024684/EU XXV. GP
Eingelangt am 08/05/14

**COUNCIL OF THE EUROPEAN UNION**

**Brussels, 8 May 2014 (OR. en)**

**9655/14 ADD 1**

**ECOFIN 464 UEM 133**

**COVER NOTE**

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| From: | Mark Bowman, Director General - International Finace, HM Treasury |
| date of receipt: | 2 May 2014 |
| To: | Carsten Pillath, Director General, DGG - Economic Affairs and Competitiveness, General Secretariat of the Council of the European Union |
| Subject: | UK Convergence Programme 2013-2014 |

Delegations will find attached the UK's Convergence Programme 2013-2014 - second part.

Encl.:

# 4 Fiscal outlook

## Introduction

4.1 This chapter:

- sets out the key economic and market determinants that drive the fiscal forecast (from paragraph 4.3);
- explains the effects of new policies announced in this Budget and since the Autumn Statement in December, and reclassifications, on the fiscal forecast (from paragraph 4.22);
- describes the outlook for public sector receipts, including a tax-by-tax analysis explaining how the forecasts have changed since December (from paragraph 4.32);
- describes the outlook for public sector expenditure, focusing on departmental expenditure limits and the components of annually managed expenditure (from paragraph 4.78);
- presents spending subject to the Government's new welfare cap and looks at some of the recent trends in welfare spending (from paragraph 4.138);
- describes the outlook for government lending to the private sector and other financial transactions (from paragraph 4.157);
- describes the outlook for the key fiscal aggregates: public sector net borrowing (PSNB), the current budget, the cyclically-adjusted current budget and public sector net debt (PSND) (from paragraph 4.173); and
- provides a comparison with forecasts from international organisations (from paragraph 4.184).

4.2 Further breakdowns of receipts and expenditure and other details of our fiscal forecast are provided in the supplementary tables available on our website. The medium-term forecasts for the public finances in this chapter consist of an in-year estimate for 2013-14, which makes use of provisional ONS outturn data for April to January and some preliminary data on tax receipts in February and early March,

and then forecasts to 2018-19.[1] As in previous *Economic and fiscal outlooks (EFOs)*, this fiscal forecast:

- represents our central view of the path of the public finances. We believe that the outturns are as likely to be above the forecast as below it. We illustrate the uncertainties that are inherent in any fiscal forecast by using fan charts, sensitivity analysis and alternative economic scenarios;
- is based on announced Government policy on the indexation of rates, thresholds and allowances for taxes and benefits, and incorporates the impact of certified costings for all new policy measures announced by the Chancellor in the Budget;
- focuses on official 'headline' fiscal aggregates that exclude the temporary effects of interventions in the financial sector.[2] The Government's fiscal mandate and supplementary target are defined in terms of these measures; and
- since the key 'ex' measures of PSNB, the current budget balance and PSND have been affected by a variety of additional one-off or temporary factors in recent years, we also focus on an 'underlying' measure of borrowing that adjusts for the largest of them. Specifically, we exclude the one-off transfer in 2012-13 related to the Royal Mail Pension Plan assets and the ongoing transfers from the Bank of England's Asset Purchase Facility (APF) to the Exchequer, which we assume will reverse within the forecast period. We similarly adjust receipts and spending aggregates where they are affected by these transfers.

## Economic determinants of the fiscal forecast

4.3 Our forecasts for the public sector finances are based on the economic forecasts presented in Chapter 3. Forecasts of tax receipts are particularly dependent on the path and composition of economic activity. And while around half of public sector expenditure is set out in multi-year plans, large elements (such as social security and debt interest payments) are linked to developments in the economy – notably in inflation, market interest rates and the labour market. Table 4.1 sets out some of the key economic determinants of the fiscal forecast and Table 4.2 shows how these have changed since our forecast in December.

### GDP and the output gap

4.4 Most economic forecasts focus on the outlook for real GDP, but nominal GDP is a more important measure for the public finances. This reflects developments in real

[1] Outturn data are consistent with the Public Sector Finances January 2014 Statistical Bulletin published by the Office for National Statistics and HM Treasury.
[2] Office for National Statistics, 2010, *Public sector finances excluding financial sector interventions*.

GDP and whole economy inflation. Nominal GDP is slightly higher in 2013-14 than in our December forecast.

4.5 The structural, or cyclically-adjusted, component of net borrowing and the current budget is estimated using the output gap. A negative output gap implies that the economy is operating below capacity, providing scope for tax revenues to increase and spending to fall as a share of GDP as the economy returns to its potential level. We estimate that the output gap was -1.7 per cent of GDP in the final quarter of 2013, slightly narrower than in our December forecast. We now expect the economy to return to its potential level and the output gap to close by mid-2018, around a year earlier than in December.

## Income and expenditure components of GDP

4.6 The composition of nominal GDP is also important for the fiscal forecast. On the income side, labour income is generally taxed more heavily than company profits. On the expenditure side, much consumer spending is subject to VAT and other indirect taxes, while business investment attracts capital allowances that reduce corporation tax receipts in the short term.

4.7 The largest source of labour income is wages and salaries, which are determined by employment and earnings. Wages and salaries growth is slightly higher in 2014-15 to 2016-17 than we forecast in December, but slower than previously assumed by the end of the forecast, once the output gap has closed.

4.8 Nominal consumer spending growth is higher in each year up until 2017-18 than we assumed in December. It is now expected to grow at an average rate of 4.6 per cent a year between 2014-15 and 2018-19.

4.9 Non-oil non-financial company profits are expected to grow by 10.7 per cent in 2014, over 3 percentage points higher than we forecast in December, reflecting strength in recent quarters. We have revised down our forecast for growth in each year thereafter, but still expect average growth of just over 5 per cent a year between 2015-16 and 2018-19.

## Table 4.1: Determinants of the fiscal forecast

| | Percentage change on previous year unless otherwise specified | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| **GDP and its components** | | | | | | | |
| Real GDP | 0.3 | 2.3 | 2.6 | 2.4 | 2.6 | 2.6 | 2.4 |
| Nominal GDP[1] | 1.4 | 4.7 | 4.6 | 3.9 | 4.6 | 4.5 | 4.4 |
| Nominal GDP (£ billion)[1,2] | 1571 | 1644 | 1721 | 1788 | 1871 | 1956 | 2042 |
| Nominal GDP (centred end-March £bn)[1,3] | 1597 | 1688 | 1754 | 1827 | 1913 | 1999 | 2088 |
| Wages and salaries[4] | 2.4 | 3.9 | 3.5 | 4.2 | 4.7 | 4.6 | 4.4 |
| Non-oil PNFC profits[4,5] | 2.8 | 7.0 | 10.7 | 4.9 | 5.4 | 5.3 | 4.8 |
| Non-oil PNFC net taxable income[4,5] | 6.4 | 6.9 | 9.8 | 3.1 | 3.2 | 2.9 | 2.4 |
| Consumer spending[4,5] | 4.1 | 4.5 | 4.5 | 4.1 | 4.8 | 5.0 | 4.7 |
| **Prices and earnings** | | | | | | | |
| GDP deflator | 1.6 | 1.8 | 2.2 | 1.6 | 1.9 | 1.9 | 2.0 |
| RPI (September) | 2.6 | 3.2 | 2.5 | 3.3 | 3.7 | 3.8 | 3.9 |
| CPI (September) | 2.2 | 2.7 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 |
| Average earnings[6] | 1.0 | 2.6 | 2.4 | 3.3 | 3.7 | 3.7 | 3.8 |
| 'Triple-lock' guarantee (September) | 2.5 | 2.7 | 2.5 | 3.3 | 3.6 | 3.7 | 3.8 |
| **Key fiscal determinants** | | | | | | | |
| Claimant count (millions) | 1.57 | 1.35 | 1.18 | 1.11 | 1.04 | 0.97 | 0.94 |
| Employment (millions) | 29.6 | 30.0 | 30.4 | 30.7 | 31.0 | 31.2 | 31.4 |
| VAT gap (per cent) | 10.9 | 10.3 | 9.9 | 9.9 | 9.9 | 9.9 | 9.9 |
| Output gap (per cent of potential output) | -2.8 | -2.0 | -1.3 | -1.0 | -0.6 | -0.2 | 0.0 |
| **Financial and property sectors** | | | | | | | |
| Equity prices (FTSE All-Share index) | 3066 | 3498 | 3747 | 3897 | 4074 | 4260 | 4449 |
| HMRC financial sector profits[1,5,7] | 3.4 | 1.4 | 2.3 | 4.0 | 4.7 | 4.6 | 4.4 |
| Financial sector net taxable income[1,5] | 4.2 | 2.6 | -0.2 | 3.1 | 7.0 | 3.4 | 3.7 |
| Residential property prices[8] | 2.1 | 4.9 | 8.6 | 7.4 | 4.3 | 3.7 | 3.7 |
| Residential property transactions (000s)[9] | 930 | 1146 | 1357 | 1407 | 1450 | 1493 | 1526 |
| Commercial property prices[9] | 2.3 | 11.9 | 2.1 | 2.0 | 3.7 | 3.0 | 2.0 |
| Commercial property transactions[9] | 1.5 | 9.3 | 3.9 | 3.1 | 3.9 | 4.1 | 3.0 |
| Volume of stampable share transactions | -18.1 | 10.5 | 3.9 | -2.6 | -2.6 | -2.6 | -2.6 |
| **Oil and gas** | | | | | | | |
| Oil prices ($ per barrel)[5] | 112.0 | 108.8 | 107.5 | 102.0 | 99.3 | 99.3 | 99.3 |
| Oil prices (£ per barrel)[5] | 70.6 | 69.6 | 64.7 | 61.1 | 59.2 | 59.0 | 59.1 |
| Gas prices (p/therm)[5] | 59.1 | 66.9 | 60.2 | 63.2 | 63.2 | 63.2 | 63.2 |
| Oil production (million tonnes)[5,10] | 44.5 | 40.6 | 39.2 | 39.2 | 39.2 | 39.2 | 39.2 |
| Gas production (billion therms)[5,10] | 13.8 | 12.8 | 12.8 | 12.7 | 12.7 | 12.7 | 12.7 |
| **Interest rates and exchange rates** | | | | | | | |
| Market short-term interest rates (%)[11] | 0.7 | 0.5 | 0.6 | 1.3 | 2.0 | 2.6 | 3.1 |
| Market gilt rates (%)[12] | 1.6 | 2.6 | 2.9 | 3.3 | 3.6 | 3.9 | 4.0 |
| Euro/Sterling exchange rate (€/£) | 1.23 | 1.19 | 1.22 | 1.22 | 1.23 | 1.25 | 1.26 |

[1] Not seasonally adjusted.
[2] Denominator for receipts, spending and deficit forecasts as a per cent of GDP.
[3] Denominator for net debt as a per cent of GDP.
[4] Nominal.
[5] Calendar year.
[6] Wages and salaries divided by employees.
[7] HMRC Gross Case 1 trading profits.
[8] Outturn data from ONS House Price Index.
[9] Outturn data from HMRC information on stamp duty land tax.
[10] Department of Energy and Climate Change (DECC) forecasts available at www.gov.uk/oil-and-gas-uk-field-data
[11] 3-month sterling interbank rate (LIBOR).
[12] Weighted average interest rate on conventional gilts.

Table 4.2: Changes in determinants of the fiscal forecast since December

| | Percentage point change unless otherwise specified | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| GDP and its components | | | | | | | |
| Real GDP | 0.2 | 0.3 | 0.3 | 0.1 | 0.0 | -0.1 | -0.3 |
| Nominal GDP[1] | 0.0 | 0.1 | 0.4 | 0.1 | 0.1 | 0.1 | 0.0 |
| Nominal GDP (£ billion)[1,2] | 0 | 3 | 8 | 11 | 14 | 16 | 16 |
| Nominal GDP (centred end-March £bn)[1,3] | -2 | 8 | 10 | 12 | 16 | 17 | 17 |
| Wages and salaries[4] | 0.0 | 0.0 | 0.1 | 0.1 | 0.2 | -0.1 | -0.2 |
| Non-oil PNFC profits[4,5] | -1.5 | 0.0 | 3.5 | -0.9 | -0.9 | -1.0 | 0.0 |
| Non-oil PNFC net taxable income[4,5] | -3.5 | -1.3 | 2.8 | -1.4 | -1.4 | -1.5 | -0.5 |
| Consumer spending[4,5] | 0.3 | 0.2 | 0.6 | 0.3 | 0.3 | 0.1 | -0.2 |
| Prices and earnings | | | | | | | |
| GDP deflator | -0.2 | -0.3 | 0.1 | 0.1 | 0.1 | 0.2 | 0.3 |
| RPI (September) | 0.0 | 0.0 | -0.3 | 0.0 | 0.1 | 0.0 | -0.1 |
| CPI (September) | 0.0 | 0.0 | -0.3 | -0.1 | 0.0 | 0.0 | 0.0 |
| Average earnings[6] | 0.0 | 0.2 | -0.1 | -0.1 | 0.1 | 0.0 | 0.1 |
| 'Triple-lock' guarantee (September) | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 |
| Key fiscal determinants | | | | | | | |
| Claimant count (millions) | 0.00 | -0.02 | -0.08 | -0.11 | -0.13 | -0.15 | -0.16 |
| Employment (millions) | 0.0 | 0.0 | 0.2 | 0.2 | 0.3 | 0.2 | 0.1 |
| VAT gap (per cent) | -0.5 | -0.5 | -0.5 | -0.5 | -0.5 | -0.5 | -0.5 |
| Output gap (per cent of potential output) | -0.1 | 0.2 | 0.4 | 0.5 | 0.5 | 0.4 | 0.1 |
| Financial and property sectors | | | | | | | |
| Equity prices (FTSE All-Share index) | -25 | 25 | 58 | 66 | 73 | 80 | 82 |
| HMRC financial sector profits[1,5,7] | 0.0 | 0.0 | 0.0 | 0.2 | 0.1 | 0.1 | 0.0 |
| Financial sector net taxable income[1,5] | 0.5 | 2.2 | -3.2 | 0.1 | 1.5 | -0.6 | -0.8 |
| Residential property prices[8] | 0.0 | 1.2 | 2.7 | 0.4 | 0.1 | 0.0 | -0.2 |
| Residential property transactions (000s)[9] | -1 | 37 | 77 | 52 | 40 | 26 | -1 |
| Commercial property prices[9] | 0.6 | 10.5 | -0.7 | -1.8 | -0.3 | -0.5 | -1.0 |
| Commercial property transactions[9] | 0.0 | 5.0 | -0.1 | 0.3 | 0.0 | -0.3 | -1.6 |
| Volume of stampable share transactions | 0.0 | 0.3 | -0.2 | -0.2 | 0.1 | 0.2 | 0.2 |
| Oil and gas | | | | | | | |
| Oil prices ($ per barrel)[5] | 0.0 | 0.5 | 3.8 | 3.1 | 1.9 | 1.9 | 1.9 |
| Oil prices (£ per barrel)[5] | 0.0 | 0.3 | 0.7 | 0.3 | -0.5 | -0.6 | -0.6 |
| Gas prices (p/therm)[5] | 0.0 | 2.4 | -7.2 | -2.4 | -2.4 | -2.4 | -2.4 |
| Oil production (million tonnes)[5,10] | -0.1 | 1.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Gas production (billion therms)[5,10] | 0.0 | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 |
| Interest rates and exchange rates | | | | | | | |
| Market short-term interest rates[11] | 0.0 | 0.0 | 0.0 | 0.1 | 0.2 | 0.1 | 0.0 |
| Market gilt rates[12] | 0.0 | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 | -0.2 |
| Euro/Sterling exchange rate (€/£) | 0.00 | 0.00 | 0.02 | 0.02 | 0.02 | 0.03 | 0.04 |

[1] Not seasonally adjusted.
[2] Denominator for receipts, spending and deficit forecasts as a per cent of GDP.
[3] Denominator for net debt as a per cent of GDP.
[4] Nominal.
[5] Calendar year.
[6] Wages and salaries divided by employees.
[7] HMRC Gross Case 1 trading profits.
[8] Outturn data from ONS House Price Index.
[9] Outturn data from HMRC information on stamp duty land tax.
[10] Department of Energy and Climate Change (DECC) forecasts available at www.gov.uk/oil-and-gas-uk-field-data
[11] 3-month sterling interbank rate (LIBOR).
[12] Weighted average interest rate on conventional gilts.

## Inflation

4.10 The CPI measure of inflation is used to index many tax rates, allowances and thresholds and to uprate benefits and public sector pensions. Our forecast for CPI inflation has been revised down slightly in the first two years of the forecast, reflecting the lower-than-expected outturns in recent months. CPI inflation is expected to be close to the Bank of England's target of 2 per cent throughout the forecast.

4.11 RPI inflation determines the interest rate paid on index-linked gilts and is used to revalorise excise duties. We have revised RPI inflation down slightly in the near term. RPI inflation is higher than CPI inflation in each year of the forecast, partly because its method of calculation drives a wedge between the two (the 'formula effect'), but also that market expectations for Bank Rate gradually feed through to the mortgage interest rate payment component of RPI inflation, which is not included in CPI.

4.12 The Basic State Pension (BSP) is uprated in April each year in line with the 'triple-lock' guarantee: by whichever is the highest of average earnings growth, CPI inflation in the previous September, or 2.5 per cent. On our current forecast, it will rise by the minimum 2.5 per cent in 2015-16 and by average earnings growth of between 3.3 per cent and 3.8 per cent from 2016-17 onwards.

## Property market

4.13 The residential property market is a key driver of receipts from stamp duty land tax and inheritance tax. House price growth has picked up further since our December forecast. Our latest forecast is for 8.6 per cent growth in 2014-15, 2.7 percentage points higher than our forecast in December. Growth remains strong in 2015-16, after which we assume house prices rise in line with earnings.

4.14 Residential property transactions have been higher than expected in recent months and are forecast to continue growing strongly in 2014-15, by more than 18 per cent over the previous year. We have revised the profile for our residential property transactions forecast, bringing more of the growth in transactions into the early years of the forecast and reducing growth rates in the later years. The level of transactions remains close to our December forecast by 2018-19.

4.15 Commercial property prices and transactions showed very strong growth in the final quarter of 2013. Average prices are now expected to grow by around 12 per cent in 2013-14 and the volume of transactions by around 9 per cent. With more activity in the near term, growth in future years is slightly lower than in December. In 2018-19, prices are forecast to be around 6 per cent higher and the volume of transactions around 3 per cent higher than we forecast in December.

## Oil and gas sector

4.16 Our oil price forecast moves in line with the average of the futures curve over the ten working days to 27 February 2014 for the next two years, and is held flat at that level for the remainder of the forecast period. Movements in oil prices and the sterling/dollar exchange rate mean that the sterling price of oil is slightly higher than we assumed in December until 2015-16 and lower thereafter. We use the same method to project gas prices. These are also lower than we assumed in December.

4.17 Oil and gas production forecasts are based on the central projection published by the Department of Energy and Climate Change (DECC). Oil production fell 8.8 per cent in 2013 and gas production fell by 7.2 per cent. Oil production is expected to fall a further 3.6 per cent in 2014 and then remain flat across the remainder of the forecast. These forecasts are little changed since December.

4.18 Projections for capital and operating expenditure by oil and gas firms are a key driver of oil and gas revenues. We have incorporated DECC estimates which are based on recent industry data. Capital expenditure is expected to remain close to its current record levels over the next couple of years. We have built in more of a decline at the end of the forecast than in the DECC estimates, on the basis that some capital plans may not take place during the forecast period.

## Equity markets

4.19 Equity prices are a significant determinant of capital gains tax, inheritance tax and stamp duty receipts. Equity prices are assumed to rise from their current level in line with our forecast for nominal GDP. The current level is determined by the average closing price of the FTSE All-Share Index over the ten working days to 27 February 2014.

## Interest rates

4.20 We use the 3-month sterling interbank rate as a benchmark for our short-term interest rate determinant. Our forecast incorporates the average forward rates for the ten working days to 27 February 2014. The futures curve implies rates will be slightly higher from 2015-16, before returning to our December assumption by the final year.

4.21 Our forecast assumes gilt yields move in line with market expectations based on average forward rates for the ten days to 27 February 2014. Gilt yields are marginally lower across the forecast than we assumed in December.

## Policy announcements, risks and classification changes

4.22 The Government publishes estimates of the direct impact of tax and spending policy decisions on the public finances in its Budget policy decisions table, after detailed discussions with the OBR. If we were to disagree with any of the final numbers they chose, we would use our own estimates in our forecast. We are also responsible for assessing any indirect effects of policy measures on the economic forecast. These are discussed in Box 3.3 in Chapter 3. We also note as risks to the fiscal forecast any significant policy commitments that are not quantifiable, as well as potential statistical classification changes. We have published a detailed briefing paper on our approach to scrutinising and certifying policy costings, and how they are fed into our forecasts, which is available on our website: *Briefing paper No 6: Policy costings and our forecast.*

### Direct effect of new policy announcements on the public finances

4.23 Annex A reproduces the Treasury's table of the direct effect on PSNB of policy decisions in the Budget or announced since the Autumn Statement. The OBR has endorsed all of the tax and AME expenditure costings in the Treasury's table as being reasonable central estimates of the measures themselves. As we explain in more detail in our annex to the Treasury's *Budget 2014 policy costings* document, a number of these costings are highly uncertain. In particular the savings and pensions package – which includes the pension withdrawals, voluntary NICs, ISA equalisation and ISA peer-to-peer loans and retail bonds measures. Measures which include assumptions on EEA net migration and the accelerated payments measure are also particularly uncertain.

4.24 Table 4.3 summarises the Treasury's Budget policy decisions table. A positive figure means an improvement in PSNB, i.e. higher receipts or lower expenditure. We produce a detailed breakdown of all of the measures announced in the Budget in a supplementary fiscal table on our website. This shows how each policy measure is allocated to different categories of tax and spending and is summarised in Table 4.3.

4.25 The tax and spending measures that the Treasury has included in its Budget policy decisions table have little cumulative effect on borrowing over the forecast, with a £5½ billion cumulative net tax cut offset by a £5¾ billion cumulative reduction in spending. The net tax cut reflects the partly offsetting effects of a number of measures that reduce receipts – including raising the income tax personal allowance, the package of savings measures and extending temporary annual investment allowances at £500,000 – and others that increase receipts – including accelerated payment in anti-avoidance cases and the income tax associated with the pension withdrawals measure. Spending cuts are focused in the years from 2016-17 to 2018-19, for which detailed plans have not yet been set. The Government has also made spending commitments related to energy intensive

industries in this Budget that it estimates will cost around £0.5 billion a year from 2016-17.

Table 4.3: Summary of the effect of identified policy measures

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Effects of receipts measures | 0.0 | 0.0 | -0.6 | -1.8 | -1.4 | -1.7 |
| *of which:* | | | | | | |
| Income tax and NICs | 0.0 | 0.3 | 0.1 | -0.4 | -0.5 | -0.7 |
| Onshore corporation tax | 0.0 | 0.0 | -0.3 | -0.7 | 0.1 | 0.3 |
| Alcohol duty | 0.0 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 |
| Stamp duty | 0.0 | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 |
| Air passenger duty | 0.0 | 0.0 | -0.2 | -0.2 | -0.2 | -0.2 |
| Climate change levy | 0.0 | 0.0 | -0.1 | -0.4 | -0.7 | -1.0 |
| Tobacco duty | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 |
| Other | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 |
| Effects of expenditure measures[1] | 0.0 | -0.5 | 0.1 | 2.0 | 2.1 | 2.1 |
| *of which:* | | | | | | |
| Current DEL | 0.0 | -0.3 | -0.3 | 1.2 | 1.2 | 1.2 |
| Current AME | 0.0 | 0.0 | 0.4 | 0.8 | 0.8 | 0.9 |
| *of which:* | | | | | | |
| Social security benefits | 0.0 | 0.0 | -0.1 | 0.0 | 0.0 | 0.0 |
| Tax credits | 0.0 | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 |
| Public service pensions | 0.0 | 0.0 | 0.7 | 1.0 | 1.0 | 1.0 |
| Debt interest | 0.0 | 0.0 | -0.2 | -0.1 | -0.1 | 0.0 |
| Capital DEL | 0.0 | -0.3 | -0.1 | 0.0 | 0.0 | 0.0 |
| Capital AME | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total direct effect of policy measures on PSNB | 0.0 | -0.6 | -0.6 | 0.2 | 0.6 | 0.4 |
| Total direct effect of policy measures on current balance | 0.0 | -0.3 | -0.5 | 0.2 | 0.6 | 0.4 |
| Financial transactions | 0.0 | -0.3 | -0.5 | -2.6 | -2.3 | -2.5 |

[1] Expenditure categories are equivalent to PSCE in RDEL, PSCE in AME, PSGI in CDEL and PSGI in AME in Table 4.17.

Note: Annex A reproduces the Treasury's full policy decisions table. Our online supplementary tables also reproduce the policy decisions table with the full classifications consistent with our forecast.

Note: this table uses the Treasury scorecard convention that a positive figure means an improvement in the PSNB, PSNCR and PSND.

4.26 Our forecast also includes the reallocation of the tax free childcare measure that was announced in Budget 2013, which provided government support for childcare up to a limit of £1,200 per child. At Budget 2013, the Government included this measure in its table of policy decisions, allocating the costs to RDEL from 2015-16 onwards. We have certified a new costing for this measure that shifts this to welfare spending in AME, with offsetting increases in receipts and reductions in RDEL. This increases welfare spending by £0.9 billion a year by the end of the forecast period. Implied PSCE in RDEL is also reduced beyond 2015-16 by the additional AME spending. These effects are set out in a supplementary fiscal table on our website, which shows a full breakdown of all the policy decisions in Budget 2014. The policy

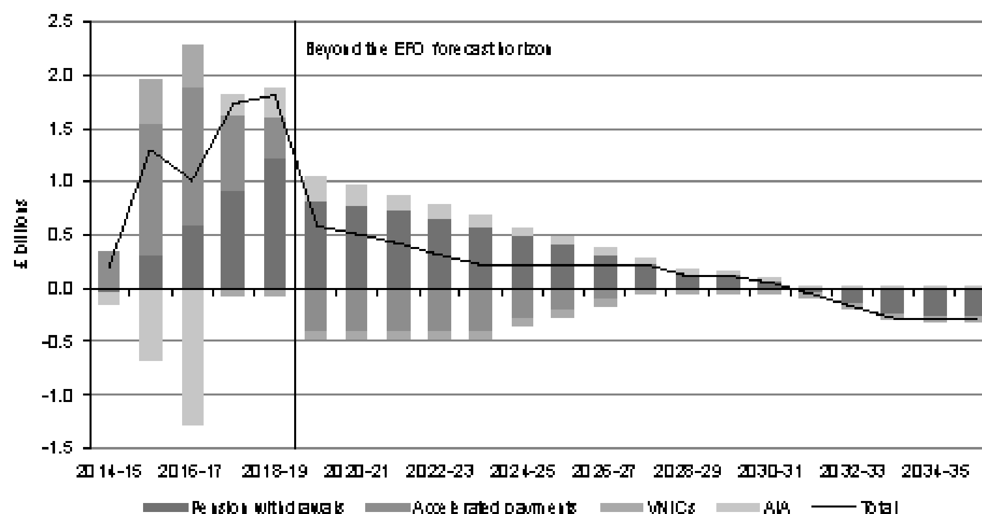
has been made more generous at this Budget, adding a further £0.1 billion to welfare spending from 2016-17 onwards.

4.27 A number of measures have markedly different implications for revenue beyond the five-year scorecard period than within it, which we will consider in more detail in our next *Fiscal sustainability report*. The Treasury has provided estimates of the longer-term revenue consequences of these measures, which are presented in Chart 4.1. These include:

- the pension withdrawals measure, which brings forward income tax receipts but has a small steady-state cost in the long term;
- voluntary NICs, which increases NICs receipts in the short term but also increases long-term state pension costs;
- the temporary annual investment allowance increase, which raises the amount of tax relief that can be claimed until December 2015, but then reduces it thereafter, largely recouping the scorecard costs; and
- accelerated payments related to tax avoidance schemes, which brings forward receipts from future years.

4.28 The net effect of these measures is to increase receipts over the scorecard horizon by £1.2 billion a year on average, but the revenue raised then drops sharply in 2019-20 and averages only £0.2 billion a year over the 15 years beyond the scorecard horizon. Given the uncertainty associated with costing these policy measures over a 5-year horizon, the longer-term implications will be also be subject to considerable uncertainty.

Chart 4.1: Revenue raised by selected Budget policy measures




Source: HM Treasury, OBR

## Box 4.1: Asset Purchase Facility flows

Since late 2012-13, excess cash held in the Bank of England's Asset Purchase Facility (APF) has been transferred to the Exchequer on an ongoing basis.

Transfers up to the level of the Bank's income in the previous year are currently treated as dividends, reducing net borrowing; beyond that, they are financial transactions, reducing the net cash requirement but not borrowing. Any payments made from the Exchequer to the APF are also currently treated as capital grants, increasing net borrowing but not affecting the current budget. This treatment will change following the ONS's Public Sector Finances Review, to be implemented later this year, and the possible implications are discussed in Annex B.

To estimate the size of future flows, we have to make assumptions about when quantitative easing (QE) will be unwound and how quickly. Our central forecast assumes that Bank Rate follows market expectations, but there is no equivalent guide to expectations for the path of QE. We therefore take a neutral set of assumptions, unchanged since we first included the APF figures in our forecast in December 2012. We assume QE remains at £375 billion and that it begins to be unwound once Bank Rate rises above 1 per cent, with sales evenly paced at £10 billion a quarter thereafter. We also assume redemptions will not be reinvested once sales begin. The first sale is assumed to be in the fourth quarter of 2015, as assumed last December.

Our projection for the overall net transfer to the Treasury is now £42 billion, up slightly

from our December projection of £40 billion. A slightly higher Bank Rate reduces net interest income between 2015-16 and 2017-18, offset later by lower gilt rates, which imply higher gilt prices at the point of sale and therefore smaller capital losses.

There is huge uncertainty about the timing and pace of QE unwinding and our assumptions should be regarded as a neutral way of illustrating the potential fiscal impact, rather than as a forecast of how the Bank of England is likely to act. Table C also shows two alternative scenarios: the first where gilt rates rise by 200 basis points when QE unwinding starts; and the second where the stock runs down only through redemptions once Bank Rate moves above 1 per cent.

The estimates of the overall transfer to the Exchequer are highly sensitive to changes in gilt rates. In the first scenario the Treasury would receive £61 billion, only to pay back £57 billion over the following years, giving a net transfer of £5 billion. In the second, the Exchequer would continue to receive cash from the APF over the next five years, reducing debt by £72 billion in total, before covering losses over a protracted period. Both scenarios would have much bigger effects beyond our *EFO* forecasting horizon, which we will revisit in this July's *Fiscal sustainability report*.

Table A: Fiscal impact of projected APF flows

| | £ billion | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 12-13 | 13-14 | 14-15 | 15-16 | 16-17 | 17-18 | 18-19 | 19-20 | 20-21 | 21-22 | 22-23 |
| Receipts | 6.4 | 12.2 | 11.6 | 7.2 | 2.9 | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Capital spending | 0.0 | 0.0 | 0.0 | 0.3 | 0.0 | 1.7 | 3.7 | 5.7 | 5.4 | 5.5 | 0.4 |
| Net borrowing | -6.4 | -12.2 | -11.6 | -6.9 | -2.9 | 1.3 | 3.7 | 5.7 | 5.4 | 5.5 | 0.4 |
| Current budget | 6.4 | 12.2 | 11.6 | 7.2 | 2.9 | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net cash requirement | -11.3 | -31.1 | -11.6 | -6.9 | -2.9 | 1.3 | 3.7 | 5.7 | 5.4 | 5.5 | 0.4 |
| Public sector net debt | -11 | -42 | -54 | -61 | -64 | -63 | -59 | -53 | -48 | -42 | -42 |

Table B: Changes to the fiscal impact of projected APF flows since December

| | £ billion | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 12-13 | 13-14 | 14-15 | 15-16 | 16-17 | 17-18 | 18-19 | 19-20 | 20-21 | 21-22 | 22-23 |
| Receipts | 0.0 | 0.0 | -0.5 | -0.2 | -0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Capital spending | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | -0.1 | -0.5 | -0.6 | -0.7 | -0.5 | 0.2 |
| Net borrowing | 0.0 | 0.0 | 0.5 | 0.3 | 0.3 | -0.1 | -0.5 | -0.6 | -0.7 | -0.5 | 0.2 |
| Current budget | 0.0 | 0.0 | -0.5 | -0.2 | -0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net cash requirement | 0.0 | -0.4 | 0.5 | 0.3 | 0.3 | -0.1 | -0.5 | -0.6 | -0.7 | -0.5 | 0.2 |
| Public sector net debt | 0 | 0 | 0 | 0 | 1 | 1 | 0 | -1 | -1 | -2 | -2 |

Table C: Fiscal impact of alternative APF scenarios

| | £ billion | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 12-13 | 13-14 | 14-15 | 15-16 | 16-17 | 17-18 | 18-19 | 19-20 | 20-21 | 21-22 | 22-23 |
| Central | | | | | | | | | | | |
| Net borrowing | -6.4 | -12.2 | -11.6 | -6.9 | -2.9 | 1.3 | 3.7 | 5.7 | 5.4 | 5.5 | 0.4 |
| Public sector net debt | -11 | -42 | -54 | -61 | -64 | -63 | -59 | -53 | -48 | -42 | -42 |
| 200bps gilt shock | | | | | | | | | | | |
| Net borrowing | -6.4 | -12.2 | -11.6 | -5.2 | 4.1 | 8.5 | 10.9 | 13.0 | 13.0 | 5.1 | 0.0 |
| Public sector net debt | -11 | -42 | -54 | -59 | -55 | -47 | -36 | -23 | -10 | -5 | -5 |
| Redemptions only[1] | | | | | | | | | | | |
| Net borrowing | -6.4 | -12.2 | -11.6 | -7.6 | -6.5 | -3.2 | -1.2 | 1.8 | 0.9 | 6.0 | 2.1 |
| Public sector net debt | -11.3 | -42 | -54 | -61 | -68 | -71 | -72 | -71 | -70 | -64 | -61 |

[1] Under this scenario the APF transfers would continue to directly affect net borrowing and net debt beyond 2022-23.

## Currently unquantifiable policy commitments

4.29 Consistent with the *Charter for Budget Responsibility*, our projections do not include the impact of policies where there is insufficient detail or certainty of implementation to quantify the impact and allocate it to particular years. Where significant, these are noted as fiscal risks:

- the Government has announced a target for central government to deliver at least £25 billion of asset sales between 2015 and 2020, comprising at least £5 billion of land and property and £20 billion of corporate and financial assets, including the pre-Browne student loan book. Sales of land and property are netted off gross capital expenditure, but as our forecasts are for net capital spending, further sales than would otherwise be expected would not affect the accuracy of our medium-term forecasts. The Government has outlined plans to raise £12 billion through student loan book sales, but we do not include any other asset sales over the forecast horizon. Additional sales of financial assets would affect our forecasts for net debt, but we will only include sales once sufficiently firm details are available of the nature, size and timing of any such transactions;

- the Treasury and Royal Bank of Scotland are in negotiations to simplify the bank's capital structure by retiring the Dividend Access Share, but the outcome is too uncertain to anticipate. The Government's shareholdings in Lloyds Banking Group may also attract dividend payments, but Lloyds would require regulatory approval to disburse any dividends and so we do not include payments over the forecast period. We also do not assume any further stakes in the banks are sold over the next few years; and

- we have asked the Treasury to identify any changes to future contingent liabilities as a result of new policy announcements since December. Contingent liabilities are not included in our forecasts, because they are future risks that could materialise but which are not currently expected to. The

Treasury has only made one new announcement that increases contingent liabilities in the future; support of debt for the Mersey Gateway Bridge project, provided through the UK Infrastructure Guarantee Scheme. We will continue to report on the broader suite of contingent liabilities, including updates on existing liabilities, in our annual *Fiscal sustainability reports*.

### Classification and accounting standards changes

4.30 From September 2014, the ONS will implement a number of changes to the public sector finances statistics. Following their review of the public sector finances, the ONS will introduce new measures that only exclude the debt and borrowing of public sector banks, as well as a number of other changes in the presentation of the data. In addition, there are a number of changes resulting from the introduction of the 2010 European System of Accounts (ESA10). We have provided further information on these changes and produced some illustrative forecasts of the effects on a number of key aggregates in Annex B. We will continue to present our forecasts on the same basis as the ONS produces outturn data. As a result, we intend to publish our autumn 2014 *EFO* forecast on the basis of the post ESA10 and PSF review measures of the public sector finances.

4.31 The International Accounting Standards Board (IASB) is finalising an accounting standard (IFRS9) which will change the basis for calculating impairment provisions for financial assets. This will raise the size of these provisions resulting in reduced corporation tax. Ahead of the publication of the standard and endorsement by the EU, the scale and timing of the impact is uncertain.

## Public sector receipts

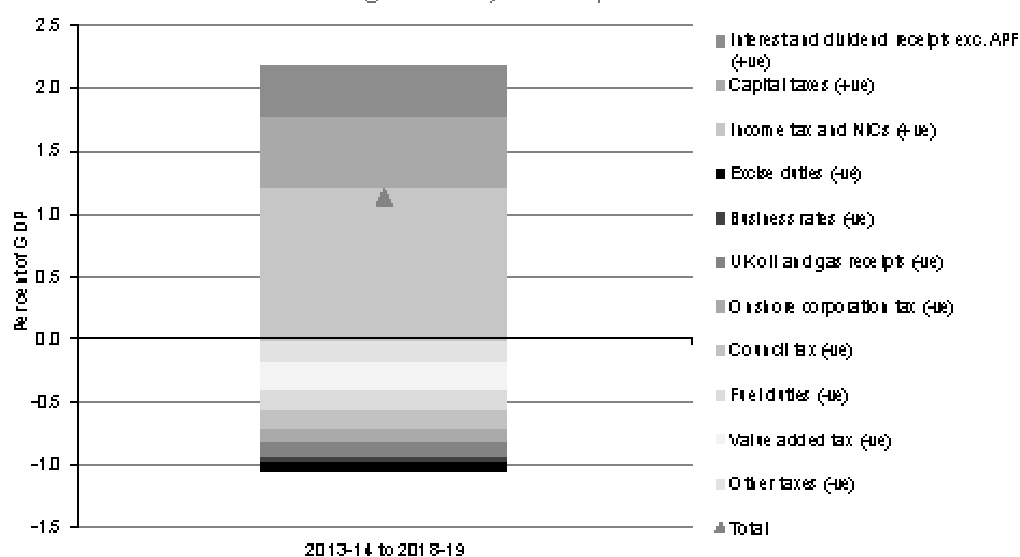
4.32 Public sector current receipts are expected to fall as a share of GDP in 2013-14, mainly as a result of lower income tax and NICs receipts. This is partly due to the £1,335 rise in the personal allowance, subdued earnings growth and the deferral of self-assessment income to take advantage of the reduction in the additional rate to 45p. A fall in oil and gas revenues has also contributed to the decline. From 2014-15 onwards, current receipts are expected to rise as a share of GDP and Chart 4.2 illustrates the sources of changes to underlying current receipts as a share of GDP by 2018-19. Table 4.4 summarises our central forecast for the major taxes as a share of GDP. Table 4.5 shows our detailed forecast for individual taxes and other receipts.

