BUDGET 98

New Ambitions for Britain

March 1998

The Financial Statement and Budget Report

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Financial Statement and Budget Report 1998

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The Financial Statement and Budget Report contains the Government's assessment of the medium-term economic and budgetary position. It sets out the Government's tax and spending plans, including those for public investment, in the context of its overall approach to social, economic and environmental objectives. After approval by Parliament for the purposes of Section 5 of the European Communities (Amendment) Act 1993, this report will form the basis of submissions to the European Commission under Articles 103 and 104c of the Treaty establishing the European Unity.

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1998 Budget at a glance

- The 1998 Budget, "New Ambitions for Britain", is a Budget to help turn the ambitions of the many into achievements. It is a Budget which will secure economic stability, reward work, encourage enterprise and promote fairness for families and children.
- The Budget will

  secure economic stability:

  - inflation target confirmed at 2½ per cent
  - rapid progress towards achieving fiscal rules but still need to guard against risks to avoid return to "boom and bust".
  - the Government will be legislating for a Code for Fiscal Stability

  encourage work:

  - New Deal to be extended to new groups excluded from the labour market
  - major programme of tax and benefit reform to make work pay, including new Working Families Tax Credit and restructuring of employee and employer national insurance contributions (NICs)
  - new help with costs of childcare through the tax system for lower and middle-income families, together with the other tax-benefit measure and minimum wage, will help people work their way up
  - skills training package will help to tackle skill shortages

  promote enterprise:

  - corporation tax (CT) main rate cut for larger companies to 30 per cent and small companies' CT rate cut to 20 per cent
  - small and medium sized companies will also benefit from exemption from move to quarterly payments
  - capital gains tax reforms, including new long-term effective rate of 10 per cent on business assets will, along with CT changes, encourage long-term investment and growth of dynamic firms
  - University Challenge fund to help commercially exploit university research

  create a fairer society:

  - significant boost to child benefit and childcare costs will help all families and tackle poverty
  - main personal tax rates remain unchanged
  - £500 million for health next year will cut hospital waiting lists
  - £250 million extra for skills and schools next year will help to cut class sizes and modernise buildings and equipment
  - environment package will improve air quality and reduce greenhouse gases
  - £500 million transport package over two years, including a £50 million boost to rural bus services
  - individual savings accounts, to be launched in April 1999, will extend savings habit to those on more modest incomes

- anti-avoidance package will help to ensure everyone makes a fair contribution to the tax base.

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1 Budget Overview

This is a Budget to secure economic stability, reward work, encourage enterprise and create a fairer society. This chapter provides an overview of the Budget: it sets out the short-term economic prospects and some of the key longer-term challenges facing the UK economy which underlines the necessity of the new policy agenda. It then summarises the key themes and measures that form part of the Budget strategy.

Introduction

1.01 The Budget sets new and long-term ambitions for Britain and responds to the major challenges facing the economy. It is a Budget to ensure economic stability, reward work, encourage enterprise and promote fairness:

- the Government's macroeconomic policies will secure **economic stability** based on low inflation and sound public finances;
- an extension of the New Deal programmes, radical tax and benefit reforms and a skills package will **promote employment and make work pay**;
- a package of **enterprise reforms,** including major corporation tax changes and support for small and growing businesses, underline the Government's commitment to promote a more dynamic business sector; and
- the **fairness** measures will help to support families with children, tackle child poverty, improve public services and the environment and ensure that people and companies pay a fair share of tax by tackling avoidance.

Prospects facing the incoming Government

1.02 The short-run economic prospects and the underlying structural weaknesses confronting the incoming Government in 1997 highlighted that much needed to be done to secure economic stability and respond to the challenges facing the UK economy.

Economic developments and prospects

1.03 Although growth averaged around 3 per cent a year in the current upswing, this gives a misleading picture of the underlying strength of the economy. In large part this has reflected the fact that the economy was recovering from a deep recession - the sustainable rate of growth remained lower.

1.04 By early or mid 1997 the economy had more or less exhausted its spare capacity and was growing at an unsustainable pace with emerging skill shortages and upward pressure on inflation. Urgent measures - including the steps to put in place a new monetary policy framework and a deficit reduction plan - have therefore been taken to put the economy on course to get back to a sustainable growth path.

1.05 With GDP currently judged to be above its trend level (a positive output gap), inflation is expected to rise slightly this year. GDP will need to grow at a below-trend rate for a time, generating a negative output gap, in order to get inflation back down to its target.

1.06 The degree of slowdown required will depend in part on pay trends. Responsible pay bargaining combined with the Government's Welfare to Work measures would allow the economy to grow towards the upper end of the forecast ranges set out in Table 1.1.

Table 1.1: Summary of economic forecast

Forecast

	1997	1998	1999	2000
GDP growth (per cent)	3	2 to 2 1/2	1 3/4 to 2 1/4	2 1/4 to 2 3/4
RPI ex MIPs inflation (per cent, Q4)	2 3/4	2 3/4	2 1/2	2 1/2

1.07 The forecast shows that:

- **GDP growth** slowed at the end of last year. It is slightly weaker this year, at 2 to 2 1/2 per cent, than forecast at the time of the Pre-Budget Report (PBR). The financial difficulties in Asia are forecast to reduce GDP growth by up to half a percentage point this year. Growth in 1999 is forecast to be a little stronger than in the PBR;
- **inflation** is forecast to peak at 3 per cent in the middle of the year, before falling back to its 2 1/2 per cent target by the end of 1999;
- rapid **domestic demand** growth has as yet shown little sign of slackening off, but is expected to slow through the course of this year in response to the increases in interest rates since last May and fiscal policy tightening;
- **net trade** is expected to continue to make a negative contribution to growth through this year and the first half of next, reflecting the continuing effects of sterling's appreciation and the impact of the financial difficulties in Asia. These are examined in more detail in Annex A;
- the **exchange rate** remains high: in trade-weighted terms, sterling has appreciated by around 25 per cent since August 1996. The Government is committed to delivering the sound, long-term economic policies which are essential to achieve and sustain a stable and competitive pound in the medium-term.

Longer-term challenges

1.08 The Government has taken effective steps in order to get the economy on course to achieve sustainable growth consistent with the inflation target. But more needs to be done to respond to the longer-term challenges facing the UK economy which are set out in the box below.

Key Challenges Facing the UK Economy

The UK economy faces a number of major challenges as we approach the 21st Century:

(i) **Globalisation:** continuing rapid growth in world trade - which as a proportion of output has doubled since the 1950s - potentially opens up new export markets and increases the range and quality of products for UK consumers. Government policy can help companies respond flexibly and quickly to market opportunities by:

- promoting economic stability which will provide the platform for firms to invest in new products and equipment;
- fostering an enterprise culture in which dynamic firms can grow; and
- ensuring that the workforce has flexible and up to date skills.

(ii) **"Information Revolution"**: the transformation in modern communications and the speed of information transfer can significantly improve economic efficiency and the quality of people's lives. But unless active labour market measures are pursued to raise employability and skill levels, the earnings gap between those in "high" and "low" skill jobs will widen further and an increasing number of people are likely to be excluded from the labour market altogether.

(iii) **Securing Growth and Fairness**: a failure to address fairness as part of an overall economic strategy can result in damaging long-term economic and social costs by:

- weakening the **long-run growth potential of the economy**: a divided labour market, with a high proportion of low skilled or inactive workers, can result in skill shortages, even at relatively high levels of unemployment. This can put upward pressure on inflation and reduce the long-run sustainable rate of economic growth consistent with low and stable inflation.

- distorting the pattern of **public expenditure** if a growing proportion has to be spent on mitigating the economic and social consequences of stagnation rather than on education and other programmes that can help improve the underlying trend growth rate.

- exacerbating the problems associated with **social exclusion** such as truancy, crime and drugs abuse. It can also put enormous pressures on families and children who are most likely to experience poverty. The effects can be lasting as there is a high probability that a child born into poverty will grow up as an adult in poverty.

Structural weaknesses

1.09 The scale of the challenge facing the UK economy is highlighted by the extent to which it is currently lagging behind other major industrial countries. For example, as Chart 1.1 shows, output per head is around 50 per cent higher in the US than in the UK.

CHART HERE

1.10 The output per head gap reflects a number of factors including:

- **low employment rate:** around one in four of the working-age population are either unemployed or economically inactive. Around one in five working-age households have no one in work, double the level in 1979 and higher than most other developed economies;
- **capital stock per employee** in other leading economies such as Japan, Germany and the US is at least 50 per cent higher than in the UK;
- Business enterprise **Research and Development (R&D)** fell in the UK relative to almost every other G7 country between 1981 and 1995.

Increasing inequality

1.11 It is also significant that the structural weaknesses have deepened as income inequality has grown. By the mid-1990s the UK had, along with the US, the widest disparity of the leading industrial economies between high and low incomes. The income share of the bottom 20 per cent of households fell from 9.6 per cent in 1979 to 6.3 per cent in 1994-95. By contrast, the share of the top 20 per cent increased from 35 per cent to 43 per cent. The impact has been felt hardest on families with children who make up a significant proportion of those on the lowest incomes.

The New Agenda

1.12 A radical new agenda is therefore needed to achieve the Government's declared objectives of raising the long-term sustainable growth rate, increasing employment and promoting a fairer society. It requires co-ordinated action using the full range of the Government's economic, tax and spending instruments. And it also requires an active partnership with other leading industrialised countries to maximise the long-term benefits.

July Budget

1.13 Last July's Budget laid the foundations: it mapped out the economic framework that will help deliver these goals. It set out a five year deficit reduction plan, began to reform corporation tax to promote investment and announced a New Deal to get the young and long-term unemployed into jobs. The health service and schools also received a major boost, reflecting the Government's priorities.

Response to the Pre-Budget Statement

1.14 The Chancellor's November Pre-Budget Statement signalled the key next steps on the economy, jobs, enterprise and creating a fairer society, and launched a wide-ranging consultation exercise. The debate that followed has helped to inform the Budget and shape some of the key measures, including the enterprise and savings measures, contained within it. The Pre-Budget consultation will now be a feature of all future Budgets.

A Budget for work and families

1.15 This Budget - the first full-scale Budget of the new Government - is a further major step forward. It focuses mainly on the economy and tax reform as the Comprehensive Spending Review - the results of which will be published in the summer - will map out the Government's spending priorities for the years beyond 1998-99. But the underlying principles will be common to both: to develop a long-term strategy for increasing economic growth and employment and tackling poverty and social exclusion.

Four elements of the strategy

1.16 The Budget is designed to link four key elements of the Government's economic strategy. These are highlighted below and set out in detail in the following chapters:

- securing **economic stability** based on low inflation and sound government finances for the long-term;
- **encouraging work** by extending the New Deal, making work pay, providing child care support, tackling skill shortages and promoting life-long learning;
- **promoting enterprise** through a range of tax reforms to boost investment and small firms; and
- creating a **fairer society**, now and in the future.

A Shared Agenda

The Government's economic and social vision is increasingly shared amongst other leading industrial economies. The G8 Conference on Growth, Employability and Inclusion held on 21-22 February under the UK Presidency in London agreed a statement of principles covering economic stability, enterprise and labour market measures that reflects the Government's priorities. The Chancellor will continue to use the UK's Chairmanship of the G8 and Presidency of the European Union to advocate the new agenda. Further details are set out in Chapter 3

Economic Stability (see chapter 2)

1.17 A platform of economic stability is an essential precondition for high levels of growth and employment. That is why, accompanying the reforms of the Bank of England to ensure stability in monetary policy, in this Budget, the Government brings forward a Code for Fiscal Stability whose statutory basis will be enacted in the Finance Bill. The Code sets out the requirements for a disciplined, transparent and accountable approach to managing the public finances.

1.18 The Government has also put in place tough rules for spending and borrowing:

- **the golden rule**: over the economic cycle, the Government will borrow only to invest and not to fund current spending; and
- **public debt** as a proportion of national income will be held over the economic cycle at a stable and prudent level.

1.19 The golden rule promotes a prudent and long-term approach to current spending and helps to promote fairness between generations because it means that the cost of public investment is met by those who benefit from that investment. The debt rule will ensure that fiscal policy is run in a responsible way and does not threaten the stability of the economy. **1.20** The Budget also demonstrates that the Government remains well on course to meet the rules on borrowing and spending which will help ensure the long-term stability that Britain needs. Progress towards these rules has been more rapid than expected. The current balance, which has been substantially in deficit since 1991-92, is expected to be close to balance in 1997-98, and the debt burden, which increased over the first half of the 1990s, is now falling, as it should at this stage of the economic cycle.

1.21 Table 1.2 shows the effects on the PSBR forecast of Budget measures and other changes. As a result of the Government's disciplined approach, public spending has been lower than expected in 1997-98, while tax receipts, particularly from self-assessment, have also been higher than expected. The underspend on the Control Total will allow higher spending in 1998-99, but the higher level of tax receipts is projected to carry through only partly to later years. More information on the public finances can be found in AnnexB.

Table 1.2: Fiscal Aggregates and changes to the PSBR forecast(1)

billion

	1997-98	1998-99	1999-00(3)	2000-01(3)
PSBR in 1997 Budget	**13.3**	**5.4**	**1.4**	**-4.4**
Effects of 1998 Budget measures		-0.2	-0.9	-1.2
Effect of forecasting changes	-8.3	-1.3	1.2	2.7
PSBR in 1998 Budget	**5.0**	**3.9**	**1.7**	**-2.9**
GGFD(2)	**8.2**	**3.0**	**-0.5**	**-4.9**
Current balance	**-1.3**	**3.6**	**8.0**	**12.6**

1 The PSBR, GGFD and current balance exclude windfall tax and associated spending.

2 General government financial deficit on UK National Accounts definitions.

3 Figures are based on illustrative case in which Control Total grows at 2 1/4 per cent in real terms after 1998-99.

1.22 Firm control of public spending is a key requirement for economic stability. In the short term, the Government has committed itself to work within existing spending ceilings for the first two years of the Parliament.

1.23 This has made it possible to undertake a Comprehensive Spending Review (CSR) which will lead to prudent and sustainable plans for the medium-term. The CSR obliges every department to review its spending, to improve efficiency and effectiveness and to reallocate resources towards the Government's priorities. The Budget includes some early outputs from this process, with additional money allocated to spending priorities including health, education and transport in 1998-99.

1.24 This has been made possible by the success of the Government's spending discipline in its first year in office. Thanks to prudent control of spending in 1997-98, calls on the Reserve have been smaller than anticipated, releasing 1.5 billion of extra resources which can be carried forward to 1998-99. A part of these extra resources has been allocated to spending priorities, and a part retained in the Reserve to deal with unforeseen needs. The full results of the CSR, including spending plans for years after 1998-99, will be announced this summer.

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2 Economic Stability

This chapter sets out how the Government is developing the macroeconomic policy framework to create economic stability, based on low inflation and sound public finances.

The key points are:

- the inflation target is confirmed as 2 1/2 per cent;
- progress towards achieving the fiscal rules has been more rapid than expected at the time of the July 1997 Budget;
- uncertainties, not least over the cyclical position of the economy, demand that the Government continues to adopt a prudent and cautious approach to fiscal policy; and
- the Government is giving the Code for Fiscal Stability a statutory basis to improve the conduct of fiscal and debt management policy and the management of the public finances.

Introduction

2.01 Economic stability is vital if the Government is to achieve its central objective of high and stable levels of growth and employment. Instability in the recent past has contributed to the UK's poor growth performance, not least by holding back the long-term investment that is the foundation for a successful economy.

2.02 Although it cannot insulate the UK from the effects of world events, such as the financial difficulties in Asia, the Government has a crucial role to play in creating a stable macroeconomic environment. High and volatile inflation, or unsustainable public finances, discourage investment directly by raising long-term interest rates, as well as indirectly by making it difficult to plan for the future.

2.03 Repeated cycles of boom and bust have been particularly damaging to the UK's long-term economic performance. Recessions lead to premature scrapping of productive capacity and increase both short-term and long-term unemployment. Reversing these effects can be a long and costly process: the economy is still suffering from the adverse effects of the deep recessions of the early 1980s and early 1990s.

2.04 Similarly, booms channel too many resources into speculative activities and not enough into others, hampering economic progress. The fleeting gains that such episodes bring are invariably far outweighed by the pain of the downturn that must follow. The box below explains how inflation damages economic growth. High inflation is also unfair, not least in the way that it arbitrarily redistributes income and wealth.

2.05 Low inflation and sound public finances are both essential building blocks for long-term growth. The new monetary policy arrangements, giving the Bank of England responsibility for setting interest rates to achieve the Government's inflation target, have put monetary policy on a credible long-term footing and have given greater assurance that low inflation will be sustained. The Government is also taking steps to strengthen the fiscal framework further, in particular by giving the Code for Fiscal Stability a statutory basis, to ensure that fiscal policy, too, fosters stability and is always set in the UK's long-term interests.

2.06 The Government has an essential part to play in promoting economic stability. However, it cannot do so on its own. Lasting results depend on government, business and individuals working together. For the immediate future, the outcome of wage bargaining will affect the extent to which growth will need to slow in order to meet the inflation target. If wage increases rise above sustainable levels, interest rates will need to be higher than they would otherwise have been, with an inevitable impact on growth and employment. In its latest Inflation Report, the Monetary Policy Committee (MPC) of the Bank of England noted that wage increases higher than 4 1/2 per cent a year could not be sustained in the long run without domestically-generated inflation rising above 2 1/2 per cent.

Inflation and economic growth

Inflation - whether or not it is anticipated - and uncertainty over inflation distort the allocation of resources, which is likely to reduce economic growth. Through its effects on technical change, including the role of investment and research and development, inflation has a significant impact on both the long-run sustainable rate of growth and the path along which an economy approaches it.

Two broad channels of influence can be identified:

- **Efficiency:** High inflation means frequent price changes. These distort the information conveyed by prices and increase the difficulty of entering into long-term contracts. Frequent price changes force people to devote more time and resources to collecting information, and increase the costs of sellers who have to implement those changes. High inflation also distorts people's savings and asset holdings, hindering a reliable supply of investment funds.

- **Investment:** Uncertainty associated with high and volatile inflation may discourage both investment and research and development by reducing the expected rate of return, or by raising the risk premium that firms have to bear. Even fully-anticipated inflation may lower the rate of return on investment, given the non-neutralities that are a feature of most countries' tax systems.

In practice, high inflation also tends to be associated with volatile inflation, so it can be difficult to distinguish the precise influences of these two aspects.

Monetary Stability

The inflation target

2.07 The Government's inflation target, as defined by the 12-month increase in the Retail Prices Index excluding mortgage interest payments (RPI ex MIPs), is confirmed as 2 1/2 per cent. Last May, the Bank of England was given responsibility for setting interest rates to meet the inflation target. The monetary framework is currently being given a statutory basis under the Bank of England Bill, which is expected to receive Royal Assent later in the Spring. The Government will monitor the target and the measure of inflation in the light of the practices of the European Central Bank, and the ability of the British economy to sustain growth with low inflation.

2.08 The inflation target is 2 1/2 per cent at all times: that is the rate which the MPC is required to achieve and for which it is accountable. The effectiveness of the target will depend on the seriousness with which breaches of the target are treated. Temporary deviations from target may occur as a result of unforeseen developments which affect the price level. If such deviations do occur, the onus is on the MPC to justify its actions. In any case, if inflation is more than 1 percentage point higher or lower than the target, an open letter will be sent by the Governor to the Chancellor so that the public is fully informed as to:

- why the divergence has occurred;
- the policy action being taken to deal with it;
- the period within which inflation is expected to return to the target; and
- how this approach meets the Government's monetary policy objectives.

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2.09 RPI ex MIPs inflation since last May has ranged between 2.5 and 3 per cent, averaging 2.7 per cent. This compares with a post-war average inflation rate of around 6percent. While recent inflation has been low by the standards of the 1970s and 1980s, and has not diverged from target sufficiently to trigger an open letter, it has so far been above the target rate most months. The effort and vigilance required to maintain low inflation should not be underestimated.

Performance against the inflation target

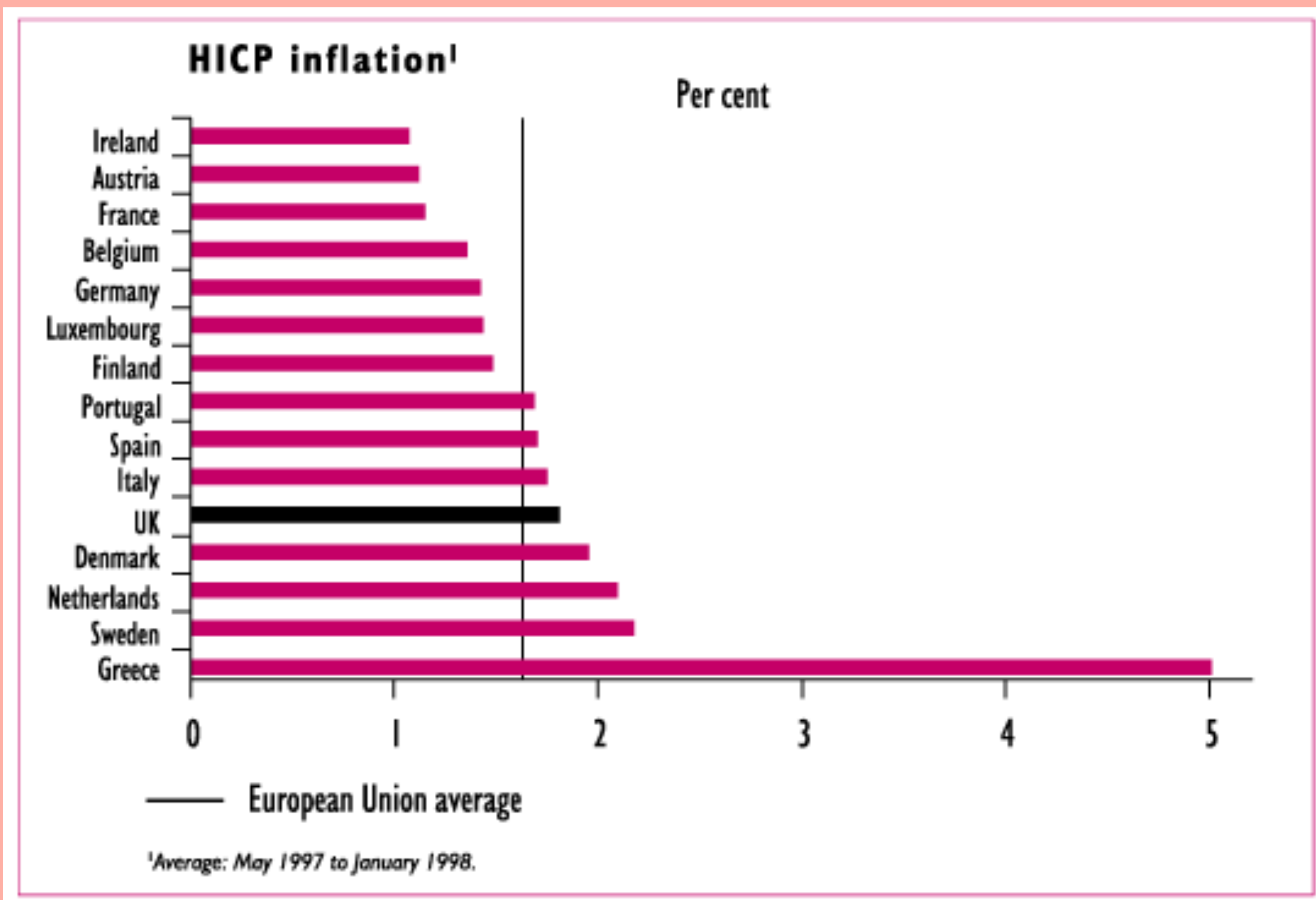
2.10 Monetary policy affects inflation with a lag. The new monetary policy framework has been in place since only last May, so the actions taken by the MPC will not yet have had their full effect on inflation.

2.11 Inflation was higher than the target throughout most of 1997, despite downward pressure from the effects of exchange rate appreciation. The present Government came into office at a time of increasing inflationary pressure, which required higher interest rates to prevent a sharp rise in inflation over the next two years. Since May, official short-term interest rates have been raised by 1/4 point on five occasions, from 6 per cent to 7 1/4 per cent.

2.12 In January 1998, inflation fell back to the 2 1/2 per cent target rate, although it is expected to pick up a little over the next few months of the year. In its latest Inflation Report, the MPC said that "monetary policy is more finely balanced than at any point since the inflation target was introduced in 1992". Upside risks to inflation were noted from higher earnings growth and the tightening in the labour market, and downside risks from the expected slower growth in the economy, and in particular, developments in Asia.

HICP inflation

The UK Harmonised Index of Consumer Prices (HICP) is a relatively new measure of inflation, prepared according to internationally agreed criteria in order to provide a more consistent way of comparing inflation across countries within the European Union. The HICP is designed specifically for cross-country comparisons and has narrower coverage than the RPI, which remains the best measure of UK inflation. HICP inflation in the UK was 1.5 per cent in January and has averaged 1.8 per cent since last May. This compares with the average of 1.6 per cent for the European Union as a whole since May.



Inflation expectations

2.13 Inflation expectations, measured on a variety of bases, have fallen since the new monetary framework was introduced. Chart 2.2 shows some measures of inflation expectations immediately before the announcement of the new monetary framework and now. This fall has contributed to lower long-term interest rates, as shown in Chart2.3, which are currently at their lowest level for over 30 years. It also supports the view that the new arrangements have enhanced the credibility of monetary policy.

2.14 It is natural that inflationary expectations should fall in this way, given the rigour and transparency of the new monetary arrangements. In time, the sure expectation that inflation will average 2 1/2 per cent over a long period will give a firm basis for far-sighted wage bargaining and price-setting decisions. Such a long-term anchor is a tangible example of the benefits that flow from, and arrangements that deliver, monetary stability.

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Fiscal Stability

The principles of fiscal policy

2.15 Five important principles lie at the heart of the Government's fiscal policy framework:

- **transparency** in the setting of fiscal policy objectives, the implementation of fiscal policy and in the presentation of the public accounts;
- **stability** in the fiscal policy-making process and in the way fiscal policy impacts on the economy;
- **responsibility** in the management of the public finances;
- **fairness**, including between generations; and
- **efficiency** in the design and implementation of fiscal policy and in managing both sides of the public sector balance sheet.

2.16 These principles are fundamental to a commonsense approach to fiscal management. They are reaffirmed in the Code for Fiscal Stability, which the Government is now taking steps to give a statutory basis in the Finance Bill. The Code sets out the requirements for an open, transparent and accountable approach to managing the public finances, which will ensure that fiscal policy is set in the UK's long-term interests.

The fiscal rules

2.17 Fiscal policy is based on the two fiscal rules announced in the July 1997 Budget:

- the **golden rule:** over the economic cycle, the Government will borrow only to invest and not to fund current spending; and
- **public debt** as a proportion of national income will be held over the economic cycle at a **stable and prudent level**.

2.18 These rules mean that fiscal policy will operate in a way that is consistent with the principles of fiscal policy. The golden rule promotes stability and responsibility in current spending and taxation. It also promotes fairness between generations because it means that the cost of public investment is met by those who benefit from that investment. A stable and prudent debt ratio will ensure that fiscal policy is run in a responsible way and does not threaten the stability of the economy.

The Code for Fiscal Stability

2.19 In the Pre-Budget Report, the Government proposed to implement a Code for Fiscal Stability to improve the conduct of fiscal policy and the management of the public finances. The Code would establish a framework for fiscal policy with the same emphasis on openness and credibility as the new monetary policy framework. In particular, the Code would require the Government to commit to:

- a set of commonsense principles of fiscal management (set out in paragraph2.15 above);
- more transparent fiscal reporting; and
- use of best practice accounting methods.

2.20 The Government has decided to proceed as planned and will give the Code a statutory basis in the forthcoming Finance Bill. Legislation demonstrates the strength of the Government's commitment to maintaining and strengthening the credibility of its economic policies. It will make policy more transparent and governments readily answerable for any departure from the

Code.

2.21 In addition to the broad proposals discussed in the Pre-Budget Report, it is now intended to cover aspects of debt management policy in the Code. The key elements of the Code are outlined in the box below. Separately, the International Monetary Fund is preparing, at the suggestion of the UK Government, a Code of Good Fiscal Practice which is likely to cover similar ground as the UK Code for Fiscal Stability.

The Code for Fiscal Stability - key provisions

Under the Code, the Government will undertake the following commitments. It will:

- conduct fiscal and debt management policy in accordance with a specific set of principles;
- state explicitly its fiscal policy objectives and operating rules, and justify any changes to them;
- operate debt management policy to achieve a specific primary objective;
- disclose, and quantify where possible, all decisions and circumstances which may have a material impact on the economic and fiscal outlook;
- ensure that best-practice accounting methods are used to construct the public accounts;
- publish a Pre-Budget Report to encourage debate on the proposals under consideration for the Budget;
- publish a Financial Statement and Budget Report to discuss the key Budget decisions and the short-term economic and fiscal outlook;
- publish an Economic and Fiscal Strategy Report outlining the Government's long-term goals and strategy for the future;
- publish a specific range of information from its economic and fiscal projections, including estimates of the cyclically-adjusted fiscal position;
- invite the National Audit Office (NAO) to audit changes in the key assumptions and conventions underpinning the fiscal projections;
- produce a Debt Management Report outlining the Government's debt management plans;
- refer all reports issued under the Code to the House of Commons Treasury Committee; and
- ensure the public have full access to the reports issued under the Code.

The fiscal stance

2.22 Progress towards reducing the public sector deficit and meeting the Government's fiscal rules has been more rapid than expected at the time of the July Budget. The current balance is estimated to have been close to balance in 1997-98, following many years of deficit. The debt burden is now falling, as it should at this stage of the economic cycle, after rising very sharply over the first half of the 1990s. Table 2.1 summarises the new public finances forecast, which is described in detail in Annex B.

Table 2.1: The public finances

	per cent of GDP						
	Outturn	**Forecast**		**Projections**(1)			
	1996-97	**1997-98**	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**2002-03**
Current balance(2)	-2 3/4	- 1/4	1/2	1 to 1 1/2	1 1/2 to 2 1/4	2 to 3 1/4	2 to 4 1/4
GGFD(2),(3)	3 3/4	1	1/4	- 1/2 to 0	-1 1/2 to - 1/2	-2 1/2 to -1	-3 1/4 to -1 1/4

PSBR(2)	3	3/4	1/2	- 1/4 to 1/4	-1 1/4 to - 1/4	-2 1/4 to - 3/4	-3 1/4 to -1
Net public sector debt(4)	45	43 1/2	42	40 to 41	37 to 39	34 to 37	29 to 34
General government gross debt(4),(5)	54 1/4	52	50 1/2	49	46 to 47	42 to 44	37 to 42

1 Based on three illustrative assumptions for spending growth (see Annex B).

2 Excluding windfall tax receipts and associated spending.

3 UK National Accounts definition.

4 Figures from 1999-2000 rounded to nearest per cent.

5 Defined on a Maastricht basis.

2.23 The PSBR in 1997-98 is expected to be about 8 1/4 billion lower than forecast in the July 1997 Budget. However, downward revisions to the PSBR forecast in subsequent years are much less. While some factors, such as higher than expected tax receipts, are expected to reduce borrowing in future years, several of the factors reducing the PSBR this year are expected to be temporary:

- lower than expected general government spending, mostly due to the estimated 1 1/2 billion underspend on the Control Total;
- public corporations surplus 1 1/4 billion larger than forecast in July;
- non-tax receipts in 1997-98 estimated to be about 1 1/2 billion higher than the 1997 Budget forecast (after adjusting for a change in the accounting treatment of the proceeds from the sale of the student loan book, which increases both receipts and spending by about 1/2 billion).

Table 2.2: Budget deficits(1)

	billion		
	Outturn	**Forecast**	
	1996-97	**1997-98**	**1998-99**
Current balance	**-20.2**	**-1.3**	**3.6**
GGFD(2)	28.3	8.2	3.0
PSBR	22.7	5.0	3.9

1 Excluding windfall tax receipts and associated spending.

2 UK National Accounts definition.

2.24 The faster than expected fall in government borrowing has brought forward part of the ongoing tightening of fiscal policy that was implied by previous forecasts. The PSBR in 1997-98 is estimated to have fallen 17 3/4 billion from the previous year, excluding windfall tax receipts and associated spending, compared with the July 1997 forecast of a 9 1/2 billion fall. Notwithstanding the temporary nature of some of the factors that have reduced the PSBR this year, budget deficits are forecast to fall further in 1998-99, and to a lower level than was expected last July.

The need for caution

2.25 The deficit reduction plan set out in the July 1997 Budget showed how the Government has set policy to meet its two fiscal rules over the economic cycle. A key feature of the Government's responsible approach to fiscal policy is to make allowance for the extent of uncertainty over the medium-term outlook for the public finances. Even now, it would only take a relatively modest misreading of the cyclical position of the economy to make achievement of the fiscal rules considerably less certain. This was why the July Budget showed progress in meeting the fiscal rules against both a central and a cautious assessment of the output gap.

2.26 Experience has shown (1) how quickly an apparently sound position can deteriorate into an unsustainable one, unless caution is exercised in setting fiscal policy; and that the costs of reversing a deteriorating fiscal position can be large.

Governments have found it much easier to reduce taxes or increase public spending than to do the reverse. Moreover, uncertainty about the underlying fiscal position means that it can take time to recognise fully the extent of any deterioration.

Progress against the fiscal rules

2.27 The Pre-Budget Report set out how the Government intends to assess progress against its fiscal rules. Both rules are to be applied over the economic cycle, with 1997-98 representing the starting point of the cycle as the economy is thought to have been close to its sustainable level in that year. Taking the two rules in turn:

- the **current balance,** shown in Chart 2.4, is forecast to be close to balance in 1997-98, and to move into surplus in 1998-99 and over the medium term on all three illustrative projections for public spending - thus meeting the golden rule, by avoiding a deficit on average over the economic cycle;

- both measures of the **debt ratio** - net public sector debt and general government gross debt - are forecast to fall over the forecast period, as would be appropriate at this stage of the economic cycle, on all three projections for public spending, as shown in Chart 2.5.

2.28 In the Pre-Budget Report, the Government also signalled its interest in public sector balance sheet data and public sector net wealth. Although net wealth is not at this stage being given a formal role in the fiscal framework, meeting the golden rule over the economic cycle should halt the sharp decline in the ratio of public sector net wealth to GDP that has occurred since 1988. The projections shown in Chart 2.5 show some modest recovery in the net wealth ratio, albeit from low levels in comparison with the 1970s and most of the 1980s.

CHART HERE

CHART HERE

Public finances - adjusting for the economic cycle

The economic cycle is one of the most important short-term influences on the UK public finances. The high growth phase of the cycle is usually characterised by higher tax receipts and falls in spending on social security, principally through unemployment-related benefits. Conversely, the low part of the cycle is marked by lower tax receipts and higher social security spending. These effects help to stabilise the economy, for instance by putting more money into the economy when demand is weak, although their overall effect may not be particularly powerful. The benefits from these "automatic stabilisers" are one of the reasons why the Government has set its fiscal rules over the economic cycle.

Cyclical fluctuations in the public finances, however, can make it more difficult to distinguish underlying trends. Looking only at the headline measures of the public finances can give a seriously misleading picture: for instance, present estimates suggest that virtually all of the PSBR surplus in the late 1980s was due to the effects of the cycle. Since July, the Government has published its key measures of government borrowing adjusted for the effects of the cycle. These are based on Treasury work, published in September 1995, that suggested that a one per cent increase in output relative to trend would reduce the PSBR by around 1/4 per cent of GDP in the first year, and around 3/4 per cent of GDP in the second and subsequent years.

Both these estimates and the assessment of the cyclical position of the economy are, of course, subject to a margin of error. Nevertheless, work by the OECD and other independent commentators has produced similar estimates. Moreover, it is much better to make an assessment of the contribution of the cycle to the fiscal position, and to publish that assessment for others to see and to comment on, than to base policy on unadjusted and potentially misleading figures.

Taking uncertainty into account

2.29 In assessing progress against the fiscal rules, it is essential to take into account both the effect of the economic cycle and the extent of uncertainty surrounding the medium-term economic and fiscal outlook. Measures of the current balance and the PSBR adjusted for the effect of the economic cycle are shown in Charts 2.4 and 2.6. These provide a useful way of illustrating the effect of uncertainty over the cyclical position of the economy, but they do not take account of other potential forecast errors, such as errors in revenue projections for given levels of GDP.

2.30 Cyclically-adjusted measures have been calculated on two bases. The first is based on the assessment that output was approximately on trend in the first half of 1997. Chart 2.6 shows that the Government inherited a structural deficit, that had been 2 1/4 per cent of GDP in 1996-97. This case is consistent with a reasonable assessment of the evidence, but one that is far from certain. The second case assumes that output is 1 1/2 per cent further above trend, which would be pessimistic but well within the possible range. On this cautious case, the margin of error in meeting the golden rule would be small. Moreover, achievement of the fiscal rules is dependent on the rising tax burden over the medium term that would result from the effects of real fiscal drag and overindexation of fuel and tobacco duties.

2.31 The projections in Charts 2.4 and 2.6 show that, on both the central and the cautious assessment of the cyclical position, the Government is on track to meet its fiscal rules over the forecast period. However, experience of the late 1980s and early 1990s shows how quickly the fiscal position can deteriorate and underlines the need for continued caution in setting fiscal policy.

CHART HERE

Stability in public spending

2.32 A key aspect of the Government's approach to economic stability is maintaining firm control of public expenditure. This involves both planning spending for the medium-term, which is the purpose of the Comprehensive Spending Review (CSR), and continuing discipline in the short term, which is provided by the commitment to work within existing spending ceilings for the first two years of the Parliament.

2.33 This summer, the CSR will produce spending plans for the years beyond 1998-99, following a rigorous scrutiny of all spending programmes. These plans will channel expenditure to the Government's priorities, while abiding by the two fiscal rules and the principles set out in the Code for Fiscal Stability. In this Budget, as in July 1997, projections of spending for 1999-2000 and beyond are based on three illustrative paths for spending, pending the conclusion of the CSR.

2.34 Some of the emerging conclusions from the CSR are reflected in those Budget measures that reallocate money to particular priorities for 1998-99. The main measures include:

- an additional 500 million for the Health Service;
- an additional 250 million for education; and
- 500 million for public transport over the next two years.

2.35 These reallocations for 1998-99 are made possible by the prudent financial discipline exerted in 1997-98, which has released resources for the Government's priorities within the overall ceilings for the two years. The 1 1/2 billion estimated underspend for 1997-98 is being carried forward into 1998-99. Of this, 500 million has been allocated to the Reserve and the remainder used to fund spending on the key priorities outlined above.

Fiscal policy and Europe

2.36 The estimated outturn for the general government financial deficit - the deficit measure used in assessing the Maastricht criteria - was 1 3/4 per cent of GDP for 1997, well below the 3 per cent reference value and lower than the other major European countries. The Maastricht debt measure - general government gross debt - is estimated to have been 53 1/2 per cent of GDP at the end of 1997. This is, again, well below the reference value of 60 per cent and is the second lowest debt ratio in the European Union.

2.37 As well as meeting the Maastricht convergence criteria, the fiscal prospect continues to be consistent with the terms of the European Union Stability and Growth Pact.

Economic stability and EMU

The single currency - the euro - will be launched on 1 January 1999. The UK Presidency of the European Union in the first half of 1998 will see the key decisions taken on which countries will join.

A successful single currency will bring benefits to the UK and other countries. It will build on existing achievements by helping to deliver macroeconomic stability through an entrenched commitment to low inflation and sound public finances. At the microeconomic level, Economic and Monetary Union (EMU) will reduce transactions costs and remove exchange rate uncertainty. Price transparency will benefit consumers and firms, increase competitiveness and open up new opportunities for trade and investment.

The Government believes that British membership of a successful single currency would benefit Britain. Provided the economic benefits are clear and unambiguous, Britain should join. At present, there is not sufficient convergence to be sure that the British economy can have stability and prosperity in EMU. The Government has therefore notified our European partners that Britain will not be joining in 1999.

In order to have a genuine choice in the future, Britain needs to prepare now, so that there is a real option of making a decision early in the next Parliament to join, should the Government, Parliament and people decide to do so. The macroeconomic framework will play a critical role in delivering the period of stability and convergence that is necessary before we are ready to join. In addition, the Government is informing business of the preparations it needs to make for the launch of the euro in 1999, and has established a Standing Committee on preparations for EMU to advise on the strategic and practical implications.

The introduction of the single currency in 1999 will affect Britain, whether we are in or out. It is in Britain's economic interest to ensure that the single currency is successful. We are therefore working with other Member States during our Presidency to ensure that EMU goes ahead on a sustainable basis. In particular, the Government is promoting a deeper discussion of economic reform ideas, backed by properly thought out action plans for Member States to deliver.

Economic reform is essential if Europe is to realise the full potential of EMU. To deliver higher levels of job creation and investment, sustainable convergence between economies must be coupled with the ability to respond more flexibly to changes in economic circumstances.

The Government is committed to such reform, which will assist in delivering the stability needed to prepare the British economy for EMU membership and help to ensure that its citizens receive the fruits of open and competitive markets. The Government is promoting greater flexibility in the British economy to contribute towards its objective of high and stable levels of employment and to ensure that we could live comfortably in EMU.

The UK is already doing much to make its markets more flexible. The Government is offering new opportunities for education, work and training for the unemployed and a new approach to tax and welfare to make work pay; promoting decent minimum standards without imposing unnecessary rules on business; and working to ensure fair and open competition in goods and services markets. To boost entrepreneurship, the Government will be working to improve access to finance and reduce barriers to the movement of capital in Europe.

Developing the fiscal policy framework

2.38 Resource Accounting and Budgeting (RAB) will bring the financial reporting of central government closer to the practices of both the private sector and much of the rest of the public sector. RAB will underpin the golden rule by making a clear structural distinction between current and capital spending, and by capturing the full costs of resources consumed during the reporting period.

2.39 Government departments are on course to produce the first full set of published resource accounts for the financial year 1999-2000. Making use of that information, resource budgeting - planning and controlling public expenditure on a resource accounting basis - will be fully implemented for the financial year 2001-02.

2.40 Following the publication of the National Asset Register in November 1997, the Government is encouraging departments and other bodies to review their asset holdings and make better use of the assets that they retain. From April 1998 until the new resource budgeting arrangements are in place, the Treasury will allow government departments to reinvest all receipts from the disposal of assets in new capital spending, subject only to certain limits necessary to ensure that these sales do not distort the Government's overall spending allocation.

2.41 Separately, the Treasury is carrying out a scoping study, jointly with the National Audit Office and other relevant bodies, into the merits and feasibility of producing whole of government accounts. The study, which should report preliminary conclusions in the summer, will consider the possible benefits of whole of government accounts and set out what further action would be required for their production.

2.42 The Government is looking at ways of developing the usefulness of the public sector balance sheet, which it believes contains valuable information for fiscal policymaking. The advent of Resource Accounting and Budgeting presents a major opportunity in this respect. The Treasury is working, with the Office for National Statistics, on how best to use the information from RAB and whole of government accounts to improve the quality of data for public sector balance sheets.

2.43 The Treasury is also working with the National Institute for Economic and Social Research and the Bank of England on a project to construct generational accounts for the UK. Generational accounting provides a framework for comparing the net burden of tax and transfer payments faced by current and future generations. Similar work in other countries has highlighted the extent to which future trends in the public finances, for instance the effect of ageing populations on pensions, might impact on future generations.

2.44 These developments will take time to implement and to have their full effect. Nevertheless, they offer the prospect of further strengthening the basis for making fiscal policy decisions. Moreover, the Government's reforms to the macroeconomic policy framework need to be complemented by reforms elsewhere, to encourage work and enterprise and to lay the foundations for a dynamic and flexible economy.

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(1) *See the discussion paper, "Fiscal policy: lessons from the last economic cycle", published in November 1997 and available from the Treasury's Public Enquiry Unit*. [back]

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comments

3 Encouraging Work

This chapter describes the Government's strategy to expand employment opportunities and make work pay. It describes the further expansion of the Welfare to Work initiative. It also sets out details of the reforms to taxes and benefits. The Government will introduce a new Working Families Tax Credit, reform national insurance contributions and tackle skill shortages. The main measures described in this chapter are as follows:

Extending Welfare to Work

The New Deal programme will be extended, with additional measures to provide help to:

- young people;
- lone parents;
- the long-term unemployed;
- partners of the unemployed;
- disabled people; and
- disadvantaged communities.

New linking rules will enable lone parents and disabled people to take a job knowing their benefit will not be put at risk if the job turns out to be short-term.

Making work pay

A 1.4 billion reform of national insurance contributions - the most significant changes for over 20 years - will improve work incentives and make it more attractive to employ people moving from welfare to work.

A new Working Families Tax Credit (WFTC) will replace Family Credit.

A childcare tax credit within the WFTC will improve help with childcare costs.

Disabled Person's Tax Credit will replace Disability Working Allowance.

Benefit rules can sometimes make people worse off when they earn more. Changes will be made to reform these.

Investing in skills

Additional expenditure will tackle the problem of structural skill shortages.

Introduction

3.01 In its first Budget, and in the Pre-Budget Report, the Government set out a new agenda to ensure high and stable levels of employment, and to promote new employment opportunities for those previously denied them. It also asked Martin Taylor, Chief Executive of Barclays, to lead a Taskforce with a view to reforming the tax and benefit systems, in order to improve work incentives, reduce poverty and welfare dependency, and strengthen community and family life. A new approach is needed for the 21st Century, reflecting changes in the labour market, in society and in the global economy. People need to have the skills to adapt to these changing circumstances, through a framework that rewards and encourages work. And, once in work, people need to have the opportunity to progress up the earnings ladder.

3.02 In the UK today, 73 per cent of the working-age population is in work. To raise this on a sustainable basis requires a reduction in the sustainable rate of unemployment, and an increase in the overall rate of labour market participation. To achieve that, it is necessary to ensure that spells of unemployment do not lead on to long-term benefit dependency, and to help those conventionally measured as falling outside the labour force to find a route into work. There are 3 1/2 million working-age workless households. But there is also evidence of skills shortages, which makes action to get the long-term unemployed back into the labour market and improve their skills even more important. This is a symptom of structural weaknesses, which can only be addressed through a comprehensive strategy for radical reform across a wide spectrum of Government activity.

3.03 The Government's strategy is to provide employment opportunity for all - the modern definition of full employment for the 21st Century - through:

- **a framework for macroeconomic stability and growth**. The strategy set out in chapter 2 will help to prevent the swings in output that destroy jobs and create the conditions in which spells of unemployment can persist, and lead to permanent exclusion from work. But, while macroeconomic stability is a necessary, it is not in itself sufficient to ensure that we expand employment opportunity to all. It is also necessary to have:
- programmes to help people from **Welfare to Work**, focussing help on the unemployed and other disadvantaged groups;
- **tax and benefit reform to make work pay**, to ensure that people are better off in work, and to help people move up the earnings and employment ladders;
- **investment in education and skills**, so that people start their working life with the skills they need for the modern labour market, and can learn through life and remain employable as the labour market changes; and
- **a flexible and adaptable labour market**, avoiding excessive regulation of markets, but backed up by a framework of minimum standards.

3.04 This Budget includes a wide range of measures in each of these areas, including extensions of the Welfare to Work initiative, national insurance reform, the new Working Families Tax Credit, and a package of measures to improve skills.

3.05 Two other policies will support these reforms. The Government remains committed to introducing a new 10 pence starting rate of income tax to improve work incentives still further, but only when it is economically right to do so. It will also ensure that the lowest-paid in work gain from a 10 pence rate. The National Minimum Wage is another essential component of the strategy to make work pay, as well as ensuring greater decency and fairness in the workplace.

Extending Welfare to Work

3.06 The Welfare to Work initiative is already extending new work opportunities to people detached from the labour market. The New Deals for young people and for lone parents are already producing encouraging early results. During 1998, the New Deals for the long-term unemployed and for disabled people will help to expand employment opportunities even further.

3.07 This Budget extends the Welfare to Work initiative by:

- directing a further 50 million of New Deal funds over the Parliament to reinforce the help provided through the gateway element of the New Deal for young people, targeted on the most disadvantaged young people, and providing more training and support for mentors;
- further extending the New Deal for lone parents, through new pilot programmes to improve further the take-up and effectiveness of the programme, at a cost of 10 million. A new linking rule will take some of the risk out of taking a job by ensuring that lone parents on benefit before April 1998 will not lose out if they take a job which turns out to be short-term;
- introducing, from November 1998, innovative pilots to provide 70,000 intensive Welfare to Work opportunities for long-term unemployed people over the age of 25. These will be modelled on the options available for the under 25s, at an additional cost of 100 million over the course of the present Parliament;
- introducing specific measures tailored to the needs of the long-term unemployed aged over 50, as part of the New Deal pilots, addressing the particular barriers this group face in moving back to work;
- providing 60 million to ensure that partners of the unemployed aged over 25 have the option to receive the help they

need to get back to work. Childless partners under 25 will be included in the New Deal for young people;

- further development of the New Deal for disabled people, alongside a reduction to barriers to work in the benefit system, and replacing Disability Working Allowance with the Disabled Person's Tax Credit;
- introducing a New Deal for Communities, to address the multiple barriers faced by those in the most disadvantaged estates at a cost, for the initial pilot phase, of 15 million.

