THE 1996 BUDGET

The Chancellor's Budget Statement 1996

The Financial Statement and Budget Report

News Releases

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A Budget for . . .

lasting prosperity

- combining sustained economic growth with low inflation so that living standards go on rising year after year.

helping people keep more of what they earn

- basic rate of income tax reduced to 23p.
- 20p income tax band widened by £200.
- income tax personal allowances further increased.
- inheritance tax threshold increased by £15,000.

high quality public services

- spending more on the services people care most about:

- the health service
- education
- combating crime.

responsible public finances

- maintaining firm control of public spending.
- reinforcing the downward path of borrowing.

protecting the ordinary taxpayer

- boosting the fight against tax and social security fraud.
- closing tax loopholes.
- phasing out special reliefs and allowances.

[Prepared November 1996]

1 The Budget

1.01 The Government is achieving its aim of combining economic growth with low inflation so that living standards go on rising year after year. The Budget provides for high quality public services, while securing the tax base and taking a further step towards the goal of a 20p basic rate of income tax. It takes no risks with the economy and ensures that borrowing remains firmly on a downward path.

The economy

1.02 The UK economy continues to perform well:

- **it is now well into its fifth year of sustained growth.** Output is over 8 per cent higher than at its previous peak in 1990. The IMF and OECD expect the UK to be the fastest growing major European economy in both 1996 and 1997;
- **living standards are rising**. A one earner, two child family on average earnings should be over £1,100 better off next year after earnings growth, tax and inflation than in 1991-92 ;
- **unemployment has fallen** to its lowest level for over 5 1/2 years and 3/4 million jobs have been created in this recovery;
- **the UK has a greater proportion of its people in work** and a lower unemployment rate than any other major European country;
- **the UK is enjoying the longest period of low inflation for almost half a century**;
- **interest rates remain at low levels by historical standards, with the lowest mortgage rates for a generation**.

1.03 The Government is determined that healthy economic growth should continue and that inflation should remain low so that families and businesses can plan for the future with confidence.

1.04 The main risks to the economy are that economic growth might be driven off course by a pick up in inflation, or that high public borrowing might lead to unsustainable levels of public sector debt. The Government has shown its determination to meet its inflation target, most recently by the interest rate increase announced on 30 October. The Budget decisions reinforce the downward path of borrowing.

The public finances

1.05 The public sector borrowing requirement (PSBR) has fallen from over £45 billion in 1993-94 to a forecast £26 1/2 billion for 1996-97. But the decline has not been as rapid as expected. In the past year, lower than expected tax revenues and higher than expected social security spending have both increased the projected PSBR. In planning the Budget, the Government has responded to these developments. Taken together, the Budget tax and public spending measures will lead to a significantly lower PSBR than would otherwise have been the case.

Table 1.1 Impact of Budget policy changes on the PSBR(1)

		£ billion	
	1997-98	1998-99	1999-00
Public expenditure(2)	-1.9	-2.5	-2.7
Revenue effects of public spending measures(3)	-0.5	-1.2	-1.8
Tax and NICs(4)	+0.7	+0.6	-0.8
Total(5)	**-1.8**	**-3.2**	**-5.2**

(1) *Measures which increase the PSBR (eg higher spending or lower taxes) are shown as positive numbers.Measures which reduce the PSBR (eg lower spending or higher taxes) are shown as negative numbers.*

(2) *Changes in the Control Total since the 1995 Budget and Budget policy measures directly affecting GGE(X). In this and other tables, references to the 1995 Budget mean after adjusting for classification changes. See Table 5.2.*

(3) *Extra revenue generated by spending package, mainly from spending measures which improve tax compliance and strengthen the fight against tax evasion. See Table 5.2.*

(4) *See Tables 1.4 and 6.1.*

(5) *In this and other tables, the totals are based on unrounded figures. They may therefore differ from the sums of the rounded figures.*

1.06 As a result, in part, of the Budget measures, the projected path of the PSBR remains on a clear downward track, in line with the Government's objective of returning towards balance over the medium term.

Table 1.2 The Public Sector Borrowing Requirement

	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
- £ billion	26 1/2	19	12	3	-8	-18
- per cent of GDP	3 1/2	2 1/2	1 1/2	1/2	- 3/4	-2

1.07 The projected fall in the PSBR over time is driven by continued firm control of public spending coupled with a gradual increase in receipts as a percentage of GDP. The increase in receipts partly results from the Government's continued commitment to future real increases in road fuel and tobacco duties, and from the measures announced in this Budget to increase the effectiveness of tax collection.

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The Budget measures

Public spending

1.08 The Budget keeps public spending under firm control. The Control Total has been reduced by £1.7 billion in 1997-98 compared to last year's Budget. The Budget makes policy changes which will reduce overall spending by £1.9 billion in 1997-98 compared with what would have otherwise been the case.

1.09 Within these tight overall spending plans, the Budget reallocates public expenditure to provide more money for the Government's priorities:

- the health service;

- education;

- combating crime

as well as meeting unavoidable extra spending pressures, in particular, for:

- higher social security spending; and

- the costs of BSE.

"Spend to save"

1.10 The Budget also gives an increased emphasis to activities which in the long run will save expenditure or increase revenue. Extra money has been provided to:

- fight social security fraud; and

- improve the Inland Revenue and HM Customs and Excise's ability to combat tax evasion and further improve tax compliance

by a series of carefully targeted measures which have good yield to cost ratios.

Tax

1.11 If the Government is to continue to be able to deliver the public services people want and work towards its aim of reducing marginal tax rates to improve incentives, it is vital to prevent the erosion of the tax base. Improving the revenue departments' ability to collect tax is one key part of this. But it is also essential to block tax loopholes where they are being exploited. The Budget contains a number of measures which will reduce tax leakage.

1.12 The Government's objectives for the tax system have long recognised that low tax rates go hand-in-hand with a broad tax base, and that while special reliefs and allowances have a role in certain circumstances, they can have distortionary effects on business decisions. The Budget makes changes to a number of special tax reliefs and allowances:

- bringing the tax treatment of both long-life business assets and the drilling of development oil wells more closely into line with normal accountancy practice;

- phasing out tax relief for profit related pay from 1998. This relief was introduced in 1987 as a way of stimulating the take up of profit related pay. Profit related pay is now widely recognised as normal element of remuneration in many businesses. The Government sees profit related pay as an important way of maintaining pay flexibility, but believes that it is now well established, and the time has come to start phasing out its specially favourable tax treatment.

1.13 The Budget raises further revenue by increasing certain indirect taxes while freezing and reducing others:

- the public finance arithmetic already assumes that duties on tobacco and road fuels will be increased each year in real terms by 3 per cent and 5 per cent respectively. The Government plans to go further this year by increasing duty on cigarettes, cigars and pipe tobacco by 5 per cent in real terms;

- the Budget also increases insurance premium tax from 2 1/2 per cent to 4per cent, and air passenger duty from £10 to £20 for flights outside the European Economic Area and from £5 to £10 for flights within the EEA;

- duties on beer, most wine and cider have been frozen, and the duty on spirits has been reduced by 4 per cent.

1.14 The Government is committed to moving towards a 20p basic rate of income tax. The Budget takes another step towards this objective by cutting the basic rate of income tax by 1p to 23p. In addition, the 20p band is widened by £200 so that over one quarter of all taxpayers will pay tax only at the 20prate. The main income tax personal allowance is increased by £280 and the married couple's allowance by £40, with bigger increases for elderly people. This is an increase in the personal allowance of £200 more than indexation.

1.15 The inheritance tax threshold is increased by a further £15,000 to £215,000. This threshold has been increased by over £60,000 in the last two Budgets.

Analyses

1.16 Charts 1.2 and 1.3 illustrate how the Government expects public expenditure to be allocated in 1997-98 and how this spending will be financed. Chart 1.2 illustrates the pattern of expenditure by function rather than department. It relies on broad assumptions about the pattern of expenditure in Scotland, Wales and Northern Ireland and by local authorities, so the figures can only be approximate (see Annex A of Chapter 5 for details). The charts do not show the considerable contribution to public services made by the private sector.

1.17 Tables 1.3 and 1.4 show the new public spending plans by department and summarise the Budget tax and national insurance measures.

1.18 Table 1.5 summarises the Government's revenue and expenditure plans for 1996-97 and 1997-98.

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Table 1.3 The new public spending plans(1)

	Change from previous plans		New plans		
			£ billion		
	1997-98	1998-99	1997-98	1998-99	1999-00
Control Total by department					
Social security(2)	0.6	1.2	79.7	82.9	86.2
Health(3)	0.8	0.4	34.9	35.4	36.1
DOE - Local government	-0.1	0.0	31.4	31.7	31.6
DOE - Other	-0.2	-0.3	7.6	7.6	7.0
Scotland, Wales and N Ireland(2)	-0.3	-0.3	29.5	29.6	29.8
Defence (excluding sale of married quarters)	-0.1	-0.4	21.8	22.2	22.8
Education and employment(4)	-1.0	-1.0	14.0	14.0	14.0
Home Office	0.2	0.1	6.8	6.8	6.9
Transport	0.4	0.1	5.2	4.6	4.3
Other departments	-0.3	0.3	19.5	20.1	20.3
Local authority self-financed expenditure	0.8	0.3	13.7	13.7	14.3
Reserve	-2.5	-2.5	2.5	5.0	7.5
Control Total	**-1.7**	**-1.9**	**266.5**	**273.7**	**280.9**
Cyclical social security(5)	0.0	-0.4	14.1	14.3	14.7
Central government debt interest(6)	0.8	0.4	24.8	24.4	24.0
Accounting adjustments	0.1	0.2	9.2	9.8	11.0
GGE(X)(7)	**-0.8**	**-1.8**	**314.7**	**322.2**	**330.6**
Real growth (per cent)					
Control Total			1/4	3/4	1/2
GGE(X)			1/4	1/2	1/2
GGE(X) as per cent of GDP			40	39	38 1/4

(1) *For definitions, rounding and other conventions, see notes in Annex A to Chapter 5.*

(2) *Excluding cyclical social security.*

(3) *Of which NHS0.50.534.435.235.9*

(4) *£Does not include local authority Total Standard Spending on education.*

(5) *Of which Budget policy changes-0.3-0.6*

(6) *Central government debt interest payments, net of interest and dividend receipts from outside general government.*

(7) *General government expenditure excluding privatisation proceeds and lottery-financed spending and net of interest and dividend receipts.*

Table 1.4 The Budget tax and national insurance measures(1)

	£ million yield (+)/cost (-) of measure			
	Changes from a non-indexed base	Changes from an indexed base		
	1997-98	1997-98	1998-99	1999-00
Income tax				

basic rate reduced to 23 per cent	-1 250	-1 250	-1 800	-1 800
personal allowances up by £200 over indexation	-1 290	-920	-1 370	-1 420
lower rate band widened by £100 over indexation	-120	-60	-140	-160
basic rate limit - indexed	-140	0	0	0
married couple's allowance - indexed	-50	0	0	0
Capital taxes				
inheritance tax threshold raised to £215,000	-45	-30	-55	-65
CGT reinvestment relief extended	-5	-5	-10	-15
Business measures				
small companies' corporation tax rate cut to 23 per cent	0	0	-80	-110
business rates transitional scheme extended	-115	-115	-100	-80
VAT registration threshold - indexed	-15	0	0	0
Measures to secure the tax base				
relief for profit related pay - phased out	100	100	700	1 700
capital allowances - long life assets	45	45	325	675
finance leasing of assets	80	80	150	150
relief for drilling production oil wells	*	*	150	200
VAT anti avoidance and revenue protection measures	560	560	320	320
insurance premium tax to 17.5 per cent on insurance sold with certain goods and services	160	160	235	260
other measures	165	165	145	150
Excise duties				
beer, most wine, cider and perry unchanged	0	-95	-100	-105
spirits cut by 4 per cent	-35	-50	-50	-50
most tobacco duties up by 5 per cent in real terms(2)	140	140	150	155
petrol and diesel up by 3p a litre (including VAT)(2)	15	15	15	15
ultra low sulphur diesel 1p differential from ordinary diesel	-15	-15	-15	-15
road fuel gas cut by 25 per cent	*	*	-5	-10
fuel and gas oil up by 5 per cent in real terms	20	15	15	20
car VED etc increased by £5, lorry VED unchanged, reductions for lorries meeting low emissions	120	40	35	30
Other indirect taxes				
main rate of insurance premium tax increased to 4 per cent	325	325	455	470
air passenger duty increased to £10/£20	125	120	385	415
Other measures	-125	40	55	50
Total (2)	**-1 350**	**-735**	**-590**	**780**

** = Negligible*

(1) *The measures and their revenue effects are set out in more detail in Chapter 6.*

(2) *Costings exclude yield from previously announced excise duty increases confirmed in this Budget:* 1 610 1 085 1 180 1 290

Table 1.5 The public finances in 1996-97 and 1997-98(1)

£ billion

	1996-97		1997-98
	1995 Budget	Latest forecast	Forecast
RECEIPTS			
Inland Revenue			
Income tax	*70.2*	68.1	71.8
Corporation tax	26.6	26.1	27.2
Petroleum revenue tax	1.0	1.7	1.6
Capital gains tax	1.0	0.9	1.1
Inheritance tax	1.5	1.6	1.6
Stamp duties	2.4	2.4	2.7
Customs and Excise			
Value added tax	47.9	47.5	50.7
Fuel duties	17.4	17.4	19.6
Tobacco duties	7.7	7.8	8.4
Alcohol duties	5.7	5.7	6.1
Betting and gaming duties	1.7	1.5	1.6
Air passenger duty	0.3	0.4	0.8
Insurance premium tax	0.7	0.6	1.2
Landfill tax	0.1	0.1	0.4
Customs duties & levies	2.6	2.2	2.4
Other			
Vehicle excise duties	4.3	4.3	4.5
Oil royalties	0.5	0.7	0.6
Business rates(2)	*14.7*	14.2	14.6
Social security contributions	*46.9*	46.7	49.1
Council tax	9.9	9.9	10.6
Other taxes and royalties	5.7	5.8	5.5
Total taxes and social security contributions	***268.7***	**265.6**	**282.1**
Other receipts(3)	*16.1*	15.3	17.2
General government receipts	***284.8***	**280.9**	**299.4**
EXPENDITURE			
Control Total by department			
Social security	*76.4*	76.9	79.7
Health	33.8	34.0	34.9
DOE Local government	31.3	31.3	31.4
DOE Other	8.2	8.4	7.6
Scotland, Wales and N. Ireland	29.4	29.6	29.5
Defence	21.4	22.1	21.8
Education and employment	14.6	14.8	14.0
Home Office	6.5	6.6	6.8

Transport	4.2	4.9	5.2
Other departments	19.5	19.3	19.5
Local authority self-financed expenditure	12.5	13.3	13.7
Allowance for shortfall		-0.6	
Reserve	2.5		2.5
Control Total	***260.1***	**260.6**	**266.5**
Cyclical social security	*13.9*	14.3	14.1
Central government debt interest(4)	*22.3*	22.2	24.8
Accounting adjustments	9.7	10.3	9.2
GGE(X)(5)	***306.1***	**307.4**	**314.7**
Privatisation proceeds	*-4.0*	-4.5	-2.0
Other adjustments(6)	*6.2*	5.6	6.3
General government expenditure	***308.3***	**308.5**	**319.0**

Expenditure, receipts and borrowing

	£ billion		
		1996-97	1997-98
	1995 Budget	Latest forecast	Forecast
General government expenditure	*308.3*	308.5	319.0
General government receipts	284.8	280.9	299.4
General government borrowing requirement	*23.5*	27.7	19.6
Public corporations' market and overseas borrowing	-1.1	-1.3	-0.4
Public sector borrowing requirement	***22.4***	**26.4**	**19.2**

(1) *On a cash basis. See Annex B to Chapter 4.*

(2) *Includes district council rates in Northern Ireland.*

(3) *Includes interest and dividends, gross trading surpluses, rent, other financial transactions, and payments to the National Lottery Distribution Fund.*

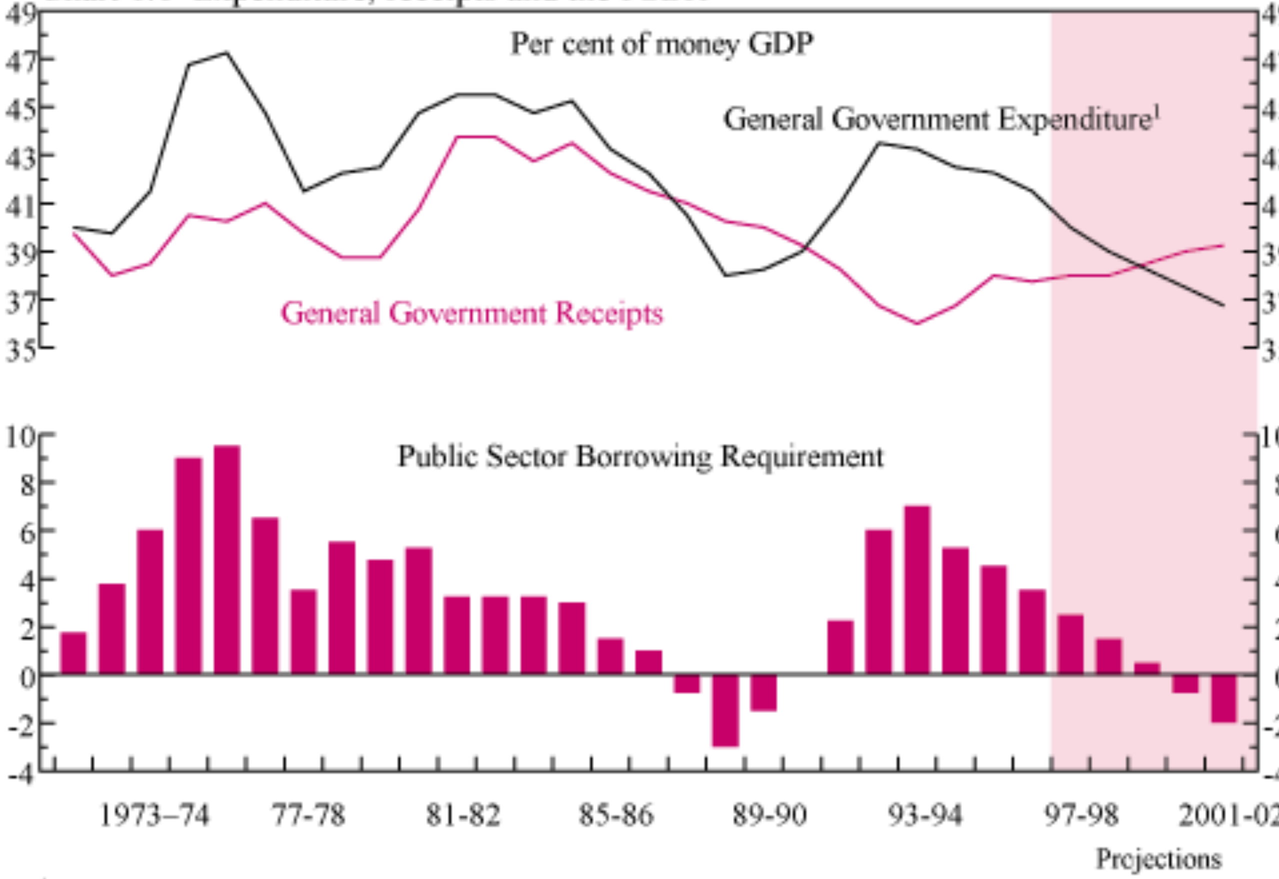
(4) *Central government debt interest payments net of interest payments and dividend receipts from outside general government.*

(5) *General government expenditure excluding privatisation proceeds and lottery financed spending and net of interest and dividend receipts.*

(6) *Lottery financed spending, and interest and dividend receipts.*

[Prepared November 1996]

Chart 1.1 Expenditure, receipts and the PSBR



[1]GGE(X). General government expenditure excluding privatisation proceeds and lottery financed spending, and net of interest and dividend receipts.

Chart 1.2: General government expenditure (X) by function 1997–98

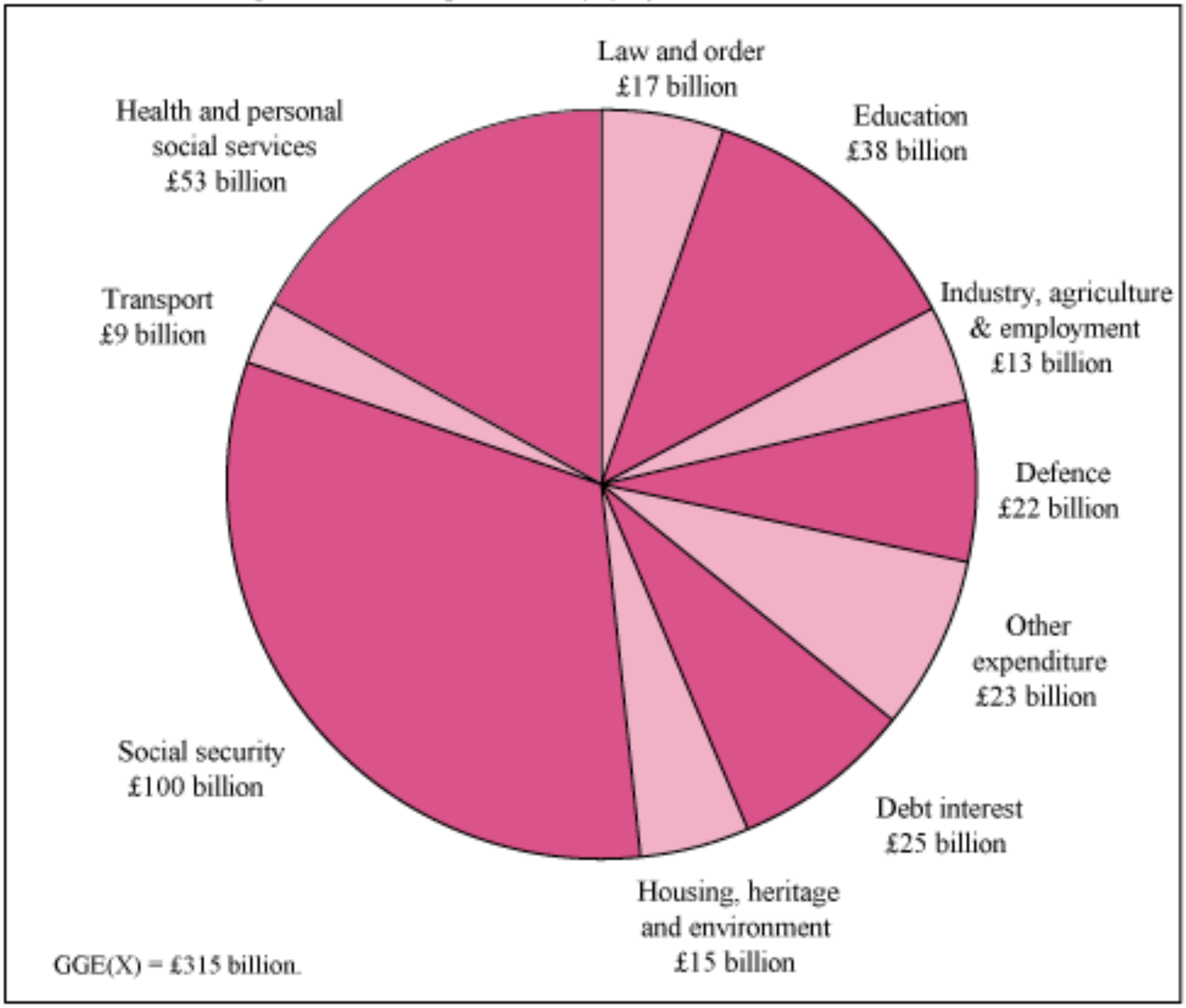
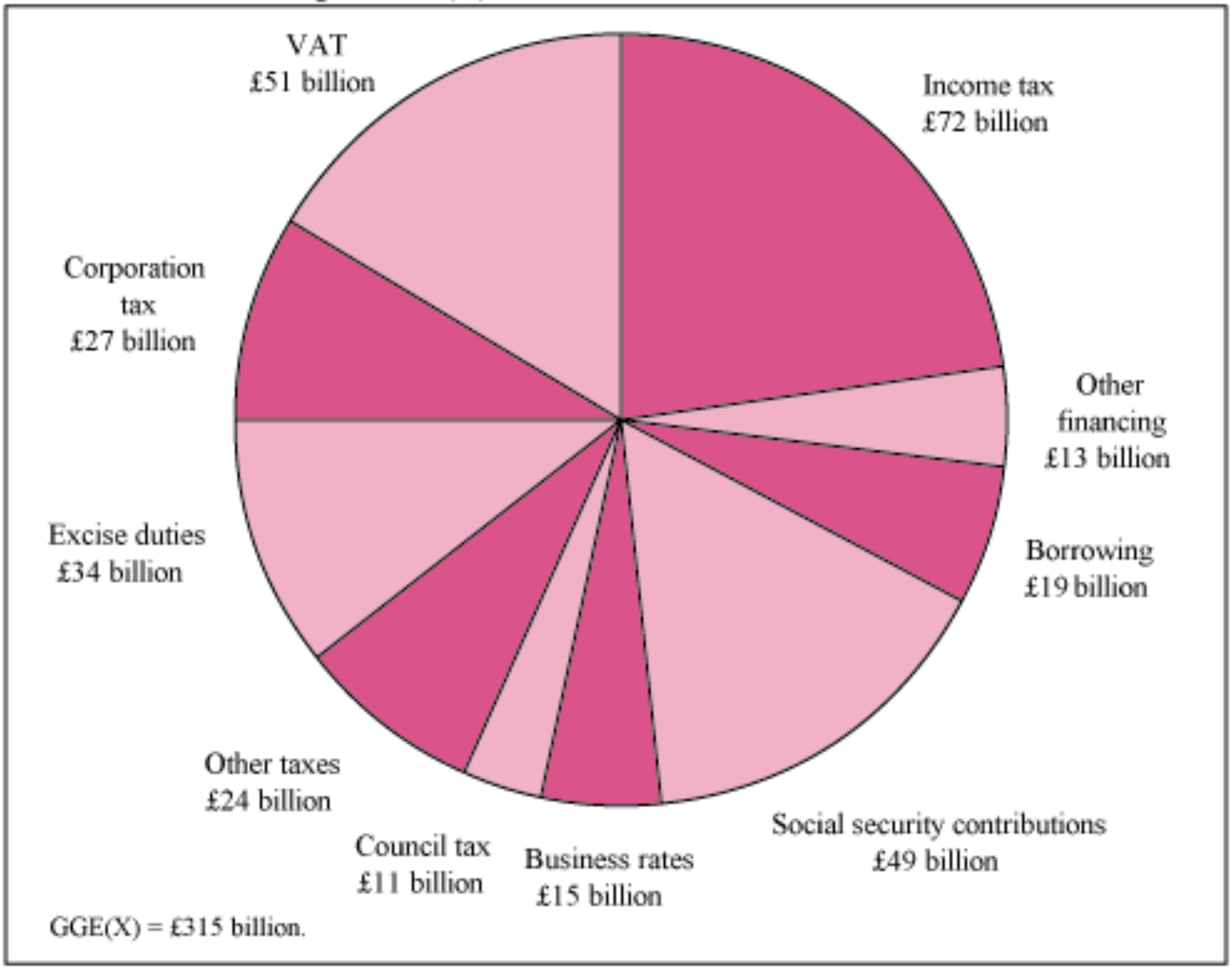


Chart 1.3: The financing of GGE(X) 1997–98



2 The Medium-Term Financial Strategy

2.01 The objective of the Government's economic policy is to promote sustained economic growth and rising living standards. This requires:

- a stable macroeconomic environment, based on:
  - low inflation on a permanent basis;
  - sound public finances;
- structural policies to improve long-term economic performance.

This chapter sets out how monetary and fiscal policies are directed at achieving a stable macroeconomic environment and describes policies which have played a key role in improving performance in the economy over the longer term.

2.02 In July, the International Monetary Fund's annual mission to review the UK economy concluded that the UK's economic performance was "enviable" and in large measure due to "sound economic policies". This Budget continues to build on these policies and, in particular, has taken firm action to bring the public finances back on track. This will safeguard the rising prosperity that has been achieved and ensure living standards continue to rise.

Macroeconomic framework

Low inflation

2.03 Economies work best when inflation is low and stable. Inflation imposes costs on the economy by distorting the economic decisions of consumers and producers. It arbitrarily redistributes income and wealth and distorts investment and saving decisions.

2.04 Monetary policy's role is to deliver permanently low inflation. The Government has set an explicit inflation objective since October 1992. The aim is to achieve underlying inflation (measured by the RPI excluding mortgage interest payments) of 2 1/2 per cent or less. Monetary policy will continue to be set to achieve this target.

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2.05 Since an inflation target has been set, the UK has achieved its best inflation performance for almost 50 years. Through a series of steps, including publication of the Bank of England's Inflation Report and the minutes of the Chancellor's monthly meetings with the Governor, the framework of monetary policy has become increasingly open and is now one of the most transparent in the world. These measures enhance the credibility of the monetary framework.

2.06 Monetary policy influences inflation only with a lag, so interest rate decisions are based on an assessment of the prospects for inflation up to two years ahead. Interest rate decisions are not based solely on any one indicator but on an assessment of all the relevant information concerning the prospects for inflation, including:

- **monetary and other financial indicators** including narrow and broad money, and its sectoral components, the exchange rate and asset prices, and expectations about future inflation;

- **indicators of activity** including measures of the level of demand (for example measures of spare capacity, retail sales growth and the state of the labour market). The overall stance of fiscal policy is also taken into account;

- **indicators of costs,** in particular wage costs and material input prices (including commodity prices).

The published minutes of the monthly meetings set out fully the considerations underpinning each discussion.

2.07 Although interest rate decisions are taken on the basis of all relevant information, the Government sets medium-term monitoring ranges for the monetary aggregates. The Government has decided to retain the current ranges for M0 and M4, of annual growth of 0-4 per cent and 3-9 per cent respectively. Since 1993, growth of M0 has consistently exceeded its range while inflation has remained low. This is likely to be related to the move to a low inflation environment and some slowdown in the rate of innovation in methods of cash payment in recent years. M4 growth has remained slightly above its monitoring range since November 1995. The introduction of the gilt repo market in January and the high level of mergers and acquisitions have temporarily boosted M4 growth this year. In the face of these uncertainties the Government will continue to keep the monitoring ranges under review.

2.08 The Government has explicitly acknowledged that events outside its control, such as sharp movements in commodity prices, might temporarily take inflation away from its target level. As a result, the Government does not expect to achieve the inflation target exactly in every month. Since 1993 underlying inflation has ranged between 2 per cent and 3 1/2 per cent. But in this forward-looking framework, monetary policy responds to changes in cost and demand pressures which alter the outlook for inflation. Interest rates were therefore increased in October 1996 in response to new data showing an acceleration of output, to pre-empt any future build-up in inflationary pressures.

Sound public finances

2.09 Fiscal policy's role is to maintain sound public finances. The Government's fiscal objective is to bring the PSBR back towards balance over the medium term, and in particular to ensure that when the economy is on trend the public sector borrows no more than is required to finance its net capital spending.

2.10 The PSBR as a share of GDP has fallen by half between 1993-94 and 1996-97. The Budget measures ensure that borrowing continues to fall and that the Government achieves its fiscal objectives. Borrowing is projected to fall below net capital spending in 1999-2000, bringing the public sector current account into surplus. The PSBR is also close to balance in that year.

Table 2.1 The public sector's finances

	Per cent of GDP						
	Outturn	Forecast		Projection			
	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
GGE(X)(1)	42 1/4	41 1/4	40	39	38 1/4	37 1/2	36 3/4
General government receipts	38	37 3/4	38	38	38 1/2	39	39 1/4
Other items(2)	1/4	0	1/2	1/2	1/2	1/2	1/2
PSBR	**4 1/2**	**3 1/2**	**2 1/2**	**1 1/2**	**1/2**	**- 3/4**	**-2**
Memo:General government financial deficit(3)	5	4	2 1/2	1 1/2	1/4	-1	-2 1/4
Public sector current balance	-3 1/2	-2 3/4	-1 3/4	- 3/4	1/2	1 3/4	2 3/4

(1) *General government expenditure excluding privatisation proceeds and lottery-financed spending, and net of interest and dividend receipts.*

(2) *Lottery-financed spending, interest and dividend receipts, privatisation proceeds and public corporations' market and overseas borrowing.*

(3) *Definition as for Maastricht criterion.*

2.11 The projected improvement in the PSBR is largely driven by the Government's tax and spending policies. Over the next five years, the PSBR as a share of GDP is projected to fall by more than 5 percentage points. Tight control of government spending contributes over 4 percentage points of this reduction, and is in line with the Government's objective of getting spending as a share of GDP down below 40 per cent. The Budget measures designed to protect the ordinary taxpayer will help secure the tax base. These changes, along with the existing commitment to future real increases in road fuel and tobacco duties, raise the ratio of government receipts to GDP.

2.12 The continuing fall in borrowing at first stabilises, and then reduces, the ratio of government debt to GDP. Lower borrowing reduces the burden of debt interest payments over time, helping to release resources for spending on public services or reducing taxes. The debt ratio is lower than in 1979, in contrast to all other major European Union countries where very sharp increases have been recorded.

2.13 The general government financial deficit (GGFD) ratio to GDP is forecast to fall below the 3 per cent Maastricht reference value in 1997-98, enabling the UK to meet the 1997 deficit criterion for qualification for participation in the single currency. The corresponding ratio of gross general government debt to GDP remains below its reference value of 60 per cent throughout.

This compares favourably with the position of other European Union member states.

2.14 The development of resource accounting and budgeting, as set out inlastyear's White Paper "Better Accounting for the Taxpayer's Money" (Cm2929), will contribute to the overall picture of the public finances and help ensure that decisions on public sector current and capital spending better reflect their economic significance. Resource accounting will be implemented in all government departments by 1998, and the first resource accounts will be published in respect of 1999-2000. These will provide information on the use of assets and the allocation of expenditure by objective. Resource budgeting will be introduced in 2000.

2.15 In recent years national saving has risen from the relatively low levels to which it fell in the early 1990s. The continuing reduction of public sector borrowing can be expected to raise the level of national saving, providing resources for investment and improving the long-run productive potential of the economy.

Improving long-term economic performance

2.16 Structural measures play an important role in improving the long-term performance of the economy. The Government has introduced an extensive programme of policies to improve the flexibility and competitiveness of the economy by making markets work better, as set out in the box below.

2.17 These policies have resulted in many improvements:

- business sector overall productivity has grown faster in the UK since 1979 than in any other major industrial economy;

- so far in the 1990s the share of UK income being spent by businesses on investment is greater than that spent in the 1980s, which in turn was greater than in the 1970s;

- the UK has succeeded in attracting record levels of inward investment, including nearly 30 per cent of all inward direct investment in the European Union, and over 40 per cent of North American and Japanese investment in this region;

- in the latest recovery employment began to rise sooner and unemployment began to fall earlier than in the previous recovery; unemployment peaked in the 1990s at a lower level than the previous peak for the first time since the 1960s, unlike any other major European Unioncountry; long-term unemployment was also lower on a similar comparison, both absolutely and as a proportion of total unemployment;

- unemployment has fallen steadily for almost four years without putting upward pressure on wages; and earnings growth is running at half the rate seen in the 1980s recovery;

- working days lost to strikes fell in the 1990s to their lowest levels since records began over 100 years ago;

- during the 1980s the UK met reviving demand by sucking in imports. In this recovery, imports have grown but exports have risen faster. Thecurrent account is broadly in balance and is expected to remain so.

Structural policies have played an important part in the strength of this recovery and are key reasons why it can be sustained into the future.

2.18 Both the IMF and the OECD recently commended the UK for its programme of reforms. The IMF said that "structural policies - notably privatisation, labour market reforms and deregulation - have contributed importantly to improving economic performance and prospects"; while the OECD in its annual survey of the UK economy noted these reforms had helped the UK become "a more flexible and less inflation prone economy".

2.19 The Budget continues to build on this success by cutting tax rates further, and by targeting spending on priority areas such as the health service, education and combating crime while maintaining a responsible approach to the public finances.

Policies to improve long-term economic performance

Cutting tax rates to sharpen incentives

- the basic rate of income tax has been cut from 33 per cent in 1978-79 to 23 per cent from 1997-98;

- the main rate of corporation tax has been reduced from 52 per cent in 1978-79 to 33 per cent now - the lowest of any major industrialised country;

- four out of five companies pay tax at the small companies rate, which has been reduced from 42 per cent in 1978-79 to 23 per cent from 1997-98;

- tax reliefs for Venture Capital Trusts and Enterprise Investment Schemes have helped promote investment in small firms.

A higher quality workforce and a more responsive labour market

- the labour market has been made more flexible through changes in employment and industrial relations law, decentralised pay setting and more flexible working arrangements;

- a range of active labour market measures has helped unemployed people to get jobs and to compete effectively in the labour market;

- reforms in education and training have contributed to higher standards and increased participation; almost 90 per cent of 16 year olds are now in education and training compared with 71 per cent in 1989-90, and almost one in three young people enter higher education, compared with one in seven in 1987.

Reducing and reforming the public sector

- 50 major businesses have been privatised since 1979 and the state-owned sector of industry reduced by about two-thirds. Privatisation has brought substantial benefits both to consumers, in terms of lower prices and better quality of service, and to taxpayers;

- the Private Finance Initiative has harnessed private sector efficiency and management expertise, with over £7 billion of deals now agreed;

- market testing, contracting out and competitive tendering have improved efficiency throughout the public sector;

- reforms in the NHS and other public services have led to improvements in efficiency and better levels of service.

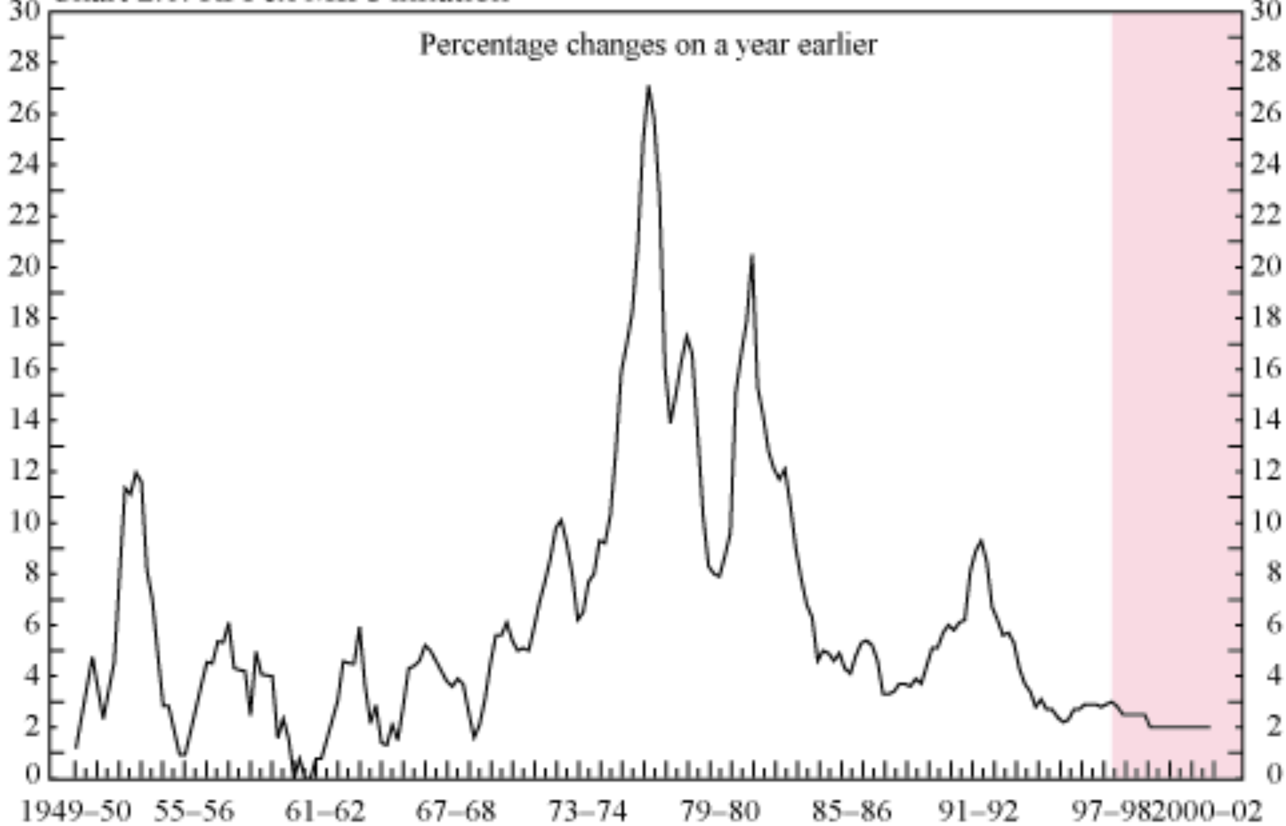
More efficient product markets

- deregulation measures have included liberalisation of the financial services sector and abolition of foreign exchange and rent controls;

- the UK has improved market opportunities for businesses through a commitment to trade liberalisation, for example by taking the lead in implementing and developing the European Union single market, and in other areas such as the negotiation of double taxation agreements.

[Prepared November 1996]

Chart 2.1: RPI ex MIPs inflation[1]



[1]Quarterly outturns until 1996 Q3; forecast from Table 3.6; projections (financial year averages) thereafter.

3 The economy: recent developments and prospects

Summary

3.01 The economy is well into its fifth year of healthy growth. GDP rose at an annual rate of around 2 1/2 per cent over the first three quarters of 1996, which is probably close to its long-run trend. Over the year to October, claimant unemployment fell by a further 235,000, and is now almost 1 million below its peak in December 1992. Underlying retail price inflation has remained at around 3 per cent over the past year. The current account was in broad balance over the first half of 1996.

3.02 Final demand has been rising strongly since the start of this year. Until mid-year, output growth was held back by an adjustment in stocks, following excess accumulation in 1995. But output growth appears to have quickened in the second half of this year.

3.03 GDP is forecast to grow by 3 1/2 per cent in 1997. Consumer demand is likely to remain strong, reflecting high personal wealth, rising real incomes and improved consumer confidence. Surveys of investment intentions point to a further acceleration in business investment over the coming year. Exports have grown more strongly this year, and should benefit from improving European markets.

3.04 Higher import costs were tending to push up inflation in 1995. This pressure has now eased, and producer output price inflation has fallen from 4 1/2 per cent at the end of last year to under 1 per cent in October. Underlying retail price inflation is forecast to fall from around 3 per cent in the fourth quarter of this year to 2 1/2 per cent by the second quarter of next year, as lower import and producer prices gradually work through to prices in the shops.

Table 3.1 Summary of forecast

			Forecast	
	1995	1996	1997	1998 H1
Real GDP growth (per cent)	2 1/2	2 1/2	3 1/2	3
Inflation (RPI excluding MIPs, Q4)	3	3	2 1/2	2 1/2 (1)
Current account (£ billion)	-4	-2 1/4	-4 1/4	-4 3/4 (2)

(1) Q2.
(2) At an annual rate.

The economy in the short term

The world economy

Summary

3.05 G7 growth continued at around trend in the first half of 1996, but the pattern varied markedly across countries, with continuing weakness in Europe offset by strength in the US and Japan. There are now signs that the recovery in Europe expected for the second half of this year is underway. The US economy grew faster than trend in the first half of the year, but growth is now slowing to a more sustainable rate. Japan has finally started to emerge from recession: growth was erratically strong in the first half of the year, but should continue at a more modest pace from now on. Overall, G7 growth is expected to average 2 1/4 per cent in 1996. With recovery firming in Europe, growth across the G7may converge next year, while still averaging around 2 1/4 per cent.

Table 3.2 The world economy

Percentage changes on a year earlier

			Forecast	
	1995	1996	1997	1998 H1
Major seven countries(1)				
Real GDP	2	2 1/4	2 1/4	2 1/2
Domestic demand	2	2 1/2	2 1/4	2 1/4
Industrial production	3	2 1/4	2 3/4	2 3/4
Consumer price inflation(2)	2 1/4	2 1/4	2 1/4	2 1/4
World trade in manufactures	10 1/2	6 1/2	7 1/4	7 3/4
UK export markets(3)	9 3/4	6	6 1/2	7 1/4

(1) G7: US, Japan, Germany, France, Italy, UK and Canada.
(2) Final quarter of each period. For UK, RPI excluding mortgage interest payments.
(3) Other countries' imports of manufactures weighted according to their importance in UK exports.

3.06 World trade has grown more slowly than in 1995, partly reflecting a weakening of Asian trade growth. Oil prices have increased sharply in recent months, but non-oil commodity prices have weakened. World inflationary pressures remain subdued.

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Europe

3.07 The activity picture in Europe has brightened a little since the early summer. In Germany, growth was stronger than expected in the second quarter. However, a considerable part of the 1 1/2 per cent increase in GDP reflected special factors, and growth is expected to stabilise at a slower rate in the second half of the year. Although fiscal policy is set to be tightened significantly, the currently low level of interest rates, rising exports and some pick-up in investment should see the recovery continue in 1997.

3.08 In France, GDP fell by nearly 1/2 per cent in the second quarter, following a strong rise in the first quarter. All the components of expenditure eased back, but this partly reflected one-off factors. The third quarter should see some rebound, following strong consumption growth over the summer. The low level of interest rates should help underpin the recovery, but growth for 1996 as a whole is still likely to be very subdued. As in Germany, prospects for next year and beyond look better.

3.09 After holding up well until the fourth quarter of last year, activity in Italy has since weakened. But with inflation at record low levels and recent interest rate cuts, prospects for 1997 seem brighter. The situation in the rest of Europe generally reflects that in the larger countries, with relatively low growth rates likely for 1996 but a pick-up expected next year. For the European Union as a whole, growth is expected to be around 1 1/2 per cent this year, rising to 2 1/4 per cent in 1997.

United States

3.10 Growth in the US was faster than trend through the first half of 1996, at an annual rate of 3 1/4 per cent. But growth slowed to an annual rate of 2 1/4 per cent in the third quarter, with a marked slowdown in consumer spending and housing investment. Growth is expected to continue at around its trend rate of 2 to 2 1/2 per cent from now on.

Japan

3.11 In Japan, recovery now looks to be firmly established, but the take-off has not been smooth. Growth, at an annual rate of 6 per cent in the first half of the year, was inflated both by public spending and the leap year effect. With public investment set to fade, growth should start to slow in the second half of the year, but the average for 1996 as a whole should still be the strongest for five years. Private sector demand is slowly taking over as the main engine of growth. Residential investment has led the way, but business investment and consumer demand have started to follow suit. The drag from net exports is also starting to fade. Despite next year's fiscal consolidation, growth is likely to continue, although at rates significantly slower than the 4 per cent averaged over the 1980s.

World trade

3.12 Growth in world trade in manufactures slowed from over 11 per cent at an annual rate in the first half of 1995 to 7 1/2 per cent in the second half, reflecting the slowdown in Europe and the US. It is estimated to have slowed further, to around 6 per cent, in the first half of 1996, as European activity remained weak and Asian trade growth slowed. World trade growth is forecast to pick up in 1997 and the first half of 1998 as European activity strengthens and Asian exports recover from their slump in 1996. UK export markets are forecast to continue growing more slowly than world trade in 1997 and the first half of 1998, reflecting faster growth in developing countries and strong intra-regional trade in Asia.

Commodity prices

3.13 Oil prices have risen sharply in recent months, and are now above theirearlier peak in the spring. It is difficult to explain this increase, although low stock levels and continuing uncertainty over the return of Iraq to the oil market have been contributory factors. The fundamentals of supply and demand generally seem to point to lower prices, but recent volatility means that any assumption about oil prices is very uncertain. For the purpose of the forecast, Brent oil prices are assumed to remain relatively high over the course of next year, averaging $21 per barrel for the year as a whole.

3.14 By contrast, non-oil commodity prices have weakened recently. Metals prices remain low following the collapse in copper prices over the summer, and grain prices have dropped sharply since the spring. The short-term outlook for raw materials prices remains weak and, with G7 growth projected to be around trend next year, non-oil commodity prices are unlikely to be a source of world inflationary pressure.

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Inflation

3.15 G7 consumer price inflation has been steady at around 2 1/4 per cent since the middle of 1995. Some have pointed to an inflation risk in the US, where unemployment is now below the level at which inflation has picked up in the past. But there is little evidence of inflationary pressures to date and, with growth now slowing, underlying inflation is not expected to pick up significantly from the rates seen over the past two years. Some margin of spare capacity is likely to continue to exert downward pressure on inflation in Japan and Europe. Overall, G7 consumer price inflation is forecast to remain at around 2 1/4 per cent in 1997 and the first half of1998.

Interest rates

3.16 Official short-term interest rates have been unchanged since January in the US and since September 1995 in Japan, but there has been some recent mild easing in continental Europe. Following a cut in the Bundesbank's repo rate in late August, most other European central banks have reduced short-term interest rates.

3.17 Following some unsteadiness over the summer, G3 long-term interest rates have fallen slightly in recent months. But the rise in long rates in the US at the start of the year has been sustained. As German long rates have drifted down since the early summer, yields in the rest of Europe have also fallen. Long-term interest rates in Japan remain low.

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The UK economy

Demand and output

3.18 Demand growth slowed in 1995, partly in response to the slowdown in activity in continental Europe. The impact on output was cushioned by an accumulation of excess stocks, and GDP grew at an annual rate of around 2per cent for much of the year. Consumer demand has strengthened since the beginning of 1996, and exports have also grown more strongly. After little growth in 1995, business investment was up substantially in the first three quarters of this year.

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3.19 Despite this strengthening of final demand, GDP growth did not pick up in the first half of 1996, as firms ran off their excess stocks. However, there are now clear signs that stronger demand is feeding through to output, and GDP grew at an annual rate of over 3 per cent in the third quarter.

3.20 It is mainly service sector output that has strengthened this year, growing at an annual rate of over 3 1/2 per cent in both the second and third quarters. Manufacturing output remained broadly flat over the year to the second quarter, held back by stock adjustment. However, it then rose by 0.7per cent in the third quarter, and business surveys suggest that it will strengthen further in the coming months. After showing little change for over a year, construction output also rose in the third quarter.

Prospects

3.21 Stock adjustment may largely have run its course. Consumers' expenditure is likely to continue to expand quickly in response to higher incomes and wealth and rising consumer confidence. With capacity utilisation rising and company balance sheets strong, this should be accompanied by a continued recovery in business investment. And exports should benefit from a strengthening of activity elsewhere in Europe. Against this background of rising demand, GDP is forecast to grow at an annual rate of almost 3 1/2 per cent over the next 18 months.

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Personal sector and the housing market

Consumers' expenditure

3.22 Consumers' expenditure has strengthened since the end of last year, growing at an annual rate of almost 4 per cent over the first three quarters of 1996, compared with growth of 2 per cent in 1995 as a whole. The pattern of spending has also changed. While services accounted for much of the growth in spending in the first half of 1995, it is spending on durable goods which has led the way so far this year. This is consistent with rising consumer confidence, strong growth in consumer credit and a recovering housing market.

3.23 Monthly indicators suggest that consumer spending has continued to grow strongly. Retail sales in the three months to October were 4 per cent higher than a year earlier, while the CBI Distributive Trades Survey shows the most buoyant annual sales growth for over eight years. New car registrations in the three months to October were up 3 1/2 per cent on a year earlier. Consumer credit rose by 16 per cent over the year to September, and the EC/GfK index of consumer confidence has risen to its highest levels since the late 1980s.

3.24 Real personal disposable income is forecast to grow by 3 3/4 per cent this year. Dividend payments, which increased by a quarter in 1995, are unlikely to rise as much this year; but real earnings are now growing more quickly, and the income tax cuts which took effect in April have added over 1/2 per cent to disposable incomes. Taking account of the tax changes announced in this Budget, real disposable incomes are projected to grow by 2 1/4 per cent next year.

3.25 Net financial wealth has grown by over 25 per cent in the past 18months as a result of strong share prices and high personal saving. Total wealth is also being boosted by rising house prices.