Table 4.4: Major receipts as a per cent of GDP

| | Per cent of GDP | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Income tax and NICs | 16.4 | 16.0 | 16.1 | 16.3 | 16.8 | 17.0 | 17.2 |
| Value added tax | 6.4 | 6.5 | 6.4 | 6.4 | 6.4 | 6.3 | 6.3 |
| Onshore corporation tax | 2.3 | 2.2 | 2.3 | 2.2 | 2.2 | 2.2 | 2.1 |
| UK oil and gas receipts | 0.4 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Fuel duties | 1.7 | 1.6 | 1.6 | 1.5 | 1.5 | 1.5 | 1.5 |
| Business rates | 1.7 | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 |
| Council tax | 1.7 | 1.7 | 1.6 | 1.6 | 1.5 | 1.5 | 1.5 |
| Excise duties | 1.3 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 |
| Capital taxes | 1.0 | 1.2 | 1.5 | 1.6 | 1.7 | 1.7 | 1.8 |
| Other taxes | 2.7 | 2.9 | 2.9 | 2.9 | 2.8 | 2.8 | 2.7 |
| National Accounts taxes | 35.5 | 35.2 | 35.2 | 35.5 | 35.8 | 35.9 | 35.9 |
| Interest and dividend receipts exc. APF | 0.5 | 0.4 | 0.4 | 0.5 | 0.7 | 0.7 | 0.8 |
| Other receipts | 1.4 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 |
| Current receipts exc. APF | 37.4 | 37.0 | 37.0 | 37.4 | 37.8 | 38.0 | 38.1 |
| APF dividend receipts | 0.4 | 0.7 | 0.7 | 0.4 | 0.2 | 0.0 | 0.0 |
| Current receipts | 37.8 | 37.7 | 37.7 | 37.8 | 38.0 | 38.0 | 38.1 |

4.33 Current receipts (on an underlying basis, excluding transfers from the APF) are expected to increase by 1.1 per cent of GDP between 2013-14 and 2018-19. Receipts that are increasing as a share of GDP add 2.2 per cent to the receipts-to-GDP ratio over this period. These are offset by steady declines in a number of other taxes, which offset the increase by 1.0 per cent of GDP.

Chart 4.2: Cumulative changes in major receipts as a share of GDP



4.34 The main drivers of increases in the receipts-to-GDP ratio come from:

- income tax and NICs, which increase as a share of GDP over the forecast as positive fiscal drag returns. On top of this, the Budget 2013 measure that abolished the NICs contracting out rebate raises NICs by 0.3 per cent of GDP from 2016-17 onwards;
- capital taxes, including stamp duty on land and shares, capital gains tax and inheritance tax, which are forecast to increase by half, from 1.2 to 1.8 per cent of GDP between 2013-14 and 2018-19. Stamp duty land tax contributes more than half of this increase as house prices and transactions continue to strengthen; and
- interest and dividend receipts, excluding APF transfers, as higher interest rates are earned on a rising stock of assets.

4.35 The main offsetting falls include:

- revenues from oil and gas producers, reflecting flat production and high operating and capital expenditure in the industry, which is tax deductible;
- onshore corporation tax, reflecting recent policy measures which lower the main rate to 20 per cent by 2015-16;
- VAT receipts, as the share of household spending on goods and services subject to the tax falls; and
- fuel duty, as improvements in vehicle efficiency and policy measures reduce growth in revenues.

Table 4.5: Current receipts

| | £ billion | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Income tax (gross of tax credits)[1] | 152.3 | 155.6 | 166.5 | 176.8 | 189.2 | 201.3 | 213.2 |
| *of which: Pay as you earn* | *132.0* | *135.5* | *140.2* | *148.2* | *158.1* | *168.6* | *179.1* |
| *Self assessment* | *20.6* | *20.9* | *27.2* | *29.0* | *31.2* | *32.8* | *34.0* |
| Tax credits (negative income tax) | -3.0 | -2.7 | -2.7 | -2.5 | -1.6 | -0.3 | 0.0 |
| National insurance contributions | 104.5 | 107.3 | 110.0 | 115.0 | 126.1 | 132.0 | 138.2 |
| Value added tax | 100.7 | 106.5 | 110.7 | 115.0 | 119.2 | 123.3 | 127.7 |
| Corporation tax[2] | 40.4 | 40.1 | 41.4 | 42.3 | 42.6 | 44.5 | 45.9 |
| *of which: Onshore* | *36.0* | *36.6* | *38.9* | *39.7* | *40.5* | *42.1* | *43.3* |
| *Offshore* | *4.4* | *3.6* | *2.5* | *2.6* | *2.2* | *2.4* | *2.6* |
| Corporation tax credits[3] | -0.9 | -1.0 | -0.9 | -0.8 | -0.8 | -0.8 | -0.9 |
| Petroleum revenue tax | 1.7 | 1.1 | 1.2 | 1.3 | 1.0 | 1.0 | 0.9 |
| Fuel duties | 26.6 | 26.8 | 26.8 | 27.2 | 28.3 | 29.1 | 29.8 |
| Business rates | 26.3 | 26.6 | 26.9 | 28.7 | 30.0 | 30.8 | 32.3 |
| Council tax | 26.3 | 27.1 | 27.6 | 28.0 | 28.9 | 29.8 | 30.8 |
| VAT refunds | 13.8 | 13.9 | 14.1 | 13.9 | 13.4 | 13.0 | 12.8 |
| Capital gains tax | 3.9 | 3.9 | 5.4 | 6.7 | 7.5 | 8.2 | 9.0 |
| Inheritance tax | 3.1 | 3.5 | 3.9 | 4.3 | 4.9 | 5.4 | 5.8 |
| Stamp duty land tax | 6.9 | 9.5 | 12.7 | 14.4 | 15.7 | 16.8 | 18.1 |
| Stamp taxes on shares | 2.2 | 3.1 | 3.1 | 3.2 | 3.2 | 3.3 | 3.3 |
| Tobacco duties | 9.6 | 9.7 | 9.9 | 10.1 | 10.3 | 10.6 | 10.9 |
| Spirits duties | 3.0 | 3.0 | 3.0 | 3.2 | 3.3 | 3.5 | 3.7 |
| Wine duties | 3.5 | 3.7 | 3.9 | 4.2 | 4.5 | 5.0 | 5.4 |
| Beer and cider duties | 3.6 | 3.7 | 3.5 | 3.5 | 3.6 | 3.7 | 3.7 |
| Air passenger duty | 2.8 | 3.0 | 3.2 | 3.1 | 3.3 | 3.6 | 3.9 |
| Insurance premium tax | 3.0 | 3.1 | 3.2 | 3.3 | 3.4 | 3.4 | 3.5 |
| Climate change levy | 0.7 | 1.3 | 2.0 | 2.5 | 2.3 | 2.2 | 2.1 |
| Other HMRC taxes[4] | 5.9 | 6.5 | 6.7 | 7.0 | 7.1 | 7.3 | 7.5 |
| Vehicle excise duties | 6.0 | 6.1 | 5.9 | 5.8 | 5.7 | 5.6 | 5.4 |
| Bank levy | 1.6 | 2.3 | 2.7 | 2.9 | 2.9 | 2.9 | 2.9 |
| Licence fee receipts | 3.1 | 3.1 | 3.2 | 3.2 | 3.2 | 3.3 | 3.4 |
| Environmental levies | 2.3 | 4.1 | 4.9 | 5.9 | 6.4 | 7.0 | 7.8 |
| Swiss capital tax | 0.0 | 0.9 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EU ETS auction receipts | 0.3 | 0.4 | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 |
| Other taxes | 6.6 | 6.8 | 6.9 | 7.0 | 6.7 | 6.7 | 6.5 |
| National Accounts taxes | 556.8 | 579.1 | 606.0 | 635.4 | 670.7 | 702.4 | 734.2 |
| *Less* own resources contribution to EU | -5.3 | -5.5 | -5.1 | -5.6 | -5.2 | -5.4 | -5.6 |
| Interest and dividends exc. APF | 8.0 | 6.8 | 7.7 | 9.5 | 12.5 | 14.7 | 16.6 |
| Gross operating surplus | 27.6 | 28.3 | 28.9 | 30.0 | 31.3 | 32.6 | 33.8 |
| Other receipts | -0.2 | -1.0 | -1.0 | -1.1 | -1.2 | -1.2 | -1.3 |
| Current receipts exc. APF | 586.9 | 607.7 | 636.5 | 668.2 | 708.1 | 742.9 | 777.7 |
| APF dividend receipts | 6.4 | 12.2 | 11.6 | 7.2 | 2.9 | 0.4 | 0.0 |
| Current receipts | 593.4 | 619.8 | 648.1 | 675.4 | 711.0 | 743.4 | 777.7 |
| *Memo: UK oil and gas revenues*[5] | *6.1* | *4.7* | *3.7* | *3.8* | *3.2* | *3.4* | *3.5* |

[1] Includes PAYE and self assessment and also includes tax on savings income and other minor components.

[2] National Accounts measure, gross of reduced liability tax credits.

[3] Includes reduced liability company tax credits.

[4] Consists of landfill tax, aggregates levy, betting and gaming duties and customs duties and levies.

[5] Consists of offshore corporation tax and petroleum revenue tax.

Note: Table is on accruals basis in line with national accounts definitions.

Table 2.8 in the online supplementary tables presents receipts on a cash basis.

Table 4.6: Changes to current receipts since December

| | £ billion | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Income tax (gross of tax credits)[1] | 0.0 | 0.1 | -0.7 | -1.1 | -0.4 | 0.2 | -0.8 |
| *of which: Pay as you earn* | 0.0 | 0.6 | 0.6 | -0.2 | 0.4 | 0.8 | 0.3 |
| *Self assessment* | 0.0 | 0.1 | -0.2 | 0.4 | 0.7 | 0.8 | 0.4 |
| Tax credits (negative income tax) | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 |
| National insurance contributions | 0.0 | 0.4 | 0.8 | 1.5 | 1.7 | 1.4 | 1.1 |
| Value added tax | 0.0 | 0.3 | 0.9 | 1.3 | 1.5 | 1.5 | 1.6 |
| Corporation tax[2] | 0.0 | 0.6 | -0.1 | 0.3 | 0.2 | 0.6 | 1.2 |
| *of which: Onshore* | 0.4 | 0.8 | 0.6 | 0.5 | 0.4 | 0.9 | 1.4 |
| *Offshore* | -0.4 | -0.2 | -0.7 | -0.3 | -0.2 | -0.3 | -0.2 |
| Corporation tax credits[3] | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Petroleum revenue tax | 0.0 | -0.2 | -0.2 | -0.1 | -0.2 | -0.2 | -0.2 |
| Fuel duties | 0.0 | 0.0 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Business rates | 0.2 | 0.0 | -0.1 | -0.2 | -0.3 | -0.1 | -0.1 |
| Council tax | 0.0 | 0.0 | 0.0 | -0.1 | -0.1 | -0.2 | -0.2 |
| VAT refunds | 0.0 | 0.1 | 0.4 | 0.5 | 0.1 | 0.1 | 0.3 |
| Capital gains tax | 0.0 | -1.1 | -1.3 | -1.3 | -1.5 | -1.6 | -1.8 |
| Inheritance tax | 0.0 | 0.0 | 0.0 | 0.1 | 0.2 | 0.2 | 0.2 |
| Stamp duty land tax | 0.0 | 0.6 | 1.9 | 1.9 | 1.8 | 1.6 | 1.3 |
| Stamp taxes on shares | 0.0 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Tobacco duties | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 |
| Spirits duties | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Wine duties | 0.0 | 0.0 | -0.1 | -0.1 | 0.0 | -0.1 | -0.1 |
| Beer and cider duties | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | -0.1 | 0.0 |
| Air passenger duty | 0.0 | -0.1 | 0.0 | -0.3 | -0.3 | -0.4 | -0.4 |
| Insurance premium tax | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Climate change levy | 0.0 | -0.3 | -0.1 | -0.1 | -0.5 | -0.7 | -0.9 |
| Other HMRC taxes[4] | 0.0 | 0.2 | 0.2 | 0.0 | 0.0 | -0.1 | -0.1 |
| Vehicle excise duties | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Bank levy | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 |
| Licence fee receipts | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 |
| Environmental levies | 0.0 | 0.0 | 0.2 | 0.3 | 0.0 | -0.5 | -0.9 |
| Swiss capital tax | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EU ETS auction receipts | 0.0 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other taxes | 0.0 | 0.7 | 0.2 | 0.2 | 0.2 | 0.1 | 0.0 |
| National Accounts taxes | 0.2 | 1.8 | 2.4 | 3.4 | 3.1 | 2.8 | 1.1 |
| *Less* own resources contribution to EU | 0.0 | -0.5 | -0.1 | -0.4 | -0.2 | -0.2 | -0.2 |
| Interest and dividends exc. APF | 0.0 | -0.3 | -0.3 | -0.3 | -0.2 | -0.4 | -0.9 |
| Gross operating surplus | -0.2 | 0.0 | 0.1 | 0.1 | 0.2 | 0.5 | 0.9 |
| Other receipts | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Current receipts exc. APF | 0.0 | 1.1 | 2.0 | 2.8 | 2.9 | 2.6 | 0.8 |
| APF dividend receipts | 0.0 | 0.0 | -0.5 | -0.2 | -0.3 | 0.0 | 0.0 |
| Current receipts | 0.0 | 1.1 | 1.5 | 2.6 | 2.6 | 2.6 | 0.8 |
| *Memo: UK oil and gas revenues[5]* | *-0.4* | *-0.4* | *-0.9* | *-0.4* | *-0.3* | *-0.5* | *-0.4* |

[1] Includes PAYE and self assessment receipts, and also includes tax on savings income and other minor components.
[2] National Accounts measure, gross of reduced liability tax credits.
[3] Includes reduced liability company tax credits.
[4] Consists of landfill tax, aggregates levy, betting and gaming duties and customs duties and levies.
[5] Consists of offshore corporation tax and petroleum revenue tax.

### Changes in the 2013-14 receipts forecast since December

4.36 Our forecast for current receipts in 2013-14 is £1.1 billion higher than in December. This mainly reflects higher-than-expected receipts from corporation tax paid by industrial and commercial companies, PAYE income tax and NICs and stamp duty land tax. This is partly offset by much lower receipts from capital gains tax and lower oil and gas revenues.

### Changes in the medium-term underlying receipts forecast since December

4.37 Our forecast for public sector current receipts, excluding APF transfers, is higher in each year than in December. The upward revision increases from £2.0 billion in 2014-15 to £2.6 billion in 2017-18, before falling back to £0.8 billion, by 2018-19. The biggest upward revisions are for stamp duty land tax, onshore corporation tax and VAT. This reflects upward revisions to our forecast for nominal consumption and company profits, as well as the strength of the residential property market.

4.38 The main downward revisions come from lower capital gains tax, largely due to the weakness in outturn receipts in 2013-14, and from lower oil and gas revenues.

4.39 Table 4.6 shows the changes in individual taxes since December and Table 4.7 breaks down these changes into those that result from revised economic determinants, changes to modelling and underlying assumptions, and the effect of policy measures announced in the Budget. We explain the changes in individual taxes in the next section of this chapter.

4.40 In summary, most of the main receipts streams have been revised up:

- VAT, reflecting our forecast for higher nominal consumption than in December;
- onshore corporation tax, reflecting higher outturn receipts in 2013-14 and an upward revision to our forecast for industrial and commercial company profits in 2014-15, which offsets the effect of our forecast for increased company investment;
- stamp duty land tax, which continues to increase with strength in transactions and prices in the residential property market, particularly in London; and
- PAYE income tax and NICs are higher in each year, reflecting higher wages and salaries.

Table 4.7: Changes to the receipts forecast since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast[1] | 606.6 | 634.5 | 665.3 | 705.2 | 740.3 | 776.8 |
| March forecast[1] | 607.7 | 636.5 | 668.2 | 708.1 | 742.9 | 777.7 |
| Change | 1.1 | 2.0 | 2.8 | 2.9 | 2.6 | 0.8 |
| *of which:* | | | | | | |
| Income and expenditure | 0.5 | 1.4 | 2.1 | 2.8 | 2.7 | 2.0 |
| Wages and salaries | 0.3 | 0.3 | 0.4 | 1.1 | 1.0 | 0.5 |
| Non-financial company profits | 0.0 | 0.7 | 1.2 | 0.8 | 0.5 | 0.2 |
| Consumer expenditure | 0.1 | 0.6 | 0.8 | 1.0 | 1.1 | 1.0 |
| Investment | 0.1 | -0.1 | -0.5 | -0.5 | -0.5 | -0.6 |
| Other | 0.0 | -0.1 | 0.2 | 0.3 | 0.6 | 0.9 |
| North Sea | 0.2 | -0.8 | -0.3 | -0.2 | -0.4 | -0.2 |
| Production | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.1 |
| Oil and gas prices | 0.1 | -0.4 | -0.1 | -0.2 | -0.3 | -0.2 |
| Expenditure | 0.0 | -0.5 | -0.2 | 0.0 | -0.1 | -0.1 |
| Market assumptions | 0.5 | 1.6 | 2.0 | 2.2 | 2.3 | 2.2 |
| Residential property market | 0.3 | 1.2 | 1.4 | 1.5 | 1.5 | 1.3 |
| Commercial property market | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Equity market | 0.0 | 0.2 | 0.4 | 0.4 | 0.5 | 0.6 |
| Interest rates | 0.0 | -0.1 | 0.0 | 0.1 | 0.1 | 0.1 |
| Prices | 0.0 | -0.1 | -0.1 | 0.0 | 0.0 | -0.1 |
| Other economic determinants | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 |
| Other assumptions | -0.3 | -0.1 | -0.5 | -0.3 | -0.8 | -1.4 |
| IT and NICs receipts and modelling | 0.4 | -0.4 | -0.1 | 0.4 | 0.5 | -0.3 |
| CGT modelling and outturns | -1.1 | -1.5 | -1.7 | -1.9 | -2.1 | -2.3 |
| Corporation tax receipts and modelling | 0.8 | 0.3 | 0.2 | 0.7 | 0.8 | 1.4 |
| VAT receipts and modelling | 0.1 | 0.2 | 0.5 | 0.4 | 0.5 | 0.5 |
| North Sea receipts and modelling | -0.5 | -0.2 | -0.2 | -0.1 | -0.2 | -0.2 |
| Interest and dividend receipts and modelling | -0.3 | -0.4 | -0.4 | -0.4 | -0.5 | -0.9 |
| Environmental taxes and levies | -0.1 | 0.5 | 0.4 | 0.0 | -0.4 | -0.7 |
| Stamp duty on shares judgement | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Stamp duty land tax judgement | 0.0 | 0.6 | 0.4 | 0.3 | 0.1 | 0.1 |
| Gross operating surplus | 0.0 | 0.1 | 0.1 | 0.2 | 0.5 | 0.9 |
| High income child benefit charge costing | -0.1 | -0.2 | -0.2 | -0.2 | -0.3 | -0.3 |
| VAT refunds | 0.1 | 0.4 | 0.5 | 0.1 | 0.1 | 0.3 |
| Other judgements and modelling | 0.3 | 0.2 | -0.2 | 0.0 | -0.1 | -0.1 |
| Budget measures | 0.0 | 0.0 | -0.6 | -1.8 | -1.4 | -1.7 |

[1] Excludes APF dividend receipts.

## Tax-by-tax analysis

### Income tax and NICs

4.41 Receipts of income tax and NICs in 2013-14 are expected to be £0.6 billion higher than in the December forecast. We have revised up PAYE and NIC receipts on employee salaries by £1.1 billion, while self-assessment (SA) income tax (which has

been subject to large forecast errors in recent years) is £0.1 billion higher than we expected. The final PAYE and NIC outturn for 2013-14 remains uncertain, given that the majority of financial sector bonuses are usually paid out in February and March, with HMRC receiving the tax in March and April. We have assumed that financial sector bonuses will be unchanged between 2012-13 and 2013-14.

Table 4.8: Key changes to the income tax and NICs forecast since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | 262.4 | 276.4 | 291.4 | 313.9 | 331.7 | 351.2 |
| March forecast | 262.9 | 276.5 | 291.8 | 315.3 | 333.3 | 351.4 |
| Change | 0.6 | 0.0 | 0.4 | 1.4 | 1.6 | 0.3 |
| *of which:* | | | | | | |
| *(by economic determinant)* | | | | | | |
| Average earnings | 0.4 | -0.3 | -0.5 | -0.1 | -0.1 | 0.3 |
| Employee numbers | -0.1 | 0.5 | 1.0 | 1.1 | 1.0 | 0.2 |
| RPI inflation | 0.0 | -0.1 | 0.2 | 0.2 | 0.2 | 0.1 |
| SA determinants | 0.0 | -0.2 | -0.2 | 0.0 | 0.4 | 0.6 |
| Other determinants | 0.1 | 0.3 | 0.3 | 0.3 | 0.3 | 0.4 |
| *(by other category)* | | | | | | |
| Latest receipts data | 0.2 | 0.0 | 0.1 | 0.3 | 0.3 | 0.4 |
| Other modelling updates | 0.2 | 0.0 | -0.1 | -0.1 | -0.1 | -1.1 |
| Revised high income child benefit charge costing | -0.1 | -0.2 | -0.2 | -0.2 | -0.3 | -0.3 |
| Revised Lichtenstein Disclosure Facility costing | -0.1 | -0.4 | -0.1 | 0.0 | 0.0 | 0.0 |
| Effect from Tax-Free Childcare | 0.0 | 0.0 | 0.0 | 0.1 | 0.3 | 0.4 |
| Budget measures | 0.0 | 0.3 | 0.1 | -0.4 | -0.5 | -0.7 |

4.42 PAYE and NIC receipts have been falling as a share of GDP in recent years, reflecting subdued earnings growth and policy measures, particularly the rises in the personal allowance. A further drop in this ratio is likely in 2014-15 given the rise in the personal allowance to £10,000 from April 2014 and continued modest wage growth. A further rise in the personal allowance to £10,500 from April 2015 announced in the Budget will lower PAYE receipts in 2015-16. Thereafter, PAYE and NIC receipts are expected to rise by 0.8 per cent of GDP, reflecting stronger earnings growth, the return of positive fiscal drag from earnings rising faster than tax thresholds and allowances, and the abolition of contracting out in 2016-17, which is forecast to raise NICs by around £5½ billion.

4.43 SA income tax receipts are estimated to have risen by 1.7 per cent in 2013-14, close to our December forecast. SA receipts that related to 2012-13 liabilities were affected by some individuals shifting income from 2012-13 into 2013-14 to take advantage of the reduction in the additional rate of income tax to 45p. This income shifting will boost receipts in 2014-15 when tax on 2013-14 liabilities is paid.

Thereafter, we expect SA receipts to be boosted by higher dividend and savings income, reflecting stronger profits and a higher path for interest rates in the later years of the forecast. SA receipts, particularly from 2015-16, will also be boosted by policy measures. The yield from the Budget 2013 and Autumn Statement 2013 measures on partnerships and the measures in this Budget and Autumn Statement 2013 designed to accelerate payments in follower cases, where taxpayers will have to pay disputed tax up front if HMRC win a test legal case, are expected to yield in total around £2 billion in 2015-16. As with all anti-avoidance measures, the yield from these measures is subject to considerable uncertainty.

4.44 We have revised a number of policy costings since the December forecast. Indications from SA returns suggest that the high-income child benefit charge, which recovers child benefit from some families with a higher rate taxpayer via the income tax system, is raising less than anticipated. This is likely due to a combination of: the survey data used previously overestimating the number of households affected; more customers failing to declare their liability than previously estimated; and a larger than expected behavioural response. We have revised total receipts down by £0.2 billion to £0.3 billion a year. We have also looked again at receipts from the Liechtenstein Disclosure Facility, which is designed to encourage UK investors with unpaid tax liabilities linked to offshore accounts to disclose and settle liabilities with HMRC. Receipts between 2014-15 and 2016-17 are likely to be around £0.5 billion lower in total than previously expected. We have also included the tax effects from the Budget 2013 move to the new tax-free childcare scheme (which will score as AME spending). The current employer-supported childcare scheme will be closed to new entrants from autumn 2015. This will reduce the tax relief granted through the scheme and raise receipts by around £0.4 billion by the end of the forecast.

4.45 The Budget announced a number of measures to reduce the income tax paid on savings income. Most tax on savings is collected through SA and the Tax Deduction Scheme for Interest (TDSI). Revenues from TDSI had dropped from a peak of £4.4 billion prior to the crisis to around £1.9 billion in 2013-14. With interest rates assumed to rise through the forecast period, we would have expected receipts to recover to £4.0 billion by 2018-19 in the absence of new measures. The measures announced in Budget 2014 will mean a more limited rise in TDSI receipts to £3.4 billion by 2018-19.

### VAT

4.46 Accrued VAT receipts are expected to have risen by 5.8 per cent in 2013-14, helped by the pick-up in nominal consumer spending in 2013 and a lower VAT gap. The VAT gap is the difference between the theoretical level of VAT payments and the actual receipts received by HMRC. Compared with the December forecast, accrued VAT receipts are expected to be £0.3 billion higher in 2013-14. By 2018-19, accrued VAT receipts are expected to be £1.6 billion higher, with the main factor being the higher level of nominal consumer spending.

4.47 Growth in VAT receipts is expected to slow in 2014-15 reflecting some easing in the momentum of nominal consumer spending through the year. Thereafter, growth in VAT receipts is expected to rise by less than nominal GDP and fall from 6.5 per cent of GDP in 2013-14 to 6.3 per cent of GDP by 2018-19. We assume that the VAT gap remains constant from 2014-15 onwards, but cuts in government spending will reduce VAT payments by the government itself. The share of household spending subject to the standard rate of VAT is expected to decline over the forecast period, as households spend relatively more on housing costs, which are not subject to VAT.

Table 4.9: Key changes to the VAT forecast since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | 106.2 | 109.8 | 113.7 | 117.7 | 121.8 | 126.1 |
| March forecast | 106.5 | 110.7 | 115.0 | 119.2 | 123.3 | 127.7 |
| Change | 0.3 | 0.9 | 1.3 | 1.5 | 1.5 | 1.6 |
| *of which:* | | | | | | |
| Household spending | 0.2 | 0.7 | 0.7 | 1.0 | 1.1 | 1.0 |
| Latest receipts | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| VAT debt | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| SRS of consumer spending | 0.0 | 0.1 | 0.4 | 0.3 | 0.3 | 0.4 |
| Other spending | 0.0 | 0.0 | 0.1 | 0.1 | 0.0 | 0.1 |

### Onshore corporation tax

4.48 Higher receipts from industrial and commercial companies more than explain the £0.8 billion rise in onshore corporation tax in 2013-14. Receipts from the sector have been boosted by an estimated 7.0 per cent rise in non-oil, non-financial profits in 2013. This has helped offset the effects of the reduction in the main rate of corporation tax from 24 per cent in 2012-13 to 23 per cent in 2013-14, the introduction of the Patent Box and the initial increase in the annual investment allowance.

Table 4.10: Key changes to the onshore corporation tax forecast since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | 35.8 | 38.2 | 39.1 | 40.1 | 41.2 | 41.9 |
| March forecast | 36.6 | 38.9 | 39.7 | 40.5 | 42.1 | 43.3 |
| Change | 0.8 | 0.6 | 0.5 | 0.4 | 0.9 | 1.4 |
| *of which:* | | | | | | |
| Industrial and commercial company profits | 0.0 | 0.7 | 1.2 | 0.8 | 0.5 | 0.2 |
| Industrial and commercial company investment | 0.0 | -0.1 | -0.2 | -0.3 | -0.4 | -0.4 |
| Other economic determinants | 0.0 | -0.2 | -0.2 | -0.2 | -0.1 | -0.1 |
| Reallocation from North Sea to Onshore CT | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Modelling updates and latest receipts data | 0.6 | 0.1 | 0.0 | 0.5 | 0.6 | 1.2 |
| Budget measures | 0.0 | 0.0 | -0.3 | -0.7 | 0.1 | 0.3 |

4.49 Compared to December, we have revised up our forecast for onshore corporation tax in each year. The effect from stronger non-oil, non-financial profit growth is partly offset by higher investment, which raises capital allowance claims against taxable profits, and by policy changes. Continued strong profit growth in 2014 is the main driver of the rise in receipts in 2014-15, countering the 2 per cent reduction in the main rate of corporation tax to 21 per cent from April 2014. The further cut in the main rate to 20 per cent from April 2015 and the increase of the annual investment allowance to £500,000 and extension to December 2015 reduce onshore corporation tax receipts growth further out.

4.50 Corporation tax receipts from the financial sector fell further in 2013-14 to around £4.5 billion. This is less than half their peak level in 2006-07. In contrast, receipts from industrial and commercial companies are already higher than their pre-crisis peak. We expect receipts from the financial sector to remain low throughout the forecast period, reflecting subdued profit growth, the cuts in the main rate of corporation tax and the high level of losses being carried forward and used against taxable profits.

4.51 Although profits growth is slightly above nominal GDP growth across the forecast, this is outweighed by the combined effect of rate cuts, higher investment allowances and other policy measures. As a result onshore CT receipts fall from 2.3 per cent of GDP in 2012-13 to 2.1 per cent in 2018-19.

## UK oil and gas revenues

4.52 Receipts from UK oil and gas companies in 2013-14 are expected to fall by 24 per cent to £4.7 billion. This compares with receipts of around £11 billion just two years earlier. The sharp fall in receipts primarily reflects the fall in oil and gas production and a 60 per cent rise in capital expenditure over the past two years. Sterling oil prices were broadly flat between 2011 and 2013. Gas prices were flat between 2011 and 2012, but rose 13 per cent in 2013. Oil and gas production fell by around

8 per cent in 2013, after a 14 per cent drop in the previous year. Spending on several large projects, and strong cost pressures are the main drivers for the sharp rise in capital and operating expenditure. With 100 per cent first year allowances available to oil and gas firms, higher investment leads to an immediate reduction in receipts.

Table 4.11: Key changes to the oil and gas revenues forecast since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | 5.0 | 4.6 | 4.2 | 3.5 | 3.9 | 4.0 |
| March forecast | 4.7 | 3.7 | 3.8 | 3.2 | 3.4 | 3.5 |
| Change | -0.4 | -0.9 | -0.4 | -0.3 | -0.5 | -0.4 |
| *of which:* | | | | | | |
| Oil and gas production | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.1 |
| Sterling oil prices | 0.0 | 0.1 | 0.0 | -0.1 | -0.1 | -0.1 |
| Gas prices | 0.1 | -0.5 | -0.1 | -0.1 | -0.2 | -0.1 |
| Expenditure | 0.0 | -0.5 | -0.2 | 0.0 | -0.1 | -0.1 |
| Reallocation from North Sea to Onshore CT | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 |
| Modelling and other | -0.3 | 0.1 | 0.0 | 0.1 | 0.1 | 0.0 |

4.53 Receipts in 2013-14 are now expected to be around £0.4 billion lower than we assumed in the December forecast, with petroleum revenue tax and offshore corporation tax each accounting for around half of the shortfall. The shortfall on offshore corporation tax comes from a re-allocation of £0.2 billion of receipts to onshore corporation tax. This reflects updated information on the allocation of receipts between ring-fenced and non-ring-fenced activities of oil and gas companies (i.e. tax on profits from oil and gas production to tax on profits arising from supplying gas and electricity or running petrol stations).

4.54 Compared with our December forecast, UK oil and gas revenues are expected to be £0.9 billion lower in 2014-15 and then up to £0.5 billion lower each year over the rest of the forecast period. Operating expenditure by oil and gas firms was higher than expected in 2013. We are now assuming continued higher operating expenditure throughout the forecast period, based on recent industry forecasts. The steeper downward revision in 2014-15 reflects gas prices around 7p a therm lower than in the December forecast.

4.55 Our forecast continues to project falling oil and gas revenues, reaching £3.5 billion in 2018-19. This is primarily due to oil futures indicating lower oil prices over the next two years. Oil and gas production is expected to be flat between 2014-15 and 2018-19, as the current high levels of capital expenditure prevent further falls in production. By 2018-19 oil and gas revenues will be 0.2 per cent of GDP, compared to the recent high of 0.7 per cent in 2011-12.

### Stamp duties

4.56 Stamp duty land tax (SDLT) is forecast to increase from £9.5 billion in 2013-14 to £18.1 billion in 2018-19. In December, we increased our forecast for 2013-14 by £1.1 billion, reflecting strength in the housing market. In this forecast we have increased this estimate again, by a further £0.6 billion, as the housing market, particularly in London, has continued to outperform our forecast and receipts have been higher than expected.

4.57 In the medium term, the strength in the housing market feeds into even higher receipts, as the average UK house price moves above the threshold for the 3 per cent rate, pushing receipts per transaction up sharply. Higher house prices, relative to our December forecast, add around £0.9 billion to receipts by 2018-19. Box 4.2 describes some of the drivers in stamp duty land tax in more detail. SDLT increases from 0.4 per cent of GDP in 2012-13 to 0.9 per cent of GDP in 2018-19.

4.58 Stamp duty on shares is expected to increase across the forecast, reflecting rising equity prices, which are assumed to move in line with nominal GDP. The volume of share transactions subject to the duty is on a declining path, which we have built into our forecast. Changes since December reflect stronger-than-expected receipts in the year-to-date, which are assumed to persist throughout the forecast.

### Taxes on capital

4.59 We now have information on capital gains tax (CGT) receipts paid in early 2014, which reflect asset disposals in 2012-13. This suggests that CGT receipts were much weaker than we anticipated in December, resulting in a downward revision to our forecast for 2013-14 of £1.1 billion. This may be due to the weakness of the economy during 2012-13 affecting the number and value of disposals. By 2018-19, CGT receipts are expected to be £1.8 billion lower than in our December forecast, reflecting the effect of the lower starting point. CGT receipts are still expected to grow strongly over the forecast, reflecting growth in house and equity prices.

4.60 Inheritance tax receipts are expected to grow by an average of nearly 11 per cent a year between 2014-15 and 2018-19. This reflects our forecast for house and equity prices and the stock of household deposits, as described in more detail in Box 4.2, and the effect of freezing the nil rate band until 2017-18. Our forecast for inheritance tax receipts is slightly higher than in December, mainly reflecting the upward revision to the forecast for house prices.

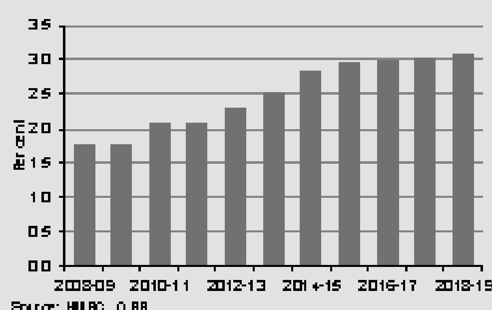
### Box 4.2: Receipts from capital taxes

Receipts from capital taxes – which include capital gains tax (CGT), inheritance tax (IHT), stamp duty land tax (SDLT) and stamp duty on shares – are expected to rise sharply from 1.0 per cent of GDP in 2012-13 to 1.8 per cent of GDP by 2018-19. This would be higher than their 1.6 per cent of GDP peak in 2007-08, prior to the financial

crisis. This reflects rising asset prices over the forecast period and the structure of the particular taxes.

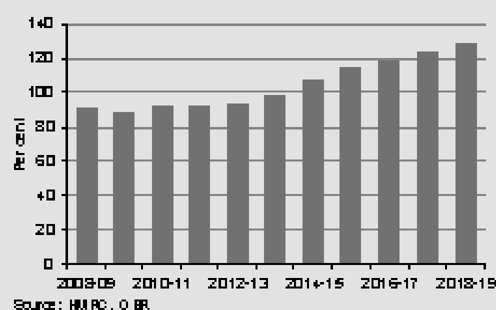
SDLT receipts are expected to have risen by 37 per cent in 2013-14. This reflects the rebound in property transactions from depressed levels as credit conditions have eased, strong house price inflation in London (which already accounts for over 40 per cent of total SDLT) and the tax structure of SDLT. With a 'slab' structure, where you pay one rate on the whole property price, and fixed nominal thresholds, SDLT is highly geared to changes in house prices. In particular, with the rate of stamp duty rising from 1 per cent to 3 per cent at a threshold of £250,000 the amount of stamp duty paid on a transaction rises from £2,500 for a transaction worth £250,000 to £7,500 for one worth £1 more. We now expect the average house price to exceed the 3 per cent threshold for the first time this year. The average effective tax rate on SDLT is expected to rise from 1.7 per cent in 2008-09 to over 3 per cent by the end of the forecast period.

Chart A: Stamp duty land tax effective tax rate




Source: HMRC, OBR

Chart B: Average house prices as a proportion of the 3 per cent threshold

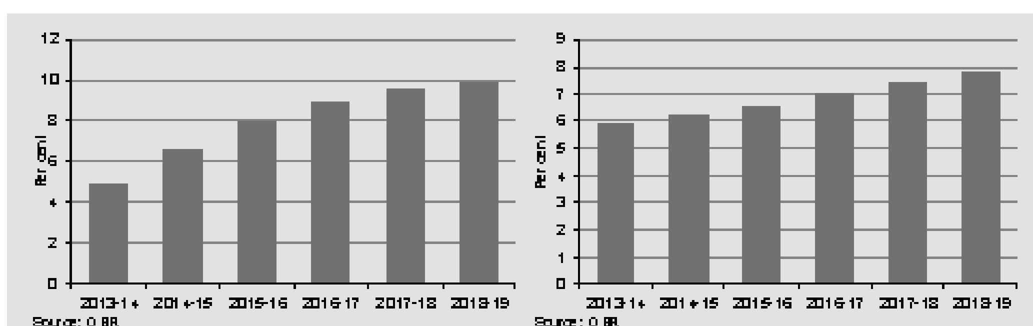



Source: HMRC, OBR

With housing accounting for around 50 per cent of estates notified for probate, the recovery in house prices over the past year has also helped to generate an 11 per cent rise in inheritance tax receipts in 2013-14. Further rises in house prices, equity prices and the stock of household deposits over the forecast period and the tax structure of IHT are expected to drive a rise of nearly 70 per cent in IHT receipts by 2018-19. The nil-rate band of £325,000 and transferable nil rate (for widows and widowers) of a further £325,000 are both being frozen until the end of 2017-18. Our forecast suggests that the proportion of deaths resulting in estates large enough to attract IHT liabilities will double over the next five years from a little under one in 20 to a little under one in ten. The effective tax rate on estates that attract IHT will also increase, largely as IHT is paid on a bigger proportion of the overall estate.[9] However, these effects would be partly offset by a roughly 40 per cent fall in the average size of estates, as a larger number of relatively smaller estates are brought into IHT.

Chart C: Share of deaths subject to IHT

Chart D: Inheritance tax effective tax rate




Although CGT was flat in 2013-14, we expect yield from the tax to more than double by 2018-19. CGT is highly geared to changes in equity prices since around three-quarters of chargeable gains are related to financial assets and CGT is only charged on the gain rather than the whole disposal price. We assume equity prices will rise from their current starting point in line with nominal GDP.

[a] The effective tax rate is calculated as a proportion of the total net chargeable value of estates where probate is granted.

### Fuel duties

4.61 The volume of fuel clearances is on a long-term downward trend, reflecting the increasing fuel efficiency of motor vehicles. Total clearances fell 10 per cent in the decade to 2012-13, with lower petrol clearances more than offsetting a rise in diesel clearances.

4.62 Fuel duty revenues in each year between 2011-12 and 2015-16 are below their 2010-11 level, helped by the reduction in the duty rate in April 2011 and subsequent duty freezes. The next duty rate rise, planned for September 2015, means that receipts are expected to grow by 1.3 per cent in 2015-16. From April 2016 onwards duty rate rises are assumed to be in line with RPI inflation, leading to receipts growth of 3.2 per cent on average between 2016-17 and 2018-19.