A New Deal for young people

3.08 The New Deal for 18-24 year olds started in January 1998 in 12 pathfinder areas. Early results are set out in the box on page 40.

3.09 As part of the New Deal for 18-24 year olds, young people first go through a gateway programme, providing intensive help with looking for and preparing for work. The gateway is proving a particularly important element of the New Deal, popular with young people and with employers. In recognition of this, the Government will channel a further 50 million into the gateway to ensure that it meets the needs of the most disadvantaged young people, and provides more training and support for mentors to help more young people make the often difficult transition from welfare into work.

A New Deal for lone parents

3.10 The New Deal for lone parents will offer the first serious national effort to help lone parents find work - through job search help, advice and training. The box on page 40 describes the early results. The New Deal will be extended to all lone parents on Income Support from October 1998. From April 1998, it will be available nationwide to all lone parents making a new or repeat claim for Income Support. The Budget provides a further 10 million for new pilots, looking at ways of extending the help available to lone parents, improving take-up and maximising the effectiveness of the programme.

3.11 The Budget also makes changes to the benefit rules to introduce a 12-week linking rule, so that lone parents on benefits can take a job knowing that they will not be worse off if the job turns out to be short-term and they have to return to benefit. Lone parents will also be one of the groups benefiting most from the Working Families Tax Credit, including the improved help with the costs of childcare.

New Deal - early results

Two of the Government's New Deals have been running for some months in pathfinder areas, in preparation for their national launch. The New Deal for 18-24 year olds starts on a national basis on 6 April 1998. The New Deal for lone parents will start in October 1998.

The New Deal for 18-24 year olds

The New Deal started in January 1998 in 12 pathfinder areas. In the first nine weeks, 12,800 young people have entered the programme. 8,800 have been matched to employers and 620 have already found work.

The vast majority of young people have welcomed the New Deal, and have noticed a real difference in the help provided by their personal advisers. The early success stories include:

- Philip, from Cumbria, who had been unemployed since 1994. With support and coaching from his New Deal personal adviser, and training in interview skills, he was referred to an interview with North West Trains, and has now started an unsubsidised job as a conductor.
- Julie, from Cornwall, a single parent since her teens, who had missed the chance to pursue education and training. As a result of advice and guidance in the gateway she has now started a Skills 2000 course, to provide her with the skills to work as a personal assistant.
- Angela, from Tyneside, suffered many frustrating failures to get past the application stage for interviews. As a result of entering the New Deal gateway she was given specialist help from the Careers Service with writing CVs and interview techniques. She went on to secure seven job interviews, and now works for a local company.

Employers continue to offer a great deal of vital support for the New Deal and the principles underpinning it. The large employers recently signing the employer agreement - signifying formal commitment to participate - include Allied Domecq, British Airways, BT, Rover Group, Securicor, Tate and Lyle and Unipart. Tesco have agreed to offer 1,500 opportunities for young people, with support for training and mentoring. Rail and bus companies continue to come forward with schemes to provide discounted fares to young people seeking work or commuting to their new job. And, in the biggest commitment to the New Deal so far, there will be around 40,000 new employment opportunities across the hotel and catering industry. Radisson Edwardian Hotels, in conjunction with the British Hospitality Association, will use the New Deal to address a skill shortage problem in this expanding industry. Training for the new recruits will be provided through a new national network of training centres, partly funded through the training subsidies available through the New Deal.

The New Deal for lone parents

Since July 1997, the New Deal for lone parents has been available in eight lead areas of the country. During the first six months, 3,760 lone parents attended an initial interview with a personal adviser, with 3,370 (90 per cent) of these joining the New Deal. More than 1,100 (one-third of those who decided to take part in the New Deal) have already successfully moved into employment. The consistent message from participants is that they welcome the New Deal and the support it offers them. Examples of early success stories are:

- a 30 year old lone mother, with two children aged 12 and 8, joined the New Deal after seeing press coverage in her local paper. Following meetings with her personal adviser, she has started working part-time at a local college.
- a 31 year old lone mother, with three children aged 4, 8 and 10, had been in receipt of Income Support since separating from her husband. She was looking for work as a receptionist or in customer services to fit in with school hours. Following a work trial, she has found employment as a receptionist.

A New Deal for the long-term unemployed

3.12 The 1997 Budget set out the Government's plan for a 75 a week subsidy to help people unemployed over two years find work. This element of the New Deal will begin as planned in June 1998. Existing employment and training measures will be focussed on this group, to provide a "gateway" onto the New Deal for the long-term unemployed, to increase the numbers getting jobs, both before and after the start of the subsidy period.

3.13 This Budget extends the New Deal for the long-term unemployed, through a series of innovative pilots starting in November 1998. The Government will provide 70,000 opportunities for the long-term unemployed aged over 25, modelled on the New Deal for the under 25s. The pilots will involve a gateway of intensive help with looking for and preparing for work, similar to that provided for young people through the New Deal. For those who do not find work through the gateway, there will then be a programme of training and work experience, lasting for three months, during which participants will have a variety of options, including self-employment, work trials with employers, job-specific training, programmes to improve basic skills, and work placements with the voluntary and environmental sectors. Those finding work will benefit from the six months subsidy of 75 a week. Additional support will be provided to help those who find work to remain in work.

3.14 The pilots will be carefully evaluated, to yield valuable evidence about what works best and to inform the future development of the Welfare to Work programme. Different approaches will be tested through the pilots. Although the main focus will be on those unemployed over 18 months, the pilots will also look at helping those unemployed for between 12 and 18 months. The pilots will be delivered through the New Deal partnership arrangements pioneered for the under 25s, with the private sector leading delivery in some areas.

3.15 People aged over 50 have suffered most from the failure of the UK labour market to extend employment opportunity to all. The proportion of working-age men over 50 out of work has doubled over the last 20 years, while women over 50 have failed to share in the increasing rate of female labour market participation. This Budget therefore includes new measures, as part of the New Deal pilots, to help unemployed people over 50 to move back into work.

A New Deal for partners of the unemployed

3.16 Partners of the unemployed are disproportionately likely to be without work themselves - contributing to the 3 1/2 million working-age households with no-one in a job. There are nearly 300,000 partners of people receiving income-related Jobseeker's Allowance. This Budget sets aside 60 million from the Windfall Tax receipts to ensure that partners over 25 have the option to receive the help they need to get back to work. Partners aged under 25 will be included in the New Deal.

A New Deal for disabled people

3.17 In the past, the benefit system has defined people with disabilities and long-term sickness by what they cannot do. This has meant condemning many people to a life of benefit dependency and low expectations. The New Deal for disabled people will instead restore the opportunity to work for disabled people, by offering people with disabilities the help and support they need to overcome the particular obstacles to work that they face, to let them fulfil their potential. Because the needs of this group have been too often neglected in the past, new strategies need to be developed and tested. The emphasis will be on innovation and flexibility, and on involving the private and public sectors as well as Government.

3.18 195 million was set aside in the 1997 Budget for this New Deal. The Pre-Budget Report announced that this will finance innovative schemes proposed by private, public and voluntary bodies to test and develop new ideas. There have been over 120 bids to run one of the first tranche of schemes. Successful bids will be announced in the late spring, and will begin in the summer.

3.19 These innovative schemes will help inform the development of a personal adviser service to offer disabled people, if they want it, the personalised support they need to find and retain work: advice, assessments and action plans, access to work placements, work trials and training. The personal advisers will also offer advice to employers looking to employ or retain disabled members of staff. Participation will be voluntary. Pilots will begin in September 1998, with a national roll-out beginning from April 2000.

3.20 This New Deal will be complemented by the introduction of a Disabled Person's Tax Credit in place of the Disability Working Allowance (DWA) from October 1999, described in paragraph 3.47, and by changes to the benefit rules. Existing benefit rules create disincentives for sick and disabled people to move into work. The Government will therefore introduce, in October 1998, a one-year linking rule. This will allow people on Incapacity Benefit or Severe Disablement Allowance, and who have been unable to work for over 28 weeks, to move into work knowing that they can return to benefit and receive the same rate as before, if the job turns out to last less than a year. This will complement the existing linking rule in DWA, and will significantly reduce the financial risks of trying out work. It addresses a major disincentive to work in the benefit system, in which disabled people can lose as much as 40 a week benefit entitlement in taking a job. The restrictions on voluntary work by recipients of Incapacity Benefit and Severe Disablement Allowance will also be removed from the same date, and eligibility to some Employment Service programmes will be extended in pilot areas from April 1999.

A New Deal for Communities

3.21 The New Deal will help those most detached from the labour market to find work and improve their long-term employability. But for those in the most deprived areas, labour market detachment can interact with other social and economic problems to create a downward spiral of disadvantage. In the most deprived estates:

- 59 per cent of working age heads of household are not working;
- 43 per cent of residents depend on Income Support;
- contact crime (such as mugging) is three times more likely than elsewhere;
- truancy is six times the national average.

3.22 The Government recognises that, to address the particular problems faced in the most deprived areas, we need a New Deal for Communities. This new initiative will extend economic opportunity, tackle social exclusion and improve neighbourhood management and quality of life in some of the most rundown areas in the country.

3.23 The Government will begin by launching a number of pathfinder projects. The lessons learnt will inform the full initiative and the Government's broader strategy on social exclusion. It will also be part of the broader strategy to make public expenditure work more effectively in deprived areas. Further details will be announced in the Summer as an outcome of the CSR and the Social Exclusion Unit's work to develop integrated approaches to the problems of the worst estates. But as a start, 15 million will be made available for pathfinder projects across the UK in 1998-99, financed from within the Control Total.

Financing Welfare to Work

3.24 The receipts of the one-off Windfall Tax on the excess profits of the privatised utilities are being used to fund the Welfare to Work programme. The first instalment of the Windfall Tax was collected as planned in December 1997. The total receipts are expected to amount to about 5.2 billion. Table 3.1 sets out the latest estimates of the allocation of the Windfall Tax receipts between programmes. These figures take into account the additional measures announced in the Pre-Budget Report and in this Budget. They reflect current levels of unemployment, and the latest estimate of the phasing of expenditure between years. The expenditure plans build in an unallocated reserve.

Table 3.1: Funding Welfare to Work [1,2]

	million					
	1997-98	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**1997-2002**
Spending by programme3,4						
A New Deal for the young unemployed	100	580	650	640	640	**2 620**
A New Deal for the long-term unemployed	0	120	160	90	80	**450**
A New Deal for lone parents	0	50	50	50	50	**190**
A New Deal for the sick and disabled	0	10	20	80	80	**200**
A New Deal for partners of the unemployed	0	0	20	20	20	**60**
A New Deal for schools	100	300	300	300	300	**1 300**
Childcare(5)	0	40	0	0	0	**40**
University for Industry(6)	0	5	0	0	0	**5**
Total Expenditure	**200**	**1 090**	**1 200**	**1 170**	**1 170**	**4 850**
Unallocated						**350**
Windfall Tax(7)	**2 600**	**2 600**				**5 200**

1 The spending in this table, financed from the Windfall Tax, is outside the Control Total. It updates Table 2.1 of the July 1997 FSBR, to reflect new assumptions about unemployment, and policy announcements made in this Budget and in the November 1997 Pre-Budget Report.

2 Rounded to the nearest 10 million. Constituent items may not sum to totals because of rounding.

3 Illustrative levels of spending based on current levels of unemployment. Actual provision for any particular year will be decided in the light of the number of eligible people and the effectiveness of the programme.

4 The Departmental breakdown of spending on the basis of these illustrative figures will be set out in "Public Expenditure Statistical Analysis", to be published in April.

5 Includes 30 million for out-of-school childcare. The costs of the 1997 Budget improvements in childcare support through Family Credit are included from April1998 until October 1999, when the measure will be incorporated within the Working Families Tax Credit.

6 As part of the 15 million finance for the University for Industry, with the remaining 10 million funded from within the control total.

7 Outturn for 1997-98, estimated receipts for 1998-99.

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comments

4 Promoting Enterprise

Earlier chapters have discussed the measures the Government is taking to promote economic stability and employment growth. Building on those foundations this chapter describes further reforms designed to help improve UK business performance.

- Further tax reform to promote enterprise and encourage investment:
    - 1 per cent cut in main and small rates of corporation tax;
    - introduction of quarterly payments for large companies, replacing ACT;
    - extension of enhanced temporary first year allowances, at a new rate of 40 per cent;
    - introduction of taper to reduce capital gains tax on assets held for longer periods, equivalent to a higher tax rate of 10 per cent after ten years on business assets;
    - unified Enterprise Investment Scheme (EIS) and CGT reinvestment relief, better targeted relief on smaller higher risk trading companies.
- Better exploiting the UK's high-tech ideas and research:
    - University Challenge Fund to create seed venture capital funds to help commercially exploit universities' research;
    - R&D report published and consultation launched;
    - consultation on management recruitment incentives.
- Improving Revenue and Customs advice and services to business:
    - move of Contributions Agency to Inland Revenue;
    - extended payroll assistance project to help new businesses;
    - simplification of corporation tax and NICs rules.

Introduction

4.01 The UK has some of the most dynamic and enterprising businesses in the world. Unfortunately there are too few of them; too many firms lag behind the standards set by these top businesses and behind the performance of their international competitors.

4.02 Improving the performance of British business has to be the responsibility of the management, employees, and shareholders in individual companies. The DTI paper "UK Competitiveness: A Benchmark for Business" sets out the challenge by comparing the performance of UK businesses against our key competitors in each sector. The UK performs well in many respects. Some sectors such as pharmaceuticals are world leaders. But too often the average performance falls behind. Unless improvements are made there must be a question-mark over the long term viability of underperforming businesses and the jobs they provide in an increasingly competitive world economy.

4.03 The UK also needs to create - and sustain - more dynamic and innovative firms which can exploit technology, be at the forefront of design, and generate highly-skilled jobs which are the key to long-term prosperity. The UK has the raw material: a high quality science and engineering base, a record of creativity and invention, and the proven record of many world class entrepreneurs. However, it does not produce such businesses in sufficient numbers or on a sufficient scale, and not enough grow to be global companies.

4.04 The Government cannot itself improve the performance of industry or create dynamic new companies. But, in partnership with business, it can create the right framework for enterprise and investment. The Government is committed to removing the barriers that hold back investment and that discourage enterprising individuals from starting dynamic businesses that would allow British products and services to lead the world in the 21st Century.

4.05 The Pre-Budget Report (PBR) identified the main barriers to business growth in the UK. Principal among these are a record of economic and fiscal instability and a tax system that has distorted investment decisions and discouraged enterprise.

4.06 Earlier chapters have set out how the Government has tackled the issues of economic and fiscal stability. But to compete effectively in the global economy the UK must also tackle its legacy of chronic under investment.

Under investment

4.07 Since at least 1960 the UK has consistently invested less as a share of GDP than the OECD as a whole. The UK share has averaged around 18 per cent, compared to the OECD average of almost 21 per cent. The UK has also invested out of a lower level of GDP per head, this translates into a lower level of investment per worker.

4.08 As a result of lower investment per worker, the UK has a lower level of capital stock per worker as Chart 4.1 shows. This helps to explain why the UK's productivity is up to 40 per cent lower than our major competitors, and hence the lower level of GDP per head. If it is to improve its relative position the UK needs to invest more than other countries as a proportion of GDP, whilst ensuring that the quality of that investment is maintained and improved.

CHART HERE

4.09 The PBR set out some of the Government's proposals for tackling these problems. Since the publication of the PBR the Government has been consulting widely on these proposals. The Government has listened to views of the business community, and the measures outlined in this Budget reflect that consultation.

A Corporate Tax System to Promote Quality Investment

Corporate Investment

4.10 This Budget continues the process of tax reform to produce a corporate and capital tax system that:

- does not distort corporate investment;
- promotes enterprise and rewards risk-taking;
- is fair and simple to apply.

4.11 The Government inherited a corporation tax system which did not encourage investment because:

- payments of tax credits on dividends were a distortion that encouraged companies to pay out dividends rather than reinvest their profits;
- advance corporation tax (ACT) led to surplus ACT for some companies, because they paid more ACT than they could set against their mainstream corporation tax bills. Surplus ACT often resulted in the double taxation of profits earned overseas when they were distributed by UK companies, and it hindered companies wanting to return excess capital to their shareholders. This distorted business decisions and led to inefficient investment.

4.12 The Government's first Budget:

- solved the first problem by abolishing payable tax credits;
- cut corporation tax rates by 2 per cent.

Advance Corporation Tax

4.13 This Budget confirms the Government's intention to deal with the second problem, by:

- abolishing ACT from 6 April 1999, which will eliminate surplus ACT for the future and reduce the complexity of the current system;
- preserving substantially companies' current expectations for using past surplus ACT after 6 April 1999

Quarterly payments of corporation tax

4.14 ACT will be replaced by a system of quarterly instalments for corporation tax paid by large companies:

- instalments will be phased in over four years, beginning with accounting periods ending on or after 1 July 1999;
- once the transition is completed, large companies will pay all their corporation tax by instalments, with 50 per cent due in-year (beginning in month seven) and the rest subsequently;
- interest rates on corporation tax underpaid and overpaid by large companies will be brought closer into line with commercial rates.

Main rate of corporation tax

4.15 The main rate of corporation tax will be cut by 1 per cent to 30 per cent from 1 April 1999 to ease further the transition to instalments.

4.16 The scheme under which companies have to account quarterly for income tax on gilt interest they receive gross will be abolished from 1 April 1999.

4.17 This package of measures will remove many of the distortions that discouraged investment. There will be a transitional cash flow impact on companies. However, taking these measures together, companies will gain by around 1.6 billion a year once these changes are complete.

Promoting Investment by Small and Medium Sized Enterprises (SMEs)

4.18 The Government recognises the importance of SMEs to a successful enterprise economy. Of the 3.7 million businesses in the UK, 99 per cent have under 50 employees. These firms provide 46 per cent of non-government jobs and, excluding financial services, 42 per cent of UK turnover.

4.19 To promote investment by SMEs this Budget:

Capital allowances

- extends enhanced allowances given to small and medium-sized business investment in machinery or plant. For expenditure in the year from 1 July 1998 the allowance will be set at a new rate of 40 per cent. This will assist cashflow and encourage SMEs to invest and modernise. The Government will review the operation of capital allowances in time for the next Budget;

Small companies corporation tax

- cuts the small companies' rate of corporation tax to 20 per cent from 1 April 1999, which will boost the after tax profits of both small and medium-sized companies and encourage them to invest;

Medium sized companies exemption

- exempts medium sized companies, alongside small companies, from quarterly payments of corporation tax to improve their cashflow;
- abolishes ACT which will improve the cashflow and reduce the compliance burden on small and medium-sized companies that pay dividends.

4.20 The Government will continue to look at how best to create an environment that encourages investment by small and medium sized enterprises. This will include reviewing the case for continuing with enhanced first year capital allowances.

Encouraging dynamic and innovative SMEs

4.21 Dynamic and innovative SMEs have the potential to make a vital contribution to employment and output growth. The evidence of the United States suggests that, increasingly, it is from small, often high-tech, start-ups that tomorrow's corporate giants grow. Yet in the United Kingdom such companies often fail to live up to their early potential. A business environment that encourages the growth of these companies is essential if the UK is to produce the high value-added products needed to compete internationally and generate the skilled employment opportunities which can sustain and improve the UK people's standard of living in a global economy.

4.22 To grow, dynamic and innovative SMEs need:

- **entrepreneurs** who have the energy and drive to grow a company;
- **access to finance** to develop good ideas into products. Many firms require significant start-up capital and development time to bring an innovative product to market. Financing these ventures is often perceived to be risky and investors need to be prepared to invest over longer periods to realise a return.

4.23 The Budget sets out a package of measures which improves incentives for entrepreneurs and investors.

Encouraging and rewarding entrepreneurs

4.24 To get the best out of the country's entrepreneurs the UK tax system needs to recognise the investment of individuals who nurture promising start-ups into successful businesses.

4.25 Reflecting this the Budget announces significant reform of Capital Gains Tax (CGT), which applies to capital gains made by individuals and trusts. The Government's objectives are to:

- encourage long term investment;
- reward risk taking and promote enterprise;
- introduce greater fairness for CGT payers.

4.26 Under the current capital gains system, tax is paid on the excess of an asset's sale proceeds over its acquisition costs, less a reduction to allow for any gain due to inflation. The system does not differentiate structurally between short-term speculative assets and longer-term holdings, or between business investment and investment in other assets. The indexation allowance also makes the system difficult to understand and complicated to administer.

4.27 The Government believes the capital taxation system should better reward long term investment particularly in economically productive business assets. The Government also wants capital taxation to be fairer and simpler to understand.

Capital Gains Tax

4.28 To achieve this the Budget introduces a CGT taper which for higher rate taxpayers will tax capital gains on business assets held for more than ten years at an effective rate of 10 per cent.

4.29 The taper will:

- for business assets, reduce the percentage of the gain chargeable from 100per cent (for assets held for less than one year) to 25 per cent (for assets held for ten years or more) - so under the new scheme the rate of tax for a higher rate taxpayer will fall from 40 per cent in the first year to effectively 10 per cent after the tenth year;
- for non-business assets, reduce the percentage of the gain chargeable from 100 per cent (for assets held for less than three years) to 60 per cent (for assets held for ten years or more) - so under the new scheme the rate of tax for a higher rate taxpayer will fall from 40 per cent in the first year to effectively 24 per cent after the tenth year.

CGT indexation allowance

4.30 The taper will replace the CGT indexation allowance on gains realised after 6 April 1998. Indexation will be frozen from 6 April 1998. Only holding periods after 5 April 1998 will count for the purposes of the taper, but, to ease the transition, there will be a one year addition for assets held at Budget day. So, for example, an asset bought on 1 January 1998 and sold on 1 July 2000 would be treated as if it had been held for three years (two complete years after January 1998 plus one additional year).

4.31 Chart 4.2 below sets out the reduction in the percentage of gain chargeable for business and non-business assets over a ten year period under the proposed reforms.

CHART HERE

4.32 The Government is committed to building a fair tax system. Chapter 5 outlines further reforms to CGT designed to ensure capital gains are taxed in a fair and consistent manner.

Company capital taxation

4.33 The Government has announced a further period for comment on the taxation of capital gains realised by companies, in the light of the package now proposed for the personal sector.

Further measures to promote venture capital

4.34 The Budget proposes further measures to stimulate the provision of equity capital for smaller, higher risk, trading companies.

4.35 The existing Enterprise Investment Scheme (EIS) is designed to promote investment in such companies. The scheme gives relief from income tax at 20 per cent and deferral of a capital gain on up to 100,000 each year. CGT reinvestment relief allows deferral of an unlimited capital gain invested in a higher risk trading company.

4.36 However, there are many areas of overlap between these two reliefs and the range of investee companies is practically identical. Under present rules, companies can hold land and other property which reduces the risk of the investment, undermining the purpose of the tax reliefs and meaning that they are not well targeted.

Venture Capital Incentives

4.37 The Government proposes changes to existing venture capital schemes to encourage the provision of new equity capital and to ensure that the schemes are targeted in the most effective way.

4.38 The Budget proposes a new EIS which merges the former scheme with CGT reinvestment relief. Its main features are:

- increasing by 50 per cent, to 150,000 per year, the amount an individual can invest under the new EIS scheme and qualify for income tax relief;
- abolition of the limit of 1 million on the amount that can be raised each year;
- preservation of the best parts of the existing reliefs:
    - up-front income tax relief, exemption from tax on gains after five years, and relief for losses against income or chargeable gains for outside investors and business angels who subscribe for shares;
    - unlimited deferral relief where chargeable gains are reinvested in newly-issued shares;
- participation is limited to investment in companies with gross assets of less than 10 million before an investment and no more than 11 million after it.

4.39 The Government also propose better targeting of the new EIS scheme and the existing Venture Capital Trust scheme by excluding:

- arrangements which guarantee a substantial part of the return;
- some land or property-backed trading activities.

Promoting innovation and research and development

4.40 The Government recognises that investment is not just about building up the physical capital stock. Investment in research and development (R&D) is also an important element in promoting the UK's competitiveness and growth. Yet, as Chart 4.3 shows, whilst almost all of our major competitors have increased R&D's share of GDP in the past decade, the UK's R&D share has actually fallen.

CHART HERE

4.41 The reforms to capital gains tax, corporation tax, and the other investment incentives outlined in this chapter are an important step towards creating a more favourable environment for investment and that will include investment in research and development. However, the Government recognises that there may be other steps that either it or business can take. That is why, in the Pre-Budget Report, the Chancellor and the President of the Board of Trade announced that they would be undertaking a wide ranging look at ways of improving the UK's record on investment in R&D.

Review of Research and Development

4.42 As the first step in this process the Treasury and DTI are jointly publishing today a consultative document, "Innovating for the Future", which identifies issues which it is the Government's intention to consider over the next year, including in the various working groups on investment and competitiveness sponsored by the DTI and the Treasury. The views of business and others are invited on the issues raised.

University Challenge Fund

4.43 The UK also needs to improve its record of exploiting the ideas generated by its many world class scientists and universities. This Budget announces a new University Challenge Fund which will help universities bridge the funding gap which can prevent them successfully transforming good research into good business. Under this scheme to create 50million in venture capital, universities will be able to compete for up to twenty seed venture capital funds. The scheme is a partnership between the Government, providing 20million, and the Wellcome Trust and Gatsby Trust, together providing an additional 20million. These contributions will lever in additional funds raised by Challenge-winning universities, in partnership where possible with the private sector.

Management recruitment incentives

4.44 The Government recognises the need to encourage top quality managers to join high-technology SMEs. It will therefore consult on ways of incentivising managers through equity based remuneration.

Helping Business - Better Advice and Better Services

4.45 The Government can play an important role in improving business performance by helping to remove barriers to growth. Regulatory burdens can involve significant costs for business, smaller companies with fewer staff and resources may face disproportionate costs. The Government is determined to ease these burdens by:

- helping businesses to comply with rules;
- abolishing unnecessary rules;
- simplifying rules.

Helping business

4.46 Helping businesses to comply with rules by providing them with advice and assistance is an important way in which government can ease the burdens of compliance. The Government is committed to looking for new ways to do this by providing better, more coordinated advice and adapting government services to new technologies and working methods.

4.47 Many businesses say they want to deal with one organisation about the tax and national insurance contributions (NICs) they collect from their employees. The Contributions Agency will therefore be transferred to the Inland Revenue in April 1999. Separately the Government is also committed to transferring the related NICs policy functions to the Inland Revenue once agreement on a new entitlement test for benefits has been reached (the Department of Social Security would retain responsibility for benefit entitlement). These transfers will further improve customer service through unified delivery of guidance and assistance, and speed the pace of tax and NICs alignment.

4.48 This Budget announces an important new payroll service which will help reduce costs for new employers. The service from the Inland Revenue is for small businesses who want to take on their first employees.

4.49 This announcement follows the early findings of an experimental service running in Leicester with employers who were not using professional help with their payroll. The service offers a range of advice to new employers including help with the employer's first pay-day, and one-to-one assistance with a wide range of other subjects such as Statutory Sick Pay, Statutory Maternity Pay, expenses, and benefits in kind. The experimental service will be offered in more areas during the coming year and will be rolled out nationally from April 1999.

4.50 The Employment Service will also take active steps to put employers, considering taking on young people under the New Deal, in touch with this service.

4.51 Increasingly businesses and individuals are managing their financial affairs electronically, using the telephone and computer, rather than just paper. So:

- an experimental call centre is being set up at East Kilbride, the first of its kind in the public sector. The experiment will test whether the Inland Revenue can use telephone call centres to deliver better, more flexible customer service and should reduce costs for members of the public by providing a quicker and more attractive alternative to doing business on paper. It will handle calls from all Scottish employers and employees - more than two million taxpayers. The Call Centre will come into operation in stages over the period late Summer 1998 to early 1999;
- from this August some taxpayers will be able to make claims and supply documents electronically rather than on paper.

4.52 The Government wants to ensure that businesses run by all sections of the community are able to benefit from the best information on their tax affairs. Customs and Excise is expanding its comprehensive introductory package for newly registered VAT businesses by developing further video aids in English and seven minority languages.

Simplifying rules

4.53 This Budget also announces further measures which reflect the Government's commitment to simpler and better regulation. For example:

- from April the Schedule A rules applying to corporation tax will be modernised and simplified to bring them closer into line with those for income tax;
- to assist companies prepare to make the changes for self assessment the legislation catering for self assessment for companies is to be restructured and written in clearer, easier to use language;
- from April 1999 the structure of employer and employee NICs will be simplified.

4.54 A detailed list of further tax simplification and abolition measures is set out in Annex C, The Budget Measures.

VAT threshold

4.55 The Government will consult on the VAT registration threshold and its impact on competition between registered and un-registered businesses. In the meantime the annual turnover threshold, above which traders must register for VAT will rise from 49,000 to 50,000 and the deregistration threshold will rise from 47,000 to 48,000 from 1 April 1998.

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comments

5 Creating a Fairer Society

The Government is committed to fairness in tax and spending. This chapter sets out how the Budget helps further the ambitions of the many, not just the few, helping those in need, encouraging work and saving, promoting a better environment and helping ensure that everyone pays a fair share of the tax burden.

This chapter outlines the measures which help create a fairer society:

- Helping families with children by increasing child benefit by 2.50 a week for the eldest child from April 1999, with the same increase carried through to the family premium in Income Support and related benefits so that poor families also benefit;
- helping families with young children with an extra 2.50 a week for each child under 11 on all income related benefits from November 1998, and the WFTC;
- An extra 500 million for the NHS;
- An extra 250 million for education;
- An extra 500 million for public transport;
- A package of measures to protect the environment;
- A new tax free individual savings account;
- A package of measures to ensure everyone pays their fair share of tax.

Annex C sets out all the Budget measures described in Chapters 3, 4, 5 and some other measures, and includes TableC1, which gives the cost or yield of all Budget measures.

Introduction

5.01 The Government is determined to create a fairer, more equal society, building on last July's Budget with a range of measures to promote fairness in this Budget, the Comprehensive Spending Review which will be completed in the Summer, and future Budgets.

5.02 Growing inequality not only has serious short-term social consequences, but it weakens the long-term potential of the economy. This Budget will help improve all our children's life chances, by helping today's families achieve their ambitions to provide a secure future for themselves and their children.

5.03 This Budget will help make the United Kingdom a fairer country.

Fairness for families and children

Child benefit

5.04 The Government is committed to supporting all families with children, in and out of work, and recognises the importance of Child Benefit in supporting children through its payment direct to mothers. From April 1999, every family with children will gain 2.50 in increased Child Benefit for the eldest child, over and above statutory indexation.To ensure this increase also goes to out-of-work families with children, the family premium in Income Support and related benefits will also be increased by 2.50 a week, in line with Child Benefit.

5.05 The Government will be examining the tax-exempt status of Child Benefit paid to higher-rate taxpaying families to help ensure a fairer distribution of resources.

Tackling child poverty

5.06 Poverty in childhood often leads to poverty in later life. The measures announced in this Budget start to address this, helping to improve people's chances to move out of poverty, giving everyone an equal chance. This Budget will help families on low incomes by:

- increasing family premium in Income Support and related benefits by 2.50 a week;
- giving an extra 2.50 a week for each child under 11 to families on income-related benefits. The evidence suggests that the costs associated with younger children are closer to those of older children than the benefit scale rates imply;
- boosting the resources of lower-paid families with children through the Working Families Tax Credit;
- making quality childcare affordable for lower-income working families with a generous new childcare tax credit within the Working Families Tax Credit.

5.07 In July the Government will also be launching a further package of spending measures as part of the Comprehensive Spending Review, to help children get off to a sure start in life.

5.08 These measures to increase support for children will be partly funded by reducing the rate of relief on the Married Couple's Allowance, and the allowances linked to it, to 10 per cent from April 1999, rebalancing reliefs to those familes with children.

Impact on families

5.09 Chart 5.1 shows the effect of Budget measures over the next two years on the disposable income of different families. On average, households will see a real increase in their disposable income of 100 a year from these changes. Poorer households will gain more on average. The poorest 20 per cent of households will gain an average of 200 a year.

Chart 5.1: The direct effect of the main Budget measures on households by income
TO FOLLOW

5.10 The Budget helps families with children in particular. The five and a half million households with children in the UK will all see increases in their disposable income, gaining an average of 250 a year. Families on low incomes gain the most on average. The 20 per cent of poorest households with children, who between them include 3.8 million children, will gain an average of 500 a year.

5.11 The following examples illustrate the increase in disposable income different families will gain from the changes made in the Budget:

- an unemployed couple with two children gain 390 a year;
- a single earner couple earning 12,000 a year with three children, gain 1,540 a year;
- a two earner couple earning about 25,000 a year, with two children, with 80 a week child care costs gain 1,210 a year.

Fairness for pensioners

5.12 From April 1999, the Married Couple's Allowance for those aged 65 and over will be increased by 1,660 and for those 75 and over by 1,680. This will provide full compensation for the restriction of tax relief for the Married Couple's Allowance.

5.13 In the Pre-Budget Report in November, the Chancellor announced an additional payment for last year and again for this year of 20 to all pensioners and 50 to pensioners on income support at a cost of 190 million in both years.

Fairness for women

5.14 Women make up two-thirds of adults in households gaining more than 5 a week from measures in this Budget. In the past, the needs of certain groups within society, including people in workless households, low earners, part-timers, and people with caring responsibilities, have often been overlooked. These are all groups in which women form the majority. This Budget helps to redress the balance for women by increasing support for these groups.

5.15 There are 1 million more women than men in the poorest 20 per cent of households. Budget measures, especially the WFTC and NICs changes (see Chapter 3) will help people in these households by boosting the incomes of the poorest working families and encouraging work. A new 60 million investment will give partners of the unemployed who are themselves out of work (95 per cent of them women) the option of access to employment programmes. Childless partners aged under 25 will be included in the New Deal for young people. The generous childcare tax credit within WFTC will help people with caring responsibilities to move into paid work. The Budget also targets increased support towards people caring for children (see 5.06).

5.16 In addition to the measures in this Budget, women will benefit from the New Deal for Lone Parents, the National Childcare Strategy, the extension of the additional personal allowance for people with disabled spouses to women, and the introduction of the part-time workers' directive. The national minimum wage will also be of particular benefit to women: of the lowest 10 per cent of earners in the UK, nearly two-thirds are women. The national minimum wage will help to remove the worst cases of discrimination, as well as to promote work incentives.

Fairness for everyone

5.17 To encourage work and reward effort, the basic and top rates of income tax will remain unchanged.

5.18 The Government remains committed to introducing a new 10pence rate of income tax to improve work incentives and take home pay still further, but only when it is economically right to do so. It also wants to ensure that the lowest paid in work gain from the 10pence rate, so any tax change will be accompanied by action on benefits rules.

5.19 For this Budget, the priority has been to help families with children first. There will be no changes to income tax rates. The main income tax personal allowances, the lower rate band, basic rate limit, and the income limit for age related allowances and the Married Couple's Allowance will all be uprated by 3.6 per cent, in line with inflation. All taxpayers will gain in cash terms from this uprating. The new allowances and bands are shown in Table 5.1.

Table 5.1

	(a year)		
	1997-98	**1998-99**	**Increase**
Income tax allowances			
Personal allowance	4 045	4 195	150
Married couple's allowance(1), additional personal allowance(1) and widows bereavement allowance(1)	1 830	1 900	70
For people aged 65-74:			
personal allowance(1)	5 220	5 410	190
married couple's allowance(1)	3 185	3 305	120
For people aged 75 and over:			
personal allowance(1)	5 400	5 600	200
married couple's allowance(1)	3 225	3 345	120
Income limit for age related allowances	15 600	16 200	600
Blind person's allowance	1 280	1 330	50

1 Tax relief for these allowances is restricted to 15 per cent for 1997-98 and 1998-99 and 10 per cent from April 1999.

	(a year)		
	1997-98	**1998-99**	**Increase**
Band of taxable income			
Lower rate 20 per cent	0- 4 100	0- 4 300	200
Basic rate 23 per cent	4 101-26 100	4 301-27 100	

Higher rate 40 per cent	over 26 100	over 27 100	1 000

Millenium Gift Aid

5.20 Under the "Millenium Gift Aid" scheme, the minimum donation to charity under the gift aid relief is reduced to 100 for gifts made to benefit anti-poverty and education projects in the world's poorest countries. This special reduction will be available for gifts made on and before 31 December 2000.

Fairness in health and education

Investing in health

5.21 An extra 500 million has been allocated to the NHS as part of a package of measures to reduce waiting lists and times. Measures to reduce NHS waiting lists and times have been under discussion in the Comprehensive Spending Review. But NHS patients are rightly concerned that they should not have to wait longer than necessary for treatment. The Government has therefore decided to implement the conclusions emerging from this part of the review immediately.

5.22 This brings the total amount of extra money allocated to health in 1997-98 to 2 billion.

Investing in schools

5.23 The modernisation of schools is a key part of the Government's emphasis on improving skills and enhancing employability. Investment that raises standards for all children will lay the foundations for sustainable economic growth and prosperity in the future.

5.24 Of the additional 210million available for education to DfEE, 100million will be spent on schools. The extra resources for schools add to the additional 1 billion of recurrent provision for 1998-99 announced in the July Budget and the new spending of 1.3 billion over five years from the New Deal for Schools (NDS).

Protecting the Environment

5.25 The Government is committed to seeing that the core principles of sustainable development underlie the Budget measures. This ensures that the tax system is fair both to future generations, and to the world in which we live.

5.26 This Budget focuses on:

- reducing emissions of **greenhouse gases**, such as carbon dioxide and methane;
- improving **local air quality**. Emissions of gases such as nitrogen oxides, and of tiny particles of smoke, can be harmful to our health;
- reducing the environmental impact of **land use and water pollution**.

5.27 Measures to pursue these objectives are set out in the following three sections. Some measures, particularly in the transport sector, such as road fuels and Vehicle Excise Duty, may impact upon more than one objective.

Integrated Transport White Paper

The tax and other measures on transport announced in this Budget are just one aspect of the Government's broader work on an Integrated Transport Strategy.

The Integrated Transport White Paper, due to be published in the Spring, will set out the Government's overall strategy for transport, which aims to address the mobility needs of all sections of society, while tackling the twin problems of congestion and the environment.

Within this overall context, the Budget measures contribute specifically to the objectives of reducing the harmful impact of the car and lorry on the environment, and encouraging a shift from the car to other modes of transport.

Climate Change and Greenhouse Gas Emissions

5.28 The UK has taken a lead internationally in promoting action to reduce greenhouse gas emissions. At the Kyoto international conference on climate change in December 1997, the European Union committed itself to reducing its emissions of six greenhouse gases by 8 per cent on 1990 levels between 2008 and 2012. The European Union has agreed to meet its commitment by burden-sharing arrangements amongst Member States to be negotiated during the next few months. Once these negotiations are complete, and our legally binding target has been agreed, the Government will consult on what sort of measures might be needed to meet its commitments.

Industrial and commercial use of energy

5.29 In every developed country, there is a debate on how to improve industrial energy efficiency, and how best to meet internationally agreed targets on climate change. So there is a need to consider a new framework to encourage greater efficiency in the use of industrial energy, and to achieve reductions in emissions of greenhouse gases. This should include a study of whether or not new economic instruments, and/or other market mechanisms should be introduced to help curb industrial emissions and if so, in what form.

Road fuel duties

5.30 The tax (duty plus VAT) on leaded and unleaded petrol will rise by 4.9pence and 4.4pence per litre respectively. Conventional diesel will be subject to a tax increase of 5.5pence a litre. The new rates take effect from Budget day.

5.31 These duty increases reflect the commitment to increase road fuel rates by at least 6 per cent on average in real terms a year. They will play an important part in discouraging unnecessary journeys, encouraging fuel efficient cars, and so reducing emissions of carbon dioxide. But they also move the relative taxation of petrol and diesel towards a fairer basis on energy and carbon content.

Minor oils duties

5.32 The duty on gas oil and fuel oil will rise by 0.24pence and 0.18pence per litre respectively on Budget day. These increases are broadly in line with the increases in duty on petrol.

Vehicle Excise Duty

5.33 Vehicle Excise Duty will be frozen for this year. Combined with the road fuel duty changes, this further shifts the taxation of motor vehicles away from ownership and towards use.

5.34 The Government will consult later in the year on graduating Vehicle Excise Duty on environmental criteria for cars. The Government is interested in introducing a reduced starting rate of 100 for the least polluting cars.

Company car fuel scales

5.35 The Government would like to ensure that company car owners who receive free fuel from their employers face the correct incentives and costs when deciding to make extra private journeys.

5.36 From 6 April 1998 there will be a 20 per cent increase, above the usual increase in line with pump prices (including fuel duty), in the scale charges used for assessing income tax and employers' NICs for free fuel provided to employees for private use of company cars by their employers. The diesel scale charges will be further increased from 6 April 1998 to bring them into line with those for petrol cars of the same engine capacity. The Government is committed to increasing the scale charge by a further 20 per cent above increases in pump prices (including fuel duty) in each year for each of the next four years (from 1999-00 to 2002--03). This will discourage employers from providing, and their employees from accepting, free fuel for private motoring in company cars. The scales used to charge VAT on fuel provided by employers for private motoring will be increased to reflect the change in fuel prices.

Other company car taxation

5.37 The current system of company car taxation, in which an employee with a company car pays less tax if 2,500 or 18,000 business miles are driven, gives an incentive to make extra journeys. In the light of emerging policy in the forthcoming

Integrated Transport White Paper, the Government will consider the case for changing the basis of taxation of company cars from bands of business mileage to bands of private mileage.

VAT on installation of energy saving materials

5.38 As announced in the Pre-Budget Report, VAT will be reduced on the installation of energy saving materials in the homes of the less well off under certain grant schemes. VAT will be charged at 5 per cent from 1 July 1998. This will allow these grant schemes to help an additional 40,000 households a year to insulate their homes and keep warm.

5.39 The Government is continuing to explore with its European partners, the possibility of a wider reduced rate of VAT for energy saving materials.

Local air quality

5.40 The Government's objectives for an integrated transport system include encouraging a shift in the mode of transport from the car to other modes of transport, and reducing the harmful impact on the environment of all forms of transport.

5.41 A number of new tax measures are being taken aimed principally at improving the quality of air, particularly in urban areas. They should also contribute to a reduction in unnecessary car journeys.

Road fuel duties

5.42 The Government intends to adjust the structure of duties on road fuels, over time, to achieve two broad objectives:

- to move towards a fairer treatment of petrol and diesel, when calculated on an energy or carbon basis. This means that the tax on a litre of diesel should be higher than that on petrol, to reflect the higher levels of carbon and energy in a litre of diesel;
- to encourage all users of diesel to switch to ultra-low sulphur diesel.

5.43 For ordinary diesel, the increase in duty over and above that of petrol also recognises the adverse effect that the use of diesel has on local air quality. Future Budgets will further increase the duty on ordinary diesel relative to unleaded petrol.

Local air pollution and the National Air Quality Strategy

The air in the UK is significantly cleaner today than in the 1950s and 1960s and levels of air pollutants are expected to fall dramatically over the next decade. Nevertheless, in some local areas - particularly congested urban areas - emissions from traffic, industry and other sources can still affect the quality of life for all.

The National Air Quality Strategy has set objectives - which are currently under review - for reductions in emissions of the eight most important air pollutants. These include:

- tiny particles of smoke or other pollutants, known as "particulates";
- nitrogen oxides.

In urban areas, road transport is the major source of air pollutants. For example, road transport can contribute up to 40-50 per cent of winter emissions of particulates in urban areas, and up to 75 per cent in smog episodes.

5.44 Ultra-low sulphur diesel, which is substantially cleaner than ordinary diesel, currently attracts a lower rate of duty, by 1pence per litre, than unleaded petrol and ordinary diesel. But the specification of ultra-low sulphur diesel has proved too liberal - it has been possible for fuels with little environmental or health benefits to qualify for this reduced rate. The specification for this lower rate has therefore been tightened.

5.45 But in recognition of the environmental and health benefits attached to this more tightly specified fuel, the duty difference with ordinary diesel is widened to 2pence. The Government expects to widen this by a further 1pence per litre in the next Budget. The increased duty differential will further encourage the manufacture and use of this fuel, which offers substantial benefits to the quality of air in urban areas by reducing the amount of nitrogen oxides, black smoke, and particulates produced during combustion.

5.46 Super-unleaded petrol contains benzene, a carcinogen. In light of the adverse health affects, the tax (duty plus VAT) on super-unleaded petrol increases by 6.1pence per litre. This will give non-essential users an incentive to switch to less harmful fuels.

5.47 Duty on road fuel gases is frozen in consideration of the environmental benefit these gases offer in relation to other road fuels.

5.48 The extra cost of enabling company cars to run on road fuel gases will be disregarded in calculating the income tax charge on company cars from 6 April 1999.

5.49 Table 5.2 shows the changes in duties on all road fuels and other hydrocarbon oils.

Table 5.2: Changes to road fuel duties

	Changes in duty (%)	**Effect of tax(1) on typical item (increase in pence)**	**Unit**
Leaded petrol	9.2	4.9	litre
Unleaded petrol	9.2	4.4	litre
Super-unleaded petrol	11.8	6.1	litre
Diesel	11.7	5.5	litre
Ultra-low sulphur diesel	9.4	4.4	litre
Gas oil	9.3	0.2	litre
Fuel oil	9.0	0.2	litre
AVGAS	9.2	2.4	litre
Road fuel gas	0.0	0.0	kg

1 Tax refers to duty plus VAT, except for gas oil and fuel oil, shown exclusive of VAT.

Bus fuel duty rebate

5.50 Bus fuel duty rebate will be raised to reflect increases in diesel duty over the next twelve months. The Government will consult shortly on how bus fuel duty rebate could be better targeted to provide incentives for lower emission vehicles, and to support rural services.

Vehicle Excise Duty

5.51 In the July Budget, the Government announced that the scheme to reduce Vehicle Excise Duty by up to 500 for lorries which meet a low emission standard would be extended to buses as well. This should encourage owners of lorries and buses to fit a "particulate trap" or convert to gas power. In January this year, the Department of the Environment, Transport and the Regions published details of how the scheme would operate. The scheme will go ahead as proposed from January 1999.

5.52 The Government has announced that there will be a review of the existing system for calculating Vehicle Excise Duty rates for lorries, taking account of decisions in the Department of the Environment, Transport and the Regions Integrated Transport White Paper on allowing heavier lorries onto UK roads. The aim of the review is to develop a system which more accurately reflects the environmental damage caused by different lorries.

5.53 The exemption from Vehicle Excise Duty for vehicles which are at least 25 years old in non-commercial classes will be frozen to include only those vehicles manufactured before 1 January 1973.

Public Transport Package

The Budget includes a 500 million boost for public transport, including 50million for rural transport services.

This new funding supports the Government's objectives of increasing accessibility and mobility in developing its Integrated Transport Strategy. Improving public transport in rural areas is a key aspect of this, and reflects the particular transport difficulties facing those in rural areas, both car owners and non-car owners. The Government recognises that certain social groups, including especially the elderly, the young, single parents and the disabled, may experience severe transport problems in rural areas. People on low incomes and the unemployed also need cheap, reliable transport in order to travel to work and seek employment.

The bulk of each country's share of the new resources will be allocated to a Bus Partnership Fund (managed by Department of the Environment, Transport and the Regions, the Scottish Office, the Welsh Office and the Department of the Environment (Northern Ireland)) to improve bus services in rural areas. This should provide up to 160 million additional bus kilometres nationwide.

Conventional public transport cannot always meet the increasingly diverse accessibility needs of rural communities. A flexible approach is required, targeted to local circumstances and drawing on the resources of the local community. The remainder of each country's share (around 5million nationwide) will therefore be devoted to community-based initiatives. Resources will be used to build on the success of existing community-based initiatives, such as community mini-buses and taxi-buses, and to facilitate better coordination of voluntary, local authority and commercial services.

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comments

Annex A: The Economy

This annex sets out the economic background to the Budget and discusses economic prospects.

The key points are:

- by 1997, the economy had largely used up its spare capacity and was growing at an unsustainable rate, putting upward p on inflation;
- the policy actions taken since last May have put the economy back on track for sustainable growth;
- underlying inflation is forecast to rise to around 3 per cent in the middle of this year, before falling back to the 2 1/2 per target by the end of 1999;
- responsible pay bargaining, combined with the Government's Welfare to Work measures, would allow faster growth and levels of employment over the next few years, consistent with meeting the inflation target.

Introduction(1)

A.01 The UK economy continues to suffer from a number of underlying structural weaknesses. As noted in Chapter 1, the level per head is below that in the other G7 economies and below the OECD average. In part, this reflects the UK's relatively low capit per person employed - the result of years of under-investment. But it also reflects the failure of previous Governments to face the of removing barriers to employment and growth. The Government is now set on providing the economic framework and opportu raise the economy's sustainable rate of growth. As described in the main chapters of this report, it is developing a comprehensive economic policies to achieve this objective, through promoting economic stability and encouraging work and enterprise.

A.02 However, at the same time as putting in place policies aimed at improving the country's long-term performance, the Gover had to address the short-term pressures facing the economy. By the middle of last year, the economy had largely used up its spare and output was growing at an unsustainable rate, putting upward pressure on inflation. Both the monetary and fiscal policy action has been taken since last May should ensure that domestic demand will slow through the course of this year, putting the economy track for more sustainable growth.

