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COVER NOTE

From:	Ivan Rogers, Permanent Representative, UK Representation to the EU
date of receipt:	28 April 2015
To:	Mr Carsten PILLATH, Director General, Council of the European Union
Subject:	2014-15 Convergence Programme for the United Kingdom

Delegations will find attached the second part of the Convergence Programme for the United Kingdom.

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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 reclassifications and new policies announced in this Budget and since the Autumn Statement 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 including those subject to the Government's welfare cap (from paragraph 4.95);
- describes the outlook for government lending to the private sector and other financial transactions, including asset sales (from paragraph 4.153);
- describes the outlook for the key fiscal aggregates: public sector net borrowing, the current budget, the cyclically adjusted current budget and public sector net debt (from paragraph 4.179);
- summarises risks and uncertainties (paragraph 4.192); and
- provides a comparison with forecasts from international organisations (from paragraph 4.193).

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 2014-15, which makes use of published ONS outturn data for April to January,[1] some preliminary data on tax receipts in February, and then forecasts to 2019-20. As in previous *Economic and fiscal outlooks (EFOs)*, this fiscal forecast:

[1] Outturn data are consistent with the *Public Sector Finances January 2015 Statistical Bulletin* (released in February) published by the Office for National Statistics and HM Treasury.

- represents our central view of the path of the public finances, conditioned on the policies and policy assumptions of the Coalition Government. On that basis, we believe that the outturns would be as likely to be above the forecast as below it;
- 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; and
- focuses on official 'headline' fiscal aggregates that exclude public sector banks. The Government's recently updated fiscal mandate and supplementary target are defined in terms of these measures.

Economic determinants of the fiscal forecast

4.3 Our fiscal forecasts are based on the economic forecasts presented in Chapter 3. Forecasts of tax receipts are particularly dependent on the profile 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 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. In Annex B, we present ready reckoners for the fiscal effects of changes in some of these determinants.

GDP and the output gap

4.4 Most economic forecasts focus on the outlook for real GDP, but it is nominal GDP that matters most when forecasting the public finances. Relative to our December forecast, cumulative nominal GDP growth between 2014-15 and 2019-20 has been revised up by 1.0 percentage points. The biggest revision is in 2019-20, reflecting stronger growth in government consumption due to a change in the Government's spending assumption.

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 receipts to increase and spending to fall as a share of GDP as the economy returns to its potential level. Our latest estimate of the output gap is slightly narrower on average across the forecast period than in December, largely reflecting the boost to demand in the near term from lower oil prices. We estimate that the output gap was -0.7 per cent of GDP in the final quarter of 2014, and that it will close slowly by late 2017.

Income and expenditure components of GDP

4.6 The composition of nominal GDP growth is particularly important. On the income side, labour income is generally taxed more heavily than company profits. On the expenditure side, 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.

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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 than in our December forecast. This includes a slightly lower forecast of earnings growth in 2016-17 and 2017-18, with stronger growth thereafter. We have revised up employment growth from 2016-17 onwards due to faster population growth. That reflects our decision to base this forecast on the ONS principal population projections rather than the low migration variant that underpinned our December forecast.

4.8 Nominal consumer spending growth is expected to be lower in most years compared to our December forecast, reflecting lower inflation throughout most of the forecast period.

4.9 Non-oil, non-financial company profits are expected to grow slightly more slowly in 2015 than we expected in December, partly reflecting recent outturn data. Financial sector profits are forecast to grow more slowly than non-financial sector profits due to both ongoing conduct fines and pressures from regulation throughout the forecast period.

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 significantly since December, primarily reflecting the implications of sterling oil prices being 30 per cent lower in the first quarter of 2015 than assumed in December. CPI inflation returns to the Bank of England's 2 per cent target by early 2019.

4.11 RPI inflation determines the interest paid on index-linked gilts and is used to revalorise excise duties and uprate business rates. Near-term RPI inflation has also been revised down since December due to lower oil prices. We have also changed our assumption for the long-term wedge between RPI and CPI inflation, which has lowered our medium-term RPI inflation forecast by 0.4 percentage points. This change is explained in Box 3.3. RPI inflation is expected to fall to a low of 0.9 per cent in the third quarter of 2015, before an increase in mortgage interest payments (MIPs) inflation pushes it up relative to CPI inflation.

4.12 The basic state pension (BSP) is uprated in April each year in line with the 'triple-lock' guarantee that it will increase by the highest of average earnings growth, CPI inflation in the previous September and 2.5 per cent. As a result, the BSP was once again uprated by the minimum 2.5 per cent in 2015-16. Our forecast now implies that it will be uprated by this minimum again in 2016-17, which would be the fifth successive year since the triple-lock was announced that the BSP had increased faster than average earnings, with a cumulative difference over that period of 8.2 per cent. On our current forecast, uprating will be in line with average earnings growth from 2017-18 onwards.[2]

[2] Earnings growth as defined for the purposes of benefit uprating – that is, AWE earnings growth in the three months to July of the preceding year. For our forecast, we use whole economy wages and salaries (as defined in the National Accounts) divided by LFS employment (excluding self-employed) in Q2 as a proxy for AWE earnings growth.

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Table 4.1: Determinants of the fiscal forecast

	Percentage change on previous year unless otherwise specified						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
GDP and its components							
Real GDP	2.1	2.6	2.4	2.3	2.4	2.3	2.4
Nominal GDP[1]	4.0	4.5	3.8	3.5	4.0	4.4	5.0
Nominal GDP (£ billion)[1,2]	1731	1809	1878	1943	2022	2111	2218
Nominal GDP (centred end-March £bn)[1,3]	1773	1840	1910	1981	2064	2163	2272
Wages and salaries[4]	2.8	4.1	3.8	3.8	4.3	4.5	5.0
Non-oil PNFC profits[4,5]	2.6	6.8	6.0	3.5	3.8	4.3	5.0
Non-oil PNFC net taxable income[4,5]	-1.0	5.6	4.6	1.1	1.0	1.9	3.1
Consumer spending[4,5]	3.6	3.6	3.7	4.2	4.5	4.6	4.5
Prices and earnings							
GDP deflator	2.1	1.7	1.4	1.2	1.6	2.1	2.6
RPI (September)	3.2	2.3	0.9	2.2	3.0	3.2	3.1
CPI (September)	2.7	1.2	0.2	1.2	1.7	1.9	2.0
Average earnings[6]	1.6	2.3	2.3	3.1	3.8	4.0	4.4
Triple-lock' guarantee	2.7	2.5	2.5	3.1	3.6	3.9	4.4
Key fiscal determinants							
Claimant count (millions)	1.33	0.95	0.75	0.74	0.76	0.77	0.78
Employment (millions)	30.2	30.8	31.2	31.4	31.6	31.7	31.9
VAT gap (per cent)	10.8	10.0	9.9	9.9	9.9	9.9	9.9
Output gap (per cent of potential output)	-2.0	-0.8	-0.4	-0.2	0.0	0.0	0.0
Financial and property sectors							
Equity prices (FTSE All-Share index)	3475	3594	3803	3937	4094	4275	4491
HMRC financial sector profits[1,5,7]	4.0	4.5	3.8	3.5	4.0	4.4	5.0
Financial sector net taxable income[1,5]	4.4	-2.1	-8.7	3.5	4.2	3.8	3.9
Residential property prices[8]	5.0	10.1	4.9	5.3	6.7	6.9	6.2
Residential property transactions (000s)[9]	1140	1195	1129	1211	1308	1386	1425
Commercial property prices[9]	17.3	17.9	1.0	1.0	1.8	3.0	4.5
Commercial property transactions[9]	8.4	9.0	6.7	2.7	2.7	2.6	2.8
Volume of stampable share transactions	13.6	4.4	-0.8	-0.8	-0.8	-0.8	-0.8
Oil and gas							
Oil prices ($ per barrel)[5]	108.8	98.9	62.1	69.2	71.4	71.4	71.4
Oil prices (£ per barrel)[5]	69.6	60.0	40.3	44.9	46.1	45.9	45.7
Gas prices (p/therm)[5]	66.9	50.2	47.8	50.3	50.3	50.3	50.3
Oil production (million tonnes)[5]	40.6	39.7	38.3	36.7	34.9	33.4	30.9
Gas production (billion therms)[5]	12.8	13.1	12.6	11.9	11.4	10.9	10.3
Interest rates and exchange rates							
Market short-term interest rates (%)[10]	0.5	0.6	0.7	1.2	1.6	1.8	1.9
Market gilt rates (%)[11]	2.5	2.3	2.1	2.3	2.4	2.5	2.6
Euro/Sterling exchange rate (€/£)	1.19	1.27	1.37	1.36	1.34	1.33	1.31

[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] 3-month sterling interbank rate (LIBOR).
[11] Weighted average interest rate on conventional gilts

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

	Percentage change on previous year unless otherwise specified						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
GDP and its components							
Real GDP	-0.2	-0.4	0.2	0.1	0.0	0.0	0.0
Nominal GDP[1]	-0.2	-0.6	0.1	-0.1	-0.1	0.2	0.7
Nominal GDP (£ billion)[1,2]	-2	-13	-10	-13	-16	-13	2
Nominal GDP (centred end-March £bn)[1,3]	-6	-13	-10	-15	-15	-6	9
Wages and salaries[4]	-0.1	0.5	0.3	0.0	-0.1	0.3	0.8
Non-oil PNFC profits[4,5]	-2.4	-0.8	-1.1	0.0	-0.2	0.1	0.7
Non-oil PNFC net taxable income[4,5]	-3.8	-0.8	-0.2	0.4	-0.1	0.4	1.2
Consumer spending[4,5]	0.1	-0.4	-0.6	0.1	-0.2	-0.1	-0.2
Prices and earnings							
GDP deflator	0.3	-0.4	0.0	-0.2	-0.1	0.2	0.7
RPI (September)	0.0	0.0	-1.2	-0.7	-0.5	-0.5	-0.4
CPI (September)	0.0	0.0	-1.0	-0.6	-0.3	-0.1	0.0
Average earnings[6]	-0.1	0.5	0.2	-0.2	-0.1	0.1	0.6
'Triple-lock' guarantee (September)	0.0	0.0	0.0	0.1	-0.2	-0.1	0.5
Key fiscal determinants							
Claimant count (millions)	0.00	-0.01	-0.09	-0.09	-0.08	-0.08	-0.08
Employment (millions)	0.0	0.0	0.0	0.0	0.1	0.1	0.2
VAT gap (per cent)	0.5	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Output gap (per cent of potential output)	0.0	0.0	0.2	0.2	0.2	0.1	0.0
Financial and property sectors							
Equity prices (FTSE All-Share index)	0	23	131	132	131	145	183
HMRC financial sector profits[1,5,7]	2.6	2.3	0.0	-0.2	-0.1	0.4	0.7
Financial sector net taxable income[1,5]	1.5	2.9	-2.6	0.2	0.5	0.5	3.0
Residential property prices[8]	0.0	-0.5	-1.6	-0.6	0.9	2.1	2.7
Residential property transactions (000s)[9]	0	-20	-164	-174	-131	-88	-78
Commercial property prices[9]	0.0	6.5	0.2	-0.3	-0.9	0.9	1.8
Commercial property transactions[9]	0.0	4.9	6.2	0.7	-0.2	0.1	0.2
Volume of stampable share transactions	0.0	3.2	2.4	-0.2	-0.2	-0.2	-0.2
Oil and gas							
Oil prices ($ per barrel)[5]	0.0	-1.6	-21.0	-16.8	-15.1	-15.1	-15.1
Oil prices (£ per barrel)[5]	0.0	-0.9	-12.8	-10.2	-9.2	-9.2	-11.1
Gas prices (p/therm)[5]	0.0	0.0	-6.8	-6.5	-6.5	-6.5	-6.5
Oil production (million tonnes)[5]	0.0	0.5	-0.9	-2.5	-4.3	-5.8	-6.3
Gas production (billion therms)[5]	0.0	0.3	-0.1	-0.8	-1.3	-1.8	-1.8
Interest rates and exchange rates							
Market short-term interest rates[10]	0.0	0.0	-0.2	-0.3	-0.3	-0.3	-0.5
Market gilt rates[11]	0.0	-0.2	-0.4	-0.4	-0.5	-0.5	-0.5
Euro/Sterling exchange rate (€/£)	0.00	0.02	0.11	0.12	0.12	0.11	0.12

[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] 3-month sterling interbank rate (LIBOR).
[11] Weighted average interest rate on conventional gilts

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Property market

4.13 The residential property market is a key driver of receipts from stamp duty land tax (and the land and buildings transaction tax in Scotland) and inheritance tax. House price growth in the last quarter of 2014 was weaker than expected, and we expect that to persist over the next two years relative to our December forecast. House price growth is stronger in the second half of the forecast reflecting stronger growth of real income per household. House prices rise faster than earnings for most of the forecast period thanks to the lagged effect of past falls in mortgage interest rates and the fact that household income growth has historically had a more than one-for-one impact on house prices.

4.14 Residential property transactions have been lower than expected in recent months, with growth in 2014-15 expected to be 4.9 per cent, below our December forecast of 6.6 per cent. Property transactions are now expected to fall by 5.5 per cent in 2015-16, reflecting the weakness of mortgage approvals in recent months. We have also revised down our medium-term assumption for turnover in the housing market. As a result, property transactions are 6.7 per cent lower on average in the final three years of the forecast than in December. This revision is explained more fully in Chapter 3.

4.15 Commercial property prices increased strongly in the third quarter of 2014. Average prices are now expected to rise by 18 per cent in 2014-15 and the volume of transactions by 9 per cent. Our forecast for price growth is similar to December, while our forecast for transactions growth is higher in 2015-16.

Oil and gas sector

4.16 We assume that for the next two years dollar oil prices move in line with the average of the futures curve over the 10 working days to 26 February, and then remain at that level. Since our December forecast, oil prices have fallen significantly (see Box 2.1). We use the same method to project gas prices, which are also lower.

4.17 Our oil and gas production forecasts are informed by the central projection published by the Department of Energy and Climate Change (DECC). The projections for oil and gas production are significantly lower than our December forecast, as reductions in the oil price mean that some new fields and projects will no longer be profitable. The effect of lower oil prices on investment is expected to be greater than the effect on production. Compared to December, we expect much lower levels of capital and operating expenditure. Lower oil and gas prices will have reduced the net present value of potential capital projects as well as reducing upward pressures on operating costs.

4.18 Given the material effects on investment and production in the North Sea that the policy changes announced in the Budget are expected to encourage, we have presented our pre- and post-measures forecasts in full later in the chapter. These are shown in Table 4.11.

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Equity markets

4.19 Equity prices are a significant determinant of capital gains tax, inheritance tax and stamp duty on shares. Equity prices are assumed to rise from their current level in line with our forecast for nominal GDP. As equity prices in the 10 working days to 26 February were above our December assumption – and that is locked in by our forecast assumption – they remain higher across the forecast period.

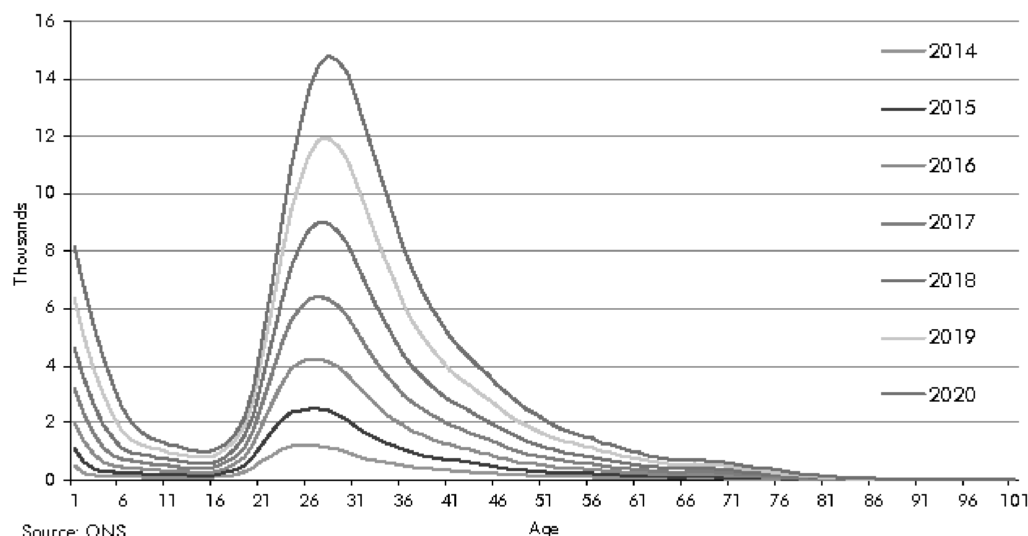
Interest rates

4.20 We use the 3-month sterling interbank rate as a benchmark for our short-term interest rate determinant. Our forecast reflects average forward rates for the 10 working days to 26 February. The futures curve implies that rates will be lower in all years of the forecast than in December, reflecting changes in monetary policy expectations. We assume that gilt yields move in line with market expectations based on average forward rates over the same 10-day period. These are also lower across the forecast period than we assumed in December.

Population

4.21 As described in Chapter 3, we have moved from the ONS 'low migration' population projections to the 'principal' projections to underpin this forecast. As well as the effects on potential output growth set out in Chapter 3, a key driver of the fiscal implications of this change for our forecast is the age structure of the addition to the population it implies. As Chart 4.1 shows, the assumed age structure is skewed heavily towards those of working age, and less towards children, while very few are assumed to be above the state pension age. By the end of the forecast period, the total population is nearly 320,000 higher than previously assumed, a 0.5 per cent increase. Within that increase, 84 per cent is assumed to be among people of working age (16 to 64 years old); by comparison 62 per cent of the population underpinning our December forecast were of working age.

Chart 4.1: The effect on the population age structure of moving to the ONS principal population projections



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 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.[3] These are discussed in Box 3.2 in Chapter 3. We note as risks to the fiscal forecast any significant policy commitments that are not quantifiable, as well as any potential statistical classification changes.

Direct effect of new policy announcements on the public finances

4.23 In Annex A, we reproduce the Treasury's table of the direct effect on PSNB of policy decisions in the Budget or announced since the Autumn Statement. We have endorsed all of the tax and annually managed expenditure costings in the table as reasonable and central estimates of the measures themselves. Annex A also includes a formal assessment of the degree of uncertainty associated with each costing that we have certified.

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 in a supplementary fiscal table on our website, showing how each policy measure is allocated to different categories of tax and spending.

[3] In March 2014, we published a 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*.

4.25 By far the largest single-year effect of a Government decision comes via its new assumption for total spending in 2019-20, although this does not appear in the Treasury's table of policy decisions. The Government has decided that total spending should grow in line with nominal GDP in that year, rather than being held flat in real terms. This implies a substantial increase in current departmental spending on public services and administration in that year, which on our estimate is equivalent to £20.2 billion.

4.26 The Budget measures in the Treasury's table of policy decisions are neutral for borrowing on average over the forecast period with 'giveaways' offsetting 'takeaways'. They raise or lower borrowing by less than £1 billion in every year. The biggest takeaway is an increase in the bank levy (raising £4.4 billion over five years), with a variety of other measures raising smaller amounts with often significant uncertainty around their costing. These are balanced by three main giveaways – further increases in the income tax personal allowance (£5.7 billion over five years), tax measures benefiting savers (£3.0 billion) and a subsidy for first-time buyers (£2.2 billion, the take-up of which is also subject to significant uncertainty).

4.27 There are some Budget measures that might be expected to have different costs in the longer term than over the five-year period of our medium-term forecast:

- sales of annuities in a secondary market would raise income tax receipts in the short term, but at the expense of future receipts. The profile would be similar to that expected for the Budget 2014 pensions flexibility measure (see Chart 4.1 of our March 2014 *EFO*);

- the tax foregone on savings income through introducing a tax-free allowance on savings income would be greater if – as we assume in our long-term projections – interest rates eventually normalise at higher rates than is implied by market expectations over the next five years; and

- the cost of the package of oil and gas tax measures would be greater in the long term if a higher proportion of North Sea companies were tax-paying, as might be expected. (Currently, a large proportion of companies have either past trading losses or tax deductible expenditure sufficient to offset the tax liability from current profits).

4.28 In contrast to the relatively small net effect of the scorecard measures, the Government has also announced significant asset sales over the coming year. The two largest sales relate to NRAM plc assets, principally the Granite securitisation vehicle, held by UK Asset Resolution and further sales of Lloyds Banking Group shares. This allows net debt to fall as a share of GDP a year earlier than in December – but at the cost of future revenue.

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Table 4.3: Summary of the effect of Government decisions

	£ billion				
	Forecast				
	2015-16	2016-17	2017-18	2018-19	2019-20
Effects of receipts measures	0.5	0.0	0.2	-0.9	-0.6
of which:					
Income tax and NICs	0.1	-0.7	-0.6	-1.6	-1.5
Onshore corporation tax	0.2	0.5	0.5	0.4	0.3
UK oil and gas	-0.2	-0.4	-0.3	-0.3	-0.1
Fuel duty	-0.1	-0.2	-0.2	-0.2	-0.3
Alcohol duty	-0.2	-0.2	-0.2	-0.2	-0.2
Bank levy	0.7	0.9	0.9	0.9	0.9
Other	0.0	0.2	0.2	0.1	0.1
Effects of expenditure measures[1]	0.3	0.0	0.0	0.0	0.0
of which:					
Current DEL	-0.5	0.1	0.1	0.0	0.0
Current AME	-0.1	-0.1	-0.1	0.0	0.0
of which:					
Welfare	0.0	0.0	0.0	0.1	0.1
Company and other tax credits	0.0	0.0	-0.1	-0.1	-0.1
Central government gross debt interest	-0.1	-0.1	-0.1	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Capital DEL	0.4	0.2	0.4	0.6	0.8
Capital AME	0.5	-0.2	-0.4	-0.6	-0.8
Total direct effect of Budget policy measures on PSNB	0.7	0.0	0.2	-0.9	-0.6
Effect of applying new Budget spending policy assumptions post 2015-16		1.9	1.9	2.0	-20.2
Financial transactions[2]	8.5	0.0	0.0	0.0	0.0

[1] Expenditure categories are equivalent to PSCE in RDEL, PSCE in AME, PSGI in CDEL and PSGI in AME in Table 4.20.
[2] Affects PSNCR, not PSNB.
Note: this table uses the Treasury scorecard convention that a positive figure means an improvement in the PSNB, PSNCR and PSND.

Contingent liabilities

4.29 We have asked the Treasury to identify any changes to future contingent liabilities as a result of new policy announcements since December. The Government has made one such announcement in this Budget: a bonus of up to £3,000 for first-time buyers saving for a deposit, which appears in the Treasury's table of policy decisions. During the period when prospective first-time buyers are saving, the potential future bonus payments will represent a contingent liability to the public sector. The scale of this contingent liability is subject to significant uncertainty. Indeed, in Annex A, we have identified the assumptions about take-up of this support as a source of uncertainty in the policy costing itself.

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Classification changes

4.30 Our forecast incorporates all the classification changes recently made by the ONS. We have also anticipated changes it has signalled it will make in March and later this year.[4] We have included these changes in our forecasts for 2014-15 onwards. Outturn data will become consistent with our forecast once the ONS has completed them. They include:

- **multilateral development banks:** subscriptions to multilateral development banks that offer primarily concessionary loans (for example the World Bank's International Development Association) will be classified as capital transfers (spending) rather than equity injections (financial transactions). This adds £1.4 billion to capital spending and borrowing from 2014-15 onwards, but has no effect on net debt;
- **depreciation of the road network:** will be calculated over a life of 55 years rather than 75 years, to harmonise with other EU member states. This adds £1.1 billion to current spending from 2014-15 onwards (with an offsetting effect on gross operating surpluses on the receipts side to leave the effect neutral for borrowing);
- **Network Rail:** changes to the modelling of Network Rail depreciation reduce current spending by £0.5 billion in 2014-15 and £0.4 billion thereafter, with an offsetting effect on gross operating surpluses on the receipts side to leave the effect neutral for borrowing;
- **Air Travel Organiser's Licensing (ATOL) protection contributions:** will be included in receipts as a tax on production, having not previously been recorded in the public finances data. This adds £0.1 billion to current receipts from 2014-15 and reduces the current deficit and borrowing accordingly; and
- **new vehicle registration fee:** the fee that is paid when a motor vehicle is registered and taxed for the first time will be netted off in receipts as a tax on production rather than treated as negative expenditure. This change in neutral for borrowing, increasing current spending and current receipts by £0.1 to £0.2 billion from 2014-15 onwards.

Financial sector interventions

4.31 The Government undertook a number of interventions in the financial sector as a result of the crisis and recession of the late 2000s. Box 4.1 provides an update on the fiscal impact of these past interventions.

[4] See 'Recent events and methodological changes' in the ONS *Public Sector Finances January 2015 Statistical Bulletin* (released in February).

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Box 4.1: Fiscal impact of the financial interventions

This box provides an update on crisis-related interventions in the financial system, in particular:

- equity injections into Royal Bank of Scotland (RBS), Lloyds and the nationalisation of Northern Rock plc;
- holdings in Bradford & Bingley (B&B) and NRAM plc, now managed by UK Asset Resolution (UKAR);
- loans through the financial services compensation scheme (FSCS) and various wholesale and depositor guarantees; and
- other support, through the asset protection scheme, special liquidity scheme, credit guarantee scheme and a contingent capital facility – all now closed.

Table A summarises the position as at the end of February 2015.[a] Since then, the Government has sold further shares in Lloyds and has announced an intention to sell more. It has also announced plans to sell NRAM plc assets, principally the Granite securitisation vehicle, held by UK Asset Resolution (UKAR). These are discussed later in the chapter.

In total, £134 billion has been disbursed by the Treasury to date since the crisis. By the end of February, principal repayments on loans, proceeds from share sales and redemptions of preference shares amounted to £39 billion, up from the £35 billion reported in our last *EFO*. The additional repayments mainly relate to the loan to UKAR (Northern Rock, NRAM plc and B&B working capital facility) and the recovery of the claim on Landsbanki estate (which operated its UK branch as Icesave) for depositors in the UK. In total, the Treasury also received a further £17 billion, mainly from fees. So the net cash position stood at around a £77 billion shortfall.

By the end of February, the Treasury was owed £37 billion – largely the value of loans outstanding – and held shares in Lloyds and RBS – valued at £49 billion – and holdings in B&B and NRAM plc.

If the Treasury was to receive all loan payments in full, and sold the shares at their latest values, it would realise an overall cash surplus of £9 billion. But these figures exclude the costs to the Treasury of financing these interventions, and any offsetting interest and dividend receipts. If all interventions were financed through debt, the Treasury estimate that additional debt interest costs would have amounted to £22 billion to date. The Treasury has also received around £5 billion of interest over the same period.

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Table A: Cost of financial interventions

	£ billion					
	Cash disbursed	Principal repayments	Other fees received[1]	Outstanding payments	Market value[2]	Implied balance
Lloyds	20.5	8.2	2.7	0.1	13.3	3.8
RBS	45.8	0.5	4.5	1.2	35.7	-3.9
UK Asset Resolution	41.3	21.2	3.7	19.1	-	2.7
FSCS	20.9	5.1	-	15.8	-	0.0
Other institutions	5.3	4.3	-	1.0	-	0.0
Credit Guarantee Scheme	-	-	4.3	-	-	4.3
Special Liquidity Scheme	-	-	2.3	-	-	2.3
Total	133.8	39.4	17.4	37.2	49.0	9.2

[1] Fees relating to the asset protection scheme and contingent capital facility are included within the Lloyds and RBS figures.
[2] Based on average share prices over the 10 working days to 26 February 2015.

*The Lloyds figures show the position at 23 February, when the Government announced the sale of the first £500 million of shares that had been sold under the current trading plan.

Public sector receipts

4.32 Table 4.4 summarises our receipts forecast. We expect taxes to have fallen by 0.5 per cent of GDP between 2013-14 and 2015-16, but then to return to just below their 2013-14 level by the end of the forecast period (due in part to the abolition of the NICs contracting out rebate in 2016-17). This would be only 0.5 percentage points higher than in 2009-10, when the budget deficit was at its peak. Non-tax receipts – in particular interest and dividend receipts – are also expected to rise over the forecast period, so that total receipts rise by 0.2 per cent of GDP between 2013-14 and 2019-20.

Table 4.4: Major receipts as a per cent of GDP

	Per cent of GDP						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Income tax and NICs	15.3	15.0	15.1	15.7	15.9	16.0	16.2
Value added tax	6.1	6.1	6.1	6.1	6.0	6.0	5.9
Onshore corporation tax	2.1	2.2	2.3	2.2	2.2	2.1	2.1
UK oil and gas receipts	0.3	0.1	0.0	0.0	0.0	0.0	0.0
Fuel duties	1.6	1.5	1.4	1.4	1.4	1.3	1.3
Business rates	1.5	1.5	1.5	1.5	1.5	1.5	1.4
Council tax	1.6	1.5	1.5	1.5	1.5	1.4	1.4
Excise duties	1.1	1.1	1.0	1.0	1.0	1.0	1.0
Capital taxes	1.1	1.3	1.3	1.4	1.5	1.7	1.8
Other taxes	2.8	2.8	2.8	2.7	2.6	2.6	2.6
National Accounts taxes	33.7	33.3	33.1	33.6	33.6	33.6	33.6
Interest and dividend receipts	0.3	0.4	0.4	0.4	0.5	0.5	0.5
Other receipts	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Current receipts	36.1	35.8	35.5	36.1	36.2	36.2	36.3

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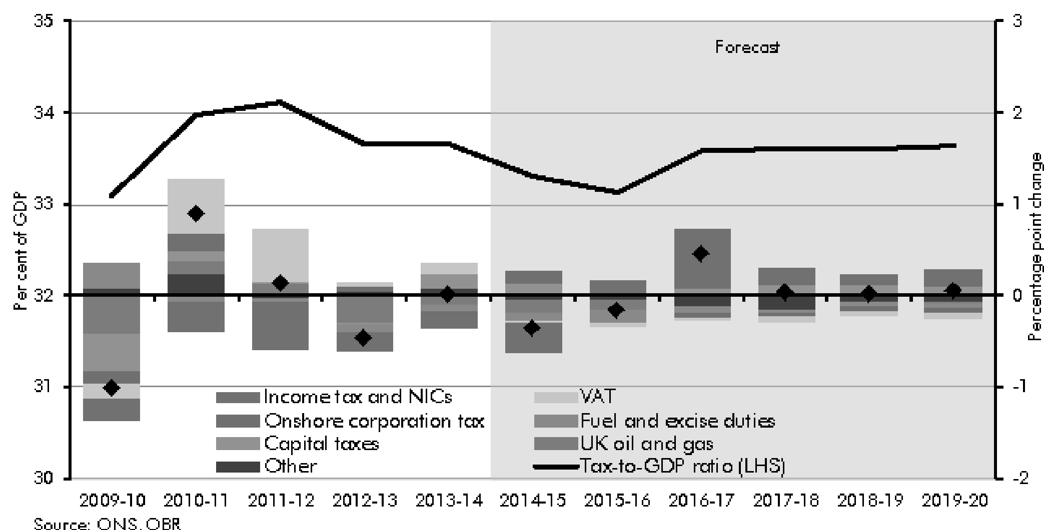
4.33 Chart 4.2 shows how the tax-to-GDP ratio has changed in recent years, broken down by tax stream. As a result of weak real earnings growth and the effect of policy measures, income tax and NICs receipts have fallen as a share of GDP in every year since 2009-10, having the largest negative effect on the total tax-to-GDP ratio over this period. Oil and gas receipts, fuel and excise duties have all fallen as a share of GDP over this period. Partially offsetting these falls are VAT receipts, which have risen by 1.2 per cent of GDP, driven by the VAT rate rises in January 2010 and January 2011.

Chart 4.2: Changes in the tax-to-GDP ratio



Source: ONS, OBR

Sources of changes in the tax-to-GDP ratio

4.34 Movements in the tax-to-GDP ratio can stem from two sources:

- changes in the composition of GDP can lead to specific tax bases growing more or less quickly than the economy as a whole; and
- the effective tax rate paid on each tax base can change due to policy or other factors.

4.35 We have used this approach to identify the main drivers of the fall in the tax-to-GDP ratio in 2014-15 and the relatively slow rise over the remainder of the forecast period.

Change in the tax-to-GDP ratio in 2014-15

4.36 Chart 4.3 shows that the main sources of the 0.4 percentage point fall in the tax-to-GDP ratio are:

- a 0.4 per cent of GDP fall in PAYE and NICs receipts, explained in roughly equal measure by the tax base – wages and salaries – rising less quickly than GDP and by a

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drop in the effective tax rate paid. The effective tax rate will have been reduced by the increase in the income tax personal allowance to £10,000. It is also likely to have been affected by changes in the composition of employment – lower paid age groups and lower paid occupations and industries have seen stronger growth in employment;

- a 0.1 per cent of GDP fall in oil and gas receipts, due to lower oil and gas prices and higher expenditure reducing taxable profits. (The steep fall in oil prices in late 2014 will mostly feed through into lower 2015-16 receipts); and
- a 0.1 per cent of GDP fall in excise duties, with receipts from fuel duty, tobacco duties and alcohol duties all falling as a share of GDP. The main source of the decline has been the tax base, which is either falling in absolute terms (tobacco) or is rising more slowly than GDP (alcohol and fuel).

4.37 Partly offsetting these falls are:

- a 0.1 per cent of GDP rise in self-assessment (SA) income tax receipts, due to the effects of income shifting prompted by the reduction in the additional rate of income tax to 45p in April 2013, which affected receipts with a lag;
- a 0.1 per cent of GDP rise in onshore corporation tax receipts, driven by growth in receipts from all sectors, partly reflecting strong profit growth; and
- a 0.1 per cent rise in stamp duty land tax (SDLT) receipts, reflecting strong growth in the tax base due to growth in house prices and property transactions over the past year. A slight reduction in the effective tax rate partially offsets this, mostly driven by the reforms to stamp duty announced in Autumn Statement 2014.

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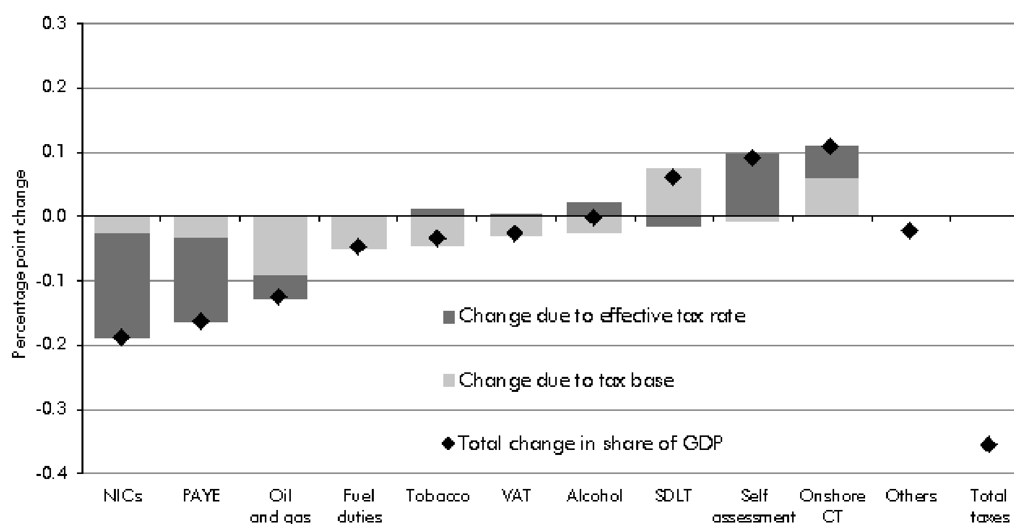
Chart 4.3: Sources of changes in the tax-to-GDP ratio (2013-14 to 2014-15)



Source: ONS, OBR

Change in the tax-to-GDP ratio over the forecast period

4.38 Chart 4.4 shows that the main sources of the expected 0.3 percentage point rise in the tax-to-GDP ratio over the forecast period are:

- a 1.1 per cent of GDP rise in PAYE and NICs receipts, driven almost entirely by a rise in the effective tax rate. The majority of this is explained by the return of fiscal drag, as productivity and real earnings growth are assumed to pick up, dragging more income into higher tax brackets. Around 0.3 per cent of GDP is accounted for by the Budget 2013 policy decision to abolish the NICs contracting out rebate, which is expected to raise NICs receipts by around £5 billion in 2016-17;

- a 0.2 per cent of GDP rise in SDLT receipts, reflecting both the tax base and the effective tax rate. Growth in the tax base reflects the growth in prices and transactions over the forecast period. With SDLT thresholds in the new 'slice' system still fixed in cash terms over the forecast period, rising house prices drag a greater proportion of the value of residential transactions into higher tax brackets; and

- a 0.2 per cent of GDP rise in SA receipts, again driven by the effective tax rate.

4.39 Partly offsetting these rises are:

- a 0.3 per cent of GDP fall in excise duties. This is explained by declining tax bases, due to falling tobacco consumption and increasing fuel efficiency, which are only partly offset by assumed rises in duty rates raising the effective tax rate. The planned September 2015 rise in fuel duty was cancelled in the Budget;

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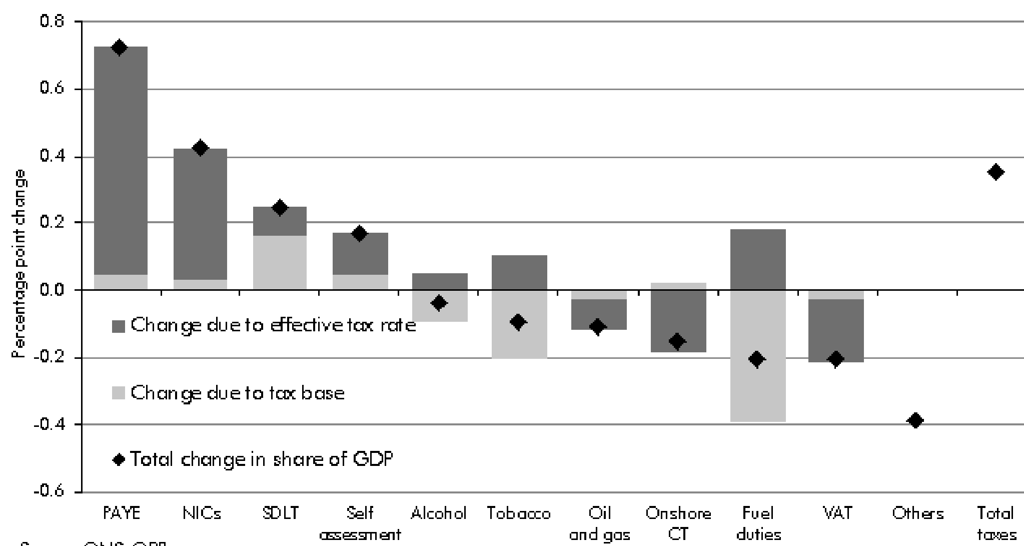
- a 0.2 per cent of GDP fall in onshore corporation tax receipts, driven entirely by a falling effective tax rate as strong growth in investment increases use of capital allowances and as the financial sector sets past losses against future liabilities;
- a 0.2 per cent of GDP fall in VAT receipts, as assumed increases in the share of household finances devoted to mortgage interest payments – which are zero-rated – make up a rising share of consumer spending, reducing the effective tax rate; and
- a 0.1 per cent of GDP fall in oil and gas receipts. The decline in the tax base is driven by lower oil and gas prices as well as a fall in the volume of production. The effective tax rate also falls over the forecast period. The policy measures announced in the Budget are assumed to raise production, but to reduce the effective tax rate further.