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3.26 With rising wealth and consumer confidence, low inflation, a shift in the balance of income growth from dividend income to wages and salaries, and further consumer windfalls from pay-outs associated with building society conversions, the saving ratio is likely to fall over the next two years. It is assumed to decline from around 12 per cent in the first half of this year to around 8 3/4 per cent by the first half of 1998, although this is still relatively high in comparison with previous periods of low inflation. With real incomes rising and the saving ratio falling, consumers' expenditure is forecast to grow by 4 1/4 per cent in 1997.

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Housing market

3.27 The recovery in the housing market is now well established. According to both the Halifax and Nationwide indices, prices have been rising since the middle of 1995, and in October were over 7 per cent higher than a year earlier. Rising house prices have helped to reduce the number of households in negative equity to less than half the peak level at the end of 1992.

3.28 Activity has also been increasing. In the third quarter of this year, the number of mortgage loans approved by banks and building societies was up by 28per cent on a year earlier, and in the three months to October turnover (as measured by particulars delivered at the Land Registry) was up by 19per cent on a year earlier.

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3.29 Low mortgage rates, rising real incomes and a low house price-earnings ratio mean that houses are very affordable, and the number of first-time buyers is now increasing. A relative shortage of certain types of property on the market has tended to push up prices. However, supply should increase in the course of the next 18months, as rising prices encourage last-time sellers or those trading down to put their houses on the market and the recent increase in new housing starts feeds through to higher completions. This increase in supply should help to moderate the increase in house prices.

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Housing investment

3.30 Private housing investment, which includes both new housebuilding and improvements to existing properties, is forecast to grow only slightly this year. The pick-up in housing starts in recent months, as housebuilders have responded to the recovery in the market, should be reflected in stronger housing investment in 1997.

Financial position

3.31 As housing investment rises next year and the saving ratio falls, the personal sector's financial surplus is projected to fall from over 6per cent of income in 1996 to around 2 3/4 per cent of income in the first half of 1998.

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Corporate sector and investment

Profits

3.32 Profits increased by around a third between 1992 and 1994. They grew more slowly from the beginning of 1995 as productivity growth temporarily slowed. But both profits and the rate of return on capital remain high by historical standards.

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3.33 The financial surplus of industrial and commercial companies has fallen from around 2 per cent of GDP in 1994 to under 1per cent of GDP in the first half of this year. However, company liquidity remains high, and the balance of firms in the CBI survey citing a shortage of internal finance as a constraint on investment eased in October to its lowest level for over seven years. The balance of firms citing a lack of external finance as a constraint on investment remains at very low levels. Companies should therefore have little difficulty in financing higher expenditure on fixed investment and stocks.

Investment

3.34 Business investment remained little changed as a percentage of GDP between 1993 and 1995, but it has increased sharply so far this year. Although the quarterly profile has been erratic, in the first three quarters of 1996 it was on average 6per cent higher than a year earlier.

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3.35 Manufacturing investment grew strongly in 1994 and early 1995, but then fell from the fourth quarter of 1995 to the second quarter of 1996. However, investment intentions in both the CBI and BCC surveys remain substantially positive, and manufacturers may have postponed rather than cancelled investment. Manufacturing investment rose by 1per cent in the third quarter. Non-manufacturing business investment fell in the third quarter from an exceptionally high second-quarter level, which was boosted by a large delivery of aircraft. However, it was still almost 8 per cent higher in the third quarter than a year earlier and the BCC survey reports that investment intentions in services have strengthened.

3.36 Overall, business investment is forecast to increase by 6 per cent this year and by 9 1/4 per cent next year. This takes full account of the substantial investment planned under the Private Finance Initiative, which offsets planned reductions in directly-financed public investment. Whole economy investment is projected to increase by 3 per cent this year and by 6 1/4 per cent next year. (Details of investment planned under the Private Finance Initiative are set out in Chapter 5.)

Table 3.3 Gross domestic fixed capital formation

	Percentage changes on a year earlier			
			Forecast	
	1995	1996	1997	1998 H1
Business(1)	1	6	9 1/4	7 3/4
Private dwellings and land(2)	-1	4 1/2	9 1/4	3 3/4
General government(3)	-3 3/4	-9 3/4	-10 3/4	0
Whole economy	- 1/4	3	6 1/4	5 3/4

(1) Includes investment by public corporations (except National Health Service Trusts) and investment under the Private Finance Initiative.
(2) Includes net purchases of land and existing buildings for the whole economy.
(3) Excludes net purchases of land and existing buildings; includes National Health Service Trusts.

Stockbuilding

3.37 Stockbuilding was heavy during most of 1994 and 1995. Stockbuilding in distribution was particularly heavy in 1994, and probably reflected expectations of strong demand. The large build-up of manufacturing stocks did not begin until the turn of 1995 and was probably largely involuntary, as firms failed to anticipate the slowdown in final demand.

3.38 Stock adjustment has been underway in manufacturing since the beginning of this year, and this held back manufacturing output at a time when demand was strengthening. Whole economy stockbuilding fell sharply in the second quarter, taking almost 1 percentage point off GDP growth, but it changed little in the third quarter.

3.39 Stock-output and sales ratios remain high in both manufacturing and retailing. With consumer demand strengthening, there should be little incentive for retailers to run off stocks. Destocking in retailing and wholesaling in the third quarter probably reflected stronger than expected demand. Business surveys indicate that there could be some further stock adjustment in manufacturing, but this is likely to be modest. It is assumed that the stock adjustment is complete by the end of this year, and movements in stockbuilding make little contribution to the forecast of GDP growth next year.

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Trade and the balance of payments

Competitiveness

3.40 Cost competitiveness tends to fluctuate with the exchange rate in the short term. It is likely to have deteriorated as sterling has appreciated this year, reversing the improvement associated with the depreciation of sterling in 1995. However, to the extent that firms adjust profit margins, temporary fluctuations in cost competitiveness need not be fully reflected in export price competitiveness. Export profit margins have been healthy in recent years.

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Export volumes of goods

3.41 The slowdown in Europe does not appear to have held back UK exports this year as much as had been feared. The volume of non-oil goods exports to European Union countries grew at an annual rate of 5 3/4 per cent in the first half of the year, and rose further in July/August. Exports to other countries were 11 1/2 per cent higher in the third quarter than a year earlier. Exports of cars have been particularly buoyant - in the three months to August they were around a third higher than a year earlier. Exports are expected to continue to grow quite strongly as the recovery in continental Europe gathers pace. Exports of manufactures are projected to grow broadly in line with UK export markets.

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Import volumes of goods

3.42 Imports of goods have also been rising more quickly this year, and in the three months to August were 8 per cent higher than a year earlier. Imports of basic materials have been weak because of lower stockbuilding, but imports of consumer goods have picked up sharply in recent months. With domestic demand strengthening, import volumes are expected to continue to grow fairly quickly next year.

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Balance of trade in goods

3.43 The deficit on trade in non-oil goods widened a little last year as the terms of trade worsened, but changed little in the first half of this year. The overall trade deficit is forecast to widen a little in 1997, an increase in the surplus on oil partly offsetting a widening in the non-oil deficit.

Table 3.4 Trade in non-oil goods

	Percentage changes on a year earlier					£ billion
	Volumes		Prices(1)			
	Exports	Imports	Exports	Imports	Terms of trade	Non-oil goods balance
1995	8 1/4	4 3/4	5 1/4	8	-2 1/2	-15 3/4
Forecast						
1996	7 1/4	8 1/4	1/4	- 1/4	1/2	-18
1997	6 1/4	7 3/4	-2	-3 1/2	1 1/2	-18 3/4
1998 H1	7	7 3/4	1/2	1/2	0	-20 1/4 (3)

(1) Average value indices.
(2) Ratio of export to import prices.
(3) At an annual rate.

Trade in services

3.44 Following the record figure in 1995, the surplus on services continued at a high level in the second quarter of this year. Export volumes of services have grown strongly over the past two years. They rose by 2 1/2 per cent in the second quarter, although this partly reflected expenditure by foreign visitors to the UK during the European football championships. The strong growth of exports of goods this year may have boosted exports of transport and business services. Import volumes of services grew rapidly in 1994. They slowed in the first half of 1995, but have picked up since and were 5 per cent higher in the first half of 1996 than a year earlier. The services surplus is forecast to remain at around its current level for the remainder of the year - giving a surplus of £6 1/2 billion for the year as a whole. It is forecast to increase to £7 3/4 billion in 1997.

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Investment income

3.45 The surplus on investment income increased from £7 3/4 billion in 1995 to £12 billion (at an annual rate) in the first half of this year. With profits on heavy foreign direct investment in the UK in recent years beginning to build up and interest rates relatively low abroad, the surplus could fall back a little next year, while remaining historically high.

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Current account

3.46 The current account deficit narrowed to just £ 1/2 billion in the first half of this year. With continuing high surpluses on services and investment income and a fallback in net transfers abroad from last year's exceptionally high level, a small current account deficit of £2 1/4 billion is forecast for 1996 as a whole. Given stronger economic growth in the UK than in the rest of the world, the current account deficit is projected to widen a little in 1997, but remain small at around 1/2 per cent of GDP.

Table 3.5 The current account

£ billion

	Manufactures	Oil	Other goods	Services	Total goods & services	Transfers and IPD(1)	Current balance
1994	-7 1/2	4	-7 1/4	4 3/4	-6	3 3/4	-2 1/2
1995	-8	4 1/4	-7 3/4	7	-4 3/4	3/4	-4
Forecast							
1996	-8 1/4	5 1/4	-9 3/4	6 1/2	-6	4	-2 1/4
1997	-8 3/4	5 1/2	-10	7 3/4	-5 1/2	1 1/4	-4 1/4
1998 H1(2)	-10	5 1/4	-10 1/4	8 1/2	-6 1/2	1 3/4	-4 3/4

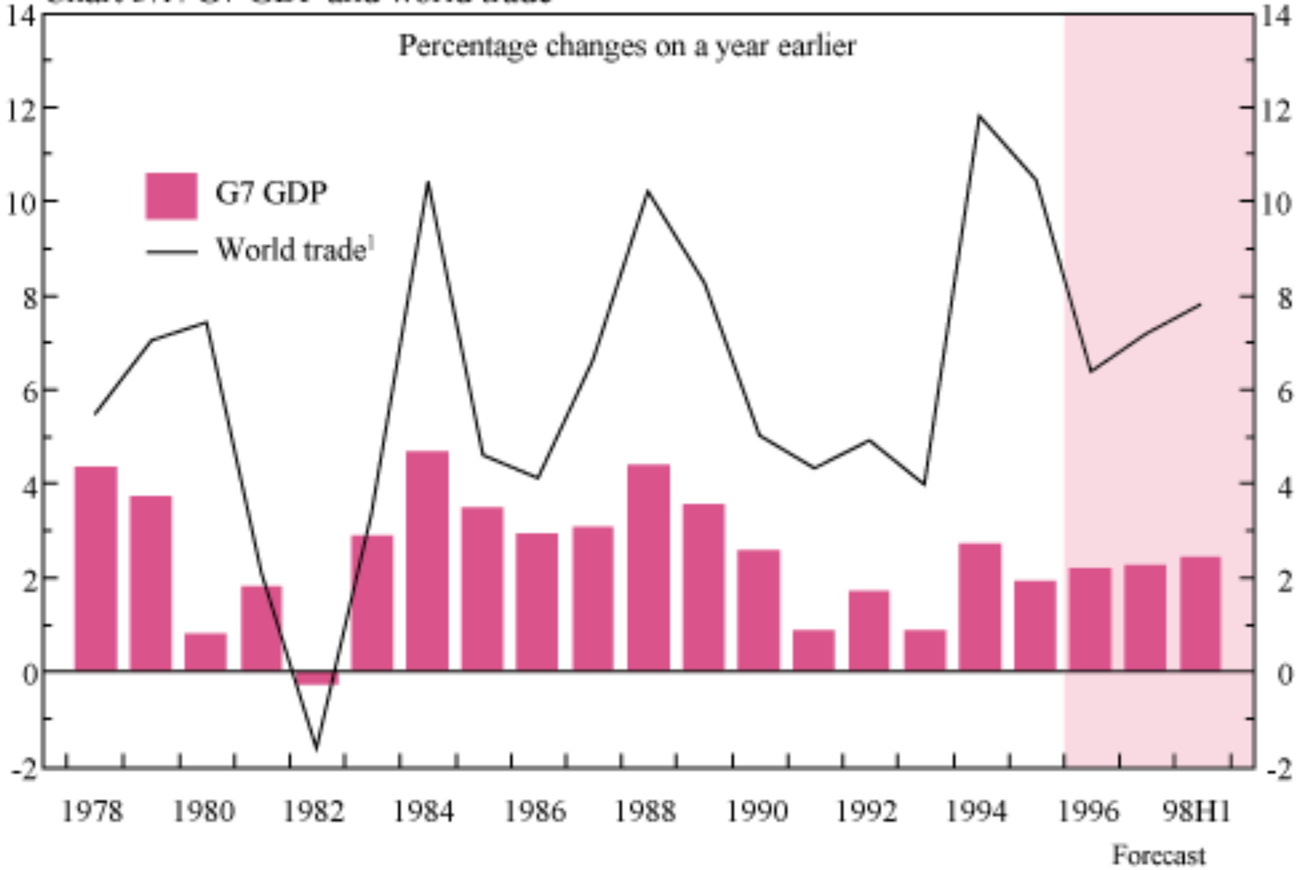
(1) Interest, profits and dividends (net investment income).
(2) At an annual rate.

Overseas assets

3.47 The sterling value of the UK's stock of net overseas assets is estimated to have been around £38billion at the end of 1995, up from around £34 billion a year earlier. This small increase largely reflects the revaluation of existing assets and liabilities. The stock of netoverseas assets is provisionally estimated to have risen to around £55 billion, or 7 1/2 per cent of GDP, in the first half of 1996, its highest level since 1989. This partly reflects favourable revaluations, but also a recorded increase in net capital outflows. However, difficulties in measuring certain capital flows - reflected in the large balancing item in the overseas account - means that estimates of net overseas assets are subject to a wide margin of error.

[Prepared November 1996]

Chart 3.1: G7 GDP and world trade



[1]Manufactures.

Chart 3.2: Non-oil commodity prices[1]

[1]Economist index.

Chart 3.3: G7 long-term interest rates and inflation

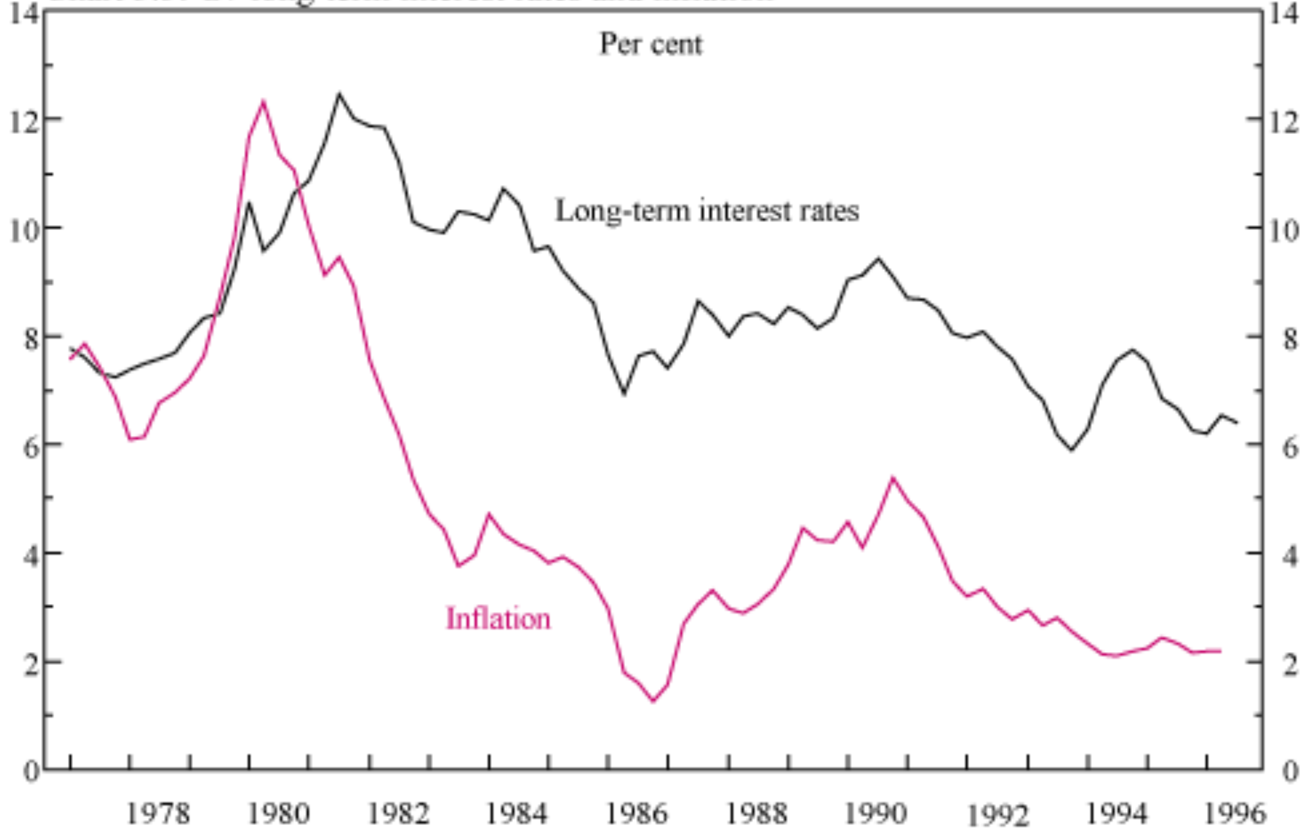
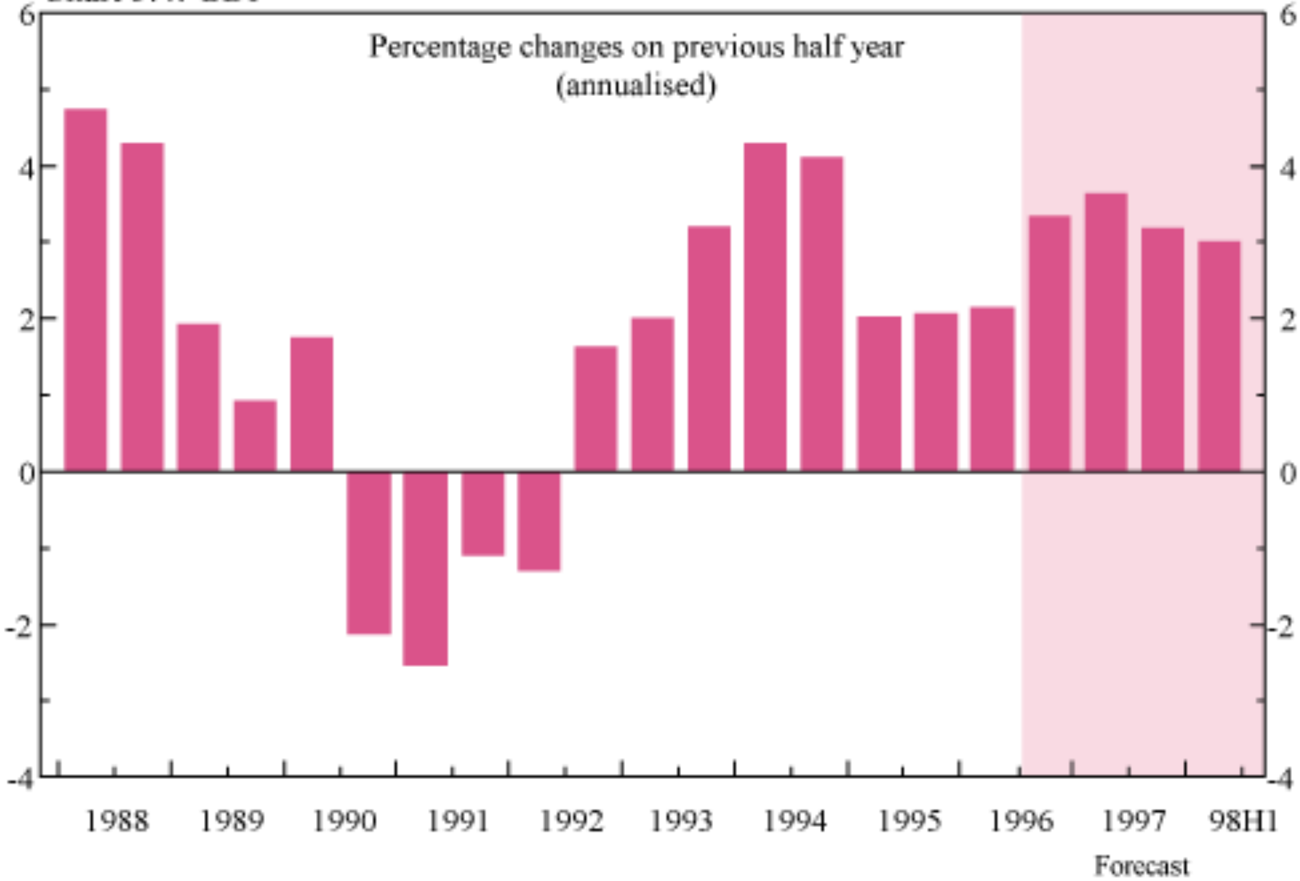
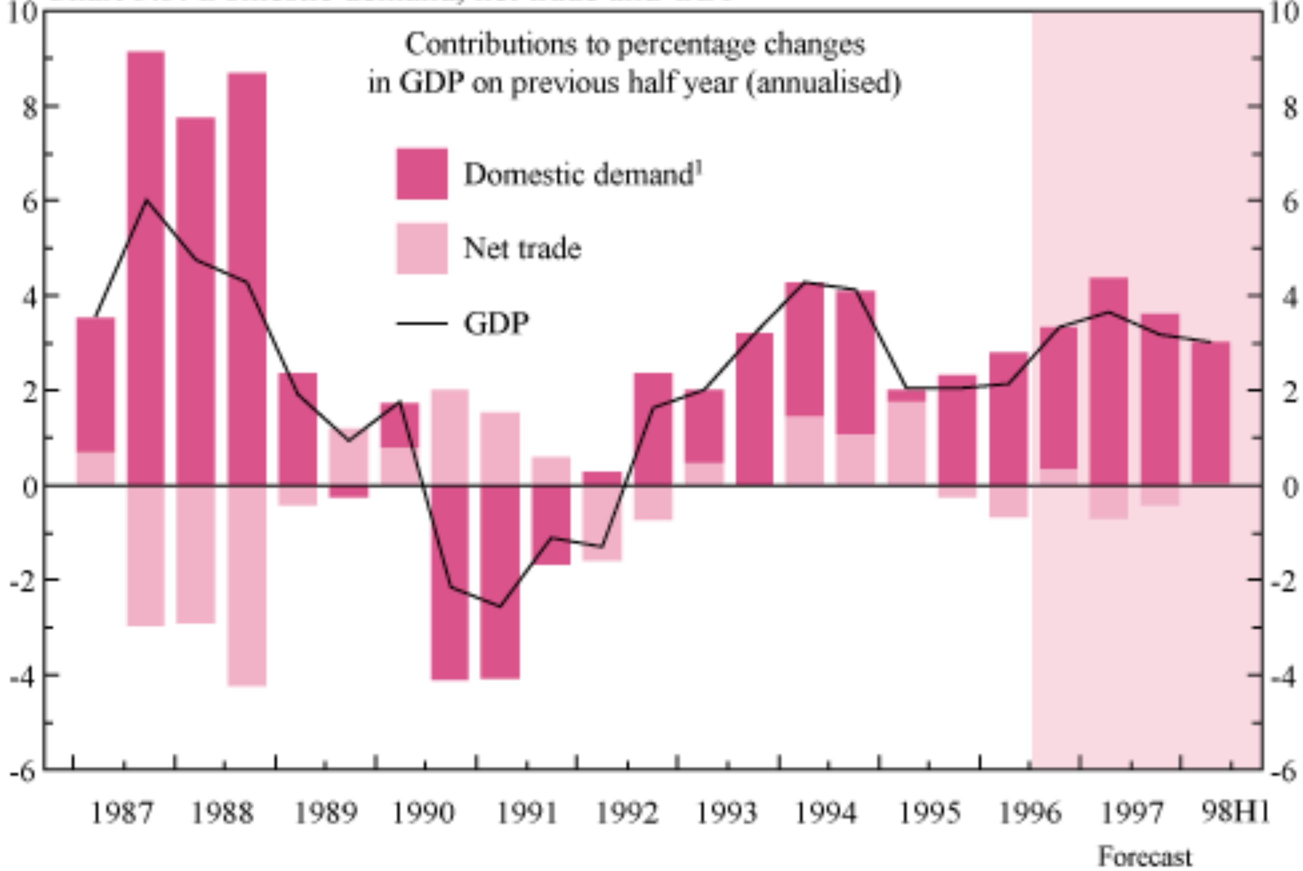


Chart 3.4: GDP



Percentage changes on previous half year
(annualised)
6
4
2
0
-2
-4
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
98H1
Forecast

Chart 3.5: Domestic demand, net trade and GDP



[1]At factor cost.

Chart 3.6: Personal sector wealth-income ratios

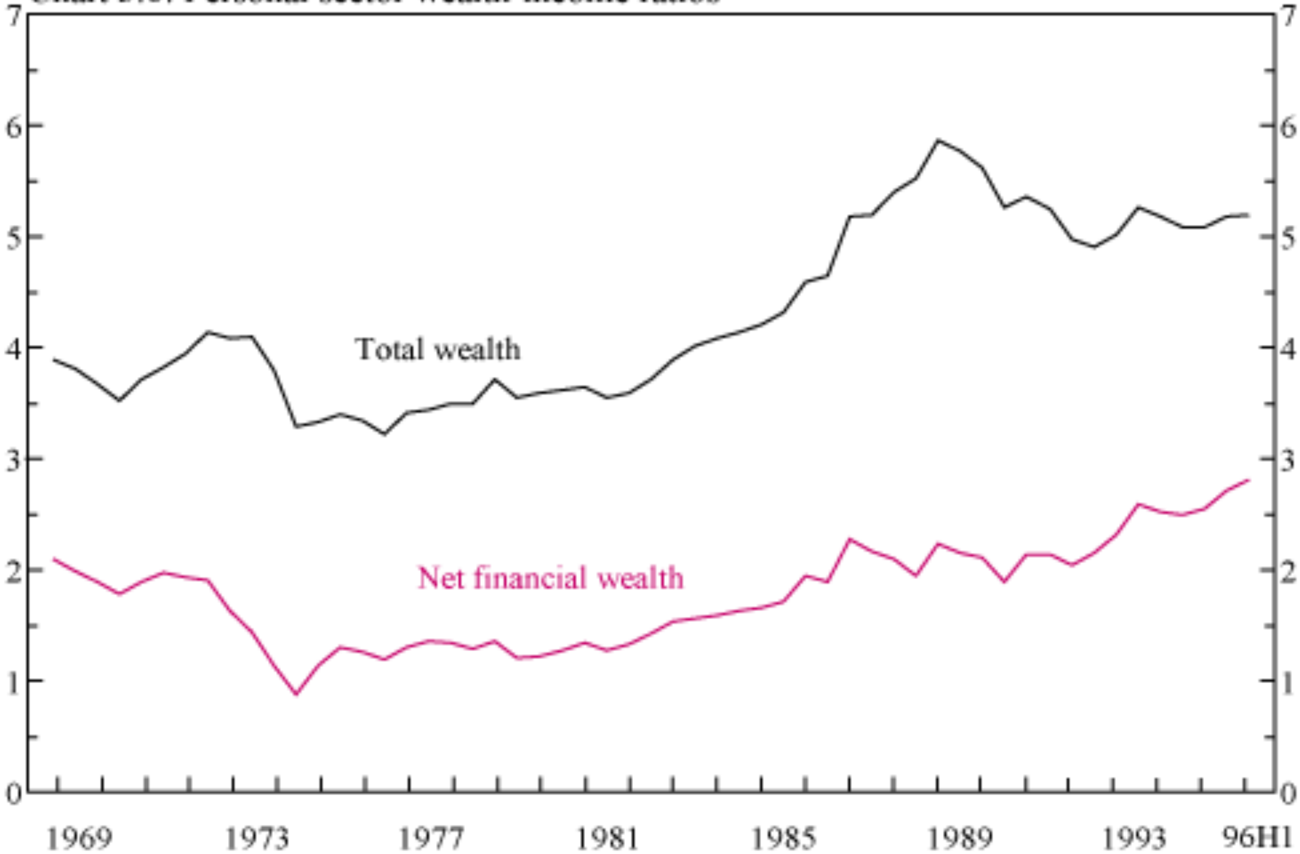


Chart 3.7: Personal sector consumption, income and saving

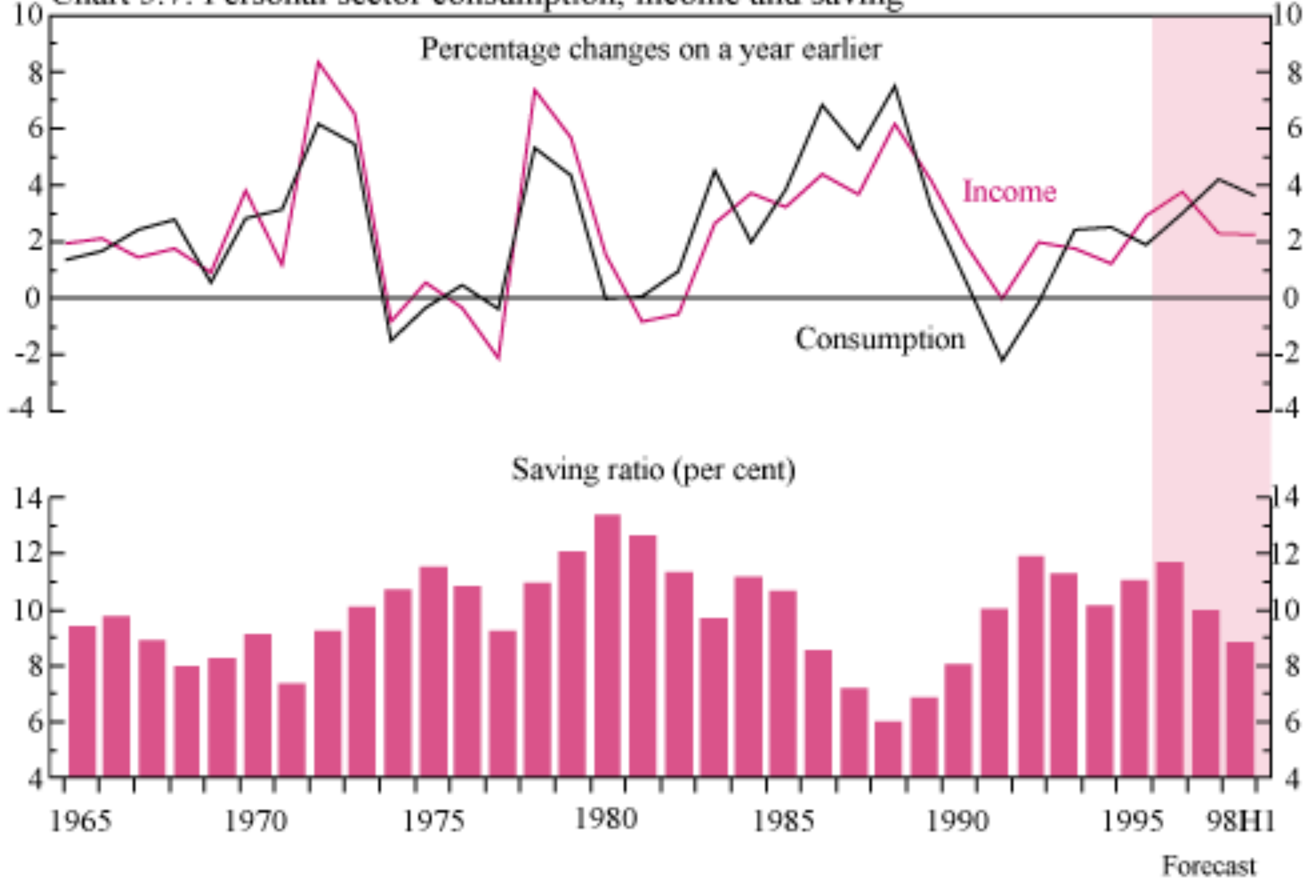
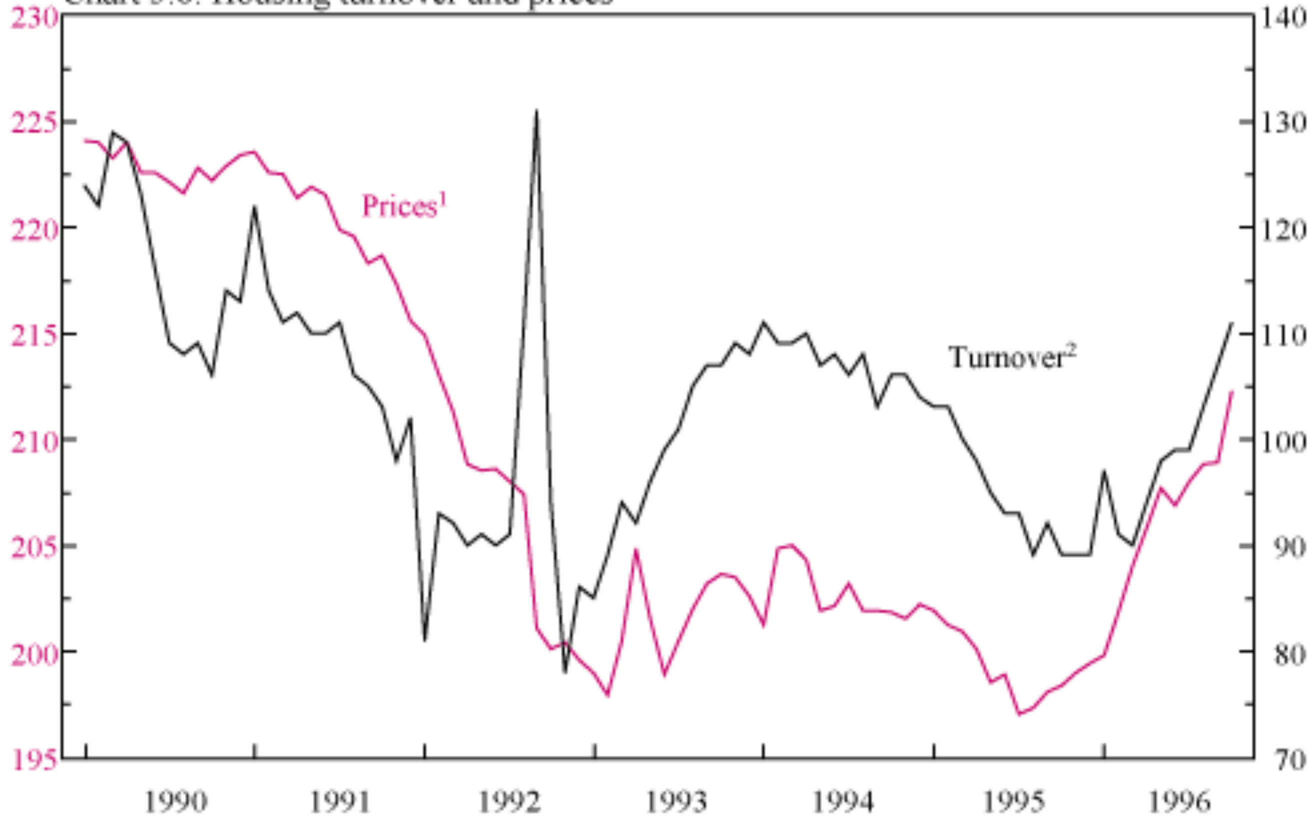
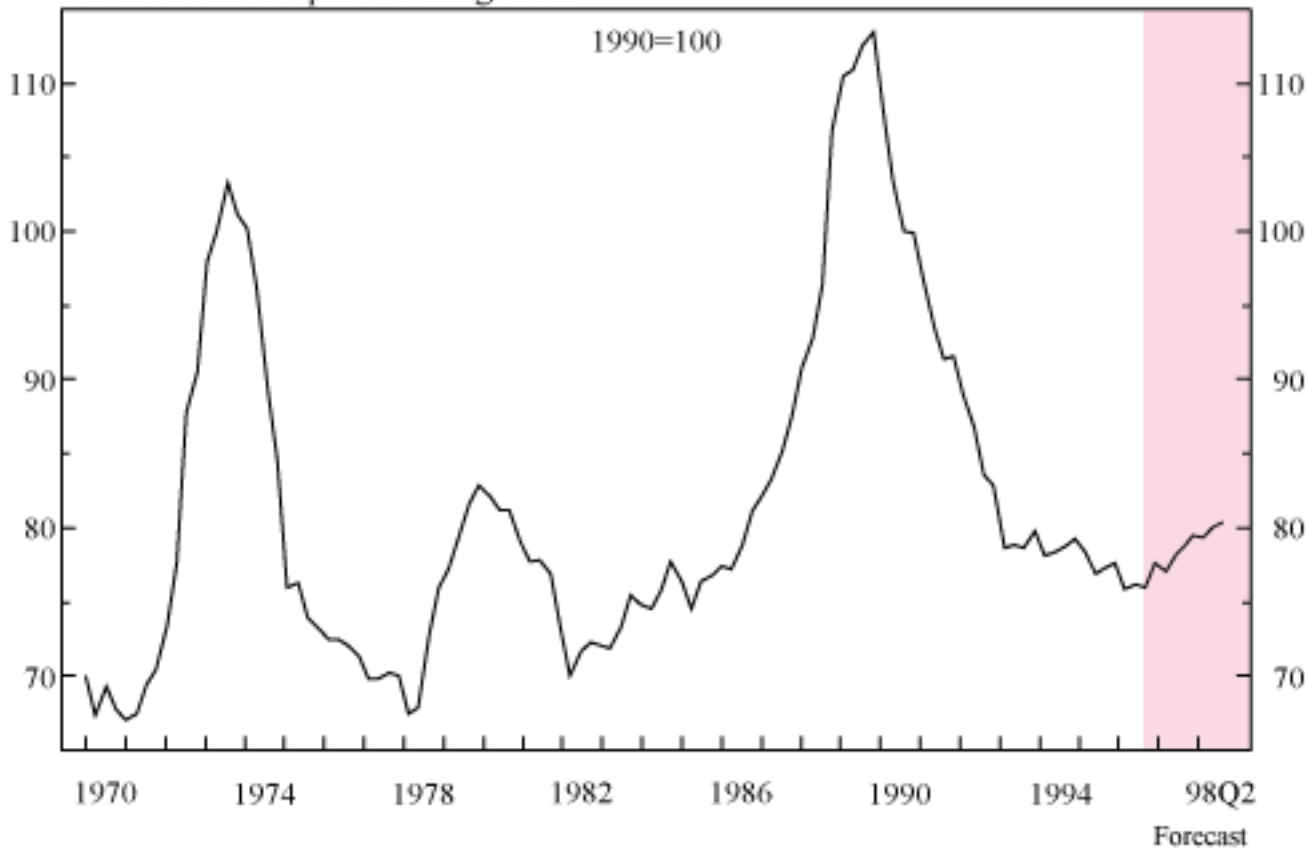


Chart 3.8: Housing turnover and prices



[1]Halifax index, 1983=100, left-hand scale.
[2]Particulars delivered, thousands, right-hand scale.

Chart 3.9: House price-earnings ratio[1]



[1]Ratio of DOE house price index to wages and salaries per head.

Chart 3.10: The personal sector financial balance

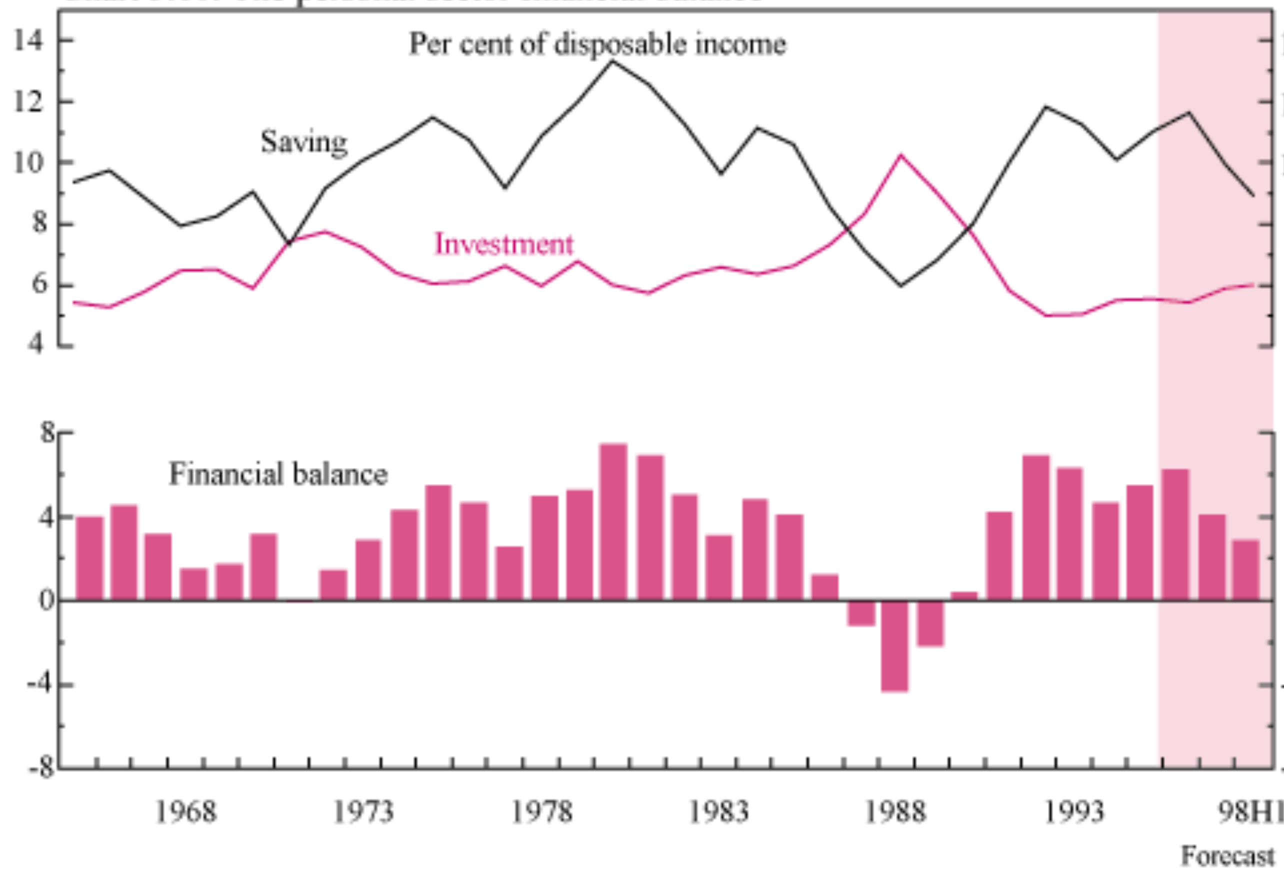
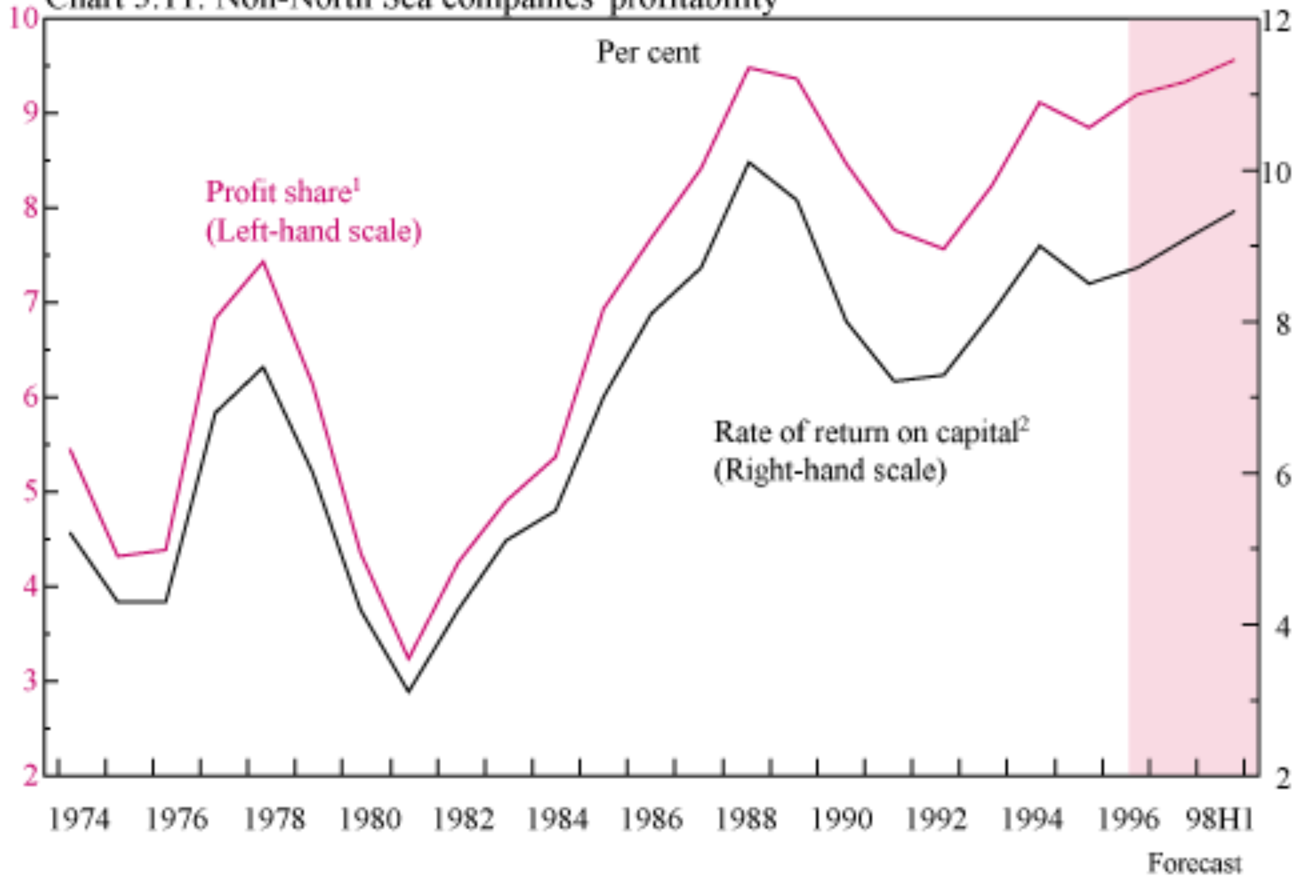
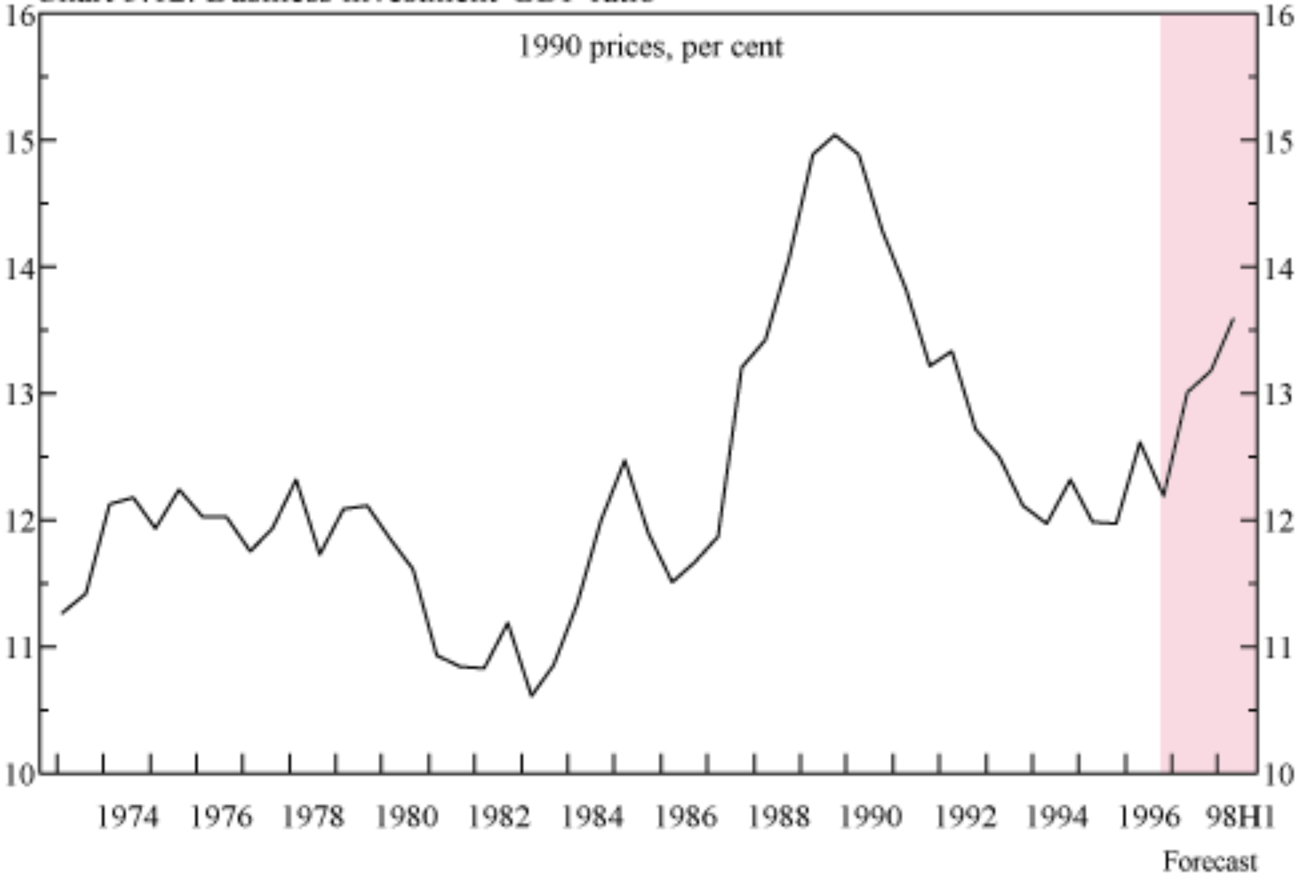


Chart 3.11: Non-North Sea companies' profitability



[1]Trading surplus as a percentage of GDP.
[2]Trading surplus as a percentage of the net capital stock.

Chart 3.12: Business investment-GDP ratio[1]



[1]Business investment includes investment by public corporations (except National Health Service Trusts) and investment under the Private Finance Initiative.

