 1993 largely due to a deterioration in the terms of trade but also due to sluggish growth in some of the UK's main trading partners. While there may be some improvement in the invisibles position, the current account deficit is projected to widen to £ $17\frac{1}{2}$  billion. This is broadly in line with the majority view of the Independent Panel, though somewhat above the average.
- Financial developments** 3.07 The sterling index has averaged  $78\frac{1}{2}$  so far this year, 15 per cent lower than in the three months before ERM suspension. Base rates at the beginning of March were 4 per cent lower than at the beginning of September. This easing of monetary policy underpins the forecast of recovery. M0 growth has been within its target range for most of 1992–93, though above it in February. M4 growth has recently been below its monitoring range.
- Public finances** 3.08 The estimated outturn for the public sector borrowing requirement (PSBR) in 1992–93 is £35 billion, well up on last year's Budget forecast but lower than in the Autumn Statement. The PSBR is forecast to be £50 billion in 1993–94.
- Assumptions** 3.09 The forecast is based on the conventional assumption that sterling remains close to recent levels, and assumes that oil prices average \$18 a barrel.

#### World economy

- Recent developments** 3.10 After stabilising in the summer, industrial production in the G7 was again falling by the end of last year, as continued weakness in Japan and continental Europe more than offset a strengthening of activity in North America. In the latest three months industrial production in the US was up 3 per cent on a year earlier compared to a fall of over 3 per cent in the major continental European economies and 7 per cent in Japan. Business confidence in the US has risen, but in Europe it is falling sharply and in Japan it is at its lowest level since 1976.

Chart 3.1 Industrial production



<sup>1</sup> Western Germany, France, Italy.

**3.11** Recent movements in industrial production have been mirrored in GDP. By the second half of the year, GDP was falling in Japan, France and Italy, while in Germany<sup>1</sup> it has fallen by a cumulative 1½ per cent from its peak in the first quarter. By contrast, in the fourth quarter of 1992, US GDP grew at its fastest rate for five years. For the G7 as a whole, GDP is estimated to have risen by 1½ per cent in 1992, following growth of only ¾ per cent in 1991.

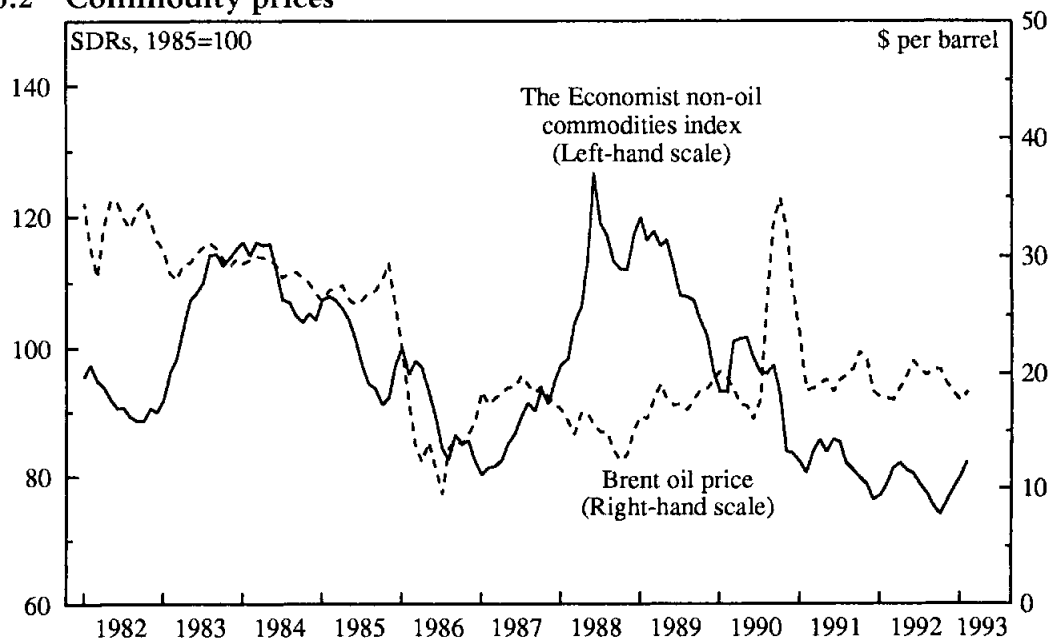
**3.12** The marked divergence in activity across the G7 is partly a consequence of recent developments in monetary and fiscal policy. In the US, real short-term interest rates have been under 1 per cent for the last year. This is in marked contrast to continental Europe where, despite some slight easing since the currency turmoil in September, real short-term rates are still very high, at around 6 per cent. And in many European countries, discretionary fiscal tightening has accompanied the monetary squeeze. But in Japan there has been a substantial monetary easing and a large fiscal package has been announced though, so far, this has failed to stem the decline in activity.

**3.13** In most countries, abundant spare capacity has maintained downward pressure on inflation. Since June, inflation has fallen by around 1 percentage point in Japan, France and Italy and has stabilised at just over 3 per cent in the US. But in Germany inflation picked up in the second half of 1992 and, following the 1 per cent rise in VAT at the beginning of this year, it is now 4¼ per cent. Average consumer price inflation in the G7 countries is just under 3 per cent.

<sup>1</sup> Throughout this chapter references to Germany relate to western Germany only.

**3.14** Despite the continued overall weakness of G7 activity, non-oil commodity prices have risen by over 10 per cent since October as the prospect of stronger US activity became apparent. However, in real terms, non-oil commodity prices remain close to their lowest level since the early 1970s. Oil prices have been relatively stable since the end of the Gulf War. Since December the Brent price has averaged around \$18 a barrel and it is assumed in the forecast to remain at that level.

**Chart 3.2 Commodity prices**



**Forecast 3.15** G7 GDP growth in 1993 is forecast to be  $1\frac{1}{2}$  per cent, the same as in 1992 and only slightly below the Autumn Statement forecast of  $1\frac{3}{4}$  per cent. However, there have been some significant changes to the prospects for individual countries. In the US, growth of  $3\frac{1}{4}$  per cent is now forecast for 1993 compared with  $2\frac{1}{4}$  per cent last November. This upward revision partly reflects a stronger outturn for the second half of 1992 than had been expected. But also, against a background of stronger business and consumer confidence, it now appears that reasonably robust growth will be maintained through 1993. It will be helped by the small fiscal stimulus included in President Clinton's budget package and by the fall in long-term interest rates following the announcement of medium-term deficit reduction measures.

**Table 3.2 World economy**

	Percentage changes on a year earlier			
	1991	Estimate 1992	Forecast 1993	1994 H1
<i>Major seven countries<sup>1</sup></i>				
Real GDP	$\frac{3}{4}$	$1\frac{1}{2}$	$1\frac{1}{2}$	$2\frac{3}{4}$
Domestic demand	0	$1\frac{1}{2}$	$1\frac{1}{2}$	$2\frac{3}{4}$
Industrial production	$-\frac{1}{2}$	$-\frac{3}{4}$	$\frac{1}{4}$	$3\frac{1}{2}$
Consumer price inflation <sup>2</sup>	$3\frac{1}{2}$	$2\frac{3}{4}$	$2\frac{1}{2}$	$2\frac{1}{2}$
World trade <sup>3</sup>	4	$4\frac{1}{2}$	$4\frac{1}{4}$	$5\frac{3}{4}$
UK export markets <sup>3</sup>	5	$4\frac{1}{2}$	$3\frac{3}{4}$	$4\frac{3}{4}$

<sup>1</sup> US, Japan, Germany, France, UK, Italy and Canada.

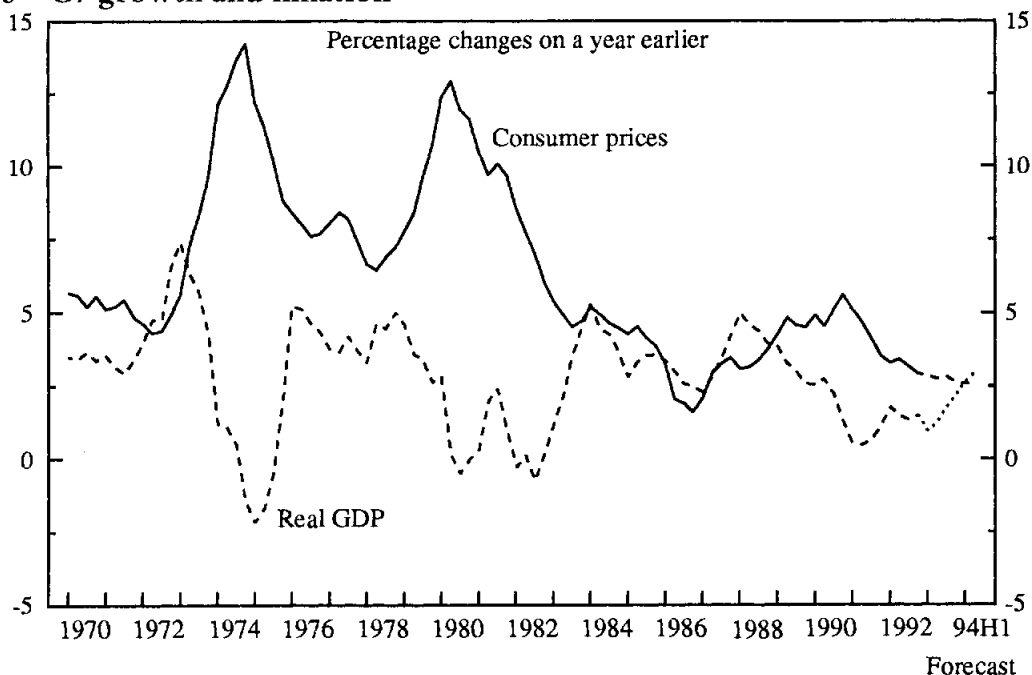
<sup>2</sup> Final quarter of each period.

<sup>3</sup> Manufactures.

**3.16** The forecast for GNP growth in Japan in 1993, at 1 per cent, is well below forecasts by the OECD and the IMF at the end of last year. This reflects the continued slide in indicators of activity in recent months, and the lack of any forward indicators yet pointing to recovery. The net stimulus from the fiscal package announced in August is likely to be considerably less than originally thought. Its impact has, in any case, been affected by the prolonged delay before its approval by the Diet.

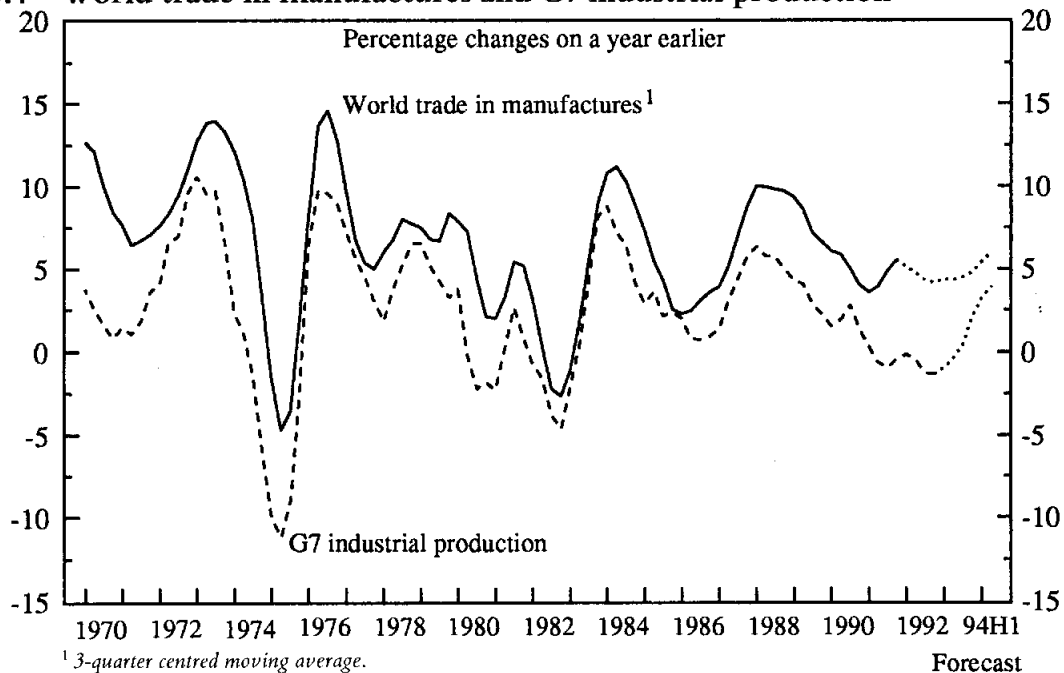
**3.17** In the three largest continental European economies, the expectation is, on average, for a fall in GDP of around  $\frac{3}{4}$  per cent in 1993, following growth of only  $1\frac{1}{4}$  per cent in 1992. In Germany, GDP has fallen for three quarters, and no pick-up is expected until the second half of the year as high real interest rates and the need for fiscal consolidation continue to depress business and consumer confidence. GDP in Italy and France will be affected directly by the weakness of activity in Germany, but also by the high real interest rates and discretionary fiscal tightening across Europe.

**Chart 3.3 G7 growth and inflation**



**3.18** Although commodity prices have picked up in recent months, output in the G7 is well below trend and the growth in demand is expected to remain weak in 1993. Hence, the prospect is for inflation to remain subdued. Consumer price inflation in the G7 is forecast to fall from  $2\frac{3}{4}$  per cent in the fourth quarter of 1992 to around  $2\frac{1}{2}$  per cent by the fourth quarter of this year, and to remain at that level in the first half of 1994.

**Chart 3.4 World trade in manufactures and G7 industrial production**



**3.19** Despite the slowdown in industrial countries, world trade has held up remarkably well, helped in part by buoyant Far Eastern markets. World trade in manufactures is estimated to have grown by  $4\frac{1}{2}$  per cent in 1992 and a similar rate of growth is forecast for 1993. However, growth of UK export markets, which are weighted more heavily towards Europe, is forecast to fall from  $4\frac{1}{2}$  per cent in 1992 to  $3\frac{3}{4}$  per cent in 1993.

### UK demand and output

#### Recent developments

**3.20** GDP rose slightly in the second half of 1992, a stronger performance than anticipated in the Autumn Statement. It edged up in both the third and fourth quarters, but non-oil GDP fell marginally. In 1992 as a whole, GDP was  $\frac{1}{2}$  per cent down on 1991, though it was broadly unchanged between the fourth quarters of 1991 and 1992. A small increase in domestic demand was more than offset by a fall in net trade volumes.

**3.21** Within GDP, oil output recovered strongly in the second half of 1992 and rose  $3\frac{1}{4}$  per cent in the year as a whole. Other energy output also recovered in the second half of the year. Manufacturing output fell back a little in the fourth quarter, though not as much as suggested by business surveys in the summer and autumn, and it was  $\frac{1}{2}$  per cent higher than a year earlier. Construction output fell in 1992 but not as much as in 1991. Service sector output was little changed.

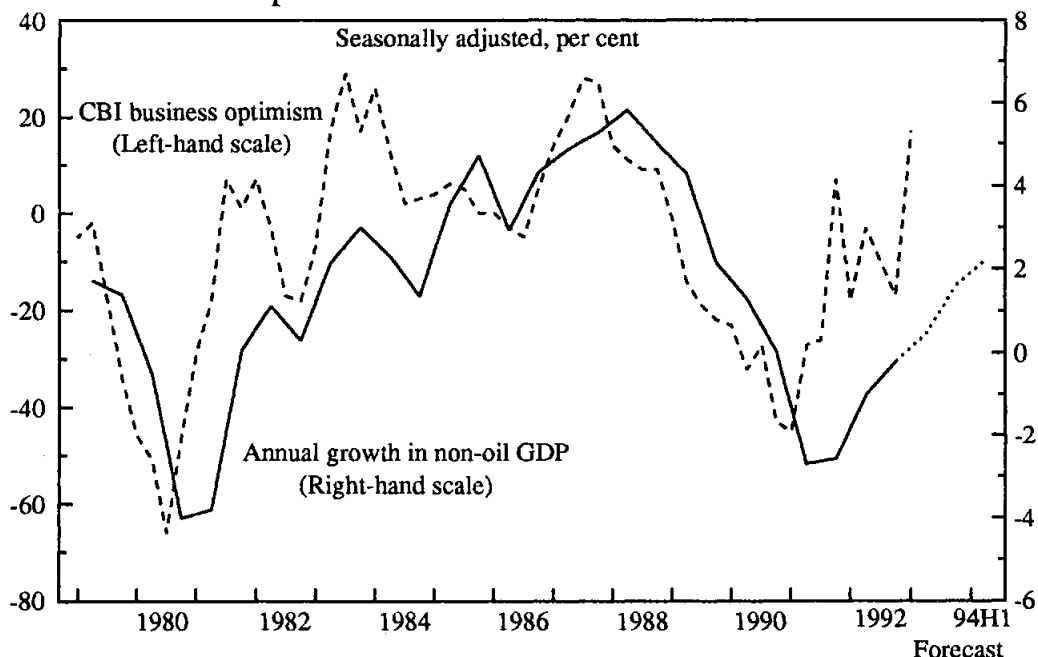
#### Prospects

**3.22** The four percentage point cut in base rates since early September, the fall in the value of sterling and the measures announced in the Autumn Statement, have enhanced the prospects for recovery. Business optimism has improved and there are signs of strengthening consumer demand.

**3.23** Nevertheless downside risks remain to the central forecast. Consumer demand may remain hesitant, held back by high levels of debt relative to income and to house prices, and by the fear of unemployment. And the outlook for the continental European economies is very subdued. Moreover business surveys have indicated false dawns before, notably in the autumn of 1991 and the spring of 1992. On this occasion, however, the improvement in confidence follows a tangible easing of policy: there is therefore a better chance that it will translate into higher activity and prove more durable.

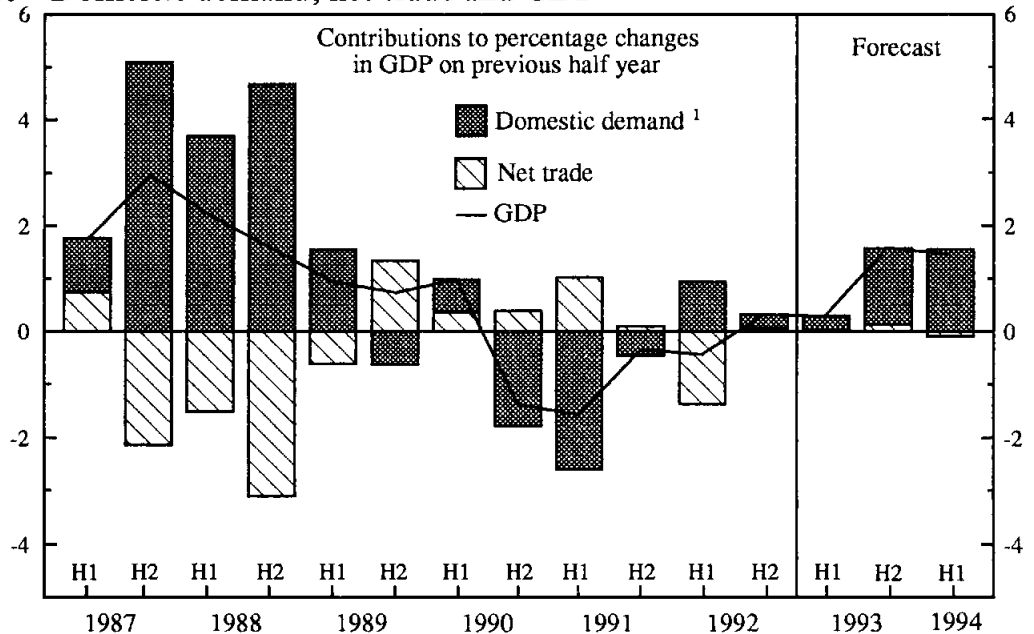
**3.24** The forecast for GDP growth in 1993 is  $1\frac{1}{4}$  per cent, broadly in line with the average of forecasts by the Independent Panel, but slightly more than in the Autumn Statement reflecting higher than expected output in the second half of 1992. Growth in the year to the second half of 1993 is unchanged from the Autumn Statement at  $1\frac{3}{4}$  per cent. It is forecast to pick up further to 3 per cent ( $2\frac{1}{4}$  per cent non-oil) in the first half of 1994. Manufacturing output is forecast to rise more rapidly than GDP during the course of 1993 because of the impact of improved competitiveness.

**Chart 3.5 CBI business optimism balance and non-oil GDP**



**3.25** The main contributions to growth in 1993 are expected to come from consumers' expenditure, up  $1\frac{1}{4}$  per cent, and exports, up  $5\frac{1}{2}$  per cent. Stocks are also forecast to make a contribution to GDP growth, with destocking coming to an end during the course of the year.

Chart 3.6 Domestic demand, net trade and GDP



<sup>1</sup> At factor cost.

### Personal sector

#### Recent developments

**3.26** Consumers' expenditure has moved ahead since the first quarter of 1992, rising by  $1\frac{1}{4}$  per cent in the year to the fourth quarter. Recent consumption indicators have turned out much as expected. But real personal disposable income was much stronger than forecast, increasing by  $2\frac{1}{4}$  per cent in 1992 despite a sharp fall in employment. As a result, the saving ratio rose  $1\frac{3}{4}$  points in 1992, to  $11\frac{1}{2}$  per cent.

#### Housing market

**3.27** Personal sector spending has been closely linked with housing market developments in the past few years. Although both turnover and prices fell sharply in the autumn of 1992, this now looks to have been the effect of the stamp duty concession, which ended in mid-August and which shifted activity into the summer. Sentiment in the housing market has clearly improved in recent months, with help from the lower level of interest rates, the reduced level of repossessions and the measures announced in the Autumn Statement to take empty properties off the market. Surveys of estate agents and housebuilders suggest greater activity in the early part of 1993, but this has not yet been reflected in official housing market turnover statistics. House prices, though  $7\frac{1}{4}$  per cent lower than a year ago according to the Halifax measure, have fallen by only 1 per cent in the last four months. The house price/earnings ratio is now back to 1986 levels, and below its average of the last 25 years. While the market is currently weak by earlier standards, both prices and turnover may start to rise during the year.