### Alcohol and tobacco duties

4.63 Alcohol duty is expected to increase from £10.4 billion to £12.8 billion between 2013-14 and 2018-19. Within this total, receipts from wine and spirits are expected to add £1.6 billion and £0.7 billion respectively, while beer and cider duties are expected to be up just £0.1 billion. This partly reflects the announcement of a 1p cut in beer duty in the Budget, but also that we expect the downward trend seen in recent years to continue over the forecast period. Clearances of beer have fallen by over 25 per cent in the ten years to 2012-13.

4.64 We expect receipts from tobacco duty to increase from £9.7 billion in 2013-14 to £10.9 billion in 2018-19. While a long-term decline in tobacco clearances reduces

tax revenues, increases in the duty rate paid on tobacco more than offset that fall. Following the Budget 2014 announcement, tobacco duty rates are planned to increase by 2 per cent above RPI inflation in each year of the forecast.

### Other taxes

4.65 **Business rates** are calculated by multiplying the rateable value of non-domestic property by the multiplier (the proportion of the rateable value due in tax). The multiplier is uprated in line with RPI inflation from 2015-16 onwards. Revenues are expected to increase from £26.6 billion in 2013-14 to £32.3 billion in 2018-19. However, we expect only modest growth in receipts from business rates in 2014-15, reflecting the announcements in Autumn Statement 2013. These include a one-year extension of the doubling of small business rates relief, the £1,000 discount for many smaller shops, pubs and restaurants and the 2 per cent cap on the multiplier increase for 2014-15.

4.66 In this forecast, we have taken on new information on the cost of a range of measures. We now have outturn data from local authorities on the take-up of Enterprise Zone relief, introduced in Budget 2011. We have reduced our forecast for the cost of reliefs on Enterprise Zones from £30 million in 2015-16 to just £6 million, a reduction of around 80 per cent. This evidence was reflected in the related Budget 2014 policy announcement.

4.67 Receipts from **council tax** are expected to be slightly lower than we forecast in December, by around £0.2 billion in 2018-19. Assumptions and changes relating to council tax are explained in more detail in the expenditure section of this chapter. Changes in council tax receipts are offset within the locally financed expenditure forecast, and are therefore neutral for net borrowing.

4.68 Where claimants of **tax credits** pay income tax, the amount of personal tax credit that offsets all or some of the tax they would otherwise have paid is classified as negative tax. This negative tax element is subject to the Government's new welfare cap. The negative tax share falls to zero in the final year of the forecast as claimants are assumed to migrate onto Universal Credit, which will be entirely classified as spending.

4.69 **Air passenger duty (APD)** receipts are expected to rise from £3.0 billion in 2013-14 to £3.9 billion in 2018-19. Growth in APD receipts reflects duty rate rises and growth in passenger numbers. Our forecast is slightly lower than in December, reflecting lower-than-expected receipts for the year-to-date and the Budget announcement halving the number of APD bands, which reduces receipts by £0.2 billion a year on average from 2015-16.

4.70 **Vehicle excise duty** is levied annually on road vehicles and is based on the amount of carbon emissions produced by different types of vehicles. Revenues are expected to fall over the forecast period, as increases in fuel efficiency reduce the

average duty rate paid. Our forecast is slightly higher than in December, reflecting the latest information on receipts in the year-to-date.

4.71 **Environmental levies** include levy-funded spending policies such as the Renewables Obligation (RO) and Contracts for Difference, Feed-In tariffs and the Warm Homes Discount, as well as revenues from the Carbon Reduction Commitment. The rise in the environmental levies across the forecast reflects the expected rise in electricity generation from renewable sources. The downward revisions to our forecast since December for the later years mainly reflect project delays reducing income from Contracts for Difference. Receipts from the Carbon Reduction Commitment are also slightly lower, reflecting a revised path for emissions.

4.72 **Environmental taxes** include the aggregates levy, climate change levy (including the carbon price floor), landfill tax and the EU emissions trading scheme (EU ETS). The Budget announcements on the carbon price floor reduce receipts by £0.9 billion by 2018-19.

4.73 Receipts from the **bank levy** are expected to be close to our December forecast throughout the forecast period. Receipts are forecast to rise from £2.3 billion in 2013-14 to £2.9 billion by 2018-19.

4.74 **VAT refunds** to central and local government are fiscally neutral as they are offset within spending. The forecast for VAT refunds largely reflects the path of government procurement and investment plans. VAT refunds are forecast to fall by an average of 1.6 per cent a year between 2014-15 and 2018-19.

4.75 We incorporate a provision for **losses related to tax litigation** in our receipts forecast. Once cases are settled, and their effects in particular years can be quantified, they are incorporated into forecasts of specific taxes. The magnitude and timing of losses is difficult to forecast as it depends on the nature of the judgement and the response from the Government. In some cases, it may represent an upside risk for the Government. We assume future litigation losses across all taxes will total £3.6 billion over the forecast period.

### Other receipts

4.76 **Interest and dividend** receipts capture interest income on the government's stock of financial assets. Receipts (excluding the dividend flows from the APF) are expected to more than double between 2013-14 and 2018-19. This reflects market expectations of the path of interest rates and that the stock of government assets is substantially higher than prior to the crisis. The Government holds larger foreign exchange reserves, more deposits at the Debt Management Office and a bigger stock of student loans. Compared with our December forecast, we expect interest and dividend receipts (excluding APF flows) to be lower over the forecast period by between £0.3 billion and £0.9 billion. The downward revision reflects modelling

changes and lower earnings on foreign exchange reserves, in part due to market expectations that euro area interest rates will stay lower for longer.

4.77 Our forecast for **gross operating surplus** (GOS) comprises our forecasts for general government depreciation and public corporations gross operating surplus. Together these increase broadly in line with GDP across the forecast, except for 2014-15, when our forecast assumes that Royal Mail is reclassified to the private sector, consistent with an ONS classification decision. Since December our forecast for GOS has increased in the last three years of the forecast due to new information from the business plans for Transport for London and Scottish Water. These increases are partly offset by a reduction in the forecast for the imputed subsidy for equity injection into the Housing Revenue Account (HRA), which is broadly fiscally neutral because it is offset by a reduction in the National Accounts adjustments in spending, discussed below.

## Public sector expenditure

4.78 This section explains our central projections for public sector expenditure, which are based on the National Accounts aggregates for public sector current expenditure (PSCE), public sector gross investment (PSGI), and total managed expenditure (TME), which is the sum of PSCE and PSGI. The Treasury plans public spending using two administrative aggregates:

- departmental expenditure limits (DELs)[3] – mostly spending on public services and administration, which can be planned some years in advance. Our forecast is based on the Government's latest plans for DELs, which were extended to include 2015-16 in Spending Round 2013 (SR13), plus our view of the extent to which departments might underspend against these limits; and

- annually managed expenditure (AME) – categories of spending less amenable to multi-year planning, such as social security spending and debt interest. We forecast these categories of spending out to 2018-19, based on determinants derived from our economic forecast.

4.79 For the years 2013-14 to 2015-16, our projections are constructed using the latest plans for PSCE in RDEL and PSGI in CDEL,[4] plus our latest forecast for departments' underspending against those plans. To this, we add our detailed forecast for AME spending, which includes items of welfare spending that are subject to the Government's new welfare cap.

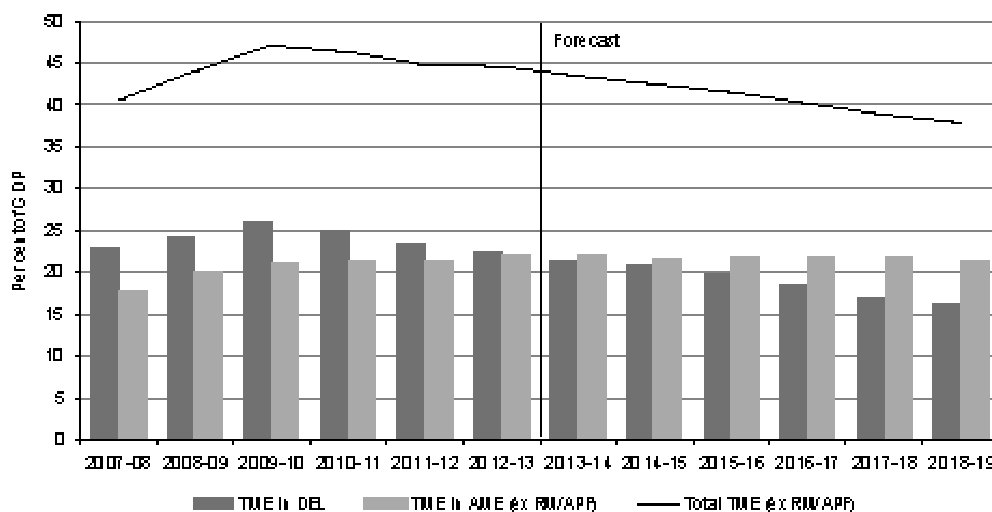
[3] Our presentation of expenditure only shows those components of RDEL, CDEL and AME that are included in the fiscal aggregates of PSCE and PSGI. For budgeting purposes, the Treasury also includes other components in DEL and AME such as non-cash items.
[4] Our forecasts for PSCE in RDEL and PSGI in CDEL are consistent with the Government's plans for RDEL and CDEL presented in the Budget. A reconciliation between the Treasury's DEL figures and ours is published in the supplementary fiscal tables on our website.

4.80 Beyond 2015-16, our projections for total spending from 2016-17 to 2018-19 are based on the Government's stated TME policy assumption, which is set out in paragraphs 4.85 and 4.86. We produce a bottom-up forecast of AME for these years, which is subtracted from the level of TME that results from the Government's policy assumption to derive implied DELs. This approach means that changes in AME spending beyond 2015-16, for example, debt interest or benefits, are offset by changes in implied DELs.

4.81 Chart 4.3 shows TME as a percentage of GDP since 2007-08, and how it splits between DEL and AME. TME increased sharply as a share of GDP through the recession of 2008-09 and 2009-10, reaching a peak of 47.0 per cent of GDP in 2009-10. With DELs fixed in cash terms through to 2010-11 in the 2007 Comprehensive Spending Review, this mainly reflected the large shortfall in nominal GDP in 2008-09 and 2009-10 relative to forecast.[5] AME spending on social security and debt interest also increased over this period.

4.82 TME has fallen from 47.0 per cent of GDP in 2009-10 to 43.5 per cent of GDP in 2013-14 and is projected to fall further to 37.8 per cent of GDP in 2018-19, excluding the effect of APF transfers in that year.

Chart 4.3: DEL and AME components of TME




Source: ONS, OBR

[5] The nominal GDP forecast underpinning the 2007 CSR projections of the public finances showed an increase of 10.4 per cent between 2007-08 and 2009-10. The latest ONS data show nominal GDP fell by 1.1 per cent over that period. That 11.6 percentage point shortfall in nominal GDP would add around 4½ percentage points to the ratio of TME to GDP, all else equal.

## Summary of the expenditure forecast

4.83 Table 4.12 summarises our latest forecast for public expenditure. TME is expressed as a share of GDP, but not all of TME contributes directly to the calculation of GDP, as it comprises benefit payments, debt interest and other cash transfers that merely transfer income from some individuals to others.

4.84 Table 4.13 shows how TME is split between DEL and AME, and the main components of AME. AME is forecast to be relatively flat as a share of GDP over the forecast period. Social security payments are forecast to fall gradually as a share of GDP as the economy recovers, while debt interest payments rise due to higher debt and interest rates. AME spending is expected to exceed DEL spending for the first time in 2013-14 and by a rising margin thereafter. This partly reflects the transfer of some spending from DEL to AME from 2013-14 onwards, reflecting local authorities retention of business rates and the localised council tax reduction schemes.[6] But it also reflects the Government's policy in setting total DELs up to 2015-16 in Spending Review 2010 (SR10) and SR13, and also beyond that, by applying the Government's TME growth assumption and further cuts to spending from 2016-17 announced in this Budget. The effect on implied DEL spending is described below.

### Table 4.12: Expenditure as a per cent of GDP

| | Per cent of GDP | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Total managed expenditure[1] | 44.7 | 43.5 | 42.5 | 41.6 | 40.2 | 38.8 | 37.8 |
| *of which:* | | | | | | | |
| Public sector current expenditure | 41.8 | 40.6 | 39.5 | 38.7 | 37.3 | 36.1 | 35.2 |
| Public sector gross investment[1] | 2.9 | 2.9 | 3.0 | 2.9 | 2.9 | 2.7 | 2.6 |
| Total public sector expenditure that contributes directly to GDP[2] | 24.0 | 23.3 | 22.6 | 21.5 | 20.3 | 19.1 | 18.3 |
| *of which:* | | | | | | | |
| General government consumption | 21.6 | 21.0 | 20.2 | 19.3 | 18.2 | 17.1 | 16.4 |
| General government gross fixed capital formation | 1.9 | 1.9 | 2.0 | 1.8 | 1.8 | 1.7 | 1.7 |
| Public corporations gross fixed capital formation | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.3 |

[1] Excludes Royal Mail and APF spending. Royal Mail and APF spending as a percentage of GDP is shown here, and headline TME is shown in Table 4.17.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Royal Mail and APF spending | -1.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.2 |

[2] GDP at market prices.

[6] These switches between DEL and AME were set out in Box 4.2 of the December 2012 *EFO*.

## Table 4.13: TME split between DEL and AME

| | Per cent of GDP | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| TME in DEL[1,2,3] | 22.5 | 21.5 | 20.9 | 19.8 | 18.4 | 17.1 | 16.3 |
| TME in AME[4] | 22.2 | 22.0 | 21.7 | 21.8 | 21.8 | 21.8 | 21.6 |
| *of which:* | | | | | | | |
| Social security[2] | 11.6 | 10.9 | 10.7 | 10.6 | 10.4 | 10.2 | 10.0 |
| Debt interest | 3.0 | 2.9 | 3.0 | 3.3 | 3.5 | 3.7 | 3.7 |
| Locally-financed current expenditure [3] | 1.5 | 2.1 | 2.0 | 2.1 | 2.1 | 2.1 | 2.2 |
| Other PSCE in AME | 5.2 | 5.2 | 5.0 | 5.0 | 5.0 | 5.0 | 5.1 |
| PSGI in AME[4] | 0.8 | 0.9 | 0.9 | 0.8 | 0.8 | 0.8 | 0.7 |

[1] In relation to table 4.17, TME in DEL is defined as PSCE in RDEL plus PSGI in CDEL plus SUME, and TME in AME is defined as PSCE in AME plus PSGI in AME minus SUME. SUME is single use military equipment.

[2] From 2013-14, grants to local authorities in TME in RDEL were increased to cover the introduction of the localised council tax reduction schemes, and social security in TME in AME was reduced because the new localised schemes replaced council tax benefit.

[3] From 2013-14, locally-financed current expenditure in TME in AME increased to include local authorities retention of business rates, and TME in RDEL was reduced because it no longer included grants to distribute these business rates to local authorities.

[4] Excludes Royal Mail and APF spending. Royal Mail and APF spending as a percentage of GDP is shown in table 4.12 and headline TME is shown in Table 4.17.

### Spending growth assumptions: effects on implied DELs

4.85 Our TME projections for 2016-17 to 2018-19 are based on the Government's stated policy assumption for TME growth. As in the Autumn Statement last year, there are two parts to the assumption:

- for 2016-17 and 2017-18, TME should continue to fall at the same average real rate as over the period covered by SR10 and SR13, with PSGI flat in real terms; and
- for 2018-19, TME should be held flat in real terms, with PSGI growing in line with nominal GDP.

4.86 For this forecast, the Government has changed the way the fall in TME over the SR10 and SR13 period is measured. As before, the Government states that both the growth rate and the baseline should be calculated excluding from 2015-16 our projected underspends in DEL and all policy measures announced in Autumn Statement 2013 and this Budget. However, the Government now also states that the 2010-11 base year should exclude underspends in DEL and all spending measures announced in the June 2010 Budget.

4.87 Applying the assumption, TME is now projected to fall by an average of 0.73 per cent a year in real terms between 2010-11 and 2015-16. This compares with the 0.49 per cent average fall projected in our December forecast. This change results from a number of factors:

- a downward revision of £0.6 billion to our forecast for AME in 2015-16, largely reflecting lower debt interest costs, reduces the nominal growth in TME over the period relative to our December forecast;

- revisions to ONS estimates of GDP deflator growth between 2010-11 and 2012-13 and to our forecast for GDP deflator growth to 2015-16 reduce the fall in real terms spending over the period. Applying this deflator change on top of the downward revision to TME in 2015-16 further increases TME in 2018-19 by £0.8 billion; and

- the 2010-11 base year has been raised by removing spending consolidation announced in the June 2010 Budget (worth £5.2 billion) and 2010-11 underspends against final plans (worth £4.7 billion). This change increases the average real cuts significantly, equivalent to a £4.5 billion reduction in TME by 2018-19.

4.88 We have raised our forecast for the GDP deflator from 2016-17 to 2018-19, which raises the nominal TME levels produced by applying the spending growth assumptions. Taken together, revisions to the GDP deflator raised TME in 2018-19 by £5.1 billion. The Government's changes to the TME growth assumption largely offset that increase. In addition, Budget measures reduce spending by a further £2.1 billion in 2018-19.

Table 4.14: Changes in TME from 2015-16

| | £ billion | | | |
|---|---|---|---|---|
| | Forecast | | | |
| | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | 744.3 | 756.3 | 765.5 | 778.7 |
| March forecast | 743.6 | 752.5 | 761.2 | 776.5 |
| Change | -0.6 | -3.7 | -4.4 | -2.2 |
| *of which:* | | | | |
| TME in 2015-16 | -0.6 | -0.6 | -0.7 | -0.7 |
| GDP deflator | 0.0 | 1.1 | 2.8 | 5.1 |
| TME growth rule | 0.0 | -2.2 | -4.4 | -4.5 |
| Budget measures | -0.1 | -2.0 | -2.1 | -2.1 |

Note: TME includes RM/APF consistent with the Treasury's spending growth rule.

4.89 Table 4.15 shows our forecast for spending growth in real terms and as a percentage of GDP, including the effects of DEL underspends and all policy measures. On the basis of current policy, including the policy measures announced in the Budget, we have derived implied levels of PSCE in RDEL and PSGI in CDEL, which grow as follows:

- implied PSCE in RDEL falls in real terms by 5.0 per cent in 2016-17, 5.2 per cent in 2017-18, and 3.0 per cent in 2018-19 – a total cut of 12.6 per cent. These reductions are illustrated in Chart 4.4; and

- implied PSGI in CDEL rises in real terms by 1.6 per cent in 2016-17, falls by 3.8 per cent in 2017-18 and rises by 3.0 per cent in 2018-19 – a total increase of 0.6 per cent.

Table 4.15: Spending real growth rates and as a per cent of GDP

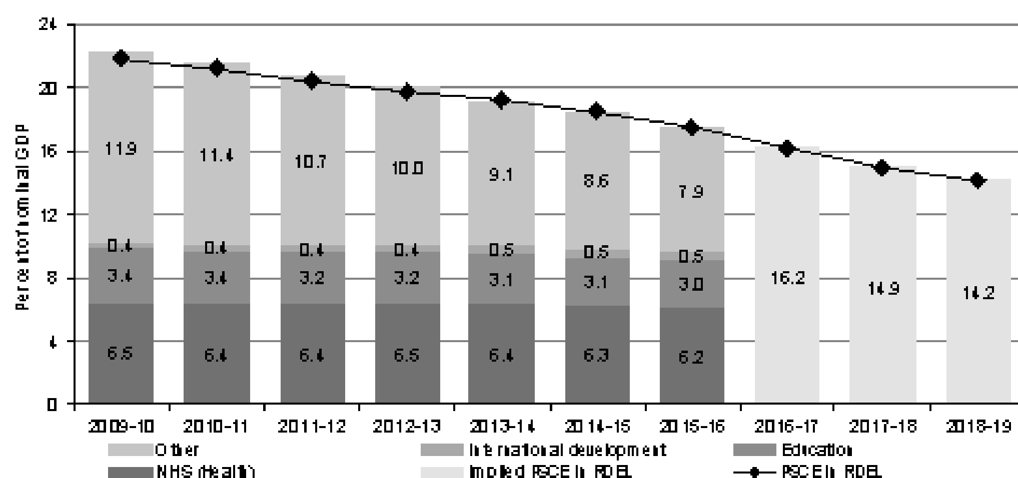
| | Real terms growth rate (%) | | | | | |
|---|---|---|---|---|---|---|
| | Spending Review years 2011-12 to 2015-16 | | Post Spending Review years | | | Total change between 2010-11 and 2018-19 |
| | Total change | Average annual change | Change in 2016-17 | Change in 2017-18 | Change in 2018-19 | |
| Total managed expenditure | -2.6 | -0.5 | -0.7 | -0.7 | 0.0 | -3.9 |
| *of which:* | | | | | | |
| PSCE | -0.9 | -0.2 | -0.8 | -0.8 | -0.2 | -2.7 |
| PSGI | -20.1 | -4.4 | 1.2 | 0.0 | 2.4 | -17.3 |
| TME in AME | 10.6 | 2.0 | 2.5 | 2.9 | 1.8 | 18.8 |
| TME in DEL | -13.9 | -2.9 | -4.2 | -5.1 | -2.2 | -23.5 |
| *of which:* | | | | | | |
| PSCE in RDEL | -12.4 | -2.6 | -5.0 | -5.2 | -3.0 | -23.5 |
| PSGI in CDEL | -23.0 | -5.1 | 1.6 | -3.8 | 3.0 | -22.5 |
| | Per cent of GDP | | | | | |
| Total managed expenditure | -4.7 | -0.9 | -1.4 | -1.3 | -0.9 | -8.2 |
| *of which:* | | | | | | |
| PSCE | -3.6 | -0.7 | -1.3 | -1.2 | -0.9 | -7.1 |
| PSGI | -1.0 | -0.2 | 0.0 | -0.1 | 0.0 | -1.2 |
| TME in AME | 0.4 | 0.1 | 0.0 | 0.1 | -0.1 | 0.4 |
| TME in DEL | -5.1 | -1.0 | -1.3 | -1.4 | -0.8 | -8.6 |
| *of which:* | | | | | | |
| PSCE in RDEL | -4.1 | -0.8 | -1.3 | -1.2 | -0.8 | -7.5 |
| PSGI in CDEL | -0.8 | -0.2 | 0.0 | -0.1 | 0.0 | -1.0 |

Note: All growths shown here include RM/APF consistent with the Treasury's spending growth rule.

4.90 Chart 4.4 shows the trend in PSCE in RDEL as a share of GDP, the proportion of national income devoted to day-to-day spending on public services and administration.[7] For the years where the Government has set plans, the chart shows the share of spending where the Government has further stated objectives, such as the commitment to maintain total health spending in real terms or to spending 0.7 per cent of gross national income on Official Development Assistance (some of which is capital, so not shown here). Beyond the years for which plans have been set, we simply show the path of PSCE in RDEL implied by the Government's total spending assumption and our forecast for PSCE in AME

[7] In outturn, includes council tax benefit and excludes the local share of business rates consistent with current budgeting treatment.

Chart 4.4: Resource DEL and implied resource DEL relative to GDP




Plans for RDEL excluding depreciation up to 2015-16. Beyond 2015-16 based on implied PSCE in RDEL calculated from the Government assumption for TME. Other includes unallocated amounts.
Source: HM Treasury Budget 2014, HM Treasury Public Expenditure Statistical Analyses, July 2013

## Summary of changes to the expenditure forecast since December

4.91 Table 4.16 shows the main reasons for the changes in our forecast of public sector expenditure since December. Tables 4.17 and 4.18 provide our detailed forecasts for spending and the changes since December. These are explained in more detail in the subsequent sections. In summary, the main drivers of the changes are:

- changes to economic determinants. In particular:
  - movements in inflation reduce spending in all years, with the profile largely explained by changes to debt interest as a result of RPI inflation;
  - revisions to the GDP deflator increase spending in 2016-17 by £1.1 billion rising to £5.1 billion in 2018-19; and
  - a lower claimant count unemployment forecast progressively reduces social security payments over the forecast period, with the effect rising to £1.5 billion by 2018-19.
- the latest information from the Treasury suggests DEL spending pressures in 2014-15 are greater than expected in December, so we have reduced our underspend assumption by £0.5 billion;
- various modelling changes made to social security, explained in more detail in the relevant section, increase the forecast in all years;

- lower debt interest costs, which reflect the reductions in our forecast for borrowing since December, reduce spending by amounts which rise to £2 billion by 2018-19;
- changes to the measurement of the TME growth assumption determined by the Government have reduced spending by £4.5 billion in 2018-19, largely reversing the increase in spending that would have resulted from an unchanged assumption being applied to our updated economy and fiscal forecasts; and
- the policy changes announced in the Budget, which are summarised in Table 4.3 and set out in full in Annex A, which reduce spending by £2 billion a year from 2016-17.

Table 4.16: Changes to the underlying spending forecast since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| March forecast[1] | 715.5 | 732.0 | 743.6 | 752.5 | 761.2 | 776.5 |
| December forecast[1] | 717.8 | 730.5 | 744.3 | 756.3 | 765.5 | 778.7 |
| Change[1] | -2.3 | 1.5 | -0.6 | -3.7 | -4.4 | -2.2 |
| *of which:* | | | | | | |
| Economic determinants | -1.1 | -1.7 | -1.1 | 0.1 | 0.8 | 2.6 |
| Inflation | -1.0 | -1.2 | -0.5 | -0.2 | -0.9 | -1.2 |
| Unemployment | -0.2 | -0.6 | -0.9 | -1.0 | -1.3 | -1.5 |
| GDP deflator | - | - | - | 1.1 | 2.8 | 5.1 |
| Other determinants | 0.0 | 0.1 | 0.2 | 0.2 | 0.2 | 0.3 |
| Market assumptions | 0.0 | 0.0 | 0.0 | 0.0 | -0.2 | -0.5 |
| Gilt rates | 0.0 | 0.0 | -0.1 | -0.2 | -0.3 | -0.5 |
| Short rates | 0.0 | 0.0 | 0.2 | 0.2 | 0.1 | 0.0 |
| Other assumptions/changes | -1.2 | 2.6 | 0.5 | -1.8 | -2.9 | -2.3 |
| Changes to DEL underspend assumptions | 0.0 | 0.5 | 0.0 | - | - | - |
| Change to TME growth rule | - | - | - | -2.2 | -4.4 | -4.5 |
| Other changes to implied DELs | - | - | - | -1.1 | 0.7 | 2.5 |
| Social security modelling changes | 0.2 | 1.7 | 1.9 | 1.4 | 1.0 | 0.9 |
| Debt interest costs from financing CGNCR | 0.0 | -0.5 | -1.3 | -1.5 | -1.8 | -2.0 |
| Other | -1.4 | 1.0 | -0.1 | 1.5 | 1.6 | 0.7 |
| Budget measures | 0.0 | 0.5 | -0.1 | -2.0 | -2.1 | -2.1 |

[1] Excludes Royal Mail and APF spending.

Table 4.17: Total managed expenditure

| | £ billion | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Public sector current expenditure (PSCE) | | | | | | | |
| PSCE in RDEL[1] | 316.5 | 315.9 | 317.8 | 312.5 | 302.5 | 292.1 | 289.1 |
| PSCE in AME | 339.9 | 352.0 | 362.1 | 379.0 | 396.3 | 414.3 | 430.3 |
| *of which:* | | | | | | | |
| Social security benefits | 182.8 | 180.0 | 184.3 | 189.1 | 193.7 | 198.6 | 203.3 |
| Tax credits | 28.6 | 28.9 | 28.9 | 29.2 | 31.4 | 34.0 | 35.4 |
| Net public service pension payments | 10.2 | 10.5 | 10.4 | 11.7 | 12.7 | 13.8 | 14.9 |
| National lottery current grants | 1.1 | 1.3 | 1.4 | 1.4 | 1.4 | 1.4 | 1.5 |
| BBC domestic services current expenditure | 3.4 | 3.6 | 3.8 | 3.5 | 3.6 | 3.9 | 4.0 |
| Other PSCE items in departmental AME | 1.1 | 1.2 | 1.3 | 1.3 | 1.2 | 1.3 | 1.2 |
| Expenditure transfers to EU institutions | 8.3 | 8.9 | 8.1 | 8.1 | 7.9 | 7.1 | 7.9 |
| Locally-financed current expenditure | 22.8 | 34.0 | 35.1 | 37.0 | 39.5 | 42.0 | 44.1 |
| Central government gross debt interest | 47.6 | 48.4 | 52.1 | 59.1 | 65.1 | 71.6 | 75.2 |
| Depreciation | 17.3 | 18.1 | 18.8 | 19.6 | 20.3 | 21.2 | 22.0 |
| Current VAT refunds | 11.6 | 11.7 | 11.9 | 11.9 | 11.3 | 10.8 | 10.7 |
| Single use military expenditure | 4.8 | 4.6 | 4.2 | 4.2 | 4.4 | 4.3 | 4.5 |
| Environmental levies | 1.7 | 3.6 | 4.4 | 5.6 | 6.3 | 7.1 | 8.3 |
| Other National Accounts adjustments | -1.5 | -2.8 | -2.6 | -2.6 | -2.6 | -2.6 | -2.7 |
| Total public sector current expenditure | 656.3 | 667.9 | 679.9 | 691.5 | 698.8 | 706.4 | 719.3 |
| Public sector gross investment (PSGI) | | | | | | | |
| PSGI in CDEL[1] | 32.2 | 33.3 | 37.4 | 36.7 | 38.0 | 37.2 | 39.1 |
| PSGI in AME[2] | 13.2 | 14.2 | 14.7 | 15.2 | 15.8 | 15.8 | 14.4 |
| *of which:* | | | | | | | |
| National lottery capital grants | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Other PSGI items in departmental AME[2] | -1.7 | 0.6 | 0.5 | 0.3 | 0.3 | 0.2 | 0.2 |
| Locally-financed capital expenditure | 6.5 | 6.4 | 6.2 | 6.5 | 7.4 | 7.2 | 6.3 |
| Public corporations capital expenditure | 7.0 | 6.8 | 7.0 | 7.0 | 6.8 | 6.9 | 6.4 |
| Other National Accounts adjustments | 1.0 | -0.1 | 0.5 | 0.9 | 0.8 | 1.0 | 1.0 |
| Total public sector gross investment[2] | 45.4 | 47.6 | 52.1 | 51.9 | 53.8 | 53.0 | 53.5 |
| *Less* depreciation | -22.5 | -23.4 | -24.3 | -25.1 | -26.0 | -27.0 | -27.9 |
| Public sector net investment[2] | 22.9 | 24.1 | 27.9 | 26.8 | 27.7 | 26.1 | 25.7 |
| Total managed expenditure[2] | 701.7 | 715.5 | 732.0 | 743.4 | 752.5 | 759.4 | 772.9 |
| Royal Mail and APF spending | -28.0 | 0.0 | 0.0 | 0.3 | 0.0 | 1.7 | 3.7 |
| Total managed expenditure (headline) | 673.7 | 715.5 | 732.0 | 743.6 | 752.5 | 761.2 | 776.5 |

[1] Implied DEL numbers for 2016-17, 2017-18 and 2018-19. Calculated as the difference between PSCE and PSCE in AME in the case of PSCE in RDEL, and between PSGI and PSGI in AME in the case of PSGI in CDEL.

[2] Excludes Royal Mail and APF spending.

Table 4.18: Changes to total managed expenditure since December

| | £ billion | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Public sector current expenditure (PSCE) | | | | | | | |
| PSCE in RDEL[1] | 0.0 | -0.5 | 1.2 | -0.1 | -3.2 | -2.1 | 1.7 |
| PSCE in AME | -0.9 | -1.2 | 0.0 | -0.2 | -0.1 | -2.0 | -3.6 |
| *of which:* | | | | | | | |
| Social security benefits | -0.1 | 0.0 | 1.1 | 1.2 | 1.1 | 0.4 | -0.2 |
| Tax credits | -0.1 | 0.1 | 0.3 | 0.4 | 0.5 | 0.3 | 0.3 |
| Net public service pension payments | 0.0 | 0.3 | -0.7 | -0.9 | -1.1 | -1.1 | -1.2 |
| National lottery current grants | 0.0 | 0.0 | -0.1 | -0.1 | -0.2 | -0.3 | -0.3 |
| BBC domestic services current expenditure | 0.0 | -0.1 | -0.2 | -0.2 | -0.2 | 0.0 | 0.1 |
| Other PSCE items in departmental AME | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Expenditure transfers to EU institutions | 0.0 | 0.1 | 0.8 | -0.4 | -0.2 | -0.2 | -0.2 |
| Locally-financed current expenditure | 0.0 | -0.2 | 0.1 | 0.0 | 0.3 | 0.2 | 0.2 |
| Central government gross debt interest | 0.0 | -1.1 | -1.8 | -0.9 | -0.2 | -0.9 | -1.7 |
| Depreciation | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.2 | 0.3 |
| Current VAT refunds | 0.0 | 0.3 | 0.5 | 0.7 | 0.2 | 0.2 | 0.3 |
| Single use military expenditure | 0.0 | -0.2 | 0.0 | 0.0 | -0.1 | 0.0 | 0.0 |
| Environmental levies | -0.3 | 0.0 | 0.0 | 0.3 | 0.2 | -0.3 | -0.6 |
| Other National Accounts adjustments | -0.5 | -0.5 | -0.3 | -0.5 | -0.6 | -0.7 | -0.6 |
| Total public sector current expenditure | -0.9 | -1.7 | 1.1 | -0.3 | -3.4 | -4.1 | -1.9 |
| Public sector gross investment (PSGI) | | | | | | | |
| PSGI in CDEL[1] | 0.0 | 0.8 | 0.3 | 0.1 | 0.0 | 0.0 | 0.3 |
| PSGI in AME[2] | 0.7 | -1.4 | 0.0 | -0.4 | -0.3 | -0.1 | -0.1 |
| *of which:* | | | | | | | |
| National lottery capital grants | 0.0 | 0.0 | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 |
| Other PSGI items in departmental AME[2] | 0.0 | -0.1 | -0.1 | -0.1 | -0.2 | -0.2 | -0.2 |
| Locally-financed capital expenditure | 0.7 | -0.2 | 0.9 | 0.5 | 1.2 | 1.1 | 1.3 |
| Public corporations capital expenditure | -0.3 | -1.0 | -1.2 | -1.2 | -1.4 | -1.3 | -1.8 |
| Other National Accounts adjustments | 0.2 | -0.1 | 0.4 | 0.4 | 0.1 | 0.4 | 0.7 |
| Total public sector gross investment[2] | 0.7 | -0.6 | 0.3 | -0.3 | -0.3 | -0.2 | 0.2 |
| *Less* depreciation | 0.0 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.3 |
| Public sector net investment[2] | 0.7 | -0.8 | 0.2 | -0.5 | -0.5 | -0.4 | -0.1 |
| Total managed expenditure[2] | -0.2 | -2.3 | 1.5 | -0.7 | -3.7 | -4.3 | -1.7 |
| Royal Mail and APF spending | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | -0.1 | -0.5 |
| Total managed expenditure (headline) | -0.3 | -2.3 | 1.5 | -0.6 | -3.7 | -4.4 | -2.2 |

[1] Implied DEL numbers for 2016-17, 2017-18 and 2018-19. Calculated as the difference between PSCE and PSCE in AME in the case of PSCE in RDEL, and between PSGI and PSGI in AME in the case of PSGI in CDEL.
[2] Excludes Royal Mail and APF spending.

## Expenditure in 2013-14

4.92 Compared to our December forecast, we have reduced TME in 2013-14 by £2.3 billion, consisting of a £1.7 billion reduction in PSCE and a £0.6 billion reduction in PSGI. The reduction in PSCE is mostly due to lower inflation reducing debt interest costs. The reduction in PSGI mainly reflects the latest available data on Housing

Revenue Account spending, offset partly by a decrease in our capital DEL underspend assumption. Detailed sectoral breakdowns of our forecasts are shown in the supplementary fiscal tables on our website.

4.93 Monthly outturn information is only available for central government spending. The February release of the monthly Public Sector Finances statistics showed that central government current expenditure in the first ten months of 2013-14 was 1.3 per cent higher than the same period last year. This compares with the 1.7 per cent increase that we are now forecasting for 2013-14 as a whole. This comparison is affected by differences in the monthly profile of central government grants to local authorities, which are lagging behind the 2012-13 profile, partly offset by transfers to EU institutions, which are ahead. The monthly profile of debt interest also varies considerably from year to year, reflecting differences in the monthly profile of the RPI, which affects debt interest on index-linked gilts.

## Departmental expenditure limits (DELs)

4.94 Table 4.19 shows our latest forecasts for PSCE in RDEL and PSGI in CDEL, and the changes in these forecasts since December. They reflect DEL plans published by the Treasury in *Public Expenditure Statistical Analyses (PESA) 2013* and *PESA 2013: Update for 2015-16*, adjusted to include the effects of policy measures announced in Autumn Statement 2013 and Budget 2014. The forecasts also include our latest assumptions for departments underspending against those plans, as shown in Tables 4.20 and 4.21, and discussed further below. For the years after 2015-16, where no plans have yet been set, our forecasts for implied PSCE in RDEL and PSGI in CDEL have been derived from the latest spending growth assumptions, as discussed above.

4.95 The main changes to our forecasts for PSCE in RDEL and PSGI in CDEL up to 2015-16 reflect changes to our underspend assumptions. Other changes to the DEL plans for these years reflect Budget measures, and switches between DEL and AME, where the Treasury has decided that spending should be reclassified between these two parts of their spending control framework. Details of the spending switched in this way are shown in a new supplementary fiscal table which accompanies this *EFO* on our website. Other changes to DEL plans in 2014-15 include an increase of £0.8 billion in RDEL to finance one-off transfers of pension liabilities for pension funds that are being transferred into the Principal Civil Service Pension Scheme. These transfers are spending neutral because they are offset by additional receipts in AME, as discussed below. CDEL is also reduced by £0.2 billion in 2014-15 to reflect the rescheduling of receipts from 2013-14 for the sale of the Olympic Village.

4.96 For the period after 2015-16, our forecasts for PSCE in RDEL and PSGI in CDEL are implied figures calculated by residual. These are the amounts that remain after the latest forecasts for PSCE in AME and PSGI in AME are deducted from the latest forecasts for total PSCE and PSGI, which are determined by the Government's

spending growth assumptions plus Budget measures. Since the growth assumptions are set in real terms, movements in our forecasts for the GDP deflator directly affect our forecasts for total PSCE and PSGI, and thus implied PSCE in RDEL and PSGI in CDEL. Table 4.19 breaks down the total movements in implied DELs to show the effects of the movement in the GDP deflator, the changes in the spending growth rule and the other changes in our forecasts that affect implied DELs after 2015-16. This shows that the reductions in PSCE in RDEL by 2018-19 from the changes to the growth assumptions only partly offset the increases from our revised forecast for the GDP deflator. PSCE in RDEL also increases by £2.4 billion in 2018-19, reflecting our lower forecast for PSCE in AME in that year (primarily due to lower unemployment). The net effect of Budget measures is to reduce PSCE in RDEL by £1.2 billion.

### DEL underspend assumptions

4.97 Our latest forecast assumes a total underspend of £7 billion in 2013-14, unchanged from our December forecast. We have changed the composition of these underspends slightly, so that we are forecasting £¾ billion more underspending within PSCE, and £¾ billion less underspending within PSGI.