Chart 4.4: Sources of changes in the tax-to-GDP ratio (2014-15 to 2019-20)



Source: ONS, OBR

Detailed current receipts forecast

4.40 Tables 4.5 and 4.6 present our detailed receipts forecasts.

Table 4.5: Current receipts

	£ billion						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Income tax (gross of tax credits)[1]	157.7	162.6	170.5	182.0	192.7	202.8	216.5
of which: Pay as you earn	*135.5*	*138.6*	*143.9*	*153.6*	*163.7*	*173.5*	*185.9*
Self assessment	*20.9*	*23.4*	*26.2*	*29.3*	*30.3*	*31.1*	*32.4*
National insurance contributions	107.3	108.7	113.2	123.9	129.2	135.4	142.7
Value added tax	106.5	110.8	114.3	117.7	121.4	125.9	131.1
Corporation tax[2]	40.3	42.4	43.0	43.6	44.6	45.6	46.6
of which: Onshore	*36.7*	*40.3*	*42.3*	*42.9*	*44.0*	*44.8*	*46.0*
Offshore	*3.6*	*2.1*	*0.7*	*0.7*	*0.7*	*0.8*	*0.7*
Corporation tax credits[3]	-1.0	-0.9	-0.9	-0.9	-1.0	-1.0	-1.0
Petroleum revenue tax	1.1	0.5	0.0	-0.1	0.0	0.0	0.0
Fuel duties	26.9	27.2	27.0	27.2	27.6	28.2	28.8
Business rates	26.8	27.3	28.0	29.0	29.5	30.7	32.0
Council tax	27.5	27.9	28.3	28.8	29.5	30.2	31.1
VAT refunds	13.8	13.9	13.9	13.2	12.7	12.7	13.4
Capital gains tax	3.9	5.7	6.5	7.3	8.0	8.8	9.8
Inheritance tax	3.4	3.8	4.2	4.6	5.1	5.7	6.4
Stamp duty land tax[4]	9.4	10.9	10.4	11.8	13.8	16.0	18.0
Stamp taxes on shares	3.1	3.0	3.3	3.4	3.5	3.6	3.9
Tobacco duties	9.6	9.4	9.1	9.0	9.1	9.2	9.3
Spirits duties	2.9	3.2	3.2	3.3	3.5	3.6	3.7
Wine duties	3.7	3.9	3.9	4.1	4.4	4.6	4.9
Beer and cider duties	3.7	3.7	3.4	3.4	3.6	3.6	3.6
Air passenger duty	3.0	3.2	3.1	3.2	3.4	3.5	3.7
Insurance premium tax	3.0	3.0	3.0	3.1	3.1	3.2	3.2
Climate change levy	1.2	1.7	2.0	2.0	1.8	1.7	1.6
Other HMRC taxes[5]	6.5	6.5	6.8	6.6	6.9	7.1	7.3
Vehicle excise duties	6.1	6.1	5.8	5.6	5.5	5.3	5.1
Bank levy	2.3	2.8	3.6	3.8	3.7	3.7	3.7
Licence fee receipts	3.1	3.1	3.1	3.1	3.1	3.2	3.3
Environmental levies	3.1	4.8	5.9	6.8	7.3	8.7	9.4
EU ETS auction receipts	0.4	0.3	0.3	0.3	0.4	0.4	0.6
Scottish taxes[6]	0.0	0.0	0.5	0.6	0.7	0.8	0.9
Diverted profits tax	0.0	0.0	0.0	0.3	0.4	0.3	0.4
Other taxes	7.3	7.2	6.5	6.1	6.0	5.9	6.0
National Accounts taxes	582.6	602.4	622.1	652.7	679.4	709.5	746.2
Less own resources contribution to EU	-2.9	-2.9	-2.6	-2.2	-2.3	-2.4	-2.6
Interest and dividends	5.9	6.4	6.7	7.5	9.2	10.7	11.9
Gross operating surplus	36.7	38.2	39.6	41.4	43.2	45.1	47.2
Other receipts	1.8	2.9	1.5	1.5	1.6	1.6	1.6
Current receipts	624.1	646.9	667.4	700.9	731.2	764.5	804.3
Memo: UK oil and gas revenues[7]	*4.7*	*2.6*	*0.7*	*0.6*	*0.7*	*0.8*	*0.7*

[1] Includes PAYE, self assessment, 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] Forecast for SDLT is for England, Wales and Northern Ireland from 2015-16.

[5] Consists of landfill tax (ex Scotland from 2015-16), aggregates levy, betting and gaming duties and customs duties.

[6] Consists of Scottish LBTT and landfill tax but not the Scottish rate of income tax or aggregates levy.

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

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Table 4.6: Change to current receipts forecast since December

	£ billion						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Income tax (gross of tax credits)[1]	0.0	-0.4	-0.2	1.0	1.2	0.7	2.6
of which: Pay as you earn	*0.0*	*0.8*	*1.1*	*2.4*	*2.4*	*2.2*	*4.1*
Self assessment	*0.0*	*-1.2*	*-1.5*	*-0.7*	*-0.5*	*-0.8*	*-0.9*
National insurance contributions	0.0	-0.2	0.2	1.0	1.0	1.3	2.5
Value added tax	0.0	0.7	0.2	0.1	-0.2	0.1	1.0
Corporation tax[2]	0.0	0.7	-0.2	0.1	0.4	0.3	1.0
of which: Onshore	*0.0*	*1.0*	*0.8*	*1.2*	*1.4*	*1.6*	*2.1*
Offshore	*0.0*	*-0.2*	*-1.0*	*-1.1*	*-1.0*	*-1.3*	*-1.0*
Corporation tax credits[3]	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1
Petroleum revenue tax	0.0	0.0	-0.5	-0.7	-1.0	-1.0	-1.0
Fuel duties	0.0	0.2	0.0	-0.5	-0.7	-0.9	-1.0
Business rates	0.0	0.2	0.4	-0.2	-0.4	-0.5	-0.7
Council tax	0.2	0.0	0.0	-0.2	-0.3	-0.4	-0.4
VAT refunds	0.0	0.0	0.1	0.1	-0.2	0.1	0.8
Capital gains tax	0.0	0.5	0.7	0.8	0.9	1.1	1.5
Inheritance tax	0.0	0.0	0.0	0.0	-0.1	-0.1	0.1
Stamp duty land tax[4]	0.0	-0.6	-1.7	-2.0	-1.8	-1.4	-0.7
Stamp taxes on shares	0.0	0.1	0.4	0.4	0.4	0.4	0.5
Tobacco duties	0.0	0.3	0.1	0.0	0.0	0.0	0.0
Spirits duties	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Wine duties	0.0	0.0	-0.2	-0.3	-0.4	-0.5	-0.7
Beer and cider duties	0.0	0.1	-0.1	-0.1	-0.2	-0.2	-0.2
Air passenger duty	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1
Insurance premium tax	0.0	-0.2	-0.3	-0.4	-0.4	-0.5	-0.5
Climate change levy	0.0	0.0	-0.1	0.0	0.0	0.0	0.0
Other HMRC taxes[5]	0.0	-0.1	-0.1	-0.3	-0.3	-0.3	-0.4
Vehicle excise duties	0.0	-0.1	-0.3	-0.3	-0.4	-0.4	-0.4
Bank levy	0.0	0.0	0.7	1.0	0.9	0.9	0.9
Licence fee receipts	0.0	0.0	-0.1	-0.1	-0.2	-0.2	-0.2
Environmental levies	-0.1	0.0	0.2	-0.2	-0.3	0.2	0.3
EU ETS auction receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Scottish taxes[6]	0.0	0.0	-0.1	-0.1	-0.1	-0.1	0.0
Diverted profits tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other taxes	2.5	0.5	0.1	0.2	0.2	0.1	0.2
National Accounts taxes	2.6	1.9	-0.8	-1.2	-2.0	-1.4	4.9
Less own resources contribution to EU	0.0	0.1	0.2	0.3	0.3	0.4	0.4
Interest and dividends	0.1	0.1	-1.0	-2.4	-2.4	-2.4	-2.8
Gross operating surplus	-1.2	-1.0	-1.4	-1.5	-1.5	-1.4	-1.2
Other receipts	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Current receipts	1.8	1.1	-2.9	-4.9	-5.5	-4.9	1.3
Memo: *UK oil and gas revenues*[7]	*0.0*	*-0.2*	*-1.5*	*-1.8*	*-2.0*	*-2.3*	*-2.0*

[1] Includes PAYE, self assessment, 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] Forecast for SDLT is for England, Wales and Northern Ireland from 2015-16.
[5] Consists of landfill tax (ex Scotland from 2015-16), aggregates levy, betting and gaming duties and customs duties.
[6] Consists of Scottish LBTT and landfill tax but not the Scottish rate of income tax or aggregates levy.
[7] Consists of offshore corporation tax and petroleum revenue tax.

Changes in the receipts forecast since December

4.41 Receipts in 2014-15 are expected to be higher than we forecast in December. That reflects stronger-than-expected receipts from onshore corporation tax, PAYE income tax and VAT. Overall SA receipts were around £0.6 billion lower than our December forecast with the provisional head of duty split suggesting that SA income tax was £1.2 billion lower than forecast, SA NIC was £0.1 billion higher and CGT receipts were £0.5 billion higher.

4.42 But our forecast for receipts has then been revised down between 2015-16 and 2018-19. As Table 4.7 shows, the key reasons for the weaker receipts forecast are:

- lower RPI inflation, which reduces excise, fuel duty and business rates, as well as interest receipts from student loans;
- SDLT, where a lower path for residential property transactions and a revised forecasting methodology (required due to the SDLT reforms announced in Autumn Statement 2014) reduce receipts;
- lower interest rates reduce income on the government's stock of financial assets, while large asset sales planned for 2015-16 – including mortgage-related assets held by UKAR and Lloyds Banking Group shares – lead to reductions in future interest and dividend receipts;
- UK oil and gas revenues, where much lower oil and gas prices, as well as a lower production forecast, reduce receipts. Policy measures announced in the Budget reduce receipts further, despite being assumed to boost production by raising the post-tax return from oil and gas extraction; and
- lower gross operating surplus (GOS), where lower outturn depreciation and lower public corporation GOS feed through into a weaker forecast. These more than offset upward revisions from classification changes.

4.43 These factors are somewhat offset by stronger PAYE and NICs receipts. Lower CPI inflation feeds through to a slower rise in tax thresholds. Since we assume that lower CPI inflation boosts real incomes – i.e. nominal income growth has not been revised down – that means more income is dragged into higher tax brackets. Higher outturn VAT, PAYE and onshore corporation tax receipts also boost receipts over the forecast.

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Table 4.7: Sources of changes to the receipts forecast since December

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	645.8	670.3	705.8	736.7	769.3	803.0
March forecast	646.9	667.4	700.9	731.2	764.5	804.3
Change	1.1	-2.9	-4.9	-5.5	-4.9	1.3
Underlying OBR forecast changes						
Total	1.1	-3.3	-4.9	-5.8	-4.0	1.9
of which:						
Income and expenditure	0.9	0.7	0.9	0.5	1.7	5.5
Average earnings	1.1	1.8	1.3	0.8	1.3	3.9
Employee numbers	0.6	0.8	1.2	1.4	2.0	2.5
Non-financial company profits	0.0	-0.3	-0.6	-0.6	-0.7	-0.6
Consumer expenditure	-0.2	-0.6	-0.6	-0.7	-0.8	-1.3
Investment	0.0	-0.1	0.4	0.4	0.5	0.4
Other	-0.4	-0.9	-0.8	-0.8	-0.6	0.5
North Sea	0.0	-0.9	-0.8	-1.1	-1.2	-1.1
Production	0.1	-0.2	-0.5	-1.1	-1.6	-1.6
Oil and gas prices	-0.2	-1.3	-1.0	-0.9	-1.0	-0.9
Expenditure	0.1	0.6	0.8	1.0	1.5	1.4
Market assumptions	0.1	-0.9	-1.2	-1.0	0.1	1.2
Residential property market	-0.2	-1.5	-2.1	-1.8	-0.9	0.1
Commercial property market	0.2	0.5	0.5	0.5	0.6	0.6
Equity prices	0.1	0.4	0.9	0.9	0.9	1.1
Interest rates	0.0	-0.3	-0.5	-0.6	-0.5	-0.6
Prices	-0.1	-0.7	-0.7	-0.4	-0.8	-1.0
Other economic determinants	0.1	0.3	0.1	-0.1	-0.1	-0.1
Other assumptions	0.0	-1.9	-3.3	-3.7	-3.7	-2.7
IT and NICs receipts and modelling	-0.9	-0.8	0.2	0.0	-0.5	-0.8
SA receipts	-1.0	-1.0	-1.0	-0.9	-0.9	-0.9
CGT receipts and modelling	0.5	0.6	0.6	0.7	0.8	1.0
Corporation tax receipts and modelling	1.0	0.5	0.6	0.8	0.9	1.2
VAT receipts	1.0	1.1	1.1	1.1	1.2	1.5
North Sea receipts and modelling	-0.2	-0.4	-0.6	-0.6	-0.9	-0.8
Interest and dividend receipts and modelling	0.1	-0.8	-1.7	-1.9	-1.8	-2.0
Stamp duty land tax judgement	-0.6	-0.8	-0.9	-1.0	-1.4	-1.5
Non classification GOS changes	-1.6	-2.0	-2.2	-2.2	-2.2	-1.9
VAT refunds	0.0	0.1	0.1	-0.2	0.1	0.8
Classification changes	0.8	0.9	0.9	0.9	0.9	1.0
Other judgements and modelling	0.9	0.8	-0.3	-0.5	0.1	-0.1
Changes due to Government decisions						
Budget measures	0.0	0.5	0.0	0.2	-0.9	-0.6

Tax-by-tax analysis of changes since December

Income tax and NICs

4.44 Receipts of income tax and NICs are expected to be £0.6 billion down on our December forecast in 2014-15. We have revised PAYE and NICs up £0.6 billion, but self-assessment

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income tax (SA) down by £1.2 billion. SA receipts remain lower in each year of the forecast, but over time this is more than offset by upward revisions to PAYE and NICs receipts and lower income tax repayments, giving a £5.1 billion net improvement by 2019-20.

4.45 PAYE and NICs receipts have been stronger than expected since our December forecast, reflecting receipts from the business services sector and from financial sector firms in non-bonus months. But in the light of initial receipts from bonuses, and recent announcements about major banks' bonus pools, we are now assuming a 10 per cent fall in financial sector bonuses in 2014-15. Some of the drop in financial sector bonuses may reflect the fact that financial firms have paid their employees higher base salaries or role-based allowances. With most bonuses paid in February and March (and received by HMRC in March and April), this judgement on bonuses remains uncertain.

4.46 Lower CPI inflation feeds through into slower growth in allowances and thresholds (which are usually uprated in line with inflation). With our nominal earnings growth forecast little changed over much of the forecast, this drags income into higher tax brackets, increasing the effective tax rate and boosting receipts by £2.1 billion by the end of the forecast period. Higher employment relative to our December forecast also pushes up PAYE and NICs receipts. This is due largely to stronger population growth, reflecting recent evidence on net migration. We have assumed that the effective tax rate is broadly flat in 2015-16. However, we expect PAYE and NICs receipts to rise as a share of GDP from 2016-17 onwards. This reflects a rising effective tax rate, due to the abolition of the NICs contracting out rebate in that year and the return of positive fiscal drag. Increasing the personal allowance further to £10,800 in 2016-17 and £11,000 in 2017-18 will reduce receipts growth in those years.

4.47 The balancing payment on 2013-14 SA liabilities was due by the end of January 2015. SA income tax receipts were £1.2 billion lower than forecast in December, but still around 12 per cent higher in 2014-15 than a year earlier. The £1.2 billion shortfall pushes through to future years. An initial analysis of SA returns suggests that income shifting related to the reduction in the additional rate of income tax to 45p boosted receipts to roughly the extent we expected. Some individuals deferred income from 2012-13 into 2013-14 to take advantage of the lower tax rate. Strong growth was recorded in both dividend and partnership income for those with incomes over £150,000. As in recent years, SA income growth for those at the lower end of the income distribution was weak. Relative to our forecast, the shortfalls for those below the additional rate threshold appear to have been in self-employment and savings income.

4.48 We expect further growth in SA receipts in 2015-16, despite the one-off boost to 2014-15 from income shifting. This in part reflects around £2¾ billion from previous Budget and Autumn Statement measures. The two largest measures boosting receipts in 2015-16 are those on partnerships and accelerated payments in follower avoidance cases. In the latter, taxpayers will have to pay disputed tax much earlier if HMRC wins a legal test case. As with all anti-avoidance measures, the yield from these measures is subject to considerable uncertainty (see Box 4.2 in our December 2014 *EFO*). The Government has extended the accelerated payments measure again in this Budget.

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4.49 With the final payment on 2014-15 SA liabilities paid in 2015-16, we also expect SA receipts to be boosted by recent strong growth in self-employment, while rising profits are likely to boost dividend and partnership income. The number of people in self-employment increased by 6.8 per cent in 2014 as a whole. The limited amount of information on self-employment incomes suggests that growth continues to be concentrated at the lower end of the income distribution.

4.50 Prior to the Budget announcement of a £1,000 allowance for basic rate taxpayers' savings income from 2016-17 and a £500 allowance for higher rate taxpayers, tax on savings interest earned through a bank or building society was deducted through the TDSI (tax deduction scheme for interest) mechanism. Higher and additional rate taxpayers would pay any additional liabilities through SA or PAYE coding adjustments. As part of the policy, TDSI will be switched off, with liabilities from savings income above the allowance paid through SA or PAYE. On a pre-measures basis, receipts from TDSI were expected to be between £1.6 billion and £1.9 billion a year between 2016-17 and 2019-20. With extra receipts related to savings income now expected through SA and PAYE, the overall cost of the measure – including the effect of greater flexibility in the use of ISAs – is £1.0 billion in 2016-17 diminishing to £0.8 billion by 2019-20.

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

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	271.9	283.6	303.9	319.7	336.2	354.1
March forecast	271.3	283.7	305.8	321.9	338.2	359.2
Change	-0.6	0.1	2.0	2.2	1.9	5.1
of which:						
(by economic determinant)						
Average earnings	1.1	1.8	1.3	0.8	1.3	3.9
Employee numbers	0.6	0.8	1.2	1.4	2.0	2.5
Inflation	-0.1	-0.2	1.0	1.6	1.8	2.1
SA determinants	-0.2	-0.3	0.0	0.0	0.0	-0.1
Other economic determinants	0.0	-0.2	-0.1	-0.1	0.0	-0.2
(by other category)						
Outturn PAYE and NICs receipts	-0.6	-0.7	-0.8	-0.9	-0.9	-1.1
Outturn SA receipts	-1.0	-1.0	-1.0	-0.9	-0.9	-0.9
Other modelling and receipts changes	-0.3	-0.1	1.1	0.9	0.4	0.4
Budget measures	0.0	0.1	-0.7	-0.6	-1.6	-1.5

VAT

4.51 Accrued VAT receipts are expected to increase by 4.0 per cent in 2014-15. This is a little higher than the 3.6 per cent growth in nominal consumer spending, which accounts for over two-thirds of the tax base. Compared to our December forecast, accrued VAT receipts in 2014-15 are expected to be up £0.7 billion. Given that growth in receipts is stronger than growth in the theoretical level of VAT payments, the estimated VAT gap – the difference between the theoretical level of VAT payments and actual receipts received by HMRC – will have fallen slightly in 2014-15. We assume that the VAT gap remains constant thereafter.

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4.52 By 2019-20, accrued VAT receipts are expected to be £1.0 billion higher than in our December forecast, thanks mainly to higher outturn receipts in 2014-15 being pushed through to future years, and a higher standard rated share of spending. Lower nominal household spending partly offsets this, reducing receipts by £1.3 billion by 2019-20.

4.53 We have revised up the share of consumer spending subject to the standard rate of VAT since December, mainly reflecting a higher estimated share in 2014. This reflects strong growth in spending on durable goods, notably on new cars. We expect this share to be flat in 2015, helped by continued strong growth in spending on durables. The recent fall in oil prices will partly offset this effect, as consumers spend less on road fuels which are generally standard-rated (road fuels are price inelastic, so a fall in the price leads to a proportionately smaller increase in volumes consumed, meaning the value of road fuels consumed falls). As in previous forecasts, the standard rated share is then expected to fall, as spending on mortgage payments is assumed to rise.

Table 4.9: Key changes to the VAT forecast since December

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	110.1	114.1	117.7	121.6	125.7	130.2
March forecast	110.8	114.3	117.7	121.4	125.9	131.1
Change	0.7	0.2	0.1	-0.2	0.1	1.0
of which:						
Household spending	-0.2	-0.6	-0.6	-0.7	-0.8	-1.3
Latest receipts	1.0	1.1	1.1	1.1	1.2	1.5
Oil price effect on standard rated share	0.0	-0.1	-0.1	-0.1	-0.1	-0.2
Other standard rated share effects	0.0	0.3	0.1	-0.1	0.0	0.3
Other spending	-0.1	-0.4	-0.5	-0.5	-0.2	0.5
Budget measures	0.0	0.0	0.1	0.1	0.1	0.1

Onshore corporation tax

4.54 We have revised our forecast for onshore corporation tax receipts up by £1.0 billion in 2014-15, in light of stronger-than-expected payments on 2014 profits from the financial sector and on 2013 profits from smaller industrial and commercial firms. Receipts in 2014-15 are expected to be up around 10 per cent on a year earlier, despite the 2 percentage point cut in the main rate to 21 per cent that came into effect from April 2014. This seems to reflect increasing profitability of financial sector and life assurance firms.

4.55 Compared to December, onshore corporation tax receipts are expected to be higher throughout the forecast, with higher outturn receipts in 2014-15 being the main driver. Lower projections of industrial and commercial profits in most years have a negative effect on receipts, partly offset by a downward revision to our business investment forecast.

4.56 Growth in receipts from onshore corporation tax is expected to slow in 2015-16 and beyond. This reflects the further cut in the main rate of corporation tax to 20 per cent from April 2015 and the increase in the annual investment allowance to £500,000 until

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December 2015. The latter measure has a large negative effect on receipts in 2015-16. Growth in receipts over the remainder of the forecast is also reduced by strong growth in investment, which increases the use of capital allowances, and by the continued high level of trading losses being carried forward and used against taxable profits in the financial sector. Despite the Autumn Statement 2014 measure to limit the use of trading losses by the banking sector (and measures announced in this Budget), corporation tax from the financial sector is still expected to be more than £4 billion lower than its pre-crisis peak in 2019-20.

4.57 Our December forecast included the receipts associated with the Autumn Statement diverted profits measure in onshore corporation tax receipts. In fact, the diverted profits tax is a separate stream of receipts, so we have removed it from the corporation tax forecast. The amount expected from the diverted profits tax has not changed since December (see Tables 4.5 and 4.6).

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

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast[1]	39.4	41.5	41.7	42.6	43.2	43.9
March forecast	40.3	42.3	42.9	44.0	44.8	46.0
Change	1.0	0.8	1.2	1.4	1.6	2.1
of which:						
Industrial and commercial company profits	0.0	-0.3	-0.6	-0.6	-0.7	-0.6
Industrial and commercial company investment	0.0	0.1	0.3	0.4	0.5	0.5
Other economic determinants	0.0	0.2	0.4	0.4	0.5	0.6
Latest receipts data	0.5	0.9	0.7	0.7	0.7	0.8
Modelling updates	0.5	-0.4	-0.1	0.0	0.2	0.4
Budget measures	0.0	0.2	0.5	0.5	0.4	0.3

[1] December forecast has been adjusted to remove diverted profits tax.

UK oil and gas revenues

4.58 UK oil and gas revenues are expected to have fallen by 44 per cent between 2013-14 and 2014-15 to £2.6 billion. This compares with receipts of just under £11 billion three years earlier. The sharp fall in 2014-15 reflects the weakness in wholesale gas prices throughout 2014 (down 16p a therm from 2013) and the more recent sharp fall in oil prices (although they still averaged $99 a barrel in 2014). The drop in receipts in 2014-15 also reflects the continued rise in operating and capital expenditure in the industry. In particular, capital expenditure rose by over 60 per cent between 2011 and 2014, due to several large projects and strong cost pressures. With 100 per cent first-year allowances available to oil and gas firms, higher investment leads to an immediate reduction in receipts.

4.59 Chart 4.5 shows the path of oil and gas receipts since 2002-03 and successive official forecasts that have been published over that period. That chart highlights the volatility of the revenue stream itself and the associated forecast errors.

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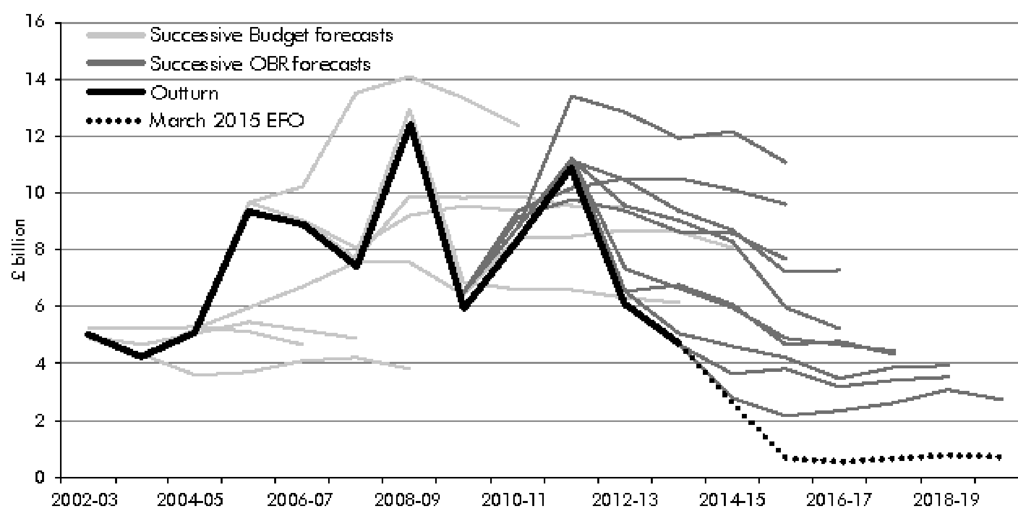
Chart 4.5: Oil and gas receipts: outturns and forecasts



Source: HMRC, HM Treasury, OBR

4.60 We use oil and gas futures to project prices for 2015 and 2016 and then hold them flat. At $62 a barrel in 2015, oil prices are expected to be $21 lower than in our December forecast and $40 lower than our March 2014 forecast. The projections for 2018 are $15 and $28 a barrel lower respectively. This has reduced our revenues forecast. In the absence of policy measures, it would be lower by around £1 billion a year.

4.61 Lower oil prices are likely to have marked effects on prospects for North Sea production and expenditure. In our December forecast, we expected capital expenditure to drop as several large projects were completed and lower oil prices reduced the likelihood of new projects coming on stream. In the absence of policy measures in this Budget, we would expect an even steeper drop as further falls in oil prices would have made it less likely that investment projects would pass hurdle rates. Incremental projects would also be expected to be cancelled and exploration and appraisal spending to be cut back quickly. The industry has already started to reduce operating expenditure.

4.62 These factors would also lead to a much lower production profile than we assumed in December, when oil and gas production was expected to be flat for much of the period, restarting its long-term decline in 2019. In the absence of policy measures, we would have revised down our forecasts for oil and gas production in 2019 by 27 per cent and 23 per cent respectively (Table 4.11).

4.63 Relative to December, our pre-measures forecast for revenues would be lower by £1 billion to £2 billion a year. By 2019-20, lower oil and gas prices would take £0.9 billion off the forecast, while the lower path for oil and gas production would reduce receipts by a further £1.6 billion. Partly offsetting that, lower expenditure would raise receipts by £1.4 billion.

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4.64 One further source of change in our pre-measures forecast is a modelling correction. The large changes to our North Sea prices, production and revenue forecasts – and the policy measures announced in this Budget – required even greater scrutiny of the outputs of the oil and gas model. That required a number of corrections and updates to the model that have reduced the forecast by an average of £0.6 billion a year from 2015-16.

4.65 The policy measures announced in the Budget to introduce a new investment allowance, cut the supplementary charge (SC) from 30 per cent to 20 per cent and a 15 per cent cut in the rate of petroleum revenue tax (PRT), reduce receipts by a further £0.3 billion a year on average. The costing of these measures involved a relatively simple static effect of changing rates, but a highly uncertain set of judgements about the effect on capital expenditure and production, which offset some of the pre-behavioural cost.

4.66 The investment allowance will provide companies with an allowance of 62.5 per cent of capital investment to offset against profits subject to the SC. The allowance replaces existing field allowances and can be offset against profits (chargeable to the SC) arising from all operations in which companies are involved, not just the project or field from which the allowance is generated. The SC and PRT cuts also raise the post-tax returns on oil and gas extraction. In reaching a judgement on the extent to which these measures would lead to increased production and investment, we considered both bottom-up evidence of the possible impact on representative project profit-to-investment ratios and top-down evidence of the impact of the policy change relative to the oil price falls already witnessed.

4.67 The judgements we have made are subject to considerable uncertainty, as it is not possible to know the precise hurdle rates or cost and price assumptions that firms will make, or the speed with which any new investment will deliver additional production. With those caveats in mind, Table 4.11 presents our pre- and post-measures forecasts of production and expenditure. We have assumed for our central forecast that the policy measures will boost oil production by 14 per cent, capital expenditure by 23 per cent and operating expenditure by 6 per cent. Different assumptions would not be unreasonable and – as illustrated clearly in Chart 4.5 – it is likely that outcomes will be different to our forecasts. But we do consider the risks to be both to the upside and the downside.

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Table 4.11: Oil and gas production and expenditure forecasts

	£ billion (unless otherwise stated)					
	2014	2015	2016	2017	2018	2019
	Pre-measures					
Oil production (million tonnes)	39.7	38.1	35.9	33.0	30.8	27.1
Gas production (billion therms)	13.1	12.5	11.5	10.8	10.1	9.3
Capital expenditure	14.8	10.5	8.0	6.0	5.0	4.0
Decommissioning expenditure	1.0	1.4	2.0	2.0	2.0	2.0
Exploration and appraisal expenditure	1.1	0.8	0.5	0.5	0.5	0.5
Operating expenditure	9.6	9.0	8.5	8.0	7.5	7.0
	Post-measures					
Oil production (million tonnes)	39.7	38.3	36.7	34.9	33.4	30.9
Gas production (billion therms)	13.1	12.6	11.9	11.4	10.9	10.3
Capital expenditure	14.8	10.8	8.3	6.6	5.9	4.9
Decommissioning expenditure	1.0	1.4	2.0	2.0	2.0	2.0
Exploration and appraisal expenditure	1.1	0.8	0.8	0.8	0.8	0.8
Operating expenditure	9.6	9.0	8.6	8.2	7.8	7.4

4.68 Overall, oil and gas receipts are set to fall to less than 0.05 per cent of GDP in 2015-16, the lowest share since 1975-76. Oil and gas receipts remain below 0.1 per cent of GDP throughout the forecast period.

Table 4.12: Key changes to the oil and gas revenues forecast since December

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	2.8	2.2	2.4	2.6	3.1	2.7
March forecast	2.6	0.7	0.6	0.7	0.8	0.7
Change	-0.2	-1.5	-1.8	-2.0	-2.3	-2.0
of which:						
Pre-measures forecast changes	-0.2	-1.3	-1.4	-1.7	-2.0	-1.9
of which:						
Sterling oil prices	-0.2	-1.1	-0.8	-0.7	-0.7	-0.6
Gas prices	0.0	-0.2	-0.2	-0.2	-0.3	-0.3
Production	0.1	-0.2	-0.5	-1.1	-1.6	-1.6
Expenditure	0.1	0.6	0.8	1.0	1.5	1.4
Modelling and outturn receipts	-0.2	-0.4	-0.6	-0.6	-0.9	-0.8
Budget measures	0.0	-0.2	-0.4	-0.3	-0.3	-0.1
of which:						
Static effect	0.0	-0.2	-0.4	-0.4	-0.4	-0.3
Behavioural effect	0.0	0.0	0.0	0.1	0.1	0.3

Stamp duties

4.69 Stamp duty land tax (SDLT) is forecast to increase from £10.9 billion in 2014-15 (including Scottish SDLT receipts) to £18.0 billion in 2019-20 (excluding Scottish land and buildings transaction tax (LBTT) receipts). Compared to December, the forecast is lower by £0.6 billion in 2014-15 and by between £0.7 billion and £2.0 billion over the forecast period.

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4.70 Residential property transactions are expected to be lower throughout the forecast period than previously assumed. Lower outturns since December and the subdued level of mortgage approvals reduce our near-term forecast, while we have revised down our assumption for the long-run trend level for transactions. This takes up to £1.2 billion a year off the SDLT forecast. Receipts have been lower in 2014-15 than would be implied by changes in prices and transactions – i.e. the effective tax rate appears to have fallen. This may reflect the slowdown in the London housing market in recent months. The weakness in 2014-15 receipts has been pushed through the forecast. We have also had to make some modelling changes due to the change from a 'slab' system to a 'slice' system announced in Autumn Statement 2014 (see Box 4.5 of our December 2014 *EFO*). The combined effect is to take over £1 billion a year off the forecast from 2017-18 onwards.

4.71 With SDLT being switched off in Scotland from April 2015, we expect SDLT receipts to fall in 2015-16. If receipts from Scotland's LBTT were included, overall receipts would be flat between 2014-15 and 2015-16. The effects of lower residential property transactions in 2015-16 and Autumn Statement reforms to stamp duty – which reduce SDLT for around 98 per cent of purchasers – offset those from further house price growth and a stronger commercial property market. Thereafter, we expect strong growth as residential property transactions pick up towards their long-run trend and higher house prices raise the effective tax rate on transactions.

Table 4.13: Key changes to the SDLT forecast since December

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	11.5	12.1	13.9	15.6	17.4	18.7
March forecast	10.9	10.4	11.8	13.8	16.0	18.0
Change	-0.6	-1.7	-2.0	-1.8	-1.4	-0.7
of which:						
House prices	-0.1	-0.3	-0.5	-0.4	0.1	0.7
Residential property transactions	-0.1	-1.1	-1.2	-1.0	-0.7	-0.6
Commercial property	0.2	0.5	0.5	0.5	0.6	0.6
Modelling and receipts outturns	-0.6	-0.8	-0.9	-1.0	-1.4	-1.5

4.72 The Scottish Government announced provisional rates for LBTT in its October 2014 Draft Budget and we included it for the first time in our December forecast. The Scottish Government then changed those rates in January. Our LBTT forecast is lower compared with December, reflecting the change in LBTT rates and a lower residential property transactions forecast for the UK as a whole. A fuller explanation can be found in our *Devolved taxes forecast* published alongside this *EFO*.

Taxes on capital

4.73 Capital gains tax (CGT) is paid via SA in the final quarter of the financial year after the year in which the gains from the sale of an asset are realised. So CGT receipts in 2014-15 reflect asset disposals in 2013-14. CGT receipts have risen from £3.9 billion in 2013-14 to £5.7 billion in 2014-15, boosted by the 13 per cent rise in equity prices in the previous year.

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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 disposal price. CGT has also benefited from the recovery in the housing market in 2013-14, as CGT is payable on disposals of non-principal residences.

4.74 Compared to our December forecast, CGT receipts have been revised up in all years. That reflects higher than expected receipts in 2014-15 (up 45 per cent on a year earlier, even stronger than the 31 per cent we forecast in December). This higher starting point for the forecast builds to larger upward revisions in later years. A higher path for equity prices is partly offset by lower residential property transactions over the forecast period. By 2019-20, CGT receipts are expected to be £1.5 billion higher than in our December forecast.

4.75 Inheritance tax receipts are expected to rise by an average of around 11 per cent a year between 2014-15 and 2019-20. This reflects our forecast for strong growth in house prices and the stock of household cash deposits, as well as the effect of the nil-rate band being frozen until April 2018. This is consistent with the proportion of estates being subject to inheritance tax rising from an estimated 6.4 per cent in 2014-15 to 11.6 per cent in 2019-20.[5] Compared to December, our forecast for inheritance tax is slightly lower in each year from 2016-17 to 2018-19 reflecting lower house prices and lower household holdings of cash and deposits.

Fuel duties

4.76 The volume of fuel clearances is on a long-term downward trend, reflecting the increasing fuel efficiency of motor vehicles. Total clearances fell 9 per cent in the decade to 2013-14, with lower petrol clearances more than offsetting a rise in diesel clearances.

4.77 While fuel duty is expected to be £0.2 billion higher in 2014-15 than assumed in our December forecast, we expect receipts to be £1.0 billion lower by 2019-20. The reduction in our RPI inflation forecast since December is expected to reduce fuel duty revenues by £0.5 to £1.0 billion a year between 2016-17 and 2019-20, as duty rates are assumed to be uprated by smaller amounts. As shown in Box 4.2, this uprating assumption could be considered a source of policy risk to the forecast given repeated decisions to cancel planned duty rises. Fuel duty has been frozen once again in this Budget. Lower pump prices resulting from the drop in oil prices are expected to boost the demand for fuel and to raise receipts by between £0.2 and £0.3 billion a year, relative to our December forecast.

Alcohol and tobacco duties

4.78 Alcohol duty is expected to increase from £10.7 billion to £12.2 billion between 2014-15 and 2019-20. Within this total, receipts from wine and spirits are expected to increase by £1.0 billion and £0.6 billion respectively, while beer and cider duties are expected to fall by £0.1 billion. We have revised down the expected growth in wine receipts over the forecast period. This reflects smaller duty rises, resulting from lower RPI inflation and measures, and a reassessment of wine consumption. After strong growth in wine clearances in the previous

[5] The forecasts underpinning these proportions are available in the supplementary fiscal tables on our website.

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decade, clearances in the past few years have been broadly flat. We now assume that wine consumption will grow in line with overall consumer spending over the forecast period.

4.79 Tobacco duties are expected to fall by £0.2 billion to £9.4 billion in 2014-15, despite the RPI plus 2 per cent rise in duty in March 2014. Cigarette clearances have trended down, thanks in part to the recent above-RPI increases in duty, changing attitudes to smoking, policies (such as the display ban) and the growing popularity of e-cigarettes. This fall also reflects the recent trend towards cheaper cigarettes, which were only a very small proportion of the market in 2008, but have since grown significantly. Because part of the duty on cigarettes depends on the final price, a lower average price reduces receipts. We expect receipts from tobacco duty to fall by a further £0.1 billion between 2014-15 and 2019-20. Rates are planned to increase by 2 per cent above RPI inflation in each year of the forecast, but this is offset by the downward trend in cigarette clearances.

4.80 The recently announced requirement for tobacco to be sold in plain packaging represents a source of uncertainty to our forecast. We have not made a specific adjustment for this, due to uncertainty around the timing of its introduction given likely legal challenges.

Box 4.2: The indexation of excise and environmental duties in our forecast

Our forecasts for excise and environmental duties assume that rates are indexed in line with default parameters. These parameters are set by the Government and detailed at each Budget in the Treasury's *Policy costings document*. The assumptions represent a source of economy and policy-related uncertainties in our forecast. In this box, we look back at how a selection of duty rates have moved over the last Parliament relative to the default uprating assumptions assumed in the OBR's first forecast in June 2010.

Table B sets out the level of selected duties at the June 2010 Budget, the default indexation parameters underpinning that forecast, what the rates would have been today in the absence of Government policy (abstracting from differences between actual inflation and our forecasts) and the actual level of rates now.

The table shows that several duties (fuel, alcohol, aggregates levy) have been reduced relative to the default uprating assumptions underpinning the June 2010 forecast. One source of potential difference between actual rates now and the level that would have been assumed had they been uprated in line with default assumptions is errors in our inflation forecasts. For example, relative to the June 2010 forecast, the level of the Retail Prices Index by the end of 2014 was 0.6 per cent lower than we forecast.

But a major source of difference has been policy changes at various Budgets and Autumn Statements that have delayed, frozen or cut rates. The main fuel duty rate has been cut once and frozen four times over this Parliament – and has been again in this Budget – leaving the rate around 20 per cent lower than it would have been if default uprating had proceeded in line with the June 2010 forecast and 19 per cent lower than if it had followed actual RPI inflation. This contrasts with the Budget 2011 fair fuel stabiliser measure, which proposed to raise fuel duty by RPI plus 1 per cent in the event of oil prices reaching $75 a barrel (later specified in regulations

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as £45 a barrel). The oil price is now £38 a barrel, but the fair fuel stabiliser was abolished in Autumn Statement 2014 (when the oil price stood at £50 a barrel).