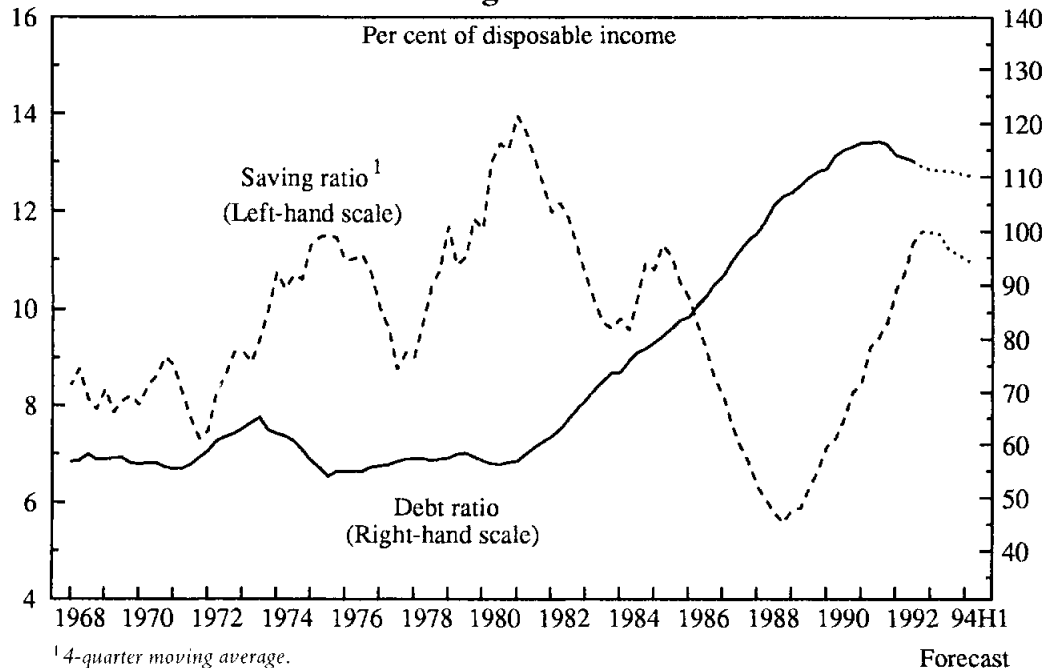
#### Prospects

**3.28** Personal sector spending is likely to continue to be restrained by the desire for further balance sheet adjustment and by the fear of unemployment. However, consumer confidence has picked up since the Autumn Statement and the interest rate cuts since ERM suspension have made current levels of debt easier to service. Retail sales have continued their upward trend, and survey and other evidence from distributors also suggests a pick-up in spending in the early months of the year. It therefore seems



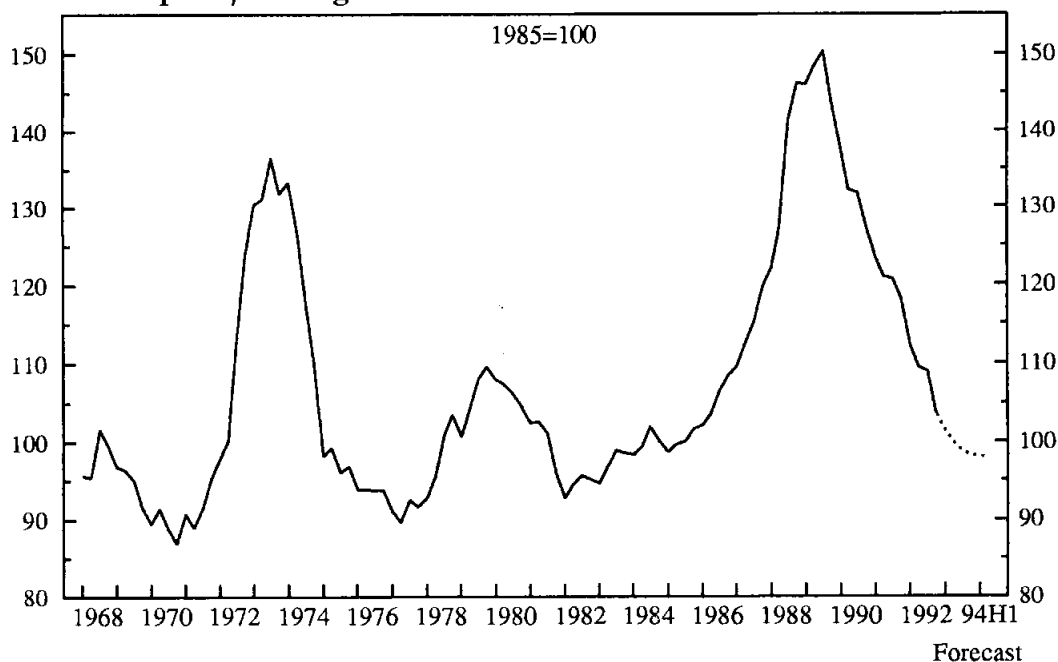
likely that there have been further increases in consumption so far in the first quarter similar to those in the second half of 1992. Moreover spending is unlikely yet to have reacted fully to the surprisingly strong growth of real incomes in 1992.

**Chart 3.7 Personal sector debt and saving ratios**



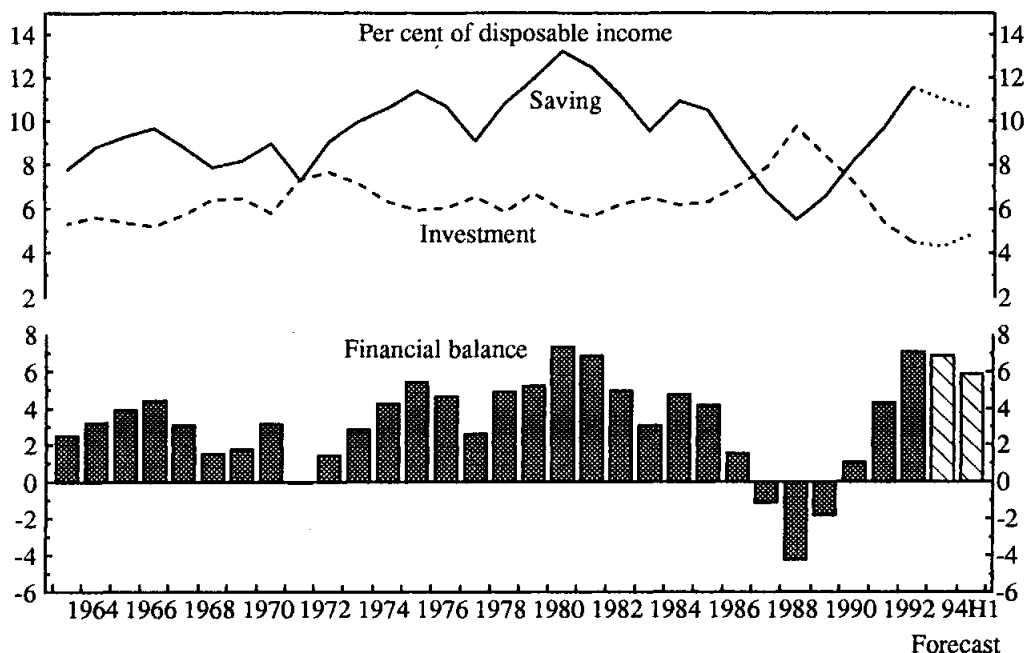
**3.29** Thus, despite projected slower growth of real personal disposable income in 1993 of  $\frac{3}{4}$  per cent, consumer spending is forecast to grow by  $1\frac{1}{4}$  per cent. This implies a fall in the saving ratio from its high 1992 level. Personal sector investment in dwellings – which includes home improvements as well as the purchase of new properties – might be little changed in 1993, following a fall of 2 per cent in 1992.

**Chart 3.8 House price/earnings ratio**



**3.30** The personal sector's financial balance is expected to remain in sizeable surplus in 1993 – about 6¾ per cent of personal disposable income. The debt/income ratio fell in 1992; it is expected to fall again in 1993 but by less than in 1992. The debt/income ratio by mid-1994 could be about 7 percentage points below its peak in 1991.

**Chart 3.9 Personal sector financial balance**



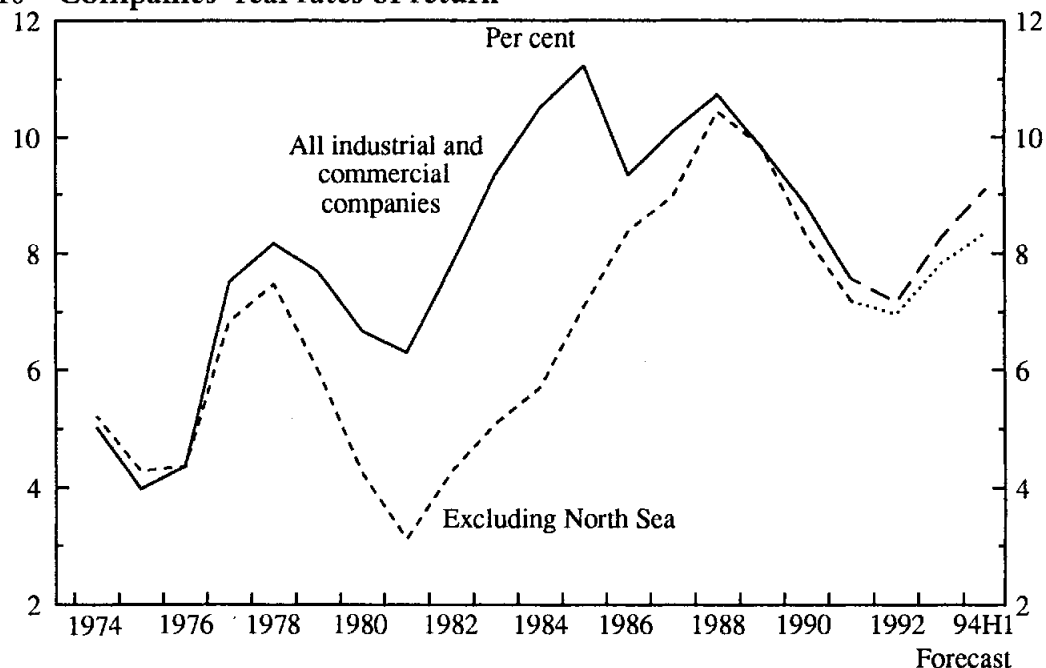
### Company sector and investment

#### Company income and saving

**3.31** Faced with falling turnover and downward pressure on profit margins through the recession, companies have reacted by cutting costs, particularly by shedding labour. As a result industrial and commercial companies' profits (net of stock appreciation) have barely risen since 1990. At the same time dividends have continued to increase, rising 20 per cent in the past two years. But with lower tax payments – down by over a quarter between 1990 and 1992 – and falling short-term interest payments, particularly in 1992, company saving (undistributed income) rose by over 6 per cent between 1991 and 1992.

**3.32** Profitability of non-North Sea industrial and commercial companies, as measured by the real rate of return, is forecast to pick up in 1993 as demand rises, firms continue tight control of labour costs, and pressure on margins eases. And with lower tax and short-term interest payments, company saving can be expected to increase sharply.

Chart 3.10 Companies' real rates of return

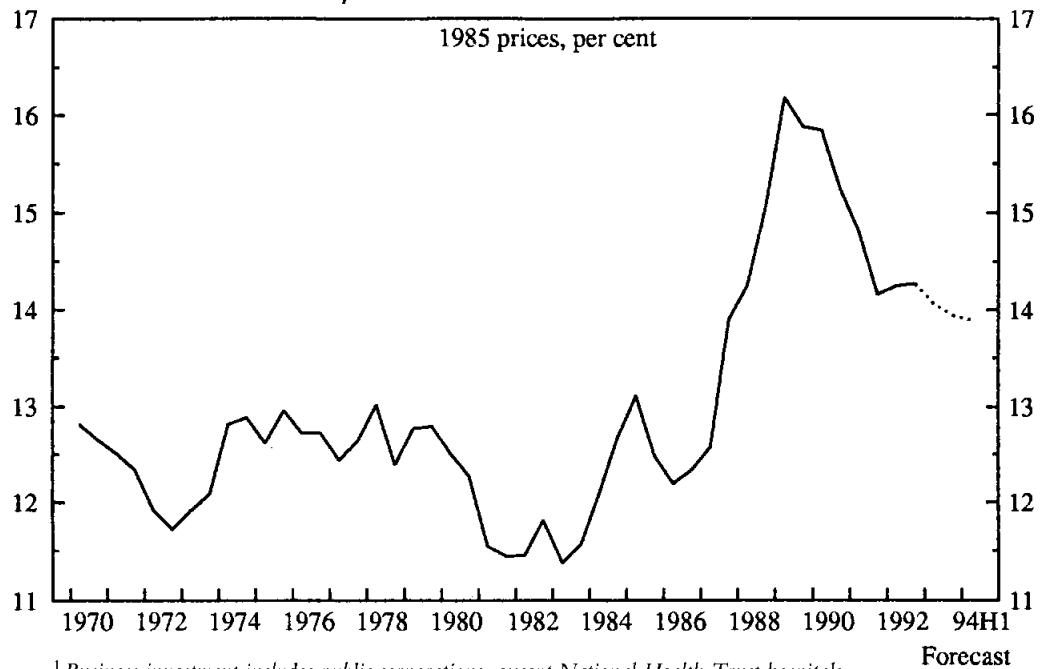


**Business investment** 3.33 Business investment has held up well during the recession. Following a 9 per cent fall in 1991, it fell by only 2 per cent in 1992, despite weak profitability, and actually rose between the second halves of 1991 and 1992. Manufacturing investment has risen for three consecutive quarters to the fourth quarter of 1992.

3.34 Given the degree of spare capacity and companies' continuing financial deficit, a sharp rebound in business investment in 1993 is unlikely. Nevertheless the temporary increase in capital allowances announced in the Autumn Statement will boost investment in 1993, and the CBI survey balances for business optimism and investment intentions recovered quite strongly between October and January.

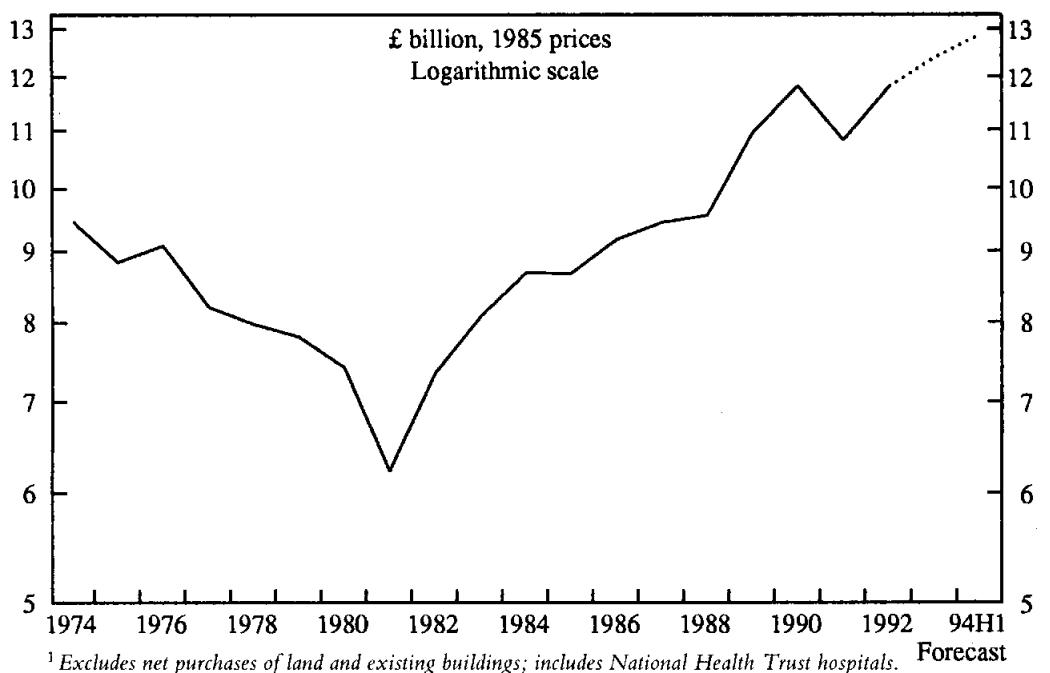
3.35 Non-oil business investment is forecast to rise modestly in 1993, by 1 per cent on 1992. However, with North Sea investment expected to fall, total business investment is forecast to fall by  $\frac{1}{2}$  per cent in 1993. Business investment rises through 1993 as recovery gathers pace and profitability improves, with growth of 2 per cent in the year to the first half of 1994. The trough in business investment as a share of GDP is likely to occur in the first half of 1994, at a level well above those seen between 1970 and the mid-1980s.

**Chart 3.11 Business investment/GDP ratio<sup>1</sup>**



**Government investment 3.36** General government investment rose by 9 per cent in volume terms in 1992. It is forecast to rise by 5 per cent in 1993 mainly due to increased local authorities' investment following the temporary relaxation of the rules for spending out of capital receipts announced in the Autumn Statement.

**Chart 3.12 General government investment<sup>1</sup>**



**Table 3.3 Gross domestic fixed capital formation at constant prices**

	Weights in 1992	Percentage changes on a year earlier		
		1992	Forecast	
		1993	1994H1	
Business <sup>1</sup>	69	-2	- $\frac{1}{2}$	2
Private dwellings and land <sup>2</sup>	15	- $3\frac{3}{4}$	$\frac{1}{4}$	6
General government <sup>3</sup>	16	9	5	$3\frac{3}{4}$
<b>Total fixed investment</b>	<b>100</b>	<b>-<math>\frac{3}{4}</math></b>	<b><math>\frac{1}{2}</math></b>	<b><math>2\frac{3}{4}</math></b>

<sup>1</sup> Includes public corporations, except National Health Trust hospitals.

<sup>2</sup> Includes net purchases of land and existing buildings for the whole economy.

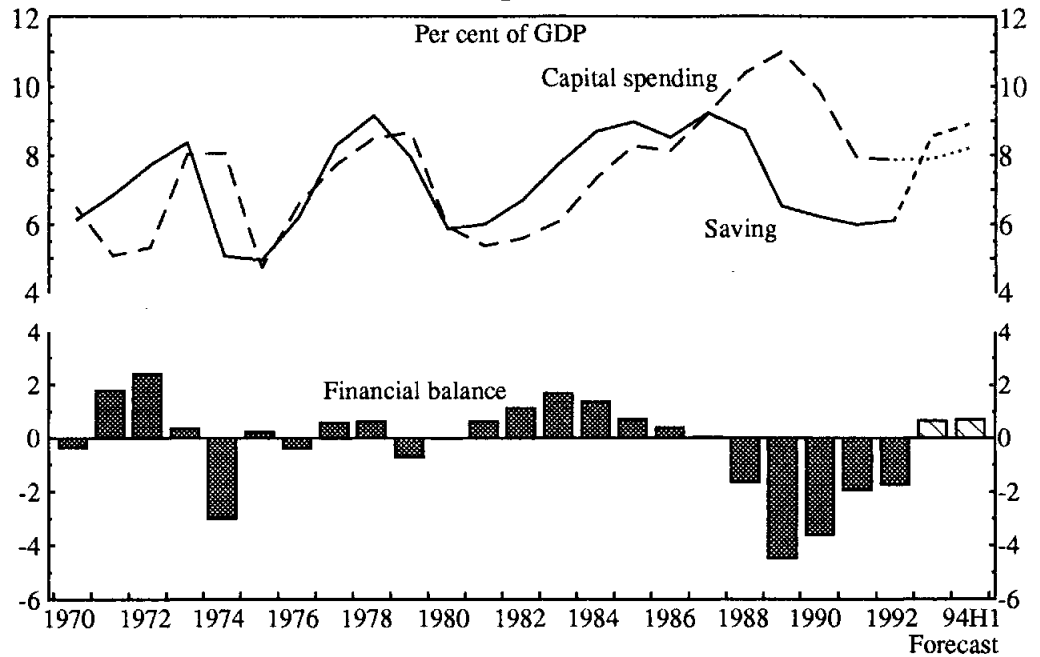
<sup>3</sup> Excludes net purchases of land and existing buildings; includes National Health Trust hospitals.

**Whole economy investment** 3.37 The forecast for whole economy fixed investment in 1993 is a small increase of  $\frac{1}{2}$  per cent. This is above the forecasts made by most members of the Independent Panel, which point to a fall in 1993. But given the uncertainties and the volatility of investment the difference is well within the margins of error; and two panel members are expecting investment to increase by more than the Treasury forecast.

**Stockbuilding** 3.38 Destocking continued in 1992, although at a slower pace than in 1991. The rate of destocking is forecast to slow further through 1993, with a return to stockbuilding expected in the second half of the year. Stockbuilding is forecast to add  $\frac{1}{4}$  percentage point to GDP growth in 1993, and  $1\frac{1}{4}$  points in the year to the first half of 1994. For 1993 the Treasury forecast is similar to most forecasts made by members of the Independent Panel.

**Companies' financial position** 3.39 Industrial and commercial companies cut their financial deficit to about  $1\frac{3}{4}$  per cent of GDP in 1992 from 2 per cent in 1991, and  $3\frac{3}{4}$  per cent in 1990. With saving increasing sharply, investment rising only slowly, and further destocking, industrial and commercial companies are expected to move into financial surplus in 1993.

Chart 3.13 Industrial and commercial companies' financial balance



**Labour market**

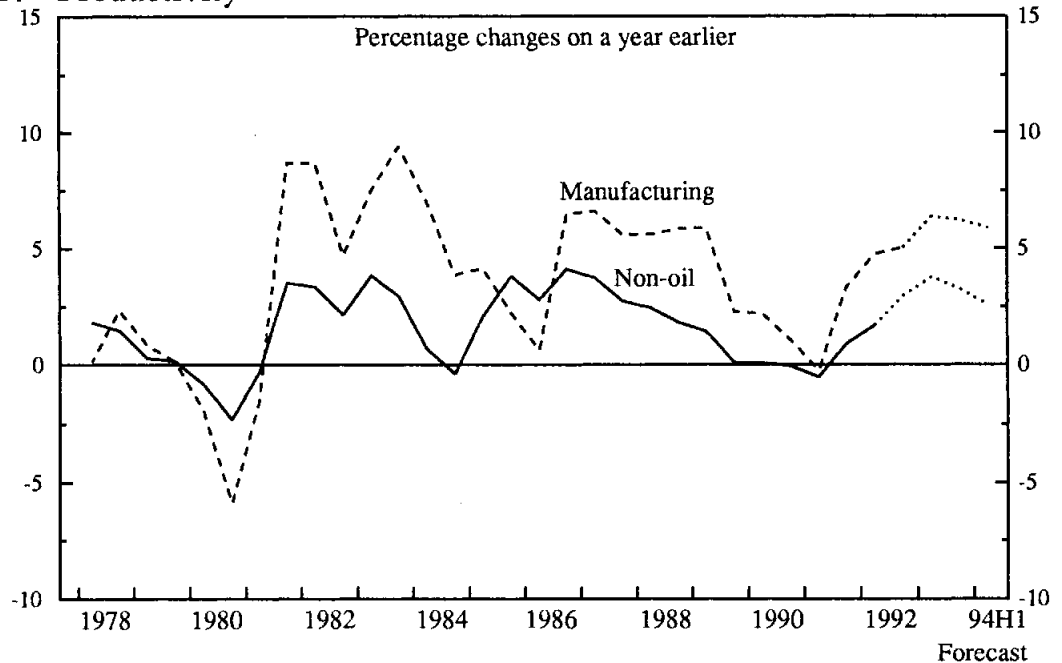
**Employment and productivity**

3.40 The cumulative fall in employment of nearly 2 million to September 1992 from its peak in June 1990 has been reflected in a strong productivity performance. Despite the weakness of output, non-oil productivity has been rising since early 1991, increasing by 2½ per cent in the year to the third quarter of 1992. Over the year to the fourth quarter of 1992 manufacturing productivity rose by 6 per cent. These rates of productivity growth are much faster than normal at this stage of the cycle.

**Unemployment**

3.41 Unemployment has risen considerably less than the fall in employment – by about 1.4 million to January 1993 from its low point in April 1990 – reflecting falling workforce participation. Following a further round of job losses in the second half of 1992 the rate of increase in unemployment rose, having moderated earlier. The rate of increase should start to slow down again as the economy recovers; though since the level of unemployment typically lags behind the cycle in activity it will be some time before it starts to fall again.

Chart 3.14 Productivity



### Trade and the balance of payments

#### Current account in 1992

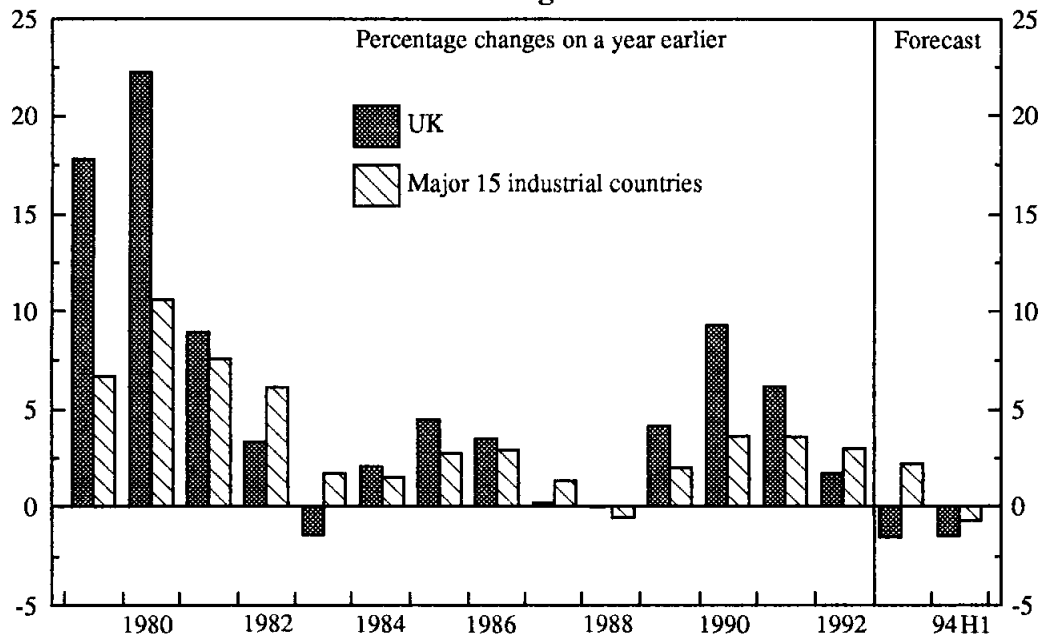
3.42 The current account deficit was £12 billion in 1992, compared with £6½ billion in 1991. The visible trade deficit rose to £14 billion, as a result of an adverse movement in trade volumes, with import volumes rising twice as fast as exports. However, exports were rising more strongly than imports towards the end of the year. Although the terms of trade deteriorated sharply in the fourth quarter of 1992 following sterling's depreciation, they were ½ per cent better in 1992 as a whole than in 1991.