4.98 The £7 billion underspend this year is measured net of DEL spending brought forward into 2013-14 under the Treasury's Budget Exchange scheme. This increased DELs by £2.3 billion, so we expect a £9.3 billion underspend against those higher DELs. In 2012-13, Budget Exchange increased DELs by £0.9 billion, and departments underspent against those increased plans by a total of £12.5 billion. As we explained in our March 2013 *EFO*, underspends were exceptionally large in 2012-13 partly because the Government encouraged departments to reduce spending further in that year.

4.99 Table 4.20 shows the detailed components of our forecast for underspends against DEL plans in 2013-14, compared with 2012-13. Compared with the initial plans in PESA 2013, the final plans for DEL spending in 2013-14 in the Supplementary Estimates in February reduced spending by £2.3 billion. (This is the net reduction, after taking account of Budget Exchange.) This £2.3 billion reduction included £2.2 billion of underspends which the Treasury has agreed that departments can carry forward into future years as Budget Exchange (as shown in Table 4.21). The £2.3 billion net underspends surrendered in this year's Supplementary Estimates are much lower than the £4.6 billion surrendered last year.

4.100 Table 4.20 also shows the further shortfalls against final DEL plans that departments have assumed in their forecasts of full year outturns submitted to the Treasury in February. These only show a further £1.2 billion of underspending. This is in marked contrast to the outturns forecast a year ago, which showed £5.8 billion of further underspends, but last year's forecasts were exceptional. Our judgement is that, consistent with past form, departments are being cautious and not forecasting the scale of underspends against final plans that we expect to materialise. Our

forecast therefore assumes a further shortfall of £3.5 billion, so that in total we expect departments to spend £4.7 billion below their final plans. This is consistent with levels of underspending against final plans seen over the last five years (excluding the exceptional 2012-13). Departments' surrenders of underspends in their final plans under the Budget Exchange regime may serve to reduce subsequent underspends against their final plans. But the experience of the last two years under Budget Exchange suggests that departments still have strong incentives to deliver underspends, in order to avoid the risks of exceeding the absolute limits set by final plans.

## Table 4.19: Key changes to DEL since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | Implied DEL[2] | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| PSCE in RDEL | | | | | | |
| December forecast | 316.4 | 316.6 | 312.6 | 305.7 | 294.1 | 287.4 |
| March forecast | 315.9 | 317.8 | 312.5 | 302.5 | 292.1 | 289.1 |
| Change | -0.5 | 1.2 | -0.1 | -3.2 | -2.1 | 1.7 |
| *of which:* | | | | | | |
| Changes to underspend assumptions[1] | -0.5 | 0.3 | 0.0 | - | - | - |
| AME DEL switches | | -0.1 | -0.4 | | | |
| Budget measures | 0.0 | 0.3 | 0.3 | -1.2 | -1.2 | -1.2 |
| GDP deflator | - | - | - | 1.1 | 2.6 | 4.9 |
| New TME growth rule | - | - | - | -2.2 | -4.4 | -4.5 |
| Other changes to implied RDEL | - | - | - | -0.9 | 0.9 | 2.4 |
| Other changes | 0.0 | 0.8 | 0.0 | - | - | - |
| PSGI in CDEL | | | | | | |
| December forecast | 32.6 | 37.1 | 36.6 | 38.0 | 37.3 | 38.8 |
| March forecast | 33.3 | 37.4 | 36.7 | 38.0 | 37.2 | 39.1 |
| Change | 0.8 | 0.3 | 0.1 | 0.0 | 0.0 | 0.3 |
| *of which:* | | | | | | |
| Changes to underspend assumptions[1] | 0.8 | 0.3 | 0.0 | - | - | - |
| Budget measures | 0.0 | 0.3 | 0.1 | 0.0 | 0.0 | 0.0 |
| GDP deflator | - | - | - | 0.1 | 0.1 | 0.2 |
| Other changes to implied CDEL | - | - | - | -0.1 | -0.2 | 0.1 |
| Other changes | 0.0 | -0.2 | 0.0 | - | - | - |
| SUME (CDEL in PSCE in AME)[3] | | | | | | |
| December forecast | 4.9 | 4.2 | 4.2 | 4.4 | 4.3 | 4.5 |
| March forecast | 4.6 | 4.2 | 4.2 | 4.4 | 4.3 | 4.5 |
| Change | -0.2 | 0.0 | 0.0 | -0.1 | 0.0 | 0.0 |
| *of which:* | | | | | | |
| Changes to underspend assumptions[1] | -0.3 | 0.0 | 0.0 | - | - | - |
| Other | 0.0 | 0.0 | 0.0 | -0.1 | 0.0 | 0.0 |

[1] Our total underspend assumption in 2013-14 is unchanged from December, but the distribution of the underspend between current and capital spending has changed as shown here. The underspends in 2013-14 include the £2 billion reduction in the DEL reserves that the Treasury included in the Autumn Statement:

| | Latest underspends in this forecast | | | Previous underspends in our December forecast | | |
|---|---|---|---|---|---|---|
| | 2013-14 | 2014-15 | 2015-16 | 2013-14 | 2014-15 | 2015-16 |
| PSCE in RDEL | -4.5 | -0.8 | -1.0 | -4.0 | -1.0 | -1.0 |
| SUME | -1.3 | -1.0 | -1.0 | -1.0 | -1.0 | -1.0 |
| PSGI in CDEL | -1.3 | -0.8 | -1.0 | -2.0 | -1.0 | -1.0 |
| TME in DEL | -7.0 | -2.5 | -3.0 | -7.0 | -3.0 | -3.0 |

[2] Changes to implied RDEL are calculated as changes to total PSCE less changes to PSCE in AME. Changes to implied CDEL are calculated as changes to total PSGI less changes to PSGI in AME.

[3] SUME is part of CDEL but is included in PSCE in AME in our tables because SUME is classified as current expenditure in the National Accounts. TME in DEL is defined as PSCE in RDEL plus PSGI in CDEL plus SUME.

Table 4.20: DEL shortfalls against PESA plans for 2013-14

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | PSCE in RDEL | | PSGI in CDEL | | TME in DEL[1] | |
| | Outturn | Forecast | Outturn | Forecast | Outturn | Forecast |
| | 12-13 | 13-14 | 12-13 | 13-14 | 12-13 | 13-14 |
| Budget Exchange carried forward | 0.6 | 1.6 | 0.2 | 0.6 | 0.9 | 2.3 |
| Further changes to final plans in Supplementary Estimates [2] | -3.9 | -3.3 | 0.0 | 0.0 | -5.4 | -4.5 |
| Shortfall against final plans in departments' full year forecast outturn in February [3] | -3.8 | -0.4 | -1.9 | -0.7 | -5.8 | -1.2 |
| OBR estimate of further shortfall | -1.4 | -2.4 | 0.0 | -1.1 | -1.3 | -3.5 |
| Total shortfall against PESA plans [2,4] | -8.5 | -4.5 | -1.6 | -1.3 | -11.7 | -7.0 |

[1] TME in DEL includes SUME.

[2] In 2013-14, the changes to plans in the Supplementary Estimates and the estimates of shortfall include the policy changes announced in the Autumn Statement which reduced PSCE in RDEL by £1.9 billion and PSGI in CDEL by £0.1 billion.

[3] In 2012-13, these forecast outturns were reduced by Treasury policy actions, which included pushing an additional £1.6 billion of spending forward into future years. The amounts carried forward were shown as 'exceptional inter-period flexibility' in Table 2.5 in *Budget 2013*.

[4] Net of increases in plans from Budget Exchange carried forward.

4.101 Table 4.21 shows our latest assumptions for DEL underspends in 2014-15 and 2015-16 against the latest amounts of Budget Exchange being taken forward into those years.

Table 4.21: DEL shortfalls against latest plans for 2014-15 and 2015-16

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | PSCE in RDEL | | PSGI in CDEL | | TME in DEL[1] | |
| | Outturn | Forecast | Outturn | Forecast | Outturn | Forecast |
| | 14-15 | 15-16 | 14-15 | 15-16 | 14-15 | 15-16 |
| Budget Exchange carried forward in PESA 2013 | 1.2 | 0.0 | 0.4 | 0.0 | 1.6 | 0.0 |
| Further Budget Exchange carried forward in 2013-14 Supplementary Estimates | 0.9 | 0.0 | 0.6 | 0.7 | 1.5 | 0.7 |
| Total Budget Exchange carried forward | 2.1 | 0.0 | 1.0 | 0.7 | 3.2 | 0.7 |
| OBR estimate of further shortfall | -2.9 | -1.0 | -1.8 | -1.7 | -5.7 | -3.7 |
| Total shortfall against PESA plans [2] | -0.8 | -1.0 | -0.8 | -1.0 | -2.5 | -3.0 |

[1] TME in DEL includes SUME.

[2] Net of increases in plans from Budget Exchange carried forward.

4.102 Compared with our December forecast, we have reduced our assumption for DEL underspends by £½ billion in 2014-15. This reflects additional spending pressures on 2014-15 spending plans from £1.5 billion carried forward into 2014-15 under Budget Exchange. Our forecast now assumes total DEL underspends against latest plans of £2½ billion for 2014-15 and £3 billion for 2015-16. These underspends are lower than our forecast for 2013-14, because they reflect additional pressures on total DELs from policy measures in previous fiscal events, the increased amounts carried forward under Budget Exchange, and also the additional £1½ billion carried forward into future years under the exceptional arrangements for 2012-13.

## Annually managed expenditure

4.103 Table 4.17 sets out our latest central projections of AME spending to 2018-19, based on our economic forecast, the latest estimates of agreed policy commitments and the measures announced in the Budget.

### Social security

4.104 Table 4.13 shows that social security expenditure is forecast to fall from 11.6 per cent of GDP in 2012-13 to 10.0 per cent by 2018-19, as lower unemployment and policy measures reduce spending.

4.105 The Government announced in Autumn Statement 2013 that it will introduce a cap on a significant amount of welfare spending, and that the OBR would assess its performance against the cap. Our forecast of spending subject to the welfare cap and some initial analysis of trends in welfare spending are set out later in the chapter.

4.106 Social security spending is higher than in our December forecast by around £1 billion a year from 2014-15 to 2016-17, and reducing thereafter. Revisions to economic determinants reduce spending by an increasing amount over the forecast period, but these are more than offset by estimating and modelling increases and the switch of tax free childcare from DEL to social security spending. Changes in social security spending are shown in Table 4.22.

4.107 The main changes arising from our economic forecast are driven by:

- lower claimant count unemployment, which reduces benefit payments by £0.6 billion in 2014-15 increasing to £1.5 billion in 2018-19; and
- our forecast of CPI inflation in 2014-15 and 2015-16 is lower, which leads to small decreases in the uprating of benefits.

Table 4.22: Key changes to social security since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | 180.0 | 183.2 | 187.9 | 192.6 | 198.2 | 203.5 |
| March forecast | 180.0 | 184.3 | 189.1 | 193.7 | 198.6 | 203.3 |
| Change | 0.0 | 1.1 | 1.2 | 1.1 | 0.4 | -0.2 |
| *of which:* | | | | | | |
| CPI | 0.0 | 0.0 | -0.3 | -0.4 | -0.4 | -0.4 |
| Claimant count unemployment | -0.2 | -0.6 | -0.9 | -1.0 | -1.3 | -1.5 |
| Pension Credit modelling | 0.0 | 0.0 | 0.1 | 0.2 | 0.4 | 0.5 |
| ESA modelling | 0.2 | 0.8 | 0.8 | 0.6 | 0.3 | 0.2 |
| DLA/PIP modelling | 0.0 | 0.8 | 0.7 | 0.4 | 0.1 | 0.1 |
| Housing benefit modelling | 0.0 | 0.1 | 0.3 | 0.3 | 0.2 | 0.1 |
| Tax free childcare | 0.0 | 0.0 | 0.2 | 0.7 | 0.8 | 0.9 |
| Budget measures | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 |
| Other | -0.1 | 0.1 | 0.2 | 0.3 | 0.2 | -0.1 |

4.108 We have made various estimating and modelling changes to our forecasts, in particular for employment and support allowance (ESA), pension credit and disability living allowance (DLA) and personal independence payments (PIP):

- ESA is higher by £0.8 billion in 2014-15 and 2015-16, and by lower amounts thereafter. We have increased the assumed caseload because the latest evidence suggests the caseload is higher than we assumed in December, despite substantial upward revisions made at that time. We have also updated the modelling on repeat work capability assessments, which has increased our assumption about the length of time and number of claimants waiting for a repeat assessment, meaning more claims continue for longer;

- pension credit spending is higher by amounts rising to £0.5 billion by 2018-19 mostly as a result of us assuming a greater number of new claimants. Recent evidence suggests the declining trend in new claimants aged 67 or over seen over recent years has abated, so we now assume a flatter trend in the forecast; and

- DLA/PIP spending is higher over the next few years. This is partly driven by the fact that the Government has adopted a phased rollout to reassessment of current DLA recipients. It also reflects preliminary analysis of the latest evidence that suggests success rates – the number of claimants successful in securing awards – have been higher than expected in the early stages of PIP rollout. We have assumed a higher success rate for claims at the start of 2014-15, which then reduces to the previous success rate assumption by the start of 2015-16. The reduction assumes that success rates will decrease as the PIP process beds in and more claims are assessed, but given the preliminary evidence on which these assumptions have been based, they are subject to

significant uncertainty and we will consider the evidence again in the autumn.

4.109 The Government has decided that tax free childcare, which was announced as a policy measure in Budget 2013, will now be classified as AME spending in social security instead of DEL, as scored at the time. The policy has been made more generous at this Budget, adding a further £0.1 billion a year to AME spending from 2016-17.

### Tax credits

4.110 Tax credit expenditure falls as a share of GDP over the forecast period, largely because of the intention to uprate the main personal elements by 1 per cent or CPI inflation in the medium term. Where claimants pay income tax, the amount of personal tax credit that offsets all or some of the tax they would otherwise have paid is currently classified as negative tax and any remaining amount is treated as spending. The negative tax share falls in later years as claimants migrate onto universal credit, which will be entirely classified as spending. As explained in Annex B, the classification of tax credits will change in 2015, so that it is all scored as spending.

4.111 Our forecast for personal tax credits is broadly unchanged since December, with slightly higher spending on households eligible for the child element only. We had assumed the number of such households would decline with unemployment, but claims have remained broadly flat despite lower unemployment. We project this to continue in future years.

Table 4.23: Key changes to tax credits since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | 31.5 | 31.3 | 31.4 | 32.6 | 34.0 | 35.1 |
| March forecast | 31.7 | 31.6 | 31.7 | 33.0 | 34.3 | 35.4 |
| Change[1] | 0.1 | 0.3 | 0.3 | 0.4 | 0.3 | 0.3 |
| *of which:* | | | | | | |
| Households entitled to Child Element only | 0.0 | 0.2 | 0.3 | 0.4 | 0.4 | 0.3 |
| Budget measures | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 |
| Other | 0.1 | 0.1 | 0.0 | 0.0 | -0.2 | -0.1 |

[1] This table shows changes to total tax credits, which are split between current receipts (shown in table 4.5) and AME current spending (shown in table 4.17). This split is shown below.

| | | | | | | |
|---|---|---|---|---|---|---|
| Changes to tax credits treated as AME spending | 0.1 | 0.3 | 0.4 | 0.5 | 0.3 | 0.3 |
| Changes to tax credits treated as negative tax | 0.0 | 0.0 | 0.0 | -0.1 | 0.0 | 0.0 |

### Public service pensions

4.112 The net public service pensions expenditure forecast measures benefits paid less employer and employee contributions received. It includes central government

pay-as-you-go public service pension schemes and locally administered police and fire-fighters' pension schemes.[8] Gross expenditure rises steadily over the forecast period reflecting the impact of demographic trends on the age profile of each scheme's membership. The income of each scheme is made up of employer and employee contributions, which are almost entirely determined by pensionable paybill. A breakdown of spending and income for the major schemes covered is included in the supplementary tables on our website.

Table 4.24: Key changes to public service pensions since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Net public service pensions | | | | | | |
| December forecast | 10.2 | 11.1 | 12.5 | 13.8 | 14.9 | 16.1 |
| March forecast | 10.5 | 10.4 | 11.7 | 12.7 | 13.8 | 14.9 |
| Change | 0.3 | -0.7 | -0.9 | -1.1 | -1.1 | -1.2 |
| Expenditure | | | | | | |
| December forecast | 35.6 | 37.0 | 38.6 | 40.4 | 42.3 | 44.3 |
| March forecast | 35.8 | 37.3 | 38.7 | 40.4 | 42.3 | 44.2 |
| Change | 0.2 | 0.3 | 0.1 | 0.0 | 0.0 | -0.1 |
| *of which:* | | | | | | |
| CPI | 0.0 | 0.0 | -0.1 | -0.2 | -0.2 | -0.2 |
| Other | 0.2 | 0.3 | 0.2 | 0.2 | 0.1 | 0.1 |
| Income | | | | | | |
| December forecast | -25.4 | -25.9 | -26.1 | -26.6 | -27.4 | -28.2 |
| March forecast | -25.3 | -26.9 | -27.0 | -27.7 | -28.5 | -29.3 |
| Change | 0.1 | -1.0 | -0.9 | -1.1 | -1.1 | -1.1 |
| *of which:* | | | | | | |
| Budget measure | 0.0 | 0.0 | -0.7 | -1.0 | -1.0 | -1.0 |
| PCSPS transfer | 0.0 | -0.8 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 0.1 | -0.2 | -0.2 | -0.1 | -0.1 | -0.1 |

4.113 While gross expenditure rises steadily in nominal terms, it remains broadly flat as a share of GDP. There have mainly been minor changes since our December forecast, driven by in-year data for 2013-14, which also affects later years, and small downward revisions to CPI inflation affecting uprating.

4.114 Our income forecast now includes a large one-off transfer of £0.8 billion in 2014-15 into the civil service pension scheme as a result of the House of Commons and General Lighthouse Fund schemes being transferred. This is neutral in spending because it is directly offset by increased spending in DEL. We expect more such transfers in accordance with Schedule 10 of the Public Sector Pensions Act 2013, which lists a number of bodies that are required to join the civil service pension scheme by 2018. Further details of the timing are not yet known, so they are not

[8] The police and firefighters' pension schemes are administered at a local level, but pensions in payment are funded from AME, along with other public service pension schemes so they are included in the pensions forecast.

included at this stage, but they are also likely to be spending neutral when they take place.

4.115 Budget 2014 has announced changes to employer contribution rates for the civil service, NHS, teachers and police pension schemes as a result of near-final valuation results. These are included as a Budget measure and are expected to yield around £1 billion a year from 2015-16. We understand that some departments have already planned for this pressure, and our view is that these pressures are not significant enough for us to change our high-level assumption about the level of departmental spending in 2015-16.

4.116 Our forecast does not take account of the new pension schemes that are expected to be implemented in April 2015 as announced in the Public Service Pensions Act 2013, which set out that new schemes would be designed for all the public service pension schemes based on career average earnings. We expect these to have a minimal effect over the forecast period because of the transitional arrangements in place. The impact of the new schemes and any revisions to employer contribution rates from the remaining valuation exercises will be fully reflected in our autumn forecast.

### EU contributions

4.117 The main component of the AME transfer to EU institutions is the UK's gross national income (GNI)-based contribution, minus the UK's abatement. The forecast for the GNI-based contribution depends mainly on the level of the agreed EU Budget and the relative GNI of each Member State. The UK abatement is affected by the UK's share of the EU VAT base and the UK's share of EU abatable receipts.[4]

4.118 The profile of UK contributions in AME over the forecast period is largely explained by the profile of EU expenditure across the 2014-2020 Multiannual Financial Framework, which was reported in Table 4.26 of our March 2013 forecast. Our December *EFO* explained the effect on the timing of payments from the new Own Resources Decision, which we assume will come into effect in 2016 retrospective from 2014. This will affect the relationship between AME and EU expenditure across the forecast period.

4.119 The change in our forecast for EU contributions shown in Table 4.25 is almost completely accounted for by us aligning our forecasts of VAT, GNI and Traditional Own Resources (TOR, mostly customs duties) for 2013 and 2014 with the latest data from the European Commission and with our economy forecast. This shows UK growth out-performing other EU countries relative to the bases used in our December forecast, increasing the UK's GNI-based contributions. This will increase UK payments in 2014-15, because of higher contributions in respect of 2014 and anticipated adjustments needed to UK contributions for 2013, but will reduce them

[4] A supplementary fiscal table on our website provides further details of UK transactions with the EU, including how these various contributions score in the National Accounts and our forecast.

in later years. This is due to the rebate, which adjusts UK contributions to be consistent with our VAT share rather than GNI share. Increased customs duties collection costs also directly reduce AME spending in 2015-16 onwards.

Table 4.25: Key changes to EU contributions since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | 8.7 | 7.3 | 8.6 | 8.1 | 7.3 | 8.2 |
| March forecast | 8.9 | 8.1 | 8.1 | 7.9 | 7.1 | 7.9 |
| Change | 0.1 | 0.8 | -0.4 | -0.2 | -0.2 | -0.2 |
| *of which:* | | | | | | |
| Revised 2013 and 2014 bases | 0.0 | 0.8 | -0.6 | -0.3 | -0.3 | -0.3 |
| Other | 0.1 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 |

### Locally financed current expenditure

4.120 Locally financed current expenditure in AME contains two components. The largest is local authority self-financed expenditure (LASFE) – local authority spending that is financed from local authorities' own sources of income, other than central government grants. Locally financed expenditure also contains Scottish Government spending financed by local taxation, which currently only consists of spending financed by business rates.[10]

4.121 The forecast of current LASFE shown in Table 4.26 is largely driven by the forecasts for council tax, and for retained business rates in England. Our forecast reflects the recent CIPFA announcement of an average 0.6 per cent council tax increase in 2014-15 in England. We have assumed the same increase applies for 2015-16, the last year for which the Government has announced that additional grant is available for councils that freeze their council tax. These increases are slightly lower than we had forecast in December, which reduces our forecast for current LASFE slightly from 2014-15 onwards. After 2015-16, we assume that council tax rises in line with CPI inflation for England, Scotland and Wales.[11] The forecast for retained business rates in England similarly reflects the latest information collected by the Department for Communities and Local Government (DCLG) for 2014-15, and we have assumed that retained business rates increase with RPI inflation over the rest of the forecast period. Council tax and retained business rates assumptions are neutral for the overall fiscal aggregates as they are consistent with our receipts forecast.

4.122 Local authorities' additions to current reserves have been an important source of past forecast errors (see our 2012 and 2013 *Forecast evaluation reports*). These additions to reserves reduce local authority current spending. For 2013-14, we

[10] Further detail on future devolved Scottish tax receipts is available in the supplementary material on our website.
[11] These council tax increases are assumed to apply in conjunction with an increase in the council tax base, which averages 1.2 per cent per year in England over the forecast period. This is measured net of discounts, including localised council tax reduction schemes. Further details of our council tax assumptions are available in a supplementary table on our website.

assume that English local authorities will have added £2.2 billion to reserves, and that they underspend their total service expenditure current budgets by £4.4 billion. This reflects the latest quarterly in-year current spending information collected by DCLG. We have assumed that English local authorities make net additions to their reserves of just under £2 billion in 2014-15, reducing to zero by 2018-19.

4.123 Table 4.26 summarises the main changes to our forecasts for current LASFE. This shows that we have increased our forecasts over the second half of the forecast period, largely because we have reduced our forecasts for capital expenditure financed from the revenue account (CERA). The CERA transfers reduce current spending and increase capital spending. The lower CERA forecast has therefore increased current LASFE and reduced capital LASFE by offsetting amounts. This reflects new information on Transport for London (TfL) spending plans that is discussed below.

### Table 4.26: Key changes to locally financed expenditure and public corporations capital expenditure since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Locally-financed current expenditure | | | | | | |
| December forecast | 34.3 | 35.0 | 36.9 | 39.2 | 41.7 | 43.9 |
| March forecast | 34.0 | 35.1 | 37.0 | 39.5 | 42.0 | 44.1 |
| Change | -0.2 | 0.1 | 0.0 | 0.3 | 0.2 | 0.2 |
| *of which:* | | | | | | |
| Council tax | 0.0 | 0.0 | -0.1 | -0.1 | -0.2 | -0.2 |
| Capital expenditure from revenue account | 0.0 | 0.0 | 0.2 | 0.5 | 0.5 | 0.5 |
| Budget measures | -0.2 | 0.1 | -0.1 | -0.1 | -0.1 | -0.2 |
| Locally-financed capital expenditure, and public corporations capital expenditure | | | | | | |
| December forecast | 14.3 | 13.5 | 14.2 | 14.4 | 14.3 | 13.3 |
| March forecast | 13.2 | 13.2 | 13.5 | 14.2 | 14.0 | 12.7 |
| Change | -1.1 | -0.3 | -0.7 | -0.2 | -0.2 | -0.6 |
| *of which:* | | | | | | |
| Capital expenditure from revenue account | 0.0 | 0.0 | -0.2 | -0.5 | -0.5 | -0.5 |
| HRA capital spending | -0.4 | -0.3 | -0.3 | -0.4 | -0.4 | -0.5 |
| Capital spending of TfL PC subsidiaries [1] | 0.0 | 0.0 | 0.1 | 0.6 | 0.7 | 0.7 |
| Other | -0.7 | 0.0 | -0.2 | 0.1 | 0.0 | -0.3 |

[1] This increase is the net result of a reduction in the adjustment included in capital LASFE that removes the financing of TfL's PC subsidiaries capital spending, which is only partly offset by a reduction in the OBR forecast for public corporations capital expenditure, to reflect the latest TfL business plans.

## Locally financed and public corporations capital expenditure

4.124 Our latest forecasts for locally financed capital expenditure (capital LASFE) and public corporations capital spending are shown in Table 4.26. Capital LASFE is

measured net of asset sales and of capital spending by local authorities' Housing Revenue Accounts (HRAs) and TfL subsidiaries, which are treated as public corporations in the National Accounts.[12] We switch these items out of capital LASFE to ensure our forecast is consistent with the National Accounts. This means that changes in capital spending by HRAs or TfL have largely offsetting effects on capital LASFE and public corporations' capital spending.

4.125 Capital LASFE remains fairly constant across the forecast, with an increase in asset sales (which reduce spending) broadly matched by a reduction in the amounts of TfL public corporations' capital spending netted off. The forecast is also boosted by an additional £0.8 billion of spending financed from capital reserves from 2015-16 to 2017-18 related to the closing stages of Crossrail construction. Further details of the components of our forecasts for current and capital local authority spending are shown in supplementary fiscal tables available on our website.

4.126 The forecast for public corporations' capital spending is largely driven by the forecasts of capital spending by HRAs, net of asset sales, and TfL's public corporation subsidiaries. Table 4.26 groups our forecasts for capital LASFE and public corporations together to show the overall impact of the revisions. There are two main areas of changes:

- we have adopted a new methodology for forecasting capital spending on major repairs and other capital spending financed from the HRA. Previously, as noted in December, we needed to use uncertain assumptions about the effects of recent HRA reforms. We are now able to forecast from HRA outturn data for 2012-13. This new approach has reduced our forecast of HRA capital spending by £0.5 billion by the end of the forecast period. We will continue to monitor trends in this spending as more outturn information becomes available; and

- we have incorporated new information supplied by TfL, consistent with their latest published business plan. This now extends to 2020-21, whereas our December forecast was consistent with plans to 2014-15 and assumptions thereafter. The latest plans are lower than our December forecast, although the profile is lumpy. TfL also plan to finance some of the public corporation subsidiaries' capital spending from the subsidiaries' operating profits, which reduces the amounts netted off capital LASFE by more than the reductions in the public corporations capital spending, raising our forecast for capital spending in total. We have also reduced capital LASFE by reducing CERA in our forecast, due to the lower current grants flowing through to finance this capital spending.

[12] These TfL transport subsidiaries trade under the company name "Transport Trading Ltd" (TTL). ONS currently classify all of the TTL subsidiaries as public corporations apart from Crossrail, which is classified as part of the local authority sector. However ONS have recently announced that they will be reclassifying several of the other TTL subsidiaries to the local authority sector. We will wait until ONS implement those reclassifications in the outturn data in the Public Sector Finance statistics before we reflect them in our forecast.

4.127 Other changes to capital LASFE include an increase in the forecast for asset sales over the first half of the forecast period, due to higher property prices and transactions, where these higher asset sales reduce net capital spending. For 2013-14, we assume that English local authorities will underspend their capital budgets by a net total of £5 billion. This reflects the latest quarterly in-year capital spending information collected by DCLG.

### Debt interest

4.128 Central government debt interest payments rise as a share of GDP over the forecast period, reflecting projected increases in interest rates and RPI inflation, and the rising stock of public debt. A lower net cash requirement, lower gilt rates and generally lower RPI inflation all reduce our forecast relative to December. These changes are partially offset by higher spending on National Savings and Investment products and a modelling change over the medium term.

4.129 We break down the debt interest forecast by financing component in the supplementary fiscal tables on our website, including a distinction between debt interest on conventional gilts for new and existing debt. Payments on the existing stock of conventional gilts are fixed for the lifetime of those gilts. With a long average maturity for UK gilts, over half of the payments on conventional gilts by the end of the forecast period relate to fixed debt interest costs on gilts that have already been issued. We also include a separate ready-reckoner table showing the approximate effect on debt interest of movements in interest rates, RPI inflation and the CGNCR.

Table 4.27: Key changes to debt interest since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | 49.5 | 53.9 | 60.0 | 65.3 | 72.5 | 76.9 |
| March forecast | 48.4 | 52.1 | 59.1 | 65.1 | 71.6 | 75.2 |
| Change | -1.1 | -1.8 | -0.9 | -0.2 | -0.9 | -1.7 |
| *of which:* | | | | | | |
| Financing CGNCR | 0.0 | -0.5 | -1.3 | -1.5 | -1.8 | -2.0 |
| Gilt rates | 0.0 | 0.0 | -0.1 | -0.2 | -0.3 | -0.5 |
| Short rates | 0.0 | 0.0 | 0.2 | 0.2 | 0.1 | 0.0 |
| Inflation | -1.0 | -1.2 | -0.1 | 0.4 | -0.3 | -0.6 |
| NS&I | -0.1 | -0.1 | 0.1 | 0.6 | 1.0 | 1.0 |
| Other | 0.0 | 0.0 | 0.3 | 0.3 | 0.3 | 0.3 |

### Other AME spending

4.130 Our forecast of **BBC** spending is slightly lower than in December as a result of slightly lower spending in 2013-14 and downward revisions to BBC spending plans.

4.131 The forecast of **National Lottery** spending had been revised down in 2013-14 as a result of latest outturn data. This feeds through to other years of the forecast, and we have also reduced growth rates across the forecast period.

4.132 Revisions to **other PSCE in departmental AME** and **other PSGI items in departmental AME** are very small. The spending included in these categories is detailed in the supplementary tables available on our website.

4.133 Table 4.17 shows a separate entry in PSCE in AME for **single-use military expenditure (SUME)**. This expenditure is treated as capital DEL in the spending control framework, but is classified as current expenditure in the National Accounts. To align with the National Accounts, we therefore exclude this spending from PSGI in CDEL and add it to PSCE in AME. This is largely unchanged since our December forecast. Most of SUME will be reclassified as capital spending this summer (see Annex B).

4.134 **Environmental levies** include spending on DECC levy-funded policies such as the Renewables Obligation, Feed-In Tariffs and Warm Homes Discount. Most of these are neutral for borrowing as they are balanced by receipts. The forecasts are explained in the receipts section.

4.135 The AME forecast includes forecasts for the further adjustments that are included in the National Accounts definitions for PSCE and PSGI.[13] Explanations and the background to **National Accounts adjustments** are given in Annex D to PESA 2013.[14]

4.136 Table 4.18 shows that current accounting adjustments have decreased by around £½ billion in each year of the forecast. This is mostly caused by downward revisions to the Housing Revenue Account imputed subsidy for equity injection, which is offset by reduced receipts in the gross operating surplus of public corporations.

4.137 Capital accounting adjustments have increased in each year of the forecast to reflect changes to our forecast of Crossrail finance and spending, which we tried to align with the likely treatment in outturn in the National Accounts. Offsetting this in 2013-14 is a large one-off receipt of £¾ billion from the mineworkers' pension scheme as a result of a surplus identified in the recent revaluation.

## Welfare cap

4.138 The Government announced in Autumn Statement 2013 that it will introduce a cap on certain items of welfare spending, excluding state pensions and the most cyclical elements of welfare. The cap has been formally defined and initially set by the Government in this Budget, and will apply from 2015-16 to the end of the

[13] Further details is provided in the supplementary fiscal tables on our website.
[14] See HM Treasury, July 2013, Public Expenditure Statistical Analyses 2013.

forecast period. It has set a forecast margin above the cap of 2 per cent in each year. The Government has asked the OBR to assess its performance against the cap and to produce an annual report on trends in welfare spending.

4.139 In future autumn *EFOs* we will formally assess whether relevant spending exceeds the welfare cap for discretionary policy reasons or the cap-plus-forecast-margin due to changes in forecast assumptions. In Budget *EFOs*, we will update our analysis without carrying out a formal assessment. We will produce our first report on welfare trends in the autumn and foreshadow that with some initial high-level analysis below.

4.140 Based on the definition set out in the Budget, Table 4.28 shows welfare spending inside the cap and welfare spending outside the cap. The welfare cap relates to these nominal spending totals. Table 4.29 presents the same welfare spending as a share of GDP, showing that on this definition it is forecast to fall from 12.8 per cent of GDP in 2013-14 to 11.6 per cent of GDP in 2018-19. Spending subject to the welfare cap is forecast to fall more steeply, from 7.1 per cent to 6.2 per cent of GDP, while spending outside the cap falls more gradually, from 5.7 per cent to 5.4 per cent of GDP.

Table 4.28: Welfare cap spending

| | £ billion | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Welfare cap | | | | | | | |
| DWP social security | 71.2 | 71.5 | 73.3 | 74.3 | 75.0 | 76.0 | 76.8 |
| *of which:* | | | | | | | |
| Incapacity benefits[1] | 13.3 | 13.3 | 13.4 | 13.5 | 13.7 | 14.0 | 14.3 |
| Statutory maternity pay | 2.3 | 2.3 | 2.4 | 2.4 | 2.5 | 2.6 | 2.7 |
| Income support (non-incapacity) | 2.7 | 2.6 | 2.6 | 2.5 | 2.6 | 2.7 | 2.8 |
| Pension credit | 7.4 | 7.0 | 6.6 | 6.5 | 6.3 | 6.1 | 5.9 |
| Winter fuel payments | 2.1 | 2.2 | 2.1 | 2.1 | 2.1 | 2.1 | 2.0 |
| Disability living allowance and personal independence payments | 13.4 | 13.9 | 14.8 | 14.7 | 14.1 | 13.5 | 13.6 |
| Attendance allowance | 5.4 | 5.4 | 5.5 | 5.6 | 5.7 | 5.8 | 6.0 |
| Carer's allowance | 1.9 | 2.1 | 2.3 | 2.4 | 2.6 | 2.7 | 2.8 |
| Universal credit[2] | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.5 | -0.2 |
| Housing benefit (not unemployed) | 19.9 | 20.3 | 21.3 | 22.1 | 22.9 | 23.5 | 24.2 |
| Other DWP in welfare cap | 2.6 | 2.4 | 2.4 | 2.4 | 2.4 | 2.5 | 2.5 |
| Personal tax credits (AME spending) | 26.8 | 27.2 | 26.8 | 27.1 | 29.3 | 31.7 | 33.0 |
| Tax free childcare | 0.0 | 0.0 | 0.0 | 0.2 | 0.7 | 0.8 | 0.9 |
| NI social security in welfare cap | 3.2 | 3.2 | 3.2 | 3.3 | 3.3 | 3.3 | 3.3 |
| Child benefit | 12.2 | 11.6 | 11.7 | 11.9 | 12.1 | 12.4 | 12.6 |
| Paternity pay | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Welfare cap in AME | 113.5 | 113.6 | 115.1 | 116.9 | 120.4 | 124.2 | 126.7 |
| Personal tax credits (negative tax element) | 3.0 | 2.7 | 2.7 | 2.5 | 1.6 | 0.3 | 0.0 |
| Total welfare cap | 116.5 | 116.4 | 117.8 | 119.5 | 122.0 | 124.6 | 126.7 |
| Welfare spending outside the welfare cap | | | | | | | |
| DWP social security | 93.3 | 90.7 | 93.0 | 96.1 | 99.2 | 102.6 | 106.1 |
| *of which:* | | | | | | | |
| Jobseeker's allowance | 5.1 | 4.3 | 3.6 | 3.4 | 3.3 | 3.2 | 3.1 |
| State pension | 79.8 | 83.0 | 86.5 | 90.0 | 93.1 | 96.8 | 100.3 |
| Council tax benefit[3] | 4.8 | - | - | - | - | - | - |
| Housing benefit (unemployed) | 3.6 | 3.2 | 2.9 | 2.8 | 2.8 | 2.7 | 2.7 |
| Discretionary housing payments[3] | 0.1 | 0.2 | - | - | - | - | - |
| NI social security outside welfare cap | 2.2 | 2.2 | 2.3 | 2.4 | 2.5 | 2.6 | 2.7 |
| War pensions | 0.9 | 0.9 | 0.9 | 0.8 | 0.8 | 0.8 | 0.8 |
| Total welfare outside the welfare cap | 96.4 | 93.8 | 96.1 | 99.3 | 102.5 | 106.0 | 109.6 |
| Total welfare[4] | 212.9 | 210.1 | 213.9 | 218.8 | 224.5 | 230.6 | 236.3 |
| *Memo: welfare cap as proportion of total welfare* | *54.7* | *55.4* | *55.1* | *54.6* | *54.4* | *54.0* | *53.6* |

[1] Incapacity benefits includes incapacity benefit, employment and support allowance, severe disablement allowance and income support (incapacity part).

[2] Universal credit additional costs not already included against other benefits (i.e. UC payments that don't exist under current benefit structure).

[3] Transferred to departmental expenditure limits.

[4] Total welfare includes welfare spending in AME and the negative tax element of personal tax credits, which will move into spending under ESA10.

Table 4.29: Welfare cap spending (per cent of GDP)

| | Per cent of GDP | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Welfare cap | | | | | | | |
| DWP social security | 4.5 | 4.3 | 4.3 | 4.2 | 4.0 | 3.9 | 3.8 |
| *of which:* | | | | | | | |
| Incapacity benefits[1] | 0.8 | 0.8 | 0.8 | 0.8 | 0.7 | 0.7 | 0.7 |
| Statutory maternity pay | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Income support (non-incapacity) | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Pension credit | 0.5 | 0.4 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 |
| Winter fuel payments | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Disability living allowance and personal independence payments | 0.9 | 0.8 | 0.9 | 0.8 | 0.8 | 0.7 | 0.7 |
| Attendance allowance | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Carer's allowance | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Universal credit[2] | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Housing benefit (not unemployed) | 1.3 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 |
| Other DWP in welfare cap | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Personal tax credits (AME spending) | 1.7 | 1.7 | 1.6 | 1.5 | 1.6 | 1.6 | 1.6 |
| Tax free childcare | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| NI social security in welfare cap | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Child benefit | 0.8 | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 | 0.6 |
| Paternity pay | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Welfare cap in AME | 7.2 | 6.9 | 6.7 | 6.5 | 6.4 | 6.4 | 6.2 |
| Personal tax credits (negative tax element) | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.0 | 0.0 |
| Total welfare cap | 7.4 | 7.1 | 6.8 | 6.7 | 6.5 | 6.4 | 6.2 |
| Welfare spending outside the welfare cap | | | | | | | |
| DWP social security | 5.9 | 5.5 | 5.4 | 5.4 | 5.3 | 5.2 | 5.2 |
| *of which:* | | | | | | | |
| Jobseeker's allowance | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| State pension | 5.1 | 5.0 | 5.0 | 5.0 | 5.0 | 4.9 | 4.9 |
| Council tax benefit[3] | 0.3 | - | - | - | - | - | - |
| Housing benefit (unemployed) | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 |
| Discretionary housing payments[3] | 0.0 | 0.0 | - | - | - | - | - |
| NI social security outside welfare cap | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| War pensions | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total welfare outside the welfare cap | 6.1 | 5.7 | 5.6 | 5.6 | 5.5 | 5.4 | 5.4 |
| Total welfare[4] | 13.6 | 12.8 | 12.4 | 12.2 | 12.0 | 11.8 | 11.6 |

[1] Incapacity benefits includes incapacity benefit, employment and support allowance, severe disablement allowance and income support (incapacity part).
[2] Universal credit additional costs not already included against other benefits (i.e. UC payments that don't exist under current benefit structure).
[3] Transferred to departmental expenditure limits.
[4] Total welfare includes welfare spending in AME and the negative tax element of personal tax credits, which will move into spending under ESA10.