The biggest exception to this is the specific duty on cigarettes, which has risen much faster than we would otherwise have assumed. In part that reflects the Budget 2011 policy measures that raised the specific duty by around £36 per thousand cigarettes, while at the same time cutting the ad valorem rate from 24 per cent to 16.5 per cent of the retail price. The main rates for vehicle excise duty (VED), air passenger duty (APD) and the climate change levy (CCL) have risen in line with the default indexation parameters.

Table B: Indexation parameters

Tax head	Level at June Budget 2010	Default indexation parameter at June Budget 2010	Level if no Government policy since June Budget 2010	Level at Budget 2015	Difference (per cent)	Default indexation parameter at Budget 2015	2014-15 receipts (£ billion)
Fuel duty[1]	57.19	RPI + 1ppl escalator until 14-15, RPI thereafter	72.48	57.95	-20.0	Freeze in 15-16, RPI thereafter	27.2
Tobacco duty[2]	119.0	RPI + 2% until 14-15, RPI thereafter	148.8	189.5	27.4	RPI+2%	9.4
VED[3]	155.0	RPI (rounded to £5)	180.0	180.0	0.0	RPI (rounded to £5)	6.1
Beer duty[4]	17.3	RPI + 2% until 14-15, RPI thereafter	21.6	18.4	-15.0	-2% in 15-16, RPI thereafter	3.3
Wine duty[5]	225.0	RPI + 2% until 14-15, RPI thereafter	281.3	273.3	-2.8	Freeze in 15-16, RPI thereafter	3.9
Spirit duty[6]	23.8	RPI + 2% until 14-15, RPI thereafter	29.8	27.7	-7.1	-2% in 15-16, RPI thereafter	3.2
Cider duty[7]	33.5	RPI + 2% until 14-15, RPI thereafter	41.8	38.9	-7.1	-2% in 15-16, RPI thereafter	0.3
APD[8]	11.0	RPI (rounded to £1)	12.0	13.0	8.3	RPI (rounded to £1)	3.2
Climate change levy[9]	0.47	RPI	0.55	0.55	0.0	RPI	1.7
Landfill tax[10]	48.0	£8 per tonne until 14-15, RPI thereafter	80.8	82.6	2.3	RPI	1.1
Aggregates levy[11]	2.0	RPI	2.3	2.0	-13.8	Freeze in 15-16, RPI thereafter	0.3

[1] Main rate (pence per litre)
[2] Cigarette specific duty (£ per 1000 sticks)
[3] Band G (£ per vehicle)
[4] Main rate (£ per 1% ABV per hectolitre)
[5] Main rate (£ per hectolitre of product)
[6] £ per litre of pure alcohol
[7] Main rate (£ per hectolitres of product)
[8] Band A (£ per ticket)
[9] Electricity rate (pence per gross KWh)
[10] Standard rate (£ per tonne)
[11] Standard rate (£ per tonne)

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Other taxes

4.81 **Business rates** have been revised up in 2015-16 and then down in each year from 2016-17, compared with December. The upward revision in 2015-16 reflects information from local authorities on the yield expected from business rates in that year. The subsequent downward revisions reflect lower RPI inflation. Business rates are calculated by multiplying the rateable value of non-domestic property by the multiplier (which is uprated in line with RPI inflation).

4.82 We have also revised down our expectation of the cost of the business rates discount to small shops, pubs, cafes and restaurants. Information from local authorities suggests a cost of less than £300 million in 2015-16 rather than the £500 million originally scored in the 2013 and 2014 Autumn Statements. The lower cost reflects fewer eligible properties and a lower take-up rate than originally assumed. In the past, we have also had to reduce our initial estimates of the cost of other business rates reliefs, such as those for enterprise zones.

4.83 Receipts from **council tax** are expected to be slightly lower than in our December forecast. These changes 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.

4.84 **Air passenger duty (APD)** receipts are expected to rise from £3.2 billion in 2014-15 to £3.7 billion in 2019-20. This reflects duty rate rises and growth in passenger numbers. Our forecast is slightly lower than in December, as lower RPI inflation means duty rates are uprated by smaller amounts.

4.85 **Vehicle excise duty** is levied annually on road vehicles and is based on the 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 lower than in December, reflecting lower RPI inflation.

4.86 **Environmental levies** include levy-funded spending policies such as the renewables obligation and contracts for difference, feed-in tariffs and the warm homes discount. We have also included the DECC capacity markets scheme in the forecast for the first time. The underlying downward revision to our forecast for 2016-17 since December reflects lower RPI inflation, but the forecast is higher overall in the final two years of the forecast due to the capacity markets scheme.

4.87 **Environmental taxes** include the aggregates levy, climate change levy (including the carbon price floor), landfill tax and the EU emissions trading scheme (EU ETS). Landfill tax receipts have been revised down by around £0.2 billion in the latter years of the forecast period, reflecting a lower proportion of waste being sent to landfill. Other taxes are broadly unchanged since December.

4.88 **Bank levy** receipts are expected to rise from £2.8 billion in 2014-15 to £3.7 billion by 2019-20. This entirely reflects the Budget announcement that the bank levy rate would rise

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to 0.21 per cent from April 2015. Excluding this measure, bank levy receipts were expected to remain close to their 2014-15 level throughout the forecast.

4.89 Receipts in 2014-15 have come in as expected a year ago. This is in contrast to previous years when receipts have disappointed. The tax base – specific types of bank liabilities – was initially over-estimated and then fell away more quickly than expected. The levy was then repeatedly raised to offset the loss of receipts from a smaller tax base. Our recent forecasts have incorporated a further near-term shrinkage in banks' balance sheets. In the current forecast, the tax base is assumed to continue to fall until 2017 and is then held flat for the remainder of the forecast. Given that the Budget announcement is for a sizeable rise in the bank levy rate, we have allowed for a larger behavioural response to the policy change. Banks may restructure their funding arrangements, while foreign banks may locate less activity in the UK.

4.90 **VAT refunds** to central and local government are neutral for borrowing, as they are offset within spending. The forecast for VAT refunds largely reflects the path of government procurement and investment. VAT refunds are therefore forecast to fall by an average of 2.2 per cent a year between 2015-16 and 2018-19, but to rise by 6.0 per cent in 2019-20 reflecting the path of government procurement implied by the Government's latest spending assumption for that year.

4.91 We include a provision for **tax litigation losses** in our receipts forecast. Once cases are settled – and their effects in particular years can be quantified – they are incorporated into the public finances. The magnitude and timing of losses is difficult to forecast as it depends on the nature of the legal judgement and the Government's response. We have kept our provision for future litigation losses over the whole forecast period at £5.6 billion, in line with the provision included in the 2013-14 HMRC Trust Statement.

Other receipts

4.92 **Interest and dividend** receipts capture the interest income on the government's stock of financial assets, which includes student loans and holdings related to financial sector interventions due to the late 2000s financial crisis. Lower interest rates through the forecast both in the UK and abroad reduce receipts compared with our December forecast. Lower inflation reduces interest income from student loans, while a lower Bank Rate assumption reduces interest income on some older student loans.

4.93 Two significant sources of revision to our forecast since December relate to the asset sales described later in this chapter. The Government has announced sales of mortgage-related assets held by UK Asset Resolution (UKAR) and of shares in Lloyds Banking Group. These sales generate cash for the Government, but reduce future income due to the mortgage interest and Lloyds dividends foregone. (We included a forecast for Lloyds dividends for the first time in our December forecast.) Together, the effect on interest and dividend receipts on our forecast is over £1 billion a year on average from 2016-17 onwards.

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Table 4.14: Key changes to the interest and dividends forecast since December

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	6.3	7.7	10.0	11.6	13.1	14.8
March forecast	6.4	6.7	7.5	9.2	10.7	11.9
Change	0.1	-1.0	-2.4	-2.4	-2.4	-2.8
of which:						
Interest rates	0.0	-0.2	-0.3	-0.3	-0.3	-0.4
Earnings on foreign exchange reserves	-0.1	-0.3	-0.3	-0.3	-0.3	-0.5
Interest on student loans (RPI effect)	0.0	0.0	-0.4	-0.3	-0.3	-0.4
Interest on student loans (other effects)	0.0	-0.2	-0.1	-0.4	-0.4	-0.5
UKAR (including effect of sales)	0.0	-0.1	-0.9	-0.8	-0.7	-0.6
Lloyds dividends (including effect of sales)	0.0	-0.3	-0.7	-0.6	-0.6	-0.6
Other	0.2	0.1	0.2	0.3	0.2	0.1

4.94 Our forecast for **gross operating surplus** (GOS) comprises general government depreciation and public corporations' gross operating surplus. Classification changes to depreciation have increased GOS by an average of around £0.9 billion a year, as explained above. More than offsetting that, we have reduced our underlying forecast for GOS by around £2.1 billion a year reflecting the latest outturn data.

Public sector expenditure

4.95 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)[6] – 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 resource and capital DELs to 2015-16, 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 out to 2019-20, based on determinants derived from our economic forecast.

4.96 For the years 2014-15 and 2015-16, our projections are constructed using the latest plans for PSCE in RDEL and PSGI in CDEL,[7] plus our forecast for departments' underspending against those plans. To this, we add our detailed forecast for AME spending.

[6] 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.
[7] 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.

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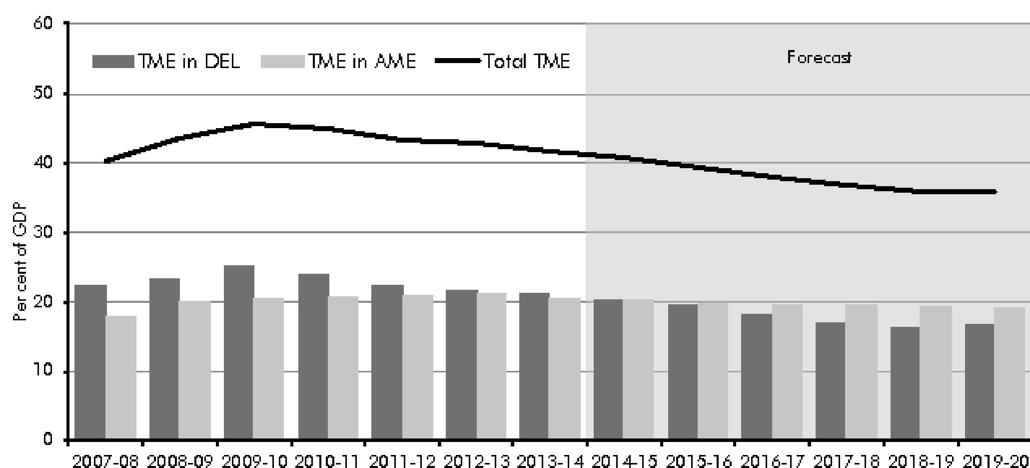
4.97 Beyond 2015-16, the Government has not set out detailed spending plans. Instead, our projections for total spending from 2016-17 to 2019-20 are based on the Government's policy assumptions for TME that are set out in paragraph 4.103. We produce a bottom-up forecast of AME for these years, which is subtracted from the level of TME that results from the Government's policy assumptions to derive implied resource and capital DELs. This approach means that changes in AME spending beyond 2015-16 – e.g. debt interest or social security – result in offsetting changes in implied DELs.

4.98 Chart 4.6 shows TME as a share of GDP from 2007-08 to the end of the forecast period, and how TME is split between DEL and AME. Spending increased sharply as a share of GDP during the late-2000s recession, reaching a peak of 45.7 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. AME spending on social security and debt interest also increased over this period.[8]

4.99 From its peak in 2009-10, we estimate TME reached 40.7 per cent of GDP in 2014-15 and will fall to 39.6 per cent in 2015-16, the final year of detailed spending plans. The Government's TME assumptions imply that spending will fall considerably further as a share of GDP, to 36.0 per cent of GDP in 2018-19 and 2019-20.

Chart 4.6: DEL and AME components of TME



Note: Series adjusted to remove discontinuities. DEL and AME series exclude major historical switches. Forecast figures exclude future classification changes not yet reflected in outturn. Details are available in the supplementary fiscal tables on our website.
Source: ONS, OBR

[8] For a detailed discussion of the public finances during this period, see Riley and Chote (2014): *Working Paper No.7: Crisis and consolidation in the public finances*.

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Summary of the expenditure forecast

4.100 Table 4.15 summarises our latest forecast for public expenditure. TME is expressed as a share of GDP, but not all of TME contributes directly to GDP, as benefit payments, debt interest and other cash transfers merely shift income from some individuals to others.

Table 4.15: Expenditure as a per cent of GDP

	Per cent of GDP						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Total managed expenditure	41.7	40.7	39.6	38.1	36.8	36.0	36.0
of which:							
Public sector current expenditure	38.1	37.0	35.9	34.5	33.3	32.5	32.5
Public sector gross investment	3.5	3.7	3.6	3.6	3.5	3.5	3.5
Total public sector expenditure that contributes directly to GDP[1]	23.2	22.6	21.8	20.7	19.5	18.8	19.0
of which:							
General government consumption	20.2	19.6	18.9	17.8	16.7	16.0	16.2
General government gross fixed capital formation	2.6	2.6	2.5	2.5	2.4	2.4	2.4
Public corporations gross fixed capital formation	0.4	0.4	0.4	0.4	0.4	0.4	0.3

[1]GDP at market prices.

4.101 Table 4.16 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. Welfare spending is forecast to fall gradually as a share of GDP as working-age benefits are uprated by less than earnings growth and as some caseloads fall as a share of the population. Debt interest payments have been revised down significantly due to lower interest rates and lower cash borrowing, including due to the effects of further asset sales. The Government's spending policy assumptions imply DEL spending will fall as a share of total spending in each year until 2018-19, but rise in 2019-20. As described in Box 4.6 of our December 2014 *EFO*, this aspect of our forecast is subject to particular uncertainties relating to future policy decisions of future governments.

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Table 4.16: TME split between DEL and AME

	Per cent of GDP						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
TME in DEL[1]	20.6	19.8	19.1	17.7	16.5	15.9	16.2
TME in AME	21.1	20.9	20.5	20.4	20.3	20.1	19.8
of which:							
Welfare spending	12.1	11.9	11.6	11.3	11.1	10.9	10.6
Debt interest net of APF	2.1	1.9	1.8	2.1	2.3	2.3	2.3
Locally-financed current expenditure	1.9	2.0	2.0	2.1	2.1	2.1	2.0
Other PSCE in AME	3.7	3.8	3.7	3.6	3.5	3.6	3.6
PSGI in AME	1.3	1.4	1.4	1.4	1.3	1.3	1.2

[1] In relation to table 4.20, 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 single use military equipment (SUME).

The Government's spending policy assumptions

4.102 For the years beyond those covered by detailed spending plans, our forecasts for spending are based on the Government's policy assumptions for growth in total spending. The precise terms of these assumptions tend to change at each Budget and Autumn Statement.[9]

4.103 The Government's policy assumptions for the growth of TME between 2016-17 and 2019-20 at Budget 2015 are as follows:

- **for 2016-17 and 2017-18:** TME should fall in real terms at the same rate as over the 2010-11 to 2014-15 period covered by Spending Review 2010. For 2010-11, the relevant measure of TME should exclude underspending against plans and the in-year spending reductions announced in the June 2010 Budget, include an estimate of the retrospective effect of our decision to anticipate the future ONS revisions to the measurement of depreciation for Network Rail and the life-length of roads, but not include the retrospective effect of our decision to anticipate the future ONS reclassification of UK subscriptions to multilateral development banks. For 2014-15, the measure of TME should exclude our measure of DEL shortfalls, include our changes to the depreciation forecast that anticipate ONS revisions mentioned above, exclude the changes to our forecast for the ONS's reclassification of UK subscriptions to multilateral development banks, exclude the net effect of the historical adjustment to the UK's GNI-based contribution to the EU, and also exclude the expected adjustment in respect of its VAT contributions to the EU in December 2014. This fall in real terms should then be applied to our pre-measures forecast of TME in 2015-16, which should also exclude our forecast for DEL underspending, exclude the reclassification of UK subscriptions to multilateral development banks, exclude the additional rebate in respect of the historical adjustment to the UK's GNI-based contribution to the EU, exclude the adjustments included in our latest forecast that would accrue in December 2015 in respect of UK GNI and VAT-based contributions to the EU in 2014-15, but

[9] Alongside this EFO, we have published a full set of the TME growth assumptions that have applied to post-Spending Review periods in each of the forecasts that we have produced since March 2011.

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include the adjustment included in our latest forecast for the expected revisions to the UK's 2015-16 GNI contributions when these are revised in May 2015.The effects of previous budget measures are also taken into account, to ensure that they have the same effect on future years as they did in each previous fiscal event. Within TME, PSGI should be held flat in real terms from a level in 2015-16 that includes our allowance for shortfall and includes the reclassification of UK subscriptions to multilateral development banks;

- **for 2018-19:** TME should be held flat in real terms, and within TME, PSGI should grow in line with nominal GDP. The results should be calculated to ensure that previous budget measures have the same effect as announced in the relevant fiscal event; and

- **for 2019-20:** both TME and PSGI within TME should be grown in line with nominal GDP. Again, the results should be calculated to ensure that previous budget measures have the same effect as announced in the relevant fiscal event.

4.104 Since December 2012, the spending assumption has been described in the Treasury's Budget and Autumn Statement documents as a 'fiscal assumption' rather than a spending assumption, with those documents noting that tax rather than spending could deliver some of the consolidation implied by the assumption. For this Budget, we have sought and received specific assurances from the Treasury that the latest assumption described above represents the Coalition Government's agreed position for Budget 2015, and that it has been discussed by the 'Quad' and agreed by both parties in the Coalition.

4.105 The complex formulation of the assumption means that changes in the implied cash paths of PCSE in RDEL and PSGI in CDEL from forecast to forecast reflect a number of factors, including:

- changes in our spending forecast in the base year for the growth assumption;

- changes in the definition of spending used to calculate the assumption;

- changes in our GDP deflator forecast, which feed through to changes in the amount of cash spending needed to achieve the assumed real growth rates, and our nominal GDP forecast;

- Government decisions shown in the Treasury's table of policy decisions and changes in its spending assumptions; and

- changes in our forecast for AME after 2015-16.

4.106 Table 4.17 sets out the changes since December to the cash values of TME implied by the latest policy assumption. It shows that:

- using the previous formulation of the spending assumptions that was Government policy in December, the £3.0 billion reduction in the forecast for TME in 2015-16 –

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largely from lower debt interest payments – would have reduced TME by an average of £4.2 billion a year over the four years from 2016-17 to 2019-20. (The effect of the GDP deflator on spending in 2019-20 is complicated by the effect of the new spending assumption on the GDP deflator. We have shown the effect here assuming the revision to the GDP deflator in 2019-20 absent the change in the spending assumption would have been proportionate to the revision in 2018-19);

- within this overall change to TME, the further large falls in AME spending – again, largely from lower debt interest payments, but also from lower welfare spending – would have meant that, over the four-year period from 2016-17 to 2019-20, DEL spending would on average have been £9.5 billion a year higher than in our December forecast; but
- the change to the spending assumptions in this Budget have reduced implied RDEL spending by around £2 billion a year from 2016-17 to 2018-19, and then increased RDEL spending by just over £20 billion in 2019-20.

Table 4.17: Changes to TME from 2015-16 since December

	£ billion				
	Forecast				
	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	746.2	746.7	751.3	765.3	779.9
March forecast	742.6	740.3	743.9	759.2	797.3
Change	-3.6	-6.4	-7.3	-6.1	17.4
Underlying OBR forecast changes					
Forecast changes since December	-3.3				
Effect of applying Autumn Statement spending policy assumptions post 2015-16		-4.4	-5.4	-4.1	-2.8
of which:					
GDP deflator	-	-0.9	-1.4	-0.1	1.3
AME	-4.3	-11.7	-13.3	-14.2	-14.4
DEL plans	1.0	-	-	-	-
Changes to implied DEL	-	8.1	9.3	10.1	10.3
Changes due to Government decisions					
Budget policy measures	-0.3	0.0	0.0	0.0	0.0
Effect of applying new Budget spending policy assumptions post 2015-16	-	-1.9	-1.9	-2.0	20.2

4.107 Table 4.18 sets out real growth rates and shares of GDP for different spending aggregates, determined by the spending policy assumptions set out above and our forecast of AME spending. It illustrates the extent to which real terms cuts to spending from 2010-11 onwards are concentrated in departmental spending – particularly day-to-day spending on public services (PSCE in RDEL) – and the large fall in spending as a share of GDP that results. The changes the Government has made to the spending assumptions for 2019-20 mean that this multi-year squeeze on public services spending is now forecast to end in 2018-19, with implied PSCE in RDEL rising slightly as a share of GDP in 2019-20. These forecasts are subject to considerable policy-related uncertainty.

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Table 4.18: Spending: real growth rates and as a per cent of GDP

	Real terms growth rate[1] (per cent)						
	2010 Spending Review (2010-11 to 2014-15)[1]	2013 Spending Round	Post Spending Review years				Total change between 2010-11 and 2019-20[1]
	Average annual change	Change in 2015-16	Change in 2016-17	Change in 2017-18	Change in 2018-19	Change in 2019-20	
TME	-0.8	-0.7	-1.5	-1.1	0.0	2.3	-4.0
of which:							
PSCE	-0.5	-0.7	-1.7	-1.2	-0.2	2.3	-3.3
PSGI	-3.6	-0.6	0.4	0.0	2.3	2.2	-10.0
TME in AME	1.4	0.1	1.9	2.0	1.2	0.8	12.2
TME in DEL	-2.8	-1.5	-5.1	-4.6	-1.5	4.3	-18.3
of which:							
PSCE in RDEL	-2.4	-1.4	-5.8	-5.4	-2.6	4.3	-19.1
PSGI in CDEL	-5.7	-1.8	-0.1	1.3	5.9	4.3	-13.2
	Per cent of GDP						
TME	-1.0	-1.2	-1.5	-1.3	-0.8	0.0	-9.0
of which:							
PSCE	-0.8	-1.1	-1.4	-1.2	-0.8	0.0	-7.8
PSGI	-0.2	-0.1	-0.1	-0.1	0.0	0.0	-1.2
TME in AME	-0.1	-0.4	-0.1	-0.1	-0.2	-0.3	-1.4
TME in DEL	-1.0	-0.7	-1.4	-1.2	-0.6	0.3	-7.6
of which:							
PSCE in RDEL	-0.8	-0.6	-1.3	-1.2	-0.7	0.3	-6.7
PSGI in CDEL	-0.2	-0.1	-0.1	0.0	0.1	0.0	-0.9

[1] Growth rates are calculated against figures for 2010-11 which have been adjusted to include an estimate for the ONS prospective revisions and classification changes which have been anticipated in this forecast. These include the changes for the UK subscriptions to multilateral development banks, the changes to depreciation and the revision to reclassify certain DVLA fees from negative spending to current receipts.

4.108 One implication of the Government's spending policy assumptions is a sharp acceleration in the pace of implied real cuts to day-to-day spending on public services and administration in 2016-17 and 2017-18, followed by a sharp turnaround in 2019-20, as shown in Chart 4.7. As we explain in Chapter 5, the implied cuts in 2016-17 and 2017-18 are a key reason why the Government is on course to achieve its new fiscal mandate to balance the cyclically adjusted current budget in 2017-18 with room to spare.

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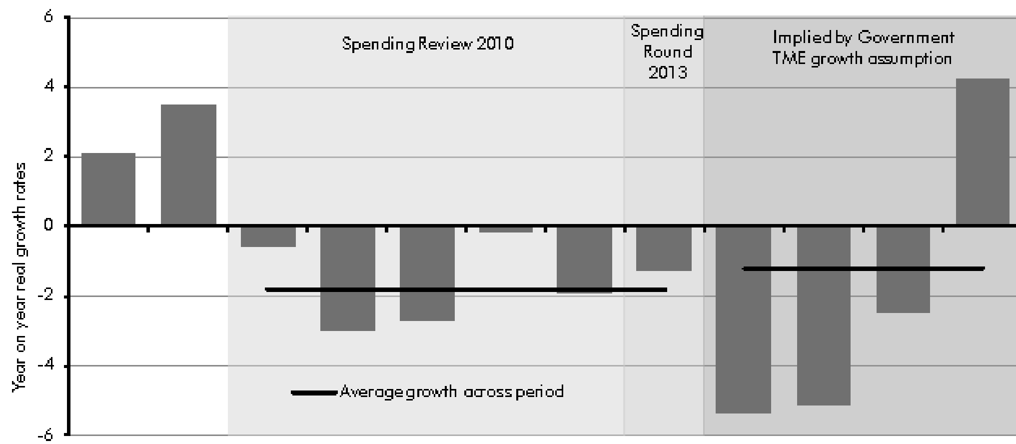
Chart 4.7: Year-on-year real growth in resource DEL



Note: RDEL series excludes major historical switches with AME as well as switches with AME in forecast years. Details are available in the supplementary fiscal tables on our website.
Source: OBR

Summary of changes to the expenditure forecast since December

4.109 Tables 4.20 and 4.21 detail our latest spending forecast and the changes since December. Table 4.19 summarises the sources of those changes. It shows that:

- the largest economy-driven changes to our spending forecast are due to lower inflation and lower interest rates. Lower inflation reduces spending on debt interest (on index-linked gilts) and on welfare and net public sector pensions spending (due to uprating);
- a lower central government net cash requirement – in part reflecting the asset sales described later in this chapter – further reduces spending on debt interest;
- the net effect of all these changes on implied DELs, before the further change in the Government's spending policy assumptions, is an increase of £8 billion in 2016-17, rising to £10 billion in 2019-20; and
- the Government's change to its spending assumptions reduces spending between 2016-17 and 2018-19, but increases it substantially in 2019-20.

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Table 4.19: Sources of changes to the spending forecast since December

	Forecast					
	£ billion					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	737.1	746.2	746.7	751.3	765.3	779.9
March forecast	737.1	742.6	740.3	743.9	759.2	797.3
Changes	0.0	-3.6	-6.4	-7.3	-6.1	17.4
Underlying OBR forecast changes						
Forecast changes since December	0.0	-3.3	-4.4	-5.4	-4.1	-2.8
of which:						
Economic determinants	-2.2	-4.7	-6.0	-7.6	-7.4	-6.5
Inflation	-2.2	-4.2	-4.7	-5.6	-6.5	-6.9
Unemployment	0.0	-0.4	-0.3	-0.3	-0.3	-0.3
GDP deflator			-0.9	-1.4	-0.1	1.3
Other determinants	0.0	0.0	-0.2	-0.3	-0.5	-0.7
Market assumptions	-0.3	-1.2	-2.1	-3.0	-3.9	-4.5
Gilt rates	0.0	-0.5	-1.2	-1.8	-2.3	-2.7
Short rates	-0.3	-0.7	-0.9	-1.2	-1.6	-1.8
Other assumptions and changes	2.5	2.6	3.7	5.2	7.1	8.2
Changes to DEL underspend assumptions	-1.0	0.0	-	-	-	-
CDEL classification changes[1]	1.4	1.4	-	-	-	-
Other changes to implied DELs	-	-	8.1	9.3	10.1	10.3
Social security modelling changes[2]	-0.5	-1.0	-1.1	-1.2	-1.3	-1.6
Non-economic pension costs	0.6	0.7	0.1	0.2	0.2	0.2
Non-exchange rate EU changes	0.1	1.3	-1.9	0.3	0.3	0.3
Other debt interest changes	0.2	-1.4	-2.0	-2.1	-1.9	-1.7
Locally-financed current expenditure	0.7	0.4	0.4	0.3	0.0	0.0
Locally-financed and public corporations capital expenditure	1.2	1.0	0.6	-0.3	0.0	-0.1
Other	-0.3	0.3	-0.6	-1.3	-0.2	0.8
Changes due to Government decisions						
Budget policy measures	0.0	-0.3	0.0	0.0	0.0	0.0
Effect of applying new Budget spending policy assumptions post 2015-16	-	-	-1.9	-1.9	-2.0	20.2

[1] Subscriptions to multilateral development banks. For 2016-17 onwards the effects of these changes are included in the changes to implied DELs.

[2] Includes the transfer of war pensions from AME to DEL.

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Table 4.20: Total managed expenditure

	£ billion						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Public sector current expenditure (PSCE)							
PSCE in RDEL[1]	317.5	316.5	316.4	301.6	289.7	287.9	308.2
PSCE in AME[2]	342.8	352.8	357.9	369.3	383.7	397.7	411.9
of which:							
Welfare spending[2]	209.4	214.5	216.9	219.5	223.6	229.3	235.1
of which:							
Inside welfare cap[2]	116.1	119.4	120.6	121.0	121.8	124.0	126.5
Outside welfare cap	93.3	95.1	96.3	98.5	101.8	105.2	108.6
Company and other tax credits	1.6	2.1	2.3	2.5	2.7	2.8	2.9
Net public service pension payments	10.9	12.5	11.1	11.2	11.9	12.7	13.8
National lottery current grants	1.2	1.4	1.3	1.3	1.4	1.4	1.4
BBC domestic services current expenditure	3.2	3.9	3.9	3.8	3.7	3.8	3.9
Network Rail other current expenditure[3]	0.4	0.9	1.0	0.7	0.4	-0.2	-0.3
Other PSCE items in departmental AME	1.4	1.2	1.1	1.1	1.2	1.2	1.2
Expenditure transfers to EU institutions	11.1	11.0	11.2	9.4	9.5	10.5	11.0
Locally-financed current expenditure	33.2	35.8	37.6	40.0	41.9	43.6	45.0
Central government debt interest, net of APF	36.1	33.6	33.7	40.4	46.5	49.0	51.1
of which:							
Central government gross debt interest	48.7	45.7	46.0	50.7	55.2	56.3	57.4
Reductions in debt interest due to APF	-12.6	-12.1	-12.3	-10.4	-8.7	-7.2	-6.2
Depreciation	26.9	28.6	29.9	31.2	32.7	34.3	36.0
Current VAT refunds	11.6	11.8	11.8	10.9	10.5	10.5	11.1
R&D expenditure	-7.1	-7.8	-8.2	-8.5	-8.8	-9.2	-9.6
Single use military expenditure	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Environmental levies	3.6	4.4	5.6	6.7	7.6	9.3	10.3
Local authority imputed pensions	1.9	1.9	2.0	2.1	2.2	2.3	2.4
Other National Accounts adjustments	-2.9	-3.2	-3.4	-3.5	-3.5	-3.6	-3.7
Total public sector current expenditure	660.3	669.3	674.3	670.9	673.4	685.6	720.1
Public sector gross investment (PSGI)							
PSGI in CDEL[1]	38.4	42.1	42.0	42.4	43.6	47.2	50.5
PSGI in AME	22.8	25.7	26.4	27.0	26.9	26.5	26.8
of which:							
National lottery capital grants	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Network Rail capital expenditure	3.1	2.2	2.4	1.5	1.4	1.8	1.4
Other PSGI items in departmental AME	-0.5	0.6	-0.1	0.4	0.6	0.8	1.0
Locally-financed capital expenditure	7.0	7.1	7.0	8.1	7.7	6.1	6.1
Public corporations capital expenditure	7.2	7.8	7.9	7.7	7.8	7.7	7.6
R&D expenditure	7.1	7.8	8.2	8.5	8.8	9.2	9.6
Other National Accounts adjustments	-1.6	-0.2	0.6	0.3	0.0	0.4	0.6
Total public sector gross investment	61.2	67.8	68.3	69.4	70.5	73.6	77.2
Less depreciation	-35.4	-37.4	-38.8	-40.2	-41.9	-43.7	-45.5
Public sector net investment	25.8	30.4	29.5	29.2	28.6	30.0	31.8
Total managed expenditure	721.5	737.1	742.6	740.3	743.9	759.2	797.3

[1] Implied DEL numbers for 2016-17 to 2019-20. 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] 2013-14 outturn figures now include the negative tax credit element of tax credit spending, in line with ESA10 changes. This element was excluded for 2013-14 outturn at Autumn Statement 2014 as the change had not yet been made by the ONS.

[3] Other than debt interest and depreciation, which are included in totals shown separately in this table.

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Table 4.21: Changes to total managed expenditure since December

	£ billion						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Public sector current expenditure (PSCE)							
PSCE in RDEL[1]	0.0	-0.3	0.1	2.6	1.9	5.0	28.5
PSCE in AME[2]	1.8	-2.1	-6.2	-12.4	-12.5	-14.7	-15.4
of which:							
Welfare spending[2]	2.7	-0.5	-1.4	-3.0	-3.9	-4.9	-5.6
of which:							
Inside welfare cap[2]	2.6	-0.3	-0.1	-1.4	-2.2	-2.8	-3.2
Outside welfare cap	0.1	-0.2	-1.4	-1.6	-1.7	-2.1	-2.3
Company and other tax credits	-0.2	0.0	-0.1	0.1	0.1	0.2	0.3
Net public service pension payments	0.0	0.6	0.7	-0.2	-0.3	-0.5	-0.5
National lottery current grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BBC domestic services current expenditure	0.0	-0.1	0.2	-0.1	-0.2	-0.2	-0.2
Network Rail other current expenditure[3]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other PSCE items in departmental AME	0.0	0.2	0.1	0.0	0.1	0.1	0.1
Expenditure transfers to EU institutions	-0.1	0.1	1.3	-2.0	-0.1	-0.1	-0.1
Locally-financed current expenditure	-0.6	0.7	0.4	0.4	0.3	0.0	0.0
Central government debt interest, net of APF	0.0	-2.3	-6.7	-7.0	-7.5	-8.5	-9.0
of which:							
Central government gross debt interest	0.0	-2.4	-5.9	-5.5	-6.1	-7.1	-7.4
Reductions in debt interest due to APF	0.0	0.1	-0.8	-1.5	-1.4	-1.4	-1.6
Depreciation	-0.7	-0.3	-0.4	-0.6	-0.6	-0.5	-0.5
Current VAT refunds	0.0	0.0	0.0	0.0	-0.1	0.1	0.8
R&D expenditure	0.0	-0.3	-0.4	-0.2	-0.5	-0.9	-1.3
Single use military expenditure	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Environmental levies	0.0	0.0	0.0	-0.1	0.0	0.3	0.4
Local authority imputed pensions	0.0	0.1	0.1	0.1	0.1	0.1	0.2
Other National Accounts adjustments	0.9	-0.3	0.0	0.0	0.0	0.0	0.0
Total public sector current expenditure	1.8	-2.4	-6.1	-9.8	-10.7	-9.7	13.1
Public sector gross investment (PSGI)							
PSGI in CDEL[1]	0.0	0.7	1.0	2.4	3.5	2.4	2.4
PSGI in AME	-0.2	1.7	1.6	1.0	-0.2	1.2	1.9
of which:							
National lottery capital grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Network Rail capital expenditure	0.0	0.4	0.7	0.0	0.0	0.0	0.0
Other PSGI items in departmental AME	0.0	0.2	-0.4	0.3	0.4	0.6	0.8
Locally-financed capital expenditure	0.6	1.0	1.1	0.7	-0.4	-0.3	-0.2
Public corporations capital expenditure	-0.2	0.2	-0.2	0.0	0.1	0.3	0.1
R&D expenditure	0.0	0.3	0.4	0.2	0.5	0.9	1.3
Other National Accounts adjustments	-0.5	-0.5	-0.1	-0.1	-0.7	-0.3	-0.2
Total public sector gross investment	-0.2	2.4	2.6	3.4	3.4	3.6	4.3
Less depreciation	0.7	0.3	0.4	0.6	0.6	0.6	0.5
Public sector net investment	0.5	2.7	3.0	4.0	4.0	4.2	4.8
Total managed expenditure	1.6	0.0	-3.6	-6.4	-7.3	-6.1	17.4

[1] Implied DEL numbers for 2016-17 to 2019-20. 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] 2013-14 outturn figures now include the negative tax credit element of tax credit spending in line with ESA10 changes. This element was excluded for 2013-14 outturn at Autumn Statement 2014 as the change had not yet been enforced.

[3] Other than debt interest and depreciation, which are included in totals shown separately in this table.

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Expenditure in 2014-15

4.110 Compared to our December forecast, TME in 2014-15 is unchanged. Within that, PSCE is down by £2.4 billion and PSGI up by an offsetting amount. The reduction in PSCE is mostly due to lower RPI inflation reducing debt interest costs. An increase in current LASFE spending is mostly offset by a reduction in welfare spending. The increase in PSGI mainly reflects higher capital LASFE spending, stemming largely from an increase in spending financed by prudential borrowing and an increase in Network Rail capital spending. Detailed sectoral breakdowns of our forecasts are shown in the supplementary fiscal tables on our website.

4.111 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 2014-15 was 1.4 per cent higher than the same period last year. That compares with the 0.6 per cent increase that we are now forecasting for 2014-15 as a whole. One reason for the further slowing in the rate of growth implied in our forecast is that the monthly profile of debt interest spending will reflect the lower rates of RPI inflation expected in the final two months of 2014-15. The outturn data for the year to date are also prone to large revisions.

Departmental expenditure limits (DELs)

4.112 Table 4.22 shows our latest forecasts for PSCE in RDEL and PSGI in CDEL, and the changes since December. For 2014-15, the changes reflect departments' latest 'forecast outturns', which were sent to the Treasury in February, plus our assumptions regarding further underspending in the final outturns.

4.113 For 2014-15 and 2015-16, PSGI in CDEL has been increased to reflect the ONS decision to reclassify the UK's subscriptions to multilateral development banks as capital grants (explained in the section on classification changes above). This increases our measure of PSGI in CDEL by £1.4 billion in both years.[10]

4.114 For 2015-16, PSCE in RDEL also reflects some offsetting switches, and some small further changes to plans, that are described below. For 2016-17 onwards, where detailed plans have not yet been set, our forecasts for implied PSCE in RDEL and PSGI in CDEL have been derived from the policy assumptions described above.

[10] PSGI in CDEL will also be increased by a similar amount in 2013-14, but this change is not shown in this *EFO* because it will not be reflected in the ONS outturn statistics for the Public Sector Finances (PSF statistical bulletin) until March, after this *EFO* is published. The ONS has announced that these subscriptions will be reclassified in two stages. The subscriptions to the International Development Association arm of the World Bank will be reclassified in the March PSF bulletin. Subscriptions to the remaining multilateral development banks will be reclassified in due course.

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Table 4.22: Key changes to DEL since December

	£ billion					
	Forecast		Implied DEL[1]			
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PSCE in RDEL						
December forecast	316.8	316.3	299.0	287.9	282.9	279.7
March forecast	316.5	316.4	301.6	289.7	287.9	308.2
Change	-0.3	0.1	2.6	1.9	5.0	28.5
of which:						
Changes to underspend assumptions[1]	-0.3	0.0	-	-	-	-
Switches between DEL and AME	0.0	-0.1				
Recosting of change to Armed Forces Pension Scheme employer contributions (Autumn Statement 2014 policy change)	-	-0.3	-	-	-	-
Other changes to DEL plans	0.0	0.0	-	-	-	-
Changes in economic determinants used in the spending assumptions	-	-	-0.7	-1.2	0.0	0.9
Other changes to implied RDEL[2]	-	-	5.4	5.2	7.0	7.4
Effect of applying new Budget spending policy assumptions post 2015-16	-	-	-1.9	-1.9	-2.0	20.2
Budget measures	0.0	0.5	-0.1	-0.1	0.0	0.0
PSGI in CDEL						
December forecast	41.4	41.0	40.0	40.1	44.8	48.0
March forecast	42.1	42.0	42.4	43.6	47.2	50.5
Change	0.7	1.0	2.4	3.5	2.4	2.4
of which:						
Changes to underspend assumptions	-0.7	0.0	-	-	-	-
Subscriptions to multilateral development banks (ONS classification change)	1.4	1.4	-	-	-	-
Other changes to DEL plans	0.0	0.0	-	-	-	-
Changes in economic determinants used in the spending assumptions	-	-	-0.1	-0.2	-0.1	0.4
Other changes to implied CDEL[2]	-	-	2.8	4.1	3.1	2.8
Budget measures	0.0	-0.4	-0.2	-0.4	-0.6	-0.8
Total TME in DEL[3]						
December forecast	358.5	357.5	339.2	328.2	327.9	328.0
March forecast	358.9	358.6	344.3	333.6	335.3	358.9
Change	0.5	1.1	5.0	5.4	7.4	30.9

[1] Other latest forecasts for underspends are as follows:

Latest underspends in this forecast	2014-15	2015-16	Previous underspends in our December forecast	2014-15	2015-16
PSCE in RDEL	-2.3	-0.6	PSCE in RDEL	-2.0	-0.6
PSGI in CDEL	-1.2	-0.5	PSGI in CDEL	-0.5	-0.5
TME in DEL	-3.5	-1.1	TME in DEL	-2.5	-1.1

[2] Other changes to implied RDEL are calculated as changes to total PSCE less changes to PSCE in AME less the effects of changes in economic determinants used in applying the spending assumptions, less changes from Budget measures and the effects of applying the changes in the new Budget spending assumptions. Other changes to implied CDEL are calculated similarly.