3.43 In 1991 the invisibles surplus benefited from contributions from abroad towards the UK's Gulf War costs and from exceptionally low net transfers to the EC. It is not surprising therefore that the surplus fell in 1992. But at £2 billion it was much lower than anticipated in last year's Budget forecast: estimates both of the level of the surplus in 1991 and of the UK's net stock of overseas assets have been revised down since then.

#### Competitiveness

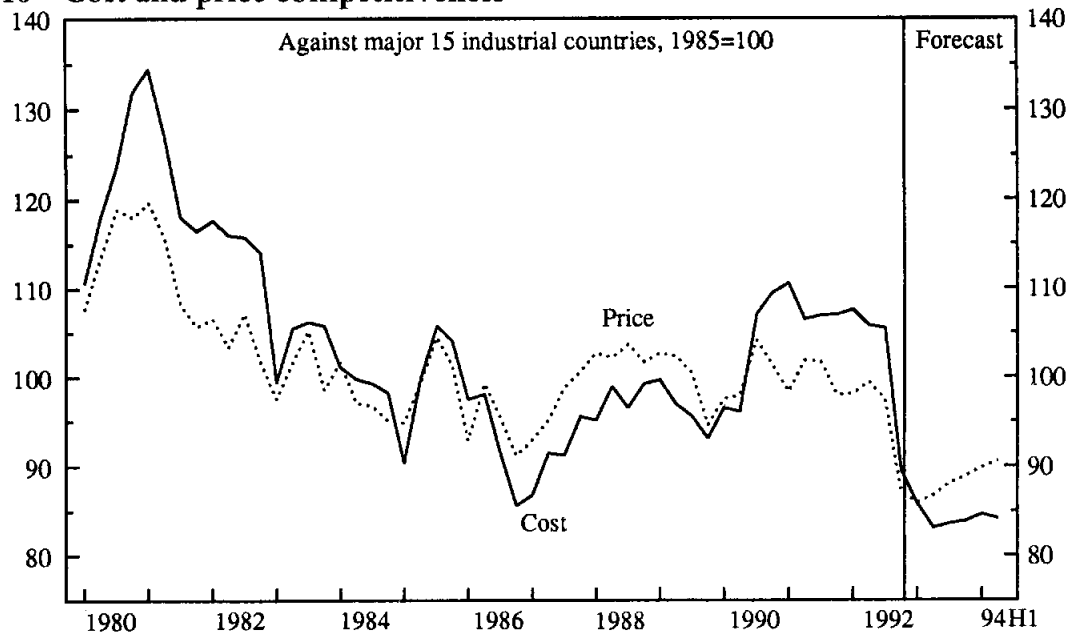
3.44 Manufacturing unit labour costs were unchanged in the fourth quarter of 1992 compared with a year earlier as earnings growth continued to slow and productivity growth picked up. By contrast, competitors' unit labour costs probably grew by 3¼ per cent. This underlying improvement in competitiveness is likely to continue in 1993, with UK unit labour costs set to fall while competitor countries' costs continue to rise. The gap between UK and overseas unit labour cost growth is forecast to improve competitiveness on its own by about 4 per cent in 1993.

**Chart 3.15 Unit labour costs in manufacturing**



**3.45** The lower exchange rate compared with most of last year will enhance this underlying improvement, so that actual cost competitiveness may be about 20 per cent better in mid-1993 than a year earlier. Price competitiveness is also forecast to improve in 1993, but not by as much as cost competitiveness because exporters are likely to rebuild their profit margins.

**Chart 3.16 Cost and price competitiveness<sup>1</sup>**

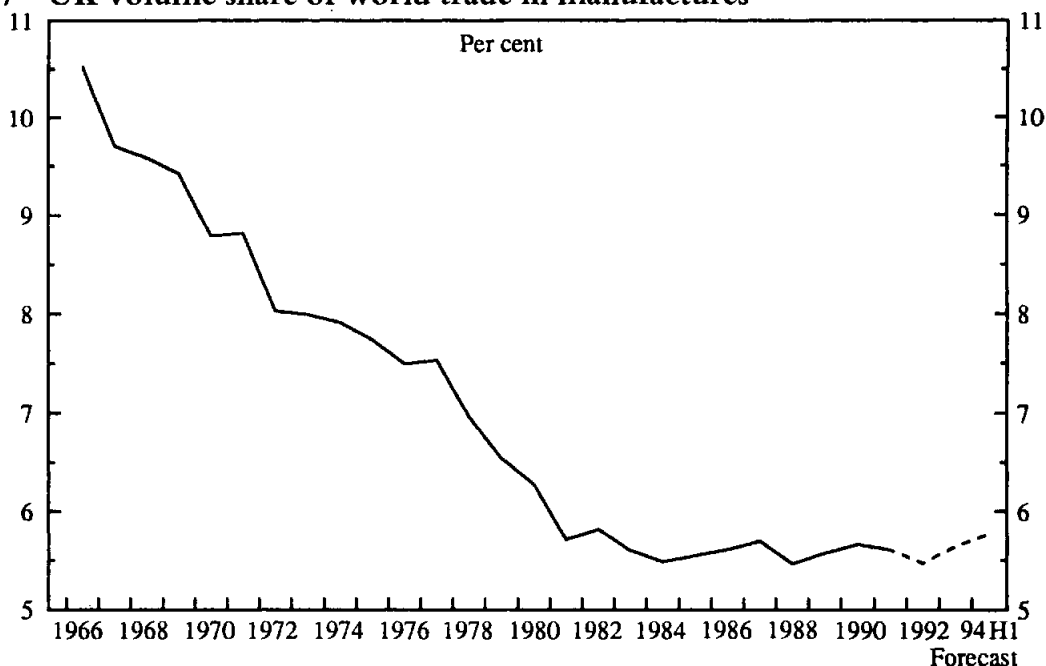


<sup>1</sup> A fall means competitiveness has improved.



**Exports 3.46** Non-oil export volumes were on an upward trend during 1992 reaching record levels in the fourth quarter. They rose  $2\frac{1}{2}$  per cent in the year as a whole. The growth of world trade in manufactured goods (which account for around 90 per cent of UK non-oil exports) is expected to be similar in 1993 to 1992, although the growth in UK export markets is forecast to fall from  $4\frac{1}{2}$  per cent to  $3\frac{3}{4}$  per cent. But better competitiveness means that exports should grow faster than this in 1993, although there is a good deal of uncertainty about the speed with which improved competitiveness will affect export volumes. Manufactured exports could rise by  $7\frac{1}{2}$  per cent in 1993, over 3 per cent faster than world trade and twice as fast as UK export market growth. Exports should continue to benefit from the improved competitiveness beyond 1993 with further increases in the UK's share of world trade. Exports of all goods are forecast to rise  $6\frac{1}{2}$  per cent in 1993 and just over 10 per cent in the year to the first half of 1994.

**Chart 3.17 UK volume share of world trade in manufactures**



**Imports 3.47** While import growth outstripped demand growth last year, the rise in import penetration was not out of line with its long term trend. The specialisation of world production has led to a rise in import penetration in the UK as in other countries. The counterpart of rising import penetration due to increased specialisation is faster growth of world trade than world activity, and with it the faster growth of UK exports than GDP. A further rise in import penetration is to be expected in 1993, though the improvements to competitiveness, which benefit firms competing with imports just as much as exporters, should keep it down. The volume of imports of goods is expected to rise by  $5\frac{1}{2}$  per cent in 1993, a little less than in 1992 despite stronger domestic demand.

Chart 3.18 Imports and total final expenditure

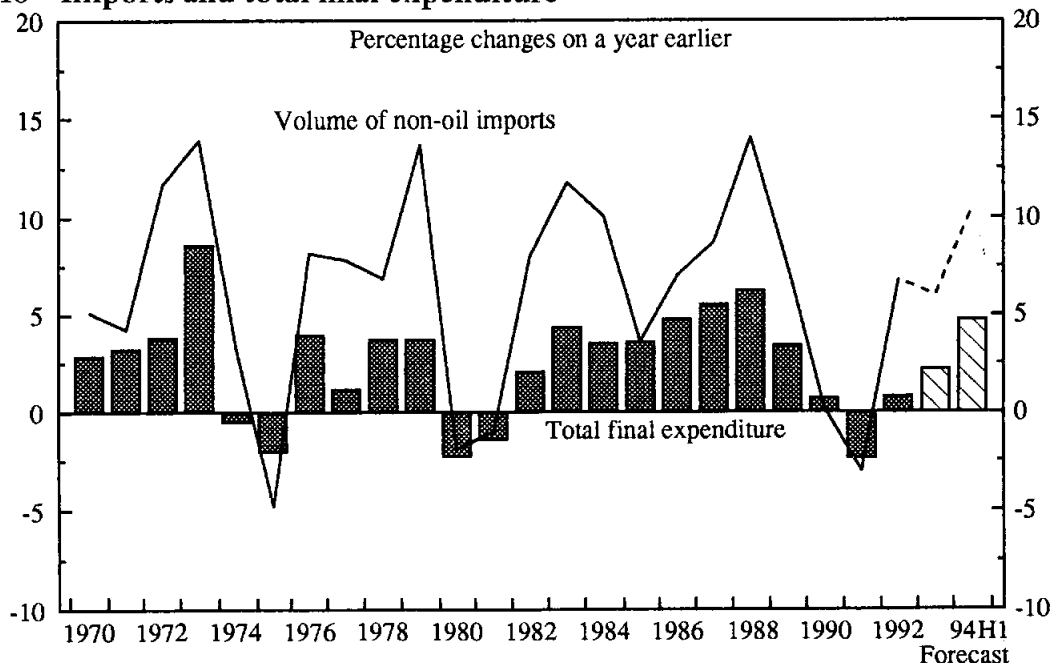


Table 3.4 Non-oil trade

	Percentage changes on a year earlier				
	Volumes		Prices		Terms of trade
	Exports	Imports	Exports	Imports	
1991	2¼	-3	¼	-2¾	3
1992	2½	6¾	1	0	1
1993 Forecast	7¼	6	6½	12	-4¾

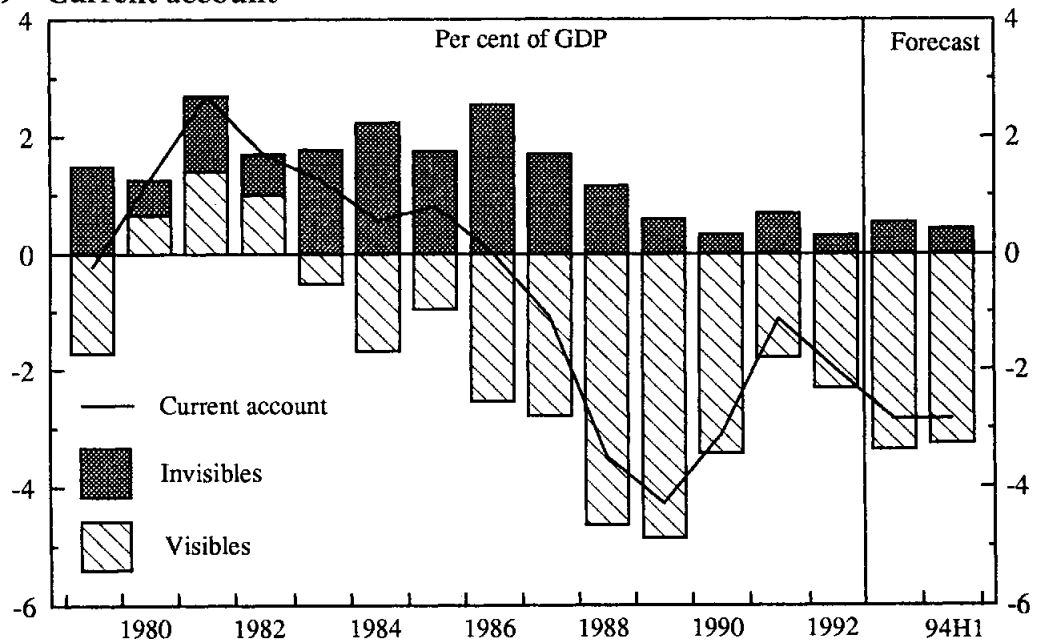
**Trade prices** 3.48 Normally after a large fall in the exchange rate import prices rise faster than export prices, and this is evident in the monthly figures available since ERM suspension. The resulting terms of trade loss, expected to be nearly 5 per cent for non-oil goods comparing 1993 with the whole of 1992, has a significant adverse effect on the visible trade deficit, more than accounting for the deterioration in 1993. However, in large part it arises because UK exporters hold back from raising their prices in the interest of selling more to their customers. The higher volumes that result will work to offset the adverse terms of trade effect, but will take some time to come through. Similarly improved competitiveness will tend to reduce import volumes, further offsetting the terms of trade loss. As export prices catch up, there is the prospect of some improvement in the terms of trade in the first half of 1994.

**The North Sea** 3.49 Oil and gas production rose 3¼ per cent in 1992. It is expected to rise by 6 per cent in 1993 as new fields begin production and as output resumes from those fields affected by the Piper Alpha disaster in 1988. Output is expected to be near the centre of the DTI's Brown Book range, which shows a further sharp increase in 1994. Net oil exports are expected to rise in 1993 with export volumes over 3 per cent higher and import volumes ½ per cent higher than in 1992. The oil surplus is expected to rise to nearly £2 billion in 1993.

**Invisibles 3.50** The surplus on interest, profits and dividends (IPD) rose from £½ billion in 1991 to £3 billion in 1992. However, several exceptional factors account for much of this turnaround: IPD was depressed in 1991 because of Gulf War effects on oil companies' profits; and during 1992 there were exceptional currency market earnings associated with the turmoil in September. Continuing current account deficits will reduce the UK's net stock of overseas assets and therefore the IPD balance over the years ahead. Against this, the lower exchange rate will raise the sterling value of foreign currency assets and receipts. The UK's net stock of overseas assets is estimated to have fallen from £11 billion at the end of 1991 to near zero in the middle of 1992. By the end of the year it had risen to £37 billion, as exchange rate revaluations more than offset the effect of the current account deficit.

**3.51** Like goods, the services balance will benefit from the improved competitiveness, though adverse terms of trade effects may dominate in 1993. The volumes of both exports and imports are forecast to rise quite strongly during 1993, exports more so than imports. But because they start from rather depressed levels in the second half of 1992, growth between 1992 and 1993 as a whole is quite modest, 1 per cent for exports and ½ per cent for imports. The balance of transfers is expected to change little between 1992 and 1993. Overall, the surplus on invisibles might be £3½ billion in 1993, up from £2 billion in 1992.

**Chart 3.19 Current account**



**The current account 3.52** The current account deficit is expected to rise to £17½ billion in 1993, with the recovery in the invisibles surplus more than offset by the increase in the visibles deficit. Although the forecast is above the average of the Independent Panel's forecasts, five of the seven panel members expect the deficit to be in the range £16½ to £20 billion.

Table 3.5 Current account

	£ billion					
	Manufactures	Oil	Other	Total visibles	Invisibles	Current balance <sup>1</sup>
1991	-3½	1	-8	-10½	4	-6½ (-1)
1992	-7½	1½	-7½	-14	2	-12 (-2)
1993 Forecast	-13	2	-9½	-21	3½	-17½ (-2¼)

<sup>1</sup> Figures in brackets are as a percent of GDP.

## Inflation

### Recent developments

**3.53** The weakness of demand has kept strong downward pressure on inflation, despite the lower exchange rate. Underlying inflation, as measured by the RPI excluding mortgage interest payments (MIPs), was 3.2 per cent in January – down 2½ percentage points since April 1992. As yet, with the exception of petrol prices, there is little obvious sign of inflationary pressures at the retail level as a result of sterling's depreciation. Since last September retail goods price inflation has continued to fall somewhat faster than retail services price inflation. All-items RPI inflation has fallen more rapidly than the underlying rate in recent months, and to a significantly lower level, reflecting the effect of mortgage rate reductions. The all-items rate in January was 1.7 per cent, the lowest rate since September 1967.

**3.54** Producer output price inflation, excluding food, drink and tobacco<sup>2</sup>, was a little higher in January and February, at 2.7 per cent, than the low point of 2.4 per cent reached in late 1992. This perhaps reflects the beginnings of the impact of the lower exchange rate on output prices. But producer output price inflation remains low by historical standards: 1992 apart, the rate was last below 2.7 per cent in May 1969. Producer input prices, on the other hand, have clearly been affected by the lower exchange rate, albeit somewhat less than expected, with the index 8¼ per cent higher in February than last August. Even so the pressure on producers' profit margins has been eased by the sharp decline in unit wage cost growth: in the fourth quarter of 1992 unit wage costs in manufacturing were unchanged on a year earlier.

**3.55** Whole economy underlying earnings growth has continued to break new ground by the standards of the past 25 years. In December it fell to 4¾ per cent, having fallen sharply since showing signs of stickiness at around 7½ per cent early in 1992. And under the influence of falling inflation, weak demand for labour, and financial pressures on companies, pay settlements have clearly resumed a downward path since last summer. CBI data point to recent settlements in both manufacturing and services falling to an average of under 3 per cent, compared to around 5 per cent a year or so earlier.

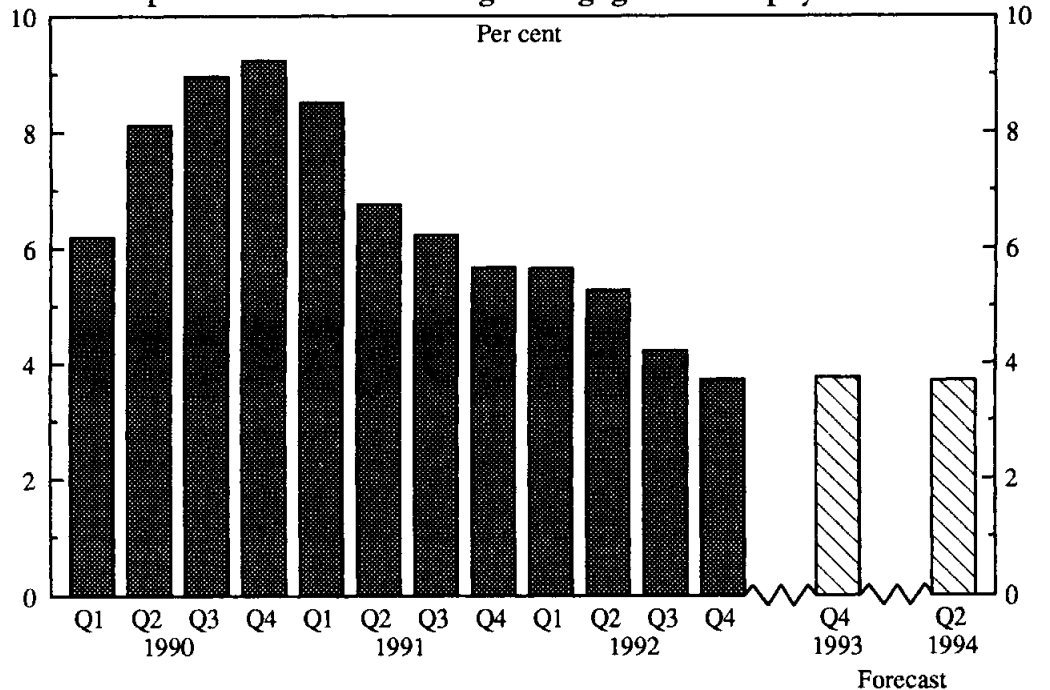
### Prospects

**3.56** Low headline inflation and a slack labour market indicate that earnings growth may continue to fall for some time yet, though a recovery in profits may progressively exert some upward pressure on earnings. With subdued earnings growth and further gains in productivity growth, unit labour costs are forecast to increase only marginally in 1993 in the private sector, and to fall in manufacturing.

<sup>2</sup> Throughout this chapter the producer price figures exclude food, drink and tobacco.

3.57 Manufacturers' input price inflation is expected to pick up further during much of 1993, largely reflecting higher import costs as a result of the lower exchange rate. Manufacturers are also likely to take advantage of increased demand partly by rebuilding their profit margins. These factors are expected slightly to outweigh the effects of lower unit labour costs on producer output prices. The net result is that producer output price inflation is forecast to rise to 4 per cent in the fourth quarter of 1993, before falling back to  $3\frac{1}{2}$  per cent in the second quarter of 1994 as import price inflation recedes.

Chart 3.20 Retail price inflation excluding mortgage interest payments



3.58 However, underlying RPI inflation is not expected to rise as much from its current level. Although retail goods price inflation is likely to pick up as the effects of the lower exchange rate feed through, services price inflation, which typically responds more slowly to changes in economic activity, should continue to come down. Underlying RPI inflation is forecast to be  $3\frac{3}{4}$  per cent in both the fourth quarter of 1993 and the second quarter of 1994. This includes the effects of the measures announced in the Budget. Compared to the Autumn Statement forecast, which allowed for increased motoring taxes to recoup the cost of abolishing car tax, the Budget is expected directly to add around  $\frac{1}{4}$  per cent to the level of the RPI excluding MIPs in 1993, and a further  $\frac{1}{2}$  per cent by the second quarter of 1994. For the fourth quarter of 1993 the Treasury forecast is just below the average of forecasts made by the Independent Panel. However, three members of the Panel have forecasts at or below  $3\frac{1}{2}$  per cent.

**Table 3.6 Retail and producer output price inflation**

	Percentage changes on a year earlier		
	1992Q4	Forecast	
		1993Q4	1994Q2
RPI excluding MIPs	3 $\frac{3}{4}$	3 $\frac{3}{4}$	3 $\frac{3}{4}$
Producer output prices <sup>1</sup>	2 $\frac{1}{2}$	4	3 $\frac{1}{2}$

<sup>1</sup> Excluding food, drink and tobacco.

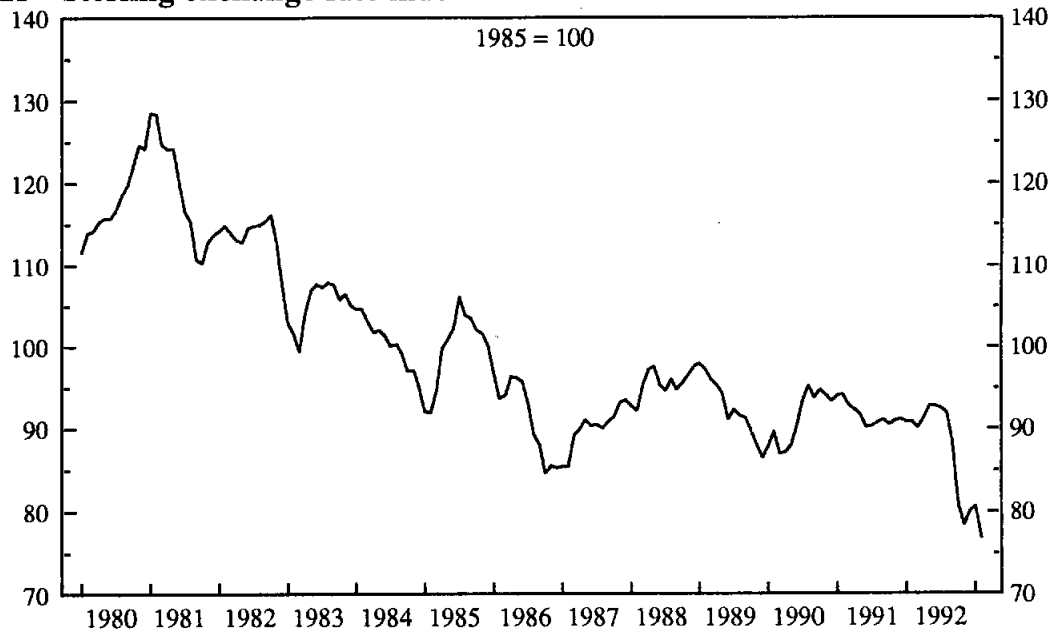
**3.59** For given underlying inflation, the all-items RPI inflation rate will depend on what happens to mortgage rates. The forecast of underlying inflation implies that if mortgage rates remained unchanged from present levels, all-items RPI inflation would be 2 $\frac{1}{2}$  per cent in the fourth quarter of 1993. A one percentage point change in mortgage rates changes the level of the all-items RPI by just over  $\frac{1}{2}$  per cent, other things being equal.