A.03 As in the November Pre-Budget Report, the projections for output growth are presented as ranges(2). These are intended to indication of how differing degrees of supply side improvement could affect the prospects for the economy over the next few yea Budget takes a further step forward in introducing policies which will encourage outcomes towards the more favourable ends of t ranges. But the actions of private individuals and businesses - for example, in avoiding excessive wage increases - will also be im determining whether the more favourable prospects materialise. Responsible wage bargaining offers the opportunity to promote j

A.04 The ranges are not an indication of the degree of forecast uncertainty. There are substantial risks to the short-term outlook could result in outcomes well outside the ranges. If domestic demand were to have more momentum than expected, the economy face a more pronounced cycle of strong growth and inflationary pressure, followed by a sharper slowdown. On the other hand, th a risk that demand could slow more rapidly than expected, for example if there were to be a further deterioration of the situation i which case inflationary pressure could undershoot the forecast. Another, and perhaps the most unpalatable, risk is that output cou currently be further above its sustainable level than estimated, implying greater inflationary pressure already in the pipeline, and t prospect of a sharper slowdown.

Trend growth and the output gap

Trend output

A.05 UK economic growth has averaged around 2 1/4 per cent a year since the mid-nineteenth century and, despite a rather bette performance during the 1950s and 1960s, this average, or trend, growth rate has not been improved upon over the post-war perio whole.

A.06 The figures at the lower ends of the forecast ranges are intended to be deliberately cautious, and make no allowance for any improvement in the supply side performance of the economy over the next few years. They are based on a trend growth rate of 2 cent a year, in line with both the post-war average and the average over the last full cycle, and are the basis of the projections of t finances set out in Annex B. However, the Government has set its sights higher - the July 1997 Budget set out the Government's a raising the trend rate of growth.

A.07 One way of achieving a better outcome is through a decline in the sustainable rate of unemployment (or NAIRU - the non-accelerating inflation rate of unemployment), which would allow a period of faster output growth and higher employment, consis meeting the inflation target. The upper ends of the forecast ranges are based on the assumption that improved labour market perfo delivers a fall in the sustainable rate of unemployment over the next three years, equivalent to trend output growing by 2 3/4 per c year through 1998 and 1999 and gradually reverting to the assumed rate of 2 1/4 per cent by the end of 2000.

The output gap

A.08 At the time of the November Pre-Budget Report, the economy was judged to be on trend, on average, in the first half of 19 has been no reason to change this view. But with output growth in the fourth quarter weaker than expected in November, GDP is estimated to have been around 1/2 per cent above its trend level (a positive output gap) in the final quarter of last year, compared 3/4 per cent estimate in the Pre-Budget Report.

The Labour Market

A.09 The view that the economy is currently operating above trend appears consistent with a wide range of labour market indica

- both the Labour Force Survey (LFS) and claimant count measures of unemployment are now below their previous troug 1990 (even after abstracting from the estimated large downward impact of the Job Seeker's Allowance on the claimant c Moreover, the LFS rate - at just over 6 1/2 per cent in autumn 1997 - is towards the lower end of the range of most estim the current level of the NAIRU (6-8 per cent);
- the unemployment rate is relatively low in the South East, where it is down to 3 per cent on the claimant count measure around 4 1/2 per cent on the LFS measure. The South West, Eastern and East Midlands regions also have LFS unemploy rates of 5 1/4 per cent or less, and are well below the national average on the claimant count measure;
- LFS short-term unemployment (less than one year), which is what matters most for wage pressure, is below its pre-reces trough; and
- vacancies (adjusted for a recent distortion) remain at a similar level to their previous peak in late 1987, while the ratio of vacancies to unemployment is well above its pre-recession peak in 1989.

A.10 There is also continuing evidence of recruitment difficulties and skill shortages:

- the latest British Chambers of Commerce (BCC) survey reported that recruitment difficulties are at similar levels to thei recession peaks in both the service and manufacturing sectors;
- although reported skilled labour shortages fell back in the most recent CBI survey of manufacturers, they are still at a le similar to that reached in 1990;
- the February Construction Confederation survey reported that labour availability was a problem for an increasing numbe companies. Around three quarters of firms had difficulty recruiting bricklayers and plasterers, with the shortage most sev London and Southern England;
- anecdotal evidence tends to reinforce the message from the surveys and suggests that skill shortages are becoming more spread; and
- earnings growth has increased from 3 1/4 per cent in the second half of 1995 to 4 3/4 per cent recently (see paragraphs A A.48).

A.11 Taken together, this evidence points to a labour market that is tightening to the stage of putting upward pressure on inflatio Moreover, it seems likely that labour market participation is now close to its current trend level, further suggesting that there is n any cyclical slack left in the labour market. Despite the working age activity rate (the proportion of the working age population e employment or unemployed) remaining around 2 percentage points below its pre-recession peak in 1990, cyclical increases in re have probably been offset by rising numbers of Incapacity Benefit claimants, students, and people taking early retirement. As a r working age activity rate has been fairly flat at around 78 1/2 per cent during the current upswing. The box on page 87 discusses trends in male and female activity and employment.

A.12 The UK's working age employment rate is currently around 73 per cent, and the Government is aiming to raise this on a su basis, with a dual approach of encouraging labour market participation among currently inactive people (i.e. raising the activity r reducing the sustainable unemployment rate. Around 11 3/4 per cent, or almost 4 1/4 million, of working age people in the UK a without work and wanting a job, despite the unemployed component having fallen to around 1.9 million. Moreover, the number c people who say they want a job as a proportion of the adult population is higher in the UK than in any other European Union cou

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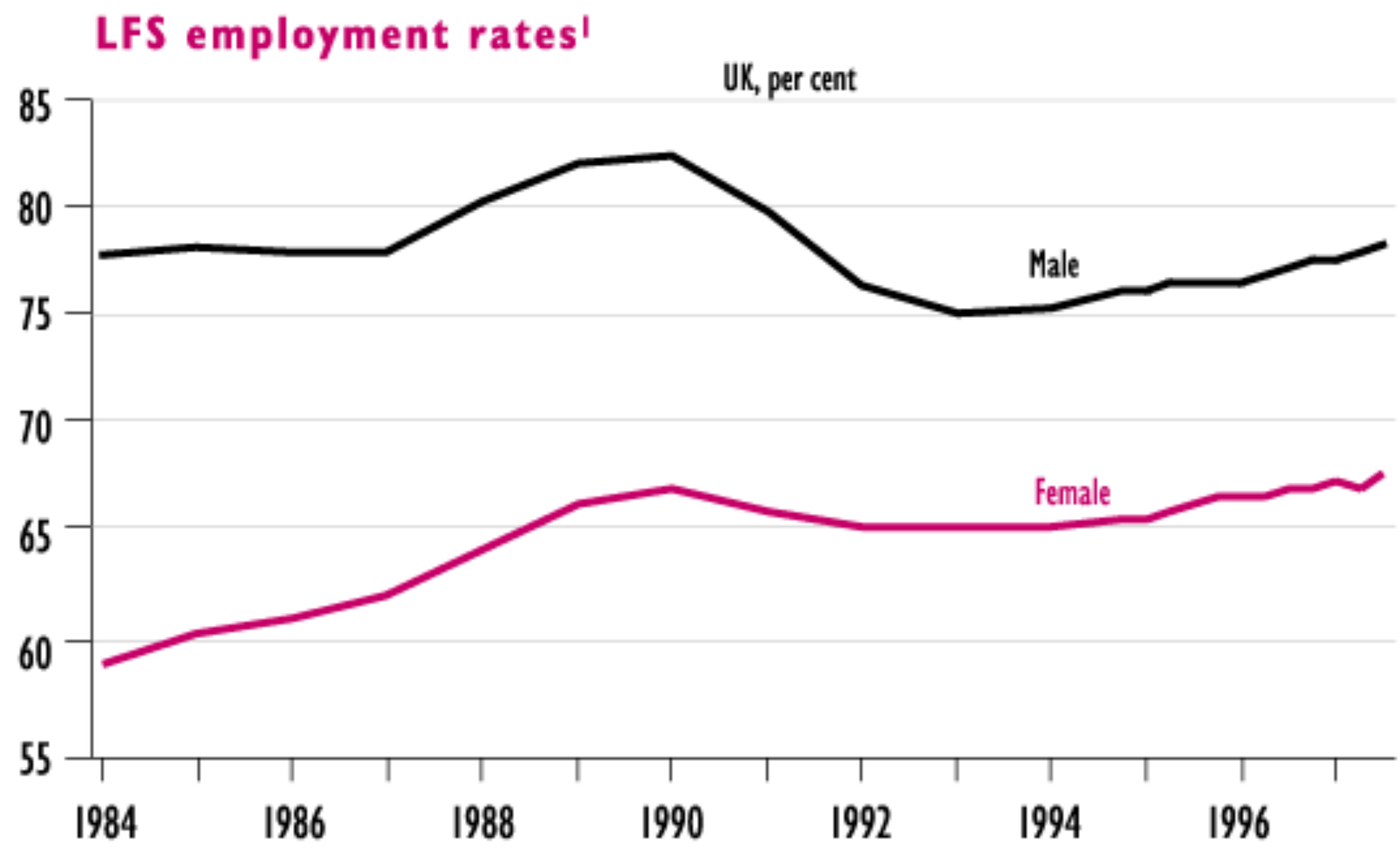
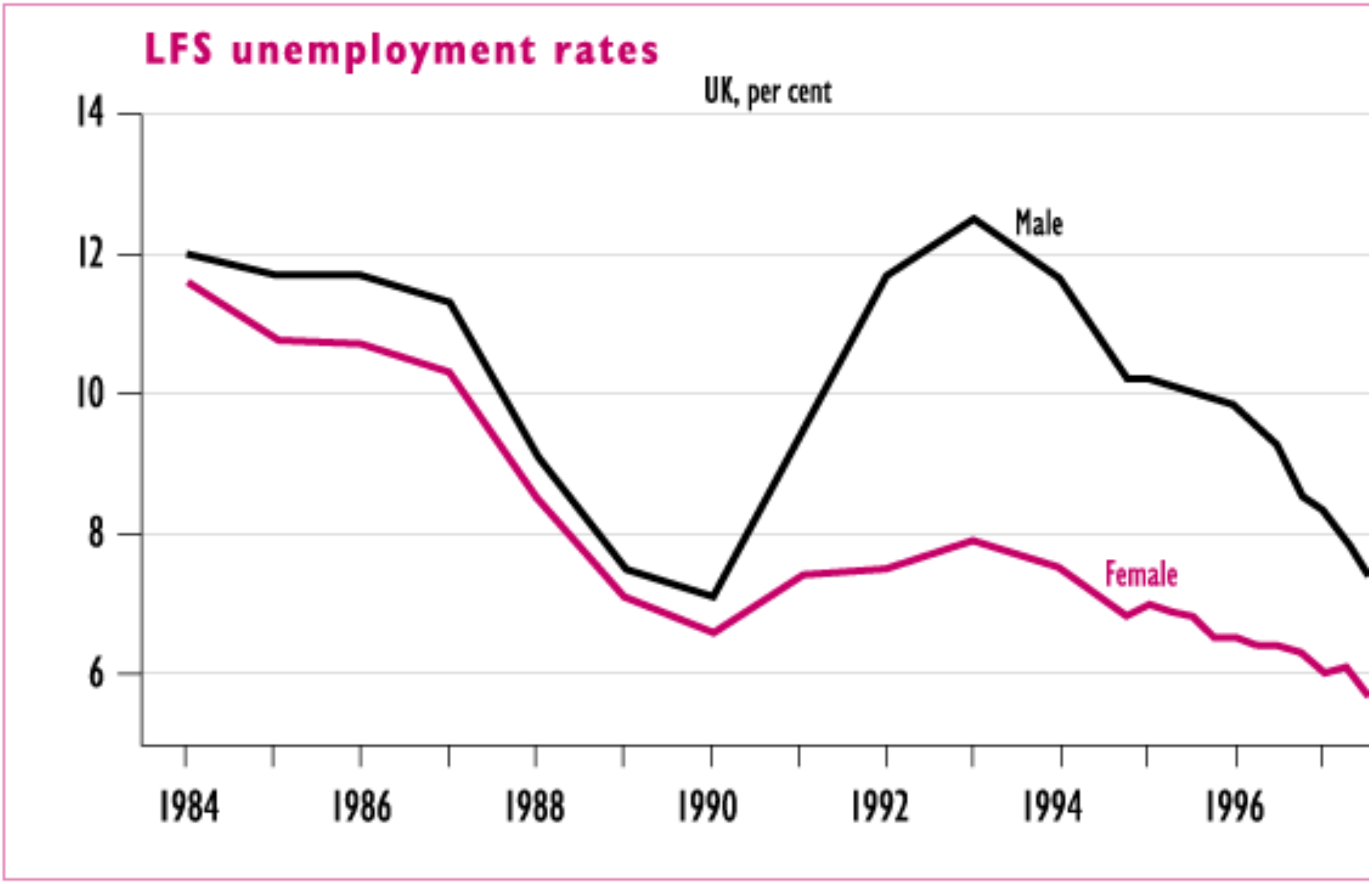
Male and female labour market trends

Male and female employment rates have moved very differently since the early 1980s. Adjusting for the economic cycle, the fen has continued on its longer-term upward trend, while the male rate has at best arrested its longer-term downward trend. These di employment trends are in part explained by changing participation (the female activity rate has been on a broadly upward trend male activity rate has been falling), but also by lower unemployment rates for women (in particular since 1990).



[1]Percentage of the population of wording age who are in employment.

The female unemployment rate was far less affected by the deep recession in the early 1990s than the male rate (both having pre been similar). Although male unemployment has fallen by proportionately more than female unemployment during the present u the male rate remains higher than its previous trough in 1990, whereas the female rate has been below its previous trough for the years.



There are a number of potential explanations for these different trends: for example, the continued relative decline of manufactu (which disproportionately employs men) and expansion of the service sector; an increase in family-friendly practices in the work women choosing to have fewer children and having them later in life; an increase in the proportion of single women; improved f educational attainment; and changing social attitudes towards female employment.

Looking ahead, the New Deal programmes, tax and benefit reform and other policy measures discussed in Chapter3 should help promote both higher male and female employment rates. In particular, the New Deals for the young and long-term unemployed (disproportionately male) should help to improve on past trends in the male employment rate. The national childcare strategy and Deal for lone parents should help to boost female participation.

A.13 The New Deal programmes for the young and long-term unemployed will enable these groups to compete more effectively Furthermore, the New Deals for lone parents and the long-term sick and disabled should increase the effective labour supply by r integrating the target groups into the labour market. The measures announced in the Budget for reforming the tax and benefit syst also increase the effective labour supply by reducing disincentives to work. As a result, more labour will be supplied at any given wage rate. This equates to a reduction in the NAIRU.

A.14 To the extent that these policies are successful, the economy will be able to sustain a higher level of GDP in the longer term faster rate of growth over the transition period.

Demand and Output

GDP

A.15 After expanding at an annualised rate of 3 1/2 per cent on average between the end of 1996 and the middle of 1997, GDP g slowed to an annualised rate of 2 1/2 per cent in the fourth quarter of last year. In 1997 as a whole, GDP is estimated to have risen cent, compared with the 3 1/2 per cent Pre-Budget Report forecast.

A.16 The slackening in the pace of output growth at the end of last year largely reflected a deterioration in net trade performance appreciation of sterling over the past eighteen months began to impact on trade volumes. Abstracting from a comparatively weak the third quarter of 1997 (which appears to have reflected the timing of spending out of windfall receipts and the effects of the Pr Wales' funeral in September), domestic demand growth has so far shown little sign of softening.

A.17 The impact of sterling's appreciation has also become evident in a growing divergence between the manufacturing and serv sectors. Service sector output (which accounts for around two thirds of total output) rose by almost 4 1/2 per cent in the year to th quarter of 1997. In contrast, manufacturing output (around a fifth of the economy) rose by around 1 per cent over the same perioc stalled around the middle of last year and fallen since the autumn.

A.18 Latest monthly indicators show continued buoyancy of consumer demand into 1998. Both January retail sales and car regis showed strong growth, and the underlying trends do not yet show convincing signs of a slowdown. Consumer confidence has dip its autumn highs, but remains well above normal levels.

A.19 In order to offset the inflationary pressures created by the positive output gap and to meet the inflation target by the end of it is likely that GDP will need to grow below its trend rate for a time to generate a negative output gap.

A.20 Net trade is expected to continue to make a negative contribution to growth through this year and the first half of next, refle appreciation of sterling and the impact of financial turbulence in Asia - which has increased since November (details are set out i on page 104). In addition, domestic demand growth is likely to slow through the course of the year in response to the increases in rates since last May and a tightening fiscal stance.

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A.21 Depending on the extent of any improvement in labour market performance, GDP is forecast to grow by between 2 and 2 1 cent this year, slightly below the Pre-Budget Report forecast reflecting recent developments in Asia. The counterpart to this, and downward revision to the estimated output gap at the end of last year, is that growth in 1999 is forecast to be a little stronger than Pre-Budget Report forecast, consistent with meeting the inflation target. Growth is projected at 1 3/4 to 2 1/4 per cent in 1999, an 2 3/4 per cent in 2000.

The personal sector

A.22 1997 saw strong growth in personal spending. Aggregate consumers' expenditure grew by 4 1/2 per cent, well above its lor average, more than enough to account for the growth of GDP last year. Spending on consumer durables rose by almost 11 per cer of expansion last seen in the late 1980s.

A.23 The major driving force was the strength of households' finances. Real personal disposable income grew by 4 1/4 per cent l driven by cyclically strong employment growth and an acceleration of average earnings. Meanwhile, a buoyant equity market led increase of 375 billion (25 per cent) in personal sector net financial wealth in the course of the year. The rapid growth in consume expenditure can therefore be readily explained by movements in income and wealth. These forces put into context the more mode contribution to spending resulting from the 35 billion of "windfall" payments received by households during 1997 from the flotat building societies and insurance companies.

A.24 The profile of consumer demand last year now points to one-off windfall-related expenditure having turned out lower than at the time of the Pre-Budget Report. Based on the MORI survey conducted last August, a transitory boost to spending of some 3 billion in 1997 had been expected, adding around 3/4 percentage points to consumption growth for the year as a whole. In some a windfall effects have been obvious, for example the summer boost to sales of household goods. Elsewhere, they are more difficul pinpoint, but the general run of indicators now suggests a boost to consumption of more like 1/2 percentage point last year, with t impact recorded during the second quarter.

A.25 Underlying growth in consumers' expenditure has clearly been running at an unsustainable rate, but it is expected to slow tl this year, partly in response to the increases in interest rates since last May. Already the impact is evident in the housing market w according to most measures, the recovery in prices has slowed. However, wider signs of a slowdown in consumer demand have y become so clear. Consumers' expenditure ended 1997 strongly, up 5 per cent on a year earlier, and the latest indications are that it begun 1998 at a similar pace.

A.26 But such momentum seems unlikely to be maintained in the face of the contractionary forces expected to be acting this yea "windfall" effect has probably already died away. Higher interest rates meanwhile take time to bite on spending, partly as consur the permanence of policy tightening, and as Annual Review Schemes trigger increases in mortgage payments. As the economy sl response to the tighter policy stance, a downturn in the growth of real incomes is also expected. In particular, employment growtl to abate and the exceptional growth in financial income seen in recent years (reflecting strong growth of dividend income) is expe weaken. On the other hand, asset prices have continued to be firm.

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A.27 Perhaps the major uncertainty is the degree to which consumers will cushion spending through lower saving as income gro slows. As noted in previous reports, the persistence of high personal sector saving has been one of the major features of the curre upswing.

A.28 This contrasts markedly with the 1980s, when the saving ratio (saving as a percentage of disposable income) fell sharply, a with a one-off stock adjustment to financial liberalisation and rising expectations of future income growth as the economy boome housing market appeared to play a key transmission role at that time, with rapidly rising prices encouraging individuals to spend the back of rising wealth, partly through a surge in secured borrowing to finance everyday spending.

A.29 The current upswing has not been associated with systemic changes in the financial system, and has also been rather differe least two other ways. First, the house price to income ratio has been more stable relative to previous cycles, and the housing weal income ratio has yet to recoup the losses of the early 1990s, dampening the willingness of individuals to borrow to finance consu Second, growth in real disposable income has been heavily buoyed by rapid growth in financial income over the past three years, particularly dividend receipts. Analysis suggests that such income exerts only a modest influence on consumer spending, which is surprising as the bulk of it flows to pension funds rather than directly to households. This has helped to hold the measured saving high.

A.30 Nevertheless, the saving ratio is expected to decline over the next three years. In part, this will reflect the relatively muted i spending of weaker financial income growth. But, in addition, high levels of confidence and record levels of financial wealth may encourage somewhat lower saving as real growth in wages and salaries eases back for the first time during this recovery. Further housing wealth may also underpin some downward movement in the saving ratio although, as noted above, any such movement i to be large.

Table A1: Personal expenditure and income

	Percentage changes on a year earlier			
		Forecast		
	1997	1998	1999	2000
Consumers' expenditure	4 1/2	3 3/4 to 4	1 3/4 to 2 1/4	2 1/4 to 2 1/
Real personal disposable income	4 1/4	2 to 2 1/2	1 1/4 to 1 3/4	2 to 2 1/4
Saving ratio (level, per cent)	11	9 1/2	9 1/4	9

A.31 Overall, consumer spending is forecast to grow by 3 3/4 to 4 per cent this year. While this would remain well above sustair rates, it conceals a considerable slowdown through the year, and growth of 1 3/4 to 2 1/4 per cent is forecast for 1999. The saving assumed to decline to around 9 per cent by 2000, which is well above the levels recorded in the late 1980s, and more so in underl (inflation adjusted) terms.

Investment

A.32 As discussed in Chapter 4, the UK's ratio of whole economy investment to GDP has been low by international standards an although non-residential and business investment ratios have been more on a par with other major economies, the UK has investe lower level of GDP per head. Consequently, UK investment per worker has been relatively low, leading to a deficient capital stoc worker. This is one key factor in explaining why the UK has a lower level of labour productivity than other major economies.

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A.33 In order to catch up with major competitors in terms of GDP per head, it will be necessary to create the conditions for apply capital and labour more efficiently, so as to encourage higher investment and realise higher productivity. Reversing the UK's relat poor investment performance is therefore a key element in the Government's strategy for raising the trend rate of GDP growth. Tl relationship between investment and growth is discussed in the box on page 93.

A.34 In the present upswing, investment has been relatively subdued. Whole economy investment fell as a share of GDP until la primarily reflecting falling general government investment, and relatively subdued residential investment. Business investment ha rising as a share of GDP since 1994.

A.35 However, whole economy investment grew more strongly in 1997, rising by 4 3/4 per cent, its fastest growth rate since 198 further fall in general government investment was more than offset by a 7 3/4 per cent rise in business investment, led by the manufacturing sector.

A.36 Looking ahead, it seems likely that investment will retain some momentum. There is widespread evidence of capacity cons both the CBI and BCC surveys report capacity utilisation in the manufacturing and service sectors at similar levels to those seen i 1980s and early 1990. The cost and supply of finance is also favourable for investment growth. The equity market is buoyant and survey reports that the cost of finance is far less of a constraint on manufacturing investment than it was in the late 1980s.

A.37 But the anticipated slowdown of demand more generally will act as a restraining influence. In particular, manufacturing inv is expected to be broadly flat this year as output prospects are depressed by the high exchange rate.

Investment and economic growth

Recent theories of growth have focused on explaining the pace of technical progress. For example, spillovers associated with inv in new technologies, knowledge-based industries and tertiary education, open up the possibility that investment in physical and h capital might permanently raise the growth rate. In any case, a rise in the investment-GDP ratio could significantly raise the grov of GDP for a protracted period, even if not permanently, as the economy goes through the transition to the higher GDP path.

Increases in capital productivity can compensate in part for low rates of investment, as appears to have been the case for the UK past two cycles. But this increase may partly have been attributable to opportunities to catch up with best practice. As such, it ma been a once and for all effect, which cannot be counted on to continue. For a given capital-output ratio, the investment ratio requ sustain steady output growth needs to be sufficient to expand the capital stock at the same rate as output after covering depreciati

Currently, the ratio of investment to GDP stands around 12 per cent for business investment, or 14 per cent for non-residential investment, and the ratio of the business sector capital stock to GDP is of the order of 2 1/2 :1. Consequently it can be calculated capital productivity were unchanged (i.e. a constant capital-output ratio), then the current investment ratio would be sufficient to trend GDP growth of 2 1/4 per cent a year only if the depreciation rate of the business sector capital stock were no more than aro 1/2 per cent a year. It seems likely that the depreciation rate exceeds this (possibly to a substantial degree). In that case, some rise current investment-GDP ratio would be required even to support trend growth of 2 1/4 per cent a year, unless capital productivity improve. If the UK is to raise its trend growth rate and catch up with other major countries in terms of GDP per head, then it seer almost certain that some considerable increase in the investment-GDP ratio will be required.

However, a higher investment-GDP ratio will not come about of its own accord. There must be the incentive to invest more, and only be worthwhile if the future returns outweigh the cost of forgone current consumption. Faster total factor productivity growtl lower cost of capital would encourage investment. Policy measures to create a stable macroeconomic environment, remove tax distortions (e.g. through reform of the corporate tax system), and otherwise promote enhanced efficiency, are designed to contrib this end. Typically higher total factor productivity will go hand in hand with a higher capital-output ratio, and raising its growth key to sustained higher economic growth.

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A.38 Overall, business investment is forecast to decelerate this year, although it is projected to continue to rise as a share of GDI economy investment is forecast to rise faster than business investment, as the large falls in general government investment of rec come to an end. The sharp rebound in general government investment in 1998, following its sharp fall in 1997, partly reflects inv under the local authority Capital Receipts Initiative and the New Deal for schools, but also the profiling of expenditure: financial figures show a much smoother path. The whole economy investment-GDP ratio is expected to rise to around 18 1/4 per cent by 2 little above its long-run average.

Table A2: Gross domestic fixed capital formation

	Percentage changes on a year earlier			
		Forecast		
	1997	**1998**	**1999**	**2000**
Whole economy(1)	4 3/4	4 3/4 to 5 1/4	2 3/4 to 3 1/4	2 1/2 to 2 3/4
of which:				

Business(2),3	7 3/4	4 1/2 to 5	3 to 3 1/2	2 1/2 to 3
Housing(2)	7 1/2	4 1/4 to 4 1/2	1 3/4 to 2 1/4	1 3/4 to 2
General government(2),4	-15 3/4	14	4 1/4	1 1/2

1 Includes transfer costs of land and existing buildings.

2 Excludes net purchases of land and existing buildings.

3 Private sector and public corporations (except National Health Service Trusts) non-residential investment. Includes investment Private Finance Initiative.

4 Includes National Health Service Trusts.

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(1) *The forecast is based on the assumption that the exchange rate moves in line with an uncovered interest parity condition, cons with the interest rates underlying the economic forecast. A full set of charts and tables relating to the economic forecast is availa Treasury's internet site (http://www.hm-treasury.gov.uk), and copies can be obtained on request from the Treasury's Public Enqui (0171 270 4558).* [Back]

(2) *Full details of the forecast ranges and their interpretation are provided with the additional material referred to in the previou footnote.* [Back]

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comments

Annex B The Public Finances

The public finances have improved more sharply than expected this year, and are projected to improve further on current policies. After a brief summary, this annex sets out the assumptions underlying the forecasts and projections outlined in Chapter2. It then deals in turn with budget deficits, debt, government receipts and government expenditure, and concludes with some further analyses of government borrowing and funding. Historical series for different measures of the budget deficit, expenditure and receipts, and a description of the accounting conventions used in presenting the public finances are given at the end of the annex.

SUMMARY

- The Government is fully on course to meet its five year deficit reduction plan. Excluding windfall tax receipts, the PSBR will probably be about 5 billion in 1997-98. This is 7 billion lower than forecast in the November Pre-Budget Report. Public spending has been lower than planned, while tax receipts have turned out higher than expected.
- The current balance, which has been continuously in deficit since 1990-91, could be close to balance in 1997-98 and be in surplus next year.
- The burden of public debt, which had risen sharply over the first half of the 1990s, has fallen slightly over the past year, as would be expected at this stage of the economic cycle, and is likely to fall further next year.
- On internationally comparable definitions (which cover only general government and exclude public corporations), both the budget deficit and debt burden were comfortably within Maastricht reference levels in calendar 1997.
- On the three illustrative public expenditure assumptions used in last July's Budget for the years beyond 1998-99 and with no further tax changes, the public finances would be expected to continue to improve over the medium term.

Assumptions

B.01 The projections:

- take account of the effects of the Budget measures, but assume that there are no further tax changes beyond the annual real increases in fuel and tobacco duties (announced in the November 1993 Budget) and the indexation of rates and allowances;
- assume that public spending is in line with cash plans in 1998-99, and for later years is as in the three illustrative projections shown in the July Budget and November Pre-Budget Report (ie real growth in the Control Total of 3/4 ,1 1/2 and 2 1/4 per cent a year); and
- assume that the economy follows the path described in Appendix A. In the interest of caution, the lower end of the range of projections of GDP growth has been used.

Table B1: Economic assumptions for public finance projections

	Percentage change on a previous year					
	1997-98	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**2002-03**
Output (GDP)	3	1 3/4	2	2 1/4	2 1/4	2 1/4
Prices:						
RPI excluding MIPs	2 3/4	2 3/4	2 1/2	2 1/2	2 1/2	2 1/2

GDP deflator	2 3/4	3	2 1/2	2 1/2	2 1/2	2 1/2
RPI (September)(1)	3 1/2	3 1/4	2 1/4	2 1/2	2 1/2	2 1/2
Rossi (September)(1)	2 1/2	2 1/4	2 1/4	2 1/4	2 1/4	2 1/4
Money GDP (billion)	**797**	**834**	**872**	**914**	**958**	**1 004**

1 Used for projecting social security expenditure over the following financial year.

B.02 Eleven of the key assumptions and conventions underlying the projections have been audited by National Audit Office (NAO). Unemployment is assumed flat at its January level and interest rates are projected in line with market expectations.

NAO audit of assumptions and conventions

The National Audit Office (NAO), in response to invitations from the Chancellor of the Exchequer, has now examined eleven of the key assumptions and conventions underlying the forecasts of the public finances. The results of previous NAO audits were published in a Command Paper issued before the July Budget (Cm3693) and a House of Commons Paper issued at the time of the November Pre-Budget Report (HC361). A report covering the assumptions on factor income shares and funding used in this Budget will be issued by the NAO on Thursday, 19 March (HC616).

The eleven assumptions and conventions that have been audited cover privatisation proceeds and most of the key aggregate determinants of tax revenues and of cyclical social security and debt interest, the main components of public expenditure outside the Control Total.

	Key determinants	Audited assumptions
Tax receipts	Economic growth	Trend GDP
	Inflation	GDP deflator, RPI
	Composition of GDP	Factor shares
	Asset prices	Equity prices
		Oil prices
	Effectiveness of anti-evasion etc. measures	"Spend to Save"
	VAT shortfall	Effective VAT rate
Cyclical social security	Claimant count	Unemployment
	Inflation upratings	RPI, Rossi, GDP deflator
Debt interest	Interest rates	Short-term interest rates
	Composition of debt	Funding assumptions
	Inflation	RPI
Privatisation proceeds		Privatisation proceeds

Budget Deficits

1997-98 estimates

B.03 Excluding windfall tax receipts and associated spending, the PSBR in 1997-98 is estimated at 5 billion. This estimate is still subject to significant error, given the difficulty of predicting public spending and receipts towards the end of the financial year. It compares with forecasts of 13 1/4 billion in the July Budget and 12 billion in the November Pre-Budget Report. The undershoot chiefly reflects an underspend on the Control Total, estimated at 1 1/2 billion, and higher tax receipts, principally from income tax following the introduction of self-assessment, VAT and social security contributions.

B.04 In spite of a reduction of over 2 1/2 billion in privatisation proceeds, the estimated PSBR (excluding windfall tax) is 17 3/4 billion lower than in 1996-97. About one quarter of this reduction is accounted for by tax measures in recent Budgets and by the introduction of self-assessment; the remainder reflects relatively fast economic growth and tight control of public spending.

B.05 The outturn for the current balance - the concept relevant to the "golden rule" - is still uncertain, since full figures are available only for the first three quarters of the financial year. It is estimated that the current balance will be close to zero in 1997-98. This follows six years of substantial deficits.

B.06 The general government financial deficit was larger than the PSBR, as it did not benefit from privatisation proceeds or a debt repayment by public corporations. On the Maastricht definition (which does not exclude the windfall tax), the provisional outturn for calendar 1997 was 1 3/4 per cent of GDP, which is the same as forecast in the Pre-Budget Report and comfortably below the excessive deficits criterion of 3 per cent.

1998-99 forecasts

B.07 The current balance is projected to continue to improve next year. On a national accounts basis, total receipts are projected to rise by over 17 billion between 1997-98 and 1998-99, at a rate slightly faster than money GDP, while current public spending is projected to rise by 13 billion. As a result, the current account is projected to move into surplus (even when the windfall tax is excluded).

Table B2: Budget deficits (including and excluding the windfall tax)

	billion		
	Outturn	**Estimate**	**Forecast**
	1996-97	**1997-98**	**1998-99**
Receipts(1)	288.1	315.7	333.0
Current expenditure(2)	308.3	314.5	327.5
Current balance	**-20.2**	**1.2**	**5.5**
Current balance excluding windfall tax(3)	**-20.2**	**-1.3**	**3.6**
Net capital spending(4)	6.7	6.3	7.0
Public sector financial deficit	**26.9**	**5.1**	**1.6**
Privatisation proceeds and other financial transactions	4.2	2.5	-0.8
PSBR	**22.7**	**2.6**	**2.3**
PSBR excluding windfall tax(3)	**22.7**	**5.0**	**3.9**
General government			
financial deficit(5) **- billion**	**29.7**	**5.7**	**1.3**
- per cent of GDP(5)	**3.9**	**0.7**	**0.1**
Money GDP - billion	752.3	796.8	833.6

1 On a national accounts accruals basis. Includes capital taxes.
2 Includes depreciation of fixed capital.
3 Excluding windfall tax receipts and associated spending.
4 Net of depreciation and less capital transfer receipts and includes capital grants.
5 Definitions on a Maastricht basis (which does not exclude the windfall tax and associated spending).

B.08 With net capital spending projected to rise, the financial deficit improves slightly less than the current balance between 1997-98 and 1998-99. There is little difference between the projected levels of the PSBR and public sector financial deficit, as privatisation proceeds are assumed to be zero, or between the public sector financial deficit and the general government financial deficit, as public corporations are projected to be close to financial balance. On all three measures, the deficit is projected to be around 1/2 per cent of GDP when the windfall tax is excluded.

PSBR

B.09 Table B2 gives a national accounts (accruals) presentation of the public finances. Table B3 presents an alternative way of looking at the PSBR, in terms of general government expenditure and cash receipts and public corporations' borrowing.

Table B3: Public sector borrowing requirement

billion	Outturn 1996-97	Estimate 1997-98	Forecast 1998-99
General government expenditure	309.1	317.1	332.5
General government receipts(1)	286.4	313.1	330.1
General government borrowing requirement	22.7	3.9	2.4
PCMOB(2)	0.0	-1.4	-0.1
PSBR			
- billion	22.7	2.6	2.3
PSBR excluding windfall tax(3)	22.7	5.0	3.9
- per cent of GDP	3.0	0.6	0.5

1 On a cash basis.
2 Public corporations' market and overseas borrowing.
3 PSBR excluding windfall tax receipts and associated spending.

Changes since last Budget

B.10 The PSBR in 1997-98 is now estimated to be 8 1/4 billion lower than forecast in the July 1997 Budget. This reflects the shortfall in general government expenditure (detailed in Table B13), higher government receipts (see Table B10) and an unexpected repayment of debt by public corporations.

Table B4: Changes since July Budget(1)

billion	1997-98	1998-99
General government expenditure	-2.3	1.2
General government receipts(2)	4.8	2.9
General government borrowing requirement	-7.2	-1.7
PCMOB(3)	-1.2	0.1
PSBR		
- billion	-8.3	-1.6
- per cent of GDP	-1.0	-0.2

1 Budget forecast has been adjusted for classification and other accounting changes. See conventions used in presenting the public finances.
2 On a cash basis.
3 Public corporations' market and overseas borrowing.

Illustrative medium-term projections

B.11 Public expenditure plans for years after 1998-99 will not be known until the summer when the results of the Comprehensive Spending Review are announced. TableB5 sets out stylised projections based on the same three illustrative assumptions for spending growth that were used in the July Budget and November Pre-Budget Report (see paragraph B.29).

comments

Annex C The Budget Measures

C.01 This annex summarises all the tax and expenditure measures in the Budget(1). Working Families Tax Credits (WFTC) and national insurance contributions measures to encourage work are described in Chapter 3. Corporation tax and capital gains tax measures to promote enterprise are described in Chapter 4. Measures to increase fairness are covered in Chapter 5.

C.02 The effect of the measures on Government revenues is set out in Table C.1. Appendix C to this annex explains the costings and Appendix B details a number of tax changes which were announced before the Budget, including measures announced in the July Budget but not yet implemented.

Encouraging work

C.03 Chapter 3 describes the Budget's measures to make work pay including, new measures for young people, lone parents, the long-term unemployed and disabled people to be funded from the Windfall Tax. These measures do not appear in TableC.1. The allocation of the Windfall Tax is shown in Table3.1. The new Working Families Tax Credit is described in paragraphs 3.35 to 3.46 (1).

C.04 A New Deal for Communities is described in paragraphs 3.21 to 3.23 (2).

C.05 The changes to the linking rules for lone parents on Income Support and disabled people on Incapacity Benefit are described in paragraphs 3.11 and 3.20 respectively (3).

C.06 The entry rates for National Insurance Contributions (NICs) will be abolished (see paragraphs 3.29 to 3.33) (4).

C.07 A disabled person's tax credit is described in paragraph3.47 (5).

Encouraging enterprise

Corporation tax

C.08 This Budget's measures to encourage enterprise are described in Chapter 4. The changes to corporation tax are to:

- cut the main rate to 30 per cent (6);
- cut the small companies rate to 20 per cent (7);
- abolish ACT and introduce quarterly payments of corporation tax (8);
- abolish quarterly accounting for gilts (9).

Capital gains tax: structural reform

C.09 Paragraphs 4.28 to 4.31 describe this Budget's structural reform of capital gains tax (10).

Other measures encouraging enterprise

C.10 Changes to reinvestment relief for investing in venture capital are described in paragraph 4.35 (11).

C.11 Other venture capital changes are described in paragraphs4.37 and 4.38 (12).

C.12 Capital allowances for small and medium sized businesses will be, for one year, provided at a rate of 40 per cent (13).

C.13 University challenge is described in paragraph4.43 (14).

C.14 The registration and deregistration thresholds for VAT will be increased to 50,000 and 48,000 respectively from 1 April

1998. There will be a consultation exercise to inform future decisions on the threshold (15).

Creating a fairer society

C.15 Chapter 5 describes the Budget's measures to help create a fairer society.

C.16 This Budget includes 2million of extra support, so that free national museums and galleries can avoid introducing admission charges, in the form of a challenge fund(--).

C.17 Income tax changes in the Budget are:

- all personal allowances will be increased in line with inflation (16);
- the lower rate band of income tax will be increased in line with inflation (17);
- the basic rate limit of income tax will be increased in line with inflation (18);
- tax relief on the married couple's allowance will be restricted from 15 per cent to 10 per cent from April 1999, and the over 65s will be fully compensated (see paragraph 5.08) (23).

C.18 Marginal deduction rates of over 100 per cent in housing benefit and council tax benefit will be removed (see 3.40) (19)

C.19 An extra 1/2 billion will be invested in the hospital waiting lists initiative (seeparagraph5.21)(20).

C.20 An extra 1/4 billion will be invested in education (see paragraphs5.23 and 5.24)(21).

C.21 A package of measures to increase support for children is described in paragraphs 5.04 to 5.07 (22).

C.22 Paragraphs 5.63 to 5.66 describe the new individual savings account (24).

C.23 Paragraphs 5.70 and 5.71 describe certain changes to inheritance tax (*).

C.24 The threshold for inheritance tax will also be increased in line with inflation (25).

C.25 Paragraph 5.73, fourth tiret describes certain structural changes to capital gains tax and an anti-avoidance measure (56).

C.26 Stamp duty rates will be increased for transfers of property above 250,000 by 1/2 per cent and for transfers of property above 500,000 by 1 per cent (26).

C.27 The higher rate insurance premium tax of 17.5 per cent will be extended to all travel insurance, from 1 August 1998, in recognition of likely changes in the market for travel insurance (27).

C.28 Paragraph 5.75 describe the increases in tobacco duties (28).

C.29 Paragraphs 5.76 to 5.78 describe the increases in alcohol duties:

- revalorisation on 1 January 1999 (29);
- duty on spirits remains unchanged (30);
- a step towards aligning low strength sparkling wine and sparkling cider (31).

VAT on company car fuel scales

C.30 The scales used to charge VAT on fuel used for private motoring in business cars are to be increased from 6 April 1998 to reflect changes in fuel prices. The scales ensure that those using business cars for private motoring do not do so VAT-free (42).

Other company car measures

C.31 Paragraph C.42 describes other company car measures (41).

Oils

C.32 The legislation which fixes the time oil becomes chargeable with excise duty is to be changed as an essential first step in simplifying and rationalising the complex charging provisions that exist in the Hydrocarbon Oil Duties Act 1979, from a date to be announced (-).

Millennium Gift Aid

C.33 The "Millennium Gift Aid" scheme is described in paragraph5.20 (33).

Gambling

C.34 The top rate of gaming duty is to be increased to 40 per cent and the gross gaming yield threshold for each duty band will be reduced from 1 April 1998. Overall, casinos have a lower effective rate of duty than most other forms of betting and gaming. The changes are designed to increase the effective rate of taxation on gaming in casinos, particularly the more profitable London casinos, while taking account of the unusually high fixed costs of the industry (34).

C.35 The cost of a 12 month licence for an Amusement With Prizes machine, or a Jackpot machine costing 5 pence or less per play is to increase to 645 (an increase of 110) and the cost of a 12 month licence for other Jackpot machines is to increase to 1,815 (an increase of 440). The cost of a 12 month licence for non-gaming machines will remain at 250. These increases above the cost of inflation reflect the new opportunities provided by deregulation. The lowest rate of duty has not been increased to take account of the difficulties non-gaming machines have faced in remaining profitable following the introduction of Amusement Machine Licence Duty. These changes will take effect for any licence applications received by Customs on or after 18 March 1998 (35).

C.36 From 1 April 1998 Skill With Prizes (SWP) machines costing 35 pence or less per play will become exempt from the duty. Currently only SWPs costing 5 pence or less per play are exempt. This change brings SWP machines into line with the exemption already available to other non-gaming machines. Legislation will also be introduced from Royal Assent to replace an extra statutory concession which provides for the exemption from Amusement Machine Licence Duty of non-prize video machines which can be played by more than one player, but where the cost for a single player to play one game alone does not exceed 35 pence. An additional limit will be introduced to state that the effective cost per player where two or more players play a game simultaneously must not exceed 50pence. This concession was introduced to give these multi-play video games the same exemption from duty as is afforded to single player video games. The legislation will regularise the position, and also closes a potential loophole by introducing the cost per player limit of 50 pence (36).

Protecting the environment

C.37 In line with the Government's commitment to increase road fuel duties by at least 6 per cent in real terms on average a year, the tax (duty plus VAT) on unleaded petrol rises on Budget day by 4.4 pence per litre, and on leaded by 4.9 pence per litre (37).

C.38 To reflect concerns over local air quality, and to encourage the manufacture and use of ultra-low sulphur diesel, the tax (duty plus VAT) on diesel rises on Budget day by 5.5 pence per litre, and on ultra-low sulphur diesel by 4.4 pence per litre. The next Budget will increase the duty differential between diesel and ultra-low sulphur diesel to 3 pence per litre. Future Budgets will further increase the duty differential between diesel and unleaded petrol (38).

C.39 The tax (duty plus VAT) on super-unleaded petrol rises on Budget day by 6.1pence per litre (39).

C.40 Vehicle Excise Duty is frozen this year for all vehicles (40).

C.41 The Vehicle Excise Duty concession of up to 500 for low emission buses and lorries will commence in January 1999 (44).

C.42 The fuel scale charges for free fuel provided by employers to company car owners will increase by 20 per cent above revalorisation from 6 April 1998, and for four following years. From 6 April 1999, the cost of conversion to road fuel gases will be ignored when calculating the tax charge (41).

C.43 Bus fuel duty rebate will be revalorised from Budget day in line with the increases in diesel duty (45).

C.44 There will be a 500 million boost for public transport. 50 million will fund rural transport services of which 45 million will fund a Bus Partnership Fund and 5 million will go to a Rural Community Transport Initiative (46).

C.45 From April 1999, the standard rate of landfill tax will be increased to 10 a tonne. Following consultation, from October 1999, there will be an exemption for inert materials used in site restoration (47).

C.46 Increases or cuts in the rate of landfill tax can be brought in immediately after a Budget, without having to wait for Royal Assent to the Finance Act. This will bring the tax in line with other taxes, like VAT or duties on alcohol, cigarettes or petrol, from Royal Assent (-).

C.47 VAT will be reduced to 5 per cent on the installation of energy saving materials under certain Government grant schemes off from 1 July 1998, as announced in the Pre-Budget Report (43).

Employment termination payments

C.48 The Budget announces simpler and more appropriate treatment of payments and benefits provided over a period of time following termination of an employment, to tax more fairly the packages provided and to ease compliance burdens for employers and employees. With effect from 6 April 1998 (48).

Schedule A for companies

C.49 Modernisation and simplification of Schedule A rules applying to corporation tax, to bring closer into line with those for income tax. Computation of rents will, from 1 April 1998, follow the rules for computation of trading profits, recognising income as it accrues and expenditure as it is incurred. Interest will continue to be dealt with under the corporate interest rules and Schedule A losses will be relieved in the same way as management expenses (49).

GAAR

C.50 Paragraphs 5.86 and 5.87 describe new anti-avoidance measures (-).

Foreign earnings deduction

C.51 The "foreign earnings deduction" will be eliminated for all but seafarers, to end a readily exploited vehicle for abuse under which certain UK residents have been able to receive large amounts of income from "working abroad" completely free from tax. With effect from 6 April 1998 (50).

Cash accounting for professionals

C.52 From 6 April 1999, practices which permit some professional businesses to pay tax on a more favourable ("cash") basis will be withdrawn, in order to level playing field for all businesses. Catching-up charge to be phased in order to spread impact for those affected (51).

Capital gain buying by companies

C.53 Legislation will be introduced to prevent avoidance by groups of companies using a device known as "gain buying" to bring together gains and losses which have arisen on assets in different economic ownership. The provisions will apply where a company joins a group on or after Budget day. Legislation will also address two smaller avoidance risks for groups of companies with capital gains. The first of these concerns transfers of assets to investment trusts or venture capital trusts. The second corrects a technical defect in the charge that can arise when a company leaves a group (52).

Remuneration in shares subject to forfeiture or conversion

C.54 Shares subject to the risk of forfeiture or conversion, awarded to employees or directors will be taxed at the point at which the risk of forfeiture is lifted or conversion occurs. This will apply to shares awarded on or after Budget day (*).

Life insurance: tax treatment of policy holders' gains

C.55 The rules for taxing gains from certain life insurances will be changed. The changes will affect policies held in trust in those circumstances where currently there is no charge and overseas life assurance business policies to deny an inappropriate tax credit. We will impose an additional annual charge on personal portfolio bonds, and will require certain non-UK life insurers to appoint a tax representative in the UK. The purpose is to make the present rules more effective in protecting UK tax revenue (53).

Pensions

C.56 A number of detailed changes will be made to improve the present controls over tax approved occupational and personal pension schemes in order to limit the scope for abuse of the pensions tax reliefs. These will include:

- introducing a special 40 per cent tax charge on personal pension arrangements that cease to be tax approved (*);
- extending the existing tax charge on certain occupational pension schemes that cease to be tax approved to put beyond doubt its effectiveness in dealing with a range of tax avoidance schemes (*);
- strengthening the present information powers and improving the arrangements for assessing and collecting tax chargeable on pension scheme administrators (-);
- introducing powers to make regulations relating to restrictions on transactions and investments by certain personal pension schemes to make sure that funds are managed in a way that is consistent with tax approval (-).

Charge on temporary non-residents

C.57 Gains arising during a period of temporary non-residence will be charged on return to the UK (see paragraph 5.73, fourth tiret) (55).

Transfer pricing and controlled foreign company rules

C.58 The transfer pricing (TP) and controlled foreign company (CFC) rules will be brought within the self assessment regime for companies. This will reverse the present position where the onus is on the Inland Revenue to apply the legislation, and will make the new regimes fairer and more effective. At the same time the transfer pricing regime will be modernised by being brought into line with OECD principles and best international practice. In both cases the new legislation has been the subject of consultation and has been refined to take into account suggestions from interested parties. The new systems will apply to UK company accounting periods ending on or after 1 July 1999 (56),(57).

C.59 In addition, the definition of activities potentially covered by the CFC rules will be strengthened in two respects. These changes will apply to CFC accounting periods beginning on or after Budget day (57).

PAYE avoidance

C.60 The rules which apply PAYE to remuneration in non-cash forms, and payments made by intermediaries and offshore employers, will be strengthened and extended with effect from 6 April 1998 (59).