Chart 3.13: Stockbuilding and its contribution to GDP growth

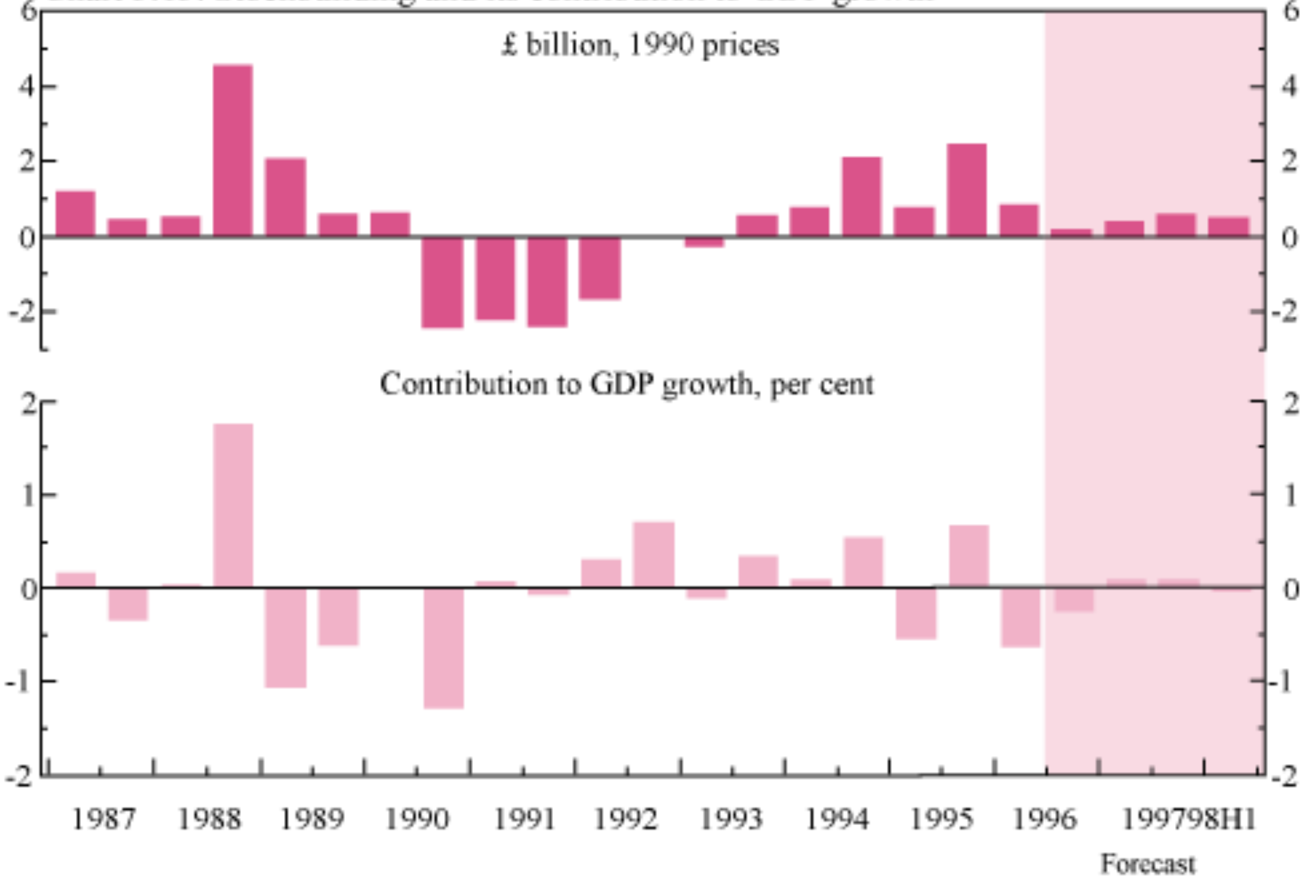
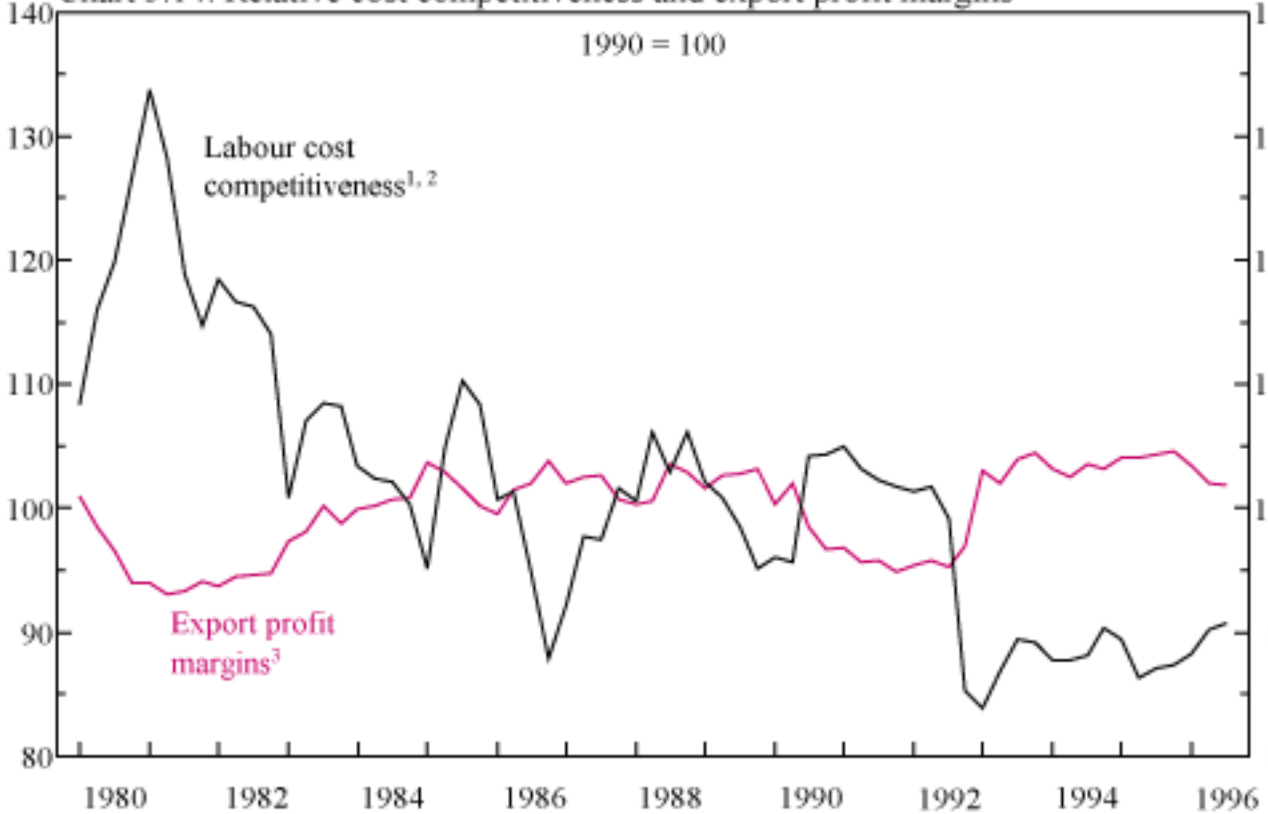


Chart 3.14: Relative cost competitiveness and export profit margins



[1] A fall means competitiveness has improved.

[2] Against major 15 industrial countries.

[3] Ratio of manufacturing export prices to estimated manufacturing costs.

Chart 3.15: Exports and overseas demand

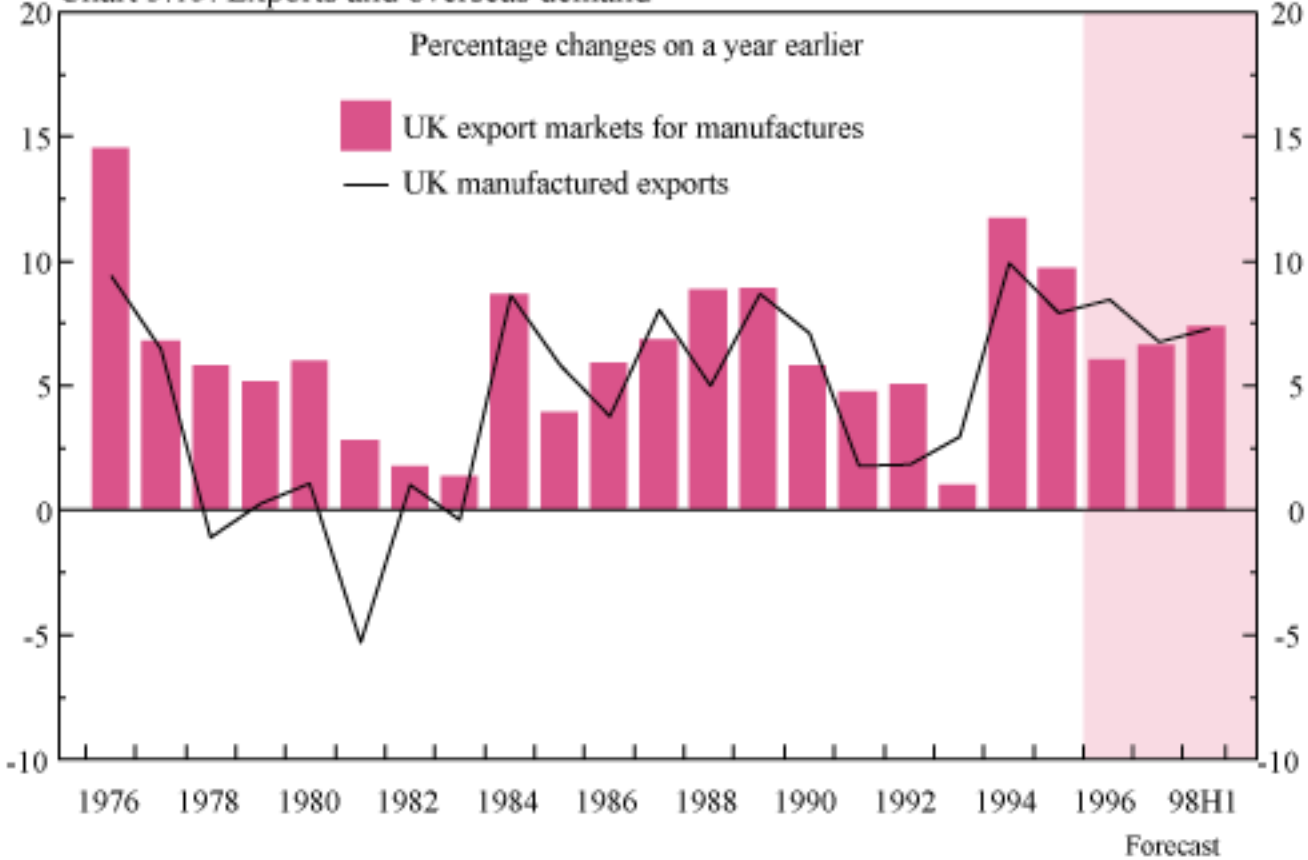


Chart 3.16: Imports and total final expenditure

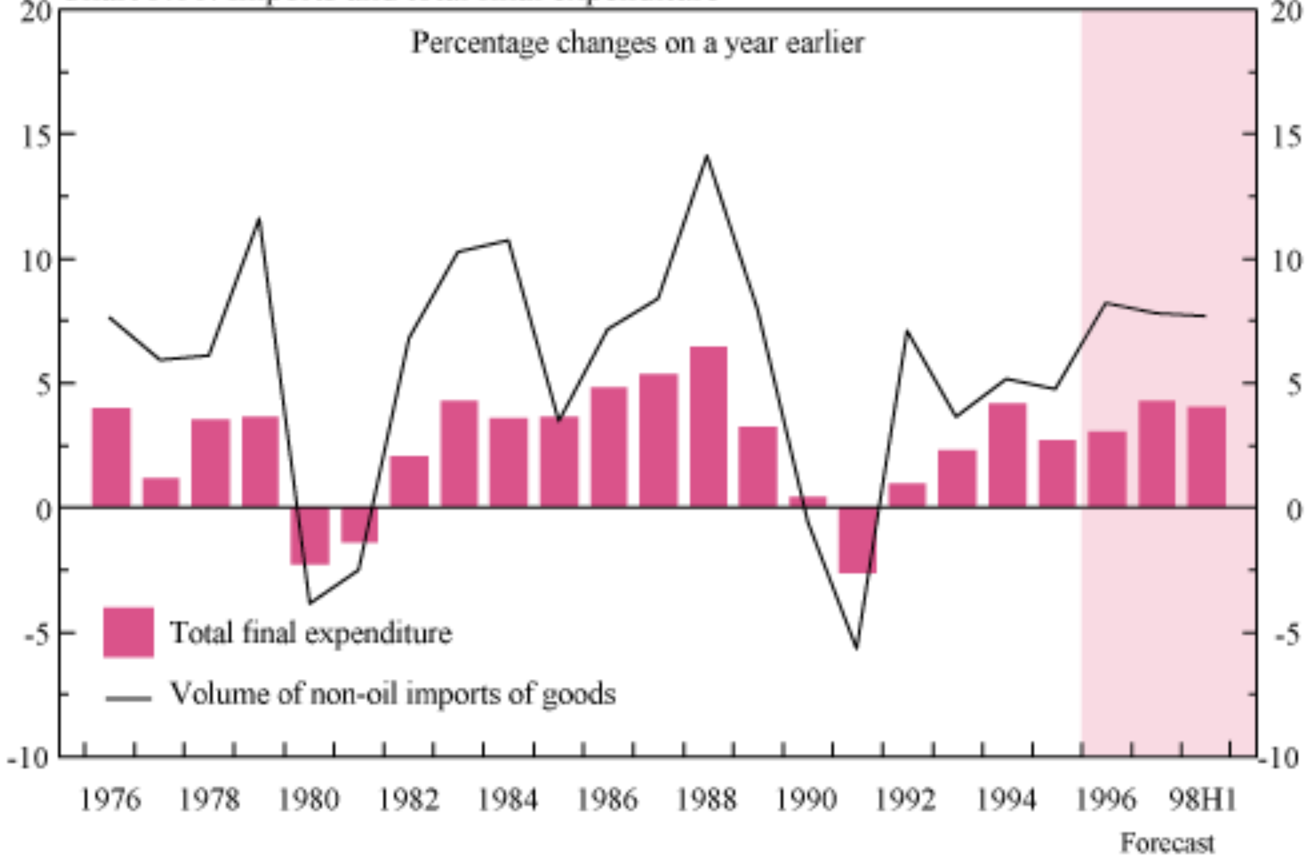


Chart 3.17: Balances on services and investment income

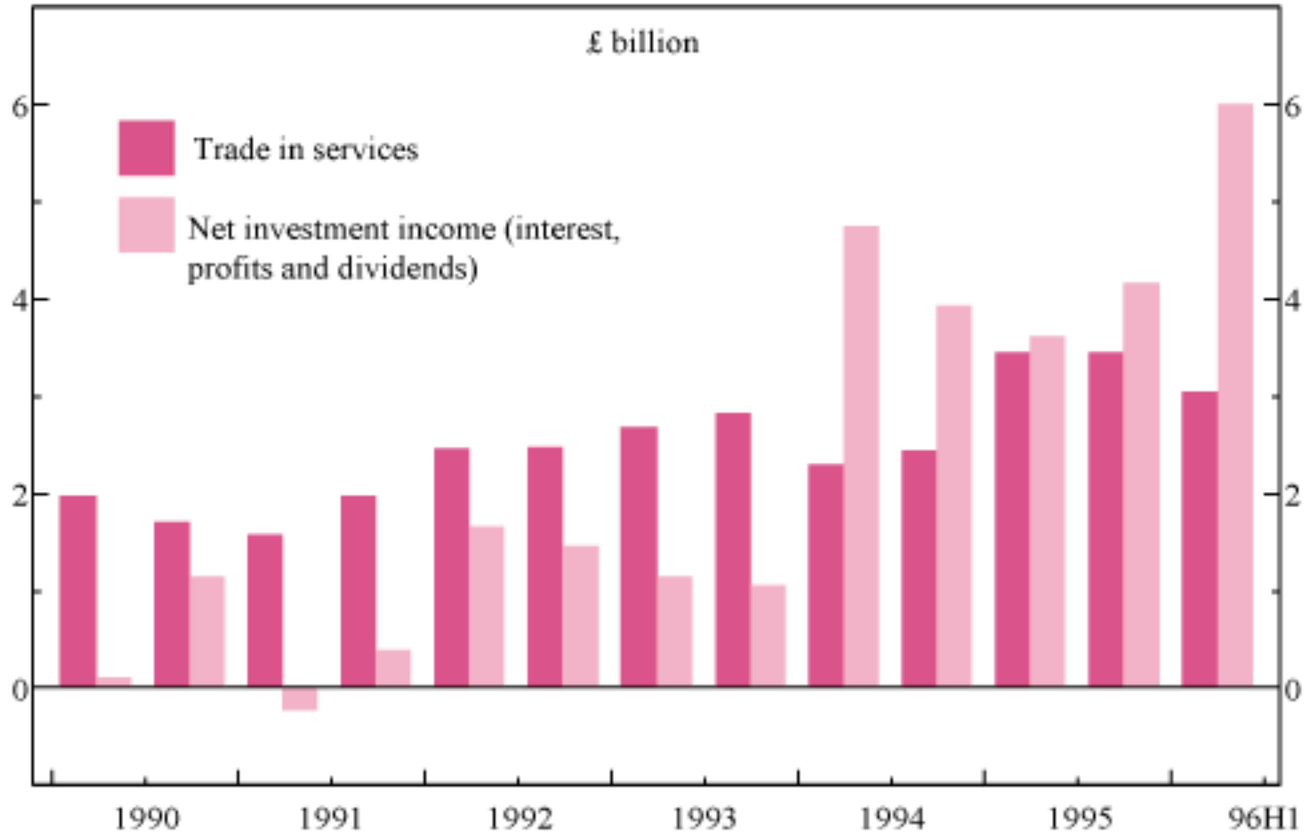
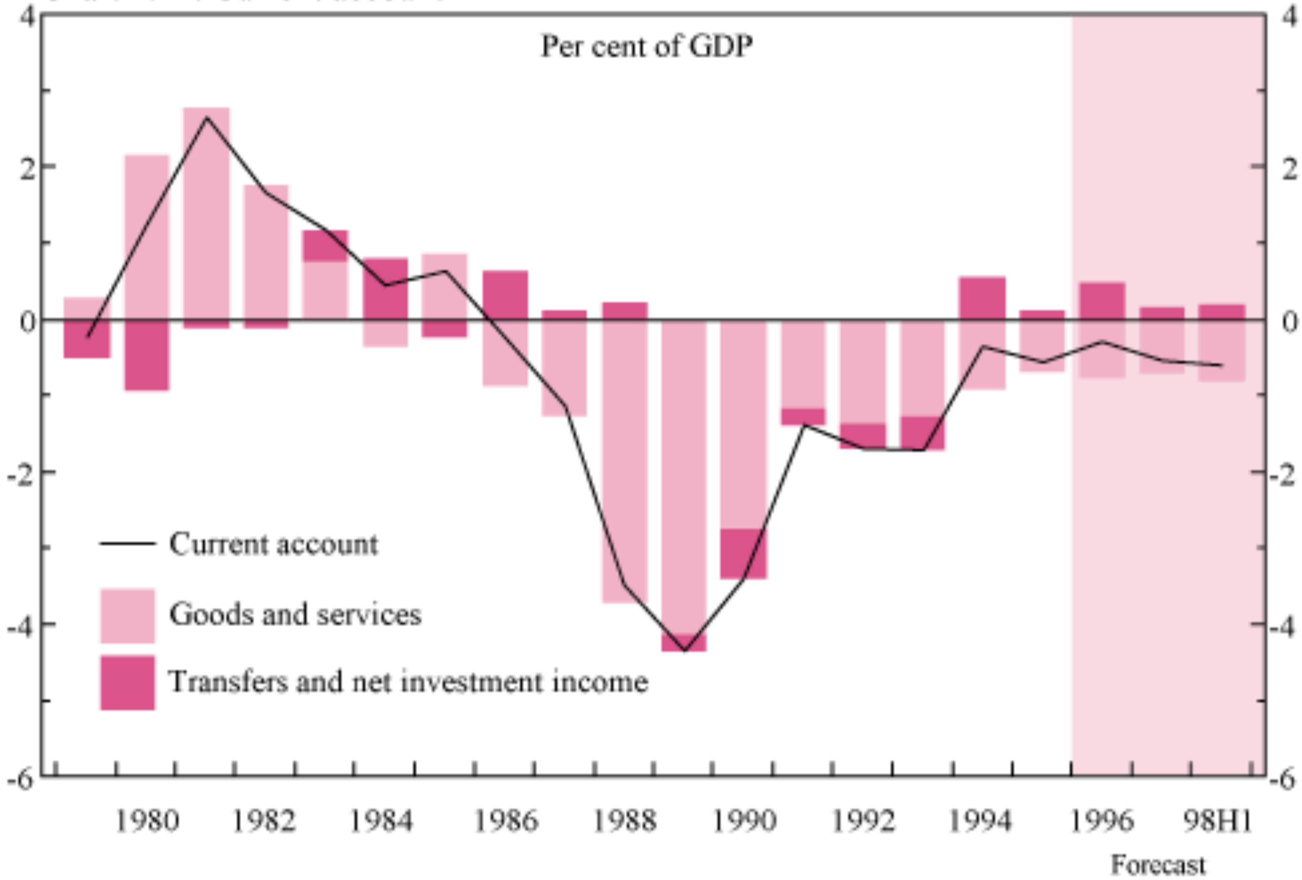


Chart 3.18: Current account



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Pattern of financial balances

3.48 With the current account projected to remain roughly in balance over the next two years, the continuing fall in the public sector deficit is mirrored mainly by a decline in the private sector (and in particular the personal sector) financial surplus from 5 per cent of GDP in 1995 to under 2 per cent in the first half of 1998.

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Labour market

Unemployment

3.49 Unemployment has continued to fall. The Labour Force Survey (LFS) measure fell by more than 150,000 over the year to the summer quarter (June to August). Claimant unemployment fell by almost 180,000 over the same period, and by a further 80,000 between August and October, suggesting that the rate of decline has gathered pace recently. In October, the claimant count was over 950,000 below its peak in December 1992.

Employment

3.50 According to the LFS, employment rose by 210,000 over the year to the summer quarter, which is greater than the fall in unemployment. The employer-based survey shows a smaller rise, but the LFS data seem more consistent with other labour market indicators.

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Productivity

3.51 Growth in productivity (output per head) appears to have been comparatively slow over the past two years, particularly in manufacturing. This partly reflects the fact that a high proportion of the growth in employment last year was in part-time jobs - measured in terms of `hours worked' rather than `heads', productivity growth would be stronger. Firms are also likely to have hoarded labour to some extent in anticipation that demand would strengthen, and productivity is likely to accelerate as output growth picks up.

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Financial developments

Sterling

3.52 The sterling exchange rate index, which measures the sterling exchange rate against a basket of currencies, has risen by almost 10 per cent since the summer, taking it above its end-1994 level. It has appreciated against the Deutschmark and the Yen and, to a lesser extent, against the US dollar. The forecast is based on the conventional assumption that sterling remains close to recent levels.

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Interest rates

3.53 Against a background of moderate growth and little sign of inflationary pressures, base rates were reduced in four 1/4 percentage point steps - from 6 3/4 per cent at the time of last year's Budget to 5 3/4 per cent in June. Mortgage rates fell by a similar amount over the same period. Although inflationary pressures remain weak, base rates were increased by 1/4 percentage point at the end of October in response to mounting evidence of strengthening activity.

3.54 Long rates rose during the first half of the year, largely reflecting a rise in world bond yields, particularly in the US. UK yields initially rose by more than those of other G7 countries, but they have been falling back recently, and the differential, particularly with US yields, has narrowed. Yields on ten-year gilts, which peaked at around 8 1/4 per cent at the end of May, are now around 7 1/2 per cent. The inflation expectations implicit in gilt yields increased in the first few months of the year, but have been declining recently.

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Asset prices

3.55 Developments in asset prices are consistent with rising confidence and profit expectations. Equity prices rose by almost 20 per cent during 1995, and they have risen by a further 7 per cent since the beginning of this year. House prices have been rising since the middle of last year. Capital and rental values in the commercial property market, which fell back in 1995, are now rising again.

Monetary aggregates

3.56 Despite the strengthening of retail sales this year, there appears to have been little underlying increase in M0 growth. It picked up during the summer months, but this was due partly to spending associated with the European football championships. Shorter-run measures have now fallen back: the three-month annualised growth rate of notes and coin in October was 6 1/4 per cent, in line with its average rise since 1993.

3.57 The 12-month growth rate of M4 has risen from around 4 per cent in late 1994 to 10.3 per cent in October this year, above the top of its medium-term monitoring range. Both corporate and personal liquidity have increased sharply. The underlying strength of corporate sector M4 partly reflects takeover and merger activity, but may also foreshadow higher investment spending. Strengthening personal sector liquidity is consistent with the forecast increase in consumption.

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Inflation

3.58 The 12-month rate of increase in the RPI excluding mortgage interest payments (MIPs) remained around 3 per cent for most of this year. Although retail prices were unchanged between September and October, the 12-month rate of inflation rose from 2.9 to 3.3 per cent, as the exceptional price falls in October 1995 were not repeated.

3.59 Retail goods price inflation fell from 3 1/2 per cent at the end of last year to 2 3/4 per cent in September. It rose to 3 per cent in October because of higher petrol prices and the drought-related sharp fall in seasonal food prices last October dropping out of the 12-month calculation. Excluding petrol and food, the 12-month rate ofgoods price inflation was unchanged from September. The increase in petrol prices, reflecting the sharp rise in oil prices in recent months, added 0.3percentage points to the 12-month RPI inflation rate in September and October.

3.60 Retail services price inflation increased from around 2 per cent at the turn of the year to 2 1/2 per cent in September. The rise to 3 per cent in October largely reflected insurance prices levelling out after the large falls over the past two years, particularly last October.

Import costs

3.61 The weakening in non-oil commodity prices and the appreciation of sterling are feeding through to import prices, which levelled out in mid-1995 and have fallen in recent months. Despite the recent increase in oil prices, import prices are likely to remain weak as further effects of the recent sterling appreciation come through.

3.62 Weak import prices have fed through to producer input prices[1], which have fallen sharply since the end of last year. Although the latest monthly data suggest that producer input prices may now have stopped falling, in October they were still 5 1/2 per cent lower than a year earlier. This has, in turn, fed through to the 12-month rate of producer output price inflation, which has fallen from a peak of 5 per cent last summer to just 0.9 per cent in October, the lowest rate for nearly thirty years.

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Earnings

3.63 Despite continuing falls in unemployment, wage pressures have remained subdued. Manufacturing earnings growth has risen only a little over the past year. Earnings growth in the service sector has picked up from a low level, but whole economy underlying average earnings growth has now remained at or below 4 per cent for over three years. Settlements have been fairly flat, suggesting that the difference between earnings growth and settlements (reflecting payments such as overtime and bonuses) has widened a little, after being squeezed last year.

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Demand pressures

3.64 Despite some pick-up recently in capacity utilisation, the latest CBI survey suggests that inflationary pressures in manufacturing remain subdued. However, retail goods price inflation has so far fallen much less than producer output price inflation, despite lower import prices of consumer goods. Retailers are likely to have taken the opportunity offered by stronger sales to undertake some rebuilding of margins. However, with competition in retailing remaining fierce, a large pick-up in margins seems unlikely.

Inflation prospects

3.65 The 12-month rate of producer output price inflation is forecast to remain below 1 1/2 per cent. Lower import prices and producer output price inflation will continue to feed through to retail prices over the next few months. With, in addition, earnings growth remaining subdued and strong retail competition restraining margins, RPI ex MIPs inflation is forecast to fall from 3 per cent at the end of this year to 2 1/2 per cent by the second quarter of 1997.

Table 3.6 Retail and producer output price inflation

			Percentage changes on a year earlier		
			Forecast		
	1995 Q4	1996 Q4	1997 Q2	1997 Q4	1998 Q2
RPI excluding MIPs	3	3	2 1/2	2 1/2	2 1/2
Producer output prices(1)	4 1/2	3/4	1/2	1	1 1/4

(1) Excluding the food, beverages, tobacco and petroleum industries.

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GDP deflator

3.66 The GDP deflator is projected to increase by 2 1/2 per cent in the current financial year and by 2 per cent in 1997-98, a little more slowly than the RPI ex MIPs in both cases, continuing the pattern of the past two years.

Forecast errors and revisions

3.67 As an indication of the margins of error around the forecasts, Table 3.9 shows average errors from Treasury forecasts over the past ten years. Errors usually increase the further ahead the forecast looks, while errors on any individual forecast may be smaller or larger than the historical averages.

3.68 The forecast of GDP growth for this year is unchanged from the Summer Economic Forecast, and 1/2 percentage point lower than in last year's Budget forecast. GDP growth in 1997 is now forecast to be slightly stronger than in the summer. RPI excluding MIPs inflation is forecast to be higher in the fourth quarter of this year than expected at the time of both the Summer Economic Forecast and the last Budget, mainly reflecting the effects of the sharp rise in oil prices since the summer. The forecast of the current account deficit for this year has been revised down since the summer. The PSBR is now expected to be £4billion lower in 1997-98 than forecast in the summer.

Table 3.7 Recent Treasury forecasts

Percentage changes on a year earlier

		1995 Budget	1996 Summer Economic Forecast	1996 Budget
				unless otherwise stated
Gross domestic product	1996	3	2 1/2	2 1/2
	1997	-	3 1/4	3 1/2
RPI excluding mortgage	1996 Q4	2 1/2	2 1/2	3
interest payments	1997 Q4	-	2 1/4	2 1/2
Current account (£ billion)	1996	-5	-3 1/2	-2 1/4
	1997	-	-1 1/2	-4 1/4
PSBR (£ billion)	1996-97	22 1/2	27	26 1/2
	1997-98	15	23	19

The Panel of Independent Forecasters

3.69 Table 3.8 summarises the forecasts of the Chancellor of the Exchequer's Panel of Independent Forecasters. For example, the Panel's forecasts of growth in 1997 range from 3 to 4 1/4 per cent, while their forecasts of inflation at the end of 1997 range from 2 1/4 to 3 1/4 per cent. The Treasury forecasts of growth and inflation are both the same as the Panel average for 1997. Further details of the Panel's forecasts are set out in Annex A.

Table 3.8 Budget and Independent Panel(1) **forecasts**

Percentage changes on a year earlier unless otherwise stated

	1996			1997		
	Budget	Independent Panel		Budget	Independent Panel	
		Average	Range		Average	Range
Gross domestic product	2 1/2	2 1/4	2 1/4 to 2 1/2	3 1/2	3 1/2	3 to 4 1/4
RPI excluding mortgage interest payments (Q4)	3	3	2 1/2 to 3 1/4	2 1/2	2 1/2	2 1/4 to 3 1/4
Current account (£billion)	-2 1/4	-2	-5 1/2 to 1 3/4	-4 1/4	-5 1/2	-10 1/4 to 0
PSBR (financial year, £ billion)	26 1/2	26	24 to 27 3/4	19	21 1/2	18 to 25 1/2

(1) See Annex A for further details.

Table 3.9 Summary of short-term economic prospects (1)

Percentage changes on a year earlier unless otherwise stated

	Forecast			Average errors from past forecasts(3)
	1995	1996	1997	
Output at constant prices(2)				
Gross domestic product (GDP)	2 1/2	2 1/2	3 1/2	1 1/2
Non-North Sea GDP	2 1/2	2 1/2	3 1/2	1 1/2
Manufacturing output	2 1/4	1/4	3	2
Expenditure components of GDP atconstant prices(2)				
Domestic demand	1 1/2	2 1/4	3 3/4	1 3/4
Consumers' expenditure	2	3	4 1/4	1 3/4
General government consumption	1 1/2	1	3/4	1 1/4
Fixed investment	- 1/4	3	6 1/4	4
Change in stockbuilding(4)	0	- 1/2	0	1/4
Exports of goods and services	7 3/4	6 1/4	5 3/4	2

Imports of goods and services	4	7	6 3/4	3
Balance of payments current account				
£ billion	-4	-2 1/4	-4 1/4	8
per cent of GDP	- 1/2	- 1/4	- 1/2	1
Inflation				
RPI excluding mortgage interest payments (fourth quarter)	3	3	2 1/2	1
Producer output prices (fourth quarter)(5)	4 1/2	3/4	1	1
GDP deflator at market prices (financialyear)	2 1/2	2 1/2	2	1 1/4
Money GDP at market prices (financial year)				
£ billion	708	746	787	15 3/4
percentage change	4 3/4	5 1/4	5 1/2	2
PSBR (financial year)				
£ billion	31 1/2	26 1/2	19	11
per cent of GDP	4 1/2	3 1/2	2 1/2	1 1/2

(1) Data in this chapter are consistent with the output, income and expenditure estimates and other series for the period to the third quarter of 1996 released by the Office for National Statistics on 21November 1996.
(2) Further detail on GDP and its components is given in Table3.10.
(3) Average absolute errors in autumn forecasts over past ten years; they apply to forecasts for 1997 unless otherwise indicated. The average errors for the current account and the PSBR are calculated as a percent of GDP. The £billion figures are calculated by scaling the errors as a percent of GDP by money GDP.
(4) Per cent of GDP.
(5) Excluding the food, beverages, tobacco and petroleum industries.

Table 3.10 Gross domestic product and its components

£ billion at 1990 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Stockbuilding	Domestic demand	Exports of goods and services	**Total final expenditure**	*Less* imports of goods and services	*Less* adjustment to factor cost	*Plus* statistical discrepancy(1)	**GDP at factor cost**
1995	363.7	119.2	99.2	3.3	585.4	167.4	752.8	169.2	75.5	0.3	508.4
1996	374.8	120.3	102.1	1.1	598.3	177.7	776.0	181.1	76.8	2.6	520.7
1997	390.7	121.1	108.4	1.0	621.2	188.0	809.2	193.4	80.0	2.8	538.7
1995											
1st half	181.2	59.5	50.0	0.8	291.4	82.5	373.9	83.2	37.8	0.0	252.9
2nd half	182.5	59.8	49.2	2.5	293.9	84.9	378.9	86.0	37.7	0.3	255.5
1996											
1st half	185.6	59.8	50.9	0.9	297.1	87.8	384.9	89.7	38.1	1.1	258.2
2nd half	189.2	60.6	51.2	0.2	301.2	89.9	391.0	91.3	38.7	1.4	262.5
1997											
1st half	193.4	60.6	53.4	0.4	307.8	92.5	400.3	94.9	39.6	1.4	267.2
2nd half	197.3	60.5	55.0	0.6	313.4	95.5	408.9	98.4	40.4	1.4	271.4
1998											
1st half	200.4	60.7	56.5	0.5	318.1	98.6	416.7	101.4	41.1	1.4	275.5

Percentage changes on a year earlier(2)

1995	2	1 1/2	- 1/4	0	1 1/2	7 3/4	2 3/4	4	2 1/4	0	2 1/2
1996	3	1	3	- 1/2	2 1/4	6 1/4	3	7	1 3/4	1/2	2 1/2
1997	4 1/4	3/4	6 1/4	0	3 3/4	5 3/4	4 1/4	6 3/4	4 1/4	0	3 1/2
1998 1st half	3 3/4	0	5 3/4	0	3 1/4	6 1/2	4	6 3/4	3 3/4	0	3

(1) Expenditure adjustment.
(2) For stockbuilding and the statistical discrepancy, changes are expressed as a percent of GDP.

The economy in the medium term

3.70 The assumptions for output growth and inflation which underlie the medium-term fiscal projections in Chapter 4 are set out in Table 3.11.

Table 3.11 Output growth and inflation(1)

	Percentage changes on previous financial year					
	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Output (GDP)	2 3/4	3 1/2	3	2 1/2	2 1/2	2 1/2
Prices						
GDP deflator	2 1/2	2	2	2	2	2
RPI ex MIPs	3	2 1/2	2	2	2	2
Money GDP	5 1/4	5 1/2	5	4 1/2	4 1/2	4 1/2

(1) Forecasts for 1996-97 and 1997-98 and assumptions thereafter.

Output

3.71 The rate at which the economy can grow over the medium term without putting upward pressure on inflation depends on the rate of growth of productive capacity (trend output growth) and the current margin of spare capacity (the output gap).

Spare capacity

3.72 While productive capacity probably grows fairly steadily, actual output growth varies more. Output fell well below its trend level in the early 1990s recession. Growth was probably significantly faster than trend during 1993 and 1994, and the output gap therefore began to narrow. However, growth was slower in 1995 and the first half of 1996, and the output gap is unlikely to have narrowed much further over this period.

3.73 Business surveys suggest that capacity utilisation is relatively high in some sectors. The CBI survey shows capacity utilisation in manufacturing above its 30 year average, and the BCC survey suggests that capacity utilisation in services may now be back to its 1989 levels. But these measures do not cover the whole economy and take little account of the degree of slack in the labour market. There is little evidence of shortages of skilled labour emerging and wage pressures have remained very moderate.

3.74 Given this rather mixed evidence, there is a large margin of uncertainty over the degree of spare capacity in the economy as a whole. But it seems plausible to assume that there is still a negative output gap of between 0 and 3per cent of GDP. This range encompasses most of the estimates given by the Panel of Independent Forecasters in their special report in June on the output gap.

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Trend growth

3.75 The trend rate of growth can be broken down into three components: the trend in productivity, trends in labour supply, and changes in the rate of unemployment. In other words, economic growth depends on how productive each worker is, how many workers are available, and how fully this labour force can be employed without putting upward pressure on inflation.

3.76 Quantitatively, trend productivity growth is the most important of these elements. Supply-side reforms, which have strengthened competition and sharpened incentives, have contributed to the substantially faster rates of productivity growth achieved since the 1970s, particularly in manufacturing. It is assumed that this improved performance is sustained over the rest of this decade, and trend productivity growth is in the range 1 3/4 to 2 per cent, in line with performance over the 1980s.

3.77 The labour supply contracted during the early 1990s, reflecting the rapid expansion of numbers in further and higher education, earlier retirement, and continued growth in the number of Invalidity Benefit claimants. However, the labour supply is probably now expanding again. The population of working age is projected to grow by between 1/4 and 1/2 per cent a year over the rest of the decade, and participation in the labour market is likely to increase as a result of continued improvement in job prospects and a levelling off in the numbers entering higher and further education.

3.78 An improvement in labour market performance is also likely to contribute to the economy's ability to supply extra output without leading to higher inflation. After rising steeply from the late 1960s to the early 1980s, the rate of unemployment that would be consistent with low, stable inflation appears to have declined significantly since the mid-1980s. In the last recession, unemployment peaked at a lower level than in the previous cycle for the first time since the 1960s, whilst wage inflation has remained historically low, despite steadily falling unemployment over the past four years.

3.79 Much of the fall in unemployment can be credited to reforms begun in the early 1980s, for example labour market deregulation, trade union reform, competition policy, and tax and benefit changes to improve incentives. A further wide ranging programme of labour market measures, including enhanced training and job placement services, has continued in the 1990s. There is much evidence that the labour market is more flexible: working patterns are more varied, wage determination has become more decentralised, the links between pay and performance are stronger and regional differentials in unemployment have narrowed.

3.80 A steep fall in the number of long-term unemployed, who tend to be more detached from the jobs market, should also help to reduce the rate of unemployment consistent with continuing low inflation.

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3.81 Taking all these factors into account, it is reasonable to assume that trend output growth over the rest of the 1990s will be around 2 1/2 per cent per annum. This is similar to the average growth rate achieved over the post-war period as a whole. It is also similar to the average of estimates made by the Panel of Independent Forecasters in their special report in June. It is quite possible that trend growth will be higher; for example, the impact on productivity growth of the recent expansion in higher and further education or of supply side reforms could be greater than allowed for. But in planning for the public finances it is sensible to err on the side of caution.

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Projections

3.82 Table 3.11 shows the economy growing at 3 1/2 per cent in 1997-98 and 3per cent in 1998-99, which brings output back towards its trend level. Thereafter, the economy grows at around its trend rate.

3.83 The existence of spare capacity means that the economy should be able to grow somewhat faster than its trend rate for a time without putting upward pressure on inflation. RPI ex MIPs inflation is assumed to fall to 2 per cent by 1998-99 and remain constant at this level.

Changes since the lastBudget

3.84 Table 3.12 compares the medium-term economic projections with those in the 1996-97 FSBR. Output growth has been slightly slower than expected this year, but is projected to be slightly faster in 1997-98 and 1998-99. By the end of the decade, the level of output is the same as that in the 1995 Budget projections. GDP deflator inflation is expected to be slightly lower in the short term than in the 1995 Budget projections. This leaves both the price level and the level of money GDP lower throughout.

Table 3.12 Differences from 1995 Budget projections

	Percentage points				
	1996-97	1997-98	1998-99	1999-00	2000-01
Real GDP growth	- 1/4	1/2	1/4	- 1/4	- 1/4
Inflation (GDP deflator)	- 1/4	- 1/2	- 1/4	0	0
Money GDP growth	- 3/4	0	0	- 1/4	- 1/4

Note:
(1)*All references to producer input and output prices in this chapter exclude the food, beverages, tobacco and petroleum industries*. back

[Prepared November 1996]

Chart 3.19: Financial balances and the current account

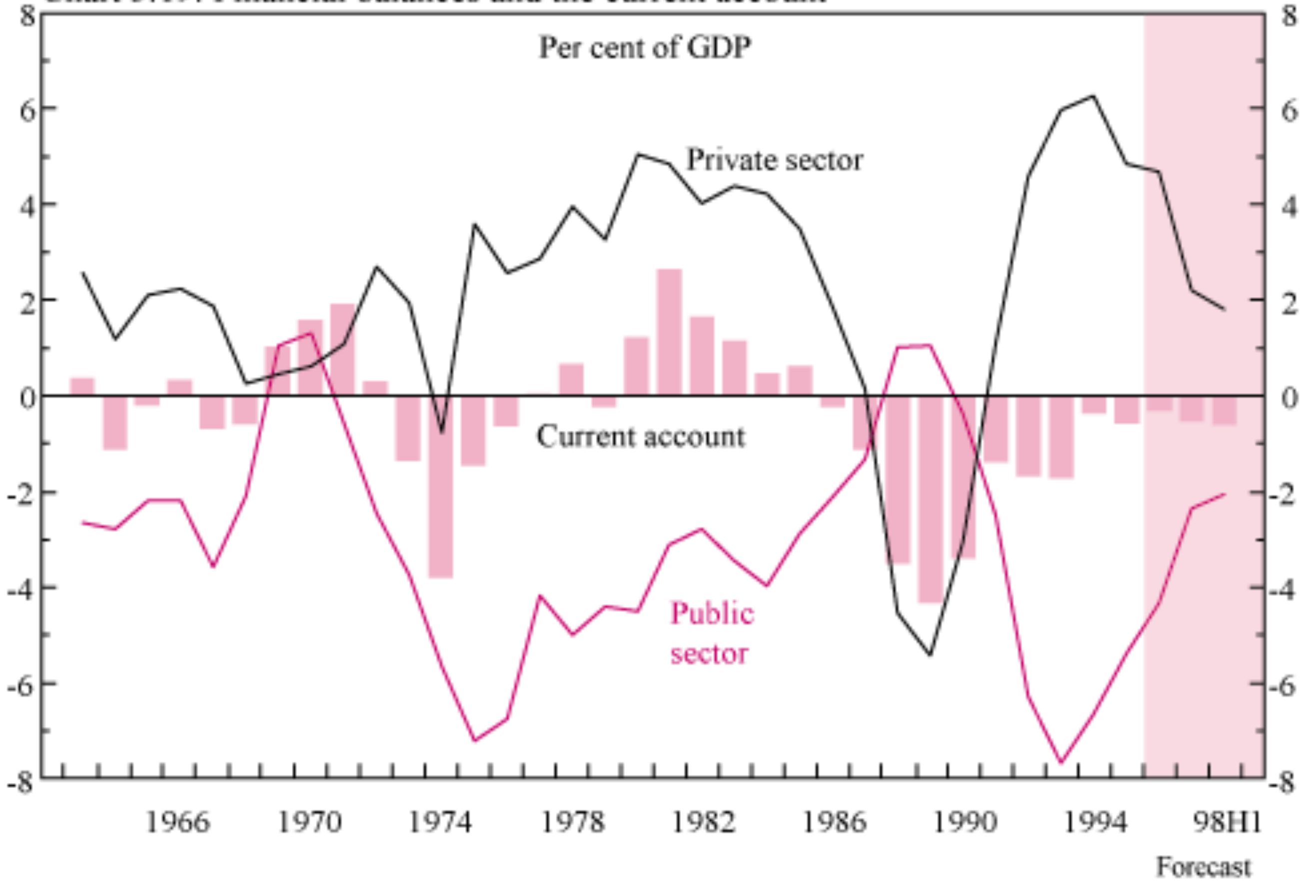
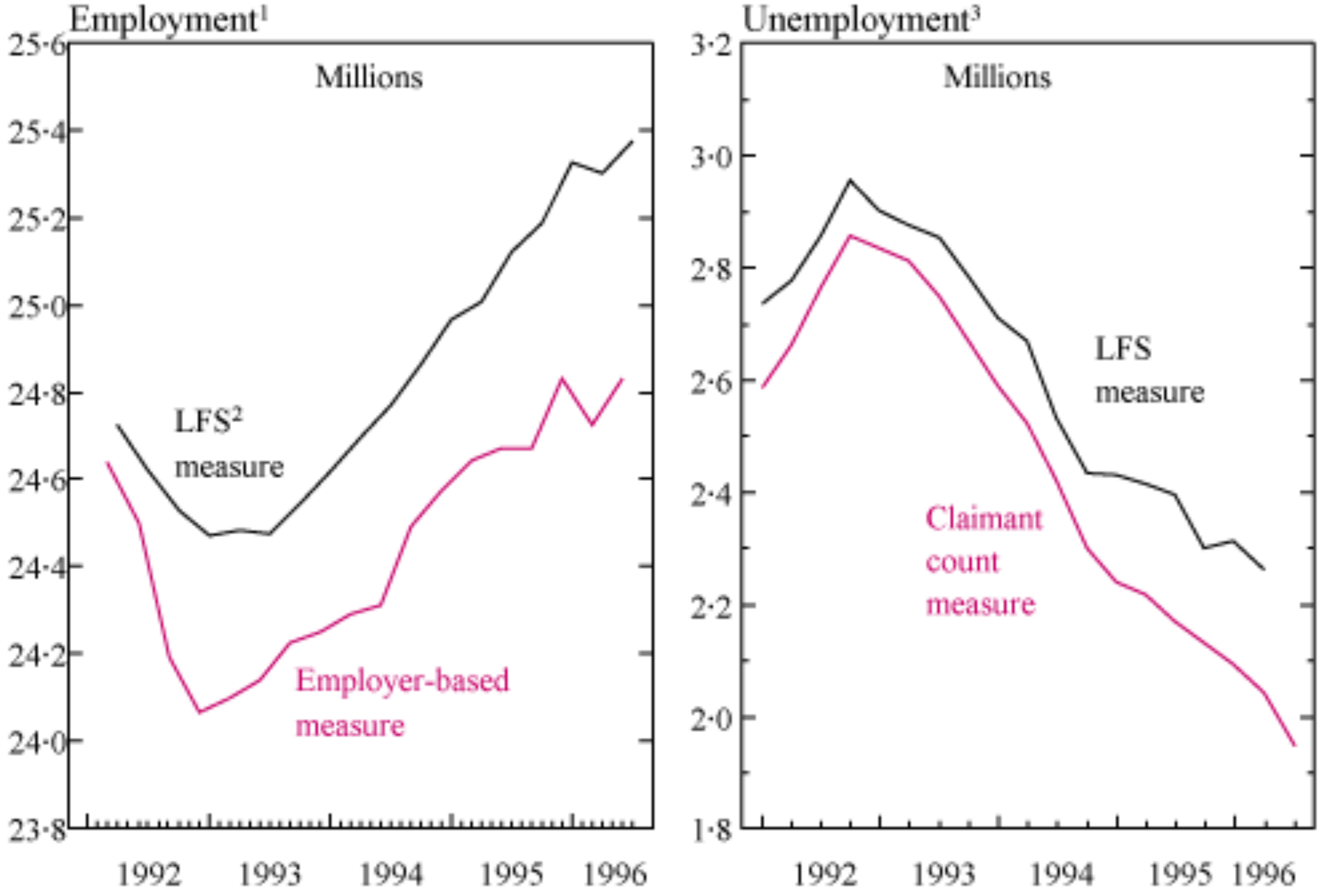


Chart 3.20: Employment and unemployment

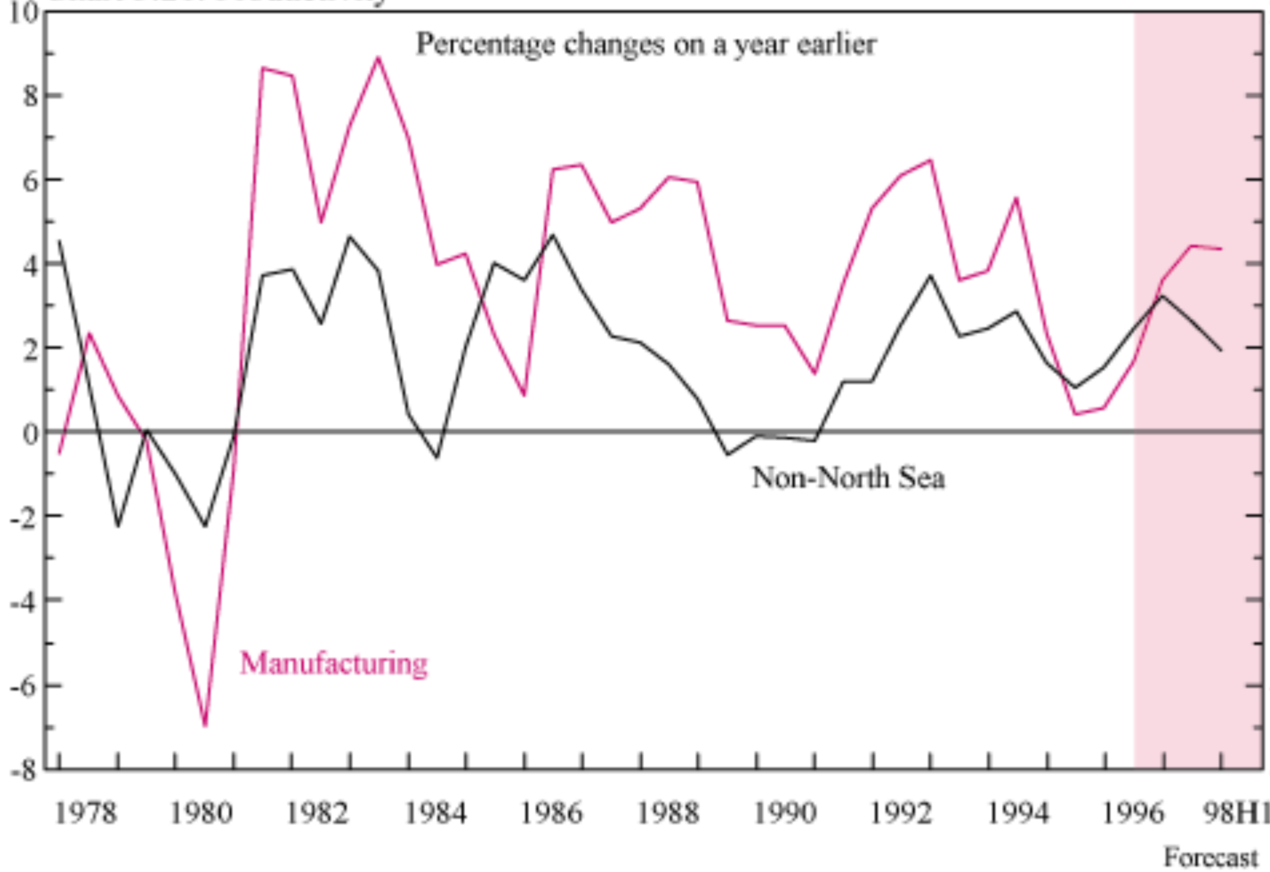


[1]GB employees plus self-employed.

[2]LFS data recorded against central month of each LFS quarter.

[3]GB. Time periods relate to LFS quarters: December to February (winter); etc.

Chart 3.21: Productivity[1]



[1]Output per person employed (employer-survey based figures).