**3.60** The relatively flat profile of the forecast for underlying inflation contrasts with the path forecast for the GDP deflator, which measures the price of domestic value added (principally unit labour costs and profits per unit of output). The GDP deflator is now expected to rise by 3 $\frac{1}{2}$  per cent in 1992–93. But in 1993–94 it is forecast to rise by only 2 $\frac{3}{4}$  per cent, partly reflecting the effect of the lower exchange rate on the terms of trade. It is also held down by low public sector pay growth as a result of the limit on settlements announced in the Autumn Statement.

**Financial developments**

**Exchange rates** **3.61** Sterling was suspended from the ERM on 16 September last year. Since then, it has traded at an average level of DM2.44, or 15 per cent below its average level during 1992 prior to suspension. Against a basket of currencies, it has averaged 13 per cent lower, with the sterling index within the range 76 to 82 $\frac{1}{2}$  since mid-October.

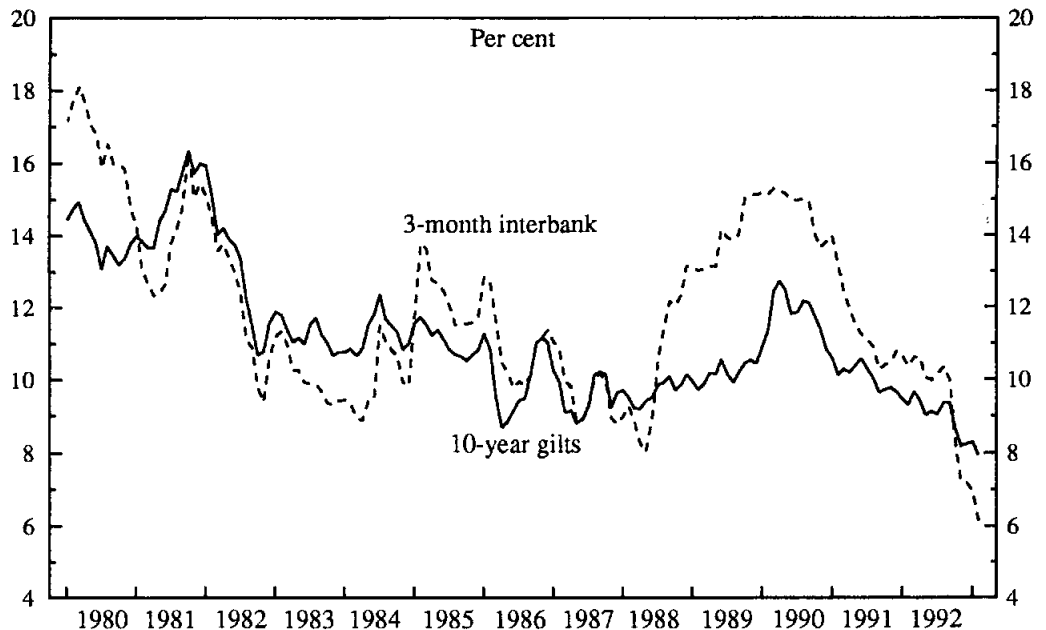
**Chart 3.21 Sterling exchange rate index**



**Interest rates** **3.62** Base rates, at 6 per cent, are four percentage points lower than before sterling's membership of the ERM was suspended, and UK short-term interest rates are the lowest in the EC. They were  $10\frac{1}{2}$  per cent one year ago. Mortgage rates have come down by less, to just under 8 per cent compared to  $11\frac{1}{2}$  per cent at the beginning of last year. At current levels they are the lowest since the early 1970s.

**3.63** Long-term interest rates have continued to fall. Ten-year yields averaged 8 per cent in February, over 1 per cent below their level a year earlier, and nearly 4 per cent lower than their average 1990 level. Since ERM suspension, the yield gap has switched over, with short rates below long rates for the first time since 1988.

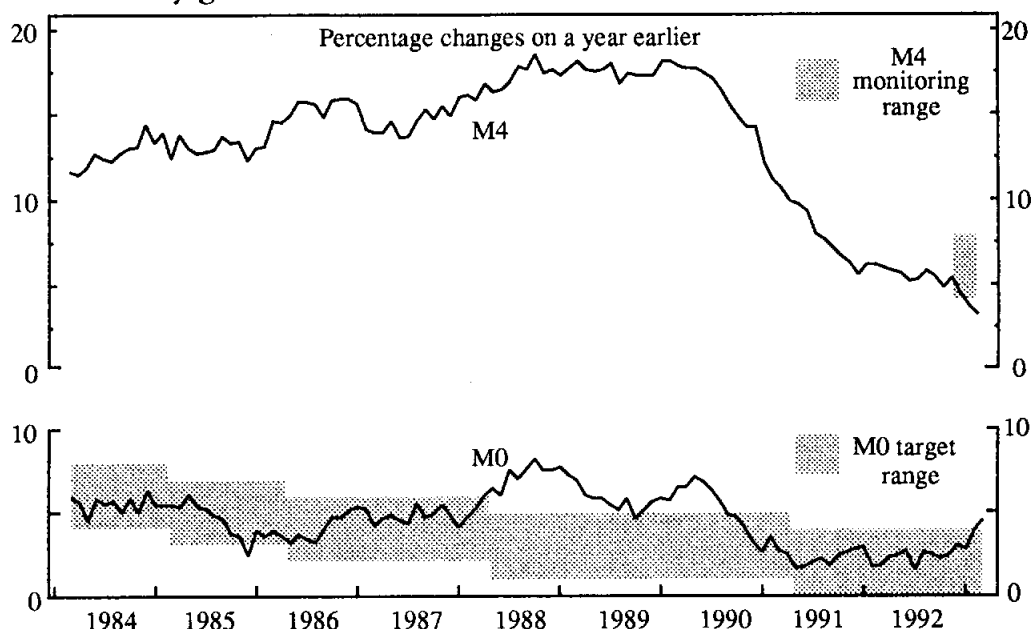
**Chart 3.22 Interest rates**



**Asset prices** **3.64** Equity prices were depressed in the run-up to the currency turbulence in September, but have since recovered strongly. In February they were 24 per cent above their average level in August. Dividend yields have fallen correspondingly, though they remain close to average levels in the mid-1980s. Commercial property rentals and residential house prices remain depressed. Although house prices in February were  $7\frac{1}{4}$  per cent below their level a year earlier (on the Halifax measure) they have fallen only 1 per cent in the last four months.

**Monetary aggregates** 3.65 Annual growth of M0 was between 1½ and 3 per cent throughout 1992, comfortably within its 0 to 4 per cent target range. Towards the end of the year, however, M0's shorter term growth rates increased strongly, and its 12 month growth rate exceeded 4 per cent in February. M0's relatively strong growth – and its correspondingly low velocity growth – may be a consequence of the falls in interest rates during the year, which reduce the incentive to economise on cash. M4 growth, in contrast to M0, has continued to fall. It was 3.2 per cent in January, below the monitoring range of 4 to 8 per cent announced in the Autumn Statement.

Chart 3.23 Monetary growth



**Credit** 3.66 The growth of M4 lending – bank and building society lending to the private sector – has, like M4, continued to decline over the past year. M4 lending's annual growth was 4.2 per cent in January. Personal sector borrowing has been depressed by weak activity in the housing market and the desire to reduce debt. Lending to industrial and commercial companies has been similarly depressed, growing by less than 1 per cent in each of the past two years.



### Forecast and outturn

**3.67** Table 3.7 compares the main elements of the forecast published in the 1992 FSBR with the outturns for 1992 or the latest estimates for 1992–93. GDP fell unexpectedly in 1992. Domestic demand and exports were weaker than forecast although the errors here were no bigger than the averages from past forecasts. But imports were stronger than projected, largely due to a shift in the composition of demand towards manufactures. This was also reflected in a larger current account deficit than forecast. The counterpart of weaker than anticipated activity has been faster progress on inflation. And the public sector borrowing requirement is likely to be well above last year's FSBR forecast.

**Table 3.7 Forecast and outturn**

	Percentage changes on a year earlier unless otherwise stated		
	1992 FSBR	Outturn or latest estimate	Average errors from past forecasts
GDP (1992)	1	–½	¾
Non-oil GDP (1992)	¾	–½	¾
Domestic demand (1992)	1¼	½	1
Exports of goods and services (1992)	3½	2	1½
Imports of goods and services (1992)	4	5¼	2¼
RPI (1992Q4)	3¾	3	1¼
GDP deflator (1992–93)	4½	3½	1
Money GDP (1992–93)	6½	3¼	1¼
Balance of payments current account (1992, £ billion)	–6½	–12	4¼
PSBR (1992–93, £ billion)	28	35	6¼

### Risks and uncertainties

**3.68** All forecasts are subject to risks and uncertainties. Recent Treasury forecasts have emphasised that these are most acute when the economy is at or close to a turning point, and that remains true on this occasion. The recent movements in the exchange rate have added to the uncertainty. The forecast is based on the conventional assumption that the exchange rate remains close to recent levels. The forecasts presented here are central forecasts, a balance of upside and downside risks. Table 3.8 shows average errors from past FSBR forecasts.

Table 3.8 Summary of economic prospects

	Percentage changes on a year earlier unless otherwise stated			
	1992	Forecast 1993	1994 H1	Average errors from past forecasts <sup>1</sup>
<b>GDP and domestic demand at constant prices</b>				
Domestic demand	$\frac{1}{2}$	$1\frac{1}{4}$	3	$1\frac{1}{4}$
of which:				
Consumers' expenditure <sup>2</sup>	$\frac{1}{4}$	$1\frac{1}{4}$	$1\frac{3}{4}$	$1\frac{1}{4}$
General government consumption <sup>2</sup>	$-\frac{1}{4}$	$\frac{1}{4}$	$1\frac{1}{4}$	$1\frac{1}{4}$
Fixed investment	$-\frac{3}{4}$	$\frac{1}{2}$	$2\frac{3}{4}$	$2\frac{3}{4}$
Change in stockbuilding <sup>3</sup>	$\frac{1}{2}$	$\frac{1}{4}$	$1\frac{1}{4}$	$\frac{1}{4}$
Exports of goods and services	2	$5\frac{1}{2}$	$10\frac{1}{2}$	$1\frac{1}{4}$
Imports of goods and services	$5\frac{1}{4}$	$4\frac{3}{4}$	$9\frac{1}{4}$	2
<b>Gross domestic product</b>				
Gross domestic product	$-\frac{1}{2}$	$1\frac{1}{4}$	3	1
Non-oil GDP	$-\frac{1}{2}$	1	$2\frac{1}{4}$	1
Manufacturing output	$-\frac{3}{4}$	$1\frac{1}{2}$	$2\frac{3}{4}$	1
<b>Balance of payments current account</b>				
£ billion	-12	$-17\frac{1}{2}$	$-18\frac{1}{2}$ <sup>4</sup>	$4\frac{3}{4}$
per cent of GDP	-2	$-2\frac{3}{4}$	$-2\frac{3}{4}$	$\frac{3}{4}$
<b>Inflation</b>				
RPI excluding mortgage interest payments (fourth quarter)	$3\frac{3}{4}$	$3\frac{3}{4}$	$3\frac{3}{4}$ <sup>5</sup>	$\frac{3}{4}$
Producer output prices (fourth quarter) <sup>6</sup>	$2\frac{1}{2}$	4	$3\frac{1}{2}$ <sup>5</sup>	$\frac{3}{4}$
GDP deflator at market prices (financial year)	$3\frac{1}{2}$	$2\frac{3}{4}$		1
<b>Money GDP at market prices (financial year)</b>				
£ billion	599	628		
percentage change	$3\frac{1}{4}$	$4\frac{3}{4}$		$1\frac{1}{2}$
<b>PSBR (financial year)</b>				
£ billion	35	50		$6\frac{1}{2}$
per cent of GDP	$5\frac{3}{4}$	8		1

<sup>1</sup> Average errors regardless of sign over past ten years; they apply to the forecasts for 1993 or 1993-94.<sup>2</sup> See footnote 1 to Table 3.9.<sup>3</sup> Per cent of GDP.<sup>4</sup> At an annual rate.<sup>5</sup> Q2.<sup>6</sup> Excluding food, drink and tobacco.

Table 3.9 Gross domestic product and its components

£ billion at 1985 prices, seasonally adjusted											
	Consumers' expenditure <sup>1</sup>	General government consumption <sup>1</sup>	Total fixed investment	Change in stocks	Domestic demand	Exports of goods and services	Total final expenditure	Less imports of goods and services	Less adjustment to factor cost	Plus statistical discrepancy <sup>2</sup>	GDP at factor cost
1991	269.1	82.3	72.5	-3.4	420.5	123.3	543.7	134.4	58.4	-0.7	350.2
1992	269.6	82.1	72.1	-1.3	422.4	125.6	548.1	141.3	57.5	-0.7	348.5
1993	273.3	82.3	72.4	-0.5	427.4	132.6	560.0	147.9	58.6	-0.7	352.8
1991 1st half	135.1	40.9	36.6	-2.2	210.4	60.9	271.3	66.5	29.0	-0.3	175.4
2nd half	134.0	41.4	35.9	-1.2	210.0	62.4	272.4	67.9	29.3	-0.4	174.8
1992 1st half	134.1	41.3	35.8	-0.3	211.0	62.6	273.6	70.5	28.7	-0.3	174.0
2nd half	135.4	40.8	36.2	-1.0	211.4	63.0	274.5	70.8	28.8	-0.3	174.5
1993 1st half	136.2	41.0	36.0	-1.0	212.2	64.6	276.8	72.3	29.1	-0.3	175.0
2nd half	137.1	41.3	36.3	0.5	215.2	68.1	283.2	75.6	29.5	-0.3	177.8
1994 1st half	138.6	41.5	37.1	1.2	218.4	71.3	289.8	79.1	30.0	-0.3	180.4
Percentage changes on a year earlier <sup>3</sup>											
1991	-2	3 $\frac{1}{4}$	-9 $\frac{3}{4}$	- $\frac{3}{4}$	-3	$\frac{1}{4}$	-2 $\frac{1}{4}$	-3	-1	- $\frac{1}{4}$	-2 $\frac{1}{2}$
1992	$\frac{1}{4}$	- $\frac{1}{4}$	- $\frac{3}{4}$	$\frac{1}{2}$	$\frac{1}{4}$	2	$\frac{3}{4}$	5 $\frac{1}{4}$	-1 $\frac{1}{2}$	0	- $\frac{1}{2}$
1993	1 $\frac{1}{4}$	$\frac{1}{4}$	$\frac{1}{2}$	$\frac{1}{4}$	1 $\frac{1}{4}$	5 $\frac{1}{2}$	2 $\frac{1}{4}$	4 $\frac{3}{4}$	2	0	1 $\frac{1}{4}$
1994 1st half	1 $\frac{3}{4}$	1 $\frac{1}{4}$	2 $\frac{3}{4}$	1 $\frac{1}{4}$	3	10 $\frac{1}{2}$	4 $\frac{3}{4}$	9 $\frac{1}{4}$	3 $\frac{1}{4}$	0	3

<sup>1</sup> Expenditure plans from 1 April 1993 treat finance provided by central government for further education institutions as grants to the personal sector, in line with the treatment of universities and polytechnics. Before then further education institutions are in the local authority sector. This change reduces the growth of the volume of general government consumption by 1 $\frac{3}{4}$  per cent in 1993, and raises the growth of the volume of consumers' expenditure by  $\frac{1}{2}$  per cent. However figures in this chapter are adjusted to exclude these effects.

<sup>2</sup> Expenditure adjustment.

<sup>3</sup> For stockbuilding and the statistical discrepancy, changes are expressed as a percent of GDP.

# Annex to Chapter 3:

## The Panel of Independent Forecasters<sup>1</sup>

### Short-term economic outlook

#### Monetary and fiscal assumptions

**3A.1** For the purpose of constructing our forecasts we have had to make assumptions about the future course of policy. As no attempt was made to agree a common set of assumptions, some of the differences between the forecasts reflect different policy settings:

- At the time we produced our forecasts **short-term interest rates** were 6 per cent. Assumptions for 1993Q4 range from 4½ to 6 per cent. All but two of us have built in some increase in rates through 1994: the range for the fourth quarter is 5 to 9 per cent.
- Congdon's forecast is based on the assumption that **M4** growth increases towards the top of its monitoring range.
- Four of us have assumed **tax increases** over the next two years: Congdon (£3 billion in 1993–94 and a further £4½ billion in 1994–95), Davies (£2 billion in 1993–94 and a further £6 billion in 1994–95), Britton (£3 billion in 1994–95) and Currie (£4 billion in 1994–95).
- Minford assumes a fall in the volume of **government consumption and investment** in 1993–94.

**Table 3A.1 Summary of short-term forecasts**

		Percentage changes on a year earlier unless otherwise stated		
		Average	Range	
			Lowest	Highest
Real GDP	1993	1.1	0.2	2.0
	1994	2.7	1.4	3.4
Unemployment (millions)	1993Q4	3.2	3.1	3.4
	1994Q4	3.1	2.7	3.6
RPI excluding MIPs	1993Q4	3.9	3.1	4.8
	1994Q4	3.5	1.0	4.9
Current account (£ billion)	1993	–15½	–20	–7½
	1994	–15½	–22	–6
PSBR (£ billion)	1993–94	47	40	55
	1994–95	45	32½	60

<sup>1</sup> This annex reproduces the section on the short-term economic outlook from the report of the Panel of Independent Forecasters submitted to the Chancellor of the Exchequer on 18 February. The full report, which includes members' individual submissions on the economic outlook and policy, is available from H M Treasury.

**Demand and activity** **3A.2** The substantial relaxation of monetary policy since sterling's suspension from the ERM has greatly improved the prospects for recovery in 1993. However, there is considerable uncertainty and disagreement about the likely strength of output. The average of our forecasts is for **GDP** to rise by 1 per cent this year. But they range from  $\frac{1}{4}$  to 2 per cent, with Minford and Godley expecting little, if any, recovery. We all expect GDP growth to strengthen in 1994, as both domestic and world demand pick up.

**3A.3** The average of our forecasts for **domestic demand** is a rise of  $\frac{3}{4}$  per cent in 1993 but the range stretches from  $-1$  to  $1\frac{3}{4}$  per cent. We agree that consumer spending is likely to be restrained by balance sheet problems (for example, the large overhang of debt), the weakness of the housing market, rising unemployment and a squeeze on real incomes caused by rising import prices: variations between our forecasts largely reflect different judgements about the extent to which these factors will hold back spending. There is less consensus about the prospects for business spending and government consumption. However, most of us agree that government consumption will make very little contribution to growth in 1993 and 1994, and only Britton and Currie expect any contribution to growth from fixed investment in 1993.

**Table 3A.2 Forecasts of domestic demand**

		Percentage changes on a year earlier		
		Average <sup>1</sup>	Range	
			Lowest	Highest
Domestic demand	1993	0.7	-1.0	1.8
	1994	2.5	1.4	3.2
Consumer spending	1993	-	0.0	1.6
	1994	-	0.9	2.9
Fixed investment	1993	-	-3.1	2.6
	1994	-	1.0	6.2
Government consumption	1993	-	-3.0 <sup>2</sup>	2.0
	1994	-	0.2	1.5

<sup>1</sup> Averages for consumer spending, fixed investment and government consumption are not shown because not all members forecast these explicitly.

<sup>2</sup> Government current and capital expenditure plus stockbuilding.

**3A.4** There have been a few signs of a pick-up in demand and activity recently: for example, improvements in retail sales, car registrations and mortgage commitments. However, there have also been continued signs of weakness, notably unemployment, broad money and credit. Given the length and depth of the recession, another year of flat or declining output would be extremely damaging to the UK economy. Although there are factors which could generate faster growth, we are therefore particularly conscious of the downside risks:

- None of us expects a strong recovery in the world economy this year. But there is a danger that the downturn in activity in Europe may be sharper than we have assumed, depressing UK exports.
- The debt overhang may be a greater brake on consumer spending than we have allowed for. The problem is that we cannot be sure how much more financial adjustment the personal sector wishes to make.
- Broad money and credit growth may remain depressed at the interest rates of 5–6 per cent we have built into our forecasts for 1993: a pick-up in M4 growth towards the top of its monitoring range is crucial to Congdon's forecast, and Minford also considers it necessary for recovery.

—The lending capacity of the monetary system may be inadequate to sustain recovery. In particular, Congdon warns that building societies may be constrained if low interest rates cause a shift in deposits to tax-free savings options such as PEPs.

**Unemployment** **3A.5** We all expect **unemployment** to rise further in 1993: our forecasts for the fourth quarter range from 3.1 to 3.4 million, with the average 3.2 million. Prospects thereafter depend on both the pace of the projected recovery and the response of real wages. Here we disagree, particularly about the “sustainable” rate of unemployment consistent with low inflation and how that is affected by changes in unemployment itself (ie whether or not there is “hysteresis”). Minford believes that high unemployment—particularly among skilled non-manual workers—will put downward pressure on real earnings, stimulating employment and reducing unemployment to 2½ million by end-1994. Other members are more sceptical about the impact of these equilibrating mechanisms and expect unemployment to remain over 3 million. Godley is forecasting further increases to 3.6 million by 1994Q4 because of insufficient growth of output.

**Balance of payments** **3A.6** The fall in the exchange rate since sterling’s suspension from the ERM has brought about a marked improvement in competitiveness which should strengthen export growth and generate substitution from imports to home production. Congdon, Minford and Sentance are forecasting that **net trade** will add about 1 per cent to GDP over the next two years. The rest of us expect little or no contribution. But even this would represent an improvement on 1992, when the deterioration in net exports reduced output by 1 per cent.

**3A.7** In the short term, J-curve effects from the deterioration in the terms of trade may cause the **current account** deficit to rise: the average of our forecasts is a deficit of nearly £16 billion in 1993, compared with £12 billion in 1992. (Minford is projecting a large fall in the deficit because he expects export prices to rise nearly as much as import prices in 1993 as a whole, leaving the terms of trade broadly unchanged.) We anticipate little change in the current account in 1994, despite the projected recovery in domestic demand.

**3A.8** We expect that the UK’s earnings on **invisibles** will improve this year and next as the recent falls in exchange and interest rates increase net receipts of interest, profits and dividends, and as the insurance cycle becomes more favourable. The balance of trade in **oil** is also likely to improve as North Sea production increases.

**Table 3A.3** Forecasts of net trade and the current account

		Average	Range	
			Lowest	Highest
Net trade <sup>1</sup>	1993	0.4	-0.1	1.3
	1994	0.1	-0.4	0.7
Current account (£ billion)	1993	-15½	-20	-7½
	1994	-15½	-22	-6

<sup>1</sup> Contribution to GDP growth, percentage points.

**Inflation** **3A.9** The outlook for inflation depends on the balance of two opposing forces. On the one hand, the fall in the exchange rate since September will inevitably put upward pressure on retail prices in the short term. On the other, the considerable slack in the economy is a powerful disinflationary force. Although the average of our forecasts is for **underlying RPI inflation**, excluding mortgage interest payments (MIPs), to remain just inside the Government’s 1–4 per cent target over the next two years, some of us expect that it will be exceeded. Congdon is the most optimistic, expecting underlying RPI inflation to fall to 1 per cent by end-1994 because of the overhang of spare capacity.

**3A.10** Those of us who forecast the **GDP deflator** expect it to increase by 3 per cent or less in 1993–94 since it is not as directly affected by the depreciation of sterling as the RPI. Most of us expect it to rise more quickly in 1994–95.

**3A.11** The extent to which any rise in inflation due to the recent fall in the exchange rate proves temporary will be determined by the behaviour of **wages**. We all agree that there is some risk that inflation could rise in 1994 as the recovery gathers pace. But we have different views about the likelihood of this occurring. Most of us think that low headline RPI inflation (due in part to recent cuts in mortgage rates) and the high level of unemployment should keep the rate of earnings growth below 5 per cent in 1994. But Britton and Currie expect that these factors will be outweighed by the effects of stronger activity, and by wage bargainers anticipating the impact of the lower exchange rate on prices.