[3] Total TME in DEL is defined as PSCE in RDEL plus PSGI in CDEL plus the small amount of SUME that is included in PSCE in AME. Under ESA10, most SUME is now classified as capital spending and is included within PSGI in CDEL. However a small amount of SUME is still classified as PSCE and is included within PSCE in AME. The latest figures for SUME are as follows:

SUME (treated as PSCE under ESA10)	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	0.3	0.2	0.2	0.2	0.2	0.2
March forecast	0.3	0.2	0.2	0.2	0.2	0.2

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DEL plans in 2014-15 and 2015-16

4.115 In 2014-15 and 2015-16, the years covered by detailed spending plans, the main change to our forecast is the classification change to PSGI in CDEL described above. Other smaller changes include:

- an upward revision to our assumption for underspends in 2014-15 (described below);
- a smaller increase in PSCE in RDEL to finance higher employer contributions to the Armed Forces Pension Scheme included as a policy change in Autumn Statement 2014. We now estimate that this will increase pension contributions by £0.3 billion less than we assumed in December, which increases our net pension payment forecast by £0.3 billion, and reduces PSCE in RDEL by the same amount (since most of the increase was covered by additional RDEL);
- various offsetting changes and switches that are neutral for TME in 2015-16, and are described in Box 4.3; and
- the Budget measures covered in Annex A.

4.116 Tables 4.9 and 4.10 show the details of our latest underspend assumptions against DEL plans in 2014-15 and 2015-16. The underspends are measured against the plans set out in the 2014 *Public Expenditure Statistical Analyses (PESA)* publication. Each year departments carry forward some specific underspends that they have surrendered under the Treasury's Budget Exchange system, and the PESA plans assume that the additional amounts carried forward will be offset by further underspends and surrenders at the end of the year. Our underspends are measured against the net PESA plans, which already include these assumed new underspends. The tables show the gross underspends, as well as the net reduction against PESA plans.[11]

4.117 Relative to our December forecast, our underspend assumption for 2014-15 benefits from knowing departments' final spending plans, as set out in the Supplementary Estimates that were published in February, and the 'forecast outturns' that were returned to the Treasury in February. These forecast outturns tend to be cautious, in that departments' spending falls away further by the end of the year. Our latest estimates of 2014-15 underspends assumes a similar fall away as in 2013-14 (Table 4.23). In total, our forecast now assumes a £3.5 billion net underspend compared to PESA plans, up from £2.5 billion in December.

4.118 In 2015-16, we assume that total net underspends will be £1.1 billion, unchanged from December. As we explained in our December *EFO*, we expect underspends to be lower in 2015-16 than in recent years because of expected pressures on budgets, and because some of the reserve has already been allocated to the NHS.[12] Since our December forecast,

[11] The 2014 PESA plans also include our forecast of net underspend against those plans from our March 2014 *EFO*. Our measure of net underspend is measured against the PESA plans excluding our previous forecast of underspends.
[12] See paragraph 4.109 of the December *EFO*, which explained why we reduced our forecast of DEL underspend by £2 billion in 2015-16.

and following the 2014-15 Supplementary Estimates, we now know the final amounts of Budget Exchange being carried forward into 2015-16. This allows us to calculate the implied gross underspending shown in Table 4.24. The implied gross underspend for PSCE in RDEL is materially smaller than in 2013-14 and 2014-15, and these judgements on underspends are subject to considerable uncertainty.

Table 4.23: DEL shortfalls against PESA plans for 2014-15

	£ billion					
	PSCE in RDEL		PSGI in CDEL		TME in DEL[1]	
	Outturn 13-14	Forecast 14-15	Outturn 13-14	Forecast 14-15	Outturn 13-14	Forecast 14-15
Budget Exchange carried forward	1.6	2.2	0.6	1.0	2.3	3.2
Gross underspend against PESA plans *of which:*	-4.5	-4.5	-1.0	-2.2	-6.8	-6.7
Supplementary Estimates (final plans)	-2.2	-1.6	-0.1	-0.8	-3.5	-2.4
Shortfall against final plans in departments' forecast outturn in February	-1.5	-1.9	-0.7	-1.1	-2.7	-3.0
OBR estimate of further shortfall	-0.8	-0.9	-0.2	-0.3	-0.7	-1.3
Net underspend against PESA plans [2]	-2.9	-2.3	-0.4	-1.2	-4.6	-3.5

[1] TME in DEL includes SUME.
[2] Total underspend against final PESA plans, net of increases in spending from Budget Exchange carried forward from earlier years.

Table 4.24: DEL shortfalls against PESA plans for 2015-16

	£ billion		
	Forecast		
	PSCE in RDEL	PSGI in CDEL	TME in DEL[1]
	2015-16	2015-16	2015-16
Budget Exchange carried forward	0.5	1.2	1.8
Gross underspend against PESA plans	-1.1	-1.7	-2.9
Net underspend against PESA plans[2]	-0.6	-0.5	-1.1

[1] TME in DEL includes SUME.
[2] Total underspend against final PESA plans, net of increases in spending from Budget Exchange carried forward from earlier years.

Box 4.3: Switches between DEL and AME and other devolution changes to DELs

In this forecast, there have been two switches between RDEL and AME that apply from 2015-16 onwards. Within AME, these changes reduce welfare spending and increase local authorities' self-financed current spending (current LASFE), giving a small increase overall that is mirrored by a small net reduction in RDEL. Specifically, as shown in Table A:

- war pensions will be will be switched out of Ministry of Defence AME into Ministry of Defence RDEL; and
- business rates in Wales will be switched out of the Welsh Assembly DEL into (non-departmental) current LASFE. In effect, they will be treated as finance raised and spent in Wales rather than as central government funding distributed from Whitehall.

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Table C: DEL and AME switches for war pensions and Welsh business rates

	£ billion				
	Forecast				
	2015-16	2016-17	2017-18	2018-19	2019-20
Changes to PSCE in AME:					
Current LASFE: devolution of Welsh business rates	0.9	0.9	1.0	1.0	1.0
Welfare spending outside the welfare cap: war pensions	-0.8	-0.8	-0.8	-0.7	-0.7
	DEL plans	Implied DELs			
Changes to PSCE in RDEL:					
Devolution of Welsh business rates	-0.9	-0.9	-1.0	-1.0	-1.0
War pensions	0.8	0.8	0.8	0.7	0.7

DEL plans for 2015-16 have also been updated to reflect the DEL spending financed by Scottish taxes and borrowing in the DELs for Scotland. Specifically:

- within PSCE in RDEL, RDEL has been increased by £0.5 billion, for the spending financed by the Scottish devolved taxes for land and building transactions and landfill; and
- this is offset within PSCE in RDEL by a reduction in the Scottish block grant of £0.5 billion.

PSGI in CDEL already includes £0.3 billion of capital spending that is expected to be financed by Scottish borrowing. This was included in CDEL plans in PESA 2014.

Implied DELs from 2016-17 to 2019-20

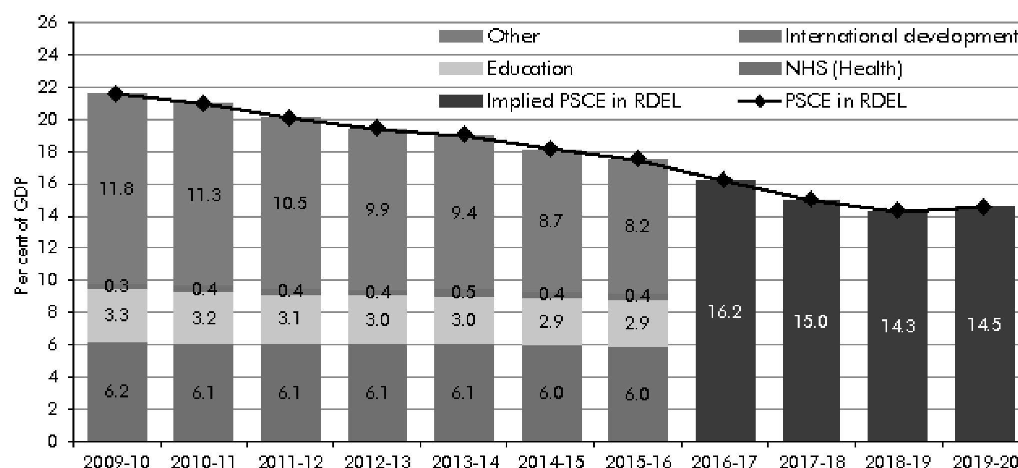
4.119 From 2016-17 onwards, DELs are inferred from the Government's spending policy assumptions and our AME forecast. Changes since December therefore reflect interaction between those assumptions and other changes to the forecast. Between 2016-17 and 2019-20, the main changes to implied DELs reflect:

- an overall reduction of £3.3 billion in our forecast for TME in 2015-16 (before measures) has been taken forward by the spending assumption, reducing overall TME by an average £4.2 billion a year, even before taking the latest change in the spending assumptions into account;
- within this £3.3 billion reduction in 2015-16, our forecast for capital spending has increased by £3.5 billion, which increases PSGI and PSGI in CDEL by £3 to £3½ billion a year. Since total spending is constrained by the overall spending assumption, this then reduces current spending, which is lower by just under £8 billion a year on average over the next four years;
- there is an even larger reduction in debt interest payments and social security spending, reflecting lower interest rates and inflation;
- the net effect of all these changes on implied RDEL, before the further change in the Government's spending policy assumptions, is an increase of over £5 billion a year, rising to £7.4 billion in 2019-20; and

- the Government's decision to change its spending policy assumptions reduces implied RDEL by £2 billion a year on average over the next three years, reducing the extent to which implied RDEL is revised up from 2016-17 to 2018-19. But the much bigger change to the spending assumption for 2019-20 increases implied RDEL by £20 billion, meaning an overall increase relative to December of £28.5 billion.

4.120 Chart 4.8 shows the trend in PSCE in RDEL as a proportion of GDP – the proportion of national income devoted to day-to-day spending on public services and administration. 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). The largest departmental budgets included in the 'other' category in Chart 4.8 are the Ministry of Defence and the Department of Business, Innovation and Skills. Beyond the years for which plans have been set, we simply show the path of PSCE in RDEL implied by the total spending assumption and our forecast for PSCE in AME. Implied RDEL rises slightly as a share of GDP is 2019-20 because the Government's spending assumption holds TME and CDEL constant as shares of GDP while AME falls as a share of GDP largely because working-age benefits are uprated by less than earnings growth and some caseloads fall as a share of the population.

Chart 4.8: Resource DEL and implied resource DEL relative to GDP



Note: RDEL series excludes major historical switches with AME as well as switches with AME in forecast years. Details are available in the supplementary fiscal tables on our website. Source: HM Treasury Public Expenditure Statistical Analyses, July 2014; HM Treasury supplementary estimates, February 2015; OBR

Annually managed expenditure (AME)

4.121 Table 4.20 sets out our latest central projection of AME spending to 2019-20, based on the economic forecast described in Chapter 3, the latest estimates of agreed policy commitments and the measures announced in Budget 2015.

Welfare cap and other welfare spending

4.122 Total welfare spending in our forecast refers to AME spending on social security and personal tax credits, a subset of which is subject to the Government's welfare cap. Table 4.25 summarises our forecasts for welfare spending over the next five years. It shows that, in nominal terms, welfare spending is forecast to rise by 9.6 per cent from £214.5 billion in 2014-15 to £235.1 billion in 2019-20. Within this total, spending on items inside the cap increases by 6.0 per cent while spending on items outside the cap increases by 14.1 per cent (as spending on state pensions is expected to rise by 17.1 per cent). Relative to the size of the economy, welfare spending is forecast to fall by 1.3 per cent of GDP between 2014-15 and 2019-20, with spending inside the welfare cap falling by 0.9 per cent of GDP and spending outside the welfare cap falling more slowly by 0.4 per cent of GDP.

Table 4.25: Welfare spending forecast overview

	Outturn	Forecast					
			Welfare cap period				
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
£ billion							
Total welfare spending[1,2]	209.4	214.5	216.9	219.5	223.6	229.3	235.1
of which:							
Inside welfare cap[1,2]	116.1	119.4	120.6	121.0	121.8	124.0	126.5
Outside welfare cap[2]	93.3	95.1	96.3	98.5	101.8	105.2	108.6
Per cent of GDP							
Total welfare spending	12.1	11.9	11.6	11.3	11.1	10.9	10.6
of which:							
Inside welfare cap	6.7	6.6	6.4	6.2	6.0	5.9	5.7
Outside welfare cap	5.4	5.3	5.1	5.1	5.0	5.0	4.9

[1] 2013-14 outturn figures now include the negative tax credit element of tax credit spending, in line with ESA10 changes. This element was excluded for 2013-14 outturn at Autumn Statement 2014 as the change had not yet been made by the ONS.
[2] Total welfare outturn inside and outside of the welfare cap in 2013-14 is sourced from OSCAR, consistent with PESA 2014.

4.123 For spending that is subject to the welfare cap, the projected fall of 0.9 per cent of GDP over the next five years is driven by:

- spending on **tax credits** falling by 0.2 per cent of GDP. Average awards grow more slowly than GDP per person as a result of previously announced measures (uprating capped at 1 per cent in 2015-16) and operational changes targeting debt and error and fraud, while caseloads are relatively flat, reflecting falling unemployment and a pick-up in average earnings;

- spending on **disability benefits** falling by 0.2 per cent of GDP. Caseloads are set to fall as eligibility is reassessed when cases are migrated from the existing disability living allowance to the new personal independence payment;

- smaller falls in spending on **housing benefit** (0.1 per cent of GDP) and **incapacity benefits** (0.1 per cent of GDP). Spending on housing benefit falls as average awards grow more slowly than GDP per person. Spending on incapacity benefits falls mainly

because the clearance of the backlog of work capability assessments (under the new contractor, Maximus) is expected to reduce the overall caseload relative to the adult population; and

- falls in spending on a number of other benefits, including pension credit (in part due to the rise in the state pension age) and child benefit (due to uprating by less than earnings growth and a rise in the number of families opting out of payment as a result of the 'high income child benefit charge').

4.124 Spending outside the welfare cap is expected to fall by 0.4 per cent of GDP. This reflects:

- spending on **state pensions** falling by 0.2 per cent of GDP. Upward pressure from an ageing population is more than offset by the raising of the state pension age. The 'triple lock' means that from 2017-18 average awards rise broadly in line with earnings; and
- spending on the unemployed – comprising **jobseeker's allowance and housing benefit paid to jobseekers** – falls by 0.1 per cent of GDP. Caseloads fall a little and average awards rise more slowly than earnings.

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Table 4.26: Welfare spending

	£ billion						
	Outturn	Forecast					
			Welfare cap period				
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Welfare cap							
DWP social security	71.7	74.6	75.7	75.3	75.2	76.1	77.6
of which:							
Incapacity benefits	13.5	14.1	14.7	14.7	14.5	14.6	15.0
Statutory maternity pay	2.2	2.2	2.3	2.3	2.4	2.4	2.5
Income support (non-incapacity)	2.6	2.5	2.6	2.6	2.6	2.7	2.8
Pension credit	7.0	6.6	6.2	5.8	5.6	5.4	5.3
Winter fuel payments	2.1	2.1	2.1	2.1	2.0	2.0	2.0
Disability living allowance and personal independence payments	13.9	15.4	15.3	14.9	14.4	14.5	14.8
Attendance allowance	5.4	5.4	5.5	5.6	5.7	5.8	6.0
Carer's allowance	2.1	2.3	2.5	2.5	2.6	2.8	2.9
Universal credit[1]	0.0	0.0	0.0	-0.1	0.1	0.3	0.3
Housing benefit (not on JSA)[2]	20.5	21.5	22.2	22.5	22.8	23.2	23.6
Other DWP in welfare cap	2.3	2.4	2.4	2.4	2.4	2.4	2.4
Personal tax credits	29.7	29.7	29.5	29.8	30.5	31.6	32.3
Tax free childcare	-	-	0.3	0.7	0.8	0.9	0.9
Child benefit	11.4	11.6	11.7	11.6	11.7	11.9	12.0
NI social security in welfare cap	3.2	3.4	3.4	3.4	3.5	3.5	3.6
Paternity pay	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Budget measures	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1
Total welfare cap[3,4]	116.1	119.4	120.6	121.0	121.8	124.0	126.5
Welfare spending outside the welfare cap							
DWP social security	90.8	92.0	93.9	96.1	99.3	102.6	105.8
of which:							
Jobseeker's allowance	4.3	3.1	2.4	2.4	2.5	2.5	2.6
State pension	83.1	86.5	89.8	92.0	95.0	98.2	101.3
Housing benefit (on JSA)	3.2	2.4	1.8	1.7	1.8	1.9	1.9
Discretionary housing payments[5]	0.2	-	-	-	-	-	-
Universal credit[1]	0.0	0.1	-	-	-	-	-
NI social security outside welfare cap	2.2	2.3	2.4	2.4	2.5	2.6	2.7
War pensions[6]	0.9	0.8	-	-	-	-	-
Budget measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total welfare outside the welfare cap[4]	93.3	95.1	96.3	98.5	101.8	105.2	108.6
Total welfare[3,4]	209.4	214.5	216.9	219.5	223.6	229.3	235.1
Memo: welfare cap as proportion of total welfare	55.5	55.6	55.6	55.1	54.5	54.1	53.8

[1] Universal credit actual spending for 2013-14 and 2014-15. Spending from 2015-16 onwards represents universal credit additional costs not already included against other benefits (i.e. UC payments that do not exist under current benefit structure).

[2] Housing benefit (not on jobseeker's allowance) is made up of a number of claimant groups. The main claimant groups are pensioners, those on incapacity benefits, lone parents, and housing benefit only claimants.

[3] 2013-14 outturn figures now include the negative tax credit element of tax credit spending, in line with ESA10 changes. This element was excluded for 2013-14 outturn at Autumn Statement 2014 as the change had not yet been made by the ONS.

[4] Total welfare outturn inside and outside of the welfare cap in 2013-14 is sourced from OSCAR, consistent with PESA 2014. For 2013-14 only, the components reflect departments' own outturns, which may not be on a consistent basis to OSCAR. For this year the components may not sum to the total for this reason.

[5] Transferred to DEL in 2014-15.

[6] Transferred to DEL from 2015-16.

4.125 Table 4.27 shows the changes in welfare spending since our December forecast. We have made downward revisions of £3.8 billion a year on average between 2015-16 and 2019-20, with greater downward revisions from 2016-17. Revisions are of a similar size inside and outside the welfare cap.

4.126 Table 4.28 sets out the main drivers of these revisions. Within the welfare cap:

- lower CPI inflation (due largely to lower oil prices) is the biggest source of revisions. This reflects two effects. First, lower inflation means slower uprating of most benefits[13] from 2016-17 onwards, reducing spending by £1.6 billion a year on average between 2016-17 and 2019-20. Second, lower inflation feeds through to a lower forecast for rents and therefore spending on housing benefit. This reduces spending by a further £0.4 billion a year on average;

- lower projected fertility rates reduce spending on tax credits, child benefit, tax-free childcare and maternity benefits by increasing amounts from 2014-15 onwards. This change is informed by evidence of lower than expected fertility rates in 2013;

- reductions in the savings associated with tax credits operational measures increase spending by £0.2 billion a year between 2015-16 and 2019-20; and

- projected spending on incapacity benefits, disability living allowance (DLA) and personal independence payment (PIP) is up by £0.2 billion a year on average between 2014-15 and 2019-20. Higher spending on incapacity benefits primarily reflects higher numbers of cases being assigned to the support group, while higher spending on DLA and PIP reflects higher than expected outturns so far in 2014-15.

4.127 For welfare spending that is not subject to the cap, Table 4.28 shows that:

- the Government's spending-neutral decision to transfer war pensions to DEL from 2015-16 reduces welfare spending by £0.8 billion a year;

- lower CPI inflation also feeds through to lower uprating of the state second pension, jobseeker's allowance and associated housing benefit payments. This lowers spending by £0.5 billion a year on average between 2016-17 and 2019-20;

- lower claimant count unemployment reduces spending on jobseeker's allowance and associated housing benefit payments by £0.5 billion a year on average between 2014-15 and 2019-20. Roughly half is due to our lower claimant count forecast and half due to lower outturn data for the housing benefit JSA caseload;

- higher-than-expected mortality rates reduce spending on state pensions by an average of £0.1 billion a year between 2015-16 and 2019-20; and

[13] Uprating for many benefits is capped at 1 per cent until 2015-16, reverting to CPI uprating thereafter.

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- the 'triple lock' means that lower inflation does less to reduce the cost of state pensions than it does to reduce spending subject to the cap.

Table 4.27: Key changes to welfare since December

	£ billion						
	Outturn	Forecast					
			Welfare cap period				
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Welfare cap							
DWP social security	-0.1	0.1	0.2	-0.4	-0.8	-1.1	-1.2
of which:							
Incapacity benefits	0.0	0.1	0.2	0.0	-0.1	-0.2	-0.2
Statutory maternity pay[1]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Income support (non-incapacity)	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Pension credit	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Winter fuel payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Disability living allowance and personal independence payments	0.0	0.1	0.2	0.0	-0.1	-0.2	-0.3
Attendance allowance	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Carer's allowance	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Universal credit[2]	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Housing benefit (not on JSA)	0.0	0.0	-0.1	-0.3	-0.4	-0.5	-0.5
Other DWP in welfare cap	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Personal tax credits	0.0	-0.4	-0.4	-0.8	-1.2	-1.3	-1.4
Tax free childcare	-	-	0.0	0.0	0.0	0.0	0.0
Child benefit	0.0	0.0	0.0	-0.2	-0.4	-0.5	-0.6
NI social security in welfare cap	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Paternity pay	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Budget measures	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1
Total welfare cap[3,4]	2.6	-0.3	-0.1	-1.4	-2.2	-2.8	-3.2
Welfare spending outside the welfare cap							
DWP social security	0.0	-0.1	-0.5	-0.8	-0.9	-1.3	-1.6
of which:							
Jobseeker's allowance	0.0	0.0	-0.1	-0.2	-0.2	-0.2	-0.3
State pension	0.0	0.0	-0.1	-0.3	-0.5	-0.8	-1.1
Housing benefit (on JSA)	0.0	-0.1	-0.4	-0.3	-0.3	-0.3	-0.3
Discretionary housing payments[5]	0.0	-	-	-	-	-	-
Universal credit[2]	0.0	0.0	-	-	-	-	-
NI social security outside welfare cap	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
War pensions[6]	0.0	0.0	-0.8	-0.8	-0.8	-0.8	-0.7
Budget measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total welfare outside the welfare cap[4]	0.1	-0.2	-1.4	-1.6	-1.7	-2.1	-2.3
Total welfare[3,4]	2.7	-0.5	-1.4	-3.0	-3.9	-4.9	-5.6

[1] The decrease in welfare spending in 2013-14 represents a change in the latest available outturn data for statutory maternity pay.

[2] Universal credit actual spending for 2013-14 and 2014-15. Spending from 2015-16 onwards represents universal credit additional costs not already included against other benefits (i.e. UC payments that do not exist under current benefit structure).

[3] 2013-14 outturn figures now include the negative tax credit element of tax credit spending, in line with ESA10 changes. This element was excluded for 2013-14 outturn at Autumn Statement 2014 as the change had not yet been made by the ONS.

[4] Total welfare outturn inside and outside of the welfare cap in 2013-14 is sourced from OSCAR, consistent with PESA 2014. For 2013-14 only, the components reflect departments' own outturns, which may not be on a consistent basis to OSCAR. For this year the

[5] Transferred to DEL in 2014-15.

[6] Transferred to DEL from 2015-16.

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Table 4.28: Sources of changes in welfare spending since December

	£ billion					
	Forecast					
		Welfare cap period				
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Welfare spending inside the welfare cap						
December forecast	119.6	120.7	122.4	124.0	126.8	129.8
March forecast	119.4	120.6	121.0	121.8	124.0	126.5
Changes since December	-0.3	-0.1	-1.4	-2.2	-2.8	-3.2
of which:						
Economic determinants	0.0	-0.1	-1.2	-2.0	-2.5	-2.7
CPI inflation	0.0	0.0	-1.1	-2.0	-2.4	-2.6
Other	0.0	-0.1	-0.1	0.0	0.0	-0.1
Estimating and modelling changes	-0.3	-0.1	-0.2	-0.2	-0.3	-0.4
Fertility assumption	-0.2	-0.3	-0.4	-0.6	-0.7	-0.8
Tax credits recostings	0.0	0.2	0.2	0.2	0.1	0.1
Incapacity benefits and disability benefits[1]	0.2	0.4	0.3	0.2	0.2	0.1
Other	-0.4	-0.3	-0.2	0.0	0.1	0.1
Other	0.0	0.0	0.0	0.1	0.0	0.0
Budget measures	0.0	0.0	0.0	0.0	-0.1	-0.1
Welfare spending outside the welfare cap						
December forecast	95.3	97.7	100.1	103.5	107.3	110.9
March forecast	95.1	96.3	98.5	101.8	105.2	108.6
Changes since December	-0.2	-1.4	-1.6	-1.7	-2.1	-2.3
of which:						
Economic determinants	0.0	-0.4	-0.7	-0.7	-1.0	-1.1
CPI inflation	0.0	0.0	-0.3	-0.5	-0.6	-0.7
Claimant count unemployment	0.0	-0.4	-0.3	-0.3	-0.3	-0.3
Other	0.0	0.0	0.0	0.1	-0.1	-0.2
Estimating and modelling changes	-0.2	-0.1	-0.1	-0.2	-0.3	-0.5
State pension mortality assumption	0.0	-0.1	-0.1	-0.1	-0.2	-0.2
Housing benefit (on JSA)	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3
Other	0.0	0.2	0.2	0.2	0.1	0.0
Transfer of war pensions to DEL[2]	0.0	-0.8	-0.8	-0.8	-0.8	-0.7
Other	0.0	0.0	0.0	0.0	0.0	0.0
Budget measures	0.0	0.0	0.0	0.0	0.0	0.0
Total welfare spending						
December forecast	215.0	218.3	222.5	227.5	234.1	240.7
March forecast	214.5	216.9	219.5	223.6	229.3	235.1
Changes since December	-0.5	-1.4	-3.0	-3.9	-4.9	-5.6
of which:						
Economic determinants	0.0	-0.5	-1.9	-2.8	-3.5	-3.8
Estimating and modelling changes	-0.5	-0.2	-0.3	-0.4	-0.6	-0.9
Transfer of war pensions to DEL[2]	0.0	-0.8	-0.8	-0.8	-0.8	-0.7
Other	0.0	0.0	0.0	0.0	0.0	0.0
Budget measures	0.0	0.0	0.0	0.0	-0.1	-0.1

[1] Disability benefits refers to disability living allowance and personal independence payment.

[2] Transferred to DEL from 2015-16.

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Public service pensions

4.128 The public service pensions forecast covers net expenditure on benefits paid less employer and employee contributions received. It includes central government pay-as-you-go schemes and locally-administered police and firefighters' schemes.[14]

4.129 Gross expenditure is expected to rise steadily in cash terms over the forecast period, as demographic trends increase the age profile of each scheme's membership. But it remains broadly flat as a share of GDP. The income of each scheme is made up of employer and employee contributions, which are determined by the pensionable paybill and the respective contribution rates. Contribution rates are determined by actuarial valuations of each of the individual schemes. A breakdown of spending and income for the major schemes covered by our forecast is included in the supplementary fiscal tables on our website.

4.130 Gross expenditure is up on our December forecast in 2014-15 and 2015-16, largely due to higher NHS scheme spending. In 2014-15, this is attributable to an increase in lump sums (due to average values rising) and to a rise in transfers out that also affects 2015-16. (The increase in NHS employees transferring out of the public sector scheme may be linked to forthcoming legislation related to the Budget 2014 pensions flexibility measures, which will prohibit transfers from unfunded defined benefit schemes into defined contribution schemes. While the legislation comes into effect from April 2015, some applications are expected to be processed in 2015-16. This effect was not fully captured in the costings of these measures for this particular scheme.) From 2016-17 onwards, the downward revision to our CPI inflation forecast reduces uprating and therefore lowers spending.

4.131 On the basis of near-final scheme valuations, Autumn Statement 2014 announced changes to employer contribution rates for the armed forces, firefighters, the judiciary, the Scottish NHS and teachers, and Northern Ireland NHS, teachers, civil service and police. These changes have been reflected in this forecast and take effect in 2015-16.

4.132 We have made two broadly offsetting changes to our receipts forecast:

- we have corrected the methodology applied in December to estimate the impact of the new, higher armed forces pension scheme (AFPS) employer contribution rate, and have updated the forecast to reflect the final rate.[15] These changes have reduced expected receipts from 2015-16 onwards; and

- a revised assumption about the impact on paybills of the pressure on spending associated with abolishing the NICs contracting out rebate in 2016-17, in line with an

[14] 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. They are therefore included in our pensions forecast.
[15] As discussed in the DEL plans section above, since the fiscal impact of the AFPS employer contribution rate is limited to £100 million via an appropriate DEL increase, a downward adjustment has been made to 2015-16 DEL in respect of this new estimate.

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update to the estimate of the central government impact. This indicates less paybill pressure, which increases pension receipts relative to the December forecast.[16]

Table 4.29: Key changes to public service pensions since December

	£ billion						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Net public service pensions							
December forecast	10.9	11.8	10.4	11.4	12.2	13.2	14.3
March forecast	10.9	12.5	11.1	11.2	11.9	12.7	13.8
Change	0.0	0.6	0.7	-0.2	-0.3	-0.5	-0.5
Expenditure							
December forecast	36.1	37.8	38.8	40.2	41.9	43.7	45.6
March forecast	36.1	38.4	39.3	40.1	41.6	43.3	45.2
Change	0.0	0.6	0.5	-0.1	-0.2	-0.4	-0.4
of which:							
CPI inflation	0.0	0.0	0.0	-0.3	-0.5	-0.7	-0.7
Increase in NHS expenditure	0.0	0.4	0.3	0.0	0.0	0.0	0.0
Other	0.0	0.2	0.3	0.2	0.3	0.3	0.3
Income							
December forecast	-25.1	-26.0	-28.4	-28.8	-29.6	-30.5	-31.4
March forecast	-25.1	-25.9	-28.2	-28.8	-29.7	-30.6	-31.5
Change	0.0	0.0	0.1	-0.1	-0.1	-0.1	-0.1
of which:							
Correction for overestimate of AFPS pensions receipts in Autumn Statement measure	0.0	0.0	0.3	0.3	0.3	0.3	0.3
Change in central government contracting out estimate	0.0	0.0	0.0	-0.2	-0.2	-0.2	-0.2
Other	0.0	0.0	-0.2	-0.1	-0.2	-0.2	-0.2

EU contributions

4.133 In our December 2014 *EFO*, we provided a step-by-step explanation of our forecast for the UK's contributions to the EU. That included an explanation of how the large one-off adjustment to the UK's historic GNI contributions announced in October 2014 was expected to affect the public finances in 2014-15 and 2015-16. The additional information provided on the assumptions underpinning our forecasts is now available in an expanded supplementary fiscal table available on our website.

4.134 Our understanding of how the historic adjustment will affect the public finances – based on Eurostat advice to the ONS – has changed slightly since December. The adjustment still amounts to a net payment of £1.7 billion before the UK abatement and £0.9 billion after it. The £1.7 billion net payment consists of a gross payment of £2.9 billion, partly offset by a refund of £1.2 billion. Both of these transactions were included in the public finance statistics in December 2014 on an accruals basis, increasing public sector net borrowing –

[16] Our latest estimates of the overall effect of the abolition of contracting out on public service pension receipts is shown in the supplementary fiscal table on our website that shows the breakdown of our forecast for each pension scheme.

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the accruals measure of the deficit – in 2014-15, as expected. The associated cashflows were all expected to take place in 2015-16, increasing the public sector net cash requirement and net debt. However £0.5 billion of the £1.2 billion refund has been received in February 2015, so that the accrued impact on borrowing and the cash impact on the net cash requirement are different by £2.2 billion in 2014-15. This will unwind in 2015-16, when the £2.9 billion payment will be made, and the remaining £0.7 billion refund will be received. The associated £0.8 billion abatement is expected to affect both public sector net borrowing and the cash requirement in 2015-16.

4.135 We have made further changes to our forecast since December, which over the forecast period average a downward revision of £0.2 billion, but include a substantial upward revision in 2015-16 and a larger downward revision in 2016-17. The main sources of changes have been:

- the sterling/euro exchange rate on 31 December 2014 – which determines the rate at which UK contributions during 2015 will be converted – was stronger than factored into our December forecast, reducing spending in 2015-16 by £0.1 billion. The exchange rate assumption underpinning future years of the forecast (described in Chapter 3) is also stronger than in December, reducing spending in later years of the forecast. Together these effects reduce spending by £0.5 billion a year by 2019-20;
- anticipated future GNI-related adjustments increase spending in 2015-16 and reduce spending in 2016-17. This reflects separate judgements related to 2014 and 2015. For 2014, we expect the UK's GNI level to be higher than assumed at the May 2014 meeting of the Advisory Committee on Own Resources (ACOR). For 2015, we also expect the May 2015 ACOR meeting to set bases that assume a higher UK share of EU GNI. Together, these mean we have revised up our estimate of GNI adjustments paid in 2015-16 from £0.2 billion to £1.4 billion and revised our estimate of associated rebates and other repayments in 2016-17, so we now expect to receive a repayment of £1.4 billion, compared with a payment of £0.8 billion assumed in our December forecast. As ever, these assumptions are associated with great uncertainty; and
- smaller changes to anticipated future VAT base adjustments, which are in part related to the switch of Europe's National Accounts from the ESA95 to ESA10 accounting framework. The latest Eurostat estimates of 2013 final consumption expenditure on both bases suggest that the UK's VAT share will be higher on an ESA10 basis. That has increased our forecast by £0.2 billion a year on average. This remains an estimate at this stage, as the first estimates of all member states' ESA10 VAT bases will not be made until the May 2015 ACOR meeting.

4.136 Future revisions associated with GNI reservations or other factors remain a source of significant uncertainty around our EU contributions forecast. The ONS has announced that it will delay the publication of this summer's Blue Book until 30 September in order to carry out the quality assurance necessary to meet with confidence a Eurostat stipulation that

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remaining GNI reservations must be addressed by 22 September.[17] We do not have firm information on which to assess whether the net effect of addressing remaining reservations in the UK and other EU member states would lead to upward or downward adjustments to the UK's contributions to the EU, so we have not adjusted our forecast at this stage. But it is clear that the possibility of such adjustments poses risks to our forecast.

Table 4.30: Key changes to EU contributions since December

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	11.0	9.9	11.5	9.6	10.7	11.2
March forecast	11.0	11.2	9.4	9.5	10.5	11.0
Change	0.1	1.3	-2.0	-0.1	-0.1	-0.1
of *which:*						
Change in exchange rate	0.0	0.1	-0.1	-0.4	-0.4	-0.5
Revisions to adjustments for UK GNI contributions for 2014 and 2015, net of refunds and associated rebate [1]	0.0	1.2	-2.1	0.0	0.0	0.0
Revisions to adjustments for UK VAT contributions for 2014 and 2015 [2]	0.1	0.2	0.3	0.2	0.2	0.2
Other	0.0	-0.2	-0.1	0.0	0.1	0.1

[1] Adjustments to UK GNI and VAT payments in respect of 2014 will be made in December 2015. Adjustments in respect of 2015 will be made during 2015, using the ACOR bases that will be agreed in May 2015. Adjustments to the UK rebate follow a year after the GNI adjustments

[2] These adjustments mainly affect the UK rebate

Locally financed current expenditure

4.137 We forecast local authority spending by forecasting the sources of income that local authorities use to finance their spending and then the extent to which spending will be higher or lower than income, thereby adding to or subtracting from their reserves. Our forecast therefore encompasses spending financed by grants from central government, which are mostly in DEL, and local authority self-financed expenditure (LASFE) in AME.

4.138 Our forecast for current LASFE is largely driven by our forecasts for council tax and business rates. The forecast profile for council tax is reduced in 2014-15 and 2015-16 by the availability of council tax freeze grant in England, which runs until 2015-16. This has meant average council tax increases of 0.9 per cent in 2014-15, as 60 per cent of local authorities have frozen their tax levels and taken up the council tax freeze grant. In 2015-16, we expect a similar rise. After 2015-16, we assume that council tax in England, Scotland and Wales will rise in line with CPI inflation.[18] These assumptions are little changed from December, but our forecasts for spending financed by council tax in LASFE have fallen by £1.2 billion over the period from 2016-17 to 2019-20, due to our lower CPI inflation forecast.

[17] See *Blue and Pink Books 2015 statement*, Office for National Statistics, 26 February 2015.
[18] These council tax increases are assumed to apply in conjunction with an increase in the council tax base, which averages 0.9 per cent a 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 fiscal table on our website.

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4.139 For English local authorities, current LASFE contains the 50 per cent of business rates that are now retained directly by local authorities. For Scottish and Welsh local authorities, reflecting the arrangements for devolution, business rates are treated as locally raised central government support. Current LASFE contains all of the spending financed by business rates. (The latest forecasts for business rates are discussed in paragraph 4.81 in the receipts section.) Council tax and retained business rate assumptions are broadly neutral for the current budget deficit and borrowing – other than some minor timing differences – as they increase receipts and spending equally.

4.140 In our December 2014 *EFO*, we described in detail the information sources we use and the judgements we make when settling on a central assumption for the extent to which local authorities will add to reserves over the next five years. These additions to reserves reduce their current spending. For 2014-15 we have revised our forecast to reflect the latest quarterly spending information collected by DCLG. We now assume that English local authorities will underspend their budgets for current expenditure on services by £2.7 billion and will therefore add only £1 billion to their net reserves rather than the £1.5 billion that we assumed in December. Our recent forecasts have assumed that English local authorities' will add to their reserves by decreasing amounts until 2018-19, and that they will be flat thereafter. Given the latest information on reduced net additions in 2014-15, we have reduced our assumptions of net additions by £0.6 to £0.2 billion over the next three years, which increases current LASFE spending.

4.141 Table 4.31 summarises the main changes to our forecast for current LASFE. This has been increased by about £1 billion from 2015-16 because of the switch of devolved business rates in Wales from RDEL to current LASFE. This is discussed in Box 4.3 above. Excluding this switch, current LASFE is £0.5 billion lower in 2015-16 with the reduction increasing to £1 billion by 2019-20. In 2015-16 and 2016-17, this spending falls mainly because of an increase in capital expenditure financed from the revenue account (CERA). The increased CERA forecast switches more local authority spending out of current spending and into capital spending. This reflects new information on Transport for London (TfL) plans that is discussed below. The remaining reductions out to 2019-20 are accounted for by lower council tax and business rates, reflecting lower inflation.