Offshore trusts

C.61 The tax treatment of offshore trusts will be amended in a number of respects. Those who set up offshore trusts before March 1991 from which they, their immediate family, or companies which they control, can benefit, will be charged to tax on gains as they arise to the trust. This measure will apply to disposals made by the trust after 6 April 1999 (allowing a transitional period for those affected to reorganise their affairs). Rules will be included to prevent exploitation of the transitional period. It is also proposed to extend the charge on the settler to include an offshore trust from which only grandchildren can benefit. It is also proposed to extend the beneficiary charge to trusts created by non-domiciled settlors (54).

Profit-related pay

C.62 The Budget includes a measure to prevent exploitation of the provisions to phase out the income tax relief for profit-related pay (PRP). This measure will prevent certain employees, who are in a registered PRP scheme, from obtaining a higher tax relief limit for a longer period by becoming a member of another registered scheme on or after 17 March 1998. It will apply where the scheme employer of the two schemes is the same person, or if the scheme employers are connected (55).

Taxation consequences of EMU

C.63 Some technical tax changes will be made to help British businesses affected by European Monetary Union, concerning foreign currency elections, foreign currency bonds, currency contracts and some other matters (*).

Adjustments to amounts of foreign tax paid

C.64 The Budget will clarify the relief for foreign tax - requiring taxpayers to notify the Revenue if the claim becomes excessive because the foreign tax is adjusted. This will clarify the taxpayer's responsibilities. The provision will apply to adjustments made on or after Budget day(*).

Limiting relief for foreign tax on certain interests and dividends

C.65 Existing restrictions on relief for foreign tax on interest received from overseas borrowers by taxpayers in whose hands the income is a trading receipt will be amended and extended to relief relating to certain foreign dividends that are trading receipts. In certain circumstances, the extension will also cover income or related expenses of associates. The changes will apply immediately to payments in respect of arrangements entered into or after Budget day, but will only apply to payments in respect of pre-Budget day arrangements from 1 January 1999 (60).

Taxation of gilts

C.66 Some small changes are made with effect from 6 April 1998 to ensure interest on existing gilts is not taxed in the hands of overseas investors, and to rationalise the operation of charges in the accrued income scheme (*).

Commercial sports clubs

C.67 The definition of non-profit making status is to be tightened to counter schemes used by commercial sports clubs to avoid VAT, from 18 March 1998 (61).

Second-hand goods margin scheme

C.68 The margin scheme for second-hand goods, etc., allows VAT to be calculated on the seller's profit margin rather than the full selling price of the goods. From 18 March 1998, where second-hand goods, works of art, antiques and collectors' items have been transferred between businesses, the profit margin for the scheme will be based on the price paid by the original purchaser, to counter avoidance (*).

Transfer of Going Concerns

C.69 A loophole which allowed assets, acquired as part of the transfer of a business as a going concern, to be given away VAT-free will be closed from 17 March (*).

Goods on hire

C.70 A loophole in VAT law which has allowed businesses outside the European Union to let goods on hire in the UK to non-business customers without charging VAT, will be closed from 18 March 1998 (*).

Group registration

C.71 A consultation is to be conducted on the VAT group registration facility. The consultation will seek views on its possible restriction to fully taxable companies, to minimise tax avoidance opportunities and achieve a better balance between revenue costs to the Exchequer and compliance costs to business (-).

Bad debt relief

C.72 UK legislation is being changed to allow businesses to claim relief from VAT on bad debts arising from barter transactions, from Royal Assent (-).

Scottish developers

C.73 From Royal Assent, Scottish property developers will have an equivalent right to reclaim VAT to developers in the rest of the UK: 20 year leases will be regarded as long leases for VAT (*).

Right of appeal

C.74 Traders' rights to a Departmental review and right of appeal to the VAT and Duties Tribunal will be increased by widening the range of circumstances where tax irregularities are notified by assessment, from a date to be announced following Royal Assent (*).

Alcohol-drawback

C.75 From a date to be announced after Royal Assent, the primary law relating to the refund of duty on beer exported from the UK will be repealed, as it is largely duplicated in regulations introduced in 1995 (-).

Air Passenger Duty

C.76 Registration procedures for foreign airlines with no business address in the United Kingdom are being changed to make it easier for them to comply with the law (*).

Redundant legislation

C.77 The Customs Duties (Dumping and Subsidies) Act 1969 is to be repealed as European Union law has made the Act redundant, from Royal Assent (-).

Carry forward of 1997-98 underspend

C.78 1 1/2 billion allocated to departments for programmes in 1997-98 has not been spent and is therefore carried over into 1998-99. This line is not included in the totals as the expenditure is accounted for elsewhere.

Transfer to Reserve from carry forward

C.79 1 billion of the carry forward has been reallocated to the Government's high priority programmes, leaving 1/2 billion to add to the Reserve for 1998-99 (62).

Table C.1: The Budget Measures

	(+ve is an Exchequer yield)			million
	1998-99 non-indexed	1998-99 indexed	1999-00 indexed	2000-01 indexed
ENCOURAGING WORK				
1 Working Families Tax Credit	0	0	-420	-1 350
2 New Deal for Communities	-15	-15	0	0
3 Linking rules for lone parents and disabled people	-10	-10	-10	-10
4 National insurance contributions: abolish entry rate for employee NICs from April 1999	0	0	-1 200	-1 350
5 Disabled Person's Tax Credit	0	0	-5	-5
PROMOTING ENTERPRISE				
6 Corporation tax: 1 per cent cut in main rate from April 1999	0	0	*	-700
7 Corporation tax: 1 per cent cut in small companies rate from April 1999	0	0	*	-90
8 Abolish ACT and introduce quarterly payments of corporation tax	+100	+100	+1 600	+2 000
9 Abolish quarterly accounting for gilts	0	0	-600	*

10 Capital gains tax: structural reform	*	*	-25	+25
11 Tax incentives for venture capital - changes to re-investment relief	*	*	+20	+30
12 Tax incentives for venture capital - other changes	+5	+5	*	-10
13 Extend enhanced first year capital allowances for SMEs at 40 per cent for one year	*	*	-140	-160
14 University Challenge	*	*	-10	-10
15 VAT registration threshold to 50,000	-5	-5	-10	-5
CREATING A FAIRER SOCIETY				
16 Indexation of income tax allowances	-820	0	0	0
17 Indexation of income tax lower rate band	-90	0	0	0
18 Indexation of income tax basic rate limit	-270	0	0	0
19 Removing marginal deduction rates over 100 per cent for working families in HB and CTB	0	0	-10	-10
20 Investing in health: waiting lists initiative	-500	-500	0	0
21 Investing in education	-250	-250	0	0
22 Child support package (excluding all WFTC and DPTC elements)	-170	-170	-1 215	-1 220
23 Married couple's allowance - cutting relief from 15 per cent to 10 per cent from April 1999. 65s and over compensated.	0	0	+720	+1 080
24 Individual savings account	*	*	+30	-30
25 Inheritance tax: index threshold	-30	0	0	0
26 Stamp duty: increase rates for transfers of property above 250,000	+390	+390	+470	+520
27 Insurance Premium Tax: 17.5 per cent rate extended to all travel insurance	+5	+5	+15	+20
28 Increase total tobacco duties in December 1998 except hand rolled tobacco by 5.25 per cent above inflation; freeze hand rolled tobacco	+25	0	0	0
29 Alcohol: revalorise in January 1999 (except spirits and low strength sparkling wine and cider)	+20	0	0	0
30 Alcohol: freeze duty on spirits	0	-5	-20	-20
31 Alcohol: further step towards alignment of low strength sparkling wine and sparkling cider	-5	-5	-5	-5
32 Hydrocarbon oils - duty rate increases for gas oil and fuel oil	+25	+25	+25	+25
33 Millennium Gift Aid	-15	-15	-25	-20
Gambling				
34 Gaming duty	+20	+20	+25	+25
35 Increase rates of AMLD (top 2 bands)	+20	+15	+20	+20
36 Increase exemption for skill with prizes	-5	-5	-5	-5

Table C.1: The Budget Measures (continued)

	(+ve is an Exchequer yield)			**million**
	1998-99 non-indexed	**1998-99 indexed**	**1999-00 indexed**	**2000-01 indexed**
Environmental measures				
37 Bring forward road fuel escalator to 17 March	+1 515	+1 110	+1 040	+1 150
38 Increase differential between diesel and unleaded petrol to 1pence				

this year, to 3pence next year and to 4pence the year after; and between diesel and ULSD to 2pence this year and 3pence the year after		+120	+120	+335	+455
39 Super unleaded petrol 1.15pence increase		+10	+10	+10	+10
40 VED: freeze for all vehicles		0	-145	-145	-145
41 Company cars fuel scales increased		+70	+70	+160	+275
42 VAT: fuel scale charges		+5	+5	+5	+5
43 Cut VAT rate on installation of energy saving materials in Government grant schemes to 5 per cent		-5	-5	-10	-10
44 VED: Concession for low emission buses and lorries		*	*	-5	-10
45 Increase bus fuel duty rebate		-40	-40	-40	-40
46 Public transport		-175	-175	-300	-50
47 Landfill tax: increase standard rate to 10, exemption for waste used in site restoration		0	-5	+50	+60
Simplification/deregulation					
48 Employment termination payments		-5	-5	-10	-5
49 Simplify schedule A: corporation tax changes		*	*	+50	*
Securing the tax base					
50 Abolish foreign earnings deduction		+100	+100	+300	+250
51 Professional businesses: withdrawal of cash basis		0	0	*	+40
52 Counter capital gain buying		+10	+10	+100	+100
53 Reform of policy holder taxation		0	0	+30	+100
54 Action on offshore trusts		*	*	+10	+50
55 PRP: taxing exploitations of the provisions		+5	+5	+5	+5
56 Charge on temporary non-residents		*	*	+20	+20
57 Controlled Foreign Companies: tighten rules		0	0	+50	+100
58 Transfer pricing: modernise legislation		0	0	+20	+50
59 PAYE avoidance		+25	+25	*	*
60 Limiting relief for foreign tax on certain interest and dividends		*	*	+10	+50
61 VAT: preventing abuse of exemption for sport		+5	+5	+5	+5
Carry forward from 1997-98	-1 500				
allocated to: Health (line 20)	-500				
Education (line 21)	-250				
Transport (line 46)	-175				
New Deal for Communities (line 2)	-15				
Control Total elements of child support (line 22)	-60				
62 Residual carry forward transferred to Reserve	-500	-500	-500		
Total cost(-)/yield(+)		-435	+165	+915	+1 210
Total cost(-)/yield(+) excluding cashflow yield from line 8		-535	+65	-685	-790

* = *Negligible*

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(1) *The effect of the Budget measures on government revenues is set out in Table 5A.1. The number in brackets after each measure refers to the line in Table 5A.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 3million a year. The overall effects of the public expenditure measures on the Control Total and General Government Expenditure are set out in Tables B.18 and B.13.* [back]

comments

List of Abbreviations

ACT	Advance Corporation Tax
AEF	Aggregate External Finance
BCC	British Chambers of Commerce
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
CIPS	Chartered Institute of Purchasing and Supply
CO_2	Carbon dioxide
CSR	Comprehensive Spending Review
CTB	Council Tax Benefit
DETR	Department of the Environment, Transport and Regions
DFEE	Department for Education and Employment
DFID	Department for International Development
DOE	Department of the Environment
DPTC	Disabled Person's Tax Credit
DSS	Department of Social Security
DTI	Department of Trade and Industry
DVLA	Driver and Vehicle Licensing Agency
DWA	Disability Working Allowance
ECGD	Export Credits Guarantee Department
ECU	European Currency Unit
EEA	European Economic Area
EFL	External Financing Limit
EIS	Enterprise Investment Scheme
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
GAAR	General Anti-Avoidance Rule
GDP	Gross Domestic Product
GGE	General Government Expenditure
GGE(X)	General Government Expenditure (excluding privatisation proceeds and lottery-financed spending and net of interest and dividend receipts)
GGR	General Government Receipts
GGBR	General Government Borrowing Requirement
GGBR(O)	General Government Own Account Borrowing Requirement
GGFD	General Government Financial Deficit
GGGD	General Government Gross Debt
GM	Grant maintained
HB	Housing Benefit
HGV	Heavy Goods Vehicle
ICCs	Industrial and commercial companies
IHT	Inheritance tax
ILA	Individual Learning Account
IT	Information Technology
JSA	Job Seeker's Allowance
LABR	Local Authority Borrowing Requirement
LASFE	Local authority self-financed expenditure
LFS	Labour Force Survey
MDR	Marginal Deduction Rate
MIPs	Mortgage Interest Payments
MOD	Ministry of Defence
Money GDP	Gross Domestic Product at current market prices
MPC	Monetary Policy Committee
MtC	Million tonnes of carbon
M0	Narrow measure of money stock
M4	Broad measure of money stock
NAIRU	Non-accelerating inflation rate of unemployment
NAO	National Audit Office
NAR	National Asset Register
NHS	National Health Service
NICs	National insurance contributions
NO_x	Nitrogen oxides
NPSD	Net Public Sector Debt
ODA	Overseas Development Administration (now DFID)
OECD	Organisation for Economic Cooperation and Development
ONS	Office for National Statistics
OPS	Office of Public Service
PBR	Pre-Budget Report
PCBR	Public Corporations' Borrowing Requirement
PCMOB	Public Corporations' Market and Overseas Borrowing

PEP	Personal Equity Plan
PFI	Private Finance Initiative
PH	Property Holding
PLG	Private/Light Goods Vehicle
PPP	Public/private partnership
PRP	Profit Related Pay
PSA	Property Services Agency
PSBR	Public Sector Borrowing Requirement
PSFD	Public Sector Financial Deficit
PSNW	Public Sector Net Wealth
PWR	Pressurised Water Reactor
PX	Ministerial Committee on Public Expenditure
RAB	Resource Accounting and Budgeting
RPI	Retail Prices Index
SDR	Special Drawing Right
SME	Small and medium sized enterprise
TESSA	Tax Exempt Special Savings Account
TSS	Total Standard Spending
UfI	University for Industry
ULSD	Ultra low-sulphur diesel
VAT	Value added tax
VCT	Venture Capital Trust(s)
VED	Vehicle Excise Duty
WFTC	Working Families Tax Credit

comments

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comments

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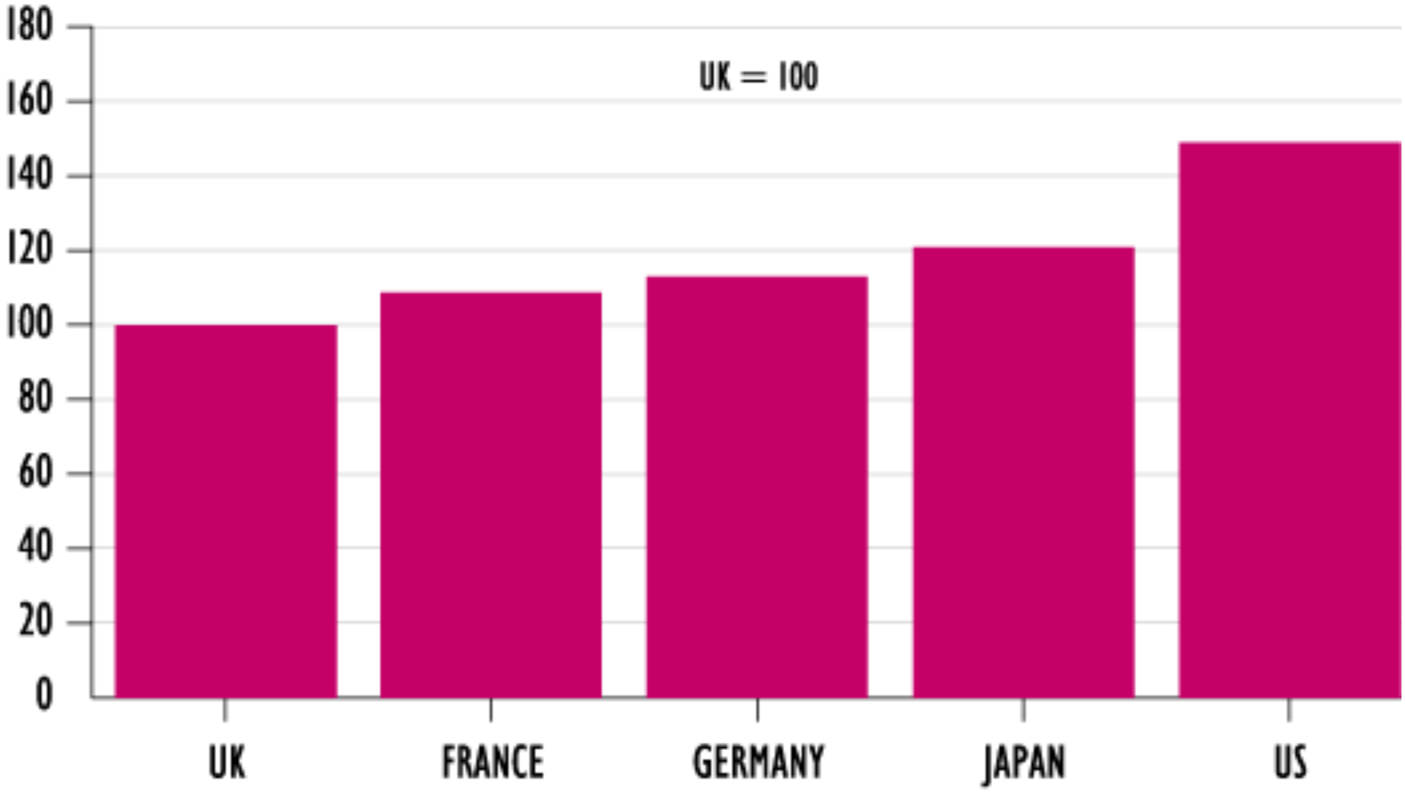
Chart 1.1: GDP per head (1997)



Source: OECD.

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comments

Encouraging Work (see chapter 3)

1.25 This Budget encourages work by:

- helping people into work by **extending the Welfare to Work initiative**;
- **making work pay** through a major package of tax and benefit reforms; and
- **improving skills** by tackling skill shortages in areas such as IT and promoting lifelong learning.

Extending the New Deal

1.26 The last Budget launched the Welfare to Work initiative to provide new employment opportunities to people detached from the labour market. The **New Deal for young people**, to help those aged 18-24 who have been unemployed for sixmonths or more, started in January in 12pathfinder areas. In the first nine weeks, 12,800 young people entered the programme, 8,800 matched to an employer, and 620 found work. The programme will go national from this April. The response from employers has been very encouraging and, in the largest commitment to the New Deal so far, around 40,000 opportunities will be available across the hotel and catering industry, with training provided through a national network of centres partly funded by subsidies available through the New Deal.

1.27 The **New Deal for lone parents** has also started in lead areas, where 1,100 lone parents have already been helped to find work, and will go national to those lone parents making a new claim for benefits from April, and for all lone parents from October. From June, people unemployed for over two years will benefit from a 75 wage subsidy.

1.28 This Budget extends the New Deal initiative:

- for the most disadvantaged young people, and to extend support and training for mentors, the Budget provides for a further 50 million for the gateway element of the New Deal;
- for lone parents, new pilots will look at ways of increasing the take-up and effectiveness of the New Deal, at a cost of 10million. There will be changes to the benefit system to reduce some of the risks lone parents face in taking a job that may not last;
- for the long-term unemployed, 70,000 new opportunities will be available through new and innovative pilots starting in November 1998. As part of the pilots, the long-term unemployed over 50 years olds will be helped through special measures targeted on their particular needs;
- for partners of the unemployed, the Government will ensure that partners over 25 have the option to receive the help they need to get back to work. Childless partners aged under 25 will be included in the New Deal;
- for disadvantaged communities, a New Deal For Communities will begin to tackle social exclusion on the most deprived estates;
- for disabled people, the Government will offer a new personal adviser service to help disabled people overcome obstacles to work. There will also be changes to the benefit system to reduce some of the risks disabled people face in taking a job that may not last.

Making work pay

1.29 This Budget begins the process of tax and benefit reform - the next stage of the modernisation of the welfare state. Following the measures in the first Budget to help people move off welfare into work, this Budget launches a New Deal for Working Families. The present tax and benefit system does not ensure that work pays: 740,000 people lose more than 70 pence in every extra pound they earn; 130,000 lose more than 90 pence in the pound. In addition, the national insurance contributions (NICs) system leaves thousands of people 1.28 a week worse off when they reach the lower earnings limit for

NICs. This means that people on low earnings can often find that the gap between in-work and out-of work income means that work doesn't pay.

1.30 The Budget therefore reforms the tax and benefits system to ensure that work and opportunity are encouraged, rather than penalised, for millions of hard-working families. The key measures include:

- **NICs**: a 1.4 billion reform of National Insurance Contributions will improve work incentives and make it more attractive to employ people moving from welfare to work. A one penny increase in earnings can trigger NICs charges ("entry fees") of 3.20 a week. The Government will abolish these "entry fees" and abolish the additional steps in employer NICs from April 1999. Employers will pay no NICs in respect of their employees' first 81 of earnings a week (up from 64). The Government is committed to making the same change for employees as soon as it can ensure that no one loses benefit entitlement as a result;
- the **Working Families Tax Credit** (WFTC), to be introduced in October 1999, will make work pay for families. It will guarantee a minimum income: every family with full-time earnings of 100 a week will be guaranteed an income of at least 180 a week. And families earnings less than 220 a week, half male average earnings, will no longer pay any net tax. It will ease both the unemployment and poverty traps. Couples will be able to choose to whom the WFTC is paid;
- **a childcare tax credit** within the WFTC will meet 70 per cent of eligible childcare costs up to a maximum cost of 100 a week (currently 60) for a family with one child and 150 a week (currently 100) for a family with two or more children. Unlike the current FC disregard, it will assist families on the lowest incomes.

1.31 Taken together with the introduction of the national minimum wage and the introduction of a 10pence starting rate of tax, when it is economically right to do so, these changes will help to make work pay.

Improving skills and lifelong learning

1.32 An extra 100 million, including an additional 10 million for the **University for Industry**, will be directed by the Department for Education and Employment (DFEE) to tackling skill shortages in key sectors and to promote lifelong learning, as part of the 250million schools and skills package across the UK.

Promoting Enterprise (see chapter 4)

1.33 The Government cannot itself improve the performance of industry or create dynamic new firms. But, in partnership with industry, it can create the right framework for enterprise and investment. The Government is committed to removing the barriers that hold back business investment and that discourage enterprising individuals from starting dynamic businesses that would allow Britain to be a world leader in the 21st Century.

1.34 This Budget continues the process of tax reform to produce a corporate and capital tax system that: rewards risk taking and encourages enterprise and does not distort corporate investment. The key measures are:

- Advance Corporation Tax will be abolished from April 1999;
- large companies will pay their corporation tax in quarterly instalments. Small and medium sized companies will be exempted;
- the main rate of corporation tax will be cut to 30 per cent from April 1999;
- the small companies' rate of corporation tax will be cut to 20 per cent from April 1999;
- enhanced first year capital allowances at a new rate of 40 per cent will be extended until July 1999;
- capital gains tax (CGT) reform, including a new effective 10 per cent rate on business assets, will tax long-term gains less heavily than short-term gains;
- unified Enterprise Investment Scheme (EIS) and CGT reinvestment reliefs will better target capital reliefs for small, higher risk trading companies;

- a new University Challenge fund will create 50 million in venture capital to help commercially exploit university research; and
- businesses will be helped through tax simplification and improved Revenue and Customs advice and services.

Creating a Fairer Society (see chapter 5)

1.35 The Budget also takes forward the Government's commitment to fairness in tax and spending.

Fairness for families and children

1.36 It promotes **fairness for families and children** by:

- increasing **child benefit** for the eldest child by 2.50 a week from April 1999, over and above statutory indexation (and carried through to the family premium in income support and related benefits). This will provide an extra 130 a year. As a result of this increase and the changes in WFTC, a couple, with two young children, on earnings of around 220 a week will see their incomes increase by 23 a week. This increased support for children will, in part, be funded by a reduction in the Married Couple's Allowance for under 65s from 15 per cent to 10 per cent from April 1999.
- increasing the relevant rates in Income Support, Family Credit and related benefits by 2.50 a week from November 1998;

Main tax rates and allowances

1.37 The Government will take further steps to improve the **fairness of the tax system as a whole**:

- it will introduce a new 10 pence starting rate of tax, when it is economically right to do so;
- this Budget makes no changes to the basic and top rates of income tax consistent with the Government's manifesto pledge for this parliament. There will be an indexed increase of 3.6 per cent in the main income tax allowances and the lower rate bands and basic rate limit.

Reducing hospital waiting lists

1.38 The Budget includes a 500 million package to **reduce hospital waiting** lists in 1998-99, taking the extra amount committed to health across the UK to 2 billion in the first two years of the Government.

Boost to schools

1.39 The Budget includes an additional 250 million boost to **schools** and **skills** across the UK, taking the extra amount committed to education to 2.5 billion since the Government came to office.

Protecting the environment

1.40 A fair tax system must also be fair to future generations and help to protect the **environment**. In last July's Budget the Government gave a clear commitment in the Statement of Intent on Environmental Taxation on the use of the tax system to reduce environmental damage. This Budget starts to deliver on that commitment; it includes a range of measures that will reduce greenhouse gas emissions and improve air quality, as well as reducing the environmental impact of landfill:

- the road fuel duty increases will help to reduce emissions of greenhouse gases from road transport;
- to improve local air quality, the increase on ordinary diesel will be above that for petrol. Cleaner diesel will receive an increased duty advantage;
- the Vehicle Excise Duty (VED) for cars will be frozen this year and the Government intends to introduce a new low

VED rate for low emission cars from 1999;

- Bus Fuel Duty Rebate will be increased; the Government will consult on how the rebate can encourage buses with cleaner engines;
- the rate of VAT on energy saving materials funded by Government schemes will be reduced to 5 per cent, allowing 40,000 more low income households to be helped;
- the landfill tax will be increased to reduce the environmental impact of landfill;
- scale charges for employees provided with free fuel for private use of company cars will be increased by 20 per cent over and above the usual fuel duty increase in this and the next four years;
- industrial and commercial use of energy: there will be a further detailed assessment of whether or not taxes or other economic instruments should be used to help reduce emissions of carbon dioxide, and, if so, how.

Improving public transport

1.41 A 500 million package of help for public transport over the next two years will include 50 million for rural transport which will provide extra support for bus services in rural areas.

Individual savings accounts

1.42 The Budget promotes **fairness in savings** by:

- introducing the proposals for the new **individual savings account** which will help to spread the savings habit to those on more modest incomes and distribute the tax relief on savings more fairly. The key features, following the consultation launched in December, are:

- the new savings account will start in April 1999, and run for at least ten years. There will be no lifetime limit;
- there will be an annual subscription limit of 5,000, of which no more than 1,000 can be in cash and 1,000 in life insurance;
- the annual limit will be 7,000 in the first year of the scheme only (1999-2000), of which no more than 3,000 can be in cash and 1,000 in life insurance;
- no further subscriptions to PEPs will be allowed after April 1999, but the PEPs held at that date will continue under the current rules and with the same tax relief as the new account; and
- no new TESSAS can be taken out after April 1999 but existing TESSAS at that date will run their five year course under the current rules. On maturity, the capital may be transferred to the new account.

Stamp duty

1.43 The rate of stamp duty on transfers of property (except shares) below 250,000 (currently 98 per cent of residential property sales) will remain unchanged. The rate will be increased on 24 March (except where transfer relates to a contract made on or before 17 March) from 1.5 per cent to 2 per cent if the price is more than 250,000 and from 2 per cent to 3 per cent if the price is more than 500,000.

Tackling avoidance

1.44 The Budget also seeks to ensure that everyone pays their fair share of tax by tackling avoidance. It includes a wide range of measures to curb avoidance, close loopholes and remove unfair advantages.

Summary

1.45 Taken together, the Budget measures represent a radical and far-reaching step towards a more productive, high-employment economy and a fairer society.

1.46 The Budget tax and expenditure measures are summarised in Table 1.3 below. The detailed measures are then set out in Chapters3 to 5 and AnnexC.

Table 1.3: The Budget Measures

	(+ve is an Exchequer yield)			**million**
	1998-99 non-indexed	**1998-99 indexed**	**1999-00 indexed**	**2000-01 indexed**
ENCOURAGING WORK				
1 Working Families Tax Credit	0	0	-420	-1 350
2 New Deal for Communities	-15	-15	0	0
3 Linking rules for lone parents and disabled people	-10	-10	-10	-10
4 National insurance contributions: abolish entry rate for employee NICs from April 1999	0	0	-1 200	-1 350
5 Disabled Person's Tax Credit	0	0	-5	-5
PROMOTING ENTERPRISE				
6 Corporation tax: 1 per cent cut in main rate from April 1999	0	0	*	-700
7 Corporation tax: 1 per cent cut in small companies rate from April 1999	0	0	*	-90
8 Abolish ACT and introduce quarterly payments of corporation tax	+100	+100	+1 600	+2 000
9 Abolish quarterly accounting for gilts	0	0	-600	*
10 Capital gains tax: structural reform	*	*	-25	+25
11 Tax incentives for venture capital - changes to re-investment relief	*	*	+20	+30
12 Tax incentives for venture capital - other changes	+5	+5	*	-10
13 Extend enhanced first year capital allowances for SMEs at 40 per cent for one year	*	*	-140	-160
14 University Challenge	*	*	-10	-10
15 VAT registration threshold to 50,000	-5	-5	-10	-5
CREATING A FAIRER SOCIETY				
16 Indexation of income tax allowances	-820	0	0	0
17 Indexation of income tax lower rate band	-90	0	0	0
18 Indexation of income tax basic rate limit	-270	0	0	0
19 Removing marginal deduction rates over 100 per cent for working families in HB and CTB	0	0	-10	-10
20 Investing in health: waiting lists initiative	-500	-500	0	0
21 Investing in education	-250	-250	0	0
22 Child support package (excluding all WFTC and DPTC elements)	-170	-170	-1 215	-1 220
23 Married couple's allowance - cutting relief from 15 per cent to 10 per cent from April 1999. 65s and over compensated.	0	0	+720	+1 080
24 Individual savings account	*	*	+30	-30
25 Inheritance tax: index threshold	-30	0	0	0
26 Stamp duty: increase rates for transfers of property above 250,000	+390	+390	+470	+520
27 Insurance Premium Tax: 17.5 per cent rate extended to all travel insurance	+5	+5	+15	+20
28 Increase total tobacco duties in December 1998 except hand rolled tobacco by 5.25 per cent above inflation; freeze hand rolled tobacco	+25	0	0	0
29 Alcohol: revalorise in January 1999 (except spirits and low strength sparkling wine				

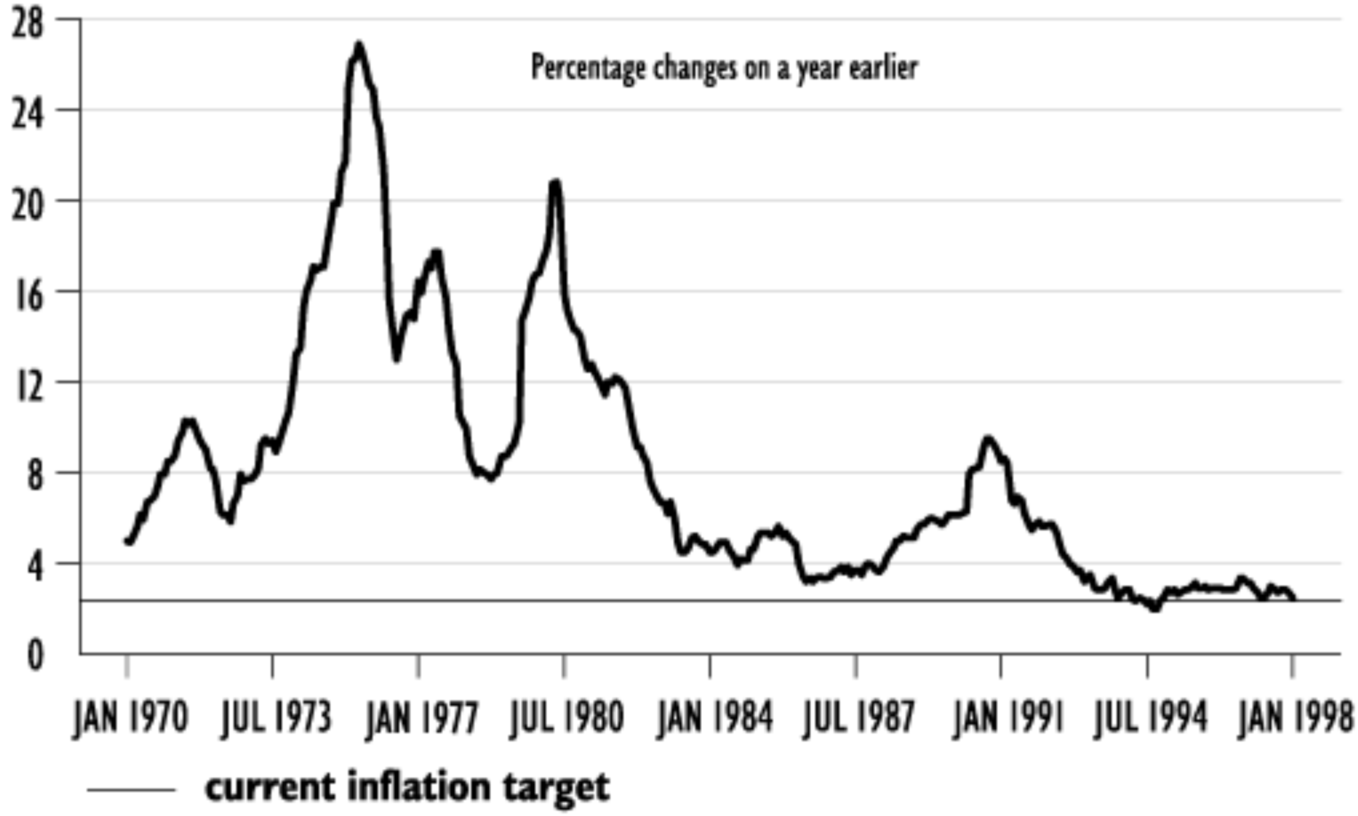
and cider)		+20	0	0	0
30 Alcohol: freeze duty on spirits		0	-5	-20	-20
31 Alcohol: further step towards alignment of low strength sparkling wine and sparkling cider		-5	-5	-5	-5
32 Hydrocarbon oils - duty rate increases for gas oil and fuel oil		+25	+25	+25	+25
33 Millennium Gift Aid		-15	-15	-25	-20
Gambling					
34 Gaming duty		+20	+20	+25	+25
35 Increase rates of AMLD (top 2 bands)		+20	+15	+20	+20
36 Increase exemption for skill with prizes		-5	-5	-5	-5
Environmental measures					
37 Bring forward road fuel escalator to 17 March		+1 515	+1 110	+1 040	+1 150
38 Increase differential between diesel and unleaded petrol to 1pence this year, to 3pence next year and to 4pence the year after; and between diesel and ULSD to 2pence this year and 3pence the year after		+120	+120	+335	+455
39 Super unleaded petrol 1.15pence increase		+10	+10	+10	+10
40 VED: freeze for all vehicles		0	-145	-145	-145
41 Company cars fuel scales increased		+70	+70	+160	+275
42 VAT: fuel scale charges		+5	+5	+5	+5
43 Cut VAT rate on installation of energy saving materials in Government grant schemes to 5 per cent		-5	-5	-10	-10
44 VED: Concession for low emission buses and lorries		*	*	-5	-10
45 Increase bus fuel duty rebate		-40	-40	-40	-40
46 Public transport		-175	-175	-300	-50
47 Landfill tax: increase standard rate to 10, exemption for waste used in site restoration		0	-5	+50	+60
Simplification/deregulation					
48 Employment termination payments		-5	-5	-10	-5
49 Simplify schedule A: corporation tax changes		*	*	+50	*
Securing the tax base					
50 Abolish foreign earnings deduction		+100	+100	+300	+250
51 Professional businesses: withdrawal of cash basis		0	0	*	+40
52 Counter capital gain buying		+10	+10	+100	+100
53 Reform of policy holder taxation		0	0	+30	+100
54 Action on offshore trusts		*	*	+10	+50
55 PRP: taxing exploitations of the provisions		+5	+5	+5	+5
56 Charge on temporary non-residents		*	*	+20	+20
57 Controlled Foreign Companies: tighten rules		0	0	+50	+100
58 Transfer pricing: modernise legislation		0	0	+20	+50
59 PAYE avoidance		+25	+25	*	*
60 Limiting relief for foreign tax on certain interest and dividends		*	*	+10	+50
61 VAT: preventing abuse of exemption for sport		+5	+5	+5	+5
Carry forward from 1997-98	-1 500				
allocated to: Health (line 20)	-500				
Education (line 21)	-250				

Transport (line 46)	-175				
New Deal for Communities (line 2)	-15				
Control Total elements of child support (line 22)	-60				
62 Residual carry forward transferred to Reserve	-500	-500	-500		
Total cost(-)/yield(+)		-435	+165	+915	+1 210
					-790
Total cost(-)/yield(+) excluding cashflow yield from line 8		-535	+65	-685	

* = *Negligible*

comments

Chart 2.1: RPI excluding MIPs[1]



[1] Retail Prices Index excluding mortgage interest payments (Note: Data before January 1976 represents all-items RPI).

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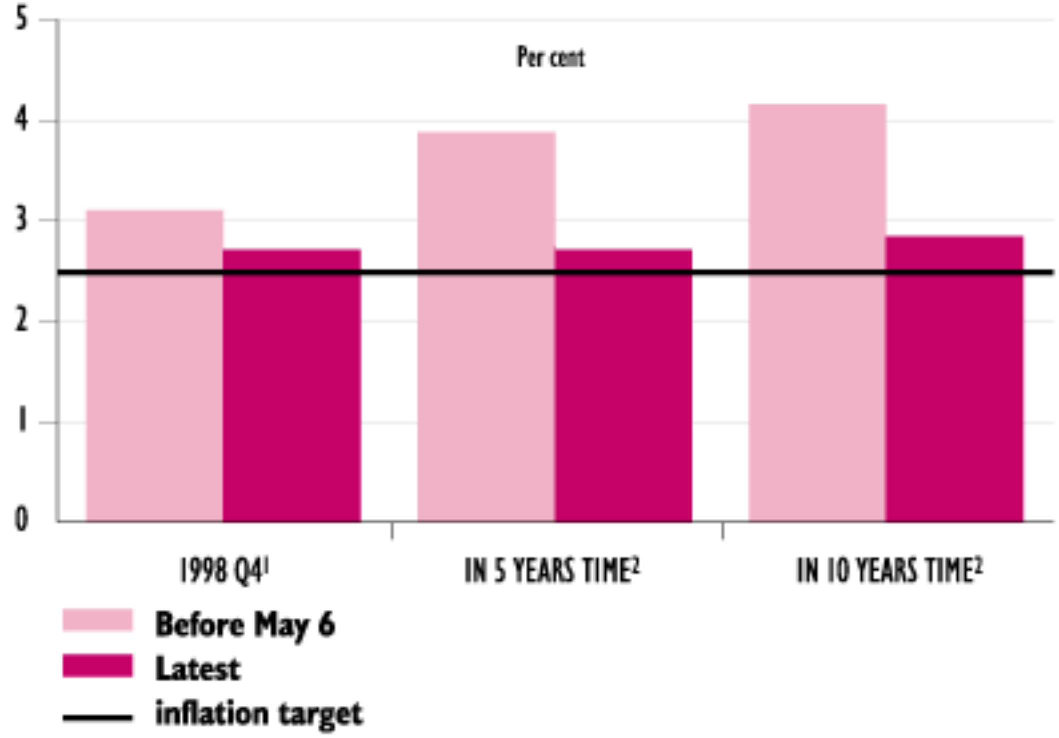
comments

Chart 2.2: Inflation expectations



[1]Average of forecasts for RPI ex MIPs inflation in 1998Q4, taken in April 1997 and February 1998 respectively.

Source: Forecasts for the UK Economy, HM Treasury.

[2]Expectations of RPI inflation derived from a comparison of conventional and index-linked gilt yields.

Source: Bank of England.

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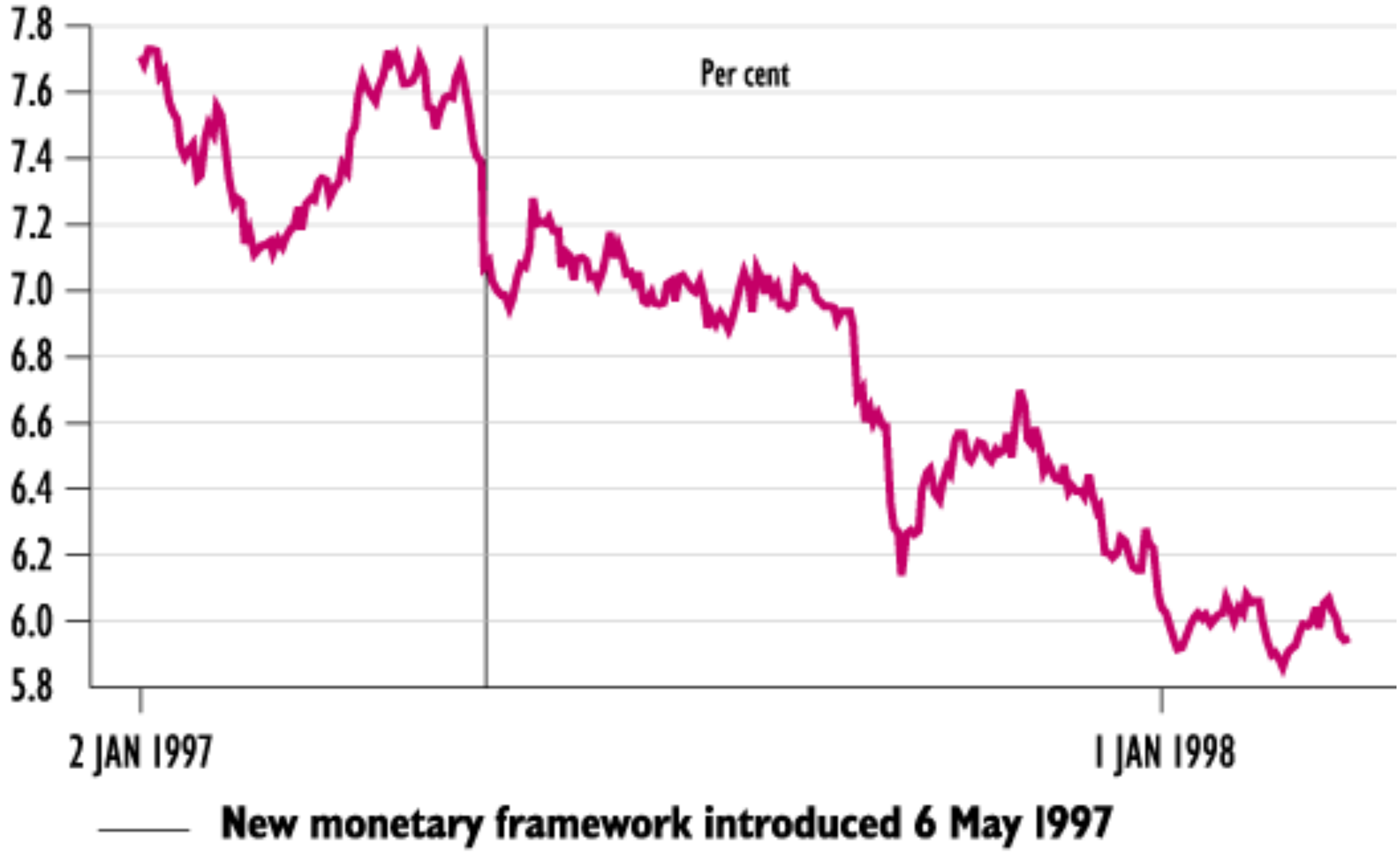
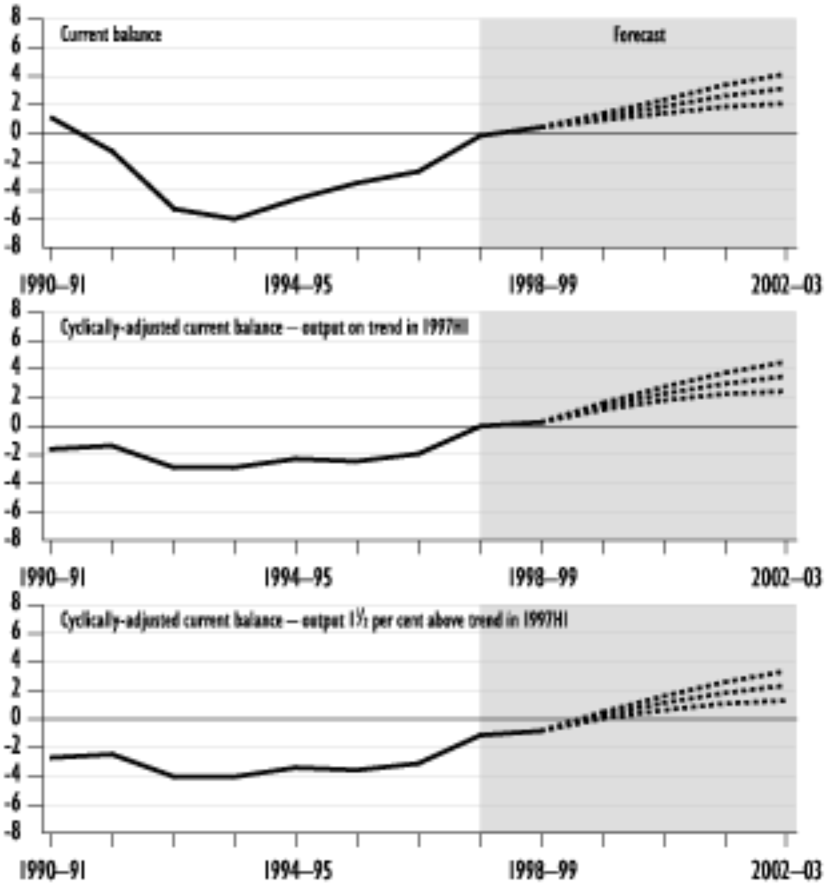
comments

Chart 2.3: 10-year nominal bond yields



comments

Chart 2.4: Public sector current balance[1] (per cent of GDP)



[1] Excluding windfall tax receipts and associated spending.

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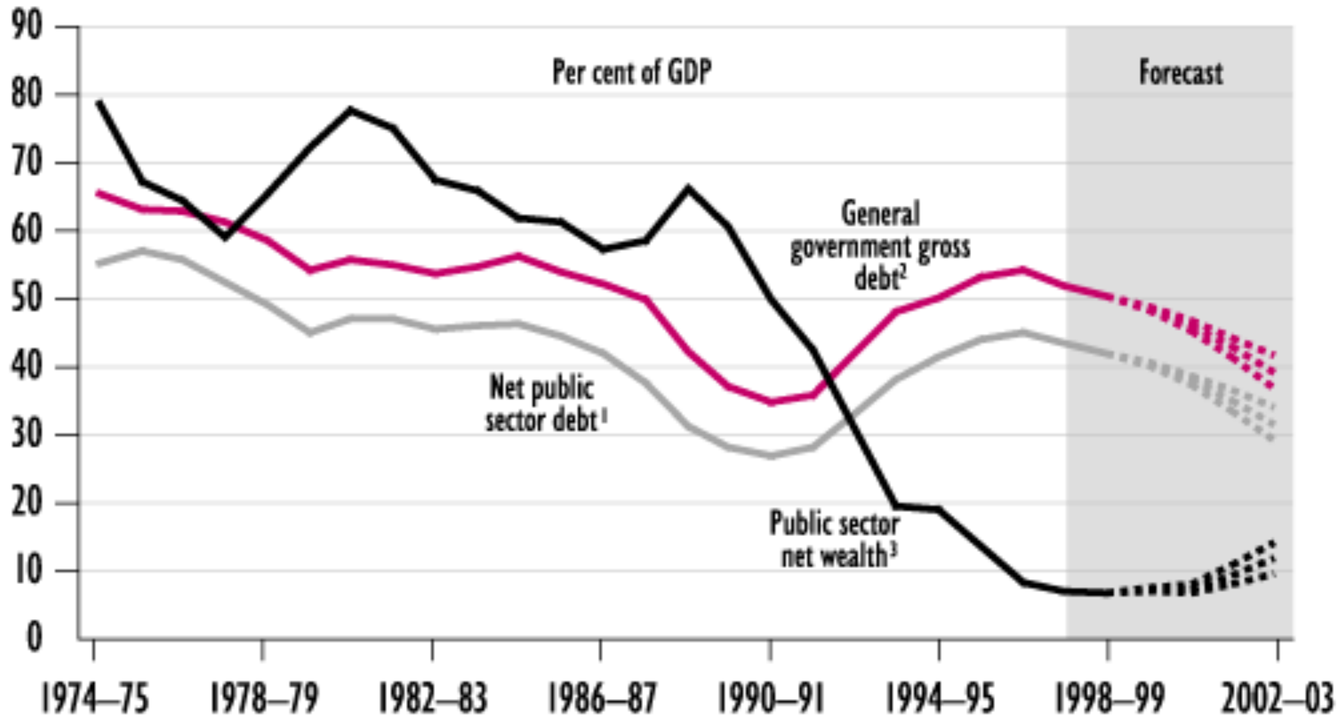
comments

Chart 2.5: Public debt and net wealth



[1]End-March debt as per cent of GDP in four quarters centred on end-March.