**Table 3A.4 Inflation forecasts**

		Percentage changes on a year earlier		
		Average	Range	
			Lowest	Highest
RPI excluding MIPs	1993Q4	3.9	3.1	4.8
	1994Q4	3.5	1.0	4.9
RPI	1993Q4	2.6	1.5	3.8
	1994Q4	3.6	1.0	5.9
Average earnings	1993	4.1	3.4	4.6
	1994	4.3	2.8	6.4

**Public finances** **3A.12** The muted recovery forecast for 1993, combined with the lagged effects of weak output in 1992 (for example, on corporation tax receipts), means that the **PSBR** is likely to rise further in the coming year: the average of our forecasts for 1993–94 is £47 billion (just over 7 per cent of GDP), up from £37 billion (6 per cent of GDP) in 1992–93. Sentance and Godley expect it to increase further in 1994–95, to £50½ billion and £60 billion respectively, because they expect relatively low growth. The rest of us expect some decline, in part due to the projected pick-up in activity but also to an assumed increase in taxes, or, for Minford, tough control of public expenditure.

Table 3A.5 Summary of panel members' short-term forecasts: overview

		Percentage changes on a year earlier unless otherwise stated										
		Britton	Congdon	Currie	Davies	Godley	Minford	Sentance	Average			
GDP	1992	-0.7	-0.9	-0.8	-0.7	-0.7	-0.9	-0.9	-0.8			
	1993	2.0	1.1	1.4	1.5	0.5	0.2	0.7	1.1			
	1994	2.9	3.4	3.1	3.1	1.4	3.0	2.3	2.7			
Domestic demand	1992	0.1	0.2	0.1	0.0	-0.5	-0.1	0.1	0.0			
	1993	1.8	0.5	1.6	1.4	0.2	-1.0	0.3	0.7			
	1994	3.2	2.9	2.6	2.7	1.4	2.9	1.6	2.5			
Net trade <sup>1</sup>	1992	-1.2	-1.4	-1.2	-1.1	-0.4	-1.2	-1.0	-1.1			
	1993	0.1	0.7	-0.1	0.1	0.3	1.3	0.3	0.4			
	1994	-0.4	0.4	0.2	0.1	0.0	-0.1	0.7	0.1			
Unemployment (millions)	1992Q4	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9			
	1993Q4	3.2	3.3	3.2	3.2	3.4	3.1	3.1	3.2			
	1994Q4	3.1	3.2	3.0	3.2	3.6	2.7	3.2	3.1			
RPI	1992Q4	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1			
	1993Q4	3.0	2.1	3.3	2.7	3.8	1.5	2.1	2.6			
	1994Q4	5.1	1.0	5.9	3.2	4.0	2.3	3.6	3.6			
RPI excluding MIPS	1992Q4	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7			
	1993Q4	4.6	3.5	4.0	3.6	4.8	3.8	3.1	3.9			
	1994Q4	4.7	1.0	4.9	3.2	4.0	3.3	3.5	3.5			
Short-term interest rates (Per cent)	1992Q4	7.6	7.6	7.3	7.6	7.6	7.4	7.6	7.5			
	1993Q4	6.0	5.0	6.0	4.5	5.5	4.9	6.0	5.4			
	1994Q4	6.7	5.0	9.0	5.0	5.5	6.0	6.5	6.2			
Current account (£ billion)	1992	-11.8	-11.8	-11.8	-11.8	-12.0	-10.8	-12.2	-11.7			
	1993	-20.2	-10.9	-19.8	-18.1	-17.0	-7.5	-16.7	-15.7			
	1994	-21.8	-9.5	-19.9	-16.5	-18.0	-6.1	-16.0	-15.4			
PSBR (£ billion)	1992-93	37.8	37	35.7	38	37	37.8	37.6	37.3			
	1993-94	43.3	44	49.5	52	55	40.1	45.2	47.0			
	1994-95	38.3	38	47.1	48	60	32.5	50.4	44.9			

<sup>1</sup>Contribution to GDP growth, percentage points.



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# 4 The Budget measures

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4.1 This chapter summarises the tax and national insurance proposals in the Budget.

4.2 The effect of these changes on government revenues is set out in Table 4.1(†). Annex A explains how the effects on yield are calculated and Annex B details a number of tax changes which were announced before the Budget. Figures for the cost of tax allowances and reliefs, which have been published in this chapter in previous years, may now be found in the Statistical Supplement to the Autumn Statement (Cm 2219).

## Inland Revenue taxes

**Income tax** 4.3 There will be no change to income tax allowances or the income limit for age-related allowances for 1993–94 (1).

<b>Income tax allowances(£)</b>	<b>Allowance for 1993–94</b>
Personal allowance	3 445
Married couple's allowance, additional personal allowance, widow's bereavement allowance	1 720
Blind person's allowance	1 080
For those aged 65 to 74:	
personal allowance	4 200
married couple's allowance	2 465
For those aged 75 and over:	
personal allowance	4 370
married couple's allowance	2 505
Income limit for age-related allowances	14 200

4.4 The 20 per cent tax band will be widened from £2 000 to £2 500 for 1993–94 (2), and by a further £500 to £3 000 for 1994–95 (5). The basic rate limit is unchanged at £23 700 (3). The new tax bands are:

<b>Bands of taxable income(£)</b>	<b>1992–93</b>	<b>1993–94</b>
Lower rate – 20 per cent	0 – 2 000	0 – 2 500
Basic rate – 25 per cent	2 001 – 23 700	2 501 – 23 700
Higher rate – 40 per cent	over 23 700	over 23 700

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(†) The number in brackets after each proposal refers to the line of Table 4.1 where its yield or cost is shown. The symbol “–” means the proposal has no effect; “\*” means it has negligible revenue effects amounting to less than £3 million a year.

**4.5** From 6 April 1994 tax relief for the married couple's allowance, and allowances linked to it, will be restricted to 20 per cent. The married couple's allowance for those aged 65 and over will be increased by £200 (4).

**4.6** Measures will be brought forward to simplify the assessment and collection of personal tax from 1996–97. The proposals, which were outlined in the Inland Revenue consultation paper "A Simpler System for Assessing Personal Tax" published in November 1992, offer the option of self-assessment to all who pay tax by assessment; apply the same rules for assessment and payment of tax to income from different sources; and simplify tax for the self-employed by assessing income for each year as it arises instead of on the "preceding year" basis.

### **Benefits and expenses**

**4.7** The car benefit scale charges will be increased by 8 per cent from 6 April 1993 (7). From 6 April 1994 they will be replaced by a charge of 35 per cent of the list price of the car, with discounts for business mileage and for cars four or more years old (9). These scale charges are used for employers' national insurance contributions as well as income tax (53).

**4.8** The scales for assessing the benefit of fuel provided by employers for private use in company cars will be increased by 20 per cent, and the reduction in the charge for 18 000 or more business miles a year will be abolished, from 6 April 1993 (8). The scales are used for employers' national insurance contributions as well as income tax (53). The fuel scales for VAT will be similarly amended (34).

**4.9** The existing charge on vans made available by employers for private use will be replaced from 6 April 1993 by a standard charge of £500 a year, or £350 if the van is four or more years old. Any benefit from a van weighing more than 3.5 tonnes will be exempt from tax (10).

**4.10** The benefit-in-kind of workplace sports facilities will be exempt from tax from 6 April 1993 (\*).

**4.11** There will be a ceiling of £8 000 per move on expenses and benefits which qualify for tax relief when paid or provided by employers as part of relocation packages. In future, relief will be available whether or not employees sell their old home. The relief will be put onto a statutory basis. Concessionary relief for payments made to help meet additional housing costs following a job related move will be withdrawn. The changes will apply to employees who start a new job on or after 6 April 1993, but there will be transitional arrangements to protect employees who are already committed to moving (11).

**4.12** Outplacement counselling provided to redundant employees will be exempt from income tax with effect from 16 March 1993, and restrictions which in some cases prevent employers getting tax relief on the costs will be removed (16).

### **Housing**

**4.13** Tax relief on mortgage interest will be restricted to 20 per cent with effect from 6 April 1994. Relief will remain at 25 per cent for those aged 65 and over who take out a loan to buy a life annuity (6).

**4.14** The stamp duty threshold for transactions in land and property will be raised from £30 000 to £60 000 for instruments executed on or after 16 March 1993 and not stamped before 23 March 1993 (28).

**4.15** Borrowers will be entitled to mortgage interest relief where, on or after 16 March 1993, a lender substitutes a borrower's new home for a previous home as security for a loan. Under present law, relief is available only if the new home is bought with a new loan (\*).

**4.16** Temporary relief for mortgage interest will be extended to:

- borrowers who move out of their home without taking out a loan to buy a new home, provided the property is put up for sale (\*);
- elderly people who move out of a property used as security for a loan which is used to buy an annuity, provided that the property is put up for sale (\*).

These changes will apply to mortgage interest paid on or after 16 March 1993.

**4.17** Two further minor changes to the tax treatment of housing are:

- new rules will be introduced for stamp duty on property purchased under the rent to mortgage and rent to loan schemes being created by the Housing and Urban Development Bill (\*);
- Inland Revenue will be given clear statutory authority to recover amounts overclaimed by MIRAS lenders, together with appropriate interest and penalties, with effect from Royal Assent (\*).

### **Savings and financial services**

**4.18** Business Expansion Scheme tax relief will no longer be available to individuals who obtain loans which are connected in any way with shareholdings they acquire through the scheme. This applies for shares issued on or after 16 March 1993 (17).

**4.19** The maximum level of earnings for which pension provision may be made with tax relief will remain at £75 000 (\*).

**4.20** A new scheme will be introduced to replace the special reserve fund and enable Lloyd's underwriters to build up a tax-free reserve to meet losses. Gains on assets representing invested premiums will be chargeable as trading profits rather than to capital gains tax. The tax treatment of certain reliefs and expenses will be simplified (18).

**4.21** Two minor measures are:

- repayments to friendly societies for their non-pension exempt business will be put onto a statutory basis (-);
- a number of minor amendments will be made to the administrative rules for Personal Equity Plans (-).

### **Charities**

**4.22** The minimum size of single donations to charities which qualify for relief under the Gift Aid scheme will be reduced from £400 to £250 from 16 March 1993 (15).

**4.23** The annual limit on charitable donations qualifying for income tax relief under the payroll giving scheme will be raised from £600 to £900 from 6 April 1993 (\*).

**4.24** Tax relief for voluntary contributions by an employer towards costs incurred by a charitable agency in running a payroll giving scheme will be put onto a statutory basis (-).

**Residence rules** 4.25 The rule under which someone who has accommodation available for use in the UK is considered resident for tax purposes for any year in which they visit the UK, will be abolished. This applies to income and capital gains tax and takes effect from 6 April 1993 (19).

**Taxation of dividends** 4.26 The value of tax credits attached to dividends paid after 5 April 1993 will be reduced from 25 per cent to 20 per cent. The income tax charge on dividends will be reduced from the basic rate of 25 per cent to the lower rate of 20 per cent. This means that basic and lower rate taxpayers will have no more tax to pay on their dividends, and no part of the tax credit will be payable to lower rate taxpayers. Higher rate taxpayers will continue to be liable at the higher rate of 40 per cent, of which 20 per cent will be met by the tax credit. Charities with dividend income will be able to claim special payments for a four year period to ease the transition to the new lower rate of tax credits (12).

4.27 The rate of advance corporation tax (ACT) will be reduced from 25 per cent to 22½ per cent for 1993–94 and to 20 per cent from 1994–95 (12).

**Business taxation** 4.28 A consultative document is being issued with a view to legislation in 1994 on a proposal which would allow companies to reclaim surplus ACT which arises from certain dividends paid out of foreign income which has borne foreign tax. The Government intends in any event to legislate in 1994 for such a scheme for international headquarters companies.

4.29 The tax treatment of foreign exchange gains and losses will be reformed so that gains and losses on all monetary assets and liabilities will be taxed or relieved as income as they accrue. The date for implementation of these changes will be announced in due course (\*).

4.30 A number of changes will be made to limit the scope for tax avoidance:

- interest accruing after 31 March 1993 which is payable within multinational groups on certain loans and other forms of debt will become chargeable to tax as it accrues rather than when it arises (13);
- group companies will no longer be able to set certain capital losses against capital gains where the losses arise outside the group and are brought in by a company joining the group. This will apply to disposals on or after 16 March 1993, where a company joined the group after 31 March 1987 (14);
- where there is a change in company ownership, in certain circumstances it will no longer be possible to set off ACT paid after the change against corporation tax paid before it (20);
- UK companies which control foreign companies will (subject to certain exclusions) be liable to UK tax on the profits of the foreign company arising on or after 16 March 1993 where the overseas tax paid by that foreign company is less than three-quarters (previously one half) of the tax that would be payable if it were resident in the UK (21);
- the capital allowance provisions for connected persons will be extended to qualifying hotels, commercial buildings in enterprise zones and scientific research assets, and will be amended so that elections are available only where both parties are entitled to capital allowances (\*);

- the provisions which limit capital allowances for assets leased overseas will be amended to ensure that they operate as originally intended (-);
- the basis on which contributions by employers to approved occupational pension schemes may be allowed for tax purposes will be clarified, with effect from 6 April 1993 (-);
- changes will be made, with effect from 16 March 1993, to the capital gains rules applying to exchanges of shares and securities under company take-overs, reconstructions and reorganisations of share capital (\*).

**4.31** European Community (EC) agricultural quotas for ewe and suckler cow premiums will qualify for rollover relief from 1 January 1993 (22). Other qualifying assets may be introduced in future by Treasury Order.

**4.32** Other changes are:

- the period for which businesses can claim relief for costs incurred before trading begins will be extended from five to seven years. Relief will also be extended to trade related charges paid by companies, and costs of preparing waste disposal sites, incurred before trading begins (\*);
- some improvements will be made to the Pay and File rules which come into force on 1 October 1993, including provision for a wider range of people to sign company returns (\*);
- the capital gain chargeable to tax when a company grants a share option to an employee under an approved scheme will be limited to the amount, if any, actually paid for the option by the employee (\*);
- the rules for the recovery of under-deductions of PAYE by Government departments will be brought into line with those for the private sector from 1993–94 (\*).

**Oil taxation** **4.33** The rate of petroleum revenue tax (PRT) will be reduced from 75 per cent to 50 per cent from 1 July 1993, and PRT will be abolished for fields which get development consent on or after 16 March 1993. Subject to transitional arrangements, spending on exploring for and appraising new fields may no longer be set against PRT arising from existing fields. Similar changes will be made for future development costs in fields for which PRT has been abolished. The special PRT allowance for tariff receipts will not be given when tariffs are paid from a new non-PRT field (23).

**4.34** Double taxation relief will be made available to reduce a PRT liability on certain non-oil production receipts (\*).

**Capital gains tax** **4.35** The capital gains tax annual exempt amount will remain at £5 800 for individuals and £2 900 for most trusts (24).

**4.36** Entrepreneurs who sell shares in their own company will not be liable to capital gains tax when the gains are reinvested in unquoted shares in other qualifying trading companies. This takes effect from 16 March 1993 (25).

**4.37** The capital gains tax retirement relief provisions will be changed to relax the shareholding condition to a single 5 per cent test and allow full-time working employees, as well as directors, to qualify for the relief. This takes effect from 16 March 1993 (26).

**Inheritance tax** 4.38 The threshold for inheritance tax will remain at £150 000 (27).

4.39 Some minor changes will be made to inheritance tax:

- the three year period after death during which land and buildings may be sold and the sale price substituted for the value at death, will be extended to four years for sales from 16 March 1993 (\*);
- where an estate contains investments with quotations that have been suspended within a year after death, the investment, if unsold, may be valued for inheritance tax purposes at the value one year after death. This will apply where the death occurred on or after 16 March 1992 (\*);
- in inheritance tax appeals, the Special Commissioners will be given powers to refer questions about the value of land to the Lands Tribunal (-).

### Customs and Excise taxes

**Value added tax** 4.40 VAT will be charged on domestic fuel and power at 8 per cent from 1 April 1994 and at the full standard rate from 1 April 1995 (29).

4.41 The turnover threshold above which traders are required to register for VAT will rise from £36 600 to £37 600 from 17 March 1993, in line with the increase in the RPI in the year to December 1992. The deregistration threshold will rise from £35 100 to £36 000 from 1 May 1993 (\*).

4.42 All major VAT penalties on late returns and misdeclarations will be reformed during 1993. The reforms are the outcome of reviews announced by the Chancellor in his 1991 and 1992 Budgets and consultation with traders (30).

4.43 Traders will be able to claim VAT relief on bad debts after six months rather than a year, from 1 April 1993 (31).

4.44 More small businesses will be able to benefit from the cash accounting scheme, under which VAT is handled on the basis of cash paid and received rather than invoiced. The turnover limit below which firms may join the scheme is being increased from £300 000 to £350 000 a year from 1 April 1993; and businesses will no longer have to make a written application to Customs and Excise to join (32).

4.45 There are a number of minor changes to VAT:

- new arrangements are being introduced to simplify the taxation of so called “triangular” transactions involving traders located in different EC member states from 1 August 1993 (-);
- the VAT relief on samples is to be simplified and widened to help businesses provide samples, with effect from Royal Assent(\*). This will help the music industry in particular;
- a scheme is being introduced to extend the number of horse owners eligible for VAT registration (\*);

- for the second year of the Payments on Account scheme starting in October 1993, businesses are to be included on the basis of their VAT liabilities in 1992–93. Under this scheme certain large businesses are required to make a monthly payment on account towards their quarterly VAT bills (\*);
- a special scheme covering gold sales between registered traders will be introduced from 1 April 1993, to minimise the increased scope for fraud arising from the introduction of the single market (\*);
- the law on input tax will be clarified to ensure that businesses only reclaim VAT on goods and services purchased for making taxable supplies, with effect from Royal Assent (\*);
- controls will be introduced, with effect from Royal Assent, to protect VAT and customs duty on vehicles brought into the UK. The previous controls lapsed when car tax was abolished in November 1992 (-);
- all training, including work experience, provided under Government funded training programmes will be exempt from VAT from 1 April 1993. This widens an existing exemption for certain training (33);
- the zero-rating on certain protective boots and helmets approved by the British Standards Institution will be extended to similar products meeting equivalent EC safety standards (\*);
- parts and equipment for some ships and aircraft, other than those used for recreational purposes, will be zero-rated from 1 April 1993 (\*).

**Excise duties** 4.46 Most excise duties will rise from 6pm on 16 March 1993. The duty on spirits is not being increased. The change in duty and its effect on the price of each product is set out below:

**Excise duty changes**

	Rise in duty (per cent)	Effect on price of typical item (pence)	Unit	
<b>Alcohol</b>				
Beer	5	1½	pint	(35)
Wine	5	5½	75cl bottle	(36)
Sparkling wine	5	9	75cl bottle	(36)
Sherry and port	5	9½	75cl bottle	(36)
Cider and perry	5	½	pint	(37)
Spirits	0			(38)
<b>Mineral Oils</b>				
Unleaded petrol	10	2.7	litre	(39)
Leaded petrol	10	3.3	litre	(39)
Derv	10	2.7	litre	(39)
Gas oil and fuel oil	10	0.1	litre	(41)
<b>Tobacco</b>				
Cigarettes	†	10	pkt of 20	(43)
Cigars	6½	4½	pkt of 5 (small)	(44)
Hand rolling tobacco	6½	13½	25 grams	(44)
Pipe tobacco	6½	5½	25 grams	(44)

† Specific duty increased by 10 per cent. Ad valorem duty reduced by 1 percentage point to 20 per cent.

**4.47** The duty on road fuels will be raised on average by at least 3 per cent in real terms in future Budgets (40). This will encourage more efficient use of fuel and reduce emissions of carbon dioxide. Developments in charging for road use will be taken into account in determining the appropriate level of duty.

**4.48** The National Lottery, which is due to start in 1994, will be taxed at a rate of 12 per cent of gross stakes (46).

**4.49** Most rates of gaming machine licence duty will be increased by 20 per cent from 1 May 1993, except for the duty on small prize machines costing less than 5p per play which is unchanged and will be abolished from 1 November 1993 (45). The exemption limit for fairground bingo will be increased to £25 from 5 April 1993 (\*).

**4.50** Hydrocarbon oil duties will be extended to all fuel substitutes including orimulsion (a fuel oil substitute), rapeseed diesel and certain motor fuel additives from shortly after Royal Assent (42).

**4.51** The definition of hand rolling tobacco will be revised from Royal Assent. This is to stop pipe tobacco, which has a lower rate of duty, being marketed for rolling into cigarettes (\*).

### Vehicle excise duties

**4.52** Duty on cars, light goods vehicles, vans and taxis will rise from £110 to £125 from 17 March 1993. A range of minor rates, including those applying to motorcycles, trade licences, and small lorries, are increased by a similar percentage (48).

**4.53** The rate for special type vehicles will be increased to £4 250 from 17 March 1993, and to £5 000 from Budget day in November 1993 (\*). Concessionary rates for vintage motorcycles will be simplified (-). Other VED rates, including the majority of those for lorries, are unchanged (49).

### Business rates

#### England and Wales

**4.54** Rate bills for properties in England and Wales which are in transition to higher bills as a result of the 1990 reforms will not increase in real terms in 1993-94. This change will reduce the total rates bill in England and Wales by 2.6 per cent (50). Bills will rise in line with the uprating of business poundages already announced in November 1992 which is based on the rise in the RPI in the year to September 1992 (3.6 per cent).

#### Scotland and Northern Ireland

**4.55** Scotland and Northern Ireland have different arrangements for business rates but their total rates bill for 1993-94 will also be reduced by 2.6 per cent (50).



### **National insurance contributions**

**4.56** From 1 April 1994 the main rate of employees' national insurance contributions will be increased by 1 percentage point to 10 per cent (51) and the Class 4 rate of contributions for the self-employed will be increased by 1 percentage point to 7·3 per cent (52).