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Table 4.31: Key changes to locally financed expenditure and public corporations capital expenditure since December

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Locally-financed current expenditure						
December forecast	35.0	37.2	39.5	41.6	43.5	45.0
March forecast	35.8	37.6	40.0	41.9	43.6	45.0
Change	0.7	0.4	0.4	0.3	0.0	0.0
of which:						
Net use of current reserves	0.5	0.5	0.6	0.2	0.0	0.0
Capital expenditure from revenue account	0.4	-1.0	-0.5	0.0	0.1	0.2
Council tax	0.0	0.0	-0.2	-0.3	-0.3	-0.4
Retained business rates	0.0	0.3	-0.1	-0.2	-0.2	-0.3
Interest receipts	0.0	-0.1	-0.1	-0.1	-0.1	-0.2
Business rates in Scotland	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2
Devolved business rates in Wales	-	0.9	0.9	1.0	1.0	1.0
Other	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Locally-financed capital expenditure, and public corporations capital expenditure						
December forecast	13.7	13.9	15.2	15.9	13.8	13.7
March forecast	14.9	14.8	15.8	15.5	13.8	13.7
Change	1.2	1.0	0.6	-0.3	0.0	-0.1
of which:						
Capital expenditure from revenue account	-0.4	1.0	0.5	0.0	-0.1	-0.2
Capital spending financed by prudential borrowing	0.7	0.3	0.2	-0.1	-0.2	-0.1
OBR timing adjustment for Crossrail	0.1	-0.3	0.2	-0.3	0.2	0.0
Capital spending of TfL PC subsidiaries[1]	0.4	-0.4	-0.3	0.1	0.3	0.5
Capital spending financed by use of capital receipts	0.3	0.1	0.0	-0.1	-0.1	0.0
Asset sales	0.1	0.2	0.2	0.1	0.0	-0.1
Other	0.0	-0.1	-0.1	-0.1	-0.1	-0.1

[1] This reflects the net change to the adjustment that reduces capital LASFE to remove TfL financing for its PC subsidiaries capital spending, and the forecast for these TfL PC subsidiaries capital spending.

Locally financed and public corporations capital expenditure

4.142 Our latest forecasts for locally financed capital expenditure (capital LASFE) and public corporations capital spending are shown in Table 4.31. Capital LASFE is measured net of asset sales. It is also measured net of capital spending by local authorities' Housing Revenue Accounts (HRAs) and the TfL subsidiaries that are treated as public corporations in the National Accounts.[19] We switch these items out of capital LASFE and include them in our forecast for public corporations net capital expenditure to ensure our forecast is consistent with the National Accounts.

[19] These TfL transport subsidiaries trade under the company name 'Transport Trading Ltd' (TTL). The ONS currently classifies all of the TTL subsidiaries as public corporations apart from Crossrail, which is classified as part of the local authority sector. However, the ONS announced last year that it will be reclassifying several of the other TTL subsidiaries to the local authority sector. We would expect that these reclassifications will have a neutral effect on the public sector finances and we will wait until the ONS implements those reclassifications in the outturn data before we reflect them in our forecast.

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4.143 Our forecast for local authorities' capital spending in England remains fairly stable over the forecast period, and continues to assume that spending is boosted by an additional £2½ billion from capital reserves over the period from 2015-16 to 2018-19, related to the closing stages of Crossrail construction. Capital LASFE declines by the end of the forecast period because we assume declining levels of spending financed by prudential borrowing and CERA, while asset sales are projected to rise. Further details are shown in supplementary fiscal tables available on our website.[20]

4.144 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.

4.145 Table 4.31 groups our forecasts for capital LASFE and public corporations' capital spending together to show the overall impact of the revisions. There are three main changes:

- we have incorporated new information supplied by TfL, consistent with their latest published business plan. This has a large impact on our forecast for CERA, since TfL transactions currently account for almost half of all CERA in England. As a result we have revised down our forecast for CERA by £0.4 billion in 2014-15 and increased it by £1 billion in 2015-16 and by £½ billion in 2016-17. The latest TfL information has also changed the profile of our forecast of their capital spending, including the amounts we assume are financed from capital LASFE;

- we have revised up our forecast for local authority capital spending in England in 2014-15 by £0.2 billion in order to reflect the latest in-year quarterly capital spending information collected by DCLG. This suggests that English local authorities will underspend their net capital budgets by a net total of £6.7 billion. Given the reduction that we expect on CERA from TfL's latest forecast above, we have assumed that the £0.2 billion increase in local authority capital spending is reflected in greater use of prudential borrowing and use of capital receipts, which also changes the profile of the capital spending from these resources later in the forecast period; and

- we have revised our forecast for sales of capital assets to reflect our latest economic assumptions for prices and volumes of property transactions, and information from DCLG on HRA sales under the Right to Buy programme.

[20] Welsh local authorities are expected to buy themselves out of the HRA subsidy system in early April 2015. The transactions associated with this buyout have not been included in this forecast because, at the stage when we finalised our pre-measures forecast in early March, it was not completely certain yet that the buyout would happen. This does not materially affect our forecast because the transactions would be contained within the public sector and would be neutral for the fiscal aggregates. Assuming the buyout goes ahead, this will involve Welsh local authorities taking £0.9 billion additional loans from the PWLB, which they would pay to central government to buy out their HRA subsidy obligations. The payment would boost capital LASFE by £0.9 billion in 2015-16, which would be offset by £0.9 billion of receipts of capital grants that would be included in other PSGI in AME. Welsh local authorities currently pay £0.1 billion negative subsidies to central government, which reduce public corporations gross operating surplus (PCGOS) in our current receipts forecast, and reduce other PSCE items in AME in our spending forecast. Assuming the buyout goes ahead, these negative subsidies would stop being paid, and PCGOS and TME would both increase by £0.1 billion, with no effect on the current deficit or borrowing.

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Central government debt interest

4.146 Central government debt interest payments (net of the effect of the Bank of England's Asset Purchase Facility (APF) holdings of gilts) are expected to be broadly stable as a share of GDP in 2015-16, but then to increase as interest rates, inflation and the stock of debt rise. But these determinants of the debt interest bill are now expected to rise more gradually than in December, so our forecast is more than £6 billion lower in 2015-16, rising to £9.0 billion lower by 2019-20. This follows large downward revisions in the December forecast itself, also due mainly to changes in determinants. On a comparable basis, our forecast for debt interest payments in 2018-19 has been revised down by £26.3 billion since our March 2014 *EFO*. In order to facilitate understanding of these significant changes, Box 4.4 describes how our forecast is built up from its key components.

4.147 Table 4.32 shows changes in central government debt interest since December. Lower RPI inflation feeds through immediately to accrued debt interest payments, but changes in interest rates take longer to affect debt servicing costs. We have revised down our RPI inflation forecast in each year, reducing debt interest payments by nearly £3 billion in most years, although the amount is larger at £4.2 billion in 2015-16. (Box 3.3 in Chapter 3 explains one source of change to our RPI inflation forecast, where we have revised down our estimate of the steady-state difference between RPI and CPI inflation.) Lower interest rates reduce spending by increasing amounts each year, rising to over £6 billion by 2019-20. These underlying interest rate assumptions are all drawn from financial market prices, as calculated and published by the Bank of England. Other changes, including the extension of pensioner bonds, updating stocks data and taking into account UKAR's latest plans, are small and broadly offsetting over the forecast period.

Table 4.32: Key changes to central government debt interest since December

	£ billion						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	36.1	35.9	40.4	47.3	54.0	57.5	60.1
March forecast	36.1	33.6	33.7	40.4	46.5	49.0	51.1
Change	0.0	-2.3	-6.7	-7.0	-7.5	-8.5	-9.0
of which:							
Interest rates	0.0	-0.3	-2.0	-3.6	-4.4	-5.3	-6.1
of which:							
APF net flows	0.0	0.0	-0.8	-1.5	-1.4	-1.4	-1.6
Other gilt rates	0.0	0.0	-0.5	-1.2	-1.8	-2.3	-2.7
Other short-term rates	0.0	-0.3	-0.7	-0.9	-1.2	-1.6	-1.8
Inflation	0.0	-2.2	-4.2	-2.9	-2.5	-2.7	-2.8
Financing	0.0	0.0	-0.2	-0.5	-0.4	-0.4	-0.3
Other	0.0	0.2	-0.4	-0.1	-0.3	-0.1	0.2
Budget measures	0.0	0.0	0.1	0.1	0.1	0.0	0.0

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Box 4.4: Forecasting debt interest spending

Given the large changes in our recent debt interest forecasts – and the added complexity that debt interest is now expressed net of the effect of gilts held by the Bank of England Asset Purchase Facility (APF) associated with past quantitative easing – this box describes how we produce the debt interest forecast and illustrates some of the sensitivities to which it is subject.

We start with an estimate of the stock of different types of debt on which government must pay some form of debt service. These include:

- conventional gilts (net of the amount held by the APF);
- index-linked gilts;
- the liabilities of the APF; and
- other financing products (such as NS&I).

We forecast changes to these stocks by adding the net cash requirement each year to the total stock of debt, projecting redemptions of gilts and other liabilities, and making assumptions about the composition of gross financing each year to cover the cash deficit and redemptions.

Spending on debt interest is then determined by the effective interest rate paid on the stock of each type of debt. Table D shows the amount of stock outstanding, the debt interest payments and the effective interest rates for different types of debt. There are different drivers of our forecasts for these effective interest rates, most of which are derived from financial market prices:

- debt servicing on conventional gilts is distinguished 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. Payments on new conventional gilts reflect current and future market conditions, as summarised in the weighted average conventional yield curve and the level of new borrowing. The stock of old conventionals declines over the forecast period due to redemptions, whereas the stock of new conventionals rises due to new gross issuance. The effective interest rate on conventional gilts is projected to be broadly flat over the forecast period, reflecting two offsetting factors: refinancing old debt at the lower prevailing rates pushes down debt interest costs; but financing new debt becomes relatively more expensive over time;
- index-linked gilts (ILGs) differ from conventionals in that the coupon payments and principal are adjusted in line with the RPI. The debt interest accrued each month therefore reflects a fixed component – the real interest rate set when gilts are sold – and a variable component – inflation. Most of the payment relates to the inflation component. Indeed real rates are currently projected to be negative over the forecast period, which means the effective rate on new index-linked gilts would continue to be less than the rate of RPI inflation;
- the APF receives coupon income on the gilts it holds and pays Bank Rate on its loan from the Bank of England. (The Bank charges the same rate on the reserves it has created to finance the loan to the APF.) The coupon payments cancel out within the public sector, so this debt is in effect financed at Bank Rate. We assume that gilts held by the APF will not

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be sold actively during the forecast period, and will only be run down through redemptions once Bank Rate begins to rise;

- the government also finances other short-term debt (mainly Treasury bills) and issues savings products through NS&I. We use short-term market interest rates to project forward payments on Treasury bills, and these also inform our forecasts for payments on most NS&I products ('pensioner' bonds are a notable exception); and
- our central government debt interest forecast includes interest payments made by UK Asset Resolution (UKAR) and Network Rail, which are both classified within the central government sector, as well as other smaller payments, such as interest on finance leases.

Table D: Total outstanding stocks, debt interest payments and effective interest rates over the forecast period

	£ billion (stock and debt interest), per cent (interest rates and RPI)				
	2015-16	2016-17	2017-18	2018-19	2019-20
Conventional gilts					
Stock (net of APF holdings)	643	715	779	802	854
Debt interest (net)	19.6	21.7	24.3	25.8	26.8
Effective interest rate	3.1	3.0	3.1	3.2	3.1
Gross effective interest rate	*3.1*	*3.0*	*3.0*	*3.0*	*3.0*
Gross interest rate on existing stock	*3.5*	*3.5*	*3.6*	*3.7*	*3.8*
Gross interest rate on new stock	*1.7*	*1.8*	*2.0*	*2.1*	*2.1*
Index-linked gilts					
Stock	303	331	361	370	393
Debt interest	9.4	13.0	15.7	16.7	17.8
Effective interest rate	3.1	3.9	4.4	4.5	4.5
Real effective interest rate	*2.2*	*1.7*	*1.4*	*1.4*	*1.4*
RPI inflation	*0.9*	*2.2*	*3.0*	*3.2*	*3.1*
NS&I					
Stock	134	136	138	140	142
Debt interest	2.0	2.6	3.1	3.1	3.0
Effective interest rate	1.5	1.9	2.2	2.2	2.1
APF					
Stock	375	349	318	293	258
Debt interest	2.1	3.6	4.6	4.9	4.8
Effective interest rate	0.6	1.0	1.5	1.7	1.9
Short-term debt					
Stock	102	103	103	104	105
Debt interest	0.7	1.2	1.6	1.8	2.0
Effective interest rate	0.7	1.2	1.6	1.8	1.9
Total identified stock	1557	1634	1699	1710	1751
Debt interest	33.1	40.9	47.8	50.5	52.4
Effective interest rate	2.1	2.5	2.8	3.0	3.0

Note: The effective interest rate is calculated as debt interest payments over the year divided by total outstanding stocks at the end of the year.

The large revisions in recent forecasts illustrate the sensitivity of debt interest payments to changes in market interest rates, inflation and borrowing. Alongside each *EFO*, we publish a

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table of debt interest ready reckoners on our website that quantify these sensitivities. Table E contains the ready reckoners consistent with this forecast. It shows that:

- the effect of a persistent increase in conventional gilt rates would only gradually build over time, as higher rates only apply to new debt issuance, and UK conventional gilts have a relatively long average maturity;
- higher short-term rates would quickly lead to higher debt interest costs, through the APF holdings and as short-term debt rolls over;
- an increase in RPI inflation would also have an immediate impact, as it increases accrued payments on both old and new index-linked debt. The table shows the consequences of a succession of shocks to annual inflation, with the higher impact over time mainly reflecting a rising stock of gilts; and
- assuming interest rates were to remain unchanged, an increase in the central government net cash requirement would have a more modest effect over the forecast period.

Table E: Debt interest ready reckoners

	£ billion				
	Forecast				
	2015-16	2016-17	2017-18	2018-19	2019-20
1 per cent increase in gilt rates	0.5	1.6	2.6	3.4	4.2
1 per cent increase in short rate	4.7	4.6	4.4	4.1	3.8
1 per cent increase in inflation	3.6	3.9	4.7	5.2	5.9
£5bn increase in CGNCR	0.0	0.2	0.3	0.4	0.5

Note: all increases are assumed to take effect at the beginning of 2015-16 and continue throughout the forecast.

The structure of the UK's debt and the effect of the APF gilt holdings also have some important implications for our forecast:

- a relatively long average maturity of existing debt means that changes in interest rates only gradually affect our medium-term forecast. More than half of the projected gilts at the end of the forecast period have already been issued (see chart A);
- the assumed skew of future debt issuance also has a bearing on our forecast, as longer-term debt tends to be relatively more expensive to finance, reflecting term premia, and conventional and index-linked gilts attract different rates; and
- the APF currently holds around a quarter of outstanding gilts. As a result, the debt interest forecast is less sensitive to changes in gilt rates than would otherwise be the case, but more sensitive to changes in Bank Rate. An additional uncertainty is also created as to how and when the APF will be run down, as the effective rate will eventually revert back to gilt rates, rather than the typically lower Bank Rate.

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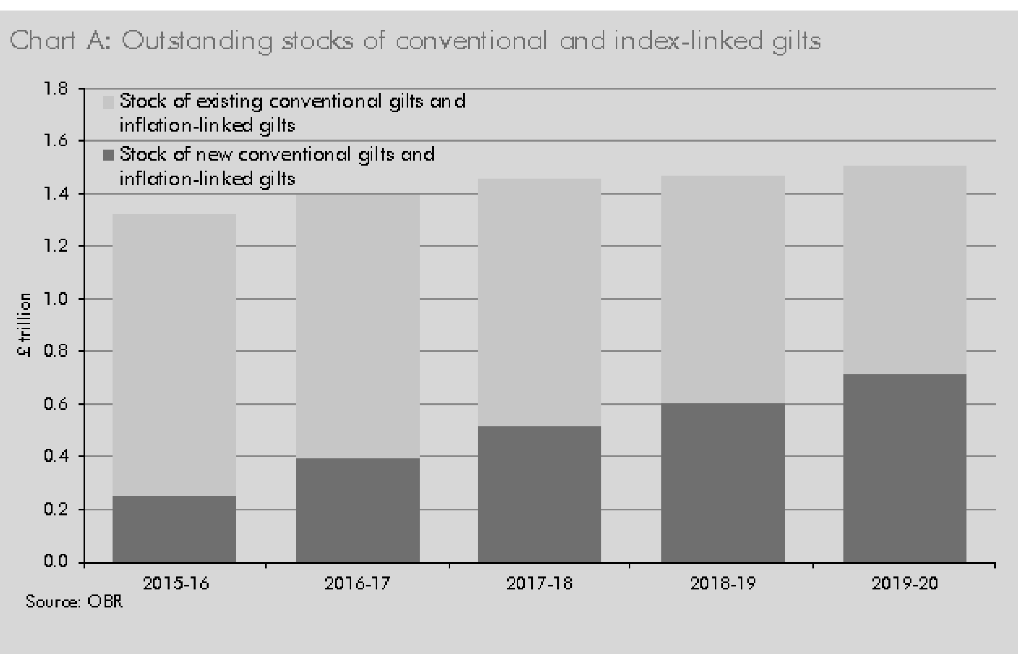

Other AME spending

4.148 Our forecast of **BBC** spending is down for most years. Some expenditure earmarked for 2014-15 has been pushed back into 2015-16, with a new, higher estimate for digital investment costs explaining most of the 2015-16 increase above and beyond that timing adjustment. Thereafter, income is down in line with expected reductions in the number of households who consume live content and thus require a television licence. Spending is assumed to fall in line with this income change.

4.149 Our forecast for PSCE in RDEL includes spending on **research & development (R&D)** which, under the European System of Accounts 2010, is classified in the National Accounts as capital spending. Our forecast for current AME spending therefore includes an accounting adjustment that removes this spending, and our forecast for capital AME spending includes an offsetting entry that includes this spending. Our latest forecast includes revisions to 2014-15 and 2015-16 that reflect the latest information on departments' forecast outturn and plans data that are held on the Treasury's public spending database. We have fed these changes through to the remainder of the forecast period.

4.150 **Other PSCE in departmental AME** is little changed over the forecast period. **Other PSGI items in departmental AME** increase in 2014-15 and 2015-16 are mostly attributable to BBC capital spending, now including assets under construction. The 2014-15 increase is also partly explained by Bradford & Bingley and NRAM plc capital spending. The spending in these categories is detailed in the supplementary tables available on our website.

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4.151 **Environmental levies** include spending on DECC levy-funded policies such as the renewables obligation, feed-in tariffs and warm homes discount. Most are neutral for borrowing as they are directly offset by receipts. The DECC capacity markets scheme discussed in the receipts section has also been included, raising 2018-19 and 2019-20, although this scheme is also neutral for borrowing. The forecasts are explained in the receipts section.

4.152 The AME forecast includes forecasts for the further adjustments that are included in the National Accounts definitions for PSCE and PSGI. Movements in the **National Accounts adjustments** forecasts typically consist of numerous small, offsetting changes. Within the current accounting adjustments, the change in the outturn for 2013-14 reflects movement in residual adjustments, while the change in 2014-15 is largely explained by a reduction in the forecast for local authorities' debt interest payments to the Public Works Loan Board. Our current LASFE forecast covers local authorities' spending on all their debt interest payments, and the payments that are netted off within the public sector are therefore removed as an accounting adjustment. Within the capital accounting adjustments, the changes in the outturn for 2013-14 reflect movement in residual adjustments, and the change over the forecast period reflects our latest forecast for the local authority financial transactions, which we remove because these are not included in PSGI. Further details of accounting adjustment breakdowns are included in the supplementary tables on our website, with the local authority debt interest change also detailed in the local authority current expenditure supplementary table. Explanations and the background to National Accounts adjustments are given in Annex D to PESA 2014.[21]

Loans and other financial transactions

4.153 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.

4.154 The public sector net cash requirement (PSNCR) is the widest measure of the public sector's cash flow position in each year.[22] It drives our 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 NS&I products.

4.155 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;

[21] See HM Treasury, July 2014, *Public Expenditure Statistical Analyses 2014*.
[22] Consistent with the measures of debt and deficit used in this forecast, PSNCR excludes the public sector banks.

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- **transactions in other financial assets:** the public sector may buy or sell financial assets, such as corporate bonds or equities. When it sells an asset for cash the initial transaction does not affect PSNB, whereas the cash received will reduce the PSNCR. But both PSNB and the PSNCR will be higher in future years if the government foregoes an income stream that flowed from the asset sold;
- **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; and
- **other factors:** we separately identify transactions relating to UKAR holdings and Network Rail, as well as including some other adjustments that do not fall into the categories above.

4.156 Net lending to the private sector, in particular for student loans, raises the net cash requirement relative to net borrowing in each year of our forecast. Table 4.33 shows the steps from PSNB to PSNCR and Table 4.34 shows the changes since our December forecast.

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Table 4.33: Reconciliation of PSNB and PSNCR

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Public sector net borrowing	90.2	75.3	39.4	12.8	-5.2	-7.0
Loans and repayments	13.7	16.8	17.2	17.4	16.7	17.0
of which:						
Student loans[1,2]	9.8	11.2	12.2	13.0	13.7	13.9
DfID	0.4	0.2	0.1	0.1	0.1	0.1
Green Investment Bank	0.2	0.4	0.2	0.0	0.0	0.0
British Business Bank	0.2	0.5	0.2	0.3	-0.1	-0.1
Help to Buy equity loans	1.4	1.5	1.3	1.3	1.2	1.1
UK Export Financing	0.0	0.3	0.5	0.5	0.4	0.3
Ireland	0.0	0.0	0.0	0.0	-0.4	0.0
Other	1.8	3.8	2.8	2.2	1.8	1.6
Allowance for shortfall	-0.1	-1.0	0.0	0.0	0.0	0.0
Transactions in financial assets	-2.0	-12.7	-2.8	-2.7	-2.6	-2.4
of which:						
Student loan book	0.0	-2.3	-2.3	-2.3	-2.3	-2.3
Royal Mail pension asset disposal	-1.0	-0.5	-0.5	-0.4	-0.3	-0.1
Lloyd's Banking Group share sales	-1.0	-9.0	0.0	0.0	0.0	0.0
Other	0.0	-0.9	0.0	0.0	0.0	0.0
Accruals adjustments	1.5	4.6	10.2	3.7	-0.6	0.2
of which:						
Student loan interest[1,2]	1.5	2.0	2.5	3.3	4.2	5.0
PAYE income tax and NICs	1.2	0.3	2.2	1.9	2.0	2.4
Indirect taxes	0.6	0.7	0.6	0.8	1.0	1.2
Other receipts	2.8	2.7	2.8	2.8	2.9	2.9
Index-linked gilts[4]	-4.6	-5.7	-0.5	-9.1	-14.3	-14.6
Conventional gilts	2.9	3.7	4.0	5.3	5.0	4.8
Other expenditure	-2.9	1.0	-1.3	-1.4	-1.4	-1.5
Other factors	-18.4	-20.6	-5.1	-3.1	-2.7	-2.4
of which:						
UKAR alignment	-8.0	-15.3	-5.7	-3.7	-3.2	-2.8
Network Rail	0.3	0.4	0.3	0.4	0.2	0.1
Alignment adjustment	-11.0	-6.0	0.0	0.0	0.0	0.0
Public sector net cash requirement	85.0	63.5	59.0	28.1	5.6	5.4

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

Cash spending on new loans	9.8	11.2	12.2	13.0	13.7	13.9
Cash repayments	12.1	13.7	14.8	15.5	16.0	16.5

[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.

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

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Table 4.34: Changes in the reconciliation of PSNB and PSNCR

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Public sector net borrowing	-1.1	-0.7	-1.5	-1.8	-1.2	16.1
Loans and repayments	-1.6	-0.8	-1.7	-2.1	-2.3	-2.6
of which:						
Student loans[1,2]	-0.5	-0.4	-0.8	-1.1	-1.2	-1.5
DfID	-1.5	-1.4	-1.4	-1.4	-1.4	-1.4
Green Investment Bank	-0.1	-0.4	0.2	0.0	0.0	0.0
British Business Bank	-0.1	0.0	0.0	0.3	0.0	0.0
Help to Buy equity loans	0.1	0.2	0.0	0.0	-0.1	-0.1
UK Export Financing	0.0	0.0	0.0	0.0	0.0	0.0
Ireland	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.3	1.3	0.3	0.1	0.3	0.4
Allowance for shortfall	0.2	0.0	0.0	0.0	0.0	0.0
Transactions in financial assets	-1.0	-9.9	0.0	0.0	0.0	0.0
of which:						
Student loan book	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
Lloyd's Banking Group share sales	-1.0	-9.0	0.0	0.0	0.0	0.0
Other	0.0	-0.9	0.0	0.0	0.0	0.0
Accruals adjustments	2.7	3.7	2.2	3.0	3.3	3.5
of which:						
Student loan interest[1,2]	0.0	-0.2	-0.5	-0.6	-0.7	-0.9
PAYE income tax and NICs	0.6	-0.8	0.1	0.1	0.1	0.5
Indirect taxes	-0.1	0.2	0.0	0.1	0.3	0.3
Other receipts	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Index-linked gilts[3]	2.2	3.9	2.4	2.5	3.2	3.0
Conventional gilts	0.2	0.4	0.4	1.0	0.6	0.8
Other expenditure	-0.2	0.3	-0.1	-0.1	-0.1	-0.1
Other factors	-3.9	-5.1	0.9	2.4	1.9	1.7
of which:						
UKAR alignment	-2.9	-5.1	0.9	2.4	1.9	1.7
Network Rail	0.0	0.0	0.0	0.0	0.0	0.0
Alignment adjustment	-1.0	0.0	0.0	0.0	0.0	0.0
Public sector net cash requirement	-5.0	-12.7	0.0	1.6	1.7	18.7

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

Cash spending on new loans	-0.5	-0.4	-0.8	-1.1	-1.2	-1.5
Cash repayments	-0.3	-0.3	-0.7	-1.0	-1.3	-1.5

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

Loans and repayments

4.157 Student loan reforms in recent years have increased the size of the upfront loans, with repayments being made over a longer period. In our 2014 *Fiscal sustainability report (FSR)*,

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we estimated that on current policy settings student loans would increase public sector net debt by a maximum of 9.8 per cent of GDP around the mid-2030s and by less thereafter.

4.158 Student numbers in England were expected to rise this year following the removal of the higher education numbers cap, but have done so by considerably less than expected. The latest data on student numbers and applications indicate a more gradual rise than in the original estimate of the cost of this policy change. We originally assumed that student numbers would rise relatively quickly as excess demand was catered for, but there have only been around 10,000 new entrants this year and applications for next year suggest a similar rise in 2015-16. We therefore assume that student numbers will rise by a further 10,000 in 2016-17, to 375,000, but remain broadly stable thereafter. This would still represent a steadily rising proportion of 18-19 year olds. (The ONS population projections that underpin our forecasts show around a 10 per cent decline in the number of 18 year olds in the population between 2015 and 2020.) The forecast also takes account of new postgraduate loans, the introduction of which was announced in Autumn Statement 2014.

4.159 Other loans include a range of other Government schemes as well as loans to Ireland. As discussed above, the ONS announced in February that it intended to reclassify the UK's subscriptions to multilateral development banks that lend at concessionary interest rates from financial transactions to capital grants. Relative to the December forecast, this increases capital expenditure by around £1.4 billion a year and reduces financial transactions by a corresponding amount.

4.160 In order to inform our forecast, we ask the Government to provide us with an estimate of the planned lending by each institution or scheme. Following downward revisions to lending by many of these other schemes in our December forecast, the changes in this forecast have been relatively small. The most notable is a small upward revision to lending under Help to Buy equity loans. In our December forecast, reflecting the tendency for new schemes to take longer than originally planned to deliver the amounts targeted – and existing schemes lending below their plans – we introduced an allowance for additional shortfalls this year and next. We have made only a small adjustment to these judgements since December. In particular, we have reduced the additional shortfall for 2014-15 to £0.1 billion, but left unchanged our assumption on the additional shortfall of £1 billion for 2015-16.

Transactions in other financial assets

4.161 We only include the impact of financial asset sales or purchases in our forecasts once firm details are available that allow the effects to be quantified with reasonable accuracy and allocated to a specific year.

4.162 At Autumn Statement 2013, the Government announced the intention to sell part of the student loan book, which it expected would raise around £12 billion over five years from 2015-16. This intention was reiterated in Autumn Statement 2014 and has been again in this Budget. The Government has informed us that the sale in 2015-16 remains its firm intention, but that there have been changes in the form of the expected sale relative to that which underpinned our previous forecast assumptions. While the preparations for the sale

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are still at an early stage and significant uncertainties remain, one implication is that it is likely that a larger quantity of loans would need to be sold to meet the Government's £12 billion central estimate for the proceeds from the sale. The Government has confirmed to us that it intends to proceed on that basis. We have therefore kept the £12 billion over five years in our latest forecast, but have revised up the extent to which future repayments and interest paid to the Exchequer will be reduced. Other things equal, these changes reduce repayments by around £¼ billion on top of the almost £1¼ billion by 2019-20 that had already been factored into our forecast.

4.163 The Government has also announced a further £9 billion of sales of its shares in Lloyds Banking Group, which we have assumed will reduce the net cash requirement by that amount in 2015-16. We assume that these sales will be made through a continuation of the trading plan that was announced in December and has so far seen the sale of £1 billion of the Government's stake in Lloyds, and through further institutional placings. In order to estimate the knock-on effect of these sales for our forecast of interest and dividend receipts – which include an estimate of dividends on Lloyds shares – we have assumed that on average the sales will take place at a small discount relative to the current share price, in part to reflect the likely impact on bank share prices of the tax policy measures (raising the bank levy and limiting tax deductibility of compensation payments to customers) announced in this Budget. We have reduced our forecast for dividend receipts by around £½ billion a year from 2016-17 onwards.

4.164 We have also included two smaller transactions in this forecast:

- the proceeds of the sale of the Government's remaining interest in Eurostar for just under £0.8 billion. The cash is expected to be received in early 2015-16;[23] and
- a preliminary estimate of the proceeds of the sale for the 2.3 and 3.4 GHz spectrum that is also expected to take place in 2015-16.[24] At an estimated £0.1 billion, we assume that this sale will be much smaller than the 3G and 4G spectrum sales that took place in 2000-01 and 2012-13. We have estimated the provisional figures in this forecast by taking the centre of the range of reserve prices indicated by OFCOM (between £50 million and £70 million) and raising it by the average ratio of the final proceeds to the reserve price in the 4G auction.

Accruals adjustments

4.165 To move from PSNB to PSNCR, it is also necessary to adjust for the likely impact of timing differences between cash flows and accruals. For example, if receipts are forecast to rise over time, the cash received in any given year will generally be lower than the accrued tax receipts.

[23] See www.gov.uk: *UK Government reaches agreement on the sale of its entire interest in Eurostar for £757.1 million*, 4 March 2015.
[24] See OFCOM: *Public Sector Spectrum Release (PSSR) Award of the 2.3 GHz and 3.4GHz bands*, 23 January 2015.

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4.166 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 lower than in December, reflecting the effects of lower Bank Rate and RPI inflation on the interest rate applied to these loans, and that more loans are sold through the asset sale described above.

4.167 Similar timing adjustments are made for expenditure. The largest is for the timing of payments on index-linked gilts. This is very sensitive to RPI inflation, as well as to the profile of redemptions, which is uneven from year to year. Positive RPI inflation raises the amount government will have to pay on index-linked gilts when they are redeemed. 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, a further downward revision to RPI inflation – including to our assumption of the steady-state difference between RPI and CPI inflation – has reduced accrued debt interest, with a largely 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. For gilts sold at a premium, the cash payments to cover coupons will be larger than the amounts accrued in debt interest. Lower gilt rates since December have increased the projected premia on gilt sales.

Other factors

4.168 The rundown of the Bradford & Bingley and NRAM plc (B&B and NRAM) loan books directly reduces the net cash requirement, a small part of which also reduces net borrowing. The largest change since December is the inclusion of the expected sale of NRAM plc assets, principally the Granite securitisation vehicle, held by UK Asset Resolution (UKAR), announced by the Chancellor in the Budget. We have assumed that this sale raises around £11 billion in 2015-16, reducing the CGNCR by that amount. (This is consistent with a further run-off of around £2 billion in Granite assets before the sale is completed.) There are a number of important uncertainties around the form and timing of this sale. We have assumed that there will be sufficient private sector demand for Granite that the sale will be successful, that UKAR will sell at a price consistent with its book value at the time of the sale, and that the sale will be completed by March 2016. It is possible that UKAR will decide to sell different assets, or that if Granite is sold that the price or timing will be different to our central forecast.

4.169 There will be knock-on effects from foregone mortgage repayments associated with the Granite sale. These reduce interest receipts (affecting both PSNB and the CGNCR) and principal repayments (affecting only the CGNCR). In total, these knock-on effects are assumed to raise the CGNCR by an average of £2 billion, on a declining path, over the forecast period.

4.170 We have also revised financial transactions in 2014-15 to reflect the £2.7 billion 'Project Slate' sale of assets by UKAR in October 2014. The asset sales had been pencilled in for

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2015-16 in previous forecasts, but should have been updated in our December forecast to occur in 2014-15.

4.171 We also include a small amount of financial transactions associated with Network Rail, which are unchanged since December.

4.172 Cash flows are invariably more volatile than the underlying accrued position of the public finances and reconciling borrowing and estimating the net cash requirement has recently proved difficult. The net cash requirement has come in lower than the bottom-up receipts, expenditure and financial transactions forecasts we use to project it would suggest.

4.173 We have again asked the Treasury to supply estimates consistent with its central data on projected departmental outlays and our forecasts for other spending and receipts. These indicate that the cash requirement will be significantly lower this year and somewhat lower next year than our previous approach would suggest. For 2014-15, we have aligned our forecasts to the new methodology, reducing the cash requirement by £11 billion, which is £1 billion more than assumed in December. For 2015-16, we have left our assumption for this gap at £6 billion. Firm spending plans have yet to be set beyond 2015-16, so we cannot do the same for later years.

4.174 We should expect there to be some discrepancy between the accrued and cash borrowing estimates each year – since neither the public sector finance statistics nor our forecasts will capture the size and timing of every government transaction perfectly – but the gap has been both large and persistent in recent years. Its persistence implies incomplete coverage somewhere in the data or forecast, rather than the timing effects that would typically be expected to open up and unwind differences from year to year.

4.175 We have not been able to reconcile these differences fully, which makes our assumptions for 2016-17 onwards subject to greater uncertainty. In the absence of strong evidence to suggest that further adjustments are required at this stage, we have not included any in 2016-17 and beyond. But we will continue to review this part of the forecast.

4.176 ONS efforts to publish greater detail on the reconciliation of accrued and cash borrowing measures may help to resolve some of this issue in time. But for now this remains a significant source of uncertainty in our forecast for the profile of PSND and (as we discuss in Chapter 5) our assessment of the Government's performance against the supplementary debt target when the margin by which debt rises or falls is small.

Central government net cash requirement

4.177 The central government net cash requirement (CGNCR) is important because it is the main determinant of Government's net financing requirement. Table 4.35 shows how CGNCR relates to PSNCR and Table 4.36 sets out the changes in this relationship since December. The CGNCR is derived by adding or removing transactions associated with local authorities and public corporations to the PSNCR. We expect local authorities and public corporations to be net lenders over the forecast period.

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4.178 Including B&B and NRAM plc and Network Rail 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.[25] This has two effects:

- the banks' and Network Rail's own cash requirements are now included in the headline CGNCR. Running down the banks' loan books reduces CGNCR by around £3 billion to £9 billion a year (excluding the Granite sale), but these do not directly affect the Exchequer;
- interactions between the Exchequer and these bodies net off within the headline measure. The banks' loan repayments to the Exchequer vary from around £2 billion to £7 billion a year; and
- the Treasury provides grants to Network Rail and will also finance its new and maturing debt in future, for which Network Rail will pay a fee. Grants are projected to be relatively stable, at just over £4 billion, and refinancing needs are up to £3 billion a year, with fees rising over time.

Table 4.35: Reconciliation of PSNCR and CGNCR

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Public sector net cash requirement (NCR)	85	63	59	28	6	5
of which:						
Local authorities and public corporations NCR	-2	-4	0	-2	-3	-5
Central government (CG) NCR own account	87	67	59	30	9	10
CGNCR own account	87	67	59	30	9	10
Net lending within the public sector	1	2	2	2	2	2
CG net cash requirement	88	69	61	32	11	12
B&B and NRAM adjustment	2	4	5	2	2	2
Network Rail adjustment	6	7	6	5	4	3
CGNCR ex. B&B, NRAM and Network Rail	96	79	72	38	17	17

[25] The Government is publishing a revised 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.

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Table 4.36: Changes in the reconciliation of PSNCR and CGNCR

	£ billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Public sector net cash requirement (NCR)	-5	-13	0	2	2	19
of which:						
Local authorities and public corporations NCR	3	2	2	0	1	0
Central government (CG) NCR own account	-8	-15	-2	1	1	19
CGNCR own account	-8	-15	-2	1	1	19
Net lending within the public sector	0	0	0	0	0	0
CG net cash requirement	-8	-15	-2	1	1	19
B&B and NRAM adjustment	2	-2	0	-1	-1	0
Network Rail adjustment	0	0	0	0	0	0
CGNCR ex. B&B, NRAM and Network Rail	-6	-16	-1	0	0	18

The key fiscal aggregates

4.179 Our central forecast for the key fiscal aggregates incorporates the forecast for receipts, expenditure and financial transactions set out earlier in this chapter. 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 is useful for illustrating the reasons for changes since the previous forecast;

- 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 current budget adjusted to reflect the estimated impact of fluctuations in the economic cycle. It represents an estimate of the underlying or 'structural' 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 used for the Government's supplementary fiscal aim.

Public sector net borrowing

4.180 Public sector net borrowing (PSNB) is forecast to be £90.2 billion in 2014-15, a decline of £7.2 billion on the previous year. Excluding the effects of some forthcoming classification changes that the ONS plans to implement this year, borrowing would be down £8.5 billion

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on a like-for-like basis. Borrowing falls in each year of the forecast, but by varying amounts. In 2016-17 and 2017-18, the falls are particularly large at £35.9 billion and £26.6 billion. The budget moves into a surplus of £5.2 billion in 2018-19, which then widens slightly to £7.0 billion in 2019-20.

4.181 Table 4.37 shows how changes in borrowing between our December and March forecasts can be decomposed into underlying forecast changes, including their interaction with the Government's December spending policy assumptions. It also shows the (relatively small) effects of the Budget measures shown in the Treasury's policy decisions table and the (much larger) effect of the Government's change to its chosen medium-term spending assumption.

4.182 Relative to our December forecast, we have revised PSNB down by £1.3 billion a year on average between 2015-16 and 2018-19. This reflects:

- a downward revision to receipts across the forecast period, with the largest downgrades for North Sea revenues (due to lower oil prices and production), stamp duty receipts (due to lower property transactions), excise duties (due to lower inflation-related uprating) and interest and dividend receipts (due to lower interest rates and the receipts foregone due to the further asset sales announced in the Budget). Public sector gross operating surplus has also been revised down (due to outturn data and an ONS reclassification change that we have anticipated in this forecast). Those downward revisions are partly offset by upward revisions to income tax receipts (due to lower inflation-related uprating and stronger employment growth from migration);

- a downward revision to annually managed expenditure, including sharply lower debt interest costs (due to lower RPI inflation and interest rates) and lower welfare spending (due to lower uprating from 2016-17); and

- a new Government policy assumption that reduces total public spending in each year from 2016-17 to 2018-19. But this reduction is smaller than the downward revision to annually managed expenditure, which means less of a squeeze on implied day-to-day spending on public services and administration than in December.

4.183 The projected budget surplus in 2019-20 is £16.1 billion lower than in our December forecast. The Government now assumes that total spending will grow in line with nominal GDP rather than whole economy inflation in that year. Combined with a lower forecast for annually managed expenditure, that means that implied public services spending in 2019-20 has been revised up by £28.5 billion (1.3 per cent of GDP) since December.

4.184 We have assumed that an increase in government spending on its paybill and procurement of this scale would feed through to nominal GDP growth in 2019-20, though not real GDP growth (which is determined by our judgements on potential output). This pushes up receipts, notably income taxes and VAT on public sector procurement. This turnaround in receipts from previous years appears in Table 4.37 as an 'underlying forecast change', but is in effect driven by the change in the spending policy assumption.