[2]Definition on a Maastricht basis: GDP on ESA basis, year ending in March.

[3]End-December net wealth as per cent of GDP in four quarters centred on end-December.

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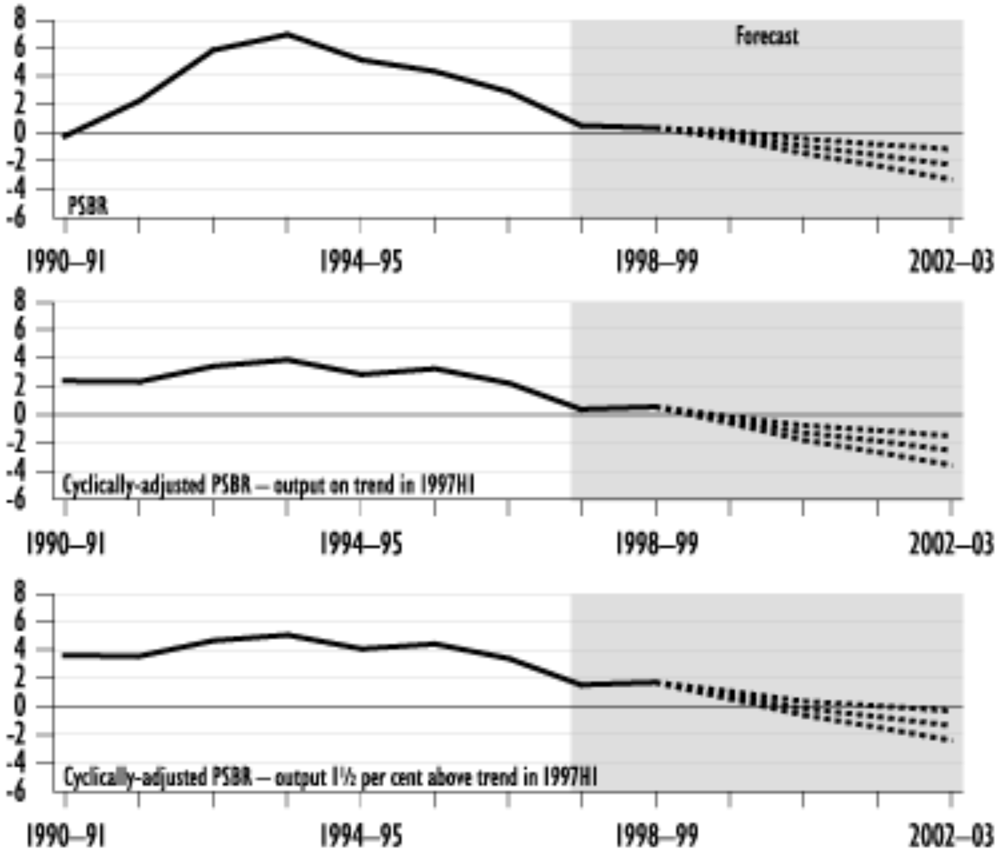
comments

Chart 2.6: PSBR[1] (per cent of GDP)



[1] Excluding windfall tax receipts and associated spending.

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comments

Making Work Pay

3.25 People are understandably reluctant to take work that does not pay. This Budget begins the process of tax and benefit reform to ensure a New Deal for Working Families - the next stage of the modernisation of the welfare state. It includes reforms to the tax system to ensure that work and opportunity are encouraged and rewarded, rather than penalised, for millions of families. This will be achieved through reforming national insurance and a new Working Families Tax Credit. A childcare tax credit within the WFTC will improve the in-work help with the costs of childcare, which is for many parents a barrier to work.

3.26 The Government's view on how tax, benefit and employment policy needs to adapt to meet the changes in the labour market and in society was set out in "Employment Opportunity in a Changing Labour Market", one of the publications accompanying the Pre-Budget Statement. Many people who can and who want to work, are discouraged from doing so by the low return from working more or even taking a job at all. This frustrates people's ambitions to provide for themselves and their families. The financial difficulties caused, when people start work or increase their earnings, are often expressed in terms of two different, but connected, traps:

- the **unemployment trap**, where the income they can make from working is little or no higher than the income they would receive if they did not take a job; and
- the **poverty trap**, where there is little reward to someone in work increasing their earnings. Very high Marginal Deduction Rates (MDRs)[1] penalise work. The most extreme form of the poverty trap occurs when MDRs exceed 100per cent, ie when the tax and benefit system mean that people receive less income as their earnings rise.

3.27 This Budget will dramatically reduce the number facing very high MDRs. It will also ease the unemployment trap by raising the incomes of those in work.

Taylor Report

3.28 Martin Taylor's Taskforce on taxes and benefits has assisted the Government in producing these reforms. The Government is publishing a series of papers on "The Modernisation of Britain's Tax and Benefit System" to mark the staging posts on the road to reform. "Employment Opportunity in a Changing Labour Market" was the first paper in the series. Martin Taylor's recommendations are being published alongside this Budget, as number two in the series. Some of these recommendations are taken on board in the Budget, and others are under further consideration. A third paper describes in detail the Working Families Tax Credit and the effect it will have on work incentives.

National insurance contributions

3.29 The Budget contains the biggest reform to the structure of national insurance contributions (NICs) since 1975, at a cost of around 1.4 billion a year from April 1999.

3.30 The current structure of NICs bears particularly acutely on the low-paid and discourages job creation at the lower end of the earnings distribution. Steps in the structure of NICs, whereby a one penny increase in pay can trigger an increase in NICs of up to 6.30 a week, distorts the labour market, discouraging progression up the earnings ladder. These distortions are greatest at the lower earnings limit, where a rise in earnings from 63.99 to 64 a week triggers a NIC charge (the "entry fee") for employees of 1.28 and for employers of 1.92 a week: one of the last remaining causes of people being worse off when they earn more.

CHART HERE

3.31 The Budget measures will abolish the "entry fee" for employees and employers, and end the additional steps in employers' contributions at 110, 155 and 210 a week. In line with Martin Taylor's recommendation, the structure of national insurance will move more into line with income tax to simplify the system and to reduce administrative burdens on employers. From April 1999, the threshold for employer national insurance contributions will be aligned with the personal allowance for income tax (81 a week 1998-99). The lower earnings limit for employees will remain unchanged (at 64 in

1998-99). But the Government is committed to aligning it with the personal allowance as soon as it has reformed the rules for contributory benefits to ensure that those who are taken out of national insurance contributions do not lose their right to accrue benefit entitlement. Martin Taylor's report will be examined further with a view to introducing possible reform of the NICs system as it applies to self-employed people.

3.32 From April 1999, employees will pay no NICs on their first 64 a week of earnings, and 10 per cent thereafter up to the upper earnings limit, 485 a week (all limits and thresholds are in 1998-99 prices). Employers will pay no NICs in respect of their employees' first 81 of earnings a week, and will then pay a single rate of 12.2 per cent thereafter. The employer package is revenue-neutral, so that the burden of employer NICs as a whole will remain unchanged. But employers will no longer have to pay NICs in respect of up to a million employees earning between 64 and 81 a week. They will also pay lower NICs in respect of (approximately) another 12 million employees earning between 81 and 450 a week (broadly, male average earnings).

3.33 The NICs reform will improve work incentives and make it more attractive to employ those moving off welfare and into work. The reduction in NICs at illustrative points on the earnings distribution at the lower end is set out in Table 3.2 below:

Table 3.2: Reduction in burden of national insurance contributions

	(per week)		
	Employee	**Employer**	**Total**
64 a week (LEL)	**1.28**	**1.92**	**3.20**
220 (half male average earnings)	**1.28**	**4.90**	**6.18**

Arrangements for contracting out of SERPS will continue broadly as at present.

3.34 As outlined in Chapter 4, the Contributions Agency will move to the Inland Revenue in April 1999.

CHART HERE

CHART HERE

A Working Families Tax Credit

3.35 The Government will introduce a new tax credit for working families with children, which will be administered by the Inland Revenue and will replace Family Credit. The Working Families Tax Credit (WFTC) will boost the incomes of low- and middle-income working families with children. As a tax credit, it will demonstrate more clearly the rewards of work over welfare and reinforce the minimum wage in making work pay. The new tax credit will also provide increased help with the costs of childcare.

3.36 The WFTC will provide around 5 billion a year of support, which represents approaching 1 1/2 billion more resources than Family Credit. By 2001, about 1 1/2 million working families will be receiving the WFTC, around 400,000 more families than would have received Family Credit.

3.37 The WFTC will ease both the unemployment trap and the poverty trap, as well as helping parents with childcare costs. It will:

- provide a guaranteed minimum income for working families. The guarantee will be at least 180 a week for a family with full-time earnings of 100 a week.
- raise the point at which families begin to pay tax: families earning below 220 a week (which is about half male average earnings) will not pay net tax after the WFTC has been introduced.
- reduce the unemployment trap by raising in-work incomes in relation to those out of work. This Budget will make a couple earning 200 a week (the average entry wage for an unemployed person returning to full-time work) more than 23 a week better off if they have two young children.
- ease the poverty trap in two ways. The taper - the rate at which the tax credit is withdrawn as net income increases - will be 55 per cent in the WFTC, compared to 70 per cent in Family Credit. As a result, half a million families will

see the return from increasing their earnings rise by one-half. And the WFTC will not begin to be withdrawn until net income reaches 90 a week, an increase of 11. These reforms will cut the number of families facing high marginal deduction rates: the number of families losing more than 90 pence of any extra 1 of earnings will fall from 130,000 to 20,000. And instead of 3/4 million families losing 70 per cent or more of any extra income they earn (as now), there will be only 1/4 million.

- end the inefficient system whereby almost 1/2 million families paid tax to the Inland Revenue while receiving Family Credit from the Department of Social Security. 97 per cent of these families will no longer pay net income tax.

Table 3.3: Effects of Budget on number of families with high marginal deduction rates(1)

	Before	After
Marginal deduction rate		
100 per cent or more	**5,000**	**0**
90 per cent or more	**130,000**	**20,000**
80 per cent or more	**300,000**	**200,000**
70 per cent or more	**740,000**	**260,000**
60 per cent or more	**760,000**	**1,010,000**

1 Figures are for families where at least one partner works 16hours or more, and are based on 1997-98 caseload and take-up rates.

3.38 The basic tax credit in the WFTC will be 48.80 a week for each family (in 1998-99 prices). There will also be tax credits in respect of each child and for childcare. The amount paid in respect of children under 11 will increase by 2.50 a week, narrowing the gap between it and that paid for older children. The evidence suggests that the costs associated with younger children are closer to those of older children than the benefit scale rates imply. Every family working 16 hours or more and earning 90 a week or less will receive at least 77.60 a week in WFTC and Child Benefit.

3.39 The WFTC will be introduced from October 1999. It will be payable through the wage packet from April 2000. Couples will be able to choose which partner receives the WFTC.

Table 3.4: Structure of the Working Families Tax Credit

	(per week; 1998-99 prices)
Basic tax credit (one payable per family)	48.80
Tax credits for each child aged 0-11	14.85
11-16	20.45
16-18	25.40
Extra tax credit for people working 30 hours or more a week	10.80
A childcare tax credit worth 70 per cent of eligible childcare with, up to maximum costs of 100 a week for families with one child and 150 for families with two or more children.	
The maximum amount of WFTC is payable is below the threshold of	90.00
Taper (Amount of tax credit withdrawn as a proportion of every additional 1 of net income in excess of the 90 threshold)	55 per cent

This example illustrates how entitlement to the tax credit will be calculated. It looks at a family with two children under 11. Both parents work, with the father earning 200 a week and the mother earning 100 a week. The family has registered

childcare costs of 60 a week.	
	per week
Earnings (father)	200.00
Less national insurance	*13.60*
and gross income tax	*21.31*
Earnings (mother)	100.00
Less national insurance	*3.60*
and gross income tax	*3.86*
Net family income (1)	257.63
WFTC (2) 39.10	
Of which: basic tax credit	*48.80*
2 child tax credits (0-11)	*29.70*
30-hour tax credit	*10.80*
childcare tax credit (70% of 60)	*42.00*
less 55 per cent of excess of (1) over withdrawal threshold of 90	*(92.20)*
Child Benefit (3)	23.25
TOTAL INCOME (1+2+3)	319.98
Memo item: net income tax	**-13.93**

CHART HERE

3.40 People working more than 30 hours a week, and receiving Family Credit, can find that their income actually falls if their earnings increase. The interaction between Housing Benefit, Council Tax Benefit, and the 30-hour premium in Family Credit means that about 5,000 families face being worse off if they increase their earnings. That will not happen under the WFTC. The Government will change the disregards in Housing Benefit and Council Tax Benefit which cause these Marginal Deduction Rates (MDRs) of over 100per cent. No family will lose as a result of this change. Reforms to national insurance contributions will remove the other cause of low-paid employees facing MDRs over 100per cent.

CHART HERE

A childcare tax credit within the WFTC

3.41 Childcare is a crucial part of the equation for parents, in assessing the financial implications of making the move off benefits and into work. This Government is determined to make work pay, and to ensure that no parent should be unable to take up the opportunity of work through lack of access to affordable quality childcare.

3.42 The Government is therefore greatly improving the help with childcare costs which is available to low- and middle-income working families. The WFTC will include a new childcare tax credit, worth 70 per cent of eligible childcare costs, up to a limit of 100 of eligible costs for families with one child and of 150 for families with two or more children. It is more generous then the current disregard in Family Credit in two ways:

- the maximum amounts are much higher;
- the credit will help those on lowest incomes (the benefit disregard provides no help to those with incomes below 77 a week).

3.43 In addition, the lower taper in the WFTC will enable people to keep more of their income. So parents will see their return from working increase, even if they have childcare costs.

3.44 The Government will also improve the childcare help available to working families in Housing Benefit and Council Tax Benefit. There will still be a disregard to meet eligible childcare costs. The maximum disregard will be equal to the maximum size of the childcare tax credit, ie 70 for one-child families and 105 for other families (up from 60 and 100 respectively).

3.45 The childcare and other changes made in introducing the WFTC will make many working families with children substantially better off. A two-earner couple, earning 450 in a week, and spending 150 on registered childcare for their two children, would receive 45 a week in the WFTC. They would receive nothing under the current rules for Family Credit and the other in-work benefits.

3.46 The new childcare tax credit within the Working Families Tax Credit will play a key underpinning role to the National Childcare Strategy, by ensuring that childcare is affordable for working families. The Government's National Childcare Strategy also aims to ensure an increase in the supply of childcare to meet the increased demand, by tackling systematically the barriers to the supply of good-quality provision, and by ensuring that all relevant partners are able to play a role in delivering this shared vision. As a start, the 300 million investment in out-of-school childcare announced in the Pre-Budget Report will be coming onstream in April 1998, with 40 million available in the first year to fund an expansion of out-of-school provision.

A Disabled Person's Tax Credit

3.47 The Government will also introduce a Disabled Person's Tax Credit (DPTC) alongside the WFTC to replace the existing Disability Working Allowance (DWA). DWA has failed as an incentive to work. Although it has helped some people back into work, take-up is a quarter of the level forecast when it was introduced. As well as making the tax credit more generous than DWA (matching the rates, tapers and thresholds in the WFTC), the Government is looking at other ways in which the DPTC can be more effective and more attractive than DWA. Taken together with the New Deal for Disabled People and the changes to linking and other benefit rules (see paragraph 3.20), this demonstrates that the Government regards helping those people with disabilities who want to work to get back to work as one of its key priorities.

A National Minimum Wage

3.48 The National Minimum Wage will help underpin these reforms. It will help promote work incentives, tackle exploitation and ensure greater decency and fairness in the workplace. It forms an integral part of the strategy for making work pay. The Government is determined to introduce the minimum wage in a sensible way, taking into account the wider effects on the economy. The Government will decide on the level and the coverage of the minimum wage when it has received and considered the recommendations of the Low Pay Commission, which are due by May 1998.

3.49 Taken together, these reforms to taxes, NICs and benefits will, supported by the National Minimum Wage, help to make work pay.

Investing in Skills

3.50 Good education and basic skills are essential foundation stones for a flexible and adaptable labour market. Since May 1997, the Government has introduced a range of measures to raise educational achievements and announced 2.3 billion of extra expenditure on schools in the July Budget, including the New Deal for schools which will ensure that more children are taught in an environment conducive to learning. For people that have already left school, the Government is considering a range of Lifelong Learning measures, as set out in the Green Paper "The Learning Age" (February 1998), many of which are also being examined in the Comprehensive Spending Review.

3.51 The underspend during 1997-98 has enabled the Government to spend more on education, to invest in schools and measures to improve skills. This spending will reflect immediate priorities, in particular the shortage of people with skills in information technology (IT) following structural changes in the use of IT in the early 1990s. The "Millennium timebomb" has added to this problem. And there are significant shortages in other areas of high technology, a reflection of inadequate education and training in the past. The University for Industry (UfI) will have a vital role in spearheading the skills and learning revolution. The extra provision of 10 million for the UfI is seedcorn funding that builds on the 5 million from the Windfall Tax announced in the July 1997 Budget. This 15 million investment provides a solid foundation on which to build a new public-private partnership, with a mission to ensure that both business and individuals can readily get access to flexible and cost effective training, tailored to their particular needs. The Individual Learning Accounts (ILAs) announced in the July 1997 Budget will help to fund the training needs of one million people on low incomes, whether using the UfI, FE colleges or other training providers.

Setting the International Agenda

3.52 The UK Government currently holds the Presidency of both the European Union and the Group of Eight leading industrialised nations. The Government has placed employability at the top of the international agenda.

3.53 At the Luxembourg Jobs Summit in November 1997 the European Union agreed concrete steps to demonstrate its new common concern about employment policy and tackling the unacceptably high levels of unemployment and exclusion in the Union. The first ever set of European Union Employment Guidelines were agreed. These Guidelines include commitments for every young person to be offered a new start before reaching six months of unemployment in the form of training, work experience, a job or another employability measure. The guidelines likewise include commitments for all unemployed adults to receive a similar fresh start before reaching 12 months unemployment.

3.54 The UK and its European partners agreed to produce by April Employment Action Plans showing how the Employment Guidelines are being implemented. The UK was the first country to produce an Action Plan which was published on 27 February. The Government intends to make employment a key focus of the Cardiff European Council in June where there will be an assessment of the 15 Action Plans.

3.55 The Government's focus on employment internationally has not been restricted to the European Union. In the G8 the Chancellor and the Secretary of State for Education and Employment co-hosted a conference in London on 21-22 February under the title "Growth, Employability and Inclusion". The conference agreed important conclusions where all members of the G8 gave their agreement to endorse the seven policy principles to generate new job opportunities and tackle unemployment and exclusion. These are:

- to promote sound macroeconomic policies;
- to institute structural reforms to labour, capital and product markets;
- to enhance employment, education and training opportunities for the young and long-term unemployed, lone parents and disabled people;
- to reform tax and benefit systems to provide work incentives;
- to foster entrepreneurship, and create a climate favourable to new and small businesses;
- to encourage lifelong learning;
- to promote equal opportunities and combat discrimination.

3.56 The G8 countries agreed to produce Action Plans showing how they are turning the principles into practice by the time of the G8 Heads of Government Summit in May, where employability will be one of the main issues to be discussed.

Note

[1] *The Marginal Deduction Rate is the proportion of extra earnings that is lost through higher income tax and NICs, and lower entitlement to in-work benefits.* back

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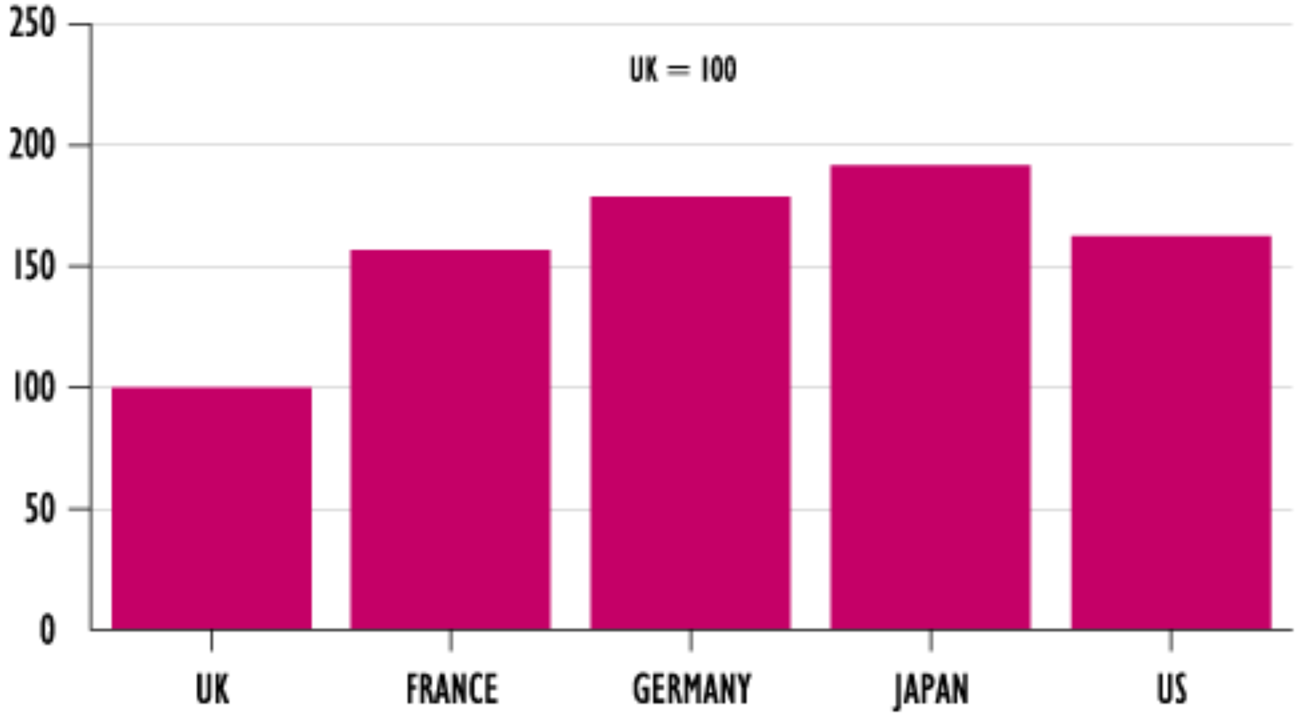
comments

Chart 4.1: Non-residential capital stock per worker (1994)



Source: National Institute of Economic and Social Research. Data on capital stock are extremely unreliable and are difficult to estimate. Different countries use different accounting procedures and different depreciation rates. Therefore these data should be seen as illustrative.

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comments

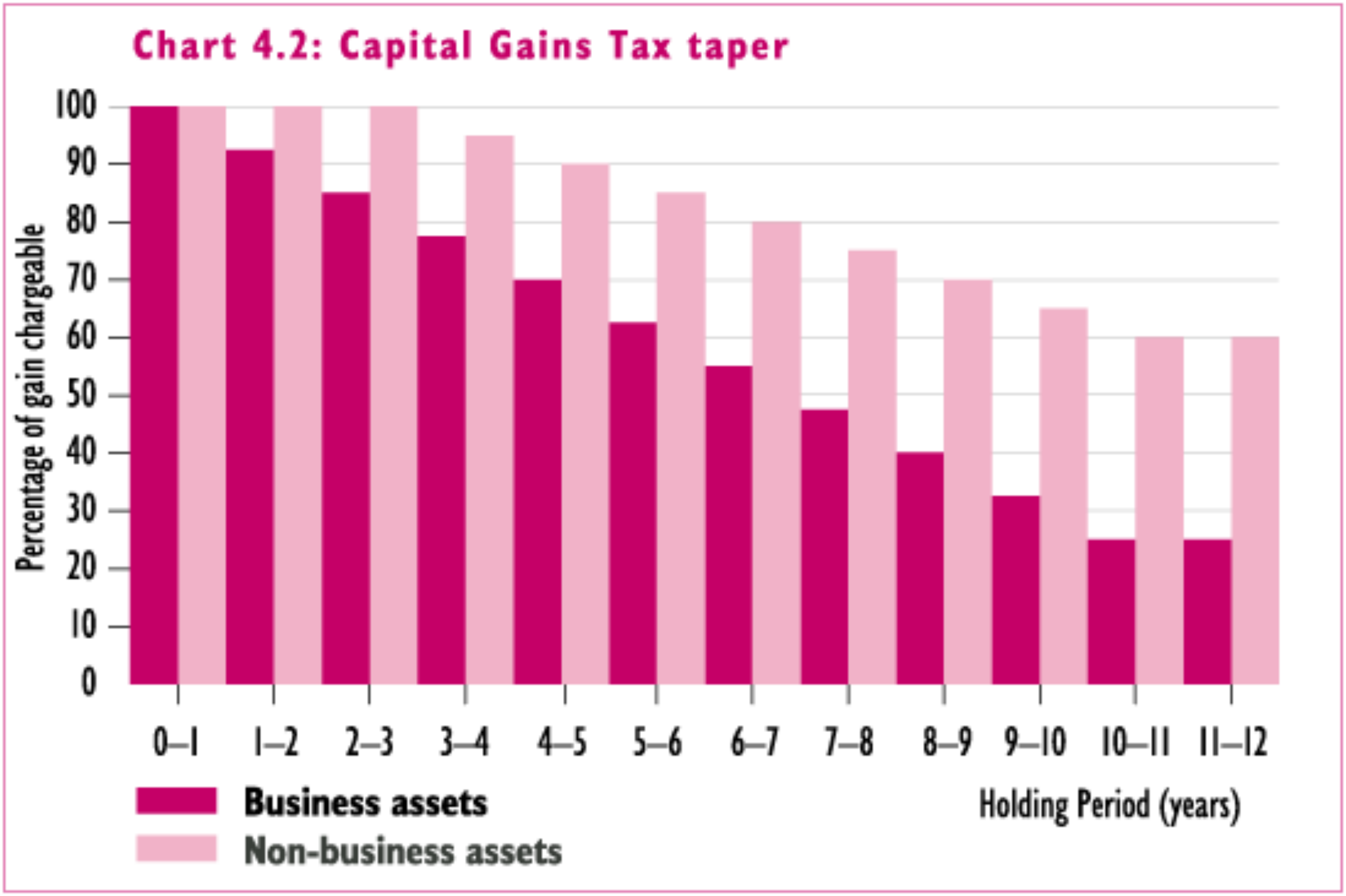
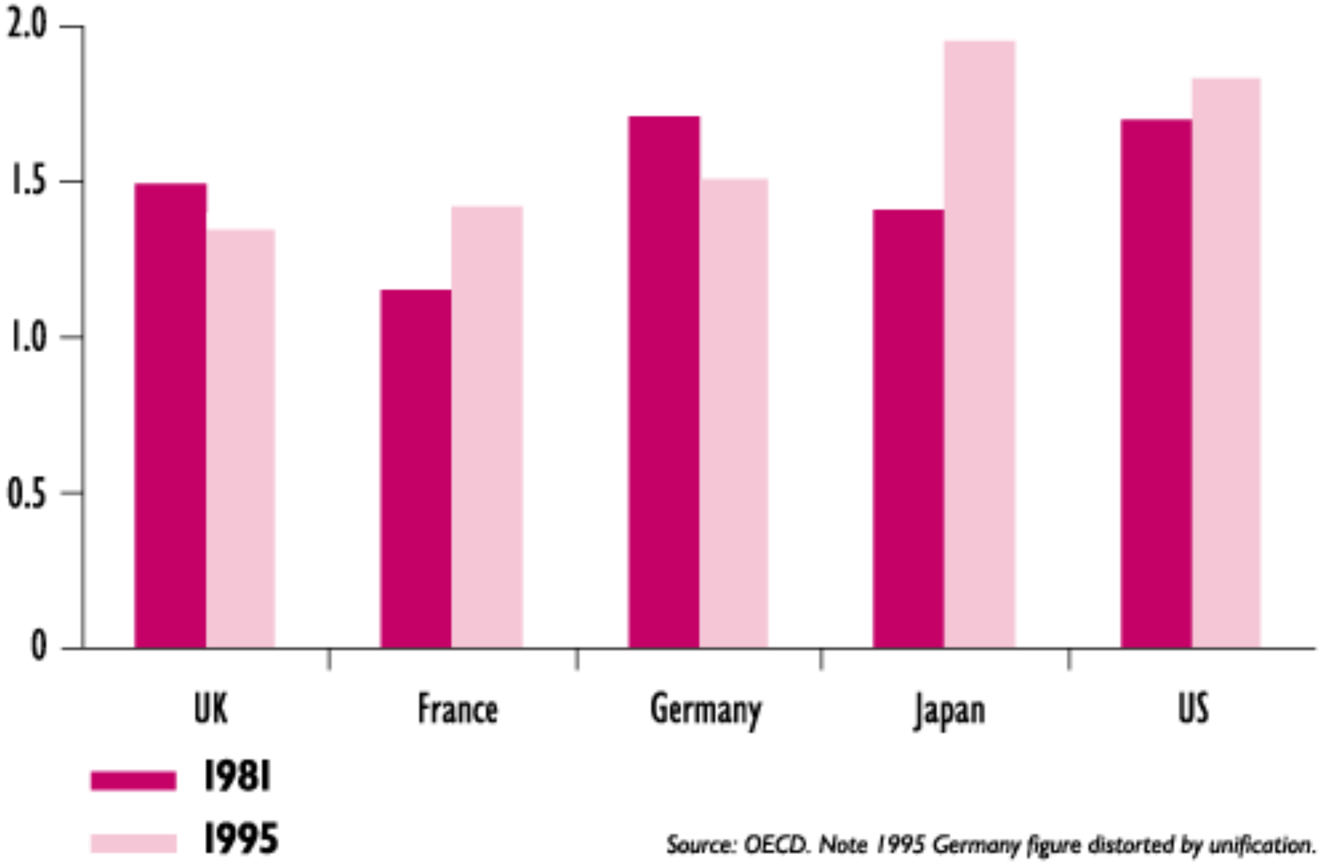


Chart 4.2: Capital Gains Tax taper
Percentage of gain chargeable
100
90
80
70
60
50
40
30
20
10
0
0–1
1–2
2–3
3–4
4–5
5–6
6–7
7–8
8–9
9–10
10–11
11–12
Holding Period (years)
Business assets
Non-business assets

comments

Chart 4.3 R&D Expenditure as proportion of GDP



Source: OECD. Note 1995 Germany figure distorted by unification.

comments

Land use and water pollution

Landfill tax

5.54 In the July Budget, a review of the operation and level of the landfill tax was announced. The review findings will be published on 18 March 1998.

5.55 To ensure that the tax continues to help minimise the environmental damage of landfill, the following changes will apply:

- the standard rate of landfill tax on active wastes will increase from 7 to 10per tonne from 1 April 1999;
- an exemption for inert waste used in the restoration of landfill sites will be introduced from October 1999;
- the lower rate of tax on inert wastes will remain at 2 per tonne.

5.56 The exemption for inert waste will help ensure that suitable materials continue to be available for the environmentally beneficial reclamation of sites. The exemption will come into force following a period of consultation on the details. The freeze in the lower rate of tax recognises that there has been some diversion of waste materials to unregulated sites.

5.57 The increase in the standard rate strengthens the incentive to reduce the landfilling of active waste. It is likely to provide a cost-effective contribution to meeting new European Union targets for reducing landfill waste. The Government will consider whether further increases are necessary in the light of the European Union targets, and the review of the National Waste Strategy.

5.58 The Environmental Bodies Credit Scheme, a system whereby landfill site operators may claim credits of landfill tax for contributions they make to approved environmental bodies, will continue. Customs and Excise will consult later this year on how the scheme could be improved, to ensure that it offers real environmental benefits, and provides good value for money. The Government will look at how the scheme could be altered to encourage recycling.

Extraction of aggregates

5.59 The July Budget announced that research would be commissioned by the Department of the Environment, Transport and the Regions into the environmental costs attached to quarrying, and in particular the supply of aggregates. The research has now been completed. It demonstrates that there are significant environmental costs not already covered by regulation. Further work is needed to build upon the initial research findings, to consider tax and other options as a means of addressing these costs, and to consider the practicalities of administering any tax. Customs and Excise will issue a consultation document on how a tax might work. In the light of reaction to this, and other continuing work, decisions on further measures will be taken.

Water pollution

5.60 A consultation paper on options for dealing with water pollution, including a system of water pollution charges, was issued by the Department of the Environment, Transport and the Regions on 26 November 1997. The Government is now considering the responses. In addition, research commissioned by the Department of the Environment, Transport and the Regions on how a system of water pollution charging might work is underway. Early results are positive, and the work is continuing.

5.61 If the results confirm that a system of water pollution charges would be practicable, and could provide a cost-effective mechanism to minimise environmental damage, then the Government will consult on a detailed proposal.

Environmental assessment of the Budget measures

5.62 The Government is committed, more generally, to ensuring that policy appraisal includes an assessment of environmental impacts. Table 5.3 contains an environmental assessment of the Budget measures which will have a significant effect on the environment, and where it is possible, gives an indication of the scale of any effects. Other measures have been considered - non-inclusion will generally reflect that environmental impacts, in absolute terms, are considered to be small.

Table 5.3: The Budget package and its environmental impact

Measure	Environmental function	Environmental impact(1),(2)
1. Consultation on a tax on the industrial and commercial use of energy	Improve energy efficiency and reduce CO_2 emissions	Reduce emissions of CO_2 and other air pollutants
2. Fuel duty increases(3),(4),(5)	Reduce CO_2 emissions	Reductions of 1.7 MtC, 0.5-1.0% of particulates and 0.3-0.7% of NO_x. Reduction of around 3 billion car kilometres
3. Increase in duty on standard diesel(3),(4)	Improve local air quality and move towards fair treatment of fuels	Reduction of 1-3% of particulates and NO_x. Very small increase in emissions of CO_2
4. Increase duty differential for ULSD(3)	Improve local air quality	Reduction of 20% of particulates and up to 2% of NO_x
5. Freeze in VED	Part of move towards shifting burden of vehicle taxation from ownership towards use	Negligible environmental impact
6. Consultation on graduated VED	Provide a tax incentive for the ownership of less polluting cars	Should result in a reduction of emissions of CO_2, NO_x and particulates
7. 500 VED discount for clean lorries and buses	Improve local air quality	Reduction in particulates and NO_x highly dependent on long-run level of take up
8. Increase in scale charges for free fuel provided with company cars(3)	Discourage the provision of free fuel and reduce CO_2 emissions	Reduction of 0.3 billion car kilometres. Reduction of CO_2 of <0.1 MtC
9. Increase in bus fuel duty rebate	Encourage bus use relative to private motoring	Small reduction in car kilometres
10. Changes to landfill tax -exemption for inert waste used for restoration -increase in standard rate -freeze in lower rate on inert wastes	Ensure waste materials available for reclamation. Reduce amount of waste going to landfill. To ensure waste materials not diverted to unregulated sites	Reduce volumes of landfill with associated methane savings and control environmental impact of landfill sites
11. Consultation on extraction of aggregates	Ensure environmental costs of quarrying captured in price	
12. Options for dealing with water pollution	Cost-effectively minimise the environmental damage from water pollution	
13. Reduction in VAT on installation of energy saving materials	Improve energy efficiency and reduce CO_2 emissions	Small reduction in emissions of CO_2
14. Minor oils duties	Reduce CO_2 emissions and other local air pollutants	Small reduction in emissions of CO_2 and other local air pollutants
15. Gas levy reduction(6)		Negligible increase in CO_2 emissions

1 These estimates are subject to significant margins of uncertainty.

2 The impact on local air quality of the transport measures will be proportionately higher in urban areas than for UK emissions. Concerns over air pollution are greatest in congested urban areas.

3 The reductions in particulate and NO_x emissions are calculated as a percentage of 2005 emissions from urban road transport, excluding any impact of Euro IV. The reductions in kilometres are the reduction on a forecast for kilometres in 2010. The reductions in CO_2 emissions are the estimated annual reductions by 2010.

4 The total impact of road fuel duty increases from 1993-2002 will reduce CO_2 *emissions by around 10MtC and road use by 29 billion kilometres by 2010.*

5 Of these reductions, 0.7 MtC, 0.2-0.4% of particulates, 0.1-0.3% of NO_x *and around 1 billion kilometres are due to bringing the increases forward to Budget day.*

6 This measure was announced in the July 1997 Budget and will be included in this year's Finance Bill.

Fairness in savings and investment

Individual savings accounts

5.63 Nearly half of the adult population have less than 200 in liquid savings and a quarter have no savings at all. The Inland Revenue published a consultative document in December 1997 on a new savings vehicle - the individual savings account - designed to develop and extend the savings habit, and to ensure that the tax relief on savings is fairly distributed.

5.64 The new account will be a stand along savings product guaranteed to run for at least ten years starting on 6 April 1999. There will be no lifetime limit. It will have a wide coverage, taking in cash (including National Savings), life insurance and stocks and shares. The account will have an annual subscription limit of 5,000 of which no more than 1,000 can go into cash and 1,000 into life insurance. In 1999-2000 only, the annual limit will be 7,000, of which no more than 3,000 can go into cash and 1,000 into life insurance. Interest, dividends and capital gains on assets held within the account will not be liable to income or capital gains tax. A 10 per cent tax credit will be payable on dividends from UK equities during the five year period to April 2004, including equities which back the life insurance component. There will be no statutory lock-in or minimum subscription.

5.65 PEPs held on 5 April 1999 will be able to continue under the current rules, outside the new savings account. They will receive tax relief on the same basis as the new account, including for five years the 10 per cent tax credit on UK equities. No further subscriptions will be allowed after 5 April 1999. The value of PEP holdings will not affect the amount that can be subscribed to the new account.

5.66 TESSAs will remain available until 5 April 1999 and subscriptions can continue for the full five-year life of the account. On maturity, the capital held in a TESSA can be transferred into the new savings account. Neither subscriptions to TESSAs nor any capital transferred on maturity will affect the amount that can be subscribed to the new account.

Stakeholder pensions

5.67 To complement the new savings measures, the Government is determined to develop a pension framework in the UK in which everyone has the opportunity to build a secure retirement income. To meet this aim, the Government is bringing forward proposals on Stakeholder Pensions, a new simple, secure, flexible and good value for money savings product. The Government intends that Stakeholder Pensions will give more people (especially low and intermittent earners, the self-employed and those without access to occupational schemes) the opportunity to save towards an adequate retirement income. A consultation paper on Stakeholder Pensions was published in November last year, and over 200 responses have been received. The Government will bring forward more detailed proposals as part of its initial response to the Pensions Review, by the middle of the year.

Pension earnings cap

5.68 For 1998-99 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 87,600.

5.69 Other pensions measures are described in Annex C, paragraph C.56.

Inheritance tax

5.70 The threshold for inheritance tax will be indexed to 223,000 for the tax year 1998-99.

5.71 Conditional exemption for heritage assets will be reformed: tax relief for chattels will generally be limited to items of pre-eminent quality (for transfers on or after 17 March 1998); tighter conditions will apply to owner's undertakings on various matters, including public access to tax exempt assets.

Paying a fair share

5.72 The Government is committed to ensuring that different sectors of the economy pay a fair and appropriate share of the tax burden.

Capital gains tax

5.73 As part of the reform of capital gains tax (CGT) described in Chapter 4, paragraphs 4.28 to 4.31, the following measures are proposed to introduce greater fairness by:

- phasing out retirement relief over a five year period from 6 April 1998. The taper will reduce the tax charge on disposals of business assets on broader basis than retirement relief. The withdrawal of retirement relief is consistent with a move towards more people having to pay some tax on their gains;
- rationalisation of the charging structure for the gains of trustees and personal representatives of deceased persons. All gains will be taxed at the rate applicable to trusts (34 per cent);
- countering the practice of the bed and breakfasting of shares to ensure that gains or losses do not arise where the investor, in effect continues to own the shares;
- charging gains on assets held at the time a person leaves the UK for a period of temporary residence abroad. Gains arising during that period of non-residence will be charged on return to the UK.

5.74 The CGT annual exempt amount will be indexed to 6,800 for individuals (and 3,400 for most trusts).

Tobacco duties

5.75 The Government maintains its commitment to protecting health by increasing the duties on tobacco by at least 5 per cent in real terms. Most tobacco duties will be increased by 8.45 per cent from November 1998. To avoid loss of revenue through cross border shopping and smuggling, duty on hand rolling tobacco will remain unchanged. This means that the overall increase in tobacco duties this year is 5 per cent in real terms.

Alcohol duties

5.76 The duty on spirits will be frozen, while that on most other alcoholic drinks will increase in line with inflation on 1 January 1999. These changes maintain the contribution to the Exchequer from alcoholic drinks by revalorising most rates. A freeze on spirits duty is designed to help both UK producers and exporters.

5.77 The duty rate on sparkling wine or sparkling made-wine of strengths exceeding 5.5 per cent abv but less than 8.5 per cent abv will fall by 20 per cent to 165.50 per hectolitre, and the duty rate for sparkling cider and perry of similar strength will rise by 20 per cent to 45.05 per hectolitre from Budget day.

5.78 Adjustments to the duties on wine and cider are a further step in eliminating the inconsistent duty treatment of sparkling cider and low-strength sparkling wine. The rates will be fully aligned in the next Budget.

Table 5.4: Changes to tobacco and alcohol duties

	Effect of tax(1) on

	Changes in duty (%)	typical item (increase in pence)	Unit
Tobacco			
Cigarettes	8.4	21	packet of 20
Cigars	8.4	9	packet of 5
Hand-rolling tobacco	0	0	25g
Pipe tobacco	8.4	12	25g
Alcohol			
Spirits	0	0	70cl bottle
Beer	3.2	1	pint
Table wine	3.2	4	75cl bottle
Cider	3.2 / 20(2)	1 / 9(2)	litre bottle
Alcopops	3.2	1	33cl bottle
Sparkling wine	3.2 / -20(3)	6 / -36(3)	75cl bottle
Fortified wine	3.2	5	70cl bottle

1 Tax refers to duty plus VAT.

2 Low strength sparkling cider.

3 Low strength sparkling wine.

Insurance Premium Tax

5.79 The higher rate of Insurance Premium Tax (17.5 per cent) will be extended to all travel insurance, thus recognising that the current selective application of the higher rate in the travel sector is likely to be less appropriate in the future marketplace.

Stamp duty

5.80 The rate of stamp duty on transfers of property (except shares) will be increased from 1.5 per cent to 2 per cent if the price is more than 250,000, or from 2 per cent to 3 per cent if the price is more than 500,000. The new rates will apply from 24 March, except where the transfer is made in pursuance of a contract made on or before 17 March.

Charities

5.81 The Government announced a Review of Charities Taxation in the July 1997 Budget. The aim of the Review is to identify a fair taxation system for charities which is coherent, consistent and simple to administer, less costly for charities to comply with, less open to tax avoidance and fair to the commercial businesses with whom charities may compete. A consultation paper on options for change, taking account of the many responses received, will be issued later in the Spring.

North Sea fiscal regime

5.82 The Government announced a review of the North Sea fiscal regime in last July's Budget. The aim was to ensure that an appropriate share of profits are being taxed while continuing to maintain a high level of oil industry interest in the future development of the UK's oil and gas reserves.

5.83 As a result of the review, the Government believes that certain aspects of the current fiscal regime are unsatisfactory. In response to requests from the industry for further consultation on any planned changes, the Government will formally consult the oil industry on specific proposals for change to the North Sea fiscal regime.

5.84 The Government also announced in the last Budget that gas levy was to be cut to zero with full effect from April 1998. This will be implemented by abolishing gas levy from 1998-99 and reducing the rate of gas levy for 1997-98 by 1 pence/therm to 3 pence/therm.

Measures to secure the tax base

5.85 The Government is committed to securing the tax base, to ensure the tax system works as Parliament intended and that no one has to bear an unfair level of taxes to compensate for shortfalls in revenue.

General anti-avoidance rules (GAARs)

5.86 During April, the Inland Revenue will be publishing illustrative clauses for the purpose of consultation on a general anti-avoidance rule. This will be done with a view to legislation being introduced in a Finance Bill after the next Budget.

5.87 Customs and Excise will be consulting about illustrative clauses for GAARs in specific areas of VAT over the summer.

Alcohol and tobacco fraud

5.88 In his Budget of 2 July 1997 the Chancellor announced a review of alcohol and tobacco fraud. The aim of the review was to identify the effects of alcohol and tobacco fraud and smuggling, assess the contribution made to the problem by a number of factors and determine the most effective remedies in partnership with industry. The Financial Secretary to the Treasury asked Customs to undertake the review, consulting widely with the trade, and other public bodies and interested parties. The Government is determined to tackle the problems of smuggling and fraud and, in view of the possible public spending implications, will announce its proposals for doing this as part of the outcome of the Comprehensive Spending Review.

5.89 Annex C describes other measures in the Budget and includes Table C1 showing the revenue effect of all the Budget tax measures, the measures announced since the July 1997 Budget and the measures announced in or before the July 1997 Budget yet to take effect.