## 4 The Budget measures

**Table 4.1 Direct effects of Budget measures(†)**

	£ million		yield (+)/cost (-) of measure	
	Changes from a non-indexed base	Changes from an indexed base	1993-94	1994-95
<b>INLAND REVENUE</b>				
<b>Income tax</b>				
1 Allowances – unchanged	—	550	750	780
2 Lower rate band – increased to £2 500 for 1993-94	-370	-300	-390	-400
3 Basic rate limit – unchanged	—	110	170	180
4 Married couple's allowance – restricted to 20 per cent etc	—	—	910	1 170
5 Lower rate band – increased to £3 000 for 1994-95	—	—	-320	-450
6 Mortgage interest relief – restricted to 20 per cent	—	—	820	870
7 Car scales – up 8 per cent	100	100	110	110
8 Fuel scales – up 20 per cent and mileage discount abolished	65	65	70	70
9 Car scales – price based charge from 1994-95	—	—	35	80
10 Company vans – new standard charge	10	10	35	30
11 Relocation expenses – reformed	—	—	200	200
<b>Income tax and corporation tax</b>				
12 Taxation of dividends	-100	-100	100	900
13 Payments treated as interest	—	—	75	100
14 Capital losses – restricted for group companies	*	*	100	100
15 Gift Aid – limit reduced	-20	-20	-30	-30
16 Outplacement counselling – exempted	-10	-10	-10	-10
<b>Income tax and capital gains tax</b>				
17 BES – “loan-linked” investments abolished	20	20	100	50
18 Lloyd's underwriters – changed tax treatment	*	*	*	-5
19 Available accommodation rule – abolished	*	*	-10	-10
<b>Corporation tax</b>				
20 Surplus ACT – use restricted	50	50	150	150
21 Controlled foreign companies	—	—	35	50
<b>Corporation tax and capital gains tax</b>				
22 Rollover relief for cwe and suckler cow premiums	*	*	-5	-5
<b>Oil taxation</b>				
23 Petroleum revenue tax – reformed	—	—	300	400
<b>Capital gains tax</b>				
24 Annual exempt amount – unchanged	—	—	5	5
25 Relief for gains in a personal company	*	*	-20	-30
26 Retirement relief – changed	*	*	-10	-20
<b>Inheritance tax</b>				
27 Threshold – unchanged	—	10	25	35
<b>Stamp duties</b>				
28 Land and property – threshold increased	-220	-220	-270	-265
<b>TOTAL INLAND REVENUE</b>	<b>-475</b>	<b>265</b>	<b>2 925</b>	<b>4 055</b>

## 4 The Budget measures

**Table 4.1 Direct effects of Budget measures—continued**

	£ million	yield (+)/cost (-) of measure		
	Changes from a non-indexed base 1993-94	Changes from an indexed base 1993-94	1994-95	1995-96
<b>CUSTOMS AND EXCISE</b>				
<b>Value added tax</b>				
29 VAT on domestic fuel and power	—	—	950	2 300
30 Reform of VAT penalties	-50	-50	-75	-75
31 VAT relief on bad debts	-150	-150	—	—
32 Cash accounting threshold raised	-5	-5	-5	—
33 Relief for Government funded training	-25	-25	-25	-25
34 VAT fuel scale charge up 20 per cent	25	25	35	35
<b>Excise duties on:</b>				
35 beer up 5 per cent	100	45	60	65
36 wine and made-wine up 5 per cent	20	10	15	15
37 cider and perry up 5 per cent	5	*	*	*
38 spirits unchanged	—	-25	-25	-25
39 petrol and derv up 10 per cent (net of car tax recoupment)	380	90	120	70
40 petrol and derv up 3 per cent in real terms in future Budgets	105	105	520	950
41 gas oil and fuel oil up 10 per cent	15	10	10	10
42 fuel substitutes—coverage extended	5	5	5	5
43 cigarettes—specific duty up 10 per cent, ad valorem duty down 1 percentage point	360	230	280	290
44 other tobacco products up 6½ per cent	25	15	15	20
45 most gaming machine licences up 20 per cent	15	15	20	20
46 Lottery duty set at 12 per cent	—	—	*	*
47 Other minor measures	—	—	—	—
<b>TOTAL CUSTOMS AND EXCISE</b>	<b>825</b>	<b>295</b>	<b>1 900</b>	<b>3 655</b>
<b>Vehicle excise duty</b>				
48 Duty on cars etc up to £125	380	310	320	330
49 Freeze most lorry rates	5	-10	-10	-10
<b>TOTAL VEHICLE EXCISE DUTY</b>	<b>385</b>	<b>300</b>	<b>310</b>	<b>320</b>
<b>Business rates</b>				
50 No real increases under transitional arrangements	-370	-370	-260	...
<b>TOTAL BUSINESS RATES</b>	<b>-370</b>	<b>-370</b>	<b>-260</b>	<b>...</b>
<b>National insurance contributions</b>				
51 1 percentage point increase in employees' main rate	—	—	1 750	2 100
52 1 percentage point increase in self-employed Class 4 rate	—	—	40	110
53 Changes to car and fuel benefit scales	—	—	60	65
<b>TOTAL NATIONAL INSURANCE CONTRIBUTIONS</b>	<b>0</b>	<b>0</b>	<b>1 850</b>	<b>2 275</b>
<b>TOTAL</b>	<b>365</b>	<b>490</b>	<b>6 725</b>	<b>10 305</b>

(†) Annex A explains how the revenue effects are calculated.

— = Nil  
 \* = Negligible  
 ... = Not applicable



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# Annex A to Chapter 4:

## How the revenue effects are calculated

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This annex explains how the effects of Budget measures on tax yield are calculated.

### The general approach

The direct effect of a tax change is the difference between the tax yields obtained by applying the post-Budget tax regime and the pre-Budget tax regime to the levels of income, profit etc expected after the Budget.

Since total income and total spending at factor cost are fixed at their post-Budget levels, the estimates of direct effects do not include any effect the tax changes themselves may have on levels of income and spending.

Other effects on behaviour are taken into account where they are likely to have a significant effect on the yield. For example, changes to excise duties influence the pattern of consumer spending.

The estimates take account of any consequential changes in receipts from related taxes. For example, the estimated yield from increasing the excise duty on tobacco includes the change in the yield of VAT on that duty, but also the change in VAT and other excise duties resulting from the new pattern of spending.

The direct effect of some tax changes is affected by the implementation of others. Where this happens, measures are costed in the order in which they appear in Table 4.1.

In the first column of the table the pre-Budget regime is simply the regime of allowances, thresholds and rates of duty which applied in 1992–93.

The remaining three columns strip out the effects of inflation on the tax system by assuming that allowances, thresholds and rates of duty are increased in line with prices in this and in future Budgets. Measures announced in this Budget are assumed to be indexed in the same way in future Budgets.

### The move to a November Budget

This year the estimates need to take account of the fact that the normal date of the Budget is being brought forward from March to November. In line with the Chancellor's decisions on indexation provisions and the timing of tax changes, the following assumptions are made in calculating the indexed base:

- March 1993 Budget:** allowances, thresholds and rates of duty raised in line with the increase in the RPI over the year to December 1992 (2.6 per cent);
- November 1993 Budget:** allowances and thresholds raised in April 1994 in line with an assumption for the increase in the RPI over the year to September 1993 (2 per cent). Rates of excise duty rise on Budget day (1 January 1994 for alcohol) in line with the assumed increase in the RPI over nine months to September 1993 (2 per cent). (This assumption for excise duties also applies to the first column of the table.)
- November 1994 Budget:** excise duties rise on Budget day (1 January 1995 for alcohol) and allowances and thresholds in April 1995 in line with the assumed increase in the RPI over 12 months to September 1994 (3 $\frac{3}{4}$  per cent).

–**November 1995 Budget:** rates of excise duty rise on Budget day (1 January 1996 for alcohol) in line with the assumed rise in the RPI in the year to September 1995 ( $3\frac{1}{4}$  per cent).

The RPI assumptions for the November 1993, 1994 and 1995 Budget are stylised figures compatible with the projections of the RPI excluding mortgage interest payments shown in Chapters 2 and 3, on the assumption that interest rates remain unchanged at current levels.

### Notes on individual Budget measures

- Inland Revenue taxes**
- 1, 3** Under statutory indexation the allowances and limits would have risen by 2.6 per cent.
- 6** Assumes interest rates are unchanged from current levels. There will also be a reduction in public spending of £80 million in 1994–95 and £90 million in 1995–96 on mortgage interest relief for borrowers who are non-taxpayers or liable only at the lower rate of income tax.
- 9** Assumes average list prices of cars will increase by 3 per cent a year. The new charge would produce the same yield in 1993–94 as the 1993–94 scale charges.
- 10** Yield under the current system is estimated at about £5 million a year. Part of the 1994–95 yield is delayed receipt of tax for 1993–94. The 1995–96 yield assumes about 350 000 vans will be taxable in 1995–96.
- 12** The estimates of revenue effects assume levels of dividends are unaffected, and include the fall in ACT payments by companies, the fall in tax credits paid to non-taxpayers and exempt institutions, the extra income tax payments by higher rate taxpayers and discretionary trusts and the increase in companies' mainstream corporation tax payments. The yield of the changes after 1995–96 is expected to be about £1 billion per year. Chapter 5 gives details of the transitional scheme of relief for charities.
- 14** The yield represents the estimated direct effect of the measure on the existing level of capital loss buying activity. Without this measure there could be a more significant loss of tax in the future.
- 18** These proposals will not affect receipts significantly before 1995–96 and are expected to be broadly revenue neutral over a period.
- 20, 21** The yields represent the estimated direct effect of the measures on the existing level of activity. Without these measures there could be a more significant loss of tax in the future.
- 23** The figures allow for effects on corporation tax receipts and estimates of the effects of the reform on North Sea activity.
- 24, 27** Under statutory indexation, the capital gains tax annual exempt amount and the inheritance tax threshold would have risen by 2.6 per cent.
- Customs and Excise taxes**
- 35–45** The effect of moving the Budget date from March to late November is to reduce yield from excise duties in 1993–94 by about £100 million. This is because there is usually a rise in clearances of excise goods before the Budget and a fall afterwards. 1993–94 will include two post-Budget dips, and this will depress receipts over the year as a whole. This is taken into account in the forecast, but not scored as a Budget measure.
- 39** These figures show the increased yield from road fuel duties which goes beyond what is required to recoup the cost of car tax abolition announced in the Autumn Statement. See Annex B.
- 46** Duty from the lottery will be broadly offset by reductions in receipts from betting and other taxes on spending.

**47** The Finance Bill will include a number of minor measures which individually and collectively have no revenue effect:

- measures to end the refund of duty on beer returned to bond following the introduction of the new beer end product duty on 1 June 1993;
- a revised definition of beer;
- a provision to tax any wine in bottles with mushroom stoppers as sparkling wine irrespective of pressure;
- reducing the maximum permitted level of fortification of wine from 23 per cent alcohol by volume to 22 per cent. This brings it into line with the maximum level permitted for made wine which was increased from 18.3 per cent to 22 per cent on 1 January 1993;
- taxing all alcoholic drinks over 22 per cent alcohol by volume at the spirits duty rate;
- an anti-avoidance measure to ensure that the correct rate of duty is paid on blended drinks;
- allowing imported spirits denatured to the requirements of other EC member states to benefit from the duty exemption for methylated spirits denatured to UK requirements;
- to levy hydrocarbon oil duties on volumes calculated at a standard temperature of 15 degrees Celsius rather than the ambient temperature;
- to extend the existing provisions in EC directives for mutual assistance and mutual recovery of VAT and customs duties to excise duties;
- existing arrangements for refunding duty on beer exported to the Isle of Man are to be repealed when agreement is reached between the UK and the Isle of Man Government on making beer duty a shared revenue.

**Vehicle excise duties** **48** Includes changes to motorcycles and other minor rates.

**Business rates** **50** The cost in 1995-96 is not known since it will depend on the transitional arrangements, if any, introduced following the 1995 revaluation.

**National insurance contributions** **52** Takes account of the fact that half of Class 4 NIC charges can be offset against self-employment income charged to income tax.

# Annex B to Chapter 4:

## Tax changes announced before the Budget

This annex sets out a number of tax changes which were announced before the Budget, the effects of which are taken into account in the forecasts.

**Table 4B.1 Direct effects of measures announced since the 1992 Budget**

	£ million	yield (+)/cost (-)		
	Changes from a non-indexed base	Changes from an indexed base		
	1993-94	1993-94	1994-95	1995-96
<b>Inland Revenue taxes</b>				
B1 Enhanced capital allowances	-200	-200	-500	50
B2 UK branches of overseas life assurance companies	---	---	15	20
B3 Postponed abolition of stamp duties on securities etc	1020	1020	40	-50
<b>Customs and Excise taxes</b>				
B4 Abolition of car tax	-750	-750	-800	-870
B5 Offsetting increase in fuel duties	750	750	800	870
B6 Restructuring of wine duty	-5	-5	-10	-20
<b>Total</b>	<b>815</b>	<b>815</b>	<b>-455</b>	<b>0</b>

--- = Nil

### **Inland Revenue taxes**

**B.1** Enhanced capital allowances were announced in the Autumn Statement on 12 November 1992 for the period from 1 November 1992 to 31 October 1993. For most investment in machinery and plant, a 40 per cent first year allowance replaces the existing 25 writing down allowance. New industrial and agricultural buildings contracted for in the qualifying period, and brought into use by 31 December 1994, will qualify for a 20 per cent initial allowance. Tax yields in 1995-96 and later years rise because relief on the balance of expenditure will be smaller.

**B.2** For accounting periods beginning on or after 1 January 1993, UK branches of overseas life assurance companies will be taxed by reference to their actual income, superseding the arrangements under which most of them were assessed on a proportion of their worldwide investment income. The full year yield is expected to reach about £50 million.

**B.3** The abolition of stamp duty on securities was announced in the 1990 Budget. The abolition of stamp duties on transfers of property other than land and buildings was announced in the 1991 Budget. The intention was that this should coincide with the introduction of the TAURUS system of paperless trading. In the light of the Stock Exchange's decision to abandon TAURUS, it is now assumed that stamp duties on securities etc remain in place, at least during 1993-94, pending the outcome of a review by the Bank of England of possible alternatives to TAURUS. The previously assumed abolition date was 1 April 1993. The revenue effects include the consequential effects on other taxes.



**Customs and Excise taxes** **B.4** Car tax was abolished in the Autumn Statement on 12 November 1992, having been halved to 5 per cent in the March 1992 Budget.

**B.5** The Chancellor announced in the Autumn Statement that the cost of abolishing car tax would be recouped from other taxes on motoring.

**B.6** A single duty band covering wines between 15 and 22 per cent alcohol by volume was introduced on 1 January 1993 to implement the EC directive on the structure of excise duties on alcohol. There is a small revenue loss because the new restructured rate is slightly less than the lower of the two duty bands it replaced.

**Table 4B.2 Direct effects of measures announced in the 1992 Budget or earlier which do not take effect before 1993–94**

	£ million		yield (+)/cost (-)		
	Changes from a non-indexed base	1993–94	Changes from an indexed base		
			1993–94	1994–95	1995–96
<b>Inland Revenue taxes</b>					
B7 K codes		200	200	—	—
B8 Abolition of BES for trading companies		*	*	20	100
<b>Customs and Excise taxes</b>					
B9 Switch to beer end product duty		-200	-200	—	—
<b>National insurance contributions</b>					
B10 Reduction in contracted out rebate and change to incentive payments		990	990	2 140	2 350
<b>Total</b>		<b>990</b>	<b>990</b>	<b>2 160</b>	<b>2 450</b>

— = Nil

\* = Negligible

**Inland Revenue taxes** **B.7** A new type of PAYE code (the K code) is introduced from 1993–94. These codes will mainly be used to collect tax on large benefits packages through PAYE, instead of by assessment at the end of the tax year. This will lead to earlier payment of tax in some cases and a one-off cash flow gain to the Exchequer in 1993–94. There is no change to tax liabilities. These arrangements were announced on 24 October 1991.

**B.8** The Business Expansion Scheme for trading companies will be abolished from the end of 1993, when the relief for private rented housing expires. Legislation was included in the Finance (No 2) Act 1992. The full year yield of £100 million reflects the current forecast of levels of investment in trading companies which might have occurred without the abolition of “loan-linked” investments.

**Customs and Excise taxes** **B.9** The Chancellor announced in the 1991 Budget that beer duty would be charged on the end product rather than at the fermentation stage. The Paymaster General announced in October 1992 that the change would take place on 1 June 1993. The new end product duty is designed on average to raise the same revenues as the duty it replaces, but there will be a one-off cost of £200 million because the new duty will be charged later, when beer is released on distribution for consumption, rather than at an early stage of the production process.

**National insurance contributions**

**B.10** It was announced on 27 February 1992 that, from April 1993, the national insurance rebate for employees contracted out of SERPS would be reduced from 3·8 per cent to 3·0 per cent for employers; and from 2·0 per cent to 1·8 per cent for employees.

From April 1993 the 2 per cent incentive payment for appropriate personal pensions and new contracted out schemes ends, and a 1 per cent additional payment for personal pension holders aged 30 and over begins.

# 5 Public expenditure

**5.01** The Government's expenditure plans for the next three years were announced in the 1992 Autumn Statement (Cm 2096) and set out in detail in Departmental Reports and the Supplement to the Autumn Statement (Cm 2201–2219). They are summarised in Table 5.1.

**Table 5.1 Public expenditure**

	£ billion				
	1991–92 Outturn	1992–93 Estimated outturn	1993–94 Plans	1994–95 Plans	1995–96 Plans
<b>Central government expenditure<sup>1</sup></b>	<b>144.6</b>	<b>158.1</b>	<b>166.4</b>	<b>172.2</b>	<b>176.9</b>
Of which:					
Department of Social Security <sup>2</sup>	51.0	56.5	59.6	61.1	64.5
Department of Health and OPCS	25.5	28.1	29.1	30.4	31.5
Ministry of Defence <sup>3</sup>	23.0	23.7	23.5	23.8	23.2
Scotland	6.0	6.5	7.3	7.7	7.9
Wales	2.6	3.0	3.4	3.5	3.6
Northern Ireland <sup>2</sup>	5.9	6.6	6.9	7.0	7.3
Other departments	30.5	33.8	36.6	38.7	38.8
<b>Central government support for local authorities</b>	<b>53.3</b>	<b>59.2</b>	<b>58.4</b>	<b>61.5</b>	<b>63.9</b>
Of which:					
revenue support grant	13.6	21.8	22.3	} 37.9	39.8
non-domestic rate payments	14.3	14.0	13.2		
current specific grants	19.7	17.3	17.0	17.8	18.3
credit approvals	4.4	4.6	4.2	4.2	4.2
capital grants	1.3	1.5	1.8	1.6	1.6
<b>Local authority self-financed expenditure</b>	<b>11.0</b>	<b>10.0</b>	<b>11.1</b>	<b>11.0</b>	<b>10.8</b>
<b>Financing requirements of nationalised industries</b>	<b>2.5</b>	<b>3.5</b>	<b>3.9</b>	<b>1.9</b>	<b>1.7</b>
<b>Reserve</b>			<b>4.0</b>	<b>7.0</b>	<b>10.0</b>
<b>New control total</b>	<b>211.4</b>	<b>230.9</b>	<b>243.8</b>	<b>253.6</b>	<b>263.3</b>
Cyclical social security <sup>4</sup>	10.9	13.3	15.1	16	17
Central government debt interest <sup>4</sup>	16.3	17.5	19.4	23½	26
Accounting adjustments <sup>4</sup>	5.5	6.2	7.5	8½	9½
<b>General government expenditure, excluding privatisation proceeds</b>	<b>244.1</b>	<b>268.0</b>	<b>285.8</b>	<b>302</b>	<b>315</b>
Privatisation proceeds	–7.9	–8.1	–5.5	–5.5	–1.0

<sup>1</sup> Includes the financing requirements of public corporations other than the nationalised industries.

<sup>2</sup> Excluding cyclical social security shown in the lower part of the table.

<sup>3</sup> Spending by Ministry of Defence in 1991–92 is shown net of overseas governments' contributions to the cost of the Gulf conflict.

<sup>4</sup> 1994–95 and 1995–96 figures rounded to nearest £½ billion.

**Changes from the previous Budget**

**5.02** The Chancellor announced a new system of public expenditure control in the 1992 Autumn Statement. From 1993–94 onwards spending will be planned in terms of a new expenditure aggregate, the new control total. The growth in the new control total will be constrained to a rate which ensures that total public spending grows by less than the economy as a whole over time. The composition and operation of the new control total were described in Annex C to Chapter 2 of the 1992 Autumn Statement and in the Autumn 1992 issue of the Treasury Bulletin.

**5.03** The control total for 1993–94 was set in the Autumn Statement at £243.8 billion. This is consistent with the previous plans for the planning total set in the 1991 Autumn Statement, after classification changes are taken into account. For 1994–95 and 1995–96 the control total was set at £253.6 billion and £263.3 billion, respectively.

**5.04** Table 5.1 sets out projections of general government expenditure (excluding privatisation proceeds). These take account of revisions to central government debt interest projections reflecting the latest fiscal projections. The projections for cyclical social security spending have been updated to take account of higher levels of unemployment since the Autumn Statement, and a reassessment of the level of cyclical spending within overall benefit expenditure.

**Public spending trends**

**5.05** The Government's objective for public expenditure is that it should take a declining share of national income over time, while value for money is constantly improved. To meet this objective, public spending needs to grow more slowly over time than the economy as a whole.

**5.06** The public spending objective is expressed in terms of the ratio of GGE, excluding privatisation proceeds, to GDP. The ratio fell sharply between 1984–85 and 1988–89 (see Chart 5.1). These were years of strong economic growth; real GDP rose by about 18 per cent, while GGE was virtually unchanged in real terms for most of the period.

**5.07** The effect of the cycle has been to increase spending in areas such as social security and to reduce GDP relative to trend. This is expected to push up the ratio to 45½ per cent in 1993–94, after which it is expected to resume its downward trend.

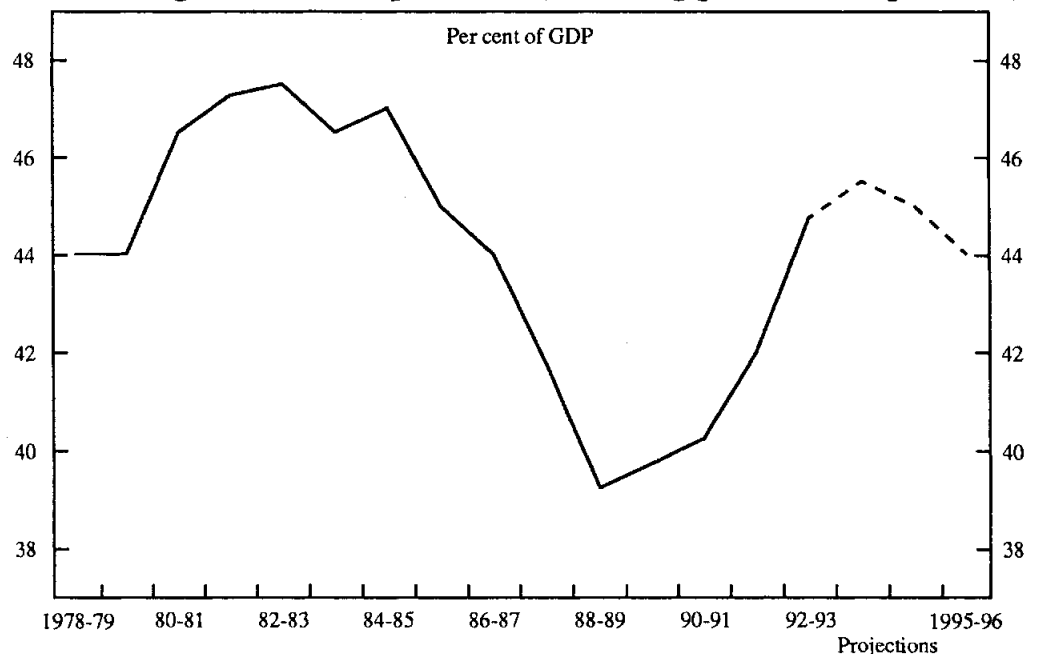
**5.08** Table 5.2 shows the projected path of real GGE and the GGE ratio, taking account of the new assumptions about money GDP shown in Chapter 2. The ratio in the current year is likely to be 44¾ per cent.

**Table 5.2 General government expenditure**

	£ billion				
	1991–92	1992–93	1993–94	1994–95	1995–96
<b>General government expenditure, excluding privatisation proceeds</b>					
cash	244.1	268.0	285.8	302	315
real terms <sup>1</sup>	244.1	259.2	269.0	273	275
per cent of GDP	42	44¾	45½	45	44

<sup>1</sup> Base year 1991–92.

Chart 5.1 General government expenditure (excluding privatisation proceeds)



**Budget measures** 5.09 Provision has been made for an extra 100 000 opportunities enabling unemployed people to undertake vocational courses, carry out voluntary work or set up in business. Two new measures will be introduced in 1993–94 – a vocational education initiative and a Community Action programme – and the existing Business Start-up scheme will be expanded. In addition, a £25 million TEC Challenge fund is being created to stimulate new ways of helping the unemployed; and four pilots will be launched to test the effectiveness of paying subsidies to encourage recruitment of long-term unemployed people. The net cost (after benefit savings) will be around £125 million, of which around £55 million is expected to fall in 1993–94.

5.10 A new four year scheme of special payments to charities will ease the transition to the system of reduced tax credits on dividends. The costs of this scheme are estimated to be £20 million in 1993–94, £35 million in 1994–95 and £30 million in 1995–96.

5.11 Planned improvements to the Loan Guarantee Scheme are estimated to cost £30 million over the next three years.

5.12 The public expenditure costs of these measures will be met within the new control totals and will not add to planned expenditure.

**Export Credit** 5.13 For 1993–94 premiums paid by exporters for medium or long-term ECGD cover will be reduced by  $7\frac{1}{2}$  per cent on average compared with 1992–93. In addition extra cover totalling £1 300 million will be provided over the next three years for markets where ECGD's exposure is already large taking account of the risk involved. The additional cover does not count as public expenditure or against the PSBR, but could lead to additions to the PSBR in future years if ECGD's guarantees are called.

**1992–93 outturn** 5.14 The plans for the current year were set in the 1991 Autumn Statement on the basis of the planning total. Table 5.3 shows the estimated outturn for the planning total by spending sector. Cyclical social security spending – unemployment benefit and income support to non-pensioners – is included

in Table 5.3 with other central government spending. The estimated outturn for the planning total, which is still subject to some uncertainty, is £226.1 billion. The outturn is £0.7 billion above the plans set in the 1991 Autumn Statement, reflecting the cost of the housing package announced in the 1992 Autumn Statement.