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Table 4.37: Public sector net borrowing

	£billion					
	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	91.3	75.9	40.9	14.5	-4.0	-23.1
March forecast	90.2	75.3	39.4	12.8	-5.2	-7.0
Change	-1.1	-0.7	-1.5	-1.8	-1.2	16.1
Underlying OBR forecast changes						
Total	-1.1	0.1	0.5	0.4	-0.1	-4.6
of which:						
Changes in the receipts forecast	-1.1	3.3	4.9	5.8	4.0	-1.9
of which:						
Inflation	0.1	0.7	0.7	0.4	0.8	1.0
Other oil and gas price effects	-0.1	0.7	0.7	1.0	1.1	1.1
Interest rates	0.0	0.3	0.5	0.6	0.5	0.6
Housing market	0.2	1.5	2.1	1.8	0.9	-0.1
Other	-0.5	1.0	1.8	2.8	1.6	-3.4
Classification changes	-0.8	-0.9	-0.9	-0.9	-0.9	-1.0
Changes in the spending forecast	0.0	-3.3				
Effect of applying Autumn Statement spending policy assumptions post 2015-16			-4.4	-5.4	-4.1	-2.8
of which:						
Inflation	-2.2	-4.2	-4.7	-5.6	-6.5	-6.9
Interest rates	-0.3	-1.2	-2.1	-3.0	-3.9	-4.5
Capital spending[1]	1.0	2.0	2.0	2.0	2.3	2.9
Other spending	-0.3	-1.8	-6.5	-5.0	-5.3	-5.0
Classification changes	2.1	2.2	2.2	2.2	2.3	2.3
RDEL	-0.3	-0.4				
Implied RDEL			4.6	4.0	7.0	8.3
Changes due to Government decisions						
Budget policy measures	0.0	-0.7	0.0	-0.2	0.9	0.6
Effect of applying new Budget spending policy assumptions post 2015-16			-1.9	-1.9	-2.0	20.2

[1]Excluding classification changes

Note: this table uses the convention that a negative figure means an improvement in PSNB.

4.185 Chart 4.9 shows current receipts and total managed expenditure as a share of GDP since 1919-20 using Bank of England and ONS data. The Government's decision to assume that spending rises in line with nominal GDP in 2019-20 means that it no longer falls to its lowest share of national income in a full year since before the war, as was the case in our December forecast. Instead, total spending falls to 36.0 per cent of GDP, which is fractionally higher than the previous post-war lows of 35.8 per cent in 1957-58 and 35.9 per cent in 1999-2000. Current receipts as a share of GDP are forecast to remain at similar levels to those seen over the last few decades.

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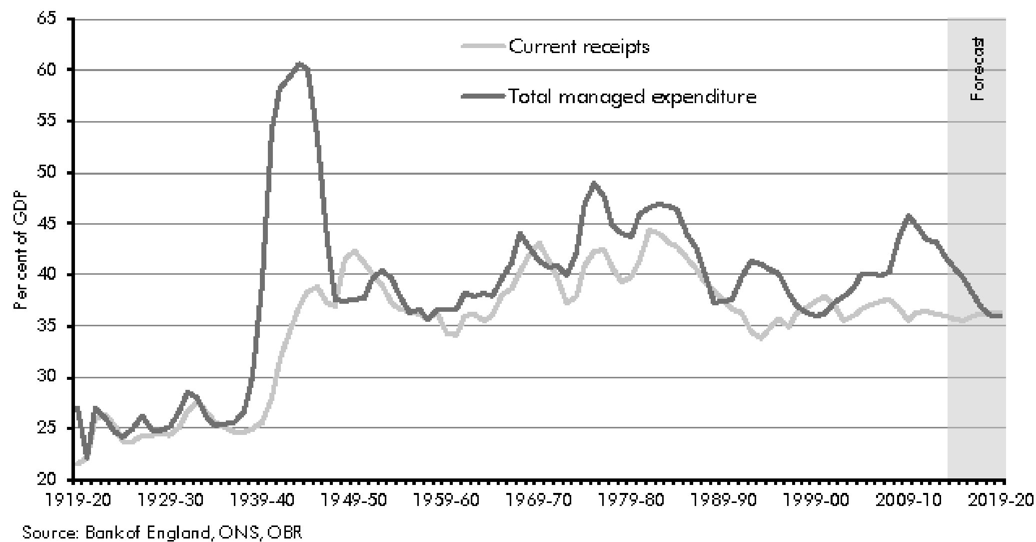
Chart 4.9: Total public sector spending and receipts



Source: Bank of England, ONS, OBR

4.186 Between 2009-10 and 2019-20, the budget balance is forecast to move from a post-war record deficit of 10.2 per cent of GDP to a small surplus of 0.3 per cent – a turnaround of 10.5 per cent of GDP (£190 billion in today's terms). By 2014-15, around half of that planned reduction – 5.2 per cent of GDP (£94 billion) – will have been completed.

4.187 Over the five years of our forecast period up to 2019-20, the main factors contributing (negatively and positively) to the removal of the remaining deficit and the move into budget surplus will include (Chart 4.10):

- relatively small increases in **debt interest** spending (0.4 per cent of GDP) as interest rates are assumed to rise in line with market expectations, which remain well below historical averages by the end of the forecast period;
- small reductions in **capital spending** (0.1 per cent of GDP);
- small reductions in **AME spending other than on debt interest and welfare** (0.3 per cent of GDP);
- a 0.5 per cent of GDP rise in **receipts**. This includes a 0.3 per cent of GDP rise in the tax-to-GDP ratio – the biggest contributors to which are positive fiscal drag in income tax and NICs as sustained productivity and real earnings growth resume and pull more income into higher tax brackets, and the abolition of the NICs contracting out rebate in 2016-17 – and a 0.2 per cent of GDP rise in non-tax revenues, notably interest on the government's stock of financial assets as interest rates rise;

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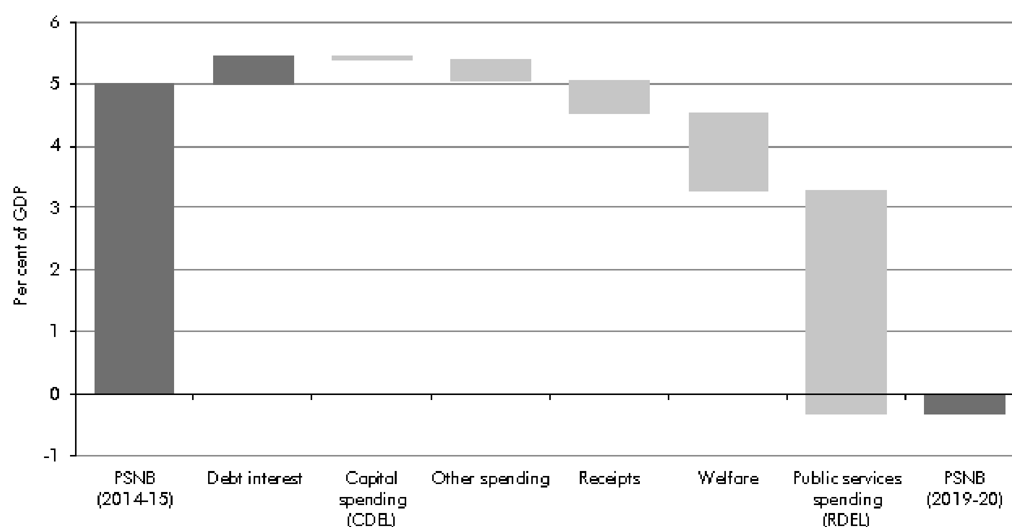
- a 1.3 per cent of GDP fall in **welfare spending**, explained largely by lower spending on working-age benefits, due to inflation uprating and lower caseloads for benefits sensitive to the economic cycle. Spending on state pensions is expected to be broadly flat as a share of GDP due to demographic trends and 'triple lock' uprating; and
- a 3.6 per cent of GDP (or £65 billion in today's terms) cut in **day-to-day spending on public services and administration**, implied by the Government's firm 2015-16 plans, its medium-term assumptions for total spending and our forecast for AME spending. This is 1.2 per cent of GDP smaller than in our December forecast, but still accounts for around 70 per cent of the improvement in the budget balance over the forecast.

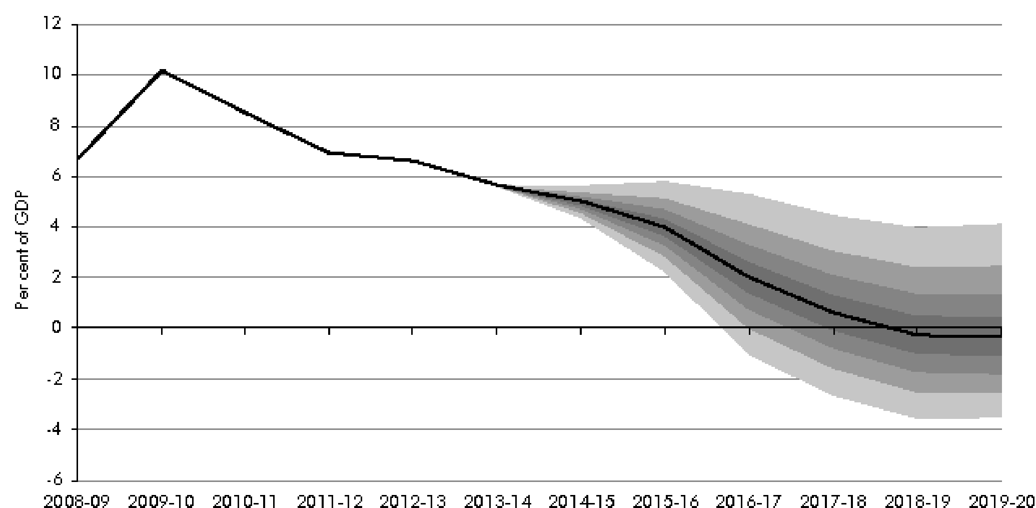
Chart 4.10: Sources of deficit reduction



Source: ONS, OBR

4.188 All fiscal forecasts are subject to significant uncertainty. Chart 4.11 shows our central forecast for PSNB with successive pairs of shaded areas around it. These represent 20 per cent probability bands, based on 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 reach balance rises from 20 per cent in 2016-17, to 40 per cent in 2017-18, and to around 55 per cent in 2018-19 and 2019-20.

Chart 4.11: PSNB fan chart



Source: ONS, OBR

Current budget

4.189 The current budget balance, which excludes borrowing to finance net investment spending, is expected to show a deficit of £59.8 billion in 2014-15, down from a peak of £103.8 billion in 2009-10. The current budget moves into surplus in 2017-18 and reaches a surplus of £35.2 billion in 2018-19 and £38.7 billion in 2019-20. The current budget balance between 2015-16 and 2018-19 has improved since December, as lower spending on debt interest and welfare more than offset the increase in spending on public services and administration implied by the Government's latest spending policy assumption. The surplus in 2019-20 has been revised down by £11.3 billion, with the revision more than explained by the change in the Government's spending assumption for that year.

Cyclically adjusted current budget

4.190 The cyclically adjusted current budget (CACB) moves from a deficit of 2.5 per cent of GDP in 2014-15 to a surplus of 1.7 per cent of GDP in 2019-20, with the balance moving into surplus in 2017-18. The CACB balance has improved by 0.2 per cent of GDP on average between 2014-15 and 2018-19, but the CACB surplus has been revised down by 0.5 per cent in 2019-20. The CACB is discussed further in Chapter 5.

Public sector net debt

4.191 We forecast that public sector net debt (PSND) will rise as a share of GDP this year, but start to fall from 2015-16 and at an increasingly rapid rate to 71.6 per cent of GDP in 2019-20. Net debt is lower that we forecast in December from 2015-16 onwards, and falls a year earlier than we expected then. Table 4.38 shows that:

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- downward revisions to the level of nominal GDP in 2014-15 have increased debt as a share of GDP. That feeds through to the rest of the forecast period, but higher nominal GDP growth later in our forecast unwinds the effect;

- our borrowing forecast – both underlying changes and the effect of Government decisions – have relatively small effects of the level of net debt. The exception is in 2019-20, where the change in the Government's spending policy assumption has increased spending and borrowing relative to our December forecast, reducing the extent to which debt falls as a share of GDP in that year. Indeed, net debt now continues to rise in *cash* terms in 2019-20 (by £9½ billion), rather than falling modestly as in our December forecast (by £4 billion);

- the Government announcement of two significant asset sales related to the mortgage assets of NRAM plc managed by UK Asset Resolution (UKAR) and its shareholding in Lloyds Banking Group have the largest effect on the debt-to-GDP ratio. Together, they are expected to reduce net debt by £20 billion in 2015-16. That means that debt falls as a share of GDP a year earlier than would otherwise have been the case. The bulk of these sales are expected to take place late in the fiscal year. Financial asset sales bring forward cash that would otherwise have been received in future in the shape of mortgage repayments and dividends (around £10 billion over the remainder of the forecast period as a result of the UKAR and Lloyds sales), so they only temporarily reduce the debt-to-GDP ratio;

- UKAR also ran down its assets more quickly in 2014-15 than we had factored into our December forecast. Much of this reflects the sale of an asset that we had assumed would be sold in 2015-16;

- changes in the premia associated with the Debt Management Office issuing gilts at prices above their nominal value have reduced our forecast for net debt slightly further. These premia are particularly associated with index-linked gilts, due to the negative real yield curve that persists over through the forecast period; and

- other factors reduce net debt further. Downward revisions to student numbers have reduced our forecast of lending on student loans by increasing amounts over time. But most of the 'other factors' line of Table 4.38 relates to the reclassification of subscriptions to multilateral development banks. This has a neutral effect on net debt, as it increases borrowing but reduces net lending by around £1.4 billion a year.

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Table 4.38: Changes to public sector net debt since December

	Per cent of GDP						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	78.8	80.4	81.1	80.7	78.8	76.2	72.8
March forecast	79.1	80.4	80.2	79.8	77.8	74.8	71.6
Change	0.3	0.0	-0.9	-0.9	-1.0	-1.4	-1.2
of which:							
Change in nominal GDP[1]	0.3	0.6	0.4	0.6	0.6	0.2	-0.3
Change in cash level of net debt	0.0	-0.5	-1.3	-1.5	-1.6	-1.6	-0.9
	£ billion						
December forecast	1402	1489	1558	1610	1638	1652	1648
March forecast	1402	1479	1533	1580	1606	1617	1627
Change in cash level of net debt	0	-10	-25	-30	-32	-34	-21
of which:							
Borrowing changes	*0*	-1	-2	-3	-5	-6	10
UK Asset Resolution	*0*	-3	-8	-7	-5	-3	-1
Lloyds Banking Group share sales	0	-1	-10	-10	-10	-10	-10
Gilt premia	0	-2	0	-2	-3	-3	-5
Other factors	0	-3	-5	-7	-9	-12	-15

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

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Table 4.39: Fiscal aggregates

	Per cent of GDP						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Receipts and expenditure							
Public sector current receipts (a)	36.1	35.8	35.5	36.1	36.2	36.2	36.3
Total managed expenditure (b)	41.7	40.7	39.6	38.1	36.8	36.0	36.0
of which:							
Public sector current expenditure (c)	38.1	37.0	35.9	34.5	33.3	32.5	32.5
Public sector net investment (d)	1.5	1.7	1.6	1.5	1.4	1.4	1.4
Depreciation (e)	2.0	2.1	2.1	2.1	2.1	2.1	2.1
Deficit							
Public sector net borrowing (b-a)	5.6	5.0	4.0	2.0	0.6	-0.2	-0.3
Current budget deficit (c+e-a)	4.1	3.3	2.4	0.5	-0.8	-1.7	-1.7
Cyclically-adjusted net borrowing	4.1	4.2	3.7	1.9	0.6	-0.3	-0.3
Primary balance	-3.8	-3.4	-2.5	-0.3	1.3	2.1	2.1
Cyclically-adjusted primary balance	-2.3	-2.7	-2.2	-0.1	1.3	2.1	2.1
Fiscal mandate and supplementary target							
Cyclically-adjusted deficit on current budget	2.6	2.5	2.1	0.4	-0.8	-1.7	-1.7
Public sector net debt[1]	79.1	80.4	80.2	79.8	77.8	74.8	71.6
Financing							
Central government net cash requirement	4.5	4.9	3.7	3.1	1.6	0.5	0.5
Public sector net cash requirement	3.7	4.7	3.4	3.0	1.4	0.3	0.2
Stability and Growth Pact							
Treaty deficit[2]	5.8	5.2	4.3	2.2	0.8	0.0	-0.1
Cyclically-adjusted Treaty deficit	4.2	4.4	4.0	2.0	0.8	0.0	-0.1
Treaty debt ratio[3]	87.9	88.4	89.7	89.7	88.2	85.7	82.8
	£ billion						
Public sector net borrowing	97.3	90.2	75.3	39.4	12.8	-5.2	-7.0
Current budget deficit	71.6	59.8	45.7	10.2	-15.8	-35.2	-38.7
Cyclically-adjusted net borrowing	70.4	76.2	68.8	36.3	11.8	-5.4	-7.0
Cyclically-adjusted deficit on current budget	44.6	45.8	39.3	7.1	-16.8	-35.3	-38.8
Public sector net debt	1402	1479	1533	1580	1606	1617	1627
Memo: Output gap (per cent of GDP)	*-2.0*	*-0.8*	*-0.4*	*-0.2*	*0.0*	*0.0*	*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.

Risks and uncertainties

4.192 As always, we emphasise the uncertainties that lie around our central fiscal forecast. We expose our judgements to different sensitivities and scenarios in Chapter 5. While there are some risks and uncertainties common to all forecasts, in this *EFO* we have highlighted:

- global and domestic risks associated with the economy (paragraph 3.111);
- prospects for North Sea revenue related to policy changes announced in the Budget and oil prices, and their effects on production and capital expenditure in the industry (paragraphs 4.58 to 4.68);

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- policy related uncertainties, including the path of public spending associated with the Government's medium-term spending assumption (paragraphs 4.102 to 4.108) and the indexation of excise duties (Box 4.3);
- the significant uncertainties associated with forecasting the UK's payments to EU institutions (paragraphs 4.133 to 4.136);
- uncertainties surrounding the scale and timing of three large asset sales planned to take place (or begin) in 2015-16: the pre-Browne student loan book, an NRAM mortgage securitisation vehicle and the Government's shareholding in Lloyds Banking Group (paragraphs 4.161 to 4.164); and
- a number of policy costings that have been incorporated into our forecast (Annex A).

International comparisons

4.193 International organisations, such as the European Commission and the 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 4.40 and 4.41 present our UK forecasts on a comparable basis. With both modelling and reporting of much tax and expenditure done primarily on a financial year basis, the calendar year forecasts are illustrative and have been derived by weighting the financial year forecasts.

Table 4.40: Comparison with European Commission forecasts

	Per cent of GDP					
	Treaty Deficit[1]			Treaty Debt[2]		
	2014	2015	2016	2014	2015	2016
UK (March EFO)	5.6	4.5	2.7	89.6	89.3	89.7
UK (EC)	5.4	4.6	3.6	88.7	90.1	91.0
Germany	-0.4	-0.2	-0.2	74.2	71.9	68.9
France	4.3	4.1	4.1	95.3	97.1	98.2
Italy	3.0	2.6	2.0	131.9	133.0	131.9
Spain	5.6	4.5	3.7	98.3	101.5	102.5
Euro area	2.6	2.2	1.9	94.3	94.4	93.2

[1] General government net borrowing.
[2] General government gross debt.
Source: European Commission, European Economic Winter 2015; OBR

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Table 4.41: Comparison with IMF forecasts

	Per cent of GDP					
	General government net borrowing			General government net debt		
	2014	2015	2019	2014	2015	2019
UK (March EFO)	5.6	4.5	-0.1	81.7	81.1	75.4
UK (IMF)	5.3	4.1	0.2	83.9	85.0	76.8
Germany	-0.3	-0.2	-0.4	53.9	51.6	42.0
France	4.4	4.3	1.0	88.1	90.6	88.8
Italy	3.0	2.3	0.4	114.3	114.0	105.0
Japan	7.1	5.8	4.7	137.8	140.0	140.7
U.S	5.5	4.3	4.0	80.8	80.9	80.8

Source: OBR, IMF, World Economic Outlook, October 2014

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Box 4.5: Deficit reduction – international comparisons

The UK budget deficit increased to a post-war high after the financial crisis and recession of the late 2000s. This box uses the European Commission's recent *Winter economic forecast* to compare the main sources of deficit reduction in the UK and a selection of other major advanced economies on common definitions.

In the UK, general government net borrowing almost quadrupled from 2007 to reach a post-war high of 10.8 per cent of GDP in 2009, the drivers of which we discussed in *Working Paper No.7: Crisis and consolidation in the public finances*. Since then, borrowing on this measure has fallen by 5.3 per cent of GDP, due entirely to expenditure falling as a share of GDP. Despite real GDP growth, a narrowing output gap, very strong employment growth and net tax-raising policy measures, government revenues have been broadly flat as a share of GDP.

Chart B shows how changes in spending and revenue have contributed to falls in general government net borrowing as a share of GDP between 2009 and 2014 in six major economies:

- in the US, borrowing peaked at almost 13 per cent of GDP in 2009, the largest deficit in the G7. Lower spending and strong growth in revenues have contributed in broadly equal terms to reducing borrowing to around 5 per cent of GDP in 2014;
- borrowing in Japan has only declined slightly over this period. It remains at around 8 to 9 per cent of GDP, largely because spending has grown faster than national income – in part driven by a rapidly ageing population. Revenue growth has more than offset that rise in spending, including through an increase in the headline VAT rate to 8 per cent;
- France has also seen spending rise as a share of GDP, but overall borrowing has fallen – and has remained lower than in the UK, US and Japan – as revenues have risen by 4 per cent of GDP in the five years to 2014;
- in Italy, government borrowing was lower than in most other G7 countries in 2009, at just over 5 per cent of GDP, although net general government debt was over 100 per cent of GDP. Since 2009, borrowing has fallen by just over 2 per cent of GDP, reflecting both lower spending and higher revenues; and
- borrowing in Germany was the lowest in the G7 in 2009, at just 3 per cent of GDP. It increased to around 4 per cent in 2010, reflecting lower revenues, but then fell close to balance in 2012. In 2014, Germany was the only G7 country estimated to have run a budget surplus, at around half a per cent of GDP. Lower spending explains the majority of the move from deficit to surplus over the past five years.

So the UK began the period with the second highest deficit (after the US) and ended with the second highest (after Japan), despite the second largest fall among these countries. The contribution of lower spending to that fall was the largest among these countries. The UK was the only country where the deficit has not been reduced by having revenue growing faster than national income. That revenue weakness has come despite employment growth in the UK over the past five years having been the fastest among these countries. It largely reflects weakness in income taxes, due to policy measures and disappointing productivity and earnings growth.

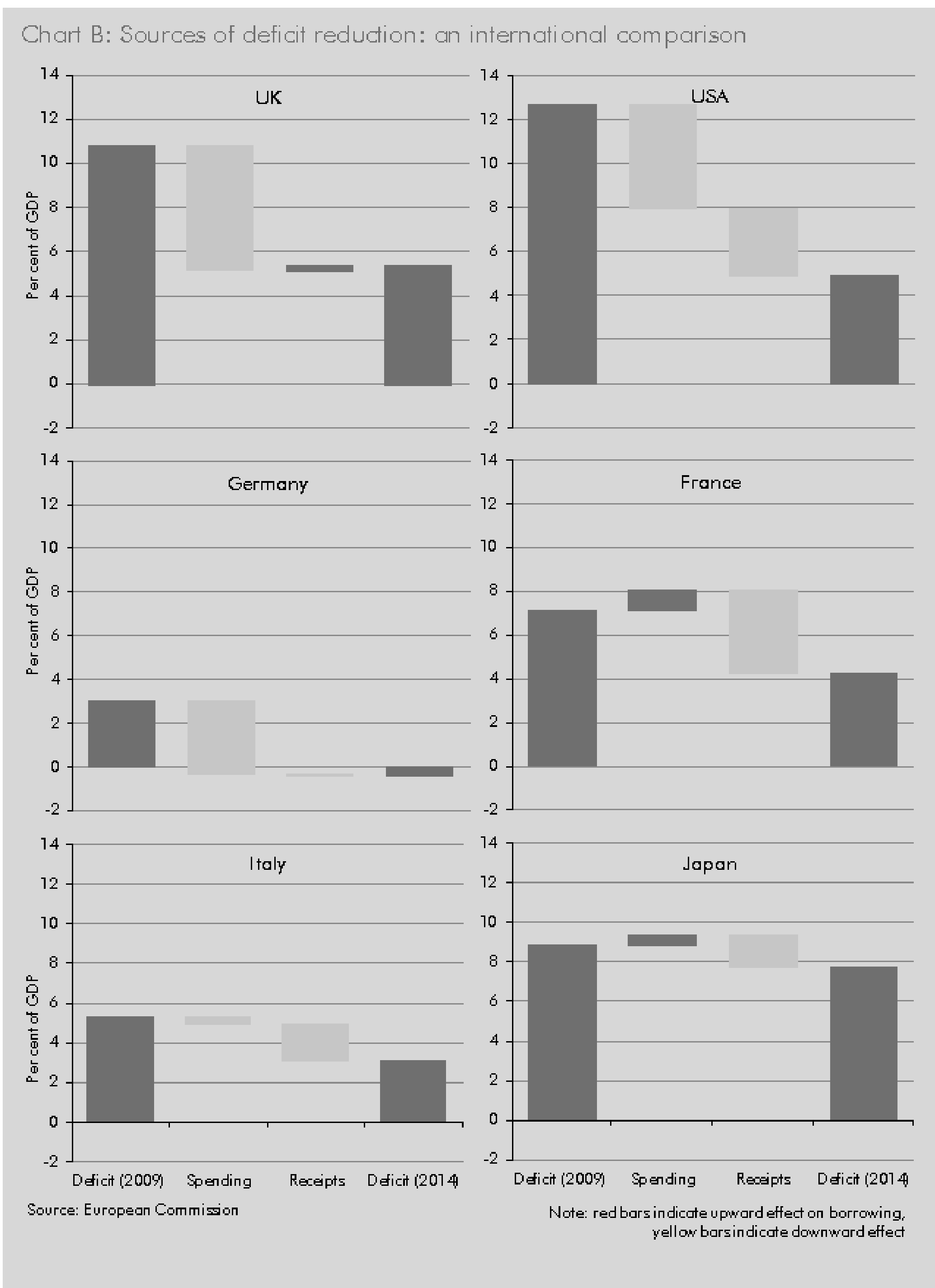
Chart B: Sources of deficit reduction: an international comparison
UK
USA
Germany
France
Italy
Japan
Per cent of GDP
14
12
10
8
6
4
2
0
-2
Deficit (2009)
Spending
Receipts
Deficit (2014)
Source: European Commission
Note: red bars indicate upward effect on borrowing, yellow bars indicate downward effect

Economic and fiscal outlook

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5 Performance against the Government's fiscal targets

Introduction

5.1 This chapter:

- sets out the Government's updated 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 5.5); and
- assesses how robust these judgements are 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 5.20).

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. In March 2014, the Government updated the *Charter for Budget Responsibility* to include details of how a new 'welfare cap' – set in Budget 2014 – would operate. In December 2014, the Government updated the *Charter* again to set a new fiscal mandate and a new supplementary target for debt-to-GDP.[1]

5.3 The Government fiscal targets assessed in this chapter are:

- *"a forward-looking aim to achieve cyclically adjusted current balance by the end of the third year of the rolling, 5-year forecast period"*.[2] (For the purposes of this forecast, the third year of the forecast period is 2017-18.) The previous target had been to achieve balance in the final year of the forecast period, which would have been 2019-20 in this forecast;
- *"an aim for public sector net debt as a percentage of GDP to be falling in 2016-17"*. The previous target had been for debt as a share of GDP to fall at a fixed date of 2015-16; and

[1] See Charter for *Budget Responsibility: Autumn Statement 2014 update*, which is available on our website.
[2] In its inquiry on Autumn Statement 2014, the Treasury Select Committee questioned the Chancellor about the change of wording from *"target"* to *"aim"* in the new Charter. In its report on that inquiry, the Committee noted that *"the Chancellor argued that* 'I do not think there is a substantive difference'".

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- *"the cap on welfare spending, at a level set out by the Treasury in the most recently published Budget report, over the rolling 5-year forecast period, to ensure that expenditure on welfare is contained within a predetermined ceiling".*

5.4 The welfare cap was formally defined and initially set by the Government in Budget 2014. The cap was set for the period from 2015-16 to 2018-19 in line with our March 2014 forecast. It was extended to 2019-20 in Autumn Statement 2014, in line with our December 2014 forecast for that year. The Government has set a 2 per cent margin above the cap that can be used to accommodate forecast changes, but not the impact of policy changes. The OBR has been tasked with assessing the Government's performance against the cap once a year alongside the Autumn Statement. In this *Economic and fiscal outlook*, we therefore provide an update on performance against the cap without formally assessing whether the Government is meeting its welfare cap commitment.

The implications of our central forecast

5.5 Table 5.1 shows our central forecasts for the cyclically adjusted current budget deficit (CACB), public sector net debt (PSND), and the welfare cap, as described in detail in Chapter 4. These are median forecasts, so we believe it is equally likely that 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					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Cyclically adjusted current budget deficit							
December forecast	2.6	2.7	2.2	0.5	-0.7	-1.5	-2.3
March forecast	2.6	2.5	2.1	0.4	-0.8	-1.7	-1.7
Public sector net debt							
December forecast	78.8	80.4	81.1	80.7	78.8	76.2	72.8
March forecast	79.1	80.4	80.2	79.8	77.8	74.8	71.6
	£ billion						
Spending within the welfare cap							
December forecast	113.5	119.6	120.7	122.4	124.0	126.8	129.8
March forecast	116.1	119.4	120.6	121.0	121.8	124.0	126.5

Fiscal mandate

5.6 Table 5.1 shows that our central forecast is for the CACB to be in surplus by 0.8 per cent of GDP in 2017-18. This means that there is a greater than 50 per cent chance of the Government achieving its new fiscal mandate. The surplus rises to 1.7 per cent of GDP by 2019-20. This means that the previous fiscal mandate would still have been met by a significant margin, although by less than in our December forecast.

5.7 We estimate that the output gap was just -0.7 per cent of GDP at the end of 2014 and that it will narrow slowly over the next few years, closing in late 2017. The path of the structural deficit therefore closely matches changes in the headline deficit.

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5.8 The CACB moves from a deficit of 2.5 per cent of GDP in 2014-15 to a surplus of 0.8 per cent of GDP in the new mandate year of 2017-18. Chart 5.1 uses cyclical-adjustment coefficients for particular types of receipts and spending[3] to show how this comes about:

- the CACB is expected to improve by 3.4 per cent of GDP between 2014-15 and 2017-18, with lower spending contributing 3.2 per cent and higher receipts 0.2 per cent;
- in 2015-16, the final year for which the Government has set detailed departmental spending plans, the CACB falls by 0.4 per cent of GDP (£8 billion). Cuts in spending more than account for that change (down by 0.8 per cent of GDP or £15 billion), with a fall in receipts – notably from the North Sea and fuel and excise duties – pushing up the structural deficit by around £7 billion. Within spending, the largest contribution to the change is a structural reduction in departmental spending (£10¾ billion);
- based on the Government's policy assumption on spending, which implies a path for departmental spending once the rest of our forecast is taken into account, the CACB falls by 1.7 per cent of GDP (£33½ billion) in 2016-17, more than twice the figure in the previous year. Again, by far the largest contribution is the 1.3 per cent of GDP implied cut in spending on day-to-day public services and administration (£25 billion). Other important contributions include the structural rise in receipts from income tax (£5½ billion) and NICs (£6¾ billion). The latter is largely explained by the abolition of the NICs contracting out rebate in 2016-17. Around two thirds of the £5 billion of additional receipts from that measure is expected to come from public sector employers, adding to the pressure on implied departmental budgets; and
- in 2017-18, the CACB again falls significantly, by 1.2 per cent of GDP (£24 billion). Once again, by far the largest contribution to that change is the cut in public services spending implied by the Government's spending assumption (£24 billion). Receipts are broadly stable as a share of GDP, as an additional year of fiscal drag boosting personal taxes and the effects of further asset price rises on capital taxes are offset by small declines in a number of other receipts.

[3] Further details can be found in Helgadottir *et al* (2012), *Working Paper No.4: Cyclically adjusting the public finances.*

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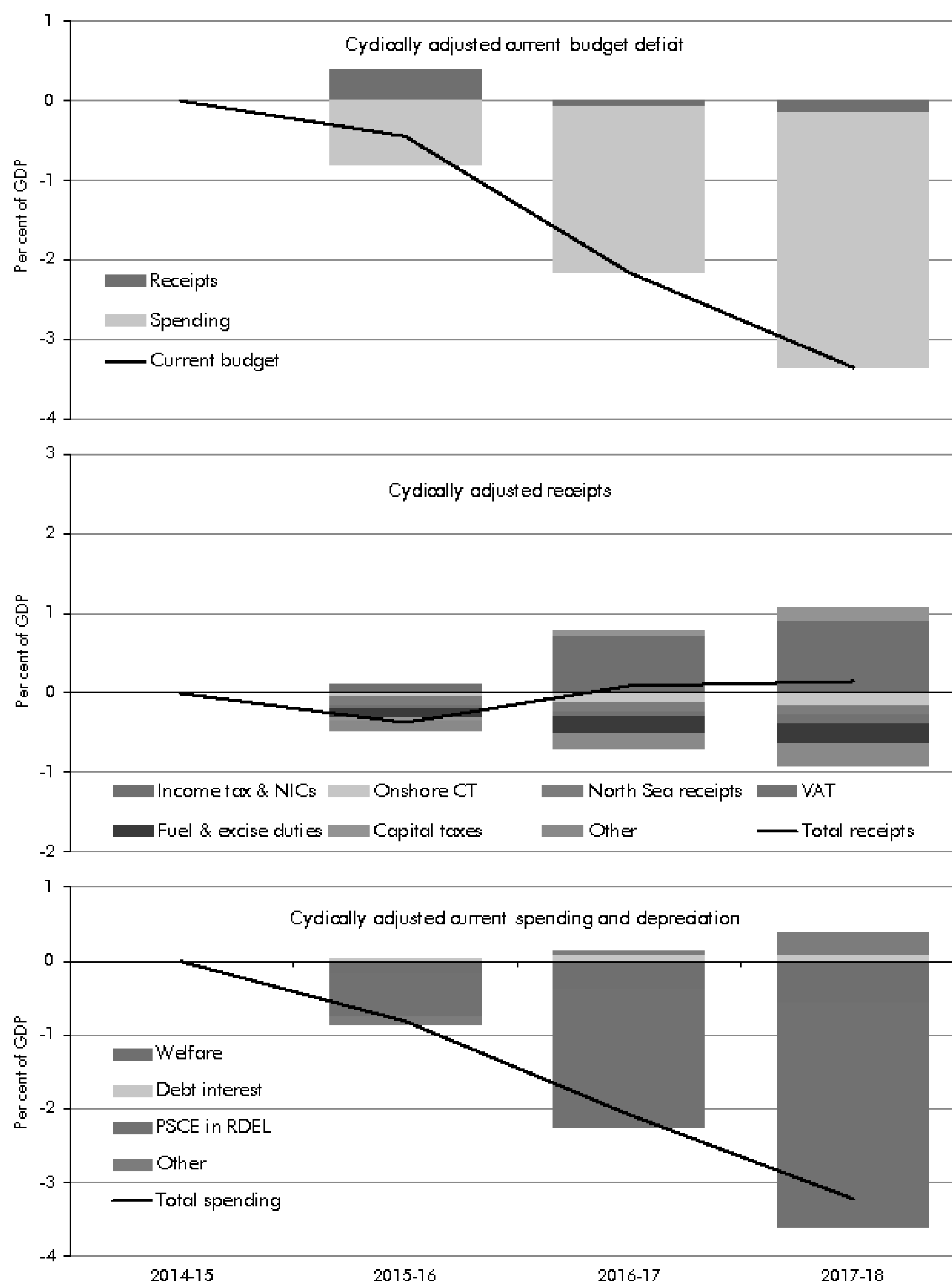
Chart 5.1: Year-on-year changes to the cyclically adjusted current budget from 2014-15 to 2017-18



Source: OBR

5.9 Table 5.2 decomposes the changes in our forecast of the CACB since December. On the basis of the new fiscal mandate year of 2017-18, it shows that:

- we expect a slightly larger surplus on the CACB in 2017-18 than in December;
- cyclically adjusted receipts were stronger than expected in 2014-15, reflecting a number of relatively small in-year changes to our forecast. But that improvement does not persist – in later years our structural receipts forecast is unchanged;
- debt interest and welfare spending have been revised down significantly since December, due in large part to lower inflation and interest rates. That is reflected as a structural reduction in spending. But part of that reduction is offset by higher departmental spending, as the Government's chosen spending assumption means that some of the lower debt interest and welfare spending eases the squeeze on implied departmental budgets rather than improving the CACB; and
- Budget measures appearing in the Treasury's policy decisions table are broadly neutral in 2017-18.

5.10 For the previous target year of 2019-20, Table 5.2 shows that we have revised our forecast of the CACB surplus down by 0.5 per cent of GDP to 1.7 per cent. While lower debt interest and welfare spending continue to reduce structural spending relative to our December forecast, the Government's decision to change its spending assumption for 2019-20 – so that total spending grows in line with nominal GDP rather than remaining flat in real terms – raises spending relative to December. That additional 0.9 per cent of GDP increase in implied day-to-day spending on public services and administration (over and above the additional 0.4 per cent of GDP implied by applying the previous spending assumption to our latest forecast) means that the surplus on the CACB is now expected to be flat as a share of GDP.

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

	Per cent of GDP						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	2.6	2.7	2.2	0.5	-0.7	-1.5	-2.3
March forecast	2.6	2.5	2.1	0.4	-0.8	-1.7	-1.7
Change	0.0	-0.2	-0.1	-0.1	-0.2	-0.2	0.5
of which:							
Budget measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other receipts	0.0	-0.3	0.0	0.1	0.0	0.0	0.0
Other non-deparmental spending	0.0	0.0	-0.2	-0.5	-0.4	-0.6	-0.7
Other departmental spending	0.0	0.1	0.1	0.3	0.2	0.3	1.3
of which:							
Before new spending assumption	0.0	0.1	0.1	0.4	0.3	0.4	0.4
Baseline spending assumption	0.0	0.0	0.0	-0.1	-0.1	-0.1	0.9

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Supplementary target

5.11 The new supplementary target requires public sector net debt (PSND) to fall as a share of GDP between 2015-16 and 2016-17, with that year fixed. As in December, we expect that PSND will fall as a share of GDP in that year, so that the Government is on course to meet its supplementary target. But just three months after having dropped it as the supplementary target, we now believe that the Government is back on course to have debt falling as a share of GDP in 2015-16, thanks in large part to its plans to sell more financial assets. The bulk of these sales are expected to take place late in the fiscal year.

5.12 Chart 5.2 decomposes year-on-year changes in the debt-to-GDP ratio over the forecast period. It shows that:

- the Government's announcement of two large asset sales – £11billion of assets of NRAM plc held by UK Asset Resolution (UKAR) and a further £9 billion of its shareholding in Lloyds Banking Group – are key factors explaining the year-on-year drop in the debt-to-GDP ratio in 2015-16. These are explained further below;
- changes in the year-on-year profile of the debt-to-GDP ratio typically reflect changes in the primary balance (the difference between non-interest receipts and spending). But the debt-to-GDP ratio falls in both 2015-16 and 2016-17 despite the primary balance being in deficit by 2.5 per cent of GDP and 0.3 per cent of GDP in those years;
- the fact that nominal GDP growth exceeds expected interest rates would, all else equal, be sufficient for debt to fall by over 1 per cent of GDP in every year, and by 1.8 per cent of GDP in 2019-20. This differential is an extremely important component of public sector debt dynamics, especially over longer timeframes. In our annual *Fiscal sustainability reports*, we analyse the impact of different assumptions on our results;
- net lending to the private sector – mainly student loans – increases net debt in every year (but, as a financial transaction, it does not directly affect measures of the deficit);
- issuing debt at a premium to its nominal value reduces net debt over the forecast period. But this is ultimately only temporary and will unwind over the long term; and
- other changes, mainly the Asset Purchase Facility and timing effects, are relatively small. Accrued receipts exceed cash receipts over the medium term, partly because some receipts are collected with a lag (including interest on student loans, where the lag can be many years).