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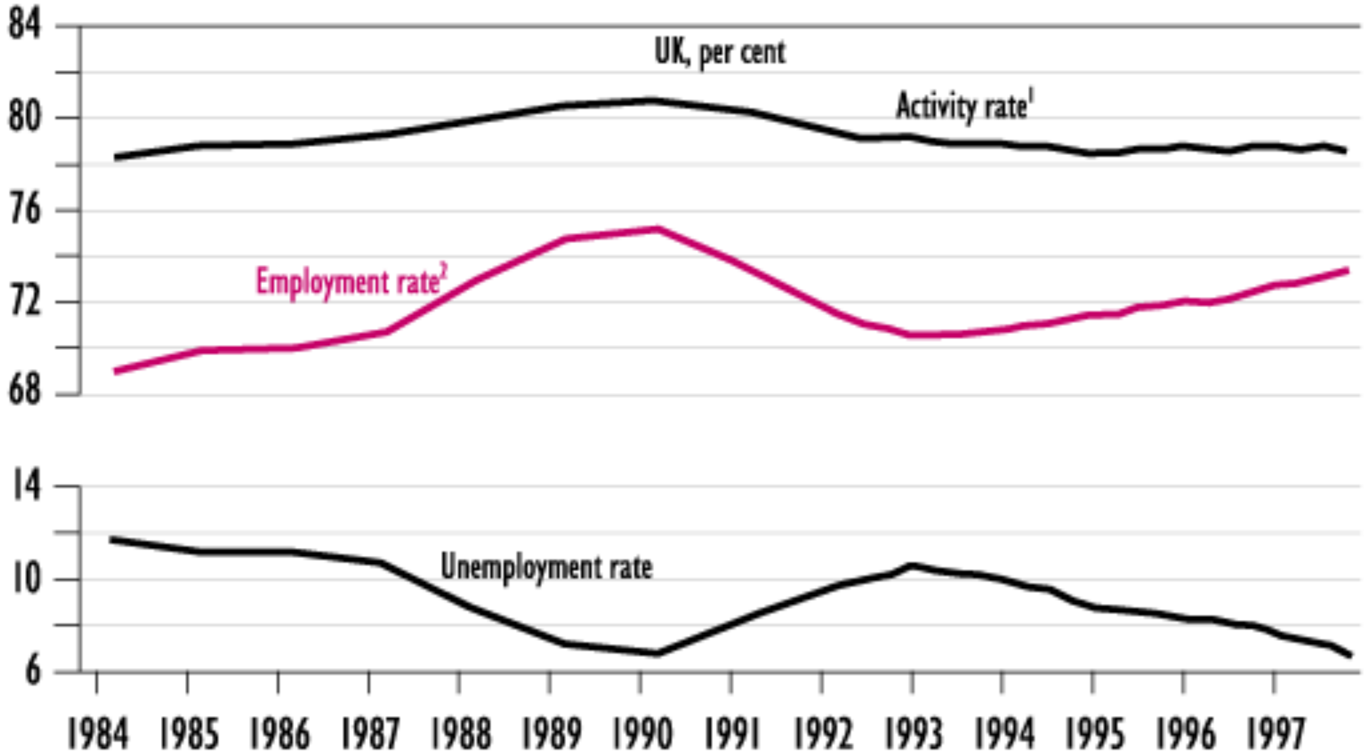
comments

Chart AI: LFS employment, unemployment and activity rates



[1] *Percentage of the population of working age who are economically active (i.e. employed or unemployed).*
[2] *Percentage of the population of working age who are in employment.*

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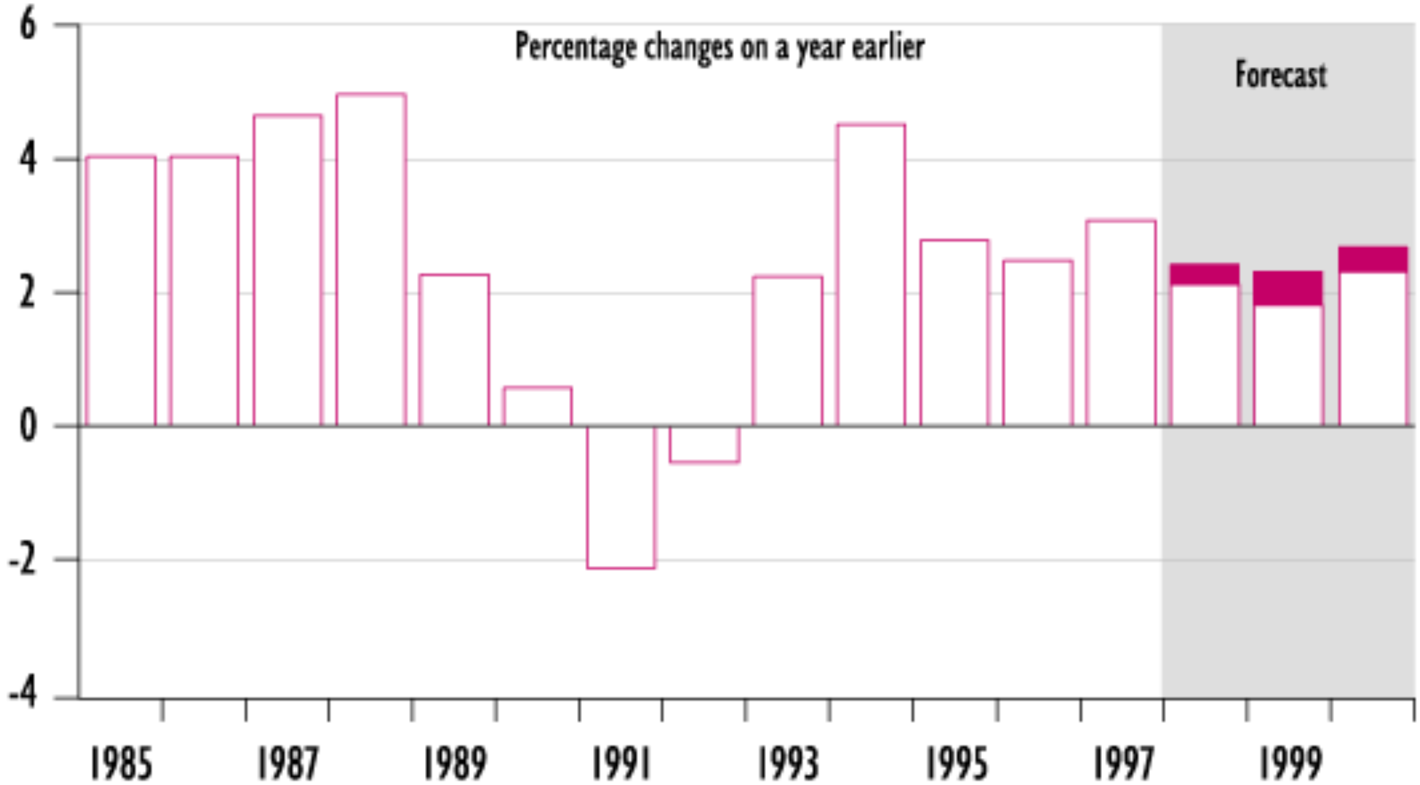
comments

Chart A2: Gross Domestic Product (GDP)[1]



[1]Shaded areas on bars represent forecast ranges.

comments

Chart A3: Personal sector saving ratio

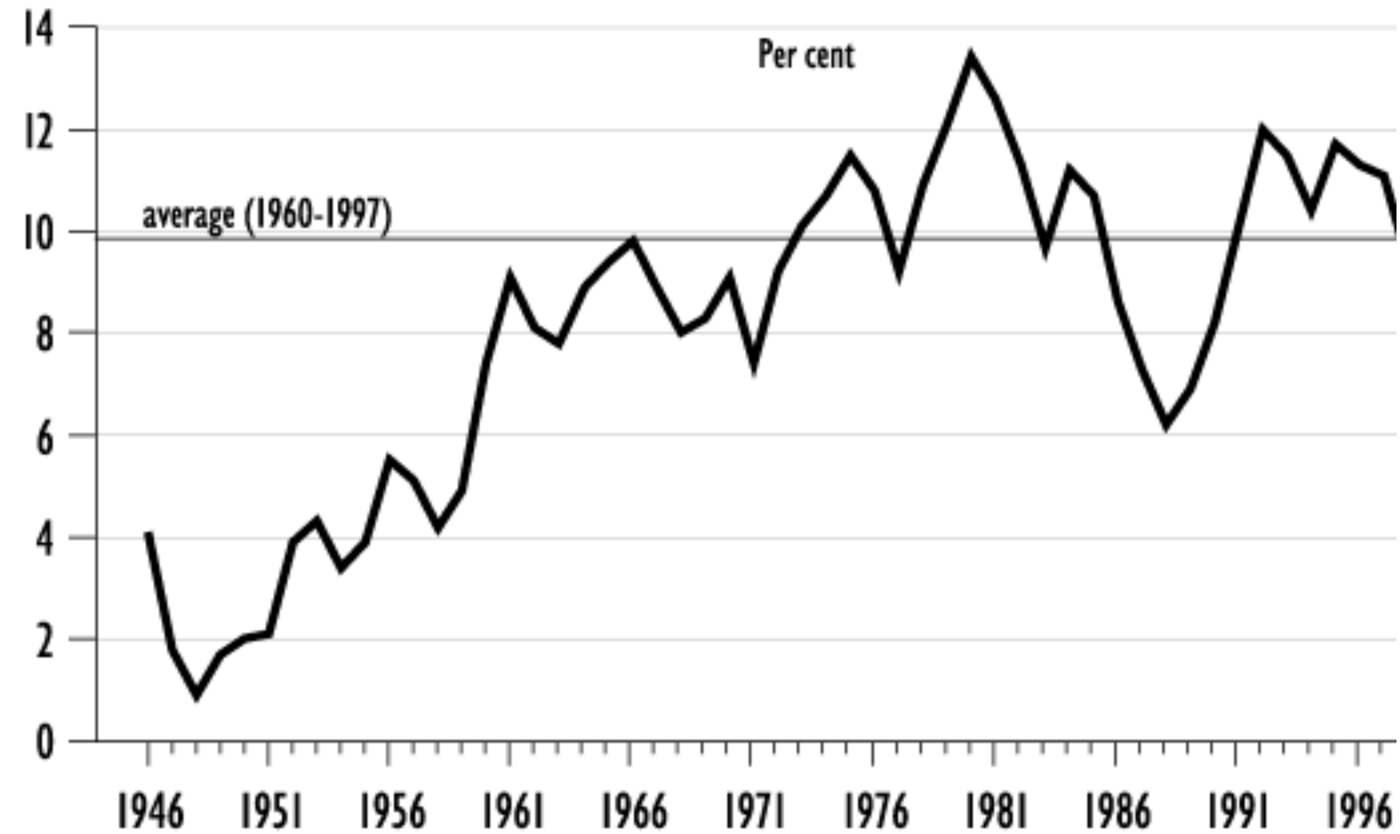


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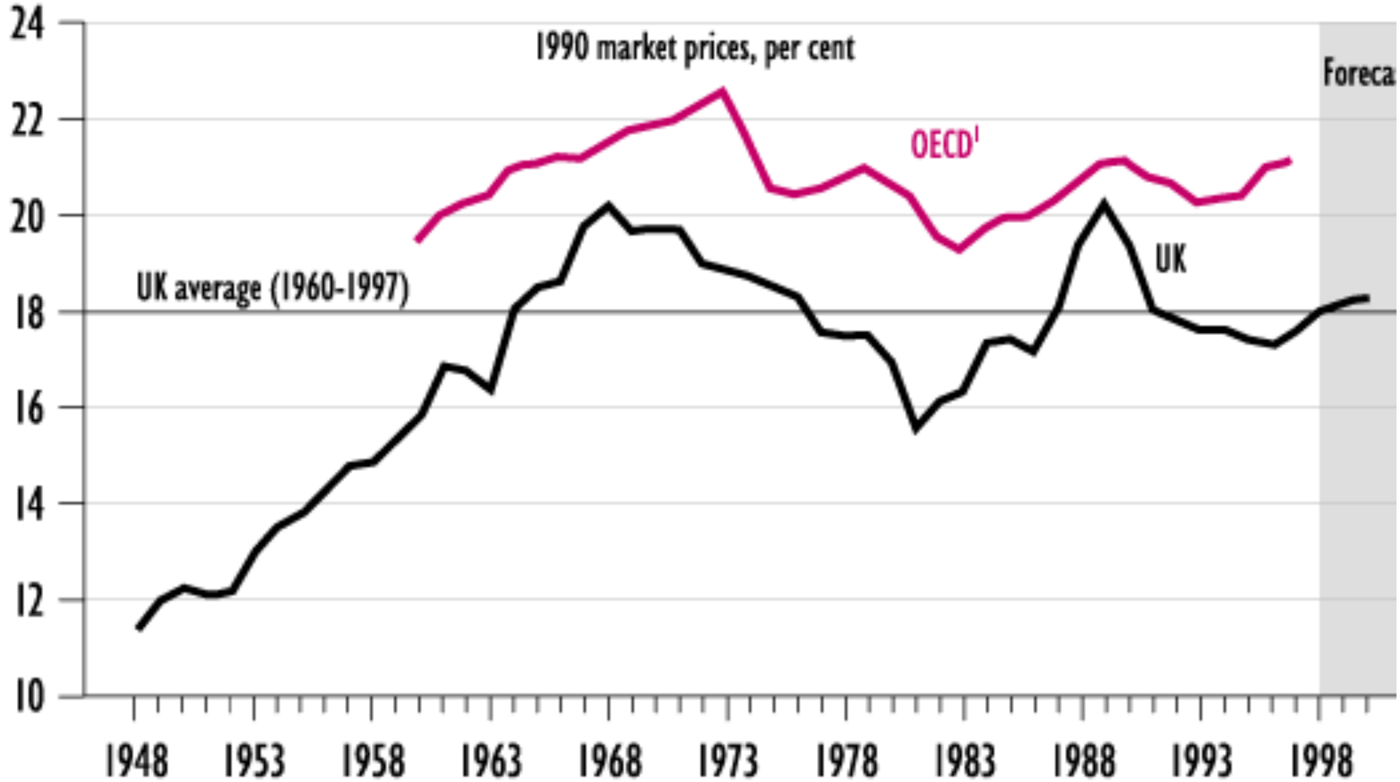
Chart A4: Whole economy investment–GDP ratio



[1]*Source: OECD.*

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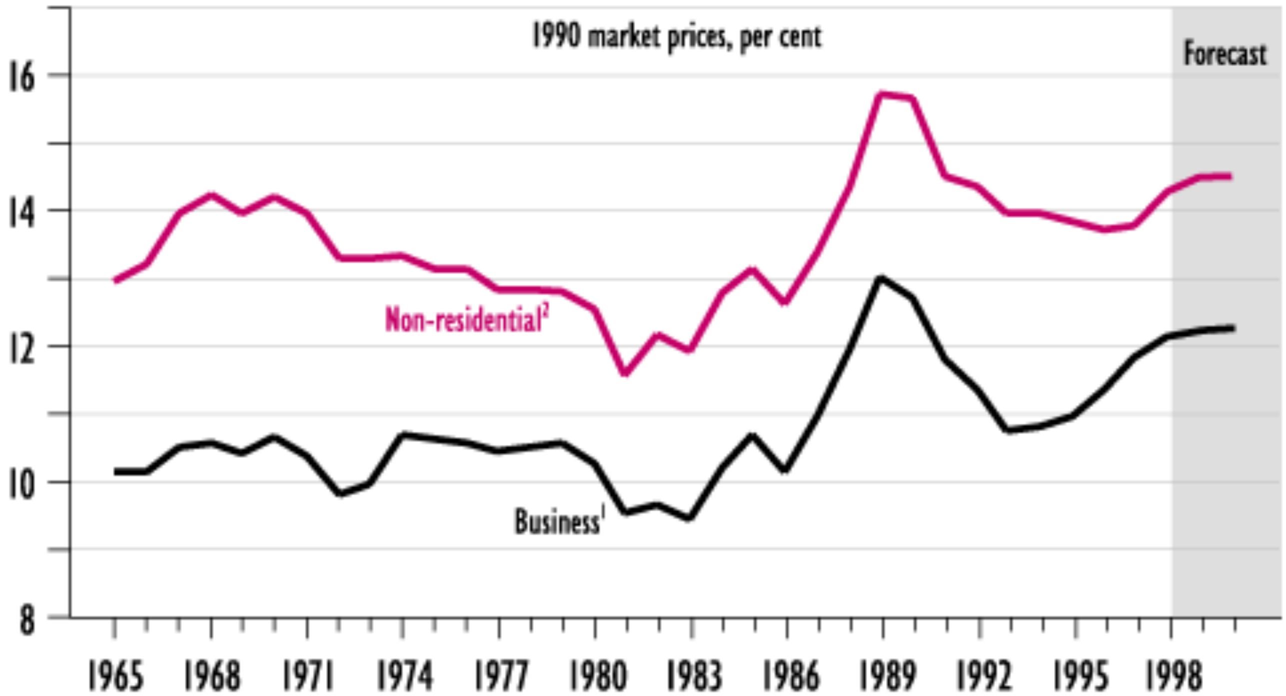
Chart A5: Business and non-residential investment–GDP ratios



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

[2] *Non-residential investment defined as business plus general government investment (see Table A2).*

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comments

Trade and the balance of payments

A.39 There is now clear evidence that the appreciation of sterling of around 25 per cent since summer 1996 is having an impact, net trade making a large negative contribution to GDP growth in the final quarter of last year. However, exports have so far stood much better than expected in the face of the appreciation.

A.40 Surveys by the CBI and BCC indicated an earlier and a sharper deterioration in the balance of trade in goods and services t has been seen in the official figures. In contrast, the CIPS manufacturing survey, until recently, had been consistently more upbea prospects for exports, taking rather longer than other surveys to indicate a negative impact from sterling's appreciation.

A.41 As discussed in the Pre-Budget Report, the behaviour of exports has perhaps not been as surprising as at first sight (this is discussed in the box on page 96). There are typically fairly long lags - of a year or more - before exchange rate movements affect volumes; and 1997 saw much stronger growth in world trade than 1996. As a result, the overall trading environment did not dete as sharply as the strength of sterling alone might suggest. Moreover, the trade balance as a whole has not deteriorated in the curre economic upswing, in contrast to past experience, suggesting some underlying improvement in export performance.

A.42 Nevertheless, the outlook for the traded goods sector is difficult, compounded by financial developments in Asia (see box c 104) which will have both direct and third market effects on UK trade. Asian demand for UK exports will weaken - indeed total imports have already fallen dramatically. In addition, an essential part of the Asian recovery will be through exports, and UK pro will face greater competition from Asian goods, both directly in the UK and in other markets where they compete with Asia for n share. In such markets, the UK faces the dual effect of sterling's appreciation over the past eighteen months and the more recent depreciations of Asian currencies. However, the UK's direct trade with the troubled Asian economies is not particularly large, accounting for less than 7 per cent of UK exports and under 8 per cent of UK imports in 1996. Moreover, at 7 3/4 per cent this ye total export market growth is expected to remain high by recent standards. Overall, and abstracting from any other changes the A financial difficulties trigger, developments in Asia are expected to reduce UK GDP growth by up to 1/2 percentage point this yea although there is a risk of a larger impact.

A.43 The difficulties faced by UK traded goods producers translate into improved opportunities for overseas competitors in the domestic market. The latest trade figures show imports rising significantly faster than exports, with imports of goods in the fourth quarter of 1997 up 10 3/4 per cent on a year earlier. Import growth is expected to continue to outstrip export growth both this yea next, resulting in a deterioration in the trade balance. But the projected slowdown in the UK economy will have a dampening eff the growth of imports, at least partly offsetting the competitive advantage gained by imports as a result of sterling's appreciation effect of developments in Asia.

Strength of sterling

Sterling's appreciation of around 25 per cent on a trade weighted basis since August 1996 has not been uniform across currencie Against the deutschemark it has gained over 30 per cent, but against the dollar only 8 per cent. Most of the appreciation occurre between August 1996 and July 1997.

To some extent, it probably reflects an element of undervaluation in the first half of 1996. Furthermore, the UK cycle has been ru ahead of that of its European Union partners, leading to relatively high UK interest rates. In addition, with financial markets not expecting the UK to participate in the first wave of EMU, investors may have switched into sterling assets as a "safe haven" fron potential uncertainties associated with EMU. However, it is difficult to explain the full extent of the appreciation by these factors

The most direct effect of an appreciation is on the balance of payments. Yet UK exports have been resilient, and the current acco for 1997 showed the first annual surplus since 1985. This partly reflects trade volumes reacting to exchange rate changes with a lag than trade prices, and import prices adjusting downwards faster than export prices. The full impact of the appreciation can be expected to come through more fully over the coming year, with a widening in the deficit on trade in goods and services (first cle evidence of which emerged in the fourth quarter of last year).

From their peak in early 1996, export prices of goods (excluding oil and erratics) have fallen by 8 1/2 per cent. Import prices pea the autumn of 1995, and have since fallen by 10 per cent. Trade prices started to fall before the appreciation. On the export side, perhaps reflected UK firms trying to boost market share through lower profit margins. The earlier appreciation against the dollar also have played a short-term role in pulling sterling prices lower. While these falls in nominal trade prices have been much shar than when sterling appreciated in the early 1980s, inflation has also been much lower, suggesting that real trade prices have not adjusted as rapidly.

There are several possible reasons why prices have not fallen faster. First, firms may have been expecting the appreciation to be lived, and therefore only lowered export prices slowly in response to progressive loss of new export orders. Second, on the impo side, foreign exporters may have taken advantage of sterling's rise to increase profit margins. Third, UK goods and services tend of better quality than they were in the 1970s and 1980s, making volumes less sensitive to changes in relative prices. Finally, muc trade actually involves multinational firms from both the UK and abroad conducting "in house" trade. Such transactions may be sensitive to exchange rate movements than "arms length" transactions between different firms, because of transfer pricing betwe plants. Nevertheless, it remains surprising that the falls in trade prices have been quite so muted.

Table A3: Trade in goods and services

	Percentage changes on a year earlier					**billion**
	Volumes		**Prices**(1)			
	Exports	**Imports**	**Exports**	**Imports**	**Terms of trade**(2)	**Goods and services balance**
1997	8	9 1/4	- 4 3/4	- 6 3/4	2	-3 3/4
Forecast						
1998	3 1/4 to 3 1/2	7 1/2 to 8	-1 3/4	-2 1/2	3/4	-11 3/4
1999	4 1/2 to 5	5 1/2 to 6	1 3/4	1 1/4	3/4	-13
2000	6 to 6 1/4	5 1/2 to 5 3/4	1 1/2	1 1/2	1/4	-12

1 Average value indices.

2 Ratio of export to import prices.

A.44 The current account as a whole is forecast to move from a surplus of 4 1/2 billion last year to a deficit of 6 1/2 billion this y around 3/4 per cent of GDP, the deficit in 1998 is expected to be modest by the standards of the late 1980s, and to remain at a sim level in 1999 and 2000. The shift into deficit largely reflects a widening of the deficit on trade in goods and services. The investm income balance has shown surprisingly little evidence of any currency translation effects so far, and the forecast reflects the judge that it will not show any large hit from sterling's appreciation, although there is a risk that such effects could emerge belatedly.

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Inflation

A.45 RPI excluding mortgage interest payments (RPI ex MIPs) inflation averaged 2 3/4 per cent in the fourth quarter of 1997, in with the Pre-Budget Report forecast, but fell back to 2.5 per cent in January - reflecting deeper than usual discounting in the Janu sales and lower food price inflation. However, retail price inflation has remained surprisingly high given the large appreciation of exchange rate since the summer of 1996. It appears that downward pressure from the exchange rate, particularly in the form of fa producer input prices, has been offset by manufacturers and retailers expanding domestic margins against a background of strong demand. Growth in unit labour costs seems to have been held in check for most of last year, though now it has probably started to

Producer prices

A.46 Input prices have continued to fall sharply, with the recent decline reflecting falling oil and food prices. In February, input were 9.5 per cent lower than a year earlier. Oil and non-oil commodity prices have recently weakened, partly reflecting developm Asia. Output price inflation has fallen from 1.5 per cent at the beginning of 1997 to 0.8 per cent in February. Given the size of the in input prices and import prices, output price inflation might also have been expected to turn negative during the course of the pa year. Instead, manufacturers appear to have taken the opportunity partly to rebuild domestic margins. During 1998, manufacturer cut back margins as activity remains weak. So, with little immediate sign of a turnaround in input prices, output price inflation is expected to remain subdued this year.

Earnings and settlements

A.47 Whole economy underlying average earnings growth was temporarily boosted by bonuses at the beginning of 1997, and fel to 4 1/4 per cent in the middle of the year. But it picked up again to 4 3/4 per cent at the end of 1997, with an increase in earnings growth in both the manufacturing and service sectors. Wage settlements have also picked up since last summer. However, they ar necessarily a good leading indicator of earnings growth, because earnings include elements of performance related pay which ma respond more quickly to changes in activity than settlements.

A.48 In the short run, the recent pick-up in earnings growth could be absorbed in firms' margins. However, any increase in real e growth above the rate of trend productivity growth could not be sustained indefinitely. As the Bank of England's Monetary Policy Committee has noted, wage increases higher than 4 1/2 per cent could not be sustained in the long run without domestically gene inflation rising above the 2 1/2 per cent target. This emphasises the need for responsible wage setting across the economy so as n threaten jobs.

Inflation forecast

A.49 During 1998, the effect of sterling's appreciation and developments in Asia are expected to result in lower goods price infla relative to services price inflation, continuing the pattern of last year. In January, goods price inflation was 1.6 per cent, while ser price inflation was 2.9 per cent (this includes utilities where prices are falling).

A.50 At the time of the November Pre-Budget Report, RPI ex MIPs inflation was forecast to rise to around 3 per cent in the seco quarter of 1998 and to remain at around that rate for the rest of the year. Developments since November have tended to point to s weaker underlying inflationary pressure, reflecting the marginally lower estimate of the positive output gap at the end of 1997 an small downward revision to GDP growth this year, together with the direct downward pressure on traded goods' prices as a result situation in Asia. Taking account of these developments and the Budget excise duty measures, RPI ex MIPs inflation is now fore be around 3 per cent in the second quarter of this year and 2 3/4 per cent in the fourth quarter.

A.51 As output growth slows below its trend rate through this year and the output gap turns negative, this is expected to put dow pressure on inflation. The RPI ex MIPs rate is projected to fall gradually to the 2 1/2 per cent target by the end of 1999. This pros further underpinned by the fall in inflation expectations since last May - see Chart 2.2

A.52 As an index of domestic output prices, the GDP deflator includes the prices of UK exports but excludes the prices of UK in Inflation measured by the GDP deflator tends to rise if export prices rise faster than import prices, ie the terms of trade increase. I this tended to boost GDP deflator inflation relative to RPI ex MIPs inflation, but the effect was more than offset by consumers' expenditure deflator inflation being unusually low relative to RPI ex MIPs inflation. In 1998, the position is expected to be revers The terms of trade are still expected to make a positive contribution to GDP deflator inflation, as import prices continue to fall fas than export prices, though less so than in 1997. But consumers' expenditure deflator inflation is assumed to move back in line wit ex MIPs inflation from now on. So GDP deflator inflation is forecast to rise temporarily above the RPI ex MIPs rate this year, ave 3 per cent in 1998-99.

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RISKS

A.53 There are, as ever, substantial risks to the forecast.

A.54 Downstream inflationary pressure could turn out to be stronger than expected if existing demand and wage pressures have l under-rated and output is now further above trend than estimated. Should this be the case, monetary policy would probably be be the game. This poses the prospect of higher inflation, higher interest rates and a sharper slowdown in growth than expected over t next two years in order to bring inflation back down to target.

A.55 If the anticipated slowdown in domestic demand were not to materialise (for example, if the saving ratio were to fall more than expected), higher interest rates might again be needed to achieve the inflation target. But the slowdown might not be as shar the first case, where the greater inflationary pressures would already be in the pipeline.

A.56 A sharp fall in the exchange rate would result in higher import prices and higher than expected inflation, boosting demand exports. The extent to which interest rates would need to react would depend on the context of the exchange rate fall. If domestic demand was strong, there would be a risk that the initial boost to inflation would be sustained, and policy would probably need to respond. However, if weaker domestic demand, possibly reflecting the saving ratio remaining high, were the cause of the exchan

fall, the longer-term inflation prospect would be more benign, and a policy response might not be necessary. Nevertheless, there c
be a period in which output was growing significantly below its trend rate with inflation remaining above target.

A.57 Perhaps the main development which could lead to a situation of weaker than expected demand and lower inflationary pres
would be a deterioration of the situation in Asia. The effects would essentially be the reverse of those described in the stronger de
case above, with a sharper slowdown in growth and the inflation target being met with lower interest rates. This, of course, emph
the importance of closely monitoring developments in Asia, where the situation is still evolving.

Table A4: Summary of economic prospects(1)

	Percentage changes on a year earlier unless otherwise stated					
		Forecast(2)			**Average errors from past forecasts**(3)	
	1997	**1998**	**1999**	**2000**	**1998**	**1999**
Output at constant prices(4)						
Gross domestic product (GDP)	3	2 to 2 1/2	1 3/4 to 2 1/4	2 1/4 to 2 3/4	3/4	1 1/2
Non-North Sea GDP	3 1/4	2 to 2 1/2	1 1/2 to 2	2 1/4 to 2 3/4	3/4	1 1/4
Manufacturing output	1 1/2	0 to 1/2	1 to 1 1/2	2 1/4 to 2 1/2	3/4	2 3/4
Expenditure components of GDP at constant prices(4)						
Domestic demand	3 1/2	3 1/4 to 3 3/4	2 1/4 to 2 3/4	2 1/4 to 2 1/2	3/4	1 3/4
Consumers' expenditure	4 1/2	3 3/4 to 4	1 3/4 to 2 1/4	2 1/4 to 2 1/2	3/4	1 1/2
General government consumption	- 1/2	1 1/4	2	2	3/4	1
Fixed investment	4 3/4	4 3/4 to 5 1/4	2 3/4 to 3 1/4	2 1/2 to 2 3/4	1 1/2	4
Change in stockbuilding(5)	0	- 1/4	1/4	0 to 1/4	1/4	1/2
Exports of goods and services	8	3 1/4 to 3 1/2	4 1/2 to 5	6 to 6 1/4	1 1/2	2
Imports of goods and services	9 1/4	7 1/2 to 8	5 1/2 to 6	5 1/2 to 5 3/4	2	3 1/2
Balance of payments current account						
billion	4 1/2	-6 1/2	-6 3/4	-6 1/2	8 1/4	11 1/4
per cent of GDP	1/2	- 3/4	- 3/4	- 3/4	1	1 1/4
Inflation						
RPI excluding mortgage interest payments (Q4)	2 3/4	2 3/4	2 1/2	2 1/2	1/2	1
Producer output prices (Q4)(6)	1/2	2	2 1/4	2 1/4	1/2	1 1/2
GDP deflator at market prices (financial year)	2 3/4	3	2 1/2	2 1/2	1	1 1/4
Money GDP at market prices (financial year)						
billion	797	834 to 837	872 to 880	914 to 925	11 1/2	17 1/4
percentage change	6	4 1/2 to 5	4 3/4 to 5 1/4	4 3/4 to 5	1 1/4	2

1 Data in this chapter are consistent with the output, income and expenditure estimates and other series for the period to the four quarter of 1997 released by the Office for National Statistics on 13 March 1998.

2 Despite the assumption that ratios of variables to GDP are largely invariant within forecast ranges, the growth ranges for GDI components do not necessarily round to the 1/2 percentage point ranges for GDP growth. This reflects the GDP growth ranges themselves being rounded, and assumed invariance of the levels of public spending and counterparts within the forecast ranges.

3 Average absolute errors in spring/summer forecasts over past ten years. The average errors for the current account are calcula a percent of GDP. The billion figures are calculated by scaling the errors as a percent of GDP by money GDP.

4 Further detail on GDP and its components is given in Table A5.

5 Per cent of GDP.

6 Excluding the food, beverages, tobacco and petroleum industries.

Table A5: Gross domestic product and its components

billion at 1990 prices, seasonally adjusted

	Consumers' expenditure	**General government consumption**	**Total fixed investment**	**Stock-building**	**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)**
1997	394.5	120.5	108.7	2.2	625.9	193.9	819.8	201.6	79.8	2.1
1998	409.5 to 410.8	122.0	114.0 to 114.3	1.2 to 1.5	646.7 to 648.7	200.1 to 200.8	846.8 to 849.5	216.8 to 217.5	80.5 to 80.7	2.3
1999	416.6 to 420.0	124.6	117.2 to 118.1	2.4 to 3.4	660.7 to 666.1	209.2 to 210.9	869.9 to 877.0	228.6 to 230.4	81.9 to 82.6	2.3
2000	425.6 to 430.5	127.0	120.0 to 121.4	2.8 to 4.4	675.5 to 683.3	221.7 to 224.3	897.2 to 907.6	241.2 to 244.0	83.8 to 84.8	2.4
1997 1st half	195.0	60.1	53.7	1.4	310.2	95.5	405.8	98.7	40.0	1.0
2nd half	199.6	60.4	55.0	0.8	315.7	98.4	414.1	102.9	39.8	1.1
1998 1st half	203.7 to 204.1	60.2	56.5 to 56.6	1.3 to 1.4	321.7 to 322.3	99.2 to 99.4	420.9 to 421.7	106.8 to 107.0	40.1 to 40.2	1.1
2nd half	205.8 to 206.7	61.9	57.5 to 57.8	-0.2 to 0.1	325.0 to 326.5	100.9 to 101.4	426.0 to 427.8	110.0 to 110.4	40.4 to 40.5	1.1
1999 1st half	207.3 to 208.7	61.9	58.2 to 58.6	1.0 to 1.4	328.4 to 330.7	103.2 to 103.9	431.6 to 434.5	112.7 to 113.5	40.7 to 41.0	1.2
2nd half	209.3 to 211.3	62.7	58.9 to 59.5	1.4 to 2.0	332.3 to 335.4	106.0 to 107.0	438.3 to 442.4	115.8 to 116.9	41.2 to 41.6	1.2
2000 1st	211.6 to		59.7 to	1.8 to	335.9 to	109.2 to	445.1 to	118.9 to	41.7 to	

half	213.9	62.8	60.3	2.5	339.6	110.4	450.0	120.2	42.1	1.2
2nd half	213.9 to 216.6	64.2	60.4 to 61.1	1.0 to 1.9	339.6 to 343.7	112.5 to 113.9	452.1 to 457.6	122.2 to 123.7	42.1 to 42.6	1.2
					Percentage changes on a year earlier(2)					
1997	4 1/2	- 1/2	4 3/4	0	3 1/2	8	4 1/2	9 1/4	4 1/2	1/4
1998	3 3/4 to 4	1 1/4	4 3/4 to 5 1/4	- 1/4	3 1/4 to 3 3/4	3 1/4 to 3 1/2	3 1/4 to 3 1/2	7 1/2 to 8	3/4 to 1 1/4	0
1999	1 3/4 to 2 1/4	2	2 3/4 to 3 1/4	1/4	2 1/4 to 2 3/4	4 1/2 to 5	2 3/4 to 3 1/4	5 1/2 to 6	1 3/4 to 2 1/4	0
2000	2 1/4 to 2 1/2	2	2 1/2 to 2 3/4	0 to 1/4	2 1/4 to 2 1/2	6 to 6 1/4	3 1/4 to 3 1/2	5 1/2 to 5 3/4	2 1/4 to 2 3/4	0

1 Expenditure adjustment.

2 For stockbuilding and the statistical discrepancy, changes are expressed as a percent of GDP.

comments

THE WORLD ECONOMY

Summary

A.58 The prospects for growth in the major industrial countries and most other regions are, overall, good. While the severity of financial difficulties in Asia has raised fears of a sharp slowdown in global activity, it is not expected to tip the world economy into recession. Nevertheless, following several years of steady growth, the risks to sustained global expansion have increased.

Table A6: The world economy

	Percentage changes on a year earlier			
		Forecast		
	1997	**1998**	**1999**	**2000**
Major seven countries(1)				
Real GDP	2 3/4	2	2	2 1/4
Consumer price inflation(2)	2	1 3/4	2	2 1/4
World trade in manufactures	11	7	7	7 3/4
UK export markets(3)	10 1/4	7 3/4	7 1/2	7 1/2

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.

Activity

A.59 Growth across the G7 as a whole is estimated to have been above its trend rate, at 2 3/4 per cent, in 1997. This reflected strong growth in North America and a strengthening recovery in core Europe. But growth in Japan fell back sharply after a very strong year in 1996. Spillovers from Asia and domestic weakness in Japan mean that G7 growth is likely to fall back in 1998 compared with 1997. However, with recovery in Europe on track and robust demand growth in the US, overall G7 GDP is expected to grow by 2 per cent this year, only slightly below its trend rate.

A.60 In a number of East Asian economies, financial difficulties mean that domestic demand growth is likely to continue to fall dramatically. But sharp turnarounds in net trade are expected partially to offset the effects on output. Nevertheless, the consensus expectation is that GDP growth will average around zero this year, in contrast to recent growth rates of 6 to 8 per cent a year. While emerging markets outside Asia as a whole have not been particularly badly hit by the turbulence, the outlook for Latin America has deteriorated following sharp policy tightening in Brazil.

A.61 Within the G7, the outlook for Japan is weak. Domestic demand slowed much more sharply than expected following last April's tax increases. In addition, the long-standing problems in the financial sector have re-emerged, illustrated by the collapse of Yamaichi Securities in November. On top of this, financial difficulties elsewhere in Asia are set to place a significant dent in Japan's export market growth and harm its competitiveness, hitting an important prop of a fragile recovery. In the absence of further policy measures, GDP growth is expected to remain very weak.

The financial situation in Asia

The severity of Asia's financial difficulties has taken nearly everyone by surprise. Following the abandonment by the authorities in Thailand of the baht's 13 year peg to the US dollar in July 1997, turbulence in Asian financial markets spread rapidly across South East Asia, and then to North East Asia in the latter part of last year. Large financial rescue packages from the international community were needed in support of programmes of reform.

Some of Asia's difficulties reflected traditional balance of payments concerns. Thailand's current account deficit was large and rising, while many countries in the region were experiencing overheating pressures. In addition, fixed exchange rate pegs to the rising USdollar eroded competitiveness at a time when key export markets were weak. But the main problems centred around financial sector weakness - with poor prudential regulation and supervision, and a lack of transparency. This led to excessive external short-term borrowing to finance investment in real estate and other unproductive areas, and insufficient hedging of foreign currency exposures.

Action from the international financial community was swift. The IMF, World Bank and the Asian Development Bank agreed programmes of reform with total financing support as follows: Philippines ($1 billion), Thailand ($17.2 billion), Indonesia ($43 billion) and Korea ($57.6 billion), including agreement from the UK to consider a bilateral loan of up to $1.25 billion to Korea. Financial turbulence in Asia has lasted longer than expected, and longer than the turbulence witnessed in Latin America in late-1994. But some confidence and stability has returned to those Asian markets where there have been strong signs of commitment to reform. Full implementation of IMF reform programmes will be crucial in restoring market confidence and ensuring a return of private capital flows.

The financial situation in Asia will have the effect of lowering both growth and inflation in the G7 economies. It is likely to affect the wider global economy through a number of channels, the most direct of which is trade. Weaker domestic demand and improvements in competitiveness mean that the Asian economies are likely to experience sharp improvements in their current account balances. This will result in weaker net trade positions elsewhere. But estimates by the IMF and OECD suggest that trade channels should have relatively small effects on activity in the European Union and the US, reducing GDP growth by around 1/2 percentage point this year. With market expectations of short-term interest rates and long-term bond yields having fallen, there could be some offset from looser monetary conditions. In Japan, however, the trade impacts are likely to be larger.

The UK's trade links with these countries are not insignificant, but are smaller than those of Japan or the US. As discussed in paragraph A.42, the Asian economies in difficulties account for a relatively small proportion of UK trade. But in addition to the impact on these bilateral trade flows, the depreciation in Asian exchange rates also means that UK exporters are likely to experience stiffer competition from Asian competitors in third markets. Overall, and abstracting from any other changes the Asian financial difficulties trigger, the impact of financial turbulence in Asia is expected to reduce UK GDP growth by up to 1/2 percentage point this year.

However, these estimates of the direct trade effects understate the downside risks. It is clear that keeping these risks to a minimum depends on the maintenance of an open global trading system, the vigorous pursuit of IMF reform programmes in the Asian countries in difficulties and adherence to sound policies in other countries which could potentially suffer from contagion if the situation in Asia were to deteriorate any further.

A.62 In the United States, growth was 3 3/4 per cent last year, much faster than expected and well above trend. This reflected rapid investment growth and robust consumers' expenditure, with some offsetting drag from net trade. GDP growth is likely to slow this year, partly reflecting the impact of the financial situation in Asia. However, buoyant domestic demand should be sufficient to sustain growth at a healthy pace.

A.63 Recovery in Europe is expected to remain on track. Activity in the largest economies picked up in the second half of last year, while some of the smaller countries have been growing robustly. But the financial situation in Asia represents an important downside risk - recovery in Germany in particular is still dominated by export growth, with high unemployment dampening the outlook for domestic demand.

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Trade

A.64 The developing Asian economies have made an important contribution to the rapid expansion in global trade in recent years, not least reflecting strong growth in intra-Asian trade. Largely reflecting Asia's financial difficulties, world trade growth in manufactures is expected to fall sharply this year to 7 per cent, but nevertheless to remain robust by historical standards. UK export market growth is likely to be less affected, and is expected to average 7 3/4 per cent this year.

Inflation and commodity markets

A.65 Global inflationary pressures have eased, from what were already low levels. The financial situation in Asia is likely to reduce the prices of tradeable goods in the G7, while lower commodity prices - particularly for oil - will also reduce inflationary pressures. G7consumer price inflation is expected to be 1 3/4 per cent this year, the lowest rate since 1986.

A.66 Oil prices - which varied between $16 and $25 per barrel during 1997 - have weakened sharply in the early months of this year. They have fallen by over a quarter since last October, mainly reflecting weaker demand from Asia and the announcement of a 10 per cent increase in OPEC quotas last November. Developments concerning Iraq were a factor behind Brent prices falling below $14 per barrel towards the end of February - levels not seen since early 1994. Non-oil commodity prices also fell sharply at the end of last year, most notably in the metals markets where Asia accounts for a large slice of global demand. However, prices have also been reacting to other factors, including improved prospects for global agricultural production, despite some localised disruptions attributed to the El Niño phenomenon.

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comments

Table B5: Projections of budget deficits and debt(1)

	per cent of GDP						
	Outturn	**Estimate**	**Projections**				
	1996-97	**1997-98**	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**2002-03**
GGR	38.1	39.3	39.6	39.4	39.8	40.0	40.1
Tax/GDP ratio(2)	36.0	37.2	37.7	37.7	38.1	38.4	38.5
(A) 3/4 per cent real CT growth							
GGFD(3)	3.8	1.0	0.4	-0.6	-1.5	-2.6	-3.4
Current balance	-2.7	-0.2	0.4	1.4	2.3	3.4	4.1
PSBR	3.0	0.6	0.5	-0.3	-1.3	-2.2	-3.2
Net public sector debt	45.0	43.5	42.1	40.2	37.4	33.7	29.3
General government gross debt(4)	54.3	51.9	50.5	48.5	45.5	41.6	37.0
(B) 1 1/2 per cent real CT growth							
GGFD(3)	3.8	1.0	0.4	-0.3	-1.0	-1.8	-2.3
Current balance	-2.7	-0.2	0.4	1.2	1.9	2.6	3.1
PSBR	3.0	0.6	0.5	-0.1	-0.8	-1.5	-2.1
Net public sector debt	45.0	43.5	42.1	40.5	38.1	35.1	31.7
General government gross debt(4)	54.3	51.9	50.5	48.8	46.2	43.0	39.4
(C) 2 1/4 per cent real CT growth							
GGFD(3)	3.8	1.0	0.4	-0.1	-0.5	-1.0	-1.2
Current balance	-2.7	-0.2	0.4	0.9	1.4	1.9	2.1
PSBR	3.0	0.6	0.5	0.2	-0.3	-0.7	-1.1
Net public sector debt	45.0	43.5	42.1	40.7	38.9	36.6	34.2
General government gross debt(4)	54.3	51.9	50.5	49.0	46.9	44.4	41.8

1 GGFD, current balance and PSBR exclude windfall tax receipts and associated spending.

2 As defined in Table B8.

3 UK national accounts definition.

4 Ratio on a Maastricht basis. GDP is on an ESA79 basis, year ending in March.

B.12 In all three cases, the public finances continue to improve. While public spending grows more slowly than GDP or (in case C) at the same average rate, revenues rise more quickly than GDP (except in 1999-2000 when the windfall tax ends). This reflects partly "real fiscal drag" (the automatic tendency under a progressive income tax system for receipts to rise more quickly than income as real income rises) and partly the commitments to real increases in road fuel and tobacco duties and the cumulative impact of previous Budget measures. The current balance moves into increasing surplus.

B.13 Table B6 shows projections of the cyclically-adjusted budget deficit on each of the three spending assumptions. The projections are based on the assumption that the economy was on trend in the first half of 1997. Alternative projections, which assume that output was already significantly above trend in the first half of 1997, are shown in Chapter 2.

Table B6: Cyclically-adjusted budget deficits(1)

	per cent of GDP		Projections				
	Outturn	**Estimate**					
	1996-97	**1997-98**	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**2002-03**
(A) 3/4 per cent real CT growth							
GGFD(2)	3.0	0.9	0.5	-0.8	-2.0	-3.0	-3.7
Current balance	-2.0	0.0	0.3	1.6	2.8	3.7	4.5
PSBR	2.3	0.5	0.6	-0.6	-1.7	-2.6	-3.5
(B) 1 1/2 per cent real CT growth							
GGFD(2)	3.0	0.9	0.5	-0.6	-1.5	-2.2	-2.7
Current balance	-2.0	0.0	0.3	1.4	2.3	3.0	3.5
PSBR	2.3	0.5	0.6	-0.3	-1.2	-1.8	-2.5
(C) 2 1/4 per cent real CT growth							
GGFD(2)	3.0	0.9	0.5	-0.3	-1.0	-1.4	-1.6
Current balance	-2.0	0.0	0.3	1.2	1.8	2.3	2.5
PSBR	2.3	0.5	0.6	-0.1	-0.7	-1.1	-1.4

1 Excluding windfall tax receipts and associated spending.

2 UK national accounts definition.

B.14 The overall budget moves into surplus by 1999-2000, both on the PSBR and Maastricht definitions. The continuing improvement in the PSBR is reflected in a gradually falling burden of public debt. The current surpluses are reflected in a very gradual recovery in public sector net wealth (see Chart 2.5 in Chapter 2).

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Forecast Errors

B.15 Budget deficits are the difference between two large aggregates of spending and receipts and forecasts of them are inevitably subject to wide margins of error. Over the past five years the average absolute errors in spring and summer forecasts of the PSBR for the financial year ahead have been of the order of about 3/4 per cent of GDP, or plus or minus 6 billion at today's prices. Errors tend to grow as the forecast horizon lengthens (see Table B7 on page 107 of the Pre-Budget Report).

B.16 Projections of the public finances are critically dependent on the path of the economy, as most tax revenues and some government expenditure, especially cyclical social security, vary automatically with the economic cycle. If GDP growth were 1 per cent higher or lower over the coming financial year than has been assumed, the PSBR might be higher or lower by around 1/4 per cent of GDP, equivalent to 2 billion, in the first year and around 3/4 per cent, equivalent to 6 billion, in subsequent years. A difference of 1/2 per cent in the average growth rate over four years could increase or decrease the PSBR by 1 1/4 per cent of GDP by the fourth year.

Public Sector Debt

B.17 Table B7 sets out projections for two measures of public sector debt. Net public sector debt is approximately the stock counterpart of the PSBR, while general government gross debt is the measure of debt used in the Maastricht criteria. (Definitions are given at the end of the annex.) Both measures have risen sharply over the 1990s, but are likely to have peaked, as a percentage of GDP. Net public sector debt is now forecast to fall from 45 per cent of GDP in March 1997 to 43 1/2 per cent of GDP in March 1998 and 42 per cent by March 1999. General government gross debt was 53.4 per cent in December 1997, compared with the Maastricht criterion of 60 per cent, and is forecast to fall to 50 1/2 per cent of GDP by

March 1999.

Table B7: Public sector debt(1)

	Outturn 1996-97	Estimate 1997-98	Forecast 1998-99
Net public sector debt			
billion	350	355	359
-per cent of GDP(2)	45.0	43.5	42.1
General government gross debt			
- billion	409	413	421
-per cent of GDP(3)	54.3	51.9	50.5

1 At end-March

2 GDP centred on end-March.

3 Ratios on a Maastricht-basis. GDP is on an ESA79 basis, year ending in March.

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B.18 In total, the Budget measures increase tax receipts by 1 3/4 , 2 1/2 and 2 3/4 billion from 1998-99 to 2000-01, respectively. Most of this extra revenue reflects the measures on company taxation and the cars package, offset in part by the Working Families Tax Credit (some of which scores as general government expenditure, see paragraphB59 in the conventions section at the end of this annex).

B.19 Table B8 gives medium-term projections of receipts. A more detailed breakdown for 1997-98 and 1998-99 is given in Table B9. Total net tax receipts are estimated to have risen by 9 1/2 per cent in 1997-98. About 1 3/4 per cent of this increase is accounted for by previous Budget measures. Net tax receipts are projected to grow by 6 per cent in 1998--99, rather faster than money GDP, mostly reflecting the real increases in fuel and tobacco duties.

Table B8: Total receipts

	per cent of GDP						
	Outturn	**Estimate**	**Projections**				
	1996-97	**1997-98**	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**2002-03**
Income tax (gross of tax credits)	9.5	10.0	10.3	10.6	10.9	11.0	11.1
Income tax credits(1)	-0.3	-0.3	-0.2	-0.2	-0.3	-0.3	-0.3
Corporation tax	3.7	3.8	3.6	3.7	3.7	3.9	3.7
Windfall tax		0.3	0.3				
Value added tax	6.2	6.4	6.4	6.4	6.3	6.3	6.2
Excise duties(2)	4.1	4.2	4.4	4.5	4.6	4.7	4.8
Other taxes and royalties(3)	6.5	6.5	6.5	6.5	6.6	6.5	6.5
Social security contributions	6.3	6.3	6.4	6.3	6.3	6.4	6.4
Net taxes and social security contributions(4)	**36.0**	**37.2**	**37.7**	**37.7**	**38.1**	**38.4**	**38.5**
Other receipts and accounting adjustments(5)	2.1	2.1	1.9	1.7	1.7	1.5	1.6
Total receipts	**38.1**	**39.3**	**39.6**	**39.4**	**39.8**	**40.0**	**40.1**
Total receipts (bn)	**286.4**	**313.1**	**330.1**	**344.0**	**364.0**	**382.8**	**402.4**

1 Mainly MIRAS and tax reliefs under the Working Families Tax Credit scheme (see paragraph B59 in conventions used in presenting the public finances).

2 Fuel, alcohol and tobacco duties.

3 Includes Council Tax and money paid into the National Lottery Distribution Fund, as well as other central government taxes. Net of bus fuel duty rebate (previously netted off excise duties).

4 Net of income tax credits; cash basis.

5 Includes tax credits scored as public expenditure (see paragraph B60 in conventions used in presenting the public finances).

Table B9: General government receipts(1)

	billion		
	Outturn	**Estimate**	**Forecast**
	1996-97	**1997-98**	**1998-99**
Inland Revenue			
Income tax (gross of tax credits)	71.5	79.4	86.1
Income tax credits	-2.4	-2.7	-1.8
Corporation tax(2)	27.8	30.5	30.0
Windfall tax		2.6	2.6
Petroleum revenue tax	1.7	1.1	0.5
Capital gains tax	1.1	1.4	2.2
Inheritance tax	1.6	1.7	1.9
Stamp duties	2.5	3.4	4.6
Total Inland Revenue (net of tax credits)	**103.7**	**117.4**	**126.1**
Customs and Excise			
Value added tax	46.7	51.0	53.3
Fuel duties	17.2	19.1	21.5
Tobacco duties	8.0	8.3	8.9
Spirits duties	1.6	1.5	1.6
Wine duties	1.3	1.4	1.5
Beer and cider duties	2.8	2.8	2.9
Betting and gaming duties	1.4	1.5	1.6
Air passenger duty	0.4	0.5	0.7
Insurance premium tax	0.7	1.0	1.3
Landfill tax	0.1	0.4	0.4
Customs duties and levies	2.3	2.3	2.0
Total Customs and Excise	**82.4**	**89.9**	**95.6**
Vehicle excise duties	4.2	4.6	4.6
Oil royalties	0.7	0.5	0.3
Business rates(3)	14.7	14.7	15.0
Social security contributions	47.1	50.5	53.7
Council Tax	10.1	11.1	11.6
Other taxes and royalties(4)	7.9	7.6	7.2
Net taxes and social security contributions	**270.7**	**296.1**	**314.1**
Interest and dividends	5.2	5.1	4.5

Gross trading surpluses and rent	4.9	4.8	4.9
Other receipts and accounting adjustments(5)	5.6	7.1	6.6
General government receipts	**286.4**	**313.1**	**330.1**
North Sea revenues(6)	3.6	3.4	2.6

1 On a cash basis.

2 Includes advance corporation tax (net of repayments):11.911.811.3

Also includes North Sea corporation tax after ACT set-off and corporation tax on gains.

3 Includes district council rates in Northern Ireland.

4 Net of bus fuel duty rebate (previously netted off excise duties). Includes money paid into the National Lottery Distribution Fund.