Chart 3.22: Sterling effective exchange rate index

Chart 3.23: UK interest rates

Chart 3.24: Monetary growth

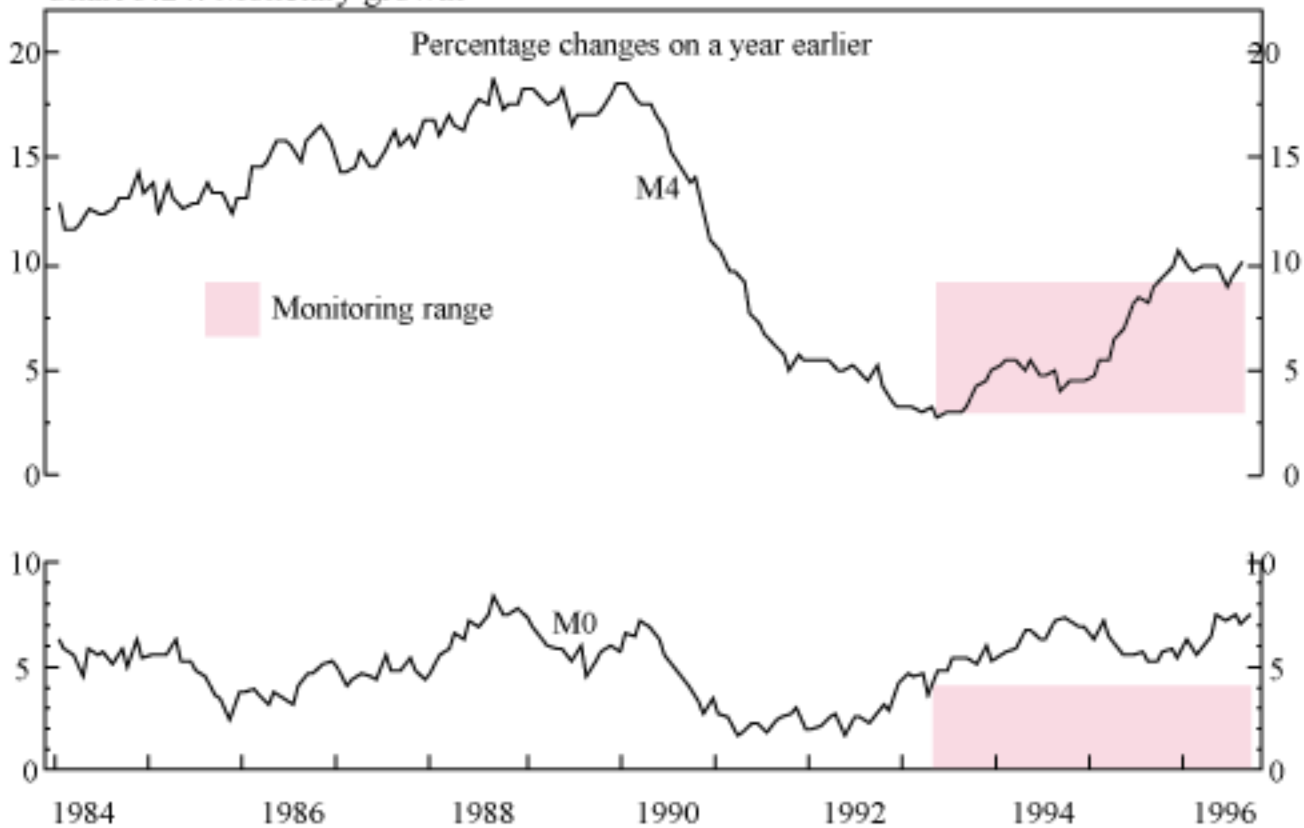
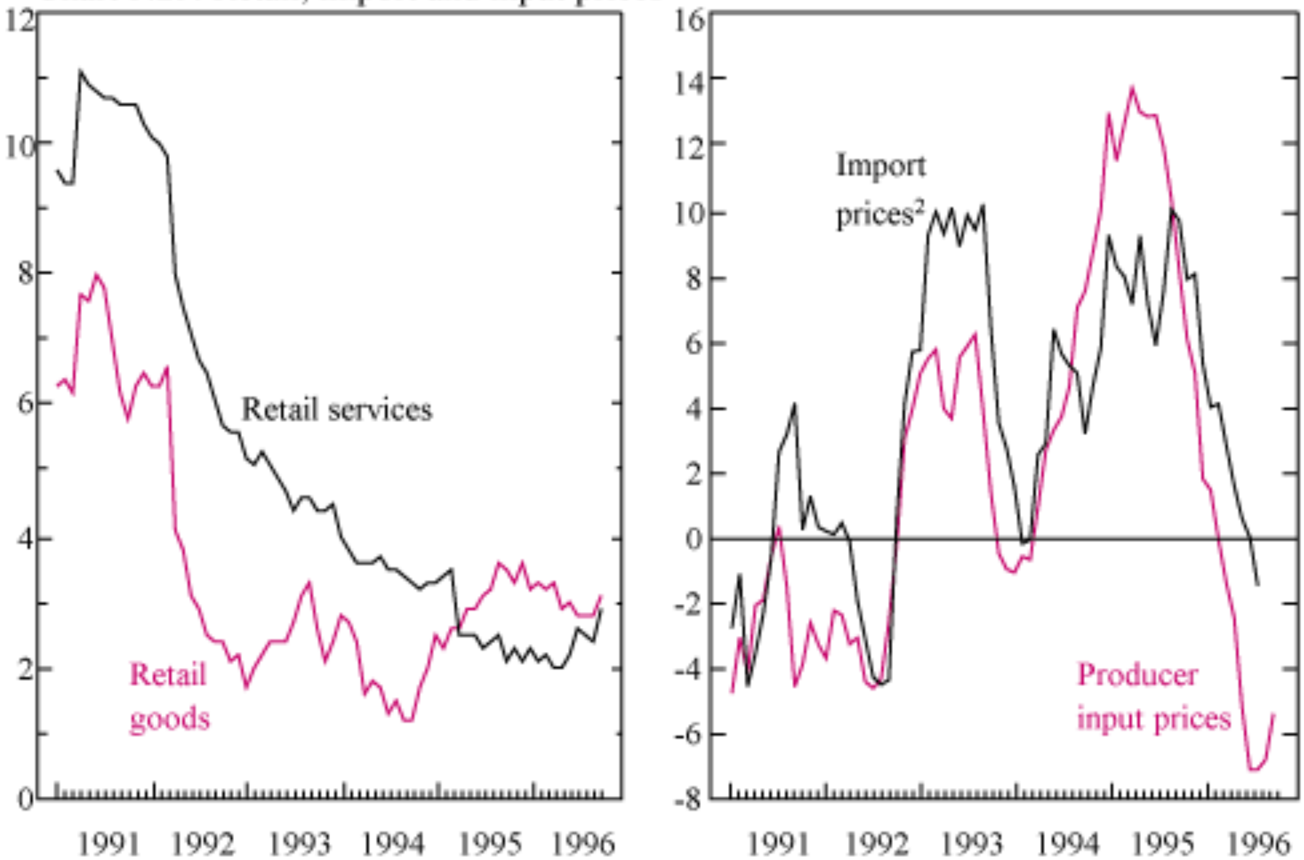


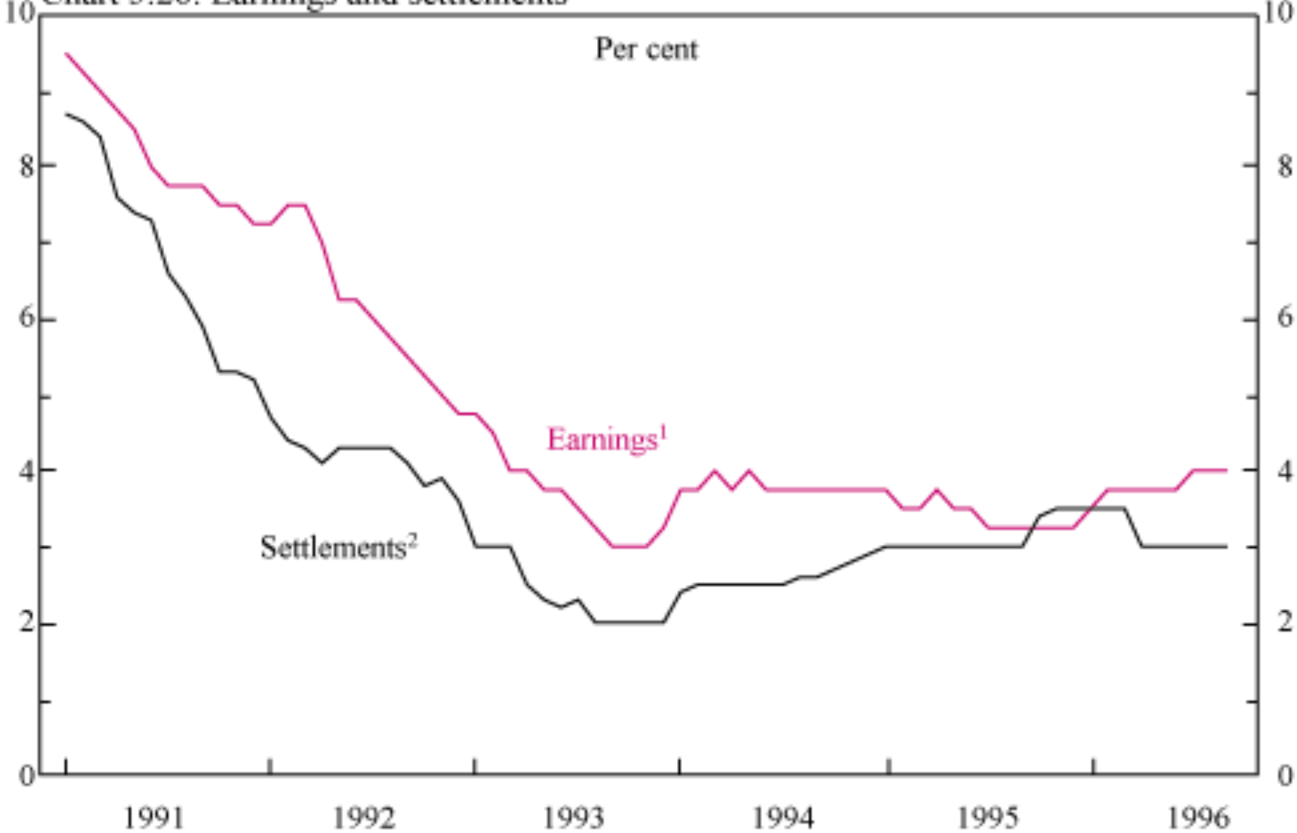
Chart 3.25: Retail, import and input prices[1]



[1]Percentage changes on a year earlier.

[2]All goods.

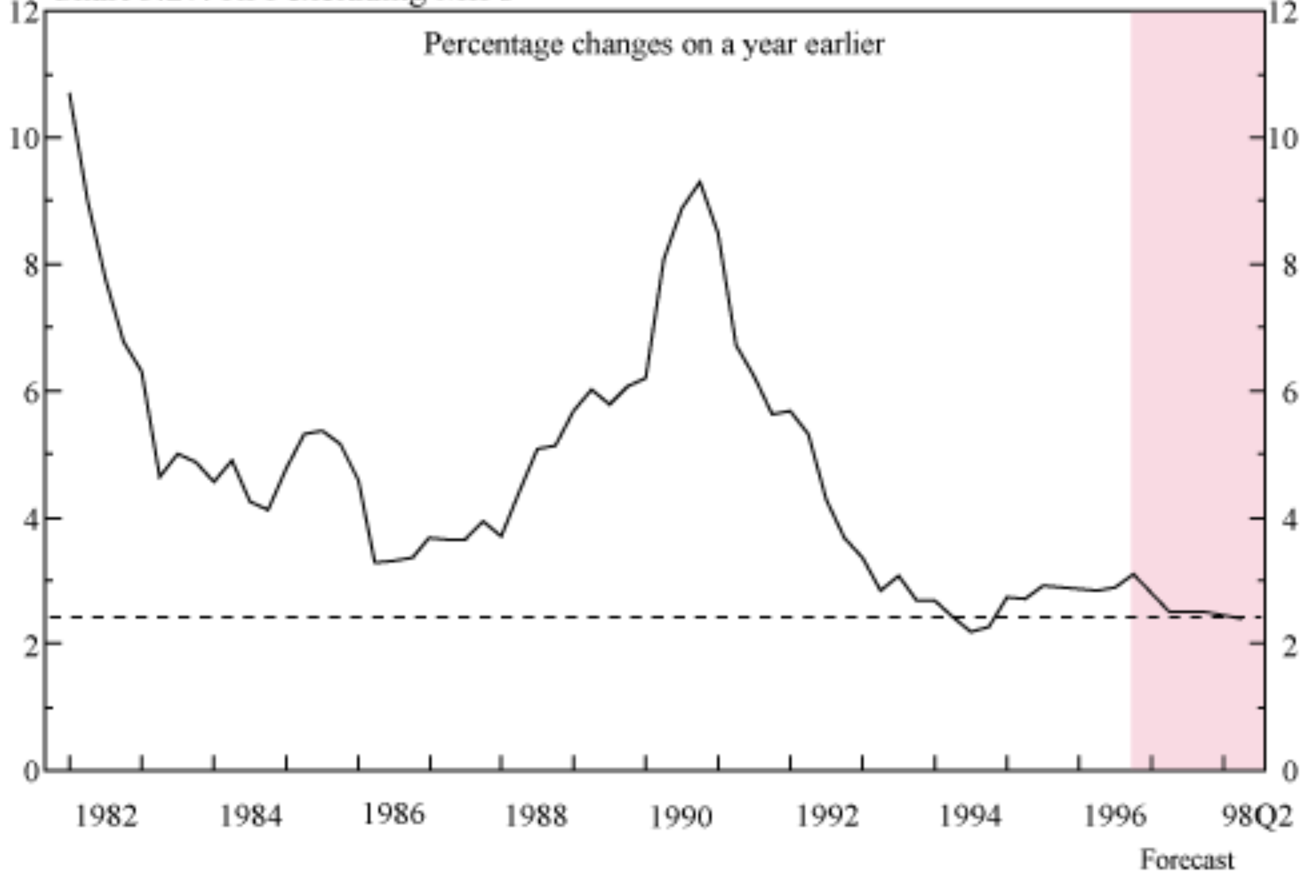
Chart 3.26: Earnings and settlements



[1] Whole economy underlying average earnings, 12-month growth rate.

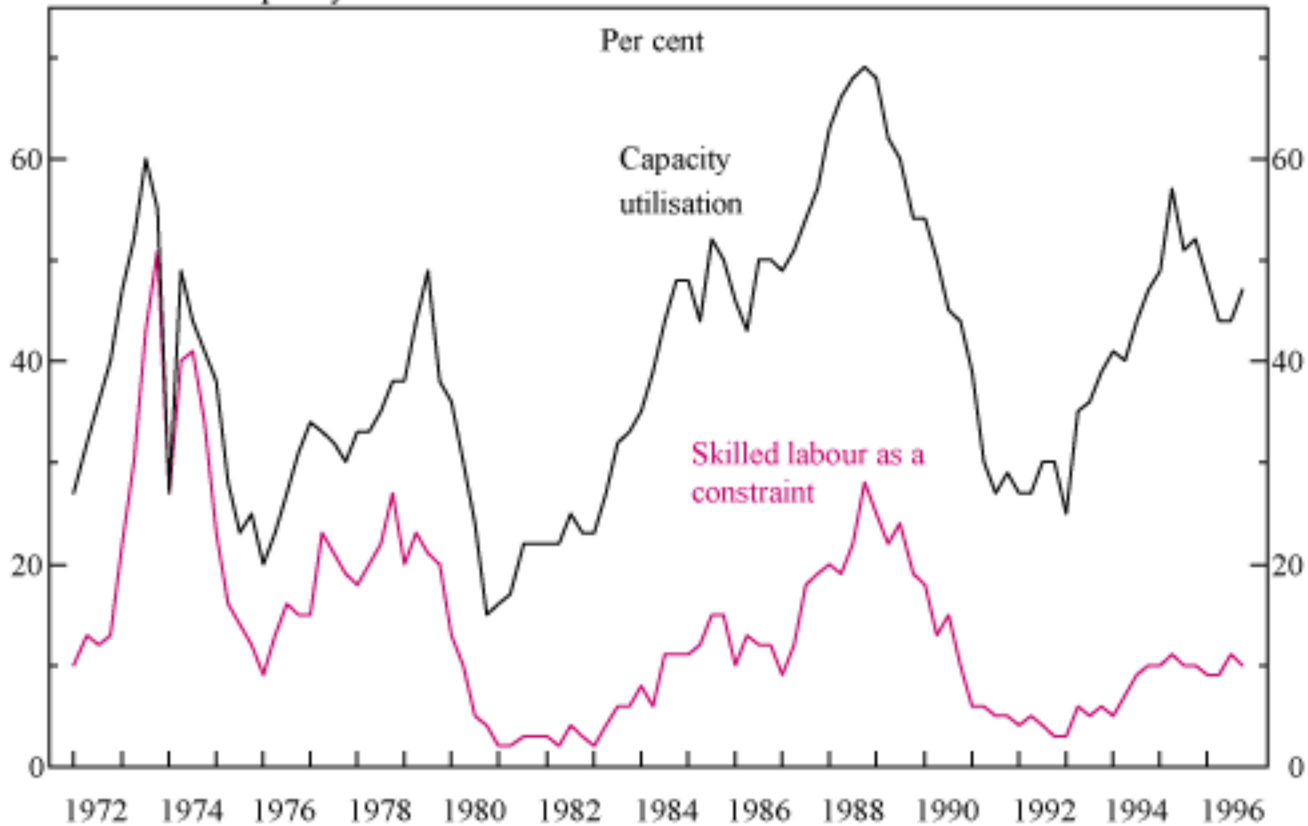
[2] Industrial Relations Services (IRS) settlements, median increase over past three months.

Chart 3.27: RPI excluding MIPs[1]



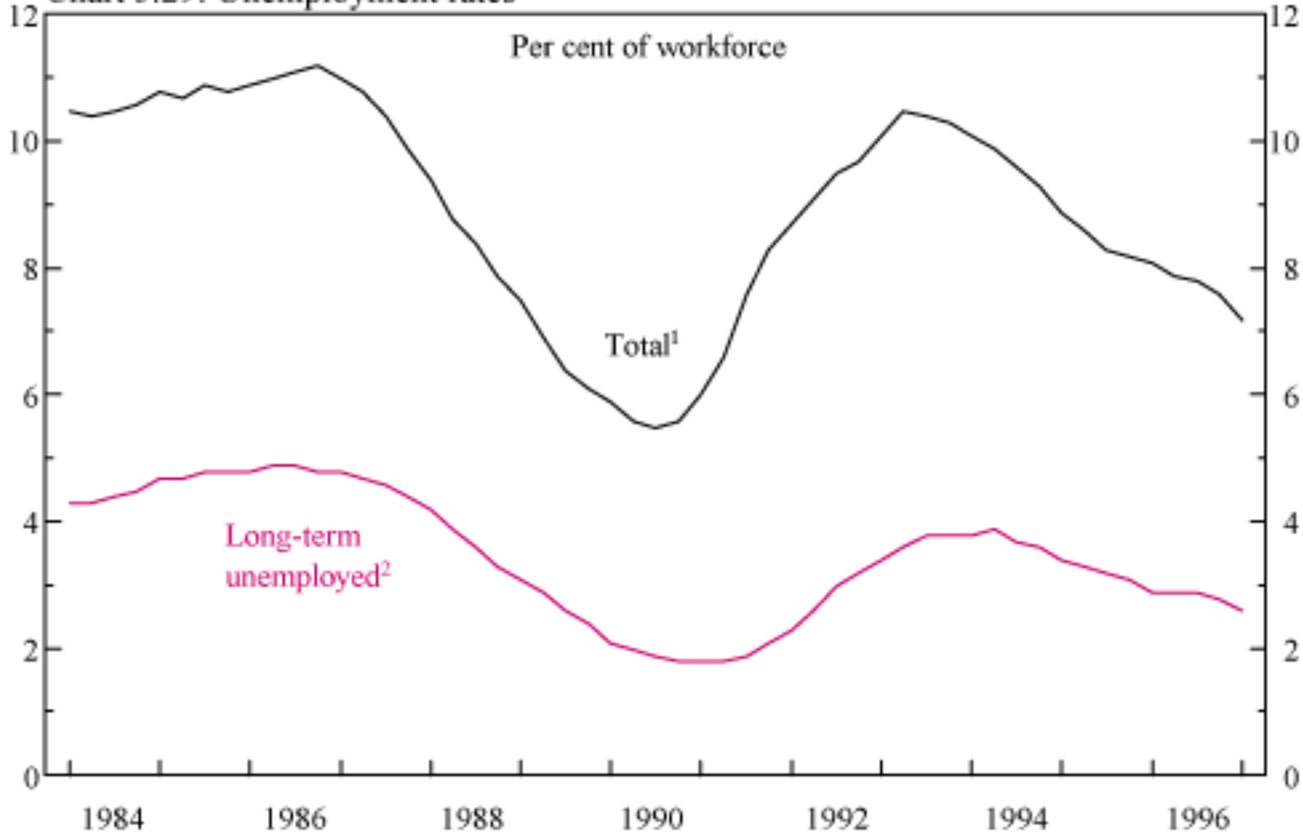
[1]Outturns until 1996Q3; forecast for 1996Q4, 1997Q2, 1997Q4 and 1998Q2.

Chart 3.28: Capacity utilisation and skilled labour constraints[1]



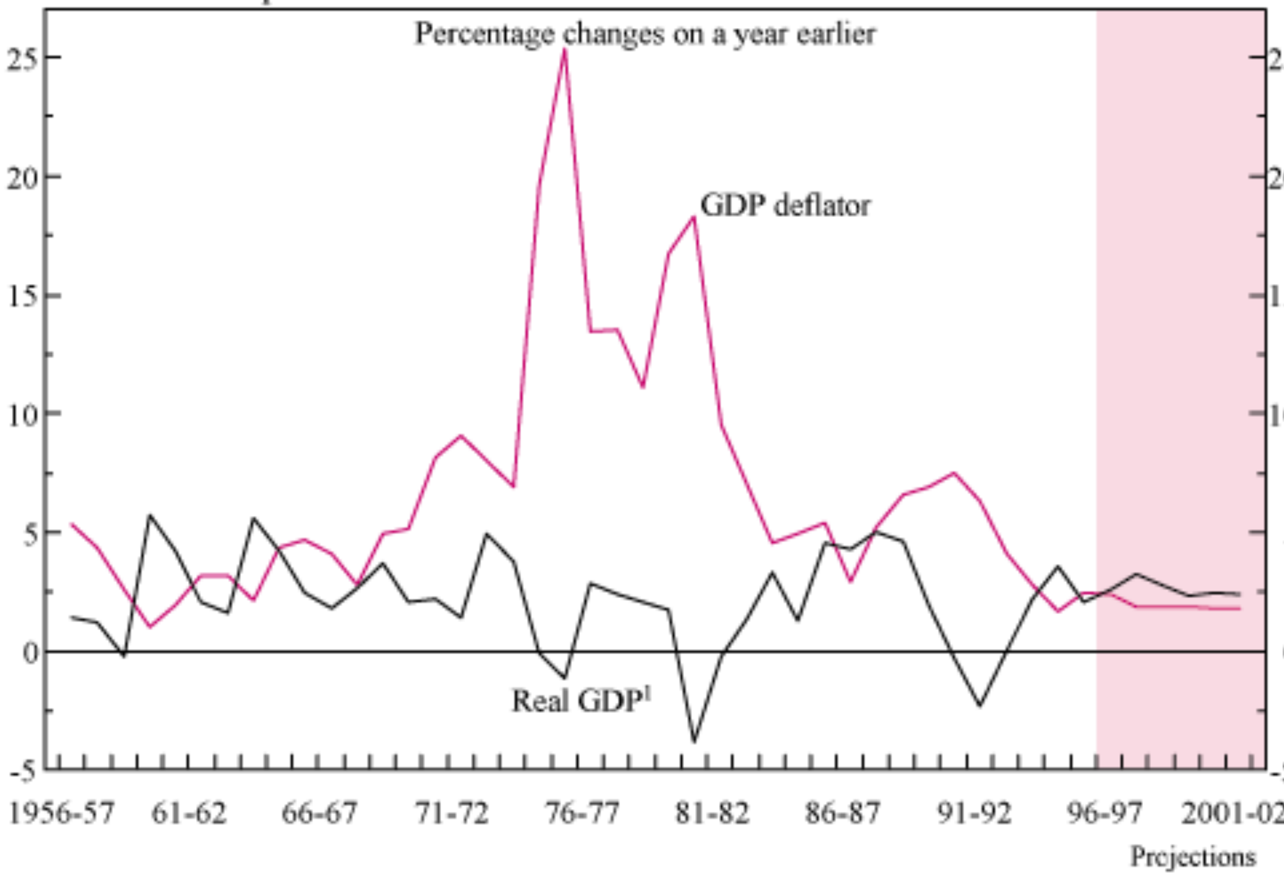
[1]Percentage balances from CBI Industrial Trends Survey of manufacturers.

Chart 3.29: Unemployment rates



[1]UK claimant count.
[2]Over 12 months.

Chart 3.30: Output and inflation



1Excluding North Sea.

Annex A to Chapter 3

The Panel of Independent Forecasters

3A.1 The tables below give details of the forecasts of members of the Panel of Independent Forecasters. Two of the Panel members, Tim Congdon and Gavyn Davies, have updated their forecasts following the publication of national accounts data on 21 November 1996. The forecasts of other Panel members are those which were published in the Panel's November 1996 report, which was submitted to the Chancellor of the Exchequer on 31 October 1996. The full report, which includes members' individual submissions on the economic outlook and policy, is available from HM Treasury.

Table 3A.1 Summary of short-term forecasts

		Percentage changes on a year earlier unless otherwise stated						
		Barker	**Congdon**	**Davies**	**Minford**	**Rosewell**	**Weale**	**Average**
GDP	1996	2.3	2.5	2.3	2.3	2.3	2.3	2.3
	1997	3.3	4.2	3.3	3.1	3.3	3.4	3.4
Claimant unemployment (millions)	1996 Q4	2.02	2.05	2.02	2.03	1.99	2.00	2.02
	1997 Q4	1.93	1.70	1.72	1.58	1.88	1.80	1.77
RPI	1996 Q4	2.7	2.7	2.7	1.8	2.5	2.3	2.5
	1997 Q4	2.7	3.7	3.0	2.2	3.0	2.8	2.9
RPI ex MIPs	1996 Q4	3.1	3.3	3.3	2.5	3.0	2.9	3.0
	1997 Q4	2.4	3.3	2.4	2.2	2.4	2.7	2.6
Whole economy underlying average earnings	1996	3.9	3.8	3.9	3.7	3.6	3.1	3.7
	1997	4.6	4.7	4.5	3.8	4.1	4.6	4.4
Short-term interest rate (per cent)	1996 Q4	6.0	6.0	6.5	5.5	5.8	5.8	5.9
	1997 Q4	6.0	7.8	6.8	6.1	7.1	5.8	6.6
Current account (£ billion)	1996	-5.5	-4.0	-1.1	-1.5	1.7	-1.3	-2.0
	1997	-10.3	-9.5	-7.4	0.0	-2.6	-3.3	-5.5
PSBR (£ billion)	1996-97	27.4	26.0	24.1	27.7	25.2	26.2	26.1
	1997-98	25.4	18.0	20.0	21.9	24.1	19.5	21.5

Table 3A.2 Forecasts of GDP and its components

		Percentage changes on a year earlier unless otherwise stated						
		Barker	**Congdon**	**Davies**	**Minford**	**Rosewell**	**Weale**	**Average**
Consumers' expenditure(1)	1996	3.2	3.1	3.0	2.2	3.0	2.9	3.0
	1997	4.0	4.3	4.0	2.7	4.1	4.0	4.1
General government consumption(2)	1996	0.5	0.9	0.9	-1.2	0.8	0.7	0.8
	1997	0.3	1.3	1.3	-0.9	0.8	0.7	0.9
Gross fixed investment(3)	1996	2.8	3.7	2.6	5.9	3.4	4.4	3.4
	1997	5.2	7.2	4.7	6.8	4.8	4.7	5.3
Stockbuilding (£ billion)	1996	2.2	2.0	0.4	-	1.5	3.0	1.8
	1997	2.7	5.0	2.1	-	1.9	2.9	2.9
Domestic demand	1996	2.4	2.6	2.0	2.4	2.3	2.6	2.4
	1997	3.5	4.6	3.9	2.9	3.6	3.4	3.7
Exports of goods and services	1996	6.5	6.6	5.9	-	6.2	7.1	6.5
	1997	5.0	6.5	3.7	-	5.0	7.2	5.5

Imports of goods and services	1996	7.0	7.0	6.4	-	6.1	8.0	6.9
	1997	6.3	8.0	5.3	-	5.3	6.5	6.3
Net trade(4)	1996	-0.1	-0.1	-0.2	-0.1	0.0	0.0	-0.1
	1997	-0.3	-0.4	-0.6	0.2	-0.1	0.1	-0.2
GDP	1996	2.2	2.5	2.3	2.3	2.3	2.3	2.3
	1997	3.1	4.2	3.3	3.1	3.3	3.4	3.4

(1) Minford forecasts non-durable consumption.
(2) Minford forecasts general government consumption and investment.
(3) Minford forecasts durable consumption, private investment and stockbuilding.
(4) Contribution to GDP growth, per cent.

Table 3A.3 Summary of medium-term projections

Percentage changes on a year earlier unless otherwise stated

		Barker	**Congdon**	**Davies**	**Minford**	**Rosewell**	**Weale**	**Average**
GDP	1996	2.2	2.5	2.3	2.3	2.3	2.3	2.3
	1997	3.1	4.2	3.3	3.1	3.3	3.4	3.4
	1998	2.6	3.7	2.5	3.4	2.1	3.5	3.0
	1999	2.5	2.9	2.7	3.3	1.8	2.6	2.6
Claimant unemployment (millions)	1996	2.02	2.05	2.12	2.13	2.10	2.10	2.09
	1997	1.93	1.70	1.82	1.76	1.91	1.90	1.84
	1998	1.90	1.50	1.70	1.33	1.86	1.60	1.65
	1999	1.78	1.40	1.59	1.03	1.88	1.50	1.53
RPI	1996	2.7	2.5	2.5	2.2	2.4	2.4	2.5
	1997	2.7	3.4	2.9	1.6	2.6	2.6	2.6
	1998	3.6	4.2	-	2.5	3.8	3.2	3.5
	1999	3.1	5.2	-	2.2	3.5	3.7	3.5
RPI ex MIPs	1996	3.1	2.9	3.0	2.7	2.9	2.9	2.9
	1997	2.4	3.2	2.7	2.0	2.4	2.7	2.6
	1998	2.9	3.8	3.0	2.2	3.1	3.0	3.0
	1999	2.6	4.8	3.0	2.2	3.5	3.5	3.3
Short-term interest rate (per cent)	1996	6.0	6.4	6.5	5.8	5.9	5.9	6.1
	1997	6.0	7.5	6.8	5.8	6.4	5.8	6.4
	1998	7.0	8.2	7.0	6.0	7.6	5.9	7.0
	1999	7.0	8.5	6.8	6.0	7.4	6.0	7.0
Current account (£ billion)	1996	-5.5	-4.6	-1.0	-1.5	1.7	-1.3	-2.0
	1997	-10.3	-9.5	-7.4	0.0	-2.6	-3.3	-5.5
	1998	-6.3	-12.5	-8.6	-0.8	-1.5	-1.3	-5.2
	1999	-4.2	-13.5	-12.9	-1.0	0.5	4.6	-4.4
PSBR (£ billion)	1996-97	27.4	26.0	24.1	27.7	25.2	26.2	26.1
	1997-98	25.4	18.0	20.0	21.9	24.1	19.5	21.5
	1998-99	18.8	10.0	14.7	13.1	17.4	7.4	13.6
	1999-2000	13.6	4.0	9.9	3.3	16.7	0.7	8.0

[Prepared November 1996]

4 The public finances

Summary

4.01 This Chapter sets out projections for the public finances up to 2001-02 after allowing for the measures in the Budget and the new assessment of economic prospects. It also includes an analysis of changes from the 1995 Budget projections. Historical series and further detail on the forecast for 1996-97 and 1997-98 are presented in Annex A. Annex B provides a guide to the different accounting conventions used in the presentation of public finances in this Chapter and elsewhere.

4.02 The projections show a steady fiscal tightening over the next five years, mainly as a result of slow growth in public spending. The PSBR is projected to fall steadily from 3 1/2 per cent of GDP in 1996-97 to be close to balance in 1999-2000, and in surplus thereafter.

The budget deficit

4.03 The projected path for the PSBR is summarised in Table 4.1.

Table 4.1 Public sector borrowing requirement(1)

	Outturn	Forecast		Projection(2)			
	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
£ billion							
General government expenditure	303.0	308.5	319.0	327	336	345	353
General government receipts	269.2	280.9	299.4	315	333	352	370
General government borrowing requirement	33.8	27.7	19.6	12	4	-7	-18
PCMOB(3)	-2.2	-1.3	-0.4	0	0	0	0
PSBR	**31.7**	**26.4**	**19.2**	**12**	**3**	**-8**	**-18**
Per cent of money GDP							
General government expenditure	42 3/4	41 1/4	40 1/2	39 1/2	39	38 1/4	37 1/2
General government receipts	38	37 3/4	38	38	38 1/2	39	39 1/4
General government borrowing requirement	4 3/4	3 3/4	2 1/2	1 1/2	1/2	- 3/4	-2
PCMOB(3)	- 1/4	- 1/4	0	0	0	0	0
PSBR	**4 1/2**	**3 1/2**	**2 1/2**	**1 1/2**	**1/2**	**- 3/4**	**-2**
Money GDP - £ billion	708.5	745.7	786.9	826	864	903	943

(1) *In this and other tables, constituent items may not sum to totals because of rounding.*

(2) *Projections are rounded to the nearest £1 billion from 1998-99 onwards.*

(3) *Public corporations' market and overseas borrowing.*

The PSBR in the short term

4.04 The outturn for the PSBR in 1995-96 was £31 1/2 billion, 4 1/2 per cent of GDP. The latest forecast for the PSBR in 1996-97 is £26 1/2 billion, 3 1/2 per cent of GDP. This represents a fall of £19 billion from the cyclical peak three years earlier.

4.05 Taking into account the tax changes announced in the Budget and the new public expenditure plans, the PSBR in 1997-98 is forecast to fall to £19billion, 2 1/2 per cent of GDP. The fall in the PSBR as a per cent of GDP between 1995-96 and 1997-98 is almost entirely due to low growth in public spending.

Medium-term PSBR projections

4.06 The projections of the public finances in the medium term are based on the assumptions on the economy set out in Table 3.11 in Chapter 3. The PSBR is projected to fall steadily, from borrowing of 3 1/2 per cent of GDP in 1996-97 to be close to balance - borrowing of under 1/2 per cent of GDP - in 1999-2000, with debt repayments in the following two years. The main influence behind the falling PSBR is the slow growth in public spending implied by the new spending plans. Of a total reduction in the PSBR of over 5 per cent of GDP in the five years up to 2001-02, around three-quarters is attributable to the projected fall in spending relative to GDP. Growth in receipts over the medium term is a little faster than that of GDP, which is the normal expectation given growth close to trend and unchanged tax policies (defined as including the existing commitments to real increases in road fuel and tobacco duties).

Other measures of the fiscal stance

4.07 Table 4.2 gives an alternative presentation of the fiscal projections on a national accounts basis (see Annex B). The table sets out projections of the current balance of the public sector and of the public sector's financial deficit and shows how they relate to the PSBR. The table also shows the financial deficit for general government.

4.08 The balance on the public sector's current account is forecast to move from a deficit of £21 billion in 1996-97 to a surplus of £4 billion in 1999-2000. Net capital spending - the public sector's deficit on capital account - is forecast at £8 1/2 billion in 1996-97, and at lower levels in future years. This reflects the increased use of private finance for what would have been up until recently publicly financed capital spending. (Capital spending under the private finance initiative does not score as public sector capital spending.) The public sector financial deficit (PSFD) is forecast at £29 1/2 billion in 1996-97, and projected to decline steadily thereafter, coming close to balance in 1999-2000, and going into surplus thereafter.

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Table 4.2 The public sector's finances

				£ billion			
	Outturn	Forecast			Projection(4)		
	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Receipts(1)	271.9	286.2	304.0	320	338	357	376
Current expenditure(1), (2)	296.4	307.1	317.7	325	334	342	350
Current balance(1)	**-24.5**	**-20.9**	**-13.8**	**-6**	**4**	**15**	**26**
Net capital spending(1), (3), (5)	10.3	8.6	6.7	6	6	6	6
Financial deficit(1)	**34.8**	**29.4**	**20.5**	**12**	**2**	**-9**	**-21**
Privatisation proceeds and other financial transactions	3.1	3.0	1.3	-0	-1	-2	-3
PSBR	**31.7**	**26.4**	**19.2**	**12**	**3**	**-8**	**-18**
General government financial deficit(6) - £ billion	35.8	30.4	20.3	12	2	-9	-21
- per cent of GDP(6)	5	4	2 1/2	1 1/2	1/4	-1	-2 1/4

(1) *Figures on a national accounts basis. See Annex B.*

(2) *Includes depreciation of fixed capital.*

(3) *Net of depreciation and less capital transfer receipts.*

(4) *Rounded to the nearest £1 billion.*

(5) *Does not include capital expenditure under the Private Finance Initiative, which is expected to amount to £10.4 billion over three years to 1999-00. See Table 5.5.*

(6) *Definition as for Maastricht criterion. GDP is on an ESA basis.*

4.09 For 1996-97, the PSFD is forecast to be higher than the PSBR by £3 billion. This has been the pattern for a number of years, and largely reflects privatisation proceeds (£4 1/2 billion in 1996-97). The other financial transactions which account for the gap between the PSBR and the PSFD - the main ones are net lending to the private sector and accruals adjustments on receipts and spending to put them onto a cash basis - increase the PSBR relative to the PSFD in 1996-97, and are expected to continue to do so. With privatisation proceeds expected to be at much lower levels in future years than in the recent past, the PSBR is higher than the PSFD in the medium term projections.

4.10 The general government financial deficit (GGFD) is the measure used in the Maastricht criteria which will be used to help determine eligibility for participation in the start of the single currency in 1999. The GGFD is forecast at £30 1/2 billion, 4 per cent of GDP, for 1996-97, falling to 2 1/2 per cent of GDP in 1997-98, below the 3 per cent reference value, enabling the United Kingdom to meet the 1997 deficit criterion for qualification for participation in the single currency. (The UK already meets the criterion on government debt.) The GGFD is projected to be in approximate balance by 1999-2000 and in surplus thereafter.

4.11 The difference between the GGFD and the PSFD is the public corporations' financial deficit. Public corporations have been in surplus in recent years but following recent privatisations the sector is expected to be in approximate balance from 1997-98 onwards.

Public sector debt

4.12 Table 4.3 sets out projections for the stock of net public sector debt and gross general government debt. (Definitions are set out in Annex B.) Public sector debt stood at £323 billion - 44 1/2 per cent of GDP - at end-March 1996. The latest forecasts for the PSBR imply a further increase in the debt/GDP ratio in the short term, to a peak of 46 per cent of GDP at end-March 1998. Thereafter the ratio is projected to fall, as the PSBR is brought down to balance and then goes into surplus.

Table 4.3 Public sector debt(1)

	Outturn	Forecast			Projection		
	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Net public sector debt							
£ billion(2)	323	350	371	384	388	382	364
per cent of GDP(3)	44 1/2	45 1/2	46	45 1/2	44	41 1/2	37 1/2
Gross general government debt							
£ billion(2)	379	411	433	448	454	450	433
per cent of GDP(4)	53 3/4	55 1/4	55 1/4	54 1/2	52 3/4	50	46 1/4

(1) *At end-March.*

(2) *Rounded to the nearest £1 billion.*

(3) *GDP centred on end-March.*

(4) *Ratio as defined as for Maastricht criterion. GDP is on an ESA basis, year ending in March.*

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4.13 Gross general government debt is the measure of debt used in the Maastricht criteria. The ratio of debt to GDP on this measure and calculated as for the Maastricht criterion stood at 53 3/4 per cent of GDP at end-March 1996, and is forecast to rise to a peak of 55 1/4 per cent of GDP at end-March 1997, before first stabilising and then declining. The forecast peak is comfortably below the Maastricht criterion of 60 per cent.

General government receipts

4.14 Table 4.4 shows the outturn for 1995-96 and forecasts and projections from 1996-97 up to 2001-02 for general government receipts and its principal components. Table 4.5 shows the same information for receipts as a percent of GDP. A more detailed breakdown for 1995-96 outturns and for the forecasts for 1996-97 and 1997-98 is shown in Table 4A.1.

Table 4.4 General government receipts

	£ billion						
	Outturn	Forecast		Projection(3)			
	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Income tax	68.0	68.1	71.8	76	81	87	93
Corporation tax	23.6	26.1	27.2	29	33	36	38
Value added tax	43.1	47.5	50.7	54	56	59	61
Excise duties(1)	28.4	31.0	34.1	37	40	43	46
Other taxes and royalties(2)	44.2	46.2	49.3	51	53	56	58
Social security contributions	44.5	46.7	49.1	52	54	56	59
Other receipts	17.4	15.3	17.2	16	16	16	16
General government receipts	**269.2**	**280.9**	**299.4**	**315**	**333**	**352**	**370**

(1) *Fuel, alcohol and tobacco duties.*

(2) *Includes council tax as well as other central government taxes.*

(3) *Rounded to the nearest £1 billion.*

Receipts in 1996-97

4.15 General government receipts are now expected to rise by a bit under 4 1/2 per cent in 1996-97. This is slightly lower than the forecast increase in money GDP, and the ratio of receipts to GDP is expected to fall marginally. This fall reflects a reduction in other (non-tax) receipts, a category which includes certain accruals and accounting adjustments. (The main factor behind the low level in 1996-97 is the accruals adjustment on index-linked gilts, reflecting a large redemption in September.) Taxes as a percent of GDP in 1996-97 are more or less unchanged from 1995-96.

4.16 This nevertheless represents faster growth in receipts relative to GDP than projected in the Budget a year ago, when the receipts to GDP ratio was forecast to fall by a half percentage point and the tax to GDP ratio by a quarter point. A contributory factor is higher forecast growth in corporation tax receipts - a rise of 11 per cent as compared with 8per cent in the last Budget - reflecting a large increase in advance corporation tax (ACT) as a result of rapid growth in dividends and other distributions on which ACT is charged. Growth in VAT receipts is also higher than forecast in the last Budget (although the level of receipts is lower). But the rise in income tax is smaller.

Shortfall in VAT receipts

The outturns for VAT receipts have been consistently below the forecasts published in the FSBR since 1989-90. Recent work by HM Treasury and Customs and Excise analyses how the problem has arisen and suggests what may lie behind it.

The VAT forecasts are derived from forecasts of the underlying tax base, the largest component of which is consumer spending. Errors in the forecasts of consumer spending, however, play little part in explaining the shortfall; it appears rather that there has been a shift in the relationship between VAT receipts and consumer spending.

The chart below shows that, although the ratio of VAT receipts to consumer spending has been rising since the early 1980s, the underlying ratio - after adjusting for increases in the VAT rate and other changes in coverage - peaked in the late 1980s and has been falling since then. Up to two years ago, VAT forecasts had assumed that this was cyclical and would reverse as the recovery progressed, but this has not happened. Had the underlying ratio remained constant at its level at the end of the 1980s, VAT receipts in 1995-96 would have been £6 billion higher.

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No single explanation of this has emerged, but a number of significant contributory factors can be identified:

- better tax planning and increasing tax avoidance by companies;

- greater than expected revenue losses from a range of tax regime changes (such as increases in the VAT registration threshold);

- losses resulting from successful legal challenges to Customs and Excise's interpretation of the law;

- and, until recently, worsening tax compliance by traders.

Other factors which may also have contributed on a smaller scale include the introduction of the National Lottery and growth in the shadow economy.

VAT receipts have picked up this year, and it looks likely that 1996-97 will see the first rise in the VAT/consumer spending ratio since the late 1980s, but to a level only slightly higher than two years earlier. Adjusted for the Budget tax measures and extra tax from the "spend to save" package, the forecasts imply a broadly flat ratio of VAT to consumer spending over the next few years. This is similar to the experience of the second half of the 1980s, the last time when consumer spending was growing at the relatively high real rates now forecast.

Receipts in 1997-98

4.17 General government receipts are forecast to rise by 6 1/2 per cent in

1997-98, which is a bit higher than the forecast rise in money GDP. The net impact of the Budget measures on receipts in 1997-98 is only marginal - a net reduction of £ 1/4 billion (-£ 3/4 billion from the Budget tax changes, +£ 1/2 billion from the "spend-to-save" package).

Receipts in the medium term

4.18 Over the medium term, general government receipts are projected to rise somewhat faster than money GDP. The net impact of the Budget measures is to raise receipts in the medium term. The Budget tax measures have a net yield of £ 3/4 billion by 1999-2000, and the "spend-to-save" package is expected to bring in an extra £2 1/4 billion a year by then. This reinforces the underlying trend of receipts growing slightly faster than GDP. As usual, the medium-term receipts projections have been made on the conventional assumption of no further changes in tax rates and an indexed tax system (except for the commitment to real increases for tobacco and road fuel duties).

Table 4.5 General government receipts as a percent of GDP

	Outturn	Forecast		Projection			
	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Income tax(2)	9.6	9.1	9.1	9.2	9.4	9.6	9.8
Corporation tax(2)	3.3	3.5	3.5	3.6	3.8	3.9	4.0
Value added tax(2)	6.1	6.4	6.4	6.5	6.5	6.5	6.5
Excise duties(1) (2)	4.0	4.2	4.3	4.5	4.6	4.7	4.9
Other taxes and royalties(1) (2)	6.2	6.2	6.3	6.2	6.1	6.2	6.2
Social security contributions(2)	6.3	6.3	6.2	6.2	6.3	6.3	6.3
Other receipts(3)	2.5	2.0	2.2	2.0	1.8	1.8	1.7
GGR	**38.0**	**37.7**	**38.0**	**38.1**	**38.5**	**39.0**	**39.3**
Total taxes and social security contributions(4)	35.7	35.8	36.2	36.5	37.0	37.5	37.9

(1) *For definitions see footnotes to Table 4.4.*

(2) *Cash receipts.*

(3) *Includes accruals adjustments.*

(4) *Measured on a national accounts (accruals) basis.*

Taxes as a share of GDP

4.19 Tax and social security contribution revenues (on a national accounts basis - the "tax burden") are now forecast at 35 3/4 per cent of GDP in 1996-97, which is a similar level to 1995-96. A rise in the tax/GDP ratio is forecast for 1997-98. Income tax is expected to fall as a percent of GDP in 1996--97, reflecting both last year's Budget and the rising cost of tax relief on profit-related pay. However, this is offset by increases (as a percent of GDP) in receipts of VAT, corporation tax and excise duties. For

1997-98, income tax receipts are flat as a percent of GDP, with the Budget measures offsetting real fiscal drag. But there are increases in receipts of certain other taxes, some of which reflect the Budget measures. Over the medium term, the tax/GDP ratio is projected to continue rising. The usual contributions from income tax (real fiscal drag) and excise duties (the policy of real increases for tobacco and road fuel duties) are re-inforced by the net impact of the Budget measures, especially from the "spend-to-save" package.

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General government expenditure

4.20 The Government's objective for public spending is to reduce it as a share of GDP over time, and in particular to reduce it to below 40 per cent. On present plans, this objective will be achieved in 1997-98. The objective is expressed in terms of GGE(X), an aggregate which excludes - from total general government expenditure - privatisation proceeds and spending financed out of National Lottery proceeds, and which also nets off interest and dividend receipts from gross payments.

4.21 Table 4.6 shows the 1995-96 outturn and forecasts and projections for 1996-97 up to 2001-02 for general government expenditure (GGE) and its main components. The projections up to 1999-2000 are consistent with the new public spending plans. Figures for later years assume that Control Total spending will grow by 3/4 per cent a year in real terms.

Table 4.6 General government expenditure

				£ billion			
	Outturn	Forecast			Projection(1)		
	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Control Total	255.2	260.6	266.5	274	281	289	297
Cyclical social security(2)	14.5	14.3	14.1	14	15	15	16
Central government debt interest	20.0	22.2	24.8	24	24	24	23
Accounting adjustments	10.1	10.3	9.2	10	11	11	11
GGE(X)(3)	**299.7**	**307.4**	**314.7**	**322**	**331**	**339**	**347**
Privatisation proceeds	-2.4	-4.5	-2.0	-1 1/2	-1	-1	-1
Other adjustments	5.8	5.6	6.3	7	7	7	7
GGE	**303.0**	**308.5**	**319.0**	**327**	**336**	**345**	**353**
GGE(X)(3)/GDP ratio - per cent	42 1/4	41 1/4	40	39	38 1/4	37 1/2	36 3/4
Real Growth - per cent: Control Total	1/2	- 1/4	1/4	3/4	1/2	3/4	3/4
GGE(X)(3)	1 1/2	0	1/4	1/2	1/2	1/2	1/4

(1) *Rounded to the nearest £1 billion, except for privatisation proceeds which are rounded to nearest £ 1/2 billion.*

(2) *For unemployed assumptions underlying projections, see economic assumptions for public expenditure, paragraph 5A.5.*

(3) *Excluding privatisation proceeds and lottery financed spending and net of interest and dividend receipts.*

Expenditure in 1996-97

4.22 GGE(X) in 1996-97 is forecast to rise by 2 1/2 per cent, which is rather lower than the expected growth in money GDP. Control Total spending is forecast at £260.6 billion, which represents an overspend of £0.5 billion on the plans in last year's Budget. The overspend mainly reflects unanticipated spending on measures to combat BSE, which is expected to reach £1 1/2 billion in 1996-97. The forecast for Control Total spending represents a fall of 1/4 per cent in real terms on 1995-96.

Expenditure over the medium term

4.23 The new public spending plans provide for Control Total spending to rise at an average of 2 1/2 per cent a year in cash terms over the next three years. Measured in real terms, the level of spending projected for 1999-2000 is only 1 1/2 per cent higher than in 1996-97. The projected real terms increase in GGE(X) is marginally smaller, a total of 1 1/4 per cent over three years.

4.24 Outside the Control Total, cyclical social security is projected to fall in real terms reflecting the assumption of falling unemployment - from an average of just under 2 million (Great Britain) for 1996-97 to 1.6million by 1999-2000. The projections also take account of Budget policy changes, which are expected to reduce spending by nearly £1 billion (6 per cent) by 1999-2000. Debt interest payments (net of receipts) are projected to continue rising in 1997-98, but thereafter to flatten off and start to decline as the level of new borrowing is reduced.

Expenditure as a share of GDP

4.25 The ratio of GGE(X) to GDP is expected to fall by one percentage point in 1996-97 to 41 1/4 per cent, a reduction of 2 1/4 percentage points from the cyclical peak in 1992-93. The public expenditure plans imply a sharp fall in this ratio over the next three years, with GGE(X) as a per cent of GDP just below the 40per cent target in 1997-98 and coming significantly below it in 1998-99. With tight control of spending assumed to be maintained through the medium term, and with debt interest expenditure benefitting from the projected reduction in borrowing, the downward trend in the GGE(X)/GDP ratio is projected to continue.