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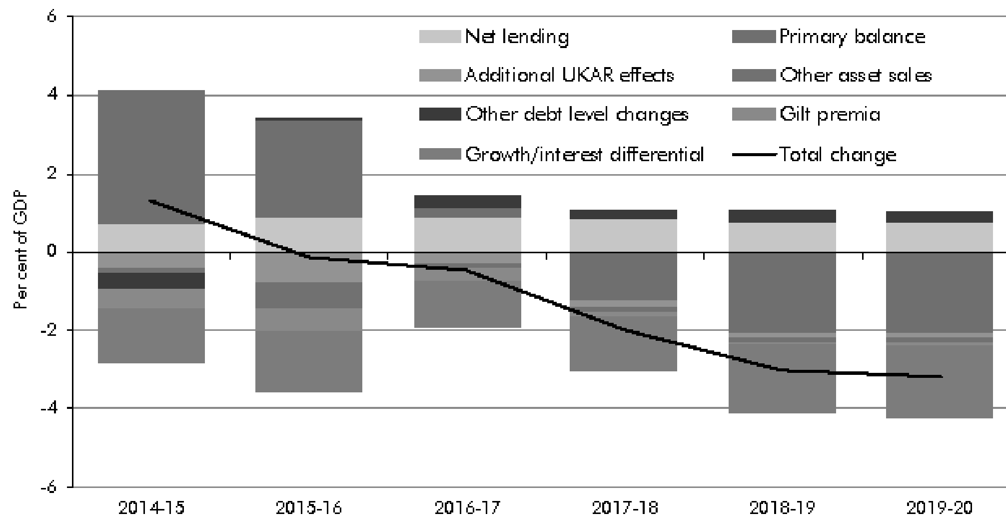
Chart 5.2: Year-on-year changes to the debt-to-GDP ratio



Source: OBR

5.13 Relative to our December forecast, we now expect PSND to rise more gradually this year and to start falling a year earlier in 2015-16. Table 5.3 decomposes changes in the profile of net debt as a share of GDP since December. It shows that:

- changes in the profile of nominal GDP growth have added or subtracted small amounts to year-on-year changes in the debt-to-GDP ratio across the forecast period, slightly reducing the ratio in 2015-16 relative to 2014-15, but slightly raising it in 2016-17 relative to 2015-16. This reflects the profile of revisions to our real GDP forecast. Stronger nominal GDP growth also reduces the ratio in the final two years of the forecast period;

- Budget policy measures that affect net borrowing – and other underlying changes to our borrowing forecast – have small effects on the profile of net debt. The exception is in 2019-20, where the Government's change to its spending policy assumption has increased spending and borrowing relative to our December forecast, reducing the extent to which debt falls as a share of GDP in that year. Indeed, net debt now continues to rise in cash terms in 2019-20 (by £9½ billion), rather than falling modestly as in our December forecast (by £4 billion);

- by far the most significant changes to the profile of net debt relate to 2015-16, where the Government has announced two significant asset sales of £11 billion of NRAM plc assets held by UKAR and a further £9 billion of its shareholding in Lloyds Banking Group. Together, they are expected to reduce net debt by £20 billion in 2015-16. That means that debt falls as a share of GDP a year earlier than would otherwise have been the case. The bulk of these sales are expected to take place late in the fiscal year. Financial asset sales bring forward cash that would otherwise have been received in

future in the shape of mortgage repayments and dividends (around £10 billion over the remainder of the forecast period as a result of the UKAR and Lloyds sales), so they only temporarily reduce the debt-to-GDP ratio. In broad terms, they leave the public sector's net worth unchanged;

- UKAR also ran down its assets more quickly in 2014-15 than we had factored into our December forecast. Because that simply brought the effect on debt forward by a year, it reduces the change in the debt-to-GDP ratio by 0.2 per cent of GDP in 2014-15 and increases it by the same margin in 2015-16;

- changes in the premia associated with the Debt Management Office issuing gilts at prices above their nominal value lead to small changes in the year-on-year profile of net debt. These premia are particularly associated with index-linked gilts, due to the negative real yield curve that persists throughout the forecast period; and

- other changes are relatively small. The reclassification of subscriptions to multilateral development banks reduces net lending in each year, but has a neutral effect on net debt as it increases net borrowing instead.

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

	Change on a year earlier (per cent of GDP)					
		Forecast				
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December forecast	1.6	0.8	-0.5	-1.9	-2.6	-3.3
March forecast	1.3	-0.2	-0.5	-2.0	-3.0	-3.2
Change	-0.2	-0.9	0.0	-0.1	-0.4	0.1
of which:						
Nominal GDP[1]	0.3	-0.1	0.2	0.0	-0.4	-0.5
Net borrowing changes	-0.1	0.0	-0.1	-0.1	0.0	0.7
Other UKAR effects	-0.2	-0.3	0.1	0.1	0.1	0.1
Lloyds Banking Group share sales	-0.1	-0.5	0.0	0.0	0.0	0.0
Gilt premia	-0.1	0.1	-0.1	0.0	0.0	-0.1
Other factors	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1

[1]GDP is centred end-March

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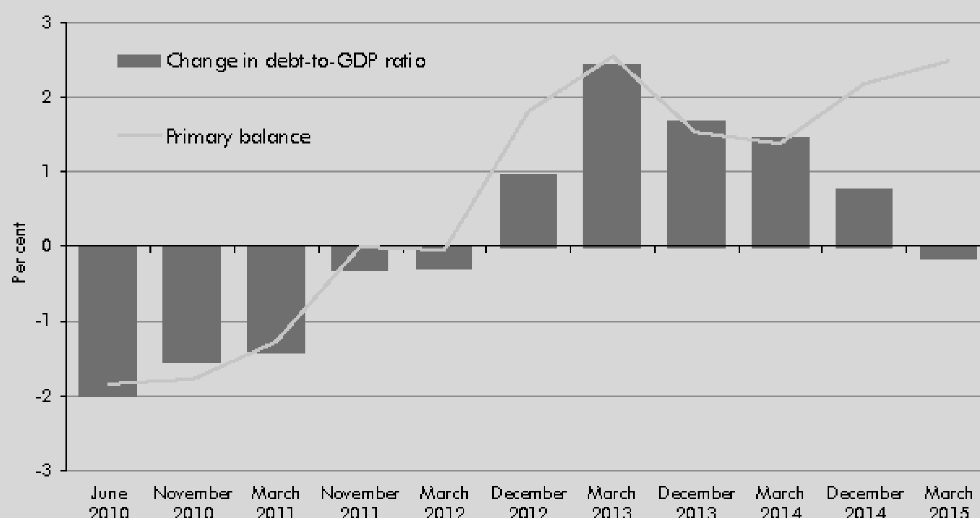
Box 5.1: Changes in our forecast for the debt profile in 2015-16

In the first OBR forecast of this Parliament in June 2010, the debt-to-GDP ratio was forecast to fall by 2.0 per cent in 2015-16, comfortably meeting the supplementary target the Coalition Government set in its first Budget. As Chart A shows, over time that margin was reduced until in our December 2012 forecast we expected debt to rise by 1.0 per cent of GDP in 2015-16. The amount by which debt was expected to increase in 2015-16 peaked at 2.4 per cent of GDP in our March 2013 forecast. Since then, the gap has declined. And we now expect the debt-to-GDP ratio to fall in 2015-16, by the small margin of 0.2 per cent.

Chart A: Successive forecasts for the change in the debt-to-GDP ratio and primary balance in 2015-16



Source: OBR

Chart A also shows that between June 2010 and March 2013 (and continuing up to March 2014), projected changes in the debt-to-GDP ratio in 2015-16 could largely be explained by our forecast of the primary balance. That has not been the case in our two most recent forecasts.

What has happened since March 2013 so that the debt-to-GDP ratio is now expected to fall? Table A uses the same decomposition of changes in the debt ratio as in Chart 5.2. It shows that:

- our forecast of the primary balance in 2015-16 has changed little since March 2013. The precise revision has been just 0.1 per cent of GDP, although this reflects an improvement up to March 2014 and then a reversal;
- the difference between interest rates and GDP growth in 2015-16 is more favourable in our latest forecast than it was in March 2013. Our nominal GDP growth forecast is 0.5 percentage points lower, but implied interest rates are 1.1 percentage points lower. The net effect is an additional 0.4 per cent of GDP reduction in the debt ratio; and

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- the main factors helping to reduce the debt ratio in 2015-16 by more than expected in March 2013 do not reduce borrowing:
  - running down UK Asset Resolution's loan book, including through the sale of mortgage assets, reduces the ratio by another 0.5 per cent of GDP;
  - other subsequently announced asset sales – notably Government shareholdings in Lloyds Banking Group – subtract 0.7 per cent of GDP from debt in 2015-16;
  - gilts are now expected to be sold at a significant premium, which reduces the debt-to-GDP ratio by a further 0.7 per cent of GDP; and
  - the net cash requirement has been lower than would be expected given our borrowing forecast in recent years, and we expect this to continue in 2015-16. This reduces the debt-to-GDP ratio by 0.3 per cent of GDP.

Table A: Sources of changes in the debt-to-GDP ratio in 2015-16

	Per cent of GDP		
	March 2013	March 2015	Change
Total	2.4	-0.2	-2.6
of which:			
Primary balance	2.6	2.5	-0.1
Growth-interest differential	-1.1	-1.5	-0.4
Additional UKAR effects	-0.3	-0.8	-0.5
Other asset sales	0.0	-0.7	-0.7
Gilt premia	0.1	-0.6	-0.7
Net lending	0.8	0.9	0.1
Other debt level changes	0.4	0.0	-0.3

Welfare cap

5.14 The welfare cap was initially set in line with our March 2014 forecast for the items of spending that lie within it. We are required to assess the Government's performance against the cap formally at each Autumn Statement, and did so for the first time in our December 2014 *EFO*. In this *EFO*, we provide an update on performance against the cap, but will not make a formal assessment until the next Autumn Statement.

5.15 Given the distinction between forecasting assumptions and discretionary policy changes in the assessment of the cap, the classification of movements in the forecast is crucial to our assessment. Some changes are obviously forecasting changes (for example, the implications of our latest economy forecast) while others are clearly policy changes (appearing in the Treasury's table of policy decisions at each Budget or Autumn Statement). But there are grey areas, notably operational changes resulting from Ministerial decisions or responses to legal challenges. These require careful consideration.

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5.16 Table 5.4 shows our forecast for spending subject to the welfare cap in each year to 2019-20, as described in Chapter 4. Our latest forecast for such spending is higher than the welfare cap in 2015-16. It is then lower than the cap between 2016-17 and 2019-20. The margin by which our forecast exceeds the cap in 2015-16 is 0.7 per cent. This is the result of forecasting changes (rather than policy changes) and lies within the 2 per cent margin allowed for such changes. The net effect of policy measures in later years is very small.

Table 5.4: Performance against the welfare cap

	£ billion				
	Forecast				
	2015-16	2016-17	2017-18	2018-19	2019-20
Welfare cap	119.7	122.3	124.8	127.0	129.8
2 per cent forecast margin	2.4	2.4	2.5	2.5	2.6
December forecast	120.7	122.4	124.0	126.8	129.8
March forecast	120.6	121.0	121.8	124.0	126.5
Change	-0.1	-1.4	-2.2	-2.8	-3.2
of which:					
Forecasting changes	-0.1	-1.3	-2.2	-2.7	-3.2
Economic determinants	-0.1	-1.2	-2.0	-2.5	-2.7
CPI inflation	0.0	-1.1	-2.0	-2.4	-2.6
Other	-0.1	-0.1	0.0	0.0	-0.1
Estimating and modelling changes	-0.1	-0.2	-0.2	-0.3	-0.4
Fertility assumption	-0.3	-0.4	-0.6	-0.7	-0.8
Tax credits recostings	0.2	0.2	0.2	0.1	0.1
Incapacity benefits	0.2	0.1	0.1	0.1	0.1
DLA and PIP[1]	0.2	0.2	0.1	0.1	0.0
Other	-0.3	-0.2	0.0	0.1	0.1
Other changes	0.0	0.0	0.1	0.0	0.0
Budget policy measures	0.0	0.0	0.0	-0.1	-0.1
Difference between March forecast and welfare cap	0.8	-1.3	-3.0	-2.9	-3.2

[1] Disability living allowance and personal independence payment.

Forecasting changes

5.17 Our forecasting changes since December have led to downward revisions to welfare spending subject to the cap of £0.1 billion in 2015-16 and an average of £2.4 billion a year from 2016-17 to 2019-20. Table 5.4 shows that:

- the single largest downward revision is due to lower CPI inflation (thanks largely to lower oil prices). This feeds through to the uprating of most benefits from 2016-17 onwards and a lower forecast for rents that reduces spending on housing benefit;

- lower projected fertility rates reduce spending on tax credits, child benefit, tax-free childcare and maternity benefits by increasing amounts between 2014-15 and 2019-20. This reflects lower than assumed fertility rates in 2013;

- we have revised down the savings associated with tax credits operational measures. These increase spending by £0.2 billion a year between 2015-16 and 2019-20; and

- estimating changes to incapacity benefits, disability living allowance (DLA) and personal independence payment (PIP) increase spending for these benefits by £0.2 billion a year on average between 2014-15 and 2019-20. For DLA and PIP, this reflects higher than expected outturn so far in 2014-15 feeding through to the forecast. For incapacity benefits, this primarily reflects higher than expected numbers of cases being assigned to the support group.

Policy changes

5.18 The Government has announced policy measures in the Budget that are estimated to reduce spending subject to the cap by very small amounts.

Risks to performance against the welfare cap

5.19 Developments in the economy – notably inflation and the labour and housing markets – pose important risks to our welfare spending forecast. We highlighted a number of broader risks to the forecast in our October 2014 *Welfare trends report*, including operational risks during a period of significant reforms. In particular, we have noted a history of optimism bias relating to reforms to incapacity benefits, disability benefits and universal credit. In this forecast, we have identified some similar – though smaller – issues in respect of operational tax credits measures. In addition, an ongoing legal case means that there is some uncertainty over the tax-free childcare policy, but at present we do not have firm evidence on which to assume a change in spending in our forecast. We will be applying the lessons from these developments when we come to certifying the Government's estimates of the fiscal impact of any future welfare reforms.

Recognising uncertainty

5.20 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. There are significant uncertainties about economic forecasts when historically large changes in the composition of national income and spending – due to the size and composition of the remaining fiscal consolidation – are in prospect.

5.21 Given these uncertainties, it is important to stress-test our judgements that the Government is on course to meet the new fiscal mandate in 2017-18 and the new supplementary target in 2016-17, and also to maintain welfare spending within the cap plus margin.

5.22 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.

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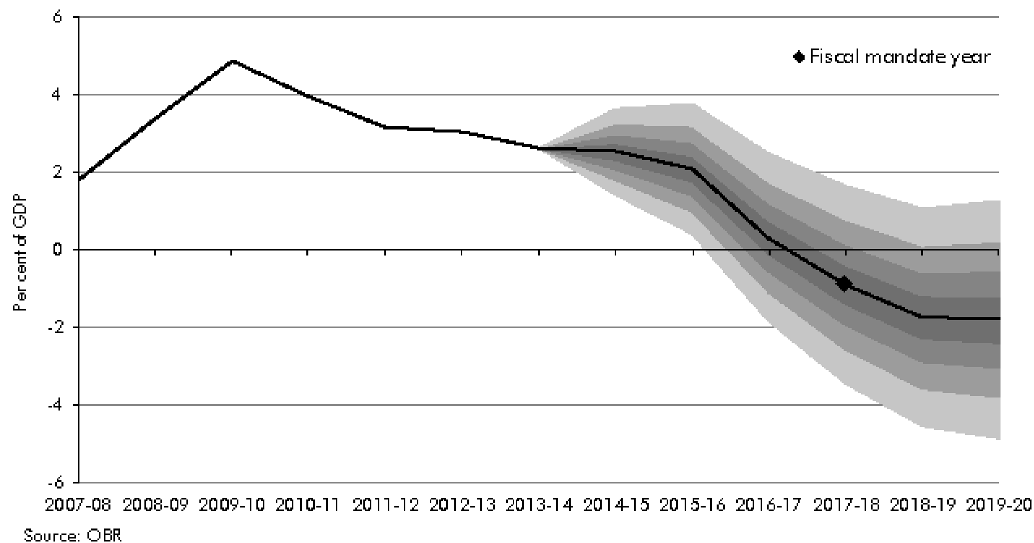
Past performance

5.23 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 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 likely forecast errors in the future.

5.24 In this spirit, Chart 5.3 shows the probability distribution around our central forecast for the CACB deficit, 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 5.3: Cyclically adjusted current budget deficit fan chart



Source: OBR

5.25 A direct reading of the chart would imply that the Government currently has a roughly 65 per cent probability of achieving a surplus on the CACB in 2017-18 and thereby meeting the mandate. The probability of achieving a surplus rises from 40 per cent in 2016-17 to 75 per cent by 2019-20.

5.26 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. But our central forecast shows the debt-to-GDP ratio falling in 2016-17. We also do not have a long enough disaggregated series of past welfare spending forecasts to produce a fan chart for the welfare cap projections.

Sensitivity analysis

5.27 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.

5.28 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 two in particular:

- the level of potential output; and
- the speed at which the output gap closes (i.e. the pace of economic growth).

5.29 Our central forecast is based on a judgement that the economy was running 0.7 per cent below potential in the final quarter of 2014, and that the output gap will close slowly over the forecast period, reaching zero by late 2017. 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 that can be observed 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?

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

- the level of the CACB deficit in 2017-18; and
- the change in PSND as a share of GDP between 2015-16 and 2016-17.

5.31 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.

5.32 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.

5.33 Table 5.5 shows that the level of potential output has a big effect on the size of the CACB deficit in 2017-18. The lower potential output is – and therefore the smaller the negative output gap or larger the positive 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.

5.34 Closing the output gap at a different pace would typically result in a change in cyclical borrowing, but would 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.

5.35 In broad terms, the level of potential output would need to be around 1¼ per cent lower in 2017-18 than in our central forecast to make it more likely than not that the mandate would be missed.

Table 5.5: Cyclically adjusted current budget deficit in 2017-18

		Per cent of GDP		
		Output gap closes		
		2015-16	2017-18	2019-20
Level of potential output in 2019-20 relative to central forecast (per cent)	-2	0.6	0.6	0.6
	-1	-0.1	-0.1	-0.1
	0	-0.8	-0.8	-0.8
	1	-1.6	-1.5	-1.5
	2	-2.3	-2.3	-2.3

5.36 Table 5.6 shows that the Government would continue to meet its supplementary target unless the output gap was materially smaller than in our central forecast, which would imply more structural borrowing.

Table 5.6: Change in public sector net debt between 2015-16 and 2016-17

		Per cent of GDP		
		Output gap closes		
		2015-16	2017-18	2019-20
Level of potential output in 2019-20 relative to central forecast (per cent)	-2	1.1	0.8	0.4
	-1	0.3	0.2	0.1
	0	-0.5	-0.5	-0.4
	1	-1.3	-1.1	-0.8
	2	-2.1	-1.7	-1.2

5.37 In previous *EFOs*, we have also quantified the risks to the fiscal mandate and supplementary target of shocks to the interest rates that the Government has to pay on its debt and possible errors in our cyclical adjustment coefficients. We have not quantified those sensitivities again, but would note that:

- since the UK has a relatively long average debt maturity, 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 five-year forecast period, the impact of a shock to the average nominal interest rate on gilts is relatively small. Box 4.4 in

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Chapter 4 discusses our debt interest forecast in greater detail and provides a ready-reckoner of the effect on borrowing of different gilt rate assumptions; and

- 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. These coefficients are highly uncertain, as the output gap is not directly observable, so there is no historical 'fact' from which to estimate the coefficients. In addition, 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. However, our current forecast of a very small negative output gap in 2016-17 and 2017-18, implies that using different coefficients would have very little impact on the estimated CACB in 2017-18.

5.38 Annex B presents some illustrative ready-reckoners of the effect on welfare spending of different changes in some of the main economic determinants. In particular, inflation surprises represent a key risk to the welfare cap, as inflation errors would broadly translate into one-for-one errors in many benefits and tax credits through their effect on uprating. Since the welfare cap was introduced, we have revised our inflation forecast down significantly, due largely to lower oil prices, with the expected effect of reducing spending subject to the cap. This has more than offset upward revisions to some other parts of the forecast. As we aim to produce central forecasts, there should be an equal possibility that future inflation surprises will be to the upside or the downside of our current forecast.

Scenario analysis

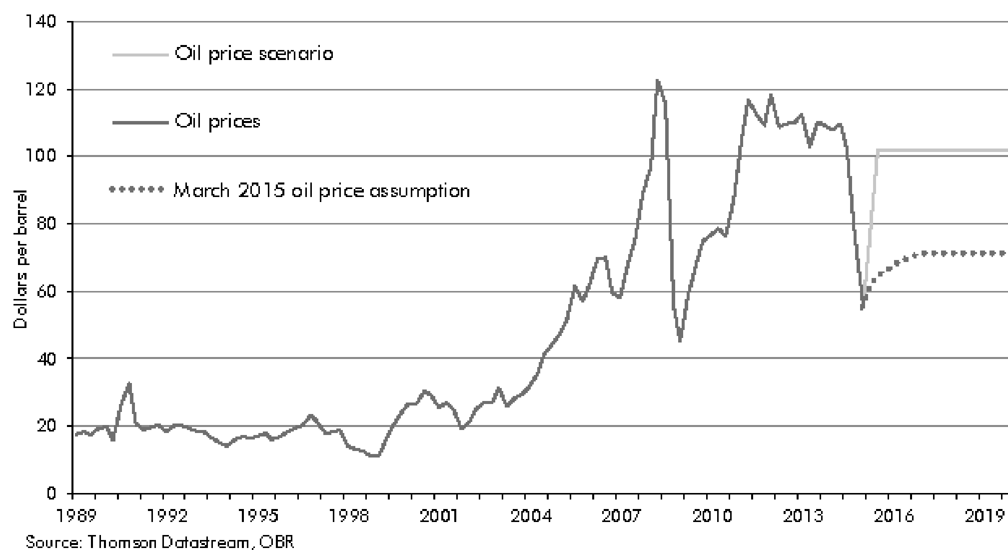
5.39 The sensitivity analysis discussed above focuses on individual factors and therefore only offers a partial assessment of potential uncertainty. In this section, we set out the fiscal implications of two illustrative alternative economic scenarios, designed to test how dependent our conclusions are 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 them occurring.

5.40 One of the most important developments affecting the public finances since our December forecast has been the further fall in oil prices. Over recent years – and indeed past decades – large and unanticipated movements in oil prices have been a relatively frequent occurrence (Chart 5.4). As discussed in previous chapters, the implications of oil price movements for the public finances depend crucially on the underlying drivers of those changes. We therefore consider two scenarios which assess the potential impact of movements in the oil price similar to those that have been witnessed in the past. Under both scenarios the oil price snaps back to around $100 a barrel (the two-year ahead futures

curve fluctuated around this level between late-2011 and mid-2014), but for different reasons. Specifically, we consider:

- a supply-driven shock, in which a drop in the global supply of oil leads to oil prices rising to around $100 a barrel within two quarters; and
- a demand-driven shock, where oil prices rise in exactly the same way, but due to stronger global GDP growth that feeds through to greater demand for oil.

Chart 5.4: Oil price scenario in the context of historical oil price volatility



Source: Thomson Datastream, OBR

Supply-driven increase in oil prices

5.41 In this scenario, we consider the implications of an exogenous shock to oil supply where the key assumptions and implications are that:

- higher oil prices feed through to fuel prices, leading to an immediate fall in real household consumption. Other effects on demand broadly cancel out. The shock increases firms' production costs, which gradually reduces non-oil business investment, and the combination of lower consumption and investment reduces import growth. Higher oil prices also encourage additional North Sea investment and production;
- the reduction in non-oil investment feeds through to slower capital accumulation and hence marginally lower labour productivity growth. Overall, the output gap widens initially as a result of lower consumption and narrows at a similar pace as in our central forecasts, implying it closes around a year later;
- most of the higher consumer price inflation reflects an import price shock, and so the implications for whole economy inflation are much smaller. CPI inflation is however

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slightly lower in mid-2016 than in our central forecast, as the oil price remains flat rather than following the upward-sloping path underpinning our central forecast. The wider negative output gap also depresses inflation slightly;

- higher oil prices have a number of direct effects on receipts, which are on balance positive. Lower fuel duty is offset by higher oil and gas receipts and VAT receipts – the latter rising as spending on fuel (which is subject to the standard rate of VAT) displaces spending on other items that are either zero-rated or subject to a reduced rate of VAT. The effect on oil and gas receipts is smaller than when we have considered the sensitivity of receipts to oil prices in the past (such as in our March 2012 *EFO*). And the direct positive effect is more than outweighed by the indirect effect through its negative implications for GDP. The effects of inflation measures on receipts are broadly offsetting;

- spending is also higher in each year. The inflation shock immediately increases debt interest on index-linked gilts, and both higher unemployment and inflation increase welfare spending. The unemployment effects are small and soon unwind, but the inflation effects are more persistent. As benefits and tax credits are uprated with a lag, this only increases spending from 2016-17 onwards. But spending from that point and beyond is determined by the Government's spending assumption. This essentially pushes through the higher spending in 2015-16 into future years. But the debt interest shock is largely a one-off, and so additional departmental spending is assumed to fill the gap; and

- the combination of marginally lower receipts and higher spending result in higher borrowing and debt in each year, and debt is flat as a share of GDP in 2015-16. The underlying structural position is a little weaker in 2017-18 and beyond, due both to lower potential output and the persistence of higher spending. And the higher uprating of tax credits and benefits leads to permanently higher welfare spending. These all serve to reduce the Government's margins against its three fiscal targets, but it would remain on course to meet all three.

Demand-driven increase in oil prices

5.42 In this scenario, we assess the implications of a demand driven shock, where oil prices rise due to stronger global GDP growth that feeds through to greater demand for oil. The key assumptions and implication of this scenario are that:

- higher oil prices affect the outlook through the same channels as under our supply-driven scenario. The immediate increase in inflation reduces real household consumption and, over time, the level of non-oil business investment and so capital accumulation. But it encourages additional North Sea production;

- stronger global growth however boosts exports, which means the initial impact on GDP growth is smaller than in the supply-driven scenario. The increase in export demand is also assumed to be persistent, which encourages business investment. So

although the output gap is initially wider than in our central forecast, it closes sooner. This has a small additional upward effect on inflation;

- the direct effects of higher oil prices on receipts (a net positive) are also invariant to whether the shock is supply or demand driven. But the negative effects on the wider economy are soon offset by stronger export demand. Although real GDP ends the period in a similar position, the higher domestic price level also boosts cash receipts;

- higher inflation increases debt interest payments in 2015-16 and welfare costs a year later. Again, the debt interest effects knock through into higher cash spending in later years due to the Government's spending assumption, in effect showing up as higher departmental spending. But total spending is marginally lower as a share of GDP over the medium term; and

- the overall fiscal picture is slightly better than in our central forecast. The Government would have a little more headroom against its fiscal mandate and supplementary aim, although the margin against the welfare cap would be somewhat smaller.

5.43 Table 5.7 summarises the economic assumptions we have made, as well as the fiscal consequences of these alternative scenarios. It shows that either scenario would have only modest effects over the medium term, with the supply-driven scenario slightly worse than our central outlook and the demand-driven scenario marginally better. But in either case the Government would continue to meet its three fiscal targets.

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Table 5.7: Key economic and fiscal aggregates under alternative scenarios

	Per cent (unless otherwise stated)				
	2015-16	2016-17	2017-18	2018-19	2019-20
Central forecast					
Economic assumptions					
GDP growth	2.4	2.3	2.4	2.3	2.4
CPI inflation (Q3)	0.2	1.2	1.7	1.9	2.0
Output gap	-0.4	-0.2	0.0	0.0	0.0
Fiscal outcome (per cent of GDP)					
Welfare cap margin (per cent)	0.7	-1.1	-2.4	-2.3	-2.5
Public sector net borrowing	4.0	2.0	0.6	-0.2	-0.3
Cyclically adjusted current budget	2.1	0.4	-0.8	-1.7	-1.7
Public sector net debt	80.2	79.8	77.8	74.8	71.6
Supply-driven oil shock scenario					
Economic assumptions					
GDP growth	2.2	2.1	2.5	2.4	2.4
CPI inflation (Q3)	0.8	1.3	1.6	1.8	1.9
Output gap	-0.6	-0.6	-0.3	-0.1	0.0
Fiscal outcome (per cent of GDP)					
Welfare cap margin (per cent)	0.7	-0.5	-1.8	-1.8	-2.1
Public sector net borrowing	4.1	2.3	0.9	0.0	0.0
Cyclically adjusted current budget	2.1	0.4	-0.7	-1.5	-1.5
Public sector net debt	80.4	80.4	78.8	76.2	73.4
Demand-driven oil shock scenario					
Economic assumptions					
GDP growth	2.4	2.4	2.3	2.3	2.3
CPI inflation (Q3)	0.8	1.4	1.8	1.9	2.0
Output gap	-0.4	-0.1	0.0	0.0	0.0
Fiscal outcome (per cent of GDP)					
Welfare cap margin (per cent)	0.7	-0.5	-1.7	-1.6	-1.8
Public sector net borrowing	4.1	2.0	0.5	-0.4	-0.5
Cyclically adjusted current budget	2.1	0.3	-0.9	-1.8	-1.9
Public sector net debt	80.2	79.6	77.3	74.0	70.6

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Executive summary

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 the 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.

4 In the absence of offsetting tax rises 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 from an ageing population is common to many developed nations.

5 Separate from our central projections, we also look at the long-term sustainability of particular tax revenues. We have updated our assessments of the outlook for oil and gas receipts and transport tax receipts. In both cases we expect revenues to decline over the long term – and to be lower on average over the next few decades than when we last examined them. This suggests that governments will need to find additional revenue streams simply to maintain total revenues as a share of GDP, let alone to meet the additional spending pressures implied by an ageing population.

6 Long-term projections such as these are highly uncertain and the results we present here should be seen as illustrative, not precise forecasts. We quantify some of the uncertainties around the projections through sensitivity analyses – by varying key assumptions on demographic trends, the medium-term fiscal position and sector-specific trends in health spending.

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, which currently ends in 2018-19. The

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report should not be taken to imply that the substantial fiscal consolidation already in the pipeline for the next five years should 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 consolidation is complete.

Public sector balance sheets

9 We assess the fiscal impact of past government activity by looking at the assets and liabilities accumulated on the public sector's balance sheet. We look at two presentations of the balance sheet: the National Accounts and the 2012-13 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. The latest published data show PSND at end-March 2014 was £1,273 billion, 76.1 per cent of GDP or £48,200 per household.

11 Public sector net worth (PSNW) is a broader balance sheet measure, which includes all physical and all financial assets. PSNW fell sharply from 2008 onwards and the latest outturn data gave a value for PSNW of minus £208 billion at the end of 2012, which was minus 13.2 per cent of GDP. No government has used PSNW as a target, in part because reliable estimates of the value of the public sector's physical assets are hard to construct.

12 The medium-term outlook for PSND and PSNW has improved since last year's *FSR*. Our forecast for the medium-term peak in PSND has fallen by 6.9 per cent of GDP to 78.7 per cent of GDP, with that peak coming one year earlier in 2015-16.

13 National Accounts balance sheet measures do not include liabilities arising from the future consequences of past government activities, for example the pension rights that have been accrued by public sector workers. But more information on liabilities of this sort is available in the WGA. These are produced using commercial accounting rules.

14 According to the 2012-13 WGA:

- the net present value of future **public service pension payments** arising from past employment was £1,172 billion or 73.3 per cent of GDP at the end of March 2013. This is £166 billion higher than a year earlier. While some of this reflects an increase in the expected future flow of pension payments – due to an additional year of public employment – much reflects the fact that the projected flow has been converted into a one-off upfront net present value sum using a lower discount rate;

- the total capital liabilities in the WGA arising from **Private Finance Initiative** contracts were £37 billion, up from £36 billion a year earlier. Only £5 billion of these were on the public sector balance sheet in the National Accounts and therefore included in

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PSND and PSNW. If all investment undertaken through PFI had been undertaken through conventional debt finance, PSND would be around 2.0 per cent of GDP higher than currently measured – little changed from last year;

- the liabilities in the WGA include £131 billion (8.2 per cent of GDP) in **provisions** at the end of March 2013 for future costs that are expected (but not certain) to arise, most significantly the costs of nuclear decommissioning. Total provisions have increased by £18 billion since last year's WGA, mainly those related to nuclear decommissioning at the Sellafield site, clinical negligence claims and a new provision for the loss of revenues when North Sea companies set off the costs of oil and gas field decommissioning against their tax bills. (This was shown as a contingent liability in last year's accounts.) Around £13 billion of provisions were actually used in 2012-13, which was close to the expectation set out in the previous year's WGA; and

- the WGA identified £88 billion (5.5 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 (so they are not included in the headline total of liabilities). The £13 billion reduction compared with last year was more than accounted for by the removal of the £20 billion oil and gas field decommissioning contingent liability. This now appears partly as a provision, but only for the period to 2017-18. Contingent liabilities relating to export finance and to clinical negligence cases were the main offsetting increases.

15 Overall gross liabilities in the WGA increased by £276 billion over the year to reach £2,893 billion at end-March 2013. This was explained by the net deficit recorded during the year, as expenditure exceeded revenue, plus the accumulation of additional public service pension liabilities described above.

16 As 2012-13 was a year in which the Bank of England expanded its quantitative easing (QE) programme, the WGA show a rise in 'government borrowing and financing' – in other words gilts sold to the private sector – of just £31 billion. This comprises net issuance of £115 billion of debt by central government, largely offset by an £84 billion increase in gilts held within the public sector by the Bank of England. The WGA show an increase in 'other financial liabilities' associated with the reserves created by the Bank of England to finance the QE gilt purchases.

17 The WGA measure of the budget deficit – called 'net expenditure' in the accounts – was 11.4 per cent of GDP in 2012-13, down slightly from 2011-12. The WGA net deficit in 2012-13 was unchanged from its level in 2009-10. This is in marked contrast to the National Accounts measure of the current deficit, which fell by a quarter over the same period. The different paths can be explained by different accounting concepts, including changes in provisions that are carried through to the WGA measure of the budget deficit. Provisions reduced the WGA net deficit by 1.9 per cent of GDP in 2009-10 (when a £25 billion provision related to the Asset Protection Scheme was reversed), but increased it by 1.0 per cent of GDP in 2012-13.

18 Unlike PSND, the WGA balance sheet also includes the value of tangible and intangible fixed assets – for example the road network and the electromagnetic spectrum respectively. These

assets are estimated at £757 billion or 47.4 per cent of GDP in March 2013. They have increased by £4 billion since last year's WGA. The overall net liability in the WGA was £1,630 billion or 102 per cent of GDP at end-March 2013. This compares with PSND of £1,185 billion or 74.2 per cent of GDP at the same date, and to a WGA net liability of £1,347 billion or 86.7 per cent of GDP a year earlier at end-March 2012.

19 In this year's report, we have again summarised policy announcements relating to guarantees and possible contingent liabilities that we would expect to appear in subsequent years' WGA. Key among these are schemes related to housing, exports and infrastructure.

20 While the precise accounting treatment of these measures will not be known until future WGAs are published, some broad implications for fiscal sustainability are clear. 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 future economic downturn, particularly if it was focused on the housing and financial sectors. The more serious the downturn, the greater the likelihood that a large proportion of contingent liabilities will crystallise to the detriment of fiscal sustainability.

21 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 state 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. Across countries and time, this has usually been the case.

Long-term projections

22 We assess the potential fiscal impact of future government activity by making long-term projections of 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 2014 *EFO*. This allows us to focus on long-term trends rather than making revisions to the medium-term forecast.

Demographic and economic assumptions

23 Demographic change is a key long-term pressure. Like many developed nations, the UK is projected to have an 'ageing population' over the next few decades, with the ratio of the elderly to those of working age rising. This reflects increasing life expectancy, relatively low levels of fertility, and the retirement of people born during the post-war 'baby boom'.

24 We base our analysis on projections of the UK population produced by the Office for National Statistics (ONS) every two years. In this *FSR* we use its 2012-based projections for the first time. The main changes since the previous projections are an increase in the estimated size of the

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population following the census, lower net migration (and a change in the profile of age-specific migration flows) and higher fertility rates in the longer term. As a result, by 2063-64 the latest projections suggest that there will be more elderly people, fewer working age people and roughly the same number of children as in the previous projections. Our central projection for the public finances uses the ONS 'low migration' population variant. This assumes net inward migration of 105,000 a year, which we consider reasonable given international trends and the direction of Government policy. We test the sensitivity of our results to a number of different demographic assumptions.

25 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 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. These assumptions are unchanged from last year's *FSR*.

26 In our latest *EFO*, we forecast the output gap to close within the forecast period, so the long-term projections in this *FSR* start from a position where the economy is operating in line with our estimate of its underlying potential. That was not the case last year, when our medium-term forecast showed spare capacity remaining at the end of the forecast period and our long-term projections started with a period of above-trend growth until the output gap had closed.

Defining 'unchanged' policy

27 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, we must first define what we mean by 'unchanged' policy over the long term.

28 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".

29 In our central projections, our assumption for unchanged policy is that beyond 2018-19 underlying age-specific spending on public services, such as health and education, rises in line with per capita GDP. As detailed spending plans are only available to 2015-16, we have to make an assumption about the composition of spending on public services in 2018-19:

- our central projection assumes that all types of departmental spending fall proportionately from 2015-16. This implies health and education spending, the main age-related elements of departmental spending, being reduced by 1.1 per cent and 0.7 per cent of GDP respectively between 2015-16 and 2018-19 (equivalent to £23 billion and £15 billion in nominal terms in 2018-19);

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- alternatively, we could assume for these three years – as we do beyond 2018-19 – that per capita spending by age and gender is fixed relative to potential earnings. Under this scenario, health and education spending would be broadly flat as a share of GDP over these three years. The Government would then have to find cuts in other spending of 1.9 per cent of GDP (£39 billion in nominal terms in 2018-19) to stick to its announced policy assumption for total spending.

30 We assume that most tax thresholds and benefits are uprated in line with earnings growth 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 benefit payments to earnings in the rest of the economy.

Results of our projections

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

Expenditure

32 Population ageing will put upward pressure on public spending. Our central projection shows spending excluding debt interest rising from 34.3 per cent of GDP at the end of our medium-term forecast in 2018-19, to 39.3 percent of GDP by 2059-60, before falling slightly to 39.1 per cent of GDP in 2063-64. That would represent an overall increase of 4.8 per cent of GDP or £79 billion in today's terms.

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

- **health spending** rises from 6.4 per cent of GDP in 2018-19 to 8.5 per cent of GDP in 2063-64, 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 2018-19 (which are included in our medium-term forecast). We assume that these affect all types of spending proportionately. We test the sensitivity of our projections to this assumption (described below);

- **state pension costs** increase from 5.5 per cent of GDP in 2018-19 to 7.9 per cent of GDP in 2063-64 as the population ages. Spending is lower by the end of the projection than last year. The projection has been pushed higher by the updated population projections, but reduced by the Government's policy of linking the State Pension age (SPA) to longevity. We assume that this brings forward the rise in the SPA to 68 and introduces rises to 69 and 70 within the projection horizon; and

- **long-term social care costs** rise from 1.2 per cent of GDP in 2018-19 to 2.3 per cent of GDP in 2063-64, reflecting the ageing of the population and the Government's announcement of a lifetime cap on certain long-term care expenses incurred by individuals. The projections are little changed from last year.

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Revenue

34 Demographic factors will have less impact on revenues than on spending. Non-interest revenues are projected to be broadly flat across the projection period as a share of GDP. In our central projections, those revenue streams that are not affected by demographics are explicitly held constant as a share of GDP – even though non-demographic factors may affect them in the future. Some non-demographic factors are explored separately in the report.