## Welfare trends

4.141 The Government has asked us to produce a new annual report on trends in welfare spending, the first of which we intend to publish alongside our *Forecast evaluation report* in the autumn. This section highlights some of the drivers of the overall welfare budget that we will be exploring in greater detail later in the year.

4.142 There are various ways of expressing public spending. For example, we can look at spending in cash terms: over the past 30 years, total spending on welfare and tax credits in Great Britain (hereafter 'welfare spending') has risen at an average rate of 6.3 per cent a year from £32 billion in 1983-84 to an estimated £204 billion this year and it is forecast to rise by 2.3 per cent a year over the next five years to £229 billion in 2018-19.[15] But without the context of what any cash amount could purchase or how much national income is available to fund it, interpreting these changes is difficult.

4.143 Two other ways of expressing spending help to address these issues, as shown in Table 4.30. In real terms, correcting for whole economy inflation, welfare spending has risen at an average rate of 3.2 per cent a year over the past 30 years and is forecast to rise at a slower 0.4 per cent a year over the coming 5 years. This implies that purchasing power of welfare spending continues to rise. Relative to national income, welfare spending was 2.1 per cent of GDP higher in 2013-14 than 30 years ago and is forecast to fall by 1.2 per cent of GDP over the next 5 years. This shows that in order to deliver the 3.2 per cent a year rise in the purchasing power of welfare spending, a larger share of national income had to be transferred to welfare recipients; that trend is expected to reverse over the forecast period.

Table 4.30: DWP and HMRC benefits and personal tax credits spending (Great Britain)

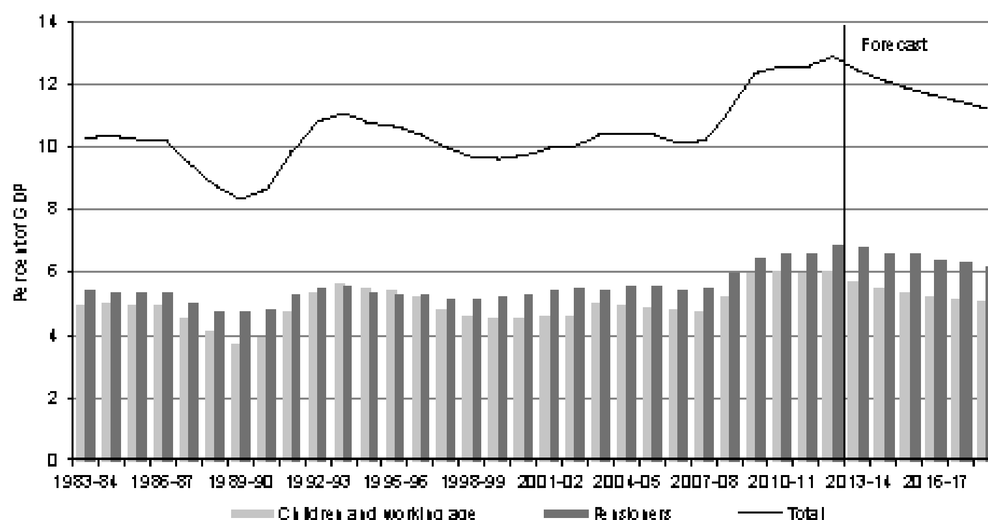
| | £ billion, nominal terms | | | £ billion, real 2013-14 prices | | | Per cent of GDP | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1983-84 | 2013-14 | 2018-19 | 1983-84 | 2013-14 | 2018-19 | 1983-84 | 2013-14 | 2018-19 |
| Welfare spending | 32 | 204 | 229 | 80 | 204 | 208 | 10.3 | 12.4 | 11.2 |

4.144 Not all elements of the welfare budget have evolved in line with the aggregate measures in Table 4.30. Chart 4.5 shows the trend in welfare spending relative to GDP over the past 30 years and the forecast period, split into spending on pensioners (mainly state pensions) and spending on children and the working-age (the largest elements of which are tax credits and housing benefit). It shows the cyclical pattern in welfare spending through the late 1980s boom and early 1990s recession, and the sharp rise and slower fall in the most recent recession and ongoing recovery.

[15] Unless otherwise stated, all figures in this section are consistent with DWP's and HMRC's current coverage and relate to spending in Great Britain only.

4.145 Welfare spending increased by 2.1 per cent of GDP between 2007-08 and 2009-10, as cash spending increased by 19.7 per cent and nominal GDP fell by 1.1 per cent. The further rise between 2009-10 and 2012-13, to a peak of 12.9 per cent of GDP, was largely explained by higher spending on pensioner benefits. Having fallen in 2013-14, welfare spending is forecast to fall by a further 1.2 per cent of GDP by 2018-19, with working-age and pensioner benefits contributing roughly equal amounts to the fall. At 11.2 per cent of GDP in 2018-19, welfare spending is forecast to remain 1.0 per cent of GDP above its pre-recession level with pensioner benefits accounting for around 0.7 percentage points of the difference.

Chart 4.5: Trends in welfare spending




Source: DWP, HMRC, OBR

4.146 There are many factors that explain the trends shown in Chart 4.5. One route into understanding these drivers is to group them into two parts, each of which can be broken down further:

- changes in caseloads as a percentage of the population. This can reflect changes in the age structure of the population – the number of people receiving pensions has risen because there are more people of pension age. Or it can reflect changes in the likelihood of a given age group claiming a benefit – the percentage of people claiming housing benefit has risen because there are more people renting rather than owning their homes, while the proportion of people claiming jobseekers allowance is related to the cyclical position of the economy; and

- changes in average awards relative to national income per person. This can reflect changes in the composition of the caseload – the rising share of employment and support allowance recipients in the contributory support

group, which attracts the highest average awards. Or it can reflect changes in the generosity of the system as a whole – the 'triple lock' on state pensions has led to the average pension rising faster than average earnings in recent years.

4.147 One factor that has pushed up most elements of welfare spending in recent years has been the fact that inflation (which is used to uprate most benefits) has out-paced growth in average earnings and nominal GDP. As Table 4.31 shows, inflation in the previous September, the month used for benefit uprating, has been higher than growth in average earnings and nominal GDP per capita in four of the five years from 2008-09 to 2012-13. In the five years to 2012-13, the cumulative growth in inflation used to uprate means-tested benefits was 11½ percentage points higher than growth in average earnings and 15½ percentage points higher than growth in nominal GDP per capita.

Table 4.31: Inflation, earnings and nominal GDP per capita

| | Per cent | | | | | |
|---|---|---|---|---|---|---|
| | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 | Total change between 2008-09 and 2012-13 |
| RPI inflation[1] | 3.9 | 5.0 | -1.4 | 4.6 | 5.6 | 18.8 |
| ROSSI inflation[1] | 2.3 | 6.3 | 1.8 | 4.8 | 6.8 | 23.9 |
| CPI inflation[1] | 1.8 | 5.2 | 1.1 | 3.1 | 5.2 | 17.4 |
| Average earnings growth[2] | 0.6 | 3.0 | 1.0 | 2.7 | 1.0 | 8.5 |
| Growth in nominal GDP per 16+ person[2] | -1.2 | -1.4 | 4.1 | 2.4 | 0.7 | 4.5 |

[1] Prior to 2011-12, means-tested benefits were generally uprated with ROSSI and other benefits with RPI (in 2010-11 these were uprated by +1.5% rather than -1.4%). The baseline assumption since 2011-12 has been to uprate most benefits with CPI.
[2] Wages and salaries per employee.

4.148 To illustrate the type of assessment we will undertake later this year, the following paragraphs explore recent trends in spending on state pension, housing benefit and jobseekers allowance.

### State pension

4.149 Total state pension spending increased by 0.7 per cent of GDP through the recession and by a further 0.4 per cent of GDP by 2012-13. This is the largest element of the total welfare budget, but the Government has chosen not to include it in its welfare cap. We expect state pension spending to fall slightly relative to GDP over the forecast period.

4.150 The main factors raising pension spending relative to GDP over the recent past have been the steady rise in the share of the population above pension age and the substantial rise in the average pension relative to average earnings, which was focused in the period from 2007-08 to 2012-13. The latter was due to state pension being uprated by more than average earnings growth, first with inflation and then in line with the 'triple lock'. This effect was particularly big in 2012-13 when pensions

were uprated by 5.2 per cent, reflecting September 2011 CPI inflation, while average earnings grew by just 1.0 per cent. The proportion of pensioners that receive the additional pension has also risen, as have average entitlements. State pension spending is expected to be broadly stable as a share of GDP over the next five years, as the male and female state pension ages are equalised and in the final few months the rise to 66 years is phased in. These changes will offset the mounting costs of the ageing population.

Table 4.32: Trends in state pension spending as a share of GDP

| | Per cent of GDP | | | |
|---|---|---|---|---|
| | 2007-08 | 2009-10 | 2012-13 | 2018-19 |
| State pension spending | 3.98 | 4.67 | 5.08 | 4.92 |
| Percentage point change since 2007-08 | | 0.69 | 1.10 | 0.94 |
| *of which percentage point contributions from:* | | | | |
| Change in pensioner share of 16+ population | | 0.10 | 0.14 | 0.03 |
| Change in average pension relative to GDP per 16+ person | | 0.60 | 0.97 | 0.90 |

### Housing benefit

4.151 Spending on housing benefit has increased substantially in recent years, rising from 1.1 per cent of GDP in 2007-08 to 1.5 per cent of GDP in 2012-13. The majority of spending on housing benefit is subject to the welfare cap. It is an area of welfare spending that has been under-forecast in recent years as we under-estimated the extent of caseload growth. We now expect housing benefit spending to fall slightly relative to GDP over the forecast period.

4.152 The largest driver of the rise in spending on housing benefit has been caseload growth in the private rented sector. This reflects both a rising share of households living in private rented accommodation and a rising proportion of those households claiming housing benefit. As a result, the share of spending accounted for by the private rented sector is forecast to rise from 30 per cent in 2007-08 to 40 per cent by 2018-19.

4.153 The trend towards renting from private landlords and away from owner-occupation pre-dated the 2008-09 recession. However, it accelerated between 2007-08 and 2012-13 as the combination of high house prices relative to average earnings and increased mortgage deposit requirements reduced access to owner-occupation for people without substantial savings or help from their families. Labour Force Survey data show the fall in owner-occupation since the recession to have been particularly marked for younger age groups.

4.154 The rising proportion of the renting population claiming housing benefit may be related to the weakness of average wage growth relative to rent inflation. This explanation is supported by DWP data, which suggest that almost all the recent rise in the private-rented sector housing benefit caseload has been accounted for by people in employment. We expect the share of claimants in the private rented

sector to continue rising over the forecast period, but for average awards to rise more slowly than nominal GDP per capita due to policy, including on uprating.

Table 4.33: Trends in housing benefit spending as a share of GDP

| | Per cent of GDP | | | |
|---|---|---|---|---|
| | 2007-08 | 2009-10 | 2012-13 | 2018-19 |
| Housing benefit spending | 1.09 | 1.40 | 1.52 | 1.34 |
| Percentage point change since 2007-08 | | 0.31 | 0.43 | 0.26 |
| *of which percentage points contribution from:* | | | | |
| *Private-rented sector (PRS) - 30% of HB in 2007-08 - of which:* | | 0.20 | 0.27 | 0.21 |
| Change in PRS caseload as a share of 16+ population | | 0.14 | 0.24 | 0.24 |
| Change in average PRS award relative to GDP per 16+ person | | 0.06 | 0.02 | -0.03 |
| *LAs, social-rented and other (SRS) - 70% of HB in 2007-08 - of which:* | | 0.10 | 0.17 | 0.05 |
| Change in SRS caseload as a share of 16+ population | | 0.02 | 0.04 | 0.00 |
| Change in average SRS award relative to GDP per 16+ person | | 0.09 | 0.13 | 0.05 |

### Jobseeker's allowance

4.155 Spending on jobseeker's allowance (JSA) is small relative to total welfare spending and national income, but is also relatively volatile. During the recession, JSA spending more than doubled as a share of GDP, with the vast majority of the increase explained by the rise in the share of the population out of work as the economy contracted. JSA spending is not subject to the welfare cap because of this close link to the cyclical position of the economy and the fiscal 'automatic stabilisers' that cushion the economy from the effects of shocks.

4.156 We expect JSA spending to reverse the recent increase relative to GDP over the forecast period as claimant count unemployment falls back below 1 million by 2018-19, and as payments are uprated by only 1 per cent up to 2015-16 and by CPI inflation thereafter.

Table 4.34: Trends in JSA spending as a share of GDP

| | Per cent of GDP | | | |
|---|---|---|---|---|
| | 2007-08 | 2009-10 | 2012-13 | 2018-19 |
| Jobseekers allowance spending | 0.15 | 0.33 | 0.33 | 0.16 |
| Percentage point change since 2007-08 | | 0.17 | 0.17 | 0.00 |
| *of which percentage point contributions from:* | | | | |
| Change in caseload as share of 16+ population | | 0.15 | 0.14 | 0.00 |
| Change in average award relative to GDP per 16+ person | | 0.02 | 0.04 | 0.00 |

## Loans and other financial transactions

4.157 Public sector net borrowing (PSNB) is the difference between total public sector receipts and expenditure each year measured on an accrued basis. But the public sector's fiscal position also depends on the flow of financial transactions, which are mainly loans and repayments between Government and the private

sector. These do not directly affect PSNB, but they do lead to changes in the Government's cash flow position and stock of debt.

4.158 The public sector net cash requirement (PSNCR) is the widest measure of the public sector's cash flow position in each year.[16] It drives the forecast of public sector net debt (PSND), which is largely a cash measure. Estimating the PSNCR also allows us to estimate the central government net cash requirement (CGNCR), which in turn largely determines the Government's financing requirement – the amount it needs to raise from treasury bills, gilt issues and National Savings and Investment products.

4.159 Differences between the PSNCR and PSNB can be split into the following categories:

- **loans and repayments:** loans that the public sector makes to the private sector do not directly affect PSNB, but the cash flows affect the PSNCR;
- **accruals adjustments:** PSNB is an accruals measure of borrowing in which, where possible, spending and receipts are attributed to the year of the activity that they relate to. In contrast, PSNCR is a cash measure in which spending and receipts are attributed to the year in which the cash flow takes place;
- **transactions in financial assets:** the public sector may buy or sell financial assets, such as corporate bonds or equities. When it exchanges one asset for an equivalent cash asset the transaction does not affect PSNB, but the associated cash flow will affect PSNCR; and
- **other factors:** this category includes one-off financial transactions that do not fall into the categories above and some other adjustments.

4.160 Net lending by the public sector to the private sector, in particular for student loans, raises the net cash requirement relative to net borrowing in each year of our forecast. The cash requirement is expected to rise in 2014-15, in contrast to net borrowing, with both measures falling in subsequent years. The rise next year can be more than explained by a number of one-offs reducing this year's cash requirement, in particular the transfer of the Asset Purchase Facility's (APF's) historic cash balance, which amounted to £31.1 billion in 2013-14 of which only £12.2 billion lowered net borrowing. Table 4.35 shows the steps from PSNB to PSNCR (on a headline basis, including the APF transfers) while Table 4.36 shows the changes since our December forecast.

[16] Consistent with the measures of debt and deficit used in this forecast, PSNCR excludes the temporary effects of financial sector interventions.

Table 4.35: Reconciliation of PSNB and PSNCR

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Public sector net borrowing | 95.6 | 83.9 | 68.3 | 41.5 | 17.8 | -1.1 |
| Loans and repayments | 13.4 | 17.3 | 19.1 | 18.6 | 18.0 | 18.6 |
| *of which:* | | | | | | |
| Student loans[1, 2] | 8.5 | 10.7 | 12.0 | 13.1 | 14.1 | 14.8 |
| DfID | 1.3 | 1.2 | 1.2 | 1.1 | 1.1 | 1.1 |
| Green Investment Bank | 0.3 | 1.0 | 1.1 | 0.0 | 0.0 | 0.0 |
| Business Bank & Finance Partnership | 0.5 | 0.8 | 0.4 | 0.2 | -0.3 | 0.0 |
| Help to Buy equity loans[3] | 0.8 | 1.6 | 1.3 | 1.4 | 1.4 | 1.4 |
| UK Export Financing | 0.0 | 0.2 | 0.4 | 0.5 | 0.5 | 0.5 |
| Ireland | 0.8 | 0.0 | 0.0 | 0.0 | 0.0 | -0.4 |
| Other | 1.2 | 1.9 | 2.8 | 2.3 | 1.2 | 1.2 |
| Accruals adjustments | 4.8 | -2.1 | -5.6 | 6.8 | 4.6 | -8.2 |
| *of which:* | | | | | | |
| Student loan interest[1,2] | 1.1 | 1.7 | 2.4 | 3.6 | 4.7 | 5.6 |
| PAYE income tax and NICs | 0.8 | 1.4 | 1.5 | 2.4 | 2.0 | 2.0 |
| Indirect taxes | 1.9 | 1.0 | 0.9 | 1.0 | 1.0 | 1.1 |
| Other receipts | 0.8 | 0.4 | 0.4 | 0.3 | 0.2 | 0.1 |
| Index linked gilts[4] | 3.3 | -10.4 | -14.2 | -3.4 | -6.5 | -20.0 |
| Conventional gilts | 3.5 | 2.9 | 2.3 | 1.9 | 2.2 | 1.9 |
| Other expenditure | -6.6 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |
| Transactions in financial assets | -6.3 | 0.0 | -2.3 | -2.3 | -2.3 | -2.3 |
| *of which:* | | | | | | |
| Lloyds shares | -3.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Royal Mail shares | -2.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Royal Mail pension asset disposal | -1.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Student loan book | -0.2 | 0.0 | -2.3 | -2.3 | -2.3 | -2.3 |
| Other factors | -26.9 | -6.9 | -7.1 | -7.0 | -6.7 | -5.3 |
| *of which:* | | | | | | |
| Asset Purchase Facility proceeds | -18.9 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| B&B and NRAM alignment | -8.3 | -7.2 | -7.4 | -7.3 | -7.0 | -5.6 |
| Public sector net cash requirement | 80.5 | 92.3 | 72.3 | 57.6 | 31.4 | 1.6 |

[1] The table shows the net flow of student loans and repayments. This can be split out as follows:

| | | | | | | |
|---|---|---|---|---|---|---|
| Cash spending on new loans | 10.3 | 12.7 | 14.4 | 15.6 | 16.7 | 17.4 |
| Cash repayments | 1.8 | 2.1 | 2.3 | 2.5 | 2.5 | 2.6 |

[2] Cash payments of interest on student loans are included within 'loans and repayments' as we cannot easily separate them from repayments of principal. To prevent double counting the 'Student loan interest timing effect therefore simply removes accrued interest.

[3] This excludes Barnett Consequentials.

[4] This reconciliation to the net cash requirement does not affect public sector net debt.

Table 4.36: Changes in the reconciliation of PSNB and PSNCR

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Public sector net borrowing | -3.4 | -0.1 | -3.3 | -6.3 | -7.0 | -3.0 |
| Loans and repayments | -0.7 | 1.1 | 1.2 | 2.9 | 2.2 | 2.6 |
| *of which:* | | | | | | |
| Student loans[1, 2] | 0.3 | 0.5 | 0.5 | 0.4 | 0.5 | 0.5 |
| DfID | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Green Investment Bank | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Business Bank & Finance Partnership | 0.1 | 0.1 | -0.2 | -0.1 | -0.5 | 0.0 |
| Help to Buy equity loans | -0.4 | 0.4 | 0.0 | 1.4 | 1.4 | 1.4 |
| UK Export Financing | -0.3 | -0.1 | 0.1 | 0.6 | 0.6 | 0.5 |
| Ireland | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | -0.5 | 0.2 | 0.9 | 0.6 | 0.1 | 0.1 |
| Accruals adjustments | -4.7 | 2.2 | 0.1 | -0.3 | 0.7 | 0.9 |
| *of which:* | | | | | | |
| Student loan interest[1,2] | 0.0 | 0.1 | -0.1 | 0.1 | 0.2 | 0.0 |
| PAYE income tax and NICs | 0.4 | 0.1 | -0.2 | 0.0 | 0.0 | -0.2 |
| Indirect taxes | 0.3 | 0.1 | 0.1 | 0.1 | 0.0 | 0.1 |
| Other receipts | 0.0 | 0.1 | 0.0 | 0.0 | -0.1 | -0.2 |
| Index linked gilts[3] | 1.0 | 1.3 | 0.2 | -0.3 | 0.3 | 0.7 |
| Conventional gilts | 0.8 | 0.6 | 0.1 | -0.1 | 0.4 | 0.5 |
| Other expenditure | -7.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Transactions in financial assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| *of which:* | | | | | | |
| Lloyds shares | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Royal Mail shares | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Royal Mail pension asset disposal | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Student loan book | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other factors | -3.5 | 0.1 | -1.0 | -1.4 | -0.6 | 0.3 |
| *of which:* | | | | | | |
| Asset Purchase Facility proceeds | -0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| B&B and NRAM alignment | -3.1 | 0.1 | -1.0 | -1.4 | -0.6 | 0.3 |
| Public sector net cash requirement | -12.3 | 3.3 | -3.0 | -5.1 | -4.6 | 0.8 |

[1] The table shows the net flow of student loans and repayments. This can be split out as follows:

| | | | | | | |
|---|---|---|---|---|---|---|
| Cash spending on new loans | 0.1 | 0.2 | 0.1 | 0.0 | 0.0 | -0.1 |
| Cash repayments | -0.2 | -0.3 | -0.4 | -0.5 | -0.5 | -0.6 |

[2] Cash payments of interest on student loans are included within 'loans and repayments' as we cannot easily separate them from repayments of principal. To prevent double counting the 'Student loan interest timing effect therefore simply removes accrued interest.

[3] This excludes Barnett Consequentials.

[4] This reconciliation to the net cash requirement does not affect public sector net debt.

## Loans and repayments

4.161 The recent student loan reforms have increased the size of upfront loans, with repayments being made over a longer period. In our 2013 *Fiscal sustainability report (FSR)*, we showed that on current policy settings we might expect the

difference between new loans and repayments to peak around the early 2030s and then fall away.

4.162 Our forecast for new student loan outlays is little changed from December. The forecast for the repayment of English loans now makes greater use of Student Loans Company data, in addition to survey data, and also makes greater use of historic earnings data to project forward individuals' future earnings paths. These changes have widened the projected earnings distribution over time, which, since payments are only due over a particular threshold, has reduced our forecast for aggregate repayments. As a consequence, we now expect greater write-offs beyond our medium-term forecast horizon, and will update the longer-term projections in our next *FSR*, to be published in July.

4.163 Other loans include lending through the Department for International Development's contributions to multilateral development banks, loans to Ireland and a range of other Government schemes. Loans through a number of these schemes, including Help to Buy equity loans, have been lower than forecast in 2013-14 and some of this is expected to be made up in following years. The Government has announced in the Budget that it will extend Help to Buy equity loans beyond 2015-16, raising lending in later years. The Budget also extends lending via UK Export Finance, superseding the Autumn Statement 2012 provisions, which were not taken up by the private sector. We now include lending budgets for the Devolved Administrations, which raises the forecast in each year.

## Accruals adjustments

4.164 To move from PSNB to PSNCR, it is also necessary to adjust for the likely impact of timing differences between cash flows and accruals. If receipts are forecast to rise over time, the cash received in any given year will generally be lower than the accrued tax receipts. We now expect a little more momentum in accrued receipts over the near term, and for this year's cash receipts to lag a little further behind.

4.165 A large component of the receipts timing adjustment relates to the interest on student loans. This is included in the accrued measure of public sector current receipts as soon as the loan is issued. However, cash repayments are not received until the point at which former students earn sufficient income. This part of the forecast is broadly unchanged since December.

4.166 Similar timing adjustments are made for expenditure. The largest is for the timing of payments on index-linked gilts. These adjustments are very sensitive to RPI inflation, as well as to the profile of redemptions, which is not smooth. Positive RPI inflation raises the amount the Government is committed to pay on index-linked gilts, and this commitment is recognised in PSNB each year. But the actual cash payments do not occur until redemption of the gilt, which may be many years in the future. In comparison to our December forecast, lower RPI inflation has reduced accrued debt interest, with an essentially offsetting change in the accruals adjustment.

There are also lags due to the timing of cash payments through the year and from auction price effects, which affect conventional gilts. For gilts sold at a premium, the cash payments to cover coupons will be larger than the amounts accrued in debt interest.

4.167 Timing effects relating to other elements of cash spending are much more difficult to forecast. We therefore typically assume that the adjustment over the forecast period is equal to its historic average. The latest central government cash data are somewhat lower than our bottom-up forecasts for the cash requirement would imply and we have set a negative spending accrual of £7 billion to reconcile the two for 2013-14. This is likely to relate to unusual activity towards the end of 2012-13. The central government net cash requirement for March 2013 was over £7 billion higher than expected in our March 2013 *EFO*, but this seems to have unwound in subsequent months.

## Transactions in financial assets

4.168 Consistent with the *Charter for Budget Responsibility*, and our wider approach to policy announcements, we only include the impact of financial asset sales or purchases once firm details are available that allow the effects to be quantified with reasonable accuracy. The Government has outlined the sale of part of the student loan book, with the intention to sell £12 billion of assets over a 5-year period from 2015-16. We have included a neutral assumption that this will be evenly spread across the five years, but do not include any other asset sales over the forecast horizon. The loan book sale will reduce future repayments and interest paid to the Exchequer.

## Other factors

4.169 Some of the cash transfers between the APF and the Exchequer in 2012-13 and 2013-14 have been treated as financial transactions, affecting the net cash requirement but not PSNB. The amount of cash being transferred this year is now expected to be a little higher than assumed in December.

4.170 The rundown of the Bradford & Bingley and Northern Rock (Asset Management) (B&B and NRAM) loan book reduces the net cash requirement directly, a small part of which also reduces net borrowing. The loan book has been wound down by more than previously expected in 2013-14, and the current plans also show a slightly quicker pace over the forecast period.

## Central government net cash requirement

4.171 The other important cash measure is the central government net cash requirement (CGNCR). Table 4.37 shows how CGNCR relates to PSNCR and Table 4.38 sets out the changes in this relationship since the December forecast. The CGNCR is derived by adding or removing transactions that are associated with local

authorities and public corporations from the PSNCR. Changes in the CGNCR forecast since December closely follow changes to our PSNCR forecast. We expect local authorities and public corporations to be net lenders from 2013-14 onwards.

4.172 The inclusion of B&B and NRAM in the central government sector means that the CGNCR is no longer simply a measure of the cash required by the Exchequer to fund its operations, which forms the basis for the Government's net financing requirement.[17] Classifying B&B and NRAM within central government has two effects. First, the banks' own cash requirement is now included in headline CGNCR. Running down the banks' loan books reduces CGNCR by around £6 billion to £8 billion a year, but these do not directly affect the Exchequer. Secondly, some of these surpluses are used to make loan repayments to the Treasury which net off within the headline measure, but reduce the Exchequer's financing requirement. These loan repayments vary from around £3 billion to £5 billion a year. The net consequence is that the headline CGNCR is between £3 billion and £6 billion lower than the Exchequer's own financing requirement over the forecast period.

Table 4.37: Reconciliation of PSNCR and CGNCR

| | £ billion | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Public sector net cash requirement (NCR) | 106 | 81 | 92 | 72 | 58 | 31 | 2 |
| *of which:* | | | | | | | |
| Local authorities and public corporations NCR | 3 | -2 | -3 | -3 | -2 | -2 | -4 |
| Central government (CG) NCR own account | 104 | 83 | 95 | 75 | 60 | 34 | 5 |
| CGNCR own account | 104 | 83 | 95 | 75 | 60 | 34 | 5 |
| Net lending within the public sector | 1 | 0 | 1 | 2 | 2 | 2 | 2 |
| CG net cash requirement | 105 | 83 | 96 | 76 | 61 | 35 | 7 |
| B&B and NRAM adjustment | 5 | 4 | 4 | 5 | 6 | 3 | 3 |
| CGNCR excl. B&B and NRAM | 110 | 87 | 101 | 81 | 67 | 38 | 10 |

[17] The Government is publishing a financing remit for 2014-15 alongside the Budget. The OBR provides the Government with the forecast of the CGNCR for this purpose, but plays no further role in the derivation of the net financing requirement.

Table 4.38: Changes in the reconciliation of PSNCR and CGNCR since December

| | £ billion | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Public sector net cash requirement (NCR) | 0 | -12 | 3 | -3 | -5 | -5 | 1 |
| *of which:* | | | | | | | |
| Local authorities and public corporations NCR | 0 | -1 | 1 | 0 | 0 | 0 | 0 |
| Central government (CG) NCR own account | 0 | -12 | 3 | -3 | -5 | -5 | 1 |
| CGNCR own account | 0 | -12 | 3 | -3 | -5 | -5 | 1 |
| Net lending within the public sector | 0 | -2 | -1 | 0 | 0 | 0 | 0 |
| CG net cash requirement | 0 | -14 | 2 | -3 | -5 | -5 | 1 |
| B&B and NRAM adjustment | 0 | 2 | 0 | 0 | 1 | 0 | 0 |
| CGNCR excl. B&B and NRAM | 0 | -12 | 2 | -3 | -4 | -5 | 0 |

### Box 4.3: Fiscal impact of the financial interventions

We have certified the Treasury's approach for calculating the net loss or gain to the taxpayer of the interventions to stabilise the financial system. In particular, these are:

- equity injections into Royal Bank of Scotland (RBS), Lloyds Banking Group (LBG) and Northern Rock plc;
- the Asset Protection Scheme (APS);
- bank funding support through the Special Liquidity Scheme (SLS) and Credit Guarantee Scheme (CGS);
- holdings in Bradford & Bingley (B&B) and Northern Rock Asset Management (NRAM); and
- other loans through the Financial Services Compensation Scheme (FSCS), various wholesale and depositor guarantees and a contingent capital facility (CCF).

The APS, SLS and CGS have now closed, with net gains to the Exchequer of £5.0 billion, £2.3 billion and £4.3 billion respectively. Fees relating to the RBS CCF, which was closed in December 2013, and to underwrite the RBS and LBG share purchases add a further £1.3 billion and £0.7 billion respectively. These figures have been captured in PSNB.

The Treasury paid £66 billion for shares in the two banks. The market value of the shares at the time of purchase was £53 billion, with the difference of £12.4 billion added to PSND. This treatment is expected to change once the conclusions of the PSF Review are implemented (see Annex B). This market value includes an estimate for the value of the Dividend Access Share (DAS) in RBS, which gives the Treasury enhanced dividends rights if RBS were to pay dividends on ordinary shares, as long as the share price remains below 650p. Changes in the market prices of the Government's shareholdings

in RBS and LBG are not reflected in PSNB and PSND until shares are sold. The Treasury sold £3.2 billion of LBG shares in September 2013, at a price above their implied value on the public sector balance sheet (but only fractionally more than it paid for them), reducing PSND by £0.6 billion. Excluding the DAS, the value of the shares sold, plus the latest volume-weighted average market prices for the remaining shares, imply a total loss of £15.6 billion on the equity shares, close to the implied loss of £15.3 billion reported in December, as LBG's share price has risen, but RBS' has fallen.

Following its review of RBS, the Treasury announced it is in advanced negotiations to simplify the bank's capital structure by retiring the DAS. The DAS is valued at £1.5 billion in the Treasury's latest accounts. This value is uncertain as the DAS is not traded.

The Treasury continue to assume that the other interventions, including holdings in B&B and NRAM, will not materially affect the aggregate loss or gain. Although the Exchequer is expected to recover its support for B&B and NRAM in cash terms, there may be a net present value cost once risk and the delay in proceeds are considered.

Overall, their approach implies an estimated direct loss to the taxpayer on the financial interventions of £0.6 billion, including the DAS and underwriting fees. If all interventions were financed through debt, the Treasury estimate that additional debt interest costs would have totalled £18.4 billion over the five and a half years to date.

## The key fiscal aggregates

4.173 Our central forecast for the key fiscal aggregates is presented in Table 4.39. It incorporates the forecasts for receipts, expenditure and financial transactions set out earlier in this chapter. Detailed tables of the fiscal aggregates and changes since December are presented at the end of this section. In this section we explain the changes in four key fiscal aggregates:

- **public sector net borrowing**: the difference between total public sector receipts and expenditure on an accrued basis each year. As the widest measure of borrowing, PSNB is a key indicator of the fiscal position and useful for illustrating the reasons for changes since the previous forecast. We focus on public sector net borrowing excluding the effects of transfers between the APF and the Exchequer;

- the **current budget**: the difference between public sector current expenditure and receipts each year. In effect, this is public sector net borrowing excluding borrowing to finance investment;

- the **cyclically-adjusted current budget**: the surplus on the current budget adjusted to reflect the estimated impact of fluctuations in the economic cycle. It represents an estimate of the underlying or 'structural' surplus on the current budget, in other words the current budget balance we would see if

the output gap was zero. It is used as the target measure for the Government's fiscal mandate; and

- **public sector net debt**: a stock measure of the public sector's net liability position defined as its gross liabilities minus its liquid assets. In broad terms, it is the stock equivalent of public sector net borrowing, measured on a cash basis rather than an accrued basis. It is also the fiscal measure used for the Government's supplementary fiscal target.

4.174 Table 4.39 shows our latest forecast for some of the key fiscal aggregates. The public finances are often affected by one-off items or other factors that it can be useful to strip out to assess underlying fiscal trends. Table 4.40 provides outturn and, where relevant, forecasts for the key special factors affecting PSNB. In this *EFO*, we have focused on PSNB excluding the impact of the one-off Royal Mail Pension Plan transfer in 2012-13 and the flow of cash transfers between the Exchequer and the APF across the forecast period. We have described this as 'underlying PSNB', though as the table shows, there are a number of other factors that it might be appropriate to strip out of the headline PSNB measure to assess underlying fiscal trends.

Table 4.39: Selected 'underlying' fiscal aggregates

| | Per cent of GDP | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Receipts and expenditure | | | | | | | |
| Public sector current receipts[1] *(a)* | 37.4 | 37.0 | 37.0 | 37.4 | 37.8 | 38.0 | 38.1 |
| Total managed expenditure[1] *(b)* | 44.7 | 43.5 | 42.5 | 41.6 | 40.2 | 38.8 | 37.8 |
| *of which:* | | | | | | | |
| Public sector current expenditure[1] *(c)* | 41.8 | 40.6 | 39.5 | 38.7 | 37.3 | 36.1 | 35.2 |
| Public sector net investment[1] *(d)* | 1.5 | 1.5 | 1.6 | 1.5 | 1.5 | 1.3 | 1.3 |
| Depreciation[1] *(e)* | 1.4 | 1.4 | 1.4 | 1.4 | 1.4 | 1.4 | 1.4 |
| Deficit | | | | | | | |
| Public sector net borrowing[1] *(b-a)* | 7.3 | 6.6 | 5.5 | 4.2 | 2.4 | 0.8 | -0.2 |
| Surplus on current budget[1] *(a-c-e)* | -5.9 | -5.1 | -3.9 | -2.7 | -0.9 | 0.5 | 1.5 |
| Cyclically-adjusted surplus on current budget[1] | -3.9 | -3.6 | -2.9 | -1.9 | -0.4 | 0.7 | 1.5 |
| Cyclically-adjusted net borrowing[1] | 5.3 | 5.0 | 4.5 | 3.4 | 1.9 | 0.6 | -0.3 |
| Primary balance[1] | -4.7 | -4.0 | -2.9 | -1.4 | 0.5 | 2.1 | 3.2 |
| Cyclically-adjusted primary balance[1] | -2.8 | -2.5 | -1.9 | -0.6 | 1.0 | 2.3 | 3.2 |
| | £ billion | | | | | | |
| Public sector net borrowing[1] | 114.8 | 107.8 | 95.5 | 75.2 | 44.5 | 16.5 | -4.8 |
| Surplus on current budget[1] | -91.9 | -83.7 | -67.6 | -48.4 | -16.7 | 9.6 | 30.5 |
| Cyclically-adjusted surplus on current budget[1] | -60.9 | -58.4 | -49.6 | -34.5 | -7.0 | 13.9 | 31.3 |
| Cyclically-adjusted net borrowing[1] | 83.8 | 82.6 | 77.5 | 61.3 | 34.7 | 12.1 | -5.6 |
| Primary balance[1] | -74.5 | -65.6 | -50.4 | -24.8 | 9.0 | 41.3 | 64.4 |
| Cyclically-adjusted primary balance[1] | -43.5 | -40.3 | -32.4 | -11.0 | 18.7 | 45.7 | 65.2 |

[1] Excluding Royal Mail and APF transfers.

Table 4.40: Special factors affecting public sector net borrowing

| | £ billion | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Public sector net borrowing | 80.3 | 95.6 | 83.9 | 68.3 | 41.5 | 17.8 | -1.1 |
| *Special factors:* | | | | | | | |
| Royal Mail | -28.0 | | | | | | |
| APF | -6.4 | -12.2 | -11.6 | -6.9 | -2.9 | 1.3 | 3.7 |
| B&B and NRAM | -0.2 | -0.6 | -0.7 | -0.9 | -1.0 | -1.1 | -1.0 |
| 4th Generation Spectrum proceeds | -2.3 | | | | | | |
| Special liquidity scheme fees | -2.3 | | | | | | |
| Swiss Capital Tax | | -0.9 | | | | | |

## Public sector net borrowing

4.175 Underlying PSNB is estimated to have fallen from its post-war peak of £157.3 billion, or 11.0 per cent of GDP, in 2009-10 to £117.4 billion (7.6 per cent of GDP) in 2011-12. This fall was driven by the recovery of the economy from the trough of the 2009

recession, the withdrawal of the temporary stimulus measures put in place by the previous Government, and by the current Government's fiscal consolidation plans.