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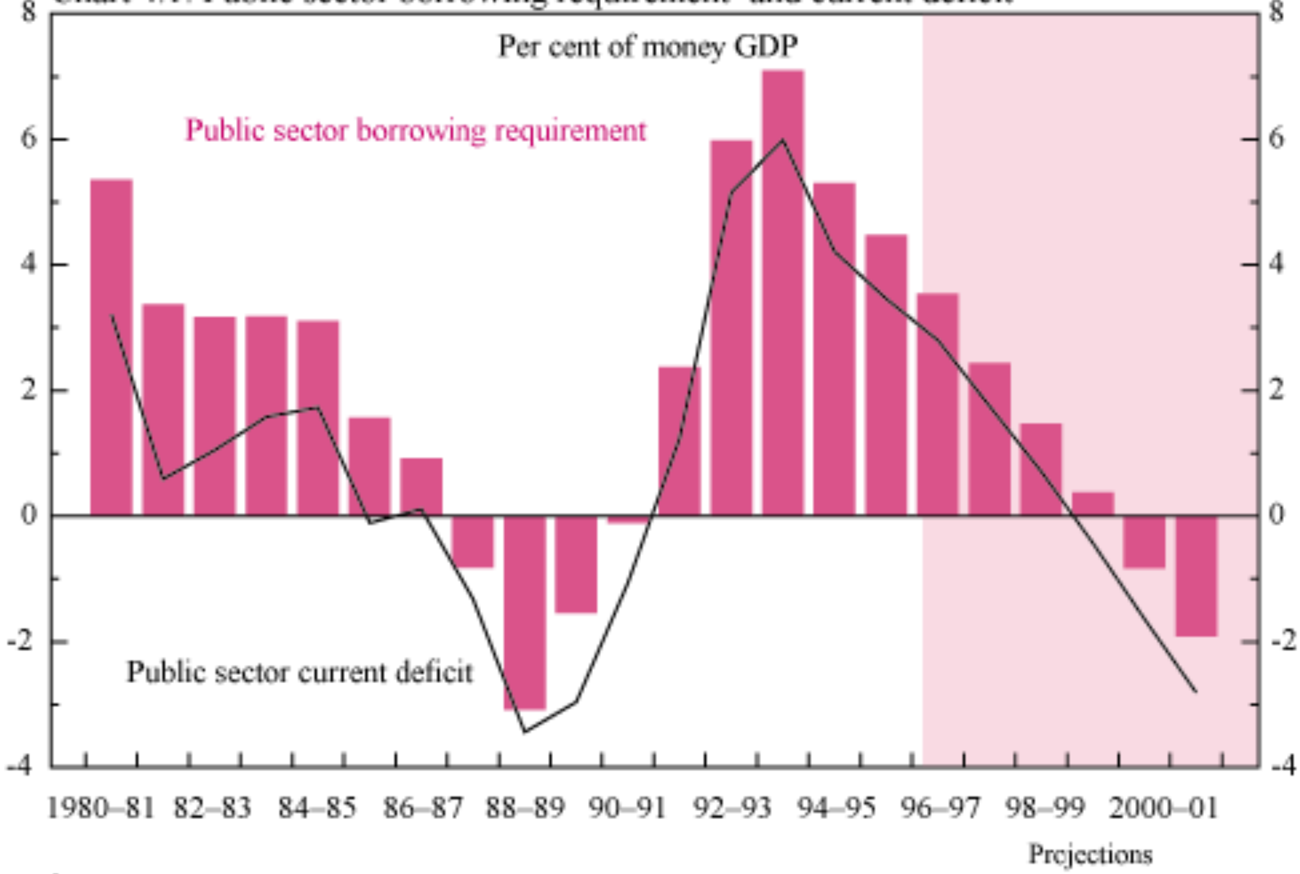
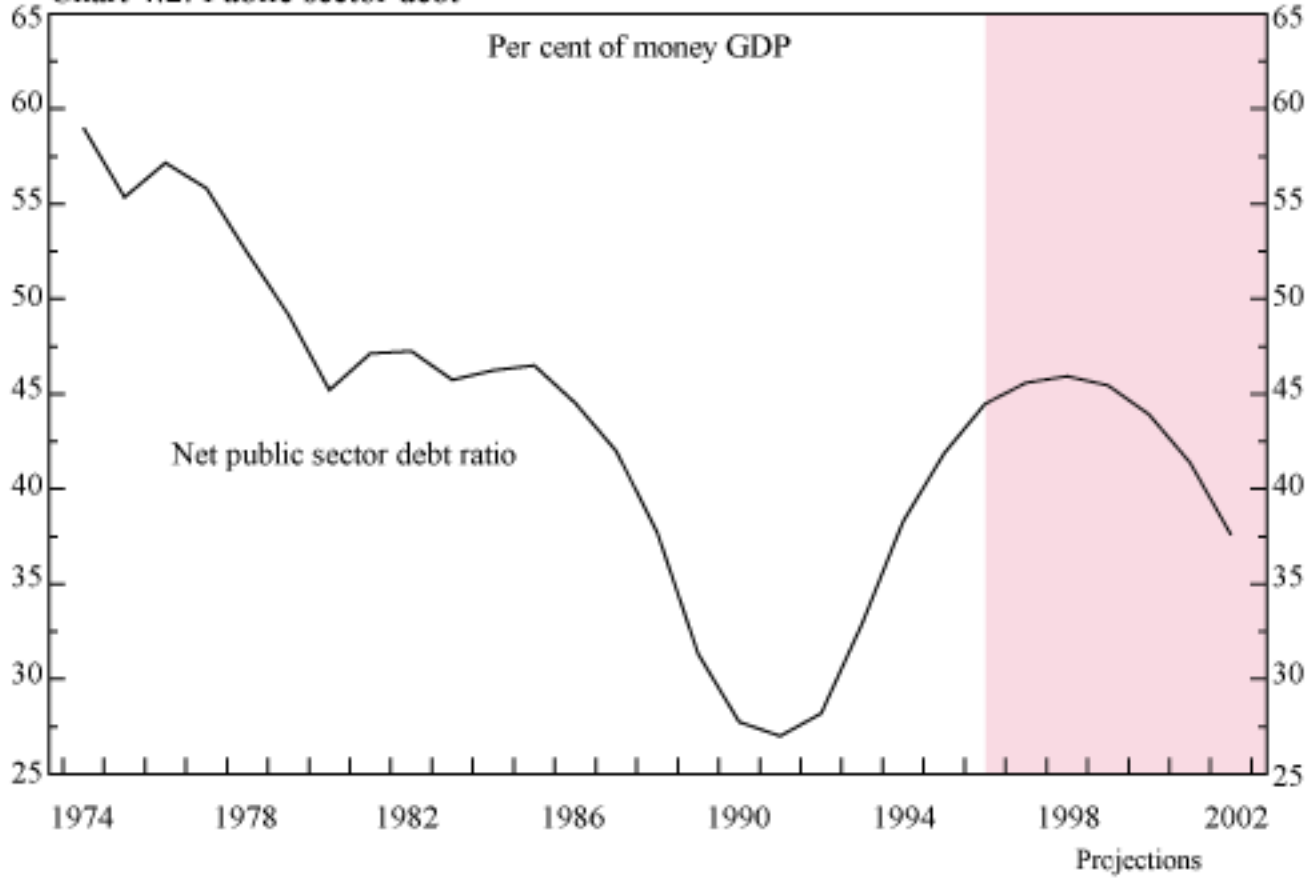
[Prepared November 1996]

Chart 4.1: Public sector borrowing requirement[1] and current deficit



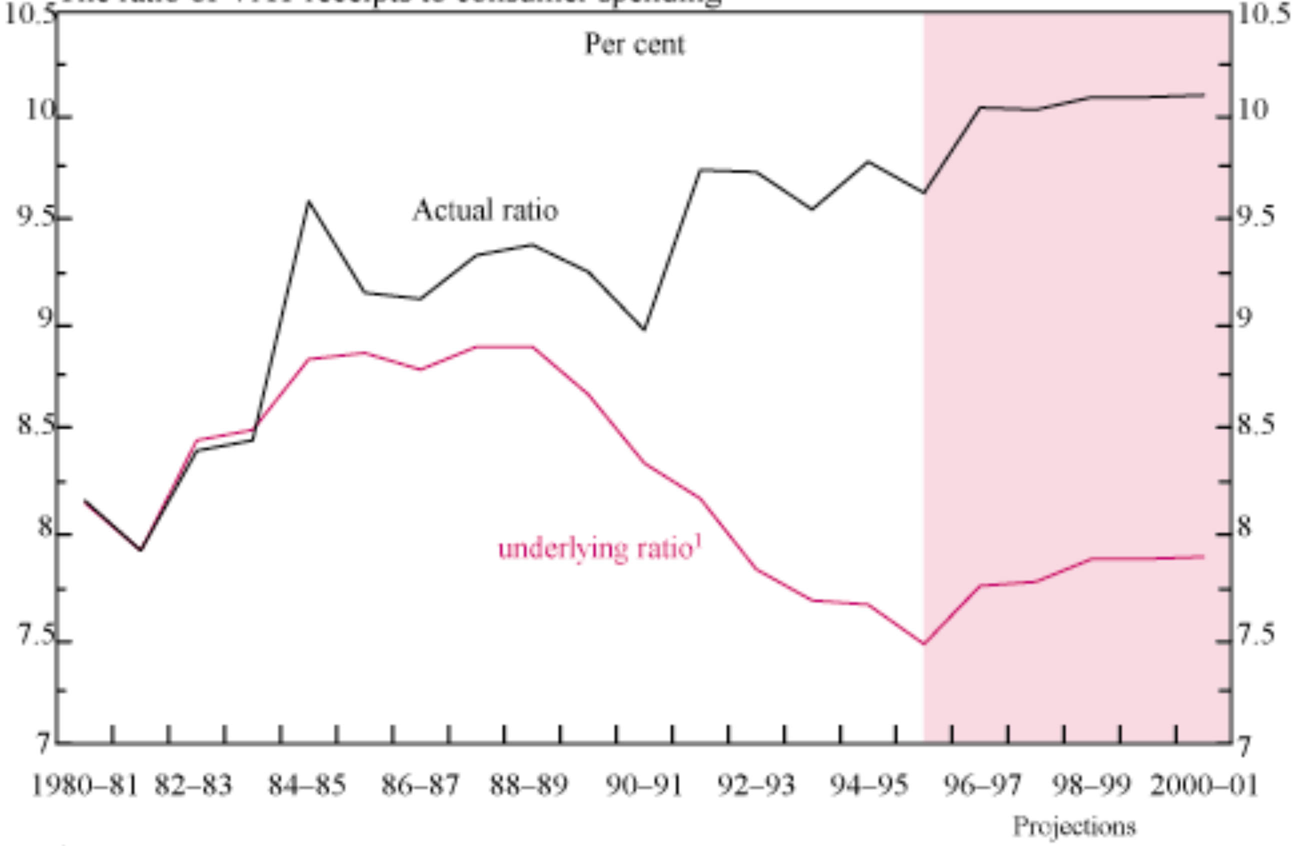
[1]Negative values of PSBR indicate a public sector debt repayment.

Chart 4.2: Public sector debt[1]



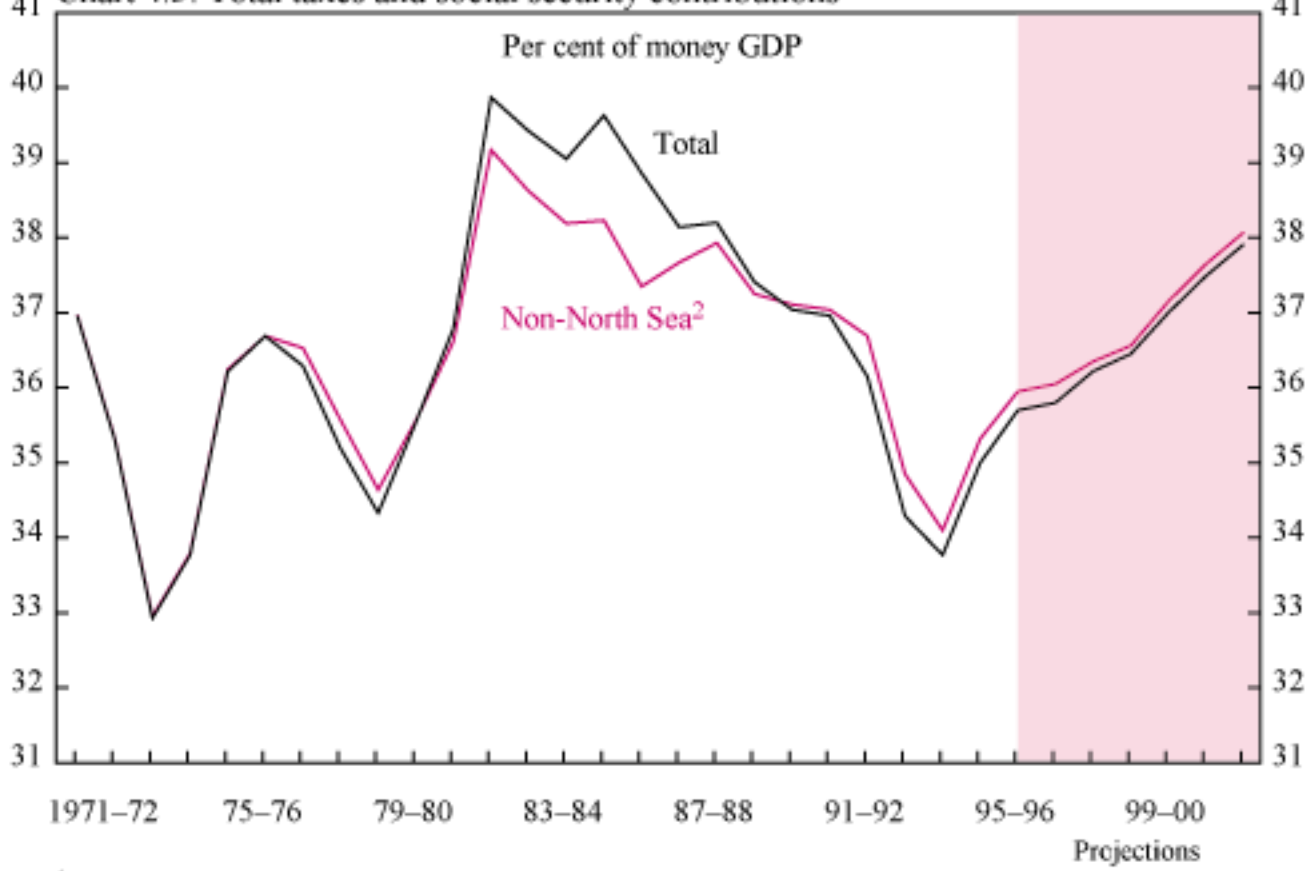
[1] At end-March as a percent of money GDP in four quarters centred on end-March.

The ratio of VAT receipts to consumer spending



[1]Excludes effects of Budget measures on VAT receipts.

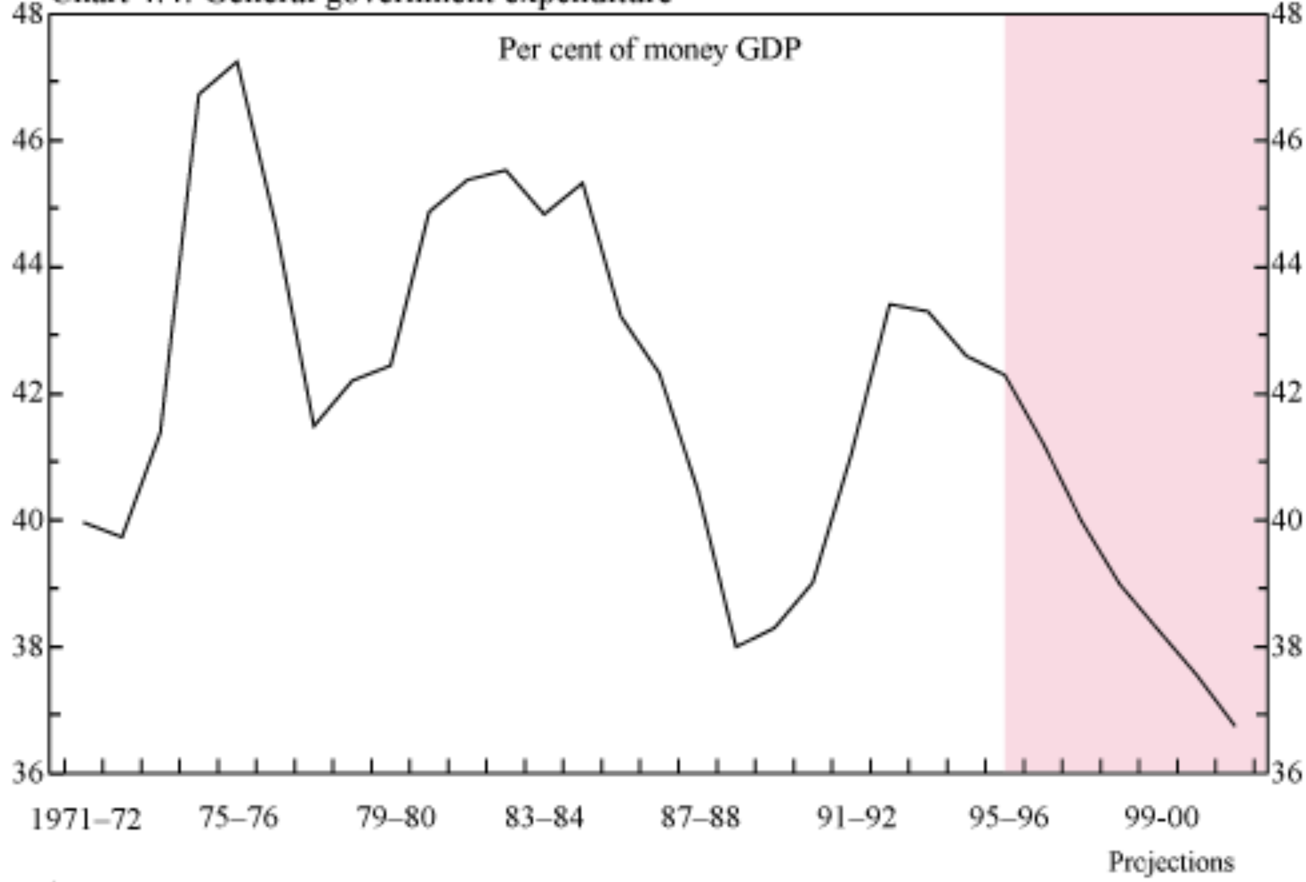
Chart 4.3: Total taxes and social security contributions[1]



[1]On a national accounts accruals basis.

[2]Non-North Sea taxes and social security contributions are expressed as a percent of non-North Sea money GDP.

Chart 4.4: General government expenditure[1]



[1]General government expenditure excluding privatisation proceeds and lottery-financed spending, and net of intere
dividend receipts.

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Changes since the last Budget

4.26 Tables 4.7, 4.8 and 4.9 summarise changes in the fiscal projections since the last Budget. More detail for 1996-97 and 1997-98 is given in Table 4A.7 of Annex A.

Table 4.7 Changes in the projections since 1995 Budget

			£ billion			
	1995-96	1996-97	1997-98(1)	1998-99(1)	1999-00(1)	2000-01(1)
PSBR path in 1995 Budget	**29.0**	**22.4**	**15**	**5**	**-2**	**-14**
Contribution(2) *from changes in:*						
GGE(X)(3)	+0.1	+1.3	-1	-2	-2	-1 1/2
general government receipts	+2.7	+4.0	+4	+8	+7	+7
other items(4)	-0.1	-1.3	+ 1/2	+ 1/2	+ 1/2	+1
Total change in PSBR	**+2.7**	**+4.0**	**+4**	**+7**	**+6**	**+6**
PSBR path in 1996 Budget	**31.7**	**26.4**	**19**	**12**	**3**	**-8**

(1) *From 1997-98 onwards, changes rounded to nearest £ 1/2 billion, except for PSBR from 1998-99, rounded to nearest £1 billion.*

(2) *Sign shows effect on PSBR, so higher expenditure and lower receipts are +ve.*

(3) *General government expenditure excluding privatisation proceeds and lottery-financed spending, and net of interest and dividend receipts. See Table 4.9.*

(4) *Lottery financed spending (+ sign), debt interest receipts (+), privatisation proceeds (-) and public corporations' market and overseas borrowing (+).*

PSBR in 1995-96 and 1996-97

4.27 The outturn for the PSBR in 1995-96 was £2.7 billion above the forecast made in the last Budget. This is mainly explained by lower tax receipts. Privatisation proceeds were also £ 1/2 billion lower than assumed. Spending (GGE(X)) turned out very close to the Budget forecasts. Receipts of income tax, corporation tax and VAT were below forecast by £0.9 billion, £1.1 billion and £0.9 billion respectively. The forecast of general government receipts for 1996-97 has been revised downwards by £4billion. The forecast for income tax is down by around £2 billion, reflecting among other things a faster than expected rise in tax relief on profit related pay. The forecast of VAT receipts is also down, by £ 1/2 billion. Corporation tax is also down by £ 1/2 billion, but this compares with a 1995-96 shortfall of over £1billion. This reflects a substantial upward revision to the forecast of ACT on dividends and other distributions.

4.28 Expenditure - GGE(X) - is up by £1 1/4 billion in 1996-97 from the last Budget. A forecast overspend on the Control Total explains £ 1/2 billion of this; the rest is higher spending outside the Control Total. Cyclical social security is up by nearly £ 1/2 billion, despite a lower level of unemployment than assumed. The rest is higher "accounting adjustments". Higher GGE(X) is partly offset by lower spending outside of GGE(X), from higher privatisation proceeds and lower than expected Lottery-financed spending. (The latter is a timing effect, reflecting a slower than expected start-up to spending.)

The projections

4.29 The PSBR projections are higher throughout than in the last Budget. Incash terms, the difference is more or less entirely explained by lower receipts, which are down in the medium-term by £7 to £8 billion a year. This is mainly the consequence of a lower level of money GDP, reflecting lower inflation than in last year's Budget projections. Money GDP in 1999--2000 is £12billion - 1 1/2 per cent - down on the last Budget, and other things equal this might be expected to reduce cash receipts by approaching £5billion. There is also some underlying reduction in the real level of receipts as compared with last year's Budget projections, as the factors behind the 1995--96 and 1996-97 shortfalls are projected to partly carry through. But much of this is offset in the medium-term by the effect on receipts of Budget tax and spending measures.

Table 4.8 Changes in the projection of receipts(1)

From 1995 Budget	£ billion			
	1997-98	1998-99	1999-00	2000-01
Current prices				
Budget measures to tax/NICs(2)	- 1/2	- 1/2	+1	+2 1/2
Other changes to tax/NICs	-3	-6	-5 1/2	-7 1/2
Changes to other receipts	- 1/2	-1 1/2	-2	-2
Total change in GGR(3)	**-4**	**-8**	**-7**	**-7**
1995-96 prices				
Total change in GGR(&)D;(3)	**-2**	**-4 1/2**	**-3 1/2**	**-3**
Change in GGR/GDP ratio - per cent	- 1/4	- 1/2	- 1/4	0

(1) *Rounded to the nearest £ 1/2 billion*.

(2) *Changes from indexed base. See Tables 1.4 and 6.1*.

(3) *Includes additional tax revenues from package of spending measures to raise revenues*

See Table 5.2.	1/2	+1 1/2	+2 1/2	+2 1/2

Table 4.9 Changes in the public spending projections(1)

From 1995 Budget	£ billion			
	1997-98	1998-99	1999-00	2000-01
Current prices				
Control Total	-1 1/2	-2	-2 1/2	-2 1/2
Cyclical social security	0	- 1/2	- 1/2	- 1/2
Central government debt interest	+1	+ 1/2	+ 1/2	+1
Accounting adjustments	0	0	+1	+ 1/2
GGE(X)(2)	**-1**	**-2**	**-2**	**-1 1/2**
Privatisation proceeds(3)	+ 1/2	0	0	0
Other adjustments(4)	0	+ 1/2	+ 1/2	+ 1/2
Total change in GGE	**- 1/2**	**-1 1/2**	**-1 1/2**	**- 1/2**
1995-96 prices				
Control Total	+ 1/2	+ 1/2	+ 1/2	+ 1/2
Cyclical social security	0	0	- 1/2	- 1/2
Central government debt interest	+1	+ 1/2	+ 1/2	+1
Accounting adjustments	0	0	+1	+ 1/2
GGE(X)(2)	**+1 1/2**	**+1 1/2**	**+1 1/2**	**+2**
Privatisation proceeds(3)	+ 1/2	0	0	0
Other adjustments(4)	0	+ 1/2	+ 1/2	+ 1/2
Total change in GGE	**+2**	**+1 1/2**	**+1 1/2**	**+2 1/2**
Change in GGE(X)(2)/GDP ratio - per cent	+ 1/4	+ 1/4	+ 1/4	+ 1/2

(1) *Rounded to the nearest £ 1/2 billion*.

(2) *Excluding privatisation proceeds, and lottery-financed spending and net of interest receipts*.

(3) *A minus sign indicates higher privatisation proceeds*.

(4) *Lottery-financed spending and interest and dividend receipts*.

4.30 Expenditure in the forecast years is a little lower in cash terms than last year's Budget projections. The new public expenditure plans reduce Control Total spending by £1 1/2 to £2 1/2 billion a year, but the reductions in GGE(X) are for the most part smaller.

4.31 As a per cent of GDP, the latest PSBR projections are 1/2 to 3/4 percentage points higher than last year's Budget projections. The receipts to GDP ratio projections are a bit lower than the last Budget at first, though the gap closes by the end. And, although in cash terms spending - GGE(X) - is down on the last Budget, a lower projected level of money GDP means that spending is a little higher relative to GDP.

Financing policy

4.32 Financing policy will be carried out on the basis set out in the gilts remit to the Bank of England (published on 27 March 1996). Table 4.10 updates the financing arithmetic to allow for the new CGBR forecast, and the latest information on gilt sales and assumptions for net National Savings inflows, and other funding. It is now anticipated that £11.9 billion of gilts sales will be required in the months November 1996 to March 1997 for full financing.

Table 4.10 Financing requirement forecast for 1996-97

	£ billion
CGBR	27.9
Gilts maturing	12.5
Plus Cumulative underfund	2.2
Financing requirement	42.6
Less Net National Savings inflow	4.5
Less Other funding	-0.3
Gilts sales required for full funding	38.4
Less Gilts sales (April - October 1996)	26.4
Further gilts sales required (November - March 1996-97) for full financing	11.9

4.33 Remits for gilts and National Savings will be published just before the start of the financial year 1997-98 setting out the borrowing programme and how it will be implemented.

Margins of Error and alternative projections

Average errors

4.34 The PSBR is the difference between two large aggregates of spending and receipts; given that it is not surprising that PSBR forecasts are subject to a wide margin of error. Over the past ten years the average absolute error on forecasts of the current year made in the autumn (November Budget forecast for the past three years, Autumn Statement forecasts for previous years) has averaged 1/2 per cent of GDP, equivalent to plus or minus £4 1/2 billion in today's prices. The average absolute error in projections for the year ahead, adjusted for subsequent Budget measures, is 1 1/2 per cent of GDP, or plus or minus £11 billion in today's prices.

Alternative projections

4.35 The path of the economy in the medium term is inevitably uncertain. However, if the profile of output was to differ from that described in Chapter3, the outlook for the public finances would be affected. More specifically, tax revenues and some government expenditure, particularly cyclical social security, vary automatically with the economic cycle.

4.36 Table 4.11 presents three different sets of growth projections, whereby GDP growth differs from the main projection by 1/2 per cent in either direction from 1997-98.

Table 4.11 Variant GDP growth projections

	1997-98	1998-99	1999-00	2000-01	2001-02
Main case	3 1/2	3	2 1/2	2 1/2	2 1/2
Higher growth	4	3 1/2	3	3	3
Lower growth	3	2 1/2	2	2	2

4.37 The sensitivity of the PSBR to each of these growth scenarios is illustrated below in Table 4.12, based upon the relationships set out in a study published by HM Treasury last year.[1] This analysis assumes that public expenditure within the Control Total is unchanged in cash terms, but cyclical social security and debt interest payments are allowed to vary with the path of output. Tax rates, allowances and thresholds are kept at the same levels as in the main projection, but revenues vary due to the different paths of output.

Table 4.12 Variant PSBR projections

			Per cent of GDP		
	1997-98	1998-99	1999-00	2000-01	2001-02
Main case	2 1/2	1 1/2	1/2	- 3/4	-2
Higher growth	2 1/4	1	- 1/2	-2	-3 1/2
Lower growth	2 1/2	2	1 1/4	1/2	- 1/4

4.38 In all cases the budget balance continues to improve, and is in surplus by the end of the period. By 1999-2000 the budget has reached surplus in the higher growth projection, and is close to balance in the main case, but there is still a deficit on the lower growth case.

1. HM Treasury Occasional Paper No. 4 "Public Finances and the Cycle". Back

[Prepared November 1996]

Annex A to Chapter 4

Further analyses of the public finances

4A.1 This annex contains a number of further analyses of the forecast of public finances in 1996-97 and 1997-98. There are also two tables which set out a historical series for the PSBR and its main components, including general government expenditure and general government receipts.

4A.2 The following analyses are included:

(i) **General government receipts** - further tax by tax details of the forecasts for 1996-97 and 1997-98 (Table 4A.1);

(ii) **Sectoral breakdown of PSBR** forecast for 1996-97 (Table 4A.2);

(iii) **Central government transactions on a cash basis** - forecast for 1996-97 and 1997-98 (Table 4A.3);

(iv) **Economic category analyses of local authority and public corporations transactions** (Tables 4A.4 and 4A.5);

(v) **A full analysis of receipts and expenditure by economic category** for 1996-97 and 1997-98 (Table 4A.6);

(vi) **Changes to PSBR forecasts** for 1996-97 and 1997-98 since the last Budget and since the Summer Economic Forecast (Table 4A.7);

(vii) **Historical series for the PSBR and its main components** (Tables 4A.8 and 4A.9)**.**

Table 4A.1 General government receipts(1)

Borrowing by sector

4A.3 Central government borrowing on its own account (ie excluding borrowing for on lending to local authorities and public corporations) more than accounted for the total PSBR in 1995-96 and is expected to do so again in 1996-97. Central government borrowing on its own account in the first seven months of 1996-97 was £6.5 billion lower than in the same period of 1995-96. By contrast, the forecast for 1996-97 as a whole implies borrowing in November to March which is only £0.5billion lower than in the same period last year.

4A.4 Privatisation proceeds account for part of this difference. Proceeds in April-October totalled £3.9 billion and very little in the way of privatisation proceeds are expected in the rest of 1996-97. This contrasts with 1995-96 when all the £2.4 billion proceeds for the year were received in the November to March period. Tax receipts in January - the usual peak month for receipts - are likely to be relatively weak as compared with the previous high months of July and October. Corporation tax receipts from industrial and commercial companies, who largely pay tax in January, are not expected to show as large a rise as did tax receipts from financial companies, who pay in October. And Schedule D income tax payments in January will be at lower tax rates (the 1996-97 rates) than the payments made last July.

Table 4A.2 Public sector borrowing requirement by sector

	£ billion			
	1995-96	1996-97		1997-98
	Outturn	Last Budget Forecast	Latest Forecast	Forecast
Inland Revenue				
Income tax	68.0	70.2	68.1	71.8
Corporation tax(2)	23.6	26.6	26.1	27.2
Petroleum revenue tax	1.0	1.0	1.7	1.6
Capital gains tax	0.8	1.0	0.9	1.1

Inheritance tax	1.5	1.5	1.6	1.6
Stamp duties	2.0	2.4	2.4	2.7
Total Inland Revenue	**96.9**	**102.6**	**100.8**	**106.0**
Customs and Excise				
Value added tax	43.1	47.9	47.5	50.7
Fuel duties	15.4	17.4	17.4	19.6
Tobacco duties	7.3	7.7	7.8	8.4
Spirits duties	1.7	1.7	1.7	1.8
Wine duties	1.2	1.2	1.2	1.3
Beer and cider duties	2.8	2.8	2.8	3.0
Betting and gaming duties	1.6	1.7	1.5	1.6
Air passenger duty	0.3	0.3	0.4	0.8
Insurance premium tax	0.6	0.7	0.6	1.2
Landfill tax		0.1	0.1	0.4
Customs duties and levies	2.5	2.6	2.2	2.4
Total Customs and Excise	**76.5**	**84.1**	**83.3**	**91.2**
Vehicle excise duties	4.0	4.3	4.3	4.5
Oil royalties	0.6	0.5	0.7	0.6
Business rates(3)	13.6	14.7	14.2	14.6
Social security contributions	44.5	46.9	46.7	49.1
Council Tax	9.6	9.9	9.9	10.6
Other taxes and royalties	6.2	5.7	5.8	5.5
Total taxes and social security contributions	**251.8**	**268.7**	**265.6**	**282.1**
Interest and dividends	5.6	4.8	5.0	5.1
Gross trading surpluses and rent	5.0	5.3	5.1	4.9
Other receipts(4)	6.8	6.0	5.2	7.2
General government receipts	**269.2**	**284.8**	**280.9**	**299.4**
North Sea revenues(5)	2.4	3.0	3.5	4.1
(1) *On a cash basis. See Annex B.*				
(2) *Includes advance corporation tax (net of repayments): (also includes North Sea corporation tax after ACT set off, and corporation tax on gains).*	9.9	9.4	11.7	11.8

(3) *Includes district council rates in Northern Ireland.*

(4) *Includes payments into the National Lottery Distribution Fund and accruals adjustments for index-linked gilts.*

(5) *North Sea corporation tax (before ACT set-off), petroleum revenue tax and royalties.*

	£ billion					
	1995-96 Outturn			1996-97 Forecast		
	Apr-Oct	Nov-Mar	Total	Apr-Oct	Nov-Mar	Total
CGBR (O)(1)	19.2	16.4	35.6	12.7	15.9	28.6
LABR(2)	0.6	-1.7	-1.1	0.3	-0.3	0.0
PCBR(3)	-1.0	-1.8	-2.8	-1.6	-0.6	-2.2
PSBR	**18.8**	**12.9**	**31.7**	**11.4**	**15.0**	**26.4**

CGBR(4)	19.7	15.8	35.5	12.5	15.4	27.9

(1) *Central government borrowing requirement on own account.*

(2) *Local authority borrowing requirement.*

(3) *Public corporations borrowing requirement.*

(4) *Central government borrowing requirement, including on-lending to local authorities and public corporations.*

4A.5 Local authorities made a net repayment of £1.1 billion in 1995-96; a zero borrowing requirement is forecast for 1996-97. Public corporations made a net repayment of £2.8 billion in 1995-96; the forecast is for a net repayment of £2.2billion in 1996-97.

Central government transactions on a cash basis

4A.6 The monthly outturns for central government borrowing are measured from the cash flows into and out of central governments funds and accounts, after consolidation. Table 4A.3 sets out the 1995-96 outturn and 1996-97 and 1997-98 forecasts for central government borrowing in terms of this cash flow presentation.

Table 4A.3 Central government transactions on a cash receipts and outlays basis

		£ billion		
	1995-96	1996-97		1997-98
	Outturn	Last Budget Forecast	Latest Forecast	Forecast
Receipts				
Inland Revenue(1)	97.1	102.6	100.8	106.0
Customs and Excise(1)	76.7	84.4	83.5	91.5
Social security contributions (GB)	42.9	45.3	45.2	47.5
Interest and dividends	8.7	7.8	8.1	8.5
Other	19.4	19.8	21.0	20.7
Total receipts	**244.7**	**259.9**	**258.6**	**274.3**
Outlays				
Interest payments	23.4	26.6	26.8	27.7
Privatisation proceeds	-2.4	-4.0	-4.5	-2.0
Net department outlays	259.3	262.5	264.9	268.0(2)
Total outlays	**280.4**	**285.1**	**287.2**	**293.8**(2)
Net own account borrowing(3)	**35.6**	**25.3**	**28.6**	**19.5**(2)
Net lending to local authorities and public corporations	-0.2	-1.1	-0.7	0.4
Net borrowing	**35.5**	**24.1**	**27.9**	**20.0**(2)

(1) *Payments to the Consolidated Fund.*

(2) *Assumes Reserve allocated to central government sector.*

(3) *Excludes net lending to local authorities and public corporations.*

Public finances by economic category

4A.7 Table 4A.6 shows a full analysis of receipts and expenditure by economic category with a breakdown between central government, local authorities and public corporations. Annex B explains the conventions used, which follow in most respects those in the UK national income and expenditure accounts.

4A.8 The table makes the assumption that the Reserve for 1997-98 is spent entirely on transactions that fall above the financial deficit line, although in practice allocations from the Reserve can also affect financial transactions. The Reserve for 1997-98 has been further apportioned between current and capital expenditure, on the basis of the experience of past outturns. It has also been assumed that all of the Reserve will be spent by central government; in practice allocations from the Reserve can be made to local authorities and public corporations spending as well.

4A.9 Tables 4A.4 and 4A.5 summarise the information on local authorities and public corporations transactions in Table 4A.6 and also provide outturn figures for 1995-96.

Table 4A.4 Local authority transactions

	£ billion		
	Outturn	Forecast	
	1995-96	1996-97	1997-98
Receipts			
Council Tax(1)	9.5	9.9	10.8
Current grants from central government	57.3	58.1	58.1
Other receipts(2)	7.7	7.8	7.8
Capital grants from central government	4.7	3.2	3.2
Total receipts	**79.1**	**79.1**	**79.8**
Expenditure			
Current expenditure on goods and services	53.0	54.2	55.0
Current grants and subsidies	13.7	13.9	13.8
Interest	4.2	4.1	4.4
Capital expenditure before depreciation	7.5	7.3	6.5
Total expenditure	**78.5**	**79.4**	**79.6**(3)
Financial deficit	**-0.7**	**0.4**	**-0.2**
Net financial transactions	-0.5	-0.3	-0.1
Net borrowing	**-1.1**	**0.0**	**-0.3**

(1) *Net of rebates and council tax benefit. Includes district council rates in Northern Ireland, shown in "Taxes on expenditure" in Table 4A.6 (line 2).*

(2) *Includes interest receipts, rent and gross trading surplus.*

(3) *Assumes no allocation from the Reserve.*

Table 4A.5 Public corporations transactions

	£ billion		
	Outturn	Forecast	
	1995-96	1996-97	1997-98
Receipts			
Gross trading surplus (including subsidies)	4.8	4.9	4.9
Other current grants	1.3	1.0	1.1
Capital grants from general government	3.5	3.1	1.8
Total receipts	**9.5**	**9.1**	**7.8**
Expenditure			
Interest, dividends and taxes on income	3.0	2.5	2.7
Capital expenditure before depreciation	5.4	5.7	5.3
Total expenditure	**8.4**	**8.1**	**8.0**(1)

Financial deficit	**-1.1**	**-1.0**	**0.2**
Net financial transactions	-1.8	-1.3	-0.2
Net borrowing	**-2.8**	**-2.2**	**0.0**

(1) *Assumes no allocation from the Reserve*.

Table 4A.6 Public sector transactions by sub-sector and economic category

£ billion

1996-97

		Central government				
	Line(1)	Central government	Local Authorities	Total	Public corporations	Public sector
Current receipts(2)						
Taxes on income and royalties	*1*	96.9	0.0	96.9	-0.2	96.7
Taxes on expenditure	2	110.0	0.2	110.2	0.0	110.2
Taxes on capital	3	3.3	0.0	3.3	0.0	3.3
Social Security contributions	4	46.8	0.0	46.8	0.0	46.8
Council tax	5	0.0	9.8	9.8	0.0	9.8
Gross trading surplus	6	-0.1	0.8	0.7	4.9	5.7
Rent and miscellaneous current transfers	7	2.7	4.1	6.8	0.4	7.2
Interest and dividends from private sector and abroad	8	2.3	0.5	2.9	0.2	3.0
Interest and dividends within public sector	9	5.8	-3.7	2.1	-2.1	0.0
Imputed charge for non-trading capital consumption	10	1.4	2.1	3.5	0.0	3.5
Total current receipts	***11***	**269.2**	**13.8**	**283.0**	**3.2**	**286.2**
Current expenditure(2)						
Current expenditure on goods and services	*12*	100.6	54.2	154.8	0.0	154.8
Depreciation	13	2.4	4.9	7.3	3.9	11.1
Subsidies	14	8.1	0.7	8.8	0.0	8.8
Current grants to personal sector	15	87.5	13.2	100.7	0.0	100.7
Current grants abroad	16	4.9	0.0	4.9	0.0	4.9
Current grants within public sector	17	58.1	-58.1	0.0	0.0	0.0
Debt interest	18	26.6	0.4(3)	27.0	-0.3	26.8
Apportionment of Reserve	*19*					
Total current expenditure	***20***	**288.2**	**15.3**	**303.5**	**3.6**	**307.1**
Current deficit	***21***	**19.0**	**1.5**	**20.5**	**0.4**	**20.9**
Capital transfers	***22***	**0.0**	**0.3**	**0.3**	**-0.1**	**0.2**
Capital expenditure(2)						
Gross domestic fixed capital expenditure	*23*	3.9	6.2	10.1	5.2	15.3
Less Depreciation	*24*	-2.4	-4.9	-7.3	-3.9	-11.1
Increase in stocks	25	0.0	0.0	0.0	0.0	0.0
Capital grants to private sector	26	3.2	1.1	4.3	0.4	4.6
Capital grants to public sector	27	6.3	-3.2	3.1	-3.1	0.0
Apportionment of Reserve	28					
Total capital expenditure	***29***	**11.0**	**-0.8**	**10.2**	**-1.4**	**8.8**
Financial deficit	***30***	**30.0**	**0.4**	**30.4**	**-1.0**	**29.4**

Financial transactions						
Net lending to private sector and abroad	31	0.4	-0.2	0.3	0.0	0.3
Cash expenditure on company securities (including privatisation proceeds)	32	-4.5	0.0	-4.5	0.0	-4.5
Transactions concerning certain public sector pension schemes)	33	1.1	0.0	1.1	0.0	1.1
Accruals adjustments on receipts	34	1.5	-0.1	1.4	0.0	1.4
Other accruals adjustments	35	0.2	0.0	0.2	-1.1	-1.0
Miscellaneous financial transactions	36	-0.1	-0.1	-0.2	-0.1	-0.3
Borrowing requirement	***37***	**28.6**(4)	**0.0**	**28.6**(4)	**-2.2**	**26.4**

(1) *Current deficit (line 21) = current expenditure (line 20) - current receipts (line 11).*

Financial deficit (line 30) = current deficit (line 21) - capital receipts (line 22) + capital expenditure (line 29).

(2) *On an accruals basis.*

(3) *Excluding local authorities' payments to central government and public corporations' payments to general government, which are in line 9.*

(4) *Own account borrowing.*

Table 4A.6 Public sector transactions by sub-sector and economic category - *continued*

£ billion

1997-98

	Central government					
Line(1)	Central government	Local authorities	Total	Public corporation	Public sector	
						Current receipts(2)
1	102.0	0.0	102.0	-0.2	101.8	Taxes on income and royalties
2	119.2	0.2	119.4	0.0	119.4	Taxes on expenditure
3	3.8	0.0	3.8	0.0	3.8	Taxes on capital
4	49.2	0.0	49.2	0.0	49.2	Social Security contributions
5	0.0	10.6	10.6	0.0	10.6	Council tax
6	-0.1	0.8	0.7	4.9	5.6	Gross trading surplus
7	2.6	4.0	6.6	0.5	7.1	Rent and miscellaneous current transfers
8	2.2	0.6	2.8	0.2	3.0	Interest and dividends from private sector and abroad
9	6.3	-3.9	2.3	-2.3	0.0	Interest and dividends within public sector
10	1.4	2.1	3.5	0.0	3.5	Imputed charge for non-trading capital consumption
11	**286.6**	**14.3**	**300.9**	**3.0**	**304.0**	**Total current receipts**
						Current expenditure(2)
12	101.8	55.0	156.8	0.0	156.8	Current expenditure on goods and services
13	2.4	4.9	7.4	4.0	11.3	Depreciation
14	7.6	0.7	8.3	0.0	8.3	Subsidies

15	90.6	13.0	103.7	0.0	103.7	Current grants to personal sector
16	5.9	0.0	5.9	0.0	5.9	Current grants abroad
17	58.1	-58.1	0.0	0.0	0.0	Current grants within public sector
18	29.3	0.4(3)	29.8	-0.3	29.5	Debt interest
19	2.2	0.0	2.2	0.0	2.2	Apportionment of Reserve
20	**298.0**	**16.0**	**314.0**	**3.7**	**317.7**	**Total current expenditure**
21	**11.4**	**1.7**	**13.1**	**0.6**	**13.8**	**Current deficit**
22	**0.0**	**0.3**	**0.3**	**-0.1**	**0.2**	**Capital transfers**
						Capital expenditure(2)
23	3.1	5.4	8.6	4.8	13.4	Gross domestic fixed capital expenditure
24	-2.4	-4.9	-7.4	-4.0	-11.3	Less Depreciation
25	-0.1	0.0	-0.1	0.0	-0.1	Increase in stocks
26	3.3	1.1	4.4	0.4	4.7	Capital grants to private sector
27	5.0	-3.2	1.8	-1.8	0.0	Capital grants to public sector
28	0.2	0.0	0.2	0.0	0.2	Apportionment of Reserve
29	**9.1**	**-1.6**	**7.5**	**-0.6**	**7.0**	**Total capital expenditure**
30	**20.5**	**-0.2**	**20.3**	**0.2**	**20.5**	**Financial deficit**
						Financial transactions
31	-0.9	-0.1	-1.0	0.0	-1.0	Net lending to private sector and abroad
32	-2.0	0.0	-2.0	0.0	-2.0	Cash expenditure on company securities (including privatisation proceeds)
33	0.7	0.0	0.7	0.0	0.7	Transactions concerning certain public sector pension schemes)
34	2.9	0.0	2.9	0.0	2.9	Accruals adjustments on receipts
35	-1.6	0.0	-1.6	0.0	-1.6	Other accruals adjustments
36	0.0	-0.1	-0.1	-0.1	-0.2	Miscellaneous financial transactions
37	**19.5**(4)	**-0.3**	**19.2**(4)	**0.0**	**19.2**	**Borrowing requirement**

(1) *Current deficit (line 21) = current expenditure (line 20) - current receipts (line 11).*

Financial deficit (line 30) = current deficit (line 21) - capital receipts (line 22) + capital expenditure (line 29).

(2) *On an accruals basis.*

(3) *Excluding local authorities' payments to central government and public corporations' payments to general government, which are in line 9.*

(4) *Own account borrowing.*

Changes to forecasts

4A.10 *Table 4A.7 provides details of changes to the public finances forecast for 1996-97 and 1997-98 since the last Budget and since the Summer Economic Forecast. Tax by tax details of the effects of the Budget measures are set out in Table 6.1, and the breakdown of the Control Total changes by Department is shown in Table 5.7.*

Table 4A.7 Comparison with previous forecasts(1)

	£ million			
	Changes since last Budget		Changes since Summer Economic Forecast	
	1996-97	1997-98	1996-97	1997-98
Expenditure				
Control Total	+0.5	-1.7	+0.5	-1.7
Other general government expenditure(2)	+0.2	+0.7	-0.1	-0.8
Public corporations' market and overseas borrowing	-0.2	+0.2	-0.4	-0.1
Privatisation proceeds(3)	-0.5	+0.5	0.0	0.0
Total expenditure	**+0.0**	**-0.3**	**+0.0**	**-2.7**
Receipts				
Inland Revenue	-1.8	-5.6	+0.1	-0.6
Customs and Excise	-0.9	+1.4	+0.2	+2.1
Social security contributions	-0.2	+0.4	0.0	+0.3
Other receipts	-1.1	-0.4	+0.1	-0.5
Total receipts	**-4.0**	**-4.2**	**+0.5**	**+1.2**
PSBR	**+4.0**	**+3.9**	**-0.5**	**-3.9**

(1) Previous forecasts have been adjusted for classification changes.

(2) *Excluding privatisation proceeds.*

(3) *A minus sign indicates higher privatisation proceeds.*

Historical series for the PSBR and its main components

4A.10 Table 4A.8 sets out historical series for the PSBR and its main components, including GGE(X), as shown in Chart 4.4. Table 4A.9 shows further details for government receipts, including the historical series for total taxes and social security contributions shown in Chart 4.3.

Table 4A.8 Historical series for the PSBR and its components

	Per cent of money GDP					
	GGE(X)	Other GGE	GGE	General government receipts	Public corporations' market and overseas borrowing	**PSBR**
1965-66	36 1/2	1 1/2	36 3/4	35 1/4	0	2 3/4
1966-67	38	1 1/2	36 1/2	36 1/4	0	3
1967-68	41 1/2	1 1/2	43	38	- 1/4	5
1968-69	40	1 3/4	41 1/2	40 3/4	0	3/4
1969-70	39 1/4	1 3/4	41	41 3/4	- 1/2	-1 1/4
1970-71	39 1/2	1 3/4	41 1/2	40 1/4	1/2	1 1/2
1971-72	40	1 3/4	41 3/4	39 3/4	- 1/4	1 3/4
1972-73	39 3/4	1 3/4	41 1/2	38	0	3 3/4
1973-74	41 1/2	2	43 1/2	38 1/2	1	6
1974-75	46 3/4	2	48 3/4	40 1/2	3/4	9
1975-76	47 1/4	2	49 1/4	40 1/4	1/4	9 1/2
1976-77	44 3/4	2	46 3/4	41	3/4	6 1/2

1977-78	41 1/2	1 1/2	43	39 3/4	1/4	3 1/2
1978-79	42 1/4	1 3/4	44	38 3/4	1/4	5 1/2
1979-80	42 1/2	1 1/2	44	38 3/4	- 1/4	4 3/4
1980-81	44 3/4	1 3/4	46 1/2	40 3/4	- 1/2	5 1/4
1981-82	45 1/2	1 3/4	47	43 3/4	0	3 1/4
1982-83	45 1/2	1 3/4	47 1/4	43 3/4	- 1/2	3 1/4
1983-84	44 3/4	1 1/4	46 1/4	42 3/4	0	3 1/4
1984-85	45 1/4	1	46 1/4	43 1/2	1/4	3
1985-86	43 1/4	1	44 1/4	42 1/4	- 1/4	1 1/2
1986-87	42 1/4	1/4	42 3/4	40 1/2	- 1/4	1
1987-88	40 1/2	1/4	40 3/4	41	- 1/4	- 3/4
1988-89	38	- 1/4	37 3/4	40 1/4	- 1/2	-3
1989-90	38 1/4	1/2	38 3/4	40	- 1/4	-1 1/2
1990-91	39	1/4	39 1/4	39 1/4	0	0
1991-92	41	- 1/2	40 1/2	38 1/4	0	2 1/4
1992-93	43 1/2	- 1/2	43	36 3/4	- 1/4	6
1993-94	43 1/4	0	43 1/4	36	- 1/4	7
1994-95	42 1/2	- 1/4	42 1/2	36 3/4	- 1/4	5 1/4
1995-96	42 1/4	1/2	42 3/4	38	- 1/4	4 1/2
1996-97	41 1/4	1/4	41 1/4	37 3/4	- 1/4	3 1/2
1997-98	40	1/2	40 1/2	38	0	2 1/2
1998-99	39	1/2	39 1/2	38	0	1 1/2
1999-00	38 1/4	3/4	39	38 1/2	0	1/2
2000-01	37 1/2	3/4	38 1/4	39	0	- 3/4
2001-02	36 3/4	3/4	37 1/2	39 1/4	0	-2

Table 4A.9 Historical series for government receipts

Per cent of money GDP

	Total taxes and NICs	Other receipts	**General government receipts**	Non-North Sea taxes and NICs(1)	Public Sector current receipts
1965-66	31 3/4	3 1/2	35 1/4	31 3/4	37 1/2
1966-67	32 1/2	3 3/4	36 1/4	32 1/2	38 1/4
1967-68	34	4	38	34	39 3/4
1968-69	35 3/4	5	40 3/4	35 3/4	42
1969-70	37 1/2	4 1/4	41 3/4	37 1/2	43 3/4
1970-71	37	3 1/4	40 1/4	37	42 3/4
1971-72	35 1/4	4 1/2	39 3/4	35 1/4	41
1972-73	33	5	38	33	38 3/4
1973-74	33 3/4	4 3/4	38 1/2	33 3/4	40
1974-75	36 1/4	4 1/4	40 1/2	36 1/4	43
1975-76	36 3/4	3 1/2	40 1/4	36 3/4	43 1/4
1976-77	36 1/4	4 3/4	41	36 1/2	43 3/4
1977-78	35 1/4	4 1/2	39 3/4	35 1/2	42

1978-79	34 1/4	4 1/2	38 3/4	34 3/4	41
1979-80	35 1/2	3 1/4	38 3/4	35 1/2	41 3/4
1980-81	36 3/4	4	40 3/4	36 1/2	43
1981-82	39 3/4	3 3/4	43 3/4	39 1/4	46 1/2
1982-83	39 1/2	4 1/4	43 3/4	38 1/2	46
1983-84	39	3 3/4	42 3/4	38 1/4	45
1984-85	39 3/4	3 3/4	43 1/2	38 1/4	44 1/2
1985-86	38 3/4	3 1/2	42 1/4	37 1/4	44
1986-87	38 1/4	3 1/4	41 1/2	37 3/4	42 3/4
1987-88	38 1/4	2 3/4	41	38	42 1/2
1988-89	37 1/2	2 3/4	40 1/4	37 1/4	41 1/2
1989-90	37	3	40	37	40 3/4
1990-91	37	2 1/4	39 1/4	37	39 3/4
1991-92	36 1/4	2	38 1/4	36 1/2	39
1992-93	34 1/4	2 1/2	36 3/4	34 1/2	37 1/4
1993-94	33 3/4	2 1/4	36	34	36 1/4
1994-95	35	1 1/2	36 3/4	35 1/4	37 1/2
1995-96	35 3/4	2 1/4	38	36	38 1/2
1996-97	35 3/4	1 3/4	37 3/4	36	38 1/2
1997-98	36 1/4	1 3/4	38	36 1/4	38 1/2
1998-99	36 1/2	1 3/4	38	36 1/2	38 3/4
1999-00	37	1 1/2	38 1/2	37 1/4	39
2000-01	37 1/2	1 1/2	39	37 3/4	39 1/2
2001-02	38	1 1/4	39 1/4	38	40

(1) *As a percent of non-North Sea GDP.*

[Prepared November 1996]

Annex B to Chapter 4

Conventions used in presenting the public finances

4B.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, 4, 5 and 6.