35 In our detailed analysis this year, we have returned to the issue of North Sea revenues. We find again that receipts are likely to fall to below 0.1 per cent of GDP over the coming decades. Our central projection suggests around £40 billion will be raised in North Sea revenues in total between 2019-20 and 2040-41, down by around a quarter relative to last year's report. The majority of this change is explained by lower production in our latest medium-term forecast, which knocks through to our long-term projection. We have considered a wide range of alternative oil price and production scenarios, all of which imply that oil and gas receipts are on a declining trend as total production from the UK continental shelf moves towards its ultimately recoverable capacity. In considering these projections, it is important to note that oil and gas receipts are the most volatile revenue streams in the UK public finances and forecasting them over even short horizons is extremely difficult. The same factors that make North Sea receipts volatile on a year-to-year basis make it very hard to predict the pace of the long-term trend decline with any confidence.

36 We have also revisited our previous analysis of the effects of improving fuel efficiency on transport taxes – fuel duty and vehicle excise duty (VED). Greater fuel efficiency reduces fuel duty receipts by reducing the volume of fuel consumed for a given number of miles travelled and reduces VED receipts because most rates paid are graduated according to fuel efficiency. Both are forecast to fall as a share of GDP in our latest medium-term forecast and our long-term projections show that trend continuing. The fuel duty projections are the more sensitive to faster or slower progress in fuel efficiency. Failing to revalorize fuel duty with RPI inflation – instead freezing rates in cash terms from the end of the medium-term forecast period – would cause a sharper reduction in fuel duty receipts than in any fuel efficiency scenario we consider.

37 In Annex A to this year's report, we have looked in more detail at employment and earnings trends that are relevant to the sustainability of the public finances. An important consequence of the rising employment and falling real wages of recent years has been to reduce the effective tax rate on labour income. More people working means more personal allowances to offset against earnings before tax is paid. Our long-term projections assume that the effective tax rate on labour income trends very slowly lower due to demographic trends. If labour market trends led to a higher or lower path for the effective tax rate on labour income, the outlook for fiscal sustainability would be correspondingly better or worse.

38 Our analysis of longer-term pressures on revenue streams suggests that governments will, over time, need to find new sources of revenue to maintain the overall ratio of revenue to national income, let alone to meet the spending pressures from an ageing population.

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Financial transactions

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

40 For the majority of financial transactions, we assume that the net effect is zero. Student loans are an important exception. Since last year's report, the Government's decision to sell the pre-2012 student loan book has exchanged some future loan repayments for upfront sale proceeds, while crystallising the loss associated with interest rate and write-off subsidies. Removing the cap on student numbers increases the annual outlays on student loans in England to 0.7 per cent of GDP a year in the long term, up 0.2 per cent of GDP from last year's report. Projections for repayments are only a little higher, despite a larger number of students making repayments, as repayments per student are now projected to be lower. We project that the direct flows will add 5.4 per cent of GDP to net debt in 2018-19, rising to 9.8 per cent of GDP by the mid-2030s, and then falling to 8.3 per cent of GDP in 2063-64.

41 In Annex B, we look in more detail at student loans, including how they are treated in the National Accounts, the Whole of Government Accounts and the Government's budgeting framework. We test the sensitivity of our projections to different assumptions about the uprating of fees, the number of students and the volatility of graduate earnings.

Projections of the primary balance and public sector net debt

42 Our central projections show public spending increasing as a share of national income beyond the medium-term forecast horizon, gradually rising towards and then exceeding receipts. 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 3.0 per cent of GDP in 2018-19 to rough balance in the late-2030s and then to a deficit of 1.7 per cent of GDP in 2063-64 – an overall deterioration of 4.7 per cent of GDP, equivalent to £77 billion in today's terms.

43 Taking this and our projection of financial transactions into account, PSND is projected to fall from its medium-term peak of around 79 per cent of GDP in 2015-16 to just over 53 per cent of GDP in the mid-2030s, before rising to 84 per cent of GDP in 2063-64. Beyond this point, debt would remain on a rising path.

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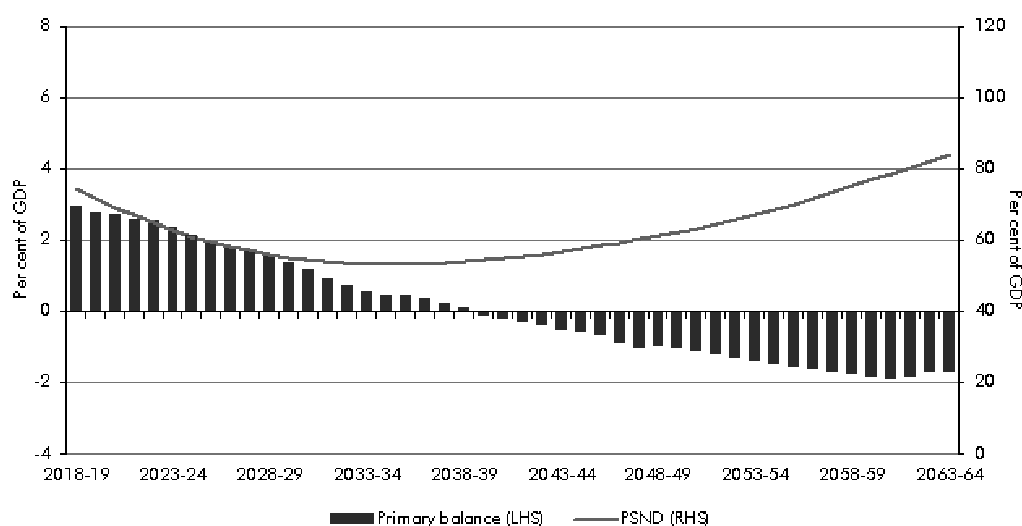
Chart 1: Central projection of the primary balance and PSND



Source: OBR

44 The primary balance and PSND at the end of the projection period have improved relative to last year. That reflects the net effect of a number of offsetting factors:

- the latest ONS population projections suggest that there will be proportionately more young and old people in the population, and fewer of working age, than the previous projections. This worsens the primary balance and raises the debt ratio;
- spending cuts pencilled in for 2018-19 improve the primary balance, which knocks through to the long-term projections; and
- linking the State Pension age to longevity is assumed to bring forward the rise to 68 and to bring rises to 69 and 70 within the projection horizon, which improves the primary balance and reduces the debt ratio.

45 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.

46 The eventual increase in PSND would be greater than in our central projection if long-term interest rates turned out to be higher relative to economic growth, 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.

47 Given the importance of health spending in the demographic challenge to fiscal sustainability, the rate of productivity growth in the sector and the level of health spending at the start of the

projection are also important assumptions. If productivity growth was weaker in the health sector than in the rest of the economy, and health spending was to be increased more quickly to compensate, then in our illustrative scenario health spending would rise by a further 5.9 per cent of GDP by 2063-64. This would see PSND rise substantially faster. If we assumed health spending moved in line with demographics from 2015-16, rather than being cut in line with other departmental spending, it would be 1.2 per cent of GDP higher in 2018-19. This would be compounded by the demographics to increase health (and therefore total) spending by a further 0.4 per cent of GDP by 2063-64.

Summary indicators of fiscal sustainability

48 In our central projections, and most of the variants we calculate, 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 be unsustainable.

49 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. We focus on a measure of sustainability that asks how big a permanent spending cut or tax increase would be necessary to move public sector net debt to a particular desired level at a particular chosen date. This is referred to as the 'fiscal gap'.

50 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 2019-20 to return PSND to 20, 40 or 60 per cent of GDP at the end of our projection horizon in 2063-64.

51 Under our central projections, a once-and-for-all policy tightening of 0.9 per cent of GDP in 2019-20 (£15 billion in today's terms) would see the debt ratio reach 40 per cent of GDP in 2063-64. But this is less than the 1.7 per cent of GDP required to stabilise debt over the longer term and so the debt ratio would continue rising beyond the target date. Tightening policy by 0.3 per cent of GDP a decade would see the debt ratio fall more slowly to begin with, but the overall tightening would be large enough to stabilise the debt ratio at around the target level and prevent it from taking off again. These fiscal gap estimates are slightly lower than in last year's report, reflecting the slightly smaller primary deficit and lower PSND at the end of the projection period. Targeting debt ratios of 20 and 60 per cent of GDP would require larger and smaller adjustments respectively.

52 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 2018-19 than we forecast in the *EFO*, the necessary tightening would be bigger or smaller by the same amount.

53 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.

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B Fiscal impact of policy decisions

B.1 The tables in this annex show the fiscal impact of policy decisions taken at Autumn Statement 2014 and Budget 2015; and of measures announced at Autumn Statement 2014 or earlier which take effect from April 2015 or later.

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

		Head	£ million					
			2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Households								
1	Personal allowance: increase to £10,600 in 2015-16 with full gains to higher rate taxpayers	Tax	0	-530	-635	-640	-655	-655
2	ISAs: transfer to surviving spouses	Tax	0	*	*	-5	-5	-10
3	Air Passenger Duty: exempting children	Tax	0	-40	-80	-85	-90	-95
Property								
4	Stamp duty land tax reform: new marginal rate system	Tax	-395	-760	-840	-850	-815	-785
5	Enveloped dwellings: increase charge for properties over £2m	Tax	+10	+95	+50	+45	+90	+140
Business and employment								
6	Employer NICs: abolish for apprentices under 25	Tax	0	0	-105	-110	-120	-125
7	Business Rates: small business relief extension	Tax	0	-500	+70	+5	0	0
8	Business Rates: cap increase at 2% in 2015-16	Tax	0	-125	-90	-85	-85	-85
9	Business Rates: increase retail discount to £1,500 in 2015-16	Tax	0	-130	+20	+5	0	0
10	Business Rates: transitional relief	Tax	0	-10	-5	0	0	0
11	Employment Allowance: extend to carers	Tax	0	-10	-10	-10	-10	-10
12	R&D tax relief: increase large firms and SME credit	Spend	0	-40	–	–	–	–
13	R&D tax relief: changes to qualifying expenditure	Spend	0	+20	–	–	–	–
Investment and growth								
14	High value manufacturing catapult	Spend	0	-25	–	–	–	–
15	R&D: innovation funding	Spend	0	-70	–	–	–	–
16	Higher education: postgraduate loans	Spend	0	-15	–	–	–	–
17	Entrepreneurs' Relief: reinvested gains	Tax	0	0	-5	-5	-5	-5
18	Social investment tax relief	Tax	0	0	-10	-15	-20	-25
19	Peer-to-peer lenders: bad debt relief	Tax	0	0	-10	-15	-20	-25
20	Supporting first-time exporters	Spend	0	-20	–	–	–	–
Energy and environment								
21	Oil and gas: 2% cut to Supplementary Charge	Tax	0	-55	-60	-50	-65	-60
22	Oil and gas: support for investment	Tax	0	-5	-15	-15	-10	-95
23	Household energy efficiency incentives	Spend	-30	-70	–	–	–	–
24	Support for off-gas-grid households	Spend	0	-30	–	–	–	–
25	Corporation tax: flood defence relief	Tax	*	-5	-5	-5	-5	-5
Community								
26	Schools and children	Spend	0	-40	–	–	–	–
27	Culture and sport	Spend	-5	-30	–	–	–	–
28	Church roof repair fund	Spend	-15	*	–	–	–	–
29	VAT: support for search & rescue and hospices	Tax	-5	-10	-5	-5	-5	-5
Base erosion and profit shifting (BEPS)								
30	Diverted profits tax	Tax	0	+25	+270	+360	+345	+355
31	Corporation tax: hybrids	Tax	0	0	+15	+70	+85	+90
32	Corporation tax: country-by-country reporting	Tax	0	+5	+5	+10	+10	+15

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		Head	£ million 2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Avoidance, tax planning and fairness								
33	Corporation tax: accounting treatment of credit losses	Tax	0	0	+5	+10	+240	+40
34	Corporation tax: bank losses restriction	Tax	0	+695	+765	+705	+695	+625
35	Non-domiciles: increase remittance basis charge	Tax	0	0	+120	+90	+90	+90
36	Self-incorporation: intangible assets	Tax	+5	+30	+80	+110	+135	+155
37	Investment managers' disguised fee income	Tax	0	*	+160	+80	+65	+55
38	Stamp duty on shares: schemes of arrangement	Tax	*	+65	+65	+55	+50	+50
39	Special purpose share schemes	Tax	0	0	+45	+40	+40	+40
40	Income tax: miscellaneous losses	Tax	0	+5	+5	+5	+5	+5
41	Venture capital schemes: restrictions on use	Tax	0	-15	+30	+10	+10	+10
42	Income tax: salary sacrifice and expenses, including umbrella companies	Tax	0	0	+120	+90	+75	+75
43	Office of Tax Simplification: review of expenses	Tax	0	-10	-5	-10	-10	-10
44	DOTAS regime changes	Tax	0	*	*	+30	+50	+70
45	HMRC: operational measures	Tax	0	-10	+260	+365	+145	+55
46	Corporation tax: accelerated payments and group relief	Tax	0	+425	-345	-40	-30	0
Previously announced								
47	Counter-terrorism funding	Spend	-20	-110	–	–	–	–
48	Pensions flexibility: decisions since Budget 2014	Tax	0	+60	-25	-25	+30	-10
49	Rail fares cap for 2015	Spend	-25	-95	–	–	–	–
50	Glasgow City Deal	Spend	0	-15	–	–	–	–
51	Migrant access to benefits	Spend	0	+15	–	–	–	–
52	Pool Reinsurance Limited: increased fee	Spend	+50	+175	+175	+175	+175	+175
Other								
53	Peer-to-peer lenders: withholding tax regime	Tax	0	0	0	+60	+10	+35
54	Public service pensions: next steps in revaluation	Spend	0	+335	+365	+375	+385	+390
55	Special Reserve	Spend	+200	0	–	–	–	–
56	Total fiscal impact of welfare cap measures[3]	Spend	-20	+150	–	–	–	–
Health								
57	Foreign Exchange fines	Tax	+1,115	0	0	0	0	0
58	NHS: fund to upgrade GP services[4]	Spend	0	-295	-295	-295	-295	0
59	Mental health and dementia	Spend	0	-45	–	–	–	–
	TOTAL POLICY DECISIONS		+865	-1,030	+75	+410	+450	+425
	Total spending policy decisions		+130	-470	+240	+250	+260	+565
	Total tax policy decisions		+735	-560	-165	+160	+190	-140
	Memo: NHS funding from the Reserve, reflected in 2015-16 spending numbers[4]	*Spend*	*0*	*-1,200*	–	–	–	–

*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, 2018-19 and 2019-20 are shown. All other spending measures do not affect borrowing as they fall within the Total Managed Expenditure assumption in those years.*

[3] *See Table 2.2.*

[4] *Spending numbers include allocations for Scotland, Wales and Northern Ireland.*

Table B.2: Budget 2015 policy decisions[1, 2]

	Head	£ million 2015-16	2016-17	2017-18	2018-19	2019-20
Personal tax						
1 Personal allowance: increase to £10,800 in 2016-17 and to £11,000 in 2017-18 with full gains to higher rate taxpayers	Tax	0	-960	-1,480	-1,585	-1,680
Savings and pensions						
2 Savings tax: allowance and ISA flexibility	Tax	-15	-1,030	-565	-640	-765
3 Help to Buy: ISA	Spend	-45	*-230*	*-415*	*-640*	*-835*
4 Annuities: secondary market	Tax	0	+535	+540	-130	-120
5 NS&I bonds for people aged 65 and over: extension	Spend	-80	–	–	–	–
6 Pensions guidance: extending availability	Spend	-20	–	–	–	–
7 Pensions: lifetime allowance to £1m from 2016-17, and index with inflation from 2018-19	Tax	+60	+300	+420	+550	+590
Duties						
8 Fuel Duty: cancel September 2015 RPI increase	Tax	-140	-240	-245	-250	-250
9 Alcohol Duty: 1p off a pint of beer and 2% off cider duty	Tax	-85	-80	-85	-85	-85
10 Alcohol Duty: reduce spirits duty by 2% and freeze wine duty	Tax	-100	-95	-100	-100	-105
Investment and growth						
11 Oil and gas: investment allowance and 10% cut to Supplementary Charge	Tax	-230	-270	-190	-200	-75
12 Oil and gas: 15% cut to Petroleum Revenue Tax	Tax	0	-125	-115	-85	-10
13 Oil and gas: support for seismic surveys	Spend	-20	–	–	–	–
14 Energy intensive industries: bring forward compensation for Feed-in Tariffs	Spend	-25	–	–	–	–
15 Exports and investment: UKTI China and trade missions	Spend	-15	–	–	–	–
16 Regional growth	Spend	-15	–	–	–	–
17 Creative industries: extend support	Spend	-5	–	–	–	–
18 Support for technological innovation	Spend	-20	–	–	–	–
19 Telecommunications	Spend	-15	–	–	–	–
20 Venture capital schemes: qualifying criteria	Tax	0	-5	-5	-15	-10
21 Enterprise Zones	Tax	*	*	-5	-5	-5
22 Financial transactions adjustment[3]	Spend	+490	–	–	–	–
Fairness, evasion and avoidance						
23 Bank Levy: increase to 0.21%	Tax	+685	+925	+925	+920	+920
24 Corporation Tax: bank compensation payments	Tax	+150	+260	+225	+180	+150
25 Evasion: Common Reporting Standard	Tax	-5	+90	+270	+75	+130
26 Employment intermediaries: travel and subsistence (umbrella companies)	Tax	0	+155	+175	+160	+145
27 VAT: foreign branches	Tax	+25	+95	+90	+85	+90
28 Corporation Tax: contrived loss arrangements	Tax	+95	+170	+170	+150	+130
29 Capital Gains Tax: contrived ownership arrangements	Tax	*	+45	+45	+45	+45
30 Tobacco: enforcement	Tax	0	+5	+10	+10	+10
31 Accelerated Payments: extension	Tax	0	+290	+175	+70	+20

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	Head	£ million 2015-16	2016-17	2017-18	2018-19	2019-20
32 Total fiscal impact of welfare cap measures[4]	Spend	-50	–	–	–	–
Health, education and security						
33 Mental health	Spend	-305	*-315*	*-325*	*-310*	*-310*
34 Health innovation	Spend	-10	–	–	–	–
35 Counter-terrorism and security	Spend	-25	–	–	–	–
36 Free school meals: small schools	Spend	-20	–	–	–	–
Transport and environment						
37 Company car taxation: 3ppt increase in 2019-20	Tax	0	0	0	0	+340
38 Heavy Goods Vehicles: freeze VED and the Road User Levy	Tax	*	*	*	-5	-5
39 Aggregates Levy: freeze in 2015-16	Tax	-5	-5	-5	-5	-5
40 Capital allowances: energy and water efficient technologies	Tax	0	+5	+15	+10	+10
41 Income Tax: extending farmers' profits averaging period to 5 years	Tax	0	-10	-30	-30	-30
Previously announced						
42 Stamp Duty Land Tax: property funds	Tax	-10	-15	-10	-5	-5
43 Guarantees income	Spend	+500	–	–	–	–
TOTAL POLICY DECISIONS		**+745**	**+45**	**+230**	**-885**	**-570**
Total spending policy decisions		+295	–	–	–	–
Total tax policy decisions		+450	+45	+230	-885	-570

**Negligible*

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

[2]Spending measures in 2016-17, 2017-18, 2018-19 and 2019-20 do not affect borrowing as they fall within the Total Managed Expenditure assumption in those years.

[3]This is a neutral reclassification from PSGI to financial transactions. See Table 2.6 for offsetting adjustment.

[4]Total fiscal impact of welfare policy decisions, including DWP DEL funding. See Budget 2015: policy costings for further detail on policy decisions, and Chapter 1 for an update on spending within the welfare cap.

Table B.3: Measures announced at Autumn Statement 2014 or earlier which will take effect from April 2015 or later[1]

			£ million				
		Head	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**
Measures announced at Autumn Statement 2014							
a	Personal allowance: increase to £10,600 in 2015-16 with full gains to higher rate taxpayers	Tax	-525	-625	-640	-650	-660
b	ISAs: transfer to surviving spouses	Tax	*	*	-5	-10	-10
c	Air Passenger Duty: exempting children	Tax	-45	-85	-90	-90	-95
d	Employer NICs: abolish for apprentices under 25	Tax	0	-105	-110	-120	-125
e	Business Rates: small business relief extension	Tax	-535	+70	+10	0	0
f	Business Rates: cap increase at 2% in 2015-16	Tax	-135	-115	-115	-185	-175
g	Business Rates: increase retail discount to £1,500 in 2015-16	Tax	-115	+15	+5	0	0
h	Business Rates: transitional relief	Tax	-10	-5	0	0	0
i	Employment Allowance: extend to carers	Tax	-10	-10	-10	-10	-10
j	R&D tax relief: increase large firms and SME credit	Spend	-40	-105	-125	-135	-140
k	R&D tax relief: changes to qualifying expenditure	Spend	+20	+55	+55	+60	+60
l	Entrepreneurs' Relief: reinvested gains	Tax	*	-5	-10	-5	-10
m	Social investment tax relief	Tax	0	-10	-15	-25	-25
n	Peer-to-peer lenders: bad debt relief	Tax	0	-10	-15	-20	-25
o	VAT: support for search & rescue and hospices	Tax	-10	-5	-5	-5	-5
p	Diverted profits tax	Tax	+25	+275	+360	+345	+360
q	Corporation Tax: hybrids	Tax	0	+15	+70	+85	+90
r	Corporation Tax: country-by-country reporting	Tax	*	+5	+5	+10	+10
s	Corporation Tax: accounting treatment of credit losses	Tax	0	+5	+10	+250	+40
t	Corporation Tax: bank losses restriction	Tax	+780	+865	+795	+785	+705
u	Non-domiciles: increase remittance basis charge	Tax	0	+120	+90	+90	+90
v	Investment managers' disguised fee income	Tax	*	+165	+80	+65	+55
w	Special purpose share schemes	Tax	0	+45	+40	+40	+40
x	Income tax: miscellaneous losses	Tax	+5	+5	+5	+5	+5
y	Venture capital schemes: restrictions on use	Tax	-15	+50	+15	+15	+20
z	Income tax: salary sacrifice and expenses, including umbrella companies	Tax	0	+85	+65	+55	+60
aa	Office of Tax Simplification: review of expenses	Tax	-10	-5	-10	-10	-10
ab	DOTAS regime changes	Tax	*	*	+30	+50	+70
ac	HMRC: operational measures	Tax	-15	+280	+390	+160	+70
ad	Corporation Tax: accelerated payments and group relief	Tax	+425	-345	-40	-30	0
ae	Pensions flexibility: decisions since Budget 2014	Tax	+60	-25	-25	+35	-10
af	Peer-to-peer lenders: withholding tax regime	Tax	0	0	+90	+10	+35
ag	Public service pensions: next steps in revaluation	Spend	+325	+355	+365	+370	+380
ah	Universal Credit: supporting 85% of childcare costs	Spend	0	-10	-130	-240	-305
ai	Employment and Support Allowance: additional healthcare professionals	Spend	+35	+125	+95	+75	0
aj	Employment and Support Allowance: restricting repeat claims	Spend	+25	+25	+10	+10	+10
ak	Pensions flexibility: notional income rules for benefits	Spend	*	*	-5	-5	-5
al	Bereavement benefits reform	Spend	0	0	-40	-35	-15
am	Simplifying assessment periods	Spend	-5	-10	-20	-25	-25
an	Work allowances: maintain current level in 2017-18	Spend	0	0	+40	+75	+100
ao	DWP fraud and error: additional capacity	Spend	+40	+10	+5	-10	0

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		Head	£ million				
			2015-16	2016-17	2017-18	2018-19	2019-20
ap	Tax credits: prevent overpayments following change of circumstances in-year	Spend	+115	+75	+50	+25	+15
aq	Tax credits: self-employment tests for Working Tax Credit	Spend	+15	+75	+30	+15	+10
ar	Pension credit passthrough	Spend	-10	0	+5	+10	+5
as	Carer's allowance: higher earnings limit	Spend	-5	-10	-20	-20	-20
Measures announced at Budget 2014							
at	Public Service Pensions: revaluation	Spend	+710	+965	+995	+1,025	+1,055
au	Pensions: reduce withdrawal tax rate from 55% to marginal income tax rate	Tax	+310	+585	+890	+1,190	+785
av	Savings tax: abolish the 10% rate and extend 0% band to £5,000	Tax	-90	-205	-205	-230	-250
aw	Voluntary National Insurance Contributions	Tax	+450	+415	0	0	0
ax	OTS Review: simplification of employee share schemes	Tax	+10	+10	0	0	0
ay	Carbon Price Floor: limit disparity between UK and EU to £18 from 2016-17	Tax	0	-340	-615	-870	-1,030
az	Combined Heat and Power: relief for onsite generation	Tax	-85	-95	-100	-105	-110
ba	Air Passenger Duty: abolish bands C and D	Tax	-205	-205	-220	-235	-250
bb	Company Car Tax: continuing to increase by 2ppt in 2017-18 and 2018-19	Tax	0	0	+220	+455	+475
bc	Landfill tax and Landfill Communities Fund: uprate and reform	Tax	+20	+15	+15	+20	+20
bd	Support for Mortgage Interest: 12-month extension	Spend	-45	-15	0	0	0
be	Tax Credits debt: increasing recovery rate	Tax	0	+110	+40	+25	+5
Measures announced at Autumn Statement 2013							
bf	Income Tax: transferable marriage allowance	Tax	-495	-595	-650	-770	-730
bg	Employer NICs: abolish for under 21s basic rate earnings	Tax	-450	-500	-535	-560	-585
bh	Housing Revenue Account: additional flexibility	Spend/Tax	-95	0	+5	+5	+5
bi	Partnerships: confirming extension to Alternative Investment Funds	Tax	+680	+430	+410	+400	+380
bj	Capital Gains Tax: application to non-residents	Tax	+5	+35	+90	+140	+190
bk	Alcohol fraud wholesaler registration	Tax	-10	+20	+275	+260	+235
bl	HMRC: extending online services	Tax	0	+65	+50	+55	+55
bm	Winter Fuel Payments: overseas eligibility	Spend	+20	+20	+15	+15	+15
Measures announced at Spending Round 2013							
bn	Annual Verification	Spend	*	*	+5	+5	+5
bo	Social rent policy	Spend/Tax	+55	+65	+110	+185	+275
Measures announced at Budget 2013							
bp	Contracting out NICs	Tax	0	+5,075	+4,930	+4,900	+4,905
bq	Inheritance Tax: threshold freeze for 3 years from 2015-16	Tax	+25	+70	+140	+210	+245
br	Corporation Tax: reduce main rate to 20% from 2015-16	Tax	-550	-1,045	-1,110	-1,125	-1,150
bs	Debt: improving coding out	Tax	+60	+55	+55	+55	+55
bt	Capital Allowances: Ultra Low Emission Vehicles	Tax	-5	-15	-20	-10	+10
bu	Company car tax: Ultra Low Emission Vehicles	Tax	-10	-15	-15	-25	-30

**Negligible*

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

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C Supplementary data tables

C.1 Information in these tables is consistent with the OBR's March 2015 Economic and fiscal outlook (EFO) and supplementary tables, unless otherwise noted. The OBR's supplementary tables are available at http://budgetresponsibility.org.uk/economic-fiscal-outlook-march-2015/. Any HM Treasury calculations are derived from and consistent with published sources. Further details of outturn statistics drawn from Budget 2015 or EFO can be found in the data sources documents on the HMT and OBR websites respectively.

Table C.1: Macroeconomic prospects

	Level[1]	Rate of Change					
	2014	2014	2015	2016	2017	2018	2019
Real GDP	1698	2.6	2.5	2.3	2.3	2.3	2.4
Nominal GDP	1788	4.4	4.1	3.5	3.8	4.3	5.0
Components of real GDP							
Private consumption expenditure[2]	1090	2.0	2.6	2.7	2.5	2.3	2.2
Government consumption expenditure	350	1.5	0.8	-0.7	-0.9	-0.2	1.5
Gross fixed capital formation	290	6.8	4.3	6.2	5.6	5.7	4.4
Changes in inventories and net acquisition of valuables (% of GDP)	-	0.2	0.1	0.0	0.0	0.0	0.0
Exports of goods and services	512	0.4	3.9	4.0	4.5	4.4	4.3
Imports of goods and services	557	1.8	4.0	4.8	4.6	4.6	4.4
Contributions to real GDP growth							
Final domestic demand	-	2.7	2.5	2.7	2.5	2.5	2.5
Changes in inventories and net acquisition of valuables	-	0.2	0.1	0.0	0.0	0.0	0.0
External balance of goods and services	-	-0.5	-0.1	-0.4	-0.2	-0.2	-0.2

[1] Pounds sterling, billion.
[2] Includes households and non-profit institutions serving households.

Source: Office for National Statistics, Office for Budget Responsibility and HM Treasury calculations

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Table C.2: Price developments

	Level	Rate of Change					
	2014	2014	2015	2016	2017	2018	2019
GDP deflator	105.3	1.8	1.6	1.1	1.5	1.9	2.5
Private consumption deflator	105.7	1.6	1.1	1.4	2.0	2.2	2.3
HICP	128.0	1.5	0.2	1.2	1.7	1.9	2.0
Public consumption deflator	100.8	0.5	-0.2	-1.4	-1.8	-0.5	3.5
Investment deflator	104.9	1.0	1.6	1.6	1.8	2.0	1.7
Export price deflator (goods and services)	99.0	-2.1	-3.8	0.6	1.1	1.2	1.3
Import price deflator (goods and services)	96.8	-3.6	-5.3	0.2	0.8	0.9	1.0

Source: Office for National Statistics, Office for Budget Responsibility and HM Treasury calculations

Table C.3: Labour market developments

	Level	Rate of Change					
	2014	2014	2015	2016	2017	2018	2019
Employment, persons (millions)[1]	30.7	2.3	1.4	0.8	0.5	0.5	0.5
Employment, hours worked[2]	987.3	2.7	1.6	0.3	-0.1	-0.1	0.1
Unemployment rate (%)[3]	-	6.2	5.3	5.2	5.3	5.3	5.3
Labour productivity, persons[4]	55254	0.3	1.1	1.5	1.9	1.9	1.8
Labour productivity, hours worked[5]	33.1	-0.1	0.8	2.0	2.5	2.4	2.3
Compensation of employees[6]	904.0	3.2	4.2	4.1	4.0	4.2	4.9
Compensation per employee[7]	29421	0.9	2.8	3.3	3.5	3.7	4.3

[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

Source: Office for National Statistics, Office for Budget Responsibility and HM Treasury calculations

Table C.4: Sectoral balances

% of GDP		2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Net lending/borrowing vis-à-vis the rest of the world		-4.7	-5.3	-4.1	-3.0	-2.6	-2.5
of which:							
- Balance on goods and services		-2.1	-1.6	-1.4	-1.4	-1.4	-1.4
- Balance of primary incomes and transfers		-2.6	-3.6	-2.7	-1.5	-1.2	-1.0
- Capital account		0.0	0.0	-0.1	-0.1	-0.1	-0.1

Source: Office for National Statistics, Office for Budget Responsibility and HM Treasury calculations

Table C.5: General government budgetary prospects

		£ billion	% of GDP						
		Outturn		Forecast					
		2013-14	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Net lending by sub-sector									
General government[1]		100.5	5.8	5.2	4.3	2.2	0.8	0.0	-0.1
Central government		102.0	5.9	5.1	4.2	2.1	0.7	-0.1	-0.1
Local government		-1.5	-0.1	0.1	0.1	0.1	0.1	0.1	0.0
General government									
Total revenue		627.9	36.3	35.9	35.5	36.1	36.0	36.0	36.0
Total expenditure		728.3	42.1	41.1	39.9	38.3	36.9	36.0	35.9
Net borrowing[1]		100.5	5.8	5.2	4.3	2.2	0.8	0.0	-0.1
Interest expenditure		49.3	2.8	2.6	2.5	2.6	2.8	2.7	2.6
Primary balance[2]		51.2	3.0	2.6	1.8	-0.5	-1.9	-2.7	-2.7
Selected components of revenue									
Taxes on production and imports		223.6	12.9	12.9	12.7	12.6	12.5	12.5	12.5
Taxes on income and wealth		203.6	11.8	11.7	11.7	12.0	12.1	12.2	12.3
Capital taxes		4.4	0.3	0.2	0.2	0.2	0.3	0.3	0.3
Social contributions		107.3	6.2	6.0	6.0	6.4	6.4	6.4	6.4
Other		89.0	5.1	5.1	4.8	4.8	4.7	4.6	4.5
Total revenue		627.9	36.3	35.9	35.5	36.1	36.0	36.0	36.0
Selected components of expenditure									
Current expenditure on goods and services		349.7	20.2	19.6	18.9	17.8	16.7	16.0	16.2
Net social benefits		222.9	12.9	12.7	12.3	12.0	11.8	11.6	11.3
Interest expenditure		49.3	2.8	2.6	2.5	2.6	2.8	2.7	2.6
Subsidies		9.4	0.5	0.6	0.7	0.7	0.7	0.8	0.8
Gross fixed capital formation		45.0	2.6	2.6	2.5	2.5	2.4	2.4	2.4
Other		52.1	3.0	3.0	3.0	2.6	2.5	2.5	2.5
Total expenditure		728.3	42.1	41.1	39.9	38.3	36.9	36.0	35.9

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

Source: Office for National Statistics, Office for Budget Responsibility and HM Treasury calculations

Table C.6: Breakdown of revenue

	£billion	% of GDP						
	Outturn		Forecast					
	2013-14	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Total revenue at unchanged policies[1]	627.9	36.3	35.9	35.6	36.1	36.0	36.0	36.0
Discretionary revenue measures[2]	-	-	0.04	-0.01	-0.01	0.02	-0.03	-0.03

[1] General government total revenue less discretionary revenue measures at Autumn Statement 2014 (consistent with the OBR's December 2014 Economic and fiscal outlook) and Budget 2015 (consistent with the OBR's March 2015 EFO)
[2] Sum of discretionary revenue measures taken at Autumn Statement 2014 (consistent with the OBR's December 2014 Economic and fiscal outlook) and Budget 2014 (consistent with the OBR's March 2015 EFO)

Source: HM Treasury calculations

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

		% of GDP	
		2009-10[3]	2015-16[4]
General public services		3.0%	4.0%
Defence		2.5%	1.9%
Public order and safety		1.1%	0.7%
Economic affairs		2.3%	1.7%
Environmental protection		0.3%	0.3%
Housing and community amenities		0.4%	0.1%
Health		7.8%	7.0%
Recreation, culture and religion		0.5%	0.4%
Education		2.2%	2.3%
Social protection		11.5%	11.1%
Total expenditure [5]		**32.6%**	**30.4%**

[1] Spending data used consistent with Public Sector Statistical Analyses 2014, HM Treasury July 2014
[2] Central government data taken from PESA table 6.4
[3] The December 2014 figures as published on gov.uk used to derive percentage of GDP calculations
[4] Percentage of GDP calculations consistent with March 2015 EFO
[5] Total expenditure is more than just the sum of the functions, it also includes EU transactions and accounting adjustments

Source: Office for National Statistics, Office for Budget Responsibility and HM Treasury calculations

Table C.8: General government debt developments

	% of GDP						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Gross debt[1]	87.9	88.4	88.8	88.7	87.1	84.4	81.4
Change in gross debt ratio	2.5	0.5	0.4	-0.1	-1.6	-2.6	-3.1
% change	2.9	0.6	0.5	-0.2	-1.8	-3.0	-3.6
Contributions to changes in gross debt							
Primary balance[2]	3.0	2.6	1.8	-0.5	-1.9	-2.7	-2.7
Interest expenditure	2.8	2.6	2.5	2.6	2.8	2.7	2.6
Stock-flow adjustment[3]	0.0	-0.8	-0.7	0.7	1.0	1.1	1.0
Implicit interest rate on debt[4]	3.5	3.0	2.9	3.1	3.2	3.2	3.3

[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

Source: Office for National Statistics, Office for Budget Responsibility and HM Treasury calculations

Table C.9: Cyclical developments

	% of GDP						
	Outturn	Forecast					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Real GDP growth (%)[1]	2.1	2.6	2.4	2.3	2.4	2.3	2.4
Net borrowing of general government	5.8	5.2	4.3	2.2	0.8	0.0	-0.1
Interest expenditure	2.8	2.6	2.5	2.6	2.8	2.7	2.6
Potential GDP growth (%)[1]	1.1	1.4	2.0	2.1	2.2	2.3	2.4
Output gap[1]	-2.0	-0.8	-0.4	-0.2	0.0	0.0	0.0
Cyclical budgetary component[3]	1.6	0.8	0.3	0.2	0.0	0.0	0.0
Cyclically-adjusted balance	4.2	4.4	4.0	2.0	0.8	0.0	-0.1
Cyclically-adjusted primary balance[4]	1.4	1.8	1.5	-0.6	-2.0	-2.7	-2.7

[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

Source: Office for National Statistics, Office for Budget Responsibility and HM Treasury calculations

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

		2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Real GDP growth (%)								
Previous update		2.3	2.6	2.4	2.6	2.6	2.4	-
Current update		2.1	2.6	2.4	2.3	2.4	2.3	2.4
Difference		-0.3	0.0	0.0	-0.3	-0.3	0.0	-
Treaty deficit (% GDP)[2]								
Previous update		6.0	5.0	4.0	2.4	1.1	0.1	-
Current update		5.8	5.2	4.3	2.2	0.8	0.0	-0.1
Difference		-0.2	0.1	0.3	-0.2	-0.3	-0.2	-
Treaty debt (% GDP)[3]								
Previous update		89.6	91.8	93.1	91.9	89.4	86.6	-
Current update		87.9	88.4	88.8	88.7	87.1	84.4	81.4
Difference		-1.7	-3.4	-4.3	-3.3	-2.4	-2.1	-

[1] Previous update numbers correspond to the OBR's March 2014 Economic and fiscal outlook
[2] General government net borrowing on a Maastricht basis
[3] General government gross debt on a Maastricht basis

Source: Office for National Statistics, Office for Budget Responsibility and HM Treasury calculations

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

		% of GDP					
	Outturn	**Forecasts**					
	2013-14	**2020-21**	**2023-24**	**2033-34**	**2043-44**	**2053-54**	**2063-64**
Total expenditure	43.5	38.0	38.2	39.6	40.9	42.3	43.3
Of which: age-related expenditures	23.3	20.6	21.2	23.0	24.2	24.8	25.1
State pensions	5.8	5.4	5.7	6.7	7.4	7.6	7.9
Pensioner benefits	1.0	0.8	0.8	0.9	1.0	1.0	0.9
Public service pensions	2.2	2.1	2.1	1.9	1.6	1.4	1.2
Health	7.9	6.5	6.7	7.5	8.0	8.4	8.5
Long-term care	1.2	1.4	1.4	1.7	2.0	2.2	2.3
Education	5.3	4.3	4.4	4.3	4.2	4.2	4.2
Net interest	1.8	2.7	2.3	1.8	1.7	2.2	3.0
Total revenue	37.7	38.1	38.2	38.4	38.7	38.7	38.6

[1] Consistent with the central projection in the OBR's July 2014 Fiscal sustainability report
[2] Sum of pensions, pensioner benefits, public service pensions, health, long-term care and education

Source: Office for Budget Responsibility

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Table C.12: Contingent liabilities[1]

£ billion	Year
	2012-13
Total quantifiable contingent liabilities	87.9
Of which: financial stability inverventions	9.9

[1]Taken from section 32.2 of 2012-13 Whole of Governments Accounts- year ended 31 March 2013, HM Treasury, June 2014

Source: HM Treasury

Table C.13: Basic assumptions

	2013-14	2014-15	2015-16	2016-17	2017-28	2018-19	2019-20
Short-term interest rate[1] (annual average)	0.5	0.6	0.7	1.2	1.6	1.8	1.9
Long-term interest rate[2] (annual average)	2.5	2.3	2.1	2.3	2.4	2.5	2.6
Nominal effective exchange rate[3]	82.8	88.0	91.0	90.6	89.9	89.1	88.3
Exchange rate vis-à-vis the € (annual average)	1.19	1.27	1.37	1.36	1.34	1.33	1.31
	2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Oil prices (Brent, USD/barrel)	109	99	62	69	71	71	71
Euro area GDP growth	-0.4	0.9	1.2	1.4	1.6	1.6	1.6
Growth of relevant foreign markets	2.5	3.1	3.7	4.7	5.1	5.2	5.2

[1] 3 month sterling interbank rate (LIBOR)
[2]Weighted average interest rate on conventional gilts
[3]Trade-weighted sterling

Source: Office for Budget Responsibility

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