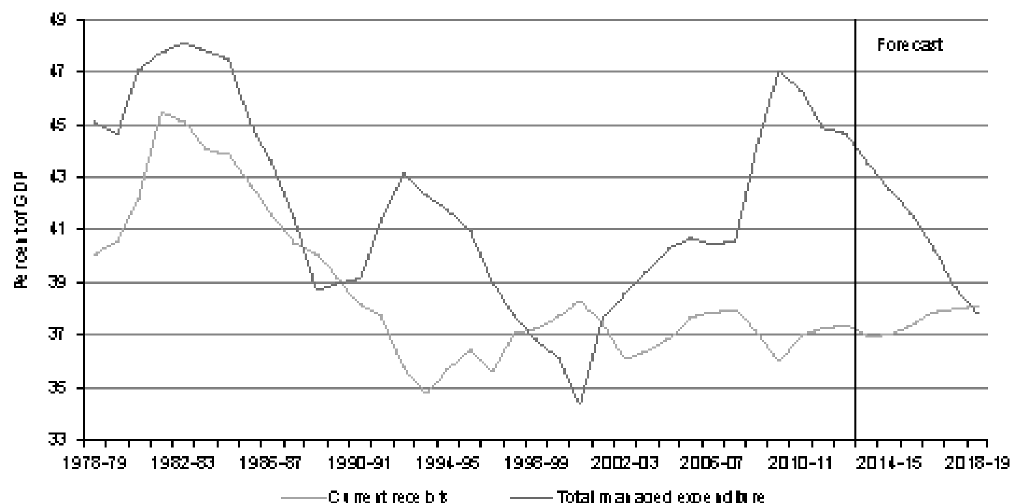
4.176 In 2012-13, the downward path of underlying PSNB slowed, with borrowing falling by only £2.6 billion as the recovery failed to take hold and the impact of high inflation in 2011 fed through to the public finances. Borrowing is forecast to fall again this year – by £7.0 billion – before resuming a more rapid decline averaging £22.5 billion a year from 2014-15 to 2018-19. As a result, underlying PSNB is forecast to show a small surplus in 2018-19 of £4.8 billion (0.2 per cent of GDP).

4.177 The 11.2 per cent of GDP reduction in underlying PSNB forecast between 2009-10 and 2018-19 would represent one of the largest deficit reductions among advanced economies in the post-war period. As Charts 4.6 and 4.7 show, the contributions to the reduction would be:

- 9.2 per cent of GDP, just over 80 per cent of the deficit reduction, from lower expenditure, with TME falling from 47.0 per cent of GDP in 2009-10 to 37.8 per cent of GDP by 2018-19. Within this total:
  - PSCE in RDEL, a proxy for day-to-day spending on public services and administration, falls by 7.7 per cent of GDP, from 21.8 of GDP in 2009-10 to 14.2 per cent in 2018-19, as shown in Chart 4.4. This is mirrored in our GDP forecast, where government consumption of goods and services falls from 23.2 per cent of nominal GDP in 2009 to 16.1 per cent by the end of the forecast, its lowest at least since 1948;[18]
  - PSGI in CDEL, public sector gross investment, falls by 1.6 per cent of GDP, from 3.5 per cent in 2009-10 to 1.9 per cent in 2018-19. In 2007-08, PSGI in CDEL was 2.7 per cent of GDP; and
  - social security spending falls by 1.1 per cent of GDP, from 11.1 per cent of GDP to 10.0 per cent in 2018-19, approaching its pre-crisis level.[17]
- 2.0 per cent of GDP from higher receipts, with the majority of the increase having taken place by 2012-13, largely as a result of the increases in the standard rate of VAT. This is followed by further increases towards the end of our forecast due to the resumption of fiscal drag, as above-inflation earnings growth pushes more income into higher tax brackets, and strong growth in capital taxes like stamp duty and inheritance tax (see Box 4.2).

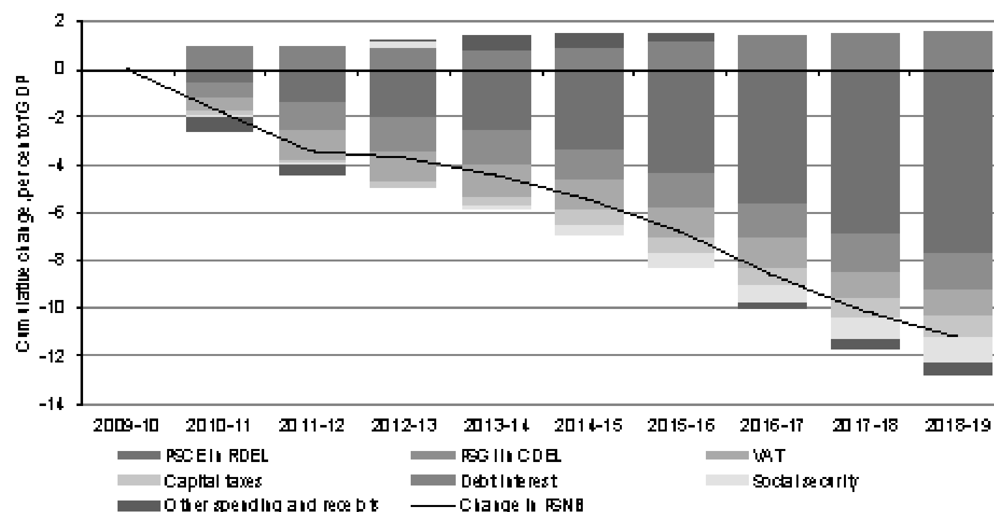
[18] In outturn, includes council tax benefit and excludes the local share of business rates consistent with current budgeting treatment.
[17] In outturn, excludes council tax benefit consistent with current budgeting treatment.

Chart 4.6: Total public sector spending and receipts




Source: ONS, OBR. Excludes Royal Mail and APF transfers.

Chart 4.7: Sources of deficit reduction




Source: ONS, OBR. Excludes Royal Mail and APF transfers.

## Public sector net borrowing in 2013-14: changes since December

4.178 We have revised our forecast for underlying PSNB in 2013-14 down by £3.4 billion relative to our December forecast. With no change in our estimate of APF transfers to the Exchequer in 2013-14, the same revision applies to our forecast of headline PSNB. Table 4.41 shows that these downward revisions are driven by the following factors:

- a £1.1 billion upward revision to receipts, reflecting higher-than-expected revenues from onshore corporation tax, stamp duty land tax, income tax and NICs and VAT. This is offset by a lower estimate for capital gains tax and revenues from North Sea companies; and
- a £2.3 billion downward revision to spending, £1.1 billion of which is from lower debt interest and a similar amount from lower public corporations' capital expenditure.

Table 4.41: Changes to underlying PSNB since December

| | £ billion | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Public sector net borrowing[1] | | | | | | |
| December forecast | 111.2 | 96.0 | 78.7 | 51.1 | 23.4 | -2.2 |
| March forecast | 107.8 | 95.5 | 75.2 | 44.5 | 16.5 | -4.8 |
| Change | -3.4 | -0.6 | -3.5 | -6.6 | -6.9 | -2.6 |
| *of which:* | | | | | | |
| Changes in the receipts forecast[1,2] | -1.1 | -2.0 | -3.5 | -4.7 | -4.0 | -2.5 |
| Changes in the spending forecast[1,2] | -2.3 | 0.9 | -0.6 | -1.7 | -2.2 | 0.3 |
| Receipts measures in the Treasury's policy decision table | 0.0 | 0.0 | 0.6 | 1.8 | 1.4 | 1.7 |
| Spending measures in the Treasury's policy decision table | 0.0 | 0.5 | -0.1 | -2.0 | -2.1 | -2.1 |

[1] Excluding APF transfers.
[2] This includes the re-allocation of the policy measure for tax free childcare announced in Budget 2013. More information is available in our online supplementary fiscal tables.

## Public sector net borrowing from 2014-15: changes since December

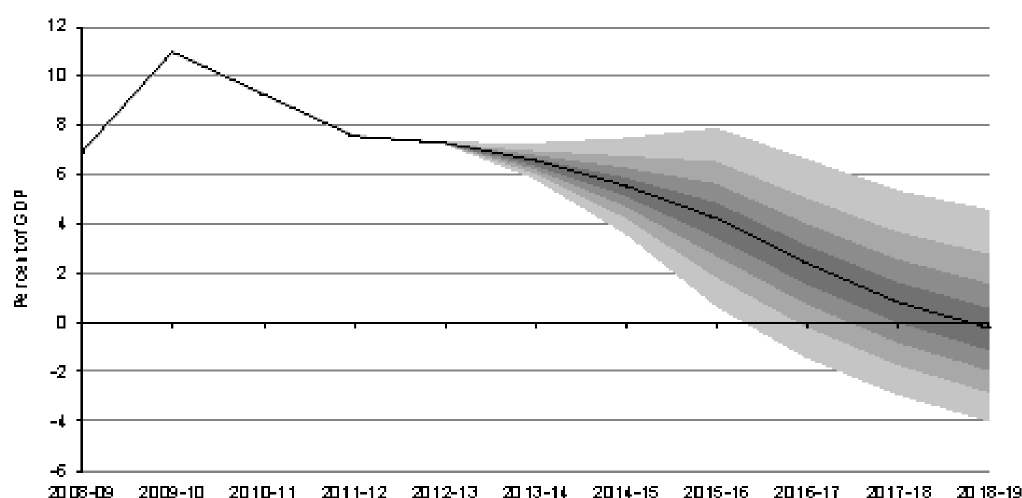
4.179 For future years we have revised down our PSNB forecast by £0.6 billion in 2014-15, rising to £6.9 billion in 2017-18 and falling again to £2.4 billion in 2018-19. Our forecast for the cash transfers between the APF and the Exchequer has changed only marginally since December, so the revisions to headline and underlying PSNB are of similar size. Table 4.41 shows that these downward revisions are driven by the following factors:

- higher receipts in each year of the forecast, with the revision increasing from £1.1 billion in 2013-14 to £4.0 billion in 2017-18. The upward revision to receipts slows in 2018-19 due to slower GDP and employment growth, once the output gap has closed;
- small changes to our forecast for spending in 2014-15 and 2015-16, followed by changes to spending from 2016-17 that reflect the Government's change to the baseline spending assumption and our revised GDP deflator forecast;

- the tax and spending measures that the Treasury has included in its Budget policy decisions table have little cumulative impact on borrowing over the forecast, with a £5½ billion cumulative net tax cut offset by a £5¾ billion cumulative reduction in spending.

4.180 All fiscal forecasts are subject to significant uncertainty. Chart 4.8 shows our central forecast for underlying PSNB with successive pairs of shaded areas around it, representing 20 per cent probability bands based in the pattern of past official forecast errors. (As with our GDP forecast, the central forecast is judged to be a median forecast, with equal probability that outcomes will be above or below the forecast.) On this basis the probability that PSNB will be back to balance rises from 5 per cent in 2015-16 to 20 per cent in 2016-17, 40 per cent in 2017-18 and just over 50 per cent in 2018-19.

Chart 4.8: Underlying PSNB fan chart




Source: ONS, OBR. Excludes Royal Mail pension fund and APF transfers.

## Current budget

4.181 Our central forecast shows the current budget moving from a deficit of £71.5 billion in 2013-14 (£83.7 billion excluding APF transfers) to a surplus of £30.5 billion in 2018-19. Relative to our December forecast, the current budget balance has improved by £2.6 billion in 2013-14, rising to £6.5 billion higher in 2017-18 and £2.5 billion in 2018-19. The drivers of the improvement in the current budget are similar to those for underlying PSNB described above.

## Cyclically-adjusted current budget

4.182 The cyclically-adjusted current budget (CACB) moves from a deficit of 2.8 per cent of GDP in 2013-14 to a surplus of 1.5 per cent of GDP in 2018-19. We expect the

CACB to move into surplus in 2017-18. As with cyclically-adjusted PSNB, the CACB is little changed on average over the forecast period. The CACB is discussed further in Chapter 5.

## Public sector net debt

4.183 We forecast public sector net debt (PSND) to rise as a share of GDP in each year up to and including 2015-16, peaking at 78.7 per cent of GDP. It falls by a small margin in 2016-17 and more rapidly thereafter, reaching 74.2 per cent of GDP in 2018-19. PSND in 2018-19 is forecast to be 1.8 per cent of GDP lower than we forecast in December. Table 4.42 breaks this change down as follows:

- upward revisions to our nominal GDP forecast have reduced the ratio of the cash value of debt to GDP in each year, with the effect rising from 0.4 per cent of GDP in 2013-14 to 0.6 per cent of GDP in 2018-19; and

- our forecast for PSND in cash terms is lower by £10 billion in 2013-14, rising to £25 billion in 2018-19. In the near term, the largest effect is from the cash flow measure of borrowing this year being revised down by more than the headline measure of borrowing. In later years, cumulative revisions to net borrowing are more important, partially offset by Budget measures that increase lending.

### Table 4.42: Changes to public sector net debt since December

| | Per cent of GDP | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | 73.9 | 75.5 | 78.3 | 80.0 | 79.9 | 78.4 | 75.9 |
| March forecast | 74.2 | 74.5 | 77.3 | 78.7 | 78.3 | 76.5 | 74.2 |
| Change | 0.3 | -1.0 | -1.0 | -1.2 | -1.6 | -1.9 | -1.8 |
| *of which:* | | | | | | | |
| Change in nominal GDP[1] | 0.1 | -0.4 | -0.5 | -0.5 | -0.6 | -0.7 | -0.6 |
| Change in cash level of net debt | 0.2 | -0.6 | -0.6 | -0.7 | -0.9 | -1.2 | -1.2 |
| | £ billion | | | | | | |
| December forecast | 1182 | 1269 | 1365 | 1451 | 1515 | 1554 | 1573 |
| March forecast | 1185 | 1258 | 1355 | 1439 | 1497 | 1530 | 1548 |
| Change in cash level of net debt | 3 | -10 | -10 | -13 | -18 | -24 | -25 |
| *of which:* | | | | | | | |
| Budget measures | 0 | 0 | 1 | 2 | 4 | 6 | 8 |
| Other changes in net borrowing | 0 | -4 | -4 | -8 | -14 | -21 | -23 |
| Other | 3 | -7 | -6 | -6 | -8 | -9 | -9 |

[1] Non-seasonally-adjusted GDP centred end-March.

Table 4.43: Headline fiscal aggregates

| | Per cent of GDP | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Receipts and expenditure | | | | | | | |
| Public sector current receipts *(a)* | 37.8 | 37.7 | 37.7 | 37.8 | 38.0 | 38.0 | 38.1 |
| Total managed expenditure *(b)* | 42.9 | 43.5 | 42.5 | 41.6 | 40.2 | 38.9 | 38.0 |
| *of which:* | | | | | | | |
| Public sector current expenditure *(c)* | 41.8 | 40.6 | 39.5 | 38.7 | 37.3 | 36.1 | 35.2 |
| Public sector net investment *(d)* | -0.3 | 1.5 | 1.6 | 1.5 | 1.5 | 1.4 | 1.4 |
| Depreciation *(e)* | 1.4 | 1.4 | 1.4 | 1.4 | 1.4 | 1.4 | 1.4 |
| Deficit | | | | | | | |
| Public sector net borrowing *(b-a)* | 5.1 | 5.8 | 4.9 | 3.8 | 2.2 | 0.9 | -0.1 |
| Surplus on current budget *(a-c-e)* | -5.4 | -4.4 | -3.3 | -2.3 | -0.7 | 0.5 | 1.5 |
| Cyclically-adjusted net borrowing | 3.1 | 4.3 | 3.8 | 3.0 | 1.7 | 0.7 | -0.1 |
| Primary balance | -3.0 | -4.0 | -2.9 | -1.4 | 0.5 | 2.0 | 3.0 |
| Cyclically-adjusted primary balance | -1.0 | -2.5 | -1.9 | -0.6 | 1.0 | 2.2 | 3.0 |
| Fiscal mandate and supplementary target | | | | | | | |
| Cyclically-adjusted surplus on current budget | -3.5 | -2.8 | -2.2 | -1.5 | -0.2 | 0.7 | 1.5 |
| Public sector net debt[1] | 74.2 | 74.5 | 77.3 | 78.7 | 78.3 | 76.5 | 74.2 |
| Financing | | | | | | | |
| Central government net cash requirement | 6.7 | 5.1 | 5.6 | 4.3 | 3.3 | 1.8 | 0.3 |
| Public sector net cash requirement | 6.8 | 4.9 | 5.4 | 4.0 | 3.1 | 1.6 | 0.1 |
| Stability and Growth Pact | | | | | | | |
| Treaty deficit[2] | 5.2 | 6.0 | 5.0 | 4.0 | 2.4 | 1.1 | 0.1 |
| Cyclically-adjusted Treaty deficit | 3.2 | 4.4 | 4.0 | 3.2 | 1.8 | 0.9 | 0.1 |
| Treaty debt ratio[3] | 88.3 | 89.6 | 91.8 | 93.1 | 91.9 | 89.4 | 86.6 |
| | £ billion | | | | | | |
| Public sector net borrowing | 80.3 | 95.6 | 83.9 | 68.3 | 41.5 | 17.8 | -1.1 |
| Surplus on current budget | -85.5 | -71.5 | -56.0 | -41.2 | -13.8 | 10.0 | 30.5 |
| Cyclically-adjusted net borrowing | 49.3 | 70.4 | 65.9 | 54.4 | 31.8 | 13.5 | -1.9 |
| Cyclically-adjusted surplus on current budget | -54.5 | -46.3 | -38.0 | -27.3 | -4.1 | 14.4 | 31.3 |
| Public sector net debt | 1185 | 1258 | 1355 | 1439 | 1497 | 1530 | 1548 |
| *Memo: Output gap (per cent of GDP)* | *-2.8* | *-2.0* | *-1.3* | *-1.0* | *-0.6* | *-0.2* | *0.0* |

[1] Debt at end March; GDP centred on end March.
[2] General government net borrowing on a Maastricht basis.
[3] General government gross debt on a Maastricht basis.

Table 4.44: Changes to the fiscal forecast

| | £ billion | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Surplus on current budget[1] | | | | | | | |
| June 2010 forecast | -65.1 | -40.2 | -16.9 | 0.4 | | | |
| December 2013 forecast | -92.8 | -86.3 | -68.3 | -51.4 | -22.8 | 3.1 | 28.0 |
| *Change* | *0.9* | *2.6* | *0.7* | *3.0* | *6.1* | *6.5* | *2.5* |
| March 2014 forecast | -91.9 | -83.7 | -67.6 | -48.4 | -16.7 | 9.6 | 30.5 |
| Net investment[1] | | | | | | | |
| June 2010 forecast | 24.0 | 19.9 | 20.6 | 20.9 | | | |
| December 2013 forecast | 22.2 | 24.9 | 27.7 | 27.3 | 28.3 | 26.5 | 25.7 |
| *Change* | *0.7* | *-0.8* | *0.2* | *-0.5* | *-0.5* | *-0.4* | *-0.1* |
| March 2014 forecast | 22.9 | 24.1 | 27.9 | 26.8 | 27.7 | 26.1 | 25.7 |
| Net borrowing[1] | | | | | | | |
| June 2010 forecast | 89.1 | 60.1 | 37.5 | 20.5 | | | |
| December 2013 forecast | 115.0 | 111.2 | 96.0 | 78.7 | 51.1 | 23.4 | -2.2 |
| *Change* | *-0.2* | *-3.4* | *-0.6* | *-3.5* | *-6.6* | *-6.9* | *-2.6* |
| March 2014 forecast | 114.8 | 107.8 | 95.5 | 75.2 | 44.5 | 16.5 | -4.8 |
| Net debt | | | | | | | |
| June 2010 forecast | 1162 | 1235 | 1284 | 1316 | | | |
| December 2013 forecast | 1182 | 1269 | 1365 | 1451 | 1515 | 1554 | 1573 |
| *Change* | *3* | *-10* | *-10* | *-13* | *-18* | *-24* | *-25* |
| March 2014 forecast | 1185 | 1258 | 1355 | 1439 | 1497 | 1530 | 1548 |
| | Per cent of GDP | | | | | | |
| Net borrowing[1] | | | | | | | |
| June 2010 forecast | 5.5 | 3.5 | 2.1 | 1.1 | | | |
| December 2013 forecast | 7.3 | 6.8 | 5.6 | 4.4 | 2.7 | 1.2 | -0.1 |
| *Change* | *0.0* | *-0.2* | *-0.1* | *-0.2* | *-0.4* | *-0.4* | *-0.1* |
| March 2014 forecast | 7.3 | 6.6 | 5.5 | 4.2 | 2.4 | 0.8 | -0.2 |
| Cyclically-adjusted surplus on current budget[1] | | | | | | | |
| June 2010 forecast | -1.9 | -0.7 | 0.3 | 0.8 | | | |
| December 2013 forecast | -4.1 | -3.7 | -2.7 | -1.8 | -0.4 | 0.7 | 1.6 |
| *Change* | *0.2* | *0.1* | *-0.2* | *-0.2* | *0.0* | *0.0* | *0.0* |
| March 2014 forecast | -3.9 | -3.6 | -2.9 | -1.9 | -0.4 | 0.7 | 1.5 |
| Cyclically-adjusted net borrowing[1] | | | | | | | |
| June 2010 forecast | 3.4 | 1.8 | 0.8 | 0.3 | | | |
| December 2013 forecast | 5.5 | 5.2 | 4.3 | 3.3 | 1.9 | 0.7 | -0.3 |
| *Change* | *-0.1* | *-0.2* | *0.2* | *0.1* | *0.0* | *-0.1* | *0.0* |
| March 2014 forecast | 5.3 | 5.0 | 4.5 | 3.4 | 1.9 | 0.6 | -0.3 |
| Net debt[2] | | | | | | | |
| June 2010 forecast | 69.8 | 70.3 | 69.4 | 67.4 | | | |
| December 2013 forecast | 73.9 | 75.5 | 78.3 | 80.0 | 79.9 | 78.4 | 75.9 |
| *Change* | *0.3* | *-1.0* | *-1.0* | *-1.2* | *-1.6* | *-1.9* | *-1.8* |
| March 2014 forecast | 74.2 | 74.5 | 77.3 | 78.7 | 78.3 | 76.5 | 74.2 |

[1] Excluding APF and Royal Mail pension fund transfers.

[2] Debt at end March; GDP centred on end March.

## International comparisons

4.184 International organisations, such as the European Commission and International Monetary Fund (IMF), produce forecasts of deficit and debt levels of different countries on a comparable basis. These are based on general government debt and borrowing and are presented on a calendar year basis. To facilitate comparisons, Tables 4.45 and 4.46 provide UK forecasts on a comparable basis. With both modelling and reporting of much tax and spend done primarily on a financial year basis, the calendar year forecasts are illustrative and have been derived by weighting the financial year forecasts.

Table 4.45: Comparison with European Commission forecasts

| | Per cent of GDP | | | | | |
|---|---|---|---|---|---|---|
| | Treaty Deficit[1] | | | Treaty Debt[2] | | |
| | 2013 | 2014 | 2015 | 2013 | 2014 | 2015 |
| UK (March *EFO*) | 5.7 | 5.5 | 4.2 | 90.1 | 91.2 | 92.8 |
| UK (EC) | 6.3 | 5.2 | 4.2 | 91.4 | 93.4 | 94.5 |
| Germany | 0.1 | 0.0 | 0.0 | 79.6 | 77.3 | 74.5 |
| France | 4.2 | 4.0 | 3.9 | 93.9 | 96.1 | 97.3 |
| Italy | 3.0 | 2.6 | 2.2 | 132.7 | 133.7 | 132.4 |
| Spain | 7.2 | 5.8 | 6.5 | 94.3 | 98.9 | 103.3 |
| Euro area | 3.1 | 2.6 | 2.5 | 95.5 | 95.9 | 95.4 |

[1] General government net borrowing.

[2] General government gross debt.

Source: European Commission, *European Economic Forecast*, Winter 2014; OBR

Table 4.46: Comparison with the IMF forecasts

| | Per cent of GDP | | | | | |
|---|---|---|---|---|---|---|
| | General government net borrowing | | | General government net debt | | |
| | 2013 | 2014 | 2017 | 2013 | 2014 | 2017 |
| UK (March *EFO*) | 5.7 | 5.5 | 1.4 | 81.4 | 82.8 | 82.4 |
| UK (IMF) | 6.1 | 5.8 | 2.7 | 84.8 | 88.0 | 90.9 |
| Germany | 0.4 | 0.1 | -0.2 | 56.3 | 54.6 | 50.8 |
| France | 4.0 | 3.5 | 1.2 | 87.2 | 88.5 | 85.4 |
| Italy | 3.2 | 2.1 | 0.5 | 110.5 | 111.2 | 105.4 |
| Japan | 9.5 | 6.8 | 5.1 | 139.9 | 141.8 | 147.2 |
| U.S. | 5.8 | 4.7 | 3.8 | 87.4 | 88.3 | 86.6 |

Source: OBR, IMF, *World Economic Outlook*, October 2013

# 5 Performance against the Government's fiscal targets

## Introduction

5.1 This chapter:

- sets out the Government's medium-term fiscal targets (from paragraph 5.2);
- examines whether the Government has a better than 50 per cent chance of meeting them, given our central forecast (from paragraph 5.6); and
- assesses how robust this judgement is to the uncertainties inherent in any fiscal forecast, by looking at past forecast errors, sensitivity to key parameters of the forecast and alternative economic scenarios (from paragraph 5.14).

## The Government's fiscal targets

5.2 In the June 2010 Budget, the Government set itself two medium-term fiscal targets for the current Parliament: the fiscal mandate and a supplementary target. The OBR is required to judge whether the Government has a greater than 50 per cent probability of hitting these targets under existing policy.

5.3 The *Charter for Budget Responsibility* defines the fiscal mandate as "*a forward-looking target to achieve cyclically-adjusted current balance by the end of the rolling, five-year forecast period*". This means that total public sector receipts need to at least equal total public sector spending (minus spending on net investment) in five years time, after adjusting for the impact of any remaining spare capacity in the economy. For the purposes of this forecast, the five-year horizon ends in 2018-19.

5.4 The *Charter* says that the supplementary target requires "*public sector net debt as a percentage of GDP to be falling at a fixed date of 2015-16, ensuring the public finances are restored to a sustainable path.*" The target refers to public sector net debt (PSND) excluding the temporary effects of financial interventions.

5.5 From our autumn 2014 forecast, we will also assess the Government's performance against its new welfare cap, which is described in Chapter 4.

## The implications of our central forecast

5.6 Table 5.1 shows our central forecasts for the cyclically-adjusted current budget (CACB) and PSND in each year to 2018-19, as set out in Chapter 4. These are median forecasts, so we believe it is equally likely that the eventual outturns will come in above them as below them.

Table 5.1: Performance against the Government's fiscal targets

| | Per cent of GDP | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| CACB | | | | | | | |
| December forecast | -3.6 | -2.9 | -2.0 | -1.4 | -0.2 | 0.7 | 1.6 |
| March forecast excluding Budget measures[1] | -3.5 | -2.8 | -2.2 | -1.5 | -0.2 | 0.7 | 1.5 |
| March forecast | -3.5 | -2.8 | -2.2 | -1.5 | -0.2 | 0.7 | 1.5 |
| CACB excluding APF[1] | | | | | | | |
| December forecast | -4.1 | -3.7 | -2.7 | -1.8 | -0.4 | 0.7 | 1.6 |
| March forecast excluding Budget measures[1] | -3.9 | -3.6 | -2.9 | -1.9 | -0.4 | 0.7 | 1.5 |
| March forecast | -3.9 | -3.6 | -2.9 | -1.9 | -0.4 | 0.7 | 1.5 |
| PSND | | | | | | | |
| December forecast | 73.9 | 75.5 | 78.3 | 80.0 | 79.9 | 78.4 | 75.9 |
| March forecast excluding Budget measures[1] | 74.2 | 74.5 | 77.2 | 78.7 | 78.1 | 76.3 | 73.8 |
| March forecast | 74.2 | 74.5 | 77.3 | 78.7 | 78.3 | 76.5 | 74.2 |
| PSND excluding APF, B&B and NRAM[1] | | | | | | | |
| December forecast | 69.9 | 74.4 | 78.3 | 80.8 | 81.2 | 80.0 | 77.6 |
| March forecast excluding Budget measures[1] | 70.1 | 73.6 | 77.4 | 79.7 | 79.6 | 78.1 | 75.7 |
| March forecast | 70.1 | 73.6 | 77.5 | 79.8 | 79.8 | 78.4 | 76.1 |

[1] These remove the direct effects. No account is taken of indirect effects, including the impact on debt interest payments.

5.7 Table 5.1 shows that in the absence of Budget measures, our central forecast would show the CACB in surplus by 1.5 per cent of GDP in 2018-19, fractionally less than we forecast in December. This remains unchanged after Budget measures are taken into account, so there remains a significantly greater than 50 per cent chance of the Government achieving balance on this measure in that year. As a result, it is still on course to achieve the mandate.

5.8 Table 5.2 decomposes the changes in our forecasts of CACB since December. It shows that:

- setting a spending assumption that extends the real cuts over the Spending Review period from a higher baseline in 2010-11 reduces structural non-investment spending by around 0.2 per cent of GDP in 2017-18 and 2018-19. (The Treasury treats this as a change to the pre-measures baseline, so does not report the additional tightening in its table of policy measures);

- measures appearing in the Treasury's Budget decisions table are broadly neutral in each year, adding a little to the surplus in the final year. This includes 0.1 per cent of GDP by 2018-19 of further spending reductions, over and above the effect of the change to the spending assumption; and

- these decisions broadly offset other forecasting changes beyond 2016-17. These reduce the CACB by around 0.2 per cent of GDP on average over the next five years, largely due to receipts being slightly lower as a share of GDP despite a narrower output gap.

Table 5.2: Changes to the cyclically-adjusted current budget since December

| | Per cent of GDP | | | | | | |
|---|---|---|---|---|---|---|---|
| | Outturn | Forecast | | | | | |
| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | -3.6 | -2.9 | -2.0 | -1.4 | -0.2 | 0.7 | 1.6 |
| March forecast | -3.5 | -2.8 | -2.2 | -1.5 | -0.2 | 0.7 | 1.5 |
| Change | 0.2 | 0.1 | -0.2 | -0.2 | 0.0 | 0.0 | 0.0 |
| *of which:* | | | | | | | |
| Budget measures | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Baseline spending assumption | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.2 | 0.2 |
| Other forecasting changes | 0.2 | 0.1 | -0.2 | -0.2 | -0.1 | -0.2 | -0.3 |

5.9 The supplementary target requires PSND to fall as a share of GDP between 2014-15 and 2015-16, with this target year fixed. Our December forecast was for PSND to rise by 1.7 per cent of GDP in that year. We now expect PSND to rise more gradually over the next three years, but a smaller rise of 1.5 per cent of GDP in 2015-16 means that the Government is still on course to miss its supplementary target. This has been the case in each of our forecasts since December 2012. PSND is expected to peak in 2015-16, as in December, but then to fall by a bigger margin in 2016-17, of around 0.5 per cent of GDP.

5.10 As Table 5.1 shows, excluding the APF transfers and the rundown of Bradford & Bingley and Northern Rock (Asset Management) (B&B and NRAM) assets, net debt would remain flat as a share of GDP in 2016-17, before falling a year later in 2017-18.

5.11 Table 5.3 decomposes changes in the profile of net debt as a share of GDP since December. This shows that:

- changes in our forecast for nominal GDP affect the denominator we use to calculate PSND as a share of GDP. Stronger nominal GDP growth slows the rise in PSND out to 2016-17, while our forecast that the output gap will closer earlier lowers growth in the final year, having the opposite effect;

- net borrowing is lower in each year of the forecast horizon, largely due to the cyclical recovery in receipts and further cuts to spending after the current Spending Review period. As borrowing now falls more quickly than in our December forecast, debt rises more slowly and then falls more rapidly as a share of GDP in 2016-17 and 2017-18;
- Budget measures that increase lending raise net debt over the period; and
- other changes lead to net debt falling by an additional 0.6 per cent of GDP in 2013-14, but have little effect in subsequent years. The cash flow measure of borrowing this year has been revised down by more than the headline measure, which appears to relate to an unusual pattern in 2012-13 that is now unwinding.

Table 5.3: Changes in the profile of net debt since December

| | Change in PSND on a year earlier (per cent of GDP) | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| December forecast | 1.6 | 2.8 | 1.7 | -0.1 | -1.4 | -2.5 |
| March forecast | 0.3 | 2.7 | 1.5 | -0.5 | -1.7 | -2.4 |
| Change | -1.3 | 0.0 | -0.2 | -0.4 | -0.3 | 0.1 |
| *of which:* | | | | | | |
| Nominal GDP | -0.5 | -0.1 | -0.1 | -0.1 | 0.0 | 0.0 |
| Budget measures | 0.0 | 0.1 | 0.0 | 0.1 | 0.1 | 0.1 |
| Other changes in net borrowing | -0.2 | -0.1 | -0.2 | -0.3 | -0.3 | -0.1 |
| Other | -0.6 | 0.1 | 0.0 | -0.1 | -0.1 | 0.0 |

5.12 Over the coming months, the ONS will implement significant revisions to the public finances, as it takes on board the conclusions from its review of the public finance statistics and changes associated with the 2010 European System of Accounts (ESA10). For this *EFO*, our forecasts are presented on the existing basis, and we discuss the possible implications of future revisions in Annex B.

5.13 As shown in Table 5.4, the forthcoming changes to the public finances data are unlikely to have a significant impact on the measured CACB at the end of the forecast horizon, and thus on the Government's chances of meeting the fiscal mandate. But even though the measured level of net debt will be significantly higher after the revisions, the chances of it falling in 2015-16 are likely to be greater if the APF starts selling gilts before the end of 2015-16, as assumed in our central forecast – although still not greater than 50 per cent. Debt would also fall more steeply if the Government was to sell more of the shares that it purchased as a result of financial interventions. This does not feature in our central forecast, given uncertainties over the potential scale and timing of such sales.

Table 5.4: Illustrative CACB and PSND post-PSF Review and ESA10

| | Per cent of GDP | | | | | |
|---|---|---|---|---|---|---|
| | | Forecast | | | | |
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Central forecast | | | | | | |
| CACB | -2.8 | -2.2 | -1.5 | -0.2 | 0.7 | 1.5 |
| PSND | 74.5 | 77.3 | 78.7 | 78.3 | 76.5 | 74.2 |
| Year-on-year change in PSND | 0.3 | 2.7 | 1.5 | -0.5 | -1.7 | -2.4 |
| Implied forecast post-PSF Review and ESA10[1] | | | | | | |
| CACB | -2.7 | -2.2 | -1.4 | -0.1 | 0.8 | 1.5 |
| PSND | 79.4 | 82.0 | 83.1 | 82.3 | 80.1 | 77.3 |
| Year-on-year change in PSND | 1.0 | 2.6 | 1.1 | -0.9 | -2.1 | -2.8 |

[1] The possible implications for debt and deficit measures are discussed in Annex B. ESA10 nominal GDP has been adjusted by the mid-point of ONS's 2½ to 5 per cent range.

## Recognising uncertainty

5.14 Past experience and common sense suggest that there are significant upside and downside risks to our central forecasts for the public finances. These reflect uncertainty both about the outlook for the economy and about the level of receipts and spending in any given state of the economy.

5.15 Given these uncertainties, it is important to stress-test our judgements that the Government is on course to meet the mandate in 2018-19, but not on course to meet the supplementary target in 2015-16. We do this in three ways:

- by looking at the evidence from past forecast errors;
- by seeing how our central forecast would change if we altered some of the key judgements and assumptions that underpin it; and
- by looking at alternative economic scenarios.

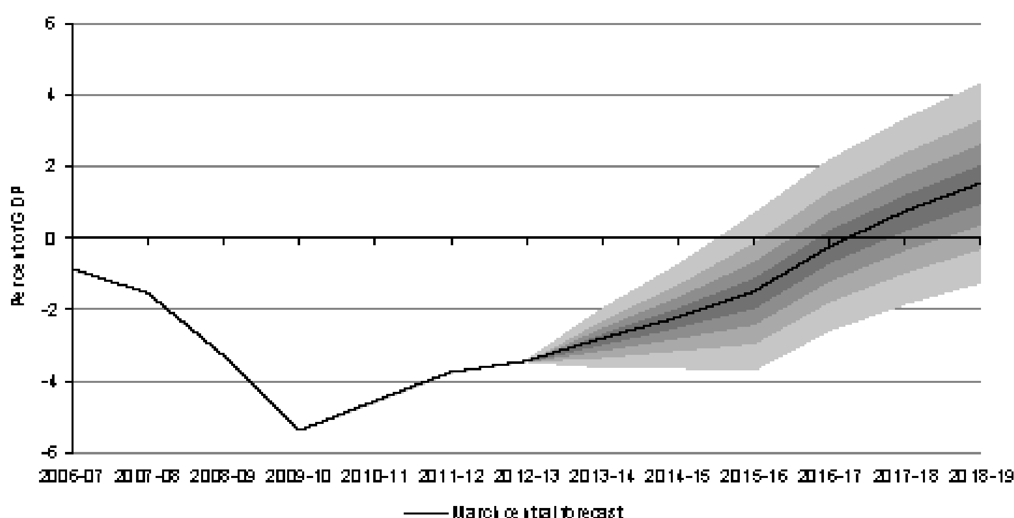
### Past performance

5.16 One relatively simple way to illustrate the uncertainty around our central forecast is to consider the accuracy of previous official public finance forecasts. This can be done using fan charts like those we presented for GDP growth in Chapter 3 and underlying public sector net borrowing (PSNB) in Chapter 4. These fan charts do not represent our assessment of specific risks to the central forecast. Instead they show the outcomes that someone might anticipate if they believed, rightly or wrongly, that forecast errors in the past offered a reasonable guide to forecast errors in the future.

5.17 In this spirit, Chart 5.1 shows the probability distribution around our central forecast for the CACB, based on past official forecast errors. The solid black line shows the median forecast, with the successive pairs of lighter shaded areas around it

representing 20 per cent probability bands. This implies that, based on current policy, there would be an 80 per cent probability of the outturn lying within the shaded bands.

Chart 5.1: Cyclically-adjusted current budget fan chart




Source: OBR

5.18 A direct reading of the chart would imply that the Government currently has a roughly 75 per cent probability of achieving a surplus on the CACB in 2018-19 and thereby meeting the mandate. The probability of achieving a cyclically-adjusted current surplus in earlier years is lower at around 65 per cent for 2017-18, 45 per cent for 2016-17 and 20 per cent for 2015-16.

5.19 Unfortunately, we cannot estimate the probability of achieving the supplementary target as we do not have the joint distribution that would allow us to apply the same technique. That said, our central median forecast shows PSND rising as a percentage of GDP in 2015-16.

## Sensitivity analysis

5.20 It is very difficult to produce a full subjective probability distribution for the Government's target fiscal variables because they are affected by a huge variety of economic and non-economic determinants, many of which are correlated with each other. However, to recognise the uncertainty in our forecast we can go further than using evidence from past forecast errors, by quantifying roughly how sensitive our central forecast is to changes in certain key economic parameters.

5.21 In thinking about the evolution of the public finances over the medium term, there are several parameters that have a particularly important bearing on the forecast. In this section, we focus on four:

- the level of potential output, captured by the size of the output gap;
- the speed with which the output gap closes (i.e. the pace of the recovery);
- the interest rates that the Government has to pay on its debt; and
- possible errors in our cyclical adjustment coefficients.

5.22 Our central forecast is based on a judgement that the economy was running 1.7 per cent below potential in the final quarter of 2013, and that above-trend growth over the forecast period will close the output gap by mid-2018, around a year earlier than in December. But neither the level of potential output nor the pace of recovery are possible to estimate with confidence, not least because the former is not something we can observe directly in economic data. So what if the medium-term level of potential was higher or lower than our central estimate, and what if the output gap closed earlier or later than our central estimates?

5.23 Tables 5.5 and 5.6 present illustrative estimates of the impact on:

- the level of the CACB in 2018-19; and
- the change in PSND as a share of GDP between 2014-15 and 2015-16.

5.24 For practical reasons, we have not undertaken complete forecast runs for each variant, but have instead used ready-reckoners and simplifying assumptions to generate illustrative estimates. We assume that a lower or higher level of potential is reflected in our starting output gap, rather than errors in forecasting trend growth over the forecast period.