4B.2 An important point to note at the outset is that the key expenditure and receipts aggregates, general government expenditure (GGE) and general government receipts (GGR), are concepts derived from national accounts definitions. But they can be disaggregated on both a national accounts basis and on a largely cash basis.

Cash basis

4B.3 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 basis also corresponds closely to the way public expenditure is planned, controlled and accounted for at present.

Tables 1.5, 4.1, 4.4, 4.5, 4.6, 4A.1 and 5.3

4B.4 The main - albeit summary - presentation of the public finances on a cash basis is given in Table 4.1. Supporting disaggregation of general government expenditure is given in Tables 4.6 and 5.3, while Tables 4.4, 4.5 and 4A.1 provide further breakdowns of general government receipts. Table 1.5 is a more detailed presentation of the public finances for the current year and year ahead.

4B.5 As far as possible, the figures in these tables relate to actual cash flows. The estimates of taxes for example are for tax payments received during the year, rather than for liabilities incurred. There are however, a number of items which are not on a cash basis:

- "social security contributions" are scored gross of amounts netted off by employers as reimbursement in respect of statutory sick pay and statutory maternity pay. These payments count as expenditure rather than negative receipts;

- VAT refunded to central and local government is included in "other taxes and royalties (Table 4.4, Table 4.5, Table 4A.1 and Table 1.5);

- an imputed flow for capital consumption by general government is included in "other receipts" (Table 4.4, Table 4.5, Table 4A.1 and Table 1.5).

These latter two flows have no impact on the PSBR as they also appear on the expenditure side of the account in "accounting adjustments" (Table 1.5). This line also includes various other adjustments needed to get back to the national accounts basis required for GGE.

4B.6 The final departure from a cash basis is the "central government debt interest" line of Table 1.5, which scores the capital uplift on index-linked gilts as interest at the time it accrues. Because the PSBR is on a cash basis, an offset is made in the form of an accruals adjustment to "other receipts" (Table 4A.1, Table 4.4, Table 4.5 and Table1.5). This removes the accrued uplift scored and adds back any actual payments of uplift on redemptions.

Table 4A.3

4B.7 The other cash-based table is Table 4A.3, which shows the finances of central government. Unlike the earlier tables this is genuinely a cash presentation based on information from central government funds and accounts. 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.

4B.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 4A.4 and 4A.5, are presented on the national accounts basis described below.

National accounts basis

4B.9 The national accounts are produced by the ONS for the UK as a whole using an internationally agreed framework. 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 different sectors.

Table 4A.6

4B.10 Table 4A.6 gives a detailed national accounts presentation of the short-term forecasts for the public finances. Under the measurement conventions used in the national accounts:

- most transactions, including most taxes (although not corporation tax), are recorded on an accruals rather than a cash payment basis;

- transactions are grouped by economic category. So, for example, transfer payments are distinguished from expenditure on goods and services;

- the value of some transactions is imputed where no money changes hands (for example, non-trading capital consumption).

4B.11 The public sector financial deficit is the balance between expenditure and income in the combined current and capital accounts (line 30 of Table 4A.6). Unlike the PSBR, the financial deficit is not wholly a measure of cash transactions because certain items above line 30 are measured on an accruals basis. The appropriate accruals adjustments are made in lines 34 and 35. Certain other financial transactions, notably net lending and privatisation proceeds are also excluded from the financial deficit, but included in the PSBR.

4B.12 As the national accounts distinguish between current and capital transactions they provide the natural framework in which to identify the current balance and capital spending. The current and capital breakdown shown in Table 4A.6 differs from the usual national accounts conventions in two respects. First, capital taxes (line3) are counted as current rather than capital receipts on the grounds that they are not strictly speaking pure taxes on capital. And second, an estimate of depreciation is deducted from capital expenditure and added to current expenditure.

4B.13 GGE can be derived from the general government column of Table 4A.6 by taking current expenditure (line 20) plus capital expenditure (line 29) and adding:

- the Reserve (lines 19 and 28, all assumed to be general government);

- net lending to the private sector and abroad (line 31);

- cash expenditure on company securities (line 32);

- and net lending by central government to public corporations (minus £0.8billion in 1996-97 and £0.6 billion in 1997-98).

4B.14 Correspondingly, GGR comprises general government current receipts (line11) plus capital transfers (line 22), less:

- transactions concerning public sector pension schemes (line 33);

- accruals adjustments (lines 34 and 35);

- miscellaneous financial transactions (line 36).

Tables 2.1 and 4.2

4B.15 A summary of the public sector column of Table 4A.6 provides the framework for Tables 2.1 and 4.2. So, for example, receipts and current expenditure in these tables correspond to lines 11 and 20 of Table 4A.6. "Public sector net capital spending" represents the balance on the capital account: that is, total capital expenditure (line 29 of Table 4A.6) net of capital transfers (line 22). GGE and GGR cannot be derived from Table 4.2 because it shows figures for the public sector, rather than just general government, and because it gives insufficient detail of the various financial transactions. Table 4.2 also shows as a memorandum item the general government financial deficit, which appears as line 30 of the general government column of Table4A.6.

4B.16 Tables 2.1 and 4.2 show the current balance in the same way as Table 4A.6, Tables 4A.4 and 4A.5 are also on a national accounts basis.

4B.17 Tables 2.1 and 4.2 show projections of the public finances over the period to 2001-02. A detailed breakdown in the form of Table 4A.6 is, however, only provided for 1996-97 and 1997-98.

Table 4A.9

4B.18 An accruals basis is used to calculate taxes (and social security contributions and council tax) as a percent of GDP (Table 4A.9 - also memo item in Table 4.5), 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.

Tables 4A.4 and 4A.5

4B.19 Table 4A.6 shows local authorities' self-financed expenditure (net of their receipts from central government - line 17) and their receipts from outside the public sector (net of debt interest payments to central government - line 9). Table 4A.4, in contrast, provides figures for total local authority expenditure and receipts. It also gives a summary presentation of the income and expenditure flows in the local authority accounts, which it is not practical to put together from any other sources.

4B.20 Table 4A.5 serves the same purposes for public corporations as Table 4A.4 does for local authorities. Because public corporations are trading bodies, the national accounts presentation is a little different from that for general government. Most current expenditure is netted off from income to leave the gross trading surplus (shown under receipts). The expenditure side of the account only shows interest, dividend and tax payments, plus capital spending.

Borrowing requirements

4B.21 The PSBR can be disaggregated into component borrowing requirements in different ways. Tables 1.5 and 4.1 show 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 4A.2 and Table 4A.6 (line 37), between central government borrowing on its own account (the CGBR(O), and borrowing by local authorities and public corporations (the LABR and PCBR respectively). Table 4A.2 also shows, as a memorandum item, the central government borrowing requirement (CGBR), which is the CGBR(O) plus central government net lending to local authorities and public corporations. The borrowing requirement shown in the general government column of Table 4A.6 is not in fact the GGBR, but the GGBR(O). The GGBR can be calculated by adding in public corporations' borrowing from central government (given in paragraph 4B.14).

Public sector debt

4B.22 Table 4.3 sets out projections for two different measures of public sector debt. Net public sector debt is the stock analogue of the PSBR. It measures the public sector's financial liabilities to the private sector and abroad, net of short-term financial assets.

4B.23 Gross general expenditure debt is the measure of debt used in the Maastricht debt criterion. As a general government measure, it excludes the debt of public corporations. It measures general government's total financial liabilities before netting off short-term financial assets.

[Prepared November 1996]

5 Public Spending

5.01 This chapter summarises the public spending proposals in the Budget.

Objectives

5.02 The Government's objectives for spending are:

- to reduce public spending as a share of national income to below 40 per cent;

- to set the path of the Control Total at a level year by year to ensure that, over time, GGE(X) grows more slowly than the economy as a whole;

- to promote spending policies which improve the use of resources and the efficiency of markets throughout the economy;

- to increase the efficiency with which public services are delivered; and

- to move public sector functions into the private sector if that is where they can be most efficiently delivered; and to promote greater use of private finance, challenge funding and other partnerships with the private sector to improve the targeting and efficiency of public services.

5.03 Objectives for specific programmes will be set out in Departmental Reports published in March.

5.04 Public expenditure, measured by the Government's expenditure target - GGE(X) - has been brought down from 43 1/2 per cent of GDP in 1992-93 to 41 1/4 per cent in 1996-97. Over the same period there has been an 8 1/2 per cent reduction in the real cost of central government administration.

5.05 The plans for public spending set out in this Budget, which cover the three financial years from 1997-98 to 1999-2000, build on these achievements and further the Government's overall objectives for public spending by:

- reducing public spending as a share of national income by 3 percentage points, bringing the ratio of public spending to GDP to 40 per cent in 1997-98;

- holding the average rate of growth of the Control Total to 1/2 per cent a year in real terms;

- increasing spending on priority areas, including education, the National Health Service and combating crime;

- stepping up the fight against abuse of social security benefits and legal aid and increasing resources for improving tax compliance;

- cutting running costs of central government by 7 per cent in real terms compared to 1996-97; bringing the cumulative real reduction to 15per cent since 1992-93;

- increasing the amount of investment undertaken through the Private Finance Initiative; and

- increasing the amount of private expenditure levered into public services, particularly in urban regeneration and housing.

The Control Total

Definition

5.06 The Government seeks to achieve its public spending objective by planning and controlling an aggregate called the Control Total. The Control Total covers 85 per cent of total government spending. It excludes cyclical social security and debt interest, the two components of spending most affected by the economic cycle, and includes market and overseas borrowing by public corporations. There are a number of other minor differences between the Control Total and general government expenditure giving rise to the accounting adjustments which are explained in Annex A to this chapter.

1996-97

5.07 The Control Total for 1996-97 is forecast to be £260.6 billion, an overspend of £ 1/2 billion compared to the plans in the last Budget after taking account of classification changes. The reason for this is that the Reserve of £2 1/2 billion is unlikely to cover completely the unanticipated increases in spending, notably the exceptional public expenditure costs of measures to combat BSE which are forecast to reach £1 1/2 billion this year.

1997-98 to 1999-00

5.08 The Control Total for the next three years is set out in Table 5.1.

Table 5.1 The Control Total

	£ billion			
	1996-97	1997-98	1998-99	1999-00
Plans in 1995 Budget after classification changes	260.1	268.1	275.6	283.2
Control Total set out in this report	260.6	266.5	273.7	280.9
Changes	0.5	-1.7	-1.9	-2.3

Planned growth

5.09 The Control Total is planned to grow on average by 2 1/2 per cent a year over the three Survey years in cash terms. On current projections of the GDP deflator, this represents real growth of about 1/2 per cent a year.

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Changes on plans

5.10 For the fifth year in succession, the Government's cash spending plans have been reduced below those set out in the previous year. In real terms the plans are slightly higher than those set out in the 1995 Budget.

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Effect of the new spending plans

5.11 In addition to measures which affect the Control Total, some measures in the Budget directly affect spending outside the Control Total. In particular, the Government has announced measures to reduce cyclical social security. Thespending plans also include measures to increase revenues, by improving tax compliance and taking further steps against tax evasion and by better targeting of Council Tax Benefit which scores as a tax refund. Taking account of these, the overall effect of spending policy measures on the PSBR are set out in Table 5.2.

Table 5.2 Total effect on the Budget of changes in public expenditure(1)

	£ billion		
	1997-98	1998-99	1999-00
Change in Control Total	-1.7	-1.9	-2.3
Measures outside the Control Total(2)	-0.3	-0.6	-0.4
Total effects on spending	**-1.9**	**-2.5**	**-2.7**
Revenue effects of spending measures(3)	-0.5	-1.2	-1.8
Total effects of spending measures on PSBR	**-2.5**	**-3.8**	**-4.5**

(1) *Measures which reduce the PSBR (lower spending or higher revenue) are shown as negative numbers.*

(2) *Cyclical social security and effect on accounting adjustments.*

(3) *Spend to save package (see page 106) and reduction in gross trading surplus of local authorities (see paragraph 5.48).*

General government expenditure

Definition of GGE(X)

5.12 To measure its progress towards its objective of reducing public spending as a share of national income, the Government uses a measure of the combined expenditure of central and local government which is based on national accounts aggregates. General government expenditure is adjusted to exclude privatisation proceeds (that is, the objective is set gross of these receipts). Expenditure out of the proceeds of the National Lottery is also excluded, and receipts of interest and dividends from public corporations and the private sector are netted off. This aggregate is called GGE(X).

Projected growth

5.13 GGE(X) is projected to grow by 2 1/2 per cent a year on average over the next three years, which is 1/2 per cent a year in real terms. This is well below the projected growth rate of the economy, so GGE(X) will decline as a share of national income.

5.14 As Chart 5.3 shows, GGE(X) is set to fall from its cyclical peak of 43 1/2 per cent of GDP in 1992-93 to 38 1/4 per cent by the end of the new public expenditure plans.

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5.15 A detailed analysis of GGE(X) is set out in Table 5.3.

The new expenditure plans

Summary

5.16 The new plans increase spending on priority programmes. Provision in 1997-98 has been increased compared to 1996-97 for the NHS, schools and for the police and prisons. Increases for priorities, together with substantial increases in the unavoidable costs of social security spending, are financed by allocating some of the unallocated part of the Government's plans (which is called the Reserve) and from savings elsewhere. The Government has retained tight control of departmental running costs, and has decided on a substantial package of measures to reduce social security fraud, improve tax compliance and combat evasion and fraud. These measures are described in the box on page106.

Table 5.3 The Control Total, GGE(X) and GGE(1)

	£ million							
	Outturn	Estimated outturn	New plans/projections			Changes from previous plans/projections		
	1995-96	1996-97	1997-98	1998-99	1999-00	1996-97	1997-98	1998-99
Central government expenditure(2)	180 516	185 900	187 200	191 400	195 300	2 000	-700	-400
Local authority expenditure(3)	75 019	75 800	76 100	77 000	77 900	1 200	900	400
Financing requirements of nationalised industries	-354	-500	740	260	70	350	620	570
Reserve			2 500	5 000	7 500	-2 500	-2 500	-2 500
Allowance for shortfall		-600				-600		
Control Total	**255 181**	**260 600**	**266 500**	**273 700**	**280 900**	**500**	**-1 700**	**-1 900**
Cyclical social security	14 460	14 300	14 100	14 300	14 700	400	0	-400
CG net debt interest	19 963	22 200	24 800	24 400	24 000	-100	800	400
Accounting adjustments	10 082	10 300	9 200	9 800	11 000	600	100	200
GGE(X)	**299 686**	**307 400**	**314 700**	**322 200**	**330 600**	**1 300**	**-800**	**-1 800**

Privatisation proceeds	-2 435	-4 500		-2 000	-1 500	-1 000	-500	500	0
Other adjustments(4)	5 751	5 600		6 300	6 500	6 600	-600	-100	300
GGE	**303 002**	**308 500**		**319 000**	**327 200**	**336 300**	**200**	**-500**	**-1 500**
GGE(X) as a percent of GDP	42 1/4	41 1/4		40	39	38 1/4	3/4	1/4	1/4

(1) *For definitions, rounding and other conventions, see notes in Annex 5.A.*

(2) *Excluding cyclical social security.*

(3) *Comprises total central government support for local authorities and local authority self-financed expenditure.*

(4) *Lottery-financed spending and interest and dividend receipts.*

Capital and PFI

Capital spending

5.17 Public services benefit not just from direct public sector investment but also from capital spending by the private sector under the Private Finance Initiative (PFI). Table 5.4 shows total capital spending sponsored by the public sector including the increasingly significant contribution through the PFI. It is forecast to rise over the next three years from over £20 billion a year to £22 billion.

Table 5.4 Public sector capital expenditure(1)

						£ billion			
			Outturn			Estimated outturn		Projections	
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00
Central government	10.3	10.9	9.8	9.0	8.4	6.9	6.2	6.9	6.8
Local authorities	7.0	7.2	6.7	7.4	7.6	7.3	6.4	5.9	5.8
Public corporations(2)	2.2	3.5	3.5	4.3	4.6	5.5	5.1	4.5	4.4
Notional allocation of the Reserve							0.2	0.5	0.8
Total public sector capital expenditure	**19.5**	**21.5**	**20.0**	**20.7**	**20.6**	**19.7**	**18.0**	**17.8**	**17.7**
Estimated capital expenditure under the Private Finance Initiative			**0.1**	**0.2**	**0.4**	**1.1**	**2.5**	**3.7**	**4.3**
Total publicly sponsored capital expenditure	**19.5**	**21.5**	**20.1**	**20.9**	**21.0**	**20.8**	**20.5**	**21.5**	**22.0**
Memo: Public sector capital(3)									
gross of depreciation	21.6	23.5	21.4	21.7	21.3	19.7	18.0	17.8	17.7
net of depreciation	11.7	14.0	11.7	11.6	10.4	8.5	6.6	6.3	5.9

(1) *Figures are shown for the national accounts definition of capital spending (including expenditure out of the proceeds of the National Lottery). See paragraph 5A.10.*

(2) *Excluding the capital expenditure of industries privatised or planned to be privatised before 31March 2000.*

(3) *Including industries now privatised while they were in the public sector.*

5.18 By themselves, even these figures can give a misleading picture of the level of investment in public services. When the Government buys services from the private sector, investment undertaken by the companies that provide the services is not counted as public sector investment; very often, however, it involves the formation of assets which are deployed to meet public needs. The box article on pages 100 and 101 looks in more detail at the way public services are increasingly being delivered in partnership with the private sector. The boundary of the sector has shifted. The privatisation programme has brought significant qualitative and quantitative benefits from capital investment in industries which used to be predominantly in the public sector.

Private Finance Initiative

5.19 The Private Finance Initiative (PFI) is a policy designed to harness private sector management and expertise in the delivery of public services. Under the PFI, the public sector does not buy assets, it buys services. The private sector is responsible for deciding how to supply those services, and what investment is required to support the services. It is also responsible for delivering the services according to the contract: on time, and to the standard specified. If the service is not available, or is below the standard required, the private sector bears a financial loss. This encourages innovation, efficiency, and good performance.

Changing the balance between the public and private sectors: privatisation, the PFI and partnership

Government policy has been to:

- reduce the size of the public sector through privatisation and contracting out;
- involve the private sector in providing existing and new services, through the private finance initiative (PFI) and challenge funding.

By themselves, public expenditure figures can give a misleading impression of activity in areas affected by these policies. The policies affect both the overall level of activity in the economy and the balance between the public and private sectors.

This is particularly true of capital spending. In real terms, direct public capital spending has fallen since 1979 (see Chart 1). The reduction is not surprising given the extent of privatisation over the period and increasing investment through the PFI.

The effect of privatisation

If public capital expenditure is adjusted to exclude those industries now privatised, a rather different picture emerges. Chart 1 shows how, leaving the privatised industries aside, public capital spending rose in real terms towards the end of the 1980s and remained consistently higher from 1989-90 to 1996-97 than it was during the 1980s. The reduction after 1996-97 reflects the increasing importance of the PFI (see below).

However, this approach does not show the impact of privatisation, which has freed industries from government control, exposed many of them to competition, and had a substantial impact on infrastructure spending.

It has not proved possible to construct an expenditure series for the capital expenditure in organisations privatised since 1979, to illustrate total investment by these bodies and the public sector during the period since 1979. Nonetheless, the capital investment of those sectors which were predominantly in the public sector in 1979 provides an approximation to the aggregate of direct public capital expenditure and the investment by the privatised industries.

Accordingly, the "1979 public sector" line in Chart 1 shows capital expenditure in the utilities and the transport and communications industries added to that in the public sector and including all health and education capital expenditure. There was a big increase in capital expenditure between 1988 and 1990, in particular. Much of this resulted from freeing the water, telecommunications and electricity industries from public spending controls. Since 1990, the higher level of investment has been maintained in real terms.

The effect of the PFI

The PFI harnesses private sector management and expertise to deliver public services. Contracts under the PFI involve capital investment by the private sector, which would traditionally have been undertaken by the public sector acquiring capital assets itself. Expenditure under the PFI is accelerating, with more than £10 billion of capital investment expected over the next three years. Chart 2 shows the main areas of expected investment under the PFI between 1997-98 and 1999-2000.

Although this investment is carried out by the private sector, it needs to be taken into account in gauging the total level of investment sponsored by the public sector. Chart 1 shows how total publicly sponsored investment is expected to remain throughout the 1990s at a higher level than at any time during the period 1980-81 to 1988-89.

Partnerships and levering in

Over the last two decades there has been a significant growth in partnerships between the public and private sectors. Such partnerships vary in size and have grown up across a wide range of activities to benefit local communities or the country as a whole.

Private expenditure in partnership with the public sector

	£ million		
	1997-98	1998-99	1999-00
(a) expenditure by the private sector complementing public provision	500	530	510
(b) direct private sector spending:			
(i) for something the public sector would traditionally have done itself	1250	1250	1240
(ii) for something the public sector is unlikely to have done	9970	8760	8940
(c) complementary private investment	5440	4640	4610
Total	**17160**	**15180**	**15300**

The finance provided in this way is now very substantial. From modest beginnings, there was an expansion throughout the 1980s and 1990s. The table shows the forecasts of finance which departments expect to be "levered in" in each of the coming three financial years - around £15billion or more a year. This is money which is not counted in the government accounts but nevertheless contributes to the overall provision of services to the country.

The table lists three broad categories of levered in finance. In several cases an important element in generating the levered in finance will be the use of Challenge Funds or schemes which incorporate challenge funding principles.

(a) Expenditure by the private sector which complements public provision is where finance from a private sector source is used on public sector services. Examples include: employers' contributions to training programmes managed by TECs; a DTI-run initiative to encourage matching funding for scientific research; support for transport infrastructure projects, including the Jubilee line extension; revenue and sponsorship for museums, galleries and other heritage bodies; and a joint funding scheme between ODA and British voluntary organisations working overseas.

(b) Direct private sector spending is private sector investment which has been generated by departmental programmes and spending, directly or as subsidies. ***(b)(i)*** includes : spending on housing which results from grants by the Housing Corporation to housing associations; a variety of projects for urban regeneration; research and development; and industrial sponsorship, for example of the Red Arrows. ***(b)(ii)*** typically covers urban regeneration where the activity is not, at least in the first instance, economically freestanding (for example, under the umbrella of regional development agencies and boards, English Partnerships and dedicated bodies for specific projects such as the Cardiff Bay Development Corporation, and through the Single Regeneration Budget challenge fund); wider regional selective assistance; transport infrastructure; environmental improvement and protection projects such as flood and coastal defences; support for business such as through Business Links; support for business in emergent countries through the activities of the Commonwealth Development Corporation; industrial research and development activities; agriculture and fisheries research and marketing; support for exporters; activities of the tourist bodies; other support for heritage bodies, such as English Heritage; National Lottery heritage projects; and the Local Authorities' Capital Challenge.

(c) Complementary private investment is where there is no public money involved, but where private sector spending supports government objectives and would probably not have taken place without prior public spending. Examples of this are: private housing developments next to similar projects supported by public grants or refurbishment of high street shops following grant-aided town centre redevelopment, which are encouraged by substantial spending from a number of urban regeneration programmes; industrial and scientific research and support, such as privately-financed medical research into cancer treatments; and activity undertaken by Further and Higher Education institutions, mainly for services provided such as research contracts for industry.

[Prepared November 1996]

Chart 5.1: The Control Total in real terms

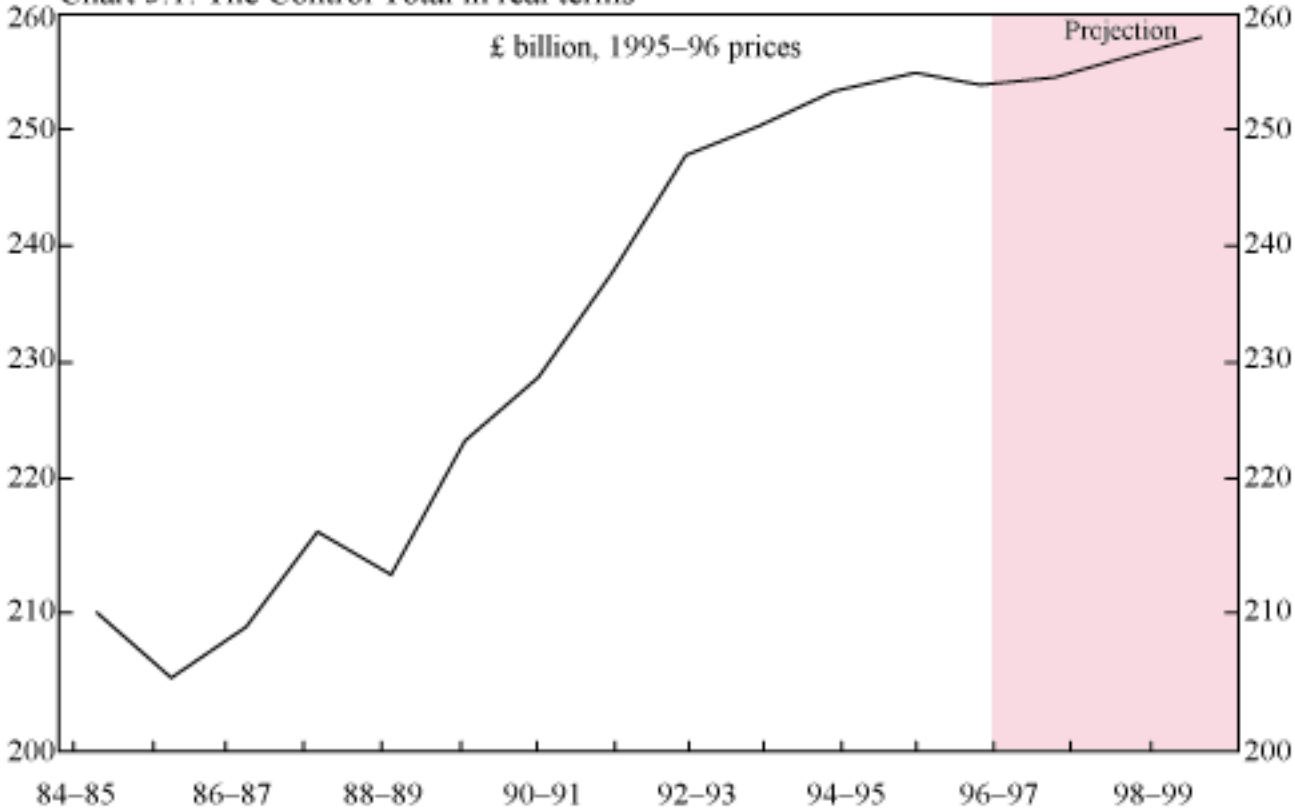


Chart 5.2: The Control Total: plans in successive Budgets

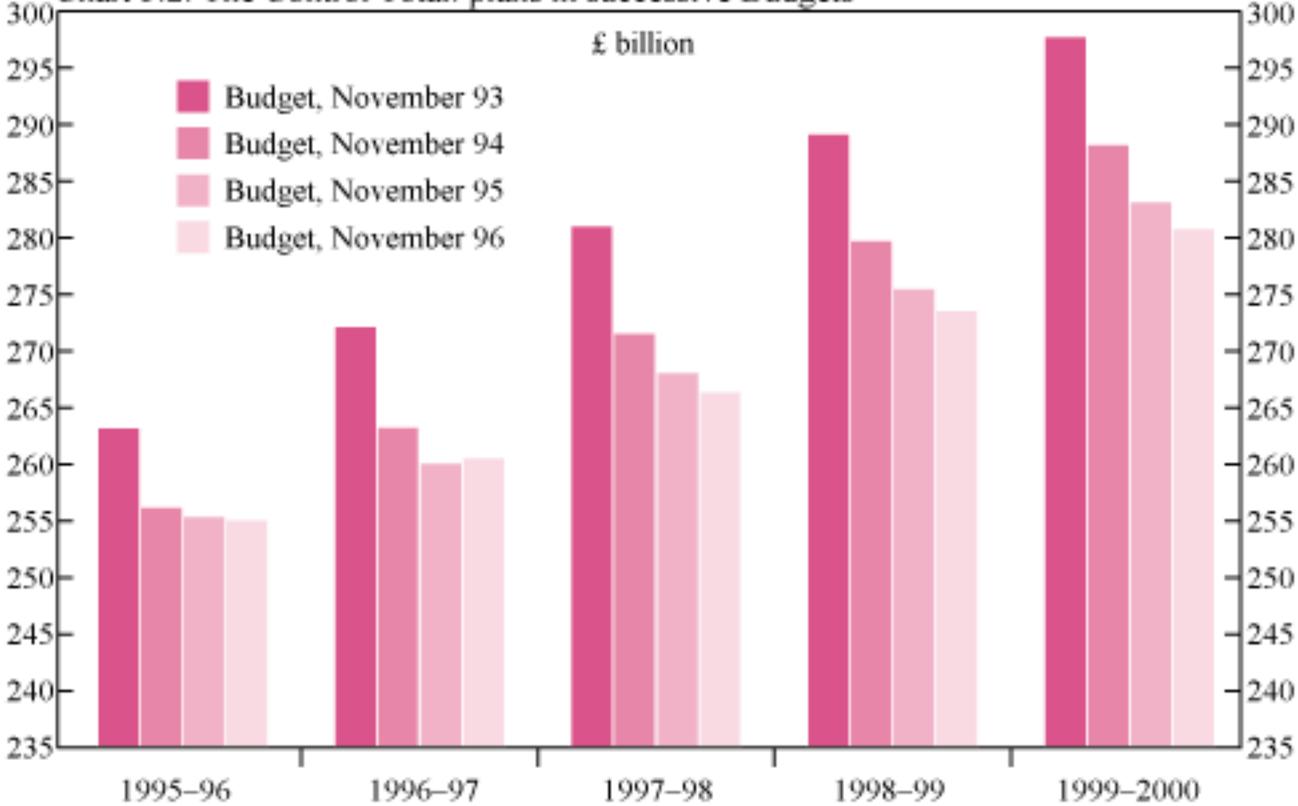


Chart 5.3: General government expenditure – GGE(X)

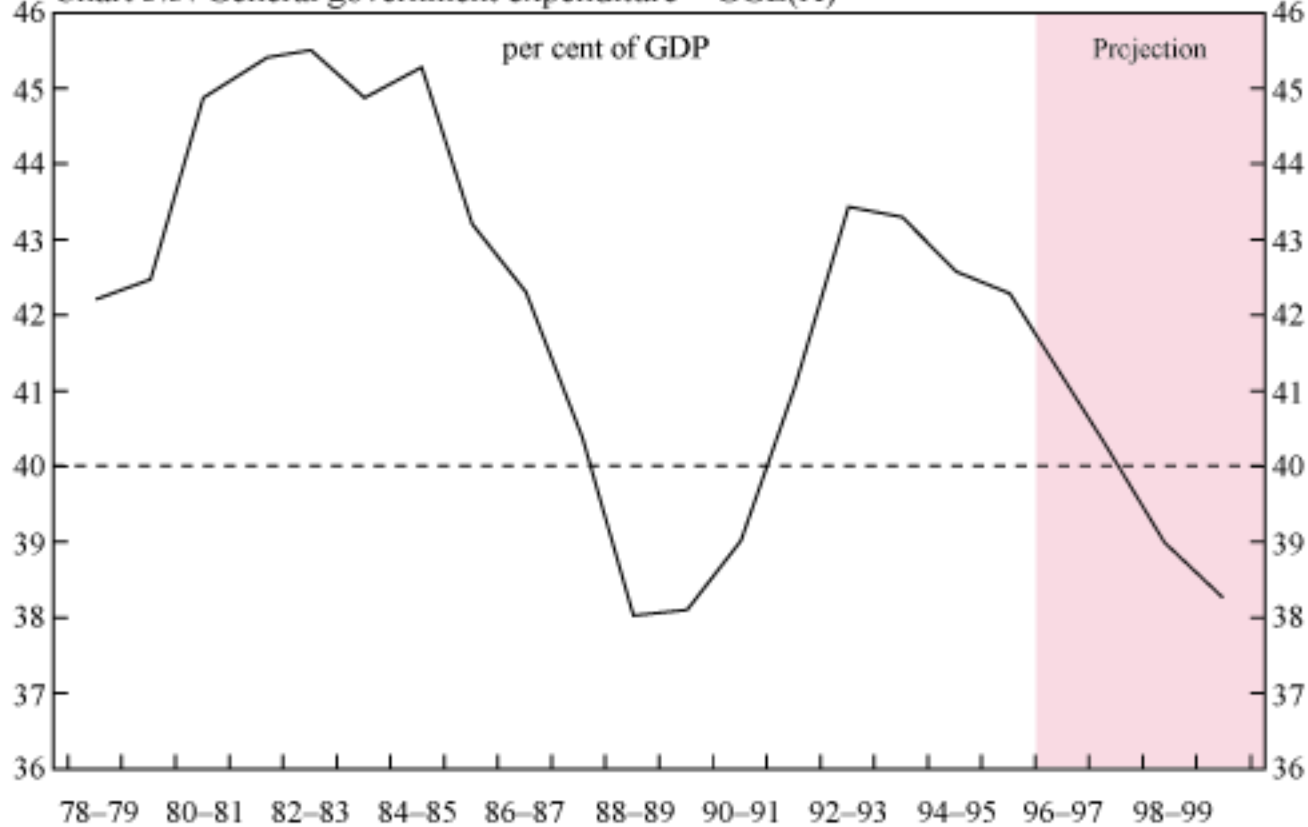


Chart 1: Capital Spending

(in real terms)

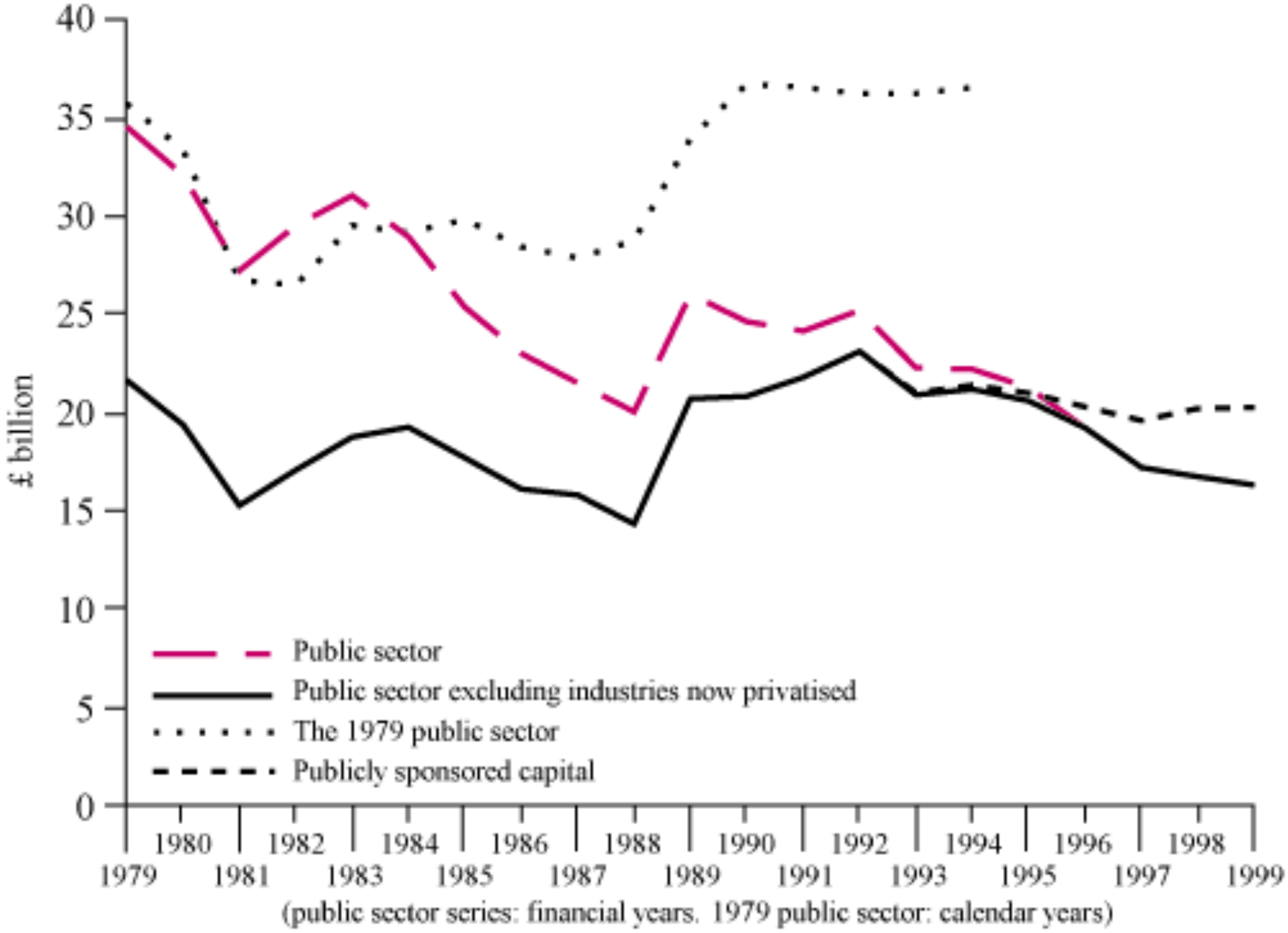
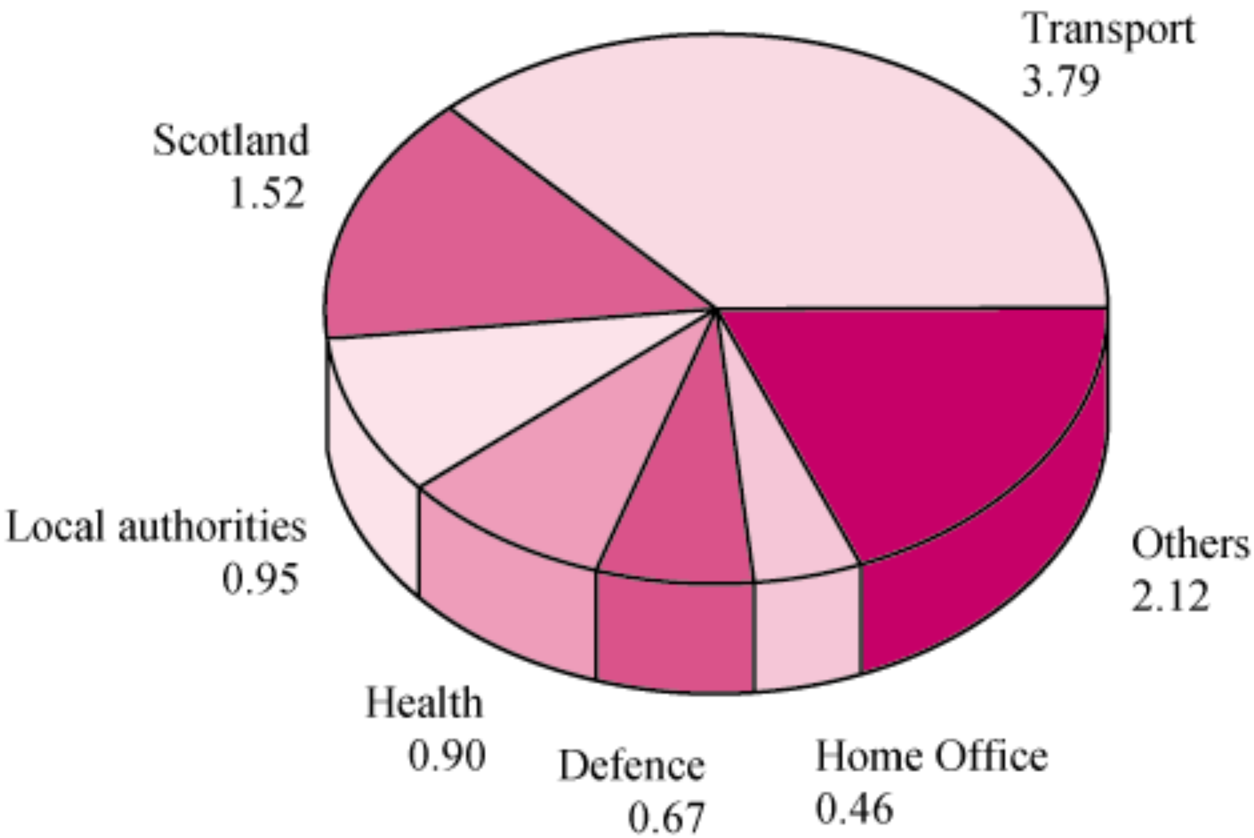


Chart 2: PFI investment 1997–98 to 1999–2000

(£ billion)



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5.20 Contracts under the PFI involve capital investment by the private sector, which would traditionally have been undertaken by the public sector acquiring capital assets itself. An example is the Prisons Service's contract for custodial services at Bridgend, rather than the acquisition of a prison building. Although this investment is now carried out by the private sector, it should be taken into account in gauging the total level of investment sponsored by the public sector. Capital investment resulting from PFI service contracts is therefore included in the total of publicly sponsored capital expenditure in Table5.4. This shows that total investment resulting from PFI contracts is expected to increase to some £4 billion a year by the end of the century. This is of course a much smaller figure than the total value of the PFI contracts involved, since it focuses solely on the capital element.

5.21 Table 5.5 shows a detailed breakdown of this investment by department for the next three years. In the three years from 1997-98 to 1999-2000, some £10 billion of capital investment is anticipated.

Table 5.5 Private Finance Initiative: estimated capital spending

		£ million		
	1997-98	1998-99	1999-00	Total
Defence	120	230	320	670
Foreign Office and Overseas Development	20	20	20	50
Agriculture	0	0	80	80
Trade and Industry(1)	10	10	0	20
Transport	1 040	1 330	1 420	3 790
Education & Employment(2)(3)	30	30	30	100
Environment(4)	130	70	30	230
Home Office	200	130	120	460
Legal Departments	60	90	120	270
National Heritage	40	60	70	170
Health	170	310	420	900
Social Security(1)	100	170	110	380
Scotland(5)	260	560	690	1 520
Wales	70	120	150	350
Northern Ireland	20	60	90	180
Chancellor's Departments	130	110	100	340
Local authorities(6)	100	350	500	950
Total	**2 510**	**3 650**	**4 260**	**10 410**

(1) *Joint Benefits Agency/Post Office Counters project recorded against social security.*

(2) *Excludes private finance activity in education institutions classified to the private sector. See para 5.43.*

(3) *PFI activity in local authority schools is included in the local authorities line.*

(4) *In addition, substantial private investment is levered in through housing, urban regeneration and other programmes.*

(5) *Includes Forestry Commission.*

(6) *Local government PFI projects in England, Scotland and Wales.*

5.22 Progress under the PFI is accelerating. Contracts which have been agreed in the last year include:

- eight design, build, finance and operate (DBFO) road projects;

- the Channel Tunnel Rail Link;

- three contracts for custodial services in privately owned prisons;

- contracts for major information systems services in the Benefits Agency, the Welsh Office and the Ministry of Defence;

- a contract to build and manage the Lewisham Extension to the Docklands Light Railway; and

- contracts for the provision of vehicles to the Ministry of Defence.

5.23 Since April 1995 the Government has introduced a series of changes to the capital finance regulations to facilitate PFI in the local authority sector. These culminated in new regulations which became effective on 31October 1996. Local authorities can now participate fully in DBFO schemes as well as joint ventures, giving them a wider choice of procurement methods.

5.24 The Government is giving authorities substantial backing by making available revenue support for £50 million of PFI investment in England this year, and £200 million next year. Support is also being made available for PFI projects in Scotland and Wales. There are now many projects in the pipeline covering a wide range of services, including schools, police stations and headquarters, magistrates courts and roads.

5.25 In the next three years the rate of investment, the flow of new PFI deals, and the delivery of PFI services, will all increase. New projects under negotiation or identified as strong future PFI candidates include major hospital projects, new DBFO road projects in England, Scotland and Wales, contracts for Government accommodation in the Treasury and the Department of Social Security, contracts for water and sewerage services in Scotland and Northern Ireland, and numerous projects in the local government sector. The first roads and prisons entirely designed, financed, built and operated by the private sector will open.

5.26 Services purchased by the public sector under PFI involve an ongoing contractual commitment to pay the private sector suppliers for services delivered. Table 5.6 shows a forecast of the committed forward expenditure for services flowing from new private investment under signed PFI deals over the next twenty-five years. A forecast is shown for each of the next three years, and for five-year averages subsequently. Actual expenditure in future years arising from these deals will depend on the details of the payment mechanism for each contract; the figures in Table 5.6 represent departments' best available estimates. The House of Commons Treasury Select Committee recommended in its sixth report, *The Private Finance Initiative*, published on 1April 1996, that the Treasury monitor these future spending commitments, and establish with departments regimes to control their growth. This has been done for each government department.

Table 5.6 Private Finance Initiative: estimated forward commitments from signed contracts

	£ million
Next 3 years	
1997-98	370
1998-99	530
1999-2000	600
Next century (averages)	
2000-01 to 2004-05	1 000(1)
2005-06 to 2009-10	650(1)
2010-11 to 2014-15	470
2015-16 to 2019-20	390
2020-21 to 2024-25	370

(1) *Includes non-recurrent public sector capital contributions to the cost of the Channel Tunnel Rail Link.*

5.27 For local authorities, the need for service departments to approve revenue support will provide the means to monitor and control the spending commitments of PFI contracts.

Public sector pay and administration costs

Public sector pay

5.28 Under the Government's approach to public sector pay, reiterated by the Chancellor in his statement on 17 September

1996, pay increases should be offset, or more than offset, by efficiencies and other economies. As in the past four years, pay settlements will have to be contained within the new spending plans, and will not be financed from the Reserve. There is no central pay norm but settlements will need to reflect continuing low inflation. The plans have been set on the basis of a rise in prices across the economy as a whole, as measured by the GDP deflator, of 2per cent a year from 1997--98. Excessive pay increases could put at risk the delivery of services.

Running costs

5.29 Running costs plans have been reduced for most departments to promote efficiency and to help make room for more spending for Government priorities. Additional spending on anti-fraud and anti-evasion measures (described on page 106), and on prisons, more than account for increases in running costs cash plans compared with revised plans.

5.30 Provision for the gross running costs of civil departments, including Executive Agencies, which is £14,919 million in 1996-97, has been set at£14,850 million in 1997-98, £14,637 million in 1998-99 and £14,736 million in 1999-2000. Compared with revised plans, provision has been increased by £230 million in 1997-98 and £356 million in 1998-99.

5.31 Chart 5.4 shows that having been held broadly flat since 1992-93, running costs will be reduced in cash terms in each of the next two years and in real terms in each of the next three years. By 1999-2000, the annual cost of the Civil Service will be 7 per cent lower in real terms (£1 billion in 1995-96 prices) than in 1996-97 and 15 per cent lower in real terms than in 1992-93.

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Ministry of Defence operating costs

5.32 Ministry of Defence administration costs are subsumed within a wider operating costs control, covering all defence costs except for the procurement of major equipment and related research. Excluding additional money which is being made available to cover in full the additional operating costs resulting from the sale of the married quarters estate, MOD operating costs will be held level in cash terms at £16.2 billion over each of the next three years.

Non departmental public bodies' administration costs

5.33 The total administration costs of the larger executive non-departmental public bodies amount to £2.1 billion in 1996-97. These costs are not subject to the running cost regime applied to Government departments but they are expected to fall by about 7 per cent in real terms by 1999-2000 compared to 1996-97, broadly in line with civil service running costs.

Fighting fraud and revenue evasion: "Spend to Save"

All departments have programmes in place to combat fraud, as a normal activity. A key aspect of the work of the Revenue departments is tackling tax evasion and improving compliance.

Dept	**Main measures**	**Cost £m(1)**	**Saving £m(1)**
Revenue	Corporate technical review and avoidance, income tax compliance, action on shadow economy	187	1 950
Customs	VAT compliance and avoidance, action on shadow economy, excise fraud and evasion, Single Market excise smuggling	88	2 250
DSS	Key components: increase pre-award checks, new claims visits and targeted reviews of high risk groups, and additional fraud investigation	469	2 145(2)
FCO	Action to improve entry clearance and reduce bogus asylum applications	5	54(3)
Home Office	Additional Airline Liaison Officers and to allow asylum application to be processed more quickly	12	61(3)
DVLA	VED evasion: nationwide extension of pilot wheelclamping scheme	15	47
Legal Aid Board	Control initiatives to combat legal aid fraud and abuse	6	116
Northern Ireland	Social security measures similar to DSS	14	63(2)

(1) *Three years 1997-98 to 1999-2000*.

(2) *Includes NICs*.

(3) *To DSS*.

In 1994 and 1995, specific programmes were established to combat social security fraud. These programmes will cost £680 million over the next three years and are expected to save nearly £4.7 billion in the same period.

This year, the spending plans of a number of departments include further provision to step up the fight against fraud and evasion. The new measures involve spending £800 million over the next three years (most of which is additional running costs), for an overall saving of around £6.7 billion. This represents a yield of over 8:1.

The cost of the measures will rise from £200million in 1997-98 to a little over £300million in 1999-2000, with the estimated savings rising from £900million next year to £3.3billion by the third year.

Most of the expenditure is on the Department of Social Security, Inland Revenue and Customs and Excise programmes, since these departments are responsible for the public spending and the revenues which are the primary targets for fraud and evasion. More detail of the measures is in the table.

The measures capitalise upon efficiency gains in the Revenue departments and the DSS which result from their Fundamental Expenditure Reviews. Improved efficiency will release experienced staff to take on new tasks which will significantly reduce spending and increase revenue while keeping administrative burdens on taxpayers to a minimum.

When added to the packages agreed for the Department of Social Security in 1994 and 1995, the new plans will involve a total spend to save programme in the departments concerned of nearly £400million next year and well over £500 million in each of the two following years.

Departmental programmes

5.34 Table 5.7 analyses the Control Total by department, showing changes from previous plans. Central government support for local authorities and the financing requirements of nationalised industries have been attributed to appropriate departments.