5 Includes accruals adjustments for index-linked gilts, and tax credits scored as public expenditure.

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

Comparison with July Budget forecasts

B.20 Total receipts are estimated to be 4 3/4 billion higher in 1997-98 than expected at the time of the last Budget, and are forecast to be almost 3 billion higher in 1998-99.

Table B10: Changes in general government receipts since July Budget

	billion	
	1997-98	**1998-99**
Income tax	0.2	0.6
Corporation tax	0.4	-2.0
Windfall tax	0.0	0.0
Value added tax	1.0	0.8
Excise duties(1)	-0.5	0.6
Other taxes(2)	1.1	0.4
Social security contributions	1.0	1.7
Other receipts and accounting adjustments	1.7	0.8
Total	**4.8**	**2.9**

1 Fuel, alcohol and tobacco duties.

2 Includes Council Tax and money paid into the National Lottery Distribution Fund, as well as other central government taxes. Net of bus fuel duty rebate (previously netted off excise duties).

Income tax receipts

B.21 Higher than expected income tax payments by the self-employed were partly offset by lower receipts of PAYE. While the higher tax payments by the self-employed could partly reflect stronger growth of self-employment incomes, it seems likely that the introduction of self-assessment has encouraged taxpayers to bring their tax affairs up to date and led to some previously undeclared income being notified to the Inland Revenue.

Corporation tax

B.22 Corporation tax receipts in 1997-98 are slightly higher than expected in July, but the forecast for 1998-99 has been revised down by 2 billion, largely to reflect the latest estimates of trading profits of industrial and commercial companies. The fall in corporation tax yield expected between 1997-98 and 1998-99 also partly results from the cut of 2 per cent in the main and small companies corporation tax rates from April 1997, announced in the July Budget.

VAT receipts

B.23 In contrast to the downward trend over the previous decade, it seems likely that the ratio of VAT receipts to consumer spending has increased in 1997-98. Strong consumer spending growth has usually been accompanied by increases in the VAT base relative to total consumer spending, and this might explain some of the increase in the VAT ratio in 1997-98. With the economy projected to slow down, the projections continue to assume a modest downward trend in the VAT ratio - an assumption which the NAO endorsed as "reasonable" at the time of the November Pre-Budget Report. Compared with a flat VAT ratio, this cautious assumption reduces receipts by 1 1/2 billion by 2002-03.

Excise duties

B.24 Excise duties in 1998-99 are projected to be somewhat higher than in the last Budget, reflecting the earlier implementation of the fuel duty escalator (in March rather than in November as previously assumed), and the additional duty increases on some road fuels.

Other taxes and receipts

B.25 The difference in the forecast of other taxes for 1997-98 mostly reflects higher than expected receipts of business rates and Council Tax, which do not carry forward to future years. The level of petroleum revenue tax expected in 1998-99 has been reduced by 600 million since July. This reflects the sharp fall in the oil price and the assumption that the price remains close to recent levels. Other receipts are also affected by a change in the accounting treatment of the proceeds from the sale of the student loan book, which increases both GGE and GGR in 1997-98 and 1998-99 compared with the July Budget projections.

Total taxes

B.26 Chart B2 shows the tax/GDP ratio, measured as total taxes and social security contributions, net of tax credits, as a percentage of GDP (see paragraphB59 in the conventions section). It is forecast to increase by 1/2 percentage point in 1998-99, largely because of Budget measures. Thereafter, it is projected to rise (on average) by about 0.2 percentage points a year, mainly reflecting the real increases in fuel and tobacco duties.

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Table B23: Public sector transactions by sub-sector and economic category (continued)

	billion 1998-99 General government Central government	Local authorities	Total	Public corporations	Public sector	
Line						
						Current receipts(2)
1	116.8	0.0	116.8	-0.5	116.3	Taxes on income and royalties
2	127.4	0.2	127.6	0.0	127.6	Taxes on expenditure
3	6.2	0.0	6.2	0.0	6.2	Taxes on capital
4	53.9	0.0	53.9	0.0	53.9	Social Security contributions
5	0.0	11.6	11.6	0.0	11.6	Council Tax
6	0.0	0.8	0.7	4.4	5.1	Gross trading surplus
7	0.9	4.0	4.9	0.5	5.5	Rent and miscellaneous current transfers
8	1.4	0.9	2.3	0.2	2.5	Interest and dividends from private sector and abroad
9	6.0	-3.8	2.2	-2.2	0.0	Interest and dividends within public sector
10	1.9	2.4	4.3	0.0	4.3	Imputed charge for non-trading capital consumption
11	**314.4**	**16.0**	**330.4**	**2.5**	**333.0**	**Total current receipts**
						Current expenditure(2)
12	104.1	58.8	165.6	0.0	165.6	Current expenditure on goods and services
13	1.9	5.5	7.4	3.5	10.9	Depreciation
14	7.4	0.7	8.1	0.0	8.1	Subsidies
15	95.0	13.7	108.6	0.0	108.6	Current grants to personal sector
16	6.1	0.0	6.1	0.0	6.1	Current grants abroad
17	61.1	-61.1	0.0	0.0	0.0	Current grants within public sector
18	28.2	0.4	28.6	-0.4	28.1	Debt interest
19	2.7	0.0	0.0	0.0	0.0	Apportionment of Reserve
20	**306.4**	**17.9**	**324.4**	**3.1**	**327.5**	**Total current expenditure**
21	**8.0**	**-2.0**	**6.1**	**-0.6**	**5.5**	**Current balance**(1)
22	**0.0**	**0.3**	**0.3**	**-0.1**	**0.1**	**Capital transfers**
						Capital expenditure(2)
23	3.4	6.2	10.0	4.2	14.2	Gross domestic fixed capital expenditure
24	-1.9	-5.5	-7.4	-3.5	-10.9	Less Depreciation
25	0.0	0.0	0.0	0.0	0.0	Increase in stocks
26	2.8	0.7	3.5	0.4	3.9	Capital grants to private sector
27	5.3	-3.6	1.7	-1.7	0.0	Capital grants to public sector
28	0.3	0.0	0.0	0.0	0.0	Apportionment of Reserve

29	**10.0**	**-2.1**	**7.8**	**-0.7**	**7.0**	**Total capital expenditure**
30	**2.0**	**-0.5**	**1.5**	**0.1**	**1.6**	**Financial deficit**(1)
						Financial transactions
31	0.2	0.0	0.2	0.0	0.2	Net lending to private sector and abroad
32	0.0	0.0	0.0	0.0	0.0	Cash expenditure on company securities (including pension proceeds)
33	1.4	0.0	1.4	0.0	1.4	Transactions concerning certain public sector pension schemes
34	1.9	0.0	1.9	0.0	1.9	Accruals adjustments on receipts
35	-1.9	0.0	-1.9	0.0	-1.9	Other accruals adjustments
36	-0.8	0.0	0.0	0.0	0.0	Miscellaneous financial transactions
37	**2.8**(4)	**-0.5**	**2.2**	**0.1**	**2.3**	**Borrowing requirement**

Historical series

B.50 Table B24 sets out historical series for the public sector current balance, financial deficit and borrowing requirement, and the general government financial deficit. It also shows series for government receipts and expenditure.

Table B24: Historical series of government expenditure, receipts and deficits(1)

	per cent of GDP								
	Public sector current balance	**Public sector financial deficit**	**Public sector borrowing requirement**	**General government financial deficit(2)**	**Net taxes and NICs(3)**	**General government receipts**	**Control Total(4)**	**GGE**	**GGE(X)**
1970-71	7.0	-0.4	1.5	-2.4		40.3		41.4	39.6
1971-72	4.5	1.2	1.6	-0.6		39.9		41.8	40.0
1972-73	2.2	3.0	3.6	1.9		37.9		41.6	39.7
1973-74	1.1	4.6	5.8	3.5		38.5		43.4	41.4
1974-75	-0.4	6.7	9.0	4.3		40.5		48.8	46.7
1975-76	-1.2	7.3	9.2	4.9		40.2		49.3	47.2
1976-77	-0.7	5.7	6.4	4.4		41.0		46.7	44.7
1977-78	-0.9	4.4	3.6	3.5		39.7		43.0	41.5
1978-79	-1.8	4.9	5.3	4.1	33.0	38.7		44.0	42.2
1979-80	-1.2	3.9	4.8	2.9	33.8	38.8		43.9	42.4
1980-81	-2.8	4.9	5.3	3.9	35.5	40.7		46.5	44.9
1981-82	-0.8	2.1	3.3	1.7	38.5	43.7		47.0	45.4
1982-83	-1.2	3.0	3.1	2.8	38.7	43.7		47.3	45.5
1983-84	-1.8	3.8	3.1	3.8	37.9	42.9		46.1	44.9
1984-85	-2.4	4.2	3.1	3.8	38.7	43.4	38.5	46.3	45.3
1985-86	-0.8	2.2	1.5	2.4	37.8	42.3	36.0	44.3	43.2
1986-87	-1.1	2.1	0.9	2.3	37.3	41.4	35.1	42.7	42.3
1987-88	0.1	0.7	-0.8	1.1	37.1	41.1	34.7	40.7	40.5
1988-89	2.0	-1.4	-3.0	-1.0	36.4	40.3	32.7	37.8	38.0
1989-90	2.0	-0.5	-1.5	0.1	36.0	40.1	33.7	38.9	38.3
1990-91	1.0	0.6	-0.1	0.9	36.7	39.3	34.5	39.2	39.0

1991-92	-1.3	3.2	2.4	3.2	35.8	38.3	36.5	40.6	41.0
1992-93	-5.3	7.6	6.0	7.5	34.2	36.7	38.0	42.9	43.4
1993-94	-6.0	7.8	7.1	7.8	33.5	35.9	37.5	43.2	43.2
1994-95	-4.6	6.3	5.3	6.2	34.7	36.9	36.4	42.5	42.7
1995-96	-3.4	4.9	4.4	5.1	35.6	38.0	35.8	42.7	42.3
1996-97	-2.7	3.6	3.0	3.9	36.0	38.1	34.5	41.1	40.9
1997-98	0.2	0.6	0.3	0.7	37.2	39.3	33.2	39.8	39.2
1998-99	0.7	0.2	0.3	0.1	37.7	39.6	33.0	39.9	39.2

1 Including windfall tax receipts and associated spending.

2 GGFD on UK national accounts definition prior to 1996-97 and a Maastricht basis thereafter.

3 As defined in Table B8. Figures are only available on a consistent basis for the years shown.

4 Figures for the Control Total are only available on a consistent basis for the years shown.

CONVENTIONS USED IN PRESENTING THE PUBLIC FINANCES

B.51 The public finances are presented in two main ways: on a national accounts basis and on a cash basis.

NATIONAL ACCOUNTS

B.52 The national accounts record most transactions, including most taxes (although not corporation tax), on an accruals basis, and impute the value of some transactions where no money changes hands (for example, non-trading capital consumption).

New system of national accounts: ESA95

In September the Office for National Statistics (ONS) will publish for the first time UK national accounts according to the definitions in the European System of Accounts 1995 - ESA95. Tables in the FSBR which use figures from the national accounts will change to reflect the introduction of ESA95. There will also be changes to other public finance statistics which follow national accounting conventions. Treasury publications after September will be on an ESA95 basis.

The **PSBR** will not change by much. It will be defined and presented in terms of ESA95 financing instruments in a way that maintains continuity with the present cash-based definition. A few financial transactions change from being PSBR determinants and become financing items - improving consistency with the national accounts. The changes were described in the *Consolidated Fund and National Loans Fund Accounts 1996/97 Supplementary Statements, December 1997*. (This will increase the 1996-97 PSBR by 115million.) Under ESA95 the Issue Department of the Bank of England is reclassified from the government sector to the banks' sector. Consequently the issue of bank notes will no longer be shown as financing government borrowing; but government debt held by the Issue Department will be. (The effects of this change is largely confined to the detailed analysis and will not significantly change the total PSBR.)

GGE was defined by ONS in terms of components from the existing system of UK national accounts. ONS are proposing to define GGE in terms of ESA95 components in a way that preserves most of the important features of the new definition. The new concept will be at a different level (mainly because of changes in the way transactions with the European Union are classified) but, along with the rest of the national accounts, the new definition will be calculated for back years to allow consistent comparisons.

The public sector **current balance**, as shown in the FSBR, is close to the ESA95 measure "net saving" for the consolidated general government and public non-financial corporations' sectors. It differs only in that net saving does not take account of capital taxes (other than capital gains tax); all capital taxes count as current revenue in the FSBR current balance.

More information on ESA95 can be found in the *Illustrative Guide to the National Accounts* published by ONS last year together with several other ESA95 publications. Afull set of explanatory documents will be issued when the Blue Book is published in September, including an article in Economic Trends showing the impact on the PSBR.

Current balance

B.53 The current balance measures the balance of current account revenue over current expenditure. The definition of the current balance presented in TablesB2, B5, B6 and B24 differs from the national accounts concept in two respects: it includes taxes on capital in current receipts and an estimate of depreciation in current expenditure.

Public sector financial deficit

B.54 The financial deficit is the balance between expenditure and income in the consolidated current and capital accounts. It differs from the PSBR because it is measured on an accruals basis and because certain financial transactions, notably net lending and privatisation proceeds, which affect the level of borrowing but not the public sector's net financial indebtedness, are excluded from the financial deficit but included in the PSBR.

General government financial deficit

B.55 The GGFD, which excludes the financial deficit of public corporations, is the most internationally comparable measure of the budget deficit. A similar measure is used in the excessive deficits criterion of the Maastricht Treaty. The Maastricht definition differs from the UK national accounts in that it scores interest on a predominantly cash basis. The capital uplift on index-linked gilts is scored at the time of the gilt's redemption (as in the PSBR), rather than on an accrued basis over the lifetime of the gilt, and interest on national savings certificates is counted when withdrawn, rather than when it accrues (as in the PSBR). The UK treatment of unfunded public sector pension schemes also differs from that in the Maastricht measure. The surplus of pensions paid over contributions is treated in the UK accounts as a financial transaction reducing government liability to pensioners and employees in such schemes. In the Maastricht measure, pension payments and contributions of unfunded schemes are treated as non-financial transactions, so increasing the deficit.

CASH BASIS

B.56 The cash approach concentrates on the actual cash transactions between the public sector and the rest of the economy. It is particularly useful for analysing the components of the PSBR, which is almost entirely a cash concept. A cash basis also corresponds closely to the way public expenditure is planned, controlled and accounted for at present.

B.57 A summary presentation of the public finances on a cash basis is given in TableB3. Supporting disaggregation of general government receipts is given in TableB9 and for general government expenditure in TableB11.

B.58 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 refunds are included in "other taxes and royalties" (TableB9); and
- an imputed flow for capital consumption by general government is included in "other receipts" (TableB9).

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

GENERAL GOVERNMENT RECEIPTS

Income tax credits

B.59 Certain income tax reliefs are payable regardless of an individual's liability to income tax; thus some payments are made to non-taxpayers. Examples are mortgage interest relief paid under the MIRAS (mortgage interest relief at source) scheme, life assurance premium relief on pre-1984 policies and private medicine insurance premium relief for over-60s. The Working Families Tax Credit will also fall into this category. Total tax relief paid under these schemes is shown as income tax credits in TablesB8, B9 and B10. Income tax receipts in these tables are shown gross of these tax credits. Some tax credit expenditure (where relief paid is in excess of an individual's total tax liability) is shown in the national accounts as general government expenditure.

Net taxes and social security contributions

B.60 Net taxes and social security contributions in TablesB8, B9 and B10 are measured on a cash basis, rather than a national accounts (accruals) basis. Income tax credits are netted off. Tax credit expenditure which is scored as general government expenditure in the national accounts is included in "other receipts and accounting adjustments" in these tables, so as to arrive at general government receipts.

GENERAL GOVERNMENT EXPENDITURE

B.61 GGE, shown in TablesB11 and B12, is a broad measure of government spending which includes: current expenditure, capital expenditure, the Reserve, net lending to the private sector and abroad, cash expenditure on company securities and net lending by central government to public corporations. GGE(X), shown in Table B11, differs from GGE in that it excludes privatisation proceeds and lottery-financed expenditure, and nets off interest and dividend receipts.

Measurement of capital spending

B.62 Public sector capital expenditure is shown in TableB14. It includes:

(i) gross domestic fixed capital formation (ie expenditure on fixed assets - schools, hospitals, roads, computers, plant and machinery etc) 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).

B.63 Net capital spending in TableB2 deducts depreciation of the public sector's stock of fixed assets.

Control total

B.64 The numbers for the public expenditure Control Total, including changes from the last Budget, are on current definitions. There have been a number of classification changes since the July FSBR, including the removal from the Control Total of local authority debt interest ultimately financed by the central government housing subsidy (housing element). This subsidy is in the Control Total, so the change removes an element of double scoring. This change reduces the Control Total by 700million in 1997-98 and 100million in 1998-99. It was noted in the November 1997 Pre-Budget Report Supplementary Material.

B.65 The other main change has been to net off the utility regulators' licence fees, reducing the Control Total by 50 million in 1997-98 and 40 million in 1998-99. In addition, continuing the implementation of changes following a review begun in February 1997, the treatment of passport fees and some other licence fee receipts in the Control Total has changed, reducing it by 20 million in 1997-98 and 40 million in 1998-99. Finally, the Control Total is reduced by 70 million in 1997-98 and increased by 2 million in 1998-99 to put the recording of the disposal of the DSS' Newcastle Estate onto a national accounts basis.

B.66 As set out in the November 1997 Pre-Budget Report Supplementary Material, it has been decided that the national accounts will score as reducing general government expenditure (GGE) the proceeds of the student loan debt sale less the capitalised value of future subsidies. The PSBR, as a cash concept, will score the full proceeds. The Control Total will continue to score the full proceeds, in line with the treatment in the PSBR, entailing an accounting adjustment in respect of the difference between the amounts scored in the Control Total and in GGE.

B.67 No adjustment has been made to the Control Total projections in respect of the replacement of family credit by Working Families Tax Credit (WFTC). The Control Total figures therefore implicitly include WFTC up to the level of the family credit expenditure it replaces. The net cost of WFTC is split between "accounting adjustments" in GGE, and "other receipts and accounting adjustments" in GGR. This scoring should not be taken as an indication of the future Control Total treatment of WFTC; whether or not any or part of WFTC should score in the Control Total has not been decided.

Local authority self-financed expenditure

B.68 Local authority self-financed expenditure (LASFE) 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 Aggregate External Finance (AEF), specific grants and credit approvals). The numbers for LASFE are affected by the classification change to remove an element of double scoring from the Control Total, although there is no extra spending power in LASFE (or the Control Total) as a result of the change.

Central government net debt interest

B.69 Central government debt interest is shown net of receipts of interest and dividends from outside general government. It scores the capital uplift on index-linked gilts as interest at the time it accrues, rather than the actual payments of capital uplift on index-linked gilts shown in the cash tables.

Accounting adjustments

B.70 The accounting adjustments include various items within GGE but outside the Control Total which are not shown separately in the tables. The larger items are non-trading capital consumption (3.7 billion in 1996-97), refunds of VAT (4.9 billion), teachers' and NHS pensions increase payments (1.6 billion), the difference between Civil Service and armed forces pensions payments and accruing superannuation liability charges (2.3 billion), and the debt remuneration element of NHS Trusts' charges to health authorities (1.3 billion). The net market and overseas borrowing of nationalised industries and other public corporations is within the Control Total but outside GGE, so net repayments increase the accounting adjustments (1.2 billion in 1996-97). Certain debt interest paid from local authorities to central government is in the Control Total but not in GGE; its removal reduces the accounting adjustments (by 3.1 billion in 1996-97). Local authority receipts of interest and dividends (0.6 billion) are netted off here. Fuller details of the accounting adjustments are given in the *Public Expenditure Statistical Analyses*.

DEBT AND WEALTH

Net public sector debt

B.71 Net public sector debt is approximately the stock analogue of the PSBR. Itmeasures the public sector's financial liabilities to the private sector and abroad, net of short-term financial assets.

General government gross debt

B.72 General government gross debt is the measure of debt used in the European Union's excessive deficits procedure. 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

Public sector net wealth

B.73 Public sector net wealth represents the public sector's net balance sheet position. It is equal to the sum of the public sector's tangible and financial assets less its financial liabilities at market value. The estimates of tangible assets are however subject to wide margins of error, because they depend on broad assumptions, for example about asset lives, which may not be appropriate in all cases. The introduction of resource accounting for central government departments will lead in time to an improvement in data quality as audited information compiled from detailed asset registers becomes available.

Departmental Groupings

Departmental Groupings

Title	Departments included	Title	Departments included
Defence	Ministry of Defence	DETR - Local Government and	Department of the Environment, Transport and the Regions - mainly block and transitional

		Regional Policy	grants to English local authorities
Foreign Office	Foreign and Commonwealth Office	Home Office	Home Office Charity Commission
Department for International Development	Department for International Development	Lord Chancellor's and Law Officers' 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 HM Land Registry
Agriculture, Fisheries and Food	Ministry of Agriculture, Fisheries and Food The Intervention Board	Education and Employment	Department for Education and Employment Office for Standards in Education
Trade and Industry - Programmes	Department of Trade and Industry Office of Electricity Regulation Office of Fair Trading Office of Gas Supply Office of Telecommunications	Department for Culture, Media and Sport	Department for Culture, Media and Sport Office of the National Lottery
Trade and Industry - Nationalised Industries	British Coal British Shipbuilders British Energy (privatised 1996) Magnox Electric Nuclear Electric Post Office British Nuclear Fuels Limited	Health	Department of Health
Export Credits Guarantee Department	Export Credits Guarantee Department	Social Security	Department of Social Security
DETR	Department of the Environment, Transport and the Regions - Transport Office of Passenger Rail Franchising Office of the Rail Regulator Department of the Environment, Transport and the Regions - Housing Department of the Environment, Transport and the Regions - Other Environmental Services Office of Water Services Ordnance Survey PSA Services Health and Safety Commission	Scotland	Scottish Office Forestry Commission General Register Office (Scotland) Scottish Courts Administration Scottish Records Office Registers of Scotland
Wales	Welsh Office Office of Her Majesty's Chief Inspector of Schools in Wales	Northern Ireland	Northern Ireland Office and departments
Chancellor's Departments	HM Treasury Office for National Statistics Crown Estate Office National Savings Government Actuary's Department HM Customs and Excise Inland Revenue National Investment and Loans	Cabinet Office	Office of Public Service Central Office of Information Cabinet Office House of Commons House of Lords National Audit Office The Office of the Parliamentary Commissioner for Administration and Health Service

	Office Registry of Friendly Societies Royal Mint Paymaster General's Office	Commissioners Privy Council Office Property Advisors to the Civil Estate
European Communities	Net payments to European Union institutions	

comments

Appendix C1: Explaining the costings

C.80 This appendix explains how the effects of the Budget measures on tax yield are calculated.

The general approach

C.81 The revenue effect of a Budget measure is generally calculated as 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 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 and quantifiable effect on the yield, and any consequential changes in receipts from related taxes. These include estimated changes in the composition or timing of income, spendings, or other tax determinants. 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 C.1.

C.82 The non-indexed base column in Table A.1 shows the revenue effect of changes in allowances, thresholds and rates of duty from their pre-Budget levels (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.

C.83 In calculating the indexed base, it is assumed that each year excise duties and VAT thresholds rise in November (January for alcohol and March for fuels) and allowances and other thresholds rise in April, in line with the increase in the RPI over 12months to the previous September. The RPI increase in the year to September 1997 was 3.6 per cent. The assumed increase in September 1998 is taken to be 3.2 per cent. The commitments for real increases in fuel and tobacco duties of 6 and 3 per cent are also built in.

Notes on individual Budget measures

Anti-avoidance measures

C.84 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.

Main corporation tax rate cut

C.85 The full effect will not arise until 2001-02 when the cost will be 1 billion.

Small companies tax rate cut

C.86 The full effect will not arise until 2001-02 when the cost will be 120 million.

Abolish ACT and introduce quarterly payments of corporation tax

C.87 The yield is expected to be 3.1 billion in 2001-02 and 2.2 billion in 2002-03. When the transition to instalments is complete in 2003-04, the Exchequer cost is expected to be about 1/2 billion a year. The revenue effects are uncertain, and they largely depend on annual changes in corporation tax liability.

Abolish quarterly accounting for gilts

C.88 There will be yields of 100 million in 2001-02 and 2002-03.

Capital gains tax: structural reform

C.89 These costings cover the measures described in Chapter 4 under the heading of "Encouraging and rewarding entrepreneurs" and in Chapter 5 "Paying a Fair Share", except for the measure dealing with temporary non-residence which is shown separately. Estimates of revenue changes take account of the likely changes on the volume and timing of disposals over the years shown. In the longer term, the Exchequer effect will depend to a considerable extent upon movements in future asset prices, any behavioural changes and other factors.

First year allowances for SMEs

C.90 There will be some increase in tax in later years as the balance of unrelieved capital expenditure carried forward is reduced by the higher allowances. The revenue effects include those for companies and unincorporated businesses.

Fuel scale charges

C.91 The yield will increase to around 600 million in 2002-03.

Individual savings accounts

C.92 These are the estimated revenue effects associated with the introduction of the new savings account (including the residual cost of PEPs and TESSAs), measured against the baseline of continuing with PEPs and TESSAs with their current tax reliefs.

Schedule A: corporation tax changes

C.93 In 1999-00 there will be a one-off yield from ending the possibility of exploiting the timing mismatch between schedule A taxation of income and Case 1 Schedule D deductions for rental expenses. After that the revenue effects are expected to be broadly neutral.

Reform of policy holder taxation

C.94 The yield will rise to 150 million in a full year.

Excise duties

C.95 The extent to which changes in excise duty rates are reflected in receipts depends partly on the extent to which manufacturers and wholesalers anticipate expected increases by releasing their goods early so as to pay duty at pre-Budget rates. Costings for excise duties normally take into account the anticipated level of such forestalling on the timing of receipts. This effect can be significant for pre-announced increases, particularly for tobacco products.

C.96 The calculation of the expected effect of changes in duty rates on consumer demand for excise goods assumes that any change in duty is passed on in full to consumers from the date of the change in duty rate.

Hydrocarbon oils

C.97 The costings do not take account of a possible shift in duty reaccepts from 1999-00 to 1998-99 resulting from the forestalling associated with a pre-announced duty increase in March 1999. In later years the forestalling effect is expected to broadly net out.

Appendix C2: Tax changes announced before the Budget

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

Table C2.1: Revenue effects of measures announced since the July 1997 Budget

	million yield(+)/cost(-) of measure			
	Changes from a non-indexed base	Changes from an indexed base		
	1998-99	1998-99	1999-00	2000-01
Inland Revenue taxes				
1 Change to the rules on travel and subsistence expenses	-100	-100	-100	-100
2 Sub-contractors in the construction industry	0	0	-10	-5
3 Agency construction workers	+10	+10	-10	*
Customs and Excise taxes				
4 Drugs and medical appliances	+25	+25	+25	+25
5 Changes to the Information Technology Agreement	-130	-130	-150	-180
6 Construction anti-avoidance measure	0	0	+25	*
7 VAT exemption of supplies of goods on which input tax recovery has been blocked	-25	-25	0	0
Total	**-220**	**-220**	**-220**	**-260**

* *Negligible*.

Inland Revenue taxes

C.98 The Government has announced that it will correct the group relief rules for consortiums, to ensure that they will work as intended (*).

C.99 The rules on employees' travelling expenses will be simplified. From 6 April 1998 employees will be able to get relief for the full costs they have to incur in travelling in the performance of their duties, or to get to or from a temporary workplace (1).

C.100 New rules designed to reduce the extent of non-payment and evasion of taxes in the construction industry, by increasing the number of subcontractors paid under deduction, are due to take effect from August 1999. These will be modified to allow some larger businesses whose operations are only partly within the Construction Industry Tax Scheme to receive income gross from those operations (2).

C.101 The provision which exempts construction workers from the agency tax rules will cease to have effect from 6 April 1998. This means that most construction workers who work through employment agencies will normally be within Schedule E from that date and agencies should deduct tax under PAYE. Agencies are already obliged to deduct Class 1 NICs in respect of payments made to construction workers, so the change will help to align the tax and NICs treatment of such workers (3).

C.102 Existing legislation taxing guaranteed returns from the disposal of futures or options contracts will be extended, with effect from 6 February, to similar returns where futures run to delivery or options are exercised (*).

C.103 It was announced on 23 February 1998 that some changes would be made, from 1 May 1998, to the terms of a relief from stamp duty reserve tax for certain exchanges of securities held in depositary receipt form or in a clearance service (*).

C.104 The capital gains tax exemption for the disposal of an interest in a resident trust will be removed where the interest disposed of is in, or arose from, a trust which has ever been an offshore trust. As already announced, this measure will apply to any disposal of such an interest made on or after 6 March 1998 (*).

Customs and Excise taxes

C.105 The Value Added Tax (Drugs, Medicines and Aids for the Handicapped) Order 1997 was approved by Parliament on 9 December 1997. It counters tax avoidance schemes designed to enable institutions such as private and NHS hospitals and nursing homes to recover previously denied VAT and/or to purchase drugs and aids for the disabled at the zero-rate (4).

C.106 The World Trade Organisation have agreed two new changes to the Information Technology Agreement (ITA), one of which took effect on 1 November 1997 and the other on 1 January 1998. The November change introduced further products to the ITA whilst the January change will speed up the gradual reduction of tariffs on imports of IT products. The table shows the effect on receipts of tax revenue; 90 per cent of customs duty revenues are subsequently passed to the European Union as Own Resources (5).

C.107 An amendment to the VAT Regulations brought forward accounting for VAT on construction services covered by stage payment contracts. For projects completed after 8 December 1997 there will now be a VAT charge 18 months after the construction services have been completed, on any part of the full charge for the construction services for which VAT invoices have not already been issued or payments received (6).

C.108 In the UK, supplies by a taxable person of goods on which they had been wholly blocked from input tax recovery have been treated as if they are outside the scope of VAT, except where they are sold at a profit, in which case output tax must be accounted for on the profit margin ("the input tax margin scheme"). The ruling by the European Court of Justice states that such supplies must be exempt. The table shows the effects of repaying claims for VAT previously paid under the input tax margin scheme (7).

Other

C.109 The Government will introduce legislation which ensures that the rules used to value North Sea gas for tax purposes will continue to operate in the way in which industry and Inland Revenue have previously applied them (*).

Table C2.2: Measures announced in 1997 Budget or earlier which take effect after this Budget

	million yield(+)/cost(-) of measure			
	Changes from a non-indexed base	Changes from an indexed base		
	1998-99	1998-99	1999-00	2000-01
Inland Revenue taxes				
1 Construction industry scheme	0	0	+300	+50
2 Mortgage interest relief restricted to 10 per cent	+950	+950	+950	+950
3 Abolition of foreign income dividends	+100	+100	+250	+250
4 Gilt interest: simplification	-75	-75	-30	+10
Customs and Excise taxes				
5 6 per cent real terms increase in road fuel duties	+420	+260	+1 410	+2 695
6 5 per cent real terms increase in tobacco duties	+25	+15	+440	+885
Other				
7 Reduction on Gas levy	-170	-170	-190	-180
Total	**+1 250**	**+1 080**	**+3 130**	**+4 660**

C.110 These measures exclude the tax policy reviews which were announced in the July 1997 Budget.

Inland Revenue taxes

C.111 The changes to the construction industry scheme are expected to take effect from 1 August 1999 (1).

C.112 Mortgage tax relief will reduce from 15 per cent to 10 per cent with effect from 6 April 1998. This includes a reduction in public spending of 50 million each year (2).

C.113 The special rules for foreign income dividends will cease to apply from 6 April 1999, except for international holding companies (3).

C.114 From 6 April 1998 anyone holding gilt-edged securities will be able to receive their interest gross, rather than after deduction of tax, if they want to (4).

Customs and Excise taxes

C.115 In the context of the above table, the indexed yield shows the revenue effect of the changes compared with revalorisation of the duty rates only.

C.116 The Chancellor said in the July 1997 Budget that road fuel duties would be increased on average by at least 6 per cent in real terms in future Budgets (5).

C.117 The Chancellor said in the July 1997 Budget that tobacco duties would be increased on average by at least 5 per cent in real terms in future Budgets as one measure aimed at reducing tobacco consumption and dissuading young people from starting smoking (6).

Other

C.118 The Gas levy will be reduced to zero from 1 April 1998. The figures are before any corporation tax effects, which are uncertain. Paragraph [5.48] explains how this reduction is to be implemented (7).

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comments

Government Expenditure

B.27 Table B11 shows the estimated 1997-98 outturn and forecasts for 1998-99 for general government expenditure (GGE) and its main components.

Table B11: General government expenditure(1)

	billion		
	Outturn	**Estimate**	**Forecast**
	1996-97	**1997-98**	**1998-99**
Control Total	259.8	264.1	274.9
Welfare to Work spending		0.2	1.1
LA spending under the capital receipts initiative		0.2	0.7
Cyclical social security	14.0	12.8	13.0
Central government debt interest	22.0	24.3	24.6
Accounting adjustments	12.2	11.0	12.2
GGE(X)(2)	**307.9**	**312.6**	**326.5**
Privatisation proceeds	-4.4	-1.8	0.0
Other adjustments	5.6	6.2	6.1
GGE	**309.1**	**317.1**	**332.5**
Memo: General government current expenditure:	*304.7*	*311.1*	*324.4*

1 See paragraphsB61-B70 in the conventions used in presenting the public finances.
2 Excluding privatisation proceeds and lottery-financed spending and net of interest and dividend receipts.

Control Total

B.28 Control Total spending in 1997-98 is estimated at 264.1 billion - a fall of 1 per cent in real terms on the previous year. This estimate represents an underspend on plans, as set out in the November 1996 Budget, of 1 1/2 billion. This underspend reflects tight control of programmes, a reduction, announced in the Pre-Budget Report, in the estimate of European Union contributions, and lower than expected social security expenditure. The Government has reallocated this underspend in the current year to 1998-99, consistent with its commitment to work within the Control Totals it inherited for the two years. The Control Total for 1998-99 represents a rise in spending of 1 per cent in real terms but a slight decrease as a percentage of GDP.

B.29 Spending plans over the medium term (1999-2000 onwards) will be set only after the Comprehensive Spending Review has been completed. As in both the July Budget and Pre-Budget Report, stylised projections for public spending are based on three illustrative assumptions:

(A) real growth in the Control Total of 3/4 per cent a year from 1999-2000 onwards (the real growth assumed from 2000-01 in the 1996 Budget);

(B) real growth in the Control Total of 1 1/2 per cent a year - roughly the average over the past 20 years;

(C) real growth in the Control Total of 2 1/4 per cent a year, the same as the estimated trend rate of economic growth.

Table B12: Government expenditure(1)

	per cent of GDP						
	Outturn	Estimate	Projections				
	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03
(A) 3/4 per cent real CT growth							
Control Total	34.5	33.2	33.0	32.5	32.1	31.6	31.1
Cyclical social security	1.9	1.6	1.6	1.6	1.6	1.6	1.6
Central government debt interest	2.9	3.0	2.9	2.7	2.5	2.3	2.0
GGE	41.1	39.8	39.9	39.3	38.6	37.8	37.0
(B) 1 1/2 per cent real CT growth							
Control Total	34.5	33.2	33.0	32.8	32.5	32.3	32.1
Cyclical social security	1.9	1.6	1.6	1.6	1.6	1.6	1.6
Central government debt interest	2.9	3.0	2.9	2.7	2.6	2.3	2.1
GGE	41.1	39.8	39.9	39.5	39.1	38.6	38.0
(C) 2 1/4 per cent real CT growth							
Control Total	34.5	33.2	33.0	33.0	33.0	33.0	33.0
Cyclical social security	1.9	1.6	1.6	1.6	1.6	1.6	1.6
Central government debt interest	2.9	3.0	2.9	2.7	2.6	2.4	2.2
GGE	41.1	39.8	39.9	39.8	39.6	39.4	39.1

1 See paragraphs B61-B70 in the conventions used in presenting the public finances.

Cyclical social security

B.30 With unemployment declining, real spending on cyclical social security has been falling since 1994-95. It fell by 6 per cent in 1996-97 and is expected to fall by a further 11 per cent in 1997-98. The forecast assumes that UK claimant unemployment remains flat at its January level of 1.40 million. On this basis, spending on cyclical social security grows by an average 2 1/4 per cent per annum in real terms, as underlying spending on the non-unemployed continues to rise. There are also Budget measures which, as part of the children's support package, are estimated to increase cyclical social security by 0.1 billion in 1998-99 and 0.3 billion per annum thereafter.

Debt interest

B.31 Central government net debt interest is estimated at 24.3 billion, or 3 per cent of GDP, for 1997-98. This represents an increase of almost 1 per cent of GDP during the 1990s, the result of high public sector borrowing. It is projected to peak, in 1998-99, and fall thereafter to 2-2 1/4 per cent of GDP by 2002-03, reflecting the projected debt repayment over the medium term.

Privatisation proceeds

B.32 Privatisation proceeds, largely from sales of British Energy and Railtrack, are estimated at 1.8 billion in 1997-98. The Government has not announced any specific sales for 1998-99 or subsequent years.

General government expenditure

B.33 General government expenditure (GGE) fell from 42 3/4 per cent of GDP in 1995-96 to 41 per cent of GDP in 1996-97.

Between 1996-97 and 1998-99 it is projected to fall by a further 1 1/4 percentage points of GDP. Over the medium term, the GGE ratio continues to fall in all three cases - to 37, 38, and 39 1/4 per cent by 2002-03 - partly (in case C entirely) because of the falling debt interest burden.

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Changes since 1997 Budget forecast

B.34 Estimated Control Total spending for 1997-98 is 1 1/2 billion lower than assumed in the last Budget, representing the estimated underspend on plans. The Control Totals for the two years 1997-98 and 1998-99 taken together are consistent with the plans set by the previous Government, adjusted for classification changes. Outside the Control Total, cyclical social security spending is almost 1 billion lower than forecast last July, of which some 3/4 billion is the result of lower unemployment. The lower level of unemployment is also expected to reduce cyclical social security in 1998-99.

Table B13: Changes in general government expenditure since July Budget(1)

	billion	
	1997-98	**1998-99**
Control Total	-1.5	1.5
Cyclical social security	-0.9	-1.1
CG debt interest(2)	-0.3	0.1
Accounting adjustments	0.1	1.3
GGE(X)	-2.6	1.7
Privatisation proceeds	0.2	0.0
Other adjustments	0.1	-0.5
GGE	-2.3	1.2

1 Budget forecast has been adjusted for classification changes. See paragraphs B61-B70 in the conventions used in presenting the public finances.
2 Central government debt interest payments net of interest and dividend receipts from outside of general government.

Capital Spending and Private Finance Initiative

Capital spending

B.35 On national accounts definitions, public sector capital expenditure has been falling in recent years. However, these definitions exclude capital spending by the private sector under the Private Finance Initiative (PFI), which also benefits public services. Table B14 also shows total capital spending sponsored by the public sector, including the rapidly increasing contribution through PFI.

B.36 The Government is committed to worthwhile capital investment. The capital receipts initiatives launched in July 1997 released 0.2 billion in 1997-98 and 0.7 billion in 1998-99 for investment to improve the local authority housing stock, provide new social housing and fund housing-related regeneration projects.

Table B14: Public sector capital expenditure(1)

						Estimate	**Forecast**
	1992-93	**1993-94**	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**

Central government	10.9	9.8	9.1	8.6	6.5	6.0	6.0
Local authorities	7.2	6.7	7.3	7.2	6.4	6.4	7.0
Public corporations(2)	3.6	3.4	4.2	4.2	4.4	4.6	4.6
Notional allocation of the Reserve							0.3
Total public sector capital expenditure	**21.6**	**19.9**	**20.6**	**20.0**	**17.3**	**17.0**	**17.9**
Estimated capital expenditure under the Private Finance Initiative		**0.1**	**0.2**	**0.4**	**1.1**	**1.5**	**3.0**
Total publicly sponsored capital expenditure	**21.6**	**20.0**	**20.8**	**20.4**	**18.4**	**18.5**	**20.9**
Memo: Public sector capital spending(3)							
gross of depreciation	*23.5*	*21.3*	*21.7*	*20.8*	*17.4*	*17.0*	*17.9*
net of depreciation	*14.1*	*11.7*	*11.6*	*10.0*	*6.8*	*6.4*	*7.0*

1 Figures are shown for the national accounts definition of capital spending (including expenditure out of the proceeds of the National Lottery). See conventions used in presenting the public finances.
2 Excluding the capital expenditure of privatised industries.
3 Including industries, now privatised, while they were in the public sector.

Private Finance Initiative

B.37 Under the PFI, the public sector purchases services from a private sector partner - which generally undertakes any capital investment required. In this way, the public sector can exploit the full range of private sector management, commercial and creative skills.

B.38 Progress under the PFI has been rapid; projects with a combined capital value of over 1.5 billion have been signed since the General Election in areas including schools, colleges, hospitals, local authorities, defence, IT and property management. The Government has instituted and carried out a thorough review of the initiative, introduced legislation where necessary, issued guidance and help, set up a skilled taskforce, and identified a small number of significant projects on which to focus the resources available. The Government is also continuing to provide support for PFI in the local authority sector, with the recent announcement that central government will support up to 500 million of investment in this area in 1998-99.

B.39 Table B15 shows a breakdown by department of the expected capital investment by the private sector over the next three years. From 1998-99 to 2000-01, some 11 1/4 billion of new investment is expected as a result of PFI. Under PFI, the public sector contracts for services not assets, and capital investment is only one of the activities undertaken by the private sector in order to supply these services. The figures in Table B15 therefore do not reflect the total value of the contracts.

Table B15: Private Finance Initiative: estimated capital spending by the private sector

million

	1997-98	**1998-99**	**1999-00**	**2000-01**
Defence	200	340	300	220
Foreign Office and Overseas Development	0	20	30	0
Agriculture(1)	10	20	20	20
Trade and Industry	10	30	60	20
Environment, Transport and Regions(2),3	920	1 070	1 520	1 380
Education and Employment(4)	0	30	20	20
Home Office	170	183	330	330
Legal Departments	10	30	20	20
Culture, Media and Sport	10	10	20	10
Health	50	320	590	790
Social Security	10	70	270	150

Scotland	70	360	540	300
Wales	10	90	70	70
Northern Ireland	0	50	100	80
Chancellor's Departments	20	50	40	40
Local authorities(5),6	10	300	300	150
Total	**1 500**	**2 970**	**4 230**	**3 600**

1 Includes Forestry Commission.
2 Includes the private sector capital investment in CTRL which is currently the subject of further negotiations.
3 In addition, substantial private investment is levered in through housing, urban regeneration and other programmes.
4 Excludes private finance activity in education institutions classified to the private sector. Estimated total capital values for these are 189million in 1997-98 and 92million in 1998-99.
5 Figures represent spending on projects signed, and expected to be signed, up to the end of 1998-99 only.
6 PFI activity in local authority schools is included in the local authorities line.

B.40 Table B16 shows a forecast of the estimated payments for services flowing from new private investment over the next twenty five years. Actual expenditure will depend on the details of the payment mechanism for each contract.

Table B16: Private Finance Initiative: estimated payments under PFI contracts

	million		**million**
1998-99	1 030	2012-13	2 910
1999-00	1 650	2013-14	2 800
2000-01	2 060	2014-15	2 730
2001-02	2 460	2015-16	2 360
2002-03	2 760	2016-17	2 450
2003-04	2 950	2017-18	2 500
2004-05	3 210	2018-19	1 980
2005-06	3 160	2019-20	1 890
2006-07	3 120	2020-21	2 080
2007-08	3 050	2021-22	1 860
2008-09	3 090	2022-23	1 990
2009-10	2 950	2023-24	1 850
2010-11	3 000	2024-25	1 830
2011-12	3 030	2025-26	1 680

Asset sales

B.41 Table B17 shows receipts from major asset sales from 1992--93 to 1998-99. Sales of fixed assets for central government (excluding Ministry of Defence and Department of Social Security) and local authorities have remained broadly stable over recent years. Excluding major one-off sales, such as the sale of Ministry of Defence married quarters, central government fixed asset sales average around 0.7 billion a year. Figures for 1998--99 are projections, and do not yet reflect the emerging review of assets in the Comprehensive Spending Review.

Table B17: General government receipts from sales of assets

billion

	Outturn					Estimate	Plans
	1992-93	**1993-94**	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**
Sales of fixed assets							
Ministry of Defence: sale of married quarters					1.0	0.7	
Department of Social Security: PRIME and Newcastle estate						0.1	0.4
Other Central government	0.5	0.5	0.6	0.8	0.9	0.8	0.8
Local authorities	2.4	3.6	2.8	2.4	2.6	2.4	2.5
Total sales of fixed assets	**2.9**	**4.1**	**3.4**	**3.2**	**4.4**	**4.0**	**3.7**
Debt sales, etc.(1)							
Sale of Housing Corporation and Housing for Wales loan portfolios					0.6	0.7	
DETR - Transport: sale of ROSCOs				0.8	1.0		
Sale of student loans portfolio						1.0	2.3
Total debt sales, etc.				**0.8**	**1.6**	**1.7**	**2.3**
Total receipts within the Control Total	**2.9**	**4.1**	**3.4**	**4.0**	**6.0**	**5.6**	**6.0**
Privatisation proceeds	**8.2**	5.5	6.4	2.4	4.4	1.8	
Total receipts from sales of assets	**11.1**	**9.6**	**9.9**	**6.4**	**10.4**	**7.4**	**6.0**

1 Includes student loan book and ROSCO sales.

comments

DEPARTMENTAL PROGRAMMES

B.42 Table B18 analyses the Control Total by department, showing changes from previous plans (as published in the Public Expenditure Statistical Analyses, March 1997). Central government support for local authorities and the financing requirements ofnationalised industries have been attributed to the appropriate departments. Departmental groupings are defined at the end of the annex.

Table B18: Control Total by department

	million				
	Outturn	**Estimate**	**Plans**	**Changes from previous plans**	
	1996-97	**1997-98**(4)	**1998-99**(4)	**1997-98**	**1998-99**
Defence	22 345	21 840	22 240	10	0
- sale of married quarters	-962	-700	0	0	0
Foreign Office	1 053	1 090	1 040	20	-20
International Development	2 344	2 260	2 310	70	-10
Agriculture, Fisheries and Food	4 229	3 620	3 370	-140	-50
Trade and industry progs	3 064	3 140	2 960	90	-60
Trade and Industry - Nat Inds	-394	-140	-140	-120	40
ECGD	15	40	60	30	60
DETR	12 975	12 600	12 150	-110	20
DETR - Local government(1)	31 321	31 380	32 760	0	860
of which education SSA	*17 764*	*18 370*	*19 380*		
Home Office	6 486	6 890	6 890	0	70
Legal departments	2 674	2 740	2 690	20	-10
Education and Employment(2)	14 495	14 620	13 070	730	-340
Culture, Media and Sport	959	910	910	30	-10
Health	33 816	35 340	37 170	420	1 500
of which NHS	*33 043*	*34 690*	*36 510*	*340*	*1 420*
Social Security(3)	76 905	79 620	83 620	-170	570
Scotland	14 421	14 520	14 580	180	180
Wales	6 817	6 950	6 970	60	100
Northern Ireland	8 026	8 280	8 400	60	150
Chancellor's departments	3 190	3 250	3 100	90	-30
Cabinet Office	1 157	970	1 310	-70	-40
European Communities	1 717	1 780	2 440	-460	50
LASFE	13 182	13 600	14 000	500	400
Allowance for shortfall	0	-400	0	-400	0
Reserve	0	0	3 000	-2 300	-2 000
Control Total	**259 834**	**264 100**	**274 900**	**-1 500**	**1 500**

1 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 other environmental services.*

2 Does not include local authority Total Standard Spending on education, shown under DETR - Local Government. Figures for 1997-98 and 1998-99 are distorted by the effect of sales of student loans and abolition of nursery vouchers.

3 Excluding cyclical social security.

4 All figures are rounded to the nearest 10 million except for the Reserve, Control Total and Local Authority self-financed expenditure (LASFE) which are rounded to the nearest 100 million.

B.43 In the July Budget the Government announced that it would work within the previous Government's Control Total plans for the first two years of the Parliament. For 1997-98 there has been an underspend on the Control Total, reflecting tight control of programmes and lower demand-led spending (see paragraph 1.24). This underspend has been carried forward into 1998-99. There has been some re-allocation between departments to reflect the Government's priorities.

B.44 The major differences from plans are as follows.

- Changes to plans for DETR reflect extra money provided in this Budget for public transport and the New Deal for Communities in 1998-99, lower costs of housing subsidies, and the introduction of certain new licence fees.
- The extra money for schools announced in the July Budget is reflected in the Local Government and territorial departments lines.
- Changes to the Education and Employment line are due to a re-profiling of the sale of student loans from 1997-8 to 1998-9 and increased take-up of end-year flexibility and include the DfEE's share of the extra 250 million in this Budget.
- The extra 2 billion of resources for the NHS over the next two years, announced by the Chancellor since the election, is reflected in the Health and territorial departments lines.
- The fall of 170 million in 1997-98 and a rise of 570 million in 1998-99 for Social Security reflects revised estimates of the number of claimants and the uprating of benefits in line with inflation, the extra 190 million in this year and next for the pensioners' fuel payment announced in the Pre-Budget Report, and the impact of some large receipts from sales of assets.
- The forecast for net payments to the European Community has been revised down for 1997-98, partly on account of the higher exchange rate.