**Table 5.3 The planning total in 1992–93, plans and estimated outturn by spending sector**

	£ billion		
	Plans <sup>1</sup>	Estimated outturn	Outturn minus plans
Central government expenditure <sup>2</sup>	167.6	171.4	3.9
Central government support for local authorities	58.4	59.2	0.8
Financing requirements of nationalised industries	3.4	3.5	0.1
Privatisation proceeds	-8.0	-8.1	-0.1
Reserve	4.0	—	-4.0
<b>Planning total</b>	<b>225.4</b>	<b>226.1</b>	<b>0.7</b>

<sup>1</sup> Plans set out in the 1991 Supplement to the Autumn Statement, adjusted for classification changes (see Annex B to Chapter 2 of the 1992 Autumn Statement).

<sup>2</sup> See footnote 1 to Table 5.1.

**5.15** The largest changes between the programme plans and the estimated outturn are:

**Central government:** higher social security spending, reflecting the effects of economic cycle (£3.0 billion) - some £1.8 billion of this falls on cyclical social security; higher spending on Housing reflecting the Autumn Statement housing measures package (£0.7 billion); higher health spending (£0.5 billion); partly offset by lower net contributions to the European Community (-£0.6 billion).

**Support for local authorities:** higher housing benefit grant (£0.5 billion); and higher student awards (£0.3 billion).

**Financing requirements of the nationalised industries:** higher external finance for British Coal (£0.4 billion) reflecting higher restructuring costs, partly offset by lower spending in this financial year by London Transport reflecting the delayed start of work on the Jubilee Line Extension (-£0.2 billion).

**Composition of the new control total**

**5.16** About three quarters of the control total will be voted by Parliament. Voted expenditure covers the spending of government departments for their own activities, their funding of other central government bodies such as the National Health Service and most of central government's support for local authorities. The most significant non-voted components of the control total are non-cyclical social security benefits paid out of the National Insurance Fund, local authority credit approvals and local authority self-financed expenditure.

**5.17** Table 5.4 shows voted and other expenditure by spending sector for 1991–92 and 1992–93 together with the plans for future years set out in the Supplement to the 1992 Autumn Statement.

## 5 Public expenditure

**Table 5.4 The new control total: voted and other expenditure, by spending sector**

	£ billion				
	1991-92 Outturn	1992-93 Estimated outturn	1993-94 Plans	1994-95 Plans	1995-96 Plans
<b>Central government expenditure<sup>1,2</sup></b>	<b>144.6</b>	<b>158.1</b>	<b>166.4</b>	<b>172.2</b>	<b>176.9</b>
Of which:					
Voted in Estimates	103.6	110.9	116.2	119.4	122.4
Other	40.9	47.2	50.2	52.8	54.6
<b>Central government support for local authorities<sup>3</sup></b>	<b>53.3</b>	<b>59.2</b>	<b>58.4</b>	<b>61.5</b>	<b>63.9</b>
Of which:					
Voted in Estimates	47.7	53.6	54.4	57.4	59.8
Other	5.6	5.7	4.0	4.1	4.1
<b>Financing requirements of nationalised industries</b>	<b>2.5</b>	<b>3.5</b>	<b>3.9</b>	<b>1.9</b>	<b>1.7</b>
Of which:					
Voted in Estimates	2.4	3.3	3.9	2.2	2.4
Other	0.1	0.2		-0.3	-0.7
<b>Local authority self-financed expenditure (non-voted)</b>	<b>11.0</b>	<b>10.0</b>	<b>11.1</b>	<b>11.0</b>	<b>10.8</b>
<b>Reserve</b>			<b>4.0</b>	<b>7.0</b>	<b>10.0</b>
<b>New control total</b>	<b>211.4</b>	<b>230.9</b>	<b>243.8</b>	<b>253.6</b>	<b>263.3</b>

<sup>1</sup> Includes the financing requirements of public corporations other than the nationalised industries as follows:

1.2                      1.7                      1.6                      1.6                      1.6

<sup>2</sup> Classification changes made in the 1992 Survey which will affect the level of voted spending within the control total from 1993-94 are treated in this table as applying also to 1991-92 and 1992-93.

<sup>3</sup> Non-domestic rate payments in Scotland will be voted in Estimates from 1993-94 onwards.

**Supply Estimates 5.18** The total main Estimates provision for 1993-94 for which the Government is seeking Parliamentary approval is shown in Table 5.5. The main Estimates were published in a series of booklets on 9 March 1993 with a Summary and Guide (Cm 2230) which explains how they relate to the control total and describes the Supply procedure.

**5.19** Of the £202.7 billion included in the main Supply Estimates, £174.4 billion is within the control total. The remaining £28.3 billion includes income support to non-pensioners in Great Britain, which is part of cyclical social security, and transfers between public sector bodies which do not score in the control total. Some 60 per cent of the money voted in Estimates is subject to cash limits.

**Table 5.5 Supply expenditure**

	£ billion			
	1991-92 Expected outturn in 1992 Budget	Final outturn	1992-93 Expected outturn	1993-94 Provision in main Estimates
Main Supply Estimates	156.7	156.7	184.5	202.7
Supplementaries and net underspending	11.7	10.9	5.4	
<b>Total Supply expenditure</b>	<b>168.5</b>	<b>167.7</b>	<b>189.9</b>	





# 6 The public sector finances

**6.01** This chapter brings together revenue (discussed in Chapter 4) and spending (Chapter 5) and provides an analysis and forecast of the public sector's overall financial position in 1992–93 and 1993–94. It begins with the latest forecasts for the public sector borrowing requirement (PSBR) in 1992–93 and 1993–94 and for the associated stock of debt outstanding. It then shows where the latest forecasts for 1992–93 differ from those in the last Budget and Autumn Statement. The remaining sections analyse in more detail:

- general government receipts and expenditure;
- the behaviour of individual sectors: central government, local authorities and public corporations; and
- revenue and expenditure by economic category.

## Public sector borrowing requirement and the stock of debt

**PSBR 6.02** The latest forecast for 1992–93 is for a PSBR of £35.1 billion, equivalent to  $5\frac{3}{4}$  per cent of GDP. This follows a PSBR of £13.8 billion ( $2\frac{1}{4}$  per cent of GDP) in 1991–92. The estimate for 1992–93 is still uncertain. The average error in past Budget forecasts for the estimated current year outturn is around £1 billion in today's terms.

**Table 6.1 Public sector borrowing requirement**

	1991–92	1992–93		1993–94
	Outturn	1992 Budget	Latest estimate	Forecast
<b>Public sector borrowing requirement</b>				
£ billion	13.8	28.1	35.1	50.1
per cent of GDP	$2\frac{1}{4}$	$4\frac{1}{2}$	$5\frac{3}{4}$	8
<b>PSBR excluding privatisation proceeds</b>				
£ billion	21.7	36.1	43.1	55.6
per cent of GDP	$3\frac{3}{4}$	$5\frac{3}{4}$	$7\frac{1}{4}$	$8\frac{3}{4}$

**6.03** The rise in the PSBR in 1992–93 largely reflects the impact of recession. Revenues have hardly increased at all in cash terms in 1992–93; general government receipts are now estimated to be only  $\frac{3}{4}$  per cent higher than in 1991–92. But public expenditure has continued to rise quite rapidly.

**6.04** Even with the recovery in economic activity forecast for 1993, the impact of the recession will continue to be felt on the public finances in 1993–94. Growth in tax revenues is likely to be slow, with a recovery in expenditure taxes being offset by continued weakness in receipts from those taxes collected in arrears, including mainstream corporation tax and income tax on self-employment income. And the Autumn Statement plans provide for a further significant rise in public expenditure in 1993–94, in part

reflecting the upward pressure of the recession on the social security programme. As a result of these factors, and taking into account the tax changes announced in the Budget, the PSBR in 1993–94 is forecast at £50.1 billion, or 8 per cent of GDP. This estimate is subject to a wide margin of error; the average error over the past 10 years on Budget forecasts of the PSBR for the year ahead is £6½ billion in today's terms.

**Public sector debt 6.05** At the beginning of the current financial year, the net stock of public sector debt stood at £168 billion, 28¼ per cent of GDP. The latest estimate of the PSBR for 1992–93 implies a rise in the debt/GDP ratio to 33½ per cent at end-March 1993 and the forecast for 1993–94 implies a further rise to 39¼ per cent at end-March 1994.

### Changes since Budget and Autumn Statement

**6.06** The latest forecast for the PSBR in 1992–93 is £7 billion higher than the forecast in last year's Budget, but £2 billion lower than the revised forecast in the Autumn Statement. As Table 6.2 shows, much the greater part of the revision since last year's Budget forecast is explained by lower receipts, reflecting weaker than expected economic activity, in particular lower than expected earnings and employment. General government expenditure is also higher than in last year's Budget forecast, in part due to the spending measures announced in the Autumn Statement. The revisions to receipts are discussed in more detail in paragraph 6.09, and the expenditure revisions in paragraph 6.16.

**6.07** Since the Autumn Statement, the forecast of receipts in 1992–93 has been revised up by around £¾ billion, and the expenditure forecast has been revised down by over £1 billion.

**Table 6.2 Changes since 1992 Budget and Autumn Statement**

	£ billion		
	Changes since 1992 Budget		Changes since Autumn Statement
	1991–92	1992–93	1992–93
<i>Expenditure</i>			
Privatisation proceeds	—	–0.1	–0.1
Other general government	–0.3	+1.5	–0.8
Public corporations' market and overseas finance	+0.3	–0.4	–0.2
<b>Total expenditure</b>	<b>—</b>	<b>+1.1</b>	<b>–1.1</b>
<i>Receipts</i>			
Inland Revenue taxes	–0.7	–4.7	–0.4
Customs and Excise taxes	—	–4.0	–0.2
Social Security receipts	+0.4	–1.3	–0.5
Other receipts	+0.3	+4.2	+1.9
<b>Total receipts</b>	<b>—</b>	<b>–5.9</b>	<b>+0.8</b>
<b>PSBR</b>	<b>—</b>	<b>+7.0</b>	<b>–1.9</b>

### Public sector finances: receipts and expenditure

**6.08** Table 1.2 gives the latest estimates for 1992–93, and forecasts for 1993–94, of general government expenditure and receipts and their components.

**Receipts 6.09** General government receipts are estimated to have risen by only  $\frac{3}{4}$  per cent in 1992–93, compared with a  $3\frac{1}{4}$  per cent rise in money GDP. Within the total:

- Inland Revenue receipts have fallen by £4 billion in nominal terms. The shortfall on the 1992 Budget forecast – which anticipated no change on 1991–92 – is due to lower receipts of both income tax and corporation tax;
- PAYE income tax has been held back by slower growth in wages and salaries than originally expected. Employment has been lower, and so has been the rate of earnings growth. Tax on self-employment income and other personal income has also fallen below the levels forecast last year;
- corporation tax receipts are now estimated to have fallen by £2½ billion in 1992–93, because of the rate cuts announced in the 1991 Budget, lower company profits and higher repayments. The downward revision to 1992–93 receipts since last year's Budget forecast reflects lower than expected profits and higher than expected tax repayments from the carry-back of losses and advance corporation tax (ACT). ACT, paid on the distribution of dividends, has remained remarkably firm (Chart 6.1);
- Customs and Excise receipts are expected to be £1¾ billion ( $2\frac{3}{4}$  per cent) up on 1991–92, largely driven by VAT. But again, this is less than anticipated in last year's Budget forecast, because consumer spending has turned out weaker. The abolition of car tax announced in the Autumn Statement has little effect on receipts in 1992–93;
- lower wages and salaries have also reduced social security receipts by £1¼ billion compared with the 1992 Budget forecast;
- lower Inland Revenue and Customs and Excise taxes and social security receipts are partially offset by £4 billion more other receipts than forecast, including £¾ billion higher community charge receipts, mainly reflecting better collection. Most of the remaining difference is on central government and local authority miscellaneous transactions, a disparate collection of identified transactions and timing and accounting adjustments. The large number estimated for 1992–93 mainly reflects the fact that borrowing – for which there is up-to-date monthly data – has been running at a lower level than can be fully explained by the available information on income and expenditure flows.

**6.10** Receipts are forecast to rise by  $2\frac{1}{4}$  per cent in 1993–94, which is again lower than money GDP growth ( $4\frac{3}{4}$  per cent). The Budget tax measures themselves will increase tax receipts in 1993–94 by £½ billion compared with an indexed base. 1993–94 tax receipts will also be affected by a number of other tax changes which have already been announced. Postponement of the abolition of stamp duty on securities will yield around £1 billion. And social security receipts will be higher as a result of changes to the contracted out rebate. The abolition of car tax implemented last November is being recouped by an increase in fuel duties, but there will be some loss of tax receipts compared with 1992–93 – around £½ billion in total – from the second year effects of the 1992 Budget.

**6.11** The forecast also takes account of the unified Budget in November, which it is assumed will index allowances and thresholds for direct taxes and revalorise excise duties in line with inflation (except for fuel duties, which it is assumed will be raised by 3 per cent more than inflation, as announced in the Budget). The new allowances and thresholds for direct taxes will not apply until the following April, but the increases in excise duties are expected to take effect immediately (except for duties on alcohol which would be raised on 1 January 1994).

**6.12** More specifically, the forecast for 1993–94 is for:

- a 2 per cent rise in income tax receipts, following an estimated  $1\frac{3}{4}$  per cent fall in 1992–93. This rise is mainly due to the Budget measures, which will add around  $\pounds\frac{1}{2}$  billion to PAYE receipts relative to an indexed base and in addition substantially reduce payments of tax credits on dividends to tax-exempt institutions. Abstracting from the Budget measures, growth in PAYE receipts is likely to be modest, reflecting anticipated low growth in wages and salaries. And non-PAYE income tax receipts are expected to fall, one factor being reduced interest income (from lower interest rates);
- a further fall of 7 per cent in corporation tax receipts. Most of this fall reflects lower ACT, as a result of the Budget changes. Mainstream corporation tax receipts may be a little lower, but the fall is expected to be much smaller than those seen in the previous two years;
- a  $6\frac{1}{2}$  per cent increase in Customs and Excise receipts. VAT is expected to be relatively buoyant as a result of growth in nominal consumers' expenditure of around 6 per cent;
- a  $4\frac{1}{2}$  per cent rise in social security receipts, after taking account of the reduction in the contracted out rebate which takes effect in April;
- a 3 per cent fall in national non-domestic rates, partly due to measures taken in this and last year's Budgets and partly reflecting a falling tax base due to the recession;
- a 6 per cent fall in net receipts of community charge and council tax from a 1992–93 level boosted by collection of arrears from earlier years.

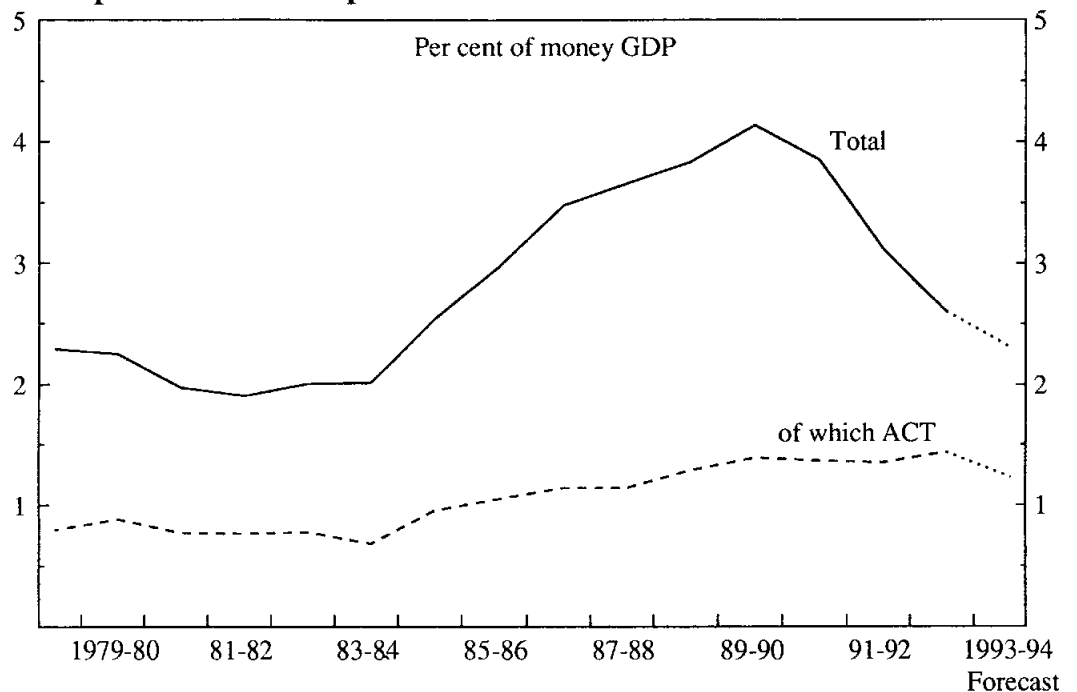
**6.13** North Sea revenues in 1992–93 are now estimated at  $\pounds 1\frac{1}{4}$  billion, similar to the forecast in last year's Budget, and a little higher than in 1991–92. Substantial tax-relievable expenditure on investment has again led to very low PRT receipts. 1993–94 is expected to see an increase in revenues to  $\pounds 2\frac{1}{4}$  billion, as a result of lower tax-relievable expenditure, a firmer sterling oil price and a projected rise in oil and gas output. Even so, North Sea revenues will still account for only around 1 per cent of total taxes, as against over 9 per cent in 1984–85.

Table 6.3 North Sea revenues

	£ billion			
	1991-92	1992-93		1993-94
	Outturn	1992 Budget	Latest estimate	Forecast
North Sea corporation tax <sup>1</sup>	0.6	0.6	0.7	0.8
Petroleum revenue tax (PRT)	-0.2	0.1	—	0.6
Oil royalties	0.6	0.5	0.5	0.7
<b>Total North Sea revenues</b>	<b>1.0</b>	<b>1.2</b>	<b>1.3</b>	<b>2.2</b>
<sup>1</sup> Before ACT set-off of:	0.4	0.3	0.5	0.6

**Taxes as a share of GDP** 6.14 Table 6.4 and Chart 6.2 show total taxes and social security contributions as a per cent of GDP. The tax/GDP ratio is estimated to have fallen substantially in 1992-93 to 34½ per cent – 2½ percentage points below its pre-recession level in 1989-90. Most of the fall reflects the impact of the recession; corporation tax receipts in particular have fallen from 4¼ per cent of GDP in 1989-90 to 2½ per cent in 1992-93, which accounts for over half of the total fall in the tax/GDP ratio over this period (Chart 6.1). Income tax revenues have fallen quite sharply as a percent of GDP in 1992-93; less than half of this fall can be attributed to the 1992 Budget.

Chart 6.1 Corporation tax receipts



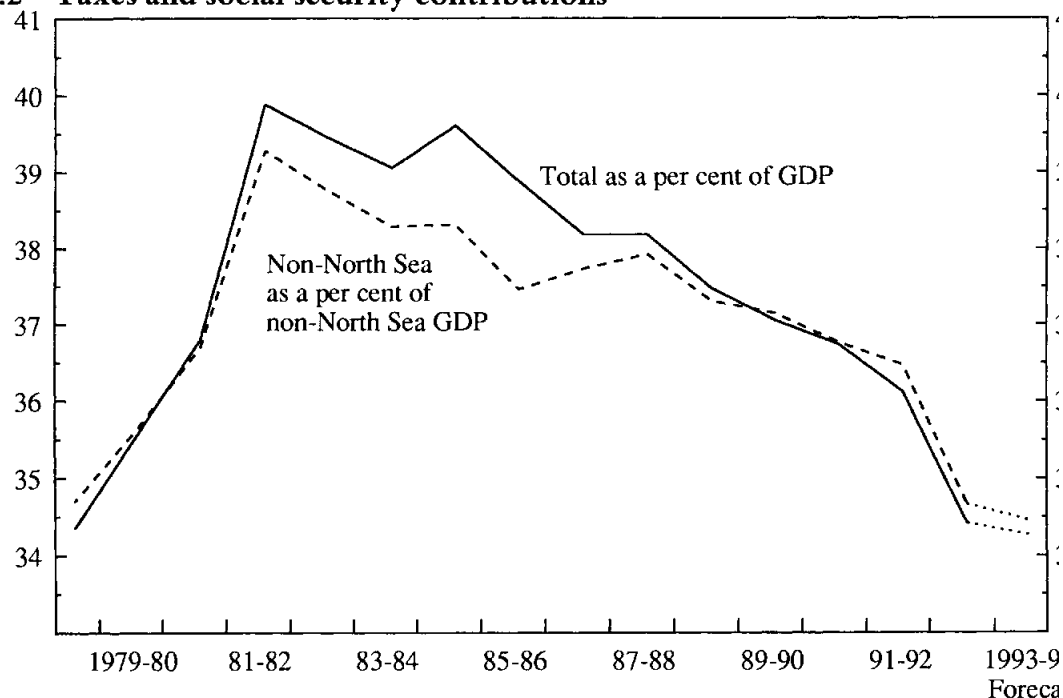
6.15 The tax/GDP ratio is projected to fall a little further in 1993-94. The recession will still be having an impact on receipts of those taxes which are collected in arrears, for example mainstream corporation tax and income tax on self-employment incomes. And PAYE receipts and social security contributions will continue to grow relatively slowly as a consequence of low wages and salaries growth.

**Table 6.4 Taxes<sup>1</sup> and social security contributions as a percent of GDP**

per cent of total GDP	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93 Latest estimate	1993-94 Forecast
<b>Total taxes<sup>1</sup> and social security contributions</b>	<b>38<math>\frac{1}{4}</math></b>	<b>37<math>\frac{1}{2}</math></b>	<b>37</b>	<b>36<math>\frac{3}{4}</math></b>	<b>36</b>	<b>34<math>\frac{1}{2}</math></b>	<b>34<math>\frac{1}{4}</math></b>
of which:-							
Income tax	9 $\frac{3}{4}$	9 $\frac{1}{4}$	9 $\frac{1}{2}$	10	10	9 $\frac{1}{4}$	9 $\frac{1}{4}$
Corporation tax	3 $\frac{3}{4}$	4	4 $\frac{1}{4}$	3 $\frac{3}{4}$	3 $\frac{1}{4}$	2 $\frac{1}{2}$	2 $\frac{1}{4}$
VAT	5 $\frac{3}{4}$	6	5 $\frac{3}{4}$	5 $\frac{1}{2}$	6 $\frac{1}{4}$	6 $\frac{1}{4}$	6 $\frac{1}{2}$
Excise duties <sup>2</sup>	4 $\frac{1}{2}$	4 $\frac{1}{4}$	4 $\frac{1}{4}$	4	4 $\frac{1}{4}$	4 $\frac{1}{4}$	4 $\frac{1}{2}$
Social security contributions	7	7	6 $\frac{1}{2}$	6 $\frac{1}{2}$	6 $\frac{1}{4}$	6 $\frac{1}{4}$	6 $\frac{1}{4}$
Community charge/council tax and rates	4	4	4	4 $\frac{1}{4}$	3 $\frac{1}{2}$	3 $\frac{1}{2}$	3 $\frac{1}{2}$

<sup>1</sup> National accounts definitions, including community charge/council tax.

<sup>2</sup> Including vehicle excise duty.

**Chart 6.2 Taxes and social security contributions<sup>1</sup>**

<sup>1</sup> On a national accounts accruals basis, including community charge and council tax.

**Expenditure 6.16** General government expenditure (GGE) excluding privatisation proceeds is now estimated to have increased by nearly 10 per cent in 1992-93. The level of expenditure is expected to be £1 $\frac{1}{2}$  billion higher than forecast in last year's Budget, with the main factors being:

- a £ $\frac{3}{4}$  billion higher planning total. (See Table 5.3. The plans for 1992-93 were set on the basis of the planning total rather than the new control total.) This reflects the additional expenditure on housing announced in the Autumn Statement;
- £ $\frac{1}{2}$  billion higher local authorities' self-financed expenditure (LASFE), which is outside the planning total but included in the new control total.