Table 5.7 Control Total by department(1)

£ million

	Outturn	Estimated outturn	New plans			Changes from previous plans		
	1995-96	1996-97	1997-98	1998-99	1999-00	1996-97	1997-98	1998-99
Defence	21 517	22 130	21 810	22 240	22 800	710	-100	-360
- sale of married quarters		-940	-700			-940	-700	0
Foreign Office	1 339	1 100	1 080	1 080	1 100	50	20	30
Overseas Development	2 371	2 340	2 220	2 320	2 350	50	-150	-100
Agriculture, Fisheries and Food								
- excluding BSE	2 778	2 870	2 880	2 830	2 840	-170	-90	-110
- expenditure due to BSE		1 540	730	580	490	1 540	730	580
Trade and industry								
- Programmes	3 220	3 250	3 070	3 050	3 000	50	-90	-100
Trade and Industry - Nat Inds	247	-520	-20	-180	-240	-240	120	10
ECGD	16	30	10	0	-30	20	0	20
Transport	4 440	4 870	5 190	4 600	4 320	720	420	110
DOE - Local government(2)	30 295	31 320	31 380	31 740	31 630	0	-50	50
DOE - other	8 955	8 380	7 600	7 640	6 960	210	-160	-260

Home Office	6 455	6 550	6 780	6 810	6 940	60	170	90
Legal departments	2 688	2 730	2 710	2 750	2 660	10	-40	-140
Education and Employment(3)	14 505	14 810	13 950	14 010	14 040	250	-1 020	-960
National Heritage	1 063	1 020	920	960	950	10	-60	-20
Health	32 930	33 970	34 940	35 380	36 120	200	770	430
of which NHS	*31 982*	33 180	34 370	35 150	35 890	130	470	460
Social Security(4)	72 665	76 920	79 740	82 950	86 200	570	600	1 150
Scotland	14 303	14 590	14 330	14 420	14 490	50	-300	-300
Wales	6 724	6 820	6 900	6 880	6 900	20	70	10
Northern Ireland	7 709	8 190	8 220	8 260	8 360	140	-20	-50
Chancellor's departments	3 298	3 270	3 170	3 200	3 220	70	40	100
Cabinet Office	1 213	1 330	1 080	1 080	1 090	380	120	140
European Communities	3 245	1 400	2 250	2 390	2 790	-900	-250	-110
Local authority self-financed expenditure	13 204	13 300	13 700	13 700	14 300	700	800	300
Allowance for shortfall		-600	0	0	0	-600	0	0
Reserve			2 500	5 000	7 500	-2 500	-2 500	-2 500
Control Total	**255 181**	**260 600**	**266 500**	**273 700**	**280 900**	**500**	**-1 700**	**-1 900**

(1) *For definitions, rounding and other conventions, see notes in Annex A. See Annex B for the composition of each departmental groupings.*

(2) *Includes payments of Revenue Support Grant and National Non-domestic Rates to English local authorities. These finance, at local authorities' discretion, arange of local services, including education, social services and other environmental services.*

(3) *Does not include local authority Total Standard Spending on education, which increased by £633million from 1996-97 to 1997-98. See paragraph 5.71.*

(4) *Excluding cyclical social security.*

Defence

5.35 The new plans for defence spending are again consistent with the Government's commitment to maintaining strong, capable and properly resourced Armed Forces. The defence budget for 1997-98 is worth the same in real terms as that announced in last year's FSBR. Defence spending will then remain level in real terms in 1998-99, and rise slightly in 1999-2000. The Ministry of Defence married quarters estate in England and Wales has now been sold to Annington Homes for over £1.6 billion; money has been added to the defence budget to pay for the additional costs of renting married quarters accommodation - £111 million in each year - and for a £100 million housing upgrade programme.

Foreign & Commonwealth Office

5.36 Provision for the Foreign & Commonwealth Office has been increased compared to last year's plans. The new plans provide for increased resources to maintain the global diplomatic effort, the activities of the BBC World Service and the British Council. In addition, the Foreign & Commonwealth Office will continue to give high priority to the promotion of exports and inward investment.

Overseas Development

5.37 Provision for bilateral aid has not been changed. Spending is planned to increase from £934 million in 1997-98 to £942 million in 1999-2000. The reduction in the overall aid budget reflects substantially lower forecasts of aid spending by multilateral institutions, and hence lower UK contributions. Ifmultilateral aid expenditure is higher than the forecast, the excess will be met from the Exchequer. In addition to publicly financed support for developing countries, the UK is the fourth largest source of private capital to the developing world. The UK has also been at the forefront of international efforts to help relieve the poorest countries of their external debt burdens.

Agriculture, Fisheries and Food

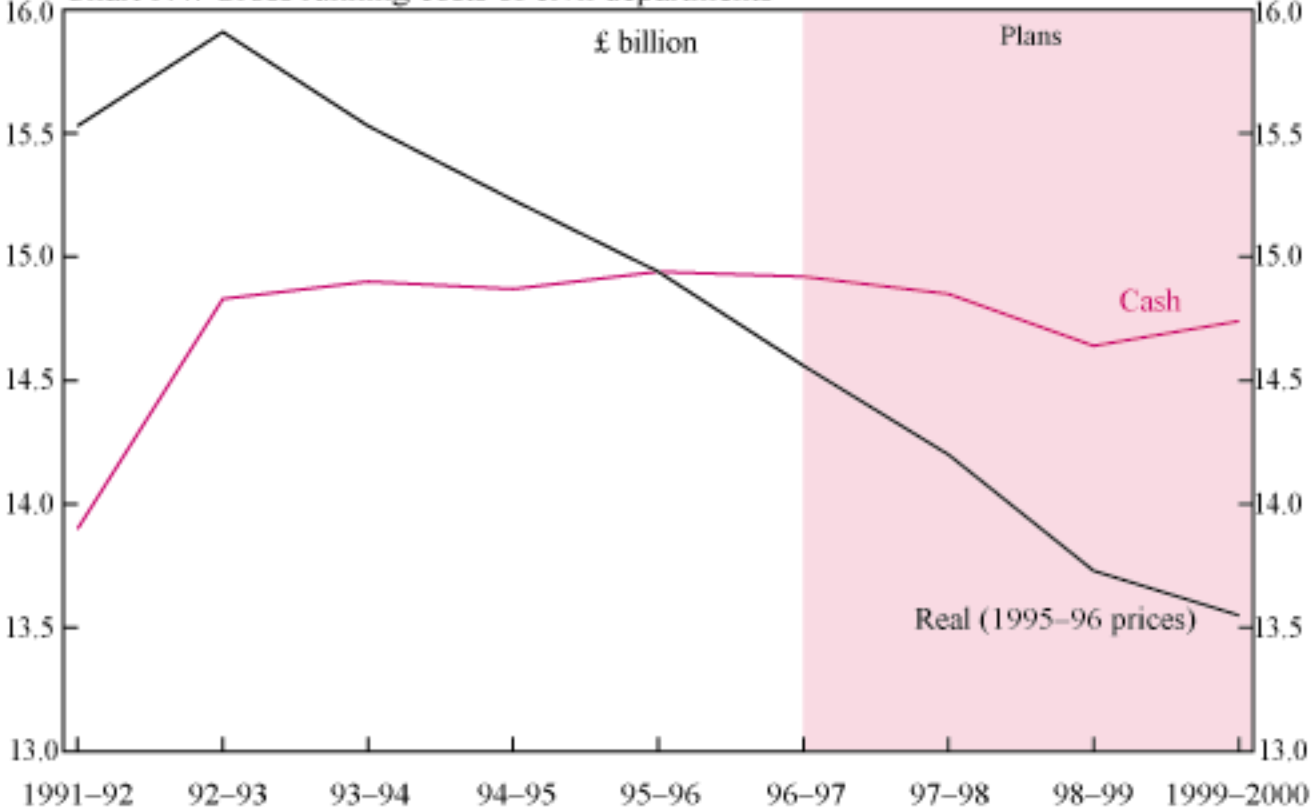
5.38 A total of £1.8 billion has been made available to spend over the next three years on the eradication of BSE. This is in addition to £1.5 billion in 1996-97. This will ensure the measures put in place to protect the public and restore the market in British beef can continue, including the removal of cattle over 30 months old from the human food chain. The plans for the rest of the agriculture programme have been reduced, partly to reflect the fall in support costs under the Common Agricultural Policy (CAP) resulting from the appreciation of the "green pound" which determines the rate on which CAP prices set in ecu are converted into national currency. An additional £60 million has been provided in 1997-98 under the HLCA scheme for support for specialist beef farmers in the hills.

Trade and Industry - programme spending

5.39 The new plans will enable the Department of Trade and Industry (DTI) to continue the work of improving the competitiveness of UK businesses with support for small businesses, exporters, inward investors and the science community.

[Prepared November 1996]

Chart 5.4: Gross running costs of civil departments



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Science and Technology

5.40 The Government remains committed to basic research and to the science base, and the proportion of DTI's resources devoted to the science budget continues to rise. In 1997-98 the science budget will be 24 per cent higher incash terms than at the beginning of the current parliament (adjusted for Dual Support Transfer) and 6 per cent higher in real terms. Total central government spending on Science and Technology in 1997-98 is expected to be about £6 billion.

Trade and Industry - nationalised industries

5.41 The new plans include an increase in Magnox Electric's External Financing Limit (EFL) following the restructuring of the nuclear industry and the revision of estimates, principally electricity prices and station outputs.

Education and Employment

5.42 There is £875 million more for schools, colleges and universities in England which includes an overall increase for spending on schools of £830 million in 1997-98. That amounts to a 4.4 per cent increase for schools compared with 1996-97. Provision for local education authority recurrent spending is 3.6 per cent higher than the corresponding figure last year. The increase for schools includes £50 million extra in the schools capital programme for repairs and maintenance. It also includes £129 million more for the national introduction of nursery vouchers for four year-olds from April 1997. The Government has also increased the plans for further and higher education by £280 million over the next two years, including £20 million in 1997-98 for a challenge fund to finance scientific equipment. The reductions in previous plans reflect the substantial student loan debt proceeds which will result from sales in each of the next three years. The debt sales will bring benefits from transferring risk for the collection of student loans to the privatesector.

5.43 The contribution of private investment of various kinds to the education and employment sectors is continuing to develop. Commercial funding of further education colleges and higher education institutions now approaches £2 billion. Private funding could add £390 million in 1997-98, £355 million in 1998-99 and £360 million in 1999-2000 over and above public funding for higher and further education institutions and grant maintained schools. Within these totals commercial borrowing is expected to form a declining share, as the proportion of deals which involve a greater degree of risk transfer, in line with the principles of the PFI, increases.

5.44 The Government is instituting three new employment initiatives. £100 million has been provided to expand the Project Work pilots, which provide intensive help with looking for work and three months of mandatory work experience, and for Contract for Work, which brings in private companies and voluntary bodies to help the unemployed into work. There will also be a programme of intensive one-to-one interviews covering all those unemployed over two years.

Transport

5.45 The new plans for Transport provide for continued improvements inthe road network and a high level of investment in public transport. The settlement secures over £3.5 billion of public investment in national roads over the next three years. In addition three DBFO schemes are due to be signed next year, adding some £350 million of private investment. The Government's policy is to make steady progress in implementing a roads programme the size of the current main programme. This is likely to mean an average of three to four significant new starts a year, with private finance continuing to play a major role in delivering the programme.

5.46 The plans also continue to give priority to public transport. London Transport core investment, including privately financed investment, is planned to average around £525 million a year, some 50 per cent higher in real terms than the average of the 1980s. At around £1.5 billion, provision for rail in 1997-98 is broadly similar to pre-privatisation levels and reflects the successful sale of profitable businesses. Net subsidy is set to decline as a result of privatisation, which is also beginning to benefit passengers through higher investment and better services, with fares capped in real terms. Significant private sector investment in rail is planned, including the Channel Tunnel Rail Link and rolling stock upgrades by the new franchisees. Private sector investment in transport generally is also growing, totalling some £750 million in 1995-96.

Department of the Environment

5.47 The Government has announced a new initiative to encourage local authorities to use private finance to renovate social housing. The Estates Renewal Challenge Fund (ERCF) has been increased to around £500 million over the next three years. This permits housing estates to be transferred to new private sector landlords who will be able to invest to improve the stock free of public expenditure constraints. As a result, there will be substantial public expenditure savings as housing investment is carried out by the private rather than the public sector.

5.48 In addition, local authorities will be allowed to spend 25 per cent of receipts generated by transfer of stock to other landlords. The levy on transfer receipts paid by local authorities will be waived for the next three years and the maximum size of transfers has been increased. There will also be an initiative to put the housing finances of local authorities whose housing debts cannot be supported by rents on to a better footing. This will make it easier for them tocontemplate transfer of their housing stock to housing associations or local housing companies. This measure will reduce general government expenditure and general government revenues, but will not have a significant impact on borrowing.

5.49 The new expenditure plans include £2.5 billion over three years for the Housing Corporation. This is a reduction on previous plans, but it is anticipated that it will allow housing associations and other landlords to secure a further £1.4 billion in private finance for new social lettings.

5.50 The Government has increased provision for environmental programmes, including the energy efficiency programme.

5.51 The plans include £1.6 billion for the Single Regeneration Budget challenge fund over the next three years which will lever-in £3.5 billion of private finance. New arrangements will be introduced allowing local authorities to use more of their capital receipts for regeneration projects.

5.52 The DOE local government programme includes the new local authority capital challenge fund of £600 million over the next three years. Italso includes the main unhypothecated current grants to English local authorities (see paragraphs 5.70 to 5.74).

Home Office

5.53 Law and order continues to be a crucial Government priority. The new plans allow planned public spending on the police to increase by £220 million in 1997-98 (in England and Wales), and includes provision to allow Chief Constables to recruit 5,000 additional police officers over the three years from April 1996. An additional £230 million is also being provided in 1997-98 for prisons, and plans provide for 8,600 new prison places by March 2000.

Legal Departments

5.54 The new plans for the Legal Departments reflect measures to curb the growth in legal aid, which has been the fastest growing spending programme in recent years. The Government will continue to increase the effectiveness with which the legal aid budget is used and tackle abuse so that the legal aid budget is expected to fall back in cash terms by the end of the Survey period.

National Heritage

5.55 The cash plans for the Department of National Heritage have been reduced in the first year as a result of a re-scheduling of payments to Welsh Channel 4 (S4C), but provide for increases over plans for the Arts Council, English Heritage and the museums and galleries. The cash reductions in the second and third years reflect lower inflation and the scope for greater efficiency in the administration of the NDPBs sponsored by the Department and the completion of the British Library.

National Lottery

5.56 The National Lottery is expected to provide around £1 1/4 billion a year for projects relating to the arts, sport, heritage, charities and the celebration of the new Millennium. This is in addition to the Government's expenditure plans. Spending of Lottery money counts as general government expenditure but is excluded from the Government's target for reducing spending as a share of national income measured by GGE(X) and is outside the Control Total.

Health

5.57 Total spending on the National Health Service will grow by £1 1/4 billion in 1997-98 compared to 1996-97, more than meeting the Government's commitment to increase real resources year by year. Current spending on patient services is planned to grow by £1.6 billion, an increase of 2.9 per cent in real terms. Efficiency savings worth around £525 million will also be ploughed back into patient care.

5.58 The NHS is also benefiting from the Private Finance Initiative. As well as a continuing flow of small schemes, commercial terms have now been agreed for a major hospital deal in South Buckinghamshire. Further schemes will follow. In total, the PFI is set to contribute some £900 million of investment in the Health Service over the next three years.

Social Security

5.59 The social security plans include revised estimates of the number of claimants and provide for the uprating of benefits every year. The plans take full account of the fall in unemployment. The real growth they imply is in line with the average for the last three years. The increases in expenditure come primarily from faster than expected caseload growth on disability benefits and Income Support. The revised forecasts also take account of new information on the real increases in average amounts paid, particularly in Income Support. The assumptions used for benefit upratings and for unemployment are set out in paragraph 5A.5.

5.60 The new plans continue the process of focusing benefits on those who need them most. As part of the spend-to-save package described on page 106, they include further steps to ensure that benefits are paid only to those who are entitled to them.

5.61 The lone parent premium in the income related benefits and, in general, One Parent Benefit will no longer be payable to new claimants from April 1998. Lone parents making new claims from April 1998 will receive the same level of family premium and Child Benefit as couples with children, equalising their position.

5.62 The qualifying rules for chronic bronchitis and emphysema and asbestos related diseases for industrial injuries benefit purposes will be extended as recommended by the Industrial Injuries Advisory Council.

5.63 Reforms of benefits paid for housing costs will continue by restricting Housing Benefit for deregulated tenancies to the local reference rent and to the costs of shared accommodation for single people under pension age, and by restricting Council Tax Benefit payable to people occupying properties with Council Tax above band E. These changes will focus benefits on those who need them most by encouraging people on benefit to take cost into account in deciding where to live.

5.64 In reforming social security expenditure to make it more affordable, the Government has often taken steps to encourage private provision. A good example of this is pensions.

Scotland, Wales and Northern Ireland

5.65 Changes in these programmes (including in the case of Wales, Total Standard Spending for local authorities) take account of changes in comparable programmes in England. Each Secretary of State has discretion within his block budget to distribute expenditure between programmes. Detailed plans will be announced shortly.

Chancellor's Departments

5.66 The expenditure of the Chancellor's departments is dominated by Inland Revenue and HM Customs and Excise. Additional funding has been made available as part of the spend to save package to increase measures to tackle tax non-compliance and tax evasion. Even after taking account of these additional resources, the costs of the Chancellor's departments continue to fall in real terms.

European Community

5.67 The actual level of net payments to the European Community fluctuates for a number of reasons, including the timing of payment of UK contributions, adjustments made to UK contributions in earlier years, and subsequent correction to the UK abatement. The projection of net payments included in the plans for the next three years reflects the estimated underlying trend of contributions to the European Community. Given the uncertainties involved, this projection does not attempt to make a more precise estimate of net contributions in particular UK financial years.

5.68 However, the figure for net payments in 1996-97 is an estimate of actual rather than trend payments since more reliable information about contributions and receipts is available for this year.

The Reserve

5.69 Within the overall expenditure totals, the Government leaves part of the plans unallocated to programmes. This safety margin, called the Reserve, enables the Government to meet unforeseen circumstances and expenses during the year without increasing the overall level of spending. The Reserve has been set at £2 1/2 billion for 1997-98, £5 billion in 1998-99 and £7 1/2 billion in 1999-2000. One potential claim on the Reserve in 1997-98 is the cost of compensation as a result of the Firearms (Amendment) Bill. The size and timing of compensation payments is uncertain.

Local Authorities

5.70 Local authorities are responsible for setting their own spending budgets. These are financed by support provided by central government and from local authorities' own resources. Local authority expenditure is included within the Government's expenditure target - GGE(X) - and within the Control Total. The Government intends to use its powers to cap local authority budgets, if that proves necessary.

5.71 In 1997-98, Total Standard Spending (TSS) in England - that is, the amount which central government judges it appropriate for local authorities to spend on revenue expenditure - has been set at £45.7 billion, including provision for the costs of local government reorganisation. Adjusting for transfers, including the introduction of nursery vouchers, the increase compared to 1996-97 is 2 1/2 per cent. Within this total,

- provision for education has been increased by £633 million (3.6 per cent);

- provision for police has been increased by £212 million (3.4 per cent); and

- provision for community care has been increased by £325 million.

5.72 Gross capital spending by local authorities in 1997-98 is projected to be around £7 1/2 billion. Capital receipts are projected at around £2 1/4 billion and net capital spending at £5billion.

5.73 In addition to publicly financed capital spending, local authorities will benefit from changes to their financial framework which enable them to make greater use of the Private Finance Initiative (see paragraphs 5.23 and 5.24).

5.74 Table 5A.7 summarises the projections of local authority spending, showing the new plans for central government support and projected local authority self financed expenditure (LASFE).

Other public expenditure

5.75 In addition to expenditure within the Control Total, General Government Expenditure includes cyclical social security, debt interest and accounting adjustments.

Cyclical social security

5.76 Cyclical social security is defined as the Jobseekers' Allowance and income support paid to people of working age. It is forecast to fall in real terms, reflecting the expected fall in unemployment. There are also measures which are estimated to reduce planned cyclical social security by a further £300 million in 1997-98, £600 million in 1998-99 and £900 million in 1999-2000. The majority of these savings come from stepping up the fight against social security fraud.

Privatisation proceeds

5.77 Privatisation proceeds are expected to be £2 billion in 1997-98. TheGovernment remains committed to maintaining the momentum of the privatisation programme; it has recently announced the future privatisation of the National Air Traffic Service. Proceeds of £1 1/2 billion are included for 1998--99 and £1 billion for 1999-2000. These proceeds are netted off general government expenditure, but they are not included in the Government's expenditure target GGE(X).

Accounting adjustments

5.78 The accounting adjustments are needed to reconcile the Control Total with the national accounts aggregates including GGE. They are explained in more detail in paragraph 5A.16. The projections are little changed in aggregate in 1997-98 and 1998-99. In 1999-2000, the adjustments are increased mainly by a revised forecast of local authority debt interest payments. This change is offset within the Control Total and has no net effect on GGE(X).

Debt interest

5.79 Central government net debt interest is projected to rise from £22.2 billion in 1996-97 to £24.8 billion next year. Thereafter it is expected to remain broadly flat, helped by the projected decline in government borrowing. Compared to the projections in last year's Budget, central government net debt interest has increased by £800 million in 1997-98, £400 million in 1998-99 and £300 million in 1999-2000.

Table 5.8 Debt interest

			£ billion		
	Outturn		Projections		
	1995-96	1996-97	1997-98	1998-99	1999-00
General government					
Gross	25.6	27.0	29.8	29.3	28.8
Receipts	5.6	5.0	5.1	5.0	4.8
Net	20.0	22.0	24.6	24.3	23.9
Central government					
Gross	25.0	26.6	29.3	28.9	28.4
Receipts	5.0	4.4	4.5	4.5	4.4
Net	20.0	22.2	24.8	24.4	24.0

[Prepared November 1996]

Annex A to Chapter 5 Public expenditure analyses

This annex includes a number of more detailed analyses of expenditure. It also explains the conventions used in presenting the figures throughout Chapter 5.

Rounding conventions

5A.1 For tables presenting the new plans the following conventions apply:

Future years: Departments' spending totals within the Control Total are rounded to the nearest £10 million (except for non-cyclical social security in 1998-99 and 1999-2000, which is rounded to £50 million). The Control Total and spending sector totals (except financing requirements of the nationalised industries), items outside the Control Total, and projections of capital spending are rounded to the nearest £100 million.

1996-97: The figures for 1996-97 are departments' best view of outturn. The rounding conventions adopted for future years also apply here to reflect their provisional nature.

5A.2 For tables which show the Control Total and GGE(X) in real terms, all figures are rounded to the nearest £100 million. Projections of capital spending in real terms are also rounded to the nearest £100 million.

5A.3 Changes and totals in the tables are based on unrounded figures. They may therefore differ from the changes and sums of the rounded figures.

5A.4 Some figures may be subject to detailed amendment before the publication of *Public Expenditure Statistical Analyses* in 1997.

Assumptions for planning public expenditure

5A.5 The economic assumptions used in the public expenditure plans are set out below. The assumptions that underlay the 1995 Budget are also shown. The assumptions for the GDP deflator in 1996-97 and 1997-98 are consistent with the short-term forecast described in Chapter 3. Those for later years, and all other figures, are assumptions not forecasts.**Economic assumptions for public expenditure**

Percentage changes on a year earlier unless otherwise stated

		1996-97	1997-98	1998-99	1999-00
GDP deflator	1996 Budget	2 1/2	2	2	2
	1995 Budget	2 3/4	2 1/2	2 1/4	
Retail prices index(1) (September)	1996 Budget	2.1	2 1/2	2	
	1995 Budget	2 1/4	2		
Rossi index(1) (September)	1996 Budget	2.6	2 1/4	2	
	1995 Budget	2 1/4	2		
Average earnings	1996 Budget	3 3/4	4		
	1995 Budget	4			
GB unemployment (millions)	1996 Budget	1.98	1.8	1.7	1.6
	1995 Budget	2.1	2.1	2.1	

(1) *Used for projecting social security expenditure in the following financial year.*

Calculation of changes from previous plans and projections

5A.6 Changes from previous plans are differences from the plans and projections for 1996-97 to 1998-99 in the last year's FSBR after account is taken of classification changes and transfers and switches between departments.

5A.7 The most significant such items included in this Report are the transfer of provision for the administration of the

Jobseeker's Allowance from Social Security to Education and Employment, and the creation of the Local Authority Capital Challenge Fund under DOE - Local Government with provision previously allocated to other Departments.

5A.8 There are a few classification changes affecting the aggregates figures. Receipts from fees for driving licences and visas are now treated as reducing the Control Total. The Control Total now includes accruing superannuation liability charges for the Royal Ulster Constabulary rather than pensions paid. There are more minor classification changes but none which affect the Control Total by more than £10million in any year.

Real terms figures

5A.9 Figures in real terms are cash levels adjusted to 1995-96 price levels by excluding the effects of general inflation as measured by the GDP deflator.

Measurement of capital spending

5A.10 The main analysis set out in Table 5.4 shows the expenditure components of the public sector's capital account, on national accounting definitions but excluding industries which have been privatised or are planned to be privatised before 31 March 2000. These differ from the Control Total measure in a number of respects described in paragraph 5A.16, the main one being the treatment of VAT refunds. The figures include:

(i) gross domestic fixed capital formation, ie expenditure on fixed assets - schools, hospitals, roads, computers, plant and machinery etc. This is measured net of receipts from sales of fixed assets (eg council houses and surplus land);

(ii) grants in support of capital spending by the private sector; and

(iii) the value of the physical increase in stocks (for central government, primarily agricultural commodity stocks).

5A.11 Estimates of depreciation of the public sector's stocks of fixed assets are based on the national accounts series produced by the Office for National Statistics (in Table14.3 of the Blue Book), together with projections by the Treasury.

GGE(X)

5A.12 The Government's objective to reduce public expenditure as a share of national income over time is expressed in terms of general government expenditure, which is the combined expenditure of central and local government, with three adjustments. GGE is adjusted to exclude privatisation proceeds (ie the objective is set gross of these receipts), expenditure out of the proceeds of the National Lottery is excluded, and receipts of interest and dividends from public corporations and the private sector are netted off. The resulting measure is referred to as GGE(X).

Central government expenditure

5A.13 This includes the financing requirements of trading funds and public corporations other than the nationalised industries. Cyclical social security spending is excluded from the measure of central government spending within the Control Total.

Local authority self-financed expenditure

5A.14 Local authority self-financed expenditure is the difference between total local authority expenditure, including gross debt interest but net of capital receipts, and central government support to local authorities (ie AEF, specific grants and credit approvals).

Central government net debt interest

5A.15 Central government debt interest is shown net of receipts of interest and dividends from outside general government.

Accounting adjustments

5A.16 The accounting adjustments include various items within GGE(X) but outside the Control Total (other than central government debt interest and cyclical social security, which are shown separately). The larger items are non-trading capital consumption (£3.3 billion in 1995-96), refunds of VAT (£4.0 billion), teachers' and NHS pensions increase payments (£1.4

billion), the difference between Civil Service and armed forces pensions payments and accruing superannuation liability charges (£1.9 billion), and the debt remuneration element of NHS Trusts' charges to health authorities (£1.2 billion). The net market and overseas borrowing of nationalised industries and other public corporations is, on the other hand, within the Control Total but outside GGE(X) such that net repayments add to the magnitude of the accounting adjustments (£1.9billion in 1995-96). Debt interest paid from local authorities to central government reduces the accounting adjustments (by £3.6billion in 1995-96). This is removed to avoid double counting between local government debt interest payments (which are shown inside local authority expenditure) and central government debt interest. Local authority receipts of interest and dividends (£0.6billion) are netted off here. Fuller details of the national accounting adjustments are given in the *Public Expenditure Statistical Analyses*.

Allowance for shortfall

5A.17 Tables setting out the estimated outturn for the Control Total in 1996-97 include an allowance for the difference between the overall assessment of likely outturn and the sum of the other components shown.

Functional analysis of GGE(X)

5A.18 Chart 1.2 provides an analysis of GGE(X) by function for 1997-98. Because this is based on assumptions about the pattern of expenditure in Scotland, Wales and Northern Ireland and by local authorities, the figures can only be regarded as accurate to the nearest £1 billion. At this degree of rounding one cannot make accurate comparisons with spending by function in previous years. Receipts from the sales of MOD married quarters and of student loans are shown as reducing "other expenditure" rather than Defence and Education.

Table 5A.1 Public expenditure, 1963-64 to 1999-2000

	Control Total(1)			GGE(X)				General government expenditure	Money GDP(2)	Adjusted GDP deflator	
		Real terms(3)			Real terms(3)						
	£billion	£billion	Annual growth rate (per cent)	£billion	£billion	Annual growth rate (per cent)	Per cent of GDP(2)	£billion	£billion	Index (1995-96=100)	Annual growth rate (per cent)
1963-64				10.9	124.5		35 1/2	11.3	30.8	8.8	
1964-65				11.8	128.7	3.4	35	12.3	33.6	9.2	4.5
1965-66				13.1	136.3	5.9	36 1/2	13.6	36.0	9.6	4.8
1966-67				14.5	144.6	6.1	38	15.1	38.2	10.0	4.2
1967-68				16.8	163.2	12.9	41 1/2	17.5	40.5	10.3	2.9
1968-69				17.5	161.8	-0.8	40	18.2	43.8	10.8	5.1
1969-70				18.5	162.7	0.5	39 1/4	19.3	47.1	11.4	5.2
1970-71				20.7	167.9	3.2	39 1/2	21.6	52.2	12.3	8.2
1971-72				23.3	173.1	3.1	40	24.4	58.2	13.4	9.1
1972-73				26.4	181.5	4.8	39 3/4	27.6	66.4	14.5	8.2
1973-74				30.5	196.3	8.1	41 1/2	32.0	73.7	15.5	6.9
1974-											

75				41.0	220.7	12.5	46 3/4	42.9	87.8	18.6	19.6
1975-76				51.6	221.3	0.3	47 1/4	53.8	109.2	23.3	25.4
1976-77				57.0	215.5	-2.6	44 3/4	59.6	127.7	26.5	13.5
1977-78				61.7	205.1	-4.8	41 1/2	63.9	148.6	30.1	13.6
1978-79				72.0	215.5	5.1	42 1/4	75.0	170.6	33.4	11.2
1979-80				87.0	222.9	3.4	42 1/2	90.0	204.9	39.0	16.7
1980-81				104.8	227.0	1.8	44 3/4	108.6	233.5	46.2	18.3
1981-82				116.3	229.8	1.2	45 1/2	120.5	256.3	50.6	9.7
1982-83				127.8	235.7	2.6	45 1/2	132.7	280.7	54.2	7.1
1983-84				136.5	240.8	2.1	44 3/4	140.4	304.4	56.7	4.6
1984-85	126.0	211.4		147.9	247.8	2.9	45 1/4	150.8	326.2	59.6	5.0
1985-86	129.5	206.0	-2.6	154.9	246.4	-0.6	43 1/4	158.5	358.4	62.9	5.5
1986-87	136.0	210.0	1.9	163.3	252.1	2.3	42 1/4	164.6	385.7	64.8	3.0
1987-88	148.6	217.8	3.7	172.9	253.5	0.5	40 1/2	173.5	427.0	68.2	5.3
1988-89	156.0	214.4	-1.6	180.7	248.3	-2.0	38	179.8	475.5	72.8	6.7
1989-90	175.1	224.9	4.9	198.0	254.4	2.4	38 1/4	200.9	517.0	77.9	7.0
1990-91	193.5	230.2	2.4	217.2	258.4	1.6	39	218.1	556.6	84.1	8.0
1991-92	213.2	238.3	3.5	238.5	266.7	3.2	41	236.2	581.2	89.5	6.4
1992-93	231.7	248.5	4.3	263.5	282.6	6.0	43 1/2	260.4	606.8	93.2	4.2
1993-94	240.7	251.0	1.0	277.0	288.8	2.2	43 1/4	276.6	639.7	95.9	2.9
1994-95	247.9	254.0	1.2	288.3	295.3	2.3	42 1/2	287.0	676.8	97.6	1.8
1995-96	255.2	255.2	0.5	299.7	299.7	1.5	42 1/4	303.0	708.5	100.0	2.4
1996-97	260.6	254.3	-0.3	307.4	299.9	0.1	41 1/4	308.5	746.0	102.5	2.5
1997-98	266.5	254.9	0.2	314.7	301.0	0.3	40	319.0	787.0	104.6	2.0
1998-99	273.7	256.6	0.7	322.2	302.1	0.4	39	327.2	826.0	106.6	2.0
1999-											

00	280.9	258.2	0.6		330.6	304.0	0.6		38 1/4	336.3		864.0	108.8	2.0

(1) *Figures for the Control Total are only available on a consistent basis for the years shown. Figures are estimated outturn for 1996-97 and plans from 1997-98 onwards.*

(2) *An adjusted series for money GDP is used in the calculation of the ratio for the years up to 1989-90. This has been constructed to remove the distortion caused by the abolition of domestic rates.*

(3) *Cash figures adjusted to price levels of 1995-96.*

Table 5A.2 Control Total in Real Terms: plans and outturn(1)

£ billion

	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000
								Plans **Outturn**	
1991 Survey	**242.6**	253.6	259.7	265.5					
1992 Survey	**241.5**	**254.2**	259.3	261.4	264.8				
1993 Survey	**245.9**	**258.7**	**263.3**	260.2	263.3	265.6			
1994 Survey	**239.8**	**251.0**	**254.2**	**257.7**	256.3	256.9	259.2		
1995 Survey	**239.0**	**249.5**	**252.0**	**255.0**	**255.5**	253.2	254.6	255.9	
1996 Survey	**238.3**	**248.5**	**251.0**	**254.0**	**255.2**	**254.3**(2)	254.9	256.6	258.2

(1) *1995-96 prices. Figures for the Control Total in previous Surveys have been adjusted for all subsequent classification changes.*

(2) *Estimated.*

Table 5A.3 GGE(X): plans and outturn(1)

Per cent of GDP

	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000
								Plans **Outturn**	
1991 Survey	**40 3/4**	41 1/4	41	40 1/2					
1992 Survey	**41 1/4**	**44**	45	44 1/4	43 1/2				
1993 Survey	**41 1/4**	**43 3/4**	**44 1/4**	43	42 1/2	41 3/4			
1994 Survey	**41**	**43 1/2**	**43 1/2**	**43**	41 3/4	41	40		
1995 Survey	**41**	**43 1/2**	**43 1/2**	**42 3/4**	**42**	40 1/2	39 3/4	38 3/4	
1996 Survey	**41**	**43 1/2**	**43 1/4**	**42 1/2**	**42 1/4**	**41 1/4** (2)	40	39	38 1/4

(1) *Figures for GGE in previous Surveys have been adjusted for subsequent classification changes and forecasts of general government interest and dividend receipts subtracted.*

(2) *Estimated.*

Table 5A.4 Control Total by department(1)

	Outturn					Estimated outturn	New plans			Year on year increase		
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	1997-98	1998-99	1999-00
Defence (excluding sale of married quarters)	22 913	22 910	22 757	22 562	21 517	22 130	21 810	22 240	22 800	-320	440	560
sale of married quarters						-940	-700			240	700	0
Foreign Office	1 103	1 242	1 244	1 263	1 339	1 100	1 080	1 080	1 100	-10	0	20
Overseas Development	1 994	2 126	2 235	2 385	2 371	2 340	2 220	2 320	2 350	-130	110	30
Agriculture, Fisheries and Food												
- excluding BSE	2 160	2 203	2 950	2 435	2 778	2 870	2 880	2 830	2 840	10	-50	10
- expenditure on BSE						1 540	730	580	490	-810	-140	-90
Trade and industry - Programmes	2 716	2 811	2 736	2 810	3 220	3 250	3 070	3 050	3 000	-190	-20	-50
Trade and Industry - Nat Inds	1 702	1 300	1 278	577	247	-520	-20	-180	-240	500	-160	-60
ECGD	215	117	-60	-26	16	30	10	0	-30	-20	-10	-30
Transport	5 361	6 568	5 973	5 989	4 440	4 870	5 190	4 600	4 320	320	-590	-280
DOE - Local government(2)	28 356	31 175	29 378	29 913	30 295	31 320	31 380	31 740	31 630	60	370	-110
DOE - Other	9 346	10 371	10 284	9 635	8 955	8 380	7 600	7 640	6 960	-780	40	-680
Home Office	5 491	5 794	5 936	6 229	6 455	6 550	6 780	6 810	6 940	230	30	130
Legal departments	2 001	2 334	2 415	2 585	2 688	2 730	2 710	2 750	2 660	-20	40	-90
Education and Employment(3)	9 920	10 762	13 616	14 364	14 505	14 810	13 950	14 010	14 040	-860	60	30
National Heritage	916	1 040	1 012	1 016	1 063	1 020	920	960	950	-90	40	-10
Health	25 544	28 213	29 773	31 585	32 930	33 970	34 940	35 380	36 120	970	430	740
of which NHS	*25 354*	27 971	28 951	30 581	31 982	33 180	34 370	35 150	35 890	1 190	780	740
Social Security(4)	54 598	61 131	67 092	69 467	72 665	76 920	79 740	82 950	86 200	2 820	3 200	3 250
Scotland	11 723	12 723	13 580	14 082	14 303	14 590	14 330	14 420	14 490	-260	90	70
Wales	5 309	5 991	6 295	6 550	6 724	6 820	6 900	6 880	6 900	70	-20	20
Northern Ireland	6 041	6 606	7 108	7 426	7 709	8 190	8 220	8 260	8 360	40	30	110
Chancellor's departments	3 502	3 478	3 393	3 329	3 298	3 270	3 170	3 200	3 220	-110	30	20
Cabinet Office	308	1 013	1 056	967	1 213	1 330	1 080	1 080	1 090	-250	-10	10
European Communities	705	1 902	1 883	1 347	3 245	1 400	2 250	2 390	2 790	850	140	400
Local authority self-financed expenditure	11 267	9 855	8 796	11 460	13 204	13 300	13 700	13 700	14 300	500	-100	700
Allowance for shortfall						-600				600		
Reserve							2 500	5 000	7 500	2 500	2 500	2 500
Control Total	**213 192**	**231 665**	**240 730**	**247 949**	**255 181**	**260 600**	**266 500**	**273 700**	**280 900**	**5 800**	**7 200**	**7 200**

£ million

(1) *For definitions, rounding and other conventions, see notes on page 118. See Annex B for the composition of each*

departmental grouping.

(2) Includes payments of Revenue Support Grant and National Non-domestic Rates to English local authorities. These finance, at local authorities' discretion, a range of local services, including education, social services and environmental services.

(3) Does not include local authority Total Standard Spending on education.

(4) Excluding cyclical social security.

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Table 5A.5 Control Total by department in real terms(1)

£ billion

			Outturn			Estimated outturn		New plans	
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00
Defence	25.6	24.6	23.7	23.1	21.5	21.6	20.9	20.9	21.0
- Sale of Married Quarters						-0.9	-0.7	0.0	0.0
Foreign Office	1.2	1.3	1.3	1.3	1.3	1.1	1.0	1.0	1.0
Overseas Development	2.2	2.3	2.3	2.4	2.4	2.3	2.1	2.2	2.2
Agriculture, Fisheries and Food (excluding BSE)	2.4	2.4	3.1	2.5	2.8	2.8	2.8	2.7	2.6
- BSE						1.5	0.7	0.5	0.4
Trade and industry - Programmes	3.0	3.0	2.9	2.9	3.2	3.2	2.9	2.9	2.8
Trade and Industry - Nat Inds	1.9	1.4	1.3	0.6	0.2	-0.5	0.0	-0.2	-0.2
ECGD	0.2	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Transport	6.0	7.0	6.2	6.1	4.4	4.8	5.0	4.3	4.0
DOE - Local government	31.7	33.4	30.6	30.6	30.3	30.6	30.0	29.8	29.1
DOE - Other	10.4	11.1	10.7	9.9	9.0	8.2	7.3	7.2	6.4
Home Office	6.1	6.2	6.2	6.4	6.5	6.4	6.5	6.4	6.4
Legal departments	2.2	2.5	2.5	2.6	2.7	2.7	2.6	2.6	2.4
Education and Employment	11.1	11.5	14.2	14.7	14.5	14.4	13.3	13.1	12.9
National Heritage	1.0	1.1	1.1	1.0	1.1	1.0	0.9	0.9	0.9
Health	28.6	30.3	31.0	32.4	32.9	33.1	33.4	33.2	33.2
of which NHS	28.3	30.0	30.2	31.3	32.0	32.4	32.9	33.0	33.0
Social Security(2)	61.0	65.6	69.9	71.2	72.7	75.0	76.3	77.8	79.2
Scotland	13.1	13.6	14.2	14.4	14.3	14.2	13.7	13.5	13.3
Wales	5.9	6.4	6.6	6.7	6.7	6.7	6.6	6.4	6.3
Northern Ireland	6.8	7.1	7.4	7.6	7.7	8.0	7.9	7.7	7.7
Chancellors departments	3.9	3.7	3.5	3.4	3.3	3.2	3.0	3.0	3.0
Cabinet Office	0.3	1.1	1.1	1.0	1.2	1.3	1.0	1.0	1.0
European Communities	0.8	2.0	2.0	1.4	3.2	1.4	2.1	2.2	2.6
Local authority self-financed expenditure	12.6	10.6	9.2	11.7	13.2	12.9	13.2	12.8	13.2
Control Total	**238.3**	**248.5**	**251.0**	**254.0**	**255.2**	**254.3**	**254.9**	**256.6**	**258.1**

(1) *1995-96 prices. For definitions, rounding and other conventions, see notes on page 136. See Annex B for the composition of each departmental grouping.*

(2) *Excluding cyclical social security.*

Table 5A.6 Financing requirements of the nationalised industries, by department and industry(1)

	£ million							
	Outturn				Estimated outturn	New plans		
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00
Trade and Industry	**1 702**	**1 300**	**1 278**	**577**	**247**	**-520**	**-20**	**-180**	**-240**
British Coal (2)	605	791	1 400	742	48	30	70	0	0
British Shipbuilders(2)	-9	-10	-9	10	-1	-0	0	-20	0
Post Office	-74	-80	-186	-235	-245	-270	-330	-335	-345
Nuclear Electric/Magnox Electric	1 180	991	726	483	235	-170	310	220	190
British Nuclear Fuels		-392	-653	-422	209	-110	-70	-40	-80
Transport	**2 051**	**2 998**	**2 244**	**396**	**-627**	**-40**	**690**	**370**	**240**
Railways (3)	1 464	2 064	1 461	-433	-1 573	-980	70	100	110
Civil Aviation Authority	33	51	91	46	34	-10	-30	-40	-20
London Transport	554	883	693	783	913	950	650	310	150
DOE - Environment	**50**	**48**	**49**	**48**	**50**	**50**	**50**	**50**	**50**
British Waterways Board	50	48	49	48	50	50	50	50	50
Scotland	**-34**	**32**	**34**	**-27**	**-24**	**20**	**20**	**20**	**20**
Caledonian MacBrayne	9	13	12	11	11	10	10	10	10
Highlands and Islands Airports	4	5	6	8	10	10	10	10	10
Other(4)	-48	14	15	-46	-43				
Total	**3 768**	**4 378**	**3 605**	**995**	**-354**	**-500**	**740**	**260**	**70**

(1) *For definitions and other conventions, see notes on page 118.*

(2) *Future plans cover the cost of residual liabilities after privatisation.*

(3) *Includes the financing requirements of British Rail, Railtrack, Union Railways and European Passenger Services but excludes Metropolitan Rail Grant and grants from the Office of Passenger Rail Franchising which were a major source of finance for British Rail from 1994-95 but outside the External Finance Limit.*

(4) *This item includes the financing requirements of nationalised industries privatised before 1995-96.*

Table 5A.7 Local authority expenditure(1)

	£ million				
	Outturn	Estimated outturn	New plans		
	1995-96	1996-97	1997-98	1998-99	1999-00
Current					
Aggregate External Finance(2)					
England	34 695	35 760	35 770	35 960	35 900
Scotland(3)	5 370	5 390	5 340	5 290	5 290
Wales(3)	2 466	2 520	2 580	2 590	2 600
Total Aggregate External Finance	42 531	43 670	43 690	43 840	43 790
Other current grants	13 857	14 050	14 320	15 540	15 880
Total current	**56 388**	**57 720**	**58 010**	**59 380**	**59 670**
Capital					
Capital grants	1 755	1 710	1 590	1 440	1 480
Capital approvals	3 672	3 150	2 790	2 540	2 450

Total capital	**5 427**	**4 860**		**4 380**	**3 980**	**3 930**
Total central government support to local authorities	**61 815**	**62 600**		**62 400**	**63 400**	**63 600**
Local authority self-financed expenditure	**13 204**	**13 300**		**13 700**	**13 700**	**14 300**
Total local authority expenditure	**75 019**	**75 800**		**76 100**	**77 000**	**77 900**

(1) *For definitions, rounding and other conventions, see paragraphs 5A.1 to 5A.4.*

(2) *Aggregate External Finance includes revenue Support Grant, distribution of Non-domestic Rate revenue and a number of specific grants which fund part of the expenditure on a specific service or activity.*

(3) *Scottish and Welsh figures for 1998-99 and 1999-2000 are illustrative; final figures will depend on the Secretary of States' decisions on the allocation of resources.*

[Prepared November 1996]

Annex B to Chapter 5 Departmental groupings

Short title used in tables	Departments covered
Defence	Ministry of Defence
Foreign Office	Foreign and Commonwealth Office - Diplomatic Wing
Overseas Development	Foreign and Commonwealth Office - Overseas Development Administration
Agriculture, Fisheries and Food	Ministry of Agriculture, Fisheries and Food The Intervention Board
Trade and Industry - Programmes	Department of Trade and Industry - Programmes Office of Fair Trading Office of Telecommunications Office of Electricity Regulation Office of Gas Supply
Trade and Industry - Nat Inds	British Coal British Shipbuilders British Energy Electricity (England and Wales) Magnox Electric Nuclear Electric Post Office British Nuclear Fuels Limited
ECGD	Export Credits Guarantee Department
Transport	Department of Transport Office of the Rail Regulator Office of Passenger Rail Franchising
DOE - Local government	Department of Environment - mainly block and transitional grants to English local authorities
DOE - Other	Department of Environment - Other than Local Government Health and Safety Commission Office of Water Services Ordnance Survey PSA Services
Home Office	Home Office
Legal departments	Lord Chancellor's Department Crown Office, Scotland and Lord Advocate's Department Crown Prosecution Service Northern Ireland Court Service Public Record Office Serious Fraud Office Treasury Solicitor's Department Land Registry
Education and Employment	Department for Education and Employment Office for Standards in Education
National Heritage	Department of National Heritage Office of the National Lottery Charity Commission
Health	Department of Health
Social Security	Department of Social Security
	Scottish Office

	Forestry Commission General Register Office (Scotland) Scottish Courts Administration Scottish Record Office
Scotland	Registers of Scotland
	Welsh Office
Wales	Office of Her Majesty's Chief Inspector of Schools in Wales
Northern Ireland	Northern Ireland Office and Departments
	HM Treasury Office for National Statistics Crown Estate Office Department for National Savings Government Actuary's Department HM Customs and Excise Inland Revenue National Investment and Loans Office Registry of Friendly Societies Royal Mint
Chancellor's departments	Paymaster Agency
	Cabinet Office Office of Public Service Privy Council Office Central Office of Information Her Majesty's Stationery Office House of Commons House of Lords National Audit Office Parliamentary Commissioner and Health Service Commissioners
Cabinet Office	Property Advisors to the Civil Estate
European Communities	Net payments to European Community institutions

[Prepared November 1996]

6 The Budget tax and national insurance measures

6.01 This chapter summarises and explains the tax and national insurance proposals in the Budget[1].

Objectives

6.02 The Government's overall objectives for the tax system are to:

- keep the overall tax burden as low as possible, through firm control over public spending;

- reduce marginal tax rates on income and business profits, to sharpen incentives to work and create wealth through enterprise and investment;

- maintain a broad tax base, which helps to keep tax rates low and avoids distorting decisions;

- shift the balance from taxes on income to taxes on spending;

- simplify the administration of the tax system and minimise the burdens which compliance places on the taxpayer;

- apply it fairly and evenly, closing loopholes so that commercial decisions are not distorted by attempts to avoid tax;

- use the tax system to enable markets to work better, for example by making decision makers aware of the external costs of their decisions;

- raise revenue in ways which do least harm to the economy and take account of the competitive position of UK business.

6.03 This Budget furthers the Government's overall objectives for the tax system by:

- continuing to keep the overall tax burden low, through firm control over public spending, and only making tax cuts which it believes are sustainable;

- cutting the basic rate of income tax and the small companies' corporation tax rate;

- cutting inheritance tax to allow more wealth to pass between generations;

- maintaining and strengthening a broad tax base, by phasing out tax relief for profit related pay, which has done the pump-priming job for which it was intended; and taking a range of direct and indirect tax measures, especially in respect of VAT, to close loopholes and to ensure that the tax system is applied evenly and fairly;

- including a number of measures to simplify the administration of the tax system;

- including a package of measures designed to improve the environment;

- seeking to raise the revenues necessary to provide public services in ways which are least distortionary and take account of the current strong position of UK business.

Personal taxation

Income

6.04 The Budget takes a further step towards a 20 per cent basic rate of income tax by cutting the basic rate of income tax from 24 per cent to 23 per cent (7); and widens the 20 per cent lower rate band by £200 in total, £100 more than indexation (5).

6.05 The Budget also proposes:

- increasing the main personal allowances by £280, £200 more than indexation (1);

- increasing the personal allowance for the elderly by £310, also £200 more than indexation (2);

- increasing the married couple's allowance, the additional personal allowance, the widow's bereavement allowance and relief for maintenance payments (3), the income limit for age related allowances (4), and the basic rate limit (6) in line with statutory indexation (based on the 2.1 per cent increase in the RPI in the year to September 1996);

- increasing the blind person's allowance to £1,280, and legislating for future statutory indexation (*).

6.06 The rate applicable to trusts will remain unchanged at 34 per cent (-).

6.07 These measures will:

- cut tax for all income tax payers, including over 3 million pensioners;

- reduce marginal rates for 16.6 million people;

- by widening the 20 pence band, ensure that over a quarter of all taxpayers continue to pay tax at a marginal rate of no more than 20 per cent; and

- take 410,000 out of income tax altogether, relative to indexation.

Number of income tax payers (millions)

Year	**Lower rate**(1)	**Basic rate**	**Higher rate**	**Total**
1991-92	-	24.1	1.6	25.7
1992-93	4.2	19.4	1.7	25.4
1993-94	5.4	17.9	1.7	25.0
1994-95	5.2	18.2	2.0	25.3
1995-96(2)	5.6	17.9	2.2	25.7
1996-97(2)	7.1	16.4	2.1	25.6
1997-98(2) (3)	7.2	16.2	2.2	25.6

(1) From 1993-94 onwards a number of taxpayers with taxable income in excess of the lower rate limit pay tax only at the lower rate. This is because it is their dividend income and (from 1996-97) their savings income which take their taxable income above the lower rate limit, and such income is chargeable to tax at the lower rate and not the basic rate.
(2) Provisional.
(3) After taking account of Budget measures.

6.08 The income tax measures mentioned above cost £2.2 billion against an indexedbase in 1997-98, rising to £3.3 billion in 1998-99 and £3.4 billion in 1999-2000.

6.09 The cut in the basic rate of income tax furthers the Government's objective of reducing marginal tax rates on income. The 23 per cent rate will be the lowest basic or standard rate of tax for nearly 60 years. Chart 6.1 illustrates the changes in income taxes from 1978-79 to 1997-98.

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6.10 The new allowances and bands of taxable income are:

Income tax allowances (£)	**1996-97**	**1997-98**	**Increase**
Personal allowance	3 765	4 045	280
Married couple's allowance(1), additional personal allowance(1), widow's bereavement allowance(1)	1 790	1 830	40
For people aged 65-74:			
personal allowance	4 910	5 220	310
married couple's allowance(1)	3 115	3 185	70
For people aged 75 and over:			

personal allowance	5 090	5 400	310
married couple's allowance(1)	3 155	3 225	70
Income limit for age related allowances	15 200	15 600	400
Blind person's allowance	1 250	1 280	30

(1) Tax relief for these allowances is restricted to 15 per cent.

Band of taxable income (£)	**1996-97**	**1997-98**	**Increase**
Lower rate 20 per cent	0 - 3 900	0 - 4 100	200
Basic rate 24 per cent	3 901 - 25 500		
Lower rate 23 per cent		4 101 - 26 100	
Higher rate 40 per cent	over -25 500	over -26 100	600

6.11 The current rent a room threshold of £3,250 a year below which no tax is paid on rent received from a lodger in the landlord's own home will be increased by £1,000 to £4,250 from 6 April 1997 (8).