B.45 There are other, smaller changes. Information on these will be set out in Public Expenditure Statistical Analyses, to be published in April 1998.

PUBLIC BORROWING BY SECTOR

Central government transactions on a cash basis

B.46 The monthly outturns for central government borrowing are measured from the cash flows into and out of central government's funds and accounts, after consolidation. Table B19 sets out the 1996-97 outturn and 1997-98 and 1998-99 forecasts for central government borrowing in terms of this cash flow presentation.

Table B19: Central government transactions on a cash receipts and outlays basis

	billion			
	1996-97	1997-98		1998-99
	Outturn	Last Budget forecast	Latest estimate	Forecast
Receipts				
Inland Revenue(1)	104.0	116.7	117.4	126.1

Customs and Excise(1)	82.4	89.4	89.9	95.6
Social security contributions (GB)	45.1	47.8	48.9	52.0
Interest and dividends	8.3	8.2	8.4	7.4
Other	21.1	20.2	20.7	19.9
Total receipts	**260.9**	**282.3**	**285.1**	**301.1**
Interest payments	26.6	27.0	26.7	26.3
Privatisation proceeds	-4.4	-2.0	-1.8	0.0
Net departmental outlays	263.5	268.6	264.7	277.6
Total outlays	**285.8**	**293.6**	**289.6**	**303.9**(2)
Net own account borrowing(3)	24.9	11.2	4.5	2.8
Net lending to local authorities and public corporations	0.2	1.2	1.7	0.9
Net borrowing	**25.1**	**12.4**	**6.1**	**3.7**

1 Payments to the Consolidated Fund.

2 Assumes Reserve allocated to central government sector.

3 Excludes net lending to local authorities and public corporations.

Financing policy

B.47 Table B20 updates the financing arithmetic for 1997-98 to allow for the latest CGBR forecast, and sets out the financing arithmetic for 1998-99. The gilts issuance programme for 1997-98 was revised in November 1997, following the November Pre-Budget Report, to meet a gilt sales requirement of 25.4 billion. However the latest CGBR forecast would require gilts sales of 20.6 billion. This means that the authorities may therefore issue 5.1 billion more gilts than required in 1997-98. This difference will be carried forward into 1998-99 as a residual which will reduce the initial requirement for gilt sales in that year. Full details of how the authorities intend to finance the CGBR in 1998-99 will be published in the 1998-99 Debt Management Report. The consistency of the debt interest forecast with these funding assumptions has been audited by the National Audit Office.

Table B20: Financing requirement forecasts for 1997-98 and 1998-99

	million				
					1998-99
	1997-98				
	March 1997 Original remit	**July 1997 Budget**	**November 1997 Pre-Budget Report**	**March 1998 Budget**	**March 1998 Budget**
CGBR	**20.0**	**12.4**	**11.7**	**6.1**	**3.7**
Net change in official reserves	0.0	0.0	0.0	0.0	0.0
Gilts maturing	19.6	19.6	19.6	19.9	16.7
plus gilt sales residual from previous financial year		-3.9	-3.9	-3.9	-5.1
Financing requirement	**39.5**	**28.1**	**27.4**	**22.1**	**15.2**
Less Net National Savings inflow	3.0	3.0	2.0	1.6	1.0
Less Other funding	0.0	0.0	0.0	-0.1	0.0
Gilt sales required	36.5	25.1	25.4	20.6	14.2
Less assumed gilt sales				25.8	
Estimated residual				**-5.1**	

Public finances by economic category

B.48 Table B23 shows a full analysis of public sector receipts and expenditure by economic category with a breakdown between central government, local authorities and public corporations. The conventions used, which follow in most respects those in the UK national income and expenditure accounts, are detailed at the end of this annex.

B.49 Tables B21 and B22 summarise the information on local authorities and public corporations transactions that appear in Table B23.

Table B21: Local authority transactions

	billion		
	Outturn	**Estimate**	**Forecast**
	1996-97	**1997-98**	**1998-99**
Receipts			
Council Tax(1)	10.2	11.3	11.8
Current grants from central government	59.3	58.7	61.1
Other receipts(2)	7.8	8.1	8.3
Capital grants from central government	2.9	3.5	3.6
Total receipts	**80.2**	**81.6**	**84.8**
Expenditure			
Current expenditure on goods and services	55.0	56.0	58.8
Current grants and subsidies	14.3	14.1	14.4
Interest	4.2	4.4	4.2
Capital expenditure before depreciation	6.4	6.4	7.0
Total expenditure	**79.9**	**80.9**	**84.3**(3)
Financial deficit	**-0.3**	**-0.7**	**-0.5**
Net financial transactions	-0.6	0.0	0.0
Net borrowing	**-0.8**	**-0.7**	**-0.5**

1 Net of rebates and Council Tax benefit. Includes district council rates in Northern Ireland shown in "Taxes on expenditure" in Table B23 (line 2).

2 Includes interest receipts, rent and gross trading surplus.

3 Assumes no allocation from the Reserve.

Table B22: Public corporations' transactions

	billion		
	Outturn	**Estimate**	**Forecast**
	1996-97	**1997-98**	**1998-99**
Receipts			
Gross trading surplus (including subsidies)	3.8	5.0	4.4
Other current grants	1.2	1.3	1.3
Capital grants from general government	3.5	2.0	1.7
Total receipts	**8.5**	**8.2**	**7.4**
Expenditure			

Interest, dividends and taxes on income	2.4	2.9	2.8
Capital expenditure before depreciation	**4.6**	**4.7**	**4.7**
Total expenditure	**6.9**	**7.6**	**7.5**(1)
Financial deficit	**-1.6**	**-0.7**	**0.1**
Net financial transactions	0.2	-0.5	0.0
Net borrowing	**-1.4**	**-1.2**	**0.1**

1 Assumes no allocation from the Reserve.

Table B23: Public sector transactions by sub-sector and economic category

		billion				
		1997-98				
		General government				
	Line	**Central government**	**Local authorities**	**Total**	**Public corporations**	**Public sector**
Current receipts(2)						
Taxes on income and royalties	*1*	111.2	0.0	111.2	-0.5	110.7
Taxes on expenditure	2	120.2	0.2	120.4	0.0	120.4
Taxes on capital	3	4.5	0.0	4.5	0.0	4.5
Social Security contributions	4	50.7	0.0	50.7	0.0	50.7
Council Tax	5	0.0	11.1	11.1	0.0	11.1
Gross trading surplus	6	0.0	0.8	0.7	5.0	5.7
Rent and miscellaneous current transfers	7	1.1	4.0	5.1	0.5	5.6
Interest and dividends from private sector and abroad	8	2.1	0.8	2.9	0.2	3.1
Interest and dividends within public sector	9	6.3	-4.0	2.2	-2.2	0.0
Imputed charge for non-trading capital consumption	10	1.6	2.3	3.9	0.0	3.9
Total current receipts	**11**	**297.6**	**15.1**	**312.7**	**3.0**	**315.7**
Current expenditure(2)						
Current expenditure on goods and services	*12*	101.5	56.0	157.5	0.0	157.5
Depreciation	13	1.7	5.1	6.9	3.7	10.6
Subsidies	14	7.5	0.7	8.2	0.0	8.2
Current grants to personal sector	15	90.8	13.4	104.2	0.0	104.2
Current grants abroad	16	5.4	0.0	5.4	0.0	5.4
Current grants within public sector	17	58.7	-58.7	0.0	0.0	0.0
Debt interest	18	28.6	0.3	28.9	-0.4	28.5
Apportionment of Reserve	19	0.0	0.0	0.0	0.0	0.0
Total current expenditure	**20**	**294.2**	**16.9**	**311.1**	**3.3**	**314.5**
Current balance(1)	**21**	**3.3**	**-1.8**	**1.6**	**-0.4**	**1.2**
Capital transfers	**22**	**0.0**	**0.3**	**0.3**	**-0.1**	**0.2**
Capital expenditure(2)						
Gross domestic fixed capital expenditure	*23*	3.2	5.5	8.7	4.2	12.9
Less Depreciation	24	-1.7	-5.1	-6.9	-3.7	-10.6
Increase in stocks	25	0.0	0.0	0.0	0.0	0.0
Capital grants to private sector	26	2.9	0.9	3.8	0.4	4.2

Capital grants to public sector	27	5.5	-3.5	2.0	-2.0	0.0
Apportionment of Reserve	28	0.0	0.0	0.0	0.0	0.0
Total capital expenditure	**29**	**9.8**	**-2.2**	**7.6**	**-1.1**	**6.4**
Financial deficit(1)	**30**	**6.5**	**-0.7**	**5.8**	**-0.6**	**5.1**
Financial transactions						
Net lending to private sector and abroad	31	-0.1	0.0	0.0	0.0	0.0
Cash expenditure on company securities (including privatisation proceeds)	*32*	-1.8	0.0	-1.8	0.0	-1.8
Transactions concerning certain public sector pension schemes	33	1.4	0.0	1.4	0.0	1.4
Accruals adjustments on receipts	34	1.7	0.0	1.7	0.0	1.7
Other accruals adjustments	35	-1.9	0.0	-1.9	0.0	-1.9
Miscellaneous financial transactions	36	-1.4	0.0	-1.4	-0.5	-1.9
Borrowing requirement	**37**	**4.5**(4)	**-0.7**	**3.8**	**-1.2**	**2.6**

1 Current balance (line 21) = current receipts (line 11) - current expenditure (line 20). Financial deficit (line 30) = capital expenditure (line 29) - capital receipts (line 22) - current balance (line 21).

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.

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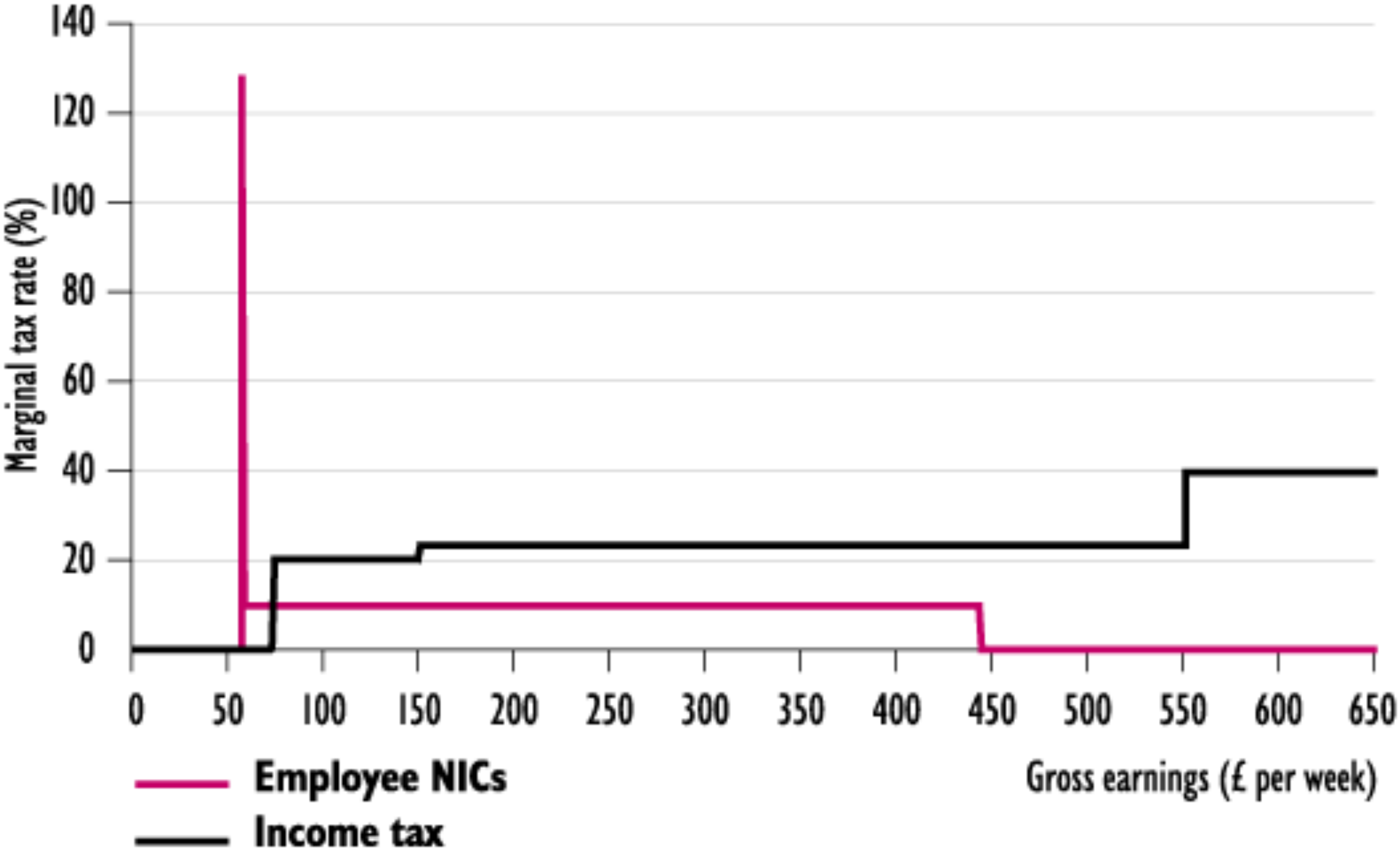
comments

Chart 3.1: Marginal rates of income tax and employee NICs



comments

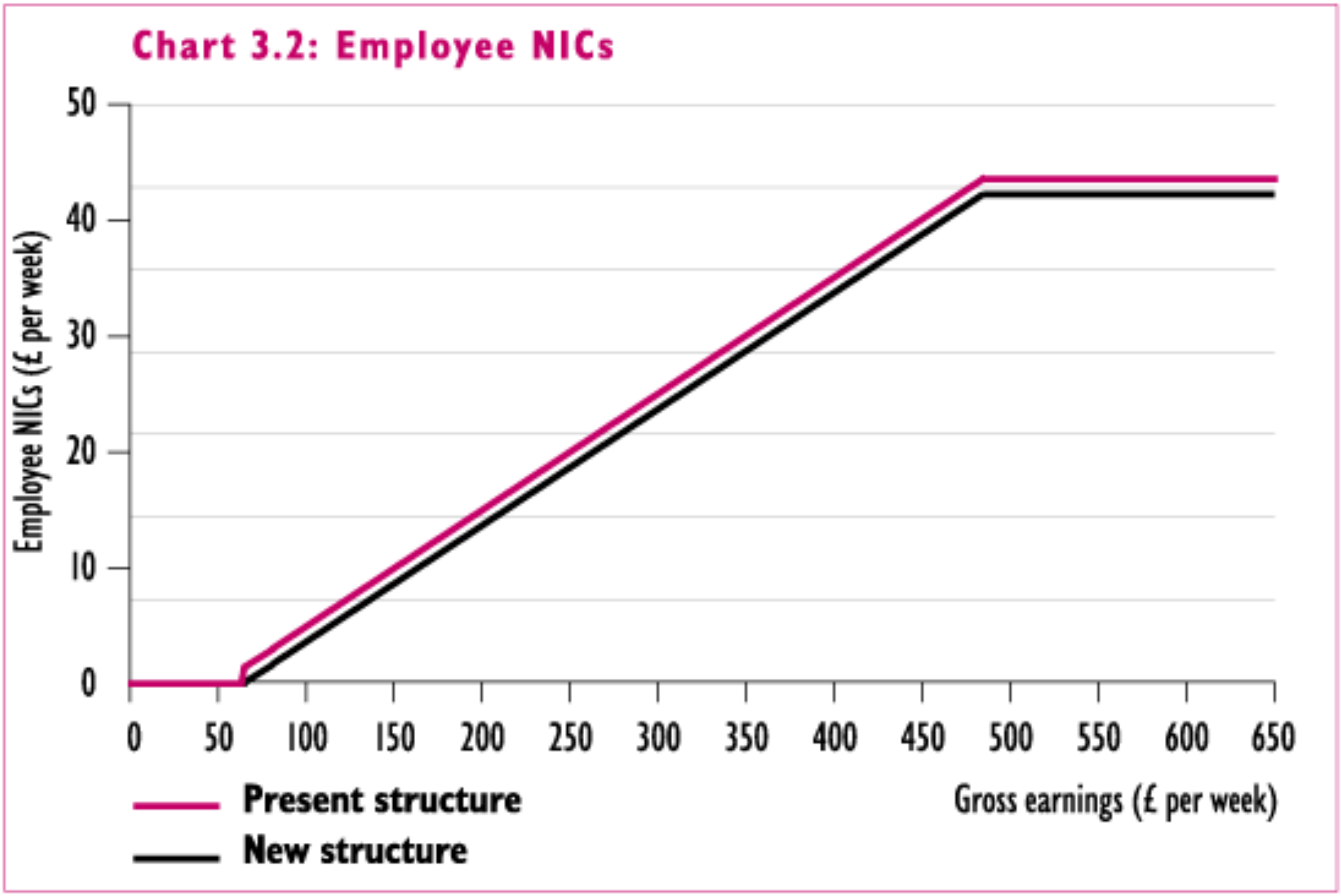
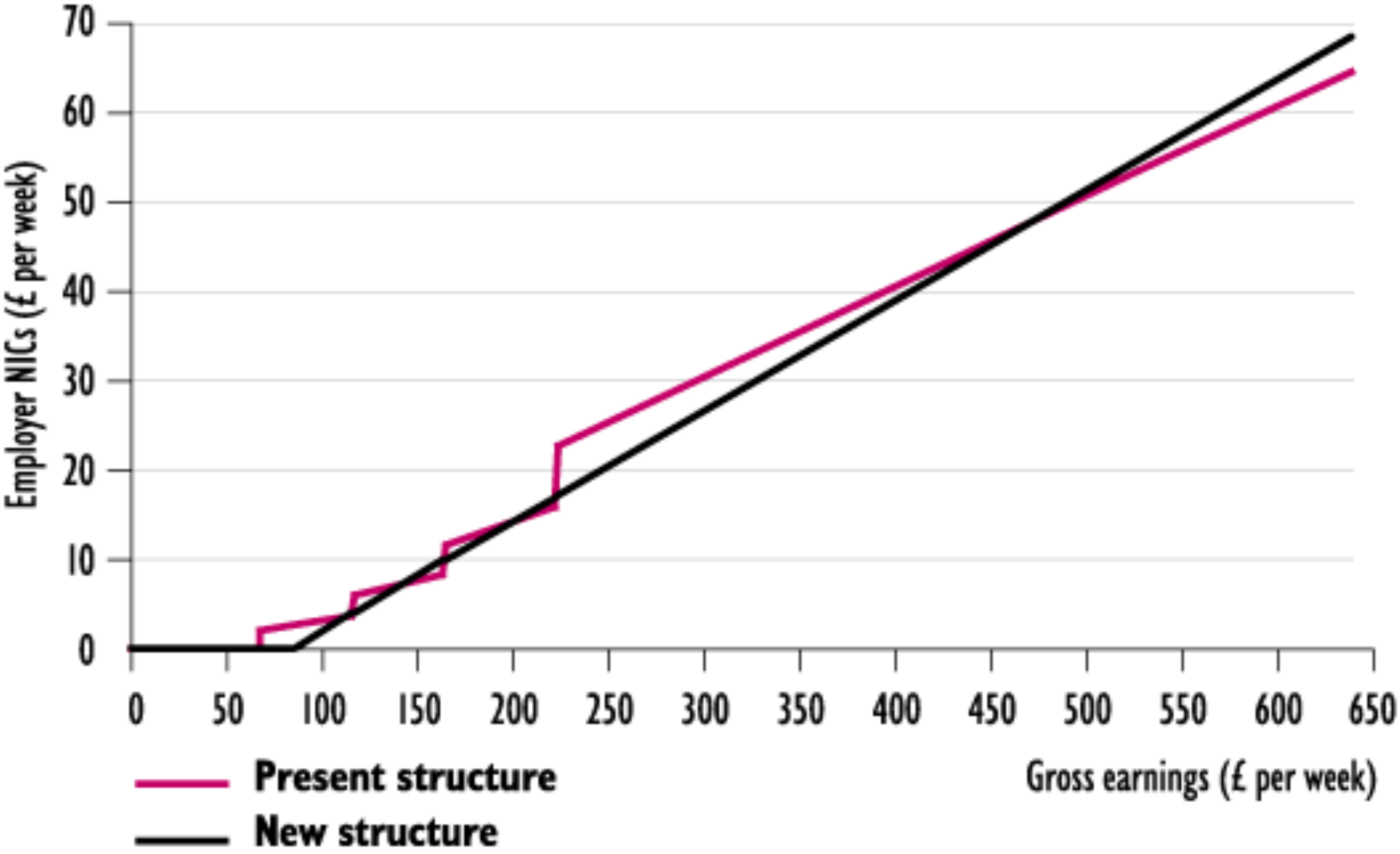


Chart 3.2: Employee NICs
Employee NICs (£ per week)
50
40
30
20
10
0
0
50
100
150
200
250
300
350
400
450
500
550
600
650
Present structure
New structure
Gross earnings (£ per week)

comments

Chart 3.3: Employer NICs



comments

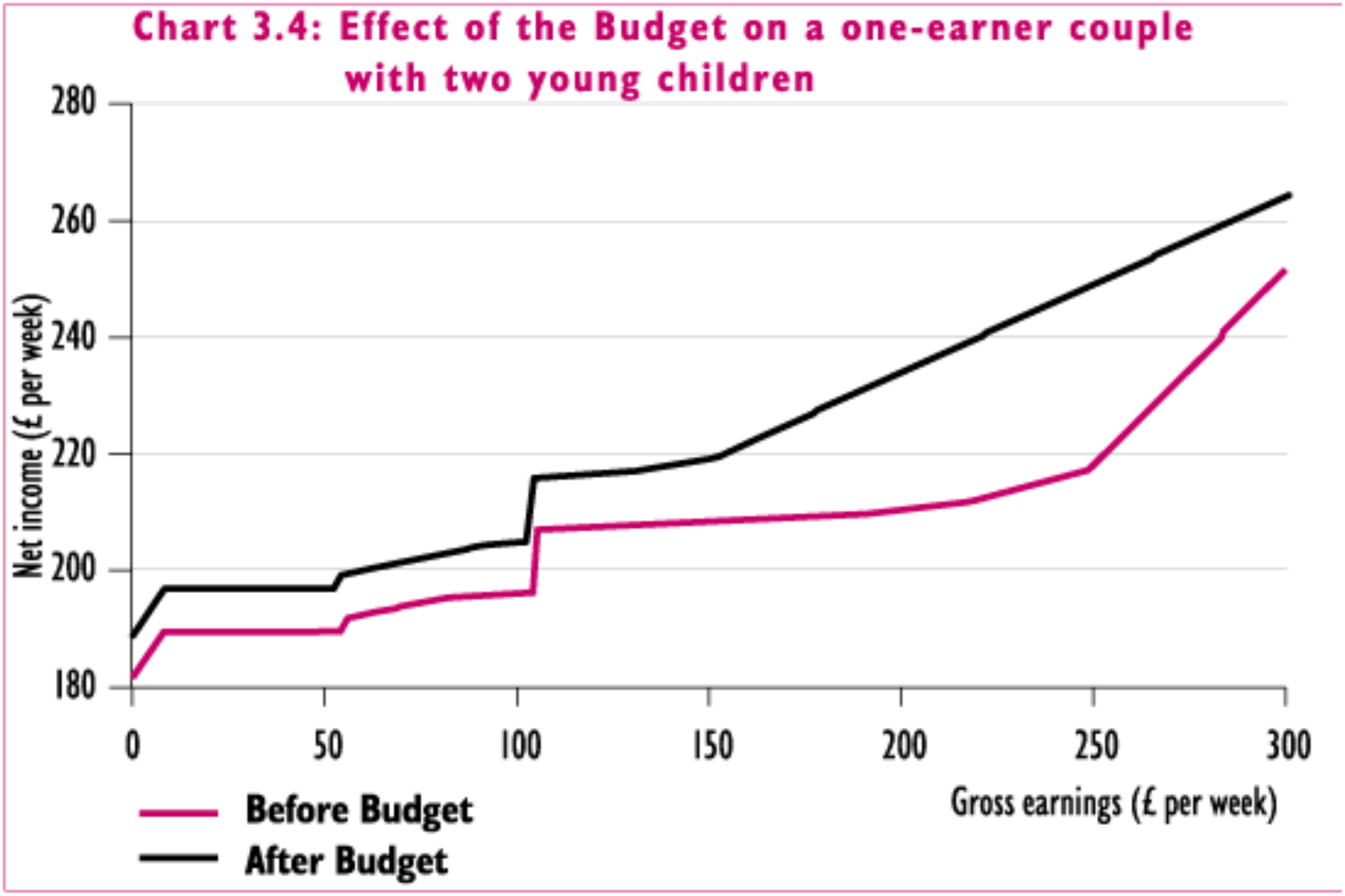
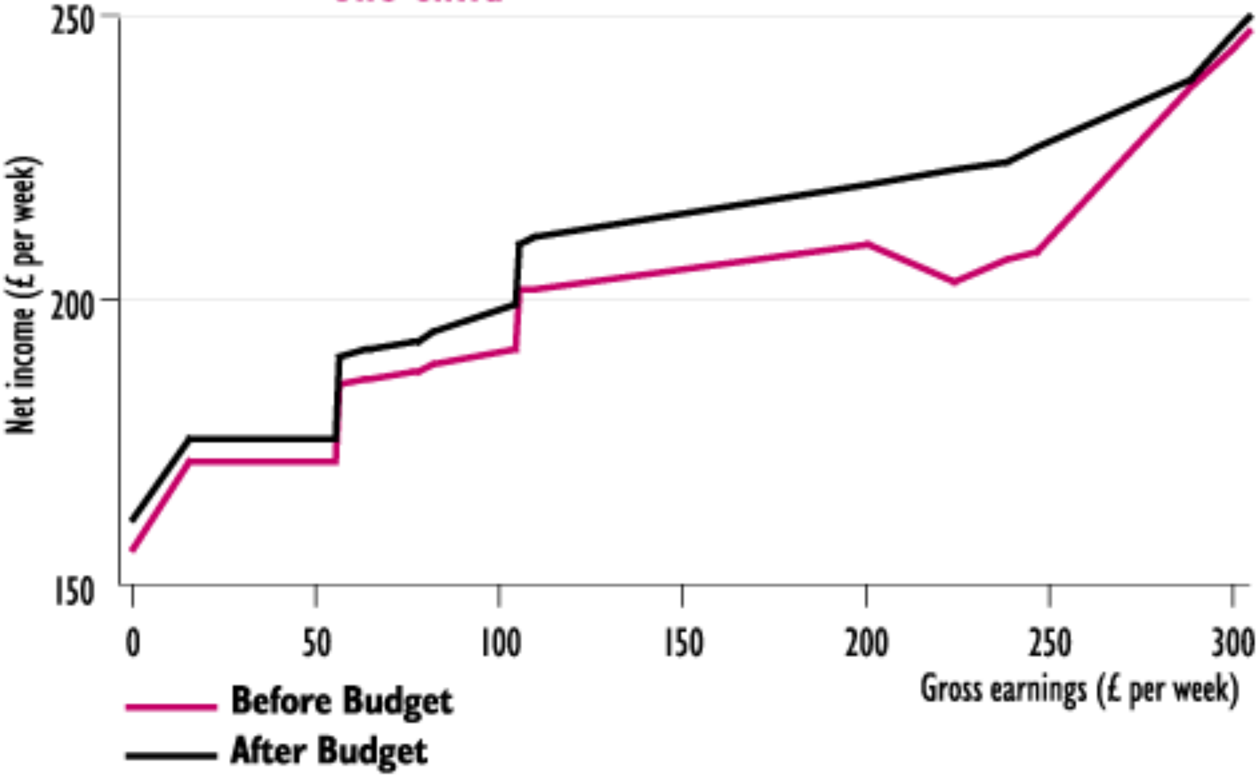


Chart 3.4: Effect of the Budget on a one-earner couple with two young children
280
260
240
220
200
180
Net income (£ per week)
0
50
100
150
200
250
300
Gross earnings (£ per week)
Before Budget
After Budget

comments

Chart 3.5: Effect of the Budget on a lone parent with one child



[1]Assuming the child is aged under 11, a typical private sector rent and council tax; earnings of £3.50 an hour, and no other income or capital.

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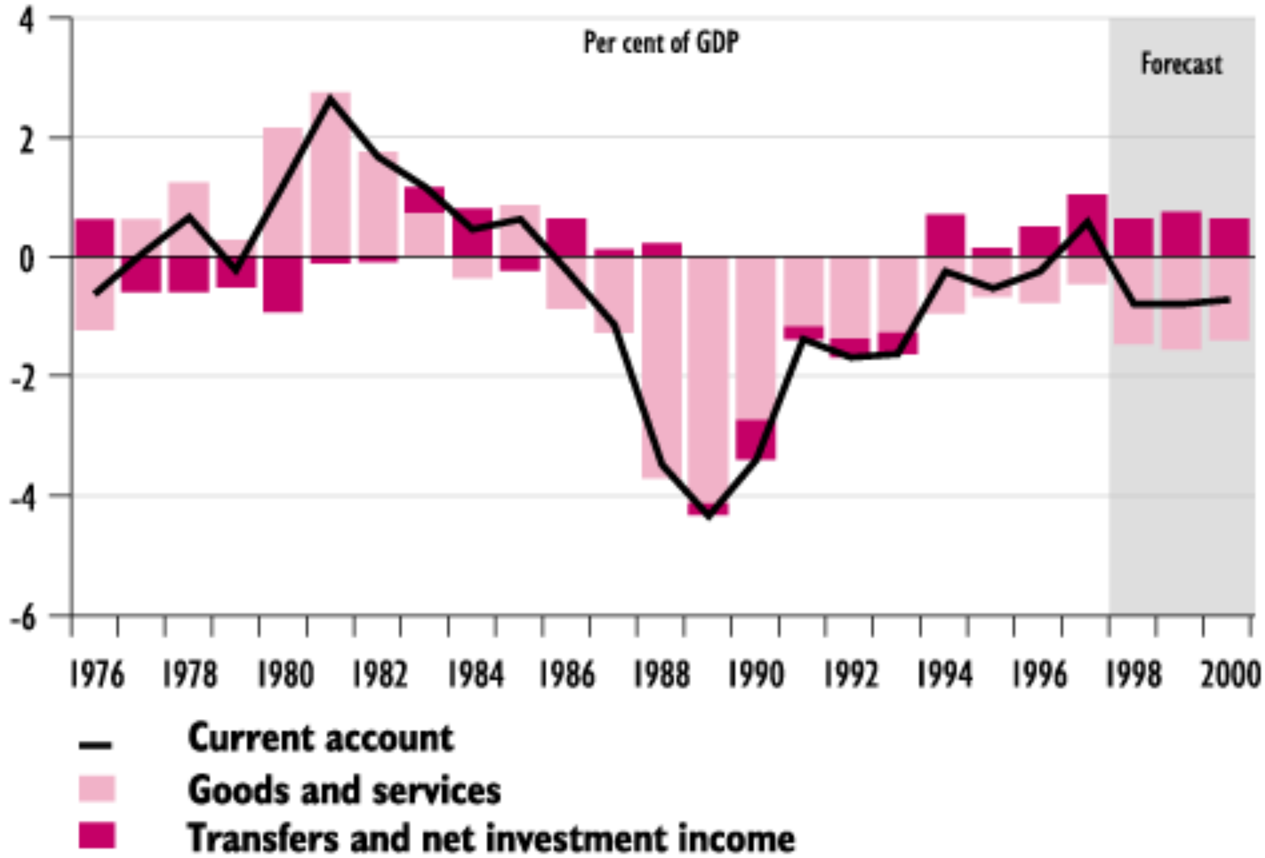
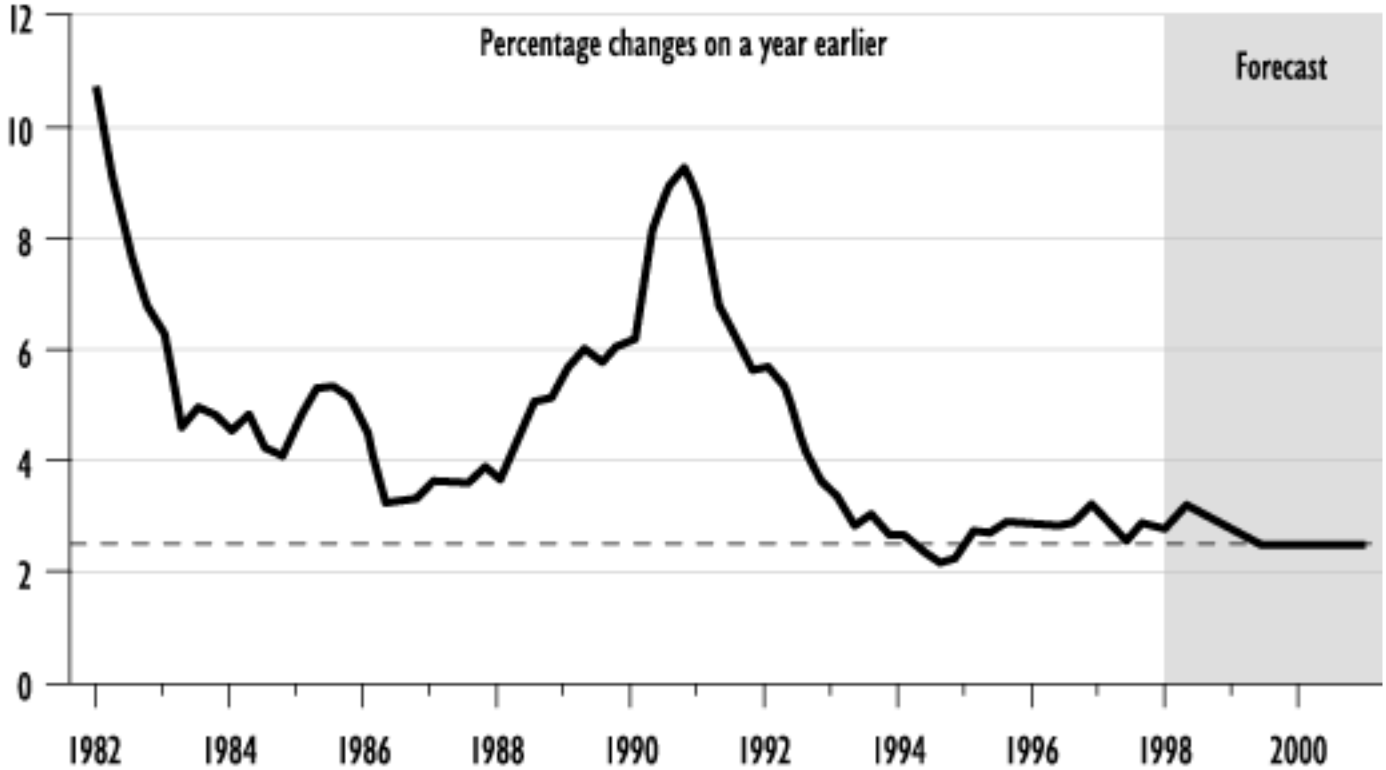
comments

Chart A6: Current account



comments

Chart A7: RPI excluding MIPs[1]



[1] Outturns until 1997Q4; forecasts for second and fourth quarters of 1998 to 2000.

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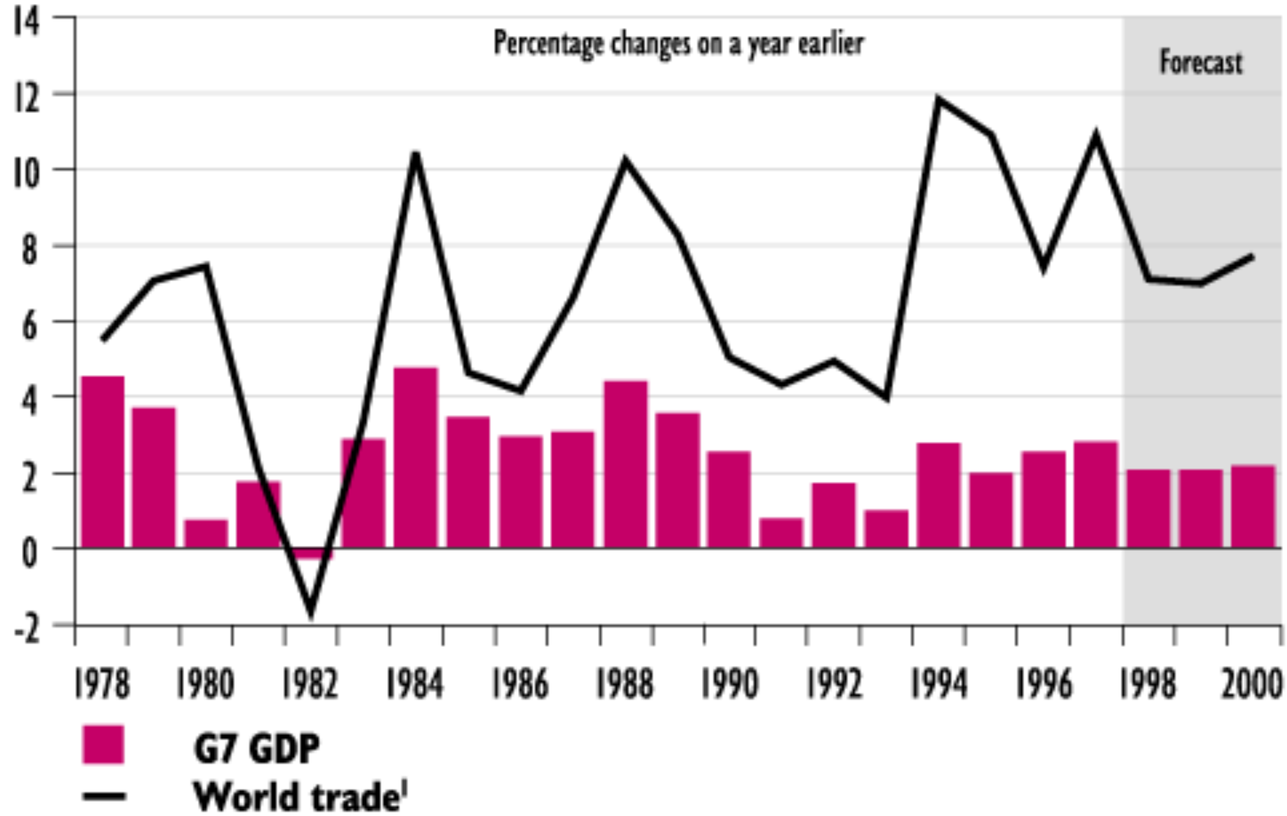
comments

Chart A8: G7 GDP and world trade



[1] Manufactures.

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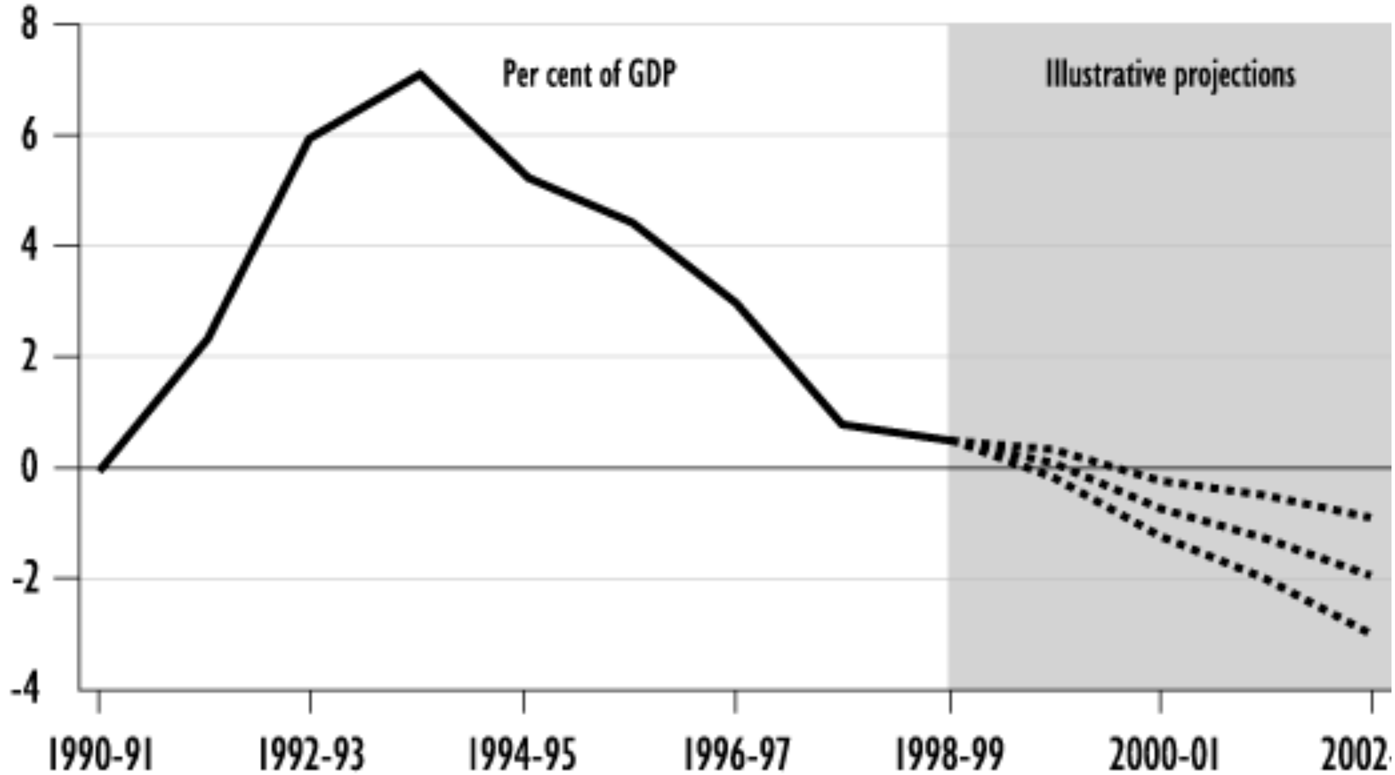
comments

Chart B1: Projections of public sector borrowing requiremen



[1]*Excluding windfall tax and associated spending.*

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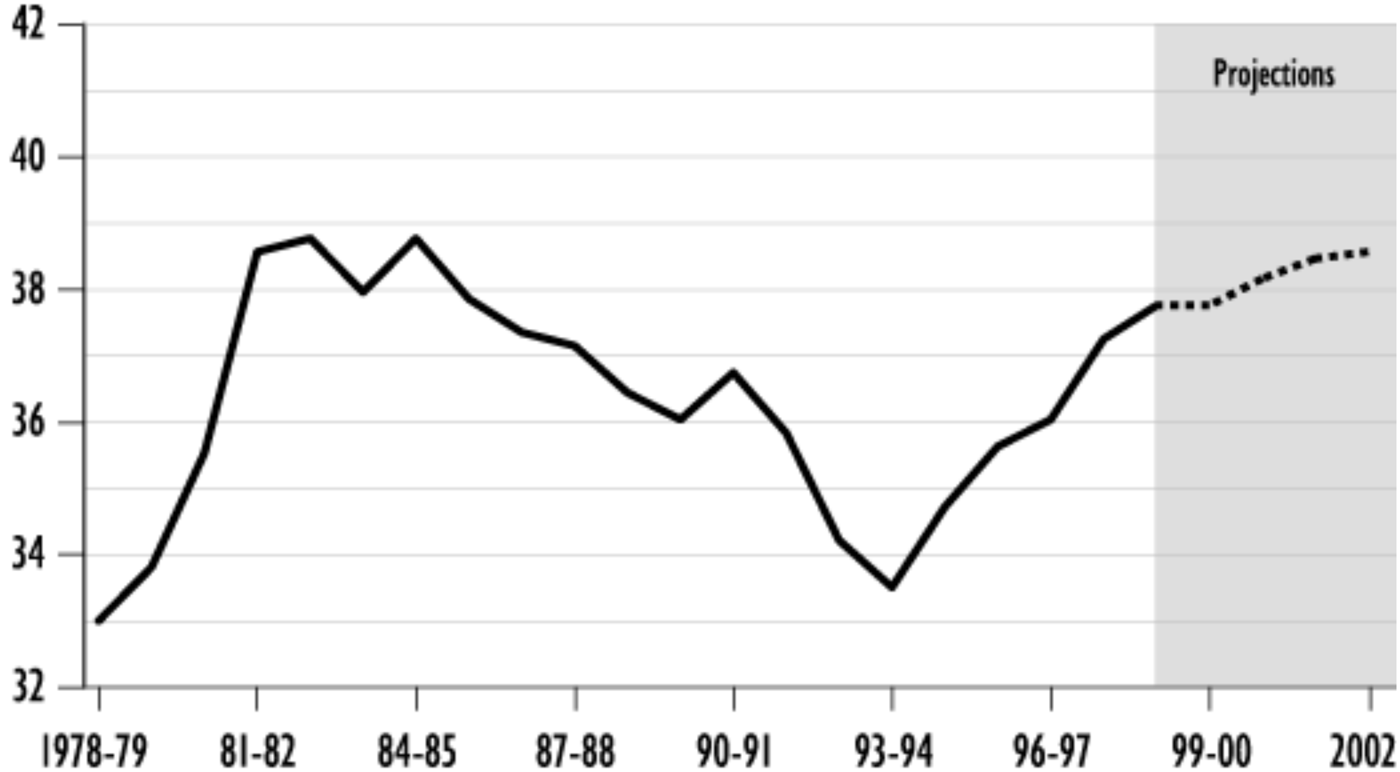
comments

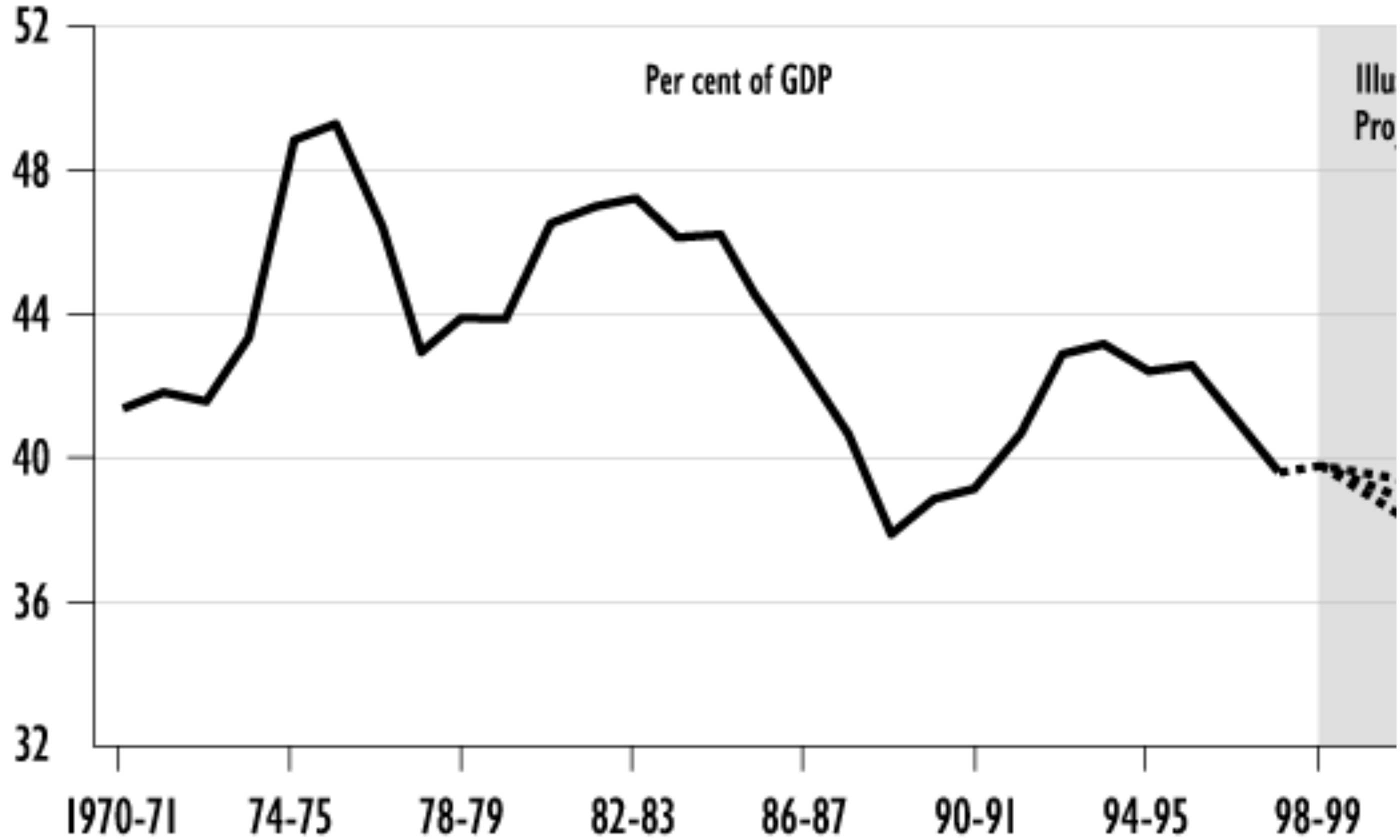
Chart B2: Tax/GDP ratio[1]



[1]Net taxes and social security contributions as defined in Table B8.

comments

Chart B3: Projections of general government expendit



comments