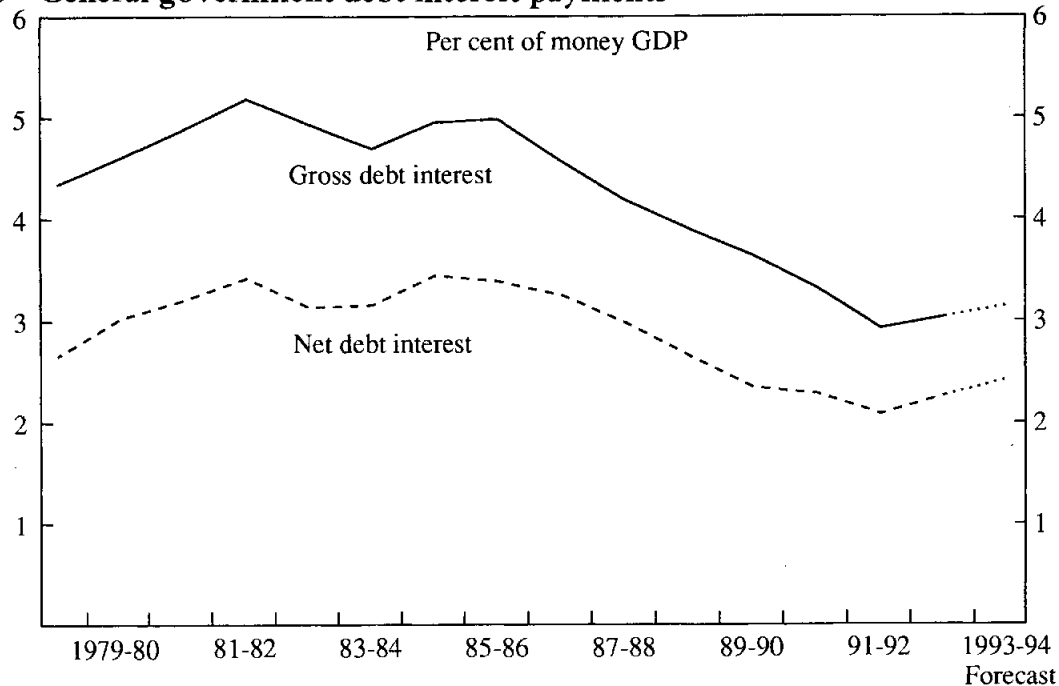
The latest estimate of public corporations' market and overseas borrowing is for a somewhat larger repayment than in last year's Budget forecast.

**6.17** Spending has grown substantially faster in 1992–93 than money GDP, so that the ratio of GGE excluding privatisation proceeds to money GDP is estimated to have risen by  $2\frac{3}{4}$  percentage points, to  $44\frac{3}{4}$  per cent. This rise reflects the continuing impact of the recession.

**6.18** The projection of spending trends set out in Chapter 5 shows real growth in GGE excluding privatisation proceeds for 1993–94 of  $3\frac{3}{4}$  per cent, somewhat slower than in 1992–93, with a further slowdown in 1994–95. But the GGE/GDP ratio is still expected to rise by a further  $\frac{3}{4}$  percentage point next year.

**6.19** Within GGE, gross debt interest payments are estimated to have increased a little as a per cent of GDP in 1992–93, reversing the downward trend seen since the mid-1980s. A further increase is likely for 1993–94. The stock of debt is now rising as a consequence of relatively high borrowing in the recession and this will more than offset the effect of lower interest rates.

**Chart 6.3** General government debt interest payments



### Public sector finances: analysis by sector

**6.20** Table 6.5 shows borrowing in 1991–92 and 1992–93 by central government, local authorities and public corporations. The estimates for 1992–93 incorporate provisional outturns for the first 11 months of the year. Nevertheless, there is still a margin of error around the estimates for the year as a whole.

**6.21** The sectoral position in 1992–93 is affected by a PSBR-neutral commutation grant of over £5 billion from central government to local authorities, which was used to repay borrowing from central government. But, even abstracting from this, the increase in the PSBR between 1991–92

and 1992–93 is more than explained by a large increase in central government own account borrowing. Excluding the commutation grant, the local authority borrowing requirement in 1992–93 is now forecast to be a repayment of £1¼ billion, which represents £3 billion lower borrowing than in 1991–92. Public corporations' borrowing in 1992–93 is expected to be a little lower than in 1991–92.

**Table 6.5 Public sector borrowing requirement by sector**

	£ billion	
	1991–92 Outturn	1992–93 Latest estimate
<b>1 Central government borrowing requirement on own account</b>	<b>11.7</b>	<b>41.5<sup>1</sup></b>
<b>2 Local authority borrowing requirement</b>	<b>1.7</b>	<b>-6.4<sup>1</sup></b>
3 of which from: central government	0.6	-6.8 <sup>1</sup>
4 market and overseas	1.0	0.4
<b>5 Public corporations' borrowing requirement</b>	<b>0.3</b>	<b>—</b>
6 of which from: central government	0.6	1.0
7 market and overseas	-0.2	-1.0
<b>8 Public sector borrowing requirement</b>	<b>13.8</b>	<b>35.1</b>
Central government borrowing requirement (lines 1 + 3 + 6)	12.9	35.6

<sup>1</sup> Includes commutation grant of £5.1 billion to local authorities which increases central government borrowing requirement on own account and reduces local authority borrowing requirement.

**6.22** Tables 6.6 to 6.8 summarise the estimated outturns and forecasts for receipts and expenditure for each of the three sectors. (More detail is given in Table 6.9.) Table 6.6 sets out the forecast for central government transactions in the cash receipts and payments format which is used for the monthly outturn figures. (Figures on the accruals basis used in the Central Statistical Office's national accounts are in Table 6.9.) The forecast of the PSBR for 1993–94 assumes that the Reserve is fully spent, though the Reserve is unallocated and is not included in the expenditure estimates for individual sectors.

**Central government** **6.23** Central government total cash receipts in 1992–93 have been no higher than in 1991–92 and tax receipts were a little lower. On the expenditure side of the account, growth in cash outlays has been boosted by the commutation grant to local authorities. Excluding this grant, the increase in net departmental outlays was still over 11 per cent. The increase in total outlays was marginally higher (11¼ per cent), reflecting rising interest payments. The large gap between growth in cash outlays and growth in cash receipts has produced a substantial rise in central government borrowing. The forecasts for 1993–94 are for a rise of 3¾ per cent in cash receipts and an increase of 7¼ per cent in underlying total outlays (adjusted for the commutation grant). The latter figure is boosted by rising interest payments and lower privatisation proceeds; the underlying increase in net departmental outlays is lower, at 5½ per cent. These figures take account of the Budget but exclude any allocation from the Reserve.



**Table 6.6 Central government transactions on a cash receipts basis**

	£ billion		
	1991–92 Outturn	1992–93 Latest estimate	1993–94 Forecast <sup>1</sup>
<i>Receipts</i>			
Inland Revenue <sup>2</sup>	79.4	76.1	76.7
Customs and Excise <sup>2</sup>	61.8	63.6	67.8
Social security contributions (GB)	34.4	35.6	37.2
Interest and dividends	9.8	8.8	8.7
Other	16.1	16.8	18.3
<b>Total receipts</b>	<b>201.5</b>	<b>200.9</b>	<b>208.7</b>
<i>Outlays</i>			
Interest payments	15.4	16.7	18.8
Privatisation proceeds	–7.9	–8.1	–5.5
Net departmental outlays	205.8	233.9 <sup>3</sup>	241.2
<b>Total outlays</b>	<b>213.2</b>	<b>242.4<sup>3</sup></b>	<b>254.5</b>
<b>Net own account borrowing<sup>4</sup></b>	<b>11.7</b>	<b>41.5<sup>3</sup></b>	

<sup>1</sup> Excluding any allocation from the Reserve.

<sup>2</sup> Payments to the Consolidated Fund.

<sup>3</sup> Includes commutation grant to local authorities of £5.1 billion.

<sup>4</sup> Excludes net lending to local authorities and public corporations.

**Local authorities** **6.24** Table 6.7 shows receipts and expenditure by local authorities. 1992–93 receipts include the commutation grant of £5.1 billion paid in October, which is classified here as a capital grant from central government. Excluding this grant, local authority receipts are estimated to have increased by 11 per cent in 1992–93. With expenditure only up by 6½ per cent, there has been a significant reduction in local authority borrowing, even before taking into account the debt repayment financed by the commutation grant.

**6.25** Information on local authorities' income and expenditure during 1992–93 is incomplete at this stage of the year, and it is not fully clear why local authorities' borrowing has been so much lower than last year. Part of the explanation appears to be an improved collection performance for community charge. In-year collection has been running at a higher rate than in 1991–92, and local authorities have continued to make progress in collection of arrears from previous years. (The latter counts as other receipts in Table 6.7.)

**6.26** Comparison of 1993–94 local authority receipts and expenditure with 1992–93 is distorted by forthcoming changes in the responsibilities of local authorities and the associated changes in central government funding. With effect from April 1993 further education colleges will be transferred to the private sector, with direct funding from central government, reducing local authority expenditure and receipts (in the form of current grants from central government) by around £3 billion. At the same time, local authorities will assume responsibility for community care provision, which will increase expenditure and receipts by around £¾ billion. Adjusting for these changes, the underlying increase in local authority expenditure in

1993–94 is projected at  $3\frac{3}{4}$  per cent, a bit lower than in 1992–93. The projected underlying rise in receipts is lower than this, at  $2\frac{1}{4}$  per cent, implying that borrowing may be higher than in 1992–93.

**Table 6.7 Local authority transactions**

	£ billion		
	1991–92 Outturn	1992–93 Latest estimate	1993–94 Forecast <sup>1</sup>
<i>Receipts</i>			
Community charge and council tax <sup>1</sup>	7.2	8.3	8.2
Current grants from central government <sup>2</sup>	50.4	55.5	54.6
Capital grants from central government	2.7	8.0 <sup>3</sup>	3.3
Other <sup>4</sup>	7.8	8.9	9.0
<b>Total receipts</b>	<b>68.0</b>	<b>80.7<sup>3</sup></b>	75.0
<i>Expenditure</i>			
Current expenditure on goods and services	48.4	51.3	49.9
Current grants and subsidies	9.2	11.0	12.7
Interest	5.6	5.0	4.8
Capital expenditure <sup>5</sup> and net lending	6.4	7.0	7.3
<b>Total expenditure<sup>6</sup></b>	<b>69.7</b> (64.3)	<b>74.3</b> (69.8)	74.7 (69.5)
<b>Net borrowing</b>	<b>1.7</b>	<b>– 6.4<sup>3</sup></b>	

<sup>1</sup> Net of rebates, community charge benefit, transitional relief and community charge reduction scheme. Includes district council rates in Northern Ireland.

<sup>2</sup> Includes domestic rate income.

<sup>3</sup> Includes commutation grant of £5.1 billion, used to repay debt.

<sup>4</sup> Includes interest receipts, rent gross trading surplus and accruals adjustments, plus other miscellaneous receipts.

<sup>5</sup> Gross capital expenditure less capital receipts.

<sup>6</sup> The expenditure figures in this table are on a national accounts basis; the figures in brackets are equivalent figures on the public expenditure measurement basis used in Chapter 5.

**Public corporations** 6.27 Trends in public corporations' finances continue to be obscured by changes in the coverage of the sector. The main one affecting the period for which figures are shown in Table 6.8 is the creation of NHS trusts, which are classified as public corporations. In 1991–92, the first year of operation, there were 57 trusts. In 1993–94, there will be 328 trusts. Much of the rise in both receipts and expenditure between 1991–92 and 1993–94 shown in Table 6.8 is accounted for by this expansion in trust numbers. Borrowing by trusts is, however, relatively small.

**Table 6.8 Public corporations' transactions**

	£ billion		
	1991–92 Outturn	1992–93 Latest estimate	1993–94 Forecast <sup>1</sup>
<i>Receipts</i>			
Gross trading surplus (including subsidies)	2.7	3.5	4.4
Capital grants from central government	1.7	2.2	1.9
Other <sup>2</sup>	1.1	0.8	0.7
<b>Total receipts</b>	<b>5.5</b>	<b>6.6</b>	<b>7.1</b>
<i>Expenditure</i>			
Interest, dividends and taxes on income	1.8	1.8	2.1
Net lending and capital expenditure	4.1	4.7	5.6
<b>Total expenditure</b>	<b>5.9</b>	<b>6.6</b>	<b>7.7</b>
<b>Net borrowing</b>	<b>0.3</b>	<b>—</b>	
<i>Public corporations' contribution to planning total:</i>			
<i>nationalised industries' external finance</i>	2.5	3.5	3.9
<i>other public corporations.</i>	1.2	1.7	1.6

<sup>1</sup> Excluding any allocation from the Reserve.

<sup>2</sup> Including trade credit and balancing item in national accounts.

### Public sector finances: analysis by economic category

**6.28** The full analysis of receipts and expenditure by economic category is shown in Table 6.9, with a breakdown between central government, local authorities and public corporations. This analysis, which distinguishes between current and capital transactions (and within the latter between physical and financial investment) shows the derivation of the public sector financial deficit. The financial deficit, unlike the PSBR, is not wholly a measure of cash transactions because certain items above line 25 of Table 6.9 (for example some taxes included in lines 1 and 2) are measured on an accruals basis. Accruals adjustments are accordingly made in lines 29 and 30.

**6.29** The Reserve for 1993–94 is assumed to be spent on transactions that fall above the financial deficit line. In practice allocations from the Reserve can also affect financial transactions (lines 26–31).

Table 6.9 Public sector transactions by sub-sector and economic category

	Line <sup>1</sup>	£ billion				
		1992-93 Latest estimate				
		General government			Public corporations	Public sector
Central government	Local authorities	Total				
<i>Current and capital receipts<sup>2</sup></i>						
Taxes on income, and oil royalties	1	72.0	—	72.0	-0.2	71.8
Taxes on expenditure	2	85.6	0.1	85.8	—	85.8
Taxes on capital	3	2.7	—	2.7	—	2.7
Social security contributions	4	37.4	—	37.4	—	37.4
Community charge	5	—	8.1	8.1	—	8.1
Gross trading surplus	6	-0.4	0.7	0.3	3.5	3.8
Rent and miscellaneous current transfers	7	0.9	3.7	4.6	0.6	5.2
Interest and dividends from private sector and abroad	8	3.2	0.7	3.9	0.5	4.4
Interest and dividends within public sector	9	5.6	-4.3	1.3	-1.3	—
Imputed charge for non-trading capital consumption	10	1.6	2.3	3.9	—	3.9
Capital transfers	11	—	0.3	0.3	—	0.2
<b>Total receipts</b>	<b>12</b>	<b>208.4</b>	<b>11.6</b>	<b>220.0</b>	<b>3.1</b>	<b>223.1</b>
<i>Current and capital expenditure<sup>2</sup></i>						
Current expenditure on goods and services	13	80.1	51.3	131.5	—	131.5
Subsidies	14	5.9	0.6	6.6	—	6.6
Current grants to personal sector	15	75.1	10.3	85.4	—	85.4
Current grants paid abroad	16	5.1	—	5.1	—	5.1
Current grants within public sector	17	55.5	-55.5	—	—	—
Debt interest	18	17.5	0.7 <sup>3</sup>	18.2	—	18.2
Gross domestic fixed capital formation	19	7.0	5.8	12.8	4.6	17.4
Increase in stocks	20	—	—	—	-0.1	—
Capital grants to private sector	21	3.7	1.3	5.0	0.1	5.1
Capital grants within public sector	22	10.3	-8.0	2.3	-2.3	—
<b>Total expenditure</b>	<b>23</b>	<b>260.2</b>	<b>6.5</b>	<b>266.7</b>	<b>2.3</b>	<b>269.1</b>
Reserve	24	—	—	—	—	—
<b>Financial deficit</b>	<b>25</b>	<b>51.8</b>	<b>-5.1</b>	<b>46.7</b>	<b>-0.8</b>	<b>45.9</b>
<i>Financial transactions</i>						
Net lending to private sector and abroad	26	0.5	-0.1	0.3	0.1	0.4
Cash expenditure on company securities (including privatisation proceeds)	27	-8.1	—	-8.1	—	-8.1
Transactions concerning certain public sector pension schemes	28	0.2	—	0.2	—	0.2
Accruals adjustments on receipts	29	-0.5	-0.5	-1.0	—	-1.0
Other accruals adjustments	30	-0.8	-0.1	-1.0	-0.4	-1.3
Miscellaneous financial transactions	31	-1.6	-0.5	-2.1	1.1	-1.1
<b>Borrowing requirement</b>	<b>32</b>	<b>41.5<sup>4</sup></b>	<b>-6.4</b>	<b>35.1<sup>4</sup></b>	<b>—</b>	<b>35.1</b>

<sup>1</sup> Financial deficit (line 25) = expenditure (line 23) + Reserve (line 24) - receipts (line 12).

Borrowing requirement (line 32) = financial deficit (line 25) + financial transactions (lines 26 to 31).

<sup>2</sup> On an accruals basis.

<sup>3</sup> Excluding local authorities' payments to central government, and public corporations' payments to general government, which are in row 9.

<sup>4</sup> Own account borrowing requirements. (See Annex, para. 6A.14)

## 6 The public sector finances

£ billion						
1993-94 Forecast						
Line <sup>1</sup>	General government			Public corporations	Public sector	
	Central government	Local authorities	Total			
						<i>Current and capital receipts<sup>2</sup></i>
1	73.7	—	73.7	-0.2	73.6	Taxes on income, and oil royalties
2	90.8	0.2	91.0	—	91.0	Taxes on expenditure
3	2.8	—	2.8	—	2.8	Taxes on capital
4	39.4	—	39.4	—	39.4	Social security contributions
5	—	8.0	8.0	—	8.0	Council tax
6	-0.4	0.7	0.3	4.4	4.6	Gross trading surplus
7	0.7	3.7	4.4	0.6	5.0	Rent and miscellaneous current transfers
8	2.7	0.5	3.2	0.5	3.7	Interest and dividends from private sector and abroad
9	6.0	-4.4	1.6	-1.6	—	Interest and dividends within public sector
10	1.5	2.4	3.9	—	3.9	Imputed charge for non-trading capital consumption
11	—	0.3	0.3	—	0.2	Capital transfers
12	<b>217.1</b>	<b>11.4</b>	<b>228.5</b>	<b>3.7</b>	<b>232.2</b>	<b>Total receipts</b>
						<i>Current and capital expenditure<sup>2</sup></i>
13	83.9	49.9	133.8	—	133.8	Current expenditure on goods and services
14	6.6	0.6	7.2	—	7.2	Subsidies
15	82.3	12.1	94.3	—	94.3	Current grants to personal sector
16	4.4	—	4.4	—	4.4	Current grants paid abroad
17	54.6	-54.6	—	—	—	Current grants within public sector
18	19.4	0.4 <sup>3</sup>	19.8	-0.1 <sup>3</sup>	19.7	Debt interest
19	7.0	6.1	13.2	5.3	18.5	Gross domestic fixed capital formation
20	—	—	—	0.2	0.2	Increase in stocks
21	3.9	1.3	5.2	0.1	5.3	Capital grants to private sector
22	5.2	-3.3	2.0	-2.0	—	Capital grants within public sector
23	<b>267.3</b>	<b>12.6</b>	<b>279.9</b>	<b>3.5</b>	<b>283.4</b>	<b>Total expenditure</b>
24					4.0	Reserve
25					<b>55.2</b>	<b>Financial deficit</b>
						<i>Financial transactions</i>
26	0.4	-0.1	0.2	0.1	0.3	Net lending to private sector and abroad
27	-5.5	—	-5.5	—	-5.5	Cash expenditure on company securities (including privatisation proceeds)
28	0.8	—	0.8	—	0.8	Transactions concerning certain public sector pension schemes
29	1.7	-0.6	1.1	—	1.1	Accruals adjustments on receipts
30	-0.6	-0.1	-0.7	-0.2	-0.9	Other accruals adjustments
31	-1.3	-0.5	-1.8	0.9	-0.9	Miscellaneous financial transactions
32					<b>50.1</b>	<b>Borrowing requirement</b>

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## Annex to Chapter 6:

# Conventions used in presenting the public finances

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**6A.1.** The FSBR presents the public finances in two main ways; on a cash basis and on a national accounts, or accruals, basis. This annex briefly describes the two approaches, and outlines the relationships between the various public finances tables in Chapters 1, 2, 5 and 6.

**Cash basis 6A.2.** The cash approach concentrates on the actual cash transactions between the public sector and the rest of the economy in any given period of time. It is particularly useful for analysing the components of the PSBR, which is itself almost entirely a cash concept. A cash framework also corresponds closely to the way public expenditure is planned, controlled and accounted for.

**6A.3.** The main presentation of the public finances on a cash basis is given in Table 1.2. As far as possible, the figures in this table relate to actual cash flows. The estimates of taxes for example are for tax payments received during the year, rather than for liabilities incurred.

**6A.4.** There are however, a number of minor items within the definition of general government receipts (GGR) which are not on a cash basis:

- VAT which is refunded to central and local government, included in “other taxes and royalties”;
- imputed contributions for statutory sick pay and statutory maternity pay, included in “social security receipts”;
- an imputed flow for capital consumption by general government, included in “other receipts”.

These flows also appear on the expenditure side of the account in “accounting adjustments”, so that their effects cancel out when calculating the PSBR.

**6A.5.** The other remaining departure from a cash basis is the “central government debt interest” line, which scores the capital uplift on index-linked gilts as interest at the time it accrues. To correct for this, an accruals adjustment is made to “other receipts” which removes the accrued uplift scored and adds back any actual payments of uplift on redemptions.

**6A.6.** Tables 2B.1, 2B.3 and 2B.5 and 5.1 are all on the same basis as Table 1.2.

**6A.7.** The other cash-based table is Table 6.6, which shows the finances of central government. Unlike the earlier tables, this is genuinely a cash presentation; the imputed flows for refunded VAT, social security contributions and capital consumption are all excluded, and the “interest payments” line takes account of actual payments of capital uplift on index-linked gilts, rather than the accrued uplift.

**6A.8.** Similar tables cannot be produced for local authorities or public corporations because the available cash data are not comprehensive. The finances of these sectors, shown in Tables 6.7 and 6.8, are presented on the national accounts basis described below.

**National accounts basis** **6A.9.** This is the internationally agreed framework within which the accounts for the UK economy as a whole are produced by the CSO. Public finances shown on this basis can thus be placed more easily into the context of the rest of the economy, highlighting the inter-relationships between sectors.

**6A.10.** Table 6.9 provides the main national accounts presentation of the public finances in the FSBR. Under the measurement conventions used in the national accounts:

- most transactions, including most taxes, are recorded on an accruals rather than a cash payments basis;
- current and capital transactions are separately identified, and both are grouped by economic category (so that, for example, transfer payments are distinguished from expenditure on goods and services);
- the value of some transactions is imputed where no money changes hands.

**6A.11.** Tables 2B.2, 2B.4, 2C.2, 6.4, 6.7 and 6.8 are all on the same basis as Table 6.9.

**6A.12.** An accruals basis is used to calculate taxes (and social security contributions and community charge) as a percent of GDP (Table 6.4), because this gives a measure of the underlying burden of taxation stemming from a particular period of economic activity. It is not affected, for example, by the precise timing of tax receipts.

**6A.13.** As Table 6.9 shows, it is still possible to build up the PSBR in terms of national accounts concepts, even though these include imputed and accrued flows. This is because the imputed flows appear on both sides of the account and so cancel out, and the financial transactions include adjustments for the difference between accruals and cash flow (lines 29 and 30 of Table 6.9).

**Borrowing requirements** **6A.14.** The PSBR can be disaggregated into component borrowing requirements in different ways. Table 1.2 shows the PSBR as the sum of the general government borrowing requirement (GGBR) and market and overseas borrowing by public corporations (PCMOB). An alternative is to split it, as in Table 6.9 (line 32), between central government borrowing on its own account (the CGBR(O)), and borrowing by local authorities and public corporations (the LABR and PCBR respectively). The borrowing requirement shown in the general government column of this table is not in fact the GGBR, but the GGBR(O). The GGBR can be calculated from the GGBR(O) by adding in public corporations' borrowing from central government (given in Table 6.5).

**6A.15.** General government expenditure is derived from the new control total, as shown in Table 1.2. But it can also be derived from the general government column of Table 6.9 by taking total expenditure (line 23) and adding:

- the Reserve (line 24, all assumed to be general government);
- net lending to the private sector and abroad (line 26);
- cash expenditure on company securities (line 27);
- and net lending to public corporations (from Table 6.5).







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