5.25 The cyclical adjustment ready-reckoner assumes that a 1 per cent change in GDP will result in a 0.7 per cent of GDP change in PSNB and the current budget after two years. The actual change in the public finances would depend on many other factors, including the composition of growth, inflation and the labour market response. While we recognise the limitations of this top-down approach, applying these ready-reckoners yields the results shown in the tables below.

Table 5.5: Cyclically-adjusted current budget in 2018-19

| | | Per cent of GDP | | | | |
|---|---|---|---|---|---|---|
| | | Output gap closes | | | | |
| | | 2014-15 | 2016-17 | 2018-19 | 2020-21 | 2022-23 |
| Level of potential in 2018-19 relative to central forecast | -2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| | -1 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| | 0 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| | 1 | 2.3 | 2.3 | 2.3 | 2.2 | 2.2 |
| | 2 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |

Table 5.6: Change in public sector net debt between 2014-15 and 2015-16

| | | Per cent of GDP | | | | |
|---|---|---|---|---|---|---|
| | | Output gap closes | | | | |
| | | 2014-15 | 2016-17 | 2018-19 | 2020-21 | 2022-23 |
| Level of potential in 2018-19 relative to central forecast | -2 | 2.3 | 2.3 | 2.2 | 2.2 | 2.2 |
| | -1 | 1.6 | 1.6 | 1.9 | 2.0 | 2.0 |
| | 0 | 0.9 | 0.8 | 1.5 | 1.7 | 1.9 |
| | 1 | 0.2 | 0.0 | 1.0 | 1.5 | 1.7 |
| | 2 | -0.5 | -0.8 | 0.6 | 1.2 | 1.3 |

5.26 Table 5.5 shows that the level of potential output has a big effect on the size of the CACB balance in 2018-19. The lower potential output is, and therefore the smaller the output gap, the larger the proportion of the deficit that is structural and the less margin the Government has against its fiscal mandate. Conversely, if potential output is higher, less of the deficit is structural and the Government has a greater margin against its mandate.

5.27 Closing the output gap at a different pace would typically result in a change in cyclical borrowing, but have little effect on the structural balance. For example, closing the output gap more slowly would result in a lower growth path, leading to more cyclical borrowing but a broadly similar level of structural borrowing.

5.28 In broad terms, the level of potential output would need to be over 2 per cent lower in 2018-19 than in our central forecast to make it more likely than not that the mandate would be missed. As set out in Chapter 3, projections of potential output vary considerably.

5.29 Table 5.6 shows that the Government would continue to miss its supplementary target unless the output gap was materially wider than in our central forecast and closed faster. The former would imply less structural borrowing, whereas the latter would suggest less cyclical borrowing.

5.30 A third potential source of departure from our central forecast is variation in the interest rates that the Government has to pay on future borrowing and some existing debt. Our central forecast assumes that gilt rates for future borrowing move in line with market expectations. But what if a shock meant that those

expectations were to prove wrong? We examine the implications of a negative shock of 50 basis points, making debt cheaper to service, and increases of 50, 100, 150 and 200 basis points, making it more expensive. For this analysis, we assume that the shock does not affect any other part of the forecast, including exchange rates and shorter-term interest rates. In reality, a gilt rate shock would be accompanied by other important changes in the economy. Table 5.7 shows the level of the CACB in 2018-19 and the change in PSND as a share of GDP between 2014-15 and 2015-16 under these variants, constructed using a ready-reckoner.

Table 5.7: Fiscal target variables under different gilt rate assumptions

| | Per cent of GDP | | | | | |
|---|---|---|---|---|---|---|
| | Change in gilt rate (bps) | | | | | |
| | -50 | 0 | 50 | 100 | 150 | 200 |
| CACB in 2018–19 | 1.7 | 1.5 | 1.4 | 1.2 | 1.0 | 0.5 |
| Change in PSND between 2014–15 and 2015–16 | 1.4 | 1.5 | 1.5 | 1.6 | 1.7 | 1.7 |

5.31 Table 5.7 shows that these illustrative shocks to gilt rates have a relatively small impact on the chances of meeting the mandate and supplementary target. This is because an increase in rates only applies to new debt issuance. Since the UK has a relatively long average debt maturity for conventional gilts, new issuance forms a relatively small proportion of the stock each year. Moreover, new issuance is projected to fall as borrowing declines. Therefore over our 5-year forecast period, the impact of a shock to the average nominal interest rate on gilts is relatively small.

5.32 Gilt rates will also affect transfers between the Exchequer and the APF as gilts are sold. If gilt rates were higher, bond prices would be lower and so capital losses for the APF would be greater. But as gilts are assumed to be sold from late in 2015-16, a gilt rate shock would have only a small effect on our assessment of the supplementary target through this channel, and no effect on the CACB in 2018-19, as transfers from the Exchequer to the APF are classified as capital spending. The treatment of the APF flows within the public finance statistics will change later this year (see Annex B).

5.33 Our final sensitivity analysis concerns uncertainty around our cyclical adjustment coefficients. Cyclical adjustment attempts to look through the effect of the economic cycle on the public finances. This is achieved by adjusting a given fiscal aggregate, such as the current budget, for the size of the output gap in the current and previous years, using coefficients to estimate a cyclically-adjusted aggregate, such as the CACB. Our approach to cyclical adjustment applies coefficients of 0.2 for the previous year's output gap and 0.5 for the current year's gap, as described in a Working Paper available on our website.[1]

[1] Helgadottir et al, 2012, Working Paper No. 4: *Cyclically adjusting the public finances*.

5.34 The coefficients are derived by analysing the past relationship between the output gap and the fiscal position. They are highly uncertain for a number of reasons:

- the output gap is not directly observable, so there is no historical 'fact' from which to estimate the coefficients;
- the number of observations on which to base coefficient estimates is limited;
- the fiscal position is affected by events that do not necessarily move in line with the cycle, such as one-off fiscal policy adjustments and movements in commodity and asset prices; and
- insofar as the current economic cycle differs from the average cycle, the relationship between the public finances and the output gap over the course of that cycle will not be captured in the coefficients.

5.35 Given these uncertainties, it is useful to consider how sensitive our central forecast is to variations in the coefficients. Our latest forecast is for the headline current budget balance to move into surplus in 2017-18, improving further to 1.5 per cent of GDP in 2018-19. If the economy is operating either at or below its potential over that period, as in our central forecast, then varying the coefficients would not affect our judgement that the fiscal mandate will be met, although it could affect the margin for error around it. Our current forecast of a very small negative output gap in 2017-18, which closes in the first quarter of 2018-19, implies that applying different coefficients would have very little impact on the CACB in that year. If the coefficients were reduced by 0.1, to 0.4 on the current year's output gap and 0.1 on the previous year's output gap, the CACB would be less than 0.1 per cent of GDP lower in 2018-19.

## Scenario analysis

5.36 The sensitivity analysis discussed above focuses on a narrow set of factors and therefore only offers a partial assessment of potential uncertainty. In this section, we set out the fiscal implications of two illustrative alternative economic scenarios, designed to test how dependent our conclusions are on key judgements that are subject to debate in the forecasting community. We stress that these scenarios are not intended to capture all possible ways in which the economy might deviate from the central forecast and we do not attempt to attach particular probabilities to their occurrence.

5.37 One current topic of debate is the path for mortgage rates over the medium term, and their possible impact on households' ability to service their debts. Our central forecast assumes effective mortgage rates rise gradually over the forecast period, and more slowly than Bank Rate, as the lagged effects of previous falls in new mortgage rates feed through to the stock of mortgages, and competition bears down on margins.

5.38 Since our December forecast, some emerging market economies have experienced significant capital outflows and accompanying currency depreciations. This volatility seems to reflect country-specific factors, and our central forecast assumes that the impact of the recent instability is short lived.

5.39 Here we examine two scenarios:

- a 'higher credit spreads' scenario, in which banks' funding costs spike up, which is one channel along which continued volatility in emerging markets could affect the UK; and
- a 'stronger demand' scenario, which could push up interest rates in the wider economy due to a steeper path for Bank Rate, as the Bank of England reacts to stronger growth in incomes and a narrower output gap.

### Higher credit spreads scenario

5.40 In this scenario, emerging market instability spills over to global financial markets. This places upward pressure on banks' funding costs that soon push domestic interest rates in the wider economy above our central forecast. The key assumptions and implications of this scenario are:

- banks' marginal funding costs rise by around 150 basis points in mid-2014, and remain elevated for a year. Such a credit shock would be of a similar duration and magnitude to events towards the end of 2011 and in 2012, linked to tensions in the euro area;
- the profile for Bank Rate remains unchanged, so these higher funding costs are passed on to the wider economy. However, the shock affects only the price of credit – the cost of new borrowing for households and businesses – and not its availability, so in that respect it is unlike the withdrawal of credit witnessed in 2008;
- higher new borrowing rates gradually push up effective interest rates, which means that, in aggregate, household interest payments account for a bigger share of disposable income. And disposable income is itself weaker, as GDP growth slows. Substantially more households are pushed to respond, by reducing consumption, restructuring debt or seeking more work (see Box 3.5), illustrating the potential result of mortgage rates rising due to factors other than income growth;
- higher risk premia slow growth of the capital stock and impair the reallocation of resources, reducing trend output, so that only half of the GDP shortfall is recovered in later years;

- weaker growth depresses receipts, and raises unemployment-related spending. Higher mortgage interest payments displace some consumption that would otherwise be subject to VAT, and also increase the RPI-CPI wedge, which raises debt interest on index-linked gilts. Applying the Government's spending assumption for the years beyond the current Spending Review period effectively pushes through the additional spending on welfare and debt interest in 2015-16; and
- both lower receipts and higher spending increase net borrowing in each year. Structural borrowing is higher in the final year, reflecting lower potential output and that the higher cyclical spending is locked in due to the spending assumption. The Government would meet its fiscal mandate, but with a smaller margin, and miss its supplementary target by a wider margin.

### Stronger demand scenario

5.41 In this scenario, interest rates in the wider economy pick up faster than in our central forecast because demand picks up by more than we expect. The key assumptions and implications of this scenario are:

- GDP grows faster over the coming two years, continuing quarterly growth rates seen in recent quarters, prompting the output gap to close earlier and then temporarily turn positive;
- this means medium-term inflation is higher relative to the central forecast and so Bank Rate rises earlier, and the yield curve is steeper. This feeds through to higher mortgage rates, with the overall increase comparable to the higher credit spreads scenario. But the rise is more gradual, and the additional mortgage payments are more than matched by higher incomes, so that fewer households are pushed to change their spending behaviour significantly;
- the stronger recovery boosts receipts growth. Spending is lower up to 2015-16 as lower welfare spending outweighs higher spending on debt interest (due to higher RPI inflation), but the total is above our central forecast thereafter, as it is linked to general economy inflation via the spending assumption; and
- net borrowing and therefore net debt are lower over the forecast horizon. The additional above-trend growth in the near term, as the output gap turns positive, and higher inflation, mean that debt falls slightly as a share of GDP in 2015-16 and so the Government's supplementary target is met by a very small margin. The structural position is largely unaffected, leaving the margin against its fiscal mandate essentially unchanged.

5.42 Table 5.8 summarises the economic assumptions we have made, as well as the fiscal consequences of these alternative scenarios. It shows that, under either

scenario, the fiscal mandate would still be met and that under the stronger demand scenario the supplementary debt target would also be met by a very small margin, unlike in our central forecast. These scenarios illustrate the difference between what might happen if interest rates rise for good reasons – stronger income growth – and bad reasons – an adverse credit shock.

Table 5.8: Key economic and fiscal aggregates under alternative scenarios

| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
|---|---|---|---|---|---|---|
| Central forecast | | | | | | |
| Economic assumptions | | | | | | |
| GDP (percentage change) | 2.3 | 2.6 | 2.4 | 2.6 | 2.6 | 2.4 |
| CPI inflation (Q3) | 2.7 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 |
| LFS unemployment (% rate) | 7.4 | 6.7 | 6.4 | 6.0 | 5.6 | 5.4 |
| Output gap | -2.0 | -1.3 | -1.0 | -0.6 | -0.2 | 0.0 |
| Fiscal outcome (per cent of GDP) | | | | | | |
| Public sector net borrowing | 5.8 | 4.9 | 3.8 | 2.2 | 0.9 | -0.1 |
| Cyclically-adjusted current budget | -2.8 | -2.2 | -1.5 | -0.2 | 0.7 | 1.5 |
| Public sector net debt | 74.5 | 77.3 | 78.7 | 78.3 | 76.5 | 74.2 |
| Higher credit spreads scenario | | | | | | |
| Economic assumptions | | | | | | |
| GDP (percentage change) | 2.3 | 1.8 | 2.4 | 2.9 | 2.7 | 2.4 |
| CPI inflation (Q3) | 2.7 | 1.8 | 1.9 | 1.9 | 1.9 | 2.0 |
| LFS unemployment (% rate) | 7.4 | 7.2 | 6.8 | 6.1 | 5.6 | 5.4 |
| Output gap | -2.0 | -1.8 | -1.5 | -0.7 | -0.2 | 0.0 |
| Fiscal outcome (per cent of GDP) | | | | | | |
| Public sector net borrowing | 5.8 | 5.4 | 4.5 | 2.8 | 1.4 | 0.4 |
| Cyclically-adjusted current budget | -2.8 | -2.5 | -1.9 | -0.6 | 0.3 | 1.1 |
| Public sector net debt | 74.5 | 78.3 | 80.5 | 80.3 | 78.9 | 76.9 |
| Stronger demand scenario | | | | | | |
| Economic assumptions | | | | | | |
| GDP (percentage change) | 2.3 | 3.1 | 3.3 | 2.5 | 1.7 | 2.0 |
| CPI inflation (Q3) | 2.7 | 1.7 | 2.1 | 2.4 | 2.4 | 2.2 |
| LFS unemployment (% rate) | 7.4 | 6.3 | 5.2 | 4.8 | 5.2 | 5.3 |
| Output gap | -2.0 | -0.8 | 0.3 | 0.6 | 0.2 | 0.0 |
| Fiscal outcome (per cent of GDP) | | | | | | |
| Public sector net borrowing | 5.8 | 4.6 | 3.0 | 1.3 | 0.5 | -0.2 |
| Cyclically-adjusted current budget | -2.8 | -2.2 | -1.4 | -0.2 | 0.8 | 1.6 |
| Public sector net debt | 74.5 | 76.7 | 76.6 | 75.1 | 73.4 | 71.1 |

# Executive summary of the 2013 Fiscal Sustainability Report

1 In the *Fiscal sustainability report* (*FSR*) we look beyond the medium-term forecast horizon of our twice-yearly *Economic and fiscal outlooks* (*EFOs*) and ask whether the UK's public finances are likely to be sustainable over the longer term.

2 In doing so our approach is twofold:

- first, we look at the fiscal impact of past government activity, as reflected in the assets and liabilities on the public sector's balance sheet; and
- second, we look at the potential fiscal impact of future government activity, by making 50-year projections of all public spending, revenues and significant financial transactions, such as government loans to students.

3 These projections suggest that the public finances are likely to come under pressure over the longer term, primarily as a result of an ageing population. Under our definition of unchanged policy, the Government would end up having to spend more as a share of national income on age-related items such as pensions and health care. But the same demographic trends would leave government revenues roughly stable as a share of national income.

4 In the absence of offsetting tax increases or spending cuts this would widen budget deficits over time and eventually put public sector net debt on an unsustainable upward trajectory. The fiscal challenge posed by an ageing population is one the UK shares with many developed nations.

5 Separate from our central projections, this year we update our assessment of the long-term decline in North Sea oil revenues as a share of national income over the coming decades and present new analysis of trends in older people's participation in the labour market.

6 Long-term projections such as these are highly uncertain and the results we present here should be seen as illustrative broad-brush projections rather than precise forecasts. We illustrate some of the uncertainties around them through sensitivity analyses – by varying key assumptions regarding demographic trends, whole economy and health sector productivity growth, and the position of the public finances at the end of our medium-term forecast horizon.

7 It is important to emphasise that we focus here on the additional fiscal tightening that might be necessary beyond our medium-term forecast horizon. The report should not be taken to imply that the substantial fiscal consolidation already in the pipeline for the next five years should necessarily be made even bigger over that period.

8 That said, policymakers and would-be policymakers should certainly think carefully about the long-term consequences of any policies they introduce or propose in the short term. And they should give thought too to the policy choices that will confront them once the current crisis-driven consolidation is complete.

## Public sector balance sheets

9 We assess the fiscal impact of past government activity by looking at measures of assets and liabilities on different presentations of the public sector balance sheet. In this report, we draw on National Accounts balance sheet measures and on the 2011-12 Whole of Government Accounts (WGA).

10 The current and previous governments have both set targets for the National Accounts measure of public sector net debt (PSND) – the difference between the public sector's liabilities and its liquid financial assets. In March 2013, PSND was £1,181 billion, 75.1 per cent of GDP or £44,810 per household. Public sector net worth (PSNW) is a broader measure, which also includes physical and illiquid financial assets. PSNW fell sharply from 2008 onwards and the latest available outturn data at the end of 2011 gave a value for PSNW of minus £197 billion, which was minus 12.8 per cent of GDP. No government has used PSNW as a target, in part because reliable estimates of physical assets are hard to construct.

11 The medium-term outlook for PSND and PSNW has deteriorated since last year's *FSR*. The expected medium-term peak in PSND has risen by 9.3 per cent of GDP to 85.6 per cent of GDP, with that peak coming two years

later in 2016-17. The expected trough in PSNW has fallen by 6.0 per cent of GDP to minus 27.1 per cent of GDP in 2016-17.

12 One of the criticisms often made of PSND as an indicator of fiscal health is that it does not account for future liabilities arising from past government action, for example contracted payments to Private Finance Initiative (PFI) providers and the accrued rights to pension payments built up over the past by public sector workers. The same criticism would apply to PSNW.

13 More information on future and potential liabilities arising from past government action is available in the WGA. These are produced using commercial accounting rules and they have somewhat broader coverage than PSND and PSNW, both in the accounts themselves and in the accompanying notes.

14 According to the 2011-12 WGA:

- the net present value of future **public service pension payments** arising from past employment was £1,008 billion or 65.6 per cent of GDP at the end of March 2012. This is £47 billion higher than a year earlier, primarily reflecting the pension rights accrued as a result of the latest year's employment. But the figure remains lower than the £1,135 billion reported for March 2010, reflecting the Government's decision in 2010 to uprate public sector pension payments by CPI inflation rather than RPI inflation (which tends to be higher). We discussed this change in last year's report;
- the total capital liabilities in WGA arising from **Private Finance Initiative** contracts were £36 billion, up from £32 billion a year earlier. Only £5 billion of these were on the public sector balance sheet in the National Accounts and therefore included in PSND and PSNW. If all investment undertaken through PFI had been undertaken through conventional debt finance, PSND would be around 2.1 per cent of GDP higher than currently measured – little changed from last year;
- there were £113 billion (7.4 per cent of GDP) in **provisions** at the end of March 2012 for future costs that are expected (but not certain) to arise, most significantly the hard to predict costs of nuclear decommissioning. Total provisions have increased by £6 billion since last year's WGA, mainly those related to nuclear decommissioning and clinical negligence. Around £12 billion of provisions were actually used in 2011-12, which was in line with the expectation set out in the previous year's WGA; and

- there were £101 billion (6.6 per cent of GDP) of quantifiable **contingent liabilities** – costs that could arise in the future, but where the probability of them doing so is estimated at less than 50 per cent. This figure has more than doubled from £50 billion last year, largely reflecting two factors: first, an increase in the perceived probability that the UK could be called upon to contribute capital to the European Investment Bank, which makes long-term infrastructure loans to EU countries; and second, an increase in the potential loss of revenues that could result as North Sea oil companies set off the costs of oil field decommissioning against their tax bills.

15 Overall gross liabilities in the WGA increased by £195 billion over the year to £2,615 billion at the end of March 2012. The main factors behind this increase are the net deficit recorded during the year as expenditure exceeded revenues, plus the accumulation of additional public service pension liabilities related to staff in employment during 2011-12.

16 The WGA show the government's net deficit rising from £94 billion in 2010-11 to £185 billion in 2011-12, which is in marked contrast to the fall in the current budget deficit from £101 billion to £90 billion shown in the National Accounts. This is because the WGA estimate of expenditure was reduced by £126 billion in 2010-11 to reflect the present value of the savings that would result from the government's decision to uprate public service pension payments by CPI.

17 Unlike PSND, the WGA balance sheet also includes the value of tangible and intangible fixed assets, which are estimated at £754 billion or 49.1 per cent of GDP in March 2012. These have increased by £28 billion since last year's WGA. The overall net liability in the WGA was £1,347 billion or 87.7 per cent of GDP at end-March 2012. This compares with PSND of £1,106 billion or 72.0 per cent of GDP at the same date and to a WGA net liability of £1,186 billion or 78.8 per cent of GDP a year earlier at end-March 2011.

18 In this year's report, we have also summarised a number of recent policy announcements relating to guarantees and possible contingent liabilities. These include a number of policies that are already in-train, including NewBuy, UK Infrastructure Guarantees and the National Loan Guarantee Scheme, and those still being worked up, including Help-to-Buy: Mortgage guarantee and aspects of the Business Bank.

19 While the precise accounting treatment of these various measures will not be known until future years' WGA are published, it is possible to think

through some of the broad implications for fiscal sustainability now. Most importantly, while each measure in isolation could well be considered a remote contingent liability, the probabilities of the various liabilities crystallising are likely to be correlated. In particular, the probability that the various parties to which the Government is exposed will default would increase in the event of a further economic downturn. The more serious the downturn, the greater the likelihood of a larger proportion of contingent liabilities crystallising to the detriment of fiscal sustainability.

20 There are significant limits to what public sector balance sheets alone can tell us about fiscal sustainability. In particular, balance sheet measures look only at the impact of past government activity. They do not include the present value of future spending that we know future governments will wish to undertake, for example on health, education and pension provision. And, just as importantly, they exclude the public sector's most valuable financial asset – its ability to levy future taxes. This means that we should not overstate the significance of the fact that PSND and the WGA balance sheet both show the public sector's liabilities outstripping its assets. This is usually the case.

## Long-term projections

21 We assess the potential fiscal impact of future government activity by making long-term projections of government revenue, spending and financial transactions on an assumption of 'unchanged policy', as best we can define it. In doing so, we assume that spending and revenues initially evolve over the next five years as we forecast in our March 2013 *EFO*. This allows us to focus on long-term trends rather than making revisions to the medium-term forecast.

### Demographic and economic assumptions

22 Demographic change is a key long-term pressure on the public finances. Like many developed nations, the UK is projected to have an 'ageing population' over the next few decades, with the ratio of elderly to those of working age rising over time. This reflects increasing life expectancy, declining fertility, and the retirement of the large age cohorts born during the post-war 'baby boom'.

23 We base our analysis on projections of the UK population produced by the Office for National Statistics (ONS) every two years. As in last year's *FSR*, we use the 2010-based population projections and the ONS's 'low migration' variant where net inward migration is assumed at 140,000 a

year. We test the sensitivity of our results to a number of different demographic assumptions.

24 As regards the economy, we assume in our central projection that whole economy productivity growth will average 2.2 per cent a year on an output per worker basis, in line with the long-run average rate. We test this assumption with alternative scenarios where productivity growth averages 1.7 per cent or 2.7 per cent. We assume CPI inflation of 2.0 per cent (in line with the Bank of England's inflation target) and a long-term GDP deflator inflation rate of 2.2 per cent. The latter assumption is lower than last year, following the reassessment we made in our December 2012 *EFO*. As such, our projections are based on a lower rate of nominal GDP growth than in last year's *FSR*.

25 Since our December 2012 *EFO*, our medium-term forecasts have included greater persistence in the degree of spare capacity in the economy, represented by a substantial negative output gap at the end of the forecast. This implies scope for above-trend growth beyond our medium-term forecast period that would support the public finances. We have therefore introduced such a period at the beginning of our long-term projections, to ensure those projections do not permanently lock in that portion of borrowing in 2017-18 that is considered cyclical in our medium-term forecasts.

## Defining 'unchanged' policy

26 Fiscal sustainability analysis is designed to identify whether and when changes in government policy may be necessary to move the public finances from an unsustainable to a sustainable path. To make this judgement, it is necessary to define what we mean by 'unchanged' policy in our long-term projections.

27 Government policy is rarely clearly defined over the long term. In many cases, simply assuming that a stated medium-term policy continues for 50 years would lead to an unrealistic projection. Where policy is not clearly defined over the long term, the *Charter for Budget Responsibility* allows us to make appropriate assumptions. These are set out clearly in the report. Consistent with the *Charter*, we only include the impact of policy announcements in our central projections when they can be quantified with *"reasonable accuracy"*.

28 In our central projections, our assumption for unchanged policy is that beyond 2017-18 underlying spending on public services, such as health, rises in line with per capita GDP. We assume that most tax thresholds and

benefits are uprated in line with earnings rather than inflation beyond the medium term, which provides a more neutral baseline for long-term projections. An inflation-based assumption would, other things equal, imply an ever-rising ratio of tax to national income and an ever-falling ratio of benefits to earnings in the rest of the economy.

## Results of our projections

29 Having defined unchanged policy, we apply our demographic and economic assumptions to produce projections of the public finances over the next 50 years.

### Expenditure

30 Population ageing will put upward pressure on public spending. Our central projection shows spending other than on debt interest falling from 36.7 per cent of GDP at the end of our medium-term forecast in 2017-18 to 36.1 per cent of GDP in 2020-21 as the output gap closes. It then rises to 40.6 per cent of GDP by 2062-63 as demographic trends lift spending on health, pensions and long-term care, an increase of 4.0 per cent of GDP or £61 billion in today's terms from the end of our medium-term forecast.

31 The main drivers are upward pressures on key items of age-related spending:

- **health spending** rises from 7.0 per cent of GDP in 2017-18 to 8.8 per cent of GDP in 2062-63, rising smoothly as the population ages. This is a slightly smaller rise than we projected last year, in part due to the additional overall spending cuts the Government has pencilled in for 2017-18 (which are included in our medium-term forecast) and in part due to the above-trend GDP growth we assume as the output gap closes after 2017-18;

- **state pension costs** increase from 5.8 per cent of GDP to 8.4 per cent of GDP as the population ages. The projected increase is slightly lower than last year's projection, in part due to the introduction of the Single Tier pension, which reduces spending in 2062-63 by 0.7 per cent. We assume pensions are uprated in line with the 'triple lock' beyond the medium-term horizon. If we instead assumed pensions were uprated in line with earnings, spending would be 0.9 per cent of GDP lower in 2062-63; and

- **long-term social care costs** rise from 1.3 per cent of GDP in 2017-18 to 2.4 per cent of GDP in 2062-63, reflecting the ageing of the

population and the Government's announcement of a lifetime cap on certain long-term care expenses incurred by individuals, following the Dilnot Review. This policy reform raises spending by 0.3 per cent of GDP by 2062-63.

## Revenue

32 Demographic factors will have less impact on revenues than on spending. Non-interest revenues are projected to rise from 37.6 per cent of GDP in 2017-18 to 38.1 per cent of GDP in 2020-21 (reflecting the assumed period of above-trend growth) and are relatively flat through the remainder of the projection, rising to 38.8 per cent of GDP in 2062-63. The aggregate projection is not significantly different from last year's report, but the composition has changed. Income tax and corporation tax are lower, in part reflecting policy announcements and changes to our medium-term forecast, while capital taxes are higher, largely due to the period of above-trend growth as the output gap is assumed to close.

33 We have updated our assessment of long-term trends in North Sea revenues, an area where our medium-term forecasts have been subject to large revisions due to volatility of oil prices, production and related costs. Revenues from the UK oil and gas sector fell from 0.7 per cent of GDP in 2011-12 to 0.4 per cent in 2012-13 and are forecast to reach 0.2 per cent of GDP by 2017-18. Our central long-term projection shows revenues falling to 0.03 per cent of GDP over the subsequent two decades. Sensitivity analysis suggests that this broad conclusion holds across a variety of reasonable assumptions for the sector.

34 We have also taken a closer look at the implications for personal taxes of the rising participation of older people in the labour market, which shows the positive overall impact a continuation of recent trends would be likely to have on GDP and tax receipts. Greater labour market participation by older people is, however, likely to reduce the ratio of personal taxes to national income, but for the relatively benign reason that national income is likely to be boosted proportionately more than tax receipts, thereby lowering the ratio while both rise in absolute terms.

35 In previous years' reports, we have looked at pressures on a number of revenue streams, including the effects of globalisation on corporation tax and VAT, fuel efficiency on transport taxes and trends in smoking on tobacco duties. These factors, and the decline in North Sea revenues illustrated in this report, suggest that governments will, over time, need to find new sources of revenue to maintain the overall ratio of revenue to national income.

### Financial transactions

36 In order to move from spending and revenue projections to an assessment of the outlook for public sector net debt, we need also to include the impact of public sector financial transactions. These affect net debt directly, without affecting accrued spending or borrowing.

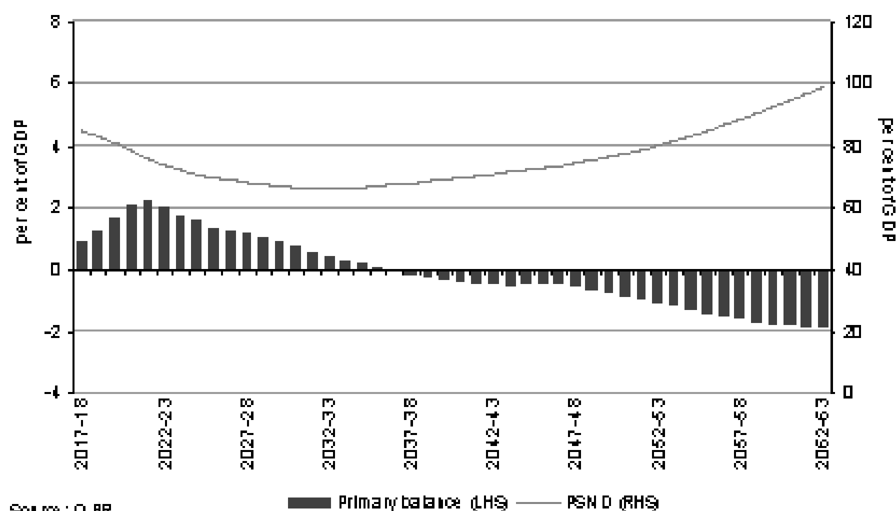
37 For the majority of financial transactions, we assume that the net effect is zero. An important exception is the impact of student loans, where the impact on net debt of the student loan portfolio is projected to peak at 6.7 per cent of GDP (£103 billion in today's terms) around the early 2030s before falling back to 5.0 per cent of GDP by 2062-63. The peak is slightly higher than the 6.1 per cent of GDP in last year's FSR, reflecting the downward revision to nominal GDP.

### Projections of the primary balance and public sector net debt

38 Our central projections show public sector revenues rising as a share of national income over the long term, but by less than the expected increase in public spending. As a result, the primary budget balance (the difference between non-interest revenues and spending that is the key to the public sector's debt dynamics) is projected to move from a surplus of 0.9 per cent of GDP in 2017-18 to a deficit of 1.8 per cent of GDP by 2062-63, a deterioration of 2.7 per cent of GDP. The change from the underlying balance in 2020-21, when the output gap has closed, is greater at 4.2 per cent of GDP. This compares to an increase of 4.3 per cent of GDP over the projection period in last year's report.

39 Taking this and our projection of financial transactions into account, PSND is projected to fall from 85 per cent of GDP in 2017-18 to 66 per cent of GDP in the early 2030s before rising again to 99 per cent of GDP by the end of our long-term projection. Beyond this point, debt would remain on a rising path.

Chart 1: Central projection of the primary balance and PSND




40 Since we have used the same population projections for this year's report, the changes to the primary balance and net debt projections result largely from non-demographic factors related to our medium-term forecast, the period of above-trend growth as the output gap closes and the effects of policy announcements. Higher net debt at the end of the medium-term forecast raises the debt projection. Above-trend growth from 2018-19 to 2020-21 offsets part of this increase. The remaining increase is largely offset by the positive impact of spending cuts in 2017-18 that were announced by the Government in Autumn Statement 2012 and the Single Tier pension reform. As a result, by 2062-63 PSND is higher by only around 8 per cent of GDP relative to last year's report.

41 Needless to say, there are huge uncertainties around any projections that extend this far into the future. Small changes to underlying assumptions can have large effects on the projections once they have been cumulated across many decades. We therefore test these sensitivities using a number of different scenarios.

42 The eventual increase in PSND would be bigger than in our central projection if long-term interest rates turned out to be higher relative to economic growth, if long-term productivity growth was weaker, if the age structure of the population was older or if net inward migration,

which is concentrated among people of working age, was lower than in our central projection.

43 Given the importance of health spending in the demographic challenge to fiscal sustainability, the rate of productivity growth in the sector is also an important assumption. If productivity growth was weaker in the health sector than in the rest of the economy, and the pace of health spending growth was to be increased to compensate, then health spending would rise by a further 1.9 per cent of GDP by 2062-63 in our illustrative scenario. This would see PSND rise substantially faster, reaching 211 per cent of GDP by 2062-63.

44 We have looked more closely at the evidence on the economic and fiscal implications of inward migration, to test the assumptions that underpin our central projections. While most recent evidence for the UK is supportive of the view that net inward migration has had a positive fiscal impact, this is largely due to the concentration of inward migration among people of working age, which is captured in our demographic projections. There is no strong evidence to suggest that inward migration has a positive or negative impact on overall productivity growth, suggesting our central assumptions are reasonable.

## Summary indicators of fiscal sustainability

45 Our central projections, and several of the variants we calculate, show that on current policy we would expect the budget deficit to widen sufficiently over the long term to put public sector net debt on a continuously rising trajectory as a share of national income. This would clearly be unsustainable.

46 Summary indicators of sustainability can be used to illustrate the scale of the challenge more rigorously and to quantify the tax increases and/or spending cuts necessary to return the public finances to different definitions of sustainability.

47 Most definitions of fiscal sustainability are built on the concept of solvency – the ability of the government to meet its future obligations. In formal terms, the government's 'inter-temporal budget constraint' requires it to raise enough revenue in future to cover all its non-interest spending and also to service and eventually pay off its outstanding debt over an infinite time horizon. Under our central projections, the government would need to increase taxes and/or cut spending permanently by around 1.9 per cent of GDP (£29 billion in today's terms) from 2018-19 onwards to satisfy the inter-temporal budget constraint. This

is down from 2.6 per cent of GDP in last year's FSR, reflecting a number of offsetting factors, the largest of which stems from the additional spending cuts the Government has pencilled in for 2017-18, the final year of our medium-term forecast.

48 The inter-temporal budget constraint has the attraction of theoretical rigour, but it also has several practical limitations. For this reason, sustainability is more often quantified by asking how big a permanent spending cut or tax increase would be necessary to move public sector net debt to a particular target level at a particular target date. This is referred to as the 'fiscal gap'.

49 The current government does not have a long-term target for the debt to GDP ratio. So, for illustration, we calculate the additional fiscal tightening necessary from 2018-19 to return PSND to 20, 40 or 60 per cent of GDP at the end of our projection horizon in 2062-63.

50 Under our central projections, the government would need to implement a permanent tax increase or spending cut of 0.8 per cent of GDP (£13 billion in today's terms) in 2018-19 to get debt back to 60 per cent, 1.2 per cent of GDP (£19 billion in today's terms) to get it back to 40 per cent and 1.7 per cent of GDP (£26 billion in today's terms) to reduce it to 20 per cent of GDP. In last year's report, the fiscal gap to returning debt to 40 per cent of GDP was 1.1 per cent of GDP. The gap in this year's report is slightly larger than last year, reflecting the slightly higher debt ratio projected for 2062-63.

51 These calculations depend significantly on the health of the public finances at the end of our medium-term forecast. If the structural budget balance was 1 per cent of GDP weaker or stronger in 2017-18 than we forecast in the *EFO*, the necessary tightening would be bigger or smaller by the same amount.

52 The sensitivity factors that we identified in the previous section as posing upward or downward risks to our central projections for PSND similarly pose upward or downward risks to our estimates of fiscal gaps. The most dramatic would be the scenario of weaker productivity in the health sector pushing up spending per person. In the scenario we illustrate, this would increase the necessary permanent policy adjustment in 2018-19 to between 3.2 per cent and 4.0 per cent of GDP depending on the target debt level.

53 Governments need not respond to fiscal pressures with a one-off permanent tightening, of course. As an alternative to the tightening of

1.2 per cent of GDP in 2018-19 necessary to meet the 40 per cent target, governments could opt for a series of tax increases or spending cuts worth an additional 0.5 per cent of GDP each decade. A more gradual adjustment would mean a smaller fall in the debt to GDP ratio in the early years before PSND stabilises around the target level.