6.12 The scales for assessing the benefit of free fuel provided by employers for private use in company cars will be increased by 13 per cent for petrol cars and 15 per cent for diesel cars, in line with changes in fuel prices, from 6 April 1997 (9). The scales are also used for employers' national insurance contributions (51) and VAT(31).

6.13 The rules on travel expenses will be changed to give relief for travelling expenses incurred by site based employees and to make fairer and less complex the treatment of triangular travel. This will come into effect from April 1998(10).

6.14 The maximum level of earnings for which pension provision may be made with tax relief (the "earnings cap") will be increased in line with statutory indexation to £84,000 (-).

Capital

6.15 The Government is committed to reducing and eventually abolishing inheritance tax and capital gains tax when resources allow. This Budget contains a further step towards that objective on inheritance tax.

6.16 Inheritance tax is currently charged at 40 per cent on the value of estates in excess of £200,000. The threshold for inheritance tax will be increased to £215,000. The increase is £10,000 more than indexation, allowing more wealth to be passed between generations free of tax. This follows an increase of £46,000 in the last Budget (11).

6.17 The capital gains tax annual exempt amount will be increased in line with statutory indexation by £200 from £6,300 to £6,500 for individuals, and by £100 to £3,250 for most trusts (-).

6.18 Changes will be made to CGT reinvestment relief. Investment in company groups with a non-resident element may now qualify for relief and the rules governing the structure of their activities will be relaxed (12).

Business taxation

Direct tax

6.19 The main rate of corporation tax will remain unchanged at 33 per cent, lower than in any major industrialised country.

6.20 The income tax package benefits some 3 million self-employed business people.

6.21 The small companies' rate of corporation tax will be reduced from 24 per cent to 23 per cent from 1 April 1997, cutting the marginal rate of tax for 350,000 companies (13).

6.22 The cut in the small companies' rate of corporation tax furthers the Government's objective of reducing marginal tax rates on business profits to create wealth through enterprise and investment in this key sector of the economy. Chart 6.2 illustrates the changes in corporation tax rates from 1978-79 to 1997-98.

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6.23 Two small amendments will be made to the Venture Capital Trust (VCT) legislation to give VCTs added flexibility to develop further. Similar amendments will be made to the Enterprise Investment Scheme and CGT reinvestment relief (*).

6.24 Inheritance tax agricultural relief will be extended to cover farmland dedicated to wildlife habitats (*).

6.25 An extra-statutory concession governing relief for employers' Class 1A national insurance contributions when computing profits for tax purposes will be legislated for (-).

Business rates

6.26 The 1994 Budget introduced a scheme to limit the real increases in business rates bills to 10 per cent for large properties, 7 1/2 per cent for small properties and 5 per cent for mixed domestic/non-domestic properties (such as shops with flats above). For 1996-97 these maximum real increases were reduced to 7 1/2 per cent, 5 per cent and 2 1/2 per cent respectively. Under both schemes, to part-finance them, those who "gained" from the revaluation had their real reductions limited to 5per cent each year (10 per cent for small businesses).

6.27 This Budget provides small businesses with substantial extra help with their 1997-98 rates bills. Properties whose rates bills are already falling in real terms will have those reductions accelerated. Rates bills for other properties will be frozen in cash terms. From 1998-99, real changes in rates bills will revert to the values previously announced (48).

6.28 The table below shows the cost of transitional schemes since the 1995 revaluation.

Cost of business rate transitional schemes: £ million

	1995-96	1996-97	1997-98	1998-99	1999-00
Cost of existing schemes	600	505	340	270	200
Additional costs of 1996 Budget measure			115	100	80

6.29 The rate poundage for 1997-98 will be increased by 2.1 per cent in line with the RPI for the year to September 1996.

Measures to secure the tax base

6.30 The Budget contains a number of measures designed to secure the tax base, through blocking loopholes and phasing out or scaling back special reliefs. Additional resources are also being provided to increase the compliance activities of the Inland Revenue and Customs and Excise.

Direct tax

6.31 Tax relief for profit-related pay (PRP) was introduced in the 1987 Budget to help get PRP schemes off the ground. These schemes were intended to stimulate closer participation by employees in the profitability of their business and to encourage greater pay flexibility. Tax-relieved schemes made a slow start over the first few years. But, since the relief was doubled in 1991, PRP has become widely recognised as a normal element of remuneration in many businesses. The Government sees PRP as an important way of maintaining pay flexibility, but believes that it is now well established, and with the cost to the Exchequer rising substantially (see Chart 6.3), the time has come to phase out its specially favourable tax treatment.

6.32 The income tax relief for PRP will be progressively reduced over a three to four year period, and then withdrawn altogether. For profit periods beginning before 1 January 1998, there will be no change in the present annual limit of £4,000 on the amount of PRP which may attract tax relief. For profit periods beginning between 1 January 1998 and 31 December 1998, the limit will be reduced to £2,000; for periods beginning between 1 January 1999 and 31 December 1999 it will be reduced to £1,000. No relief will be available for profit periods beginning on or after 1 January 2000 (14).

CHART HERE

6.33 This Budget has also introduced a range of other direct tax measures with the aim of further securing the tax base.

6.34 The tax treatment of machinery and plant with an expected working life of more than 25 years will be brought more into line with the commercial accounting practice. The rate at which capital allowances are given on such assets purchased new on or after Budget day will be reduced from 25 per cent to 6 per cent per annum. The change will not apply to such investment up to 2010 in ships or railways (15).

6.35 Legislation will be introduced to counter avoidance schemes which turn interest earnings of finance lessors into capital receipts and to align the recognition of finance lessors' income more closely with commercial accounting practices (16).

6.36 The 100 per cent corporation tax deduction for intangible costs of drilling most production oil wells will be withdrawn. These costs will now only be eligible for mineral extraction capital allowances at 25 per cent on a reducing balance basis. The change applies to expenditure incurred on or after Budget day, except for expenditure to which a company was committed before Budget day and which will be incurred within the next year (17).

6.37 Measures will be introduced to ensure that, from Budget day, capital gains will remain chargeable where the tax status of a security alters, and to legislate for an extra-statutory concession so that it works as intended (18).

6.38 A stamp duty reserve tax charge will be introduced from Budget day to counter abuse of the stamp duty exemption for bearer securities issued in foreign currency by UK companies (19).

6.39 New measures will be introduced to counter contrived claims to double taxation relief (20).

6.40 Certain payments made under life insurance policies will be treated, with unlimited retrospection, as capital payments for the purposes of the special tax regime applicable to gains on policies of life insurance (*).

6.41 Changes will be made to clarify the rules preventing avoidance of income tax by UK residents from the transfer of assets abroad in relation to income arising on or after Budget day (*).

6.42 Employers who pay their employees in shares in their own company will, with effect from midnight on Budget day, be obliged to account for income tax under PAYE when the payment is made, unless the shares are provided under a scheme approved by the Inland Revenue. Such payments are currently treated as benefits in kind on which employees pay income tax after the end of the tax year. This measure does not apply to shares under options granted but not exercised before Budget day. Parallel measures will be applied to national insurance contributions (21).

6.43 Legislation will be introduced allowing the Department of Social Security to pass information to the Inland Revenue and Customs and Excise to assist those departments perform their duties, from Royal Assent (-).

VAT

6.44 To strengthen the tax base and combat VAT avoidance, a range of specially targeted measures will be introduced to collect VAT where and when it should properly be paid, and to protect future revenues. They will be reinforced by an extension of recently developed methods under the "spend to save" package, to control higher risk traders more effectively.

6.45 The main VAT anti-avoidance and revenue protection measures are to:

- restrict the availability of the special schemes used by retailers to account for VAT to businesses which cannot account for VAT in the normal way, from a current date as Customs discuss the issue with individual retailers; and withdraw the standard method of calculating gross takings (under which traders can delay accounting for VAT on in-house credit sales), from 1 March 1997 (25);

- counter tax avoidance by VAT groups on the purchase of international supplies, from Budget day (*);

- restrict further the option to charge VAT on supplies of property, so that it applies only to property used mainly for VATable business purposes. The measures take effect from Royal Assent, but will not affect supplies made after that date under leases executed before Budget day (27);

- tax at a 17.5 per cent rate of insurance premium tax certain insurance sold with other goods or services (for example mechanical breakdown insurance, travel insurance, and insurance sold with TV and car hire), unless bought direct from the insurer when it will be taxed at 4 per cent (see paragraph 6.69 below). The change is being made because some providers have avoided VAT by inflating the charge for the (VAT-exempt) insurance element liable to insurance premium tax. It will take effect from 1 April 1997 (42);

- prevent manipulation of the bad debt relief provisions. The main provision, for recovering input tax on supplies where no payment has been made and the supplier has lodged a claim for bad debt relief, affects supplies made after midnight on Budget day. The time at which bad debt relief can be claimed will be changed from six months from the time of supply to six months from the time payment is due, from 17December 1996. Other provisions, which drop the requirement for a transfer of title to goods before entitlement to bad debt relief and repeal legislation relating to the "old scheme" for bad debt relief, take effect from Royal Assent (26).

- counter schemes using non-EC suppliers to supply VAT-free telecommunications services to customers in the UK, from a date to be agreed by all member states (28);

- ensure that the existing zero rates for the sale of donated goods cannot be used to allow organisations who make VAT-exempt supplies to obtain items of equipment free of VAT, with effect from Budget day (*);

- specify the conditions under which charitable providers of institutional or domiciliary care or treatment will be entitled to purchase a specified range of "relevant goods" at the zero rate. This will take effect from Budget day (*);

- strengthen the rules to prevent the artificial separation of businesses to get below the VAT registration threshold, from Royal Assent (*);

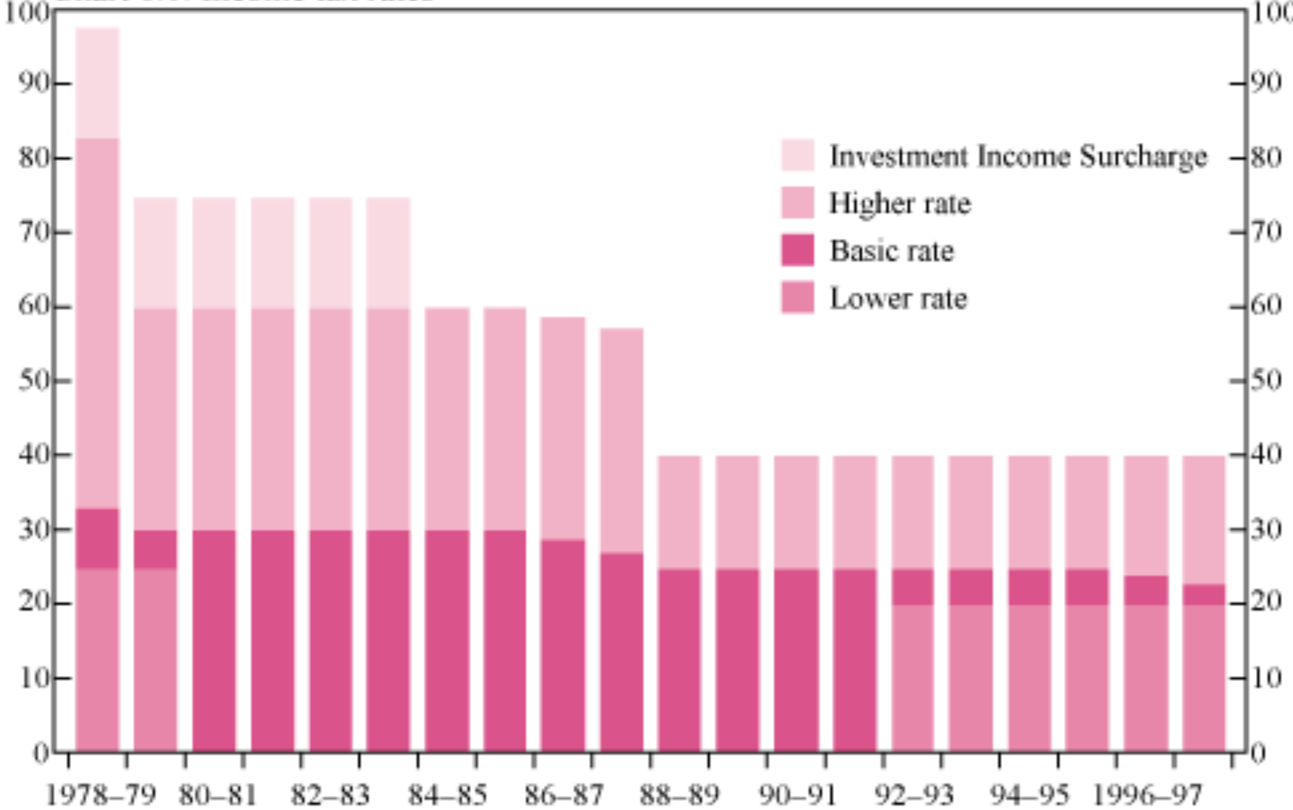
- ensure that businesses hiring out staff have to account for VAT on the salary costs of the staff, even where these are met direct by the client business, with effect from 1 April 1997. Customs will be consulting those affected with a view to allowing the present VAT treatment to continue for genuine secondments (*).

6.46 As announced on 18 July 1996 (31), a three year limit is being introduced for refunds of VAT and other indirect taxes and associated statutory interest, where appropriate. There will also be changes to the provision on "unjust enrichment" to seek to prevent windfall profits to refund recipients. The three year limit applies from 18 July 1996 for VAT, but will apply from Royal Assent for other indirect taxes. From the same dates, Customs' power to assess for underpayments of VAT and other indirect taxes is being reduced from six years' arrears to three (29).

Note:
(1) *The effect of measures on government revenues is set out in Table 6.1. Annex A explains the costings and Annex B details a number of tax measures which were announced before the Budget. The number in brackets after each proposal refers to the line in Table 6.1 where its yield or cost is shown.The Symbol* "-" *means that the proposal has no effect on revenue.* "*" *means it has negligible effects on revenue amounting to less than £3 million a year.* back

[Prepared 26 November 1996]

Chart 6.1: Income tax rates



Note: in 1996–97 and 1997–98 savings income is taxed at the lower rate for basic rate payers (as for dividends fr
1993–94).

Chart 6.2: Corporation tax rates

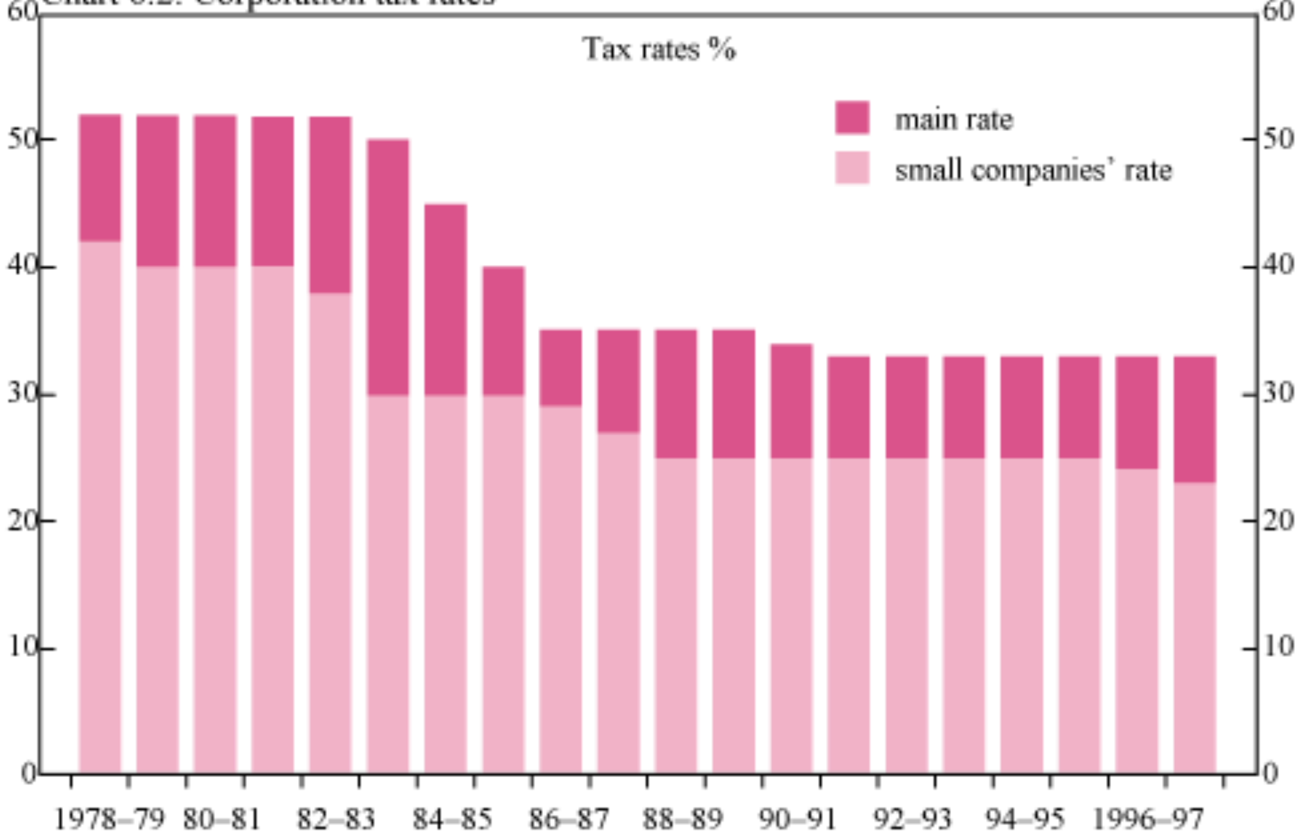
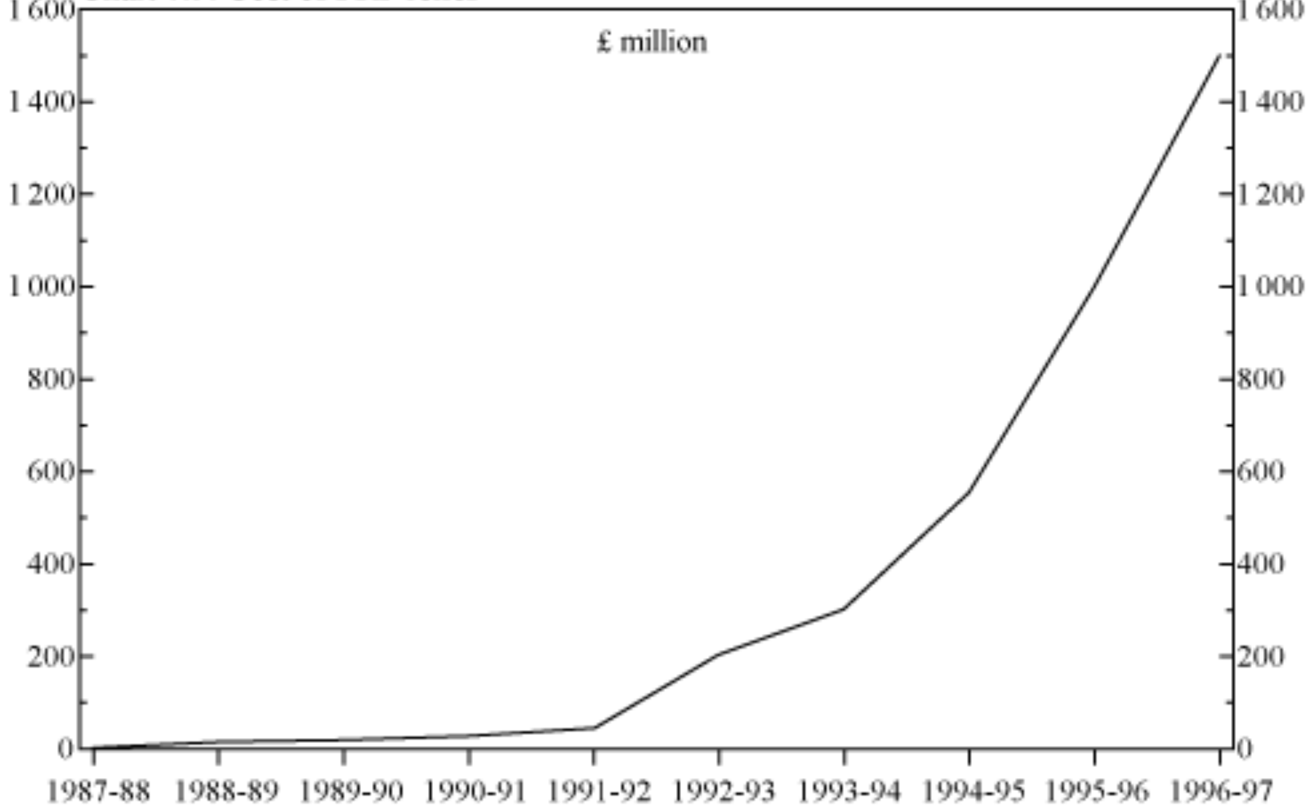


Chart 6.3: Cost of PRP relief



Back to previous text

Simplification and deregulation

6.47 In line with the Government's tax objectives and the direction of previous Budgets, this Budget includes a range of measures intended to help to simplify the tax system and to ease the administrative burdens it places on business.

Direct tax

6.48 A stamp duty exemption will be introduced for certain demutualisations of insurance businesses, subject to conditions (23).

6.49 Mergers between authorised unit trusts will be exempted from stamp duty and stamp duty reserve tax (SDRT) if they take place between Royal Assent to the Finance Bill and 30 June 1999. The stamp duty regime for repurchases of units by unit trust managers will be simplified (*).

6.50 Companies owned by charities will be allowed to make covenanted donations to the parent charity after the end of the accounting period in which the donation fell due, but still get relief in that accounting period. The new rules will apply to donations made in accounting periods beginning on or after 1April 1997 (*).

6.51 Tax relief for vocational training will be extended from 1 January 1997 to those receiving career development loans and "access funding". Administrative procedures for vocational training relief will be simplified. The extra-statutory concession exempting the benefit of employer-funded training will be modernised and enacted (22).

6.52 The requirement to deduct income tax at source from rental payments in respect of electric, telegraphic, or telephone wires or cabling (wayleave payments) will be abolished (24).

6.53 The National Savings Bank's continuing ability to pay interest on deposits without deducting tax will be ensured (-).

Indirect tax

6.54 Customs and Excise debt recovery legislation will be rationalised and consolidated. The measures will simplify the law and introduce common rules for debt recovery for all the Department's taxes, from Royal Assent (44).

6.55 Simplification and deregulatory changes to VAT will include:

- the annual turnover threshold above which traders must register for VAT will rise from £47,000 to £48,000 from midnight on Budget day, and the deregistration threshold will rise from £45,000 to £46,000. The registration and deregistration thresholds for acquisitions from other Member States will increase from £47,000 to £48,000 on 1January 1997 (30);

- consultation with business is to take place on a review of the capital goods scheme, with any consequential changes to take effect as soon as possible after the end of the consultation period (-);

- limited retrospection will be allowed for changes to the composition of VAT groups and the effects of group treatment on bodies with special status (for example, charities) will be clarified, from midnight on Budget day (32);

- statutory cover for an existing extra-statutory concession will be provided from Royal Assent, by extending the registration provisions in Schedule 1 of the VAT Act 1994 to allow businesses making specified exempt supplies to register (-);

- statutory cover for the existing extra-statutory concession, relating to the conversion of commercial property to residential dwellings, described at paragraph 6B.11, will be provided from Royal Assent (-);

- VAT law is to be amended from 1 January 1997 so that professional services performed by registered pharmacists and supplied through partnerships or limited companies will be exempt from VAT. The measure brings VAT law into line with existing practice (-);

- businesses in the payments on account scheme for large VAT payers willbe able to appeal to a VAT Tribunal if Customs refuse to allow them to pay on account the actual monthly liability instead of preset amounts calculated by Customs. This measure will take effect from shortly after Royal Assent (-);

- measures are to be introduced to revise and clarify the VAT exemption for the supply of insurance and related services, with effect from Royal Assent(-).

6.56 Changes are to be made to the structure and administrative arrangements for gaming licence duty, following consultation with the casino industry. From 1 October 1997 the duty will be renamed gaming duty and some of the requirements used in the control of casinos will be relaxed (*).

6.57 From 1 January 1997, the annual Intrastat threshold above which traders must provide Customs and Excise with detailed statistics on trade within the European Union will be increased from £160,000 to £195,000 (-).

6.58 Statutory cover will be provided for an existing extra-statutory concession, which allows certain insurance premiums charged to UK banks or financial institutions to be treated as exempt from insurance premium tax where the insurance covers the risk of non-repayment of a loan made to an overseas customer to finance a non-UK transaction. This will take effect from Royal Assent (-).

6.59 The present extra-statutory concession, which simplifies the administrative arrangements for insurance premium tax on healthcare insurance premiums deducted from employees' pay, will be extended and given legal effect. This will take effect from Royal Assent (-).

Excise duties

6.60 From Royal Assent, the assessment mechanism for excise duty provisions contained in Section 12 of the Finance Act 1994 will be extended to cover circumstances where there has been an overclaim or other form of irregularity (*).

Tobacco

6.61 The Government is committed to increasing tobacco duties each year by at least 3 per cent in real terms so as to improve the nation's health. This year it has decided to go a little further than this. Duties on most tobacco products will be increased by 5 per cent in real terms, 7.1 per cent nominal, from 6pm on Budget day. Duty on hand-rolling tobacco will be increased in line with inflation (36).

Fuel

6.62 The taxes (duty plus VAT) on petrol and diesel will rise by 3p per litre from 6pm on Budget day, in line with the Government's commitment to increase duty on average by at least 5 per cent a year in real terms (37). Duties on gas oil and fuel oil will rise by 0.17 pence and 0.13 pence per litre respectively (40).

Air quality package

6.63 In addition to continuing to meet the commitment to increase petrol and diesel duties, the Budget contains a package of measures designed to improve the environment by attacking particulate and other harmful vehicle emissions. The three elements of this package are:

- from a date to be announced, the duty on ultra low sulphur diesels which meet certain environmental standards will be reduced by 1penny per litre, so as to move towards equalisation of pump prices with conventional diesel (38);

- from 6pm on Budget day, the duty on road fuel gases (liquefied petroleum gas and compressed natural gas) will be cut by 25per cent (39);

- and a VED reduction of up to £500 for lorries which meet a low emissions standard will be introduced from early 1998, following consultation on the implementation details. This will encourage the fitting of particulate traps or conversion to gas power (47).

Alcohol

6.64 For the second Budget running, duties on beer, most wine and most cider and perry will remain unchanged (33). Duty on spirits will be reduced by 4 per cent from 6pm on Budget day (34).

6.65 From 1 January 1997 there will be an increase in the duty rates applicable to the two duty bands for coolers (wine and made wine, including "Alcopops"), of strengths not exceeding 4 per cent and 5.5 per cent alcohol by volume (abv), which will be aligned with the rates due for beer at 4.0 per cent abv and 5.5per cent abv respectively(35).

6.66 From 1 January 1997 the duty rate on sparkling wine or sparkling made-wine of strengths exceeding 5.5 per cent abv but not exceeding 8.5 per cent abv will be reduced to £195.63 per hectolitre, and the duty rate for sparkling cider and perry of similar strength will be increased to £36.45 per hectolitre (*).

Excise duty changes

	Changes in duty (per cent)	Effect on tax(1) of typical item (pence)	Unit
Alcohol			
Beer	0	0	pint
Most wines	0	0	75cl bottle
Spirits	-4	-26	70cl bottle
Most ciders and perry	0	0	pint
Tobacco			
Cigarettes	7.1(2)	15	packet of 20
Cigar	7.1	7	packet of 5
Hand-rolling tobacco	2.1	5	25g
Pipe tobacco	7.1	8	25g
Fuel			
Leaded petrol	6.5	3	litre
Unleaded petrol	7.5	3	litre
Superunleaded petrol	6.8	3	litre
Diesel(3)	7.5	3	litre
Gas oil	7.3	0.17 (exc VAT)	litre
Fuel oil	7.2	0.13 (exc VAT)	litre
AVGAS	6.5	1.5	litre
Road fuel gas	-25	-8	kg

(1) Tax refers to duty plus VAT unless otherwise stated.
(2) Specific duty up by 5.5 per cent. Rate of ad valorem duty up by one percentage point.
(3) At a date to be announced, duty on ultra low sulphur diesel will be reduced by 1 penny per litre.

Air passenger duty

6.67 The rates will be increased from £5 to £10 for flights within the UK, or from the UK to states within the European Economic Area, and from £10 to £20 for flights elsewhere, with effect from 1 November 1997 (43).

Betting, gaming and lottery

6.68 The levels of amusement machine licence duty are unchanged (*), in common with other duty rates for betting, gaming and the lottery (-).

Insurance premium tax

6.69 The insurance premium tax rate will rise from 2 1/2 per cent to 4 per cent on most general insurance from 1 April 1997

(41).

Vehicle Excise Duty (VED)

6.70 VED on private/light goods vehicles (PLG), chiefly cars, taxis and vans, will rise by £5 to £145 from 27 November 1996, broadly in line with inflation. Rates for motorcycles over 250cc will also rise by £5 to £60, while rates for other size motorcycles will be unchanged (45).

6.71 Duty on lorries will be frozen, the seventh successive Budget freeze for most rates of lorry VED (46).

6.72 A number of minor changes will be made to:

- place on a statutory basis a current extra-statutory VED exemption for disabled people undergoing long-term treatment in hospital (*);

- bring the enforcement and administration of licences for vehicles which are exempt from VED ("nil" licences) into line with licences on which duty is payable (*);

- enable enforcement of VED payments made by methods such as direct debit, in order to allow major vehicle fleet operators and others to purchase licences by direct debit via computer links (*);

- enable unlicensed vehicles to be removed without prior clamping, in certain special circumstances (for example, if they have formerly been subject to illegal removal of a clamp) (*).

Direct/indirect tax balance

6.73 The tax measures in this Budget collectively take further the Government's objective of shifting the balance of taxation from taxes on income to taxes on spending. Chart 6.4 illustrates how the balance has changed from 1978-79 to Budget projections for 1997-98.

CHART HERE

National insurance contributions

6.74 From April 1997, the main rate of employer NICs will be reduced from 10.2per cent to 10 per cent, as announced in the 1995 Budget. This Budget increases the lower earnings limit from £61 to £62 a week, in line with the single person's rate of retirement pension, and increases the upper earnings limit from £455 to £465 a week (50). The earnings thresholds for the employers' lower rate bands will remain unchanged (49). So the structure of contributions for 1997-98 will be:

Structure of national insurance contributions 1997-98

	Percentage NIC rate	
Weekly earnings	Employees	Employers
Below £62	0	0
£ 62 to £109.99		3
£110 to £154.99		5
£155 to £209.99	2% of £62 plus 10%	7
£210 to £465	of earnings between	10
Above £465	£62 and £465	10

6.75 Treasury grant not exceeding 4 per cent of contributory benefit expenditure will be made available to the National Insurance Fund in 1996-97. The Government Actuary will report on the likely effect of the changes on the Fund.

Table 6.1 Revenue effects of Budget measures

£ million yield (+)/cost (-) of measure

Changes
from
a non-

	indexed base	Changes from an indexed base		
	1997-98	1997-98	1998-99	1999-00
INLAND REVENUE				
Personal taxation				
1 Personal allowance - up by £280	-1 160	-840	-1 250	-1 300
2 Age related allowances - up by £310	-120	-80	-120	-120
3 Married couple's allowance - indexed	-50	0	0	0
4 Income limit for age related allowances - indexed	-10	0	0	0
5 Lower rate band - up by £200	-120	-60	-140	-160
6 Basic rate limit - indexed	-140	0	0	0
7 Basic rate - reduced to 23 per cent	-1 250	-1 250	-1 800	-1 800
8 Rent a room threshold increased	*	*	-5	-5
9 Car fuel scales increased	30	30	30	30
10 Changes to the rules on travel and subsistence expenses	0	0	-5	-5
Capital				
11 Inheritance tax threshold - up £10,000 over indexation	-45	-30	-55	-65
12 CGT reinvestment relief extended	-5	-5	-10	-15
Business measure				
13 Small companies' corporation tax rate cut to 23 per cent	0	0	-80	-110
Measures to secure the tax base				
14 Tax relief for profit related pay - phased out	100	100	700	1 700
15 Capital allowances - long life assets	45	45	325	675
16 Finance leasing of assets	80	80	150	150
17 Relief for drilling production oil wells	*	*	150	200
18 CGT: treatment of securities	5	5	15	20
19 SDRT bearer securities	50	50	50	50
20 Countering contrived claims to double taxation relief	*	*	50	50
21 PAYE/NICs avoidance: payment in "own company" shares	110	110	30	30
Simplification and deregulation				
22 Extension of vocational training relief	*	*	*	-5
23 Stamp duty: demutualisation of insurance companies	-10	-10	-5	-5
24 Abolition of deduction of tax at source from wayleaves	-5	-5	*	*
CUSTOMS AND EXCISE				
Value added tax: measures to secure the tax base				
25 Changes to special accounting schemes for retailers	360	360	25	25
26 Bad debt relief	120	120	175	165
27 Land and property	70	70	110	120
28 Telecommunications and similar services	10	10	10	10
Value added tax: other measures				
29 "Unjust enrichment" and statutory interest	-100	-100	-100	-100
30 Registration threshold - indexed	-15	0	0	0
31 Car fuel scales increased	20	20	25	25
32 Group treatment	-5	-5	-5	-5

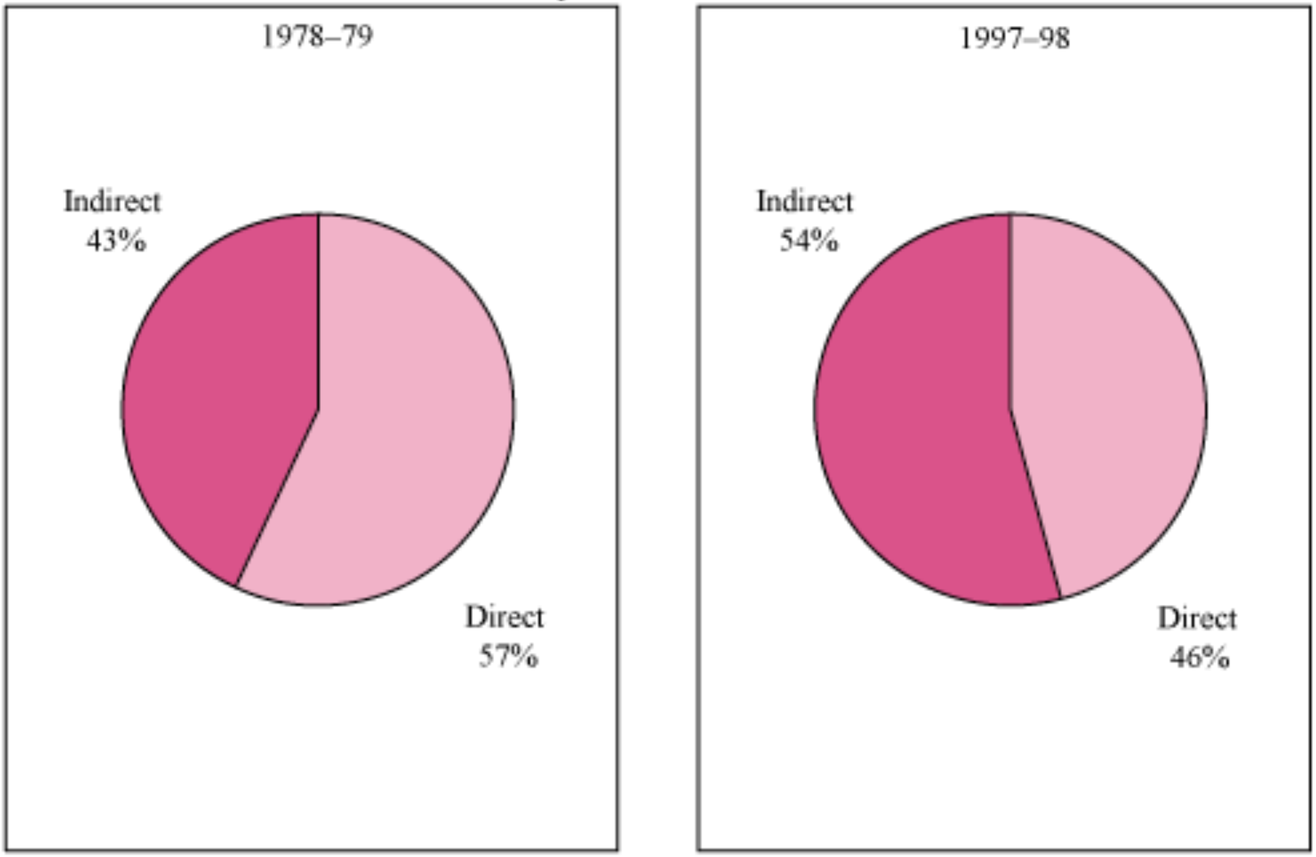
Excise duties on:				
33 Beer, most wine, cider and perry unchanged	0	-95	-100	-105
34 Spirits cut by 4 per cent	-35	-50	-50	-50
35 Coolers less than 5.5 per cent alcohol by volume - increased	5	5	10	10
36 Tobacco up by 5 per cent real, but hand-rolling tobacco indexed(1)	140	140	150	155
37 Petrol and diesel up by 3p per litre (including VAT)(1)	15	15	15	15
38 Ultra low sulphur diesel 1p differential from ordinary diesel	-15	-15	-15	-15
39 Road fuel gas cut by 25 per cent	*	*	-5	-10
40 Fuel and gas oil up by 5 per cent in real terms	20	15	15	20
Other measures				
41 Insurance premium tax from 2.5 per cent to 4 per cent	325	325	455	470
42 Insurance premium tax to 17.5 per cent on insurance sold with certain goods and services	160	160	235	260
43 Air passenger duty from £5/10 to £10/20	125	120	385	415
44 Debt recovery: rationalisation of law	5	5	0	0
VEHICLE EXCISE DUTY				
45 Car VED etc increased by £5	120	50	50	50
46 Lorry VED unchanged	0	-10	-10	-10
47 Reductions for lorries meeting low emissions	*	*	-5	-10
BUSINESS RATES				
48 Extend transitional scheme so no cash increases for small properties in 1997-98	-115	-115	-100	-80
NATIONAL INSURANCE CONTRIBUTIONS				
49 Employer NICs - freeze the three intermediate earnings thresholds	0	100	100	100
50 All other NICs thresholds - indexed	-65	*	*	*
51 Car fuel scales increased	0	0	10	10
Total	**-1 350**	**-735**	**-590**	**780**

** = Negligible.*
(1) Tax increases previously announced and at a minimum confirmed in this Budget

5 per cent real increase in road fuel duties	*1 210*	*850*	*935*	*1 030*
3 per cent real increase in tobacco duties	*400*	*235*	*245*	*260*
Total	*1 610*	*1 085*	*1 180*	*1 290*

[Prepared 26 November 1996]

Chart 6.4: Direct and indirect taxes as per cent of total tax revenue



Note: Direct includes NICs and, for 1978–79, the national insurance surcharge.

Annex A to Chapter 6 Explaining the costings

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

The general approach

6A.1 The revenue effect of a Budget measure is the difference between the tax yield from applying the pre-Budget and post-Budget tax regimes to the levels of total income and spending at factor cost expected after the Budget. The estimates do not therefore include any effect the tax changes themselves may have on overall levels of income and spending. They do however take account of other effects on behaviour where they are likely to have a significant effect on the yield, and 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, and the change in the yield of VAT and other excise duties resulting from the new pattern of spending. Where the effect of one tax change is affected by the implementation of others the measures are costed in the order in which they appear in Table 6.1.

6A.2 The non-indexed base column in Table 6.1 shows the costs of allowances, thresholds and rates of duty which applied before this Budget (including any measures, such as the real increases in fuel and tobacco duties, previously announced but not yet implemented). The indexed base columns strip out the effects of inflation by increasing the allowances, thresholds and rates of duty in line with prices in this and in future Budgets (again taking account of measures previously announced but not yet implemented). Measures announced in this Budget are assumed to be indexed in the same way in future Budgets.

6A.3 In calculating the indexed base it is assumed that each year excise duties rise in November (January for alcohol) and allowances and thresholds rise in April, in line with the assumed increase in the RPI over 12 months to the previous September. The increase in the year to September 1996 was 2.1 per cent. The commitments for real increases in fuel and tobacco duties of 5 and 3 per cent respectively are also built in. The RPI assumptions are 2 1/2 per cent, 2 per cent and 2 per cent for September 1997, 1998 and 1999 respectively.

Notes on individual Budget measures

The numbers below refer to lines in Table 6.1.

Inland Revenue taxes

The costs of the following measures in a full year, against an indexed base, are:

1	£1,140 million
2	£110 million
5	£70 million
7	£1,700 million.
3,4	The increases in allowances and limits are rounded according to statutory rules after being increased in line with the rise in the all items Retail Prices Index in the year to September 1996.
14	The yield in 2000-01 is £3,100 million.
15	The yield increases over the next 10 to 20 years. The actual amounts depend on future investment levels.
17	The yield in future years is likely to be less than £200 million per year.
18 to 21	The yields represent the estimated direct effect of the measures with the existing level of activity. Without these measures there could be a more significant loss of revenue in the future.

Customs and Excise taxes

28	Costings assume an implementation date of 1 May 1997; the effective date however depends on EC agreement on the necessary derogation.

38 Costings assume an implementation date of 15 May 1997; the effective date however depends on EC agreement on the necessary derogation.

Revenue effects in

1996-97

A number of Budget measures have non-negligible revenue effects in the current financial year, 1996-97. These are summarised below:

Measures in 1996 Budget which have non-negligible revenue effects in the current year

		£ million yield (+)/cost (-) of measure
		Changes from an indexed base
		1996-97
26	VAT: bad debt relief	30
29	VAT: "unjust enrichment" and statutory interest	-60
33	Beer, wine and cider	-15
34	Spirits	-10
36	Tobacco	30
37	Petrol and diesel	35
40	Minor oils	35
Total		**-15**

[Prepared November 1996]

Annex B to Chapter 6 Tax changes announced before the Budget

Table 6B.1 Revenue effects of measures announced since the 1995 Budget

	£ million yield (+)/cost (-) of measure			
	Changes from a non-indexed base	Changes from an indexed base		
	1997-98	1997-98	1998-99	1999-00
Inland Revenue taxes				
1 Stamp duty/SDRT relief for intermediaries	-25	-25	-50	-50
2 Capital allowances for fixtures (1)	*	*	25	50
3 Purchase of own shares and special dividends	200	200	400	400
4 Interest on late payments and tax overpaid	75	75	75	75
5 Repayment supplement - changes to the rules	-5	-5	-5	-5
Customs and Excise taxes				
6 VAT: Concession on option to tax buildings sold for residential development	-100	-100	-110	-120
7 VAT: Exemption for cultural admission charges	-5	-5	-5	-5
8 Ending VAT avoidance on fuel and power	25	25	25	25
9 VAT on vouchers and promotional schemes	-20	-20	-20	-20
Vehicle excise duty				
10 Exemption for non-business HGV's over 25 years old	*	*	*	*
Total	**150**	**150**	**325**	**340**

(1) *The yield may rise to £100 million per annum in future years.*

* = *Negligible.*

Inland Revenue taxes

6B.1 The present stamp duty and stamp duty reserve tax (SDRT) reliefs for market-makers and broker-dealers will be replaced by a relief for intermediaries, from a date to be appointed by HM Treasury (1).

6B.2 It was announced on 24 July 1996 that changes would be made to the rules for giving capital allowances on fixtures in buildings. The changes, which will apply to expenditure incurred on or after the date of announcement, limit allowances to the original cost of the fixture, prevent the acceleration of allowances and remove allowances from fixtures leased to non-taxpayers under equipment leases. Further changes will be made to simplify the operation of the rules (2).

6B.3 The payable tax credits on purchases by companies of their own shares and certain special dividends were removed for distributions made on or after 8 October 1996, to counter tax avoidance (3).

6B.4 It was announced on 11 November 1996 that the Treasury would be laying regulations in January to amend the way that interest rates on late and overpaid income and capital gains tax are calculated. The changes will result in a higher rate of interest being charged for overdue tax and a lower rate of interest being paid for tax overpaid (4).

6B.5 A supplement on repayments of overpaid income tax and CGT under self assessment will be calculated for 1996-97 and subsequent years from the date the tax was paid instead of from the later of the due date or the date of payment (5).

6B.6 On 14 November 1996, the Government announced amendments to the tax rules for corporate loan relationships to correct certain technical defects in the legislation. These measures will align the rules with Parliament's original intentions and will apply from the date of announcement (*).

6B.7 Non-stamp duty restrictions on equity lending will be removed. Legislation about stock lending and manufactured payments will be simplified (*).

6B.8 On 18 November 1996, it was announced that regulations would be made next year to extend and simplify the arrangements for paying gilt interest gross to overseas investors (*).

6B.9 On 12 July 1996, the Government announced a measure to pre-empt the use of artificial derivative transactions to turn interest-like income into capital gains (*).

6B.10 Existing rules allow a group that is selling all of its North Sea licence interests to transfer unused petroleum revenue tax (PRT) reliefs to the buyer. From 23 July 1996, claims for these reliefs made by the buyer will only be allowed if they would have been allowed on a claim by the seller. This puts beyond doubt that the existing rules cannot be manipulated. This will protect substantial amounts of PRT (-).

Customs and Excise taxes

6B.11 With effect from 12 February 1996, Customs and Excise made an extra-statutory concession allowing vendors of commercial property for conversion to residential dwellings to opt to charge VAT on the sale. This allowed them to recover any associated VAT they had incurred in connection with the property. The VAT charged on the sale of the building would normally be recoverable by the developer, so that there would be no hidden VAT reflected in the price of the dwellings when they are sold (6).

6B.12 A new exemption from VAT for admission charges to certain cultural places and events was introduced from 1 June 1996 (7).

6B.13 A measure was enacted to end VAT avoidance whereby some organisations had been able to avoid VAT on fuel and power by exploiting the zero rate for supplies of water. It took effect from midnight on 26 June 1996 (8).

6B.14 The European Court of Justice issued rulings on 24 October 1996 in two cases involving vouchers. The rulings were that businesses should only account for tax on the sum received for vouchers sold at a discount and that manufacturers should be able to reduce their output tax when making payments to retailers accepting vouchers (9).

Vehicle Excise duty

6B.15 A change to VED was enacted during the passage of the 1996 Finance Bill to extend the exemption for vehicles over 25 years old to include vehicles such as preserved steam and agricultural vehicles, preserved road rollers, ex-commercial and ex-military vehicles and fire engines (10).

Table 6B.2 Measures announced in 1995 Budget or earlier which take effect after the 1996 Budget

	£ million yield (+)/cost (-)			
	Changes from a non-indexed base	Changes from an indexed base		
	1997-98	1997-98	1998-99	1999-00
Inland Revenue taxes				
1 Gilt Strips	-540	-540	-190	-130
2 Construction industry scheme	0	0	0	300
Customs and Excise taxes				
3 5 per cent real increase in road fuel duties	1£585	1£110	2£170	3£405
4 3 per cent real increase in tobacco duties	505	295	570	865
National insurance contributions				
5 Employer NICs	-505	-505	-600	-635

Vehicle excise duty				
6 Off road notification scheme	5	5	15	20

Inland Revenue taxes

6B.16 The November 1995 Budget announced the intention to proceed with a gilt strips market and make directions to the effect that all holdings of strippable gilt issues would pay interest gross once the strips market became operational. On 13 August 1996, HM Treasury issued directions that all current and future issues of strippable gilts will pay interest gross from June 1997 (1).

6B.17 The changes to the construction industry scheme are expected to take effect no earlier than August 1999 (2).

Customs and Excise taxes

6B.18 The Chancellor said in the November 1993 Budget that road fuel duties would be increased on average by at least 5 per cent in real terms in future Budgets (3).

6B.19 The Chancellor said in the November 1993 Budget that tobacco duties would be increased on average by at least 3 per cent in real terms in future Budgets (4).

6B.20 The yields shown in lines 3 and 4 of Table 6B.2 include the effects of duty increases in future Budgets. The footnote to Table 6.1 shows only the yield from implementing the commitments in this Budget.

National insurance contributions

6B.21 The main rate of employer NICs will be reduced from 10.2 per cent to 10 per cent from April 1997, to offset the revenue from the landfill tax (5).

Vehicle Excise duty

6B.22 It was announced in the 1995 Budget that an off road notification scheme is going to be introduced for all cars, vans, tricycles and motorcycles. It has since been decided to extend this scheme to lorries as well. Keepers of vehicles will be required to notify the Driver and Vehicle Licensing Agency (DVLA) when a vehicle excise licence is not to be renewed because the vehicle is taken off the road, sold or scrapped. This will enhance DVLA's enforcement effort, reduce duty evasion and improve the vehicle record. This new system will be phased in starting in early 1997. The figures for the off road notification scheme are revised estimates, which differ from those in the Financial Statement and Budget Report 1996-97 (6).

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List of abbreviations

ACT	Advance Corporation Tax
AEF	Aggregate External Finance
AGR	Advanced Gas-cooled reactor
BCC	British Chambers of Commerce
Blue Book	UK national accounts
BNFL	British Nuclear Fuels Limited
BSE	Bovine Spongiform Encephalopathy
CAA	Civil Aviation Authority
CAP	Common Agricultural Policy
CBI	Confederation of British Industry
CGBR	Central Government Borrowing Requirement
CGBR(O)	Central Government Own Account Borrowing Requirement
CGT	Capital gains tax
CTRL	Channel Tunnel Rail Link
DBFO	Design, Build, Finance and Operate
DCS	Defence Costs Study
DFEE	Department for Education and Employment
DOE	Department of the Environment
DSS	Department of Social Security
DTI	Department of Trade and Industry
DVLA	Driver and Vehicle Licensing Agency
ECGD	Export Credits Guarantee Department
ECU	European Currency Unit
EEA	European Economic Area
EFL	External Financing Limit
ERI	Effective exchange rate index
EU	European Union
FCO	Foreign and Commonwealth Office
FE	Further Education
FSBR	Financial Statement and Budget Report
FT-SE	Financial Times All Share index
G3	Major three industrial countries comprising: US, Japan and Germany
G7	Major seven industrial countries comprising: Canada, France, Italy, Germany, Japan, UK and US
G10	Group of industrial countries comprising: Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, UK and US
GDP	Gross Domestic Product
GGE	General Government Expenditure
GGE(X)	General Government Expenditure (excluding items described in Annex A of Chapter 5)
GGR	General Government Receipts
GGBR	General Government Borrowing Requirement

GGBR(O)	General Government Own Account Borrowing Requirement
GGFD	General Government Financial Deficit
GM	Grant maintained
HGV	Heavy Goods Vehicle
IHT	Inheritance tax
IT	Information Technology
LABR	Local Authority Borrowing Requirement
LASFE	Local authority self-financed expenditure
LFS	Labour Force Survey
MIPs	Mortgage Interest Payments
MOD	Ministry of Defence
Money GDP	Gross Domestic Product at current market prices
MTFS	Medium-Term Financial Strategy
M0	Narrow measure of money stock
M4	Broad measure of money stock
NAIRU	Non-accelerating inflation rate of unemployment
NHS	National Health Service
NICs	National insurance contributions
ODA	Overseas Development Administration
OECD	Organisation for Economic Cooperation and Development
ONS	Office for National Statistics
OPS	Office of Public Service
PCBR	Public Corporations Borrowing Requirement
PCMOB	Public Corporations' Market and Overseas Borrowing
PFI	Private Finance Initiative
PH	Property Holding
PLG	Private/Light Goods Vehicle
PSA	Property Services Agency
PSBR	Public Sector Borrowing Requirement
PSFD	Public Sector Financial Deficit
PWR	Pressurised Water Reactor
RPI	Retail Prices Index
SDR	Special Drawing Right
TSS	Total Standard Spending
VAT	Value added tax
VED	Vehicle excise duty

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