# B Fiscal impact of policy decisions

Table A.1: Autumn Statement 2013 policy decisions[1]

| | Head | £ million | | | | | |
|---|---|---|---|---|---|---|---|
| | | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| **Spending Totals** | | | | | | | |
| 1 Spending total adjustment | Spend | +1,080 | +1,120 | +1,040 | - | - | - |
| 2 Special Reserve | Spend | +900 | 0 | 0 | - | - | - |
| **Households** | | | | | | | |
| 3 Income Tax: transferable marriage allowance | Tax | 0 | 0 | -495 | -600 | -660 | -775 |
| 4 Free School Meals: extension | Spend | 0 | -620 | -755 | - | - | - |
| 5 Fuel Duty: cancel 2014 increase | Tax | 0 | -415 | -710 | -735 | -755 | -780 |
| 6 Rail fares at RPI for 2014 | Spend | -10 | -35 | -35 | - | - | - |
| 7 VED: direct debit | Tax | 0 | -5 | -15 | -15 | -20 | -20 |
| **Young People and Support for Work** | | | | | | | |
| 8 Employer NICs: abolish for under 21s basic rate earnings | Tax | 0 | 0 | -465 | -495 | -520 | -530 |
| 9 Higher Education: abolish the cap on student numbers | Spend | 0 | -120 | -290 | - | - | - |
| 10 Higher Education: additional funding for STEM subjects | Spend | 0 | 0 | -40 | - | - | - |
| 11 Further Education: additional higher apprenticeships | Spend | 0 | -10 | -35 | - | - | - |
| 12 Help to work: support for long-term unemployed | Spend | 0 | -190 | -230 | - | - | - |
| 13 Help to work: benefit savings | Spend | +25 | +130 | +140 | - | - | - |
| 14 New Enterprise Allowance: extension | Spend | 0 | -25 | -55 | - | - | - |
| **Business Tax** | | | | | | | |
| 15 Business Rates: small business relief extension | Tax | 0 | -500 | +65 | +10 | 0 | 0 |
| 16 Business Rates: relaxing single property criteria | Tax | 0 | -5 | -5 | -5 | -5 | -5 |
| 17 Business Rates: cap increase at 2% in 2014-15 | Tax | 0 | -270 | -255 | -255 | -270 | -275 |
| 18 Business Rates: £1,000 discount for two years for shops, pubs and restaurants up to £50,000 rateable value | Tax | 0 | -350 | -425 | +70 | +10 | 0 |
| 19 Business Rates: reoccupation relief for retail premises | Tax | 0 | -5 | -10 | -5 | 0 | 0 |
| 20 Bank Levy: base and rate | Tax | 0 | +265 | +520 | +535 | +535 | +535 |
| **Enterprise and Housing** | | | | | | | |
| 21 Corporation tax: film tax relief | Spend | 0 | -10 | -20 | - | - | - |
| 22 Employee Ownership: further support[2] | Tax | 0 | -15 | -25 | -25 | -25 | -30 |
| 23 Science: support for quantum technologies | Spend | 0 | -30 | -35 | - | - | - |
| 24 Housing Revenue Account: additional flexibility[2] | Spend/Tax | 0 | 0 | -155 | -5 | +10 | +20 |
| 25 Right to buy | Spend | 0 | 0 | -50 | - | - | - |
| 26 OTS Review: simplification of employee share schemes | Tax | 0 | +5 | +5 | +5 | +20 | +20 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Energy and Environment** | | | | | | | |
| 27 Energy prices: support for vulnerable households | Spend | 0 | -320 | -320 | - | - | - |
| 28 Energy efficiency: grants for households | Spend | 0 | -120 | -120 | - | - | - |
| 29 Energy efficiency: grants for landlords | Spend | 0 | -30 | -30 | - | - | - |
| 30 Energy efficiency: public sector | Spend | 0 | -30 | -30 | - | - | - |
| 31 Fuel Duty: support for cleaner fuels | Tax | 0 | 0 | -5 | -10 | -20 | -40 |
| 32 Climate Change Levy: data centres | Tax | 0 | -5 | -15 | -15 | -15 | -15 |
| 33 Corporation Tax: new pad allowance for shale gas | Tax | 0 | 0 | * | -5 | -20 | -20 |
| **Avoidance, tax planning and fairness** | | | | | | | |
| 34 Accelerated payments in follower cases | Tax | 0 | +135 | +660 | -35 | -40 | -45 |
| 35 Onshore employment intermediaries | Tax | 0 | +520 | +425 | +380 | +415 | +445 |
| 36 Dual Contracts | Tax | 0 | 0 | +85 | +60 | +60 | +65 |
| 37 Compensating Adjustments | Tax | 0 | +60 | +125 | +120 | +115 | +110 |
| 38 Venture Capital Trusts: share buy-backs | Tax | 0 | +50 | +35 | +10 | +20 | +25 |
| 39 Avoidance schemes: using derivatives | Tax | +40 | +40 | +20 | +10 | 0 | 0 |
| 40 Oil and gas: offshore chartering | Tax | 0 | +140 | +115 | +100 | +90 | +80 |
| 41 Partnerships: confirming extension to Alternative Investment Funds | Tax | 0 | 0 | +680 | +430 | +410 | +400 |
| 42 Automatic Exchange of Information agreements with Overseas Territories | Tax | * | * | * | +25 | +10 | +5 |
| 43 Double taxation relief: closing loopholes | Tax | +10 | +20 | +5 | 0 | 0 | 0 |
| 44 CGT: amending final exemption period for private residences | Tax | 0 | 0 | +65 | +90 | +100 | +105 |
| 45 CGT: application to non-residents | Tax | 0 | 0 | 0 | +15 | +40 | +70 |
| 46 Corporation tax: change of ownership rules | Tax | -30 | -10 | 0 | 0 | 0 | 0 |
| **Fraud, Error and Debt** | | | | | | | |
| 47 Alcohol fraud wholesaler registration[4] | Tax | 0 | 0 | -5 | +15 | +230 | +215 |
| 48 HMRC: extending online services[4] | Tax | 0 | 0 | +15 | +50 | +45 | +50 |
| 49 Tax credits: improving collection and administration[2,4] | Spend/Tax | -5 | +355 | +615 | +75 | +10 | +5 |
| 50 Tax credits: annual entitlement[2,4] | Spend/Tax | 0 | 0 | +65 | +5 | 0 | 0 |
| 51 Tax debt: improved collection[4] | Tax | 0 | +55 | +20 | 0 | 0 | 0 |
| 52 Overseas life certificates: extension | Spend | 0 | +20 | +25 | - | - | - |
| 53 DWP fraud: sharing RTI data | Spend | 0 | +130 | +20 | - | - | - |
| **Spending Round and Other Measures** | | | | | | | |
| 54 Gross tax costs of tax measures with spending impacts after 2015-16[5] | Tax | 0 | 0 | 0 | -20 | -60 | -85 |
| 55 Local authority capital receipts flexibility | Spend | 0 | +10 | -20 | - | - | - |
| 56 Pension credit passthrough | Spend | 0 | -5 | 0 | - | - | - |
| 57 Final impact of Spending Round measures | Spend/Tax | +10 | -60 | -185 | -185 | -275 | -380 |
| 58 Winter Fuel Payments: overseas eligibility | Spend | 0 | 0 | +20 | - | - | - |
| 59 Alcohol price floor | Tax | 0 | -5 | -5 | -5 | -5 | -5 |
| TOTAL POLICY DECISIONS | | +2,020 | -135 | -75 | -410 | -570 | -855 |
| Total spending policy decisions | | +2,000 | -45 | -565 | 0 | 0 | 0 |
| Total tax policy decisions | | +20 | -90 | +490 | -410 | -570 | -855 |

*Negligible

[1] Costings reflect the OBR's latest economic and fiscal determinants.

[2] Spending measures do not affect borrowing in 2016-17, 2017-18 and 2018-19 as they fall within the Total Managed Expenditure assumption. Where numbers for spending measures are shown, this reflects tax elements to predominantly spending measures

[3] This is additional to the £50m pa provided in Budget 2013.

[4] HMRC has been provided with additional funding of £150m for these measures. The costings are shown net of additional funding.

[5] These are adjustments for where tax policies have a spending element which feeds through to the TME assumption but not the bottom line in 2016-17, 2017-18, and 2018-19. See the Policy Costings document for further details

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Table B.2: Budget 2014 policy decisions[1,2]

| | Head | £ million | | | | |
|---|---|---|---|---|---|---|
| | | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| **Spending** | | | | | | |
| 1 Public Service Pensions: revaluation | Spend | 0 | +725 | +985 | +1,015 | +1,045 |
| 2 Spending adjustment: extending Autumn Statement savings | Spend | 0 | 0 | +1,040 | +1,040 | +1,040 |
| **Personal Tax** | | | | | | |
| 3 Personal allowance: increase to £10,500 in 2015-16 with equal gains to higher rate taxpayers | Tax | 0 | -1,410 | -1,770 | -1,875 | -1,895 |
| 4 Transferable marriage allowance: increase to £1,050 and set at 10% of personal allowance | Tax | 0 | -25 | -30 | -35 | -40 |
| **Savings and Pensions** | | | | | | |
| 5 Pensions: reduce withdrawal tax rate from 55% to marginal income tax rate | Tax | -5 | +320 | +600 | +910 | +1,220 |
| 6 Consumer advice for pensions | Spend | -10 | -10 | – | – | – |
| 7 Savings tax: abolish the 10% rate and extend 0% band to £5,000 | Tax | 0 | -135 | -320 | -325 | -355 |
| 8 ISAs: equalise stocks and shares and cash ISA limits and increase to £15,000 | Tax | -5 | -80 | -230 | -395 | -565 |
| 9 ISAs: including peer-to-peer lending and retail bonds | Tax | * | * | -10 | -20 | -35 |
| 10 NS&I bonds for people aged 65 and over | Spend | -45 | -170 | – | – | – |
| 11 Voluntary National Insurance Contributions | Tax | 0 | +415 | +435 | 0 | 0 |
| **Investment and Growth** | | | | | | |
| 12 Annual Investment Allowance: double to £500,000 until December 2015 | Tax | -85 | -665 | -1,270 | +175 | +270 |
| 13 R&D tax credits: increase payable element for SMEs | Spend | -5 | -50 | – | – | – |
| 14 Alan Turing Institute for Big Data | Spend | * | -20 | – | – | – |
| 15 Centres for doctoral training | Spend | -30 | -30 | – | – | – |
| 16 Catapult centres: cell therapy and graphene | Spend | -5 | -20 | – | – | – |
| 17 Seed Enterprise Investment Scheme and CGT relief: make permanent | Tax | 0 | -5 | -10 | -5 | -40 |
| 18 Social Investment Tax Relief | Tax | 0 | -10 | -20 | -25 | -35 |
| 19 Business rates for Enterprise Zones | Tax | -5 | -5 | -5 | -5 | -5 |
| 20 Apprenticeship Grant for Employers programme: extension | Spend | -100 | -100 | – | – | – |
| 21 Degree level and masters level apprenticeships | Spend | -10 | -10 | – | – | – |
| 22 Cambridge City Deal | Spend | 0 | -25 | – | – | – |
| 23 Right to Buy | Spend | +10 | +20 | – | – | – |
| 24 OTS Review: simplification of employee share schemes | Tax | 0 | +10 | +10 | 0 | 0 |
| **Energy** | | | | | | |
| 25 Carbon Price Floor: limit disparity between UK and EU to £18 from 2016-17 | Tax | 0 | 0 | -340 | -615 | -870 |
| 26 Combined Heat and Power: relief for onsite generation | Tax | 0 | -65 | -70 | -75 | -80 |
| 27 Climate Change Levy: metallurgical and mineralogical exemption | Tax | -20 | -25 | -25 | -25 | -25 |
| 28 Oil and gas: changes to offshore chartering and Wood Review implementation | Tax | -10 | -15 | -10 | -5 | -5 |
| **Duties** | | | | | | |
| 29 Alcohol duty: 1p off pint of beer and freeze cider duty | Tax | -110 | -110 | -110 | -110 | -110 |
| 30 Alcohol duty: freeze spirits duty and | Tax | -175 | -185 | -195 | -205 | -215 |

| | | | | | | |
|---|---|---|---|---|---|---|
| abolish wine escalator | | | | | | |
| 31 Tobacco duty: continue 2% escalator from 2015-16 | Tax | 0 | +40 | +75 | +110 | +135 |
| 32 Bingo duty: reducing rate to 10% | Tax | -30 | -40 | -40 | -40 | -40 |
| 33 Machine games duty: increasing the rate on B2 machines to 25% | Tax | +5 | +75 | +80 | +85 | +90 |
| Transport and Environment | | | | | | |
| 34 Flooding: maintenance and defences | Spend | -100 | -70 | – | – | – |
| 35 Potholes: challenge fund | Spend | -200 | 0 | – | – | – |
| 36 Air Passenger Duty: abolish bands C and D | Tax | 0 | -215 | -225 | -230 | -250 |
| 37 Regional Air Connectivity Fund: support for new routes | Spend | -10 | -10 | – | – | – |
| 38 Company Car Tax continuing to increase by 2ppt in 2017-18 and 2018-19 | Tax | 0 | 0 | 0 | +240 | +480 |
| 39 Motoring tax changes to VED and capital allowances | Tax | * | * | -5 | -10 | -15 |
| 40 Aggregates Levy: freeze in 2014-15 | Tax | -5 | -5 | -5 | -5 | -5 |
| 41 Landfill tax and Landfill Communities Fund: uprate and reform | Tax | * | +5 | +5 | +10 | +10 |
| 42 Capital allowances: energy and water efficient technologies | Tax | * | * | +5 | +10 | +15 |
| Education, Welfare and Culture | | | | | | |
| 43 Tax-free Childcare: increase cap from £6,000 to £10,000 | Spend | 0 | -25 | – | – | – |
| 44 Early Years Pupil Premium | Spend | 0 | -60 | – | – | – |
| 45 Support for Mortgage Interest: 12-month extension | Spend | 0 | -90 | – | – | – |
| 46 Restrictions on migrants' access to benefits | Spend | +40 | +80 | – | – | – |
| 47 Employment and Support Allowance: waiting days | Spend | +5 | +10 | – | – | – |
| 48 Tax Credits debt: increasing recovery rate | Tax | 0 | 0 | +35 | +5 | 0 |
| 49 Theatre productions: tax credit | Spend | -5 | -15 | – | – | – |
| 50 Cathedrals grant repair scheme | Spend | -10 | -10 | – | – | – |
| 51 Cultural gift scheme: extension | Tax | -10 | -10 | -10 | -10 | -10 |
| Avoidance and Tax Planning | | | | | | |
| 52 Accelerated payments: extension to disclosed tax avoidance schemes and the GAAR | Tax | +290 | +1,230 | +1,300 | +715 | +385 |
| 53 Avoidance schemes using the transfer of corporate profits | Tax | +60 | +80 | +80 | +85 | +75 |
| 54 Direct recovery of debts | Tax | 0 | +65 | +110 | +100 | +90 |
| 55 Enveloped dwellings: new bands between £500,000 and £2 million | Tax | +35 | +70 | +90 | +80 | +90 |
| 56 Venture capital schemes: restrictions on use | Tax | 0 | +35 | +65 | +55 | +45 |
| TOTAL POLICY DECISIONS | | -550 | -560 | +225 | +635 | +400 |
| Total spending policy decisions | | -540 | +80 | +2,025 | +2,055 | +2,085 |
| Total tax policy decisions | | -10 | -640 | -1,800 | -1,420 | -1,685 |

*Negligible

[1] Costings reflect the OBR's latest economic and fiscal determinants

[2] Only spending numbers which directly affect borrowing in 2016-17, 2017-18 and 2018-19 are shown. All other spending measures do not affect borrowing as they fall within the Total Managed Expenditure assumption in those years

Table B.3: Measures announced at Autumn Statement 2013 or earlier which take effect from April 2014 or later[1]

| | | Head | £ million | | | | |
|---|---|---|---|---|---|---|---|
| | | | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Measures announced at Autumn Statement 2013 | | | | | | | |
| a | Income Tax: transferable marriage allowance | Tax | 0 | -490 | -590 | -655 | -780 |
| b | Fuel Duty: cancel 2014 increase | Tax | -370 | -620 | -640 | -660 | -680 |
| c | VED: direct debit | Tax | -5 | -20 | -20 | -20 | -25 |
| d | Employer NICs: abolish for under 21s basic rate earnings | Tax | 0 | -440 | -480 | -505 | -520 |
| e | Help to work: benefit savings | Spend | +130 | +140 | +85 | +60 | +40 |
| f | New Enterprise Allowance: extension | Spend | -5 | -45 | -10 | 0 | 0 |
| g | Business Rates: small business relief extension | Tax | -580 | +75 | +15 | 0 | 0 |
| h | Business Rates: relaxing single property criteria | Tax | -10 | -5 | -5 | -5 | -5 |
| i | Business Rates: cap increase at 2% in 2014-15 | Tax | -285 | -310 | -295 | -300 | -300 |
| j | Business Rates: £1,000 discount for two years for shops, pubs and restaurants up to £50,000 rateable value | Tax | -325 | -430 | +70 | +10 | 0 |
| k | Business Rates: reoccupation relief for retail premises | Tax | -15 | -25 | -10 | * | * |
| l | Corporation tax: film tax relief | Spend | -10 | -20 | -25 | -25 | -25 |
| m | Employee Ownership: further support | Tax | -10 | -20 | -20 | -20 | -25 |
| n | Housing Revenue Account: additional flexibility | Spend | 0 | -155 | 0 | +10 | +20 |
| o | OTS Review: simplification of employee share schemes | Tax | +5 | +5 | +5 | +20 | +20 |
| p | Climate Change Levy: data centres | Tax | -5 | -25 | -20 | -20 | -20 |
| q | Corporation tax: new pad allowance for shale gas | Tax | 0 | * | -5 | -20 | -20 |
| r | Accelerated payments in follower cases | Tax | +15 | +305 | +300 | +200 | +100 |
| s | Onshore employment intermediaries | Tax | +445 | +425 | +380 | +410 | +440 |
| t | Dual Contracts | Tax | 0 | +75 | +55 | +55 | +60 |
| u | Venture Capital Trusts: share buy-backs | Tax | +50 | +35 | +15 | +20 | +25 |
| v | Oil and gas: offshore chartering | Tax | +145 | +125 | +110 | +95 | +95 |
| w | Partnerships: confirming extension to Alternative Investment Funds | Tax | 0 | +680 | +430 | +410 | +400 |
| x | CGT: amending final exemption period for private residences | Tax | 0 | +70 | +100 | +110 | +110 |
| y | CGT: application to non-residents | Tax | 0 | 0 | +15 | +45 | +70 |
| z | Alcohol fraud wholesaler registration | Tax | 0 | -5 | +15 | +235 | +215 |
| aa | HMRC: extending online services | Tax | 0 | +15 | +50 | +45 | +50 |
| ab | Tax credits: improved collection and administration | Spend | +270 | +545 | +210 | +155 | +50 |
| ac | Tax credits: annual entitlement | Spend | 0 | +70 | +55 | +10 | 0 |
| ad | Tax debt: improved collection | Tax | +35 | +5 | +5 | 0 | 0 |
| ae | Overseas life certificates: extension | Spend | +5 | +10 | +15 | +20 | +20 |
| af | DWP fraud: sharing RTI data | Spend | +110 | +20 | +15 | -25 | 0 |
| ag | Local authority capital receipts flexibility | Spend | 0 | +10 | -20 | -10 | 0 |
| ah | Pension credit passthrough | Spend | -5 | -5 | 0 | +5 | +5 |
| ai | Winter Fuel Payments: overseas eligibility | Spend | 0 | +20 | +25 | +25 | +25 |
| aj | Alcohol price floor | Tax | -5 | -5 | -5 | -5 | -5 |
| Measures announced at Spending Round 2013 | | | | | | | |
| ak | Additional interviews throughout claim | Spend | +55 | +90 | +100 | +125 | +130 |
| al | Seven waiting days for unemployed claimants | Spend | +30 | +100 | +275 | +255 | +260 |
| am | Three-monthly interviews | Spend | +15 | +25 | +30 | +35 | +35 |
| an | Annual Verification | Spend | 0 | +5 | +5 | +10 | +10 |
| ao | Social rent policy | Spend | 0 | +45 | +140 | +295 | +490 |
| ap | DWP benefits: recovering debt | Spend | +95 | +55 | +40 | +15 | 0 |

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| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Measures announced at Budget 2013** | | | | | | |
| aq | Carbon Reduction Commitment: exclude schools | Tax | 0 | -65 | -65 | -65 | -70 |
| ar | Lorry road user levy and offsetting VED reduction | Tax | +30 | +25 | +25 | +25 | +20 |
| as | Contracting out NICs | Tax | 0 | 0 | +5,145 | +5,010 | +4,975 |
| at | Inheritance tax: threshold freeze for 3 years from 2015-16 | Tax | 0 | +30 | +125 | +280 | +390 |
| au | National Insurance: £2,000 Employment Allowance | Tax | -1,250 | -1,375 | -1,605 | -1,745 | -1,800 |
| av | Corporation tax: reduce main rate to 20% from 2015-16 | Tax | -10 | -510 | -995 | -1,065 | -1,090 |
| aw | Stamp duty: abolish schedule 19 charge | Tax | -160 | -160 | -160 | -165 | -170 |
| ax | Tax relief: health interventions | Tax | -10 | -15 | -15 | -20 | -20 |
| ay | Health interventions | Spend | -10 | +10 | +10 | +15 | +15 |
| az | Personal allowance: increase by an additional £560 to £10,000 in 2014-15 | Tax | -1,160 | -1,040 | -260 | -115 | -190 |
| ba | Pensions tax relief: individual protection | Tax | +105 | +95 | +40 | 0 | 0 |
| bb | Offshore employment intermediaries | Tax | +80 | +80 | +90 | +95 | +100 |
| bc | Partnerships | Tax | +125 | +365 | +300 | +285 | +285 |
| bd | Debt: improving coding out | Tax | 0 | +115 | +50 | +30 | +30 |
| be | Avoidance schemes: enhanced information powers | Tax | +5 | +35 | +35 | +35 | +35 |
| bf | Penalties in avoidance cases | Tax | +55 | +75 | +30 | +30 | +30 |
| bg | Capital Allowances: Ultra Low Emission Vehicles | Tax | 0 | -5 | -15 | -20 | -15 |
| bh | Company car tax: Ultra Low Emission Vehicles | Tax | 0 | -5 | -5 | -10 | -15 |
| | **Measures announced at Autumn Statement 2012** | | | | | | |
| bi | Corporation tax: decrease main rate to 21% from 2014-15 | Tax | -495 | -940 | -1,040 | -1,055 | -1,075 |
| bj | Child Benefit: increase by 1% for two years from 2014-15 | Spend | +175 | +270 | +290 | +290 | +290 |
| bk | Housing Benefit: increase Local Housing Allowance by 1% for two years from 2014-15 with provision to high rent areas | Spend | +25 | +40 | +40 | +45 | +50 |
| bl | Universal Credit impact of work allowance measure and increase by 1% for two years from 2014-15 | Spend | * | +55 | +425 | +960 | +1,175 |
| bm | Higher rate threshold: index by 1% for two years from 2014-15 | Tax | +320 | +785 | +985 | +1,040 | +1,180 |
| bn | Capital gains tax: increase annual exempt amount by 1% for two years from 2014-15 | Tax | 0 | +5 | +15 | +15 | +15 |
| bo | Tax credits: error and fraud | Tax | +185 | +185 | +120 | +35 | 0 |
| bp | Pensions: restrict tax relief | Tax | +275 | +505 | +830 | +1,085 | +1,250 |
| | **Measures announced at Budget 2012** | | | | | | |
| bq | Corporation tax: decrease main rate to 24% in 2012-13, 23% in 2013-14 and 22% from 2014-15 | Tax | -915 | -975 | -1,030 | -1,045 | -1,065 |
| br | Company Car Tax | Tax | +115 | +360 | +310 | +320 | +330 |
| bs | Insurance tax: Claims Equalisation Reserves | Tax | +85 | +90 | +80 | +80 | +85 |
| bt | Life assurance premium relief | Tax | 0 | +5 | +5 | +5 | +5 |
| | **Measures announced at Budget 2011** | | | | | | |
| bu | Corporation tax: decrease to 25% in 2012-13, 24% in 2013-14 and 23% in 2014-15 | Tax | -905 | -965 | -1,020 | -1,035 | -1,055 |
| | **Measures announced at Spending Review 2010** | | | | | | |
| bv | Child and Working Tax Credits: use real time information | Spend | +200 | +245 | +230 | +120 | 0 |
| | **Measures announced at June Budget 2010** | | | | | | |
| bw | Corporation tax: decrease main rate to 26% in 2012-13, 25% in 2013-14 and 24% in 2014-15 | Tax | -3,105 | -3,775 | -4,025 | -4,090 | -4,170 |
| | **Measures announced before June Budget 2010** | | | | | | |
| bx | Landfill tax: increase in 2014-15 (2009 Pre-Budget Report) | Tax | +65 | +60 | +60 | +60 | +60 |

* Negligible

[1] Costings reflect the OBR's latest economic and fiscal determinants

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# Supplementary data tables

C.1 Information in these tables is consistent with the OBR's March 2014 *Economic and fiscal outlook* and supplementary tables, unless otherwise noted. The OBR's supplementary tables are available at http://budgetresponsibility.org.uk/economic-fiscal-outlook-march-2014/.

Table C.1: Macroeconomic prospects

| | Level[1] | Rate of change | | | | | |
|---|---|---|---|---|---|---|---|
| | 2013 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| Real GDP | 1532 | 1.8 | 2.7 | 2.3 | 2.6 | 2.6 | 2.5 |
| Nominal GDP | 1621 | 3.4 | 5.0 | 4.0 | 4.4 | 4.6 | 4.5 |
| **Components of real GDP** | | | | | | | |
| Private consumption expenditure[2] | 991 | 2.3 | 2.1 | 1.8 | 2.5 | 2.7 | 2.4 |
| Government consumption expenditure | 345 | 0.9 | 1.2 | -0.5 | -1.2 | -1.8 | -0.9 |
| Gross fixed capital formation | 216 | -0.5 | 8.6 | 8.2 | 7.8 | 7.9 | 6.8 |
| Changes in inventories and net acquisition of valuables (% of GDP) | - | 0.3 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Exports of goods and services | 476 | 0.8 | 2.6 | 4.7 | 5.0 | 5.0 | 4.7 |
| Imports of goods and services | 499 | 0.4 | 3.0 | 4.3 | 4.8 | 4.8 | 4.7 |
| **Contributions to real GDP growth** | | | | | | | |
| Final domestic demand | - | 1.6 | 2.9 | 2.3 | 2.6 | 2.7 | 2.5 |
| Changes in inventories and net acquisition of valuables | - | 0.3 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| External balance of goods and services | - | 0.1 | -0.2 | 0.1 | 0.0 | 0.0 | -0.1 |

[1] Pounds sterling, billion

[2] Includes households and non-profit institutions serving households.

Table C.2: Price developments

| | Level | Rate of Change | | | | | |
|---|---|---|---|---|---|---|---|
| | 2013 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| GDP deflator | 105.8 | 1.6 | 2.3 | 1.6 | 1.8 | 1.9 | 2.0 |
| Private consumption deflator | 108.9 | 2.2 | 2.4 | 2.2 | 2.2 | 2.2 | 2.3 |
| HICP | 126.1 | 2.6 | 1.9 | 2.0 | 2.0 | 2.0 | 2.0 |
| Public consumption deflator | 99.1 | -0.7 | 0.5 | 0.1 | -0.2 | -0.1 | 0.6 |
| Investment deflator | 104.3 | 0.7 | 0.8 | 0.4 | 1.7 | 1.8 | 1.6 |
| Export price deflator (goods and services) | 105.7 | 1.0 | -2.3 | 0.7 | 1.6 | 1.8 | 1.8 |
| Import price deflator (goods and services) | 106.2 | -0.1 | -3.3 | 0.3 | 1.4 | 1.7 | 1.6 |

Table C.3: Labour Market developments

| | Level | Rate of Change | | | | | |
|---|---|---|---|---|---|---|---|
| | 2013 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| Employment, persons (millions)[1] | 29.9 | 1.3 | 1.6 | 0.8 | 0.9 | 0.9 | 0.7 |
| Employment, hours worked[2] | 958.2 | 2.0 | 1.6 | 0.2 | 0.1 | 0.2 | 0.0 |
| Unemployment rate (%)[3] | - | 7.6 | 6.8 | 6.5 | 6.1 | 5.7 | 5.4 |
| Labour productivity, persons[4] | 51,259 | 0.5 | 1.1 | 1.5 | 1.6 | 1.7 | 1.8 |
| Labour productivity, hours worked[5] | 30.8 | -0.2 | 1.2 | 2.1 | 2.4 | 2.5 | 2.4 |
| Compensation of employees[6] | 867.4 | 2.9 | 3.5 | 3.9 | 4.9 | 4.7 | 4.4 |
| Compensation per employee[7] | 29,010 | 1.6 | 1.8 | 3.2 | 3.9 | 3.7 | 3.8 |

[1] All aged 16 and over
[2] Millions per week
[3] ILO measure, all aged 16 and over
[4] GDP per worker, pounds sterling
[5] GDP per hour, pounds sterling
[6] Pounds sterling, billion
[7] Pounds per worker

Table C.4: Sectoral Balances

| % of GDP | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Net lending/borrowing vis-à-vis the rest of the world | -3.9 | -2.9 | -1.8 | -1.6 | -1.4 | -1.3 |
| - Balance on goods and services | -2.1 | -1.4 | -1.1 | -1.0 | -0.9 | -0.8 |
| - Balance of primary incomes and transfers | -2.2 | -1.5 | -0.9 | -0.9 | -0.7 | -0.7 |
| - Capital account | 0.2 | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 |

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Table C.5: General Government budgetary prospects

| | £ billion | % of GDP | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Outturn | | Forecast | | | | | |
| | 2012-13 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| **Net lending by sub-sector** | | | | | | | | |
| General government[1] | 81.2 | 5.2 | 6.0 | 5.0 | 4.0 | 2.4 | 1.1 | 0.1 |
| Central government | 82.9 | 5.3 | 6.1 | 5.2 | 4.1 | 2.4 | 1.1 | 0.2 |
| Local government | -1.7 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | 0.0 | -0.1 |
| **General government** | | | | | | | | |
| Total revenue | 584.0 | 37.2 | 37.2 | 37.2 | 37.3 | 37.5 | 37.5 | 37.6 |
| Total expenditure | 665.2 | 42.4 | 43.2 | 42.2 | 41.3 | 39.9 | 38.6 | 37.7 |
| Net borrowing[1] | 81.2 | 5.2 | 6.0 | 5.0 | 4.0 | 2.4 | 1.1 | 0.1 |
| Interest expenditure | 47.8 | 3.0 | 3.0 | 3.0 | 3.3 | 3.5 | 3.7 | 3.7 |
| Primary balance[2] | 33.4 | 2.1 | 3.0 | 2.0 | 0.7 | -1.1 | -2.6 | -3.6 |
| **Selected components of revenue** | | | | | | | | |
| Taxes on production and imports | 209.3 | 13.3 | 13.5 | 13.6 | 13.6 | 13.5 | 13.4 | 13.3 |
| Taxes on income and wealth | 196.0 | 12.5 | 12.1 | 12.3 | 12.6 | 12.8 | 13.0 | 13.2 |
| Capital taxes | 3.2 | 0.2 | 0.3 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 |
| Social contributions | 104.5 | 6.7 | 6.5 | 6.4 | 6.4 | 6.7 | 6.7 | 6.8 |
| Other | 71.1 | 4.5 | 4.8 | 4.7 | 4.4 | 4.2 | 4.1 | 4.1 |
| Total revenue | 584.0 | 37.2 | 37.2 | 37.2 | 37.3 | 37.5 | 37.5 | 37.6 |
| **Selected components of expenditure** | | | | | | | | |
| Current expenditure on goods and services | 339.6 | 21.6 | 21.0 | 20.2 | 19.3 | 18.2 | 17.1 | 16.4 |
| Net social benefits | 217.2 | 13.8 | 13.4 | 13.0 | 12.8 | 12.7 | 12.6 | 12.4 |
| Interest expenditure | 47.8 | 3.0 | 3.0 | 3.0 | 3.3 | 3.5 | 3.7 | 3.7 |
| Subsidies | 9.4 | 0.6 | 0.7 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| Gross fixed capital formation | 27.5 | 1.8 | 1.9 | 2.0 | 1.8 | 1.8 | 1.7 | 1.7 |
| Other | 23.5 | 1.5 | 3.3 | 3.2 | 3.2 | 2.9 | 2.8 | 2.8 |
| Total expenditure | 665.2 | 42.4 | 43.2 | 42.2 | 41.3 | 39.9 | 38.6 | 37.7 |

[1] Treaty deficit
[2] General government net borrowing less interest expenditure

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Table C.6: Breakdown of revenue

| | £billion | % of GDP | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Outturn | | Forecast | | | | | |
| | 2012-13 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| Total revenue at unchanged policies[1] | 584.0 | 37.2 | 37.2 | 37.2 | 37.3 | 37.6 | 37.6 | 37.7 |
| Discretionary revenue measures[2] | - | - | 0.00 | -0.01 | 0.00 | -0.11 | -0.09 | -0.11 |

[1] Sum of discretionary revenue measures taken at Autumn Statement 2013 (consistent with the OBR's December 2013 Economic and fiscal outlook) and Budget 2014 (consistent with the OBR's March 2014 Economic and fiscal outlook)

[2] General government total revenue less discretionary revenue measures at Autumn Statement 2013 (consistent with the OBR's December 2013 Economic and fiscal outlook) and Budget 2014 (consistent with the OBR's March 2014 Economic and fiscal outlook)

Table C.7: Central Government expenditure by function[1, 2]

| | | % of GDP[3] | |
|---|---|---|---|
| | | 2009-10 | 2014-15 |
| General public services | | 3.2% | 4.0% |
| Defence | | 2.6% | 2.1% |
| Public order and safety | | 1.2% | 0.8% |
| Economic affairs | | 2.5% | 2.0% |
| Environmental protection | | 0.3% | 0.3% |
| Housing and community amenities | | 0.8% | 0.3% |
| Health | | 8.2% | 7.7% |
| Recreation, culture and religion | | 0.5% | 0.4% |
| Education | | 2.3% | 2.2% |
| Social protection | | 12.2% | 11.8% |
| Total expenditure[4] | | **34.8%** | **32.5%** |

[1] Spending data used consistent with Public Expenditure Statistical Analyses 2013 (PESA 2013), HM Treasury July 2013.

[2] Central Government data taken from PESA table 6.4 and Public Corporations' data from PESA Table 8.4.

[3] The latest money GDP figures as published on GOV.UK used to derive "percentage of GDP" calculations.

[4] Total expenditure is more than just the sum of the functions, it also includes EU transactions and accounting adjustments.

Table C.8: General Government debt developments

| | % of GDP | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Outturn** | **Forecast** | | | | | |
| | **2012-13** | **2013-14** | **2014-15** | **2015-16** | **2016-17** | **2017-18** | **2018-19** |
| Gross debt[1] | 88.3 | 89.6 | 91.8 | 93.1 | 91.9 | 89.4 | 86.6 |
| Change in gross debt ratio | 3.4 | 1.3 | 2.1 | 1.3 | -1.2 | -2.5 | -2.9 |
| % change | 3.9 | 1.5 | 2.4 | 1.5 | -1.2 | -2.7 | -3.2 |
| **Contributions to changes in gross debt** | | | | | | | |
| Primary balance[2] | 2.1 | 3.0 | 2.0 | 0.7 | -1.1 | -2.6 | -3.6 |
| Interest expenditure | 3.0 | 3.0 | 3.0 | 3.3 | 3.5 | 3.7 | 3.7 |
| Stock-flow adjustment[3] | -0.7 | -0.7 | 1.1 | 0.8 | 0.6 | 0.4 | 0.8 |
| Implicit interest rate on debt[4] | 3.6 | 3.5 | 3.6 | 3.8 | 3.9 | 4.2 | 4.3 |

[1] Treaty debt
[2] General government net borrowing less interest expenditure
[3] Change in Treaty debt less general government net borrowing
[4] Interest expenditure as a per cent of Treaty debt in previous year

Table C.9: Cyclical Developments

| | % of GDP | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Outturn** | **Forecast** | | | | | |
| | **2012-13** | **2013-14** | **2014-15** | **2015-16** | **2016-17** | **2017-18** | **2018-19** |
| Real GDP growth (%)[1] | 0.3 | 2.3 | 2.6 | 2.4 | 2.6 | 2.6 | 2.4 |
| Net borrowing of general government | 5.2 | 6.0 | 5.0 | 4.0 | 2.4 | 1.1 | 0.1 |
| Interest expenditure | 3.0 | 3.0 | 3.0 | 3.3 | 3.5 | 3.7 | 3.7 |
| Potential GDP growth (%)[1] | 0.5 | 1.5 | 1.9 | 2.1 | 2.2 | 2.2 | 2.2 |
| Output gap[2] | -2.8 | -2.0 | -1.3 | -1.0 | -0.6 | -0.2 | 0.0 |
| Cyclical budgetary component[3] | 2.0 | 1.5 | 1.0 | 0.8 | 0.5 | 0.2 | 0.0 |
| Cyclically-adjusted balance | 3.2 | 4.4 | 4.0 | 3.2 | 1.8 | 0.9 | 0.1 |
| Cyclically-adjusted primary balance[4] | 0.2 | 1.5 | 0.9 | -0.1 | -1.7 | -2.8 | -3.6 |

[1] Expressed in financial rather than calendar years
[2] A plus sign means deficit-reducing one-off measures
[3] Treaty deficit less cyclically-adjusted treaty deficit
[4] Cyclically-adjusted treaty deficit less interest expenditure

Table C.10: Divergence from previous update[1]

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
|---|---|---|---|---|---|---|---|
| **Real GDP growth (%)** | | | | | | | |
| Previous update | 0.2 | 0.8 | 2.0 | 2.4 | 2.7 | 2.8 | - |
| Current update | 0.3 | 2.3 | 2.6 | 2.4 | 2.6 | 2.6 | 2.4 |
| Difference | 0.1 | 1.5 | 0.6 | 0.0 | -0.1 | -0.2 | - |
| **Treaty deficit (% GDP)[2]** | | | | | | | |
| Previous update | 5.6 | 6.8 | 6.0 | 5.2 | 3.5 | 2.3 | - |
| Current update | 5.2 | 6.0 | 5.0 | 4.0 | 2.4 | 1.1 | 0.1 |
| Difference | -0.4 | -0.8 | -1.0 | -1.2 | -1.1 | -1.2 | - |
| **Treaty debt (% GDP)[3]** | | | | | | | |
| Previous update | 90.7 | 94.9 | 98.6 | 100.8 | 100.8 | 99.4 | - |
| Current update | 88.3 | 89.6 | 91.8 | 93.1 | 91.9 | 89.4 | 86.6 |
| Difference | -2.4 | -5.3 | -6.8 | -7.7 | -8.9 | -10.0 | - |

[1] Previous update numbers correspond to the OBR's March 2013 *Economic and fiscal outlook*

[2] General government net borrowing on a Maastricht basis

[3] General government gross debt on a Maastricht basis

Table C.11: Long-term sustainability of public finances[1]

| | **% of GDP** | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Outturn** | **Forecasts** | | | | | |
| | **2012-13** | **2020-21** | **2022-23** | **2032-33** | **2042-43** | **2052-53** | **2062-63** |
| **Total expenditure** | 43.6 | 39.8 | 39.7 | 41.1 | 42.6 | 43.6 | 45.5 |
| Of which: age-related expenditures[2] | 24.4 | 21.6 | 21.9 | 23.4 | 24.8 | 25.3 | 26.4 |
| State pensions | 6.0 | 5.7 | 5.8 | 6.6 | 7.5 | 7.6 | 8.4 |
| Pensioner benefits | 1.2 | 1.0 | 1.0 | 1.0 | 1.1 | 1.1 | 1.1 |
| Public service pensions | 2.2 | 2.2 | 2.2 | 1.9 | 1.6 | 1.4 | 1.3 |
| Health | 8.1 | 6.9 | 7.0 | 7.6 | 8.2 | 8.5 | 8.8 |
| Long-term care | 1.2 | 1.4 | 1.5 | 1.8 | 2.1 | 2.3 | 2.4 |
| Education | 5.6 | 4.5 | 4.5 | 4.5 | 4.3 | 4.4 | 4.4 |
| Net interest | 2.1 | 3.0 | 2.9 | 2.6 | 2.7 | 3.1 | 4.0 |
| **Total revenue** | 38.0 | 38.8 | 38.7 | 38.9 | 39.5 | 39.5 | 39.7 |

[1] Consistent with the central projection in the OBR's July 2013 *Fiscal sustainability report*

[2] Sum of pensions, pensioner benefits, public service pensions, health, long-term care and education

Table C.12: Contingent liabilities[1]

| £ billion | Year |
|---|---|
| | 2011-12 |
| Total quantifiable contingent liabilities | 100.8 |
| *Of which: financial stability inverventions* | 9.9 |

[1] Taken from section 32.2 of 2011-12 Whole of Government Accounts- year ended 31 March 2012, HM Treasury, July 2013

Table C.13: Basic assumptions

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
|---|---|---|---|---|---|---|---|
| Short-term interest rate[1] (annual average) | 0.7 | 0.5 | 0.6 | 1.3 | 2.0 | 2.6 | 3.1 |
| Long-term interest rate[2] (annual average) | 1.6 | 2.6 | 2.9 | 3.3 | 3.6 | 3.9 | 4.0 |
| Nominal effective exchange rate[5] | 82.8 | 82.8 | 86.1 | 85.8 | 85.1 | 84.3 | 83.6 |
| Exchange rate vis-à-vis the € (annual average) | 1.23 | 1.19 | 1.22 | 1.22 | 1.23 | 1.25 | 1.26 |
| | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** |
| Oil prices (Brent, USD/barrel) | 112 | 109 | 107 | 102 | 99 | 99 | 99 |
| Euro Area GDP growth | -0.7 | -0.4 | 1.0 | 1.4 | 1.7 | 1.9 | 2.0 |
| Growth of relevant foreign markets | 2.0 | 2.1 | 4.7 | 5.2 | 5.3 | 5.4 | 5.4 |

[1] 3 month sterling interbank rate (LIBOR)
[2] Weighted average interest rate on conventional gilts
[5] Tradeweighted sterling

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